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Foreword

Like US-Russia relations, the relationship between Beijing and Washington is just the right mix of darkness and light in each party's intentions. Above all, never call the other enemy or even adversary for fear of triggering a series of diplomatic and military decisions. Just like the US's missile shield in Europe does not target Russia but Iran, the defense agreements Washington is attempting to forge with certain Southeast Asian countries do not target Asia, but the freedom of the seas. Last month, Washington quickened the pace by meeting the leaders of Myanmar, Indonesia and Vietnam. It is said in China that the alliance strategy is in full swing, a year before the presidential elections in the United States. Is **Barack Obama** looking to make the signed agreements impossible to unravel? In any case, this has not escaped China's strategists: they are wondering whether or not the diplomatic non-alignment principle is tenable in the current climate, even though officially the Chinese Foreign Ministry is strongly rejecting the game of alliances it qualifies as having been inherited from the Cold War. Several eminent representatives of the Chinese community of government experts, the only community able to dare make comments and suggestions on sovereign issues, are beginning to publicly reconsider the usefulness of the "strategic partnerships" signed with 70 countries in the world if they do not represent a rampart against foreign influences. At the same time, the United States concluded more than 60 agreements of the military variety that are more or less binding in terms of

reactions to an attack against one of the countries having signed them. China would be well advised to go beyond the economic scope of its presumably strategic agreements and demonstrate its intentions for more reliable agreements, beginning with its neighbor countries and particularly within the framework of the **Shanghai Cooperation Organisation (SCO)**. After all, China's diplomacy has been uncompromising on issues it considers non-negotiable (Hong Kong, Taiwan, Tibet): "you are either with us or not a friend of China..." Implying that China could be just as uncompromising if the United States goes too far. The Beijing-Moscow axis is not explicitly mentioned, but is at the forefront of everyone's minds. The fact is that, even if China wanted to equate its own security with the fate of other sovereign countries, which would go against its own political foundations, it simply does not have the military resources (yet). China may be tempted to bluff at first. In parallel, the country will ask more of its neighbors, see to reinforcing its economic security in the agreements and do what it has always done, but in its own time, that is concluding agreements and partnerships that are as vast and comprehensive as possible and giving the diplomat-generals more slack in the rope associating them with foreign armies. The professionalization of the People's Liberation Army, which is playing out as we speak, should make this evolution easier. However, just like on the economic front, time is of the essence and the windows of opportunity are closing rapidly.



Diplomacy

Lackluster China at COP21

As the planet's largest emitter of greenhouse gases, China was naturally the object of particular attention during the **United Nations Conference on Climate Change (COP21)** that was held in Paris from November 30 to December 11. China's attitude before the conference may have seemed encouraging as Beijing wanted to paint the picture of a responsible power both for the international community and its own population: during a European summit in June 2015, China had indeed declared itself in favor of obtaining a restrictive agreement during the COP21. On June 30, it had submitted rather ambitious and voluntary objectives, including reaching its CO₂ emissions peak in 2030 at the latest, reducing its CO₂ emissions by 60 to 65% compared to 2005 and increasing the share of non-fossil fuels to 20%, also by 2030. In September, **Xi Jinping** had even appeared alongside Barack Obama for the joint publication of their environmental objectives and the announcement of the creation of a Chinese carbon market based on the polluter pays principle by 2017. Despite these signs of goodwill, the position that was actually defended by China and its climate negotiator, **Xie Zhenhua**, during the conference was more ambiguous than announced, and closer to the arguments of the developing countries. With India, China supported the concept

of "common but differentiated responsibilities," involving the right for the countries of the South to not have their development hindered by environmental protection measures, and the duty of the North to finance these measures. China also objected to certain specific items during the negotiations, for example the obligation of an upwards revision of the emission reduction targets every five years. The country also benefited from implicit support from the United States, which is also reluctant to agree to any binding commitments. The main measures included in the final agreement therefore seem to be more of a compromise. The objective of keeping the increase in global temperature under 2 degrees Celsius, and even 1.5 degrees, has been rightfully acknowledged, and \$100 billion in aid to developing countries has also been agreed on. The progress reports are the only restrictive component of the agreement. However, this raises the question of the reliability of the data that is given, and therefore the possibility itself of any kind of evaluation. In November for example, China made an upwards revision of its coal production figures (+600 million tons per year) for the past 10 years, and admitted that its sulfur dioxide emissions for 2014 had been underestimated by 50%.

Protection of intellectual property rights and China-Europe relations

According to a recent **World Intellectual Property Office (WIPO)** report, online music sales have increased tenfold in ten years, reaching a total of \$14.9 billion in 2014. Today, music still does not have to be paid for in China. That is the substance of the analysis made by the intellectual and industrial property professionals during the 8th Annual Copyright Conference that was held during patent week in Beijing last November. The change in business model is imminent as the interests are now aligned. At the same time, the European and Chinese intellectual property protection agencies, the **European Patent Office (EPO)** and the **State Intellectual Property Office (SIPO)**, which answers directly to the State Council, gathered to

celebrate the 30th anniversary of their relationship, which was initiated in Munich on June 11, 1985.

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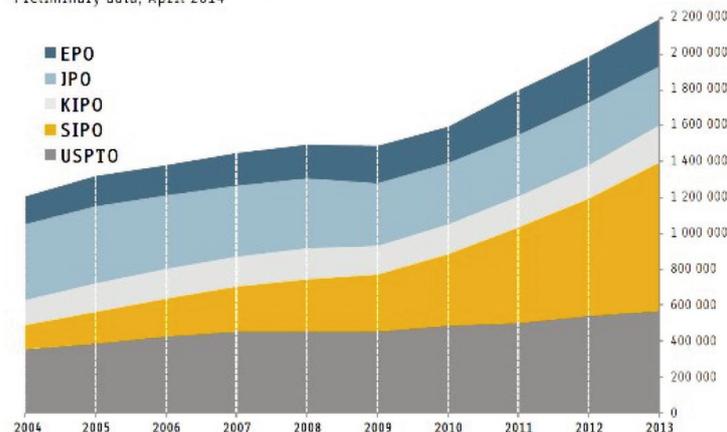


Source : China Daily

“Intellectual property rights” continued SIPO Director **Shen Changyu** insisted on pointing out that China’s current IIP system mostly arose from the relations developed with the EU and EPO, and added that three specialized courses had been created in Beijing, Shanghai and Guangzhou in 2014. EPO President **Benoit Battistelli** topped off this statement by saying that their cooperation had contributed to the modernization of China... In concrete terms, the SIPO processed around 1 million patent requests in 2014, of which 127,000 were foreign. EU countries represented 20% of the requests. Inversely, and also for 2014, China represented 9% of the some 270,000 patent

filings requested with the EOP, mainly in the information science and digital industries, as well as in the telecommunications sector. For the first year, **Huawei** is among the top ten filers, in 5th place. China has also more than doubled its requests in the past five years, according to Benoit Battistelli. Nevertheless, it has been underlined that both sides are having more and more difficulties evaluating the requests due to the increasing complexity of the technology involved. Since 2010, the five largest global agencies (USA, Japan, EU, Korean and Chinese) have been meeting as the “IP5” in an attempt to harmonize the current systems.

Patent filings at IP5 Offices
Preliminary data, April 2014



Source: Five IP Offices (IP5)

China-Australia: not entirely free trade

The free trade agreement between China and Australia, also known as **ChAFTA**, is entering into force on December 20. Encouraged by the government coalition and business sphere in Australia, the agreement will have met with some ultimate resistance from the labor opposition that wanted to further discuss certain dispositions for employment, which it considered insufficiently protected in the agreement. Initiated in 2005, the negotiations for ChAFTA took ten years and were finally signed on June 17, 2015. According to the agreement, 95% of Australia’s exports to China will be exempt from tariffs and businesses operating in the services sector will benefit from better access to the Chinese market. Also according to the agreement, Chinese investments will not be

subject to approval from Australia’s **Foreign Investment Review Board (FIRB)**. However, a new control system for foreign investments entered into force on December 1. In this new system, the conditions for acquiring local real estate property are stricter and in the direct continuation of an amendment proposed by the government earlier in the year (Foreign Acquisitions and Takeovers Legislation Amendment Bill 2015). Furthermore, the system is intended to reinforce foreign investment transparency in the agricultural sector as the current review threshold, for any investment above A\$252 million, excludes the majority of projects due to the small average size of the country’s agricultural businesses and farms. (continued on page 4)

“China-Australia” continued The screening threshold for agricultural land purchases has been reduced to A\$15 million. Agribusiness projects will now be reviewed when over A\$55 million. Yet China invested A\$632 million in 2014, almost double the amount of the previous year. The FIRB’s decision has not been understood in China and is seen as a real slap in the face, especially as the new dispositions do not apply to investments coming

from the United States or New Zealand. The **Business Chamber of Australia**, for its part, estimates that it goes against the development of the sector, sending a conflicting signal to the world. This episode is an example of a quasi-schizophrenic evolution in international trade after the WTO’s temporary self-effacement as it is torn between opening to international markets and concurrently seeking secure outputs for the national economies.

Domestic Policy

Military reform: Central Military Commission gains power

An important **Central Military Commission (CMC)** work conference chaired by Xi Jinping was held in Beijing from November 24 to 26 and laid the cornerstone for a comprehensive reform of the Chinese army. A fundamental change in structure is indeed planned, placing the CMC at the head of the administration, command of the entire People’s Liberation Army (PLA) and the police forces. Up until now, the PLA was not structured around a central command, but was administered by four general departments and made up of seven independent regional military commands (Shenyang, Beijing, Lanzhou, Jinan, Nanjing, Guangzhou and Chengdu). These seven commands will be reworked into four or five “combat zones” that will be supervised by a general command center directly under CMC orders. The timeline for this large-scale restructuring is short as it will have to be finalized in 2020 but implemented on January 1, 2016. During the military parade commemorating the end of World War II on September 3, Xi Jinping announced that 300,000 non-combatant job cuts in the PLA.

Towards a more efficient and responsive army

It would be false to see this reorganization from the perspective of a simple rationalization in the context of the economic slowdown in China. The primary objective of this operation is to modernize, professionalize and improve the efficiency of the PLA. It is a question of bringing it up to international standards and giving the country an army to match its international ambitions. Commentators have underlined that transforming

the regional commands into combat zones is similar to the changes operated in the American and Russian armies. Nevertheless, they also insist that both the United States and Russia had planned these changes over thirty years. The reorganization of the PLA will therefore be operated in haste. Despite the reassurances of Chinese Defense Ministry spokesperson **Yang Yujun**, who confirmed that the reforms would not change the essence of China’s defense policy, which would be “by nature defensive,” one might think that the increasing tension in the South China Sea is a determining factor in Xi Jinping’s decision to conduct these reforms so quickly.

Reinforced political control

Besides the need to modernize the PLA, the reform also has a more political chapter: Xi Jinping is looking to reinforce the Party’s total control over the army through this reorganization, for which the central position of the CMC he is the head of seems to be the best guarantee. In the words of Xi Jinping himself, one of the goals of the reform is to reinforce the principle that “the CPC has absolute leadership over the armed forces.” Reworking the seven regional commands is a part of this logic. The fight against corruption has also been mentioned as justifying the reform and has already cast aside those whose influence could be troublesome such as the two vice presidents of the CMC: **Xu Caihou** in June 2014 and **Guo Boxiong** in July 2015. Political commissars from the CCDI will be reinforcing the ranks of the army controllers, a sign that the hunt for “tigers” and “flies” continues.

Economy & Finance

Main economic indicators

October and November 2015 (BNS and/or Markit)		
	October	November
Exports	-6,9%	-6,8%
Imports	-18,8%	-8,7%
Manufacturing PMI	49,8 48,3 (Markit)	49,6 48,6 (Markit)
Non-manufacturing PMI	53,1 52 (Markit)	53,6 51,2 (Makit)
Industrial production	+5,6%	+6,2%
FDI	+4,2%	+1,9%
ODI	+14,3%	+12,6%
Electricity consumption	-0,2%	+0,6%
Retail sales	+11%	+11,2%
Inflation	+1,3%	+1,5%

Yuan in IMF currency basket: consecration or encouragement?

On November 30, 2015, the **International Monetary Fund (IMF)** officially accepted to include the yuan in its special drawing rights system (SDR), an international reserve asset that can be traded for other currencies included in the currency basket. The yuan will therefore be included in the basket at the amount of 10.92% as of October 1, 2016, along with the dollar (41.7%), the euro (30.9%), the pound (8.1%) and the yen (8.3%).

Beijing's efforts acknowledged

This is an important symbolic victory for Beijing, which had set itself the goal since 2010, as well as an acknowledgment of the efforts it has made in terms of liberalizing its financial system. The fact that the system that is used to set the yuan exchange rate was changed in August and issuing sovereign bonds in yuan on the London Stock Exchange in October were recently among the important steps of the process. The IMF considered that the Chinese reforms had made it

possible to sufficiently largely develop the use of its currency in international trade, as well its being freely accessible. The IMF therefore considers the yuan as a sufficiently secure currency to grant it reserve currency status. This positive sign directed at the investors could stimulate an increase in demand for the Chinese currency.

Pending new reforms

Yet this is far from being an established fact as there remain quite a number of liberalization efforts to make. In fact, the IMF's decision seems to be mostly seen as a symbolic and political measure aimed at encouraging Beijing to make progress with its reforms, rather than a consecration. The central banks, as well as the private investors, will in particular be waiting to know to what extent China will get politically involved to regulate the yuan before increasing their exposure to the currency. The markets are still expecting a significant decrease in yuan value.

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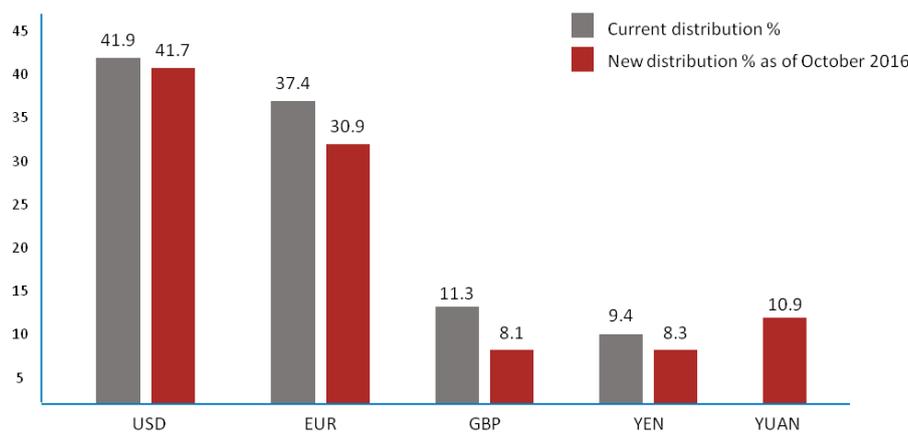
“Yuan in IMF currency basket” continued

An international status that remains fragile

Finally, despite Beijing’s efforts, the internationalization of the yuan is still only beginning. The Chinese currency’s weight in world exchange reserves is currently only 1.3%. The RMB is only used in 2.4% of global payments (SWIFT figures, September 2015). Cross-border investments in yuan remain scarce. The consequences of including the yuan in the SDR

will therefore be very progressive and determined by the investors’ trust in Beijing’s pursuing the reforms. On December 3, the director of the Chinese central bank’s Monetary Policy Department no. 2, **Ms. Xing Yujing**, announced that the inclusion would help reforms aimed at improving the accessibility to and total convertibility of the yuan. Premier **Li Keqiang** has also supported continued reform.

Special Drawing Rights SDR



Source: FMI

Industry

Europe falls into trap of Chinese solar panels

On December 5, the **European Commission** extended the anti-dumping measures against Chinese solar panels for 15 months and decided to open an evaluative investigation into the measures two years after their implementation in 2013. In November, two Chinese companies (**China Solar** and **Sunny Solar**) had violated their obligations on their minimum import prices (MIP) by manufacturing panels under different brands. **ProSun**, the European consortium of industry manufacturers, had alerted the Commission beforehand on the possible deviancies of these companies. Other companies are also on the radar. Yet it is China that today has the world’s largest solar capacity, in front of Germany. China has made a commitment to move up to an additional 500 GW of solar and wind power by 2030. That is

the gist of the message the MOFCOM and its Trade Remedy and Investigation Bureau attempted to convey by reacting, on December 8, to the Commission’s decision, which they had been anticipating for several months: the annual solar power capacities in Europe went from 24 gigawatts in 2012 to 7 GW in 2014; its share in the global installed capacity went from 74% to 14.5% during the same period. So, in the end, what does Europe want? **CGN Europe Energy (CGN-EE)**, a subsidiary of China’s nuclear giant **CGN**, has announced a solar power investment in France, partnering with **Inovia Concept Développement**, an SME from the region of Bordeaux. By going up the renewable energy value chains like so, China is continuing the upgrading and internationalization of its businesses.

Business Environment

Terrorist risk and security for Chinese businesses abroad

The **MOFCOM** has warned Chinese companies operating abroad that they have to cope with rising insecurity. This message was particularly targeted at companies operating in the mixed (non-exclusive State capital) and private sectors facing terrorist risks. Four Chinese nationals were recently executed by terrorist groups. Three of them were among the 22 victims of the deadly hostage taking at the **Radisson Hotel** in Bamako on November 20. They were working for the international subsidiary of the **China Railway Construction Corporation (CRCC)**, which was working on a mission with the Malian Transport Ministry. They were **Zhou Tianxiang**, CEO of **China Railway International Group**, Vice-CEO **Wang Xuanshang** and Africa Director **Chang Xuehui**. According to the MOFCOM's figures, 30,000 Chinese companies were active abroad in 2014, representing a total volume of assets of \$3 trillion. Since 2010 and despite the publishing of "information guides" regarding the protection of people and property, these companies, and particularly SMEs and SMLs, are taking a long time to get up to speed. The new dispositions are still an assembly of general recommendations that are not part of the labor code. Therefore, business leaders are not required to conform to a number of legal and contractual obligations to effectively protect their employees working

abroad. A dual reality therefore subsists: that of the large groups, which have been aware of the risks for awhile now and have the financial and organizational resources, and that of the smaller entities that have been left to fend for themselves to interpret the MOFCOM's non-restrictive texts. For the latter, safety and security procedures are usually implemented without the necessary support of the consulate nor by turning towards high-standard outside companies specialized in the matter. In any case, through its spokesperson on December 2, the MOFCOM addressed a new message to its most exposed companies: they are now intimated to "be better knowledgeable of the danger and complexity of outside risks, become aware of said risks and assume their responsibilities by improving their risk management (...)." Second, they have also been asked to "proceed with an upstream risk evaluation (...) and train expatriate personnel before departure (...) and help get them in touch with local protection services." However, there are fears that this encouragement to prudence will not be sufficient to take into consideration the security of employees. Unless the cutbacks in certain PLA corps lead to a useful increase in personnel for China's safety/security companies, an industry that is currently undergoing a major restructuring.

Online prostitution in Guangdong

The **Ministry of Public Security (MPS)** has created a special unit in Guangdong Province in charge of battling online prostitution, or more exactly its encouragement. Criminal gangs are progressively setting themselves up in the public sphere by using the instant messaging services **WeChat** and **QQ**, SMSs and other technical means that detect and collect the phone numbers of potential clients in certain ill-famed places. In Southern China, these gangs are often connected with gaming and miscellaneous trafficking, and are helped by the local banks, which in turn are supported by local official

networks. It is common to see a significant increase in activity during the period of the Chinese New Year. The police get organized accordingly and have already released a few figures to better justify the activation of its future investigations. Surprising figures indeed: since the beginning of the year, close to 120,000 suspects have been remanded in (administrative) custody by the police at the level of the province! For the city of Shenzhen and the month of last March alone, the local police reportedly arrested 103 alleged members of a gang of online panderers.

in brief

Ideological education assumes task of “supplementing calcium and strengthening bones” for Party members > The Communist Party of China intends to develop ideological and political education for its some 88 million members. On December 13, the Central Committee released a document highlighting the fundamental role of the Party schools in the training of a “troop of officials that are as strong as iron in belief, faith, discipline and sense of responsibility,” according to Xi Jinping. Also according to the Chinese president, these teachings have to be a “calcium supplement” and “strengthen bones.” Ideological discipline is an increasingly recurrent theme in China’s political discourse. At the end of November, Minister for Education **Yuan Guiren** also called for a reinforcement of the socialist values education system, after having denounced the ideological slackening of certain teachers.

Chinese NGO files complaint against Volkswagen > A Tianjin court has accepted the complaint of Chinese NGO **China Biodiversity Conservation and Green Development Foundation** against the German automobile manufacturer **Volkswagen** regarding the EA189 diesel motor scandal. The motors allegedly included software making it possible to circumvent exhaust emission standards. Last July, the same NGO had already sued **ConocoPhillips** and **CNOOC** regarding the oil spill in the Bohai Sea in 2011. Although the number of vehicles called back in China was fairly low (fewer than 2,000), the trial could have harmful consequences for Volkswagen’s image on one of its biggest markets. The media coverage of the trial could be increased by the recent pollution spikes that have been recorded in the Chinese capital.

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