



IN THIS ISSUE:

IN A FORTNIGHT By L.C. Russell Hsiao.....	1
INTERNATIONAL MONETARY REFORM AND THE FUTURE OF THE RENMINBI By Pieter Bottelier.....	2
CHINA'S STRATEGY TOWARD CENTRAL AMERICA: THE COSTA RICAN NEXUS By Daniel P. Erikson.....	5
CROSS-STRAIT MATRIX: THE ECONOMIC COOPERATION FRAMEWORK AGREEMENT By Terry Cooke	7
FOOD SECURITY IN AFRICA: CHINA'S NEW RICE BOWL By Loro Horta.....	10



China-Zambia Friendship Farm

China Brief is a bi-weekly journal of information and analysis covering Greater China in Eurasia.

China Brief is a publication of The Jamestown Foundation, a private non-profit organization based in Washington D.C. and is edited by L.C. Russell Hsiao.

The opinions expressed in China Brief are solely those of the authors, and do not necessarily reflect the views of The Jamestown Foundation.



For comments or questions about *China Brief*, please contact us at pubs@jamestown.org

1111 16th St. NW, Suite #320
Washington, DC 20036
Tel: (202) 483-8888
Fax: (202) 483-8337

Copyright © 2009

In a Fortnight

By L.C. Russell Hsiao

CHINESE STATE-OWNED MILITARY FIRM REPORTS MAJOR INCREASE IN SALES

Recent reports within the Chinese press revealed that sales of a Chinese state-owned military conglomerate that produces equipments and arms for both civilian and military applications have rose substantially in the first quarter of 2009. A case in point is the Beijing-based China South Industries Group Corporation (CSIGC), one of the country's largest civilian-military firms, which stated that its first-quarter sales rose 8.4 percent year on year to \$5.73 billion (38.99 billion Renminbi). According to the official Xinhua report, CSIGC reportedly earned over \$100 million (710 million Renminbi) in profits in the first quarter—with profits increasing month-on-month—citing data released by the company in late April (Xinhua News Agency, April 26).

The figures in the report only cited sales for civilian products such as small cars and motors, and no details were given on the composition of total sales from military products. “In the first quarter, the company sold 300,000 sets of vehicles, up 13.2 percent year on year. The growth was more than 9 percent higher than a 3.88-percent growth in the country's overall domestic auto sales in the same period.” Moreover, “sales from its power transmission and transformation, as well as new-energy sectors, jumped almost 60 percent year on year to 3.44 billion yuan [approximately \$500 million]. The company's sales of transformers surged 73 percent” (Xinhua News Agency, April 26).

CSIGC is a state-owned enterprise under the direct administration of the Chinese State Council. The company was re-structured in the landmark reforms of 1998, which divided China's defense industrial base into civilian and military components. CSIGC

is comprised of 64 large-and medium-sized industrial enterprises, 13 research institutes and other corporations. According to a Chinese government website, CSIGC holds 11.6 percent and 50 percent of shares of North Industries Finance Company Ltd. (NORFICO) and China North Industries Corporation (NORINCO), respectively (Techinfo.gov.cn). While CSIGC produces equipment for civilian uses, it is known for its research and development of “special equipment” for the country’s armed forces.

The growth in sales of CSIGC and its sister organizations in recent years have increased in line with the People’s Liberation Army’s (PLA) military budget, which analysts say creates a feedback loop for PLA defense modernization. The PLA’s overall budget has been increasing by double-digits annually for the past two decades, and the modernization of the Chinese military is stoking concerns of a regional arms race and raising international awareness about the impact of Chinese arms sales toward conflict zones.

Andrei Chang, the editor-in-chief of *Kanwa Defense Weekly*, noted in a January report that the quantity of Chinese military arms and equipment transferred to Africa is expanding. According to Chang, the arms and equipment are being “traded for oil, mineral resources and even fishing rights.” For instance, “Zambia has used its copper resources to pay China in a number of military deals, for instance, and Kenya has been negotiating with China to trade fishing rights for arms” (UPIAsia, January 26).

While China’s military exports are soaring, Russian arms sales on the other hand have been in decline. According to a Russian official, Moscow’s sales of weaponry and military technology to Beijing continue to drop from previous years. Anatoly Isaikin, general director of Rosoboronexport—a Russian arms export monopoly—told the *Rossiiskaya Gazeta* that “sales have dipped about \$1 billion a year” (*The Moscow Times*, April 19; UPI, April 11). *The Moscow Times* reported that Russia has pulled in \$16 billion from arms sales to China since 2001, and this includes Su-27 and Su-30 fighter jets, Kilo class diesel submarines and air defense systems. Yet, Isaikin said that the Chinese share of Russian arms exports fell to 18 percent last year and could continue dropping to 10-15 percent in the future. Isaikin attributes this to Russia’s expansion into other arms markets (*The Moscow Times*, April 19). The Russian arms industry, however, has been trying to lobby for stronger Sino-Russian defense ties due to concerns about the 62 percent drop in Russian arms sales to China in 2007 (SIPRI’s online Arms Transfers Database, March 31, 2008; *Moscow News Weekly*, March 27, 2008; *China Brief*, April 16, 2008).

Mr. L.C. Russell Hsiao is Associate Editor of *The*

Jamestown Foundation’s China Brief.

International Monetary Reform and the Future of the Renminbi

By Pieter Bottelier

Since People’s Bank of China Governor Zhou Xiaochuan’s proposal for reforming the international monetary system was published on March 23, there have been new developments with regard to the international use of the Chinese currency Renminbi (RMB). The historical context of Governor Zhou’s proposal and the prospects for the international use of the RMB are interrelated. In spite of the generally negative press reports in the United States, Zhou’s proposal was couched in careful, professional and non-provocative language. Although the proposal may have been partly motivated by domestic politics, it does reflect deep-rooted concern in China that the international financial crisis and subsequent U.S. responses to it could undermine the purchasing power of the dollar. Since most of China’s \$2 trillion plus reserves are invested in dollar-denominated financial assets, Beijing’s concerns are understandable. While some in the United States argue that China should not fret about excessive dollar exposure—because that is the result of its controversial exchange rate policy—it should be recognized that China’s worries about the future of the U.S. dollar are widely shared and that Zhou’s proposal appears to have been well received in many quarters around the world.

BACKGROUND TO ZHOU’S PROPOSAL

China is afraid that the vast increase in U.S. fiscal deficits combined with the Federal Reserve’s efforts to keep interest rates low by injecting large amounts of liquidity in the economy will leave the Federal Government overleveraged and unable to maintain macroeconomic stability while at the same time protect the international value of the dollar. China is also concerned that continuing uncertainty surrounding resolution of the toxic asset problem of U.S. and European banks will slow global economic recovery. It is too early to know whether U.S. Treasury Secretary Timothy Geithner’s plan (announced on the same day as Zhou’s proposal) will work, but China would have preferred more drastic, coordinated trans-Atlantic action to remove the toxic assets from the banking system once and for all. In their view, this could have been done in ways similar to what the Chinese government did a decade ago in removing huge amounts of non-performing loans from the balance sheet of its banks. The Chinese realize that such action might have required the temporary nationalization

of many banks, which would have been highly controversial and problematic in practice [2].

Although international agreement on Zhou's proposal seems highly unlikely, its launch may set in motion a process of gradual change in the global monetary system, including the growing international use of the RMB.

China's central bank and other government-owned financial institutions, including China's sovereign wealth fund (CIC) hold an estimated \$1.5-1.6 trillion in U.S. dollar-denominated financial assets. The rest is denominated in other convertible currencies. Official gold reserves amounted to 1,054 tons at the end of March 2009, accounting for about 1.5 percent of total reserves at the current gold price. China is not only the largest foreign creditor of the U.S. Federal Government, but also of government-sponsored enterprises (GSE) Fanny Mae and Freddie Mac. To protect the value and the liquidity of its reserves, China has been quietly changing their composition from GSE bonds to Treasuries and from long-maturity Treasuries to short-maturity ones [3]. China continues to buy newly issued Treasuries and there is no evidence yet that it is diversifying its reserves away from U.S. dollars [4].

"In the interest of international financial stability," Zhou proposed the creation of a new international reserve currency that is disconnected from individual nations, issued in accordance with agreed rules and stable in value. For this purpose he proposed to modify the IMF's Special Drawing Right (SDR), a synthetic reserve asset and unit of account created by international agreement in 1969 to supplement official reserves of member countries and to support the Bretton Woods fixed exchange rate system.

A BRIEF HISTORY OF THE SDR

SDRs were created in light of serious concern at the time that a shortage of gold and gold-linked U.S. dollars (or dollar-denominated financial instruments) to finance international trade would slow global growth. The IMF was given authority to issue SDRs to central banks of member states to supplement their reserves in accordance with an agreed-upon formula.

The creation of the SDR marked the most significant international financial agreement since the emergence of the Bretton Woods system at the end of World War II, which was based on the gold-backed U.S. dollar. That system was created against the advice of Keynes who, at the Bretton Woods conference of July 1944 proposed the creation of a synthetic reserve and settlement currency (which he named the Bancor), based on the weighted average value of a basket of 30 commodities. In addition, Keynes proposed

the establishment of an international financial clearing house with rules aimed at automatically redressing large international trade imbalances.

The SDR in its original form was a much simpler instrument than Keynes' still-born Bancor. It was not a currency, but a unit of account, initially linked to gold at the fixed rate of 1 SDR per 0.888671 grams of fine gold—the same as for the U.S. dollar at that time—to be used as reserve asset and for settlement between member central banks only.

The SDR became largely redundant a few years later when the United States, under the Nixon Administration, was forced to abandon the gold standard in 1971. That marked the beginning of the present floating exchange rate system for major currencies, with the U.S. dollar—since then a fiat currency—serving as the world's premier reserve asset and settlement currency. The value of the SDR was redefined as a basket of four currencies, which today consists of the U.S. dollar (44 percent), Euro (34 percent), Japanese Yen (11 percent) and British Pound Sterling (11 percent). Under the current international monetary system, there is no "natural" limit to the issue of U.S. dollars as there was under the Bretton Woods system when the dollar was backed by gold at a fixed rate of exchange. Under the floating rate system, the U.S. is under no obligation to protect the international value of the dollar, but the system is nonetheless stable, at least in principle, as long as the rest of the world is willing to hold all Treasuries not held by Americans.

Zhou's proposal brings the limits of that willingness into view, but there is at present no viable alternative to the U.S. dollar as the global reserve currency. The significance of the Euro—accounting for about 26 percent of international reserve holdings at present—is unlikely to increase much, because, in the absence of a European ministry of finance, the market for Euro-denominated bonds will remain segmented. Buyers of Euro bonds have to choose between bonds issued by 16 different EU member countries using the Euro as their national currency; the pricing of Euro bonds differs with market perceptions of the credit worthiness of issuing countries. The Euro bond market is large, but not nearly as deep and liquid as the market for Treasuries. Other convertible currencies are too small to serve as reserve currency on a large scale.

Zhou proposes to enhance the use of the SDR as a reserve asset and to make it usable as an invoicing and settlement currency in international trade and financial transactions. With those objectives in mind, he proposes to: 1) make the SDR convertible into other currencies, 2) promote the use of the SDR for commodity pricing, investment and corporate book-keeping, 3) create SDR-denominated

tradable financial instruments, 4) update the formula used for the allocation of new SDRs by the IMF, 5) update the valuation base of the SDR by including other currencies in its base (presumably including the RMB), and 6) promote confidence in the value of the SDR by shifting from a purely unit-of-account system to a system that is backed by real assets such as a reserve pool. The U.S. dollar would undoubtedly remain the most important component of the new SDR for many years and would continue to serve as a reserve currency, depending on country preferences. Zhou believes that his proposal would also serve the long-term economic interests of reserve currency countries such as the United States, as it would promote international financial stability.

At the end of his proposal Zhou suggests that countries with large dollar reserves should be permitted to delegate the management of part of their reserves to the IMF. This suggestion aims at reviving the IMF “substitution account” idea that was negotiated in the late 1970s, but never implemented. Under that concept, countries with a lot of dollar reserves would be permitted to convert part of their reserves into SDRs, reducing the exchange risk to which they are exposed. It would allow reserve-rich countries such as China to off-load a portion of their dollar reserves without depressing the market value of the U.S. dollar or increasing the market value of alternate reserve currencies such as the Euro.

None of Zhou’s proposals are unworkable in principle—his main idea echoes efforts by Keynes in the 1940s to create a synthetic reserve and settlement currency—but they require international agreement, which will be extremely difficult, if not impossible, to obtain. As custodian of the world’s premier reserve currency, principal beneficiary of the present international monetary system and largest debtor country, the United States has little incentive to change the system and de-facto veto power over proposals such as Zhou’s. Besides, many in the United States see Zhou’s proposal as an attempt to undercut U.S. global power and are opposed to it for political reasons. Although the U.S. dollar will probably remain the world’s premier reserve currency for a long time, the use of the RMB as trade settlement currency is likely to increase.

PROSPECTS FOR GREATER INTERNATIONAL USE OF THE RMB

Initially, international use of the RMB for transaction purposes was more the result of spontaneous developments in the region than of deliberate actions by the Chinese government, except in Hong Kong and Macao, where local RMB use is governed by inter-governmental agreements. Local use of the RMB in some neighboring countries in Asia—mainly for transaction purposes—has been growing

for years (e.g. in northern Thailand, northern Vietnam, Myanmar and eastern Russia). Driven by considerations of convenience, it was neither encouraged nor discouraged by the Chinese government as no policy on this appears to have been articulated. In areas where the local use of the RMB is spreading, it is usually at the expense of the U.S. dollar as transaction currency, not as reserve currency.

In response to the current international financial crisis, the Chinese government is taking steps to facilitate the use of the RMB as a settlement currency for trade and other current account transactions in Asia and beyond. RMB-denominated lines of credit have been extended to several neighboring countries and bilateral local currency swaps totaling about \$95 billion have been negotiated with Malaysia, South Korea, Indonesia, Hong Kong, Argentina and Belarus. Banks in 6 eastern Chinese cities have been assigned to try out RMB trade financing. On May 18, 2009, it was announced in Beijing that the central banks of China and Brazil will work out an arrangement under which China’s imports from Brazil can be paid in RMB, while Brazil’s imports from China can be paid in Brazilian real, bypassing the use of the U.S. dollar as settlement currency, as in the case of local currency swap agreements.

Because of the large accumulation of RMB balances in Hong Kong banks in recent years, one mainland commercial bank, the Bank of China (BOC), has been issuing RMB-denominated bonds there since 2007. It is expected that Chinese corporations will be allowed to open RMB accounts in Hong Kong and elsewhere before long. The potential for increased international use of the RMB as local transaction, invoicing and international settlement currency is significant. The increased regional use of the RMB for invoicing, transaction and settlement purposes will probably also enhance its potential use as a store of value, even before full convertibility has been reached.

Increased use of the RMB as trade settlement currency will make it easier for China to promote exports and to protect its exporters from exchange risk. It also reduces transaction costs and avoids the need for hedging. Potential benefits for corporations will vary, depending on their underlying business model.

Another important aspect of increased international use of the RMB is that it would make it easier for China to “flexibilize” its exchange rate management and thus reduce the need for large-scale domestic sterilization of excess liquidity in domestic banks. Greater exchange rate flexibility would in turn facilitate the gradual opening of China’s capital account and movement toward full convertibility. It would also reduce the need for U.S. dollars and other reserve currencies for transaction purposes.

All in all, it seems likely that the financial crisis will lead to more hedging by Beijing of the U.S. dollar through increased international use of the RMB and accelerated movement toward full RMB convertibility. Once that milestone has been reached, which could happen in 5-10 years, one big obstacle to the use of the RMB as an international reserve currency will have been removed. Another requirement is that China's domestic capital markets become much larger, diversified and liquid than they are at present and free themselves from government intervention. This will probably take decades, even if China continues to develop at a high rate.

Pieter Bottelier is Senior Adjunct Professor of China studies at Johns Hopkins School of Advanced International Studies (SAIS) in Washington DC.

NOTES

1. Zhou Xiaochuan is (since 2002) governor of China's central bank, People's Bank of China (PBC). He has been actively involved in designing and managing China's economic and financial reforms since the mid-1980s in several senior positions. His monetary reform proposal was published on the website of PBC: www.pbc.org.cn
2. These observations are based on meetings with senior financial officials in Beijing in January and March 2009.
3. Keith Bradsher, *China grows more picky about debt*, New York Times, May 21, 2009. Because of its large dollar holdings, China cannot diversify away from the dollar without risking a drop in its value.
4. China does not publish the composition of its reserves; the dollar component is generally estimated at 65-70 percent.
5. Fred Bergsten of the Peterson Institute for International Economics made a similar proposal in *How to solve the problem of the dollar*, Financial Times, December 10, 2007. In *We should listen to Beijing's currency idea*, Financial Times, April 8, 2009, Bergsten explains why Zhou's currency reform proposal has to be taken seriously and why the creation of an IMF substitution account is a good idea.

China's Strategy toward Central America: The Costa Rican Nexus

By Daniel P. Erikson

When Chinese President Hu Jintao visited Costa Rica last November and announced that the two countries were initiating free trade talks, it marked the beginning of a new phase in China's courtship of Central America. Indeed,

China's striking economic growth over the last decade has positioned Beijing as a crucial economic partner of all of Latin America's major economies, with total bilateral trade exceeding \$140 billion last year. Yet, Central America largely remains a missing link in this agenda. While the commodity exporting countries of South America have profited handsomely from their relationship with China, Central America has felt the sting of Chinese competition in the manufacturing sector. More crucial, from Beijing's perspective, is the fact that the Central American region constitutes the most significant bloc of countries in the world that continues to maintain diplomatic relations with Taiwan. As a result, Chinese leaders are puzzled as to how to improve relations with Central American nations that are largely peripheral to China's economic concerns but central to Beijing's mission of peeling away Taiwan's remaining trappings of state sovereignty, which include its diplomatic partners overseas.

Latin America is half a world away from the decades-long conflict simmering in the Taiwan Strait, but the diplomatic tussle between Taiwan and China remains a red-hot issue in the Caribbean and Central America. Beijing rigorously promotes its "One China" policy, which means that non-recognition of the Taiwanese government is a prerequisite for conducting formal diplomatic relations with the PRC—in effect forcing other governments to choose between Beijing and Taipei. Although each of the Latin American countries involved in this geopolitical chess match have little individual clout, together they make up the most significant group of states caught in the cross-Strait tug-of-war, representing 12 of the 23 countries that recognize Taiwan. Today, Taiwan preserves official relations with six Central American countries (i.e. Guatemala, Belize, Nicaragua, El Salvador, Honduras, and Panama), five Caribbean countries (i.e. the Dominican Republic, Haiti, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines) and Paraguay—the lone holdout in South America.

After nearly a decade of fairly stable alliances, the battle between China and Taiwan in Latin America really began to heat up in 2004, as China's economic growth better positioned it to compete head-to-head with Taiwan in the field of "dollar diplomacy," which entails wooing potential diplomatic allies with promises of trade, investment and official development assistance. The island nation of Dominica defected to China in 2004, followed by Grenada in 2005, but Taiwan struck back in 2007 by wooing the newly-elected government of St. Lucia. Yet, Beijing notched a major victory later that year by winning over Costa Rica, which was the first Central American country to recognize China. For China, which is always sensitive to U.S. perceptions of its involvement in Latin America, Costa Rica's benign image in Washington

allowed China to sidestep accusations that its outreach to Latin America focuses primarily on leftist countries that have hostile relations with the U.S. It would have been far more attention-provoking for Beijing to begin its Central American outreach with Nicaragua's left-wing government, for example, which would have set Washington's neoconservatives on edge.

In March 2008, Taiwan's hard-fought presidential election produced political shockwaves that sent ripples all the way to Latin America when Ma Ying-jeou, a mild-mannered 57-year old lawyer led the Kuomintang (KMT) nationalist party back to power for the first time since 2000. Unlike his predecessor Chen Shui-bian, who sympathized with Taiwan's independence movement, Ma has pledged to improve relations with the People's Republic of China. He has said he opposes both pursuing Taiwan's independence and negotiating reunification with China, arguing that "the status quo is the best choice." These statements have been watched very closely by the dozen Latin American and Caribbean countries that have diplomatic relations with Taiwan, as many leaders wonder whether the time is ripe to jump ship and seal relations with China. In recent months, China's relations with Taiwan have edged toward détente, including opening trade and travel ties, as well as a landmark decision by China to allow Taiwan's participation as an observer at the World Health Organization. Ma's conciliatory stance toward China has in fact lowered the temperature of cross-Strait competition in the Americas. Nevertheless, when President Ma planned a tour through Central America from May 27 to June 2, a spokesman for China's Foreign Ministry firmly restated Beijing's position: "The Chinese government adheres to the one-China policy and opposes Taiwan having official exchanges with any country. This position remains unchanged" (Xinhua News Agency, May 21).

THE CASE OF COSTA RICA

Costa Rica has now emerged as the stress test for both local and regional neighbors in evaluating the impact of China's expanding partnerships in this distant but vital part of the world. In June 2007, the decision of Costa Rican President Oscar Arias to revoke relations with Taiwan and embrace China was a major coup for the Chinese leadership. At the time, it prompted speculation that Costa Rica's switch would precipitate a broader "domino effect" that could lead to many of the six other countries in the Central American isthmus to switch sides in favor of Beijing. Instead, a nearly two year period of hiatus has settled in after several years of frenetic activity, and no other Latin American or Caribbean country has followed in Costa Rica's footsteps. The potential explanations for this include inattention from China, Taiwan's active diplomacy,

the lessening of tensions in the Taiwan Strait, and a "wait-and-see" attitude by other Central American governments, who want to know how China's relationship with Costa Rica evolves before embarking on a similar path. What has become clear over the past two years, however, is that China is focusing on creating a model relationship with Costa Rica that will serve as a regional example of the benefits of formalizing ties to Beijing.

Upon announcing the establishment of diplomatic relations between Costa Rica and China, President Arias described his decision as "an act of foreign policy realism which promotes our links to Asia. It is my responsibility to recognize a global player as important as the People's Republic of China" (Xinhua News Agency, June 7, 2007). China promptly dispatched Wang Xiaoyuan, an experienced Chinese diplomat who had served as the PRC's ambassador to Uruguay, to set up a new embassy in San José. At first blush, Arias, who won a Nobel Peace Prize in 1987 for his role in helping to end the wars then raging in Central America, seemed an unlikely candidate to be the region's first leader to recognize China. An advocate of democracy, he frequently spoke out against communism and tangled publicly with Cuba's Fidel Castro. But the tremendous financial rewards that his nation reaped from China soon proved to be an important component of his *realpolitik*. Papers released under court order in the fall of 2008 revealed that a secret deal had been struck between China and Costa Rica during the negotiations over diplomatic recognition. In exchange for Costa Rica's move to expel Taiwan's diplomatic mission, Beijing agreed to buy \$300 million of Costa Rican bonds and provide \$130 million in aid to the country, as well as provide scholarships to enable study in China (*New York Times*, September 12, 2008).

Now the two countries are embroiled in trade talks as Costa Rica seeks to become the third country in the region, after Chile and Peru, to sign a free trade deal with China. Costa Rica was among the six countries (including the Dominican Republic) that signed the Central American Free Trade Agreement (known as DR-CAFTA) with the United States in 2005, but it will be the first Central American country to negotiate a trade deal with China. The first round of talks took place in Costa Rica last January with follow-up talks in Shanghai in April. The process is scheduled to be completed before Arias leaves office in 2010, but even with a formal trade arrangement bilateral trade has zoomed upwards to \$2.9 billion in 2008, a more than thirty-fold increase since 2001. China has also offered to help Costa Rica build an oil refinery to improve its access to energy (Xinhua News Agency, November 19, 2008). Of course, Costa Rica's deepening relationship with China has circumscribed its ability to deal with issues that are

sensitive to the Chinese leadership beyond just Taiwan. For example, in August 2008, Arias asked the Dalai Lama, a fellow Nobel Peace Prize winner and the spiritual leader of Tibet, to cancel a planned private visit to Costa Rica. Arias cited “scheduling problems,” but it is clear that he knew that a visit by the Dalai Lama would have sacrificed Costa Rica’s chance to host Hu Jintao later that year.

PATIENCE IS A VIRTUE

Given the increasing weight of the Chinese economy in the global system overall, all of Taiwan’s allies in the Western Hemisphere are under continually building pressures to formalize their budding ties with Beijing. This makes the fact that there has been no additional movement in Central America toward recognizing Beijing all the more intriguing. At this juncture, the loss of even one more Central American ally would represent a damaging reversal for Taiwan that could further cripple Taiwan’s claim to sovereignty. The Costa Rica example demonstrates, however, that China’s regional strategy has shifted toward providing more succulent carrots (rather than punitive sticks), and there is little question that Taiwan is desperately trying to prevent additional defections. China appears to have bet that developing an intensive, multi-faceted relationship with Costa Rica may have a powerful demonstrative effect on other countries in the region—assuming that Costa Rica is viewed as reaping substantial benefits. Guatemalan President Alvaro Colom may be too absorbed in his country’s contentious politics to risk a China diversion, but other governments in El Salvador and Honduras are certainly eyeing Beijing, even as they play host to President Ma of Taiwan. The spring election of Mauricio Funes of the left-wing FMLN as El Salvador’s new president has prompted an especially frantic wave of outreach from Taiwan, including an impromptu post-election visit by the Taiwanese foreign minister, in an effort to keep another Central American country from falling into China’s grasp. Since the election of Daniel Ortega in November 2006, Nicaraguan officials have been careful to assure Taipei that cooperation between the two countries will continue. China has attempted to put pressure on tiny Belize by working through the Caribbean Community, a regional organization of mainly English-speaking governments who have mostly eschewed Taiwan in favor of China. Recently elected Panamanian president Ricardo Martinelli vowed to review his country’s relations with China and Taiwan during the election campaign, but his instincts as a successful businessman may pull him toward China.

Chinese leaders are eagerly interested in expanding their success with Costa Rica to other parts of Central America, but in the short term they are not going to force the issue. Rather, China correctly views Costa Rica’s 2007 conversion

as a major victory that they have time to savor and deepen before conducting their outreach to other countries in the region with renewed intensity. China’s carefully calibrated patience toward Central America helps to explain why even President Ma’s upcoming visit to the region has not caused much of a stir in Beijing. When it comes to the battle for diplomatic recognition in Central America, China feels confident that time is on its side.

Daniel P. Erikson is Senior Associate for U.S. policy at the Inter-American Dialogue, where he manages a program on China-Latin American relations.

Cross-Strait Matrix: The Economic Cooperation Framework Agreement

By Terry Cooke

Against the backdrop of the reeling global economy, Taiwan-China rapprochement has shown steady and, at times, dramatic progress. The Economic Cooperation Framework Agreement (ECFA) put forward by Taiwan’s Kuomintang (KMT) administration under President Ma Ying-jeou is being used by Taipei and Beijing as the main harness for moving bilateral relations forward. Goodwill between top officials from the KMT and the Chinese Communist Party (CCP) at the three official meetings and other side trips notwithstanding, the possibility of reaching a formal agreement in 2009 or later depends on complex bilateral (i.e. China and Taiwan), triangular (i.e. China, Taiwan and the United State), multilateral (e.g. ASEAN, WTO), and even global forces (e.g. the global recession and the G-20 response). A review of the ECFA’s original and current forms helps explain why Beijing has so far been receptive to the plan, and why the Ma administration has been keen on pushing the initiative. Analysis of the main ‘matrix’ factors—bilateral, triangular, multilateral and global—surrounding the plan is central to understanding the outcome of April’s ground-breaking meeting as well as anticipating how the process is likely to unfold in the run-up to the next formal meeting this fall.

ECFA: THE CONTEXT

Discussion of the ECFA (which was originally called the Comprehensive Economic Cooperation Agreement or CECA) began in late February 2009. Only scant mention of the plan had surfaced during Ma Ying-jeou’s electoral campaign leading up to the Taiwanese presidential election in February 2008. Following Ma’s inauguration, the issue

went dormant publicly as the new administration focused, during the spring of 2008, on resuscitating the process of high-level cross-strait dialogue between the KMT and CCP that had been closed off during the Democratic Progressive Party (DPP) administration on Taiwan; then on achieving a series of transport and other ‘direct link’ break-throughs during formal talks in June 2008; and finally on advancing a cross-strait memorandum of understanding for financial cooperation during the high-level talks between Taiwan’s former Vice-President and KMT Chairman Lien Chan and China’s President Hu Jintao at the Asia-Pacific Economic Cooperation (APEC) meeting in Peru in November 2008 (eTaiwan News, Nov 21, 2008). Although the CECA proposal only emerged in mature form in March 2009, ECFA had clear and identifiable antecedents: 1) the creation in 2000 of the Cross-Strait Common Market Foundation by the current Taiwanese vice-president, Vincent Siew, following his loss in Taiwan’s 2000 Presidential election to Chen Shui-bian; 2) the formal accession of China and Taiwan to the World Trade Organization in December 2001; and 3) the signing of the China and Hong Kong closer economic partnership arrangement (CEPA) in June 2003.

Each of these antecedents gave a clear imprint to the plan that Ma Ying-jeou alluded to during his campaign and began rolling out after the advent of the new lunar year in February 2009. The Cross-Strait Common Market Foundation concept originally developed by Siew derived its inspiration from the early EU model, focusing on trade, tariff reduction, and tariff harmonization as early steps in a process leading eventually to a common currency, shared institutions, and elimination of border controls [1]. The common market referent provided the two sides with a neutral and successful thought-model that the KMT leadership and Beijing could appeal to during a series of party-to-party talks undertaken in 2005. Similarly, the joint accession of China and Taiwan to the WTO in 2001 provided an enforceable multilateral framework to which all future trade arrangements—either bilaterally between China and Taiwan or separately with other trading partners in the region and the world—would have to adhere to. Finally, the CEPA signed by China and Hong Kong gave Taiwan a model that could be studied and emulated with respect to its WTO-consistent trade-enhancements, notwithstanding the fact that the agreement was, and remains, anathema politically because of concerns in Taiwan over the agreement’s effect on Taiwanese sovereignty.

THE CROSS-STRAIT PERSPECTIVE

Nourished by these tap-roots, the ECFA concept sprouted again dramatically in early 2009 as the global economy continued to worsen. In mid-February, attention in

Taiwan galvanized around the CECA concept after local press reported the Taiwanese National Security Council’s Secretary General, Su Chi, as stating that the government had decided to sign a CECA with China (CNA, Feb 14). Major industry associations immediately voiced support for the initiative, even before anti-China sentiment in Taiwan’s fractious democracy could organize to oppose the initiative. Yiin Chi-min, the minister of economic affairs, and President Ma then began an energetic campaign of pitching the concept to the Taiwanese public—presenting it as ‘inevitable’ and a virtual *fait accompli*, as a process that could be wrapped up by mid-year, as something that could add nearly 1.4 percent to Taiwan’s GDP, and as a boon to Taiwan’s efforts to forge free trade agreements (FTAs) with ASEAN, the United States and others.

During March and April, public debate over the concept led to various adjustments of these ‘pitch points.’ First, the CECA name was jettisoned as being too reminiscent of China’s CEPA with Hong Kong. Given Beijing’s sovereignty over the Hong Kong Special Administrative Region (SAR), the concern was that a similarly named trade agreement would erode Taipei’s posture of vigorously contested sovereignty vis-à-vis Beijing. Next, admission was made that the democratic nature of Taiwanese society required more public airing of the concept and a greater degree of consensus-building before the concept would be ripe for finalization in an agreement with Beijing. Accordingly, the timeframe for concluding the agreement with China has now lengthened. Following the model of the Financial Cooperation Agreement (which was discussed informally in the 2nd round in November 2008 and formally concluded in the 3rd round in April 2009), the ECFA is being staged for informal levels of discussion at the 4th round of the process, which is slated to take place at the end of 2009 (*United Daily News* [Taiwan], May 27).

THE ‘TRIANGULAR PERSPECTIVE’ WITH THE UNITED STATES

—
In trade, as well as in political matters, the triangular relationship between Taiwan, China and the United States has an important bearing on the tenor of cross-strait developments between Taiwan and China. This reflects two key facts: 1) the United States has been the primary destination market for large-scale manufacturing investment by Taiwanese entrepreneurs in the mainland; and 2) the United States has been the dominant political-military force maintaining the ‘status quo’ balance across the Taiwan Strait. Yet, with regard to the ECFA, the United States has been at pains to step back and to encourage the development of the CECA/ECFA process on its own bilateral merits. This fits in with broad U.S. regional policy goals of supporting cross-strait commercial engagement and economic integration as means for promoting regional

prosperity and stability. The ECFA proposal and the cross-strait cooperative dialogue process more generally are both seen in Washington as practical mechanisms for advancing those goals.

Likewise, the United States has been careful to keep the focus of the discussion about ECFA's benefits to the direct bilateral pay-off for Taiwan and China and not to countenance wishful thinking in Taiwan that an ECFA with China would open a 'backdoor' to concluding a FTA with the United States. In the waning years of the Bush Administration, Taiwan pushed actively for entry into FTA negotiations with the United States. Taiwan's strategic focus on a FTA with the United States was designed to offset the marginalization continually forced upon it by Beijing as China completed a flurry of trade deals with ASEAN and other trade partners excluding Taiwan. In Taipei's thinking, a trade deal with the United States would not only bring some direct benefits to its robust trading relationship with the United States, it would more importantly provide cover for ASEAN and other potential trade agreements to strike their own deals openly with Taiwan. From the U.S. standpoint, however, existing obstacles must first be removed for there to be any possibility of entering into negotiations for a U.S.-Taiwan FTA. First, the United States has long required thresholds of progress by Taiwan in the existing U.S.-Taiwan Trade and Investment Framework (TIFA) talks as a precondition to considering a possible U.S.-Taiwan FTA. Those thresholds have not yet been met with respect to certain intellectual property right protections and various sector-specific issues. More fundamentally, the global economic crisis and the transition in the United States to a new Democratic administration in the executive branch have added new uncertainties to the FTA roadmap for Taiwan. Politically, President Barack Obama does not yet have fast-track trade negotiating authority from Congress. Economically, the global downturn has prompted closer scrutiny by the U.S. government of all such trade deals.

THE MULTILATERAL PERSPECTIVE

With the Doha process stagnant, there has been a pronounced tendency for regional and bilateral deals to proliferate and fill the void. This tendency has been especially evident in Asia, with China acting as the 'belle of the ball.' The China-ASEAN FTA is the most notable of many trade agreements forged recently by Beijing. Taiwan, by contrast, appears to be the wallflower in China's dance with regional trade partners. Taiwan's predicament largely stems from its lack of U.N. membership as well as the deterrent effect of Beijing's long-standing effort to marginalize Taiwan's international space, which is a cause of considerable local anxiety and frequent press commentary.

For most of 2008, Taiwan continued to pin its hopes on the possibility of entering into FTA trade talks with United States as a way of reassuring potential trade partners in the region through U.S. 'legitimization.' As 2008 ended, however, the Ma administration's approval rating began to reflect the country's deteriorating economic indicators. Accordingly, external factors—including the current stasis in the Doha round, proliferation in regional trade deals from which Taiwan is excluded, and the uncertainty concerning the future priorities of the Obama administration during its transition—stoked the coal beneath the ECFA. The ECFA undertaking, with roots as far back as 2000, and carefully cultivated by the KMT leadership during its pair of trips to the mainland in 2005—began to blossom this spring because Taipei recognized an acute need to boost its economic competitiveness and because Beijing had given the KMT assurances through the existing cooperative dialogue process. In fact, Beijing's posture of dropping opposition to Taiwan gaining observer status at the World Health Assembly (WHA) improves this particular cross-strait dynamic considerably. On the one hand, China gains recognition—amid concerns of a swine flu pandemic—for showing responsibility as a global stakeholder, overdue as such a gesture may be. At the same time, anxiety in Taiwan over its international marginalization is relieved to some extent while providing a political boost to President Ma's policy of cross-strait engagement.

CONCLUSION: THE GLOBAL PERSPECTIVE

The Ma administration presided over one of the country's largest drops in economic growth prospects, which was severely dented by successive months of year-on-year drops in exports close to 50 percent. The ECFA represents its best near-term option for reviving the economy. For China, whose preoccupation with 'split-ists' has shifted to Tibet since Chen Shui-bian and the DPP's departure from power, the ECFA promises two benefits worth pursuing: 1) a closer economic embrace with 'Taiwan compatriots'; and 2) enhancing international perception of China as a responsible economic 'stakeholder' in the region. For the United States—the vital triangular partner to cross-strait stability—the ECFA is broadly in line with the longstanding policy of encouraging cross-strait commercial engagement.

It perhaps required the shock of an economic downturn to position Taiwan and China for the next level of mutual engagement and economic integration. While joint entry into the WTO was immeasurably important to both parties as a confidence-building measure, Geneva has not served as an arena to directly advance bilateral rapprochement. While economic integration has proceeded apace to meld the two countries' IT sectors into a nearly seamless

global supply chain, integration of many other sectors (such as agriculture, tourism, transportation, energy, petrochemicals, and advanced semiconductors) has been impeded by political opposition and various national security concerns.

While the global financial crisis may have pushed Taiwan and China significantly closer in their economic relationship, neither party should ignore the key ‘lessons learned’ from the crisis. The deliberate ECFA process seems to be structured on a shared recognition that cross-Strait economic integration needs to be pursued in a measured and balanced fashion, not as a pell-mell rush. The staged scheduling of the ECFA as first an informal topic and then a formal topic at successive rounds of the high-level cooperative dialogue process is largely designed to allow time for public opinion in Taiwan to recognize the need for, and to help shape the final form of, this outcome. In the final analysis, the ECFA appears to represent a recognition in both Taipei and Beijing that they need to work together to co-manage the impact of the global economic crisis by adding previously-insulated sectors of their respective economies to the cross-Strait grid.

Merritt T. (“Terry”) Cooke, Ph.D., is the principal of www.terrycooke.com, a professional speaking and corporate seminar/scenario enterprise. He is also Founder and Chairman of GC3 Strategy, an international market development consultancy targeting ‘green energy/technology’ opportunities in Greater China. Terry’s full bio is available at www.terrycooke.com/bio.aspx and publications at www.terrycooke.com/weblinks.aspx. Terry has served as Director for Asian Corporate Partnership at the World Economic Forum (‘Davos’) and is a career member of the U.S. Senior Foreign Commercial Service.

NOTES

1. See “A Cross-Straits Common Market—Working Together to Build Prosperity in the Asia-Pacific Region” by Vincent C. Siew at <http://www.crossstrait.org/version3/subpage4/sp4-3.htm>.

Food Security in Africa: China’s New Rice Bowl

By Loro Horta

The People’s Republic of China (PRC) is home to 22 percent of the world’s population, but has only 7 percent of its total arable land. Following the Chinese people’s recovery from the humanitarian disaster of the

“Great Famine,” which according to one authoritative account contributed to the death of 36 million Chinese between 1958 and 1961 (*South China Morning Post*, July 6, 2008), the Beijing government has made it a priority to ensure self-sufficiency in the supply of basic products for the Chinese diet (e.g. rice and grain). In the past three decades, the country’s breakneck economic growth has led to the rise of a new wealthy class in Chinese society made up of hundreds of thousands of Chinese people whose dietary demands have changed and who consumes more food. Starting in the 1990s, in order to accommodate this growing demand, China began encouraging its citizens to establish agricultural-businesses overseas. Initially, most of this investment went to nearby countries such as Laos, Burma and Cambodia. Yet, scarcity of land and sprawling overpopulation in these countries have led to political backlashes that prompted the central government to turn its attention to Africa at the beginning of this decade to fill its people’s rice bowl.

To put this growing demand into perspective, the Chinese were consuming 25 kilograms (kg) of meat a year in 1985. Two decades later, its consumption reached 52 kg, and it is expected to climb as high as 70 kg by 2020. The consumption of more agriculturally intensive products such as soybeans, potatoes and cereals has increased between 16 and 30 percent in the past decade [1]. Rice consumption is declining as a more wealthy urban population develops a taste for a Western-style diet. The consumption of seafood has increased significantly in the past decade, with shortages of certain products now common. The increase in China’s food consumption also comes at a time when arable land in the country is sharply shrinking as a result of over planting and land loss due to environmental damage caused by rapid industrialization. According to Yang Xiong at the ministry of agriculture, China lost 8.9 million hectares of farmland between 1995 and 2007 [2].

THE SCRAMBLE FOR AFRICAN LAND

African nations, with their vast and sparsely populated fertile lands, offer China a solution to its rising food demand. Most Chinese investment in African agriculture is concentrated in southern Africa: Mozambique, Tanzania, Malawi and, increasingly, Angola. The first major Chinese investment in Africa’s agricultural sector was in 1995 when Zhongkan Farm, a private company, invested \$220,000 in a farm project in Zambia (Xinhua News Agency, March 21, 2006). By 2007 China had some 63 agricultural investment projects in southern Africa ranging from small-scale farms to large cattle-raising grounds [3].

In the past two years the central government has taken the lead and encouraged Chinese state-owned enterprises

to invest in Africa's farms. In August 2008, the Governor of China Development Bank Chen Yuan told a gathering of African finance ministers in Mauritania: "China Development Bank is anxious to work in the area of agriculture. Given the current scenario of a great shortage of food and food price hikes I believe African countries should put agricultural development as their top priority" (Reuters, August 1, 2008).

MOZAMBIQUE, TANZANIA AND ANGOLA

In early 2008 the Chinese government pledged to invest \$800 million to modernize Mozambique's agricultural sector. The plan includes increasing the rice production of the former Portuguese colony from its current 100,000 tons to 500,000 tons per year in the next five years. With this objective in mind, Beijing is bankrolling the establishment of an Advance Crop Research Institute and several other small agricultural schools throughout the country. Over 100 Chinese agricultural specialists are currently stationed in Mozambique, including teams from the Hunan Hybrid Rice Institute, China's top institution in the field of hybrid rice research [4].

Other major Chinese projects include the construction of numerous irrigation and canal networks, including a massive canal connecting land-locked Malawi by way of Lake Malawi—the second largest in the continent—to rivers and dams in Mozambique. In the past two years, the search for new land has led Beijing to aggressively seek large land leases in Mozambique, especially in its most fertile areas, such as the Zambezi valley in the north and the Limpopo valley in the south. The Zambezi valley is the richest agricultural region of Mozambique with an area of 230,000 kilometers spread between Tete and Zambezia provinces [5].

Chinese investment in the Zambezi valley started in mid-2006 when China's state-owned bank Eximbank (Import Export Bank) granted \$2.3 billion in soft loans to the Mozambican government to build the Mpanda Nkua mega dam on the Zambezi stretch of Tete province. Since then China has been requesting large land leases to establish Chinese-run mega farms and pasture areas for cattle raising. A memorandum of understanding (MoU) was reportedly signed in June 2007, under which an initial 3,000 Chinese settlers were to move to Zambezia and Tete provinces to run farms along the valley [6].

The Chinese Ambassador to Tanzania, Liu Xinsheng, announced in April 2008 that China may invest upward of \$400 million to modernize the local agricultural sector while in Beijing the Chinese Ministry of Agriculture has pledged to assist Africa in creating a "green revolution,"

a process of rapid increase in agricultural production that results from the introduction of advanced biotechnology, modern irrigation and better managerial skills. According to a ministry of commerce official, China currently has 1,134 agricultural experts serving in Africa and has given \$600 million in assistance to the sector since 2002. This assistance ranges from major irrigation projects to donations of agricultural equipment to extending generous credit lines. Another former Portuguese colony, Angola, is fast becoming a major destination for Chinese agribusiness [7].

Angola is already China's biggest trading partner in Africa and its single largest oil supplier accounting for 15 percent of the PRC's total oil imports. The country, with its vast land—1,246,700 square kilometers—and a population of just 16 million, offers China great opportunities, particularly in beef production, but also in some luxury items now in ever greater demand in China such as coffee, spices, tropical fruits, sugar and cotton. China's agricultural investments, which were primarily concentrated on Southern Africa, are now slowly spreading to other parts of the continent such as Guinea Bissau in West Africa where China recently established several hybrid rice experimentation farms. In early 2007 Chinese businessmen pledged to invest \$60 million in the country's cashew nut industry, which is one of the biggest such industries on the continent.

While China may be primarily motivated by its need to meet its rising food demand, the modernization of the African agricultural sector is also likely to benefit the people of that continent. In 2007 the Ugandan government thanked China for its support in developing the country's agricultural industry. After serious food shortages last year that degenerated into violent riots, the Senegalese government was eager to attract Chinese investment. According to Professor Li Anshan, one of China's top African specialists at Beijing University: "Africans desperately need to modernize their agriculture both to insure their food security and to earn hard currency by exporting it. China needs to deal with its growing food demand and Africa seems to offer the solution" [8].

CONCLUSION

If China is indeed able to help launch a "green revolution" in Africa, millions of Africans will have a chance at a better future. At the same time, however, if China's ambitious plans are not carried out with proper considerations for the environment and its impact on Africa's agricultural land, the continent may one day find itself in a similar predicament to the one confronting China today.

For instance, various NGOs in Mozambique and

foreign experts have begun to express concern over the environmental impact of the Mpanda Nkua mega dam on the ecosystem of the Zambezi valley. Daniel Ribeiro, a biologist and the head of Justica Ambiental, a local NGO, argued that, “No serious environmental impact study was conducted, the people whose land will be flood were not consulted or properly compensated. No doubts that we need electricity and to modernize our agriculture [*sic*]. But at what cost?” [9].

While considerable attention has been paid to Chinese interest in African oil and other mineral resources, it is perhaps in the agricultural and food processing sector where China may have a more significant impact on the continent’s future. Yet, whether Beijing’s grand plans for Africa will really materialize and help the continent alleviate its chronic food shortages, or will it become another of the many empty promises made to Africa remains to be seen.

Loro Horta works for the United Nations Integrated Mission in Timor (UNMIT). He is a graduate of People’s Liberation Army National Defense University (PLANDU). His writings on the Chinese military and other China related topics have been published by Military Review, Australian Army Journal, Strategic Analysis the Center for Strategic and International Studies, Washington D.C., and Yale Magazine. His articles have appeared on Asia’s major newspapers such as the Straits Times, The Bangkok Post, The China Post, Australian Financial Review, The Sydney Morning Herald, Jakarta Post and Asia Times. The views expressed here are strictly his own.

NOTES

1. Hongbo Liu and Claus Diblitz, “Determinants of meat consumption in China” Working Paper 40, December 2007, Asian Agribusiness Research Centre, Stuart University.
2. Interview with Yang Xiong, Ministry of Agriculture of the People’s Republic of China, Beijing, September 12, 2008.
3. This figure was given during a seminar attended by the author on *Trade and Investment Between China and the Portuguese Speaking Countries*, hosted by the Chinese Ministry of Commerce Central School in Changing, Beijing between September 7-10, 2008.
4. Statement by Tomas Mandiate Minister of Agriculture and Fisheries of Mozambique on March 30, 2006 at <http://www.agroportal.pt/x/agronoticias/2006/03/31.htm>.
5. Loro Horta, “China’s relations with Mozambique: A Mixed Blessing,” April 1, 2008 *Online Africa Policy Forum* Center for Strategic and International Studies (CSIS) Washington D. C. at <http://forums.csis.org/africa/?p=97>. and “The Zambezi Valley: China’s first Agricultural colony?” June 9th 2008, Online Africa Policy Forum,

Center for Strategic and International Studies (CSIS) Washington D. C at <http://forums.csis.org/africa/?p=120>.

6. *Noticias Lusofonas* “Empresas chinesas anunciam investimentos no Vale do Zambeze” June 3, 2006 (*Lusophone News*, Chinese companies announce investment in the Zambezi Valley).
7. *Jornal de Angola* “Banco Chines propoen credito para agricultura” Marco 13 2009 (Chinese bank proposes agriculture credit line).
8. Interview with Professor Li Anshan, Department of History University of Beijing, September 14, 2008, Beijing.
9. Interview with Daniel Ribeiro, Beijing May 15, 2008.
