

Executive Summary

At the start of 2008, the economic outlook for the Asia Pacific region is more uncertain than it has been since the 1997-98 Asian Financial Crisis. With the full consequences of the sub-prime loan problem in the United States still playing out, the potential for turbulence in the financial markets to spill over into the real economy remains a serious concern. Notwithstanding these and other risks, the economic outlook for the Asia Pacific region is cautiously optimistic.

We expect real GDP growth of 4.9 percent in 2008 for the region as a whole, picking up in 2009 to 5.2 percent. The current slowdown in the United States is not expected to turn into a full-blown recession. Barring further shocks, a rebound in the US housing sector could begin as early as the second half of 2008. The Chinese economy will continue to expand at double-digit rates through 2009, led by private consumption and investment, while Japanese growth is expected to dip below 2 percent in the next two years.

Inflation is on an upward trend for the region as a whole, with prices in China showing the sharpest increase over the last year. Consumer prices for the region will climb a projected 2.5 percent in 2007, accelerating to 2.7 percent in 2008, in spite of falling US inflation and persistent deflationary pressures in the Japanese economy.

The external sector continues to be characterized by huge current account imbalances across the Pacific. The fall in the US dollar over the last two years is having an impact on the US external balance, with American imports in 2007 expected to have grown by only 2.2 percent. As a share of GDP, the US current account deficit is on a clear downward trajectory.

The counterpart surpluses of East Asian economies continue to very large, especially in the case of China. Despite Chinese efforts to increase imports and reduce exports, the current account balance is forecast to balloon to about US\$507 bn in 2009, which is roughly 10 percent of GDP. China has nevertheless become an important source of demand for intermediate goods from the rest of East Asia and is increasingly seen as an alternate engine of growth for the region.

According to the 2007 PECC survey of opinion leaders, nearly half of respondents believe the Chinese economy will be larger than the US economy by 2020. Whether or not this is an accurate projection, the fact that opinion leaders have this sentiment indicates an important shift in the mindset of the region. A majority of respondents already believe that a slowdown in the Chinese economy would have a greater impact on East Asia than a slowdown in the US economy.

This report points to three sets of challenges facing the Asia Pacific region, and the potential for transpacific cooperation to address these challenges.

In the area of energy and the environment, including climate change, transpacific cooperation can play a special role in reconciling developed and developing economy perspectives, and in balancing short-term assurances about the cost of prevention against the need for long-term assurances that greenhouse gas emissions will be capped. APEC is well placed to make advances on these fronts precisely because it has a diverse membership that spans developed and developing economies, and encompasses a wide range of energy interests.

Despite repeated “last ditch” efforts on the part of the US, EU, India, and Brazil, the Doha Development Round appears to be no closer to completion at the end of 2007, more than a year after its scheduled completion date. Respondents to the PECC opinion poll chose the Doha Round as the most important item for APEC Leaders to tackle at their recent Sydney meeting. The second most important issue was the establishment of a Free Trade Agreement of the Asia Pacific (FTAAP), suggesting that opinion leaders are pushing for more trade liberalization in the region, and that they do not necessarily

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see a contradiction between multilateral and regional efforts.

The US current account deficit and the corresponding surpluses held by Asian economies, especially China, continue to be top-of-mind in many policy discussions. The recent sharp depreciation of the US dollar may signal a new phase in the long-awaited unwinding of global imbalances – and the growing risk of a hard landing in the United States. Part of any solution to the transpacific imbalance is a shift towards greater consumption (and hence lower savings) in Asia. According to our survey, 80 percent of respondents believe that private consumption will become the engine of growth for Asia in the next decade.

The institutional landscape of the Asia Pacific has become more complex in recent years. The East Asia Summit and ASEAN Plus Three processes have added to the already numerous meetings of officials working on economic and non-economic issues affecting the region. Our survey of opinion-leaders suggests that there is considerable dissatisfaction with the current state of regional organizations at both the transpacific and sub-regional levels. In general, APEC and ASEAN come out better than their younger siblings the EAS and the ASEAN plus Three. Only 30 percent of opinion leaders agreed that competition from the EAS was an important or very important threat for APEC. They were split, however, on whether APEC is as important today as it was in 1989, and they see nagging problems in both the institutional structure and focus of APEC.

Our survey suggests strong support for greater institutional development of APEC. Nearly half of opinion leaders identified a “weak international secretariat” as a very important or important challenge for APEC. Further, when asked if the APEC Secretariat should be strengthened by appointing a multi-year fixed-term Executive Director and the recruitment of professional staff, respondents answered overwhelmingly in the affirmative. Indeed, respondents identified “Strengthening the APEC Organization” as one of the top five priorities for the grouping.

APEC recently completed a mid-term review of its progress towards the Bogor targets of “free trade and investment in the Asia Pacific by 2010 for developed economies and 2020 for developing economies”. While the review outlined credible achievements in particular areas of liberalization and facilitation, it also made clear that the Bogor goals will not be achieved. The Individual Action Plan and Collective Action Plan processes provide collegial discussion on how individual economies are making progress towards collective goals in economic integration, but they provide no mechanisms for enforcement.

The failure to meet the Bogor goals does not in itself invalidate the importance of APEC, but it does raise questions about the comparative advantage of the regional forum in advancing trade and investment liberalization and facilitation. As APEC comes to terms with its inability to meet the 2010 Bogor deadline, the challenge is to find a new way of articulating the organization’s *raison d’être* and new approaches for promoting more open trade and investment in the region. Our survey results confirm the commonly-held perception that APEC members lack commitment to the organization. In this sense, the most serious threat to APEC ultimately will not come from a competing organization or from the failure to meet the Bogor targets, but rather will be due to a lack of will from within to revive itself.

One area in which there is strong agreement among opinion leaders is the need for Asian economies to play a larger role in the governance of key international bodies such as the World Bank and the International Monetary Fund. Until recently, Asian countries placed little emphasis on international governance issues, preferring to focus on domestic economic development and political stability. As Asia’s economic weight increases, in part through deeper regional integration, the case for stronger representation in international organizations - and greater responsibility for the international economic system - will be irresistible.