China's Leadership Transition and Implications for Asia

16 SEPTEMBER 2017

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CONTENTS

Executive summary 1
Introduction 5
Changing nature of Chinese politics 6
Assessing the 19th Party Congress 11
Implications for Chinese economic policy 19
Implications for Asia, security, prosperity and stability 23

CONTACTS

Evan Medeiros
Managing Director, Asia
+1 202.552.5388
medeiros@eurasiagroup.net

Callum Henderson
Managing Director
Global Markets, Asia Pacific
+65 6679 6258
henderson@eurasiagroup.net

Meredith Sumpter
Director, Asia
+1 202.903.0019
sumpter@eurasiagroup.net

Michael Hirson
Director, China
+1 646.291.4037
hirson@eurasiagroup.net

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Executive summary

The 2017 Chinese Communist Party’s (CCP) leadership transition will shape China’s political and economic trajectory for the next five—or even possibly the next 15—years. President and Party Chairman Xi Jinping will almost certainly emerge stronger from the 19th Party Congress, with implications for China’s emergence as a global player in the 21st Century.

Changing nature of Chinese politics

China’s upcoming leadership transition should be understood in the context of a political system that is evolving and changing as Xi asserts his vision for the future of Chinese politics, economics, and diplomacy. Xi is remaking Chinese politics with himself and the party at the center.

The relevance of political factions is decreasing and individual networks are becoming more notable drivers of promotions and political change. Accordingly, members of Xi’s network are well positioned to assume leadership positions at the 19th Party Congress in 2017 and the 20th Party Congress in 2022.

Assessing the 19th Party Congress

The leadership transition “process” in China is still new and poorly institutionalized, which is a source of uncertainty about the outcome for this fall. There are few formal rules guiding it, such as the stipulation that a party congress must be held every five years. There are, however, several norms that are likely to govern the leadership transition. The mix of rules and norms that Xi’s uses (or does not) will reveal much about his leadership style.

The leadership transition will solidify Xi’s control over the country. During the past five years, he has positioned himself as the “core leader” and prepared his allies to take positions of power; several could be possible successors. While Xi will push some boundaries, making this leadership transition less predictable than previous ones, he is unlikely to stay for a third term (or at least makes move toward that end right now).

The scale of the turnover will be substantial and the implications will be significant for China, Asia, and global markets. There will likely be a 70% turnover at the very top (that is, the Politburo Standing Committee) and substantial change below that level (the Politburo).

A knock-on effect of personnel changes in the party apparatus will be shifts in many senior government positions, especially among the key economic decision-makers. This will directly affect the speed and scale of Xi’s economic and social policies. With key allies in place to oversee economic policy, Xi will be better placed to overcome the entrenched interests and bureaucratic inertia standing in the way of his goals.
Implications for Chinese economic policy

In Xi’s second term, the overall orientation of economic policy will hew more closely to Xi’s vision. Economic stability and upgrading China’s economy will be the first and second order priorities for Xi. “Xi-economics” will emerge as a more forceful mix of market liberalization in some areas, and a heavy hand for the CCP and the state in others.

This dynamic will have mixed implications for China’s economic outlook in the next five years. Xi will intensify efforts to head off a crisis in the financial sector, even at the cost of accepting modestly lower economic growth. But Xi’s impulse for strong state and party control will continue to conflict with many types of much-needed market reforms, such as commercializing state-owned enterprises (SOEs). The upshot could be a sharper-than-expected slowdown in growth toward the end of his second term as the return on capital diminishes.

The president’s new campaign to prevent financial risks will continue and its scope will likely expand from its current focus on cleaning up the financial sector to deleveraging. Expect more top-down industrial policies designed to favor advanced manufacturing, technology, and other areas of the “real economy,” to upgrade China’s economy. With regard to foreign investment, China will be more willing to open areas such as health, education, and financial services to both private and foreign competition, while officials more slowly introduce minor openings in other areas.

Implications for Asia

The past five years of Chinese diplomacy have revealed that Xi is the architect of a more globalist posture and more assertive behavior in Asia. In the next five years, this will continue, albeit in different ways than before, especially regarding China’s external economic profile. Ultimately, Xi will seek to accelerate the emergence of a regional order where China has preponderant influence.

However, China will also remain a somewhat reluctant global leader, facing constraints to its influence and foreign policy initiatives. China will explore the boundaries of its power and influence and will struggle to reconcile its multiple and competing foreign policy interests. How the country balances them will define its image in the region and world for the foreseeable future.

In Xi’s second term, China will succeed in its goal of achieving greater economic integration with other East Asian countries and greater military advantage over them. It will advance its efforts to take a leading role in defining and driving Asia’s economic future. Economic gains at home will translate into increasing Chinese investment in its military capabilities.

More specifically, on military issues, the Chinese navy will play an increasingly active role in Asia and globally. As naval capabilities develop, China will focus on “far seas” protection, including in the Arctic for both resource extraction and as a means to prevent military encirclement by opposing powers.
With increasing confidence in its economic strength and military superiority, China's tolerance for challenges to its identified interests likely will diminish, especially on matters related to sovereignty and territorial integrity. Beijing will press countries to meet China's needs first.

Yet there will be constraints on China's rising influence. First, the country will struggle to reconcile its desire to project its “peaceful rise” with its increasingly muscular pursuit of strategic objectives in East Asia. Second, Chinese assertiveness could generate a counter-reaction in the rest of the region.

From Beijing’s perspective, however, the level of pushback is likely to be manageable. It is unlikely that the entire region—or a significant collection of regional actors—will coalesce around a coordinated effort to confront Beijing.

Beyond Asia, China will continue its pattern of becoming more active on global issues. Under Xi, the country has shown an increased willingness to get involved on issues previously of marginal interest such as Syria, the Middle East peace process, the Iran nuclear freeze, global climate change efforts, global public health, peacekeeping, and the global fight against Islamic extremism.

Anxious about the unraveling of the post–World War II global order, China will largely seek to keep global rules and norms intact and global institutions such as the UN functional. That said, it will aim to promote a fairer, more equitable, and balanced global governance system that takes more into account China's interests as well as those of developing countries. This will be a paradox for China as it evolves from identifying with developing nations to increasingly being seen as part of the developed world and the rule-making countries, as opposed to the rule-taking countries.

**Key issues: US-China, Belt and Road Initiative, Hong Kong & Taiwan, North Korea, maritime**

Xi will face the mounting challenge of managing tensions with the US over trade and North Korea, as well as other issues such as Taiwan and possibly the South China Sea. The Chinese president is far more comfortable with friction and tensions in US-China relations than his predecessors and, thus, frequent ups and downs are likely. Volatility in US-China relations is a virtual certainty for the remainder of US President Donald Trump's term.

Xi will want his successor to continue prioritizing the Belt and Road Initiative (BRI), though much will depend on whether he can place one of his allies into the general secretary role. There are concerns domestically about the risk of BRI investments and the ability of China's state-backed banks, commercial lenders, and borrowers to make good lending decisions. The initiative lacks a concrete framework and supporting policies, calling into question the government’s ultimate ability to steer it.

Still, BRI offers Beijing a key tool to expand its influence with the rest of the world: Its focus on infrastructure and connectivity draws countries into China's diplomatic
orbit, and underscores Beijing’s ability to articulate a global strategy. BRI is the only new and big idea in current global economic affairs.

Hong Kong and Taiwan will remain Beijing’s two most immediate territorial interests during Xi’s second term. The outlook for each is a tighter grip, albeit with important nuances. Beijing’s waxing influence in Hong Kong will expand considerably in coming years. It will continue to deploy both formal and informal measures aimed at drawing Hong Kong closer, especially if pro-independence voices continue to gain traction. With Taiwan, the trajectory is clearly headed toward more pressure, though there is a constraint to Beijing’s efforts to tighten the screws.

When it comes to North Korea, Beijing views Pyongyang’s chronic provocations and efforts to develop nuclear weapons and the intercontinental ballistic missile technology to deliver them as dangerous and growing liabilities. That said, Chinese leaders will remain unwilling to squeeze Kim Jong-un’s regime hard enough to risk toppling it, and China’s spotty record in fulfilling pledges to do more to restrain North Korea is unlikely to improve.

In terms of maritime issues, Beijing has solidified its advantage over the other South China Sea claimants with its seven reclaimed features. This calm is likely to continue in Xi’s second term, as no other regional players appear willing to challenge China, and Beijing has limited incentives to expand further. As long as Beijing retains this superiority, Chinese leaders are unlikely to push harder on their sweeping claims unless they feel provoked.

In both the South and East China Seas, China will maintain its near-constant presence around the disputed Paracel, Spratly, and Senkaku/Diaoyu Islands. Its navy, including the submarine fleet and its aircraft carriers, will maintain a presence out to the second island chain, with the next step likely being a more permanent presence for coast guard vessels and planes on the seven reclaimed features.
Introduction

China’s upcoming leadership transition is taking place at a time when Xi has emerged as China’s most powerful leader in two decades. Still, there is still much uncertainty about China’s future trajectory—and what Xi will do in his second term. Among Western and Asian policymakers, business leaders and analysts, there are numerous (and intensifying) debates about where the country is heading, and what it means for regional and global security and prosperity, including on the issues of:

• Will Xi Jinping seek to strengthen the institutionalization of China’s political system or assert his personal authority over the political transition process?
• How will Xi pursue the further rebalancing of China’s economy and will he embrace market oriented reforms in a manner that accepts a reduced role for the state in economic life?
• How will China pursue its security interests in Asia as it becomes the dominant regional economic power; and
• How will Xi assert China’s interests in global institutions and contribute to global governance?

The answers to these questions will provide important clarity about the future trajectory of China at a time of political change under Xi, and as China’s regional influence and global stature rise.

Much of the current research on these questions assesses these questions individually, but not how they all affect politics, economics, diplomacy, and defense affairs. An integrated approach is needed to assess the interaction between China’s new political leadership (under Xi) and the impact on policymaking in all of these areas. This study attempts to do just that.

The study opens with an assessment of China’s changing political environment and how Xi is remaking Chinese politics. It then considers what these changes mean for the leadership transition, the selection of China’s next generation of leaders, and Xi’s ability to wield political influence over China’s party and government systems through 2022 and beyond.

The study then evaluates the implications of the leadership transition for China’s economic policy and plans to upgrade the economy. The second half of the study assesses China’s role in Asia and globally in Xi’s second term, before turning to key foreign policy challenges: US-China relations, the BRI, Hong Kong and Taiwan, the Koreas, and Asian maritime issues.
Changing nature of Chinese politics

There are several new aspects of China's politics and policymaking that have emerged during Xi’s tenure. This section assesses these dynamics and their implications for future policymaking.

Factions declining in China’s elite politics

Traditionally, political factions have played determinative roles in Chinese political life. The three main factions over the last two decades have been: the Shanghai Clique, the Communist Youth League (CYL), and the Princelings. All three are represented on the current Politburo Standing Committee (PBSC).

The Shanghai Clique mainly comprises third- and fourth-generation leaders associated with former president Jiang Zemin.

The CYL includes former president Hu Jintao and his proteges, many of who used CYL networks to advance within China’s political system.

The Princeling faction, from which Xi Jinping comes, include the offspring of China’s original first- generation revolutionaries.

However, we assess that factions and factional analysis are diminishing in their relevance to understanding policy outcomes China. Instead, for a variety of reasons, individual networks are more notable drivers of promotions and political change. There are several reasons for this.

First, factions have become diluted over time, with an increasing degree of overlap among the Shanghai Clique, the CYL, and the Princelings. Many Chinese political leaders now have ties to more than one.

For example, Li Zhanshu is a Princeling and one of Xi’s closest advisers, but he is also a former CYL official. Similarly, Liu Yunshan, a member of the PBSC who identifies with Xi Jinping and, earlier, to the Shanghai Clique, had a career that involved much work with the CYL faction; he was a ranking CYL official in Inner Mongolia during Hu’s leadership of the national CYL. Similarly, Vice President Li Yuanchao, who is believed to be in the CYL faction, is both a Princeling and served under Jiang in Shanghai as chief of the Shanghai CYL.

Second, differences in ideology and policy preferences among the three groups have become blurred as the Chinese political system has evolved.

Xi’s own group draws from individuals across factions and ideologies, which has resulted in a set of policies covering a range of factional positions and policy preferences. Xi’s ability to concentrate power has made his agenda dominant at the central and local levels—squeezing out much of the room for factional politics. The various factions also lack strong policy priorities in general. Within the Shanghai Clique, some former leaders such as Jiang and Zeng were more aligned with old revolutionaries and conservatives, while others such as Zhu Rongji and Meng Jianzhu were pro-reform.
The rise of personal networks

A key reason for the decreasing relevance of factions is the growth of individual networks as drivers of policy change and promotion. Zhou Yongkang, the purged former member of the PBSC of the 17th Central Committee, illustrates this point well. Zhou was closely aligned with Jiang and part of the Shanghai Clique, but he developed his own personal coterie filled with associates from his career in the oil industry, his family members, the security bureaucracy, and others from his time as party chief in Sichuan.

Xi, too, has drawn from his vast personal network to build his team. Under Xi, personal connections have become a stronger indicator of ideological affiliation and policy priorities than connection to one of the three factions.

Indeed, right now the most important individual network is Xi’s. He has surrounded himself with an amorphous group of people who have one thing in common: At one point in their lives, they shared a personal or professional connection with the president. This group has less to do with ideology than with proximity. Members of Xi’s guanxi network are close confidants who he has known for decades. They include acquaintances from his youth; Princelings; Tsinghua University alumni; and officials from Fujian, Zhejiang, and Shanghai.

Xi’s preference for certain individuals included in this network has been revealed through promotions to key positions in central and local governments since he assumed power. By promoting close friends and allies, Xi has developed a solid and capable coterie made up of both civilian and military leaders. These individuals from local and central governments are a significant political force in China today.

Members of Xi’s network are well positioned to assume leadership positions at the 19th Party Congress in 2017 and the 20th Party Congress in 2022. Already, since the end of the National People’s Congress in March, a number of senior and mid-level officials with close ties to the president have been promoted to key positions in local and central governments.

Meanwhile, the prospects for the Shanghai Clique and the CYL to enhance their clout at the 19th Party Congress are bleak. Age limits and Xi’s anticorruption campaign have contributed to the fading relevance of both groups. Notably, several top CYL officials, including CYL chief Qin Yizhi, who is a full member of the Central Committee, reportedly have not been invited to the Party Congress.
Xi Jinping reorients Chinese politics

Xi Jinping is re-wiring Chinese politics in important and potentially lasting ways.

First, Xi has consolidated power faster than any of his predecessors. When Xi came to power he quickly acquired all three of China’s most important titles: general secretary of the CCP, president of the People’s Republic of China, and chairman of the Central Military Commission (CMC). His predecessor, Hu, had to wait two years before Jiang Zemin gave up the title of CMC chairman.

After coming to power, Xi quickly sidelined the opposition by going after key members of both the Shanghai Clique and the Communist Youth League. Through his anticorruption campaign, he brought down Zhou Yongkang, who was one of the most powerful and prominent members of the Shanghai Clique, as well as Generals Guo Boxiong and Xu Caihou—who all had ties with Jiang. The vast personal network Zhou had established within the oil industry was also targeted and dismantled. The CYL was similarly sidelined as Xi took down a number of its members, and Hu Jintao allies, in his campaign and dramatically reduced funding for the group.
Xi also acquired in 2016 the designation of “core leader,” whereas Hu Jintao did not receive the title at all. This status was a key testament to his success in consolidating power and gaining enough central support. Jiang Zemin and Deng Xiaoping were the only others to previously receive this designation. For Xi, this means that CCP members should now look to him and not to previous leaders for signals in the run-up to the 19th Party Congress.

Second, when Xi came to power, he made a number of changes to the Central Committee’s leading small groups (LSGs), effectively centralizing his decision-making authority there. In general, LSGs coordinate the implementation of policies across the party and state system. Under Xi, the number of LSGs has expanded by 16.

One of Xi’s most prominent new groups is the Leading Small Group for Comprehensively Deepening Reform, which was created to implement reforms announced at the Third Plenum. The power of this new LSG was expanded by the establishment of subgroups in every province. It has grown beyond its coordinating role to play a central role in drafting economic policy, which gives Xi, as the head of the group, a greater say in a field generally reserved for the vice premier.

Two other key LSGs created by Xi to push policy priorities are for internet security and informatization and the BRI. Xi has placed himself at the head of these and many other LSGs, including those for military reform, security, and finance.

Unlike China’s other policymaking organs, the LSGs are staffed by Xi, generally with members of his network. This has reduced the power of the State Council and the broader government ministries to shape policy in any direction other than of Xi’s choosing.
Third, Xi has no obvious opponents on the PBSC. The strength of the Shanghai Clique and the Communist Youth League on the committee has declined, largely as a result of age limits. The only three members of the PBSC associated with the Shanghai Clique—Liu Yunshan, Yu Zhensheng, and Zhang Dejiang—are set to retire in 2017 and only one purported member of the faction, Shanghai party secretary Han Zheng, is a candidate for the PBSC next year.

The CYL is also likely to have only one representative on the PBSC after the 19th Party Congress: Li Keqiang. Two prominent members of the CYL suffered political setbacks in recent years: Ling Jihua, Hu Jintao’s former right-hand man, was taken down for corruption and Vice President Li Yuanchao failed to enter the PBSC at the 18th Party Congress.

Fourth, Xi has marginalized the opposition. For a brief period in early 2016, it seemed as though a serious challenge to Xi’s authority was emerging. An essay entitled “A Thousand Yes-Men Cannot Equal One Honest Advisor” was published on the website of the Central Commission for Discipline Inspection. This essay, which called for the ability to air opinions freely and accept suggestions, was significant because it appeared on a CCP website. In addition, an open letter calling for Xi’s resignation was posted to the state-linked Wujie News website the day that the National People’s Congress began. The article, which was signed by “local Party members,” blamed Xi for China’s economic, ideological, and political anxiety. Another media outlet, Caixin, was punished for an article quoting a Chinese People’s Political Consultative Conference delegate on the lack of freedom to offer suggestions at political meetings, and the social media website of prominent commentator Ren Zhiqiang was shut down after he responded negatively to Xi’s comments emphasizing government control of the media.

However, these incidents were isolated and did not seem to gain any significant traction among the political elite or the general public. There have been no similar events since, which seems to signal that Xi effectively quashed discontent and marginalized whatever opposition may have been starting to emerge.
Assessing the 19th Party Congress

The 2017 CCP’s leadership transition, which formally begins with the 19th Party Congress, will take place this fall and will shape China’s political and economic trajectory for at least the next five years and probably the next 15 years. Xi will almost certainly emerge stronger from the Party Congress. But the key questions are: How much stronger? Stronger in what ways? And what will Xi do with this expanded influence?

The scale of the turnover will be substantial and the implications will be significant for China, Asia, and global markets. There will likely be a 70% turnover at the very top (the PBSC) and substantial change below that level (the Politburo).

Leadership change at China’s 19th Party Congress (Staying / Possible promotion to PBSC / Retiring)

A knock-on effect of personnel changes in the party apparatus will be shifts in many senior government positions, especially among the key economic decision-makers. This will directly affect the speed and scale of reform of China’s economic and social policies. Xi is intently focused on reducing China’s financial risks and accelerating a shift away from low value-added sectors (such as inefficient steel production) to fast-growing and strategic sectors such as advanced manufacturing. With key allies in place to oversee economic policy, Xi will be better positioned to overcome the entrenched interests and bureaucratic inertia standing in the way of his goals.

The leadership transition is not a one-time event, but rather an ongoing process. It begins with the 19th Party Congress and continues until March 2018 when the
annual National People’s Congress (NPC) is convened. The latter meeting will preside over the change of government positions, which normally follows the change in party positions, such as the top regulators and perhaps the new head of China’s central bank. Once there is a change in government positions to bring them into line with the party positions, then the transition moves into the informal phase of establishing the power relationships among the new players.

Importantly, the upcoming transition will provide greater clarity about the future leadership of China. The next Central Committee will be filled with many members of China’s sixth generation (mainly those born after 1960), including in the Politburo and the PBSC. China’s future sixth-generation leaders will be different from their predecessors, having grown up during the reform and opening period of the 1980s.

**Rules versus norms**

The leadership transition process in China is still young and not deeply institutionalized. Since 1949, the first real handover from one generation of leaders to another (in which a new leader wasn’t designated far in advance by CCP elders) was in 2012 from Hu Jintao to Xi. Previously, Jiang Zemin and Hu had both been chosen by Deng and other elders in 1989 and 1992, respectively.

In this context, there is both science and art to understanding elite politics in China and especially leadership transitions. Even when considering the so-called science, however, past events are not a certain predictor of future ones.

There are no formal rules guiding the leadership transition in China. The only stipulation, according to the CCP’s constitution, is that a party congress be held every five years. There is no rule that the general secretary can only stay for two five-year terms, even though that has become the norm since Jiang stepped down in 2002. To be sure, according to the state constitution, however, government leaders such as the president, the premier, and the head of the parliament are limited to two five-year terms.

Despite the lack of rules, there are several norms that will likely govern the leadership transition. These have evolved since the late 1990s when Jiang developed and deployed them, opportunistically, to remove opponents. Subsequent leaders kept them in place, but they are not set in stone.

The first norm is that any PBSC or Politburo member aged 68 or older has to retire; any member aged 67 or younger can stay for another five-year term. This norm was first established in 2002.

The second norm is that all PBSC members will be drawn from non-retiring Politburo members; the one exception is for successors to Xi and Li, who can be drawn from the approximately 200 members of the Central Committee. The latter event is called a “helicopter promotion.” Both Xi and Li were helicopter promotions to the PBSC in 2007.

The third norm is that in drawing from the eligible Politburo members, the appointments have been on the basis of seniority, defined by tenure on the Politburo.
CHINA’S LEADERSHIP TRANSITION AND IMPLICATIONS FOR ASIA

and the Central Committee rather than necessarily by age. The members of the Politburo that have served the longest (even if they are not the oldest) have a greater chance of making it into the PBSC.

In the coming transition, this norm may not be strictly adhered for the PBSC, given the paucity of good choices for Xi among some of the more senior members of the Politburo. For example, Vice President Li Yuanchao is one of the most senior members of the current Politburo but has declining political influence and is not likely to go any further. Director of the Party’s General Office Li Zhanshu is not senior, but he will probably get the nod to join the PBSC given his close ties to Xi. Xinjiang Party Secretary Zhang Chunxian and Central Propaganda Chief Liu Qibao, both Politburo members but not Xi allies, are likely to be passed up.

Large-scale leadership change

Applying these norms is where science ends and the art of predicting China’s elite politics begins. Assuming the norms are adhered to, there are a variety of claims we can make about the scope of the change next year.

First, the most substantial change will be at the top, in the PBSC. Five of the seven PBSC members will be replaced, marking a 70% change. This provides Xi with a huge opportunity to select a leadership team that will fully support his policy initiatives. There are persistent rumors that Xi will allow Wang Qishan to remain in place, so he can continue to guide the anticorruption effort. We don’t give this rumor much credence because Xi would open a can of worms by changing the age norm; Xi has viable replacements in either Li Zhanshu or Zhao Leji; and according to our contacts, Wang Qishan is simply tired after decades in senior policymaking and wants to retire. Second, about two-thirds of the remaining 25-member Politburo (those not on the seven-member Standing Committee) may change through a combination of retirements and promotions to the PBSC. At least six members will retire, assuming the age limits are used. Another three to five members will transition into the PBSC, resulting in a net change of 9 to 11 seats in the Politburo. The Central Committee members that flow into these vacated Politburo slots will form the core of the sixth-generation leaders, in addition to the successors to Xi and Li.

Xi sets the stage

Ultimately, the leadership transition in the 19th Party Congress will solidify Xi’s control over the country. This effort will be the culmination of his moves to amass power over the past five years, which are outlined below.

Positioning himself and his key allies

Xi’s efforts to institutionalize and extend his control over the past five years have underpinned his success in becoming one of China’s strongest leaders to date. At

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1 In Chinese, the exact wording of “seniority” in the party context is “先到先得” or “first come, first serve”; that means no matter how old you are, if you came into the Politburo earlier, you get promoted earlier.
China’s 6th Plenum in October, his achievements were made official with a designation as the “core leader.” The official designation of “core leader,” which was first bestowed on Jiang Zemin by Deng Xiaoping to bolster Jiang’s credibility after the Tiananmen Square incident, is a clear sign that Xi will face little resistance to setting the agenda for the 19th Party Congress.

Since 2012, Xi has also systematically been placing his people in key positions throughout the country and strengthening the role of the party in order to place himself at the core of decision-making at all levels of government. Many of Xi’s allies have been rapidly promoted during his first term.

In addition to Liaoning Party Secretary Li Xi, other provincial promotions Xi backed included those with Zhejiang ties: Shanghai Mayor Ying Yong; Deputy Party Secretary of Hubei and Wuhan Party Secretary Chen Yixin; Shanxi Governor Lou Yangsheng; and Shaanxi Governor Hu Heping. There are also the fast-rising technocrats such as Chen Jining, who became the mayor of Beijing after serving as the environment minister and president of Tsinghua University; head of the General Office of the Central Leading Group for Internet Security and Informatization Xu Lin; and chairman of the National Development and Reform Commission He Lifeng, who worked with Xi when the latter was vice mayor of Xiamen. In addition, technocrat Zhang Qingwei was promoted to Heilongjiang’s party secretary in April.

More recently, there was the July ouster of Chongqing Party Secretary Sun Zhengcai and the promotion of Guizhou Party Secretary Chen Min’er to Sun’s spot. Chen Min’er previously was the governor and then the party secretary of Guizhou province. He is associated most closely with Xi and not with any particular faction. He is also one of only three provincial party secretaries born after 1960, putting him in a position to be promoted to the Politburo and even the PSC in 2017.

Also of note was the norm-breaking promotion of Xi ally Cai Qi to the post of Beijing mayor in October 2016 and party secretary in May 2017. Cai did not have previous experience as a party secretary or leader of a province or municipality prior to becoming Beijing mayor. Cai was also promoted four times in the past three years, from a vice governor of Zhejiang to Beijing party secretary, a position that will likely land him on the next Politburo.

**Institutionalizing anticorruption**

A key method for gaining control has been the institutionalization of Xi’s signature anticorruption drive throughout all levels of government. Given that he sees graft as one of the biggest threats to party continuity, all the related changes during his first term suggest that this emphasis on anticorruption will continue into his second term.

In particular, the Central Commission for Discipline Inspection, the top anticorruption body in China, has undergone a number of reforms in the past two years to make it a more independent and pervasive entity. The most important change was making anticorruption officials answerable only to central government bodies, which removed the conflict of interest in pursuing corruption cases against local officials.
The State Council in late 2016 announced the creation of a new independent national supervisory commission to prosecute anticorruption activities at all levels of government as well as inside and outside the party. Placing both party and non-party members under its purview could allow Xi more direct control over anticorruption prosecutions without having to go through the judicial branch.

**Elevating the Communist Party in government**

Another way that Xi has consolidated his control is by giving a greater role to the CCP in government affairs across the board. Starting at the very top, Xi carved out a larger role for the party in State Council ministries—functional departments that have traditionally emphasized governance and policy over party ideology.

Traditionally, State Council ministers have been appointed concurrently as minister and party secretary of the department in order to ensure efficient implementation of policy. But ever since the 18th Party Congress, Xi has appointed separate party secretaries to various State Council ministries.

At the Ministry of Transportation, Xi appointed Yang Chuantang as party secretary alongside minister Li Xiaopeng. The appointment of Yang, an experienced party cadre who managed the politically challenging areas of Xinjiang and Tibet, was likely to promote party anticorruption efforts within the ministry, which has a long history of corruption and favoritism.

At the state-owned Asset Supervision and Administration Commission, Hao Peng, former Qinghai governor, was appointed party secretary alongside chairman Xiao Yaqing. Hao, with zero SOE experience, seemed like an unlikely hire for the post. However, Hao’s appointment gives Xi a mouthpiece to ensure that SOEs will be promoted as the backbone of national economic and regional stability regardless of actual economic viability—a key point of Xi’s reform agenda.

Party control has also significantly increased in certain provincial capitals. In Nanjing, Wuhan, Shenyang, Lhasa, and Fuzhou, the provincial capital party secretary position has been filled by a provincial vice party secretary instead of a member of the provincial party standing committee. Provincial vice party secretaries are of a high enough rank to have a say in province-wide policy, thus giving more weight to the provincial capital party secretary position.

Around the time of these promotions, these particular capitals were targeted as government priority urban clusters by the central government. Powerful provincial capital party secretaries will be better able to implement Xi’s urbanization drive in these areas.

**Possible successors**

One of the most consequential aspects of the change at the 19th Party Congress will be the choice of two leaders for the PBSC who are young enough to serve for 15 years, effectively succeeding Xi and Li Keqiang. The only two candidates on the Politburo with that age profile are Guangdong Party Secretary Hu Chunhua and,
before he was removed, former Chongqing party secretary Sun Zhengcai. Neither are close to Xi and both have their weaknesses. (Sun no longer has any chance given the investigation he is under related to corruption; Sun will likely be expelled from the Politburo before the Party Congress.)

Hu Chunhua, 54 years old, is a CYL cadre handpicked by former president Hu Jintao as a potential successor after Xi. Hu Chunhua worked under Hu Jintao in Tibet during the 1980s and '90s. He was later appointed Hebei governor and Inner Mongolia party secretary before becoming Guangdong party secretary in 2012. He is viewed in party circles as having been promoted too fast. His governance record in the three localities has been less than sterling.

Sun had long been dogged by allegations of family corruption before he himself was placed under investigation in July 2017. He also had no obvious factional affiliation—only a series of influential patrons—and was never Xi’s favored candidate.

With Sun’s ouster in July, his replacement Chen Min'er, 57 years old, is now almost certain to land a position on the Politburo and probably the PBSC. Chen is clearly being groomed. He is a one-term Central Committee member and served as Guizhou party secretary before being promoted to Chongqing party secretary. Chen worked under Xi in Zhejiang as the lead of province-wide propaganda efforts and is one of only three provincial party secretaries born after 1960. Xi promoted Chen to Zhejiang provincial standing committee before moving him to Guizhou to serve as governor. Given his close ties to Xi, his credentials, and his age, Chen is now considered a strong contender to succeed Xi Jinping.

Zhang Qingwei, 55 years old, a three-term Central Committee member and Heilongjiang party secretary, is also considered a potential successor, perhaps as premier. Zhang is a defense technocrat who chaired the State Administration of Science and Technology from 2007–2008 after having led China's spaceflight and moon-landing projects as general manager of China Aerospace Science Corporation. He served for six years as governor of Hebei before being moved to Helongjiang in 2017. Zhang is considered among China’s most promising leaders, but his lack of party work experience makes him more of a dark horse candidate than Hu or Chen.

If Hu was designated as Xi’s successor, it would create a separate power center in the CCP given the former's close ties to Hu Jintao. If Chen is designated successor, however, Xi and his allies would be more likely to retain control over the CCP for the next 15 years.

If anything, ousting Sun and appointing Chen in his place suggests Xi may be more likely to appoint Chen as his successor by bringing him into the PBSC. He can now claim that Chen has experience—even if it is limited—of running a major municipality in the wake of a corruption scandal. That scenario would be strikingly similar to Xi's own path after he was appointed party secretary of Shanghai when the previous official, Chen Liangyu, was taken down on corruption charges.
**Xi may push some boundaries**

One of the most prominent attributes of Xi’s tenure as China’s top leader has been his willingness to push parameters of the permissible in Chinese politics. Thus, we cannot rule out the possibility that the jockeying and outcomes of the 19th Party Congress will be less predictable than previous ones.

In 2012, Xi reduced the PBSC from nine members to seven and could reduce it further. At this stage, expanding it to nine or reducing it to five does not immediately serve Xi’s interests, but nothing should be ruled out at this point.

Xi’s anticorruption campaign has been so far-reaching and intensive that it has changed the contours of elite politics, and the potential effects on this fall’s leadership transition are still coming into focus. Xi has used the anticorruption campaign to remove a PBSC member, four Politburo members, and two uniformed vice chairmen of the Central Military Commission. This is extraordinary in the annals of CCP history and could affect the selection of the next set of top leaders.

The big risks to monitor include: additional purges of top leaders, an expansion or contraction of the PBSC, no designation of clear successors for Xi and Li, and the rejection of current succession norms.

**Xi will not stay for a third term**

The most frequently debated topic in Chinese politics right now is: Will Xi Jinping stay for a third term? Xi’s recent purges and promotions have generated speculation about his efforts to expand his own power, with implications for the coming leadership transition and his policy agenda—especially related to economic reforms.

Our short answer to the above question is: No. We assess there is only a 25% chance that Xi will make a move to stay on past 2022 at the party congress this fall. But we do not rule out entirely the possibility that Xi, at some point during his second term, could decide to stay beyond 2022 as the results of this fall’s 19th Party Congress unfold.

There are several reasons on which we base our judgment.

First, Xi doesn’t need to stay on for a third term; he has an alternative that has just as much upside benefit (perhaps more) and very little downside risk. In 2022, it is more likely that Xi will step down but retain: (1) his position as chairman of the CMC, and (2) his designation as the “core leader” with the corresponding position as No. 1 in the CCP hierarchy. In addition, he will promote as many of his allies as possible to the PBSC and the Politburo.

This collection of positions and designations would provide Xi with substantial and enduring influence in Chinese politics after 2022, arguably more than Deng had when he promoted Jiang to be general secretary in 1989. This configuration is also well known and accepted within Chinese politics; Deng stayed on under Jiang Zemin for two years and Jiang did the same under Hu in 2002. Notably, Hu did not stay on under Xi in 2012 (and we wonder if Xi owes Hu something for that gracious move.)
Second, Xi cares deeply about the credibility and legitimacy of the CCP. If he tried to stay on for a third term, he would be undermining many of the rules and norms that have guided leadership transitions in the reform era—and he would not want to do that. Some of these go back to the days of Deng Xiaoping, who sought to institutionalize processes for leadership transition.

Xi knows that the first (and only) true leadership transition in the reform era occurred when Xi and Li Keqiang were chosen in 2007 and then when they came to power in 2012. (Deng had previously chosen both Jiang Zemin and Hu Jintao.) Undermining such processes after one successful transition would be very destructive for the CCP.

Third, Xi would generate substantial dysfunction in the CCP and the government as well as broad resistance from within the CCP if he tried to remain in power, reducing the chances that he will try.

Under the state constitution, the president is limited to two five-year terms. By contrast, in the CCP constitution, there is no such limit. Thus, Xi could stay for a third term as general secretary of the CCP but not as president. This would complicate China’s leadership structure: There would now be a general secretary, a president (head of state), a premier (head of government), and a head of the military. Visiting heads of state would not know who to meet: the general secretary, the president, and/or the premier—or all three?

Trying to stay on for a third term would also generate backlash from many sectors within the CCP, including the various elders. By our count, there are more than 20 former PBSC members still alive and they could become an active source of opposition. Such a move by Xi could eliminate all the guiderails used to navigate the informal world of leadership succession in China and produce a world in which such transitions become a free-for-all. This would open the CCP to destructive infighting, which is why so many current and former leaders would oppose it.

Given Xi’s large and consequential policy agenda for his second term, which notably includes accelerating key economic reforms and completing controversial military reforms, it is unlikely he would burn through his political capital with the CCP by trying to stay on for a third term. Even if Xi did want to stay for a third term, he would not signal it now. Doing so would have many risks and few benefits. Signaling such a move now risks Xi spending the next five years defending his decision for a third term and not driving his policy agenda, which remains expansive and politically controversial.

If Xi really wants a third term, it would make more sense to wait until the 20th Party Congress gets closer to make such a move. In this scenario, Xi would hold off on appointing two successors to himself and Li into the next PBSC but not make clear his plans to stay on in 2022.
Implications for Chinese economic policy

How will Xi use his increased political strength after the 19th Party Congress to shape China’s economy?

The overall orientation of economic policy will not change, but it will become more disciplined in hewing to Xi’s vision. “Xi-conomics” will emerge as a more forceful mix of market liberalization in some areas and a heavy hand for the CCP and the state in others. Xi will embrace both market forces and the state in a robust manner.

In short, Xi views himself as more of a “modernizer” of the CCP and the state than as a “market reformer” per se. This will be reflected in the nature of his economic policy, and have mixed implications for China’s economic outlook in the next five years. Xi will intensify efforts to head off a crisis in the financial sector, even at the cost of accepting modestly lower economic growth. But his impulse for strong state and party control will continue to conflict with many areas of much-needed market reforms, such as commercializing SOEs. The upshot could be a sharper-than-expected slowdown in growth toward the end of his second term.

First priority is economic stability and will remain so

Xi’s primary economic objective during his second term will be to maintain financial and economic stability. He will likely accomplish that goal, barring an exogenous shock.

The president is deeply committed to the new campaign to prevent financial risks, which will continue well into next year, if not beyond. Xi has clearly internalized the idea that China’s debt risks are among his greatest challenges. The scope of the campaign will likely expand from its current focus on cleaning up the financial sector to deleveraging more broadly.

The political scales are tilting in favor of reducing debt, even at the price of slower growth. There is a 65% chance that starting next year, the leadership will lower the official growth target below 6.5%, or deemphasize its importance, if meeting the target conflicts with the goal of slowing the pace of credit expansion.

Debt has grown faster than GDP

![Graph showing Total loans and Nominal GDP growth from 2008 to 2017](source: Bloomberg, Eurasia Group)
...and GDP is propelled by the target

Second priority is upgrading China’s economy

Xi’s second economic policy priority will be to facilitate China’s transition to a more sophisticated economy and avoid the “middle income trap.” In practice, this objective will translate into more top-down industrial policies designed to favor advanced manufacturing, technology, and other areas of the “real economy.”

During his first term, Xi’s signature economic initiatives were largely industrial policies that favored manufacturing (for example, Made in China 2025) and regional integration (for example, the BRI and Xiong’an New Area).

China will channel more resources into these areas during Xi’s second term, via mechanisms such as state-directed “guidance funds,” prioritized bank lending, and instructions to SOEs (and even private firms). These efforts will also involve increasing restrictions on foreign technology firms to limit competition for domestic players and retain state control.

A growing theme during Xi’s second term is likely to be debates about whether industrial policies are diverting resources away from more efficient and productive ventures. Especially as China moves from playing catch up to seeking to dominate areas at the technological frontier, such as artificial intelligence and quantum computing, its investment-intensive industrial policies will become increasingly costly. The result could be a drag on the country’s long-term growth potential.

In the meantime, Xi’s industrial policy drive will increasingly stoke trade tensions with the US, Europe, and other trade partners.

Reforms will prove a mixed bag

China will accelerate progress in areas of social welfare, including healthcare reform, pension reform, fiscal reform (tax collection and revenue-sharing), some types of hukou reform, poverty alleviation, and other initiatives that expand the so-
cial safety net. Such reforms enjoy strong backing among the public and, while they may involve conflicts among cash-strapped bureaucracies, they face few ideological opponents. Moreover, a stronger social safety net reduces precautionary savings among households, in turn boosting consumption and supporting the economic “rebalance” away from investment.

The rebalance starts [slowly]

Source: World Bank, Eurasia Group

More technical types of reforms will also advance at a steady clip, such as the creation of more transparent capital markets, more efficient and market-oriented energy price-setting mechanisms, streamlined business approval procedures, and lower fees and taxes. These will be overseen by technocrats.

Foreign investment liberalization will present a more complex story. Officials will be more willing to open areas such as health, education, and financial services to both private and foreign competition, while they more slowly introduce minor openings in other areas.

Last, there will likely be little or no progress in some areas because they conflict with Xi’s impulse to strengthen state control. The most important such area is SOEs, which falls into two camps. Among those SOEs owned by the central government, progress will be scant or even reversed. Xi has consistently articulated a vision of SOEs as consolidated “national champions” that advance political objectives. “Reform” in this area increasingly refers to efforts to inject private capital without ceding state control.

Local SOEs may see more mixed reforms. The leadership is, in principle, looking to pare back or shutter “zombie” companies, but local governments fight back hard to retain the employment and patronage opportunities that these SOEs provide. Based on the experience of the past two years, the most likely outcome is a real but very gradual reduction in the number of local SOEs and their resources.

Beyond SOEs, other areas that will witness little progress include efforts to strengthen an independent judiciary, hukou reform to allow more densely populated first-tier cities, reductions in state control of capital markets and technology policy, endeavors to curb moral hazards, and attempts to limit the state’s influence in deci-
sion-making at private firms. Xi has proven willing to roll back any or all progress in these areas when volatility arises.

In other words, reforms aimed at reducing state control and placing more resources in the hands of private enterprises will continue to lag. The result may lower the economy’s long-term productive potential and lead to a sharper than expected slowdown in growth—possibly to around 4%—by the end of Xi’s second term.
Implications for Asia, security, prosperity and stability

In his second term after gaining greater control over the Party and government, Xi, the architect of China’s more globalist and assertive behavior, will seek to position the country as an even more influential actor, both in Asia and globally. At the same time, China will face constraints in its various external initiatives. China’s ongoing transition from its international identity as a developing country to a developed one is not complete.

Over the next five years, Beijing will seek to accelerate the emergence of a regional order where China has preponderant influence and to elevate China’s stature globally, while not assuming too many burdens. The push and pull of rights and responsibilities will define the kind of global identity China assumes under Xi.

China views its foreign policy as essential to the country’s “great national rejuvenation” ahead of the centenary anniversary of the Communist Party in 2021. However, it will struggle to reconcile its multiple and competing foreign policy interests. Ultimately, how China balances these interests will define its role in the region and beyond for the foreseeable future.

### Foreign policy interests

- Protecting sovereignty and territorial integrity
- Modernizing China’s military
- Projecting the image of China’s “peaceful rise”
- Promoting stable regional environment in Asia
- Preserving solidarity with developing countries and the BRICS
- Preserving unfettered access to resources that China needs to fuel its economic expansion
- Maintaining generally stable relations with other major powers (e.g., U.S., Russia, Japan)
- Being seen as contributing to some global public goods

Source: Eurasia Group

In Xi’s second term, China will acquire greater economic integration with and military advantage relative to all other East Asian countries. It will do so by taking a leading role in defining and driving Asia’s economic architecture. Beijing will promote trade agreements and multilateral trade pacts such as the Regional Comprehensive Economic Partnership, as well as infrastructure efforts to deepen economic connectivity and supply chain integration, such as the BRI. Concerns about US protectionism will further push regional economies to remap trade and investment patterns as a means to capture new growth and hedge against US trade actions.

Meanwhile, economic gains at home will translate into increasing Chinese investment in its military capabilities. China will push forward efforts to allocate more of its military budget to advanced warfighting capabilities and less to personnel costs. China accounted for 40% of the rise in Asian defense spending in 2015 alone and is expected to reach annual military spending of $225 billion by 2020. China is moving
to having multiple aircraft carriers, strong undersea capabilities, a modern and
dense air force and navy, one of the world’s largest ballistic missile forces, and growing
capabilities in asymmetric realms such as cyber and space.

As China gains confidence in its economic and military capabilities, its tolerance
for challenges to its identified interests may decline, especially on matters related
to sovereignty and territorial integrity. During this period, and especially if the US
becomes less engaged in Asia, China will seek to lock in its position in the disputed
maritime areas of the South and East China Seas. It also could become more aggressive in its efforts to chip away at Taiwan’s international standing.

China’s rising military spending supports naval power projection

$ billions

Beijing almost certainly also will try to press countries to meet China’s needs first
and/or defer to China on issues of core relevance to it. A stronger Chinese hand
(and lingering uncertainty over the US role) may increase the likelihood that China
will pressure smaller countries to bend more toward Beijing and that small Asian
countries see little alternative to self-censoring in defense of their own interests.
The 2017 “Framework for the Code of Conduct in the South China Sea,” which was
agreed to at the ASEAN-China ministerial in August, is a case in point; the docu-
ment is decidedly Beijing friendly.

China’s constraints

There will also be constraints on China’s rising influence, in Asia and globally.

First, China will feel the pull of reconciling its desire to project the image of a
“peaceful rise” with its more robust pursuit of its economic and security interests
in East Asia, including the use of coercive means. Chinese activism will generate
discomfort in the region and, thus, push Asian countries to diversify further their
economic and security ties as a hedge against a more assertive China.

In countries ranging from India, Indonesia, Myanmar, and Vietnam, fear of Chinese
assertiveness as well as nationalism in these countries has and will continue to
motivate resistance to these kinds of Chinese actions. The level of pushback likely will be manageable from Beijing's perspective, though, given that it is unlikely the entire region—or a significant collection of regional actors—will coalesce around a coordinated effort to hinder Beijing's efforts.

Similarly, regional institutions such as ASEAN likely will remain relatively modest in their influence, in the face of Chinese activism. This is largely because of their collective decision-making structures and Beijing's ability to influence at least one member within the organization to be mindful of China's interests. As the diplomatic drama on the South China Sea has played out, the strengths and weaknesses of ASEAN, the ASEAN Regional Forum, and the East Asia Summit have become readily apparent.

**Constraints to China's rise**

- **Reconciling “peaceful rise” with increasingly muscular pursuit of strategic objectives in Asia**
- **Counter-reaction to Chinese assertiveness**
- **Rise of other regional powers such as India, Australia, Japan, and Singapore**

Even as regional institutions face their constraints, other countries including Singapore, Japan, Australia, and India will remain active in Asia security and economic affairs, preventing the creation of an environment in which China dominates. Singapore is a regional financial center and may become only more important under the BRI; India is the region's fastest growing economy and expanding its military capabilities; Japan is the third largest economy and a key investor in the region; and Australia has established strong links with the US, Japanese, and Indian militaries. None of these players wish to confront China, but all will work to preserve a stable, open, and transparent economic and security order in Asia as China's presence and influence grow.

**China's globalism**

Beyond the region, China also will continue its pattern of greater activism on global issues. Under Xi, China has shown an increased willingness to get involved on issues previously of marginal interest to Beijing; this includes Syria, the Middle East peace process, the Iran nuclear program, climate change efforts, global public health, peacekeeping, and the global fight against Islamic extremism. China also has supported key features of the post–World War II order and thus it appears interested in keeping some global rules and norms intact (such as nonproliferation) and will continue to invest in global institutions such as the UN, the World Bank, and the IMF.

China will continue to act largely on its own, its military will remain focused on Asia, and it will continue to rely on trade and investment to expand its political influence. On issues of global governance, China will aim to promote a fairer, more equitable, and balanced set of rules, norms and institutions which take greater
account of developing countries’ interests in general, and of China’s interests in particular. This will be a paradox for China as the country evolves from identifying with developing nations to increasingly being seen as part of the developed world and the rule-making countries, as opposed to the rule-taking countries.

There will be tension between what China is doing globally to provide public goods—through combatting climate change, investing in public health (notably in Africa), and stepping up peacekeeping and UN commitments—and the country’s willingness to assertively pursue its interests. For example, Xi does not feel that prevailing Western views on cyberspace management are compatible with China’s needs. Xi has called for establishing a “community of common destiny in cyberspace,” and will continue to push his vision for cyber governance and cyber norms at the UN.

Economically, Xi is positioning China as the major driver of global growth and a shaper of international economic rules and norms. Chinese leaders will point to the country’s economic development as vital to the global economy and to the economic performance of regional and global powers. It will champion its efforts to support inclusive growth and connectivity through its leadership of new multilateral lending institutions such as the BRICS Bank and the Asian Infrastructure Investment Bank, as well as through consumption, trade and investment, and infrastructure with the BRI.

China will prod international institutions to take greater account of its priorities in a bid for a more “equitable” international economic order. In practice, this means China will support broad measures to boost global growth while carving out protections for the tools it needs for its own domestic development, including state support for SOEs and controversial industrial and acquisition policies. China will also seek a greater role in setting international technical standards with its companies making greater investments in R&D, particularly in semiconductors, mobile phones, the Internet of Things, artificial intelligence, and robotics.

On military issues, the Chinese navy will play a more influential role in China’s military strategy and doctrine. Its influence will be supplemented by its purchases of foreign ports where it can dock its ships and a growing submarine fleet. China will add 32 submarines to its current fleet of 58 by 2030—the most of any Asian country. Its People’s Liberation Army Navy (PLAN), which now possesses the largest number of vessels in Asia, has shifted from “near sea” defense to “far seas” protection. This means that the PLAN will increasingly conduct operational tasks outside the first island chain and beyond.

As its naval capabilities develop, China will expand its presence in the sea—including in the Arctic, both to exploit the area for its natural resources and as a means to prevent military encirclement by opposing powers. In this effort, China will not seek confrontation with other powers such as Arctic states, and may act in concert with Arctic states to extract resources there rather than act alone.

**US-China relations**

What will the US-China relationship look like in Xi’s second term? Xi will face mounting challenges related to rising tensions with the US over trade and North
Korea, as well as other issues such as Taiwan and possibly the South China Sea.

Xi is far more comfortable with friction and tensions in US-China relations than his predecessors and, thus, volatility in US-China relations is likely. Although Xi and President Donald Trump started off well following their meeting at Mar-a-Lago, their second meeting at the G20 in July marked a new phase in US-China ties—one defined by disagreement. Since then, US-China tensions have only been exacerbated by North Korea’s tests of intercontinental ballistic missiles (ICBM), China’s ambivalence toward pressuring North Korea, and US frustration with China’s trade and investment policies.

The G20 meeting was the first time the two presidents met since their first meeting in April at Mar-a-Lago and, more importantly, since the US took several actions against China in late June, including arms sales to Taiwan, sanctioning four Chinese actors for assisting North Korea, a naval freedom of navigation operation in the South China Sea, and downgrading China in the human trafficking report.

The G20 bilateral meeting was fundamentally about putting down markers for progress, setting expectations, and trying to put a floor under a challenged relationship; it succeeded in the first two goals but probably not in the third one, which is why more volatility can be expected. It was followed by the first Comprehensive Economic Dialogue, where such little progress was made in talks that both sides canceled their post-negotiations press conferences. Trump’s planned visit to China this year will be the next major benchmark in US-China relations.

Most of Trump’s advisers, and lately Trump himself, have become disillusioned with limited Chinese assistance and will now shift to coercive approaches to elicit changes in China’s behavior. North Korea conducted its first ICBM test on 4 July and then a second ICBM test on 28 July, actions that appeared to cause Trump to become very frustrated with China and Xi for his unwillingness to put more pressure on Pyongyang.

The US may impose tougher sanctions against numerous Chinese actors and take several trade enforcement actions against them. For example, the US may launch an investigation into Chinese theft of intellectual property with a focus on its industrial policy and its de facto policy of forced technology transfer. This was the basis for the August announcement about a pending investigation invoking Section 301 of the 1974 Trade Act.

There is no clear pathway to bridging festering differences on North Korea, trade, and other issues, meaning that Washington is poised to put more pressure on Beijing, which will likely hasten the downward slope of the US-China trajectory. Beijing’s support for the new UN Security Council Resolution 2371 on North Korea likely reduces the risk of US secondary sanctions on China but will not deter the US from pursuing trade action against China.

For China’s part, Xi will seek to sidestep fresh tensions and place heavy emphasis on maintaining exchanges and investing in the relationship. Xi called for joint efforts to keep bilateral ties on track, and his advisers are stressing that complicated issues in the bilateral relationship will take time to solve.
Attention will remain on economic ties, with the US likely to continue to press China to undertake structural reforms related to overcapacity, market access, and industrial policy. China will balk at moving much beyond what it has already committed to do, but given its desire to uphold “process as progress” will stress making use of bilateral consultations on the “one-year plan” to address economic irritants in the relationship.

Xi doesn’t want a difficult and unstable relationship with the US during a leadership transition year that would be a distraction and a political liability. Xi also can’t give away too much, as that has its costs as well.

None of this bodes well for the future of US-China ties this year and beyond the leadership transition, although the downward slope of the bilateral trajectory is not steep—at least not yet. Both Washington and Beijing are trying to find ways to bridge their differences, especially now that Trump is preparing for a visit to China this fall. It is notable that China’s reaction to all four US actions in late June was largely rhetorical and well within the bounds of past reactions. Trump also outwardly appears to value his personal relationship with Xi.

If, however, these policy differences widen and/or broaden, the two presidents’ personal ties attenuate, and the domestic politics for both leaders worsen, US-China tensions could rise even further. A North Korea crisis or major trade action by either side could precipitate this.

**Belt and Road Initiative**

Xi Jinping’s BRI is less a geopolitical strategy and, at this stage, more of a geopolitical aspiration to reshape China’s economic and diplomatic ties with Asia, Eurasia, the Middle East, and, ultimately, Europe. Indeed, it is an ambitious task.

The BRI initially emerged in 2013 as China’s response to former President Barack Obama’s “Asia-Pacific Rebalance” strategy, and the initiative initially focused on two routes through Southeast Asia and Central Europe. It has since expanded to incorporate pathways through the Arctic, the Mediterranean Sea, and the South Pacific. The initial 65 belt and road countries has grown to more than 100 participating countries, according to the Chinese.
In its present form, the BRI appears to be an accumulation of international projects thrown under the same umbrella by Chinese corporations seeking preferential funding and political clout, both private companies and SOEs. Many BRI projects have high political risk, a low rate of return, and very long investment timelines. It remains to be seen whether Chinese private companies and SOEs are up to the challenge of making these projects financially viable—or scouting out successful projects in the first place.

What the initiative does offer Beijing is a pathway to expand its economic and political ties with the rest of the world in a manner that offers these regions and countries the ability to fill critical gaps in their growth strategies. The BRI, with its focus on infrastructure and connectivity, draws countries into China's orbit by providing them practical and tangible assistance to some of their greatest developmental bottlenecks; China's hope is that it can incubate the development of markets that Chinese companies can sell into.

In this regard, the BRI has proven to be an initial success. For many participating countries, the BRI is a welcome opportunity to get much needed funding and support for projects that need to get done but are not gaining support on purely commercial terms. In Southeast Asia, leaders of Malaysia, the Philippines, and Thailand welcome BRI investment despite domestic concerns over environmental degradation, local hiring discrimination, and development rights.

In some cases but not all, countries will align politically with Beijing in exchange for BRI support for needed infrastructure projects. Philippines President Rodrigo Duterte was rewarded with $24 billion in signed cooperative deals, many of which will fall under the BRI umbrella, following his decision not to press the Philippines' territorial claims.

Signs of this prioritization have been appearing in the West as well: Greece, which has signed multiple energy and infrastructure deals with China (including a stake in one of its major ports), recently blocked an EU statement on Chinese human rights abuses.

The initiative in its current form lacks a concrete framework and supporting policies, calling into question the government’s ultimate ability to navigate both domestic and external barriers to realizing the full potential of BRI. Domestically, there are concerns about the ability of China’s state-backed banks, commercial lenders, and borrowers to make good lending decisions. The initiative could face external pressure as well. There will be clear tension as China seeks to expand its access to markets abroad through building connectivity even as it reduces market access for foreign companies domestically.

**Hong Kong and Taiwan**

Hong Kong and Taiwan will remain Beijing’s two most immediate territorial interests during Xi’s second term. The outlook for both is a tighter grip, albeit with important nuances.
Beijing’s effort to gain and expand its political influence is most clearly on display in Hong Kong, and its efforts are likely to expand considerably over the coming years. Xi is a relative hardliner on the issue of Hong Kong; compared with his predecessors, he attaches substantial importance to Hong Kong’s symbolic value as an integral part of China.

The pace of infringements on the territory’s autonomy is increasing. These include everything from the Ministry of Foreign Affairs’ comments that the Sino-British Joint Declaration, which safeguards the territory’s autonomy, is now a “historical document” with no modern relevance, to indications that Beijing may push the new administration of Carrie Lam to introduce controversial anti-subversion legislation.

These actions are, in part, a response to the emergence of a pro-independence wing of the opposition camp in Hong Kong. A series of mostly young activists that entered political life after the 2014 Umbrella Movement protests are more vocal and now are shaping opposition policies. They are in turn a reflection of a broader shift of the spectrum of Hong Kong public opinion away from Beijing. The current cycle of opposition and Beijing tit-for-tat dynamics have provoked strong reactions from Beijing, which in turn has led to a greater push for independence; this pattern may ebb and flow in coming years, but it is difficult to imagine a reversal.

Beijing is expected to continue deploying both formal and informal measures aimed at constraining political space in Hong Kong, especially if pro-independence voices gain momentum. Formal measures include unilateral interpretations of the Basic Law by the Standing Committee of the National People’s Congress, though these are relatively rare. Informal measures include the expansion of the Central Liaison Office’s involvement in Hong Kong government policymaking, retaliation against unfavorable press coverage through advertising withdrawals, and abductions of Hong Kong residents to the mainland.

In some sense, these informal measures have more impact on the territory’s autonomy than formal measures. They will continue to blur the line between Hong Kong and the mainland for years to come.

Taiwan presents a more complex picture for Beijing, however. The trajectory for cross-Strait relations is clearly heading toward more pressure. President Tsai Ing-wen will not endorse the so-called 1992 Consensus as a basis for China-Taiwan dialogue and communication. The mainland has therefore ceased all high-level communication with Taiwan officials (and much of the lower-level engagement as well). It has also imposed soft sanctions on group tourism to the island and educational exchanges.

More recently, Beijing has adopted an more coercive approach. These measures include high-profile military drills near the island and punishing nations that still provide full diplomatic recognition to Taiwan, such as Panama. Such actions appear less designed to persuade Tsai to endorse the 1992 Consensus than to signal to the pro-independence wing of the Democratic Progressive Party that any move toward formal independence will be met with military force.
However, there is some constraint to Beijing’s efforts to pressure Taiwan. Measures to radically change the security situation or to crush Taiwan’s economy would almost certainly generate a “rally around the flag” effect and lead voters to blame a downturn on Beijing, not on Tsai. Considering Beijing’s medium-term goal to oust Tsai and propel the more mainland-friendly opposition Kuomintang (KMT) party candidate into the presidency and legislature, that result would be counterproductive.

The near-term challenge for Beijing will be grappling with the KMT’s own struggles. The party is listless and consumed with infighting, an ongoing investigation into its party assets, and an inability to capitalize on Tsai’s weak approval ratings. Its troubles are only likely to grow as Tsai continues to shepherd her signature policy promises—namely, on pension reform and infrastructure stimulus—through the legislature, which will shore up her weak ratings and improve her image as a decisive leader.

As in Hong Kong, the long-term challenge for Beijing is that popular opinion in Taiwan is shifting further away from the mainland. There is no longer a major competitive constituency that opposes Tsai’s position on cross-strait relations. The KMT’s advocacy of closer relations with the mainland is increasingly unpopular and appears to be slowly and fitfully evolving toward a more centrist position, especially as the KMT ages and the “deep blue” camp fades from politics. It remains an open question of how Beijing might react if it perceives that the KMT is not only seriously weakened, but might never return to power in its mainland-friendly form.

**The Koreas**

There is a fundamental tension at the heart of Beijing’s approach toward the Koreas and this will define its approach to North Korea going forward. On the one hand, Beijing views North Korea’s chronic provocations and efforts to develop nuclear weapons and the ballistic missiles as growing liabilities. On the other, Chinese leaders will remain unwilling to pressure Kim Jong-un’s regime to the point that such pressure might cause political and social instability, even though many in the US believe that is what is necessary to prompt North Korea to come back to the negotiating table.

The US and Japan will intensify their efforts to pressure China to do more to rein in North Korea; this could involve imposing “secondary sanctions” on Chinese entities and individuals doing business with North Korea, especially if Beijing does not fully implement the new UN sanctions. While these further unilateral sanctions will irritate Beijing, they are unlikely to prompt it to take a significantly harder stance on Pyongyang. Beijing believes that it has far less influence over North Korea than the US and other countries assume, and it will continue to reject accusations that it is coddling and enabling Kim.

Disagreements over how best to address the North Korea threat will prompt the Trump administration to search for less direct but potentially more effective ways to make China more amenable to supporting the US “maximum pressure” strategy. For example, Beijing likely agreed to vote along with other UN Security Council members on 5 August for even broader sanctions on the North to avoid the US imposing additional unilateral sanctions on China under a new sanctions law Trump signed in early August.
Japan's efforts to play a major role in containing North Korea using sanctions or other measures will further complicate Beijing's already testy relations with Tokyo. Prime Minister Shinzo Abe is determined to maintain solidarity with the US even though doing so heightens the risk that Beijing will retaliate by placing restrictions on Japanese businesses or increasing military activities around Japanese territory. Japan's plans to continue to boost military spending and otherwise enhance its military capabilities and readiness to counter geopolitical tensions in Asia will likewise add to current tensions with Beijing.

South Korean President Moon Jae-in is seeking to reduce tensions with North Korea through dialogue and engagement but this will not help ties with Beijing, and it may inject some frictions into Seoul's ties with Washington. Especially troublesome has been Beijing's decision to express its opposition to Seoul's plans to deploy the US Terminal High-Altitude Area Defense (THAAD) anti-missile system by imposing restrictions on South Korean firms. Moon's efforts after taking office in May to delay THAAD's full deployment raised hopes in Beijing that he would eventually decide to reject it entirely, but North Korea's frequent missile tests have since changed Moon's stance on THAAD, and this situation will continue to strain economic and political ties.

**Maritime: South China Sea and East China Sea**

In both the South and East China Seas, China will seek to consolidate its gains and defer any diplomatic agreement that restricts its ability to do more in the future. The Chinese debate about whether stability or strategic advantage is their main goal is alive and well in Beijing.

China will maintain its near-constant presence around the disputed Spratly, Paracel, and Senkaku/Diaoyu Islands with its coast guard and fishing fleet. Meanwhile, China's navy is never far away and it will maintain a naval presence well beyond the first island chain and in to the Philippine Sea.

In the East China Sea, China and Japan will remain at loggerheads in their long-running issues regarding the Senkaku/Diaoyu islands. China will send additional ships and aircraft into waters and airspace around the islands, prompting Japan to respond by intercepting them and building up its coast guard and naval assets in the region. The status quo will likely hold, but these encounters between the two sides at sea and in the air means there is a constant risk of accident and, more broadly, an environment of a militarized competition between Tokyo and Beijing.

The situation in the South China Sea has stabilized in the last year, primarily as President Rodrigo Duterte of the Philippines has pursued a soft landing by not pursuing the Philippines' claims following the Hague ruling in 2016. The other claimants have also not sought to challenge China. Currently, Beijing has solidified its advantage in the area with its seven reclaimed features and facilities it has built on them.

In the current situation, China has limited incentives to keep pushing its claims given its substantial achievements to date, but we cannot rule out such a scenario in
Xi’s second term. As long as Beijing retains its superior position, however, the other claimants are unlikely to push back harder.

The US will continue a series of freedom of navigation and overflight exercises in the South China Sea, but these are unlikely to rile China so long as it judges that US activity will be limited to these periodic maneuvers, and US influence with claimant countries kept in check.

If China is provoked, either by claimants or more aggressive actions on the part of the US, Beijing would likely respond by shoring up its presence on its reclaimed features, for example by placing additional equipment there, including both the Coast Guard and the uniformed military; such a step by China could draw the US military further into these disputes.

The calm is likely to continue as long as no other regional players step up and challenge China. A unified ASEAN effort is also unlikely due to pushback from China-friendly countries. Even Vietnam, which has a track record of challenging China’s activities in the sea, allegedly took a step back recently when Beijing threatened military action over drilling rights in disputed waters.

The agreement between China and ASEAN countries on a South China Sea code of conduct framework at the ASEAN summit on 6 August will lock in a period of calm while negotiations on a code of conduct proceed. Any final code of conduct text might address freedom of navigation and issues such as joint response mechanism for crises and militarization. However, completing full negotiations on the text this year is unlikely, especially given divisions over whether the code should be legally binding. China is pushing for a nonbinding code, which is likely to meet resistance from some ASEAN members like Vietnam and Indonesia.