MERICS CHINA UPDATE

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METRIX

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37 of China’s 90 pig breeds are threatened by extinction, according to the Chinese Ministry of Agriculture – alarming news at the beginning of the Year of the Pig. Western breeds have pushed indigenous ones out of the market, reports the South China Morning Post. Western pigs grow faster and can be slaughtered earlier. Their leaner meat also makes them more appealing to health-conscious consumers. The Chinese government tries to save the threatened breeds through designated breeding programs.

TOPIC OF THE WEEK: China and the Venezuela crisis

Venezuela's Guiado appeals to China to switch sides

Venezuela's self-declared interim president John Guaido has reached out to Beijing in his quest for international recognition. In a written interview with the South China Morning Post on February 1 he said that China would continue to play an important role in Venezuela's economic development under his leadership, and he assured Beijing that Chinese investments would be protected. China has been a key investor and financial supporter of the Maduro government, which Guaido is trying to end.

As a growing number of governments have recognized Guaido as the legitimate leader of Venezuela, China and Russia are supporting the status quo under Nicolás Maduro. China, however, has been less outspoken, suggesting that Beijing may be hedging for a change of government. On February 1, a Chinese foreign ministry spokesperson said that Beijing had been in contact with all sides in the Venezuelan crisis.

Guaido, President of the National Assembly, Venezuela's legislature, had called the elections that returned Maduro to power illegitimate and declared himself interim President of Venezuela on January 23. Despite mass protests against his government, Maduro has refused to step down. In the following days, the United States and most Latin American countries recognized Guaido as Venezuela's President, and several EU countries including Germany, France and the UK followed suite in early February.

China's cautious stance may signal that China is more concerned about its economic interests than about maintaining solidarity with the socialist regime of Maduro who took over after the death of his mentor Hugo Chavez in 2013. Over the past 10 years, China, attracted by Venezuela's rich natural resources, has invested heavily in projects in the country, many of which, however, were not completed, dotting the country with eerie abandoned construction sites.

But today it appears likely that Venezuela might default on a big portion of the more than 50 billion USD in outstanding Chinese loans. After profiting from the commodities boom of the early 2000s, Venezuela entered long years of economic crisis. The loans from China were partly to be paid back through oil shipments, but due to production problems Venezuela has not been able to fulfill its obligations, leading to a declining share of Chinese oil imports supplied by Venezuela (2017: 5%, 2018: 3.6%).

In the interview, Guiado said that Chinese projects in Venezuela were failing because of the Maduro government's corruption and "plundering of our state resources." His pledge to restore transparency also contained a warning note to Beijing when he vowed to review whether agreements with China had been signed in adherence to "due process."

MERICS analysis: MERICS Belt and Road Tracker.

CHINA AND THE WORLD

China criticizes US withdrawal from INF Treaty

China has protested the US withdrawal from the INF nuclear arms control treaty – the agreement between the United States and the Soviet Union that defused the missile crisis during the Cold War. "China opposes the US withdrawal and urges the US and Russia to properly deal with disputes through constructive dialogue," a Chinese foreign ministry spokesman said in a statement.

The US decision is ostensibly a reaction to treaty violations by Russia, but observers have suggested that the main motivation was to contest China's military expansion.

China, which is not bound by the treaty, has built up a massive arsenal of short- and intermediate-range land-based missiles, which would allow it to challenge the United States in the Western Pacific. To counter this, the United States would need to deploy ground-based intermediate-range missiles in the region, which are cheaper than air- and sea-based platforms.

On January 1, US President Donald Trump had announced that the United States would leave the Intermediate-Range Nuclear Forces (INF) Treaty within six months unless Russia proved its full compliance. He declared that the United States was withdrawing because of Russia' violations of the treaty since 2014.

The INF Treaty was signed in 1987 between the United States and the Soviet Union, and it banned all ground-based missiles, as well as their launchers, with ranges of 500 to 5,500 kilometers. The treaty did not cover air- or sea-launched missiles.

The US withdrawal from the treaty could trigger an arms race, as China is likely to respond to an increase in US deployments of missiles to the region. There is also the issue of which country may host these US intermediate-range missiles. While the US military base in Guam would be an obvious choice, Guam is a very small island, which would limit the mobility of missiles and therefore make them easy targets in case of conflict. Other options include South Korea, Japan, Philippines, Taiwan, Australia, but some of these countries may refuse to host them in order to avoid angering Beijing.

China's Davos honeymoon comes to an end

China's political system came under the spotlight at this year's edition of the World Economic Forum in Davos. In a blistering critique to the CCP's model of governance, the wealthy investor and philanthropist George Soros called Chinese President Xi Jinping "the most dangerous opponent of open societies." The speech illustrated the changing global debate about China since 2017, when Xi had presented himself as a champion of free trade and globalization, raising expectations that China might fill the leadership vacuum left by the United States' isolationist foreign policy.

While Soros is not a head of government, his accusation was nonetheless significant, especially as investors often remain silent over – or even deny – political repression in China in order to safeguard their financial interests in the country.

Citing the Social Credit System, Soros focused on the use of IT monopolies and Artificial Intelligence by China's one-party state for "totalitarian" purposes of repression and surveillance. He also criticized the personality cult around Xi and the abolition of the presidential term limit, as well as the "uneconomic" and predatory logic of several BRI investments. China's Foreign Ministry dismissed Soros's remarks as "meaningless."

Beijing sent its largest-ever delegation to this year's event. Amidst a trade war with Washington and weak growth at home, Chinese delegation leader and vice-president Wang Qishan tried to revive the spirit of 2017 when he described his country as the "architect of world peace, contributor to global development and protector of the international order." At a separate panel, Fang Xinghai, the vice chairman of China's main securities regulator, lectured Western democracies about their need for reform.

China's representatives struggled to convince the audience in Davos this year, given that Xi's reformist promises have largely failed to materialize. China's trading partners complain about obstacles for foreign businesses in China and are increasingly alarmed by the country's market-distorting industrial policies as well as its track record of state-sponsored espionage and IP theft. The BRI, Xi's pet project, faces scrutiny for fueling corruption, unsustainable debt and socioeconomic risks in many developing countries. The CCP has increased repression and censorship over civil society and intensified the persecution of Xinjiang's Muslims.

MERICS analysis: MERICS Belt and Road Tracker.

News in brief

- Europe: China hits back at Norwegian intelligence for accusing Huawei of spying
- Canada: Ambassador to China resigns after controversial comments on Meng Wanzhou
- Africa: China writes off debt to gold-rich Cameroon
- 5G: EU considers excluding Chinese companies from networks
- BRI: Maldives wants to renegotiate deals
- Cross-strait relations: Chinese military flies aircraft close to Taiwan
- Space: Chinese ground station in Argentina raises suspicion

POLITICS, SOCIETY AND MEDIA

Blackwater founder's company criticized for alleged plan to build training base in Xinjiang

A company founded by former US military contractor Erik Prince has drawn criticism for planning to build a training camp in China's Xinjiang province. The Hong Kong-listed Frontier Services Group had said in a statement on January 22 that it had entered a preliminary agreement with an industrial park in the city of Tumxuk. According to his spokesman, Prince had no knowledge of this memorandum. An FSG spokesman said the statement had been "published in error by a staff member in Beijing" and that it had been taken off the website.

Prince is the brother of US education secretary Betsy DeVos. He founded the notorious security company Blackwater, which made worldwide headlines during the Iraq war when its employees shot 17 unarmed civilians in Bagdad. Four former employees are serving prison sentences, Blackwater was sold and renamed Academi.

FSG's interests in Xinjiang are connected to China's efforts to secure the trading routes along its Belt and Road Initiative, which presents growing business opportunities for Chinese and international security companies. The company had first announced its plans to enter into the business of logistics security in Xinjiang und Pakistan in 2018.

But as China intensifies the repression against Xinjiang's Muslim minority, international companies are under pressure to prove that their activities in the region are not connected to the surveillance, arbitrary detention, or forced labor of Uighurs and other religious minorities. According to estimates, up to one million people are currently detained in so called "re-education camps" in Xinjiang, and recent reports document that detainees are subjected to forced labor or are being assigned labor after their release. The US sportswear company Badger recently cut ties with Xinjiang-based supplier Hetian Tianda as the latter is suspected to employ forced laborers.

MERICS analysis:

- Podcast with Adrian Zenz on re-education camps in Xinjiang.
- "Guardians of the Belt and Road: The internationalization of China's private security companies." MERICS China Monitor by **Helena Legarda** and **Meia Nouwens**.

Social media post sparks reaction on China's media policy

The Chinese New Year is usually the time of year when China's leadership prefers happy news. However, in the midst of the festive season, a social media post has sparked a critical debate on the role of the media in China. It told the touching story of a 25-year-old who sought success and wealth but, disappointed by the "cold" and "stratified" Chinese society, eventually committed suicide.

The story went viral on Chinese social media and was deleted within 24 hours. The editorial team of the social media publisher "Mimeng" (咪蒙) apologized for the "negative influence" the story had created, announced to close its account on the microblogging platform Weibo and to refrain from posting via WeChat for two months. The social media account of the party-state newspaper "People's Daily" accused the author of "manipulating the public's emotions" on its own Weibo account.

The article triggered a discussion on the role of media and journalism in China. "Media is still under the absolute power of the government," the social media account "WeThinker" commented on the events.

The author also criticized the tabloid-style that Mimeng's success in China is based on: "with the marketization of media, the logic of capital became the other hand that directs media."

Luo Dong, an editor of daily newspaper Beijing News, took the event as an opportunity to write an op-ed on the difficult situation of journalists at established media who find themselves in fierce competition with new media to catch the attention of readers. His account can also be read as a very implicit critique of lack of openness in China's public sphere: "In society, unlike in competition between countries or in the market, you have no right to force the other party to admit defeat. ... In this sense, opinion competition requires an atmosphere of openness and tolerance to each other."

The last bigger public discussion on China's media policy took place in 2016, when real estate entrepreneur Ren Zhiqiang criticized party and state leader Xi Jinping's remarks that "the party media needs to bear the surname 'party'" (党媒姓党). The Chinese Communist Party, though, sticks to its course of control and censorship: At the 12th Politburo study session on January 25th, the CCP again stressed the necessity of a "horizontal and in-depth integration of traditional media and new media for ideological work."

News in brief

- Censorship: Cyberspace Administration suspends "The Paper" for 30 days
- Under watch: China's Foreign Correspondents Club deplores surveillance of foreign journalists
- Under arrest: Citizen activists Liu Feiyue and Wang Quanzhang in prison for "subversion"
- Surprise pick: CCP veteran and diplomatic novice becomes party secretary at Foreign Ministry

ECONOMY, FINANCE AND TECHNOLOGY

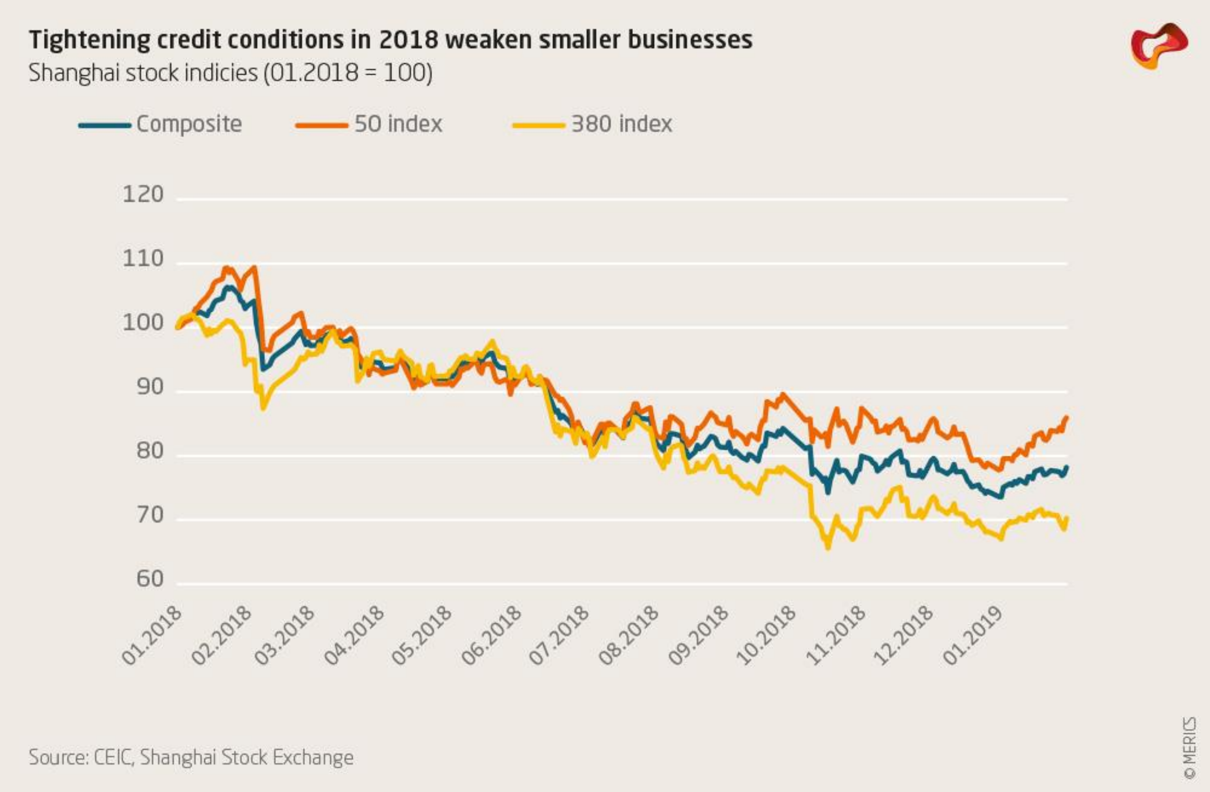
Wave of profit warnings bodes ill for economy

The number of Chinese companies reporting a drop in earnings has increased significantly. According to data compiled by Bloomberg, 440 out of more than 2400 mainland-listed firms that had reported their earnings ahead of a February 1 deadline reported deteriorating financial results for 2018. 373 even disclosed that they would report a loss. 86 per cent of these companies had been profitable in 2017.

The drop in company earnings is a very serious sign of weakness, especially since China will have peak bond repayments in 2019 and 2020. Bond defaults tripled between 2017 and 2018. A wave of defaults could rock the financial system badly.

As a result of tightening credit conditions in 2018, smaller businesses have taken the hardest hit. They visibly underperformed large companies in the market. The stock indices for the 50 largest and 380 largest firms have since August 2018 stopped moving together. (see graph)

At a time when the country is also embroiled in a trade standoff with the United States, China's leaders are likely to deal with this problem by loosening liquidity conditions, despite the long-term risks of rising debt. Recent reserve requirement cuts of banks will help companies refinance their debt and stay afloat despite losses.



Beijing grants selected European companies greater market access

Chinese authorities have made a series of offerings to European companies to deepen their investments in China. BT (formerly known as British Telecom) is the first global telecommunications company to receive nationwide licenses from the Ministry of Industry and Information Technology (MIIT). According to a press release published by BT on January 24, the company can now contract directly with domestic customers in all of China and make out invoices in Chinese yuan.

Several German companies have also been granted better market access. In November last year, Allianz became the first foreign insurance company to obtain approval by the China Banking and Insurance Regulatory Commission (CBIRC) to establish a wholly foreign-owned insurance holding company in China. BMW was the first international carmaker to benefit from Beijing's relaxed ownership rules for the Chinese auto market, and BASF was allowed to establish the first chemical plant in China which is completely foreign-owned.

At the Bo'ao Forum in April 2018, China's party and state leader Xi Jinping proclaimed "a new phase of opening up." A series of measures to loosen restrictions on foreign companies followed. While all eyes are on the US-China trade relations, European companies are among the first beneficiaries of China's recent efforts to further open up its economy. However, the examples mentioned above merely represent flagship cases that are meant to add credibility to China's commitments. The access to and operations of foreign companies on Chinese markets remain fairly restricted. Changes only take place gradually and in carefully selected areas that are opportune to Beijing's strategic interests of greater self-sufficiency and global tech leadership.

China joins global discussions on e-commerce rules

China and the United States have joined 74 other nations to discuss rules for e-commerce outside of the World Trade Organization (WTO) framework. The announcement at this year's World Economic Forum in Davos represents a new push for multilateral consensus in key areas of global digital governance. Yet the informal nature of the planned talks itself starkly reminds of the fragility of the global economic architecture. Only in December did talks within the WTO umbrella fail to reach a consensus.

Participation of the world's leading internet commerce nations, China and the United States, is key to the new effort. The Trump administration's disdain for multilateralism includes criticism of the WTO for perceptions that the organization failed to hold China to its market liberalization promises after accession in 2001.

Estimates of the size of the global e-commerce market range in the trillions of US dollars. But growth of e-commerce and related payment platforms is inhibited by the lack of a consistent global regulatory approach. Worse, there are fears that without a set of global rules to govern the digital space that a "splinternet" will emerge instead.

China's particular approach to internet governance has been especially criticized. Beijing currently bans foreign companies from transferring Chinese consumer data outside of China. It also forces them to disclose source codes for software and demands that they store their data in China.

News in brief

- Reciprocity: China pledges to upgrade foreign investment law
- Powering up: CATL boosts battery cell factory in Germany – up to 100 GWh
- Restart: China reportedly plans revival of solar subsidy program
- Upgrade: China's cabinet plans new perks for manufacturers in bonded zones
- Oversight: PBOC sets up department to monitor systemic risks
- Misgivings: United States submits 70 questions about China's subsidies to WTO
- Denmark: two Huawei staff expelled for flouting work and residency permits

THE EUROPEAN VIEW

EU strives to find unified position on China

China has made its way up the EU foreign policy agenda along with growing security concerns. It has become a priority topic in ministerial meetings and sparked discussions about the safety of Europe's critical and digital infrastructure.

Following a proposal by European Commissioner for Foreign Affairs, Federica Mogherini, the EU foreign ministers agreed on February 1 to put China on the agenda of the next Foreign Affairs Council meeting. While the topic is regularly discussed on the level of embassies it is rarely the focus at meetings of foreign ministers. It is another step to find a common position on China before the EU-China Summit on April 9, 2019.

According to Reuters, the EU is also considering legislative proposals to enhance the safety of the EU's critical infrastructure. An inclusion of 5G mobile networks in the EU's 2016 Cybersecurity Law would ban businesses from using equipment provided by any country or company suspected of using its equipment for spying or sabotage. As China's National Intelligence Law requires Chinese "organizations and citizens" to "support, cooperate with, and collaborate in national intelligence work" the amendment might be effectively used as a ban of Chinese telecommunications company companies Huawei and ZTE from European 5G mobile networks.

The developments in cyber security are part of a toughening stance of the EU vis-à-vis China. In November of 2018, the EU proposed rules for an investment screening mechanism to coordinate scrutiny of foreign investments into Europe, which will be voted on by the European Parliament in February or March. On January 25, it was reported that the Chinese state-owned power company China Three Gorges had halted its talks for a takeover of Portugal's main energy operator EDP. The decision was partially influenced by a toughening EU regulatory environment.

PROFILE: Yang Hengjun

Australian passport cannot save a critical Chinese blogger

"At the time when you read this letter, (...) I will have been abducted once again." The Chinese Australian author and journalist Yang Hengjun had asked his friend and PhD supervisor Feng Chongyi to publish these words in the case of his arrest.

This has now happened. On a trip from New York to Shanghai, the 53-year old Yang was separated from his wife and stepdaughter in transit in Guangzhou. Yang was arrested on charges of endangering national security.

Yang has lived in Australia for 20 years and holds an Australian passport since 2002. He graduated from the University of Technology in Sydney with a doctoral thesis on the topic: “The Internet and China’s Future: The influence of internet journalists and bloggers on the democratization of China.“

Yang decided to leave academia in 2009 and became an online journalist. In his blogposts, he advocated for democratic change in China. In 2011 he was arrested for the first time in his home country, and he wrote fewer blogposts over the past three years.

Yang’s mentor Feng assumes that the arrest is related to Beijing’s recent pushback against critics abroad. Yang is held under house arrest at a secret location. According to Chinese law he can be held incommunicado for up to six months.

Lawyers hired by Yang’s wife have been denied access to Yang. For those writing critical blogposts in Chinese language, even a foreign passport does not offer protection.
