

## stars insights: 20 August 2018

### “Made in China 2025 – Insights for Companies and Investors”

At their last meeting, *Friends of stars*, an exclusive circle of supporters of stars, gained excellent first-hand insights from **Joerg WUTTKE**, Chief Representative, BASF China, Former President, European Union Chamber of Commerce in China and Member of the stars International Board, Beijing. Joerg shared his view on the latest developments of China's ambitious global initiatives, how they start to backfire and what it means for President Xi's position. This summary has been written by David Erne, Director Asia at stars.

#### China's industrial policy blueprint: Made in China 2025

- **Made in China 2025 (MiC 2025)** is a strategic initiative issued by Premier Li Keqiang in 2015 to **comprehensively upgrade Chinese industry**. MiC 2025 focuses on **10 strategic sectors**, such as **robotics, semiconductors, aviation and new energy vehicles**. The key goal of the initiative is **self-sufficiency**.
- The Chinese government believes that **bureaucratic planning** delivers better results than **market forces**. One of the biggest risks of MiC 2025 therefore is a **nationalisation of designated industries**.
- When Beijing whistles, everyone will follow to please President Xi Jinping. However, **in private many Chinese entrepreneurs do not think highly of these initiatives**. Rather than dancing to the tune of Beijing, they would prefer to act more freely with regards to their investment decisions.
- As a result of MiC 2025, **Chinese companies went on a shopping spree abroad**. This has raised **concerns in the US and in the EU** that Chinese companies, backed by the state, could overtake its own companies and it has led to **tougher screening of Chinese investments**. MiC 2025 is at the heart of the trade standoff between the US and China.

#### The big picture: China's global power grab starts to backfire

- A few months ago, after having **abolished presidential term limits**, Xi Jinping seemed unstoppable. Today, however, it looks like **he may have overreached**. An **economic slowdown** and a **tanking stock market** are feeding domestic discontent, while abroad, in Western capitals and financial centers, there's a **growing wariness of Chinese ambitions**.
- Prominent academics, economists and some officials have begun to **question Xi's overall policy direction**. Some argue that the fault lies with an **overly assertive rhetoric about China's rise**, e.g. overhyped public plans for the Belt and Road Initiative (BRI), that provoked fear and prompted backlash as the US interpreted it as a strategic challenge.
- As **China is not ready for such a confrontation**, there is a newfound sense of self-doubt and some look back nostalgically to **Deng Xiaoping's maxim that China should hide its strength and bide its time**, i.e. to keep a low profile to make China great again.
- As a result of this backlash, official Chinese rhetoric has started to **downplay high-profile strategies including BRI and MiC 2025**. While the rhetoric is changing, the wisdom of the initiative, closely identified with Xi, is beyond question.

### US-China trade war

- **Beijing went into the trade war reasonably confident of victory.** It was argued that Beijing could buy Trump off by promising to increase imports.
- But as tariffs came into force, it became clear that **the situation was worse than expected.** The consensus now is that the **trade war is not only about trade.** It is rather about differences in economic systems and great power rivalry. Beijing now sees it as **Washington's goal to force changes to China's economic model** that will limit its rise.
- The **US threat to cripple Chinese high-tech company ZTE** by denying it exports of US chips was **an embarrassment for Xi** as it clearly showed that **China is still far from independence on dozens of key technologies** and will continue to rely on imports for the foreseeable future.
- As China is learning the hard way how much power the US wields (and how willing it is to use it), the **trade war has now become the prism through which Xi's perceived failings are best projected.**

### Geopolitical hot spots

- Despite all the talk about **North Korea**, it is **unlikely to turn into a hot conflict.**
- **The biggest risk in the region is Taiwan.** Even though for the last couple years it has been relatively quiet around what Beijing refers to as a "renegade province", the conflict has simply been deferred, but not resolved.
- Jiang Zemin brought back Hong Kong and Macao, Xi Jinping wants to bring back Taiwan. **It is just a question of time until the conflict gets back on the agenda.**

### Changing investment climate in China: The example of BASF

- Aided in part by trade tensions between Beijing and Washington, **Germany's BASF** just a few weeks ago managed to wrap up a preliminary deal **to build China's first wholly foreign-owned chemicals complex.**
- The proposed complex, worth some **\$10 billion in investment to 2030**, will be located in **Guangdong**, China's most populous province with more than **110 million residents** and **annual GDP growth of 7%.**
- Foreign companies and investors should now **think the unthinkable** and have a fresh look at the opportunities in China **as foreign investment curbs are eased** and Beijing is moving to fulfil its promise to open its markets.

### How the power of Xi disrupts supply chains

- As party secretaries all over China follow the whims of an all-powerful Xi, supply chains are disrupted at short or no notice at all, severely hurting the planning security for companies. **Two illustrative examples:**
- **1. Xi wants blue winter skies in Beijing:** In order to achieve that, coal plants in Hebei (province surrounding Beijing) are turned off and **Beijing residents switch from coal to gas to heat their homes.** The huge spike in demand for gas can only be met by **diverting gas from Sichuan to Beijing.** As a result, Beijing has blue skies, but **companies in Southwest China relying on the supply of gas have to shut down for several months** and need to comfort themselves with the vague promise that production can restart once Beijing is getting warmer.
- **2. Xi wants to beautify Beijing:** In order to achieve that, in a matter of a few weeks during last winter, **about 2 million people** (which corresponds to about 10 percent of the city's population) **living there illegally had to leave Beijing** as

their makeshift homes and roadside shops were razed to the ground. As a result, the **city's delivery services** which build the backbone of the thriving e-commerce industry and which rely on cheap labour **came close to a standstill**.

#### Anti-corruption campaign

- Upon taking office, Xi vowed to **crack down on “tigers and flies”**, i.e. high-level officials and local civil servants, and his **anti-corruption campaign has netted well over 100 top officials**, including political heavyweights like **Bo Xilai** and **Zhou Yongkang**. In total **more than a million Communist Party officials have been disciplined**.
- While the anti-corruption campaign is **hugely popular among the people**, it has **antagonized large swathes of the elite**. The question now is how long Xi can keep the elite in check.

#### What does this all mean for Xi's position?

- While **Xi may have lost some of his ability to inspire confidence** among his people, **he is still firmly in control** of China's levers of power and money and he is **more capable than ever of inspiring fear**.
- Rather than from a popular uprising, any potential challenge to Xi would have to come from **infighting among the elite**. For now, however, there are **no outwardly visible signs of organized opposition to him in the party**.

#### Three parting shots

- **IP protection and technology transfer**: The **biggest risk for IP of foreign companies** does not emanate from the (lack of) IP protection or (forced) technology transfer in China, but from the **level of cyber security at the headquarters in their home countries**, as those increasingly become preferred targets of Chinese hackers.
- **AI and innovation**: China is making **big strides in areas such as AI, big data, face and voice recognition**. While these technologies are deployed to further refine the control mechanisms of the Communist party, **the surveillance state also has a strong business dimension** which enables international expansion.
- **China in 2023**: In 2023, the **Communist Party of China (1949-)** will have been in power for as long as the **Communist Party of the Soviet Union (74 years from 1917-1991)**. In order to avoid a similar demise of his party, Xi will make sure that businessmen like Jack Ma and Wang Jianlin never acquire as much power as the likes of Boris Berezovsky and Mikhail Khodorkovsky.

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