

# STATE OF THE REGION

2010 – 2011



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# Message from the Co-Chairs of PECC

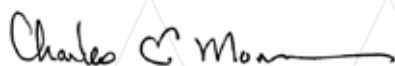
We are pleased to present the Pacific Economic Cooperation Council's fifth *State of the Region* report. The release of this report just prior to the G20 and APEC Leaders' meetings could not be more timely. In the context of heightened uncertainty about the health of the world economy and strained international economic relations, our report provides an analysis of the macroeconomic challenges facing the region, and the results of a survey of over 400 opinion leaders from twenty-two Asia-Pacific economies. In addition, as APEC takes stock of its Bogor 2010 target for free and open trade and investment, we provide a measure of progress towards this goal in the form of our updated index of Asia-Pacific economic integration.

Although growth in the region has resumed since the recession of 2008-09, much of the recovery is a result of the unprecedented stimulus measures taken by major economies. There remains a great deal of uncertainty as to whether those stimulus measures should be extended, or withdrawn. What is certain is that expansionary fiscal and monetary policies will need to be withdrawn at some point and that measures will be needed to restore business confidence and private demand. In this report, we outline the structural reforms that are needed in the region to transition to what APEC leaders in Singapore last year described as more "balanced, inclusive, sustainable, and innovative" growth.

In November 2010, the Asia-Pacific region which has been the growth engine of the world economy in recent years will have an opportunity to demonstrate its leadership through the G20 summit in Seoul and the APEC leaders' meeting in Tokyo. APEC can provide essential support for global consensus by once again affirming the need for structural reforms, helping economies shape their own domestic plans of action for reform and bringing a wider group of key like-minded economies into a globally concerted effort.

One of the biggest challenges will be to "rebalance" demand among surplus and deficit countries, the largest of which are in the Asia-Pacific region. Opinion leaders in our survey strongly endorse the need for greater emphasis on domestic demand-led growth in East Asian economies, as well as for a reduction in US deficits and the strengthening of financial regulations globally. Likewise, there was broad agreement that the implementation of structural reforms was the most important action to rebalance growth in the region and that the biggest challenge to structural reforms is entrenched interests who oppose change. This points towards a need for greater efforts to build awareness on the importance of structural reforms and for adjustment policies to help those who will be adversely affected by economic reforms.

There are many people who made this report possible, in particular the coordinator of the project, Yuen Pau Woo, and our other colleagues in the editorial committee Ian Buchanan, Manfred Wilhelmy, Wu Zhenglong, David Hong, Yoshiji Nogami, Soogil Young, and Tan Khee Giap. We also owe a special debt of gratitude to Dr. Wendy Dobson who contributed the opening chapter of this report. We also thank our member committees without whose support this report would not be possible and for their efforts in taking the time to identify and solicit responses from opinion leaders to our annual survey.



**Charles E. Morrison**  
Co-Chair



**Jusuf Wanandi**  
Co-Chair

# Message from the Coordinator

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The world economy has been on a roller coaster ride since the collapse of Lehman Brothers in September 2008. A deep plunge in economic output through the greater part of 2009 was followed by a sharp upturn, only to settle now into what can be described as a period of great uncertainty. Recovery in the US and Europe has been spotty, and the risk of another financial crisis remains present. Contrasting policy responses across the Atlantic further complicate the outlook, and underscore the differences among leading nations not only in prognosis but also in the type and degree of international coordination that is needed for sustained recovery.

The Asia-Pacific region faces a similar challenge. Even though Asian economies were less affected by the downturn and have largely recovered, the savings-investment imbalances which were at the root of the 2008-09 economic crisis have yet to be resolved, and an international consensus on how to address this problem remains elusive. In the meantime, businesses and workers most severely affected by the crisis are clamoring for their governments to take punitive action against other economies — leading to the specter of currency and trade wars.

Hence, if there is a single message from this year's State of the Region report, it is that the spirit of regional economic cooperation that led to the integration of Asia-Pacific economies over the last 20 years is again sorely needed. Major surplus and deficit economies in the region are key to solving the problem that has come to be known as "global rebalancing". In the last weeks of 2010, they will have not one, but two opportunities to face up to this challenge — first at the G20 Summit, then at the APEC Leaders' Meeting.

While much has been made of the distinction — even competition — between the two organizations, the practical reality is that both APEC and G20 have a contribution to make in reducing international economic tensions. As a fledgling group that is still finding its niche in international economic governance, the G20 has an important declaratory role in signaling the willingness of major surplus and deficit economies to redress global imbalances. APEC, with its longer tradition of economic cooperation and more recent focus on structural reform, can lead the way with a program of regional cooperation on the very reforms that are needed to rebalance growth and to make it more sustainable.

Our cover design tries to convey the extensive and intricate interconnectedness of the region. Seen one way, the stacked triangles can be as robust and durable as a steel frame, or — seen in a different way — as fragile and ephemeral as a house of cards. The outcome will depend on sound policy development and international economic cooperation.



**Yuen Pau Woo**  
Coordinator for *State of the Region*  
President & CEO  
Asia Pacific Foundation of Canada

# Executive Summary

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Even as the economic recovery from the downturn of 2009 gathers momentum across much of Asia-Pacific, there is great uncertainty in the region about its durability. The risk of another economic downturn stems less from a renewed bout of financial sector problems than from a failure of international economic cooperation. The forthcoming G20 and APEC Summits provide an opportunity for leaders of major economies to address the current unsustainable pattern of global flows and to step back from the brink of currency and trade wars.

Chapter 1 describes the current economic environment and the pattern of recovery in the Asia-Pacific region over the last 12 months. It points out that the underlying problem of global savings-investment imbalances have not been resolved, and that these imbalances continue to weigh heavily on the world economy. To achieve a more sustainable growth path, the report stresses that the extraordinary fiscal interventions during the economic crisis have to be unwound, and surplus economies have to rely less on exports for growth. This will require structural reforms in both deficit and surplus economies, and a high degree of international cooperation.

Financial regulatory reform in the advanced economies at the epicenter of the crisis is an ongoing priority. To achieve sustainable growth, financial institutions must also be willing to resume lending. A troublesome aspect of the recovery is the uncertainty around financial sector reforms, both because of pushback from powerful vested interests and the need to get the reforms right. In the troubled advanced economies the extraordinary support for the financial sector during the crisis has to be unwound and banks' bad assets removed from their balance sheets. Risks of future instability also need to be reduced and ways found to tackle future financial crises without taxpayer support.

APEC has an opportunity to make a unique contribution to global rebalancing by showing regional leadership on structural reform. APEC leaders could commit to deliverables appropriate to surplus and deficit economies in such areas as regulatory reform of services, the financing and provision of infrastructure, development of a low carbon economy, and capital market reforms to allocate capital resources more efficiently. Collective action in a number of these areas has the potential to be new growth engines for the region.

Highlights from our annual survey of regional opinion leaders are described in chapter 2. Across the Asia-Pacific region, opinion leaders are less optimistic about the prospects for growth over the next year than they were in last year's *State of the Region* survey. Thirty-six percent of respondents expected global growth to be stronger over the next 12 months compared to 26 percent who thought it would be weaker. The biggest risk to growth was identified as weakness in the US economy.

We asked opinion leaders what they thought should be the top five priorities for APEC leaders when they meet in Yokohama. The top issues were as follows: i) a post-crisis strategy for the region; ii) a free trade area of the Asia-Pacific; iii) the WTO Doha Development Round; iv) financial sector regulatory reform, and v) the region's response to climate change.

Our survey highlights the importance of strengthened financial regulations across the world to achieve sustained growth as well as rebalancing growth towards greater emphasis on domestic demand in East Asia. This rebalancing will require the kind structural reforms described in chapter 1 and elaborated in the PECC task force report on "Inclusive, Balanced, and Sustained Growth" released in 2009.

On trade issues, our survey underscores the need for more focus on behind the border issues such as intellectual property rights, standards and regulatory issues. These items were rated as the top 3 challenges to doing business in the region.

In chapter 3, we update our index of regional economic integration. In summary, the index shows a continued deepening of Asia-Pacific economic integration. However, the index also shows that while overall economic integration has increased, there are growing divergences in key development indicators such as real GDP per capita, education expenditure, and life expectancy. The growing divergence in these other areas, both among economies and within economies, threatens support for further liberalization of trade and investment in the region as well as the appetite for precisely the kind of international cooperation that is needed today to avert global economic conflict.

# Chapter 1

## Sustaining Global Growth

# Chapter 1

## Sustaining Global Growth

Growth in the Asia-Pacific region rebounded in 2009-10 but risks in the 2011 outlook have increased with Europe's sovereign debt problems, weak US growth and rising international tensions over external imbalances and exchange rate regimes. Urgent short-term measures are needed to take up the slack and head off protectionism.

The most important outcome of the G20 summit in Seoul will be evidence of leaders' commitment to macroeconomic and structural measures to assure balanced and sustained medium-term growth. As the world's most dynamic region, the Asia-Pacific economies have a particularly important role to play and much at stake.

To achieve sustainable long-term growth the extraordinary fiscal interventions in the crisis must be wound down, global growth must be rebalanced and structural policies adopted that raise the region's growth potential. A strategy for restructuring and rebalancing was put forward in 2009 in a task force report commissioned by the Pacific Economic Cooperation Council which identified policy priorities for economies in Asia-Pacific, acting on their own and collectively, to sustain growth beyond the crisis. This chapter builds on that report.

In 2010 collective action has been high on the agenda. Economies in the Asia-Pacific hosted two G20 leaders' summits, at Toronto in June and Seoul in November. At Toronto as growth rebounded, leaders agreed to a macroeconomic exit strategy, pledging to cut fiscal deficits in half by 2013 and to stabilize or reduce debt-to-GDP ratios by 2016. The G20 Mutual Assessment Process supported by the international institutions examined the global consequences of economies' domestic policies and identified opportunities for their governments to do things differently – and to do different things – to contribute to a more positive global outcome. If growth continues to lag and external imbalances are not addressed the risks of trade protectionism will rise.

At the Seoul G20, Asia will be in the spotlight. Despite the resumption of robust growth in the Asian economies, its composition still needs to shift from reliance on external demand to greater reliance on domestic demand. Such a shift will help to take up the slack caused by the slow recovery in the largest advanced economies. But, as pointed out by the 2009 task force, sustainable growth depends on an agenda of challenging policy changes: structural and institutional changes to support global rebalancing by relying more on domestic demand, financial regulatory reforms and the successful conclusion of the global trade talks. Progress is reported in the next section. The final section suggests the priorities for action in 2011, both by major economies and collectively in APEC and Asia's main regional institutions.

### Progress Towards Strong, Sustainable and Balanced Growth

The G20's framework for strong, sustainable and balanced growth relied on fiscal and monetary stimulus, which would be wound down with the resumption of self-sustaining private sector growth. In 2010 global growth has increased to an expected 4.8 percent average rate, but it is multi-speed (Figure 1). By IMF estimates, among the biggest economies China's economy is expected to grow by 10.5 percent, Japan at 2.8 percent and the United States at 2.6 percent. These rates are expected to moderate in 2011 to 4.2 percent as output returns to pre-crisis levels and productivity increases as jobs are not replaced. The Asia-Pacific region as a whole is expected to rebound to 4.4 percent growth this year.



Figure 1: Real GDP Growth, IMF October 2010



## Macroeconomic Exit Strategies

The first priority for governments and central banks in the advanced economies is to ensure that private sector growth is rebounding: that businesses are restocking inventories; hiring rather than firing; that labor market expansion is supporting household income growth and consumer spending which in turn is encouraging businesses to invest. The evidence is still muted and authorities are being cautious. If stimulus is withdrawn before sustainable growth is achieved, these economies could enter a renewed slump, even a deflationary spiral. Exit too late, however, and precious resources have been wasted and the seeds of future inflation sown. At the same time the large OECD economies have little room left for further fiscal stimulus because of large structural deficits and high levels of indebtedness: the IMF projects aggregate public indebtedness will be 110 percent of GDP in 2015.

In economies with large credit bubbles, interest rates are at historic lows and central bank balance sheets are in uncharted territory. While monetary policy should not be used to reduce the real burden of public indebtedness, central banks continue to rely on quantitative easing to provide stimulus.

The G20 leaders' commitment to fiscal consolidation at Toronto helped to formalize the need for exit strategies in the advanced deficit economies. These need to be signaled well in advance to condition expectations. But such exit strategies should also be structured to anticipate longer-term requirements and to be 'growth-friendly'. They should take account of longer-term imperatives such as demographic shifts; thus as fiscal stimulus is removed, primary balances should be improved to meet the challenges of aging populations (which implies both tax reforms and changes in entitlements). Governments should also shift public spending in the direction of investments that foster future growth, such as education, green infrastructure, physical infrastructure upgrading and the reduction of distortionary taxes. In surplus economies, shifts in spending are desirable to support households bearing the burdens of adjustments in product and labor markets in some cases and to support aging populations in others.

The exit strategies of the United States, China and Japan are of particular importance in the Asia-Pacific region. In the United States, there is debate over whether more stimulus is needed on one hand or fiscal austerity on the other. Stimulus proponents argue for more public spending to maintain demand in the absence of rising private demand, job growth, (Table 1) and fiscal problems of state governments. Proponents of austerity argue that such spending will increase public indebtedness, add to uncertainty about future taxes, continue to mask structural unemployment, and inhibit businesses' investment and hiring decisions. Without a compromise, the United States lacks a credible medium-term fiscal consolidation plan. Prior to the Toronto summit President Obama publicly committed to reduce the fiscal deficit to 3 percent of GDP by 2015. But the administration's own 2011 budget projected the deficit-to-GDP ratio will drop to 11 percent in 2010 (down from 13 percent in 2009) and decline to not more than 4 percent between 2015 and 2020 (whereas 2-3 percent is considered to be sustainable). Private sector forecasts have the deficit remaining above 5 percent of GDP in the next decade. These numbers are not sustainable.

The Administration's proposals in the 2011 budget rely mostly on expenditure compression rather than on added revenues. The imminent expiration of Bush-era tax cuts, a major factor contributing to persistent deficits, is also the subject of heated debate. The economic reality is that achieving a sustainable fiscal position will require higher revenues raised in a 'growth-friendly' way, such as through tax reforms that shift the burden of taxes away from income and property towards consumption. Since no politician is willing in the current polarized political environment to advocate higher taxes, the bipartisan National Commission for Fiscal Responsibility and Reform, with all expenditure and revenue items on the table, is the most promising mechanism to provide objective analysis and expert advice.

**Table 1: Unemployment Rates**

|                   | 2007  | 2008  | 2009  | 2010 | Change in rate<br>2007-2010 |
|-------------------|-------|-------|-------|------|-----------------------------|
| Australia         | 4.37  | 4.25  | 5.59  | 5.19 | 0.83                        |
| Brunei Darussalam | 3.41  | 3.75  | 3.75  | 3.75 | 0.34                        |
| Canada            | 6.04  | 6.16  | 8.28  | 7.99 | 1.95                        |
| Chile             | 7.03  | 7.41  | 9.63  | 9.00 | 1.97                        |
| China             | 4.00  | 4.20  | 4.30  | 4.10 | 0.10                        |
| Colombia          | 11.15 | 10.58 | 12    | 12   | 0.85                        |
| Ecuador           | 8.80  | 6.90  | 8.50  | 8.60 | -0.20                       |
| Hong Kong (China) | 4.02  | 3.52  | 5.15  | 4.39 | 0.37                        |
| Indonesia         | 9.11  | 8.39  | 8.00  | 7.50 | -1.61                       |
| Japan             | 3.85  | 3.99  | 5.08  | 5.15 | 1.30                        |
| Korea             | 3.25  | 3.18  | 3.65  | 3.30 | 0.05                        |
| Malaysia          | 3.20  | 3.30  | 3.70  | 3.50 | 0.30                        |
| Mexico            | 3.72  | 3.96  | 5.47  | 5.00 | 1.28                        |
| Mongolia          | 2.80  | 2.80  | 11.60 | 3    | 0.20                        |
| New Zealand       | 3.68  | 4.18  | 6.15  | 6.23 | 2.55                        |
| Papua New Guinea  | na    | na    | na    | na   | na                          |
| Peru              | 8.42  | 8.39  | 8.60  | 8.02 | -0.40                       |
| Philippines       | 7.33  | 7.40  | 7.48  | 7.20 | -0.13                       |
| Russia            | 6.10  | 6.40  | 8.40  | 7.50 | 1.40                        |
| Singapore         | 2.13  | 2.23  | 3.03  | 2.08 | -0.05                       |
| Chinese Taipei    | 3.91  | 4.14  | 5.85  | 5.25 | 1.34                        |
| Thailand          | 1.38  | 1.39  | 1.39  | 1.39 | 0.01                        |
| United States     | 4.61  | 5.82  | 9.28  | 9.73 | 5.12                        |
| Vietnam           | 4.64  | 4.70  | 6     | 5    | 0.36                        |

Source: IMF WEO downloaded on 6 October, 2010: unemployment, percent total labor force

China also carried out a strong fiscal stimulus program beginning in 2008. A surge in directed lending by the banking system magnified the impact of increased government spending. In 2009 China's growth performance led the world; as signs of inflation appeared in late 2009 administrative measures were used to rein in bank lending to the property markets and local governments. By mid-2010 signs of slowing activity prompted some loosening of credit for infrastructure and alternative energy investment. Exchange rate management was also eased prior to the Toronto summit as the central bank abandoned the de facto peg to the US dollar and returned to the practice begun in July 2005 of managing the exchange rate relative to a basket of currencies.

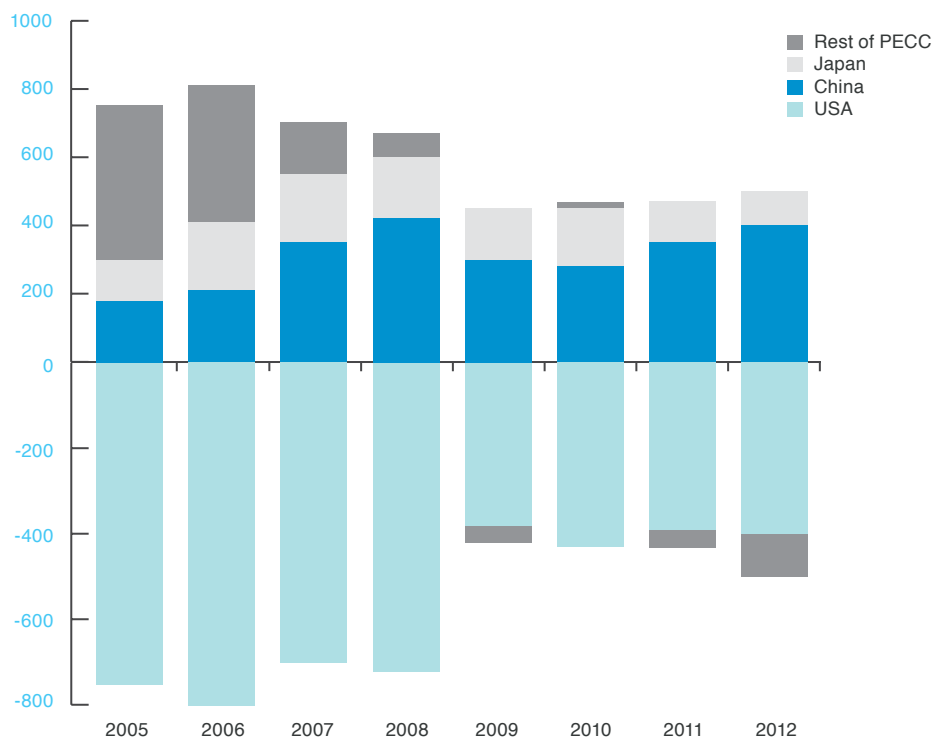
Japan, the economy most affected by the collapse of net exports in 2009, experienced a robust rebound in 2010 with growth nearly 5 percent in the first quarter and expected to average 2.4 percent for the year. As the restoration of external demand fades and fiscal policies are tightened, however, growth is expected to slow in 2011.

While short-term macroeconomic exit and fiscal consolidation is not a particular priority in East Asian economies with prudent fiscal and monetary policies, the medium-term imperative of global rebalancing will depend their active participation in reducing reliance on export-led growth and depending more on domestic demand.

### Addressing Global Imbalances

The second priority, and more difficult, is to change the composition of aggregate demand as growth returns. Global current account imbalances peaked in 2006 but the IMF expects them to rise again, as surpluses rise in East Asia with the restoration of global trade and financing flows (top segment of each bar in Figure 2). To prevent their recurrence, economies with external surpluses should rely more on domestic demand and imports while those with external deficits should rely more on exports. Flexible exchange rates would help cushion the necessary adjustments.

**Figure 2: Current Account Imbalances**

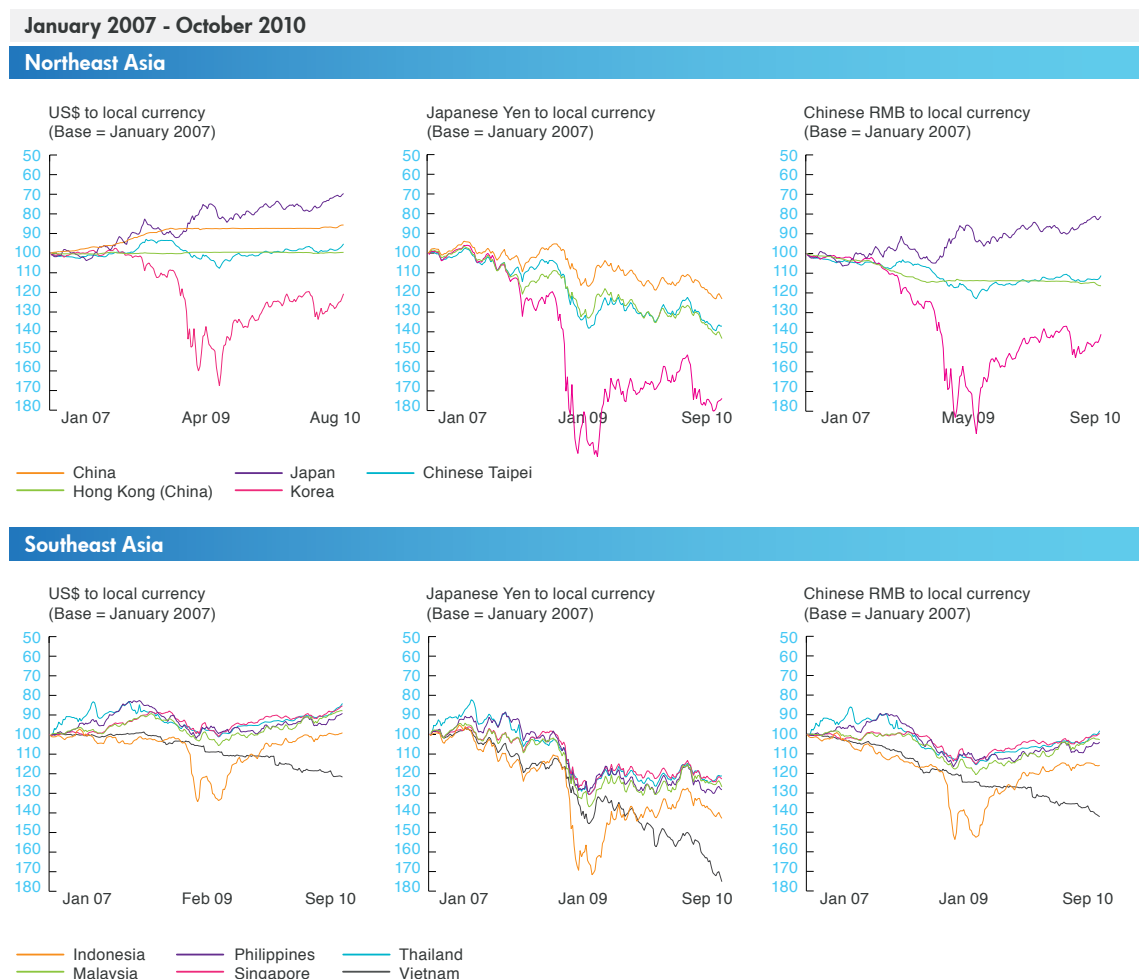


Source: IMF WEO database downloaded on 6 October

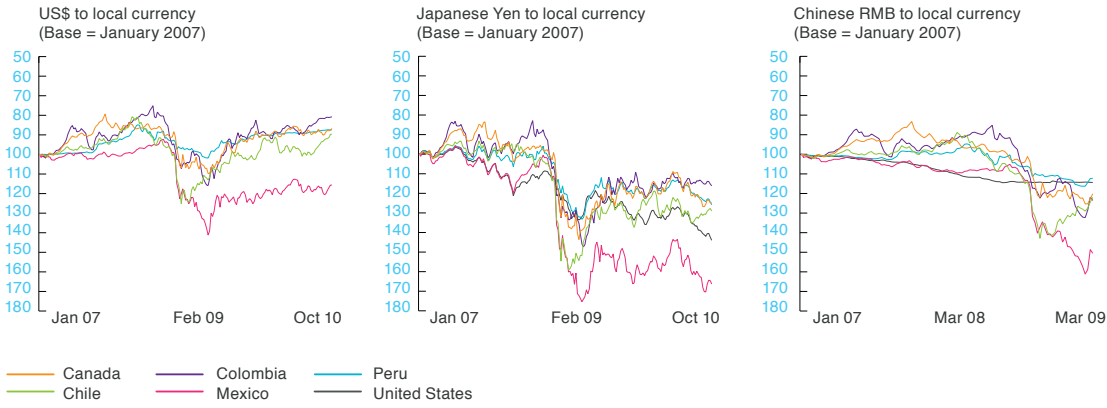
Rebalancing will be both a technical challenge and the G20's biggest political challenge. Some surplus economies continue to resist flexible exchange rates, reflecting fears that real and nominal exchange rate volatility will undermine their export-led growth while doing little to address structural problems in either deficit or surplus economies. Few currencies in Northeast or Southeast Asia have shown much upward flexibility against the US dollar (Figure 3) with Korea showing a large depreciation. Movements in RMB exchange rates have largely mirrored those against the US dollar. Japan is the exception; yen appreciation is reflected in the sharp downward movements of other currencies against the yen.

The buildup of foreign exchange reserves since 2008, which in China, Malaysia, Singapore and Thailand now amount to 50 percent or more of nominal GDP (Table 2), provides further indication of resistance to appreciation. Yet one of the lessons to draw from the market adjustments that reduced the imbalances in 2009 is that they could have been less disruptive with flexible exchange rates. In the absence of flexible exchange rates more of the burden of adjustment must be borne by structural policies that may not be popular at home as they impact consumer and trade interests vested in the unsustainable status quo. With the US consumer no longer the engine of growth it once was, surplus economies must make a determined effort to rebalance to take up the slack.

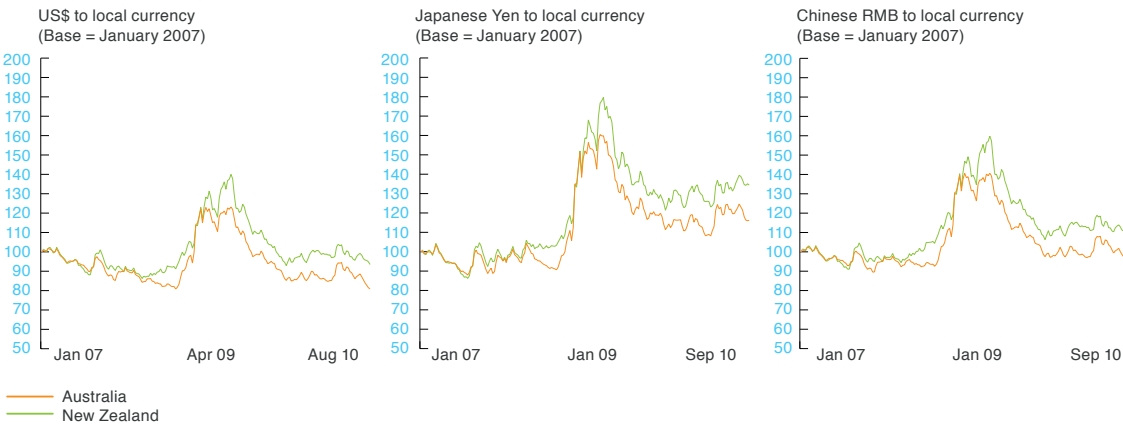
**Figure 3: Asia-Pacific Exchange Rate Movements**



## Pacific Americas



## Oceania



Source: Pacific Exchange Rate Service ([fx.sauder.ubc.ca](http://fx.sauder.ubc.ca)), Sauder School of Business, University of British Columbia

**Table 2: Foreign Exchange Reserves minus gold (US\$ billion)**

|                   | May 10   | % change from September 2008 | % of nominal GDP | Months of imports |
|-------------------|----------|------------------------------|------------------|-------------------|
| Australia         | 33.21    | 20.1%                        | 3.3%             | 2.1               |
| Brunei Darussalam | 1.33     | 47.0%                        | 12.8%            | 5.3               |
| Canada            | 55.90    | 23.3%                        | 4.2%             | 1.6               |
| Chile             | 24.83    | 2.7%                         | 15.4%            | 6.1               |
| China             | 2,456.19 | 22.3%                        | 49.3%            | 28.6              |
| Colombia          | 25.29    | 7.0%                         | 10.9%            | 8.6               |
| Ecuador           | 3.56     | -62.1%                       | 6.4%             | 2.8               |
| Hong Kong (China) | 256.10   | 37.3%                        | 121.6%           | 8.3               |
| Indonesia         | 71.75    | 23.3%                        | 13.3%            | 8.1               |
| Japan             | 1,011.61 | 3.7%                         | 20.0%            | 18.8              |
| Korea             | 270.14   | 11.3%                        | 32.4%            | 8.5               |
| Malaysia          | 94.11    | -16.3%                       | 48.8%            | 7.7               |
| Mexico            | 103.55   | 4.6%                         | 11.8%            | 4.1               |
| Mongolia          | 1.35     | 43.9%                        | 32.1%            | 6.1               |
| New Zealand       | 18.02    | 20.6%                        | 15.3%            | 7.2               |
| Papua New Guinea  | 2.45     | -0.3%                        | 30.9%            | 8.6               |
| Peru              | 33.32    | -1.4%                        | 26.3%            | 16.6              |
| Philippines       | 41.02    | 19.1%                        | 25.4%            | 8.4               |
| Russia            | 428.99   | -26.5%                       | 34.8%            | 24.5              |
| Singapore         | 198.36   | 14.9%                        | 108.8%           | 8.6               |
| Thailand          | 140.22   | 28.7%                        | 53.1%            | 11.1              |
| United States     | 113.13   | 46.3%                        | 0.8%             | 0.7               |
| Vietnam           | 13.85    | -72.1%                       | 14.9%            | 2.2               |

Source: Foreign exchange reserves minus gold from IMF IFS online downloaded on 12 October 2010, GDP from IMF WEO, import data from IMF DOTS  
\* Data for Chinese Taipei not available.

The IMF in cooperation with the OECD and other international organizations has shown the benefits of collective action to reduce imbalances and the risks of continuing the status quo. In preparation for the Toronto summit the IMF prepared a base line scenario of growth and output in 2014 based on member economies' own forecasts and adjustment packages. These were then adjusted for consistency and subjected to alternative assumptions reflecting upside possibilities and downside risks. Significantly the model assumes exchange rate flexibility. The differences in outcomes under the two scenarios are startling. Collective action yields large benefits: world output would be higher by US\$ 1.6 trillion and global growth over the next five years would be 2 1/2 percent higher than the baseline. Over 29 million jobs would be created globally, including 13.2 million in emerging Asia (Table 3A.).

**Table 3A: Upside Scenario: Employment and Output Gains by region (IMF Mutual Assessment, June 2010)**

|                   | Employment | Unemployment 1/     | Real GDP           |           |
|-------------------|------------|---------------------|--------------------|-----------|
|                   | (Millions) | (Percentage points) | (2009 USD billion) | (Percent) |
| United States     | 3.1        | -2.0                | 426                | 3.0       |
| Euro area 2 /     | 4.6        | -2.8                | 563                | 4.5       |
| of which Germany  | 1.6        | -3.8                | 174                | 5.2       |
| Japan             | 0.5        | -0.8                | 126                | 2.5       |
| Emerging Asia     | 13.2       | -0.7                | 128                | 1.4       |
| Rest of the world | 8.2        | -1.1                | 370                | 2.1       |
| World             | 29.5       | -1.4                | 1614               | 2.5       |

# Notes:

1/ Unemployment for emerging Asia and rest of the world is calculated using the respective output responses and assuming the maximum estimated unemployment response in the other regions.

**Table 3B: Downside Scenario: Employment and Output Losses**

|                   | Employment | Unemployment 1/     | Real GDP           |           |
|-------------------|------------|---------------------|--------------------|-----------|
|                   | (Millions) | (Percentage points) | (2009 USD billion) | (Percent) |
| United States     | 1.6        | 1.0                 | 765                | 5.4       |
| Euro area 2 /     | 2.1        | 1.3                 | 705                | 5.6       |
| of which Germany  | 0.7        | 1.6                 | 192                | 5.7       |
| Japan             | 1.0        | 1.5                 | 244                | 4.8       |
| Emerging Asia     | 11.3       | 0.6                 | 109                | 1.2       |
| Rest of the world | 6.6        | 0.9                 | 301                | 1.7       |
| World             | 22.7       | 0.9                 | 2124               | 3.1       |

2/ Based on PPP-weighted average of Germany and the other euro members; employment and real GDP level is a sum of Germany and the other euro area members.

Risks in the downside scenario compared to the baseline (Table 3B) imply large losses in output and employment – 23 million jobs lost of which more than 11 million are in emerging Asia and a million in Japan — and poverty would increase by an estimated 60 million people. World output will be 3.1 percent lower and unemployment nearly 1 percent higher than the baseline.

Comparison of the downside and upside scenarios provides a dramatic estimate of the global benefits of collective action. Global output would be 5.6 percentage points higher with policy actions (comparing Tables 3A and 3B fourth columns, bottom lines) than if the risks were to materialize. Unemployment would decline rather than rise (even in emerging Asia unemployment rises in the downside scenario).

What are the key policy actions that account for the differences in these scenarios? Clearly growth-friendly fiscal consolidation in deficit economies is essential. Beyond that two kinds of structural reforms are included in the models: structural reforms that strengthen domestic demand (and compensate for lower US consumer demand) and structural reforms that enhance productive potential.

**Strengthening domestic demand:** Economies with external surpluses are assumed to take up some of the slack in global demand by strengthening domestic demand with such measures as strengthened social safety nets with pension and health insurance programs, enhanced physical infrastructure that reduces supply bottlenecks, reformed corporate governance and more-developed financial markets that can extend credit to small and medium-sized enterprises. Household demand is assumed to expand as wage rises are permitted, restrictions loosened on labor mobility and households provided with capital income-generating opportunities. The structure and timing of such reforms will depend on each economy's economic circumstances and institutions, but the direction and urgency of the reforms is clear if longer-term sustainable growth is to be achieved.

The Mutual Assessment exercise found that raising public investment in emerging Asia by 2 percent of GDP over three years increases domestic demand relative to the base case through investment projects and stronger safety nets that provide targeted transfers to the poor. These expenditures are financed with higher deficits and higher consumption taxes.

**Enhancing economic potential:** Advanced economies with external deficits could take a number of measures that include reforming entitlement programs, product market reforms that encourage competition in network industries, professional services and retail distribution. The OECD estimates that even moving to 'best practice' product market regulation would raise productivity growth. Labor market reforms to increase the flexibility of labor markets, particularly in Europe, would also be growth-enhancing. Emerging market deficit economies could simplify product market regulation and increase the efficiency of the formal sectors to encourage more employment.

These changes would support more balanced growth through time. Current account deficits will decline as currencies depreciate, savings will rise in advanced deficit economies and external demand for their products will increase while in advanced surplus economies product and labor market reforms will enhance both investment and consumption. In emerging surplus economies, reduced precautionary saving and higher infrastructure spending will boost domestic demand and imports which, with currency appreciation, will help reduce current account surpluses.

## Financial Regulatory Reforms

Financial regulatory reform in the advanced economies at the epicenter of the crisis is the third priority. To achieve sustainable growth, financial institutions must also be willing to resume lending. A troublesome aspect of the recovery is the uncertainty around financial sector reforms, both because of pushback from powerful vested interests and the need to get the reforms right. In the troubled advanced economies the extraordinary support for the financial sector during the crisis has to be unwound and banks' bad assets removed from their balance sheets. Risks of future instability also need to be reduced and ways found to tackle future financial crises without taxpayer support. Financial reform legislation along these lines has been adopted in the United States but global standards are still needed to prevent new regulatory differences that will affect cross-border capital flows. The Basel institutions have decided on new and safer minimum required standards for capital and liquidity that will be presented to leaders at the Seoul summit.

## Safeguarding Trade Liberalization and Concluding the Doha Round

The fourth priority is to safeguard trade liberalization despite the lack of global growth momentum. The IMF's downside scenario paints the risks of renewed recession. Jobless growth and rising structural unemployment in the run up to US midterm elections risks renewed protectionism and political pressures to turn back globalization. Few governments have much fiscal room to maneuver in the face of still-high unemployment and rely instead on external demand. If both deficit and surplus economies pursue the same strategy the threats of protectionism will rise. The return of the US trade deficit in June 2010 to a size not seen since the crisis began reflected weaker-than-expected growth in exports, the weaker euro and resistance by major exporters in Asia and Europe to rebalance their economic growth. Up to now the APEC and G20 leaders have repeatedly charged their trade ministers with finding ways to finish the Doha round. At Seoul, leaders should agree on a balance of interests and direct their negotiators to conclude the Doha round as soon as possible and no later than the end of 2011. There is a unique window of opportunity that will close in 2012 when major elections and leadership transitions are scheduled. Another statement of good intentions will be insufficient. The gains that are available should be locked in. Issues of WTO reform and updating can follow.

## Delivering Action

Many of the macroeconomic and structural policy priorities were identified in the 2009 task force report on economic crisis and recovery. Concrete commitments are now required by individual surplus and deficit economies and by Asia-Pacific institutions.

**The United States:** A credible medium-term plan of fiscal consolidation is required, no matter the outcome of the political debates about its composition. This is unlikely until after the November 2010 mid-term elections, however, when the bipartisan, advisory National Commission on Fiscal Responsibility and Reform's final report comes due. All options should be on the table, including a broad-based consumption or carbon taxes as well as spending cuts. Policy initiatives to increase US exports in the next five years should be consistent with the global trade liberalization agenda.

**China:** As a major surplus economy China's relatively fixed exchange rate implies that much of the burden of rebalancing must be carried by domestic policy changes. Domestic policies are moving to encourage the growth of domestic demand but more can be done. Structural reforms in the services industries that allow more competition would raise productivity. Further fiscal reforms to extend education services, infrastructure, public pensions and health insurance to the rural areas, along with labor market reforms that raise wages will help reduce high household saving rates. Likewise, measures are needed to lower excessive savings in the corporate sector, including tax reform and higher dividend payments by state owned companies. Raising artificially low input prices for energy, land, water, the environment and capital will change incentives for industrial production. And allowing exchange rate appreciation will facilitate these shifts, either real appreciation through higher domestic inflation or nominal appreciation.

**Other Asian economies:** Other surplus East Asian economies could contribute more to global demand by reducing export incentives, increasing domestic demand through infrastructure projects and raising productivity in services industries by encouraging competition. They could make labor and product markets more flexible and encourage household consumption by creating social safety nets and developing domestic financial markets in ways that reduce credit constraints on households and small businesses.



Europe: Since much of the uncertainty about global growth prospects emanates from Europe, crisis management measures are still of considerable importance. The European stabilization fund and unprecedented central bank intervention have bought time for economies like Greece with sovereign debt problems to restructure their finances. But serious questions remain about economic governance in the euro zone where deeper coordination is required to restore and maintain fiscal prudence. Clearly future economic growth will depend on rising productivity which in turn will require politically-difficult and long-delayed product and labor market reforms in a slow-growth environment. Germany as the large surplus economy should stimulate domestic demand to facilitate such changes.

## APEC

APEC has an opportunity to establish interaction between the global processes of the G20 and regional processes in Asia-Pacific. At the Yokohama summit on November 13-14 APEC leaders could link their five-part growth strategy to G20 priorities. Such an APEC strategy could enhance G20 legitimacy by including more economies. APEC's recent focus on structural reform lends itself well to helping the region's economies identify the policy frameworks needed to sustain growth once economies exit from the extraordinary stimulus measures taken in response to the crisis. The APEC High Level Policy Roundtable in Beppu last August identified key areas where the Asia-Pacific can take a leading role in defining the shape of the post-crisis global economy. APEC leaders could commit to deliverables appropriate to surplus and deficit economies in regulatory reforms of services sectors, the financing and provision of infrastructure that deepen APEC connectedness and advance the low carbon economy, and capital market reforms to allocate capital resources more efficiently. Collective action in a number of these areas could be growth engines as the 2009 task force pointed out. Serious consideration should be given to appointing a high-level task force on structural adjustment to work out a regional strategy with milestones and deliverables to be agreed at Honolulu.

Other Asian regional institutions also have potentially supportive roles to play. The ASEAN+3 Macroeconomic Research Office (AMRO) which is being set up as a surveillance mechanism to support CMIM (Chiang Mai Initiative Multilateralization) macroeconomic cooperation could provide institutional support for rebalancing among its members.

Individual governments could also consider setting up independent expert advisory commissions to identify and publicly discuss desirable policy changes that require difficult adjustments, along the lines of the US National Commission. Other examples of government initiatives are Singapore's Economic Strategies Commission chaired by the Minister of Finance and the Malaysian government's New Economic Model. These mechanisms could help build public support for the restructuring agenda and reduce the risks of the IMF's downside scenario that could occur if governments merely opt for quick fixes and declare success.

## Conclusion

The growing international tensions over recurring global imbalances and the slow movement by governments to reform both structural policies and exchange rate regimes are contributing to an unprecedented crisis atmosphere. Without resolute action by leaders the hard won gains of globalization may be at stake. The Yokohama APEC summit can build on the G20 framework and decisions taken at Seoul. Discernible forward momentum is needed in 2011 or the G20's credibility and effectiveness will wane. Asia-Pacific economies have a particularly large stake in realizing the IMF's upside scenario and should push for and support commitments to collective action that support balanced and sustainable global growth.

## Annex A

### GDP Growth

|                             | 2005  | 2006  | 2007  | 2008  | 2009  | 2010  | 2011 | 2012 |
|-----------------------------|-------|-------|-------|-------|-------|-------|------|------|
| Australia                   | 3.20  | 2.55  | 4.81  | 2.24  | 1.25  | 3.00  | 3.47 | 3.48 |
| Brunei Darussalam           | 0.39  | 4.40  | 0.16  | -1.94 | -0.49 | 0.50  | 1.01 | 1.22 |
| Canada                      | 3.02  | 2.82  | 2.20  | 0.52  | -2.46 | 3.10  | 2.67 | 2.72 |
| Chile                       | 5.55  | 4.59  | 4.57  | 3.72  | -1.53 | 5.03  | 6.01 | 4.60 |
| China                       | 11.29 | 12.69 | 14.19 | 9.60  | 9.10  | 10.46 | 9.59 | 9.54 |
| Colombia                    | 4.95  | 7.11  | 6.25  | 2.73  | 0.83  | 4.69  | 4.58 | 4.57 |
| Ecuador                     | 5.74  | 4.75  | 2.04  | 6.52  | 0.36  | 2.90  | 2.25 | 2.00 |
| Hong Kong (China)           | 7.08  | 7.02  | 6.38  | 2.16  | -2.76 | 6.04  | 4.69 | 4.32 |
| Indonesia                   | 5.69  | 5.50  | 6.35  | 6.01  | 4.55  | 6.00  | 6.20 | 6.50 |
| Japan                       | 1.93  | 2.04  | 2.36  | -1.20 | -5.22 | 2.82  | 1.50 | 2.04 |
| Korea                       | 3.96  | 5.18  | 5.11  | 2.30  | 0.20  | 6.06  | 4.48 | 4.21 |
| Malaysia                    | 5.33  | 5.85  | 6.48  | 4.71  | -1.71 | 6.72  | 5.30 | 5.20 |
| Mexico                      | 3.21  | 4.93  | 3.34  | 1.49  | -6.54 | 4.98  | 3.92 | 4.96 |
| Mongolia                    | 7.25  | 8.56  | 10.22 | 8.92  | -1.61 | 8.55  | 7.04 | 6.16 |
| New Zealand                 | 3.16  | 1.01  | 2.78  | -0.15 | -1.59 | 3.00  | 3.16 | 3.05 |
| Papua New Guinea            | 3.92  | 2.29  | 7.15  | 6.66  | 4.54  | 7.96  | 5.55 | 2.97 |
| Peru                        | 6.83  | 7.74  | 8.91  | 9.80  | 0.86  | 8.27  | 6.00 | 5.71 |
| Philippines                 | 4.95  | 5.34  | 7.09  | 3.69  | 1.06  | 7.04  | 4.46 | 4.50 |
| Russia                      | 6.39  | 8.15  | 8.54  | 5.24  | -7.90 | 3.97  | 4.34 | 4.40 |
| Singapore                   | 7.38  | 8.64  | 8.54  | 1.78  | -1.28 | 15.00 | 4.55 | 4.37 |
| Chinese Taipei              | 4.70  | 5.44  | 5.98  | 0.73  | -1.91 | 9.32  | 4.41 | 4.69 |
| Thailand                    | 4.61  | 5.15  | 4.93  | 2.46  | -2.25 | 7.52  | 4.00 | 4.25 |
| United States               | 3.05  | 2.67  | 1.95  | 0.00  | -2.63 | 2.64  | 2.31 | 3.04 |
| Vietnam                     | 8.44  | 8.23  | 8.46  | 6.31  | 5.32  | 6.47  | 6.82 | 7.04 |
| All Asia-Pacific            | 4.40  | 4.60  | 4.57  | 1.87  | -1.33 | 4.38  | 3.66 | 4.09 |
| PECC                        | 4.31  | 4.44  | 4.38  | 1.71  | -1.03 | 4.40  | 3.63 | 4.08 |
| PECC ex US,<br>China, Japan | 4.15  | 4.55  | 4.63  | 2.29  | -1.19 | 5.27  | 4.07 | 4.18 |
| APEC                        | 3.70  | 4.19  | 3.95  | 1.97  | -1.36 | 4.84  | 3.58 | 3.69 |
| World                       | 4.55  | 5.21  | 5.34  | 2.83  | -0.58 | 4.77  | 4.22 | 4.54 |

Source: IMF WEO downloaded on 7 October 2010, Gross domestic product, constant prices

## Inflation

|                             | 2005  | 2006  | 2007 | 2008  | 2009  | 2010  | 2011  | 2012 |
|-----------------------------|-------|-------|------|-------|-------|-------|-------|------|
| Australia                   | 2.67  | 3.54  | 2.33 | 4.35  | 1.82  | 2.96  | 3.04  | 3.03 |
| Brunei Darussalam           | 1.09  | 0.20  | 0.29 | 2.72  | 1.80  | 1.80  | 1.80  | 1.80 |
| Canada                      | 2.23  | 2.02  | 2.13 | 2.38  | 0.29  | 1.77  | 2.02  | 1.98 |
| Chile                       | 3.05  | 3.39  | 4.41 | 8.72  | 1.68  | 1.72  | 3.00  | 3.00 |
| China                       | 1.82  | 1.47  | 4.77 | 5.90  | -0.69 | 3.52  | 2.71  | 2.00 |
| Colombia                    | 5.05  | 4.30  | 5.54 | 7.00  | 4.20  | 2.41  | 2.65  | 3.15 |
| Ecuador                     | 2.10  | 3.30  | 2.28 | 8.40  | 5.16  | 4.00  | 3.50  | 3.10 |
| Hong Kong (China)           | 0.91  | 2.02  | 2.03 | 4.29  | 0.52  | 2.70  | 3.00  | 2.50 |
| Indonesia                   | 10.46 | 13.10 | 6.03 | 9.78  | 4.81  | 5.07  | 5.50  | 5.36 |
| Japan                       | -0.30 | 0.30  | 0.00 | 1.40  | -1.38 | -0.99 | -0.32 | 0.20 |
| Korea                       | 2.75  | 2.24  | 2.54 | 4.67  | 2.76  | 3.10  | 3.40  | 3.00 |
| Malaysia                    | 3.05  | 3.61  | 2.03 | 5.40  | 0.60  | 2.20  | 2.10  | 2.30 |
| Mexico                      | 3.99  | 3.63  | 3.97 | 5.13  | 5.30  | 4.24  | 3.20  | 3.02 |
| Mongolia                    | 12.46 | 4.49  | 8.17 | 26.81 | 6.27  | 10.52 | 8.88  | 6.20 |
| New Zealand                 | 3.04  | 3.36  | 2.38 | 3.96  | 2.12  | 2.55  | 5.55  | 2.40 |
| Papua New Guinea            | 1.82  | 2.37  | 0.91 | 10.76 | 6.92  | 7.13  | 7.98  | 6.72 |
| Peru                        | 1.62  | 2.00  | 1.78 | 5.79  | 2.94  | 1.70  | 2.47  | 1.99 |
| Philippines                 | 7.63  | 6.24  | 2.81 | 9.30  | 3.25  | 4.49  | 4.00  | 4.00 |
| Russia                      | 12.68 | 9.68  | 9.01 | 14.11 | 11.65 | 6.56  | 7.45  | 6.47 |
| Singapore                   | 0.47  | 0.97  | 2.10 | 6.61  | 0.59  | 2.83  | 2.37  | 2.07 |
| Chinese Taipei              | 2.31  | 0.60  | 1.80 | 3.53  | -0.87 | 1.50  | 1.50  | 1.50 |
| Thailand                    | 4.54  | 4.64  | 2.24 | 5.47  | -0.85 | 3.05  | 2.76  | 2.53 |
| United States               | 3.37  | 3.22  | 2.87 | 3.82  | -0.32 | 1.42  | 0.96  | 1.36 |
| Vietnam                     | 8.39  | 7.50  | 8.35 | 23.12 | 6.72  | 8.40  | 8.00  | 6.05 |
| All Asia-Pacific            | 3.05  | 2.91  | 2.99 | 4.49  | 0.56  | 1.92  | 1.75  | 1.83 |
| PECC members                | 2.61  | 2.60  | 2.71 | 4.04  | 0.04  | 1.70  | 1.49  | 1.61 |
| PECC ex US,<br>China, Japan | 3.53  | 3.60  | 2.98 | 5.15  | 2.20  | 2.99  | 3.04  | 2.84 |
| APEC members                | 3.15  | 3.10  | 2.65 | 4.53  | 1.94  | 2.57  | 2.61  | 2.41 |
| World                       | 3.77  | 3.70  | 4.01 | 5.98  | 2.46  | 3.67  | 3.14  | 2.92 |

Source: IMF WEO, downloaded on 7 October 2010, Inflation, average consumer prices

**Current Account Balance (US\$ billions)**

|                   | 2005    | 2006    | 2007    | 2008    | 2009    | 2010    | 2011    | 2012    |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Australia         | -41.73  | -41.56  | -58.60  | -47.48  | -43.69  | -29.83  | -29.42  | -51.54  |
| Brunei Darussalam | 5.03    | 6.46    | 6.23    | 8.52    | 4.86    | 5.18    | 5.44    | 5.73    |
| Canada            | 21.38   | 18.06   | 11.89   | 6.48    | -38.08  | -44.25  | -44.36  | -40.90  |
| Chile             | 1.45    | 7.15    | 7.46    | -2.51   | 4.22    | -1.36   | -4.41   | -5.17   |
| China             | 160.82  | 253.27  | 371.83  | 436.11  | 297.10  | 269.87  | 324.80  | 394.30  |
| Colombia          | -1.89   | -2.98   | -5.98   | -6.88   | -5.15   | -7.55   | -8.53   | -7.40   |
| Ecuador           | 0.36    | 1.62    | 1.66    | 1.21    | -0.38   | -0.47   | -1.04   | -0.97   |
| Hong Kong (China) | 20.18   | 22.94   | 25.53   | 29.30   | 18.28   | 18.90   | 20.28   | 21.77   |
| Indonesia         | 0.28    | 10.86   | 10.50   | 0.13    | 10.58   | 6.40    | 0.54    | -4.20   |
| Japan             | 165.69  | 170.44  | 210.97  | 157.08  | 141.75  | 166.46  | 133.31  | 134.73  |
| Korea             | 14.98   | 5.39    | 5.88    | -5.78   | 42.67   | 26.04   | 30.58   | 25.33   |
| Malaysia          | 20.70   | 25.82   | 29.76   | 38.85   | 31.84   | 32.13   | 32.54   | 32.96   |
| Mexico            | -4.55   | -4.45   | -8.40   | -15.89  | -5.24   | -11.63  | -14.58  | -16.71  |
| Mongolia          | 0.03    | 0.22    | 0.27    | -0.72   | -0.41   | -0.81   | -1.65   | -1.74   |
| New Zealand       | -9.24   | -9.09   | -10.44  | -11.32  | -3.57   | -4.42   | -6.47   | -8.48   |
| Papua New Guinea  | 0.30    | 0.44    | 0.21    | 0.81    | -0.54   | -1.42   | -1.65   | -1.44   |
| Peru              | 1.15    | 2.85    | 1.36    | -4.72   | 0.24    | -2.06   | -3.63   | -3.80   |
| Philippines       | 1.98    | 5.35    | 7.12    | 3.63    | 8.55    | 7.81    | 7.20    | 6.98    |
| Russia            | 84.44   | 94.34   | 77.01   | 103.72  | 49.52   | 69.83   | 62.06   | 46.81   |
| Singapore         | 26.72   | 35.10   | 47.18   | 35.82   | 32.39   | 44.48   | 42.91   | 42.16   |
| Chinese Taipei    | 17.58   | 26.30   | 35.15   | 27.51   | 42.92   | 42.64   | 43.32   | 44.78   |
| Thailand          | -7.64   | 2.32    | 15.68   | 1.63    | 20.29   | 11.10   | 8.48    | 6.13    |
| United States     | -747.59 | -802.64 | -718.09 | -668.86 | -378.43 | -466.51 | -400.43 | -419.75 |
| Vietnam           | -0.56   | -0.16   | -6.99   | -10.79  | -7.44   | -8.51   | -9.16   | -9.73   |
| US                | -747.59 | -802.64 | -718.09 | -668.86 | -378.43 | -466.51 | -400.43 | -419.75 |
| China             | 160.82  | 253.27  | 371.83  | 436.11  | 297.10  | 269.87  | 324.80  | 394.30  |
| Japan             | 165.69  | 170.44  | 210.97  | 157.08  | 141.75  | 166.46  | 133.31  | 134.73  |
| Rest of PECC      | 421.08  | 378.93  | 135.29  | 75.67   | -60.42  | 30.18   | -57.69  | -109.28 |

Source: IMF WEO downloaded on 7 October 2010, current account balance US\$ billions

### Current Account Balance (Percent of GDP)

|                   | 2005  | 2006  | 2007  | 2008   | 2009  | 2010   | 2011   | 2012   |
|-------------------|-------|-------|-------|--------|-------|--------|--------|--------|
| Australia         | -5.65 | -5.30 | -6.16 | -4.49  | -4.40 | -2.45  | -2.27  | -3.85  |
| Brunei Darussalam | 52.80 | 56.33 | 50.88 | 59.12  | 46.68 | 43.32  | 43.19  | 43.99  |
| Canada            | 1.89  | 1.41  | 0.84  | 0.43   | -2.85 | -2.83  | -2.72  | -2.41  |
| Chile             | 1.23  | 4.88  | 4.54  | -1.47  | 2.61  | -0.68  | -1.98  | -2.11  |
| China             | 7.13  | 9.34  | 10.64 | 9.65   | 5.96  | 4.70   | 5.06   | 5.50   |
| Colombia          | -1.29 | -1.85 | -2.84 | -2.95  | -2.21 | -2.67  | -2.77  | -2.26  |
| Ecuador           | 0.97  | 3.88  | 3.65  | 2.22   | -0.67 | -0.76  | -1.60  | -1.43  |
| Hong Kong (China) | 11.35 | 12.08 | 12.33 | 13.62  | 8.68  | 8.35   | 8.34   | 8.39   |
| Indonesia         | 0.10  | 2.98  | 2.43  | 0.03   | 1.96  | 0.92   | 0.07   | -0.49  |
| Japan             | 3.64  | 3.91  | 4.82  | 3.21   | 2.80  | 3.09   | 2.35   | 2.29   |
| Korea             | 1.77  | 0.57  | 0.56  | -0.62  | 5.13  | 2.64   | 2.90   | 2.25   |
| Malaysia          | 15.00 | 16.44 | 15.92 | 17.48  | 16.50 | 14.68  | 13.76  | 12.90  |
| Mexico            | -0.54 | -0.47 | -0.82 | -1.46  | -0.60 | -1.16  | -1.40  | -1.50  |
| Mongolia          | 1.29  | 7.02  | 6.74  | -14.02 | -9.77 | -13.86 | -22.88 | -22.48 |
| New Zealand       | -8.29 | -8.44 | -7.97 | -8.64  | -3.03 | -3.21  | -4.38  | -5.57  |
| Papua New Guinea  | 6.08  | 8.00  | 3.29  | 10.05  | -6.84 | -16.14 | -18.53 | -16.40 |
| Peru              | 1.45  | 3.09  | 1.27  | -3.71  | 0.19  | -1.34  | -2.23  | -2.20  |
| Philippines       | 2.01  | 4.55  | 4.94  | 2.17   | 5.31  | 4.13   | 3.39   | 3.05   |
| Russia            | 11.06 | 9.53  | 5.93  | 6.22   | 4.02  | 4.73   | 3.70   | 2.51   |
| Singapore         | 21.30 | 24.19 | 26.69 | 18.53  | 17.77 | 20.46  | 18.40  | 17.27  |
| Chinese Taipei    | 4.82  | 6.99  | 8.94  | 6.83   | 11.34 | 9.99   | 9.51   | 9.11   |
| Thailand          | -4.33 | 1.12  | 6.35  | 0.60   | 7.69  | 3.55   | 2.54   | 1.72   |
| United States     | -5.92 | -5.99 | -5.11 | -4.66  | -2.68 | -3.19  | -2.64  | -2.65  |
| Vietnam           | -1.06 | -0.27 | -9.83 | -11.95 | -7.99 | -8.34  | -8.06  | -7.76  |

Source: IMF WEO downloaded on 7 October 2010, current account balance US\$ billions

### Weights for GDP Growth

|                   | APEC   | PECC   | PECC ex China, Japan, US | Asia-Pacific |
|-------------------|--------|--------|--------------------------|--------------|
| Australia         | 3.18%  | 3.30%  | 14.21%                   | 3.15%        |
| Brunei Darussalam | 0.04%  | 0.04%  | 0.18%                    | 0.04%        |
| Canada            | 4.51%  | 4.68%  | 20.15%                   | 4.47%        |
| Chile             | 0.53%  | 0.55%  | 2.35%                    | 0.52%        |
| China             | 13.77% | 14.28% |                          | 13.65%       |
| Colombia          |        | 0.74%  | 3.20%                    | 0.71%        |
| Ecuador           |        | 0.17%  | 0.73%                    | 0.16%        |
| Hong Kong (China) | 0.67%  | 0.70%  | 2.99%                    | 0.66%        |
| Indonesia         | 1.57%  | 1.63%  | 7.01%                    | 1.56%        |
| Japan             | 15.18% | 15.75% |                          | 15.05%       |
| Korea             | 2.98%  | 3.09%  | 13.31%                   | 2.95%        |
| Malaysia          | 0.64%  | 0.66%  | 2.85%                    | 0.63%        |
| Mexico            | 3.17%  | 3.29%  | 14.14%                   | 3.14%        |
| Mongolia          |        | 0.01%  | 0.06%                    | 0.01%        |
| New Zealand       | 0.40%  | 0.42%  | 1.80%                    | 0.40%        |
| Papua New Guinea  | 0.02%  |        |                          | 0.02%        |
| Peru              | 0.38%  | 0.40%  | 1.71%                    | 0.38%        |
| Philippines       | 0.50%  | 0.52%  | 2.23%                    | 0.50%        |
| Russia            | 4.45%  |        |                          | 4.41%        |
| Singapore         | 0.59%  | 0.61%  | 2.61%                    | 0.58%        |
| Chinese Taipei    | 1.24%  | 1.29%  | 5.55%                    | 1.23%        |
| Thailand          | 0.83%  | 0.86%  | 3.71%                    | 0.82%        |
| United States     | 45.07% | 46.75% |                          | 44.67%       |
| Vietnam           | 0.27%  | 0.28%  | 1.20%                    | 0.27%        |

#### Notes:

- Data for members of both PECC and APEC are included here and form the aggregate "Asia-Pacific"
- Members of PECC who are not members of APEC are: Colombia, Ecuador and Mongolia
- Members of APEC who are not members of PECC are Papua New Guinea and Russia
- The weights are based on GDP in US\$ at current prices for the past 3 years

# Chapter 2

## Survey of Opinion Leaders

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## Survey of Opinion Leaders

As discussed in the previous chapter, economic growth in the region rebounded in 2009-2010. Much of this growth, however, has come as a result of large fiscal and monetary stimulus measures implemented by governments in response to the crisis. Last year's *State of the Region* report outlined the strategies employed to rebalance economic growth in the Asia-Pacific. These strategies are the focus of debate for G20 leaders when they meet in Seoul and APEC leaders in Yokohama.

This chapter contains the results of a survey of more than 400 opinion leaders from government, business and the non-government sectors (primarily the research community) conducted between 16 September to 16 October 2010. This survey is not one of public opinion, but rather of those who lead opinions. Respondents include senior officials, business leaders, media commentators, and leading scholars/analysts. For the details of all of the questions please see the tables.

### Priority Issues for Yokohama

When APEC leaders gather in Yokohama for their meeting on November 13-14, they will be faced with a large ongoing agenda for regional cooperation. They will also be meeting just a day after G20 leaders conclude their meetings in Seoul. We asked opinion leaders what they thought the top 5 priorities for APEC leaders should be from a list of 22 possible issues covering the range of work that APEC addresses through its various working groups and committees.

The top 5 five issues were:

- A post-crisis growth strategy for the region
- A Free Trade Area of the Asia-Pacific
- The WTO Doha Development Round
- Financial sector regulatory reform
- The region's response to climate change

Of the top 5 issues selected by respondents, three are regional in nature – a Free Trade Area for the Asia-Pacific, the region's response to climate change and a post-crisis growth strategy for the region. The other two, the WTO Doha Round and financial sector regulatory reform are global in nature.

These priorities are little changed from last year's survey results below with the exception of the Free Trade Area of the Asia-Pacific:

- Continued action on the economic crisis;
- Regulation of the financial sector;
- Restarting the Doha process;
- Climate change and the Copenhagen Deal; and
- Reducing the cost of doing business

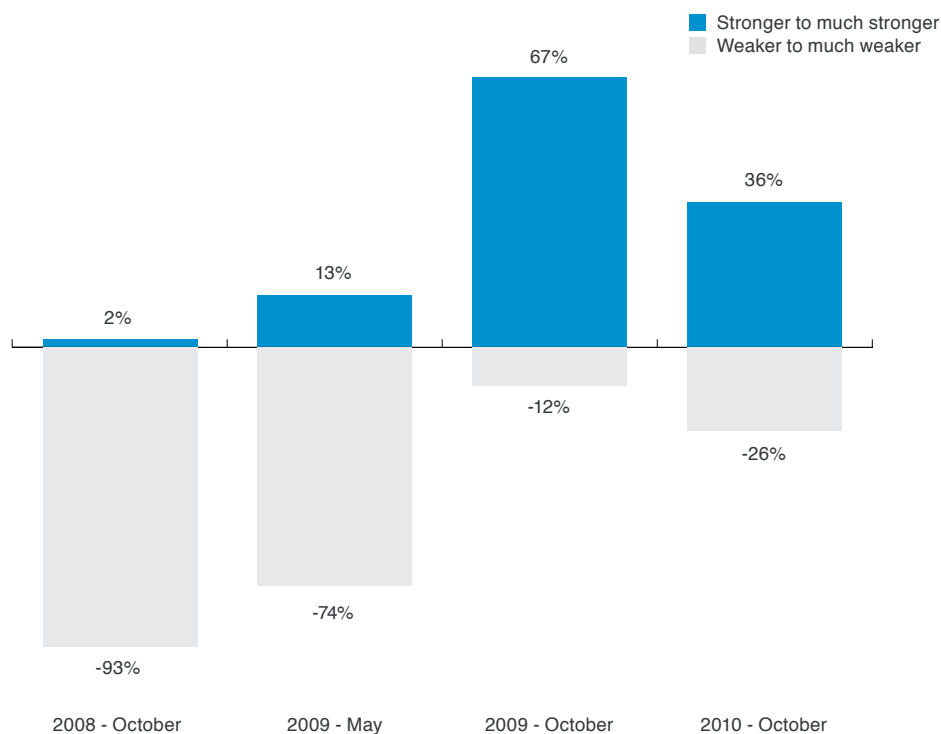
Deeper analysis of the findings shows some interesting divergences between respondents from business, government and the non-government sectors. Business and government respondents placed the Free Trade Area of the Asia-Pacific as the top agenda item for APEC leaders while respondents from the non-government sector prioritized the post-crisis growth strategy for the region. Both business and non-government respondents thought that leaders should focus on APEC reform and institutional strengthening instead of the region's response to climate change.



## Optimism on the Wane

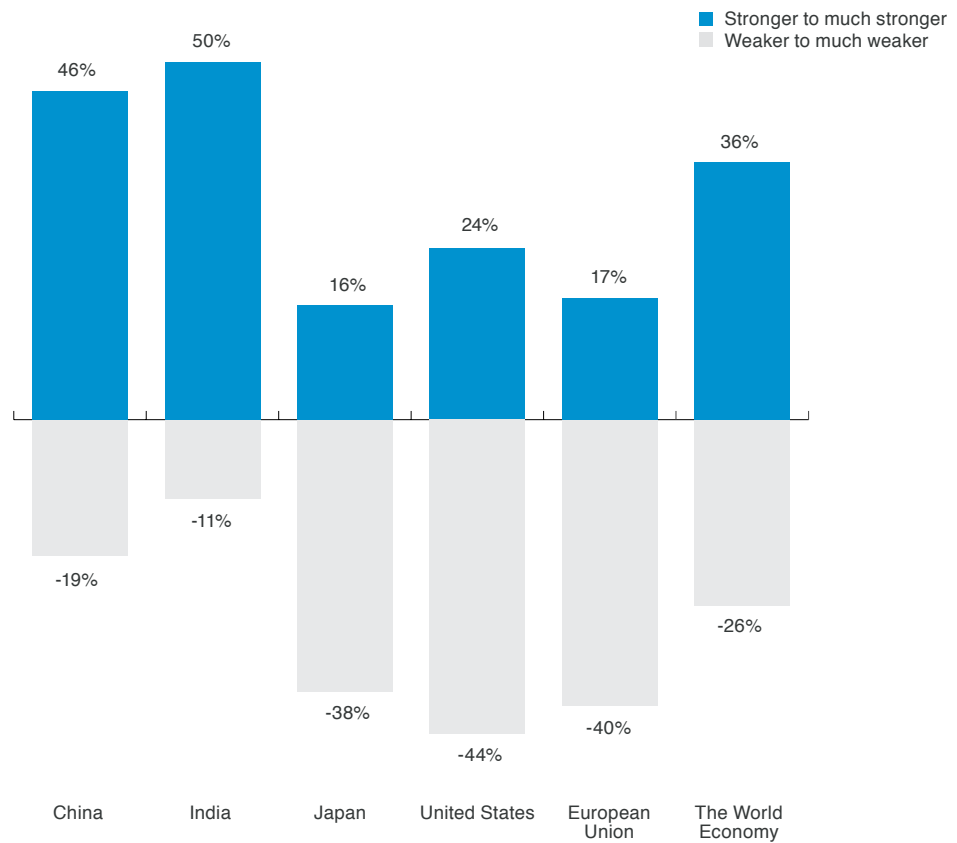
Across the Asia-Pacific region opinion leaders are less optimistic about the prospects for growth over the next year than they were in the last *State of the Region* survey in October 2009. Respondents were equivocal about their expectations for growth over the next 12 months. Thirty-six percent of respondents expected global growth to be stronger over the next 12 months compared to 26 percent who thought it would be weaker.

**Chart 1: Expectations for growth of the global economy: in October 2008, May 2009, October 2009 and October 2010**  
(% respondents who thought economic growth for the global economy would be weaker to much weaker and stronger to much stronger)



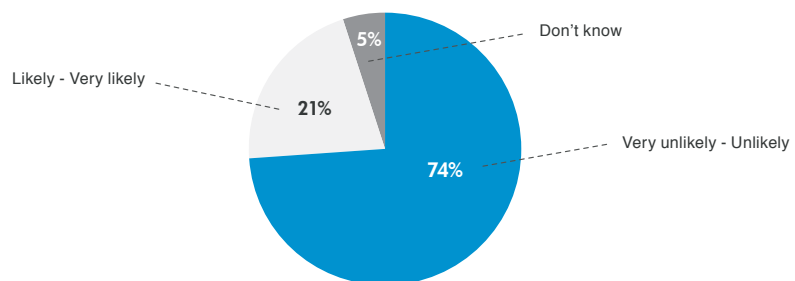
However, what was notable was that respondents around the region are much more positive about the prospects for growth in China and India. In contrast, respondents were pessimistic about the growth outlook for the United States and Japan, with about twice as many respondents expecting “weaker to much weaker” growth in those countries than those who were expecting “stronger to much stronger” growth.

**Chart 2: What are your expectations for economic growth over the next 12 months compared to the last 12?**  
 (% respondents who thought economic growth in the following economies/regions would be stronger to much stronger)



While hopes for a sustained recovery have tempered somewhat in the last year, respondents were nevertheless confident that the world economy would not experience a “double dip” recession. Seventy four percent of respondents said a global recession in the next 12 months was “unlikely” or “very unlikely”.

**Chart 3: What is the likelihood of another global recession in the next 12 months?**



## Risks to Growth

From a list of 20 items, respondents were asked to rate the top sources of risks to growth for their economies over the next 2-3 years. The top 5 risks were identified as follows: slower growth in the US economy; high energy prices; protectionism; high food prices; and a sovereign debt crisis in the Euro-zone.

**Table 1: Risks to Growth** (1=very low risk, 5=very high risk)

|  |      |
|--|------|
| Slower growth in the US economy          | 3.54 |
| High energy prices                       | 3.30 |
| Protectionism                            | 3.21 |
| High food prices                         | 3.07 |
| A sovereign debt crisis in the Euro-zone | 3.02 |
| Slower growth in the Japanese economy    | 3.00 |
| Shortage of available talent/skills      | 2.98 |
| Slower growth in the Chinese economy     | 2.90 |
| Deterioration in US-China relations      | 2.84 |
| Current account imbalances               | 2.81 |

## Balanced and Sustainable Growth and Responses to the Global Economic Crisis

A detailed discussion of the challenges to balanced and sustainable growth in the region is found in chapter 1. We tested some of the policy prescriptions for balanced and sustainable growth with survey respondents.

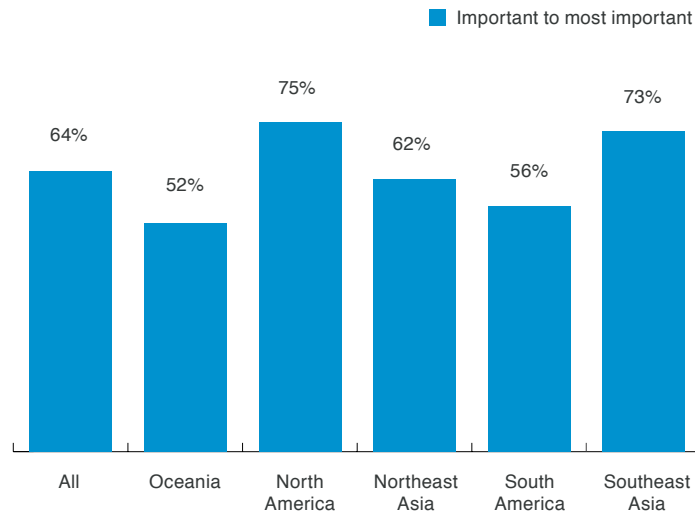
**Table 2: Policy Objectives for Achieving Sustained Growth in the Asia-Pacific over the next 5 years** (1=least important, 5=most important)

|  | All  |
|--|------|
| Strengthening financial regulations across the world   | 3.80 |
| Rebalancing growth towards greater emphasis on domestic demand in East Asian economies                   | 3.73 |
| Reducing the US fiscal and current account deficits  | 3.61 |
| Increasing final goods trade among Asian economies   | 3.52 |
| Increasing exchange rate flexibility   | 3.33 |
| Replacing the US dollar with other currencies and/or special drawing rights in foreign exchange reserves | 2.44 |

The most important policy objective was the strengthening of financial regulations followed by increasing domestic demand in East Asia and reducing the US fiscal and current account deficits. Of note is the strong consensus around the region on the importance of increasing domestic demand in East Asia. Currency “fixes” were not considered as important, with “exchange rate flexibility” and “replacing the US dollar with other currencies” ranked much lower.

**Chart 4: Rebalancing growth towards greater emphasis on domestic demand in East Asian economies**

(% respondents who rated this as the most important or next most important policy objective for achieving sustained growth in the Asia-Pacific region over the next 5 year)



We also asked respondents about the actions that should be taken to rebalance growth in the Asia-Pacific region.

**Table 3: Actions to Rebalance Growth in the Asia-Pacific (1=least important, 5=most important)**

|   | All  | Business | Government | Non - government |
|---|------|----------|------------|------------------|
| The implementation of structural reforms                                      | 3.74 | 3.65     | 3.80       | 3.75             |
| The liberalization of investment policies                                     | 3.66 | 3.87     | 3.58       | 3.59             |
| The liberalization of the service sector                                      | 3.65 | 3.63     | 3.64       | 3.65             |
| Increased investment in social spending such as education and health programs | 3.63 | 3.76     | 3.64       | 3.57             |
| Enhanced social safety nets   | 3.61 | 3.54     | 3.44       | 3.71             |
| Investment in physical infrastructure   | 3.58 | 3.88     | 3.48       | 3.50             |
| The conclusion of the WTO Doha Development Round                              | 3.40 | 3.39     | 3.50       | 3.37             |
| Greater flexibility in labor markets  | 3.37 | 3.67     | 3.33       | 3.26             |
| An agreement on environmental goods and services                              | 3.20 | 3.18     | 3.17       | 3.22             |

The implementation of structural reforms ranked as the most important action to rebalance growth followed by investment liberalization, service sector liberalization, and increased spending on social priorities. However, business respondents had a slightly different sense of priorities ranking investment in physical infrastructure as the most important and including flexibility in labor markets as a top action.

The above results validate APEC's focus on structural reform issues as a key component of the new growth strategy described in chapter 1.

We further asked respondents to rate various components of structural reform in their economies.

**Table 4: Components of Structural Reform** (1=not important, 5=very important)

|                                 | All  | Oceania | North America | Northeast Asia | South America | Southeast Asia |
|---------------------------------|------|---------|---------------|----------------|---------------|----------------|
| Corporate governance            | 3.76 | 3.29    | 3.44          | 3.79           | 3.94          | 4.18           |
| A transparent legal environment | 3.72 | 2.81    | 3.18          | 3.91           | 3.83          | 4.34           |
| Financial sector reform         | 3.58 | 3.33    | 3.52          | 3.74           | 3.31          | 3.67           |
| Enhanced social safety nets     | 3.56 | 2.38    | 3.24          | 3.81           | 3.94          | 3.95           |
| Competition policy              | 3.53 | 3.37    | 3.32          | 3.53           | 3.63          | 3.75           |
| Labor market reform             | 3.47 | 3.35    | 3.14          | 3.43           | 3.90          | 3.65           |

For all sub-sectors of respondents (business, government, and non-government), the top three components were corporate governance; a transparent legal environment; and financial sector reform. However there was considerable variation between sub-regions on the relative importance of each component.

Southeast and Northeast Asians for example ranked a transparent legal environment as the most important whereas North Americans ranked financial sector reform as the most important.

We also asked opinion leaders to consider some of the challenges in implementing structural reform in their economies. Southeast Asians and North Americans ranked the problem of entrenched interests particularly high whereas in Australia/New Zealand and South America, the biggest perceived problem was the “lack of understanding about the benefits of structural reform”.

**Table 5: Challenges to Structural Reform** (1=no challenge, 2=small challenge, 3=moderate challenge, 4=major challenge, 5=very major challenge)

|  | All  | Oceania | North America | Northeast Asia | South America | Southeast Asia |
|--|------|---------|---------------|----------------|---------------|----------------|
| Entrenched interests oppose change                             | 3.85 | 3.62    | 4.23          | 3.83           | 3.31          | 4.02           |
| The lack of understanding of the benefits of structural reform | 3.71 | 3.73    | 3.85          | 3.61           | 3.73          | 3.73           |
| Benefits are diffuse while the costs are concentrated          | 3.30 | 3.40    | 3.61          | 3.19           | 3.10          | 3.28           |

## Regional Economic Integration and Cooperation

We asked respondents to rate the biggest challenges to doing business in the Asia-Pacific region, drawing on a list of eight issues. Poor intellectual property rights protection was identified as the top issue, with respondents from Northeast Asia and the business community taking a particularly strong view on this issue.

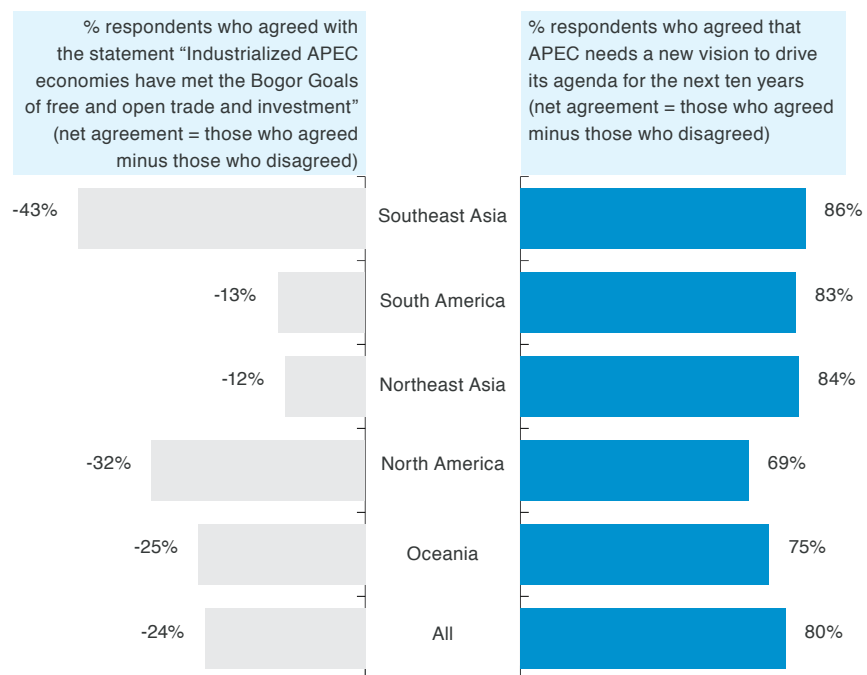
**Table 6: Challenges to doing business in the Asia-Pacific** (1=least important, 5=most important)

|  | All  |
|--|------|
| Poor intellectual property rights protection                   | 3.68 |
| Multiple standards for products and services across the region | 3.60 |
| Regulatory impediments to operating in overseas markets        | 3.55 |
| Complex rules of origin  | 3.41 |
| Protectionism in emerging markets                              | 3.34 |
| Protectionism in developed market economies                    | 3.29 |
| Lack of openness to foreign direct investment                  | 3.26 |
| Inflexible labor markets                                       | 3.10 |

This year marks the first of the Bogor target dates, when industrialized APEC member economies are supposed to have achieved “free and open trade and investment”. We posed a number of questions related to the APEC’s regional integration and cooperation agenda. As in the previous two SOTR reports, we also present in chapter 3 an updated measure of regional economic integration in the Asia-Pacific region, using a specially constructed index of integration.

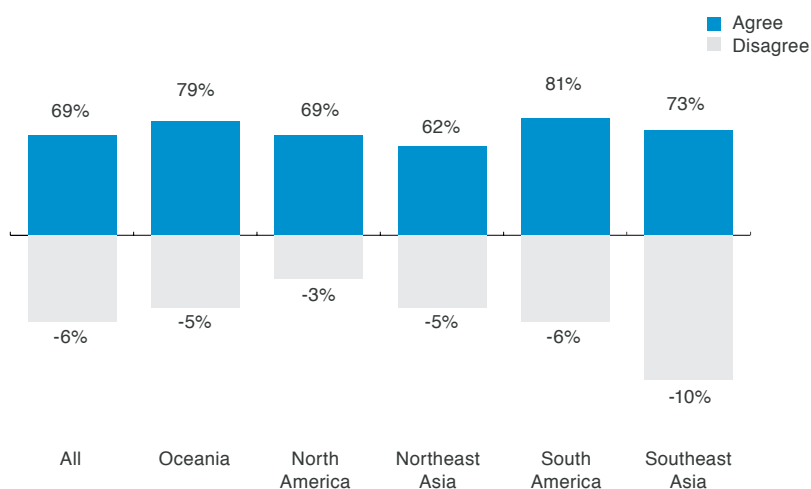
In spite of the considerable achievements made in the region in lowering tariffs and non-tariff barriers, opinion leaders are unconvinced that the industrialized economies have met the Bogor Goals of free and open trade and investment.

**Chart 5: Bogor Goals and New Agenda**



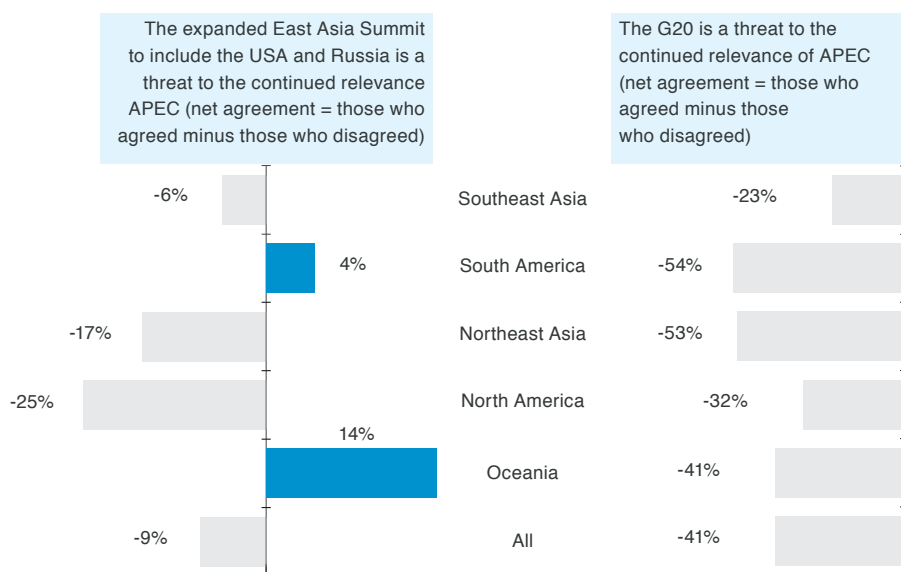
While there was little agreement that the Bogor Goals have been met, there was, in contrast, near unanimous agreement that APEC needs a new vision to drive its agenda for the next 10 years. Likewise there was also wide support for the region to pursue economic integration on multiple tracks including the “ASEAN plus” agreements and the Trans-Pacific Partnership.

**Chart 6: Regional economic integration should be pursued on multiple tracks including the ASEAN plus agreements and an expanded Trans-Pacific Partnership (% respondents who agree/disagree)**



Prior to the economic crisis, the APEC Leaders’ Meeting was the only annual event where leaders of world’s three biggest economies – the United States, China, and Japan – would meet on a regular basis. With the institutionalization of the G20 leaders process and the expansion of the East Asia Summit to include Russia and the United States, APEC has lost this monopoly. We asked opinion leaders whether they thought the expanded EAS and the G20 were ‘threats’ to APEC’s continued relevance.

**Chart 7: Regional and Global Institutions**



Regional opinion leaders did not see these developments as threatening APEC, with the exception of respondents from Australia & New Zealand and South America who expressed concerns about the expansion of the East Asian Summit for the future relevance of APEC.

### Importance of APEC Activities

We also asked respondents to consider the importance of various APEC activities. The Trade Ministers' Meeting ranked as the most important followed by the Leaders' Meeting. The individual action plans and peer review process – which are in many ways seen as signature APEC activities based on the principle of concerted unilateral liberalization – were ranked as the least important.

**Table 7: Importance of Various APEC Activities** (1=not important, 5=very important)

|                                     | All  |
|-------------------------------------|------|
| Trade Ministers' Meetings           | 3.95 |
| Annual Leaders' Meetings            | 3.86 |
| Trade facilitation                  | 3.85 |
| Trade and investment liberalization | 3.83 |
| Economic and technical cooperation  | 3.75 |
| Finance Ministers' Meetings         | 3.68 |
| Committee/Working Group meetings    | 3.47 |
| APEC CEO Summit                     | 3.24 |
| Individual Action Plans             | 3.04 |
| Peer Review                         | 3.02 |



## Annex B

### Respondent Profile

The panelists were selected by PECC's member committees from academe, business, government, and civil society on the basis of their level of knowledge of the Asia-Pacific region. The criteria given for the selection of panelists were as follows:

#### Government

Panelists should be either decision-makers or senior advisors to decision-makers. As a guide, the government respondents last year included a number of former and current Ministers, Deputy and Vice-Ministers, Central Bank Governors and their advisors for Asia-Pacific issues, current APEC Senior Officials, and a number of former APEC Senior Officials.

#### Business

Panelists should be from companies who have operations in a number of Asia-Pacific economies or conduct business with a number of partners from the region, this might include each economy's current ABAC members as well as past ABAC members.

#### Non-Government: Research Community / Civil Society / Media

Panelists should be well-versed in Asia-Pacific affairs, being the type of individuals whom the governments, businesses, and the media would tap into to provide input on issues related to Asia-Pacific cooperation. These include presidents of institutes concerned with Asia-Pacific issues, heads of departments, senior professors, and correspondents covering international affairs.

| Sector         | No. of respondents |
|----------------|--------------------|
| Business       | 101                |
| Government     | 87                 |
| Non-government | 234                |
| Total          | 422                |

For this survey we define those sub-regions as:

- Oceania: Australia and New Zealand
- North America: Canada, United States and Mexico
- Northeast Asia: China, Japan, Hong Kong (China), Korea, Mongolia, Russia and Chinese Taipei
- South America: Chile, Colombia, Ecuador and Peru
- Southeast Asia: Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam

| Sub-Region     | No. of respondents |
|----------------|--------------------|
| Oceania        | 56                 |
| North America  | 77                 |
| Northeast Asia | 156                |
| South America  | 48                 |
| Southeast Asia | 84                 |
| Other          | 1                  |
| Total          | 422                |

## Growth Agenda and Economic Crisis

What are your expectations for economic growth over the next 12 months compared to the last year?

|                          | Much Weaker | Somewhat weaker | About the same | Somewhat stronger | Much stronger | Don't know / No response | Total |
|--------------------------|-------------|-----------------|----------------|-------------------|---------------|--------------------------|-------|
| China                    | 1%          | 18%             | 34%            | 32%               | 14%           | 0%                       | 100%  |
| India                    | 0%          | 11%             | 36%            | 38%               | 11%           | 3%                       | 100%  |
| Japan                    | 6%          | 32%             | 45%            | 15%               | 1%            | 1%                       | 100%  |
| United States of America | 6%          | 37%             | 32%            | 23%               | 1%            | 1%                       | 100%  |
| European Union           | 6%          | 34%             | 34%            | 16%               | 1%            | 9%                       | 100%  |
| The World Economy        | 1%          | 25%             | 36%            | 35%               | 1%            | 1%                       | 100%  |

What is the likelihood of another global recession in the next 12 months?

| Very unlikely | Unlikely | Likely | Very likely | Don't know | Total |
|---------------|----------|--------|-------------|------------|-------|
| 6%            | 68%      | 19%    | 2%          | 5%         | 100%  |

How do you rate the following risks to growth for your economy over the next 2-3 years?

(Please use a scale of 1-5, with 1 representing a very low risk and 5 a very high risk)

|   | 1<br>Very low risk | 2   | 3   | 4   | 5<br>Very high risk | Don't know / No response | Total |
|---|--------------------|-----|-----|-----|---------------------|--------------------------|-------|
| Slower growth in the US economy           | 1%                 | 11% | 30% | 40% | 15%                 | 4%                       | 100%  |
| High energy prices                        | 3%                 | 19% | 30% | 35% | 10%                 | 3%                       | 100%  |
| Protectionism                             | 7%                 | 17% | 32% | 31% | 10%                 | 3%                       | 100%  |
| High food prices                          | 6%                 | 24% | 26% | 36% | 5%                  | 4%                       | 100%  |
| A sovereign debt crisis in the Euro-zone  | 4%                 | 20% | 37% | 27% | 7%                  | 6%                       | 100%  |
| Slower growth in the Japanese economy     | 5%                 | 26% | 33% | 25% | 7%                  | 4%                       | 100%  |
| Shortage of available talent/skills       | 7%                 | 24% | 29% | 28% | 7%                  | 5%                       | 100%  |
| Slower growth in the Chinese economy      | 9%                 | 30% | 27% | 25% | 7%                  | 3%                       | 100%  |
| Deterioration in US-China relations       | 8%                 | 27% | 34% | 24% | 4%                  | 4%                       | 100%  |
| Current account imbalances                | 9%                 | 26% | 29% | 24% | 6%                  | 6%                       | 100%  |
| Natural disasters                         | 13%                | 22% | 28% | 19% | 11%                 | 6%                       | 100%  |
| Global warming                            | 15%                | 22% | 31% | 21% | 7%                  | 4%                       | 100%  |
| Political tensions in the South China Sea | 16%                | 23% | 28% | 22% | 6%                  | 4%                       | 100%  |
| Sharp fall in asset prices                | 6%                 | 35% | 34% | 16% | 5%                  | 4%                       | 100%  |
| Premature exit from stimulus policies     | 8%                 | 27% | 36% | 19% | 4%                  | 7%                       | 100%  |
| Banking/financial sector crisis           | 14%                | 29% | 29% | 18% | 6%                  | 4%                       | 100%  |
| Terrorist acts                            | 14%                | 25% | 32% | 18% | 6%                  | 6%                       | 100%  |
| North Korea                               | 17%                | 25% | 23% | 21% | 8%                  | 7%                       | 100%  |
| Water pollution and shortages             | 18%                | 27% | 26% | 20% | 6%                  | 4%                       | 100%  |
| A health pandemic                         | 19%                | 37% | 23% | 11% | 2%                  | 9%                       | 100%  |

**Please rate the importance of the following policy objectives for achieving sustained growth in the Asia-Pacific region over the next 5 years.** (Please use a scale of 1-5, with 1 representing the least important and 5 the most important)

|  | 1<br>Least<br>important | 2   | 3   | 4   | 5<br>Most<br>important | Don't<br>know / No<br>response | Total |
|--|-------------------------|-----|-----|-----|------------------------|--------------------------------|-------|
| Strengthening financial regulations across the world   | 1%                      | 8%  | 22% | 41% | 25%                    | 4%                             | 100%  |
| Rebalancing growth towards greater emphasis on domestic demand in East Asian economies                   | 1%                      | 8%  | 22% | 41% | 23%                    | 5%                             | 100%  |
| Reducing the US fiscal and current account deficits  | 1%                      | 10% | 26% | 38% | 20%                    | 5%                             | 100%  |
| Increasing final goods trade among Asian economies   | 1%                      | 11% | 29% | 41% | 14%                    | 4%                             | 100%  |
| Increasing exchange rate flexibility   | 4%                      | 13% | 34% | 33% | 12%                    | 5%                             | 100%  |
| Replacing the US dollar with other currencies and/or special drawing rights in foreign exchange reserves | 23%                     | 32% | 23% | 13% | 6%                     | 4%                             | 100%  |

**Please rank the following actions in terms of their importance to rebalancing growth in the Asia-Pacific region.** (Please use a scale of 1-5, with 1 representing the least important and 5 the most important)

|   | 1<br>Least<br>important | 2   | 3   | 4   | 5<br>Most<br>important | Don't<br>know / No<br>response | Total |
|---|-------------------------|-----|-----|-----|------------------------|--------------------------------|-------|
| The implementation of structural reforms                                      | 0%                      | 7%  | 25% | 42% | 20%                    | 5%                             | 100%  |
| The liberalization of investment policies                                     | 1%                      | 7%  | 28% | 42% | 17%                    | 5%                             | 100%  |
| The liberalization of the service sector                                      | 1%                      | 8%  | 28% | 45% | 14%                    | 4%                             | 100%  |
| Increased investment in social spending such as education and health programs | 1%                      | 5%  | 17% | 40% | 26%                    | 11%                            | 100%  |
| Enhanced social safety nets   | 1%                      | 10% | 27% | 41% | 17%                    | 5%                             | 100%  |
| Investment in physical infrastructure   | 0%                      | 6%  | 20% | 37% | 24%                    | 11%                            | 100%  |
| The conclusion of the WTO Doha Development Round                              | 2%                      | 18% | 26% | 27% | 21%                    | 6%                             | 100%  |
| Greater flexibility in labor markets  | 3%                      | 11% | 32% | 38% | 10%                    | 6%                             | 100%  |
| An agreement on environmental goods and services                              | 5%                      | 18% | 32% | 31% | 10%                    | 5%                             | 100%  |

**Please rate the importance of the following components of structural reform in your economy.** (Please use a scale of 1-5, with 1 representing not important and 5 very important)

|                                 | 1<br>Not<br>important | 2   | 3   | 4   | 5<br>Very<br>important | Don't<br>know / No<br>response | Total |
|---------------------------------|-----------------------|-----|-----|-----|------------------------|--------------------------------|-------|
| Corporate governance            | 2%                    | 8%  | 24% | 38% | 23%                    | 5%                             | 100%  |
| A transparent legal environment | 6%                    | 9%  | 19% | 32% | 29%                    | 5%                             | 100%  |
| Financial sector reform         | 3%                    | 12% | 26% | 34% | 20%                    | 5%                             | 100%  |
| Enhanced social safety nets     | 4%                    | 14% | 23% | 31% | 23%                    | 4%                             | 100%  |
| Competition policy              | 3%                    | 12% | 29% | 31% | 20%                    | 5%                             | 100%  |
| Labor market reform             | 3%                    | 14% | 29% | 34% | 16%                    | 5%                             | 100%  |

Please rate the following in terms of the challenge that they pose to structural reform in your economy.

|  | 1<br>No<br>challenge | 2<br>Small<br>challenge | 3<br>Moderate<br>challenge | 4<br>Major<br>challenge | 5<br>Very<br>major<br>challenge | Don't<br>know / No<br>response | Total |
|--|----------------------|-------------------------|----------------------------|-------------------------|---------------------------------|--------------------------------|-------|
| Entrenched interests oppose change                             | 1%                   | 6%                      | 24%                        | 31%                     | 32%                             | 6%                             | 100%  |
| The lack of understanding of the benefits of structural reform | 2%                   | 9%                      | 24%                        | 36%                     | 23%                             | 5%                             | 100%  |
| Benefits are diffuse while the costs are concentrated          | 2%                   | 11%                     | 34%                        | 32%                     | 13%                             | 9%                             | 100%  |

## Regional Cooperation and Integration

**What are the biggest challenges to doing business in the Asia-Pacific region?**

*(Please use a scale of 1-5, with 1 representing the least important and 5 the most important)*

|  | 1<br>Least<br>important | 2   | 3   | 4   | 5<br>Most<br>important | Don't<br>know / No<br>response | Total |
|--|-------------------------|-----|-----|-----|------------------------|--------------------------------|-------|
| Poor intellectual property rights protection                   | 0%                      | 9%  | 31% | 36% | 19%                    | 5%                             | 100%  |
| Multiple standards for products and services across the region | 1%                      | 8%  | 35% | 37% | 14%                    | 5%                             | 100%  |
| Regulatory impediments to operating in overseas markets        | 1%                      | 7%  | 37% | 38% | 11%                    | 5%                             | 100%  |
| Complex rules of origin  | 2%                      | 12% | 38% | 31% | 12%                    | 5%                             | 100%  |
| Protectionism in emerging markets                              | 2%                      | 18% | 32% | 35% | 9%                     | 5%                             | 100%  |
| Protectionism in developed market economies                    | 6%                      | 17% | 28% | 32% | 12%                    | 5%                             | 100%  |
| Lack of openness to foreign direct investment                  | 2%                      | 14% | 42% | 30% | 7%                     | 5%                             | 100%  |
| Inflexible labor markets                                       | 5%                      | 18% | 40% | 25% | 6%                     | 6%                             | 100%  |

Please indicate your agreement or disagreement with the following statements.

|  | Strongly disagree | Disagree | Neither agree or disagree | Agree | Strongly Agree | Don't know / No response | Total |
|--|-------------------|----------|---------------------------|-------|----------------|--------------------------|-------|
| Industrialized APEC economies have met the Bogor Goals of free and open trade and investment   | 9%                | 34%      | 21%                       | 18%   | 1%             | 17%                      | 100%  |
| APEC needs a new vision to drive to its agenda for the next ten years  | 0%                | 2%       | 8%                        | 45%   | 37%            | 6%                       | 100%  |
| The expanded East Asia Summit to include the USA and Russia is a threat to the continued relevance APEC  | 8%                | 32%      | 22%                       | 23%   | 8%             | 8%                       | 100%  |
| The G20 is a threat to the continued relevance of APEC   | 13%               | 45%      | 19%                       | 14%   | 3%             | 7%                       | 100%  |
| APEC is as important today as it was in 1989   | 7%                | 23%      | 22%                       | 31%   | 9%             | 7%                       | 100%  |
| India should be a member of APEC   | 5%                | 14%      | 20%                       | 37%   | 16%            | 8%                       | 100%  |
| The Asia-Pacific needs a forum for Leaders to discuss political and security issues  | 3%                | 12%      | 15%                       | 37%   | 26%            | 7%                       | 100%  |
| The expanded Trans-Pacific Partnership (TPP) is the best pathway to a region-wide trade area   | 4%                | 9%       | 32%                       | 26%   | 11%            | 18%                      | 100%  |
| The ASEAN plus agreements are the best pathway to region-wide trade area   | 3%                | 16%      | 34%                       | 30%   | 8%             | 10%                      | 100%  |
| Regional economic integration should be pursued on multiple tracks including the ASEAN plus agreements and an expanded Trans-Pacific Partnership | 1%                | 4%       | 17%                       | 45%   | 25%            | 8%                       | 100%  |
| The practice of an annual APEC leaders meeting should be abandoned   | 25%               | 35%      | 13%                       | 8%    | 4%             | 15%                      | 100%  |

Please rate the following regional groupings in terms of their effectiveness in the following areas, using a scale of 1-5. (1 – not effective, 5 – highly effective, DK – don't know)

|   | ASEAN | East Asia Summit | APEC | ASEAN Regional Forum |
|---|-------|------------------|------|----------------------|
| Liberalization and facilitation of trade and investment                       | 2.98  | 1.99             | 3.03 | 1.95                 |
| Political and security dialogue   | 2.84  | 2.45             | 2.31 | 2.73                 |
| Economic cooperation / technical assistance                                   | 2.89  | 2.23             | 3.14 | 2.08                 |
| An opportunity for leaders to discuss immediate issues facing their economies | 3.39  | 2.96             | 3.55 | 2.62                 |
| Community Building  | 3.24  | 2.26             | 2.74 | 2.27                 |
| Addressing the needs of the business community                                | 2.62  | 2.07             | 3.00 | 1.90                 |

## APEC

Please rank the importance of APEC activities in the following areas. (Please use a scale of 1-5, with 5 representing very important and 1 not important. Please select DK if you are not sure)

|                                     | 1<br>Not<br>important | 2   | 3   | 4   | 5<br>Very<br>important | Don't<br>know / No<br>response | Total |
|-------------------------------------|-----------------------|-----|-----|-----|------------------------|--------------------------------|-------|
| Trade Ministers' Meetings           | 1%                    | 4%  | 15% | 33% | 36%                    | 10%                            | 100%  |
| Annual Leaders' Meetings            | 3%                    | 9%  | 14% | 24% | 40%                    | 10%                            | 100%  |
| Trade facilitation                  | 1%                    | 5%  | 16% | 36% | 31%                    | 11%                            | 100%  |
| Trade and investment liberalization | 1%                    | 7%  | 20% | 30% | 32%                    | 10%                            | 100%  |
| Economic and technical cooperation  | 1%                    | 7%  | 18% | 37% | 26%                    | 11%                            | 100%  |
| Finance Ministers' Meetings         | 1%                    | 6%  | 22% | 41% | 20%                    | 10%                            | 100%  |
| Committee/Working Group meetings    | 2%                    | 7%  | 21% | 38% | 18%                    | 14%                            | 100%  |
| APEC CEO Summit                     | 3%                    | 13% | 24% | 34% | 13%                    | 13%                            | 100%  |
| Individual Action Plans             | 3%                    | 14% | 26% | 25% | 14%                    | 17%                            | 100%  |
| Peer Review                         | 2%                    | 12% | 27% | 29% | 12%                    | 18%                            | 100%  |

What do you think should be the top 5 priorities for APEC Leaders to discuss at their upcoming meeting in Yokohama? (Please select only five (5) issues, using a scale of 1-5, please write 1 for the issue you think is most important, 2 for the next most important issue and so on)

|   |  |    |  |    |  |    |  |
|---|--|----|--|----|--|----|--|
| 1 | A post-crisis growth strategy for the region | 7  | Post crisis exit strategies  | 13 | Reducing costs of business by cutting red tape         | 19 | The implications of the expanded East Asia Summit for APEC |
| 2 | A Free Trade Area of the Asia-Pacific        | 8  | The expansion of the Trans-Pacific Partnership to include more members | 14 | Trans-Pacific imbalances and exchange rate adjustments | 20 | Emergency preparedness                                     |
| 3 | The WTO Doha Development Round               | 9  | Managing the proliferation of preferential trade agreements            | 15 | Protecting intellectual property rights                | 21 | Corporate social responsibility                            |
| 4 | Financial sector regulatory reform           | 10 | Energy security  | 16 | Reducing corruption                                    | 22 | Terrorism  |
| 5 | The region's response to climate change      | 11 | Investment in physical infrastructure to facilitate trade              | 17 | Labor mobility   | 23 | Inflation  |
| 6 | APEC reform / institutional strengthening    | 12 | Food security  | 18 | Expansion of APEC membership                           |    |  |

# Chapter 3

A Composite Index of Economic  
Integration in the Asia-Pacific

# Chapter 3

## A Composite Index of Economic Integration in the Asia-Pacific

In the closing months of 2010, the Asia-Pacific Economic Cooperation (APEC) forum is rapidly approaching the first of its Bogor target deadlines for establishing “free and open trade” amongst its developed member economies. Since APEC has not defined “free and open trade”, there are potentially many different ways to measure its success in achieving this target.

In an attempt to provide additional clarity, the Pacific Economic Cooperation Council (PECC) has created a measure of economic integration across 17 APEC economies (data was not available for Brunei Darussalam, Papua New Guinea, Peru, and Russia). The PECC Composite Index of Asia-Pacific Economic Integration tracks both the extent to which the economies are becoming more alike in their economic characteristics (i.e. “convergence” measures) and the relative importance of regional trade, investment and human flows compared to economic relations with the rest of the world.

The index was first unveiled in 2008, using data up to 2005, and it has since been updated to include 2007 data.

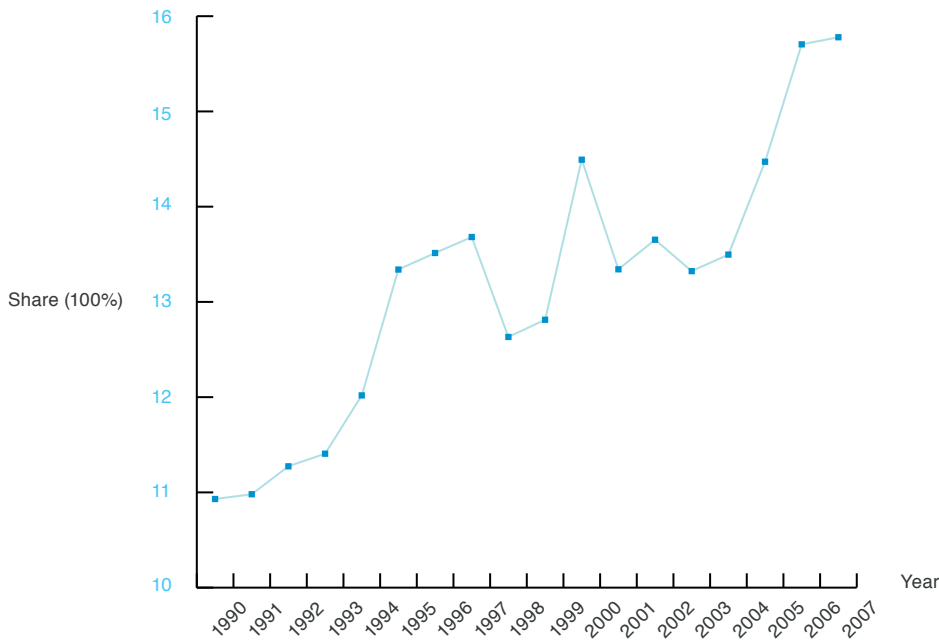
Major findings of the 2010 Composite Index of Asia-Pacific Economic Integration include:

- Overall, the APEC economies were more integrated at the end of 2007 than in 2006. The composite index for the region as a whole increased from 9.72 in 2006 to 11.18 in 2007, approaching levels of integration not seen since 2000.
- Despite enhanced economic integration, economic disparity in the region has been increasing since 1999, reaching a new high of inequality in 2007.
- Economy-by-economy analysis indicates that the majority of APEC members deepened economic integration into the Asia-Pacific region in 2007, while changes in relative integration rankings were modest.
- Singapore, Hong Kong (China), and Chinese Taipei strengthened their leading positions as the three most regionally integrated economies in the Asia-Pacific.
- Australia, Vietnam, and the United States each moved up a notch in their positions since 2006.
- On the other hand, Malaysia, Mexico, and the Philippines each experienced a decrease in economic integration with the region in 2007. The Philippines replaced the United States to join Indonesia and China as the three economies that are least integrated with the Asia-Pacific in 2007.
- Intra-regional FDI and tourist inflow shares in 2007 saw large gains, increasing to approximately 4.9% and 27.3% respectively.



## Intra-regional Trade Share, Asia-Pacific

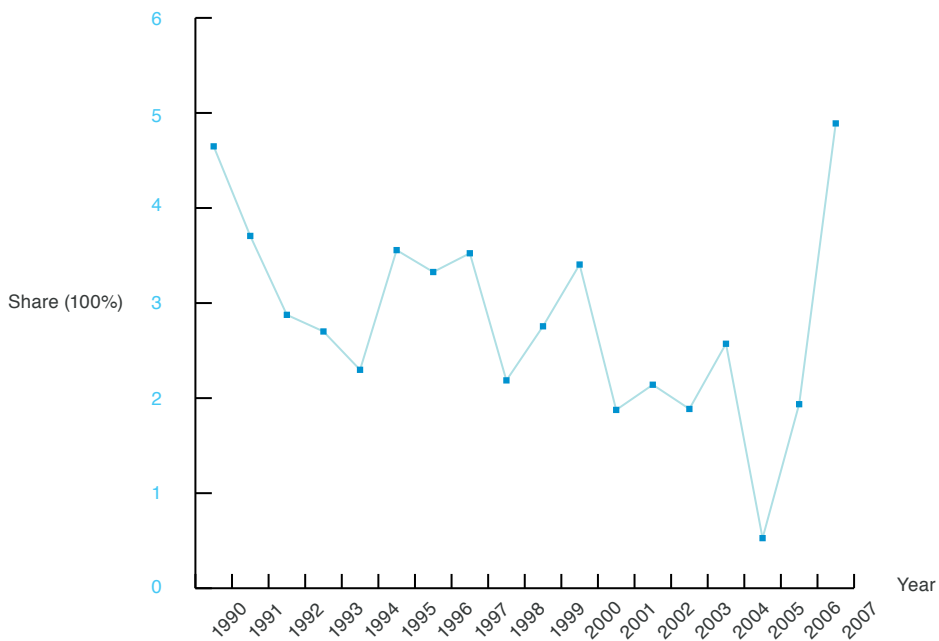
Figure 1: Trade Share in AP Region



The intra-regional trade share in 2007 remained almost unchanged from 2006 levels. For the purposes of the index, this calculation excludes trade between geographically contiguous economies.

## Intra-regional FDI Share, Asia-Pacific

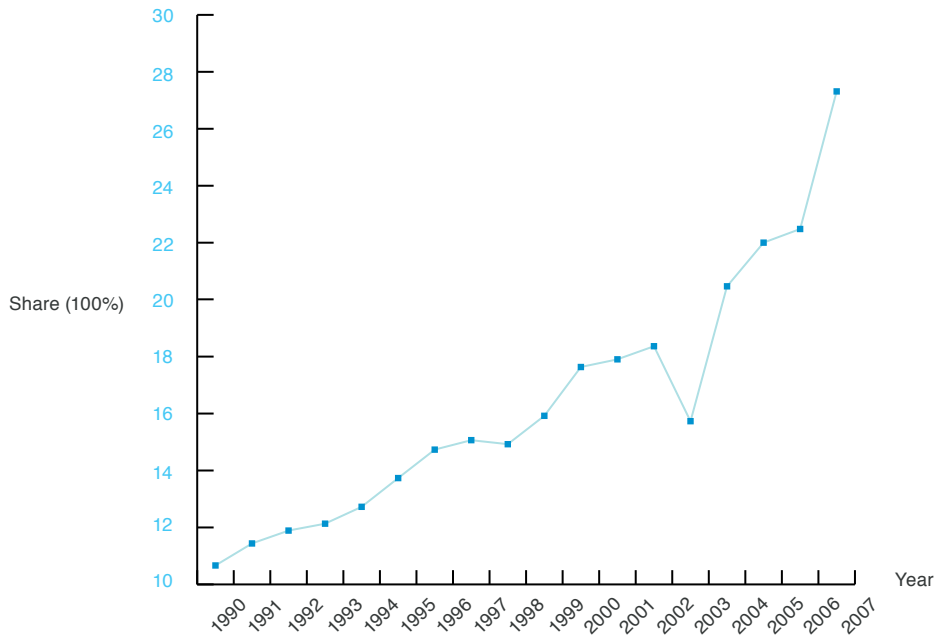
Figure 2: Intra-AP FDI Share within AP Region



Intra-regional FDI share reached a new high in 2007, reaching nearly 5 percent.

### Intra-regional Tourist Inflow, Asia-Pacific

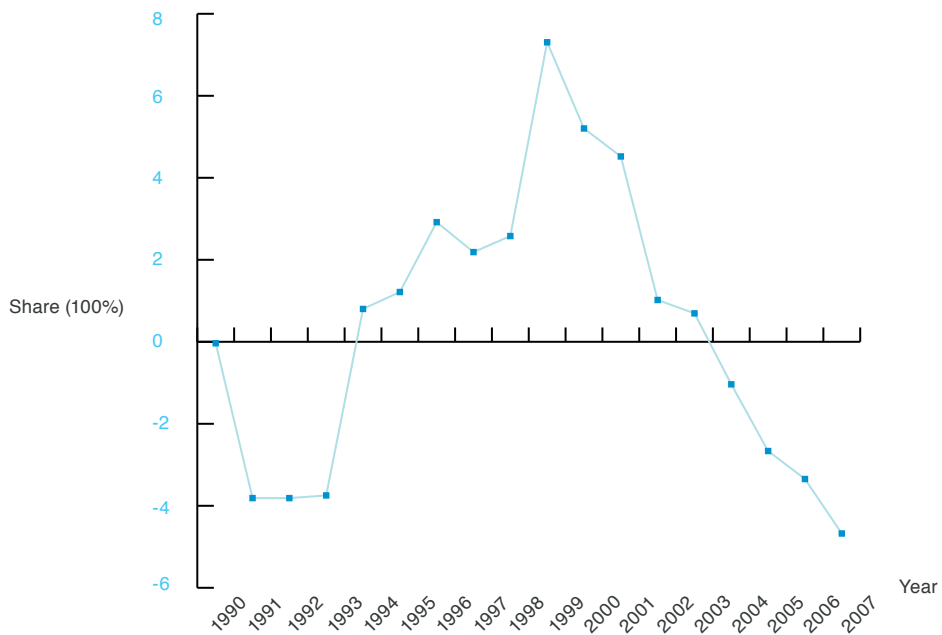
Figure 3: Share of Intra-AP Tourists Inflow



The share of intra-regional tourism inflows showed a sharp increase between 2006 and 2007 .

### Updated Convergence Index: 1990-2007

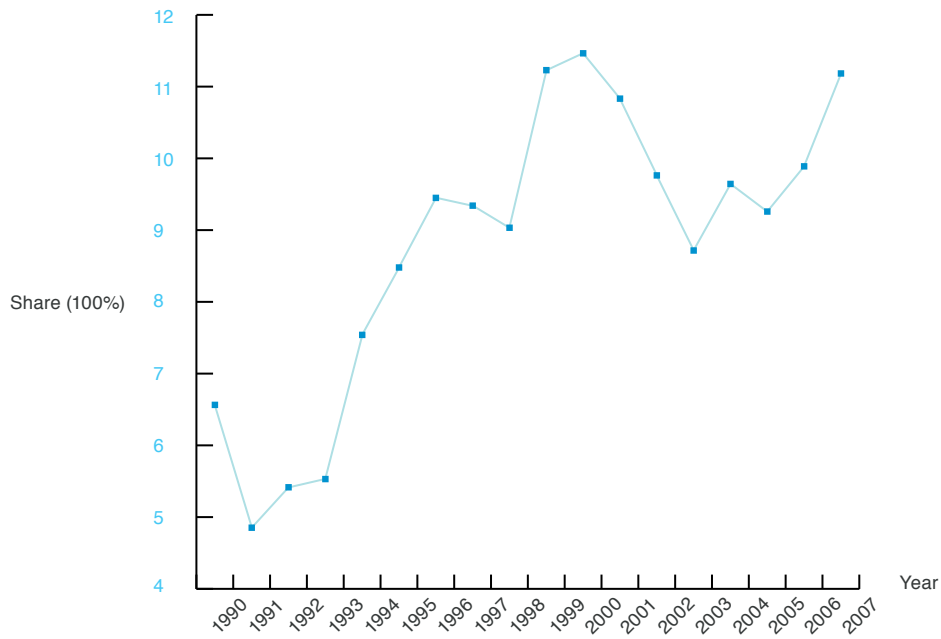
Figure 4: Updated Convergence Index: 1990-2007



The convergence index suggests that economic disparity in the region has been increasing since 1999, reaching a new high of inequality in 2007. The convergence index is based on deviations from GDP per capita, life expectancy and the level of urbanisation and educational investments.

## Updated Composite Index: 1990-2007

Figure 5: Updated Composite Index: 1990-2007



Despite indications of greater economic divergence, the composite index shows that, on the whole, regional economic integration in 2007 increased over 2006 levels.

**Table 1: Comparison of 2006 and 2007 Composite Index**

| Economy           | 2007<br>(Chained) | 2007<br>Ranking | 2006<br>(Chained) | 2006<br>Ranking |
|-------------------|-------------------|-----------------|-------------------|-----------------|
| Singapore         | 359.99            | 1               | 268.68            | 1               |
| Hong Kong (China) | 321.97            | 2               | 118.51            | 2               |
| Chinese Taipei    | 114.71            | 3               | 97.91             | 3               |
| New Zealand       | 97.8              | 4               | 70.58             | 4               |
| Korea             | 60.17             | 5               | 66.97             | 5               |
| Australia         | 52.36             | 6               | 43.76             | 7               |
| Malaysia          | 52.06             | 7               | 49.08             | 6               |
| Thailand          | 42.64             | 8               | 37.56             | 8               |
| Chile             | 26.05             | 9               | 26.18             | 9               |
| Japan             | 20.27             | 10              | 19.39             | 10              |
| Canada            | 17.51             | 11              | 15.09             | 11              |
| Vietnam           | 12.02             | 12              | 9.4               | 13              |
| Mexico            | 12                | 13              | 12.22             | 12              |
| United States     | 8.97              | 14              | 6.03              | 15              |
| Philippines       | 8.14              | 15              | 8.39              | 14              |
| China             | -3.25             | 16              | -4.48             | 16              |
| Indonesia         | -16.9             | 17              | -20.22            | 17              |
| <b>AP Region</b>  | 11.18             |                 | 9.72              |                 |

The majority of economies increased their economic integration into the Asia-Pacific region in 2007, but any changes in relative integration rankings were modest. Singapore, Hong Kong (China), and Chinese Taipei strengthened their leading status as the most regionally integrated economies, while Korea, Chile, Philippines and Mexico all experienced a decrease in economic integration in 2007.

### How to Read the PECC Index of Asia-Pacific Economic Integration

The composite index of economic integration is based on a combination of measures that on the one hand looks at the extent to which the reference economies are becoming more alike in their economic characteristics (“convergence” measures) and on the other hand at the relative importance of trade, investment and human flows within the region compared to economic relations with the rest of the world. The convergence measures are premised on the notion that integration will lead to greater uniformity among the economies. Accordingly, more trade and investment among regional partners may not translate into a higher score on the integration index if at the same time the partners are diverging in terms of income, education, life expectancy, urbanization, and economic structure. Furthermore, since the trade, investment, and tourism measures are calculated relative to global transactions, the index will rise for a given economy only if that economy’s share of trade/investment is growing relative to total trade and investment.

An important feature of the index is that it excludes trade and investment flows among geographically contiguous sub-regional trade agreements, namely NAFTA, the ASEAN Free Trade Area, and Australia-New Zealand Closer Economic Relations. It also excludes flows between China, Hong Kong (China), and Chinese Taipei. This is to control for the effect that sub-regional flows may have on the index, whereby a very high degree of integration among, for example, NAFTA economies could result in a falsely high measure of integration with the Asia-Pacific region as a whole. In the case of China, Hong Kong (China), and Chinese Taipei, the exclusion of intra-regional flows did not affect the positions of Hong Kong (China) and Chinese Taipei at the top rankings of the index. On the other hand, China’s much lower ranking suggests that a large share of its trade and investment flows with Asia-Pacific partners is with Hong Kong (China) and Chinese Taipei, and that its share of trade and investment with economies outside of the Asia-Pacific is larger than that of other economies in the region.

Caution should be exercised in the interpretation of these findings. The measures chosen for inclusion in the composite index are imperfect indicators of “convergence” and trade/investment integration. The rankings in turn should not be read normatively as “league tables” in the sense that a higher ranking is superior to a lower ranking. Indeed, a low ranking may simply indicate that an economy is more oriented globally than regionally, as is likely the case for China and the United States.

Nevertheless, the change in index value for a given economy over time can be read as a measure of its changing economic orientation. The index value for the region as a whole can also be seen as a measure of closer economic ties among Asia-Pacific economies and as one indicator of APEC’s success. We believe that this finding should be an important – and positive – factor in assessing APEC’s 2010 Bogor target.

### Technical Note on the Composite Index of Asia-Pacific Economic Integration

The index is constructed in two stages, with weights assigned by “Principal Components Analysis” – which calculates the relative importance of each sub-component based on its statistical qualities – rather than by subjective assessment.

In the first stage, a convergence index is constructed to measure the dispersion of selected economic indicators among the Asia-Pacific sample economies. The convergence index is a measure of whether the economies are becoming more alike as a result of closer interaction and economic development. The indicators included in the convergence index are as follows:

- Real GDP per capita
- Share of non-agricultural sector in GDP
- Ratio of urban residents to total population
- Life expectancy
- Share of education expenditure in GDP

In the second stage, indicators of trade, investment, and people flows are added to the convergence index and weights are assigned, again using Principal Components Analysis, resulting in the composite index. A change in this year’s index is the use of time-varying weights which are used to update the index using a chained weight approach. Time-varying weights ensure that the relative importance of weights remains accurate from year to year while a chained approach ensures that indices in the composite index are comparable across the 1990 to 2007 period. The chained weights used in the composite index are as follows:

- Composite = 0.2370
- Share of exports and imports to / from other Asia-Pacific economies = 0.2951
- Share of foreign direct investment flows to / from other Asia-Pacific economies = 0.1094
- Share of Asia-Pacific tourist flows from other Asia-Pacific economies = 0.3585

The economies included in the index are all APEC members, namely, Australia, Japan, Korea, China, Hong Kong (China), Chinese Taipei, Vietnam, Thailand, Philippines, Indonesia, Singapore, Malaysia, United States of America, Canada, Mexico, Chile, and New Zealand. The stage two components exclude flows among geographically contiguous sub-regional trade agreements, namely, the Association of Southeast Asian Nations Free Trade Area (AFTA), North America Free Trade Agreement (NAFTA), and Australia-New Zealand Closer Economic Relations. It also excludes flows between China, Hong Kong (China), and Chinese Taipei.

A full description of the composite index is found in Chen, Bo and Woo, Yuen Pau (2009), *A Composite Index of Economic Integration in the Asia-Pacific Region*, available at [www.asiapacific.ca](http://www.asiapacific.ca)

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