ASIA SOCIETY POLICY INSTITUTE

POLICY PAPER

BY KEVIN RUDD

JULY 29, 2022

THE CHINESE ECONOMY, THE 20TH PARTY CONGRESS, AND IMPLICATIONS FOR US-CHINA RELATIONS

Delivered as the Inaugural Susan Shirk Lecture on US-China Relations at the University of California San Diego

---

ABOUT THE AUTHOR

The Hon. Kevin Rudd AC is

President and CEO of the Asia Society, and inaugural President of the Asia Society Policy Institute. He served as 26th Prime Minister of Australia (2007 to 2010, 2013) and as Foreign Minister (2010 to 2012).

ABOUT THE ASIA SOCIETY POLICY INSTITUTE

With a solution-oriented mandate, the Asia Society Policy Institute (ASPI) tackles major policy challenges confronting the Asia-Pacific in security, prosperity, sustainability, and the development of common norms and values for the region.

INTRODUCTION

Three months from now, the Chinese Communist Party (CCP) will convene their most consequential Party Congress in 40 years.

It was at the 12th Party Congress back in 1982 that the party, under the leadership of Deng Xiaoping, set China's political and ideological direction for the next 35 years. At the 12th Congress, the party formally resolved ideologically that China would attach total priority to economic development through a strategy of market reform at home, opening abroad, and a foreign policy (including a relationship with the United States) designed primarily to accommodate both. It was the same Congress that also formally adopted the 1981 "Resolution on Certain Questions on Party History," which concluded that Mao Zedong had committed profound errors for having departed from the party's official line in 1956 on the primacy of economic development, continuing instead with another 20 years of political class struggle. And it was the 1982 Congress that also resolved formally to repudiate Mao's personality cult, absolute power and leadership-for-life and restore the principles of collective party leadership – including an evolving convention of term limits.

These were the core ideological principles that defined the Deng, Jiang, and Hu era of Chinese politics and the extraordinary decades of economic growth that followed. They also defined the unofficial social contract between the Communist Party and the Chinese people – a people whose faith in the CCP's legitimacy had been shattered by the political chaos, economic collapse, cultural vandalism of the Mao's Cultural Revolution. And a people who were then offered instead the prospect and then the reality of rising living standards – and personal lives less dominated by an omnipresent party. These principles also underpinned an unprecedented period of Chinese global engagement during which China enjoyed increasingly unfettered access to global product, service, and capital markets; where Chinese growth increasingly drove the global economy, and when China became an increasingly integrated part of the existing international political and economic order

That era has now passed. And the new era of Xi Jinping has begun. This is not simply an analytical assertion on my part. It is what Xi himself has proclaimed: as Mao's era of China standing up was followed by Deng's era of China becoming prosperous, now followed by Xi's self-proclaimed new era of Chinese national power. This change is not simply a reflection of Xi's Marxist predilection for elegant forms of political symmetry. It also reflects profound adjustments in the party's overall ideological parameters under Xi as he continues to reinterpret the underpinnings of Deng's 1982 ideological consensus.

This process began in 2013 with Document Number 9 and the reassertion of the paramount importance of Marxist-Leninist ideology itself as the political cornerstone of the

©2022 The Asia Society. All rights reserved.

power and legitimacy of the party – in one fell swoop repudiating Deng's most celebrated aphorism (*bujiang lun*) that the time had come to stop talking about theory and to just get on with the practical business of economic growth.

It continued at the 19th Party Congress in 2017, when Xi formally deployed the tools of dialectical materialism to redefine the party's central contradiction from the paramount importance of developing the forces of production to a new priority on the relations of production (i.e. class inequality) under the overall political-economy rubric of "unbalanced development."

It has also been reflected in Xi's most recent writings in the party's theoretical journals where he begins to also deploy the tools of historical materialism to challenge yet another Dengist doctrine on the hundreds of years that the inequalities of the primary stage of socialism could endure – to begin to imply that this era may also soon be drawing to a close.

And on politics itself, and most particularly the power of the leader, Xi's 2021 "Resolution on Party History" on the occasion of the party's centenary conspicuously omits the 1981 resolution's condemnation of the cult of personality, life-tenure, and the loss of collective leadership as Xi – as the party's core leader, new helmsman, and Marshall of the PLA – moves him seamlessly toward a record third term at the 20th Congress.

As for China's place in the region and the world, over the last seven years Xi has spoken with increasing clarity of an unfolding struggle for the future of the international system – anchored in an even more fundamental geopolitical struggle with the United States amid what he describes as the rise of the East and decline of the West.

These profound changes have not been confined to the ideological domain. Ideology and the band of meaning it represents remain the headwaters for a cascading set of changes in China's political discourse and policy direction within the self-contained, ideational political ecosystem of the Chinese Communist Party. In understanding Xi Jinping's China, we ignore ideology at our peril. It is an important signaling system for downstream direction across politics, the economy, and foreign policy. And, in Xi's first decade in power, ideological change has been reflected in a profound move to the left in Chinese politics and economics and to the right in Chinese nationalism and foreign policy.

So what of the future? The process of ideological and policy change in Xi Jinping's brave new world has not been completed. Indeed, it may barely have begun.

That is why as we approach the 20th Party Congress this October-November, we will need not only to analyze its significance against the background of the changes that have already occurred under Xi, but also what is new. Not just new in terms of personnel – although that will be important in understanding continuing changes in the party's factional equilibrium between left and right. But also in terms of changes in the ideological formulations to be found in Xi's report to the Congress on the economy and the relative roles of the private and public sectors. And equally critically, in decoding any new ideological formulations on the party's understanding of China's international environment, including the likelihood of war after 21 years of a "period of strategic opportunity" during which period this was judged to be low.

In this context, the purpose of this lecture is not to try and cover the field across the vast range of potential ideological, policy, and personnel changes that may arise from the congress.

My purpose is narrower than that.

First, it is to examine where the Chinese economy stands near the eve of the Congress.

Second, it's to examine what this may mean for political and economic policy outcomes following the Congress.

And third, it's to analyze what these may in turn mean for the future direction of Chinese foreign policy, and in particular China's posture towards the United States and its allies.

In the months ahead, I intend to separately address the broader question of continuing ideological change in China and what this may mean for our understanding of Xi's grand strategy for the decade ahead.

THE STATE OF THE CHINESE ECONOMY

In March of this year, Beijing set its annual economic growth target at 5.5% – the lowest in decades, but still highly ambitious given the circumstances. Xi reaffirmed this commitment as recently as a speech in June. While in China the leader can never be wrong, the prospects of actually delivering 5.5% growth appear to be increasingly remote.

China's economy grew by 0.4% in the second quarter compared with the same period last year according to official data released this month. This is down from 4.8% growth in the first quarter. To put this in perspective, this is the second slowest growth rate in at least thirty years. With only 2.5% growth in the first half, reaching 5.5% annual growth for the year would require growth to surpass 8% for the next two consecutive quarters. This would be a heroic achievement, albeit one which Chinese statisticians from time to time have massaged, with limited regard for economic reality.

The Politburo, however, in meeting this week on the economy, appears to have accepted the inevitable, saying in a statement that it would merely attempt to keep the economy within "a reasonable range" for the year, now without any mention of a specific target. Speaking at the World Economic Forum last week, Premier Li Keqiang said China would not "sacrifice future interests to go after an excessively high growth target," but would "take a realistic approach and do the best within our means to strive for fairly good results in economic development for the full year."

New growth estimates between 4-4.8% have begun to be floated in state media by senior economists. But even this would require a remarkable turnaround. Most international economists currently predict full-year Chinese growth for 2022 to come in under 3%.

China's official inflation numbers remain low at 2.5%, but given rising food prices around the country, these numbers are not believable. Similarly with China's official unemployment numbers, which were 5.5% in June compared with 5.9% in May. But these official numbers reflect only urban unemployment, whereas rural numbers are likely to be much higher. Meanwhile official youth unemployment stands at an alarming 19.3%, up from 18.4% in May, which is the highest since records began after the Cultural Revolution. With nearly one in five Chinese youth – many of them college graduates – now out of work, the party is acutely aware of real, growing risks to social and political stability. It's top priority is now job creation, with Li last month pointing to maintaining a 5.5% unemployment rate as the key number to meet.

Put simply, these are not a good set of economic numbers going into the Party Congress. That have also triggered a significant internal debate on what has gone wrong with China's economic performance, why, and who is to blame.

The Great COVID Lockdown

Of course, the proximate cause for this recent slowdown is straightforward: the draconian "zero-COVID" lockdown policy which has cratered economic activity in many of China's largest cities for months at a time this year. Shanghai's economic output, for instance, shrunk 13.7% in the last quarter, following weeks of lockdowns.

Nonetheless, Xi has shown no signs of backing down from his zero-COVID strategy, signaling that economic damage is an acceptable price to pay for keeping the COVID caseload low, declaring during a recent inspection tour in Wuhan that "even if there are some temporary impacts on the economy, we will not put people's lives and health in harm's way."

For Xi, who last year claimed personal credit for total victory over COVID-19 in China, unlike what the official media described as the collective political and policy failures across the US and rest of the West, sustaining "zero-COVID" has become a domestic political necessity. We should therefore expect no significant change in China's zero-COVID policy until after the Party Congress in October is concluded, although there is considerable work underway across multiple Chinese government agencies on how these internal and external controls might be eased and eventually lifted in the future.

But with COVID once again threatening major new outbreaks in China, with new cases now at a higher official number than at any time since May, and with at least 264 million people in 41 cities once again under full or partial lockdowns, China's immediate economic future is looking, as Li put it in May, "complicated and grim" (*fuza er yanlun*).

But in truth the recent impact of the COVID lockdowns tends to obscure a much deeper set of policy and structural problems in the Chinese economy that have been at work over a number of years that are causing China's historical growth levels to falter.

Policy Settings

Since 2015, I have been writing that China's market economic reform program has been faltering. This was underlined in a series of quarterly economic dashboards produced between the Asia Policy Institute and the Rhodium Group across ten policy domains, including competition policy, capital markets reform, and SOE reform.

And, since 2018, I have been writing that, in addition to reform stalling, a new trend of policy reversal had also become evident, particularly since the 19th Party Congress in 2017, where we have seen a more general retreat from the market, toward the less than tender embrace of the Chinese party-state.

We have seen this across a number of policy frameworks and instruments including:

- the revitalization of **industrial policy** at a grand scale;
- the resuscitation of a doctrine of **national self-sufficiency**;
- party representation in the **management of private firms** (including in their recruitment policies);
- the co-option of private firms into the party's **United Front strategy**;
- the so-called **mixed economy model**, which is code language for mixed equity arrangements between SOEs and the private sector;
- **a party rectification campaign** against the legal and judicial system, reminding all that the courts are there to serve the party and will never be independent (including in commercial cases);
- **the crackdown on tech platforms**, under the rubric of national competition policies while happily leaving existing public monopolies untouched;
- a separate crackdown against what Xi describes as **the "fictitious" economy** (i.e. property) as opposed to the "real" economy (i.e. manufacturing);
- the launching (and then the un-launching) of **Xi's "common prosperity" agenda**, designed to reign in the perceived excesses of the billionaire class and begin to turn the corner on China's rising income inequality;
- the new mercantilism of **Xi's "Dual Circulation Economy" model**, whereby the party aims to maximize the world's economic dependence on the Chinese market while minimizing China's economic dependence on the world through national self-sufficiency - all part of what Xi's happy band of planners now calls the "great domestic circulation," also in turn part of what Xi also calls "a new form of open policy";
- all of which can be summed up by what Xi now calls the **"New Development Concept"** – a new economic framework (or at best "chapeau") for the next stage in China's economic development, which is itself part of the "new era" in Chinese politics that Xi first proclaimed at the 19th Congress.

There are multiple causes of this profound shift to the left in economic policy settings under Xi Jinping. These include the 2015 domestic stock market implosion and self-induced financial crisis; the US-China trade war of 2017-19; the separate but related imposition of a new range of export restrictions across multiple US and allied technologies, particularly in semiconductors; the imposition of parallel import restrictions against Huawei and other Chinese firms in 5G; rolling supply chain crises arising from the pandemic; the international reaction to China's increasing recourse to different forms of economic coercion against various foreign countries with whom China has foreign and security policy differences; the ever-present specter of international economic sanctions on human rights now, and on Taiwan in the future (underscored by Russia's experience following the invasion of Ukraine); together the general deterioration in the geo-political relationship with the US and the as yet inchoate but still impactful debate in both Washington and Beijing on economic decoupling.

But in addition to these largely externally generated policy dynamics, there are also a number of internal political dynamics that have been generated in large part by Xi Jinping's Marxist-Leninist ideological worldview – a worldview which at base is deeply skeptical about the power and position of the domestic private sector at home and the political reliability of the international private sector abroad.

Whatever the causalities, the consequences of Xi's move to the interventionist, statist, protectionist, and mercantilist left on the economy are real, measurable, and negative in terms of China's overall business confidence, productivity, private fixed capital investment, foreign direct investment, and economic growth numbers.

The impact of all the above on Chinese economic dynamism has been pronounced.

Indexes measuring Chinese private sector confidence hit their lowest level on record in May, other than the financial crisis of 2008 and the initial pandemic shock of February 2020.

As a percent of Chinese GDP, private fixed capital investment – which had grown steadily since the 1970s – peaked in 2013, after Xi's rise to power, and has stagnated ever since. Especially with half of that investment over last decade flowing into the property market, private investment now appears set for sharp declines in 2022 data as a driver of growth.

Nor is investment any longer flowing in from outside of China. Foreign capital has been leaving the country at unprecedented rates over the past six months. The value of yuan-denominated financial assets in China held by foreigners fell by more than $150 billion in the first quarter of 2022, the single biggest drop ever recorded. According to a forecast by the Institute of International Finance, some $300 billion in capital will likely flow out of China this year, up from $129 billion in 2021.

And on the single-most important long-term factor of all, productivity, the situation is severe. According to a study released this year by the IMF, China's annual rate of improvement in total factor productivity (the best measure of long-term economic development) averaged an impressive 22% between 2003 and 2011, but declined sharply to a mere 5% between 2011 and 2019, after Xi took power. In the view of many analysts, this decline likely continued to accelerate significantly after 2020 to less than 2%.

Then there are even deeper structural factors at work. China is facing a serious demographic crisis, with an official fertility rate of 1.15, the second lowest in the world after only South Korea. According to recently released UN projections, China's total population will peak this year and begin to decline, losing its status as the world's most populous country to India as soon as next year. This has already put significant strain on China's working-age demographics, with China's working population already having peaked in size in 2011, and the country's age dependency ratio already 42 percent and rising rapidly. This will in turn put significant strain on the Chinese health care and pension system, further undermining government finances. There is a very real chance that China will now grow old before it grows rich.

The combined result of all these factors has manifested itself in China steadily sinking annual overall growth numbers, which have declined steadily from over 10% in 2010 to under 6% in 2019. Economic growth has been visibly struggling for some time now under Xi, even before the COVID-19 pandemic.

The long-term significance of this fact on the future size and strategic leverage of the Chinese The long-term significance of this fact on the future size and strategic leverage of the Chinese economy cannot be understated. A growth rate that is cooling so substantially (and arguably prematurely) means that China may not succeed in escaping the "middle-income trap" common to developing economies. It may also mean then China never surpass the economic power of the United States, as was once assumed to be inevitable, or if so by a narrow margin. Hence why in recent months Xi has reportedly pushed officials to urgently ensure China's annual growth remains above that of the United States.

The Tech Sector

The impact of Xi's policies on the Chinese tech sector has been particularly significant.

Beginning last year with a blitz of regulatory investigations intended to make a show of force, the Chinese state began to open investigations and impose new controls and billions in fines for "monopolistic behavior," violation of data privacy standards, and cybersecurity and national security concerns, on dozens of Chinese technology giants, including Alibaba, Didi, Meituan, ByteDance, and others. Of particular significance, the central government also began to limit Chinese technology companies' ability to pursue IPOs in overseas markets, effectively restricting them to raising funding outside of China as Xi began to pursue a policy of decoupling on his own terms.

The result has been dramatic. Between the start of 2021 and July of 2022, the overall value of Chinese technology stocks fell by 40%. A number of Chinese tech giants have begun pulling out of overseas markets and returned home. China's once high-flying technology founders, like Alibaba's Jack Ma, went suddenly from the most visible symbols of Chinese success, to virtual public disappearance. And this week Ma agreed to relinquish his control of Ant Group, following two years of regulatory pressure since his foiled attempt to complete a record-breaking IPO for the firm.

But perhaps the most meaningful long-term impact is that venture capital investment into the Chinese technology sector has declined. In the first half of the year just under $5 billion flowed into China-focused venture capital and private equity funds, down 94% from last year and the smallest half-year total since 2009.

In recent months, however, with growth slowing and unemployment rising, Xi has begun to back off his regulatory onslaught against the technology companies. Just last week, regulators ended their year-long investigation into ride-hailing giant Didi with a $1.2 billion fine, but in doing so signaled they are ready to move on to more pressing concerns. The "vile" technology company (as state media once described it) had been made the poster-child of the Common Prosperity crackdown, but now authorities have put ensuring employment over ideological rhetoric.

Nonetheless, the critical question is whether the tech sector will recover its former confidence and resume its normal pattern of investment – or whether, together with the rest of the private economy, they will be remain concerned about the party's policy direction after the Party Congress given the underlying continuity of Xi's political and ideological framework.

The Property Sector

As with Tech, the impact of Xi's new policy directions has also been particularly evident in the property sector.

Following the 2015 stock market crash, China's leadership became acutely concerned about further risks to financial stability. Xi's right-hand man on economic policy, Liu He, took the lead in seeking to ensure there would be no future unexpected financial shocks, and was soon appointed to lead a new body, the Financial Stability and Development Committee dedicated to this mission. Its primary task became deleveraging the Chinese financial system as a whole, and the property sector in particular.

Progress has been uneven over the years since then. But when Xi began to declare (first in 2017 and then regularly) simply that: "houses are for living in, not for speculation," political momentum in support of the deleveraging of the property sector resumed. This was followed by repeated broadsides against the "reckless expansion of capital" more broadly.

Here you had a rational public policy need on the part of Chinese finance bureaucrats (i.e. deleveraging the Chinese property and financial sectors, given corporate debt totals of more than $27 trillion, or around 159% of GDP, and government debt of some 66% of GDP) being turbocharged by an overarching ideological imperative on the part of Xi Jinping himself to rein in capitalist excess.

This culminated in the August 2020 unveiling of Xi's "Three Red Lines" policy to force deleveraging, introducing implicit caps on three sets of corporate debt ratios: debt to cash, net debt to equity, and debt to assets. This was back when Xi and the political system believed that COVID had become a problem for the US and the West while having been effectively contained in China itself. This policy would become a fateful event for Evergrande, the property sector as a whole and the millions of customers they have between them, given that over 70% of Chinese household wealth is invested in the $52 trillion sector.

This became evident earlier this month with the outbreak of a protest by nearly a thousand people at the Zhengzhou branch of the People's Bank of China (in Henan province) which was then violently broken up by plainclothes local police. The protestors had gathered there because four fraudulently managed banks in Henan had lost their money and frozen them out of withdrawing their funds.

But while these banks may have been engaged in fraud, their sudden exposure was part of a much wider problem: the Chinese property sector appears to be in an unfolding crisis that began with the default of Evergrande last year, when it was unable to continue raising new debt (on top of its $300 billion in existing debts) due to the three red lines policy. Last Friday, Evergrande CEO Xia Haijun resigned following the discovery that he had tried to funnel $2 billion to the indebted company from one of its subsidiaries, ending a long saga of corporate mismanagement by the conglomerate, and further complicating yet-to-be announced restructuring plans.

But the problem has now spread far beyond Evergrande. With multiple Chinese developers having now defaulted, the broader bond financing market is now in crisis, with average yield on developers' junk bonds forced up to nearly 26% as of mid-July. Even formerly healthy, state-backed developers are now beginning to feel the squeeze.

New housing projects starts dropped 45% year-on-year in June, while construction on an estimated 13 million apartments has ground to a halt, tying up more than 4 trillion RMB worth of mortgage debt in suspended projects.

With much of their profits formerly flowing from real estate, local Chinese banks have now lost much of their cash flow, putting their finances under significant pressure. Insolvency risks are therefore growing among China's nearly 4,000 small and medium-sized banks, who collectively hold nearly $14 trillion in assets.

Furthermore, local governments have for years raised much of their revenue (an average of some 40%) from land sales and so-called "local government financing vehicles," which have borrowed money from banks. But now, with the property market at a standstill, local governments have also found themselves in serious financial difficulties, facing an expected 6 trillion RMB ($900 billion) shortfall in revenues this year.

Local government financing vehicles that have borrowed heavily from banks or issued bonds will in turn have great difficulties servicing their own debt, let alone bailing out distressed banks. Which is why, while the depositors in Henan province were supposed to be entitled to insurance of up to 500,000 RMB according to government regulations, so far they have been promised only a fraction of that amount as the Henan Government proved to be either unwilling, or unable, to fulfill that obligation.

It does not help that, by 2021, 90% of new home sales in China were "pre-sales" – homes that buyers took mortgages on before they were even built. These presales accounted for more than half of developers financing by the end of 2021. Indeed, bank financing for developers was cut to only 11% of their total financing in the wake of the "three red lines" policy. Home buyers have therefore been trapped paying for mortgages on projects that may never be completed, while developers will argue to local governments that they will be unable to stay afloat without the continuation of mortgage payments.

Chinese citizens have therefore begun boycotting mortgage payments on property projects that have not yet been completed (or, in many cases, even begun). So far developers have only delivered around 60% of the homes they presold between 2013 and 2020). As of last week, it is estimated that the number of projects subject to boycotts had climbed to over 300, collectively worth nearly $300 billion. In the meantime, property developers' contract suppliers have also begun refusing to pay back loans to the banks, saying they cannot afford to do so until defaulted developers pay them monies owed. By the end of June, there were an estimated 1,666 property company projects that had ceased payments, up from 135 in January.

In other words, there is a widening vicious cycle between banks, developers, consumers and local governments. This in turn has potentially profound macro-financial, macro-economic and political stability consequences.

First, the property sector represents some 29% of GDP. It has been a big part of China's economic success narrative over the decades. But the uncomfortable truth (as in many countries, not least the US during the sub-prime crisis) is that China's property boom has been built on a mountain of debt, part of which has now proven to be unsustainable. The unfolding crisis in the property sector therefore represents a big factor in China's overall slide in economic growth.

Second, there is the quantum of debt itself. China's combined public and private debt represents as much as 300% of GDP. This is almost 50% higher than the global average, according to the IMF, with China alone accounting for almost a third of a surge in global debt that has occurred since 2019. The ripple effects emanating from the Chinese property sector are capable of destabilizing the wider Chinese financial system – especially if a loss of consumer confidence results in further bank runs beyond the property sector. Insolvency risks are currently significant among China's nearly 4,000 small and medium-sized banks, with nearly $14 trillion in collective assets, and in recent years some have already had to be bailed out or allowed to collapse, such as the regional lender Baoshang Bank in 2020.

Third, housing represents 70% of household assets. If the value of these assets is debased, there is a tail risk of grassroots political instability as public protests (like Zhengzhou) proliferate.

Finally, the potential for political instability is likely to be compounded by rising unemployment due to property company collapses.

Financial Risk

These combined risks have sent the central government in Beijing scrambling to try to push local and provincial governments to restore financial order, forcing local banks to disclose the degree of their mortgage exposure, while also calling for local governments to quickly deploy all of this year's funds raised by issuance of special bonds, urging the provinces to "strive to achieve the best results possible."

But there is only so much they can do. In a recent speech Li Keqiang revealed that multiple provinces had already appealed to the central government for financial assistance. Beijing, however, has been reluctant to enact a major bailout. Or as Li recently warned local officials directly: "I am here to let you know my bottom line… There is a reserve fund managed by the premier. Other than that, local governments must raise funds [on your own]."

This week, however, the central government was forced to accept the reality that local governments cannot handle the problem completely on their own, with the State Council approving a plan for the People's Bank of China to mobilize $148 billion in low-interest loans to help developers refinance and complete stalled property projects. This step, which the central government had long sought to avoid, will, however, ultimately layer additional debts into the system, while delaying a correction driven by market realities.

As long as China could maintain high annual growth, of over 6%, it was possible to paper over any debt problems. But that kind of growth is no longer happening, so now the overall financial and economic system may need to face a reckoning. High growth covers a multitude of underlying weaknesses. Whereas longer-term low growth exposes the same. And as we all know, if the tide goes out, it can be economically confronting and politically embarrassing for all if it's found the emperor has no clothes.

Of course, these problems in the property and finance sectors are not exclusively of Xi's making. But Xi has compounded them. In particular through his ideological crusade against "the fictitious economy" – itself a term lifted directly from Marx's *Das Capital*. Previous Chinese governments over a long period, despite repeated declaratory efforts to transform the economy from an investment-led to a consumption-led growth model, have at best been partially successful. Just as repeated declarations on deleveraging the property and finance sectors since the 2008 Global Financial Crisis have largely failed.

Debt-fueled public investment in infrastructure, combined with debt-fueled private investment in property, have remained as major economic growth drivers. But these appear to be becoming unsustainable against the magnitude of the debt burden, as well as the confidence crisis that emerges once debt-servicing becomes problematic – leaving aside the impact of any future interest rate adjustments as a result of rising inflation.

If you add to these growth-related challenges the problems of depressed consumer confidence and modest private consumption induced by rolling COVID lockdowns, together with depressed business confidence resulting in declining private capital investment, the problem becomes much worse.

Overall Economic Impact

The calculation of any economy's GDP accounts for the combined product of four principal drivers: private consumption, government spending, business investment (including in property), and net exports.

Of these four, China is potentially in trouble on two of them: private consumption and business investment (and especially in terms of residential construction). Between them, these represent approximately 80% of Chinese GDP.

That leaves only the other two to carry the growth burden for the period ahead: government spending (i.e. infrastructure investment) and net exports. Together, these represent some 20% of Chinese GDP.

Furthermore, the already parlous state of local government finances, further undermined by the contraction of property sector transactions in the revenue side, and the demand for local bank bailouts and home-purchaser insurance obligations on the expenditure side, means that local government's ability to fund yet another round of economic stimulus through local infrastructure projects to simulate the economy is limited.

Policy Response: To Course Correct, or Not to Correct – That is the Question

With the fundamentals of growth stagnating, meager productivity improvement, and both Chinese consumer and business confidence both hitting record lows this year, there are only two options available for the central government to pursue if it is not willing to consider serious market reform: a return to public stimulus spending, and a doubling down on export-driven mercantilism.

Although the Chinese leadership has worked rhetorically to play down the prospects for large-scale stimulus spending in public – with Li vowing recently that "China will not introduce super-large-scale stimulus measures" – policy signals are nonetheless beginning to point in the opposite direction. In addition to the bailout loans for stalled development projects, Beijing has reportedly in recent weeks quietly moved to make available a total for some 7 trillion RMB ($1 trillion) in funds available for new infrastructure spending, according to an analysis by Bloomberg. This is the equivalent of 5.6% of GDP. By contrast, however, this compares with 12.5% of GDP in public stimulus spent by the Chinese central government during the 2008 Global Financial Crisis (and 27% of GDP when including local government spending). This new spending includes an unprecedented 1.5 trillion RMB worth of "special" bonds for local governments to be able to sell for infrastructure funding. Overall, infrastructure spending is forecast to rise 7.7% in 2022, according to projections by Citigroup. This is in line with a political decision reached by Xi and the Politburo in April, when it was concluded that it would be necessary to "strengthen infrastructure construction in an all-around way" in order to "expand domestic demand" and "achieve expected economic and social development goals," including full employment.

But this temporary fix of stimulus from debt-fueled infrastructure development – most of which will flow to state-owned enterprises – will ultimately exacerbate the core problem of inefficient top-down investment-driven growth, the expanding role of the party-state in the economy and ballooning national debt.

As for exports, the most recent data suggests that China's mercantilist approach is continuing to generate a growing balance of trade surplus. With exports riding a global pandemic recovery boost to surge 17.9% last month, the trade surplus reached a record high of $98 billion for the month of June.

It remains to be seen, however, whether this continues to be sustainable against declining global growth, rising energy prices and general inflation, supply chain complexity, and the longer-term processes of "decoupling" – either decoupling with Chinese characteristics or American characteristics, or, as is more likely, an untidy combination of both. Neither public investment nor net exports add up to a sustainable Chinese economic growth narrative. As former Minister of Finance Lou Jiwei astutely pointed out earlier this month, it is small and medium-sized private sector companies that provide 80% of China's employment opportunities. (Lou, for his previous troublesome heretical statements like this one, has been essentially banished from power).

But these private firms have also had their confidence in the system shaken over the last two years. They have not been targeted like big Tech, big property, big finance or big business. But they can read the signals from above: if they grow too large (that is: if they are successful) they are only liable to be punished for that success by greater scrutiny and government pressure, even as their opportunities to raise capital and someday launch profitable IPOs is curtailed. Moreover, small and medium-sized businesses are the ones that have been most badly impacted by the zero-COVID lockdowns, damaging not only their ability to compete and survive, but their confidence that the government takes their needs seriously. Now a number of China's most successful entrepreneurs are voting with their feet. According to one private consultancy's estimate, some 10,000 high-net-worth Chinese citizens, with a collective $48 billion in wealth, are now actively seeking to leave China in 2022 – the largest predicted wealth and talent outflow out of any country except Russia. Tellingly, the number of family offices established in Singapore has doubled in a single year.

When asked about what good governance required, Confucius said three things were necessary: enough weapons, enough food, and the trust of the people. If one had to be given up, he said, it should be weapons. If two, then even food should be given up, for "without the trust of the people, the government cannot stand" (民無信不立 *minwuxinbuli*). For many of China's private sector entrepreneurs, the shock of the zero-COVID policy may have becszx.voome the final straw. After a decade of economic policy direction under Xi, many see the writing on the wall. It may well now be difficult to recover.

Unless a fundamental and enduring course correction becomes evident at the 20th Party Congress, China risks killing the goose that laid the golden egg. But that would mean not just a change in senior personnel at the 20th Congress, nor just a change on policy, but more fundamentally a change in ideology.

But under Xi, given the underlying reasons for the ideological shift since 2012 and in particular since 2017, including his assessment of what is politically necessary to preserve the power of the party for the long-term, it is difficult to see Xi changing course back to a more pro-market policy equilibrium. That is not Xi's underlying worldview. That does not make it impossible, particularly if Xi becomes fully seized of the risks of rising urban unemployment at home, and of overtaking America aboard. But so far Xi seems prepared to pay the financial and economic cost of the reassertion of political and ideological control. I will return to his question of course correction after I examine the likely outcomes of the Party Congress.

THE POLITICS OF THE 20TH PARTY CONGRESS

So where does the economy leave the politics of the 20th Party Congress?

Under normal circumstances, the poor state of the economy would leave the country's political leadership under extreme political pressure, given the underlying nature of the post-Cultural Revolution social contract between party and people: that in exchange for ever-improving economic well-being that the legitimacy of the party's hold on political power would not fundamentally challenge.

With faltering growth, the party is it seems no longer holding up its end of the bargain. But since 2017, and arguably since 2012, these have not been normal political circumstances. Indeed, Xi Jinping appears to have created his own "new normal" – not in the economy, but in politics – whereby Xi's consolidation of personal political power over the last decade is near complete. We see this across multiple fronts.

First, any constitutional impediment to Xi remaining as President after next year was removed through the state constitutional amendment of 2018.

Second, the political precedent of age-based retirement (*qishang baxia*) has already been qualified with the decision to appoint Wang Qishan as Vice President in 2018, when given his age at the time he would normally have been retired. The political precedents are now set for Xi to remain in office indefinitely – in contrast with the provisions of the 1981 resolution on preventing a return to Mao's example of remaining leader for life.

Third, the Chinese official media's increasingly hagiographic treatment of Xi Jinping as *renmin lingxiu* (or "people's leader") and *weida duoshou* ("great pilot") has set the stage for Xi remaining China's paramount leader for the very long-term – in contrast once again with the 1981 resolution and its conclusions on the importance of the principle of collective leadership against one-man rule.

Fourth, no designated successor or potential successors were appointed at the 19th party Congress, unlike at the 17th Congress in 2007.

Fifth, the political opposition to Xi, while real, has been emasculated. The most significant, and many of the less significant, of his opponents in the party, military, and the security apparatus have been purged. And others live in fear that they might be – either through the ongoing anti-corruption campaign, or through a party rectification campaign, or through other special means.

Finally, on the question of ideology, Xi has long set the stage for a new era in Chinese politics requiring new norms compared to the Deng-Jiang-Hu era of the past. The 19th Party Congress ideologically declared a "new era" – the third great era after the Mao and Deng eras of the past. As noted above, a new taxonomy surrounding the central missions of each era has also been declared: Mao's era of New China's founding; Deng's era of building prosperity; and now Xi's era of developing and articulating Chinese power – with each of these eras requiring a different form of revolutionary leadership.

Hence why, within the Xi Jinping worldview, this new era requires a new politics (strong leadership, versus collective leadership), a new economic framework (the New Development Concept, versus market-oriented reform), and a new theoretical framework (Xi Jinping Thought, which now ranks with Mao Zedong Thought in a trilogy also containing Deng Xiaoping Theory, though with Deng's theory being progressively relegated to the lesser ranks of theoretical contribution along with Jiang and Hu).

Xi Jinping Thought is also designed to correct the ideological excesses of his three predecessors in order to secure the party's long-term hold on power, rather than leaving the ideological door ajar for any form of "peaceful transition" to a more democratic political system (as occurred in Xi's rolling nightmare of the demise of the Communist Party of the Soviet Union.) Moreover, a new approach to Chinese leadership politics, new economic challenges at home, and now from a more hostile environment abroad, together with the looming strategic crisis with the United States over Taiwan, all also demand new ideological leadership compared to the past.

This relatively clear-cut evidence of Xi's impending reappointment was underscored further by a recent major article by Qu Qingshan, President of the Central Committee Institute of Party History and Literature on 7 July this year, which appeared under the particularly snappy title of "New Journey, New Thought, New Chapter: Understanding the Five Dimensions Necessary to Master the Two Establishes" (新征程 新思想 新篇章｜从未来维度认识把握"两个确立). This meant namely "establishing Xi Jinping as the party core as well as the core position of the entire party, and also establishing the leading position of Xi Jinping Thought on Socialism with Chinese Characteristics for the New Era." (确立习近平同志党中央的核心，全党的核心地位；确立习近平新时代中国特色社会主义思想的指导地位.) This is important because Qu is the principal author of the Resolution on Party History for the centenary of the party's founding in 1921 – only the third such resolution in the party's entire history, the others being in 1946, 1981, and now 2021. These resolutions are critical signposts in the evolution of China's formal ideological line.

Qu justifies the continuation of Xi's rule on three grounds. "First, to deal with the pressing need arising from changes the world has not seen in a hundred years." (应对世界百年未有之大变局的迫切需要). Second, to be "on guard against and deal with the risks and challenges to bring about the realization of the China dream of the great rejuvenation of the Chinese nation." (防范和应对各种风险挑战，实现中华民族伟大复兴中国梦). Third, to "promote the party's own internal revolution, to submit itself to examination as we embrace the urgent needs of the future." (推进党的自我革命，走好新的赶考之路的迫切需要).

These are important formal rationalizations for Xi remaining in power. They emphasize unprecedented internal and external threats that would prevent China's rise to a position of being the preeminent global power. They also emphasize the centrality of having a revolutionary party capable of managing these threats. And most importantly a leader – Xi Jinping – capable of delivering on both.

Furthermore, the relative weighting attached to each of these elements in Qu's article is significant. The first part dealing with China's role in the world takes about 6,000 words. Part two deals with China's domestic development, and part three the CCP's own evolution, with each being about 2,500 words in length. In other words, the external threats facing China are now seen as the major reason for retaining Xi as the party's core leader. It repeats the general line that: "Western countries, led by the United States, do not want to see the emergence of a strong China, much less a strong socialist China… Our country faces a complex international environment. The struggle between the two social systems and the two ideologies will also be long-term, complex, arduous and severe. The strategic game between China and the US is bound to last for a long period of time, and we must be fully ideologically and functionally prepared for this."

Importantly, this article was first published in the official newspaper of the Central Discipline Inspection Commission and the National Security Commission (纪检监察报) instead of *People's Daily or Xinhua*. It was not accompanied by an official English translation. This indicates that that its audience was intended to be the domestic party audience, and its newspaper placement indicates that party discipline will be enforced by the legal system so as to uphold Xi's continuing status as core leader.

For all these reasons, it is clear that Xi Jinping will be reappointed as General Secretary this October. The real question is who else will be appointed to the seven member Standing Committee, the 25 member Politburo (these numbers might change given Xi's need to amend the existing rules/norms), and who will be the principal members of Xi's economic team – and whether they will have independent political standing from Xi sufficient to contest his current economic line and its generalized assault on market principles, the private sector as a whole, and the tech, finance, and property sectors in particular. In other words, will they have the policy predisposition and the power to substantively course correct on the economy, or not?

On the general question of likely leadership changes at the 20th Congress (except Xi), two members of the Standing Committee and an additional eight members of the wider Politburo are over the age limit for reappointment. These are Li Zhanshu (71), Han Zheng (68), Wang Chen (71), Sun Chunlan (72), Liu He (70), Yang Jiechi (72), Yang Xiaodu (68), Chen Xi (68), Xu Qiliang (72) and Zhang Youxia (72).

As to the specific question of who will lead the economic team: despite the fact that current Premier Li Keqiang is not over the age limit he does not have a close relationship with Xi, he was appointed from a factional grouping separate from Xi's grouping, and he has already indicated this will be his last term. And he has also proven to be ineffective in resisting the party's overall move to the left on economic policy. So he is likely to be replaced.

Who are possible candidates to replace him, and to form the new economy team?

First there is Li Qiang (63): currently Shanghai party secretary, Xi's close ally since his time in Zhejiang, and perhaps his ideal candidate for the Premier – but possibly affected by what happened during Shanghai's extended lockdown, as well as limited by zero experience in the State Council.

Second, He Lifeng (67): another of Xi's close allies and currently Chair of NDRC. He is commonly expected to succeed Liu He as the vice premier in charge of financial and economic affairs.

Third, current Deputy Premier and Standing Committee member Wang Yang (67): a protégé of Hu Jintao, but one who has been distancing himself from Hu's Communist Youth League faction for some years, has recently expressed personal loyalty to Xi, and is considered to be a "rational choice" as the next Premier – although likely only for one term, given his age, which actually makes him more likely to be picked.

Fourth, Hu Chunhua (59): also a Vice Premier and politburo member who is a protégé of Li Keqiang and Hu Jintao, and who is among Xi's least preferred candidates, but is on paper qualified all around.

Fifth, Chen Min'er (61): Xi's close ally since his time in Zhejiang, currently serving as Chongqing party secretary, he is likely Xi's ideal candidate for the Politburo Standing Committee, and likely the State Council, but has relatively little experience with the economy.

Of this list, Wang Yang and Hu Chunhua would be the most "reformist" on the economy. Li Qiang and He Lifeng less so. A wild card would be for Xi to retain existing Deputy Premier Liu He, despite his current age of 70, and promote him to the premiership. Liu, unlike Wang and Hu, has unimpeachable political loyalty to Xi Jinping, but also has the strongest economic reform credentials of all.

However, while Wang, Hu, and Liu would be positive appointments to the most senior economic position in the Chinese party-state, none of them would have the independent political leverage to fundamentally countermand Xi Jinping's predilection to continue to take the economy to the left. And on this core question, despite low growth, I see little evidence to date that Xi is like to significantly redirect economic policy settings back toward the private sector, the market, and open international economic engagement – particularly given his deeply set ideological bearings, as reinforced by his increasingly grim assessment of the international threat environment that he now perceives.

Indeed, at the 28 July Politburo meeting on the economy, the party's failure to reiterate its 5.5% growth rate target for 2022 indicates that Xi Jinping is now himself resigned to paying the reputational price of coming in under target. Or, that he feels sufficiently confident in his political position three months out from the Congress to not care. The new target is simply "striving for the best outcome."

The Politburo reinforced the fact that Xi's zero-COVID policy will remain in place. And that for the second half of the year "macro policies should play an active role in expanding demand, and that fiscal and monetary policies should effectively make up for the lack of social demand." It added that "monetary policy should ensure reasonably sufficient liquidity, credit formation should be boosted and new infrastructure construction should be better leveraged by policy banks and investment funds."

It specifically commanded that the "real estate market remain stable," while adhering to the Xi Jinping ideological position that "houses are for living in, not speculating on." Furthermore, "the overall stability of the financial market should be maintained while defusing risks from various local banks." Meanwhile, on the tech sector, China should continue with a "well-regulated and healthy platform economy" once the "rectification" of the sector is completed.

In other words, what we see in this last Politburo meeting before the *Beidaihe* recess is a combination of stimulus as per the classic playbook, not the reformist playbook. And with the core questions of the property sector and so-called "platform" technology sector still kicked down the road. This does not bode well for China's medium-to-long-term economic growth.

IMPLICATIONS FOR US-CHINA RELATIONS

So what impact does the state of the economy and the political prospects for the outcome of the 20th Party Congress have for the future direction of Chinese foreign and security policy and China's relationship with the United States?

On this point, the best indication to date is Xi's remarkable speech to Chinese provincial and ministerial level leaders on 27 July which the media entitled "An Address on Studying the Spirit of General Secretary Xi Jinping's Speeches in Preparation for the 20th Party Congress." In my analysis, the speech contains an important new formulations that we should examine closely between now and the Congress itself.

The critical paragraph is as follows: "…必须深入分析国际国内大势，科 学把握我们面临的战略机遇和风险挑战。当前，世界百年未有之大变局加速演进，世界之变、时代之变、历史之变的特征更加明显。我国发展面临新的战略机遇、新的战略任务、新的战略阶段、新的战略要求、新的战略环境，需要应对的 风险和挑战、需要解决的矛盾和问题比以往更加错综复杂。全党必须增强忧患意识，坚持底线思维，坚定斗争意志，增强斗争本领，以正确的战略策略应变局、 育新机、开新局，依靠顽强斗争打开事业发展新天地…"

"*We must deeply analyze the domestic and international situation and scientifically master the strategic threats, risks and oppor-*

tunities we face. At present, the speed of change we are seeing we have not seen in a century. The defining characteristics of the global changes, the changes of the era, and historical changes we are seeing are becoming even clearer. ***In our development, we face new strategic opportunities, new strategic responsibilities, a new strategic stage, new strategic requirements, and a new strategic environment. We must handle risks and challenges. We must solve new contradictions and problems which are even more complex than before****. The entire party must strengthen its consciousness of hardship, maintain its baseline way of thinking, be resolute in our consciousness of struggle, strengthen our leadership in this struggle, manage change through correct strategy and tactics and new techniques, opening up new situations, and by relying on the strength of our struggle open up new ground."*

First, this formulation of "new strategic opportunities, responsibilities, and requirements in this new strategic environment and new strategic stage" appears destined to replace the party's standard formulation over the last 20 years of a period of strategic opportunity (*zhanlue jiyuqi*). The latter has been parsed in the past as meaning that the party can assume there was no prospect of major wars, which therefore enabled China to focus exclusively on economic development. This net assessment appears to have now changed. In the party's formal strategic assessment (using the tools of dialectical analysis applied to China's international circumstances, China's comprehensive national power and the forces opposing it) the CCP appears to be formally concluding that the risk of international crisis, conflict and war is now increasing. Very soon, I predict, the party's official literature will be awash with a new education campaign on the "Five New Strategics."

Second, in Xi's analysis, this represents a "new strategic environment and a new strategic stage." Officially, this is now a significantly more hazardous era. And it therefore mandates a new approach to China's historical policy settings on reform and opening, underscoring the need for a new framework of the securitization of everything, as well as national economic self-sufficiency.

This "new strategic stage" also deliberately complements and mirrors the various other "new stages" in China's development that Xi has announced over the last five years: China's "**new stage of economic development**," announced in 2020, that required a more state interventionist "**new development concept**"; China's "new era," announced with great fanfare at the 19th Congress in 2017 and underpinned by the party's adoption of a "**new principal contradiction**" to deal with the "unbalanced development" created during Deng's "primary stage of socialism," but now warranting a different approach under a higher form of socialism than the previous 35 years; as well as, of course, China's new ideological setting of "Xi Jinping Thought on Socialism with Chinese Characteristics for the **New Era**," also announced in 2017.

Historical materialism has been hard at work these days. New periodizations are now in abundance. Indeed, all things seem to have been made new. And this era of the "new" now seems to cover the field: from ideology and politics to strategic affairs, and the economy.

Third, consistent with Xi's attachment to the disciplines of dialectical materialism, Xi's formulation emphasizes both contradiction and struggle – not just in the domestic domain as he has articulated in the past, but now in the international domain as well. From time to time, we have seen this before. But not in so forthright, definitional, and declaratory a statement as this. Again this appears to presage a formal ideological preparation for the party to be ready for major confrontation, conflict, or even war with the United States.

Fourth, Xi Jinping's "five strategics," and the challenges, threats and contradictions that they represent, may even presage the 20th Party Congress adding further to the party's 2017 formal redefinition of the party's principal contradiction by now adding a new major *external* security contradiction to the party's existing *internal* economic contradiction. In 2017, this new internal contradiction was defined as the need to deal with unbalanced economic and social development because of excessive reliance on market forces. If a new external contradiction is to be added, it would most likely be the United States and possibly US allies. If indeed a new external contradiction is added to the party's formal ideological discourse, it would harken back to the days of the Sino-Soviet split when Mao defined China's principal contradiction as the threat posed by "Soviet Social Imperialism."

Importantly, this ideological formulation legitimized the use of armed force against the Soviet Union (a fellow socialist state) along the Sino-Soviet border. Also importantly, this was the last time that a foreign power was formally defined as China's major contradiction or challenge. Even if the formal public language of contradiction does not change at the 20th Party Congress, it may well be that a classified party document does this in relation to the United States. Either way, public or classified, this would represent the conclusion of a long analytical process that distilled the "general trend" (or "zhuliu") made up of the proclamation of the US National Security Strategy in 2017 the US-China trade war of 2018-19, the geopolitics of the pandemic 2020-22, the decoupling debate and its implications for China's own global supply changes, the largely bipartisan nature of US China strategy and the fact that this strategy has increasingly attracted pan-allied support through the Quad, the hardening of security policy postures in both the ROK, AUKUS, NATO, and the post-invasion of Ukraine European Union.

In summary, Xi's new language on the "Five New Strategics" seems to portend a second great change in China's formal ideological worldview. The first was the 2017 change in Beijing's domestic economic narrative from pure economic development to a more qualified form of development defined by a new role for the party in the economy in terms of state planning, industrial policy, and lowering income inequality. The second ideological change now appears to be the formal assertion of a new foreign, strategic, and security narrative on top of this revised economic narrative. Or, as I have argued elsewhere, China's domestic political economy has headed left, while Chinese nationalism has headed right, supporting a more assertive foreign and security policy abroad. And both are part of a wider Xi Jinping ideological worldview of Marxist Nationalism.

The impact of these emerging ideological changes on the underlying structure of the US-China relationship are potentially profound. As I have argued earlier in this lecture, in China ideology matters. And Xi Jinping's Marxist-Leninist-Nationalist ideology matters a lot. Changes in the formal ideological discourse convey an authorized change in the band of meaning that is now permissible within the internal political language of the party. This in turn authorizes a raft of potential policy debates and decisions to give effect to this newly defined "objective ideological truth" through the "scientific" analytical processes of dialectical and historical materialism. In other words, ideological change has long represented the headwaters for downstream political and policy change. We saw this under Mao and the theoretical preeminence of class struggle. We saw this under Deng with the theoretical preeminence of unleashing the economic forces of production while relegating the "relations of production" or class inequality. We now see this again under Xi after 2017 with his relegation of unbridled economic growth to more state-interventionist and egalitarian form of growth. And we may see it again after 2022 if we see an effective relegation of the overall economic agenda to a new, broad strategic security agenda – which would increasingly define the "new era" that lies ahead.

Double Messaging: So Why Does Xi Argue the US is a New Strategic Threat to China – While Rejecting the Idea that this is Strategic Competition between China and the US?

Given the above, it is therefore ironic that, within 24 hours of this major ideological address by Xi Jinping on China's increasingly adversarial strategic environment, Xi had this third virtual summit with President Biden on 28 July. I use the term ironic deliberately.

To recap, on 27 July, Xi argued to his domestic political audience to fasten their ideological seatbelts for a new strategic era of international contradiction and struggle – potentially spelling the end to a 20 year period of peace, stability, development and "strategic opportunity," and therefore requiring the party to adopt new strategy and tactics to deal with the new threats and challenges this presents. Yet, on 28 July, in the Chinese official readout, "President Xi underscored that to approach and define China-US relations in terms of strategic competition and to view China as the primary rival and the most serious long-term challenge would be misperceiving China-US relations and misreading China's development and would mislead the people of the two countries and the international community." (习近平强调，从战略竞争的视角看待和定义中美关系，把中国视为最主要对手和最严峻的长期挑战，是对中美关系的误判和中国发展的误读，会对两国人民和国际社会产生误导.)

In other words, the party's internal audience is told on one day that the strategic race with the US is becoming shaper to the extent that it now requires a new strategic response, while the international audience is told the next day that it is wrong for the US to characterize the US-China relationship as one of strategic competition!

The nature of this – dare I say it – "contradiction" is underscored further if we cast back to the Qu Qingshan epistle of early July that justified the need for Xi Jinping's long-term leadership of the party on the grounds that "the struggle between two social systems and two ideologies will be long-term, complex, arduous, and severe. The ***strategic contest*** between China and the United States is bound to last for a long period of time, for which we must be fully prepared ideologically and in our work." (两种社会制度、两种意识形态的斗争也将是长期的、复杂 的、艰巨的、严峻的。中美之间的战略博弈，势必持续一个较长的时期，我 们对此必须做好充分的思想准备和工作准备.) Even Qu's use of the term "strategic contest" or " zhanlue boyi" seems very close to the concept of "strategic competition" or "zhanlue jingzheng".

The uncomfortable truth for the Chinese ideological class is that it is increasingly impossible to double message this underlying geo-political reality: a life and death struggle in a strategic contest between two irreconcilable worldviews in the one hand, while suggesting some sort of "community of common destiny for all humankind" where there are nether winners nor losers on the other. The reality of China's underlying worldview is increasingly a binary "struggle" with the United States, however China's ideologues may seek to mask it for presentational purposes. Or as China's "wolf warriors" have been wont to say: it's not what words are used, it's the concrete actions that do. The point here is to not to engage in a mindless semantic debate. It is to encourage our Chinese friends to accept both the operational ***and*** the declaratory reality of what is unfolding in the acute forms of strategic competition we see in the US-China relationship in order to politically authorize discussion on, and development of, the substantive mechanisms necessary to manage that relationship.

This raises the question of why China's ideologues find it difficult to officially recognize the day-to-day, practical reality of real-world strategic competition between China and the US over Taiwan, the South China Sea, the East China Sea, trade, investment, technology, currency, cyber, space and human rights. I wrote on this recently in an article in Foreign Affairs entitled "Rivals Within Reason." There I argued that for China to formally recognize the reality of strategic competition with the United States would force the CCP to acknowledge formally that they are indeed in a race with America for strategic, economic, technological, and ideational primacy, both regionally and globally. The logic of any competition is that the purpose is to prevail. Competition is not about a shared outcome. It's about who comes first and who comes second. To recognize that reality would be to blow apart the whole notion of zero conflict, zero confrontation, mutual recognition of the legitimacy of each other's political systems, and the ever-present doctrine of "win-win" co-operation that has been the official Chinese formulation on US-China relations under Xi Jinping since 2014.

Despite Xi's formal rejection of the strategic competition frame in his reported remarks on 29 July, it may still be possible for China to work around the American language. Again, as I recently argued, language along the lines of "peaceful co-operation, positive competition, within a framework of necessary strategic guardrails," may be more acceptable to Beijing.

The key reason ideological, doctrinal and strategic language is important for China is that it authorizes (or does not authorize) creative, downstream policy activity. If Chinese officials remain locked in to an artificial, unrealizable, and ultimately duplicitous universe of zero strategic competition, it makes it harder for those officials to explore a range of real-world strategic stabilization mechanisms with the US.

If this remains the case, then we are more likely to end up locked into the increasingly dangerous reality of "unmanaged strategic competition" that we are in at present where there are no rules of the road. Whereas the alternative framework of "managed strategic competition" that I argue for provides some potential for basic guardrails around a defined set of strategic red lines, some rules of the road for non-lethal strategic competition in all domains beyond those red lines, and the political and diplomatic space for strategic collaboration in critical areas of bilateral and global importance like climate change, global financial stability, global build health and nuclear non-proliferation.

But at Least for the Short Term, There May Still Some Emerging Political Space for Stabilizing the US-China Strategic Relationship

Beyond this overarching debate about strategic language, however, the import of the two-hour long 29 July Biden-Xi call is that both sides appear to be edging toward four things:

- An emerging pattern of more **regular strategic dialogue** at the presidential and ministerial level, although the operational substance of these emerging mechanisms remains limited;
- An emerging interest in managing some of the **existing strategic red lines** down rather than up (see for example the attitude of the administration to the proposed visit to Taiwan by Speaker of the House Nancy Pelosi, as well as parallel commentary from Beijing that while the visit would trigger a Chinese response, it has no interest in allowing this to escalate into a general war);
- A continuation of **vigorous competition** across the rest of the relationship; and
- The gradual acceptance of cooperative actions between working-level officials on **climate change, global financial and economic stability, and global public health** (although Beijing still is not formally resiling from its position of the last 18 months that progress in one area must be contingent on a more general normalization of the overall relationship and a return to the bilateral status quo ante).

Furthermore, the fact that this third Xi-Biden call still occurred and was not cancelled in the midst of the public fusillades from Beijing over the proposed Pelosi visit provides some evidence that both China and the US remain interested in stabilizing the relationship. This has also been evident in the public language of multiple representatives of the US Administration over many months now embracing the notion of "managed competition" and the need for "guardrails" in the relationship. At least for the next six months, as each side attends to its domestic politics, both Washington and Beijing may seek to stabilize the relationship through a set of bilateral management mechanisms. *Stabilization*, however, falls well short of any form of *normalization* that would take us back to the halcyon days of "strategic engagement." Those days now appear to be long gone.

For short-term stabilization through to the end of the Party Congress/US Congressional mid-term elections to translate into a longer-term stabilization (let alone normalization) of the US-China relationship would require a sustained program of work around the five sets of strategic redlines that I identify in *The Avoidable War*. For that to occur, I argue that a framework of "managed strategic competition" (MSC) remains necessary. It is not important what language is used to describe MSC. What is important is its operational content. And there are precedents for these sorts of de-minima strategic guardrails that can be located in the long and torturous history of the US-Soviet relationship following the near death experience of the Cuban Missile Crisis of 1962 and the Cold War.

CONCLUSION

To conclude, I return to the more immediate question I have posed for this lecture on the impact of a weakening Chinese economy on the upcoming 20th Party Congress, and the impact of both these domestic factors on the future course of China's relationship with the US.

First, Xi Jinping looms as a formidable, long-term adversary of the United States. Xi will not only be reappointed to a third term. I also argue that Xi (given a history of family longevity and a fear of leaving the political stage due to what might befall him at the hands of others) is likely to remain China's paramount leader through until 2037. That is another three congresses, by which time he will be 84. This also means him being in political harness to deliver the next stage of China's new development strategy, due for competition by 2035 as China drives toward becoming the world's largest military, economic, and technological power.

Second, Xi's power is likely to remain unchecked by the normal disciplines of collective leadership as his predecessors die out and the Great Purge of his critics and opponents continues.

Third, Xi's fundamental strategic weakness is the economy. It represents his Achilles heel. He has limited feel for finance, the economy, and markets. He instead sees himself as a grand political and military strategist. He devolves economic policy and management responsibilities to others, but so far with a set of political, ideological, and foreign policy constraints that leave the party's economic leadership with limited room to move. The key unanswered question is to what extent could that change with the next generation of economic leadership after the 20th Party Congress and next year's NPC. Of the five candidates examined, the critical combination of both independent political power and reformist policy direction appears to be lacking. But unless there is a sustained course correction on economic policy, there will be significant implications for China's future growth rate and the long-term size of China's economy, its financial system and the robustness of its currency against any future sanctions taken by the United States and its allies over Taiwan.

Finally, the early ideological indications in the lead up to the Party Congress are that, with the continuation of strong, highly centralized political leadership (notwithstanding the critical risk of a weakening economy), we appear to be entering a period where China's perception of its strategic security and its strategic contest with the US will come to dominate everything. And that includes the economy. Indeed, the words "strategic security" are increasingly likely to now become the dominant ideological, political, policy narrative. It is also within this ideological framework that nationalism looms as an increasingly dangerous variable in the management of any future incident-based escalation with the US and its allies. On this score, the long-term trend lines still look dangerous, whatever short-term stabilization mechanisms may be embraced between the two countries.

Which is why I argue that the principles of "managed strategic competition" offer the best of many bad options for the future if we are to navigate past this avoidable war, in what looms as a decade of living dangerously.