Conference on

APEC Economies: A Paradigm Shift?

Edited By:

Tan Khee Giap

Eduardo Pedrosa

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Foreword

The regional and global economies have undergone a transformation over the last few years. The shift of economic activity from Europe, the United States and other developed markets to emerging markets has been accelerated by the impact of the global economic crisis. In spite of the crisis, the benefits of globalization and integration should be clear to all. APEC members, through their commitment to free trade in the Bogor Goals, have been a great success story, lifting millions out of poverty and raising living standards across the region. This success story should be a clear signal that the benefits of trade liberalization are too large to squander, even when domestic protectionist sentiments rise during economic downturns.

However, as has been outlined by previous PECC task force reports and highlighted by APEC leaders, there is a need to make growth more inclusive and to make our economies more resilient against future crises.

Social priorities such as healthcare, pensions and education are critical to achieving these aims. Thinking cannot be short term and must be based on a rigorous examination of the effectiveness of policies with longer experiences implementing social policies as well as the unique domestic circumstances in all of our economies. However, there are lessons that can be learnt, for example, the public good dimensions of healthcare and education often lead perverse incentives that distort markets.

The effectiveness of labor market policies is also being questioned. Income inequality has generally been on the rise. Maintaining competitiveness while increasing wages requires governments to consider a range of policy options. Over the longer-term education policies need to increase productivity as well as giving economies greater flexibility to respond to rapid structural shifts in technology and demand patterns.

Within the Asia-Pacific there are still economies and provinces poorly connected to the global economy. A deep look at how different areas connect to the global market and designing policy frameworks that encourage their participation in the global economy will help to reduce some of the inequalities that exist both within and between our economies.

Commodities markets are going through a period of flux and uncertainty. For food and agriculture, demand and supply side developments are generating policy responses, some of which are undermining confidence in international markets and hampering their ability to effectively and appropriately allocate resources. In the energy and mineral sector, changes in demand patterns, new technologies and environmental goals are changing the nature of market interactions. Finding policy structures and international cooperation that meet domestic political requirements as well giving confidence in market mechanisms are pre-requisites to ensuring that the post-crisis world does not descend into an anarchic scramble for resources.

The region has seen a proliferation of institutions that deal with the issues that confront policy makers: the G20 is one, albeit a global grouping; the East Asia Summit another, the APEC Plus Three and Chang Mai Initiative on financial issues; the ASEAN plus agreements and Transpacific Partnership on trade policy issues and so on. These efforts can be viewed as experiments on how to best both facilitate the integration process as well as managing its broader social, economic and political impacts.

PECC in turn needs to consider how it can best channel its ideas and suggestions into these different processes. The conference co-organized by the Pacific Economic Cooperation Council (PECC), and the Singapore National Committee for Pacific Economic Cooperation (SINCPEC) in April 2012 brought thoughtful insights into the new challenges facing the region and called for new approaches to addressing them. We would like to thank Prof Tan Khee Giap and his team for providing our community with an opportunity to discuss the profound changes taking place in our region.

Jusuf Wanandi

Co-chair

Don Campbell

Co-Chair

Executive Summary

The 2012 SINCPEC conference was held back-to-back with the PECC's Standing Committee. This SINCPEC conference was a prelude to the APEC meetings held in Vladivostok in September 2012.

The objective of this conference was to provide ideas and suggestion on the major issues that leaders of the Asia-Pacific region have identified, focusing on further trade liberalization, nurturing Asia-Pacific growth with paradigm shift and potential structural change needed, as well as securing future growth through functional cooperation.

The wide range of discussions held at the SINCPEC conference set the scene for the PECC Standing Committee meeting, where members deliberated on the future role of the organization and its relevance to the region.

The first plenary session on 'Further Trade Liberalization for APEC Economies' addressed issues relating to Trans-Pacific Partnership agreement, invigorating trade and investment liberalization and facilitation in the Asia Pacific. Three topics were covered in this section: Trade Liberalization within the Regional Economic Architecture; Consolidating Sub-Regional Initiatives: The EAFTA as Catalyst; The Completion of the ASEAN Economic Community 2015.

The session on 'Trade Liberalization within the Regional Economic Architecture' described the regional economic architecture as concentric circles with ASEAN and APEC at the core, respectively. These concentric circles are expected to form the pathway for a free trade area of the Asia-Pacific, which is important to maintain regional peace and stability.

'Consolidating Sub-Regional Initiatives: The EAFTA as Catalyst' discussed the obstacles that exist in the establishment of a region-wide East Asia free trade area, and the options possible in the face of these obstacles. The economic integration in Northeast Asia was also discussed, as well as Korea's position on regional economic integration.

The section on 'The Completion of the ASEAN Economic Community 2015' considered the motivation to achieve the ASEAN Economic Community by 2015, and how far ASEAN is away from this target.

The second plenary session on 'Nurturing Asia Pacific Growth in the Aftermath of the Fiscal Crises in Europe: Paradigm Shift and Structural Change Needed' will discussed how APEC economies can cope with external debt and ensure fiscal sustainability. The session began with a discussion on Russia's objectives in APEC, and was followed by a presentation on the motives driving Japan's contributions to ASEAN. This plenary session ended with the lessons that Asian economies can learn from the on-going European fiscal crisis, and introduced a simple measure of fiscal sustainability that governments can use as an early warning signal.

The third plenary session was on ‘Securing Future Growth through Functional Cooperation’. The first section on ‘Healthcare as an Inclusive Growth Sector’ discussed why healthcare is a key element of any kind of inclusive growth. Moreover, this section explained the importance and difference of living well versus just living longer, and what governments can do to help citizens to live well.

Food security is one of APEC’s 2012 priorities. The session on ‘Food Security in APEC Economies’ elaborates why food reserves are rising in importance, and how APEC can be used as a platform to meet emergency food needs.

‘Energy Security in APEC Economies’ focused on energy security, a key global issue. The paradigm shift in the gas markets in the APEC region was discussed, and the developments in the outlook for global natural gas trade was used to suggest how the concept of energy security will evolve in the light of technological progress and associated changes in estimates of resource reserves.

The following session on ‘Infrastructures and Connectivity in Asia-Pacific: The Case of Mainland ASEAN Economies’ talks about the kind of quality growth ASEAN should aim for in the future.

The fourth plenary session was on ‘Nurturing Asia Pacific Growth: Competitiveness Enhancement and Productivity Drive for APEC Economies’. The first of the four topics of this plenary session was on ‘Competitive Challenges in Uncertain Times’. This section discussed the importance of a favorable international architecture, and the importance of involvement of the business and government, for fostering future prosperity. The discussion highlighted the importance of the PECC and APEC agendas to the future of their members.

The second topic is on ‘Addressing Labor Market Mix, Enhancing International Competitiveness and Growing Inclusivity: The Singapore Case’. This session looked at the Singaporean experience on competitiveness, and alternative approaches in enhancing international competitiveness through wages-productivity-competitiveness nexus. This section also discussed the broad principles to mitigate income disparity and labor market failure.

The third topic on ‘Market Forces versus Market Failure for Private Sector Competitiveness’ described the Philippines experience and highlighted the challenges that developing economies face as they try to be more competitive.

The final topic in plenary session four is on ‘Competitiveness Enhancement: Business Financing and Capital Market Reform in China’, and the focus of this topic was on China’s capital markets and financing channels, its investor landscape, as well as the problems China faces in its capital market reforms.

The fifth plenary session was on ‘The Future Role and Continued Relevance of PECC’. This session discussed the issues relating to the strategic importance of regional economic integration and cooperation vis-a-vis Asia-Pacific Economic Cooperation (APEC), East Asian Summit (EAS), Group of Twenty (G-20) and Global Governance Group (3G).

This conference was co-organized by the Pacific Economic Cooperation Council (PECC), and the Singapore National Committee for Pacific Economic Cooperation (SINCPEC) in April 2012.

Acknowledgements

The PECC and SINCPEC are grateful to all who have contributed in one way or another towards the successful publication of this report.

In particular, the organizers would like to thank all contributors and participants of the event who have helped make the event a huge success.

Table of Contents

Conference Programme

PECC-SINCPEC Conference on
"APEC ECONOMIES: A PARADIGM SHIFT?"
26-27 April 2012
Orchard Hotel, Singapore

Thursday,
26 April 2012

0800 – 0845 **Conference Registration**

0900 – 0935 **Opening Session**

0910 – 0915 **Opening Remarks**
Mr Jusuf Wanandi
Co-Chair, Pacific Economic Cooperation Council (PECC);
Chair, Indonesian National Committee for Pacific Economic Cooperation (INCPEC); &
Vice Chair, Board of Trustees, Centre for Strategic and International Studies
Indonesia

0915 – 0925 **Keynote Address**
Professor Wang Gungwu
Chairman, Governing Board, Lee Kuan Yew School of Public Policy;
Chairman, East Asia Institute, National University of Singapore; &
Chairman, Board of Trustees, Institute of Southeast Asian Studies
Singapore

0925 – 0950 **Coffee Break**

0950 – 1105 **Plenary Session 1**
Further Trade Liberalization for APEC Economies
This session will discuss the issues relating to Trans-Pacific Partnership agreement, invigorating trade and investment liberalization and facilitation in the Asia Pacific.

Plenary Session Chair:
Mr Denis McNamara
***Chair*, New Zealand Committee of the Pacific Economic Cooperation Council (NZPECC); &**
***Consultant*, Lowndes Associates**
New Zealand

0950 – 1040 **Moderator:**
Mr Vincent Kong
Director of Economic Cooperation, Ministry of Foreign Affairs and Trade
Brunei Darussalam

Panel Speakers:

1. **"Trade Liberalization within the Regional Economic Architecture"**
   Mr Dominic Goh
   Director-General, International Economics Directorate, Ministry of Foreign Affairs
   Singapore

2. **"Consolidating Sub-Regional Initiatives: The EAFTA as Catalyst"**
   Dr Wook Chae
   Chair, Korea National Committee for Pacific Economic Cooperation (KOPEC) &
   President, Korea Institute for International Economic Policy
   Korea

3. **“The Completion of the ASEAN Economic Community 2015”**
   Mr Steven Wong
   Senior Director, Institute of Strategic and International Studies
   Malaysia

1040 – 1105 **Discussion Session**

1105 – 1230 **Plenary Session 2**
Nurturing Asia Pacific Growth in the Aftermath of the Fiscal Crises in Europe: Paradigm Shift and Structural Change Needed
This session will discuss how APEC economies can cope with external debt and ensure fiscal sustainability.

Plenary Session Chair:
Mr Hugh Stephens
Vice-Chair, Canada National Committee for Pacific Economic Cooperation (CANCPEC) &
Executive in Residence, Asia Pacific Foundation of Canada
Canada

1110 – 1130 **Keynote speaker:**
“Nurturing Asia Pacific Growth in the Aftermath of the Fiscal Crises in Europe: Paradigm Shift and Structural Change Needed, or the Russian Approach Perhaps?”

Ambassador Leonid Moiseev
Ambassador Extraordinary and Plenipotentiary, Embassy of the Russian Federation in Singapore
Russia

1130 – 1205 **Moderator:**
Miss Monica Ochoa Palomera
Director for Transpacific Cooperation Mechanisms, Ministry of Foreign Affairs &
Mexico National Committee for Pacific Economic Cooperation (MXCPEC)
Mexico

Panel Speakers:

1. **“Renewed Roadmap for Japan in ASEAN for Strategic Economic Cooperation”**
   Professor Shujiro Urata
   Professor, Graduate School of Asia-Pacific Studies, Waseda University
   Japan

2. **"The On-going European Fiscal Crisis: Lessons for Asian Economies"**
   Professor Ramkishen Rajan
   Professor, International Economic Policy, School of Public Policy, George Mason University &
   Visiting Professor, Lee Kuan Yew School of Public Policy, National University of Singapore
   Singapore

1205 – 1230 **Discussion Session**

1230 – 1340 **Lunch**

1340 – 1520 **Plenary Session 3**
Securing Future Growth through Functional Cooperation

Plenary Session Chair:
Mr Ian Buchanan
Chair, Australian Pacific Economic Cooperation Committee (AUSPECC) &

Senior Executive Advisor, Booz & Company
Australia

1345 – 1405 **Keynote speaker:**
"Healthcare as an Inclusive Growth Sector"
Professor Ranga Krishnan
Dean, Duke-NUS Graduate Medical School
Singapore

1405 – 1455 **Moderator:**
Mr Denis McNamara
Chair, New Zealand Committee of the Pacific Economic Cooperation Council (NZPECC); &
Consultant, Lowndes Associates
New Zealand

Panel Speakers:

1. **"Food Security in APEC Economies"**
   Dr David Hong
   Vice-Chairman, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC) &
   President, Taiwan Institute of Economic Research
   Chinese Taipei

2. **"Energy Security in APEC Economies"**
   Dr Tilak K Doshi
   Principal Fellow and Head, Energy Economics, Energy Studies Institute, National University of Singapore
   Singapore

3. **"New Technologies of Infrastructures and Connectivity"**
   Dr Narongchai Akrasanee
   Chair, Thailand National Committee for Pacific Economic Cooperation (TNCPEC) &
   Honorary Advisor, Fiscal Policy Research Institute
   Thailand

1455 – 1520 **Discussion Session**

1520 – 1535 **Coffee Break**

1535 – 1715 **Plenary Session 4**
Nurturing Asia Pacific Growth: Competitiveness Enhancement and Productivity Drive for APEC Economies

Plenary Session Chair:
Dr Manfred Wilhelmy
Chair, Chilean National Committee for Pacific Economic Cooperation (CHILPEC) &
Executive Director, Chile Pacific Foundation
Chile

1540 – 1600 **Keynote speaker:**
Professor Michael Enright
Sun Hung Kai Professor of Business Administration, University of Hong Kong &
Director, Asia-Pacific Competitiveness Program, Hong Kong Institute of Economics and Business Strategy
Hong Kong

1600 – 1650 **Moderator:**
Mr Dambadarjaa Jargalsaikhan

Secretary General, Mongolian National Committee on Pacific Economic Cooperation (MONPECC)
Mongolia

Panel Speakers:

1. **"Addressing Labour Market Mix, Enhancing International Competitiveness and Growing Inclusivity: The Singapore Case"**
   Associate Professor Tan Khee Giap & Professor Tan Kong Yam

   Chair, Singapore National Committee for Pacific Economic Cooperation (SINCPEC) &
   Co-Director, Asia Competitiveness Institute and
   Associate Professor of Public Policy, Lee Kuan Yew School of Public Policy, National University of Singapore
   Singapore

   Director, Asia Competitiveness Institute, Lee Kuan Yew School of Public Policy, National University of Singapore &
   Professor, Division of Economics, School of Humanities and Social Sciences, Nanyang Technological University
   Singapore

2. **"Market Forces Versus Market Failure for Private Sector Competitiveness"**
   Dr John Avila
   Trade Policy Assistance Manager, Office of Economic Development and Governance, USAID Philippines
   Philippines

3. **"Competitiveness Enhancement: Business Financing and Capital Market Reform in China"**
   Mr Stuart Leckie & Ms Rita Xiao

   Chairman, Stirling Finance Limited
   Hong Kong, Special Administrative Region, China

   Consultant, Stirling Finance Limited
   Hong Kong, Special Administrative Region, China

1650 – 1715 **Discussion Session**

1715 – 1745 **Media Briefing:**

1. **Mr Jusuf Wanandi**
   Co-Chair, Pacific Economic Cooperation Council (PECC),
   Chair, Indonesian National Committee for Pacific Economic Cooperation (INCPEC) &
   Vice-Chair, Board of Trustees, Centre for Strategic and International Studies
   Indonesia

2. **Associate Professor Tan Khee Giap**
   Chair, Singapore National Committee for Pacific Economic Cooperation (SINCPEC) &
   Co-Director, Asia Competitiveness Institute and
   Associate Professor of Public Policy, Lee Kuan Yew School of Public Policy, National University of Singapore
   Singapore

1815 – 1845 **Cocktail**

1845 – 2045 **Distinguished Dinner Speaker:**
Dato Timothy Ong
Chairman, Asia Inc Forum
Brunei Darussalam

Moderator:
Ambassador Yoshiji Nogami
Chair, Japan National Committee for Pacific Economic Cooperation (JANCPEC) &
President, Japan Institute of International Affairs
Japan

Dinner

END OF PECC-SINCPEC CONFERENCE 2012 DAY ONE

Friday,
27 April 2012

0845 – 1020 **Plenary Session 5**
The Future Role and Continued Relevance of PECC
This session will discuss the issues relating to the strategic importance of regional economic integration and cooperation vis-a-vis Asia-Pacific Economic Cooperation (APEC), East Asian Summit (EAS), Group of Twenty (G-20) and Global Governance Group (3G).

0845 – 0950 **Moderator:**
Professor Stephen Cheung
Chair, Hong Kong Committee for Pacific Economic Cooperation (HKCPEC) &
Dean and Professor (Chair) of Finance, School of Business, Hong Kong Baptist University
Hong Kong, Special Administrative Region, China

Distinguished Special Guests:

1. **Ambassador Muhamad Noor**
   Executive Director, Asia-Pacific Economic Cooperation (APEC) Secretariat

2. **Associate Professor Tan See Seng**
   Deputy Director, Institute of Defence and Strategic Studies;
   Head, Centre for Multilateralism Studies, S. Rajaratnam School of International Studies, Nanyang Technological University
   Singapore

0950 – 1020 **Discussion Session**

END OF PECC-SINCPEC CONFERENCE 2012 DAY TWO

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1. Opening Remarks

Mr Jusuf Wanandi
Co-Chair, Pacific Economic Cooperation Council (PECC)
Chair, Indonesian National Committee for Pacific Economic Cooperation (INCPEC) &
Vice-Chair, Board of Trustees, Centre for Strategic and International Studies
Indonesia

The focus of this conference is on the paradigm shift. In particular, what needs to be done following the crisis in Europe and to a certain extent, in the United States? There is a need for adjustment and thus, a paradigm shift. In addition, there is a shift of economic power towards this part of the world. As a result, we have to prepare ourselves to face these challenges. We will need to define these challenges and to discuss what should be done now in preparation for the future.

PECC should tap on these discussions and decide on what needs to be done in the face of the challenges identified. PECC will also need a paradigm shift – instead of purely providing intellectual support, PECC could perhaps plan some activities which may aid in certain important issues.

2. Keynote Address

Professor Wang Gungwu
Chairman, Governing Board, Lee Kuan Yew School of Public Policy
Chairman, East Asia Institute, National University of Singapore &
Chairman, Board of Trustees, Institute of Southeast Asian Studies
Singapore

The world economies, whether it is the advanced, the emerging or the developing, will continue to face great uncertainties. A replay of the turmoil witnessed in the 2009 western financial tsunami cannot be ruled out. There is a need for some deep soul searching and preparation for some fundamental changes in several areas.

The globalization and financial integration that we have seen have clearly led to further interdependence amongst global economies. One can say that this trend displays the greatest intimacy in our economies that the world has ever experienced. Greater intimacy is likely, even though it is unknown if the consequences will prove to be positive or negative. Various international economic frameworks, regional institutional architectures and free trade agreements are being pursued, all being set up to enhance the globalization process. The goal is to push for further integration towards a single global economy in which we seek greater efficiency, better governance and sustained prosperity for people everywhere.

However, it is widely acknowledged that the 2009 western financial crises that engulfed both the American and European economies are the result of weak leadership and governance failure. In this world of close interdependency, such crises not only test our system's economic resiliency, but also the effectiveness of leadership and governance. This includes, of course, the APEC economies, especially those of the emerging economies of China, India and ASEAN that have so far coped well with their fiscal prudence, somewhat improved competitiveness and, not least, sufficient savings.

The western economies have come to realize that the continued expansion of government spending to be financed by mounting external debts cannot be sustained any longer. They have noted that continuing to have high and rising wages that is not matched by improved productivity also cannot go on forever. It is obvious that the burden of the welfare state with aging populations can only exacerbate an already vulnerable economic situation. According to the latest statistics by the International Monetary Fund (IMF), the debt to gross domestic product ratio for advanced economies could reach 100% by 2013. That would have risen from the 75% ratio in 2007, already the highest in over 130 years except for the Second World War period!

Whether it is public debt restructuring or further private debt refinancing, ultimately citizens would have to pay for all of that at some point in the future. They can only achieve that if their economies regain competitiveness. Otherwise, something must give way and that would no longer be a problem in economics. Larger issues like national unity, social and political stability, will all be at stake. This pursuit of seeking short-term gains at the expense of long-term social and economic costs is irresponsible, to say the least. If continued, it would be a clear demonstration of leadership failure.

In confronting crises of the kind we face today, be it domestic or international, leaders would need the political will and courage to push for real change. This may involve a paradigm shift through which deep structural reforms are made in order to get to the heart of the difficult problems ahead. In the words of Singapore's Deputy Prime Minister Tharman Shanmugaratnam, who is also the Chairman of the IMF's Governing Panel, when he appealed to leaders of the world in the recent IMF meeting: "Bring the long-term agenda of growth and social equity to the short-term political and economic discourse".

As we are aware, Trade and Investment Liberalization and Facilitation (TILF) has become one of the APEC's major tasks since the first Economic Leaders' Meeting in Seattle in 1993. That was followed by the ambitious Bogor Declaration in 1994, to complete the achievement of the goal of free trade and investment in the Asia Pacific by no less than the year 2020. As we work towards the Bogor Declaration, we need to recognize not just the achievement of APEC in TILF thus far but, more importantly, also the rising expectations for APEC leaders to deliver even more!

There is now great interest to assess the continued relevance and performance of APEC. This can only intensify in the light of enhanced East Asian regional cooperation since the 1997 Asian Financial Crisis. That was when concentric circles of cooperation like ASEAN+3 and ASEAN+6, were coupled with new regional and bilateral free trade agreements, which happened both within the APEC economies and with outside partners. Also, recent interest in the Trans-Pacific Partnership (TPP), as we move towards a more ambitious vision for a Free Trade Area of the Asia-Pacific (FTAAP), has further highlighted the important role of APEC.

Going forward, the fundamental issue remains. How are the APEC economies to avoid past pitfalls committed by some member economies? Have they the courage to think and act outside the box? Leaders of APEC economies, with the requisite wisdom and courage, should continue to search for solutions. They must find ways to decrease economic vulnerability and reduce financial precariousness and, at the same time, enhance competitiveness and ensure fiscal sustainability. PECC, being a sister institution to APEC, clearly has a critical role to play to help chart a road map for Asia Pacific economic and financial integration.

PECC, under the track II approach, is therefore tasked to explore a new agenda and provide feedback for APEC. It might even be more ambitious and seek to advise wider global institutions, including G-20, the IMF and the World Bank. As I understand from the rich conference program for today and tomorrow, many speakers are out to do just that. I also notice that there is an interesting discussion on the future role and continued relevance of PECC, to be followed by a PECC Standing Committee Retreat. Such is the spirit I alluded to earlier, one that is engaged in regular review and preview of focused and practical responses. This is paramount in a dynamic global condition in which crises, new challenges and opportunities confront our leaders almost every day.

3. Further Trade Liberalization for APEC Economies

Chair
Mr Vincent Kong
Director of Economic Cooperation, Ministry of Foreign Affairs and Trade
Brunei Darussalam

3.1 Trade Liberalization within the Regional Economic Architecture

Mr Dominic Goh
Director-General, International Economics Directorate, Ministry of Foreign Affairs
Singapore

The regional economic architecture can be described as consisting of two circles, one with ASEAN at the centre, and the other with APEC at the core.

ASEAN at the CORE

The ASEAN core moves out to ASEAN+3 with the East Asia Free Trade Area (EAFTA), then to ASEAN+6 with the Comprehensive Economic Partnership for East Asia (CEPEA), and now to the new Regional Comprehensive Economic Partnership (RCEP). On the ASEAN side, the idea is to promote regional economic integration.

The EAFTA was first proposed in 2001, and started in the ASEAN+3 economies comprising the 10 ASEAN economies with China, Japan and the Republic of Korea. The CEPEA was proposed in 2006, and covers the ASEAN+6 economies comprising ASEAN, China, Republic of Korea, Japan, Australia, India and New Zealand. The CEPEA is also open to Russia and the US.

RCEP is an attempt to move away from the +3 or +6 terminology, and to think of it in terms of a consolidated FTA for all the ASEAN+1 agreements. The intention of RCEP is to combine the web of ASEAN+1 FTAs into a single regional FTA. The RCEP framework was endorsed by the Leaders at the 19th ASEAN Summit in November 2011, and the target launch of negotiations is at the 21st ASEAN Summit in November 2012. The key principles of RCEP are to be:

- Significantly better than existing ASEAN FTAs
- Open and inclusive, giving priority to current ASEAN FTA partners

APEC at the CORE

The APEC circle has the aim to create a free trade area of the Asia-Pacific. This was a vision of the Bogor goals in 1994, which aim for free and open trade in the Asia-Pacific by 2020. The Trans-Pacific Partnership (TPP), although not an official APEC project, is an attempt to meet that goal.

The TPP started in 2002 between Singapore, New Zealand and Chile. The intention was to introduce an FTA of the Asia-Pacific. When Brunei joined, the partnership became known as the TPP. There are now 9 members in the TPP: Singapore, Brunei, New Zealand, Chile, Peru, US, Vietnam, Australia and Malaysia. Three more economies are interested to join the TPP: Japan, Canada and Mexico. The membership criteria of TPP are:

- Priority given to APEC members (TPP is open to all APEC economies, there is no requirement for any invitation to join)
- Potential entrants must have the ability to meet the ambition and standards of a high-quality 21^{st} century FTA
- Existing parties must agree by consensus on admitting new members

Strategic Rationale

The regional economic architecture has the following strategic rationale:

- Aims to engage all regional players with a stake in the region including the US, Russia, India
- Promotes economic cooperation
- Gives all players a stake in the region via their dependence on one another for trade and investment *etc*.
- Promotes peace and stability
- Creates conditions for all regional economies to prosper together

ASEAN's role in this can be seen in the following:

- ASEAN Free Trade Area (AFTA) launched in 1992
- ASEAN+FTAs (all major trading partners such as Australia, New Zealand, China, India, Japan, Republic of Korea)
- ASEAN Economic Community (AEC) by 2015 (AFTA was not sufficient since although there was tariff-free access, there was still non-tariff barriers; aim of AEC is to create a single market and production base, free flow of goods, services, investments and skilled labor and freer flow of capital)

Concluding Remarks

The two circles, one with ASEAN at the centre, and the other with APEC at the core, are expected to merge to form a pathway towards a Free Trade Area of the Asia-Pacific (FTAAP). Both are seen as legitimate pathways towards the FTAAP. The FTAAP will cover nearly 60% of global GDP and more than half of world trade, and will help maintain regional peace and stability.

3.2 Consolidating Sub-Regional Initiatives: The EAFTA as Catalyst

Dr Wook Chae
Chair, Korea National Committee for Pacific Economic Cooperation (KOPEC) &
President, Korea Institute of International Economic Policy
Korea

Region-Wide FTA in East Asia

The rationales for the region-wide East Asia Free Trade Area (EAFTA) are:

- Economic benefits
- High level of economic dependency among East Asian economies (Table 3.2.1 shows that majority of the East Asian economies' intra-regional trade registered an increase from 1990 to 2010)
- Spaghetti bowl phenomenon (overlapping or incompatible rules or origin requirements)
- Need for a larger intra-regional market after the global financial crisis
- Means to overcome the global imbalance

Table 3.2.1 Share of Intra-Regional Trade Among East Asian Economies

	ASEAN+3	
	1990	2010
Brunei	81.7	78.8
Cambodia	68.6	39.7
Indonesia	51.6	58.4
Lao PDR	85.7	84.2
Malaysia	49.6	54.6
Myanmar	58.7	81.4
Philippines	32.8	54.4
Singapore	39.5	48.9
Thailand	42.6	50.4
Vietnam	27.8	54.6
China	21.3	26.8
Japan	21.2	41.5
Korea	29.1	42.2
East Asia	28.6	42.2

Source: Calculated from IMF (2009, 2011), Direction of Trade Statistics.

Various obstacles exist in the establishment of a region-wide East Asia Free Trade Area (EAFTA):

- Diversity among East Asian economies (there are differences in culture, political systems and the level of economic development; Table 3.2.2 shows the diversity among East Asian economies in terms of population, GDP and per capita GNI)
- Existence of sensitive sectors and products in East Asian economies
- Political and administrative burdens

- Additional benefits for ASEAN economies unclear
- Conflicts of interest among China, Japan and Korea
- EAFTA versus CEPEA

Table 3.2.2 Diversity Among East Asian Economies

Data as of 2010	Population (Millions)	GDP (Billions of USD)	Per Capita GNI (USD)
Brunei	0.4	13.0	32,647.6
Cambodia	14.1	11.3	684.3
Indonesia	239.9	707.4	2,611.5
Lao PDR	6.2	6.5	1,005.4
Malaysia	28.4	237.8	8,083.0
Myanmar	48.0	42.0	876.2
Philippines	93.3	199.6	2,851.5
Singapore	5.1	222.7	42,165.1
Thailand	69.1	318.8	4,413.8
Vietnam	87.8	103.9	1,144.6
China	1,318.2	5,739.4	4,529.4
Japan	126.5	5,458.9	44,268.5
Korea	48.2	1,014.4	21,057.9
ASEAN	592.3	1,863.1	3,061.0
CJK	1,492.9	12,212.6	8,431.1

Sources: UN National Accounts [online].

There is a growing and urgent need for a region-wide FTA in East Asia, yet at the same time, various obstacles exist. Under such conditions, the options for the region-wide FTA are:

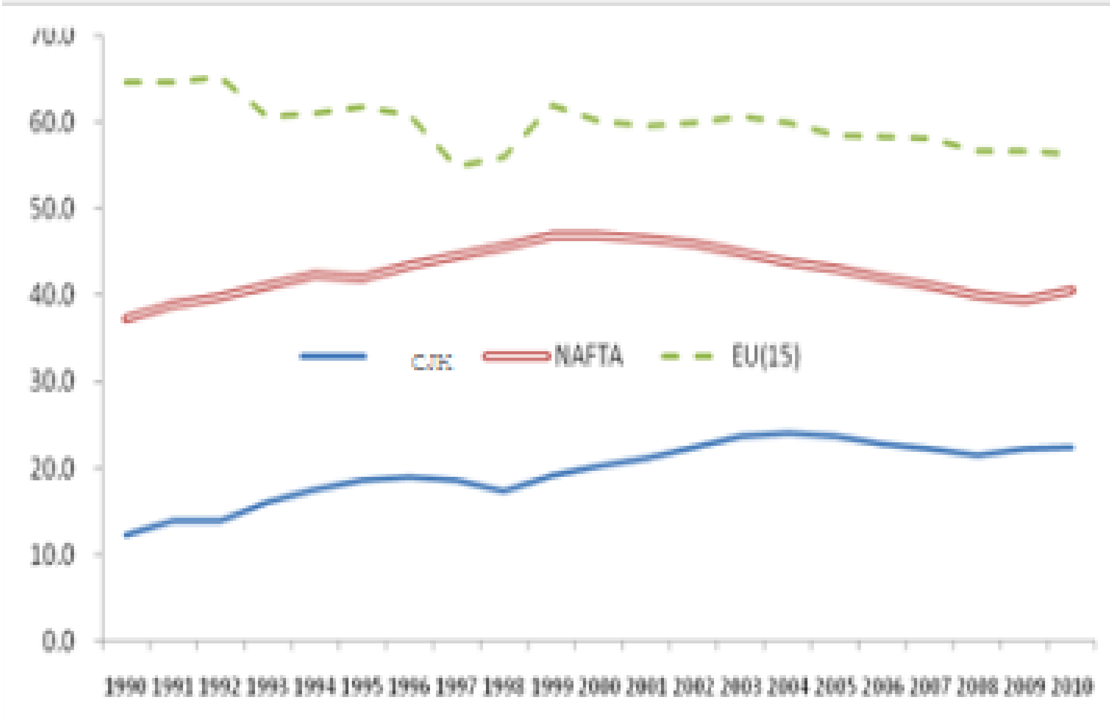
- A high quality FTA among as many regional economies as possible. This is the most ideal option, but is not realistic in the short-term.
- The more realistic option will be to start with an FTA which could be realized in the near future. For instance, a trilateral FTA could be started among China, Japan and Korea. This could be extended to an ASEAN+3 FTA, or even to ASEAN+6 with Australia, New Zealand and India included as well. In the long run, the East Asian economies may pursue a European-style of economic integration (financial and capital market integration).

Economic Integration in Northeast Asia

In terms of functional economic integration, there is no FTA between China, Japan and Korea. However, functional economic integration of these three economies has progressed by a substantial degree. Figure 3.2.1 shows that the intra-regional trade dependence between China, Japan and Korea is important and has been, in general, on the rise (market-driven integration) since 1990. However, the intra-regional trade dependence of the North America Free Trade Agreement (NAFTA) and the European Union (EU) has been declining during the 2000s. Table 3.2.3 shows that the trade volume of China-Japan-Korea (CJK) surpassed that of NAFTA.

Even though there is no institutional economic integration, efforts have been made in that direction. Negotiations for Korea-China FTA and China-Japan-Korea FTA are expected to be launched in 2012.

Figure 3.2.1 Expansion of Intra-Regional Trade Dependence Among China, Japan and Korea



Source: : IMF(2011). Direction of Trade Statistics.

Table 3.2.3 Snapshot of C-J-K and Major Economic Blocs (2010)

	Population (100milion, %)	GDP (trillion, %)	Trade (trillion, %)
CJK	15.5(22.3)	12.4(19.6)	5.3(17.5)
ASEAN+3	21.4(30.8)	14.2(22.5)	7.4(24.5)
ASEAN+6	33.4(49.8)	17.2(27.4)	8.4(27.8)
EU	5.0(7.2)	16.2(25.7)	10.1(33.5)
NAFTA	4.6(6.6)	17.3(27.4)	4.6(15.3)

Source: Global Insight; IMF DOT.

Some of the challenges and opportunities for economic integration among China, Japan and Korea include:

- Uncompetitive sectors may be a challenge, but the CJK FTA may be the means to further economic reform (strengthening national competitiveness).
- Competition for economic and non-economic hegemony is another challenge, but the CJK FTA could be the means of settling intra-regional conflicts (raising the sense of community).
- The concerns of extra-regional economies are the third challenge, but the CJK FTA could be the means of trade liberalization (contributing to global trade liberalization and promoting EAFTA).

Korea's Position on Regional Economic Integration

(i) East Asia

In the short-run, Korea will pursue bilateral FTAs with China and/or Japan as well as the CJK FTA. Subsequently, it will move on to ASEAN+3 and then towards ASEAN+6. According to an estimation by the Korea Institute of International Economic Policy, the economic effect of ASEAN+6 is the biggest among the three forms of integration, but the difference in impact size between ASEAN+3 and ASEAN+6 is minimal – ASEAN+6 may be more significant in political or diplomatic aspects than in economic aspects for Korea. Korea desires to achieve a high level of liberalization in the CJK FTA by first pushing for a similarly high level of liberalization in bilateral FTAs such as the Korea-China FTA and/or the Korea-Japan FTA.

(ii) TPP

Korea considers the TPP as a high-quality integrated economic community with a very high level of liberalization. TPP deals not only with elimination of custom duties and non-tariff barriers, but also with cross-cutting issues as harmonization of regulations, regional economic integration, the promotion of small-and-medium enterprises and strengthening of competitiveness. Korea does not have an immediate incentive to join the TPP in the short run as Korea has already signed FTAs with most current TPP members and is engaged in FTA negotiations with the remaining members. Korea's decision to join the TPP will depend on factors such as:

- Progress in CJK FTA and EAFTA
- Regional policies by China and Japan
- Evolution of the TPP; participation of other economies in the Asia-Pacific

3.3 The Completion of the ASEAN Economic Community 2015

Mr Steven Wong
Senior Director, Institute of Strategic and International Studies
Malaysia

Most policy actions happen for a reason. Often, inaction does as well. The reasons are usually based on interests and interests in turn, dictate motivations. The stronger the interests, the greater the motivations and, presumably, more effort will go into formulating and implementing outcomes. The first question we can consider today therefore is how strong are the interests behind completing the ASEAN Economic Community (AEC) by 2015.

The failure of the Doha Development Agenda round of multilateral trade negotiations in Cancun in the autumn of 2003 set the context for the vision casting that resulted in the AEC. With still-fresh memories of the 1997 Asian Financial Crisis, and combined with the rising threat of a super-competitor in the People's Republic of China, these gave urgency to the adoption of the Bali Concord II, which had, as one of its three pillars, the AEC.

The AEC was given further momentum in early 2007 when, at the 12th ASEAN Summit in Cebu, leaders shortened the timeframe for achieving a region with free movement of goods, services, investment, skilled labor, and freer flow of capital to 2015. Why did they do this if they did not consider the completion of the AEC to be pressing? They could have dragged their feet and quibbled over detail endlessly as they had done in the past.

If further proof were needed of their red-blooded commitment, they adopted the AEC Blueprint in Singapore the following year. The Blueprint further underscores the seriousness of turning the region into a single market, production base and highly competitive region by 2015. To top it off, ASEAN adopted a scorecard system to monitor progress. The AEC Scorecard progress report is to be presented to the ASEAN Economic Ministers (AEM) in four biennial phases from 2008 to 2015.

By all accounts, the nature of the actions taken indicates the very substantial interests and motivations underlying the completion of the AEC. It is difficult to fault the leaders and senior officials, who have shown nothing but strong political will in embarking on the AEC project. They, and we, could have opted to live quiet lives instead.

This logically suggests that an incomplete AEC by 2015 would be quite costly both for ASEAN as a whole and its ten member states. This then brings us to the second question: how far has each of the four elements of the AEC Blueprint been achieved? The four elements are:

- A single market and production base
- Competitive economic region
- Equitable economic development
- Integration into the global economy

Thus far, two AEC Scorecards have been produced (2009-10, 2010-11), with another two to come before 2015. On the face of it, as of October 2011, ASEAN economies were said to have achieved 75.7% of the targeted measures for Phases 1 and 2. Implementation rates are calculated as a ratio of measures that are fully implemented to a total of measures targeted. This is a pretty high figure and would seem very respectable given that ASEAN still has a little less than halfway to go. To be sure, some have voiced concerns at the lower rate of completion between the two phases – 83.8 Phase I versus 68.6 Phase II. However, there have been achievements and that is not something to decry.

Straight-line reasoning does not always work. In the first place, the ratio of implemented to targeted completion of measures could be an overly simplistic measure. Second, the inability to fully achieve targets can have consequential cumulative effects down the line. Any unfinished business not only has to be carried forward but can impede other targets from being achieved. Third, there is the issue of quality: given the ambitious goals that have been set, have the targets been set to be as demanding as they need to be? Have the targets been set too low so that failure is difficult?

Issues of methodology in measuring the progress in completing the AEC by 2015 can certainly be debated. However, even by the existing methodology, warning bells have been sounded and the tasks ahead made urgent. Scorecard II points to delays in ratification of ASEAN agreements and adoption into national laws and regulations as being significant obstacles to implementation. Certainly, this is an area requiring renewed action. However, some of the outstanding actions would suggest that there is a low probability of completion given the context and conditions of member states and the tasks that need to be undertaken (eg on connectivity). This may not be due to any lack of will per se, but of a lack of technical capacity and human and sheer financial resources.

The 41st ASEAN Economic Ministers Meeting in Bangkok requested the Economic Research Institute for ASEAN and East Asia (ERIA) to study the scorecard monitoring process and provide substantive analyses and independent reviews of the AEC Blueprint implementation. ERIA's scorecard is more analytical as compared to ASEAN Secretariat's straightforward compliance-type/accomplishment based scorecard. One recommendation emerging is that ASEAN member states need to establish national-level coordinating committees to implement the AEC.

It seems clear that on the present trajectory, there will be elements of the AEC that could well remain unfinished business by 2015. It is also clear that the reason will have much to do with national technical capacities to implement 'behind-the-border' measures but also some of the usual foot-dragging by economies with respect to opening up. It is further clear that the quality of the AEC completion will continue to be taken to task, with allegedly 'loosely defined' targets and implementation measures.

This may be nothing more than to say that the AEC will continue to be a work-in-progress. The conundrum is that the less seriously member states take the 2015 target date, the less effort they will put into the project. For pure administrative and managerial reasons, therefore, they will want to maintain a hard deadline, in which case there should be a renewed and concerted push to the finishing line right about now.

There will need to be a deepening programme post-2015 if the word 'community' is to have any real meaning as the leaders intended. The payoffs of success and the costs of failure to urgently complete a genuine AEC will have to be constantly brought to mind if momentum is not to cease and we are left with an incomplete and unusable product.

3.4 Comments & Discussion

Comments & Discussion: Mr Dominic Goh's Presentation

A member of the audience remarked that there is a trade-off between the quality of the TPP and the number of members it has. To this, Mr Dominic Goh responded that the membership issue is indeed one of the issues the TPP is currently facing: how high should the membership be? There are parties of different development within the TPP. While the original aim of the TPP is always towards a high quality FTA, there is the question of how high it should be. Ever since the US joined, they have been pushing for higher and higher standards such as for labor standards and enhanced information technology protection. Now that the parties are approaching the end game, there is a need to decide if they want to stay at this high level, or whether they want to try to bring things down and show some flexibility and see where the possible landing zones are for the various chapters. Although no one knows where the landing zone will be, flexibility is on the cards, in order to try to conclude this by 2012.

A question was asked on the practicality and solidarity of the regional framework to all parties in the framework, given that there are already some complaints from ASEAN economies of trade deficits in the ASEAN+China FTA. In response, Mr Dominic Goh commented that not all ASEAN economies have ratified the ASEAN+China FTA possibly due to domestic reasons. Whilst he is unaware of the details, from the policy perspective, there is strong political will on the general level in ASEAN to proceed on the larger architecture such as the TPP and RCEP. While there may be backsliding at certain times, the general movement will be forward.

Mr Dominic Goh was also asked his opinion on whether the ASEAN-centric process or the APEC-centric process is more important. To this, he commented that whilst talks in the TPP are at a very advanced stage and look very much further ahead, RCEP may be easier to harmonize agreements. As such, Singapore places resources in both areas, as well as the WTO.

There was a comment that the tendency for protectionism has risen after the global financial crisis, and the G-20 has been fairly instrumental to limit the rise of protectionism. However, the G-20 is not completely successful and the 450 rules and regulations made related to protectionism looks set to rise. As such, the suggestion to involve the WTO and possibly APEC was made. The WTO provides rules of trade, and is helpful to economies such as Korea, ASEAN and other developing economies.

In response, Mr Dominic Goh agrees that the WTO is very important as the guarantor of the multilateral trading system. From Singapore's perspective, there is strong and equal emphasis placed on all three: WTO, ASEAN trade agreements and TPP. Regional discourse is focused on TPP because it is something that affects the region. WTO appears to be pretty much stuck for the next few years, as there is a very strong divide between the developed and developing economies. There is very little room for maneuver in WTO as neither side is willing to give any concession to move forward. Given the situation at the WTO, regional attempts at ASEAN+ free trade agreements and TPP are all attempts, in a way, to move forward on free trade.

Mr Dominic Goh further commented that high standards shouldn't stop anyone from joining the TPP. Vietnam has great difficulties but they are trying very hard, and if Vietnam manages to meet the requirements of TPP then it would be a model for other regional developing economies to join TPP given they face similar challenges. As for APEC's possible involvement in the issue, it is likely to be difficult because the two camps in the WTO are represented by two of the major APEC economies. If they are not able to move the WTO, it is unlikely that they can cooperate in APEC to try to move WTO at the same time.

Comments & Discussion: Dr Wook Chae's Presentation

With regard to the observation made that Korea does not seem to be ready for the CJK FTA, Dr Wook Chae agreed that the Korea-China FTA may come before CJK FTA. There is pressure from China on the Korea-China FTA and at the same time, Korea needs the big Chinese market. As a result, it is likely that Korea will soon pursue a bilateral FTA with China. It is difficult to achieve a high level of trade liberalization in the case of the CJK FTA.

In addition, Korea does not have an immediate interest in pursuing the TPP as the TPP requires a very high level of agricultural liberalization which is really difficult for Korea to comply with. As such, the stance in Korea is to first observe the evolvement of TPP's progress before deciding on its involvement in a later stage.

Comments & Discussion: Mr Steven Wong's Presentation

Mr Steven Wong was asked his opinion on what other organizations such as APEC and PECC can do to contribute practically to the huge institutional capacity deficit in the majority of the APEC economies in their capacity to actually implement many of those rules, regulations and expectations on the currently proposed agreements. In response, Mr Steven Wong said that time is the solution. While it may help if there were offers of technical assistance in terms of institution building and infrastructure, there is still the element of time to put them all together.

4. Nurturing Asia Pacific Growth in the Aftermath of the Fiscal Crises in Europe: Paradigm Shift and Structural Change Needed

Chair
Mr Hugh Stephens
Vice-Chair, Canada National Committee for Pacific Economic Cooperation (CANCPEC) &
Executive in Residence, Asia Pacific Foundation of Canada
Canada

Moderator
Miss Monica Ochoa Palomera
Director for Transpacific Cooperation Mechanisms, Ministry of Foreign Affairs &
Mexico National Committee for Pacific Economic Cooperation (MXCPEC)
Mexico

4.1 Nurturing Asia Pacific Growth in the Aftermath of the Fiscal Crises in Europe: Paradigm Shift and Structural Change Needed, or the Russian Approach Perhaps?

Keynote Speaker
Ambassador Leonid Moiseev
Ambassador Extraordinary and Plenipotentiary, Embassy of the Russian Federation in Singapore
Russia

The conclusion of negotiations for Russia's admission to WTO last year is strong evidence of Russia's commitment to trade liberalization. This choice was made despite the difficult situation in the national economy. Russia's admission to WTO is expected to aid in its long-term economic growth, with estimates indicating a contribution of up to 3% of Russia's GDP growth in the coming decade. This increase will result from more intense competition, higher direct investment, as well as a more transparent and predictable business climate.

Nevertheless, the actual trend of the growth in the Russian economy in 2012 will be closely connected to the situation in the world markets of commodities, oil and gas, as well as to the situation in the capital markets.

Russia needs to consistently respond to the uncertainty in economic growth through better quality and well-prepared horizons of integration. Dynamic regional economic integration under the customs union between Russia, Belorussia and Kazakhstan increased mutual trade by 37% in 2011. Starting from 2012, Russia is moving towards deeper integration within the framework of the Common Economic Area covering free movement of goods, capital and working force.

The APEC agenda should deal with the risks of crisis contagion, and increasing influence of financial distortions on world commodity markets, trade and investment. Russia's priorities for APEC include:

- Trade and investment liberalization
- Regional economic integration
- Food security

- Supply chain connectivity
- Fostering intensive cooperation for innovative growth

Russia's key objective in APEC is to further liberalize trade and investment and to facilitate economic integration in the Asia-Pacific region. Russia also plans to promote APEC cooperation on food security. Like all other member economies, Russia has a stake in ensuring that food is available, affordable, safe and of high quality. In light of the growing social commitments of governments in the aftermath of the global financial crisis, it is necessary to develop stable food markets and dampen price fluctuations. Furthermore, there is a need to search for ways to ensure agricultural development based on increasing mutual investments, modern technologies and compliance with quality standards.

The prospect for greater integration in APEC is closely connected with the need for reliable supply chains in the region. This led to the supply chain connectivity initiative which commenced in Singapore in 2009, and was further discussed in Japan in 2010, and in the US in 2011. There is a need to move faster in improving supply chain connectivity within APEC in order to contribute to the resilience and development of APEC economies. In addition, there is also the need to understand the challenges that we are facing today concerning APEC's supply chains.

Innovation-based economic development is crucial for stable economic growth. This issue, which Russia sees as priority, has been met with a positive response by APEC members. Possible ways to promote extensive interaction among universities, research centres and the business community must be explored. Cooperation in education and the development of human capital is vital. The protection of intellectual properties is also becoming increasingly important, and there are opportunities for advancing joint initiatives in this field within APEC.

<u>Russia's Future Economic Development</u>

In Russia's future economic development for the five or six years that lie ahead, the following must be considered:

- The optimal level of fiscal burden. In Russia, this is about 35.6% of GDP.
- The admissible level for electricity, natural gas and transportation costs. Russia enjoys a big advantage as it has the cheapest energy resources; however, because of the current market economy, the price of the natural resources is expected to grow continuously.
- How fast to withdraw the government from the economy
- How to strengthen Russia's financial system. In 2011, bonds and shares of Russia's companies average 21% of the turnover on the London stock exchange. Russia is thinking about establishing its own financial centre in Moscow.
- Pension system reform. This is probably one of the most difficult, and a big social problem.
- Openness of the economy.
- The best correlation between the policy of development and modernization, and the policy of maintaining major macroeconomic balance, in Russia's budget.

The biggest challenge that Russia faces now is the problem of world governance. Although this is a universal problem, it is acute in Russia. As a result of the APEC chairmanship, a very heated debate was stimulated in Russia of how to best govern its huge country.

4.2 Renewed Roadmap for Japan in ASEAN for Strategic Economic Cooperation

Professor Shujiro Urata
Professor, Graduate School of Asia-Pacific Studies, Waseda University
Japan

Japan's Economic Cooperation towards ASEAN

The level of cooperation that Japan extended to ASEAN has been quite intensive and extensive. Recently, Japan's economic cooperation focused on assisting ASEAN's achievement of AEC. AEC is a community with four distinct characteristics:

- Single market and production base
- Highly competitive economic region
- A region of equitable economic development
- A region fully integrated into the global economy

Japan has undertaken various projects in the form of constructing hard and soft infrastructure, to help ASEAN form a single market and production base. With regards to hard infrastructure, Japan is involved in the development of corridors facilitating the expansion of trade, investment and movement of people within these economies which should enable ASEAN to promote economic growth. Another specific project which Japan has assisted is the development of maritime ASEAN economic corridor, which consolidates connectivity through the development of port, port-associated industries as well as energy and information communications technology network; this will contribute to the economic development of ASEAN to form a single market. As for soft infrastructure, Japan has assisted programmes such as ASEAN Smart Network, which supports logistics of people and goods across borders.

Another feature of AEC is the region of equitable economic development. In this area, Japan has contributed in assisting human resource development and providing assistance to the development of small and medium enterprises.

The motives behind Japan's cooperation can be categorized as:

- Economic objectives. Having a successful AEC will contribute to the economic growth of ASEAN which will in turn contribute to the economic growth of East Asia, and that will have a beneficial impact on Japan. Apart from export growth, Japanese companies which have already invested much in ASEAN will benefit as ASEAN's markets increase and human resources improve. A successful AEC is beneficial not only to Japanese companies but also to all economies in this region, and ultimately impact the economic growth of the world.
- Non-economic objectives. Japan has had a very good relationship with ASEAN and Japan's enhanced economic cooperation will contribute to developing even better relationship. This is important as China and India are increasing their influence in this region.

ASEAN's successful economic development is evidence that Japan's contribution to ASEAN has been quite successful. In recent months, Japanese government has announced several cooperation programmes. Japan has also contributed a lot in the setting up of an Economic

Research Institute for ASEAN and East Asia (ERIA). ERIA has been conducting a number of interesting research which would help ASEAN to establish AEC.

There are, though, several challenges in Japan's cooperation towards ASEAN. One is the ASEAN-Japan Comprehensive Economic Partnership Agreement. Japan's trade liberalization in this AJCEP framework is about 90%, lower than ASEAN-Australia-New Zealand (100% from the side of Australia and New Zealand) and China-ASEAN (more than 95%). Japan did not open as much as it should, and the problem is due to agriculture. Japan's inability to move forward in many areas including TPP, Asean+3, ASEAN+6, is probably attributed to their inability to deal with the fiscal issue. The Japanese government is busy engaging in discussion of domestic consumption tax and social security issues.

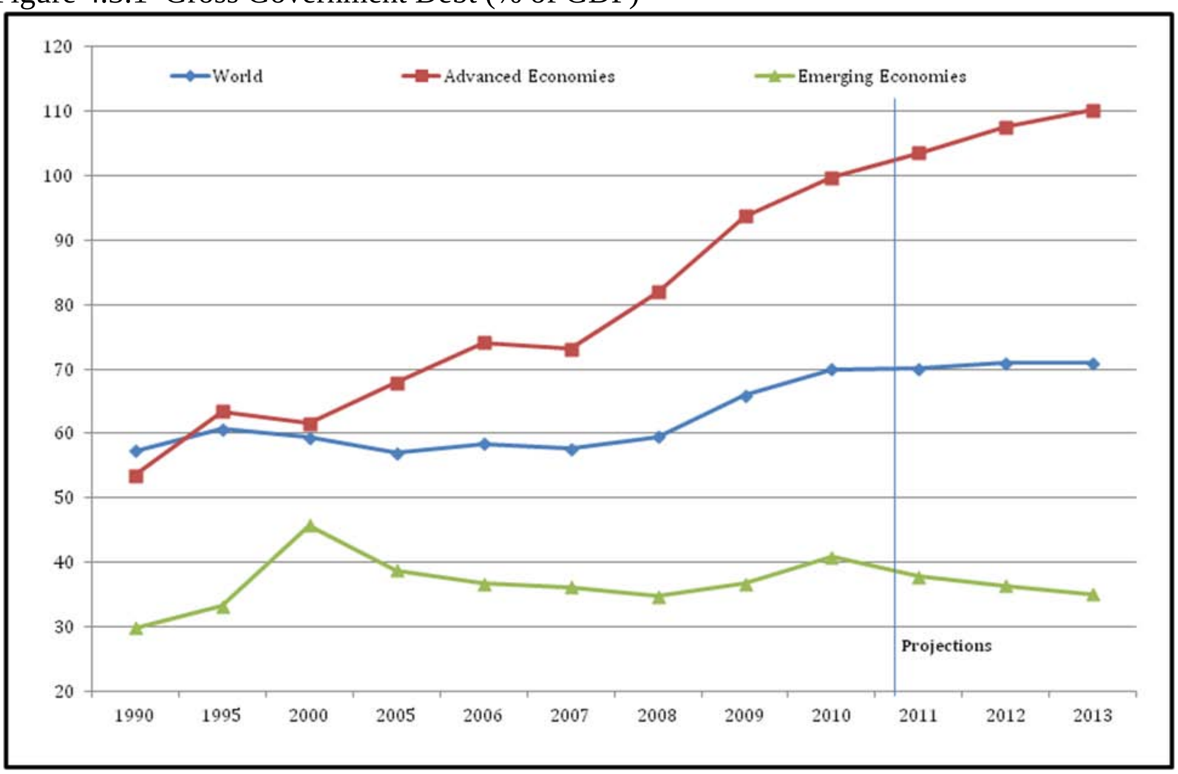
4.3 The On-Going European Fiscal Crisis: Lessons for Asian Economies

Professor Ramkishen Rajan
Professor, International Economic Policy, School of Public Policy, George Mason University &
Visiting Professor, Lee Kuan Yew School of Public Policy, National University of Singapore
Singapore

Public debt and fiscal imbalances are primarily an advanced economy problems, although not all advanced economies have these problems. When looking at policy issues, it is important to differentiate between gross versus net debt. Most of the data that we look at is gross debt. Take Japan for instance. Japan's gross debt is about 220% to 240% of GDP, while its net debt is about 160% of GDP. Net debt does not consider the financial asset position of the government (eg bank deposits, bonds etc.).

The whole idea of fiscal sustainability is to be able to manage public debt without significant adjustments. As such, it is probably better to consider net debt rather than gross debt, but the problem of this is the absence of good data on net debt for the various economies. Apart from data issues, another argument against using net debt is that a lot of government liabilities are not made explicit. Gross debt is akin to a crude balancing out. Although governments have some financial assets, but they have not incorporated all the liabilities, so gross debt can be taken as a crude measure.

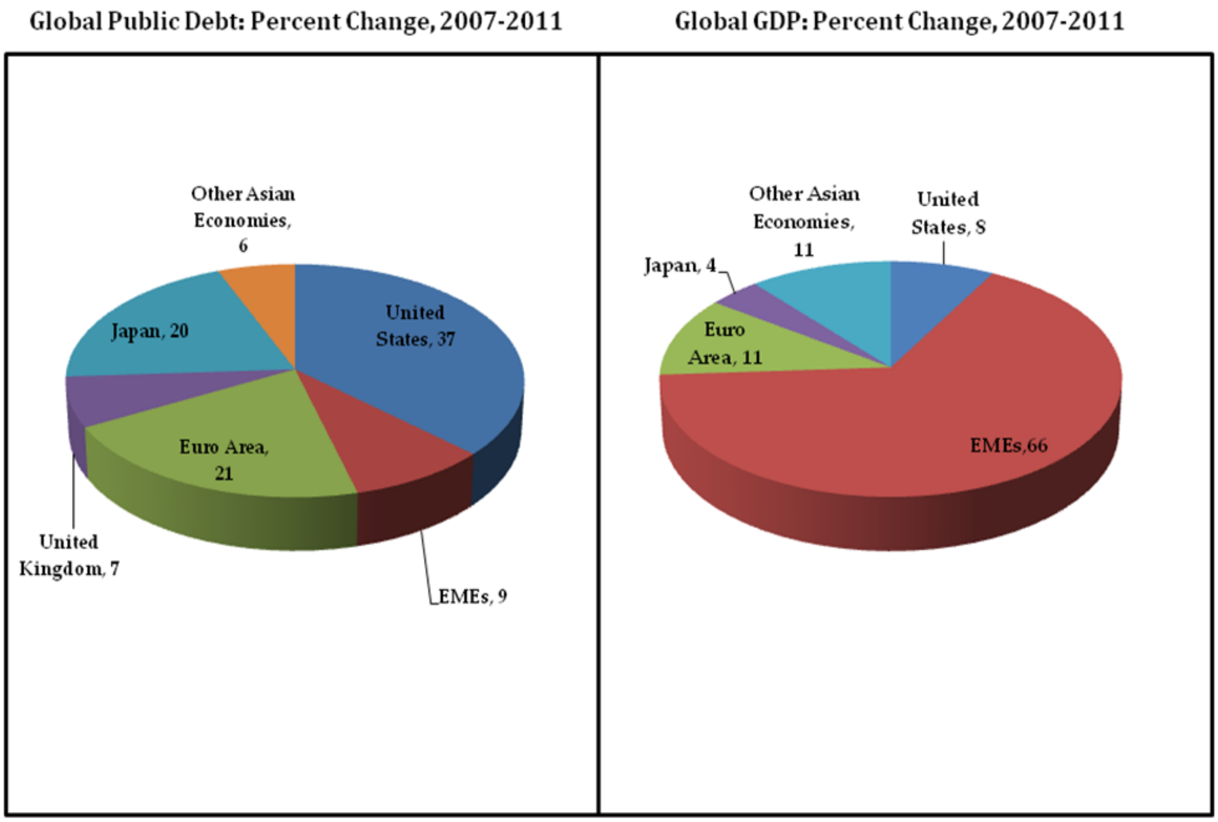
Figure 4.3.1 Gross Government Debt (% of GDP)



Source: Compiled from IMF.

Figure 4.3.1 shows the gross government debt. In the case of the advanced economies, the gross government debt can be seen to exceed 100% of GDP. For emerging economies, there appears to be a stable, if not slightly declining trend. In addition, from Figure 4.3.2, one can see that advanced economies played a major role in terms of contributing to the overall increase in gross debt while emerging economies played a significant role in the overall contribution of GDP growth in the economy. Clearly, there are differing trends between the advanced and emerging economies, and it points to an advanced economy issue.

Figure 4.3.2 Global Public Debt & GDP

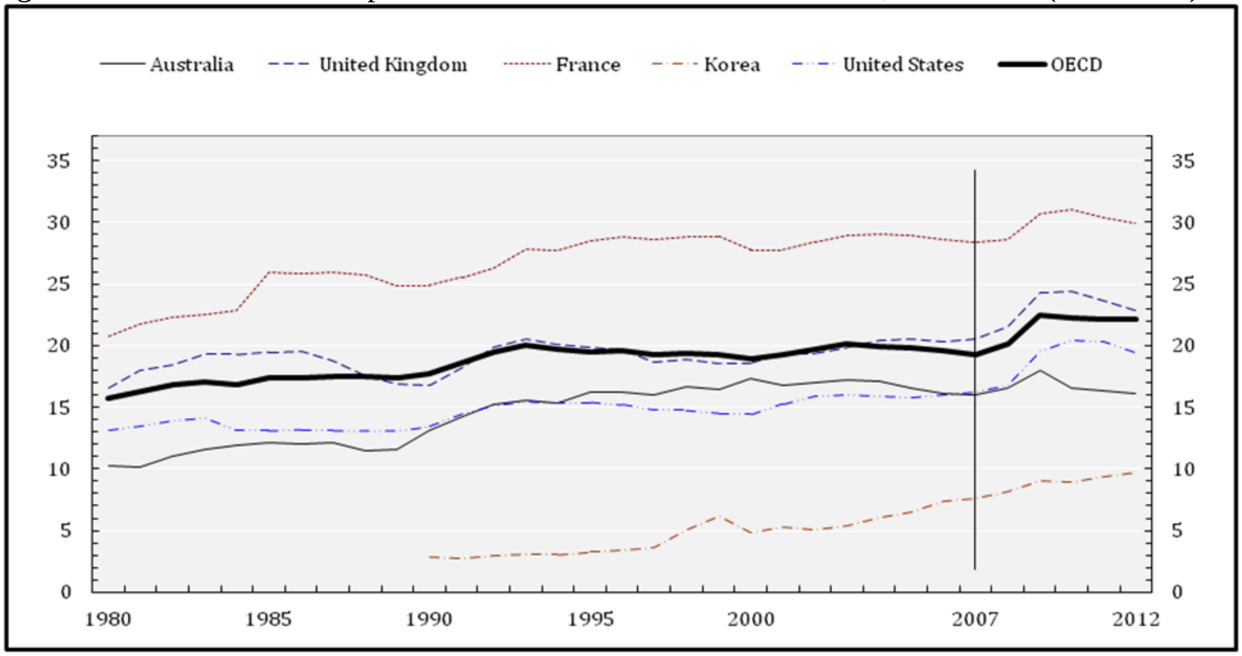


Source: Reproduced from Prasad (2011) based on IMF data.
Note: The charts show the percentage contribution of countries or country groups to the changes in the absolute levels of global net government debt and global GDP (measured in a common currency at market rates).

Deficits can be a result of expenditure and/or revenue issue. Looking at the revenue as a share of GDP, most advanced economies do as well, if not better, than a lot of emerging economies. Thus, the deficit problem of the advanced economies is on the expenditure side with it being about 40-45% of GDP. Out of that, a significant portion is attributed to the social expenditure (see Figure 4.3.3). Social protection is a significant contributor to the overall growth in expenditure.

The coming decade is predicted to be a 'decade of debt' if the advanced economies do not deal with the deficit issue now.

Figure 4.3.3 Public Social Expenditure in Selected OECD Economies, 1980-2012 (% of GDP)



Source: Reproduced from OECD Social Expenditure database (SOCX).

Fiscal Sustainability

How is fiscal sustainability measured? Qualitatively, the IMF has the definition 'fiscal policy stance can be regarded as unsustainable if, in the absence of adjustment, sooner or later the government would not be able to service its debt'.

Operationally, most people start out with the notion of intertemporal fiscal solvency criterion. This basically means that the present value of future primary surpluses must equal the initial level of public debt or some target level of public debt. Issues with this measure include the appropriate discount rate to use for the future as well as the appropriate timeframe.

At an operational level, fiscal sustainability often refers to the situation where the public debt to GDP (debt-to-GDP) stabilizes. The following equation gives a very simple rule of thumb in terms of how to calculate a very simple measure of fiscal sustainability:

$$d^* = \frac{pb(1+g)}{g-r}$$

where

- d is the debt-to-GDP ratio
- r is the real interest rate
- g is the long run growth rate of real GDP
- pb is the primary deficit to GDP.

If debt is growing in nominal terms but GDP is growing faster, as a share of GDP, this is manageable. This simple measure of sustainability says that, if an economy is running a primary deficit, economic growth rate must exceed real interest rate for the debt-to-GDP ratio to decline.

There are two aspects of the fiscal deficit. One is current expenditure and the other aspect is the interest burden. When the economy is running a deficit, try to ensure that the economy is growing faster than the interest payments. For instance, if average historical interest rates are 2%, while the economy grows at 6% and the primary deficit is 3% of GDP, the debt-to-GDP ratio stabilizes at around 80%.

Many of the fiscal sustainability measures focus on solvency. The big issue of solvency is liquidity. There may be a situation where, based on underlying fundamentals or projected fundamentals and growth rates, the debt-to-GDP ratio looks fairly sustainable but financial markets may decide not to continue financing that debt. If that happens, economies will face a problem. This is the big debate that has been going on. There are arguments that, with the exception of Greece, many economies in Europe appeared fiscally sustainable before the crisis, with the overall debt-to-GDP ratio on the slightly declining trend. However, after the asset bubble collapsed and stimulus and other measures were introduced with the governments taking on explicit liabilities, the debt-to-GDP ratio went up significantly. As such, some have argued that it is not a solvency issue for most economies in Europe with the exception of Greece, but a liquidity problem; the real issue is about classic capital inflows boom and bust.

If liquidity is a problem, how do we try to get a measure of sustainability based on liquidity? The IMF and others have developed some early warning signals measures. None of them are quite helpful because there are all sorts of issues such as herd mentality, causing their use to be limited. A great deal of attention is now focused on how the appropriate levels of debt-to-GDP ratio such that economic growth is not a problem. From the operational policy perspective, this information is very helpful. Although there is no knowing when the crisis might hit in terms of liquidity, but some measure of threshold (ie how large is too large) is useful. There have been a number of studies, and the most cited studies suggest a 90% threshold.

Recent studies suggest that for advanced economies the threshold is about 60-90% of GDP while for emerging market economies it is about 40-70%. The threshold falls within the broad IMF suggestion of 60% debt-to-GDP ratio which has been used in policy circles; 60% seems to be the number bandied around. The problem is, it is uncertain how the IMF arrived at this number.

Assuming 90% debt threshold, growth of 2% and long term yield of 1% for advanced economies, the sustainable primary deficit is around 0.9-1% of GDP. Assuming 40% debt threshold, growth of 7% and long term yield of 2% for emerging economies, the sustainable primary deficit is around 1.9-2% of GDP. Even without a liquidity crisis, fiscal adjustment should be undertaken by economies to ensure durable long run growth.

4.4 Comments & Discussion

Comments & Discussion: Ambassador Leonid Moiseev's Presentation

Ambassador Leonid Moiseev was asked his opinion on whether the present crisis in Europe is a European problem rather than a global issue. To this, he responded that the present crisis is global and what is happening in Europe is practically happening in many parts of the world as well.

Another question was on the possibility of an ocean liner moving from Asia to Europe via the Arctic, the sea laws that will apply to that ocean route and how that would affect ocean liners. Ambassador Leonid Moiseev commented that the Arctic Council will address those issues.

Comments & Discussion: Professor Shujiro Urata's Presentation

Professor Shujiro Urata was asked his opinion on alternative sources of energy for Japan given that the Japanese people oppose restarting the nuclear plant as a result of the Fukushima plant problems. In his opinion, it is very costly to look for an alternative source of energy. Japan recorded a trade deficit last year for the first time in more than three decades due to substantial increase of oil and natural gas purchased. Finding a new source of energy is a big issue, and it is difficult to find a solution in the short run. Another issue which has been discussed quite intensively is the purchase of gas from the US. Energy issues are very important and have been discussed in many places including the TPP.

Comments & Discussion: Professor Ramkishen Rajan's Presentation

On his opinion on whether the bailout by the World Bank and IMF is sustainable and if the financial crisis is over, Professor Ramkishen Rajan commented that it will be sufficient if the crisis doesn't get out of hand. If the crisis gets out of hand, no amount is sufficient.

As for the lessons for Asian regionalism from the Euro zone's crisis, Professor Ramkishen Rajan is of the view that, regardless of potential outcomes of the Euro zone crisis, the advent of the euro itself has had a major impact on policy and academic thinking in Asia on monetary regionalism. Deeper monetary integration must wait, as it will be beneficial to see how Europe handles the enhanced measures – whether successful or not.

5. Securing Future Growth through Functional Cooperation

Chair
Mr Ian Buchanan
Chair, Australian Pacific Economic Cooperation Committee (AUSPECC) &
Senior Executive Advisor, Booz & Company
Australia

Moderator
Mr Denis McNamara
Chair, New Zealand Committee of the Pacific Economic Cooperation Council (NZPECC) &
Consultant, Lowndes Associates
New Zealand

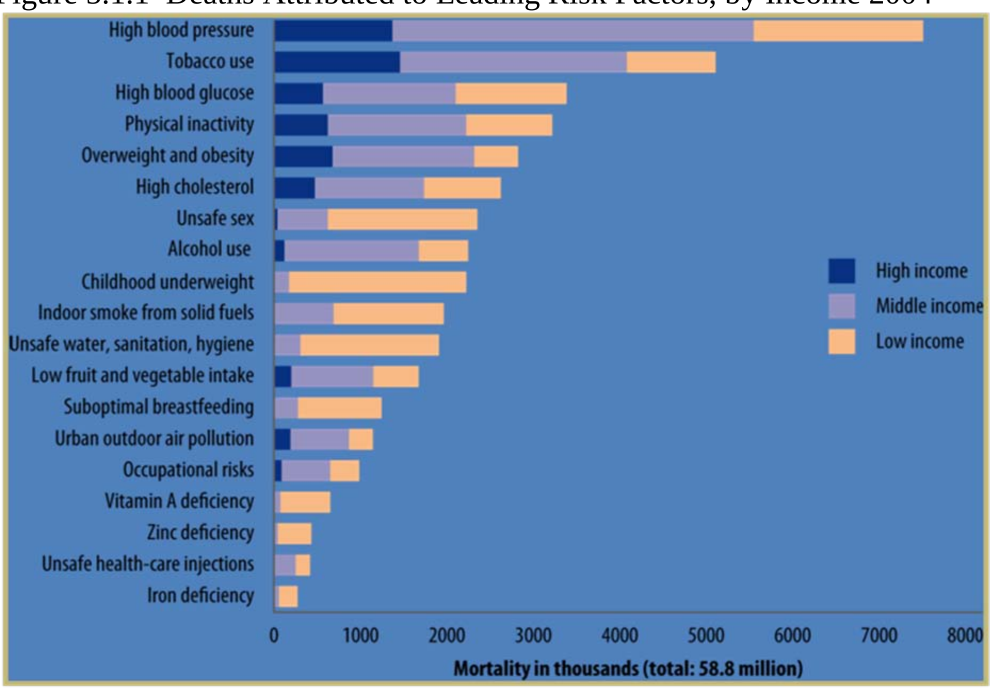
5.1 Healthcare as an Inclusive Growth Sector

Keynote Speaker
Professor Ranga Krishnan
Dean, Duke-NUS Graduate Medical School
Singapore

APEC aims to achieve balanced, inclusive, sustainable, innovative and secure growth. Healthcare is a key element of any kind of inclusive growth.

Where Are We Now?

Figure 5.1.1 Deaths Attributed to Leading Risk Factors, by Income 2004

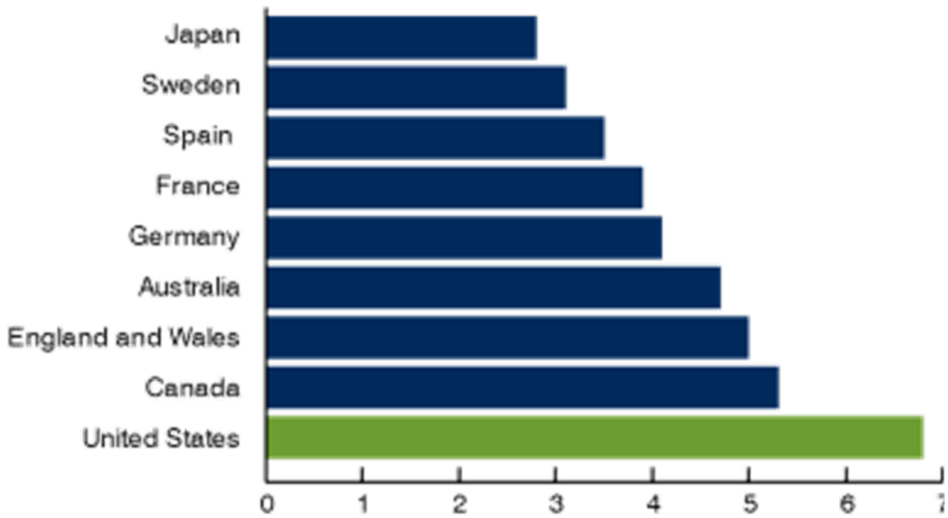


Source: Global Burden of Disease, 2004 Report, WHO, 2008

The leading risk factors of death include infectious diseases, cardiovascular diseases and cancer (see Figure 5.1.1). In every one of them, there has been a lot of progress in reducing the number of deaths due to those causes. However, deaths still occur, but the question is when it does happen.

In assessing the health of the population, one usually looks at the infant mortality rate – how many children die shortly after birth. Japan has brought down their infant mortality rate to a low 3 per 1,000 (see Figure 5.1.2) but in many economies including many developed economies, their rates are double to triple that of Japan's. As such, the infant mortality rate is an area that efforts could be made to bring down the rate further. If the infant mortality rate is reduced, the overall mortality rate goes down dramatically, and longevity goes up. The reason for differences in infant mortality rates between economies is often local – the main reason is lack of education and pre-natal care (ie care for the mother before the birth of the baby).

Figure 5.1.2 Infant Deaths per 1,000 Live Births, International Comparison 2007



Source: Commonwealth Fund National Scorecard on U.S. Health System Performance, 2008

When analyzing data between economies, it is important to use comparable data. In the calculation of the infant mortality rate, some economies exclude immigrants in their calculation, some exclude their citizens living abroad, while some omit or miscount premature births. However, the net effect is that people are living longer. 2000 years ago, the average Roman could expect to live 22 years. Those born in 1900 could expect to live 47 years. In 1930, it had risen to about 60. Now it is around 75 and every year, the life expectancy seems to increase by 1-1.4 years. A newborn born last year can expect to live for 78 years.

It is important to keep in mind that longevity and individual lifespans have been increasing in almost all the developed economies over the past 10 years. The question is, how much of it is healthy? Just living longer is not significant; it is how long one is living healthily that is significant. Living healthy is estimated at 6-10 years below the overall rate.

One other factor to keep in mind is, because we are all living longer, there is a silver hair tsunami going on globally. From 1950 to 2050, the world population will have increased by a factor of 3.6; those 60 plus will have increased by 10 and those 80 will have a 27-fold increase. It is becoming a women's world because women tend to live longer. As such, there will be more older women as we move forward.

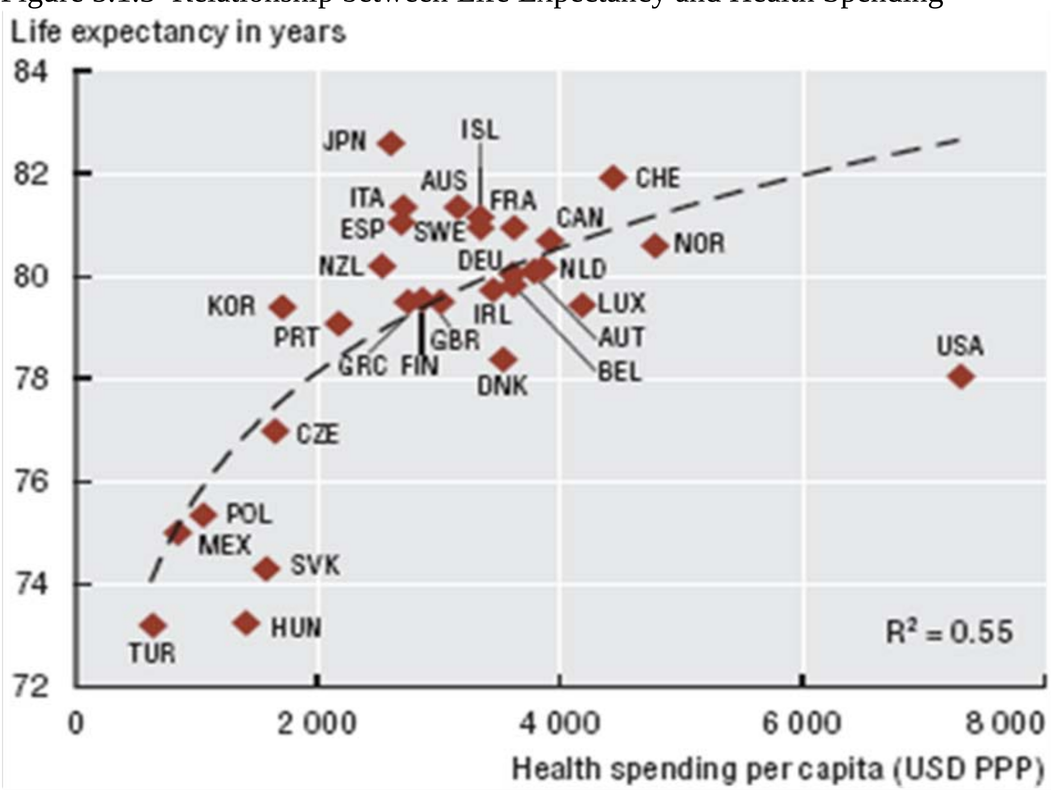
The main factors that play a role in mortality are:

- Pre-natal care
- Vaccination
- Water
- Sewage
- Education

The major reason affecting mortality is not the healthcare system or the number of beds or the number of doctors; it is sanitation, clean water, income and literacy rates. Studies of multiple economies using regression analysis found no significant relationship between life expectancy and the number of physicians and hospital beds per 100,000 population, or healthcare expenditures as a percentage of GDP.

Beyond a certain point, increasing physicians and healthcare costs is not likely to have a significant impact on mortality. Figure 5.1.3 shows the relationship between life expectancy and health spending. The curve is very sharp, and shows that increasing cost does not impact longevity much at higher spending levels.

Figure 5.1.3 Relationship between Life Expectancy and Health Spending



Source: OECD Health Data 2009, OECD (http://www.oecd.org/health/healthdata).

A focused example is the big difference in lifespan between African-Americans and Caucasians in the US. It is tempting to attribute the difference to a discrepancy in healthcare system.

However, upon close scrutiny, the biggest single factor is income. Poverty is related to factors including education and to a certain extent what they eat. Apart from income, the other factor is personal risks such as obesity, blood pressure, alcohol intake, diabetes, cholesterol and smoking. These two groups of factors account for most of the difference in life expectancy.

We all live longer, and the healthcare costs are going up across all economies. Although the increase is usually reported as a percentage of GDP, it is better to look at other metrics as well since a huge GDP can mask the healthcare expenditure.

Two factors for the increase in healthcare costs are

- Who makes the choice
- Who pays for the cost

The US data from Medicare shows that more than 25% of the budget goes to care for patients in their last year of life. Most American patients want to die well, not to die badly (in hospital for the last weeks of their lives). However, in most western economies, people die in a hospital. There is a big disconnect, and one of the largest factors is education. Family members and individuals are often not educated about their own options. It is important to have advanced directives that can be passed to others to ensure others are aware of one's wishes. There are also all kinds of incentives leading to the more people dying in hospitals. The incentives in most healthcare systems drive towards hospitalization, since both hospitals and physicians make money out of it. There are also all kinds of incentives designed to provide more healthcare rather than more benefit.

Medicine is one of the few fields with the laws of supply and demand turned upside down. In medicine, supply drives its own demand. If one is running a hospital, the hospital has to be kept full of paying patients. In the US, no one thinks of the cost because someone else is paying for it. By law, Medicare cannot reject any treatment based upon cost, even if the treatment will not make much of a difference.

<u>What Do We Want?</u>

As individuals and as a population, what we really want is to live well longer. This translates to reducing the disease burden. Infectious diseases have been reduced, but the one big disease that is growing fast is how you feel – depression (see Figure 5.1.4). The incidence of depression is growing fast globally, and is turning out to be one of the big impact factors on the quality of life.

One of the factors that can reduce the disease burden and improve the quality of life is public health or population care. Public health is the science and art of preventing disease, prolonging life and promoting health through the organized efforts and informed choices of society, public and private organizations, communities and individuals.

A lot of the benefit comes from prevention or early identification and treatment. Importantly, none of this happens in isolation. It is driven by factors such as incentives, economic factors, education and mainly integration. In the US, $12 billion is spent on public health, but close to a trillion on healthcare. The one thing that is likely to have the biggest impact is the one that no one pushes for. Some of the major public health issues all of us know about are infectious diseases (cooperative technology can be used to identify and provide information on new diseases and the spread of diseases), obesity, water sanitation, urban density, poverty and pollution.

Figure 5.1.4 Projections of Global Burden of Disease from 2004 to 2030

Rank	2004		2030	Rank
1	Lower Respiratory Infection		Unipolar Depression	1
2	Diarrheal Diseases		Ischemic Heart Disease	2
3	Unipolar Depression		Road Traffic Accidents	3
4	Ischemic Heart Disease		Cerebrovascular Disease	4
5	HIV/AIDS		COPD	5
6	Cerebrovascular Disease		Lower Respiratory Infection	6
7	Prematurity and low birth weight		Hearing loss, adult onset	7
8	Birth asphyxia and birth trauma		Refractive errors	8
9	Road Traffic Accidents		HIV/AIDS	9
10	Neonatal infections and others		Diabetes mellitus	10
15	COPD		Neonatal infections and others	11
14	Refractive errors		Prematurity and low birth weight	12
15	Hearing loss, adult onset		Birth asphyxia and birth trauma	15
19	Diabetes mellitus		Diarrheal Diseases	18

Source: Global Burden of Disease, 2004 Report, WHO, 2008

It is a natural reaction of people to think of casinos negatively as casinos are inherently wrong. An interesting example is the Cherokee, in a very poor place which was allowed to build a casino. Everyone was worried about the negative impact of the casino, and a study was made on the region many years before and many years. The findings of the study are unexpected – casino improved health. Health was improved because parents had jobs, and parents could take better care of their children so the latter's health improved.

<u>The Singapore Healthcare System</u>

Singapore tried to build a system to deal with all aspects of healthcare. The population of Singapore is small, its people are relatively well-off and enjoy a good life expectancy. What many are unaware of is the huge emphasis on health promotion and disease prevention. There are also all kinds of systems to deal with the incentives which are incorrect and which incentivize more care. Rather, there are systems to incentivize appropriate care. The insurance system consist of a multi-tier health protection with:

- Government subsidy for public hospitals;
- Medisave – a compulsory individual medical savings account;
- Medishield – an insurance account on top of Medisave; and
- Medifund – a medical endowment fund which is a safety net for needy patients

Delivery is primarily done through private medical practitioners but specialist care for most patients is still the public sector. The financing is through a compulsory medical savings account, and those who cannot afford it have the medical endowment fund.

In many parts of Asia, there are older populations, fewer children and fewer marriages. Innovations may be the one solution that may help in many matters of healthcare.

Remember, it is not the healthcare delivery system that is the focus, it is public health.

5.2 Food Security in APEC Economies

Dr David Hong
Vice-Chairman, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC) &
President, Taiwan Institute of Economic Research
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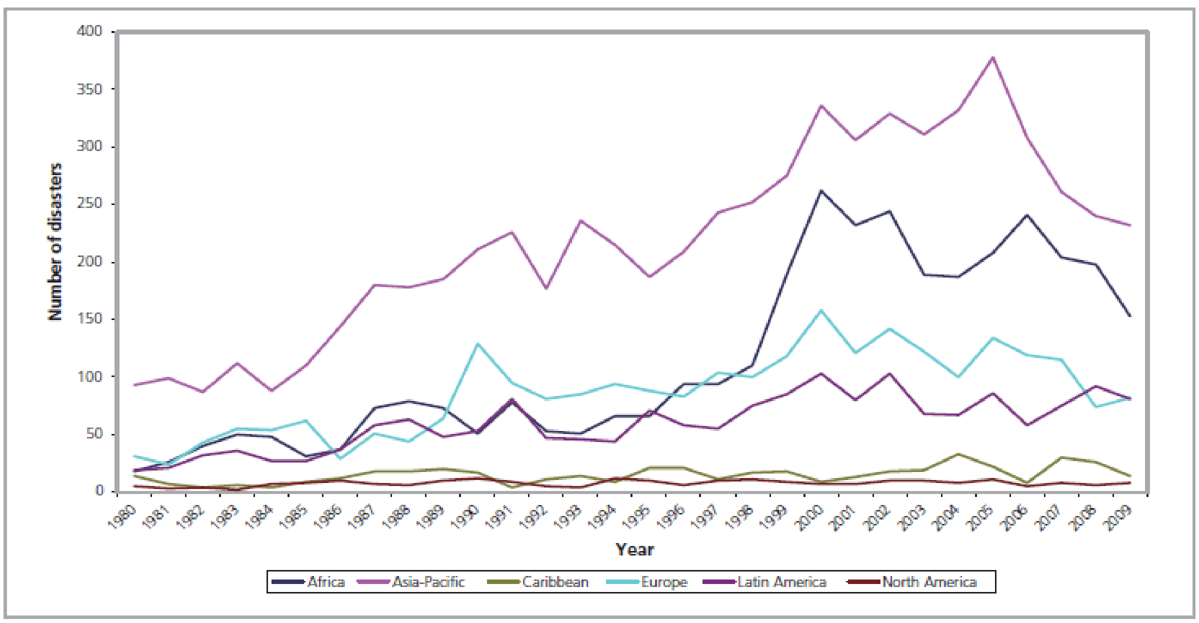
Causes of Emergency Food Needs

Major natural factors cause emergency food shortage:

- Climate change and global warming amplify extreme weather conditions, such as typhoons and heat waves. They further magnify seasonal stresses, such as droughts and floods. Such impacts on agriculture and food security would be severe.
- Natural disasters affect livelihoods and farming. Droughts, floods, typhoons and other extreme weather events lead to sharp variations in food production.
- Driven by extreme weather disasters, emergency food needs have increased dramatically, and cause short-term transitory insecurity in recent years especially in the Asia-Pacific Region.

Figure 5.2.1 Disasters by Global Regions



Source: ESCAP based on data from EM-DAT: The OFDA/CRED International Disaster Database – www.emdat.be – Université Catholique de Louvain – Brussels – Belgium

The Asia-Pacific region is particularly at risk to different types of natural disasters due to its geological and geographical features. The Pacific-Rim earthquake belt is an area with seismic and volcanic activities among the highest in the world. Nearly one-third of the world's tropical cyclones form within the western Pacific, and this makes the Pacific basin the most active in tropical cyclones on Earth. Consequently, certain areas of the Asia Pacific region are frequently devastated by typhoons, storm surges, floods, landslides, earthquakes, volcanic eruptions and drought that cause billion worth of damages of agricultural production. People in the region are 4 times more likely to be affected by natural disasters then those in Africa and 25 times more vulnerable than Europe or North America. As shown in Figure 5.2.1, the Asia-Pacific region has suffered more disasters then Africa, Europe, Latin America, Caribbean and North America.

Food Reserve to Meet Emergency Food Needs

Historically, food reserves have been a policy instrument used by policymakers to support emergency food needs arising from the impact of natural disasters. Particularly, emergency response reserves stress the function of maintaining a small scale stock for immediate food relief to meet emergencies induced by natural disasters.

Food reserves serve as an insurance policy against natural disasters. The significance of food reserves is they're capability to activate emergency food relief when an extreme natural disaster occurs and causes food crisis. To some extent, food reserve serve as a first source to expedite food release. Therefore, it is a first defense line to ensure food security.

Food reserve is rising in importance, and findings of studies indicate that economies with reserve stocks were able to respond more quickly than those without reserves.

International Cooperation in Providing Emergency Food Needs

Examples include:

- G20 Group Pilot project for an Emergency Humanitarian Food Reserves
- ASEAN+3 Emergency Rice Reserve (APTERR)

(I) G20 Emergency Food Reserve

In 2011, G20 Agriculture Ministers' meeting endorsed a Ministerial Declaration and Action Plan on Food Price Volatility. Ministers agreed on the need to study the feasibility of an 'Emergency Humanitarian Food Reserve'. The objective is to create an emergency humanitarian food reserve pilot project, involving the civil society and the private sector.

(II) ASEAN+3 Emergency Rice Reserve (APTERR)

The APTERR comes from the ASEAN Food Security Reserve Agreement (AFSR) signed by ASEAN ministers in 1979. The purpose is to create a regional rice stockpile dedicated to emergency response. ASEAN members with Japan, Korea and China have decided to set up APTERR, as a permanent mechanism to promote cooperation in safeguarding food security and meeting emergency food needs. The APTERR is based on the principle of mutual assistance and collective self-reliance.

APEC as a Platform to Meet Emergency Food Needs

APEC has an unique stake in the establishment of a regional food emergency mechanism able to address emergency food needs. With member economies across a wide geographic span that covers various climate zones suitable for different staple crops, APEC will benefit from a regional cooperation that features diverse sources of food, which helps to meet emergency food needs and reduce food security risks.

Under the 2010 APEC Niigata Declaration on APEC Food Security, APEC ministers agreed on the importance of social protection measures such as safety nets and other policies that protect the most vulnerable from shocks such as natural disasters. Ministers agreed to examine the feasibility of establishing cooperative approaches to address emergency food needs.

In 2011, Chinese Taipei proposed the APEC Food Security Forum – APEC Food Emergency Response Mechanism (AFERM) with APEC funding. The purpose of this forum is to seek the most effective way to support emergency food needs in line with Niigata Declaration. The AFERM could serve as a solution to address emergency food insecurity through the building of a strong coordinated reserve buffer system. Such 2011 initiative can be used to fulfill one of APEC's 2012 objectives.

Food security is one of APEC's 2012 priorities. Russia's 2012 APEC chairmanship will promote:

- Trade and investment liberalization
- Reliable supply chains
- Innovative growth
- Strengthening food security
  - Pursuing sustainable agricultural development and stable markets including increased transparency, monitoring and information exchange on agricultural production
  - Developing policies for community resilience and a more inclusive food supply for socially vulnerable population groups

Therefore, AFERM could be a feasible option to fulfill the 2012 APEC priority of 'strengthening food security':

- The AFERM is to create a network of virtual food stock
- APEC economies that participate in AFERM can contribute any of earmarked crops in kind or in cash
- With analyses and assessments conducted by the AFERM Expert Team, the mechanism will come up with optimal levels of specific crops including rice, maize and wheat
- The AFERM will be operated with the principles of cost-effective, voluntary basis, collective action, risk sharing and self-management
- The AFERM is designed for short-term emergency food relief in times of natural disasters

With regard to the progress of AFERM, a working meeting was held in Chinese Taipei on 10-11 April 2012. In the meeting, it was further confirmed that the AFERM would be conducted in fully-grant form of food relief from earmarked reserves to be pledged by APEC member economies. As a result, the mechanism will not cause market distortion.

It was decided that AFERM will function with existing humanitarian food relief programs. In addition, AFERM would function with flexibility, such as considering changing economic conditions. The following were recommended:

- A relevant feasibility report needs to be further refined
- A revised report will be submitted to APEC meetings for consideration to be adopted as a pathfinder initiative
- APEC member economies are welcome to participate and give comments on AFERM

5.3 Energy Security in APEC Economies

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Singapore

Sometimes, it is the issue of appropriate definitions that bring out the most difficult questions. Energy covers a wide range of industrial sectors, and presents policy-makers with a multiplicity of challenges related to the policy objectives of economic efficiency and competitiveness, environmental sustainability and energy security. This section focuses on natural gas, partly because it shows what paradigm shifts can mean in the world of energy, and it also gives some evolving ideas about energy security.

Defining Energy Security

'Energy security' is often used in an imprecise manner by a range of constituencies for different and sometimes at cross purposes. For example, the coal lobby in the US is equally vociferous in supporting domestic coal production as the 'green' lobby is in supporting solar and wind power, all in the name of energy security. Energy security thus is a highly contested area of debate that carries competing policy implications with different impacts on social welfare and national security. As such, clear definitions are critical. While there exists various concepts of energy security, most useful definitions focus on opportunity costs (i.e. real economic costs) rather than the physical availability of fuels.

There is a plethora of metrics utilized to track energy security which range from fuel imports and energy expenditure to energy intensity, price volatility, environment impacts, and energy research and development. Take for instance the case of Singapore, which imports 100% of its oil and gas utilized. It would be odd to rate Singapore as less 'energy secure' than, say, Nigeria, just because the latter is a net exporter of hydrocarbons. Not having to depend on imports of energy is not necessarily the most important measure of energy security. Implications for energy security depend on how such energy metrics are used analytically and the economic and political context in which different countries operate.

There have been many attempts to convert the many dimensions of energy security into a single metric for popular consumption. These attempts appear ad-hoc and arbitrary, as it is difficult to attach weights to various metrics. Ultimately, such weights are judgment calls. As an example, consider high oil prices. Even for net oil importing countries, high oil prices are not necessarily negative. If in times of high global economic growth and rising prosperity, high oil prices are not an issue. Indeed, high oil prices are critical in promoting expenditures on exploration and development and encouraging innovations in energy efficiency and conservation. Single measures of energy security are bound to provide dubious results. Bad policy can come from bad definitions of energy security.

Paradigm Shift: Gas Markets in APEC

It is instructive to look at previous forecasts of Asia's energy situation to see if these have been borne out and whether there have been recent new developments not foreseen a decade earlier. About 15 years ago, Kent Calder, Director of the Program on US-Japan Relations at Princeton University wrote a book on the critical challenges facing Asia, with a fairly grim prognosis (see Figure 5.3.1). According to Calder, Asia's rapid economic growth, booming energy demand and its critical energy dependence on the Middle East combined with the waning of American influence in the Pacific Basin would lead to energy shortages, regional rivalries and a deeper linkage between China and the Middle East.

Figure 5.3.1 Asia's Deadly Triangle

Table 5.3.1 Primary Energy Demand by Region

	1980	2008	2035	CAGR 1980-2008	CAGR 2008-2035	Share 2008	Share 2035
OECD	4,067	5,236	5,681	0.9%	0.3%	43.2%	33.5%
North America	2,102	2,620	2,864	0.8%	0.3%	21.6%	16.9%
United States	1,802	2,160	2,265	0.6%	0.2%	17.8%	13.4%
Europe	1,501	1,766	1,904	0.6%	0.3%	14.6%	11.2%
Non-OECD	2,981	6,567	10,826	2.8%	1.9%	54.1%	63.8%
Asia	**1,066**	**3,724**	**6,711**	**4.4%**	**2.3%**	**30.7%**	**39.6%**
China	**603**	**2,271**	**3,835**	**4.7%**	**2.0%**	**18.7%**	**22.6%**
India	**208**	**669**	**1,464**	**4.1%**	**3.1%**	**5.5%**	**8.6%**
Middle East	**114**	**589**	**1,000**	**5.8%**	**2.1%**	**4.9%**	**5.9%**
World	7,219	12,132	16,961	1.8%	1.3%	-	-

Source: IEA World Energy Outlook 2011 (New Policies Scenario)

Consider the demand leg of the triangle. Table 5.3.1 shows the primary energy demand by region. From 1980-2008, the OECD growth rate is 0.9% compared to 2.8% for non-OECD and 4.4% for Asia. The world outlook (2008-2035) predicts barely 0.3% long run growth for OECD economies, much less than the other regions in the world. The OECD will account for less of global demand for energy, while non-OECD will account for up to two-thirds of global demand for energy.

Fossil fuels are indispensable sources of energy. Coal, oil and natural gas are expected to continue to occupy a predominant share of fuel sources in the foreseeable future (see Figure 5.3.2). Oil, gas and coal will remain indispensable fuel sources for our energy future, despite increasing interest in alternative and renewable energy.

Figure 5.3.2 Major Gas Flows, 2010

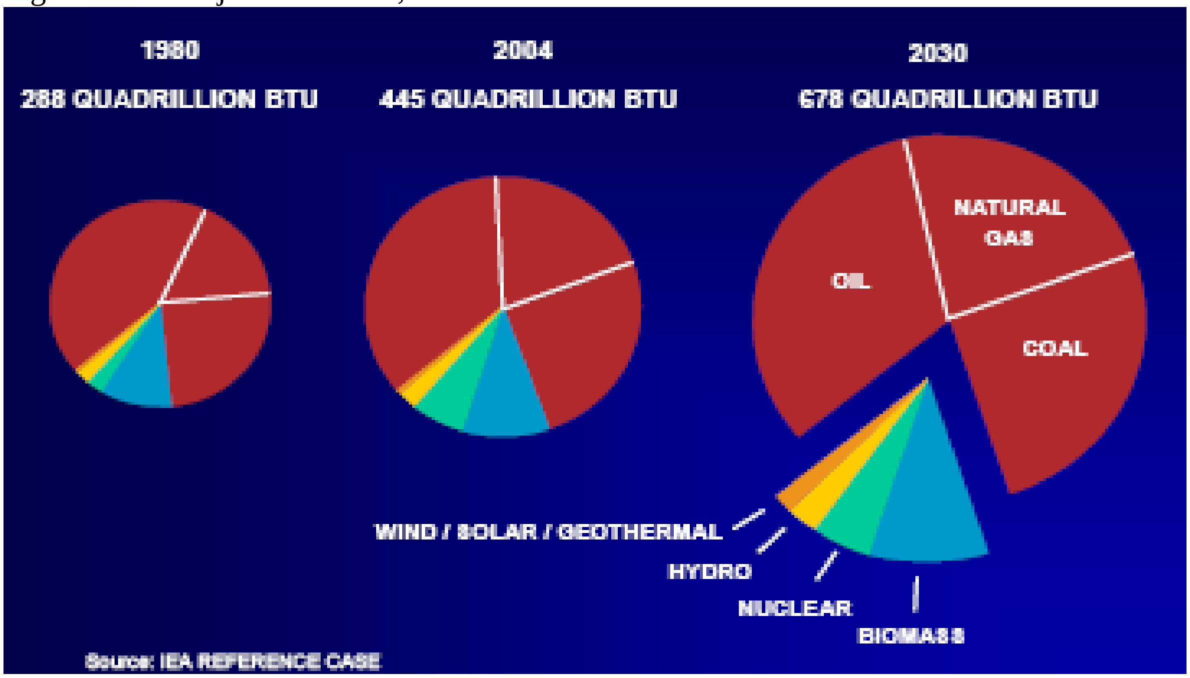


Figure 5.3.3 Major Gas Flows

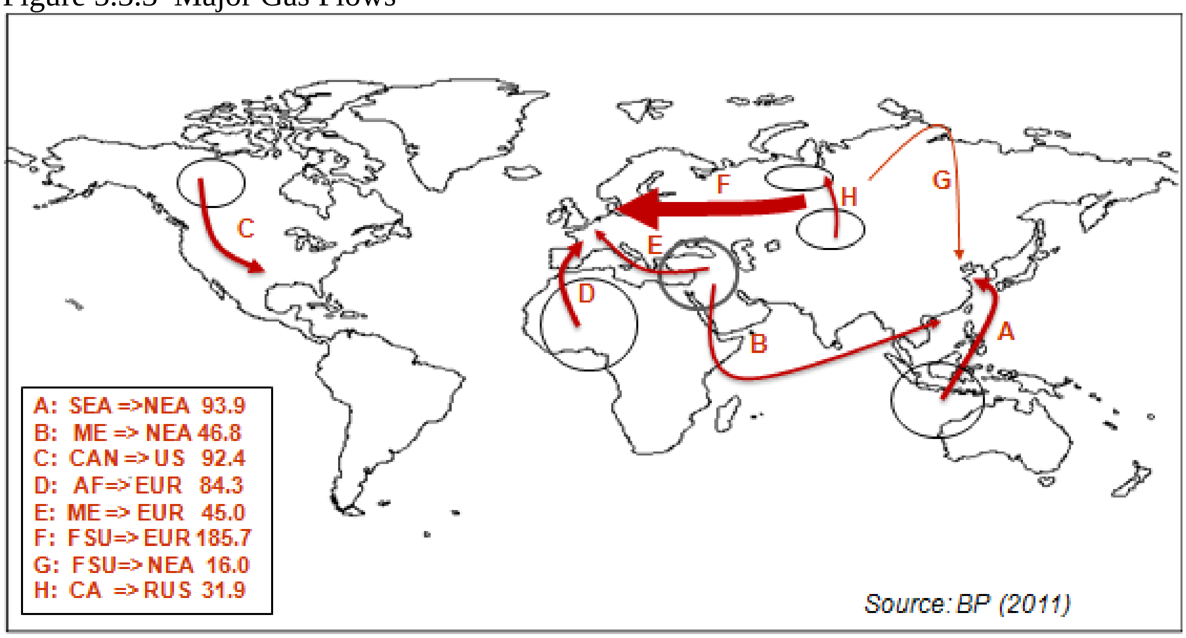


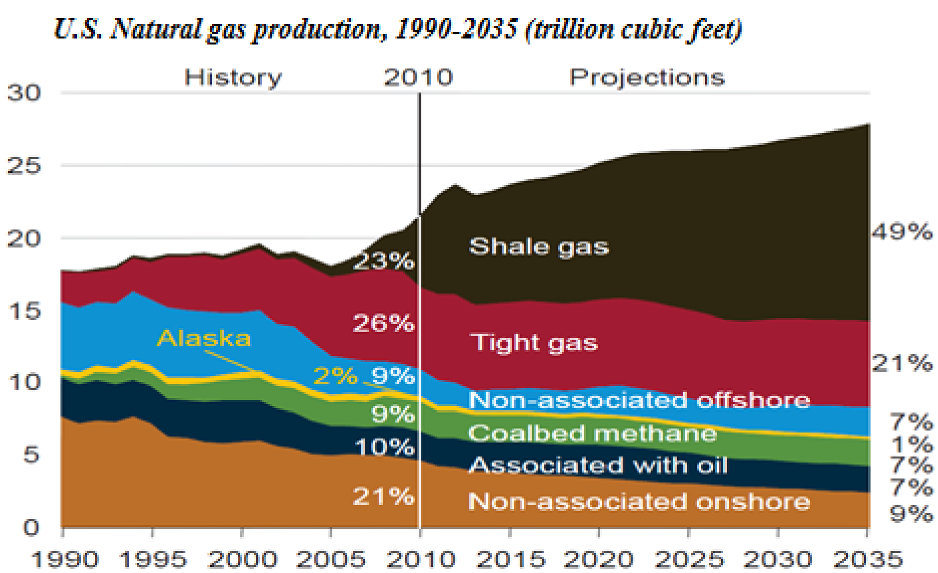
Figure 5.3.3 shows a chart of the estimated major inter-regional gas trade movements for 2010. Total imports and global consumption are 975 and 2,858 billion cubic metres (Bcm) respectively.

The following characterize key patterns of the global gas trade:

- Intra-regional flows of gas remain important, with gas flows from Canada to US (92.4 Bcm), from South-East Asia (SEA) and Australia to the Far East (93.9 Bcm), and from Central Asia to Russia (31.9 Bcm); SEA refers to the ASEAN economies as well as Australasia; Far East refers to China, Japan, South Korea, North Korea, Mongolia and Chinese Taipei; Central Asia refers to the Central Asian economies formerly in the Soviet Union
- The largest flow of gas is from Russia and Central Asian FSU economies to Europe (185.7 Bcm), though Europe also receives significant gas imports from Africa (84.3 Bcm) and the Middle East (45.0 Bcm); FSU includes all the Central Asian FSU economies as well as Russia
- In addition to gas imports from SEA, the Far East receives imports from the Middle East (46.8 Bcm) and, increasingly, from the Former Soviet Union as well (16.0 Bcm)
- In terms of gas trade, North and South America are effectively isolated from the rest of the world, with few significant trans-Pacific or trans-Atlantic gas flows.
- Flows are primarily regional but increasingly becoming inter-regional.

Figure 5.3.4 illustrates the paradigm shift in relation to gas production. The findings are from the Energy Information Administration (EIA) which forecasts the gas supply in the US. The estimate of gas reserves has increased by more than 10 times in North America compared to a few years back where the reserve production ratio was 12 years. Unconventional shale gas production has surged and is expected to constitute up to half of total US output of natural gas by 2030. The unanticipated improvements of technology in exploiting unconventional gas (such as horizontal drilling and hydraulic "fracking") meant that resource reserve estimates have dramatically increased rather than decreased.

Figure 5.3.4 US Gas Supply Forecasts



Source: EIA, 2012

14

On the back of these developments is the production outlook for unconventional natural gas, US gas companies have looked into potential exports of Liquified Natural Gas (LNG). Estimates of potential exports into Asia from the US range from 10 million tons to 40 million tons. In other words, significant LNG exports are expected from the US when only a few years ago, most forecasts assumed that the US would emerge as a major global importer of LNG.

Current US-Asia gas price differentials are over \$10; purchasing gas in the US was \$10-12 cheaper than purchasing in Japan in late 2011 and early 2012. If the US begins LNG exports into Asia, lower price differentials are expected. More importantly, the pricing basis will change. Economies such as Japan and Korea will, for the first time, be able to buy gas that is not linked to oil prices but related to US domestic gas pricing indices. These developments in the outlook for global natural gas trade suggest how the concept of energy security evolves in light of technological progress and associated changes in estimates of resource reserves.

Conclusion: Energy Security

Energy security is a key global issue, and high oil prices and intense price volatility has accentuated this concern. The perception of widespread multiple geopolitical risks include:

- Instability associated with US military intervention in the Middle East and its consequences such as the rise of Iran in regional influence and the rise of Shia-Sunni tensions in the Gulf
- The Arab Spring and its uncertain geopolitical implications
- Venezuela's nationalization of its oil resources
- Russia's tough stance on foreign investments in its oil and gas sectors
- The lack of security in major oil producing regions (e.g. the Niger delta)

One way to mitigate these risks is to diversify geographically so as to reduce dependence on particular economies or regions. Diversifying fuel types is another way, as it ensures exposure of an economy is not limited to one particular type of fuel but to a range of fuels with different risk characteristics.

However, the notion that energy security can be improved by ending import dependence on oil from the Middle East is unrealistic and misguided. The crude oil market is now inherently global, where arbitrage among many players establishes international trading patterns and worldwide oil prices are adjusted by markets for crude oil quality and transport costs. The world price of crude oil is the same whether the oil comes from unstable regions of the world or from traditional "safe" oil exporters. As such, a policy of simply redirecting oil flows established by the market can be inefficient and does nothing to enhance energy security.

Policies that accelerate a premature transition from oil and gas to other sources of energy can be costly and require sustained subsidies. For example, palm oil for bio-diesel can cause deforestation and loss of biodiversity.

Market processes are inherently more efficient. Economies specialize in sectors in which they have a comparative advantage, and use export proceeds to pay for required imports. 'Making' oil (via exploration and production) is not inherently superior to just buying oil in the open market; it all depends on whether one is better at 'making' oil or making other goods and services in order to buy the needed oil. For instance, Singapore does not produce one drop of oil of its own yet boasts the world's 3rd largest petroleum refining centre and has more oil and refined petroleum product storage tanks than many parts of Asia. Subsidizing oil exploration and production may be costly, wasteful and inefficient if the requisite geology, skills set and commercial enterprise are lacking. While purchasing equity in oil and gas companies does not yield direct access to energy resources, it does give comparable exposure to energy prices.

5.4 Infrastructures and Connectivity in Asia-Pacific: The Case of Mainland ASEAN Economies

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We are interested in future growth, and this must be 'quality growth' meaning, it should be::

- Secure: food security, education for all, universal healthcare and energy security
- Culture-based
- Environment friendly

Some Asian economies are growing out of subsistence, but very much less and less so. Growth must be driven by commerce (*ie* trade and investment), and the ASEAN-based commerce can now be relied upon as a growth driver, a new paradigm shift with:

- Rising income
- Better utilization of resources
- Allowing market forces to work

New and additional means of connectivity will enhance ASEAN commerce. The commercial infrastructures of the original ASEAN 5+1 were built to serve the Western-oriented commerce. Businesses with Northeast Asia could be served by these infrastructure (*ie* the main seaports and airports), all well equipped with the needed out-of and into-border facilities. Now, more and more trade is cross-border trade, particularly trade among the mainland ASEAN economies. For example, for Thailand, trade with the immediate neighbor economies was US$37 billion out of US462 billion or 8.3% in 2011, 78% of which was cross-border trade. This trade has been growing at double-digit rates.

Even with poor connectivity, physical infrastructures as well as other complicated procedures, trade still flourished. Cross-border trade could also be relied upon for trade beyond border. Through cross-border trade, an economy like Thailand could reach trade destination beyond border such as Vietnam, Southern China, Singapore, Bangladesh and India.

Attempts have been made to build more physical infrastructure for better connectivity. For example, the 3rd Thai-Lao bridge over the Mekong River was opened symbolically on 11 November 2011, the Armistice Day. The 4th bridge in the Northern Thailand and Lao PDR is about to be built. There is a project to connect the Eastern Seaboard of Thailand to Tavoy in Myanmar. In addition, the grand scheme for connectivity among mainland ASEAN economies plus China has been built on the ADB-sponsored concept of economic corridors including East-West, North-South and South-South. Parts of these corridors are now in operation. Moreover, with the rapidly opening of Myanmar for commerce, the economic corridor concept is becoming a real commercial proposition.

While physical infrastructures always take time to be built, they have a certain known timeframe. It is the institutional infrastructures for cross-border trade that could delay the real connectivity, as these take even longer to be implemented, and with often unknown timeframe.

There is a need for ASEAN economies to learn more about their past. This knowledge and understanding about ASEAN are crucial for better connectivity.

5.5 Comments & Discussion

Comments & Discussion: Professor Ranga Krishnan's Presentation

Professor Ranga Krishnan was asked his opinion on the benefits of extending longevity. In response, he commented that almost all economies measure mortality and longevity but do not measure the quality of life which is actually the most important variable, because of difficulties in measuring this variable.

On why the casino study was cited, Professor Ranga Krishnan replied that since such a study was conducted and since the results were startling, it was an interesting finding to share.

Comments & Discussion: Dr David Hong's Presentation

Dr David Hong was asked his view on the expected differences between APEC and current religious group institutions that deliver food to the needy. To this, his reply was that APEC is a formal, regional organization with a much larger scale and thus will involve much more participants compared to those of any religious groups. The program on food security is still underway and is expected to be submitted to APEC in 2012.

A member of the audience asked if the proposal of having food reserves to mitigate against price fluctuations or short term emergencies will take into account the longer term trend of increasing food demand (eg as a result of population growth, climate change). To this, Dr David Hong explained that the aim is to take care of short term disasters and will not aim to disrupt market mechanisms which should take care of the long term issues.

Comments & Discussion: Dr Tilak K Doshi's Presentation

Dr Tilak K Doshi addressed the possibility of using fossil fuels in the future given that all energy resources are diminishing. According to Dr Tilak K Doshi, it is indeed true that coal, oil and gas will be diminishing. However, the speed of this happening may be much longer than what many think. It is thus a competition between diminishing resources and boundless human ingenuity and technology.

6. Nurturing Asia Pacific Growth: Competitiveness Enhancement and Productivity Drive for APEC Economies

Chair
Dr Manfred Wilhelmy
Chair, Chilean National Committee for Pacific Economic Cooperation (CHILPEC) &
Executive Director, Chile Pacific Foundation
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Moderator
Mr Dambadarjaa Jargalsaikhan
Secretary General, Mongolian National Committee on Pacific Economic Cooperation (MONPECC)
Mongolia

6.1 Competitive Challenges in Uncertain Times

Keynote Speaker
Professor Michael Enright
Sun Hung Kai Professor of Business Administration, University of Hong Kong &
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There are a number of global tectonic shifts taking place today, such as:

- The global economic crisis and its aftermath
- The shift of economic balance to Asia-Pacific
- Resource and environmental challenges
- The connections made possible by the combination of globalization and modern information technology and communication technology

The above has certain implications for governments and companies:

- Understanding the shifts is vital for economiess/regions to succeed
- Going forward, markets will be tighter and tougher in many cases than they have been in the last decade of easier money, easier lending and easier growth
- National/regional sources of advantage/disadvantage will be more important than ever before
- Generating business innovation will be more important than ever before
- Paradigm shifts of different orders and different types throughout the region will be necessary to prosper going forward

Figure 6.1.1 shows the GDP and the trade trajectories. If we look at the trajectory the economy was on before the crisis, that's what everyone was preparing for and expecting, and what governments and companies were investing in. Since the crisis and taking the IMF predictions to 2016, the world would have lost approximately US$60 trillion in GDP over just an 8-year period – that is one year of global GDP lost. The trade situation is even worse. If we compare the trajectory we were through 2007 with what happened since the onset of the crisis, and the current projections, the world would lose approximately US$110 trillion worth of trade over an 8-year period. That is roughly 3.5 times of annual global exports.

Figure 6.1.1 A World in Crisis

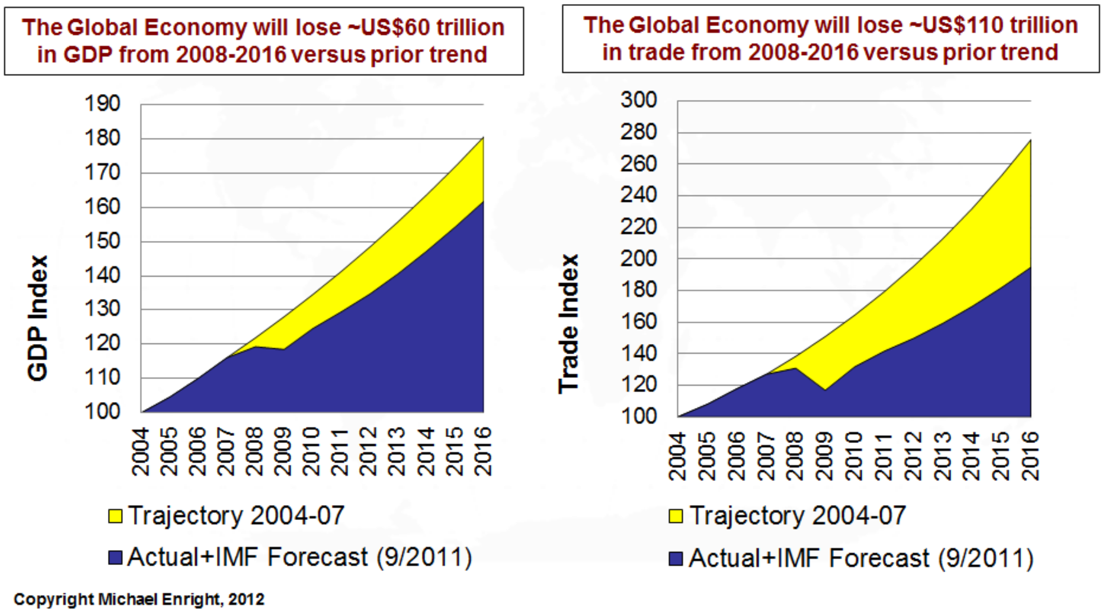
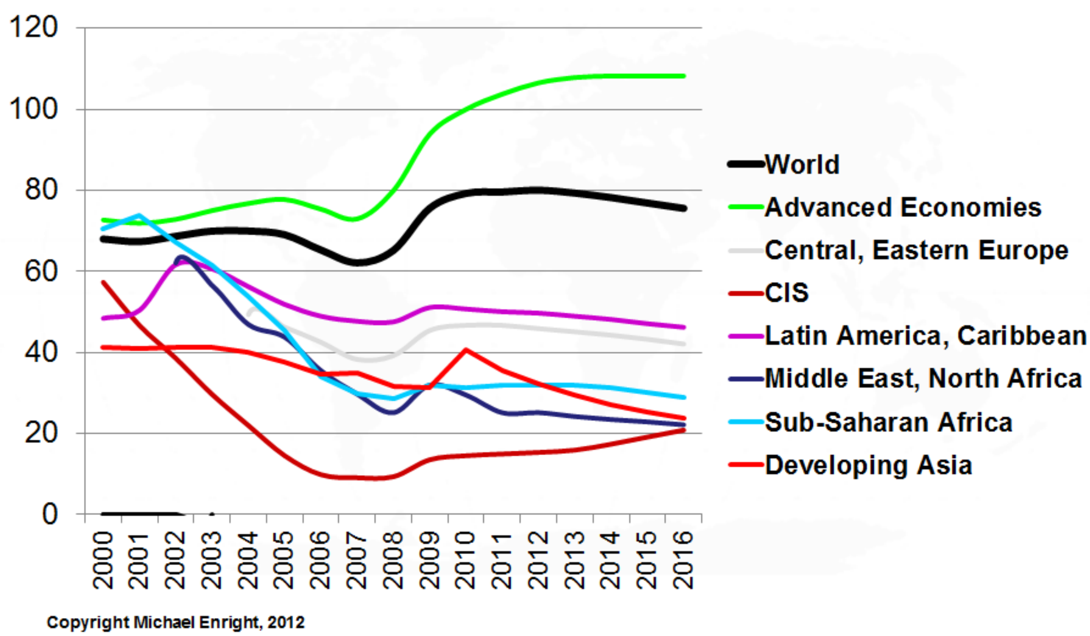


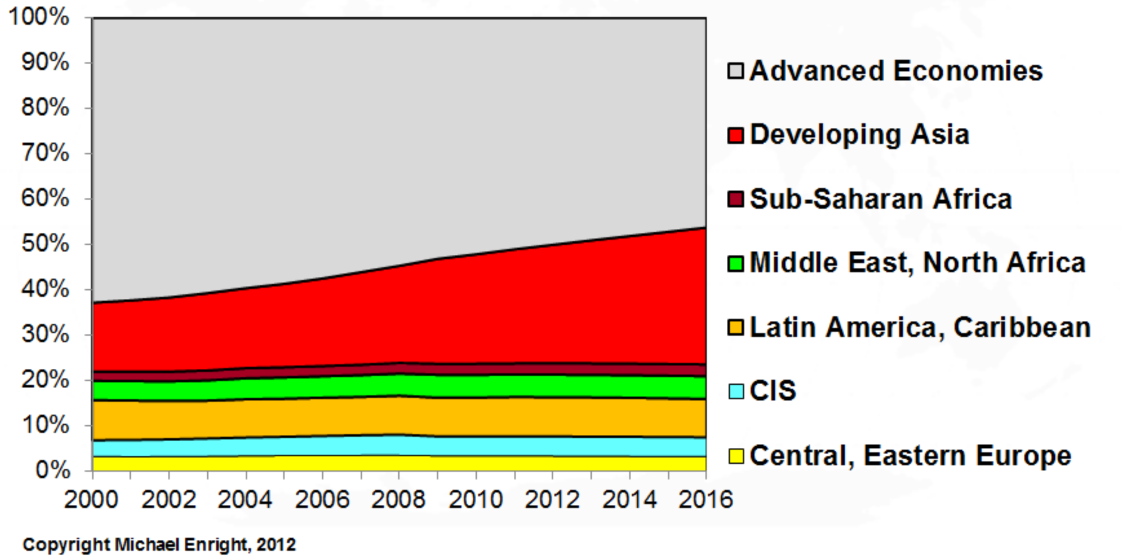
Figure 6.1.2 Gross Government Debt (% of GDP, IMF Forecasts 9/2011)



The advanced economies are increasing their debt (see Figure 6.1.2),while the rest of the world has been decreasing its debt – the latter has become more in essence, fiscally responsible over the last decade while the advanced economies have become less so.

In terms of rebalancing (see Figure 6.1.3), we know that developing countries particularly in Asia, are the ones that are gaining. What is striking is, to a first approximation, developing Asia is picking up ALL of the increase in market share, while the advanced economies are losing ALL of the share that is being lost.

Figure 6.1.3 Rebalancing: Share of World GDP (PPP, IMF Forecasts 9/2011)



For 18 of the last 20 centuries, it was the Chinese and Indian economies that were the dominant economies of the world. Until the 1820s, an economy's size was predicated on its agricultural output which in turn was what supported the population, and which in turn produced the agricultural output. Economic weight scaled with population. As globalization proceeds, as technology, finance, and inputs are more available, and markets are more open, we are starting to go back to a balance where economic output scales with population. This has a substantial implication not only for China and India, but for Indonesia, SEA and the developed economies as well.

Growing populations and economies have resulted in resource pressures. Some resource prices have doubled in real terms over the last 10 years, some have gone up 4 times and some like iron ore has gone up 14 times. Regardless of whether oil has reached its peak, there are many resources where ready supplies are dwindling or at least will start being in short supply over the next couple of decades.

The same developments have caused environmental challenges as well. Environmental challenges include:

- Global population to 2050. The world is moving to a population of 9 billion
- Greenhouse gas emissions. If the projections are accurate, there is no way the greenhouse gas emissions can be brought under control without the BRICS economies (*ie* Brazil, Russia, India, China and South Africa) and other developing economies making substantial changes in the way they operate. It is just not enough for the OECD economies to do so.
- Water scarcity. Over 50% of the world's population is in a water shortage or acute water shortage situations already.

If we look at electronic connectivity, one of the striking features is that Asia already accounts for about 44% of global internet users, nearly 3 times the number in North America, and roughly twice the number in Europe (see Table 6.1.1). The electronic link in global interaction over the internet is likely to be an Asian phenomenon over the next decade or so.

Table 6.1.1 Internet Usage

World Regions	Internet Users 2000	Internet Users Dec 2011	Penetration 2011 (% Population)	Growth 2000-2011	Users %
Africa	4,514,400	118,609,620	11.4 %	2,527.4 %	5.7 %
Asia	**114,304,000**	**922,329,554**	**23.8 %**	**706.9 %**	**44.0 %**
Europe	105,096,093	476,213,935	58.3 %	353.1 %	22.7 %
Middle East	3,284,800	68,553,666	31.7 %	1,987.0 %	3.3 %
North America	108,096,800	272,066,000	78.3 %	151.7 %	13.0 %
Latin America / Carib	18,068,919	215,939,400	36.2 %	1,037.4 %	10.3 %
Oceania/ Australia	7,620,480	21,293,830	60.1 %	179.4 %	1.0 %
World Total	360,985,492	2,095,006,005	30.2 %	480.4 %	100.0 %

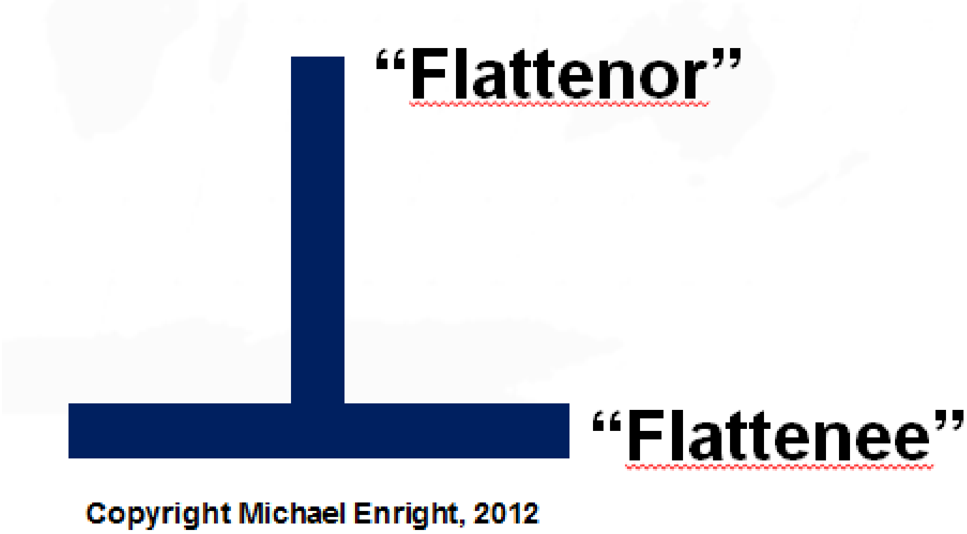
Source: Internet World Stats

Over the last few decades, the international portion of the global economy, be it investment, trade of various forms and global capital flows, have all outstripped global GDP growth. This means that, to be in the growing aspects of the world economy, one has to be active in the international economy. At the firm level, major multinationals and smaller companies are starting to divide up their activities into ever finer slices and then placing each activity in its optimal location.

We are familiar with the notion that we have a knowledge economy now, but people tend to define knowledge economy too narrowly. They tend to think of it as research and development or science-based innovation. The most knowledge intensive activities that go on within firms and within economies go on in the boardrooms and in the corner offices. It is the ability to take and understand a new technology and what that means in terms of new products or serving new customer needs. It is a matter of understanding how to set up and manage a global organization to bring resources over from all over the world, combine them together and then send them out to meet varying needs all over the world.

In addition, we need to think about this whole flat world phenomenon. Some claim that globalization has made the world flat (through factor price equalization). The reality is that the world is like an upside down T (see Figure 6.1.4). Today, the individuals, the organizations and the economies that can generate the ideas can now harness global resources. In fact, before he died, Steve Jobs was probably making more money as an individual than the factories that were assembling the iPods and iPads that Apple was selling. Thus, the key in the so-called flat world is to understand how to be the one with the ideas so you can be the 'flattenor' rather than the flattenee. Today, if you are not driving the steam roller, you will get caught underneath it. If we think about knowledge in doing upfront development and the branding as the source of value today, that may be temporary , just like with physical manufacturing. When we start seeing economies like India and China get into the knowledge kind of things, there is the potential for the value at those ends to collapse as well, and companies and firms have to understand this. Firms must have the contingency plan to tackle the challenge that some company may one day offer the same product, service or process at a fraction of today's price.

Figure 6.1.4 The 'Flat' World



The Competitiveness Imperative

Many of today's global economic problems have arisen because individuals, companies and economies have tried to borrow, rather than earn, their prosperity. The simple fact is that individuals, companies and economies have to improve their competitiveness if they are to achieve a prosperity that is sustainable. Improved competitiveness is essential if economies are to grow without pushing unsustainable debt levels higher. Improved competitiveness is also essential for economies that have avoided the excesses, because they will be fighting for international markets that are less robust than expected. In today's world, it is competitiveness that allows a nation or region to control its own destiny, to be the 'flattenor' rather than the 'flattenee'.

As such, there is a need to think about activities as well as industries, innovation as well as research and development, cities as well as countries, production chains as well as production, and clusters as well as economies.

(I) Activities as well as Industries

With globalization, an economy or city does not have to be able to do everything in order to get into the economic game. This is fundamentally good news for developing economies in particular but it is also good news for any economy that understands that industries and companies perform a variety of activities and that all the economy needs to do is to be competitive in some. It doesn't have to be competitive in everything.

(II) Innovation as well as Research and Development

New technologies create innovation, but innovation also occurs through new applications of existing technologies. Other forms of business innovation that creates a competitive advantage include:

- New geographic, product, service markets
- New ways of reaching customers
- New business models
- New management tools and techniques
- New ways of carrying out activities
- New organizational forms
- New ways of communicating inside and outside the organization

In many cases of leading innovators, their innovations that changed the world were not technological innovations. Bill Gates' innovation involved understanding the power of standards in PC software. Michael Dell's innovation was direct selling in the personal computer industry

Analysts and governments tend to focus a huge part of their efforts on what goes on in the research lab as opposed to what goes on to the rest of the economy. Business innovation and competitiveness gets driven at several different levels:

- Firm level drivers. Economies need the firms that are capable of innovating.
- Industry level drivers. Economies need the industries that have the right combination of competition and cooperation that create pressures and incentives to innovate.
- Cluster level drivers. Economies need clusters of industries that supply spillovers, inputs and the customer base without which innovation cannot occur.
- National (regional) level drivers. Economies need the right national condition to foster business innovation.
- Supranational level drivers. Economies must understand and fit in to the right international framework so their innovations can be leveraged globally.

In this five-level setting, no single level is able to create competitiveness, but disadvantages at any single level can kill competitiveness.

(III) Cities as well as Countries

Cities are drivers of business and innovation all over the world, but urban development is a real challenge. The biggest portion of the world's population within 20 years is going to be in cities in developing economies, and many of these cities have enormous issues. The key is creating development that not only moves the city and its surrounding areas, but is also inclusive in the process. The following approach can aid in making urban development inclusive:

- Serving different parts of the community with infrastructure, utilities and public services, housing and transportation, addressing affordability and coverage issues in the process
- Providing employment opportunities not just in high-tech and modern service industries, but also in construction and tourism, urban support services, transportation and logistics, and traditional business, perhaps through microfinance and small business promotion, traditional business
- Improving public safety/health by providing safe public spaces such as retail locations and schools, safe water and food through sanitation and cold storage facilities, waste management

to reduce disease, preventative and traditional medical care that improve people's lives and make them more productive
- Community-based management and administration to resolve the land, transport and documentation issues that plague many cities, and provide the, neighborhood-based services people need

(IV) Production Chains as well as Production

The world today has many complex production chains and systems, and thus there are many different ways that any individual economy can take part. A focus on competitiveness and development increasingly requires economies to figure out how they can fit into these chains and systems.

(V) Clusters as well as Economies

This is the idea of thinking about interrelated firms and industries, and how those can work to improve economic development and competitiveness.

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In the present situation, there is a need for a new paradigm as many companies and governments face difficult questions:

- How will the budget issues affect governments and firms?
- How can we stimulate local employment without becoming protectionist?
- How can we link companies to local skills, capabilities, mentors and capital as well as infrastructure and shared services?
- How will many governments and firms react when they are pressed to do more with less?

The responses we need are somewhat different than in the past. Going forward, fostering prosperity will require:

- More comprehensive development activities (soft as well as hard side)
- Understanding the environment, getting the basics right
- Creating innovative business communities
- Actively linking companies and industries within the local system to foster clusters
- Actively linking with other clusters within the nation, around the world
- Leveraging local advantages and international linkages

All of this can only be done within a favorable international architecture, and with the involvement of business and government. This is why the PECC and APEC agendas are so important to the future of their members.

6.2 Addressing Labor Market Mix, Enhancing International Competitiveness and Growing Inclusivity: The Singapore Case

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In terms of competitiveness, Singapore is full of problems and these are serious problems.

<u>Growing Inclusivity: Globalization Drive, Government Behaviors and Worsening Income Disparity</u>

Singapore joined the league of wealthiest economies and ranks 3rd by per capital GDP in 2011 (see Table 6.2.1). However, the growth was not inclusive.

Table 6.2.1 Ranking by Per Capita GDP, 2011

Economy	Per Capita GDP (PPP$)	Rank		Economy	Per Capita GDP (PPP$)	Rank
Qatar	88,559	1		Ireland	38,550	14
Luxembourg	81,383	2		Sweden	38,031	15
Singapore	**56,522**	**3**		Kuwait	37,849	16
Norway	52,013	4		Iceland	36,621	17
Brunei	48,892	5		Denmark	36,450	18
United Arab Emirates	48,821	6		Belgium	36,100	19
United States	47,284	7		Germany	36,033	20
Hong Kong, China	45,736	8		Chinese Taipei	35,227	21
Switzerland	41,663	9		United Kingdom	34,920	22
Netherlands	40,765	10		Finland	34,585	23
Australia	39,699	11		France	34,077	24
Austria	39,634	12		Japan	33,805	25
Canada	39,057	13		Korea, South	29,836	26

Source: International Monetary Fund (IMF) data set

Comparing Singapore with Hong Kong (China), Singapore's GDP is 42% of Hong Kong's in 1987, 54% in 1997, 86% in 2007, 99% in 2010 and by 2017, Singapore's GDP is expected to be 16% larger than Hong Kong's. This is despite Singapore having to provide a budget for defense and without the support of a motherland in the WTO.

In addition, it is observed that whenever there has been a recession, Hong Kong sunk deeper while whenever there is a rebound, Singapore rebounded higher (see Figure 6.2.1). Singapore is able to squeeze more growth out of the economy than Hong Kong.

Figure 6.2.1 Real GDP (PPP) Growth of Singapore versus Hong Kong, China

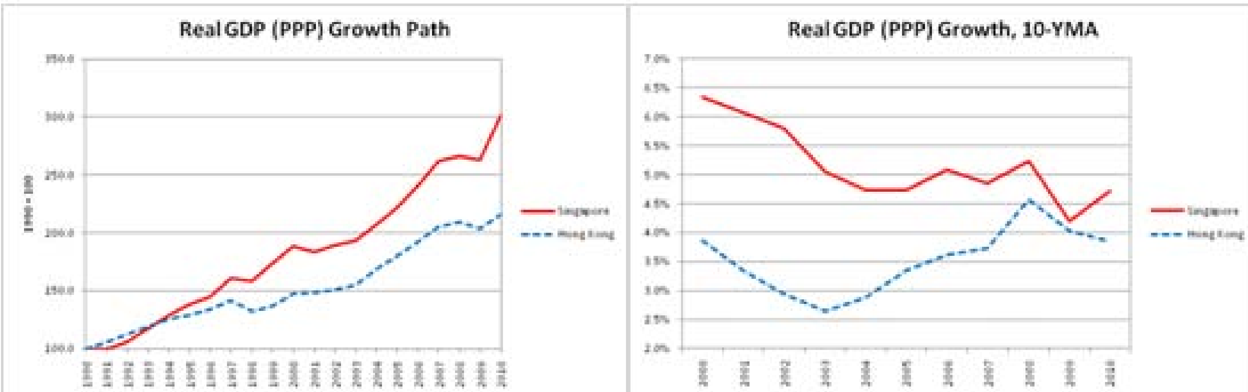
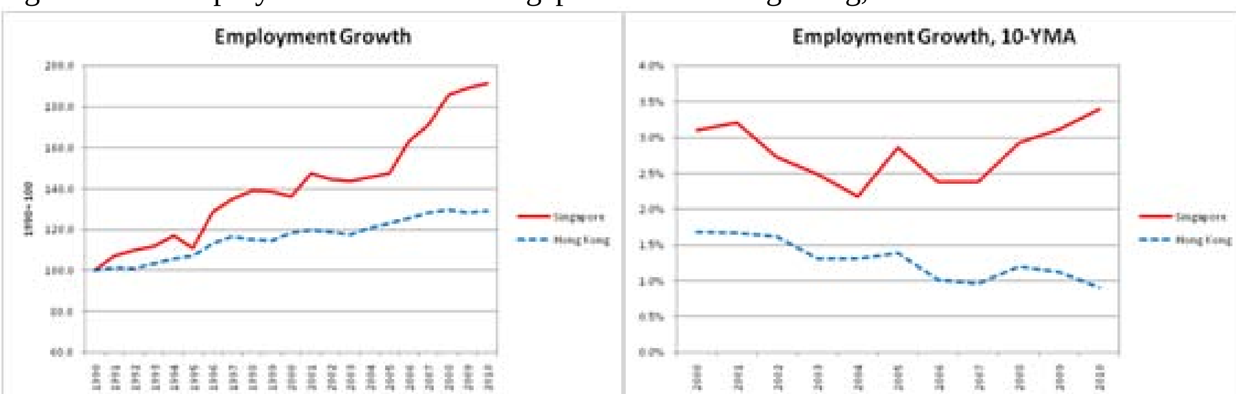
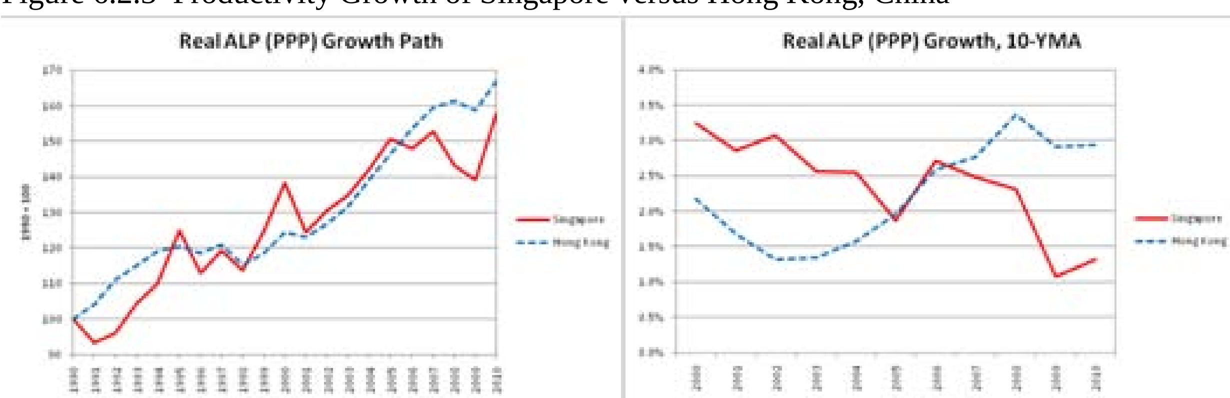


Figure 6.2.2 Employment Growth of Singapore versus Hong Kong, China



Turning to employment growth, Singapore's employment picked up very fast (see Figures 6.2.2). However, there is a problem of having abundant blue-collared workers in the region. It is supposed to be a blessing for Singapore due to cost reduction, but in fact, it is a nightmare.

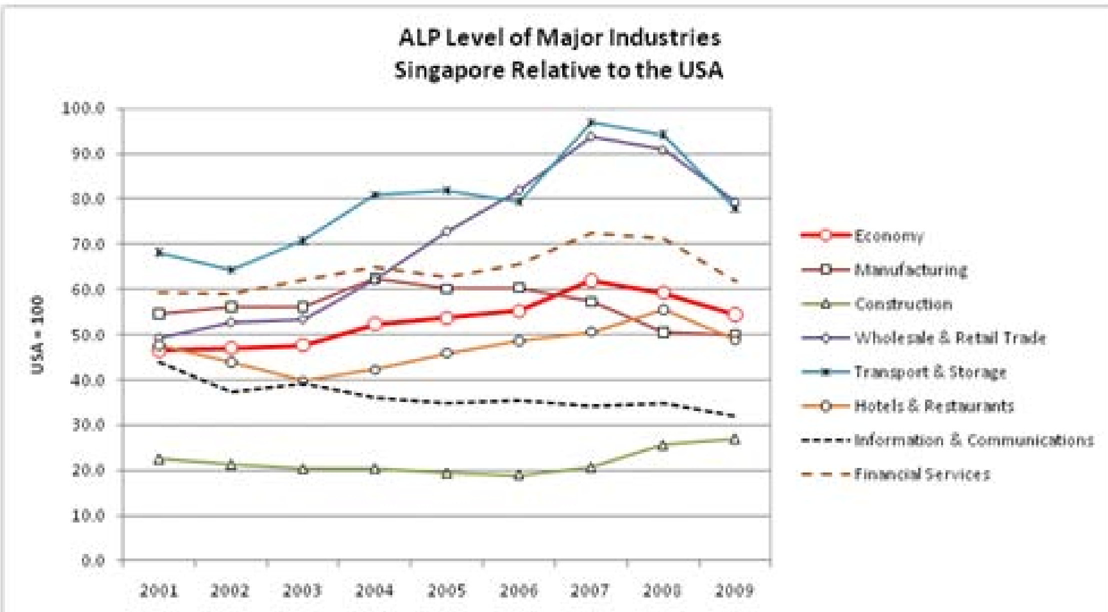
Figure 6.2.3 Productivity Growth of Singapore versus Hong Kong, China



In terms of productivity, Singapore is in real trouble while Hong Kong (China) is doing very well in this area (see Figure 6.2.3). Over time, Singapore is slowing down but Hong Kong (China) is moving up. Hong Kong (China) has successfully transformed into a more services-oriented economy from manufacturing.

Figure 6.2.4 shows the labor productivity of the major industries in Singapore relative to the US. Singapore's productivity is currently about half of the US's (represented by the 'Economy' line which is close to 50%). Only a few sectors in Singapore are performing relatively well such as 'Transport and Storage' which is international. It is unsurprising that 'Construction' registers very low productivity. As a result of these dismal results, the government is keen to drive the productivity up. The inability of Singapore to drive productivity up after a long drive towards increasing productivity points to a classic labor market failure in Singapore.

Figure 6.2.4 Labor Productivity Relative to the US



The latest Economic Strategies Committee (ESC) proposal calls for:

- Seizing growth opportunities
- Developing a vibrant SME sector and globally competitive companies
- Attracting and rooting multinational companies and global SMEs
- Growing knowledge capital
- Making Singapore a leading global city
- Fostering inclusive growth
- Ensuring energy resilience and sustainable growth
- Maximizing value from land as a scarce resource

The Singapore government is too efficient – the economy rebounds less than a year after every recession that took place. As the economy rebounds too quickly back each time, it doesn't help the labor market to restructure appropriately.

As of 2012, there are 440,000 Singaporeans who earn less than $1,700 per month. The median gross income of Workfare Income Supplement (WIS) recipients in 2008 and 2009 is $808 and

$822 per month respectively with the qualifying income ceiling known as the 'living wage' set at $1,500 per month in 2009 by the government.

In addition, Singapore's Gini Coefficient hit the all time high of 0.489 in 2007. It should be noted though, that the Gini Coefficient does not reflect the true picture because it omits public housing subsidies, healthcare and education subsidies. The Singapore government has been using the surpluses (*ie* return from investments) to subsidize the income disparity gap. The special transfers to annual government budget amounted to $2.5 billion per year between 2000 and 2012, largely funded through net investment income contributions to annual budget amounting to $3.9 billion per year over the same period. At present, Singapore is able to contain the disparity of the income. However, if the net investment income is not good, and as the population ages with more elderly workers continuing to find their skills obsolete, there will be a need to search for alternative sources of money to fund the difference.

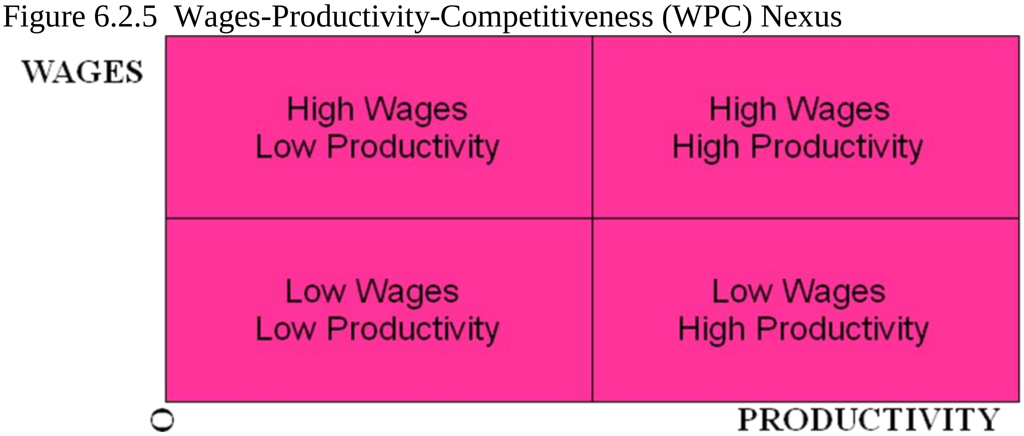
<u>Enhancing International Competitiveness Through Wages-Productivity-Competitiveness (WPC) Nexus</u>

Professor Lim Chong Yah came up with a 'shock therapy' to let wage growth jump ahead of the productivity growth. His three-year wage reform is as follows:

- Main proposal is for Singaporeans earning below $1,500 a month to get pay rises of 15% in the first year, a further 15% in the second year and 20% in the third year of the wage restructuring.
- Over the same period, his plan also calls for a wage freeze for those earning above $15,000 a month.
- Over the same period, Singaporeans whose earnings fall in between would get an annual pay rise of around 4-5% (well above the productivity of 2%).

The alternative approach suggested by Secretary-General Lim Swee Say of the National Trade Union Congress (NTUC) is to do the opposite and push on skill-upgrading, skill matching and job contents redesigning, to let wage growth lag behind productivity growth.

Figure 6.2.5 Wages-Productivity-Competitiveness (WPC) Nexus



Currently, Singapore labor is at the lower left quadrant (low wages-low productivity) of Figure 6.2.5. It is the common aspiration of all Singaporeans to work steadily from the lower left quadrant exhibiting low wages-low productivity stalemate towards the upper right quadrant of high wages-high productivity ideal of inclusive growth.

Professor Lim Chong Yah's suggestion is to take the upper left quadrant (high wages-low productivity) and hopefully to shock the people into the upper right quadrant of high wages-high productivity. The upper left quadrant (high wages-low productivity) is the classic case of European economies where the high wages are not matched by productivity, meaning they are not competitive. In a competitive world, one cannot afford to lag a few years, as competitors will take over.

The alternative approach by Secretary-General Lim Swee Say is to move from the lower left quadrant (low wages-low productivity) to the lower right quadrant (low wages-high productivity), and finally to the upper right quadrant of high wages-high productivity. Here, there is a dilemma as well, since if one pays peanuts, one gets monkeys. There is not much incentive for employees to put in their best effort if the pay is low. The employers will not pay high wages when there is an abundance of foreign labor prepared to take a cut of Singaporean workers' salaries. When employers have an excessive amount of labor, there is no motivation to improve productivity.

<u>Addressing Labor Market Mix, Counter Productivity Shortfalls and Avoiding Low Wage Economic Underclass Trap</u>

Employees are reluctant or unable to put in their best performance given the poor effort-remuneration wage structure as productive local workforce tend to shun away from those industries because stagnated low wages are unmatched by the rising cost of living. Moreover, imposing a minimum wage is not desirable, since the minimum wage will apply to all workers, including foreign workers.

Hence, the WIS Scheme became necessary especially to Singaporeans who are now in their late 40s and early 50s who are faced with skill mismatch and skill obsolescence. Rapid globalization for Singapore further aggravated the low skill-low productivity labor market paralysis with skill-mismatch and rapid skill-obsolescence.

However, the question is, how long and how much can the government subsidize? In view of this, we propose the establishment of a Wage-Productivity-Competitiveness Taskforce with terms of reference to:

- Evaluate the social profile and constraints of the low wage Singaporeans and the emerging economic underclass (generation difference, say, where the son's earning capacity is worse than the father's)
- Better understand industry-specific labor issues, business difficulties and market requirements (should not have a foreign labor policy that cuts across all and is a one-size-fits all)
- Explain and educate the public at large on the urgency of productivity drive, competition and work discipline

There is a need to have a 'Singapore-first' policy, such that foreigners will be employed only if there are no Singaporeans who wish to take on the job. There is thus a need to ensure decent wages for the jobs.

The five concrete broad principles to mitigate income disparity and labor market failure are:

- Rationalizing the foreign workforce to correct labor market structure, improved labor market efficiency and raising wage/gross domestic product ratio.
- Pro-active and targeted management in skill-matching, skill-upgrading, job-skill contents re-designing and comprehensive education investment in indigenous manpower to equip with modern skill-in-demand. This is possible as Singapore has agencies in place and the resources to see this through.
- Changing fundamental philosophy of public policies in pursuit of optimal, inclusive, balance, green and clean or non-corrupt growth as a small open economy. Instead of questioning the wage cost, the business cost should be examined.
- Redefining key performance indicators, strengthening policy mechanisms and financial budget allocations of government agencies. Revenue maximization or reducing subsidies cannot be the benchmark, since if this continues business costs will be up.
- Continue to sharpen Singapore's international competitive edge, plugging further into globalization in trade and finance and maintain first world standard of living.

6.3 Market Forces versus Market Failure for Private Sector Competitiveness

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This section describes the Philippines experience and highlights the challenges that developing economies face as they try to be more competitive.

<u>Market Forces</u>

The neoclassical theory of markets suggests that:

- There are sufficient number of independent producers
- There is rivalry in terms of price, quantity, service or a combination of these
- Consumers and producers are able to exercise freedom of choice
- There is efficient allocation of resources which increases consumer welfare
- Market information and price signals are transmitted

<u>Market Failures</u>

Market failures include:

- Negative externalities – failure to account full cost to others
- Positive externalities – failure to account for benefits to others
- Public goods – undersupplied due to meager financial returns
- Imperfect competition – market power
- Information asymmetries

It suffices to say that government intervention or state role in the economy is justified or rationalized on the basis of market failures. The 1997 Asian financial crisis as well as the recent 2008 global financial crisis leads to a resurgence of the need for more regulation.

<u>Competition Policy and Government Failures</u>

Regulation can be viewed as limiting the market or limiting competition. For instance, regulatory policies can be viewed as inhibiting the market in terms of licensing, franchising, permits, tariff and non-tariff measures, anti-dumping and countervailing duties.

Regulation sometimes portrays behavioral restraints:

- Abuses of dominant position like preventing entry or forcing exit through predatory pricing, market foreclosure
- Cartels and collusion (price fixing, bid rigging, allocation of customers or markets, output restrictions)

Barriers to entry limit competition and allow existing firms to gain market power, increase prices and reduce output and welfare.

Market failures are essentially governance failures. Governance failures and weak institutions (rent-seeking and regulatory capture) stand in the way of good regulation.

As such, governments should come up with competition policy. Competition policy should aim to preserve and promote competition through the prevention of restrictive business practices by firms and their abuses of economic power including inefficient government regulation. Competition policy should be consistent with policies that enhance competition in local and international markets like liberalized trade policy, relaxed foreign direct investment and ownership requirements and economic deregulation.

When we think of competition policy in the context of developing economies like the Philippines, there is a need to recognize that even where market failures are correctly diagnosed, the capacity of the state to intervene is severely hampered as a result of reasons such as the following:

- By absence expertise, lack of information, principal-agent problems
- By weak incentives (low government pay)
- By poor enforcement where correct action is identified
- By lack of coordination, collection action problem

Public institutions are beset by short-time horizons and fragmented polities.

Philippine Experience

In the case of the Philippines, there are laws on competition. However, these are old laws on the books, but there is no practice or tradition of competition law. In addition, there is no enforcement, jurisprudence or enforcement authority with respect to restraints in trade. No high priority has been given to the adoption of a competition law, despite the existence of various pending legislative proposals. Moreover, the recent creation of the Office of Competition is poorly resourced and relations with other regulatory authorities are unclear. It appears that there is a conspiracy to protect dominant players in the Philippines. In essence, competition policy doesn't really work. The danger is the creation of a very strong law on competition policy and delegates it to a weak institution that could be subject to rent-seeking and patronage politics. The law could actually be abused rather than lead to efficient outcomes.

In the past, when reform is supported, the approach is a sectorial basis of regulatory reform. Two sectors are chosen as illustration: air transport and domestic shipping. These two sectors are important because the Philippines is an archipelago economy. Much of trade and the transit of goods take place by air or by sea. The problem is, in the past it was a monopoly and heavily protected by the government.

Consider first air transport services. 98% of international traffic travel by air. In the past, there used to be one dominant national carrier – legacy of one-airline policy. The supply is driven by bilateral service agreements. There is capture of Civil Aeronautics Board (CAB) – the main regulatory body – and air service panels. In addition, there is concentration on Manila (the Manila airport which is the hub of the Philippines airlines) at the expense of secondary routes. Air liberalization efforts include the following:

- Recomposition of CAB with independent and technically competent officials
- Redefinition of 'national interest' to consider users of services
- Pocket open skies and expansion of bilateral service negotiations

- Open skies for secondary gateways; recomposition of air panels.

As for domestic shipping, maritime transport facilitates 98% of inter-island, regional domestic trade. High transport costs contributed to inefficiencies

Conclusion: Some Observations

Government intervention or regulation did not necessarily address market failure. The regulatory environment must enable the market. Competition is always superior to more regulations. Independence and accountability of regulatory authorities is important, but the regulatory capacity also needs to be challenged.

6.4 Competitiveness Enhancement: Business Financing and Capital Market Reform in China

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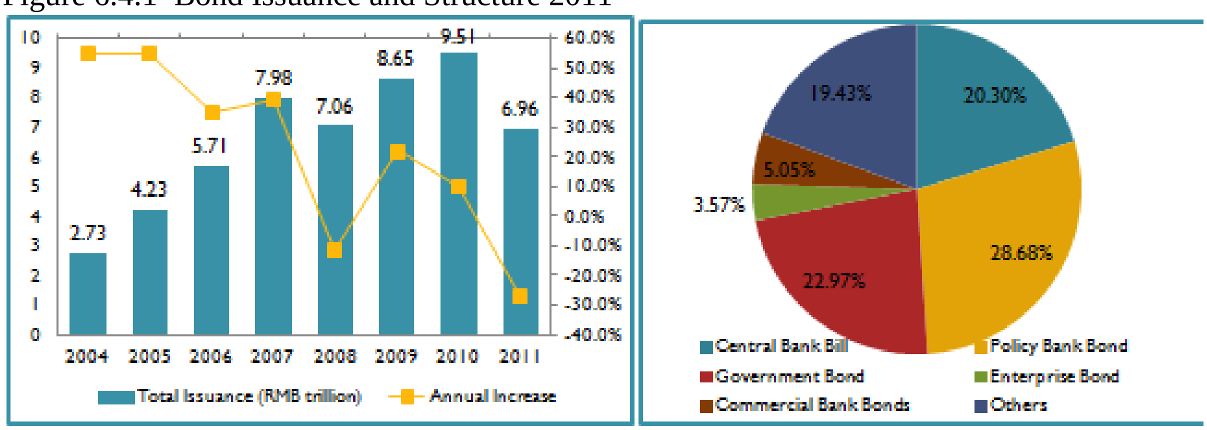
Hong Kong, Special Administrative Region, China

Capital Markets

China has achieved huge success in developing its capital markets. Looking at equities, the combined market capitalization of Shanghai, Shenzhen and Hong Kong Exchanges together (USD 5,670 billion) has far surpassed that of Tokyo (USD 3,325 billion). China also established ChiNext – can be viewed as the NASDAQ of China – and commenced margin trading, short selling and index futures. However, China's stock market still has problems, and its volatility remains very high.

For the bond market, Figure 6.4.1 shows that the total issuance in 2011 has declined from 2010. The decrease is mainly due to the sharp decrease in the Central Bank Bills. China's bond market is still an unbalanced one – the Central Bank Bills, Government Bonds and Policy Bank Bonds still account for more than 70% of the total issuance, although this is already a reduction from the highest level of 93% attained in 2007. As for the corporate bond market, it is still dominated by the large state-owned enterprises. As such, China's bond market is not yet efficient – although total issuance is very high, liquidity remains low and there is no market-oriented pricing mechanism.

Figure 6.4.1 Bond Issuance and Structure 2011



Source: Annual Review of China's Bond Market, by China Government Securities Depository Trust & Clearing Co., Ltd.

Financing Channels

Capital markets is all about efficient asset allocation and enhancing competitiveness. Bank loans still dominate business financing for both state-owned enterprises and SMEs, with RMB 110 trillion banking assets, more than 90% of all financial assets in China. Recently, IPO is a common way to enhance competitiveness as it allows the organization to:

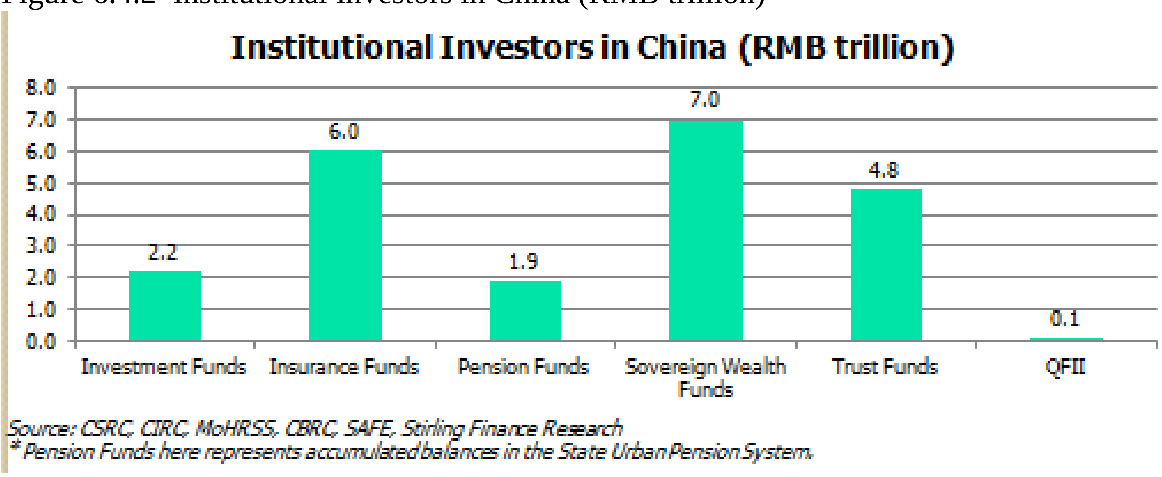
- Access new funding
- Build market awareness
- Bring in large stakeholders, usually institutional investors
- Eliminate agency problem
- Broaden governance structure

Apart from the current inefficiency in the bond market and its dominance by large companies, private lending is on the rise.

Investor Landscape in China

More than 80% of trading volume still comes from retail investors, which reveals the heavy speculation in the market. However, the market is becoming a more balanced one, with institutional investors progressively taking over from retail investors as the major force. From Figure 6.4.2, it can be seen that the institutional assets continue to expand, and there is now more interaction among institutional investors.

Figure 6.4.2 Institutional Investors in China (RMB trillion)



Consider the investment funds organizations. They commenced in 1998, expanded very quickly until 2007, but then shrank during the last 5 years. Currently, there are approximately 69 Fund Management Companies (FMCs) with 914 registered investment funds by 31 December 2011. The fund industry has relatively high openness to global players – there are 39 joint ventures out of the 69 FMCs. The industry is active in both stock and bond markets, but do not always act as a rational institutional investor.

Insurance companies also experienced rapid expansion from RMB 260 billion assets in 1999 to RMB 6 trillion in 2011. However, the insurance sector has relatively low openness. Foreign insurers still face regulatory barriers in geographic expansion and some important business lines. This led to only 4% market share for foreign life insurers in all, and only 1% market share for all foreign non-life insurers. Regarding investments, the insurance sector faces strict regulations. As such, there are currently more than 50% of insurance assets sitting in bonds, and the insurance sector has less than 2% holding of stock market capitalization in China. The insurance sector is not generally active in trading, but focus on long-term strategic investments.

As for pension funds, the cumulative balance in state urban pension system rose to RMB 1.9 trillion in 2011, largely derived from individual accounts, with exponential growth in the last two decades. Regarding the investment scope, the state pension assets are limited to bank deposits and government bonds, with only 2% per annum returns in the past 10 years. However, there are some new movements – the National Social Security Fund has been permitted to manage RMB 100 billion of Guangdong Province's individual account pension assets, which can be invested in both the equity and bond markets.

Table 6.4.1 Top Ten Sovereign Wealth Funds, December 2011

Country	Fund Name	Assets (USD, billion)	Inception	Source of Funds
UAE - Abu Dhabi	Abu Dhabi Investment Authority	627	1976	Commodities
China	SAFE Investment Company	568	1997	Non- commodities
Norway	Government Pension Fund – Global	560	1990	Commodities
Saudi Arabia	Saudi Arabia Monetary Agency	473	N/A	Commodities
China	China Investment Corporation	410	2007	Non- commodities
Kuwait	Kuwait Investment Authority	296	1953	Commodities
China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	293	1993	Non- commodities
Singapore	Government Investment Corporation	248	1981	Non- commodities
Singapore	Temasek Holdings	157	1974	Non- commodities
China	National Social Security Fund	138	2000	Non-commodities

Source: Sovereign Wealth Fund Institute; Stirling Finance Research

Table 6.4.1 shows the top 10 sovereign wealth funds (SWFs). These account for almost 80% of the total assets of all SWFs. China has 4 out of the top 10 in the world (highlighted in red in the table).

Consider the National Social Security Fund (NSSF), ranked 10th of the SWFs. This was established in 2000 as a pension fund of last resort, but in recent years it is acting more like a SWF. Out of the portfolio of USD138 billion assets, 58% are direct investments and the remaining 42% are managed by external parties which include both domestic and global fund managers. The current asset allocation has currently 7% international allocation, but the upper limit is 20%. The NSSF is a very long-term institutional investor in the capital markets, with its every move watched closely by the market.

The China Investment Corporation (CIC) is ranked 5th of the SWFs. It was established in September 2007, and its assets doubled from an initial USD 200 billion to USD 410 billion as at 31 December 2010. There are currently 59% of assets allocated through external appointments. However, CIC also conducts its own direct investments. Domestically, it is the major shareholder of the largest banks in China through its subsidiary Central Huijin. Internationally, it also has some direct investments, such as in Morgan Stanley.

Consider too, SAFE (State Administration of Foreign Exchange) Investment Company, ranked 2nd of the SWFs. SAFE is the government body of China's foreign exchange reserves. China's foreign exchange reserves as of 31 December 2011 is valued at USD 3.18 trillion. SAFE is not active in the domestic capital market but it has quietly built up stakes in over 50 European companies, Australian banks and private equity (PE) funds. It conducts investments through its Hong Kong subsidiary ('SAFE Investment Company Limited').

Figure 6.4.3 Interaction of Trust Industry with other Markets

Trust companies also experienced exponential growth, from RMB 150 billion in 2004 to TMB 4.8 trillion in 2011. Trust companies still remain the most flexible type of institution in China, in both fundraising and investing. From Figure 6.4.3, in the credit market, trust companies can issue bank-trust products, and act as a shadow banking system in China. In the real estate market, it can help the real estate developers to issue funds from the high net worth individuals. It also acts as an intermediary to offer private management funds.

PE firms are very long-term oriented investors with quick expansion in the recent years. However, they are still largely unregulated in China until December 2011. Now, the National Development and Reform Commission (NDRC) is the main regulator for large PE firms.

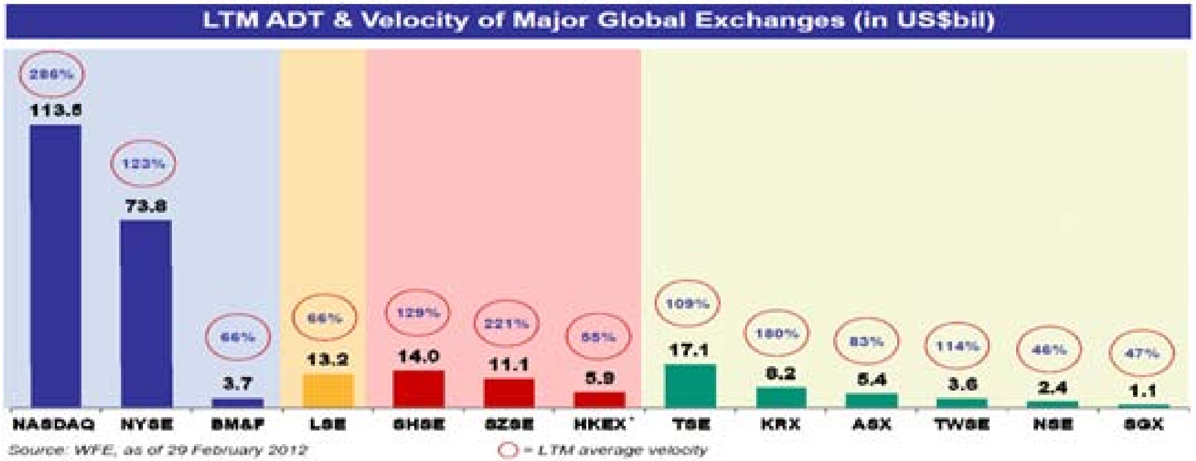
Capital Market Reforms

There are 4 prevailing problems:
- Speculative trading activities and high volatility
- IPO fever versus low dividend payouts
- Lack of transparency
- Financing difficulties for SMEs

(I) Speculative Trading Activities and High Volatility

Figure 6.4.4 shows the average daily turnover and velocity of major global exchanges. China's exchanges still experience speculative activities compared to say Singapore's SGX which has a velocity of less than 50%. As such, one of the targets of reforms is to address the problem of speculative trading. The reforms include the encouragement of more institutional investors (such as pension funds, sovereign wealth funds, insurance companies) to increase long-term strategic investment:
- Guangdong has permitted RMB 100 billion of pension assets to the NSSF
- There is continuous relaxation on investment restrictions regarding stocks and bonds for insurance companies and enterprise annuities

Figure 6.4.4 Average Daily Turnover & Velocity of Major Global Exchanges (USD Billions)



(II) IPO fever versus low dividend payouts

Reforms in this area attempt to curb speculation and fine-tune market mechanism by:

- Imposing specific limits on daily price movements and transaction volume to curb excessive speculation on IPOs
- Developing rules on fair profit sharing and requiring dividend payout

(III) Lack of transparency

Reforms in this area focus on improving information disclosure and investigating market irregularities. The very large cases are under investigation. Regarding IPOs, information is to be disclosed in a comprehensive, complete and accurate manner.

(IV) Financing difficulties for SMEs

SMEs in China employ 80% of working population, account for 60% of China's GDP and contribute 50% of government's tax revenue. Big state-owned enterprises have more capital than they need, so they become lenders through financial subsidiaries. SMEs, however, face fund raising difficulty and some turn to shadow banking systems which charge up to 30% per annum lending rate. Reforms in this area aim at the opening of more channels for business financing:

- Private lending in Wenzhou is formalized, and direct overseas investments for individuals – up to a cap of USD 200 million per annum – is allowed
- There are plans for an over-the-counter equities market in China
- High yield bond market for small businesses
- PE and Venture Capital funds are encouraged to help small firms during pre-listing period

6.5 Comments & Discussion

Comments & Discussion: Professor Michael Enright's Presentation

Professor Michael Enright was asked how he would compare generating ideas to the commercialization of ideas? To this, he responded that it is not just the generating of ideas, but the matching of existing or new needs of markets with what can be done; having ideas for products and services that can be pushed towards commercialization. The real action is in taking existing knowledge and bundling it into new products and services that can be then sold to others. Any new technology that can be commercially valuable takes about 15 years between the initial technology developments till when there is a commercially valuable output. This means that anything that is going to be commercially valuable in the next 15 years has already been invented. It is a matter of taking it, packaging it into products or services and pushing it through to the marketplace – that's where the value is created.

Comments & Discussion: Associate Professor Tan Khee Giap's Presentation

A member of the audience asked if it is better to work on increasing business productivity instead of looking at wages only. In response, Associate Professor Tan Khee Giap commented that, apart from wage cost, other components of business cost include government fees and charges, rental and land costs. In terms of business productivity, the multinational companies have productivity that is internationally comparable since they attract able people with a career path. As for those who are less academically inclined and less proficient in English, they tend to go to SMEs. As such, to address the productivity problem faced by SMEs, grants and subsidies are unlikely to work.

There was a remark that competitiveness is not independent, and international competitiveness brings to mind, domestic competitiveness. Associate Professor Tan Khee Giap was asked his view if Singapore has been over-emphasizing on international competitiveness, causing the domestic side to be neglected to a certain extent.

Associate Professor Tan Khee Giap is of the view that Singapore is liberal in terms of its labor policy because it aims towards international competitiveness. He suggested that employers of non-tradable jobs sign a statutory declaration to declare that all the information provided in the application form is right, and that they have actively sought local workforce and to provide some evidence of it. There should be a Singaporeans-first policy for non-tradable jobs. There is no need to fear of such a policy harming international competitiveness, since the Singapore government has always created more jobs than Singaporeans can fill. However, wages paid have to be matched by productivity.

7. Remarks on the Regional Architecture

Dato Timothy Ong
Chairman, Asia Inc Forum
Brunei Darussalam

The work of the PECC to improve our regional institutions, to help build regional architecture that better serves our needs is of great importance. Many of the challenges we face in a globalized world – financial imbalances, global and regional economic turbulence, climate change, terrorism, health pandemics are simply beyond the capacity of single countries to resolve unilaterally. Since the world is too large and the nation state too limited, the case for regionalism is compelling. All this is obvious and few would argue against it. What is less obvious is where we go from here.

Let me make a few observations. Firstly, there is no doubt that Asia Pacific regionalism has come a long way in the last two decades but there is also no doubt that we are a long way from the promised land. Two decades or so ago the Asia Pacific could be described as a region without regionalism. Today the Asia Pacific could be described as active regionalism in search of a region.

Following a period of extraordinary creativity and enthusiasm in the 1990s in which the good men and women of the PECC played key roles in producing ideas and concepts for regional design, there has been a rich flourishing of regional institutions. In addition to ASEAN, there are today the ASEAN Plus Three, East Asia Summit, ASEAN Regional Forum, APEC and the Trans Pacific Partnership (TPP). To top it off there has been a proliferation of bilateral preferential trade arrangements euphemistically described as “free trade agreements”.

But there are significant gaps in the current regional architecture:

- APEC, the key economic forum does not include India.
- China remains suspicious of the TPP.
- There is no forum through which the conflicting territorial claims in the South China Sea can be effectively resolved.
- None of the existing institutions address all the key dimensions of regional cooperation that they now need to face.
- None of the regional institutions effectively connect with evolving global arrangements including the G20 process.

Underlying this institutional incompleteness are strategic and tactical differences. At the strategic level there are at least two competing visions of the region. There is the vision of a trans-Pacific economy linking the countries of the Pacific Rim through closer economic integration. APEC and the Trans Pacific Partnership are grounded in this vision. Then there is the vision of a political community with a distinctive Asian identity. The ASEAN plus Three and EAS are grounded in this vision.

Tactically, there are also basic differences as to how best regional architecture can and should be constructed. There is the view which advocates focusing on regionalism as it is. Existing institutions however inadequate are fundamentally sound. If it ain’t broke, why fix it? Then there is the view which advocates focusing on regionalism as it should be. Gaps in the present regional architecture call for new blueprints for new architecture. If it ain't working, build a new one. There is the view that Asian regionalism should have precedence over Asia Pacific regionalism. And there is the view that both regionalisms should be pursued as complementary to each other.

This incompleteness and fluidity in the regional architecture reflects strategic and tactical differences and the absence of a clear common vision of the region. These strategic and tactical differences arise from what Ian Bremmer in his latest book refers to as a "G-Zero" world, a world of every nation for itself, a world without clear global leadership. In his somewhat dramatic words "The G20 doesn't work, the G7 is history, the G3 (USA + Europe + Japan) is a pipe dream, and the G2 (USA + China) will have to wait. Welcome to the G-Zero". Because effective regionalism requires leadership, the ramifications of a G-Zero world are far reaching.

At a time when the need for international cooperation is urgent, the USA is increasingly unable and unwilling to exercise leadership while China and India are not yet ready to provide the leadership required. In such a world, the regional architecture will continue to be untidy and incomplete because the political means to achieve coherence will be in short supply. In such a world efforts to introduce comprehensive and coherent blue prints for the Asia Pacific are likely to be frustrated. Such a world is not entirely bleak for regionalism.

In such a world there will be opportunities for pragmatic sub-regional arrangements like the TPP which regional players will increasingly recognize as presenting the best chance of moving forward in an increasingly fluid and leaderless geopolitical landscape. In such a world, the role of the PECC with its wealth and experience in scholarship and intelligence applied to the key challenges of our region will continue to be of great relevance.

May the PECC continue to prosper. Thank you for your attention.

8. The Future Role and Continued Relevance of PECC

Moderator
Professor Stephen Cheung
Chair, Hong Kong Committee for Pacific Economic Cooperation (HKCPEC) &
Dean and Professor (Chair) of Finance, School of Business, Hong Kong Baptist University
Hong Kong, Special Administrative Region, China

7.1 Regional Economic Integration: The Role of APEC

Ambassador Muhamad Noor
Executive Director, Asia-Pacific Economic Cooperation (APEC) Secretariat

PECC is the birthplace of APEC. In addition, PECC is one of the three bodies who have a permanent seat at all APEC meetings. From the point of view of APEC, PECC has been relevant, remains relevant, and will continue to be relevant in the years to come.

Regional Economic Integration in the Asia-Pacific

Some of the regional economic integration initiatives in the Asia-Pacific include:
- ASEAN Free Trade Area
- ASEAN+3 (China, Japan and Korea)
- ASEAN+8 (China, Japan, Korea, Australia, New Zealand, India, US and Russia)
- ASEAN Economic Community (AEC)
- Trans-Pacific Partnership (TPP)
- East Asia Summit (EAS)
- Group of Twenty (G20); more global than regional, but included here as a reminder of the work in APEC given what is going on in G20

Apart from the above groupings, there are FTAs and RTAs (Regional Trade Agreements) in the APEC region. There are 49 intra-APEC FTAs and RTAs signed, with 44 of them already in force. The latest ones include the Korea-US FTA and the Chile-Vietnam FTA.

APEC members signed 128 FTAs in total, with 110 of them in force, while ASEAN has trade agreements with a few economies.

The APEC Agenda

APEC was originally established to
- Strengthen the open multilateral trading system. In pursuing this objective, APEC will be WTO-consistent. WTO has 2 basic principles, and one is the ‘most favored nation’ (MFN) treatment. This means that every member of the WTO is going to be provided the MFN treatment, meaning every member has equal treatment.
- Enhance trade and investment liberalization in the Asia-Pacific

- Intensify Asia-Pacific development cooperation. This can be interpreted as economic and technical cooperation (ECOTECH). Since 1993, over 1,600 ECOTECH projects have been undertaken and there are currently more than 150 projects. In 2011, US$14 was committed to such capacity-building projects.

The 1994 Bogor Goals aim for free and open trade and investment in the Asia-Pacific by 2010 for industrialized economies and by 2020 for developing economies. In relation to the Bogor Goals, APEC agreed on a broader-based growth strategy in 2010, the APEC Growth Strategy. The five attributes of the APEC Growth Strategy are:

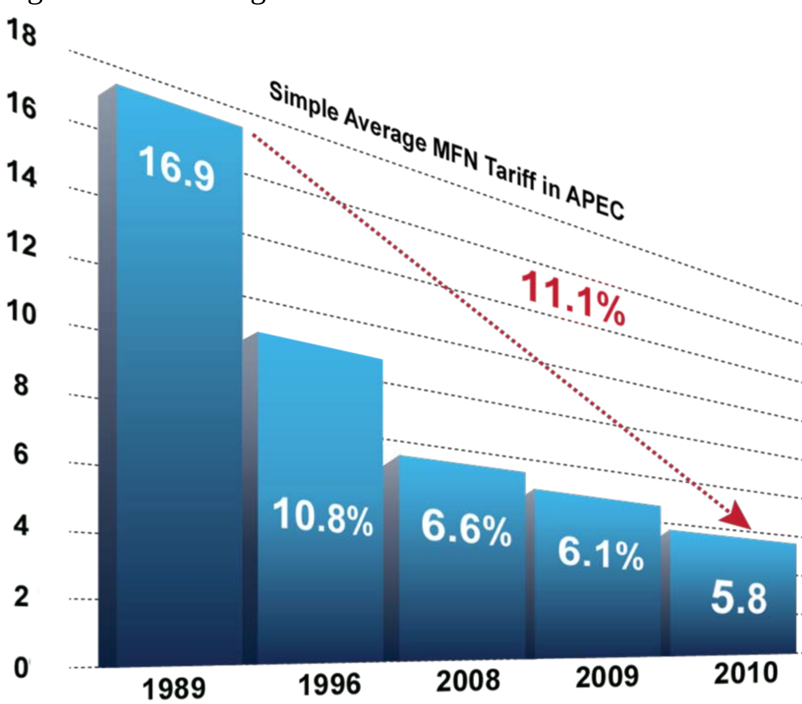
- Balanced Growth: concerned about balances amongst and within economies. Structural reform and social safety nets are some of the things pursued towards achieving this objective.
- Inclusive Growth: even though Asian economies have done better in the last few years, the income distribution has not been favorable. Spreading the benefits of trade is one step towards achieving this objective.
- Sustainable Growth: environmental and energy constraints
- Innovative Growth: knowledge-based economy
- Secure Growth: food security, pandemics, counter-terrorism

Nevertheless, the focus of APEC remains trade and investment liberalization even with this broader based approach.

<u>APEC: Delivering Results</u>

By 2010, the average MFN tariff in APEC was 5.8% (see Figure 7.1.1); in fact, amongst the industrialized members of APEC, it was only 3%.

Figure 7.1.1 Average MFN Tariff in APEC

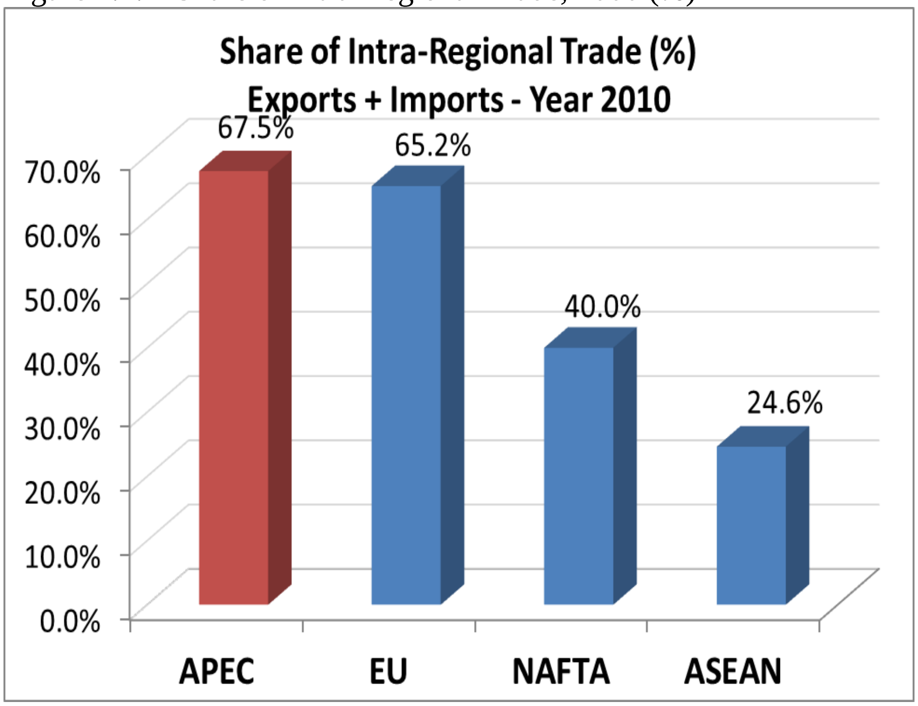


As tariffs are now low, APEC has started to focus on non-tariff issues. APEC has done two Trade Facilitation Action Plans, one for the period 2002-2006 and the other for the period 2007-2010. As a result, the trade transaction costs are reduced by 5% each time. There is also progress in terms of measurement over the years, and the 5% reduction in the 2007-2010 period translates to US$58.7 billion in savings.

Apart from the reduction in tariffs and trade transaction costs, there is also work done on the ease of doing business and supply chain performance in the Secretariat. In addition, empirical research by the APEC Policy Support Unit has these findings:

- APEC membership has strong effect on trade
- APEC economies are more likely to export/import with members than non-members
- Impact of APEC on trade is comparable to FTA, even though members are not bound by treaty obligations

Figure 7.1.2 Share of Intra-Regional Trade, 2000 (%)



From Figure 7.1.2, it can be seen that APEC members' trade with one another is much higher than the EU, NAFTA and ASEAN even though APEC members are not bound by formal trade agreements.

Building on the regional economic integration, the Free Trade Area of the Asia-Pacific (FTAAP) is pursued as a WTO-plus, high-quality free trade agreement building on ASEAN+3, ASEAN+6 and the TPP with APEC as an incubator of FTAAP. APEC is currently working on the 'next generation' trade issues. APEC will continue to develop its work on:

- Investment services
- E-commerce
- Rules of origin
- Standards and conformance
- Trade facilitation

- Environmental goods and services

APEC Priorities for 2012

APEC's priorities for 2012 are:
- Liberalizing trade and investment and expanding regional economic integration
- Strengthening food security
- Establishing reliable supply chains (involves ensuring quick recovery of supply chains in the light of disasters)
- Fostering innovative growth

APEC, according to the outlook from the IMF, is going to do better than the rest of the world. However, APEC still has to grapple with the issues of contagion given challenges in the other parts of the world.

7.2 Whither PECC in the Evolving Global Economic Architecture?

Associate Professor Tan See Seng
Deputy Director, Institute of Defence and Strategic Studies; &
Head, Centre for Multilateralism Studies, S. Rajaratnam School of International Studies,
Nanyang Technological University
Singapore

PECC's Accomplishments: Its Role in and Relevance to Asia-Pacific Regionalism

PECC furnished a ready model for APEC's creation in 1989, in terms of structure, conventions, agenda, participants and even limitations of regionalism. There are other achievements such as the innovated peer review system for corporate governance. Although the PECC did not initiate the establishment of a regional financial architecture, the PECC has played a major role in supporting and advocating that construction and matters related to that process such as:

- Short-term liquidity finance mechanism
- An effective regional surveillance mechanism
- An exchange rate policy
- Coordination mechanism
- Development of an Asian Bond Market

Prior to APEC's formation, PECC was the Asia-Pacific region's principal forum on trade, investment and related economic affairs.

PECC is the progenitor of open regionalism. The PECC has long aimed and continues to aim to foster an open Pacific region and strengthen the global multilateral trading system. In addition, the PECC has long advocated open regionalism against the worrying trend towards regional trade blocs (eg NAFTA, AFTA).

The PECC played a major role in promoting a regional financial architecture that is consistent and consonant with, not competitive against, the global architecture. Open regionalism arguably furnished a fungible concept to rationalize the outward and inclusive orientation of regional security institutions (eg EAS).

Has the Asia-Pacific Outgrown PECC?

The regional architecture's evolving variable geometry and concentric circles make service solely to one institution (APEC) questionable. PECC may want to think of moving beyond just serving APEC.

Neither command regionalism nor functional (results-oriented) regionalism is likely to trump the status-quo regionalism with variable geometries and concentric circles. Looking forward, an incremental streamlining is probably conceivable, but a clear division of labor is unlikely; overlapping agendas is likely to continue. This raises questions about the role of PECC in response to such a structure. Can and should the PECC therefore facilitate other regional arrangements other than just APEC? Should the PECC's agenda then have a specific or comprehensive focus mirroring the agendas of these other institutions?

Has PECC Outlived its Usefulness?

PECC's very success in nurturing intergovernmental cooperation is also its bane: competition from APEC and other arrangements for the interest and involvement of senior policymakers. With this competition, can the PECC bring together core policymakers and decision makers, sustain their interest long enough and ensure their participation in PECC activities? That is a big challenge for any institution.

There are suggestions that the PECC has grown large and cumbersome. Its size prevents meaningful discussions, threatening to make it irrelevant to policymakers.

Keeping PECC Relevant in the 21st Century: Some Recommendations

There is a need to enhance PECC's research and advocacy capabilities and increase its resources, as incremental enlargement of its agenda is unlikely to stop. The PECC needs to go beyond areas of immediate interest to APEC in order to stay ahead of the curve in anticipating emerging economic and other challenges, and consider alternative cooperative initiatives currently neglected by APEC economies. At the same time, it may be necessary to restructure and streamline PECC to rid it of inefficient and incoherent elements.

In addition, PECC should move beyond APEC to engage G20, the key global framework. Given PECC's sensitivity to developing/emerging economies' concerns, it would make good sense to engage the Global Governance Group (3G) and facilitate its efforts towards better coordination and cooperation between G20 and non-G20 economies.

Conclusion

There is no doubt regarding PECC's relevance to Asia-Pacific. However, challenges for PECC include:

- Its continued relevance to both the region and even to the world
- Getting the region to stay committed to open and inclusive regionalism, amidst the growing short-to-medium term preference for bilateral and plurilateral trade agreements
- Getting the region to focus on growth rather than fixate on bond markets

7.3 Comments & Discussion

Comments & Discussion: Ambassador Muhamad Noor's Presentation

One of the questions asked was what PECC has done to contribute to APEC's achievement. To this, Ambassador Muhamad Noor replied that apart from the role PECC played in giving birth to APEC, the mechanism of peer review that APEC members use was also copied from the PECC model. In addition, PECC plays a very important supporting role by keeping APEC members up to date on the recent going-ons that the former may have missed. The State of the Region report by PECC is also extremely useful, and APEC can trust PECC to come up with well thought out recommendations as they have a very good feel of what is going on in the region given they are there all the time.

One member of the audience asked if the 5% savings in trade transaction costs, is a zero-sum game. Ambassador Muhamad Noor explained that the large majority of the gain is through the simplification of customs procedures which has saved a lot of time for businesses to move goods across borders, and for people to move across borders as well. The APEC Business Travel Card (ABTC) allows cardholders the privilege of traveling without visa to any of the 18 member economies of APEC. Thus, the savings is not a zero-sum game.

There was a comment that the mechanisms in APEC are really suited to structural reforms agenda. Ambassador Muhamad Noor agreed and confirmed that structural reforms are still very much on APEC's agenda (behind the border reforms). These reforms work towards the ease of doing business, financing for business and dealing with regulations among others. APEC economies are doing much better than the rest of the world in doing business. The new agenda for structural reforms include added elements pertaining to helping SMEs, improving women's participation and working towards inclusiveness.

Comments & Discussion: Associate Professor Tan See Seng's Presentation

Associate Professor Tan See Seng was asked what PECC can do for G20 and the world. In response, Associate Professor Tan See Seng remarked that many seemed to think that the Eurozone crisis is all about the fiscal policy, and once the finances are right, the crisis will be resolved. Hence, In view of this, PECC can be a platform to urge and encourage European friends to focus on growth since growth provides the basis for sound fiscal policy. In addition, PECC could also assist in providing ideas and recommendations in the recovery of Europe and the US. With respect to G20, PECC could keep G20 focused, and assist in holding the G20 accountable to previous promises it has made in time to come.

Appendix: Abbreviations

ABAC	APEC Business Advisory Council
AEC	ASEAN Economic Community
AFERM	APEC Food Emergency Response Mechanism
AFSR	ASEAN Food Security Reserve Agreement
AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
AUSPECC	Australian Pacific Economic Cooperation Committee
CANCPEC	Canada National Committee for Pacific Economic Cooperation
CEPEA	Comprehensive Economic Partnership for East Asia
CNCPEC	China National Committee for Pacific Economic Cooperation
COLPECC	Colombia National Committee for Pacific Economic Cooperation
CTPECC	Chinese Taipei Pacific Economic Cooperation Committee
EAFTA	East Asia Free Trade Area
EAS	East Asia Summit
ERIA	Economic Research Institute for ASEAN and East Asia
EU	European Union
FTA	Free Trade Agreement
FTAAP	Free Trade Area of the Asia-Pacific
GDP	Gross Domestic Product
GNI	Gross National Income
HKCPEC	Hong Kong Committee for Pacific Economic Cooperation
IMF	International Monetary Fund
INCPEC	Indonesian National Committee for Pacific Economic Cooperation
IPS	Institute of Policy Studies
JANCPEC	Japan National Committee for Pacific Economic Cooperation
KOPEC	Korea National Committee for Pacific Economic Cooperation
MANCPEC	Malaysian National Committee for Pacific Economic Cooperation
MFN	Most-Favoured-Nation
MXCPEC	Mexico National Committee for Pacific Economic Cooperation
NAFTA	North American Free Trade Agreement
NZPECC	New Zealand Committee of the Pacific Economic Cooperation Council
OECD	Organization for Economic Co-operation and Development
PECC	Pacific Economic Cooperation Council
PPP	Purchasing Power Parity
RCEP	Regional Comprehensive Economic Partnership
RTA	Regional Trade Agreement
SEA	Southeast Asia
SINCPEC	Singapore National Committee for Pacific Economic Cooperation
TILF	Trade & Investment Liberalization & Facilitation
TNCPEC	Thailand National Committee for Pacific Economic Cooperation
TPP	Trans-Pacific Partnership
UN	United Nations
US	United States
USD	United States Dollar
WTO	World Trade Organization