

How is China manufacturing 2015 going ?

China's plans to upgrade its industry have sent shockwaves through the world. Will they come to pass?

In August, Australia banned the Chinese telecoms giant Huawei from rolling out the national 5G network, ruling that it was "likely to be subject to extrajudicial directions from a foreign government that conflict with Australian law".

The inference was clear: Australia did not wish to hand the keys to its digital future to companies that could be compromised by foreign intelligence agents. It came after the Chinese government introduced a new intelligence law in 2017, demanding that "any organisation or citizen shall support, assist and co-operate with state intelligence work".

5G is seen as the rails that will power a future of driverless cars and smart cities. It is one of the technologies central to China's plans to digitise and upgrade its manufacturing base, an initiative known as Made in China 2025.

Australia's action will also affect Chinese smartphone maker ZTE, which will be banned from selling mobile devices through Australian carriers. It's a new nadir in a horrendous period for ZTE, which was paralysed by US sanctions earlier this year for contravening US embargoes on trading with Iran and North Korea.

Taken in the wider context, these moves are symbolic of growing pushback against a number of elements in China's rise. In both cases, there are fears that Chinese-made electronics can be effectively used for espionage purposes.

"You have this existential crisis, in that China Inc. has its fingers in everybody's business. They can shut you down, strongarm you, there's no data privacy. You have to hand it over to them," says Alex Capri, visiting senior fellow to the National University of Singapore's business school.

Another cornerstone of Beijing's masterplan, the Belt and Road Initiative (BRI), has come in for increasing criticism due to the level of indebtedness it forces on the recipients of massive infrastructure loans.

Meanwhile, at the epicentre of all of this is a trade war between China and the United States. The US has placed a series of tariffs on Chinese imports in response to government subsidies. China has for years flooded markets with cheap goods, ranging from steel to solar panels to sweatshirts. But tellingly, 80% of the goods targeted by the US to date can be connected to Made in China 2025, including radio and radar equipment, lasers and imaging and navigational equipment.

Manufacturers around the world are fearful that China will replicate the model used in its initial industrial revolution on this high-tech version: give huge loans and grants to manufacturers who make products much cheaper than anywhere else and then sell them into western markets, undercutting the competition. The early signs are not good.

“Overcapacity has already emerged at the low end of China’s industrial robotics industry with duplicative developments of related industrial parks across the country and subsidies that favour products from a given city or province. Overcapacity at the low end of some segments of the semiconductor industry as well as new energy vehicles are also definite possibilities,” Lance Noble, senior analyst at Gavekal Dragonomics, a Hong Kong-based financial research organisation, tells **GTR**.

Will China pay heed to these fears? In recent months, Made in China 2025, and even BRI, have appeared less frequently in Chinese government-controlled media. Reporters, bankers, insurers and contractors jokingly refer to “Belt and Road fatigue” after years of being bombarded with propaganda promoting the initiative.

For Made in China 2025, China may feel that its telegraphing of such controversial intentions – to install global champions in high-tech industries – is spooking the rest of the world, and has decided to downplay its significance. This does not, however, mean that it is ready to abandon the plans – they are too important to China’s economy.

Ain’t no stopping us now

“I think they’re definitely going to go ahead,” says Carlos Casanova, Asia Pacific economist at insurer Coface. “Made in China tries to bring manufacturing away from low value to high value in order to ensure China is able to transition from industry to consumption-led growth, but also that enough value-add stays in the country. It facilitates a transition into the higher income bracket, so it avoids the middle income trap. They don’t want to see a ‘Japanisation’ of the economy, where a large proportion of the Chinese population remains middle income.”

Casanova is referring to Japan’s “lost decade” – a misnomer, given that it started in 1989 and continues today – in which the economy has stagnated, real wages have fallen and demographic shifts have hollowed out the workforce. China’s economy has slowed. It is heavily over-leveraged and it has an ageing population. There are signs that Japanisation is already underway, with Made in China 2025 a means of halting – or at least slowing – this.

“It’s a top-down initiative that aims to provide government support both in the form of protectionism but also subsidies, to ensure certain segments of the economy can thrive and become global leaders. What worries countries like the US and EU is that there are targets for global market share in certain sectors. That’s a direct economic threat to some of the European and US companies that are currently leading in these spaces,” Casanova says.

Western companies only have to look at the strides made by Huawei, which has already leapfrogged US and EU telecoms providers in emerging markets such as Latin America and Southeast Asia. This is a scenario they’re keen to avoid in sectors such as artificial intelligence, semiconductors, certain areas of automotive, chemicals and medicines – those which have very high value-added elements to their manufacturing.

What's the big idea?

Made in China 2025 targets 10 sectors in which it wants to become global leaders by the stated date. The industries selected are: IT, robotics, aerospace, ocean engineering and high-tech ships, railway equipment, energy-saving vehicles, power equipment (such as smart grid technology), new materials, medicine and medical devices and agricultural machinery. There are separate plans to turn China into the world's hub for artificial intelligence.

Some of the plans make for interesting reading. In Shenzhen, over the border with Hong Kong, Tetra Architects & Planners have planned the world's first drone highway. A 12-lane existing highway would be replaced with a 30km, four-lane facility for driverless vehicles and drones, as part of the Shenzhen Organic City. The designs resemble an environmentalist cut of Blade Runner, and such a reality is surely years in the future.

Next year, however, Shenzhen will launch its first "smart road", equipped with smart traffic lights, maps and lampposts mounted with security cameras designed to catch people breaking the law.

Sector-wise, China wants to dominate 80% of the global renewable energy equipment market by 2025. It wants to produce 95% of its own farming equipment by that year, and make 80% of the world's smart vehicles. Train manufacturers are being mandated to make 40% of their sales abroad and next-generation shipbuilders to own 80% of the global market, all by the 2025 deadline.

It's little wonder foreign high-tech manufacturers in the world are concerned. Neighbouring Taiwan and South Korea could be among the worst affected, since they are among the world's premier semiconductor manufacturers. Conversely, other countries in the region could benefit.

"In Asia, South Korea faces the most potential challenges from a moderately successful effort to upgrade China's industrial base. As China continues to move up the value chain, countries like Vietnam are well positioned to capture lower-end manufacturing activity that is no longer economical in China," Noble says.

Loosening the belt?

A gripe among trade financiers is that BRI has been handled almost exclusively internally. Chinese money has built projects, to Chinese design, employing Chinese labour, contracts and insurance. What was envisioned as a great opportunity for project involvement has turned into a source of frustration.

There have been some signs that China welcomes international capital for Made in China 2025. Indeed, foreign financiers have been invited to the second round of fundraising for the main semiconductor fund. Banks are eyeing the opportunity.

"I don't see much change in how we finance, but maybe the industries we finance. Industries that are high in the value chain, where new technology is more relevant, could become pillars of the Chinese economy, while lower-end industries could move out of China," Aziz Parvez, head of trade and supply chain finance at Bank of America Merrill Lynch, tells **GTR**.

Banks may hope that BRI isn't the funding model used for China's industrial upgrade. But given the level of scrutiny and ire this initiative has attracted from the very top of the US government, they should tread carefully should they choose to be involved.

"I don't think that the leading role of China's policy banks in making loans for BRI-related projects tells us very much about opportunities for foreign funds to play a role in Made in China 2025," says Noble.

"However," he adds, "choosing to do so may not win you many friends in Washington."

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