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In a Fortnight

By L.C. Russell Hsiao

CHINA DEBATES FOREX RESERVES; BOOSTS STRATEGIC PETROLEUM RESERVES

A string of recent pronouncements from Beijing leaders capped off with a strong statement by Premier Wen Jiabao over his concerns for the value of China's $681.9 billion investment in U.S. Treasury bonds has highlighted a troubled Chinese leadership's outlook for 2009. Premier Wen's statement was received by analysts as a strong warning to Washington. It follows a revision in the $588 billion Chinese fiscal stimulus package (see Willy Lam's article in this issue) at the recently concluded National People's Congress (China's parliament) and the release of a joint communiqué at the close of the G-20 finance minister meeting by Brazil, India, Russia and China (BRIC). The timing of these pronouncements outlines the silhouette of China's nascent comprehensive economic strategy at home and abroad. Moreover, it is an outlay of the on-going heated debate within China over its roadmap for economic recovery and a test of Sino-U.S. relations, given China's massive $2 trillion foreign exchange reserves (*China Daily*, December 17, 2008).

During the "meet-the-press" session after the close of the NPC on March 12, Premier Wen said, "We [China] lent such huge fund to the United States and of course we're concerned about the security of our assets and, to speak truthfully, I am a little bit worried." In an unusually direct appeal, Wen added, "I request the U.S. to maintain its good credit, to honor its promises and to guarantee the safety of China's assets" (Xinhua News Agency, March 13). On the issue of China's foreign reserves, Wen asserted that Beijing's primary concern will be to preserve its national interest, but he also acknowledged that, "we [China] also have to consider the stability of the overall international financial system, as the two factors are interlinked." Wen's statement linking China's national interests to stability in the international financial system were meant to allay concerns over the possible destabilizing impact of China's rise in the international system. The statement also reflects the oft-stated official position that China is a responsible stakeholder, and to brush aside any lingering expectation that China will take a leadership role in reshaping the post-Bretton Woods system.

In an interview with the Chinese publication *Economic Observer*, Wu Xiaoling, vice president of the NPC Financial and Economic Affairs Committee, explained that "[China's] reserves were a form of liability that could not be directly used for public spending" (Economic Observer [China], March 13). "Though the foreign currency reserves are an asset of the central bank, they are also a liability—the central bank is indebted to society, and must be safeguarded" Wu added. Wu was also the ex-deputy governor of the central bank and former chief of the State Administration of Foreign Exchanges (SAFE), which is the administrative agency that manages the state foreign reserve system. When asked about the central government's approach to the management of its foreign reserves under the global financial crisis, Wu stressed: "ensure safety, profitability and liquidity." In the same interview, it was reported that China's account surplus declined by 27 percent year-on-year in 2008, illustrating the stress on the value of Chinese assets. "The best way to minimize [further] risk is to scale down the size of the foreign currency reserves." According to Wu, other ways the government can reduce the heavy burden of the reserves is by "setting up a Renminbi equity investment fund, or expanding trade and foreign investment" (Economic Observer, March 13).

One sector for development clearly targeted by Beijing's diversification campaign is its strategic petroleum reserves (SPR) (*China Daily*, March 2; *Sankei Shimbun*, March 4). As early as January 2009, Zhang Guobao, head of the NEA and Vice-minister of the National Development Reform Commission, penned an article in the *People's Daily* saying, "The country [China] should take advantage of falling global energy prices to increase its oil reserves" (*China Daily*, March 2). According to a plan recently released by China's National Energy Administration (NEA), China plans to build nine large refining bases along its coastal areas over the next three years (*China Daily*, March 2). In a national energy conference in early February, the NEA also announced that China will build eight new strategic SPR bases on top of the current four by 2011, and increase China's strategic crude capacity from 103 million barrels (mb) to 281 mb. The four existing SPR bases are in Zhenhai, Zhoushan, Huangdao and Dalian; two confirmed venues for future SPR tanks are in Huanggao and Jinzhou; and the following venues are possible locations for the remaining six SPR tanks that are being planned to be built: Quanzhou, Shantou, Guangzhou, Bao'an, Zhanjiang, Yangpu, Yantai, Binhai, Caofeidian, Tieling, Linyuan, Lanzhou, Wanzhou and Shanshan (*China Daily*, March 2).

Western analysts, however, point out that the two countries' current strategy and economic trajectory are in a knot: "If China refuses to keep buying our bonds, the value of the dollar will plunge, and so, too, will the value of China's foreign reserves held in dollars," said Peter Navarro, an associate professor of public policy at the Paul Merage School of Business, University of California, Irvine. Navarro added, "On the other hand, if China keeps buying our debt to prop up the dollar, it faces a strong likelihood that with so much fiscal stimulus and easy money coursing through the U.S. system, inflation is all but inevitable. That, too, will ultimately devalue the dollar and therefore Chinese foreign reserves. So, for the Chinese, the question is whether to cut and run now or hold on and be scalped later."

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Mixed Signals from 11th National People's Congress

By Willy Lam

Premier Wen Jiabao has pulled out all the stops to reassure the National People's Congress (China's parliament)—and the world—that the Hu-Wen government's revamped stimulus package can ensure an eight percent growth rate this year. That the Chinese Communist Party (CCP) has discouraged NPC deputies from speaking out on Beijing's three-month-old, 4 trillion yuan (about $588 billion) resuscitation program, however, has betrayed a disturbing lack of confidence. The CCP leadership has also continued to put the lid on political reform in an apparent attempt to preserve socio-political stability in a year that is marked by sensitive dates such as the 20th anniversary of the June 4, 1989 crackdown. Moreover, the clout of the military and security forces, Beijing's most reliable weapon for muzzling dissent, has expanded. This has fed speculation that the People's Liberation Army (PLA) will be getting even more resources for the modernization of weaponry.

At the post-NPC press briefing last week, Wen reiterated his cabinet's main message during the nine-day parliamentary session, that "an eight percent GDP expansion is the government's pledge and responsibility." While pointing to unspecified "difficulties" concerning Beijing's ability to reach this goal, the 67-year-old premier said: "It's attainable through hard work." Both at the NPC and the press conference, Wen disclosed more details about the unprecedented large-scale "save-the-market" package. He indicated that the central government was pumping 1.18 trillion yuan ($173.5 billion) into the economy—595 billion yuan ($87.5 billion) of which had already been spent on infrastructure and other areas—with the rest coming from local administrations and commercial enterprises. Yet, other measures, such as 600 billion yuan ($88.2 billion) worth of tax cuts, 850 billion yuan ($125 billion) earmarked for medical facilities from now until 2011, as well as improvement in teachers' salaries and workers' pension, are on top of the 4 trillion yuan ($588 billion) injection. Moreover, Wen indicated that the central government could, if necessary, dig into its sizeable central coffers for additional steps to reinvigorate the economy. "We have prepared contingency plans to handle greater difficulties," he said. "We have prepared enough ammunition and we can launch new economic stimulus policies at any time" (Xinhua News Agency, March 13; Reuters, March 13).

Yet, the 2,900 deputies attending this annual NPC session—China's premier showcase for "people's democracy"—have been given scant opportunity to discuss the stimulus game plan either within parliament or with reporters. This is despite the fact that the Wen cabinet had made minor changes to the package apparently due to criticism that not enough is being done to beef up the social security net. For example, 550 billion yuan ($80.8 billion) worth of investment—230 billion yuan more than what was announced last November—will be lavished on housing, health and education. Outlays on infrastructure, on the other hand, have been cut from 1.8 trillion yuan to 1.5 trillion yuan ($220.5 billion) (Xinhua News Agency, March 6; *Ming Pao* [Hong Kong daily], March 6).

NPC deputies, however, have not been consulted on this crucial economic strategy. The roughly 70 percent of parliamentarians who are party members had been told before the session opened on March 5 by the NPC Party Committee not to table embarrassing motions. This is despite the fact that relatively liberal scholars and media have raised questions galore about the way the 4 trillion yuan pie is being divvied up. For example, Cao Honghui, a senior researcher at the prestigious Chinese Academy of Social Sciences (CASS), cast doubt on the efficacy of newly minted infrastructure schemes. "Some [projects] are meant to serve the real [needs of the regions]," he said. "Some are not based on realistic considerations, and others are merely efforts to wangle money out of central authorities." In a commentary entitled "Hoping that information about the 4 trillion yuan package will be more transparent," the *New Beijing Post* suggested that the NPC passes laws and regulations to supervise how the gargantuan sums are being used. The same murkiness has surrounded the 200 billion yuan ($29.4 billion) worth of government bonds that have been raised for regional administrations. According to the official *Shanghai Securities News*, the funds will be fairly evenly distributed amongst the provinces and major cities. This is notwithstanding the fact that some provinces have been hit worse by the financial crisis than others (*Ming Pao*, March 12; *New Beijing Post*, March 7; *Shanghai Securities News*, March 11). In yet another attempt to put up a façade of unity, the party leadership had forbidden parliamentarians from the regions to openly lobby for more funds for their localities (*Ming Pao*, March 12).

Perhaps to forestall criticism that the CCP authorities are bent on preserving the NPC's rubberstamp image, Congress Chairman Wu Bangguo said that China would never adopt the Western system of the "tripartite division of power" or institutional checks and balances. Wu, a member of the party's Politburo Standing Committee, indicated that parliamentarians would "fulfill their functions according to law [and] under CCP leadership." "We will never copy the Western model," Wu added. "We cannot superimpose the Western legal system on China's legal system" (China News Service, March 9; *People's Daily*, March 10). This is despite the fact that both in the *Government Work Report to the NPC* and the post-NPC press conference, Wen vowed to "enthusiastically push forward the reform of the political system." "We must ensure that the people have the right to know, to participate, to express themselves and to supervise [the government]," he said. The premier also pledged that the leadership would "promote the reform of the judicial system so as to improve social equality and righteousness" (Xinhua News Agency, March 5; *People's Daily*, March 14).

Part of the reason why deputies attending the NPC and the even more toothless Chinese People's Political Consultative Conference (CPPCC)—an advisory council for the party and state apparatus—were enjoined to observe strict discipline is that the two sessions coincide with ongoing disturbances in Tibet as well as neighboring provinces with large Tibetan populations. March 10 marked the 50th anniversary of the Dalai Lama's flight to India. And although protests so far have been less ferocious than those of last year, Beijing had by late February moved several tens of thousands of PLA and People's Armed Police (PAP) officers into the trouble-prone region. Hu Jintao and other leaders have taken advantage of the presence of international reporters in Beijing to sell their vision of a Tibet whose standard of living is fast expanding under tight Chinese control. While talking to parliamentarians from the Himalayan region, President Hu noted that the authorities were "constructing a firm and impregnable great wall [around Tibet] for countering separatism and upholding national unity." He added that Beijing had confidence in the "perennial order and stability" of Tibet (Xinhua News Agency, March 9; The Associated Press, March 9).

Apart from the police and the paramilitary PAP, the CCP leadership is calling on regular PLA troops to snuff out challenges to the regime. NPC spokesman Li Zhaoxing indicated that the 14.9 percent boost in the PLA's budget this year would help "maintain [socio-political] stability and other non-warfare military operations," thus implying that the troops were taking a more active role in combating destabilizing forces within China. It is perhaps a reflection of their enhanced political role that parliamentarians representing the armed forces were much more assertive than their civilian counterparts. For example, PLA officers at the NPC were aggressively lobbying for more resources to build or procure big-ticket hardware such as aircraft carriers. According to delegate Hu Yanlin, a former political commissar of the Navy, aircraft carriers were "the symbol of a big power, something that generations of naval officers have dreamt about." Added Vice-Admiral Zhao Guojun: "China needs to build a strong navy capable of functioning in the distant oceans. Therefore, constructing aircraft carriers is just a matter of time" (*Liberation Army Daily*, March 4; *International Herald Leader* [Beijing], March 3; *Straits Times* [Singapore] March 6).

Moreover, military parliamentarians have insisted that infrastructure projects that are being financed by the stimulus package should have dual civilian-and-military features and applications. Commentators in the nation's military press have called this "hitching a ride" on the new highways, railways, tunnels, ports and airports that will be constructed in the coming few years. Bai Zixing, a senior officer in the PLA General Staff Department, said at the NPC that the government should follow Chairman Mao Zedong's instructions about the "synthesis of war and peacetime [requirements]" through "adequately coordinating national defense construction on the one hand, and [civilian] economic construction on the other." Yan Jixiong, political commissar of the Henan Provincial Military District, pointed out that new highways, bridges and tunnels that are being built should take into consideration the specifications of military vehicles and other hardware. "There have been cases where military vehicles and equipment can't pass through tunnels that are just several centimeters too low," Yan added. "Given that most infrastructures are built for life, it's important that military requirements be taken into account at the design stage" (*Liberation Army Daily*, March 8).

While hobnobbing with NPC delegates from central Hubei Province, Premier Wen urged local officials to "further boost their competence in handling complicated [political] situations, and to raise the government's capacity to implement scientific and democratic decision-making." "We must improve our ability in intimately liaising with the people, and enhance the government's credibility," he added (Xinhua News Agency, March 7; *People's Daily*, March 8). Yet, the CCP leadership's refusal to vouchsafe top-level "people's representatives" full say at the NPC, not to mention giving more powers to military forces to crush internal dissent, does not seem an ideal recipe for either beefing up the ruling party's legitimacy or defusing growing contradictions between the authorities and the people.

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China's Maturing Relationship with Latin America

By Evan Ellis

The five-nation visit by Chinese President Hu Jintao to Latin America in conjunction with the November 2004 Asia-Pacific Economic Cooperation Forum (APEC) summit in Santiago, Chile, marked the beginning of a fundamental transformation in China's relationship with Latin America. Prior to that trip, the People's Republic of China (PRC) had almost no presence in the mainstream Latin American political, business and social discourse. The message sent by President Hu and his delegation during that trip was the Chinese intent to promote and accelerate a nascent partnership with the region.

Following Santiago, four years elapsed before the site of the annual APEC summit returned to Latin America. When President Hu traveled to the region in November 2008 to attend the APEC summit in Lima, Peru, the trip highlighted how far China's relationship with Latin America had evolved in only four years.

President Hu's trip came just weeks after the PRC's induction as a voting member of the Inter-American Development Bank. It also coincided with the release of China's first policy paper on the region, "China's Policy Paper on Latin American and the Caribbean." The paper confirms Beijing's intention to expand its engagement with Latin America on multiple fronts, from investment to technology partnerships to military exchanges [1]. En route to Lima, President Hu stopped in Costa Rica, which in June 2007 became the first Central American nation in the post-Cold War era to switch its diplomatic recognition from Taiwan to mainland China. In Cuba, Hu signed 37 agreements and had a photo op with an ailing Fidel Castro, which reinforced China's role as Cuba's principal extra-hemispheric patron [2]. In addition, the APEC summit highlighted the efforts of Peru and Chile to position themselves as commercial hubs in the developing trade between China and South America.

The Maturation of the Trade Relationship

Since 2004, China's relationship with Latin America has not only expanded quantitatively, but has also matured qualitatively in terms of both transactions and knowledge.

The growth of China-Latin America bilateral trade from $10 billion in 2000 to $102.6 billion by the end of 2007 [3] reflects two reinforcing phenomena: 1) the expansion of commodity exports to China by a small set of southern cone countries, and 2) a broad-based penetration by China into Latin American product markets.

The primary products purchased by China from Latin America have been commodities such as iron, copper, soy and fishmeal that do not require complex transactions or an extensive local presence. As PRC experience with the region has grown, however, it has cautiously established an investment presence in key commodity sectors. In Venezuela, it moved from modest oilfield operations in the Lake Maracaibo area to a more important and potentially riskier presence as a minority partner in developing the massive heavy oil reserves in the Orinoco river basin. In Peru, China Aluminum Corporation committed to invest up to 2.2 billion over the next 30 years for the rights to operate a mine at Toromocho [4]. In February 2009, during an official visit to Brazil, Chinese Vice-President Xi Jinping signed a preliminary accord for a $10 billion loan to the Brazilian national oil company Petrobras, providing it with capital for developing new deepwater oil reserves, which could ultimately be exported to the PRC [5].

In some cases, these investments have proven problematic for the PRC. Two years after a Chinese consortium invested $1.42 billion to purchase the Ecuadoran assets of the Canadian oil firm EnCana in 2006. The Ecuadoran government forced the Chinese to give up property rights in oil fields that had been part of the purchase and sign a new contract in which they simply extracted oil from the territory under a service contract with Ecuador [6]. Hutchison Whampoa Limited was forced to withdraw from a concession to operate the port of Manta when it could not resolve a dispute with the Ecuadoran government concerning the contractual obligations for investment in the port [7]. In Chile, China Minmetals invested $550 million in a copper advance purchase agreement with the state mining company COLDELCO, only to discover in 2009 that the agreement did not give it the expected right to acquire a 49 percent stake in the new Chilean mine "Gabriel Mistral" [8]. In Venezuela, a 2006 decision by PdVSA to stop producing the heavy petroleum product ormulsion left in the lurch a power plant built by the Chinese to use it [9].

Beyond commodities, select Latin American companies such as Grupo Modelo, FEMSA and GRUMA have made some progress building markets in the PRC, selling recognized brand name products to the growing Chinese middle class. Latin American governments have also improved their ability to support their nationals seeking to do business in China, opening commercial attaché offices in secondary locations such as Shanghai and Guangzhou, in addition to their embassies in Beijing. They are also expanding and refining the capabilities of trade promotion organizations tied to the government such as ProChile, APEX, Fundacion Exportar, PROCOMER, and CORPEI. Additionally, they have created technical frameworks to support trade and investment including bilateral free trade agreements with China, such as those of Chile (2006), Peru (2009), and Costa Rica (initiated November 2008), as well as reciprocal investment protection agreements (Colombia, November 2008) and individual phytosanitary agreements. Nonetheless, those governments and producers have discovered that despite such efforts, traditional products such as coffee and fruits have not sold well in the PRC. In addition to issues of Chinese tastes, these perishable products and the labor required to harvest them makes them uncompetitive against closer, lower-cost producers such as the Philippines.

With respect to Chinese exports to Latin America, the PRC has not only increased its market share, but also the sophistication of its product offering in Latin American consumer markets. As factories in the PRC produced more items and Latin American traders became more sophisticated in dealing with those factories, China has complimented its offering of labor-intensive manufactured goods such as clothing, toys and footwear with a broad selection of Chinese motorcycles, cars, heavy machinery, appliances, and consumer electronics. The PRC has also launched projects to build assembly facilities in the region itself, leveraging the access to third-country markets afforded by regional free trade agreements. Chinese auto companies DongFeng, Geeley, and FAW [10], for example, have announced plans to create assembly plants in the Mexican *maquiladora* sector, in order to achieve duty-free access to the U.S. car market under provisions of the North American Free Trade Agreement.

Finally, China or Hong Kong-based companies with a more multinational character have expanded their physical presence in the region to service clients. These companies include the logistics company Hutchison-Whampoa, China Overseas Shipping Company (COSCO), the telecommunications companies ZTE and Huawei, and Hong Kong Shanghai Bank of China (HSBC).

The Expanding Influence of China

Although the expanding volume of trade and investment between the PRC and Latin America is impressive, perhaps the most significant transformation has been the expanding weight of the PRC in the calculations of political leaders, businesspeople, and others in the region.

The perception that China is emerging as a key economic and political player has been a powerful motivator for leaders to invest time and resources to leverage, accommodate, or defend against such a future. The decision by Costa Rican President Oscar Arias to diplomatically recognize the PRC in June 2007 was motivated, in part, by his conviction that positioning his country in line with China's rise was necessary for it to play a leading role in the Americas. The investment of time by Latin American leaders to promote their countries' commercial and political relationship with the PRC through official visits to China has been similarly impressive. During 2008, for instance, four Latin American heads-of-state made high-level visits to China accompanied by trade and investment-oriented delegations: Peruvian President Alan Garcia (February), Chilean President Michele Bachelet (April), Mexican President Felipe Calderon (July), and Venezuelan President Hugo Chavez (September).

In the private sector, the calculation of businesspeople that the PRC will be among the most important markets of the future has motivated a wide range of corporate leaders to dedicate significant time and capital to position themselves in China, even when those companies do not expect to generate a profit from their China operations for years.

In the academic world, Chinese language programs and China studies programs in Latin American universities have proliferated since 2004. While the United States remains a dominant cultural and economic reference, a growing mass of Latin American students are investing their futures in the expectations of China's future importance.

The Impact of the Global Recession

The transformation of China's relationship with Latin America during the past four years is an inadequate measure of the rate of change to come. In particular, the deepening global recession, which may bring about financial and political upheaval, can fundamentally transform the roles of actors such as the PRC in the international system.

In the short to medium term, the recession is likely to severely strain China's relationship with Latin America. The PRC is likely to reduce its purchase of primary products from Latin America, while simultaneously seeking to boost its sale of goods there to compensate for lost sales to its traditional customers in the United States and Europe. This will exacerbate the existing trade deficit. The diminishing benefits of the PRC as a customer of Latin American goods, in combination with heightened competition from China as a major seller—as Latin American producers teeter on the edge of solvency—is likely to strengthen political forces with the social constituency in the region critical of trade with China This could fuel local resentment against Chinese companies' actions such as the 2006 takeover of an Andes petroleum oil field in Tarapoa, Ecuador [12], or the 2007 violence against the Chinese company Petroriental in Orellana [13]. It could also foment violence against ethnic Chinese in the region, as demonstrated by the incidents in 2004 against Chinese shopkeepers in the Venezuelan communities of Maracay and Valencia [14]. Such events may also motivate the PRC to work with governments in the region in new ways to protect PRC businesses and the Chinese Diaspora in ways that it did not do during the previous century when the PRC was weaker.

At the same time, if the PRC is able to effectively manage the tensions generated by economic conditions, both at home and in Latin America, it may emerge from the crisis with a dramatically stronger position in the region. The evaporation of Western capital from the region has increased the region's leaders' focus on the PRC and its $2 trillion in foreign currency reserves as a potential new source of global liquidity and investment. The steep decline in global commodity prices and asset values provide an opportunity for the PRC to acquire more assets in Latin America at bargain prices, while also winning influence and goodwill for investing in the region at a time in which Western investors are not.

As the global recession deepened in February 2009, for the first time ever, two senior Chinese officials made simultaneous multi-country trips to the region. Chinese Vice-President Xi Jinping, mentioned as a likely successor to Hu Jintao, paid visits to Jamaica, Colombia, Venezuela, Brazil and Mexico, while Hui Liangyu, the Chinese vice-premier, made trips to Argentina, Barbados, Ecuador, and the Bahamas. Other factors must be considered as well, such as how the crisis affects the competitive position between China and other outside players in Latin America, such as India. While it is difficult to determine the outcome of such interactions, it is likely that the next time that APEC hosts its annual summit in Latin America, the region's relationship with China will have evolved as much, if not more, than the change witnessed from the 2004 Santiago summit to the 2008 summit in Lima.

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NOTES

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China's Inroads into East Timor

By Ian Storey

China was the first country to establish diplomatic relations with the Democratic Republic of Timor-Leste—more commonly referred to as East Timor—when it gained formal independence on May 20, 2002 (*China Brief*, July 5, 2006). Since that time China has expanded its economic interests in East Timor and raised its political profile. The PRC's role in East Timor, however, should not be overstated: Chinese aid to the impoverished nation is dwarfed by that from major donors including the European Union, United Nations, Australia, Japan, and Portugal, and East Timor's immediate neighbor and former occupier Indonesia figures much larger than China in Dili's foreign policy. Moreover, recent government projects involving PRC companies have generated intense controversy in East Timor's political arena and underscored the negative impact that Chinese-style assistance can have on the development of good governance and environmental protection in less developed countries of Southeast Asia.

CHINA'S RISING PROFILE

The majority of PRC aid to East Timor over the past seven years has been devoted to the construction of key government buildings in Dili, giving China maximum exposure for a relatively low outlay. In early 2008 China handed over the Ministry of Foreign Affairs building, a large office complex built at a cost of $7 million. Several miles away, construction of the presidential palace is nearing completion, also paid for with $6 million in Chinese aid.

China's next major aid project will be a $6 million office complex to house the Ministry of Defense and Security and headquarters for the Timor-Leste Defense Force (*Forcas Defesa Timor Lorosae*, F-FDTL).

In addition to financing the construction of government buildings, however, China has also provided aid to help improve East Timor's weak human resources. Since 2002, more than 400 East Timorese civil servants and technical personnel have undertaken various training courses in the PRC, including in public administration, economic planning, tourism, health, construction, and technology. The Chinese government has also made available a number of university scholarships for East Timorese. Two areas of Chinese support that have been particularly useful have been public health and agriculture. Since 2004, China has dispatched two batches of resident medical teams to the country, comprising more than 20 doctors. The PRC has also launched a hybrid rice plantation project to assist East Timorese farmers to increase rice output to ameliorate chronic food shortages. Western diplomats complain, however, that China seldom coordinates its aid projects with other countries or with the UN [1].

Since independence East Timor has been subject to periodic bursts of political instability and violence, most seriously in 2006 when divisions within the armed forces drove the country to the brink of civil war and in February 2008 when assassination attempts were made against President José Ramos Horta and Prime Minister Xanana Gusmão, which spurred concerns that East Timor was dangerously on the brink of becoming a failed state. Yet, throughout these periods of instability the PRC continued to express confidence in East Timor's economic prospects, earning it kudos from the government [2]. Since February 2008 the political situation has stabilized and the economy has demonstrated respectable growth rates of 8-10 percent; China has been well-placed to take advantage of that growth. The value of two-way trade has expanded from $1.7 million in 2005 to $9.4 million in 2008, making China the country's fourth largest trade partner after Indonesia ($91.8 million), Singapore ($48.8 million), and Australia ($33.7 million) [3]. Recent years have witnessed an influx of PRC nationals into East Timor in search of economic opportunities. There are an estimated 1,000-3,000 PRC nationals in East Timor making them one of the largest foreign communities in the country [4]. The majority of Chinese working in East Timor are engaged in the restaurant trade or street hawking, many without valid work permits. The government has turned a blind eye to illegal Chinese workers as they have helped grease the wheels of economic growth, particularly in the countryside.

As the economic outlook for the country improves the government will invite tenders for a number of large infrastructure projects in 2009, including a major expansion of the airport, new roads, dams and port facilities [5]. Chinese construction companies are expected to bid for several of these projects, but will likely face stiff competition from their counterparts in South Korea, Malaysia and Indonesia.

Energy Resources

One of China's primary interests in East Timor is to gain access to the country's oil and gas reserves. So far, however, it has made little headway, underlining the limits of Beijing's influence in Dili. In 2005 state-owned energy company PetroChina conducted a $1.6 million seismic study to assess the extent of East Timor's onshore reserves. At the conclusion of the survey PetroChina failed to secure exclusive extraction rights from the China-friendly government of then Prime Minister Mari Alkatiri [6]. The project has failed to advance since then.

The bigger prize for China would be access to East Timor's liquefied natural gas (LNG). In 2005 East Timor and Australia shelved their maritime boundary claims in the Timor Sea and agreed to evenly split royalties from the Greater Sunrise gas field, estimated to contain 8.3 trillion cubic feet of natural gas and 300 million barrels of crude oil, and predicted to generate billions of dollars in revenue for East Timor over its life time [7]. Before production can begin, however, Dili and Woodside Petroleum, the main Australian player in the project, must reach agreement on where the LNG is to be processed. Three options are currently on the table: the first is to pipe the LNG to a processing facility in Darwin, Australia; the second is to build a floating processing facility in the field; and the third is to pipe the gas to East Timor. Woodside is said to favor the first option, but the government of East Timor has championed the third option so as to create jobs and boost the local economy. Dili has contracted the Malaysian energy company Petronas to conduct a viability study into a pipeline to East Timor and the initial findings are reportedly promising [8]. There have been suggestions that if this third option gets the green light, China's state-owned energy companies might bid to build the pipeline with an eye to purchasing the bulk of the LNG. South Korea and Thailand have also expressed a keen interest in buying LNG from East Timor, though their enthusiasm may have waned due to the global financial crisis and falling energy prices. Beijing, hedging a rise in the price of hydrocarbons once the inevitable economic recovery gets underway, is likely to take a more long-term view.

Chinese Military Aid

East Timor's armed forces, the F-FDTL, is a small force of 1,200 personnel that has been riven by political and regional rivalries, suffered from poor discipline and morale, and lacks modern equipment. Since independence the bulk of military assistance to the F-FDTL has come from Australia, Portugal, the United States, and Brazil. China has played a relatively minor supporting role, providing $1 million worth of equipment including tents, uniforms, and transport vehicles. In addition, China has spent $6 million on accommodation buildings for F-FDTL officers. According to its embassy in Dili, the PRC has provided training slots for 20 East Timorese military personnel since 2002 [9]. In its first major defense contract with the PRC, in 2007 East Timor purchased eight Chinese-built jeeps mounted with machine guns.

Last year, however, China positioned itself to play a much more prominent role in the development of the F-FDTL. In April, the East Timorese government signed a $25 million contract with Poly Technologies, a subsidiary of China Poly Group—a defense company with close links to the PLA—for two coastal patrol vessels. The vessels will be modified versions of the Type-62 Shanghai-class patrol boat, which was designed in the 1960s: 43 meters long, displacing 175 tons and armed with two 30-mm cannons. The contract also includes training for 30-40 F-FDTL personnel in China and the construction of a small landing dock on the south coast.

The purchase of the patrol boats has generated controversy in East Timor. The main criticism concerns the lack of transparency surrounding the deal: an open tender process was not conducted and the decision to buy the boats was seemingly a unilateral one made by Prime Minister Gusmão. Despite calls from opposition politicians and NGOs the government has refused to make public copies of the contract with Poly Technologies.

The suitability of the vessels has also been called into question. Although the government has rationalized the acquisition on the grounds that the country needs an expanded naval force to deal with problems such as illegal fishing, the Shanghai-class boats are not designed to deploy far from homeport and are ill suited for the tropical and rough conditions common in the Timor Sea. Accordingly, when the vessels are delivered at the end of 2009 they will likely add little to East Timor's defense capabilities.

The contract for the Chinese patrol boats has also been questioned by one of Dili's main security partners. The acquisition of a light naval force was recommended in *Força 2020*, East Timor's ambitious 2006 defense white paper [10]. When the report was made public, Australia's then Foreign Minister Alexander Downer criticized it as "completely unrealistic" for East Timor's defense needs [11]. Notwithstanding Canberra's lack of support, it is clear that the government is continuing to use *Força 2020* as a blueprint for the development of the F-FDTL. The Prime Minister's decision to buy the two patrol boats from China can be seen in part as sending a message to Australia—East Timor's well-meaning but often overbearing neighbor—that Dili has other options when it comes to choosing its defense partners.

China to Electrify the Nation

Even more potentially explosive than the patrol boats has been China's proposed participation in a major national electrification project. Power outages are a common occurrence in Dili, and outside the capital most East Timorese have no access to electricity. To provide for current and future energy needs East Timor had been exploring the use of clean and renewable energy sources such as hydroelectric, biogas and wind. In October 2008, however, the government made a complete U-turn on this initiative when it awarded a contract to the Chinese Nuclear Industry 22nd Construction Company (CNI22) for two heavy oil power plants and a national power grid.

Opposition politicians and environmental groups have castigated the government's decision on the grounds of transparency, environmental impact, quality and even constitutionality [12]. First, the period in which companies were invited to bid for the project was unusually short at three weeks, leading to accusations that the government already had a favored contractor. As was the case in the Chinese patrol boats, the government has refused to publish details of the contract. Second, the two power plants are more than 20 years old and burn heavy fuel oil, which releases sulfur, carbon dioxide and other pollutants into the atmosphere. Moreover, critics claim that use of this kind of oil is not cost effective because it is not produced in East Timor and will have to be imported from overseas. Third, the tender called for the completion of the project within one year, raising issues of quality control. Fourth, the project is budgeted to cost $375 million to be paid over a four year period. To fund this and other infrastructure projects the government has proposed a $681 million budget for 2009, which will necessitate the withdrawal of $590 million from the country's Petroleum Fund, $181.2 million above what the government is allowed to withdraw. The Petroleum Fund is essentially a sovereign wealth fund that is designed to prevent the government from squandering or misappropriating revenue generated from energy resources (only a small percentage of the fund can be used for public spending each year) and to provide financial security for future generations of East Timorese—at the end of 2008 it contained $4.4 billion [PM's speech January 2009, see endnote 13]. In November 2008 the Court of Appeal ruled in favor of a group of opposition Members of Parliament who had challenged the budget on constitutional grounds [13]. The government, however, brushed aside the ruling and in his January 2009 address to parliament on the budget Prime Minister Gusmão reaffirmed his government's resolve to press ahead with the power plants [14]. As a result, China has quickly found itself at the center of East Timor's most controversial political issue. On March 17, President Ramos Horta told parliament that he shared many of the concerns that have been raised about the contract and called for the establishment of an independent body to conduct an environmental impact and technological assessment of the power plant project (WAtoday.com.au, March 18).

Since East Timor gained independence in 2002, China has established itself as an important player in the nation's foreign and economic affairs. Yet its role has been magnified, particularly when compared to Australia, Portugal, Indonesia, and the United Nations. Moreover, wasteful and environmentally unsound projects such as the patrol boats and power stations may tarnish China's image in the fledgling republic. Whether this will be detrimental to China's long-term interests in East Timor, however, remains to be seen.

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Notes

1. Interviews with Western diplomats, Dili, December 2008.
2. See Loro Horta, "Timor-Leste and China: The Dragon's Newest Friend", RSIS Commentaries, September 27, 2007 < http://www3.ntu.edu.sg/rsis/publications/Perspective/RSIS0972007.pdf>
3. Timor-Leste National Statistics Office <http://dne.mof.gov.tl>
4. Interview with East Timor government official, Dili, December 2008.
5. Ibid.
6. Ibid.
7. Jesse Wright, "Risky pipedreams for East Timor," *Asia Times Online*, May 31, 2008.
8. "East Timor says optimistic on site of LNG plant," Reuters, March 4, 2009.
9. Information provided by PRC Embassy, Dili, December 2008.
10. See < http://www.locjkt.or.id/Timor_E/pdf/Forca202007.pdf>
11. Mark Dodd, "E Timor military blueprint unrealistic: Downer", *The Australian*, June 8, 2007.
12. See < http://www.laohamutuk.org/Oil/Power/08PowerPlant.htm>
13. "East Timor court rules against PM", BBC News, November 13, 2008.
14. See < http://www.laohamutuk.org/econ/OGE09/PM-OGE09-14Jan09En.pdf>

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China and the Arctic: The Awakening Snow Dragon

By K. Joseph Spears

China is very dependent on international shipping for its economic development. Any changes to world shipping routes will have a direct impact on China's economy and potential trade with respect to both imports and exports. The Arctic Ocean is in a state of rapid flux that scientists have not seen in recent times. The Arctic is changing rapidly and this will have a profound effect on global shipping routes. This article is based on the writer's experience in what a changing Arctic might look like and the possible impact on China's future. This article is by nature a horizon scanning prediction based on an understanding of shipping theory and practice. Shipping by its nature is secretive and the open source literature on this subject for commercial reasons is sparse. It is hoped that this article will provide the reader with some perspective and context to deal with these changes in the Arctic.

Over 50 percent of the sea-ice cover in the Arctic Ocean in the last two summers has disappeared. This reality—a melting arctic—is outstripping the predictive climate models. An open Arctic Ocean presents a unique opportunity for China and international trade generally. Commercial shipping is the lifeblood of international trade with over 90 percent of the world's international trade carried by commercial shipping. With or without a great global recession, shipping will continue to be the thread that keeps the world economy operating—whether the cargoes are bulk commodities, oil or manufactured goods. China is dependent on foreign trade and 46 percent of its GDP is shipping dependent [1]. Any event that affects shipping will have a measurable effect on the Chinese economy, and the changing physical landscape of the Arctic region will certainly have a major impact on China's economic future.

The search for the Holy Grail of a Northwest Passage through the Arctic from Europe to China for trade drove exploration and the "discovery" of the New World for centuries. This article, the first of a series, will examine the future scenarios for new commercial shipping routes across the top of the world—one of the world's last frontiers. During the Cold War the Arctic was the center of action for subsurface activity. The use of polar routes revolutionized air travel in the last century and the advent of new shipping routes will do the same for commercial shipping in this century. These new routes, because of significant distance and fuel savings, could produce a seismic shift in world trade patterns and the nature and form of commercial shipping. China is 4000 nautical miles closer to the European Union and the East coast of North America sailing through the Arctic Ocean, and currently there are no vessel size restrictions and other regulations unlike in the Suez or Panama Canal. There are presently no fees for Arctic routes. In addition, the smaller ecological footprint of reduced fuel costs per ton-mile might also be an added incentive for the development of an Arctic route. Arctic shipping could be another aspect of the new green wave that is sweeping the shipping industry, as more attention is being paid to the environmental impact of shipping including fuel efficient and emission reduction of commercial shipping.

Scientists in Copenhagen attending a conference from March 10 to March 12 hosted by the University of Copenhagen in conjunction with a number of other universities warned that the predictive climate models that underlay the 2007 United Nations Intergovernmental Panel on Climate Change (IPCC) climate change report have underestimated the rate of sea change. This conference is a precursor to a Governmental Climate Change scheduled for December in Copenhagen and which will supplement the IPCC Report. Given the effects of global climate change, the scientists are pointing out that these changes are occurring faster and the potential for feedback loops that increase the sea-ice melting process is very real. Feedback loops are natural processes that can increase the rate of warming or sea-ice changes, for example melting permafrost may release methane which has a greater capacity to increase global warming. Methane is essentially CO_2 on steroids. The present concentration of CO_2 in the atmosphere is 380 parts per million (PPM), which is the highest in perhaps the last 30 million years. What seems clear is that the sea-ice cover in the Arctic Ocean is going to decrease and thin in the coming years. Many researchers have stated that in the Arctic the climate changes have magnified at least twofold. China has maintained a considerable scientific program in both the Arctic and Antarctic and has been conducting scientific research on climate change with a special focus on how this will affect China in a warming world. It has partnered with other arctic nations in joint scientific programs and was involved in the recent International Polar Year (IPY) program, which was a major coordinated research program on Polar research [2].

The opening up of the Arctic Ocean, as early as 2013, will create new opportunities for shipping. At the same time, the fast melting Greenland ice cap will likely increase the number of calving icebergs, which will continue south into the Great Circle shipping route across the North Atlantic. The International Ice Patrol led by the United States Coast Guard maintains a close watch of icebergs in this well traveled shipping lane in the Atlantic.

To enter the Arctic Ocean from the Indo-Pacific where commercial traffic would enter from China, the only entry point is the Bering Strait, which separates Russia from the United States. It was known as the "Ice Curtain" during the Cold War, and is now being referred to as the Bering Gate. The Strait is a narrow choke point only 52 nautical miles wide with a depth of 30 to 50 meters. There are three possible international shipping routes once a vessel enters the Arctic: 1) The North East Sea Route or Northern Sea Route along the Russian coast (NSR), 2) the Transpolar Route and 3) the North West Passage (NW Passage) through the Canadian Arctic archipelago.

The former and the latter shipping routes transit internal coastal waters of Russia and Canada respectively and are subject to the application of the laws of the coastal state. These two countries as coastal nations will control these routes. The Canadian NW Passage, the shortest route of the three, is, in fact, 5 separate geographical routes through the Canadian Arctic archipelago. Canada has enacted the Arctic Waters Pollution Prevention Act that imposes a variety of restrictions on navigation and requires ice classed vessels and ice navigators. Russia has the same type of restrictions and charges for ice-breaker support along the NSR.

The Transpolar Route would transit the Arctic Ocean and be outside the territorial jurisdiction of any of the Arctic coastal states and would be on the high seas. There is no specific restriction on navigation under the Law of the Sea Convention for high seas navigation and the only laws applicable would be the law of the flag state of the vessel. The Law of the Sea Convention sets out the international legal regime for the Arctic.

In the past, the Transpolar Route was not given much commercial interest because of the barrier posed by multi-year sea-ice in the Arctic Ocean. The lack of salt content as the ice ages hardens the sea-ice. Again, most shipping companies do not disclose their future commercial plans. In the Arctic Ocean, there historically was very hard multi-year ice, which would raft up and prevent even the largest ice breakers from getting through. The sea-ice is dynamic and is moved by ocean currents and tides and winds that can raft the sea-ice into pressure ridges and extend more then 100 feet below the surface. The multi-year ice even without the pressure ridges is very hard and difficult to penetrate by even the largest icebreakers which are presently operated by the Russian government in a public–private partnership with the Murmansk Shipping Company. MSC manages the powerful Russian nuclear icebreakers on a commercial basis, which are available for charter. These Russian icebreakers are the world's largest and a number are nuclear powered. The traditional approach to ice breakers has been to have specialized purpose-built vessels usually government owned and operated to provide icebreaking support to commercial cargo vessels. In other words, the icebreakers have very limited cargo capacity. China has one large research icebreaker, the Snow Lion (Xuelong), which is used for research purposes in both the Arctic and Antarctic. This is a former Russian-built icebreaker [3].

The ship design technology presently exists for vessels to operate year round in the Arctic. It simply needs to make economic sense. There is no reason why China can't come up to speed on this technology as it is readily available in the commercial domain. Finland is arguably the world leader in the development of icebreaking technology. With dropping bunker fuel costs since the global economic slowdown, a 4000 mile distance saving may not make such a great difference as it did a year ago but in the longer term the cost saving would be considerable. According to one recent article, it is estimated that for one containership the cost saving could be in the range of a cost reduction of half a million dollars [4]. Given the recent fluctuations in the shipping world it is difficult to obtain accurate predictions. The cost saving could be considerable but this may be offset by increased crewing or marine insurance costs. Given the predictive nature it is difficult to be more precise given the large number of variables. Shipping costs are a function of supply and demand.

There are environmental and economic benefits from using few and larger vessels over a shorter geographical distance. With containerships of which China is a major world operator, the ocean freight costs could be greatly reduced as the vessel would not have to enter west coast North American ports and/or pay the canal fees which can be substantial. One can not underestimate the importance of decreased ecological footprints. In a rapidly warming planet this will become more important to the end consumers most of whom purchase the goods from manufacturers in China.

Shipping remains the most energy efficient way to move goods. In a global economy, with no depth restriction on a trans-polar shipping route, very large vessels could be built especially if deep water transshipment ports were developed. The vessels would not have to be restricted to a single type and could include containerships, bulk carriers and oil and LNG tankers.

In an article that appeared in the *Financial Times* of London in January 2008, Professor Robert Wade of the London School of Economics wrote:

> The country has lately displayed special interest in relations with Iceland, the tiny island in the north Atlantic, which with its strategic location is believed to get a key role in future shipping in the region. China wants to start shipping containers in the north, and sees the deep-sea ports of Iceland as potential port bases.

This was the subject of a recent conference hosted in Iceland in 2007. Given the secretive and commercial nature of shipping there is little information in the public domain [5].

A melting Arctic Ocean has a major impact on China and it could become a major Arctic shipping nation. It appears that China has not engaged in the development of ice technology, which tends to be dominated by the Nordic countries and the focus in recent years has been the development of the Russian gas field in the Barents Sea. Yet this is readily commercially available and technology transfer agreements could be developed between ship design and engineering firms and China. This approach has been used in South Korea shipyards for new vessel construction destined for the icebreaking tankers used in the Russian Arctic gas fields.

China has sought observer status at the Arctic Council, a grouping of the Arctic Nations that looks at various arctic issues including shipping. The Arctic Council was set up in 1996 and is an intergovernmental forum of nations which border the Arctic Ocean. This serves as a forum to deal with arctic issues. One example of the work the Arctic Council is doing is an arctic shipping assessment which is a collaborative effort. The Arctic Council is keenly aware of the challenges presented by arctic shipping [6].

The International Maritime Organization (IMO), which is a highly successful United Nations Organization that sets international maritime standards that are adopted by the world's flag and coastal states is working to develop a Polar Code with the support of the International Group of Classification Societies which will set uniform construction requirements for commercial vessels and navigation standards for arctic waters. Lloyds Registry of Shipping is one of the oldest of the Classification standards.

Underwriters take these issues into account when setting marine insurance premiums in underwriting the risk. Marine Insurance costs presently serve more of a barrier to commercial arctic shipping than vessel icebreaking technology.

China presently is conducting research in both the Arctic and Antarctic with an emphasis on climate change. China has one of the world's largest non-nuclear icebreakers used in Polar research. Much of the international community is clamoring for a special international regulatory regime to govern commercial activity in the pristine Arctic Ocean Basin including shipping. Traditionally China has kept a low profile on shipping matters but it is starting to take a much more active role in increasing arctic research in both the Arctic and Antarctic. In the recent past it has maintained an active program of Arctic and Antarctic stations and has partnered with a number of Arctic nations and has set up a research station in Norway. China's arctic research is well coordinated. While China has remained on the outside of the shipping side, it would take very little commercial effort to come up to speed on the state of the art commercial icebreaking and polar capable vessels. With a melting arctic that may be less of a problem than we think. China's extensive scientific research provides a solid basis for the development of Arctic commercial shipping. In 2008 it established a research station at 87 degrees North. China is a major trading nation that has much to gain with a reliable and low cost shipping route across the top of the world. yet, there may be little snow or ice in the coming decades for this emerging and awakening of a shipping Snow Dragon. China's economic future may be intricately linked to a melting Arctic.

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Notes

1. This dated shipping data (2003) is taken from a presentation given by Gao Weijie, vice senior executive president of COSCO Group, at the International Maritime Forum and can be found at http://www.cosco.com/en/pic/forum/654923323232.pdf.
2. China's polar research is coordinated by the Chinese Arctic and Antarctic Agency. See http://www.chinare.cn/en/index.html.
3. A good overview on sea-ice changes, ice classed shipbuilding technology and Chinese Arctic scientific research can be found at the conference proceedings of the Maritime Security Conference 2008 held in Victoria , British Columbia hosted by the Canadian Department of National Defense and the MarPac Commander. See the Focus on the Arctic Panel which can be viewed online at http://www.msc2008.blip.tvwww.msc2008.blip.tv. The writer wishes to thank Dr. James Boutilier for asking him to participate as a discussant on this panel.
4. An excellent article was written on the Arctic shipping by Dr. Scott Borgerson in the March 2008 issue of Foreign Affairs 'Scramble for the Arctic' which can be found at http://www.foreignaffairs.com/articles/63222/scott-g-borgerson/arctic-meltdown. In the article the writer makes reference to a 17.5 Million dollar cost saving to 14 Million dollar cost saving with respect to a single containership voyage. Given the number of containerships presently idle, it is presently difficult to accurately assess the potential cost savings in today's economic climate.
5. The 2007 Conference held in Iceland in entitled Breaking-The-Ice- Prospects of a Transpolar Route can be found at http://www.mfa.is/media/Utgafa/Breaking_The_Ice_Conference_Report.pdf.
6. The overall work of the Arctic Council work can be found at www.arctic-council.org. The Arctic Shipping Working Group of the Arctic Council can be viewed at http://arcticportal.org/pame/amsa.

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