Report number: PAMIR2023050401

PAMIR Executive Brief

China Update

4 May 2023

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A long-simmering IP case that could affect production for most Apple products again is attracting attention in China. Chinese analysts say this complicated case involving AI company Shanghai Xiao-i Robot Technology Company (Xiao-i) is a contest of government relations for both Xiao-i and Apple in China and in the US and involves factors of US-China relations.

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Executive Summary

- Shanghai's High Court will hear a patent infringement case on 5 May that could affect most Apple products. Three years ago China's Supreme Court ruled in favor of the plaintiff, Shanghai Xiao-i Robot Technology.
- USTR warns that the pace of reforms aimed at addressing IP issues has slowed, despite China implementing amendments to its patent, copyright, and criminal laws.
- The US imposed sanctions on four Chinese companies for assisting Iran's drone program, which has been supporting the Russian military in Ukraine.
- US Homeland Security will begin a 90-Day "Sprint to Counter PRC Threats" to intensively counter national security threats from China and will increase information sharing with the US private sector.
- Guizhou province announced its inability to pay back debt and is seeking assistance from the central government.
- China's foreign minister made a "rescue visit" to Manila to salvage deteriorating relations, but Chinese ships continue aggressive actions in the South China Sea.

US-China Relations

Economy & Technology

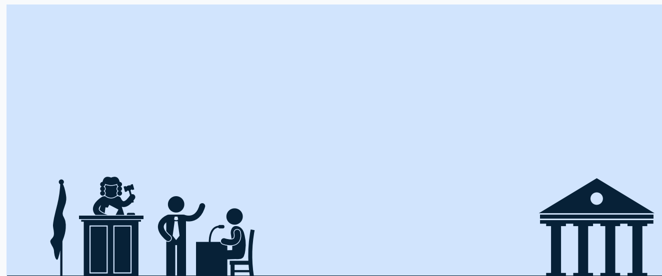
On 18 April China's Ministry of Commerce announced unprecedented personal sanctions against Lockheed Martin’s CEO, COO, and CFO and Raytheon Missiles & Defense president and two vice presidents, as well as other senior executives. The sanctions include a ban on Chinese exports to the two companies “to prevent Chinese products from being used in their military business" and a call for all Chinese companies to “strengthen their due diligence and compliance system to verify transaction information."

Intellectual Property

On 20 April China’s Supreme People’s Court (SPC) published an IP white paper that indicates Chinese courts in 2022 received 526,165 IP cases and concluded 543,379, which included some from previous years.

More than 90,000 cases were settled through arbitration for an 80% success rate. The paper revealed a surge in IP cases from central and western China but a drop in overall cases from 642,968 in 2021. China now has 558 courts that handle IP cases.

The paper reported that SPC IP Court has established a communication mechanism with the World Intellectual Property Organization (WIPO). In 2022, Shanghai, Fujian, and Hainan established relations with the WIPO Arbitration and Mediation Center to handle IP disputes with foreign entities.



- Foreign entities prevailed in 51% of IP administrative rulings and 68% of rulings for financial penalties in all IP cases handled by the important Beijing IP Court, as it reported in November 2022. Foreign cases accounted for 20% of its total case load.
- The SPC IP Court paper did not mention a foreign entity success rate for its cases, but since was established in 2019, it has handled 1,257 cases filed by foreign entities against Chinese entities and concluded 864 cases.

On 26 April the Chinese government announced 861,000 foreign patents were registered in China in 2022 – 4.5% more than in 2021 and involved 58,000 foreign companies, 2,000 more than 2021. The total of valid foreign brands in China was 2.03 million, up 5.9% from 2021.

Apple:

A long-simmering IP case that could affect production for most Apple products again is attracting attention in China. Chinese analysts say this complicated case involving AI company Shanghai Xiao-i Robot Technology Company (Xiao-i) is a contest of government relations for both Xiao-i and Apple in China and in the US and involves factors of US-China relations. A researcher from China's Ministry of Commerce told Chinese media that the case will "energize" more Chinese tech companies to "protect their IP rights," regardless of the outcome.

Chronology of Apple–Xiao-i Dispute

- Xiao-I was established in 2004, the same year it filed a patent related to chatbots. China's State Intelligence Property Office (SIPO) granted the application in 2009.
- In June 2012 Xiao-i filed a lawsuit against Apple with the Shanghai No.1 Intermediate People's Court (SHIC) claiming that Siri infringed on its chatbots patent.
- In November 2012 Apple filed an application with SIPO for an executive review of the validity of the Xiao-i patent, which SIPO upheld in September 2013. Apple then sued SIPO in Beijing No. 1 Intermediate Court (BJIC), which ruled in favor of SIPO. In July 2014 Apple appealed to Beijing High Court, which overturned the BJIC ruling in favor of Apple in April 2015.
- In May 2015 Xiao-i appealed to China's Supreme Court. Meanwhile, in April 2016, citing the verdict by Beijing High Court, SHIC delivered a final verdict and rejected Xiao-I's 2012 case.
- In May 2017 China's Supreme Court started a review of the Xiao-i case and ruled in June 2020 that the Xiao-i patent was valid. The case was one of the Top 10 IP cases in China in 2020.
- In August 2020 Xiao-i filed a suit against Apple in Shanghai High Court (SHHC) and demanded $1.4 billion compensation. In September 2020, Xiao-i asked SHHC to order Apple to stop producing, selling, or using any products which infringe on its patent – this included most Apple products. On 25 April 2023 SHHC announced that it would start the trial of Xiao-i vs Apple on 5 May.

USTR:

The annual “Special 301 Report on Intellectual Property Protection and Enforcement” the US Trade Representative (USTR) released on 26 April confirms IP protection and enforcement in China remain a serious concern.

In 2022 China continued implementing amendments to its patent, copyright, and criminal laws.

- According to the report, the pace of reforms aimed at addressing IP issues slowed. While right holders have welcomed some positive developments, they raise concerns about the adequacy and effective implementation of these measures, as well as about longstanding issues like technology transfer, trade secrets, bad faith trademarks, counterfeiting, online piracy, and geographical indications. Also, statements by Chinese officials that tie IP rights to Chinese market dominance still raise strong concerns.

- Chinese tech stocks plummeted on 21 April, probably in expectation of the US executive order. On the same day, China's Foreign Ministry spokesman stated, "We noted relevant reports and are firmly opposed to this…The US has been building 'a small yard with high fences' and pushing for decoupling and fragmenting industrial and supply chains." Chinese state media also questioned US statements that the US has no interest in economic decoupling with China, referring to US National Security Adviser Jake Sullivan's recent comment that the US is not decoupling with China, but de-risking.

Sanctions and Restrictions

On 19 April the US Treasury Department imposed sanctions on four Chinese companies—three based in Hong Kong—for assisting Iran's drone program; six other entities were sanctioned in March. According to the US government, the blacklisted Chinese companies have sold thousands of aerospace components to the military-controlled Iran Aircraft Manufacturing Industrial Company. Some Iranian drones were being used by Russia in the Ukraine war.

On 22 April China extended anti-dumping duties on imports of US-made dispersion unshifted single-mode optical fibers used for high-speed and long-distance data transmission. China originally imposed this tariff in April 2011, and in July 2018, as part of the US-China trade war, raised the range of tariffs on the US products from 4.7%-18.6% to 33.3%-78.2%.

China also has anti-dumping tariffs on similar products from the EU, Japan, and South Korea, which, in turn, impose duties on Chinese optical fibers.

President Biden is close to issuing an executive order in the next few weeks that could restrict US investments in Chinese technology companies that have national security applications for the US.

The new restrictions would include key sectors: semiconductors, artificial intelligence, quantum computing, and biotechnology.

Biden will likely ask other G-7 members to do the same during the G-7 summit on 19 May. Some Chinese analysts describe the new US restrictions as "historically unprecedented" and suggest their aim is to prevent China from building these technologies and products or purchasing them anywhere.

Some Chinese analysts warn that new US restrictions will create "big obstacles" for China's tech innovation and industry upgrade. They also say new US restrictions will compel China to go all out to acquire technologies needed for China's future.

- In 2019 US sanctions stopped all technical support for Huawei's key enterprise management software system, Enterprise Resource Planning (ERP), but on 20 April Huawei declared that it successfully replaced the old ERP with its own MetaERP for operations in more than 170 countries.

National Security

On 21 April US Homeland Security Secretary Mayorkas announced a Homeland Security Department-wide 90-Day "Sprint to Counter PRC Threats." The operation is designed to "drive down risk and assess the evolving threat in six key areas":

1. Defending critical infrastructure.
2. Disrupting the global fentanyl supply chain.
3. Preventing the PRC from abusing the lawful US travel system to harass dissidents.
4. Protecting against PRC malign economic influence.
5. Advancing safety, security, and economic prosperity in the Arctic and Indo-Pacific.
6. Sharing information on PRC threats with our partners across all levels of government and the private sector.

Chinese state media characterized the Homeland Security move as US efforts to "hype a China Threat" and contain China.

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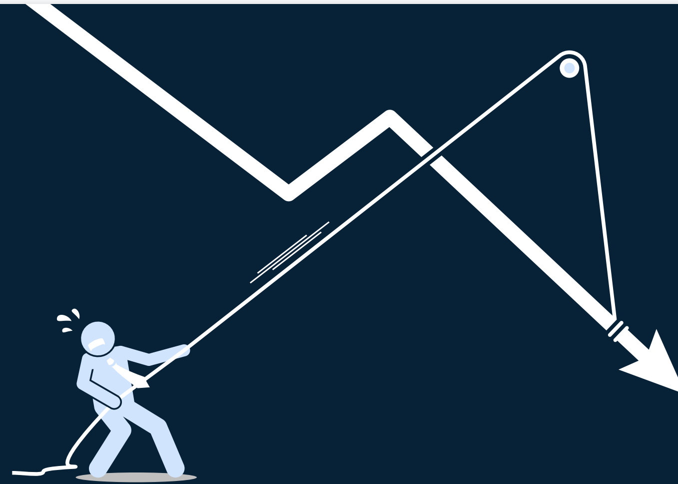
PROFITS FOR CHINA'S INDUSTRIAL ENTERPRISES FELL BY 21.4% IN Q1



China's Economy

On 17 April Guizhou province in southwest China was the first to announce inability to pay back debt and to seek assistance from the central government. According to a provincial government document, as of December 2022 Guizhou had a 531.67% debt ratio with total debt of RMB 1.24 trillion.

The province collected only RMB 58.2 billion in revenue last year. Chinese reporting said that in 2022 Guizhou ranked 5th in terms of debt ratio among China's 31 provinces and metropolitan cities. The northeast province of Jilin had a debt ratio of 1009.1%, followed by Tianjin City, Yunnan, Guangxi, and Qinghai, whose debt ratios were all over 750%. Local government debt is a time bomb for China's economy, according to some economists.

China's Ministry of Finance said central government 2023 financial assistance to provincial governments will total RMB 1.006 trillion ($146 billion), 3.6% more than in 2022 and passing the threshold of RMB 1 trillion for the first time in history – it will account for 72.38% of total central government spending (73.09% in 2022). Ten years ago, in 2013, central government financial assistance for provincial governments was RMB 488.6B, 70.24% of the central government budget.

DEBT RATIO OF THE PROVINCE OF JILIN IS 1009.1%

RETAIL SALES INCREASED 5.8% YoY

CHINA'S SERVICE INDUSTRY GREW 5.4% YoY

On 18 April China's National Bureau of Statistics (NBS) published data for China's economy in the first quarter 2023:

- **Industrial production** was up 3% YoY: private enterprises +2%; SOEs +3.3%; and foreign enterprises down 2.7%. In March, the PMI was 51.9%, above the contraction benchmark of 50%, but dropped back to 49.2% in April.
- **Profits** for China's industrial enterprises plummeted 21.4% in the first quarter YoY: SOEs dropped 16.9%; private enterprises -23%; and foreign-invested enterprises -24.9%. The worst sectors were energy -97.1%; IT manufacturing -57.5%; and chemical -54.9%.
- **GDP** grew 4.5% YoY, compared to 2.9% in Q4 2022. Chinese economists attributed the rebound to China's removal of Covid-19 controls. They particularly credited the bounce to China's service industry, which grew 5.4% YoY and 3.1% more than Q4 2022; China's restaurant industry revenue went up 13.9%.
- **Retail sales** increased 5.8% YoY and jumped 10.6% in March, the highest level of growth since June 2021, and a significant recovery from -5.9% in November 2022.
- **Investment** in fixed assets increased 5.1% YoY: infrastructure investment jumped 8.8%; manufacturing +7%; high-tech +16%. The real estate industry investments dropped 5.8%; real estate sales by square foot were down 1.8%.
- **Foreign trade** increased 4.8% (exports up 8.4% and imports +0.2%): 52.4% of China's foreign trade was by private companies; 30.7% by foreign-invested companies; and 16.7% by SOEs. In March, RMB-denominated exports were up 23.4%; US dollar-denominated exports up 14.8% and imports up 6.1%.

Chinese economists said March export growth was driven largely by previous months' backlogs when China was under Covid lockdown. They warned that Chinese exports will meet strong headwinds in months ahead since US and EU demands are down — in Q1, China's exports to EU were up only 0.3%.

At the same time, the proportion of China's overall exports to developed countries has been continuously shrinking — the proportion of exports to Japan contracted from 11% in 2005 to 5%; US from 22% to 14%; and EU from 20% to 15%.

- Prices continued a downward trend: CPI was 2.1% in January, 1% in February and 0.7% in March; PPI was -0.8% in January, -1.4% in February, and -2.5% in March. Economists worry this trend could indicate slowing demand that could lead to deflation in coming months. But an NBS spokesman said Consumer Price Index (CPI) and Producer Price Index (PPI) in Q1 were influenced greatly by abnormal Covid restrictions, and he expected CPI and PPI will return to normal levels in the second half of 2023.
- The unemployment rate of 5.5% was down 0.1% from the previous quarter; however, youth unemployment (ages 16-24) was 19.6%. In July, 11.58 million Chinese college graduates will join the labor force, 820,000 more than in 2022 — employment pressure will continue.

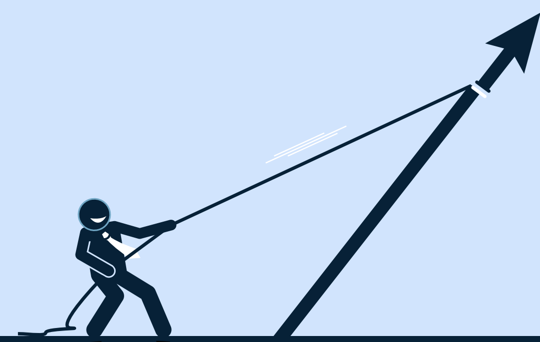
Chinese and overseas economists believe China's economy will meet the government growth target of 5% for 2023, barring unexpected events.

YOUTH UNEMPLOYMENT (AGES 16-24) WAS 19.6%

On 20 April China's Ministry of Commerce (MOFCOM) reported that in Q1 China received RMB 408.45 billion in foreign investments, up 4.9% YOY. The number of new foreign-invested companies exceeded ten thousand, a 25.5% increase. Investments from Britain jumped 680.3%; France 635.5%; Canada 179.7%; Japan 47.7%; Switzerland 47.4%; and South Korea 36.5%. Investments in the high-tech sector totaled RMB 156.71 billion, up 18% YoY; investments in R&D were up 24.6%; in the electronic and communication sector +55.7%; and in pharmaceuticals +20.2%. MOFCOM did not mention US investments in its report.

- Despite the political rhetoric, European businesses are not in step with US economic containment of China, observe Chinese analysts. For example, Airbus signed a contract with Aviation Industry Corporation of China (AVIC) and Tianjin City government to build a second Airbus 320/321 production line in China. AVIC is China's largest defense aviation SOE and is sanctioned by the US. On 19 April Volkswagen announced a plan to invest $1.09 billion to build an R&D and procurement center in Shanghai.
- European products also are finding their way back to China after China lifted its Covid restrictions. The Financial Times reported China drove Porsche sales up 18% and Louis Vuitton sales 17% in the first quarter.

MOFCOM also reported China's overseas non-financial investments were $31.54 billion, up 17.2% YoY. 18.3% of the investments, totaling $5.76 billion, went to Belt & Road (BRI) countries.



INVESTMENTS IN HIGH-TECH SECTOR TOTALED RMB 156.71 BILLION UP 18% YoY

Southeast Asia

Phillipines

On 11-28 April the US and Philippines conducted an unprecedented large military exercise across the Philippines involving more than 18,000 soldiers, including 12,200 US troops. US-Philippines relations have been warming, and earlier in the month the Philippines granted the US access to four additional military bases, three of which are located across from Taiwan.

In response to a deterioration of China-Philippines relations that has occurred since President Marcos' state visit to China in January, Chinese Foreign Minister QIN Gang on 21-23 April made a "rescue visit" to Manila and met with Marcos, the vice president, and the foreign minister.

According to China's Foreign Ministry, Qin recalled the joint statement signed by Marcos in January that "affirmed the two countries should be good neighbors, good relatives, and good partners." Qin, however, resorted to standard formulations when he ignored Chinese provocations in the South China Sea and put the onus on Marcos to improve relations:

- Qin said China hopes the Philippines will "translate into actions its commitment to upholding strategic independence rather than picking sides…properly handle Taiwan-related and maritime issues in line with the overall interests of regional peace and stability and fundamental interests of the two peoples."

In response to a deterioration of China-Philippines relations… Chinese Foreign Minister QIN Gang… made a "rescue visit" to Manila and met with Marcos, the vice president, and the foreign minister.

- President Marcos stated, “It’s very, very useful and very, very productive that Minister Qin came here and that we were able to talk things a little bit through, make plans for the future, continue to work on growing the relationship between the Philippines and China…and to establish more lines of communications so that any event that occurs in the West Philippines Sea (also known as the South China Sea) that involves China and the Philippines can immediately be resolved.”

Foreign Secretary Manalo’s statement on the meeting with Qin “reaffirmed the Philippine’s adherence to the One China policy, while at the same time expressing concern over escalating tensions across the Taiwan Strait.” On 19 April when asked at a Philippine Senate hearing on the Enhanced Defense Cooperation Agreement (EDCA) with the US if the Philippines would allow the US to store weapons for a Taiwan contingency, Manalo testified that, “Our view is that EDCA is not aimed at any third country, it’s meant for use for the Philippines and of course in connection with our treaty with the United States.”

Chinese maritime activity in the disputed South China Sea continued unabated in late April:

- The day after Foreign Minister Qin’s visit to Manilla, Chinese coast guard ship had a near at-sea collision with a Philippine patrol vessel carrying journalists.
- On 29 April the Philippine coast guard identified more than a hundred Chinese vessels parked at Whitsun Reef, which the Philippines claims as part of its exclusive economic zone.

President Marcos began a visit to Washington on 1 May.

Strategic outcomes

Apple—Xiao dispute and tech investment

LEVEL OF CONCERN

5 4 3 2 1

China is closely watching the latest US moves to restrict technology-related investment and will be certain to factor those developments into the Shanghai court's ruling on the Apple–Xiao i dispute. The court's decision ultimately lies with the political leadership, which will have to weigh the certain loss of technological investment against the potential for business uncertainty, disruptions to production and employment, and loss of markets.

Pamir Position

Pamir observes that China could compensate for a ruling in Apple's favor by introducing obstacles and other retaliatory measures in related areas.

Business Impact

Pamir recommends that companies plan for disruptions to IT supply chains and expect the need for scrutiny of counterparts or contacts that China might use as third-party intermediaries in otherwise prohibited business dealings.

Strategic outcomes

Level of Concern indicators - what they mean

1 - indicates no change to the status quo

2 - indicates escalating tensions

3 - indicates aggressive escalation

4 - indicates high probability of impending crisis event

5 - indicates a full-scale crisis or conflict situation.

How we calculate them

- Frequency of references to subject in Chinese-language official government statements, credible press reporting, and social media
- Frequency of references to subject in English-language official government statements, credible press reporting, and social media from the US, EU, UK, Australia, Japan, etc.
- Consistency of historical, current, and emerging trendlines related to the subject
- Aberrations in official Chinese-language policy formulations
- Strategic shifts in official Chinese government and military signaling through diplomatic, information, military, and economic actions and behavior

Analytic Methodology: internal monitoring with quantitative and qualitative analysis of Chinese media and propaganda; comparative trend analysis, intelligence tradecraft; other proprietary methods.

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