



BASC NEWS

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Strategic Miscalculations in the Chinese Currency Dispute

by Vinod K. Aggarwal and Simon J. Evenett



Photo by Nicholas Cosonery

The IMF-World Bank Annual Meetings in October failed to produce any progress on China's exchange rate policy. With no trigger to force an end game, the Chinese felt little need to make concessions. So the currency dispute rolls on – and the risk that some further miscalculation on either side of the Pacific could set off a series of tit-for-tat retaliations looms larger than ever.

US policymakers and analysts seem fixated on the US dollar-Renminbi exchange rate to the exclusion of almost everything else. The logic underlying this focus is far from apparent. Even the most ardent China basher does not assert that a Renminbi revaluation is the silver bullet that will put the US economy back on track after the sharpest recession since the 1930s. The danger that the Chinese exchange rate policy "may" (to use Paul Krugman's word) cause up to 1.4 million job losses is contested, and in any case pales in light of the fact that the US economy has lost 8.3 million jobs since the start of the Great Recession. A sense of proportion has been lost. Any economic adviser who cannot name ten more important policy priorities for the US Administration and Congress should be the next to join the unemployment queue.

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APEC Update | The Yokohama Vision



APEC leaders at Yokohama, Japan. Photo by: Ryan Lim/Malacañang Photo Bureau/PNA

by Cindy Li
BASC Research Assistant

As global economic concerns continue to ease, APEC directed its efforts beyond promoting “growth as usual” towards facilitating high-quality growth in its member economies, which now account for 57% of the world’s GDP. Under the theme of “Change and Action,” APEC leaders evaluated members’ progress in achieving the Bogor Goals and worked towards establishing new policies that would reassert the relevance and effectiveness of the organization. The summit culminated in the adoption of the leaders’ declaration, the “Yokohama Vision,” which highlights APEC’s goal of transforming the region into an open “community.”

In accordance with this year’s theme, APEC leaders took their first substantial step toward developing a comprehensive long-term framework for facilitating high-quality growth. The Leaders’ Growth Strategy highlights the pathways towards achieving the five attributes of balanced, inclusive, sustainable, innovative, and secure growth. APEC members will focus on creating a strong regional economic environment through macroeconomic policies that seek to balance current account deficits and surpluses and structural reforms that boost global demand and foster job creation. The leaders’ statement also urges members to move towards more market-determined exchange rates and refrain from competitive devaluation of currencies. APEC reiterated the importance of environmentally friendly and innovative growth as well as its intent to foster inclusive growth with an emphasis on small and medium-sized enterprises and opportunities for potentially marginalized groups. In order to ensure the Strategy’s successful implementation, the leaders instructed senior officials to conduct annual progress reviews and plan to reevaluate the direction of the plan based on these results in 2015.

After four years of careful consideration, the APEC leaders have finally pledged to take steps towards turning the Free Trade Area of the Asia-Pacific (FTAAP) into a “concrete vi-

sion.” The FTAAP will be pursued as a comprehensive free trade agreement that addresses “next generation” issues of trade and investment. The leaders identified the ASEAN+3, ASEAN+6 and the Trans-Pacific Partnership (TPP) frameworks as the foundation on which to build and develop the FTAAP. The United States, the 2011 APEC chair, will attempt to lay the groundwork for the free trade area next year through the expansion of TPP talks as it aims to complete the partnership before the 2011 APEC Summit in Honolulu.

2010 also marks the first milestone for the Bogor goals, as industrialized member economies were assessed on whether they have met trade liberalization standards set by the 1994 Ministerial Meeting in Indonesia. In addition to the five industrialized economies due for review this year, eight developing economies also volunteered to be reviewed ten years ahead of schedule. Although more work remains to be done, results indicate that the economies under review have made significant progress toward achieving the goal of free and open trade. The average applied tariff rate of 2010 economies has decreased from 8.2% in 1996 to 5.4%, compared to a world average of 10.4%. The remaining economies will be evaluated in 2020.

While progress towards reaching the Bogor goals serves as a testament to the work that APEC has done in facilitating regional trade, the organization’s ability to promote concrete change remains significantly hindered by the voluntary and consensus-based nature of agreements between APEC members. The Yokohama Vision describes an APEC community that is economically integrated, robust and secure. However, that vision will remain only a vision until APEC can take the steps necessary to effect substantial change. While plans to facilitate high-quality, long-term growth and to pursue the FTAAP reflect a clear effort to increase the effectiveness of APEC, the resounding echo of concerns regarding the lack of concrete results indicates the necessity of further introspection. The United States will likely undertake the task of increasing the organization’s effectiveness in 2011 as it seeks to reassert the relevance of APEC as well as its own influence in the region.

Director's Notes

Dear Readers,

Thank you for your interest in the work of the Berkeley APEC Study Center. We strive to keep you informed about the latest developments in politics and trade in the Asia-Pacific region, and hope you find this issue of *BASC News* informative. This issue has a strong focus on China, with articles on the Chinese currency controversy, and Chinese investment in the Democratic Republic of the Congo. We also include analyses of the recent APEC meeting and economic and political developments in India, Latin America, Vietnam and ASEAN.

We begin the issue with a piece (reprinted from the Harvard Business Review blog) in which Simon Evenett and I argue that U.S. policymakers have misdirected their energies by lobbying China primarily for a revaluation of the renminbi. This single-minded focus on currency manipulation has come at the expense of attention to an issue we regard as even more damaging to U.S. business interests—China's pursuit of protectionist industrial policies that undermine both the intellectual property rights of U.S. firms and the ability of those firms to compete in the Chinese market. However, U.S. policymakers are not the only ones guilty of a "strategic miscalculation"—China's trade partners may be less willing to tolerate the country's protectionist turn than its policymakers had hoped.

We continue to focus on China in a series of BASC Spotlight articles. Michelle Chang describes China's significant investment in the Democratic Republic of the Congo (DRC). She argues that whereas some scholars see these deals as mutually beneficial, with China securing access to valuable mineral resources and constructing much-needed infrastructure in return, Chinese economic activity in the DRC is in fact poorly regulated, lacking in transparency, and of questionable benefit to citizens of the DRC. Mona Fang describes the increasingly amicable relationships between Vietnam and developed economies such as the U.S. and Japan, and argues that those countries' concerns about China's rise, made more urgent by China's recent embargo on the shipment of rare earth metals to Japan, are motivating the U.S. and Japan to look to Vietnam as an alternative source of labor and natural resources. Similarly, Robert Nelson argues that India is attempting to position itself as a "benevolent" regional counterweight to China, and is reaping the benefits of this stance through the US-India nuclear trade deal and closer economic and nuclear cooperation with Japan.

Moving away from China, Ren Yi Hooi argues that the growth of trade relationships between India and Latin America, including trade agreements with Mexico, Chile and Mercosur, is likely to accelerate in the future. Lauren Dansey describes the Chiang Mai Initiative Multilateralization (CMIM) and its institutionalization through the ASEAN+3 Macroeconomic Research Office (AMRO), arguing that this multilateral currency swap system will stabilize the currencies of member countries and guard against future financial crises. And Kathy Bowen argues that the way forward for the stalled Doha multilateral trade talks may lie in service sector liberalization, a move that could benefit both developed and developing countries and pave the way for an agreement on the thornier issues of agricultural and non-agricultural market access.

In the Book Review section Do-Hee Jeong reviews the newest BASC publication, *Trade Policy in the Asia-Pacific: The Role of Ideas, Interests and Domestic Institutions*, currently in press with Springer. The collection of essays, which I co-edited with BASC Research Affiliate Seungjoo Lee, represents the culmination of a two-year project on "The Evolution of East Asian Regionalism" that ended in 2008.

Cindy Li's APEC Update describes the November 2010 APEC meeting in Yokohama, Japan. 2010 was an important year for APEC as it marked the deadline for industrialized member states to achieve the Bogor Goals. Li describes the progress of APEC members toward achieving the Bogor Goals, as well as APEC's new emphasis on high-quality growth.

Finally, in our BASC Projects update, Sara Newland describes the center's recent activities, including a three-year project, "The Transatlantic Relationship in a Post-Transatlantic World," which will culminate in Spring 2011 with a conference on the rise of China and its impact on the EU, the US, and the system of international institutions led by the traditional Western powers. We are also hard at work on a project on trade-security linkages in the Asia-Pacific, with lessons learned from EU and US efforts in their trade negotiations. This project has been generously funded by the Center for Global Partnership and the Korea Foundation. Our first conference on that topic will be held in December 2010, and we will have a follow-on conference in the summer next year.

The Berkeley APEC Study Center is grateful for support from the Korea Foundation, the Center for Global Partnership (part of the Japan Foundation), and numerous sources of support at UC-Berkeley, including the EU Center for Excellence, the Institute for East Asian Studies, the Center for Chinese Studies, the Institute of European Studies, the Institute of International Studies, the Institute of Slavic, East European and Eurasian Studies, and the Clausen Center for International Business and Policy. We are also deeply indebted to the Ron and Stacy Gutfleish Foundation for their ongoing support of our research efforts.

Vinod K. Aggarwal
Director, BASC

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Why, then, so much focus on the Renminbi? Unlike some of the more worrying developments in Chinese policy over the past few years, China's exchange rate policy is relatively straightforward to explain, involves trillions of dollars of reserves (big numbers scare people), and transparently responsive to US pressure. (Any impact is easy to gauge in terms of changes in the currency's value.) Mix all this together with long-standing fears about outsourcing, and a potent brew can be concocted before the US mid-term elections. Witness the demonization of China in television ads in many ongoing races for Congress.

Important details don't seem to worry many US political leaders. The fact that estimates of the extent of Chinese currency undervaluation are so broad as to be useless for guiding policymaking is overlooked. Little mention is made of the flip side of China's cheap currency, which is cheap Chinese imports – which have done much to keep prices under control and allow working Americans to stretch their recession-squeezed budgets. The fact that cost competitiveness and jobs at US exporting firms depend on cheap Chinese parts and components is swept aside, even though jobs in exporting industries tend to pay a premium over others. Has anyone bothered to calculate how many million Americans would be worse off if China let its currency rise considerably against the US dollar?

We are long past being surprised when complicated and nuanced problems are, in the midst of an electoral whirlwind, turned into reductionist rallying cries. However, in this case, what is most depressing is that the simple-to-tell currency story has stolen the limelight from potentially more worrying complaints about shifts in the terms upon which Beijing is willing to deal with foreign business. These include the continued use of government procurement, subsidies, lending policies, and regulatory measure to force technology transfer by the Chinese government to favor its own domestic industries.

Having just concluded the analysis that will be the basis of a larger article ("The Financial Crisis, "New" Industrial Policy, and the Bite of Multilateral Trade Rules," *Asian Economic Policy Review*, 2010, Vol. 5, Issue 2), we now have clear evidence that many countries have used the financial crisis as an opportunity to pursue industrial policies. In particular, the 2009 Directive by the Chinese government has restricted foreign participation in computers and application equipment, communications products, modern office equipment, software, new energy and new energy devices, and high-efficiency and energy-saving products by specifying intellectual property requirements that favor Chinese firms (Global Trade Alert, January 25, 2010). Although China has backed off slightly under intense foreign pressure, its policies toward foreign companies remain focused on extracting as much as it can to bolster its own domestic producers.

In recent months Western, Japanese, and Indian business people have spoken out against these developments with uncharacteristic bluntness and frequency. In some cases their complaints have been anonymous: One executive, for example, reacting to prospects that China would force foreign auto makers producing electric vehicles in China to share critical technologies, said the action was "tantamount to China strong-arming foreign auto makers to give up battery, electric-motor, and control technology in exchange for market access." (*The Wall Street Journal*, September 16, 2010). In other cases, executives' concerns have been attributed to them. GE's Jeffrey Immelt, speaking at a dinner gathering in Rome, said: "I really worry about China; I am not sure that in the end they want any

of us to win, or any of us to be successful (*Financial Times*, July 1, 2010). While a GE spokesman, sensitive to GE's dependence on the Chinese market, later attempted to soften the remarks by claiming they had been taken out of context, he did not deny that Immelt had made them.

The Americans have not been alone. As the *Wall Street Journal* reported on July 19, 2010, both Jürgen Hambrecht, chairman of BASF SE, and Peter Löscher, chief executive of Siemens AG, complained in a meeting with Premier Wen Jiabao about "rules that foreign companies say compel them to transfer valuable intellectual property in order to gain market access." Japanese auto executives, too, have been deeply concerned about China's export restrictions on rare earths that are needed for their hybrid cars (*New York Times*, September 24, 2010). And Lakshmi Mittal, CEO of ArcelorMittal, called for China to reduce restrictions on inward investments in view of his difficulties in investing in steel projects in China (*Financial Times*, October 12, 2010).

These developments imply that policymakers' sole focus on China's exchange rate policy may be a gross strategic miscalculation. First, the overall harm done to the West's commercial interests from any Chinese currency misalignment could very well be trivial compared to the intellectual property, innovation, and other commercial opportunities lost due to recent Chinese industrial policies. Second, with these policies growing with a vengeance, any Western victory on the renminbi would be pyrrhic as Western firms could be subject to greater murky protectionism by the Chinese authorities (on murky protectionism, see Baldwin and Evenett (2009). Richard Baldwin and Simon J. Evenett (eds.) *The collapse of global trade, murky protectionism, and the crisis: Recommendations for the G20*. A voxEU publication. April).

Some in Beijing have probably miscalculated too. Having departed from the commercial equivalent of its policy of a "peaceful rise," some Chinese may have believed too much of their own rhetoric on the inevitability of their country's rise and the willingness of foreigners to pay a growing price for access to their market. It is one thing to be a small free rider on the global trading system, another to be a heavy rider and be the object of widespread opprobrium from all its trading partners. What initially has appeared to be a strategically sophisticated neo-mercantilist policy may well prove to be very short-sighted in the longer run. The oil price spike of 2008 should have demonstrated to any open-minded observer that supply chains can be shortened dramatically if circumstances dictate.

Policymakers on both sides of the Pacific should eschew selective characterizations of economic interdependence and seek to head off the real, first order threats to the benefits from globalization.

This article originally appeared on the Harvard Business Review Blog at URL: http://blogs.hbr.org/cs/2010/10/the_strategic_miscalculations.html

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BASC Projects | Exploring the Asia-Pacific and Beyond

By Sara Newland
BASC Project Director

BASC is always a busy place, and this year has been no exception! Our busy schedule continues into 2011, and we are excited to share with you some news about our completed projects and the ones to watch for in 2011.

As this newsletter goes to press, we are completing final preparations for a December 2010 conference, generously funded by the Korea Foundation and the Japan Foundation's Center for Global Partnership, entitled "Linking Trade, Traditional Security, and Human Security: Lessons from Europe and the Americas and Implications for Asia." The conference will bring together prominent scholars from Australia, East Asia and the US to discuss how linking economic and security concerns affects bilateral and multilateral trade agreements.

BASC is nearing completion of a major three-year project, "The Transatlantic Relationship in a Post-Transatlantic World," funded through the generous support of the EU Center for Excellence. This project, organized around a

series of conferences and book projects, examines the consequences of Russia's resurgence and the rise of China and India as major global powers for the US and the EU, as well as for the global institutional architecture designed by—and consistent with the aims of—the traditional Western powers. In 2009, the project focused on the implications of Russia's rise for the transatlantic partnership. BASC organized a conference on "Responding to a Resurgent Russia: Russian Policy and Responses from the EU and US." The papers from that conference are now in the final editing stages and will be published in an edited volume in 2011. An April 2010 conference, "Nationhood and Nation-Building in South Asia," was co-organized by BASC and the Center for South Asia at Stanford University. Finally, we are currently making preparations for an April 2011 conference, "China Rising: EU and US Responses to a Changing World Order." Cosponsored by the EU Center for Excellence, the Institute for East Asian Studies, the Center for Chinese Studies, and the Clausen Center for International Business and Policy at the Haas School of Business, the conference will bring together American, Eu-

ropean and Chinese scholars, working across the three dominant theoretical approaches to the study of international relations, to discuss the Sino-American and Sino-European relationships and the implications of China's rise for the international institutional order. This conference will include a public roundtable discussion between several of the speakers, so please check the BASC website (<http://basc.berkeley.edu>) in the coming months for details!

In addition, keep an eye out for our latest book, coedited by BASC Director Vinod Aggarwal and BASC Research Affiliate Seungjoo Lee. *Trade Policy in the Asia-Pacific: The Role of Ideas, Interests, and Domestic Institutions* is currently in press with Springer and is available for purchase on amazon.com. You can read more about the volume in Do-Hee Jeong's book review in this issue of BASC News.

Finally, our eight undergraduate research assistants are working hard to provide commentary on the latest developments in the Asia-Pacific region. Please check the BASC blog (<http://bascresearch.blogspot.com>) for twice-weekly updates.

Book Review |

Digging Deeper: Ideas, Interests and Institutions behind Preferential Trade Agreements

Review of the Newest BASC Publication: *Trade Policy in the Asia-Pacific: The Role of Ideas, Interests and Domestic Institutions*

by Do-Hee Jeong
BASC Research Assistant

With multilateral trade negotiations largely stalled after the failed WTO Doha Round, there has been an unprecedented explosion of bilateral and minilateral preferential trade agreements among the transpacific countries. Without an overarching global-level trade regime and especially in the midst of the current global economic crisis, countries are frantically scrambling to sign trade agreements to improve their competitive positions, complicating the already overcrowded spaghetti bowl of economic arrangements.

To shed light on this development, many previous works have concluded that without a multilateral trade regime, countries have shifted trade strategies to pursue new trade

arrangements involving fewer actors in order to minimize the effects of external shocks and systemic changes such as the Cold War, the Asian Financial Crisis and the recent global financial crisis. However, a new volume edited by Vinod K. Aggarwal and Seungjoo Lee provides a more nuanced analysis and innovative framework to better understand the country-specific and multifaceted domestic factors behind this competitive pursuit of trade agreements. Although shocks and systemic changes do influence national interests to change trade policies, this explanation alone falls short of capturing the unique differences in national responses. Previous studies have often underspecified the types of arrangements and trade strategies by lumping them together under a general category, making it difficult to examine the specific policy-making processes, preferences and motivations of each country behind the types of arrangements they

pursue. By contrast, the authors take a more comprehensive approach. To account for the diverse economic arrangements, they search deeply into the intricacies of domestic politics to examine the motivations behind the various types of trade policies and strategies through the domestic bargaining game approach focusing on ideas, interests and institutions. The authors venture into new territory, examining the interplay of government agencies, business groups, labor unions and NGOs, and unveiling the decision-making processes behind preferential agreements.

Aggarwal and Lee provide a thoughtfully crafted foundational framework to specify the different types of arrangements in order to illuminate the country-specific driving forces behind them. By specifying the eight attributes of trade agreements, the authors are able to demonstrate how each country's perception and ideas, interests and domestic institutions influence its preferred engagement approach, dimensions and characteristics of the arrangements it pursues. Aggarwal and Lee categorize the resulting trade strategies into four "trade policy constellations," ranging from maintaining the status quo to dramatically departing from existing trade policies. This conceptual approach serves as the foundation for the book's five case studies, which systematically analyze the relationship between domestic factors and trade strategies.

In China's case, Ming Wan argues that the state's national interests are still the main driver behind China's trade policies since those negatively affected by liberalization either do not have channels to express grievances or are too occupied with more immediate domestic problems, although Wan forecasts that China's domestic politics will play an increasing role in its regional strategy in the future.

According to Ellis S. Krauss and Megumi Naoi, in Japan, despite intrabureaucratic conflict of ideas with the Ministry of Foreign Affairs and disputes with the Ministry of Agriculture, Forestry and Fisheries over agricultural issues, the Ministry of Economy, Trade and Industry (previously the Ministry of International Trade and Industry) has been the main driver behind the country's shifted interest to regional arrangements. Domestic agricultural pressures, the 1994 transformation into a Mixed Member Majoritarian system that gave rise to the opposition Democratic Party of Japan, and transformations in public attitude towards liberalization were also key sources for change in Japan's regional strategy.

In the case of South Korea, Sang-young Rhyu compares the sources behind the ten year lag behind the Korea-Japan

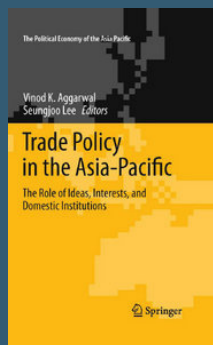
FTA and the contrasting, expedited conclusion of the KORUS FTA. He concludes that ideas supporting regionalism—facilitated by strong institutions in South Korea, the US's ambitions to regain its hegemony in the region, and weak veto groups against the FTA—led to rapid negotiations, while almost opposite conditions continue to stall the FTA with Japan.

Amy Searight explains the transformation of US trade policy in the transpacific region from one dynamically engaged in creating a new vision for regional economic and security integration to one that is only responsive to regional trends. The US has not adjusted quickly and adeptly to the changing economic institutionalization in Asia. This paralysis is due to domestic political constraints on trade policy and tension between its self-complacency as an "indispensable nation" and fear of exclusion from regional cooperative frameworks.

As for Singapore, Lee Lai To and Ren Yi Hooi show how the city-state embarked on a more practical approach than the other countries discussed above towards bilateral FTAs. Increasing awareness of the weaknesses of existing regional institutions, deeper understanding of the economic benefits of FTAs, and strategic calculations to strengthen foreign relations—facilitated by the state-centric domestic structure and business sector indifference—have mobilized Singapore to pursue an active strategy of concluding a plethora of regional as well as transregional agreements.

Through these in-depth analyses of each country's case, the authors once again remind us that states are not mere billiard balls in the international system. Rather, they are complex actors differentiated by unique internal influences that affect their trade policies and strategies. The authors bridge the academic void of previous studies by systematically demonstrating how ideas, interests and institutions play central roles in the types of arrangements sought by transpacific countries in the face of external changes and shocks.

The evidence put forth by each country's case creates a more rich, dynamic and complex picture of the driving forces behind the exponential growth in bilateral and multilateral trade arrangements in the Asia-Pacific. The innovative framework provided by Aggarwal and Lee allows the reader to easily grasp the complex and multidimensional relationship between domestic politics and trade relations. This new publication serves as a pioneering guidebook towards better understanding and interpreting the rapid and numerous changes in the Asia-Pacific region.



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China Goes to the Congo

by Michelle Chang
BASC Research Assistant

China calls it a “win-win” strategy. In October 2009, the People’s Republic of China inked a \$6 billion infrastructure and loan deal with the Democratic Republic of Congo according to which China would extract about 11 million tons of copper and 620,000 tons of cobalt from the DRC over the next 25 years. In exchange, China would build for the DRC 1,800 miles of railways, 2,000 miles of roads, hundreds of hospitals, health centers, schools, and two universities, besides building new copper and cobalt mines.^[1] The deal was originally intended to be even bigger. Originally valued at \$9 billion, it was reduced to \$6 billion under pressure from the IMF on the grounds that the original deal would significantly increase the DRC’s outstanding foreign debt. In return for the commitment, the IMF offered to the DRC a \$550 million loan and a debt relief program to reduce the DRC’s public debt from \$13 billion to \$4 billion.^[2]

Simply judging by these figures, it is tempting to say that China’s strategy in the DRC and other Sub-Saharan African countries is indeed creating “win-win” situations. In this simple barter system, China provides the basic infrastructure desperately needed by many African states, and in return extracts vital resources to feed its fast-growing, hungry economy. Moreover, in the case of the DRC, the country only had to forgo \$3 billion of Chinese investments to win \$9 billion of debt relief from the IMF. However, those who argue in favor of China’s strategy tend to stop at quoting the development benefits promised in these resources-for-

infrastructure deals. After all, who would deny that building roads, hospitals, and schools works to the benefit of a country like the DRC? However, when we start to demand the details of these development promises and learn about their actual impacts in the DRC, the perfect picture begins to crack.

As journalist Howard French recounts his travels in Sub-Saharan Africa, he observes many worrying trends following the Chinese investments in the DRC. For one thing, there is little transparency in the China-DRC deal; the public is barely informed of, and certainly lacks the power to influence, where the new railways and roads will be built. Road construction prioritizes the ease of transporting minerals for export rather than improving welfare for the Congolese people.^[3] Meanwhile,

education facilities, if built, would not deliver the imagined benefits. According to education experts interviewed by Howard French, new schools will do little to educate Congolese children without a functioning school system and trained teachers. According to another account by journalist Richard Behar in his award-winning report, many of the new private hospitals built by China are simply unaffordable in a country where 80 percent of inhabitants live on only 50 cents a day.^[4]

Furthermore, the problems associated with China’s presence in the DRC extend beyond the business deals themselves. As mineral prices rose rapidly a few years ago, thousands of Chinese migrants came to the DRC in a “gold rush” to profit from small-scale mining operations by bribing Congolese officials and paying cheap prices to obtain visas and mining permits. Most of these mining activities were very small in scale and required no sophisticated infrastructure or equipment, and hence made negligible contribution to local infrastructure development and capital accumulation. When the financial crisis hit in 2008 and commodity prices plunged, most of them fled the scene, leaving behind unpaid workers and industrial wastelands.^[5] According to the DRC’s Minister of Mining, Victor Kasongo, most of the Chinese business activities in Congo are in fact illegal and not accounted for by the China-DRC business deals, largely due to ineffective and corrupt governance by the DRC government. Kasongo estimates that black-market mining, much of it commissioned by Chinese financiers, constitutes as much as 75 percent of the minerals exported out of Congo every year.^[6] In those cases, the DRC is simply losing its enormous mineral wealth without receiving any development commitments in return.



Chinese President Hu Jintao meets with the President of DRC, Joseph Kabila. Photo by Xinglei Pang.

of the 2,000 miles of roads promised, hundreds of miles have been laid down to connect to remote towns with no industry or natural resources but where officials who took part in the deal have built palatial residences. Moreover, there is reason to believe that even the new

continued on the next page

China is indeed generating enormous economic activities in the DRC and throughout Sub-Saharan Africa, and for better or for worse, revolutionizing the continent. The vital infrastructure that China helps to develop is supporting the livelihood and improving the wellbeing of many Africans. China's business activities in the region also offer valuable development lessons to Western nations and aid agencies. However, enthusiasts of China's African presence all too often refer to vague development promises and simple economic figures to assert that China's "win-win" strategy is actually bringing substantial and lasting benefits to Sub-Saharan nations. As we have seen in the case of the DRC, reality on the ground is too often inconsistent with promises on paper. The

DRC has traded away hundreds of billions of dollars worth of nature's endowment; will a better nation come forth from modern infrastructure built on China's wealth, or will the nation be stripped of its riches and sink into further problems of misdirected resources? The answer remains unclear.

- [1] French, Howard. 2010. The New Empire. *The Atlantic*, May 2010: 58-69.
- [2] Wroughton, Lesley. 2009. DR Congo Wins IMF Loan, Enters Debt Relief Program. *Reuters*, 12 December 2009.
- [3] Whewell, Tim. 2008. China to Seal \$9bn Congo Deal. *BBC*, 14 April 2008.
- [4] Behar, Richard. 2008. China Storms Africa. *Fast Company*, June 2008: 100-123.
- [5] French 2010, 66
- [6] Behar 2008, 115

Chinese Economic Muscle Gives Rise to Greater International Cooperation

by Mona Fang
BASC Research Assistant

China's flexing of economic muscle, most recently taking the form of a shipment ban on rare earth metals, has heightened international awareness about the vulnerability of an economy too dependent on the resources of one country. In response to China's threatening economic moves, nations like Japan and the United States, with advanced economies reliant on the goods and services provided by less developed countries, have begun to seek feasible alternatives. Vietnam has emerged as a favorite alternative. With the development of their low-cost manufacturing industries, Vietnam has recently enjoyed friendlier relations with countries such as Japan and the United States, economic giants seeking to weaken the link between their economic prosperity and Chinese resources.

The spotlight on Vietnam seems to chiefly be a reaction to China's recent restriction of rare earth metal exports to Japan. China's export ban on these materials has signaled a shift away from the pattern of stable economic ties, causing an anxious Japan, whose high-tech sector is heavily dependent on these minerals, to look to other sources. Consequently, a month after China's embargo was enacted, Japanese Prime Minister Naoto Kan and his counterpart Nguyen Tan Dung met over negotiations that would expand Vietnam's rare earth metals production through Japanese financial and technical support and, in effect, give rise to a competitor that could potentially challenge China's monopoly in the production of such resources.^[1] In exchange for Vietnam's agreement to an economic move that may be perceived by Chinese officials as a deliberate affront, Japan has promised to help develop Vietnam's expanding nuclear power, having signed a contract to build two nuclear reactors in the country.^[2]

Japan is not the only country shaken by the forcefully self-interested pattern in China's economic actions. Unsurprisingly, like its Asian ally, the United States is also looking to build stronger ties elsewhere to cushion the blow of China's protectionism. The US choice of Vietnam as a potential ally, however, is unexpected. Given the antagonistic history between the two countries, a legacy of the Vietnam War that only began to shift with reestablishment of diplomatic ties a

mere 15 years ago, and the countries' disagreement on issues such as human rights, the atmosphere of wary tension between the United States and Vietnam may not be the most conducive to establishing a close political relationship.^[3] Yet, the US has shown initiative in setting a new precedent in their approach to communicating with Vietnam. Cabinet-level meetings between the two countries have become standard as Secretary of State Hilary Clinton and Defense Secretary Robert Gates have both paid visits to Vietnam this year in the hopes of achieving closer relations and mutual cooperation on key issues of interest to both parties.^[4] Clinton's visit in July, a response to China's initial open assertion of its claim on the South China Sea, saw a tougher US stance on protecting the freedom of navigation in the crucial region.^[5] Gates' more recent visit, part of meeting attended by defense chiefs from ASEAN and its partner nations, included scheduled private talks with his Vietnamese counterpart regarding military and security issues notably the growing threat of China.^[6] While Vietnam is considerably poorer, smaller and far less economically developed than its powerful neighbor to the north, the United States hopes to incorporate Vietnam as one of many components in its overarching strategy of dealing with an increasingly aggressive China.

Although it is too early to tell whether these initial cooperative measures will crystallize into lasting formal ties or if they will have any negative effect on China, what is certain is that countries like Japan and the US see viable alternatives to economic dependency on China in its Southeast neighbors. Such agreements and the strengthening of relations with countries like Vietnam seem to be working to the advantage of all parties involved and may be a further step in warmer relations between the less developed Southeast Asian region and more established world powers.

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- [2] Ibid.
- [3] Mydans, Seth. "US and Vietnam Build Ties With an Eye on China." *The New York Times* 13 Oct. 2010: A9.
- [4] Ibid.
- [5] Ibid.
- [6] Ibid.

Indian Business Interests: Using the Threat of a Rising China to Boost Trade Deals

by Robert Nelson
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Recent events in East and South-East Asia have forced many countries in the region to become increasingly concerned about a more belligerent China. The Chinese embargo on rare-earth elements, and China's increased military presence in the South China Sea, have led countries like Vietnam and Japan to look for some other power to balance China's increasing influence. The US is the obvious choice, and America is happy to oblige, feeling that it has abandoned the region for too long. But another rising power, India, is eager to take on the role of regional counterweight.

The Indian foreign policy establishment sees the potential for huge gains by promoting itself as the benevolent giant in the region. Military matters are foremost on their agenda, with India growing increasingly concerned about the Chinese construction of ports in Sri Lanka and Pakistan. To counter this perceived threat, India has sought out military contacts with many of its neighbors. For example, India is helping Vietnam's military train in mountain and jungle warfare. Though military engagement is not the only way India is strengthening its ties with its neighbors, the business lobby in India is also pushing trade agreements as a way to bolster relations.

India's focus on countries like Vietnam and Japan is referred to as India's "Look East" policy. It has been the position of the Indian government since the early nineties, and people on both sides of the Himalayas see it as an attempt to counter China. Prominently placed on this agenda is a strengthening of trade deals. At an event hosted the Confederation of Indian Industries (CII) President Nguyen of Vietnam praised the "Look East" policy and said Vietnam strongly supports the ASEAN-India FTA. Organizations like the CII are using the implicit threat of a rising China to promote these kind of FTAs and other trade deals.

Most notable is the US-India nuclear trade deal. The CII and the US-India Business Council worked overtime to



President Obama at the US-India Business Council during his 2010 visit to India. Photo by Jason Reed

get the deal through. The CII alone spent \$538,000 on travel for Congressmen to India in order to persuade them to support the deal. The benefits to both countries are clear. India will gain increased access to nuclear power and the energy that its growing economy desperately needs, while US nuclear firms will benefit from the technology trade, and military hardware firms like Lockheed Martin were told that the nuclear deal would open up the sale of jet fighters to India. Given that Obama and Singh are expected to sign a jet fighter trade agreement in the near future, the deal appears to be delivering on its promise.

While lobbyists for the nuclear deal were likely motivated by the financial rewards it promised, the governments of these two countries appeared to be equally persuaded by the strategic gains that come from a stronger US-India partnership. The US wants to be more involved in Asia, and it believes the best way to do that is to strengthen India. The US, separated from the region by the Pacific, sees India as an Asian power with a comparable population and economic

position to China, but with democratic values that make it a natural ally. The US in turn can offer India military and financial assistance. It is these strategic benefits, as well as the financial ones, that the lobbyists focused on when trying to get representatives to support a nuclear deal.

Nonetheless, throughout the entire process both the business lobby and the governments had to do a dance and not be blatantly Sinophobic in their public statements. Both the US and India, while concerned about an increasingly aggressive China, are also major trading partners with China. The CII is quick to brag about the fact that Indian and Chinese bilateral trade will soon reach \$60 billion. The US likewise consistently states that it has no interest in "containing" China. Essentially, the business lobby gets to play both sides of the field. Publicly it can promote trade between all countries, China included, on the grounds of free trade and its benefits. But privately, the business lobby can use the threat of a rising China to form trade-based alliances that have financial benefits for businesses.

The process appears to be repeating itself in Japan. There, India is promising Japan that it will become an alternative source of rare-earth minerals and Japan is agreeing to speed up a nuclear cooperation deal between the two countries. Here again everything is put publicly in the terms of expanding trade and international relationships, but the timing of this agreement and China's rare-earth embargo cannot be ignored.

As China continues its rise, it will continue to be catalyst for trade deals—not just because of economic gains, but also out of fear.

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India and Latin America: A Newfound Partnership

by Ren Yi Hooi
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While much attention been dealt to China's huge investments in the Latin American region, another fast-growing, over-sized and resource-hungry country has quietly begun to stake out a portion of the territory. India's economic ties with Latin America have grown significantly in recent years – and experts believe that further expansion could proceed in leaps and bounds. A recent study, "India: Latin America's Next Big Thing?" published by the Inter-American Developmental Bank (IDB), established huge potential for growth in trade and investment between the two areas. After all, Latin America's abundance of energy resources and bountiful supply of fertile land literally lay the grounds for India's entry into the lush tropical region.

Given such natural synergies, what is the current state of development in terms of symbiosis between the two regions? According to the IDB record mentioned above, India's ties with Latin America have been growing quickly, but still remain small relative to both its potential volume and Latin America's total trade volume. Latin American trade volume with India, valued at \$17 billion in 2009, currently represents only 0.8 percent of the region's overall trade

volume, barely a tenth of China's 7.7 percent (and 140 \$billion) share. This statistic, backed by evidence of high Indian tariffs on Latin American exports and the presence of other non-tariff barriers as well as high transport costs, indicates that economic cooperation between the two areas is as yet rather limited.

Still, the fact that more progress can be made does not detract from the fact that progress has been made. India's trade with

Latin America, which saw a volume of only \$2 billion in 2000, has increased over eightfold over the last nine years. It is further increasing as a partial result of trade agreements such as the India-Mercosur PTA enacted in 2009. At the same time, it is reported that Indian companies have invested around \$9 billion in Latin America over the last few years. India has also begun to explore the fields of technical assistance, development of renewable energy, antiretroviral medicine development and IT in the Latin American region. In terms of politically established relationships, Brazil currently has the closest

links with India, but Chile and Mexico have begun creating real partnerships as well. These include the India-Chile Preferential Trade Agreement (signed 2005) and the India-Mexico Bilateral Investment Promotion and Protection Agreement (signed 2007). Latin America's allure has thus prompted India into making an



Indian Prime Minister Singh and Brazil President Luiz Inacio Lula da Silva at the 2006 India-Brazil-South Africa (IBSA) summit. Photograph by Evaristo SA

attempt to cultivate the multitude of opportunities available.

Furthermore, there are several reasons to be optimistic about future progress in the India-Latin American economic partnership. India's liberalization and strong domestic demand have fueled economic growth in recent years. The fact that these are expected to continue means that 1) India's gross domestic product—and with it its need for foreign resources—is expected to grow at over 8% for the next few years, and 2) tariffs and other trade barriers could undergo reductions as well. According to the Indian Ambassador to the United States Meera Shankar, this means that "India's trade profile is going to change and that will provide great trade opportunities for Latin America." At the other end, the Latin American region succeeded in rebounding reasonably well from the recession and is projected to grow at 3.9% in 2011. Although this pales in comparison to the fiery growth of the Asian emerging markets, it signals that investing in Latin America still remains a sound choice for India. Furthermore,

many countries in Latin America have begun to take active steps in attracting trade and investment from the rest of the world instead of waiting passively for investments to flow in.

What does this all mean for both regions as well as the world? First, India should continue to stake out its spot in Latin American investments, because India and Latin America both show economic potential and complementarities which bode well for the burgeoning partnership. Given that China-Latin America trade grew from \$12 billion to \$140 billion in under a decade, it is reasonable to expect India to attain a trade volume of at least \$100 billion within the next 10 years given the similarities in the types of partnerships it is seeking. Second, this may only be achieved if India continues to liberalize its economic system and revise its tariff as well as non-tariff barriers. Finally, success in advancing the regional partnership would not only fuel India's growth, but also help Latin America's business landscape to flourish – and it would be beneficial for Latin America to take active steps to advance the partnership as well.

The CMIM: Making Progress in Regional Financial Cooperation

*by Lauren Dansey
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The 1997 Asian Financial Crisis had a profound affect on the outlook of regional leaders. Many Southeast Asian countries were disappointed with the response, or lack thereof, by the United States and equally frustrated with the 'help' from the International Monetary Fund. Asian countries have since developed regional tools meant to guard against financial crises, one such provision is the Chiang Mai Initiative Multilateralization (CMIM).

The CMIM stabilizes regional currency by establishing a

decentralized foreign exchange reserve of one hundred and twenty billion US dollars; the reserve pool provides emergency funds to members who are facing a liquidity shortage. China, Hong Kong (who is paying in separately), Japan, and Korea are collectively contributing ninety-six billion US dollars while ASEAN countries are collectively contributing twenty-four billion US dollars to the exchange system. In May, the Finance Ministers and Central Bank Governors of the ASEAN Members States, China, Japan and Korea (ASEAN+3) and the Monetary Authority of Hong Kong, China, met at the Asian Development Bank annual meeting and agreed to install ASEAN+3 Macroeconomic Research Office (AMRO). AMRO will be the monitoring and surveillance body of the CMIM and is set to begin work in Singapore by 2011.

The ASEAN+3 Macroeconomic and Research Office is tasked with monitoring the \$120 billion reserve of the CMIM. AMRO, though based in Singapore, will be run by the Ministries of Finance, Central Banks and Monetary Authorities of ASEAN+3 countries. Three important functions of AMRO are to identify financial weaknesses in member economies, use the information to offer policy recommendations, and ensure that swaps are exchanged pursuant to the rules of the CMIM agreement. These measures protect CMIM economies from runs on their currencies like those that occurred in 1997.

Though the CMIM developed as a response to the 1997 Asian Financial Crisis, the CMIM is not the first Asian currency swap. The region initially developed the ASEAN Swap Arrangement, or ASA, in 1977. ASA was started by five ASEAN nations (Indonesia, Malaysia, Philippines, Singapore, and Thailand), but the swaps were merely short-term liquidity support. It was only after the 1997 crisis that Asia-Pacific countries looked to significantly deepen regional financial integration. In 1999, ASEAN countries collaborated with China, Japan, and South Korea to create a bilateral swap system called the Chiang Mai



ASEAN +3 Leaders during the 13th ASEAN Summit in Singapore. Photo by Julius Reyes.

Initiative (CMI) that has since developed into the multilateral swap system, the Chiang Mai Initiative Multilateralization. The CMI and the CMIM demonstrate regional efforts to create a reserve where member economies have access to funds to guard against future financial crises. As the CMIM has become more institutionalized through the AMRO office, there is greater assurance that the swap will effectively prevent capital flight. This assurance has increased banker and corporate confidence

in the stability of their investments in countries that are members of the CMIM, which decreases the risk of capital flight.

Creation of the AMRO and other developments in the CMIM aptly come at a time when many regions are addressing another financial crisis. Countries that are most affected by the current financial crisis such as South Korea are set to benefit from the financial security the CMIM has created.

The Doha Trade Talks and Service Liberalization: A New Way Forward?

*by Kathy Bowen
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Following the G20 Summit, pundits and public officials are speculating that the November meeting in Seoul contributed to momentum for a final push to conclude the Doha multilateral trade talks. WTO optimists, however, may be disappointed if the United States fails to put forward a bold, new proposal that encourages reciprocity from members of the developing

country coalition. While WTO ambassadors from key member states recently reached informal agreements on a few contentious issues, including fisheries subsidies, agricultural and non-agricultural market access (NAMA) represent perennial hurdles to a successful conclusion. Despite the extended break from negotiations, WTO representatives are still unsure of how to break the impasse. The answer may lie in liberalizing the global service sector, an area in which developing countries have developed an offensive interest. By making an unconditional offer on services, Washington



World leaders at the November Seoul Summit. Photo source: Presidencia de la Nacion Argentina

would provide developing country negotiators and leaders with political cover to compromise on agriculture and NAMA.

The broad quid pro quo that has been on the table since 2008, a cut in agricultural subsidies in the United States and European Union in exchange for industrial market access from developing nations, has failed to draw concessions from either side. The common refrain from leaders of both coalitions is that they are forfeiting a far greater quo than the other side's quid; neither side wants to move first for fear of losing face and bargaining leverage. For example, US Ambassador to the WTO Michael Phunk recently commented that for developed nations, "what is very clear is the pain and what is not so clear is the gain." Roberto Azvedo, Brazilian Ambassador to the WTO, echoed this sentiment, suggesting that "in agriculture we're not convinced we're getting a lot."

With both coalitions understating the payoffs from the existing equation, officials may benefit from setting these issues aside momentarily in favor of service talks. Developing countries have already expressed their interest in bringing service negotiations 'on par' with agriculture and NAMA. India, which has taken an offensive interest in services, has found support in China, Brazil, and South Africa on the issue. Since the breakdown of the talks in 2008, the provision of high technology services has ballooned as a percentage of India and China's GDP. Moreover, the relative openness of the United States service sector plays an extensive role in the growth of Indian and Chinese information technology companies. India, in particular, has been pushing hard for liberalization through the General Agreement on Trade in Services. Indian negotiators have aggressively sought greater binding commitments in Mode 4, or the temporary movement of service professionals. Additional concessions on Mode 1, cross-border supply, and Mode 3, commercial presence,

could benefit both American and Chinese industries alike.

An offer on services by Washington could be particularly powerful following recent protectionist moves that limit foreign access to the domestic high-tech market. An August bill that hiked temporary visa fees for companies who sponsor more than fifty percent of their employees on H-1Bs disproportionately impacted Indian companies and was perceived as a blow to Washington and New Delhi's broader relationship. Moreover, a number of states, including Ohio, have enacted or are in the process of enacting regulations to slow the process of offshore outsourcing. While the substantive impact of recent actions is limited, the directional logic of service protectionism, in which one restriction snowballs in both number and magnitude, is worrying to countries like India. The recent wave of visa restrictions, which also included a limitation on stimulus TARP funds excluding companies who do not employ a majority of US workers from hand-outs and a United States Center for Immigration Services memorandum limiting third-party placement of service professionals, signals to countries like India that even more severe limitations on Mode 4 market access could be in store.

US negotiators should exploit the reliance of India's thriving information technology industry on access to the American market. India, widely believed to be the spoiler in the 2008 agricultural negotiations, has hinted that flexibility might be forthcoming if Washington were to make additional offers to liberalize services. In exchange, Washington should ask for deeper cuts in manufacturing tariffs on imported goods. This equation would allow both sides to tout tangible benefits in terms of new market access to domestic audiences. New offers on services, then, may demonstrate gains to both sides, providing the domestic political cover that allows policymakers on all sides to make necessary concessions on agriculture and NAMA.

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