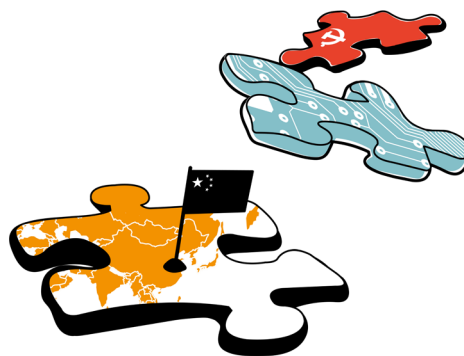


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MERICS China Essentials



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TOP STORY

Xi's leadership remains unchallenged despite economic crisis

As China adamantly sticks to its zero-Covid policy, the economic cost has become huge, and the public is seething with discontent. Beijing's extreme lockdowns have led to protests and clashes between authorities and residents forced to stay home for weeks without normal access to food and medical supplies. In what some observers saw as a public act of defiance to Xi Jinping's zero-Covid policy, Premier Li Keqiang was seen on a much-publicized inspection tour in Yunnan without wearing a mask. He has also appeared to diverge from Xi's confidence that his anti-Covid policy "will stand the test of time." The Premier has called for more government aid for the economy, emphasizing that support for businesses is a good antidote to Covid-induced economic slowdown.

But an economic crisis does not automatically translate into leadership struggle – and the media highlighting Premier Li for a day doesn't make a coup. Xi has spent a decade eliminating opposition and alternative factions at the center of the Chinese Communist Party (CCP) and has attained considerable control over the security services and armed forces. This means that Xi as yet can contain the severe loss of citizens' trust in government stemming from often chaotic lockdowns even in major cities like Beijing and Shanghai. Online protests are quickly being censored and physical protests quelled by China's enormous security apparatus. If anything, China's zero-Covid policy reminded the urban middle classes that the CCP can and will intervene in their lives if need be.

While the number of cases in the latest wave of outbreaks has subsided and death rates remain below levels seen in Europe and the United States, the harsh lockdowns look set to depress economic growth to lows last recorded in the early 1990s. Businesses and logistics infrastructure are struggling to resume operations after being forced to shut for weeks and it is unlikely government stimulus will be able to boost economic growth to this year's target of 5.5 percent. Internal debates about measures will go on and personnel changes will be decided as the CCP prepares for its 20th Party Congress in the fall. But no shifts away from "zero Covid" or established economic measures are apparent. With security and stability the mantra, Beijing will not make any rash moves.

MERICS analysis: "While public discontent and heated behind-the-scenes policy debates look set to continue, they will likely lead to little more than the scapegoating and dismissal of local or regional officials – decisions that Xi will construe as changes-for-the-better under the 'people centric' CCP of Xi Jinping Thought," says **Nis Grünberg**, Lead Analyst at MERICS. "Xi looks set to remain front and center. He is backed by a group of aides in the Politburo and faces no signs of any challenge to his ambition to secure a third term as paramount leader at the Party Congress towards the end of the year."

Media coverage and sources:

- China Media Project: [Politics on page one](#)
- The Economist: [Rumors emerge of disharmony within China's leadership](#)
- Wall Street Journal: [China's top two leaders diverge in messaging on Covid impact](#)

TOPICS

Certain trajectory in uncertain times - Beijing seeks stability in its foreign policy

Despite hopes for stability in the run-up to this fall's 20th Party Congress, Beijing sees itself as facing an increasingly hostile international environment – one defined by its struggle with the West over the shape of the international order. The West's decisive response to Russia's war on Ukraine and growing American and European engagement with Indo-Pacific partners has fueled fears in Beijing of a US-led containment strategy.

US President Biden's recent visit to Asia, where he announced the new Indo-Pacific Economic Framework for Prosperity and met with other leaders of the QUAD format, and the EU summits with Japan and India are seen as attempts to isolate China. Such fears are likely being heightened by disruptions to diplomatic exchanges as a result of China's zero-Covid policy, increasing the risk of an echo-chamber effect among the Chinese top leadership.

To ensure stability despite a more volatile and unpredictable international situation, China has on the domestic front begun pre-emptive preparations in case it too becomes the focus of economic sanctions like Russia. Beijing in March ran an exercise to see how government agencies would respond to such moves by the West. Internationally, China has doubled down on its foreign policy trajectory – there are no signs of China reconsidering its anti-Western alignment with Russia. For instance, China conducted an annual joint air-force exercise with Russia over the East China Sea earlier than usual, while Biden met the other QUAD-format leaders of Japan, India and Australia in Tokyo.

Beijing has increased its efforts to rally states dissatisfied with the current international order in a push for greater multipolarity channeled through loosely defined formats like the Global Development Initiative, the new Global Security Initiative, or an expanded BRICS grouping. Beijing has also intensified diplomatic outreach, particularly to the Global South. In a counter to the US's Indo-Pacific Economic Framework for Prosperity, Foreign Minister Wang Yi toured eight South Pacific island-nations – although he failed to get them to endorse a “Common Development Vision” including security cooperation, akin to a controversial deal Beijing has with the Solomon Islands.

MERICS analysis: “While the current international environment remains volatile and uncertain, Beijing's foreign policy seems unlikely to change in the foreseeable future”, says MERICS analyst **Grzegorz Stec**. “This is all the more likely as international friction looks set to continue after the publication of the “Xinjiang Police Files”, for instance, or the looming Indo-Pacific-focused NATO summit. Unless major developments cause a shift in thinking, Beijing will continue to fortify China domestically and expand a coalition based on push-back to the Western-led international order.”

More on the topic: In the latest [MERICS China Security & Risk Tracker](#), MERICS Lead Analyst **Helena Legarda** and Analyst **Grzegorz Stec** look at how China's Global Security Initiative seeks international buy-in for Beijing's vision of the global order.

Media coverage and sources:

- Asia Nikkei: [Indo-Pacific framework to begin with 13 nations, including India](#)
- Chinese MFA: [Foreign Ministry Spokesperson Wang Wenbin's Regular Press Conference](#)
- AP: [China falls short on big Pacific deal but finds smaller wins](#)

Foreign business sentiment continues to plummet amidst unending “zero-Covid”

While much of the world has shifted to “living with Covid,” China continues to inflexibly apply its zero-Covid strategy to fight a Coronavirus variant very different to the one that emerged two and a half years ago. The resulting rolling lockdowns have caused economic disarray and seriously impacted investor sentiment – and even China’s leadership is worried about the trajectory of the economy. The pandemic days in which China was the safe harbor for many companies – a market in which they could reliably keep operations humming as Beijing’s zero-Covid strategy proved effective – are over.

Premier Li Keqiang on May 25 held a call with over 100,000 officials at every level of government in an attempt to coordinate policy to keep the economy from derailing completely. Two days prior to the meeting, Li and the State Council published 33 economic measures that were aggressively pushed forward in the virtual meeting with the aim of eking out at least some positive growth in the second quarter of 2022. This doesn’t mean Beijing has abandoned the many long-term ambitions it has pursued in recent years – deleveraging, technology regulation, real estate cleanup, and decarbonization. But these goals and general fiscal discipline are clearly on hold for now as the Chinese government focuses on dealing with this self-induced crisis.

Foreign business sentiment has not responded well. Li was once again deployed as the personification of economic competence on May 19 when he hosted representatives from major foreign business associations and chambers of commerce to take in their concerns. But the May 24 Conference Board Measure of CEO Confidence for China was still grim. Sentiment was extremely negative about the current situation, but expectations for the coming six months were perhaps even more striking: 47 percent of CEOs surveyed expect sales in China to worsen, and 27 percent expect them to remain the same. This tacit vote of no confidence in Beijing’s ability to emerge from crisis this year also signals a growing acceptance that China won’t abandon “zero-Covid” any time soon.

MERICS analysis: “Li Keqiang has been ordered to keep the economy on track without disturbing Xi Jinping’s zero-Covid strategy. This puts China’s Premier in the role of a fire chief who has been told to put out a raging inferno without any water,” says **Jacob Gunter**, Senior Analyst at MERICS. “Details that have emerged from Li’s meeting with officials suggest a desperation to hold the economy together. But until the zero-Covid strategy is abandoned, there is only so much Li can do to maintain the economic baseline. Foreign investors are increasingly flustered with an unflinching Beijing.”

Media coverage and sources:

- Conference Board: [The Conference Board Measure of CEO Confidence™ for China: 2022 H1 Results](#)
- CNBC: [China holds an unprecedented, massive videoconference on the economy](#)
- SCMP: [China has 33 ways to get economy back on track, but critics say 'adjusting zero-Covid strategy is key'](#)

Warning signs for China in global competition for talent

Social and economic uncertainty and Covid restrictions are casting a pall on Xi Jinping's ambition to turn the country into a "talent powerhouse" for bright and innovative people from around the world. China's National Immigration Administration on 23 May banned "non-essential" foreign travel, while maintaining tight restrictions on foreign nationals entering the country. Cross-border travel looks set for another miserable year: the number of trips into and out of China declined 5.9 percent year on year to 30 million in the first quarter of 2022; foreigners arriving and departing numbered 4.5 million in 2021, less than five percent of 2019 levels.

There is anecdotal evidence that talented people (both domestic and foreign) living in China are getting restive. Online searches involving the word "migration" are spiking, visa-service agencies overburdened, and social-media memes like "runology" (润学) and "the last generation" quickly censored. Customs logs show a net outflow of 68,000 residents from Hong Kong this year, extending the 2021 decline.

Nevertheless, Beijing reiterated its plans to turn cities like Hong Kong, Shanghai and Beijing – some of the epicenters of recent lockdowns – into "global talent centers and innovation highlands" when the Politburo passed (but did not publish) the Talent Development Five Year Plan (2022 – 2025) on 29 April. But talented foreigners might think twice about migrating to these hubs following the plight of foreign students studying in China.

Despite prominence in the "Educational Silk Road" and niceties about "South-South collaboration," more than 50,000 students from India and Pakistan have been left in limbo in their home countries for over two years of the pandemic. China's Ministry of Foreign Affairs said late April that preparations for students to start were underway, but it gave no details and has not reported on progress since then.

MERICS analysis: "In the short run, China's zero-Covid strategy is putting it on a path towards isolation and even de-coupling," says **Jeroen Groenewegen-Lau**, Head of "Science, Technology and Innovation" at MERICS. "Longer term, it is not obvious how China would make up for lost ground in the global competition for talent, beyond targeting the many Chinese students that are still studying overseas."

Media coverage and sources:

- Sixth Tone: [Eventually, China's borders will reopen. Will foreigners return?](#)
- CSIS: [How China's human capital impacts its national competitiveness](#)
- ST Daily (CN): [有人欲出游办理护照，国家移民局：建议推迟或取消出境游行程](#)
- Quartz: [China has abandoned its foreign students over Covid zero](#)

VIS-À-VIS

Johnny Erling: "This is all about major domestic, foreign and economic policy mistakes"

MERICS China Essentials spoke with Johnny Erling about difficulties and uncertainties China is currently facing. A MERICS Senior Fellow, he is looking at Chinese domestic politics and the Communist Party in the run-up to the 20th Party Congress at the latter end of 2022. He lived in China for several decades and was Beijing correspondent for the German newspaper "Die Welt" and Austria's "Der Standard" from 1997 to 2019.

China's Covid policy was once successful, but is now a source of uncertainty. Why?

Beijing did not expect this intense Covid-19 wave. With the virus suppressed by widespread lockdowns, the crisis seemed to be over in 2020. But then Xi Jinping was somewhat surprised to discover China had not solved the problem as the more contagious Omicron variant and low vaccination rates, especially among the elderly, undermined early successes. Xi's response was a foregone conclusion – the zero-Covid strategy of 2020, even if it doesn't fit today's infection patterns. As a result, about 45 cities were in lockdown by mid-April, one in three citizens and 40 percent of the economy. This has led to great uncertainty in populace and leadership. Xi had construed initial successes in fighting the virus as systemic superiority – order in China, chaos in Europe and North America. He was also always eager for China's economy to grow faster than that of the US – an ambition that also looks set to be thwarted in 2022.

Could this uncertainty call into question Xi's goal of further consolidating power?

For Xi, the top priority is this fall's big five-yearly Communist Party meeting. The plan is for the Party Congress to elect him general secretary for a third time, the crucial step towards his re-election as head of state by the National People's Congress in spring 2023. Millions of Covid deaths would mar this staging, which is why Xi believes he has no choice but to crack down on the virus in this whack-a-mole manner – even if that upsets the population, paralyzes the economy, and makes foreign countries question China's reliability.

Xi is also doing everything else he can to ensure a smooth party congress. The vetting of delegates has been tightened, proponents of any line critical of Xi will not be given a stage. There are also plenty of propaganda activities underway to help citizens, from young to old, and all officials toe the line. Xi will probably also intensify his anti-corruption and self-criticism campaign – and it will probably claim some prominent victims as a result. In a quite unprecedented way, the bureaucracy is pulling out all the stops to make the staging of the party congress a success.

So, Xi will be able to deal with the uncertainty that has arisen at home and abroad?

The zero-Covid strategy is a real mess – the populace is unhappy, the economy is crippled, and unemployment is rising alarmingly, especially among university graduates. And that's not Xi's only mistake – China is increasingly isolated in foreign policy because of its support for Russia. This is all about major domestic, foreign and economic policy mistakes by a head of state and party leader apparently unable to take advice. But Xi is still in total control, there are no signs of any group or groundswell that could threaten him; the army and police have sworn their allegiance to him.

The Chinese leadership is counting on lifting the lockdowns in Shanghai and other large cities before the end of June – and then on publicly celebrating this step as a great triumph. This is meant to restore the image of China as a bastion of order, much like the initial disaster in Wuhan was celebrated as a national feat of strength when the strict lockdown ended. Under the current circumstances, I expect Xi to be resoundingly re-elected as party leader in the fall and as head of state in the spring. Starting March 2023, he might well initiate much-needed corrections to his recent mistakes, to again spur growth and win back foreign-policy leeway. But for now, the Party and People's Congresses have top priority.

PROFILE

Zhejiang Orient Gene, Hangzhou Alltest and Acon Biotech Hangzhou - Three Chinese self-testing companies finally tap into their home market

Zhejiang Orient Gene, Hangzhou Alltest and Acon Biotech Hangzhou may sound like obscure Chinese companies. But the chances are that parts of what they make went up your nose or down your throat in the past year. The three are China's largest manufacturers of rapid Covid tests by volume, together producing up to 30 million kits per day. Their biggest customers up until recently have been in Europe and the United States – and now China could take up the slack as pandemic measures are relaxed elsewhere.

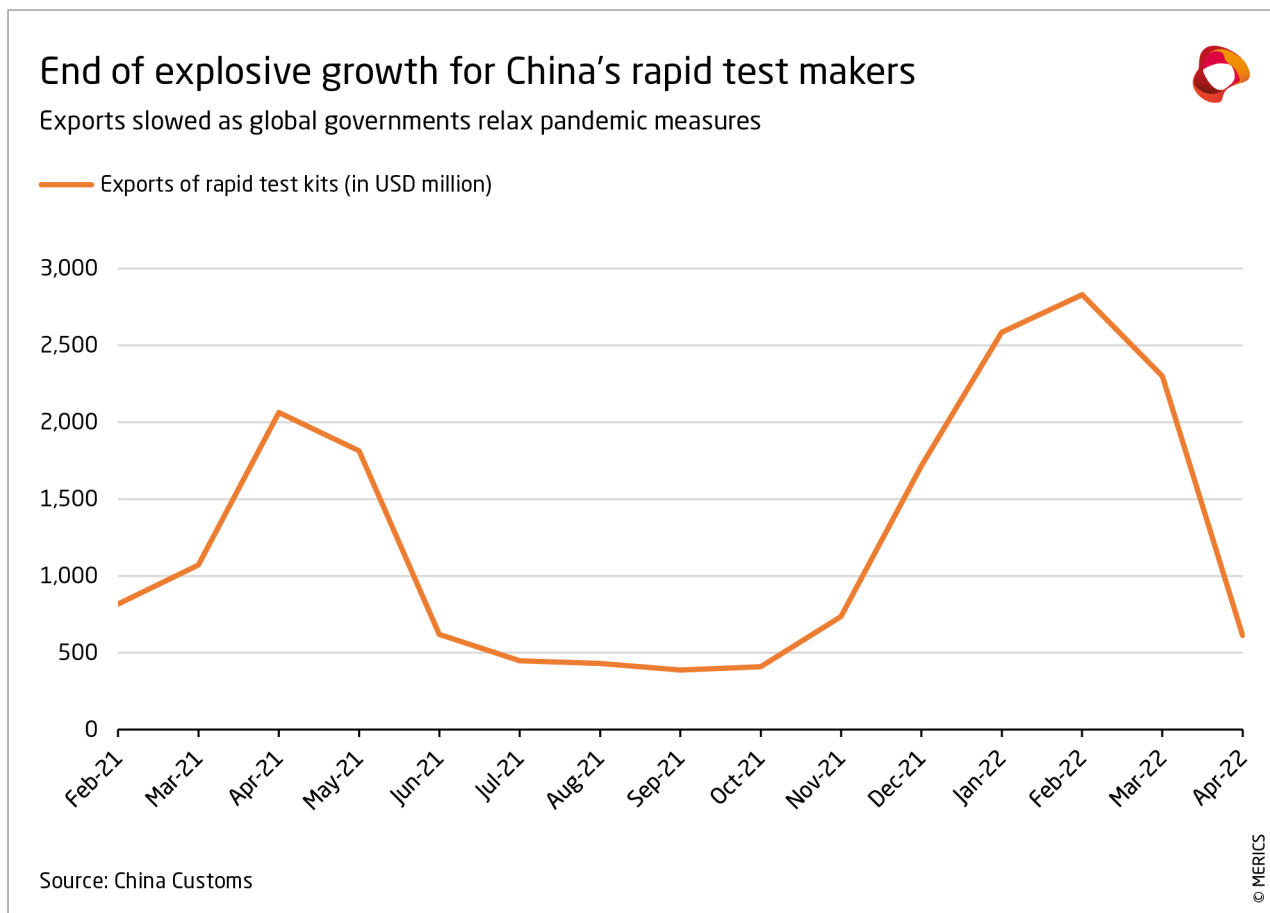
Outbreaks of the Omicron variant last year sent governments in many pandemic hot spots scrambling for rapid test kits. The surge in global orders saw the fortunes of these Chinese firms soar. Zhejiang Orient Gene, the biggest of the three, saw its annual profit grow by 193 percent to 4.9 billion CNY last year. It was one of the first Chinese Covid-test manufacturers of rapid tests kits to receive European Union (EU) certification in 2020.

The oldest of the three, Acon Biotech Hangzhou, was founded in 1995, and all three companies have specialized in the production of medical diagnostic tools for at least a decade. That is why all three firms were able to quickly adapt manufacturing resources to produce rapid tests for Covid-19 when demand exploded. All three set up labs, production and sales offices in the EU, the United States and Canada. To fund expansion, Orient Gene and Hangzhou Alltest even went public on the Shanghai stock exchange.

But with many countries around the world now rolling back their testing regimes, orders have slowed. Exports of test kits were down by more than 70 percent month-on-month in April this year. Luckily for these Chinese companies, domestic demand may now fill the gap. The country's healthcare system is overwhelmed by having to test millions of

residents in the latest wave of outbreaks. To help ease the pressure, the Chinese government approved the use of self-administered rapid test kits earlier this year.

Exhibit 1



Media coverage and sources:

- Nikkei Asia: [Chinese healthcare companies hit Covid jackpot with home-test kits](#)
- SCMP: [As China's Covid-19 test kit orders surge globally, manufacturers are hiring en masse to meet demand](#)

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