

# China 2023: The Reopening

## Implications for the South Caucasus and Central Asia

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### *Topics of Discussion*

*China's economic growth. Global reliance on China. U.S.-China relations. Sustainability. Implications for South Caucasus and Central Asia.*

This document summarizes a roundtable discussion with Yermolai Solzhenitsyn, a Shanghai-based senior partner at McKinsey & Company who specializes in the metals, mining, and energy industry. The discussion took place on 23 February 2023 at ADA University under the auspices of the Institute for Development and Diplomacy (IDD), in partnership with PASHA Holding, and hosted by Prof. Damjan Krnjević Mišković, IDD's Director for Policy Research, Analysis, and Publications. More than 40 high-level individuals from government, industry, and think tanks participated in this off-the-record, invitation-only event.

### *The Reopening of China*

The world has long been aware of China's potential, yet this awareness has only started being utilized in a practical way for the past 15-20 years. For example, in 2020, China's GDP was 18 percent, making it the second highest in the world, behind that of the U.S. at 25 percent and similar to that of the EU, which is also at 18 percent. Moreover, China has a more-privately-owned economy than other countries, such as Russia, with the private sector accounting for about 50 percent of the total GDP.

In the years preceding the onset of the COVID-19 pandemic, China was averaging around 7 percent growth, with productivity increasing as well. China's 14<sup>th</sup> Five Year Plan

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coincided with the onset of the pandemic, and whilst many countries chose to allocate money to support families and middle-sized businesses during this time, China chose to invest in improving its communications and transport industries, specifically AI, 5G, Big Data, and electric vehicle charging points. Because of this, Chinese companies are gaining more experience and expertise in making these technologies and products. This enables them to have the capacity and skills to continue doing it in countries that do not yet have this technology, since domestic growth in China is slowing down. Similarly, according to predictions, by 2025 5G connections in China will reach 822 million and, in the U.S., 5G will reach 202 million. When adjusted to reflect the countries' respective populations, this averages out to about the same reach and penetration; however, a higher demand due to China's larger population means that it will become more adept at implementing 5G than the United States. Moreover, increased urbanization is taking place in China, with current figures at around 65 percent and expected to reach 70 percent by 2030. Evidence was presented indicating that the benefits of this include reduced transport and energy costs, which in turn is likely to further China's economic growth.

Income growth is lifting households in China into the 'mass affluent' class or above: as any country gets richer, it is inevitable that the margin of growth will slow. Moreover, China already has a rapidly aging population, and data shows that as people become richer, they tend to have less children, which will further contribute to this. China could end up in a situation where there are lots of elderly people to care for and fewer people in the workforce.

Moreover, in the Chinese economy, reliance on consumption has increased. Despite this, household consumption in China remains at a relatively low level compared with other countries. Although the market still has expansion potential, it remains to be seen whether consumption will, in fact, grow. It is estimated that consumption in China will reach \$12 trillion by 2030, compared to the current \$6 trillion. Despite this, consumer confidence in China has dipped due to the implementation of zero-Covid policies, which was reversed only recently. During the foregoing period, people in China tended to save money instead of spending. Early 2023 indicators show that the mood is now getting better, but people are still inclined to save rather than spend.

Projections regarding the replacement of repetitive task workers with optimization and automatization were also discussed, with 220 million people in China estimated to require a career change due to such and similar trends. If China cannot figure out how to overcome such challenges through programs like the retraining of workers, then these will not be able to be solved globally. This is because China accounts for 35 percent of the global total of people requiring a career change. A similar issue surrounds climate change. As China accounts for 27 percent of global carbon emissions, the rest of the world will not be able to become carbon neutral without China's participation.

Emphasis was also placed on figures that show how much other economies depend on China and vice versa in areas like trade, demand, technology, capital,

and investment opportunities. The data presented indicates that, whilst China is becoming more self-sufficient, the world, in parallel, is becoming more dependent on China. Despite China's growth slowdown, the country is projected to account for 25 percent of the world's growth, and, in some sectors, 30-40 percent of global demand. Interestingly, 'China is becoming more Chinese,' with trends showing that Chinese students are now more attracted to working for leading Chinese companies rather than international companies upon university graduation. Similarly, local brands in China are growing stronger compared to multinational companies (MNCs).

Despite this, MNCs are still attracted to China as they can continue to capitalize on the economic growth of the Chinese market. Moreover, MNCs are starting to form diverse partnerships with China to accelerate growth and access local innovation. Currently, there are more patents filed in China than in the U.S. Similarly, global technology companies are starting to learn and mimic technological innovations in China, and more can be expected. For example, YouTube has started mimicking TikTok in its new YouTube Shorts feature. Similarly, R&D expenditure in China is now second only to that of the United States. Despite this, China remains an importer of intellectual property and has not yet become independent in this critically important field.

China is the core manufacturer and demand center for sustainability solutions for the planet. Globally, China has an 85 percent share in solar panel manufacturing and a 36 percent share of solar demand, accounting for 56 percent of wind power installations and 70 percent of lithium-ion battery production. Moreover, as 14 percent of all new vehicles in 2022 were electric, the importance of China, which produces 60 percent of global electric vehicles and accounts for 50 percent of sales, cannot be overstated. Although concern for the environment is an important factor, China is also interested in promoting sustainability to increase its self-sufficiency. As China is dependent on imports of natural gas and crude oil, sustainable solutions are important to increase affordable energy security.

Another aspect of the discussion centered on the effective supply and utilization of China's processing capacity, which is an important part of feeding the global demand for core metals. These metals are sourced from many other countries around the world, but a large proportion are then processed within China. On a global scale, the stability of this situation is troubling: if a factory in China was to be suspended or terminated, this could have drastic consequences for global metal supply.

Finally, despite increased tensions between China and the U.S., trade links continue to increase. Whilst China continues to export to the U.S. at a rapid rate, U.S. exports into China are more inconsistent, although they generally show a very slow upward trend.

## *Implications for the South Caucasus and Central Asia*

Investments made in the context of the China-led Belt and Road Initiative have slowed in the past few years. Although some infrastructure was built along the route, construction has halted as demand has been reduced. Due to this, the South Caucasus and Central Asia (Eurasia or the Silk Road region), specifically Azerbaijan, needs to find alternative ways to benefit from the reopening up of China after COVID-19. The conflict over Ukraine, and the imposition of a West-led sanctions regime against Russia and the ongoing ones against Iran has placed a spotlight on the BRI's middle land route: transport and all other forms of connectivity from China to Europe now need to follow the Middle Corridor path, which can greatly benefit the Silk Road region.

Due to China's experience and expertise in a variety of industries, the presence of Chinese companies and production plants in other countries can jump start sectors of the economy, if properly managed. The Silk Road region could therefore benefit from Chinese companies operating within its geography. Azerbaijani companies could attract Chinese capital and industry by travelling to China to form connections and networks with Chinese companies. Alternatively, Azerbaijan could encourage Chinese companies to visit the country through hosting annual corporate conferences and other similar forums. None of these approaches have been pursued at optimal levels.

One specific way that the Silk Road region could benefit from China's growth is through utilizing the provisions of the 2022 U.S. Inflation Reduction Act. In part, this legislation allows for tax credits for owners of electric vehicles, which requires the production of batteries. However, exemptions were put in place for batteries that were not sourced from 'free trade' countries—of which China is not included. This provides a big opportunity for countries such as Azerbaijan, as currently the U.S. penalty is based on the geographical location of the company and not the nationality of ownership. If Chinese companies create production and distribution plants in Azerbaijan, for example, this would enable them to potentially sell tax credit permissible batteries to the U.S. market.

Moreover, as one of Azerbaijan's main priorities is the transition to green energy, the utilization of China's experience and expertise in this field can be of use. This also applies to other areas, such as 5G advancement and R&D growth and cooperation. A potential challenge of attracting Chinese companies into Azerbaijan could be a large investment for only a small share of profits. However, this could be offset by the potential to learn from the company and then apply the technology in Azerbaijan.

Moreover, as the end of the era of markets, competition, and trade is coming to an end, the move towards diversification will mean that partnerships will become key in moving forward.