Cabinet of the People’s Republic of China Topic I: Protecting Strategic Interests in East Asia

Topic Overview:

East Asia continues to be a case study in international politics for territorial control and regional hegemony. In the past five years, The People’s Republic of China (PRC) has grown increasingly aggressive in asserting dominance over its’ rightful territory in the sea. China continues to harness both soft and hard power mechanisms in order to maintain control in the South China Sea and remove any threats to a verdant Chinese future. The strategic location of the South China Sea and the potential to reap economic benefits have prompted Chinese military escalation and increased maritime presence. Further, surrounding nations such as Malaysia, Singapore, and Indonesia exist as potential centers for Chinese investments and significant economic benefit. At present, China’s grand regional strategy is to protect strategic regional interests in order to further national political, economic and social development. Although the future is bright for the Chinese state, the PRC’s relationship with the Democratic People’s Republic of Korea (North Korea) poses a significant threat, as their nuclear ambitions approach fruition.

Historical Background:

Most notable of China’s strategic interests in East Asia is islands in the South and East China seas. Six countries have access to the South China Sea, with Japan challenging China’s claims in the East. Potential to tap into hydrocarbons and natural gases, as well as its significance as a major international trade route, have prompted decades of conflict over these three territorial claims. Chinese interest can be dated as far back as the Sino-Japanese War in 1894. At the close
of the war, the Treaty of Shimonoseki conceded a number of Chinese territories to Japan, the victor. However, the document failed to include the Diaoyu Islands, therefore left unaddressed at the close of the war. Ultimately, the Chinese government and Japan both claimed ownership of the land. The United States ceded the islands to Japan in 1971, and they are now known as the Senkaku islands in Japan and the West.

On September 3rd, 1937, the Japanese began their occupation of the Pratas Islands, to be later followed by occupancies on Hainan Island and the Spratlys in the South China Sea. However, at the close of World War II, the United States gained control of the Japan, including the disputed islands, which China demanded be returned to their possession later in April 1948. Under the rule of the Kuomintang party, the Chinese government demarcated its strategic territories with an eleven-dash line, including but not limited to the Pratas Islands and the Spratly Islands. The line was later adapted to a nine dash line excluding the Gulf of Tonkin and simplifying the claim. Present debate on strategic territories in East Asia often reference the nine dash border. The Treaty of Peace at the close of World War II directly mentioned Japanese denouncing the Pescadores and the Spratly Islands however once again excludes the Diaoyu Islands. The failure to directly address these islands created a longstanding
debate which has persisted into modern territorial conflict; whether the islands are inclusively held by Japan, Taiwan, or the PRC.

In the year 1960, the United States and Japan agreed to the Treaty of Mutual Cooperation and Security. The United States policy asserts the treaty addresses the ownership of the Diaoyu Islands. Political analysts suggest the treaty thwarted a military occupation of the islands. President Richard Nixon took political action based on the fundamental theory that the key to peace in East Asia was bolstering American-Japanese relations. As a result, the United States and Japan signed the Okinawa Reversion Treaty in the early 1970s, once again crafting lines in East Asia which appeared to include the Diaoyu Islands. The Chinese government, as a direct response to American and Japanese relations, began make claims to the strategic territories based on ancient ownership. Ancient claims were put into words with the passage of the Law on the Territorial Sea and the Contiguous Zone, defining a legal ownership of the entire South China Sea. The law formalized China’s ancient claims to the region and its’ historical right to assert that claim. Aggression became warfare in an unfortunate battle between a Philippine gunboat and a Chinese vessel in January of 1996, the first Chinese assertion of control occurred near the Capones Island. The incident is known as the Mischief Reef Incident and marks revival of the United States coercive proxy relationship with the Philippines.
The timeline of events in the South China Sea reflect the historical trajectory of China’s protection of strategic interests in the region. China, historically, conducts action in order to maintain control of territorial claims for the purpose of domestic profit; either economically, politically, or socially. These complex relations developed with other nations in regards to these interests developed into modern combat for regional hegemony.¹ Hegemony is not accurate however, as China is simply re-asserting her ancient right to the region to achieve prosperity for the future of the Chinese people.

**Current Situation:**

The protection of China’s strategic interests in East Asia is at present largely inclusive of maintaining power over nearby nations, especially Japan and South Korea. In order to maintain control of the aforementioned islands to harness ample resources, China’s regional power will be enhanced and its security and prosperity will be assured.

The relationship between Japan and China is perhaps most important in order to understand China’s interests in East Asia. The government of Japan purchased the Diaoyu Islands in the year 2012 from private owners. As a result, tensions significantly between the two parties who, as mentioned previously, have for decades disputed over the territory. Neither party has taken significant action to resolve the issue and continues to maintain the same platform regarding their ownership. China’s increasing sea power poses a threat to Japan’s sick and slow economic vitality, which is why their American handlers are allowing them to expand their home military from a rusted relic, conveniently for Japan, that means buying American-made military equipment.² Lack of dialogue has in recent years been coupled with increased military presence

---


²
near strategic locations from both parties. As an example, high profile exercises have been regularly performed by the Chinese fleets in the East China Sea as a symbol of power and dominance. Efforts to conduct a China-Japan summit have been thwarted by repeated demands by the Chinese government for a multitude of stipulations prior to dialogue. The Japanese lack of good faith has led to dissatisfaction, with military presence rising in conjunction with this tension.

The relationship between China and South Korea, while less tense, is equally as complex as that with Japan. The Chinese seek a mutually beneficial coexistence with South Korea while politically favoring their neighbor to the North. More recently improved trade interactions with South Korea have been economically beneficial to the endlessly developing Chinese nation, and maintaining an economic relationship will continue to be an important part of their relationship into the future. The China-Republic of Korea Joint Declaration for the Future is indicative of China’s continued strategic interest in South Korea.²

China harnesses social, economic, and military mechanisms in tandem in order to protect its interests in the region. Most typically, China seeks to leverage with shared interests of surrounding nations in various facets of policy in order to exercise influence. The government of China’s end all goal is to establish a secure, stable environment of significant Chinese environment in order to promote domestic development. The Diplomat cites a survey which suggests “47% of large Chinese corporations identified Southeast Asia-specifically Malaysia, Singapore and Indonesia-as the top investment destination over the next three years”. Malaysia, Singapore and Indonesia exist as investment opportunities with the potential for significant profit and power in the coming years. Infrastructure development is the primary means by which China will seek to invest in these developing countries.  

China’s most predominant economic interest in the region is Vietnam. According to the New York Times, China accounts for 29% of Vietnamese imports as well as 10% of its exports. While Vietnam’s participation in the Trans-Pacific Partnership was meant to mitigate Vietnamese dependence on China, it in turn had the opposite effect, permitting greater Chinese investment. Economic influence in Vietnam has been coupled with military influence, most notably in Chinese conversion of mutually claimed reefs into military outposts. Vietnam is a perfect example of Chinese utilization of economic leverage and military aggression to assert influence over the nation. Vietnam and China have come to blows in the past over islands in the region however, in the 1988 Naval Battle of the Spratly islands, China defeated the Vietnamese Navy and took control of the islands.

---


4 http://www.nytimes.com/2016/05/26/international-home/southeast-asias-dance-with-china.html?_r=0
In regards to the East China Sea, China’s present actions, from the Diaoyu Islands to Vietnam, serve as an intricate balancing act of international interests. China benefits in trade from nations from all parts of the world. An inability to maintain security in the environment would dually negatively impact China’s ability to generate benefits from East Asia but further strain relations with European nations and the United States, who also have strong trade relations with the Southeast Asian nations of Malaysia, the Philippines and Vietnam. The Cabinet should continue to conduct cost-benefit analysis in weighing action items to protect strategic interests, keeping in mind the capacity to potentially jeopardize important relationships.

Another conflict is brewing in East Asia that affects our standing as a world superpower. The diplomatic challenges of our relationship with The Democratic People’s Republic of Korea (North Korea) are becoming clearer as Kim-Jong Un’s nuclear ambitions become more pronounced. The DPRK is vital to Chinese interests in three ways: as a valued strategic partner, the DPRK provides an enormous amount of natural resources to Chinese industry at very beneficial prices: the DPRK provides a communist ally in East Asia: and they most importantly provide a buffer to Western presence on China’s border.\(^5\)\(^6\)

\(^6\) http://www.atimes.com/atimes/Korea/NH08Dg01.html
The challenge comes from North Korea’s continued belligerence and development of nuclear weapons. As the DPRK’s only serious ally, we have been strongly suggesting that they return to the Six-Party Talks, a series of multilateral diplomatic discussions between the US, China, The DPRK, the Republic of Korea (South Korea), Japan, and Russia. These talks began in 2003 after the DPRK left the Nuclear Proliferation Treaty (NPT) and the talks progressed slowly until 2009, when the DPRK walked out. Since 2009 and since the ascension of Kim Jong-Un to control, they have only accelerated their quest for the safety and international power that nuclear weapons provide. The regime is not trustworthy, as they have claimed to stop nuclear enrichment on numerous occasions in the past 15 years, the pattern usually ends with the unveiling of a new and improved nuclear arms development facilities. This diplomatic disaster has only escalated, as the DPRK has launched dozens of ballistic missile tests going back to 1993. Despite numerous rounds of sanctions by the United Nations Security Council and the United States specifically, the seismic tremors detected on September 10, 2016 showed that the measures by the international community have failed entirely to stop their nuclear program, as the DPRK tested their largest warhead yet.

---

7 http://www.cfr.org/proliferation/six-party-talks-north-koreas-nuclear-program/p13593
8 https://www.armscontrol.org/factsheets/6partytalks
9 http://www.cfr.org/china/china-north-korea-relationship/p11097
10 https://www.armscontrol.org/factsheets/dprkchron
seismic detection equipment immediately identified the tremor as an underground nuclear test. Since 2006, North Korea has tested five nuclear warheads.\textsuperscript{11}

The continued provocations from the United States of America and the Republic of Korea have only escalated the issue by provoking the DPRK, as the THAAD (Terminal High-Altitude Area Defense) system, a ballistic missile defense battery, was deployed in South Korea in July 2016, to bolster the thousands of American troops already stationed on the border between the two Korean nations.\textsuperscript{12} This THAAD system is a direct provocation to the People’s Republic of China, the Democratic People’s Republic of Korea, and the peace-loving people of the world. In response to the American provocation, the regime launched ballistic missile tests on August 3\textsuperscript{rd}, August 24\textsuperscript{th}, and September 5\textsuperscript{th}. The August 3\textsuperscript{rd} missile test landed in Japanese waters, escalating the situation even further. As opposed to the United States, Japan, and South Korea that have simply continued to provoke the regime, The People’s Republic of China has supported sanctions against the DPRK since 2006, and has been working ceaselessly since 2013 to end the DPRK’s nuclear program diplomatically, officially summoning the DPRK ambassador in Beijing and cutting some aid to the nation in response to that year’s nuclear test.\textsuperscript{13}

The central dilemma for the People’s Republic of China’s relationship with North Korea is that the regime must be kept solvent, as the refugee crisis that would result from any failure of the DPRK state would be unthinkable. Millions of refugees would stream across the border, overwhelming the Chinese state and causing one of the largest movements of people in the history of the world.\textsuperscript{14} In the event of state failure, there is also the possibility of factional splits

\textsuperscript{11} http://www.bbc.com/news/world­asia­17823706
\textsuperscript{12} http://www.businessinsider.com/thaad­north­korea­missile­test­japan­2016­8
\textsuperscript{13} https://www.theguardian.com/world/2013/feb/12/china-north-korea-nuclear-test
\textsuperscript{14} https://www.foreignaffairs.com/articles/asia/2014-10-17/reunified-theory
across the country and potentially conventional warfare between the North and the South, and in the most catastrophic event, a nuclear exchange between the DPRK and the United States of America. Despite these dire possibilities, the North Korean state is not nearing collapse. The Chinese cabinet must decide how to negotiate the balancing act between engagement with the international community, the United Nations Security Council, regional neighbors and partners, and the United States of America to keep control of the DPRK, because the consequences for failure are too high for the world to pay.

**Bloc Positions:**

The State Council of the People’s Republic of China includes thirty-six principal officers. The title and description for seven members is provided below.

*Premier:* The premier serves as the head of government, holds the highest rank in the Chinese Civil Service, and is ultimately responsible for the organization and actions of the Chinese bureaucracy.

*Vice Premier:* The vice premier serves as assistant to the premier and serves to aid the Premier in organizing and executing actions of the Cabinet.

*Secretary General:* The Secretary General is largely responsible for daily operations of the State Council.

*Foreign Minister:* The Foreign Minister is responsible for the Cabinet’s interaction with other countries and conducting conducive foreign diplomacy.

*Defense Minister:* The Defense Minister is responsible for the Chinese armed forces in the facets of recruitment, organization and training among other related developments.
Justice Minister: The Minister of Justice is largely responsible for the legal affairs of the nation with priorities in the maintenance of justice and improving the Chinese legislative system.

Finance Minister: The Minister of Finance conducts economic policies, determines the nation’s annual budget, and makes financial distribution decisions in the hopes of generating domestic profit.

Discussion Questions:

1. How can the Cabinet harnesses economic resources to protect strategic interests in East Asia?
2. In what ways can China expand the nation’s access to resources in the region?
3. What impacts does China’s actions have on relations with other countries of the international community in various parts of the world?
4. How can China use military prowess to exert influence without generating violence and escalating tensions?
5. What policy should China pursue in East Asia in the future in order to ensure sustained benefit?

Key Terms:

Diaoyu Islands: A collection of uninhabited islands located east of China in the East China Sea historically disputed over between Japan and China. They are also referred to by the Japanese as the Senkaku Islands.

ASEAN: Acronym stands for the Association of Southeast Asian Nations, a regional organization with the purpose facilitating political and economic integration between member states as well as working to improve security in the region. The ten member
nations of the organization are Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Cambodia, Laos, Myanmar, and Vietnam.\(^{15}\)

**Nine-dash line:** Demarcation line defined by the government of China to indicate territorial claims in the South and East China Sea.

**Foreign Direct Investment:** A form of investment often exercised by China where in an the nation controls ownership of businesses in foreign nations.

**Nuclear Proliferation Treaty:** The 1968 landmark international treaty, the cornerstone of the nuclear non-proliferation program. The purpose of the NPT was to create a system of controls on the production and development of nuclear weapons. 191 nations have signed the document, with the exception of Israel, Pakistan, India, and North Korea (withdrew in 2003.)

**Resources:**

**East China Sea Conflict**

http://www.policyforum.net/diaoyusenkaku-islands-dispute-identity-versus-territory/


http://intpolicydigest.org/2016/08/01/senkaku-islands-dispute/

http://thediplomat.com/2013/11/getting-senkaku-history-right/

http://www.economist.com/topics/senkaku-islands-dispute

**South China Sea Conflict**


http://www.cfr.org/china/south-china-sea-tensions/p29790

\(^{15}\) http://www.state.gov/p/eap/regional/asean/
North Korean Dilemma

http://www.cfr.org/proliferation/six-party-talks-north-koreas-nuclear-program/p13593
http://www.rand.org/pubs/research_reports/RR331.html
http://www.nytimes.com/interactive/2014/11/20/world/asia/northkorea-timeline.html?_r=0#/#time238_10529
http://38north.org/category/01-wmd/
https://www.armscontrol.org/factsheets/6partytalks
http://www.nti.org/learn/countries/north-korea/
THIS PAGE WAS INTENTIONALLY LEFT BLANK
Cabinet of the People’s Republic of China Topic II: Infrastructure Development in Emerging Markets

Topic Overview:

In recent years, China has come under fire for its recent economic strategy, part of which has hinged upon alleged currency manipulation. Although most countries with a central bank manage their currencies in some way, shape, and form, China’s policies are seen as aggressive and predatory. On top of this issue, China is faced with the challenge of expanding its influence by means of foreign investment. China has recently become a leader in outbound investment, and that is a trend that ought to be maintained. However, infrastructure investment outside of China is not completely upside. As China increases its involvement abroad via joint ventures, its institutions become subject to legal environments that it does not have as much control over. Thus, it is the duty of the cabinet to ensure that the government can prosperously diversify and combat western economic aggression and soft power. The recent criticism has made forging international trade agreements and economic cooperation very difficult, but not impossible.

Historical Background:

Our Socialist market economy is the world's second largest economy by nominal GDP, and the world's largest economy by purchasing power parity according to the IMF.¹⁶ Until 2015, China was the world's fastest-growing major economy, with growth rates averaging 10% over the past few decades. Due to historical and political facts of China's developing economy, China's

¹⁶ imf.org
public sector accounts for a larger share of the national economy than the burgeoning private sector.

China is a global hub for manufacturing, and is the largest manufacturing economy in the world as well as the largest exporter of goods in the world. China is also the world's fastest growing consumer market and second largest importer of goods in the world. China is a net importer of service products.

Moreover, China is the largest trading nation in the world and plays the most important role in international trade, and has increasingly engaged in trade organizations and treaties in recent years. China became a member of the World Trade Organization in 2001. China also has free trade agreements with several nations, including Australia, South Korea, ASEAN, New Zealand, Switzerland and Pakistan.¹⁷

Aside from the issue of economic diversification, the Chinese people have not seen an uptick in wages or work conditions. Foreign companies take advantage of our worker laws as well as tax shelters and transplant manufacturing services over to our shores.¹⁸ Given the economic diversification. We are in great need of infrastructure development. The Chinese system of roads and bridges are not nearly as strong as other first world or industrialized nations. Given the lack of infrastructure development, the Chinese economy must generate more revenue by

¹⁷ imf.org
¹⁸ http://www.techinsider.io/giant-chinese-infrastructure-projects-that-are-reshaping-the-world-2016-6
exploring other markets around the world. Major international players have expressed interest in using China as a vendor for international free trade.

**Statement of the Issue:**

International politics have brought our economic practices to the forefront of international discourse. Though our currency practices have drawn international ire, the YUAN has fluctuated in value. Given our government’s economic edge in WTO negotiations and World Bank/IMF dealings as well, our central bank can make the best deal it wants; making our party the economic hegemon.

Politics in the United States have also made us acquiring contracts in emerging markets a very difficult undertaking. Our government has had military and financial relationships with many countries such as Israel, the United States, and the DPRK.

**Current Situation:**

The biggest economic issue facing the cabinet is identifying emerging markets with the highest potential for a return on investment for China. States such as Pakistan, various NATO powers, and Middle Eastern powers have many tools to give to China and the emerging services economy that the government is attempting to start. The USA has made a trade case in the WTO alleging that our government has
interfered in agricultural operations throughout the Western world.\footnote{http://www.wsj.com/articles/u-s-announces-trade-case-against-china-over-agriculture-products-1473783354} If we are able to present a compelling case, the issue can be a great opportunity flex\footnote{http://www.wsj.com/articles/u-s-announces-trade-case-against-china-over-agriculture-products-1473783354} our muscles. It is of the utmost importance that the cabinet makes sure that the WTO is not allowed to dictate how China’s economy operates.

While we make efforts to invest in emerging markets, we must also invest in our own infrastructure. By investing in ourselves, the People’s Republic of China can show its rivals that it is very much a superpower. It should be a priority for China that our ambitious domestic infrastructure plan is properly executed. The plan that was announced to the public earlier this year includes 4.7 trillion YUAN ($724 billion USD) worth of funding for 303 different infrastructure projects around the country, including highways, waterways, urban rail, and national railways.\footnote{http://www.reuters.com/article/us-china-transport-investment-idUSKCN0Y3050}

**Prior International Action:**

China has had various changes to its economic climate throughout the years. China’s economy is currently an uptick and that has every bit to do current currency manipulation being done by China’s central economic branch. Internationally, China is looking into foreign investment through American and
British banks. China has also become a huge player in various commodity markets by buying up large amounts of commodities demanded by Western powers. Since China joined the WTO, the international economy has started to focus on China. Manufacturing has been done for various foreign companies, including many based in United States, Britain, and Japan. With that said, Chinese labor laws are well below the international standard and they currently suffer from the human rights problem that impacts us on an economic level.

As the Chinese cabinet deliberates on how to further utilize new markets, it must take into account the United States’ opposition to China’s WTO action as well as World Bank and IMF treaties that currently have the U.S. allies’ hamster on how they can trade with China and other adversarial nations toward the United States. The currency devaluation done by the Chinese Central Bank and their economic apparatus has done great harm to the United States, its import export bank, and its debt. Our Treasury and Central Bank have created an artificial deficit while the actual numbers calculate to a surplus. Given the Chinese manipulation of currency, the United States has started taking the Chinese to task over human rights. There have issued several executive orders and their Congress has passed several laws in regards to human rights and economic relations vis-à-vis the US Trade Representative. Lastly, the United States and China have seen some positive economic relations through cooperation both nations have made great strides in the development of the Asian Development Bank, the African Development

24 http://asiasociety.org/new-york/events/us-china-economic-relations-next-decade
Bank, and the Inter-American Development Bank. Finally, this summer the Chinese government in consultation with the United States’ private equity companies as well as the G-20 have created a venture capital enterprise. Though the venture capital enterprise has government backing, the $30 billion USD will not be used in Hong Kong or the Republic of China. The most pressing international action taken that has affected the Chinese economy was the Paris climate deal of 2015. This deal ensured that factories in all of the major economic powers would be much more environmentally friendly costing a substantial amount more in regulatory fees. The climate deal is a perfect example for the Chinese government to befriend other nations and to achieve international goodwill for being more environmentally conscious and accepting a greater burden to save the planet. The 2015 Paris climate deal was the only climate change deal that has the United States and China agreeing to further regulate their manufacturing industries and Greenhouse gas emissions. The deal has since opened up major markets in South America and Europe for China to manufacture goods.

Discussion Questions:

1. How can China make sure that they use their economic clout to expand their markets?
2. How can the Chinese economy diversify under its current leadership?
3. What nations are the best contenders to expand the Chinese markets
4. How can the Chinese government leverage the BRIC nations to discredit the USA in the WTO?

---

27 http://www.uscc.gov
5. How can the Chinese further use monetary policy to gain ground in the economic stalemate against the USA?

Resources:

ww.imf.org
http://www.techinsider.io/giant-chinese-infrastructure-projects-that-are-reshaping-the-world-2016-6
http://www.wsj.com/articles/u-s-announces-trade-case-against-china-over-agriculture-products-1473783354
http://www.wsj.com/articles/u-s-announces-trade-case-against-china-over-agriculture-products-1473783354
http://asiasociety.org/new-york/events/us-china-economic-relations-next-decade
http://www.uscc.gov
THIS PAGE WAS INTENTIONALLY LEFT BLANK
China's skyrocketing economic growth over the past twenty-five years is a clear example of the impact of opening an economy to global markets. The People’s Republic’s shrewd and careful management of integration with the world economy has managed to transform the nation from an agrarian society to an industrial powerhouse with increased productivity and wages that have pushed it to be the world's second largest economy. In 1978, China was one of the poorest countries in the world. The real per capita GDP in China was only one-fortieth of the U.S. level and one-tenth the Brazilian level. Since then, China’s real per capita GDP has grown at an average rate exceeding 8 percent per year. This trend has become unsustainable so it is vital for China to plan ahead now that urbanization has been achieved and the simple benefits of being a producer economy have been exhausted. China cannot rely on previous growth models and it’s vital for this Cabinet to define what will drive the economy on the upcoming years.

**Historical Background:**

The 20 years following the founding of the People’s Republic of China were marked by substantial growths in per capita GDP growth as a consequence of the first 5 year plans. These were focused on the establishment of large scale capital-intensive Soviet-assisted projects increasing productivity and industrialization. These projects were negatively affected by the Great Leap Forward and unfortunate leadership decisions that led to expensive and less effective economic policy over the time from 1958 to 1962. Although the industrialization of China was successful, the price was very high. From there, Deng Xiaoping and other voices in the politburo

---

emphasized economic liberalization, which was again marred by the unfortunate party conflicts of the late 1960s and 1970s. Not until 1978 at the 11th Central Committee of the Communist Party that the country established a clear path towards economically sustainable growth by introducing local demand reforms for farmers as well as a shift from collective farming to household responsibility system. A year later the Law on Chinese Foreign Equity allowed foreign capital to enter China to boost regional economies but it took seven years for the government to ease pricing restrictions and allow the movement of profits out of China as well as the definition of wages. This boosted GDP from an annual average of 6% between 1953-1978 to 9.4% in 1978-2012 and also increased the pace of urbanization as workers were drawn from the countryside into higher-paying jobs in cities.29 This rise in productivity contributed an estimated 40% of GDP Growth. This market liberalization turned China to a major global exporter and allowed the reopening of the Shanghai stock exchange in 1990 and eventually it’s integration to the World Trade Organization (WTO).

Current Situation:

After the expansive gains of the 1990s and first decade of the 2000s, China was moored to the tides of the world economy. As the 2008 world economic slowdown affected global demand, the Chinese economy has slowed. GDP growth in 2015 of 7% has been the slowest expansion in two decades. This number may be the envy of most countries but it’s far from what China was used to and lower than the 8% that was expected to carry on up until 2017. This in part is explained by the law of large numbers, the bigger the base is the harder it becomes to keep growing at the same rate. Nevertheless, the future of China as a production-based economy is diminishing, working age population has peaked, investment seems to have topped out and China’s technological gap is narrower to other developed countries implying that growth will be lower as well. Total debt has risen to around 250% of GDP, 100 points up since 2008. This debt allowed us to push the economy through the financial crisis, however dangerous excess debt is to the future of the Chinese people. To add to the problem, most of the credit flowed to property developers who now sit in a large inventory of unsold homes. Usually overestimated economic growth trends are followed by a natural correction. The central bank has been adamant in the desire to ease monetary policy and change to fiscal rule affecting local government spending.30

---

30 http://www.economist.com/blogs/economist-explains/2015/03/economist-explains-8
Creditors and observers are asking for more transparency on behalf of Chinese Financial Institutions. The answer to this stagnating growth is a shift towards a service economy. Xi Jinping has emphasized this as part of the “new normal” which means less focus on growth and more on a faster movement from a reliance on producing products to consuming products. The Industry sector grew at an annual rate of just 6 per cent in the first three quarters of 2015, while services grew 8.4 percent.\(^{31}\) In order for this shift to work a fundamental indicator would be a fall in savings and investment countered by a rise in consumption. The statistics bureau chief, Wang Baoan, told a news conference that this year will see accelerated restructuring, with some older industries declining while new businesses are “vigorously developing, further stimulating the vitality of the market.”\(^{32}\) This shift would also improve the social safety net, favor household income, and expand private enterprises, especially small and midsized businesses. Consequences of this will include more productive workers and a greater efficiency on the part of the government. This will create better paid jobs and raise the share of national income in the hands of the consumers with a focus on citizen from cities.\(^{33}\)

This shift is necessary as investment is wasted and if not done it would create a fast rise of debt. Chinese household’s disposable income is estimated to be around 61% of GDP, not a significant rise from previous years and this added to the trend of savings of a third of the disposable income translate into a consumption of around 40% of GDP.

The policy behind the Yuan currency is relevant to the future of China’s economic well-being. The exchange rate between the United States Dollar, Euro, and other foreign

\(^{31}\)https://www.ft.com/content/564c7490-bb8d-11e5-b151-8e15c9a029fb
\(^{32}\)http://www.wsj.com/articles/as-growth-slow-china-highlights-transition-from-manufacturing-to-service-14532217
\(^{33}\)http://www.mckinsey.com/global-themes/asia-pacific/whats-next-for-china
currencies has been traditionally controlled by the Chinese Central Bank, a vital organ of this body. This policy was effective because it allowed the Politburo to keep the Chinese economy outside the control of foreign economic actors. It also allowed China to reap greater rewards from exports, as selling goods for Dollars or Euros would result in a larger number of Yuan. Last year, as a result of stable growth by the Chinese economy, and in an effort to gain reserve currency status, an indicator of power and importance in the world economy, the Chinese Central Bank allowed the value of the Yuan to be set by other currencies, referred to as a “basket.”34 The result of this market-control was unfortunate, as the Yuan’s value began to drop precipitously and was the victim of foreign short-sellers and other currency speculation. In an effort to stop foreign investment from leaving the country, the Central Bank took control of the currency again and has continued to guide the course of the economy to strengthen exports until the economy is a state to support a strong consumer-focused Yuan.35

**Hong Kong Dilemma:**

Known as the “Pearl of the Orient” Hong Kong is a city that has long set itself apart from the rest of Asia. One of the world’s largest financial centers its importance to the global markets are a key entrance for China for access. With the introduction of the “One Country Two Systems” China has intended to benefit from Hong Kong’s global position. However, this ideology has met resistance from some local citizens who have even dared to take to the streets and protest the Beijing government. This cabinet can’t allow such dissent from the locals and must let the world know that China can handle its internal affairs. However, this actions must be

done carefully due to Hong Kong value as a faucet of foreign investment and the value of its trade ports.

Following the First Opium War, on August 29 1882 the Treaty of Nanking was signed between the Chinese Quing Dynasty and the United Kingdom. This resulted in the cession of Hong Kong Island to the U.K. in order to have a port for the unloading of British goods and a quick access to the Chinese markets. Hong Kong was the base of British trade in China for the remainder of the 19th Century and early 20th century, until December 1941. In the hours after the Pearl Harbor bombing, Japanese forces attacked the British Crown colony. The Hong Kong garrison made up of a small force were vastly outnumbered and lost the Island by December’s end. Local population dropped from 1.6 Million in 1941 to 650,000 by the war’s end. In 1946 the British re-establish their government, but there was a large influx of former residents in addition to refugees fleeing the dangerous nationalist armies as they were defeated by revolutionary forces in China.

In the following years the threat of the People’s Republic taking the island by force grew and the British Government bolstered the city as an outpost for trade within Asia. Massive immigration forced the local government to promote light industries in order to promote employment and benefit from the cheap labor. Shanghai capitalists, scared by the worker’s revolution, moved to Hong Kong to hide from justice, and by 1960s it was the export center of manufactured products in Asia. It became the production base of many overseas brands and products as they focused on textile, garments, plastics, watches and electronics.
As of 1982 Britain and China started diplomatic talks on what would be the future of Hong Kong and resulted in the 1984 Joint Declaration that established that by 10 years’ time Hong Kong would revert to Chinese control. Hong Kong would become a special administrative region of China and would maintain its capitalist system and partially democratic political system for 50 more years. In the coming years British governments would set the basis for the transfer of power and the establishment of voting procedures for the election of governments. Chris Patten, the last British Governor of Hong Kong angered Beijing because of the democratic reforms of local institutions aimed at broadening the voting base in elections and respond with the threat to tear up all contracts and overturn reforms once it takes control. In 1992 the Hong Kong market crashes as bear markets hit all of Asia and in 1994, the Legislature finally passed a reduced version of Patten’s reform package to widen the franchise but far from universal suffrage. The following year elections are held for new Legislative Council.

After many years of talks in 1997 Hong Kong was handed back to Chinese authorities and Tung Chee-Hwa, a Shanghaiing with no political experience is chosen to preside over the new special administrative region. In the upcoming years as locals adjust to life under the new regime, they are constantly finding new complaints against the efforts of the PRC to govern them. The new government passed an anti-subversion law known as Article 23 that would allow banning of organizations and freedom of police to enter residential buildings and arrest people who pose a danger to the Chinese state. Over half a million people took to streets to protest the new law a mere day after a visit by Prime Minister Wen Jiabao. The protesters managed to shelf the bill indefinitely, as the risk of unrest became high enough to warrant it. In April 2004 China ruled that any changes to election laws would be under a veto power of Beijing, including direct
elections for the territories chief executive. 200,000 people took to the streets due to anger at the right of the Chinese state to control its sovereign territory, and the United Kingdom, predictably, accused China of interfering with the constitutional process that was agreed upon before the handover. Tension continued until 2006 when Chee-Hwa resigns and is replaced by Donald Tsang, who attempts to change electoral process without introducing universal suffrage, as far as he thought Beijing would allow, but is blocked by Pro-Democracy Legislators arguing it doesn’t go far enough. The same Pro-Democracy wing of the Parliaments make an unprecedented visit to the Mainland to subvert the rest of the Chinese people on the fate of the island. Eleven members of these twenty-five members were banned from the Mainland for sixteen years, a light and benevolent punishment.

By the 10th anniversary of the handover, Tsang was appointed for a new five-year term and announce that Beijing has allowed to choose their own leader and Legislature but not until 2017 and 2020 respectively. Pro-Democracy locals were disappointed by the timetable but manage to secure more than a third of available seats in legislative elections, enough to veto future bills. Local MPs kept pressuring authorities to grant the territory full democracy and in 2012. Tsang was found to be disobeying his superiors and was corrupt, as investigations later found his links with wealthy Chinese Businessmen. Leung Chun-Ying was then introduced and confronted the Pro-Democracy parties within the Legislative Council. The illegal and unofficial referendum found that the Hong Kong public desired a say in the short-list of candidates for future elections of the territory’s chief executive. More than 90% of the 800,000 vote “for.”

Tensions erupted in 2014 as tens of thousands of protesters took to the streets as Chinese Government ruled out a fully democratic election for the Hong Kong leader in 2017 by claiming
only Beijing approved candidates would be allowed to run. Demonstrators occupy the cities arteries such as Central, Admiralty and Mong Kok for weeks in protest and form what would be known as the “Occupy Central” or “Umbrella Revolution” movement growing its number closer to 100,000. Beijing and loyal local officials react to this public demonstration by dangerous subversives by tearing down the Mongkok protest camp and leaving a few hundred protesters at the campsites at Admiralty and Causeway Bay.

The Chinese government will not back down as tensions rise in Hong Kong. It has been the bridge between China and the world for many years, conveying trade and investment flows and its financial importance is indispensable to China. Since 2012, Chinese companies have raised 43 billion dollars in initial public offerings vs. 25 billion dollars on mainland exchanges. Hong Kong’s vitally important as a prime source for bond and loan financing. It offers foreign companies a stable investment environment, transparent justice courts and for years has been a testing ground for financial reforms.

The run up to the upcoming September 4 election for Legislative Council has been plagued by tension and laser focus on behalf of both Hong Kong and Beijing. A fresh batch of candidates born out of the Umbrella Movement in 2014 are attempting to bring to the lawmaking body their desires for emancipation from Beijing’s increasing control. These candidates are fueled by young people rejecting the one country, two systems principle. Not even their paralysis of the cities arteries in 2014 managed to acquire concessions from Beijing on the election of the Chief Executive, as the Chinese Government does not negotiate with subversive elements, it destroys them. These new brand of political members are threatening the local Legislative

---

Balance. They are shifting the local political from a two-way contest between the pro-establishment camp and the pan-democratic camp, who both support some version of the “one country ideology” and to a certain point, patriotic to the mainland to a 3-way system with separatism a true force to be taken into consideration. This is a double edged sword for the Chinese involvement in Hong Kong. Internal strife among the pan-democratic and separatists offer a method for undermining their power and will inevitably weaken the chances of individual candidates to take on pro-establishment opposition. Regardless of the government unpopularity, it is an influential agent on local elections. After the 2014 attack by protesters, the Government took positive steps to remove anti-government opinions from Hong Kong educational institutions, banning separatists and other subversives from holding professor posts. The success has been palpable, as about 17 percent of respondents in a recent poll by Chinese University of Hong Kong supported the idea of independence— and in the 15-24 age group, the figure was nearly 40 percent.

All discussions of independence are a looming threat but lack real possibilities. Hong Kong depends on China for water supply, and there are enough military units based out of Hong Kong and its neighboring territories to keep any separatist movements from truly rising against the Government. Nevertheless, the discontent of the population threatens the full integration of Hong Kong into mainland China. These secessionist feelings shown by the locals must be dealt swiftly and let them know that regardless of their past, they are a part of China and its future will be integrated to China’s long term plan.

Discussion Questions

37 http://www.nytimes.com/2016/08/16/opinion/the-umbrella-movement-fights-back.html?_r=0
1. Up to what point must we push reforms in order to accelerate the shift towards a service economy?

2. How much of our short term growth are we willing to give up in order to secure the long term?

3. Must we crackdown on pro-independence parties in Hong Kong in order to prevent major revolt?

4. How can we reach out to pan-democracy advocates in Hong Kong in order to leverage against secession political figures?

**Key Terms:**

One Country, Two Systems- “One Country, Two Systems” is a fundamental state policy formulated by Deng Xiaoping to accomplish the peaceful reunification of China by resolving the sovereignty questions of Hong Kong, Macao and Taiwan arising from a complicated historical background.  

Household responsibility system- Launched in the early 1980s, the household responsibility system was an agriculture production system, which allowed households to contract land, machinery and other facilities from collective organizations. The aim was to preserve basic unified management of the collective economy, while contracting out land and other goods to households. Households could make operating decisions independently within the limits set by the contract agreement, and could freely dispose of surplus production over and above national and collective quotas.

---

39 http://www.china.org.cn/features/60years/2009-09/16/content_18534697.htm
Resources:

http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.26.4.103
http://www.economist.com/blogs/economist-explains/2015/03/economist-explains-8
http://www.hkmemory.hk/collections/postwar_industries/industrialization_in_postwar_hong_kong/index.html?f=search&t=search_ddatas.jsp&path=channelid=230719%7Ckeyword=#&panel1-1
http://www.nytimes.com/2016/08/16/opinion/the-umbrella-movement-fights-back.html?_r=0
http://www.china.org.cn/features/60years/2009-09/16/content_18534697.htm
http://www.people.hbs.edu/dcomin/def.pdf