



# BASC NEWS

Berkeley APEC Study Center  
Winter 2015/16, Volume 18

UC Berkeley

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## OVERSELLING THE TRANS PACIFIC PARTNERSHIP: THE TRADE-SECURITY NEXUS

By Vinod K. Aggarwal



*Photo Credit: Michael Bradley AFP/Getty*

For decades, first under the auspices of the General Agreement on Tariffs and Trade (GATT) and then its successor organization the World Trade Organization (WTO), countries successfully negotiated the reduction of both tariffs and non-tariff barriers every few years. But in December 2015, after 14 years of fruitless negotiations, WTO members terminated the Doha Round.

With problems in the Doha Round, countries have negotiated a flurry of bilateral FTAs. While there were only 47 FTAs in 1994, by the end of 2015, the number had increased to 262.<sup>1</sup> The result of this proliferation of these FTAs has been labeled as a “spaghetti” or “noodle bowl.” Two of the prominent mega-FTAs involve countries in the Asia Pacific—the recently concluded but yet to be ratified Trans Pacific Partnership (TPP); and the proposed Regional Comprehensive Economic Partnership (RCEP). Proponents of the TPP have argued that this agreement will strengthen the strategic role of the United States in the region, in part by countering China’s membership in the RCEP.

### The Origins of TPP and RCEP

Twelve countries in Asia and the Americas negotiated the TPP trade deal that concluded in October 2015. Alongside the United States and Canada, the accord includes three Latin American countries (Chile, Mexico, and Peru), four Southeast Asian countries (Brunei, Malaysia, Singapore, and Vietnam), and three traditional U.S. partners in the region (Australia, Japan, and New Zealand). The free trade area that would be created by TPP would encompass 800 million people and almost 40% of global GDP.<sup>2</sup>

The idea of creating a pan-Asia Pacific trade agreement, with roots back to academic writings in the 1960s, began to move forward in 2006 with enthusiastic support from the APEC Business Advisory Council. The strategy was to turn APEC from a “talk shop” into the FTAAP, endorsed by President George W. Bush. In September 2008, the Bush Administration signaled its intent to become part of the so-called P4, which subsequently evolved into the TPP, as part of its own Asian engagement strategy.<sup>3</sup> Soon thereafter, Australia, Peru,

and Vietnam also announced that they intended to participate.

In November 2009 the Obama Administration affirmed that it intended to take part in TPP negotiations. After several years of prolonged negotiations, an agreement was finally reached in October 2015. Still, while the negotiations have been concluded, TPP's ratification is hardly a foregone conclusion, particularly in the United States, an issue we will turn to following an overview of RCEP.

RCEP consists of 16 countries known as ASEAN+6. This grouping brings together the ten member states of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam), and six of its major regional economic partners (Australia, China, India, Japan, Korea, and New Zealand).

Japan first proposed a free trade area covering ASEAN+6 countries. With TPP underway, China, which initially pressed strongly for a grouping that would only include ASEAN+3, agreed to the ASEAN+6 approach. Moreover, in addition to China, ASEAN countries not involved with TPP negotiations were also keen to make progress in trade liberalization. These include Indonesia, Thailand, and the Philippines, three of the four most populous members of ASEAN.<sup>4</sup>

The idea of creating RCEP was first discussed in November 2011, and formalized a year later. In May 2013, officials established working groups on the three issues they hoped to address: trade in goods, trade in services, and cross-border investment. In contrast to TPP, which aims to become the “gold standard” for international trade and tolerates few carved out exceptions for individual countries, RCEP is considerably more accommodating and focuses on traditional trade policies, rather than the comprehensive set of domestic policies and regulations being discussed in TPP. Currently, negotiations are ongoing and eleven rounds have been completed. Although participants have set a target of the end of 2016, given the relative lack of progress, this deadline seems overly ambitious.

RCEP will create the largest free trade area in the world. While it accounts for about 30% of global GDP, less than TPP, it will have a combined population of over three billion people.<sup>6</sup>

### **Ratifying TPP: The Challenges**

Despite the conclusion of the negotiation phase of the TPP, ratification remains in doubt—particularly in the United States. A number of specific areas of the agreement have proven contentious and these disputes will continue to fester as TPP moves toward ratification.

First, with respect to intellectual property (IP) provisions, TPP mimics current U.S. law, which has led to complaints both in

the United States and abroad. Foreign TPP partners are resistant to expanding their copyright protections to the American scope, arguing that such regulations impede on their sovereignty.<sup>6</sup> With respect to pharmaceuticals, members of Congress have expressed concern that increased IP regulation will restrict access to medicine in the developing world, weakening access to inexpensive generic drugs. Biologics, a class of drugs developed to treat rheumatoid arthritis, psoriasis, Crohn's disease, and many others, have also been a source of much controversy. The pharmaceutical industry lobbied for increased protections to prevent competitors from copying and selling biosimilars without expending the same resources on clinical trials. Current U.S. law protects such drugs for 12 years, but under fire, the United States negotiated a two track system that protects data for either five or eight years.<sup>7</sup>

Second, currency manipulation issues have also created controversy for TPP. While it has no specific language around currency manipulation, there is a separate anti-manipulation declaration that does not contain any specific enforcement mechanisms.<sup>8</sup>

Third, although the TPP text notes that state-owned enterprises cannot be favored over private entities, the complex nature of ownership and structure of state-owned enterprises in Southeast Asia leaves many unanswered questions over how to enforce this clause.<sup>9</sup> For free-market proponents, the validation of foreign state-owned enterprises is against the principles the TPP supposedly espouses.<sup>10</sup>

Fourth, the TPP's Investor-State Dispute Settlement (ISDS) clause, which enables foreign companies to sue national governments in binding arbitration for regulations that may diminish profitability, has proven contentious.<sup>11</sup> This could lead to investors being compensated for governments implementing regulations designed to promote sustainability, human rights, and intellectual property.

From an aggregate economic standpoint, projecting the impact of the TPP is particularly thorny given the deal's scope and the diversity of countries involved. According to a widely cited study by Petri and Plummer in 2012, updated in 2016, swift TPP implementation will raise U.S. real income by \$131 billion by 2030 with similar large gains in Japan.<sup>12</sup> This study has been criticized in by Jeronim Capaldo et al.'s 2016 study, which attacked the underlying CGE model used in the Petri-Plummer work as being an unrealistic representation of how countries will react. Meanwhile, a 2016 World Bank Study using another CGE model found that the GDP impact for the United States and Australia will be negligible, and with few losses for non-TPP members in the region.<sup>13</sup> These widely diverging projections show the uncertainty of the TPP's economic outcome. For the U.S. ratification process this makes selling the TPP as an economic win more difficult, pressuring officials to use se-

curity rhetoric.

With growing opposition to trade liberalization, and to globalization more generally, the Obama Administration (and the Bush Administration before it) has pushed the importance of TPP as balancing China, both from an economic and security standpoint:

“[T]he TPP means that America will write the rules of the road in the 21st century. When it comes to Asia, one of the world’s fastest-growing regions, the rulebook is up for grabs. And if we don’t pass this agreement—if America doesn’t write those rules—then countries like China will. And that would only threaten American jobs and workers and undermine American leadership around the world.”<sup>14</sup>

With respect to security considerations, trade negotiations, be they on a multilateral, bilateral, or minilateral basis, have often reflected both security and economic interests. The GATT, in particular, had important security overtones given the context of the Cold War. And the bilateral FTAs concluded by the Bush Administration in the 2000s were often created with a clear political and security intent.<sup>15</sup>

What is different in this case is that the growing domestic opposition to trade liberalization has made the selling of TPP very difficult, leading to reliance on oversold strategic claims about the U.S.-China relationship and broader security concerns in the Pacific.<sup>16</sup> In May 2015, a letter from seven former defense secretaries and ten top military leaders to the U.S. House of Representatives noted: “While the economic benefits of both these agreements would be substantial, as former Secretaries of Defense and military leaders we believe there is an equally compelling strategic rationale for TPP and TTIP.”<sup>17</sup> They went on to argue, “In fact, China is already pursuing an alternative regional free trade initiative. TPP, combined with TTIP, would allow the United States and our closest allies to help shape the rules and standards for global trade.” In concluding, the letter argued:

“The stakes are clear. There are tremendous strategic benefits to TPP and TTIP, and there would be harmful strategic consequences if we fail to secure these agreements. In both Asia-Pacific and the Atlantic, our allies and partners would question our commitments, doubt our resolve, and inevitably look to other partners. America’s prestige, influence, and leadership are on the line.”

Current Secretary of Defense Ashton has also emphasized this strategic theme. As he put it:

“But TPP also makes strong strategic sense, and it is probably one of the most important parts of the rebalance, and that’s why it has won such bipartisan support. In fact, you may not

expect to hear this from a Secretary of Defense, but in terms of our rebalance in the broadest sense, passing TPP is as important to me as another aircraft carrier. It would deepen our alliances and partnerships abroad and underscore our lasting commitment to the Asia-Pacific.”<sup>18</sup>

What has been the Chinese reaction to these claims, both economic and security, about balancing against China? Many Chinese academics and commentators have been scathing in their criticism of TPP, arguing that the U.S. is pushing this accord, TPP, to contain China.<sup>19</sup> Chinese officials have been more measured in their response. For example, Foreign Ministry spokesman Lu Kang made a statement telling nations “not to politicize trade and economic issues.”<sup>20</sup> President Xi Jinping at the November 2015 APEC meeting argued that its members should “make free trade arrangements open and inclusive to the extent possible with a view to enhancing economic openness in our region and upholding the multilateral trading regime.”<sup>21</sup>

Yet with election season underway in the United States and with Democratic candidate Hillary Clinton and the leading Republican contenders opposing TPP, passage is not likely to be easy. The temptation to frame the agreement in both economic and strategic balance of power language in an effort to pass TPP may thus divert attention from the specifics of the agreement.

The rise of anti-globalization sentiment in the United States has meant that the Obama Administration (and the Bush Administration before it) have over-emphasized the security benefits of these accords. While the latter has been relatively restrained in its reaction to these claims, the arguments often strain credulity and fail to emphasize the merits of the agreement on its own. It would much better if the Obama Administration would make a realistic appraisal of the pros and cons of TPP from an economic perspective, rather than selling it as a security strategy. ■

For endnotes to article, please go to page 15.

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*This is an abridged version of the article “Mega-FTAs and the Trade-Security Nexus: The Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP)” in Asia Pacific Issues, No. 123, East-West Center, Honolulu.*

## DIRECTOR'S NOTE

Dear Colleague,

Thank you for your continued interest in the Berkeley APEC Study Center (BASC). This newsletter brings to you our most recent research on human capital development within APEC, China's new two-child policy, and ASEAN's changing role in the Asia-Pacific.

Katheryn Sehyen Lee calls attention to APEC's new agenda on human capital development. After providing a brief account of failed APEC's efforts to strengthen human resources, she argues that this new commitment recognizes the region's economic challenges in the face of an increasingly digitalized world and can effectively complement existing measures to promote economic integration. It also represents an opportunity for APEC to take leadership in a new area of development.

Yilun Cheng gives a comprehensive account of China's notorious one-child policy and its recent replacement by a more relaxed universal two-child policy. Yilun first examines the historical context of China's birth control policies up till the 1980s. Then she analyzes how since then the one-child policy has given rise to a severely skewed sex ratio and a rapidly aging labor force. Finally, Yilun argues that even though the new two-child policy will only have minimal demographic effects, it will stimulate China's weakening national economy and also produce a new generation of highly educated laborers that will assist China's structural economic adjustments.

Sumner Fields reviews ASEAN's membership model and the structural issues it creates. He contends that ASEAN's reliance on gradual consensus has served it well in attracting foreign direct investment since the 1990s. However, due to the slow growth of intra-ASEAN trade, member states have become extremely vulnerable to global economic trends. Moreover, the lack of political unity among member states has hindered effective response to security threats including China's aggressive moves in the South China Sea.

I hope this newsletter will help enhance your understanding of politics, economics, and business in the Asia-Pacific. The Berkeley APEC Study Center is grateful for support from the Institute of East Asian Studies, Center for Chinese Studies, Center for Japanese Studies, Center for Korean Studies, EU Center for Excellence and the Institute of International Studies at UC Berkeley and the University of St. Gallen for our cooperative projects. We are also deeply grateful for the sustained support of the Ron and Stacey Gutfleish Foundation.

Vinod K. Aggarwal  
Director, Berkeley APEC Study Center



## BASC PROJECTS

Trade negotiations have taken center stage in many countries this year. Mega-Free Trade Agreements (FTAs) such as the Trans-Pacific Partnership (TPP), Regional Comprehensive Economic Partnership (RCEP), and Trans-Atlantic Trade and Investment (TTIP) brought together negotiators across the Pacific and the Atlantic to agree on ambitious inter-regional free trade agreements. These international negotiations have revealed national priorities, and domestic debates ensued over these preferences.

On April 10-11, 2015, the Berkeley APEC Study Center organized a conference on “The Political Economy of the Transatlantic Trade and Investment Partnership (TTIP): Origins, Evolution, and Implications” in Berkeley. Scholars from Asia, Europe, and the U.S. gathered to examine the origins, evolution, and impact of TTIP in economic, security, and political dimensions. The conference focused on the obstacles facing negotiators as well as the consequences of a final agreement.

This conference was generously funded by the Ministry of Education and the Ministry of Foreign Affairs in Taiwan and the Taipei Economic and Cultural Office in San Francisco. Additional sponsors include the Institute of East Asian Studies, the Berkeley APEC Study Center, the EU Center for Excellence, and the Clausen Center for International Business & Policy, UC Berkeley.

BASC then held a followup conference on October 16-17, 2015 titled “Unpacking TTIP Negotiations,” in partnership with the University Libre de Bruxelles at the European Commission in Brussels, Belgium. This conference included a public policy panel with attendees from various EU agencies and member-state governments followed by a research workshop with academics and policymakers at the offices of the Swedish Permanent Representative to the European Union. These papers will run in a special issue of *Business and Politics* in 2016.

Concurrently, BASC is organizing a two-day conference on Internet governance and state vulnerability in Fall of 2016 with generous support from the Center for Long-Term Cybersecurity at the University of California, Berkeley. BASC is also developing a project on disaster preparedness and management among APEC countries. A one day conference on the topic will be held on April 29, 2016.

Our website has more information on our current projects, scholarly research articles, books, and commentary. Please visit us at [basc.berkeley.edu](http://basc.berkeley.edu). We also have talented undergraduate research assistants who bring unique perspectives on a variety of topics on our blog. You can find more of their analyses in this newsletter and on our website.

Claire Tam  
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## BASC NEWS

BASC News is published by the Berkeley Asia-Pacific Economic Cooperation Study Center (BASC)

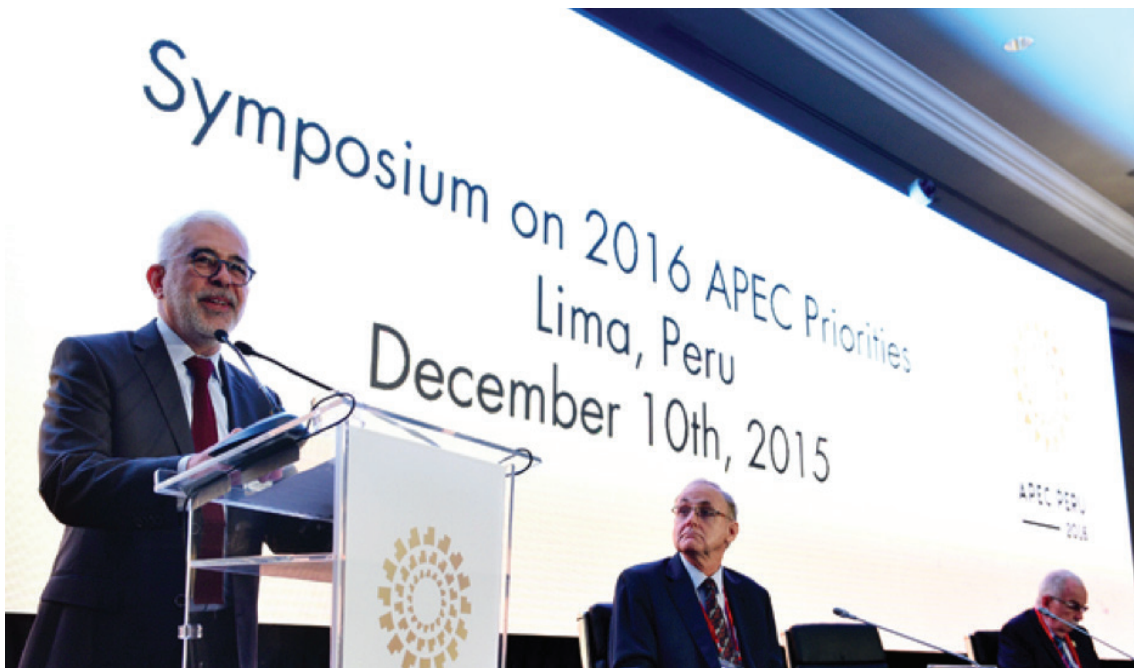
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## APEC IN 2016: THE YEAR OF HUMAN CAPITAL DEVELOPMENT



*The 2015 APEC Summit was hosted by Peru.*

*Photo Credit: APEC 2015 Twitter*

*By Katheryn Sehyen Lee, BASC Research Assistant*

In December 2015, the 2016 APEC Senior Officials meeting was held in Lima, Peru. During this high-level meeting on APEC's goals and priorities for 2016, the Peruvian Ambassador Luis Quesada announced the new theme, "Quality Growth and Human Development."<sup>1</sup> Although a common theme in many other regional and international organizations, human development is fairly new to APEC. Its mission statement includes broad economic goals such as "championing free and open trade and investment, promoting and accelerating regional economic integration, encouraging economic and technical cooperation, enhancing human security, and facilitating a favorable and sustainable business environment," but not human development such as investment in human capital or resources.<sup>2</sup> This APEC update will trace the origin of APEC's recent shift in priorities and address possible challenges and implications for the future. The announcement of a new APEC agenda that goes beyond liberalization reflects not only its need to adjust to the changing global economic landscape, but also to strengthen the economic integrity of the Asia-Pacific and reassert its influence as a leading economic institution.

According to the statement issued at the APEC Senior Officials' Meeting, the goals of APEC in 2016 include: 1) advancing regional economic integration and quality growth; 2) enhancing the regional food market; 3) working towards the modernization of micro, small and medium-size enterprises in the Asia-Pacific; and 4) developing human capital.<sup>3</sup> Specifically, APEC's active move towards promoting non-traditional

knowledge-based economies, specifically by developing human capital, is new. Even just a year ago during the November 2014 Summit in Beijing, APEC defined its priorities in much broader terms such as: "deepening regional economic integration, promoting economic reform and innovating development, and building infrastructure investment and comprehensive security."<sup>4</sup> In fact, its very first official organization-wide announcement of commitment to human development was made only recently during the 2015 Leaders Meeting held in Manila, where the new agenda of building "inclusive economy" was agreed among 21 member economies.

APEC's initial efforts on developing human resources can be traced back to 1990 when the Human Resources Development Working Group (HRDWG) was established with an aim of building the region's "human capacity."<sup>5</sup> The 1994 Declaration of the Human Development Resources Framework in Bogor, Jakarta also called on HRDWG to prepare an annual work plan for human resources development in APEC and advance "the design, development, and delivery of practical and appropriate education and training."<sup>6</sup>

However, since the establishment of HRDWG, there has been little substantive accomplishment. Most of the proposals were tabled just in the last few years and even those still remain in discussion stage including Port Moresby Joint Statement on the 2015 High Level Policy Dialogue on Human Capacity Building and the 1st High-Level Policy Dialogue on Science

and Technology in Higher Education (HLPD-STHE).<sup>7</sup> While the APEC Human Resources Development Ministerial Meeting in September 2014 did issue Action Plan for 2015-2018, its success also remains to be seen.<sup>8</sup>

Moreover, the HRDWG's position within APEC has been weak. According to the 2014 Independent Assessment of the HRDWG, "many delegates, especially those new to APEC, find the myriad of HRDWG mission, priority, goals, and objectives to be confusing" and the differentiated purposes and functions of the three HRDWG Networks - Capacity Building Network (CBN), Education Network (EDNET), and Labor and Social Protection Network (LSPN) - remain unclear.<sup>9</sup> Likewise, APEC must first address the existing bureaucratic challenges in order to establish focused plans that can guide the priorities set for 2016.

The importance of human capital in generating economic growth may be obvious. Nonetheless, the lack of tangible results on human capital investment in previous years makes APEC's commitment in 2016 even more noteworthy. Although the concrete steps toward the new commitment will not be determined until the next APEC meeting, the new approach employed by APEC still has several important implications.

Human capital development signals rapidly transforming economies of the Asia-Pacific in an increasingly globalized and digital world. As the conclusion of the Trans-Pacific Partnership (TPP) in late 2015 has also shown, a new set of issues has arisen for trade agreements including telecommunications standards, internet regulation, data privacy, cybersecurity and intellectual property.<sup>10</sup> Likewise, the technological breakthroughs have pushed economies to move towards knowledge-based investment including human capital in recent years. Moreover, human development represents a new growth driver for an APEC that is facing the "new normal." According to the 2014 IMF's World Economic Outlook database, developed and developing economies in the region have experienced economic growth that is 0.5 points and 0.2 points lower, respectively, than the previous year.<sup>11</sup> Thus, the shift in APEC's agenda reflects the rise of global knowledge economy that presents not only challenges, but also opportunities.

Second, focusing on human capital reflects APEC's continued willingness to integrate economies in the Asia-Pacific. During the 2015 Leader's Meeting, President Benigno Aquino of the Philippines stressed that APEC must promote "growth that balances the pressing needs of the present with our shared mission of leaving behind a region and a world that is better than we found it."<sup>12</sup> In previous years, closing the gaps between developed and developing economies has primarily relied on investing in service sectors, micro business, and small and medium enterprises, as well as women's participation in entrepreneurship and the labor force in APEC.<sup>13</sup> The new focus

on human capital will complement the existing measures that promote economic cooperation and integration. For instance, human development can expand the capacity of technology/knowledge absorption and diffusion, thus helping to reduce the technology gaps between developed and developing economies. Likewise, initiatives that transfer knowledge from developed to developing member economies may be revived to promote greater regional economic integration. For instance, programs similar to those of the 2012 APEC Education Ministerial meeting in South Korea—which extend APEC's education knowledge base—as well as the HRDWG-led intra-APEC student exchange could be possible foundations to build upon in 2016.<sup>14</sup> In sum, the new priority of APEC allows the organization to take advantage of new areas of cooperation to promote collaboration between member economies and balanced growth in the region.

Third, the shift in agenda may also be seen as APEC reasserting its position and influence in the region. In recent years, the organization has been losing ground, especially with the rise of other regional organizations like the Association of Southeast Asian Nations (ASEAN)'s Economic Community (AEC) also making efforts at economic integration. For instance, since 2010, ASEAN has established Labor Ministers Work Program, which acknowledged human capital development as a "primary concern and the need to prepare labor force amidst the accelerating globalization and trade liberalization."<sup>15</sup> While APEC and ASEAN's mutual interest in human capital may allow both organizations to cooperate, APEC's new agenda has a potential to advance the organization's role as a facilitator of human development across the Asia-Pacific. In contrast to ASEAN, APEC's diverse membership that consists of both developing and developed economies also gives clear advantage. For instance, the United States, a developed economy, introduced APEC Scholarship Initiative in 2015 which aims to have one million intra-APEC university-level students per year by 2020.<sup>16</sup> On the other hand, developing economies like Vietnam has hosted the 6th Human Resources Development Ministerial Meeting in 2014 to use APEC human resource development activities as a source of capacity building.<sup>17</sup> In other words, each member economy in APEC can take into account its own strengths and weaknesses to substantiate tangible results in human development. Likewise, human capital development opens up opportunities for APEC to lead a paradigm shift in the economy of the Asia-Pacific.

To conclude, APEC's new agenda in 2016 revolves around determining how to unlock and modernize human capital. In an increasingly globalized economy, the development of human capital is becoming even more important to international competitiveness and economic growth. However, human development is not only about "enhancing the acquisition of 21st Century skills" or "addressing the advanced technology requirements of 21st century jobs in the context of knowledge



based economy building;<sup>18</sup> it is also about addressing the significant impact of government investment on human capital on reducing economic gaps and promoting regional economic integration. Promoting human development for APEC, including clarifying how HRDWG can function and contribute to APEC's new goal, remains a challenge. Nonetheless, successful consolidation of human development as an APEC process will allow the organization to participate in global

markets, close economic gap between APEC economies, and achieve balanced prosperity.

Although APEC is a legally non-binding forum, its shift towards human development serves as an important guide to the next generation agenda of its member economies. ■

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## CHINA'S TWO CHILD POLICY



*Photo Credit: The Economist*

*By Yilun Cheng, BASC Research Assistant*

■ On October 29th 2015, after a four-day summit on sustainable economic development, Chinese leaders released a statement endorsing a revised family planning law that would allow all Chinese couples to have two children instead of one. While this was seen as a sudden change, it was actually the culmination of a decline in the one-child policy's enforcement over the past few years. In 2013, Chinese officials announced a relaxation in the policy that allowed married couples to have a second baby as long as one parent was an only child. Since past adjustments had not led to significant demographic changes, the government decided to repeal the policy after having dictated the reproductive choices of countless Chinese families for thirty-seven years. The new two-child policy will come into effect after the National People's Congress officially ratifies it in March 2016.

This article will first review the historical background of

China's birth control policies, focusing on the economic hardship that prompted Chinese leaders to carry out the "later, longer, fewer" campaign in 1973 and the more compulsory one-child policy enacted in 1979. Then, the article will elaborate on the unfavorable demographic trends—gender imbalance skewed toward a heavily male and a rapidly aging society—that came with the restrictive one-child policy as well as their negative economic and social consequences. Finally, the article will analyze the potential effects of a universal two-child policy. In terms of demographic impact, due to increasing cost of raising a second child in urban areas, the policy is likely to have a limited impact on the country's total fertility rate. It is unlikely that China will return to replacement level fertility anytime soon. Neither does evidence support policy-makers' assumption that a two-child policy will automatically close the gender gap and rejuvenate the population. However, in the short run, the policy will act as a fresh stimulus to the economy and in-



duce domestic consumption and infrastructure investment in baby-related industries. It will also, within a few decades, produce a new generation of highly educated laborers more fit to work in China's developing modern services sectors.

After its founding in 1949, the “New China” soon encountered a burst of innovation in agricultural technologies called the Green Revolution. The introduction of high yield crops and rising popularity of chemical fertilizers in the early 1950s significantly improved food availability and brought about accelerated population growth. The government's pro-natalist rhetoric during the Great Leap Forward (1958-1960) also caused the population to expand uncontrollably. By 1964 China's total fertility rate reached a historical high point of 6.16 births per woman, and in the following decade the population grew by 100 million every five years, almost twice as fast as it was in the early days.<sup>1</sup> The out-of-control population growth proved to be destructive to China's already collapsing economy. With the Cultural Revolution disrupting both agricultural and industrial productions, China's national output could not accommodate the rapidly increasing population. As China resorted to issuing commodity ration coupons, it became extremely difficult for ordinary people to access not only luxury goods such as bicycles, sewing machines, and radios but also the most basic of necessities.<sup>2</sup> It was in this historical context that Chinese sociologist Ma Yingchu's fear of a Malthusian Catastrophe was rekindled among party leaders, who then embarked on the country's first massive birth control campaign to restrain population growth.

During the 1970s, the government initiated the “later, longer, fewer” campaign which, contrary to the common misconception of its reliance on voluntary compliance, involved a series of coercive measures including forced abortions, IUD insertions, and sterilizations. The campaign led to a drastic decline in China's total fertility rate from 5.8 in 1950 to only 2.7 to 2.8 at the end of the 1970s.<sup>3</sup> In fact, more than 70% of China's post-1970 population decline took place before the one-child-policy.<sup>4</sup> Nevertheless, as Deng Xiaoping and other post-Mao leaders explored ways to increase the nation's GDP per capita, they began to seek more restrictive birth control policies. Influenced by Western organizations like Club of Rome and Sierra Club, Chinese scientist and bureaucrat Song Jian made use of incorrect demographic projections—which economists have since dismissed—to conclude that China's optimal population was 700 million and an immediate adoption of the one-child policy was necessary to achieve zero population growth.<sup>5,6</sup> Finally in 1979, backed by Song Jian's pseudo-scientific claims, the government enacted a policy requiring all couples, with the exception of ethnic minorities, to have no more than one child. The policy relied on a carrot-and-stick approach: while compliers received preferable job opportunities, supplementary pension in old age, and a monthly stipend of about 5% of their wages, those having supernumerary chil-

dren without permits risked losing their jobs and faced severe fines, as high as thousands of US dollars.<sup>7</sup>

The policy was not applied evenly across the country. Although strictly enforced in urban environments, the policy was soon deemed unfeasible in rural areas where people most rigorously adhered to the Confucian concept of “filial piety”. In small towns sons were considered more valuable, not only for their ability to perform physical labor and support their parents in old age, but also because they could carry on their family names to the next generation.<sup>8</sup> Consequently, starting in 1984, most rural couples were allowed two children, in some regions by law and others due to lack of implementation.<sup>9</sup> At that time more than 80% of the Chinese population were rural farmers, so this relaxation substantially undermined the effectiveness of the one child policy.<sup>10</sup> On one hand, the one-child policy has consolidated the success of the “later, longer, fewer” campaign and further reduced the totally fertility rate from 2.7 in 1980 to the current level of 1.7.<sup>11</sup> On the other hand, the Chinese government's assertion that the policy has prevented 400 million childbirths is a highly exaggerated claim.<sup>12</sup> Scholars have largely discredited this estimate since it not only ignores the fertility decline in the 1970s but is also based on unrealistic population projection.<sup>13</sup>

Today, undesirable demographic changes on account of the one-child policy have pushed the government to repeal its original policy. Of the policy's many difficult legacies, the severely skewed sex ratio is the most prominent. China was a predominantly agricultural society with the cultural tradition of son preference and a high demand for male labor on family farms. Consequently, after the government enacted the one child policy, abortion of the female fetus soon became common practice. The situation was exacerbated when ultrasound machines became available in most Chinese towns, allowing pregnant women to screen for the sex of their fetus. After the mass production of ultrasound equipment began in 1982, China's sex ratio at birth (SRB) increased substantially, peaking at 1.21 males to females in 2005, and despite having declined to 1.16 in 2015, still remains the highest in the world.<sup>14</sup> Even though China outlawed sex selective abortions in 2005, it is almost impossible to enforce the law because of the difficulty in demonstrating couples' real intention.<sup>15</sup> During the one-child era, female infanticide was also practiced on a large scale, especially in the more conservative southern provinces such as Hunan and Guangxi.<sup>16</sup> Although it is hard to accurately estimate China's infanticide rates, the fact that the number of excess males grew from 18.5 to 328.9 million in the first ten years of the one child policy suggests the extent to which female newborns were selectively murdered.<sup>17</sup> As a result, in an average Chinese village, the ratio of unmarried males to females between the ages of thirty and thirty-five is now as high as 75.0, which has led to widespread depression among young men as well as increasing social instability.<sup>18</sup>

Another negative consequence of the one-child policy is a rapidly aging population. The sudden drop of fertility rates, combined with prolonged life expectancy, has filled the country with 209 million people aged sixty and older. These individuals now constitute about nine percent of the whole population. With the baby boomers of the 1960s beginning to retire in the coming decades, it is expected that by 2050, 36.5% of the country population will be senior citizens outside of the workforce.<sup>19</sup> The aging society has given rise to the “4-2-1” phenomenon, in which both parents and four grandparents are financially dependent on one working-aged grandchild. Yet with over 200 million migrant workers looking for opportunities outside their villages and an increasing number of young urban couples living separately from their parents, 31.8% of elder people are now “empty-nesters,” receiving minimum care from their offspring.<sup>20</sup> Neither is China’s social security system prepared for this change. Even though over 70% of China’s senior citizens are already not granted sufficient pension coverage, with the explosion in the elderly population, estimates show that by 2030 pension deficits will appear and by 2050 the accumulated shortfall will add up to 90% of the country’s GDP.<sup>21</sup>

An aging workforce has undoubtedly slowed down China’s GDP growth. China’s working-age population first experienced negative growth in 2012 and by the end of last year was decreasing by 4.87 million laborers per year.<sup>22</sup> In fifteen years it is projected to contract by 0.7% annually.<sup>23</sup> Even though in the past, internal migration has compensated the lost of labor in the urban setting and fueled China’s macroeconomic growth with low-skilled laborers, as China gradually loses its comparative advantage in traditional labor-intensive industries, a decline in working population will more clearly manifest its negative effect on the economy.<sup>24</sup> Also, at the early stage of the one-child policy, China’s economy benefited from decreasing youth dependency, which allowed parents to shift their investment from child-related expenditures to financial assets. Between 1981 and 2013, China’s gross capital formation as a percentage of GDP rose steadily from 33% to 48%.<sup>25</sup> But, as the elderly continue to draw more money just to support themselves, savings and investment rates could decline at rates similarly drastic to their rise in the past few decades. This would only exacerbate China’s economic predicament.<sup>26</sup>

Despite these unwanted population trends, the concept of allowing all couples to have two children has been an extremely sensitive issue among party leaders. Although talks on further relaxation began in 2010, it was not until this past October that the government decided to repeal the original law in favor of a universal two-child policy. It predicted, however, that the new policy would only have a modest effect on the birth rate. The policy shift assumes that the country’s demographic changes since the 1980s are mainly attributable to restrictive governmental policies, but socioeconomic development would have

given rise to similar changes in the absence of the one-child policy. For example, one crucial reason behind China’s skewed sex ratio is the high level of rural-urban migration across the nation. There has been a tendency for female migrant workers to marry urban men with higher socio-economic status in order to obtain permanent residence status (*hukou*) in the cities.<sup>27</sup> Therefore it was only when combined with China’s rapid urbanization that the one-child policy caused such a severe degree of gender imbalance in the countryside.

Moreover, economic growth in China has altered the cost-benefit calculation in fertility decisions. In urban regions the cost of raising a child through age sixteen is approximately 490,000 yuan (77.165 US dollars), and more than 60% of urban parents expressed that they would not have a second child after the relaxation.<sup>28</sup> When compared with the global value, China’s fertility rate is not much lower than its expected value given the country’s economic development.<sup>29</sup> The government’s twenty-five-year-long pilot project in Yicheng County also indicates that given urban residents’ low childbearing intention, an alternative two-child option will not significantly raise the fertility rate.<sup>30</sup> The prospects for restoring fertility rate to replacement level becomes even dimmer considering the fact that, under the coercive one-child policy, over 200 million Chinese couples have been pressured into permanent sterilization and are now incapable of giving birth to more children.<sup>31</sup>

Neither can the new policy effectively cure the country of sex imbalance and aging. It is predicted that the new policy will have only a minimal effect on the aging society. Baby boomers from the 1950s and 1960s will age in the following decades and keep the country’s population relatively old.<sup>32</sup> Also, contrary to common belief, allowing couples to have a second child will not necessarily alleviate the problem of gender imbalance. Studies show that since most Chinese families find a second daughter especially undesirable, after the relaxation, not only parents who do not want daughters at all but also those who had previously decided to raise a daughter will be more likely to abort the second female fetus to avoid two daughters.<sup>33</sup> In fact, gender imbalance is not particular to China. Other patriarchal societies in Asia such as Vietnam, India, and South Korea also experienced skewed sex ratio even though they did not have any birth restrictions.<sup>34</sup> In South Korea, for instance, gender ratio went through a turbulent change from 1.07 in 1983 to 1.17 males to females in 1990 while the natural fertility rate remained steady.<sup>35</sup>

Nevertheless, in the short run the two-child policy has the potential to spur China’s weakening national economy. Combined with the rise of E-commerce, the policy shift will stimulate domestic consumptions in areas including but not limited to food, toys, children’s garments, family automobiles, and early education. The E-commerce market first experienced a boost in 2013 when the government relaxed its one-child pol-

icy, allowing parents who are both single children themselves to have a second baby.<sup>36</sup> The number of E-suppliers for baby products reached 65 billion at the end of 2013 and 200 billion in 2014.<sup>37</sup> It is expected that the latest relaxation will have a similar if not more profound impact on domestic consumption in the context of growing E-commerce. China's securities industry predicted that the two-child policy would yield huge consumption dividends of 120 to 160 billion yuan (18.7 to 25.9 billion US dollars) per year.<sup>38</sup>

The new policy also sent a positive signal to investors previously discouraged by China's stock market turbulence over the past year. The day after its announcement, most baby-related stocks opened significantly higher, some upwards of 20%.<sup>39</sup> Since then, almost 70% of these companies reported significant increase in profits.<sup>40</sup> The infant formula industry, especially, is projected to expand by 10 to 20% annually and grow into a 90 billion yuan (US \$14 billion) business by 2018.<sup>41</sup> Yashili, China's leading milk powder producer already made a new 1.1 billion (US \$171.2 million) investment plan to build new factories and secure market share in the future. Even the hotel industry has taken action to develop new room plans to accommodate parents and their two children.<sup>42</sup>

Moreover, although the number of children resulting from the two-child policy is not enough to offset China's aging trend, it will, in the long run, help create a workforce that could improve the nation's economic competitiveness. Due to growing labor costs, the model of cheap migrant workers that China has come to depend on has lost its appeal in the international context. From 2005 to 2010, the monthly wage of the migrant works increased by 14.1% from 875 yuan (US \$130) to 1690 yuan (US \$252).<sup>43</sup> As traditional labor-intensive industries in China encounter enormous difficulties due increasing labor costs, China must shift to high quality human capital as the

foundation of its new development strategy.<sup>44</sup> At present, 40% of China's total labor works in the tertiary industry, and there exists a huge labor shortage in emerging modern service sectors, including the Internet, finance, technology, and media.<sup>45</sup> In a few decades, the increase in birth rate, though moderate, will create a young and educated labor force more suited to work in these new fields, contributing approximately 0.5% to the country's economic growth rate.<sup>46</sup>

In abolishing the one-child policy, Chinese leaders make no pretense of trying to improve the country's human rights condition. Rather, they have depicted it as a calculated move to solve China's current demographic problems and, thus, combat the nation's economic slowdown. In fact, the policy is consistent with Premier Li Keqiang's plan to revive the economy through long-term adjustments. For him, the weakening of China's economy is rooted in its unhealthy demographic structure and triggered by the expansion of reckless investment. Countering the trend of aging is, therefore, a crucial part of his structural reform program.<sup>47</sup> Nevertheless, the new two-child policy is too little, too late, and observers should not be overly optimistic about its potential impact on the China's demographics. Statistics reveal that socioeconomic development has played a huge role in the past decline of China's reproduction rate and that simply relaxing its birth restrictions will not significantly boost the number of newborns or generate a younger population. Ironically, the new policy's most noticeable benefit is its short-term impact on child-related investment, which, according to the principles of "Likonomics," could easily backfire by adding more unstable factors to China's financial market.<sup>48</sup> Although the policy has the potential to produce a high-quality workforce in a few decades, it still remains uncertain whether this impact will be significant enough to counter the nation's large-scale economic slowdown. ■

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## *Business and Politics is Moving to Cambridge University Press*

In the past year, we've published a number of outstanding articles on topics as diverse as lobbying around greenhouse gas emissions, technological innovation, and class relations and continue to grow both in terms of submissions and subscriptions. In October, we were proud to publish a special issue on "Structural Power and the Study of Business" with guest editor, Pepper D. Culpepper. The release fortunately coincided with the American Political Science Association meeting in San Francisco and we were thrilled to host an event that many of the contributors to the issue, board members, and panelists across business and politics could attend.

We are excited to announce a new partnership with Cambridge University Press to begin in 2017. We are already working with their team on the transition and look forward to broadening BAP's audience and our ability to contribute to the knowledge of the field as well as a venue for scholars around the world to share their work and continue to engage in debates surrounding the interaction between business and political actors.

From our team here in Berkeley, we wish you every success in 2016.



## TROUBLE AHEAD FOR ASEAN



*ASEAN Community Signing Ceremony.*

*Photo Credit: ASEAN*

*By Sumner Fields, BASC Research Assistant*

■ With the release of a final TPP agreement and continued negotiations over RCEP, ASEAN is positioning itself as the central economic intermediary in the Asia-Pacific.<sup>1,2</sup> However, with the ongoing South China Sea dispute, China-led Asian Infrastructure Investment Bank, and US Pivot to Asia policy, Southeast Asia is also becoming a faultline in the geopolitical system as China and the US bolster their presence in the region.<sup>3,4</sup> ASEAN nations have taken advantage of their strategic location as the global gateway to China to become the second fastest growing Asian economic bloc of the 2000s.<sup>5</sup> However, the diffuse structure which has integrated Southeast Asia into the global economy is not equipped to handle growing external political tension, mounting internal strife and inequality, and planning the region's future development, calling ASEAN's long-term stability into question.

The challenges which ASEAN will face in the coming years stem from its membership makeup and the success of its economic mission. The 10-nation community together had the 7th largest nominal 2013 GDP at \$2.6 trillion and its more than 600 million people form the world's third largest market by population after China and India.<sup>6</sup> Southeast Asia has large populations of Muslims, Buddhists, Christians, and Hindus who speak languages belonging to over five different languages families. ASEAN countries range from democracies to autocracies, and include the highly developed Singapore along with developing Laos. This cultural and development diversity makes creating ASEAN-wide standards on environmental, la-

bor, and other regional concerns difficult as countries like the Philippines and Laos have diverging interests and enforcement capabilities. The political diversity makes human rights and political freedoms sensitive topics for ASEAN-wide discussions.

Founded in 1967 as an anti-communist bloc of Indonesia, Malaysia, the Philippines, Singapore, and Thailand, ASEAN's initial mission focused on security against the destabilizing influences of Indochina's decolonization.<sup>7</sup> This agenda shifted with the end of the Vietnam War, China's re-opening, and the rise of neoliberalism. ASEAN changed from a regional security organization into an economic community, signaled by the ASEAN Free Trade Agreement (AFTA) in 1992.

ASEAN as a political and economic community relies on gradual consensus rather than top-down edicts, and the overarching government body minimally interferes with member state sovereignty. This approach has served ASEAN well since the shift to economics in the 1990s. From 2002-2013, the size of the bloc's economy increased over 300%, second in growth only to China in Asia.<sup>8</sup> ASEAN average GDP per capita (in 2010 USD) doubled from US\$1,640 in 2005 to US\$ 3,149 in 2010. From 2000 to 2013, the percentage of people living below the UN poverty line of \$1.25 per day dropped from 14% to 3%.<sup>9,10</sup> In terms of importance in global trade, ASEAN's 2015 FDI exceeded that of China for the first time since 1993, making ASEAN the number one destination for

FDI in the world.<sup>11</sup> As an institution, ASEAN has been the driving force in this economic transformation through the creation of ASEAN Plus Three, ASEAN-Australia-New Zealand FTA (AANZFTA), ASEAN-China (ACFTA), ASEAN-India (AIFTA), ASEAN-Japan (AJCEP), ASEAN-Korea (AKFTA).<sup>12</sup> These FTAs and regional fora were key in making Southeast Asia an attractive alternative to China and India, especially for lower-end manufacturing, in ways that the individual nations were not given their lower infrastructure development levels. The ASEAN forum has allowed Southeast Asian countries to negotiate with large economies and earn their position at the heart of the 'noodle bowl' of cross-border integrated global manufacturing.

However, this stellar growth obscured structural issues in the ASEAN system which are becoming more prominent under political strain. ASEAN countries rely heavily on exports, which make up over half of its GDP and account for almost 10% of total world exports, making them vulnerable to global trends like the current downturn in China.<sup>13</sup> To mitigate this risk, the ASEAN Economic Community (AEC) was implemented.<sup>14</sup> The AEC allows cross-border production cycles to increase with a 40% regional value content (RVC) requirement for tariff-free products.<sup>15</sup> The AEC's purported deeper market integration strives to maintain ASEAN's competitiveness and reinforce intra-ASEAN trade connections.

However, despite being in implementation in 2015, the AEC has had limited impact on intra-ASEAN trade. With the AEC's weak enforcement powers, non-tariff barriers continue to impede regional integration.<sup>16</sup> The largest trading partners of most ASEAN members are not other members. By comparison, the largest trading partners of most EU members are other EU members and NAFTA members Mexico, Canada, and the US all appear among each other's top five trading partners.<sup>17</sup> ASEAN members' economic cooperation seems not to be about creating stronger bonds between Southeast Asian economies but rather creating a more attractive package to outside investors and MNCs looking to operate in the region. Negotiations for the TPP show how tenuous the bond between ASEAN nations remain, as the negotiations for TPP did not include most members of ASEAN, leading to complex questions of how to enforce TPP and ASEAN regulations. Although most major ASEAN members have announced lukewarm plans to join, the TPP complicates the economic ties between ASEAN members.<sup>18</sup>

Looking ahead to future competitiveness, ASEAN countries, despite being awash in FDI, still suffer from significant infrastructure shortcomings that keep ASEAN in the lower and medium ends of the manufacturing process.<sup>19</sup> Due to its lack of teeth, the AEC and other ASEAN agreements have little to say about the national spending needed for capital

improvement or creation of regional networks. Much of the push for regional infrastructure networks comes from China, leaving many countries reluctant to engage in such cooperation over concerns of national sovereignty.<sup>20</sup>

Additionally, ASEAN's mature economies like Thailand have a growing middle class and a working class that has largely left subsistence poverty.<sup>21</sup> Market competition means that MNCs and Chinese national giants are pouring into the market, especially e-commerce. While there are ASEAN-based entrants into the booming e-commerce and mobile markets, domestic companies face a steep uphill climb to reach the level of sophistication of their overseas rivals.<sup>22,23</sup> With ASEAN's openness to the outside world and its lack of political unity, the region cannot use the closed model of China to foster local market operators.<sup>24</sup> While this may mean that ASEAN consumers at the end of the day get the best product that emerges from the competition, ASEAN countries face a challenge in turning their own consumer demographic shift into domestic higher-end manufacturing opportunities and tech-related service industries.

At the same time as it fuels growth, ASEAN's status as a place of cheap labor and open markets is straining domestic tensions in many ASEAN countries. A report by the Filipino Ibon Foundation encapsulates growing discontent in the region, echoing regional civil organizations in an open letter delivered at a Malaysian ASEAN meeting, that aggressive pursuit of market liberalization and a race to the bottom has left ASEAN countries with large pockets of entrenched poverty and no redistributive welfare systems.<sup>25</sup> AEC promises closer integration economically, but says nothing about how ASEAN members should spend their money to assist low income families whose cheap labor fuels the economy. With ASEAN's weak supranational structure, ASEAN members have had little cooperation on shared concerns like refugees, economic migrants, and human trafficking, which will most likely worsen as borders become more porous with closer economic ties. Although the Socio-Cultural Community Blueprint highlights these issues, like most ASEAN agreements the proposal leaves little clarity to governance and enforcement guidelines. With increased economic integration, regional inequality is becoming more apparent, but political dialogue to address these concerns has not materialized.

On the geopolitical front, while ASEAN has been able to skillfully curry China's favor when there was declining US FDI in the 2000s, ASEAN as an institution has not been able to handle the threat and opportunity that China presents.<sup>26</sup> China claims a wide swath of the South China Sea contested by the Philippines, Vietnam, Brunei, and Malaysia. While the dispute involves ASEAN members and China, ASEAN as a whole has not been a force of mediation with China or between ASE-

AN countries. Although the issue is brought up at ASEAN summits, many member states remain silent on China's claim.<sup>27</sup> China has leveraged its economic influence in the region, noticeably using Cambodia to stop a 2012 joint communique on the South China Sea.<sup>28</sup> Ironically for a group whose original mission was regional security, ASEAN now seems unable to come up with a community-wide stance on its members' sovereignty. The Philippines's claim was recently brought before the Hague, showing that ASEAN members are looking for international mediation of some kind if they cannot find it with ASEAN.<sup>29</sup>

Well before the Hague hearing, the vacuum left by ASEAN's silence was filled by the United States, which has recently increased its military activity in the South China Sea.<sup>30</sup> The South China Sea issue shows the direst challenge of ASEAN's economic ascendancy without accompanying political integration. ASEAN, with its very politically different member states, has largely skirted the issue of how to create regional political cooperation, but Southeast Asia's increasing importance in the world means that ASEAN as an organization will be put under political strain. Currently, most countries in ASEAN are playing a game between China, the US, and Japan to attract FDI. With the current lack of unity among ASEAN states, if a conflict erupted in the South China Sea, it might spell the end for ASEAN as member states would be called upon to side with

China or the US (or remain neutral). This would interrupt the system of regional economic integration, as the US and China could force ASEAN members to re-erect barriers with unallied states. Unresolved political tension threatens ASEAN's prosperity, but ASEAN seems paralyzed on the issue.

ASEAN's current model has served it well in recovering foreign investor trust through the Asian financial crisis, early 2000s recession, and the Great Recession. But ASEAN must evolve to deal with the consequences of its success. At home, ASEAN members need to find ways to transition into the next stage of development, directing FDI and domestic policy into infrastructure development and improving human capital. ASEAN needs effective intraregional frameworks to deal with labor abuse and refugees while also putting in place systems of welfare and industrial regulation, or face future political consequences. To the world, ASEAN must either become a more politically coordinated community on issues that threaten its members, or it must devolve its economic integration to lessen the economic impact of a potential conflict in the region. Although faced with such tough decisions of identity and direction, ASEAN might provide a vital mediation point between the US and China and offer a much-needed third voice in the US and China dominated Asia-Pacific. ■

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