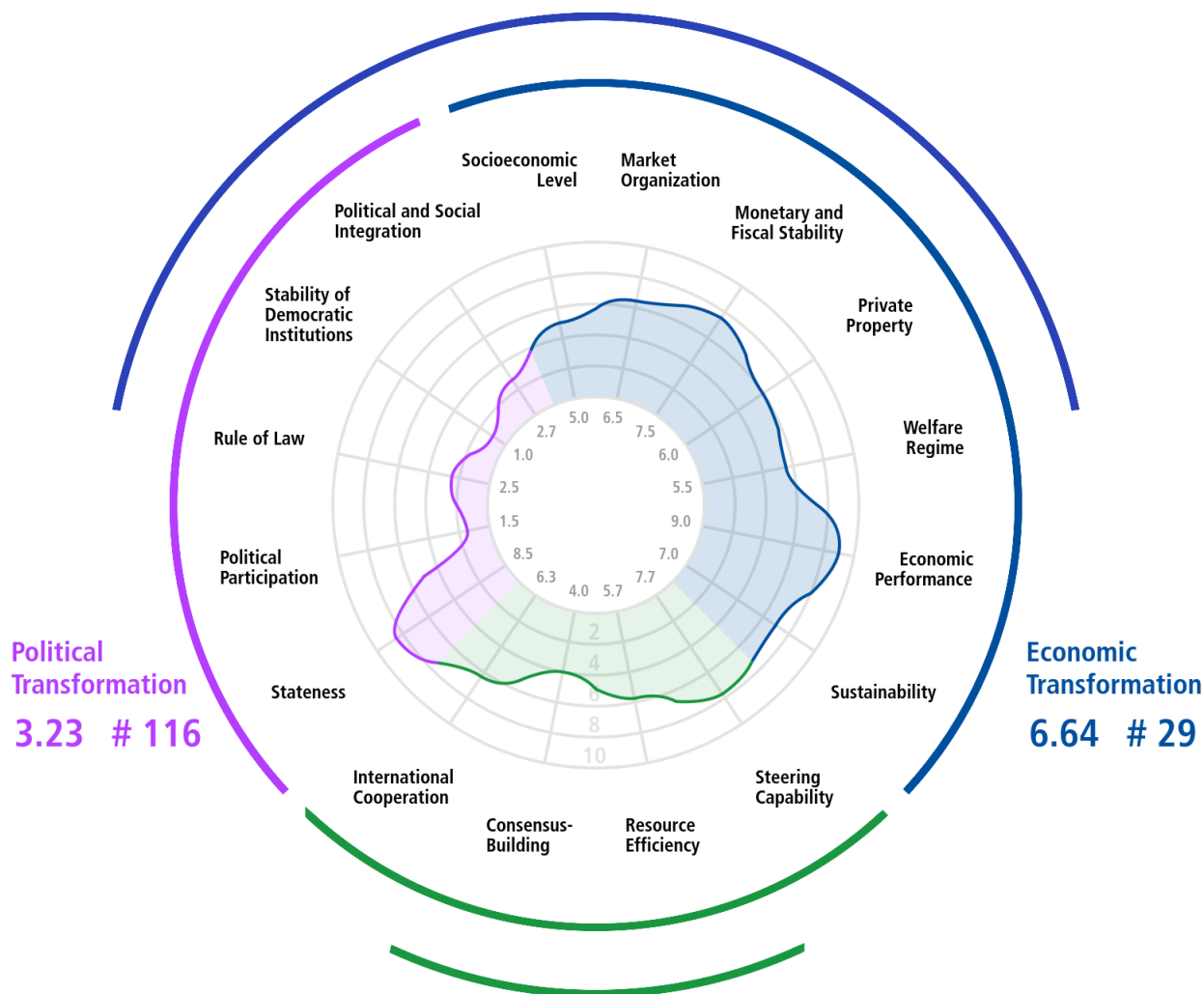


# China

## Status Index

**4.94 # 78**

on 1-10 scale out of 137



## Governance Index

**5.29 # 48**

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2022**. It covers the period from February 1, 2019 to January 31, 2021. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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## Contact

Bertelsmann Stiftung  
Carl-Bertelsmann-Strasse 256  
33111 Gütersloh  
Germany

### Sabine Donner

Phone +49 5241 81 81501  
[sabine.donner@bertelsmann-stiftung.de](mailto:sabine.donner@bertelsmann-stiftung.de)

### Hauke Hartmann

Phone +49 5241 81 81389  
[hauke.hartmann@bertelsmann-stiftung.de](mailto:hauke.hartmann@bertelsmann-stiftung.de)

### Claudia Härterich

Phone +49 5241 81 81263  
[claudia.haerterich@bertelsmann-stiftung.de](mailto:claudia.haerterich@bertelsmann-stiftung.de)

### Sabine Steinkamp

Phone +49 5241 81 81507  
[sabine.steinkamp@bertelsmann-stiftung.de](mailto:sabine.steinkamp@bertelsmann-stiftung.de)

**Key Indicators**

Population	M	<b>1402.1</b>	HDI	<b>0.761</b>	GDP p.c., PPP \$	<b>17312</b>
Pop. growth <sup>1</sup>	% p.a.	<b>0.3</b>	HDI rank of 189	<b>85</b>	Gini Index	<b>38.5</b>
Life expectancy	years	<b>76.9</b>	UN Education Index	<b>0.657</b>	Poverty <sup>3</sup>	% <b>5.4</b>
Urban population	%	<b>61.4</b>	Gender inequality <sup>2</sup>	<b>0.168</b>	Aid per capita	\$ <b>-0.4</b>

Sources (as of December 2021): The World Bank, World Development Indicators 2021 | UNDP, Human Development Report 2020. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

## Executive Summary

Mass demonstrations in Hong Kong against China's circumvention of Hong Kong's political autonomy, the passage of the Hong Kong National Security Law, China's increasingly assertive foreign policy, worsening relations with the United States and Australia, and the regime's efforts to control the damage caused by COVID-19 (which broke out in the city of Wuhan) overshadowed the review period.

Hong Kong saw sustained mass demonstrations between June and December 2019 over a planned extradition law that was widely seen as targeting not only criminals, but also Hong Kongers critical of Beijing. In June 2020, the Standing Committee of China's National People's Congress passed the National Security Law, which basically ended Hong Kong's political autonomy. In the months after the law was passed, dozens of protesters, opposition politicians and Jimmy Lai, the owner of the critical Apple Daily, were arrested.

China's leaders continued their efforts to project China as a great power, signaling the abandonment of the more passive approach that characterized foreign policy before Xi came to power. As part of its Belt and Road Initiative, it continued to sign bi- and multilateral trade agreements, as well as provide loans for infrastructure investments. Politically, it rejected criticism of its worsening human rights situation, its hardline approach to the protests in Hong Kong and the passage of the National Security Law, arguing that such criticism was an interference in its internal affairs. The "trade war" with the United States continued and relations deteriorated. Relations with Australia, China's main source of coal, also soured and resulted in China imposing trade sanctions on Australia.

In December 2019, the COVID-19 pandemic began to spread in the city of Wuhan. Much of 2020 was characterized by the regime's damage control efforts – with regards to criticism of having mishandled the outbreak and failing to contain the pandemic. It succeeded in both: the regime initially averted systematic enquires into the origins of the virus and brought the spread of COVID-

19 under control through a hard lockdown, travel restrictions, quarantine measures and mass testing.

While some observers predicted a “Chernobyl moment” for the regime due to its bungled initial reaction to the outbreak, the regime seems to have emerged strengthened. In terms of organization, the lockdown measures strengthened the party’s control over social organizations. In addition, it drew legitimation from the fact that it was able to contain the spread of the pandemic while the number of casualties in most other countries was high.

COVID-19 facilitated not only the extension of the Chinese Communist Party’s (CCP) control over society, but also benefited digital public service provision. The government kept its citizens well informed about its containment measures and was generally responsive to citizen enquiries and complaints. However, China’s citizens that do not own a smartphone faced severe restrictions accessing almost all public services, including entry into supermarkets. Economically, the pandemic once more delayed measures to strengthen domestic consumption. To mitigate the impact of the lockdowns especially on small and medium-sized enterprises, the government promised tax rebates and other indirect subsidies, and facilitated access to cheap credit.

## History and Characteristics of Transformation

Economic transformation in China was initiated through the “Opening and Reform” policy introduced in 1978. After the upheaval of the Cultural Revolution, the Chinese leadership emphasized economic and political consolidation. Despite initial structural deficiencies and distortions, economic reforms benefited from preconditions seldom found in developing countries: the large rural workforce facilitated the recruitment of cheap labor for the emerging industrial sector, and the government expropriated land at low or no compensation, which further served to keep factor costs low. Despite the existence of a planned economy, the public sector remained rather limited. Overseas Chinese from Hong Kong and Taiwan were eager to provide scarce capital and managerial know-how as soon as the Chinese leadership decided to experiment with foreign direct investment. These specific circumstances considerably facilitated economic development.

Consensus among the leadership to determinedly follow the Opening and Reform policy drove economic reforms. However, since the Tiananmen massacre in 1989 when the People’s Liberation Army (PLA) violently cracked down on a pro-democracy movement led by students, there have been no attempts to increase political competition or even initialize a transition to liberal democracy. In the aftermath of the “incident,” which remains a taboo topic in China, political reformers were purged from the CCP leadership and since then, party and state elites have been united in their commitment to limit reforms to the economic area and allow political reforms only in the administrative sector, enhancing governance, but not democracy.

Economic reforms and decentralization during the same period have proceeded gradually and been subject to experimentation. In this way, China has avoided the transformational “shocks” that occurred in the Russian Federation, for example. Absent a detailed roadmap, the Chinese leadership allowed for reform initiatives from lower administrative levels to be implemented locally and by way of trial-and-error. If successful, these local initiatives were adopted as national policies. The leadership’s decision to let a planned economy and the gradually emerging private sector coexist has proven most important in maintaining economic stability. During the reform process, the de facto economic importance as well as the political appreciation of the private sector increased steadily.

Economic reforms were accompanied by yearly GDP growth rates of about 10% from 1978 to 2010 and, with the exception of two spikes in 1988 and 1989 (18%) and 1994 and 1995 (24%), relatively low levels of inflation. Growth rates have declined after the global financial crisis from 2008 to 2010 and the ensuing global recession. Living standards have improved significantly, and the number of absolute poor has steadily decreased. This overall success is clouded by the increasingly uneven spread of wealth. Urban incomes today are more than three times those of rural incomes, and the Gini index (officially 0.474, by some measures even as high as 0.61) reveals that, even by the standards of other emerging markets (for example, countries in Latin America or South Africa), China now has one of the most unequal societies in the world.

A semi-functional legal system, a lack of sustainability in economic development and corruption constitute other serious problems. The deterioration of the environment is causing enormous economic and social costs. In addition, the Chinese government is increasingly under pressure to fulfill the demands of the population for better public goods (reliable social security, health care and pension systems, a working infrastructure), affordable housing, career opportunities and a more accountable government. The Xi administration reacts to this pressure by means of a targeted policy alleviation program, enhanced access to social services, improvement of working conditions, the surveillance of public sector employees and stricter environmental standards. At the same time, the government has strengthened the public security apparatus, implemented a tight system of electronic surveillance, and continues to curtail freedoms of information and expression. The COVID-19 pandemic accelerated these trends.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

There is certainty about the nation's existence as a state and, with the exception of secessionist movements in the autonomous regions Tibet and Xinjiang, virtually no competition with the state's monopoly on the use of force. Tibet, and especially Xinjiang, have become police states where organizing dissent and voicing opposition has become virtually impossible. Hong Kong's status as a Special Administrative Zone does not constitute a limitation of the Chinese government's monopoly of the use of force.

According to the Chinese constitution, China is a unitary, multiethnic state. There are 56 recognized ethnic groups in China, but Chinese of the Han ethnicity make up more than 90% of the population. Most citizens seem to accept and support the People's Republic of China as a legitimate sovereign nation-state. Minority rights in self-governance and representation, economic autonomy, educational autonomy, religious freedom, cultural expression, language use and freedom from discrimination are guaranteed by law.

In practice, however, enforcement of the law is very uneven. Only those beliefs and customs that are compatible with the CCP ideology can be openly voiced and exercised. This has led to considerable pressure from Tibetan and Uyghur autonomy or secessionist movements. The CCP uses repression, surveillance and indoctrination in an attempt to stabilize these two regions. Experts estimate that 10% of the Xinjiang's population (roughly 16 million people strong) is forcefully interned in "re-education camps." Detainees are held incommunicado for months on end, and according to former detainees, violations of the personal integrity of inmates occur.

The self-immolation of Tibetans (157 since 2009, three of which took place in 2018, one in 2019, none in 2020) testifies to the desperation with which some of the roughly 6.5 million ethnic Tibetans (less than 50% of the population in China-controlled Tibet) regard the situation. Under Xi, the regime's assimilation policies intensified.

Question  
Score

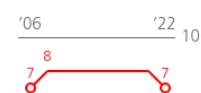
Monopoly on the  
use of force

9



State identity

7



In September 2020, thousands of students, teachers and ordinary citizens protested, went on strike or boycotted classes in Inner Mongolia over a curriculum reform designed to standardize teaching materials and privilege Mandarin Chinese over Mongolian as language of instruction.

The state is defined as a secular order; religious dogmas have no influence on politics and/or the law. Only five religions – Protestantism, Catholicism, Buddhism, Daoism and Islam – are officially recognized. They are subject to varying degrees of control, with Taoists being the least controlled, and Tibetan Buddhists (6–8 million), Uyghur Muslims (11 million) and Falun Gong adherents (7–20 million) the most affected by religious persecution.

In China, a fundamental and sufficiently differentiated bureaucratic structure extends over the entire territory. Villages are not a part of the formal administrative structure but are linked to it by means of CCP branches. Jurisdiction, taxation and law enforcement are exercised throughout the realm. One-stop e-government websites facilitate accessibility and enhance efficiency. These websites were strengthened during the COVID-19 pandemic, during which basic infrastructure services continued to be provided virtually uninterrupted. The number of localities where public infrastructure is weak and access to basic utilities remains inadequate is continuously decreasing. According to official statistics, 80% of China's rural population has access to safe drinking water and nearly all households have access to a water source. Problems with equal access to education and medical services remain, however.

## 2 | Political Participation

National level authorities are not selected by free and competitive general elections but are generally chosen by the Organization Department of the Chinese Communist Party. Indirect elections, in which People's Congresses elect the congresses at the next higher level, and the National People's Congress elects the leaders of the executive, merely serve as a procedural legitimization. At the local level, limited venues for participation, such as elections for village and urban residents' committees as well as village leaders and party branch secretaries exist. However, these organizations are not part of the formal administrative structure, otherwise such elections would not be possible. The nomination of candidates, voter eligibility and election campaigns are subject to local government and party control and manipulation.

No interference of religious dogmas

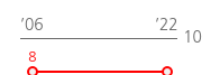
10



1

Basic administration

8



1

Free and fair elections

1



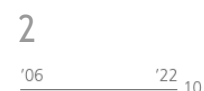
The political authorities have the effective power to govern and are not overruled by veto powers. The military is under control of the civilian party leadership. However, rulers at the central level are not democratically elected – the elections that do take place are a facade. Instead, delegates to the national legislature (the National People’s Congress) and all leading political and government positions are filled by an internal selection process controlled by the Communist Party. In the aftermath of the first wave of the coronavirus in China, the power of the National People’s Congress was cut remarkably. The congress has (once again) been downgraded to a rubber stamp institution. With one or two exceptions regarding laws and regulations in the fields of environmental protection.

Effective power to govern



The state often interferes with freedom of association and assembly. The number of registered social organizations in China has increased from 153,322 (2000) to 817,360 (2018), 444,092 of which are classified as “non-enterprise units run by an NGO.” These organizations are not allowed to operate independently; instead, they need to find a governmental host organization and then subject themselves to demanding procedures to obtain registration with the Ministry of Civil Affairs or its local counterparts. This severely restricts their autonomy.

Association / assembly rights



Political organizations competing with the CCP, for example, “opposition parties” such as the China Democratic Party, are prohibited. Since the government fears that stronger NGOs could limit state control over society, only NGOs with a non-political agenda are tolerated and even supported by the regime. Such NGOs can help the government to shoulder responsibilities such as emergency relief after natural disasters, or provide social services where the adverse effects of economic development have negatively affected people’s lives (e.g., issues of environmental protection; health care/AIDS; support for the disabled and orphans). For example, the amendments to the Environmental Protection Law (passed in 2015) upgraded the status and power of environmental NGOs in China. They are now authorized to file public interest lawsuits to halt environmental pollution at the local level. The central government’s “war against pollution” and the recent “carbon cut” rely on cooperation with and assistance of local civil society. They are especially welcome where governmental agencies lack the funds, the will or know-how to provide relief themselves.

In an attempt to strengthen the CCP’s control over local communities, grassroots party organizations have been strengthened. There are indications that social organizations have been coopted by such organizations more than before. The motive for coopting social organizations is both increased control and the co-production of local policy implementation. If a social organization succeeds, the party branch will take credit. The Charity Law, in effect since 2016, makes it easier for non-registered organizations to raise funds, but increases government supervision. The Law on the People’s Republic of China on Administration of Activities of Overseas Non-governmental Organizations in the Mainland of China, which has been in effect since



2017, shifted responsibility for supervising foreign NGOs from the Ministry of Civil Affairs to the Ministry of Public Security. Non-Chinese NGOs can support Chinese NGOs and individuals only if they have previously registered with the Ministry of Public Security.

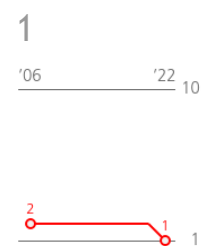
Demonstrations and other forms of protest are illegal without a government permit, which is almost impossible to obtain for ordinary citizens. Peaceful demonstrators risk arrest, though small, non-political protests, which are the majority of protests in China, are often ignored by the authorities. However, the punishment of protesters has increased under Xi. Because of limited freedom of movement due to COVID-19, public assemblies proved even more difficult to organize during the first months of 2020. Thereafter, lockdowns occurred only when and where new cases emerged, and these were limited to only a few days.

Although guaranteed by the constitution, freedom of expression is severely curtailed. Still, Chinese citizens increasingly make use of the internet, social media and other mass communication technologies to express critical views, raise public awareness and criticize government actions. The government reacts to this challenge with tightening controls on these technologies, for example by shutting down critical websites, blocking text-message services and censoring online content; moreover, the email and phone communications of political activists are monitored. Censorship has been extended to private groups on the popular social media app “WeChat.” In 2018, millions of accounts on Weibo, the Chinese equivalent to Twitter, were deleted. That same year, some Chinese citizens with Twitter accounts were allegedly pressured to remove content from their feeds or shut down their account altogether. Arrests of bloggers and “cyber dissidents” have continued.

Most television, radio and print media are controlled and/or owned by state organs. The work of journalists is heavily censored by the CCP. China’s rank in the World Press Freedom Index has dropped from 148 in 2018 to 177 out of 180 countries in 2020. Citizen journalists who reported about the breakdown of medical facilities in the city of Wuhan, where COVID-19 began to spread in the fall of 2019, have disappeared. Reports on the conditions surrounding the outbreak by Caixin magazine were quickly censored and a number of citizens were arrested for spreading rumors about COVID-19 on social media.

Freedom of expression is curtailed not only through surveillance and censorship, but also by flooding social media such as WeChat and Weibo with increasingly attractive content. Propaganda organs, such as the People’s Daily, the CCP’s party newspaper, are among the accounts with the most followers on these platforms. Propaganda capitalized on the inability of most democracies, especially the United States, to contain COVID-19 infections. Critical voices were drowned out in a barrage of “positive” reports about the containment of the pandemic both in state media and on social media.

Freedom of  
expression



Foreign media companies face frequent discrimination and are blocked after critical reports or in retaliation for measures taken against Chinese journalists abroad. In 2020, the New York Times, the Washington Post and the Wall Street Journal had to close their offices in China. The space for academic research and discourse has become subject to even stricter controls during the review period.

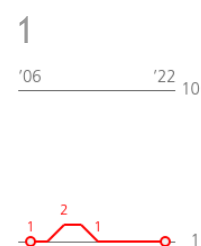
### 3 | Rule of Law

The political system is characterized by the Leninist principle of concentration of state powers with the National People's Congress (NPC) as the formally highest organ of power. In principle, all state organs, the executive and the judiciary at the central level as well as at the local levels, are responsible to the NPC or local People's Congresses, respectively. Thus, the constitutional framework does not establish a system of separation of powers. Since the CCP is constitutionally defined as the supreme ruler, it commands state institutions, and the NPC and local People's Congresses are subject to CCP directives and control. Although the rule of law has been enshrined in the constitution, the CCP remains above the law. Therefore, a system of checks and balances does not exist.

The first-in-commands of government departments and local administrations have had a varying amount of discretion. Since the late 1970s, the regime has been oscillating between the delegation of political and administrative competences and the (re-)centralization of power. The Xi Jinping era is once more one of recentralization, and the increasing porosity of the boundary between party and state. What is more, there has been a tendency for power to not only flow toward the central government, but to be concentrated in the hands of Chairman Xi Jinping himself. Xi presides over an increasing number of groups and commissions, which put him in charge of important policy areas such as administrative reform, cybersecurity, national security, foreign affairs and the military. Term limits for the chairmanship were removed in 2018. (There have never been formal term limits on the position of CCP general secretary).

According to the Global States of Democracy Index, the central government declared a lockdown in Wuhan on January 23, which was lifted on April 8. There were repeated lockdowns in the Hubei province. At the end of January, many provinces and autonomous regions declared a public health emergency. The authorities used strict tracing and isolation measures. Parliament did not review these measures.

Separation of powers



Although the judiciary is institutionally differentiated, there exists a considerable lack of judicial independence. Despite the leadership's repeated vocal commitment to the rule of law, China's legal system remains tightly under the control of the CCP and interference with the work of the judiciary still occurs frequently. Particularly within the lower-level courts, judges are very susceptible to corruption. The bar lacks independence, as the All-China Lawyers Association is institutionally subordinated to the Ministry of Justice. Particularly in criminal cases and defense of rights cases, lawyers are curtailed when performing their duties, especially in conducting investigations and gathering evidence. In addition, lawyers are often harassed and even debarred when representing defendants in human rights cases. Since 2007 when the authority to review death sentences was given back to the Supreme People's Court, the number of death sentences and immediate executions has dropped significantly, although it is still considered the highest in the world.

Although strict laws against corruption are in place, they were rarely enforced in the past, except in the form of campaigns. One such campaign began with Xi Jinping's ascent to power and has continued throughout the review period. This campaign followed the established practice of corruption being investigated by the Communist Party's Commission for Discipline and Inspection, which has gained in importance; dozens of high-ranking officials (above the rank of vice-minister) have been investigated, but merely a fraction of cases are submitted to the state judicial organs for prosecution. The anti-corruption purge targets officials at all levels and in all sectors of the regime: party, government, representative organs, universities, state-owned enterprises and the military. Since the start of the campaign, millions have been investigated, subjected to indoctrination sessions or forced to engage in "criticism and self-criticism."

Anti-corruption laws have become stricter, imposing limits on the gifts officials can receive and the amounts of money they can spend on official banquets. Foreign media reports, which made their way into China and targeted the huge personal wealth accumulated by the families of leading party cadres (including family members of Xi Jinping), have shattered the stereotype that corruption does not affect the top leadership and is only a local phenomenon. However, anti-corruption campaigns do not only affect the political realm. During the review period, "petty corruption" in the form of demanding bribes for services has become more difficult. Service providers are monitored with computer programs and even video cameras, and the electronization of financial transactions has imposed additional barriers to corrupt behavior.

#### Independent judiciary

2

'06 \_\_\_\_\_ '22 10



#### Prosecution of office abuse

5

'06 \_\_\_\_\_ '22 10



The constitution guarantees certain civil rights, such as freedom of speech, of the press, of assembly, of association, of demonstration, of religious belief, of person and so on. Nevertheless, the CCP and state organs frequently interfere with these rights.

Religious/spiritual groupings, such as underground protestant churches and Catholic communities allegiant to the pope, are not tolerated by the authorities and activists are frequently persecuted. Tensions between the government and religious groups, as well as religious persecution have intensified in recent years. According to the Australian Strategic Policy Institute, the authorities destroyed thousands of mosques in Xinjiang between 2017 and 2020. Maltreatment, physical abuse and torture of prisoners are prevalent. In Xinjiang, millions of citizens have been detained in “re-education camps” against “religious extremism” during the period of observation. Ethnic minorities are politically and economically discriminated against, as public life is dominated by Han Chinese; minority regions lack significant autonomy rights. Although the Chinese constitution stipulates that both men and women enjoy equal rights and legislation for the protection of women’s rights has been in place since 1996, in practice, women’s rights and opportunities are still severely compromised in many parts of China.

While in principle, victims can seek redress for such violations, corruption and the lacking independence of the judiciary hampers the efficacy of these mechanisms. Regime critics are subject to extra-legal detention, torture and harassment even after their release. There have been reports of human rights violations during the lockdown of Wuhan city in early 2020, with forced detentions in mass quarantine halls, and individuals who refused to comply with orders sometimes beaten or otherwise abused.

#### 4 | Stability of Democratic Institutions

The formal arrangement of political institutions is characterized by the supremacy of the CCP; thus, the People’s Republic of China (PRC) can be classified as being a one-party authoritarian political system. All leading political actors are recruited from within party ranks. Other political organizations in competition with the CCP are forbidden and suppressed. There are no meaningful general elections through which the people could change the government. The judiciary is not independent; especially in “sensitive” cases involving public disturbances, state secrets or product safety, political involvement in the judicial process and in decision-making is frequent. In December 2018, two Canadians were arrested on unknown charges in what observers claim is an act of retaliation against the arrest of Huawei Corporation’s chief financial officer in Vancouver, raising concerns that wanton arrests and trials of foreign nationals might become a tool to exert pressure on or extract concessions from foreign governments. As of January 2021, they remain in custody.

#### Civil rights

2

'06 \_\_\_\_\_ '22 10



1

'06 \_\_\_\_\_ '22 10



#### Performance of democratic institutions

Political leaders have endorsed the direct elections of village and urban residents' committees and encouraged greater transparency and popular participation in local governance. However, these measures are not intended to influence developments at the central level, but aim instead at improving good governance and strengthening party supervision. In addition, these elected bodies are not part of the government's formal administrative system.

Even though intellectuals affiliated with government think tanks and some high-ranking CCP cadres have talked about the virtues of democracy for China (and have come up with labels such as "incremental" or "orderly" democracy), these should not be mistaken as a future commitment to political reform toward a multiparty liberal democracy. Quite to the contrary, on many occasions, the upholding of one-party rule and the socialist system is highlighted while "Western-style democracy" is repudiated.

China's one-party authoritarian regime contains many channels for public consultation, but the government follows up on complaints and opinions voiced by citizens only selectively. Since Xi Jinping took power, the CCP regime is marketing its authoritarian system more aggressively, claiming that it represents a viable alternative to liberal democracy. In addition, the Xi regime has largely reversed Deng-era measures that aimed to separate party and state, and once more emphasizes a strong party that takes precedence both over the law and state institutions.

## 5 | Political and Social Integration

The party system is dominated by the CCP; even though eight so-called democratic parties are officially recognized, they are subordinated to the CCP. CCP membership has grown to nearly 92 million (by the end of 2019) or 6.57% of the population. As of 2019, there exist nearly 4.7 million grassroots-level party organizations throughout China, nearly one million more than a decade before. The proportion of private entrepreneurs, self-employed and college graduates being disproportionately high among new members. Farmers, herders, fishermen and retirees continue to form the CCP's backbone. Representation of women has improved but remains small. Only 25.6% of CCP members were female in 2019, although this was an increase from 16.94% in 2009. Even though the Chinese party-state does not rely on direct elections, it uses indirect feedback mechanisms (e.g., online monitoring of public opinion). In addition, the system operates with "deliberative" elements. Before passing new laws and regulations, the NPC publishes some drafts online to collect comments and replies.

Commitment to democratic institutions



Party system



In China, the system of cooperative associations is very heterogeneous and characterized by differences in the relationship to the state. Mass organizations such as the All-China Federation of Trade Unions, the All-China Women's Federation, or the China Youth League are funded, controlled and supervised by the state and mainly operate as purveyors of CCP policies to respective membership groups.

Several interest groups have been established on the initiative of the state and count as "Gongos," that is, government-organized non-governmental organizations. There also exist NGOs which concentrate mainly on social issues, such as environmental protection, animal welfare, representation of the interests of marginalized groups (women, the disabled, ethnic minorities, children), and provide services, such as legal aid and consumer protection. Homeowner's associations and business associations, which represent the interests of well-off strata in Chinese society, often have an impact on local politics.

China has a thriving state-approved non-profit sector, in which an unknown number of informal, non-registered associations are active in areas such as environmental protection, alumni activities or self-help. However, NGOs are poorly connected, lack organizational capacity and funding. As the state tightly controls the working of social associations and rigorously bans politically undesirable NGO activities, large segments of interests remain under-represented. There have been attempts to establish "free" associations apart from the All-China Federation of Trade Unions (ACFTU) (and other mass organizations), which have been repressed by the authorities.

Many Chinese have only vague ideas about democracy and often reveal a conflicted understanding about what the concept means. According to the World Values Survey, Chinese generally think positively about democracy; almost 90% consider having a democratic government a good thing. This attitude partly stems from the fact that the Chinese government calls itself democratic. However, the broad interest in a responsible, incorrupt and predictable form of government has not yet led to demands for political participation. Even if many Chinese today are ready to strongly criticize governmental arbitrariness and officials' chicanery, the overwhelming power of the state frightens off any demands for democratic participatory rights or attempts to become personally engaged in politics.

Recent studies based on list experiments shed doubt on the extremely high levels of trust in the Chinese government reported in opinion surveys. That said, the level of trust in the government has increased during the course of the COVID-19 pandemic, both because the disease has been largely contained in China and because the containment strategies of most other countries failed. Again, one should not forget that the Chinese party-state operates with its own definition of "democracy," which is largely procedural (e.g., with consultative and limited elections). However, there are trends that the CCP authorities have begun framing China's political system as a democracy and by denigrating liberal democracies as "so-called" democracies.

Interest groups

2

'06 '22 10

2

1

Approval of  
democracy

n/a

'06 '22 10

n/a

1

According to surveys, the level of interpersonal trust is extremely high in China and is almost on par with the level encountered in Scandinavian countries. Parochial trust, that is strong loyalties between family members, is particularly pronounced. In rural China, especially in the south, clans and traditional family structures still play an important role in social and political life.

Civic trust is also growing, as citizens affected by severe problems – such as environmental degradation, local government corruption or violations of basic human rights – associate for purposes of self-help. Occasionally, these associations are supported by activist lawyers. These groups are closely watched; and since they often aggressively bring social ills and wrongs to the fore, local governments in particular try to silence them by repressing activists and leaders.

There are signs that the COVID-19 pandemic might have negatively affected solidarity and the capacity to self-organize. Lockdowns, the provision of basic necessities and other measures to contain the pandemic were largely coordinated and implemented by CCP-led neighborhood committees together with street-level bureaucrats, which left little room for self-organization. In addition, citizens informed on each other for not wearing masks or violating hygiene regulations.

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

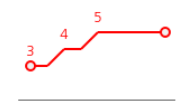
China's GDP has continued to grow, albeit at a smaller pace than in the previous years. The structural transformation of the economy from industry to services and from capital investments to consumption have not affected China's social development and inequality to a large degree. According to official statistics, the overall distribution of income, measured by the Gini coefficient, was 0.465 in 2019, which likely is a conservative estimate. Wealth distribution is even more unequal: according to a report by Beijing University, 1% of China's households owns one-third of China's wealth. Between 1995 and 2012, the Gini coefficient for household wealth increased from 0.45 to 0.73.

Reducing poverty has been one of the signature policies of the Xi Jinping administration. Measures include targeted poverty alleviation, improving access to social services, and increasing welfare handouts. According to official statistics, extreme poverty, defined in 2011 as an annual personal income of less than CNY 2,300 PPP, was eradicated in 2020. Applying the lower World Bank poverty line of less than \$1.90 PPP per day, poverty had disappeared by 2016. China's HDI has continued its slow upward trend and stands at 0.761 in 2019. China now falls into the

Social capital

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'06 '22 10



Question  
Score

Socioeconomic  
barriers

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'06 '22 10



class of countries with high human development. The annual capita disposable income in urban/rural areas in 2017 totaled CNY 39,250/CNY 14,617 (\$6,047/\$2,000). The gap between urban and rural incomes is continuing to decline, with ratio now standing at 3:1. However, these values do not take into account informal incomes, the variation of living standards across China, wealth, and the effect of rapid urbanization.

Traditionally, Chinese women are well-integrated socially and economically. With a value of 0.168, China ranked 39th in the Gender Inequality Index in 2019. However, discrimination exists in the labor market. The difference in labor force participation was 14.6% in 2019, and the estimated GNI per capita was one-third less for women than for men in 2017. Ethnic minorities are subject to social and economic exclusion and marginalization, with the majority of China's poor living in minority regions. Most prominently in the Muslim Xinjiang Uyghur region and the Tibet Autonomous Regions, political marginalization, territorial infiltration and cultural insensitivity by Han Chinese, unequal access to well-paid work often provoke violent resistance, have led to the formation of separatist movements and drastic counter-measures by the Chinese government, for example the incarceration of millions of Uyghur citizens in re-education camps.

Economic indicators		2017	2018	2019	2020
GDP	\$ M	12310409.4	13894817.5	14279937.5	<b>14722730.7</b>
GDP growth	%	6.9	6.7	5.9	<b>2.3</b>
Inflation (CPI)	%	1.6	2.1	2.9	<b>2.4</b>
Unemployment	%	4.4	4.3	4.6	<b>5.0</b>
Foreign direct investment	% of GDP	1.3	1.7	1.3	-
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ M	188676.1	24130.9	102909.9	<b>273980.4</b>
Public debt	% of GDP	51.7	53.8	57.1	<b>66.3</b>
External debt	\$ M	1704516.2	1961528.2	2114162.9	<b>2349388.6</b>
Total debt service	\$ M	206284.4	240940.0	275776.8	<b>273800.2</b>



Economic indicators		2017	2018	2019	2020
Net lending/borrowing	% of GDP	-	-	-	-
Tax revenue	% of GDP	9.4	9.1	-	-
Government consumption	% of GDP	16.3	16.5	16.8	-
Public education spending	% of GDP	3.7	3.5	-	-
Public health spending	% of GDP	2.9	3.0	-	-
R&D expenditure	% of GDP	2.1	2.1	-	-
Military expenditure	% of GDP	1.7	1.7	1.7	1.7

Sources (as of December 2021): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

## 7 | Organization of the Market and Competition

Competition in China is market-based, but the playing field is not level. China's private enterprises dominate the economy: In 2018, private enterprises generated 60% of China's GDP and 80% of China's urban workforce was employed by private companies. However, most private enterprises are small and face three challenges: access to capital, access to markets and overdue payments. In 2019, the liability-asset ratio of private enterprises was 57.4%, while that of centrally managed state-owned enterprises was 65%. These conditions are not uniform across China. Where the private sector dominates, for example in the Pearl River Delta, production chains facilitate independence from state actors. Sectors and areas with strong state involvement are often a difficult environment for private firms. Several of the most successful private enterprises, for example in the high-tech and telecommunications sectors, have their origin in government institutions and were founded by former officials or people with good connections to the government.

The legal framework for private business continues to be weak, opaque and arbitrarily implemented. The anti-crisis stimulus measures of the Chinese government since 2008 have mostly propped up big state-owned enterprises (SOE) to the detriment of private businesses, though their access to credit has improved since 2016, when their liability-asset ratio stood at 50%.

Foreign business investments remain subject to government restrictions, yet these restrictions are gradually being repealed. In 2020, the number of sectors where foreign investment was either prohibited or tied to restrictions such as a minority or equal share policy, or control by the Chinese partner, decreased to 32. Repatriation of profits is difficult due to foreign exchange controls and extensive approval and implementation procedures. In September 2013, the government established the

Market  
organization

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Shanghai Free Trade Zone (SFTZ), where commodities can be imported tax-free and foreign investments are permitted in all but 16 sectors. Since then, 17 more free trade zones have been established, with six established in 2019 alone. The free trade zones are also seen as a test lab for full yuan convertibility. Capital account settlements have indeed been made easier than in the rest of China, but full convertibility is still limited and tied to several requirements, because the government fears that an uncontrolled outflow of renminbi could negatively affect macroeconomic stability. In contrast, Hong Kong residents can exchange an unlimited amount of yuan since November 2014 in an attempt to facilitate trading between stock exchanges in Hong Kong and Shanghai.

In August 2008, a new anti-monopoly law went into force. It prohibits monopoly agreements between competitors, the abuse of dominant market positions and administrative monopolies. It also aims to tear down artificial trade barriers within China to eliminate local protectionism. The Ministry of Commerce (MOFCOM), National Development and Reform Commission (NDRC) and State Administration for Industry and Commerce are responsible for implementing the law.

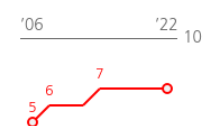
In early 2018, the Anti-Monopoly Bureau was established within the State Administration for Market Regulation (SAMR), replacing three anti-monopoly organs under three different bodies. Six anti-monopoly guidelines published in September 2018 guide the work of SAMR. In 2020, SAMR imposed the maximum possible fine on three pharmaceutical companies, which were found guilty of abusing their collective dominance. In some strategic sectors (defense, energy production, petroleum, gas, petrochemicals, coal, civil aviation, shipping), the state upholds the existing monopolies of state-owned enterprises, with the partial exception of the Shanghai Free Trade Zone, where limited investments in shipping and transportation are possible.

Since the global financial crisis, China has become somewhat less dependent on foreign trade. While in 2006 exports equaled 36% of China's GDP, the respective figure for 2019 was 17.4%. Similarly, imports declined from 31% to 14.45%. However, the export of manufactured products, a large number of which are assembled from imported parts, still plays an important role in the Chinese economy, and in 2012 China surpassed the United States as the world's largest trading nation (merchandise trade, excluding services).

Since accession to the WTO in 2001, foreign trade has been continually liberalized; direct intervention in trade decreased, import barriers have been reduced and the mean most-favored-nation tariff rate was 9.86% in 2018. Many machinery and material inputs required for manufacturing are tariff-exempt, especially for enterprises operating in the 113 "Comprehensive Bonded Zones" (known as "Special Customs Supervision Zones" before 2014). After several years of negotiation, the

#### Competition policy

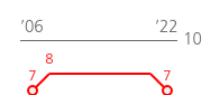
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#### Liberalization of foreign trade

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Regional Comprehensive Economic Partnership with ASEAN, and Japan, Korea, Australia, New Zealand was signed in November 2020.

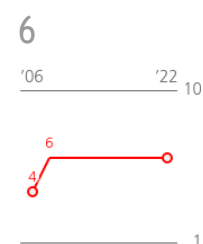
The seventh WTO Trade Policy Review for China, issued in July 2018, notes that clearance times for imports and exports have been shortened, but also finds China's subsidy policy very opaque. In January 2018, the Anti-Unfair Competition Law went into effect. The enforcement of Intellectual Property Rights was strengthened but remains a challenge. In 2016, a new cybersecurity law was enacted. The law requires foreign companies to store their data on servers based in China and has made the use of Virtual Private Networks (VPNs) more difficult. The banking and insurance markets were further liberalized, though Chinese companies have become so entrenched that it will be difficult to gain a foothold in the market. In 2019, the Chinese government imposed punitive non-tariff barriers on Australian coal and wine in apparent retaliation for worsening political relations. The 14th Five-Year Plan (discussed by the Fifth Plenum in October 2020 and to be passed by the NPC in 2021) adds two new features: "dual circulation" and "secure supply chains," which will most likely have an impact on China's foreign trade strategy.

Since 2016, banks have been able to set higher and more market-oriented interest rates on deposits; local governments are now allowed to issue bonds in order to roll over debts incurred by local government financing vehicles; a deposit guarantee was introduced; and six domestic privately owned banks have been established. These measures are aimed at mitigating the considerable risks caused by a fast-growing shadow banking system.

At first glance, China's banking system appears solid. In 2018, 35.5% of China's banking assets were held by five state-owned commercial banks. China has fully adopted the Basel III risk-based capital standards. In the review period, the ratio of non-performing loans increased slightly from 1.7% in 2017 to 1.9% in 2019. Artificially low interest on deposit loans and relatively high interest on bank loans provide these banks with cheap money. At 9.1% in 2018, the capital-to-assets ratio is rather low by international standards, but high compared with China's previous values, which were as low as 4.4% in 2005. The four biggest state-owned commercial banks (SOCB) are listed on stock exchanges and belong to the world's biggest banks with regard to market capitalization. This has brought not only fresh capital to the system at large, but also foreign accounting groups now review the banks' financial reports, which has resulted in greater transparency. According to WTO commitments, much of the banking sector has been opened to foreign banks and restrictions on foreign banks' local currency businesses have been lifted, but the market share of foreign banks remains small.

Privatization in the financial sector is not far advanced; most non-bank financial institutions, such as life insurance, investment, and securities companies, are state-owned or controlled by local governments. However, this excellent performance can partly be explained by the fact that high-risk lending is occurs outside the formal

Banking system



banking system. Stimulus measures by the Chinese government during the global financial crisis led to a relaxation of the rules on informal lending, and trust companies, small lending companies and informal lenders have captured increasing shares of the financial market. Between 2014 and 2018, off-balance sheet lending by China's local governments tripled from CNY 10 trillion to CNY 30 trillion, more than double the amount of on-book lending.

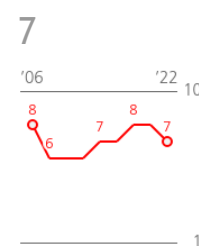
Commercial banks are connected to the shadow banking system. They short-sell wealth management products to finance the high-risk operations of trust companies and are required to lend money to local government investment vehicles. In addition to issuing bonds, a number of local governments have resorted to tapping the informal financial system to roll over their loans. Land and real estate serve as the main collateral, making China's financial system extremely sensitive to real estate bubbles. The government seeks to rein in the shadow banking sector by de-emphasizing GDP growth in local government leaders' annual evaluations while at the same time imposing negative sanctions on incurring liabilities and tightening asset management rules. The lack of information on the true size of the shadow banking system, its various connections with China's commercial banks and the linkages with citizens' deposits and mortgages makes it difficult to estimate the overall impact of a default of informal loans on China's financial system. According to Moody's, the relative size of the shadow banking sector has declined from 87% of GDP in 2016 to 70% of GDP in 2018.

## 8 | Monetary and fiscal stability

China's inflation rate remained low and stable during the review period. After fluctuations of the consumer price index between -0.7% (2008 – 2009) and 5.4% (2010 – 2011), consumer prices increased 2.1% between 2015 and 2016 and 2.9% between 2018 and 2019. After a slow and gradual decline of exports between 2014 and 2016 from \$2.34 trillion to \$2.097 trillion, exports picked up again in 2019 (\$2.499 trillion). A similar, albeit more marked trend is evident for imports, which declined from \$1.95 trillion in 2014 to \$1.59 trillion in 2016, but rebounded to \$2.077 trillion in 2019. In 2019, foreign direct investments rose 2.11% over 2018. China's currency reserves, which had increased from \$1.53 trillion in 2007 to \$3.83 trillion in 2014, fell to \$3.03 trillion in 2016, but increased again to \$3.24 trillion in 2019. China has a managed exchange rate. In March 2014, the daily trading band for the Chinese yuan against the dollar was increased from 1% to 2%. In 2016, the Chinese renminbi was integrated into the IMF (SDR) currency basket – even though it is not yet ranked as a freely convertible currency.

The Chinese central bank is not independent, but under tight oversight by the central government, which sees the financial system as an important instrument for macroeconomic control. To stimulate post-COVID-19 economic growth, the

### Monetary stability



government provided liquidity by cutting the reserve requirement ratio and incentivizing local governments to issue bonds and invest in infrastructure projects. In addition, the government announced tax exemptions and other cost cuts for businesses in May 2020 to soften the impact of the COVID-19 crisis on the economy. At the time of writing, these measures have not fueled inflation.

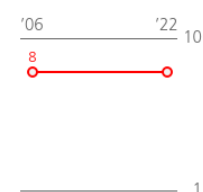
Macroeconomic stability is of utmost importance to the Chinese government. After the world financial crisis, economic growth declined from the previous double-digit rates to 6.7% in the third quarter of 2018. Because of the COVID-19 crisis, GDP growth slowed to 2.3%. However, the real growth rate was probably much lower and perhaps even negative. As the economist Michael Pettis points out, non-productive investment is included when China's GDP is calculated (or rather decided), so it is a poor measure of productivity growth.

The government has engaged in structural reforms, for example, by eliminating excess capacity in the steel and real estate sectors, deleveraging firms and local governments, improving total factor productivity, and issuing tax breaks. Still, the declining profits of industrial enterprises, high levels of local government debt and trade frictions with the United States have negatively affected macro stability. During the review period, the government continued to try and boost domestic consumption, which is impeded by the high level of inequality and high savings levels of risk averse households.

The basic challenge for Chinese authorities is still the same: to maintain annual growth at a high enough rate to guarantee an adequate number of jobs while at the same time rebalancing the economy toward a more sustainable consumer-driven development path. The current account balance was \$141.3 billion in 2019, external debt \$2.1 trillion and external reserves \$3.1 trillion. According to official statistics, the government deficit stood at 6.3% of GDP and national debt at 52.6% of GDP in 2019. To mitigate the effect of the COVID-19 crisis on China's economy, the government adopted indirect (e.g., a reduction in the mandatory reserve ratio of banks and tax breaks) and direct (e.g., subsidies and investments related to mitigating the COVID-19 pandemic and infrastructure spending) measures, which added up to \$500 billion. Since the onset of the pandemic, China's debt burden has grown by around 30%.

Fiscal stability

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## 9 | Private Property

In October 2007, China's first private property rights law came into force. The law "protects the lawful property of individuals," state-owned assets and prohibits the illegal possession, destruction or looting of state property by private persons.

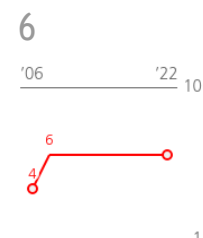
However, the implementation and enforcement of these formal regulations is inconsistent and arbitrary, due to a weak judiciary and to corruption in administrative agencies. All land ownership still remains with the state; this means there are no secure property rights for peasants. To address the problem of forced resettlement caused by large-scale governmental construction projects or illegal land grabs by local authorities, the Chinese government in early 2013 promised to better protect land use rights, increase compensations to farmers, even allowing the latter to directly negotiate the sale of rural construction land. This rule also gives farmers the possibility to merge plots and employ modern farming technologies on larger fields, thereby increasing productivity and income. The long-term aim is to push urbanization and pool rural land for large-scale farming by agricultural enterprises.

The enforcement of intellectual property rights remains sketchy. China is the only "priority one" country in the European Commission's report on the protection and enforcement of intellectual property rights in third countries (December 2019). The report points out several persistent and serious problems with forced technology transfers, intellectual property thefts, counterfeiting and requirements to give up sensitive technology for market access. However, it also notes improvements such as the establishment of specialized courts for intellectual property rights, and the amendment of relevant laws and regulations during the review period. In January 2019, a new e-commerce law was passed, and the trademark law and the anti-unfair competition law were improved in April 2019. In November 2020, the copyright law was revised.

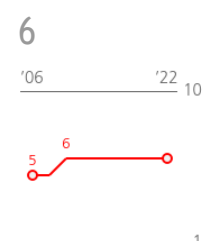
Due to murky ownership structures, hidden subsidies and various statistical indicators, it is nearly impossible to draw an exact line between what is referred to in China as the "public" and "non-public" sectors. At the end of 2017, there were 27.26 million private enterprises and 65.79 million individually owned businesses, which altogether employed 340 million people. 90% of these companies are in the service sector, 8% in industry and 2% in agriculture. In the industrial sector, private enterprises made up 87% of all enterprises with a revenue over CNY 20 million in 2017 and were responsible for 30.76% of total profits. In recent years, large private enterprises have dominated online retail in China and have become important players in cross-border acquisitions.

Although private enterprises also benefit from the private property rights law, some stumbling blocks remain, such as difficulties in accessing capital, licensing procedures hampered by long delays, a lack of transparency, local government

Property rights



Private enterprise



favoritism and the pressure to pay illegal fees. After a period of favoring SOE over private enterprises, the government has now improved credit access for private enterprises. To mitigate the negative impact of the COVID-19 pandemic, the government has promised to further support small and medium-sized enterprises by ensuring easier access to credit and other indirect subsidies such as tax cuts. So far, the government has not taken equity stakes in troubled firms or nationalized companies.

## 10 | Welfare Regime

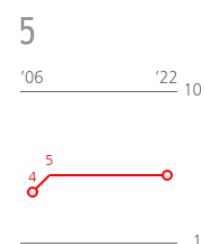
Basic public social security systems covering pensions, health care, unemployment, accidents and maternal care are in place in China and have been gradually extended from the urban to the rural population while a rapidly increasing number of rural poor can now claim social benefits. Services are funded through contributions by employees, employers and government subsidies. The welfare regime is largely public, but individuals can purchase additional insurance from private companies. However, as family farmers are not considered employed, unemployment insurance still only covers employees of urban enterprises and institutional organizations. Furthermore, entitlements depend to a significant degree on the size of contributions, meaning that those with low incomes receive only very basic and limited services.

Another serious problem is social security benefits for migrant workers, as many employers do not pay the necessary premiums, even though the law obliges to do so. In addition, although the Social Insurance Law, which has been in effect since 2011, mandates the transferability of earned social insurance benefits, it faces severe challenges in practice.

Likewise, the large number of Chinese employed in the informal sector suffers from inadequate coverage for social risks. China's urbanization regulations, which were unveiled in 2013 and 2014, stress that the rights and social integration of migrant workers must be improved. Finally, urban and rural social security systems are to be integrated, with the ultimate aim of abolishing discrimination against those with rural household registrations. According to official statistics, 943 million people were enrolled in the basic pension system by the end of 2018 and 196.4 million urban residents contributed to unemployment insurance schemes in 2018.

Universal health insurance coverage has been achieved in 2020, but the benefits of basic medical insurance are low. Since hospitals and doctors often charge arbitrary fees or insist on bribes for service, there is a high degree of uncertainty as to which costs for health care and other risks might be expected in the future. For example, the system is not designed to treat expensive chronic diseases, and the poor can often not afford to pay the patient's contribution, which de facto excludes them from medical insurance benefits. The Chinese government has not handed out additional subsidies to citizens to cushion the impact of the COVID-19 crisis but has punished profiteering on vital goods such as personal protective equipment and sanitizers.

Social safety nets





Facilities for education, social security and public services are developed in urban coastal regions and are steadily improving in the rest of the country. However, the quality of services individuals receive depends on income. China's male-to-female ratio at birth is 1.18 and mirrors the preference of Chinese parents for their first child to be male. Though forbidden, many parents use prenatal diagnostics to determine the sex of their child, and female fetuses are sometimes aborted. Owing to historical factors, there remains a 5% gender gap in adult literacy (2010), but literacy rates for those aged 15–24 are near-universal and virtually identical.

In terms of gender (but not wealth), China is one of the most equal countries in Asia in terms of access to education. Female enrollment rates are higher than male enrollment rates in primary, secondary and tertiary education. However, females are disadvantaged both in access to jobs and salaries. In 2020, female labor force participation was 43.6% and GNI per capita was one-third less for women than for men in 2017. This marks an overall worsening of the situation: in 1990, women earned almost 80% of men's salaries. Especially among the older generation and in particular in rural areas, women are not regarded as equals, but the situation is changing for younger generations. Women's participation in politics remains severely limited. Only 24.9% of representatives to the National People's Congress (NPC) are women, although this an increase of 1.5% over the previous NPC. There are even fewer women in the echelons of power: no woman has ever been appointed to the CCP's Politburo Standing Committee, and only one out of 25 members of the Politburo and 10 out of 205 members of the Central Committee are female. Female provincial party secretaries or governors are extremely rare.

Economic exclusion of and social discrimination against ethnic, religious and linguistic minorities in mainstream society continue. Especially migrant workers and their children are still disadvantaged.

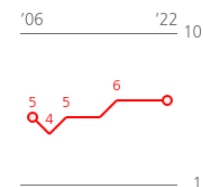
## 11 | Economic Performance

Macroeconomic performance in China continued to be rather high compared with other major (emerging) countries but was lower than in the past. Growth rates dropped from 9-12% before the world financial crisis to a "new normal" of 6-7% post-crisis. However, China's GDP figures cannot be directly compared to those of other countries, because they also include a significant amount of non-productive investments – real GDP is probably significantly lower than what the official figures state.

At 2.1% in 2016 and 2.9% in 2019, inflation was low. GNI per capita at market exchange rates was \$16,785 PPP in 2019. The official unemployment rate remained stable at 4.4% in 2020 but is likely higher in reality. In 2017, government tax revenue equaled 9.4% of GDP, total government expenditure amounted to CNY 22.09 trillion; gross government debt stood at 52.6% of GDP in 2019 but is probably much higher

### Equal opportunity

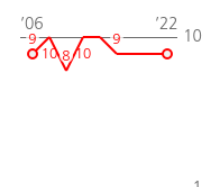
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### Output strength

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as some local governments and state-owned enterprises loans count as private debt. To ameliorate the effects of the COVID-19 crisis on the economy, the government granted tax breaks, eased access to credit and invested in (emergency) infrastructure. The total cost of these measures is estimated at around \$500 billion. The COVID-19 pandemic has negatively affected economic activity in China, as GDP grew by only 2.3% in 2020.

## 12 | Sustainability

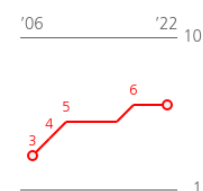
In 2018, China emitted 10.064 megatons of carbon dioxide, the highest total worldwide and far surpassing that of the United States. On a per capita basis, however, China's emissions are significantly below those of developed countries in Asia and half of those of the United States. Still, in November 2014, the United States and China agreed to cut CO<sub>2</sub> emissions. China promised to cap its emissions by 2030 and the United States pledged to reduce emissions to a figure 28% below its 2005 levels by 2025. Emissions remained largely stable between 2013 and 2018, though the slight increase since 2016 has raised the question of whether this stabilization is the result of slowing demand rather than efforts to reduce emissions.

Of particular concern for the Chinese authorities are air and water quality. Air quality has improved slowly, but steadily. Sulfur dioxide emissions decreased from 25 million tons in 2007 to 8.75 million tons in 2017. Water pollution is another serious problem. According to official statistics, only 6.6% of urban groundwater is fit for drinking. Overall, nearly 60% of China's groundwater was rated "relatively poor" or "very poor" (worse than Grade II). As pollution is responsible for some premature deaths, it has become a major public concern and represents a bottleneck for China's continued development; environmental protection is high on the CCP's agenda. In 2015, coal power plants supplied 65.2% of China's energy, down from 69% in 2010. As China's coal is high in sulfur and coal firing greatly contributes to air pollution, the government is gradually banning the use of coal stoves, replacing coal with gas or power as the prime energy source of households. The contribution of coal power plants to China's energy mix is to drop further to the benefit of water, wind and nuclear energy. In addition, inefficient power plants are being closed.

In April 2014, the environmental protection law was amended for the first time in 25 years, removing limits on fines for polluters. The problem, however, is implementation, because the incentives for local governments to allow factories to cut production costs by polluting the environment is high while the risk of detection low. In 2018, the government has started to reward local leaders for improvements in the environment while putting less emphasis on GDP growth. Nearly six million cars that did not meet emission standards had been pulled off China's roads by the end of 2015, and an increasing number of cities have started to apply the "China VI" emission standards, which are set to replace the "National V" standards nationwide by 2023.

Environmental  
policy

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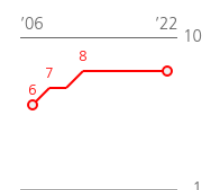
The Chinese government incentivizes innovations in green technology to meet challenges at home, but also to export technology abroad. In January 2020, China's NDRC issued regulations to ban non-degradable bags, single-use straws and single-use plastic items by 2025. At the end of 2020, 46 pilot cities had established garbage sorting systems. By 2025, such systems are planned to be implemented in all prefecture- and directly administered cities. In December 2020, Xi Jinping announced that China would reduce carbon intensity by 60% by 2030 based on 2005 levels.

China's research and technology sector is rather advanced and continues to improve. Spending on R&D as a percentage of GDP has risen from 0.6% (1995) to 2.23% (2019), overtaking Europe in terms of R&D intensity. R&D is heavily driven by foreign companies' investments and is dispersed unevenly across the country. Chinese patent offices receive more applications than other countries. However, against 1.4 million innovation patent applications in China (2019) stand 5.323 "triadic" patents (patents granted in China, Japan and Europe) held by Chinese innovators in 2018. In 2018, less than a quarter of all successful patent applications in China were filed by foreign actors, who had been responsible for one-third of all successful applications in 2013. Still, the number of domestic invention patent applications increased about 10-fold to 1.4 million between 2005 and 2018.

Expenditure on education accounted for 3.57% of GDP in 2018. Since previous funding has been distributed unevenly across regions and institutions, favoring urban and coastal regions as well as tertiary institutions, the government is now focusing on rural areas. Given the size and heterogeneity of the country and its various provinces and regions, the quality of the education system remains uneven. Highly competitive, world-class institutions exist alongside low-quality segments of the educational system. Overall, national and province-level education policies ensure a nationwide system of solid education and training. However, the rural population is significantly disadvantaged regarding access to higher population. China's U.N. Education Index score was 0.657 in 2019, on par with countries such as Turkmenistan, Gabon and Indonesia.

Education policy /  
R&D

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## Governance

### I. Level of Difficulty

China's political leaders face several structural constraints, some natural, others man-made. Droughts, floods and earthquakes occur regularly in China and not only cause thousands of deaths every year, but also impede China from achieving its goal of food autarky. Furthermore, environmental degradation and water scarcity increasingly constrain the country's development. China's size, combined with uneven development and underdeveloped regional markets, pose great challenges to landlocked and mountainous provinces in central and western China. Severe income inequality strains not only social stability, but also domestic consumption, thereby limiting the competition needed for innovation.

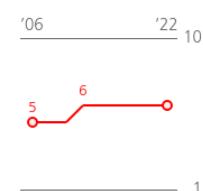
After profiting from three decades of "demographic dividends" from a large working-age population, the share of retired persons is increasing. As a result of its one-child policy, in 2012 for the first time China's working-age population (between 15 and 59 years old) shrank, albeit it only by 3.45 million out of almost 940 million people. China is the first country where the "demographic window," a beneficial relation between the working- and non-working-age populations, will close while the country is still in a developmental stage. The one-child policy was relaxed in 2013 and again in 2015 but has thus far failed to trigger higher birth rates.

With wages having increased substantially, not least due to mass demonstrations, foreign companies have left China to relocate manufacturing centers to "cheaper" countries, such as Indonesia, Vietnam or India. The CCP leadership seeks to address this problem by strengthening domestic consumption, encouraging "indigenous innovation" and investing in "smart factories," where processes are fully automated and machines communicate with each other through the internet. Artificial intelligence and web-based commerce are further sectors which the government expects will drive economic growth. Major challenges are posed by the facts that most Chinese cannot afford high-quality products, most enterprises have narrow profit margins and do not invest in R&D and property rights protection remains lax.

Low levels of education especially in rural areas pose a severe structural constraint. Much of China's new growth depends on the digital economy and companies might find it difficult to recruit enough skilled personnel.

Structural constraints

6



In comparison with Europe and the Americas, reported rates of COVID-19 infections were low in China. Still, China's policy of strict lockdowns in the first quarter of 2020, which included workers in manufacturing and service, led to a temporary economic slowdown. Arguably, the pandemic has had a positive effect on governance, because e-government capacities had to be increased to facilitate the provision of services under strict lockdown. The same, however, is true of surveillance capacities, which are likely to further consolidate China's authoritarian one-party state.

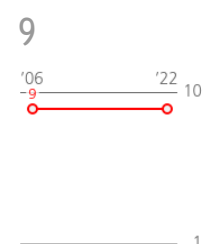
China lacks a robust tradition of civil society, not least because Chinese society is still largely centered on personal networks and because intermediate organizations have not played an important role in China's history. Citizens might organize spontaneously to further their aims, as evidenced by popular protests, but these organizations tend to crumble once the event is over. Nevertheless, the number of officially registered social organizations and NGOs has steadily increased from 153,222 in 2000 to 817,360 in 2018. Official registration entails finding a government unit to act as a guarantor and fulfilling a number of other requirements that serve to keep a check on social sector growth. However, the number of small and unregistered organizations is estimated to run into the millions.

The government is faced with the quandary of needing social participation to enhance the provision of public service while fearing that these organizations may challenge its power. Hence, registered NGOs and non-registered voluntary organizations are only partially able to provide channels for popular participation or representation of social interests. In recent years, grassroots NGOs have been increasingly co-opted by party branches. The government's exhortations for philanthropic donations are largely ignored.

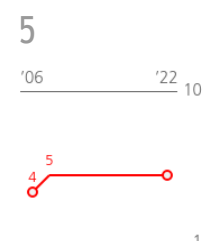
There are no irreconcilable social or religious cleavages in China. With the exception of some minority (e.g., Uyghur and Tibetan) populations, there are also no irreconcilable ethnic cleavages. One reason for this is that most Chinese ethnicities act in accordance with the prevailing modernization paradigm of the Chinese Communist Party. Dozens of protests staged by Chinese citizens occur daily, but most of these are small and concerned with existential issues, such as wage arrears, the demolition of houses and the relocation or expropriation of rural land. Although not as frequent, spontaneous and large-scale demonstrations occur almost annually, often in the form of "not in my backyard" protests aimed at polluting factories and waste plants.

Economic development has proceeded in a highly unequal manner, as indicated by widening wealth gaps and unequal access to health care, secondary and higher education, and contributes to the fragmentation of society into a small, affluent group and a large, economically underprivileged group. Occasionally, conflicts with the police or other state organs lead to outbursts of mass vandalism.

#### Civil society traditions



#### Conflict intensity



Relations between Han Chinese and Tibetan and Uyghur minorities remain tense; control is maintained through a massive, visible police presence in strategic locations, mass surveillance and the incarceration of millions of citizens in re-education camps. In Beijing's center, police with anti-riot gear are stationed at strategic points 24 hours a day, and visitors to Tiananmen square need to subject themselves to a thorough security control. The initial measures to contain the COVID-19 pandemic led to some dissatisfaction being voiced on the internet. There were sporadic incidents in which patients attacked nurses, but no violent confrontations involving larger groups.

## II. Governance Performance

### 14 | Steering Capability

The Chinese government pursues social stability and economic development as its two main priorities, but global status and reputation have become a priority under the Xi administration as well, especially after the National Party Congress in 2017. In contrast, transformation toward democracy based on the rule of law is not one of the government's long-term strategic aims. Rather, the government follows a deliberate strategy of counterbalancing the threat of pro-democracy tendencies and challenges to the party's political hegemony.

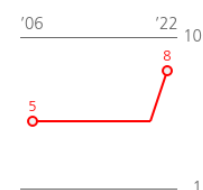
Policymaking is characterized by long-term perspectives and subject to evidence-based impact assessment and strategic planning. The government uses guidelines to provide a framework for binding and non-binding policy objectives. Five-year plans specify social and economic targets, some of which are quantified and binding while others are non-quantified and highlight results that local governments should try to achieve. Major policy changes – like those involving innovation or education – take longer to achieve, so the timeframe is extended to 10 or even 15 years. The central government has prioritized investment in the development of artificial intelligence, a field in which it envisions China will become a market leader by 2030. The government also continues to promote “green” technologies and infrastructure projects abroad. In contrast, the previous program of “Made in China 2025” has been de-emphasized. At the local level, targets are tackled incrementally by formulating annual plans. These plans have thus far been consistent; yet, while crises might delay the achievement of targets, no five-year plan has been abandoned.

Overall capacity is weakened by both the de facto hierarchization of departments and implementation gaps between envisioned and actual outcomes. Departments concerned with economic development usually take precedence over those with social or environmental portfolios. Local governments are given several abstract achievement targets, the fulfillment of which often depends on their priorities,

Question  
Score

Prioritization

8



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capabilities and budgetary means. Increased domestic consumption and less reliance on capital building has been one of the government's long-term plans which has been affected by COVID-19. To maintain economic growth, the government once more set incentives for capital building – at the cost of making society more equitable. Considerable resources have been invested into mitigating poverty, but not into stimulating consumption more generally.

Over the last two decades, the government has established internet-based channels for citizens to voice their grievances and responsiveness to such demands contributes to stability. However, such participation is unlikely to lead to demands for greater liberalization, especially because increased responsiveness to everyday grievances co-exists with the increased government control of civic space.

The central government can effectively implement political priorities that it considers binding, but the range and extent of its capacity to do so depends on its resolve and on the interests of local governments. However, the center's control over local governments' policy implementation has been tightened in recent years. First, the regime uses surveillance technology not only to monitor its population, but also to control its bureaucrats. Public feedback channels also help to identify implementation gaps.

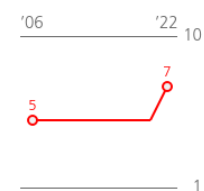
Policy implementation capacity is thus increasing, but the government does not intend to implement political reform measures that might initiate a transformation toward democracy based on the rule of law. Policy implementation is easiest where interests and priorities converge, economic growth being a prominent example. It is most difficult where the priorities of the central government do not match those of local actors, and where it monitors and sanctions non-compliance weakly or not at all. Implementation of a policy against the will of local governments is possible yet costly and is usually carried out in the form of campaigns. While compliance is important, and can be ensured, in times of crisis the central authorities depend on local initiative to govern routine affairs and to contextualize development targets.

However, the room for error has decreased and policy failures often result in the dismissal of local leaders. The Xi administration's campaign against corruption effectively illustrates this fragile balance. The campaign antagonizes the overwhelming majority of local officials, who have no real power to resist it. However, it stymies local initiative, which is likely to adversely affect local development and may ultimately threaten the economic dynamism of the country as a whole.

The government's fight against the coronavirus pandemic is unlikely to further China's transformation toward democracy and a market economy. First, the COVID-19 crisis resulted in an upgrading of governance and surveillance technologies, which have benefitted the authoritarian regime. Second, the government uses the failure of the United States government, but also other democracies, to contain the pandemic to its advantage.

Implementation

7



The Chinese leadership demonstrates the ability and willingness to learn from past experiences and from new sources of knowledge. This willingness is mainly confined to social and economic policies, but also extends to administrative reforms, which are commonplace at the city and county level. Officials and administrators formulate such reforms by learning from past experience and by studying examples at home and abroad. For example, the current debates about the reform of the social insurance systems (and, especially, the pension system) are informed by exchange with scholars and politicians from Europe.

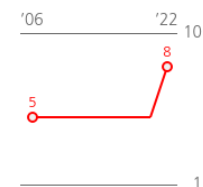
Most notably, elements of consultation are applied in lawmaking, the preparation of budgets and the monitoring of officials, oftentimes using the internet. They also use digital technologies such as big data analytics, facial recognition, artificial intelligence and cloud computing to improve policy outcomes. However, while these reforms improve governance, they should not be confused with a process of democratization within the regime.

The leadership acknowledges that the past priority on unconfined economic development has brought about social conflict, a highly uneven distribution of wealth, environmental deterioration and an inability for most Chinese enterprises to move up the value chain, and is formulating policies to counter these trends. Former President Hu Jintao's emphasis on more social equality and justness as well as sustainable development is now part of the party constitution. These reforms, however, face strong opposition by special interest groups (big state-owned companies and banks) which benefit from unequal access to resources and influential decision-makers, and hamper the implementation of reform measures.

In some cases, the Chinese government also reflects past failures. The new urbanization plan, for example, re-considers the unexpected negative side-effects of China's past (failed) eco-city construction projects (which resulted in "ghost cities"). The Chinese leadership is not willing to accept that more pluralism and democratic reforms such as media freedom and public participation are required as a safeguard against this sort of undue influence and corruption. Instead, the present Xi Jinping administration seeks to discipline special interest groups by detecting and punishing deviation through the CCP's disciplinary apparatus. The COVID-19 pandemic has stimulated institutional learning especially in the fields of e-government, crisis management, organization and deployment, and propaganda. None of these measures benefit democracy or a market economy.

#### Policy learning

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## 15 | Resource Efficiency

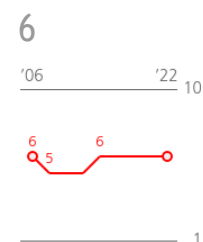
The quality of the civil service has improved; meritocracy through competitive examinations and task-related performance appraisals has been introduced, and the vast majority of civil servants now hold university degrees. E-government and performance monitoring have been widely introduced in China's bureaucracy, and China ranked 45th in the U.N. E-Government Survey 2020, up from rank 78 in 2012. Its E-Government Development Index value was 0.79, which puts China in the class of countries with a “very high” score. It ranks ninth on the E-Participation Index.

Bureaucratic professionalism and efficiency, however, is still affected by petty corruption and the overarching power of the CCP, which, through the nomenclature system, influences personnel appointments to upper levels of government and party bureaucracies, putting party loyalty and support for present leaders before professional competence. One reason for corruption is low salaries. In January 2015, civil servants received the first pay raise in 9 years. Although the salaries of the lowest-ranked civil servants were doubled, their new monthly income of CNY 1,320 (\$212) is still very low considering the high costs of living in many of China's cities.

China's budgetary system is highly decentralized, with local governments responsible for more than 85% of total government expenditures. The central government takes in over half of all revenues then shares that revenue with the provinces at its discretion. Given the lack of transparency and accountability, fiscal resources are distributed not according to a common and equally implemented scheme but are influenced by the respective provincial leader's political weight and negotiating skills. The central government seems to profit from this arrangement. At 3.7% of GDP, the overall budgetary deficit in 2017 was low compared to other countries. However, the deficit is growing – in 2014, the deficit was only 1.8% of GDP. On the other hand, local government debt increased following the world financial crisis, accounting for up to 60% of GDP in 2017, according to an estimate by S&P Global Ratings.

As part of a national experiment, several provinces have begun to issue two kinds of bonds in 2014, one to finance revenue-generating projects such as toll roads, another to raise non-earmarked revenue. There is a tendency at the local level to invest in showy projects and create industrial overcapacity. The government has reacted by deleveraging local governments and state-owned enterprises, measures which were partially rescinded in response to the COVID-19 pandemic.

Efficient use of assets





The Chinese government often has difficulty reconciling conflicting policy objectives and interests due to a lack of horizontal and vertical coordination as well as friction between administrations at the national, departmental and regional/local levels. These problems result from differing incentives at the central and the local level, the different priorities of the various ministries, and the competition departments are subjected to. For example, the central government attempts to prioritize sustainable and equitable growth as well as to curb excessive speculation in real estate, but local governments thwart this policy by fueling excess development in their localities to expand employment opportunities and revenues from which they gain individual political and economic profit.

However, priority policies are coordinated in so-called Leading Small Groups, steering bodies that consist of high-level officials from different departments. Two new such bodies to improve coordination have been created under the personal leadership of Xi Jinping: one on national security (“National Security Council”), the other on “Comprehensively Deepening Reform.” Crises are tackled by establishing ad hoc task forces. Although in routine politics, waste resulting from overlapping areas of responsibility and sloppy implementation are considerable, communication channels between the various administrative levels are superb, although this usually only becomes apparent in crises and emergencies when non-conformity results in harsh punishment.

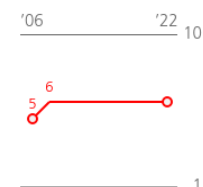
The COVID-19 pandemic has laid bare both the key weakness and strength of China’s system of governance. The weakness is its susceptibility to intervene in the bureaucratic process because of actual or perceived political priorities. The authorities reacted to the SARS crisis in 2003 by setting up an independent disease reporting mechanism, but this did not prevent politicians from intervening in disease reporting once more. The strength is its capacity to quickly develop and implement emergency measures, and to mobilize its bureaucracy in doing so. While all news related to the break-out of COVID-19 was censored, the population received regular information on the development of the disease and the measures taken to contain it.

China’s supreme auditing institution is the National Audit Office, which publishes regular reports on state spending. In line with China’s open government information policy, statistics on budgetary revenues and expenditures are published on local government websites and in statistical yearbooks. Public tenders are the main method of government procurement, and tenders are published on government and specialized bidding websites. Government departments receive hundreds of thousands of open government information requests annually. That said, information containing “state secrets” is exempt from these requests, which provides officials with a loophole. However, citizens have taken the government to court to challenge their refusal to provide access to information.

The Xi Jinping administration has initiated the largest anti-corruption campaign since Reform and Opening began in 1978. Targets are officials in the CCP, the government, the military and state-owned companies. Xi announced that this campaign would

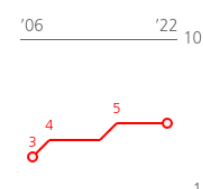
#### Policy coordination

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#### Anti-corruption policy

5



focus on high-level officials. Former Politburo Standing Committee member Zhou Yongkang, former vice-chairmen of the Military Commission Xu Caihou and Guo Boxing, head of the Central Committee's United Front Work Department Ling Jihua and vice chairman of the Chinese People's Political Consultative Conference Su Rong were investigated for corruption between 2013 and 2015. In 2017, Sun Zhengcai, the party secretary of Chongqing, was sentenced to life in prison. By the end of 2018, millions of persons had been investigated and 621,000 officials had been punished.

Preventive measures such as sunshine regulations, which force officials to reveal their assets to the public, however, have not been implemented. As corruption in the CCP has been systemic and graft, nepotism, bribery and sale of office widespread, it is unclear how targets are chosen, and whether the campaign represents an attempt to weed out political opponents, improve the foundations of China's development, or both.

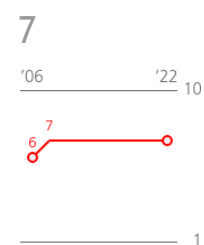
Apart from systemic political corruption, "petty" corruption – like mandatory payments for better services – is still widespread in Chinese society. However, this has been made somewhat harder with the open government initiative implemented in 2008, which improves access to government information, allows people to request files and enables the payment automatization for taxes, fines and services. A strict code of conduct for officials has been implemented, regulating, among other things, the amount of public funds that can be used for accommodation and banquets. Nonetheless, corruption persists, a result of the lack of competitive political processes, institutional checks and balances, accountability mechanisms, an independent judiciary and a free press.

## 16 | Consensus-Building

The Chinese government remains strongly committed to preventing the emergence of democratic tendencies; there is consensus among the members of the political leadership and the regime coalition that a transformation toward democracy based on the rule of law must be avoided.

There is broad consensus among Chinese leaders that the continuation and strengthening of one-party rule, the improvement of living conditions and the defense of national sovereignty and territorial integrity are the country's top goals. Similarly, there is agreement that these goals should be reached through economic development, international integration, strengthening of China's military force and increasing the CCP's control over the state and society. The Third Plenum of the CCP's 18th Party Congress confirmed that a market economy remains a strategic and long-term goal, and that the CCP wishes to improve governance yet avoid taking steps toward liberal democracy. This theme was reinforced at the 19th Party Congress in October 2017, when Chairman Xi reconfirmed China's commitment to markets and international

Consensus on goals



trade. However, the Chinese government has been accused of selectively imposing trade barriers to protect domestic companies or retaliate against political slights. One Leading Small Group, headed by CCP General Secretary Xi Jinping, has been created to coordinate reforms in the marketization of government services, the structure of SOEs, the fiscal system, rural-urban development, citizen consultation and the judiciary, as well as to emphasize the improvement of environmental protection, anti-corruption, internet control and state security. Although these reforms will not be met with approval by all political actors, their power to veto them is marginal.

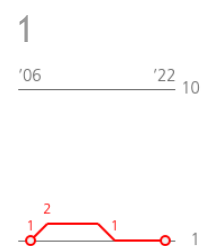
Since the late 1980s, the party leadership has been united in their opposition to China becoming a liberal democracy. CCP General Secretary Xi Jinping has pledged to improve the “rule of law” in China, meaning that CCP and government officials will be required to follow formal rules and will be punished for deviation. At the same time, he stresses that the CCP as an organization will remain above the law, and measures have been taken to increase the CCP’s dominance over state institutions and Xi’s dominance over the CCP. An organized opposition to the CCP’s one-party rule does not exist. Any attempt to question the status quo is met with persecution and long prison sentences.

Cleavages exist mainly along ethnic and social lines. Unconstrained competition in unequal markets has caused income and wealth inequality to rise dramatically since the early 1980s, making China one of the most unequal societies in the world. There are serious social distortions and conflict between those segments of the populace with access to education, health care, social security, adequate incomes and living conditions, and those without. Violent eruptions of anger by groups of disadvantaged citizens proliferated throughout the 2010s but have become less frequent since about 2018.

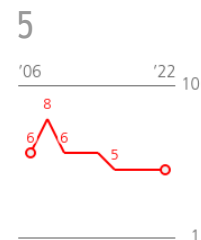
Reasons for the decline in social unrest include the government’s responsiveness toward the concerns of groups such as migrant workers, as well as increased surveillance and repression. One of the CCP’s prominent fears is that it may be swept away by a dissatisfied populace. CCP General Secretary Xi Jinping claims to be following the “mass line,” a term often associated with Mao Zedong, which raises expectations among the urban and rural poor, and serves to widen the existing cleavage. However, increased spending for health care and other social services demonstrate that the government is seeking to ameliorate these conditions. Furthermore, the government continues to subsidize provinces in western and central China, and co-finances poverty alleviation programs in China’s poorest counties. Since 2004, income and expenditure differentials between the provinces have reduced, both because of catch-up development and the central government’s redistribution of revenue.

Nevertheless, the fact that income and wealth inequality in the general population have not decreased substantively shows that in all provinces the richest subset of the population profits disproportionately from these developments. This is true also for

Anti-democratic actors



Cleavage / conflict management



minority provinces and, along with several other factors, is responsible for China's ethnic cleavages. Budgetary transfer payments to Tibet and Xinjiang are disproportionately large, but it is chiefly the rapidly growing Han Chinese population in these provinces that is profiting from infrastructure investments and new economic opportunities. This fact, and the central government's lack of respect for the religion and traditions of these people have been major reasons for the rise of separatist movements, which the government quells through the use of repression, indoctrination and surveillance.

Political decision-making is dominated by internal debates between the CCP and state organs. In recent years, the party and the government have strengthened the integration of expert advice from think tanks and individual academics in formulating policy, and the government has tried to strengthen citizen input into policymaking by holding public hearings on pending national legislation since 2000. In addition, central and local governments operate complaint platforms where citizens can serve as monitors for policy implementation.

However, such participation is limited and constrained. There is very little space for civil society to help set agendas, except through mass protests that force the government's hand. "Civic spaces" on the internet are subject to surveillance and censorship, as the government incentivizes citizens to express their grievances on sanctioned channels instead of social media. Hence, even the limited chances for participation and discourse are strongly regulated, monitored and controlled by state and party organs.

In case public debates become too explicitly critical of political processes or developments, such debates are suppressed and individuals leading these debates face harassment and even prosecution. Central government regulations state that the general public should participate in the performance evaluation of local officials and administrative departments, but this policy is implemented only selectively. Residential committees, which are de jure autonomous organizations but de facto supervised by CCP branches, have been instrumental in enforcing lockdowns to prevent the spread of COVID-19.

The Chinese government regularly invokes collective memories of past injustices perpetrated by Western "imperialism" or Japanese "militarism" to incite national unity, and to garner support for its political goals of national development and grandeur. The "Chinese Dream" concocted by the Xi Jinping administration is a recent example. Once more, the 19th century Opium War is invoked as the reason for why China lost its status as a world power, with the Xi administration promising to duly restore China's lost status. The "Chinese Dream" mentality is nationalist in so far as it not only demands a return to "Chinese" values in science, technology and even law, but it also entails the blaming of "Western" powers for trying to undermine China's rise intentionally. This is a theme also in the statements of the country's increasingly assertive diplomats, whose style has been characterized as "Wolf

Civil society participation

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Reconciliation

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Warrior Diplomacy.” Concerning its own past, the government strictly prohibits all public discourse on human rights violations and does not acknowledge the responsibility of the CCP regime for past injustices, such as the Great Leap famine, the Cultural Revolution and the Tiananmen Square massacre.

## 17 | International Cooperation

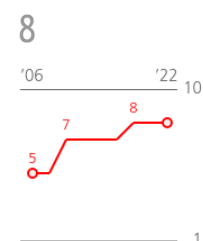
China maintains cooperative ties with multilateral institutions such as the IMF, the World Bank and the Asian Development Bank, as well as with foreign governments, but has become increasingly independent of international support, which it now provides to developing countries in Central Asia and Africa. In fact, China’s self-image has transformed from a recipient to a donor country. China initiated several new mechanisms parallel to existing multilateral bodies, such as a new bank by BRICS member countries (New Development Bank) and the Asian Infrastructure Investment Bank (AIIB). The New Development Bank signed its first loan agreement in 2016 and, in 2018, was rated AA+ by Fitch ratings. The AIIB was launched in 2016 and is the main vehicle through which China’s One Belt One Road development program is financed. In 2018, it had issued more than \$5 billion in loans to finance 28 projects in 13 countries, with the largest number of projects (seven) established in India.

These initiatives more or less directly challenge the global U.S. (Bretton Woods institutions) and regional Japanese (ADB) leadership roles in economic governance. The Chinese government made good use of technical cooperation, and the transfer of “green” technologies, sustainable development, health care, social security and legal knowledge, but is now increasingly providing such support to other countries. The government does not allow any international interference in what it terms “internal affairs,” especially concerning democratic reforms, adherence to human rights standards and the solution of the Taiwan question.

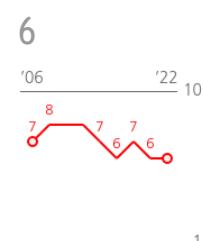
China’s relationships with other countries is characterized by both cooperation and conflict. On the one hand, the country’s demand for commodities, capital and consumer goods, as well as its role as the hub of Asian transnational production networks has made China a vital trading partner for many countries. In addition, China has taken on a leading role in regional and international organizations and has initiated trade partnerships such as the Belt and Road Initiative and the Maritime Silkroad. China makes significant contributions to U.N. peacekeeping, both financially, and by contributing troops and police. The country is a signatory to the Paris Agreement to reduce greenhouse gases.

At the same time, traditional sources of conflict with Western countries have persisted and, in some cases, have even intensified. Both the United States and the European Union still complain about trade deficits, restrictions to market access, forced knowledge transfers and rampant violations of intellectual property rights, as well as

Effective use of support



Credibility



the country's hunger for resources, export restrictions or cyberattacks on government networks and private corporations. In the context of its Belt and Road strategy, China has financed infrastructure projects in developing countries. A number of countries have not been able to repay these loans, leading to accusations of China pursuing "debt trap diplomacy."

China's double-digit growth rates in defense spending, its more assertive behavior in regional territorial conflicts and its self-confident and occasionally threatening diplomats have raised concerns as to whether China's self-proclaimed "peaceful development" will persist. Two Canadian citizens, who were arrested on vague charges of "endangering national security" in December 2018, have been held incommunicado for more than two years. The arrests came in the aftermath of the apprehension of Huawei Chief Financial Officer Meng Wanzhou in the context of an extradition treaty with the United States and were interpreted as an act of hostage-taking in order to force the release of Meng. During the review period, representatives of the Chinese government issued unspecified threats against Australia and several European democracies for "interfering in China's internal affairs," for example, by blocking Huawei from providing 5G architecture, giving an award to the publisher Gui Minhai (Sweden) or allowing critical media reports.

China has not engaged in international or multilateral efforts to coordinate the COVID-19 response. Still, the lack of U.S. leadership in the Indo-Pacific (and elsewhere) in 2020 created an opening for the CCP to seek worldwide leadership through global propaganda campaigns and "masked diplomacy."

2020 saw a major conflict between China and India over border disputes in Ladakh. In June, Chinese and Indian soldiers engaged in an unarmed skirmish in disputed territory, which reportedly led to the death of 20 Indian and 43 Chinese soldiers. By December 2020, the conflict had not been resolved.

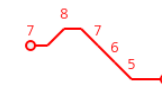
China maintains good relations with Central Asian Countries, which are a vital part of China's Belt and Road Strategy, as well as Russia. The situation in the East China Sea (Diaoyudao/Senkaku islands) and the South China Sea (Spratly Islands, Scarborough Shoal) remains volatile, but there were no conflicts during the review period. The Xi administration continues to pressure Taiwan, which the government regards as an inalienable part of the People's Republic, to commit to reunification with the mainland.

In southeast Asia, the Chinese government is on good terms with most states in the region. It has deepened economic ties with Myanmar, offsetting the country's fallout with parts of the international community due to its role in the Rohingya crisis of 2017. The United States' self-centered policy under the Trump administration has also pushed Malaysia closer to China. Relations with Vietnam remain volatile: in April 2019, a Chinese vessel sank a Vietnamese fishing boat.

Regional  
cooperation

5

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## Strategic Outlook

The Chinese government seems to have been successful in controlling the COVID-19 pandemic with comparatively few lives lost and manageable economic costs. Nevertheless, the government is likely to approve additional measures to help small and medium-sized enterprises overcome the negative effects of the pandemic. This will make structural adjustments difficult.

Another challenge comes from demands by the international community for China to allow scientists uninhibited access to research facilities to learn more about the origins of the pandemic. The “lab theory” has not been falsified and even gains currency as deficiencies are found in theories that claim COVID-19 is a zoonotic disease.

The increasing concentration of power in Xi Jinping’s hands is another trend that bears watching. The personalization of power in China allows the regime to devise and implement policies more nimbly and flexibly but risks major disruptions if Xi should suddenly become incapacitated or fail to designate a successor in time. Another, more immediate risk is that Xi receives incorrect information because elites and advisers tell the leader what they think he would like to hear.

Maintaining the cooperative international atmosphere necessary for China’s attempts to escape the “middle income trap” by gaining privileged access to foreign markets and infrastructure is another challenge. During the review period, the Chinese government consolidated a growing support coalition. However, most members of this coalition consist of authoritarian regimes, while China’s actions both at home and abroad continue to alienate citizens in many democracies. The Chinese authorities have become increasingly self-assured of the developmental path they have taken and they defend the values that underlie their model. Some of these values, especially those that are rooted in a realist world view in which the strong command the weak, are not compatible with those emphasized by liberal democracies.

Reshaping the relationship between China, and the United States and Europe will be demanding for all actors concerned, especially because the transatlantic relationship has suffered because of the previous administration’s often unpredictable policies. This creates an opening for China. As U.S. citizens hold increasingly negative views about China, the incoming U.S. administration will need to avoid being perceived as “too soft” on China. Germany, France and other major European economies, however, are likely to consider the Chinese market as essential for their post-COVID-19 recovery, which suggests a more conciliatory posture toward China precisely at a time when the country is literally pushing its boundaries – both in the South China Sea and the Taiwan Strait.

Keeping Europe’s history in mind, European leaders should consider the long-term consequences of accommodating China’s increasing violations of democratic norms in her interaction especially with weaker states. In doing so, they risk sacrificing long-term stability for short-term economic gain.