Conference on

# New Priorities of Regional Economic Integration – Mandate for APEC


**Edited by:**

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**Eduardo Pedrosa**

**Blake Harley Berger**

# Foreword

This year APEC celebrates the twenty-fifth anniversary of its establishment as well as the twentieth of its seminal Bogor Goals. Anniversaries are times for both celebration as well as reflection. As such, PECC, which paved the way for APEC's foundation hosted a conference to consider what the 'new priorities' of APEC might be.

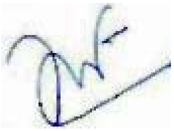
This discussion was not driven only by a desire for reflection but by the significant changes that have taken place to the regional and global economies over the past quarter of a century. Moreover, this discussion comes at a time when it seems that recovery from the 2007-2009 Global Financial Crisis is finally taking hold. The recovery is still shaky, and growth remains driven by the extraordinary stimulus policies that were needed to prevent a 1930s style depression. Now we are normalizing again but having learned from past experience, we have entered a 'new normal' some rules of the game had to be tweaked and new rules established; new areas for growth are being explored vigorously.

With the 'new normal' in mind, PECC Singapore conference this year covered a broad topic of regional economic integration with a renewed angle and pragmatic approach. The invited speakers and guests discussed the different patterns and approaches in implementing structural reforms that are needed to get the economies back on track towards sustainable and inclusive growth. Panelists discussed how to ensure that all economies could gain from participating in structural economic adjustments and the global value chains. Ensuring that no one is left out from the next phase of economic growth in the region is the underpinning principle behind our goal of creating a Free Trade Area of the Asia-Pacific (FTAAP). In efforts to realize this goal, we have outlined through this conference, first, the importance of upholding the multilateral trading system, and ensuring that the spaghetti bowl of bilateral, regional, and plurilateral agreements should all serve as building blocks to reinvigorating the global trading system, namely the World Trade Organization (WTO). We discussed how APEC could play a role in strengthening the WTO and keeping it relevant. Secondly, we discussed the importance of improving physical connectivity within and between economies in recognition of the urgent need to address the infrastructure deficit in the region. Twenty-five years since its creation, APEC has contributed significantly to removing various trade barriers and reducing cross-border inefficiencies. The next task is to strengthen connectivity in tangible terms and through regulatory reforms domestically and regionally to ensure high-quality and inclusive growth.

Thirdly, we discussed the importance of financial cooperation in the region. Without financial stability, further trade liberalization efforts and growth spurts will not pay off in the long run.

The Asia-Pacific has become the center of global growth. An integrated, efficient, and prosperous Asia-Pacific region is critical to sustain growth also in other parts of the world.

We would like to express our sincere appreciation to the many eminent speakers and moderators who have contributed to making this conference a fruitful and insightful exercise. We thank Professor Tan Khee Giap, the Chairman of SINCPEC for hosting and Ambassador Tang Guoqiang, Chairman of CNCPEC for co-organizing this year’s conference in support of China’s chairmanship of APEC.



Jusuf Wanandi
Co-Chair

Donald Campbell
Co-Chair

# Acknowledgements

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

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

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Conference Programme

**Program for**
**2014 PECC Singapore Conference on**
**New Priorities of Regional Economic Integration—Mandate for APEC**

## Co-Organized by SINCPEC & CNCPEC, 10-11 February 2014, Orchard Hotel Singapore

**Overview**

The regional and global economies are undergoing a structural transformation, partially a response to the upheaval caused by the Global Financial Crisis but also due to rapidly evolving changes in regional economies. Policy-makers are experimenting with various instruments to manage these changes.

This conference aims to provide a venue for stakeholders from different parts of the region and different perspectives to share their views and expertise on different ways in which APEC can play a role in managing the change.

The conference consists of 4 sessions. The panels for each session will address the issue from a different set of perspectives.

| **Day 1, 10 February 2014** | |
|---|---|
| 0830-0900 | **Registration of participants** |
| 0900-0930 | **Welcome Remarks:**<br>• Dr Tan Khee Giap, *Chairman*, Singapore National Committee for Pacific Economic Cooperation (SINCPEC)<br>• Mr Jusuf Wanandi, *Co-Chairman*, Pacific Economic Cooperation Council (PECC)<br>• Ambassador Tang Guoqiang, *Chairman*, China National Committee for Pacific Economic Cooperation (CNCPEC) |
| 0930-0950<br><br>0950-1000 | **Day One Opening Speech**<br>• Mr Lim Hng Kiang, Minister for Trade and Industry, Singapore<br><br>**Q&A Session**<br><br>**Moderator:**<br>• Mr Jusuf Wanandi, Co-Chairman, Pacific Economic Cooperation Council (PECC) |
| 1000-1040 | **Coffee Break** |
| 1040-1100<br><br>1100-1115 | **Keynote Speech**<br>• Mr La Yifan, *Vice Chairman*, APEC SOM & *Under Secretary-General*, National Organizing Committee for APEC 2014, Ministry of Foreign Affairs of China<br><br>**Q&A Session**<br><br>**Moderator:**<br>• Dr Djisman Simandjuntak, *Chairman*, Indonesian National Committee for Pacific Economic Cooperation (INCPEC) |

| | |
|---|---|
| 1115-1230 | **Session I: Strategic Assessment and Outlook of Asia Pacific Economy**<br>The Asia Pacific economies are undergoing structural reforms for the purpose of achieving sustainable development and improving people's living standards. Based on the stocktaking of the experience in the past and an outlook of the direction of regional economic development for the next 5-10 years, we need to study:<br>1. The different patterns of economic restructuring and the approaches of implementation.<br>2. How APEC can enhance economic policy coordination towards achieving the Bogor Goals, bearing in mind APEC's interim milestones and commitments for implementation<br>3. How to ensure that all economies gain from participating in structural economic adjustment and the global value chain<br><br>**Moderator:**<br>• Mr Denis McNamara, Chairman, New Zealand Committee of the Pacific Economic Cooperation Council (NZPECC) |
| 1115-1135 | **Keynote Speech**：<br>• Mr Bert Hofman, Chief Economist for the East Asia and Pacific Region, The World Bank |
| 1135-1215 | **Panel Discussion**:<br>• Dr Manfred Wilhelmy, Chairman, Chilean National Committee for Pacific Economic Cooperation (CHILPEC) & Executive Director, Chile Pacific Foundation<br>• Mr Yuen Pau Woo, President & Chief Executive Officer, Asia Pacific Foundation of Canada<br>• Mr Ong Ye Kung, Director (Group Strategy & Development), Keppel Corporation<br>• Dr George Manzano, Member, Philippine Pacific Economic Cooperation Committee (PPECC) & Assistant Professor, School of Economics, University of Asia and the Pacific |
| 1215-1230 | **Q&A Session** |
| 1230-1430 | **Lunch** |
| 1300-1320 | **Guest of Honour:**<br>• Professor Wang Gungwu, Chairman, East Asian Institute, National University of Singapore |
| 1320-1335 | **Q&A Session**<br><br>**Moderator:**<br>• Dr Narongchai Akrasanee, Chairman, Thailand National Committee for Pacific Economic Cooperation (TNCPEC) |
| 1430-1600 | **Session II: Regional Economic Integration and Multilateral Trading System**<br>The number of regional and bilateral trade agreements in the Asia Pacific region has increased with the WTO DDA facing challenges. With the WTO as the core of multilateral trading system, the regional trading arrangements should reinforce each other, instead of excluding each other.<br>a) What should be our roadmap and framework of Asia Pacific regional economic integration, taking various FTA proposals into consideration?<br>b) How can APEC promote the synergy of various regional economic integration mechanisms existing in all APEC economies on both sides of the Pacific Ocean?<br>c) How can APEC economies contribute to ensure that the WTO process remains current and relevant?<br><br>**Moderator:**<br>• Dr Djisman Simandjuntak, Chairman, Indonesian National Committee for Pacific Economic Cooperation (INCPEC) |
| 1430-1450 | **Keynote Speech**<br>• Mr La Yifan, Vice Chairman, APEC SOM & Under Secretary-General, National Organizing Committee for APEC 2014, Ministry of Foreign Affairs of China |
| 1450-1530 | **Panel Discussion:**<br>• Dato Paduka Lim Jock Hoi, Chairman, Brunei Darussalam National Committee for Pacific Economic Cooperation (BDCPEC)<br>• Professor Song Hong, Assistant Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences, China<br>• Professor Naoyuki Yoshino, Professor of Economics, Keio University, Japan |

| | |
|---|---|
| 1530-1545 | • Ambassador Mark Trainor, Principal Advisor, Trade & Economic Group (TEG), Ministry of Foreign Affairs and Trade, Wellington, New Zealand<br><br>**Q&A Session** |
| 1545-1615 | **Coffee Break** |
| 1615-1730<br><br><br><br><br><br><br><br><br><br><br>1615-1635<br><br>1635-1715<br><br><br><br><br><br><br>1715-1730 | **Session III: Physical Connectivity**<br>Of the three aspects of connectivity, physical connectivity is of fundamental significance to the promotion of regional integration. We shall pay attention to the urgent needs and the long-term roadmap of regional physical connectivity.<br>1. What are the possible options for a roadmap of Asia Pacific physical connectivity? How can we make best use of Indonesia's Connectivity Framework?<br>2. What are the priorities for physical connectivity currently?<br>3. How can the developed and developing economies both contribute to regional connectivity?<br>4. How can APEC economies enhance connectivity across borders of vast distances, for example through improving our air, maritime and cyber connectivity?<br>5. How to develop the proposed Asia Infrastructure Investment Bank as an inclusive, cost effective and sustainable solution to the financing bottleneck?<br><br>**Moderator:**<br>• Dr David Hong, Chairman, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC)<br><br>**Keynote Speech:**<br>• Dr Mari Pangestu, Minister for Tourism and Creative Economy, Indonesia<br><br>**Panel Discussion:**<br>• Dr Biswa Bhattacharyay, Former Advisor/Director, Asian Development Bank & Visiting Professor, University of International Business and Economics<br>• Mr Steven Wong, Deputy Chief Executive, ISIS Malaysia<br>• Mr Hugh Stephens, Vice Chairman, Canadian National Committee for Pacific Economic Cooperation (CANCPEC) & Executive-in-Residence, Asia Pacific Foundation of Canada<br>• Mr Mark Rathbone, Advisory Asia Pacific Capital Projects & Infrastructure Leader, PwC Singapore<br><br>**Q&A Session** |
| 1800-2030<br><br>1800-1830<br><br>1830-1850<br><br><br>1850-1900 | **Welcome Dinner**<br><br>**Cocktail Reception**<br><br>**Guest of Honour:**<br>• Mr Bilahari Kausikan, Ambassador-at-Large & Policy Advisor-AAL, Singapore<br><br>**Q&A Session**<br><br>**Moderator:**<br>• Dr Tan Khee Giap, Chairman, Singapore National Committee for Pacific Economic Cooperation (SINCPEC) |
| **END OF CONFERENCE DAY 1** | |

| **Day 2, 11 February 2014** | |
|---|---|
| 0900-0930 | **Registration of participants** |
| 0930-0940 | **Welcome Remarks:**<br>• Ambassador Donald Campbell, Co-Chairman, Pacific Economic Cooperation Council (PECC) |
| 0940-1000 | **Day Two Opening Speech**<br>• Professor Dr Bambang Permadi Soemantri Brodjonegoro, Vice Minister for Finance, Indonesia |

| | |
|---|---|
| 1000-1010 | **Q&A Session**<br><br>**Moderator:**<br>• Ambassador Donald Campbell, Co-Chairman, Pacific Economic Cooperation Council (PECC) |
| 1010-1030 | **Coffee Break** |
| 1010-1145 | **Session IV: Financial Cooperation in the Asia-Pacific**<br>Financial cooperation remains a weak link in regional economic cooperation. In the regional efforts to make structural adjustment for economic growth, an important role should be given to financial cooperation.<br>1. What is the current status of financial cooperation in Asia Pacific?<br>2. What measures should be taken by member economies to enhance the financial cooperation (monetary policy coordination, capital market, financial regulations, connectivity and currency swap)?<br><br>**Moderator:**<br>• Professor Stephen Cheung, Chairman, Hong Kong Committee for Pacific Economic Cooperation (HKCPEC) |
| 1030-1050 | **Keynote Speech:**<br>• Professor Xiang Songzuo, Chief Economist, Agricultural Bank of China |
| 1050-1130 | **Panel Discussion:**<br>• Dr Yoichi Nemoto, Director, ASEAN+3 Macroeconomic Research Office (AMRO)<br>• Dr In Huh, Assistant Professor, Department of Economics at Chonnam National University, Gwangju, Korea<br>• Professor Ramkishen S Rajan, Professor of International Economic Policy, School of Public Policy, George Mason University<br>• Mr Ian Buchanan, *Chairman*, Australian Pacific Economic Cooperation Committee (AUSPECC) on “Asia Infrastructure Investment Bank Working Paper by AUSPECC, CNCPEC & SINCPEC” |
| 1130-1145 | **Q&A Session** |
| 1145-1205 | **Concluding Session: Next Steps**<br>This session will draw together the discussions from the previous sessions to propose recommendations to be made by PECC to APEC and other officials.<br><br>**Concluding Remarks:**<br>• Ambassador Tang Guoqiang, Chairman, China National Committee for Pacific Economic Cooperation (CNCPEC) |
| 1205-1400 | **Lunch** |
| **END OF CONFERENCE** | |

# Day One Welcome Remarks

- Dr Tan Khee Giap

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

- Mr. Jusuf Wanandi

  Co-Chairman, Pacific Economic Cooperation Council (PECC)

- Ambassador Tang Guoqiang

  Chairman, China National Committee for Pacific Economic Cooperation (CNCPEC)

Dr. Tan Khee Giap:

Good morning Minister Lim Hng Kiang, Minister for Trade and Industry, Singapore, your excellencies and distinguished guests, PECC co-chairs, and ladies and gentlemen. From Lee Kuan Yew School of Public Policy, we make only three points; first, a warm welcome to Singapore to this beautiful and safe city. Second point, this is a very useful track-two forum for us to exchange ideas, discussions, and exchange of views. I hope that we will have a very fruitful conference for the next two days. Finally, usually you thank the organizers, especially the ladies and gentlemen who have been helping me at the end of the conference, but I would like you to acknowledge what they have been doing; can we give them a round of applause.

Mr. Jusuf Wanandi:

Good morning excellencies, ladies and gentlemen, friends, and a very welcome to Minister Lim Hng Kiang, Minister for Trade and Industry, Singapore, who not only showed his interest in supporting us by being present here but the whole department has been helping us, and we would like to thank you.

As you know this conference is not only talking about the economic part, which is very important and puts economic cooperation upfront, but at the same time we are very honored to have Professor Wang Gung-wu here, who is the chairman of the Lee Kuan Yew School, who will give us some perspective on history which is a very important part of our efforts in this part of the world. Ambassador Bilahari Kausikan, as a strategist, will give us the strategic environment that we are talking about when we talk about economic cooperation in this part of the world. We are going to have fruitful meeting altogether in the next one and a half days. We are also going to thank Dr. Tan Khee Giap and his staff for that.

On the purpose of this conference, as you know this is the second one that SINCPEC has done for us with the support of the government of Singapore; every beginning of the year, three years in a row, supports a conference in Singapore to give some input to the next chair, the next country and government that is going to organize APEC. We did this last year successfully with the APEC held in Indonesia. This year we are going to do that for the APEC that is going to be held in China, and the third one hopefully next year, we can do that also for the one that is going to be organized by the Philippines. PECC of course is supporting APEC, for its work is to integrate the regional economies in the Asia Pacific because it is becoming the most important region for global growth and development; the Asia Pacific region should be decisive in assisting the global economy which is now still in the transition period. APEC is not only important and critical to the Asia Pacific but also globally.

The first cluster of this conference will be on the strategic assessment and outlook of the Asian Pacific economies, and also discussed will be its impact on the global economy. In the second cluster on regional economic integration and multilateral trading system, it is recognized that whatever the Asia Pacific is going to achieve in its trading system will have an impact and important bearing on the global multilateral trading system and that has happened earlier in our history. This has been shown of course in Bali, where the WTO's first movements after seven years of being dormant has been moving because the APEC summit gave it support a few weeks before, also that event was before the Uruguay round. That is why the dichotomy, I hope the Minister will also stress that, Regional Comprehensive Economic Partnership (RCEP) and Trans-Pacific-Partnership (TPP) in the Asia Pacific region has to be overcome, so that an FTAAP can become a possibility and have a maximum impact on trade gains to the extent of $1.9 trillion by 2025. For this, a more transparent process is necessary and everyone in the region should be in principal participating. Some compromises will be necessary for this to happen.

The third cluster is on connectivity; at the summit in Bali last year, APEC leaders agreed to a connectivity framework that could help guide a process that could address the infrastructure deficit. The challenge for China as chair of this year's APEC is to make a deal. China has a head start on this with its announcement of a regional infrastructure investment bank, the idea still has to be worked out to overcome the gaps in the current financing arrangement and there are many. Despite all the potential benefits regional institutions from ASEAN to APEC have given to the region so far, infrastructure investment is still needed to ensure people have the wherewithal to participate in the global economy. Not only would investment in connectivity help solve the increasing income inequality but also would sustain aggregate demand for the future.

The fourth cluster on regional financial cooperation has been high on the agenda since 1977 and 1978, but it remains embryonic and much more is needed to be done to ensure that regional safety nets can be counted upon in the case of emergencies, and that they complement and supplement global ones. The integration of financial markets promises the ability to those with insufficient financial systems to access capital at cheaper costs. In fact, while East Asian regionalism has made finance an important vehicle for integration through the Chiang Mai Initiative Multilateralization (CMIM) and the ASEAN Plus Three Macroeconomic Research Office (AMRO). APEC has not been able to integrate the financial part of their cooperation into the rest of Asia Pacific economic integration, it is high time they are going to do that soon.

Ambassador Tang Guoqiang:

Your excellency Mr. Lim Hng Kiang, Minister of Trade and Industry, Singapore, Mr. Jusuf Wanandi and Mr. Don Campbell, co-chairs of the PECC, and Dr. Tan Khee Giap, Chairman of SINCPEC, distinguished guests and ladies and gentlemen, good morning. At the very beginning of this Chinese New Year, the Year of the Horse, it is a great honor to join a great many distinguished government officials, scholars and entrepreneurs to explore the new priorities in regional economic integration, and to define the new mandate for APEC. This annual PECC event is specially intended for the yearly APEC meeting. As China is the host APEC 2014, China National Committee for Pacific Economic Cooperation (CNCPEC) is pleased to co-organize this conference with the Singapore National Committee for Pacific Economic Cooperation (SINCPEC) under the auspices of PECC. I would like to take this opportunity to express my sincere thanks to Dr. Tan Khee Giap, Chairman of SINCPEC, for making this a reality. It was him who invited me as early as last February to co-organize this conference. Over the past year, he has been working hard on this event; he even flew to Beijing to discuss with us programs and invited speakers. It was not so easy for him and his team to finish all the preparation work. Special thanks also goes to the PECC co-chairs for their full endorsement and support. They are instrumental in formulating the current program. The PECC International Secretariat led by Eduardo Pedrosa provided very professional assistance in the process of organization. I would like to thank them for their contribution, which is highly valued by the CNCPEC. PECC is one of the institutional observers of APEC, and it is well positioned to provide policy recommendations to APEC. Last December, the CNCPEC held successfully the APEC symposium in Beijing. A great part of success was owed to the PECC because a large number of speakers were in fact members of various PECC committees. Our present event is a PECC marked policy dialogue dedicated to the APEC process. This event precedes the first APEC senior official meeting to be held later this month.

In the Year of the Horse, I think we have two Chinese expressions, which are proper to describing the role of the PECC. Firstly, “Like a leading horse”, PECC is playing a pioneering role in setting the agenda for regional economic cooperation. Secondly, with the contribution of PECC, the APEC process will turn out a great success. I believe that the discussions and consensus in the next two-day conference will provide an important intellectual support to the APEC 2014 meetings. With this I would like to conclude my welcoming remarks and wish the conference a great success.

# Day One Opening Speech

**By:**
Mr. Lim Hng Kiang
Minister for Trade and Industry, Singapore

**Moderator**:
Mr Jusuf Wanandi
Co-Chairman, Pacific Economic Cooperation Council (PECC)

Mr. Lim Hng Kiang:

Let me first wish everyone a happy lunar new year. It is my pleasure to welcome all of you to Singapore and today's conference.

Regional Economic Integration Discussions Timely

This is an ideal time for an exchange of ideas on regional economic integration. We are into a new APEC year, with China at the helm after Indonesia's able 2013 chairmanship. There is renewed WTO momentum following the Bali Ministerial Conference in December. In parallel, regional economic architectures have grown in recent years. It is therefore timely for conversations on ensuring that multiple avenues to trade liberalization are complementary, effective and cohesive. Fundamentally, all our efforts must work towards strengthening the multilateral trading system.

Next Step is Towards the FTAAP

APEC has always been forward-thinking. APEC Leaders alluded to a vision for a Free Trade Area of the Asia Pacific, or FTAAP, as early as 2004 (in Chile). This was in response to suggestions from APEC's business arm, the APEC Business Advisory Council, who foresaw benefits of such a large FTA. In 2010 (in Japan), APEC Leaders concretized the vision by outlining "pathways to FTAAP". Already then, they envisioned the FTAAP to be a comprehensive, high quality agreement, developed and built on ongoing regional undertakings, which address "next generation" trade and investment issues.

This vision is even more relevant today. It must be reignited through a revival of the discussions we have been having, on and off, on the FTAAP, over the past ten years. Discussions must be robust at all platforms – policy-makers, businesses, and academics alike.

While discussions would naturally involve intricate complexities, the challenge should not be seen as too overwhelming for APEC. APEC economies already belong to several regional initiatives. Our current journeys should place us in good stead to take the next step towards the FTAAP.

Today, I will share some of my thoughts on how we can proceed. I hope this will be the start of more discussions.

d) First, we need to be vigilant in implementing our 2020 Bogor Goals and 2015 commitments. These are (i) the Supply-Chain Connectivity Initiative, (ii) the Ease of Doing Business Action Plan, and (iii) tariff reduction on Environmental Goods. These are milestones towards realizing the FTAAP. China's 2014 chairmanship will be crucial for achieving our 2015 targets. Faltering on this means we falter in our path towards our FTAAP aspirations.

e) Second, we must ensure that our current agreements are of the highest quality possible. Regional architectures like the ASEAN Economic Community (AEC), the Pacific Alliance, the RCEP, and the TPP are all mutually reinforcing pathways to the FTAAP. These pathways must be of high- standard to lead to a credible and meaningful FTAAP.

f) Finally, we need to explore ways to bring the various paths together smoothly. We need to continue conversations on the principles our Leaders outlined in their 2010 "Pathways to FTAAP" declaration. We need to start answering fundamental questions on the principles upon which the FTAAP will be based. Important principles such as:

    a. One, how do we ensure that the FTAAP is **comprehensive and current in scope**. We can, for instance, ensure complete product coverage for market access. We can also incorporate issues from our most contemporary agreements into the FTAAP. What is the best way to do this?

b. Two, how do we ensure that the FTAAP is of **superior quality**. What is the best way to bring over ambitious and beneficial portions of our individual agreements into the FTAAP? As a regional grouping, our economies would benefit from cumulative rules of origin. Also robust transparency and trade facilitation principles to minimize non-tariff barriers among us. Can we use model chapters or articles to achieve this? How do we guarantee that there is also no backtracking of existing commitments?

c. Three, how do we ensure a **robust modality for negotiations**? Can we lock-in a single undertaking principle for negotiations? Also inclusivity for the participation of all APEC economies. Can APEC's capacity building arm be tapped on to make all economies ready?

These are some key principles we must collectively consider and agree upon, for further and concrete steps towards the FTAAP.

<u>Using Experiences of Current Regional Economic Integration Architectures on the Way to the FTAAP</u>

Today, APEC economies are involved in several regional architectures, like the Pacific Alliance and ASEAN. We should leverage on our achievements and start our FTAAP journey from high ground.

a) ASEAN, for instance, is progressing well, towards the AEC, having completed about 80% of their economic integration measures. ASEAN's commitments are progressively incremental, and tracked using a scorecard mechanism. ASEAN can use this experience to contribute to the FTAAP

b) The Pacific Alliance has progressive initiatives like the integrated Latin American stock exchange market (the MILA); an Air Services Agreement; and the progressive elimination of almost all tariffs. APEC members who are in the Pacific Alliance can play a leadership role in discussions on financial cooperation and deeper integration in the Asia Pacific.

c) The RCEP and TPP will be current agreements when concluded. The RCEP could potentially transform the region into an integrated market of over 3 billion people, with a combined GDP of more than USD 17 trillion, or about a third of the world's current annual GDP. The TPP will include 21st century issues, like e-commerce, intellectual property, competition, and regulatory coherence. Both agreements must inform and feed into the FTAAP.

From these we can see that while the FTAAP will be highly complex and challenging to negotiate, we are not starting from a zero base.

Regional Initiatives Must Support the Multilateral Trading System (MTS)

As we pursue regional and plurilateral initiatives, however, it is crucial that our top priority remains the multilateral trading system. The aim of our regional work, including the FTAAP, must be to create a positive domino effect of opening up more and more markets for global trade liberalization.

Indeed, although the WTO succeeded in delivering some Doha Development Agenda (DDA) outcomes in Bali, substantive results were modest. Regional economic integration will remain important in sustaining the global trade liberalization momentum. In parallel with APEC's own integration agenda, APEC economies can help further the WTO's agenda by playing a leadership role in implementing multilateral commitments; bringing market access initiatives to the WTO; and exploring new trade-related issues.

Conclusion

Conferences like these are thus useful. They provide stakeholders a platform to share views, perspectives, and expertise on issues that are critical to the global economy. The PECC is invaluable in bringing together eminent persons from industry, government, and academic circles to jointly brainstorm ideas that assist and mold APEC's future work. APEC's policy-makers will benefit from journeying with our academic and business arms towards our collective vision. Your ideas and feedback are thus welcomed and imperative to the process.

On this note, I wish you fruitful discussions in these two days, and a fulfilling year ahead.

**Question and Answer Session**

Mr. Jusuf Wanandi:

I am very honored to chair this session because as we have heard, and I would again like to thank Minister Lim, the expectations for the region and APEC particularly, has put on PECC, and our inputs and thinking is a very important process for the whole development of the region. I'm very honored to be able to get this question; how to establish a greater regional trading system in this part of the world? As the Minister has mentioned actually some of the elements are already present and based on those we are looking forward to seeing much more development in the future.

Participant:

APEC perhaps should really focus on really limited item agenda every time it meets. I expected APEC Beijing is also going to do the same thing, and most that I expect from APEC Beijing would be; first, impetus to progress in the FTA, however incremental. The progress made in Bali, in my view, is very important even in terms of substance as it was very limited, but I think if APEC Beijing can move governments to agree on one more in the FTA agenda that would be great. Despite the progress in regional agreements, in the end we all depend on multilateralism. Number two; we are faced with these different ambitions in regional negotiations right now in our part of the world; for example, the RCEP, TPP, and the Pacific Alliance. I think APEC Beijing should also try to agree on principals on how to bring these different regional initiatives into coherence or something like harmony. The old guards of open regionalism remain very important here. Last one; sector agreements are increasingly seen as a realistic approach to trade negotiations under the WTO, what is your view on this trade in services agreement? I suppose Singapore is not part of it yet.

Minister Lim Hng Kiang:

I think you have touched upon three very key issues. First, how do you maintain impetus on the DDA momentum? We should not under sell what was achieved in Bali - it was a very important achievement - but we also recognize that it was practically done at the 11th hour. So the key task for us this year is to operationalize what was created in Bali to make sure we execute and implement what was agreed particularly on the trade facilitation package. Secondly, we have to set up what are the tasks ahead for us because what we achieved in Bali, we still need to complement the rest of the agenda in the DDA; it is an very important task this year to set out what we need to do, should it be another mini-package? Should we be so ambitious as to cover everything else in the DDA or should it be somewhere in between? In the months ahead we need to settle this very important issue. So the work on DDA is still critical for us in the months ahead. Thirdly, on the principles to bring the various regional agreements together, I think it's very important and touched upon it in my speech, and I think this is where the PECC can really add value to outline the key principles whether it is high quality, comprehensiveness, and inclusiveness. I think once we settle on the key principles, this issue will be a very important guiding post for us when we embark on the negotiations. Fourthly, I fully agree with you on sector agreements and the importance of the agreements. It is a pity in Bali that we could not seal the updating of the Information Technology Agreement (ITA) agreement. The ITA is a real pathfinder on how you can get together a critical mass of economies and countries to have an agreement, multilateralize it and Most Favored Nation (MFN) it to the rest of the world. I think this is a very sensible and the right approach for sectorial agreements. Now how do we do that for the environmental goods, this is a new initiative that the major economies have all come together and proposed how to operationalize this for services which is a even more complicated negotiation, these are critical issues. But for sectorial agreements, we need to strike a balance between targeting the sector, where you are likely to be successful, versus having a boarder sector approach that is more comprehensive, so you need to strike the right balance. So these are all very important agenda items for us and it promises to be a full year for all those involved.

Mr. La Yifan:

I am impressed with your statement concerning the development of the FTAAP concept over the past ten years; you mentioned that the concept was first raised ten years ago, and that a lot of discussion over the concept over the past several years has been taken up by our leaders in the declaration on previous occasions. I tend to agree with you that it is highly necessary to have a region wide free trade arrangement that will harmonize the different existing FTA's that will bring benefits to the wider membership in this region. In your view, I would like to ask, what will be the major obstacles for us to move forward this concept of the FTAAP? Second, how to ensure the diversity in the APEC members could be accommodated as we move forward? That is to say how to look after the different levels of member development to ensure that their interests are taken into account. Lastly, I am from the National Organizing Committee for APEC 2014 this year and I tend to come here to keep my ears wide open to listen to your views and suggestions, but I would also like to seek your opinions on how we could move forward this concept of FTAAP this year? What are your expectations?

Minister Lim Hng Kiang:

Ladies and Gentlemen, now you know how important this conference is, he's here with all his ears open and so we know that value add you put into this conference is crucial. I think that this is a major issue before us, how do we bring forward and operationalize the vision of our leaders on the FTAAP. As I mentioned, in 2010 our leaders set up the vision of a pathway towards the FTAAP. Even at that stage because of the regional FTA's that we are separately embarked on, one tangible way we can reach this ultimate goal of an FTAAP is to encourage a different pathway of getting there. The different pathways also recognize in realistic way that diversity within the APEC economies and the different levels of development that you alluded to, for us I think if we take these concepts of moving by separate pathways ultimately merging towards the FTAAP, then first of fall let's try to conclude the various pathways in an expedient way possible. As for the TPP, as you all know, we are in the final stages of concluding the TPP. For the RCEP, we have set up the basic principles and work groups, and we have a target that we are going to try and complete this by 2015. I think we should try and keep this deadline in mind. For the AEC and the Pacific Alliance, there are some very useful lessons and some very useful examples embedded within these two agreements. I think we can strengthen these features and possibly port them over to the FTAAP when we reach that stage of negotiating or merging the FTAAP.

What are the obstacles? First, we need to identify what are the key features or key principals. What are the useful features that can be ported over? And realistically for us it is the two key pathways, TPP and RCEP that would allow us to merge ultimately when we want to negotiate an FTAAP among all the APEC economies. For the TPP and RCEP to merge, the levels of ambition should not be too wide, otherwise the merger of two equals would be more difficult. As we try to complete the TPP, we must keep this in mind. As we embark on the RCEP, I think we must encourage as high an ambition as possible so that when we try and bring the two together, the gap between the two is not too big. I see that as one of the major issues before us. So first try to keep the deadlines so that we can bring forward the vision of the FTAAP and operationalize this in the not too distant future. Second, make sure the levels of ambition are not too significantly apart so that we can bring them together. Third, let's identify the principles as well as the key features that we can bring from all the various regional FTAs when we embark on the FTAAP.

Dr. Narongchai Akrasanee:

Just to follow up on just what you have just said and relating to the last part of your presentation, this is about regional initiatives that must support the WTO. I beg to think otherwise. I think that the WTO needs to support regional initiatives. Ask not what we can do for the WTO, ask what the WTO for us. I think we've been paying a lot of money to the WTO; the Doha round started in 2001, it is now 2014 if it has taken that long it means that it is not going to happen. That's the natural law in life. So we are working on a number of regional initiatives, RCEP, TPP, FTAAP and so on. I think one problem, I've been working on these regional initiatives for a long time, is our technical expertise about trade negotiations. I think the WTO has a lot of them so it's about time they should do something for us; otherwise we should stop paying bills to them.

Minister Lim Hng Kiang:

First of all, the WTO plays a critical role in setting the global trading regime. Our view of the WTO I think is shared by many of you here including Thailand, that you need a global sheriff to set the rules and to settle disputes. Now even beyond that very basic role, the WTO is very important to make sure we don't fall back into protectionism. These are the two basic roles of the WTO. In addition to these two roles, I think the WTO has an important role in making sure that we resolve some of the very difficult trading issues on a global basis. There are some issues that you can resolve at the regional basis, but all of us recognize that for the global trading regime some very fundamental issues can only be done at the global level, for example agricultural subsidies by the developed countries. The U.S. just passed the farm bill and the EU also has the CAP policy. Now all this cannot be resolved regionally, it can only be done on the global negotiation table, otherwise the overall global agricultural trade will always be severely impacted. In the fourth area, I think the WTO has a very important role to play in addressing new issues. I think we can address new issues at the regional level, but for the global trading regime to keep up and be relevant to modern commerce and modern supply chains, the WTO has to import these new issues. I think the WTO will continue to have a critical role. Singapore pays substantial dues because the WTO levies the deals based on participation in global trade, on that basis Singapore's dues are huge, but we are very happy to pay our share of running the

WTO.

On technical expertise, I think that's a very important point. I fully agree with you, the WTO secretariat and the staff there, despite being one of the smallest UN affiliated organization, has huge expertise. It's a pity that many of the developing countries have not been leveraging that capacity and capability. I know from personal experience that the WTO secretariat and staff are more than happy to provide technical expertise and capacity building. Singapore continues to leverage the WTO secretariat in new areas of trade research, for example, in recent years we have started to look at trade not just in export and import numbers, but also in value added terms. I can tell you that there is a huge reservoir of data and expertise within the WTO. Similarly if all WTO members want to make use of the WTO secretariat for capacity building, I'm sure they would be very happy to accede to your request.

Mr. Ian Buchanan:

At the Taiwan Economic Summit that the PECC had last October, I think we reached almost identical conclusions to what you just laid out. That RCEP and TPP, two beds with shared dreams. However, we felt that waiting till both or one is complete before trying to look into integration is a danger. It is a danger in that the two have significant different implications in terms of behind-the-border issues. If we ended up with China in one, many countries across both, and had the number one economy in the U.S. in the TPP; and number two, RCEP at that time with the significant thinking of whether it was intellectual property or other behind-the-border issues, integration might not move smoothly. Given the positive comments about the role of PECC, we started a discussion, so I would like your thoughts and comments on it, about whether we might not immediately set up an informal channel between the two negotiation teams with the PECC as a trusted intermediary facilitator in order to begin to have informal discussions on some of the invariably tougher issues, which are not negotiations but the beginning of forming hopefully common dreams on those issues.

Minister Lim Hng Kiang:

I think this is a very positive and constructive analysis and approach to the challenges we face. If you look at TPP and RCEP, first of all we have a structural difference. In TPP, we started off with four of the smallest economies in APEC and we incorporated a very critical principle, that of inclusivity and inclusiveness. So that principal is embedded in the TPP; so today the

TPP welcomes participation first from APEC economies and then later beyond the APEC family to join the TPP because we envisage that as a very inclusive platform. For RCEP, our approach was slightly different because we wanted to integrate the existing ASEAN Plus One FTAs; that sets out a structural difference in that before you join the RCEP, it requires you for the time being to have an ASEAN Plus One agreement first. For example, if the U.S. were to express the wish to join RCEP, I think the U.S. would have to work out an ASEAN Plus One agreement and then later on incorporate that agreement into the RCEP which is an additional step. But the concept of inclusivity is also there, just that because RCEP was envisioned as an amalgamation of the ASEAN Plus One this will be the requirement. Beyond the structural impediments or structural requirements, the coverage and scope are also different. As you mentioned, there are some issues that are included in the TPP and some, which are not in the RCEP, particularly behind the border issues and also some of the so-called 21st century issues. That is something we are fully aware of and that is the reason why the RCEP partners in the latest discussions, we have decided to set up working groups to look at some of these areas. Not all the 21st century issues and not all the areas you would like, but some of the key areas; for example, competition and intellectual property. How do we extend the existing coverage of the ASEAN Plus One into these new areas, so that the gap between the TPP and RCEP is not too wide. So among the trade negotiating committee members, I think they recognize this challenge and are taking modest steps to deal with it. I think this is where the PECC can come in very effectively. I think you are not as hampered as your officials and can take a more comprehensive and more ambitious approach to see how to bridge the differences, what intermediate steps you can take sensibly rather than waiting to the end when you try to merge two big agreements. I think this would be a very useful role of the PECC.

# Keynote Speech

**By:**

Mr. La Yifan

Vice Chairman, APEC Senior Official Meeting & Under Secretary-General, National Organizing Committee for APEC 2014, Ministry of Foreign Affairs, China

**Moderator**

Dr Djisman Simandjuntak

Chairman, Indonesian National Committee for Pacific Economic Cooperation (INCPEC)

Dr. Djisman Simandjuntak:

I am here to introduce our keynote speaker, Mr. La Yifan. He is very much the right person for us, considering that he is now in charge of APEC 2014 preparation in Beijing and he has had a very long experience in international organizations. He served ten years at the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) in Bangkok, five years in New York, and another three years in Geneva. Through these postings Mr. La Yifan accumulated a very good mastery of global issues that confront us all. He was Deputy Director General in 2010-2013 at the Department of International Organizations. Right now, Mr. La Yifan is Vice Chairman of APEC's Senior Official Meeting and Under Secretary-General of the National Organizing Committee for APEC 2014 of the Ministry of Foreign Affairs, Beijing, China. As I said in earlier session this morning, we really need something concrete to be delivered from APEC Beijing 2014. Without further ado let me invite Mr. La Yifan to make his keynote speech that I think will serve as a kind of guidance for our two-day conference.

Mr. La Yifan:

The New Year always brings us new hope. At the beginning of the Chinese Year of the Horse, I would like to wish you all excellent health and happiness. This winter is warmer than of 2008, as we all have to brave the chill of the international financial crisis. At the moment optimism is in the air and we can all smell it. The recovering momentum of the major economies becomes clearer. The United States starts to grow, the Euro Zone ended its long time recession, the whisper about the possible falling apart of Euro Zone has disappeared. The emerging economies slowed down but there growth continues. The African economies as a whole shows impressive performance. Recently the United Nations, the International Monetary Fund (IMF) and the World Bank have all upgraded their forecast on global economic growth rates. It is foreseeable that the world economy for this year will return to a fast track of recovery driven by both emerging and developed economies. It requires continued common efforts to turn the positive forecast into reality.

First, enhance confidence in the world economy and consolidate the momentum of recovery. The fact that the developed ended recession is good news for us all. It will certainty help boost sustained and healthy development of world economy. The moderate contraction of the emerging economies is a normal phenomenon of economic cycle. Besides, it is also due to the initiatives by emerging economies themselves in structural adjustment in order to achieve more sustained growth in the long run. In general, we should take advantage of the increasing favorable factors and positive momentum in the world economy, increase spillover and trickling down effects, and enhance the irreversible momentum of the economic recovery.

Second, improve global economic governance and honor the reform commitment. Unstable and uncertain factors of world economy still exist, such as the negative impacts due to exit strategies by major developed economies, various forms of trade protectionism, and difficulties of economic structural adjustment faced by many economies. International community needs to strengthen and improve global economic governance mechanisms, and take solid steps to implement the G20 reform commitment. To Asia Pacific economies, we need to make concerted efforts to cooperate and coordinate within international and regional economic mechanisms including the G20 and APEC.

Third, build and strengthen an open and inclusive global economic and trade system. International community should firmly safeguard the multilateral system centering on the WTO, promote new and greater breakthroughs of the Doha Development Agenda based on the Bali Package deal and fight against protectionism in various forms. We should improve communication and coordination of different FTA arrangements among different sub-regions in the region and we should unite as one. We should abandon zero-sum concept and shape the new pattern of economic integration for a win-win result.

Fourth, seize the new opportunity of China's reform and opening up, and work for common development. The performance of China's economy for last year is uncommon. Our annual economic growth rate slowed down to 7.7%, lowest in decades, but still staying ahead of all the other major economies. Total value of import and export reached 4.16 trillion USD. For the first time in recent history we have again turned ourselves into the world's largest trader in goods. The steady growth and prospect of China's economy is good news for the region and the world as a whole. In the next five years, we will import 10 trillion USD worth of goods, and outbound investment will exceed 500 billion USD, and our outbound tourists will exceed 400 million. Last November, the Third Plenary Session of the 18th Central Committee of the CPC launched a series of greater reform measures and initiatives including promoting the new system of open economy, accelerating the FTA arrangements, relaxing investment access, and expanding the opening of inland and border areas. These measures are not only favorable for China's future development but also favorable for the Asia Pacific region and the world. They will certainly bring greater opportunities for business and development.

Ladies and Gentlemen, the Asia Pacific region including ASEAN is renowned as a region with huge potential. It is also an important engine in driving international economic revival and growth. It has in fact contributed to more than 50% of world economic growth in recent years. With the support of stable macro-economy and mutual reinforcing investment and trade, rapid growing service industry and strong domestic demand. Our region will continue to be a region with sound momentum for further development.

However, we should also realize that prosperity and stability of the Asia Pacific region is faced with new challenges, including regional hot spot issues, rising possibility of economic instability and uncertainty, traditional and non-traditional security threats such as terrorism and Internet crime. Our task is still daunting to maintain peace and promote common prosperity in the region. Taking stock of historical development in the region and looking forward to the future of the regional economic integration, it is important that we make progress in the following areas.

First, we must maintain a peaceful and stable environment. I would like to quote the words of Chinese President Xi Jinping who once said, "Peace, like air and sunshine, is hardly noticed when present, but none can live without." History has taught us that development and prosperity is like a highly fragile plant. It is only in full blossom in a peaceful and stable environment. If we follow closely the twist and turns in the Middle East and North Africa, we could find the unrest there has not only inflicted enormous suffering on the ordinary people but also consumed valuable time and resources for national development. And only when we look at the Asia Pacific, we then come to realize how much we have benefitted from a peaceful and stable environment on the whole for so many years after the Second World War. We are all winners in that process. For that, China always firmly supports peace and stability in our region and beyond. Having been thrown into deadly wars of the last century, our aspirations for peace are most relentless and unyielding. We have benefitted a lot from a peaceful regional and internationally environment and in turn want to contribute to it through our own development. That said, lasting peace and stability in our region is not a solo task for China. It is also everyone else's responsibility to contribute to the process through concrete steps of strengthening mutual trust and promoting common development.

Second, we must break new grounds for cooperation. There now exists an increasing number of multilateral Free Trade Arrangements in the Asia Pacific region. Trends towards integration and fragmentation are both on the rise. As a result, member economies face a "dilemma of choices". We believe the realization of regional economic integration requires both vision and action. The vision should be bold, strategic, and in harmony with the global trend. The action should be cooperative, practical and consistent with Bogor goals. Members of the Asia Pacific community should work together to embark on the FTAAP process. As Minister Lim has just said, that concept has been brought forth ten years ago and touched upon by our leaders on several occasions, and it is about time to take concrete steps to move it further. Efforts should also be made to support the multilateral trading regime, promote trade and investment liberalization and facilitation and further strengthen cooperation on global value chains and supply chains. In order to make sure that every member economy benefits. It is also imperative to enhance economic and technical cooperation, capacity initiatives and other programs that address the needs of different developing economies.

Third, we must continue reform and promote innovative growth. The international financial crisis has exposed the unsustainability of the traditional growth pattern and altered us to the urgency of structural and innovative development. With that spirit of innovation and reform over the past couple of years, many Asian and Pacific economies have taken steps to transform economic growth patterns and to improve the quality and efficiency of our economies. This shared pursuit has sustained the Asian Pacific economic integration with enormous power. Innovation, reform and growth are inseparable. With smart policies, they can reinforce each other and tap huge potential.

Fourth, we must continue to promote comprehensive connectivity. It is part of the priorities by the previous APEC host, Indonesia. When we took over the baton, we intend to continue to push forward the work on comprehensive connectivity, which is the foundation for long-term economic development in the region. The achieving of the goal of comprehensive connectivity in our region will benefit the economies of our region both in scope and in long term. The opportunities of cooperation are abundant. We need to formulate solid plans that cover both sides of the Pacific Ocean. Since funding remains a bottleneck, we also need to think of new ways to expand channels of financing, improve infrastructure-financing mechanisms, and foster investment partnerships among governments, private sector and international institutions. We believe that improving infrastructure and stronger cooperation under international fora will eventually lead to stronger ties among our people. In the spirit of long-term and common development, China has already proposed a number of initiatives, for instance the "Silk Road Economic Belt" and "Maritime Silk Road for the 21st Century", and upgrading of the ASEAN-China FTA, and the establishment of Asia Infrastructure Investment Bank (AIIB). I do believe that further down the road these proposals will gather tremendous momentum for the economic growth and connectivity of our region.

Ladies and Gentlemen, this year marks the 25th anniversary of APEC. Twenty-five years ago APEC was founded with the commitment to deliver economic growth in the region and improve people’s living and livelihood and promote regional prosperity. The founding of APEC has not only turned a new page in regional economic and trade cooperation in our region, but also serves as a milestone in promoting regional trade liberalization and facilitation. Today APEC has already become a vital contributor to global economic governance and regional economic cooperation.

We are fully aware of our responsibility of being APEC host again thirteen years later since 2001 in Shanghai. We’ve kept thinking about how we can deepen mutual beneficial cooperation, carry forward the spirit of APEC community and promote regional economic cooperation. We are also thinking about how we can better use APEC as a bridge to link every member economy in the spirit of openness and inclusion. APEC members have high expectations for us. We will try hard not to fail your expectations and make 2014 APEC a milestone. And that also depends on your wisdom, suggestions, proposals and support.

During the Informal Senior officials meeting held last December in Beijing, we proposed a theme “Shaping the Future through Asia Pacific Partnership”. That is based on the above considerations that are also based on the APEC agenda and cooperation in recent years. We intend to build upon the achievements made over the years, and efforts made by the previous host. We’re not starting anew. Under the theme, we will focus on three priorities: namely, advancing regional economic integration, promoting innovative development and growth, strengthening comprehensive connectivity and infrastructure development. Later this month in Ningbo, we will hold the first Senior Officials Meeting and related meetings, which is the first official event in China APEC year. We will fully discuss around the theme and priorities, identify key areas of cooperation and formulate working plans for cooperation for this year. We welcome you in Ningbo and work together with all APEC members to make contributions for our common good.

The preparation for APEC economic leaders meeting is systematic work, which relies on active participation and strong support of all stakeholders including PECC. PECC is an observer of APEC and also an important think tank in the region. PECC has abundant resources and distinct advantages. We welcome your further inputs and contributions.

Looking to 2014, Asia Pacific has become a common destination with more converged interest but faced with more complicated challenges in the years ahead. China will do it’s upmost to fulfill the responsibility of the host to carry forward the community spirit in the region and to promote a more active and innovative regional economic cooperation. On the basis of past achievements, we will make new progress in regional economic integration and connectivity and contribute more to sustained development, progress and prosperity in the region. It is the year of the horse. Let's start to run.

**Question and Answer Session**

Dr. Djisman Simandjuntak

Thank you very much Mr. La Yifan.  You have hinted to us the likely framework for APEC 2014 with the three priorities that you emphasized in your speech. As you underlined at the beginning, we are all winners of peace and I think peace is very important to economic development in our part of the world. But some are big winners, some lesser winners, but winners we are all nevertheless. More specifically we are all winners of trade policy reforms that we have been doing all along, multilaterally, regionally and unilaterally over the last forty years. Now we have to deal with China as East Asia’s number one in many and perhaps in many more ways in the years to come. Ladies and gentlemen, Mr. La Yifan has outlined to us how China is going to take the responsibilities that come along with the rise of China and its status as a number one trader and, sooner or later, also as number one investor. We have a few minutes left for discussion, and I would appreciate if you can focus on how our PECC can contribute to the success of APEC 2014.

Participant:

I wonder if Mr. La Yifan can comment on China's thinking around the Asian Infrastructure Investment Bank (AIIB)? How does China intend to pursue this idea, because you've identified the issue of infrastructure and connectivity as a major challenge to the region?

Mr. La Yifan:

Dr. Simandjuntak has mentioned that China has turned itself in so many areas as number one in the world, I take that as a complement. We are the most populous country in the world and continue to be number one in many areas, such as mobile phone users, Internet users, and number one in terms of foreign exchange reserves. According to WHO, we are also number one in new cancer cases. That is the latest publication. Coming back to the question just raised. We have actively realized the importance of developing infrastructure before you embark on the roads of economic development. In fact in China we have a saying, "if you want to be prosperous build a road first." For that reason and based on our own experiences, we have concentrated so much on infrastructure and connectivity. Not only in our own country but also in the region. For that purpose, we have made a proposal for the establishment of an AIIB. That concept has already gradually and steadily taken roots. For the moments, my colleagues in the Treasury Department have already started the process of informal negotiations and consultations with the regional governments. We hope by the end of the year there will be some concrete outcomes, but that will also depends on all the other parties. We believe that this bank is not something exclusive, it is open and inclusive, and will served purpose of contributing to infrastructure financing for the region and beyond. For connectivity, we rely on the wisdom of all the member economies of APEC, in particular our previous host Indonesia. We are receiving concrete proposals coming from all the members. I believe in the upcoming SOM1 in Ningbo, there will be more concrete ideas in that regard.

Dr. Narongchai Akrasanee:

It’s very clever of the organizers to start the program with China. It reminds me of this quotation about Spiderman, “Power comes with responsibility.” In the case of China, I am reminded of Napoleon Bonaparte who said, “When China moves it will move the world.” That’s why he did not move to China, he was afraid of China at the time. The evidence is quite obvious when China moved in 2001 into WTO it moved the world. This time China has made a very strong announcement at the Third Plenum last November about the new China move. I would very much like to hear from the speaker about these new policies, the so-called new China reforms. The speaker talked about this earlier, and about seizing new opportunities of the new China reforms. This is the most important part of the speech; first, about supporting economic recovery; second about improving economic governance; and third, also about supporting the WTO. Making such statements is like saying “mother is a good person.” It is very standard and I think we can skip most of those and concentrate on China’s reform. I hope very much that this APEC in China would focus on this particular point of China’s reforms, in particular the implications of China’s financial reforms. The world has been disturbed by this financial crisis for too many years, and we’ve been looking forward to a new so-called financial governance of the world, and we wonder whether and how the new China reforms would contribute to the development of the financial sector of the world.

Mr. La Yifan:

Thank you very much for that question. First of all I would like to thank Napoleon about his predictions so many years ago. In fact, despite all the achievements we still consider ourselves a developing economy. If talked about the financial impact of China’s development in that setting, we are still learning from the advanced economies on how to make our financial sector more efficient, more upbeat to the global economy. You’ve also talked about the responsibilities, I certainly agree with you, with power comes responsibility. We are trying our very best to be responsible; not only for our own economy, but also for the region and the world. Many people have focused on the fact that we have over the past decade a double digit growth in our military spending, but I can also tell you our foreign aid has also grown over the past decade with double digit growth. Our financial contribution to the United Nations regular budget has even grown triple digits, so that is a fact. Talking about financial fluctuations especially, some of the economies devaluated their currencies in order to get out of the recession. It is tempting for us to devalue also, but as a responsible member of the international community, instead we maintained the stability of our currency and have in fact appreciated recently. With that measure, we are trying to do our upmost to be a responsible member.

However, due to the limits of our overall development level, we couldn’t do more. We are also expecting the other countries to also adopt the same approach; if that is the way, it is good news for the region and the world.

Dr. Djisman Simandjuntak:

As far as bilateral initiatives are concerned, China has done an enormous job in terms of cooperation with all countries in all continents. The challenge now is how China should play its role in regional and multilateral institutions.

Professor Christopher Findlay:

PECC and APEC have a very active relationship in the discussion of services reform. Could you say a little more about the focus on services in this year’s APEC? Following on from Dr. Narongchai, services reform is a big part of the reform agenda in China, and if you could say a little more about that and how you see the work in APEC complementing domestic reform would be helpful. China has an opportunity to really stake out a very good services reform agenda for the region, and we would be pleased to work with you on that.

Mr. La Yifan:

Thank you for that question. Of course the service sector is something that we are trying very hard to increase the portion of the services sector in the overall economy and we would like you to note for the first time in our history that the service sector has taken over the other two sectors in the Chinese economy. We take that as a positive sign, which means that our structural reform has started to show some results. It is even more important for the improvement of economic development patterns in China, because we have in the past relied on too heavily on our exports and the export driven economy. I believe it is a similar case for many economies in the region. For that reason, among the three priorities for the APEC year, we have proposed innovative development, economic reform and growth as the second priority. Under that priority, we are keen to listen and learn useful experiences of our developed partners. We will take some of the useful proposals into our leaders' declaration. If we can formulate some concrete results, that would be even better. That would be in line with the economic structural reform of China, but also in line with policy priorities of a number of economies in the region.

As the host, we will keep our ears wide open, and listen patiently to the advice and proposals from the member economies including the more developed economies like Australia.

Dr. Djisman Simandjuntak:

The other way round is also important. How are we, countries in the region, engaged with China and doing our respective homework? Last night the queuing at the airport was unusually long. Imagine what might happen if 400 million more Chinese tourists come to Southeast Asia over the next five years? A lot of preparation will be needed. Thank you very much Mr. La Yifan for the inspiring speech. We wish you a great success in leading your team to make APEC 2014 a great success.

# Session I: Strategic Assessment and Outlook of Asia Pacific Economy

The Asia Pacific economies are undergoing structural reforms for the purpose of achieving sustainable development and improving people's living standards. Based on the stocktaking of the experience in the past and an outlook of the direction of regional economic development for the next 5-10 years, we need to study:

(1) The different patterns of economic restructuring and the approaches of implementation.
(2) How APEC can enhance economic policy coordination towards achieving the Bogor Goals, bearing in mind APEC’s interim milestones and commitments for implementation.
(3) How to ensure that all economies gain from participating in structural economic adjustment and the global value chain.

**Moderator**:
Mr. Denis McNamara
Chairman, New Zealand Committee of the Pacific Economic Cooperation Council (NZPECC)

**Keynote Speech:**
Mr. Bert Hofman
Chief Economist for the East Asia and Pacific Region, The World Bank

**Panel Discussion:**

- Dr. Manfred Wilhelmy
  Chairman, Chilean National Committee for Pacific Economic Cooperation (CHILPEC) & Executive Director, Chile Pacific Foundation
- Mr. Yuen Pau Woo
  President & Chief Executive Officer, Asia Pacific Foundation of Canada
- Mr. Ong Ye Kung
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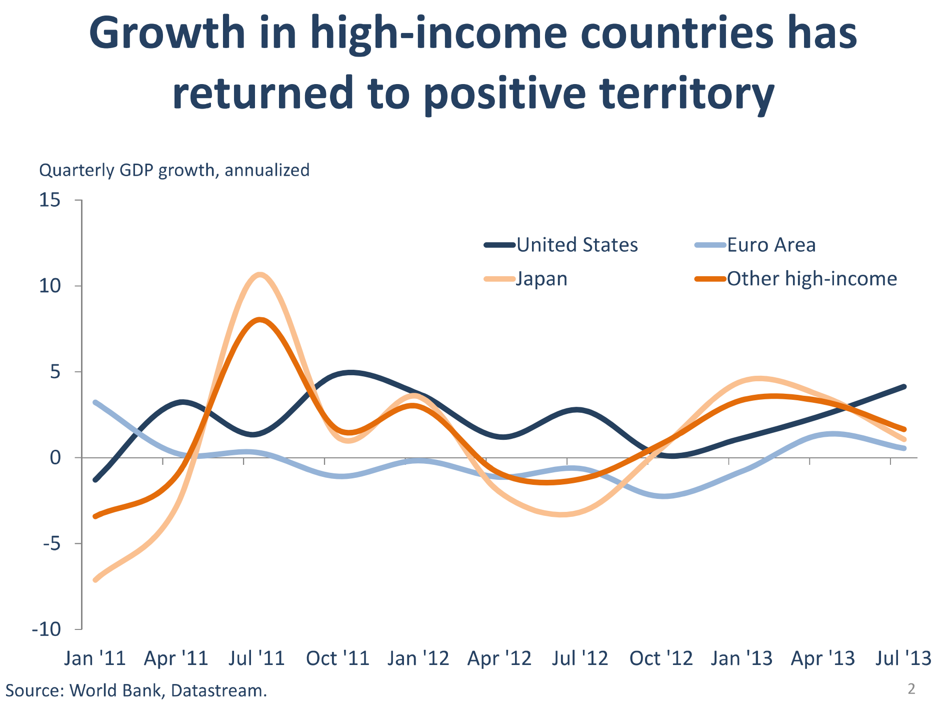
Mr. Denis McNamara:

This session nicely runs on from the previous session and the speech by Mr. La Yifan, who reminded us twenty-five years ago of the objectives that were set up by the formation of APEC. This session is concentrating on the strategic assessment of what has happened and where we are going in the future. It's about change, and that is a tremendous thing. Change is inevitable, the question is, is whether we are doing it right.

Mr. Bert Hofman:

Mr. La Yifan made it very easy, he introduced a number of themes that I will actually dig into a little bit. I was asked to speak about the strategic assessment of the APEC and the world economy, and how the APEC economies have developed over the last twenty-five years. Convergence is really theme within APEC and I'll show you why.

Figure 1.1



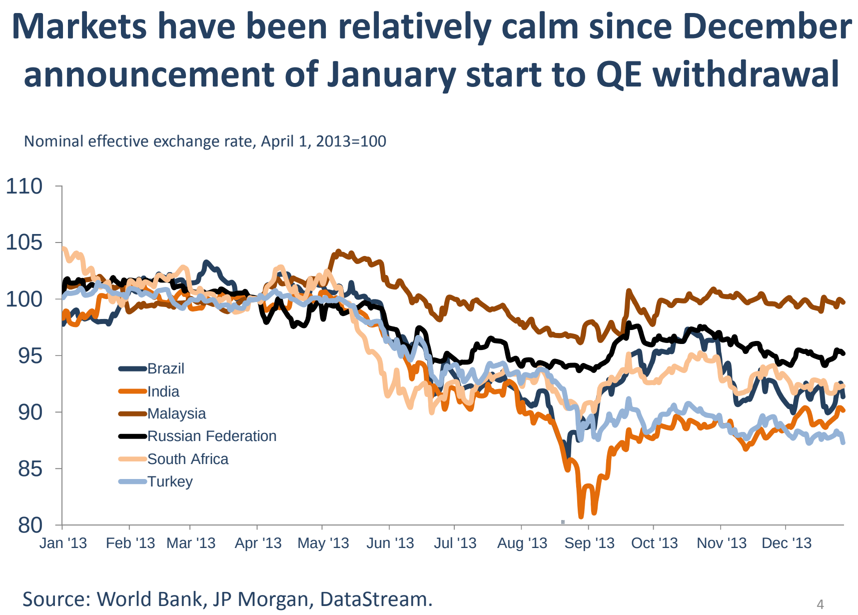

The world economy is entering a new phase; we are now clearly post-crisis and see normalization of macroeconomic policies over the next three to five years. We still have to watch this play out, clearly there are still issues; EU's moderate growth; Japan is a question mark, is Abenomics going to work? But overall we are likely to see a recovery that is likely to sustain, and the crisis is over.

The tapering of not just the U.S. and EU policy, Japan's exceptional monetary policy over time will have a little bit of a rough ride, but most developing countries in our view have their act together far better than even in 2008 or let alone during the Asian Financial Crisis. We believe that for most, the turbulence that comes from the tapering of those measures over the next years can and will be managed; of course, there's always the but.

There is always risk, and this needs to be managed. If you want, it is still the highest priority for most policymakers within the region. However, with a recovering world economy, the structural agenda is clearly coming to the forefront and that's a good thing. The structural bottlenecks have been a constraint on growth. For the last five years, it was on demand. Focus was on keeping demand going, and rightfully so. By now, the underlying growth rate, the structural growth, of most developing economies has slowed down, in part because we think the structural agenda has been on the backburner, it needs to come on the front burner again to regain the rapid growth that we saw before the financial crisis. I think the panel has some great ideas on how to do that; I am just going to glance over very broad barometers.

We see growth firming up in developing countries, and even after a short dip in the South Asia continent, things are looking up again going forward. There has been quite a bit of volatility last year in the talks about the tapering. But when tapering actually started in December 2013, markets have been relatively quiet. With one or two exceptions, and these one or two exceptions are important because they may have implications for APEC countries; in the middle of last year, the market reaction was any emerging economy, the drawing back capital from emerging economies.

Figure 1.2




Now the markets have become far more discerning, and only very few are at the center of attention. It is now no longer the fragile five, but the desperate duo (Turkey and Argentina). Turkey is still a bit more vulnerable. Turkey is the only one who has seen a more heavy depreciation. Commodity prices have been easing but have now been stabilized, but still high compared to early 2000's and at higher level than during the depth of the crisis, still some developing commodity dependent countries will be affected by that.

Figure 1.3

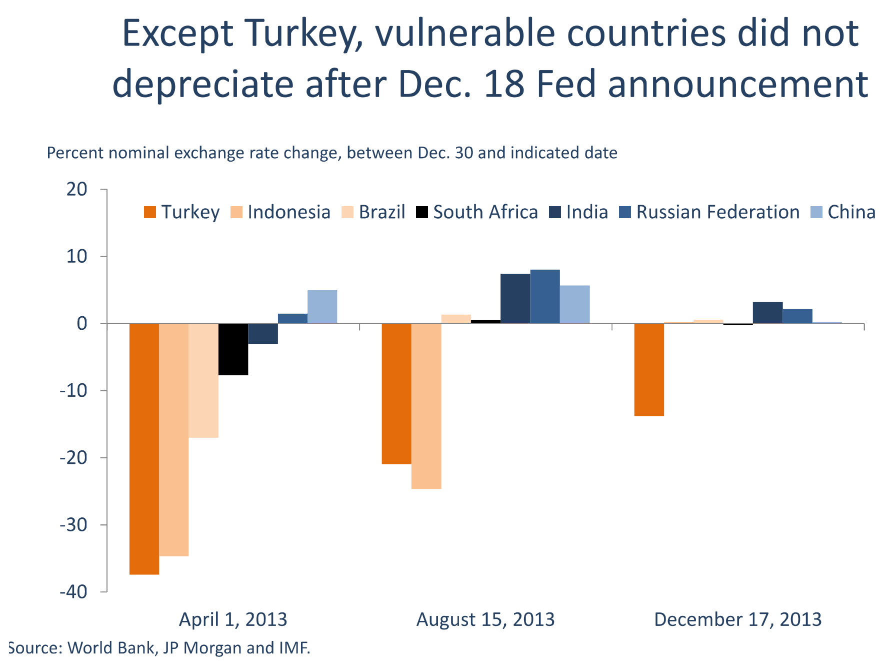
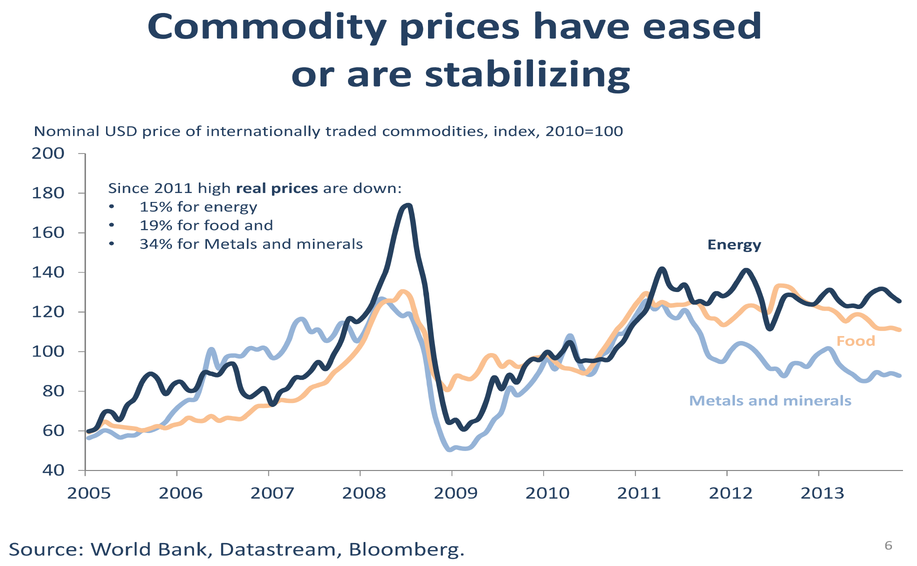
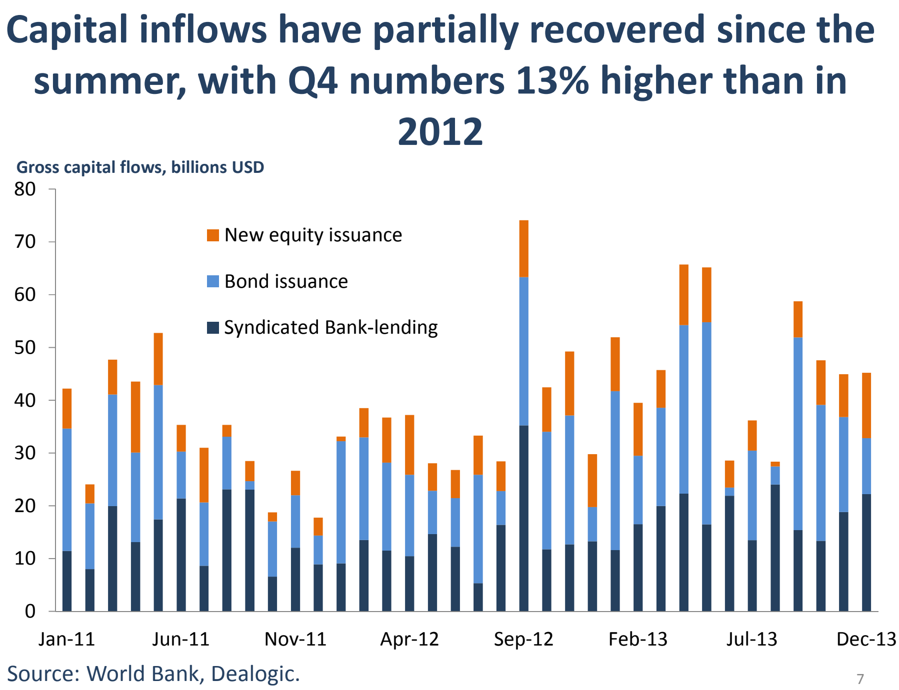


Figure 1.4



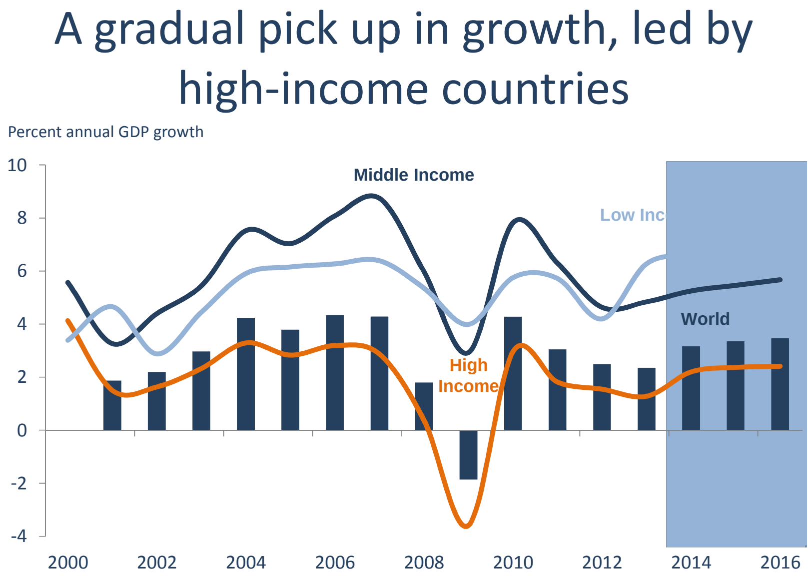

Capital flows to developing countries were under pressure in the middle of last year (2013), as said during the talk of tapering, since then they have been reasonably well recovering even though the most recent data shows that the inflows in emerging markets funds has been reducing, and therefore we could see yet another reduction in capital flows to developing countries, but it will stay positive.

Figure 1.5



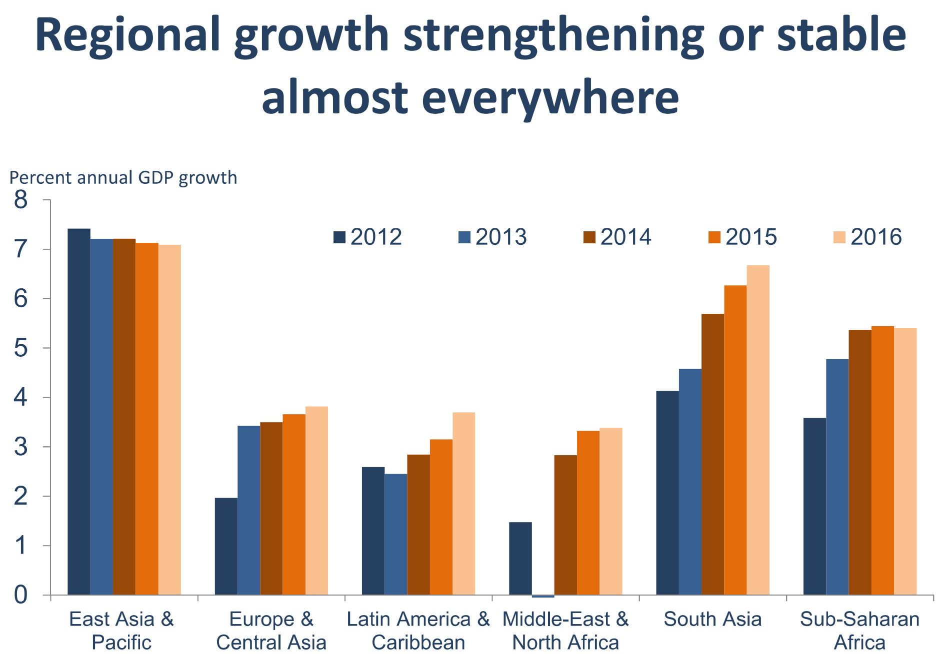
Our forecast for the next couple of years is a gradually recovering world economy, this time lead by advanced economies but developing economies still benefitting from additional demand coming from the advanced economies. Through the regions, we see that East Asia is still very strong, and Europe, emerging Europe, is gradually recovering from the weaknesses in the Euro-area. Latin American and the Caribbean are doing relatively well and accelerating, and South Asia is overcoming weaknesses over the last couple of years.

Figure 1.6




Source: World Bank.

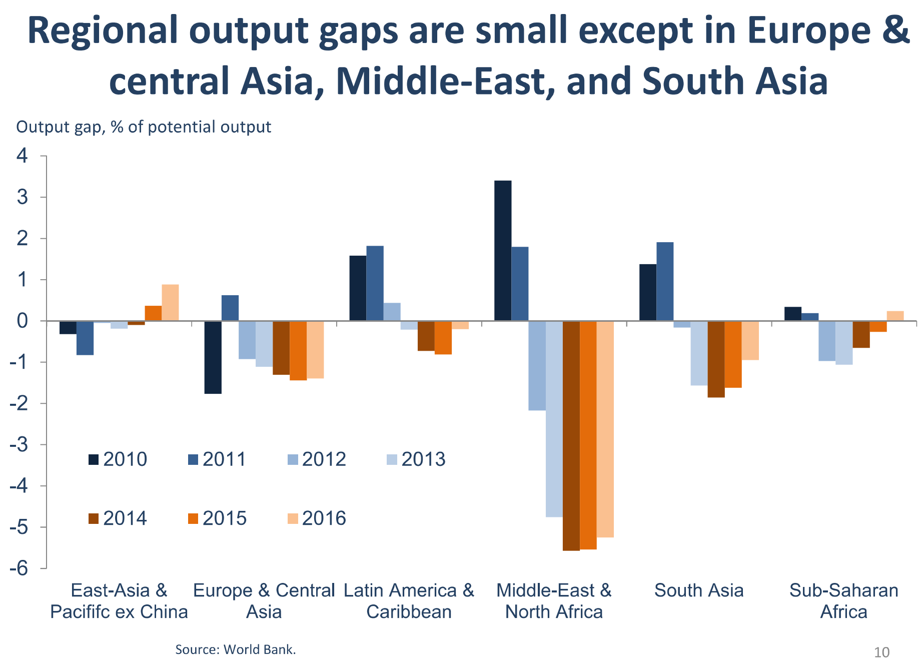
Figure 1.7




Source: World Bank. 9

If looking at regional output gaps (how close is demand to capacity), we see that most developing regions, with the exception of the Middle East because of the political chaos, are close to capacity growth. That means you can't grow much faster than your capacity growth, otherwise you run into issues of inflation, current account deficits and potential unsustainability, and that's not something you want to have at a point in time when the tapering of monetary policies starts to happen around the world.

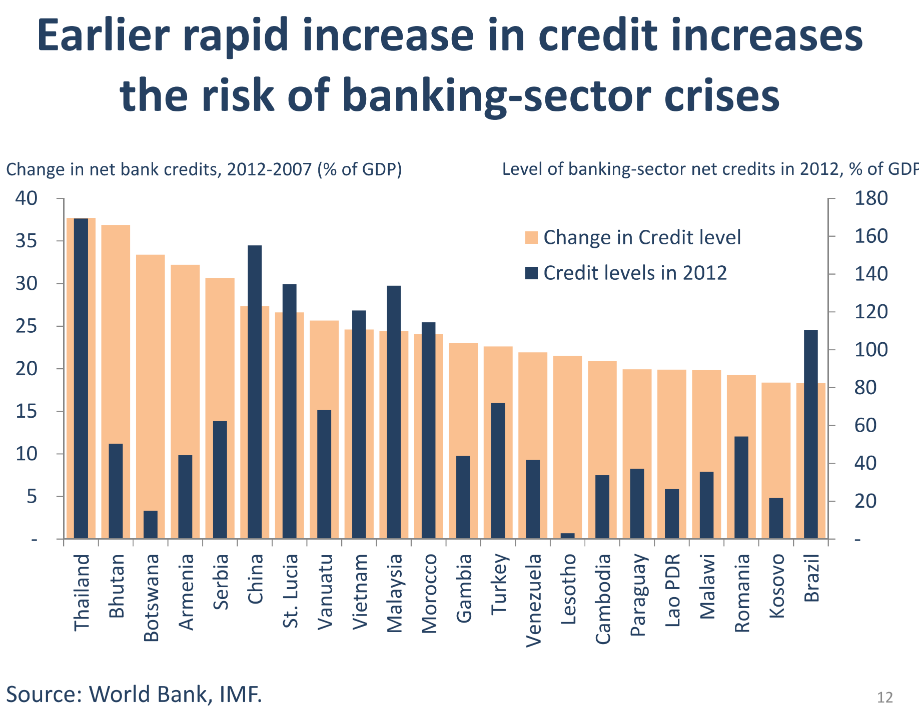
Figure 1.8




On the tapering and the potential effects, we did quite a bit of modeling work and even under quite extreme circumstances you see the impact of tapering in the end is relatively small. This shows that capital flows to developing countries as a percentage of GDP of developing countries and even in quite extreme, the lowest line projects something of a 200 basis point increase in the U.S. interest rate if you want a very sudden increase, even that will maintain capital flows to developing countries as being positive.

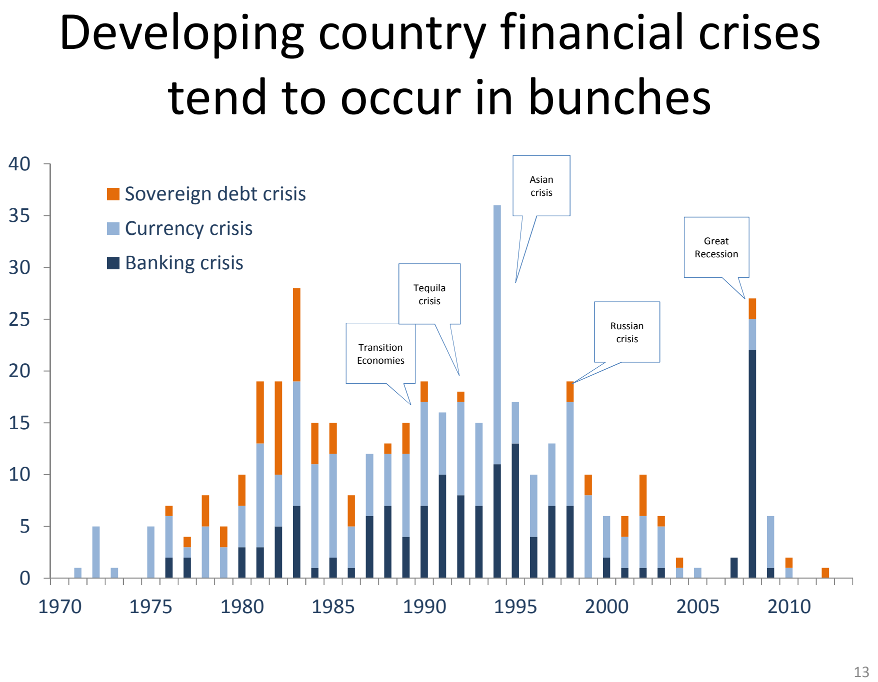
Overall there doesn't seem to be too much to worry about if indeed you have your act together, and most countries have, and are quite strong, have large international reserves, and reasonably solid banking systems. But there are a few things to worry about. The main one on my mind is a very rapid increase in credit over the last five to six years in developing countries; China stands out, I'm afraid, not necessarily in a good sense. Overall debt-to-GDP is over 200 percent, and overall credit-to-GDP is about 160 percent, a very rapid increase in both of those numbers. Not all of them are fully controlled on the banking and financial side, the shadow banking system and on the real side, local governments have been borrowing through their local government financing vehicles both relatively in-transparent ways of managing the financial sector, and therefore it has increased the risk in China. But in other countries, including Thailand and other APEC members, Malaysia, you've seen a rapid credit increase as well. I think this is one of the biggest risks. Of course China has a relatively managed, almost closed capital account, so they will be far less impacted by the tapering than many of the countries in the region. So China has its own problems that it has to deal with in the financial sector, but less related to tapering than for instance Thailand, Malaysia or Indonesia for that matter who have very open capital accounts.

Figure 1.9




And of course, even if you're in good shape yourself as a country, you always have to watch your neighbors. As an economist for East Asia, I watch the Ukraine, Turkey, Argentina and South Africa, why is that? Because history shows that crisis's come in bunches, and of course, we are very well aware of that in the region, where somewhere in July 1997 Thailand said they were going to float the Baht, and we were very convinced that it wouldn't have impact on any other countries in the region because they looked so strong. Now we know better, and if you look at history it is quite interesting how indeed there's a bunching of those financial crisis. It's actually remarkable how little or few financial crisis were triggered by the global financial crisis, it was largely a Western country phenomenon and didn't spillover into the emerging world which in the past it happened much more. Nevertheless, the region is in relatively good shape but keep watching the neighbors.

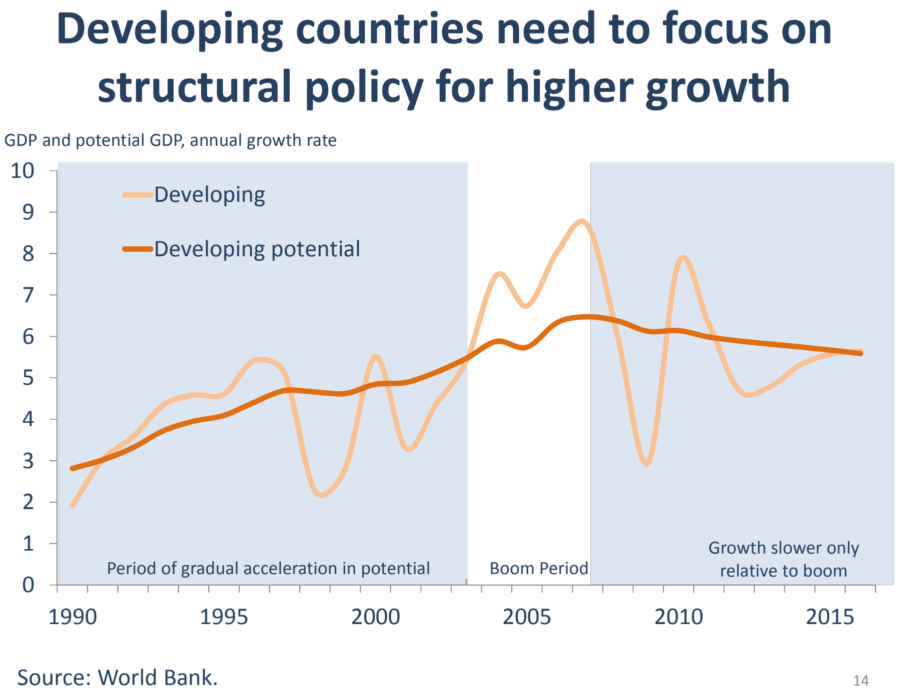
Figure 1.10




So developing countries are now growing. Demand in our projections is going to hit capacity constraints, and that means if you want to grow faster without inflation and current account deficits, you actually need to turn this around (the dark line) and the dark line has been coming down, i.e. potential growth has been declining since the break of the financial crisis. This is not surprising as there was an enormous amount of volatility and it was very difficult to actually do reasonable investment in there, and the structural agenda was also on the backburner over the last four to five years.

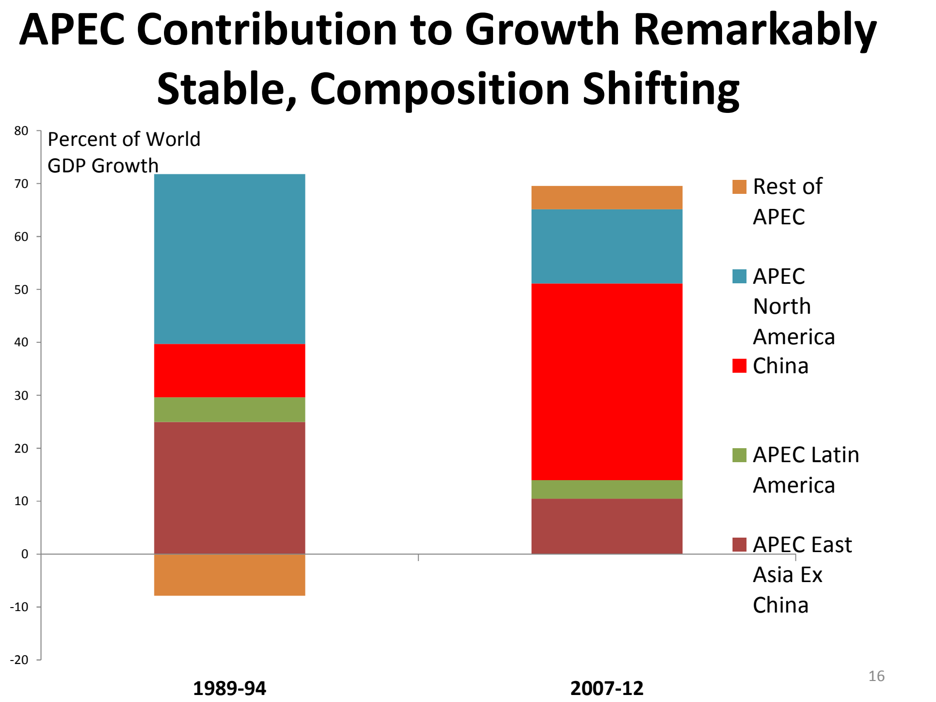
Going forward if you want to go back to the higher growth rates that you saw in the boom periods, you have to continue to have the structural reforms going that will increase your capacity growth.

Figure 1.11



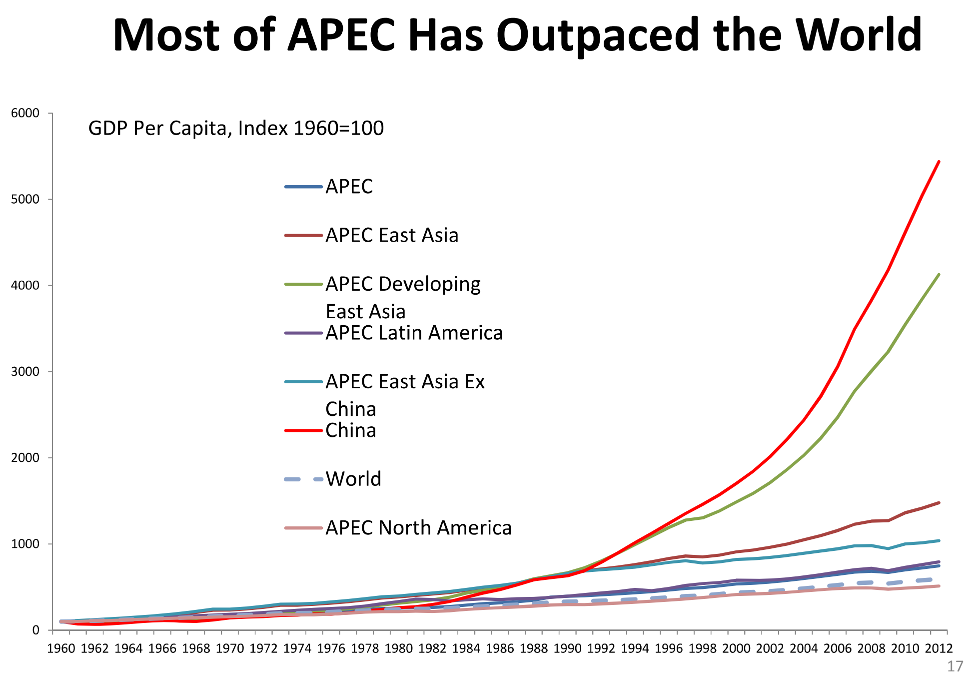

Turning to APEC. APEC frankly, I had to do some handwork because World Bank doesn't have an APEC program standard – APEC is more 60% of world GDP in terms of growth. The start of APEC in 1989-1994, you see that 60% of world growth indeed comes from APEC and that hasn't changed; 2007-2012, it's more or less the same. The composition within APEC has changed dramatically. Before China had a reasonable 10% percentage point growth contribution to world growth, now it is 1/3; so a dramatic increase because China had 10% twenty years ago meant far less and China was still small. Now China is very large, and 7-8% now means far more. China really is the big change here. Russia had a negative contribution but has since begun to turn positive. Strong growth because of APEC, this is a reflection that emerging economies play a far larger role in the world economy compared to ten to twenty years ago.

Figure 1.12



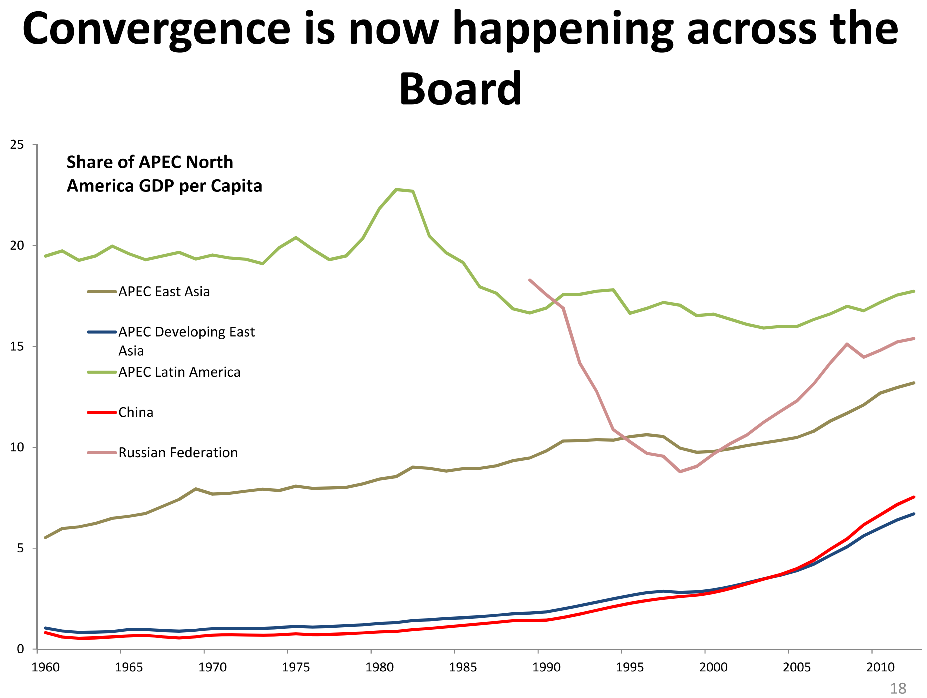

If you look at GDP-per-capita over the last fifteen years, APEC has been a real success story. China almost 10 folding its per capita income since the 60's. Each and every APEC member except the North American members have outpaced the world average, and have done better than the rest of the world.

Figure 1.13



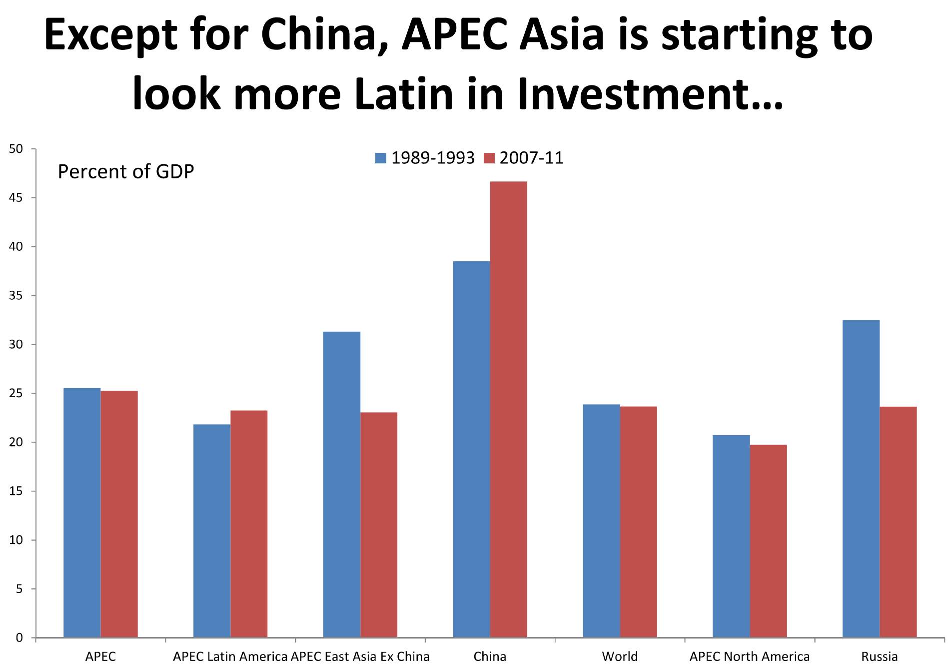
Over the last fifteen to twenty years, maybe that is with the founding of APEC, there's also been a true convergence. This shows per capita income as a share of North America's per capita income, here you see what Vice Chairman La Yifan said, of course China is growing very rapidly but look at the per capita income, there only less than 10% of the North American per capita income. So China's big and growing very rapidly but still relatively modest in terms of per capita income. Interestingly enough the Russian Federation after its transition declined, growing very rapidly and converging to the United States or North America per capita income. Even Latin America after its lost decade in the 1980's and 90's has now started to catch up in recent years.

Figure 1.14




If you want to see a great story of convergence, whether this is APEC itself or whether it is the countries themselves that have done sensible things, this is a remarkable picture of convergence. If you go into a bit more detail, there are other convergences as well. We're all becoming more Latin. Even East Asian's are become more Latin. China in terms of investment, China of course is exceptionally high with almost 50% of GDP in investments, but once you take out China, the rest of APEC in Asia is starting to look quite similar to Latin America in terms of investment levels.

Figure 1.15




It is no longer the East Asian exception with very high investment and export rates; Latin American exports are starting to rise quite rapidly as a share-of-GDP, and of course, East Asia as well. It is no longer if you want a Latin domestically oriented internally focused economy, not quite a big jump outwards in Latin America as well, and by in large outpacing the average in APEC. There has been a convergence in models if you want in both investments, exports, and as well as in services.

Figure 1.16

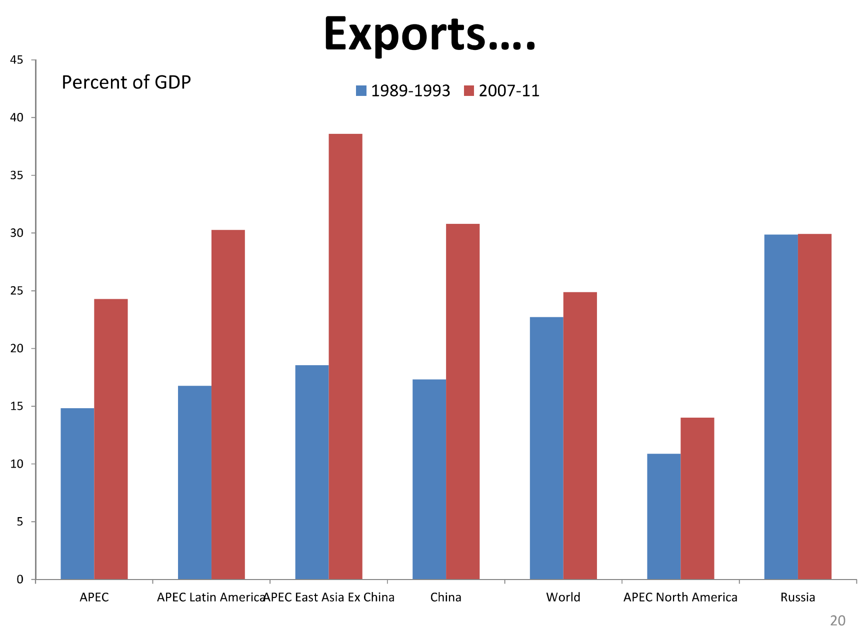
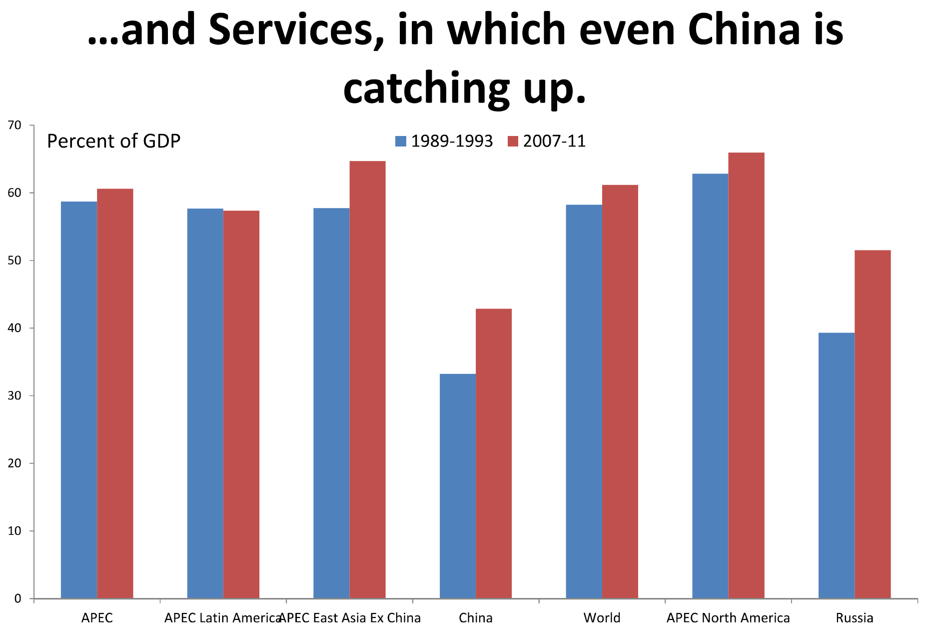


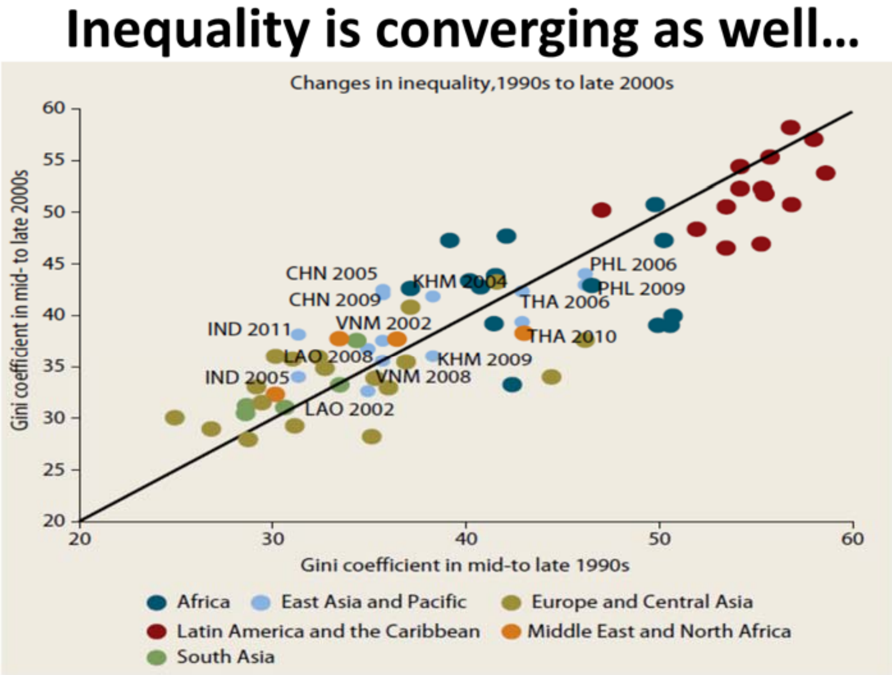
Figure 1.17




Before Mr. La Yifan said that China is behind in services, yes they are in part it is a statistical problem I think, but they are catching up quite rapidly; but of course here East Asia, outside China, has already caught up. Again, the image of East Asian APEC members as the manufacturing juggernauts is no longer true. Indonesia is interesting in that they have caught up very rapidly in part driven by natural resources wealth, which employs only a very few people, get spread and then is consumed by services; maybe that's a bit of a distortion, but nevertheless a very rapid convergence as well.

Finally, even inequality in APEC is converging, and that's not necessarily a good thing. The good thing is that you see here the GINI Coefficient (the measure of inequality) for the Latin American economies in the 1990's and the latest that we have, so here the Latin American's used to be very unequal and they still are, but really most of them have seen a decline in their inequality. Whereas a lot of the Asians, the blue dots, they are on the increase, still low but still rising and rising quite rapidly; in Indonesia and China, they say it has declined already but the dramatic increase over the last thirty years from a GINI Coefficient of less than .3 to almost .5, starts to look very Latin American. Maybe unavoidable in rapid growth, it is interesting to see far more similarities now, and maybe far more issues associated with it because managing high inequality in a political sense is not so easy as many countries around the world have shown lately.

Figure 1.18

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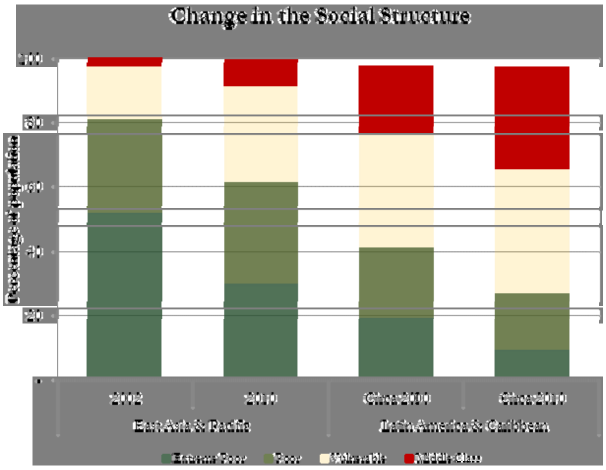
Final point of convergence, even though Latin America is far ahead of East Asia in the rise of the middle class, which is only starting in East Asia, the middle class here is defined as anybody that spends between $10 and $100 dollars a day, that's already quite seriously rich in World Bank terms, but it is what we call the middle class. Latin America and the Caribbean have a far larger middle class at about 30%, East Asia is only starting but is growing quite rapidly from the past. So you see that countries doing relatively well and their patterns of development are starting to converge, and even their social structures are becoming more similar. If you want you have more in common and more to talk about, we have found that the middle classes are good for policy, i.e., better policies are associated with higher shares of middle class in the economies.

Figure 1.19

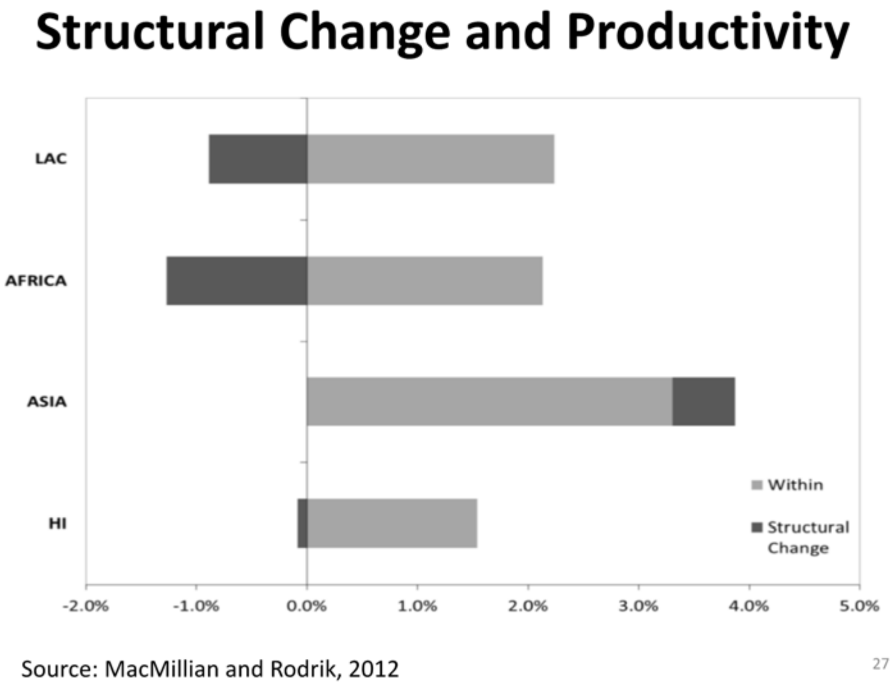
# The Rise of the Middle Class




*Notes: East Asia & Pacific: China, Indonesia, Malaysia, Philippines, Thailand, Vietnam. The data for Latin America & Caribbean includes Argentina (2000-2010), Bolivia (2000-2008), Brazil (2001-2011), Chile (2000-2009), Colombia (2001-2009), Costa, Rica (2000-2009), Dominican Republic (2000-2010), Ecuador (2000-2010), El Salvador (2000-2010), Guatemala (2000-2011), Honduras (2001-2010), Mexico (2000-2010), Panama (2000-2010), Paraguay (2001-2010), Peru (2000-2010) and Uruguay (2000-2010). Source: POVCAL and household surveys.*

Final slide, as mentioned before, most developing economies are starting to hit their capacity constraints, so in order to continue to grow rapidly or accelerate growth rates you have to do structural reforms. Actually surprisingly and the data shows is that inter-productivity increases is how you grow. All parts of APEC have done relatively well in growth, what I find interesting, research done by Denny Roderick and Ms. Macmillan, is how the different resource allocation is on the different continents. Both Asia and Latin America, two constituting parts of APEC, have done relatively well in increasing productivity within sectors, and that’s what you see in the grey. Asia has grown a little more rapidly, but Latin America is doing very decently. So the intra-productivity increases due to all kinds of reforms, not just reforms and policies, but also the entrepreneurs across the Pacific saw that increased productivity in the sectors are very well. But there is a very different pattern of structural changes that are met. Mainly it means that the question is are resources, capital and labor, moving to those sectors that are increasing their productivity most rapidly? You’ll find a remarkable contrast. In Asia, those sectors that are increasingly becoming productive and attract more resources; in Latin America, they do not.

Figure 1.20




Now the question is why they do not? There are all kinds of reasons, but one of them could be that, these protected sectors that are privileged continue to amass capital and have privileged ties to banks and can get bank loans or are behind protective walls and can continue to give high wages that attract the labor. Just suppose Latin America would manage to shift this part to here (indicating to the PowerPoint), they could gain 2-3 percentage points of GDP in growth. So let's talk about making those reforms happen.

Dr. George Manzano:

The global crisis of 2008 has turned economic logic on its head, particularly in Southeast Asia. Prior to the crisis, the region's large export-driven industrial base was seen almost entirely as a source of strength being export oriented. During the crisis, it has become a liability. Openness has become a liability, something that our speaker mentioned earlier. The financial crisis of 1997 was considered a curse in this part of the world. However given what happened in 2008 and the fact that the financial and banking system of Southeast Asia remained relatively stable during the turmoil, the 1997 crisis has become almost like a blessing in disguise. The crisis of 1997 was a very difficult period but it served as an early warning. Efforts were expended to recapitalize the banks and to look more closely into the system, improve it and shield it from the bigger bang that would come in 2008.

Yet after the crisis, economies do adjust and recover as we saw in the presentation of Mr. Bert Hofman. The speed at which they rebound depends on many factors; the quality of economic policies, the quality of the structure of the economies.  Now trade flows among APEC economies have exceeded the pre-2008 crisis levels, perhaps the same can be said for FDI flows in Asia, although one might not be able to say the same for world FDI flows.

Crisis often times leads to soul searching among policymakers and stakeholders alike. What has gone wrong? What are the merits of openness? Is it a good thing in itself? Is there an optimal level of openness? And because countries are normalizing these days, there is enough respite for economist and policymakers to mull over these issues. What is the role of capitalism in driving economy activities? Is there such a thing as too much capitalism? Is there a middle ground for capitalism? These are big picture stuff.

On the topic of  'what are the strategic options open for different stakeholders in the Asia Pacific six to seven years after the global financial crisis, 'I would like to propose two things:

First, to look at global supply chains, production, international production networks, and not to focus on simply goods and services per sector as the unit of analysis for evaluating trade flows, negotiating trade agreements, and crafting facilitation and other means of cooperation. Second, the global crisis just unmasked that capitalism, the sort that glorifies short term profits and profits at all costs, as mainly unsustainable.  Many observers have pointed to that particular issue as the cause of the 2008 crisis, which prompts us again to look around for alternative systems. Perhaps business and policymakers alike can look at emerging alternatives such as the 'shared value' as a paradigm that could animate sustainable Asian-Pacific growth moving forward.

Now let us talk about production networks as the unit of analysis. Global trade is increasingly shifting towards trade in intermediate goods.  As many people observe, not all of trade is in intermediate goods, but an increasing proportion of trade is in intermediate goods. More international traded products are composed of parts and components from a number countries that are trade to other countries to be assembled into a final product. Estimates vary between ½ to ¾ of overall world trade is in intermediate goods. In Asia, this trade in intermediate goods is quite high and among developing countries it is quite high too. Now how will phenomenon of global supply chains, production networks change our way of thinking about comparative advantage and negotiation in trade talks regarding openness in general. Could we change it?

First, what could be the basis of comparative advantage? Before, one can usually match products with countries or economies - labor or capital abundance determines the source of comparative advantage. Now however, international specialization has raised trade in 'tasks' and value added rather than final goods as important considerations. That's perhaps a promising way to look at trade in this part of the region in the APEC economies. I would even stretch it a little further. Inasmuch as services, -logistics, distribution, trade finance - are embedded in the supply chains. And if you look at them as a unit of analysis, then these services are there to support the production process. So it is not just matter of pitting one service against another. Services could be seen as a compliment to the production process. In this way, negotiators can move away from considering trade in services on a per sector basis, but to look at services as an important driver of comparative advantage in the supply chain. So the dichotomy between services negotiations and goods negotiations can be addressed this way.

Now what are the implications of this on trade policy or negotiation? First, global supply chains by nature pass through borders, negotiating efforts should be focused on enhancing a country's the ability to participate in these networks. So the 'race to bottom' should be superseded as the 'race to interlink' in these global supply chains. In this manner, we look at facilitation as a very important driver for participating in the supply chain.. So facilitation becomes an increasingly important element in the negotiation compared to protection. At the same time, as economies become more interdependent due to the supply chains, there is less impetus for protection. As trade in intermediate goods and services become more pronounced the general trade relations will acquire a more complementary texture rather than a competitive one. As we know, one good depends on another and as one economist said, because high income countries are more likely to be in the upstream of the global production chain, their imports from lower income-countries are more likely to contain their own value added. So issues such as: "Does it matter in what part of the supply chain you are? '; What does moving up in the supply chain mean?'; Perhaps these can be thoughts to ponder.

Lastly, we have seen the interaction of the location of the businesses and the communities and societies in those locations. Therefore one issue we can look at, how does one reconcile societal needs of the communities where the elements of the supply chains operate and economic efficiency? Is there always a trade off? One can have both progress in generating business value and social values at the same time. I would like to propose we look further at alternative systems, such as the ‘shared value,’ making it part of the core value proposition of business to look at the needs of the communities it operates.

Mr. Ong Ye Kung:

When I was in the APEC circuit, it was quite clear that the anchor that held us together was the understanding that the U.S. involvement across the Pacific in Asia is of strategic importance to the region. This is in itself a huge topic, but if we wind back and recall the events of World War II and the events of the Vietnam War, we know the importance of U.S. involvement in the region and how it shaped the region. At the same time a second important factor, that was well articulated by Mr. La Yifan, is the rise of China, being the largest population in the world, huge country in this region full of promises in terms of opportunities, growth, the upgrading of lives, bringing hundreds of millions of people out of poverty. U.S. and China are, as one old teacher of mine taught me, are the two suns in our solar system, and we must make sure that these two suns work together to prosper and all of us little countries around have to make sure we are not scorched by the suns but have a place under the sun. And that is the context of why APEC is important. APEC was not of great influence for some time. I think the turning point was 1993, where in an act of statesmanship, President Bill Clinton convened a leaders meeting in Blake Island, and there he brought the leaders of APEC members economies together and formed a community. I don’t think coincidentally that after the meeting, in 1994, the Uruguay round of negotiations under the WTO was concluded. I think that it was totally in President Bill Clinton’s mind that by bringing the economies of North America and Asia together, he brought the Europeans to the table in the Uruguay round and concluded the negotiations. I think the concept of dynamic competition in Free Trade was then quite well established since then.

In 1994, in another act of great statesmanship, when the APEC leaders meeting was held in Indonesia presided over then by President Suharto, APEC leaders declared the Bogor Goals - 2010 free and open trade and investments amongst industrialized economies, in 2020 amongst all economies of the APEC community. Unfortunately, 2010 came and gone, I was out of the circuit and did not hear any major announcement that the Bogor Goals was achieved. I assumed it was not. It is important, and maybe I am old fashioned, that APEC’s agenda has been always about free trade, with Bogor Goals as it is an aspiration and guiding compass, because it is through free trade and mutual dependency in trade and investment that we bring the whole Asia Pacific community together and maintain peace and stability for the region.

Today, if I were to look going forward ten years or more, what will be the systemic risks that we face? If we confine ourselves to just economic risks, I think there are two. One, I think one potential systemic risk is in the U.S., with the risk of a ballooning budget deficit. We hear about tapering and the U.S. economy is recovering, but today politics in the U.S. is not conducive to allow a structural solution to its fiscal deficit. But notwithstanding there continues to be confidence in the U.S. dollar as a global reserve currency. There is always the worry that one day there will be a default by the U.S. on its Treasuries and that is a huge systemic risk that needs to be prevented. A second potential systemic risk, that was previously acknowledged by the speakers as well, is how China reforms its economy. I do not think that the current model of investment and export led growth is sustainable. I believe the leaders in China know that. So it is undergoing significant reforms of its own economy is taking the bull by the horns, and how China reforms its economy is of tremendous interest to all of us.

If we look at the two systemic risks, and analyze them deep enough, we cannot run away from concluding that there is a need for a more open trade and investment environment, and ensuring that by observing the discipline of a free market economy. In 2000, at the sidelines of the APEC leaders meeting in Banda Seri Bagawan, then Singapore Prime Minister Goh Chok Tong and then President Bill Clinton launched the U.S.-Singapore FTA, I was involved in those negotiations, I think it was a good opportunity for Singapore where we used free trade to restructure and reform our economy. It was the first FTA that Singapore entered into that adopted a negative list system. It reminds me of the free trade zone that Shanghai has just implemented. Negative lists means that every industry and sector is opened unless we specifically negotiated to be reserved. So it was a huge change of mindset for Singapore bureaucrats and negotiators to go through sector-by-sector which are the sectors we need to protect and others we just have to open. One thing that we were quite glad at that point in time, we somehow foresaw and protected the gaming industry. So today, the Government retain all rights to regulate and limit the gaming industry.

Another example was competition policy; Singapore had never felt that there was a need for competition policy. But through the negotiations, we learnt about the importance of having a competition policy and today we have the institutions, a competition commission, that helped police how the market economy will work.

Dr. Manfred Wilhelmy:

I am going to provide a Latin American perspective, focusing, first, on our place in the global value chains, and second on the role of the Pacific Alliance. The comments by Bert Hofman and especially his comparisons between East Asia and Latin America I found very interesting and fascinating. His observations give an idea how the role of Latin America in the global system compared to East Asia has been changing. It is good to hear that Asians are becoming more Latin in some ways, but in our part of the world we would also like to resemble Asia in more than one way, and emulate some of the economic and business good practices that we see in this dynamic region. One word of caution: it is not the same to speak about APEC Latin America and Latin America and the Caribbean as a whole. APEC Latin America is only three economies (Mexico, Peru, and Chile). We wish that in the future APEC Latin America were four or five economies, but, courtesy of the APEC moratorium on the admission of new members, such an expansion is not on the agenda today. Latin America and the Caribbean as a whole includes one big economy –Brazil- two additional PECC economies –Colombia and Ecuador-, other Atlantic economies such as Argentina, plus a number of other economies. A few of them have significant relations with the Asia-Pacific region.

Regarding the place of Latin America in the global value chains, especially vis-a-vis the Asia-Pacific region: our trade with the Asia-Pacific economies has dramatically increased since the 1990s, especially but not exclusively in the context of the bigger role of China in international trade. The traditional pattern has been that Latin American economies supply mostly commodities (raw materials and fuels) to East and Southeast Asia, and import a wide range of Asian manufactures. Much of Latin American economic development has taken place behind protective trade barriers, but of course this is obsolete, a part of economic history, while some governments, especially those not bordering the Pacific, still try to cling to protectionist policies.  In terms of foreign direct investment in Latin America, the role of Asia-Pacific economies has so far been rather limited, but there is a lot of potential for growth. Japan was the first East Asian economy to invest in Latin America. More recently, Australia has played an increasingly important role, especially in the mining industry, and now the arrival of China as a foreign investor in Latin America is an important development, but it is still at an incipient stage. The motivations are to secure stable sources of supply of commodities (such as minerals, foodstuffs, timber, and fuels), and in some cases to access Latin American markets via assembly and manufacturing operations.

I am aware that talking about economies specializing in the export of commodities brings about the idea of the so-called "curse" of natural resources. While in Latin America we have experienced this "curse", I believe that developing the commodities trade can be a positive factor in our growth and development. This is for several reasons. The development of extractive industries can be made more efficient and sustainable. In this regard, foreign investors from advanced economies can play important roles, transferring technologies and good practices to these industries. Second, the development of modern commodities sectors requires investment in better physical connectivity, aiming to become more competitive in the export of commodities over long geographical distances, such as those between Latin America and markets in East and Southeast Asia. This may require the introduction of new business models for infrastructure development, based on public-private partnerships (PPP). Third, the development of various industries specializing in commodities can stimulate the domestic services sector, such as engineering services, environmental services, product testing, maintenance, IT services, and others. To the degree that such services are supplied efficiently, some of the companies involved can start exporting services. This is already beginning to take place in economies such as Chile. Some engineering services can be supplied efficiently to remote clients via the Internet, i.e., the natural barrier of geographical distance is still there, but modern firms can deal with this factor, and compete with companies from developed economies, or join some of them for specific projects.

In addition, some of the proceeds from the export of commodities, especially in times of boom, can be well invested, thus helping to avoid suffering from the "curse", eventually benefitting other sectors of the exporting economy. Well-designed public policies involving the collection and investment of royalties levied on mineral exports have the potential to spur the development of areas such as science and technology linked to economic projects. Another way to avoid, or at least to mitigate, the so-called "Dutch disease", is to establish sovereign funds that are kept abroad, thus avoiding the exchange of large amounts of foreign currency that could undercut the competitiveness of exports. Such resources are saved for various objectives, including the needs that arise once the boom is over and the "rainy days" arrive in the economy.

Finally, the evidence from studies on several Latin American commodities exporters shows that there need to be no conflict between the growth of the commodities sector and non-traditional, value-added exports, that develop new niches in many markets, including the Asia-Pacific region, often taking advantage of the lowering or elimination of trade barriers under FTAs. Of course, mitigating the Dutch disease is a condition for making such new export lines profitable, and the investment in achieving better levels of productivity in the non-traditional export sectors is also important.

So far, Latin American trade with East and Southeast Asia shows that we are exporting lower numbers of different goods, and fewer companies are involved, compared to Latin American exports to other markets, such as the U.S., the EU, and markets within the Latin American and Caribbean region. FTAs and the TPP, together with more vigorous market intelligence and trade promotion efforts, could make important contributions to change this situation. Also very important is the consideration that we ought to be able to add more value to the various commodities that we export. This, I believe, should be understood more in terms of the logic of business than in terms of the well-meaning political discourse of the authorities. Some Latin American commodities exporters are succeeding in adding value to their products, adding new export lines by investing in the development of more sophisticated products. For example, a Chilean fishing company that sells fish oil and meal, is now manufacturing Omega 3 oils for international customers such as pharmaceutical companies. In the forestry sector, several companies are moving up the value-added ladder by manufacturing panels and parts for the construction and furniture industries. In other sectors, it is difficult to find customers willing to buy processed goods. For example, exporters of soybeans in Brazil and Argentina find that Chinese purchasers demand the basic product.

In some of our larger markets or in the framework of regional or sub-regional integration areas, there is a growing potential for participation in international value chains, either related or unrelated to natural resources. For example, the manufacturing sectors in Mexico and Brazil are well positioned to participate in inter-regional value chains in the automotive or civilian aircraft production industries (especially medium-sized jets). Multinational companies are key players in such processes. But it must be recognized in a realistic way that inter-regional processes of adding value and combining industrial production are more difficult to handle, and thus more sparse, than regional or sub-regional chains, like the ones that George Manzano commented upon. To develop combined industrial production across borders, the mobility of management and technical personnel must be convenient and cost-effective; big geographical distances make complex arrangements for international production less likely. Thus Mexican companies can take advantage of their location close to the US and Canada, while combined manufacturing operations involving faraway Chile will be less frequent. On the other hand, due to a dense network of FTAs, Chile has the potential exporting advantages that might be realized by companies from nearby countries such as Brazil and Argentina. This is part of the Chilean aspiration to be seen as a "bridge" between South America and the Asia-Pacific region.

I was heartened by Minister Lim's very generous and positive assessment of the Pacific Alliance. This is still a new initiative. It enjoys a high level of political support from participating governments, it has generated much business interest, and has attracted a large number of observer countries, which is a challenge in itself. If well designed and implemented, the Alliance can be a big opportunity for the three Latin American members of APEC plus Colombia. Costa Rica (which, by the way, exports electronic circuits to Asia), and Panama are likely to join soon.  The first goal is to achieve free trade in goods and services among members; so far there is agreement on 92% of tariff lines. The second goal is to free up movements in capital. In this connection, the private sector has created MILA, an integrated platform of stock exchanges in Colombia, Peru, and Chile, now being joined by Mexico. It will take time and much effort to build up trade volume through MILA, but once technical and marketing issues are properly addressed, the potential is big. The third goal, to free the movement of persons, is quite ambitious but also realistic, as labor mobility between participating economies is increasing, as is cooperation among governments to handle security aspects. Other dimensions include cooperation for infrastructure development (which must include countries on the Atlantic side of South America), energy cooperation (such as interconnection of electric grids), trade facilitation (establishing "single windows" for trade operations), and facilitating cross-border mergers and alliances of companies (for example, by making the tax factor neutral in such operations).

Concerning the observer countries, they must be offered interesting roles, or they will begin to lose interest a while. I believe the external cooperation dimension is crucial to effectively engage these countries, most of which are developed economies.

Getting closer to the Asia-Pacific region is a stated goal of the Pacific Alliance, but so far there is no road map for achieving this objective. Individual Alliance countries have FTAs with a number of East Asian economies, and all except Colombia participate in the TPP process, i.e. there is a need to discuss an Alliance strategy vis-a-vis the Asia-Pacific region. As the Alliance since 2012 has a Business Advisory Council, CEAP, it would make sense to develop links of cooperation with the APEC Business Advisory Council, ABAC, a suggestion that has been raised but no concrete steps have been taken.  The rich experience of ABAC in engaging the

APEC governments to discuss the integration agenda no doubt could provide a valuable learning experience for the CEAP.

Mr. Yuen Pau Woo:

Commenting on Mr. Hofman's presentation, which I felt was very interesting and illuminating. There were two major themes in the presentation; first, convergence of economies in the region; and second, the normalization of the business cycle. I won't say a lot about convergence except that you may be aware that the PECC puts out an annual index on regional economic integration, which is kind of a measure of a convergence, and in fact convergence is one of the sub-indicators of the index and we've been tracking the integration of the region or the convergence of the region over the years, and we found the same harmonization or coming together of the economies in the Asia Pacific region. You have given us some interesting ideas for some new measures to add to the indicators.

I want to spend more time on commenting on the idea of a normalizing world economy. I'm sure you mean normalizing in the business cycle sense that we are returning to a greater capacity utilization in the world economy, as oppose to normalization in the sense that this is the normal state of things. It may be an unstable normal. I would in fact argue that the normal to which we are returning to could well be a very new normal, one that we are not familiar with and that we are not sufficiently prepared for. This new normal has been defined mostly by commentators in which the withdrawal of monetary stimulus on the part of the U.S., the so-called taper, is a very big issue.

Perhaps, I think as important or an even more important factor in the new normal which pushes us in the same direction and which will have longer term consequences is of course the deleveraging of the Chinese economy, which is the same removal of stimulus from global demand, but which could be much more profound because of the size of the Chinese economy and the amount of work that has to be done in China. Why I say this could be a more important factor in the so-called normalization of the new normal of the world economy is because China seems to be very serious about this. Of course the proof will be whether China can deliver its reforms but the 3rd Plenum announcement of the 18th Party Congress and the statements about how the market is going to be decisive factor in making decisions is very profound and could affect the structural conditions of the regional economy in ways that I will describe shortly. I would just point out that you alluded to it in your last slide, in which you showed that most of the productivity gains in China come from within existing sectors rather than from structural change. So you can only imagine if China were able to generate productivity gains from structural change rather than simply from within existing sources of growth would be very great change both within the Chinese economy and beyond.

One of the major messages in my brief presentation is that the new normal could well be defined more by China's impact on the region than by the impact of the U.S. economy. Let me start with the real economy, where the new normal is not the normal we are returning to in 2008 where we had, you may remember we had very severe current account balances, in fact that was the big discussion in this kind of meeting, PECC and APEC, about how to resolve trans-pacific regional imbalances. China's current account surplus in 2008 was something like 10-11% of GDP, a massive amount that caused a lot of unhappiness on the other side of the Pacific. China's current account balance is barely 2% and probably falling. Japan of course is currently in a account deficit position, and because of the structural changes in the U.S. economy that is being driven by unconventional oil and gas, where the U.S. could well emerge as a major energy exporter, including an exporter to Asia; we could see a possibly long term energy surplus on the part of the U.S. resulting in a very significant impact on trans-pacific balances. That of course is already a major reason for why the Japanese trade balance is in deficit. Of course the unconventional energy revolution in the U.S. has structural implications that go beyond the trade balance to manufacturing, relocation of production, the cost of competitiveness of the U.S. economy especially vis-à-vis the E.U., those are things we quite haven't fully thought through. My point generally on the issue of current account balances, that we are in a new world where the problem of the trans-pacific regional imbalance is no longer the problem that we faced barely 7 years ago; we will be looking at much more intra-regional trade imbalances and possibly some difficulties and conflicts within the region among East Asian economies.

Let me move to the money economy, where the new normal is going to be very different from the old normal. This stems from my belief that if structural reforms in China do go ahead it will have a much more profound impact on interest rates than tapering by the Federal Reserve. Of course the fundamental direction of Chinese reform in the financial sector is to make interest rates more market driven, which will mean higher interest rates, they have already allowed interest rates to drift upwards and the quest to reduce debt in the economy will push it in the same direction and the same way if they proceed with financial sector reforms with some gradual opening of the capital account, further liberalization and internationalization of the

RMB, all of that I think will have quite sharp implications for monetary cooperation in the region. Take for example the amount of lending that is provided by China's development finance institutions. China's Development Bank, the CDB, and China's EX-IM Bank already lends more money to developing countries than the World Bank. So their impact on financial flows is very great. This is setting aside private investment, FDI and all of that; I am just referring to development financing. What does this mean for regional cooperation? I think a lot more emphasis is going to have to be placed on financial cooperation, particularly on monetary cooperation, the utilization of domestic savings for domestic investment projects, and development of regional bond markets. Of course these are the issues we discussed about in the late 1990's after the Asian Financial Crisis; there's been some modest movement but really no impetus to pay serious attention to these issues because we've been complacent in believing that they are not going to be that urgent. But I think in fact that there has been some greater urgency because changes are coming not because of the U.S. but because of China. Likewise we need greater cooperation in the area of reserve pooling, of course in the Chiang Mai agreement plus, greater focus on prudential regulations of financial institutions, and in general share enough information among monetary authorities to make sure that the new world of financial market development driven by Chinese account liberalization is something that the region can cope with.

**Question and Answer Session**

Dr. Naoyuki Yoshino:

Directed to Mr. Hofman. I am interested in the monetary policy of very large countries, such as the U.S., Europe and Japan. Quantitative easing usually goes too much, whenever there is a recession especially the one we have been facing, and then the huge liquidity will look for places to invest, and then commodity prices rise and the money usually comes to the developing world. Then after the recovery is over, the money will go back. I think that causes huge turmoil in emerging markets. So the monetary policy in many advanced countries should not only look at their own country but also in worldwide financial activities. What do you think about the impact of that huge liquidity into the global market? Second, commenting on exchange rates movement, China is pegging very closely to the U.S. dollar, should there be harmony in economic integration?

Mr. Bert Hofman:

Frankly, on the first, I fully agree. We've been on a monetary sugar high or monetary morphine, where indeed in part developing countries or emerging economies have been influenced by advanced countries monetary policy, not all to the good. I think most countries try to manage as well as they could, but with the withdrawal it created normalization. Not more than one year ago the tables were turned. We were all talking about the detrimental effects on asset prices, the currency wars. Now a number of developing economies are feeling the pull back, and began complaining about that.

On the point of coordination, I find your comment very valid; there was very little to see in the Federal Reserve statements, which were just about the U.S. I frankly think they may be right, but I do recall that in 2008, the G20 and coordination amongst the G20 was very instrumental in getting out of the global financial crisis, or at least preventing the global financial crisis from becoming the great depression. There's some scope for further talks and consideration.

On the second, frankly, for thirty years we lived under Bretton Woods affecting the exchange rate system with rules, and people seemed to be all quite happy. China has managed its exchange rate; it has certain policy goals, which the exchange rate plays a role. They have an exported oriented economy, which the exchange rate is a far more important variable to China with over 35% of GDP in exports compared to the U.S. which has only 15% of GDP. There has been benign neglect from a large domestic oriented economies towards an exchange rate is far more natural than for China, which has a far larger share in exports.

For economists, it's not the nominal exchange rate that counts; the nominal exchange rate is driven by your economic system, the real exchange rate counts. If you look at real exchange rate development over the last ten years, there has been persistent appreciation so rapidly so more than the time during the float from 8.2 to 6.10.  Since inflation rates are higher in China than the rest of the world, there has been a real appreciation in the Yuan, despite that, China has been relatively strong in exports even though there has been tapering a little bit. Nevertheless in a world economy that has been down, they have done relatively well. So the exchange rate policy of China has been relatively effective. In addition, the nominal value of the Yuan hasn't changed much, but nevertheless the issues of account surpluses are beginning to be resolved, they are 2% of GDP. Economist prediction, this is going to change, I fully agree with Mr. Woo, there's always an expectation of China's success in implementing the 3rd Plenum reforms, which means that investments in China will go down as share of GDP.

The current account surpluses in economist speech are nothing but the difference between savings and investments. Savings react very slowly, large to demographics and income per capita. Investments react much more forcefully to monetary conditions domestically, credit creation included. So if China takes its financial sector reforms seriously, investment to GDP ratio now 50% will go down. So the current account surpluses will reappear and quite forcefully so, maybe not 10% of GDP, but two to three years down the road, we'll be talking again about the rising surpluses of China. Frankly, I do not believe that this is a policy issue; I do not believe that it should be a policy issue of current account surpluses or deficits, but it is. Reality says that it is, people talk about it. I think it will come back.

Ambassador Mark Trainor:

Picking up George Manzano's point about global value chains (GVC) as a unit of analysis for the negotiating of trade agreements, which I think is an interesting idea. How to turn this into reality is not very clear to me. What do I want to share is steps towards that. Seems to me, one approach is to at least seek to focus negotiations around the things that make material differences to countries participation in the GVC, so things like the elimination of tariffs. The OECD work on trade and value added really emphasizes the impact of even small tariffs as good cross and re-cross borders. Focus on non-tariff barriers because of the impact that has on the GVC's. One of the big lessons out of the OECD work was the importance of services. Half of the value of trade in value added is services and that leads to thinking about GVC related services as areas to really focus on and the realization of the liberalization efforts, so issues like transport services, cargo handling and legal related services and similar issues. Perhaps education services given the propensity for trade that you see in educated societies. Again on investments as facilitator for GVCs, I wanted to seek your reaction on that in order to get to a more rooted GVC based-approach to negotiations.

Dr. George Manzano:

I agree with what you proposed. There are, though, a number of fundamental steps that need to be taken. There is always a problem of measurements of value added; how they define it and measure it. 'Value added' will have an effect on the bilateral trade between two countries. The balance of trade, as currently measured has a political economic context in trade negotiations. Another issue is to identify what are the major value chains. Perhaps one can research on mapping them out. In that case, if value chains are especially prevalent in the Asia Pacific then it would be easier (because they constitute low hanging fruits) to liberalize because Asia Pacific economies are dominant suppliers, and their defensive interests are not that insurmountable. I agree that services are important components and to what extent services become the driver of comparative advantage is an interesting issue to look at. That should open the minds of negotiators on imports and liberalizing services in the political economy of trade negotiations.

Dr. Malcolm Cook:

Question for Mr. Woo. I wanted to bring together two points that you made about the new normal in the regional financial relations. About China, normalizing and an early point made by the Minister that APEC doesn't have a very good track record in actually working effectively on financial cooperation. How can you see that APEC may be able to play a larger role in that area given that if your new normal is what you say?

Mr. Yuen Pau Woo:

I think the simple answer is that it will be particularly effective this year not-with-standing the traditional reservations regarding APEC's institutional capacity because China is chairing APEC this year; I think we really have to face that fact, that all of us come from economies that are members of APEC and have to recognize that this is a very special and important year, because China is providing leadership and China has expressed a desire to do things with its own economy that APEC can be helpful on. So if China opens the door for APEC to provide further impetus and encouragement for China's domestic reform process, the rest of the region should enthusiastically chime in with support. This is not to say China drives APEC, but I think our Chinese friends recognize very well that they have an opportunity to use their position in an international forum to help their domestic reforms process perhaps not unlike how Japan is thinking about the TPP as a way to implement the Third Arrow.

# Session II: Regional Economic Integration and Multilateral Trading System

The number of regional and bilateral trade agreements in the Asia Pacific region has increased with the WTO DDA facing challenges. With the WTO as the core of multilateral trading system, the regional trading arrangements should reinforce each other, instead of excluding each other.

(1) What should be our roadmap and framework of Asia Pacific regional economic integration, taking various FTA proposals into consideration?
(2) How can APEC promote the synergy of various regional economic integration mechanisms existing in all APEC economies on both sides of the Pacific Ocean?
(3) How can APEC economies contribute to ensure that the WTO process remains current and relevant?

**Keynote:**

Mr La Yifan

Vice Chairman, APEC SOM & Under Secretary-General, National Organizing Committee for APEC 2014, Ministry of Foreign Affairs of China

**Moderator:**

Dr Djisman Simandjuntak

Chairman, Indonesian National Committee for Pacific Economic Cooperation (INCPEC)

**Panel Discussion**

- Dato Paduka Lim Jock Hoi
  Chairman, Brunei Darussalam National Committee for Pacific Economic Cooperation (BDCPEC)
- Professor Song Hong
  Assistant Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences, China
- Professor Naoyuki Yoshino
  Professor of Economics, Keio University, Japan
- Ambassador Mark Trainor
  Principal Advisor, Trade & Economic Group (TEG), Ministry of Foreign Affairs and Trade, Wellington, New Zealand

Dr. Djisman Simandjuntak:

We are going to think aloud about how regional integration in our part of the world can be deepened for the benefit of billons inhabiting our region. We have actually one Keynote speech plus four discussions. I have pre-discussed with them ways to make the panel affective, lets first listen to the second speech by Mr. La Yifan. This time around on a different topic, more precisely on connectivity which has been high on the agenda of APEC for a number of years now. APEC is yet to really come up with a coherent program to deliver in terms of connectivity to the economies in the region.

Mr. La Yifan:

I would like to talk about regional economic integration and also where we want to fit it into the agenda and priorities of China-APEC year. Last December, in Beijing, APEC Informal Senior Officials Meeting (ISOM) reaffirmed the critical role of APEC in regional economic integration, and had agreed to list the issue as one of the three priorities for China APEC year.

Regional economic integration, over the years, is the driving force for sustained growth in the Asia Pacific region, and it has also brought about unprecedented prosperity and stability**.** Back in 1994, our leaders had drawn the blueprint in Bogor, Indonesia for Asia Pacific Economic Cooperation and Integration. Twenty years later, as we are faced with fallout of world financial crisis and a bit shaky recovery, it is even more imperative for us to uphold the spirit of Bogor goals. We should strive to establish an open economy, promote innovative growth, and connectivity, and establish an inclusive and mutually beneficial Asia Pacific common market. In this way, we should work together to ensure our region will continue to play a leading role in the recovery of the world economy. It is a relief indeed as we have achieved the Bail early harvest last December. It is our hope that we make further progress to promote multilateral trading system.

At the same time, also noted the cropping up of regional FTAs, such as TPP and RCEP. With various membership and different negotiation approaches. If we see them as half-full glass of water, they may promote liberalization and integration as a starter, which may contribute to the regional integration at the later stage. But if we see them as half-empty glass of water, they may change the direction and priority of regional integration and lead to fragmentation. In 2004, as indicated this morning by Minister Lim, APEC has already taken up this concept of FTAAP.

Ten years on, there are still some worries about this concept, namely different FTAs have complicated rules of the region, making relevant businesses hard to enjoy the benefits of FTAs.

Second, due to overlap in membership, many economies have to attend trade negotiations of different FTAs and stretch their teams of negotiators. Therefore, it is difficult for small and developing economies to fully engaged.

Competition among FTAs has led to second best choice syndrome. All economies have to face the consequences of dilemma to choose the best choice. First, a TPP without China and RCEP without United States has in itself drawn a line on the pacific. Both China and the U.S. and other economies would rather not see the line and take sides. The above worries have reinforced the idea of a region-wide integration. It is something that covers the whole region and it could also bring the most benefit for the entire region. In 2009, a team of experts from Australia, China, ROK and New Zealand has come up with a joint research that indicated under a scenario of trade liberalization through tariff elimination, trade facilitation and liberalization of trade in services, the GDP of APEC economies will benefit by 2.3%. Another research indicates that TPP, RCEP and FTAAP will contribute 0.14%, 0.94% and 2.48%, respectively to GDP growth for APEC economies.

As for the U.S., an FTAAP could bring 2.5 folds more benefit than TPP, even with an expansion of 16 members. Among all mechanisms in the region, the APEC is the one with the highest level of participation, widest scope and most influential in the region. In 2006, our leaders in Hanoi for the first time set the concept of an FTAAP in their declaration as a long term prospect and instructed official to undertake further studies on the ways and means to promote regional economic integration. In Yokohama, in 2010, our leaders said in their declaration that we would take concrete steps to realize an FTAAP, which is a major instrument to further APEC regional economic integration agenda. Last October, our leaders in Bali, Indonesia reaffirmed their commitment to achieve an FTAAP, including by continuing APEC's work to provide leadership and intellectual input in the process of regional economic integration. Since Hanoi, the concept of FTAAP had been discussed for well over 8 years. And there is already an emerging consensus and basis for further discussion. However, it still remains just a concept. And it is about time to make further progress.

Our APEC economies are capable to move further and turn the concept into fruition. To that end, some experts had proposed to develop timeframes, roadmaps and study plans to embark on the process. We are open to these ideas. We will conduct further discussions within APEC throughout the year. We will have SOM1 in Ningbo and the Ministers Responsible for Trade Meeting in May in Qingdao. We are looking forward to more substantive discussions.

In recent years, new members like G20, had served well against international economic tides and played an important role in macroeconomic and financial policy dialogue and coordination. At the same time, bilateral, plurilateral and multilateral cooperation mechanisms have surged ahead. Back in 1989, when APEC was founded, there were only 3 cooperation forums and 3 FTA agreements in the region; now there are 25 and 56, respectively. Some may question whether the role and influence of APEC declining. To respond negatively to the question, APEC should seize the time and forge ahead in regional economic integration. At the same time, not to replace or contradict all existing FTA negotiations, but to complement them. This would create more trading opportunities and new jobs for our people. APEC can then prove its relevance and leadership role in the region. Based on the new development in global trade, we strengthen cooperation on trade facilitation, supply chain, and value chain, with a view to promoting regional integration. At the same time, we should support multilateral trading system based on WTO. Diversity is the nature of APEC and also its treasure. We should strength our efforts in capacity building in trade and investment, in order to share the benefits of liberalization and narrowing the gaps among different members. PECC has for years promoted regional economic integration and gathers together public, private and academic circles. And thanks to tirelessly efforts of the PECC and others, APEC was initiated twenty-five years ago. It also served as a think tank for APEC over the years. For that reason, this symposium and this subject chosen by the organizer is a meaningful one. We attach importance to APEC. We welcome your participation and contribution. The previous speaker talked about a strong host and a strong Chair this year, which is China, and there are a lot of high expectations. I would like to stress that the chair is at the hands with its members, and we are here to listen to your views, proposals and contributions throughout the year. With joint efforts by member economies, we will achieve relevant and substantive results by November. Thank you.

Dr. Djisman Simandjuntak:

Thank you, Mr. La Yifan. Coming from Indonesia, where the Bogor goals were declared 20 years ago. I can only give my full support to idea of keeping FTAAP in whenever we discussed about regional integration in our part of the world. Thank you for the speech. Let’s continue with our panelists. To my left, we have Dato Paduka Lim Jock Hoi, who played a very important role in leading the early negotiation in RCEP. I have asked him to discuss how RCEP negotiations has progressed so far and what the divisive issues are and whether it is realistic to expect convergence between RCEP and TPP.

Dato Paduka Lim Jock Hoi:

Let me begin by saying that in 1993, we had the Bogor goals, which were agreed by all the leaders, and we agreed again in 2010, which has passed, and finally now in 2020; these are basically non-binding, unilateral bases of free trade arrangements. But, it was not able to move that process because it was non-binding; so, it had been very much a best endeavor. The leaders, especially the business people encouraged the leaders to think about how best we can bring forward these 2020 Bogor goal. One way is being coined as part of FTAAP – is one of the vehicles that we look forward to having a complete free trade area in the region, and several of the vehicles are very much the TPP, RCEP and CJK (China-Japan-Korea) playing important roles. ASEAN is very much in the forefront because of its role in RCEP and Pacific alliances. These are the vehicles that we think would be able to help and provide a platform for the future FTAAP, if we were to realize it within our region.

I think it is important that under the RCEP, which is another initiative of ASEAN, which is very much ASEAN driven because it is an amalgamation of 5 FTAs and has the potential to have value-added if you were to include all the 6 countries of the ASEAN dialogue partners, becomes a very powerful and important FTA if we were to realize what is being agreed to by the leaders on guiding principles. The guiding principles point towards a high quality and comprehensive FTA – which has to be concluded by 2015. The region has ample opportunity to push for FTAs and it has the potential to grow and increase trade and investment, and also the free flow of goods and services in the region. To date, I think we in RCEP have engaged in many rounds of negotiations, and we are making a very positive progress. A number of key working groups have now been established to negotiate basically goods, services, investment, rules of origin, custom procedures and legal matters. We also have a working group on competition policies, intellectual property, and economic and technical cooperation. The roads have been chartered by the negotiators and working groups; we already had 3 rounds of negotiations, and several rounds of negotiations are being planned for this year. We think this is a very good progress that we have made, although there is still long way to go. We hope by the end of 2014, we should have something on the table for the ministers and leaders to look into it. Obviously, it would be very difficult and a great challenge for all of us to move the process, but with all understanding that the FTA that we have with ASEAN Plus-Plus are a value-added to the negotiations. Of course, there are certain difficulties, especially in the area of goods and how we can manage to get the architecture right in such a way that we have a comprehensive goods and services in the agreements. Obviously, we have other issues like labor and environment that are very difficult and delicate matters, but these are the areas that we will have to confront in the future, and this is the future work program. I have great hope that we will be able to conclude the negotiations even if we conclude them by the end of 2015; we should have some other areas that we can have built into the agenda.

If you compare RCEP with the TPP – which has been going on for the past four years, they are in the later stages of negotiations. We are hoping that the TPP will conclude by this year, as it was supposedly to be last year. As you know, there are many complicated matters that needed to be addressed, so again we missed the target to conclude last year, I think this year we have to conclude them by the middle of this year due to the mid-term elections in the United States. If you look at the TPP and RCEP coverage, they are more or less the same, comprehensive in nature and highly ambitious. We understand that RCEP is still in the initial stages, it has had some difficulties in economic development understanding as compared to TPP, and requires some levels of understanding. TPP has also the same problems, but this is driven by the United States, thus the nature of process is different. Bearing in mind the nature of process as you look at the scope and coverage, they are very much the same.

Secondly, the membership is very much the same, but if you look at TPP it is very comprehensive including Latin America. If you look at RCEP, it includes important members like China and India, which bring more impetus in the process of negotiations. What I believe these two processes, together with ASEAN, together with the Pacific alliances, CJK, would provide a conducive environment for further progress in the negotiations. I that believe two processes, RCEP and TPP will eventually converged at the end and this way I have the optimistic view that we will have the FTAAP in the Asia Pacific region at the end of the day. It will take a long time, but it will have the potential to converge because of the scope, the level of ambition and comprehensiveness are there.

I would like to pose one question, if we were to look into how best we can help this in the broader multilateral trading system we have to factor in Trans-Atlantic Free Trade Area. Trans-Atlantic Trade and Investment Partnership (TTIP) is a very important process happening in the

Trans-Atlantic region, which we have not been able to monitor. It would be good if the TPP or PECC will be able to look this area and how to converge them for the bigger multilateral market. From my perspective, TPP and RCEP are mutually reinforcing each other and complementary to each other towards a greater FTAAP. Thank you.

Dr. Djisman Simandjuntak:

This brings certain optimism. We have been worried about the possibility of RCEP too low in terms ambition; but as you said both TPP and RCEP are comparable issue coverage and ambition. Let's move to Professor Song Hong, an Assistant Director at the Institute of Economics and Politics at the Chinese Academy of Social Sciences in China. Mr. La Yifan mentioned about the FTAAP in his speech needs to be discussed more thoroughly in connection with the overall policy of China and with regards to regional economic integration particularly in East Asia.

Professor Song Hong:

It is pleasure to be here to join this discussion. I think this is a very difficult question. I'm speaking my own personal views. In terms of the RCEP, China can join and promote this regional integration, this is due to two reasons; first, it is more comfortable for China to join the RCEP, in terms of the liberalization processes and commitments, as compared to the TPP and others. Second, China's current work with ASEAN to promote Asian integration. RCEP is not so much like APEC because most of the members are mainly from Asia. I am not sure about the leadership, especially if you want to promote trade integration successfully and aggressively like the TPP; even though it is one of our priorities we cannot comfortably join that.

As far as the TPP is concerned, in my personal view, there are two reasons that I think China should join the TPP; firstly, because China wants to reform and upgrade our economy. The TPP can act as a pressure to promote this upgrading and transformation for China's economy. Second reason is that until this moment, it is difficult for China to initiate a unilateral regional initiative effort like the TPP, which the U.S. promotes, which is because of leadership as I just mentioned. By joining the TPP, China can liberalize its economy and promote more pressure on our economy. Most importantly, we can join this liberalization process in Asia Pacific.

The second question I want to answer is about the roadmap of APEC integration. Like I mentioned, the diversity of the APEC economies, in terms of culture, languages, sciences and development levels, is so diverse for the APEC economies. In my opinion, I think we can have different platforms and architectures for the economies, with some moving faster than others like TPP, and have ambitious objectives and are more comprehensive in coverage and scope. In addition, liberalize more slowly and not so aggressively or ambitiously like RCEP and others. We can promote and support some of the bilateral arrangements in the region. All these arrangements can do something to promote some of the integration in the APEC community. In the end, just like what had happened in China in the last thirty years, Deng Xiaoping's famous policy is to first have some of the people get rich first, and then other regions and people can follow. I think APEC integration can also have this similar policy. Let some of these countries move first and have high quality FTA arrangements, and then the other countries slowly move. The key is that we must encourage every APEC economy to move and not let some countries not do anything. This is my opening. Thank you.

Dr. Djisman Simandjuntak:

Thank you Professor Song. We move on to our third panelist, Professor Yoshino to talk about the financial side rather than the trade side of integration. He is now Professor of Economics at Keio University in Japan, but he is the designate dean of Asian Development Bank Institute (ADBI) - starting in April this year (2014). It is an institute that has been playing an important role in preparing policies, ideas and inputs into policy making, particularly when it comes to trade integration. The financial side is important. Without further ado, let me invite Professor Yoshino to make his presentation. He will be using some PowerPoint slides.

Professor Naoyuki Yoshino:

The first page shows the foreign exchange reserves of Asian countries, as you can see, China, Japan, South Korea and Singapore, lots of accumulation of foreign exchange reserves in Asian region. These are the 2006 figures.

Figure 2.1

**FOREIGN EXCHANGE RESERVES OF ASIA**

| Economies | US Dollars (in Thousands ) |
|---|---|
| China | 877 637 000 |
| Japan | 837 712 000 |
| South Korea | 212 271 000 |
| Singapore | 121 412 000 |
| Malaysia | 73 097 100 |
| Thailand | 53 709 300 |
| Indonesia | 38 172 300 |
| Philippines | 17 848 000 |
| Vietnam | 10 742 000 |
| Cambodia | 1 007 340 |
| Myanmar | 890 021 |
| Brunei | 480 349 |
| Lao PDR | 249 478 |
| Total | 2 250 227 888 |

The trade patterns of this region are mainly supply chains, which we have talked about. The final destinations are the U.S. and the E.U. So, many Asian countries received US dollar and Euro. That is why many Asians invest into U.S. and Europe because there are low currency fluctuations. But, we need free trade in Asia Pacific region. Middle-income classes in the region are growing as well as consumption and investment. So, if we can promote free trade among these Asian countries, we can exchange our currencies with each other. This is the Asian countries and where are we investing in? First, for Thailand, the top country is E.U., second country is the U.S. Next for Malaysia, it is EU, Singapore, and the U.S. Through Singapore, and it has invested in the U.S. and Europe. This can be seemed that most of Asian countries are investing into Europe and the U.S. This is because final target of the trade is the U.S. and the E.U. We receive Euro and U.S. dollar, and we tend to invest into American and European markets. Once we developed our regional trade among Asian countries, then we receive Thai Baht, Indonesian Rupiah and so on. In this way, we invest in each other. Current situation of Asian financial flows is mainly Europe and United States. These are mainly via government bonds, U.S. treasuries and bonds.

Figure 2.2

## Where are Asian Countries' Investing ?

| Country | Target country | Totals |
|---|---|---|
| **Thailand** | No1 EU | 110.85 |
| Total=402.83 | No2 USA | 105.98 |
| | No3 Singapore | 44.76 |
| | No4 Hong Kong, China | 22.19 |
| | No5 Japan | 7.46 |
| **Malaysia** | No1 EU | 145.28 |
| Total=496.67 | No2 Singapore | 81.74 |
| | No3 USA | 52.25 |
| | No4 Hong Kong, China | 22.75 |
| | No5 Switzerland | 5.64 |
| **Singapore** | No1 USA | 363.61 |
| Total=812.3 | No2 EU | 235.98 |
| | No3 Hong Kong, China | 70.97 |
| | No4 Japan | 44.51 |
| | No5 Switzerland | 9.32 |
| **Hong Kong, China** | No1 EU | 538.10 |
| Total=1 374.93 | No2 USA | 462.25 |
| | No3 Singapore | 137.46 |
| | No4 Japan | 82.94 |
| | No5 Bermuda | 46.52 |

Then who are investing into Asian region? First one is Thailand, they are the E.U. and the U.S. these are the top countries. Second for Malaysia, EU, Singapore and then the U.S. But through Singapore, many foreign investors are coming in. These are mainly for stock ownership. So, Asian's are investing into government bonds long-term. Foreign investors are coming into Asia in terms of stocks and short-term funds. In other words, Asian investors are mainly in safe assets, but lowest interest rate of return and they are long term. American and European investors invested into Asian stocks and short-term investments. So, if we can promote financial trade flow among the Asian Pacific region, we can change this kind of financial flows.

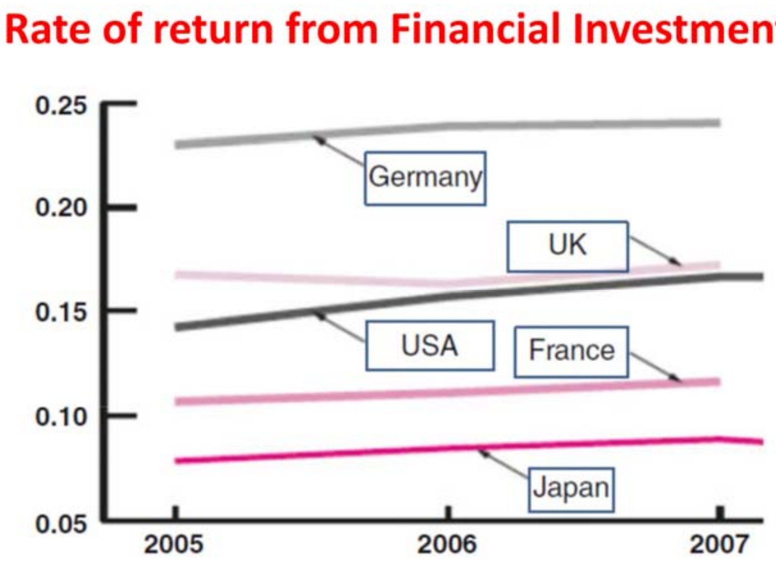
Figure 2.3

## Who are investing into Asia ?

| Country | Country | Billion US dollars |
|---|---|---|
| **Thailand** | No1 EU | 10.33 |
| Total=3 108 | No2 US | 8.88 |
| | No3 Singapore | 1.80 |
| | No4 Indonesia | 1.57 |
| | No5 Hong Kong, China | 1.55 |
| **Malaysia** | No1 EU | 13.18 |
| Total=3 781 | No2 Singapore | 7.51 |
| | No3 USA | 5.67 |
| | No4 Hong Kong, China | 1.96 |
| | No5 Australia | 1.43 |
| **Singapore** | No1 EU | 629.28 |
| Total=2 016.86 | No2 USA | 290.31 |
| | No3 Australia | 169.66 |
| | No4 Malaysia | 167.83 |
| | No5 South Korea | 90.30 |
| **Hong Kong, China** | No1 EU | 1 291.81 |
| Total=4 365.57 | No2 USA | 581.56 |
| | No3 Cayman Islands | 548.15 |
| | No4 Bermuda | 450.65 |
| | No5 China P.R. | 412.99 |

This is the interest received on derivatives. As you can see, the bottom line is Japan. This is because we are investing in government bonds, which is the safest assets, but the lowest rate of return. Many Asian countries are very similar to Japan. So, we have the safest asset but the lowest rate of return.

Figure 2.4




Next, I would like to talk about FTA negotiations. When we talk about FTAs, we are always talking about the benefits. But I think it is very important to talk about the losers. How should we compensate for losers? The Japanese example number one, we have failed one FTA because golden fish SMEs are imposing it and politicians in the region have strongly supported it. We have failed in some of the FTA negotiations. Number two, agriculture farmers are very much politically very much supported. So, SMEs and agriculture farmers are the top two negotiators that we have to deal with. How do we compensate for losers and so on?

The next figure shows the number of SMEs in Thailand, number of farms, GDP and employment. It is very large in Asia.

Figure 2.5

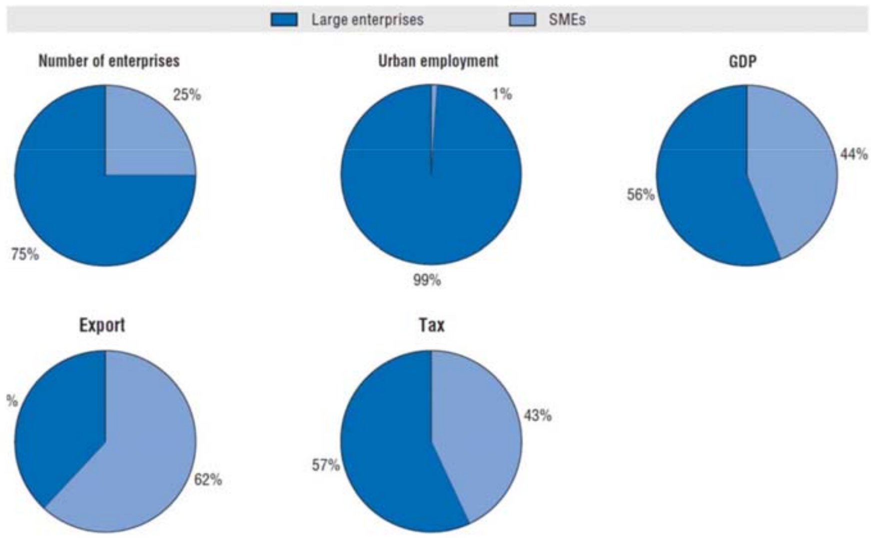
Table 2. **Share of SMEs in Thailand**

| Type of enterprise | No. of enterprises (% of total) | No. of employees (% of total) | GDP contr. in mill. Baht (% of total) |
|---|---|---|---|
| SMEs | 2366227 | 8900567 | 3244974 |
| | (99.6%) | (76.0%) | (38.2%) |
| Large enterprises and others | 9141 | 2810767 | 5239226 |
| | (0.4%) | (24.0%) | (61.8%) |
| Total | 2375368 | 11711334 | 8484200 |
| | (100.0%) | (100.0%) | (100.0%) |

This is for China, where SMEs dominate the market.

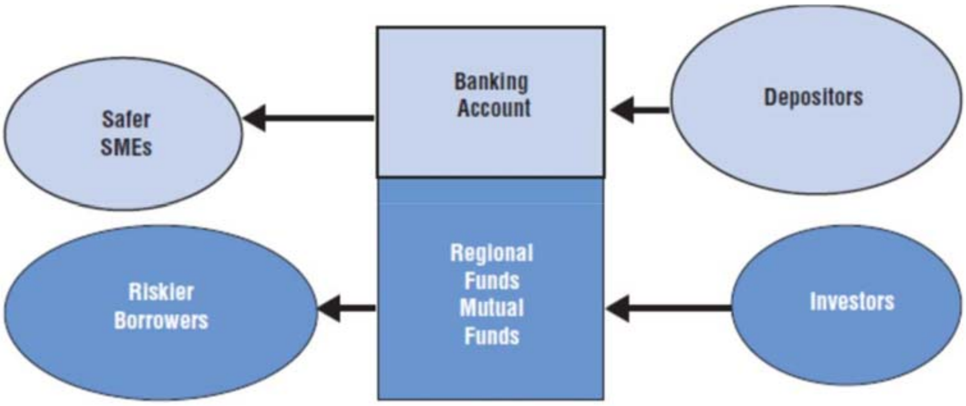
Figure 2.6

Figure 4. **Share of SMEs in China**




We always have to negotiate with the losers who are mainly from the weak SMEs and agriculture farmers. In order to compensate for those, we need some set of blueprint on what to do. Agricultural farmers in Japan is the biggest obstacle for FTA. However, many of them become very old, over sixty years old. However in Japan, they want to keep their land, rather than selling it to others. So, what we have done is ownership of land are old farmers, but the use of those land can leased to young farmers. We have set up those financing methods to Japanese agriculture farmers. I hope this kind of new financing method to young farmers can make the agriculture farming in Japan drastically different. This is also came from the blueprint of our proposal for the agriculture ministry.

Figure 2.7




Next, gains from free trade we have often talked about. These gains can be put to set up a trust fund in order to help SMEs and agriculture farmers. In order to provide some of compensation for a certain period of time. But we have to keep in mind those subsides have to be limited. Once it keeps on going, then politicians will have big power and they relied on those subsides. Hometown investment trust funds were created for SMEs and agriculture sector and so on. The method is we know who would be borrowing this money. Investors come from either depositors or they go to local banks. Local banks set up these funds to provide money to young agriculture farmers who want to lease land from old farmers. This is done just last year in Japan and this is growing very rapidly. We could elaborate more much sophisticated financing methods. Banks lend money in those sectors. They could issue some bonds and then investment funds can be combined all together. This is my book "Hometown Investment Trust Funds" and this is kind of trust fund could be well developed in Asian region, in order to compensate those losers and to show how should they change their production methods and agriculture techniques. This is my presentation. Thank you. [1]

Dr. Djisman Simandjuntak:

Let's continue with our last panelist, Ambassador Mark Trainor, who is principal advisor at the Trade and Economic Growth, Ministry of Foreign Affairs and Trade, New Zealand. It is 11 hours from here, but I think New Zealand has always been a strong supporter of integration in the region. Mark is going to concentrate on how to create a link between RCEP and multilateral institutions.

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[1] Yoshino, N., "Global Imbalances and the Development of Capital Flows among Asian Countries," OECD Journal: Financial Market Trends 1: 81–112 (OECD, 2012);
Yoshino, N. and S. Kaji Hometown Investment Trust Funds: A Stable Way to Supply Risk Capital, (Springer, 2013).

Ambassador Mark Trainor:

Thank you very much. Yes, I will concentrate mainly on the question about how APEC economies can support the multilateral trading system. I think the question is about the interaction of regional economic integration and the multilateral trading system. I should say that at the outset of the WTO remains for New Zealand, the main stage of the trading system, notwithstanding the fact that we like many other countries that are represented in PECC had been very active in pursuing bilateral and regional free trade agreements given the lack of progress in Geneva. But our Trade Minister Tim Groser said recently that ultimately we will all need to go back to Geneva and it is really just the question of the timing and the content of that. The return to Geneva will be very heavily influenced by what we called the mega regional FTAs that are under negotiation at the moment. Arguably, two or three of these mega regional FTAs are being negotiated here in this region. I'm referring of course to RCEP, TPP and CJK negotiations. Here I agreed with Dato Lim Jock Hoi that we should also take into account TTIP as one of the building blocks towards the reinvigorated multilateral trading system.

Looking at the WTO, maybe I should start by saying that I wouldn't completely agree with some of the earlier speakers this morning that the WTO is no longer useful for us. I do understand the frustration. I think it is worthwhile to recall that there is a range of reasons why the WTO is ultimately important for all countries, small countries and large. For small countries, it is indispensable that there is a functioning negotiating arm in the WTO in order to sustain the health of the other parts of the WTO, both the monitoring role and the dispute settlement role. The importance of this to the small countries is obvious at many levels. But, I think at the most fundamental – just quote a comment from Richard Baldwin and Patrick Low from 2009, who said that the "jungle law is much more evident when large countries sit down with small ones than it is in the WTO context." The multilateral system is also very important for large countries. Among many factors, even large countries can be affected by trade diversion and trade discrimination arising from regional trade agreements. Economists recognize that there can often be sub-optimal outcomes.

There are a number of other factors about why the return of the WTO in a serious and comprehensive way will be necessary at some point in the future. Minister Lim touched on a number of them this morning. I think New Zealand would very much endorse some of the points that he made. There are some outstanding trade policy issues that can only be addressed effectively on a global multilateral footing. He highlighted about subsidizes, of course there are some other issues as well. Secondly, I think we may find the pressure from business manifests itself more in the future around the way in which different regulatory regimes impede the functioning of GVCs. We are already seeing businesses campaigning pretty strongly against non-tariff measures. But, even more fundamentally, there's is a growing gap between the trade policy issues that we addressed in the Uruguay round, which are basically the issues of the 1980s and then maybe some cases even in the 1970s, and commercial and trade policy reality well into the 21st century, so that has to be addressed.

Just recalling my Minister's observations on the timing and character of a return to intensive multilateral negotiations being affected by the mega regional FTA's. From our perspective, it is probably not realistic to expect to cut across those existing negotiations at present. Neither here in this region nor particularly transatlantic; we recognize that but we do think it is important that policy thinkers, like participants in conferences such as this, should be thinking about what some of the basic features could look like. Now, one thing from recent meetings after Bali has been a very wide recognition that WTO members need now to have serious conversations about the core market access issues of the Doha round; market access in agriculture, goods (not agricultural goods) and services. It is also pretty clear from what we are seeing that after Bali, export competition would be seen as a key component that negotiations need to deal with.

In terms of the way forward, we don't really see a mini package as the way to proceed. Rather, the big lesson out of the last ten to fifteen years is that to deal with those really difficult issues that I had identified earlier i.e. the core Doha round issues; we need a large package of outcomes that basically all can buy into. One of the key principles that was expressed recently in meetings in Geneva by the newly elected Director-General in fact, has included the need for adherence to the parameters of the Doha agenda. Alongside this, an openness to address urgent challenges and shifts in trade patterns and practices to the extent that members can agree on. I think this is a really important point because it links the discussion in Geneva together with context of all of that, which is this huge energy in the regional trade agreement negotiations, particularly in this region.

Now, this is pretty delicate area. All of these issues involve a lot of potential complications as well as opportunities that would need to be navigated. But, it dovetails into the need to update the global trade rules and taking into account what we are doing in this region. In conclusion, I would simply say that ultimately all roads do need to lead back to Geneva, but the bridge to get there is actually through the Doha agenda.

Dr. Djisman Simandjuntak:

We provided enough stuff for this discussion. Let's keep in mind how our group can prepare and contribute to the successful conclusion of APEC 2014 later on. We should keep this in mind; this is the purpose of this year's conference. Without further ado, let me invite questions from the floor.

**Question and Answer Session**

Mr. Steven Wong:

Question to Mr. La Yifan and Professor Song, how are we to understand China's bilateral negotiations now with the U.S. on investments; for example, they've been restarted again after for having stopping for a few years. As I understand it, the nature of these discussions between the U.S. and China on the bilateral investment treaty (BITs) is about as advanced as anything that is out there. Also China continues and has just recently made a new offer of packages with the intention of joining the common procurement within the WTO. Now all of these things while we are talking RCEP and standards many of these things are actually more TPP-like, rather than RCEP-like, and they are ongoing now. What are we to understand from this? Even while China is pushing the RCEP, they are also engaging at the multilateral level, things where even TPP members are not members of the common procurement agreement and with the U.S. on very high level and high standard BITs.

Dato Paduka Lim Jock Hoi:

Someone from the government stop me if I talk too much about the negotiations between the China and the U.S. on the bilateral investment treaty running into danger of making some un-proper leaks for the negotiations. I will leave enough room for the academic point of view to present their answers. As I understand, the negotiations concerning bilateral investment treaties and also government procurement, the discussion is still going on, and we often encountered problems on both sides. On both sides in the sense with regard to investment, there have been some complaints of the United States using national security to block some of the investments and mergers on commercial basis; those are the difficulties that are still there but consultations are underway.

Professor Song Hong:

Just two comments; first, China and the U.S. are in reaching negotiations. I think it's difficult because the requirements from the U.S. are very high. Even if we already have some commitments including negative lists and opening up sectors, and also for the pre-established national treatment for foreign investment in China; we also know that the U.S. always has some temples for investment chapters in some of the FTA arrangements, such as North American Free Trade Agreement (NAFTA) and the TPP; the requirements also for state-owned enterprises (SOE) and mutual treatment for SOE's. And for the investor, and the state dispute mechanism is difficult; opening is difficult. Second point, the mention about the treaty between the U.S. and China joining the negotiations on services, government procurement, and ITE negotiations; I think this is one of the directions for the comprehensive reform agenda, and we already have directions to participate in different levels of the liberalization processes including the multilevel, bilateral and regional levels.

Ambassador Mark Trainor:

Points in response to the question; it does seem to me that it goes to the point that Dato Lim Jock Hoi and the Singaporean Minister for Trade and Industry made about the desirability and prospect for having the level of ambition that in both TPP and RCEP being not too dissimilar if they are to be complementary and stepping stones, which is certainly how we see them in relation to the vision of APEC leaders' for regional free trade; so I think that this is a lens that maybe useful to view these set of questions.

Mr. Hugh Stephens:

It becomes a question of almost standards of wisdom that when we talk about these different tracks, the TPP, RCEP, pathways forward finding cross walks is how we all get to the same solution and so on. Consider this other scenario for a moment and ask for your reaction. As we had hoped that the TPP was to be concluded by the end of last year but it wasn't. The addition of Japan makes things a lot more complicated and maybe I'll be proven wrong that it will be completed early this year before the midterm elections; but let me postulate that if it's not, we lose that window, even if there's the extremely complex process of getting it approved by congress with various resolutions floating around regarding currency provisions and a majority of congress already indicating that they are not going to give the Trade Promotion Authority (TPA). Then we have the RCEP, which is moving along slowly. Pleased to hear there have already been three rounds of negotiations, and the working groups have been set up; if I was going to be putting money on that horse I don't how much I would put on that. I'm just asking that we think about the other side of this; that the TPP doesn't come home this year, that the RCEP doesn't, how serious a setback is this? We've always assumed that these were steps towards ultimately breathing life into Doha and so forth. If we can't even get agreement on what are some pretty significant regional trade agreements, what hope is there for Doha? Well the answer maybe that we should just be optimistic, I will be optimistic. I would like reactions to the other scenarios, how serious would this be, and what is the likelihood that a year from now we don't see any of these agreements being concluded and looking at a different global scenario.

Ambassador Mark Trainor:

My crystal ball is pretty blurry; it's hard to predict what's going to happen in the next few months. For my own part, I really do not want to speculate on what might happen and therefore what the consequences of that will be at this stage. I think we are poised to be at a quite important juncture for the TPP negotiations, so I myself don't find it of use to go there. It's an interesting question, but I think we could be perhaps timely to explore it later in the year when we actually know what's happened.

Dr. Djisman Simandjuntak:

I agree I do think we need a plan B.

Dato Paduka Lim Jock Hoi:

I think it is a very difficult question, but I think when we talk about Japanese inclusion in TPP as a barrier, I think it is otherwise because the Japanese are a very meticulous people who have prepared for the last 2 years for their entry into the TPP and it was very smooth and very positive. As to whether we can conclude, I think we are trying our best. I think in a couple weeks' time there will be some progress to make it work. It is very difficult, but as I said we have to conclude by the middle of this year. TPP and TPA are still going on, it is looking a little bit difficult but it is not insurmountable. I think we are very optimistic; once TPA is done, TPP negotiations will be smoother. There are other difficult areas; everyone knows the SOE's are one of the major obstacles, and investor state dispute settlement (ISDS) is a very important issue for many countries, environment is an issue, labor is an issue, we still have a host of issues to try to come to a compromise among ourselves.

On RCEP, we are very practical people within ASEAN; we work on an ASEAN basis. Mark will comment on that. We are trying to make the whole groundwork done properly before we embark on the real negotiations. The real negotiation is going on regarding the goods already, I think this is very important. We know that the failure of getting RCEP done by the end of 2015 will be a tremendous pressure for our leaders; for our leaders have already endorsed it and said you must come out and get it done by 2015. So the pressure is on the negotiators. I'm sure that we have planned from now on until next year to get it done, with the inclusion of the ministers and leaders intervention, we will be able to come to some compromise. At the end of the day, I would not want to predict that we will not be able to get FTAAP, but the FTAAP is a long-term process and if we look at 2010 and 2020, I think we are on the way there.

Dr. Djisman Simandjuntak:

The question in ASEAN that we have never faced is how close are we to the intended package?

Dr. Naoyuki Yoshino:

We have had a meeting with Prime Minister Abe three times in these three to four months with business leaders. Everybody wants to promote TPP, but the problem is agricultural farmers as I mentioned and the SMEs. And currently, the Agricultural Minister is Mr. Hiashi, and his prediction is that within three to four years many of the current agricultural farmers will retire. Then we are going to promote a new financing method to young people who want to make better agricultural farming. We have to wait for the old people to get out from agricultural farming market. We are very optimistic about the future of the TPP. Prime Minister Abe is a strong promoter of the TPP.

Dr. Djisman Simandjuntak:

I think China can produce very strong impetus by announcing something like unilateral concessions during or after the APEC leaders meeting, this is what a leader in global trade usually does. The British did with the Compton-Chevalier Agreement long ago, and the U.S. did it by announcing the General Agreement on Tariffs and Trade (GATT) Agreement and a number of other initiatives. I think China can afford this if you can move the world by sowing certain commitments by announcing certain concessions, I think it's worth the try.

Mr. La Yifan:

I certainly will bring your thoughts by to my leadership for serious consideration. Back to the question from the floor, you know we are well-wishers. Let's keep our fingers crossed that both the TPP and RCEP would concluded its negotiations on time because our leaders have already pointed out that they all serve as pathways towards a region-wide economic integration. Just to prepare for the worst-case scenario as you have just said both free trade arrangements have failed to reach its target, then what shall we do? For example, we may have to take the plan B as the following: first, all members of APEC should refrain from announcing any new protection measures, we should make that commitments at the highest level this year. Secondly, we should pick up again the Bogor goals, which pushes forward the regional liberalization and facilitation over the past 20 years. Somebody have complained about the lack of specificity of the Bogor goals but we, the Chinese, see it otherwise. We believe it as conducive to the region wide liberalization trend, and to just give you a figure; back in 1994 when we had announced the goals in Bogor, Indonesia the total trade volume of China was 200 billion, twenty years later its 4 trillion, a twenty fold increase of our trade. For that reason we should pick up the Bogor goals, review them. I remember in the early days we had the individual action plans and collective action plans; the next target that is 2020 is still ahead of us. Let's compare our record to see what not only China, but everyone of us sitting around the table could do to contribute to this region-wide trade liberalization and facilitation. Lastly, if something is beyond our reach, we may have to think about the lowest level dominator. So let's not try to be over ambitious and strive for something region wide at a low level and for that reason we should make the Plan B now instead of when we have a crash landing.

Professor Christopher Findlay:

To Ambassador Mark Trainor about trade in services agreement (TISA). How do you see that playing out? You talked about the WTO getting lots of things on the table. My impression is, yes people understood that but the services team got bored with waiting for that and went off on their own, and that makes your strategy more difficult. There's a relationship between TISA and the WTO; and on the other side, have you guys been thinking about the relationship between TPP and TISA? What's the three-way connection there? Could TISA be a reference point for other regional agreements?

Ambassador Mark Trainor:

I said earlier that some of these issues about the relationship between both regional economic integration and on the multilateral system, between sectorial deals and agreements like TISA and the WTO are pretty delicate. Obviously, we are thinking very much about those issues, it's a negotiation that is proceeding quite actively now and there's quite significant interest from some major parties to join the TISA process, but it is very much in a fluid stage at the moment. I think one thing I would say, if we look at particularly sectorial approaches, which was touched on earlier, there is as Minister Lim said this morning, there's actually an important balance there between those opportunities to advance liberalization but not getting into a situation where you have drained all the water out of swimming pool and there's actually nothing left there to support liberalization of the really hard issues which have been with us for thirty to forty years. That's quite a tricky issue where you balance all of that.

## Session III: Physical Connectivity

Of the three aspects of connectivity, physical connectivity is of fundamental significance to the promotion of regional integration. We shall pay attention to the urgent needs and the long-term roadmap of regional physical connectivity.

(1) What are the possible options for a roadmap of Asia Pacific physical connectivity? How can we make best use of Indonesia's Connectivity Framework?
(2) What are the priorities for physical connectivity currently?
(3) How can the developed and developing economies both contribute to regional connectivity?
(4) How can APEC economies enhance connectivity across borders of vast distances, for example through improving our air, maritime and cyber connectivity?
(5) How to develop the proposed Asia Infrastructure Investment Bank as an inclusive, cost effective and sustainable solution to the financing bottleneck?

**Moderator:**

Dr. David Hong

Chairman, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC)

**Keynote Speech:**

Dr. Mari Pangestu

Minister for Tourism and Creative Economy, Indonesia

**Panel Discussion:**

- Dr. Biswa Bhattacharyay
  Former Advisor/Director, Asian Development Bank & Visiting Professor, University of International Business and Economics
- Mr. Steven Wong
  Deputy Chief Executive, ISIS Malaysia
- Mr. Hugh Stephens
  Vice Chairman, Canadian National Committee for Pacific Economic Cooperation (CANCPEC) & Executive-in-Residence, Asia Pacific Foundation of Canada
- Mr. Mark Rathbone
  Advisory Asia Pacific Capital Projects & Infrastructure Leader, PwC Singapore

Dr. David Hong:

This conference is about new priorities in regional economic integration. Last session we talked about is important part of the regional economic integration, the trading system integration. After that logically, we have to the deal with the supply side, supply chains and integration. We have to think about connectivity and the important part that is connectivity. According to the APEC Connectivity Framework, physical connectivity includes improving supply chain performance, connect and integrate logistics, transport, energy and telecommunication infrastructure in the APEC region has been considered the fundamental significance in the promotion of regional integration. It is specified in this session that we shall pay attention to the urgent needs in the long-term road map of regional physical connectivity. Important issues such as the potential option for such a road map and the connectivity framework current priorities and the laws of developing economies and how to enhance connectivity and shorten distance and how to start an Asian Infrastructure Investment Bank should all be thoroughly discussed by our panelist.

First panelist discussion will be with Dr. Biswa Bhattacharyay. Before we came to Singapore, we had communication between the moderator and the panelist. With Dr. Biswa Bhattacharyay, I asked him, you were the task force manager and the principal author of the ABDI’s book Infrastructure for a seamless Asia. You proposed an Asian Infrastructure Fund. Would you be kind of enough to share your proposal. Also what are your ideas of a physical roadmap regarding connectivity, and additionally, as we know Indonesia Connectivity framework calls for APEC economies to promote connectivity and boost infrastructure until 2030, what is the connection between APEC’s Bogor goals, which is 2020, and connectivity of 2030. Is connectivity 2030 comprehensive enough to serve us APEC goals after fulfilling the Bogor goals? That was my original thought regarding the question to him.

Dr. Biswa Bhattacharyay:

I was invited in the last meeting, unfortunately due to some urgent work I could not attend. But I am very happy to be here, particularly talking about the subject of physical connectivity, which is very close to my heart. The book mentioned by the moderator “Infrastructure for a Seamless Asia” was released in 2009, and due to popular demand, the book was translated into Japanese and Chinese.  I am very happy to know that the Chinese President, Xi Jinping, announced the creation of an Asian Infrastructure Investment Bank (AIIB), which will make our dream of an Asian Infrastructure Financing Bank or Fund (as suggested in the aforementioned study) into a reality.  I first try to answer the first two questions briefly and then spend a little more time talking about what is the appropriate intuitional framework we need for enhancing physical connectivity in the APEC region.

1. The Long-term Roadmap of APEC Physical Connectivity

Based on the Indonesia Connectivity Framework 2013-2030, the priority areas of a feasible road map for the hard infrastructure aspect of APEC physical connectivity may include:

a) Develop and implement a long-term (up to 2030) plan on connecting infrastructure development and investment in APEC for a well-designed, sustainable, seamless and resilient infrastructure connectivity. This plan should take into consideration the existing regional, sub-regional and bilateral infrastructure initiatives, frameworks and aim to synergize APEC works with these initiatives.
b) Expand and enhance APEC's trade routes and corridors, and strengthen regional quality transportation networks, including roads, railroads, ports, dry ports and airports;
c) Advance APEC cross border energy networks and interconnections;
d) Achieve universal and high-speed broadband access;
e) Achieve an APEC Single Window (ASW) similar to a Global Single Window (ASW) as proposed by UNECE and UNESCAP— "*A facility that allows parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfill all import, export, and transit-related regulatory requirements. If information is electronic then individual data elements should only be submitted once*." This will reduce trade cost significantly and increase the speed of the movements of goods and services. This will be very useful for SME.
f) Enhance financing and funding environment, mechanism, framework, and products to encourage long term investors including private investors.

In order to develop of a feasible road map with a time horizon up to 2030,

a) There is a need to prepare a long-term strategic integrated infrastructure connectivity plan together with priority projects and alternative financing sources.
b) This integrated APEC-level plan should take into considerations of existing bilateral, sub-regional infrastructure initiatives as well as region-wide initiatives in Asia and the Pacific, North America and South America.

c) This plan should have important specific milestones and be developed, coordinated and monitored through an appropriate institutional framework. A results-oriented planning framework is necessary to monitor the progress against specific measurable milestones.

In Asia and also in Latin America there is no dearth of infrastructure initiatives. As a matter of fact there are overlapping infrastructure initiatives in Asia and Latin America.

There are more than seven overlapping sub-regional infrastructure initiatives in Asia and the Pacific that involves APEC member countries such as:

a) ASEAN (with 10 Southeast Asian member countries most of which are members of APEC) with major infrastructure connectivity initiatives of the ASEAN Transport Network, and the ASEAN Energy Network. ,
b) Greater Mekong Sub region (GMS) (China, Thailand, Myanmar and Viet Nam),
c) BIMP-EAGA (Brunei, Indonesia, Malaysia and Philippines),
d) IMT-GMT (Indonesia, Malaysia and Thailand),
e) Greater Tumen Initiatives (GTI) (North East Asian countries—Korea and People Republic of China and Russia),
f) Pacific Island Forum(PIF)( Papua New Guiney) and
g) BIMSTEC (Myanmar, Thailand).

There are three Pan-Asian initiatives, namely Asian Highway, Trans-Asian Railway and Asian Dry ports. The Pan-Asian initiatives that were proposed by UNESCAP, include the Asian Highway involving 28 Asian countries, which connects Asia with Turkey, and eventually connects with Europe. The Trans-Asian Railway involves 28 Asian countries. In addition, there are bilateral initiatives connecting neighboring countries.

There are three sub regional initiatives in South America, (i) Integration of Regional South American Infrastructure (IIRSA) (Peru and Chile as member countries), (ii) Plan Puebla Panama (PLPP) including Mexico, and (iii) Andean Community including Peru.
One needs to integrate existing initiatives to achieve pan-APEC connectivity. The roadmap of APEC Connectivity should be based on the road maps of the above sub regional programs. We need to have an infrastructure development plan for APEC taking into consideration all these initiatives— bilateral, sub-regional and regional.

APEC member countries, especially Asia countries are at different stages of development as well as the sub-regions. The best approach of APEC connectivity is that we connect neighboring countries within a sub region through the sub-regional programs followed by connecting the neighboring regions through regional programs and thus we connect the whole region.

2. The Connection between APEC Bogor Goals 2020 and Indonesia's Connectivity Framework 2030

To achieve APEC's core mandate to attaining the Bogor Goals of free and open trade and investment in the Asia-Pacific by 2020, APEC needs "well-designed, seamless, sustainable and resilient infrastructure development and investment for enhancing physical connectivity resulting in decreased trade cost and smoother movements of goods and services".

"The increased physical connectivity can enhance economic growth and increase productivity, and provide significant positive flow-on effects including improved access to markets, job creation and manufacturing growth among others. Infrastructure investment is likely to have a significant impact on gross domestic product (GDP). The World Bank estimates that "a 10% increase in infrastructure provision raises growth by 1% in the long-term".

An ADB study shows that the use of FTA by businesses (particularly SMEs) is low in Asia. In contrast, Physical connectivity - a road or rail- has direct impact on the economy and, therefore, is a very powerful tool for development.

In order to rebalance Asia's growth, it is necessary to enhance intraregional trade in Asia. At present, Asians are mainly exporting to the advanced economies. But now is the time when Asians should trade more to each other and create more regional demand. This is very good for regional economic stabilization and balancing Asia's growth.

Therefore, in order achieve Bogor goals, increased physical connectivity is required to ensure more inclusive and sustainable growth through increased trade as a result of reduced trade cost as well as through connecting remote/isolated and/or lagging regions/countries to the leading business centers, ports and airports.

In order to make connectivity 2030 more comprehensive, there is a need develop an appropriate institutional and planning framework for development and investment cooperation for enhancing physical connectivity. The framework will establish criteria for priority projects including PPP projects as well as the possible sources of financing

- A Framework of Regional Financial Cooperation for Promoting Physical connectivity.

One of the major challenges of physical connectivity is mobilizing adequate financing. The above sub regional infrastructure initiatives have very good and ambitious plans, but they are not financing institutions.

National Infrastructure Financing Need and Gap

a) Asia and the Pacific needs around $6.9 trillion in connecting infrastructure, namely, transport, energy and telecommunications which include both greenfield and brownfield projects during 2010-2020— on an average, $ 630 billion per year;
b) Supply of infrastructure financing from the public sector of developing Asia will continue to be about $130 billion per year. Depending on past trends and future projections, WB and ADB can provide up to $20 billion per year for Asia's infrastructure;
c) The private sector investment in the Asia and the Pacific reached $100 billion in 2010;
d) Even if the private sector continues to invest $100 billion per year in coming years, the infrastructure financing gap is expected to be $380 billion per year.
e) The existing financial institutions will not be able to meet the above infrastructure financing gap.

Regional or Cross-border Infrastructure Financing Need

a) The identified 1202 regional projects (involving more than one countries) needs around US$320 billion for the period 2010-2020— with an average infrastructure investment need of about $30 billion per year. These projects are conceived under various pan-Asian (such as Asian Highway, Railway and Dry Ports), sub-regional and bilateral infrastructure programs.

Institutional Framework for Pan-Asian Seamless Connectivity

d) Market-led Asia's integration and its fragmented institutional arrangements; and heterogeneity in the level of development among countries call for a pan-Asian approach with a new pan-Asian institutional framework integrating existing sub regional and regional institutions.

Pan-Asian Infrastructure Forum (PAIF)

a) A “Pan-Asian Infrastructure Forum (PAIF)” or A Pacific Infrastructure Forum (PIF) should be established to help coordinate and integrate existing sub regional infrastructure initiatives toward a seamless Asia. This will facilitate Pan-Asian cooperation, coordination, and partnership through a Pan-Asian Infrastructure Forum.

b) PAIF can help coordinate and integrate existing bilateral, sub-regional and regional initiatives for achieving a seamless connectivity.

c) PAIF will bring together (i) representatives/senior policy makers of all sub-regional and regional programs and their member countries, (ii) major international and regional institutions, such as ADB, World Bank, APEC, ASEAN, ASEAN Plus Three, East Asia Summit, and UNESCAP, and (iii) major private sectors involved in infrastructure development and financing.

d) PAIF will develop an Asian infrastructure development strategy including transport and energy policies; and identify and prioritize important regional connectivity projects through facilitating consensus building among stakeholders.

e) Exchange relevant information and experience to reduce information asymmetry among various stakeholders; and

f) Conduct research, share knowledge and best practices and assist in capacity building on regional infrastructure issues.

Asian Infrastructure Financing Fund or Bank

An “Asian Infrastructure Financing Fund (AIFF)” or “Asian Infrastructure Financing Bank (AIFB) is needed to mobilize regional and international funds (public and private) and help prioritize, prepare, and finance “bankable” regional infrastructure projects. This bank will be dedicated to regional projects to enhance Asia’s connectivity and move toward the creation of a seamless Asia. This organization will implement programs/initiatives for an Asian Infrastructure Network connecting sub regions to each other and countries within a sub-region.

a) AIFB can be best thought of as a multi-donor and public private partnership platform that provide good means to collect and administer funds received and then has the flexibility to move them according to suitable priorities and sequencing.

b) Capital can be raised from a variety of sources such as public sectors/ governments, multilateral development banks, bilateral agencies, private sectors, sovereign wealth funds, Islamic and pension funds. An initial capital of around $30 billion will be appropriate to match yearly regional or cross-border infrastructure financing needs of about $ 30 billion.

c) This bank or fund can be supported by creating a special joint grant and concessional fund facility by the ADB, WB and other MDBs and bilateral financial institutions of major advanced economies in and outside Asia as well as private sectors.

d) The private sector participation is necessary to obtain adequate funding, efficiency in implementation and to provide access to technical or industry expertise of the private sector, such as creating consortiums of firms in rail development or port logistics. The interface with the private sector would help in identifying and designing bankable regional projects and in negotiating with governments and potential private investors.

Major functions of AIFB include:

a) Identifying, prioritizing, preparing, designing, and promoting the development of bankable regional infrastructure projects. The quality of this process is critical because the goal is to produce a list of well- designed, and priority bankable projects that accurately describe the benefits, costs and risks of projects in ways that make clear how they are good bets for large public and private investments;

b) Arranging cost-effective financing from pubic and privates sectors; and

c) Providing necessary incentives to countries (particularly low- income and less developed ones) to agree to and implement regional projects. One option is to provide providing grants and concessional financing; and to assist in capacity building to low income developing countries with low technical capacities. This will reduce asymmetric costs and distribute benefits properly among participating countries. In general, low-income developing countries may not receive proportionate benefits compared to middle- income countries participating in a regional project.

Corporation Andina de Formento (CAF) experience in South America suggests that regional organizations can be very adept at mobilizing long-term financing for regional connectivity. CAF is a PPP development bank established in 1970 that currently consists of eighteen countries in Latin America, the Caribbean and Europe, as well as fourteen private banks from the Andean region. This experience will be useful for the development of AIFB.

Dr. David Hong:

Steven, you gave us good points on the development of the TPP and RCEP when we met in Taipei in November of last year. The question is about REI and physical connectivity or supply chains. TPP and RCEP will probably reshape the underlying cost structures and thus shift supply chain locations but stimulating trade and investment among participants. The question is how the TPP and RCEP will drive the change on the regional supply chains and what remarkable changes members and non-members should be aware of? Another questions would be, Asia Pacific economies are in diverse phases of economic development, regional supply chains or production networks will be joined by both developed and developing economies in the region. However, certain economies might possess the most critical or irrepressible phase of the production networks, and it means that some unexpected and significant disruptions could stop the supply chains from functioning regularly. On the other hand, certain economies might lose their critical phase of networks and be challenged by others with improved and more attractive and competitive advantages. How should economies address different impacts associated with disruptions or competition in supply chains?

Mr. Steven Wong:

Dr. Hong was referring to a very intensive two-day seminar in Taipei, which actually was held by Taiwan, because they are very keen to look at the issue of the TPP with the view of being a member. On the issue of supply chains and production networks, let me say that production networks are one of the explicit goals of the TPP, and when you talk about the TPP, the ministers will say that the aims of the TPP is also to benefit particularly not only the advanced countries but also the developing countries has to do with production networks and supply chains; so this is one of the explicit goals of the TPP. If you look at it, it’s really not one particular chapter or one particular set of measures it is all of them taken together. In the market access for goods, services and investments obviously is one of the core things in the agreement, but as well there are many others that are required for the purpose of developing supply chains.

Most of you would know, some of you may not, in FTA negotiations, we spend a lot of time, most of our time, on what to exclude from free trade rather than what to put up on free trade. It's always the negotiation of the exemptions that takes more time, and that's why within the services sector, a great deal of efforts by individual governments to put down what goes in tier one and tier two exemptions. Both in terms of RCEP as well as the TPP, a lot of it hinges on what are these things that are subject to exemptions and carve outs; many of the obstacles to supply chain development lies outside of the industry proper. There was mention of it this morning; there was logistics, distribution, custom procedures, business services and telecommunications; there's a whole range of issues, it's a cluster of things that actually creates supply chains. Internal transportation is one of the most problematic for the ASEAN countries, in terms of we can't even go in and ship goods from one part of ASEAN to another because there are certain policies, market sharing among current suppliers, there are cartel type of arrangements and so forth. All of these things then will lead to the pressures for exclusion.

Positive list and fragmented approaches are going on; I don't think they are going to be able to do this and that is why you need to take a big knife and slice through this with great gusto, and this is what the current types of FTA arrangements try to do. That you don't focus on the small things, because the small things can be actually counteracted by other things. If we do everything right in the ideal situation, regional economic integration will make cross-border trade as easy as interstate trade; that's in theory. It will be as simple as shipping from one part of Thailand to the north or south, I presume is easier because you don't have to go through customs, fill out forms and assess what your qualifications are. It is likely under these circumstances that domestic pressures on this will actually reduce, it can improve because of the competition and additional investments.

There are many supply chains today that do not exist simply because there just isn't the investment. For example, for countries that are agricultural and are developing, many of the things that you require – cold rooms for example – are just not there. By taking a big sledge hammer and knocking it out is probably the way to go. These kinds of ad hoc-fragmented approaches don't work.

On the second question, my interpretation of the question is what happens if floods occur in Thailand every three years, and as a result of this the whole automotive chain continues to be disrupted time and time again in a very practical sense. Once you are the hub, you are the hub.

Once manufacturers stand the risk if there's anything that happens to the hub, whether it is the weather or political or any other thing that could happen to it, this is going to affect the whole performance of the value chains. I can tell you Malaysia use to not be the hub, but a hub for E&E sector; we've lost that. We retained some parts of it because of the vertical disintegration, but many parts of it have moved out. So even in production networks, you will see that they are not static or constant and are subject to change. The idea is that we want that to happen and we want to move to high end; we're actually saying we don't want this production network to be static; we want to take the good stuff and pass the other stuff. So actually production networks are not static, they are constantly evolving. I think in the process of change, there are these risks that are happening now. For example, if we look at certain decisions that have been made by Thailand and by certain big automotive companies, they have now chosen Indonesia as their point of investment. How much of this had to do with that there are these problems in terms of production networks? I would expect that some parts of it had to do with it. Of course the pull of the bigger Indonesian market is also very prevalent. It is also a combination of these kinds of decisions, will mean that if you are a hub today that doesn't mean you will remain a hub or the center of production forever. Nothing bad may happen to you, but other better things might happen elsewhere, that's how I would look at this whole thing.

Dr. David Hong:

Energy demand is critical for physical connectivity. From the perspective of Canada, how do you view energy infrastructure and connectivity for Asia? What can APEC economies do to enhance connectivity and how does it apply in the case of West Coast energy? In addition, can PECC pay a role in enhancing connectivity?

Mr. Hugh Stephens:

Physical connectivity is one of the biggest challenges in APEC. Indonesia's APEC Framework on Connectivity[2] outlines a number of key objectives for physical connectivity: these include connecting and integrating logistics, transport, energy, and telecommunications infrastructure. There are a number of challenges associated with connectivity, as identified by the Framework. Among these are the need to advance cross border energy networks and interconnections, strengthening regional transportation networks and ports and the need to connect the region's

[2] http://www.apec.org/Meeting-Papers/Leaders-Declarations/2013/2013_aelm/2013_aelm_annexA.aspx

"developed and emerging growth centers around and across the Pacific." These all relate to the supply of energy and transportation of energy within the physical connectivity framework, a key issue for Asian growth.

Many have said that the 21st Century will belong to Asia, but energy supply will be the key determinant of whether Asia can meet its full potential. That potential, according to the ADB's 2013 Asian Development Outlook[3], will see Asian GDP grow from 28% of global output in 2010 to 44% by 2035. However energy consumption is projected to increase from 34% in 2010 to between 51 and 56% by 2O35. The ADB identifies a number of challenges; the impact of the growth of the use of fossil fuels on climate change; the need to develop renewables, curb consumption, deploy new technologies (carbon capture and storage), *and measures to secure access*. The Bank notes that oil consumption is expected to double, gas to triple and coal (already the largest source of energy) to increase by 80%, and asks rhetorically, "Where will Asia find so much energy—over half the energy needed by the entire world in 2035?"

Part of the problem is that Asia's energy endowment is insufficient. While it has 35% of the world's proven coal supply, it has only 16% of gas and 9% of oil reserves. The traditional source of supply, the Middle East, is very insecure. The answer is to develop supply from within the APEC region. The potential is there. Of the world's estimated largest gas reserves, five are in Asia-Pacific (China, US, Canada, Mexico, Australia). According the US Department of Energy, China has the world's largest estimated reserves of shale gas but there are huge obstacles, human and technical, to extracting them. With respect to proven oil reserves, Canada has the 3rd largest pool with 173 billion bbl. (after Venezuela and Saudi Arabia). Russia is 8th (80 billion bbl); China is 12th (25 billion bbl); US 14th (20 billion bbl); Indonesia 27th (4 billion bbl)4. It is clear therefore that North American gas and oil can and should be an important factor in Asia's continued economic growth. However, there are significant physical connectivity challenges. While physical connectivity is an issue on the Asian side of Asia-Pacific, it is a growing issue on the North American side of the Pacific basin, particularly in western Canada.

## Canadian Energy Projects and the Connectivity Challenge

[3] http://www.adb.org/publications/asian-development-outlook-2013-asias-energy-challenge
4 https://www.cia.gov/library/publications/the-world-factbook/rankorder/2244rank.html.

While Canada has huge oil and gas reserves, physical connectivity to Asia is a challenge with two primary dimensions (1) getting the energy and resources to tidewater and (2) building the export facilities. Both pose considerable challenges—physical, environmental and legal. Geography plays an important part. Most of Canada's oil reserves are in Alberta, and to some extent Saskatchewan. The gas reserves are in Alberta and BC. The federal government has ultimate jurisdiction over pipeline construction but the provincial governments have significant influence, particularly when pipelines will cross their territory.

The current situation with respect to Canadian oil and gas can be described as being largely "locked in" to the North American market owing to lack of infrastructure and physical connectivity to Asia. And within North America, much Canadian production cannot even be easily transported to US refineries because of pipeline constraints. The solution to those constraints, the Keystone XL pipeline from Alberta to Texas is held up in administrative limbo in the US as environmentalists and oil industry advocates fight it out—with the Obama Administration sitting largely on the sidelines5. This delay has given impetus to the proposal to build a "Northern Gateway Pipeline" from Alberta to the coast in British Columbia, but there are environmental concerns (the potential for pipeline and tanker spills), native land claims and the issue of economic benefits to be resolved. The British Columbia government has laid down a number of conditions before it will support construction of a pipeline to move bitumen. Instead, BC has pushed Liquefied Natural Gas (LNG) exports. This will involve constructing natural gas pipelines to tidewater on the north or south coast as well as liquefaction facilities. At the same time, hearings have commenced with regard to an expansion (twinning or doubling) of the existing Trans-Mountain pipeline from Alberta to the southwest coast in Vancouver.

With regard to the LNG projects in BC, there are currently 12 projects under licensing or review, many involving Asian investors (PetroChina, Kogas, Mitsubishi, Petronas, Japan Petroleum, Petroleum Brunei, CNOOC, JGC and Inpex from Japan, Woodside Petroleum of Australia). Also involved are Shell, Chevron, Exxon, British Gas, and some Canadian players. The key issues for these projects are price, contracts (which remain uncertain), environmental issues (which are probably manageable), land claims issues (the First Nations are generally in favor owing to their participation in the economic benefits) and overall demand in Asia and alternate

5 http://www.csmonitor.com/USA/2014/0220/Did-go-slow-approach-on-Keystone-XL-pipeline-just-get-slower.

sources of supply. BC has moved recently to clarify the tax regime that will apply, although details are still scarce.

Canada is of course not the only source of supply. There are other key players in the region, notably Australia and potentially the US and Mexico, Russia and China, and out of the region Qatar, Mozambique and others, although security can play more of an issue here. It is hard to predict what the chances are for completion of the physical connectivity energy projects in Canada. The Keystone XL is given a 50/50 chance of US approval and if it goes ahead it may take some of the wind out of the sails of the Northern Gateway pipeline. The doubling of the Trans-Mountain pipeline will likely proceed and the BC government is betting that at least two or three of the dozen LNG projects will proceed. These projects have the potential to make a significant contribution to Asia’s energy needs in the area of gas and a modest contribution in oil.

Enhancing Connectivity: What happens next?

What can APEC economies do to enhance connectivity and how does it apply in the case of west coast energy? It is interesting to note that there is no shortage of financing. Chinese and Malaysian national oil companies have become directly involved as have some Korean and Japanese players, with Petronas (which acquired Canadian gas player Progress Energy last year) reportedly willing to invest up to $36 billion dollars to bring these resources to Asia. These companies have the capacity to influence price and manage demand in their markets and therefore their direct involvement is essential. At the same time, Canadian stakeholders (provincial and federal governments, environmental advocates, First Nations, industry) need to resolve their conflicts and develop a balanced strategy that will serve both Canada and Asian markets.

A Role for PECC?

The issue of Asian supply and demand, physical connectivity within the Asian region and across the Pacific and critical elements of timing and pricing require further study. The conclusions could have an impact on the decisions taken by policy makers in both energy importing and exporting countries. PECC is well placed to undertake such a study.

Dr. David Hong:

About the Asian Infrastructure Bank (AIIB), mentioned by Chinese Leaders Mr. Xi Jinping in APEC leaders meeting last year. It would seek to cooperate rather than compete with other sources of funds, particularly the Asian Development Bank as they both have similar functions and objectives. May we know more about how they can complement each other? How to develop a proper framework for regional financial cooperation for promoting physical connectivity, including regional capital markets, earmarked funds, AIIB's, and so on.

Mr. Mark Rathbone:

Two quite challenging questions. Let me start by just posing the reasons for why we might be looking at something like an Asian Infrastructure Bank and regional financial cooperation when it comes to connectivity, this will allow me to answer the questions more effectively.

Firstly, everyone recognizes and acknowledges the benefits that can be achieved through achieving a more connected set of economies across ASEAN. Better trade, flow of goods, breakdown barriers in trade, making ourselves more competitive globally, and lower the costs of production and transport, it is very obvious why there should be connectivity between the differing territories. Certainty a number of roadmaps and concepts have been put forward over the course of the last five to ten years; for example, the Transport Ministers in 2010 put forward the ASEAN Highway Network (AHN). I would hazard to guess that not one of those projects has actually reached financial close and started construction as of yet. Now one must understand why this is the case.

Firstly, I think at the basic level, across most of the region, you have within territories very naïve project preparation and pipeline management principals. So projects are coming to the market and they are not being prepared effectively for the private sector or anyone else to go build and finance these projects. At a very macro level, it is very easy to start drawing lines around a map saying we need a highway that goes from Sumatra connected by port to Singapore and then to Malaysia then into China. I can understand that it is really logical and it is very clear, but within territories if you haven't got the ability or the finances to prepare the projects effectively and take them to the market those projects won't get built.

Secondly, there are multiple regulatory challenges across the ASEAN territory. In terms of regulatory development, if you look at viability gap funding, only very recently Indonesia and the Philippines have the viability gap financing by government into non-viable infrastructure projects have been allowed. Land acquisition law is something that has been dogging Indonesia's infrastructure development for many years, only in the last 6 months has that regulation been passed in Indonesia. So there are many examples of regulatory inhibitors around infrastructure development across our region.

Thirdly, risk allocation and the trade off with reward. A lot of the markets that surround us have different risk profiles. Now if you are taking more risk as an investor, you expect a return. A lot of the projects we talk about are not economically viable projects, so there has to be a degree of subsidy that has to come in from the government or some other source to make the projects viable for investors and operators. Without that you simply won't get the projects closed, and they will not be bankable, as we call it in the financing market.

In terms of institutional connectivity, I think that is very important as well. Institutional strengthening, this leads me on to talking about Indonesia as an example, which will then take me to the answer of your questions. Indonesia five to six years ago had a very haphazard approach to procuring infrastructure. In 2005, I attended a conference down there, where over a 120 projects were released on to the market in one day. Not one project has closed since then, not one. Why is that? Not one of the projects was prepared effectively; you had very little regulatory support for the projects, the procurement process was non-existent. So effectively, the question was asked, here are the 120 projects, come and give us your money to invest in Indonesia. Simply that will not happen. Capital will go to projects that are the easiest to close, that provide economic return, and where people can understand the competitive element that they will be involving themselves in within the territory. So talking about Malaysian companies going in there. If I'm in the United Kingdom investing in Malaysia, I want to make sure that there will be fair competition.

In the recent two years or so, Indonesia has done a huge amount to strengthen their institutions. Firstly, they have created the Indonesia Infrastructure Guarantee Fund (IGGF) and Indonesia Infrastructure Finance (IIF). Secondly, PT Sarana Multi Infrastruktur (PT SMI) have become far more involved in governing how infrastructure is developed. Thirdly, you have gotten new regulations that are being passed in Indonesia to strengthen institutions in the regulatory process. For example, the procurement process is now a published process; it is now transparent, clear, supported by multilaterals, and so people are more confident that they can bid on these projects. Land acquisition laws have been passed, viability gap regulations have been passed;

so the institutions and regulatory framework are being made more robust. IIF and IGGF provide some financial support to the surrounding infrastructure development, but very minor. Again, that points to the need for an AIIB.

Just as an illustration of some of the barriers that these territories face. When I was looking at some trade statistics in preparation for the meeting, the first thing that astounded me was if you go to a super market in Jakarta and buy oranges, those oranges will come from China and not from Medan which is where they have a large orange production area and agricultural area. Why? Because shipping it inside Indonesia from Medan to Jakarta is more expensive than shipping it from Shanghai to Jakarta, which is ridiculous. Shipping of cement to Jakarta fro, Rotterdam is cheaper than shipping cement from Jakarta to Papua New Guinea (PNG). Cement in PNG is 20 times more expensive than Jakarta. This is just a couple of examples of the trade barriers and trade issues that are created through poor connectivity. The government of Indonesia has done a huge amount to address this, and I've mentioned a few of the regulatory changes.

Then we move on to question one. Firstly, what is the role of the Asian Infrastructure Bank? I think it's important to recognize the importance of the multilaterals that current exist, ADB, World Bank, IFC and the role that they play in creating a better infrastructure environment. But they have limited capital and limited capacity, and also a very specific direction and strategies on what they will invest and how they will do it. I think if you consider the scale of financing that is required across Asia, so the published numbers are between \$8 trillion and \$10 trillion over the next ten years, it's a huge amount of capital needed. There is not that amount of capital within the financial markets to fund that kind of infrastructure in Asia. There is sufficient capital to fund the pipeline that is in the market now, there's a big difference between those two. So I think the first thing is the AIIB provides a very substantial potentially liquidity pool for certain types of projects. At a basic level, clearly they can provide debt and equity financing directly to projects, and they can also provide technical support in financing the development of projects.

However, I think there are more specific areas where AIIB would be more beneficial. Firstly, I think it would be in a situation where they should not be competing with commercial banks; commercial banks play a role. The AIIB has been put forward as a method of plugging funding gaps for connectivity around Asian infrastructure. So firstly, I would say funding specific regional developments that will aid connectivity; so transport networks, non-viable projects,

projects where you have very substantial capital requirements that will only be made through something like the AIIB. Viability gap funding, rather than being a pure commercial bank, maybe have some commercial elements provide a form of viability gap funding that might be in the form of soft loans or interest-free loans to governments to help make non-viable projects viable, because a big toll-road, a high-speed rail network, or a MRT system on its own might not be viable. However, the surrounding economy would make it viable through the better transport of goods and people.

Process, help make processes more simplified. If you tried to raise financing through the ADB, World Bank or IFC, it is quite a complicated process and it recognized more generally that it's harder to do that than raising it through commercial banks. I would say right away the AIIB should make it easy to attract capital; there shouldn't be that many hoops to jump through. Working capital funding for the project that are struggling. Political risk guarantees and credit swaps are a very easy way of helping; sectors that are not normally funded by multinationals and commercial banks so non-viable projects for example.

In terms of capital market development, I think the most important way that they could help is a central infrastructure bank for Asia is to provide long-dated cheap financing either in the form of bonds or debt of some sort on which you can latch projects. That will help local capital markets look at other products that are being priced for infrastructure over a longer term and will ease the burden on individual projects as well. I think that they can play a very valuable role in that. They can also provide the role that the old mono-lines use to play pre-financial crisis; IREP bonds or projects ensure that they become credit worthy or investment grade and so they can raise financing.

How does one develop this regional financial cooperation? I think its very easy to identify difficulties, you just need to look at Europe and the single currency to see that. The primary blockage is that each territory has its own approach to the way it develops infrastructure. Countries approach infrastructure as sovereigns, they don't see it as a club of countries coming in and allowing other countries to build their own infrastructure. That simply doesn't happen. Different countries have different regulatory frameworks and ways of procuring assets. I think a number of questions need to be asked. One, why are we enabling this cooperation? What are the funds for? If you are going to have an AIIB, where is financial cooperation around countries who will fund it? Do all territories have to fund it or is there choice around it? It is profit driven or is it more directed to plugging viability gaps that are needed. For bankable projects there's enough capital, what you need is capital for non-bankable projects and that will allow capital to find infrastructure homes. I think practically you can create institutions, you can have better capacity created through financial cooperation, so having forums and more APEC's where we can all meet and talk to governments to discuss issues, I think that's very helpful. Cross-border alignments around tariffs, so that if you have a railway line or a highway going through borders to allow connectivity, tariffs are clearly very important that they have to be regulated. How do you deal with currencies? AIIB financial cooperation deals with currency risk? One of the biggest barriers around infrastructure investment in Indonesia, the Philippines, and Vietnam is currency. Then finally, governance structures around how you might develop them.

Dr. Mari Pangestu:

I will say something on physical connectivity; but if I may, I would also like to address something from the tourism and travel perspective and also regarding travel facilitation, which is one of the APEC initiatives that we hope will be carried through this year.

One of the priorities for the China year, if I'm not mistaken, is about connectivity, and when you talk about connectivity, if we read the APEC economic leaders statement from 2013, promoting connectivity means physical connectivity, institutional connectivity, and people-to-people. I know that this session is talking about physical connectivity. I think we should also address some of the people-to-people and institutional connectivity. I think connectivity, lets perhaps start by asking the basic question, why when we talk about regional integration, whether in APEC, ASEAN or wider, connectivity becomes such an important issue? I think it's because you have worked on regional integration for a long time, whether as an academic researcher or in policy, we have found that once that you reduce tariffs, non-tariff barriers and so on, you do need to have greater connectivity between countries as well as within countries. This is so that you can ensure that the benefits of the integration are going to benefit and balance benefits between countries and as well as within countries. We need to remind ourselves to why this is important; it's not just an efficiency issue. When we in Indonesia worked a lot in the last few years on our national logistics or connectivity master plan, we came up with the vision that you do this for; first, obviously to reduce the costs of transactions and transportation, but in a country like Indonesia and for many other countries, increasing connectivity within your own country as well as between countries is also question of reducing the imbalances between regions and ensuring regional integration is going to be leading to balanced and inclusive growth. I think this is just an introduction to why physical connectivity is important;

it is not just an efficiency argument but it is also an inclusive and balanced development argument.

We've argued that this is important because if you don't get that part right, the balanced and inclusive development, you can't get the support domestically for continued regional integration in terms of the flow of goods and services. So I just wanted to remind ourselves of this important point because it is something that when we were working through our ASEAN region in 2011 and again in 2013 in APEC, that was very much in the back of our minds.

Now let me try to share with you my views on physical connectivity, both the physical connectivity and people-to-people connectivity. If you start with physical connectivity, I recall we had a similar session twelve months ago; it was in-line with preparing for the upcoming APEC year in 2013 that we had this discussion. When we talked about infrastructure development, the message that came out from all the discussants at the time was that financing was the least of the problem. The policy side, the best practices and getting your public-private partnership framework in place, they were much more important than financing; if you could get that right then the financing is less of an issue if I recall correctly. I think that's why in 2013, we did focus on coming up with this APEC investment infrastructure framework and a lot of thought was put into the framework, part of the plan was to have an APEC advisory panel and a pilot private-public partnership center in Indonesia. I think we've realized in Indonesia that financing is an important issue, but financing isn't such a big issue when you can get your policy framework right. We've actually been struggling for a couple of years in getting our policy framework in place, and dealing with the uncertainties. Certainly land issues, we know is one of the biggest problems we face in Indonesia, and possibly in other countries. I think what APEC is good at doing is sharing best practices in how you can deal with these different issues.

I would say the number one issue for Indonesia is the land. We don't have public domain laws; when you want to build infrastructure for the public good, you can't shift people as long as you can compensate them. We don't have that law. We have a government regulation that tries to address it, but it turns out that the government regulation is not strong enough. Once we did some amendments to the law, it turns out that when you try to implement it on the ground, it's not so easy. I think the sharing of best practices in dealing with such problems could be the job of an expert advisory panel. Designing public-private partnerships with the right incentives, getting the tariffs right, governance structure right and getting it so that the incentive structure is going to be attractive enough for the financing to come in, these are all important lessons that we could share in this APEC network. I see that there is an idea of pilot public-private partnership center in Indonesia, and I hope that basically the government finance ministry will support it. I think that our finance ministry has been quite focused on this public-private partnership and the role of government in facilitating or underwriting the risks when needed for some of these public-private partnership projects without incurring the contingent liabilities that come with it. Here is where your good governance comes in.

I think this is very important and we feel if we can pick a pilot project that involves at the minimum two APEC economies that would be great to try and test whether we can actually do cross-border planning for the physical connectivity idea.

One of the questions being asked here, is how can developed and developing economies both contribute to regional connectivity? I think here the sharing of experiences is one, financing obviously is another, and to the extent you can share also the standards that come with building a road or building a harbor or ports. Not just the hard infrastructure and physical infrastructure, like when we were developing the national logistics blueprint, we found that the soft infrastructure, the services side of delivering connectivity, whether it's your warehousing, logistics, airport management, port management, systems and technology that can help to make sure that you have efficient logistics becomes a very important part of connectivity. One thing is to actually physically build the ports, harbors and roads, but it is another thing to actually implement and make sure that there is efficient connectivity. That is just within the country, when you talk about cross-border it is even more complicated obviously. What you want is standardized custom procedures. In the case of tourism, you want to have visa facilitation; you'd actually want free visas if you could get it with the exceptions of certain categories of people. Just like you have goods that you want to be flowing through green lanes as much as possible and you classify goods based on risk. For people you could do the same thing; you could classify different classifications of travelers, those who are frequent travelers or business travelers, like we have with the APEC Business Travel Card, they can go visa free. That increases the movement of goods and people, but you still have a system that captures the high risks goods or high-risk people. To me trade facilitation and travel facilitation has a lot of these similarities. For us to be able to get there, we need to do a lot of work in terms of agreeing on standards, systems, and at the end of the day the sharing of information. With customs it is the same thing, you need to share information with people, it's the same thing and probably a little more complicated because of you have more concerns on the security side, but it's the same thing with goods; it's customs immigration quarantine, and the security aspects for goods and people, you have similar security considerations and they need to be coordinated if you want to have fast flow of goods, services, and people across borders. I think connectivity involves us thinking about the physical connectivity, building the infrastructure and thinking through best practices, good policies and public-private partnerships that can go with it, and then with the financing that comes with it.

Thinking about the institutional set up and framework that must happen to ensure that you have faster, convenient, safer and securer movements. I'm taking this from the leaders statement actually; when we talk about the travel facilitation initiative, we talk about making travel more accessible, convenient, and efficient, while at the same time safe and secure. Goods are actually very similar in my opinion. I think this is something that APEC again is good at because we can discuss and coordinate without really negotiating. We have done pilot projects whether it's on the goods side or on the people side. I would say on the goods side, our trade facilitation initiative reducing costs of transactions of trade by 5% and now 10% was a good initiative that pushed our customs people to work together.

On the travel side, I hope the representatives from China in the audience, we hope that China will continue to take onboard the travel facilitation initiative of APEC, which was started in 2011, and we picked it up in Indonesia in 2013. What we tried to do was push this forward because what has happened in APEC, you have six programs and five sub-fora all looking at the issue of travel. One set of people is the business mobility group, which looks at the visa issue. We from the tourism side would like to see the APEC Business Travel Card, which is a very successful pilot for business travel, be expanded for more frequent travelers and possibly in the future to tourism travel and so on. There are other initiatives such as airport and tourist friendly airport programs, passenger advance information programs, where just like goods where you can send information in advance about the passenger and you will have faster clearance. You can share the use of technology, whether it is biometric passports or automatic gates and so on, are all possibilities in the system and the technology which will make your airports clearance of goods, your customs and quarantine side as well as your immigration and visa side work much more efficiently. The APEC Business Travel Card started only with a few. We can do the same thing on the tourism and frequent traveler side by starting with a few countries to begin with, at the minimum the ASEAN members in APEC, we are already to some extent visa-free.

I wanted to share some numbers with you because the numbers are good to convince people that this is an important issue. When we did the APEC high level travel dialogue in Bali last year, we did some number crunching to see what would happen if you reduced visa restrictions and asked the UN World Tourism Organization and the World Travel Tourism Council to study on what would be the impact for APEC economies. The study is quite interesting; the study shows that 20% of all international travel to and within the APEC region still requires traditionally paper visas. The study concluded that if we implemented the visa facilitation program, say that you remove that 20% and went to something that is online or easier, you could generate a 12-18% increase or 38-57 million additional tourist arrivals, which would generate 2-2.6 million new jobs directly. We don't talk about the indirect creation of jobs. 62 to 89 billion more foreign exchange earnings by 2016. There was actually a table that compared the ease of visas between the APEC economies, and some are very advanced and some still have a higher use of paper visas. Even if you migrated from traditional paper visa to something that is just having information online and being able to apply online, you could already have an impact on people-to-people movement.

APEC as a region accounts for about 30% of the 1 billion tourist numbers, and we as a region are the fastest growing region for tourism. We can do a lot in terms of the various initiatives, which are already in APEC, but what needs to happen is coordination between the sub-groups within APEC. To mention the five sub-groups that are working on this issue in APEC; we have six programs in APEC which all deal with improving people-to-people connectivity and having better airports that are safe, secure and convenient. We have airport partnership programs and the APEC Business Travel Card, trusted traveler programs for points of entry, air passenger security screening, advance passenger information, and how to have better facilitation for checked baggage. These six programs are unfortunately in five sub-fora, so they are not talking to each other basically. One of the things we tried to do with the high level policy dialogue is to encourage how you can have the five sub-fora, transportation working group, the business mobility working group, which deals with the APEC Business visa, we would like for them expand beyond business visas, the subcommittee on custom procedures, counter terrorism working group and the tourism working group; they are not coordinating, just like within countries, we need to coordinate between immigration officials, the customs, quarantine, security people and the airport managers also have to be coordinated; national coordination as well as regional coordination.

Finally, I would like to say on question four and five of this session. Once you have the airports and the ports, you also need the services. You do need to have the opening up of the air travel, airlines and maritime side. In ASEAN, we already have Open Skies; in APEC, there are also similar pushes towards opening up of the airline and maritime accessibility for services to be more open between APEC economies. This is going to give a big boost to travel because we know that low cost carriers have been a big boost to air travel, and if we talk about cruise ships and so on that's another area. Finally on the question on the AIIB, which I know being proposed by China, I think we need to think about once you have the AIIB, how does it link to the existing regional and other multilateral banks that deal with financing in infrastructure. Maybe we could see it as part or complimenting what already exists.

**Question and Answer Session**

Mr. Hugh Stephens:

On your comment about freer travel for leisure visitors, I fully take your point about the economic benefits that can flow from this. When I go to Thailand, Malaysia or Singapore, I just show up at the frontier and come in. When I go to Indonesia, I have to go to consulate or queue up at the airport and pay $25 for a sticker to be placed in my passport. Why doesn't Indonesia unilaterally disarm on this and take leadership?

Dr. Mari Pangestu:

I've been trying! If it was up to me it would already be done, but of course I have to cooperate with the immigration, security people, at least our immigration ministry is much more open, it's the security people that we always have issues with. I think we are getting somewhere. At least now, Indonesian's can actually now go through the auto-gate, you no longer have to line up at immigration. They promised me the next step would be to identify certain categories of foreign travelers that will also have the same possibility of lining up at immigration but going through the auto-gate once they have the biometric passports or other measures posted. I think you don't mind paying the $25 if you don't have to line up to clear immigration, we're trying to see whether we can get visa-on-arrival placed in your ticket and include it in the payment of the ticket. Therefore once you enter, as long as there is an indicator of visa payment, you can again either use the auto-gate or just line up at immigration. We are thinking this through and learning from other countries. The problem with the immigration and security side is there is this thing about reciprocity; if Canada would give Indonesian's free visas then we would give Canadian's free visa, that's how our immigration and security people think, and it is actually how the law sounds. The law also says that under certain circumstances you can give free visas as long as the benefit is clear. Actually a lot of countries have dispensed with reciprocity requirements and given visa free for certain categories or certain parts of the country. Korea, for example, has very smartly given Chinese visitors to Jeju Island free visas, things like that. Travel went up by 100-200%. These are also numbers that we share with our immigration officials in trying to ease travel so that there is more people-to-people movement.

Mr. La Yifan:

Let me introduce myself first, I am the Undersecretary General from the Chinese National Organizing Committee for APEC 2014. Therefore, I'm listening and I'm going to bring all your ideas to headquarters. Two points. First, on the easing of travel within APEC economies, I fully buy your ideas. We should not only expand the current APEC Travel Card system but also expand it to some other travelers, possibly tourist at a later stage. So that is the reason I would highly suggest that Indonesia together with the likeminded members to continue to pursue these ideas through the relevant working groups, committee meetings and leaders meetings. I want to inform that someone will be convinced in Ningbo next week.

Secondly, with regard to your initial ideas of the proposed AIIB, I've also listened to your views and in fact that proposal is still developing itself. There is already informal consultations and negotiations and process kick started. We hope that Indonesia together with the other member economies will actively participate in that process and contribute to it.

Dr. Mari Pangestu:

Thank you. Please, I hope that you can get the China National Tourism Agency (CNTA), who will be leading on the tourism side, to be able to coordinate what we tried to do with all the other agencies and sub-fora, so that the APEC travel facilitation initiative can really continue to progress in the year that China is hosting APEC.

Dr. Naoyuki Yoshino

I am very interested in infrastructure financing and funding but sensitive risks will be associated because it is not one country but several countries. How will it be possible to mitigate currency variances in many different countries?

Dr. Biswa Bhattacharyay:

That is an important question because as after the U.S. tapering of QE3, several emerging economies are experiencing depreciation in their currencies. One way to minimize risk is to raise finance through local currency bonds in the respective countries. Another measure has been used by the IFC and partially by the ADB is loan through local currency swap. Currency swap is available in major Asian countries and can be used for providing not too long-term loans— up-to fifteen years.

Participant:

Let me just add, there was something set up by ASEAN a few years ago, the CMIM fund which is $240 billion and that was specifically for liquidity issues surrounding currencies. I don't believe that it has been used as of yet. Currency swaps are only as good as so long as there is depth in the swap market for that currency. A lot of the currencies used that we have around our region are relatively inconvertible; you can't really go and change Vietnamese Dong in the Singapore change alley for U.S. dollar, they won't give it to you; so I think a lot of work needs to be done. The role of the AIIB and facilitating better currency "swap ability" around our region because that can really play a role, the World Bank and ADB are doing so already. The depth of that market is relatively thin and the length of the market is quite thin.

Dr. Narongchai Akrasanee:

Addressing the question to Dr. Biswa. I was hoping that you would update us on the latest development of connectivity. I think over the years we have done a lot of work following the guidelines from ADB. We are not starting from the beginning; we have had a series of conferences on connectivity, including one in Singapore last year. We were talking about all the ideas, some of them being repeated today, but actually a lot of things have happened. We just opened the fourth Mekong Bridge, now we can travel by land to China easily through mainland Southeast Asia. We have four bridges now in operation and all of them financed by public funding. That's why I asked as far as land transportation is concerned, I think on the mainland things are progressing without any financial constraints. We have a lot of new airports that people can use that has been the traditional connectivity. Telecommunications there is no need for public funding. Private companies can finance them. Energy connection and power lines, we have now so many energy projects all being connected among ourselves. So perhaps Dr. Biswa can update our meeting and tell us where we are now. As far as I am concerned, financing as I said or as heard before, maybe is the last issue. If projects are good there will be lots of money looking for good projects. A few years ago when we heard about the European financial institutions having balance sheet problems and withdrawing from many of the projects that they pledged that they would finance earlier. But later on we had our Asian financing institutions financing all of them. So in a way, I think it would be of use for Dr. Biswa to update us now.

Dr. Biswa Bhattacharyay:

It's a very complex process to update the status of various initiatives with overlapping goals and ambitions. The Greater Mekong Region is the most successful story about the land transport connectivity. Asia has several archipelago countries, such as Indonesia, Malaysia, and Japan. Based on my experience, the World Bank and ADB usually do not lend for ports and airports because the overarching objectives of lending for these developments banks is poverty reduction. The IFC, the private sector arm of the World Bank, and the private sector window, ADB does lend to commercial projects in transport, energy and telecom. Basically the sovereign lending is not provided for most commercial projects. There is a huge need in this area. Asian Highway and Asian railway are making good progress but there are several missing links. Countries with missing links include low-income countries. These low-income countries do not have enough capacity or finance to implement these projects. The inter-country border connections particularly in land are weak. As per ADB study, trade of most goods between Asian countries move through sea even if there are land border connections. There are also soft connectivity problem in border movements. It takes long time moving goods through borders. The trucks have to unload at one border and a new truck picks it up at the border of the neighboring country. Due to the lack border customs agreement among countries, the systems and procedures are very complex and time consuming causing significant delay. The railway lines are not compatible between neighboring countries such as broad gauges and narrow gauges.

The main focus of the AIFB (similar to CAF) will be more on regional connectivity projects, involving more than one countries. The main objective of establishing AIFB is to provide large loans for traditional infrastructure projects. These loans should be given in multiple currencies for regional connectivity. There is a huge need for the ports and the airports. We need mass transport and rapid transport systems, such as MRT, and LRT.  What I foresee in future that any distance within 500 km should be connected by high speed or bullet train which is environmentally more sustainable than air transport.  This transport will be more inclusive in the sense that it will be more cost effective and affordable by the middle class.

# Day Two Welcome Remarks

Ambassador Donald Campbell
Co-Chairman, Pacific Economic Cooperation Council (PECC)

Ambassador Donald Campbell:

We got off to a good start yesterday looking at the sets of issues that are confronting us. The structural changes taking place in Asia in response to opportunities in the region and pressures from outside the region. I found very enjoyable the discussion and I think there's a lot of work to be done on the trade front and with the various agreements under negotiation. The ultimate aim of a FTAAP must still be our objective. We also had a very good discussion on physical connectivity, Mari Pangetsu made an interesting call for expanding the scope of connectivity beyond physical infrastructure. The discussion on the Chinese proposal for an Asian Infrastructure Bank needs to be address.

Today we're going to be concentrating on financial cooperation in Asia. We have a keynote address first by the Vice Minister for Finance of Indonesia, we're delighted to have you with us here this morning, followed by a panel. This area has been called in a sense the weak link in terms of work and activity and progress that has been done. We're in a very different place in the Asia Pacific than we were certainly fifteen-sixteen years ago and even in 2008, nevertheless there are a lot of forces of turmoil out there and it behoves us to address these sets of issues in as meaningful a way that we possibly can. That will be the agenda for this morning, and we'll then have some concluding remarks and discussion as China prepares for the APEC meeting and as PECC sees what contribution it can make to this very important year for China. We're going to end up with an open lunch and the PECC standing committee will have a separate working lunch to conclude the day's event.

# Day Two Opening Speech

**By**:
Professor Dr Bambang Permadi Soemantri Brodjonegoro
Vice Minister for Finance, Indonesia

**Moderator:**
Ambassador Donald Campbell
Co-Chair, Pacific Economic Cooperation Council (PECC)

Dr. Bambang Permadi Soemantri Brodjonegoro:

First of all on behalf of the Mnistry of Finance of Indonesia, I would like to thank you for the invitation from the PECC to give a keynote speech on behalf of my minister. Of course as you know, Indonesia has been an active member of APEC, we are just not a member but we can assume that we are one of the active members within APEC. Fortunately last year, we were the Chairman of APEC last year. I think during 2013, I believe that there have been some productive output from the Indonesian chairmanship of APEC, and some of them of course I would like to share with you especially related to the Ministry of Finance track.

Before we go into detail, let me share with you our global challenges that we have to face, not only this year but in the years ahead. We identify three main global challenges that not only for advanced economies in APEC but also for emerging markets and developing economies need to handle. The first is and will affect everyone is the weak global economic growth. I think there's no doubt about this issue because the world economic outlook from the IMF always revised down economic growth especially for 2013. For 2014, there has been some hope that the economic growth might be better than 2013, although of course there are a lot of notes to ensure the prediction will be correct. At least the recovery in the U.S., what has been happening in Japan, at least gives us some relieving indication that the weak global growth might be over or might take some time. At the same time, we also saw that China's growth is now at the range of 7-8% which is of course the highest maybe among countries in the world, at least among the G20 members. For global economic growth of course, China growth of 8% will have some impact especially for countries like Indonesia because China is one of the major trading partners for Indonesia. If the 2014 could be better than 2013, then we can be quite convinced that the Asia Pacific once again will be the source of economic global growth. Currently, we are still the power of the economic growth, but when the economic growth weakens of course people think whether the Asia Pacific role will be as important as before or might to share the role with other parts of the global economy, like Europe.

Figure 3.1

| | 2012 | 2013 | | 2014f | | 2015f | |
|---|---|---|---|---|---|---|---|
| | | Jun-13 | Jan-14 | Jun-13 | Jan-14 | Jun-13 | Jan-14 |
| **World** | **2,5** | **2,2** | **2,4** | **3,0** | **3,2** | **3,3** | **3,4** |
| Memo item: World (2010 PPP weights) | 2,9 | 3,1 | 2,9 | 3,8 | 3,7 | 4,1 | 3,9 |
| **High income** | **1,5** | **1,2** | **1,3** | **2,0** | **2,2** | **2,3** | **2,4** |
| Euro Area | -0,6 | -0,6 | -0,4 | 0,9 | 1,1 | 1,5 | 1,4 |
| Japan | 1,9 | 1,4 | 1,7 | 1,4 | 1,4 | 1,3 | 1,2 |
| United States | 2,7 | 2,0 | 1,8 | 2,8 | 2,8 | 3,0 | 2,9 |
| **Developing countries** | **4,8** | **5,1** | **4,8** | **5,6** | **5,3** | **5,7** | **5,5** |
| China | 7,7 | 7,7 | 7,7 | 8,0 | 7,7 | 7,9 | 7,5 |
| Indonesia | 6,2 | 6,2 | 5,6 | 6,5 | 5,3 | 6,2 | 5,5 |
| India [6,7] | 5,0 | 5,7 | 4,8 | 6,5 | 6,2 | 6,7 | 6,6 |

*Source: WEO, Bloomberg, World Bank,*

We can see that Europe's recovery is still quite slow, there has been some constraints in European economic growth so we can still be convinced that the Asia Pacific is still the one. We need to solve our own problems.

The second global challenge is about the issue of the QE Tapering. Of course this might affect more the emerging countries. Some APEC members like Indonesia and other Southeast Asian countries might be affected by the QE Tapering issue. There are two sides of the coin. At one side, if there is a tapering at a certain speed, of course, it will affect our economic growth to slow down, this includes emerging markets and Indonesia. Of course, people will think that our inflow will be lower than before, it might create capital outflow and issues like that. There is uncertainty in this issue.

On the other side of the coin, if there is QE tapering and if let's say the speed is faster meaning that the U.S. economy is on the right track. The U.S. economy is still trying to recover and the latest data that I just read a couple of days ago, the unemployment rates in the U.S. is now around 6.6%. If I'm not mistaken, the Fed has 6.5% unemployment as an indicator and after that might reduce significantly the monetary stimulus. Of course, if the U.S. unemployment lower and lower meaning the U.S. economy is getting better. A better U.S. economy together with a better Japan economy will of course help other APEC members including for example Indonesia, because again aside from China, Japan and the U.S. are also not only important trading partners but also the source of FDI. So we really hope that the U.S. economy is really getting better, that the Japan economy is getting better, but at the same time we have to manage the transition from non-conventional monetary policy when the Federal Reserve is very aggressive in pouring the money into the market, back to the conventional when the Federal Reserve has limitations in terms of market activity. We are actually having to face the transition from non-conventional into conventional monetary policy. At the same time there is hope that the trade activity will be higher because of the size of the U.S. economy as well as the Japan economy. That's the second issue regarding the QE.

The third issue maybe more relevant to economies like Indonesia and some other economies that may not be APEC members is commodity prices volatility. Of course, now in APEC I believe in the near future maybe in during China's chairmanship or the Philippines chairmanship next year, maybe we need to start to discuss in more serious manner the issue of energy. Why energy? Because we just heard that the U.S. has done a big transformation in terms of energy resources. We use to know that the U.S., although that they produce a lot of oil and gas, they also were one of the main importers of oil and gas. Shale gas is not only producing gas but also produces oil, which means the U.S. will be back to the so-called golden era. They can handle energy problem on their own, rather than relying on the Middle East and the import of gas from there. Now the U.S. is on their own, this is of course good for the U.S. meaning economic growth in the U.S. will be healthy. I also learned that the unemployment of 6.6% and the reduction of unemployment is very interesting. Previously when unemployment was still around 7+% somehow it was hard to reduce to 7.1 or 7%. Somehow when the reduction hit 7% suddenly it was quite fast to reach 6.6%.

Figure 3.2

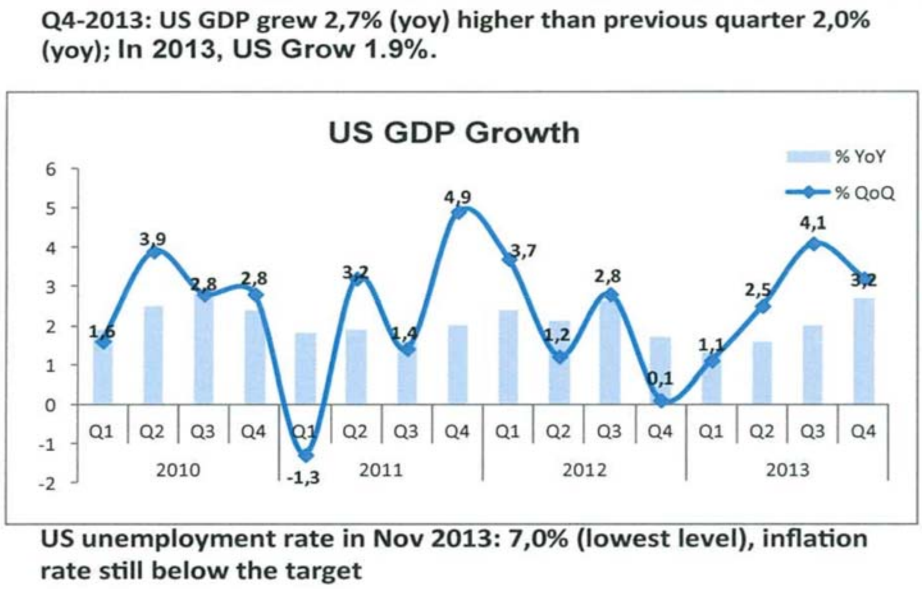
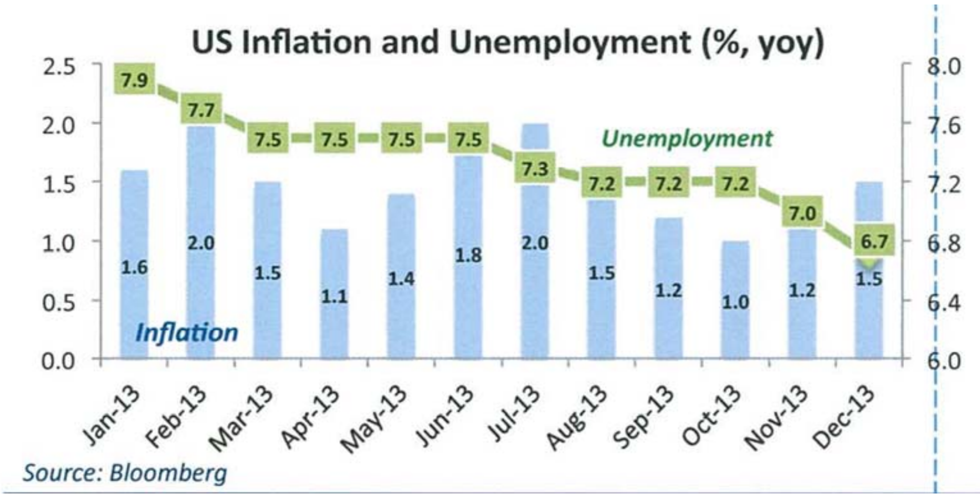


Figure 3.3




What I heard it is partly because of the shale revolution. The shale gas industry provides employment to the U.S. citizens and that reduces U.S. unemployment rate. Of course it's good, but remember the correlation between energy prices and commodity prices. If the U.S. has the shale gas revolution meaning the international price of oil and gas will be lower for sure, now supply can cope with demand. We know demand is growing but the supply quite massive, not only in the U.S. but it is one of the major suppliers. So the price of energy is lower and it will correlate positively with the commodity price. For Indonesia, we have to face the reality in the near future that the price of coal will be lower, the price of our crude palm oil, one of our major export commodity, will be lower and then other types of mining resources as well plantation products. We have to face the reality that Indonesia can no longer survive with only exporting the commodity or the raw materials. This is the time for Indonesia to start thinking about manufacturing. Of course, the contribution of manufacturing to Indonesia's GDP is around 23%. For the standard industrialized economies this much less than the requirement. The rule of thumb is around 30% or so, so we are still at 23%. It is one of the reasons, we are enjoying too much the commodity price boom. During the non-conventional monetary policy it did not only give our economic growth at more than 6%, on the other side it creates higher price of commodity. Now we are facing a slowing growth and lower commodity price. To deal with the challenges, I think Indonesia's economy as well as other APEC economies we need to do transformation or at least do some adjustments. For our case, Indonesia economic transformation, or what we use to call it in Indonesia structural transformation, is a must. What kind of subtle transformation? We need to reduce the reliance on the commodity and now shift towards manufactured products and we need to be serious in attracting FDI as well as trying to do more exports of our products especially manufactured products. Competitiveness is the key.

I think we only have a very short time to do these adjustments, otherwise not only other APEC members but other parts of the world will be more competitive than Indonesia.

I think to give you some flavor about APEC in the near future. I think the cohesiveness among APEC members have to be even stronger given the new type of future we are going to face. We really hope that flow of trade among APEC members will be easier, between Indonesia, the US, Russia, eastern parts of Asia, Southeast Asia, and as well as South America.

Of course, there are still stumbling blocks. We understand that in Indonesia, as Jusuf Wanandi knows, there are still some parts of Indonesia that we should be totally on our own and not have to rely on imports from other countries and need to become self-sufficient in everything. This of course is impossible. We have to maintain this political perception with the economic reality. I think that's the challenges that we are going to face. In more technical terms, these kind of challenges can be translated into current account deficits. We are now facing the current account deficit, we used to have current account surpluses for some amount of time but now we are facing a deficit. Although the deficit has been smaller compared to the second quarter 4.4% GDP, third quarter 3.7% of GDP and fourth quarter, although it has not been released, it will be much lower than 3% and could be close to 2% of GDP. It is good, but again we have to take into account the government is deliberately trying to slow down the economy, and therefore the current account deficit will be lower. It is not sustainable, we have to do other things. Structural reformation of course is the answer. Another issue will be exchange rate pressures.

On the financing issues. In the Indonesian chairmanship last year, one of the concrete products from the finance minister track is how to finance the infrastructure. Of course, when we talk about the economy, sometimes we are discussing too much on the demand side. On how to create more demand. Sometimes we forget, once we have the higher demand we need the supply. We need to fulfil that demand. How do we fulfil this demand? By providing the supply. How can you provide the supply? You need to have good infrastructure. For a country like Indonesia, which is a complicated country because we are the largest archipelago in the world, infrastructure is really a must and we are now facing infrastructure deterioration all of Indonesia. In fact, for almost the whole month of January and up to early February, maybe you have read in the newspaper, we are experiencing some heavy rains and floods everywhere. Floods is just not floods with a disaster but the long term impact of floods aside from failure of harvest, more importantly infrastructure is continuing to deteriorate. In Jakarta, now you are facing the issue of the bad quality of roads because of the floods. The challenges are quite a lot.

Aside from other factors, financing is a very important issue. The APEC finance minister meeting in Bali last year, all of the finance ministers from member economies agreed that we are going to promote public-private partnerships in infrastructure. Of course when you talk about public-private partnerships, it will include the financing issue. Why PPP? Because we understand that the government budget is limited, and we understand as well in some APEC economies have been very successful in getting private structure to build infrastructure together with the government and public sector, which is very important for Indonesia, Southeast Asia, and even for some in South America. An APEC PPP Experts Advisory Panel has been established, and it was the commitment of APEC finance ministers in 2013, in order to promote PPP in infrastructure area in the region. This Panel will help the establishment process of PPP center under the Indonesian Ministry of Finance. We are going to have the follow-up discussion next Monday in China at the first deputy finance meeting in China. Of course, we would like to thank the support of Australia and Canada to our PPP center. Again, among APEC members we have to share experience, and we have to share best practices. This APEC PPP Experts Advisory Panel will be one medium to disseminate and share best practices in building infrastructure in other APEC economies. Not only that, we hope someday in the future, we would like to have some kind of strong financing effort from APEC members in helping other APEC members in improving their infrastructure. Of course this is still a long term goal, but at least starting with this APEC PPP Experts Advisory Panel and PPP centre of excellence supported by all members would be a good foundation in order to have something like an APEC infrastructure financing scheme in the future.

Those are the so-called technical issues that APEC needs to handle in the upcoming years. Others include budget pressures is more on the domestic side, price stability and inflation; I think once we have good infrastructure, the issue of price stability could be overcome.

On the financial systems. Of course we learnt from the QE tapering; what happened in Indonesia, we thought that after we recovered from the 1998 crisis and we were quite successful in handling the 2008 global financial crisis, we think that Indonesia should be okay and ready for any type of turmoil in a global financial system. I have to be honest, during the QE tapering issues we are quite nervous. We are nervous because the so-called financial system stability, it is there, but somehow it is not too convincing. It is not convincing because the investors that are active in our stock market, bond market and as well as the currency market are mostly foreign investors. Foreign investors as you know, they are easy come easy go. Once they find an area is dangerous, they will stay away. Once it is promising they will jump in. Of course given this vulnerability, we are quite nervous. At that time, we are trying to improve our second line of defence to deal with the possibility of capital outflow, of any possible emergency situation. So far we have been okay in dealing with this turmoil, but still I think APEC is more on the trading side, trade among member economies. I think this is also the time for APEC to be more serious in terms of financial system stability. Not only a single member financial stability, but also regional financial system stability.

We have already started with the ASEAN Plus Three for example, the CMIM with the AMRO, trying to provide basically a defence for any financial instability. This is ASEAN Plus Three, which consists of ASEAN, China, Japan and Korea. You might not have to replicate the idea, because the IMF is still around. I think there should be some kind of more financial cooperation in terms of maintaining stability, what will be the vehicle? I think I can propose one thing. Unfortunately, usually the central bank governors are not part of APEC discussions even in our financial ministry, they only invited into one meeting. One way to do that, why don’t we try rather than setting up another CMIM, maybe bilateral swap agreements among central bank authorities or governments would be one of the good ideas. For example, Indonesia, aside from CMIM that involves Japan, China and Korea, Indonesia individually has bilateral swap agreements with Japan, China and Korea. Basically we have double defence; we have CMIM that’s one thing, and we have bilateral agreements as another part of the defence. We signed bilaterally with Japan, China and Korea. I think it is good if we can broaden this kind of collaboration among APEC members, not only among ASEAN+3, but hopefully between Indonesia and Australia, or Indonesia with the U.S. Or Indonesia with Russia or Indonesia with others. I think it is very important because it’s not about the money, because actually this is just signing the agreement that if something happens they can do swap in terms of currency. So nothing happens in terms of transactions especially if there is no emergency or crisis. At least, let’s say today we announced or Indonesia signed another agreement with Australia, the second day the market will react positively, stock market, bond market, and currency market. Investors cannot analyze individual countries in detail. They might to look Indonesia as if Indonesia is one of the emerging markets. If something bad were to happen in India, they will assume that this will happen also in Indonesia. If something bad happens in Brazil, something will happen in Indonesia. So there is this kind of presumption and how can we deal with that? We have to convince the market. How can we convince the market? There are many ways of course from our side as well. But because we are in an APEC forum, I think the swap agreement is one way. You might come up with other vehicles to boost the financial system stability. APEC should be no longer just trade, but should more than just financial stability but also economic stability. I always think, this is from a very naïve perception, that if Europe is slowing down and there is not enough demand from Europe for our products or commodities, I think the role of Europe should be replaced by APEC.

Why do we have APEC? We have APEC because we need to survive as individual countries, but survival supported by other members. If Europe has problems and let's say other sources of our trade have problems. I think APEC should fulfil the gap and role. I think given the size of APEC as the most dynamic part of the world, I think the role should be taken very well. Maybe we still need more time and know sometimes that APEC members have their own agenda, which is of course acceptable, every country has its own. More importantly don't forget APEC itself, otherwise what I am afraid of and worry is that APEC becomes less and less relevant for some member economies. Of course they will host APEC chairmanship once it is on the rotation; but why we need APEC is very important at least we can explain to our own people and citizens, like last year when Indonesia hosted APEC and there was news that in order to host the APEC summit we need some $100 billion rupiah. People started asking, why we have to spend that much money for this event. Of course you cannot say because we have to host several thousand guests, we need to provide accommodation, security and this and that, this is very technical and administrative. We need to convince our brothers and sisters in our country that APEC is important because the future of Indonesia for example will rely on APEC economic growth. This very simple explanation could make people understand that this is an investment and not just an expense in terms of hosting an event. I hope that this will become our common platform because we cannot make APEC less relevant. Somehow as a representative of the deputy finance of the G20, sometimes I still feel relieved that Indonesia has not been the chair or president of G20. I could not imagine for example, next year that Indonesia is chairman of G20 and people ask me why we have to spend so much money and energy to be the chair of G20. To be honest, it's hard to answer that type of question. I think G20 although maybe the meeting is more intensive and more frequent, but there is so-called pounding or close relations among the members. Sometimes during the meeting, the US says one thing, Europe another and Asia another, so its somehow quite complicated for countries like Indonesia and emerging markets to understand what is going on in the global world. Still we need to participate in G20 because we don't want emerging markets to be left out by the advanced countries. So APEC hopefully will provide better relationships among the member economies and more understanding about each individual member economies problems.

**Question and Answer Session**

Mr. Bernard Pouliot:

We've been and some of our members have been involved in the Coal Bed Methane (CBM) gas in Indonesia. As we know, the shale gas is happening in the U.S., many are looking at that including China, how to exploit the shale gas that is underdeveloped? Indonesia is very active in that sector. What are the policies towards that? It seems to be very different policies related to FDI. There are some people who say they cannot get a majority stake, or cannot control these assets. How does this work? Therefore this seems to be slowing down the investment in the gas sector. I would like to have your opinion.

Dr. Bambang Permadi Soemantri Brodjonegoro:

Thank you for your question. It is a very interesting topic because the CBM is one alternative to having gas in Indonesia. In fact for Indonesia our oil production has been declining quite rapidly from 1.3 million per day in 1990's to now 800,000 barrels per day. We still have some reserves for gas; we still have two or three gas fields that need to be explored. When it comes to the CBM, in terms of the arrangement, the arrangement of CBM will be similar to the arrangement for the natural gas fields. Meaning that we are going to apply the production-sharing contract for this activity. If you are asking why investment in this area is a bit slow? I don't have the answer right now, I have to check with my colleague in the ministry of energy, but I think you know very well about the gas business and exploration model. For example, we have several big natural gas fields that can only be explored when they already find the customers. Long-term customers with certain prices already committed then they can start the exploration of the proven gas fields. I don't know whether this gas coming from CBM should follow that kind of model. If they follow that kind of model, of course we in Indonesia need to improve the domestic market mechanism.

The problem is we have the problem with oil deflation, at the same time we still have the gas. Unfortunately, in terms of the energy mix, we are still heavy on the fuel, for example, for transportation. There is very little initiative for using gas for transportation. I think your point is well taken, I think Indonesia needs to improve the domestic market for gas, because I don't think we can afford to export the gas. The price of exported gas is going to be declining because of the shale gas in the U.S. So it means the only visible market is the domestic market, but unfortunately the domestic market has not been well developed. Gas is only used for power plants and some industries but not much on the household or transportation. I think once we deal with the issue of the gas for transportation and gas for households hopefully the gas exploration through CBM will be done. For shale gas in Indonesia, can I inform you we unfortunately we don't have much shale gas in Indonesia. A (company) has already started doing the exploration of shale gas but it is very little. It is not much compared to Dakota.

Participant:

I would like to share with you my views which are consistent or supporting what you have said. First, I think it is about time that we redirect APEC; I've been saying it for some time and glad that you are saying it now because you are in the position. I am now aging and less influential these days in the political circles. I think we should want APEC to deal with economic stability and financial stability, I think we should not put too much attention to liberalization and the Bogor goals. I came to that conclusion back in 1995, when I attended APEC debate about the Bogor Goals. The Bogor Goals of 2010 and 2020, and the debate on whether that was a commitment or voluntary. Malaysian Dato Rafidah kept saying it involuntary, the U.S. keeps saying it is a commitment. So the conclusion as the Philippines suggested that it was a voluntary commitment, and he used this metaphor of a man asking a woman to marry. When you are asking her that is voluntary, when she says yes then it is a commitment. From then on, I knew that the Bogor goals, we would not be able to achieve it. They kept saying Bogor Goals. In 2001, came the Doha Round. After that every APEC leaders' statement started with the commitment to the Doha round; that was nonsense. I know behind the scenes, officials never wanted to have the conclusion of the Doha round, but they always supported the Doha round. Therefore, I feel that in order for APEC to be relevant we should refocus APEC to our economic and financial stability; the causes of which I shared with you a 100%. But then how much can we expect? How much can we expect from APEC to work on these issues? I think the answer lies in the fact that APEC, we have two giants or elephants, the U.S. and China. It depends very much on how the two elephants behave, or what mood they are in; whether they are making love or they are fighting or just lying still. We would all be affected by how they behave. If you analyze the situation this year about the financial stability, it would come from the U.S. because of the fiscal public debt, and the debt ceiling would be challenged again and again, this $17 trillion. Everytime it happens it affects the bond market, it affects bonds view and capital flows, it affects us. That sequestration has more or less been settled for a while, but the debt ceiling will continue to be adjusted or requested. In the U.S., they use this American football politics, meaning blocking anything for any reason without any reason, because of that there is crazy and stupid politics just like Thai politics, very similar. You can expect to have this even if they are phasing out from the non-conventional monetary policy this year, you can expect to have financial instability coming from the US also.

In China, I don't know, we have many Chinese friends here. Whether this so-called private debt would be a problem. A few weeks ago we had one and there is a rumour that there may be several others about shadow banking and private debt. Everytime that happens it affects the financial markets. You know as well as I do that the financial market, the money people and players, they play on us, they play on our nerves, U-curve and equity prices. In that sense I think it will be very useful to raise this subject and to put that on the agenda about economic and financial stability; but how much we can achieve from these leaders whose mission is to come to the meeting for photo opportunity and having full dress designed by the host. It seems that if we do not reform APEC, it will become less and less relevant.

Dr. Bambang Permadi Soemantri Brodjonegoro:

Member economies in APEC already realize that now the most important trading partners, import and export, will be other APEC economies. Meaning that the idea of trade liberalization coming from the Bogor Goals has been mostly fulfilled. We don't need to go more aggressively into liberalization agenda, because at the end, for example, in ASEAN we already have ASEAN FTA. AFTA already has bilateral AFTA with Korea, India, Australia and New Zealand. I think among clusters of APEC members there have been very intensive trade liberalization. So I agree with you the next step after we realized that liberalization is there, is how to maintain the financial system stability. I think trade liberalization and financial system stability are related. If you have problems with trade movement it might affect the financial system stability, at least it goes through the balance of payment and trade deficit or current account deficit, at the end its your currency. What happens in the global world everything is inter-connected, nothing can be hidden anymore from other economies. I share the idea APEC needs to step forward in terms of trying to help improve the financial system stability.

Professor Christopher Findlay:

There's some new data out from the WTO and the OECD on trade value-added; it shows that for Indonesia, the share of services in the value of exports and we're able to break down the value of exports into goods and services inputs. The services share looked to be low compared to the rest of ASEAN. There's also some World Bank data which says Indonesia's services sector is relatively highly restricted. What's your impression where policy is up to in Indonesia? Do you think there's an argument for a really solid services reform program? How could APEC support that?

Dr. Bambang Permadi Soemantri Brodjonegoro:

I think you are correct when you mentioned that trade of services should become the next focus of Indonesia. In fact when we suddenly had the problem of current account deficit. Of course, first we identify the issue because of the trade deficit, because of the goods trade, we import a lot and export less than that. Actually the most fundamental problem of the current account deficit is not on the goods trade activities but more on the services. Indonesia basically relies too much on import of services for freight and the financial sector. I think your suggestion to try and give more emphasis on the trade of services should be our first priority over goods. For goods, as I mentioned, trade liberalization is already there, in Indonesia, ASEAN and APEC in general. What we don't have is the services. So far we are struggling with services and rely too much on imports. In the end we are in a deficit. Not only in the so-called service deficit but also in current accounts deficits. I think I will try to suggest to my colleagues in the Ministry of Trade to give more serious thought to services.

Ambassador Mark Trainor.

I wanted to jump in on that to inject the thought that even goods liberalization in FTA's is pretty far progressed. There is it seems to me a link to things like RCEP, where the broader scope of that negotiations can help to support liberalization in sectors like services, investment, and competition issues. I wanted to seek any views that you may have on domestic structural adjustment, which was identified as a critical need, and external trade agreements and the way in which the can perhaps buttress that process.

Dr. Bambang Permadi Soemantri Brodjonegoro:

I think domestic adjustment is important but I have very important point to share with you. With few countries, also APEC members, we try to have economic partnership agreements. In these economic partnership agreements, of course we are not talking about the trade of goods but also trade of services. Somehow during the negotiations of these economic partnership agreements, we found out that the discussion or negotiation about trade of goods is tough but there is always a resolution or compromise at least between the two parties. When it comes to discussion of the trade of services, including send some of our skilled labour to their respective countries, somehow the discussion becomes so tough. So at the end we cannot find a good resolution. Somehow the Economic Partnership Agreement (EPA) discussion becomes delayed and a heated discussion. At the end maybe the result is a partial result. We can agree on some parts but not agree on others. What we don't agree of course will include services. This might be the area, of course it is outside the Ministry of Finance that needs to have a better platform for services negotiations among APEC members.

## Session IV: Financial Cooperation in the Asia-Pacific

Financial cooperation remains a weak link in regional economic cooperation. In the regional efforts to make structural adjustment for economic growth, an important role should be given to financial cooperation.

- What is the current status of financial cooperation in Asia Pacific?
- What measures should be taken by member economies to enhance the financial cooperation (monetary policy coordination, capital market, financial regulations, connectivity and currency swap)?

**Moderator:**

Professor Stephen Cheung

Chairman, Hong Kong Committee for Pacific Economic Cooperation (HKCPEC)

**Keynote Speech:**

Professor Xiang Songzuo

Chief Economist, Agricultural Bank of China

**Panel Discussion:**

- Dr. Yoichi Nemoto
  Director, ASEAN+3 Macroeconomic Research Office (AMRO)
- Dr. In Huh
  Assistant Professor, Department of Economics at Chonnam National University, Gwangju, Korea
- Professor Ramkishen S Rajan
  Professor of International Economic Policy, School of Public Policy, George Mason University
- Mr. Ian Buchanan
  Chairman, Australian Pacific Economic Cooperation Committee (AUSPECC)

Professor Stephen Cheung:

I would like to summarize three points that has been discussed thoroughly in yesterday's session and this morning's session. The first point is emerging market currencies are under pressure, particularly the Argentinean Peso and Turkey Lira falling sharply and several countries opting in increasing interest rates. The Chinese economic data shows signs of slowing down. Second, on the American side and U.S. economy side, the American data are providing a mixed picture that we are still not very certain on the economic recovery. With a declining purchasing manager index for manufacturing and also decline in vehicle sales in January. Although this morning, the Vice Minister mentioned the falling in unemployment rate, but he did not mention the labor participation rate in the U.S.; that is a very crucial factor in the U.S. It’s not very clear whether the U.S. economy has recovered. The third point, again to mention, the fact that the tapering effect which will have a tremendous impact on APEC economies, particularly on Asia emerging markets.

A moment ago, Dr. Narongchai commented on the need for financial cooperation among the APEC countries. I did have a chance in participating in a financial cooperation work maybe twelve to thirteen years ago during the Asian Financial Crisis. At that time, we noticed that the region’s liberalism, region openness and liberalization played a very important role in facilitating trade. Trade helped our economy, we saved a lot of foreign reserves during the 80’s and 90’s. But the experience tells us during the Asian Financial Crisis, only one single incident we have may lost our savings that we accumulated during the hard labor trade. Financial market cooperation could be something that we should pay attention to. How we can make our financial market, which is stronger than 1998 but could be even stronger by putting our efforts together to provide some sort of cushion for our economy during difficult times. I know we have the CMIM, but the psychology plays a large role in financial markets, particularly the herding behavior. Some investors can’t even differentiate the difference between India and Indonesia in the global markets. With this I hope to set the scene for my keynote speakers and panel speakers.

Professor Xiang Songzuo:

My talk is on regional financial cooperation as well as integration, which are very important and broad topics. I would like to touch on three key points; first, fundamental question or problem, why does Asia and the Pacific region need to further promote financial as well as monetary cooperation and integration? I think we need to rethink the fundamental question to seek deeper answers for this question. Second, I would like to reveal or summarize the key progress in the past two decades in regional financial cooperation. Thirdly, from a Chinese perspective, I would like to focus on over theorized fields of cooperation in finance and money; I also would like to propose two concrete proposals.

First of all, for the fundamental question, I would like to mention three major points; first, with the impressive high growth rates of the economies as well as trade in the Asia Pacific region; however, so far we, frankly speaking, we must recover. The Asia and Pacific region still remains predominately the biggest U.S. dollar bloc. Every part of this area has been increasing its U.S. dollar reliance. I use this term U.S. dollar reliance to describe every aspect of the consequences of the biggest U.S. dollar area. So in terms of trade settlements, financial transactions, bond insurance, rescue payouts of possible financial crisis, we always rely on the liquidity of the U.S. dollar. Of course, every part of this area must face problems of the so-called original sin and currency mismatch.

Original sin meaning is very dynamic. During the booming era's we don't like currency appreciation. We are always opposed to the very fast appreciation of our currencies. However, during a recession or crisis period, we are very worried about the depreciation of the currencies. The exchange of volatility in any case is a very bad thing for our area. The third issue, this area just because we have not developed very liquid and deep financial markets. Even though we have accumulated huge foreign reserve money, we must invest voluntarily, necessarily or even be forced to invest huge foreign reserve money in other markets, particularly the U.S. Treasury bond markets. You all know the figures of foreign reserve money; China, Hong Kong and Taiwan, combined together into the so-called Great China Area, have accumulated almost $5 trillion USD foreign reserve money, which accounts for almost 40% of worldwide aggregated foreign reserves reported recently by the IMF. Japan, South Korea, Malaysia and Singapore all these economies have also accumulated large reserve money and intend to invest in developed financial markets.

Thirdly, with such huge reserve money invested in the U.S. and other developed financial markets for so low rates of return. Yesterday in Hong Kong, I joined another conference for the reserve asset management by the central bankers. Every representative from the Central Banks were talking about that now is the period and even era of so-called no yield. With such a no yield, we invest huge reserve monies into other markets; however, the Asian Pacific area, many countries need desperately investment in terms of infrastructure and many other areas to sustain its long term goals. How can we solve and think about these problems? How can we think of a way out to this dilemma? This is a humiliating problem.

I think the solution to this problem, at least part of the important solution for all these problems, are deepening and strengthening regional financial as well monetary economic integration and cooperation. So let me summarize briefly the current schedules of financial cooperation in Asia and the Pacific. In the past two decades, particularly after the 1997 Asian Financial Crisis, we have made great efforts to promote regional financial cooperation. So far personally, I think we have established and accomplished to set up three important pillars of regional financial cooperation; first of all, I think the most important progress in this regional financial cooperation is the CMIM and the multiple CMIM's. After 2008 financial crisis, the CMIM has been strengthened and enforced greatly and with a size of $240 USD billion. The IMF delinked portion has been reduced to 30% and also we have precautionary mechanisms. More importantly, three years ago the CMIM set up the ASEAN Plus Three Macroeconomic Research Office (AMRO) to do research and some kind of surveys on regional economies. However, even with this key progress, shortcomings still remain. First of all, the mechanism for advanced disbursement surveying vulnerability assessments faces stigma affects, how to address this? All these issues need to be further addressed and strengthen in the future.

The certain panel of financial cooperation is cooperation between or coordination between central bankers, so there is an executive meeting for East Asian policymakers of central banks. So far there have been eighteen meetings held among governors. Through all these meetings, last year the meeting was held in Kuala Lumpur, and during all these meetings central bankers reached some consensus and practical approaches to contain the financial crisis and liquidity crisis in the region. The third pillar is the bilateral currency swap lines. Many such kind of agreements have been signed, particularly Chinese Peoples Bank (PBC) will signed many currency swap lines with countries of this region; for example, PBC has signed with Asian countries total swap lines of almost 1.4 trillion RMB. Of course, over the issue of swap lines many people argue for and against currency swap lines. Yes, there remains problems as well doubts about the feasibility and complexity of the swap lines. First of all, swap lines maybe not political sustainable, and certainly swap lines may have to expand regionally in order to strengthen a regional insurance mechanism. Based on these three pillars, financial cooperation among the Asia Pacific area has made impressive progress in these years, especially after 2008 financial crisis.

From China's side, for example, RMB trade settlement between China and Asian countries has increased from almost zero to more than $1.2 trillion RMB, direct exchange trading between Chinese currency and the currencies of several Asian countries, like Thailand's baht has been proceeding quite well. Certainly the next step measures that we should take in order to promote further cooperation in finance in the region, from a Chinese perspective, we are focused on and pay very much attention to four fields of financial cooperation among Asian and Pacific countries. First of all, is how to improve and strengthen crisis prevention mechanism? Of course there are many mechanisms for crisis prevention of liquidity crisis, currency crisis, and broadly financial crisis; there are the CMIM, currency swap lines, and coordination mechanism among central bankers. However, we need make all these mechanisms more operational, more concrete and more practical. Third, we are paying very much attention to encouraging trade and investment settlements, bond issuing, and trade in foreign exchange under commodity transactions with local currencies. I think these are the key measures to solve the problems of the original sin and currency mismatch. If we can settle trade and financial transactions with our own currency, of course we will reduce the U.S. dollar reliance in our trade and financial transactions.

The third field we are focused on is encouraging the mutual opening of domestic financial markets, including equity markets, bond markets, and foreign exchange markets. In this sense, at the end of last year, Chinese Communist Party passed a very important resolution for deepening reforms. In these documents, the Chinese authorities promised to open up further the Chinese domestic markets. The Governor of the PBC said that after the meeting, Governor Zhou made it clear from this year forward we must push forward further capital account liberalization, particularly with the Shanghai Free Trade Zone experiment. Certainly we will expand exchange rate flexibility, and we will reduce the daily intervention of the foreign exchange markets. For interest rate liberalization, so far we already accomplished at least 90% all in the off-limit for deposit interest rate is still regulated but I think in two to three years all these regulations will be removed. The PBC also emphasized that from this year on, we will enlarge the cultures of every investment vehicles for foreign investors and domestic investors wanting to invest overseas, they will enlarge cultures of Qualified Domestic Institutional Investors (QDII), Qualified Foreign Institutional Investor (QFII), Renminbi Qualified Domestic Institutional Investor (RQDII), and Renminbi Qualified Foreign Institutional Investors (RQFII). Also I think maybe after the Congress meeting next month, they will launch the QDII Version 2, in order to encourage domestic Chinese investors to invest directly in the Hong Kong Stock Exchange. In this sense, the Chinese government has made promises and commitments to open up China's domestic financial markets in order to attract foreign investors, and to promote regional and multiple financial and monetary cooperation.

The four fields we've emphasized and established in the original financial infrastructure in Asia and the Pacific area, including possibly the following initiatives. First of all, our region, the Asia and Pacific region, needs trade and government bond settlements system under the so-called Asian bond initiative, which I remember which was proposed by leaders many years ago on the Asian bond initiative. Unfortunately, not very great progress has been made after it was initiated. What we need is regional settlements intermediary (RSI), which I think is a very important infrastructure to promote monetary and financial cooperation in this region. Certainly, we need other kinds of financial infrastructure to promote this; for example, trade and financial settlements with local currencies. Chinese authorities particularly the PBC say they have now been working very hard in setting up Chinese-own-styled ships to facilitate the RMB settlements across borders. The Chinese government will encourage commercial bankers, like my bank the biggest bank for commercial bankers, to set up more settlement branches in Europe, London, Luxemburg, Frankfurt and other important financial centers. All of these efforts need to be more efficient and upgrading financial infrastructure for this region, which are instrumental in the promotion of monetary and financial transactions particularly for equity, bond insurance and investments.

Let me conclude by suggesting two concrete proposals. Personally, first of all, I just mentioned the CMIM is probably the most important progress landmark in regional financial cooperation. However, personally, I think the CMIM so far is still an official commitment, not a real Asian Monetary Fund (AMF). I suggest we need to upgrade or transform the CMIM into a real fund with a total capital of $240 billion dollars. If that's the case and we do that, the AMF can recreate the high talent managers to manage such huge fund and we can have very sound returns for this fund. In the future, we can also enlarge the total volume of this fund. We cannot stay and cannot be satisfied by the official commitment; we need a real fund in the region with such huge reserve money for the many members of the region.

Secondly, you know now 70% of the portion of the CMIM commitment of funds is linked to conditionality of the IMF, which personally, there are some other considerations of why we link the portion of CMIM to the IMF conditionality's. So I suggest we need to reconsider our philosophy or approach with the IMF delinked portion, should be decreased at least to 50% as soon as possible.

The second proposal is we need to establish the Asian infrastructure investment bank as soon as possible. Of course, the participants in this conference yesterday and today touched this topic, it's the initiative put forward by Chinese President Xi Jinping last APEC meeting in Indonesia with the meeting with Indonesian President Susilo Bambang Yudhoyono. There is also some of kind of paradox or dilemma with such large monies, and that every member of this area lacks investment, particularly, long-term investment in infrastructure. Why don't we make best use of our money? Why do we need to invest our money into very low yields and the U.S. Treasury markets? I think AIIB is a very good idea to launch very soon. These are my two practical proposals.

Dr. Yochi Nemoto:

You have heard in the earlier sessions of this conference on the progress made in economic and trade integration, and in physical connectivity in the region. For some, it seems are of the view that regional financial cooperation in the Asia Pacific has not proceeded at the same pace, and that this sector might affect the pace and scope of further regional economic integration as a whole. While this concern needs a more comprehensive answer, I would like to give you some assurances in some areas. We have learned firsthand from the Asian Financial Crisis experience that the crisis can be very painful, it can disrupt economic development, and greatly push back countries income levels. Therefore, crisis prevention is crucial; the regional financial safety net is one important tool that would provide a cushion for countries. In this regard, I would like to share with you the developments in the ASEAN+3, the CMIM, and the role of AMRO.

Before doing so, I would like to first discuss the situation that our emerging Asian economies are facing and help point out the growing importance of regional financial safety nets in the Asia Pacific. Emerging economies in Asia are expected to grow faster this year and next; however, unlike in the past three to four years, they will play a supporting role in contributing to global growth and possibly give the main driver's seat to advance economies. Besides, the balance of support from domestic and external demand in emerging Asia would be different than in the past few years. External demand from the economic recovery in advance economies, particularly the US, would be crucial to help maintain the growth momentum. On the other hand, domestic demand would likely become less buoyant, with less fiscal space given the earlier significant spending. In Asia some countries might face external market pressure as market participants increasingly focus on external conditions, especially current account conditions. We have heard clearly from Professor Dr. Bambang this morning, how keen the Indonesian authorities are in dealing with the current account situation of Indonesia and in conducting macroeconomic policies. These countries have tried to restrain domestic demand before worsening external demand conditions could possibly lead to disorderly capital outflows. Although growth would continue to be quite satisfactory, we still need to be very mindful of the risk ahead.

First, given the tendency and the need to rely more on external demand if growth in large economies such as the US, Europe and China moderates, this would be a significant risk to emerging markets or EM's going forward. Second, in some countries, the previous policy mix during 2010-2012 in the form of low real interest rates and high credit growth have helped spur strong growth, but have also contributed to fast rates of expansion, rising household debt and asset prices. The debt pattern of over-stretched households and corporates and overall risk for external borrowing could rise sharply as financial conditions tighten with further global and domestic economic recovery. Third, as US monetary policy normalizes, the region will face challenges from fluctuations of capital flows. While high level of foreign reserves and flexible exchange rate management could provide significant buffers in several economies. Those with small foreign reserves covers and weak external conditions could still face difficulties posed by capital sudden stop or reversals.

Let me briefly introduce the CMIM, if you are not yet familiar with it. The CMIM has established in response to what we have experienced and learned from the Asian Financial Crisis and the recent global financial crisis, which showed us that the financial crisis can occur abruptly and can be very destabilizing. Sufficient buffers and crisis prevention mechanisms are therefore needed to help avoid them or mitigate the impact. The CMIM is a multilateral currency swap arrangement among certain members that evolved from a series of bilateral swap among members. An important point I would like to stress is that this is a single agreement among 13 members. It became effective March 2010 with an agreed size of $120 USD billion. I will skip the later development because Professor San beautifully described the development of CMIM after 2010.

Let me turn to our office AMRO and our mandate. AMRO is the regional macroeconomic surveillance research office of the CMIM and ASEAN+3 members. Our objectives are to monitor and analyze regional economies and contribute to the early detection of risk and support swift implementation of immediate actions and decision making of the CMIM. We are based here in Singapore and began operation in 2011. In that sense, we are less than three years old and just like a baby. To fill the challenges and important mandate given to AMRO, we have been growing our office. We currently have 28 staff of 12 member economies, 15 of whom are full time economist who regularly conduct country surveillance.

Let me elaborate on AMRO status. While AMRO supports the co-chairs of the ASEAN+3 Finance Ministers and central bank governors' process in the CMIM matters, at present AMRO is not the official secretariat of the CMIM. Therefore, currently we are not in a position to officially explain the current content of the CMIM agreement, and to represent the views of the CMIM members. In this regards, last year our stakeholders, the ASEAN+3 Finance Ministers and central bank governors, agreed to transform AMRO from a company to an international organization. This is a crucial transformation that is AMRO's priority for this year. Once having achieved international organization status, AMRO can take on the secretariat function of the CMIM as guided by the ASEAN+3 members and to better support CMIM activities. We trust that this status will also enable AMRO to better represent, and give a strong original voice in the international fora.

As a new institution with a challenging mandate, there are immediate tasks that AMRO needs to accomplish amid this fast challenging environment. I would like to point out two. First, we are working hard to enhance the effectiveness of the surveillance activities, especially in the areas of finance sector stability and capital flows so that we would be able to detect the problems early on. That is the natural conclusion of the current environment in which we are situated. Second, AMRO plans to enhance collaboration with other international financial institutions to improve our institutional capacity. So far we have established cooperation with the IMF, ADB, and OECD. We believe that these endeavors will raise capacity to effectively support the CMIM, and thereby make an important contribution to financial cooperation in our region.

Dr. In Huh:

I think that the keynote speech and Dr. Nemoto already covered what I had prepared, however let me echo what the keynote speech and what Dr. Nemoto said. As you know, ASEAN Plus Three has financial cooperation starting after the Asian currency crisis. Our reason as the ASEAN Plus Three and the world faced a growing economy, the regionally GDP has been growing for the past three decades very fast and China is leading our regionally GDP growth. Within the ASEAN Plus Three region, intra-region trade has been increasing significantly. While the regional trade with the US has shrunk over the decade after the Asian currency crisis due to the vertical integration of supply chains within regional trade has been increasing and the portion of within region has increased steadily over years. It might be a problem or strength of our region. Our official reserve holdings in the region total is rapidly growing so our official reserve holdings is significantly much larger than the official regional holdings in the Euro area and even now it has always been an increasing trend.

Figure 3.4

GDP (In Billions, USD)

| YEAR | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| ASEAN+3 | 6,501 (20.4%) | 6,590 (19.8%) | 7,238 (19.4%) | 8,071 (19.2%) | 8,537 (18.8%) | 9,057 (18.4%) | 10,107 (18.2%) | 11,849 (19.4%) | 12,289 (21.2%) | 13,607 (21.6%) |
| U.S | 10,286 (32.2%) | 10,642 (32.0%) | 11,142 (29.8%) | 11,868 (28.3%) | 12,638 (27.8%) | 13,399 (27.3%) | 14,078 (25.4%) | 14,441 (23.6%) | 14,256 (24.6%) | 14,660 (23.3%) |
| EU | 6,337 (19.9%) | 6,917 (20.8%) | 8,534 (22.9%) | 9,767 (23.3%) | 10,148 (22.3%) | 10,740 (21.9%) | 12,338 (22.3%) | 13,635 (22.3%) | 12,517 (21.6%) | 16,263 (25.9%) |
| World | 31,903 (100%) | 33,210 (100%) | 37,332 (100%) | 41,998 (100%) | 45,431 (100%) | 49,155 (100%) | 55,392 (100%) | 61,221 (100%) | 57,937 (100%) | 62.909 (100%) |

Source: IMF. World Economic Outlook April 2010

The CMIM was endorsed in 2000, it has been established regional funding mechanism for preventing currency crises in the region. ABMI has suggested and ASEAN Plus Three wanted to force regional bond market development and this is the framework that they want to promote regional currency bond market. We also in the beginning had the ERPD economic policy review and dialogue, which is basic form of surveillance mechanism for the regional cooperation. Swap transactions need the proper surveillance mechanism, and we need immediate policy recommendations after once a country has asked support from the swap agreement, so we set up the economic review and policy dialogue. Now it has developed into AMRO. AMRO has been started to become an independent surveillance facility supporting the CMIM decision-making. Member countries agreed to make AMRO into an international organization. Even though the keynote speech said that we did not develop the ABMI, we had some progress in recent years. We made a credit guarantee and investment facility which has started to work from last year. ABMI basically promotes the infra and system development in regional currency bond market, discussing as the keynote speech said, we are now discussing the regional settlement intermediary for making cross border settlements easier.

Even though we have made a lot progress after the global financial crisis it looks like that CMIM's not effective enough. The size of CMIM is $240 billion; if you look at Korea alone, our foreign reserve is more than $300 billion, and if you look at China has about $4 trillion in foreign reserves and don't need the CMIM as a supporter of their foreign reserves. We don't know yet whether it is effective or practical. The CMIM never been used, so we don't know how it will work when the member countries ask for help. To be more practical, we have to develop financial cooperation as the keynote speaker suggest, we should make a fund rather than just a network of swap agreements. Now the member countries central banks are earmarking the money for the CMIM, and it makes them fragile and not practical. If you look at the treaty, they even have an opt-out contract and you can walk out when a member country ask for a swap agreement.

I had the chance to read the CMIM agreement. It looks like not very practical agreement. That's why member countries don't ask for the CMIM for the help yet. For the CMIM to be practical, it should be real money should be there, not earmarked money. However making it as a fund could be a long way to go. One of the important obstacles is the IMF conditionality's. Even though we increased the delink portion from 20% to 30%, still we have 70% linked portion and this is very significant amount of money. It means if you want money from the CMIM, you have to ask the money from the IMF first in order to get money from the CMIM.

It's already been discussed about that we need to increase the delinked portion. Further development of the Asian Bond Market Initiative (ABMI), you have to increase currency convertibility within the region. If you look ASEAN Plus Three members, besides the Japanese Yen, local currencies in the region is not convertible yet. Inconvertibility is preventing the international demand for those local currency bonds. So in order to forge a local currency bond market, we have to promote the member countries' currencies convertibility. Even though we say a beautiful word of "cooperation", financial cooperation won't be the perfect solution for the financial crisis. Sometimes when we have a crisis in the member countries, if we have very strong financial cooperation all the member countries will get to the problem. Financial cooperation can increase the contagion effect, rather than be a safety net. Therefore AMRO should be strengthened as an independent surveillance mechanism, and act as preventer of contagious effects.

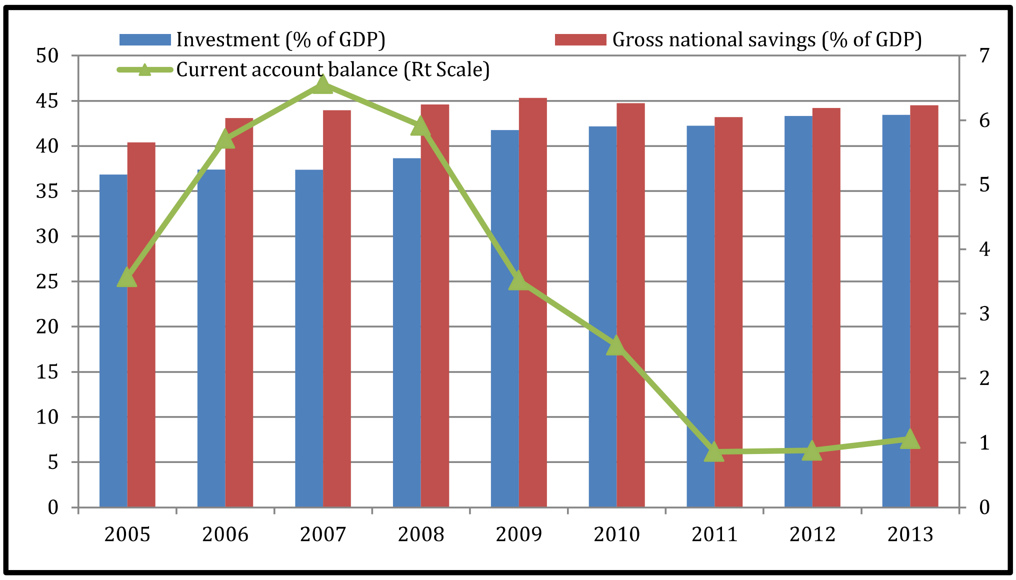
Dr. Ramkishen S Rajan:

I was thinking when I was asked to this panel that there would be overlap in what the panelist said given that there are just a handful of initiatives on financial cooperation. I have asked what value-added could I bring to the table especially given that the panelists know much more about the policy initiatives. I figured let's do something radical and look at the data. I spent some time looking at the data on capital flows and etc.; let me run through the story as I see it based on the data.

Current account surpluses; in the region as a whole, we still have current account surpluses, there are obviously exceptions like Indonesia, but current accounts surpluses have come down quite significantly. When you think about current account surpluses, the first thing that should come to your mind analytically is not about whether it is goods or services, but it is really about account balances as a reflection of national savings over investments. So than I asked the question, if the current account surpluses have come down, what's the primary driver behind that? If you look at the data, the primary driver seems to have been, there's a marginal decrease in national savings, but really the primary driver has been investments. I haven't had time to look at the details on investment, but I suspect that if you look at the increase in investment rates in recent times, they have been largely driven by the non-tradable rather than tradable sectors, real estate etc. In any case, the broad story is current account surpluses, but they have come down.

Figure 3.5

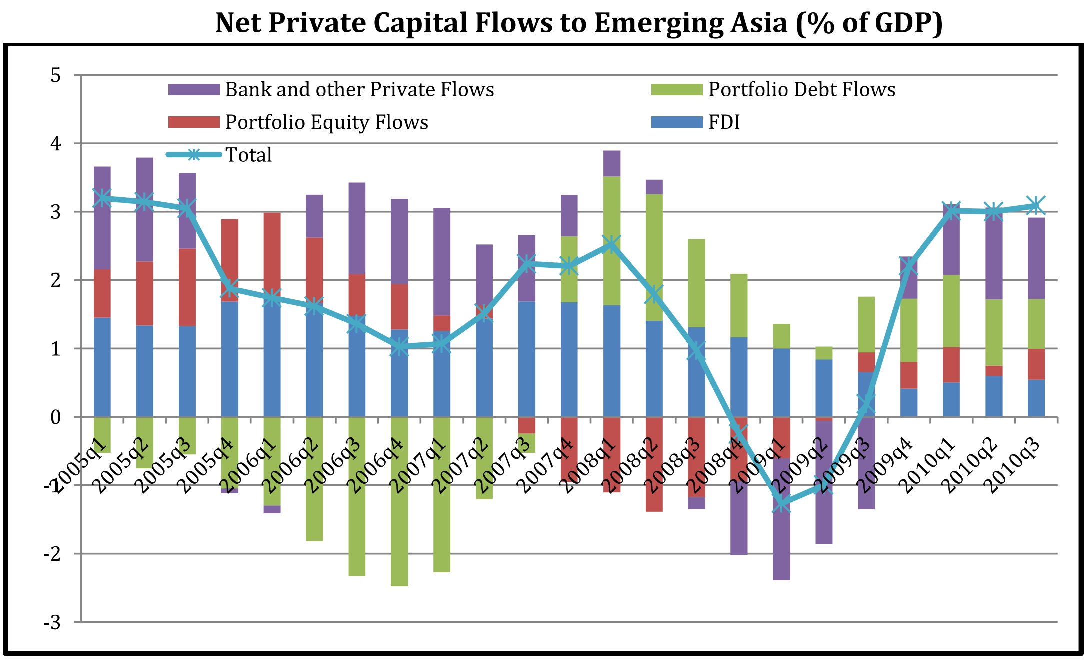
**Emerging Asia: Current Account-Savings-Investment Balance (% of GDP)**




Note: Excludes Singapore

What's interesting about the region, except for some quarters between 2008 and 2009 we know what happened then, generally the region ran capital account surpluses. You have declining current account surpluses but still fairly large capital account surpluses. If you look at capital account data and details, there are some interesting things to find. One issue is the declining share-of-FDI. If you look at capital account flows as a share of GDP, one thing that's very clear is that FDI as a share-of-GDP and overall share of capital flows has been coming down.

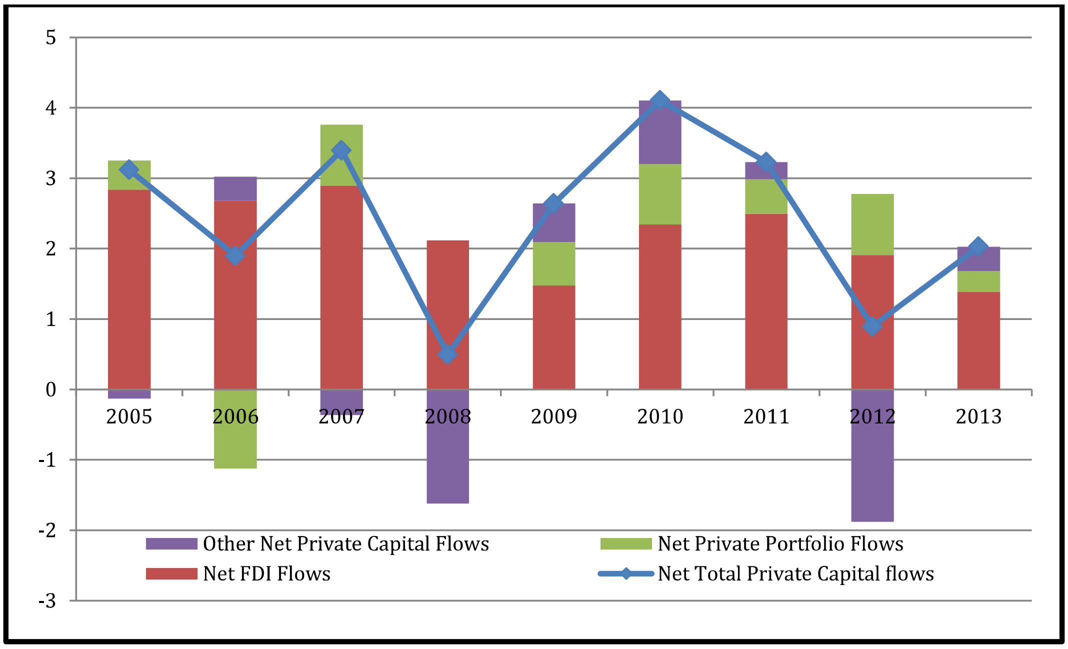
Figure 3.6




Second, if you look at the periods of sharp outflows of capital, you have three components; sometimes, its bank flows in most recent periods, sometimes portfolio equity or portfolio debt flows. If you look at the entire period between 2005-2010/2011, if you look at those periods, there have been three periods where there are significant outflows. In each of the periods, different components of capital flows have been the driver; portfolio equity and portfolio bonds, and more recently bank flows. The last thing about capital flows that people have to keep in mind is actually misleading because most of our data on capital flows is net flows. Sometimes people point out that even in the heyday of the region, meaning after the financial crisis before the global financial crisis when the region started doing well by 2003-2004, net capital flows as a share-of-GDP never outpaced what it was pre-Asian Financial Crisis. People made up all stories about well that's because we never had any implicit guarantees etc., so you don't expect it to reach that level. But actually that's not true.

Figure 3.7

**Net Private Capital Flows to Developing Asia (% of GDP)**



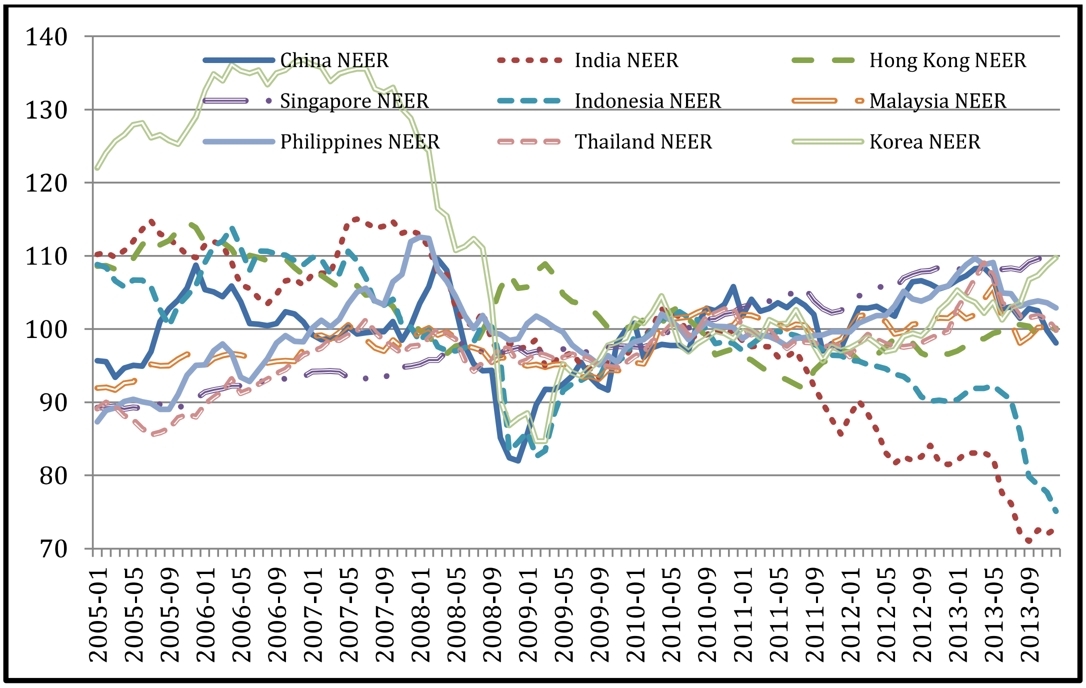

Note: Excludes Korea and Singapore

What you want to do is break up capital flows into gross inflows and gross outflows. Gross inflows have actually taken off significantly, the big change that has happened in the region is significant gross outflows from the region; that's the real problem looking at net flow data, you should look at gross outflows.

In any case, coming back to the issue, capital account surpluses are smaller but there are still issues with current account surpluses and overall balance of payment surpluses, but what does that mean? It has to be either shared between exchange rate appreciations, and there has been some exchange rate appreciation, again there are exceptions with Indonesia with current account deficits, but largely gradual nominal effects of exchange rate appreciation but has been built up in reserves.

Figure 3.8

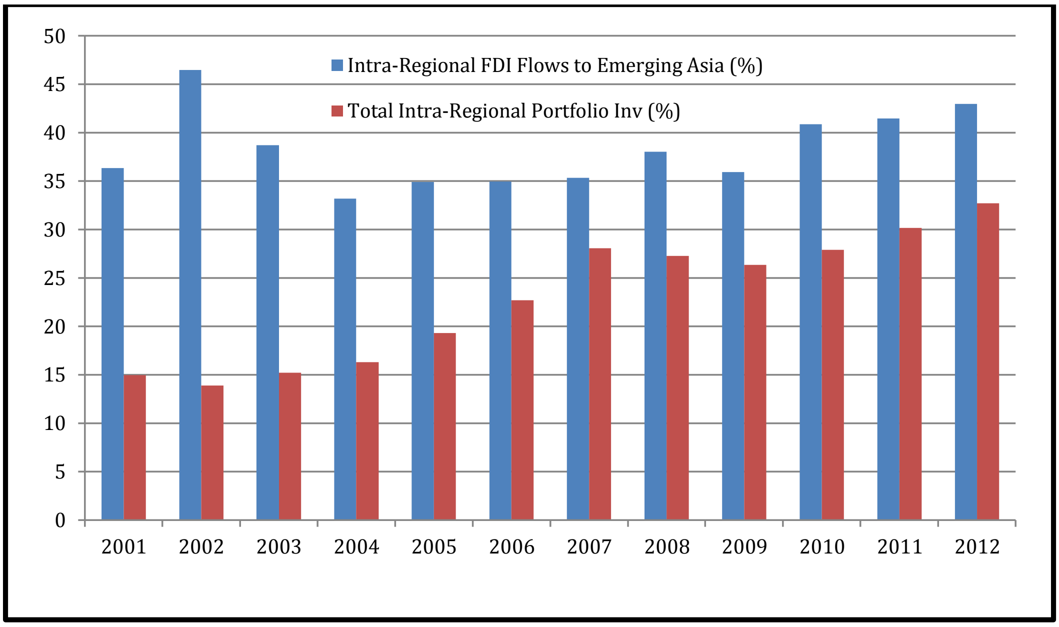
**Selected Emerging Asia: Nominal Effective Exchange Rate Index (2010=100)**




There's a big question to ask. When we talk about external vulnerability, what is the appropriate yardstick to think about? But we shall leave this aside. Now you say ok, this is what's going on a broad level, now since we are interested in the region, let us look at intra-regional flows. This caught me by surprise actually; intra-regional capital flows have increased quite significantly. I don't have very good bank data and there are issues with bank data, but if you look at portfolio flows which you can break down into equity, debt and FDI, the portfolio flows in general have increased quite significantly like 15%-30% of intra-regional shares between 2001-2012; but of that the big change has been portfolio bond flows, the extent of intra-regional portfolio bond flows have increased significantly. FDI has remained fairly and is actually reasonably high between 39%-40%. Overall, the bottom line is that intra-regional flows in absolute terms and as a share of total flows have increased but the big increase has been in the bond aspect.

Figure 3.9

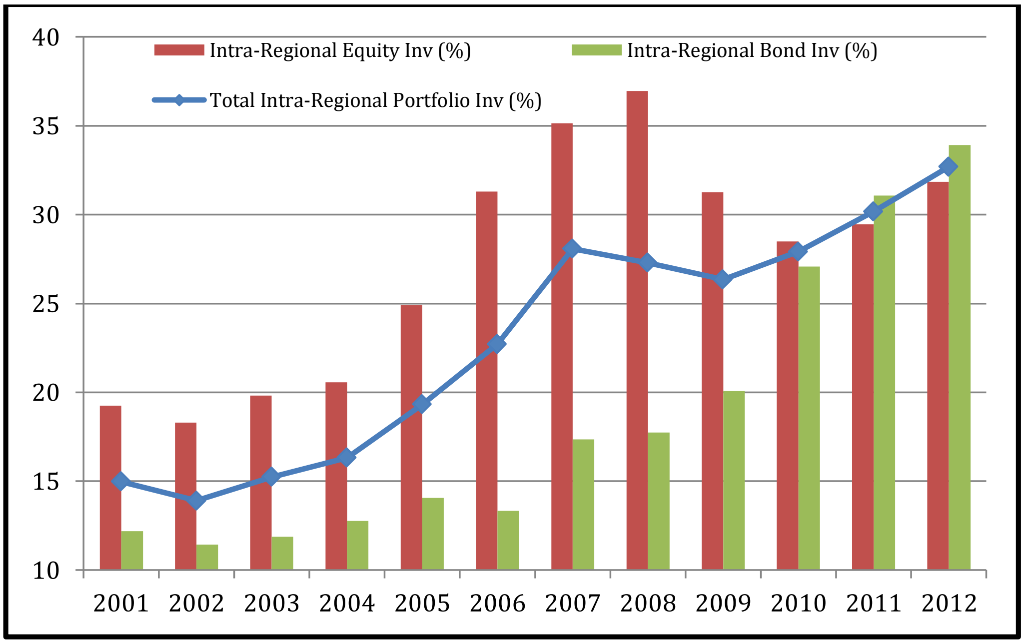
**Emerging Asia: Intra-Regional Capital Flows (2001-2012)**




Note: Portfolio Investments based on Source country; FDI based on Destination country

Figure 3.10

**Intra-Regional Portfolio Investments in Emerging Asia (%): 2001-2012**

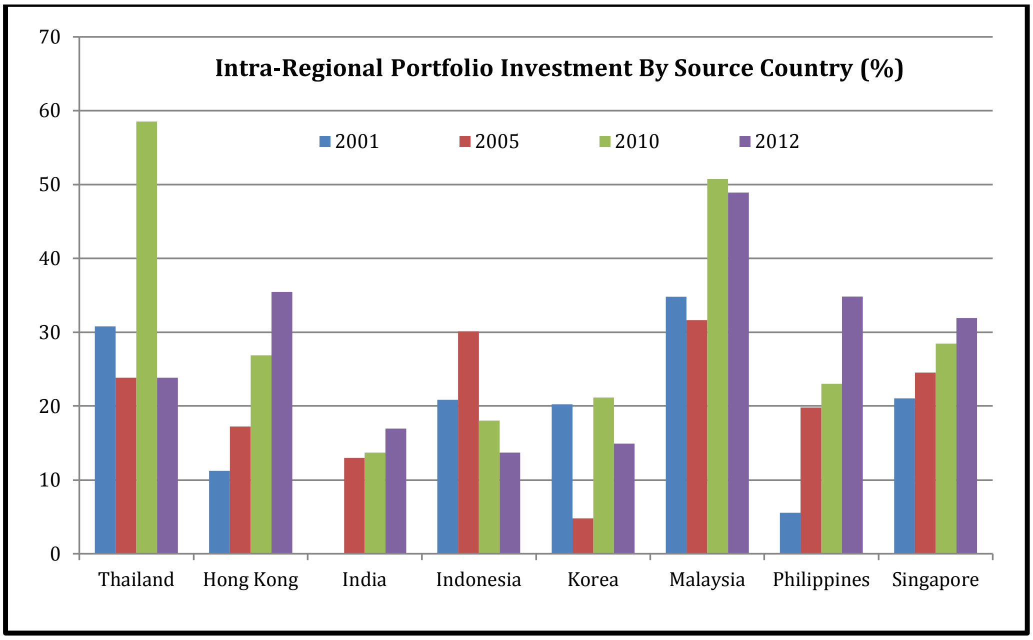



Note: Emerging Asian Source countries include: Thailand, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines and Singapore. Emerging Asian Destination Countries include all of the above and China, Taiwan and Vietnam.
Source: IMF, CPIS

Whenever you do anything on intra-regional flows, I am not looking at all APEC and PECC members, it is really just about emerging Asian economies, but whenever you look at data on intra-regional flows you have to keep in mind three things. One is the Hong Kong-China effect; certainly a big effect, I've have gotten into in detail with FDI, the bulk of FDI flows in the region, intra-regionally, is really between Hong Kong and China, and China-Hong Kong. You take that off the table, intra-regional flows don't look nearly as attractive. Two, Japan; if you look at the share of the region intra-flows have gone up, but Japan as a share of its total outflows and inflows, Asia is still a fairly small component. In absolute terms it is large but Japan is still very global; when you include Japan into the data, intra-regional shares will come down. There are still issues with data that becomes muddied in terms of offshore financial centers.

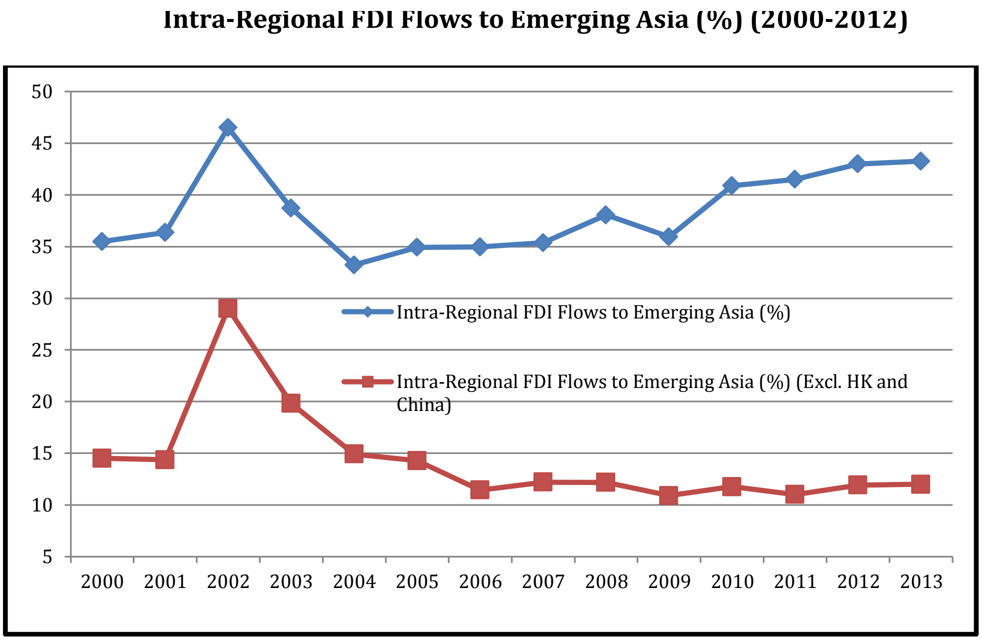
Figure 3.11

**Intra-Regional Portfolio Investment by Selected Emerging Asia (2001-2012)**




Note: Emerging Asian Source countries include: Thailand, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines and Singapore. Emerging Asian Destination Countries include all of the above and China, Taiwan and Vietnam.
Source: IMF, CPIS

Figure 3.12




Note: Emerging Asian Source countries include: China, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, Korea, Taiwan, Thailand and Vietnam. Emerging Asian Destination countries include all of the above except Taiwan.
Source: EIU World Investment Services Database

What conclusion do you draw from this? I wouldn't immediately draw the conclusion that the region has become more integrated financial, why? Because as we all know, it is not enough to say in absolute terms or as a share of total capital flows, that's not enough to look at, it gives you an indication, but you also have to have a yardstick. It could well be that the region is investing significantly more within the region than they used to, but that could be because the region as a whole has also become significant global investors or global recipients for capital flows. The idea is that you simply can't look at shares and say that they have become more regionally focused. You need some yardsticks; some of the yardsticks you can use to compare to other regions, the simplest and on a superficial level is trade intensity indices or gravity models. The bottom line seems to be is that the region is definitely becoming financial integrated but there is not necessarily a regional bias. Meaning that in absolute or share-of-GDP, there is much more capital flows within the region, but also this region is also receiving and investing much more capital from overseas; there's not a regional bias in terms of what's been happening.

Think about trade integration vs. financial integration; what's the usual story about trade integration, very large levels of trade integration, whatever the number is 50% or 60%, but a large part of that is in parts and components, which is still heavily dependent on external demand globally. The parallel story in financial integration in absolute terms has increased but you can't necessarily say that there is a regional bias. The region has become much more globally financially integrated than it had been regionally financially integrated. You can again do sophisticated methods, Professor Cheung and others; simple types of analysis, for example, looking excess returns on equity and do various decomposition of how much of it is regional or global, and still global shares are quite significant.

The last set of issues, what does this all imply for policy? When you think about policy, what has actually been happening in the region is two sets of policy initiatives; one is more at the micro level in terms of developing financial markets, whether it be the bond market, credit and related issues; then at the macro level, when you think about the financial market development, I won't get into the critique about what we need or what's going on. How would you think about financial market development? I think of it in two ways; development of regional financial markets, one is a source of trying to reduce the extent of vulnerabilities in the region to global shocks, there's a hypothesis, and one of the reasons why the region does not have a regional bias in terms of investments is because of the underdeveloped financial markets. Yes a lot of things have improved but there's still a long way to go. If you want to reduce the degree of vulnerability of the region to external shocks, like Federal Reserve tapering, we need to really put in a much more concerted effort in developing these financial markets intra-regionally. Number two, there's also a growth aspect that has been touched upon, the other reason for intra-regional development of markets is intra-regional recycling of funds, which then stimulates growth; that's the financial market development side of the story.

On the macro side of the story is what we heard about AMRO and CMIM, which is independent of what's going on, we're always going to be vulnerable to external shocks so we need proper crisis management and prevention tools, and that's where AMRO comes in. The idea behind my value-added here was to think about the data, conceptualize these initiatives, and about how I see them.

Mr. Ian Buchanan:

Process started with discussions at the Bali forum after Xi Jinping announcement in Indonesia about the AIIB. It was followed by a visit by China PECC to Australia to Canberra and Sydney, where we furthered the discussions again they were very productive. After the visit, we drafted a joint note, which was then shared with SINCPEC to get input. From that draft note, we've come up with the paper that has come and which is in all of your packs today. I'd like to express that this is not a PECC research paper, but a collaboration between three PECC committees trying to build on an announcement by President of China, and which we are now seeking today your support for China PECC to take forward and submit through the appropriate channels when they get back to China.

What I am going to do is very briefly read what I consider the highlights from the paper. First highlight is that we've had tremendous positive feedback as we've gone around and shared our thinking and the announcement. It's been welcomed as quote an "excellent idea and a productive move", and it is been seen as a very positive indication of China's commitment to regional connectivity and coordination; so very positive and on link between infrastructure, connectivity, and balanced, sustainable and equitable growth.

Next we all know over the last two days with countries in the region committed to industrialization with a huge sum involved. The numbers that have been thrown around $8-10 trillion over the next ten years, no one institution or government can fund that. So there is a requirement for collective effort and there is a requirement to go beyond purely commercial into political. One of the things we spent a lot of time talking about is how to strengthen political will as a result of this new institution. We came up with five principles that we have laid out in the document.

First, it will be a very specialized multinational development bank, but it's not just a financing platform. We recognize that financial gap is huge but the solution requires much more than just funding. This is a multifunctional institutions not just a multinational institution dedicated not only to the financial infrastructure but also in providing technical assistance and facilitating regulatory convergence. In my wrap up, I'll give a few thoughts on the type of activities and institutions, such as this, should be able to do and go beyond those of existing institutions.

Point Two. Membership. The first step this will go in phases and we see it as begin almost like open regionalism, this is an open process. The first step is that membership should evolve. Note these are just recommendations: the government of China, particularly the finance ministry will be responsible not PECC. We think it should be an open process in which the initial members of the AIIB are those regional countries that wish to be members. There should be no coercion and no exclusion. Second to foster open regionalism beyond the ongoing process in enrolling new members as stockholders and also encouraging private capital. Again, we see this institution as putting its money where its mouth is and encouraging public-private partnership in this process.

Point Three, its relationship with other financial institutions. Again, in support of open regionalism, we feel that the AIIB must be complementary to existing private-public, and multilateral institutions and should fill a need. That's going to require analysis, and in my terms, as a strategy consultant, that means strategic assessments, SWOT analysis, gap analysis and all of that stuff; I will come back to that in my wrap up.

It has to not just talk good governance, but has to walk good governance. Which means that this institutions should be a shining beacon that can be held out as a preeminent example of its own quality governance and strategy; having had forty years working on infrastructure projects in the region in groups like this the real barriers to make the project happens – it's usually not money. So we need to have the AIIB as a shining beacon through its behavior, it should be market oriented in its approach, but not limited to a pure market approach. What I mean by that it shouldn't be going in to the subsidy game, but it should be going into the externality game. It should not just look at the narrow confines of the IRR on the project itself but should be able to look beyond the region and country, it should look at quantifying the externalities and identifying the stakeholders who benefit from those externalities e.g. if we connect a producing region to a market the benefits can be shared and aligned with costs. In my conclusion I will give you specific data on that. At the moment pure market forces do not always allow the different stakeholders who benefit to align with those who incur costs. The AIIB will look to intermediate some of those market imperfections.

Public-Private partnerships. What we see here is that not just in its own capital but in all capital going into projects, the AIIB should act as a catalyst to help public-private partnerships succeed. I worked on PPP for about three decades, I remember working with GE at one point. The complaint was the legal paper work for their Paiton power plant project in Java, which ultimately failed, was taller than Jack Welsh - the CEO of GE. The complexities of these things often contribute to their failure, so we need to look at how to intermediate and simplify how we deal with inconsistent regulations. We must go to root cause and not just symptoms. The AIIB should collaborate with those other multilateral institutions and with private sector.

Moving into the wrap up. We see the AIIB as an important building block in closing the gaps of the institutional infrastructure in the region. We see it as a new multilateral, multilayer financial institution. What we would like to ask today is to encourage feedback in the Q and A, and encourage PECC to provide support to China PECC to submit this paper to the government as a submission from PECC.

Let move away from my spokesperson role of the tri-lateral and speak as an individual. In a very brief wrap up here, in my view failure is not an option. Having seen the pain trying to get infrastructure projects off the ground in the region for forty years, we all know it's always complex. I liked Mr. La Yifan's quote yesterday regarding the Chinese proverb: "*If we want to be prosperous, first build a road*". In our region, if you want balance, sustainable, inclusive and that is equitable growth we need infrastructure and we need it fast. What we heard over the last two days is some very specific examples of where we have collectively failed. Mark Rathbone of PWC last night said, the ASEAN Transport Ministers had a wonderful 2010 plan for regional road infrastructure, but not a single length of road has been completed. In 2008, he talked about the Indonesian infrastructure market place conference in Jakarta. I happened to be there. He said that there were over 120 PPP offers that were beautifully presented in terms of power point but as he said - a great event but not a single project realized. We failed. He also said in Jakarta that it is cheaper to buy oranges from Shanghai than from Sumatra. Cement in West Papua is 20 times the cost of the cement in Java. These are infrastructure failures and therefore market failures, and therefore the market failure element is where the AIIB can come in.

Last weekend in Indonesia, a state-owned airlines was closed, and many of the low-cost carriers announced they were slashing routes, schedules and frequencies, because most of Indonesia's main airports are now running at about 100-150% of rated capacity and the average waiting time in the plane engines on burning fuel can be over an hour. Right now, the plans and ability to get new airports open is very weak. They opened the Medan airport recently with no transport access and Lion Air, a single Indonesian airlines, has just announced it is going to buy 500 new aircrafts. Indonesia is gradually coming to a stop because of infrastructure gaps. The problems go way beyond finance. They go into the political economy, we don't deal with political economy so well at PECC we need to figure out how we and the AIIB are going to be able to do that.

Dr. Mari Pangestu gave some very short examples on the political economy failure; she talked about legislative gaps, land acquisition laws that were weak, and in many countries of the region the political cycle is shorter than the infrastructure cycle. That means when the election comes up, as one of my collogues a very prominent business man and now a minister in Indonesia said privately, when Indonesia democratizes, he said "Mr. Minister our business members at KADIN (Indonesian Chamber of Commerce and Industry) no longer can afford to support Indonesia's increasing costly democracy". When you get a political cycle, the big infrastructure projects become political and black money snowballs, which therefore delays them. All of these are the real issues, I think virtually all of us know this but dealing with it is still a problem.

On top of that, many governments in the region as the democracies develop are becoming very complex coalitions. Barisan National in Malaysia has 13 different member parties, each party is given a big project as a reward and therefore you don't get national interest, you get party interest. The expression in Indonesia and Malaysia is "where you have sugar, you have ants". AIIB needs to go beyond funding. As a strategist, I think it has many very good point.

In Dr. Mari Pangetsu's comment on the CMIM was quoted "not very practical". We need to get real money there, and need to know how to access it. The challenge for AIIB is how we ensure it is practical, it is strategic, and it fills a gap and gets the job done.

Let me wrap up with three strategic perspectives as a consultant not as chair of AUSPECC and representing the tri-lateral group. Number one to get a solution you cannot address symptoms, you have to address the root cause. You have to understand the highest sensitivity impact where to intervene. This is very complex to do and requires very careful analysis. Secondly, once you understand the root cause and which levers will give you the highest sensitivity impact as AIIB, you need a SWOT analysis, where are we as AIIB relative to the differentiated, relatively stronger, relatively more capable to intervene here than all of the other existing institutions. What's the root cause, the highest sensitivity impact, where are we differentiated to have an impact. Finally, based upon this insight you need a strategy to what capabilities will AIIB in order to have the maximum impact. There will have to be a financial component and that financial component will fill very specifically targeted gaps, not replace what's there. Longer term financing at competitive rates. Viability gap funding to help make projects viable which are not quite not meeting commercial aspirations; wrap bonds, new funding sources, sharia compliant funding. We recently started working in Malaysia trying to get the Islamic Development Bank to step in on some major infrastructure projects in the region. Political risk guarantees and syndication of public and private lenders. We also need, point two, an accessible financial and online market place run by AIIB which is a market place for the sharing of best practices and it must be accessible. Its best practices on project planning and preparation, on key success factors for PPP's, and on where technical support can be achieved. Finally for the political economy, again the most complex and sensitive, the thinking is a senior advisory board of grey hairs and who have deep access behind the scenes in the largest biggest need potential borrowers, when political parties shift and political will falters, when the time for the contract to increase rates on the toll road or water prices built into the PPP come through and the government doesn't do it. The white hair and grey beard can go and chat unofficially to the party in power and suggest that relations with the AIIB and shareholders and other related parties would be switched off suddenly unless compliance improved. There is precedent. SRI used to team informally with the World Bank to do this. It has been done in the region before and it can be done again - but needs the will and desire for AIIB to do it.

**Question and Answer Session**

Mr. Bernard Pouliot:

We're talking about the financial market, how to deepen the financial market, and clearly the bond markets in Asia have got to expand in local currencies and it is important. I support totally Professor Xiang on the agricultural bank; why put your money in the U.S. Treasury when there are so many good projects in Asia, where it can be applied and get better yields, and it is necessary. The other thing that needs to be developed in the region and China has started, that is a credit rating agency. On the public-private-partnership basis, not on a private basis, clearly for me I've always thought Hong Kong should be the right spot to have this sort of center of excellence, where public-private-partnership could be developed. That there is a rating agency that is not just dependent on what's happening in the U.S. In many ways, when you look at different countries, we have our own Food and Drug Administrations (FDA); FDA's are related to the local market and we do that for food. We don't do that for financial services, we accept automatically what the Moody's and Standard and Poor's tell us, and yet there are differentiations in different markets. I think something should be done. There was an initiative in the past by EDB about creating local credit rating agencies. There should be on the APEC side of it. On the ASEAN part of it, a public-private-partnership related to a credit rating to support that bond market; that bond market is not just a bond market that is supportive by the Moody's of the world, but is a much more extended, with less conflict of interest, and involving all the stakeholders. It is a question about credit rating agencies and what is being done by APEC.

Dr. Yochi Nemoto:

I remember I was involved the ADBI initiative ten years ago. I vaguely remember there was one initiative to create a certain regional credit agency in the region in order to differentiate the credit ratings from the region from the three major global credit rating agencies. I think they are still struggling to pursue this agenda. Unfortunately, I heard that several local rating agencies are now affiliated with the global giants. I agree with your point.

Mr. Steven Wong:

Very interesting proposal for this AIIB. One question, let us assume it's going to be $240 - $250 billion or somewhere around there, this presumes that if you take 8% risk weighted capital, it can have assets of up $3 trillion dollars. But that's the question, what is the currency? What is the medium in which this $3 trillion worth of assets is going to be? I presume it's going to be in USD because you are going to raise bonds, bonds have to be USD otherwise you are going to pay an extremely high cost for them and there will be no takers. If I am correct, this whole infrastructure bank is going to be USD and that's going to be the medium of exchange, and it is not going to do anything of the things that we talked about because, we can poke holes and fun at it, there is still no alternative to the USD global reserve currency in this region. Now we're talking about an increase in the influence of RMB, I cannot foresee any time in the next five years or ten years that you can even have half of that portfolio financed in RMB. Now the problem with having USD is that it is exactly what these countries that have infrastructure needs don't have, they don't have USD. So someone has to sit down there and say I will swap out whatever the currencies you have into USD, I am going to be a dollar banker for you and take that currency risk for however long it is going to take, twenty years or thirty years. So I don't think that the infrastructure bank may not solve the problem, but it will lead to a bank that is going to have to take the currency risk and answer to the businesses, unless my understanding is wrong on this.

Professor Xiang Songzuo:

I think you mentioned two different issues. The AIIB, the key purpose is to make better use of money in the region, and if we increase the trade and financial settlement with local currencies in the future if AIIB is set up, the share capital could be local currencies, not only USD. I think monetary substitution is very slow and gradual process, and no currency can replace the key currency the USD; a century ago it was the sterling pound. I think there are two issues.

Back to this gentleman's credit agencies, Chinese Treasury bond markets are now number four in terms of volume. More credit agencies emerged in the past years in China; there is intensive competition with the three giants from overseas, the U.S. and Europe also came into Chinese credit agency market. Yes, I think not only do we need domestic credit agencies and intensive competition among them, but we need intra-regional credit agencies. There are two approaches to that. We can encourage domestic credit agencies to do business across the border. Last year, I remember there was a multinational credit agency launched by credit agencies from China, Europe and Russia. I don't know how business is going on now. Second, maybe if the AMF is in place and encouraged that we can set up an intra-regional agency. Between the two approaches, I don't know which one is better. Of course, it is crucial for the development of a regional bond market particularly in China, so now we are in very urgent need for credit agencies to make a price mechanism for all these kinds of bonds, not only in treasury bonds but corporate and municipal bonds.

Mr. Edward Clayton:

In the discussion about the bank, we heard from Mr. Ian Buchanan some comments around ants and sugar, and some of the teeth that the bank would need. Yesterday evening, we were talking about infrastructure and it was being discussed that it is now possible to drive a truck from here to China. In fact strangely enough, as I was driving to Kuala Lumpur airport to come down here, there was a radio program talking about the very same thing with representatives from Volvo truck, trucking magazine editor, and a trucking operator from Malaysia. They said that's great, except that Singaporean trucks can't operate in Malaysia, Malaysian trucks can't operate in Thailand, and therefore you can have a fantastic road but the trucks are not going to go from Singapore to Thailand until those political issues are resolved. So the question is to what extent will the bank have the teeth necessary to cause these trans-border issues to be resolved, because otherwise we will be spending a lot of money on infrastructure but the trucks will be stopping at every border for three or four hours while the cargo is unloaded. We will be just wasting the benefits that will be gained.

Mr. Ian Buchanan:

I can’t tackle it in terms of giving an answer, but what I can say is two things. First, I was somewhat shocked when I moved to Australia; I found that the Australian rail network doesn’t connect with each other and again you need different state licenses for your trucks. I’ve been in Australia now twelve years. Even Australia, which has been around for 200 years, has struggled to do that in one country. Getting these regulations across the country, these are both commercial and political economy issues, the ways in which truck licenses are given out in some countries in the region are highly political and the perception of competition. I think that what we said in our presentation about the AIIB it will be part of the submission, it won’t suggest that the AIIB has teeth as such. It will have persuasive capabilities designed in it. Bringing the parties together supported by analysis, demonstrating to all parties the huge cost to their economy of not participating in this process is the sort of way I would see this happening. It is going to be a persuasion with a little bit of grey hairs behind the scenes supported by top quality analysis and calling people out. If one country tries to block a transnational system, than I think at the APEC leaders meeting it should be on the agenda.

## Concluding Session: Next Steps

This session will draw together the discussions from the previous sessions to propose recommendations to be made by PECC to APEC and other officials

By:
Ambassador Tang Guoqiang
Chairman, China National Committee for Pacific Economic Cooperation (CNCPEC)

Distinguished guests, colleagues, ladies and gentlemen,

I have organized my summary around the session themes. I would like to thank Minister Lim Hng Kiang for setting the stage with his views on how APEC can achieve its goal of a Free Trade Area of the Asia Pacific. I would also thank Mr. La Yifan for his input on APEC 2014 meetings in Beijing, we rely on him to convey our discussions to the APEC team in Beijing.

**Session I: Strategic Assessment and Outlook of Asia Pacific Economy**

The global economy is steadily recovering from the economic crisis, especially the United States and the EU. Their exit from stimulus poses specific challenges, especially for emerging economies. The sudden and drastic slowing of monetary expansion poses risks, disorderly exits are impacting emerging markets and these in turn have feedback mechanisms that may jeopardize the recovery.

This leads to our first recommendation.

***Recommendation 1:***
*We welcome the positive economic news but just as coordination was essential in entering into stimulus, coordination is essential in exiting. We urge authorities responsible to coordinate and consult with each other as they exit from stimulus.*

Beyond the immediate turbulence in financial markets, the world economy is 'normalizing' but this is a 'new normal'. This new normal will be very different from the pre-Global Financial Crisis economy. Firstly, the characteristics of growth in the major economies of the region are changing: the US current account deficit, long a concern is shrinking – helped by the development of new energy sources, China's surplus is now significantly reduced and Japan has been posting deficits. The region as a whole needs to respond to this. Critically, many emerging markets are now growing at or near their potential level of growth.

***Recommendation 2:***

*Regional processes should aid emerging economies to focus on structural policies that will boost their growth potential. APEC has a significant headstart in thinking about structural reform, more focus on this will help economies to respond to these tectonic shifts taking place in the global economy.*

Trade in intermediates, the emergence of global value chains, and our understanding of them highlight the importance of the role of services in trade.

***Recommendation 3***

*Much more work needs to be done to understand the role of services as a driver of comparative advantage.*

Many economies in the region have and are continuing to institute significant policy reforms. APEC can play a role to help encourage this process and learn from each other's successes as well as mistakes.

***Recommendation 4***

*Even as understanding of GVCs has increased, more still can be done. Some thinking needs to be done in terms of GVCs as a unit of analysis in international trade.*

**Session II: Regional Economic Integration and Multilateral Trading System**

The breakthrough in Bali at the WTO is a positive signal and that momentum must be carried forward. APEC which played such a critical role in the conclusion to the Uruguay Round should continue to support the WTO as the key global trade institution. Some issues such as agricultural subsidies can only be settled at the global level. While plurilateral agreements are important tools, some balance needs to be struck to ensure that there is enough in an eventual package to attract all members to reach a conclusion.

While the Bali package is welcome, and work needs to be done to conclude the rest of the negotiations, there is significant progress being made in regional trade agreements – the ASEAN Economic Community, the Regional Comprehensive Economic Partnership, the Trans-Pacific Partnership, the Pacific Alliance and the China-Japan-Korea FTA. In terms of the TPP and RCEP there is significant overlap in issues and progress being made in each agreement.

As progress is made in these agreements, attention must be paid to how they can lead to a Free Trade Area of the Asia-Pacific. APEC members should firstly encourage the swift conclusion of ongoing negotiations and secondly ensure that the benefits of the FTAAP are achieved, significant thinking and dialogue are needed and principles are developed to ensure that the FTAAP is current and comprehensive.

***Recommendation 5***

*It is essential for APEC to look at the current RTA negotiations and consider how they can be adopted into an FTAAP. This might include the model measures that have already been developed. PECC should consider establishing such a group to bring together thinking from the negotiations into a more informal dialogue to make recommendations to APEC.*

Agreements such as the TPP, RCEP, Pacific Alliance and TTIP while having similarity in scope have different emphasis and ways of addressing issues. These need to be better understood so that as rules are developed in them, they are ultimately compatible with a global system.

***Recommendation 6***

*Engage in a dialogue to understand how and why different agreements are dealing with the same issue in different ways.*

**Session III: Physical Connectivity**

At their meeting in Bali last year APEC leaders' adopted a Connectivity Framework, the challenge this year is to work out a blueprint on connectivity.

Connectivity is critical to ensuring that economic integration leads to inclusive growth. Investing in infrastructure will increase the potential of the emerging markets for growth. The infrastructure deficit in the region is well known. In terms of connectivity – transport; energy and telecommunications; there is a need for around US$630 billion a year. In terms of cross-border infrastructure the region needs investment of around US$30 billion a year for various pan-Asian projects.

The proposed Asian Infrastructure Investment Bank could play a critical role in the implementation of APEC's Connectivity Framework. Such a fund would not be to replace or compete with existing multilateral banks such as the World Bank, or ADB but to compliment them. There remain many critical areas where funding is badly needed. These include project preparation where capacity in the region is lacking as well as inadequate regulatory support and legal systems.

***Recommendation 7***

*There is a need to focus on infrastructure projects that will promote regional connectivity. The capitalization of the AIIB could start at that level, and it is necessary to understand how regional organizations can effectively promote infrastructure investment.*

***Recommendation 8***

*To establish a Pan Asia Infrastructure Forum to coordinate and integrate existing bilateral, sub-regional and regional initiative, it should include representatives of all regional programs and their members; regional institutions such as ADB, World Bank, APEC, ASEAN, EAS and ESCAP.*

***Recommendation 9***

*The policy and infrastructure frameworks that would enable transpacific trade need to be further studied – building on previous PECC study on this issue with a special emphasis on the potential for transpacific gas trade to reduce global greenhouse gas emissions.*

### Session IV: Financial Cooperation in the Asia-Pacific

The developments in the financial markets of the Asia Pacific region are of concern.
In the financial sector, the existing cooperation mechanisms and regional financial institutions are relatively weak. Although economic growth is recovering it is still weak and the potential is there for the global recovery to be derailed. Low real interest rates and high credit growth had helped spur strong growth, but had also contributed to fast credit expansion, rising

household debt and asset prices. The debt burden of over-stretched households and corporates, and the rollover risks for external borrowing could rise sharply as financial conditions tighten with further global and domestic economic recovery. The region is exposed to more economic and financial risks. We must prevent risks from piling up and causing major economic and financial turbulence in the Asia-Pacific. It is all the more necessary for regional economies to capitalize on our own strength and work together to build secure and effective regional financial systems.

Since the 1997-98 financial crisis, Asian economies have accumulated significant reserves, the motivation for this is well-known but it also has costs. In addition to reserve accumulation, the region has also created a variety of coordination and surveillance mechanisms to avoid a repeat of the crisis.

However, there remain some fundamental problems. At the micro-level the region's financial markets are not sufficiently developed for the region to recycle its own savings into productive investments. At the macro-level some progress has been made with the establishment of the CMIM and AMRO. However these institutions need some improvements and need to be complemented with other institutions.

The composition of regional trade is changing and is likely to continue to change in the years ahead. Intra-regional trade is increasing and yet much of this trade is settled in US dollars.

***Recommendation 10***

*AMRO should complete its transition to an international organization. This would open up the possibility, if playing a more supportive role in the CMIM and act as a de facto secretariat for it. Economies in the region should enhance the capacity of economic surveillance and crisis rescue and prevention, and work together to safeguard financial stability. This could include the transformation of the CMIM into a real Asian Monetary Fund. One important consideration is how much of the CMIM funding would be de-linked from the IMF.*

***Recommendation 11***

*We should improve regional capital markets, especially direct financing to support real economy, improve the use of capital and reduce systemic risks in financial markets. While developing domestic capital markets, we should open wider, improve cross-border financial transaction and clearance mechanisms, increase financial regulatory cooperation, and enhance connectivity among regional capital markets.*

***Recommendation 12***

*We should expand the use of currencies of the regional economies for denomination, settlement and value reserve to effectively reduce exchange rate risk and cost of transaction and further boost intra-regional trade and investment. Governments in Asia should give more policy support to the bilateral currency swap and to the settlement in general trade with their currencies.*

A group of PECC committees, AUSPECC, CNCPEC and SINCPEC have been working on ideas for how the AIIB might work, they suggest the following principles:

As a specialized multinational development bank, the AIIB should be established to act as a financing platform for Asian regional infrastructure building. As a regional financial institution, the AIIB should be started by the interested governments in the region. Open regionalism should be practiced by way of enrolling new members from within and without as stockholders in future and also encouraging the participation of private capital. Open regionalism should be reflected in its relations with organizations. It should be complementary to existing public and private institutions. The AIIB is just one more specialized institution to fill in the enormous capital gap of the infrastructure development in Asia. Best practices should also be introduced at the very beginning of the AIIB. The investment behavior of AIIB should be market oriented. It is encouraged to design innovative loan products. The AIIB should encourage the participation of private capital by identifying more bankable projects in collaboration with the host economies.

***Recommendation 13***

*It is time to put the Asia Infrastructure Investment Bank (AIIB) into practice. The AIIB could be an open platform to finance infrastructure investments in Asia and Pacific area. The above suggestions should be considered.*

**Conclusion**

I have given you a long list of 13 recommendations. But there were even more, which shows the richness of our discussions. Some of them are for us to take to APEC Officials and others are for ourselves to consider. APEC has been and will continue to be an important institution for regional cooperation. That is why we must redefine its new priorities and strengthen the implementation of its mandate.

With this, I thank you all for your contributions. We count on your continuing intellectual support to make this year's APEC a success.

# Appendix: Abbreviations

ABAC: APEC Business Advisory Council

ABMI: Asian Bond Market Initiative

ADB: Asian Development Bank

ADBI: Asian Development Bank Institute

AEC: ASEAN Economic Community

AHN: ASEAN Highway Network

AIFB: Asian Infrastructure Financing Bank

AIFF: Asian Infrastructure Financing Fund

AIIB: Asian Infrastructure Investment Bank

AMF: Asian Monetary Fund

AMRO: ASEAN+3 Macroeconomic Research Office

APEC: Asia-Pacific Economic Cooperation

ASEAN: Association of Southeast Asian Nations

ASW: APEC Single Window

AUSPECC: Australian Pacific Economic Cooperation Committee

BDCPEC: Brunei Darussalam National Committee for Pacific Economic Cooperation

BIMP-EAGA: Brunei, Indonesia, Malaysia and Philippines and East ASEAN Growth Area

BIMSTEC: Bay of Bengal Initiative Multi-Sectorial Technical and Economic Cooperation

BIT: Bilteral Investment Treaty

CAF: Corporation Andina de Formento

CANCPEC: Canadian National Committee for Pacific Economic Cooperation

CBM: Coal Bed Methane

CDB: China Development Bank

CHILPEC: Chilean National Committee for Pacific Economic Cooperation

CJK: China-Japan-Korea

CMIM: Chiang Mai Initiative Multilateralization

CNCPEC: China National Committee for Pacific Economic Cooperation

CNTA: China National Tourism Agency

CPC: Chinese Communist Party

CTPECC: Chinese Taipei Pacific Economic Cooperation Committee

DDA: Doha Developmental Agenda

EM: Emerging Markets

EPA: Economic Partnership Agreements

ESCAP: Economic and Social Commission for Asia and the Pacific

EU: European Union

EX-IM: Export-Import

FDA: Food and Drug Agency

FDI: Foreign Direct Investment

FTA: Free Trade Agreement

FTAAP: Free Trade Area of the Asia Pacific

GATT: General Agreement on Tariffs and Trade

GDP: Gross Domestic Product

GMS: Greater Mekong Sub-region

GSW: Global Single Window

GTI: Greater Tumen Initiative

GVC: Global Value Chains

HKCPEC: Hong Kong Committee for Pacific Economic Cooperation

IFC: International Finance Corporation

IGGF: Indonesia Infrastructure Guarantee Fund

IIF: Indonesia Infrastructure Finance

IIRSA: Integration of Regional South American Infrastructure

IMF: International Monetary Fund

IMT-GMT: Indonesia, Malaysia and Thailand Growth Triangle

INCPEC: Indonesian National Committee for Pacific Economic Cooperation

ISDS: Investor State Dispute Settlement

ITA: Information Technology Agreement

ISOM: Informal Senior Officials Meeting

LNG: Liquefied Natural Gas

MILA: Latin American Stock Market

MFN: Most Favored Nations

MTS: Multilateral Trading System

NAFTA: North American Free Trade Agreement

NZPECC: New Zealand Committee of the Pacific Economic Cooperation Council

PAIF: Pan-Asian Infrastructure Forum

PBC: People’s Bank of China

PECC: Pacific Economic Cooperation Council

PIF: Pacific Island Forum

PLPP: Plan Puebla Panama

PPECC: Philippine Pacific Economic Cooperation Committee

PPP: Public-Private-Partnerships

PNG: Paupa New Guniea

PT SMI: PT Sarana Multi Infrastruktur

QDII: Qualified Domestic Institutional Investors

QE: Quantitative Easing

QFII: Qualified Foreign Institutional Investor

RCEP: Regional Comprehensive Economic Partnership

RMB: Renminbi

ROK: Republic Of Korea

RQDIF: Renminbi Qualified Domestic Institutional Investor

RQFII: Renminbi Qualified Foreign Institutional Investors

RSI: Regional Settlement Intermediary

SINCPEC: Singapore National Committee for Pacific Economic Cooperation

SME: Small-to-Medium Enterprises

SOE: State Owned Enterprises

TISA: Trade In Services Agreement

TPA: Trade Promotion Authority

TPP: Trans-Pacific-Partnership

TTIP: Trans-Atlantic Investment Partnership

UN: United Nations

UNECE: UN Economic Commission for Europe

UNESCAP: UN Economic and Social Commission for the Asia Pacific

USD: United States Dollar

WTO: World Trade Organization