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EAST ASIA SPOTLIGHT

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The Middle Kingdom Returns
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EDITOR'S LETTER

I remember waking up one morning earlier in the year and reading a headline. It wasn't a particularly troubling headline, but still, my heart sank a little. In the days that followed, I learned that the situation had the potential to change the political dynamic of an entire region. It also had the potential to change the color of one of our working manuscripts. I first received a call from the editor assigned to the paper, then later an email from the writer. What should we do?

At the Journal of International Policy Solutions, our primary goal is to explore current topics in international affairs, focusing on the problems that drive news headlines and echo across the various policymaking chambers around the world. This mission is emblazoned on our website, it is listed on all of our public relations materials, and is referenced at least one time on this page each issue.

There are, of course, perils to this approach. Like many academic journals of this nature, we publish once a year, leaving ample time for elections, protests and fiscal crises to foul what would otherwise have been a perfect snapshot of a particular place and time. In many ways, our writers and editors are like exhausted and desperate photographers and the world they are trying to capture a fussy infant, never sitting still for that one elusive shot. This puts us in the contradictory position of seeking policy analyses and solutions that will ultimately lead to progress on tough issues, while simultaneously hoping that the world will remain static long enough for our writers to formulate a response.

The reality is that current affairs are never static, and our longer format will never be able to keep up with each headline. The headlines themselves may not be able to keep up. At a time in which newspapers are folding, blogs seem like an outdated medium, and a few Twitter posts can scoop a television crew, we found ourselves asking, where do we fit into this picture?

I contend that our journal, and many like it, continues to play a vital role in the unpacking of deeply complicated issues, from the international politics of energy security to the efficacy of multi-billion dollar foreign aid programs – issues that simply can not be accomplished in 140 characters or even 500 words. We pride ourselves on the fact that our contributors consistently produce relevant, actionable policy solutions that any policymaker could pick up and apply to her situation, yet we also know that situations change. The true value of this type of work rests in the way it helps us think about the problems we face; it helps us understand the history, the economics, the politics, the culture – even the psychology – beneath the headlines. This work is the hulking mass of ice beneath the small shard that peeks above the surface.

The theme of this issue is East Asia, covering a range of topics on a region that currently dominates headlines and policy discussions. As the world cranes its neck towards Asia, skimming news articles and Twitter feeds, we present this issue not as a competitor with other mediums, but as a complement. Long after elections, protests, and crises have eroded the direct pertinence of our articles, we stand behind their value as critical analyses that will retain their value over time.

As for that imperiled manuscript, we gave up chasing headlines, and sure enough, after all the hand-wringing in the media, the situation changed very little. If you hurry, you may be able to catch the paper before the world changes again. And while you're at it, JIPS also has a Twitter and Facebook page. We also have a blog, but you probably don't have time for that.

Adrián Pavía
EDITOR IN CHIEF

JAPAN AND SOUTH KOREA IN CENTRAL ASIA

From Unilateral Dipomacy to Collaboration towards Energy Security

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Edited by Diana Muratova

ABSTRACT

In recent years, Central Asia's energy resources, primarily in the form of oil and natural gas, have elevated the region's geostrategic importance among energy importing countries in Europe and East Asia. This is particularly true for natural resource-scarce Japan and South Korea, as both countries face increasing competition for energy resources from the rapidly growing economies of China and Southeast Asian states. This paper analyzes the specific diplomatic strategies adopted by Japan and South Korea to build ties with Central Asia. Japan, a pioneer of Official Development Assistance (ODA), has used foreign aid as its a primary tool to engage the region, thereby initiating opportunities for private corporations to invest in energy extraction projects in countries like Kazakhstan and Uzbekistan. South Korea, on the other hand, has focused on private investment through Korean conglomerates known as *chaebŏl*, and benefited from cultural ties to the Korean diaspora mainly in Uzbekistan. Using a comparative approach to Japanese and South Korean policies in Uzbekistan, the paper concludes that the two states' divergent strategies have the potential to merge into a potent partnership - driven by the underlying reality that separately neither country has the ability to challenge the rise of China or Russia's continued influence on Central Asian states.

INTRODUCTION

Located at the intersection of Europe, East Asia, and the Middle East, Central Asia is increasingly becoming a focal point of geopolitical interactions and a key player in the global energy sector. Central Asian nations, such as Kazakhstan, Turkmenistan, and Uzbekistan, as well as their Caspian neighbour, Azerbaijan, are rich in resources that grant them strategic importance in the global chase for energy security. While these endowments do not match those of the countries in the Organization of Petroleum Exporting Countries (OPEC), they are attracting increasing interest, especially given the recent unrest and instability in the Middle East. Central Asian petrostates may be land-locked, but by rail and pipeline, they offer an alternative route to over-crowded sea lanes from the Persian Gulf to East Asia passing through the Strait of Malacca.

Much of the geo-strategic importance of Central Asian states can be attributed to the threat to energy security caused by the exponential growth of relatively new economic giants like China. As China and Southeast Asian economies expand their might and demand more resources, the competition for energy grows ever more fierce in East Asia. In efforts to diversify energy dependence, Northeast Asian states have utilized foreign aid, as well as public and private investment, as the primary tools for diplomacy with Central Asia – all with an eye towards energy extraction. Two states that have been particularly active in the Central Asian energy arena are Japan and Korea. Japan pioneered investment in the region by pursuing Official Development Assistance (ODA) diplomacy and securing major business deals for its corporations. The Republic of Korea[1], on the other hand, was a recipient of overseas aid until the early 1990s.[2] Thus, its involvement in Central Asia has been driven by private investment rather than direct assistance.

Taking into account the growing energy competition that Japan and Korea face with their Asian neighbours and the opportunities that Central Asian states present in energy security, this paper aims to reconcile the vulnerability of the former two with the advantages of the latter. This paper will first describe the competitive environment around energy security and explain the geopolitical significance of the Central Asian arena. Next, it will examine Japan and Korea's involvement in the region, focusing on two mechanisms: aid and private investment. In efforts to shed light on the two distinct approaches towards the region, the paper presents a case study about the two states' interaction with Uzbekistan. Lastly, it offers a policy recommendation that encourages cooperation between Japan and Korea with regard to their interests in Central Asia. More specifically, it draws on mutual benefits of engaging in a joint forum similar to the Shanghai Cooperation Organisation (SCO).[3]

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THE COMPETITION FOR ENERGY

Energy resources, such as oil, natural gas, coal, and nuclear power, are essential to power economic activity. Japan and Korea are particularly energy-hungry, especially in sectors such as electricity, manufacturing, and transportation.[4] Unfortunately, the two nations are not only energy-scarce, but are also distant and difficult to reach from global energy hubs, such as the Middle East and Latin America.[5] Both Japan and Korea import over 80 percent of their total primary energy, more than 80 percent of which comes from the politically and diplomatically unstable Middle East.[6] At present, they have few alternatives to the sea lanes that transport oil and natural gas from Middle Eastern energy giants, such as Saudi Arabia, Qatar, and Iran. Two thirds of the total tonnage passing through the Strait of Malacca is crude oil, and 80 percent of Japan and Korea's oil imports are delivered this way.[7] Moreover, China is now the world's second largest oil consumer, further heightening the competition for oil imported through the strait.[8]

Northeast Asian governments recognise that energy resources are key to economic growth and, consequently, domestic stability. The geopolitical calculus of energy, therefore, plays a major role in diplomacy. With oil prices reaching "an all-time record high in 2011,"[9] and a strong public reaction against nuclear power following the 2011 meltdown of a nuclear reactor in Fukushima, Japan, governments are looking to diversify their sources, supply chains, and procurement methods to avoid an over-reliance on certain sources of energy. Japan and Korea have historically been dependent on nuclear power for energy generation, making current and future administrations particularly vulnerable to public backlash.[10] Moreover, they contribute to Asia's above-average projected growth in natural gas consumption between 2008 and 2035, implying a shift to greater reliance on this energy source.[11]

THE NEW ENERGY ARENA: CENTRAL ASIA

Although Central Asia is still relatively small compared to OPEC, it plays a key supporting role in the global energy market. Central

Asia and the Caucasus hold 2.7 percent of global oil reserves, 80 percent of which are in Kazakhstan, and 7 percent of the globe's natural gas reserves.[12] Moreover, Kazakhstan, Turkmenistan, and Uzbekistan, the three major energy-rich Central Asian countries, are mainly producing at or around their full capabilities, which makes them prime markets for investment by energy-hungry economies like Japan and Korea.

While political instability and Moscow's influence on the region's authoritarian regimes are still major causes for caution in diplomatic circles,[13] there are an increasing number of energy trades, by rail and pipeline, that take place directly with Central Asia's neighbours to the east (China) and west (Europe via the Caspian Sea and the Baku-Tbilisi-Ceyhan pipeline). The increased economic activity around energy, despite the uncertainty about their political future, illustrates the growing importance of the natural endowments that these states possess.

As energy consumption and the desire to diversify sources rises in Northeast Asia, producers in Central Asia and the Middle East are welcoming the economic boon their energy sources deliver. This "energy ellipse"[14] is currently, and will continue to be, a major variable in Japan and Korea's diplomatic and business calculations with the two regions.

JAPAN AND CENTRAL ASIA: ODA DIPLOMACY

Japan's two decades of deflation and recent natural disasters have led some analysts to declare its decline and relegation to the sidelines of pan-Asian interactions. Indeed, as Chung (2011) argues, by 2030, India, South Korea, and the combined economies of the Association of Southeast Asian Nations (ASEAN) are all likely to possess economies that are bigger, and faster growing, than "an ageing Japan mired in government debt."[15] However, Japan currently remains a top global economy and continues to play a unique diplomatic role in Central Asia and beyond.

A defining feature of Japan's domestic and foreign policy is its renunciation of war and "use of force as means of settling international disputes," as stated in Article 9 of its constitution.[16] Moreover, Japan places great value on democracy and a liberal market economy, both of which it actively promotes throughout the globe. As Chung indicated in his analysis of Japan's overseas involvement, "[t]he trump card of Japanese diplomacy is that Japan is considered non-threatening."[17] Not only is Japan not territorially contiguous to any other state, it is committed to "ensuring world peace and stability."[18]

Japan's trade and investment strategy is particularly globalised, as it stresses but does not strictly require, liberal democracy and rule of law. More importantly, Japan is heavily reliant on ODA, including technology transfers and personnel training, as part of its economic foreign policy.[19] These characteristics give the East Asian giant a unique position in the diplomatic arena when negotiating for energy contracts. Japan's Ministry of Foreign Affairs clearly states that an objective of Japan's ODA is "to contribute to the peace and development of the international community, and thereby to ***help ensure Japan's own security and prosperity***..."[emphasis added].[20] This statement indicates that Japan is fully aware of the benefits it receives as a donor, particularly from states in possession of resources essential to its security and prosperity, including oil, gas, and uranium. As such, it has considerably stepped up its donations to the geopolitical heartland of Central Asia in recent years, transitioning from its traditional concentration on large-scale infrastructure projects to aid that is "more diverse, more human in character, and more supportive of structural reform".[21]

Japan has been a major donor in Central Asia since the collapse of the Soviet Union and the largest donor since 1997.[22] Its overtures to the region began when Prime Minister Hashimoto Ryutaro announced a new campaign of 'Silk Road Diplomacy' in 1997.[23] The following decade saw an increased number of official visits to the region, in efforts to deepen ties with Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.[24] However, progress has been stymied by short-lived governments that make it difficult to pursue a long-term diplomatic agenda.[25] Since the end of the Koizumi Administration in 2006, the terms of the next six prime ministers have averaged only about one year in length.[26] Thus, in addition to increased competition with fellow East Asian nations, Japan's domestic environment, characterized by frequent changes in leadership, has hindered the implementation of much-needed reform policies and slowed progress on long-sighted energy diplomacy.

Business ties are another link between the archipelago and Central Asia. The Japanese *sōgō shōsha*, or general trading companies, are "equipped to handle multiple sides of a given transaction:" providing capital and equipment, financing a project, finding a market for goods and services, and offering intellectual services such as research and expertise.[27] Their broad base and long-term outlook has allowed them to enter developing and as-yet-unprofitable markets, such as those found in Central Asia. Along with INPEX (the International Petroleum Exploration Corporation) that is majority-owned by the Japanese government and has an 8.33 percent stake in Kazakhstan's Caspian Kashagan oil field, the *sōgō shōsha* have been active in the region from soon after the former Soviet states' independence.[28] Japan's top trading companies have each focused on different Central Asian markets: Mitsubishi Corporation, the largest *sōgō shōsha*, is mainly involved in Kazakhstan, Itochu has focused on Turkmenistan, and Mitsui Corporation's business is centred in Uzbekistan. In 1995, Mitsubishi carried out a feasibility study with Exxon and the China National Petroleum Corporation (CNPC) into a 6000-kilometre gas pipeline from Turkmenistan to Kazakhstan and China.[29] A 'Silk Road Energy Mission' was sent to Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan in 2002 with "high-power" government and industry officials "to explore possible areas of cooperation."[30] In April 2007, Foreign Minister Amari Akira toured Central Asia with 150 officials and business representatives of 29 companies who made 24 business deals, including uranium supply contracts between Kazakhstan and Itochu, Tokyo Electric Power Company (TEPCO), and Chubu Electric Power Company.[31] In October, Toshiba Corporation, Japan's largest manufacturer of nuclear reactors, sold a 10 percent share in its Westinghouse Electric Company to Kazatomprom, Kazakhstan's state-owned nuclear holding company. In exchange for access to Japan's cutting edge nuclear technology, Kazatomprom offered access to its domestic market.[32]

Despite increased business activity in Central Asia, Japan has yet to fully tap into the energy markets in the region. While there has been some success in reaching energy deals, Japan should capitalise on this momentum by investing in more business and economic activity around energy security. In order to further strengthen economic ties,

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Japan should continue to offer ODA while expanding other forms of investment, such as through INPEX, to mitigate some of the risk-aversion of its private firms. More importantly, these objectives should be achieved through cooperation with Korea, another important player in the region, in a three- or multi-party economic forum. Historical tensions with Korea and China, heightened by Japan's recent announcement to increase defence spending for the first time in a decade,[33] have proven as insurmountable obstacles to more integrated action in the past and could continue to hinder cooperation in strategic locations such as Central Asia in future. Thus, the establishment of economic dialogue will also serve as "an opportunity for historic reconciliation between Japan…and its Asian neighbours…to dissipate lingering distrust and tension, legacies of the Pacific War."[34]

KOREA IN CENTRAL ASIA: BUSINESS FIRST

Unlike Japan, Korea was a recipient of foreign aid until the early 1990s.[35] Although Korea had been providing aid, mainly in the form of loans, to Central Asia for over 20 years, it first acceded OECD's Development Assistance Committee in 2010.[36] Korea is proud to be the first Development Assistance Committee (DAC) donor to emerge from the ranks of Least Developed Countries (LDCs),[37] a model it can use to promote relations with developing states. However, Korea's ODA volume is still "modest," especially in relation to Japan's. Although it is a major donor to Azerbaijan, with 45.5 percent of region's total aid disbursement, and makes considerable contributions to Uzbekistan, it still donates a small percentage of total aid to the region.[38]

In contrast to Korean government's late start in ODA to Central Asia, the nation's companies entered the region as soon as the Soviet Union fell. For example, Shindong Enercom Inc., a large Korean conglomerate specialising in cotton trade, first entered Uzbekistan in 1991, and in 2008 founded Uz-Shindong Silicon, a joint venture to develop silicon fields in the Jizzakh region.[39] In November 2007, the first Korea-Central Asia Cooperation Forum was held in Seoul under Prime Minister Han Deok-su and Minister for Foreign Affairs and Trade Song Min-sun.[40] The forum welcomed government officials, industry representatives, and academics to establish regular annual dialogue and promote the Korean development model. Moreover, in 2008, President Lee Myung-bak announced a new pursuit of a 'Global Korea' for the "New Asia Initiative" to promote Korean construction, manufacturing, and telecom companies.[41] This initiative upgraded Kazakhstan and Uzbekistan to strategic partners of Korea and led to the signing of Memoranda of Understanding to develop Central Asian resources, build power plants, and establish internet networks in Kazakhstan.[42]

These strong business ties, like Japan's, have mainly been forged by large companies, or conglomerates, known as *chaebŏl* in Korean. Similar to Japan's *sōgō shōsha*, the *chaebŏl* have "formidable" marketing skills and can "efficiently procure and assemble the specialised components and services required to build and operate large-scale" projects such as "industrial and resource-extraction complexes."[43] These qualities predispose the *chaebŏl* to success in areas that smaller and more specialised companies would find difficult. Thus, they have been capable of entering the Central Asian market with long-sighted projects in the energy sector.

While this business model is common to both Japan and Korea, Korea has a strong bond to Central Asian states that Japan lacks: namely the large population of *kŏryŏ saram* or Soviet Koreans, residing mainly Kazakhstan and Uzbekistan.[44] These populations were deported from Eastern Siberia in 1937 by the Soviets suspicious of Japanese influence, and aggregated into all-Korean kolkhozy, or collective farms, to pursue specialized farming. Fluent in Russian, they were able to acquire training from Russian technicians and become wealthy urbanites with privileged positions in society.[45] Thus, although Korea's presence is no rival to Japan's financial and diplomatic clout in the region, it does benefit from deep cultural ties with Central Asian states, a more recent growth model, and more dynamic business connections through a joint forum.

CASE STUDY: SECURING ENERGY INTERESTS IN UZBEKISTAN

Uzbekistan is distinctive from its neighbouring Central Asian nations in that, although it is not the largest geographically, it is centrally located and the most populous.[46] Uzbekistan has also benefited from strong growth since the global economic crisis, with an 8.5 percent increase in Gross Domestic Product (GDP) in 2010,[47] and a range of natural resource endowments, namely 594 million barrels of proven oil reserves in 2012,[48] some non-ferrous metals, 2 percent of the world's total known recoverable uranium,[49] and 1.6 trillion cubic metres of proven natural gas reserves as of 2010.[50] Uzbekistan's greater gas reserves may yet prove to be even more valuable, as economies around the globe seek not only to diversify their energy sources in terms of country of extraction but also in terms of resource type.

Uzbekistan's government has not let this shift in the country's favour pass by unnoticed. There have been a number of official visits between Uzbekistan and Japan since the collapse of the Soviet Union, with the aim of strengthening economic ties between the two countries.[51] A notable example of such dialogue took place in 1998, when the chairman of Keidanren, the Japanese Business Federation, led a mission of 12 Japanese firms to Uzbekistan, Kazakhstan, and Turkey. This initially small-scale 'business diplomacy' followed investment in the region by the Japanese government through ODA.[52] More recently, in 2008, a Japan-Uzbekistan Investment Agreement (officially "for the Liberalization, Promotion and Protection of Investment") was signed in Tashkent.[53] Japan has prioritised support for legal reform in Uzbekistan and, consistent with its emphasis on liberal democracy and rule of law, has chosen to pay special attention to the "situation of human rights" in the country.[54]

Korea, on the other hand, is a major trade partner to Uzbekistan as a "cost-effective supplier of both consumer and capital goods,"[55] which accounted for 7.4 percent of Uzbekistan's imports in 2010.[56] Its major exports to Uzbekistan are machinery, such as cars and automobile parts. Uzbekistan exports much less to Korea, mainly uranium and agricultural products. Moreover, due to the country's "highly regulated trade regime", bilateral trade with Korea has actually decreased in recent years.[57] Despite these setbacks in economic relations, President Lee Myung-bak visited Uzbekistan, Kazakhstan, and Mongolia in August 2011, reinforcing bilateral bonds and leading the Korea-Uzbekistan Business Forum to sign Memoranda of Understanding in seven areas, including rare metals.[58] There was also a 2.6 billion USD deal signed between the Korean Gas Corporation (KOGAS), GS Engineering and Construction,

Joining efforts to engage Central Asia will help Japan and Korea address their long-term economic vulnerabilities to unstable sources by not only diversifying the type of energy resources their strong economies consume, but also focusing on geographical diversification away from the Middle East.

Hyundai Engineering, Samsung Engineering, and Uzbekneftgaz, Uzbekistan's state-owned oil and gas company, to construct a gas-chemical plant in the Surgil field.[59]

While there are commonalities between Japan and Korea's activities in Uzbekistan, the differences are more striking. Japan has been a major aid donor since the country's post-Soviet independence; Korea only recently stepped up its aid to Central Asian states. Japan's business activities started later and more tentatively; a wide range of Korean firms directly invest in or export their products to Uzbekistan. While Prime Minister Koizumi was the only Japanese leader to visit the country, official meetings have been more frequent and fruitful between Korea and Uzbekistan.

More importantly, Uzbekistan's case illustrates that Japan's priority for diplomatic relations with Central Asian states emphasizes political stability for medium-term security in the region, while Korea prioritizes development of resources towards its own domestic energy security. Consistent with these approaches, Japan's diplomacy and private investment in the region have been characterised by caution, risk-aversion, and lack of depth, while Korea's firms have been more enthusiastic, innovative, and decisive. However, these differing strategies in Central Asia need not be mutually exclusive. In fact, there are complementarities in the two approaches towards Uzbekistan that highlight potential gains to both Japan and Korea from diplomatic, if not economic, coordination in resource-rich Central Asian states.

CONCLUSION: POLICY RECOMMENDATIONS

The observations above emphasise the energy potential of Central Asia and the gains awaiting Japan and Korea, two countries facing increasing competition from their Asian neighbours for influence and access to the region. As two energy-poor and hungry Northeast Asian nations, there is much that Japan and Korea have in common in their geopolitical concerns and energy security goals despite an imperial history of mistrust and hostility. Both must compete with rising demand for scarce energy resources not only from China but also from other industrialising Asian economies, such as Thailand and Indonesia. Both have considerable capacity and are likely to continue their ODA programmes in accordance with their strategic interests in Central Asia. Lastly, both governments clearly state that a distinctive characteristic of their aid, be it material- or knowledge-based, is that they provide not only financial assistance but also a breadth of experience in rapid modernisation and growth. Moreover, while Korea's economy is now more dynamic, Japan still has the third largest GDP in the world. As such, despite an imperial legacy of mistrust and hostility, Japan and Korea share business market climates that will help them converge on forward-looking strategies.

However, the two countries have established their own fora for interaction with Central Asia, with Japan mainly driven by liberal rhetoric and risk-averse investments and Korea relying on its innovative and decisive private firms. More importantly, these strategies are more complementary than mutually exclusive, leaving room for the two countries to unite and coordinate their diplomatic and energy security interests. If they were to approach Central Asian states together, Japan and Korea could establish a competitive economic forum, similar to the Shanghai Cooperation Organisation (SCO), to pool from mutual strengths and tackle competition in the region with a united front. Such an alliance would maximize Japan's record of promoting political stability and market economy values and practices, without strict expectations of liberalisation and democratisation imposed by the United States, and benefit from the government's long-standing and significant aid contributions to the region. On the other hand, the alliance could leverage Korea's cultural ties, aggressive business relations, and economic growth model, to pursue deeper relations with the region.

With weaker ties between Central Asia and the growing economies in Southeast Asia and Latin America, Japan and Korea should seize the moment to take advantage of their presence in the region. The two countries have a combined history of financial aid and cultural solidarity, which is only intensified with the increased economic activity carried out by their respective private sectors. This three-pronged approach, combined with the promotion of economic liberalization and the engagement of local governments through long-term arrangements, gives Japan and Korea considerable leverage against another major player in the energy arena, China, which not only lacks the credibility of democracy-promotion, but has also focused the SCO on security cooperation rather than economic engagement.

Joining efforts to engage Central Asia will help Japan and Korea address their long-term economic vulnerabilities to unstable sources by not only diversifying the type of energy resources their strong economies consume, but also focusing on geographical diversification away from the Middle East. As Japan and Korea's common Achilles' heel of energy dependence undergoes increasing pressure in years to come, the returns to cooperation over competition rise ever higher.

NOTES

1 Hereon referred to as 'Korea.'

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10 Prior to Fukushima, 28 percent of energy in Japan, and 38 percent of energy in Korea came from nuclear power. *Asia Pacific Energy Research Center. APEC Energy Demand and Supply Outlook: 4th Edition*, Institute of Energy Economics, Japan (2009).

11 *Annual Energy Outlook 2012*. 2012. U.S. Energy Information Administration (EIA). http://www.eia.gov/forecasts/archive/aeo12/pdf/0383(2012).pdf.

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16 The Constitution of Japan. Prime Minister of Japan and His Cabinet. <http://www.kantei.go.jp/foreign/constitution_and_government_of_japan/constitution_e.html>

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35 Jin Wook Choi, “Articles: From a Recipient to a Donor State: Achievements and Challenges of Koreas ODA.” International Review of Public Administration 15, no. 3 (2011), 38.

36 The Framework Act on International Development Cooperation “lays out the principles, objectives, and coordination mechanism of Korea’s ODA.” Similar to the Japan International Cooperation Agency (JICA), the Korea International Cooperation Agency (KOICA) was established in 1991 and implements the grants determined by the Ministry of Foreign Affairs and Trade. In conjunction, the Economic Development Cooperation Fund (EDCF), which was established in 1987, implements loans determined by the Ministry of Strategy and Finance.

37 Ibid.

38 *Korea International Cooperation Agency: Annual Report 2011* (Korea International Cooperation Agency, November 2012). <http://www.koica.go.kr/upload/pr/annual/2011annual_e.pdf>

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ETHNIC DISCRIMINATION AGAINST XINJIANG'S UYGHURS

Western China and the Way Forward

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INTRODUCTION

There is a long history of conflict between the Han Chinese and the Turkish Muslim people of northwestern China, known today as Uyghurs. Since before the founding of the People's Republic of China, the Chinese Communist Party (CCP) has espoused autonomy for minority groups, and for the Uyghurs it seemed like this policy had come to fruition when the Chinese province of Xinjiang became the Xinjiang Uyghur Autonomous Region in 1955. However, very little actual autonomy has been devolved to Xinjiang's minority groups, and huge influxes of Chinese migrants since 1949 have drastically changed the demographic and economic structure of the region. Uyghurs claim they have been marginalized and often discriminated against in Xinjiang, despite official Chinese efforts to improve Uyghur living standards and economic opportunities. The government's most recent large-scale policy in the region, the Western Development Program, has focused on developing Western China, which is also supposed to benefit minorities in the region. With the official stated goal of rebalancing China's regional inequality of development and opportunities, the Western Development Program, initiated in 1999, offered Western provinces, including Xinjiang, preferential tax rates, land use rights and bank loans, resulting in a sizable influx of capital to the region, as well as investment in transportation and other infrastructure development.[1] Such policy has resulted in an even larger influx of Han Chinese to the province, with tensions culminating in an outbreak of inter-ethnic violence in 2009, leaving close to 200 dead by official records.[2] This paper seeks to determine to what extent Uyghurs are discriminated against economically in Xinjiang, and whether or not conditions have improved in recent years.

Xinjiang province is important to China because of its resources and strategic location, while separatist movements among ethnic Uyghurs threaten the notion of "One China" as an indivisible Chinese nation made up of 56 different ethnic groups. The Chinese government does all it can to avoid any ethnic friction, and "boosting national unity" and "maintaining social stability" are two of the stated political goals of the Western Development policy.[3] Beijing would like to have Uyghurs integrate with mainstream Han Chinese society and peacefully accept Chinese Communist Party rule, with economic development seen as the main factor leading to this desired outcome. Thus, China is trying to suppress Uyghur separatism and improve Uyghur living conditions at the same time.

There are several reasons that China's leadership cannot tolerate any degree of Uyghur separatism. First, as stated, Xinjiang is a region of immense strategic importance to China. It makes up about one-sixth of China's land area and has rich mineral resources, including natural gas, oil, and non-ferrous metal deposits. An estimated one-third of China's oil reserves are in Xinjiang.[4] It also shares borders with eight other countries in Central Asia, making it important for China's trade and security interests. Second, as mentioned, China's claim to Xinjiang is an important part of its "One China" policy, and if it were forced to grant greater autonomy to Xinjiang, it may then have to do the same for Tibet and maybe even other minorities. Finally, the Chinese Communist Party has shown that it is not willing to be challenged politically by any possible competitor, particularly one associated closely with an ethnic identity, be it Tibetan, Uyghur or Zhuang. For all these reasons, China has responded to Uyghur agitation with tight controls and even violent force.

Uyghur separatism has been on the rise, with activity rising in the wake of independence movements among Central Asian former Soviet Republics. There have been several hundred incidents of bombings, riots, demonstrations, and assassinations in Xinjiang since 1990. In return, Beijing has restricted religious freedoms, increased police presence and surveillance, sometimes even using blatant brutality to maintain control in Xinjiang. Since 1996, it has carried out several "Strike Hard" campaigns targeting petty crime as well as separatism, terrorism, and extremism. As part of these campaigns, several thousand Uyghurs have been detained, tried, and sentenced, often under the broad and nebulous category of political crimes. These campaigns have only served to further alienate the Uyghurs, resulting in more rounds of violence.[5] Since 9/11, the Chinese government has exploited the global war on terrorism to label Uyghur separatist elements "terrorists" and crack down on them even more harshly.[6]

Uyghur separatism is arguably China's most critical threat to internal security.[7] From China's perspective, this makes the need to improve the Uyghurs' economic situation even more urgent. It is likely that part of the rationale for the Western Development Program is to try to improve living conditions for ethnic minorities and remove economic catalysts of separatism.[8] Two recent surveys of Han Chinese and Uyghurs working in Urumqi, the capital city of Xinjiang, have very mixed findings, but they suggest that although Uyghurs in general have significantly lower incomes than Han Chinese in the province, Uyghurs are able to effectively compete with Han Chinese in some sectors. Moreover, there is little evidence of discrimination against Uyghurs in the state sector, and a small minority of upwardly mobile Uyghurs are among the top earners in Urumqi, their success coming through CCP membership, education, and business.

CHINA'S EFFORTS TO IMPROVE UYGHUR ECONOMIC CONDITIONS: A HISTORICAL PERSPECTIVE

It is well-known that China's urban-rural and upper class-lower class income gaps are wide and have only been increasing since the mid-1980s, and the very poorest areas of China are in the Western regions west of the Aihui-Tongcheng line.[9] According to a 1994 China Today report, of the 80 million Chinese then living in poverty, 80 percent lived in minority regions.[10] Although economic growth has brought many out of poverty, it has been uneven. By 2004 per capita GDP in Eastern China was 2.5 times that of Western China.[11] Somewhat ironically, Chinese policies are both perpetuating this inequality – and even discrimination – while also serving as the Uyghurs' and other minorities' best hope to escape poverty. Loosening of the hukou system – the familial registration system designed to restrict mass migration and encourage settlement stability – has given all Chinese a better chance to migrate in search of economic opportunities, but this has also allowed for the latest wave of Han migrants to Xinjiang. To be sure, the Western Development Program, and similar initiatives, have poured cash into Xinjiang and other western provinces and allowed for vast infrastructure improvements, but Han Chinese are often favored for employment on these projects. Chinese migrants can play an important, perhaps key, role in the development of Xinjiang's economy, but the Uyghurs often see them as only "reinforcing a colonial rule, monopolizing local natural resources, and accumulating wealth by exploiting minorities."[12] Scholars have documented a large and widening income gap between Uyghurs and Han Chinese, and Uyghurs generally hold the less desirable jobs in Xinjiang.[13]

Barry Sautman (1998) emphasizes the breadth and depth of China's preferential policies for minorities, saying they are arguably the world's largest case of what would be called "affirmative action" in the United States or "positive discrimination" in Britain.[14] He recognizes the CCP's "paternalistic and hierarchical approach to minority affairs" and China's desire to advance social evolution of the minorities, but he also sees many benefits to minorities, including some that allow them to maintain their traditional ways.[15] According to Sautman, preferential policies for Uyghurs in Xinjiang have fallen into three main categories: family planning, education, and employment. Uyghurs have consistently been allowed to have more children than Han families in Xinjiang. There is a large gap in educational attainment between Han Chinese and Uyghurs, but a higher proportion of minority students receive government aid, minority students enjoy significantly lower minimum scores required on university entrance exams, and in 1997, Xinjiang's governor asserted that minorities accounted for 60 percent of the enrollment in Xinjiang's colleges and universities, which is a higher proportion than their share of the population in Xinjiang.[16]

In matters of hiring and promotion, Mao Zedong originally proposed that the training of minority cadres would be the key to solving China's "nationalities problem." There are many cases of minorities holding more high-ranking state offices in minority areas than their share of the population, but they are generally underrepresented in the ranks of CCP cadres, though the percentage of minority membership in the Chinese Communist Party has been gradually increasing. Minorities enjoy less of an advantage in seeking employment in other jobs, though quotas and preferential hiring processes theoretically favor minorities seeking many government-sponsored jobs in many different sectors. Large state-owned enterprises in Xinjiang, for example, must employ at least 25 percent minority workers.[17]

On the other hand, Matthew D. Moneyhon (2003) sees almost all of Chinese minority policy as a thinly veiled set of policies for reinforcing CCP and Han domination of China and Xinjiang specifically. He argues that the Western Development Program may be little more than "the latest incarnation of Beijing's strategy to integrate and assimilate minorities into the fabric of greater China."[18] He questions the economic viability of the plan and documents the changes made to China's regional autonomy around the time the plan was rolled out that actually "recentralize decision-making powers." The program's focus on huge infrastructure projects attracts more Han migrants seeking work opportunities and may simply be a calculated pretext for further increasing the Han proportion of Xinjiang's population. Finally, Moneyhon gives examples of patronizing statements made by Han Chinese leaders that cast Western Development as a "civilizing project." He implies that the whole project is intentionally designed to co-opt minorities into assimilating with the Han Chinese culturally and politically.[19]

By 2004, per capita GDP in Eastern China was 2.5 times that of Western China.

Chinese policy towards the Uyghurs and other minorities clearly involves an intriguing mix of positive and negative aspects. This leads to the central question of this paper: to what extent have the policies resulted in, or failed to mitigate, economic discrimination against Uyghurs in Xinjiang, and does the economic situation seem to be getting better or worse?

RECENT PATTERNS OF UYGHUR EMPLOYMENT AND INCOME

Unfortunately, the Chinese government does not release statistics on income or other development indicators for the different ethnic groups in China, making it nearly impossible to determine how Uyghur incomes or economic opportunities have changed over time. However, two independent academic studies were published in 2011 that examined Uyghur and Han wages and employment patterns in Urumqi. Xiaowei Zang (2011) conducted a random household survey of 800 Uyghur and Han residents of Urumqi in 2005, and Anthony Howell and Cindy Fan (2011) conducted a survey of 399 migrants working in the service sector—both Han Chinese and Uyghurs—in Urumqi in 2008. The results of these surveys provide some insight into the level of inequality between Han Chinese and Uyghurs in Xinjiang's capital city. They also reveal some other interesting patterns.

The Uyghur and Han respondents to Zang's household survey actually look quite similar in many areas. The average age for both groups was around 50, and 85 percent of the Uyghur respondents and 90 percent of the Han respondents were married. Men made up slightly more than half of the Han respondents, while women formed a slight majority of the Uyghur respondents. Uyghur respondents were actually slightly more likely to have full time work (62 percent, compared to 57.7 percent for Han Chinese). Han Chinese had a slightly higher level of education on average, though the largest number of respondents in both groups had received a junior high school education only, followed by senior high education for Han Chinese but only primary school education for Uyghurs. However, a higher percentage of Uyghur respondents had a university education (7.2 percent of Han Chinese and 10.1 percent of Uyghurs). The low gap in education, and relatively high percentage of college-educated Uyghurs, may be a result of Urumqi's status as a center for Uyghur professionals and intellectuals.[20]

The biggest difference between Han and Uyghur respondents were in the areas of party membership and state employment. Thirty percent of Han respondents were CCP members, compared to only 13 percent for Uyghurs. Also, over three-fourths of the Han Chinese surveyed worked in the state sector, whereas less than two-thirds of the Uyghurs had state employment. Interestingly, about half of Han respondents' fathers were state workers, whereas about a third of the Uyghurs' fathers were state workers.[21] This means that today, Han Chinese in Urumqi are only 28 percent more likely to work for the state than their Uyghur counterparts, whereas their fathers were 53 percent more likely to work for the state than the Uyghurs of the previous generation.

[The] statistics suggest that Uyghurs who are educated, and who work in the state sector, are recipients of little to no pay discrimination, whereas less educated Uyghurs working in the private sector may be strongly discriminated against in terms of financial compensation.

The reported incomes of the survey respondents are the most important evidence for assessing inequality in Urumqi. The average monthly income of Han survey respondents was 1,141.7 RMB, compared to 892.9 RMB for Uyghurs (USD $176 and $138, respectively, in 2011 dollars).[22] The paragraphs below expand on these figures to partly account for this difference.

Uyghur men make only about 12 percent less than Han Chinese men in Urumqi, but there are striking wage differentials between Han Chinese and Uyghurs for some background characteristics. According to the survey result, there is no statistically significant difference between the wages of illiterate or college-educated Uyghurs compared to Han Chinese. There are, however, large differences in wages for most other educational categories, with Han Chinese senior high school graduates earning significantly more than their Uyghur counterparts. Interestingly, Han Chinese enjoy higher gains to secondary education, whereas Uyghurs receive higher gains to tertiary education. There is no significant difference in income between Han Chinese and Uyghurs who work in the state sector, although Uyghurs who work outside the state sector make almost exactly half as much as Han non-state workers. Moreover, Uyghurs who belong to the CCP actually make more money on average than Han Chinese CCP members (1,775 RMB to 1,524 RMB per month respectively, a difference of 16 percent). This is a statistically significant difference that suggests in general only Uyghur elites are allowed to join the party, and when they do, they are well compensated.[23] These statistics also suggest that Uyghurs who are educated, and who work the state sector, are the recipients of little to no pay discrimination, whereas less educated Uyghurs working in the private sector may be strongly discriminated against in terms of financial compensation.

The wage differentials within ethnic groups are also illuminating. For example, the wage differential between men and women is higher for Uyghurs than for Han Chinese, which may mean that Uyghur women are especially vulnerable to pay discrimination. Also, as suggested above, Uyghurs gain a much greater competitive advantage by being party members – and especially by working in the state sector – than Han Chinese. Uyghurs outside of the state sector on average make only about a third as much as Uyghurs who are state employees, whereas Han Chinese in other sectors on average make three-fourths as much as those who work in the state sector.

A statistical analysis performed by Zang shows that all other factors held constant, Uyghurs in Urumqi make 31 percent less than Han Chinese, and this result is statistically significant at the .01 level. However, when this same analysis is performed using only state workers, there is no significant difference between the earnings of Uyghur and Han respondents. All other factors held constant, Uyghur respondents outside the state sector make about half as much as their Han counterparts. From this study, Zang also concludes that discrimination is a more plausible cause for Han-Uyghur income differentials than ethnic variation in education levels attained.[24]

The aforementioned Howell and Fan survey of migrant service-sector workers conducted in 2008 in Urumqi had some similar findings, but also some interesting differences. It is important to note that the two surveys cannot be directly compared because Howell and Fan interviewed only migrants, and their findings apply only to the service sector rather than the economy as a whole. Additionally, they used a different sampling strategy with a lower sample size (399 migrants total, of which only 75 were Uyghurs). Howell and Fan note that Uyghurs are much less well-represented in industry in Urumqi, which is why they chose to focus on the service sector. They also emphasize the segregation between Han Chinese and Uyghur establishments in most of Urumqi.[25] The two ethnic groups have separate niches within the informal service sector as well, with Han Chinese migrants involved in a wider range of vending and service jobs, while most Uyghurs in the informal sector sell ethnic foods or "goods of higher value," such as jewelry, electronics, and counterfeit money.[26]

Among the migrants surveyed in Howell and Fan's study, Uyghurs were slightly younger than Han Chinese, more likely to be male and more likely to be married. In addition, Uyghurs were more likely to be illiterate and more likely to have migrated recently (40 percent within the past 3 years, as compared to 16 percent for Han Chinese). Around three-fourths of both groups had migrated from a rural area. About a quarter of each group found work through friends or family, and whereas 6.8 percent of the Uyghurs were government-sponsored, only 4.5 percent of the Han Chinese had government sponsorship. The Uyghur migrants also had higher educational attainments than their Han counterparts—48.2 percent of Uyghur migrants had completed high school, and 13.3 percent had a college education, compared to 34.9 percent and 5.6 percent for Han migrants. This is reflected in the fact that a fifth of the Uyghurs had migrated for education, as compared to less than a tenth of Han Chinese. Moreover, while a quarter of Han Chinese migrants worked in the informal sector, only 17.3 percent of Uyghur migrants did.[27] Over eighty percent of Han migrants came from provinces outside of Xinjiang, whereas all of the Uyghurs migrated to Urumqi from other areas in Xinjiang. Lastly, all of the leading origin provinces for Han Chinese migrants are inland and poor—Henan, Sichuan, Gansu, and Shanxi. All of these factors suggest that recent Han migration to Urumqi is most likely driven by economic opportunities and not directly orchestrated by the government. In fact, the Uyghur migrants can be seen as better off by many measures, although their fewer numbers suggest that it is often only the most upwardly mobile Uyghurs that migrate to Urumqi.

One key finding is that, among this sample of migrants, both self-employed Uyghurs and Uyghur employees earn slightly more money than their Han counterparts. Uyghurs in the service sector make slightly more money as well. Finally, Uyghur professionals make significantly more money than their Han counterparts. The largest group of Han Chinese migrants are self-employed, and most of the Han migrants work in retailing. An even higher ratio of Uyghurs are self-employed, and most Uyghurs work in services. Uyghur migrants in this sample were also almost twice as likely to work in the professional sector as Han migrants. Howell and Fan take this as evidence of "the success of minority preferential policies in nurturing some Uyghurs into the upper echelons of society."[28]

However, Uyghur employment tends to be concentrated in relatively narrow markets—almost 90 percent of Uyghur migrants in retail sold ethnic goods and 80 percent of Uyghur migrants in the service sector worked in restaurants. Even among professionals, most of the Uyghur professionals were businesspersons, which may also explain their higher earnings than Han professionals, who were more often "lawyers, doctors, or government workers."[29] Overall, Howell and Fan's results show that Uyghur migrants compete quite effectively with Han migrants in only some parts of the service sector.

POLICY ANALYSIS AND RECOMMENDATIONS

In some ways, the results of these two studies have left researchers with more questions than answers. It is clear that structural discrimination does exist in the employment market in Xinjiang, but it does not appear to be explicitly state-sponsored, which seems to provide support for the stated goal of the development program. However, while there are opportunities for Uyghurs to move up to better employment, it may only be the most upwardly mobile – politically or economically – Uyghurs that are enjoying this benefit. It is also evident that those who incorporate themselves into the state system benefit to a much greater extent than those who do not. Future research may seek to investigate the extent to which working in state institutions leads to greater cultural assimilation.

In either case, government policies will clearly play a leading role in improving opportunities for Uyghurs, whether it is just removing current barriers to equal opportunity or actually putting in place a system of positive discrimination that benefits Uyghurs. The CCP is motivated to do so. A People's Daily editorial on July 5, 2013 addressed the fourth anniversary of the Uyghur uprisings in Urumqi and talked about the future of Xinjiang. The article said that fighting terrorism would be integral to creating a more united society in Xinjiang, and the language emphasized the need to integrate different groups into a single society, stating that such "terrorist elements" were not representative of the society as a whole.[30] But it will take more than optimistic talk to see society transformed in Xinjiang. With regard to the studies, Zang's finding that state workers (Han Chinese and Uyghur) earned a significantly greater amount of compensation than other workers, and that the state was responsible for much more than half of the employment in Urumqi, suggests that the government could do more to help Uyghurs. The state sector is clearly the backbone of the economy in Xinjiang; the government should hire at least a proportion of Uyghur employees equal to their share of the broader employable population.

The biggest policy questions concern what should be done to improve Uyghur opportunities in the private sector, where the greatest amount of economic discrimination appears to take place. We need to know more about the nature of discrimination in the private sector. Are Uyghurs openly discriminated against – for example, businesses employing an overt policy of not hiring or serving Uyghurs – or is the discrimination subtler? We also need to know the extent to which the Urumqi economy, educational system, and residential areas are segregated. Perhaps the only way to break down the discrimination present in the system is to take a heavy-handed approach similar to what the United States did during the Civil Rights era: force integration even when it means substantially interfering in private business and communities. Perhaps even more integrated education would make a difference by forcing Han Chinese and Uyghurs to study together and hopefully break down ethnic prejudices. These are thorny policy issues that will not be resolved quickly or easily.

If the government can create avenues for the Uyghurs to productively participate in the regional economy, in more than just a few specific sectors, it will actually serve the interests of the national economy.

Furthermore, it is unclear whether massive government intervention in the economy of Xinjiang actually improves or limits Uyghur opportunities—would they be better or worse off under a more classic system of free enterprise? On the one hand, Uyghurs may lose the preferential government policies that they currently enjoy, and they may fail to compete in a private sector that seems to discriminate against them. The latter is probably the most likely scenario. However, it is possible that if party membership and government jobs, which currently comprise more Han Chinese than Uyghurs, weren't so central to the economy, the Uyghurs would find a way to compete effectively and even prosper.

Thus, one policy option that would clearly benefit Uyghurs, would be to open up Communist Party membership to the general Uyghur population and end political repression of minorities in Xinjiang. If Uyghurs had more access to the party, they would certainly use it to craft policies favorable to them. Even more importantly, as long as Uyghurs continue to be suspect politically, that distrust will almost certainly leak over into economic matters, no matter how many preferential policies the government implements for Uyghurs. This may actually be the one thing that would do the most to accomplish the government's goal to integrate Uyghurs into mainstream society and achieve ethnic harmony in Xinjiang in the long run. The reality, however, is that this may not be realistic given the political conditions in China today.

The Uyghur dilemma can be seen in the broader context of a national economic problem. Although China's high-investment, export-oriented economy has done it well over the last 30 years, upward pressure on wages is pushing factories inland and economists both in China and abroad advocate moving away from an investment-driven economy to one that's based more on domestic consumption. The key to further economic development for the world's second largest economy are the poor and marginalized groups in the inland provinces struggling to break in to China's growing middle class. If the government can create avenues for the Uyghurs to productively participate in the regional economy, in more than just a few specific sectors, it will actually serve the interests of the national economy.

The key may not be to increase Uyghur participation in the state sector, which suffers from soft budgets and over-capacity -- particularly in the wake of the 2009 stimulus -- but rather to unleash the entrepreneurial spirit of this population. The government can do more to increase domestic tourism, specifically agriculture-based tourism designed to bring visitors to the Xinjiang area to explore the comparative knowledge advantage of the Uyghur people, while at the same time tapping into a growing middle class of Han Chinese unfamiliar with China's western provinces. Also, the central government can "look west instead of east" for answers to Xinjiang's economic and social divide. Starting in 2011, Xinjiang hosted the China-Eurasia Expo, in an effort to revitalize the Xinjiang economy. In 2011 the Turkish-Chinese Industrial Park was founded, based on the common language and culture of the Turkish and the Turkic Uyghurs, and $680 million dollars of trade with Central Asia was reported.[31] These are steps in the right direction.

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THE CHINA-NORTH KOREA ECONOMIC RELATIONSHIP

'Lips and Teeth' or Strictly Business?

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ABSTRACT

Trade between China and North Korea has grown dramatically since the beginning of the 21st century. Due to investment risks and an overriding emphasis on political stability, this relationship has been largely limited to Chinese investment in North Korea's natural resources. However, a renewed imperative to redevelop the economies of its northeastern provinces, Jilin and Liaoning, has created incentives for the Chinese government to pursue deeper levels of economic integration between the two countries. This paper examines the potential for increased Chinese investment in North Korean Special Economic Zones (SEZs), and in particular the Rason SEZ, to support the continued development of northeastern China, while at the same time allowing the North Korean government to receive increased levels of foreign direct investment and experiment with limited reforms to its economy.

INTRODUCTION [1]

In June of 2011, heavyweights from the Chinese and North Korean governments came together to celebrate the groundbreaking of the Hwanggumpyong and Wihwa Special Economic Zones (SEZs).[2] Women in traditional Korean hanboks escorted them around, while speeches were given by both Kim Jong Il's brother-in-law, Jang Song Thaek, one of ten members on the powerful National Defense Commission, and China's Minister of Commerce, Chen Deming. They lauded the possibilities of the SEZs to increase freight transit and tourism, as well as "promot[ing] from a new angle the economic development in not only the two countries but also Northeast Asia and giv[ing] affirmative effect on the global economic development."[3] Only six months later there were unconfirmed reports that the Chinese had rejected the North Koreans' draft law on the SEZ's development because the law was not 'business-friendly," and had "problems regarding taxes, accounting, remittance of profits and stability of investment."[4] Although North Korea has subsequently released a revised draft law,[5] this episode highlights the promises and frustrations that China has faced since the early 2000s with the beginnings of earnest investment into North Korea.

Though stability on the Korean peninsula remains the overriding goal of Chinese policymakers, they have also pushed strenuously for North Korea to institute economic reforms similar to those implemented in China. Despite earlier signs from Kim Jong Un that reform might have been on the way, it is clear that these attempts have been a failure. This, more than anything, accounts for the staggering disparity in trade volume between China and South Korea, $246 billion in 2011,[6] and China and North Korea, $5.7 billion in 2011.[7] Simply put, China will not go out of its way to invest in a country that remains a severe market risk unless there are strategically significant reasons to do so. Despite the frequent professions of friendship and closeness, Chinese investment in North Korea follows a similar pattern to any number of developing countries with abundant natural resources. In addition, North Korean officials have often left state visits to China disappointed and empty-handed. This includes Kim Jong Il on the multiple visits he made prior to his death,[8] and Jang Song Thaek on a trip in August 2012.[9]

Nevertheless, opportunities for strategic investment in the North Korean economy remain, and if leveraged effectively could contribute both to China's continued growth and to a more stable relationship between North Korea and China. This paper will examine not only the main drivers of the China-North Korea economic relationship, but also what the relationship is likely to look like in the future. First, it will briefly explore the economic relationship since 2000 when trade between the two began to increase markedly. Second, it will explore the role of China's northeast provinces, particularly Jilin and Liaoning, in the economic relationship. Third, it will delve further into China's role in developing the Rason SEZ, and determine how successful it has been thus far. Fourth, the paper will conclude with an examination of China's policy options for managing the economic relationship with North Korea in the future.

THE ECONOMIC RELATIONSHIP SINCE 2000

Since the turn of the millennium, trade volumes have increased in step with the deepening political relations between the two countries. Total trade has increased from an estimated $488 million in 2000[10] to $5.7 billion in 2011 (*See* **Appendix A** *for 2000-2011 trade data*).[11] Food aid has increased similarly, though not at the same rate as market-based activity. The drivers of this growth have not been the SEZs mentioned previously, although Chinese and North Korean officials hope they will play a much larger role in the near future. Instead, it has been largely driven by natural resources. While South Korea has much of the arable land on the Korean Peninsula, the North has an abundance of natural resources, including gold, silver, copper, lead, zinc, and many others.[12] Despite serious concerns among the Chinese over North Korea's investment environment, the difference in transportation costs from importing from North Korea, as opposed to Brazil or Australia, make it worth the risk.[13] This is unlikely to change anytime soon; Goldman Sachs has estimated the potential value of North Korea's mineral reserves at 140 times the country's 2008 GDP,[14] leaving large potential for extraction if North Korea ever truly opens up.

Besides the scale of mineral deposits in North Korea, there are two other reasons that Chinese firms are tempted to invest. First, mining in China has become more difficult as the country continues to grow towards middle-income status; people are no longer willing to put up with the environmental effects of mining, not to mention the astounding loss of life that continues to plague the industry.[15] The virtual absence of these concerns in North Korea makes investment look increasingly attractive going forward. Second, North Korea's pariah status with the rest of the world gives Chinese firms a big advantage. Drew Thompson, Director for China, Taiwan and Mongolia for the Department of Defense (2011) remarks, "North Koreans are not able to access international pricing regimes; instead, they are compelled to accept the best price they can get from Chinese buyers."[16] In fact, the only successful firms in the mining industry in North Korea are Chinese – which Ferrie (2012) points out makes them a de facto monopsony.[17]

However, major problems remain with the investment environment in North Korea, which explains why exports from the North to China remain strikingly low despite huge mineral deposits. Horror stories abound about Chinese firms signing contracts to invest in a mine only to find out that another company had already signed a contract for that exact same mine.[18] Chinese firms surveyed by Haggard and Noland (2011) list major concerns with the investment environment, where bribery and corruption are rampant, fair and unbiased arbitration mechanisms are non-existent, and the fear of expropriation is extremely high.[19] One interesting point is that almost no trade with North Korea is conducted by big state-owned enterprises (SOEs); the majority is done by small and medium-sized enterprises because larger SOEs see little profit to be gained in the current environment.[20] The major obstacle is clearly the ruling regime, which retains a myopic focus on earning hard-currency to ensure support from the military and party apparatchiks. Again, as Thompson notes, "North Korean officials and companies lack a long-term perspective and see transactions only as opportunities to earn cash. Building relationships and trust is difficult is difficult in an atmosphere where rent seeking is the norm."[21]

Although a great deal less is written about China's exports to North Korea, it still accounts for a significantly higher portion of the bilateral trade relationship. In fact, exports have risen over 500 percent since 2000, climbing from $570 million in 2000 to over $3 billion in 2011. Whereas exports in the 1990s were mostly grain, charcoal and light industry products,[22] recent years have shown some diversification with electronics (including computers), machinery, and vehicles (cars, trucks and bicycles) making up a greater percentage.[23] North Korea also imports almost all of its oil from China, for which it pays a premium, another symbol of how cut off from the world market it remains.[24] On top of these, there is also a high demand for Chinese goods like clothing, small electronics, and other miscellaneous goods that North Korean traders then sell at the jangmadangs, or markets that have become prevalent since the famine period.[25] More controversially, China has not done a great deal to stem the flow of luxury goods going to North Korea, despite UN Security Council Resolution 1874, a resolution to which China had agreed following the second North Korean nuclear test.[26] The luxury goods that pass from China into North Korea are a key component of how the Kim family maintains regime support among elites.

As mentioned previously, China cut much of its aid in the wake of the fall of the Soviet Union, partly for domestic reasons (a fall in grain production) and partly due to bilateral tension (North Korea may have refused aid following Chinese recognition of South Korea.)[27] While food aid has ebbed and flowed, since 2000 it has been consistently above 100,000 tons per year (*See* **Appendix B**). China has also provided energy and fuel sources throughout the years, including coke, crude oil and diesel.[28] In addition to this overt aid, there is also an implicit balance of payments subsidy which can be observed in the burgeoning trade deficit, averaging nearly $700 million over the past ten years.[29]

NORTHEASTERN CHINA

Although China has experienced miraculous growth for the past thirty plus years, not all regions have benefitted equally. Among the initial "losers" – relative to other provinces – were the northeastern provinces. One aspect of this is the fact that SOEs, which were so critical to growth in previous times, were drastically cut during the 1990s, leaving a large pool of unemployed and disgruntled workers in the wake of such reductions.[30] Furthermore, whereas proximity to Hong Kong and Taiwan undoubtedly boosted the economies of the coastal provinces in the southeast, the northeast provinces, especially Jilin and Liaoning, have the unlucky fortune of being situated next to North Korea. However, while levels of development still lag behind those of the coastal provinces to the south, in the past decade their economies have grown significantly as China refocused its plans to redevelop the northeast.[31] This renewed focus on developing the northeastern provinces means that there remain incentives for further Chinese investment in North Korea, at least in a few specific areas, despite the difficulties referenced earlier. The primary incentive is to increase economic opportunities and conversely reduce instances of labor unrest in the northeastern provinces. This investment also has the potential to stimulate reform in North Korea itself and boost cross-border trade (while reducing refugee outflow into China),[32] and while this may not be the primary motivation for further investment, it is certainly an important secondary benefit.

Opportunities for strategic investment in the North Korean economy remain, and if leveraged effectively could contribute both to China's continued growth and to a more stable relationship between North Korea and China.

The northeast provinces are especially important with regards to North Korea because nearly all trade and investment into the border from China flows from them, particularly Jilin and Liaoning. Nearly 75 percent of legal trade between the two countries passes through Dandong in Liaoning, and the two provinces are responsible for 63 percent of legitimate investments into North Korea.[33] Outside of the obvious locational reasons, the presence of a large Korean speaking population in the Yanbian Korean Autonomous Prefecture, located in Jilin, also explains the disparity in trade numbers. It is no wonder that provincial officials have been at the forefront of promoting stronger economic ties and increased integration with the North.[34] Although it is Liaoning that dominates trade, Jilin may be the province that would benefit the most from a reformed North Korea. Unlike Liaoning, which has Dandong, a border city facing North Korea across the Yalu River, Jilin is landlocked and lacks access to a port; the belief that a port could help Jilin reimagine itself as a logistics hub, among other things, has been the major motivator behind the Changchun – Jilin – Tumen (Changjitu for short) project.

While China's first attempt at boosting the northeast region, the Tumen River Area Development Programme (TRADP), was largely a failure,[35] the more recent Changjitu project has much greater promise. The Changjitu project's primary goal is to develop Changchun and Jilin City as hubs for innovation in science and technology, which, in turn, would support the development of advanced industrial sectors in each city. One of the biggest problems with this plan is that these cities – the two largest cities in the province – are both landlocked and lack easy access to a port. This is why the third part of the Changjitu project is to develop the smaller cities in the Tumen river area, including Hunchun and Tumen City, as logistic hubs. These cities are located close to the border, and would process goods produced in Changchun and Jilin City, preparing them for shipment through North Korea's Rajin port.[36]

Already the Chinese central and provincial governments have shown a greater willingness to invest, with large investments in infrastructure, including green-lighting new expressways, airports and railway freight ports.[37] Companies that currently benefit from subsidies and other incentives related to a variety of industries will also be eligible to use them in Changjitu while also benefiting from the project's other preferential policies.[38] Ultimately, the desire to link Changchun, Jilin, Yanji, Tumen and Hunchun with North Korea's Rason SEZ, in order to establish northeast China as a "logistic hub, international cooperative base, and cutting-edge industrial base in Northeast Asia,"[39] provides a compelling reason for China to stay committed to the project despite the risks. If this plan can be realized, the northeast region as a whole, and Jilin in particular, will benefit greatly. Access to the North's harbor will cut down on transportation time and costs for moving raw materials from the northeast to southeast China, as well as cutting down on transport time and costs for shipping to Japan and South Korea.[40]

NORTH KOREA'S RASON SEZ

Chinese policymakers see greater development of North Korea's SEZs as necessary for the Changjitu project to succeed. This is particularly true of the Rason SEZ, due to its key strategic location (along the Tumen River, close to the Chinese border) as well as its use as a port. Though the North Korean government was unsuccessful in attracting investment to Rason after it was established in 1991, the previously discussed Changjitu project makes it much more important to China's development plans for the northeast. Therefore, they will likely have a higher tolerance for issues that drove off other investors in the past. The zone itself is 469 sq km, with 185 sq km suitable for industrial development;[41] access to the zone from China is currently provided by road and rail, with the road in the midst of a significant upgrade that should be completed shortly.[42] The law establishing the Rason SEZ contained several sections meant to soothe investor worries, including guarantees that property and investor rights would be protected by law, protections for intellectual property rights and assurances that illegal interference with business operations would not be tolerated, among others.[43]

These articles hit on nearly every concern that investors have complained about in the past, especially the lack of rule of law and unbiased arbitration mechanisms. However, there are red flags even within the law itself; Article 7 mentions that the government can, if there are "unavoidable reasons," expropriate or temporarily use investors' property. As Ferrie (2012) remarks, "confiscating property for unavoidable reasons and compensating absolutely for property are not components of a preferential investment opportunity."[44]

Despite these concerns, China has reportedly promised to build an airfield and power plant, along with obtaining the rights to three new piers, with total investment potentially reaching as high as $3 billion.[45] In addition, Chinese companies are already moving in with various services. Yanbian Tianyu International Trading Company has plans to construct a casino, hospital, bread factory and telecommunications building, while Tianyu Group has plans to expand the previously-established Rason Free Trade Market.[46]

Beyond the benefits that China seems likely to reap from this joint venture, there is reason to believe that the North Korean government is serious about ensuring that this project goes forward. The North Korean economy continues to struggle, and is in desperate need of foreign investment if it wishes to grow. However, opening up the entire country to foreign investment, and instituting the types of legal and regulatory changes that would likely be necessary to attract foreign investors carries a great risk to the stability of the current North Korean regime. As such North Korea now allows for the existence of entirely foreign owned businesses, but only within the borders of its SEZs.[47] By restricting this – and other reforms like exempting firms from double taxation – to SEZs, they are able to attract some foreign investment, and to experiment with some legal and regulatory changes at the margins without needing to worry about the destabilizing effect that these changes might have if instituted on a broader scale.

THE FUTURE ECONOMIC RELATIONSHIP AND POLICY OPTIONS

As detailed above, the China–North Korea economic relationship is largely market-based and represents a pragmatic approach by both countries. This highlights the greater ambivalence that China feels towards North Korea, at least in some corners of the policymaking process. While the International Department and military may maintain close contact with their North Korean counterparts, rumblings of discontent have been building for some time in places like the Ministry of Foreign Affairs, Ministry of Commerce and Chinese think tanks.[48] The former see the aid as natural based on the historic friendship between the two and also a method to maintain stability in the region.[49] The latter see it as a waste of money, especially given the continued provocations by the North Koreans over this period of time.[50] The real question is how the relationship will evolve in the near future.

The future prospects of the China-North Korea economic relationship will be partly determined by the extent to which the current North Korean regime is serious about reform.

The future prospects of the China-North Korea economic relationship will be partly determined by the extent to which the current North Korean regime is serious about reform. Events of the past several months, including the escalation of regional tensions by the North Korean government, make this prospect seem uncertain in the short run. Conversely, events such as these may make reform even more necessary in the long run should North Korea become even more reliant on trade with China due to increasingly strict sanctions by the United States and its allies. Certainly, China not only sees economic opportunities in reform, such as supporting continued growth of the northeastern economies and gaining greater access to a large supply of natural resources, but also a chance to improve the security climate on the peninsula as well. In the most optimistic scenario, a reformed North Korea is more likely to be at peace with the South and US and would require less aid and less protection in the international arena. As economic reform gradually took over, North Korean people would become richer, providing 22 million new customers on the border. Inevitably the investment climate would also improve as North Korea normalizes and the rule of law becomes more important.

However, China, and Chinese companies, will tread carefully before making significant investments in North Korea. The recent Xiyang Group dispute is a case in point for why they remain wary. Xiyang set up a joint mining venture with a North Korean company in 2007, making substantial investments, which would be guaranteed for thirty years.[51] Unfortunately, once the facility was completed, the North Koreans tore up the contract and demanded greater concessions. The Xiyang Group, unlike other Chinese companies, publicly denounced not only its North Korean partner but also the North Korean state itself, saying "Only after one year of real manipulation did we understand the nightmare of North Korea's investing environment."[52] Yet, more surprising may have been the fact that North Korea attempted to defend itself through official state media, stating that Xiyang was primarily to blame, but also making promises to "ensure the legitimate rights and interests of all investors willing to develop international investment relations on the principles of mutual respects, equality, reciprocity and law-observance."[53] This is a positive sign that North Korea is finally listening to investor's concerns and understands that successful advancement of its economy is contingent on fostering a friendly investment climate.

Even if the North engages in serious, Chinese-style reform, there remain major potential pitfalls for China. First and foremost is the issue of stability. There are plenty of opportunities that could arise for Chinese investment, but reform would also open up fissures at the top-level between various factions, such as the party and military, and the bottom-level due to information inflows. Perhaps at first the average North Korean would be grateful to have more opportunities, but development often leads to greater demands, and potentially protests – as China experienced in 1989. This is the major challenge that China must contemplate. It would be thrilled if North Korea undertook economic reform, but not at the expense of stability which remains its main priority. If the North Korean regime were to collapse, China would not only have to deal with the inevitable refugee flows into the northeastern provinces – exacerbating the economic situation – but also the prospect of a unified Korea on its border.

Second, North Korean reform would potentially also open the country up to other countries for investment, breaking the hold that China has over the North Koreans. As stated previously, China is a de facto monopsony when it comes to buying North Korean natural resources – allowing it to buy at a cheaper price. In addition, it is a de facto monopoly when it comes to shipments into North Korea, especially with regards to oil. A reformed North Korea would see its relations with the outside world improve, with the likely result that China would pay and sell at closer to market prices. Nonetheless, this may be dependent on how the nuclear issue is approached, especially with regards to the U.S., South Korea and Japan. If those three countries remain adamant about full denuclearization, reform may lose momentum and ultimately fail, leading North Korea back to dependency on China. If those three countries decide that a reformed North Korea will be less of a threat and more likely to give up their nuclear program in the future, it will introduce more competition and raise the price for Chinese investment. However, these concerns are likely to be outweighed by the improvement in the overall investment environment that would emerge.

POLICY OPTIONS

Going forward, China is faced with several choices. It could endeavor to substantially increase investment in North Korea in an attempt to increase pressure on the isolated nation to make significant reforms to its economy. Conversely, it could cut off trade and aid completely. Finally, it could maintain something like the status quo, where it continues to invest in a handful of projects with clear, concrete benefits for China. The major problem with the first option is that, as detailed previously, the economic environment is not conducive to a substantial increase in investment on a country-wide level, especially since that investment would be underwritten by the Chinese government through subsidies to private companies or investment by SOEs. There is also no guarantee that this increased Chinese investment would have much of a positive impact on the North Korean economy, especially in the likely scenario that elites control most of the profits, with little trickling down to ordinary North Korean citizens. If anything, a large inflow of investment into North Korea before North Korea reforms its economy would likely intensifying the current deficiencies rather than solve them.

China could also theoretically cut off trade and aid with North Korea, but this is also an unappealing choice because of the possible strategic ramifications. Most analysts agree that without this assistance, especially in the form of oil and food, the North Korean regime would find it difficult to sustain itself, and could possibly collapse. While that would rid China of an obvious headache, the side effects might end up being even worse. The nightmare scenario is instability in the form of large-scale migration of North Koreans into the Chinese northeast looking for work, potentially destabilizing the region. In addition, China is already in a difficult position strategically. It is surrounded by countries that are, at best, mistrustful of China and wary of its rise. While North Korea may not be much of a friend, it's still the closest relationship that China has in the region, and as stated before it is able to extract natural resources at lower than market prices. That could all change if the regime were to collapse.

Therefore, the policy option that makes the most sense for China is to strike a middle path, by investing in limited projects that have tangible benefits for Chinese economic development, while continuing its current North Korean policies with respect to traditional avenues of trade and foreign aid. The aforementioned Rason SEZ is an example of this type of narrowly-focused investment project, and the Chinese government will likely expend the requisite resources to ensure the success of this endeavor. Successful completion of the Rason SEZ would provide the northeast provinces with access to a port for trade, furthering the growth of Liaoning and especially Jilin province. Given China's desire to ensure that this region experiences similar rates of growth as already experienced by its southern coastal provinces, they have strong incentive to put up with some of the difficulties of doing business in North Korea for this reason alone. Beyond this, however, successful development of the Rason SEZ would also create an area where limited economic reforms could be introduced to a small section of the North Korean economy, without pressuring the entire economy to adopt reforms that it may not currently be ready to undertake.

This would allow the North Korean regime to introduce reforms in an isolated form, with minimal risk of contagion. Furthermore, if the project is successful, the economic benefits reaped by the North Koreans could provide significant incentive for them to adopt some of the same economic reforms from the SEZ in other parts of their economy. If it is not, China may simply return to the status quo without imperiling its security and stability interests. Thus, even if the development of the Rason SEZ itself may have a limited effect on the growth of North Korea's economy in the short run, it could be an important first step in moving North Korea along the path to broader economic reforms in the future, with minimal risk when compared to large-scale reforms. This would ultimately benefit North Korea as well as China. Moreover, there are other areas where this strategy may also be successful. The two SEZs mentioned in the beginning of this paper, the Hwanggumpyong and Wihwa SEZs, which sit across the border from Dandong, could be the next area in which China tests this strategy. While these two SEZs were created several years ago, they have mostly sat dormant and undeveloped. However, although nowhere near the level of development taking place in the Rason SEZ, since late 2012 it appears that they have also seen new construction and infrastructure improvements.[54] This suggests that North Korea is finally getting serious about developing these areas as well, and if this is the case, represents another opportunity for China to strategically invest and encourage limited economic reforms in North Korea. By pursuing this strategy, China can continue to encourage economic reform to the extent that it will reduce tension in the region and provide more lucrative investment opportunities, but not at the expense of stability. Focused investment in projects, like the Rason SEZ, appears to represent the best opportunity to accomplish these goals and to increase prosperity and security throughout the region.

The policy option that makes the most sense for China is to strike a middle path, by investing in limited projects that have tangible benefits for Chinese economic development, while continuing its current North Korean policies with respect to traditional avenues of trade and foreign aid.

NOTES

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17Alan Ferrie, "Strategy for the Successful Development of the North Korean Minerals Sector," 6. However, Aden (2011) also discusses two other reasons that this discount might exist. In the specific case of iron ore, North Korea exports ore with lower iron content per ton meaning that it would be cheaper regardless. In addition, the reduced transportation costs mentioned before also reduce the price lower than it would be on the world market. See Nathaniel Aden, "North Korean Trade with China as Reported in Chinese Customs Statistics: 1995-2009 Energy and Minerals Trends and Implications," *The Korean Journal of Defense Analysis* 23, no. 2 (June 2011), 249.

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33 Thompson, "Silent Partners: Chinese Joint Ventures in North Korea.", 26 and 53.

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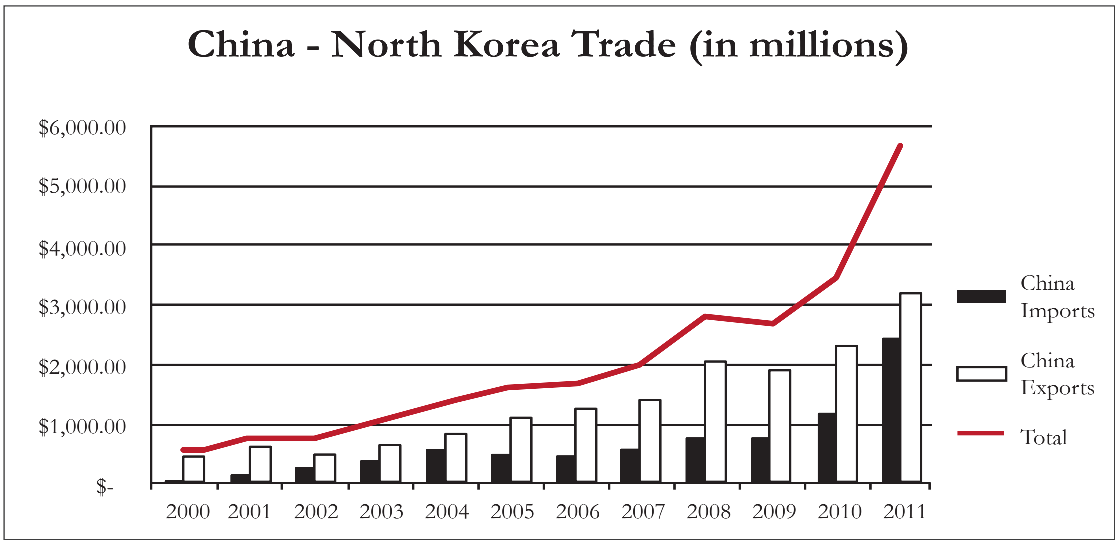
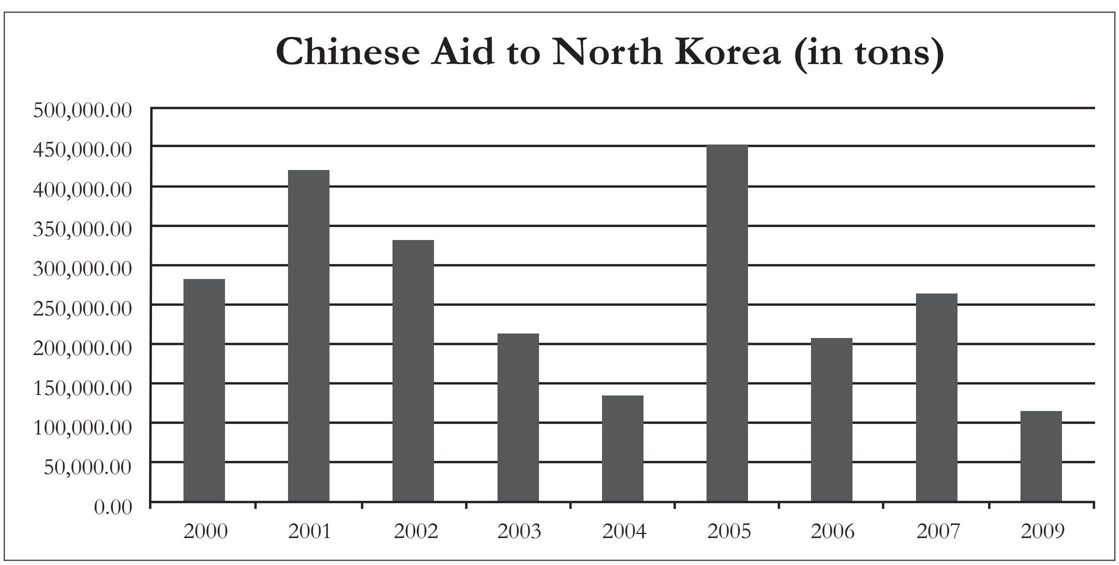
APPENDIX

APPENDIX A: China-North Korea Trade Data, 2000-2011



Sources: Years 2000-2009: Dick K. Nanto, Mark E. Manyin, and Kerry Dumbaugh, “China-North Korea Relations,” *Congressional Research Service* (22 January 2010); Year 2010: “Inter-Korean Trade Falls to Half of North-China Trade in 2010,” *Yonhap* (23 March 2011); Year 2011: “N. Korea-China Trade Jumps 62 Pct in 2011: Data.” *Yonhap* (31 January 2012).

APPENDIX B: Chinese Aid to North Korea, 2000-2009



Source: World Food Program’s International Food Aid Information System (INTERFAIS) database.

Featured Faculty Contributor

CHINA'S LATEST TRADE FIGURES

Blip or a Crisis Announced?

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The unexpected drop in the Chinese trade statistics for June released on July 10th caused widespread surprise. Not only did the total volume of trade fall for the first time (year-on-year) since the global financial crisis of 2009, but the decline encompassed both imports and exports, all of China's leading trading partners and its most intensely traded commodities.

Immediate explanations for the decline focused on two leading culprits: that trade is a leading indicator of Chinese GDP, which may be entering a slow-down; or that the weak figures reflect a crack-down by the authorities on the practice of false invoicing by exporters in order to evade controls on capital inflows.

But perhaps the most likely single factor is the simultaneous emergence of a serious shortage of liquidity in the Chinese banking system. Drawing on the experience of the global financial crisis, which also saw a freeze in bank lending twinned with a dramatic collapse in global trade flows, new research has been exploring the special dependence of international trade on the financial sector (Manova and Chor 2012, Paravisini et al. 2011, Baranga 2013), and finds that a country's trade tends to disproportionately respond to disruptions in the access to credit, above and beyond the response of the domestic economy.

The current Chinese episode, while (so far) much milder in scale than the problems that beset the US, Europe and Japan from the middle of 2008, appears to be following a similar pattern, and given the widely reported difficulties facing Chinese banks, a period of weakened trade should not be unexpected.

According to the official statistics from the China Customs Information Center (CCIC), Chinese exports in June 2013 were 3.3 percent lower than June 2012, Chinese imports were 0.9 percent lower, and total trade declined by 2.2 percent. Behind the headline figures, the decline appeared to be systematic across most trade partners and commodities: exports to China's three largest markets, the US, EU and Japan all contracted (by 5.4 percent, 8.2 percent and 5.1 percent year-on-year respectively); Chinese imports from Japan also fell sharply (by 16.3 percent), while imports from the EU rose by 0.8 percent and from the US by 14.7 percent; but since China continues to run a significant trade surplus, total trade with each of its three largest partners declined year-on-year overall (by 0.4 percent, 5 percent, and 11.2 percent respectively).

This pattern of general contraction also appears among disaggregated commodities: of the 33 commodities reported by CCIC, the three largest export sectors by value (Mechanical and Electrical Products, Hi-tech Products, and Automatic Data Processing Machines and Units) all contracted their exports (by 4.9 percent, 3.1 percent and 17.7 percent year-on-year, respectively). On the import side, the three largest commodities are Mechanical and Electrical Products, Hi-tech Products, and Crude Petroleum Oil, which shrank 1.3 percent, rose 0.24 percent and shrank 7.6 percent year-on-year; and of the 33 reported commodities, 21 saw imports fall and 21 saw exports fall (not all in the same 21 sectors).

The absolute trade decline is particularly surprising in the context of China's robust recent economic growth. Over the previous two and a half years, trade volumes had been growing by an average 0.68 percent per month. **Figure 1** compares the actual trade flows to a simple forecast, constructed from the monthly growth rate of 0.68 percent, adjusted for seasonal monthly fluctuations (the most significant of which are the increase in trade in December, followed by a sharp decline in February, driven by the timing of the Chinese New Year). The figures for June 2013 stand out as the sharpest deviation (in either direction) from the baseline forecast in the whole sample.

Coincident with the unusual weakening of trade, China's banking system has been undergoing an episode of stress unprecedented in the past seven years. On June 20th 2013, the overnight Shanghai Interbank Offer Rate (SHIBOR), the benchmark rate at which banks in Shanghai make unsecured overnight loans to one another (as measured by the National Interbank Funding Center) peaked at 13.4 percent. Increases in unsecured interbank interest rates are frequently interpreted as indicators of a lack of confidence in the local financial system, as creditors hoard cash and demand prohibitive interest rates even for overnight loans, reflecting a fear of counterparty default.

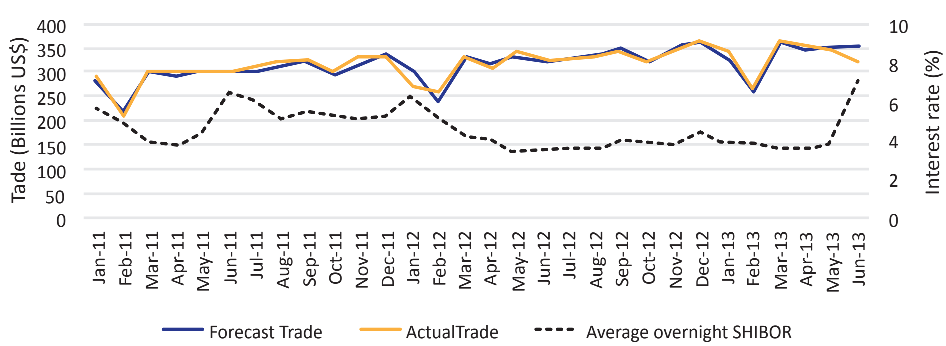
The June 2013 spike was 50 percent higher than the previous peak in October 2007 of 8.5 percent, and towers over the rates prevailing during the global financial crisis from 2008 Q3 through 2009, when the People's Bank of China (PBOC) ensured the Chinese banking system had ample liquidity and access to funding at record low rates.

However, as reported by the Economist on June 22nd ("The Shibor Shock"), rather than supply extra liquidity as SHIBOR started to climb, the PBOC engaged in open market operations on June 18th, selling some of its stock of bonds to drain cash out of the banking system. This exacerbated Chinese banks' liquidity crunch, reflecting the authorities' tough new stance towards banks that have overextended their credit.

The average overnight SHIBOR rate prevailing during each month is illustrated on the right-hand axis of Figure 1. The average rate understates how dramatically the overnight rate spiked in late June, but nevertheless one can see how the increase in rates in Jan 2012 and June 2013 both coincided with unexpectedly low trade volumes.

The negative correlation between the real cost of capital and trade flows has been documented repeatedly, both in terms of long-run trends (the steady growth of trade as a share of GDP during the long period of increased globalization from the 1980s to the end of the 2000s coincided with a secular decline in real interest rates around the world, one feature of the Great Moderation); and during dramatic short-run deviations from trend, of which the 2008-09 crisis is only the most vivid example.

Figure 1: Chinese Trade and SHIBOR, Jan 2011 - Jun 2013



A leading explanation for trade's excess sensitivity to the state of capital markets stems from one of international trade's most distinctive features – it takes longer to deliver goods to foreign customers than to local markets. This extra delivery time locks up more working capital to finance an international transaction than for a local deal, and so when the cost of working capital rises, international transactions become disproportionately more expensive than local sales, which can be settled relatively swiftly.

While in principle these additional financing costs could fall on either importer or exporter, depending on the structure of the contract (if the importer pays up front, they face the costs, while an exporter who is only paid on delivery would bear the incidence), recent research on how these costs are shared (Schmidt-Eisenlohr (2012), Antras and Foley (2013), Baranga (2013)) suggests that they tend to be spread over both parties. This is consistent with a financial shock like the SHIBOR spike impacting both China's import and export sectors.

Conventional trade models predict that trade responds proportionately to GDP, which embodies both "push" and "pull" supply and demand forces. So one natural response to the weak Chinese trade data was to interpret them as a leading indicator of the long-anticipated slowdown in China's breakneck GDP growth. China bears were to be disappointed however, as the Q2 GDP figure released on July 15th showed GDP hitting the 7.5 percent growth target, a mere 0.2 percent down on the 7.7 percent growth achieved in Q1.

Given skepticism about the quality of Chinese statistics, it is tempting to conclude that these numbers are inconsistent and hence unreliable. However the theory of trade finance suggests that increases in the cost of credit could generate exactly this pattern, in which trade responds much more quickly and negatively than GDP to a credit crunch. It is quite possible for trade volumes to fall even while GDP growth remains robust.

The second hypothesis for the trade slowdown, that it reflects the elimination of previously inflated trade figures following a crackdown on capital control evasion, also seems inadequate. Artificially inflated export invoices allow firms to move capital held overseas behind China's capital controls, since the Renminbi is convertible on current account and so can be exchanged for foreign currency to finance trade transactions. Since this kind of transfer pricing is illegal, and requires a high degree of trust between participants, it is easier to do within the firm than at arms-length, and much of the suspect activity is believed to take place between Chinese firms on the mainland and their affiliates in Hong Kong (Wall Street Journal, Apr 2013).

A crack-down on this kind of capital control evasion would be expected to disproportionately hurt reported trade with Hong Kong, but not legitimate arms-length trade with other trading partners. While the June 2013 trade figures do show a decline in trade with Hong Kong that is larger than for China's average trade partner (7 percent for exports and 7.8 percent for total trade, year-on-year), this explains only a small fraction of the recent trade decline, which extends to China's largest overseas trading partners.

There are several lessons from and for the recent Chinese experience: firstly, it confirms that abrupt changes in financial conditions can be transmitted very rapidly to the traded goods sector, which is much more sensitive to the cost of capital than firms operating exclusively in the domestic economy; secondly, the experience of the 2008-09 crisis is that as credit begins to flow again, international trade can recover strongly, and more rapidly than GDP. There is no reason to expect China's trade to suffer lasting damage as a result of a temporary liquidity squeeze. On the other hand, a sustained tightening of monetary policy could be expected to have a dramatic effect on Chinese trade. Since both importers and exporters tend to suffer when the cost of capital rises, this may not contribute greatly to Chinese policymakers' goal to reduce China's trade surplus.

As of the time of writing, the PBOC had reversed its policy, reportedly injecting $8.2 billion of cash into financial markets through open market operations, its first increase in liquidity since February, and this had the desired effect of bringing the overnight SHIBOR back down to under 3.5 percent by early July. If Chinese banks' financial difficulties are transitory, then we should expect Chinese trade to rebound strongly. But the PBOC may increasingly face a tension between its desire to restrict liquidity to prevent credit bubbles and inflationary pressure from emerging, and the strong vested interests in China's traded goods sectors, which are particularly dependent on reliable access to finance for trade credit.

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OUR WORLD

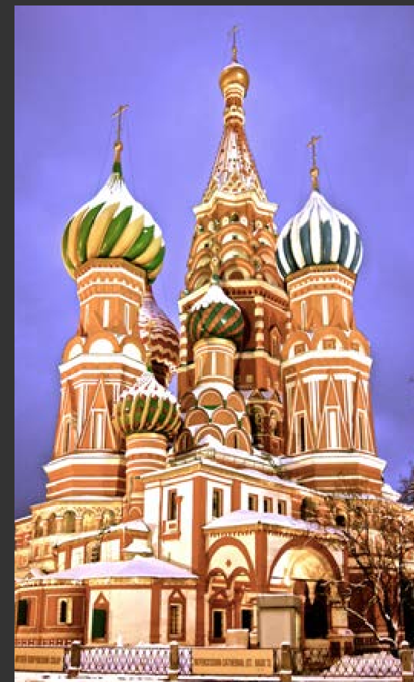
A Photo Essay

As we focus on big problems at the highest levels of power, it is equally important to remember the people on the ground, around the world, who live these issues. We asked a handful of current and former IR/PS students to share their impressions of these quiet moments.

Michael Biediger
Russell Edwards
Philipe Moura
Diana Muratova

University of California, San Diego, IR/PS

Diana Muratova,
Harvesting rice in synchrony,
Siem Reap, Cambodia.



Philipe Moura,
Saint Basil's Cathedral, Moscow, Russia

Diana Muratova,
The Intersection, Naga City, Philippines.

Russell Edwards,
Resting, Cambodia.

Russell Edwards,
Buddhist Monk, Thailand.

Michael Biediger,
Passing Time, Suzhou, China

SHIFTING THE SPOTLIGHT

Combating Sexual Exploitation in Japan through Demand-Focused Legislation

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Edited by Kevin Stahler

ABSTRACT

Over the last two decades in Japan, the demand for commercial sex has led to the sexual exploitation of women and children in new and increased forms; two such examples include compensated dating between underage Japanese girls and adult men (referred to as *enjo kōsai*) and the sex trafficking of women and children into Japan. Lawmakers have traditionally tried to address these issues with ineffective legislation that solely focuses on supply. This work proposes to build upon the relative successes of the Law for Punishing Acts Related to Child Prostitution and Child Pornography and for Protecting Children (CPCPL) – legislation that effectively took the fight to the purchasers of illicit sexual service – by ultimately applying a demand-focused framework to future legislation addressing sex trafficking in Japan.

INTRODUCTION

Throughout the world, an estimated 27 million people are victims of human trafficking.[1] Approximately 80 percent of these victims are trafficked for the purpose of sexual exploitation, and 98 percent of these sexually exploited victims are women and girls.[2] Despite these staggering numbers and global efforts to address sex trafficking, discourse and legislation is often exclusively focused on the victims and their handlers. Those who purchase sex from trafficked victims remain largely overlooked or legally exempt, even as this demand for sexually exploited women and children continues to drive the fastest growing criminal enterprise in the world.

In Japan, the demand for commercial sex has led to new and increased forms of sexual exploitation of women and children. However, even with decades of supply-focused policy and discourse attempting to curb the behavior of sex market victims, Japan unexpectedly passed legislation in 1999 to address demand when sexual exploitation involved children. By focusing on demand, the Law for Punishing Acts Related to Child Prostitution and Child Pornography and for Protecting Children (CPCPL) resulted in a significant shift in discourse surrounding sexually exploited minors. Girls caught up in the sex market were now viewed as victims rather than perpetrators. The CPCPL effectively shifted the spotlight to focus on the men demanding their services.

In contrast, legislation and discourse surrounding sex trafficking in Japan continues to ignore the demand side of the sex industry, further fueling the sexual exploitation of trafficked adult victims. As evidenced by the relative success of the CPCPL at shifting societal discourse and deterring demand for sex with minors, combating sex trafficking in Japan requires thorough demand-focused legislation.

This paper begins with the case of *enjo kōsai*, otherwise known as "compensated dating," and its role in the creation of the CPCPL. *Enjo kōsai*, involving dates between underage girls and adult men that at times involves sex, became a social epidemic in late 20th century Japan. Initially, discourse surrounding *enjo kōsai* focused solely on the actions of adolescent girl participants and their perceived contribution to Japan's societal downfall. However, to combat *enjo kōsai* and other issues related to the sexual exploitation of minors, the CPCPL set an unusual and important precedent by punishing demand rather than supply, effectively shifting the focus from Japanese adolescent girls to the men purchasing their services. While the CPCPL requires several modifications to more comprehensively address the sexual exploitation of minors through *enjo kōsai* and related issues such as child pornography, it was largely successful in shifting societal focus to the buyers of children and away from the children themselves.

Next, this paper takes lessons learned from the CPCPL and applies them as a framework for tackling the exploitation of trafficked victims within the Japanese sex industry. Japan is a primary destination country for sex trafficking, but does not actively prosecute the purchase of sexual services from human trafficking victims, leaving hundreds of thousands of women and girls vulnerable to sexual exploitation.[3] These victims require legislation that addresses the driver of the market and their enslavement: the demand for their services. Ultimately, this paper proposes clear next steps for Japanese policy makers to implement in order to better combat sex trafficking in Japan, primarily by updating the Prostitution Prevention Law (PPL) and endowing it with demand-focused legislation modeled after the CPCPL.

SETTING THE STAGE FOR THE *ENJO KŌSAI* EPIDEMIC

Japan's Prostitution Prevention Law (PPL) of 1956 criminalized prostitution, yet today Japan maintains the world's largest sex market dealing in Asian women. It is estimated that Japan's massive sex industry accounts for 1-3 percent of its GDP, which equates to the same percent of its GDP devoted to national defense.[4]

While in theory the PPL banned prostitution, its many loopholes and sole focus on the supply side of the sex market actually provided an operational framework within which the sex industry flourished. Under the PPL, prostitution only involves vaginal intercourse, and is defined as "sexual intercourse with an unspecified other party for compensation or for a promise of compensation."[5] In other words, the law does not ban sex with a "specified person," or someone who has become an acquaintance. This semantic vagueness makes legal enforcement problematic. Punishable offenses under the law include operating prostitution facilities, soliciting clients for purposes of prostitution, procuring a person for prostitution, coercing a person into prostitution and receiving compensation from the prostitution of others.[6] The PPL does not prohibit the actual sale of sex or other sexual services, and does not prosecute those purchasing sexual services.[7]

The enactment of the PPL resulted in the closure of many brothels in the 1950s, but also led to the creation of numerous new entertainment industry establishments including "soaplands" (bathhouses with individual rooms), strip bars, sex show theaters, hostess clubs, love hotels, and massage parlors with individual rooms where prostitution still effectively operates behind closed, unregulated doors.[8] By the late 20th century, prostitution and other sexual services remained a large part of the booming sex industry within Japan. The yakuza, Japan's organized crime syndicate, adept at managing loopholes within the PPL and thus controlling the sex industry, began trafficking foreign women into Japan during the 1980s to fuel the growing domestic demand for commercial sex.[9]

By the 1990s, demand within the sex market led to new activities such as the aforementioned *enjo kōsai*, which involves junior high or high school girls interacting with adult Japanese men for money and gifts. The girl's role in *enjo kōsai* can include anything from dinner and conversation to karaoke and group activities – and even lead to sex. This behavior marked a new societal trend: sex work was no longer limited to the economically disadvantaged. Middle- and upper-class adolescent girls could now participate and earn large amounts of money, up to several hundred US dollars for one encounter.[10] For adolescent girls, *enjo kōsai* offered a convenient avenue to the increasingly prevalent culture of conspicuous consumption valued by postmodern Japanese society. The increased portrayal of schoolgirls as sexual objects throughout popular culture and the media contributed toward this new realm of earning potential for adolescent girls through *enjo kōsai*.

Japanese society began to regard adolescent girls as direct contributors to a perceived moral degeneration of society, associating *enjo kōsai* with the prostitution market. In the beginning, societal discussion regarding *enjo kōsai* exclusively examined the adolescent girl participants. Japanese newspapers, news TV shows, magazines, and numerous other forms of media in particular focused solely on the supply side of *enjo kōsai*, deriding adolescent girls to a stereotypical "schoolgirl" figure characterized by materialism, consumerism, and unchecked sexuality. Since society at large viewed these girls as the future wives and mothers of Japan, *enjo kōsai* served to further a growing moral panic in the 1990s and motivated legislative discussion on how to address the issue.

At the same time, Japan faced increasing international criticism for its failure to address two specific issues of growing importance to the international community: child pornography and sex tourism. Distribution of child pornography was legal in Japan during this period, therefore making Japan a prime target of blame for its global proliferation. Some argued that eighty percent of the world's child pornography originated in Japan in the late 1990s.[11] Also unflattering, some wealthy Japanese businessmen developed a reputation as sex tourists who purchased sexual services from women and children in developing countries throughout Asia.[12] Although sex tourism included customers from all developed countries, Japanese male sex tourists outnumbered those of other nations.[13] International pressure to regulate these global issues generated legislative discussion in Japan on protecting children from sexual predation and became the primary catalyst for legislation on the domestic issue of *enjo kōsai*. With the issues of child pornography and sex tourism coming to prominence simultaneously, discussion regarding the commercial sexual exploitation of children had reached a boiling point in Japan at the turn of the 21st century.

With the issues of child pornography and sex tourism coming to prominence simultaneously, discussion regarding the commercial sexual exploitation of children had reached a boiling point in Japan at the turn of the 21st century.

ENJO KŌSAI POLICY ADOPTION

Initially, the Japanese parliament showed a lack of commitment to policy adoption focused on *enjo kōsai*, particularly regarding the protection of adolescent girls. Although many prefectures have increased the age of sexual consent to as high as eighteen years, the national age of consent in Japan remains thirteen, thus rendering the illegality of *enjo kōsai* questionable.[14] The PPL, the Child Welfare Law, and the Criminal Code do not include provisions specifically applicable to child prostitution.[15] While police reprimanded many adolescent girls for *enjo kōsai* under local obscenity laws, male participants were legally exempt. Public attention focused on the behavior of adolescent girls, rather than their need for protection against predation.

International focus on Japan grew during this period, specifically regarding child sexual exploitation. In 1996, the international NGO End Child Prostitution in Asian Tourism (ECPAT) joined with UNICEF and the Swedish government to hold the First World Congress against Commercial Sexual Exploitation of Children in Stockholm. The conference addressed the responsibility of all industrialized nations to prohibit and punish their own citizens for sexual child exploitation in developing countries, and recognized Japan as particularly lacking in this area.[16]

While many Japanese politicians avoided the issues of child pornography and sex tourism, some did press for reform. Sumiko Shimizu, a female socialist member of Japan's parliament, lobbied for policy adoption, arguing: "The key problem in this country is that the sexual exploitation of children is socially permitted."[17] Masako Owaki, another female legislator, visited Thailand in 1996 to investigate claims about Japanese sex tourism. After meeting with young Thai girls and hearing their stories – in fluent Japanese – about their Japanese sex tourist customers, Owaki was compelled to act.[18] Shimizu and Owaki, in cooperation with ECPAT Japan, worked toward a parliamentary bill addressing the sexual exploitation of children overseas.

At the same time, domestic legislative discussion for policy on *enjo kōsai* continued to focus on the perceived immorality of the adolescent girl, linking it to educational problems and a growing fear of juvenile crime.[19] Addressing child pornography and sex tourism in a way that effectively punished male perpetrators required either separating these issues from *enjo kōsai*, or shifting the overall legislative conversation on the issue. Lawmakers from the ruling coalition in 1997 comprised of members from the Liberal Democratic Party (LDP), the Japan Socialist Party, and the New Harbinger Party – took advantage of the international climate by merging the issues together under one bill, introduced to parliament in spring of 1998.[20] This bill united the international community's concerns about sex tourism and child pornography with the growing national discussion on *enjo kōsai*. Conservative LDP members pressed the bill forward as a solution for *enjo kōsai*.[21] After nearly a decade of enjo kōsai discussion and over two years of legislative efforts, the result was a combined bill that took ECPAT's human rights violation framework and applied it to all three issues. Without the child sex tourism and child pornography issues dovetailing the *enjo kōsai* discussion, resulting legislation would have likely focused on punishing adolescent girls. ECPAT's localized pressure combined with international attention instead effectively incorporated international human rights norms into Japan's new law on child prostitution and child pornography, the CPCPL.

CPCPL IMPACT AND SHORTCOMINGS

In 1999, the Japanese parliament unanimously passed the Law for Punishing Acts Related to Child Prostitution and Child Pornography and for Protecting Children, known as the CPCPL. The law applies to children under the age of eighteen, posits the adult customer as the criminal party, and criminalizes sexual intercourse and similar acts between adults and children through offers or promises of compensation to the child, both in Japan and overseas.

Under the CPCPL, all responsibility falls on the male participants of *enjo kōsai*. Considering that legislative and public discourse for nearly a decade focused primarily on adolescent girl participation, this change is significant in that it treats minors as victims, rather than agents. The focus on male participants, however, is weakened by Article 3 of the CPCPL, which cautions that in application, "care should be exercised so as not to infringe upon the rights of the people without due cause."[22] This vague statement provides the National Police Academy (NPA), notorious for blaming Japanese youth for societal problems, the discretion to determine appropriate application of the law.[23] Article 3 provides the NPA significant power to subjectively interpret and implement the CPCPL and thus should be eliminated.

Furthermore, the CPCPL bans the production, distribution, and sale of child pornography, as well as the trafficking of children for the purpose of prostitution or pornography.[24] However, the law does not ban the possession of child pornography, or regulate online child pornography. An amendment that criminalizes possession as well as viewing and accessing child pornography online is required to adequately address demand in the case of child pornography.

The CPCPL also does not provide specific enforcement mechanisms for Japanese sex tourism, and from 1999 to 2004 the NPA pursued only five cases involving exploited children overseas.[25] Since the adoption of the CPCPL in 1999, sex tourism has remained a severe problem throughout Asia, and Japan has failed to deter the participation of its citizens. The CPCPL requires an amendment providing clear mechanisms for the investigation and prosecution of the acts it criminalizes. The NPA should also require specialized training and formal instruction for identifying and prosecuting sex tourist crimes.[26]

Despite its shortcomings in addressing child pornography and sex tourism, the CPCPL set an important precedent by punishing demand for domestic prostitution when it involves children. Since 2000, the NPA has arrested between 600 and 1,200 men annually for prostitution with adolescent girls.[27] By punishing demand in this case, Japan is effectively shifting the focus of *enjo kōsai* to the buyers of prostitution, rendering them visible and accountable and providing a deterrent for future participation.

SEXUAL EXPLOITATION LEGISLATION: A NEW WAY FORWARD

The CPCPL's success in addressing demand for child prostitution, as well as the lessons learned from its shortfalls, provides a useful framework for effectively addressing another significant, related issue within Japan: sex trafficking. Japan must craft legislation similar to the CPCPL to address the sexual exploitation of trafficked victims in Japan through a focus on punishing demand.

Japanese adolescent girls are not the only exploited victims of the Japanese sex industry. Japan has an estimated 100,000 foreign sex workers, many of them victims of the human trafficking industry.[28] Japan is a major destination country for the sex trafficking of women and girls from Asia, Latin America, and Eastern Europe.[29] Traffickers often promise their victims lucrative jobs and money in foreign countries. They also provide transportation and false documentation in order to get victims to their destination. Upon arrival, the traffickers demand large sums of money as payment from their victims, often forcing them into a lifetime of sexual servitude.[30] By the late 1990s in Japan, one sexual encounter with a foreign sex worker cost approximately $200, meaning foreign sex workers earned $7.3 billion per year for their industry operators, including recruiters, middlemen, immigration fixers, translators, forgers, travel agents, pimps, bar owners, and yakuza traffickers.[31] The size of the industry has only increased since, particularly due to growing yakuza operations.

Yakuza connections to government officials and the criminal organization's entrenchment within Japanese society enable them to maintain control of the sex industry.[32] The yakuza possess a high level of acceptance within Japanese society that is rare in other countries.[33] There are twenty-two legally recognized yakuza groups in Japan, listed with their emblems on the National Police Academy homepage. These groups have maintained close relations with key political figures, political groups, and government officials.[34] In 2011, Seiji Maehara, Japan's Foreign Minister, stepped down due to an investigation concerning payments he received during appointment from a foreign advisor to the largest yakuza conglomerate in Japan. In October 2012, Japan's Justice Minister admitted his connection to members of the yakuza and stepped down after only three months in office.[35] Meryll Dean, Oxford professor of Japanese law, notes "the institutionalised nature of their business organization and structure in a society that both demands and accepts sexual exploitation of women makes the yakuza involvement one of the major obstacles to tackling the problem of human trafficking in Japan."[36]

Given the yakuza's intractable influence and control of the massive Japanese sex market, addressing the supply side of the market has thus far proven futile. A thorough examination of the current sex trafficking legal framework will provide a clearer understanding of the necessity for a demand-focused legal response.

The only solution to combat Japan's sex trafficking problem, given the institutionalization of both the yakuza and the massive sex industry, is to target demand, specifically for prostitution.

SEX TRAFFICKING LEGAL FRAMEWORK

Anti-trafficking legislation did not exist in Japan before 2005. Before 2005, the NPA dealt with trafficking by arresting and prosecuting traffickers when able to deomonstrate sufficient evidence for the violation of the following laws:

- Employment Security Law (Article 63, placement in harmful work)[37]
- Immigration Control Law (Article 73.2, facilitation of illegal work)[38]
- Prostitution Prevention Law (PPL, Article 12, managed prostitution)[39]

Trafficked victims were treated as illegal immigrants with no legal protection and were generally deported to their home countries at their own expense. Convicted foreign brokers were also deported and arrested upon arrival in their home countries.

Increased international pressure from both the U.N. and the U.S. steered Japan toward taking initiative on anti-trafficking measures, including the initial signing, but not ratification, of the Protocol to Prevent, Suppress, and Punish Trafficking in Persons in December 2002 – otherwise known as UN TIP, supplementing the U.N. Palermo Protocol – and ratification of the Protocol to the Convention on the Rights of the Child on the sale of children, child prostitution, and child pornography in April 2004. These limited efforts on the part of Japan, however, were not enough. In 2004, the U.S. downgraded Japan to the Trafficking in Persons (TIP) Report Tier 2 Watch List, harming Japan's reputation within the international community and highlighting its extreme human trafficking problem as well as its failure to provide evidence of improved efforts. Japan is the only G8 and advanced industrialized country to have received this Tier 2 Watch List placement.[40] The 2004 TIP Report states that, "considering the resources available, Japan could do much more to protect its thousands of victims of sexual slavery."[41] In addition to this ranking, in 2004 the International Labor Organization (ILO) conducted a study funded by the Japanese government on human trafficking within Japan. The study provided embarrassing detailed information on both Japan's failure to punish human traffickers along with its negative treatment of victims.[42] This report drew further international attention to the severe sexual exploitation of human trafficking victims within Japan.

In response to international pressure, by June 2005 Japan made trafficking persons into the country a criminal offense. The law, however, only punishes those responsible for the supply side of the market. Much like the PPL, the demand for sexual services is not criminalized. While legislation criminalizing human trafficking is a step in the right direction, Japan remains one of the primary destination countries for the trafficking of sexually exploited women and girls. Increased legislative efforts that address demand are essential to deal with this problem.

A DEMAND-FOCUSED SOLUTION

The only solution to combat Japan's sex trafficking problem, given the institutionalization of both the yakuza and the massive sex industry, is to target demand, specifically for prostitution. This could be carried out in several ways:

- **Reform the Prostitution Prevention Law (PPL) for Japan-wide legislation**. Reforming the PPL to punish buyers would effectively target the often-ignored demand side of the sex market. Just as the CPCPL reframed the issue of *enjo kōsai* by focusing on the men involved, punishing demand under the PPL would bring attention to buyers rather than the often-exploited sellers. Sweden provides an exemplary model: in 1999 it passed legislation rendering the buying of sexual services illegal.[43] By 2009, this law in Sweden effectively reduced street prostitution by half and provided a significant deterrence to sex traffickers.[44] While the situation in Japan is certainly different than in Sweden, entrenched yakuza control of the sex market and the demand-focused precedent set by the CPCPL demonstrate both the importance and feasibility of addressing demand. Japan should criminalize demand under the PPL, thereby strengthening the law to actually punish offenders as well as deter other potential buyers of sexually exploited victims. Deterring demand within the sex market would serve to decrease the overall size of the market, effectively decreasing the need for a supply of trafficked victims.
- **Institute demand-focused legislation at the city and prefecture level**. Prior to CPCPL adoption, the Tokyo Metropolitan government passed *enjo kōsai* regulations in 1997 that targeted the customers and intermediary organizers of *enjo kōsai* rather than adolescent girls.[45] In contrast, other prefectures throughout Japan, such as Gifu and Osaka, adopted regulations addressing *enjo kōsai* that punished adolescent girls in varying degrees.[46] Despite the differing focus, the lesson here is clear: in lieu of national legislation, city and prefectural governments can – and do – adopt their own measures to address sexual exploitation. While ultimately national legislation would provide the most comprehensive demand focused policy, city and prefectural legislation would initiate the process and address demand for sex trafficking on a smaller scale that could then incrementally expand by demonstrating a model of success to other prefectures and ultimately the Japanese National Diet.

As demonstrated by the CPCPL legislative process, demand-focused legislation is unlikely to occur without certain contributing factors. Policy adoption requires attention from the international community and legislative support from key Diet members, as well as a general heightened visibility of sexual exploitation in society and the media as evidenced in the case of *enjo kōsai*. Methods to align the interests of these players towards combating demand for sexual exploitation include:

- **Increase international pressure**: International pressure is particularly crucial for policy adoption within Japan. Indeed, without international pressure to adopt anti-trafficking legislation, trafficking humans across Japan's borders would likely still be legal. The international community and local NGOs must pressure Japan to take legislation one step further by addressing demand for prostitution and effectively punishing and deterring buyers. Particularly important to this step, the U.S. government must downgrade Japan's Tier 2 placement on the U.S. Trafficking in Persons Report to realistically reflect its lack of progress in combating sex trafficking. International political pressure, in conjunction with domestic support from Japanese politicians and increased societal awareness of the issue, will spur Japan to take stronger legislative action.
- **Increase pressure on politicians**: Influential female Diet members were crucial in shaping the demand-focused CPCPL. Local NGOs such as ECPAT, in conjunction with the international community, must continue to pressure key Japanese politicians to support comprehensive demand-focused legislation. Demonstrating the severity of sex trafficking is particularly important: local NGOs should take Japanese politicians on a tour of the sex market and allow them to speak with identified victims in their own backyard. Building support from key politicians in Japan will help to align domestic political efforts with the international community, as well as demonstrate the importance of focusing on demand to the rest of Japanese society.
- **Increase societal visibility**: The Japanese public must be educated on the realities of sex trafficking within their country. Current information presented to the public by the Japanese Government Inter-Ministerial Liaison Committee, created to coordinate anti-trafficking initiatives, frames the issue as a problem affecting "foreign women."[47] This discourse leaves out entirely the demand side of the market, rendering those who buy the services of sexually exploited women unaccountable and invisible. This discourse also fails to connect the sexually exploited trafficked victims with the domestic adolescent girls already considered victims of the sex market. Important first steps toward increased societal visibility include civil society campaigns driven by local NGOs educating the public on the realities of sex trafficking, news stories that accurately reflect the status of sexually trafficked women, key political figures publicly decrying the actions of those who frequent the sex market, and accurate information presented by the government that identifies the demand side of the market.

The international community, key Japanese politicians, and overall societal discourse must shift to view sex trafficking as a human rights violation driven by domestic demand in order to bring about a solution. While the yakuza's control of the sex market complicates this path and certainly requires further consideration, shifting the spotlight to address demand remains an important first step toward a solution for sex trafficking.

CONCLUSION: SHIFTING THE DISCOURSE

The CPCPL set an important precedent by punishing demand, effectively reframing the issue of *enjo kōsai*. Adolescent girls, initially viewed as perpetrators, became protected victims. Most importantly, the law removed the luxury of protection for the buyer, rendering them publicly visible and accountable. Just as the CPCPL shifted the focus from adolescent girls to adult men by targeting demand, demand-focused legislation elsewhere in the sex market could effectively shift the spotlight on prostitution from the often-exploited workers to the invisible buyers.

In addition to legislation – and in order for legislation to occur – Japan also requires a shift in discourse about women trapped in the sex market. Although it took over ten years, policy on *enjo kōsai* that recognizes and prosecutes demand was adopted when this domestic problem was reframed as a global human rights issue. Since policy adoption, the shift in public discourse surrounding adolescent girls caught up in the sex market is even more pronounced: these girls are viewed as victims rather than perpetrators, and those who purchase their services are fueling the problem. While shifting discourse and policy to focus on demand will not eradicate all sexual exploitation of women and children, it represents an important and realistic first step toward addressing sex trafficking.

If applied elsewhere, the significant precedent set by reframing *enjo kōsai* to a human rights violation could have important consequences. Women in Japan and many other areas of the world are often treated as sexual objects, available for domination. Shifting the spotlight to focus on the demand side of the sex market, condemning the actions of buyers, could lead to a substantial change in the future not just for women in Japan, but for all women and girls worldwide.

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VLADIVOSTOK IN CONTEXT

Challenges and Opportunities for Russia's East Asia Policy

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ABSTRACT

The 2012 Asia-Pacific Economic Cooperation (APEC) forum, held in the eastern Russian city of Vladivostok, once again called attention to Russia's far eastern region. Now viewed as the key to economic integration with East Asia, the Russian Far East (RFE) has struggled politically and economically, suffering from stagnation, underdevelopment, political isolation, and a lack of autonomy to take advantage of neighboring countries' growth. This paper argues that the poor state of center-periphery relations between the Far East and Moscow, in which the capital dominates all aspects of Russian political, economic, and cultural life, has resulted in a frontier-like status for the RFE despite hundreds of year of rule. Through an analysis of governing structure, historical relations with Asian neighbors, and development strategy, the paper identifies the roots of this center-periphery dynamic, identifying the specific barriers that need to be addressed to improve Pacific relations.

I. INTRODUCTION

When Secretary of State Clinton visited Moscow in 2009 to meet with Foreign Minister Sergey Lavrov and then-President Dmitry Medvedev, the man that most considered the true leader of Russia was suspiciously absent. Quite purposefully, Vladimir Putin was in Asia meeting with Chinese Premier Wen Jiabao to celebrate the 60th anniversary of establishing bilateral diplomatic relations.[1] As part of these meetings, the two signed twelve bilateral agreements, including partnership deals in nanotechnology, nuclear power, civilian aviation, banking, high-speed rail and most importantly energy.[2] Agreement on a natural gas pipeline from Altai and an offshoot to China of the planned East Siberia-Pacific Ocean (ESPO) oil pipeline grabbed headlines, as did Putin's condemnation of America's "irresponsibility" in letting the Global Financial Crisis occur. The financial crisis hurt the Russian economy more than most, with GDP only surpassing pre-crisis 2008 levels in first quarter 2012,[3] leading to further backlash against reliance on the West. Concurrently, the groundwork was being laid for the 2012 leader's summit of the Asia-Pacific Economic Cooperation (APEC) forum in Vladivostok, an eastern Russian city located on the Pacific, close to the borders of China and North Korea. In preparation for the event and rife with symbolism, Russia constructed a billion dollar cable-stayed bridge, the longest of its type in the world, to the barren Russky Island (population 5,000),[4] the planned location of the meetings. More than bridge to nowhere, however, it was hoped that the APEC summit would open the doors to Asia.

Discussions were held relating to four major issues, including trade and investment liberalization, regional economic integration, strengthening food security and establishing reliable supply chains, as well as cooperation to foster innovative growth. Despite these discussions, however, major obstacles remain which Russia must deal with if it is to truly join 'the pacific century.' Those obstacles are centered mostly on Russia's management of the Russian Far East (RFE).

The Russian Far East is a region shrouded in mystery, even to most Russians. While Russia has tentatively tried to orient itself eastwards in recent years, continuing to emphasize the importance of its strategic relationship with China and Asia's prominence as a driver of global economic growth, the Far East is but a footnote in this story, resigned primarily to its role as a source of natural resources. There are a number of reasons the Far East has remained so underdeveloped, ranging from cultural, political, climactic and economic explanations. These reasons share a common theme, however, in that they represent the region's status as less a fully-fledged Russian region, but as a 'frontier' of geopolitical interest. The problem with Russia's Asia-centric strategy is that its recent approaches do not show any fundamental change in this mentality. Recent glimmers of hope, such as APEC 2012, which for the first time was hosted in Vladivostok, have held only false promise. In order to deepen involvement, lingering issues such a territorial disputes and overreliance on the energy sector need to be addressed.

Part of Asia geographically, Russian Far East has remained economically depressed while its neighbors in the region have experienced rapid growth. With the exception of Sakhalin's promising energy industry, the Russian Far East is in a sorry state, heavily dependent on Moscow for support, while at the same time being cut off from most Russian economic activity. So far, Moscow has been unable to produce conditions for economic growth in the Far East. The top-level attempts at building bilateral ties with China and playing host at APEC show that getting involved in Asia is a major priority and a possible solution to the problem.

Can Russia really be considered an Asian power if its territory in Asia is little more than a frontier? Why is the relationship between neighboring economies so heavily dominated by Moscow, when we've seen in other countries the benefits of decentralization and opening to outside capital, trade, and competition?

This paper argues that the poor state of center-periphery relations between the Far East and the capital – in which Moscow and St. Petersburg have historically dominated all aspects of Russian political, economic, and cultural life – has resulted in the farthest regions of the country maintaining their basic frontier-like status despite hundreds of year of rule. This colonial attitude lends itself both to economic mismanagement and underdevelopment, as well as political isolation and a lack of autonomy to take advantage of neighboring countries' growth. The frontier was instead viewed in terms of resources and population, a peripheral buffer, which was to be maintained against the threat of foreign territorial aspirations.[5] While the climate and remoteness of the Russian Far East certainly does not invite development, this paper argues that a dysfunctional and outdated center-periphery relationship has made a bad situation much worse, resulting in Russia's relatively marginal place in Asia. The second section of this paper explores the center-periphery relationship in its geographic, historic, and cultural context; the third section examines energy resources' role in this context; the last section outlines policy recommendations, and provides a reexamination of APEC within the context of the limitations presented in this paper.

2. THE CENTER-FAR EAST DYNAMIC

2.1. Geography and Governing Structure

A fundamental source of the problem between Russia's center and its eastern periphery is Moscow's distance from the East. The sheer physical space between the Far East and Moscow—seven time zones, or a 12-hour flight—makes the act of governing difficult. For example, by the time people come into work in Moscow at 8:00AM, it is already 3:00PM in Vladivostok; there are only two to three hours of overlap during the normal business day to collaborate.

Added to this is the Moscow-centric decision making policy, which relegates regional governments to the lowest tier. Federal subjects in Russia are generally less autonomous than American states; yet it seems the case that Pacific Russia's unique position might merit unique policies: what works in European Russia may not work in Asia. In fact, as a result of Soviet economic planning and communism's disregard for cost, many regions became reliant on Moscow for support after the collapse. Hill and Gaddy (2003) examine this phenomenon in Siberia, but the lesson may be applicable to the Far East as well.[6] In examining the "cost of cold" on industry in Siberia, which was located there by communist planners as opposed to market forces, Hill and Gaddy find that much of Siberia is economically nonviable, arguing that the only solution may be to relocate to warmer climes.[7] The RFE shares similarities in that its major hub—Vladivostok—was centrally important to the Cold War, and since the collapse of the USSR has struggled to find a new purpose.

Despite these physical and structural shortcomings, the RFE does have a significant source of potential strength, which may also be the key to Russian economic integration with Asia: proximity to China, Korea, and Japan. This argument is not new. Scholars have been pointing out that Russian and Asian cooperation is a logical fit for some time. Nester (1993) wrote that, "Japan and Russia need each other. Few relationships make more economic sense. Japan is the world's leading manufacturing, financial and technological power but is natural resource poor, while Russia's economy is collapsing but is natural resource rich."[8] While Russia is no longer collapsing, gains from integration are what Russian leaders are banking on when they emphasize movement toward Asia. How much of an effect these gestures such as APEC really make is in doubt, however. This is because potential for cooperation is spoiled by national political obstacles, which are a result of the dysfunctional center-periphery relationship that still regards the Far East as the Russian frontier and resists foreign economic influence, while refusing to give ground on territorial disputes for fear of setting precedent losing territory. For example, the longstanding Kuril Islands dispute and lack of a peace treaty with Japan is a prominent example of this tendency, which will be explored further in the next section.

2.2. Historical Context

The historic context of Russia's involvement in Asia is also worth noting, as it is a major contributing factor to the poor state of affairs. The Russian Empire approached the Far East with imperial designs and conquered territory from both China – such as Port Arthur, now known as Lüshun – and Japan. The history of aggression and competition for dominance was a greater objective than trade or economic growth; Vladivostok, after all, means "conquer the East" and was founded as an imperial military outpost. That this city now plays host to APEC is a somewhat ironic turn of events since Russia's historic emphasis in the region has been to either exert geopolitical hegemony or thwart any potential rival from acceding to that role.[9] Russian suspicion and militarism only grew after the defeat of the Russian Pacific Fleet at the hands of the Japanese in the Russo-Japanese War in 1905. Focus on territorial expansion continued throughout the first part of the 20th century, and following the Second World War Stalin took as spoils the lands which had been lost as well as more, such as the Kuril Island chain. Major Far Eastern cities such as Vladivostok continued to be more valuable as strategic forts than prosperous cities.

The dominant strategic concern of security and political influence did not change during the Soviet period: support of China as a communist state gave way to the Sino-Soviet Split, which soured relations for decades. This made Russians especially cognizant of the 'soft underbelly' that was exposed in the Chinese-Russian border, prompting the first fears of Chinese infiltration of the periphery. Japan's close alliance with the United States and its declared position as an unsinkable aircraft carrier opposed to Soviet aggression meant close economic relations were not an option. Meanwhile, Soviet support of North Korea was a drain on resources and made another enemy in South Korea. The Soviet Union prepared to fight wars against the U.S. and its allies as well as China, resulting in a heavily militarized zone. Cities like Petropavlosk-Kamchatsky and Vladivostok were closed even to most Russians until after the fall of the Soviet Union because of their importance to the military-industrial complex.[10] As such, there has been very little history of economic involvement in Asia. The opportunity has only arisen in the wake of the collapse of the USSR. Rozman (2007) identifies four persuasive arguments for why little progress has been made in breaking away from this historic geopolitical orientation vis-a-vis Asia.[11] These specific cases show how divisive policies, stuck in a 'Soviet' mentality, have been seen as preferable to the type of cooperation and compromise that can eventually lead to deeper economic ties and mutual development.

First, China's rise has encouraged Russia to continue playing the great-power game in Asia. This has been done primarily by cooperating with China as a hedge against the U.S. and its allies, but there is also a certain amount of distrust of China – and Chinese immigrants – because of the disparity between population densities on opposing sides of the border. This has limited cross-border investment and the flow of workers.

Second, North Korean saber rattling has benefited Russia's strategic role as a mediator – a role that has provided an excuse for Russia to focus on military involvement as opposed to forging economic ties with either North or South Korea. Resolution of the conflict is not in Russia's immediate interest given its military focus, so there is little opportunity to move beyond the security issue.

The third reason is that the Kuril Islands dispute with Japan has continued from the end of World War II to this day with no resolution. Both sides claim the islands as their own and despite diplomatic relations being established in 1956, no peace treaty was signed. Despite upbeat negotiations in 1997-1998 and 2000-2001, there was no compromise, and since then Putin adopted a hard-line stance. As the islands are currently in Russia's possession, maintaining the status quo is in Russia's interest.

The fourth, which is somewhat related to the China issue, is that political leadership of the Russian Far East has sought to play on the population's fears of foreign domination, emphasizing in particular the 'ethnic threat.' Xenophobia is a major problem in the country, and is a sentiment that has expanded beyond the extreme fringe of public opinion. Viktor Ishayev, Putin's presidential envoy to the Far East and Khabarovsk regional governor from 1991 to 2009, repeatedly warned about the 'yellow threat,' stating that China was considering the annexation of large parts of Russian territory.[12] Protectionist political and economic elites use these fears as an excuse to defend their own interests against greater competition. As a result, foreign investment is often scared away. For example, Rostislav Turovsky, the general director of the Agency for Regional Research, said that "the expansion of foreign business [in the Far East] may lead to a situation in which this region de jure will remain Russian but de facto will be converted into a raw material supplier for China and Japan."[13] That greater integration with foreign economies may actually be a good thing for Russia is largely ignored.

In all of these instances we see Russia approach the East more like an imperial power concerned over its Eastern colonial holdings than a nation-state confident in its Far Eastern 'Russianness." Furthermore, the fact that these cases have allowed Russia to maintain its political-strategic involvement in the region does not necessarily equate to the best outcomes for Russia. The opportunity cost each of these policies should be considered. It is often the case that countries are able to get together and benefit from peaceful rela-

While the climate and remoteness of the Russian Far East certainly does not invite development, a dysfunctional and outdated center-periphery relationship has resulted in Russia's relatively marginal place in Asia.

tions and high levels of economic integration only after their geopolitical concerns have already been settled. Modern day Europe is the best example of this; the settling of the territorial status quo after World War II has allowed economic integration in the form of the EU to proceed. This is not the case in Asia, where there are still many territorial disputes, conflicting ideologies, and lingering hopes for regional hegemony. Yet, the situation and prospects for improvement have benefited from the end of the Cold War. The fact that only a little over twenty years have passed since the collapse of the USSR should temper pessimism about Russia's role in the region. In any case, it is clear that the legacy of Russian historical political imperatives linger in the present, a mentality that is currently blocking further integration in the region.

2.3. Governance and the Rule of Law

Poor rule of law is also an obstacle to closer integration with Asia. As mentioned earlier, frontier regions tend to brew lawlessness, and the Far East's continued status as a frontier in the Russian mentality has reinforced this. Corruption is particularly bad, as evidenced by a 2004 study, which compared regions across Russia, in which no region in the RFE earned a "competitive market" designation.[14] Smuggling of pirated or fake Chinese goods into Russia is common. The act of poaching rare animals, such as the Amur Tiger and Leopard, has driven many species to near extinction and garnered interest of international groups like the WWF.[15] State department cables and media also mention the "forest mafia" and their organized efforts at illegal logging.[16] Criminals, called 'Partisans' by the locals – a term laden with communist freedom fighter connotations – in Primorsky Krai went on a killing spree, targeting police, and were widely cheered by the populous.[17] The comparison to American 'Westerns' might not be so false; in Russian cinema their parallel was the "Ostern" (Eastern) because the Russian frontier has always been the East. Even though these examples of lawlessness and frontier-mentality may not be the norm, they are part of the psychological and cultural makeup which serves to distance the periphery from the center.

3. ENERGY EXPORTS: THE EXCEPTION?

The one area in which the Russian government has attempted to overcome these obstacles and engage in trade and in longstanding economic partnerships has been in the energy sector. Pipelines to China and South Korea and LNG exports to Japan are expected to account for between 22 and 25 percent of Russia's total energy exports by 2020.[18] Energy is undoubtedly where Russia has a competitive advantage: Russia has oil and natural gas and many of its neighbors do not. There are, of course, arguments against an energy-driven policy of economic engagement. Much has been said on the subject of relying too heavily on energy, with "Dutch disease" and the "resource curse" being common subjects of discussion. This widespread belief—true or not in the case of Russia—may be partly why former President Medvedev admitted that Russia's reliance on energy exports was "humiliating."[19] Additionally, the constant refrain in Russian politics, ostensibly after oil price shocks, that the economy should be diversified takes for granted the assumption that relying on oil is a bad thing.[20] President Putin however, has always benefitted from high oil prices ("Vladimir the Lucky", as some call him) and it remains to be seen whether oil prices are kind to him again.

The alternative would be to use tax revenue from these extractive industries to encourage economic diversification – such as the Skolkovo nanotechnology project, an attempt to lure high-tech industries to the country with tax breaks and new infrastructure – or save for a crisis, which is where money to defend the ruble during came from the Financial Crisis. Unfortunately, those who recommend such policies assume that they will work because other governments, such as the governments of Norway and Canada, successfully implemented them. Russia is not Norway or Canada; instead, as Ahrend (2005) notes, "...as Russia's political pluralism and freedom have been reigned in, checks and balances on state policy and top officials have lapsed."[21] Thus state ownership has actually aggravated corruption and economic performance rather than improved it.

Russia should learn from China's use of special economic zones to encourage foreign investment, especially given its proximity to China, Japan and Korea.

Given control over the extractive industries in the form of state-owned oil and gas companies, the center took this one step further and imposed extremely high tax rates on these firms (for example, the current marginal tax rate for exported crude is approximately 82 percent).[22] Due to such high taxation rates, and widespread renationalization, the vast majority of oil revenue goes directly to Moscow's coffers. This began partly as an attempt to avoid the economy becoming overheated as a result of the oil price surge of the 2000s and represents an earlier Soviet – or even mercantile – mindset that resource production within the country is, de facto, the property of the state. In a somewhat addictive twist, however, the government has become increasingly reliant on oil and natural gas taxes for its tax revenue. Therefore, there is a disincentive to return to a freer system which might encourage competition and a diversification. In the RFE, an interesting case study is Sakhalin Island, where state owned Gazprom forced out Shell at a price "below the market rate" only months after effectively nationalizing Yukos.[23] In scaring away potential foreign investors, it appears that Russia's energy resources serve more as a life-line that allows the government to line its pockets rather than as area for cooperation. So while it may seem at first glance that the Far East's energy prospects may provide a route for economic revitalization, the reality is far more difficult. So far no leader has been willing to make the difficult transition towards diversification.

4. POLICY OPTIONS

Overall, it looks as though a widespread shift in mentality is needed if Russia hopes to change the composition of its Eastern periphery and, by extension, advance its role in East Asian affairs. Improvement in the rule of law is important as a precursor to free enterprise, which might better allocate the resources of the Far East and possibly distribute the wealth locally, resulting in deeper growth than that brought by jobs working for state owned industries which export the wealth back to Moscow. Because the government is so reliant on oil rents for its budget, however, this is likely to be the most difficult area of reform. Excluding reform of the energy sector, there are few areas in which the RFE would have a competitive advantage. Considering the huge tax revenues brought in by petro-fuels as the price of oil continues to rise again, it may not be a bad idea to invest some of that oil wealth into a diversification fund. This would mirror prior use of oil revenues to establish the stabilization fund, which was used to bail out the Russian economy during the financial crisis, and would expand upon Medvedev's and Putin's shared platform of modernization. It is more likely, however, that further investment in modern industries will take place west of the Urals; Skolkovo may not have displaced Siberia's Akademgorodok – the famous center of scientific instituted located in Novosibirsk, Siberia – as a center of technical expertise yet, but it sends a firm message where the Russian elite believe their future lies: the West. The great length, and great cost – approx $21 billion USD[24] – that has gone into hosting APEC in Vladivostok therefore sends mixed messages.

On the topic of disputes with Asian neighbors, a combative stance towards territorial disputes, which were a result of prior imperial expansionism and continued identification with land as prestige, continues to sour relations with Japan and has certainly caused problems with China in the past. How can Russia become closer with the Asian tigers of modern growth if it is stuck in patterns of the past? This is made even more difficult by the fact that the RFE does not seem to lend itself well to a better economic relationship. However, the political obstacles could likely be addressed if the leadership decided to engage smaller issues and use these political victories to slowly dismantle the old paradigm. This would be a good first step, because political openness is needed before economic cooperation is even a possibility. Working on issues such as migration, smuggling, trade regulations and technical assistance at APEC 2012 was certainly a good start. In the long-term, resolving the Kuril Islands dispute would be a step in the right direction towards Russia moving beyond the past and building a shared future with its neighbors, but this will require the political cover of perceived progress and shared compromise that can only come if they tackle less intractable issues first.

Finally, on the topic of center-periphery relations, it appears that increasing centralization of power has hurt the Far East's ability to act in accordance with local realities. While these policies, such as imposition of centrally appointed regional *polpreds* – supra-regional governors who oversee multiple federal units – seemed a good way to implement Putin's early anti-corruption drive, they also introduced additional layers of bureaucracy and opportunities for infighting. What is needed now is additional autonomy and less barriers for entrepreneurs; there has to be space for private enterprise. Russia should learn from China's use of special economic zones to encourage foreign investment, especially given its proximity to China, Japan, and Korea, which are all linked in complex global production chains. If Russia can find a step in this chain which would benefit the Far East, that would be their best option; but the business climate would need to improve for this to be a possibility.

4.1. Postscript: APEC's False Promise

APEC's symbolic value almost certainly outweighs the benefits of the actual discussions and finished agreements, but 2012's conference put Russia and the Far East in the spotlight. APEC is often criticized for being little more than a talk shop; a former Australian foreign minister characterized it as "four adjectives in search of a noun."[25] As it turned out, the general statements of cooperation and nonbinding agreements went on as usual. Russia missed out on a large opportunity, however, as a major flare-up of territorial dispute between China and Japan became an important topic of discussions. Given its own territorial disputes in the Kurils, Russia could have made a grand gesture of great importance by easing territorial concerns on that front, for example by offering a settlement with Japan, giving a precedent for other ongoing disputes. Unfortunately, however, Russia's frontier and resource-driven mentality are still too strong, with Medvedev visiting the disputed islands only months before APEC.

The Far East and its lack of development remain an ongoing concern to the central government: just recently President Putin announced a $43.5 billion infrastructure development project aimed at jumpstarting the economy. One of the three areas of focus is modernizing the Trans-Siberian railroad to Vladivostok; a potential linkage which would improve the Far East's attractiveness as a transportation and logistics hub serving for Asian goods destined to European markets. It remains to be seen, however, whether this will be simply more wasteful central planning. If political obstacles are not improved with neighboring countries and potential trade partners, the improved railroad may resemble the billions spent on the so-called 'bridge to nowhere' at APEC, because improved infrastructure will mean nothing if there is no demand for it.[26]

NOTES

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2 Anatoly Medetsky, "Putin, Wen Sign Off on Oil Pipeline," *The Moscow Times* (29 October 2008). <http://www.themoscowtimes.com/news/article/putin-wen-sign-off-on-oil-pipeline/372000.html>

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4 I visited the island in 2010 with a State Department official, when the only attractions were Soviet-era artillery emplacements and acres of wilderness. There was much work to be done, and panicked politicians feared the conference might be moved to St. Petersburg if preparations were behind schedule, as had happened with the World Tiger Summit.

5 Xenophobia has been a constant problem in Russia, coupled with insecurity about its vast territorial holdings. A recent example can be found in a 2008 news article, in which President Dmitry Medvedev was quoted as saying that the Russian government must take immediate action to avoid losing the Russian Far East: Paula A. Goble, "Will Russia Lose the Far East?" *The New York Times*, online edition (29 September 2008).

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THE U.S. PRESIDENT'S EMERGENCY PLAN FOR AIDS RELIEF (PEPFAR)

Efficiency and Value in Limiting and Preventing Global HIV/AIDS

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ABSTRACT

This study examines the effects that PEPFAR spending per capita has had on altering rates of HIV incidence in target-country youth (ages 0-14) since the program's inception in 2003, through 2009, the most recent year in which reliable data have been made available. It uses a fixed-effects model with controls for country-level differences to infer that each constant 2000 U.S. dollar spent per capita by the PEPFAR program has an impact of -.056% on the incidence of HIV in youth. Although this is an encouraging result as it adheres to one of the main facets of the PEPFAR mission of decreasing the transmission of HIV from mothers to their children, the study goes on to caution against analyses performed based upon the data currently available. It recommends that PEPFAR enhance and expand the availability of its spending data in order to allow for further, more robust, independent evaluations.

INTRODUCTION

President George W. Bush: "Today, on the continent of Africa, nearly 30 million people have the AIDS virus, yet across that continent, only 50,000 AIDS victims - only 50,000 - are receiving the medicine they need. I ask [for the help of] Congress to … turn the tide against AIDS in the most afflicted nations of Africa and the Caribbean."

Dr. Peter Mugyenyi: "That sounded like melodious music. From there onwards, things would never be the same. And that was victory for the people who were suffering and who were now going to have hope." [1]

It is common knowledge that the HIV/AIDS pandemic has dealt a brutal blow to a significant portion of the developing world, but many do not realize quite the extent of the damage, nor how preventable and treatable this condition has become. A conservative estimate by the UNAIDS organization determined that as of 2003, several developing nations had over 20 percent of their populations infected with HIV. The upper estimates put many African countries well into the 30 percent range[2] - nearly a ***third*** of their populations suffering from HIV. Even more disturbingly, with the 1996 development of Anti-Retroviral Drugs (ARVs),[3] HIV transformed from a "death sentence" into a survivable condition, yet a UNAIDS report estimated that there were still nearly 8,000 AIDS deaths per day seven years later.[4]

In response to these sobering trends, the administration of President George W. Bush launched the U.S. President's Emergency Plan for AIDS Relief (PEPFAR) in 2003, which committed $15 billion over the first five years of the program (2003-2008, PEPFAR I) and over three times that amount dedicated to sustaining positive impact in the second period (2009-2013, PEPFAR II). The program works not only to save the lives of many of those already infected, but also to prevent the transmission of HIV/AIDS to future generations. PEPFAR began by targeting 15 of the hardest-hit countries,[5] calling them focus countries, and has become increasingly focused on bilateral efforts outside of those as the program has developed, expanding partnerships in several of the original focus countries and beginning efforts in various new regions. The program is the largest commitment by any nation to combat a single disease internationally, and is a cornerstone of the U.S. Global Health Initiative, which has a special focus on improving the health of women, newborns and children.[6]

According to PEPFAR's website, mother-to-child transmission is a significant cause of new HIV infections among children worldwide, and prevention methods have three potential benefits: saving the life of the woman, protecting her newborn from HIV infection, and keeping the family together by preventing orphanhood. Therefore PEPFAR uses a holistic, or "combination," approach to prevent infections from spreading this way. Its strategies include, among others, Preventing Mother-To-Child Transmission (PMTCT) interventions, the Abstinence/Be Faithful Program, and Anti-Retroviral (ARV) Drugs and Services. The overarching goal of PEPFAR is to decrease the new occurrence, and eventually the prevalence, of HIV/AIDS by providing counseling regarding abstinence, condom use, and pre-natal care, as well as providing testing, antiretroviral drug prophylaxis and treatment.[7] PMTCT interventions, through which women can learn their HIV status and access essential care if positive, or receive information on ways to protect themselves if negative, are an important element of PEPFAR's prevention strategy. According to PEPFAR: without PMTCT, approximately 25-40 percent of babies of HIV-positive mothers will be born infected; with PMTCT, that number drops to below 5 percent.[8,9] Stopping the proverbial "bleed" in HIV transmission from one generation to the next is of vital importance in eventually limiting or eliminating the presence of HIV/AIDS in areas that have been rampant with them in the recent past.

This study will focus not on the *prevalence* of HIV in these societies, which refers to the current number of people suffering from the illness in a given year, nor on HIV/AIDS-related deaths – but rather on the *incidence* of new HIV cases, which refers to the frequency of development of new HIV infections in the population.[10] More specifically, the study will use a fixed-effects model on a panel data set of 150 countries between 1990-2009 to determine what the effect of PEPFAR spending per capita has been on the incidence of HIV in the 0-14 age group, with particular attention paid to the 15 countries the program has targeted between its enactment in 2003 and 2009. This will help provide a basis for understanding how well the program has progressed, determining statistically whether the vast sums of money spent have, in fact, been used wisely and resourcefully, or if instead, as critics have argued, billions of taxpayer dollars have been squandered on a bloated program with disproportionately small effects on the HIV/AIDS relief effort. I hypothesize that the results will show a one percent decrease in new incidences of HIV for every extra PEPFAR dollar spent per capita, but I do not foresee that result being statistically significant as there is a limited quantity of data available.

STUDIES PREVIOUSLY PUBLISHED

As of the date of this writing, analyses of the results of PEPFAR's "smart investments" to "save lives… [and] build more secure families"[11] are sorely lacking, and PEPFAR's official studies evaluating the impact of programs for PMTCT are not slated to be available until 2013.[12] Originally, the U.S. Institute of Medicine (IOM) was the agency exclusively tasked by Congress with monitoring and evaluating the progress of the PEPFAR initiative. It released an initial study reviewing the program's progress in 2007, though as of this writing, a program-wide update has not yet been made public. One important admission made by IOM was that "data are not yet available with which to determine the quality or impact of [the services PEPFAR is providing]," revealing implicitly that as of four years into the PEPFAR program, there was still insufficient data to support spending.[13] A lack of organized, reliable, and coordinated data and collection methods would lead to shortcomings in any efficiency study, which is reflected in both IOM's results and those of this study, and will be discussed further on. Additionally, although the IOM's original report draws several conclusions regarding PEPFAR's broad achievements such as the distribution of anti-retroviral medications and the provision of testing and counseling, it is at best vague regarding PMTCT and its influence on new cases of HIV in infants and young people. In fact, it defers instead to the determination put forth by the Office of the United States Global AIDS Coordinator (OGAC) in its Annual Reports to Congress.

As reported by OGAC, in order to determine its effects on averting HIV infections in infants thus far, PEPFAR itself has been calculating a figure by multiplying the total number of HIV positive pregnant women receiving ARV prophylaxis in each country by 19 percent. This is an approximation of infections averted using a single-dose nevirapine regimen, which is expected to reduce HIV transmission to newborns from about 35 percent to about 16 percent.[14] According to OGAC's reports, "this is likely a significant underestimate" since most countries are using much more effective drug regimens for some of their PMTCT participants -- as per 2006 and 2010 World Health Organization (WHO) guidelines -- and without precise data by country on how many women are receiving each drug regimen, it claims the estimation methodology used is the most accurate currently available.[15] This conclusion is echoed by the Global HIV/AIDS Response Progress Report, a collaboration of the World Health Organization, UNAIDS, and UNICEF: "The mathematical modelling of mother-to-child transmission and the number of children acquiring HIV infection has limitations, [but] it remains the only way to systematically assess impact across many countries and regions and globally."[16]

In spite of the disclaimers emanating from several experts on the reliability of this means of evaluating PMTCT's effectiveness, PEPFAR's website claims that PMTCT has virtually eliminated mother-to-child transmission in certain countries, and that globally the number of children born with HIV has dropped substantially since 2001. It goes on to say "the world has made incredible progress – thanks mostly to the commitment of the American people. We have shown that PMTCT works: the challenge is reaching all the women in need."[17] These statements are certainly unclear in terms of PEPFAR-specific effects and even more so about funding results. Not only is the current mathematical modeling method admittedly an understated (and thus inaccurate) method of program evaluation regarding incidence in youth, but it also takes no account of PEPFAR's efficiency in terms of costs – a highly germane matter that is to be discussed in much more depth in this analysis.

It does merit mention, however, that as of 2011 OGAC, in consultation with its US Government PEPFAR implementing agencies, is in the process of developing a promising Implementation Science (IS) framework which incorporates monitoring and evaluation, operations research, and impact evaluation, and will "provide structure, methodological rigor, and diversity as well as knowledge generation to meet the needs of the program and the global community."[18] Through this framework, and with the help of various researchers solicited through a call for supplements,[19] PEPFAR is taking steps to, with time, evaluate its program in a detailed manner on a country-level basis. Additionally, PEPFAR's Scientific Advisory Board began an expenditure analysis pilot exercise in 2009 on four countries: Uganda, Mozambique, Guyana and D.R. Congo. This study involved the collection of expenditure data covering a period of a year, by cost category and program area, and allowed programmers to understand the full PEPFAR costs of delivering a quality unit of service and the variability of these costs within a limited context.[20] Since specific, thorough, country-level evaluations are precisely where PEPFAR has been lacking thus far, the results of this and further future IS studies should be tremendous. For more immediate purposes, however, this study utilizes the spending data that is already available to the public in an attempt to provide a reasonable and independent expenditure effect estimate, with the caveat that the amount of clear, specific data made public by the principal agencies collecting it – namely UNAIDS and PEPFAR – has been relatively limited.

[The PEPFAR] program is the largest commitment by any nation to combat a single disease internationally, and is a cornerstone of the U.S. Global Health Initiative.

Another study published with methods quite similar to those in this evaluation focuses on epidemiological trends using longitudinal data from 1997 to 2006 on sub-Saharan countries with a generalized HIV epidemic. It uses a mixed-effects model to compare the difference in percentage change in the outcomes between PEPFAR's focus countries and other countries in sub-Saharan Africa, prior to and after the beginning of PEPFAR activities.[21] The study finds that after PEPFAR funding began to roll out in 2003, the annual percentage change in the number of deaths due to HIV was lower by 5.8 percent in the focus countries compared to the controls. However, as is to be expected, it finds no significant differences in the percentage changes in prevalence. Though its data structure and time periods are similar, and it addresses some potentially relevant results of PEPFAR treatment -- the decrease in numbers of HIV/AIDS deaths and prevalence -- it does not discuss or evaluate incidence, which is how it is distinguished from this analysis.

DATA

The HIV/AIDS infection statistics utilized for this study came from the UNAIDS Report on the Global AIDS Epidemic 2010.[22] All ranges of data were transformed into their means for the analysis. For example, if the figure "<100 – <1,100" was provided, it was entered into the final data as "600". UNAIDS has made its 2003-2009 HIV/AIDS data public, but as of this writing, data from 2010 and beyond have yet to be posted by either UNAIDS or the WHO. Although some data has been released via UNAIDS' Data Tables,[23] as well as its Global Report[24] and a joint-effort 2011 Progress Report,[25] the information provided is either unspecific or regionally-based, making it unsuitable for this type of quantitative, country-level research. Thus, due to the lack of a reliable source of more current HIV/AIDS data, this evaluation of the PEPFAR program does not extend beyond 2009.

Control variables, such as GDP and the GINI index, were sourced from the World DataBank: World Development Indicators (WDI) and Global Development Finance (GDF).[26]

The PEPFAR funding dataset was generated by piecing together statistics from PEPFAR Operational Plans, which ranged from Fiscal Years 2005 to 2010. The specific headings under which data were found were "Focus Country Allocations", "Funding Totals for PEPFAR Focus Countries," and "Funding for Other PEPFAR Countries." [27] In order to put monetary data into comparable terms, all financial statistics were adjusted to constant year 2000 U.S. dollars. Inflation figures were drawn from the U.S. Department of Labor's Bureau of Labor Statistics Consumer Price Index Inflation Calculator, which provided equivalent values from one to another year's dollar value.[28]

EMPRIRICAL METHODOLOGY

While the most relevant variable in an estimating equation would seem to be PEPFAR's Prevention Spending, instead this study will use total PEPFAR spending as its explanatory variable. The reasons behind this are twofold: first and foremost, PEPFAR has not publicized data under the category "Prevention Spending" for 2003 or 2004. Not only are these years vital to this analysis, but prevention spending also undeniably took place during the period in question, and it is not accounted for as such in the data;[29] Secondly, there are several expenses that factor in to attaining an accurate cost relationship with the dependent variable that are not included in the "Prevention" cost figures – such as operating expenses and general population ARV treatment. The latter can indirectly affect parent-to-child transmission in preventing the spread of HIV/AIDS infection to mothers or potential mothers (thus passing this benefit on to their children), and the former should certainly factor in when accounting for cost-per-capita to implement a program – but it is unknown exactly how the operating costs are divided between the three facets of the PEPFAR approach. Given these considerations, a prevention cost figure would provide a negatively biased coefficient. Thus, in order to deduce a more accurate figure on the effects of spending per capita, total PEPFAR spending is used to explain changes in incidence of HIV in youth.

result, the missing PEPFAR spending values are replaced with zeros[32] and fixed-effects with no controls is run again. Now the model is much more reliable with 3000 observations, and a similar coefficient that remains statistically significant (**Table 1, Column 1**). Then the original controls are added once again, making the PEPFAR spending coefficient less significant (**Table 1, Column 2**). An attempt is made at running random effects with controls (**Table 1, Column 3**) followed by a Hausman test to determine whether random-effects is more appropriate than fixed-effects, which determine that random-effects is not a viable option. Going back to the fixed-effects model, the error terms are now run on their own lags, revealing that there is not serial correlation. The controls are left in the equation under the belief that – even though the F-test tells us they are not significantly different than zero – they are economically significant, and in a larger sample these controls would be statistically significant as well. There may be a very small amount of collinearity between the independent variables, but not enough to justify removing the controls. At this point the model for the final analysis has been determined to be fixed-effects including controls.

FINAL MODEL

to this result, if PEPFAR were to pour $100 per person into this effort in one country, the number of newborns and children (ages 0-14) infected with HIV would decrease by 5.6 percent in said country. Thus theoretically, in a country like Botswana (a focus country), an additional $2000 PEPFAR funding for each of its approximately two million residents[33] would total about $4 billion and would *completely wipe out* new HIV infections in children and newborns in the country.

This model, however, has a number of limitations. Since PEPFAR has worked alongside several other HIV/AIDS relief programs in the countries that data is available on, including the multi-lateral effort to fight AIDS, TB and Malaria – the Global Fund – which the PEPFAR program provides considerable funding for,[34] it is extremely difficult to tease out which efforts are truly contributing specifically to the decrease in HIV incidence. That said, PEPFAR is at the very least a major player in the effort as it is dedicating an enormous amount of money to HIV/AIDS relief and prevention, and it is focusing particularly on objectives such as that measured by our dependent variable – the prevention of the transmission of HIV/AIDS from mothers to their children. When compared to the other regional global health initiatives, PEPFAR has been – at least as recently as 2010 – far and away out-spending the competition[35]. Hence it appears a large portion of country-level effects can be attributed to PEPFAR spending, though the reader should be aware of the potential noise that might enter the data in this fashion, as well as the fact that increased spending, if inefficient, is virtually meaningless. This efficiency is precisely what this study has sought to estimate, and although it does not provide an entirely trustworthy coefficient, it does offer a promising figure that maintained consistently negative coefficients ranging between -.01 - .06 through all of the tests that were run, indicating there is very likely a negative – albeit imprecise – relationship between these two variables.

$$\text{Log(Incid\_0\_14)}_{it} = \alpha_i + \beta_1 \text{PEPFARpc}_{it} + \beta_2(\text{GDP\_billions})_{it} + \beta_3(\text{GINI\_Coefficient}) + \sum_{2009}^{2003} \delta + U_{it}$$

The evaluation begins with a visual depicting the incidence of HIV in the focus versus the control groups alongside spending (Exhibit 1), which confirms the theory that with increased HIV/AIDS prevention and treatment spending, incidence will drop. The quantitative evaluation then commences with what appears to be the best potential model: fixed-effects, leaving in missing values for PEPFAR funds that were not specified in the data. It is impractical to use a two-way fixed-effects model because if the treatment and time variables were to be interacted, the relevant coefficient would drop due to collinearity since all the focus countries begin receiving funding at the same time, in entry period 2003.[30] Thus PEPFAR funding per capita already acts as a treatment dummy, making the interaction term irrelevant. The first fixed-effects model, with dependent and independent variables and no controls, gives a negative, statistically significant coefficient. When controls for GDP and GINI coefficients are added,[31] the PEPFAR spending per capita coefficient becomes much more statistically significant. Random effects with controls provides a similar output, but with a very limited number of observations (only 72) which suggests this model is not very reliable.

To attain a more illuminating and trustworthy

VARIABLE DESCRIPTIONS:

$\text{Log(Incid\_0\_14)}_{it}$ represents the log of (or percent change in) the number of new incidences of HIV in the 0-14 age group.

PEPFARpc is PEPFAR spending per capita in U.S. Dollars adjusted to the year 2000 equivalents.

GDP_billions is a country's Gross Domestic Product in billions of year 2000-adjusted U.S. dollars.

GINI_Coefficient is the GINI inequality index number assigned to each country by the World DataBank.

Σ_2009^2003δ is the sum of the dummy variables representing each year of the PEPFAR program, 2003-2009.

RESULTS

Ultimately, the model's coefficient on PEPFAR spending per capita is -.056 which, as expected, is not statistically significant at traditional levels but is at the 10 percent confidence level. This figure makes theoretical sense, as it indicates that each dollar increase in PEPFAR spending per capita decreases incidence of HIV in the 0-14 age group in the countries studied by .056 percent, which is an important goal of the program. According

ROBUSTNESS CHECKS

A non-trivial concern in discussing the results of this program is with potential cross-sectional endogeneity, a feature that could make treatment results look more substantial than they truly are. It is particularly important to check endogenous effects in this case because PEPFAR's programs are not randomly assigned, but rather targeted at countries with already-high levels of HIV/AIDS infection. According to PEPFAR's website, its 15 focus countries are "among the world's most severely affected nations. Collectively, they are home to approximately half of the world's estimated 33 million HIV-positive people and to almost 8 million children orphaned or made vulnerable by HIV/AIDS."[36] Typically, when coming off of their peaks, these trends might fall even without the treatment, and continued pre-treatment trends or simple mean reversion could be falsely attributed to the treatment after it is implemented. The running of a several probit models, as expected, demonstrated highly statistically significant evidence of endogeneity. The possibilities of pre-treatment trends or mean reversion can also be fairly clearly discerned in the original visual model of our dependent variable, HIV incidence (ages 0-14) (**Exhibit 1**), confirming our suspicions that endogeneity is occurring. Given our relatively high degree of certainty that this effect is taking place, any further analysis must be looked at with some degree of skepticism, though results may not necessarily be invalidated.

Additionally, when the error terms of the model were regressed on their own lags, none of the lags had a statistically significant relationship, meaning that there was no serial correlation taking place. This is likely because the treatment takes place quickly and over a relatively short time period with a large number of countries both receiving and not receiving treatment. The effects of PEPFAR expenses relating to incidence in infants are almost immediate – for instance, pregnant women in this program take nevirapene *during* pregnancy, leading to a treatment effect on incidence with a nine-month lag, or often less in the case that those who receive treatment were already pregnant upon program implementation. Other preventative measures encouraged with PEPFAR spending, such as condom use or abstinence, should theoretically stop pregnancies from occurring in the first place, at most leading to one-year lag in effects – a reasonable time for women of childbearing age to get pregnant and have a child, or if treated, to avoid doing so. Thus, since this is not a slow-moving effect, but is nearly immediate, it is not auto-correlated.

CONCLUSION

Based on all of the factors discussed above, the model provided is theoretically logical in indicating a -.056 percent relationship between new incidences of HIV/AIDS and PEPFAR per capita spending. The coefficient is trustworthy in that it provides a reasonable and relatively statistically sound figure for the degree of cause and effect between increased funding and the lowering of HIV incidence given the large scale of the program and the amount of money that has been devoted to these countries. The inferences that can be made from this figure are in keeping with the original hypothesis that HIV incidence is being prevented relatively cost-efficiently – but ultimately it is up to the reader, policy-makers and tax-payers to determine whether or not this level of efficiency is enough.

Readers should also be aware that the policy conclusions drawn from this number must be limited due to an essential shortcoming in not just this estimation but in several (if not all) of the studies that have been performed regarding PEPFAR: the data these studies are a based on, provided exclusively by the program on its own spending activities, is sparse and insufficient.[37] In order for future studies to convey more reliable, accurate results, PEPFAR's data must be more transparent, thorough, specific, and it must be released more often. Ideally, clearly delineated spending data for each individual target country, specific program or project goal that funding is targeted to, and time period (per year, if not month), should be provided by the PEPFAR program as soon as it is available. It would also be helpful to have statistical data (i.e. population, incidence and prevalence rates, program treatment rates, etc.), including follow-up data, collected on a country-by-country basis and furnished by PEPFAR. The follow-up data is vital after treatments are implemented so that, for example, instead of just knowing that 200,000 pregnant mothers were treated with ARVs and that a certain percentage of their babies should be protected from HIV infection, we would know how many children born to those mothers were actually born with and without HIV. The publication of this statistical data by PEPFAR would also allow researchers to attribute program benefits directly to PEPFAR, whereas with country-wide data such as that provided by UNAIDS, there are any number of factors that introduce noise into the data, preventing accurate designation of cause and effect. For instance, the presence and participation of other initiatives (GAVI Alliance, UN programs) in the same country, can dull or exaggerate PEPFAR-specific program successes and shortcomings.

The above data should be provided in a timely manner, and assess both focus countries and any other countries where PEPFAR spending takes place, accounting for all spending it does as well as all basic statistics, and thus allowing credit to be given where credit is due. Though PEPFAR has begun piloting a cost-efficiency study in four countries, and has called for a number of researchers to help with more thorough future evaluations – both of which are to be applauded – its efforts at data publication and evaluation must be widely broadened. Additionally, in order to allow for non-PEPFAR endorsed studies to take place and eliminate the possibility of evaluator bias, the data referenced above must be made publicly available before accurate, robust, truly independent studies may take place.

Despite these shortcomings in the data, the results attained demonstrate fairly clear benefits from PEPFAR's implementation: This program is saving lives. Unfortunately, as a result of the recent financial crisis in the U.S., PEPFAR funding has already flat-lined,[38] and the program might even be at risk of losing its funding[39] to the countless other taxpayer-funded programs that may not be nearly as effective or important as PEPFAR. It is vital that initiatives such as PEPFAR – that are truly making positive strides – be defended, and with more data, a much stronger case could be built for them, quite possibly extending their existence. The policy recommendation to increase data collection and transparency extends to all aid programs. In order to truly be able to evaluate programs that work (like PEPFAR) and filter them out from those that do not, detailed data must be made available in a timely fashion. With the resulting evaluations, policy makers can make more informed program funding decisions, potentially saving both lives and money.

NOTES

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31 These two controls were elected because neither should be a channel of impact taking away from the treatment effects, and both differentiate the countries accounted for in a meaningful and important way. It is also for this reason that HIV prevalence, deaths, and HIV/AIDS-caused orphans have been omitted as variables: because their effects would muddy the results of the treatment and likely cause it to appear less effective than it actually is.

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APPENDIX

EXHIBIT 1:

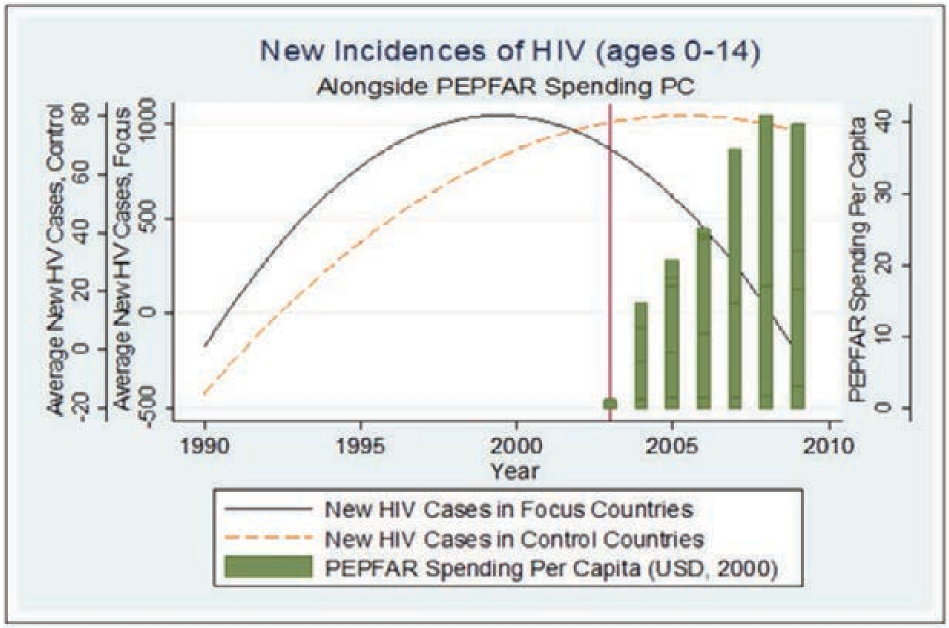

TABLE 1:

Table 1			
Estimates where Missings==0	(1)	(2)	(3)
	Fixed Effects with No Controls	Fixed Effects with Controls	Random Effects with Controls
PEPFAR per capita adjusted	-0.021	-0.056	-0.044
	(4.68)**	(1.82)*	(1.39)
year==2003	0.032	-0.042	-0.005
	(0.75)	(0.47)	(0.06)
year==2004	0.050	0.027	0.020
	(1.18)	(0.27)	(0.19)
year==2005	0.068	0.043	0.044
	(1.62)	(0.54)	(0.55)
year==2006	0.019	0.042	0.076
	(0.44)	(0.41)	(0.73)
year==2007	0.035	0.000	-0.001
	(0.84)	0	(0.01)
year==2008	0.022	-0.116	-0.124
	(0.51)	(1.11)	(1.19)
year==2009	-0.004	0.021	0.035
	(0.09)	(0.16)	(0.27)
GDP_billions		0.000	0.000
		(0.17)	(1.57)
GINI coefficient		0.005	0.013
		(0.91)	(2.48)**
Constant	1.069	0.499	0.612
	(95.20)**	(1.94)*	(2.25)**
Observations	3000	520	520
Number of countryid	150	136	136
R-squared	0.01	0.02	
Absolute value of t statistics in parentheses			
* significant at 10%; ** significant at 5%			

THE CASE FOR SOCIAL ENTREPRENEURSHIP

The Nursing School Project in Bwindi, Uganda: An Interview with James D. Jameson

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Introduction by Adrian Pavia

James D. Jameson has built a reputation as a successful business leader and entrepreneur in fields as diverse as agriculture, publishing, book distribution, defense electronics and real estate in the U.S. and abroad. He is a member of the Board of Directors of The Chief Executives' Organization and the Reason Foundation, and also served as a member of the President's Export Council and as a member of the Export Import Bank Board of Directors, as well as on the Board of the Committee for Foreign Investment in the United States.

Mr. Jameson is also an advocate for social development and an avid philanthropist. He is Chairman of the Advisory Board for the School of International Relations and Pacific Studies at the University of California at San Diego and also serves on the Advisory Board of the Scripps Institute of Oceanography. Mr. Jameson received a B.A. and M.B.A. from Stanford University.

Most recently, he has supported development projects in Mexico and Uganda by using an entrepreneurial approach to social development. In the following pages, Mr. Jameson offers insight into the movement, as well as the details on a project to build a much-needed nursing school in Bwindi, Uganda.

INTRODUCTION: THE BWINDI NURSING SCHOOL CASE

In 2010, James Jameson and friend Steve Wolf traveled to Bwindi, Uganda on a hiking expedition through the Bwindi Impenetrable Forest, an ancient forest located in the southwestern corner of the country. It was there that they encountered a local community hospital, meeting a young Ugandan woman named Jane Anyango, who they discovered was the sole Registered Nurse at the hospital – a facility that serves over 40,000 people. After spending more time with the local population, the two decided that they would use their business and entrepreneurial expertise – Mr. Wolf is a former chairman and CEO of United Airlines – to assist this community in the development of an urgently needed nursing school.

The two realized that the "traditional approach" to development – which would involve partnering with a local or internationally-based NGO and seeking funding from a donor through an international development bank or developed country – could take 10 years or longer just to open the school, let alone graduate trained nurses. Therefore, they decided to adopt an entrepreneurial approach to this social development project.

In recent years, the term 'social entrepreneurship' has generated a great deal of attention among both scholars and practitioners alike.[1] One of the most broad, and therefore perhaps most useful, definition is an individual or entity that seeks "large-scale change through pattern-breaking ideas about how governments, non-profits, and businesses can address significant social processes."[2] Many definitions focus on individuals, like Mr. Jameson and Mr. Wolf, who decided to work outside of the constraints of existing institutions, often working from scratch.[3] The motivation for this approach can be traced to the same motivations that spawned the not-for-profit organizations of the 20th century: namely, a response to the failures of both public and business enterprise.[4] However, in this case, the shortcomings of NGOs and philanthropic organizations has led to the adoption of new models of social development, including the use of entrepreneurial tactics that, as others have noted, would not be out of place in innovation hubs like Silicon Valley.[5]

With regard to the nursing school project in Bwindi, Mr. Jameson confirms the unorthodox characteristic of the approach, describing the planning phase as having "no long-term feasibility study, no interviews with the local community, no grant applications, and no support from international or local NGOs." Instead, they adapted techniques honed from years of starting for-profit enterprises, using their own connections, expertise, intuitions, and private capital.

There are, of course, risks to this approach, and not all scholars believe that societal problems can be solved without the structure of public institutions.[6] However, the results are compelling. The Uganda Nursing School - Bwindi, affiliated with the Ugandan Christian University (UCU), is slated to open in November of 2013 and was completed in just two and a half years. It is also expected to be self-sustaining, through tuition payments, after only two years in operation.

Mr. Jameson took some time to discuss the Bwindi project, as well as his approach to social development and the larger phenomenon of social entrepreneurship.

Can you talk a little bit about your recent development project in Bwindi, Uganda? What specifically sets this apart from other, perhaps more traditional, development projects?

There are two main differences between the Bwindi project and other traditional development projects. First, Steve Wolf, Scott Kellermann and I established a "speed of trust." The fact that we were all committed to seeing this project succeed meant that we could rely on the fact that, as both project facilitators *and* stakeholders, we would each come through when the need arose. This allowed us to get started on crucial aspects of the nursing school without having all of the pieces in place, knowing that we could count on each other to meet obligations as we progressed. This allowed us to drastically cut down the total project time – from conception of the initial idea to the opening of the nursing school. Normally, a project would either have to be put on hold until key decisions are cleared, or would remain in development purgatory while committees sorted them out. Case in point: for the Nursing School diplomas to be valid in Uganda, we needed to have a certified university on board as an affiliate. While we had contacted Uganda Christian Universities (UCU) to use their name and logo on our diplomas, the final negotiations and agreements were not signed until April 2013. Had we waited to get started on this project until this very crucial step was cleared, the Nursing School would not have opened until 2015 or later. We established trust and mutual understanding with UCU early on and knew that they would come through.

Second, what was unusual about this project was that, between Steve and me, we had start-up funding secured even before the planning stage of the project was complete. Normally, a development need or project assessment is identified. Based on this, the entire project is outlined, including an estimation of all associated costs. At this point, the project proponents search for donors, grants, and other sources of funding. With the nursing school, we wanted to ensure that this project wouldn't fail specifically due to a lack of funding. We knew that the need for nurses existed, and that we had the right mix of people to give us a fair shot at establishing a self-sustainable nursing school in the long run; so we were willing to put the money up-front. However, another positive effect of having the start-up funds available was that we addressed costs and overhead as they came up. The amount of time this saved us was significant and probably another reason why we have managed to complete the construction of the school in such a short amount of time.

What exactly characterizes an entrepreneurial approach to social development? What obstacles are you avoiding by sidestepping governmental or ODA funding and support?

First of all, the return on investment (ROI) for us is the knowledge that, in addition to addressing a preexisting need, we can ensure that the project is self-sustaining in the long run.

Using the same approach that we would follow for a business or capital venture, we decided to take on the risk of investment by personally putting up the funding in advance and addressing costs as they came up. This means that, in the case of Bwindi, had there been significant delays or failures in achieving success at key steps, the resources already committed to the project would not have been recoverable. At the same time, if expenses were misjudged or underestimated, we would not have a grant or government funding upon which we could rely. Had we sought out traditional sources or partnerships, we would have been forced to contend with bureaucracy and red tape that would have slowed us down in the decision-making process. By assuming some of the forecasting risk and working on mutual trust with our partners – in essence that they would come through – we sidestepped many of the issues that ODA-funded projects face, whether they are protracted delays or an unnecessarily lengthy project timeline. By absorbing some of the risk, we were able to carry on with key processes simultaneously rather than mitigating these risks by waiting.

By absorbing some of the risk, we were able to carry on with key processes simultaneously rather than mitigating these risks by waiting.

If investors – private donors in most cases – are the ones absorbing much of the risk, how to you assuage their fears? Do you find that donors suffer from the same level of risk aversion as large, bureaucratic agencies?

This is probably correct. As I mentioned, in Bwindi we were willing to put up our own money as start-up funding. Considering that Steve comes from large corporate business and I am an entrepreneur, we were not as risk averse as large government agencies tend to be. However, there are ways to earn the trust of donors that can alleviate such anxiety. For example, we wanted to have a greater level of engagement in the project: I made several trips to Uganda between 2010 and June 2013 and I am personally involved in fundraising efforts within my network. I think that this personalized approach assures other partners and donors that the project is being managed well, and even encourages donors to give more than just their money. Thus, engagement is key. Donors, especially when giving to large organizations, may have doubts about how their money is being used. Subsequently, a large portion of that organization's activities may focus on transparency and other such initiatives, which aren't directly tied to the target population. In a project where the donors have a high level of involvement, this is typically not an issue.

Do you see this type of approach being adopted on a larger scale? Does its very nature limit its applicability to larger populations or wider geographic areas?

As a measure of "success" for the nursing school project, I would first look at health outcomes, rather than just the speed at which we have accomplished goals, or other similar project performance indicators. Basically, the question that matters most to me is, *What impact has the Nursing School had on local communities?* The key here is that we are working with local communities in rural areas. Whether you adapt this approach to the narrowest population or expand to larger communities, the entrepreneurial approach is still valid. What worked for us was that we had very capable local partners. While the need for nurses in Uganda is apparent – in 2010 there were just 13 nurses for every 10,000 people – we only became aware of this because of the work that the Kellermanns have been doing with the community hospital. [The Kellerman Foundation has been operating a community hospital in Bwindi since 2002.] Other than the community hospital, we also had the support of local health workers, and nurses from the community who are now taking on leadership positions within the nursing school. Thus, with the right mix of people and resources, this project could be replicated many times over. On a larger scale, I could see several small and medium-sized enterprises being established simultaneously – for example, 5-6 nursing schools operating in Rwandan villages at the same time – though, again, in our case we had excellent people in Uganda that made this approach feasible. When it no longer becomes possible to engage the people closest to the problem, it is time to scale down.

You have experience in entrepreneurship here in the United States, as well as in many developing countries globally. What would you say are the main differences – obstacles, opportunities – of working in developed versus developing countries?

There seems to be a wide scope for entrepreneurship in developing countries, especially in new or emerging industries. The use of technology or raw materials, for example, is crucial for business growth, but access to these resources remains a problem. In some cases, access is restricted through government regulation or trade barriers, which then facilitates the creation of grey markets, corruption and, ultimately, changes to the rules.

Developed countries have more experience with market forces and generally have more business-friendly mechanisms in place, even in the field of social development. Consider, for example, in the U.S. you can now incorporate as a B corporation. B corporations are, generally speaking, those businesses that are using their resources to solve societal or environmental problems. Additionally, you also have countless ways to organize a non-profit that better meets your needs and goals and, of course, offers a variety of tax incentives. This is a fairly new concept in developing countries such as Uganda, where the role of the NGO or social organization has generally been to "give," without building many mechanisms for getting anything in return. This does not necessarily hinder entrepreneurialism, but more can be done – such as incubators, start-up support, etc. – to foster entrepreneurialism in these countries.

What does the future hold for you, and social entrepreneurship at large? Who are the leaders in this field? Where do you see this movement going in the next few years?

On a personal level, I am in the autumn of my life. With skills and intuition refined over the years, along with a dose of good luck, I have led a good life, and I feel that now is the time to give back to society. A social investor seeks out opportunities in development that can guarantee some ROI. While for most social investors, the ROI usually means profits, I am interested in gaining satisfaction from helping improve the lives of those around me and in communities where I am involved.

In the larger picture, the vast majority of social development remains within the purview of NGOs and government agencies, but the emergence of the social investor – be it high net-worth individuals or aspiring entrepreneurs from local communities – is an interesting and exciting development. I think the future of social development rests in the hands of young leaders who are willing to take on leadership roles in society. For example, in my project in El Barril, Baja California, many young people are leaving the community to find opportunities elsewhere. This is due to the fact that the local community does not provide opportunities for higher education, nor does it offer many career opportunities. Thus, one of the challenges this community faces is to provide its youth with adequate engagement and opportunities that will help with development efforts. In Uganda, we have several young members of society who are taking on these leadership roles. For example, one of our nurses [the aforementioned Jane Anyango] left Bwindi to get her masters' degree in nursing in the U.K. and returned to head the Nursing School administration, which has led to the initial success of the Nursing School Project.

NGOs and government agencies play an important role in development, and are rightly the primary architects for many large-scale development projects, especially in areas such as infrastructure. But as more and more focus is placed on "micro-projects," as well as the localization of development priorities, I foresee a huge opportunity for the involvement of social entrepreneurs in these projects, and would hope to see even greater participation outside of the traditional channels. This is especially true of the youth, who hold the greatest potential to enact change.

NOTES

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CUBA IN MOTION

First-Hand Observations of a Country in Transition: An Interview with Collin Laverty

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Collin Laverty is president of Cuba Educational Travel. Laverty graduated from the School of International Relations and Pacific Studies at the University of California, San Diego in 2012, where he was a Foreign Language and Area Studies (FLAS) fellow. He previously worked as a policy analyst at the Center for Democracy in the Americas, where he currently sits on the board. Laverty is the author of several articles and reports on Cuba and U.S. foreign policy, including his recent report "Cuba's New Resolve: Economic Reform and its implications for U.S. Policy." He is the coauthor of a forthcoming report on the private sector in Cuba, which he will publish along with Dr. Richard Feinberg at the Brookings Institution in Fall 2013.

INTRODUCTION

In the five years since Raúl Castro accepted the presidency from his older brother, Cuba has experienced a number of incremental economic reforms – officially called "updates" in Cuba to avoid implying a complete departure from the status quo – that are irrevocably altering the lives and livelihood of a large majority of its inhabitants. The movement began with the liberalization of regulations for small-businesses and farms, and has since included the announcement of comprehensive tax reforms and the dismantling of state-owned enterprises.

The result of these changes has been the movement of hundreds of thousands of Cubans from the public sector into private industry, with the majority of these people operating small business enterprises such as barbershops, nail salons, and taxis.

The catalyst for these changes is the current state of the Cuban economy, which has been plagued by deep problems dating back decades to the fall of the Soviet Union. Since 1989, and the collapse of Soviet subsidies to the island nation, Cuba has been characterized by low productivity, a lack of domestic and foreign investment in capital, and a current foreign debt total of about $22 billion. These structural problems have even imperiled Cuba's once vaulted state-managed education and healthcare industries. The hope is that economic reform will reverse these trends.

Concurrently, the United States has also taken measures to change the status quo. In 2009, the Obama administration relaxed travel restrictions and remittances to Cuba, the first significant policy shift towards deepening ties between the two countries in nearly 10 years. U.S. officials have dubbed these changes "people-to-people" allowances, which they believe is crucial to facilitating the flow of information, strengthening Cuban civil society, and ultimately bolstering the nascent liberal changes in the communist state.

Colin Laverty has experienced these changes firsthand, on both sides of the policy shift. Laverty is a Cuba analyst and president of Cuba Educational Travel, an independently owned and operated company that organizes educational exchange programs and person-to-person contact between the people of the United States and Cuba. JIPS sat down with Laverty to discuss his first-hand observation of the changes taking place as well as his recommendations for U.S. policymakers, many of whom have accompanied Laverty on his many visits to Cuba.

These days, it would seem that the Cuban government is seeking a way to balance the need for economic reform with the desire to retain control. How do you see that tension playing out on the ground?

Up until now the government has been very cautious – prioritizing stability while also making drastic changes within the context of the last five decades of communist rule. While focused on the economy, the changes are also political in nature. One U.S. diplomat in Havana recently acknowledged that, as Cubans become more independent economically, they will also become more independent politically, noting that, in particular, the power schemes are shifting. It's inevitable that the growth of the private sector and a middle class will lead to new political constituents, posing new challenges to the government. Up until now the government has been able to manage this new dynamic, and I don't see them having major problems for the time being. I would classify the steps taken so far as Phase 1: decentralization, or the expansion of small-scale businesses and the increased ability to buy and sell homes and cars, all of which tinker at state control. Phase 2, which will likely include increased foreign investment, the creation of middle scale businesses, the addressing of the dual exchange rate system and other more significant policy changes will ultimately reveal the deep challenges the government faces in terms of improving the economy while retaining its monopoly on control. At some point soon, the government will also have to decide whether it hopes to increase its competitiveness by giving the population access to the internet.

In what ways has the economic reforms of the last six years impacted the different sectors of the economy? More specifically, who has gained the most, and who has lost the most?

In any reform process there are going to be winners and losers. The winners have been the nearly half a million cuentapropistas (self-employed) who have been able to open – or find work at – new businesses. Private farmers and cooperative farmers have also made significant gains, enjoying more freedom to produce, transport and market goods, enjoying higher earnings and more autonomy. Consumers have also benefited through access to more goods and services. Raul Castro and other reformers could also be labeled political winners, as they've fought the bureaucracy, ideology and other barriers to implement a reform program. Most importantly, the younger generation has benefited as hope for the future has increased. The losers have undoubtedly been the bureaucrats and ideologues opposed to the changes because of entrenched interest and ideology. However, moving forward, the changes will produce more losers outside of the realm of politics. Market reforms have already led to increased food prices, needed reforms to monetary policy will be painful and the State's needed removal of subsidies and bloated payrolls will leave many vulnerable. As in the 1990s, inequality can be expected to increase. The government has said it will create targeted welfare programs for the most marginalized, but the task won't be easy.

From the perspective of someone who spends most of your time in Cuba, having first-hand experience with the levels of bureaucracy and state control, what are the biggest barriers to running a business in Cuba today?

The three biggest challenges that come to mind are technology, a distorted market and a counterproductive mentality amongst some people. Cuba cannot be competitive when managers and employees don't have access to high-speed internet or long distance phone dialing. Period. My business is not located in Cuba, so luckily I don't have to deal with the distorted market, but for companies and individuals that do, it's a significant challenge. Imports are strictly controlled and the goods that are available at state-run stores are excessively overpriced and low quality. Part of it has to do with the effects of the U.S. embargo and increased shipping costs, but much of it has to do with outdated pricing methods and luxury taxes. In the end, businesses and individuals often buy their computers, televisions, phones and other goods from mules coming from Miami and Latin America instead of in official stores. Finally, the inefficient economic model has led many people to earn more economically, from theft, and politically, from putting barriers that the common attitude is to do nothing, rather than make things happen. With low salaries and excessive controls, the incentives are not there for low and middle level managers to say "yes." That being said, Cuba has much to offer in terms of human capital, with an educated, healthy workforce that's eager to do better. At some point the economic reforms should get to the heart of these problems and it will be a brighter day for businesses and workers in Cuba.

As Cubans become more independent economically, they will also become more independent politically.

How much do international relationships and partnerships influence the future of Cuba's leadership? Are the Castros pursuing relationships that might be more likely to preserve the Revolution?

One of the great achievements of the Cuban Revolution has been its successes in international diplomacy. Cuba, a rather insignificant island in the Caribbean, has been involved in many of the most important world events over the last 50 years – nuclear weapons, presidential assassinations, civil wars in Central America, independence movements across the globe, among others. At the same time, Cuba's international relationships with allies and enemies have strongly influenced domestic governance and popular opinion. Historically the country has suffered from overdependence on one country - e.g. Spain, the United States and then the Soviet Union – and even prior to the passing of Hugo Chavez, the Cuban government had begun to diversify its partnerships, strengthening ties with Angola, Brazil, Russia and other countries. While these countries may share ideology and similarities in international politics, they are also investing time, money and resources and push for a return on their investments, which helps encourage the government to reform, the opposite effect of the U.S. embargo, which provides cover to hardliners in the government and security apparatus to do nothing.

A specific reform often cited is the self-employment licenses, which are beginning to create new commercial sectors in Havana. What exactly does this change mean for Cuba and where have you seen the biggest impact?

The increased number of people opening and working at private businesses is impressive. A stroll down any street in Havana will provide ample proof of just how present the changes are, with dozens of different restaurants, bed and breakfasts, diners, nail salons, photography shops, mechanics, plumbers and other self-employed out and about. Many of the businesses are small-scale, employing 2-3 people, and are primarily situated in the service sector. As such, they will not fundamentally alter the Cuban economy. However, the opening has had an important effect on the thinking of Cubans who now creatively ponder how to be successful in the private market. Those who are successful actively look at growing their businesses or opening a second one. Most likely the government will expand the scope of private enterprise and medium and large-scale businesses will be formed, more profoundly affecting the makeup and performance of the Cuban economy. So far the changes are quickly leading to the growth of a new middle class in Cuba.

In the first Obama Administration, certain restrictions on travel and remittances to Cuba were removed, opening up a new flow of people and dollars between countries. What impact has this policy had on the reform process in Cuba, if any, and were you able to perceive changes on the ground?

The effect of the changes enacted by the Obama Administration has been huge. They couldn't have occurred at a better time. As it became easier for U.S. citizens and residents to visit and send money to Cuba, the Cuban Government also freed up the private sector in Cuba. Much of the startup capital for new businesses has come from relatives in the

United States, as do many of the inputs. Moreover, Cuban-Americans visiting family and non-Cuban Americans on people-to-people trips to Cuba often frequent these private establishments, boosting their market and also providing them with much needed know-how. Many small businesses in Cuba wouldn't be flourishing without support from family and friends in the U.S. The Obama Administration should take additional steps to allow for the flow of people, money and goods to Cuba, which will aid the growing private sector, a key goal of U.S. foreign policy toward Cuba.

President Obama and Secretary Kerry should take advantage of the unique position that they're in to drastically reform U.S. policy toward Cuba. The executive branch has significant flexibility to make important policy changes that do not require changes to the law or Congressional approval.

For obvious reasons, the vast majority of American officials have not spent time in Cuba. If you could take policymakers to Cuba, what would be the most important thing they should see?

Over the years I have helped to organize dozens of trips for U.S. Members of Congress and their staffers to Cuba with the Center for Democracy in the Americas. The trips are particularly important because so much is said about Cuba in the U.S., often times by people who have never set foot on the island, and reaching out and talking to Cubans gives policymakers a new perspective. We always try our best to give them access to a wide range of individuals from government, academia, religious organizations, the private sector and most importantly, average Cubans on the street and in their homes. Things aren't easy in Cuba for many, and there is a plethora of opinions about politics and economics amongst the population. However, it's hard to find one person who thinks that the embargo has done anything good for the country. This is an important message for members of Congress to see, hear and feel when speaking to the actual people who are affected by our policy on a daily basis.

Based on your experience and ground-level observations, do you have any policy recommendations for the U.S.?

President Obama and Secretary of State John Kerry should take advantage of the unique position that they're in to drastically reform U.S. policy toward Cuba. The executive branch has significant flexibility to make important policy changes that do not require changes to the law or Congressional approval. President Obama won about half of the Cuban-American vote, which no longer votes based on anti-Castro ideology and clearly supports engaging Cuba. He didn't pander to hardline Cuba exiles in either presidential election, doesn't owe them anything and they are increasingly insignificant. Within his executive authority he can expand travel, make some trade easier, authorize direct talks and take other important steps that would improve the bilateral relationship.

Right now the U.S. is not a positive influence in a country just 90 miles off the coast of Florida. Cuba is a neighbor and natural trade partner, but our policy has completely isolated us from the changes that are taking place. The next Summit of the Americas in Panama may not happen because all Latin American countries have said they won't participate unless the U.S. allows for Cuban inclusion at the event. Cuba currently holds the chairmanship of the Community of Latin American and Caribbean States (CELAC), a new hemispheric organization that includes all nations in the region – the next summit will be held in Havana. Brazil is building a port and airports in Cuba. Cuba is hosting talks between the Colombian Government and leftist rebels in an attempt to end that country's protracted civil war. Hugo Chavez came and went and Cuba, now having normalized relations with every country in the region and almost every country in the world, is still here. As Cuba makes drastic reforms to its economic system, it's communist China pushing them to make good on credits, socialist Brazil quietly discussing human rights, Islamic Saudi Arabia restoring its water system and capitalist Singapore managing the ports, while the U.S. remains on the sidelines, downplaying any positive changes.

A radical change in U.S. policy will not realistically occur overnight. However, the Obama administration should make the following changes:

•Acknowledge publicly that the reforms in Cuba are positive.

• Further loosen restrictions on U.S. citizens' travel to Cuba.

• Allow the growing private sector to export to the United States.

• Remove Cuba from the State Sponsors of Terrorism List.

• Encourage Cuba's inclusion in international summits and forums.

• Allow Cuba's participation in international financial institutions.

• Stop fining third country banks and companies for doing business with Cuba.

• End the illegal and counterproductive USAID Cuba "democracy program."

• Enter into bilateral talks with the Cuban government.

INSIDE CUBA

A Photo Essay

Russell Edwards
Pedro Pereira

University of California, San Diego, IR/PS

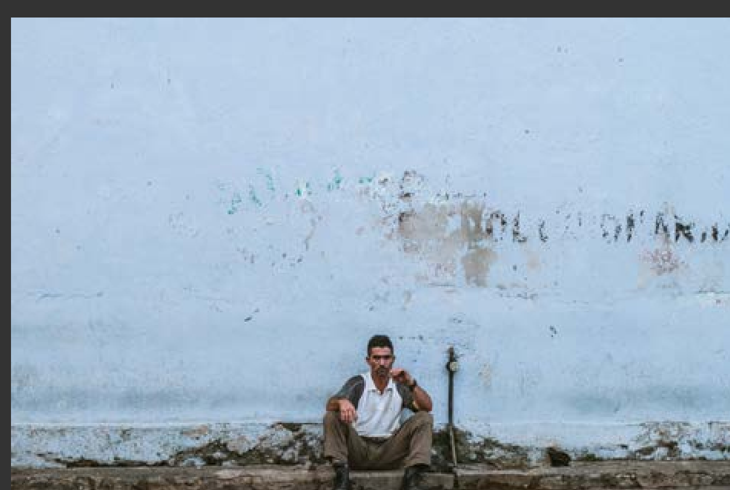
Pedro Pereira,
Car at Paseo de Marti, Habana Vieja.

Russell Edwards,
Man sitting at the Malecón in Havana.

Russell Edwards,
Apartment building in Havana.

Russell Edwards,
Percussionist at Santeria concert in Callejon de Hamel.

Russell Edwards,
Cigar maker in Havana.



Russell Edwards,
Man in Havana.

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