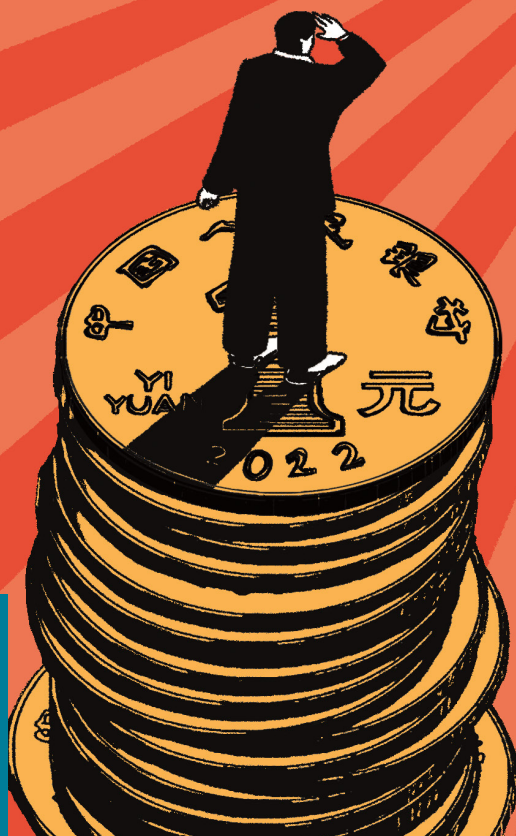


# THE FUTURE OF XI'S CHINA

## SCENARIOS AND IMPLICATIONS FOR EUROPE

edited by **Alessia Amighini**

introduction by **Paolo Magri**



ISPI



**THE FUTURE  
OF XI'S CHINA**  
**SCENARIOS AND IMPLICATIONS  
FOR EUROPE**

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edited by Alessia Amighini

**ISPI**

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*The opinions contained in this Report are solely those of the authors and do not necessarily reflect the opinions of the Ministry of Foreign Affairs and International Cooperation and ISPI.*

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# Introduction

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Since the establishment of the People's Republic of China in 1949, the Communist Party has succeeded in bringing about an unexpected transformation of the country and has turned China into a great economic and development success. Despite this, the spread of the Covid-19 pandemic and the more recent war in Ukraine have put to the test the Chinese economic model and China's international standing. While China seemed to have successfully handled the proliferation of the virus during the first waves, in 2022 the development of new variants has resulted in widespread lockdowns across some of the country's major economic centres – such as Shenzhen and Shanghai – with repercussions on domestic production and exports. In addition, the notion that Covid had originated in China, with mounting doubts as to whether the government had withheld crucial information on the virus, has caused part of international opinion to become more wary of China and hesitant to become too reliant on the nation. Similarly, China's refusal to condemn Russia's invasion of Ukraine and Xi Jinping's repeated expression of support to Putin in recent years have made many governments, especially in the West, reconsider their position on China, worrying over the two leaders' close relationship. Therefore, Western distrust towards the Chinese leadership – largely reciprocated by China – as well as the impact of the pandemic on the economy and society are expected to interact with pre-existing challenges facing China, such as demographic decline and the imperative for a green

transition, as well as Beijing's attitude towards developed and developing countries.

Since its economic opening up in 1978, the living standards of the Chinese population have improved, with hundreds of millions of citizens lifted out of poverty, and China has become an upper-middle-income country. Similarly, the share of the educated population has grown and access to health has improved. The leadership of the Communist Party of China (CPC) has also pushed to increase the country's involvement in existing international institutions such as the International Monetary Fund and the United Nations, going as far as to establish – and often to lead – new multilateral cooperation frameworks. As a result of these decades of efforts, the country has become one of the major players in the international economic and political system. China has gone from being a closed and planned economy reliant on agriculture to being the world's second largest economy, while still retaining its single-party government.

Being integrated into the world's economic and diplomatic institutions means that China has abandoned its isolationist past, integrating itself in the international system through trade, investment, and finance. As a matter of fact, China has become an important market destination for exports and numerous countries are now reliant on Chinese imports, including the United States and the European Union. The country has also opened up to receiving substantial foreign investment, as well as investing in projects and enterprises abroad itself – most notably the infrastructure investments under the Belt and Road Initiative.

China's exceptional economic growth was made possible by capital accumulation through cheap state credit, cheap labour and a vast manufacturing sector that derived its fortunes from exports. Today, however, the working-age population has shrunk, the costs of labour have risen – allowing scope for competition with other developing states to attract foreign businesses – and domestic consumption and innovation are not



yet strong enough to drive the economy forward. The CPC's leadership is coming to understand that the previous sources behind the country's economic growth have been exhausted and that a renewed model of development is needed.

The PRC will face numerous challenges in the coming decades in its quest to continue the country's social and economic development. The declining birth rate and diminishing share of people of working age, for example, will impact the country's productivity. Even more challenging will be implementing the economic transition without affecting the economy and damaging the country's manufacturing sector. China needs to reduce its dependence on coal, which still covers more than half of the country's energy needs, to meet the goal of becoming carbon neutral by 2060. Despite the good intentions stated by the PRC, it will be arduous to renounce coal in the post-Ukraine-war world, marked by uncertainty in energy markets and by a return to policies aimed at ensuring energy security. At the same time, the war has caused Russia to be isolated from the West and to strengthen its partnership with China, allowing Beijing privileged access to Russian raw materials, such as coal, gas and oil. Still, hope for China to continue along the path of the energy transition rests in the fact that over the last decades Beijing has increased investments in the green and renewable energy sectors, becoming the world's first producer of lithium-ion batteries and solar panels.

The war in Ukraine and the pandemic have also polarised international opinion on the PRC – and its leader Xi – with Western democratic countries largely steering their China policies towards containment, while more developing countries remain close to China and reluctant to follow the West's lead. The increasing power competition between the US and China deriving from the international climate of uncertainty is likely to produce some changes in Chinese foreign policies and the PRC's standing – reinforcing China's assertiveness and increasing its cooperation with other nations dissatisfied with the current status quo.

Whether China will keep growing in the coming years also depends on factors outside its control. The pandemic and the war in Ukraine have given rise to an uncertain international environment, where countries' policies are ever more polarised and tensions between superpowers are mounting. The instability caused by the past years' events will have spillover effects on individual countries. The consequences of the pandemic were felt by most countries in the world, with the logistic sector blocked by border restrictions and manufacturers unable to continue their production due to shortages of products or supply chain disruptions. In Europe, the war in Ukraine has already affected many individual countries due to their dependence on Russian energy supplies. While China seemed to have handled the negative economic effects of the pandemic during the first two years, in 2022 new waves of the virus have caused major economic centres to go into lockdown thereby affecting production and causing some protests and discontent among the population. Similarly, while China has not been as affected as European countries by the energy crisis resulting from the Ukraine war, rising commodity prices at the global level and worsening relations with European countries – which are among China's main trade partners – have impacted the Chinese economy. The country's domestic challenges will be complicated by the unstable conditions of the international landscape, leaving Xi – on his way to being confirmed for an unprecedented third mandate at the Party's National Congress in October – with the task of taking decisions that could give China new stimulus, or lead the country to a more severe economic slowdown.

It is precisely this set of international and domestic challenges that China will face in the coming years that the current Report sets about to explore.

In the first chapter, Michele Bruni analyses in detail the difficulties deriving from China's demographic crisis. As the country's elderly population is bound to increase in the coming decades, people of working age will become less and less

numerous. The chapter walks us through China's demographic transition and the stages that have led to the current population slowdown, trying to understand the impact of the lower fertility rate on the Chinese socioeconomic situation.

The second chapter, by Kaho Yu, focuses on the obstacles that the PRC is facing to successfully complete its energy transition. The author argues that the current war in Ukraine, with the consequent energy crisis, has shifted the focus of many states away from energy transition and toward energy security matters. The dilemma over whether to continue implementing the ecological transition or whether it is more important to guarantee enough energy for a country has deepened frictions at the international level over environmental standards and policies. Throughout the chapter, Yu details the Chinese climate commitments through the years and the attempt by the PRC and other developing countries to find their own pace in the race to reach carbon neutrality. Will China's currently conservative climate policies and significant investments in renewable energies be sufficient to curb the nation's dependence on fossil fuels?

Niall Duggan unpacks the role of China in the developing world in the third chapter of the Report. The author re-examines the importance of the developing world in China's quest for international recognition. As the "Champion of the Developing World", through the years the PRC had been taken as a model for some developing nations as a country that did not conform to the Western approach to global governance while still achieving great economic success. While China has entered many traditional international organisations, it has worked to both steer the agenda towards a more receptive stance vis-à-vis the needs of the developing world and create new multilateral organisations that are more inclusive of non-Western powers. Thus, the chapter studies the international position of China as a leader of the developing world in global governance.

In the next chapter, Brian Carlson discusses how China's international standing has been affected by the war in Ukraine.

After choosing not to condemn Russia's invasion outright, China's international reputation has suffered particularly among democracies with advanced economies, risking exacerbating the competition with the US and its allies. At the same time, however, the author reminds us that not every country has responded so harshly to Russia's invasion. There is thus an opportunity for China to boost cooperation with those countries that have not followed the US line, particularly in the Global South.

To close our Report on the challenges and opportunities for China in the coming years, Alessia Amighini lays out the obstacles to China's internationalisation of its financial sector. The country has been trying to distance itself from the US-led international financial system by trying to strengthen the renminbi. In this regard, the war in Ukraine, with Russia's exclusion from many dollar-dominated international systems, might be instrumental in attracting more countries to use the Chinese currency. The chapter walks us through the development of State-Owned Enterprises (SEO) in China and the reforms of the financial sectors that have taken place in China over the last decade, detailing China's bottlenecks and successes on the path to the opening up of its financial sector.

*Paolo Magri*  
*ISPI Executive Vice President*

# 1. China's Demographic Challenges: Past, Present and Future

Michele Bruni

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In the next thirty years China will be affected by a rapid increase in the number and share of elderly people. Ageing is not the first demographic challenge confronting the Middle Kingdom. China has already faced an educational challenge and an employment challenge of unprecedented dimensions and has been the only underdeveloped country to do so successfully. Now the question is: will China be equally successful in dealing with the ageing process and the structural shortage of labour that are going to simultaneously affect it in the remaining part of this century?<sup>1</sup>

## China's Demographic Development

On 1 October 1949, with a population of 542 million inhabitants, China was the most populous country on the planet. After 73 years, with 1,411 million inhabitants, China is still the most populous country on the planet but its population will shortly start to decline, as the country has moved from a phase of rejuvenation to a phase of ageing.

Behind this dramatic evolution there is a phenomenon that from the end of the eighteenth century has progressively affected all countries on the planet: the demographic transition.

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<sup>1</sup> This article largely benefits from the narrative proposed by Michele Bruni (2022).

## The Demographic Transition

The demographic transition (DT) is a process that brings a population from a traditional regime, characterised by high rates of fertility and mortality to a modern regime, characterised by low rates of fertility and mortality.

The demographic transition started to affect France and a few other European countries at the end of the eighteenth century and by now has spread to all countries on the planet in a complex interaction with “modernisation”.

Generally speaking, the demographic transition is positively related to economic growth and social development, while institutional, religious, political and ideological factors play a major role in determining its pace and impact. Taking a labour market perspective, it is important to distinguish between three separate phases:<sup>2</sup>

1. In the first phase, the death rate declines, mainly as a consequence of the decline in infant and child mortality; total population grows at increasing rates and the share of the young population increases.
2. In the second phase, the birth rate starts to decline, progressively converging toward the mortality rate. Total population grows at a decreasing rate; the share of the population in working age increases and the share of the young population declines; it is toward the end of this phase that the aging process starts.
3. In the third phase, the birth rate falls below the death rate. Total population decreases, the share of older people increases, while those of the working age population and of the young decline.

Therefore, the DT is a process that brings a country from a phase of rejuvenation to a phase of ageing, with an intermediate

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<sup>2</sup> This classification differs from the standard one but is more suited to analysing the relationship between the DT and the labour market (M. Bruni, 2022).

period characterised by an expansion of the population in working age.<sup>3</sup> However, the most significant aspect of the DT is the increase in total population, which in many cases is a real population explosion. This may seem not to square with a phenomenon whose main characteristic is a decline in fertility. As a matter of fact, the explanation is quite simple. The DT starts with a decline in mortality due mainly to a decline in infant and child mortality; this allows an increasing number of boys and girls to reach reproductive age, while fertility remains at previous traditional levels. The inevitable consequence: an increasing number of births that leads to increasing rates of population growth.

Let's finally observe that all the segments of a population and, more specifically, the youth population, the population in working age and the elderly population are affected by the demographic transition, as is the total population. Every group, starting with the young, will first experience growth at an increasing rate, then growth at a declining rate, and will then decline.

## **China's Demographic Transition**

The main phases

The crude birth rate (CBR) and the crude death rate (CDR) allow us not only to capture the evolution of the demographic transition but also to identify its various phases.

In 1950, the CBR in China was still above 40 per thousand, a level typical of traditional societies, while the CDR level (23 per thousand) shows that the demographic transition was already on its way (Figure 1.1-A). In the following 20 years the CDR fell more rapidly than the CBR resulting in a positive

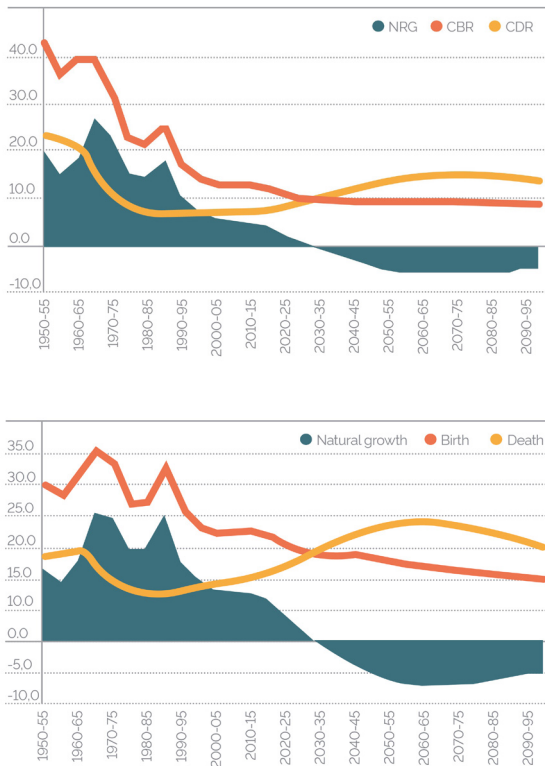
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<sup>3</sup> What will happen later remains an open question. My personal bet and hope are that population size will continue to decline for a long period of time.

trend in the natural rate of growth (NRG), which peaked at around 2.7% at the end of the 1960s.

At the beginning of the 1970s China entered the second phase of the demographic transition, with natural rates of growth progressively declining to their present level of around 10 per thousand; during this period the CBR declined while the CDR first declined less rapidly and then started to increase.

FIG. 1.1 – CHINA - (A) CBR, CDR AND NRG; (B) NUMBER OF BIRTHS, DEATHS AND NATURAL GROWTH (1950-2100)



Source: elaboration on Undesa, 2019, 2020-2100 zero migration scenario



The forecast made by UNDESA before the Covid-19 pandemic (shown in Figure 1.1) suggested that China would complete the second phase of the DT at the beginning of the 2030s and then enter and remain in the third phase through the rest of the twenty-first century. The latest available data shows that the impact of Covid-19 on fertility has been extremely significant. According to the National Bureau of Statistics of China, in 2021 the CBR and CDR were down respectively to 7.52 and 7.18 per thousand. The persistence of the pandemic therefore suggests that the NRG could in fact become negative as early as 2023, approximately ten years earlier than the UNDESA forecast.

The evolution of the number of births and deaths (Figure 1.1-B) allows us to complete the analysis of the DT process. The former reflects not only the fertility trend but also the trend for women of childbearing age. At the beginning of the 1950s, the yearly average number of new-born children was 25 million (i.e., one fourth of the world total) and reached a peak of 30 million in the second half of the 1960s. After declining for a decade, it peaked again at around 28 million in the second half of the 1980s, despite the introduction of the one-child policy in 1980.<sup>4</sup> Since then it has dropped at an extremely fast pace to its present level of around 10.5 million, 7% of the world total. From 1960 to 1980 the average number of yearly deaths dropped from 14 to 7 million. Since then, it has progressively increased to its present level just above 10 million and, as indicated above, it will probably shortly exceed the number of births.

### The impact on the age structure

With the passing of time, every generation (the people born in a given year) progressively ages. This implies that when the DT starts, bigger and bigger waves of new-born babies will begin to move up the population age pyramid resulting first in an increase in the young population, then of the working age

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<sup>4</sup> As we will see later, this was due to the lowering of the legal age of marriage.

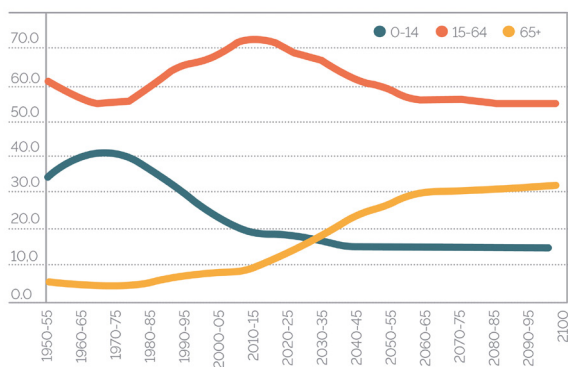
population and finally of the elderly population. The ageing process is then compounded by the fact that after 30-to-40 years from the beginning of the DT the number of new-borns will start to decline, while average life expectancy progressively increases.

In China the phase of rejuvenation lasted until 1965, when the share of children 0-14 reached an all-time high of 41.2%; however, their number peaked in 1975 at 369 million, almost double the number recorded in 1950 (Figure 1.2).

The share of the working age population reached a record high of 73.3% in 2010, but in absolute terms peaked in 2013 at around 1 billion, which was three times greater than in 1950.

Finally, the share of the elderly population remained below 5% until 1985 and passed the 10% mark only a few years ago. However, in the absence of migration, it is projected to increase for the next 30 years, reaching and staying above 31% in the remaining part of the century.

FIG. 1.2 – CHINA - (A) TOTAL POPULATION; PERCENTAGE COMPOSITION BY MAIN AGE GROUP; (B) TOTAL POPULATION AND MAIN AGE GROUPS; ABSOLUTE LEVEL IN SELECTED YEARS; TOTAL CHANGE AND AVERAGE YEARLY CHANGE IN THE RELEVANT INTERVAL



	0-14	14-64	65+	Total
<b>Absolute Value</b>				
1950	189	341	25	554
1975	369	519	38	926
2015	254	1,022	131	1,407
2060	190	762	399	1,351
2100	153	602	347	1,102
<b>Total absolute change</b>				
1950-1975	180	178	13	372
1975-2015	-115	502	93	481
2015-2060	-64	-260	268	-56
2060-2100	-37	-160	-52	-249
<b>Yearly absolute change</b>				
1950-1975	7.2	7.1	0.5	14.9
1975-2015	-2.9	12.6	2.3	12.0
2015-2060	-1.4	-5.8	6.0	-1.2
2060-2100	-0.9	-4.0	-1.3	-6.2

Source: elaboration on UNDESA, 2019

In conclusion, in 73 years China's population has increased from less than 550 million to more than 1,410 million, and its age structure has dramatically changed from a situation in which 4 persons out of 10 were under 14 to one in which 7 out of 10 are of working age.

## China's Demographic Transition in the International Context

A simple way to assess the speed at which China has run along the path of the DT is to compare the evolution of its total fertility rate (TFR) with that of other regions and countries.

In 1950-55 China's TFR exceeded 6.1 children per woman (Table 1.1), which was above the Asian average. However, this

continent was characterised by a very broad spread of national fertility rates with, for instance, Singapore at 6.61, India at 5.90 and Korea at 5.65, but with Japan already at 2.96. In the same period the global average rate was 5 children per woman. Africa (6.57) and Latin America (5.83) were also largely above the world average. Considerably lower rates were recorded by Northern America (3.34), Australia and New Zealand (3.27), but especially Europe (2.66) whose countries had been the first to be affected by the DT.

After 35 years the total fertility rate had declined in all the regions considered, albeit at a different pace. In the New World Countries (the US, Canada, Australia and New Zealand) and in Europe it had already dropped below replacement level, marking the fast progress of these regions toward the third phase of the demographic transition. In Africa almost nothing had changed and the total fertility rate was still at 6.5 children per woman, with very few countries recording rates below 6, and even fewer below 5. The progress of Latin America along the DT path was moderate, its total fertility rate having dropped below 4.

In Asia the situation was still extremely polarised. At one end, there were Korea and Singapore, where the TFR was already below replacement level with rates similar or even lower than those of Western countries. At the other end, there were countries such as Oman, the United Arab Emirates and Afghanistan where the TFR was still above 7. However, in Asia as a whole the decline was quite pronounced, the average TFR having dropped to 3.5.

TAB. 1.1 – WORLD, CONTINENTS AND SELECTED COUNTRIES;  
TOTAL FERTILITY RATE  
(1950-55, 1985-90, AND 2015-20)

	1950-55	1985-90	2015-20
	Total fertility rate		
China	6.11	2.73	1.69
Asia	5.83	3.50	2.15
India	5.90	4.30	2.20
Japan	2.96	1.65	1.37
Korea	5.65	1.57	1.11
Singapore	6.61	1.70	1.21
Africa	6.57	6.50	4.44
Latin America and The Caribbean	5.83	3.94	2.04
Europe	2.66	1.88	1.61
Italy	2.36	1.35	1.33
Northern America	3.34	1.79	1.75
Australia and New Zealand	3.27	1.89	1.84
World	5.00	3.40	2.50

Source: UNDESA, 2019

In the next 30 years the decline in fertility reached all countries across the planet so that by now they are all on the path of the demographic transition, as a flock of sheep descending from the mountain toward the sea, the one in front being the first hit by this extraordinary demographic “revolution”, and those at the end being the last to be affected. Therefore, still high in the mountains we find all the African countries – the TFR of the continent still being almost 4.5 children per woman –, but also Afghanistan. Far below we find Asian and then Latin American countries, with average total fertility rates in these two regions of 2.15 and 2.04 respectively.

Considering the socioeconomic situation of the PRC at the start, the fall of the Chinese TFR stands out for its extraordinary speed. It dropped from 6 to 3 children per woman before the enactment of the one-child policy, fell below replacement level at the beginning of the 1990s, and China is now one of the 90 countries that have reached or are very close to reaching the third phase of the DT.

How can we explain this outcome? And in what measure has it been due to the infamous one-child policy? A brief historical survey of the Great Population Debate that raged in the second part of the twentieth century and a comparison with other countries and regions will put this issue in a historical perspective and help to shed some light on this thorny issue.

## **The Great Population Debate**

Population explosion takes centre stage  
in the Cold War period

At the beginning of the 1950s demographic forecasts formulated in the framework of the demographic transition made it clear that the population of the planet was increasing at unprecedented rates – more than 2% per year. This was to be attributed to poor countries, especially Asian countries, India first and foremost. Moreover, the root cause of this demographic trend was that the decline in the CBR could not parallel that in the CDR. It was also felt that the birth rate of Asian countries was resistant to change, and production gains could not be sufficient to compensate for demographic growth. In conclusion, to promote economic development, it was necessary to reduce fertility. This thesis was supported by economists,<sup>5</sup> endorsed by Margaret Sanger's feminist

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<sup>5</sup> See for instance A.J. Coale and E.M. Hoover, *Population Growth and Economic Development*, Princeton University Press, 1958.

movement, and embraced by a neo-Malthusian movement with strong ecological underpinning, as clearly spelled out in the movement's manifesto, the *Population Bomb*,<sup>6</sup> and later by *The Limits to Growth*.<sup>7</sup>

It must be recalled, however, that Anne and Paul Ehrlich's book appeared two years after Lyndon B. Johnson had decided to make foreign aid dependent on the adoption of family planning programmes.<sup>8</sup> Many factors played an important role, but the most important was the fear that overpopulation would create poverty and that poverty would breed communism. The position adopted by the US was soon also embraced by Japan, Sweden and the UK, leading to a dramatic increase in the funds available to international organisations and private institutions to carry out fully fledged population policies.

At the beginning of the 1970s the US and its allies promoted the organisation of the first World Population Conference, which was held in Bucharest in 1974. The goal was to obtain a global commitment to reduce population growth. This position was, however, successfully opposed by Third World countries. Headed by Russia, China and the Socialist Bloc, they contended that what was needed were not pills and condoms but massive economic aid, an idea that was well summarised by the Indian Minister of Health Karan Singh's slogan "development is the best contraceptive". Approved after very difficult negotiations, the final Plan of Action of the Conference opened the way to the adoption of family planning policies flanked by an expansion of public health services in many Asian countries, while Catholic Latin American countries favoured the intervention of NGOs.

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<sup>6</sup> P.R. Ehrlich, *The Population Bomb*, Sierra Club/Ballantine Books, 1968.

<sup>7</sup> D.H. Meadows, D.L. Meadows, J. Randers, W.W. Behrens III, *The Limits to Growth*, Universe Book, 1972.

<sup>8</sup> The decision was probably inspired by a research study by Stephen Enke, an economist working for the Rand Corporation.

## The fading out of demography

In the second half of the 1970s the population debate began losing its intensity. However, it was this period that saw the adoption of fully fledged population policies in India and China (see below).

A milestone in the second phase of the Debate was the appearance of Julian Simon's very influential book *The Ultimate Resource*.<sup>9</sup> Simon believed that people are resource creators, not resource destroyers. Human ingenuity, he argued,<sup>10</sup> is "the ultimate resource" that makes all other resources more plentiful. Therefore, population growth far from being a hindrance to economic growth is the solution to resource scarcities and environmental problems.

Then in 1984, at the second World Population Conference held in Mexico City, the Reagan administration, under the pressure of antiabortionist groups, announced a fundamental change in its policy: to receive US government global family planning funding foreign non-governmental organisations were required to certify that they would not perform or actively promote abortion as a method of family planning, even when using non-US funds. The motivations? At the economic level the US took the position, clearly inspired by Simon's work, that the world was not facing a population crisis and that population growth was neutral with respect to economic growth. But the most important factor was probably the political pressure of antiabortionist groups.

The decision of the US government convinced feminist and human right groups as well as environmentalists that it was politically advisable to distance themselves from the population movement. The largely democratic US Congress maintained

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<sup>9</sup> J.L. Simon, *The Ultimate Resource*, Princeton, Princeton University Press, 1981.

<sup>10</sup> Taking a historical perspective, he maintained that empirical analysis showed no correlation between population growth and per capita income, while it was evident that humanity had always been able to solve the problem of scarcity by increasing the supply of natural resources or developing substitutes for overused resources.



high funding levels, but the absence of a strong US voice and diplomatic pressure weakened the sense of urgency that had characterised the population policies of the previous decade. As a consequence, the Great Population Debate<sup>11</sup> progressively faded, while population growth started to be considered if not a positive factor at least a neutral factor. As a result, the third World Population Conference held in Cairo in 1994 saw a paradigm shift, with the adoption of a Program of Action that assigned an explicit feminist agenda to population programmes.

In the following decades population growth continued to be outside centre stage, and no global population conference was held despite the fact that some interesting findings shed new light on the relationship between population growth and economic development.<sup>12</sup>

In the first place it was pointed out that a decline in fertility would lead to an increase in the share of working age population and this would create a window of opportunity during which a country could potentially increase its savings and investment levels – a phenomenon that was defined “demographic dividend”.<sup>13</sup>

In the second place, extended econometric analyses have shown that:

... in contrast to assessments over the last several decades, rapid population growth is found to have exercised a quantitatively important negative impact on the pace of aggregate economic growth in developing countries.<sup>14</sup>

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<sup>11</sup> GNAT TV (Director), *GMALL Lectures - Whatever Happened to the Population Explosion?*, 29 July 2021, <https://www.youtube.com/watch?v=aBgxtr4MRgM>

<sup>12</sup> S. Fox and T. Dyson, *Part 2: Is population growth good or bad for economic development?*, International Growth Center (IGC), 22 December 2015.

<sup>13</sup> D. Bloom and J. Williamson, “Demographic transitions and economic miracles in emerging Asia”, *World Bank Econ. Rev.*, vol. 12, no. 3, 1997; A. Mason, *Population Change and Economic Development in East Asia: Challenges Met, Opportunities Seized*, Redwood City, CA, Stanford University Press, 2001.

<sup>14</sup> N. Birdsall and S.W. Sinding, “How and Why Population Matters: New Findings, New Issues”, in N. Birdsall, A.C. Kelley, and S.W. Sinding (Eds.),

Finally, more recently a negative relationship, whose strength has increased with time, has emerged in the post-1980 data.<sup>15</sup>

Despite these very interesting results, in the last 20 years the population explosion that has been affecting the countries we euphemistically call Least Developed has been attracting very little attention, and even less attention has been paid to its impact on poverty. The interest of demographers and economists has been more and more focused on two phenomena affecting the more developed countries, ageing and immigration, while the international debate has centred around climate change and global warming, and in this case again only marginal attention has been paid to the impact of the demographic factor.

## **The Enactment of Population Policies and Their Impact**

India: population policies during the emergency

India was one of the first countries to attempt to control fertility, initially on the basis of studies by demographer Gobaswami and Margaret Sanger's public interventions, and later on under the pressure of donor countries. Early measures were financed mainly by private institutions (the Ford Foundation first and foremost) and aimed to explain to women the benefits of having small families. Starting in 1966 the budget allocated to population policies significantly increased and new programmes were enacted that led to the voluntary sterilisation of around 14 million people in the following eight years. This mainly voluntaristic approach dramatically changed from 1975, when Indira Gandhi proclaimed a state of national Emergency. In

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*Population Matters – Demographic Change, Economic Growth, and Poverty in the Developing World*, Oxford, Oxford University Press, 2003.

<sup>15</sup> D.D. Headey and A. Hodge, "The effect of population growth on economic growth: A meta-regression analysis of the macroeconomic literature", *Population and Development Review*, vol. 35, no. 2, 2009, pp. 221-48.

the following two years her son Sanjay, convinced that curbing population growth was key to economic development and endowed with special powers due to his family ties, launched a campaign of compulsory sterilisation: in two years 18 million people were sterilised, many forcibly, in camps that very rarely met minimum standards of hygiene. This policy was stopped in 1977 when Indira Gandhi lifted the state of emergency. In the election that followed, Indira Gandhi's Congress party paid a heavy toll for the Emergency and Sanjay's initiatives, dropping from the 43.9% obtained in 1971 to 34.5%.

### China: The one-child policy

Two years later China adopted the infamous one-child policy, which was in fact the final act of less drastic approaches to curb fertility that in the previous thirty years alternated with measures of opposite sign. Family planning services were introduced in 1953 but were blocked in 1958, during the Great Leap forward. In 1964 family planning was resumed but in 1974 China was one of the country leading the opposition to the proposals of the US and its allies at the Bucharest Conference and this despite the fact that between the objectives of the fourth Five-Year Plan (1970-74) was the deceleration in population growth while Chinese families were urged to delay the birth of the first child, to lengthen the interval between children and to reduce their number, under the slogan "later, longer, fewer".<sup>16</sup> However, there is no doubt that the adoption of the one-child policy "one of the most puzzling projects of the post-Mao party-state" represented a game changer decision.<sup>17</sup>

A major role was certainly played by Prof. Song Jianthe, the top Chinese expert in control theory, missile guidance and control system. Together with a small research group he

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<sup>16</sup> For an interesting survey of Chinese fertility slogans see: J. Li, "China's propaganda journey from "only one child is good" to the three-child policy", *Quartz*, 7 June 2021.

<sup>17</sup> S. Greenhalgh, "Missile Science, Population Science: The Origins of China's One-Child Policy", *The China Quarterly*, vol. 182, 2005, pp. 253-76.

produced a series of quantitative demographic scenarios which showed that the accelerated demographic growth of China would not only pose a threat to the security and even survival of the nation by destroying the natural resources necessary to sustain economic growth but would also threaten human survival by destroying the world's environment. In his opinion the situation left no choice but to adopt a drastic measure in which the interests of the individuals had to be subordinated to the interest of the nation. The success of Song initiative must be imputed to the pragmatism and trust in science brought about by Deng Xiaoping who had also already expressed the opinion that a rapid growth of a largely rural population was a major obstacle to China's economic and social development. The one-child policy was finally approved in September 1980, despite the opposition of some of the party leaders.

During its first years of implementation these suggestions were not followed and the high number of abortions and sterilisations ignited strong reactions especially in rural areas, which in their turn prompted the introduction of numerous exceptions, while in the nineties the one-child policy was in fact abandoned in favour of an extremely variegated and diversified approach, with the one-child policy evolving into a 1.5 child policy.

However, by the mid-1990s the TFR fell below replacement level and numerous scholars began to call for the measure be abolished in order to avoid its dramatic impact on the population age structure. As a matter of fact, the Chinese government waited until 2013 before starting to relax the one-child policy, which was finally abolished only 1 January 2016. As was to be expected, this had only marginal and temporary effects on the number of births and I have no doubt that the same will happen with the more recent pronatalist initiatives.

### India and China policies

It is evident that China's on child policy widely differ from India's population measures. In the first place the adoption of the one-child policy was not the result of foreign pressure but

of a process of conversion of the communist leadership to ideas previously condemned, a conversion supported by scientific analyses, and based on a pragmatic approach to policy making. It did also respond to an ideological approach shared by many Chinese citizens that puts the welfare of the nation above that of the individual. Finally, as showed by the debate that preceded the enactment of the new measure, the party leadership was fully aware of its dramatic implications. The letter that announced the approval of the measure did in fact forbade the use of violence and asked the party cadres to enforce the policy using political and ideological means, a suggestion that was not followed in the first year of the enforcement of the policy.

The question that remains to be answered is whether the one child policy was really necessary, what was its impact and more generally whether population policies have been effective.

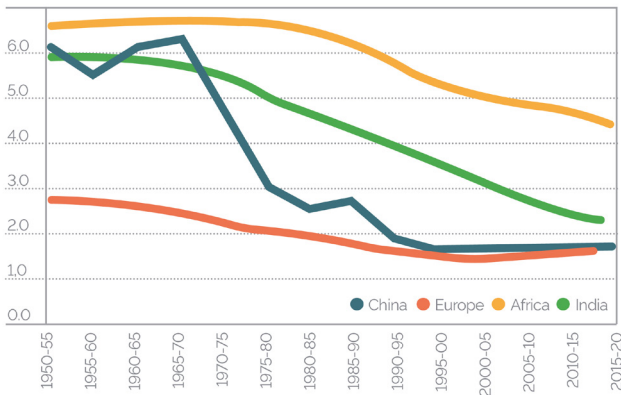
## **The Impact of Population Policies**

Figure 1.3 compares the evolution of China's TFR with those of Africa, Europe and India. In both Africa and Europe the evolution of fertility appears quite smooth. In Africa the TFR remained substantially constant up to the end of the 1970s and then slowly declined. In Europe the trend was negative up to the beginning of the century and then showed a very modest upturn. Africa has been largely immune from population policies; in Europe some countries have adopted pro-natalist measures in the last 20-to-30 years, but it is not evident whether or to what extent the small increase in fertility recorded in some European countries is to be attributed to these measures or to the arrival of a large number of migrants with a higher fertility rate than that of the native population.

The evolution of India's fertility rate also appears quite smooth. As a matter of fact, the TFR started to decline when the country began adopting sterilisation policies, but the rate of decline during the period 1965-80 does not show any abrupt acceleration.

The case of China is quite different and, in some way, unique. The TFR remained substantially stable above 6 children per woman till the end of the 1960s, a period that was characterised, as we have seen, by contradictory demographic measures. In the following decade the TFR dropped quite abruptly from an average of 6.3 children per woman in the period 1965-70 to below 3 around 1980. We should recall that in its constant fertility scenario Song used a TFR of 2.3. However, it is also true that in the 1980s the TFR remained substantially stable despite the enactment of the one-child policy due to a lowering of the age of marriage. However, from the beginning of the 1990s, the Chinese TFR has always been below replacement level. Although it is true that China's TRF has fallen below replacement level at a very low income per capita, it is also true that in China improvement in education has been much greater than in low- and lower-middle-income countries, while some scholars have suggested that a special role could have been played by Confucianism.

FIG. 1.3 – CHINA, INDIA, AFRICA AND EUROPE;  
TOTAL FERTILITY RATE (FROM 1950-55 TO 2015-20)



Source: elaboration on UNDESA, 2019

So, while it remains very difficult to assess the role played by the one-child policy, and therefore its necessity, what remains true, as will be discussed later, is that China's low rate of population growth has certainly favoured its fight against poverty and unprecedented growth in GDP per capita.

## Demographic Challenges

Taking a labour market perspective, human life can be divided into three phases: the training phase, the working phase and the post-working phase.<sup>18</sup> As we have seen, the DT involves first an increase of the young, then in the working age population and finally of the elderly, while working age population declines. This implies that the DT process generates three socioeconomic challenges.

The first relates to education and vocational training: the increasing number of first-year enrolments and of the total number of pupils, generally in a situation of widespread illiteracy, creates a series of serious problems, from lack of infrastructure to a shortage of qualified teachers.

The second challenge relates to the creation of a number of jobs, possibly of formal jobs, sufficient to keep pace with a potential supply of labour expanding at an increasing rate.

Then, the moment comes when the number and share of the elderly population starts to increase and this obviously creates a problem for the welfare system. The seriousness of the problem is compounded by the fact that, at the same, the country suffers a decline in the population in working age and therefore in the number of people that are expected to pay for pensions and to take care of the elderly, and more generally to sustain the nation's economic growth and social development.

Obviously the faster the evolution of the DT and the more pronounced its impact on the age structure of the population,

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<sup>18</sup> M. Bruni, "A Stock-Flow Model to Analyse and Forecast Labour Market Variables", *Labour*, vol. 2, no. 1, 1988, pp. 55-116.

the more demanding and the more complex these challenges will be. China, as we have already seen, has been marching, or rather, running along the path of the demographic transition at a very fast pace.

### The education challenges

When the People's Republic of China came into existence, less than 20% of its citizens could be considered literate, despite the numerous initiatives undertaken first under the modernisation push of the May Fourth Movement and then by the Communist Party. The Chinese government was therefore confronted with two big problems: dealing with massive adult illiteracy, while providing formal education to a growing number of children.

A preliminary decision concerned the distinctive writing system that had characterised China for more than 3,000 years.<sup>19</sup> It had been held by both foreign and Confucian scholars that the use of Chinese characters could constitute a serious obstacle to learning and to economic development.<sup>20</sup> This idea was paralleled by estimates that put the literacy rate in Qing China at 1.2%. In fact, more recent studies have reached the conclusion that the literacy rate was much higher and that there was an average of one literate person per family.<sup>21</sup> This implied that China's economic backwardness could not be ascribed to the use of characters.<sup>22</sup>

The Chinese government decided to maintain the traditional writing system, recognising it as a founding element of Chinese

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<sup>19</sup> The oldest that have been discovered appear in oracle bone inscriptions excavated in the Yin Ruins in Anyang City, Henan Province, that date back to 1400 BCE.

<sup>20</sup> J.K. Fairbank, *The United States and China*, Cambridge MA, Harvard University Press, 1883.

<sup>21</sup> E.S. Rawski, *Education and Popular Literacy in Ch'ing China*, Ann Arbor MI, University of Michigan Press, 1979.

<sup>22</sup> The great achievements of the Egyptian civilisation confirm that non alphabetical writing is not a hindrance to cultural and socioeconomic advancement.



culture. At the same time, however, it decided to simplify characters by reducing the number of strokes used to write them and to spread the use of pinyin, while Putonghua, the language spoken in Northern China, was adopted as national standard.

To provide basic literacy, the Chinese government acted at two levels: on the one hand, it adopted the *two-track system for dual tasks*, with “key” schools to train experts and “non-key” schools to raise the cultural level of the masses; on the other, it expanded and strengthened the education and vocational training system.

This latter task was extremely complex given that the number of children entering education age every year increased from 14 million at the beginning of the 1950s to 26 million at the beginning of the 1970s, while the number of children aged 6-18 years doubled, from 143 million to 285 million. However, in 1965 the total number of students enrolled in formal education was around 130 million and reached 210 million in 1980. The rapid success of the Chinese drive for literacy is testified by the fact that the literacy rate was already around 66% by 1964 and reached 77% by 1982, so that a UNESCO report noted that:

China's efforts in anti-illiteracy are clearly the greatest experiment in mass education in the history of the world.<sup>23</sup>

In the following years, the literacy rate continued to increase, reaching 84% by 1990 and 93% by 2000, and in 2017 it was up to 95.1% (97.5% for men and 92.7% for women), while illiteracy was concentrated among the elderly.

The success of China's education effort is also testified by the evolution of the enrolment structure by educational level from a situation in which primary school accounted for more than 90% to one in which 47% of pupils are in primary school, 21% in junior secondary, 18% in senior secondary and 14% in university education.

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<sup>23</sup> H.S. Bhola, *Campaigning for literacy: eight national experiences of the twentieth century*, UNESCO, 1985.

There is no comparison between China's achievements in education and those of the countries that were in similar socioeconomic situation in 1949. While by now all Chinese children receive compulsory education, the gross enrolment rate in higher education increased from 12.5% in 2000, to 26.5% in 2010 and to 54% in 2019, which is much higher than those of South Africa (24%), India (29%) and Brazil (43%), and getting very close to those of the UK (61%), Italy (64%), Portugal (66%) and France (69%).

Even more importantly from the perspective of the ongoing competition for world leadership (which will be largely based on the capacity to produce a labour force with a high educational level), in 2019 the number of boys and girls graduating with a first level university degree reached a record 7.6 million, which exceeds the combined number produced by the US and the EU27, both at around 3 million. The number of university graduates with Master's and PhD degrees (around 650,000) remains lower, but the trend in enrolment shows that China will soon take the lead in this metric too.

Let us finally recall that the number of Chinese students attending foreign universities in the last ten years has almost tripled, increasing from 230,000 to 660,000.

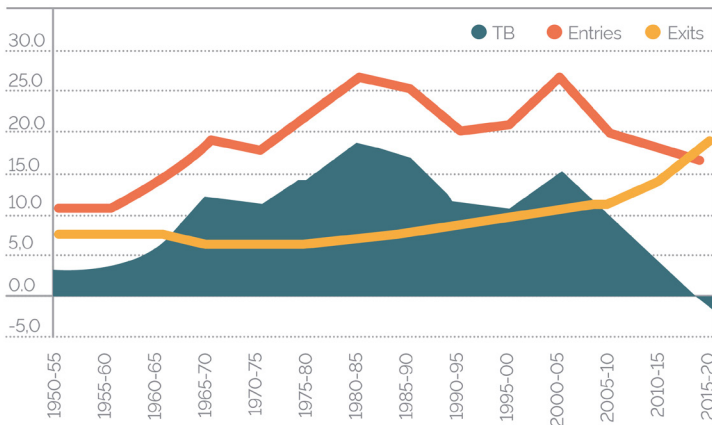
### The employment challenges

From 1949 to 2013 the Chinese working age population (WAP), the source of labour supply, increased by around 665 million (from 341 to 1,006 million), which is 18 times the working age population of Italy and three times that of the US; it has since declined to today's 965 million.

To capture the dynamics of China's WAP, Figure 1.4 shows the average number of yearly generational entries, generational exits and natural balance for the 5-year periods from 1950 to 2020. Generational entries (the number of people that reach 15) steadily increased from an initial level of around 11 million to a record high of 26 million in 1980-85. China then entered the second phase of the DT of the WAP in which the WAP

grew at a decreasing rate, with a short interruption between 1995 and 2005.<sup>24</sup> As we have already seen, in 2013 China then entered the third phase of the DT of the WAP in which the supply of labour declined.

FIG. 1.4 – CHINA - WORKING AGE POPULATION (15-64);  
GENERATIONAL ENTRIES, GENERATIONAL EXITS  
AND TOTAL BALANCE (FROM 1950-55 TO 2015-2020)



Source: elaboration on UNDESA, 2019

Generational exits (the number of people that reach 65 or die within the 15-64 age group) had a much more regular evolution, increasing from its lowest level of 6.5 million to today's 15.5 million. As a result, the average yearly growth of the WAP increased from just over 3 million to a record high of almost 19 million in the 1980; a second peak of 15.5 million was reached between 2000 and 2005 and then, as we have already seen, the WAP started to decline in 2013.

Despite the different dynamics of the generational turnover, the two 35-year periods 1950-85 and 1985-2020 show a very

<sup>24</sup> This reflects the increase in the number of births between 1980 and 1990.

similar average yearly growth, 10 million in the first period and 9.5 million in the second.

It is evident that such an impressive increase in the WAP has created an extremely difficult employment challenge for the Chinese economy, a challenge that has been successfully confronted with the creation of 570 million additional jobs.

This remarkable result rests on unprecedented rates of economic growth made possible by the introduction of a series of courageous reforms, including structural reforms of the economic system and of the labour market. These reforms have contributed to transforming China from a backward agricultural society into a largely urban society in which the production of nontangible goods and the use of nontangible factors is becoming extremely significant.

According to official data, between 1952 and 2019 China's GDP has grown at an impressive average yearly rate of 8.4%. Different phases do however emerge.

After 30 years of turbulence in which the Chinese economy was subject to violent oscillations,<sup>25</sup> variability declined, and GDP started to grow at an unparalleled pace with an average yearly growth rate above 10% from 1992 to 2012. After 2010, the rate of growth of GDP has progressively decreased but remains largely above those of Western economies.

In its first 30 years China's economic system adhered to the principles of a command economy in which the government controlled a dominant share of production, set prices and allocated resources to achieve socioeconomic goals decided at the central level. This period was characterised by the collectivisation of agriculture, the backyard furnaces, the Great Leap Forward, the Cultural Revolution and violent power struggles; it was also punctuated by numerous economic downturns caused by the implementation of inconsiderate economic policies and natural disasters. However, GNP grew

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<sup>25</sup> In this period the Chinese economy suffered a dramatic dip during the Great Leap Forward and reached peaks of growth above 15% in 1964, 1969 and 1970.

on average by 6.2% and GNP per capita by 4.3%, while life expectancy increased to unprecedented levels and infant mortality significantly declined.

1979<sup>26</sup> marks a turning point in the political, economic and social history of China. The Chinese government, under the leadership of Deng Xiaoping, began to adopt a series of far-reaching measures, the most important being the creation of special economic zones, the reform of state-owned enterprises and the introduction of market-oriented reforms in the agriculture sector and rural areas. These measures aimed to progressively combine central planning and some features of a market economy to increase productivity, foster technological progress and improve living standards.

During the 1990s, the Chinese government started a large-scale privatisation process guided by the strategic principle of leaving the competitive market (personal services and manufacturing of consumer goods) to private enterprises and maintaining control of the strategic market (infrastructure construction, energy and raw materials). In this way, while creating room for private enterprises, the government contributed to their success by providing energy, water and natural resources at artificially low prices and building an extensive infrastructure network, which was one of the pillars of the Chinese miracle.<sup>27</sup>

The last important event of this period was the accession of China – whose economy was still approximately the size of France's – to the World Trade Organization in 2001. The stage was set for China to become the factory of the world, and in the following decade China replaced the United States as top

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<sup>26</sup> China's economic reform process began in December 1978 when the Third Plenum of the Eleventh Central Committee of the Communist Party adopted Deng Xiaoping's economic proposals. Implementation of the reforms began in 1979.

<sup>27</sup> X. Geng, X. Yang, and A. Janus, State-owned enterprises in China: reform dynamics and impacts, in R. Garnaut, L. Song, and W.T. Woo (Eds.), *China's New Place in a World in Crisis: Economic, Geopolitical and Environmental Dimensions*, Australian National University, 2009.

producer of manufactured goods.<sup>28</sup> At the macro level, this period saw an average rate of growth above 10% with a record 13.9% in the secondary sector.

Let us finally recall that in the second half of 2008, in response to the global financial crisis, China launched a major investment programme that included credit expansion and large-scale investment in real estate and infrastructure. As a result, while Western economies had negative or very low rates of growth, China's GDP grew at record rates. When the impact of the huge stimulus package started to fade away, the rate of growth of GDP fell below 10% and since then has continuously declined, hitting the lowest pre-pandemic level in 2019 (6.1%).<sup>29</sup> Moreover, it became increasingly evident that the policies adopted by China had a series of notable negative consequences: from widening income inequalities to overcapacity in numerous economic sectors, from heavy pollution to an inefficient financial system.

In 2014, taking stock of the situation, Xi Jinping announced that China had entered a new phase of economic development that he defined the "New Normal" in which it was necessary to move toward a model based on domestic consumption and on sustained technological change that would raise productivity and push the Chinese economy up the global value chain. Focusing more on quality than on quantity, the new system would pursue a constant improvement and upgrading of the economic structure driven by innovation, instead of capital investment, and a substantial improvement in the educational level of the labour force.

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<sup>28</sup> The period was also characterised by a decline of the public sector, an increasing amount of foreign direct investment, substantial reforms of labour market regulations – of which the most significant were the Minimum Wage Regulations (2004), the Employment Contract Law (2008), the Employment Promotion Law (2008), and the Labour Disputes Mediation and Arbitration Law (2008) – and a large-scale expansion of the informal sector, as well as a renewed process of de-accumulation of surplus labour that raised the first signals of local labour shortages and caused a considerable increase in labour unrest.

<sup>29</sup> After falling to 2.3% in 2020, China's GDP grew by more than 8% in 2021.

Coming back to the labour market, its evolution reflects both the quantitative growth of the economy and the institutional changes we have just summarised.

At the beginning of the story the Chinese labour market was governed by rules consistent with a command economy, but with some unique features.<sup>30</sup> In the first place, while in rural areas young men would “freely join” the labour force as soon as they were old enough to work in the fields, young urbanites upon completing their education were directly allocated to state-owned enterprises that managed most of the urban economy. The introduction of the *Hukou* system and its strict enforcement prevented workers from moving not only from one province to another but also from rural to urban areas.

All this can be summarised by recalling that during this period workers, companies and the state were linked in a system that came to be known as the *iron rice bowl*, a special form of occupational welfare that entitled the worker to lifelong employment, a steady income and numerous benefits, including a share of the goods and services redistributed by the state.<sup>31</sup> Under this system the workplace was a small society where the managers were not only responsible for organising production but also managed the welfare of the workers and their family.<sup>32</sup> This, together with limited alternatives and the lack of exit options, generated a high dependence of workers on their workplace, a loyalist response and finally a culture of paternalistic dependence totally consistent with Confucian tradition. It also contributed to legitimising the regime and vindicating the “superiority of socialism” and its care for the welfare of the working class.<sup>33</sup>

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<sup>30</sup> N. Majid, *The great employment transformation in China*, Employment Working Paper No. 195, International Labour Organization, 10 November 2015.

<sup>31</sup> M.K. Lee, *Beyond the iron rice bowl: Chinese occupational welfare in market transition*, University of London, 1998.

<sup>32</sup> G.E. Henderson and M.S. Cohen, *The Chinese Hospital: A Socialist Work Unit*, New Haven, Yale University Press, 1984.

<sup>33</sup> T. Saich, *China: politics and government*, London, Macmillan, 1981.

1979 also marks a historical turning point for the Chinese labour market. An increasing number of employed persons had to learn the hard way the implications of the market in terms of job security, while some of those exiting the education phase had to find a job on their own. However, jobs became more diversified and working conditions improved, while new opportunities were offered by international investments as well as by the construction of the basic infrastructure necessary to support them. Joint ventures could choose their employees following market rules, and state-owned enterprises started to be granted the right to hire and dismiss workers, depending on production needs. Rural labour markets also started to improve: the introduction of the household responsibility system<sup>34</sup> brought significant improvements in the living standards of farmers who were allowed to work in local non-agricultural activities, especially in Township and Village Enterprises.

In this period employment grew at the incredible rate of almost 20 million per year. However, this reflects the growth of the rural population more than that of output and productivity. The employment level was still driven by the supply side, so much so that more than 40% of the additional jobs were “created” by the agriculture sector, which reached an all-time high of 391 million, almost 60% of total employment, in 1991 (Table 1.2).

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<sup>34</sup> The system reduced the quota of output the farmer had to give to the state and rewarded them for producing above and beyond the target.



TAB. 1.2 – CHINA - EMPLOYMENT BY MAIN ECONOMIC SECTORS; ABSOLUTE VALUES. PERCENTAGE COMPOSITION IN SELECTED YEARS FROM 1952 TO 2017; AVERAGE ABSOLUTE CHANGE AND AVERAGE PERCENTAGE CHANGE IN SELECTED PERIODS

	Primary	Secondary	Tertiary	Total	Primary	Secondary	Tertiary	Total
	Absolute Values				Percentage composition			
1952	173	15	19	207	83.5	7.4	9.1	100
1978	283	69	49	402	70.5	17.3	12.2	100
1991	391	140	124	655	59.7	21.4	18.9	100
1991	366	157	210	733	50.0	21.4	28.6	100
1991	279	218	263	761	36.7	28.7	34.6	100
1991	209	218	349	776	27.0	28.1	44.9	100
	Average yearly absolute change				Average yearly percentage change			
1952-1978	4.2	2.1	1.2	7.5				
1978-1991	8.3	5.4	5.8	19.5	2.6	5.6	7.5	3.9
1991-2002	-2.2	1.5	7.8	7.1	1.0	2.6	6.9	2.7
2002-2010	-10.9	7.7	6.7	3.5	-2.7	3.6	4.5	1.1
2010-2017	-10.0	0.0	12.2	2.2	-7.1	3.9	6.2	0.6

Source: elaboration on data retrieved from the database of the Chinese Statistical Bureau

Finally, the prohibition of moving from the agricultural sector to the industrial sector, from rural to urban areas and from one province to another started to be relaxed. The structural shortage of labour generated by incredibly high rates of economic growth in the coastal provinces began to attract the large number of disguised unemployed (the unlimited supply of labour) present in rural areas and poor provinces, causing the largest migration flows in human history. The almost 300 million people that have left their birthplace to work and live where the labour market needed them have played a central role

in allowing China to become the factory of the world and to sustain its economic growth.<sup>35</sup>

In 1992 the Chinese labour market entered a new phase in which the average yearly rate of growth of employment fell abruptly to around 1% and then progressively declined to become negative in 2018. A major cause of this is that agricultural employment, which in the previous 40 years had contributed to employment growth by almost 50%, started to decline at a very impressive rate (2 million in the first ten year and then more than 10 million per year) due to both a partial generational substitutions and urbanisation. As a consequence, the employment structure by sector underwent major changes. The share of agriculture declined from almost 60% to around 25%, that of services increased from 19% to more than 45% while that of industry increased from 21% to 28% but peaked to more than 30% in 2011.

Obviously, the characteristics of the employed also progressively evolved. The most interesting changes relate to their age structure and education. We can in fact safely assume that, on the one hand, the number of entrants into the labour market progressively declined while the size of older generations progressively increased and, on the other, the average educational level of new entrants was higher than that of those leaving the labour market. As a result, the average age of the employed increased, as did their educational attainment.

The challenges of the future:  
ageing and structural shortage of labour

The countries that reach the third stage of the DT are confronted with a final challenge, a process of progressive ageing but even more importantly a parallel contraction of the population in working age.<sup>36</sup>

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<sup>35</sup> B.M. Gardner, *China's great migration: how the poor built a prosperous nation*, Oakland, CA, Independent Institute, 2017.

<sup>36</sup> Population ageing is defined as the increase in the percentage of elderly people

The countries more advanced along the path of the DT i.e., those economically more advanced, have been affected by this process for quite some time. In 1950 the share of elderly people was around 10% in France, Germany, and Italy. In 2020 the percentage was above 20% in all these countries and, in a zero-migration scenario, is projected to reach or pass the 30% mark by 2050.

China and India show how the delay in the beginning of the DT and the different speed of the transition impact on the percentage of older people. In 1950 the two countries had a similar percentage of elderly (3.4%), but in China the ageing process has taken place at a much faster pace so that the percentage of elderly people is now 12% compared to 6.6% in India. According to UNDESA, by 2050 in China the share of the elderly population will reach 25.9% and in India only 13.6%. In short, the ageing process in India is lagging 25 years behind China's.

The ageing process is paralleled by a decline in the share of the population in working age. In the more developed countries this has been going on for at least three decades despite the massive immigration process affecting these economic systems and is expected to continue and become really dramatic in the next 30 years. (Italy is a case in point). In China, as mentioned earlier, the WAP peaked in 2013; according to the CBS, the WAP share was 71.8% of total population, a much higher proportion than in the more advanced countries due to the greater speed with which the number of births declined starting in 1990. In India the WAP's share is projected to reach a peak during the 2030s.

Since pensions are paid by the employed, the parallel increase in the number of elderly people and decline in the number of people in working age is obviously an explosive situation that has already led many countries to bring major changes to their pension system.

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in the total population. It is therefore a relative phenomenon that depends not only on the increase in the number of older people but also on the dynamics of the other age groups; more specifically the phenomenon is generally compounded by a simultaneous decline in the WAP.

In a recent book<sup>37</sup> I have argued that, in absence of migration, the decline in WAP that will affect China in the next 30 years will be extremely significant: dropping by 77 million from 2020 to 2035 and by 97 million in the following 15 years, which corresponds to an overall decline of almost 18%.<sup>38</sup> I have further argued that no employment or active labour policy will be sufficient to make up for the resulting shortage of labour. In other words, the Chinese labour market is bound to be affected by what I have defined a Structural Shortage of Labour, a problem that makes mass immigration unavoidable. In other words, China will be able to continue along the path of economic growth necessary to improve the socioeconomic conditions of its citizens and for the survival of its political system only by adopting a mass immigration policy. I have further argued that China could transform this “problem” into an opportunity by

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<sup>37</sup> See M. Bruni, *China, the Belt and Road Initiative, and the Century of Great Migrations*, Cambridge Scholars Publishing, 2022 and also Idem, *Leadership economica, transizioni demografiche e migrazioni internazionali. Il caso della Cina*, Quaderni della Fondazione Brodolini, 2016; Idem, “Dwindling Labour Supply in China: Scenarios for 2010-2060”, in I. Attané and G. Boacheng, *Analyzing China's Population*, INED Population Studies, n.3, Springer, 2014, pp. 227-54; M. Bruni, “Migration and demographic projections: A new methodology to jointly build market and demographic scenarios”, *Genus*, vol. 68, no. 3, 2012, pp. 1-26.

<sup>38</sup> Many countries will experience a much more substantial contraction of the WAP: in Italy, for instance, according to UNDESA, the WAP will decline by 33%. It should therefore be evident that the difficulties our companies are facing in finding employees have one main cause: a shrinking labour supply. Obviously, companies should pay fair wages and offer workers adequate working conditions. Clearly, providing training and retraining to the labour force could shorten the time necessary to find a new job and improve short-term employee turnover; however, these measures cannot solve the problem, which is a dramatic quantitative shortage of labour that can only be faced with a rational, well planned and organised migration policy. A similar situation will affect almost all European countries, Northern American countries, some Asian countries such as Japan, Korea, Singapore and Thailand, and the Gulf countries. The cause is the demographic polarisation that will affect the planet at an increasing rate. However, the shortage of labour will not depend only on demographic trends but also on the rate of GDP growth and technological change of the countries with a declining WAP.

exploiting its institutional structure and acting in the context of the Belt and Road Initiative that will be characterised, as will the planet as a whole, by a deep demographic polarisation. But then, how many migrants will China need?

To provide an answer to this question I have built a series of combined labour market and demographic scenarios using a simple model based on the interaction of the demographic sphere and the economic sphere.<sup>39</sup>

In the intermediate, “more probable” scenario<sup>40</sup> the labour shortage is estimated at 222 million and the total migration balance at 259 million for the period 2020-50, the yearly averages progressively increasing from 2.4 million in the first decade, to 10.9 in the second and to 12.6 in the third.<sup>41</sup>

Starting from this migration estimate, I have then computed a demographic scenario characterised by an increase of 27 million of WAP and of 177 of total population, while the elderly increase by 190 million and the young decline by 39 (Table 1.3). Obviously, this has notable consequences on the age structure: the share of the young will decline from 16.8% to 12.4%, that of the WAP from 70.6% to 64.4% while the share of the elderly will increase from 12.6% to 23.2%, much less than what would happen in absence of migration.

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<sup>39</sup> M. Bruni, “China’s New Demographic Challenge: From Unlimited Supply of Labour to Structural Lack of Labour Supply. Labour market and demographic scenarios: 2008-2048”, *Materiali di Discussione*, no. 643, 2011, Università degli Studi di Modena e Reggio Emilia, Dipartimento di Economia Politica.

<sup>40</sup> In this scenario the rate of activity is assumed to be constant, therefore the estimate mainly reflects the interplay of the trend in working age population and the assumption that the employment level first declines (due to the contraction of employment in the agricultural sector) and then moderately increases driven by the service sector.

<sup>41</sup> M. Bruni, “China’s New Demographic Challenge”..., cit.

TAB. 1.3 – CHINA - INTERMEDIATE DEMOGRAPHIC SCENARIO FOR THE 2020-50 PERIOD (MILLIONS)

	Absolute Values			Percentage Composition			Empl	RoE	Total
	0-14	15-64	65+	0-14	15-64	65+			
2020	235	989	176	16.8	70.6	12.6	775	78.4	1,400
2035	204	966	295	13.9	66.0	20.1	766	79.3	1,465
2050	196	1,016	366	12.4	64.4	23.2	837	82.4	1,577
2020-2050	-39	27	190	-4.4	-6.2	10.6	62	4.0	177

Source: elaboration on data retrieved from the database of the CS

The analysis therefore suggests that a decline in fertility does not necessarily lead to a decline in the working age population and total population, as is normally believed. In fact, both variables can increase, and the change will be positively correlated to labour shortage. This result derives from what seems to me a very realistic hypothesis that a structural shortage of labour will necessarily result in a positive immigration balance and that the higher the labour shortage the higher the growth of the WAP and total population. An interesting and significant implication is that China will not lose its demographic primacy to India.

Coming to the labour market it must be underlined that despite what could be considered a huge immigration flow, to satisfy the modest increase in employment assumed in the scenario (+62 million, 8% over a 30-year period) the rate of employment (RoE) will have to increase from a present value of 78.4% to 82.4%)

But what about the socioeconomic burden?

## The socioeconomic burden

To obtain a more accurate appraisal of the socioeconomic burden and its evolution we will replace the standard demographic indicators with economic indicators of dependency which use as denominator the employed i.e., those that support others, and not the WAP, which includes people that need to be supported.<sup>42</sup>

$$\begin{aligned} \text{TEDI} &= (\text{Tot. POP} - \text{Empl.}) / \text{Empl.} * 1000 \\ &= (\text{NotEmpl./Empl.}) * 1000 \end{aligned}$$

The Total Economic Indicator of Dependency (TEDI) measures how many people 1,000 employees have to support besides themselves. This indicator is based on the idea that the evolution of the socioeconomic burden is not the result of unavoidable demographic trends but of the interaction between the demographic and the economic spheres; in so doing it allows us to assess the role of both components in determining the level and evolution of the socioeconomic burden. Moreover, it allows us to determine the “contribution” to the socioeconomic burden and its evolution of economically relevant typologies of dependents: those in which the society is investing (the young and students); those that provide maintenance services to the employed members of the family (normally defined as inactive); and those that have already contributed to society by producing goods and services or equally important maintenance services (the elderly).<sup>43</sup> The available data does not allow us to make such

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<sup>42</sup> M. Bruni, “The century of the great migration. Demographic forecast, migration and transition theory: A market perspective”, *Papeles De Poblacion*, vol. 15, no. 62, 2009, pp. 9-73; Idem, *Ageing, the socioeconomic burden, labour market and migration. The Chinese case in an international perspective*, GLO Discussion Paper, no. 222, Global Labor Organization (GLO), Maastricht, 2018.

<sup>43</sup> This indicator has other positive characteristics. In the first place it allows us to compare the situation of countries with different definitions of WAP and especially different ages of entries into and exits from the labour market (China being one of them); it will also allow us to keep comparing the socioeconomic

a precise evaluation for China but only to build some estimates for the young, the inactive in working age and the elderly.

Our estimate for 2020 TEDI is 807. The most important category to be supported is represented by the Young (42%) followed by the Elderly (31.5%) and then the Inactive in Working Age (INWA) with 26.5%. Under our assumptions, in the next 30 years TEDI will progressively increase up to 968 while the share of the Young and of the Inactive will progressively decline and that of the Elderly will soon become a majority and reach a share of 53.3% in 2050.

TAB. 1.4 – CHINA - TOTAL AND SPECIFIC ECONOMIC INDICATORS OF DEPENDENCY (2020-50)

	Y_ED I	INWA_ED I	E_ED I	TED I	Y_ED I	INWA_ED I	E_ED I
2020	339	214	254	807	42.0	26.5	31.5
2035	301	200	436	937	32.1	21.4	46.5
2050	275	179	514	968	28.4	18.5	53.1
2020-2050	-64	-35	260	161	-13.6	-8.0	21.6

Source: elaboration on data retrieved from the database of the CSB

To evaluate the level and structure of China's socioeconomic burden and the forecast evolution, we can compare it with that of the EU28.

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burden when the definition of WAP is changed to take into consideration the increase in life expectancy and the changes in the duration of the various stages of life.



## The EU 28 socioeconomic burden

Comparing the present population structure of the EU28 with that of China (Table 1.5) two major differences appear: the lower weight of the WAP and the higher weight of the elderly, while from a labour market perspective the EU28 has a lower RoE.

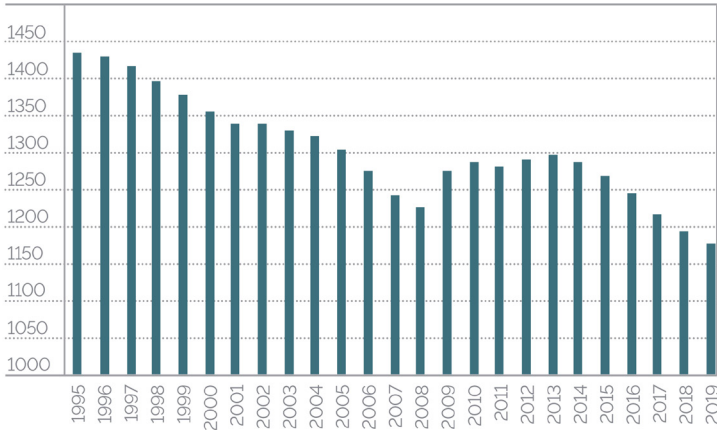
TAB. 1.5 – EU28; TOTAL AND SPECIFIC ECONOMIC INDICATORS OF DEPENDENCY (2020-50)

	Absolute Values			Percentage Composition			Empl	RoE	Total
	0-14	15-64	65+	0-14	15-64	65+			
1995	89	324	71	18.3	67.0	14.7	199	61.4	484
2019	80	331	104	15.5	64.4	20.2	236	71.3	514
1995-2019	-9	7	33	-2.9	-2.6	5.5	37	10	30

Source: elaboration on data retrieved from ILOSTAT

Moving to the socioeconomic burden and its dynamics, our calculations show that from 1995 to 2019 the EU28's TEDI shows a pronounced negative trend, declining from an initial value of 1,433 to a final value of 1,178 (Figure 1.5). Moreover, TEDI shows a cyclical behaviour, decreasing in periods of economic expansion and increasing in periods of economic crisis.

FIG. 1.5 – EU28; TEDI; 1995-2019



Source: elaboration on data retrieved from ILOSTAT

The long-term decline of the EU28's TEDI is explained by an increase in employment (+37 million, +18.7%) and a decline in the Not Employed (-7 million, -2.4%) (Table 1.6). This resulted in a very moderate increase in the WAP (around 7 million) and a notable increase in the RoE from 61.4% to 71.3%, despite the fact that from 1995 to 2019 the Migration balance of the EU28 was approximately 25 million migrants.<sup>44</sup> The only period that saw a trend reversal was 2009-13, in which under the impact of the international financial crisis the level of employment declined by 5 million (-2.3%), while the number of the Inactive in working age increased by 10 million (+3.6%).

The decline in the total TEDI has been paralleled by a substantial change in the structure of the population needing support (Table 1.9). In 1995 the largest share, at 44%, was that of the inactive in working age, followed by the young and then the elderly which accounted for only  $\frac{1}{4}$  of the total. After 24 years, the most numerous group, with a share of 37.3%, has

<sup>44</sup> In the absence of migrants, the RoE should have climbed to more than 77%.

become that of the elderly, followed by the inactive in working age and then by the young with 28.6%.

TAB. 1.6 - EU28; EMPLOYED, NOT EMPLOYED, TOTAL POPULATION, TEDI; ABSOLUTE VALUES, ABSOLUTE CHANGE, PERCENTAGE CHANGE; 1995, 2008, 2013, 2019

	Employed	Not Employed	Tot. Pop.	TEDI
	Absolute Values			
1995	199	285	484	1.433
2008	225	276	501	1.274
2013	220	286	505	1.301
2019	236	278	514	1.178
	Absolute changes			
1995-2008	26	-9	17	-158
2008-2013	-5	10	5	26
2013-2019	16	-8	9	-122
1995-2019	37	-7	30	-254
	Percentage changes			
1995-2008	13.1	-3.2	3.5	-11.0
2008-2013	-2.3	3.6	1.0	2.1
2013-2019	7.4	-2.7	1.7	-9.4
1995-2019	18.7	-2.4	6.3	-17.8

Source: elaboration on data retrieved from ILOSTAT

The negative trend of the EU28's TEDI reflects the negative trend of the great majority of member countries: from 1995 to 2019 TEDI increased in only three countries: Denmark, Greece and Romania. In 1995 TEDI values were spread between the highest at 2,093 in Spain and the lowest at 985 in Romania. In the following 24 years this spread shrank, the ranking notably changed, and the number of countries with very low values increased. In 2019 the countries with the highest TEDI were Greece (1,753) and Italy (1,564). At the other end of

the ranking, we find six countries with values below 1,000, implying that one employed person has to support only one other person (Table 1.7).

TAB. 1.7 – EU28 MEMBER COUNTRIES

TEDI		
1	Netherlands	936
2	Germany	944
3	Estonia	972
4	UK	978
5	Austria	990
6	Czechia	994
7	Cyprus	1,026
8	Denmark	1,036
9	Lithuania	1,053
10	Sweden	1,061
11	Portugal	1,090
12	Latvia	1,091
13	Luxembourg	1,091
14	Slovakia	1,102
15	Slovenia	1,128
16	Ireland	1,146
17	Finland	1,147
18	Poland	1,147
19	Hungary	1,149
20	Bulgaria	1,157
21	Romania	1,242
22	Malta	1,340
23	Belgium	1,346
24	Spain	1,372
25	Croatia	1,403
26	France	1,424
27	Italy	1,564
28	Greece	1,753
	EU28	1,178

Source: elaboration on data retrieved from ILOSTAT

What does the analysis of the socioeconomic burden of the EU28 suggest with respect to the Chinese situation?

### Some final considerations on the socioeconomic burden

China's TEDI is currently much lower not only than that of the EU28 as a whole but also than the lowest national TEDIs within the EU. There are mainly two reasons for this: the larger share of the population in working age and an extremely high RoE.

However, according to our forecast China's TEDI will progressively increase as the share of WAP converges towards the EU's present level. It will, however, remain below the 1,000 mark because under our assumption the RoE will increase to over 82%. If this were not to happen and the RoE were to remain stable or decline, China would need a higher Migration balance and TEDI would increase. It is nevertheless clear that even in this case China's socioeconomic burden would remain at a totally acceptable level. Obviously, this would not rule out the possibility of an increasingly unequal income distribution, a problem that should be high on the Chinese government's agenda.

## **Poverty: The Mother of All Demographic Challenges**

As we have already seen, in the last 70 years China's population has almost tripled, increasing from around 500 million to more than 1.4 billion. Moreover, even in absence of reliable quantitative information, we can safely state that in 1950 China was one of the poorest countries in the world. It is therefore evident that the biggest demo-economic challenge China had to face was to get its citizens out of poverty.

In February 2021, Xi Jinping announced that in 2020 China had reached this goal by lifting almost 800 million people out of poverty. In so doing it "had contributed to almost 75% of the global reduction in the number of people living in extreme poverty".<sup>45</sup>

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<sup>45</sup> *Four Decades of poverty Reduction in China: Drivers, Insights for the World and the Way*

To better appreciate China's achievements in poverty reduction, we can also compare the evolution of China's GDP per capita (pc) with that of other countries (Table 1.8). In 1990<sup>46</sup> China's GDP pc was still lower than that of India, slightly higher than that of low-income countries (LIC), and equal to 5.3% of the GDP pc of high-income countries (HIC). In the following 30 years China's GDP pc increased 18 times, that of India 5 times, and those of LIC and HIC 3 times. As a result, in 2020 China's GDP pc had climbed to 33.8% of that of HIC, a much stronger performance than India's whose GDP pc had increased from 6.5% to 12.8% of that of HIC; it should be underlined that in the same period the GDP pc of LIC had fallen to 4% of that of HIC. Let us also recall that in 2020 the Chinese GDP pc had become slightly higher than the global average (in 1990 it was around 1/6 of it) and was almost triple that of India.

Considering the whole 1990-2020 period, for the world as a whole the compound average rate of growth (CAGR) of GDP was 5.2% and that of the population 1.3%; as a result, the CAGR of GDP pc was 3.8% (Table 1.9). In the same period the performance of both low- and high-income countries has been similar, their GDP pc having increased at an average rate of 3.3-3.4%, which is lower than the world average. The relevant point is that the relatively poor performance of LIC is attributable to a higher rate of population growth which has neutralised the higher rate of GDP growth.

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*Ahead*, The World Bank Group, Washington, 2021.

<sup>46</sup> This is the first year for which comparable data are available.

TAB. 1.8 – CHINA, INDIA, LIC AND HIC - GD PER CAPITA, PPP (CURRENT INTERNATIONAL \$); ABSOLUTE VALUES AND PERCENTAGE INCIDENCE OF CHINA, INDIA, AND LIC WITH RESPECT TO HIC

	China	India	LIC	HIC	World
	<b>Absolute Value</b>				
1990	982	1,201	787	18,427	<b>5,558</b>
1995	1,861	1,573	845	22,515	<b>6,581</b>
2000	2,921	2,096	988	28,082	<b>8,017</b>
2005	5,054	2,953	1,248	34,274	<b>10,164</b>
2010	9,254	4,237	1,579	39,615	<b>12,252</b>
2015	12,898	5,465	1,765	45,696	<b>15,140</b>
2020	17,211	6,504	2,057	50,967	<b>17,135</b>
	<b>% incidence on HIC</b>				
1990	5.3	6.5	4.3	100.0	<b>30.2</b>
1995	8.3	7.0	3.8	100.0	<b>29.2</b>
2000	10.4	7.5	3.5	100.0	<b>28.5</b>
2005	14.7	8.6	3.6	100.0	<b>29.7</b>
2010	23.4	10.7	4.0	100.0	<b>30.9</b>
2015	28.2	12.0	3.9	100.0	<b>33.1</b>
2020	33.8	12.8	4.0	100.0	<b>33.6</b>

Source: elaboration on WB data

China's performance has been in a class of its own, coupling a 10.8% CAGR of GDP, which is much higher than that of LIC and India, with a 0.7% CAGR of population similar to that of HIC, half that of India and  $\frac{1}{4}$  of that of LIC.

TAB.1.9 - CHINA, INDIA, LIC, HIC, AND WORLD; COMPOUND AVERAGE RATE OF GROWTH OF GDP, POPULATION, AND GDP PER CAPITA IN SELECTED PERIODS

	China	India	LIC	HIC	World
1990-2020					
GDP	10.8	7.4	6.1	4.1	5.2
Pop	0.7	1.5	2.8	0.6	1.3
GDP pc	10.0	5.8	3.3	3.4	3.8

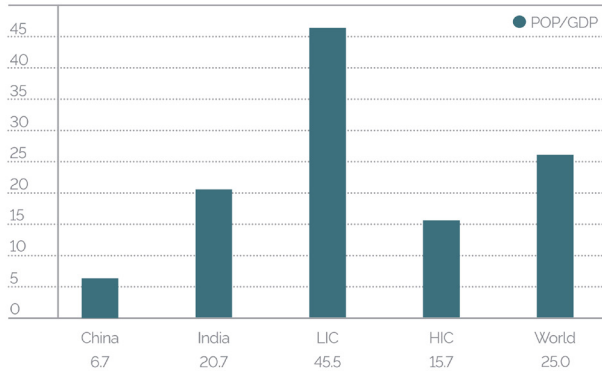
Source: elaboration on WB data

Figure 1.6 tries to capture the different role played by demographic trends in determining the growth of GDP pc in different geographical areas. Demographic growth eroded  $\frac{1}{4}$  of GDP growth globally,  $\frac{1}{5}$  in HIC and almost half in LIC. The impact in India is not far from the impact across the planet ( $\frac{1}{5}$ ); China, with less than 7%, suffered the lowest impact. In conclusion, the extraordinary increase in China's GDP pc is the combined result of an extremely high rate of growth of production and a very low rate of population growth.

However, this is a description and not an explanation of China's performance and does not provide much insight into the relationship between demographic growth and economic growth.



FIG. 1.6 – SELECTED COUNTRIES AND GROUPS OF COUNTRIES;  
PERCENTAGE OF GDP GROWTH ERODED BY POPULATION GROWTH  
(1990-2020)



Source: elaboration on WB data

In 2021, a World Bank report developed a detailed analysis of the “historically unprecedented” speed and scale of China’s poverty reduction. The Report noted that “China’s poverty reduction story is primarily a growth story” and its success was to be attributed to two factors:

*i) broad-based economic transformation and ii) targeted support provided to areas disadvantaged by geography and the lack of opportunities and later to individual households.*<sup>47</sup>

The Report essentially supports an institutional explanation of China’s success in poverty reduction which

benefited from effective governance, which helped coordinate multiple government agencies and induce cooperation from non-government stakeholders” while “The process of economic transformation was facilitated by sound macroeconomic management, and substantial public investment in connectivity infrastructure, which supported the competitiveness of industries and favoured domestic market integration.”<sup>48</sup>

<sup>47</sup> World Bank (2021).

<sup>48</sup> Ivi, p. 9.

What about demography? The report seems to ascribe a positive role to the DT, noting that China profited from a low fertility rate and benefitted from a large demographic dividend.

The World Bank's analysis however does not make a clear analytical distinction between the role of demography and that of economic growth. I believe that, on the contrary, the key to understanding the complex and bidirectional relationship between demographic growth and economic growth is to cast the discussion within the framework of the DT, realistically assessing the situations created by the DT process, without assuming *a priori* that abstract possibilities are good in themselves.

Moreover, the analysis of the relationship between demography and economics must be set in the relevant historical context, taking into consideration the characteristics of each historical moment. More specifically, the challenges that confronted the countries that are now classified as economically more advanced were much less demanding than those faced by the less developed countries in the last 70 years. In fact:

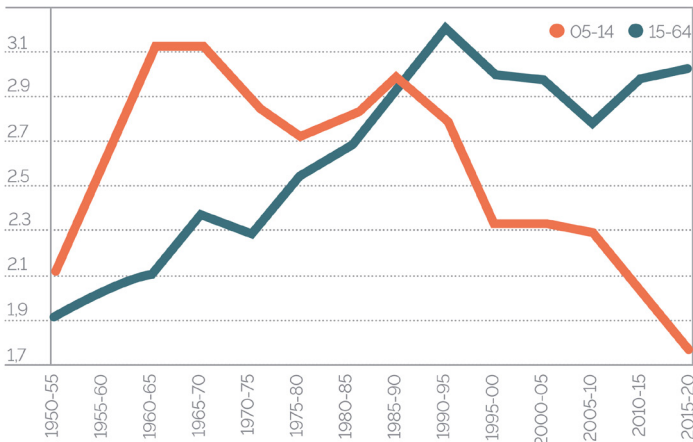
- the phases of the DT lasted much longer;
- the educational requirements of the labour market were much lower;
- the employment challenge manifested itself when a large portion of the structural surplus of labour generated by the second phase of the DT could successfully migrate to other countries attracted by the employment opportunities present (or forcefully created) in them.

By contrast, the situation confronting poor countries after WWII has been characterised by:

- a much shorter and more pronounced first and second phase of the DT;
- a strong hostility to immigrants including in countries affected by a structural shortage of labour.

In summary the countries that started to be affected by the DT in the second half of the twentieth century were hit first by an unprecedented explosion in the number of children of school age, in the presence of a labour market requiring an increasing level of educational attainment, and then by an equally unprecedented explosion in the working age population during a phase in which hostility toward migrants was increasing. This situation was the result of growing xenophobic sentiments and misplaced prejudices supported and popularised by right-wing movements and parties, while only a minority of economists and demographers half-heartedly tried to oppose these positions.

FIG. 1.7 – LOW-INCOME COUNTRIES; AVERAGE RATES OF GROWTH OF THE POPULATION 5-14 AND OF THE POPULATION 15-64 FOR THE FIVE-YEAR PERIODS FROM 1950-55 TO 2015-20



Source: elaboration on UNDESA, 2019 data

Figure 1.7 illustrates the relevant demographic trends for the Least Developed Countries. The average rate of growth of children aged 5 to 14 years increased up to its highest level, above 3%, in 1960 so that their number doubled in less than 30 years. Only after 1990 did the rate start to seriously decline.

In the meantime the rate of growth of the WAP progressively rose, peaking at more than 3% at the beginning of the 90s, and has since remained at levels above 2.7%.

I find it difficult to consider these demographic trends as conducive to economic development, and the socioeconomic “evolution” of the LIC clearly shows that the secret weapon the DT was providing them, the *ultimate resource* in Simon’s definition,<sup>49</sup> was in fact playing a negative role.

As we have seen, China found itself in a very similar demographic situation, but China was capable of successfully tackling these challenges, first by reducing the fertility rate, then by providing young people with an increasing level of education, finally devising and enacting the economic reforms necessary to provide jobs to the growing number of increasingly better educated young people reaching working age.

In conclusion, I believe that the impact of the DT on the demographic growth of a country far from promoting economic growth raises serious socioeconomic challenges, which are now much greater than those faced by the more developed economies in the nineteenth and twentieth century.

China has shown that the key to socioeconomic growth is to confront them successfully one after the other; but it has also shown that this requires an intelligent, pragmatic approach, the capacity to devise the right policies, but especially an institutional setting capable of enacting them rapidly and forcefully.

The open question now is whether China will also succeed in overcoming the structural shortage of labour that looms over its future.

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<sup>49</sup> J.L. Simon (1981).

## **2. What About Climate? China's Energy Transition and the War in Ukraine<sup>1</sup>**

Kaho Yu

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The Ukraine crisis has reignited the energy transition dilemma across the world, shifting governments' focus to energy security. The crisis has sent a warning message to the world that the pace of energy transition could be highly uneven across regions. Although energy insecurity driven by the crisis becomes an accelerator for Europe's energy transition, it pushes developing countries such as China to be more fossil fuel-dependent. In the long run, China will continue with a conservative climate strategy to meet both its carbon neutrality goal by 2060 and its pressing development needs. Although it will be difficult for China to catch up with the pace of Europe's transition, it will continue to strengthen its climate commitments, clean tech innovation, critical mineral sector, and green finance. This chapter attempts to examine the challenges China faces within its current energy transition strategy and what is changing with the war in Ukraine.

Although there is a global consensus to decarbonise the world, there are different views about how fast this transition should be. Russia's invasion of Ukraine has reignited the dilemma of energy security versus energy transition, further deepening

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<sup>1</sup> The opinions expressed in this article are the author's own and do not reflect the view of his employer or affiliated organisations.

the global division on climate actions. Skyrocketing energy prices and supply shortages across the globe have contributed to an energy crisis just a few months after COP26 called for speeding up emission reduction. This reflects the fact that many policymakers have underestimated the lengthy progress of decarbonisation and the costly disruption it could have on the traditional energy supply. In March 2022, deeply concerned by the Ukraine crisis, the International Energy Agency (IEA) held a ministerial meeting and set the twin goal of energy security and energy transition for the global energy system. The IEA's decision to re-introduce energy security alongside its long-standing energy transition agenda reaffirms the importance of energy security concerns in policymaking, but whether it could enable or constrain energy transition varies across countries.

China is not free from the dilemma of energy security versus energy transition. China, alongside many other developing countries, has been trying to find a more balanced approach to pursuing an energy transition. Over the last two decades, Chinese policymakers have incorporated climate change and low-carbon transitions into their energy strategy. To navigate supply disruptions driven by geopolitical tensions and the pandemic, the top Chinese leadership has also emphasised the importance of fossil fuels in ensuring basic energy security. The way and pace at which China promotes energy transition has impacted global, regional, and national energy markets, with significant geopolitical consequences.

## **Evolution of China's Energy Transition Through a Policy Lens**

While energy policy is always on China's top national agenda, it has undergone an unprecedented transition over the last few decades. It has evolved over time from a traditional "self-reliance" approach of securing supply for economic and geopolitical goals to a more balanced strategy that incorporates new elements, such as carbon neutrality and climate consideration. Traditionally,

the Chinese leadership view energy as a national security issue because an unobstructed supply of energy is crucial to China's survivability and daily operations. The primary goal of China's energy policymaking used to be ensuring "the availability of energy at all times in various forms, in sufficient quantities, and at affordable prices".<sup>2</sup> After China became a net oil importer in 1993, the government started to diversify its supplies for energy security reasons by promoting overseas upstream investments via its going-out strategy.<sup>3</sup> Energy transition started to become a more important policy agenda in the following two decades after the Chinese government gradually expanded the scope of energy security with new elements, particularly climate change and sustainable development.

Since Xi Jinping took office as the president of China in 2012, the country's energy transition policy has undergone rapid progression driven by multiple factors, including the Paris Agreement, domestic need for sustainable development and commitment to global climate governance. These major issues and crises have reshaped Chinese energy strategies with emerging elements, such as energy transition and supply chain security. Unlike China's traditional approach to energy security, acquiring energy resources abroad is no longer the sole objective of energy policymaking or cooperation. Instead, China's strategic focus has expanded from quantitative objectives (e.g. increasing the amount of oil imported) to qualitative objectives (e.g. upgrading the supply chain and sustainable development).<sup>4</sup>

Signing the Paris Agreement in 2016 boosted China's plan for energy transition with more robust climate agendas.<sup>5</sup> Since then, China has adopted multiple policies in terms of setting

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<sup>2</sup> International Energy Agency (IEA), *Energy Security*, 2019.

<sup>3</sup> G. Leung, "China's Energy Security: Perception and Reality", *Energy Policy*, vol. 39, no.3, 2011, pp. 1330-37.

<sup>4</sup> K. Yu, "The Geopolitics of Energy Cooperation in China's Belt and Road Initiative", *NBR Special Report*, no. 68, 2017, pp. 29-39.

<sup>5</sup> J. Ma, "Mission Possible: China's Climate Change Policy after the Paris Agreement", *L'Europe en Formation*, no. 380, 2016.

emissions reduction targets, piloting emissions trading schemes, and capping energy consumption. It has also introduced climate finance and a nationwide carbon market as a way to offset emissions. Strategic emerging industries are identified for investments to promote renewable energy development and clean tech innovations. During this period, Chinese regulators have conducted more frequent environmental and price investigations in carbon-intensive sectors as a way to curb steel production. Among them, industrial hubs from northern and south-eastern China faced higher regulatory pressure to decarbonise, improve energy efficiency, and reduce overcapacity.

China's cross-over between energy security and climate ambitions is also observed in the Belt and Road Initiative (BRI). The overall energy strategy under the BRI framework focuses not only on imports of resources but also on sustainable development.<sup>6</sup> On the one hand, transnational energy cooperation, especially the massive development of energy infrastructure and improved market access, remains an important means for China to achieve its energy security goals. Under the BRI, China signed a number of flagship energy agreements that significantly contributed to the country's energy security, including the Russia-China gas pipeline (Eastern route) in 2014, the Yamal LNG deal in 2017, and Arctic LNG 2 in 2019. On the other hand, Beijing has long claimed that the BRI will be green and efficient.

Since China signed the Paris Agreement in 2016, Chinese authorities have sought to accommodate climate finance and sustainable development under the framework of the BRI. According to the Vision and Actions on Energy Cooperation, BRI energy cooperation must "attach great importance to the issue of environmental protection in the process of energy development and strive to encourage the efficient development

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<sup>6</sup> PRC National Energy Administration (NEA), [Vision and Actions on Energy Cooperation in Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road](#), 2017.



and utilisation of clean energy”.<sup>7</sup> China claims that it “will strictly control the emission of pollutants and greenhouse gases, raise energy efficiency and contribute to green and efficient development in all countries that participate in the BRI”.<sup>8</sup> This statement implies that certain environmental conditions might be included in BRI energy investments. Institutionally, China seeks to promote clean energy and infrastructure investment via the Asian Infrastructure Investment Bank (AIIB).<sup>9</sup> An expansion in investment in renewable energy, such as solar power and power transmission lines, is expected to enhance connectivity and sustainable development in the region.

The year 2020 marked the period when the top Chinese leadership reaffirmed the country’s climate commitment with clearer targets and roadmaps. During a UN General Assembly meeting, President Xi outlined China’s aspiration to hit peak emissions before 2030 and become carbon neutral before 2060. A year later, China released a new decarbonisation framework – Action Plan for Carbon Dioxide Peaking Before 2030 – restating the country’s goals for 2025 and 2030.<sup>10</sup> Such declarations affirm China’s ambition to transition towards low-carbon development in its overall energy strategy. More importantly, China’s climate commitments have created strong political incentives for local governments to proactively implement low-carbon policies.

China continued to step up its climate efforts in 2021. In his speech at the UN General Assembly on September 21, 2021, Chinese President Xi Jinping pledged that China would not build new coal-fired power plants overseas and would step up support for other developing countries in developing green and

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<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> Oxfam, *The AIIB’s Energy Opportunity: How the Asian Infrastructure Investment Bank’s Energy Lending Can Chart a New Path of Sustainable Development*, 2017.

<sup>10</sup> National Development and Reform Commission People’s Republic of China (PRC NDRC), *Action Plan for Carbon Dioxide China*, 2021.

low-carbon energy.<sup>11</sup> During COP26 Glasgow in November 2021, China further called on developed countries to provide support to help developing countries do better in dealing with the climate crisis.<sup>12</sup> It also submitted an updated National Determined Contribution (NDC) to the United Nations with slightly more ambitious targets than previously, reaffirming Beijing's pledge to peak carbon emissions before 2030. However, its last-minute intervention, together with India, to weaken the language on fossil fuel in the Glasgow Climate Pact reflected the fact that the Chinese government will only adopt a conservative plan for energy transition, with a limited negative impact on its economy.<sup>13</sup> These all put China under the spotlight over whether it would be able to ensure domestic growth and advance decarbonisation in other developing countries amid international pressure for more emissions reduction.

However, it is important to note that the increasing environmental focus in China's energy policy does not mean that the Chinese leadership has departed from its traditional understanding of energy security. In 2020, in response to the Covid-19 pandemic and trade war, President Xi repeatedly highlighted supply security in government meetings and speeches.<sup>14</sup> In the same year, the National Energy Administration (NEA) issued a list of policy areas that it would focus on to ensure energy supplies in 2020, including power supply, grid networks, oil and gas infrastructure, and coal projects. The statement issued reflected the fact that, due to supply chain disruption during the pandemic and trade war, China had to prioritise the security of critical supply for growth and social stability, bringing back its initial outlook of self-reliance. Indeed,

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<sup>11</sup> United Nations, [China Headed Towards Carbon Neutrality by 2060; President Xi Jinping Vows to Halt New Coal Plants Abroad](#), UN News, 2021.

<sup>12</sup> E3G, [China's New NDC – E3G Responds](#), 2022.

<sup>13</sup> K. Mathiesen, "The Last Minute Coal Demand That Almost Sunk the Glasgow Climate Deal", *Politico*, 2021.

<sup>14</sup> J. Xi, "Certain Major Issues for Our National Medium- and Long-Term Economic and Social Development Strategy", *Qiusbi Journal*, 2020.

China's action plan for carbon reduction in 2021 reaffirmed that traditional energy security was the country's bottom line.

China's energy white paper in 2021 – *Energy in China's New Era* – adequately summarises China's energy and climate strategy for the decade.<sup>15</sup> The White Paper introduces a new energy security strategy centred around a conservative approach towards balancing environmental goals and development needs, achieving greater self-reliance, and creating a clean and diversified energy supply system. On the one hand, it confirms China's target of achieving carbon neutrality by 2060 and reiterates strong policy support for renewable energy. On the other hand, in pursuit of greater self-reliance, the strategy promotes domestic fossil fuel production and considers cleaner and more efficient utilisation of fossil fuels as part of China's "green development". It also indicates that non-fossil fuels, particularly renewable and nuclear energy, will play an increasingly crucial role in China's energy mix supply system, despite their current modest contribution.

## **Dilemma in China's Energy Transition and Four Structural Challenges**

Nowadays, the energy transition is unprecedentedly characterised by the need to accelerate addressing today's climate challenges, but this process takes "on different specificity depending on the country, energy source and timeframe".<sup>16</sup> In other words, energy transition is a permanent phenomenon in a world energy system that is continuously changing. Given strong path dependencies, countries, including China, will approach energy transition from a variety of starting points, pathways, and paces. Academic studies suggest that energy transition could be enabled and constrained by structural factors associated with socio-political,

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<sup>15</sup> PRC National Energy Agency (NEA), *Energy in China's New Era*, 2021.

<sup>16</sup> L. Chester, "Conceptualising Energy Security and Making Explicit its Polysemic Nature", *Energy Policy*, vol. 38, no. 2, 2010.

macroeconomic, and geopolitical factors.<sup>17</sup> A policy change in energy transition can occur when there is an abrupt change in external circumstances, such as geopolitical conflicts, severe supply insecurity, or an innovative breakthrough, which alters the mindset of policymakers, eventually leading to new policy goals and instruments.<sup>18</sup> Energy insecurity, such as extreme energy prices, power shortages, natural disasters, and supply disruptions, is seen as a crisis that could alter policymaking, including energy transition. This leads to the dilemma of energy security versus energy transition, in which a country could find it difficult to efficiently balance both.

Beijing's revisitation of the "self-reliance" priority during recent the crisis reflects the dilemma of energy transition that China has been facing. Despite increasing climate pressure, it has proven unrealistic for China to phase fossil fuels – especially coal, oil and gas – out of its energy structure altogether over the next decade. A key driver behind Beijing's bid to bolster energy security is its heavy dependence on energy imports, which represents a strategic vulnerability in a world characterised by rising geopolitical rivalries. In short, trapped by this dilemma, Beijing wants to boost domestic fossil fuel production in pursuit of "self-reliance" while simultaneously pursuing a gradual energy transition. In other words, the current energy security challenges that China faces do not merely entail domestic production and resource trade, but also the diversification of sources and transportation routes, as well as the structural contradictions arising from the need for a balance between economic growth and sustainable development. Over the last few decades, these challenges have been intensified by a series of

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<sup>17</sup> H. Singh, "The Energy Transitions Index: An Analytic Framework for Understanding the Evolving Global Energy System", *Energy Strategy Reviews*, vol. 26, 2019.

<sup>18</sup> P. Hall, "Policy Paradigms, Social Learning and the State: The Case of Economic Policymaking in Britain", *Comparative Politics*, vol. 25, 1993, pp. 275-97; D. Helm, "The new energy paradigm", in D. Helm (Ed.), *The New Energy Paradigm*, Oxford, Oxford University Press, 2007, p. 9.

risks, such as financial crises, oil price fluctuations, trade wars, the Covid-19 pandemic, and military conflicts.

To meet its commitment to the Paris Agreement as well as its pledges to peak emissions by around 2030, China would have to start speeding up its transition away from coal to cleaner energy sources. Chinese Greenhouse gas (GHG) emissions now exceed those of the entire developed world, and China's contribution is critical in restricting global warming to 1.5°C above pre-industrial levels by 2100. However, the emission targets set by China to reduce the use of coal appear unambitious. For example, Chinese official data showed that the share of coal in China's energy mix has been falling slightly from over 70% to below 60% over the last decade; it is still growing in absolute terms. Similarly, the NEA has set the target of cutting coal consumption to below 56% of primary energy consumption (for example, direct use of coal for domestic heating and manufacturing) in 2021, from 56.8% in 2020.<sup>19</sup>

Growing power demand in China has become an obstacle to phasing out coal in the power generation mix especially when the China Electricity Council is expecting a sharp uptick in electricity demand as soon as pandemic restrictions ease and the economy continues to recover. China is seeking a rapid economic recovery from the Covid-19 slowdown instead of the 'green-centred' recovery adopted by the EU. It is unlikely that renewable and nuclear power generation, which is growing at around 1% per year, will meet the increasing appetite in the next decade. Moreover, lower pollution levels during the Covid-19 shutdown have also seen a relaxation of air quality targets, further encouraging coal use. Therefore, although the share of coal in the electricity mix is falling, it is still growing in absolute terms to fill the gap.

It is estimated that China must close 600 coal plants by 2030 to have any chance of meeting its 2060 net zero target,

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<sup>19</sup> M. Xu, "China to Cut Coal Use Share Below 56% in 2021", *Reuters*, 22 April 2021.

replacing 364 GW of capacity with renewables.<sup>20</sup> However, to balance climate goals and development needs, China is expected to replace older and less efficient coal-fired power stations with newer and more efficient ones. Once these new fleets of coal-fired power stations come online, they will continue operating up to 2050 and will maintain coal consumption throughout their lifespan. The emission trading scheme, launched in early 2021 and covering the power sector, is seen as a key policy tool for achieving decarbonisation. However, it will take time to bed in, and in its current form, it could even encourage investment in large, modern coal-fired power plants.

There are four structural factors that make it difficult for China to eliminate its reliance on cheap coal resources. First, keeping global warming below 1.5 degrees could be a costly race against time for developing countries like China. Developed countries with stronger public and private sectors are more capable of bearing the higher economic costs of energy transition.<sup>21</sup> It is also easier for these countries to support the R&D of low-carbon technologies and compensate for the losses incurred by phasing out fossil fuel technologies. By contrast, the socio-economic cost of climate actions could be too high for developing countries like China, with pressing development challenges to support a stringent carbon policy.

Second, the pace of energy transition is highly sensitive to structural socio-economic factors, such as GDP growth, inflation, oil price trends, R&D budgets, unemployment, and poverty levels.<sup>22</sup> In particular, high oil prices would drive

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<sup>20</sup> F. Harvey, “China ‘Must Shut 600 Coal-Fired Plants’ to Hit Climate Target”, *Guardian*, 15 April 2021.

<sup>21</sup> J. Jewell and A. Cherp, “On the Political Feasibility of Climate Change Mitigation Pathways: Is It Too Late to Keep Warming Below 1.5°C?”, *WIREs Climate Change*, vol. 11, Issue 1, 2019.

<sup>22</sup> C. Tudor and R. Sova, “On the Impact of GDP per Capita, Carbon Intensity and Innovation for Renewable Energy Consumption: Worldwide Evidence”, *Energies*, vol. 14, 2021; S. Khanab, Y. Wang, and A. Zeeshan, “Impact of Poverty and Income Inequality on the Ecological Footprint in Asian Developing Economies: Assessment of Sustainable Development Goals”, *Energy Reports*,

more investment into the oil and gas sector, and hence away from renewables.<sup>23</sup> Moreover, developing countries like China have prioritised domestic development agendas, such as poverty eradication and economic growth, over speeding up the energy transition. Their economies are more vulnerable to the social impact of strict environmental regulations, such as unemployment caused by divestment from the oil and gas sector. As a result, China will likely take a slower but just transition path than developed countries.

Third, the promotion of the energy transition in China heavily depends on its institutional capacity. It is not a question of the political will to make a single climate pledge but rather the ability to introduce national environmental legislation that aligns with major multilateral climate agreements. The implementation of decarbonisation policies, such as the expansion of renewables and coal power phase-outs, requires a strong regulatory framework that ensures a transparent, stable investment context for low-carbon businesses. In other words, loose targets and policy goals could constrain the pace of the energy transition in China. Within a short period of time, China's top-down governance approach has boosted investment not only in renewables but also in coal.

Fourth, the promotion of energy transition relies on international climate cooperation or global climate governance, which cannot be unaffected by the overall geopolitical trends in which China faces increasing pressure.<sup>24</sup> Although more peaceful and interdependent big-power relations mostly favour climate cooperation, geopolitical tensions trigger strategic

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vol. 8, 2022.

<sup>23</sup> Renewable energy sector is considered to be more resilient and favourable for investment during low oil prices. See, McKinsey, [Lower Oil Prices But More Renewables: What's Going On?](#), 2015.

<sup>24</sup> M. Hafner and S. Tagliapietra, "The global energy transition: a review of the existing literature" in M. Hafner and S. Tagliapietra (Eds.), *The Geopolitics of the Global Energy Transition. Lecture Notes in Energy*, 2020.

confrontation, deprioritising the agenda of energy transitions.<sup>25</sup> Threats associated with big-power competition, US-China trade tensions, sanctions, potential military conflicts, and malicious control of supply chains since the Paris Agreement have destabilised the international environment for China to promote energy transition.

China's concern about these difficulties explains why it remains conservative in its climate talks. For example, on his trip to Tianjin in September 2021, US climate envoy John Kerry asked Chinese leaders, including Foreign Minister Wang Yi and China's climate envoy Xie Zhenhua, to accelerate its climate efforts and give up support for coal-fired power plants.<sup>26</sup> However, the Chinese side reportedly vowed to follow its own plan on climate matters rather than bowing to US pressure. China has made it clear that its decarbonisation timeline and strategy are very different (i.e. slower) from the West's, which it has no intention of following. China's attitude during the meeting also confirmed that coal would remain a key option in its energy mix in the short- to mid-term. The key difference is that China has planned a much more conservative approach towards balancing environmental goals and development needs by simultaneously supporting fossil fuels and non-fossil fuels.

## **Ukraine Crisis Intensifying China's Energy Transition Dilemma**

The Ukraine crisis is severely disrupting the global energy market and further intensifying the dilemma of energy security vs. energy transition. Energy insecurity has sped up the energy transition in the EU; however, it has also pushed China, as

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<sup>25</sup> Wilson Center, [Climate Change, Grand Strategy, and International Order](#), 2021.

<sup>26</sup> L. Kuo, "Kerry Calls on China to Do More to Tackle Climate Change Crisis as China Warns U.S. Pressure Will Derail Cooperation", *Washington Post*, 2 September 2021.



well as some Asian developing countries, to remain fossil fuel-dependent so as to ensure basic energy supplies. Although renewables opportunities in China remain robust, they have further solidified the role of coal in ensuring basic energy needs. China and the EU are now exposed to high energy security risks, but they have distinct agendas for their energy transition.

The EU considers renewable energy to be part of its energy security formula. In Asia, renewable energy is also an important source of energy supply, but it is not an immediate solution to the current situation.

Before the Ukraine crisis, China had already been calling for boosting energy security with fossil fuels due to ongoing disruptions from the pandemic and trade war. A power supply crisis due to aggressive (coal-fired) power rationing measures in 2021 revealed the dilemma embedded in China's green strategy. In August 2021, the National Development and Reform Commission (NDRC) asked 20 major Chinese cities and provinces to reduce energy consumption to meet their annual emission targets.<sup>27</sup> However, the move consequently cut electricity power to major industrial hubs in Jiangsu, Zhejiang, and Guangdong, accounting for almost one-third of China's economy. The power crisis in China interrupted the supply chain of multinational companies that relied on raw materials and electronics from China. Energy-intensive companies, such as steel mills, textile firms, and electronics components manufacturers in major industrial hubs, have reportedly been forced to close or halt activities. The crisis also resulted in sudden blackouts for households and interrupted public services, ranging from water supplies to hospitals. As a result, in September 2021, China's NEA asked coal companies to increase their output to ensure energy supplies for power generation and heating in the upcoming winter.

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<sup>27</sup> K. Yu, *Energy Transition Dilemma in the Context of the Ukraine Crisis*, Presentation at Energy Council, 7 June 2022.

The decision to have aggressive coal-fired power rationing measures was considered to be driven by a combination of tightening emission standards, rising electricity demand, and political pressure to ensure blue skies at the Winter Olympics in January 2022. The power supply shortage reflected the fact that renewables and nuclear power alone were not able to sustain China's electricity demand. More ironically, the crisis broke out shortly after President Xi gave his speech at the UN General Assembly on September 21, 2021, which highlighted China's effort to halt building new coal-fired power plants overseas. The dilemma in China's green strategy will likely remain unresolved over the next decade. While the power crisis will continue to push the government to speed up renewables expansion, it will also increase political pressure to ensure the energy security of fossil fuels, particularly coal.

The Ukraine war has only further deepened the Chinese leadership's concern about energy insecurity. For example, the top Chinese leadership has repeatedly reaffirmed the role of coal in ensuring a basic energy supply.<sup>28</sup> The People's Bank of China has increased special loans for the clean and efficient use of coal to RMB 300 billion, almost four times more than the financial support for renewables.<sup>29</sup> Despite Western pressure, China has continued to buy oil and gas from Russia, taking advantage of hugely discounted prices. China scaled back Russian coal purchases in March 2022 due to sanction concerns but resumed them shortly after. In March and April 2022, China doubled its imports of Russian coal and cut coal tariffs for 10 months to facilitate more imports.<sup>30</sup>

The global division of the pace of energy transition has resulted in new patterns of trade interdependence that would, in turn,

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<sup>28</sup> G. Collins, "China's Energy Nationalism Means Coal Is Sticking Around", *Foreign Policy*, 2022.

<sup>29</sup> PRC State Council, *China's Central Bank Steps Up Support for Clean, Efficient Coal Use*, 2022.

<sup>30</sup> M. Xu, "China April Coal Imports Soar, Driven by Panic Orders in Early March", *Reuters*, 9 May 2022.

further impact China's energy transition. Due to the global call for energy transition, major oil and gas producers, from Saudi Arabia to a sanctioned Russia, started to face declining oil and gas revenues as traditional buyers (e.g. European buyers) are divesting from carbon-intensive projects. These challenges have driven them to seek alternative buyers from emerging markets who are more flexible with using fossil fuels, such as China. The current energy transition dilemma has become a silver lining for these oil and gas producing countries, as the world is increasingly concerned with energy security. Demand from these regions allows major producers, such as Saudi Arabia, to continue their fossil exports and build a business cycle that uses revenue from gas to support decarbonisation. It even provides sanctioned Russia with a breathing space to partially buffer its market lost by re-directing its energy exports away from Europe. Due to the sanctions, Russia has already sped up its "Pivot to the East", shifting its commodity (oil, gas, and coal) exports to Asian importers who prioritise energy security and are less concerned by Western sanctions. Since many buyers are now unwilling or unable to import Russian commodities, the pool of buyers is becoming smaller, and they are also paying much lower prices compared to other suppliers. However, with more discounted imports, it is becoming even more difficult for China to get rid of its fossil fuel dependence in the future.

## **Widening Europe-China Division on Climate Actions in a Post-Ukraine Crisis World**

In the post-Ukraine crisis era, China will continue with a conservative climate strategy to meet both its carbon neutrality goal by 2060 and its pressing development needs. While China will step up its carbon reduction commitments gradually, it will be hard for it to resolve its energy transition dilemma and catch up with the pace of Europe's transition. Ambitious policy decisions to accelerate energy transition rely on a strong energy security foundation. Otherwise, inadequate preparation for a

smooth energy transition will only add to supply disruptions, especially in developing countries. While supply disruptions during the recent power crisis and Ukraine crisis underscore the importance of building a stronger renewable energy sector, they also show that the world still needs oil, gas, and coal to maintain energy security. Despite rapidly growing investment in renewables, China, like many other Asian developing countries, still relies on fossil fuels and is not ready to fill the gap with renewables. This is largely a result of a lack of advanced energy technology, such as energy storage and carbon capture (CCUS) technologies. Although wind and solar power production has soared in China over the last decade, they are still far from a reliable solution.

A successful Chinese energy transition requires support from governments in funding innovations of green technology, such as battery technology, energy efficiency, and CCUS, that could materially speed up the transition process. Battery storage solutions will likely make renewable assets more cost-competitive with fossil fuel sources, enhancing the adoption of renewables in China in the long term. However, since it is difficult for China to significantly reduce its high reliance on fossil fuels in the foreseeable future, efficiency and CCUS technologies are also particularly crucial to cleaning the country's carbon-intensive industries. In other words, the pace of China's energy transition will only accelerate without supply disruptions if there are major breakthroughs in clean tech innovation.

Given its natural advance of vast mineral deposits, China is expected to strengthen its influence over the global supply chain of critical minerals, which are crucial to the innovation of clean technology, such as EV batteries, motors, wind turbines, and energy-efficient lights. The Chinese government has identified "new materials" as one of the 10 strategic sectors in "Made in China 2025", an initiative aiming at reducing its economy's reliance on imported technologies and upgrading China's manufacturing capacity by 2025. China will continue to strengthen its leading role in the global supply chain of critical

minerals by a combination of nationalistic industrial policy, production and export restrictions, and overseas investment. In other words, China is eager to be the world factory of energy transition technology, supplying critical minerals and related products to countries, especially those (e.g. European countries) with plans to accelerate their energy transitions.

Other than industrial measures, China will also roll out more green instruments, such as emissions trade systems (ETS) and green bonds, that could help offset emissions without significantly impacting its economy, which heavily depends on fossil fuels. After a decade of preparation, China's national emission trade scheme officially entered operation in 2021<sup>31</sup> and was expected to roll out more green financial products. However, the effectiveness of these green instruments remains unclear. Despite being welcomed by a global audience, their implementation will likely be hindered by a number of structural obstacles, such as misreporting, constant policy changes, bureaucracy, and weak non-compliance punishment.

Rome was not built in a day, and there is no magic switch to the energy transition. China is not free from future energy crises of price volatility and supply shortages – a new normal in a world undergoing accelerated energy transition. China will have to continuously adjust its energy security approach and mitigate the costly disruption of the energy transition. As a result, China will continue to flip-flop between its decarbonisation and energy security policies in the foreseeable future. A China with stringent emission reduction policies would be more climate-resilient in the long run, but it could not avoid greater energy security risks in the short term. By contrast, if China continues to prioritise short-term energy security and the need to tackle energy poverty, delayed or conservative climate action will still expose it to higher disruption risks in the future, as sudden policy changes will become necessary. Without significant

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<sup>31</sup> L. Tan, “[The First Year Of China's National Carbon Market, Reviewed](#)”, *China Dialogue*, 2022.

technological breakthroughs, it would remain difficult for China to break this dilemma. As a result, the division between China and Europe on climate actions will only be further widened.

### **3. A New Non-Aligned Movement? China's Leadership of the Developing World**

Niall Duggan

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As a result of China's rise, its new model of development has become a model for development throughout the developing world. This has fuelled a new round of debates concerning the sustainability of transatlantic norms, ideas, and institutions that have dominated global governance. A key question of international affairs is the ascent of China and how that ascent of China affects the global governance system which manages the international economy. This chapter looks at China's self-described role as the "Champion of the Developing World" in global governance and uncovers how China's new development model affects China's current position within global governance. As several regions are attempting to adopt aspects of China's model, the success of China's development model represents a new force in defining the rules of the game through both traditional bodies of global governance and Chinese-constructed bodies of global governance.

The People's Republic of China (China) has long been considered reluctant to adopt a leadership role in global governance.<sup>1</sup> However, increasingly China is undertaking

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<sup>1</sup> N. Duggan, S. Wei, and J.C. Gottwald. "Global Governance with Chinese Characteristics?", in A. Triandafyllidou (Eds.), *Global Governance from Regional Perspectives a Critical View*, Oxford, Oxford University Press, 2017, pp. 161-80; J.C. Gottwald. "China's roles in international institutions: The case of global

a leadership role in global economic governance. Unlike the states that have driven global governance since 1945, which have been industrialised market-led economies and most liberal democracies, such as the US and UK, China is an emerging economy with a hybrid market (both centrally controlled and market-led) and a one-party Leninist political system. The rise of China, a self-identifying developing state, to a leadership position in global governance raises questions regarding China's role in the international system of the global economy.<sup>2</sup> How far will the Chinese model of development (the China Model) change the norms of global economic governance? This chapter will focus on understanding how China adapts its leadership role in global governances.

This chapter outlines the historical and contemporary origins of China's leadership in the developing world or its "Champion of the Developing World" role. The chapter outlines the long-held Chinese great power role, which became the socialist great

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economic governance", in S. Harnisch, S. Bersick, and J.C. Gottwald (Eds.), *China's International Roles Challenging or Supporting International Order?*, Abingdon, Routledge, 2015, pp. 127-44; J.C. Gottwald and N. Duggan, "Hesitant Adaptation: China's New Role in Global Policies", in S. Harnisch, C. Frank, and H.W. Maull (Eds.), *Role Theory in International Relations*, London-New York, Routledge, 2011, pp. 234-51; M. Huotari, "Finding a new role in the East Asian financial order: China's hesitant turn towards leadership", in S. Harnisch, S. Bersick, and J.C. Gottwald (Eds.) (2015), pp. 145-68. N. Duggan, S. Wei, and J.C. Gottwald. "Global Governance with Chinese Characteristics?", in A. Triandafyllidou (Eds.), *Global Governance from Regional Perspectives a Critical View*, Oxford, Oxford University Press, 2017, pp. 161-80; J.C. Gottwald. "China's roles in international institutions: The case of global economic governance", in S. Harnisch, S. Bersick, and J.C. Gottwald (Eds.), *China's International Roles Challenging or Supporting International Order?*, Abingdon, Routledge, 2015, pp. 127-44; J.C. Gottwald and N. Duggan, "Hesitant Adaptation: China's New Role in Global Policies", in S. Harnisch, C. Frank, and H.W. Maull (Eds.), *Role Theory in International Relations*, London-New York, Routledge, 2011, pp. 234-51; M. Huotari, "Finding a new role in the East Asian financial order: China's hesitant turn towards leadership", in S. Harnisch, S. Bersick, and J.C. Gottwald (Eds.) (2015), pp. 145-68.

<sup>2</sup> "China must adhere to the Historical Orientation of 'developing countries'", *Xinhua*, 29 March 2010. "China must adhere to the Historical Orientation of 'developing countries'", *Xinhua*, 29 March 2010.



power role during the early period of the People's Republic, and its developing great power role, which emerged after the Sino-Soviet split that led to the role of "Champion of the Developing World". The chapter then outlines how this new role shapes China's current position within global governance. The chapter will focus on China's presence in traditional global governance institutions, such as the G20, the IMF, and the World Bank, which were mainly built on Western norms, and then focus on China in new institutions such as the New Development Bank (NDB), developed with BRICS, and the Asian Infrastructure Investment Bank (AIIB), a Chinese-led body. This chapter concludes by outlining an understanding of why China undertakes actions within global governance to promote its position as the leader of the developing world.

## **China's Emergence as the Champion of the Developing World**

Since the creation of the People's Republic of China in 1949, the developing / Third World has played a central role in Chinese foreign policy, and China has self-identified as a member of this bloc.<sup>3</sup> How does this identity affect China's behaviour in international affairs and its foreign policy actions is a key question to understand China's role in international politics.

Many Western scholars pointed to the tributary system of the late Ming dynasties as an example of Chinese leadership in interstate affairs. However, scholars such as Nianshen Song<sup>4</sup>

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<sup>3</sup> L.C. Harris and R.L. Worden, "Introduction: China's Third World Role", in L.C. Harris and R.L. Worden (Eds.), *China and the Third World: Champion or Challenger*, Santa Barbara, CA, Praeger, 1986, pp. 1-11; N. Duggan, "China - The Champion of the Developing World: A Study of China's new Development Model and its Role in Changing Global Economic Governance", *Politics & Policy*, vol. 48, no. 5, 2020a, pp. 836-58; N. Duggan, "China's changing role in its all-weather friendship with Africa", in S. Harnisch, S. Bersick and J.C. Gottwald (Eds.) (2015), pp. 207-25.

<sup>4</sup> S. Nianshen, "Tributary' from a Multilateral and Multilayered Perspective", *The*

have highlighted that the tributary system of the late Ming dynasties was far more than an interstate system: it was a multilateral and multi-layered system of international relations which cut across politics, economies and science. This system still has an effect on China foreign policy action today. The conception of China within the tributary system positions China at the centre of a complex, multilevel power nexus and has a profound effect on China's ontological understanding of its role within international relations, placing it as a central power or "civilization-state".<sup>5</sup> The concept of China as a central power can be seen in Chinese foreign policy documents, including *China's Peaceful Development* (2011), *China's Foreign Aid* (2014) and *China and the World in the New Era* (2019).

The period of semi-colonisation of China by Western powers (1839-1949), known as the "century of humiliation", has a modern influence on China's identity.<sup>6</sup> This period contributed to the fall of the Qing Empire and the rise to power of the Chinese Communist Party. The narrative of the century of humiliation based on an anti-imperialist and pro-developing state created a socialist great power role and then a developing-state great power role for China in international relations.<sup>7</sup> This role included developing a foreign and domestic policy which focused on themes such as anticolonialism, North-South economic injustice, and South-South Cooperation which were informed by Marx's writings on the integration of global capital markets. Once the Sino-Soviet split had taken place, China's Third World policy took centre stage in China's foreign policy.<sup>8</sup> While China

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*Chinese Journal of International Politics*, vol. 5 no. 2, 2012, pp. 155-82.

<sup>5</sup> L. Pye, "China: Erratic State, Frustrated Society", *Foreign Affairs*, vol. 69, no. 4, 1990, pp. 56-74.

<sup>6</sup> N. Duggan, "A New Chinese National Identity: The Role of Nationalism in Chinese Foreign Policy", in L. Zhouxiang (Eds.), *Chinese National Identity in the Age of Globalisation*, Singapore, Palgrave Macmillan, 2020b, pp. 161-82.

<sup>7</sup> Duggan (2015).

<sup>8</sup> S.A. Smith, "China's Third World Policy as a Counterpoint to the First and Second Worlds", in L.C. Harris and R.L. Worden, *China and the Third World: Champion or Challenger*, Santa Barbara, CA, Praeger, 1986, p. 53.

adopted the socialist great power role in its Third World foreign policy, the Sino-Soviet split required China to create a new role to differentiate itself from both the USSR and the West. This new role was the developing-state great power role.

In order to support developing countries, “Chinese efforts focused on weakening the superpowers (the two sole members of the First World) by encouraging greater independence on the part of their respective European allies and supporting the demands of the Third World for a New International Economic Order”.<sup>9</sup> China’s isolation after the foundation of the Peoples Republic of China limited China’s search for allies. Anticolonialism rather than socialism was a *cause commune* with developing countries which allowed China to find allies.<sup>10</sup> The colonial question, which concerned the peoples of Africa and Asia that convened in Bandung (Indonesia) in 1955, accelerated China’s involvement with the developing world, laying the foundation for South-South Cooperation.<sup>11</sup> This was China’s attempt to shed its historical victimhood during the century of humiliation through the promotion of decolonisation. Through these foreign policy actions China became a leading actor for the developing world in a Western-dominated global system.<sup>12</sup> In turn China looked to the developing world as a source of support in global politics, most famously looking to the developing world for support to replace the Republic of China as the Chinese representative on the United Nations Security Council.

China “modified, but did not fundamentally alter, the structure of China’s international roles after 1989”, and China continued to play the role of Champion of the Third World.<sup>13</sup>

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<sup>9</sup> C.L. Hamrin, “Domestic Components and China’s Evolving Three Worlds Theory”, in L.C. Harris and R.L. Worden (Eds.) (1986), p. 41.

<sup>10</sup> Ibid.

<sup>11</sup> N. Choucri, “The Nonalignment of Afro-Asian States: Policy Perception, and Behaviour”, *Canadian Journal of Political Science*, vol. 2, no. 1, 1969, pp. 1-17.

<sup>12</sup> Duggan (2020a)

<sup>13</sup> O. Beylerian and C. Canivet, “China: Role Conceptions after the Cold War”, in

By the end of the Cold War and despite the collapse of the Soviet Union, China continued to self-identify as a Third World country and as a Champion of the Third World but did reduce its leadership of the world socialist revolution.<sup>14</sup>

As the Cold War came to an end China's relationship with the West was badly damaged by the Tiananmen Square massacre in 1989. Support of China by the developing world during China's relative international isolation following the Tiananmen Square massacre in 1989 helped to refocus China's foreign policy on the developing world throughout the 1990s. China's policy throughout the 1990s highlighted the non-universality of the liberal democratic model, revived the spirit of Bandung between China and the developing world and outlined the shared history between China and developing states of victimhood of the Western colonial process. These policies demonstrate that China conceives itself and the developing world as victims, implying that the international community should right historical wrongs.

By promoting stronger rights for developing countries, China thus continues to perform the same leadership role which it played in the Cold War. As Zhang Jun, the permanent representative of China to the United Nations, asserted, "China is still 100 percent a developing country".<sup>15</sup> Therefore, China continues to see the developing world as a source of support in international affairs.

In China's developing-state great power role, China undertook foreign policies which created a narrative which framed China both as a developing state and as a powerful state

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P.G. Le Prestre (Ed.), *Role Quests in the Post-Cold War Era*, Quebec City, McGill-Queens University Press, 1997, p. 221.

<sup>14</sup> O. Beylerian and C. Canivet (1997), p. 189; L.C. Harris and R.L. Worden (1986), p. 5; H. Harding, "China's Changing Roles in the Contemporary World", in H. Harding (Ed.), *China's Foreign Relations in the 1980s*, New Haven, Yale University Press, 1984, pp. 177-223; R.L. Worden, "International Organizations: China's Third World Policy in Practice", in L.C. Harris and R.L. Worden (Eds.) (1986), pp. 75-95.

<sup>15</sup> Hong Xiao, "UN envoy backs developing nations", *China Daily*, 31 July 2019.

that used its position to protect itself and other developing states. These roles have created both domestic and external role expectations that China will continue to champion the position of developing states.<sup>16</sup> If this is the case, then Chinese routinised foreign policy actions in global governance should reflect this expectation. Therefore, routinised foreign policy actions in global governance that maintain China's role of champion or leader of the developing world should be clear in global governance bodies as well as Chinese-centred bodies that aim to become part of the global governance system as well as China-centred multilateral regional forums.

### **China's Role as a Leader of the Developing World in Global Governance Bodies**

China is now playing a key role in the Western-constructed traditional global governance system.<sup>17</sup> Since the early 1990s, China has used its position to represent developing countries and their development agendas in the traditional global governance system.<sup>18</sup> China has actively transferred knowledge of its own model of development to the global governance system, focusing on areas such as agriculture, trade development, disaster prevention and relief, finance, industrial development, and social and public management. In line with its role as Champion of the Developing World, within global governance China is also the driving force for agenda change

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<sup>16</sup> Duggan, (2020a); Duggan (2015), pp. 207-25.

<sup>17</sup> N. Duggan and J.C.L. Azalia, "From Yekaterinburg to Brasilia: BRICS and the G20, road to nowhere?", *Revista Brasileira de Política Internacional*, vol. 63, no. 1, 2020, pp. 1-18, N. Duggan and Y. Tiberghien, "Existing and Emerging Powers in the G20: The Case of East Asia", *Asien*, vol. 128, 2013, pp. 28-44; M. Huotari (2015).

<sup>18</sup> S.S. Kim, "International organizations in Chinese foreign policy", *Annals of the American Academy of Political and Social Science, China's Foreign Relations*, vol. 519 no. 1, 1992, p. 143.

within these bodies.<sup>19</sup> This can be seen in China's routinised foreign policy actions in such bodies as the G20, the IMF, and the World Bank.<sup>20</sup> Within these bodies China has driven changes in the global governance agenda to increase focus on and consideration of development issues.<sup>21</sup>

The G20 marks a shift in the global balance of power away from Western powers and toward emerging economies.<sup>22</sup> China has been an active member of the G20 since 1999 and has used the G20 to push for reforms of the international financial architecture.<sup>23</sup> China has used the G20 to push for reforms which have a greater effect on developing states such as energy and food security and climate change.<sup>24</sup> A clear example of this is Chinese pressure within the G20 to increase the focus on the food security of the developing nations has already created some reforms within global food security governance.<sup>25</sup> Focusing on the least-developed countries at the G20 meeting in 2011, Hu Jintao called for tariff-free and quota-free treatment for the least-developed countries as well as increasing food security globally.<sup>26</sup> Development issues highlighted by China in the G20 are framed within the narrative of South-South Cooperation.<sup>27</sup> However, despite the strong role that China plays in world economic trade, its position within the

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<sup>19</sup> Duggan, (2020a).

<sup>20</sup> Duggan and Azalia (2020); N. Duggan, "The Rise of China Within Global Governance", in B. Dessein (Eds.), *Interpreting China as a Regional and Global Power Nationalism and Historical Consciousness in World Politics*, Basingstoke, Palgrave Macmillan, 2014, pp. 249-70.

<sup>21</sup> Duggan and Azalia (2020); N. Duggan and T. Naarajärvi, "China in Global Food Security Governance", *Journal of Contemporary China*, vol. 24, no. 95, 2015, pp 943-60.

<sup>22</sup> Duggan and Tiberghien (2013).

<sup>23</sup> "Chinese FM says China plays unique, important role at G20 summit", *Xinhua*, 20 June 2012.

<sup>24</sup> J.J. Kirton, *China's G20 Leadership*, New York, Routledge, 2019.

<sup>25</sup> Duggan and Naarajärvi (2015).

<sup>26</sup> *Ibid.*

<sup>27</sup> *Xinhua* (2012).

institutions that form global economic governance is relatively weak. China has therefore attempted to use the G20 to push reforms and restructuring of global financial governance and global economic governance.<sup>28</sup>

Focusing on the IMF and World Bank, China has also called for reforms of the key institutions that govern global financial trade. While Beijing replaced the Republic of China in the IMF in 1980, it did not become a proactive member pushing for reforms until 2007. Since then China has sought to reform the IMF to reshape it to reflect the contemporary structure of the global economy to give greater representation to developing states.<sup>29</sup> Despite being the world's second-largest economy, China is underrepresented in the IMF. Since 2008 China has pushed to increase its voting share and the voting share for other developing states. In 2009, the IMF agreed to restructure its voting system in order to give emerging economies a greater say within the institution. The IMF agreed to introduce this reform in 2010. Under the current IMF voting system, China has 6.08% of the overall voting quotas. By comparison, Japan has 6.14%, and the US has 16.50%.<sup>30</sup> This is a small change considering that in 2008 China had 4% of the voting share in the IMF voting system, compared to Japan's 6.56%, and the US's 17.69% at the time.<sup>31</sup> While China has been reluctant to assume greater responsibility in pushing for reforms backed by developing states, China has been successful in improving its own position in the IMF, in the voting system of the IMF, but it still does not reflect the importance of China or that of the wider developing world.

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<sup>28</sup> L. Hongsong, "Political Opportunities and China's Proposing Behavior in the G20", *Chinese Journal of International Review*, vol. 1, no. 1, 2019, p. 1850002.

<sup>29</sup> International Monetary Fund, "IMF Members' Quotas and Voting Power, and IMF Board of Governors".

<sup>30</sup> International Monetary Fund (IMF), "IMF Members' Quotas and Voting Power, and IMF Board of Governors", 2022.

<sup>31</sup> Duggan (2020a).

China has actively called for reform of global economic governance with the World Bank often being a key focus. Focusing in part on the World Bank, Zhou Xiaochuan, then governor of the People's Bank of China, stated that "The [2008 financial] crisis called again for creative reform of the existing international monetary system".<sup>32</sup> In 2010 at the G20 summit in Pittsburgh, China used its position in the G20 to push for reforms in the voting structure of the World Bank to increase the voting power of developing countries.<sup>33</sup> In 2012 World Bank member states reached an agreement on a 3.13% shift in voting power to give emerging and developing nations greater influence in the World Bank. The result of this was an increase in the votes of the developing world to 47.19%, from 44.06%. China's own voting power increased in the World Bank, rising from 2.78% to 4.42%, which has given China the third-largest voting power after the US and Japan.<sup>34</sup> While China did increase its voting power in the World Bank, it was unable or unwilling to use the Bank promote its own model of development.<sup>35</sup>

In both the case of the IMF and the World Bank, China has attempted to create a greater balance of voting power between developing and developed countries within these institutions. In undertaking this role Chinese foreign policy has gone beyond its traditional role of scepticism toward global governance. In accordance with China's role of leader of the developing world, China has become a driving force in reforming the World Bank and the IMF through the G20 to give a greater voice to developing states. However, China has not used these Western bodies of global governance to promote its own model of

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<sup>32</sup> Q. Wang, "G20 must look beyond the needs of the Top 20", *The Times*, 27 March 2009.

<sup>33</sup> "China urges IMF to accelerate quota adjustment", *Xinhua*, 25 April 2010a.

<sup>34</sup> "Chinese minister: World Bank reform benefits world development", *Xinhua*, 26 April 2010b; "China's voting power in World Bank ascends to third place", *Xinhua*, 26 April 2010c.

<sup>35</sup> Li H., "The Chinese Model of Development and Its Implications", *World Journal of Social Science Research*, vol. 2, no. 2, 2015, pp 128-38.



development but rather it has tried to increase the focus on development issues in the bodies which make up the current system of global governance.

## **Chinese Centric Global Governance Bodies and Multilateral Regional Forums**

Since the 1960s China has played a key role as an alternative source of development aid and assistance for developing states. However, it was not until the 1990s that China began to develop an alternative model and system of development, but without an alternative structure to support the development of this model in other states.<sup>36</sup> To develop this structure China first used its bilateral relations with developing countries before developing a network of Beijing-centred multilateral regional forums and finally developing non-Western-constructed, often Chinese-centred, global governance bodies. In doing so China once more presents itself as the champion/leader of the developing states.

In 2019 Foreign Minister Wang Yi outlined that cooperation with developing countries is a firm strategic priority in China's diplomacy.<sup>37</sup> As part of this foreign policy strategy China has developed both Chinese constructed global governance bodies and Chinese-centred multilateral regional forums. Both these developments are part of a long line of China's multilateral charm offensives in the developing world, going back to the mid-1990s.<sup>38</sup>

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<sup>36</sup> D. Brautigam, *Chinese Aid and African Development: Exporting Green Revolution*, London, Macmillan, 1998.

<sup>37</sup> D. Cao, "Xi calls for expansion of global partnerships", *China Daily*, 9 September 2019.

<sup>38</sup> I. Sohn, "After renaissance: China's multilateral offensive in the developing world", *European Journal of International Relations*, vol. 18, no. 1, 2011, pp. 77-101; L. Dittmer and G. Yu, *China, the Developing World, and the New Global Dynamic*, Boulder, CO. Lynne Rienner, 2010.

China has developed multilateral regional forums with developing states in regions such as the Middle East, Oceania, Africa, and Latin America and the Caribbean. These forums have included promoting political relations on the basis of mutual respect and forging closer trade and economic links so as to achieve common development.<sup>39</sup> The role of China as a leader in development has shaped the foundation of these forums which promote the shared history of anticolonialism and engagements based on the principle of South-South Cooperation.<sup>40</sup> These principles promote expanding cultural exchange through drawing on one another's experiences and strengthening cooperation in international affairs to promote common development.<sup>41</sup>

In 2004, China established the China-Arab Nations Cooperation Forum (CAFC) for cooperation with the Middle East and North Africa.<sup>42</sup> Wang Yi noted that this forum intended to “step up coordination and collaboration in regional and international affairs, [and] turn the balance of power in favour of developing countries”.<sup>43</sup> In Latin America, China has created new multilateral forums to work as a consultation mechanism between China and the existing regional and sub-regional bodies in Latin America, such as the Andean Community, the Rio Group, and MERCOSUR.<sup>44</sup> Beyond this China has also created new forums in Latin America, such as the Forum of China and the Community of Latin American and Caribbean States (CELAC), established in 2011. Within the wider region

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<sup>39</sup> Duggan (2020a).

<sup>40</sup> The State Council, The People's Republic of China, *Full Text: China and the World in the New Era*, 27 September 2019.

<sup>41</sup> Duggan (2020a).

<sup>42</sup> Ministry of Foreign Affairs of the People's Republic of China, [Action Plan of the China-Arab Cooperation Forum \(2008-2010\)](#), 2008.

<sup>43</sup> S. Tiezzi, “China Seeks Expanded Role in Middle East”, *The diplomat*, 4 June 2014.

<sup>44</sup> G. Strüver, “Bereft of Friends? China's Rise and Search for Political Partners in South America”, *The Chinese Journal of International Politics*, vol. 7 no 1. 2014. pp. 117-51.

China also established the China-Caribbean Economic and Trade Cooperation Forum in 2004. These bodies created by China were designed to support the development of trade and investment, the transfer of knowledge, and the opportunity to offer mutual support between China and the Caribbean and China and Latin America in international affairs.<sup>45</sup> China has also developed strong links with Oceania, creating forums that focus on the development goals of the Pacific Islands.<sup>46</sup> In 2006 China set up the China–Pacific Island Countries Economic Development and Cooperation Forum. This forum was designed on the basis of cooperation between developing states in international and regional affairs.<sup>47</sup> The forum also allowed China to determine the development agenda in a region which will be critically affected by the climate change crisis.

These forums in Latin America and the Caribbean, the Middle East, and Oceania have been used for the successful promotion by China of its model of development. However, by far the most successful Chinese-centred regional forum to promote the Chinese model and reinforce the Chinese role as the leader of the developing world has been the Forum on China-Africa Cooperation (FOCAC). FOCAC is the most developed Chinese forum in terms of encouraging states to adopt the China Model as well as reinforcing the Chinese self-identity as leader of the developing world. The first ministerial meetings held in Beijing in 2000 were made up of more than 80 ministers from more than 40 African countries, as well as representatives of nearly 20 international organisations and African regional organisations. This forum therefore was a

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<sup>45</sup> Duggan (2020a).

<sup>46</sup> K. Hannan and S. Firth, "Trading with the Dragon: Chinese trade, investment and development assistance in the Pacific Islands", *Journal of Contemporary China*, vol. 24, no. 95, 2015, pp 865-82.

<sup>47</sup> Ministry of Commerce of the People's Republic of China, [Address of Wang Yang at the 2nd China-Pacific Island Countries Economic Development and Cooperation Forum and the Opening Ceremony of 2013 China International Show on Green Innovative Products & Technologies \(Full Text\)](#), 12 November 2013.

step beyond the other Chinese forums as China attempted to link this forum to the wider structure of global governance. The 2010 forum resulted in the Beijing Declaration and a Program for China-Africa Cooperation in Economic and Social Development. In 2005, FOCAC was upgraded to a “Summit Meeting of Chinese and African Leaders”. At each following summit, China and African countries have agreed to advance a “new type of strategic partnership”, expanding their cooperation in the United Nations, the World Trade Organization, and other international and regional organisations.<sup>48</sup>

These China-centred multilateral regional forums are Beijing’s efforts to create and expand multi-layered transnational government networks that offer China an alternative network to direct the agenda of international politics.<sup>49</sup> These forums allow China to build a foundation of support among developing states in international affairs – this is both in Western-constructed international organisations where China can promote common development among developing states, increasingly based on the China Model of development, and also in Chinese constructed bodies which are now active in global governance.

Since the beginning of the Chinese reform period China has had a history of cooperation with UN development bodies and other development banks and agencies. This includes cooperation with such bodies as the OECD’s Development Assistance Committee (DAC) via the China-DAC study group, as well as with international aid agencies. However, China has been reluctant to participate in established donor-led groups such as the Paris Club.<sup>50</sup> This is due to a fundamental difference between Chinese and Western views of the model of

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<sup>48</sup> FOCAC, [Forum on China-Africa Cooperation Beijing Action Plan \(2019-2021\)](#), 2018.

<sup>49</sup> Duggan (2020a).

<sup>50</sup> N. Duggan, J.C.L. Azalia, and M. Rewizorski, “The structural power of the BRICS (Brazil, Russia, India, China and South Africa) in multilateral development finance: A case study of the New Development Bank”, *International Political Science Review*, 14 October 2021.

development that emerging/low-income states should follow. The main area of dispute is the Chinese focus on infrastructure and productive activities compared to the Western focus on social development.<sup>51</sup>

Due to this fundamental difference between China and the West, China has turned to creating its own international institutions either by itself, such as the AIIB, or with other developing states, such as the NDB.

Established in 2015 with 57 members the AIIB as of 2022 has 105 members. The Bank was designed to be a new source of financing for infrastructure in Asia. At the core of the development of this Bank was a “developing countries first agenda”.<sup>52</sup> While the AIIB has developed some levels of cooperation with the World Bank and other multilateral developments banks the difference in position on a model of development has limited the scope of cooperation with these bodies. In line with China’s role as champion or leader of the developing world, China strengthened its assistance in infrastructure construction and production capacity building for developing countries. Through the AIIB China has also increased its supports for developing countries by providing training for their economic and trade professionals as well as promoting trade development of these countries in line with the principles of South-South Cooperation.

China has also looked to cooperate with other emerging economies to develop international institutions as alternatives to Western-created institutions. At the BRICS Summit in 2014, President Xi incorporated China’s cooperation in BRICS into China’s conception of its traditional role as a representative of the developing world.<sup>53</sup> China pushes for

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<sup>51</sup> Ibid.; Z. Suisheng, “Whither the China Model: revisiting the debate”, *Journal of Contemporary China*, vol. 26, no. 103, 2017, pp. 1-17.

<sup>52</sup> H. Meibo, Na C., and Yanhong C., “An Analysis on the Potential Competitiveness of the Asian Infrastructure Investment Bank”, *Asia-Pacific Development Journal*, vol. 23, no. 2, 2016, pp. 19-34.

<sup>53</sup> Duggan and Azalia (2020).

BRICS to play a greater role in the global economy as well as supporting developing states in global economic governance. Within this push to ensure that each and every country enjoys equal opportunities in the global economy there would be a requirement to improve the position of the developing world within the global economy.<sup>54</sup>

The establishment of the NDB in 2015 by BRICS is considered a major breakthrough for a proactive role of BRICS in the reform of global governance, and this is done under the leadership of China.<sup>55</sup> China presented the establishment of the NDB as a major step in turning global affairs into something fairer and more equal, thereby indirectly criticising the existing structure as unfair.<sup>56</sup> Strengthening cooperation with BRICS and attempting to use the NDB to reform the global order fits within the Chinese role of champion or leader of the developing world. China's actions in constructing new global governance bodies, which promote a new model of development, a Chinese model of development, through the NDB, shows Chinese leadership among developing countries. By seeking collective action through BRICS China took a more visible, proactive leadership role among developing states in global governance. China's actions in developing the AIIB is a clear example of China developing its own international institution to support its leadership role, as is more clearly seen in the Chinese created multilateral regional forums.

## **Conclusion**

There are both domestic and international expectations which shape Chinese foreign policy but it is also true that Chinese foreign policy is shaped by the old and new role that China has played in global affairs. The Chinese government must

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<sup>54</sup> Duggan, Azalia, and Rewizorski (2021).

<sup>55</sup> Duggan and Azalia, (2020).

<sup>56</sup> Duggan (2020a).

accommodate these roles in its foreign policy actions. The promotion of the Chinese model of development in global governance is a clear example of Chinese foreign policy meeting both these domestic and global expectations (both old and new). These expectations have pushed China toward a focused leadership role in global affairs where its routinised foreign policy actions promote the position of developing states in global governance.

China's routinised foreign policy actions in global governance are in line with the role of "Champion of the Developing World", which is anti-imperialist and pro-developing states. These roles can be linked back to its role as a socialist great power and a developing-state great power during the Cold War. As a result of this role as the leader of the developing world, China undertakes routinised foreign policy actions in order to underwrite its notion of "self", allowing China to maintain a historical narrative which meets both domestic and global expectations of China as a developing state and as a great power. This routinised foreign policy has included creating an alternative model of development and the institutional need to support it. The development of a network of China-centred multilateral regional forums, its pro-developing states position in bodies and its construction of non-Western bodies that promote the Chinese model of development are clear examples of China's routinised foreign policy actions to support or underwrite this Chinese leadership role of the developing world.

Chinese investment in its routinised foreign policy to maintain the narrative of a leader of the developing world comes at a cost both in terms of a material cost and opportunity cost. In terms of studying the role of China in global governance it is clear that China not only wishes to replace the United States as the leader within the current international system but also wishes to reshape the system itself.<sup>57</sup> This is clear from the

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<sup>57</sup> Duggan (2020a).

fact that China has created new bodies outside the control of the United States and has increased its voting power within Western-created global governance bodies.

China has had limited success in reshaping the current international system. What success China has had has come from the support of the developing world. China has achieved this support by acting as the leader for the developing world in global governance. China has done this by positioning itself as a developing state with a shared history of victimhood at the hands of Western colonial powers, and by challenging the unfair structure of global governance. As China has played this role, it has created an external expectation from developing countries that China will act to promote the rights of the developing world. These expectations, together with China's historical role as an anti-imperialism power, have led to a domestic expectation that China would defend the rights of developing nations in global affairs. Therefore, China's routinised foreign policy in global governance must be understood in the context of China's historical role as it is a key consideration in shaping China's foreign policy, particularly in the area of norm setting within global governance.



## 4. Fading or Staying? China's International Standing After the Ukraine Invasion

Brian G. Carlson

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Russia's war in Ukraine holds important implications for China's international standing, its economic and security relationships, and its approach to great-power competition. China's rivalry with the United States, which has intensified in recent years, was already set to become the defining feature of the international system in the coming decades. The war in Ukraine, however, is likely to have a major impact on how this rivalry develops. It could have the effect of accelerating the onset of bipolarity and the consolidation of two rival blocs, with the United States and its allies and partners on one side and China on the other, with Russia as its main partner.<sup>1</sup>

At the time of writing in mid-September, the war in Ukraine continued on its unpredictable course. A rapid advance by Ukrainian forces in the country's northeast and the regaining of large swaths of territory that Russian forces had occupied for months raised hopes that Ukraine could achieve a relatively favorable outcome or even an outright victory. At the same time, the extent to which the Ukrainian military would be able to push Russian forces out of Ukraine's territory remained in question, given Russian President Vladimir Putin's determination to

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<sup>1</sup> B.G. Carlson, "China-Russia Relations and Asian Security", in B.G. Carlson and O. Thränert (Eds.), *Strategic Trends 2022: Key Developments in Global Affairs*, Zürich, Center for Security Studies, ETH Zürich, 2022, pp. 11-41.

press forward with his aims. Putin issued threats of escalation, including the possible use of tactical nuclear weapons, and stood prepared to wield the energy weapon against Europe as the winter approached. A protracted conflict without a settlement appeared to remain a distinct possibility.

The war in Ukraine could play a role in the US-China rivalry analogous to the role that the Korean War played in the US-Soviet Cold War. As in the case of the Korean War, the war in Ukraine could help to consolidate a geopolitical divide between the United States and its allies and partners on the one side and a Beijing-Moscow axis on the other. China's reaffirmations of support for Russia as its strategic partner throughout the war have further soured European views of China, which had already grown increasingly negative in recent years. The war has promoted transatlantic unity, not only in opposing Russia, but also in devoting increased attention to the challenges that China poses. The United States and China have taken some limited steps toward economic decoupling. The war in Ukraine is likely to weaken Russia significantly, both economically and militarily, leaving the country increasingly dependent on China.<sup>2</sup> All of these trends have major implications for China's international standing and for the foreign policy course that Chinese President Xi Jinping is likely to pursue if, as expected, he wins support for his third term in office at the 20th Party Congress scheduled for fall 2022.

## **China's View of Russia's War in Ukraine**

On February 4, 2022, Putin and Xi met in Beijing and issued a joint declaration asserting that their two countries' friendship had "no limits." Despite this claim, China appeared at least somewhat surprised by Russia's full-scale invasion of Ukraine less than three weeks later on February 24. China has refused to condemn Russia for the war, abstaining from votes in the UN Security

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<sup>2</sup> J.I. Bekkevold, "Ukraine Is the Korean War Redux", *Foreign Policy*, 28 June 2022.

Council and General Assembly censuring the Russian invasion. China has endorsed Russia's position that Western policies, particularly NATO expansion, provoked the crisis. China also criticized the imposition of sanctions on Russia. At the same time, China declined to endorse Russia's war. It refrained from providing Russia with weapons or helping it to evade sanctions, actions that could have subjected China to secondary sanctions or other penalties by the West. In sum, China declined to provide Russia with material support for its war effort, but neither was it willing to heed Western calls to rein in Russia.

Chinese leaders continued to regard Russia as an important partner in challenging the United States and the existing international order. They believed that their close partnership with Russia gave them a favorable position in the US-Russia-China triangle. They saw little benefit in helping the United States to combat Russia, especially as China's own rivalry with the United States intensified. From China's standpoint, the worst outcome of the war in Ukraine would be a total Russian defeat resulting in the collapse of Putin's regime and its replacement by a new government with a less friendly view of China. A scenario in which Putin, backed into a corner by military failures in Ukraine, might resort to the use of chemical or nuclear weapons would also carry major risks for China's international reputation.<sup>3</sup>

The developing international situation holds both downsides and opportunities for China. Among the downsides are the potential for harm to China's international reputation, the intensification of great-power competition, and risks to China's economic and security interests. Following an initial period of confusion in the immediate aftermath of Russia's invasion of Ukraine, however, China's leaders began to perceive opportunities in the current situation as well. The outlines of their approach to the new situation are becoming visible.

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<sup>3</sup> B.G. Carlson, "Russia's War in Ukraine: China's Calculus", CSS Analyses in Security Policy, no. 303, May 2022.

## Downsides for China

Russia's war in Ukraine threatened to impose significant reputational costs on China. In recent years, China's international image has already suffered in response to many of its actions, including repression and human rights abuses domestically and assertive foreign policy behavior abroad. In April 2020, months after the outbreak of the coronavirus pandemic, an internal report prepared by a think tank under China's Ministry of State Security concluded that worldwide anti-China sentiment was at its highest level since the bloody crackdown on protesters at Tiananmen Square in 1989.<sup>4</sup> China's international image has continued to suffer in the period since then as a result of several factors, including diplomatic failures, economic coercion, failure to wield soft power effectively, and its support for Russia.<sup>5</sup> China suffered particular damage in its relations with the advanced economic powers of North America, Europe, and Asia.<sup>6</sup>

China's collapsing international image, especially in democracies with advanced economies, contributes to the intensification of great-power competition. From the perspective of China's leaders, this is merely the continuation of trends that have already been visible for many years. Since coming to power in late 2012, Xi has perceived a darkening strategic landscape for China. In April 2014, Xi unveiled the Overall National Security Outlook, which establishes a broad framework for responding to security challenges both new and old. This document reflected the belief of many national

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<sup>4</sup> *Reuters*, "Exclusive: Internal Chinese report warns Beijing faces Tiananmen-like global backlash over virus", 4 May 2020.

<sup>5</sup> J. Kurlantzick, "China's Collapsing Global Image: How Beijing's Unpopularity Is Undermining Its Strategic, Economic, and Diplomatic Goals", Discussion Paper, New York, Council on Foreign Relations, July 2022.

<sup>6</sup> R. Hass, "From Strategic Reassurance to Running Over Roadblocks: A Review of Xi Jinping's Foreign Policy Record", *China Leadership Monitor*, no. 73, Fall 2022, p. 12.

security hawks in China that the country's existing national security architecture was inadequate for dealing with new domestic forces and international threats. It also represented a significant revision of China's assessment of the international environment. In 1985, Deng Xiaoping declared that "peace and development are the theme of the times." In 2002, building upon Deng's assessment, Jiang Zemin identified a "period of strategic opportunity" for China. The Overall National Security Outlook and the foreign policy that Xi has pursued since its unveiling reflect a much more pessimistic view of the international situation. Xi expressed this view in April 2022, two months after Russia's invasion of Ukraine: "In recent years, the theme of the times of peace and development has faced serious challenges, and the world is neither peaceful nor tranquil".<sup>7</sup>

In recent years, including during the period since Russia's invasion of Ukraine, Xi and other Chinese leaders have observed developments that seem to confirm this view. In the United States, a bipartisan consensus has formed on the need for a firm line against China.<sup>8</sup> The Biden administration has continued many of the policies toward China that the Trump administration implemented, which aimed to strengthen the US position in competition with China for economic, technological, and military primacy. The United States has also strengthened alliances and other partnerships designed to counter China's rise. The Quadrilateral Security Dialogue, or Quad, a partnership that includes the United States, India, Japan, and Australia, began holding summits at the level of heads of state. The Australia-United States-United Kingdom (AUKUS) partnership, which will allow Australia to acquire nuclear-powered submarines, is also a source of concern to

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<sup>7</sup> J. Blanchette, "The Edge of an Abyss: Xi Jinping's Overall National Security Outlook", *China Leadership Monitor*, no. 73, Fall 2022, p. 1-2.

<sup>8</sup> B.G. Carlson, "U.S.-China Strategic Competition in Each Domestic Context," in S. Grano and D. Huan (Eds.), *China-US Competition: Impact on Small and Middle Powers' Strategic Choices*, Cham, Switzerland, Palgrave Macmillan, forthcoming.

China. Japan is adopting a new defense policy, increasing defense spending, and expressing growing interest in assisting in the defense of Taiwan. South Korea's new president, Yoon Suk-yeol, has argued for closer security cooperation with the United States and with the Quad.

Europe and the transatlantic partnership have also devoted increased attention to China. A report by the European Commission in 2019 called China a "systemic rival".<sup>9</sup> The communiqué that NATO heads of state issued at the conclusion of their summit in June 2021 mentioned China for the first time. The communiqué declared that China posed a serious of formidable challenges, including its challenge to a rules-based order, its cyber and hybrid threats, and the expansion of its nuclear arsenal.<sup>10</sup> The NATO 2022 Strategic Concept declared that China's "stated ambitions and coercive policies challenge our interests, security and values". The Strategic Concept also drew attention to the deepening partnership between China and Russia, declaring that "their mutually reinforcing attempts to undercut the rules-based international order run counter to our values and interests".<sup>11</sup>

One common view was that transatlantic unity in opposing Russia's aggression in Ukraine was essential not only for its own sake, but also as part of the effort to resist China's ambitions.<sup>12</sup> In particular, the frustration of Russia's aims in Ukraine and the imposition of heavy punitive measures on Russia could help to deter a potential Chinese invasion of Taiwan. The sweeping international sanctions that Western countries and other advanced economies imposed on Russia also served as a

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<sup>9</sup> BDI, *China - Partner and Systemic Competitor: How Do We Deal with China's State-Controlled Economy?*, 10 January 2019.

<sup>10</sup> NATO, *Brussels Summit Communiqué. Issued by the Heads of State and Government participating in the meeting of the North Atlantic Council in Brussels 14 June 2021.*

<sup>11</sup> NATO, *Strategic Concept. Adopted by Heads of State and Government at the NATO Summit in Madrid 29 June 2022*, p. 5.

<sup>12</sup> S. Kotkin, "The Cold War Never Ended: Ukraine, the China Challenge, and the Revival of the West", *Foreign Affairs*, vol. 101, no. 3, May/June 2022, pp. 64-78.

warning of the economic penalties that China might face for an attack on Taiwan or other acts of aggression.

Such considerations were potentially of special concern for China's leaders given the downturn in the Chinese economy. China's GDP grew by just 0.4 per cent in the second quarter of 2022, putting the country on track to fall well short of its target for annual GDP growth of 5.5 per cent. China's economic growth had already begun to slow following decades of high-speed growth, but many of Xi's policies have caused growth rates to slow even further. Xi has pursued statist economic policies, including crackdowns on the technology, finance, and real estate sectors, that have the objective of strengthening the party's grip on power but have had the effect of restricting economic growth. He has also persisted in imposing zero-covid policies, including extended lockdowns in major cities, that have choked off economic activity even further. The economic effects of the war in Ukraine, including the global rise in inflation, posed a further threat to China's export-oriented economy. On the other hand, China took advantage of sanctions on Russia's energy sector to secure favorable prices for Russian oil.

Domestic politics were also an important consideration for Xi and the Chinese leadership. In 2018, Xi secured the removal from the Chinese constitution of the presidential term limit of two five-year terms. At the 20th Party Congress, Xi planned to secure approval for his continuation as general secretary of the Chinese Communist Party and as president, with his third term in the presidency to be officially confirmed during the national legislative sessions in spring 2023. During the run-up to the 20th Party Congress, Xi had an incentive to maintain stability and avoid any surprises, either in domestic politics or international affairs, that could jeopardize his bid to continue as China's leader.<sup>13</sup> Xi also sought to build support to install loyalists in important party positions during the congress.

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<sup>13</sup> K. Rudd, "Rivals Within Reason? U.S.-Chinese Competition Is Getting Sharper - but Doesn't Necessarily Have to Get More Dangerous", *Foreign Affairs*, 20 July 2022.

This situation provided an incentive for Xi pursue a relatively restrained foreign policy during 2022. At the time of writing, the most serious crisis in US-China relations since Russia's invasion of Ukraine had occurred at the time of Speaker of the House Nancy Pelosi's visit to Taiwan in August. China responded to this visit by holding extended military exercises featuring missile launches in the waters surrounding Taiwan, but no invasion occurred and none appeared imminent at the time of writing.

## **Opportunities for China**

Russia's war in Ukraine thus created many challenges for China, but it also opened some opportunities that China has attempted to seize. Although many of the world's advanced capitalist democracies mounted a strong reaction to the Russian invasion, featuring wide-ranging sanctions and moral condemnation, the world was far from united in its response. India and other major countries declined to join sanctions against Russia or to criticize it for the invasion. Like China, India bought oil from Russia at favorable prices, weakening the effect of Western sanctions on Russia's energy sector. Throughout the Global South, many other countries also declined to join in the international condemnation of Russia. China therefore perceived an opportunity to take advantage of reluctance in many parts of the world to follow US leadership.

China's introduction of the Global Security Initiative is one part of this effort. The GSI, which Xi announced during a speech in April 2022, represents an effort by China to advance its own conception of international order. Fundamental to this conception is the notion that China, in contrast to the allegedly unreliable and chaotic United States, is a force for global stability. By calling into question US ability to provide regional and global order, this initiative aims to deter countries from strengthening security cooperation with the United States. The initiative also aims to counter accusations that China acts in



aggressive and revisionist ways. It establishes a framework for the strengthening of China's own partnerships to counter the United States and its network of allies and partners.<sup>14</sup>

China has recently made efforts to improve relations with India. The bilateral relationship suffered a severe breakdown in June 2020, when Chinese and Indian border guards fought a deadly clash along the two countries' disputed border in the Galwan Valley, high in the Himalayas. China may have provoked the clash in an effort to send a warning to India about establishing closer security relations with the United States. If so, this action had the opposite effect, as India drew closer to the United States and other members of the Quad during the subsequent period. This included the elevation of the Quad to the level of heads of state. More recently, however, China has conducted diplomatic outreach to India. In March, following India's decisions not to support resolutions in the UN General Assembly condemning Russia's invasion of Ukraine and not to join international sanctions against Russia, Chinese Minister of Foreign Affairs Wang Yi made an official visit to India. In September 2022, China and India agreed to pull soldiers back from friction points along the border following 16 rounds of commander-level talks aiming to ease tensions. Xi and Indian Prime Minister Narendra Modi planned to meet for the first time since the border clash during the Shanghai Cooperation Organization (SCO) summit in Uzbekistan in September 2022.<sup>15</sup>

China has also sought to strengthen cooperation within BRICS and the SCO. In 2022, China hosted summits of foreign ministers and heads of state of the BRICS grouping, which also includes Brazil, Russia, India, and South Africa. Xi encouraged the group to expand its membership and to increase cooperation on issues such as the digital economy, trade, investment, supply chains, and global development.

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<sup>14</sup> B. Lin and J. Blanchette, "China on the Offensive: How the Ukraine War Has Changed Beijing's Strategy," *Foreign Affairs*, 1 August 2022.

<sup>15</sup> S. Yasir, "2 Years After Deadly Fistfights, India and China Pull Back From Border", *New York Times*, 9 September 2022.

China aims to turn BRICS into a developing world bloc that would compete with the Quad, the G-7, and the G-20. China also continued its longstanding efforts to strengthen the SCO, a grouping that originally included China, Russia, and Central Asian countries but has expanded to include India and Pakistan and was set to welcome Iran as a new member in September 2022. To date, China has been unsuccessful in its efforts to establish a free trade area and a development bank within the framework of the SCO, but it plans to continue pressing for the organisation to act more assertively on international security and economic issues. China aims to use both BRICS and the SCO to promote cooperation with countries that are reluctant to follow the United States, though India could use its membership in both organisations to limit their anti-US character.<sup>16</sup>

China is also seeking to strengthen partnerships with the Global South.<sup>17</sup> China's aim is to build a sphere of influence among this group of countries, which encompasses the emerging, non-Western, and largely nondemocratic world. China is building influence in these countries through economic development assistance, including investments in infrastructure through its Belt and Road Initiative (BRI). By attempting to establish a united front with countries of the Global South, China hopes to build a counterweight to the West and to frustrate attempts to stifle China's rise. China has already succeeded in persuading many countries from the Global South to vote against efforts in UN bodies to condemn China for its human rights abuses in Xinjiang. Countries of the Global South could also provide valuable markets for Chinese exports, sources of energy and other raw materials, and access to geographical chokepoints that are crucial for international shipping and logistics.<sup>18</sup>

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<sup>16</sup> Lin and Blanchette (2022).

<sup>17</sup> Ibid.

<sup>18</sup> N. Rolland, "China's Southern Strategy: Beijing Is Using the Global South to Constrain America", *Foreign Affairs*, 9 June 2022.

Through these initiatives, China is attempting to stake out its position on issues related to international order and global governance. It is also attempting to build coalitions of countries that are disaffected by US leadership and willing to provide at least some support for China's positions. For a variety of domestic and international reasons, China has pursued a relatively restrained foreign policy since Russia's invasion of Ukraine. Following this fall's 20th Party Congress, however, China's foreign policy is likely to become increasingly assertive.

### **China's Coming Assertiveness**

In the aftermath of the global financial crisis that began in 2008, China began to pursue an increasingly assertive foreign policy. This trend became especially pronounced following Xi's accession to power. During Xi's tenure, China has cast aside Deng's famous foreign policy maxim, which is often translated as "bide your time and hide your capabilities". According to Avery Goldstein's analysis, Xi has pursued a foreign policy strategy of reassurance, reform, and resistance, with resistance as the most visible component.<sup>19</sup>

Analysts offer competing interpretations for China's growing foreign policy assertiveness. One common explanation is that Chinese leaders felt increasingly confident in their country's growing power, especially following the financial crisis, and therefore were emboldened to act assertively. According to another interpretation, Chinese leaders have sensed in recent years that their power is peaking. Slowing economic growth rates, continued domestic problems, and coordination by other countries to constrain China's growing power all provide evidence that the country's rise could be ending. Such considerations could make China's leaders increasingly

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<sup>19</sup> A. Goldstein, "China's Grand Strategy under Xi Jinping: Reassurance, Reform, and Resistance," *International Security*, vol. 45, no. 1, Summer 2020, pp. 164-201.

risk-prone as they sense a closing window of opportunity to act before trends turn decisively against them.<sup>20</sup> Others have questioned this interpretation, noting that recent words and actions by China's leaders suggest sustained confidence in their country's rising power.<sup>21</sup>

Whether China's foreign policy assertiveness is driven by confidence or anxiety, or perhaps by some combination of the two, it is likely to continue and even become stronger during the period following Xi's expected success in prolonging his tenure in office. Following the 20th Party Congress, China is likely to assert its interests strongly, both diplomatically and, if Chinese leaders conclude that it is necessary, through the use of military force.<sup>22</sup> Xi's desire for stability in the period leading up to the 20th Party Congress acts to restrain Chinese assertiveness. After the conclusion of the congress, this political pressure will be removed, and Xi will enjoy uncontested authority. This will increase his freedom to intervene in disputes along China's periphery and to resist the US presence in Asia.<sup>23</sup>

Of special concern is the likelihood that China will act with increasing assertiveness toward Taiwan. Chinese leaders believe that the United States in recent years have taken steps to weaken the "one China" policy, thereby encouraging eventual Taiwanese moves toward independence. China has already taken legal steps that aim to strengthen its claims in the Taiwan Strait. Since 2020, China has formally denied the existence of the median line in the strait, which both sides had long recognised tacitly as an informal maritime boundary. In June 2022, China declared that the Taiwan Strait should not be considered international

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<sup>20</sup> M. Beckley and H. Brands, "The End of China's Rise", *Foreign Affairs*, 1 October 2021; H. Brands and M. Beckley, "China Is a Declining Power - and That's the Problem", *Foreign Policy*, 24 September 2021.

<sup>21</sup> O. Skylar Mastro and D. Scissors, "China Hasn't Reached the Peak of Its Power: Why Beijing Can Afford to Bide Its Time", *Foreign Affairs*, 22 August 2022; Rudd (2022); Hass (2022), pp. 10-11.

<sup>22</sup> Lin and Blanchette (2022).

<sup>23</sup> Y. Sun, "What to Expect From a Bolder Xi Jinping: Get Ready for a More Ambitious Chinese Foreign Policy", *Foreign Affairs*, 28 July 2022.

waters. China could take additional steps to alter the status quo, such as declaring the Taiwan Strait to be inside its own exclusive economic zone. China could also add further elements to its military exercises around Taiwan, such as flying jets directly over Taiwanese territory. Such steps might increase the risk of an unintended military confrontation with the United States. China is also likely to seek ways to exert pressure in advance of Taiwan's local elections in late 2022 and presidential elections in 2024, with the aim of intimidating voters into supporting candidates who are favorably disposed toward China.<sup>24</sup> Many analysts are concerned about the possibility that China could attack Taiwan at some point during the present decade, with recent US intelligence estimates even warning that such an attack might occur by 2024.<sup>25</sup>

Other parts of Asia could also be scenes of rising tension, including Northeast Asia. As in the past, China would be likely to react negatively to efforts by the United States and South Korea to strengthen deterrence of North Korea in response to provocations by the regime in Pyongyang. China, which views such moves as threatening to its own security, would be likely to strengthen its own military forces in the region and increase coordination with North Korea. China would also be likely to apply pressure on South Korea in response to its efforts to increase security cooperation with the United States and other US allies in Asia. China could respond similarly to efforts by Japan to strengthen its ability to defend the Senkaku Islands, which China claims and calls the Diaoyu. China could also seek to consolidate its position in the South China Sea. Gen. Mark Milley, the chairman of the Joint Chiefs of Staff, has already expressed concern about an increased tempo of Chinese aerial intercepts of US warplanes and naval intercepts of US vessels in 2022. China could ratchet up the pace of such activities in an effort to counter US freedom of navigation operations. The

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<sup>24</sup> Sun (2022); Lin and Blanchette (2022); Hass (2022), p. 14.

<sup>25</sup> Wong, Sanger, and Qin, "U.S. Officials Grow More Concerned About Potential Action by China on Taiwan", *New York Times*, 25 July 2022.

net effect of such actions would be to raise tensions and security concerns across the Asia-Pacific region.<sup>26</sup>

## Managed Strategic Competition?

The likelihood that China will pursue an increasingly assertive foreign policy following the conclusion of the 20th Party Congress raises the question of whether steps could be taken to manage the US-China rivalry and prevent it from erupting into military conflict. The developing situation is potentially fraught with peril. The growing US-China rivalry calls to mind the potential for a clash between an established hegemon and a rising challenger that has been the subject of extensive study in international relations.<sup>27</sup> In such situations, the outbreak of avoidable conflict through the security dilemma, misperception of the other side's intentions, or other mechanisms becomes a source of acute concern.<sup>28</sup>

Former Australian Prime Minister and Foreign Minister Kevin Rudd argues that the United States and China should attempt to establish “managed strategic competition”.<sup>29</sup> In Rudd's view, the United States and China have reasonably accurate understandings of each other's strategic intentions, but they have been engaged for several years in a “strategic free-for-all with no rules of the road to constrain them.” In this increasingly dangerous situation, the two countries need to establish “guardrails” around their relationship, Rudd argues. Under managed strategic competition, the two countries would mutually agree upon a set of constraints that would stabilize the relationship.<sup>30</sup>

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<sup>26</sup> Sun (2022).

<sup>27</sup> G. Allison, *Destined for War: Can America and China Escape Thucydides's Trap?*, New York, Houghton Mifflin, 2017.

<sup>28</sup> R. Jervis, *Perception and Misperception in International Politics*, Princeton, N.J., Princeton University Press, 1976.

<sup>29</sup> K. Rudd, “Short of War: How to Keep U.S.-Chinese Confrontation From Ending in Calamity”, *Foreign Affairs*, vol. 100, no. 2, March/April 2021, pp. 58-72.

<sup>30</sup> Rudd (2022).

In Rudd's conception, managed strategic competition should consist of four elements. First, the two countries should establish a clear understanding of each other's redlines on a series of issues, including Taiwan, the South and East China seas, the Korean Peninsula, space, and cyberspace. Second, they should embrace "nonlethal strategic competition" in economics, technology, foreign policy, and even in the enhancement of their military capabilities, with the aim of preventing this competition from erupting into direct military conflict. Third, the United States and China should pursue cooperation in areas of common interest, including climate change, global public health, global financial stability, and nuclear nonproliferation. Finally, dedicated cabinet-level officials in both countries would have to oversee this managed strategic competition and insulate it from domestic and international political factors that might threaten its success.<sup>31</sup>

Such an effort would not be easy, given the intensification of the US-China rivalry. Both sides might eventually see the benefit of stabilizing the relationship, however, much as the United States and the Soviet Union did after the Cuban Missile Crisis of 1962. Following that near-catastrophe, the two superpowers made a series of arrangements that provided stability in the relationship, culminating in the Helsinki Accords of 1975. Based upon events in 2022, including some frank diplomatic discussions that have occurred between high-ranking officials in both countries, Rudd already sees signs that both countries might be prepared to consider such arrangements.<sup>32</sup>

Russia's war in Ukraine threatens to complicate such efforts considerably, however. In the view of Robert Legvold, the United States and China are not yet engaged in a cold war, but events might be heading in that direction. By itself, a new US-China cold war could be manageable under the sort of arrangements that Rudd proposes. However, as Legvold writes,

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<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*

the United States and Russia have been locked in a new cold war since 2014, when Russia annexed Crimea and began its support for an insurgency in the Donbas. Thus, the rise of a new US-China cold war would create an international system defined by “two interlocking cold wars”. In this situation, the structure of the international system would become rigidly bipolar, with the United States and its allies and partners on one side and a China-Russia axis on the other. “The force field created when the untamed animosity between Russia and the West merges with a comparable hostility between China and the United States”, Legvold writes, “will vastly shrink the room for maneuver of those struggling to stay above the confrontation”. India, which has stayed out of the conflict between Russia and the West, would see its options severely constrained in the face of its own growing rivalry with China and a clear Russia-China alignment. Countries of the Global South might try to play the two sides off against each other, but ultimately they would find it difficult to avoid choosing sides.<sup>33</sup>

In such a situation, Legvold argues, Rudd’s proposals for managed strategic competition would stand no chance of success. The world would enter a historical period that would be more destructive and dangerous than the Cold War’s most perilous phase, namely the years between the 1948 Berlin blockade and the 1962 Cuban Missile Crisis. The modern world’s economic, technological, and social relationships would make such a period potentially more destructive than the early phase of the Cold War, and the potential for military conflicts resulting from both interlocked cold wars would make it more dangerous. These risks create a need for reciprocal measures by both sides to ease tensions, Legvold argues. For example, China could back away from claiming the Taiwan Strait as its territorial waters, and the United States could reaffirm its one China policy. As China’s nuclear

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<sup>33</sup> R. Legvold, “Two Cold Wars in a New Bipolar World”, *The National Interest*, 4 September 2022.



arsenal expands, a bilateral strategic stability dialogue is also necessary.<sup>34</sup>

Russia's war in Ukraine is likely to be seen as an important early episode in the unfolding US-China rivalry. As discussed in this chapter, it is likely to have a profound effect on China's foreign, economic, and security policies, as well as on its international standing and reputation. China's response to these effects will have a significant impact on its trajectory in the near future. Western policymakers must pay careful attention to these factors as they fashion their policies toward China in the years ahead.

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<sup>34</sup> Ibid.



## 5. Opening Up? China's Financial Sector to the Test

Alessia Amighini

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Russia's invasion of Ukraine has brought international relations to a critical juncture. China, meanwhile, has been stepping up its financial reforms. Although these two developments may appear to be separate, they are actually interlinked". Western sanctions on Russia are accelerating the reduction of interdependence between the United States and China – a process known as decoupling – and this is pushing Beijing more emphatically towards an international financial architecture characterised by a stronger renminbi. As Russia has been denied access to nearly half of its \$630 billion in foreign exchange and gold reserves, the United States has proved how powerful the dollar system still is. That is exactly what China wants to challenge by carving out an ever-larger niche for its currency. And what better time to do that than when a large neighbouring country is banned from the system and requires new channels to regulate international transactions?

The US, EU, UK and other countries have banned individuals and citizens from interactions with the Central Bank of Russia, Russia's Ministry of Finance, and the National Wealth Fund. Seven Russian banks have also been barred from the SWIFT global payments system. Other banks and financial institutions, although not excluded from SWIFT, have also been subject to sanctions. International payments for foreign businesses operating in Russia using sanctioned banks may still

make and receive payments, but transfers may be delayed. More recently, VISA and Mastercard suspended operations in Russia.

There has been some speculation in China as to whether China's CIPS (Cross-Border Interbank Payment System) payment system can act as a substitute for banks that have been banned from SWIFT. So far, this appears unlikely, as it has a much lower number of participating banks than SWIFT – 1,280 financial institutions in CIPS across 103 countries and regions, of which just 75 are directly participating banks, compared to SWIFTS' 11,000 across 200 countries and regions. It is also still reliant on SWIFT for information exchange with indirect participants, as only direct participants can transfer information. However limited in scope, China hopes that CIPS could become a viable alternative for companies in the longer term should the SWIFT ban remain in place for a long time, because this would also require the adoption of the RMB, as CIPS only settles transactions in this currency. This would accelerate the trajectory of Chinese financial reform, which started many decades ago at a much slower speed.

## **Reforms of the Financial Sector and SOEs**

The reform of state-owned enterprises (SOEs) and the financial sector have both been key elements of China's economic reform process over the past 40 years: they are twin priorities, in the sense that the direct cause of the fragility of the banking system, weakened by a mass of bad debts, is the excessive indebtedness of SOEs to large state-owned banks, due in part to the limited size of the bond and stock markets, which need to be large, deep and resilient to rebalance the financial system from over-reliance on banks.

Financial system reform also features in the 14th Plan (2021-25). Specific areas of financial system reform include improving the formation and transmission of market interest rates. SOE reform is not a new goal; it appeared again in the 14th Five-Year Plan, including the improvement of the state asset management

system, as well as the imposition of accountability in SOE management. In fact, the Chinese authorities have still failed to implement the reform programmes, which were already present in the third plenum in 2013, and this explains the slowdown in Chinese productivity, the source of the country's persistent slowdown in economic growth.

## SOEs Today After 40 Years of Reforms

As SOEs were the backbone of China's economy during the era of central planning, their reform is the most important change in China's enterprise system to have taken place during the transition to the current form of State capitalism, in conjunction with other institutional and policy reforms. Unlike in former European socialist countries, in China, SOE reform did not lead to rapid and widespread privatisation.<sup>1</sup> Aware and afraid of the profound economic, social and political consequences of abrupt SOE reform without creating the necessary conditions for change (McMillan and Naughton 1992),<sup>2</sup> Chinese reformers followed a gradual and experimental approach to reform. The main goal of market-oriented reforms, as repeatedly stated by the Chinese government, is to build a socialist market economy with the state-owned sector as a driving force.

Chronologically, the SOE reform process can be divided into four phases, marked by important policy documents and reform initiatives promulgated by the Communist Party of China (CPC) and the Chinese government in line with their broad economic reform agenda. The first phase, between 1978 and 1992, at the beginning of the economic transition, was

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<sup>1</sup> B. Naughton, *The Chinese economy: Transitions and growth*, Cambridge, MIT Press, 2007; Zhang 2009.

<sup>2</sup> J. McMillan and B. Naughton, "How to reform a Planned Economy: Lessons from China", *Oxford Review of Economy Policy*, vol. 8, no. 1, Spring 1992, pp. 130-43.

characterised by measures to improve the performance of the mammoth and inefficient SOEs through greater autonomy and the introduction of a principle of competition among them, but without affecting the state ownership of SOEs due to the need for the state to control all means of production.<sup>3</sup>

The second phase of reform, between 1992 and 2003, was motivated by the need to address the increasing losses of SOEs.<sup>4</sup> To this end, a process of rationalisation of SOEs was introduced to reduce the number of smaller enterprises in favour of strengthening the larger ones, and the transformation of ownership (*ga ʼzhi* or restructuring), which started after Deng Xiaoping's tour of southern China in 1992. *Gaizhi* has become an essential element in the government's grand strategy of building "a modern production system to realise the socialist market economy", as set out by the 14th CPC National Congress.<sup>5</sup> A substantial step in the creation of a new regulatory framework was the promulgation of the Companies Act in 1993 and the Competition Act in 1994. In addition, the policy of layoffs allowed a large number of workers to be laid off in the process of change of ownership.<sup>6</sup> While restructuring served as a euphemism for privatisation, a number of reforms were introduced, including employee share ownership, public offerings (with internal restructuring measures such as debt/equity swaps, which, however, did not change the state's controlling shares), leasing and joint ventures with foreign companies.<sup>7</sup>

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<sup>3</sup> G.C. Chow, *China's Economic Transformation*, Malden, MA, Blackwell, 2002.

<sup>4</sup> R. Garnaut, L. Song, and Y. Yao, "Impact and significance of State-owned Enterprise Restructuring in China", *The China Journal*, vol. 55, 2006, pp. 35-63.

<sup>5</sup> L. Song, "State and Non-State in China's Economic Transformation", in G.C. Chow and D. Perkins (Eds.), *Routledge Handbook of the Chinese economy*, New York, Routledge, 2015.

<sup>6</sup> *Ibid.*; G.H. Jefferson, *State-owned enterprise in China: Reform, Performance and Prospects*, Waltham, MA, Brandeis University, Department of Economics and International Business School, Working paper n. 109R, 2016.

<sup>7</sup> Garnaut, Song, and Yao (2006).

The third phase of large SOE reforms, in the decade between 2003 and 2013, was characterised by the goal of maintaining large SOEs. At the same time as defining the guiding principles on the consolidation and development of the public economy in line with the importance of the development of the private economy,<sup>8</sup> the 16th National Congress established the State Assets Supervision and Administration Commission (SASAC), under the authority of the State Council, in March 2003. The national-level commission directly supervises central SOEs, the largest of China's major industries, while indirectly supervising local SOEs, which are under the direct supervision of local governments. From 2003 to 2006, the number of central SOEs under the SASAC was reduced from 196 to 159 after consolidation and restructuring,<sup>9</sup> and then to 106, in 2015-16.<sup>10</sup>

China's SOEs continue to play a significant role in several strategic sectors, including new energy sources, telecommunications and information technology, automation, transport equipment (such as automobiles, aviation, shipbuilding and high-speed railways), new materials, space technologies, construction, materials development and infrastructure, and most notably also financial institutions. The government also called on SOEs to play a critical role in achieving the goals of the "Made in China 2025" policy, which aims to build high-end manufacturing industries in all key industrial sectors.

The 14th Five-Year Plan reaffirmed the crucial role of SOEs in the Chinese economy. This should come as no surprise, since the more than a decade-long trend of shrinking SOE footprint, which began with the SOE reforms in the late 1990s, came to a substantial halt after Xi Jinping became China's leader in late

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<sup>8</sup> W. Yang, "The New Round of Reform of State-owned Enterprises", *Journal of Entrepreneurship in Emerging Economies*, vol. 7, no.1, 2015, pp. 55-66.

<sup>9</sup> M. Mattlin, *The Chinese Government's New Approach to Ownership and Financial Control of Strategic State-owned Enterprises*, Helsinki, Bank of Finland Institute for Economics in Transition, BOFIT Discussion Paper n. 10, 2007.

<sup>10</sup> Jefferson (2016).

2012. The Chinese authorities' insistence that SOEs maintain a key role in the economy is problematic for China's long-term economic growth prospects, considering the current leadership's poor track record in SOE reform. The state sector has remained inefficient and has become an increasing drag on China's growth. Maintaining the primacy of SOEs also has implications for China's external economic relations, particularly the already strained economic relationship with the United States.

## **Financial Sector Reform**

At the beginning of the economic reforms in late 1978, the country had only one financial institution, the central bank, the People's Bank of China (PBoC). This served as both a central bank and a commercial bank and managed 93% of the country's total financial assets. Over the subsequent 40 years, the financial sector underwent major reform, opening and development. Today, the so-called "big four" are regularly ranked among the 10 largest banks in the world. The Chinese stock and bond markets have also entered the global top ranks in recent years. The renminbi is part of the International Monetary Fund's Special Drawing Rights (SDR) basket, along with the dollar, euro, British pound and Japanese yen.

The rationale behind financial sector reform is closely linked with the evolution of the SOE sector. Indeed, the banking problems in the late 1990s were a direct consequence of the need to carry on supporting large corporations, which continued to operate in increasingly open and competitive markets, but were relatively less efficient than private ones, and therefore needed special support. As tax revenues fell rapidly relative to GDP throughout the 1980s, it became clear that the government would have no funds to support SOEs. An alternative was to continue to allocate large volumes of credit to SOEs, at relatively low prices, so that SOEs could survive even if their performance continued to deteriorate.



China's financial sector reforms during the past four decades have been numerous, but not very effective in terms of reform quality. China has huge volumes of financial assets managed by a large number of financial institutions, and the Chinese authorities maintain serious and extensive restrictions on financial markets, including interest rates, exchange rates and the allocation of funds. The dual-track approach between the state and non-state sector has resulted in deep financial repression, which is a form of distortion. This financial reform model worked quite well initially, evidenced by strong economic growth, but now creates risks. Empirical analyses have confirmed that in the 1980s and 1990s financial restraint had a positive effect on growth, while in the 2000s it had a negative effect. Repressive financial policies have also helped maintain financial stability, and investor confidence, albeit with increasing moral hazard consequences over time. The combination of a large supply of money – from the bank-dominated financial system and the government's implicit guarantee policy – and the limited pool of investable assets increased financial risks.

In the aftermath of Donald Trump's visit to China in 2017, according to the main international newspapers, one of the results of the summit was the announcement of the opening up of the Chinese financial sector to foreign capital, much more than it had been until then.

Finance remains to this day one of the most protected and closed spheres in China. Although in the WTO accession protocol in 2001, China committed itself to progressive liberalisation and opening, without geographical restrictions, as early as December 2006, there is still no sign of this opening today. It is true that since 2004, four of China's five largest banks, all publicly owned, have taken minority stakes – HSBC in the Bank of Communication, Bank of America in the China Construction Bank, a consortium led by Royal Bank of Scotland in Bank of China, and Goldman Sachs leading a consortium investing in the Industrial and Commercial Bank of China. This, however, has not led to any improvement in

the inefficiency in the intermediation of the huge amount of savings available in the country, because nothing has changed in the degree of financial innovation and corporate governance rules, which is why foreign holdings have so far not instilled any mechanism of competition.

But what does the announced opening consist of? The current limit of 20% private ownership in banks and financial intermediation companies was about to be abolished, with an overall maximum of 25% for foreign ones. Foreign investors would face the same limits as the Chinese, i.e. a maximum share of 30% in private banks. In securities management companies and insurance companies, the limit would rise to 51% (from the previous 49% and 50% respectively) and three years after the change there would be no limit at all.

Although the Anglo-Saxon press rushed to attribute the announcement to American pressure on Beijing, on closer inspection it was simply a reiteration of what had already been announced, i.e., that the government will review (it is not known when and how) the barriers to foreign shareholdings and acquisitions in the banking, financial and insurance sectors, confirming what was indicated the previous December by the National Development Reform Commission, the body in charge of medium-long term economic planning and of the important task of defining Chinese investment strategies abroad and in China. This explains why analysts were not shocked to hear reform announcements again. When better to repeat the announcement than at a summit with the world's leading economy, at a time of thirst for results to bring home?

This was therefore a typical opportunistic move by the Chinese authorities, at a time when the big international banks, disappointed by the lack of progress on in any significant opening of the Chinese financial, banking and insurance sector to foreign companies, had already started to reduce their Chinese holdings, first and foremost Goldman Sachs. The only foreign bank with a significant stake remained HSBC with 19% of Bank of Communication. However, there were also those who had increased their holdings, such as

Morgan Stanley earlier the same year, from 33% to 49%, the maximum allowed, in its Chinese joint venture Morgan Stanley Huaxin Securities, in the hope that reforms would begin soon.

At a time when the world's second largest economy is bidding to become a regional financial hub with global ambitions, the distrust of foreign banks in China's financial reforms is not a good sign. Above all, however, it is at the root of the substantial capital outflow that has contributed to the depreciation of the yuan, this year at an all-time low against the dollar. Greater openness to foreign acquisitions and shareholdings is essential to redress the imbalance between inflows and outflows. The former were not particularly buoyant at this time. Between January and October 2017, they increased by 1.9% year-on-year, reaching a value of \$102 billion, while the latter saw a setback in 2017, in the form of a 44.3% reduction year-on-year, to a value of only \$57 billion, as a result of the bans imposed by Beijing since last summer. The ban on large investments, which has been deemed "irrational", was actually prompted by a fear of excessive capital outflow. Gone are the days when a weak yuan served the purpose of keeping exports high. Now Beijing needs a strong currency to prevent capital flight: partly foreign but mainly Chinese.

Back in August 2020, Yi Gang, Governor of the People's Bank of China, announced that China will push to promote the opening of the country's financial sector regardless of how the international situation changes. According to Yi, China will continue to implement phase one of the economic and trade agreement with the US, while continuing the measures announced to open up China's financial sector. Yi cited measures such as the abolition of investment quota limits for Qualified Foreign Institutional Investors (QFII) and Qualified Foreign Institutional Investors in Renminbi (RQFII), allowing companies such as American Express, MasterCard and Fitch ratings to enter the Chinese market. Yi added that, in the meantime, China will promote full implementation of the foreign investment administration model of pre-establishment

national treatment plus negative list, and unify the foreign exchange management policies applied in opening up the Chinese bond market.

The 14th Five-Year Plan states that China will promote research and development of its own digital currency, which was partially introduced in 2020. In recent years, China's central bank has been developing and testing a government-issued digital RMB, known as DCEP (short for Digital Currency Electronic Payment). Although the widespread introduction of a digital central bank currency in the world's most populous nation will be gradual, the emergence of a digital RMB could bring significant benefits for the rapid digitisation of China's economy and facilitate cross-border RMB payments and internationalisation of the currency. China has also reiterated that, in addition to the digital RMB, it will promote financial innovation, provided this is pursued in an orderly manner and subject to prudential supervision so as to prevent systemic risks: the cornerstone of every measure introduced over the past 40 years in the financial sector reform process.

## **Joint Stock Programmes**

Two programmes – Shanghai-Hong Kong Stock Connect and Shenzhen – were undertaken by the Chinese Communist Party and domestic regulators, in November 2014 and December 2016 respectively, to allow foreign investors, including individuals, direct access to stock markets. With the Joint Announcement of the People's Bank of China and Hong Kong Monetary Authority, Bond Connect, a pilot programme, was launched on 3 July 2017. Initially, this involved only Northbound Trading, which allows Hong Kong and foreign investors to access the Chinese interbank bond market (without limits or quotas), but a Southbound channel opened in September 2021.

According to the Bank for International Settlements (BIS), on 10 April 2014, the China Securities Regulatory Commission (CSRC) and the Securities and Futures Commission (SFC) of

Hong Kong SAR announced the establishment of Shanghai-Hong Kong Stock Connect, a pilot programme aimed at establishing reciprocal access to stock markets between Mainland China and Hong Kong. On 17 October, the CSRC and the SFC signed a Memorandum of Understanding and agreed on the principles and arrangements for cross-border regulatory and enforcement cooperation under the programme. On 10 November, the two commissions approved the launch of Stock Connect, which took place on 17 November 2014.

This connecting programme between Shanghai Stock Exchange (SSE) and Stock Exchange of Hong Kong Limited (SEHK), also known as “direct train”, will enable stock trading between the two exchanges. In the “southbound link” from Shanghai to Hong Kong, Mainland investors can trade up to 266 admitted shares listed in Hong Kong, up to a daily quota of RMB 10.5 billion (net) of purchases and an aggregate quota of RMB 250 billion. The shares admitted to trading represent 82% of SEHK’s market capitalisation. In the “northbound linkage” from Hong Kong to Shanghai, international investors can trade up to 568 admitted shares listed in Shanghai, up to a daily quota of RMB 13 billion (net) of purchases and an aggregate quota of RMB 300 billion. The shares admitted to trading represent 90% of the market capitalisation of the SSE. Quotas apply to “buy” orders only, while “sell” orders are always allowed. Quota adjustments are possible in the future.

The programme must ensure that brokers comply with the rules and regulations in two very different markets. Preparing and streamlining operations for the launch of Stock Connect involved significant challenges and required extensive cooperation from the respective regulators. One major issue was taxation. On 14 November, the Chinese Ministry of Finance, the State Tax Administration and the CSRC announced the waiver of capital gains levies for “northbound” investors for an unspecified period, and for individual “southbound” investors for three years. Investors on both sides will be exempt from corporate taxes on stock trading.

Stock Connect potentially represents a milestone in China's capital movement liberalisation process. The SSE has the seventh largest market capitalisation in the world, at \$2,960 billion at the end of October 2014, yet it remains a relatively closed market. Prior to Stock Connect, foreign institutional investors could only access China through the Qualified Foreign Institutional Investor (QFII) and RMB QFII (RQFII) programmes on the basis of memoranda of understanding between their country and China; these programmes are subject to regulatory approval and strict trading quotas granted on an individual basis. Stock Connect represents a major addition to existing programmes and entails an unprecedented opening of Chinese capital markets:

- while the pre-existing programmes cover flows in only one direction, Stock Connect loosens restrictions on capital flows in both directions: northbound trading is open to all investors, southbound trading to institutional and private investors with securities and liquid assets of at least RMB 500,000 from mainland China;
- northbound trading will be quoted in RMB but settled in offshore RMB, while southbound trading will be quoted in Hong Kong dollars but settled in onshore RMB. Trading and settlement in RMB will encourage greater use of this currency;
- Hong Kong's pool of RMB liquidity, consisting of deposits and certificates of deposit in the Chinese currency, already amounted to RMB 1.1 trillion, an amount sufficient to meet the expected demand for Stock Connect. Nevertheless, the People's Bank of China decided to abolish, with effect from 17 November, the daily ceiling of RMB 20,000 per person applied to foreign exchange transactions by Hong Kong residents. This should make it easier for them to participate and encourage local financial institutions to offer more RMB investment products. However, the transfer of renminbi

to onshore bank accounts remains subject to the daily ceiling of RMB 80,000 per person, limiting the likely impact on capital flows between the two territories;

- Mainland Chinese companies that do not participate in the Qualified Domestic Institutional Investor programme can now raise funds globally, as their shares become accessible to international investors under the new programme;
- compared to the QFII and RQFII programmes, trading through Stock Connect is not subject to lock-up or repatriation constraints.

Stock Connect was expected to reduce price differences for shares of Chinese companies listed on both markets, i.e. A-shares listed on mainland stock exchanges and H-shares listed in Hong Kong. These two share classes are traded separately, with massive restrictions on access to A-shares for foreign investors, and the possibility of arbitrage between the two markets was limited. Stock Connect could also affect other activities, even though both funds and securities remain within the closed loop of the two settlement systems: when northbound investors sell A-shares purchased through Stock Connect, the proceeds go back into their bank account in Hong Kong. The investor will not be able to use the proceeds to invest in other types of assets in Mainland China. But QFII and RQFII investors will now be able to release part of their shares originally intended to invest in equities, in order to invest, for example, in fixed income assets. As a matter of fact, the yield on 10-year Chinese government bonds has decreased since the main Stock Connect announcements. Moreover, the spread between onshore and offshore renminbi interest rates has narrowed since May 2014. However, the initial weakness in Stock Connect trading contributed to an increase in the offshore RMB/USD rate as enthusiasm for the renminbi waned.

Between 2006 and 2016, the GDP of the People's Republic of China more than tripled to \$11 trillion (the equivalent of the

US in purchasing power terms, PPP); the market capitalisation of the Shanghai and Shenzhen stock exchanges increased fivefold to \$7 trillion and the number of listed companies more than doubled to 3,200. Again, thanks to Share Issue Privatisation (SIP) and Share Structure Reform (SSR), in 2016 Tradable shares (those freely exchangeable and holdable by domestic investors) accounted for 75% of the total (the other 25% are held by public entities linked to the Chinese Communist Party); 58% of Tradable shares are held by retail investors, who account for 80% of daily trading volume. The market for domestic equity mutual funds is still young (born in 1998) and in 2016 they managed assets worth \$500 billion (compared to 7,000 managed by US equity funds). In this context, the Chinese Communist Party and domestic regulators have undertaken two projects to allow foreign and retail investors direct access to equity markets: Shanghai-Hong Kong Stock Connect (SHKSC), active since November 2014, and Shenzhen-Hong Kong Stock Connect (SZHKSC), active since December 2016. In order to trade Chinese A-shares through the Stock Connect programmes, financial institutions or intermediaries must qualify as China Connect Exchange Participants (CCEP) or Trade-through Exchange Participants (TTEP), i.e. be authorised to trade on the Stock Exchange of Hong Kong (SEHK) and be listed as SEHK Participants.

Northbound channels are those used by Hong Kong brokers to buy A-shares and Southbound channels are used by Chinese investors to buy SEHK-listed securities. All the intermediaries present are based in Hong Kong but, for certain institutions, they are subsidiaries of foreign groups.

The literature on the financial system of the People's Republic of China is very extensive.<sup>11</sup> Li (2016) provided a first, brief

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<sup>11</sup> See Franklin Allen, the most prolific authors on the subject: F. Allen, J. Qian, and M. Qian, Law, "Finance, and economic growth in China", *Journal of Financial Economics*, vol. 77, Issue 1, 2005, pp. 57-116; Idem, "China's Financial System: Past, Present, and Future", 28 March 2007; F. Allen, J. "QJ" Qian, C. Zhang, and M. Zhao, "China's Financial System: Opportunities and Challenges", NBER



description of the functioning of the Shanghai-Hong Kong Stock Connect programme and assesses the consequences that this could have on the dynamics of capital account convertibility, internationalisation of the RMB and sophistication of Mainland markets.<sup>12</sup> Wang et al. (2016) concluded that the connection of the two Chinese stock exchanges, SSE and SEHK,<sup>13</sup> positively impacted on returns and the volatility of Chinese stock markets has increased significantly. Other studies have shown that the connection of the two Chinese stock exchanges, SSE and SEHK, increased volatility. Bai and Chow (2017) analysed the short- and medium-term consequences on the Shanghai and Hong Kong stock exchanges following the opening of the SHKSC, and confirmed an increase in liquidity and volatility and an increase in systemic risk in the medium term.<sup>14</sup>

It is since 2002, with the launch of the QFII, that the People's Republic of China has gradually begun to allow foreign institutional investors to gain direct exposure in secondary domestic financial markets (thus excluding participation in IPOs and bond issuance), allowing them to buy A-shares in the domestic stock exchanges of Shanghai and Shenzhen.<sup>15</sup> A-shares, shares of Chinese companies denominated in RMB therefore, could finally be included in the portfolios of those funds with

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Working Paper 17828, 2012; F. Allen and J. Qian, "China's financial system and the law", *Cornell Int'l LJ*, vol. 47, 2014, p. 499; F. Allen, J. "QJ" Qian, and X. Gu, "An Overview of China's Financial System", *Annual Review of Financial Economics*, vol. 9, no. 1, 2017, pp. 191-231.

<sup>12</sup> J. Li, *Shanghai-Hong Kong Stock Connect: Main Characteristics, Strategic Significance, and Regulatory Response, in Development of China's Financial Supervision and Regulation*, New York, Palgrave Macmillan, 2016, pp. 209-28.

<sup>13</sup> Y.-C. Wang, J.-J. Tsai, and Y. Li, "The Influence of Shanghai-Hong Kong Stock Connect on the mainland China and Hong Kong Stock Markets", *The International Journal of Business and Finance Research*, vol. 10, no. 3, 2016, pp. 1-10.

<sup>14</sup> Y. Bai and D.Y.P. Chow, "Shanghai-Hong Kong Stock Connect: An analysis of Chinese partial stock market liberalization impact on the local and foreign markets", *Journal of International Financial Markets, Institutions and Money*, vol. 50, 2017, pp. 182-203.

<sup>15</sup> Allen et al. (2012).

exposure to the People's Republic, together with B-shares, shares of Chinese companies denominated in Renminbi, but listed in another currency (e.g. USD in Shanghai or HKD in Shenzhen). Over the years, the process of opening up financial markets has continued and foreign institutional investors have gained gradual access to other assets such as government bonds, corporate bonds and some futures. This progressive and gradual opening-up, typical of the modus operandi of the regulators, has led to several positive results such as a decrease in the cost of capital, an increase in the GDP growth rate and an increase in private investment.

The Chinese Communist Party and regulators have a considerable interest in the benefits, in terms of increased efficiency in the allocation of financial resources, that can arise from the involvement of foreign investors and the liberalisation of capital markets, both of which are typical aspects of free-market capitalist ideology. These advantages are often the result of the development of new forms of investor protection, for both local and foreign investors, and the improvement of corporate governance standards, which result in a reduction in information asymmetries.<sup>16</sup> All these aspects are very important for the domestic stock market, where approximately 85% of trading volume is generated by retail investors,<sup>17</sup> and regulators hope that liberalisation and the consequent participation of foreign intermediaries, who are known to be more sophisticated, will increase the efficiency of the financial system as a whole.<sup>18</sup>

The idea of increasing the efficiency of domestic markets by allowing gradual access to foreign institutional investors is one of the factors behind the liberalisations that have taken place since 2002. Other significant liberalisations of the financial markets includes the launch of the programme of RQFII programme in 2011, by the China Securities Regulatory Commission (CSRC),

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<sup>16</sup> G. Bekaert and R.H. Campbell, "Emerging markets finance", *Journal of empirical finance*, vol. 10, no. 1-2, 2003, pp. 3-55.

<sup>17</sup> Atkin et al. (2016).

<sup>18</sup> Allen et al. (2012).

the People's Bank of China (PBC, the Central Bank of China) and the State Administration of Foreign Exchange (SAFE). RQFIIIs were created to allow foreign investors to reinvest their offshore RMB funds directly into domestic financial markets (thus eliminating exchange rate risk), but also to facilitate the international dissemination of the yuan.<sup>19</sup>

Although this had been talked about for over a decade, it was not until 2009 that the project to spread the use of the yuan (RMB or CNY) as a currency exchange and reserve currency for central banks and in international markets was implemented, leading to its inclusion (in 2016) in the basket of currencies that determine the value of Special Drawing Rights (SDRs), a special reserve of the International Monetary Fund. The aim of SDRs is to increase the stability and security of the International Monetary System by freeing it from sole dependency on the US dollar and thus from the so-called Dollar Trap and, ideally, from the Triffin Dilemma.

Similar reasoning lies behind the proposal by Governor Zhou Xiaochuan of the People's Bank of China to implement the use of SDRs with the aim of creating an international currency not subject to the risk of individual countries, whose value is derived from a basket composed of the currencies of the nations with the largest GDP, as opposed to the current dollar-centric system. The rise in Chinese financial market performance is therefore underpinned by the increased liberalisation of the capital and debt market, with the participation of more sophisticated foreign intermediaries, together with the CPC's desire to spread the use of the yuan, by increasing its transferability and convertibility (capital account convertibility).

The CPC's latest effort in this area is the opening of the two Stock Connect channels that directly connect investors of the Hong Kong stock exchange with those in Shanghai and Shenzhen. Started as a pilot project in November 2014, with

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<sup>19</sup> N. Salidjanova and I. Koch-Weser, [China's 2014 Government Work Report: Taking Stock of Reforms](#), US-China Economic and Security Review Commission Staff Research Backgrounder, 2014.

the opening of the SHKSC, and followed by the more recent opening of the SZHKSC in December 2016, this innovation is revolutionising the way investors can interact with Mainland financial markets and has greatly expanded the audience of potential investors, both foreign and domestic. Indeed, any broker qualified as an Hong Kong Stock Exchange (SEHK) Participant, and then as a China Connect Exchange Participant (CCEP), can allow its clients to participate in A-share trading, within the limits of the daily trading quotas. The same possibility is given to Mainland investors (who participate in the SSE and SZSE) who, through brokers who are members of the SSE or SZSE, can participate in the trading of the securities and instruments listed on the SEHK that have been included in the Stock Connect securities (SCsec), again respecting the limits placed on the daily trading volume.

With the Joint Announcement of China Securities Regulatory Commission and Securities and Futures Commission of 10 April 2014, the Securities and Futures Commission (SFC, the regulator for the Hong Kong Stock Exchange) and the China Securities Regulatory Commission (CSRC, the regulator for the Mainland), announced the launch of Shanghai-Hong Kong Stock Connect, which will become operational on 17 November 2014. The Stock Connect programme is intended to allow foreign and Hong Kong investors to buy securities and shares (A-shares) directly on the Shanghai Stock Exchange (SSE) by approaching a broker or bank based in Hong Kong and operating in the SEHK (SEHK Participants). The programme also allows Chinese investors to gain access to the Hong Kong Stock Exchange by contacting the Shanghai Stock Exchange Members (SSE Members).

Initially, only the most important and qualified financial institutions were allowed to participate in the programme, but the thresholds and participation requirements were later lowered, allowing smaller and newer intermediaries to enter the market as well. Hong Kong-based institutions trading in securities listed on the Shanghai Stock Exchange,

under the Shanghai-Hong Kong Stock Connect (SHKSC) programme, constitute the investment channel known as the Northbound Trading Link. Conversely, intermediaries trading in securities listed on the Hong Kong Stock Exchange form the Southbound Trading Link. The two channels are regulated separately and have different characteristics. Securities may be suspended from trading if deemed necessary, even by one of the competent authorities (SEHK or SSE), and regulators are also given the option of blocking the entire flow of trading. HKEx, through its subsidiaries, SEHK and the Hong Kong Securities Clearing Company Limited (HKSCC), has opened a branch office in Shanghai to prepare all the necessary infrastructure for the connection. SEHK and SSE have created the Trading Link, which deals with Mutual Order-Routing, then diverting incoming orders from Hong Kong into the SSE book for matching; while HKSCC and China Securities Depository and Clearing Corporation Limited (CSDC-ChinaClear) have established the Clearing Link, which handles settlement, clearing and depository services.

As with the stock market, the debt market in China (which is the third largest in the world after the US and Japan, with \$9.8 trillion in bonds) offers higher yields than the traditional developed markets and, like for equity, bonds will also be included in global indices, attracting investment from foreign players who currently hold less than 2% of Chinese debt (compared to 30% of US debt held by foreign investors). From the perspective of an investor with a diversified portfolio, however, a significant indicator is the covariance between the yields of the A-shares and the return of the portfolio. The correlation between the returns of Western developed market equities is very high, whereas the same indicator between A-shares and other markets is very low. Therefore, Mainland markets offer the opportunity for greater portfolio diversification (including currency diversification) with higher average returns.<sup>20</sup>

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<sup>20</sup> Ibid.

It seems appropriate to ask whether the policy-makers' objectives are indeed those stated. The complexity of the defined rules, which make it very difficult for the investor to meet the required conditions, seems at odds with the intention of increasing the depth and efficiency of the market and the desire to welcome more foreign investors and capital. The peculiarity and specificity of the rules actually gives investors in the market a clear advantage. The classic conflict between insiders and outsiders seems to form, where the latter come up against high barriers to entry, suggesting that the apparent desire to improve market access perhaps conceals the intention, on the part of the regulators, to favour Chinese intermediaries. The search for intermediaries present and authorised to operate in the various markets seems to confirm these barriers, as 78% of SEHK Participants are based in Hong Kong, while intermediaries with domestic euro currency represent just over 1%. If such specific and disparate rules and limits for each market remain in place and no attempt is made to move towards greater simplification, the Chinese regulators will have little success in achieving their stated objectives.

## **London as a Major Chinese Financial Outpost**

Starting with the China-UK Joint Statement in 2015, when “Both sides support[ed] the Shanghai Stock Exchange and the London Stock Exchange to carry out a feasibility study on a stock connect”, China and the UK eventually reached an agreement at the 10th UK-China Economic and Financial Dialogue in 2019, when

Both sides welcome the official launch of the London-Shanghai Stock Connect and the listing of Global Depository Receipts (GDR) on the London Stock Exchange (LSE) by Huatai Securities as the first GDR product under the London-Shanghai Stock Connect and welcome qualified LSE-listed companies to list China Depository Receipt (CDR) on Shanghai Stock Exchange.<sup>21</sup>

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<sup>21</sup> 10th UK-China Economic and Financial Dialogue, 2019.

Shanghai-London Stock Connect has been developed jointly by SSE and LSEG, with the support of both the UK and Chinese governments and in collaboration with regulatory authorities. The Stock Connect has since allowed eligible companies listed on the Shanghai Stock Exchange or the London Stock Exchange to list depository receipts on the other exchange that can be traded under local rules in the local time zone.

Company	Pricing Date	Deal Value USD	Market Value USD
Huatai Securities	14 June 2019	1.7 bn	25.3 bn
China Pacific Insurance	16 June 2020	2 bn	37.6 bn
China Yangtze Power	24 September 2020	2 bn	64.8 bn
SDIC Power Holdings	16 October 2020	201 m	9.5 bn

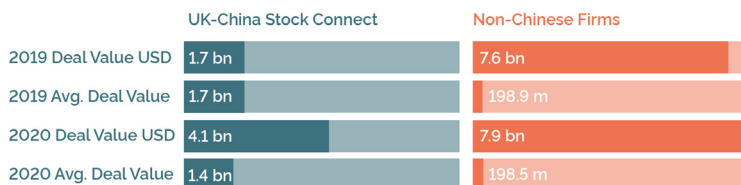
According to Cristiano Dalla Bona, the Shanghai-London Stock Connect scheme got under way with 4 transactions and over \$5.8bn of volume over 2019 and 2020, but there are fears that there is little more to come in the future in London.<sup>22</sup> Four Chinese companies ended up listing global depository receipts on the LSE between 2019 and 2020: Huatai Securities (HTSC), China Pacific Insurance, (CPIC), China Yangtze Power (CYPC), and SDIC Power Holdings Co (SDIC). However, while several Chinese companies found new opportunities to raise money in London, there has been no reciprocal issuance by UK firms in China, causing some to question the scheme and its viability.

Although the scheme has allowed Chinese companies to raise large amounts of money in London, the overall impact has been limited. China proposed to expand the Shanghai-London Stock Connect programme to include companies listed on the

<sup>22</sup> C. Della Bona, "Connection Issues – Hopes fade for Shanghai-London Stock Connect scheme", *Analytics*, 16 May 2022.

Shenzhen Stock Exchange, as well as Swiss and German stock exchanges, according to public information. Heavy equipment manufacturer Sany Heavy Industry, pharma company Lepu Medical Technology and battery producer Gotion High-Tech all filed documentation with local exchanges about their intention to issue GDRs in Switzerland.

Chinese stock connect listing size dwarfs average UK IPO



According to Reuters, a stock connect scheme linking Shanghai and London will be broadened to include Shenzhen-listed companies, as well as capital markets in Germany and Switzerland, CSRC announced at the end of 2021. Expanding the Shanghai-London Stock Connect scheme would help facilitate cross-border investment and promote the opening-up of China's capital markets. Under the current scheme, companies traded in Shanghai and London can list on each other's bourses, by selling so-called depository receipts. Chinese companies can raise fresh capital, but UK-listed companies cannot, as they are only allowed to issue Chinese Depository Receipts (CDRs) backed by existing shares. CSRC published revised rules for consultation, allowing offshore companies to raise fresh capital under the scheme, which will expand to include Germany and Switzerland. In addition, qualified Shenzhen-listed companies can also participate in the expanded programme. All in all, it is still unclear to date how the Shanghai London Joint Stock Connect programme will proceed and consequently, how China's future "financial openness" will shape up.



## Conclusions

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Xi Jinping will start his third five-year term as General Secretary of the Chinese Communist Party at a time of significant domestic and international instability.

Some of the issues that Xi Jinping will have to face with an even stronger mandate after the Congress are: first and foremost, the outbreak of Covid-19 variants. The government was forced to impose harsh lockdowns on hundreds of millions of Chinese citizens in the spring of 2022, due to the weak vaccine coverage in the country. After being shielded by international isolation and the obsessive search for any single positive Covid-19 test for a couple of years, the inhabitants of Shanghai, Shenzhen and other major centres in the country were forced back into the nightmare of the early months of 2020 when the pandemic first erupted in Wuhan. In particular, Shanghai residents flooded social media with videos of protests against the government's inability to provide people with food supplies and healthcare. Xi Jinping persisted with the Zero-Covid policy even at the cost of damaging economic growth, very far below the target of 5.5% GDP growth set in March during the Two Sessions. However, the Chinese government opted to minimise the spread of the pandemic over people's dissatisfaction and economic stagnation in order to guarantee a stable political transition from Xi Jinping's second to third term set for the 20th Party Congress.

But China's main challenges are long-term. This report presents what will shape China's policies in the coming decades both at home and abroad:

- First of all, the demographic trend at home is not reversible and will radically transform China in a few years. The young, growing population that sustained the rise of the economy since the late 1970s will be superseded by an aging and shrinking population. This will result in a growing burden for China's welfare system, and the labour market will face dramatic shortages. How to fix these problems? A possible solution might be found in a positive migration balance in the coming decades, as has happened in developed economies all around the world. According to estimates provided by Michele Bruni in chapter 1, the need for foreigners might exceed 200 million in the next three decades. If this were to happen, Chinese society would be dramatically shaken. Indeed, according to the 7th national census released in 2021,<sup>1</sup> there were only 845,697 foreigners living in China (less than 0.1% of the total population) at the time, and considering people not born in the mainland who had lived there for over five years that number was even lower at 603,682. Roughly speaking, in order to meet the country's labour market needs, China's foreign population could increase from 1 to 200 million in less than 30 years. How this would affect Chinese society, which has thus far been largely isolated, is probably one of the big questions of the century that needs to be solved very soon. Such a shift would probably involve forging a different relationship with the countries that could provide this workforce, i.e., developing nations.
- China has a long tradition of presenting itself as the leader of the Third World, and current international events are forcing it to stress this link once again. At the time of the Cold War, Beijing was one of the strongest voices among the non-aligned countries. Beijing framed

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<sup>1</sup> "Over 1.4 mln foreigners, non-mainland Chinese take part in China's 7th national census", *XinhuaNet*, 11 May 2021.

its relationship with them as South-South cooperation against the role played by former colonial powers. A similar framework has been promoted again in the last decade. Indeed, a major goal of Xi Jinping's well-known Belt and Road Initiative (BRI) was to boost international consensus over China's international presence in a manner designed in Beijing and not in Washington. After a strong start, the BRI probably did not deliver the expected consensus to Beijing, due to the project's lack of clarity and because of strong opposition from the US and the European Union, which presented initiatives explicitly designed to counter it, such as Global Gateway and Build Back Better for the World. However, China did not give up its quest for the consensus of developing countries and presented two major initiatives on this matter: the *Global Development Initiative* (GDI) and the *Global Security Initiative* (GSI). As their respective names imply, both the economic and the security dimensions are addressed, and China's declared aims are to present an alternative to the US-led liberal world order. Although the GDI was first presented at the United Nations General Assembly in 2021, the push to develop a coherent Chinese framework for the world order gained urgency after the Russian invasion of Ukraine in 2020. The invasion was anticipated by the (in)famous meeting between Xi Jinping and Putin at the inaugural ceremony of the XXIV Winter Olympics Games in Beijing. The final communiqué described the relationship between the two countries as a friendship without limits, implying not China's approval of the Russian invasion of Ukraine but rather a shared critique of the existing world order. Xi Jinping (along with Russia) also promoted an alternative world order during the BRICS Summit hosted virtually by China in June and during the Summit of the Shanghai Cooperation Organization (SCO) held in September in Samarkand. The leading

theme of the two summits was in fact enlargement to new partners such as Argentina (BRICS) and Iran (SCO).

- A widening divide between China and the West will also have an impact on China's attempt to secure its energy supply and to lead the transition towards a greener economy. A growing competition over resources is set to start as a consequence of the war in Ukraine, and trade in critical materials and technologies is already being weaponised. This scenario will affect China's as well as the global race for the green transition because of the politicisation of primacy in sustainable technologies and industries in the context of great power competition between China and the US. Succeeding in the green transition is not only a positive outcome for the environment but will define the future of industrial shares across the world. However, China's path is not an easy one, since Xi Jinping will have to harmonise different and conflicting interests such as economic growth and the implementation of low-carbon policies.
- Closely linked to the issues of international consensus and the need for structural reform is the review of China's financial sector and SOEs. The international dimension of restructuring the financial system means that China will be able to create – in practice and not only in theory through rhetorical summit statements – an alternative order to the Western one. China's role as the world's top buyer of fossil fuels might be instrumental in creating such a system – it is not by chance that Saudi Arabia is a forerunner in signing agreements of this kind<sup>2</sup> – even though it will not happen swiftly. However, the real challenge for China is to review its domestic financial system, a long-term necessity for

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<sup>2</sup> S. Said and S. Kalin, “Saudi Arabia Considers Accepting Yuan Instead of Dollars for Chinese Oil Sales”, *The Wall Street Journal*, 15 march 2022.

China which has always been stalled by vested political and economic interests, and which Xi Jinping promised to address at the beginning of his leadership, but has yet to be accomplished.

In conclusion, although China is nowadays facing urgent challenges, those looming over the coming decades are far more alarming. The China we know, with a huge and ethnically homogenous population, might be on the verge of experiencing a watershed moment. This once-in-an-era shift would occur while the post-Cold War international order is collapsing, two main poles are emerging and China is looking to add new partners to its own area of influence, especially among developing countries. To sustain its economy, China needs to complete the green transition and reform the financial system, proving that even an autocracy is able to implement structural reforms that will harm the vested interests of the ruling elite.

From the European Union's perspective, this means considering that in the long-term China's demography will change dramatically, with knock-on effects on its fiscal budget and social cohesion. Moreover, the latent competition with the US is now declared and explicit, and will be played out across the world to win friends and resources.



## About the Authors

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