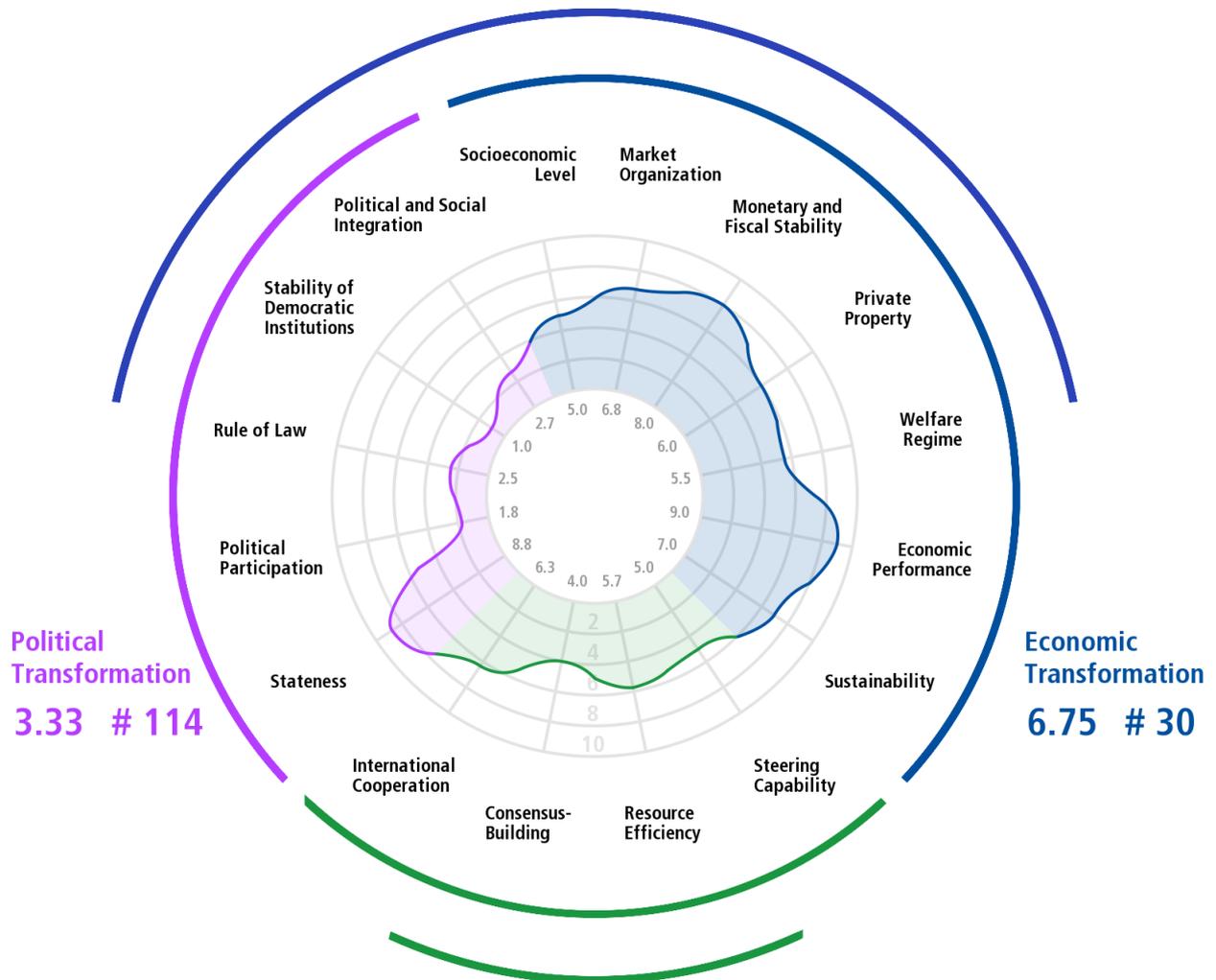


China

Status Index

5.04 # 81

on 1-10 scale out of 137



Governance Index

4.71 # 77

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

Population	M	1392.7	HDI	0.758	GDP p.c., PPP \$	18210
Pop. growth ¹	% p.a.	0.5	HDI rank of 189	85	Gini Index	38.6
Life expectancy	years	76.5	UN Education Index	0.649	Poverty ³	% 7.0
Urban population	%	59.2	Gender inequality ²	0.163	Aid per capita \$	-0.8

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

During the review period, China's structural challenges have further intensified. GDP growth has continued to decline and the average age of China's population continues to increase, both of which have increased pressure on China's rudimentary social security system. The government has all but abandoned the one-child policy and now encourages young couples to have children. However, birth rates have not increased markedly. Investments in automatization, predictive algorithms (artificial intelligence) and the online economy represent additional attempts to improve long-term microeconomic stability, as do attempts to deleverage the economy and the real estate sector, and to reduce value-added and personal income taxes. Targeted poverty alleviation, implemented to prevent abuse by local politicians, is another measure aimed at aiding people in need and, ultimately, enabling them to consume.

These measures are promising. However, it will take time before they have an effect and they will have other negative consequences (e.g., reducing fiscal revenues and increasing public liabilities). Local government debt, a source of great concern for the government, remains high, but has been rolled over into long-term government bonds, providing the government with some respite until the bonds reach maturity. Although the government has vowed to improve access to credit for small- and medium-sized enterprises, the latter are still fundamentally disadvantaged compared to China's state-owned enterprises.

Headway was also made with respect to environmental protection. Local governments are banning household use of coal and have introduced incentives for households to switch to natural gas and electricity. Electronic vehicles are promoted, and registering a fossil-fuel powered car is becoming increasingly difficult. Perhaps as a consequence of these measures, although perhaps also because of economic recession, China's air quality has improved during the review period. However, the "carbon cut" and concerns about sustainable development might negatively affect GDP growth.

In domestic politics, Xi's position as first in command has been strengthened. The abolition of term limits for the presidency is a strong sign that Xi's tenure might be extended beyond the two terms that have become the norm since Deng Xiaoping passed away in 1997. Although the presidency is largely ceremonial, and the much more important position of the Communist Party of China's (CCP) general secretary is not subject to term limits, the constitutional change might nevertheless prepare the ground for Xi continuing to stay in power beyond 2022. Besides the term limit extension, the Xi administration continued to crack down on political opponents, human rights lawyers and religious authorities, and imprisoned millions of Uyghur citizens. The latter measure was first denied, then justified as a "human rights" policy designed to rid China of religious extremism. During the review period, the government also stepped up ideological indoctrination and surveillance, has continued to advocate its authoritarian political system as an alternative to liberal democracy and extended its propaganda apparatus abroad. Finally, the CCP's control over state institutions and the economy has been re-strengthened, and the leadership of the CCP is now enshrined in the state constitution.

In international politics, the Chinese government maintained its resolute stand toward territory it claims belongs to the People's Republic of China in the South China Sea and East China Sea. At the same time, it also continued to engage developing countries worldwide in its Belt and Road and Maritime Silk Road initiatives. In early 2018, the CELAC states (Latin America and Caribbean islands) were invited to participate in these initiatives, as China's leaders attempt to tap new export markets (especially for green technologies, but also for arms). Relations with Japan have improved markedly, while relations with the United States have deteriorated. At the end of the review period, two Canadian citizens were detained in an apparent retaliation for the arrest of Huawei Chief Financial Officer Meng Wanzhong by Canadian police. While Meng has been freed on bail and awaits an extradition hearing to the United States, Michael Kovrig and Michael Spavor are being held incommunicado without being formally charged of any crime.

History and Characteristics of Transformation

Economic transformation in China was initiated through the "Opening and Reform" policy introduced in 1978. After the upheaval of the Cultural Revolution, the Chinese leadership emphasized economic and political consolidation. Despite initial structural deficiencies and distortions, economic reforms benefited from preconditions seldom found in developing countries: the large rural workforce facilitated the recruitment of cheap labor for the emerging industrial sector, and the government expropriated land at low or no compensation, which further served to keep factor costs low. Despite the existence of a planned economy, the public sector remained rather limited. Overseas Chinese from Hong Kong and Taiwan were eager to provide scarce capital and managerial know-how as soon as the Chinese leadership decided to experiment with foreign direct investment. These specific circumstances considerably facilitated economic development.

Consensus among the leadership to determinedly follow the Opening and Reform policy drove economic reforms. However, since the Tiananmen massacre in 1989, when the People's Liberation Army (PLA) violently cracked down on a pro-democracy movement led by students, there have

been no attempts to increase political competition or even initialize a transition to liberal democracy. In the aftermath of the “incident,” which remains a taboo topic in China, political reformers were purged from the CCP leadership. Since then, party and state elites have been united in their commitment to limit reforms to the economic area and allow political reforms only in the administrative sector, enhancing governance, but not democracy.

Economic reforms and decentralization during the same period have proceeded gradually and been subject to experimentation. In this way, China has avoided the transformational “shocks” that occurred in the Russian Federation, for example. Absent a detailed roadmap, the Chinese leadership allowed for reform initiatives from lower administrative levels to be implemented locally and by way of trial-and-error. If successful, these local initiatives were adopted as national policies. The leadership’s decision to let a planned economy and the gradually emerging private sector coexist has proven most important in maintaining economic stability. During the reform process, the de facto economic importance as well as the political appreciation of the private sector increased steadily.

Economic reforms were accompanied by yearly GDP growth rates of about 10% from 1978 to 2010 and, with the exception of two spikes in 1988 and 1989 (18%) and 1994 and 1995 (24%), relatively low levels of inflation. Growth rates have declined after the global financial crisis from 2008 to 2010 and the ensuing global recession. Living standards have improved significantly, and the number of absolute poor has steadily decreased. This overall success is clouded by the increasingly uneven spread of wealth. Urban incomes today are more than three times those of rural incomes, and the Gini index (officially 0.474, by some measures even as high as 0.61) reveals that, even by the standards of other emerging markets (for example, countries in Latin America or South Africa), China now has one of the most unequal societies in the world.

A semi-functional legal system, a lack of sustainability in economic development and corruption constitute other serious problems. The deterioration of the environment is causing enormous economic and social costs. In addition, the Chinese government is increasingly under pressure to fulfill the demands of the population for better public goods (reliable social security, health care and pension systems, a working infrastructure), affordable housing, career opportunities and a more accountable government. The Xi administration reacts to this pressure by means of a targeted policy alleviation program, enhanced access to social services, improvement of working conditions, the surveillance of public sector employees and stricter environmental standards. At the same time, the government has strengthened the public security apparatus, implemented a tight system of electronic surveillance, and continues to curtail freedoms of information and expression.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

There is certainty about the nation's existence as a state and, with the exception of secessionist movements in the autonomous Tibet and Xinjiang regions, virtually no competition to the state's monopoly on the use of force.

According to the Chinese constitution, China is a unitary, multiethnic state. Most citizens seem to accept and support the People's Republic of China as a legitimate sovereign nation-state. Minority rights in self-governance and representation, economic autonomy, educational autonomy, religious freedom, cultural expression, language use and freedom from discrimination are guaranteed by law. In practice, however, enforcement of the law is very uneven and this has led to considerable pressure from Tibetan and Uyghur secessionist movements, which have become more and more frustrated with their lack of effective political and cultural minority rights and equal opportunities in economic life. Violent mass uprisings, such as in March 2008 (Tibet) and July 2009 (Xinjiang), were prevented in the review period by a massive deployment in security forces to the regions. As of 2018, an estimated 10% of the province's population has been forcefully interned in "re-education camps." Detainees are held incommunicado for months on end, and according to former detainees, violations of inmates' personal integrity occur. The number of Tibetans who have self-immolated in protest (146 between March 2011 and December 2016, 6 in 2017, 3 in 2018) has shown the degree of continuing dissatisfaction with the current situation.

Question
Score

Monopoly on the
use of force

9



State identity

8



The state is defined as a secular order; religious dogmas have no influence on politics and/or the law. Only five religions – Protestantism, Catholicism, Buddhism, Daoism and Islam – are officially recognized yet strictly controlled. With the proceeding erosion of communist ideology as well as traditional Chinese family values, people yearn for spirituality. Thus, all kinds of religion, including folk religion and ancestor worship, attract more and more adherents. The government had long been tolerant of the revival of these various forms of religion in the belief that it will foster social cohesion. Especially noteworthy is the spread of Christianity with an estimated 80 million followers, many of whom congregate in illegal house churches. While it had long been the case that only house churches faced occasional harassment, this situation has changed in the reporting period. Between July 2016 and April 2017, the Chinese authorities began large-scale demolition work at the Buddhist Institute in Larung Gar, which is believed to be the largest Buddhist institute in the world. According to official statements, the demolitions are a part of Larung Town’s urbanization drive and should serve to modernize the institute. In the province of Zhejiang, the authorities continued to remove crosses from church buildings by order of party secretary Xia Baolong. According to local estimates, 1,700 churches have been decapitated between 2013, when the campaign started, and early 2016. In December 2018, an independent protestant church in the city of Chengdu was forcefully shut down. The pastor and members of the congregation were taken into custody. Online sales of the Bible have been banned since April 2018. In Xinjiang, millions of Uyghur citizens are interned in “re-education camps” designed to “fight terrorism.” In 2017 and 2018, the government also demolished mosques in Xinjiang. On February 1, 2018, a revised version of the “Regulations for Religious Affairs” came into effect. Religious organizations are placed under stricter control than before. Among other measures, donations by foreign entities are now banned.

In China, a fundamental and sufficiently differentiated bureaucratic structure extends over the entire territory. In a few rural areas, however, the public infrastructure is still weak and access to basic utilities remains inadequate. However, the situation is gradually improving. Nearly all Chinese citizens have access to a water source, and access to sanitation has increased from 65% of the population in 2005 to 77% of the population in 2015. Priority conflicts among different layers of the administration exist. As each administrative unit controls only the next lower level, it is difficult for the central government to ensure that national policies that need to be contextualized are implemented correctly at the city, county and township levels. In March 2018, new checks-and-balances institutions were added to the state constitution in order to enforce the implementation of central policies and regulations. In addition, the central government is increasingly relying on big data to supervise and control the implementation of reform policies at the various levels of administration. Furthermore, the promotion (and demotion) of cadres and state officials formally also relies on the performance evaluation and reports by local citizens. The system hence operates with a combination of hierarchical and vertical control mechanisms.

No interference of religious dogmas

10



1

Basic administration

8



1

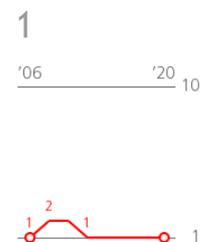
2 | Political Participation

Although the Chinese state constitution includes references to elections, national level authorities are not selected by free and competitive general elections but are generally chosen by the Organization Department of the Chinese Communist Party. Indirect elections, in which People's Congresses elect the congresses at the next higher level, and the National People's Congress elects the leaders of the executive, merely serve as a procedural legitimization. At the local level, limited venues for participation, such as elections for village and urban residents' committees as well as village leaders and party branch secretaries, and experiments with primaries and elections for township-level legislatures and party secretaries exist. However, these are not designed as democratic experiments but as instruments to make governance in a one-party system more effective. The nomination of candidates, voter eligibility and election campaigns are still subject to local government and party control and manipulation.

The political authorities have the effective power to govern and are not overruled by veto powers. The military is under control of the civilian party leadership. However, rulers at the central level are not democratically elected – the elections that do take place are a facade. Instead, delegates to the national legislature (the National People's Congress) and all leading political and government positions are filled by an internal selection process controlled by the Communist Party.

Although freedom of association and assembly is guaranteed by the constitution, the state often interferes with this right. The number of registered civil society organizations in China has increased from 153,322 (2000) to 761,539 (2017), but these organizations are not allowed to operate independently; instead, they need to find a governmental host organization and then subject themselves to demanding procedures to obtain registration with the Ministry of Civil Affairs or its local counterparts. This severely restricts their autonomy. Political organizations competing with the CCP, for example, "opposition parties" such as the China Democratic Party, are prohibited. Since the government fears that stronger NGOs could limit state control over society, only NGOs with a non-political agenda are tolerated and even supported by the regime. Such NGOs can help the government to shoulder responsibilities such as emergency relief after natural disasters, or provide social services where the adverse effects of economic development have negatively affected people's lives (such as issues of environmental protection; health care/AIDS; support for the disabled and orphans). For example, the amendments to the Environmental Protection Law (passed in 2015) upgraded the status and power of environmental NGOs in China. They are now authorized to file public interest lawsuits to halt environmental pollution at the local level. The central government's

Free and fair elections



Effective power to govern



Association / assembly rights



“war against pollution” and the recent “carbon cut” rely on cooperation with and assistance of local civil society. Supporting such NGOs is an element of the new strategy of “social management” and is especially welcome where governmental agencies lack the funds and/or will to provide relief themselves. Many Chinese social organizations used to be dependent on foreign funding, raising concerns that dependence on foreign donors would constrain their autonomy. In September 2016, a new Charity Law came into effect. The law makes it easier for non-registered organizations to raise funds, but increases government supervision. In January 2017, the Law of the People’s Republic of China on Administration of Activities of Overseas Non-governmental Organizations in the Mainland of China went into effect. The purpose of the law is to enhance oversight over non-Chinese NGOs operating in China. For example, responsibility for supervision has shifted from the Ministry of Civil Affairs to the Ministry of Public Security. Non-Chinese NGOs now can support Chinese NGOs and individuals only if they have previously registered with the Ministry of Public Security.

Although guaranteed by the constitution, freedom of expression is still severely curtailed. Still, Chinese citizens increasingly make use of the internet, social media and other mass communication technologies to express critical views, raise public awareness and criticize government actions. The government reacts to this challenge with tightening controls on these technologies, for example by shutting down critical websites, blocking text-message services and censoring online content; moreover, the email and phone communications of political activists are monitored. Censorship has been extended to private groups within the popular social media app WeChat. In 2018, millions of accounts on Weibo, the Chinese equivalent to Twitter, were deleted. That same year, some Chinese citizens with Twitter accounts were allegedly pressured to remove content from their feeds or shut down their account altogether. Arrests of bloggers and “cyber dissidents” have continued. Most television, radio and print media are controlled and/or owned by state organs. The work of journalists is heavily censored by the CCP, with China ranking 148 out of 180 countries according to Reporters without Borders (2018). Generally, official news reporting meets with widespread suspicion by the population. Some (state-owned) media outlets follow a market logic by proclaiming nationalist content (e.g., in China’s island disputes with its neighbors) even if this is not in sync with official policy positions. Foreign media companies also face frequent discrimination and are blocked after critical reports. The Open Net Initiative classifies China’s internet censorship and surveillance as “pervasive.” With formal channels of expression severely limited, people take their grievances to the streets. The number of protests and public disturbances has steadily increased and was estimated to stand at 180,000 in 2010. Although protests are common, this figure should be read with caution, because it is very difficult to verify. Furthermore, the overwhelming majority of these protests involve very few people.

Freedom of
expression

2

'06 '20 10

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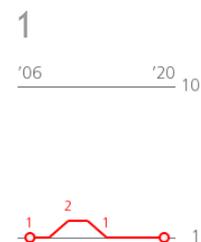
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3 | Rule of Law

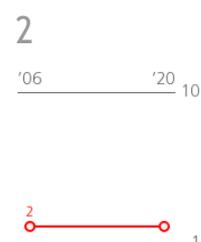
The political system is characterized by the Leninist principle of concentration of state powers with the National People's Congress (NPC) as the formally highest organ of power. In principle, all state organs, the executive and the judiciary at the central level as well as at the local levels, are responsible to the NPC or local People's Congresses, respectively. Thus, the constitutional framework does not establish a system of separation of powers. Since the CCP is constitutionally defined as the supreme ruler, it commands state institutions, and the NPC and local People's Congresses are subject to CCP directives and control. Hopes from abroad that the NPC or local congresses might play a more independent role have not materialized. Although the rule of law has been enshrined in the constitution, the CCP remains above the law and has been willing to engage in only what is officially referred to as "governing the country by law." This is different from rule by law, because the CCP as an organization trumps the law. Therefore, a system of checks and balances does not exist. The first in command of government departments and local administrations have had a varying amount of discretion. Since the late 1970s, the regime has been oscillating between the delegation of political and administrative competences, and the (re-)centralization of power. The Xi Jinping era has been one of recentralization. What is more, there has been a tendency for power to not only flow toward central government, but to be concentrated in the hands of Chairman Xi Jinping himself. Term limits for the president (and vice-presidents) were removed in 2018. There have never been formal term limits on the position of CCP general secretary.

Although the judiciary is institutionally differentiated and despite new regulations that formally strengthen law-based governance, there exists a considerable lack of judicial independence. Despite the leadership's repeated vocal commitment to the rule of law, China's legal system remains tightly under the control of the CCP and interference with the work of the judiciary still occurs frequently. Particularly within the lower level courts, judges are very susceptible to corruption. The bar lacks independence, as the All-China Lawyers Association is institutionally subordinated to the Ministry of Justice. Particularly in criminal cases and defense of rights cases, lawyers are curtailed when performing their duties, especially in conducting investigations and gathering evidence. In addition, lawyers are often harassed when representing defendants in human rights cases. Since 2007, when the authority to review death sentences was given back to the Supreme People's Court, the number of death sentences and immediate executions has dropped significantly, although it is still considered the highest in the world.

Separation of powers



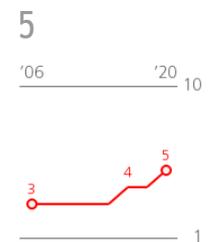
Independent judiciary



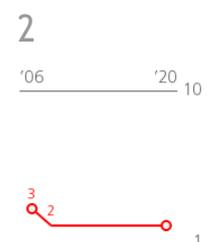
Although strict laws against corruption are in place, they were rarely enforced in the past, except in the form of campaigns. One such campaign began with Xi Jinping's ascent to power and has continued throughout the review period. This campaign followed the established practice of corruption being investigated by the Communist Party's Commission for Discipline and Inspection, which has gained in importance; dozens of high-ranking officials (above the rank of vice-minister) have been targeted, but merely a fraction of cases are submitted to the state judicial organs for prosecution. While it seems that the party leadership is concerned about the spread and levels of corruption and correctly sees this as one of the major stumbling blocks of regime legitimacy and effectiveness, the logic of political survival through distribution of spoils and privileged access to exclusive goods (as in any single-party regime or dictatorship) means that problems of corruption and shortcomings of anti-corruption efforts are systemic. During the review period, abuses of office continued to be prosecuted rigorously. In the first 10 months of 2018, 68,500 officials were disciplined, raising the total number of people punished for corruption since 2012 to nearly 350,000 at the end of 2018. The anti-corruption purge initiated by the Xi Jinping administration targeted officials at all levels and in all sectors of the regime: party, government, representative organs, universities, state-owned enterprises and the military. Since the start of the campaign, the number of officials committing suicide has increased, leading to speculation that the campaign is responsible for these suicides. However, there is no tangible proof that this is indeed the case. Anti-corruption laws have become stricter, imposing limits on gifts officials can receive and the amounts of money they can spend on official banquets. Foreign media reports, which made their way into China and targeted the huge personal wealth accumulated by the families of leading party cadres (including family members of Xi Jinping), have shattered the stereotype that corruption does not affect the top leadership and is only a local phenomenon. However, anti-corruption campaigns do not only affect the political realm. During the review period, "petty corruption" in the form of demanding bribes for services has become more difficult. Service providers are monitored with computer programs and even video cameras, and the electronization of financial transactions has imposed additional barriers to corrupt behavior.

The constitution guarantees certain civil rights, such as freedom of speech, of the press, of assembly, of association, of demonstration, of religious belief, of person and so on. Nevertheless, the CCP and state organs frequently interfere with these rights. For example, religious/spiritual groupings, such as underground Protestant churches and Catholic communities' allegiant to the pope, are not tolerated by the authorities, activists are frequently persecuted, and buildings such as churches and mosques demolished. Maltreatment, physical abuse and torture of prisoners are prevalent. In Xinjiang, millions of citizens are detained in "re-education camps" against "religious extremism." In rural areas, the state is not willing or able to prevent large-scale human rights violations by private actors, resulting in widespread forced labor, abductions and human trafficking. Forced resettlement due to large-scale governmental

Prosecution of office abuse



Civil rights



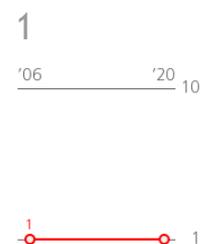
construction projects or illegal land grabs by local authorities violates people's property rights. Ethnic minorities are politically and economically discriminated against, as public life is dominated by Han Chinese, while minority regions lack significant autonomy rights. Although the Chinese constitution stipulates that both men and women enjoy equal rights and legislation for the protection of women's rights has been in place since 1996, in practice, women's rights and opportunities are still severely compromised in many parts of China. While in principle, victims can seek redress for such violations, corruption and the lacking independence of the judiciary hampers the efficacy of these mechanisms.

4 | Stability of Democratic Institutions

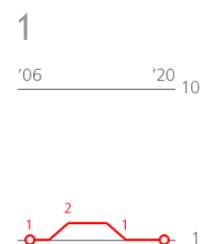
The formal arrangement of political institutions is characterized by the supremacy of the CCP; thus, the People's Republic of China (PRC) can be classified as being a one-party authoritarian political system. All leading political actors are recruited from within party ranks. Other political organizations in competition with the CCP are forbidden and suppressed. There are no meaningful general elections through which the people could change the government. The judiciary is not independent; especially in "sensitive" cases involving public disturbances, state secrets or product safety, political involvement in the judicial process and in decision-making is frequent. In December 2018, two Canadians were arrested on unknown charges in what observers claim was an act of retaliation against the arrest of Huawei Corporation's chief financial officer in Vancouver, raising concerns that wanton arrests and trials of foreign nationals might become a tool to exert pressure on or extract concessions by foreign governments.

Political leaders have endorsed the direct elections of village and urban residents' committees and encouraged greater transparency and popular participation in local governance. However, these measures are not intended to influence developments at the central level, but aim instead at improving good governance and strengthening party supervision. In addition, these elected bodies are not part of the government's formal administrative system. Experiments with democratic selection procedures, such as primary elections, have been introduced at the township level, but have progressed slowly. Even though intellectuals affiliated with government think tanks and some high-ranking CCP cadres have talked about the virtues of democracy for China (and have come up with labels such as "incremental" or "orderly" democracy), these should not be mistaken as a future commitment to political reform toward a multiparty liberal democracy. Quite to the contrary, on many occasions, the upholding of one-party rule and the socialist system is highlighted while "Western-style democracy" is repudiated. China's one-party authoritarian regime contains many channels for public consultation, but the government follows up on complaints and opinions voiced by citizens only selectively. Since Xi Jinping took power, the

Performance of democratic institutions



Commitment to democratic institutions



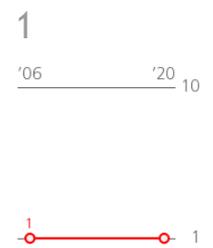
CCP regime has been marketing its authoritarian system more aggressively, claiming that it represents a viable alternative to liberal democracy. Among others, it now stresses the concept of “meritocracy” and “enlightened rule.”

5 | Political and Social Integration

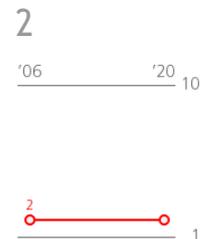
The party system is dominated by the CCP. Even though eight so-called democratic parties are officially recognized, they are subordinated to the CCP. CCP membership has grown to almost 90 million (by the end of 2017), the proportion of private entrepreneurs, self-employed and college graduates being disproportionately high among new members. This means that the new urban middle class, as the “winner” amid China’s many economic reforms, now constitutes the country’s most important social base and the backbone of the CCP. Peasants and urban industrial workers in turn have become marginalized. Even though the Chinese party-state does not rely on direct elections, it uses indirect feedback mechanisms (e.g., online monitoring of public opinion). In addition, the system operates with “deliberative” elements. Before passing new laws and regulations, the NPC publishes some drafts online to collect comments and replies.

In China, the system of cooperative associations is very heterogeneous and characterized by differences in the relationship to the state. Mass-organizations such as the All-China Federation of Trade Unions, the All-China Women’s Federation, or the China Youth League are funded, controlled and supervised by the state and mainly operate as purveyors of CCP policies to respective membership groups. Several interest groups have been established on the initiative of the state and count as “Gongos,” that is, government-organized non-governmental organizations. There also exist NGOs that concentrate mainly on social issues, such as environmental protection, animal welfare, representation of the interests of marginalized groups (women, the disabled, ethnic minorities, children), and provide services, such as legal aid and consumer protection. Homeowner’s associations and business associations, which represent the interests of well-off strata in Chinese society, often have an impact on local politics. China has a thriving state-approved non-profit sector, in which an unknown number of informal, non-registered associations are active in areas such as environmental protection, alumni activities or self-help. However, NGOs are poorly connected, lack organizational capacity and funding. As the state tightly controls the working of social associations and rigorously bans politically undesirable NGO activities, large segments of interests remain underrepresented.

Party system



Interest groups



Many Chinese have only vague ideas about democracy and often reveal a conflicted understanding about what the concept means. According to the World Values Survey, Chinese generally think positively about democracy; almost 90% consider having a democratic government a good thing. This attitude partly stems from the fact that the Chinese government calls itself democratic and partly from a reluctance to engage in any experimentation that might destabilize the current status quo. Hence, the broad interest in a responsible, incorrupt and predictable form of government has not yet led to demands for political participation. Even if many Chinese today are ready to strongly criticize governmental arbitrariness and officials' chicanery, the overwhelming power of the state frightens off any demands for democratic participatory rights or attempts to become personally engaged in politics.



According to surveys, the level of interpersonal trust is extremely high in China and is almost on par with the level encountered in Scandinavian countries. Parochial trust, that is strong loyalties between family members, is particularly pronounced. Civic trust is also growing, as citizens affected by severe problems such as environmental degradation, local government corruption or violations of basic human rights, associate for purposes of self-help. Occasionally, these associations are supported by activist lawyers. These groups are closely watched; and since they often aggressively bring social ills and wrongs to the fore, local governments in particular try to silence them by repressing activists and leaders.



II. Economic Transformation

6 | Level of Socioeconomic Development

China's GDP has continued to grow, albeit at a smaller pace than in the previous years. The structural transformation of the economy from industry to services and from capital investments to consumption have not affected China's social development and inequality to a large degree. According to official statistics, the overall distribution of income, measured by the Gini coefficient, was 0.474 in 2012, which likely is a conservative estimate. Wealth distribution is even more unequal: according to a report by Beijing University, 1% of China's households owns one-third of China's wealth. Between 1995 and 2012, the Gini coefficient for household wealth increased from 0.45 to 0.73. Reducing poverty is one of the signature policies of the Xi Jinping administration. Measures include targeted poverty alleviation, improving access to social service and increasing welfare handouts. Given the absence of a unified national poverty line and statistical manipulation in local governments, China's poverty rate is difficult to pinpoint. According to World Bank statistics, 0.7% of the population earned less than \$1.90 (PPP) per day in 2015,



effectively halving the poverty headcount ratio of 2014. China's HDI has continued its slow upward trend and stands at 0.753 in 2017. China now falls into the category of countries with high human development. The per capita disposable income totaled CNY 36,396 (\$5,419) in urban and CNY 13,432 (\$2,000) in rural areas in 2017. The urban-rural income gap is continuing to decline, standing now at 3:1. However, these values do not take into account informal incomes, the variation of living standards across China, wealth and the effect of rapid urbanization. In addition to the rural-urban divide, there is also a divide between the rich Eastern (coastal) provinces and remote Western provinces. The "New Silk Road" initiative launched in 2013 seeks to link urban, industrial centers with their neighboring provinces and hence to facilitate some spill-over effects. These new "metropolitan clusters," a cornerstone of the "new urbanization strategy," should then be connected with the six transnational New Silk Road corridors. Traditionally, Chinese women are well-integrated socially and economically. With a value of 0.152, China ranked 36th in the Gender Inequality Index in 2017. However, discrimination exists in the labor market. The difference in labor force participation was 14.6% in 2017, and the estimated GNI per capita was one-third less for women than for men in 2017. Women's participation in politics remains severely limited. Only 24.9% of representatives to the National People's Congress are women, an increase of 1.5% over the previous NPC. They are even fewer in the echelons of power: no woman has ever been on the CCP's Politburo Standing Committee, and only one out of 25 members of the Politburo, and 10 out of 205 members of the Central Committee are female. Women acting as provincial party secretaries or governors are extremely rare exceptions. Ethnic minorities are subject to social and economic exclusion and marginalization, with the majority of China's poor living in minority regions. Most prominently in the Muslim Xinjiang Uyghur region and the Tibet Autonomous Regions, political marginalization, territorial infiltration and cultural insensitivity by Han Chinese, unequal access to well-paid work often provoke violent resistance, have led to the formation of separatist movements and drastic counter-measures by the Chinese government, for example, the incarceration of millions of Uyghur citizens in re-education camps.

Economic indicators		2015	2016	2017	2018
GDP	\$ M	11015542.4	11137945.7	12143491.4	13608151.9
GDP growth	%	6.9	6.7	6.8	6.6
Inflation (CPI)	%	1.4	2.0	1.6	2.1
Unemployment	%	4.6	4.5	4.4	4.4

Economic indicators		2015	2016	2017	2018
Foreign direct investment	% of GDP	2.2	1.6	1.4	1.5
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ M	304164.4	202203.4	195116.7	49091.6
Public debt	% of GDP	41.1	44.2	46.8	50.6
External debt	\$ M	1325925.5	1415835.8	1709948.6	1962304.4
Total debt service	\$ M	126443.1	165486.9	204732.0	235548.4
Net lending/borrowing	% of GDP	-	-	-	-
Tax revenue	% of GDP	9.4	9.2	-	-
Government consumption	% of GDP	14.0	14.4	14.5	-
Public education spending	% of GDP	-	-	-	-
Public health spending	% of GDP	2.9	2.9	-	-
R&D expenditure	% of GDP	2.1	2.1	2.1	-
Military expenditure	% of GDP	1.9	1.9	1.9	1.9

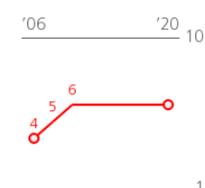
Sources (as of December 2019): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Competition in China is market-based, but the playing field is not level. China's private enterprises dominate the economy. In 2018, private enterprises generated 60% of China's GDP, while 80% of urban laborers are employed by private companies. However, most private enterprises are very small and find it difficult to obtain access to markets and capital. In 2017, the liability-asset ratio of private enterprises was 53%, while for centrally controlled state-owned enterprises it was 68%. These conditions are not uniform across China. Where the private sector dominates, for example in the Pearl River Delta, production chains facilitate independence from state actors. Sectors and areas with strong state involvement are often a difficult environment for private firms. Several of the most successful private enterprises, for example in the high-tech and telecommunications sectors, have their origin in government institutions and were founded by former officials or people with good connections to the government. The legal framework for private business continues

Market organization

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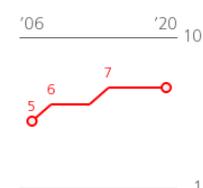


to be weak, opaque and arbitrarily implemented. The anti-crisis stimulus measures of the Chinese government since 2008 have mostly propped up big state-owned enterprises (SOE) to the detriment of private businesses. Though access to credit for private businesses has improved since 2016, when the liability-asset ratio for private businesses stood at 50%. Foreign business investments remain subject to government restrictions, yet these restrictions are gradually being repealed. In 2017, the number of prohibited sectors for foreign investment fell to 27, and the number of sectors where investments are tied to restrictions (e.g., a minority- or equal share policy) or Chinese control fell to 21. Repatriation of profits is difficult due to foreign exchange controls and extensive approval and implementation procedures. In September 2013, the government established the Shanghai Free-Trade Zone (SFTZ), where commodities can be imported tax-free and foreign investments are permitted in all but 16 sectors. In 2015, three more free trade zones were established, with a further seven in 2017. The free trade zones are also seen as a test lab for full yuan convertibility. Capital account settlements have indeed been made easier than in the rest of China, but full convertibility is still limited and tied to several requirements, because the government fears that an uncontrolled outflow of RMB could negatively affect macroeconomic stability. In contrast, Hong Kong residents can exchange an unlimited amount of yuan since November 2014 in an attempt to facilitate trading between stock exchanges in Hong Kong and Shanghai. During the review period, there continued to be improvements regarding the procedures involved in starting a business. Starting a business in China takes 8.6 days and four procedures with a cost of 0.4 % of GNI per capita. For starting a business, China scored 93.52 out of 100 and ranked 28 out of 190 countries.

In August 2008, a new anti-monopoly law went into force. It prohibits monopoly agreements between competitors, the abuse of dominant market positions and administrative monopolies. It also aims to tear down artificial trade barriers within China to eliminate local protectionism. The Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC), and the State Administration for Industry and Commerce are responsible for implementing the law. In 2017, the governmental initiative of the 13th Five-Year Plan for Market Supervision and Control recommended that China should strengthen competition policy. In order to implement the initiative in early 2018, a new Anti-Monopoly Bureau was established within the State Administration for Market Regulation (SAMR), replacing three anti-monopoly organs under three different bodies. This can be regarded as a substantial effort to strengthen institutional efficiency and increase transparency. Furthermore, six anti-monopoly guidelines published in September 2018 guide the work of SAMR. These guidelines concern anti-monopoly supporting regulations, anti-monopoly enforcement, the protection of intellectual property rights, regulation of industry price conducts, price behavior of medical drugs that are in short supply, and a draft for the revision of the Anti-Unfair Competition Act. In some strategic sectors (defense, energy production, petroleum, gas, petrochemicals,

Competition policy

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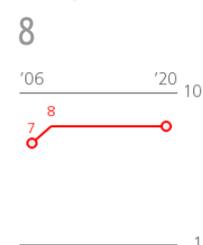


coal, civil aviation, shipping), the state upholds the existing monopolies of state-owned enterprises, with the partial exception of the Shanghai Free Trade Zone, where limited investments in shipping and transportation are possible.

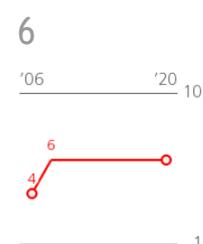
Since the global financial crisis, China has become somewhat less dependent on foreign trade. While in 2006 exports equaled 36% of China's GDP, the respective figure for 2017 was 26%. Similarly, imports declined from 31% to 18%. However, the export of manufactured products, a large number of which are assembled from imported parts, still plays an important role in the Chinese economy, and in 2012 China surpassed the United States as the world's largest trading nation (merchandise trade, excluding services). Since accession to the WTO in 2001, foreign trade has been continually liberalized; direct intervention in trade decreased, import barriers have been reduced and the mean most-favored-nation tariff rate was 9.3% in 2017. Many machinery and material inputs required for manufacturing are tariff-exempt, especially for enterprises operating in the 113 "Comprehensive Bonded Zones" (known as "Special Customs Supervision Zones" before 2014). The signing of a Regional Comprehensive Economic Partnership with ASEAN and Japan, Korea, Australia, New Zealand and India had been expected for November 2018, but failed because the signatories were unable to agree on key terms. The seventh WTO Trade Policy Review for China, issued in July 2018, notes that clearance times for imports and exports have been shortened, but also finds China's subsidy policy very nontransparent. In January 2018, the Anti-Unfair Competition Law went into effect. The enforcement of Intellectual Property Rights was strengthened, but remains a challenge. In 2016, a new cybersecurity law was enacted. The law requires foreign companies to store their data on servers based in China and has made the use of Virtual Private Networks (VPNs) more difficult. The banking and insurance markets were further liberalized, though established Chinese companies have become so entrenched that it will be difficult for new companies to gain a foothold in the market.

Important banking sector reforms have been implemented in the review period. Since 2016, banks have been able to set higher and more market-oriented interest rates on deposits; local governments have been allowed to issue bonds in order to roll over debts incurred by local government financing vehicles; a deposit guarantee was introduced; and six domestic privately owned banks have been established. These measures are aimed at mitigating the considerable risks caused by a fast-growing shadow banking system. At first glance, China's banking system appears solid. In 2018, 35.5% of China's banking assets were held by five state-owned commercial banks. China has fully adopted the Basel III risk-based capital standards. In the review period, the ratio of non-performing loans doubled from 0.9% to 1.9%, although the current rate is still very low. Artificially low interest on deposit loans and relatively high interest on bank loans provide these banks with cheap money. At 8.56% in 2017, the capital-to-assets ratio is rather low by international standards, but high compared with China's previous values, which were as low as 4.4% in 2005. The four biggest state-owned commercial banks (SOCB) are listed on stock

Liberalization of foreign trade



Banking system



exchanges and belong to the world's biggest banks with regard to market capitalization. This has brought not only fresh capital to the system at large, but also foreign accounting groups now review the banks' financial reports, which has resulted in greater transparency. According to WTO commitments, much of the banking sector has been opened to foreign banks and restrictions on foreign banks' local currency businesses have been lifted, but the market share of foreign banks remains small. Privatization in the financial sector is not far advanced; most non-bank financial institutions, such as life insurance, investment, and securities companies, are state-owned or controlled by local governments. However, this excellent performance can partly be explained by the fact that high-risk lending occurs outside the formal banking system. Stimulus measures by the Chinese government during the global financial crisis led to a relaxation of the rules on informal lending, and trust companies, small lending companies and informal lenders have captured increasing shares of the financial market. Between 2006 and 2013, off-balance sheet lending has increased from 5.5% to 34.6% of GDP. Commercial banks are connected to the shadow banking system. They short-sell wealth management products to finance the high-risk operations of trust companies and are required to lend money to local government investment vehicles. In addition to issuing bonds, a number of local governments have resorted to tapping the informal financial system to roll over their loans. Land and real estate serve as the main collateral, making China's financial system extremely sensitive to real estate bubbles. In the review period, the government sought to rein in the shadow banking sector by de-emphasizing GDP growth in local government leaders' annual evaluations, while at the same time imposing negative sanctions on incurring liabilities. As a consequence, growth of fixed asset investment by local government financing vehicles decreased from 9.8% in 2015 to 7% in 2017. The lack of information on the true size of the shadow banking system, its various connections with China's commercial banks and the linkages with citizens' deposits and mortgages makes it difficult to estimate the overall impact of a default of informal loans on China's financial system. According to Moody's, the relative size of the shadow banking sector has declined from 87% of GDP in 2016 to 70% of GDP in 2018.

8 | Monetary and fiscal stability

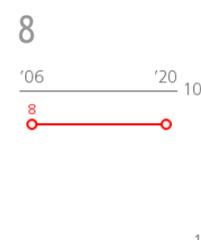
China's inflation rate remained low and stable during the review period. After fluctuations of the consumer price index between -0.7% (2008–2009) and 5.4% (2010–2011), consumer prices increased 2% between 2015 and 2016, and 1.6% between 2016 and 2017. After a slow and gradual decline in exports from \$2.34 trillion to \$2.097 trillion between 2014 and 2016, exports picked up again to \$2.263 trillion in 2017. A similar, albeit more marked trend is evident for imports, which declined from \$1.95 trillion in 2014 to \$1.59 trillion in 2016, but rebounded to \$1.841 trillion in 2017. In 2017, foreign direct investments rose 7.9% over 2016, but increased somewhat slower in the first 11 months of 2018 (7.3%). China's currency reserves, which had increased from \$1.53 trillion in 2007 to \$3.83 trillion in 2014, fell to \$3.03 trillion in 2016, but increased again to \$3.16 trillion in 2017. China has a managed exchange rate. In March 2014, the daily trading band for the Chinese yuan against the U.S. dollar was increased from 1% to 2%. In 2016, the Chinese renminbi was integrated into the IMF (SDR) currency basket – even though it is not yet ranked as a freely convertible currency. The Chinese central bank is not independent, but under tight oversight by the central government, which sees the financial system as an important instrument for macroeconomic control. The People's Bank of China is seeking to control the renminbi and capital flows, and – alerted by the spread of crypto-currencies – is cracking down on speculation in digital currencies.

Macroeconomic stability is of utmost importance to the Chinese government. Following the world financial crisis, economic growth declined from double-digit rates to 6.7% by the third quarter of 2018. Instead of passing a stimulus package, the government has engaged in structural reforms, such as eliminating excess capacity in the steel and real estate sectors, deleveraging firms and local governments, and improving total factor productivity. Still, the declining profits of industrial enterprises, high levels of local government debt and trade frictions with the United States negatively affect macrostability. During the review period, the government continued to try to boost domestic consumption, which is impeded by a high level of inequality and the high savings rates of risk-averse households. The basic challenge for Chinese authorities is still the same: to maintain annual economic growth at a high enough rate to guarantee an adequate number of jobs, while at the same time rebalancing the economy toward a more sustainable consumer-driven development path. Officially reported public debt continued to grow in the review period and stood at 47.6% of GDP in 2017, but debt levels might well be much higher. A sizable amount of public debt occurs in the form of loans and investments into companies run by local governments, so-called Local Government Investment Vehicles. Since 2015, China's city-level governments have been given the authority to issue bonds, which further complicates the analysis of China's overall fiscal health.

Monetary stability



Fiscal stability

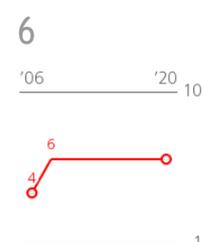


9 | Private Property

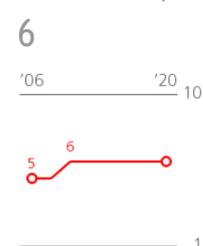
Private property is recognized by the state constitution, and China's first private property rights law came into force in October 2007. The law "protects the lawful property of individuals," state-owned assets and prohibits the illegal possession, destruction or looting of state property by private persons. However, the implementation and enforcement of these formal regulations is inconsistent and arbitrary, due to a weak judiciary and to corruption in administrative agencies. All land ownership still remains with the state; this means there are no secure property rights for peasants. To address the problem of forced resettlement caused by large-scale governmental construction projects or illegal land grabs by local authorities, the Chinese government promised in early 2013 to better protect land use rights, increase compensation for farmers, even allowing the latter to directly negotiate the sale of rural construction land. This rule also gives farmers the possibility to merge plots and employ modern farming technologies on larger fields, thereby increasing productivity and income. The long-term aim is to push urbanization and pool rural land for large-scale farming by agricultural enterprises.

Due to opaque ownership structures, hidden subsidies and various statistical indicators, it is nearly impossible to draw an exact line between what is referred to in China as the "public" and "non-public" sectors. At the end of 2017, there were 27.26 million private enterprises and 65.79 million individually owned businesses, which altogether employed 340 million people. 90% of these companies are in the service sector, 8% in industry, and 2% in agriculture. In the industrial sector, private enterprises made up 87% of all enterprises with a revenue over CNY 20 million in 2017 and were responsible for 30.76% of total profits. In recent years, big private enterprises have dominated online retail in China and have become important players in cross-border acquisitions. Although private enterprises also benefit from the private property rights law, some stumbling blocks remain, such as difficult access to capital, licensing procedures hampered by long delays and a lack of transparency, local government favoritism and pressure to pay illegal fees. After a period of favoring SOEs over private enterprises, the government has now improved credit access for private enterprises.

Property rights



Private enterprise

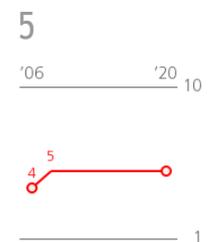


10 | Welfare Regime

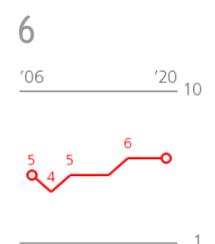
Basic public social security systems covering pensions, health care, unemployment, accidents and maternal care are in place in China and have been gradually extended from the urban to the rural population, while a rapidly increasing number of rural poor can now claim social benefits. However, as family farmers are not considered employed, unemployment insurance still only covers employees of urban enterprises and institutional organizations. Furthermore, entitlements depend to a significant degree on the size of contributions, meaning that those with low incomes receive only very basic and limited services. Another serious problem is social security benefits for migrant workers, as many employers do not pay the necessary premiums, even though the law obliges them to do so. In addition, although the Social Insurance Law in effect mandates the transferability of earned social insurance benefits since 2011, it faces severe challenges in practice. Likewise, the large number of Chinese employed in the informal sector suffers from inadequate coverage for social risks. China's urbanization regulations, which were unveiled in 2013 and 2014, stress that the rights and social integration of migrant workers must be improved. Finally, urban and rural social security systems are to be integrated, with the ultimate aim of abolishing discrimination against those with rural household registrations. According to official statistics, 915 million people were enrolled in the basic pension system by the end of 2017 and 187.8 million urban residents contributed to unemployment insurance schemes in 2017. The government has set the goal of achieving universal health insurance coverage by 2020. This goal has largely been met, although the benefits of basic medical insurance are low. Since hospitals and doctors often charge arbitrary fees or insist on bribes for service, there is a high degree of uncertainty as to which costs for health care and other risks might be expected in the future. For example, the system is not designed to treat expensive chronic diseases, and the poor can often not afford to pay the patient's contribution, which excludes them from medical insurance benefits.

Facilities for education, social security and public services are developed in urban coastal regions and are steadily improving in the rest of the country. However, the quality of services individuals receive depends on income. China's male-to-female ratio at birth is 1.18 and mirrors the preference of Chinese parents for their first child to be male. Though forbidden, many parents use prenatal diagnostics to determine the sex of their child, and female fetuses are sometimes aborted. Owing to historical factors, there remains a 5% gender gap in adult literacy (2010), but literacy rates for those aged 15 to 24 are virtually identical (99.6% female, 99.7% male). In terms of gender (but not wealth), China is one of the most equal countries in Asia in terms of access to education. Female enrollment rates are higher than male enrollment rates in primary, secondary and tertiary education. However, females are disadvantaged both in access to jobs and salaries. In 2017, female labor force participation was 43.7% and GNI per capita was one-third less for women than for men in 2017. This marks

Social safety nets



Equal opportunity

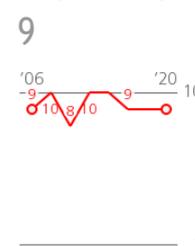


an overall worsening of the situation: in 1990, women earned almost 80% of men's salaries. Migrant workers and their children are still disadvantaged, but the Xi Jinping administration is showing commitment to fully integrate migrants into society. The measures proposed in 2013 and 2014 include integration into social security systems, social integration and access to education. This comes on the heels of the closure of several Beijing schools for migrant children. Among the older generation, especially in rural areas, women are not regarded as equals, although this situation is changing for younger generations. Regarding political participation, women held 24.9% of the National People's Congress seats in 2017, but are all but excluded from any organization with decision-making powers. Economic exclusion of and social discrimination against ethnic, religious and linguistic minorities in mainstream society continue.

11 | Economic Performance

Macroeconomic performance in China continued to be rather high compared with other major (emerging) countries, but was lower than in the past. Growth rates dropped from 9% to 12% to 6% to 7%, which has been announced as “the new normal.” GDP grew 6.1% in 2016 and 6.3% in 2017 and stood at \$16,807 per capita in PPP terms. At 2.0% in 2016 and 1.6% in 2017, inflation was low. GNI per capita at market exchange rates was \$8,826 in 2017. The official rate for urban unemployment was 2.0% (2017), the surveyed unemployment rate, which includes migrant workers, stood at 5% in 2018. In 2017, government tax revenue equaled 9.4% of GDP, and total government expenditure amounted to CNY 17.26 trillion, an increase of 7.5% over 2015; gross government debt stood at 47.6% of GDP in 2017, but is probably much higher as some loans by local governments and state-owned enterprises count as private debt. It should be added, however, that experts doubt the reliability of official data. Furthermore, these figures do not include the difficult-to-measure informal economy and capital flows within the shadow banking system.

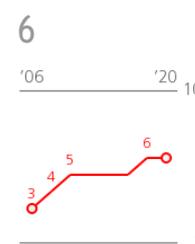
Output strength



12 | Sustainability

In 2014, China emitted 10.3 billion tons of carbon dioxide, the highest total worldwide and far surpassing that of the United States (5.25 billion tons). On a per capita basis, however, China's emissions are significantly below those of developed countries in Asia and half of those in the United States. Still, in November 2014, the United States and China agreed to cut carbon dioxide emissions. China promised to cap its emissions by 2030, and the United States pledged to reduce emissions to 28% below its 2005 levels by 2025. Air and water quality are of particular concern to Chinese authorities. Air quality has improved somewhat during the period under review. Values for atmospheric particulate matter with a diameter less than 2.5 millimeters have decreased from a mean annual exposure of 58.17 cubic meters in 2010 to 56.33 cubic meters in 2016. Water pollution is another serious problem.

Environmental policy



According to a report by Xinhua News Agency, only 3% of urban groundwater is fit for drinking. Overall, nearly 60% of China's groundwater was rated "relatively poor" or "very poor." As pollution is responsible for some premature deaths, it has become a major public concern and is a bottleneck for China's continued development; environmental protection is high on the CCP's agenda. The government initiated a "carbon cut" and invests in the development of green technologies, which it also seeks to export. In 2015, coal power plants supplied 65.2% of China's energy, down from 69% in 2010. As China's coal is high in sulfur and coal firing contributes greatly to air pollution, the government is gradually banning the use of coal stoves, replacing coal with gas or electricity as the prime energy source for households. The contribution of coal power plants to China's energy mix will decline further and be replaced by water, wind and nuclear energy. In addition, inefficient power plants are being closed. As a short-term measure, nearly six million cars that did not meet emission standards were pulled off China's roads by the end of 2015. The government is promoting the use of electronic vehicles and is gradually banning fossil fuel powered cars. In April 2014, the environmental protection law was amended for the first time in 25 years, removing limits on fines for polluters. The problem, however, is implementation, because the incentives for local governments to allow factories to cut production costs by polluting the environment is high while the risk of detection low. In 2018, the government started to reward local leaders for improvements in the environment while placing less emphasis on GDP growth.

China's research and technology sector is rather advanced and continues to improve. Spending on R&D as a percentage of GDP has risen from 0.6% (1995) to 2.13% (2017), overtaking Europe in terms of R&D intensity. R&D is heavily driven by foreign companies' investments and is dispersed unevenly across the country. Chinese patent offices receive more applications than other country. However, 2.889 million "triadic" patents (patents granted in China, Japan and Europe) were held by Chinese innovators in 2015, compared to 1.38 million patent applications in China in 2017. In 2017, almost one quarter of all successful patent applications in China were filed by foreign actors, who were responsible for one third of all successful applications in 2013. Still, the number of domestic invention patent applications increased nearly tenfold to 1.25 million between 2005 and 2012. Expenditure on education accounted for 3.06% of the GDP in 2017. Since previous funding has been distributed unevenly across regions and institutions, favoring urban and coastal regions as well as tertiary institutions, the government is now focusing on rural areas. Unsurprisingly, given the size and heterogeneity of the country and its various provinces and regions, the quality of the education systems remains somewhat uneven. Highly competitive, world-class institutions exist alongside low-quality segments of the educational system. Overall, however, national and province-level education policies ensure a nationwide system of solid education and training. According to the U.N. Education Index, China's level of education has slowly, but gradually increased from 0.565 in 2007 to 0.644 in 2017.

Education policy /
R&D



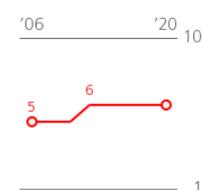
Governance

I. Level of Difficulty

China's political leaders face several structural constraints, some natural, others man-made. Droughts, floods and earthquakes occur regularly in China and not only cause thousands of deaths every year, but also impede China from achieving its goal of food autarky. Furthermore, environmental degradation and water scarcity increasingly constrain the country's development. China's size, combined with uneven development and underdeveloped regional markets, pose great challenges to landlocked and mountainous provinces in central and western China. Severe income inequality strains not only social stability, but also domestic consumption, thereby limiting the competition needed for innovation. After profiting from a three decades of "demographic dividends" from a large working age population, the share of retired persons is increasing. As a result of its one-child policy, in 2012 for the first time China's working age population (between 15- and 59-years-old) shrank, albeit it only by 3.45 million out of almost 940 million people. China is the first country where the "demographic window," a beneficial relation between the working- and non-working age populations, will close while the country is still in a developmental stage. The one-child policy was further relaxed in the review period, but has thus far failed to trigger higher birth rates. With wages increasing substantially (often up to 40% per year), not least due to mass demonstrations, an increasing number of foreign companies are leaving China to relocate manufacturing centers in "cheaper" countries, such as Indonesia, Vietnam or India. The CCP leadership seeks to address this problem by strengthening domestic consumption, encouraging "indigenous innovation," investing in "smart factories," where processes are fully automated and machines communicate with each other through the internet. Artificial intelligence and web-based commerce are further sectors that the government expects will drive economic growth. Major challenges are posed by the facts that most Chinese cannot afford high-quality products, most enterprises have narrow profit margins and do not invest in R&D and property rights protection remains lax.

Structural
constraints

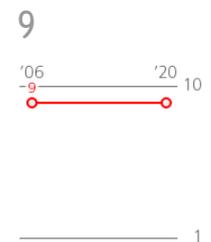
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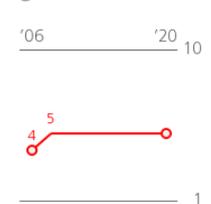
China lacks a robust tradition of civil society, not least because Chinese society is group-centered. Nevertheless, the number of officially registered social organizations and NGOs has steadily increased from 153,222 in 2000 to 761,539 in 2017. Official registration entails finding a government unit to act as a guarantor and fulfilling a number of other requirements that serve to keep a check on social sector growth. However, the number of small and unregistered organizations is estimated to run into the millions. The government is faced with the quandary of needing social participation to enhance the provision of public service while fearing that these organizations may challenge its power. Hence, registered NGOs and non-registered voluntary organizations are only partially able to provide channels for popular participation or representation of social interests. The government's recent exhortations for philanthropic donations are largely ignored.

While there are no irreconcilable ethnic, social or religious cleavages in China yet, social unrest is commonplace. However, most demonstrations of dissatisfaction with the government policy are small – comprising only a dozen or so people – but are concerned with existential issues like wage arrears, the demolition of houses and the relocation or expropriation of rural land. Although not as frequent, spontaneous and large-scale demonstrations occur almost annually, often in the form of “not in my backyard” protests aimed at polluting factories and waste plants. Economic development has proceeded in a highly unequal manner, as indicated by widening wealth gaps and unequal access to health care, secondary and higher education, and contributes to the fragmentation of society into a small, affluent group and a large, economically underprivileged group. Occasionally, conflicts with the police or other state organs lead to outbursts of mass vandalism. Relations between Han Chinese and China's Tibetan and Uyghur minorities remain tense after major riots in 2008 (Tibet) and 2009 (Xinjiang). State control is maintained through a massive, visible police presence in strategic locations and the incarceration of millions of citizens in re-education camps. In Beijing's center, police with anti-riot gear are stationed at strategic points 24 hours a day and visitors to Tiananmen square are subjected to a thorough security screening.

Civil society traditions



Conflict intensity



II. Governance Performance

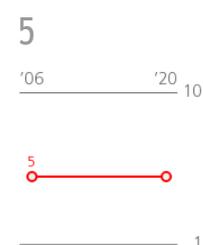
14 | Steering Capability

The Chinese government pursues social stability and economic development as its two main priorities. In contrast, a transformation toward democracy based on the rule of law is not one of the government's long-term strategic aims. Rather, the government follows a deliberate strategy of counterbalancing the threat of pro-democracy tendencies and challenges to the party's political hegemony. Policy-making is characterized by long-term perspectives and subject to evidence-based impact assessment and strategic planning. The government uses guidelines to provide a framework for binding and non-binding policy objectives. Five-year plans specify social and economic targets, some of which are quantified and binding, while others are non-quantified and highlight results that local governments should try to achieve. Major policy changes – like those involving innovation or education – take longer to achieve, so the timeframe is extended to 10 or even 15 years. In addition, the Xi administration has used the “two one-hundred” formula (100 years of CCP/100 years of PRC) as a timeline to achieve official development goals. In the review period, the central government has prioritized investment in the development of artificial intelligence, a field in which it envisions China will become a market leader by 2030. The government also continues to promote “green” technologies and infrastructure projects abroad. In contrast, the previous program of “Made in China 2025” has been de-emphasized. At the local level, targets are tackled incrementally by formulating annual plans. These plans have thus far been consistent; yet, while crises might delay the achievement of targets, no five-year plan has been abandoned. Overall capacity is weakened by both the de facto hierarchization of departments and implementation gaps between envisioned and actual outcomes. Departments concerned with economic development usually take precedence over those with social or environmental portfolios. Local governments are given several abstract achievement targets, the fulfillment of which often depends on their priorities, capabilities and budgetary means.

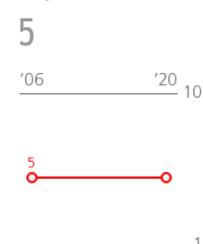
The central government can effectively implement political priorities that it considers binding, but the range and extent of its capacity to do so depends on its resolve and on the interests of local governments. Moreover, the government is not intending to implement political reform measures that might initiate a transformation toward democracy based on the rule of law. Policy implementation is easiest where interests and priorities converge, economic growth being a prominent example. It is most difficult where the priorities of the central government do not match those of local actors, and where it monitors and sanctions non-compliance weakly or not at all.

Question
Score

Prioritization



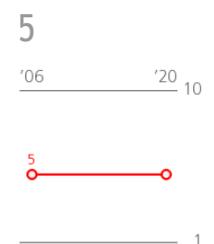
Implementation



Implementation of a policy against the will of local governments is possible yet costly and is usually carried out in the form of campaigns. More important than these issues is the fact that the central government depends on local initiative to govern this continent-sized country with institutions that are highly centralized in form. While compliance is important and can be ensured in times of crisis, the central authorities depend on local initiative to govern routine affairs and to contextualize development targets. Xi administration's campaign against corruption, continued during the review period, effectively illustrates this fragile balance. The campaign antagonizes the overwhelming majority of local officials and stymies local initiative, which was a central driver of policy change under the Hu Jintao administration. On the one hand, the threat of punishment makes local officials more likely to implement central policies, such as Xi Jinping's targeted poverty alleviation, or policies to provide limited public accountability and better e-government services. On the other hand, these threats are likely to adversely affect local development and may ultimately threaten the economic dynamism of the country as a whole. Local officials are already complaining about overwork and a career in government appears increasingly less attractive for highly qualified individuals.

The Chinese leadership demonstrates the ability and willingness to learn from past experiences and from new sources of knowledge. This willingness is mainly confined to social and economic policies, but also extends to administrative reforms, which are commonplace at the city and county level. Officials and administrators formulate such reforms by learning from past experience and by studying examples at home and abroad. For example, the current debates about the reform of the social insurance systems (and, especially, the pension system) are informed by exchange with scholars and politicians from Europe. Most notably, consultative elements are applied in lawmaking, the preparation of budgets and the monitoring of officials, oftentimes using the internet. However, while these reforms improve governance, they should not be confused with a process of democratization within the regime. In recent years, the leadership ranks have acknowledged that the past priority on unconfined economic development has brought about social conflict, a highly uneven distribution of wealth, environmental deterioration and an inability for most Chinese enterprises to move up the value chain. Former President Hu Jintao's emphasis on more social equality and justness as well as sustainable development is now part of the party constitution and plays an important role in the 12th Five-Year Plan (2011–2015). These reforms, however, face strong opposition by special interest groups (big state-owned companies and banks), which benefit from unequal access to resources and influential decision-makers, and hamper the implementation of reform measures. The Chinese leadership is not willing to accept that more pluralism and democratic reforms such as media freedom and public participation are required as a safeguard against this sort of undue influence and corruption. Instead, the present Xi Jinping administration seeks to discipline special interest groups by detecting and punishing deviation through the CCP's disciplinary apparatus.

Policy learning

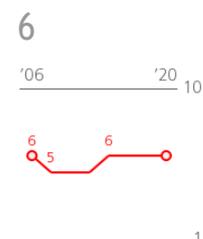


15 | Resource Efficiency

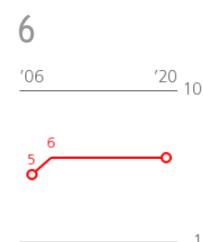
The quality of the civil service has improved; meritocracy through competitive examinations and task-related performance appraisals has been introduced, and the vast majority of civil servants now hold university degrees. E-government and performance monitoring have been widely introduced in China's bureaucracy and China ranked 65 in the U.N. E-Government 2018 survey, up from rank 78 in 2012. In the U.N. E-Government Development Index, China scored 0.68, placing it in the class of countries with a "high" score. Bureaucratic professionalism and efficiency, however, is still undermined by rampant corruption and the overarching power of the CCP, which, through the nomenclature system, influences personnel appointments to upper levels of government and party bureaucracies, putting party loyalty and support for present leaders before professional competence. One reason for corruption is low salaries. In January 2015, civil servants received the first pay raise in nine years. Although the salaries of the lowest-ranked civil servants were doubled, their new monthly income of CNY 1,320 (\$212) is still very low considering the high costs of living in many of China's cities. China's budgetary system is highly decentralized, with local governments responsible for more than 85% of total government expenditures. The central government takes in over half of all revenues then shares that revenue with the provinces at its discretion. Given the lack of transparency and accountability, fiscal resources are distributed not according to a common and equally implemented scheme but are influenced by the respective provincial leader's political weight and negotiating skills. The central government seems to profit from this arrangement. At 3.5% of GDP, the overall budgetary deficit in 2017 was low compared to other countries. However, the deficit is growing. In 2015, the deficit was only 2.3% of GDP. On the other hand, local government debt has increased since the beginning of the world financial crisis. Local government debt amounted to 60% of GDP in 2017, according to an estimate by S&P Global Ratings. As part of a national experiment, several provinces have begun to issue two kinds of bonds in 2014, one to finance revenue-generating projects such as toll roads, another to raise non-earmarked revenue. There is a tendency at the local level to invest in showy projects and create industrial overcapacity. The government has reacted by deleveraging local governments and SOEs during the review period.

The Chinese government often has difficulty reconciling conflicting policy objectives and interests due to a lack of horizontal and vertical coordination as well as friction between administrations at the national, departmental and regional/local levels. These problems result from differing incentives at the central and the local level, and the different priorities of the various ministries. For example, the central government attempts to prioritize sustainable and equitable growth as well as to curb excessive speculation in real estate, but local governments thwart this policy by fueling excess development in their localities to expand employment opportunities and revenues from which they gain individual political and economic profit. However, priority

Efficient use of assets



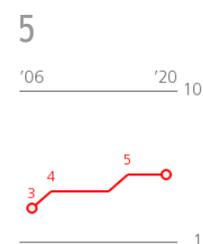
Policy coordination



policies are coordinated in so-called Leading Small Groups, steering bodies that consist of high-level officials from different departments. Two new such bodies to improve coordination have been created under the personal leadership of Xi Jinping: one on national security (“National Security Council”), the other on “Comprehensively Deepening Reform.” Crises are tackled by establishing ad-hoc task forces. Although in routine politics, waste resulting from overlapping areas of responsibility and sloppy implementation are considerable, communication channels between the various administrative levels are superb, although this usually only becomes apparent in crises and emergencies when non-conformity results in harsh punishment.

The Xi Jinping administration has initiated the largest anti-corruption campaign since Reform and Opening began in 1978. Targets are officials in the CCP, the government, the military and state-owned companies. Xi announced that this campaign would focus on high-level officials. Former Politburo Standing Committee member Zhou Yongkang, former vice-chairmen of the Military Commission Xu Caihou and Guo Boxing, head of the Central Committee’s United Front Work Department Ling Jihua and vice chairman of the Chinese People’s Political Consultative Conference Su Rong were investigated for corruption between 2013 and 2015. In 2017, Sun Zhengcai, the party secretary of Chongqing, was sentenced to life in prison. By the end of 2017, more than half a million people had been investigated, and 254 high-ranking officials had been indicted or convicted on corruption charges. As corruption in the CCP has been systemic and graft, nepotism, bribery and sale of office widespread, it is unclear how targets are chosen, and whether the campaign represents an attempt to weed out political opponents, improve the foundations of China’s development, or both. Apart from systemic political corruption, “petty” corruption – like mandatory payments for better services – is still widespread in Chinese society. However, this has been made somewhat harder with the open government initiative implemented in 2008, which improves access to government information, allows people to request files and enables the payment automatization for taxes, fines and services. In addition, e-government services have been steadily upgraded and expanded. Nonetheless, corruption persists, a result of the lack of competitive political processes, institutional checks and balances, accountability mechanisms, an independent judiciary and a free press.

Anti-corruption
policy



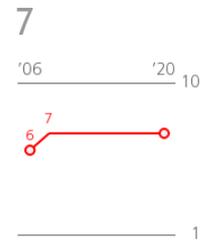
16 | Consensus-Building

The Chinese government remains strongly committed to preventing the emergence of democratic tendencies; there is consensus among the members of the political leadership and the regime coalition that a transformation toward democracy based on the rule of law must be avoided.

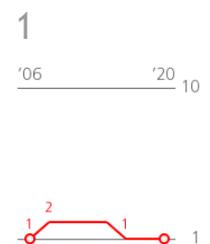
There is broad consensus among Chinese leaders that the continuation of one-party rule, the improvement of living conditions and the defense of national sovereignty and territorial integrity are the country's top goals. Similarly, there is agreement that these goals should be reached through economic development, international integration and the strengthening of China's military force. The Third Plenum of the CCP's 18th Party Congress confirmed that a market economy remains a strategic and long-term goal, although there are actors in the CCP that wish to strengthen state planning at the cost of market allocation. The Third Plenum also reiterated that the CCP wishes to improve governance yet avoid taking steps toward liberal democracy. This theme was reinforced at the 19th Party Congress in October 2018, when Chairman Xi reconfirmed China's commitment to markets and international trade. However, the Chinese government has been accused by the U.S. government of selectively imposing trade barriers to protect domestic companies. In an escalating trade conflict, both sides imposed punitive tariffs on strategically important goods. One Leading Small Group, headed by CCP General Secretary Xi Jinping, has been created to coordinate reforms in the marketization of government services, the structure of SOE, the fiscal system, rural-urban development, citizen consultation and the judiciary, as well as to emphasize the improvement of environmental protection, anti-corruption, internet control and state security. Although these reforms will not be met with approval by all political actors, their power to veto them is marginal.

Since the late 1980s, the party leadership has been united in their opposition to China becoming a liberal democracy. CCP General Secretary Xi Jinping has pledged to improve the "rule of law" in China, meaning that CCP and government officials will be required to follow formal rules and will be punished for deviation. At the same time, he stressed that the CCP as an organization will remain above the law. In 2018, a constitutional amendment enshrined the CCP's leading role in Article 1. Organized opposition to the CCP and one-party rule does not exist. Any attempt to question the status quo is met with persecution and long-term imprisonment.

Consensus on goals



Anti-democratic actors

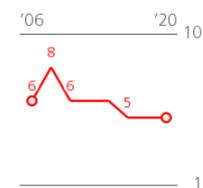


Cleavages exist mainly along ethnic and social lines. Unconstrained competition in unequal markets has caused income and wealth inequality to rise dramatically since the early 1980s, making China one of the most unequal societies in the world. There are serious social distortions and conflict between those segments of the populace with access to education, health care, social security, adequate incomes and living conditions and those without. Violent eruptions of anger by groups of disadvantaged citizens proliferated dramatically and are now commonplace, and one of the CCP's prominent fears is that it may be swept away by a dissatisfied populace. CCP General Secretary Xi Jinping claims to be following the "mass line," a term often associated with Mao Zedong, which raises expectations among the urban and rural poor and serves to widen the existing cleavage. However, increased expenditures for health care and other social services illustrate that the government is seeking to ameliorate these conditions. Furthermore, the government continues to subsidize provinces in western and central China and co-finances poverty alleviation programs in China's poorest counties. Since 2004, income and expenditure differentials between the provinces have been reduced, both because of catch-up development and the central government's redistribution of revenue. The Gini coefficient of provincial revenues and expenditures decreased from 0.47 and 0.35 in 2004 to 0.28 and 0.21 in 2012. Nevertheless, the fact that income and wealth inequality in the general population have not decreased shows that the richest subset of the population in all provinces profits disproportionately from these developments. This is true also for minority provinces and, along with several other factors, is responsible for China's ethnic cleavages. Budgetary transfer payments to Tibet and Xinjiang are disproportionately large, but it is chiefly the rapidly growing Han Chinese population in these provinces that is profiting from infrastructure investments and new economic opportunities. This fact and the CCP central government's lack of respect for the religion and traditions of these people have been major reasons for the rise of separatist movements.

Political decision-making is dominated by internal debates between the CCP and state organs. In recent years, the party and the government have strengthened the integration of expert advice from think tanks and individual academics in formulating policy, and since 2000, the government has tried to strengthen citizen input in policy-making by holding public hearings on pending national legislation. Today, developments of general concern such as health care, education and especially environmental problems and corruption are discussed more broadly in society – not least via the internet. Administrations at all levels have created public consultation platforms in which citizens can voice their demands and grievances, and the information from these platforms further serves to monitor local officials. Nevertheless, even the limited chances for participation and discourse are strongly regulated, monitored and controlled by state and party organs. In case that public debate becomes too explicitly critical of political processes or developments, such debates are suppressed and individuals leading these debates face harassment and

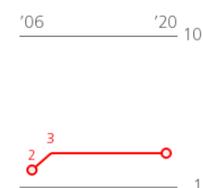
Cleavage / conflict management

5



Civil society participation

3



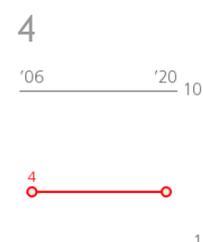
even prosecution. Central government regulations state that the general public should participate in the performance evaluation of local officials and administrative departments, but this policy is implemented only selectively.

The Chinese government regularly invokes collective memories of past injustices suffered from Western “imperialism” or Japanese “militarism” to incite national unity and to garner support for its political goals of national development and grandeur. The “Chinese Dream” concocted by the Xi Jinping administration is a recent example. Once more, the 19th century Opium War is invoked as the reason why China lost its status as a world power; the Xi administration promises to duly restore this status. The “Chinese Dream” mentality is nationalist in so far as it not only demands a return to “Chinese” values in science, technology and even law, but it also entails the blaming of “Western” powers for trying to intentionally undermine China’s rise. Concerning its own past, the government strictly prohibits all public discourse on human rights violations and does not acknowledge the responsibility of the CCP regime for past injustices, such as the Great Leap Famine, the Cultural Revolution and the Tiananmen massacre.

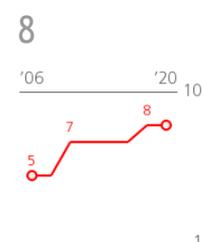
17 | International Cooperation

China maintains and expands cooperative ties with multilateral institutions such as the IMF, the World Bank and the Asian Development Bank as well as with foreign governments to obtain support for ongoing economic reforms. In the review period, China has initiated several new mechanisms parallel to existing multilateral bodies, such as the creation of a new bank by BRICS member states (“New Development Bank”) and the Asian Infrastructure Investment Bank (AIIB). The New Development Bank signed its first loan agreement in 2016 and, in 2018, was rated AA+ by Fitch ratings. The AIIB was launched in 2016 and is the main vehicle through which China’s One Belt One Road development program is financed. In 2018, it issued more than \$5 billion in loans to finance 28 projects in 13 countries, with seven projects established in India. These initiatives more or less directly challenge the U.S. global (Bretton Woods institutions) and Japanese (ADB) regional leadership roles in economic governance. Some nations, among them Japan and Germany, have canceled financial assistance to China and concentrate instead on technical cooperation, focusing mainly on the transfer of “green” technologies, sustainable development, health care, social security and legal reforms. China makes efficient use of this support, particularly in areas where it lags technologically, such as in renewable energy sources and energy conservation. However, such assistance is exclusively concerned with social and economic reforms. The government does not allow any international interference with what it terms “internal affairs,” especially concerning democratic reforms, adherence to human rights standards and the solution of the Taiwan question.

Reconciliation



Effective use of support

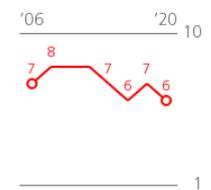


The country's demand for commodities, capital and consumer goods as well as its role as the hub of Asian transnational production networks has made China a vital trading partner for many countries. In addition, China participated in global peacekeeping and conflict resolution efforts. At the same time, traditional sources of conflict with western countries have persisted, and in some cases even intensified. Both the United States and the European Union still complain about trade deficits, market access restrictions, forced knowledge transfers, rampant violations of intellectual property rights, China's hunger for resources, export restrictions, and cyber-attacks on government networks and private corporations. China's double-digit growth rates in defense spending and its more assertive behavior in regional territorial conflicts have raised concerns in the United States and in regional countries as to whether China's self-proclaimed "peaceful development" will persist. In December 2018, two Canadian citizens were arrested on vague charges of "endangering national security" and held incommunicado. The arrests came in the aftermath of the apprehension of Huawei Chief Financial Officer Meng Wanzhou in the context of an extradition treaty with the United States and were interpreted as an act of hostage taking to force the release of Meng. China has threatened Canada with unspecified consequences.

Relations between China and its Asian neighbors have improved in the review period after heightened conflict in the East China Sea (Diaoyu Dao/Senkaku islands) and the South China Sea (Spratly Islands, Scarborough Shoal). In October 2018, Japanese Prime Minister Shinzo Abe visited China for three days to de-escalate tensions over the East China Sea and explore options of common resource exploration. However, the Xi administration is increasing pressure on Taiwan, which the government regards as an inalienable part of the People's Republic of China. During the review period, the Xi administration has heavily promoted its Belt and Road and Maritime Silk Road initiatives, vaguely specified policies designed to encourage economic investment and trade across the world. In the review period, several infrastructure agreements were initiated or continued in Africa, South Asia, Southeast Asia, Europe and South America. During the review period, the Xi administration continued its modernization of the Chinese military (especially its naval forces), shifting the military balance in Asia clearly in its favor. China is also pursuing a "new neighborhood strategy" with Central Asia and has settled disputes and reduced tensions with Russia via the Shanghai Cooperation Organization.

Credibility

6



Regional cooperation

5



Strategic Outlook

Developments during the review period suggest that the Chinese government is facing an uphill battle. The CCP leadership is seeking to consolidate its power over society and its own agents, remove structural constraints and stimulate the economy – all at the same time. The struggle of the Chinese government to overcome the manifold challenges facing the country also affect China's international relations. China's leaders want the country's industry to continue serving as the manufacturing workshop of the world, and at the same time uses the Belt and Road and the Maritime Silk Road initiatives to gain a foothold in developing countries, and (perhaps more importantly) create demand for China's construction and telecommunication companies.

These moves, along with the creation of regional financial organizations (e.g., the Asian Infrastructure Investment Bank and the New Development Bank) are likely to have a positive impact on the Chinese economy, but also create political challenges that Chinese leaders might not have expected. For one, China's strategy of calling itself a developing country in order to obtain concessions, while at the same time providing loans for infrastructure projects in developing countries has reached its expiration date. The Japanese government has suspended technical assistance to China and the U.S. Trump administration is pressuring China's leaders to lessen the U.S. trade deficit with China. During the period under review, several states in Africa and Latin America (including Panama and the Dominican Republic) ended their diplomatic recognition of the Republic of China (Taiwan) in preference to the People's Republic of China. This led to reactions from the United States and Taiwan and re-fueled the "China Threat" debate in the United States. As the economic and political importance of China increases, the country's political and economic expansion is regarded with greater scrutiny by international observers. China's politicians react with a mixture of defiance and open hostility to accusations made against public and private actors, while attempting to influence international public opinion by extending the reach of its propaganda system beyond China's borders.

Besides the very real issues of tension (e.g., the Chinese government's trade policy and its territorial claims), the CCP's international communication strategy has become the source of an increasing conflict. This conflict is not primarily based on material issues, but on a difference in values. When communicating its strategies, the Chinese government tends to employ persuasion, frequently refuses to be held accountable and demands trust. This creates skepticism among educated audiences in liberal democracies, to whom trust in politicians, especially in non-elected ones, is anathema. As a consequence, the media, social influencers and increasingly politicians in liberal societies have begun to voice doubts about the CCP's motives and extrapolate from China's domestic politics how the CCP might project power abroad. In combination, CCP leaders' style of communicating with outside observers, increasing domestic human rights violations and erroneous or one-sided media reports about the country (e.g., social credit, so-called backdoors in Huawei products and AI capabilities) are giving rise to a narrative that challenges CCP's self-characterization as a peaceful, responsible and reliable international actor.

The Chinese government faces the very real risk of isolating itself from the world's liberal democracies, an outcome that has become more likely with the arrest of two Canadians, Michael Kovrig and Michael Spavor. The two Canadians were detained and held incommunicado without being charged in an apparent act of retaliation to the apprehension of Meng Wanzhong, Huawei's chief financial officer, in Canada, after a U.S. court had issued an arrest warrant. The situation is very different from that in the previous review period when, territorial conflicts and domestic repression notwithstanding, some observers hoped that China, along with the European Union, could fill the void left in the international arena by an increasingly self-absorbed U.S. government. If past experience is a guide to the future, the Chinese government might reconsider its hardline positions at home if long-standing trade partners (e.g., EU member states) stand firm in their values, withstand attempts at intimidation or manipulation, and engage with China under the condition that its government follows due processes and adheres to the international treaties it has signed.