MERICS CHINA UPDATE

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METRIX

71,55
Billion dollars

Kweichow Moutai, the top-maker of China's distilled grain liquor baijiu, is now the world's most valuable liquor company. Its market capitalization of 71.55 billion USD is now slightly higher than that of Johnnie Walker whiskey maker Diageo.

TOPIC OF THE WEEK: TRUMP AND XI – FIRST ENCOUNTER

Xi and Trump discuss rising tensions with North Korea

Source: World Economic Forum / Valerie Di Domenico and actionsports via 123RF

A few days after their first summit meeting in Florida, China's President Xi Jinping and U.S. President Donald Trump have discussed the rising tensions with North Korea over the phone. According to the party-state Xinhua news agency, Xi called for a peaceful resolution of the conflict.

The Trump administration is pushing for a more confrontational approach towards North Korea, and Trump announced in a Twitter message that he needed China's help in reining in its neighbor. "North Korea is looking for trouble. If China decides to help, that would be great. If not, we will solve the problem without them! U.S.A." He also declared that he had promised Xi a better trade deal in return for support on North Korea.

The two leaders had avoided discussing the issue in public during their summit in Mar-a-Lago as both countries pursue very different strategies on North Korea. The meeting had taken place in the shadow of the U.S. bombardment of a Syrian military airport in retaliation for the Assad regime's use of chemical weapons against civilians. The attack took place while Xi and Trump were having dinner.

Directly after Xi's visit, the U.S. Pacific Command dispatched a navy strike group led by aircraft carrier "USS Carl Vinson" to the Korean peninsula in a demonstration of military force to Pyongyang. The EU expanded its sanctions against North Korea in early April.

China and South Korea agreed to impose tighter sanctions against North Korea, should Pyongyang conduct further tests of nuclear or long-range missiles. China has started sending back North Korean coal imports, and editorials in Chinese party-state media openly threatened to cut off Pyongyang's oil supply. It is however unclear how much influence China still has on its ally.

Trump calls off U.S.-China trade war – at least for now

U.S. President Donald Trump has backed away from his campaign vow to punish China for distorting the bilateral trade balance by manipulating its currency. "They are not currency manipulators," he told the Wall Street Journal. He also said that he was willing to accept a larger U.S. deficit in exchange for China's help on solving the conflict with North Korea.

The Treasury Department confirmed that its upcoming semi-annual report on currency practices would not name China a manipulator – a label that could trigger trade sanctions against China.

The conciliatory tone vis-à-vis Beijing follows the meeting between Trump and Xi Jinping in Florida, during which both sides gave themselves 100 days to reduce their trade frictions. The deadline for the "100-day action plan" will nearly coincide with the publication of a report by the U.S. Department of Commerce identifying trade abuses. It remains to be seen what role China will play in this report.

Both sides also agreed on Xi's proposal to set up four new dialogue mechanisms on issues ranging from diplomacy to cybersecurity, which are supposed to replace the Strategic and Economic Dialogue set up under the Obama administration. The meeting in Mar-a-Lago was the first opportunity for the two leaders to get to know one another. Trump agreed to a return visit to China in 2017.

Rather than risking a trade war with the world's second largest economy, U.S. administration officials are now trying to talk up possible Chinese concessions on market access for U.S. beef imports and U.S. service-sector investments. These concessions would be relatively easy to make since China had already indicated movement on both issues during the years of the Obama administration. Some observers also expect announcements of Chinese purchases in the U.S. in the coming months, e.g. of airplanes or agricultural goods. Critics warn that steps like these won't be enough to tilt the trade balance between the two countries.

CHINA AND THE WORLD

HNA foreign acquisition spree continues despite tighter regulations

As China's outbound direct investment has slowed down in light of tighter regulations at home, one company seems undeterred and continues its global buying spree. The HNA Group has struck a number of high-profile deals since January, ranging from aviation and finance to prime real estate in New York. The Financial Times estimates that the group has spent over 40 billion USD on overseas acquisitions over the past two years.

In April, the Hainan-based private conglomerate announced a one billion USD deal for Singapore-based logistics service provider CWT. In Germany, the owner of Hainan Airlines is in the process of purchasing the regional Hahn Airport. It has branched out into the financial sector by acquiring a 4.8 percent share in Deutsche Bank, by buying a share in Old Mutual's fund management unit in the U.S., and by bidding for German shipping financier HSH Nordbank. According to Reuters, the group is also in negotiations to acquire a controlling stake in the owner of the publisher of Forbes magazine.

Observers have been baffled that HNA's overseas investment activities seem unchanged despite stricter capital controls in China and announcements of more government scrutiny for investments abroad. There has been speculation that the political connections of HNA's top management may have allowed the company to keep up its activities. Others note that the company has adjusted to the new environment, for example by keeping most of its deals under 1 billion USD, the threshold for increased scrutiny of outbound deals.

The rapid pace of HNA's foreign acquisitions along with the company's rising debt levels reinforces concerns about financial leverage of Chinese companies and about the risks to Chinese banks financing investments abroad.

Report accuses China of global cyber-attacks on cloud servers

A China-based hacking operation is reported to have attacked IT service providers and cloud service providers around the world to spy on their clients ranging from political organizations to the corporate sector. The report, which was released in April by PriceWaterhouseCoopers and BAE Systems, describes the systematic breach of data security as "one of the largest ever sustained global cyber espionage campaigns." According to the Telegraph, the UK's National Cyber Security Centre also contributed to the research.

The report dubs the activities "Operation Cloud Hopper" and links them to a group known in the security community as ATP10, which is assessed as "highly likely to be a China-based threat actor." The intrusions coincide with the Chinese workday, which includes a two-hour lunch break. The hackers use a mix of hacking tools and open-source malware to attack their targets.

The targeted service providers were in the U.S., Canada, Brazil, the UK, France, Switzerland, Norway, Sweden, Finland, Australia, South Africa, South Korea, India, Thailand, and Japan. In a separate campaign, the group is said to have launched direct attacks on political and business organizations in Japan.

News in brief

- ChemChina-Syngenta deal approved: anti-trust authorities in EU and U.S. allow purchase of Swiss pesticide maker

- Siemens employee arrested for espionage: man accused of selling company secrets to Chinese competitor.
- China visit of Norwegian PM seals reconciliation: countries restore ties after fallout over Nobel Peace Prize for Liu Xiaobo, discuss cooperation in Arctic
- Volkswagen and Chinese Mobvoi cooperate on smart cars: joint venture will tap Beijing start-up's voice recognition technology
- China opens delayed Myanmar oil pipeline: faster supplies from Middle East and Africa

POLITICS, SOCIETY AND MEDIA

New Beijing regulation offers rewards for reporting "foreign spies"

The city of Beijing encourages its citizens to report foreigners for suspicious behavior that could indicate that they are spies. A regulation issued on April 10 (公民举报间谍行为线索奖励办法) offers rewards between 10,000 and 500,000 CNY for leads that help authorities to detect "espionage." Citizens can report "suspicious activity" via a phone hotline, by postal mail or in person.

The new regulation is another sign of the growing atmosphere of suspicion in China. It will likely have at least some impact on how Chinese and foreigners in Beijing interact in their daily lives.

Since Xi Jinping came to power, the CCP has stepped up its rhetoric against "foreign infiltration," "espionage," and "hostile forces" undermining Chinese national security. As per the new National Security Law passed on July 1, 2015, a "National Security Day" intended to educate the Chinese public is to be held on April 15 each year. In April 2016, Beijing authorities published a cartoon series to warn government employees of foreign spies.

Mobilizing the population in the wake of large-scale political events such as the upcoming Party Congress this fall is a usual practice. This is the first time, however, that formal measures for reporting on espionage conduct are published. The Beijing Daily published the regulations along with an explanatory article, which defined the suspicious activities as "political infiltration" (政治渗透), "splitting [the country] and overturning [the government]" (分裂颠覆) or "gathering and stealing information" (情报窃密). The article also contained information on source protection and legal consequences of reporting fake information or rumors.

Chinese "House of Cards": anti-corruption campaign becomes TV hit

The TV series "In the Name of the People" (人民的名义) is being hyped as the Chinese answer to the popular U.S. series "House of Cards." The new show, which started to air on Hunan TV on March 28, attracted 170 million viewers within its first week. The main difference between to the U.S. version is that the Chinese drama contains a moral message: it highlights the necessity and the success of the Xi Jinping administration's fight against corruption.

In 55 episodes, the show by famous Chinese series director Li Lu revolves around the juicy details of fictional corruption cases: a government official is caught in bed with a blond mistress, a party cadre hides stacks of cash in his apartment. The party-state Xinhua News Agency praised the series as a "phenomenal screen work." Viewers appreciated the authentic representation of the characters.

"In the Name of the People" has broken with a previous ban on showing corruption on television and depicting high-ranking cadres as villains. Instead, it seems to enjoy highest level support: the Supreme People's Procuratorate, the Propaganda Department of Jiangsu province and the Central Military Commission all contributed to the show's generous budget of 120 million CNY.

According to Xinhua, the aim of the series is to educate the public on the dangers of corruption and to prevent future cases. The decision to lift the taboo seems to indicate that the CCP has confidence in the popularity of its campaign and wants to use the series as a way to mobilize support for it in the future.

Hospital reform in Beijing: cheaper drugs, more expensive doctors' visits

Chinese physician engaged in consultation session. Source: imtmphoto via 123RF

In what could be the beginning of a nation-wide effort to bring down costs in China's public health system, the city of Beijing has launched a comprehensive reform of its 3,600 hospitals on April 1. According to the Municipal Commission for Health and Family Planning, the introduction of price controls will ensure that costs for prescription drugs will drop by 20 percent. At the same time, medical exams and procedures, as well as treatments with traditional Chinese medicine, will become more expensive.

The non-transparent cost structure of many public hospitals, many of which relied on mark ups on drug prices and overprescriptions to finance their budgets, have caused public discontent for years. The new rules are supposed to halt this abuse. The city also set up a website on which patients can search information on prices, effects and authenticity of medications.

China's hospitals, like many hospitals worldwide, struggle to generate profits while guaranteeing basic access to health services. The pilot project in Beijing is expected to provide impulses for reforms on a national level, but technical difficulties could stand in the way of a broader reform. The sale of prescription drugs in Beijing will be handled by a specialized software in the future. But many clinics in rural areas lack the necessary IT to implement such a system.

News in brief

- Xinjiang passes law to curb "religious extremism": ban on range of religious acts and local customs
- Hong Kong Chief Executive-Elect in Zhongnanhai: CCP leadership gives full backing to Carrie Lam
- Anti-corruption agency continues hunt for "tigers": Xiang Chunbo, Chairman of China Insurance Regulatory Commission, accused of serious disciplinary violations
- Foreign NGO Law: 62 organizations have registered as of April 1, 170 applications still pending

ECONOMY, FINANCE AND TECHNOLOGY

State-owned enterprises look for strategic investors

China Unicom's parent China United Network Communications Group Communications Ltd is expected to be among the first batch of state-owned Chinese companies to participate in a mixed-ownership reform plan. In unconfirmed reports, China's major privately owned tech giants Alibaba, Tencent, and Baidu are named as possible strategic investors.

The mixed-ownership scheme is part of ongoing efforts to enhance the efficiency and profitability of China's state-owned enterprises (SOEs). The approach was first announced by the National Development and Reform Commission after the Central Economic Work Conference in December 2016. According to official documents, mixed-ownership aims at fostering market driven decision-making at SOEs by reducing the state's role from a manager to a stakeholder.

China Unicom is one of China's three largest mobile network providers. Its parent company was one of six companies selected to participate in pilot programs to introduce mixed-ownership of SOEs at the end of last year. The other companies in the group are China Southern Power Grid, Harbin Electric, China Nuclear Engineering Group, China Eastern Air and China State Shipbuilding. According to Chinese media reports, the government also plans to open the defense technology and oil exploration sectors to domestic private investment.

China's roughly 150,000 SOEs still dominate large parts of the economy, and previous reform efforts have yielded mixed results. They ranged from merging SOEs into even larger companies to limited liberalization measures in the telecommunications sector.

The new program may take these efforts a step further, but it also shows that SOEs will continue to play a vital role in China's economy. It remains to be seen how much managerial freedom the private investors will have under the mixed-ownership model. It will also be much more difficult to persuade private companies to invest in less attractive entities.

Xiongan New Area: Beijing's sustainable twin sister?

The Chinese leadership plans to build a new urban hub next to the nation's capital. On April 1, the Central Committee of the CCP announced the establishment of "Xiongan New Area" in Hebei province, about 100 kilometers southwest of Beijing.

The main purpose of the project is to relieve the capital of its congestion and pollution pressures. The idea to build a smart and sustainable new city just outside of Beijing is also fueled by the hope to create a new business and high-tech hub – similar to the way the Pudong New Area evolved into Shanghai's financial center. Chinese media have highlighted the project's potential opportunities for foreign investors.

The new urban area, which will straddle three counties in Hebei province, is meant to boost the integration of the regions of Beijing, Tianjin and Hebei. Xiongan New Area will eventually cover 2,000 square kilometers, nearly three times the size of New York City, and become the home of 11 million people.

In 2015, the Politburo issued an outline to clarify Beijing's role as the "center of politics, culture, international exchange and technological innovation." But the Economist speculates that many businesses and universities will likely be urged to move to Xiongan. Whether Xiongan can rise to the ranks of Shanghai or Shenzhen remains to be seen. China has experimented with building new mega-cities from scratch over the past decades, with mixed results. But President Xi Jinping's strong support for the project could help Xiongan become a success story.

China opens seven new free trade zones

China has opened seven additional free trade zones (FTZs) with the aim to boost regional development in several inland provinces. The new zones in Liaoning, Shaanxi, Sichuan, Hubei, Henan, Zhejiang, and Chongqing were inaugurated on April 1, bringing the total number of free trade zones to 11.

The new zones are tailored to bring trade and investment into the most promising sectors in these less developed parts of China. Zhejiang will focus on oil and gas trading, Henan on transportation and logistics, and Hubei on intelligent manufacturing. The zone in Liaoning is supposed to help with revitalizing state-owned industries in the northeast. Sichuan and Chongqing's task is to improve access to China's western provinces, and Shaanxi is set to play a role in developing China's Belt and Road Initiative in Central Asia.

The new free trade zones can bring a boost to these regions and potentially bring opportunities for foreign investors, although investment restrictions are likely to remain in place. The Chinese government will only selectively open sectors, in which foreign investment is seen as necessary to promote regional development. Based on the experiences with the existing zones in Shanghai, Fujian, Guangdong and Tianjin, there is little reason to expect that the new trade zones will lead to better market access for international companies overall. The government does reduce the number of industries with restrictions for foreign investment on paper (so-called negative lists) in FTZs, but in practice, sectors that are not on that list can still have industry-specific barriers.

News in brief

- Alibaba joins efforts to protect water resources: tech giant teams up with environmental organizations
- China becomes powerhouse for biotech drugs: global pharmaceutical companies cooperate with start-ups in China