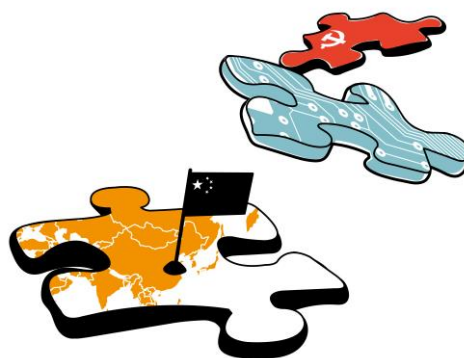


SEPTEMBER 23, 2021

MERICS

China Essentials



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TOP STORY

Transatlantic cooperation on China hits choppy waters

Australia, the US and the UK announced a new trilateral security partnership (AUKUS) to confront China in the Indo-Pacific only hours before the EU released its new strategy to play a bigger role in the area through stronger regional partnerships. The move damaged transatlantic ties and, in particular, hit France as Australia ditched a EUR 50 bn contract for French submarines to acquire US nuclear-powered alternatives via AUKUS.

By excluding Brussels and Paris from the alliance, Washington signaled its impatience with the EU's approach to relations with Beijing and its skepticism that Europe will become a relevant security partner in the Indo-Pacific in the near term. The move called into question the future of European involvement in the region on the very day the EU published its new Indo-Pacific Strategy. Championed by France, it was meant to give new momentum to Brussels' efforts to become a more relevant actor in the Indo-Pacific.

Australia, the US and the UK reportedly failed to inform Brussels or Paris ahead of their announcement. This infuriated the French government, which recalled its ambassadors to Canberra and Washington and now appears to be pushing Brussels to postpone the inaugural meeting of the EU-US Trade and Technology Council. Should perceptions of US disloyalty take root in the EU, AUKUS will likely increase tensions between Europe and the US just as ties were reviving after the Trump presidency. This could make US ambitions to get Europe to more actively confront China even more of a long shot.

At the same time, Australia's acquisition of US submarine technology will only make China double down on military buildup and modernization – and could be even more uncompromising with AUKUS partners. With tensions in the Indo-Pacific region set to rise, Beijing will likely try to take advantage of any transatlantic rift to reach out to Paris and Brussels. China will look for an opportunity to bring EU-China ties back on track by using developments to further push its point that Washington is an unreliable partner.

MERICS analysis: “Coming just weeks after the chaotic withdrawal from Afghanistan, the AUKUS announcement will increase concerns across Europe that the EU can't rely on the US,” said **Helena Legarda**, Senior Analyst at MERICS. “The agreement will lend new urgency to calls for more European strategic autonomy and defense cooperation. This could hinder EU-US cooperation on dealing with China in a number of policy fields.”

Media coverage and sources:

- White House: [AUKUS announcement](#)
- Politico: [Biden shuns EU with Asia-Pacific power play](#)
- Chinese MFA: [First official reaction by Chinese government](#)

METRIX

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Between 2017 and 2020 China's place in the [World Bank's Ease of Doing Business](#) ranking went up by 47 places, from rank 78 up to rank 31. China is now ranking higher than Italy and other European countries. The World Bank measures the regulations that enhance business activity and those that constrain it. Yet, an internal audit of the Doing Business team by law firm Wilmer Hale has revealed significant concerns over the accuracy of the conclusions drawn in the report for several countries, including China. Since the audit was published, the World Bank has announced that it would [discontinue the report](#).

MERICS analysis: "The scandal surrounding the Doing Business report demonstrates the growing influence that Beijing has on international institutions, in this case through implicit willingness to politicize contributions to the World Bank if China's rating was deemed insufficient," said **Jacob Gunter**, Senior Analyst at MERICS. "Yet, while its ranking should likely be lower than it is in the most recent report, this does not mean that China has done nothing to ease the administrative costs and challenges of doing business, as evidenced by modest progress reported in surveys from the European, German, and US Chambers of Commerce in China over the last few years."

TOPICS

China holds "patriots only" election in Hong Kong

The facts: Hong Kong held its first election after reforms earlier this year decreed only "patriots" – people deemed loyal to China and Hong Kong – could stand for public office. About 4900 voters went to the polls to choose members of the Election Committee who will pick the city's Chief Executive and nearly half of the Legislative Council (LegCo). Even though glitches delayed the result by over 13 hours, Beijing hailed the election a success. A mere 364 of 1500 seats were contested and only one opposition candidate, Tik Chi-yuen, managed to win one.

Meanwhile, the city's largest pro-democracy union coalition, the Hong Kong Confederation of Trade Unions, became the latest civil-society group to disband over persecution and security concerns. Ahead of the election, police invoked the National Security Law and ordered organizers of the annual Tiananmen vigil to delete all online posts commemorating the victims of the crackdown. Police also arrested three student activists for allegedly spreading anti-government messages by giving away snacks.

What to watch: This election is a scene-setter for the LegCo election in December. Delayed for a year due to the Covid-19 pandemic, it could see mainly pro-China candidates voted into public office as a result of the electoral reforms implemented in May. Only 20

out of the legislature's 90 seats are directly elected, with the rest determined by the Election Committee and the city's influential trade and industry interest groups. Voter turnout will be keenly watched to gauge public sentiment. Macau held its LegCo election this month and saw a record low number of registered voters taking part. Opposition politicians had been barred from running.

MERICS analysis: This is the beginning of a profound shift in Hong Kong politics. Electoral reforms and the ongoing crackdown on dissent have made it almost impossible for opposition leaders to run for public office and civil society bodies to participate in politics. Instead of "Hong Kong people running Hong Kong," the experiment put in place after colonial rule, it is now a case of "patriots governing Hong Kong," as ordered by Beijing. By only allowing pro-China loyalists at the helm, Hong Kong's political agenda will increasingly be dominated by priorities very much in line with Beijing's directives.

Media coverage and sources:

- SCMP: [Hong Kong's election committee finalized after marathon vote](#)
- HKFP: [Macau: Legislative election turnout at historic low after opposition barred from running, gov't blames weather and Covid](#)
- NIKKEI Asia: [Hong Kong police invoke security law to censor online posts](#)

China applies to join transpacific trade agreement

The facts: China applied to join the Comprehensive and Progressive Agreement for Transpacific Partnership (CPTPP) on September 16. The agreement is the successor to the original TPP, which collapsed after the Trump administration withdrew from it, though many of its provisions regarding subsidies, state-owned enterprises and other distortions remain. Some 11 countries from the Pacific Rim were initial signatories.

What to watch: China will struggle to join this club – which requires unanimous approval by current members – for two reasons: first, it has politically and economically aggravated many of the signatories, most notably Japan, Vietnam, Canada and Australia; second, China would have to enact major reforms to comply with the trade partnership's rules on subsidies and state-owned enterprises, among others. Many of these are founding elements of an agreement that aims to counter distortions from China.

MERICS analysis: "China likely has two possible goals in mind. The first is to actually be accepted and use negotiations to carve out exemptions for itself – or even dismantle provisions against subsidies and state-owned enterprises," said **Jacob Gunter**, Senior Analyst at MERICS. "The second, more cynical, goal is to delay further enlargement of the partnership and to use any denial of its application as evidence that China is being 'contained' by foreign powers."

Media coverage and sources:

- ABC News: [China formally applies for CPTPP membership after lobbying Australia](#)
- SCMP: [Beijing's bid to join CPTPP may fail yet also succeed, experts say](#)

VIS-À-VIS

Max J. Zenglein on the Evergrande crisis: “A government bailout should not be expected”

Chinese real estate giant Evergrande is teetering ominously. Observers and investors are looking with concern at the group, which has amassed a debt mountain of more than USD 300 billion. Some fear insolvency, which could send shockwaves through the real estate and financial markets. MERICS China Essentials asked MERICS Chief Economist **Max J. Zenglein** for his take.

Is Evergrande really threatened with insolvency, and could such an insolvency result in the collapse of the real estate and financial markets?

I do not expect Evergrande to become insolvent. Nor do I think that the Chinese real estate market will collapse or that will trigger a financial crisis in China. The Chinese government wants to avoid that at all costs. It will try to let the pressure out of the real estate bubble in a slow and controlled way. This process will drag on for many years. Evergrande itself is threatened with breakup. It is also possible that the group will be placed under government control, as we have seen for example with Anbang in 2018.

Why has the government let it get this far?

The government and regulators have been warning for some time that they would no longer tolerate the excesses in the Chinese real estate market. Real estate developers like Evergrande have taken on massive amounts of debt to build new apartments. At the same time, many Chinese have speculated in real estate, driving up prices. Xi Jinping has been warning for years that houses are for living, not speculating. Now the government has made financing more expensive for real estate developers and restricted land sales. It has also formulated “three red lines”, i.e., thresholds of financial ratios, to improve financial health back in October 2020. Beijing wants to prevent the emergence of even greater risks to China's financial system.

What kind of toolkit does the government have at its disposal to manage the situation?

The immediate risk posed by Evergrande would be a default on some of its liabilities, which is already underway due to the absence of cashflow to make payments to lenders or to continue construction activities. Evergrande has been trying to sell assets to raise cash, but other than a few cases, most companies are unwilling to buy what they view to be toxic assets. Beijing could command its SOEs to buy some assets or take over contracts and see them completed to help stem the bleeding and buy time. The party could also make it a political mission of private companies to take over some of these assets in return for political favor, or the state could create some incentives for them to do so.

A government bailout, however, should not be expected. Instead, the government's policy priorities will determine a hierarchy on how liabilities will be dealt with. The foremost priority will be on limiting the impact on private households and contractors for the sake of minimizing the immediate economic risk. The tanking stock market will affect domestic and foreign investors alike, but this is hardly a development that concerns the government as long as it can contain the overall fall out of Evergrande on financial markets. Foreign

bond holders can expect to be at the bottom of the list and should brace themselves for default on payments.

What consequences could Evergrande's situation have for international bondholders?

Evergrande has borrowed a total of more than USD 20 billion from international investors. Some of them will probably lose a lot of money. Nevertheless, I don't think a global shock wave is likely. However, the case shows the risks that lie dormant in the Chinese financial system. Foreign investors have recently had more and more opportunities to operate directly on the Chinese market.

Looking beyond Evergrande, how will China's property market change?

The biggest challenge will be to prevent housing prices to collapse as China's economy becomes less reliant on real estate for economic growth and private investors diversify their investment portfolios. Looking forward I do expect more regulation coming that will shake up real estate, including an end or at least a limit to how homeowners pay in advance for property that is not yet built. I could also imagine a form of government mandated investor protection for real estate investment. Or why not a mandate for real estate companies to contribute to "common prosperity" by building "affordable" housing.

PROFILE

Liu Simu: Chinese-born Hollywood hero unwanted in China

32-year-old Liu Simu recently shot to global fame for playing the lead role in the Disney blockbuster "Shang Chi and the Legend of the Ten Rings". The film is the first in the lucrative Marvel franchise to feature an Asian superhero and has grossed over USD 260 million worldwide, topping box offices in nearly 50 countries, including the United Kingdom, Germany, and South Korea. Despite the movie's success, Chinese censors have not yet given approval for it to be screened in mainland China – and they might never.

One reason could be the backlash Liu triggered in China for an interview he gave in 2017 in which he described his country of birth as "third world". The interview with the actor, who was born in Harbin, China, and emigrated to Canada with his parents when he was five, is no longer available online. But Chinese social media users have recently reposted screen shots of it and called on fellow citizens to boycott the movie.

Liu is the latest celebrity of Chinese ancestry to be mired in a surge of nationalism on the country's social media. Beijing-born, US-based director Chloe Zhao was criticized earlier this year for being unpatriotic in calling China a place with "lies everywhere" in a 2013 interview. Chinese censors subsequently blocked news of her being named best director at the Oscars, and her movie "Nomadland" was never released.

Liu's Marvel installment could suffer the same fate for another reason. China's Global Times has called the movie unacceptable for adapting material from a Marvel comic that the ultra-nationalist state tabloid says is full of racist stereotypes vilifying ethnic Chinese. A ban in China would be another setback for Hollywood productions in the world's largest movie market that sticks to a strict quota of 34 foreign films a year.

Media coverage and sources:

- Box Office Mojo: [Shang-Chi and the Legend of the Ten Rings](#)
- Screen Daily: [‘Shang-Chi’ top of the world as box office hits \\$256m](#)
- CNN: [Starring in a Marvel blockbuster doesn't exempt this Canadian from scrutiny in Xi's China](#)
- CNN: [This year's Oscars could have been a moment of pride for China. Then politics got in the way](#)
- Weixin (CN): [美媒:这部美国电影若无法在中国上映,影响会很大!](#)
- CNN: [What if China no longer needs Hollywood? That's bad news for the film industry](#)

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MERICS' Top 3

- Reuters: [In climate pledge, Xi says China will not built new coal-fired power plants abroad](#)
- Politico: [Von der Leyen's subtext: It's all about China](#)
- NDR: [Chinesische Reederei steigt bei Hamburger Hafenterminal ein](#)

Politics, society and media:

- SCMP: [2021 National Games of China](#)
- CNN: [China rushes to contain 'school centered' Delta outbreak before major holiday season](#)
- NYT: [China #MeToo figure vows to appeal after losing landmark case](#)
- FMT: [Australian uni says Chinese Uighur profiling study breached ethics code](#)

Economy, finance and technology:

- Reuters: [China's high-tech push seeks to reassert global factory dominance](#)
- The Economist: [The vanishing allure of doing business in China](#)
- NPR: [Big sell-off in Chinese real estate stocks caused worldwide market dip](#)
- WSJ: [Xi Jinping aims to rein in Chinese capitalism, hew to Mao's socialist vision](#)

International relations:

- SCMP: [Climate change: China should pledge absolute carbon emissions cap until 2025, advisory body headed by vice-premier says](#)
- SCMP: [Angela Merkel and Xi Jinping discuss 'close economic ties' in likely last official call together](#)
- AP: [Germany says China has refused port stopover by warship](#)

- Reuters: [IMF chief called out over pressure to favor China while at World Bank](#)
- Xinhua: [Xi calls for steady transition of Afghan situation, dialogues with Afghanistan](#)
- Xinhua: [China, U.S. hold 12th political party leaders dialogue](#)

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