

# Teneo Insights Series: China Update: CCP Turns 100, Data Security Concerns, US-China Policy and the 2022 Olympics

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**Alexandra Lager (AL):** Good day and thank you for joining today's Teneo Insights Series. A recording and podcast of this call will be available on Teneo's website. Now, I would like to hand it over to our host, Kevin Kajiwaru.

**Kevin Kajiwaru (KK):** Well, thank you very much, Alex, and good day, everyone, and thank you for joining today's edition of Teneo Insights. I'm Kevin Kajiwaru, Co-President of Teneo Political Risk Advisory in New York City. July the 23rd marked the 100th anniversary of the

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**Chinese Communist Party marking its status as the longest ruling communist party in history. It was founded in Shanghai in 1921, and this anniversary happened to coincide with roughly the first six-month milestone of the Biden presidency, a period which, surprising to some, saw no improvement in Sino-American relations, as the new administration continued many of the policies, if not the rhetoric, of its predecessor.**

**This period has been characterized by now two tense diplomatic meetings, increasing concerns over everything from data security, foreign listings, human rights in Xinjiang and in Hong Kong, the security and status of Taiwan, the domestic situation in the United States. All of this, of course, in the context of urgent global issues, COVID, and climate change most importantly, requiring both Chinese and American joint and individual action.**

**So here with me today to help sort through all of these issues, I'm joined by two of my colleagues. Paul Haenle is Teneo's Chairman of the Asia Pacific Region. He heads our Beijing office and he is also Director of the Carnegie-Tsinghua Center in Beijing. Paul served presidents George W. Bush and Barack Obama in the National Security Council as the Director for Chinese, Mongolian, and Taiwanese Affairs. He was also the White House representative to the U.S. negotiating team at the Six-Party Talks nuclear negotiations. And Gabe Wildau leads our political risk analysis of China from the United States. Gabe spent over 14 years in China, most recently as the Shanghai Bureau Chief of the Financial Times, and before that with Reuters and Gavekal Dragonomics. So thank you guys both for joining me today.**

**So here we are. I think we all recall the footing that the relationship got off to with**

**the new Biden Administration in Alaska. The atmospherics were just as bad at the diplomatic meetings in Tianjin last week involving Deputy Secretary of State Wendy Sherman. And in his July 1st 100th anniversary speech, Xi Jinping warned that anyone who challenged the country's sovereignty would, quote, "Crack their heads and spill blood on the great wall of steel built from the flesh and blood of 1.4 billion Chinese people." He sounded more like Kim Jong-un than the leader of one of the world's great superpowers.**

**So give us a sense of where we are in this most important bilateral relationship of the 21st century. Paul, let's start with you. Give us the level set here.**

**Paul Haenle (PH):** Well, thanks, Kevin, and I agree with your general premise. The first six months of the Biden administration have been, I think, tougher and more continuity than perhaps some had expected, especially in China. Or at least that they had hoped for. But that being said, my own sense is that this is not the end of the story. I think what we're seeing in terms of the Biden administration is a deliberate, and I think it will be a sequenced approach to China, beginning with a strong focus on and priority on domestic renewal and outreach to allies. And then, I think that is the first critical piece of their China policy, and frankly, their foreign policy writ large, to be honest, because you hear the same explanation when you ask them about policy toward Russia or policy toward other parts of the world. So they want to get those too because they think it will allow them to approach China and other foreign policy issues from a position of greater strength.

**So on the domestic renewal side, we've seen the administration putting efforts forward to ramp up vaccine distributions, get COVID under control, pass the stimulus bill, other legislation on Capitol Hill, infrastructure bill, outreach to allies. I think we've seen some successes. I**

think they've begun that process of coordinating with allies much better than the previous administration, especially on its approach to China. You look at the Quad, the G7, NATO, USEU. You've had several joint statements around Xinjiang with partners and allies around the world. The joint statement on China's hack of the Microsoft Exchange email servers, these are all, I think, important successes.

And then in terms of the dialogue with China, I think we're starting to see some high-level dialogue. Obviously you mentioned the meetings in Alaska, Wendy Sherman's visit to Tianjin. On climate policy, John Kerry went to Shanghai earlier this year. I will say the trade and economic policy reps do speak by phone, and they've done that on multiple occasions this summer, so there is dialogue taking place. However, what you're seeing more is both sides kind of laying down their bottom lines and clarifying what actions they want the other side to take that they see as undermining their own interest. There hasn't been a lot of constructive dialogue.

My own sense is what we're doing, the two sides, is going through a process of trying to figure out how to position themselves with regard to the other, in a new era, frankly, of U.S.-China relations, where a lot has changed and a lot is changing in terms of power dynamics, in terms of each country's perceptions of how it sees itself and how it sees the other in the world. And neither side at this point is in a particular hurry. You've got, as I said, the sequencing approach on the U.S. side. China seems happy to wait. They're saying they're looking to the U.S. to take the initiative and improve their relationship because they blame the previous administration 100% for the downturn in relations, and the rhetoric you're also hearing where the Chinese side says the U.S. doesn't have the legitimacy to criticize China about its own situation, domestic situation, human rights. China's clearly feeling much more confident.

That being said, there is some discussion about a meeting between our two presidents here, maybe in the fall, on the margins of the G20 or COP26. We'll see. It's not clear yet, but that will be an important marker, but that's basically what I think is happening right now between the U.S. and China.

**KK: Just a quick question with regards to—and maybe this is not that important a question, because the messaging is more consistent out of this White House than out of some of its predecessors on China, as well as on many other policies. But for our listeners, when it comes to the administration, who are the key voices that they ought to be listening to on China policy, obviously beyond the President himself?**

**PH:** Within the administration?

**KK: Within the U.S. administration. Yeah.**

**PH:** Okay. I was going to say, outside of the administration, I would say it would be Gabe, and me, and you. No. But in the administration, I think that's a good point, because right now, one of the factors, I think, that's delaying a sort of coherent China policy is the fact that key players are not yet in key positions. So you have Kurt Campbell, Laura Rosenberger, and others in the National Security Council. So they're pretty full up right now. At the State Department, the Assistant Secretary for East Asia, Dan Kritenbrink, hasn't been confirmed yet. Treasury, Commerce, USTR, there's a lot of positions there that still have to be filled, and a lot of the critical policies toward China are going to come out of those agencies. Treasury, Commerce, USTR. And then of course China has its new ambassador in place, Qin Gang, just within the last week or two in the U.S. We do not have an ambassador to replace Ambassador Branstad from the Trump administration.

So that's also a delay in terms of getting through these formal policy reviews because those key people are not yet in place.

**KK: And you mentioned in your initial remarks that on the one hand, both sides, China included, are sort of willing to wait and willing to be patient here. On the other hand, you made reference to this expectation that the Biden administration will undo some of the "wrongs" of the Trump administration. Six months into this, do you get any sense of Chinese frustration that that does not appear to be happening in the U.S.?**

**PH:** I still maintain quite a bit of dialogue with Chinese experts and business leaders. I sense a huge degree of frustration. The official narrative, as I said, is that the downturn in relations is 100% percent the responsibility of the Trump administration. There's very little self-reflection about China's own policies, and behavior, rhetoric, and the rest. And so, there was a hope that the Biden team would come in, and I personally think the Biden team has taken a number of important steps to improve our approach to China. In particular, our tone, our outreach to allies. In my view, these are positive steps. But on the Chinese side, they were hoping that the Biden team would reverse many of the policies and actions of the Trump administration, in particular, the tariffs, and they haven't seen that, and that's frustrating to them.

China wants to stabilize relations, but they're not putting a lot forward in terms of concrete ideas for how to do that. They're not offering a lot to do that, with the exception of dialogue. But dialogue, many in the U.S. see as a sort of a mixed bag, because the Chinese don't always make a lot of commitments in dialogues, and there's a sense that the Chinese may use dialogues to drag out issues.

So, yes, there's huge frustration. I think in China, they were wanting more change. They

were wanting the administration to reverse a lot of the Trump administration's policies. They haven't seen it. They see a lot of tough rhetoric around strategic competition, and they don't like that. And so in a sense, they're, I think, waiting and watching, and they don't see a lot of upside right now to being proactive, and to giving signals of where China might be willing to make some changes, or modifications, or concessions. Very little of that right now.

**KK: Gabe, Paul's been talking about sort of where we are right now, but if you pull back a little bit here, when you talk to your interlocutors in China, and in your studies of China's government, what do you think right now is their view of U.S. motivations? Big scale, strategic motivations with regards to China? And do you think those are, in fact, realistic? Do they align with what our actual strategic policy toward China is? And I'm talking about there is a perception, yes, that the U.S. wants to essentially, with its allies, contain China's rise and prevent it from assuming its rightful place in global affairs. Talk about that a little bit.**

**Gabriel Wildau (GW):** Yeah. I think you put it pretty well. China's leadership is cynical or skeptical about U.S. statements about human rights and about democratic values. They basically see U.S. motives as being about containment, and they don't really think that, although the U.S. government raises various grievances, whether it's about the South China Sea or about intellectual property, about mercantilist trade policies. Ultimately they think it's about the existing global hegemon trying to prevent a new global hegemon from supplanting it, and therefore they don't believe that any specific concessions by the US or by China would really lead to an improvement of relations, so long as China is not willing to give up its ambitions to become the world's largest economy, to become at least a regional hegemon or at least to increase its influence in Asia at the expense of the U.S., if not globally.



And so I think that is kind of the source of the paralysis and stalemate that Paul described in terms of neither side being willing to compromise, and neither side really believing that the other side is operating in good faith in terms of being willing to take substantive steps.

So I think where we stand, therefore, is kind of these dialogues and these diplomatic encounters, maybe the best we can hope for is that things don't get worse or that the two sides understand each other better, can avoid miscalculations and accidents, because no one really expects a breakthrough or kind of substantive deliverables. Even if this meeting that Paul referenced between the two presidents happens at the end of this year, it's hard to be optimistic that anything is going to come out of that. That would mark a shift in direction.

**KK: Two of the real hallmarks of the Xi Jinping era have been, one, that China has taken on a more—they've become more ideological, right? The most ideological since the Mao leadership. And the other is the great confidence that China continues to demonstrate under him. We're very clear of his perception that the East is rising and that the West is declining. But I think that over time, China watchers would note that you can't really straight-line anything out of China. The leaders since Mao have differed quite a bit in their approaches. And so, I'm wondering how much, especially now that that Xi Jinping has also eliminated term limits effectively for himself. How much should we straight-line about Chinese policy and ideology at this point? And my second question is, on the one hand, they're demonstrating great confidence, on the other hand, they will squash anything that looks like dissent or deviation from their policy goals, which suggests a greater insecurity than their rhetoric would imply.**

**And I'm wondering if that is the case, is there a deep insecurity? And what does that stem from?**

**GW:** So, I would say it's useful to distinguish here between kind of domestic political trends and elite politics within China, versus China's kind of stance towards the world. And so, what we've seen in the first domain is a kind of a centralization of power around President Xi, more power in the communist party versus the state apparatus, a crack-down on domestic dissent, and a somewhat more status economic policy, state intervention as economic policy. I think, there's some grumbling within Chinese policy, at least in some circles among more liberal economic policy types. Then on the other hand, if we look at China's stance towards the U.S. or Chinese foreign policy, there I think there's a greater degree of consensus. Even if you imagine that President Xi had sort of secret enemies who wanted to weaken him, maybe even unseat him at next year's Party Congress or force him to not take a third five-year term as general secretary. Even if you thought that those were the trends in elite politics, I am skeptical that, that kind of change would lead to a substantial shift in China's foreign policy. Because I think there's a degree of consensus that you're going back to what I said earlier, that U.S. wants to contain China, but China doesn't want to be contained. China thinks it deserves a seat at the high table in global affairs. They intend to be the world's largest economy. They intend to increase their technological self-sufficiency. They intend to use their economic might to increase their geopolitical diplomatic influence around the world. The core sovereignty issues like Hong Kong, South China Sea, Taiwan, they're not very willing to compromise. And I think any other leader, even if Xi were to be sidelined, or even if there were a shift back more towards the kind of collective leadership we saw in the Hu Jintao era, I don't think that would fundamentally shift a lot of those key foreign policy objectives.

And, the Chinese public has basically become more nationalistic, and is kind of on board with that basic agenda as well. So, we could see some tweaks around the edges under a new leadership. And certainly, there are people in China who are uncomfortable with the way that Xi has centralized power, certainly the way that, and I know we're going to get to this, but the latest ructions in financial markets around the technology crackdown, just the way that's been carried out is disturbing, including to people within China.

But, if we're looking at the key sources of conflict between the U.S. and China, there's not a strong sort of pro-democracy movement within China, where that if it succeeded, it could put at ease the U.S. administration, the U.S. public about China's motivations and China's place in the world. I mean, a different China where collective leadership was stronger, where Xi was sidelined would not be a democratic China. And so, it would not be a China where Twitter, and Facebook and Google were uncensored. And so therefore, I think, and what we've seen from the Biden administration, I think is a greater willingness on its side to kind of frame the conflict with China, in terms of values and in terms of ideology. Whereas Trump was more transactional. And, the Trump view seems to be at least before the pandemic, that if they got the trade deal and if certain specific concerns were addressed, we could ease tensions with China. But the Biden administration has been much more forthright in framing it as a contest between democracy and authoritarianism. And in that context, I think compromise becomes a lot more difficult. And so from the Chinese perspective, there's not much prospect that even shifts within domestic politics would change the bilateral relationship or the geopolitical tensions with the west.

**KK: And then, what do you think on this issue of China's confidence or insecurity domestically? I mean, it seems to me that notwithstanding that they are now the**

**longest surviving communist party ruling government, that this kind of stifling of descent historically has not led to longevity in regimes. And so, is it internal insecurity, or is it looking at what happened ultimately to the Soviet Union and so on? What's behind that?**

**GW:** Yeah, I mean, it could be seen as a form of insecurity. I think the Chinese leadership does believe that if you loosen things just a little bit, they can quickly spiral out of control. And there's no room for kind of partial loosening because chaos is always just around the corner. So, you could call that paranoia, but I think it's not paranoia, in so far as they think that things are going well. The current approach is working. So, they're just going to stick with it and they see no reason to shift course. The ideological tightening is, at least from Xi's perspective, is having its intended result. So, there's a way in which that's paranoia, but I think you're right that the Soviet influence or the China's interpretation of what happens to the Soviet Union is very much influential here, where they basically see Gorbachev as hastening the decline of the Soviet Union, the perestroika and détente were sort of, or at least perestroika was a mistake that led to the collapse. And, that's an object lesson where you give an inch and your opponents take a mile. I think we can also see the influence of the Soviet experience in terms of China's ethnic policies in Xinjiang and elsewhere, where they saw that allowing autonomy or allowing ethnic tensions to roil unchecked ultimately ends up having weakening at the core, the imperial core ends up feeling the effects of turmoil on the periphery. And so, that's why we see this very hardline policy.

**PH:** I wanted to just say a couple of things on confidence and insecurity, because that is a great question. You mentioned the hundredth anniversary of the party and that's an important event for China. And I think it's important for our listeners to understand. There's a huge sense

of huge ambition and pride in China. This was the, they achieved the first centennial goal of becoming a really moderately prosperous society. Great, I think there's a great degree of confidence and expectations for China's future. And on Xi Jinping, I know Gabe wasn't suggesting that there's risk for him. I think that by all accounts, his grip on power right now is probably stronger than ever and I think Gabe would agree with that.

**GW:** Definitely.

**PH:** There's no sign he's leaving office at the 20th Party Congress next fall, and he's wanting to position himself and he's making progress and doing this as one of the great leaders of China. The propaganda in China, there's a saying that says Mao helped China stand up. Deng helped China to get rich. And, Xi Jinping is helping China get strong. And I think that there's a lot of support for that. There were hugely ideological components in his speech. The main feature of those ideological components being the fact that he attributed the root causes for China's successes and development over the last three decades, and China's new strength and new power to the Chinese Communist Party and to Marxism and Leninism. Not to the reform and opening up era launched by Deng over three decades ago.

And as you said, despite he was saying in May at a Party study session that Chinese leadership should present a more lovable image of China—of course, we saw the hardline rhetoric coming out of that. And then finally, I think there was, what we see often is this victim narrative, the 100 years of humiliation, which helps to incite popular support in China and pushback on what is perceived as foreign humiliation.

**GW:** 200 years of humiliation.

**PH:** So now, it's 200 years. And so in a sense, as Xi Jinping says, China's moving closer to

the center of the world stage and they're going to be less tolerant of this foreign bullying. So, I think the 100th anniversary event, you could see a lot of what you talked about in terms of confidence, more assertiveness—and China's handling of the pandemic after the early missteps, the economic resilience of China. And then, as they look around the world and they see Western democracies, they see rising populism in Europe, they see political chaos and unrest in the United States. And, that I think gives them a much greater sense of confidence. But you're absolutely right, there is a debate. Is it the China's confidence, or is it that it's a fragile power secretly trying to stay afloat?

And, I agree with Gabe that they use that paranoia and insecurity really just to stay focused on the mission at hand and to stay in power. But, the things that Gabe talked about, the centralization of power around Xi, more control of policy by the senior party leaders versus the state apparatus, repression of the domestic audience, a return to sort of Mao era tactics. I think these are all potential risks. Right now at this snapshot in time, there's great confidence and I think the leadership is doing quite well. Downturn in the economy, some crisis with the United States—there's a number of things that could emerge that could cause the administration, the leadership in China, to have difficulty. When you centralize power around one leader, if things are going really well, that's really good for that leader in the party. When things start not to go well, that's also a risk to the leader and the party.

**KK:** So we're going to turn to the economy here in a few minutes, but since you brought it up, Paul, I want to turn to potential crisis point for one second here. And, I asked you to level set on the overall relationship at the outset, but let's level set on another issue here and that's Taiwan. Obviously, a lot has been made of the increasing military might of China. And it's increasing in

**assertiveness, rhetorically, diplomatically, and militarily with regards to Taiwan. And, you've seen some hyperbolic Western reaction to that as well. The Economist magazine put on its cover that it's the most dangerous place in the world with the big target right on Taiwan and whatnot. Give us your sense of where the Taiwan issue is right now, and how realistic it is as a near-term trigger point, or where do you think it becomes an actual real strategic concern?**

**PH:** So this is a great question, and I will start with the 100th anniversary event. If you look at the language, the party line that came out of that event, you come away with the conclusion that the party line has remained unchanged with regard to Taiwan reunification because in Xi's centennial speech, he talked about the 1992 consensus and the policy of peaceful reunification. So, there's not a lot you could take away from that speech that would give you a sense there's any sort of urgency to deal with it through more aggressive military means in the near term. But as you indicate, a lot of analysts are looking at this and seeing signals that Beijing might be reconsidering this peaceful approach and might be contemplating some sort of armed unification effort. Folks that are pointing to this are noting public support in China through media, through social media, also some official, within the Chinese military establishment, for example, support for some sort of armed effort to reunify with Taiwan.

There are analysts also saying that China is beginning to doubt that the U.S. has the military power to stop China from taking Taiwan. So, maybe there's a window of opportunity right now. And, that the U.S. doesn't have the international clout anymore to rally an effective coalition around China. The national security law is a good example. The international response, a lot of angry statements, sanctions, but at the end of the day, did China really incur huge costs? And so, that's the analysis around maybe Chinese leaders are looking to

do something fairly quickly, aggressively. Other analysts in the U.S. however, and I would put myself in this camp to be honest with you, for Beijing to launch an unprovoked attack on Taiwan, Chinese leaders would basically, as my friend Ryan Haas says, would have to mortgage all other priorities in service of that one goal.

And there's a lot, if you listen to the centennial speech, there's nine or 10 major national goals that came ahead of discussion on Taiwan. They've also got to factor in that an unprovoked attack would almost certainly involve U.S. forces to some degree. Could they control the escalation? Geographic escalation of that? Risk of nuclear escalation is involved. What would it do to China's image in the world? Huge anxieties would be created in the region around China as a military aggressive power. And this could lead countries in the region to bandwagon—this is something China's been trying to avoid. And of course, there's risks of capital flight, trade diversions, and this could have a significant impact on China's economic competitiveness. So despite all of these huge downsides for China, we can't rule it out a 100% that China won't decide to sort of proceed. And so, it's important for the U.S. to be very clear and try to remain an active deterrent. But I think in the near term the risk of some sort of military attack by China is low. Now, the last thing I'll say is China is preparing, even if they're not preparing for some sort of military attack here shortly, there are a number of other tactics, these gray zone tactics that they're doing every single day, intimidation, coercion, Chinese drills, activities in Taiwan's air defense identification zone. And these are used to try to wear down and subdue Taiwan over time and so we need to stay attuned to those as well and have policies directed to mitigate the effectiveness of those.

**KK: One final question on the strategic front, it's become public in recent days that China is rapidly building ICBM missile silos,**



**land-based, in various parts of the country. How do you and how does the national security apparatus in the United States and military apparatus view this development? Is China on a rapid pace of increasing its nuclear arsenal, which just to level set for everybody has been quite small versus it's been more a deterrent in nature for China versus the arsenals of the United States and Russia, or are they trying to gear up for what they think is inevitably having to enter into a strategic arms control negotiations ultimately with the U.S., and Russia, and other powers?**

**PH:** Yeah, I think that's a possibility. I mean, these developments are pretty significant and they're starting to get more attention, but as you said, the Chinese have had this minimum deterrent strategy, which means that they possess no more nuclear weapons than is necessary they believe to defeat an adversary. China has got about one fifth, I think, of the U.S. arsenal and the Russian arsenal. And now there's upwards of these 200 new silos that have been identified, so there's a lot of speculation. I mean, the fact that we have to speculate is not a good sign because it means that there's very little communication in our military to military space, so the Chinese can sort of reassure, especially major nuclear powers, in terms of what they're trying to do.

They may be wanting a nuclear arsenal that matches China's increased economic, technological, and military strength. They also could be concerned about American missile defenses or Iran's nuclear buildup. They're also maybe concerned that the silos that they have now are vulnerable to attack and so they build 200 and they can place the minimum amount of missiles that they have now in any of those 200. So it could be reducing the risk to those missiles. There's also speculation that the Chinese know that the Biden administration or feel that the Biden administration will want to enter in some sort of negotiation with China

around nuclear arms talks. And given that China has so few nuclear weapons, they may want to build more so that they have more leverage at the table, so it could be any of those. But the lack of transparency I think is concerning here, there should be some discussion between the U.S. and China. Otherwise, you create threat perceptions and then countries will come to their own conclusions. But this is where I think we need to have more dialogue about what this is all about.

**KK:** Gabe, you and Paul have both talked about the continued policy direction of the Biden administration on some of the economic policies that the Trump administration implemented on the trade front, et cetera, et cetera. But in recent weeks, a lot of the news has been around China's crackdown on the technology sector and on foreign listings. I guess the question here is more narrowly focused, is there some sort of a debate going on among the Chinese leadership right now about how far to go on cracking down on foreign listings and more broadly, should anyone derive anything from this about Xi's attitudes toward the ostensibly private sector writ large? Or are we reading too much into it?

**GW:** Yeah, I think there are some investors who probably are reading too much into the recent market turmoil and the recent policy actions by China against the tech sector and against foreign listings, or maybe they're taking not quite the right lesson from it. I think that the big context for what we've seen against the tech sector over the last several months is we see that China's policy objectives are no longer limited to just encouraging growth and welcoming foreign investment as the top priority. There's this common prosperity agenda, which relates to social equality and kind of non-economic quality of life type of concerns, and the various crackdowns, whether it's against anti-monopoly, or about data security, or about the education sector,

or now about the low wage workers who work for these food delivery platforms, or whether it's about the impact of video games on children, all these crackdowns potentially hurt economic growth, at least in the short term, they definitely cause financial turmoil.

I think what we see from the leadership is a willingness to accept those costs, because these are important priorities and growth is in terms of China's legitimacy or the Communist Party's legitimacy addressing these concerns around family, and family stress about education, around the impact on low wage workers and the kind of working conditions of these delivery drivers. All of these things the party sees as key to its legitimacy. So specifically on foreign listings, I mean, this is a concern related to data security and the concern that if companies like DiDi list on foreign stock exchanges, DiDi Global, the Uber-type ride hailing app, if they list on foreign exchanges, this could lead to the leakage of valuable data or sensitive data from China abroad to foreign regulators.

So we're going to see regulations to address this. But I don't think we're going to see a total cutoff of foreign listings. I think China actually still very much values the fact that certain Chinese companies can access foreign capital markets and can grab foreign investment. But it's no longer the overriding priority compared to other priorities. So they're trying to strike a balance. And I think that the priorities around social equality and common prosperity are the way to view this, rather than seeing it as President Xi or the Communist Party being broadly hostile to the private sector. Or about trying to show Jack Ma who is boss or show Pony Ma, the founder of Tencent, who is boss, or kind of remind companies that the Communist Party has the final say on everything.

I can tell you that no Chinese business leader was under any illusion before the recent

crackdowns about who the boss was. And so there was no need for any kind of reminder, it's really about achieving this set of policy objectives. And nor is it about kind of trying to punish foreign investors specifically. It's really more about a kind of indifference to the interest of domestic and foreign investors—the investor class generally, as compared to trying to pursue these other policy objectives. So what we see now is investors pouring over President Xi's past speeches, or pouring over People's Daily to try to get policy signals about what the next regulatory crackdown will be. But broadly, I think we see a willingness to kind of address these social issues, even at the expense of investors and powerful companies.

**KK: Yeah. Deng Xiaoping said “to get rich is glorious,” just not as rich as Jack Ma apparently. Gabe, you issued a note to clients earlier this week about the recent Politburo meetings and their acknowledgement and sort of policy responses to economic slowdown after the initial rebound from the pandemic. Obviously now, you’ve got the Delta variant appearing pretty much across China, albeit at much smaller numbers than we’re seeing in the United States and other countries. But quite simply, this is going to probably further delay consumer rebound in China. And so you’re hinting that we should expect further loosening of policy in China. Can you talk a little bit about what you expect out of economic policymaking as we head toward the Party Congress later next year?**

**GW:** Yeah. So here, we're talking about really short-term trends in China's economy and economic policy. Paul and I have been talking about kind of big picture secular trends, but the Politburo meets every three months to talk about the economy and to set policy. And what we saw at the end of July was a pretty clear signal that China's recovery from the pandemic, economic recovery, has been strong and so China was really tightening for the last

eight months, tightening fiscal and monetary policy because the recovery was strong. And now they're shifting back towards a loosening stance because growth is starting to slow, and now we have this outbreak of the Delta variant and again, a very strong reaction in terms of lockdowns, partial lockdowns, and travel restrictions, and response to this outbreak that would be considered tiny by global standards, but China has this zero tolerance policy.

And so we have an economic impact now where the economy was already slowing and that's what the Politburo acknowledged just a few days ago. But the economic hit as a result of the Delta variant is now going to kind of compound the slowdown and so China may therefore have to accelerate the policy loosening it was already planning to take, but that it was going to do very gradually because growth is still kind of on a glide path, at least for the rest of this year. And the growth concerns were mainly about next year. But growth for the rest of this year was expected to be driven by consumption and consumer services. That's what had recovered relatively slowly compared to the kind of industrial economy and the factory, the manufacturing sector had kind of led the recovery out of the pandemic. Consumer services, because of lingering COVID concerns, consumer services, travel, entertainment, dining had recovered much more slowly. That was expected to pick up the slack now in the coming months, but because of this new outbreak and the summer travel season is basically canceled now in China, at least for August.

So that's going to set back the consumption recovery that everyone expected and it's going to put more pressure on policy makers to kind of ramp back up the investment driven growth and investment driven stimulus that they traditionally relied on, but which they've been trying to get away from. But since we know that that going into next year and the Party Congress, they very much want strong headline

growth, they're going to be under pressure to kind of return, at least to some extent, return to that old investment playbook, rely on infrastructure, rely on housing in order to drive growth to put President Xi and his group of senior leaders in a strong political position heading into that Party Congress.

**KK: The other big event in China ahead of the Party Congress is the Olympics. And I'm just struck, obviously because we're watching sort of the winding down of the Tokyo Games right now, but I'm wondering Paul, what you also think on this front. When we go back to the 2008 Olympics in Beijing, the Summer Games, it was clearly a giant coming-out party for China on the global stage, right? I think we all remember the opening ceremonies of that being quite dramatic. What does the Olympics mean to them this time around and what should we expect, not in terms of sport, and gaming, and all that, but in terms of, what's the message that China is going to send with it this time around? And does that pose any risks for global advertisers of the Olympic movement? Obviously a lot of American and Western corporations rely heavily on being able to get their message out during the Olympic games. Is there going to be risk this time around because of all these bigger tensions between the U.S. and China?**

**PH:** That's a great question and we're starting to look at that very, very closely. I think given the fact that we've seen some of the difficulties with the Tokyo Olympics and the fact that it's been fairly subdued, I think Tokyo wanted to use the Olympics to say the world is back and we're beyond COVID. And to use the Olympics to sort of signal that and have a huge amount of enthusiasm behind the Olympics, which would obviously benefit Tokyo and the Olympics itself and that hasn't really played out. It's been a great Olympics, don't get me wrong, but it hasn't been I think what officials in Tokyo had wanted. And I think the Chinese will see

an opportunity there. Of course, yes, to say the world is getting beyond COVID, but most importantly to demonstrate what the Chinese have done in dealing with COVID and getting the economy back up and running. That's not going to be easy, especially as Gabe was referring to with these new Delta variants that are emerging in China, and China still remains quite closed off to foreigners. So there's a lot of uncertainties in terms of how they're going to play the Olympics, but they clearly want to use it as an opportunity to showcase China's strength and capabilities in terms of dealing with the virus, getting their economy back up and running much quicker than other countries in the world did, and all the rest. Whether they will be able to do that or not I don't know.

You'll remember, of course, and I was President Bush's China Director at the time, he went to the Olympics and that was a big boon. The Chinese really wanted heads of state from countries around the world to go and they put a lot of pressure on companies. President Bush wasn't under any pressure. He decided a year in advance that he was going to go to support the American athletes. President Biden will not go to the Olympics this year, that I can guarantee you. On Capitol Hill, there's a lot of discussions and meetings around what Capitol Hill should do, what Congress should do around U.S. corporate sponsorship to the Olympics. And that's a space that we need to watch play out over the next several months as we approach the Olympics in February 2022.

**KK: Guys, I have a question here for both of you. When you contextualize everything we've been talking about, from the big picture relations between China and the U.S., China's own trajectory and then, even these more near term economic issues and the like. When you talk to Fortune 100 American corporations and their leaders, do you feel that there is a very realistic view of China and that the calibration efforts on—and I know I'm asking you to talk about**

**this writ large and not on a company by company or even industry specific basis, but in general terms, is the recalibration of Western corporations toward their China dealings, whether it's using them as a source of goods or as a market that they're trying to do business in, or do they need to move more to reflect the reality that you guys have just presented?**

**PH:** Sure. I think that you hear a lot of companies talking about reducing. First of all, there's a huge amount of risk and uncertainty in the business landscape in China. No doubt. But there's also a huge amount of potential. And so, companies are trying to figure out how to maneuver through that. And with the increased risk, you hear a lot of companies saying that they want to take steps to diversify their risk and doing a lot of analysis. My sense is that they're doing some things, but there's probably more that they could actually do. Because a lot of this is sort of happening incrementally over time, some of these more negative changes in China and they don't want to wake up in 10 years and say I should have done more 10 years ago.

But I think one of the misperceptions is that this all comes out of the blue, that it's all a surprise when things happen. Gabe talked about the regulatory pressure that we're seeing now. The truth is that regulatory authorities in China are actually well known for advanced signaling. And Gabe and myself, we try very hard to watch those signals. So I guess there is a lot that companies can do. And we talk to companies a lot about what they can do to reduce their risk, to diversify, understanding the relationship between the industry that companies are in, or that firms are investing in, in terms of the Chinese national strategies and policies—that's an important element. Making sure that there's no excuse. That you're in full compliance so that Chinese regulatory authorities can't go after you.



Actively monitoring, for example, regulatory and policy space, at a sophisticated level.

This stuff can be done. As I said, there is advanced signaling that takes place. So there's a lot of things that companies can do and we often find that they're not doing that would be very helpful in helping them think about how to maneuver through what's increasingly a much more complicated business environment.

**KK: Gabe, how about you?**

**GW:** I agree with everything Paul said. I think if the question is are companies doing enough to take account of the risk and to plan accordingly? I think it's useful to distinguish between planning based on your base case versus planning based on tail risks or contingencies. And the reason I say that is because, despite all the talk of de-coupling, what we see in the trade data, what we see in the investment data is foreign investors and foreign companies remain very interested in investing in China. And it's very striking, for example, some of the commentary in the Western investment community around the market turmoil related to all these regulatory actions in China is are Chinese becoming un-investable.

It's too unpredictable. And the government intervention is too much. Meanwhile, if you look at the financial market data, the fund flow data, you see foreign investors poured more into China last month, then over the last several. It was a big month for net inflows into China equities. So my clients don't think China is un-investable, that is for sure. On the other hand, and I think what that speaks to is that the commercial opportunities, the business opportunities to China are still very strong. Where the risk comes from and where maybe not enough planning is happening is on these kinds of tail risks or contingencies related to U.S. policy. We have been continually surprised by the toughness of some of the policies over

the last couple of years, both under Trump and under Biden. And so depending on your read of U.S. politics and politics in other Western countries, it's possible that foreign companies are not being careful enough and they're not planning for the contingency that... Like the government may force us to decouple, even if the commercial logic, even if we want to keep being there, we may not be allowed.

And so, the probability of that may only be 20%, but if you're a huge company, 20% probability, 10%, you still have to plan for it. So I don't think we're going to see a catastrophic breakdown of commercial business relations between China and the West, but nor can I rule it out. And so I think companies probably need to plan for those kinds of contingencies, even if they're not that likely.

**KK: Final question for you guys. This is a big one and you only have a couple of minutes to answer this, but it's got to be, I have to think for both of you it's an amazing time, right? To be a China watcher, China advisor, China analyst, because you're seeing something play out in real time that nobody ever has really done before, right? Or it's been 100 plus years since it last happened, which is this supplanting of one economy by another, as the largest. And it's happened only a handful of times in human history. And of course, as we all know, with the exception of the U.S. taking over from the U.K., it's very rarely happened peacefully.**

**We could go on and on about all of the mutual interests of the U.S. and China, the existential interests of the U.S. and China, the commercial ties between the U.S. and China. How worried are you ultimately that not next year, maybe not five years, not 10, that there's some sort of clash, whether it's military or not, but something that would be catastrophic to economic interests of the United States and the Western economies**

**and to China's itself, that some sort of conflict—how likely is it?**

**PH:** I think that things are difficult right now. But I don't think in the near term we're at huge risk for conflict, with the exception perhaps of some sort of inadvertent military collision in the South China Sea. Or in the airspace. Of course we remember the EP-3 crisis, which took place back in 2001 in April. And if you look back in 2001, 20 years ago where our two planes collided, a U.S. crew crash landed in Hainan Island. And through creative diplomacy, the two countries were able to work through that, get our crew back, get our plane back, albeit in small boxes, cut up into pieces, but nevertheless, we worked through it and our relationship even got better after that.

And I think a large reason for that was that the leaders on both sides thought it was in their interests at that time to do that, to resolve that. And so they spent a lot of diplomatic effort to do that. And they were able to do that. If you were to think of some sort of an EP-3 crisis today, given the domestic politics in both countries, given the level of nationalism that we see in particular in China, but also in the U.S. And the fact that in 2001, we didn't have social media. So add a social media component to that. I worry very much if there is some sort of inadvertent collision. In armed forces, China's military has grown considerably. They've got a lot more ships out there operating around our ships. And so, just by virtue of the fact that there's more aircrafts and ships out there, the risk of some clash goes up. I think our encounters are quite professional right now. And I hope it stays that way, but it doesn't mean there isn't a risk. And so, right now I think that is the biggest risk of some—the escalation around some event like that could be very difficult for our leaders to manage.

And so, despite the antagonism right now between the U.S. and China, we do, and I have an article coming out this week on how we have got to get our military, the military dialogue, our crisis management mechanisms up and running for the purposes that I just described.

**KK: And Gabe, I'm going to give the last word to you on this.**

**GW:** Yeah, I think Paul put it pretty well. I think the risk of an acute conflict is low. But Paul's also right that should one occur, the dynamics in favor of escalation would be very difficult to resist because the politics on both sides would prevent either side from kind of backing down the way we saw in the Hainan crisis. On the other hand, I do think both sides, maybe especially the Chinese side—China is not incentivized at this moment to spark an acute crisis because of what we were discussing earlier. They believe time is on their side. So if a crisis is destined to occur, they would prefer it occur five or ten years from now, when they believe there'll be stronger, relatively speaking, than they are today. So I think the risk is low, but accidents do happen. And if something does happen, it could be difficult to get out of.

**KK: Well, we have to leave it here. China and China-U.S. are obviously big issues. We will continue to address them on this call. So gentlemen, we'll have you back. I want to thank you very much for being here today and thank the rest of you for joining us. Teneo Insights is going to go on summer hiatus now. We will be back after Labor Day on Thursday, September the 9th. So I hope everybody has a chance to enjoy their summer. Thanks again for joining. I'm Kevin Kajiwarra in New York.**



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