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Chinese Premier Wen Jiabao and Russian President Vladimir Putin

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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

Editor's Note

The 17th National Congress of the Communist Party of China (CCP) concluded in Beijing with thunderous applause echoing from the Great Hall of the People. With the next National Congress slated for 2012, the 17th National Congress unveiled President Hu's cast of star "Princelings," ordaining the Fifth Generation of CCP leaders chosen for grooming to take over the helm of the CCP when Hu steps down in 2012. Given the significance of "generational" change in the history of CCP's elite politics and its impact on China's political transition, the China Brief invited its analysts to use this rare window to assess the direction of the CCP's domestic and foreign policies. In Issue 19, Dr. Li Cheng gave an in-depth forecast of the major players that may enter the Politburo leading up to National Congress. In Issue 20, Senior Fellow Willy Lam analyzed the choices that were made and offered a sobering account of CCP intra-party reform. In this issue, the China Brief invited Dr. I-Chung Lai, a Member of the Executive Board of the Taiwan Thinktank, to take us into the turbulent waters of the Taiwan Strait and analyze the implications of the National Congress on China's Taiwan policy.

Amid U.S. lawmakers' growing concerns of the recent influx of Chinese firms buying up stakes in strategic U.S. industries, Dr. Wenran Jiang tries to put a damper on these fears and argues that the investment strategies adopted by Chinese businesses are, in fact, a function of its commitment to free market principles.

Also included in this issue, Dr. John C.K. Daly followed the heavy tracks left by Premier Wen Jiabao's trip to Uzbekistan for the sixth annual Shanghai Cooperation Organization (SCO) meeting of the Council of Heads of Government, and Wen's whirlwind Eurasia state visits to Kazakhastan, Kyrgyzstan, Russia and Tajikistan. Daly discovered a subtle crack in the perceived monolith SCO, where the interests of the two powerhouses, China and Russia, diverge on priorities for the SCO and Central Asia.

In the Middle East, with the Iraqi government still mulling over the February draft oil law, Dr. Yitzahk Shichor's piece analyzes China's entry strategy and how it is steadily building its economic stake in Iraq.

We remind our valued readers that the China Brief serves a wide community of policy makers, business leaders, experts, academics and students in various disciplines with timely analysis. Your feedback is very important to us. Please send your thoughts and comments to the editor: Hsiao@jamestown.org.

L.C. Russell Hsiao
Associate Editor

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17th Chinese Communist Party Congress: Policy Implications on Taiwan

By I-Chung Lai

As expected, no major "policy" surprise came from the 17th Chinese Communist Party Congress, particularly towards Taiwan. President Hu Jintao's political report on Taiwan from now until 2012 will be more of the same. The Anti-Secession Law (fan fenlie guojia fa) provided the legal foundation, and Hu's "four-point" guidelines are directing the policy [1]. Though conciliatory in tone, the policy remains unchanged.

Political rhetoric notwithstanding, there are still some interesting nuances worthy of pointing out. First, contrary to the general expectation, the report laid no direct refutation of Taiwan's referendum for joining the UN. Second, in comparison with the 16th Communist Party Congress, there was no mention of "not giving up using force to settle the Taiwan issue," a point hammered indiscreetly by former president Jiang Zemin. Third, the precondition for party-to-party dialogue has slightly changed from "recognize the 'one China' principle" (chengren yige zhongguo de yuanze) to "recognize that both Taiwan and Mainland belongs to one China" (chengren daliu he taiwan tongshu yige zhongguo). Whether those subtle differences indicate some real changes in China's approach towards Taiwan for the next five years remains to be seen, however, those changes do suggest that Hu is in greater control of the Taiwan policy.

Speak Softly and Carry a Big Stick

The Taiwan section in the political report is a classic example of the "speak softly and carry a big stick" strategy. Not only did the report not lash out against Taiwan's referendum for joining the UN, but it also did not mention "not giving up using force to settle the Taiwan question." The report repeatedly emphasized the goal of peaceful unification and devoted a full paragraph on the various plans for cross-Strait economic cooperation—it even suggests a possible peace agreement.

Although there was no mention of "not giving up using force to settle the Taiwan question," the military preparation against Taiwan has accelerated in recent years: missiles deployed against Taiwan are now close to 1,000, up from 500 just three years ago. The peace agreement is conditioned in Taiwan's acceptance of the "one China principle," which the majority of the Taiwanese people rejected. Also veiled beneath this peace agreement is the notion that acceptance of such an agreement vindicated the "Anti-Secession Law": since Taiwan is not going to invade China, the peace can be easily achieved as long as China gives up using force against Taiwan. The peace agreement applies to two warring parties—a direct reference to the KMT-CCP civil war as described in the first article of the "Anti-Secession Law."

China Continues Outsourcing Taiwan Policy to the United States

Although the report does not directly refute Taiwan's UN referendum, Hu did something unprecedented by explicitly stating that "all" Chinese people have the right to "co-determine" (gongtong jueding) the future of Taiwan. This bears several readings. First, it can be seen as Hu preparing some wiggle room "to not act" should Taiwan's UN referendum pass in March 2008. Since no matter what the referendum result is, it will not change the (believed) reality that Taiwan is still part of China and it will not be a part of UN, and that only Chinese people have the final say about the future of Taiwan regardless of the Taiwan's referendum result.

Second, it can be seen as Hu seeking to move more in line with the U.S. position, as this formula seems to be more compatible with the current Bush administration policy toward cross-Strait relations, which is that "matters [are] to be resolved peacefully by the people on both sides of the Taiwan Strait, absent the threat or use of force, and should be acceptable to the people on both sides of the Taiwan Strait." Judging from this angle, it seems that China will likely continue to rely on the U.S. to rein in Taiwan, whether it is on the referendum issue or on other issues that China considers unacceptable.

TAO's Approach on Taiwan Heavily Criticized

Hu's silence on Taiwan's UN referendum can be interpreted as Hu's frustration with the effectiveness of its Taiwan policy to date. Compared with Hu's statement back in 2005, in which Hu repeatedly brought up criticism about how unpopular the Democratic Progressive Party's (DPP) policy was among the Taiwanese people, there was no such confidence demonstrated in this report this time. Thus, Hu resorting to the "Chinese people to co-decide the future of Taiwan" indicates a lack of confidence on Hu's part on the Taiwan policy.

Though China is aware of the DPP's position on the referendum, the Kuomintang's (KMT) followthrough on this issue presents a total surprise. The past two years of cultivating CCP-KMT relations by former KMT Chairman Lien Chan proves futile in this referendum episode since—as now revealed—Lien Chan has very little influence, if not inverse influence on the decision of the KMT's presidential candidate Ma Ying-jeou. There were also rumors in Beijing that the Taiwan Affairs Office (TAO) was heavily criticized for distancing itself too much from DPP and tying itself too close to the KMT, thus having no channels to influence DPP. As a result, CCP entangles itself in Taiwan's polarized green-blue political mud fighting and virtually becomes hostage to KMT's domestic political struggle, a position CCP avoided for the past five years.

The slight change in condition for party-to-party dialogue in Hu's political report also invites speculation on criticism of TAO's approach. In the past, it was "recognize the one China principle;" the new language is to "recognize that both Taiwan and Mainland belongs to one China." Though it presents no major difference in principle, some observers did suspect this change is aimed particularly at DPP's presidential candidate Frank Hsieh. Frank Hsieh, before assuming the chairman of DPP in July 2000 and then the Kaoshiung city mayor, once said that both Kaoshiung and Xiamen are "one nation, two cities" (Sintao Daily, July 2, 2000). Frank Hsieh also mentioned that the current ROC constitution endorses a "constitutional one-China" in principle (Central News Agency, July 16). Despite receiving heavy criticism during the DPP party primary, Frank Hsieh has not changed his interpretation of the current constitution in Taiwan, only to say that it presents a problem to be reckoned and dealt with. Since Hu's "both sides belong to one-China" is an even more vague approach on the so-called "one China" principle, it can easily be bridged over with Frank Hsieh's "'constitutional' one-China," so long as Frank Hsieh does not advocate constitutional reform that will touch the sovereignty issue, as argued by some observers. If this is indeed the case, it indicates some subtle changes from TAO's tactic of "unite with the KMT to constrain the DPP."

The election result of the 17th Central Committee members might reveal the trace of how the party reviews the TAO's work. Due to retirement, Director Chen Yunlin is no longer elected as a member of the Central Committee, but the Deputy Director Cheng Li-Chun, whom many believed is in line to succeed Chen to assume the directorship, received votes only to enable him to be a 18th supplementary Central Committee member. As a result, it is almost certain that when the new TAO director is appointed next March, it will be someone from outside the TAO.

Whether the perceived displeasure toward the current TAO's efficacy represents a shift in Taiwan policy in the making remains to be seen. Hu is still the chairman of the Taiwan Task Force (zhongyang duitaigongzuo lingdaoxiaozu). TAO plays the role of implementing policy made by the Taiwan Task Force, though its director is also part of the task force. No evidence suggests that the change of personnel in the Taiwan Task Force following the result of the 17th CCP Congress will result in the change of policy.

March 23: The Aftermath of Taiwan's 2008 President Elections

The overall impression of Hu's political report to the 17th CCP Congress is that economic development trumps all. The Chinese government is also determined to have a successful Beijing Olympic event. Not to mention that China would like to avoid becoming a factor in Taiwan's two upcoming elections. Thus, the conventional wisdom suggests that there will be no action expected from China before the March 22 presidential election in Taiwan. How, then, would China start to move in the election's aftermath when the next president is known?

There are speculations in Taiwan that China might start to push something after March 22 by offering discussion on items to be included in the "peace agreement," in order to probe how much the new president-elect is willing to compromise. It is likely that China will take the May 20 inauguration speech as the first measure to decide what Beijing will do afterwards. The various tools associated with the Olympic event can also be applied by China toward Taiwan. These are premature suppositions, but observers in Taiwan are expecting that China may make this move right after the conclusion of the presidential election—even before the start of the Beijing Olympic event.

Taiwan's Uncertain Political Outlook to Remain Until the End of Beijing Olympics

No matter the result of legislative and presidential elections—there are four possibilities—a major power transition will take place in the party that loses the presidential election. If Frank Hsieh loses, it is possible that the "four kings and one queen" that dominates the DPP will cease being the leaders and the issue of generational power transition will come to the fore. If Ma Ying-jeou loses, KMT will face another major power struggle. Whether Lien Chan and James Soong will come back to take back the helm, or some leaders of younger generation will surface, begs all kinds of speculation. This process definitely will be messy and Taiwan's political outlook will become quite uncertain for sometime to come. It will remain so all the way into September 2008, after the second legislative session that year, for it to settle down.

The aforementioned projections indicate a cross-Strait scenario that when translated suggests minimal conditions for conflict before September 2008, since when the new president is sworn in, both sides will be busy with their own respective businesses: Beijing Olympics for China and indulgences in the consequence associated with the power transition for Taiwan. There is one caveat, however, as numerous failed predictions on cross-Strait development in the past suggest, while evidence indicating continuity will rule the day, surprises (be it from China, Taiwan or even the United States) always prevail.

Dr. I-Chung Lai is a Member of the Executive Board of the Taiwan Thinktank, and former director of Department of International Affairs, Taiwan's Democratic Progressive Party.

Notes

1. In the guideline, Hu said that the China will "never sway in adhering to the one-China principle, never give up efforts to seek peaceful reunification, never change the principle of placing hope on the Taiwan people, never compromise in opposing 'Taiwan Independence'" (Xinhua, March 5, 2007).

China Flexes Its Muscles on Wall Street

By Wenran Jiang

First, it was the massive accumulation of China's foreign reserves in Beijing's wallet, the largest in the world, with $1.4 trillion. A major portion of that money has flowed into the U.S. Treasury bonds, subsidizing much of the Bush administration's deficit-driven economy. Then, there was the global expansion of large Chinese companies searching for energy and resources to satisfy its hungry growing economy, offset by a failed $18 billion takeover effort of the U.S. energy company Unocal by China National Offshore Oil Corp (CNOOC). Now, China has begun to accelerate and diversify its foreign investment portfolio in a much more confident manner. Last month, CITIC Securities Co. reached an agreement with Bear Sterns Companies to invest $1 billion in each other. This was followed by the announcement that the Industrial and Commercial Bank of China Ltd. (ICBC) will buy 20 percent of South Africa's Standard Bank Group Ltd. with $5.5 billion in cash. Time has come for China's financial giants to flex some of their muscles.

"Partners of Choice" Investment Approach

Both transactions have made history in China's financial and banking sectors. CITIC Securities Corp. is China's largest stock operator and one of the biggest in the world. Its $1 billion investment in the New York-based securities firm Bear Sterns Cos. is by far the largest overseas expansion by any Chinese securities firm. The deal gave CITIC a 6 percent stake in Bear Sterns, which will in turn have 2 percent equity in CITIC. If approved, the transaction will give CITIC direct access to Wall Street. The two firms also plan to form a new joint venture company in Hong Kong to explore expansion possibilities in the booming Asian market.

Call the CITIC-Bear Sterns deal a "perfect match" or "marriage of convenience," but the fact is that CITIC has the extra cash and Bear Sterns is looking for new opportunities. CITIC Securities has seen its fortune growing with unbelievable speed. This year alone, its market value has more than quadrupled to $50 billion, leaping to No.1 stock brokerage status in Asia. Moreover, the fast-running bull's net profit in the first nine months of this year is about $1.1 billion, seven times more than the same period last year (Reuters, October 22). On the other hand, Bear Sterns, 84 years-old and the fifth largest U.S. securities firm, has suffered from the subprime mortgage meltdown with two of its hedge funds going bankrupt, and its stock value dropping 37 percent this year. The new alliance with CITIC is projected to strengthen Bear Sterns' competitiveness in the Chinese market.

The ICBC $5.5 billion purchase of a fifth stake in Standard Bank, in contrast, is by far the biggest overseas banking acquisition effort by any Chinese company. ICBC, listed in both Hong Kong (HKEX) and Shanghai Stock Exchanges (SSE), is the now the world's largest bank, with a market capitalization of about $319 billion, managing assets worth about $1.1 trillion (Mail and Guardian, October 30). The 20 percent stake in Standard Bank gives ICBC access to Standard Bank's banking and financial operations both in the African continent and in 38 resource rich countries in the Middle East, Latin America and Asia. For Standard Bank, the Chinese cash infusion turns South Africa into China's largest foreign investment destination in the African continent, giving Standard access to the fastest growing economy in the world, and enabling it to manage financial flows between African and Asian markets.

China's "Go-out" Strategy for Surplus Capital [1]

These transactions are the latest in a series of Chinese banking and financial outreaches around the world in recent months. Fueled by a rapidly expanding domestic stock market and the continuous inflow of foreign investment, China's capital market is loaded with an excessive amount of money seeking investment opportunities. The Chinese authorities have accordingly relaxed controls over institutional and private investments abroad, and announced new rules to encourage outflow of Chinese capital. Here are some of the latest developments:

- In May, the Chinese government spearheaded the overseas capital rush by announcing that it would invest $3 billion in Blackstone Group, to be managed by a newly established State Investment Company. Clearly a diversification effort from putting China's huge foreign reserves into U.S. Treasury bonds, Beijing characterized the 10 percent stake in the New York-based firm as "just looking for better return" (Bloomberg, May 22).

- In June, Beijing delivered the first $1 billion of a $5 billion commitment to the China-Africa Development Fund which was set up to enhance China's economic ties with African countries, and to help Chinese trade and investment in the continent " (Xinhua, June 27).

- In July, China Development Bank (CDB), a state-owned policy bank, agreed to spend $3 billion to purchase a 3 percent stake in Barclays PLC of Britain. This will make CDB the largest share holder of Barclays which is the largest issuer of credit cards in Europe and the third-largest banking group in Britain with around 27 million customers and clients in more than 50 countries and regions (Xinhua, July 24).

- In October, Minsheng Banking Corporation, China's seventh largest bank by market value, announced that it would spend $317 million for a 9.9 percent stake in UCBH Holdings Inc. and may eventually own up to 20 percent of the San Francisco-based commercial bank. This marks the biggest leap abroad of a Chinese private bank (Shanghai Daily, October 8).

- Beijing has also moved to allow private citizens to invest overseas through a growing number of Chinese banks, security companies, fund-managing firms and insurers under the Qualified Domestic Institutional Investor program (QDII). Furthermore, it was reported that the latest Chinese QDII investor raised more than $13 billion, over 3 times more than its originally projected amount (China Daily, October 16).

These developments—the shift from government managed funds to provide sector initiatives—have represented a small leap forward for China's capital outflow into the world financial market, and it has raised concerns about both the nature of these investments and Chinese intentions behind them.

Unocal: Lesson Learned but Barriers Ahead Still

It was not so long ago that China's banking and other financial institutions were perceived as burdened with bad loans, non-transparent, lagging behind in much needed reform and facing the danger of collapse. Chinese leadership, however, seems to be determined to prevent these problems from becoming worse. There is also no doubt that, while all these issues may come back to haunt the Chinese economy, China's booming stock market in the past few years has injected new confidence into China's newly emerged financial power houses. Their march toward the world stage seems to be based on a few lessons learned from the past.

First, unlike CNOOC's failed bid to buy Unocal two years ago, none of the latest Chinese financial activities abroad pursued 100 percent takeovers or majority holding status of any foreign financial institutions. Rather, their common feature is to be participants in a minority holder position, ranging from a few percentage points to no more than a 20 percent equity share. By coincidence or by design, these acquisition efforts were carried out in a fashion that clearly tried to avoid creating any major threat perceptions or raising alarms about China's intentions.

Second, all these investments are targeted at partners that can further expand China's financial and investment portfolios around the world. These partner institutions will provide an established global financial infrastructure that the newly emerged Chinese counterparts lack, thus satisfying future development needs of China's overseas investment drive.

Third, in these investment transactions, the Chinese firms were aiming at a small part of equity rather than asserting control over the execution of the new partnerships. The Chinese institutions are all aware that they lack managerial know-how, operational knowledge and market expertise in global finance, and hope to learn from their foreign counterparts through these new joint ventures.

Finally, Chinese ventures involved in the latest overseas expansions have emphasized the commercial nature of their actions. Equity, profits, management skills, access to markets and sustaining China's continuous economic development, they argue, are the true motives of these overseas investments.

While many welcome China's new financial adventures that bring new opportunities, others have expressed serious reservations comparable to the tense debates surrounding CNOOC's bid for Unocal in 2005, although CITIC Securities' $1 billion investment in Bear Sterns Co. only gives the former a 6 percent equity in the latter. Notwithstanding, the U.S. Treasury, under its Committee on Foreign Investments in the United States (CFIUS), will work with several departments—including Justice, Commerce, State and Defense—to investigate whether the deal raises concerns for national security, according to a report from the Telegraph (Telegraph, October 24).

Another deal—the Chinese tech company Huawei Technologies' proposed $2.2 billion purchase of U.S. communication firm 3Com—one which Huawei is pursuing with its U.S. partner, Boston-based equity firm Bain Capital, has also aroused strong sentiments in some quarters of the United States for its perceived national security risks. The buyout proposal gives Bain Capital 83.5 percent of 3Com stock while Huawei has only 16.5 percent. U.S. Congressman Duncan Hunter (R-CA) declared during a recent CNN interview that the recent bid "goes right to the heart of cyber security," referring to some of 3Com's U.S. government contracts, which might be compromised if the acquisition materializes (Caijing.com.cn, October 23).

Such rhetoric from the U.S. Congress is familiar, but if the Chinese firms have learned their lessons from the CNOOC-Unocal episode and are now approaching their global reach-out with caution, the U.S. Congress does not seem to be behaving any differently than during the time when it treated the Unocal bid by CNOOC as a potential national security threat. Rather than rushing to simplistic conclusions and overacting, both sides could benefit when reminded that China's booming-hot capital outflow, although still under the shadow of communism, is traveling on the path well laid out by the logic of modern capitalism.

Dr. Wenran Jiang is a professor of political science and acting director of the China Institute at the University of Alberta, and a senior fellow at the Asia Pacific Foundation of Canada. The views expressed in his publications are his own and do not reflect the institutions with which he is affiliated. He can be reached at: wenran.jiang@ualberta.ca

Notes

1. Shanghai's city government adopted a "Go-out" economic strategy in 2001, characterized by the strategy of "foster[ing] a group of influential multinationals and establish a group of overseas production bases to boost its transfer of matured industries to overseas" (People's Daily, June 6, 2001).

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Premier Wen's Eurasia Tour : Beijing and Moscow's Divergent Views on Central Asia

By John C.K. Daly

On November 2, the sixth annual meeting of the Shanghai Cooperation Organization (SCO) Council of Heads of Government began in Tashkent, Uzbekistan. The six member states include Kazakhastan, China, Kyrgyzstan, Russia, Tajikistan and Uzbekistan [1]. India, Iran, Mongolia and Pakistan attended as observers and Afghanistan as a guest of the host country Uzbekistan. Xinhua News Agency, the mouthpiece of the Chinese government, breathlessly reported: "In a friendly, pragmatic, and constructive atmosphere, delegations of the member states held in-depth discussions on a host of pressing issues, including deepening economic trade and cultural cooperation within the SCO as well as safeguarding the region's peace, stability and security"(Xinhua, November 3).

Behind all the camaraderie, two underlying issues permeated the discussions: joint military cooperation and trade, most notably in energy. It is on these two issues that Russian and Chinese priorities diverge, with the Central Asian SCO members watching from the sideline.

In spite of a 20-point declaration that was subsequently issued on strengthening cooperation among SCO member states in the economic, investment, innovation, science, educational and cultural fields, perhaps the most telling point was the seventh item, which stated "that the SCO member states should cooperate closely to map out a common position on energy issues." Significantly, none of the items specifically mentioned deepening military cooperation, only a general commitment to deepening regional security.

Russia is most keenly interested in military cooperation, envisaging the SCO as an embryonic Eurasian counterweight to NATO and U.S. "hegemony." Russia successfully linked the SCO to the Collective Security Treaty Organization (CSTO) through the signing of a memorandum that focuses on broadening cooperation on issues such as security, crime and drug trafficking. China is more interested in the SCO developing into a nascent trading organization loosely based on a European Union model.

Both interpretations can claim successes and failures. Russia has had remnants of the 201st Motorized Rifle Division based in Tajikistan since the Soviet Union's collapse in 1991. In October 2003, the Russian Federation established an airbase at Kant, near Bishkek, ostensibly to provide immediate air support for CSTO ground units. The Kant airbase was Russia's first foreign military facility established since 1991, and it is less than 30 miles away from the U.S. aerial facility at Manas (see Terrorism Monitor, January 18). The U.S. facility was established in the aftermath of the 9-11 attacks in December 2001, along with another airbase at Karshi-Khanabad in Uzbekistan. In contrast, China currently has no foreign military bases.

Both China and Russia have been opposed to the U.S. military presence in Central Asia. Following Washington's ambivalent response to the May 13, 2005 tragic events in Andijan, the Uzbek government on July 29 told the Pentagon to evacuate the bases within six months, which it did in November 2005. The SCO saw the dispute as a heaven-sent opportunity, in stark contrast to Washington characterizing Andijan as a terrorist plot that subsequently lead to a resolution in July 2005. At a summit in Almaty, the SCO called for nations to deny asylum to Uzbek refugees who had fled from Andijan to Kyrgyzstan as well as for setting a timetable for the withdrawal of U.S. bases in the region (Pravda, July 22, 2005).

From August 8—17, the SCO staged "Peace Mission 2007," an anti-terrorism exercise that was the SCO's largest joint exercise in its six-year history, with nearly 6,500 troops and 80 aircraft participating. The exercise was held in two areas, first at the Russian Army's 34th Motorized Rifle Division facility in the Volga-Urals Military District. Then at Chinese insistence, the exercise later shifted to Urumqi, capital of China's Xinjiang Uighur Autonomous Region (XUAR). The one point of commonality between all six SCO members is the need to fight terrorism. In stark contrast to U.S. diplomatic fumbling in Central Asia, Russia, pressing forward wherever it might gain a military advantage, has convinced CSTO's Secretariat and joint headquarters to finalize a draft agreement to form a single collective Central Asian air defense system (Agentstvo Voyennykh Novostey, November 6).

While Moscow and Beijing can concur about the need to diminish or even end U.S. military presence in Central Asia, their views on economic issues diverge sharply. Wen used the occasion to network with delegates and forcefully promote bilateral energy schemes with the attendees. Wen held talks with Iranian First Vice President Davudi on a host of issues, including energy. Iran gained a powerful ally in Wen over its nuclear dispute with the West, with Wen concluding: "China respects Iran's right to peaceful use of nuclear energy … The Chinese side holds the view that peaceful resolution of the Iranian nuclear issue through negotiation is the best option" (Xinhua, November 3). As China is a member of the UN Security Council and thus able to block further sanctions proposed by the United States, it is likely that Tehran would return this favor and show its appreciation by allowing increased Chinese access to the country's vast energy resources.

Wen followed up the SCO meeting with an official state visit to Uzbekistan on November 3; it was the first visit to Uzbekistan by a Chinese Premier in 13 years (former Premier Li Peng first visited in 1994). Wen met with Uzbek President Islam Karimov, Prime Minister Shavkat Mirziyaev, and leaders of the Oly Majlis legislature. For the first eight months of 2007, total Sino-Uzbek trade reached $750 million and China is now Uzbekistan's fourth-largest trading partner (Zhongguo Tongxun She, November 6).

Wen then hurried to Ashgabat, meeting on November 3-4 with Turkmen President Gurbanguly Berdimukhamedov, where the prime topic of conversation was the construction of a Turkmenistan-China natural gas pipeline (Xinhua, October 26). More than any other Chinese Central Asian initiative, this is the one that rattles Moscow's cage the most, as it currently has a lucrative export monopoly via its Transneft pipelines, buying Turkmen gas for $100 per 1,000 cubic meters while shipping its own natural gas to

European consumers for $260 per 1,000 cubic meters. Loss of Turkmen gas would force Russia's Gazprom to dig deep into Russia's indigenous resources while depriving it of the added cash flow, should the 4,350 mile-long natural gas pipeline to China with a 30 billion cubic meters annual capacity, agreed upon in April 2006 by the late Turkmen President Saparmurat Niyazov, ever come to fruition.

While in Belarus, Wen signed a basket of agreements with Belarus President Alyaksandr Lukashenka totaling $530 million, and announced that China approves Belarusian acceptance into the WTO. As Belarus is energy-poor, it seems likely that the agreements paralleled those signed in Moscow for machinery imports (ITAR-TASS, November 5).

During Wen's November 5-6 visit to Russia to follow up on the SCO forum, Wen put forward a four-point proposal in Moscow at the second high-level Sino-Russian economic forum to boost bilateral economic and trade cooperation (Xinhua, November 6). During the visit, the two sides were set to conclude 15 agreements worth $1.3 billion (ITAR-TASS, November 6). According to Russian Ambassador to China Sergei Razov, in 2007 Russian-Chinese bilateral trade will exceed $40 billion, a growth over 2006's rate of $33 billion.

Russia, however, realized that it suddenly joined a host of nations in developing a trade deficit with China in 2007 for the first time (Xinhua, June 27). Moscow officials believe that the shortfall can be made up by increasing exports of timber, oil and machinery to China. Currently oil and oil products account for nearly 54 percent; in 2006, nearly 6 million tons of oil were exported to China, a 25 percent increase over 2005 exports. China is also Russia's second-largest arms export market, only exceeded by India (ITAR-TASS, November 6).

The most interesting item on the Sino-Russian economic forum agenda for discussion between Zubkov and Wen was undoubtedly the agreement that the pair was expected to sign for constructing an oil pipeline from Skovorodino, Russia, to the Chinese frontier. While the interest might be there, Russia is insisting that the deal incorporates long-term import quota guarantees with pricing policy assurances. The pipeline would replace Russia's current oil shipments by railway, which is believed in Beijing to be grossly inefficient (Interfax, November 5).

By any yardstick Wen's visit can only be judged a grand success, but it also revealed the underlying rifts between China and its largest SCO partner, Russia. Moscow did not see off the American military from Central Asia only to see them replaced with multitudes of Chinese businessmen. Behind all the recent smiles, Beijing and Moscow's shadow struggle for primacy in Central Asia continues unabated.

Dr. John C. K. Daly received his Ph.D. in Russian and Middle Eastern Studies from the University of London and is former Adjunct Scholar at the Middle East Institute in Washington, DC.

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China Means Business in Iraq

By Yitzhak Shichor

After a few years of practical exclusion dictated by the United States, China is about to resume its economic and perhaps military presence in Iraq. It was reported in mid-October that Baghdad has awarded the Shanghai Heavy Industry Corporation a $940 million contract to build an enormous power plant in Wasit, southeast of Baghdad. If and when completed, the plant would supply 1,300 megawatts of electricity, a major increase of over one quarter to Iraq's existing electricity supply (International Herald Tribune, October 19; New York Times, October 18). Earlier reports said that Chinese-made weapons had been discovered in Iraq, including 100mm, 82mm and 60mm rockets (World Tribune, May 1). Lethal armor-piercing ammunition, used by insurgents in Iraq against U.S. targets, had apparently been supplied by Iran with no evidence of Chinese involvement (Financial Times, July 6). Yet there are initial indications that Beijing is about to resume arms sales to Iraq, though on a smaller scale for the time being. On October 5, 2007, Baghdad's Al-Iraqiyah al-Sharqiyyah Television reported that, according to President Jalal Talabani, Iraq would purchase from China some $100 million in light military equipment for the Iraqi Police, because "the capacity of the U.S. factories is not enough to provide Iraq quickly with all its needs." He said that only one in five Iraqi police officers is armed (Washington Post, October 4). These modest steps, still a far cry from China's earlier military and economic involvement in Iraq, should be attributed to painstaking and often secret negotiations that culminated last June in the Iranian President Mahmoud Ahmadinejad's visit to China.

President Talabani's Visit Opens a New Chapter in Sino-Iraqi Relations

The first ever Iraqi president to visit China, Jalal Talabani started a week-long official visit to China on June 20, 2007, heading a 36-member delegation, including Iraq's Oil and Finance ministers and representatives of four other ministries. Talabani had been in China twice before, first in 1955 as a youth, before the establishment of diplomatic relations between the two countries, and again in 2003 before he was elected president of Iraq in April 2005, the first Kurd to hold such a position. His visit entailed a number of decisions and agreements that, if implemented, could become a turning point in relations between the two countries.

One agreement concerned the Iraqi debt to China. This debt has been accumulated since the early 1980s when China started large-scale weapons sales to Iraq (during its war with Iran) and considerably increased its involvement in Iraq's labor and construction market. From 1982-1989 China sold Iraq arms valued at $4.939 billion, 31.4 percent of all its arms sales in that period and over twice the value of Chinese arms sold to Iran (SIPRI Arms Transfers Database). Originally estimated at $4 billion, the debt–that, evidently, has not been serviced at all and accrued huge interest–had reportedly blown up by early February 2004 to $5.8 billion (AFP, February 29, 2004). By the time Talabani visited China, the Iraqi debt must have almost doubled. Still, in May 2007, China's Foreign Minister Yang Jiechi stated: "The Chinese government is ready to substantially reduce and forgive the debts owed by Iraq. In particular, it will forgive all the debts owed by the Iraqi government," implying that debts by other Iraqi organizations and companies would not be fully written off (Xinhua, May 3). Iraq requested, however, that China would deal with its debt reduction and forgiveness on the basis of the policies of the Paris Club, an informal group of 19 creditor countries, of which the PRC is not a member. Earlier, in November 2004, the Paris Club agreed, conditional on certain provisions, to cancel 80 percent (over $31 billion) of Iraq's debts to them so as to facilitate the rebuilding of the war-torn country. This was a gesture to the United States that had been pressing for waiving 95 percent of Iraq's debts (Washington Post, November 22, 2004).

Before leaving, Talabani had been quoted as saying that he would like to have $8 billion of the debt to China cancelled (China Daily, June 22), implying that (given the Paris Club agreements) the debt stood at around $8-10 billion. During Talabani's visit, Beijing agreed to write off some, though not all, of the Iraqi debt. As China's Foreign Minister Yang Jiechi said in May, Iraq's request to treat its China debt according to the Paris Club arrangements would be resolved through continued friendly consultation. Beijing's unwillingness or inability to provide precise details about its commitment to write off Iraq's debt may have to do with the fact that the precise size of this debt is unknown to China, as well and very difficult to quantify. Also, it may reflect China's reluctance to accommodate Washington, whose invasion of Iraq it had opposed all along. When U.S. envoy James Baker III tried to convince China's leaders to cut the Iraqi debt, PRC Prime Minister Wen Jiabao said that China "would consider reducing the debts owed to Iraq out of humanitarian concern" (Xinhua, December 29, 2003). In May 2007, Yang announced that the Chinese government would give Iraq a grant of 50 million Yuan (about $6.5 million) to be used for public health and education.

China's reluctance and passivity to write off Iraq's debt may have been determined by what Beijing perceives as its exclusion from Iraq's reconstruction contracts by the United States. At the same time, however, its eventual agreement "to substantially forgive Iraqi debt" might have something to do with the $260 billion bonds, issued by the pre-1949 Nationalist Government, that are still held by Americans and that the PRC has so far refused to honor (China Daily, June 22). At an interesting time, House Concurrent Resolution 160, introduced in May 2007 by a number of U.S. legislators, would deny the Chinese access to the U.S. capital markets until Beijing "fully honors repayment of its outstanding defaulted public debts owed to United States citizens" (Washington Times, June 26). By forgiving Iraqi debts, Beijing may expect Washington to likewise treat the debts owed by the PRC as a successor government that is not responsible for its predecessor's liabilities.

New Energy to Bilateral Ties: Reviving Suspended Oil Projects

Meeting with Talabani, China's President Hu Jintao said that the visit would "add new energy to the bilateral [Sino-Iraqi] ties." Apparently, this pun is not coincidental as it underlines perhaps the main outcome of the visit: China's "return" to the Iraqi oil market. To be sure, China has never played any significant role in Iraq's oil market. Indeed, in 1997 CNPC (in collaboration with China's giant armaments producer NORINCO, or Northern Industries Corporation) did sign a 23-year $0.7-1.2 billion PSA (production sharing agreement) with Saddam Hussein to develop the Al-Ahdab oilfield. Yet, U.N. sanctions that had been imposed on Iraq prevented the implementation of the contract and, following the American occupation of Iraq in 2003, all foreign oil contracts were suspended.

Initial indications of Iraq's policy change began to emerge in October 2006, following the visit of Iraq's Oil Minister Husayn al-Shahristani to China. For the first time since the war Iraq publicly and officially welcomed Chinese oil companies to participate in the reconstruction of its oil industry (BBC, October 31, 2006). Until then China had been basically excluded from Iraq's reconstruction that is almost totally monopolized by companies associated with the United States and its allies. Turning to China mainly reflects the deteriorating security situation in

Iraq that makes it much less attractive, and much more dangerous, for Western companies. In fact, China's thriving international energy policy has been built–willingly or not–upon the reluctance of Western companies to invest in violent, unstable and isolated countries such as Sudan, Nigeria, Angola and Iran (Associated Press, October 28, 2006; Xinhua, October 31, 2006). Yet even China, whose workers and engineers abroad have in recent years experienced kidnapping and other acts of terrorism, may not be so enthusiastic to resume its economic presence in dangerous Iraq, especially in view of the additional legal and technical obstacles [1].

Negotiations between Chinese and Iraqi representatives began in November 2006 but could not proceed quickly because Iraq's new hydrocarbon law, which the Parliament was supposed to enact before the end of the year, has been consistently put off. Thereby the negotiations postponed the reconfirmation of the suspended contracts as well as the revival of the Iraqi National Oil Company that was to take charge of developing oilfields, including Al-Ahdab. A China National Petroleum Corporation (CNPC) delegation went to Iraq in March 2007 probably to discuss the fate of the 1997 agreements and to amend them in advance of the forthcoming law. It appears that there is no question if the contracts would be implemented; the question is when and how. Yet, at the time of writing Iraq is hardly mentioned at all on the CNPC website and homepage [2].

To avoid any misunderstanding, Iraq's Oil Minister, who accompanied Talabani in his trip to China, underlined: "The contract with the previous administration [i.e. Saddam Hussein's] is still valid–it was signed and we will honor it." He then mentioned that some technical problems have to be solved before the reconfirmation: "We have been talking since I visited China eight months ago and the Chinese have just submitted a revised proposal to meet the new technical requirements for oil field development laid out by the Iraqi government" (Financial Times, June 22). Iraq's top oil and gas adviser Thamer al-Gadhban, reiterated that "these contracts will not be cancelled, they will not be required to bid again, they just have to be amended." He added, "China is very important for us–their Ahdab field is in a fairly safe area, but [the contracts] will be amended." The main problem, however, is that the 1997 contract "was signed based on vertical drilling, but as it is in a fertile area, we need to change the contract to horizontal drilling so [as] not to disrupt the fertility of the nearby area" (Dow Jones Emerging Markets Report, June 27). Earlier in March, Baghdad asked the Saudi oil firm Al-Waha, partly owned by CNPC, to investigate drilling a single vertical well in Al-Ahdab and spreading out horizontally, rather than sinking several wells into the valuable agricultural land (Reuters, March 12).

Even if the problem of horizontal drilling could be overcome, which would be unprecedented in Iraq's oil production and evidently very costly to solve, the resumption of Sino-Iraqi oil relations still depends on the promulgation of the Iraqi Oil Law. Finally approved by the Iraqi government in mid-February 2007, the "Draft Iraq Oil and Gas Law" was submitted to the parliament in May. Since then there has been no progress. This law is crucial for China's resumed oil ventures in Iraq since, as Iraq's oil minister put it, all oil contracts signed before the passing of this law would be considered "illegal" (The Hindu, November 7). Indeed, Article 40 of the Draft Law that covers existing contracts insists that the Iraqi Ministry of Oil (and other companies and organizations specifically authorized by it) "shall review all the existing exploration and production contracts with any entity before this law enters into force to ensure harmony with the objectives and general provisions of this law. These contracts must then be submitted to the Federal Oil and Gas Council, to ensure and to validate the maximum economic return for the people of Iraq." Contracts signed with the Kurdistan Region shall be similarly reviewed by "the Designated Authority" of this region.

Picking Up Slowly

Since the early 1990s and especially since the 2003 war Sino-Iraqi bilateral economic relations have been substantially disrupted. In 2000 Sino-Iraqi trade turnover reached $975 million, reflecting primarily a considerable growth in imports compared to 1999, which consisted mainly of a one-time acquisition of nearly 3.2 million tons of Iraqi oil. Diminishing to $56 million in 2003, bilateral trade has begun to grow, reaching $470 million in 2004, $820 million in 2005 and over $1.144 billion in 2006, including over $653 million in Chinese imports. China's construction services have also substantially declined due to the 2003 war. The value of contracts that had reached $145 million in 2002, declined to $128 million in 2003 and then nosedived to less than $9 million in 2004, picking up slightly to over $11 million in 2005 and climbing to $50.5 million in 2006 (all data from China Statistical Yearbook 2007 and earlier years). These figures provide the best evidence of China's exclusion from Iraq's reconstruction projects [3].

Given the deteriorating situation in Iraq and the pressure on the U.S. administration to pull back, it is quite possible that the U.S. withdrawal, if and when undertaken, would create a vacuum that could put China in a very advantageous position. Sudan is the obvious precedent; Washington had not only evacuated Sudan but also forced other Western countries to do the same, thus paving the ground for China's presence–and possibly predominance. Although

China has always been careful to avoid involvement in other countries and reluctant to take such a responsibility, especially under unstable and violent circumstances, the prospects of gaining access to Iraqi oil–whose reserves are estimated to be second or third in the world and dramatically dwarf those of Sudan, Angola or Nigeria–may overcome these concerns. Beijing has become more self-confident and daring in its overseas ventures. Nevertheless, it may take some time as Iraq's oil law is still blocked, its security situation does not seem to improve and the United States is still there.

Dr. Yitzhak Shichor is Professor of East Asian Studies and Political Science at the University of Haifa, and Senior Fellow, the Harry S. Truman Research Institute for the Advancement of Peace, the Hebrew University of Jerusalem, Israel.

Notes

1. Xia Ji, "Zhanzheng yinying xia jiannan fushu de Yilake shiyou gongye" [The Difficulties in Reviving Iraq's Oil Industry under the Shadow of the War], Shiyou Huagong Jishu Jingji [Oil and Chemical Industry Technology Economy], Vol. 21, No. 5 (2005), pp. 18-22.
2. See China National Petroleum Corporation's website: www.cnpc.com.cn/cnpc/.
3. On China's interest in Iraq's reconstruction, see: "Yilake zhongjian yushang ji" [Business Opportunities in Iraq's Reconstruction], interview with Iraq's ambassador to China, Zhongguo Jingji [China's Economy] (March 1, 2005), pp. 16-18.