LATIN AMERICAN NEWSLETTERS

latin america-asia review

November 2007 ISSN 1744-8654

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China overtakes Canada as main source of US imports

China overtook Canada to become the US's biggest source of imports for the first time, according to US official figures published last month. The figures, which are for the first nine months of 2007, come from the US Census Bureau and they put Chinese exports to the US at US$234.4bn for the first nine months, just ahead of Canada's US$232.6bn.

What is significant is that China's trade with the US is badly out of balance. Its sales to the US are worth five times what it buys from the US. Canada's trade surplus with the US is worth only around a third of its exports and Mexico's trade surplus is equivalent to only around half its exports. The weakness of the dollar clearly has something to do with China's booming sales in the US. Although the renminbi has appreciated against the dollar over the past 12 months, it appreciation has been nothing compared to the 18.5% surge in the Canadian dollar. The renminbi has appreciated by a scant 5% against the dollar over the past 12 months.

US economy optimists argue that the weakness of the US dollar will bring the US current account (whose biggest factor is the trade account) back towards balance. At its worst, two years ago, the US current account deficit was running at 7% of GDP; the deficit is now down to around 5.5% of GDP. The problem with this argument is that, as the US Census Bureau pointed out, China's exports to the US actually increased in the month of September to a new record of US$29.4bn, even though the overall US trade deficit fell to its lowest level for 18 months. The renminbi's competitiveness against the dollar means that Chinese goods remain cheap in the US but US goods remain comparatively expensive in China.

If China continues as the US's main source of imports, the renminbi's undervaluation will become a greater concern to other countries interested in trading with the US, not just US companies which feel that they are being undercut in their home market. China now has a 16.3% share of US imports, up from 7.2% in 2001. China's power as an exporter means that it will probably run a trade surplus of around US$300bn with the rest of the world this year. The US, as the world's biggest economy, accounts for the bulk of this. China's trade surplus with the US, in the first nine months stood at US$187.6bn. And this is despite the import restrictions the US, and other countries, have put on Chinese exports of textiles and car components.

Now that the perils of cheap money have been laid bare by the sub prime mortgage crisis in the US, governments around the world are likely to revise their view that cheap Chinese goods are economically beneficial in clamping down on inflation. Unless China starts to balance its trade more, it is likely to find more barriers being erected to its products, not only in the US but also in other countries around the world.It is worth noting that Canada, like Mexico, makes up for what it has been loosing in the US import market by buying more US goods.

	R US$bn 2000-2006	R % M3 2000-2006	R/debt 2000-2006
China	166-1,066	10-24	8-13
Japan	347-875	6-15	2-2
Taiwan	107-266	19-34	8-8
Russia	24-295	44-77	2-5
Korea	96-238	29-38	2-2
Other Asia	325-647	27-30	2-2
Lat Am	136-271	23-25	1-2
Mid East	75-178	25-30	2-2
Cent & E Eur.	69-181	39-36	2-1
Ind ecs	344-334	3-2	0 0

Source: BIS

R = Reserves

THE SUBPRIME CRISIS IN THE US

How will the crisis affect Asia and Latin America?

The turmoil in the international financial markets since mid-August initially prompted international investors to pull back from risky assets and seek the security of US Treasury bills. Second thoughts -and the promise of cuts in US interest rates, which were fulfilled first in September and then again in October- prompted investors to go back into US equities. Analysts were quick to rationalise this move: they noted that as a result of globalisation 50% of sales generated by companies who are members of the S&P 500 come from outside the US. Some analysts try to argue that this phenomenon will underpin the US dollar: companies will have to repatriate these profits and investors will buy their shares. We don't buy this argument. We believe that the dollar will fall further against most major currencies.

Indeed, on 7 November the dollar lurched horribly following a comment from Cheng Siwei, the vice chairman of the standing committee of China's National People's Congress. He said that China should diversify its reserves away from the dollar. Such a move has long been feared by US economists and policymakers but China has previously never speculated publicly about implementing it. The tacit agreement between the US and China has been that the US will not press the Chinese too strongly on the undervaluation of the renimbi provided the Chinese continue to buy US securities and to fund the US current account deficit, which, in turn, is largely the result of China's export drive to the US.

If the Chinese break this tacit deal it is far from clear who will go on funding the US current accounts deficit. This will mean that the US will either have to pay higher interest rates to fund the deficit at its current level (still around 5% of GDP) or reduce it further. With this background, the question is: why should investors buy the shares of US companies, which generate only half their sales outside the US when, with a bit of research, they could buy non-US companies which have a much lower US exposure.

Our view is that exposure to the US economy is not going to be a comfortable experience for most companies over the next 18 months to two years. The sub prime turmoil has already shaken two of the US's biggest financial companies: Merrill Lynch and Citigroup. In some ways the current crisis has major similarities to the Latin American debt crises of the 1980s. Then US banks swallowed the argument that countries could not go bust, just as the current generation of bankers believed that financial engineering and derivatives could protect them from the consequences of their "bigger fool" lending policies. It is also worth noting that Citigroup was the first major bank (in 1987) to accept that "The countries do not go bust" argument was wrong.

It turned this decision into a competitive advantage, providing against Latin American loans it accepted were likely to be dud. Weaker banks did not have the cash flow to afford the provisions Citigroup made, so a host of what were then known as money centre banks were forced into mergers. Citigroup's huge provisions (US$15bn so far) against sub-prime assets is likely to set off a similar reduction of the financial services industry, though this time it will not be just US banks which will suffer. Already regional banks in northern Germany and northern England have been hurt.

The big question for both Asia and Latin America is how the financial turmoil will affect the US economy. Ostensibly the US escaped more or less unscathed from the Latin American debt crisis. A disappearance of a few big US banks had little effect on US jobs and economic growth. The effect of the Latin American debt crisis on Latin America, however, was profound. Our

> "The social consequences of this mass migration are just beginning to appear. The US has failed to rationalise the immigration situation, probably because of its distractions in the Middle East. Immigration has become an economic and emotive issue in the US."

view is that the effect on the US economy of the sub-prime crisis could be equally profound. It could force major changes in US economic behaviour which will have considerable effects on the US's trading partners. One big effect could be a rebalancing between consumption and saving: this would reduce US demand for credit and thus demand for imports.

There were two main consequences of the Latin American debt crisis. The first, reinforced by the Mexican crisis of 1995 and the Argentine collapse of 2002, was that Latin American policy-makers formed a new consensus that foreign debt, of any sort, is dangerous. Big borrowers such as Mexico and Brazil developed their own capital markets: they allow foreign investors in, but they are much less dependent on them than when they borrowed abroad. Indeed Brazil is now so attractive to foreign investors that the New York Stock Exchange took a symbolic 1% stake in the Brazilian market, the Bovespa, when the Bovespa went public at the end of October.

The second consequence of the debt crisis was huge emigration, principally from Mexico and Central America, to the US. This vast movement of people initially had only economic benefits: the US got the cheap labour its economy needed and Latin America got remittances which, arguably, were better directed and more economically beneficial than foreign loans. Latin America's economies, however, stagnated for a decade. Only now are they reviving.

The social consequences of this mass migration are just beginning to appear. The US has failed to rationalise the immigration situation, probably because of its distractions in the Middle East. Immigration has become an economic and emotive issue in the US. In early August the Department of Homeland Security announced that it was increasing penalties for companies and executives who resorted to hiring illegal migrants. On 20 August, the US government deported Elvira Arellano, an illegal Mexican immigrant whose son was born in the US. In mid-August Arellano took the risk of leaving the sanctuary of the Chicago church where she had lived for a year to campaign in Los Angeles for immigrants' rights. Her deportation made headlines across the US and around Latin America for two reasons. Public pressure in Mexico prompted President Felipe Calderón to meet her and endorse her campaign.

Arellano embodies the hugely complicated immigration issue. To her supporters, she has been exploited. The US had needed her and used her (she worked at O'Hare International Airport) but now it needs her no longer, she is expendable. The danger of splitting her from her eight year old son comes a distant second to the needs of the US economy.

The second reason why Arellano's deportation is important is that it shows that the anti-immigrant mood in the US is strengthening. No major US politician has protested against Arellano's deportation. This suggests that anti-immigration rhetoric will increase in the run-up to next year's presidential elections. This combination of increasing anti-immigrant rhetoric and harsher policies will affect US relations with Latin America. Already, Calderón has signalled that he wants to keep his distance from the US and is busy mending relations with the US's bête noires in the region: Venezuela and Cuba.

Anti-immigrant rhetoric in the US may be a product of the slowing economy. The apparent collapse of the US construction industry has thrown a lot of hardworking immigrants on to the US labour market.Some of the US economic forecasts for the long term (the next two years) effects of the sub-prime mortgage crisis are extremely gloomy. Merrill Lynch's US economist believes, for example, that the US growth rate may be only a third of what it was in 2006. So far there is little sign of a major US economic slowdown, but we are convinced it will come.

If the US goes into a consumer-led recession some of the froth will be blown off the world economy. Some commodity prices, notably copper and oil, are likely to come down. Food prices will also weaken. It is worth noting that South America is expecting a bumper harvest. This should mean that maize prices, which have been pushing up food prices around the world, will fall further.

A slowdown in the US consumer demand will hit Mexico and Central America much harder than South America. South America, however, is vulnerable to any slowdown in Chinese demand which is unlikely to change until after the Olympics next year. More of Chile's copper goes to China than to the US, while Brazil and Argentina sell the bulk of their soya to China.

The key effect, however, of a significant recession in the US's economic and political influence will be undermined. Even Mexico, which swallowed the neoliberal Washington Consensus more or less neat, has been backing away from the idea that free markets and democracy can reduce poverty significantly. China is a prime example of successful economy that has neither free markets nor democracy. Indeed it is possibly the only example of a successful (fast growing, low inflation, poverty reducing) economy that does not have free markets.

“The danger for the Chinese economy is that the lack of a free market will create destructive distortions in the economy. The most obvious sign of this is the wild overvaluation of Petro-China which, thanks to its initial public offering on the Shanghai exchange became the world's first US$1trillion company by market capitalisation.”

The danger for the Chinese economy is that the lack of a free market will create destructive distortions in the economy. The most obvious sign of this is the wild overvaluation of Petro-China which, thanks to its initial public offering on the Shanghai exchange became the world's first US$1trillion company by market capitalisation. As many analysts have pointed out, taking the freer Hong Kong market as a guide, the market capitalisation is actually two-thirds lower.

Chinese investors have so few choices about where to put their savings that they are forced to chase the prices of equities they can buy to ridiculous levels. As the Latin American debt crisis and now the US subprime mortgage disaster show, eventually markets exhaust the supply of bigger fools. What seems to appeal to Chinese policymakers is the Latin American combination of natural resources and states with stronger public sectors. China recently announced that it was setting up a fund to invest US$6bn in projects in Venezuela. This looks similar to the huge promises made by China's leader Hu Jintao on his Latin American tour of 2005. A lot of these have yet to materialise.

In Latin America, the disenchantment with neoliberal economic policies is growing. There are growing signs the President Lula da Silva in Brazil may finally be making some leftwards moves. One sign of this is his reassembling of state companies: state-owned companies have been buying rivals and bolstering their market position.

CENTRAL BANKS

The changing role of reserves

China is not the only emerging market in which the central bank has been accumulating reserves. In Latin America, as well as in other emerging markets, central banks have been accumulating reserves.

The most dramatic run-up in Latin America is in Brazil, where reserves, which were a cause for IMF concern in 2000, now top US$150bn. The big economic questions, addressed by the Bank for International Settlements (BIS) in its recent annual report, are; what purpose do reserves have in a modern economy and are central banks the appropriate institutions to manage reserves?

Asia, especially China which has been accumulating reserves at what even the BIS hints is a destabilising rate, is starting to believe that perhaps central banks are not the right institutions to manage reserves. Worth noting is that China has formed links with a US private equity firm, Blackstone, which

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Source: BIS

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astutely floated on the New York Stock market just before the current bout of financial jitters. The plan seems to be that Blackstone will help China's central bank diversify its reserves which are assumed, by financial markets, to be almost entirely invested in US Treasury securities. Blackstone reportedly advised China to back (the failed) take-over by the British bank Barclays of ABN-AMRO a leading Dutch bank. More interesting still is that influential economic officials in China have also hinted that some the reserves will be used in fund to buy strategic stockpiles of commodities.

The US has no use for reserves as it prints dollars, which has been the world's reserve currency since the eclipse of sterling.The management of its stockpiles of oil and base metals has a major effect on commodity markets. The US tends to buy when prices are low and sell when they are high.

What the table overleaf shows is how reserves have changed in the past six years. For Latin America (which the BIS define as Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela) the big change has been in the ratio between reserves and short-term debt. Reserves are now twice the value of these countries short-term (up to one-year) debt. Eastern Europe is the only region where the ratio has moved in the opposite direction: this is probably because so many East European countries have joined, or are on their way to joining, the Euro. Another interesting point from the BIS table is how little monetary illusion has changed in Latin America. In 2000, when convertibility in Argentina was still the rage, reserves were equivalent only to 23% of broad money. Under convertibility the central bank tied money supply to reserves. These reserves were supposed to be generated in the traditional way by exports but as convertibility decayed foreign borrowing was used to beef up the money supply.

Now the figure for the whole of Latin America is up, but only to 25%. Compare this with the changes in China (10% to 24%) and Russia (44% to 77%). This suggests that depositors in China and Russia have little confidence in the banking system. Odder still is the data received from Japan, which suggests that the authorities are still continuing to pump out money into the economy to try to get it moving. In industrialised countries monetary illusion is complete: Bank of England bank notes still promise to pay the bearer, but what the bearer will get is unclear.

Bizarrely, the only Latin American economy to have addressed these issues discussed by the BIS is Venezuela. President Hugo Chávez has an undervalued reputation as an economist. His instinct that central bank reserves - which are reaching 25% of GDP- were far too high is clearly correct. Orthodox economists may quibble at the way he raided the central bank's reserves to pump up public spending, but the policy is clearly right.

What is odd about Chávez's lead is how few other governments have followed. Peru, a country with pressing social problems, has the equivalent of 12% of GDP sitting in the central bank. The big question is what Brazil will now do; its reserves, by far the biggest in the region, will, on current trends, be equivalent to the whole of the public sector's foreign debt in 12 months time.

Brazil's choice will be particularly interesting because the Real is slowly internationalising as a currency. The BIS notes that in several emerging countries where reserves exceed liquidity needs, domestic monetary policy is becoming more closely watched than central bank reserve levels as a measure of a country's credit-worthiness. Other Latin American countries, notably Chile, have already set up funds outside the central bank to manage windfalls. These funds are used mostly to ensure that the budget does not become unhinged. The surge in reserves across the region poses a completely new set of questions that will demand new answers.

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Costa Rica switches sides

The Costa Rican government severed its six-decade-long tie to Taiwan on 1 June and switched diplomatic recognition to the People's Republic of China. Costa Rica's President, Oscar Arias, said that the decision was "an act of elemental realism due to the growing importance of China in global affairs". The change in Costa Rica's foreign policy towards China is unlikely, however, to skittle over the rest of Taiwan's allies in the region in the short term. Taiwan is, however, likely to have pay even more for the diplomatic support of Central America.

Taiwan's president, Chen Shui-bian said on his trip to Central America at the end of August that China had simply bribed Costa Rica to change sides. He said that China had spent US$400m on persuading Costa Rica to switch though he made it clear that not all this money had been spent in Costa Rica.

The main reason for the change was Costa Rica's surging exports to China. Costa Rica is one of Intel's major micro-chip manufacturing sites. A large proportion of these chips go into PCs made by Lenovo, the personal computer manufacturing business which China bought from IBM in 2005. In 2006 Costa Rica exported goods worth US1.083bn to China and imported goods worth US$618m from China. Costa Rica is rare in Latin America in running a trade surplus with China. The Costa Rican government admits that 93% of the country's exports to China come from Intel, the microchip manufacturer which has one of its main global production facilities in Costa Rica.

The success of the Intel facility is powering the Costa Rica's exports. These represent 22% of the country's total exports, which in the first quarter of 2007 came to US$$2.21bn, up 11% on the same period of 2006. The surge in demand for microprocessors from Lenovo in China converted China into Costa Rica's second biggest export market after the US. In March the US accounted for 42% of Costa Rica's exports while China accounted for 23%.

Following the change in diplomatic recognition from Taipei to Beijing, the Cámara de Exportadores de Costa Rica (Cadexco) said that it would try to develop and diversify Costa Rican exports to China. Mónica Araya, the president of Cadexco, claims that companies should be able to increase exports of perishable goods; software and medical products to China.

China exploited the importance of Lenovo's business with Intel in Costa Rica to encourage the Costa Rican government to make the switch from Taipei. Beijing insists that countries cannot continue to recognise Taiwan, which Beijing regards as a rebellious province, if they want an embassy in Beijing. Beijing is not bothered, however, if countries continue to trade with Taiwan once they have switched diplomatic recognition to Beijing. Costa Rica's trade with Taiwan is, however, small in comparison with trade with the mainland: some US$260m annually. On this trade, Costa Rica ran a deficit of about US$75m, according to figures from the Central American economic integration secretariat (Sieca).

As Costa Rica has a target of doubling the country's total exports to US$18bn by 2010, the choice of Taipei or Beijing was a no-brainer. China's potential as an export market is far greater than Taiwan's. Costa Rica kowtowed in the approved fashion. In an official declaration it recognised "the People's Republic of China [as] the sole legitimate government representing the whole of China" and that "Taiwan [was] an inalienable part of the Chinese territory".

In a bitter diplomatic note the Taiwanese foreign minister, James Huang, declared: "It is ironic that a Nobel Peace Prize winner establish[ed] diplomatic relations with a country that does not respect peace, nor democracy, nor human rights". Huang was referring to Arias, who won a Nobel Peace Prize in 1987 for helping to resolve conflicts in Central America. To be fair to Arias, China's poor human rights' record has not deterred 168 nations represented in the UN from maintaining diplomatic relations with China. Taiwan, meanwhile, is currently recognised by only 24 countries. Five of these countries are in Central America: El Salvador, Guatemala, Honduras, Nicaragua and Panama. Haiti and the Dominican Republic also recognise Taiwan. In the English-speaking Caribbean the picture is more mixed, with countries playing off the rivalry between Beijing and Taipei (see box).

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Trade may have been the principal reason for Arias's decision but politics also came into the mix. Arias is seeking a non-permanent seat in the UN Security Council for Costa Rica next year and Chinese backing is necessary. The idea that Arias sees himself as the world's peace-maker and that he can solve Chinese-Taiwanese hostilities, or even encourage China to improve its human rights provisions, would be ridiculous were it not for Arias's almost boundless ambition.

Costa Rica's switch only prompted other members of the Central American Integration System (Sica) to reaffirm their commitment to Taiwan. Nonetheless, the Beijing government made it clear that Costa Rica is "the first step" to win over other Central American and Caribbean countries. In order to set off a "domino effect" in the region the Chinese will allow Costa Rica to run considerable trade surpluses. China vowed to take on Taiwan's investments in Costa Rica and has promised to build an oil refinery.

The Costa Rican government said that it hoped that its decision would not affect relations between the Sica and Taiwan. In the short-run, the other countries in the region are likely to benefit as Taiwan opens its wallet to prevent further defections. Taiwan is already one of the main external sources of finance for Sica and it has vowed to provide more aid and business deals for the group's members, especially Nicaragua, as the government of President Daniel Ortega is ideologically closer to Beijing than to Taipei.

Longer term, trade with the People's Republic has more potential than trade with Taiwan, even for Central America. Unlike South America, Central America is not a net food exporter; nor is the region rich in minerals. According to Sieca's figures, the Sica as a whole exported goods worth US$608m to China last year. Costa Rica accounted for 85% of the regional total. Its exports doubled between 2005 and 2006. Meanwhile, the group as a whole imported US$1.6bn from China in the same period. Significantly, Costa Rica imported less than one-third of the total figure and was the only Sica country to post a trade surplus with China.

In comparison, Sica's trade with Taiwan was small, worth US$526m last year. Central America also ran a trade deficit with Taiwan: US$280m in 2006. The governments of El Salvador and Honduras hope to turn this position around after the signing, last May, of a trilateral free-trade agreement with Taiwan. However, Panama, Guatemala and Nicaragua already have free-trade agreements with the Taiwanese and still posted trade deficits.

TAIWAN'S COUNTER-OFFENSIVE

Flashing the dollars

Taiwan believes that diplomatic friendship can still be bought. At the end of August Taiwan's president Chen Shui-bian began a weeklong progress through Central America, dispensing largesse.

The aid he is pledging is an increasingly unpopular policy at home. Opposition lawmakers, and the local media, have criticised the president over his generous financial commitments to Central American countries. Chen's visit started in Honduras where there was a one day summit with Central American leaders (though none from Costa Rica) and then included El Salvador and Nicaragua.

Chen's pledges included a US$5m loan to Honduras while visiting the country and the possible construction of a hydraulic power plant there at a cost of US$300m. El Salvador has got a lock on Taiwan's imports of coffee: In 2006 Taiwan spent US$31m on coffee imports, (all from El Salvador) while China spent US$35m. Taiwan has 23m citizens and China 1.3bn. In Nicaragua, neither Chen nor Ortega mentioned figures but both were upbeat about the state of relations between the two countries.

"Taiwan's absence from the UN means that it cannot be a member of the World Health Organization. Nicaragua abstained in the 14 May vote on whether the World Health Organization should invite Taiwan to join. The US and Japan both support Taiwan's membership of the WHO and Canada wants Taiwan to join the WHO's technical committees."

In return Chen secured commitments from both El Salvador and Honduras to back Taiwan's attempt to rejoin the UN, this time as Taiwan. Previously, Taiwan had represented the whole of China. Taiwan was ejected from the UN in favour of China in 1971, and its efforts to rejoin since have been blocked by Beijing. In 1993, Taiwan sought to rejoin the UN as the Republic of China. Now it is happy to join as Taiwan. Nicaragua said that it would wait until the result of the referendum in Taiwan on whether to rejoin the UN before deciding whether to support Taiwan's UN application. The Taiwanese referendum is due to be held in March 2008.

Arguably Nicaragua has already had a lot of Taiwanese help this year. Taiwan and (bizarrely) Cuba were the main countries to provide help during the country's electricity supply problems in the first half of the year. Besides what Chen doled out, Taiwan is emphasising aid to Central America as part of its US$340m budget to assist third-world countries. Taiwan claims to offer new types of aid that it hopes China cannot match. The new development aid will include US$2m for St. Lucia, and, more surprisingly, extended aid for Costa Rica, the Taiwanese Foreign Ministry's International Cooperation and Development Fund said. The aid budget, which comes from parliament and the interest on a US$240m fund left over from US aid to Taiwan in the 1960s, has held steady for about five years as other government departments lose funding, Chen said.

The fund decided that from the second half of this year through 2008 it would offer aid it believes China lacks experience to provide. Chen Cheng-Chung, the fund's secretary-general, named agricultural and Internet expertise and hospital resources as three potential areas. Nicaragua asked President Chen for US$38m to help equip hospitals. When President Chen visited the Hospital Manolo Morales in Managua, the health minister, Maritza Cuan, asked him to give the hospital US$30,000 in medicine and equipment. Taiwan has already provided Nicaragua with knee surgeons; dentists; paediatricians, and gynaecologists.

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Latin America has been a priority for Taiwan this year. The president's trip followed an expedition by Vice President Annette Lu to other key allies, Paraguay, the Dominican Republic, Panama and Guatemala, in July. This was the first formal visit to the region by a Taiwanese official since Costa Rica switched allegiance to China.

In Latin America, Taiwan-funded scholarships and private investment aid would continue for Costa Rica as Taiwan "waits to see" whether that country switches back to Taiwan, President Chen said. St. Lucia will receive US$2m for public health, meat processing factories and banana planting, he said. Over the next18 months, a slice of aid money would go to the Vatican, arguably Taiwan's most influential ally, to help fund its effort to rid banana crops of disease in Latin America.

Energy is one of the industries in which Taiwan believes that it can provide most help to Central America. Nicaragua made a bid for Taiwanese help in developing its alternative energy sources from wind, volcanoes and, more conventionally, hydroelectric power. Guatemala is counting on Taiwanese help to build a new oil refinery to supply the whole of Central America.

Summit: On 23 August President Chen attended the VI heads of state and government meeting from Taiwan and Central America and the Dominican Republic. The summit was held in Honduras and the attendees were: Said Musa, the prime minister of Belize; President Óscar Berger of Guatemala; President Elías Antonio Saca of El Salvador; President Manuel Zelaya Rosales of Honduras; President Martín Torrijos of Panama; Nicaragua's vice president, Jaime Morales Carazo, and Vice President Rafael Alburquerque from the Dominican Republic.

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Taiwan's success with St Lucia

On 25 April the government of Saint Lucia announced that it wanted to renew diplomatic ties with Taiwan. The move, initiated by Prime Minister John Compton, made Saint Lucia the 25th country to recognise Taiwan. Thirteen of the 25 countries are in Latin America and the Caribbean. St. Lucia broke ties with Taiwan and recognized China in 1984 when Prime Minister Kenny Anthony came to power.

Saint Lucia's foreign minister, Rufus Bousquet, said that the government's decision to recognise Taiwan did not mean it wanted to break ties with Beijing, but China refuses to have relations with countries that have diplomatic ties to Taiwan, as they consider Taiwan a renegade province. The Taiwanese foreign minister, James Huang, visited Saint Lucia in December 2006 and March 2007, provoking fierce criticism from China. "We have been very careful about making this decision, and now that we have taken it, we do not expect the Chinese will love us any more for it," Bousquet said. "But we expect that they will conduct themselves in a manner that is acceptable to our government." Bousquet said that the decision was based on which country could offer a better deal to St. Lucia, where 20% of the population lives in poverty.

The People's Republic, which had built a sports stadium and was finishing a psychiatric hospital, called the switch back to Taiwan a "brutal interference in China's internal affairs." A statement carried by the official Xinhua News Agency on 1 May by Chinese foreign ministry spokesman Liu Jianchao said, "We express indignation and opposition."

Taiwan's ambassador to St Lucia all but accused the Beijing government of racism. Tom Chou, the new ambassador who arrived at the end of July, said that the size of the Beijing-built psychiatric hospital suggested: "it's the Chinese way of saying there are a lot of people in St. Lucia in need of psychiatric treatment."

Ties with China did not improve the lot of many St. Lucians. The last 10 years has seen a handful of Chinese businesses open on the island, mainly restaurants and shops. But St. Lucia has not seen the predicted influx of Chinese tourists.

For its part, Taiwan propagated new strains of fruits and vegetables and introduced agricultural techniques during its time here. Bousquet said Taiwan has agreed to help St. Lucia diversify its agriculture sector, boost tourism, develop livestock and create information technology learning centres, all of which fit into the government's plans to combat poverty.

JAPANESE CARS IN MEXICO

Taking over

Sales of Japanese vehicles in Mexico, long a stronghold of the General Motors; Ford, Chrysler and Volkswagen, are booming. In 2006, Japanese auto companies led by, Honda, Toyota and Nissan grabbed a record 32% of the Mexican market. That's up 9 percentage points since 2000, according to the motor industry association, Amia.

The rise of the Japanese has complicated the business outlook for General Motors, Ford Motor and DaimlerChrysler. They saw their combined market share of the Mexican market fall by seven percentage points to 48% over the same period. Volkswagen is also losing its market share. The German car-maker ended 2006 with a scant 12% of the Mexican market, a loss of nearly eight percentage points since 2000.

Japanese manufacturers have been helped by a trade agreement with Mexico, which was implemented in 2005, allowing more of their cars to enter the country duty-free. But price isn't the only factor driving sales. Quality and service are winning customers in Mexico, just as they have in the US. Honda and Toyota dominated the most recent J.D. Power & Associates' satisfaction survey in Mexico.

Just over 1.1m new cars and trucks were sold in Mexico in 2006, making the country the 14th-largest market in the world. Sales were boosted last year by cheap credit, and though credit remains historically cheap there are signs that the really fast growth in the market may be over. Even so, sales of new cars have jumped by 35% a year since 2000.

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Analysts claim that there is still plenty of pent-up demand. Only 20% of Mexicans own a car, despite rules in Mexico City which encourage people to own two cars. As an environmental measure, cars with odd number plates alternate each day with those even number plates on the capital's roads. Most residents get around this restriction by owning two cars: one with an odd and one with an even number plate.

Nissan has been selling vehicles in Mexico since the 1960s and operates two assembly plants in Aguascalientes and Cuernavaca. It's low-cost Tsuru is the nation's bestselling car. Even so, Nissan's sales slipped 2.8% in 2006, though they have picked up again in 2007. The big growth in Japanese sales is coming from newer Japanese players.

Toyota only started selling in Mexico in 2003 and has seen its sales increase more than 500% to just over 60,000 vehicles last year. Its manufacturing operation, for pick-ups and trucks, is at Tijuana. Toyota's most popular model is a Sports-utility vehicle (SUV), the RAV4. SUVs also feature prominently in the sales of other Japanese manufacturers such as Mitsubishi Motors, Suzuki and Honda.

One reason why Mexicans like Japanese cars is, as they tend to keep their cars for years, maintenance and warranties are big cost considerations. US companies and VW often require owners to get regular services at their dealerships some of which charge inflated prices for the work. Analysts said Honda and other Japanese companies are winning customers with transparent, low-cost maintenance fees that can save thousands of dollars over the life of the vehicle.

A survey found that a VW dealership in Mexico City wanted US$327 to perform a 10,000km service on a Jetta compact. Honda charges US$80 for a

"Nissan, which was the country's second biggest vehicle producer in 2006 behind General Motors (GM), is now the country's biggest producer. It is on course to produce around 480,000 vehicles this year. In 2006 GM produced 502,544 but this year is on course to build around 422,500 vehicles."

10,000km service on all models it sells in Mexico. The prices are posted at each dealership's garage and are the same throughout the country.

The Mexican government has high hopes for the motor industry. It said that it expects the country to be producing 3m vehicles by 2015. In 2006 it produced 1.9m vehicles.

In the shorter term, the industry's outlook is less impressive. In the first seven months of 2007, the seven vehicle makers in Mexico built 1.115m vehicles; 1.4% less than the 1.131m they produced in the first seven months of 2006.

Only Nissan, Toyota and Volkswagen increased their output. The traditionally big producers (Chrysler, General Motors and Ford) all saw double digit declines. Honda, a small producer was down 5%.

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The economy minister, Eduardo Sojo dismissed the current difficulties and said that he also expected the industry to increase its value added from US$39bn in 2006 to US$78bn in 2015. He expects the industry to continue to export between 70% and 80% of its total production.

Car production in Mexico

Period	Daimler Chrysler	Ford motor	General Motors	Honda
Jan 2006	23,990	25,122	39,239	2,165
Feb	28,428	28,558	36,703	2,090
Mar	33,372	33,553	43,609	2,125
Apr	20,412	28,092	34,121	1,810
May	33,950	33,360	43,718	2,225
Jun	37,012	33,237	48,391	2,220
Jul	19,049	5,722	32,805	2,045
Aug	27,678	36,515	49,992	1,696
Sep	16,918	33,937	51,604	2,040
Oct	21,692	33,756	45,612	2,072
Nov	32,330	34,987	45,980	2,194
Dec	18,556	23,071	30,770	1,580
Total 2006	313,387	349,910	502,544	24,262

Car production in Mexico

Period	Nissan	Renault	Toyota	Volks wagen	total
Jan 2006	31,736	--	--	33,039	155,291
Feb	34,770	--	6,131	30,150	166,830
Mar	40,283	--	2,925	36,776	192,643
Apr	22,078	--	2,618	23,081	132,212
May	33,245	--	0	25,059	171,557
Jun	35,902	--	5,643	31,922	194,327
Jul	34,178	--	0	24,803	118,602
Aug	35,152	--	5,781	22,713	179,527
Sep	28,753	--	2,625	28,700	164,577
Oct	45,074	--	3,047	28,644	179,897
Nov	39,587	--	2,351	36,336	193,765
Dec	27,681	--	2,088	25,797	129,543
Total 2006	408,439	0	33,209	347,020	1,978,771

Source: Amia

“What is interesting is that, per capita, Latin American countries spend more on education than China, and even weighted for purchasing power parity, but they produce fewer engineers and other professionals.”

HIGHER EDUCATION

The differences between Asia and Latin America

Although Latin American policymakers say that they are worried by the higher educational attainments of Chinese and Indian students, the main focus of Latin American educational policy is still on the early years. Both Mexico and Brazil are spending increasing portions of their education budgets on pre-school and primary education. Asian countries, by contrast, prefer to spend their money on creating a scientific and technological elite

Latin American policymakers have long been worried at the impressive educational figures generated by China. The most quoted is that each year China produces 442,000 graduate engineers plus another 42,000 people with a Master's in Engineering and a further 8,000 who have completed a doctorate in the subject. This is substantially more (four times more) than even the US produces. The US has been, traditionally, the economy with the best-qualified workforce.

What is interesting is that, per capita, Latin American countries spend more on education than China, and even weighted for purchasing power parity, but they produce fewer engineers and other professionals. One reason for this is that Latin American education ministries subscribe to the currently fashionable educational theory that the most important years for a child's education are from ages one to seven. In Mexico, for example, pre-school education will be compulsory from 2008.

China's educational focus, and, to a less dramatic extent, India's as well, is on higher education. It is worth noting that Andrew Chi Chinh Yao has been lured to Qinghua University, near Beijing, from Princeton, in the US. He is one of the world's top computer scientists and the significance of his move was reported in the New York Times at the end of October 2005. By contrast, Latin America's few Nobel prizewinners for science work abroad: Mexico's only Nobel prizewinner for science, Mario Molina, works in the US.

Currently China has twice as many students at domestic universities as Mexico, even though its education spending is half of Mexico's. In 2003/04 there were 2.33m Mexicans aged between 18 and 24 in higher education. That is equivalent to around 20% of the Mexicans in that age bracket. The 4.6m Chinese in higher education are the privileged elite of around 140m of their coevals. The teaching of these Chinese students is probably better than in Mexico. Around 40% of the university teachers at the University of Beijing, for example, have a second degree or doctorate from a foreign university.

The question for China is whether the deliberate creation of an educated elite (and one that is predominantly scientific and technological) is the right policy for a developing country. Latin America's education systems have aimed at educating everyone and some institutions, notably the Universidad Nacional Autónoma de México (UNAM) have a proud history of allowing poor children to have opportunities that their parents never even conceived.

Latin American academics probably have more intellectual freedom than their Chinese counterparts, though this will change if more foreign academics move to China. What Latin America has in abundance is a lot of clever academics brimming with ideas about how to speed up development, improve income distribution and generally make life better for the next generation. What Latin America lacks, as usual, are the bloody-minded managers, both political and economic, to implement these ideas. The Inter-

American Development Bank's view -that the key difference between China and Latin America is that China chooses the right policies and then implements them efficiently- is undeniable.

"Economists argue that one of the main reasons for Mexico's comparatively low productivity growth is its low level of human capital. Human capital reflects the skills flexibility not only of Mexican workers but also their managers. The OECD defines human capital in Mexico as the average number of years of schooling. For the bulk of its working population (ie aged from 35 to 54), Mexico has the lowest figure for any member of the OECD."

Some statistics

Brazil spends about 8% of its annual budget on education. This is about 3% of GDP. Mexico spends 18% of its budget on education, by far the highest proportion in the 20 countries that belong to the Organization of Economic Cooperation and Development (OECD), but this is only 4% of GDP. Under a law passed in 2002, the government should be devoting 8% of the country's GDP on education in 2006. Even at 4% of GDP Mexico is still spending twice as much in GDP terms as China. Adjusted for purchasing power parity Mexico is still spending twice as much on education as China.

Although neither of the Latin American big two countries is handling the school population that China (or India) has to manage, they are still dealing with large numbers in global terms. The huge increase in population in Mexico and Brazil, especially, means that these two countries' educational systems are handling similar numbers to the US. According to OECD figures (Stéphanie Guichard's The Education Challenge in Mexico, from which virtually all the education statistics from this point on in this article are taken) the US has about 56m people in its educational system, while Brazil has 66m and Mexico about 28m. Guichard notes that there are more school-aged children in each of the six largest Mexican states than in whole of either Greece or Portugal.

Economists argue that one of the main reasons for Mexico's comparatively low productivity growth is its low level of human capital. Human capital reflects the skills flexibility not only of Mexican workers but also their managers. The OECD defines human capital in Mexico as the average number of years of schooling. For the bulk of its working population (ie aged from 35 to 54), Mexico has the lowest figure for any member of the OECD.

Admittedly, younger workers are better educated than the 35 year-olds but what is disconcerting, and unique amongst all OCED countries, is that the oldest workers (the 55 to 64 year olds) are better educated than the generation below them. This data reflects the failures of Mexican education policy in the 1960s and early 1970s. In 1960, the average Mexican had less than three years of schooling. In 2004, he or she had eight years. This is still low, even by Latin American standards: Mexican education officials reckon that children who start school this year will now enjoy 13 years of schooling.

There must be some doubt about whether this noble ambition will be realised. What is worrying is that there has been little change in the figure for average years of schooling in Mexico over the past 20 years. This is very different from other, comparatively poor OECD countries, such as Korea, Spain or Greece which have made startling progress in increasing the years of schooling.

So the initiative by the radical mayor of Mexico City, Marcelo Ebrard, is highly significant. As Ebrard is the most likely presidential candidate for the leftwing Partido de la Revolución Democrática in 2012, the move has important implications for other politicians in Mexico.

Ebrard's initiative is to offer cash prizes of US$300 to primary school children (aged between four and 12) who produce outstanding results. The children have to score average marks of nine out 10 throughout the year to qualify for the prize. Axel Didriksson, the education secretary for Mexico City, said that the star pupils would also be eligible for extra classes. The children could choose whether to take extra classes in science, maths or education.

The importance of the initiative is threefold. There is an increasing realisa-

"Once governments start categorising teachers as good or bad they run into problems with the unions. The teachers' union, the SNTE, is the biggest trade union in Latin America, with 1.4m members."

tion in Mexico that the country's education system is failing its pupils. The federal government has begun to square up to the hugely powerful teachers' union, the Sindicato Nacional de Trabajadores de la Educación, led by Elba Esther Gordillo. Gordillo, sensing the imminence of a political fight, has tried to warn Josefina Vázquez Mota, the education minister, not to interfere in education and upset the teachers'domination. The Mexico City initiative sidesteps the teachers' union.

The second reason why the initiative is significant is that where Mexico City leads the rest of the country soon follows. Ebrard's patron, Andrés Manuel López Obrador, who was narrowly defeated in last year's presidential election, pioneered flat monthly payments to pensioners and to single mothers. So popular were these that most regional governments now also offer them. The third reason why the scheme is significant is that it is not classically left-wing. Old-style socialists prefer subsidies to incentives. The Mexico City proposal appears to be completely meritocratic. Private school pupils will not be eligible for the prizes.

Didriksson said that pupils would get US$15 a month to cover expenses such as transport and books and a one-off annual payment of US$180. This will go into a savings account at a commercial bank. The idea is that one payment secures support from the family while the annual payment rewards the pupil. The programme will be launched in November with one hour of extra classes a week. The idea is to build this up quickly to three hours a week.

Educationalists, predictably, fret that this programme may not work as it is intended or may even be counter-productive. In education however, the best is always the enemy of the good. The Mexico City government does not know what the end result of the programme will be, but at least it is trying something. Even if the programme fails, the government will have learnt some useful information on why it failed.

If the Mexico City experiment works, similar programmes could be rolled out across the region. Mexico, like most of Latin America, lags China, India and Eastern Europe in valuing education. One of the great achievements of post-revolutionary Mexico was the creation of the virtually free national university, UNAM, which offered the children of poor peasants and manual workers opportunities their parents never had. UNAM is still an influential institution, though its political weight has diminished dramatically. A generation ago over half of the cabinet would invariably be UNAM graduates. In Calderón's cabinet graduates from private universities dominate.

Mexico has been trying to improve its education system since the beginning of the 1990s. The problem is that it is easy for governments to allocate more money to education but hard for them to ensure that the money is spent on improving quality. Once governments start categorising teachers as good or bad they run into problems with the unions. The teachers' union, the SNTE, is the biggest trade union in Latin America, with 1.4m members.

So far the SNTE has been successful in siphoning the increases in the education fund. Guichard points out that 90% of the money spent on education goes on salaries. To be fair, this is true for the budget as a whole: most economic commentators reckon that only about 10% of the Mexican budget of around U$157bn is at the government's discretion. What is more striking, as Guichard points out, is that Mexico is the OECD country in which teachers' pay increased most in real terms between 1996 and 2002. This is why Gordillo commands such loyalty and political power.

Guichard also points out that the decentralised way education is managed in Mexico means that it is all but impossible to shift teachers from places which are losing population to those that are gaining it. This means that some teachers have tiny classes while others have rooms of 50 or more children. Another practice Guichard highlights is the way the SNTE controls the hiring of teachers. She notes that according to a recent survey in Este País, a third of teachers admitted that buying teaching jobs was common practice. Social research shows that teachers are comparatively well paid and virtually unsackable. Almost the worst that can happen to a dud teacher is that he or she is asked to move schools.

What is clear is that the Mexican educational system, almost certainly unwittingly, educates a few people comparatively well, and most poorly. A comparison of the education attainments of 15 year olds in selected Latin American countries (Mexico, Brazil, Argentina, Chile and Peru), shows that those Mexican pupils in school at 15 are attaining the levels of their peers in Brazil, Argentina and Chile, but only just over half of them are still in school. The other Latin American countries have at least 75% enrolment: this is true even Peru, where attainment is significantly lower than the other Latin American countries.

"A new piece of analysis from Education Sector, a Washington-based think tank on education issues, found that that although there was a 15% increase in the issuance of foreign student visas (...) the number of foreign students studying in the US is still about 20,000 less than the pre-9/11/01 figure."

THE US AND EDUCATION

Are foreign students spurning the US?

A new piece of analysis from Education Sector, a Washington-based think tank on education issues, found that that although there was a 15% increase in the issuance of foreign student (F-1) visas by the US government in 2005/2006, to 273,870, the number of foreign students studying in the US is still about 20,000 less than the pre-9/11/01 figure. International competition for students is hotting up. The Bologna Process in Europe, which make it easier for European graduates to do post-graduate work in other European countries, has led to a fall in the number of European students studying in the US. Singapore is also trying to establish itself as an international centre for higher education. Australia already has.

In 2002 the OECD estimated that the global higher education market was worth about US$30bn in 2000. The three market leaders according to the OECD were the US (with a higher education income of US$10.2bn or 3.5% of the country's total non-factor service exports); the UK (with an income of US$3.75bn or 3.2% of its total service exports and Australia with US$2.18bn or 11.8% of its total service income. Since then Australia has overtaken the UK in the number of foreign students it educates.

The US is still the single biggest educator of foreign students. What is significant is that while the US appears to be losing students, other countries are gaining them. From 1999 to 2005, foreign enrolments increased by 28% in Britain, 42% in Australia, 46% in Germany and 81% in France, the Education Sector study noted.

In 1999 the US educated 31% of all international students. The UK came next with 16%, followed by Germany and France (12% and 9%, respectively) and Australia (8%). These five countries account for more than 75% of all foreign students studying in the OECD area. Australia's market is China, Malaysia and Singapore.

The US introduced tougher visa requirements for students after the 9/11 attacks. This probably hit applications. Academics also say that applications in popular fields, such as computer science and engineering, had started to fall off before 2001. This is because a US qualification was no longer a guarantee of a Green Card and a job in the US. Chinese and Indian students flocked to US in the 1980s and the 1990s because the US high-tech industry had a real lack of skilled people. The dotcom bust and the continuing sluggishness in the computer industry in the US has encouraged the next generation to stay at home.

In 2005/06, the number of international students enrolled in US higher education institutions remained steady at 564,766. This is a fraction of a percent of the previous year's totals, according to Open Doors 2006, the annual report published by the Institute of International Education (IIE), with support from the US Department of State's Bureau of Educational and Cultural Affairs. This marks the seventh year in a row that America has hosted more than half a million foreign students. A peak of 586,323 occurred, which has been followed, three years ago, by declines of 2.4% and of 1.3% in the past two years.

Australia is now the world's second biggest educator of undergraduates and graduates. During 2005 there were a total of 344,815 enrolments by full-fee overseas students in Australia. This represents an increase of 7.0% from 2004 and shows slightly stronger growth than the 5.9% recorded between 2003 and 2004. There are now more foreign students studying in Australia than in the UK. The UK had 318,395 foreign students in 2004/05.

There are limitations to any method for monitoring the US's record in attracting foreign students. The correlation between F-1 visas issued and enrolments is not exact. Some students acquire visas but don't come; some F-1s are, effectively roll-overs; awarded to students already enrolled in the US but needing a new visa to return.

Enrolment figures are also imperfect. Most foreign students are in the US for more than one year, so it can take several years for changes in visa policy or student enrolment patterns to appear. The advantage of the "visas awarded" figure is that it is current and reflects the most recent trends in the consular offices.

Enrolments

A new analysis included in Open Doors for the first time shows US colleges and universities reporting an 8% increase in new enrolments for 2005/06, with 142,923 newly enrolled students in autumn 2005, compared with 131,945 the previous autumn.

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A more recent online survey, which IIE conducted with seven other national higher education associations to provide an early snapshot of autumnal 2006 enrolments, shows 52% of US campuses reporting increases in new enrolments for Fall 2006, and only 20% reporting declines (28% reported no change). These findings, together with the report from the US Department of State Bureau of Consular Affairs which showed the 15% rise in the number of student visas issued in the year ending September 2006, indicate that foreign student numbers are increasing in the 2006/07 academic year.

The sheer scale of the US higher education industry is daunting. The US has several thousand campuses able to host international students. This is 10 times as many as any other host country.

For the fifth consecutive year, the University of Southern California remains the US campus with the largest international student enrolment, at 6,881 students. Columbia University moved up from fourth to second place with 5,575 international students. The 2005/06 top five host institutions - all perennially popular destinations for international students - are rounded out by Purdue University (moving up to third place from sixth), New York University (up one place to four), and the University of Texas at Austin.

> “Strong increases from a number of countries in the Middle East offset continued declines in the number of students from several other countries this year. Among the larger senders, most notable was the increase in the number of students from Saudi Arabia (up 14% to 3,448), which is consistent with a new Saudi government program that began to make scholarship awards in Fall 2005.”

Each of these top five host campuses reported an increase in the total number of international students. The Open Doors report found that there were 142 US campuses that hosted at least 1,000 foreign students.

Open Doors 2006 reports increases in the number of students from seven of the 10 leading places of origin, with particularly large increases from the Republic of Korea (third place, up 10% to 58, 847), Taiwan (sixth place, up 8% to 27,876), and Mexico (seventh place, up 7% to 13,931). India remains the largest sending country by a large margin, although the number of students declined by 5% this year to 76,503. Mainland China remains in second place, with numbers steady at 62,582 (up 0.1%). Students from Hong Kong, now the 12th leading place of origin (up from 15), increased by 9% to 7,849. Notable increases of 25% each were seen in students from Nepal (moving up to 19) with 6,061 students, and Vietnam (now 24), with 4,597 students.

Among the top 20 senders, the sharpest rates of declines in 2005/06 were seen in students from fourth-place Japan (down 8% to 38,712), eighth-place Turkey (down 7% to 11,622, reversing last year's growth of 9%), 15th-place Colombia (down 7% to 6,835), and 20th-place Pakistan (down 8.5% to 5,759). Malaysia, with a 10% decrease to 5,515 students, was the only country to drop out of the top 20.

Asia remains the largest sending region, accounting for 58% of total US international enrolments. The total number of students from Asia showed an increase of just under 1% in 2005/06, with 3% and 2% gains from East and Southeast Asia balanced by a 3% decline in students from South and Central Asia.

Strong increases from a number of countries in the Middle East offset continued declines in the number of students from several other countries this year. Among the larger senders, most notable was the increase in the number of students from Saudi Arabia (up 14% to 3,448), which is consistent with a new Saudi government program that began to make scholarship awards in Fall 2005. In addition, students from Israel increased by 3% to 3,419, reversing a decline of 4% the previous year. There were declines in the numbers of students coming from a number of other countries in the region, including Lebanon, United Arab Emirates, Syria, and Qatar.

Some of the declines in US student visas being awarded are steepest in countries with large Muslim populations. Since 1997-98, the report finds the number of visas awarded to students from the UAE, to be down 75.6%. There is a 61% fall in F-1s for Omanis; a 60% fall in F-1s to Moroccans; and 55% falls for both Bangladesh and Indonesia.

Heightened security concerns may not be the only reason for the drop off in F-1s. There was a near 50% drop is F-1s issued in Switzerland. This is probably because of the "Bologna Process" efforts to harmonise higher education in Europe. Many US universities had been warning that the Bologna Process would encourage more of the best European students to pursue their graduate educations in Europe and not the US. Overall the issuance of F-1s in the whole of Europe was down by 21% in the period.

More surprising is the 47.5% drop in F-1s issued to Latin Americans. The big rise in F-1s is from China, India and South Korea.

Cash contributions

International students contribute approximately US$13.5bn to the US economy, through their expenditure on tuition and living expenses. Department of Commerce data describes US higher education as the country's fifth largest service sector export. The Open Doors report found that 68% of all international student funding comes from sources outside of the US.

California remains the leading host state for international students (75,385, up less than 1%), followed by New York (64,283, up 4%), Texas (46,869, down 1%), Massachusetts (28,007, up less than 1%), and Florida (26,058, down less than 1%), followed by Illinois, Pennsylvania, Michigan, Ohio, and Indiana. In the top 20 leading hosting states, more than half had foreign enrolments that were increased or unchanged. Indiana had the largest percentage increase (up 6% to 13,992, moving into the top 10 this year), and the largest decrease was in Virginia, with a 6% decrease to 11,701.

The most popular fields of study for international students in the US in 2005/06 were Business and Management (18% of total), Engineering (16%) and Physical and Life Sciences (9%), followed closely by Social Sciences (8%) and Mathematics and Computer Sciences (8%).

TECHNOLOGY

Is China benefiting from R&D?

China accounts for barely 2% of the total capital spending by US companies but 10% of all US companies' R&D in the computer and electronics industries.

A generation ago China picked information technology, biotechnology, space technology, laser technology, automation technology, energy and advanced materials as the key areas in which it needed to develop expertise to modernise its economy. The government's solution was to send science and engineering students to the US on state scholarships.

As a sop to the isolationalists the government also increased research budgets for research institutes and universities in China. This money was wasted. Chinese companies did not reduce their dependence on foreign technology; China's policymakers took a view in the 1990s that quantity was preferable to quality. Essentially China was copying Japan and South Korea both of which invested heavily in their domestic universities as a way to modernise their economies. Since 1998 China has more than quadrupled its number of university students: even so only there are only 16m of them

China still sends its best students abroad for advanced studies. One-quarter of foreign PhD candidates in the US are Chinese. But, like India, China is increasingly succeeding in luring back some of these academic expatriates to teach the next generation. Beijing says 170,000 Chinese who studied abroad have returned: it adds that 30,000 of them came back in 2006.

"China still sends its best students abroad for advanced studies. One-quarter of foreign PhD candidates in the US are Chinese. But, like India, China is increasingly succeeding in luring back some of these academic expatriates to teach the next generation."

The returnees have yet to have much effect on Chinese business. Chinese companies' capacity for innovation is still well below those of Taiwanese or South Korean companies. The country's R&D is getting a keener edge. China has passed Germany to stand fifth in international new-patent rankings. In 2006 China spent more than Japan on R&D for the first time, according to the Organization for Economic Co-operation and Development. Only the US spends more. In the last decade, R&D has more than doubled as a share of China's gross domestic product.

Some 250 to 300 multinationals--including most of the world's leading computer and telecom companies--have set up R&D operations in China. Among them are Microsoft; Nokia; General Electric; Unilever and Alcatel-Lucent; Google; IBM; Motorola and Intel .

Research scientists in China are comparatively cheap. They cost around 65%

of the counterparts in the US and Europe. They are increasingly productive. Alcatel, a communications multinational that owns Bell Labs and spends US$3.6 bn a year on R&D, says its researchers in Shanghai are generating patents faster than the rest of the company.

This success may prompt China to become more respectful of intellectual property and to allow clever people to become rich. This should mean that the Chinese financial system will have to become better at backing small but clever companies. Traditionally the state-owned banks have preferred to lend to heavy industry and infrastructure projects. These borrowers have implicit government guarantees for their loans.

China has also learned a lesson from the US: invest in defence related R&D, both for its own sake and as an economic catalyst. According to a recent report by the US's Office of Naval Research, China "is investing more heavily in the hard science areas that underpin modern defense and commercial activities, whereas the US is investing more heavily in the medical, psychological and social problem science areas that underpin improvement of individual health and comfort."

> "The Economic Development Board (EDB) of Singapore wants to attract 150,000 foreign students to Singapore by 2020. Whether the EDB can realise this ambition looks uncertain after the University of New South Wales Asia pulled out."

SINGAPORE'S PROBLEMS

Australian university pulls out

Singapore's bold plan to become an international hub for higher education has run into difficulties. One of the first Australian universities to set up on the island state has pulled out because so few non-Singaporeans wanted to go there.

The Economic Development Board (EDB) of Singapore wants to attract 150,000 foreign students to Singapore by 2020. Whether the EDB can realise this ambition looks uncertain after the University of New South Wales Asia pulled out. The UNSW had planned to establish an operation in Singapore with a ratio of seven foreign students to every three local students. It failed. Only three of 10 students in its first batch were foreigners. So the UNSW announced that it was closing down its Singapore operation at the end of June. The university had only opened in March, cited unexpectedly low enrolment rates as one of the reasons for its abrupt shutdown.

The university had expected 300 students for the initial intake in March, but only 148 qualified out of 710 applicants. It then expected 480 students for the second semester but, the vice-chancellor, Professor Fred Hilmer, said that "it was clear that this target would not be met". He conceded that "when a student says 'I want an Australian degree', what they really mean is, 'I want the experience of living in Sydney... buying surf boards.'"

The EDB remains confident about hitting its 2020 target. It claimed that the Singaporean offshoots of Insead, the University of Chicago, and specialised institutions such as the UNLV (University of Nevada, Las Vegas) and Tisch School of the Arts were all doing well in Singapore. The EDB claimed that 90% of the students are foreigners at S P Jain, a leading business school from India which recently set up its third campus in Singapore.

The EDB said that Singapore now had 80,000 foreign students up from 50,000 in 2001. The factors which attracted them, the EDB said, were Singapore's status as a strategic location as an East-meets-West focal point, the opportunities to work with over 7,000 multinational corporations on the island, and its 'squeaky-clean' image, and safety, said the EDB.

COMPARATIVE DATA

Brazil and Colombia have both seen their currencies appreciate strongly against the US dollar over the past 12 months. This has helped them to keep inflation under control. China, by contrast has seen its currency appreciate by only 5% against the US dollar -so the rise in international oil, grains and metal prices (all priced in dollars) has had far more of an effect. The Chinese government is becoming increasingly concerned about inflation, which is now running at a higher annual rate than in most of Latin America. Only the inflation recidivists of Argentina and Venezuela have higher annual rates.

It is worth noting that out crude calculation for assessing real interest rates shows that China's real interest rates are still negative, while in Latin America only Venezuela has heavily negative interest rates.

Comparative data	GDP growth		Consumer price index		GDP US$bn	Real interest rates	Exchange rate local currency vs US$	
	% change year-on-year	quarter	% change	12 months to	2006	%	% change in past year	rate on 31/10/07
China	11.5	Q3	6.2	Sep	2,668	-3.0	5.2	7.46
Hong Kong	6.6	Q2	1.6	Sep	190	3.3	0.1	7.8
India	9.3	Q2	7.3	Aug	906	-0.5	12.5	39.3
Indonesia	6.3	Q2	6.9	Oct	364	2.0	0.0	9,097
Japan	1.6	Q2	-0.2	Sep	4,340	1.0	1.7	115
Malaysia	5.7	Q2	1.8	Sep	149	1.6	6.4	3.34
Pakistan	7.0	Yr to June-2007	8.4	Sep	129	1.5	0.0	60.7
Singapore	9.4	Q3	2.7	Sep	123	-0.2	7.0	1.45
South Korea	5.2	Q3	3.0	Oct	888	2.3	4.0	939
Taiwan	5.1	Q2	3.1	Sep	364	-0.5	2.4	32.4
Thailand	4.4	Q2	2.5	Oct	206	1.0	2.0	34.0
Argentina	8.7	Q2	8.6	Sep	214	4.0	-1.9	3.15
Brazil	5.4	Q2	4.1	Sep	1,067	7.0	14.0	1.74
Chile	6.1	Q2	5.8	Sep	145	0.0	6.0	494
Colombia	6.9	Q2	5.0	Sep	135	3.4	13.5	1,990
Mexico	2.8	Q2	3.8	Sep	840	3.6	0.0	10.7
Venezuela	8.9	Q2	15.3	Sep	181	-6.0	-44.0	6,300
US	2.6	Q3	2.4	Feb	13,201	2.8		

LATIN AMERICA-ASIA REVIEW is published bi-monthly (6 issues a year) by Intelligence Research Ltd, 61 Old Street, London EC1V 9HW, England; Telephone +44 (0)20 7251 0012, Fax +44 (0)20 7253 8193, eMail: subs@latinnews.com. Visit our website at: http://www.intelligenceresearch.com EDITOR: WILL OLLARD. SUB-EDITOR: BRUCE DOUGLAS. Subscription rates will be sent on request.