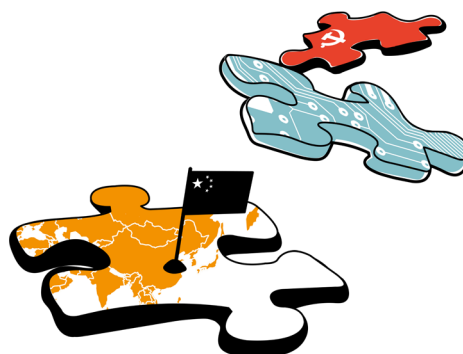


SEPTEMBER 22, 2022

MERICS China Essentials



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TOP STORY

Xi at the SCO meeting: Forging alliances and securing energy supplies

Xi Jinping's participation in the Shanghai Cooperation Organization (SCO) summit in Samarkand, Uzbekistan, on 15 September highlighted the importance of Central Asia to Beijing's global ambitions and energy security. Geopolitics and Xi's first in-person meeting with Russian President Vladimir Putin since Russia invaded Ukraine (and Putin's acknowledgement of China's concerns) took center stage. But this could not hide the fact that Central Asian countries have become key to Beijing's plans to diversify energy imports – Turkmenistan, Kazakhstan and Uzbekistan have considerable natural gas and uranium reserves – and that some countries in the region have in the past months become more wary of Russia.

This was Xi's first trip abroad since the start of the Covid-19 pandemic in early 2020 and he appeared to make the most of it. Apart from Putin, he met bilaterally with the heads of state of almost every other of the nine SCO members, including Kazakhstan and Uzbekistan. And he made time for the leaders of some SCO "observers", "dialogue partners" and "guest attendees," including Mongolia, Turkmenistan and Belarus. All this activity made Xi's omitting to meet Indian Prime Minister Narendra Modi all the more glaring. Tensions between the two countries have been running high since 2020, when their troops clashed at the India-China border.

Central Asia will remain a focus of Beijing's foreign policy, and the SCO and formats like the BRICS group are meant to help Beijing stand up to Western pressure and push back against the Western-dominated global order. As relations with Western powers are becoming increasingly tense, the Chinese leadership sees the SCO as a group of largely like-minded countries. Foreign Minister Wang Yi has called the SCO a "circle of friends" to break US "encirclement". This is one reason why Beijing has stepped up its support for SCO enlargement, with this summit seeing the induction of Iran as a full member and the start of the accession process for Belarus.

MERICS analysis: "Moscow has traditionally been wary of Chinese forays into Central Asia, but its war against Ukraine has changed the dynamics," says **Helena Legarda**, Lead Analyst at MERICS. "Many countries in the region are uneasy about Moscow's invasion of Ukraine and are looking to rebalance diplomatic ties, giving Beijing a chance to step in at Moscow's expense."

Media coverage and sources:

- Xinhua News: [习近平会见俄罗斯总统普京 \(Xi meets Putin\)](#)
- Ministry of Foreign Affairs of the PRC: [President Xi Jinping Attends the 22nd Meeting of the SCO Council of Heads of State and Delivers Important Remarks](#)
- Global Times: [Xi's trip to Central Asia 'breaks US encirclement' with 'a circle of friends at SCO'](#)
- MERICS: [Kazakhstan's three-way balancing act between competing powers is under pressure](#)

METRIX

4

This is the number of times US President Joe Biden has publicly said the US would defend Taiwan if China attacked it – an apparent serial breach of Washington’s decades-old “strategic ambiguity” that is meant to keep Beijing – and Taipei – guessing about how the US would react if the former attacked the latter. Each time, the White House has been quick to reiterate that the official US policy towards Taiwan hasn’t changed. A growing number of US pundits believe Biden’s clarity has put an end to strategic ambiguity. But this raises the question whether its successor is automatically a clearly unambiguous policy – or simply ambiguous ambiguity, sowing new confusion. (Sources: [WP](#), [Vox](#), [White House](#), [ABC News](#))

TOPICS

China’s chip-making breakthrough is reliant on Western technology

The facts: After long trailing in computer-chip making, China appears to have taken a big step towards manufacturing so-called 7 nanometer (nm) chips, an advanced technology currently dominated by Taiwan. The breakthrough by Shanghai-based Semiconductor Manufacturing International Corp. (SMIC) could boost Beijing’s efforts to make China self-sufficient in high technology – even though SMIC seems to have drawn on a process that industry giant Taiwan Semiconductor Manufacturing Company (TSMC) abandoned in development several years ago and that is reliant on Western manufacturing equipment. TSMC’s cutting-edge chips currently measure 5nm – and the company is working on 3nm models.

What to watch: While Beijing has given China’s investment vehicles a mandate to fund a domestic supply-chain for advanced chips, its gains so far have been meager. SMIC’s feat could be the first step in changing that – although it remains to be seen whether the company can use old technology to make its chips as well and as cheaply as western rivals do using newer methods. TSMC abandoned a similar process due to the technical limitations of scaling it. If SMIC continues to make chips in this way, it will be relying on older deep ultraviolet technology from Japan, the EU or the US. For its smallest chips, TSMC relies on newer extreme ultra-violet lithography, a technology banned from sale to China by the US.

MERICS analysis: “SMIC’s breakthrough is more of a political statement than a true achievement in China’s semiconductor race with the West,” says **Antonia Hmaid**, MERICS analyst. “The process is not efficient and not easily adapted to make even smaller and faster chips. However, cutting-edge technology is generally much less strategically important than many people think. SMIC’s fabrication processes are

good enough to make chips for most applications – even if, tellingly, they still rely on technology made in the US, EU or Japan.”

Media coverage and sources:

- EDN: [The truth about SMIC's 7-nm chip fabrication ordeal](#)
- MSN: [SMIC's New 7nm Chip Should Worry West — But There's A Way Out](#)

CNY depreciation complicates China's economic situation as challenges pile up

The facts: China's currency fell through the much-watched exchange rate of 7 yuan (CNY) to 1 US dollar (USD) on September 16 – something that had only happened twice during Xi Jinping's decade in power. The yuan's depreciation from around 6.37 in mid-April makes it costly to import the goods China needs for infrastructure projects and other investments as part of Beijing's efforts to boost economic growth. It also makes foreign inputs for China's exports more expensive.

The decline comes as the US Federal Reserve has raised interest rates – five times since mid-March – in an attempt to subdue inflation. Even though central banks have been raising rates, the euro and British pound have also fallen as economic and political uncertainties encouraged investors to buy the USD as a safe haven. In contrast, the People's Bank of China (PBOC) faces little inflation and has been cutting interest rates as part of Beijing's efforts to prop up the Covid-19-hit economy.

What to watch: Currency depreciation will above all hurt China's efforts to boost growth through infrastructure investments and higher consumer demand. At first glance, a weaker CNY should make China's exports cheaper for those paying in dollars. But this also means pricier imports that will drive inflation, especially imports of raw materials, energy and other commodities Beijing needs for its infrastructure-focused stimulus measures. Furthermore, a weakening CNY will add to growing capital outflow caused by China's various economic problems and investors looking for returns elsewhere. Finally, breaking the 7:1 rate will also have a psychological impact on already-weak business and consumer confidence.

MERICS Analysis: “The CNY is currently depreciating against the USD like most currencies, albeit for very different reasons. This serves as a reminder of how out of synch China's economy is with its biggest partners,” says **Jacob Gunter**, MERICS Senior Analyst. “The PBOC will need to try to balance the need to tighten interest rates to prop up the currency on one hand, and the need to loosen interest rates to support GDP growth on the other. Whichever way the authorities lean will inherently limit Beijing's ability to manage the broader economic challenges of the day.”

Media coverage and source:

- MERICS: [China's caution about loosening cross-border capital flows](#)
- Bloomberg: [Offshore Yuan Drops Past 7 Per Dollar for First Time Since 2020](#)
- Nikkei: [China cuts rates again to shore up stumbling economy](#)

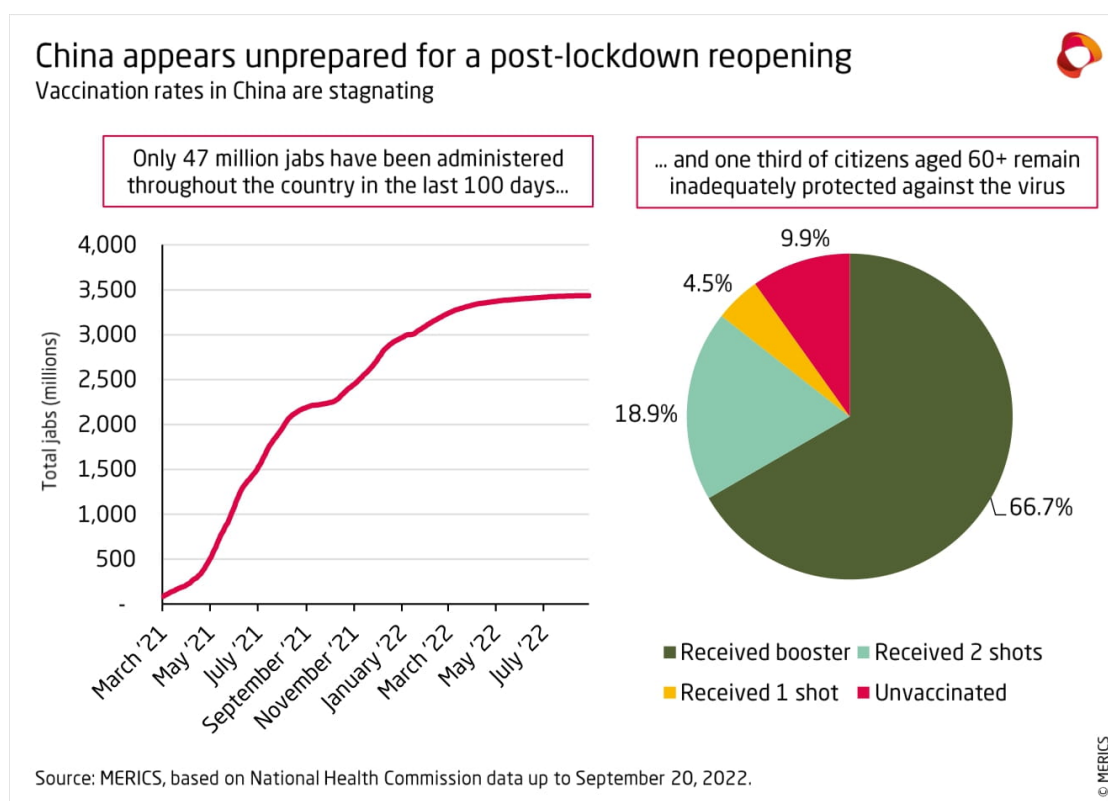
- SCMP: [China's yuan breaching key level of 7 per US dollar for first time in over 2 years creates quandary for Beijing](#)

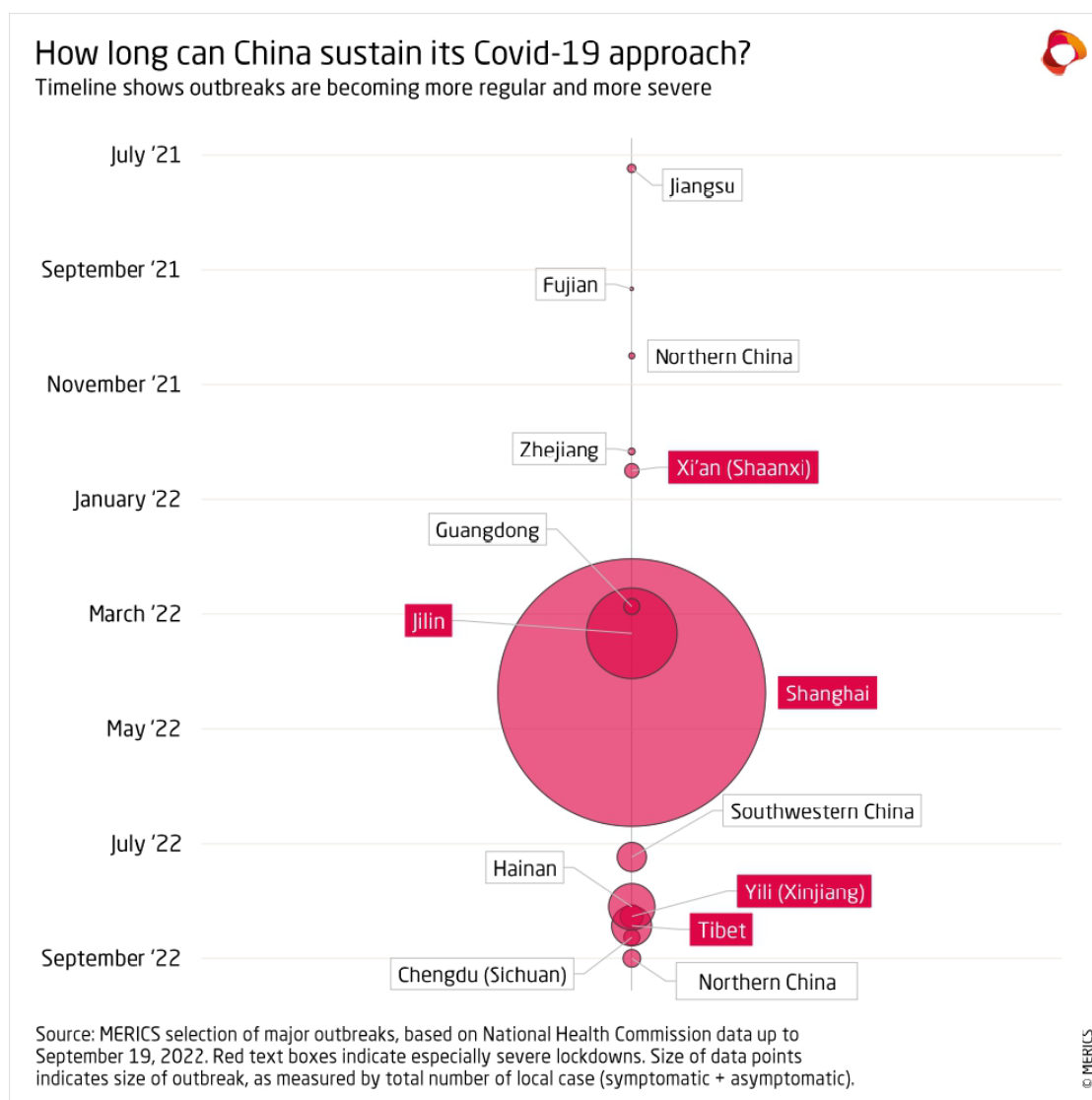
Chinese public increasingly worried Zero-Covid is becoming an end of itself

The facts: With the 20th Party Congress looming, the Chinese public is getting increasingly restive about the strict enforcement of the country's zero-covid policy. For example, in an apparent rush to hit a zero-covid deadline of September 19, officials in Guizhou were ferrying contacts of positive cases into quarantine in the middle of the night, when the bus crashed and killed at least 27 people on board. Social-media reactions were shrill. "What makes you think that you won't be on that late-night bus one day?" read one comment on Weibo garnering 250,000 likes, with another responding "we're all on the bus, we just haven't crashed yet."

What to watch: As usual, central leaders divert the public's anger to local officials, holding a few accountable but ignoring the systemic issues that give rise to accidents like these. The threat of punishment to local officials for mishandling an outbreak is so great that they repeatedly cut corners on safety in the name of zero-covid.

MERICs analysis: "Despite widespread public criticism in recent weeks, hopes for any change in China's zero-covid policy directly after the 20th Party Congress seem premature", says MERICs Analyst **Vincent Brussee**. "By all known metrics, the country is less prepared for re-opening than it was in summer. Vaccination and booster rates have stagnated over the past months, so overall immunity may even have dropped as the protection of early vaccinations has worn off. Moreover, winter is coming, increasing pressure on China's shaky healthcare system."





Media coverage and source:

- China Digital Times: [Bus Crash Kills 27 in Late-night Transit to Remote Quarantine Facility](#)
- Washington Post: [China channels anger over quarantine bus crash toward local officials](#)

REVIEW

Volt Rush: The Winners and Losers in the Race to Go Green by Henry Sanderson (Oneworld Publications, 2022)

Henry Sanderson's highly readable book focuses on China's role in the supply of batteries for electric vehicles (EV), especially its footprint in mining and refining raw materials for them. He makes a convincing case that this story matters widely because the demand for raw materials makes the era of clean energy "as geopolitical as the age of oil." The US

Congress recently passed the Inflation Reduction Act, which, among other things, effectively aims to oust China from American battery supply chains.

Sanderson's experience as a journalist shines through in the book, which includes a wealth of details about companies and characters involved. His narrative is structured around the main minerals needed for EV batteries. Mineral by mineral, he sheds light on the business activities of Chinese companies from Southeast Asia to Africa. With these many stories he paints a bigger picture, in which the world has come to depend on a handful of Chinese firms for its energy transition, with China itself dependent on raw material imports, as it excels primarily in the midstream activity of refining the raw materials.

As to the widely assumed involvement of the Chinese state, Sanderson notes private companies like Tianqi Lithium or Huayou Cobalt dominate the sector. But he is also clear that China's government was no idle bystander – these companies received loans from China's state-owned banks or benefitted from highly political resource-for-infrastructure deals in countries like the Democratic Republic of Congo. Private entrepreneurship and state support made China the crucial link in EV supply chains.

The author also looks at how the EV industry might source minerals in future – for instance, through recycling and deep-sea mining. In the light of debates about reliance on China, he focuses on efforts in Europe and North America. But it would have been compelling to learn more about China's own attempts to reduce its dependence on raw material imports. After all, it wants to become a global leader in EV battery recycling – and Europe has a history of sending its waste to China for processing.

Reviewed by **Gregor Sebastian**

PROFILE

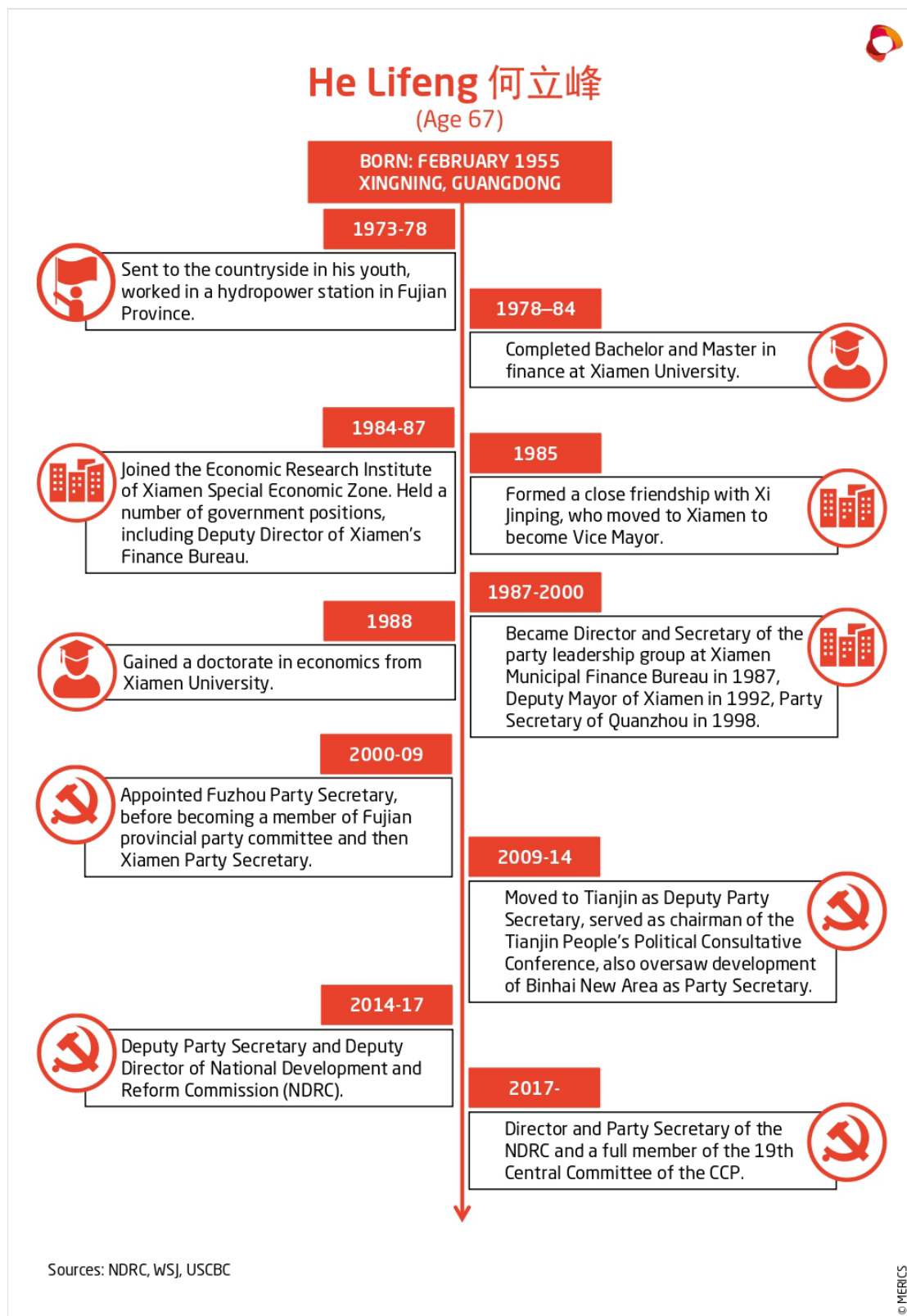
He Lifeng - Economic planner looks set to become new economic czar

The economist He Lifeng is considered one of Xi Jinping's closest allies, having accompanied the Chinese Communist Party's (CCP) leader on most of his tours around the country. The Guangdong native has worked in economic planning for decades and currently serves at its pinnacle as Chairman and Party Secretary of the National Development and Reform Commission (NDRC). October's 20th CCP Congress looks set to promote him to the seven-member Standing Committee of the Politburo, the most powerful political body in China.

There, He is expected to replace Liu He, often dubbed China's "economic czar," and assume day-to-day charge of the CCP's Central Economic and Financial Affairs Commission, which is chaired by Xi. Harvard-trained Liu He is 70 and so has passed the Politburo's unofficial retirement age of 68. With loyalty to the Party leader a priority, He Lifeng will more likely follow Xi's orders than to exert an open influence as China's next economic czar. His portfolio will cover state-owned enterprises, the financial sector and trade negotiations with the US and the EU.

He Lifeng became known for his involvement in infrastructure development and special economic zones while holding senior posts in Fujian and Tianjin. After a doctorate in

economics, he worked his way up through the municipal finance and tax offices of Xiamen in the 1980s, working under Xi when the latter was vice mayor. After himself serving as a vice mayor, he from 1995 held senior positions in Fujian, including provincial party leader, and in 2009 moved to Tianjin as deputy party secretary. He was made vice-director of the NDRC in 2014.



Media coverage and sources:

- WSJ: [China's Xi Weighs Tapping Loyalist as Next Economic Czar](#)
- SCMP: ['Economic tsar' Liu He has President Xi's full trust, but who can fill in when Liu retires?](#)

MERICs CHINA DIGEST

[China protests to International Atomic Energy Agency over AUKUS nuclear safeguards \(SCMP\)](#)

China has raised strong objections with the International Atomic Energy Agency (IAEA) urging the nuclear watchdog not to back Australia's plans to acquire nuclear-powered submarines through the AUKUS pact. Australia negotiated a deal with the US and Britain in September last year to acquire submarines as part of the security pact formed to counter China's growing military presence in the Asia Pacific. (14/09/22)

[Zhengzhou Becomes First Big City to Scrap 'Hukou' Restrictions \(Sixth Tone\)](#)

Zhengzhou is the first big Chinese city to abolish restrictions imposed through China's household-registration or "hukou" system, a longstanding policy that controls social migration by restricting access to social welfare benefits and the right to purchase properties. The city decided to scrap barriers for buyers without a local registration to stabilize the real estate market and attract talents from across China, allowing people moving there to apply for the necessary household registration documents. (15/09/22)

[Monkeypox: don't touch foreigners, says China health chief, as first case reported \(The Guardian\)](#)

The chief epidemiologist of China's Center for Disease Control and Prevention Wu Zunyou advised people to avoid physical contact with foreigners to prevent the possibility of a monkeypox infection in a widely shared Weibo post. China had just reported the first known case of the virus in the country on September 16. (19/09/22)

[One year on, few details available about detention of activists Wang Jianbing and Sophia Huang Xueqin](#)

Some details emerged about the situation of labour activist Wang Jianbing and #MeToo journalist Sophia Huang Xueqin after they've disappeared into state detention a year ago. According to information provided by friends of Wang his case has now been sent to court, after having been returned to the police for a second investigation. Huang's case has also been sent to court and the two are expected to face trial at an unknown date. (19/09/22)

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