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The Cross-Strait Intelligence Contest Continues Without Quarter

by Peter Mattis and Zoë Moore


The Judicial Yuan building. (Source: Wikipedia)

Last week, the Taiwan High Court found retired air force Colonel Liu Sheng-shu (劉聖恕) and five serving military officers guilty of espionage for China. The court sentenced Colonel Liu and two of his co-conspirators to approximately 20 years in prison, marking some of the harshest sentencing for espionage in recent years (Taipei Times, October 26). Liu's spy ring is one of at least 11 rings Taiwanese authorities have broken up over the last two years. These Chinese spies targeted Taiwan's military, civilian government, industry, and the overseas communities of Chinese minorities. In some cases they were able to operate for years. Although it is tempting to read these cases as simply more examples of Beijing's relentless intelligence operations against Taiwan, these cases and the tradecraft employed suggest some positive developments—or the relative absence of dangerous trends—in the cross-strait intelligence contest. The cost in trust of Chinese intelligence operations, the requirements of deterrence, and the potential costs of a cross-strait conflict combine to suggest that a wider international effort to counter Chinese intelligence operations is warranted.

Recent Taiwanese Espionage Cases

Ringleader	Collaborators	Recruitment method	Payout	Agents' Access to Information	Intelligence Type	Legal Status
Air Force Colonel Liu Sheng-shu (劉聖恕)	5+ active-duty officers: Lieutenant Colonel Sun, Major Liu, Major Kung, Major Teng, Major Lin	Recruited in China in 2013 on a business trip	NT $16.7m ($514,000)	Indirect	Military	Sentenced to 20 years and 6 months (co-conspirators' sentences range from 6 months to 20 years)
Fang Hsiang (方翔) and Jan Chu (冉菊)	Chen Te-men-po-yen, former civil servant and Mongolian and Tibetan Cultural Center staff member; intermediary who monitored Taiwan independence activists; gang member	Visit to Hainan, by State Security Department of Hainan	969,000 NTD	Mix of indirect and direct	Political	Charged (08/25/2023)
Hu Chi-yao (胡繼堯) and retired Sergeant Chen Min-cheng (陳敏政)	Attempted to recruit Major Lin of Penghu Defense Command, Taiwanese-Vietnamese businessman Lin to recruit soldier agents	Meeting between Chen and Kinmen Defense Command general, made possible by Hu's business ties	$NT 100,000s ($3,000s)	Mix of indirect and directs	Military	Charged (8/18/2023)
Former Army Major Hsiao	Army Major Ho, Commander at Huadong Defense Command, and several military officers, 7 total defendants	Undisclosed	Undisclosed	Direct	Military	Detained (08/2023)
Army Lieutenant Colonel Hsieh	Active and retired military personnel	Undisclosed	Undisclosed	Mix of in-direct and direct	Military	Detained (08/2023)
Lu Chi-hsien (魯紀賢)	Five co-defendants suspected of forming spy ring of at least 10 military officers	Recruited by Chinese intelligence officers after retirement	Undisclosed	Direct	Military	Detained (7/20/2023)
Former Presidential Guard Sun Han-fang (孫翰方)	Wang Wen-yen (王文彥)	Chinese Intelligence officer surnamed Fang in Guangzhou at Taiwanese business community social event	$3000 payouts for military information, vacation to Bali, Singapore, South Korea	Direct	Political	Sun: 32 months; Wang: 16 months
Shao Wei-chiang (previously served in the army)	Col. Hsiang Te-en (向德恩) and at least one other	(Undisclosed how Shao was recruited) Shao, a retired army lieutenant and local travel operator recruited Hsiang in Kinmen	$560,000 ($18,000)	Direct	Military	Hsiang sentenced to 7.5 years, Shao to 15 years

Sources: Taiwan News, Focus Taiwan/CNA, Taipei Times, BBC News, Reuters, Liberty Times

Notable Trends: Retired Officers and High Payouts

Analyzing a country's intelligence operations through open sources is an inherently fraught analytic exercise. It is impossible to know how representative the data are, or their quality. The lack of Taiwanese espionage convictions does not mean Chinese intelligence has not successfully recruited sources, but rather that the spies have not been caught. Conversely, a large number of cases could signify Taiwan's counterintelligence has effectively protected the government, despite the appearance of widespread infiltration. With those caveats in mind, there are a few noteworthy observations that can be made from recent cases—not all of which are negative or reinforce perceptions of Taiwan's inability to deal with Chinese espionage.

First, Chinese intelligence continues to rely heavily on retired Taiwanese officials and military officers who come to China as the starting point. These retired officials recruit members for their rings from networks formed when they were active-duty, as well as from officers facing financial difficulties that they can identify. In one example, Lu Chi-hsien (魯紀賢), a former Diabolo Champion and army veteran, organized a spy ring by focusing on recruiting officers susceptible to payouts, by recruiting from pawnshops, moneylenders and loan-sharks close to army bases. (Taipei Times, July 21)

Money seems to be the primary motivation in many of these cases. Colonel Liu was forced to turn over profits from espionage totaling NT $16.7 million (US$515,800) upon conviction. He was offered bonuses proportional to his success in recruiting members to his ring, and to those members' access to information. Liu received bonuses of NT $200,000-NT $700,000 for each new individual and distributed NT $30,000-NT $100,000 to officers when they supplied Taiwanese military information (Taipei Times, April 23; Taiwan News, April 06). In the case of Sergeant Chen Min-cheng and businessman Hu Chi-yao, who were charged in August 2023, the two men received hundreds of thousands of Taiwanese dollars from Chinese intelligence officers and deliberately targeted intermediaries and new agents who had financial difficulties (Focus Taiwan, August 18, 2023).

Second, Chinese case officers appear to operate mostly from China rather than coming to Taiwan themselves. Back in 2017, the case of suspected intelligence officer Zhou Hongxu (周泓旭) suggested that Chinese intelligence services may be sending more intelligence officers to Taiwan to conduct operations. Zhou, a Chinese national and graduate of National Cheng-chi University (NCCU) in Taipei, attempted to bribe junior government agency officials and universities for classified documents. While a student at NCCU, Taiwan Ministry of Justice Investigation Bureau officials believe Zhou actively aimed to make friends to recruit a spy ring of Taiwanese nationals (China Brief, August 17, 2017). However, when analyzed alongside the other cases uncovered in the last two years, Zhou's case does not seem to represent a methodological departure for Taiwan operations. Instead, case officers based in China recruited Taiwanese who could then identify and recruit and exploit friends, former colleagues, and acquaintances.

That the Zhou case did not become a new normal suggests one of two possibilities. The first and more optimistic possibility is that Chinese intelligence maintains a degree of respect for Taiwan's counterintelligence capabilities inside Taiwan. The second is that Taiwanese intelligence has been unable to identify and arrest Chinese intelligence officers operating inside Taiwan for breaking national security-related laws. Democracies sometimes struggle to effectively counter espionage, in part because of the burden of proof. The absence of public cases does not constitute evidence—or the lack of evidence—for Taiwanese incompetence. However, it points to an uncertainty to which observers, including those in governments that partner with Taiwan, should be alert.

Third, the highest-ranking military officer in these cases was a retired colonel. In the past, a comparable number of spy rings revealed at least one former Taiwanese flag officer spying for China. More recent cases have mainly involved retired mid-senior officers recruiting active-duty mid-senior officers and junior officers—a stark downgrade for Chinese intelligence services' sources, who included Brigadier General Lo Hsien-che, Major General Hsu Nai-chuan, Vice Admiral Ko Cheng-sheng, and Lieutenant General Chen Chu-fan (China Brief, November 7, 2014).

Fourth, the significant sentences handed down to retired Colonel Liu and two of his co-conspirators may mark the beginning of a change in how Taiwan punishes Chinese spies. Taiwanese authorities have long complained about the permissive environment for Chinese spies and the lack of a deterrent through prison time. As recently as September, Taiwanese legislators criticized the government for not punishing spies sufficiently, particularly those who were former military officers (Radio Taiwan International, September 26). Some more egregious cases in the past include the 14 month sentence handed to former deputy commander of the Navy Vice Admiral Ko Cheng-sheng in 2014 for providing military secrets to Chinese intelligence, and the 12 months that his handler, Shen Ping-kang, received (Taipei Times, October 3, 2014; see China Brief, November 7, 2014). By contrast, in June this year former presidential guards Sun Han-fang (孫翰方) and Wang Wen-yen (王文彥) had their prison terms reduced from three years and four months to two years and two months, and from one year and ten months to one year and four months, respectively, because the classified information they stole was not particularly sensitive (Taipei Times, June 4). Even these reduced sentences are still harsher than those received previously for more serious crimes.

Industrial Espionage

Chinese industrial and economic espionage also are on the rise—at least as a matter of national concern. In cases of industrial espionage, individuals are encouraged to steal designs for military technologies or for those in critical economic sectors, or these individuals are poached by Chinese companies. For instance, in 2022 a group of 14 individuals formerly employed by Catcher Technology Company were poached by Luxshare Precision Industry Co (立訊精密), a Chinese company. They were charged with corporate espionage for stealing large amounts of R&D and management secrets (Taipei Times, July 17, 2022; Focus Taiwan, July 15, 2022). Two semiconductor companies have also been found guily of poaching talent. Beijing-based semiconductor company Starblaze Technology was found to have been running an illegal R&D center in Taiwan, while state-affiliated Tongfu Microelectronics was illegally paying employees in Taiwan via offshore accounts (Taipei Times, April 9, 2022).

Spies are often charged under Article 2 of the National Security Act, found guilty of "initiating, funding, hosting, manipulation, directing, or developing an organization [for a foreign country, Mainland China, or organizations, institutions, groups established or substantially controlled by them]" (Taiwan Laws and Regulations Database, June 6, 2022). To incorporate industrial espionage in statute, in May 2022 the Legislative Yuan passed amendments to the National Security Act, adding industrial espionage as a category of violation, prohibiting employees in key technological industries from traveling to China without permission, and setting a jail term of up to 12 years or a fine of up to NT $100 million (US $3.37 million) for stealing information about critical technologies (as defined by the National Science and Technology Council) for adversaries.

Geared towards combatting Chinese economic espionage, including theft of trade secrets and talent poaching in key industries, these amendments echo other counterintelligence provisions undertaken by the Tsai administration. All of these have been adopted during a period of increasing competition and suspicion, as China looks to become self-reliant in manufacturing semiconductors and other critical technologies (China Brief, August 17, 2017; Lee and Li via Lexology, May 27 2022).

Conclusion

The recent cases serve as a reminder that Taiwan's counterintelligence challenge continues apace. The Chinese Communist Party's (CCP) relentless intelligence effort against Taiwan does more damage than simply the theft of national security secrets. Regardless of the damage, every case undermines the trust Taiwan's partners have with the island country. Foreign observers are justifiably concerned: The nature of espionage and the CCP's historical successes suggest that these arrests and convictions are only part of a larger picture.

Deterring a war over Taiwan—including a blockade, which is an act of war—requires other countries to work closely with Taipei. The potential consequences of such a war and the wider economic reverberations suggest that Taiwan's partners and every country with a concern for peace and stability in the western Pacific cannot sit out the cross-strait intelligence contest. Because Chinese intelligence operations undermine necessary trust, counterintelligence cooperation with Taiwan is a necessary component of effective deterrence. Taiwan, for its part, has a great deal of experience to share and to contribute to a wider international effort.

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Issues of Centralization, From Financial Work to Personnel

by Willy Lam

Chinese President Xi Jinping. (Source: Guangdong Provincial Government website)

Chinese Communist Party (CCP) General Secretary Xi Jinping called for tighter Party and state control of the financial sector in the quinquennial Central Financial Work Conference that ended in Beijing on October 31 (Xinhua, October 31). All seven Politburo Standing Committee (PBSC) members as well as provincial leaders and the heads of financial and securities regulatory units participated in the conference. Stressing that party authorities should exert more oversight over the nation's banks and other financial institutions, the general secretary vowed to make "greater efforts to comprehensively step up financial supervision, optimize financial services, prevent and resolve risks so as to promote high-quality development of China's financial sector" (Xinhua, October 31; CGTN.com, October 31; Bloomberg, October 23).

In his speech to the conclave, the supreme leader also cautioned that financial supervision should be effected under the principles of "seeking progress while maintaining stability, taking one step at a time, and avoiding excessive ambition or [relying too much] on foreign [models]." Xi emphasized that adequate funding be devoted to establishing a "modern industrial system" based on the "real economy (实体经济)." Following Beijing's long-standing industrial policy, more resources will be earmarked to high-tech areas such as information technology, artificial intelligence, biotechnology, new materials, advanced pharmaceuticals, and drivers of the "green economy" such as electric cars (Gov.cn, August 22; Center for Strategic and International Studies, May 23).

Yet the "CCP core for life" has not made much reference to more pressing issues such as restructuring the overleveraged real estate sector or mitigating the heavy indebtedness of nearly all local administrations. Top real-estate corporations such as Evergrande have run up debt totaling more than Renminbi (RMB) 2.4 trillion (approximately $330 billion), and nothing has been done to help the tens of thousands of Evergrande customers whose prepaid apartments remain unfinished—or the foreign investors in related bonds. Moreover, the lack of sufficient funds to handle withdrawals from depositors at financial institutions in areas including Hebei and Guangdong have caused runs on medium-sized state-owned banks (Asia Times, October 14; French Radio International Chinese, October 12).

Stasis and the State in Financial Policy

In even worse shape than housing giants are local administrations and their heavily indebted investment vehicles. Latest estimates show that administrations at the provincial, municipal, and county levels have raised loans totaling RMB 98 trillion (nearly $13.5 trillion). At least half of the annual income of these local governments—which have been excessively dependent on land sales and related taxes—is being used merely to service interest on their loans and bonds. At the Central Financial Work Conference, Xi pledged a "long-term mechanism" to restructure and resolve regional debt. In late September, Beijing kicked off an RMB 1 trillion ($137 billion) debt swap program to allow local administrations to replace their so-called "hidden debt" for bonds carrying lower interest rates. Last week, the government also announced a separate, unusual RMB 1 trillion central government bond issuance to support local spending (Caixin.com, November 1; Bloomberg, November 1). Given the tendency of local governments to float new loans and bonds to cover old borrowings, the prospects of a short-term resolution to the problem seem bleak.

Xi's team has also failed to address the critical issue of a severe decline in foreign direct investment (FDI) into China, which is one reason why funds in many industrial sectors are drying up and exposure to global technology has been stymied. From January to September 2023, FDI was a mere $125.75 million, a drop of 8.4 percent from the same period in 2022 (Trading Economics, October 20). In the meantime, funds—mainly US dollars—being remitted overseas by enterprises and individuals keen to leave the People's Republic of China (PRC) reached $54.9 billion last month, the largest outflow since January 2016 (Nikkei Asia, October 25).

Of perhaps even more significance for the future of reform is the Xi administration's efforts to de-marketize the whole real estate sector to revive the pre-1994 system of Party cells and administrative offices distributing subsidized housing to their members or workers. According to an exclusive report by the state-run *Economic Observer Net*, the State Council recently distributed Central Document No. 14, entitled "Guiding Opinion Regarding the Planning and Construction of Affordable Housing (关于规划建设保障性住房的指导意见)," that would significantly revive the pre-reform practice of government and public units selling or renting out subsidized housing to their workers. According to the Document, the resuscitation of the system of subsidized housing (保障房) is based on the principle of "the affordability for wage earners, and the balance and sustainability of funding [used for these projects]" (Eeo.com.cn, October 16; South China Morning Post [SCMP], August 18). Experts recruited from all over the country to a particular locality are also entitled to subsidized housing. Observers have noted that while normal "commodity housing (商品房)" will still be retained, these units are mainly meant for higher-income workers and members of the middle class. The model for giving out "subsidized housing (保障房)" for the general working class—and leaving so-called "commodity housing" for the relatively rich segment of the population—bears resemblance to the well-known housing models adopted in Singapore. **[1]**

Experimentation with the resuscitation of the Maoist principle of the de-commercialization of housing has already taken place in Xiong'an, Xi's model city for the future based just outside Beijing (People's Xiong'an Net, February 6). What many Chinese residents worry about, however, is that those who have already purchased "commodity housing"—even if such housing is still under construction—might not be eligible for the subsidized housing that several dozen cities have started to build. Moreover, the Xi and the CCP leadership has yet to ensure that failing real estate giants such as Evergrande and Country Garden will be obliged to sufficiently compensate dissatisfied customers.

Personnel Issues at the Heart of Policy Stasis

Xi's apparent failure to introduce more market-oriented measures to restructure key sectors such as real estate and banking could reflect an ongoing series of high-level personnel-related events, which cast doubt on the paramount leader's control over his top brass in both the civilian and military sectors.

On October 26, Xi sacked state councilors General Li Shangfu (李尚福) and Qin Gang (秦刚), who had also held the titles of defense minister and foreign minister, respectively. No explanation has been given for the sudden disappearance of the two men, who were once considered protégés of the supreme leader. The Party and government have also left the public in the dark regarding investigations into scores of senior military cadres in the equipment procurement departments, the Rocket Force, as well as the diplomatic establishment. These organs have been accused of corruption and the leaking of state secrets to Western nations, including the United States and the United Kingdom. Qin was replaced by his old boss Wang Yi (王毅), the former foreign minister who was promoted to the Politburo at the 20th Party Congress in October 2022. Despite his reputed closeness to the PLA top brass, Xi, who is commander-in-chief, has so far failed to find a replacement for General Li. This became awkwardly apparent as Beijing hosted an annual international defense forum at the end of October (BBC Chinese, October 26; VOA Chinese, October 24; Xiangshan Forum, accessed November 2).

The unexpected death of former premier Li Keqiang (李克强), who was a member of the PBSC from 2007 to 2022, provides a stark reminder of both the confusion and opacity of CCP elite politics and Xi's apparent disdain for market-oriented reforms. The large-scale and spontaneous mourning of the 68-year-old Li has posed a threat to the legitimacy and stability of the Xi Jinping regime. Although public remembrance activities have been largely confined to Hefei, the capital of Anhui Province where Li was born in 1955, this was due to the decision by President Xi and the CCP Propaganda Department to scrub clean all references to Li in the social and mass media. Police in big cities such as Beijing and Shanghai have also been mobilized to stop mass gatherings commemorating the former premier (BBC Chinese, October 31; Radio French International Chinese, October 28).

Li was the last PBSC member to have openly advocated the continuation of reform and opening, the signature policy of Deng Xiaoping, China's chief architect of reform. On a visit to Shenzhen—the first special economic zone established by Deng—several months before stepping down as head of the central government in March, Li said that reform must go on, "just as the [direction of the flow] of the Yangtze and Yellow Rivers cannot be reversed" (United Daily News, October 27; VOA Chinese, August 22). Li, who became premier in March 2013, was sidelined from major decision-making on economic issues within a year of taking office—a move away from the norm that the premier oversees all financial and economic decision-making in the country. Any outpouring of grief by members of the public could be seen as unmistakable support for Li's (and by extension Deng's) reform policies. On the contrary, Xi's apparent nervousness about the popularity of the late premier, who from 2012 to 2022 was the highest-ranked PBSC member after Xi, suggests that the supreme leader sees his grip on power as less than assured (VOA Chinese, October 30; Radio French International Chinese, October 29).

Conclusion

The Xi administration has disseminated a toned-down verbal eulogy of Li, but has decided not to hold any public mourning ceremony. This stands in contrast to the funeral arrangements that followed the death of former Party Chairman Jiang Zemin (江泽民) in December 2022. The train of events surrounding Li's death has compounded the impression—particularly among foreign investors—that elite politics in China is as opaque as it is cold-blooded. In terms of immediate impact, it is difficult to see how Li's departure and the disappearance of Qin Gang and Li Shangfu could affect the CCP's policy direction, given that the overall trajectory is set by Xi. However, there will be a longer-term detrimental effect, both on the quality of policymaking and on Xi's authority, particularly his ability and willingness to push market-oriented policies. His apparent inability to tackle severe economic challenges head-on, such as a collapsing housing market and the heavy indebtedness incurred by state-owned enterprises and local governments, will hardly burnish the reputation of the "leader for life."

The deaths and disappearances at the highest echelons of the Party in recent months echo the silence in the policymaking domain. The underwhelming outcome of the Central Financial Work Conference suggests that the leadership is waiting to see how its current batch of policies play out over the coming months. But it also suggests that the leadership is low on ideas, or at least on the willingness and capacity to implement them: Old tools—like financial support to the real estate sector and anti-corruption to mitigate some of the financial sector's problems—do not constitute the fix that China's economy needs.

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Notes

[1] Stephan Ortmann & M. Thompson, "China's Obsession with Singapore: learning authoritarian modernity", *Pacific Review*, v.27, 2014, Issue 3, pp.433-55.

Challenges for Beijing's Digital Renminbi Ambitions

by Matt Fulco

QR codes to pay using the e-CNY. (Source: Sohu)

Arriving in the midst of an intensifying great power competition between China and the United States, the digital Renminbi (RMB) has been the subject of intense speculation and hype since its launch in October 2020, mostly from observers outside of China who overstate its potential capabilities. On November 2, Hong Kong's Secretary for Financial Services and the Treasury, Mr. Eddie Hui Ching-yu, said at a Fintech Week event that he would promote digital RMB for retail settlement in the Hong Kong market, allowing tourists visiting Hong Kong to use the digital currency for retail spending (Sohu, November 2). Across the Taiwan Strait, Xiamen Xiangyu Group (厦门象屿集团有限公司) successfully issued the first cross-strait digital RMB bond, worth RMB 500 million ($68.7 billion), the proceeds of which will be mainly used for the company's Taiwan-related capital needs. This move was touted as boosting cross-strait integration and development (East Money, November 2).

There are fears that China might "mint the money of the future" through its central bank digital currency (CBDC) (Bloomberg Opinion, April 4, 2021), and academics have argued that "China's central bank digital currency will transform the international monetary and financial systems" (University of Oxford Law Blog, November 18, 2022). Such analyses overlook the fact that Beijing has resisted expected further liberalization of its financial system since Xi Jinping came to power in 2012, and in particular since China's 2015 stock market crash—widely believed to have spooked the Chinese leader. With his increasing focus on national security (People.cn, May 30), Xi will be highly unlikely to sign off on a loosening of foreign exchange and capital controls necessary to fast-track internationalization of the RMB, especially with capital outflows hitting a seven-year high of $75 million in September (South China Morning Post, October 23). With the Chinese capital account remaining closed, the digital RMB will encounter the same internationalization challenges as the physical fiat currency.

Beijing will seek to selectively boost cross-border use of its digital currency, notably through Project mBridge, in which the Bank of International Settlements (BIS), Hong Kong, Thailand, and the United Arab Emirates (UAE) are also participating (China Construction Bank, September 28, 2022). At the recent Belt and Road Initiative Forum in Beijing, the UAE and China signed two agreements focused on digital currency: one between the Bank of China and the UAE's Bank of Abu Dhabi, and another between the People's Bank of China and the Central Bank of the UAE (The Third Belt and Road Forum for International Cooperation, October 18). However, Beijing's primary focus in the short and medium terms will be the domestic market, where it seeks to gain greater control over digital payments that have historically been dominated by the technology juggernauts Alibaba and Tencent. However, that will be an uphill battle given the popularity of those payment systems and the lack of clear advantages for consumers and businesses to transacting in its CBDC.

Low Uptake

In July, former People's Bank of China (PBOC) governor Yi Gang (易纲), speaking at an event organized by the Monetary Authority of Singapore (MAS), said that total CBDC transactions had jumped to RMB 1.8 trillion ($247 billion) as of the end of June, an exponential (1,699 percent) increase from RMB 100 billion ($13.7 billion) as of August 2022. While that data suggest that adoption of the digital currency is indeed picking up speed, it is important to note that as a share of the overall cash in circulation in China, this figure remains a miniscule 0.16 percent (Mpaypass.com.cn, August 1).

Qin Xuan (秦璇) who holds a PhD in accounting from Fudan University, explored why adoption of the CBDC has been slow in a recent interview. "After all, the digital Renminbi is something new," Qin said. For it to gain mass adoption, a number of issues need to be addressed, such as its stability and reliability, incentives for commercial banks and other institutions, and "how to balance the relationship with third-party payments such as WeChat and Alipay," Qin added (The Paper, September 12). This point about Alipay and WeChat Pay is particularly salient. Chinese leader Xi Jinping has presided over a severe crackdown on China's erstwhile high-flying internet economy, nominally in a bid to curb the monopolistic power of platform companies and the so-called "disorderly expansion of capital"—a phrase that began appearing regularly in state media around the time that Ant Group's planned initial public offering in Hong Kong and Shanghai was aborted (see China Brief, December 23, 2020). At China's Central Economic Work Conference held in December 2020, strengthening anti-monopoly work and preventing disorderly expansion of capital were highlighted as "key tasks" for the first time (Gov.cn, December 27, 2020). Thereafter, both Alibaba and Tencent were forced to restructure. Beijing also forced Alibaba to break up its once-lucrative digital financial services business to reduce risk and give the Communist Party greater oversight.

While Beijing has never explicitly called for the digital RMB to replace the internet giants' payment systems, it nevertheless has sought to dilute their duopolistic grip over a market that was worth $70 trillion in 2022 (Pbc.gov.cn, March 27). Yet the effort has not been successful to date. Together, Alipay and WeChat Pay still have about a 90 percent share of China's mobile payments market (The South China Morning Post, May 4). Chinese consumers may resent some of the internet giants' admittedly monopolistic behaviors, but the platforms are so embedded into everyday life in China that it is nearly impossible to live without them. The CBDC does not offer consumers any compelling benefits over existing digital payment methods integrated with the respective ecosystems of the internet giants, which span everything from e-commerce to retail banking to entertainment. For that reason, Beijing has pressed Alipay and WeChat Pay to promote the digital yuan through their respective platforms. At a recent financial forum, Mu Changchun (穆长春), director of the PBOC's Digital Currency Institute, called for a unified QR code for retail payments that could ensure the digital RMB could be used for any retail transaction. Implicit in his speech was an expectation that Alipay and WeChat Pay would improve their respective interoperability with the CBDC (The Paper, September 3).

Cross-border Experimentation

Concurrent with its efforts to promote the digital currency domestically, Beijing is exploring cross-border use cases. These initiatives are more nascent than domestic pilots. Even though about 130 countries are experimenting with CBDCs, China is the only major economy to launch one (The Atlantic Council, June).

China has spearheaded the first large-scale cross-border CBDC project covering trade settlement and interbank transfers, mBridge, named for its custom-built blockchain. From August 15 to September 23, 2022, mBridge was tested in a pilot involving real-value transactions that included 20 commercial banks from China, Hong Kong, the UAE, and Thailand. Over $12 million was issued on the platform, facilitating over 160 payment and foreign exchange payment-versus-payment (PvP) transactions valued at more than $22 million overall (China Daily, November 1, 2022). The ostensible purpose of mBridge is to make cross-border payments more seamless than they otherwise can be due to cumbersome correspondent banking networks. Colin Pou Hak-wan, executive director of financial infrastructure at the Hong Kong Monetary Authority (HKMA), said last year that the project could boost connectivity in international payments and facilitate international trade. Thus, "cross-border transfers could shorten from multiple days to near real-time," he said. (China Daily, November 1, 2022). Yet existing real-time payment solutions, such as the interbank messaging network Society for Worldwide Interbank Financial Telecommunication's (SWIFT) Global Payments Innovation (GPI) platform, launched in 2018, have already solved most of the issues on which mBridge purports to be focused. SWIFT GPI counts 4,000 financial institutions in its network. $300 billion is sent each day on the network in 150 different currencies (SWIFT, accessed November 4).

An additional motivation for mBridge—at least from Beijing's perspective—is to develop a global payment system that could circumvent the US dollar and the SWIFT network over which Washington exerts strong influence. On the one hand, China intends to make itself more sanction-resistant, but even if Beijing and Washington manage to avoid financial war, the Chinese Communist Party (CCP) is determined to chip away at so-called "dollar hegemony" with a multilateral blockchain-based cross-border payments system that excludes the United States. Indeed, the Chinese Communist Party (CCP) remains deeply unsettled by the US dollar's dominance. "The hegemony of the US dollar is the main source of instability and uncertainty in the world economy," China's Ministry of Foreign Affairs said in a February report (FMPRC, February 20).

At Hong Kong's FinTech Week in 2022, Mu Changchun explained how mBridge could potentially give the RMB a larger global role. He said that the platform is designed to allow participation by central banks, whether or not they have already established their own domestic CBDC system, possibly negating the need for dollars in foreign exchange. "You can also adopt these existing traditional payment systems such as RTGS [real-time gross settlement] or FPS [Faster Payment System], so that central banks or monetary authorities can issue their own CBDC on mBridge without establishing their own CBDC system," Mu said (South China Morning Post, November 2, 2022).

Rising Domestic Use, Selective Cross-Border Applications

Looking ahead, the digital RMB is likely to gain traction fastest in areas where the CCP can mandate its use. That means domestically, and especially in the state economy. To that end, beginning in May, thousands of government workers and employees of state-owned companies in Changshu (常熟), a major city in Jiangsu Province, began to receive their salaries entirely in CBDC (CCTV.com, May 19). Pilots that began in 2019 have since expanded to 26 pilot areas in 17 provinces and special municipalities, including Shanghai, Shenzhen, and Xi'an (People.cn, December 20, 2022).

While there are concerns about privacy, it is unlikely that these will dissuade Beijing from increasing circulation of the digital RMB where it can. Chinese laws forbid telecommunication operators and internet service providers from gathering and using the personal data of digital RMB account holders, but given the ascendancy of national security in Xi Jinping's China, it can be assumed that authorities will have access to such data if they deem it necessary (see China Brief, December 21, 2015, February 26, 2021).

Some of the most prominent public faces of China's CBDC emphasize that it supports "controllable anonymity": Users can choose how much personal information they want to provide through the app. In a long commentary published last year, Mu Changchun said that if CBDC users refuse to provide personal information through the app, it "will strictly implement" their requests, adding that it is "designed to protect personal privacy" (Finance 40 Forum, October 8, 2022). Irrespective of the actual amount of privacy protection the CBDC offers, it is likely to be greeted with suspicion in any country which has strained ties with China, which at this point encompasses most advanced economies. Yet developing countries and others friendly with China, especially those with ties to Beijing through the Belt and Road Initiative (BRI), may be more amenable to adopting it in some regard.

Conclusion

The mBridge project should be observed closely to see if it comes to fruition. All the participants in mBridge are also involved with BRI, with the UAE an especially enthusiastic booster of both the mammoth infrastructure initiative and China's digital currency. Underlying such deals are a persistent concern that tensions between China and the United States could eventually escalate to the point that Beijing would be the target of sanctions. China and its key partners want to explore how this CBDC can help them prepare for that possibility. "For soundness, we need highly resilient robustness," UAE advisor Shu-Pui Li said at Hong Kong Fintech Week last year. "We cannot tolerate any disruption. At the moment, we see that happening" (Ledger Insights, November 1, 2022).

"Resilient robustness" could be interpreted to mean a China-centric digital payments rail in which transactions are settled in digital RMB, and thus can be immune to any American pressure. Yet to reach that stage, much work remains to be done. To ensure widespread participation, Beijing will have to successfully make the case that there are clear economic and financial benefits to participating countries beyond insurance against hypothetical American sanctions. Additionally, the continued tight restrictions on the Chinese currency's exchange rate and the capital account will limit what the digital RMB can achieve internationally.

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Money Alone is Not Enough: The Future of China-Argentina Relations

by Román Ortiz

The Espacio Lejano Station in Neuquén Province, Argentina. (Source: Wikipedia)

Observers assessed the outcome of the first round of Argentina's presidential elections held on October 22 as good news for the Chinese government (VOA, October 26). Against the odds, Sergio Massa, the Peronist candidate and current minister of economy, emerged on top, despite his overseeing an annual inflation rate of almost 140 percent. Meanwhile, Javier Milei, the libertarian opposition candidate, took the second place (Yahoo Noticias, October 23). These two politicians will compete for the presidency in the second round of the election scheduled for November 19.

At first glance, the victory of Massa should be an encouraging sign for the People's Republic of China (PRC) since it keeps open the possibility that the China-friendly Peronist party remains in government. However, a more granular analysis suggests two alternative outcomes: First, Milei is likely to be the eventual winner after the second round of voting, which would make the new occupant of the Casa Rosada (the Argentinian presidential palace) a politician who has called the PRC an "assassin" and who plans to freeze relations with Beijing. Second, if Massa wins the presidency, his more moderate Peronism is far from the Third-World foreign policy promoted by the outgoing president, Alberto Fernandez, and his vice-president and former president, Cristina Fernandez. Thus, regardless of the outcome of the presidential election, Beijing's desires to increase political influence over Buenos Aires, which have focused particularly on its defense policy, are likely to be curtailed.

A decrease in political influence with Buenos Aires would deal a serious blow to the Chinese strategy in Latin America, in which Argentina plays a critical role. Argentina is the only large country in the region to join the Belt and Road Initiative (BRI). It also exports food, minerals, and oil needed by the Chinese industrial sector. Argentina's expansive territory represents a natural platform to project power within South America and to the South Atlantic. Buenos Aires's geopolitics makes it particularly attractive for Beijing, which is exploring opportunities to secure rights for a naval base on the west coast of Africa in order to gain access to the Atlantic. Argentina also forms a key part of PRC efforts to consolidate its hegemony over the Global South. Specifically, the PRC views Argentina as a counterbalance to Brazilian regional hegemony, which motivated China's interest in Argentina joining the BRICS grouping of countries, against Brazilian opposition.

Economic Ties

To gain influence over Argentina, the PRC has deployed its traditional playbook, moving the bilateral relationship through phases of ever-increasing involvement. In 2004, Argentina's President Nestor Kirchner and General Secretary Hu Jintao (胡锦涛) signed an agreement of "Strategic Partnership" (People's Daily, November 17, 2004). In 2014, President Cristina Fernandez and Xi Jinping (习近平) upgraded the relationship to the level of "Comprehensive Strategic Partnership" (FMPRC, February 5, 2015). The final step was in 2022, consisting of Argentina's accession to the BRI. President Alberto Fernandez and Xi Jinping came to an agreement during a meeting on the sidelines of the Beijing Winter Olympics in February 2022 (Global Times, February 6, 2022).

Deep Chinese penetration into the Argentine economy accompanied these warming diplomatic ties. Beijing exploited Argentina's increasing financial difficulties to gain privileged access to its market. A key step was the agreement for a currency swap between PRC and Argentinian national banks in 2009, under the Peronist administration of Cristina Fernandez. This financial arrangement functions as a line of credit, which has since reached $18 billion, allowing Sergio Massa to meet Argentina's IMF debt payments and thereby avoiding a default, keeping his presidential aspirations alive (Bloomberg, October 18).

The PRC has also supported Chinese companies' bids in Argentina for infrastructure projects with financing guarantees—an almost irresistible offer for a country with an extreme lack of capital and urgent infrastructure needs. These bids have made the PRC a key player in strategic sectors. They include: the rail industry, via the China Machinery Engineering Corporation's overhaul and modernization of the Belgrano Cargas railway (Casa Rosada, October 15); riverine transport, through political pressure for CCCC Shanghai Dredging Co. to win the contract to manage the Parana-Paraguay waterway; the energy sector, with the agreement to build Atucha 3 nuclear reactor, and the building and exploitation of Cauchari Solar Plant; and the commodities sector, with the acquisition of Argentinian Lithea by China's Ganfeng Lithium (Casa Rosada, October 15; TN, May 30; Reuters, July 11, 2022).

This economic engagement has generated some pushback. Beijing's investments have incurred delays; Argentine manufacturers have raised concerns about unfair Chinese commercial practices; local environmentalist groups have protested against the impact of PRC-run projects; and security frictions have arisen over PRC distant water fishing vessels and their illegal fishing in South Americans waters (Infobae, March 29, 2021; Reuters, March 16, 2016). However, Chinese efforts to become an indispensable economic partner for Buenos Aires can be judged on balance as a success. Loans and investments have been accompanied by a dramatic increase in trade: In 2021, the PRC became Argentina's second largest market after its neighbor Brazil, accounting for 8.28 percent of Argentinian exports and 19.93 percent of imports.

The relationship-building process on the Argentinian side has been led by the leftist faction of the Peronist party. Former president and current vice-president Cristina Fernandez has played a crucial role in some of the milestones of China-Argentina bilateral engagement, such as formalizing the currency swap deal and, more recently, Argentina's agreement to join the BRI. However, Peronists have not been the sole political force promoting economic ties with the PRC: In May 2017, Mauricio Macri, the center-right president and predecessor to Alberto Fernandez, signed investment agreements with Xi Jinping tallying $15 billion (La Nacion, May 17, 2021).

Argentine Politics and Defense Cooperation

This apparent consensus among the Argentine political establishment about the importance of economic ties with the PRC hides deep misgivings and discord concerning political alignment with Beijing. While the left wing of the Peronist party has actively sought a strategic partnership with the PRC to counterbalance the United States and build international autonomy, the center-right opposition groups and the moderate sectors of Peronism prefer to limit Chinese engagement to the financial and commercial sectors. These differences are especially visible in defense cooperation.

Cristina Fernandez deployed a systematic effort to expand defense cooperation with the PRC during her presidency (2007–2015). In 2007, the two countries' defense ministries signed a memorandum of understanding creating the Joint Commission of Defense, which has become a centerpiece of bilateral cooperation and touts five meetings to date, most recently in 2021 (Pagina 12, March 30, 2021). Building on the work of this commission, the Fernandez administration broadened cooperation, coordinating with China on military education and training, procurement, and base rights in Argentinian territory (Perfil, December 11, 2019).

Since 2021, Beijing has deployed various incentives to further increase defense cooperation with Buenos Aires. In the political domain, the PRC has consistently taken Argentina's side in its conflict with the United Kingdom over the sovereignty of the Falkland/Malvinas Islands (China Daily, July 21). At the same time, it has provided military assistance, including equipment and education. In practical terms, this support has been very limited, consisting of two field hospitals and a few slots in Chinese military schools for Argentine officers. However, this cooperation stands in sharp contrast to that of several Western partners whose plans to provide military equipment to Argentina—particularly air assets—have clashed with persistent British diplomatic efforts to block any transfer of modern defense systems so long as their territorial dispute remains unsolved.

Cristina Fernandez also negotiated the purchase of a large package of Chinese weapons systems and aircraft, including 110 Norinco ZBL-09/VN1 armored personnel carriers (APCs), 5 P18 Corvettes, an Antarctic vessel, and planned to co-produce Changhe Z-11 helicopters (MercoPress, February 5, 2015). These projects were all cancelled or postponed by the subsequent administration. The purchase of APCs was ruled out and the corvettes were replaced by French-made offshore patrol vessels. The only Chinese equipment actually acquired was 4 Norinco WMZ-551B1 APCs, which have proved prone to breakdowns (Indodefensa, August 11, 2018). Thus, the Fernandez administration's attempt to reduce Argentinian dependency on Western military equipment suppliers and replace them with PRC manufacturers was a total failure.

Quintuco Space Monitoring Station

A 2012 agreement to establish a space station in Quintuco, Neuquen province, represents a major concession to China by Argentina. The purpose of the facility is, according to the agreement, to support Chinese programs for exploring the Moon and Mars. Nevertheless, the civilian nature of the space monitoring station is disputed. **[1]** Quintuco's facility is managed by the China Satellite Launch and Tracking Control General (CLTC), a body under the People's Liberation Army's Strategic Support Force. Though the number of Chinese personnel assigned to the base is small (nine individuals), all of them are military personnel and Argentine officials do not have control over their activities. The actual operations of the facility are performed remotely from the PRC, and the PLA's detachment in Quintuco only performs maintenance and supervisory functions. Additionally, there are signs that its 16-story antenna has the capability to gather data about satellites, long-range missiles, and space vehicles. In short, Quintuco's space base is a dual-use facility in formal as well as practical terms. The space monitoring station began operations in 2018, during the term of President Mauricio Macri (2015–2019). Despite dramatically slowing defense engagement with the PRC to a set of education and training activities with emphasis on peacekeeping operations, Macri faced legal obstacles and fears of economic reprisals which prevented his administration from terminating the agreement on the space monitoring station signed by President Cristina Fernandez.

Prospects for an expansion of Chinese-Argentine defense cooperation looked more promising once again with the return to power of the Peronist party in 2019, led by President Alberto Fernandez and now Vice-President Cristina Fernandez. The new government moved forward with two key procurement projects. Plans for the acquisition of Chinese Norinco ZBL-09/ VN1 APCs restarted, and this time involved the purchase of 209 vehicles for a figure close to $600 million to be paid over 12 years (Zona Militar, November 25, 2021). The PRC also offered the sale of 12 JF-17 Thunder fighter-bombers for $644 million, to be paid through a flexible financial arrangement across the same period. This would have been a strategic success for the Chinese arms industry, not only by providing high-tech weaponry to a country in the western hemisphere, but also by gaining a decisive influence over the Argentine Air Force. However, this is put into question by the impending end of President Fernandez' term, and as things stand, China seeks to lose out to the United States in the deal (Eurasian Times, October 14).

The establishment of a new Chinese military enclave on Argentine territory was also discussed. This news was made public after the announcement by Gustavo Malella, the governor of Tierra del Fuego Province, who referenced a potential Chinese investment package to build a base in Ushuaia to support Beijing's Antarctic operations (Polar Journal, February 6). Malella led "Forja," a regional party closely allied to Cristina Fernandez and the Peronist left. His Chinese counterpart for these talks was Shuiping Tu, legal representative of HydroChina Corp (中国水电工程顾问) in Argentina and member of the Chinese Communist Party.

The State of Play

President Alberto Fernandez's administration is coming to an end. As such, the chances for any of these projects to become reality are slight. In October, the US government approved the transfer of a package of F-16 multirole fighters operated by Denmark to Argentina. This gave the Argentine Air Force access to the United States's preferred air platform, disincentivizing any potential deal to acquire the Chinese aircraft. At the same time, before Argentina's National Congress, Sergio Massa rejected any Chinese involvement in the construction of infrastructure to support Argentine Antarctic activities in Ushuaia (Infobae, September 30, 2022).

Several factors explain the overall failure of attempts by the PRC to gain leverage on Buenos Aires' defense apparatus. The Argentine armed forces are closely connected to the West in terms of military doctrine and equipment. For decades they have preferred Western weapons systems when they have been accessible and distrusted the acquisition of key assets such as the JF-17s which would tie them to the PRC or any other non-traditional supplier. Quality issues surrounding Chinese-made equipment have also reinforced this reluctance.

Chinese plans to penetrate the Argentine defense system have also been damaged by a broader concern with political influence. The calculation that economic weight can easily be transformed into political influence—a key principle in the Chinese approach to the relations with the Global South—has turned out to be much less straightforward than expected. Governments in Africa, Latin America, or the Middle East usually welcome foreign investment as long as it is not tied to political demands, and drag their feet or even openly oppose interference in sensitive sectors unless they come from a country perceived as politically friendly. This is also the case for Argentina: Even if its dire economic situation has made Buenos Aires increasingly dependent on Chinese financial support, the center-right government of President Macri ensured that Chinese loans and investments remained divorced from defense. The difference in policy witnessed under the administrations of Cristina Fernandez and Alberto Fernandez had less to do with the effectiveness of Beijing's economic pressures than with the ideological preferences of the leftist faction of the Peronist party, which saw China as a valuable ally in its crusade to weaken the United States' traditional links with Argentina's armed forces.

Conclusion

If the historical trend holds and ideological preferences of the occupant of Casa Rosada are important in predicting the shape of Argentina-China relations, Beijing should not be optimistic going into the November election. Massa is well connected in Washington and has publicly rejected the establishment of a Chinese base in Ushuaia. His competitor Milei has publicly committed to cutting ties with the Chinese regime. Argentina may be a good test case for Xi Jinping and his advisers to understand that, sometimes, money is not enough.

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Notes

[1] Online interview with former Argentinian government official, October 9th, 2023