



# BASC NEWS

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## CRISIS-ERA INDUSTRIAL POLICY AND THE GROWING CLASH AT THE WTO

By: Vinod K. Aggarwal and Simon J. Evenett



*Trade disputes have arisen over industrial policy in areas such as solar power, wind power and biofuels.*

*Photo Credit: Bureau of Labor Statistics*

Before the financial crisis ushered in the current global economic downturn, there was a strong intellectual consensus among mainstream economists and policymakers about the merits of free trade. The world had seen the spread of pro-competition principles, binding multilateral trade rules, hundreds of so-called free trade agreements, and literally thousands of bilateral investment treaties. Did all this serve to prevent discriminatory and selective state intervention during the crisis era? The number of trade disputes launched at the WTO this year would suggest no. At the current rate, 2012 will easily see more disputes than in the two previous years combined.

This is in spite of a low incidence of new tariffs and quotas—which might seem surprising given how extensively governments resorted to them in the 1930s. But the days are long gone that such tools were the extent of protectionist interventions. As business managers know, tariffs and quotas take time to shift sales from foreign to domestic sources—time they don't have during financial crises, as the credit needed to make payroll and to pay for parts and components dries up. Besides, in sharp downturns, many customers cancel their orders, so there are fewer sales to shift in the first place.

What we've seen instead is selective subsidization—a more

direct response to the fact that, at the onset of a crisis, firms need cash more than they need customers. Indeed, so many governments implemented subsidies (thereby delaying reductions in capacity and employment in many sectors and thus distorting trade flows) that we saw the perverse effect for a while that no one brought cases to the WTO. As the saying goes, people who live in glass houses shouldn't throw stones (See *Figure 1*).

The governments behind these subsidies weren't only interested in stabilizing their firms. They were also interested in restoring economic growth. In addition to across-the-board monetary and fiscal policy measures, many of them targeted specific sectors and even specific firms as growth poles. This amounts to a revival of the industrial policy that has been poooh-pooohed for decades in the US, the UK, and much of the English-speaking world.

Now, disputes have arisen over these crisis-era state efforts at industrial policy, particularly in auto parts, wind power, and solar panels—and also over some pre-crisis industrial policy initiatives, such as those relating to biofuels. But do these formal objections reveal only the tip of the iceberg?

Official sources cannot answer this question, as they don't systematically collect data on industrial policy inter-

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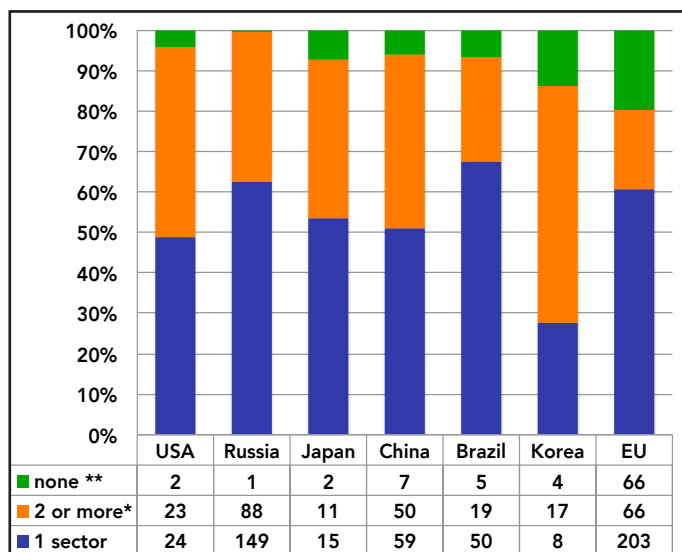


Figure 1. Almost all crisis-era intervention targeted one or more sectors

ventions. Instead we need to consult an independent source. Over the last few years, Global Trade Alert (GTA) has tracked state measures taken in the course of the downturn that are likely to vary the extent of discrimination against foreign commerce in national markets. Rather than relying on self-reporting by governments, this database is assembled by independent researchers and trade policy analysts located in all regions of the world.

In a forthcoming article, we offer our analysis of GTA's database, focusing on seven leading jurisdictions (Brazil, China, EU, Korea, Japan, Russia, and the US), and finding important differences among them. They gave us plenty of evidence to sift through; out of a worldwide total of over 1500 measures in the three years starting in November 2008, these jurisdictions were responsible for 869 (See Figure 2).

The EU implemented the most state measures (335) and Korea the least (29). Brazil has the highest percentage of measures that benefit foreign firms or at least don't harm them (41%) whereas Japan and the EU have the lowest (13% and 7% respectively). This highlights how often the foreign operations of companies have been harmed during the crisis era.

Further analysis of state intervention shows that Japan and the EU combine high levels of discrimination against foreign firms and high selectivity among its own firms, while Brazil does the opposite.

The US, Russia, and Korea combine intermediate levels of discrimination and selectivity. Meanwhile, China engages in significant discrimination against foreign firms rather than selectivity among its own firms. So managers shouldn't make assumptions that foreign governments choose their favorites in the same way.

Our analysis shows that it would be wrong to think of discrimination as being solely on nationality grounds ("us" versus "them"). Considerable discrimination among firms has been an important feature of crisis-era policy choice. Given the number of firms on the brink of collapse during the worst of the global financial crisis, referring to such discrimination as

shifting the burden of adjustment (which largely amounts to contraction of output and shedding of excess capacity) from favored firms to their domestic and foreign rivals. Contests for influence over public policy have an added edge for managers during crises.

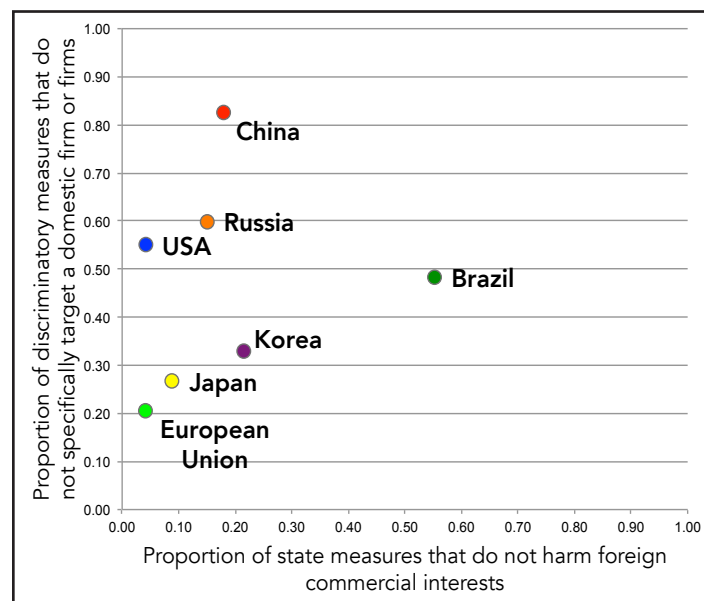


Figure 2. Resort to discrimination against foreign commercial interests and targeting specific firms within sectors

Why haven't WTO rules stopped all this discrimination from happening? It turns out that the coverage of WTO rules is uneven. For some policies—like tariffs on the imports of industrial goods—the WTO rules are tough. For other policies—such as subsidies or visa restrictions for temporary staff—WTO rules are much weaker, and in certain policy areas, non-existent.

Governments chose to evade the tougher WTO disciplines to different degrees. At the low end, Brazil resorted to weakly WTO regulated measures in just 12 percent of its measures; at the other extreme, the European Union resorted to them 83 percent of the time. Various forms of subsidies (outright bailouts, trade finance and investment incentives) account for the high proportions of weakly regulated measures employed by Russia, Japan, Korea, and the EU—although the policy mixes in these jurisdictions vary (See Figure 3).

Here's the bottom line for managers: don't count on WTO rules to protect your interests. It is clear that, during the crisis era, policy choice has sought to circumvent the stricter WTO rules. Because so much of this favoritism has taken the form of various subsidies rather than import-reducing measures such as tariffs and antidumping measures, governments have felt they did not have to change their rhetoric. Publicly, they can claim to maintain "open borders" to commerce even as they are aggressively shifting the odds in favor of a select few.

Don't be misled by the avowed rejection of protectionism. Just because tariffs aren't being raised across the board, doesn't mean firms' overseas commercial interests are being treated without prejudice. Policymakers' commitment to the

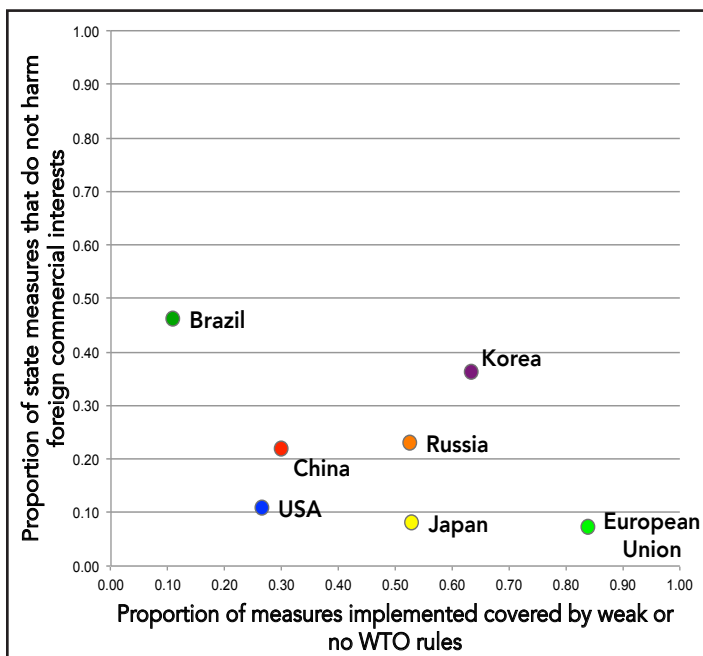


Figure 3. Major powers that discriminated more against foreign commercial interests also tended to resort to policies covered by weak or no WTO rules.

level playing field has been tested during the crisis era and found wanting—and managers must now live with the consequences. ■

This piece was adapted from the authors' article published in the *Harvard Business Review* blog on October 22, 2012 titled "The Sad Truth Behind Growing Clashes at the WTO" and their article "Industrial policy choice during the crisis era."<sup>[1]</sup>

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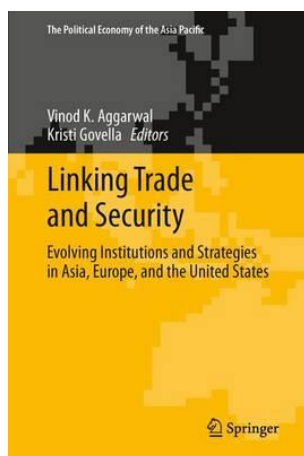
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## DIRECTOR'S NOTES

Dear Friends,

Thank you for your continued interest in the Berkeley APEC Study Center (BASC). We carry out interdisciplinary research on politics, economics, and business in the Asia-Pacific and collaborate with scholars from different countries, institutions, and centers around the world on APEC and Asia-Pacific related issues. This newsletter brings you analysis of post-crisis sectoral discrimination, a comparison between the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP), island disputes, economic cooperation between China and Japan, the global nuclear energy market, the U.S.-China wind energy market, and the Confucian revival in China.

The newsletter's lead article examines post-financial crisis industrial policy that Simon Evenett and I wrote, which is adapted from a *Harvard Business Review* blog. We analyzed state responses to the global economic downturn in seven major economies—Brazil, China, EU, Korea, Japan, Russia, and the U.S.—and found the use of selective intervention measures that often discriminate against both foreigners as well as among firms domestically. We also show that many of these measures either violate or circumvent WTO rules against discrimination.

Daniel Chen analyzes two competing multilateral trade frameworks in Asia-Pacific, the TPP and RCEP. The breadth and depth of the two trade agreements vary significantly and have attracted different champions: the U.S. promotes TPP while China supports RCEP. The article examines the comparative national benefits that these arrangements are likely to deliver.

Elizabeth Vissers examines the impact of the *Senkaku/Diaoyu* island disputes on short-term and long-term economic cooperation between the world's second and third largest economies—China and Japan. She draws attention to the vicissitudes of the Chinese-Japanese economic relations as the formal negotiations for a joint trilateral FTA among China, Japan, and Korea are set to begin.

Mika Ciotola surveys the world nuclear power market after the Fukushima Daiichi incident in March 2011 and analyzes how developed and developing countries pursue different national strategies in the nuclear energy market. Some countries like Japan and Germany have temporarily suspended domestic nuclear energy production while China, India, and South Korea have actively expanded overseas.

Jake Lerner compares American and Chinese wind industrial policy. China is clearly a frontrunner in the wind energy market as the government is aggressively developing its wind industry as part of its national plan for alternative energy. On the other hand, Lerner finds that the U.S. is falling behind in the global wind energy market due to inconsistent policies.

Victoria Gu notes the Confucian revival in China and analyzes the teachings of Confucius and Adam Smith as they apply to the Chinese economy. By comparing the *Analects* of Confucius and *Theory of Moral Sentiments* of Adam Smith, she seeks to find solutions for current problems in China's political and economic development.

In the APEC Update section, Elizabeth Vissers reports on the APEC Summit in Vladivostok, Russia, in September 2012. The leaders gathered under the theme of "Integrate to Grow, Innovate to Prosper" and focused on four key areas: liberalizing trade and investment and expanding regional integration; strengthening food security; establishing reliable supply chains; and cooperating to foster innovative growth.

Finally, in October 2012, BASC's newest edited volume, *Linking Trade and Security: Evolving Institutions and Strategies in Asia, Europe and the United States*, was published by Springer. This book is a culmination of a three-year project, and Mika Ciotola reviews the findings of this work. The Berkeley APEC Study Center is grateful for support from the Korea Foundation and the EU Center for Excellence at Berkeley, and is deeply grateful for the sustained support of the Ron and Stacy Gutfleish Foundation.

Vinod K. Aggarwal  
Director, Berkeley APEC Study Center

## APEC UPDATE | INTEGRATE TO GROW, INNOVATE TO PROSPER

By: Elizabeth Vissers, BASC Research Assistant

■ With the global economy yet to recover fully from the 2008 financial crisis, the Euro crisis ongoing, and high public deficits and debts placing constraints on some advanced economies, countries around the world are recognizing the Asia-Pacific region as an increasingly important engine for growth. Accordingly, APEC members met this year under the theme of “Integrate to Grow, Innovate to Prosper” to further build on the last twenty years of achievements since the first Economic Leaders’ Meeting in 1993 in Seattle: trade quadrupled and foreign direct investment in the region grew at a rate of over twenty percent annually.<sup>[1]</sup> Russia hosted the 2012 APEC conference in Vladivostok, continuing its commitment to promote trade and investment liberalization after acceding to the World Trade Organization in 2012, a development that means that all APEC member economies are now also members of the WTO.<sup>[2]</sup> Alongside enduring efforts to achieve the Bogor Goals and establish a Free Trade Area of the Asia-Pacific (FTAAP), under Russia’s leadership APEC leaders focused on four key areas this year: liberalizing trade and investment and expanding regional integration; strengthening food security; establishing reliable supply chains; and cooperating to foster innovative growth.

In line with the trade liberalization and regional economic integration agenda, and in light of concerns over protectionist trends, APEC members committed to avoid “raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing WTO-inconsistent measures in all areas, including those that stimulate exports” until at least the end of 2015.<sup>[3]</sup> Furthermore, leaders urged continued work toward a FTAAP, by building on existing trade agreements and initiatives in the region and by establishing model measures. One such model measure, the APEC Model Chapter on Transparency on RTAs/FTAs, was endorsed this year to be utilized as a manual for the negotiation of future trade agreements. This chapter on transparency adds to fourteen other APEC model measures on topics including trade in goods, technical barriers to trade, government procurement, cooperation, dispute settlement, trade facilitation, electronic commerce, rules of origin and origin procedures, sanitary and phyto-sanitary measures, environment, competition policy, and temporary entry of business persons. In the area of green growth, APEC leaders made progress by creating the APEC List of Environmental Goods, for which they agreed to reduce applied tariff rates to five percent or less by 2015.

To strengthen food security, APEC member economies promoted investing in agriculture to increase sustainable food production and productivity, supporting agricultural research, ensuring open and efficient food markets, improving access to

food, expanding public-private partnerships, adopting innovative technologies and regulations, and creating a transparent and stable agricultural trading system. APEC also established the Policy Partnership on Food Security and formulated a specific list of steps to be taken to advance food security.

Next, APEC member economies focused on establishing reliable supply chains, a vital issue considering the significant volume of trade in the region. Leaders committed their economies to meet a goal of a ten percent APEC-wide improvement in supply-chain performance, meaning decreased time, cost, and uncertainty of moving goods through the region, by 2015. In addition, they emphasized identifying and resolving chokepoints as an important step toward establishing efficient

and secure supply chains, along with the necessity for resiliency planning. APEC leaders also agreed that members needed to endeavor to technologically enhance supply chains and streamline their customs procedures. Finally, members highlighted emergency preparedness, disaster resiliency, disaster risk management strategies, and guidelines for financial authorities’ responses to natural disasters as vital areas for continued work and collaboration.

Another area identified for intensive cooperation was fostering innovative growth. Leaders worked to further objectives of effective, non-discriminatory, market-driven innovation policies in part by upgrading the Industrial Science and Technology Working Group into a Policy Partnership on Science, Technology and Innovation (PPSTI). The PPSTI is meant to bring together key stakeholders to drive innovation, as well as facilitate Technology Innovation Dialogues to discuss ways in which innovative technology can be used to address challenges faced by APEC member economies. The focus on innovation also encompassed assisting small, medium, and micro-sized enterprises (SMMEs) and promoting cooperation on the development of education, as both are seen as important drivers of innovation and growth. Similarly, women were recognized as a crucial component of economic prosperity and the commitment to empower them was reaffirmed.

Ultimately, the 2012 APEC meeting focused largely on measures to build confidence, stability, and growth in the Asia-Pacific region’s economies and markets. With instability in the Euro zone and a global economy that has yet to fully recover from the financial crisis, the world is increasingly turning to the Asia-Pacific for future growth and investment. APEC leaders hope to harness this opportunity and lead the region toward further development and prosperity by integrating and innovating. ■



Hilary Clinton at the 2012 APEC Conference in Vladivostok, Russia. Photo Credit: AP

For endnotes to the article, please go to page 17.

## BOOK REVIEW | LINKING TRADE AND SECURITY

Vinod K. Aggarwal and Kristi E. Govella, eds. *Linking Trade and Security: Evolving Institutions and Strategies in Asia, Europe and the United States*. New York: Springer, 2012.

By: Mika Ciotola, BASC Research Assistant

■ Growing complexities in today's global environment elucidate an ongoing redefinition of interstate trade and security relations. Editors Vinod Aggarwal and Kristi Govella focus on this evolving dynamic within the Asia-Pacific, Europe, and US in their newest edited volume. While much of the past literature has analyzed the interplay between trade and security, Aggarwal and Govella do so with a fresh lens, carefully examining the emerging and increasingly intricate web of trade agreements and security issues.

This volume directly addresses the question of how interstate trade arrangements and security concerns affect each other by bringing to the fore valuable insights on how complicated the ideas of trade and security have each become. The book importantly distinguishes the multiple forms of trade agreements—such as bilateral, minilateral, and multilateral—as well as traditional and non-traditional security matters. The contributing authors probe military defense concerns in addition to the rising concerns for human rights, labor and the environment, illuminating more ways in which trade and security are inextricably linked. The volume further draws on the interactions that the Asian region has had with the US and the EU in order to effectively highlight how inter-regional networks address the trade and security nexus.

Aggarwal and Govella lay the conceptual groundwork by introducing the idea of issue-linkages and how they unfold in interstate negotiations. The editors facilitate the reader's journey through the next ten chapters, each of which tackles specific components of the multiplicity of trade schemes and security issues the volume ultimately illustrates.

The series of case studies opens with David Vogel's "Global Trade Linkages: National Security and Human Security," in which he examines the relationships between trade standards, military security, and human security measures on a multilateral level. He delves into these relationships within the GATT and the WTO, and how the various issues determine membership, trade terms, and policymaking decisions. Despite WTO efforts to accommodate labor and environmental linkages in trade agendas, many developing countries regard these non-trade linkages more as trade restrictions that adversely affect their economies. Such opposition has rendered human security concerns relatively weak on a global level, while bilateral agreements have allowed the US and EU to play a more dominant

role in enforcing non-traditional security issues.

On trade and security complexities within intra-Asian economic arrangements, John Ravenhill investigates the impact that APEC has had on reducing security conflicts in the region. He contends that APEC's contribution to regional security has been relatively small but that the interest in military security as well as energy and food security issues is rising. The chapter ends with an intriguing, open-ended question of how APEC will accommodate the expanding East Asia Summit (EAS) as the latter continues to include nations outside of the region.

Jonathan T. Chow and Ming Gyo Koo provide complementary analyses on ASEAN.

Chow discusses ASEAN's general reluctance to link trade to both traditional and human security issues, contextualizing ASEAN within the Cold War and post-Cold War periods. He maintains that in the latter period, ASEAN members agreed to separate trade and non-trade measures at any level because they regarded such as Western attempts to limit Asia's economic growth. Although ASEAN is beginning to consider human security issues, it appears that ASEAN will continue to prioritize economic regionalization over other concerns.

Koo then seeks to highlight the trade-security relations within the ASEAN's various minilateral groupings, such as ASEAN+1, ASEAN+2, and the EAS. His analysis spotlights the effect of Sino-Japanese antagonisms on ASEAN membership and US determination to re-engage Asia through such arrangements as the Trans-Pacific Partnership. Koo points our attention to the potentially debilitating effect of ASEAN's forum varieties on regional coordination, affirming that coordination is indeed key to integration.

Ming Wan specifically analyzes the progress of the Shanghai Cooperation Organization (SCO) and its potential to create long-term stability both economically and politically. Wan reflects on the relationships among SCO members, exposing Sino-Russian tensions over traditional security matters and also the effect that Sino-Russian cooperation has had on Central Asian stability. He ultimately argues that the SCO creates a stable security context in which economic coordination can develop.

Seungjoo Lee and Atsushi Yamada both deliver a well-rounded discussion on the East Asian pursuit of FTAs with regard to traditional and non-traditional security measures. Lee looks at the differences of traditional linkage strategies



*Linking Trade and Security: Evolving Institutions and Strategies in Asia, Europe, and the United States explores the question of a changing trade dynamic. Photo Credit: Jim Watson/Reuters*

among China, Japan, Singapore, and South Korea in relation to the post-Cold War environment and the 1997 Asian financial meltdown. He concludes with an interesting perspective on the distinct trade-security policy choices between major and smaller players in the region. Yamada builds on Lee's discussion through a detailed analysis of intra-Asian bilateral FTAs involving human security linkages. He takes a more specific approach and surveys the Japan-Philippines Economic Partnership Agreement, which has sparked considerable debates over the non-traditional security issue of labor.

The last two chapters evaluate trade-security relations from outside Asia. Through an analysis of specific bilateral FTAs, Aggarwal focuses on US attempts to establish effective linkages with both national defense and human security matters, which further reveals the role of state and non-state actors. He contends that partisan politics will continue to impact FTA formation and the level of importance of non-traditional security matters during negotiations.

Anders Ahnliid rounds out the compilation of case studies with his evaluation of the EU and its growing FTAs. This chapter interestingly analyzes the extent to which environmental, labor, democracy, and human rights standards are institu-

tionalized within the EU's diverse trade arrangements, offering insight into the substantial differences between EU and US trade policies.

The editors engagingly conclude the book with their assessment of the previous chapters, incorporating key concepts from the case studies into the theoretical framework they had introduced earlier. Aggarwal and Govella propose what Asia's future will hold regarding the interplay among the variety of trade arrangements and security elements. This volume is a timely, informative and comprehensive guide into the growing trade-security nexus today. The comprehensive chapters are not only well researched and thoroughly engaging but also successfully integrated together. *Linking Trade and Security* serves as a solid foundation for further studies on how the economic-security nexus will evolve among Asia, Europe, and the US. ■

*Linking Trade and Security: Evolving Institutions and Strategies in Asia, Europe and the United States* was published in October 2012. It is available for purchase at Amazon.com and Barnesandnoble.com. See page 2 for more details.

## BASC PROJECTS | EVOLVING INSTITUTIONS IN THE ASIA-PACIFIC

The Berkeley APEC Study Center is always bustling with interesting research projects on politics, economics, and business in the Asia-Pacific. We bring together scholars of diverse expertise and perspectives for vibrant intellectual exchanges and disseminate knowledge through articles, books, conferences, and various other avenues. As we wrap up the year 2012, we are excited to tell you about our ongoing and new projects at BASC.

In August 2012, we organized a conference, "Linking Trade and Security in the Asia-Pacific," at the East-West Center in Honolulu and brought together scholars to discuss the trade-security nexus in Asia-Pacific. This conference was generously funded by the Korea Foundation. At this two-day conference, scholars presented papers on the trade-security nexus in the Asia-Pacific and its linkage to different issue areas such as labor, environment, and human rights, at the individual, subnational, national, and international levels. Currently, we are editing the papers from this conference for a special issue of a journal.

Our three-year project on traditional and non-traditional trade and security concerns culminated in an edited volume, *Linking Trade and Security: Evolving Institutions and Strategies in Asia, Europe and the United States*. This book analyzes different institutions in the Asia-Pacific such as WTO, APEC, ASEAN, Shanghai Cooperation Organization (SCO), and bilateral preferential trade agreements (PTA) and how they have been and are likely to address growing linkages of trade and security.

We also launched a new project, "Industrial Policy in the Financial Crisis Era," funded by the EU Center for Excellence at Berkeley, to examine industrial policy developments and state responses to the financial crisis in different countries. Vinod K. Aggarwal and Simon J. Evenett are currently organizing a conference to be held in May 2013 in Berkeley with participants from around the world. A follow-up conference will be held in the fall of 2013 in Switzerland, with funding from the University of St. Gallen. Please stay tuned for more updates.

We also constantly update our website for scholarly research articles, books, and commentary. Please visit us at [basc.berkeley.edu](http://basc.berkeley.edu). Currently, the Center has five undergraduate research assistants, who are undertaking research on bilateral and multilateral trade institutions, and the effects of these institutions on governments, firms, and the public in the Asia-Pacific. We hope you will find their perspectives in this newsletter and on our blog posts refreshing and enlightening!

Bora Park  
Project Director, Berkeley APEC Study Center

## TPP v. RCEP: COMPETING VISIONS FOR EAST ASIAN TRADE ARCHITECTURE?



*President Obama and Premier Wen Jiabao at East Asian Summit in Phnom Penh, Cambodia on November 20, 2012. Photo Credit: Jason Reed/Reuters*

By: Daniel Chen, BASC Research Assistant

■ In December 2012, members of the Trans-Pacific Partnership (TPP) will hold their 15th round of negotiations in Auckland, New Zealand, seeking to push TPP one step closer to finalization. In November, members of ASEAN and six FTA partners gathered in Phnom Penh, Cambodia to discuss the Regional Comprehensive Economic Partnership (RCEP).

Heralded as a comprehensive “twenty-first century trade agreement,” TPP will incorporate issues necessary for the next wave of economic integration. This comprehensive agreement covers areas such as regulatory coherence, competition policy, government procurement, the environment, financial services, and intellectual property, among other issues.<sup>[1]</sup> While most FTAs allow certain exemptions in order to be domestically palatable, TPP members are negotiating and debating a unified market access schedule, making it increasingly difficult to carve out sensitive sectors by overriding already-existing FTAs.<sup>[2]</sup> For these reasons, TPP has been deemed the “gold standard” for FTAs.

Similarly, economic ministers from the countries interested in RCEP have vowed to make RCEP a “modern, high quality agreement, which will underpin and promote future growth, development, and integration in the participating countries.”<sup>[3]</sup> Nonetheless, RCEP has less stringent adoption standards and covers fewer areas of trade than TPP. Because TPP covers a wide range of sectors and policies, developing countries may have trouble accepting its provisions and acceding to the agreement. Instead, according to the ASEAN Secretariat, RCEP “can be accomplished in a sequential manner or a single undertaking or through any other agreed modality” while also providing for “special and differential treatment to ASEAN Member States.”<sup>[4]</sup> Thus, some scholars have argued, “A pragmatic RCEP approach that takes into account a second-best

world with greater market access might be more appealing to some ASEAN members, as opposed to ‘no gold standard, no deal.’”<sup>[5]</sup> In light of this, are TPP and RCEP complementary or competing visions for East Asian trade architecture?

TPP is the centerpiece of the Obama administration’s “pivot” or rebalancing towards Asia. Recognizing the nexus between economic prosperity and national security, TPP and APEC are the engines of a renewed American effort to combat its decreasing relevance in a region witnessing the ascendancy of an increasingly powerful China. Given this interpretation, the negotiating members of TPP and RCEP may demonstrate the distinctive perspectives governing each trade agreement.

TPP encompasses eleven countries from three continents: Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the United States; RCEP involves the ten members of ASEAN and six FTA partners: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam as well as China, India, Japan, Australia, New Zealand, and South Korea. Both trade agreements are open trade agreements, meaning more members can join as long as they are willing to accept the existing provisions. TPP is a U.S.-led effort while RCEP is an ASEAN-championed agreement that promotes ASEAN centrality, the belief that ASEAN, instead of the larger economies of China, Japan, or the United States, should be the hub of developing a wider Asia-Pacific regional trade architecture.<sup>[6]</sup> Furthermore, RCEP differs from TPP in that TPP includes the United States but not China, Japan, India, and South Korea—the main dynamic engines of economic growth in Asia. Unable, unready, and unwilling to accede to TPP, could China back RCEP as a strategic response to the American-led TPP efforts? As China rises as a dominant economic player

in the Asia-Pacific, its involvement in RCEP could be a geopolitical maneuver to match growing U.S. influence in the region. RCEP may be China's own attempt to link FTAs and security.

Not only this, but could RCEP prove to be a repudiation of the high standard framework of American FTAs and TPP? Before Mexico and Canada acceded to TPP, the economic calculus undergirding the agreement was based on future potential, not short-term gains. Many of the previous nine countries had already negotiated and completed FTAs with one another; even now, with Mexico and Canada joining, TPP is mainly restricted to relatively developed countries. The opposite is true of RCEP.

Table 1. Comparison of TPP and RCEP.

	TPP	RCEP
<b>Negotiating/ Interested Countries</b>	Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, United States	China, India, Japan, Australia, New Zealand, South Korea, Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam
<b>Countries negotiating both:</b> <i>Australia, Brunei, Malaysia, New Zealand, Singapore, Vietnam</i>		
<b>Economic Coverage, 2011</b>		
GDP (% global share)	25.6%	28.4%
Merchandise trade (% global share)	16.3%	27.7%
Population (% global share)	7.3%	47.9%
<b>Speed of negotiations</b>	- Started in March 2010 - "Broad Outline" achieved November 2011 - 15th Round of TPP negotiations taking place in Auckland, New Zealand: December 3-12, 2012	- Starting November 2012
<b>Depth of issues covered</b>	- Include trade in goods, services, and investment - Trade facilitation - IPR, competition policy, government procurement, labor, and environment	- Three working groups on trade, services, and investment

Adapted from Das, 2012

RCEP has already gained traction with developing countries, mainly because it will be a lower-standard agreement and because the flexibility principle allows countries to accede to the agreement's provisions with varying speeds. However,

in addition, developed countries that have shown interest in TPP, such as Australia, New Zealand, Singapore, and Japan, are also involved in RCEP. Perhaps developed countries view the RCEP model as more viable in the Asia-Pacific region. This view is decidedly false. For example, Australia is keen on maintaining TPP because of the high standards covered by the agreement. However, they are also interested in RCEP because the agreement would cover eight of Australia's top ten trading partners and almost sixty percent of Australia's each-way trade.<sup>[7]</sup> In addition, Australia's Minister for Trade and Competitiveness, Dr. Craig Emerson, noted that he will seek to upgrade RCEP's own standards as well: "I have made clear to my ministerial counterparts that Australia will pursue the inclusion of labor and environmental issues in the scope of the agreement once negotiations are launched."

Similarly, other developed countries, South Korea and Japan, have their reasons for supporting RCEP. South Korea, having already completed an FTA with the United States, has thus accomplished much of what it would desire under TPP. RCEP then has a different focus for Korea, offering "a chance for South Korea to capitalize on a production network in the East Asian region."<sup>[8]</sup> For Japan, "the fact that [it] is poised to begin new trade talks with fifteen other Asian countries, but not with the United States, does not signal that Japan is now less interested in joining... TPP," according to experts in Washington, D.C.<sup>[9]</sup> In addition, Japan may be moving towards RCEP and away from trilateral talks with China and South Korea due to strained relationships from the territorial disputes and the desire to strengthen ties in the region.<sup>[10]</sup> Nonetheless, Japan is still interested in joining TPP because it offers the opportunity to deepen ties with the United States, something RCEP lacks, while simultaneously encouraging necessary domestic economic reforms. In addition, negotiating the agreements in parallel would potentially allow Japan to utilize TPP as leverage to extract greater concessions during RCEP negotiations.<sup>[11]</sup>

Thus, because of the different nature of each agreement, it appears TPP and RCEP can coexist for the time being. Countries involved view the different facets of each agreement as complementary, not competing. TPP covers a much larger range of goods and services while RCEP has only three working groups. TPP has stringent standards while RCEP is more flexible in addressing developmental needs. TPP offers economic benefits with the United States while RCEP would bring access to the giant Chinese market. While RCEP may possibly be China's response to an increased American relevance in Asia, Fred Bergsten and Jeffrey Schott point out that FTAs cannot "contain" countries.<sup>[12]</sup> The United States cannot overreact to RCEP but must also remain guarded and continue to demonstrate the relevance of TPP for the Asia-Pacific region. China and the United States are not enemies. Neither are RCEP and TPP. ■

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## CARS, ISLANDS, AND ECONOMICS: HOW THE ISLAND DISPUTE HAS AFFECTED CHINA-JAPAN ECONOMIC TIES



*Protest over Senkaku/Diaoyu Islands outside the Japanese consulate in Shanghai.*

*Photo Credit: Aly Song/Reuters*

By: Elizabeth Vissers, BASC Research Assistant

The dispute between Japan and China over the *Senkaku*, or *Diaoyu*, islands in the East China Sea has become an increasingly heated and contentious issue, further souring a relationship that is already rife with historical tensions between the two countries. With neither country giving up its claim to the unsettled but potentially resource-rich islands, no clear solution is in sight, and analysts are left to speculate about what will happen next.

Proponents of liberalism in international relations claim that economic ties and interdependence between countries create shared interests that promote cooperation and discourage conflict. China and Japan certainly have immense economic ties, the severing of which would significantly impact both of their economies, not to mention that of Asia more broadly. But it remains to be seen if these links will be enough to prevent a major conflagration, or if maybe they will be strategically utilized to expose and take advantage of each other's vulnerabilities.

Total trade between Japan and China amounted to \$345 billion in 2011, which makes up 9% of China's and 21% of Japan's overall trade.<sup>[1]</sup> The investment picture is somewhat different, with Japan investing \$12.6 billion in China last year, according to the Japan External Trade Organization, while China's total foreign direct investment in Japan only amounted to \$560 million by the end of 2011.<sup>[2]</sup> Furthermore, Japan's FDI in China increased by 16 percent in 2011 compared to 2010, despite a slowing Chinese economy and an overall decrease in foreign investment there.<sup>[3]</sup>

Despite these economic links, anti-Japan protests began

and were allowed to spread to over 80 cities in China, even resulting in damage to Japanese electronic plants and car dealerships, following the Japanese government's purchase of several of the *Senkaku* islands from their private Japanese owners.<sup>[4]</sup> *The New York Times* commented that the weeklong protests "suggested that the Chinese leadership approved the outpouring of nationalism in part as insulation against criticism of the party itself during the [upcoming] transition of power," and that the "bold color photographs on the front pages of state-run newspapers, particularly of the protests outside the Japanese Embassy in Beijing, were evidence that senior leaders approved of the demonstrations, and suggested that, in some respects, they were even organized by the government."<sup>[5]</sup> These protests have encouraged a growing anti-Japanese sentiment in China, which has manifested itself in consumer choices and affected Japanese companies and products.

The impact of the dispute on Japanese brands is manifested by the 49 percent sales decrease of Toyota cars in September in China, compared to September of last year.<sup>[6]</sup> Honda's sales also dropped by 40 percent<sup>[7]</sup> in September year-on-year, and Nissan was down 34.6 percent.<sup>[8]</sup> Mitsubishi's sales in China plunged 63 percent and Mazda's fell by 35 percent in September.<sup>[9]</sup> Although Japanese carmakers have been hit the hardest, they are not the only Japanese companies to suffer. Nippon Airways reported over 40,000 cancellations of seat reservations on its China-Japan routes from September to November,<sup>[10]</sup> and semiconductor companies such as ROHM Co., Ltd. have seen a decline in orders in large part due to the troublesome

car sales numbers.<sup>[11]</sup> Overall, trade between China and Japan decreased by 4.5 percent in September year-on-year, with Chinese imports from Japan falling by 9.6 percent, although exports to Japan rose by 2.2 percent.<sup>[12]</sup>

Even in October, when protests had simmered down, Japanese carmakers' depressed sales numbers in China failed to rebound. Year-on-year, Toyota figures were down 44 percent in October, and Nissan's sales dropped by 41 percent.<sup>[13]</sup> Overall, Japanese-brand car sales fell 38 percent in October compared to a year earlier, amounting to just 98,900 units sold (see Figure<sup>[14]</sup>), the lowest monthly total since 2009. This correlated to an over 5 percent drop in market share, from 13 percent in September, already down from over 20 percent before the protests started, to 7.6 percent in October.<sup>[15]</sup> This market share has been taken over largely by other foreign brands such as Hyundai, Audi, BMW, and Mercedes-Benz.<sup>[16]</sup>

In response to these severe sales hits, Toyota, Honda, and Nissan projected it would be necessary to roughly cut in half their production in China. Reports claimed that Nissan planned to "suspend the night shift at its passenger car factories in China and operate only during the day," and that Toyota and Honda would achieve decreased production by "shortening working hours and slowing down the speed of production lines."<sup>[17]</sup> Since Toyota's sales in China did not pick up in October, the company is reportedly planning an extended production cut that will last through at least July 2013,<sup>[18]</sup>

and *Bloomberg* reports that Japanese automakers may even face production cuts into 2014.<sup>[19]</sup> These cuts in production not only hurt the Japanese companies' profits, but also the Chinese who are working at their facilities, be it manufacturing plants or car sales outlets.

Still, several prominent editorials calling for sanctions on Japan have appeared in Chinese newspapers, including "Consider Sanctions on Japan" in the *China Daily*, in which Jin Baisong argues that Japan would be hurt significantly more than China would be if sanctions were imposed.<sup>[20]</sup> Similarly, an article in the *People's Daily*, the voice of the Chinese Communist Party, claimed that China would be better able to absorb the consequences of an economic war with Japan, especially considering that Japan's economy has already suffered through two lost decades, the 2008 financial crisis, and the 2011 earthquake and tsunami.<sup>[21]</sup> On the other hand, Hu Shuli, editor in chief of *Caixin* Media and one of China's chief economic journalists, argues that "notions of punishing Tokyo economically for buying the islands... is unrealistic," citing the extensive employment of Chinese workers at Japanese-owned companies.<sup>[22]</sup> Thus, sanctions could result in enormous job cuts, which could cripple the Chinese economy and under-

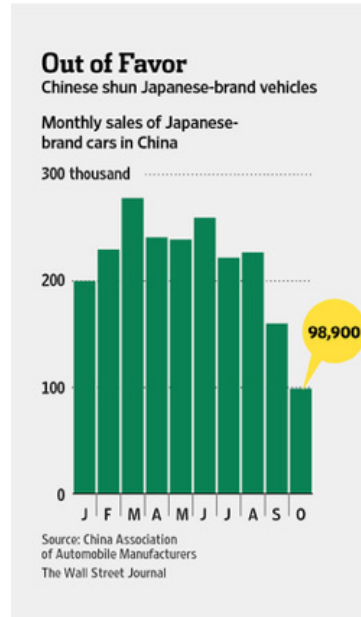
mine the Communist Party's development-centered legitimacy.

Regardless of which country would be most hurt by sanctions, it is clear that both Japan and China would suffer. According to the *Wall Street Journal*, China has benefited from Japanese investment, especially in terms of job creation, as well as from Japanese technology. Furthermore, Japan is one of China's largest export destinations, following only the United States and the EU. Similarly, Japan exports more expensive machinery and advanced technology to China than to any other country in the world, and its corporations benefit from their foreign investments in China. Not only would economic sanctions hurt these two countries, though, but the Asian and potentially even global economy more broadly would suffer as important supply chains of goods from iPhones to cars would be disrupted.<sup>[23]</sup>

Ultimately, Japan's and China's economies are powerfully linked, and many interests have a stake in preventing the severing of these links. Economic ties may prove important enough to prevent a serious escalation of the islands dispute, rather than becoming a tool to exact pain on one another in the form of sanctions. For long-term economic cooperation, Japan and China have continued to move forward with efforts to spur trilateral trade cooperation between themselves and South Korea, suggesting that although the territorial dispute is by no means inconsequential, the Japanese and Chinese governments recognize the importance of and wish to further strengthen their trade relationship anyway. The three countries announced at the East Asia Summit in Cambodia (November 18-

20, 2012) that official negotiations for a trilateral FTA would start early 2013.<sup>[24]</sup> The high-level leadership of China, Japan, and South Korea had agreed in May to begin trilateral FTA talks by the end of the year, building on a tripartite investment agreement and preliminary working-level discussions,<sup>[25]</sup> and thus the fact that they are following through on these plans in spite of the *Senkaku/Diaoyu* dispute is a promising sign of economic cooperation. A China-Japan-South Korea FTA, which would encompass roughly 20 percent of global GDP if implemented,<sup>[26]</sup> would create a major regional trade bloc that would benefit all three economies, as well as potentially providing increased impetus to negotiations for the Regional Comprehensive Economic Partnership (RCEP) between the Association of Southeast Asian Nations (ASEAN) member states, China, Japan, South Korea, India, Australia, and New Zealand.<sup>[27]</sup> These trade agreements would hopefully engender not only economic benefits, but also incentives to maintain stability in the region and resolve disputes diplomatically. ■

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Source: The Wall Street Journal

## THE GREEN LIGHT FOR NUCLEAR POWER



*A year after the devastating Fukushima nuclear incident, Japanese and global nuclear power markets still have concerns over nuclear safety.*  
 Photo Credit: Carolyn Kaster/AP Photo

By: Mika Ciotola, BASC Research Assistant

■ Since the Fukushima Daiichi nuclear plant's incident on March 11, 2011, worries over nuclear energy have continued to affect domestic and global nuclear power markets. Public concerns over plant reactor safety pushed Japan out of the domestic market and into the global market while most Western European countries such as Germany and Italy withdrew altogether. On the other hand, strong economic ambitions have pulled together China, India, South Korea, and a number of developing countries. On state-society relations, the debate between pro-nuclear state interests and anti-nuclear citizen interests would undoubtedly persist and define policies as new players navigate nuclear territory.

Japan is far from settling on a nuclear policy that satisfies everyone. On September 14, 2012, Prime Minister Yoshihiko Noda announced the "Revolutionary Energy and Environment Strategy" that would facilitate Japan's gradual transition away from nuclear energy by 2040.<sup>[1]</sup> The deadline immediately drew criticisms from power companies that strongly opposed complete shutdowns and also citizen protection groups that pushed for the deadline to be as early as 2030. Noda had hoped to appease both sides of the spectrum but was charged of being "too lax" and "too strict" in his decision-making capabilities.

On September 19, 2012, Noda reneged on the strategy, calling the 2040 deadline a mere "reference point" and defend-

ing his prudent decision to postpone any definite plans.<sup>[2]</sup> His abrupt policy reversal was a result of strong opposition from the Japanese Business Federation, *Keidanren*, and other business groups that decried nuclear phase-out plans as simply "impractical" for a resource-strapped nation like Japan.<sup>[3]</sup> For a country that derived 30 percent of its total energy from nuclear power before the incident, a phase-out is understandably daunting. Rising costs associated with using alternative energies further threaten Japan's already distressed economy. Since the meltdown, Japan has emphasized conservation, revived its natural gas and oil plants, and turned to fossil fuel imports. Increased dependence on imports, however, added to the country's first trade deficit last year in over thirty years.<sup>[4]</sup> Although antinuclear proponents believe that Japan has been and will be able to live without nuclear energy, the fiscal imbalance tells a different story, which is an issue the government cannot afford to overlook.

Amid inconclusive debates over domestic nuclear energy production, Noda's "no-plan" plan has actually realized a rather explicit policy move towards the exports of idling nuclear power. In late October 2012, a large Japanese conglomerate Hitachi won a bid to take over the Horizon Nuclear Power Project of building six nuclear plants in the UK.<sup>[5]</sup> The program promises to feed British energy demand as well as nourish the Japanese economy through nuclear technology exports.

The bid over Horizon Nuclear Power Project reveals a broader transformation of the global nuclear industry. The UK had been initially set to sign the deal with Germany's two largest electricity utilities, RWE and E.ON.<sup>[6]</sup> They then pulled out from the Horizon plan and put up their holding for sale because after witnessing the nuclear disaster in Japan, many Germans protested and forced Chancellor Angela Merkel to hasten a complete phase-out by 2022, thereby abandoning the nuclear market entirely. Doing so meant shutting down Germany's seventeen nuclear plants, which delivered about a quarter of total electricity in 2010, and building wind, solar, and coal plants instead.<sup>[7]</sup> While the UK continues to pursue nuclear energy as part of its economic and "green" growth strategies, other European countries such as Italy, Switzerland, Belgium and Spain have joined Germany and announced anti-nuclear policies.<sup>[8]</sup>

On the other hand, China was quick to capitalize on Germany's exit. Two of China's major energy state-owned enterprises, China Guangdong Nuclear Power Company (CGNPC) and State Nuclear Power Technology Corporation (SNPTC) immediately teamed up with France's Areva and the US Westinghouse power reactor firms to enhance China's chances of winning the Horizon bid given their advanced nuclear technologies.<sup>[9]</sup> Although China, France, and the US walked away from the bid due to some remaining technological issues, these partnerships nevertheless reflect China's increased determination to improve its nuclear sector and expand overseas. In late 2011, CGNPC agreed to invest in two of Romania's power plants and expects to further develop its nuclear agreements with Thailand and Vietnam. This year another major consortium, China National Nuclear Corporation (CNNC), began similar construction deals with Argentina and Turkey.<sup>[10]</sup>

South Korea is an active player in the global nuclear industry as well. In 2009, Korea Electric Power Corporation (KEPCO) won the contract to build reactors in the United Arab Emirates, defeating major players like Areva and General Electric.<sup>[11]</sup> Discussions on developing several additional reactors surfaced earlier this year as KEPCO hopes to become the world's third largest reactor exporter by 2030.<sup>[12]</sup> It is currently coordinating on overseas projects with twenty-three nations, such as Jordan, Kazakhstan, the Philippines, and China.<sup>[13]</sup> Export revenues remain a high priority for the Asia-Pacific powers, raising the bar of competition and validating Japan's

nuclear initiatives. The domestic nuclear market is also very important for the Asia-Pacific powers. China has surged ahead in domestic nuclear plant construction in hopes of feeding growing energy demand and curbing greenhouse gas emissions. At present, China has the most number of reactors under construction in the world and hopes to build up to 100 reactors in the next twenty years in order to reduce its fossil fuel dependence.<sup>[14]</sup> Out of the over sixty reactors under construction worldwide in 2012, twenty-six are in China, compared to ten in Russia and seven in India, while other developing countries such as Jordan, Vietnam, and the UAE are embarking on their first projects.<sup>[15]</sup> India too has begun plans to build thirty reactors and increase its nuclear energy composition to 25 percent of total energy by 2050.<sup>[16]</sup> In November 2012, India settled a deal with Canada to more easily access Canada's vast uranium supply after having agreed last year to import nuclear technologies from South Korea.<sup>[17]</sup>

This nuclear revival in the wake of Fukushima does not go undisputed among civil society groups in the emerging economies. Post-Fukushima panic in southern India peaked in September 2012 as the government allowed India's Nuclear Power Corporation to begin operating the Kudankulam Project, the country's largest plant.<sup>[18]</sup> Similar angst is beginning to surface in the Pengze plant in Jiangxi province in China,<sup>[19]</sup> and in South Korea, where a wide probe was launched to inspect all nuclear reactors in the country.<sup>[20]</sup>

As some countries enter the nuclear market with greater determination while others leave entirely, public opinion is set to shape the terms of competition. Anti-nuclear protests symbolize the public's distrust in government and industry to provide adequate safeguards around power plants. Whether it is to engage in more overseas projects or increase energy independence at home, a country's success will rely on developing safer nuclear technologies. Despite anxieties over energy safety and supply, nuclear growth remains a bright spot in the future for many. As countries move forward, one can only hope that the burgeoning partnerships will foster greater prudence in developing nuclear technology and safety. ■

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*Hitachi and General Electric designed a joint nuclear power plant model shown at an international nuclear energy exhibition in October 2012.*

*Photo Credit: AFP Photo/Hoang Dinh Nam*

## COMPARING AMERICAN AND CHINESE WIND INDUSTRIAL POLICY



*As world economies push for alternatives to fossil fuels, China and the United States take divergent paths to wind industrial policy. Photo Credit: Sheng Li/Reuters*

By: Jake Lerner, BASC Research Assistant

■ As the political, environmental, and fiscal costs of fossil fuel use continue to rise, alternative energy development is becoming an increasingly important economic (and perhaps strategic) imperative for modern states. Many nations are engaging in diverse measures to bolster their alternative energy assets and alternative energy development sectors, but perhaps most notable among these are the United States and China. As the two largest economies in the world, these countries have both explicitly framed alternative energy development as a key part of their respective national energy policies, but their paths diverge. Whereas China has taken a more aggressive approach to promoting its wind industries at home and abroad, the United States has tended to protect its wind industry from external competition. This article will specifically analyze the wind industry of each country as a means of highlighting the different approaches to alternative energy industrial policy taken by each country.

The wind sector can actually be broken into three distinct industries: wind turbine manufacturers, wind developers that produce wind energy on wind farms, and power distribution companies that maintain and develop power grids to transport energy to end users). Each of these is integral to a successful wind market. The interdependence of these industries is obvious in China, where the lack of grid development has become a huge obstacle to the development of China's domestic wind industry. Lines to power producing regions are often inefficient or nonexistent entirely: as little as 22

percent of Chinese wind power actually reaches end-users.<sup>[1]</sup> Thus, actions by China's two state-owned power grid companies, State Grid Corporation of China and China Southern Grid company, have come to play a key role in China's wind sector development strategy. Grid-side development of the sector currently takes two forms. First, a nation-wide plan to expand ultra-high-voltage grid networks will make it more efficient to get wind energy to eastern consumers from China's wind farms in the North and West.<sup>[2]</sup> Second, the Chinese government has recently put into place a quota system that will require Chinese utilities to get 15% of their energy from renewable sources by 2013.<sup>[3]</sup> The hope is that grid companies will expand to more regions so they can meet these quotas.<sup>[4]</sup>

Meanwhile, China continues to take other measures to foster its wind industry as well. As early as 2005, turbine manufacturers in China benefitted from the reduced income tax rates and value-added tax credits.<sup>[5]</sup> With cheap coal dominating the Chinese energy markets, the National Development and Reform Commission even set wind power prices at a subsidized level to compete with coal.<sup>[6]</sup> These measures have been perhaps too successful in generating a domestic supply of wind energy in the PRC: huge year on year profit losses for big Chinese turbine manufacturers and the high percentage of turbines disconnected from the grid both testify to oversupply and slowing demand in the Chinese wind market.<sup>[7]</sup> Thus, China is increasingly working to develop its wind assets abroad, and seeking markets to drive domestic turbine production.

Several large Chinese turbine manufacturers have entered into joint ventures with foreign companies, such as a venture between turbine producers Siemens and Shanghai Electric, which constitutes all of Siemens' business in China.<sup>[8]</sup> In addition, private Chinese turbine manufacturer Ming Yang has entered into a joint venture with Reliance, and Indian firm, to give both firms a stronger foothold in the Indian turbine market.<sup>[9]</sup> Moreover, the Chinese development has taken to providing loan guarantees to foreign governments and developers so that they can buy Chinese turbines. For example Argentina just finalized a deal to start heavily developing wind using Chinese turbines with a financing plan of over \$1 billion from the Chinese development bank.

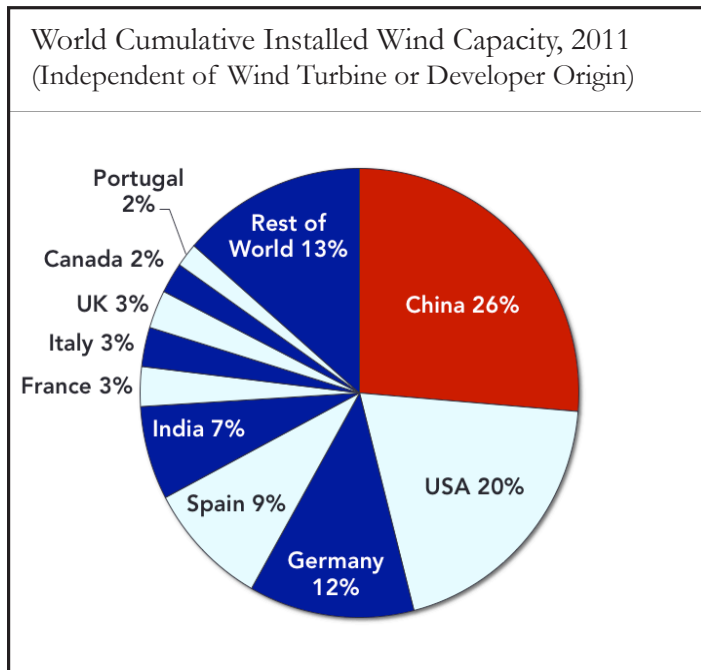


Figure 1. In 2011, China was the country with the most total wind energy capacity, regardless of turbine or developer origin. The US was second.  
Source: Global Wind Energy Council

The US approach to wind energy sector could be characterized as more passive than the Chinese approach. Unlike China, where three quarters of domestic development and turbine production is owned by Chinese firms (and almost entirely SOE's), the US wind sector is almost entirely privately owned. However, the US has taken large steps in recent years in pursuit of development. In the 2012 State of the Union Address, President Obama specifically took aim at China with remarks about his commitment to renewable energy: "I will not cede the wind or solar or battery industry to China or Germany because we refuse to make the same commitment here." He also said that the US should "double-down on a clean energy industry that never has been more promising."<sup>[10]</sup>

By contrast, the federal government has provided positive incentives: the Federal Production Tax Credit (PTC) has been cited as a huge driver of growth in the wind industry over the past several years. However, this tax credit is set to expire at the

end of 2012, and wind industry experts worry that this could destroy growth of the industry: in past years in which the PTC has been allowed to expire it has resulted in over 70% drops in new wind installations, nationwide.<sup>[11]</sup> This is in large part due to the increased profit margins on development the credit allows, but also the stability it provides: by lowering overhead for wind development, these credits increase confidence that the industry will weather dips in demand.

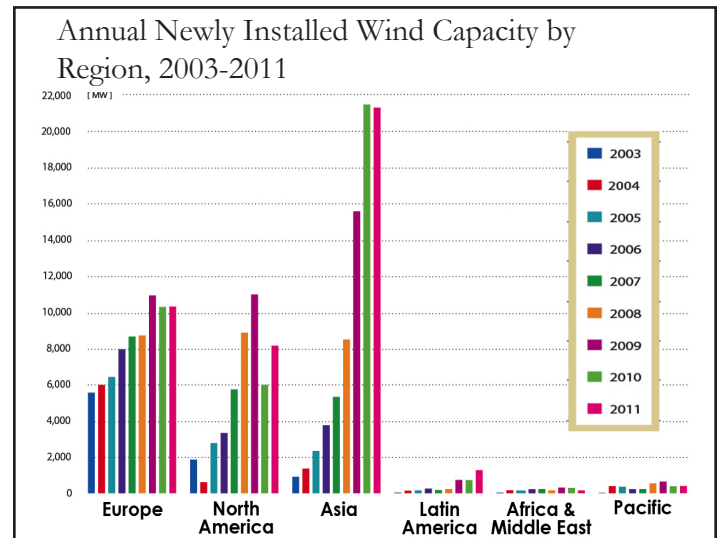


Figure 2. Since 2003, Asia has been the fastest growing region in terms of annual newly installed wind capacity. Source: Global Wind Energy Council

Moreover, America has taken a strong role in defending its wind industry against unfair practices abroad. In 2010, the US won a case before the WTO regarding China's subsidies to its wind industry.<sup>[12]</sup> Although China complied and removed some domestic production incentives from its wind energy policy, the US wasn't satisfied. Earlier this year, the US Commerce Department levied anti-dumping tariffs against Chinese wind turbines, claiming that the Chinese companies were attempting to gain market share in the US by selling the turbines below cost of production.<sup>[13]</sup>

But what have been the real effects of these policies, and where does each industry stand today? At the end of 2011, 28% of the world's installed wind energy capacity was in China, while 20% was in the US. Moreover, China dominates the wind turbine production markets, with four Chinese firms controlling almost 30% or the global turbine production market. In contrast, only one American firm (GE Wind) is among the top ten turbine producers and accounts for 9% of global installed turbine capacity.<sup>[14]</sup> For the time, at least, it seems that China's state driven wind industrial policy is succeeding both in protecting its own wind market from an oversupply problem and establishing its wind industry as an internationally competitive force in a way America's passive wind program has been unable to achieve. ■

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## A CONFUCIAN REVIVAL



*In light of the power transition in the Chinese Communist Party, questions of reform may be answered by a return to the doctrines of Confucius. Photo Credit: Frederic J. Brown / AFP / Getty Images*

By: Victoria Gu, BASC Research Assistant

■ In light of the leadership change at the 18th National Congress of the Chinese Communist Party (CCP) this month, many wondered what China's next step in development would be. Earlier in 2012, a World Bank report titled "China 2030: Building a Modern, Harmonious, and Creative High-Income Society" detailed the need for a stronger economic model in order to face new challenges domestically and in the world economy.<sup>[1]</sup>

Confucianism may well be a potential solution for such reform. An article published by *BusinessWeek* in November 2012 detailed a rise in Confucianism in China in areas such as business, education, and political science.<sup>[2]</sup> But contrary to what some may believe, a reinstatement of Confucianism would not be a reversion back to pre-modern times: it may be a step towards progress and full transition into a market economy.

As it turns out, Confucianism is not so different from the moral and classical economic doctrines of Adam Smith, the father of modern capitalism. Since Adam Smith's *Wealth of Nations* provides the theoretical basis for the modern neoliberal framework, the compatibility of the two ideologies legitimizes the possibility of using Confucianism to answer troubles in China's current political economy.

An analysis of Adam Smith and Confucius reveals that they share fundamental tenets that are strikingly relevant to addressing vital problems that plague today's China. Some of these tenets are as follows:

### Benevolent governance

The biggest issue surrounding Chinese development and social stability is corruption and collusion between business and the government. Adam Smith and Confucius were both adamantly anti-corruption. As described in his *Wealth of Nations*, Smith is a believer in a small government that creates and regulates a framework of rules for the market. Included in these

rules is the elimination of collusion and corruption. Confucius also saw corrupt officials as not fulfilling their role as a benevolent ruler. In his *Analects*, Confucius says, "When a country is well governed, poverty and a mean condition are things to be ashamed of. When a country is ill governed, riches and honor are things to be ashamed of."<sup>[3]</sup>

### "Fellow-feeling" and Compassion

One of the side effects of China's pursuit towards rapid growth is the loss of compassion and the loss of the social networks that once existed during the pre-reform era. In turn, the bonds among fellow Chinese are lost and quality of life are directly affected. Both Confucius and Adam Smith emphasize the importance of compassion, or what Smith calls "fellow-feeling," as a necessary component to leading a virtuous life. In *Theory of Moral Sentiments*, Smith writes:

How selfish so ever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.<sup>[4]</sup>

Each thinker makes normative claims that people should develop compassion. Confucius says, "A youth, when at home, should be filial, and, abroad, respectful to his elders. He should be earnest and truthful. He should overflow in love to all, and cultivate the friendship of the good."<sup>[5]</sup>

### Laissez-Faire

Undoubtedly, much economic progress that has been made in China in recent years can be attributed to the liberalization of the economy. Chinese officials implemented gradual privatization reforms such as introducing Special Economic Zones selectively, which epitomized

mized the principle of laissez-faire. In French, laissez-faire means: “let it be.” In Smithian economics, laissez-faire implies an environment free from tariffs, subsidies, and monopolies. Confucian theory is anti-taxation as well. Mencius, one of Confucius’s intellectual descendants, writes in *Kung-sun Ch’au*:

If, in the market-place of his capital, he [the ruler] levy a ground-rent on the shops but do not tax the goods, or enforce the proper regulations without levying a ground-rent; then all the traders of the kingdom will be pleased, and wish to store their goods in his market-place.<sup>[6]</sup>

The idea of the “invisible hand” of the market is analogous to the Chinese philosophical concept of the *Dao*. In Chinese, the *Dao* means “the way.” An essential component of the *Dao* is letting things take their course. Much like Adam Smith’s “invisible hand,” the *Dao* is the natural order that underlies and governs everything in existence, including the market.

### Equal Opportunity

As the inequality gap grows, unrest in the lower socioeconomic classes resulting from a lack of opportunities has become much more prevalent. Adam Smith himself was a proponent of education for all classes. He states:

The expense of the institutions for education and religious institution, is likewise, no doubt, beneficial to the whole society, and may, therefore, without injustice, be defrayed by the general contribution of the whole society.<sup>[7]</sup>

Although he concedes that a capitalist system leaves some better off than others, the means to becoming better off should be available to everyone. Confucius, as the master and the teacher, more forcefully claims, “In teaching there should be no distinction of classes.”<sup>[8]</sup>

### Confucius and Smith, Smith and Confucius

The similarities between Confucius and Adam Smith are indicative that Confucianism is indeed applicable to a modern economic framework. In this way, Confucianism can be seen less as an ancient idea and more insightful guidance that may solve some of the problems in China. The fact the two ideological frameworks of East and West so greatly coincide further legitimizes the potential for Confucianism serving as the guiding principle for China’s development agenda in the coming years. ■

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