State of the Region

Session 3: The Future of Regional Economic Cooperation

Dr. Charles E. Morrison

Our final session is the capstone of a long and very rich day of discussions. The topic of the session, “The Future of Regional Economic Cooperation,” really is what PECC is all about. We have four distinguished speakers, whom I will introduce briefly.

Our first speaker is Ambassador Kurt Tong, who is the US Senior Official for APEC. His career includes a 17-year tour in the US Foreign Service, mostly in Northeast Asia – and he comes to us fresh from the third APEC Senior Officials’ Meeting in San Francisco.

Mr. Jusuf Wanandi, who is PECC International Co-Chair, will follow Ambassador Tong. He already as been introduced so I won’t repeat what you’ve already heard except to say that Jusuf is a long-time friend of mine.

And another long-time friend is Dr. Narongchai Akrasanee. Like Jusuf, Narongchai is a founder of the PECC process. He also embodies all of the sectors — business academia, and government service. He was a member of Thailand’s parliament and at one point he was Minister of Commerce. But most important, he’s a graduate of the Johns Hopkins University, my alma mater.

Our final speaker will be Dr. Fred Bergsten, who also has had a very impressive career. In his early years, he advanced at a very rapid rate in government service. But he has spent the last 30 years as Director of the Peterson Institute for International Economics, building and maintaining one of the most influential economic research institutes in the United States. Fred has been a very faithful participant in all of the meetings sponsored by PECC and the US Asia Pacific Council. So we have a great group. Kurt, please begin.

Ambassador Kurt Tong

Good afternoon, everybody. It’s a real pleasure to address PECC, which, as you all know, is really the godfather of APEC in a number of ways. The collective wisdom of this room has provided APEC an enormous amount of intellectual firepower over the years and guided it in the right direction. And those of us who have had to slavish in the salt mines of the APEC bureaucracy have appreciated getting all the guidance we could. And so it is a true honor to be here today, and I would like to thank all of you in advance for your advice — because I hope to hear some today.

continued on page two
Session 3: The Future of Regional Economic Cooperation

Defining APEC – So what is APEC? I think you all know. It is a voluntary membership organization of 21 economies united around the goal of bringing the Asia-Pacific region closer together in terms of economic policy and actual economic behavior. APEC aims to deepen the relationships between the economies of the Asia-Pacific region in the interest of greater prosperity for all concerned.

“Why APEC,” though, is another question, and an increasingly relevant one in view of the proliferation in recent years of alternative approaches. This is represented in the topics of this session, the different groupings and organizations associated with each of our names and to which we will direct our comments.

So let me spend a couple of minutes explaining “why” APEC before delving into what APEC is doing in 2011 and what the United States sees as the path forward for an organization that we frequently and emphatically refer to as the premier economic organization in the Asia-Pacific region.

Mission-Specific – Why APEC?
First, it is mission-specific. Unlike many international organizations that bring nations together and then decide what they want to do, APEC, from its very inception, was designed around a concept of regional economic integration. For that purpose, it has the right membership.

Voluntary – Second, no one has forced anyone to become a member of APEC. None of the economies felt they had to join. They all signed up for it. It’s a voluntary organization. Any economy could leave at any point without any grave repercussions.

There is no obvious geographic imperative other than the fact that all of the economies are bordered on the Pacific in one way or another or close to it. But it is the right membership because it is voluntary. The APEC economies have all signed up to be there and bring their economies closer together.

Dynamic Economies – It is also the right membership because APEC represents over half of global GDP, almost half of world trade, and 40 percent of the world’s population. It is an enormously influential group and it’s also a collection of the most dynamic economies in the world today. Most of them are located in the East Asian region.

But if you look at the membership on the eastern side of the Pacific, it also reflects dynamism. The economies of Chile, Peru, and Mexico are on the move, particularly in the area of trade policy, pursuing aggressive, forward-looking policies.

Non-Binding Approach – Third, APEC is not the WTO. By that I mean that APEC economies do not sign any binding treaties. There is no dispute resolution mechanism, nor will there ever be one, at least in the foreseeable future.

In short, there are no penalties for non-performance. Even if you don’t pay your dues, you might get a nasty letter, but that would be about it.

The fact that APEC is voluntary also means that anything can be put on the agenda. And anything can be pushed through the agenda as long as the economies agree that it’s a valuable enterprise. That flexibility is critical and allows the organization to move in ways far ahead of a binding organization with a tightly negotiated agenda.

Practical Focus – Fourth, APEC deals with the practical and technical, which is a unique combination. So you have an organization that brings leaders together — but it also has a subcommittee on standards and performance. Not many organizations can combine that high-level political character with deep technical expertise so that political commitments, in turn, can be translated into high-quality practical initiatives.

By comparison, the OECD [Organization for Economic Cooperation and Development] has an enormous amount of technical expertise. But the OECD never meets at the leaders’ level. It doesn’t really set the global direction. Rather, it responds to an agenda that has been established by other organizations. APEC is an organization that both promotes an agenda but also has the technical capacity to move it.

Private-Sector Input – Finally, and the most important and unique aspect of APEC as an organization, is its
openness to input from outside government. That is something that we’re continuing to develop and deepen, particularly in the US host year. The degree to which we have private sector representatives in the room as trade policy is being debated, for example, is rather unique.

The extent of private sector input makes many of the economies quite uncomfortable when they are on the defensive on an issue, including the United States. But this results in higher quality discussions.

Issues like supply-chain connectivity or environmental business services have progressed much further in APEC than in other international organizations. In addition, these issues have been very much informed by the push from the private sector. So the interaction between the public and private sectors that APEC affords is one of its unique strengths.

**The degree to which APEC has private sector representatives in the room as trade policy is being debated is unique**

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**Regional Economic Integration Theme** – The first theme — which is the most directly targeted at the FTAAP — concerns regional economic integration, with a special emphasis on next-generation trade and investment issues. The issues are market-based innovation, supply-chain connectivity, and greater involvement by small- and medium-sized enterprises in international trade.

At the third APEC Senior Officials’ meeting in San Francisco, we discussed work programs that were being developed to address those three elements of next-generation trade and investment issues.

**Green Growth Theme** – The second theme is green growth, again with the particular focus on trade in environmental goods and services. We hope to achieve something truly significant in 2011 in liberalizing trade and investment in environmental goods and services in the Asia Pacific region. This was the most hotly debated topic at the Senior Officials’ Meeting in San Francisco, and I expect it will remain that way in the run up to the Leaders’ Meeting in Hawaii.

There are other green-growth initiatives within APEC pertaining to reforming fossil-fuel subsidies, combating illegal logging, developing low-emissions strategies, and so forth. Some of these are development-oriented and less related to trade. Those are all proceeding quite well. This idea of linking green development to overall economic development is a profound theme for the year.

**Regulatory Cooperation and Convergence** – The third theme is regulatory cooperation and convergence. When we first used the word convergence, there was a gasp from the collective APEC senior officials: “What are you proposing?! That the United States set all the regulations for the region?”

And I said, “Well, no. Not quite that.” Rather, this year we’re focusing on developing some best practices in the regulatory area. These would include regulatory impact assessments, good coordination between agencies setting regulations, and improved transparency, openness, and public participation in the regulatory processes.

Review of 2010 – So what are we doing in APEC right now? The agenda was shaped by last year’s outcomes and this year’s ambitions. 2010 in many ways was a seminal year for APEC — and it didn’t get any attention whatsoever as far as I could tell and I was there. It was rather overshadowed by the G-20 meeting, which took place a couple of days before APEC’s 2010 meeting.

But two important things came out of the APEC 2010 meeting. First, there was an affirmation of the so-called Bogor Goals, which called for developed economies to completely liberalize trade and investment by 2010 and developing economies to realize these goals by 2020. A report was issued that said the developed economies had not yet achieved free and open trade and investment, but had made significant progress.

Along with that, the leaders laid out a rather specific vision for a Free Trade Area of the Asia Pacific [FTAAP]. This represents an ambitious goal for a next-generation trade and investment agreement, not just a least-common-denominator expression of a desire for a regional trade pact. It is a truly penetrating objective that we share together. That was a fundamental breakthrough, and I believe it is quite closely tied to the increasing traction and momentum in favor of the Trans-Pacific Partnership [TPP].

**2011 Focus on Practical Results** – So with that as background, in 2011 the United States focused almost exclusively on trying to achieve practical results that would push us towards a FTAAP. We’ve done this around three themes.
Session 3: The Future of Regional Economic Cooperation

So far, we’ve achieved a good buy-in from the APEC economies. Some are little more reluctant than others to commit themselves to a time-line of commitments to reshape their regulatory systems. But this is having an indirect but subtle and significant impact on the pursuit of this overall goal of realizing a seamless regional economy.

Those are the three themes for the year. [Please click here for the Honolulu Declaration issued by the APEC Leaders, in which they pledged to realize a ‘seamless regional economy’ by implementing measures aimed at promoting the three themes.]

Overall Vision – The overall vision that underlies the US approach was presented by Secretary of State Clinton in a speech here in Washington to APEC Senior Officials in March 2011 and in another speech in Hong Kong in July 2011. Basically, she said we, as APEC members, are aspiring to realize collectively an economic platform in the region that is open, free, transparent, and fair.

Being “open,” means open to all economies from around the world, not just a bloc. “Free,” refers to a goal of realizing the least number of barriers in trade and investment. “Transparent,” means that the rules of the road are clear to all participants concerned. And “fair,” means that the rules of the road are interpreted and enforced identically for all participants in the regional economy.

That vision is becoming the shared vision of APEC. The TPP is a concrete manifestation of that philosophy, of a platform that has minimal barriers to trade and investment that is open to more economies to participate. We are quite enthusiastic about this initiative as an extension of APEC pushing in the direction of the FTAAP.

Importance of Realizing Results – As we prepare for the APEC Leaders’ meeting in November, we are extremely cognizant of that fact that there are multiple initiatives at about the same time.

First, President Obama will go to France for the G-20 meeting to talk about global macroeconomic policy. Soon afterward, he will go to Hawaii for the APEC meeting to discuss the Asia-Pacific trade regime. Then he will travel to Bali to attend the East Asia Summit to explore developments in the Asia-Pacific region and security issues.

In a context where there are multiple forums and multiple opportunities for leaders to get together, one wonders whether they might get tired of seeing each other with such frequency. So you must have a compelling reason to continue to meet and to expend all of the resources to do so. A leaders-level initiative must produce results. You must justify the continued existence of the organization.

‘Get Stuff Done’ – So we have adopted “get stuff done” as the theme for the US APEC year. We just have to get things done and achieve practical results and push the ball forward, not just make pronouncements. The markets need more than that.

Mr. Jusuf Wanandi

My task is to talk about the East Asian Summit [EAS] and what the strategic developments in East Asia are that could make the EAS an important institution in the future.

Chinese Economy – The Chinese economy has now become the center of the East Asian economy because of the demography that has defined the size of the Chinese economy for our region and the world. But it’s also due to increases in productivity, thanks to investment in education and R&D for China’s economy.

Since East Asia has become an enormous economy, the importance of the region has also increased. When in the previous decades the United States defined the politics and security of East Asia, the future of the region’s strategic development will be more complex.

US Needs Allies’ Cooperation – At one stage 40 years ago shortly after China opened up to the United States, Japan and China were willing to give the dominant rule to the United States in East Asia. But now, not one country on her own could maintain peace, stability, and development of East Asia. While the United States is still a great power and its military might is still the greatest, it no longer can keep the East Asian regional order alone. The United States needs her allies and friends to do it together.
While China seems to want a US presence in East Asia, she recently stressed that the US role should be more multilateral in the future. And if China’s national interest is at stake, she will definitely come forward more strenuously and openly. That can be acceptable in the region when it is done peacefully in a rational and open way through statements, dialogues or diplomatic approaches.

**China Should Abandon ‘Old Ways’** – I think China should not repeat its earlier ways that smacked of “revolution.” China is now big and developing very fast and therefore she does not need the old ways and methods that were used when she was still feeble and not as recognized internationally as nowadays.

“Soft power” is the way for her to move on in the future. That will not always be easy because among her populace, there is a certain pride in what China in the meantime has achieved. Those who hold this view could pressure Beijing to be more assertive.

In the last two years, China policies on the Korean peninsula and her claims on the East China Sea and South East Asian Sea have created reactions from countries in the region that are not conducive to her own national interest and peace and stability in the region.

Even when China has the military capacity to face the United States in defending her coastal areas in an asymmetric strategy — even if the United States dominates the Western Pacific — China still needs peace and stability in her environment for economic development. Conflict or confrontation will be against China’s efforts to develop economically and modernize.

**Winning Back Trust** – In 2011, China has changed these assertive, strong policies with an initiative to talk bilaterally to South Korea and the United States about another series of Six-Party Talks aimed at de-nuclearizing Korea. This change occurred after the Cheonan and the Yeonpyeong Island incidents. But the other parties to the Six-Party Talks were non-committal because they thought it was too little and too late. I thought that the proposal should not be rejected outright.

So because China’s proposal was not submitted earlier, she should take up other measures to win the trust of the region. It might take some time to learn, and we have to admit that it was only 30 years ago that China was exposed to the outside world regularly.

**Code of Conduct for South China Sea** – China’s willingness to prepare a Code of Conduct for the South China Sea based on the Declaration of Conduct has shown a willingness to work with ASEAN and to find a way out of her problems in Southeast Asia. In so doing, she tried to recover some of her credibility.

Another important problem that may arise, however, is whether the United States can restrain herself if China would like to assert her “strong” way in the future.

More important, is whether United States can accept China as an equal. This cannot be easily discerned or projected in the near future because there are many opinions in the United States that have not been consolidated into one big stream of opinion.

**Importance of US-China Cooperation** – Besides, it should also be recognized that the United States has an interest in securing China’s cooperation in many fields, such as US economic development, eliminating the nuclear weapons of North Korea and Iran, dealing with the problem of the environment and climate change, and other common goods, like pandemics, food and energy security, and so forth.

Meanwhile the East Asian region, including ASEAN and Indonesia, has an interest in seeing the relationship between the two great powers be free of conflict. That is why we must watch strategic developments in East Asia very carefully. Even if economic power cannot be translated immediately into political power, it is going to happen soon enough. Just look at the pace of China’s economic development and the fact that within 20 years, China’s GDP may become the largest in the world.

**China’s Defense Budget** – With the exception of 2010, China’s defense budget has doubled in the past 15 years. In another decade, one can expect that China’s military continued on page six
Session 3: The Future of Regional Economic Cooperation

power could balance that of the United States, especially in East Asia. Because of the future prospect of a change in the balance of power, the countries of East Asia must prevent the development of the same trauma and tragedy that befell Europe at the end of the 19th century with the birth of extreme ideologies, such as Fascism/Nazism and Communism, followed by World War II and the Cold War. This only ended in 1989, when the Berlin Wall and Communism collapsed and the USSR broke up.

We are aware that those tragedies and challenges also could happen in East Asia. That is why we have to establish East Asian regional institutions to assist the strengthening of bilateral relations between the United States and China. ASEAN and others managed to craft a new East Asian Summit that will include the United States and Russia.

'Concert of Powers' – Hugh White, a well-known strategist from the Australian National University stated that the East Asian Summit should try very hard to become a “concert of powers” in East Asia, which can establish order in the region and create an environment where China and the United States can cooperate better and ease tensions between them. EAS will decide strategic issues in the economic, political, and security fields.

The implementation of the EAS decisions can be realized by existing regional institutions. For example the ASEAN Regional Forum could implement non-traditional security matters, while the ASEAN Defense Ministers, plus the United States, Russia, China, South Korea, India, Japan, Australia and New Zealand and Australia — also known as the ADMM +9 — would focus on traditional security measures. The ASEAN + 3 members would address functional cooperation including economic cooperation.

To be effective, the ADMM+ should be held annually rather than once every three years, and the ASEAN +3 should be open for other members of the EAS if need be.

All of the decisions at the East Asian level, especially at the EAS, can become inputs for the APEC Summit or the G-20 process since East Asia’s contribution to global development, especially on economic issues, could be important in view of the fact that nine of the EAS members are also members of the G-20.

Thank you for your kind attention.

Dr. Narongchai Akrasanee

Good afternoon. I’m very honored to be on this panel, especially with Jusuf Wanandi. We worked together to create PECC a long time ago. I’m also honored to be speaking with Fred Bergsten, who, you may not know, is the main person responsible for the first APEC Summit.

We must establish East Asian institutions to assist the strengthening of US-China relations

Fred and I were serving on the Eminent Persons Group at that time, and he had an idea that having a summit would push APEC forward.

He happened to have a friend at the White House, President Clinton. So he called President Clinton and proposed the summit idea. Right away President Clinton said yes, so we launched the APEC summit process. Since some county leaders could not attend or some countries simply did not have a leader, we decided to call it the Leadership Summit.

Origin of APEC – Also, originally, we were going to call APEC the “Asia Pacific Economic Community.” However, a Chinese participant in the Eminent Persons Group rejected the use of “community,” so we settled on “cooperation.”

Eighteen years have passed, and now we are about to have another summit. We almost have a Clinton and Clinton situation, but the second Clinton lost the election, so instead of having another Clinton at this summit, we are going to have President Obama instead.

I have been asked to talk about the ASEAN+3. I’d like to show you this graphic [see slide on page 7]. This is a summary of my life’s work. It’s my resume. Since 1973, I have been working on all these things, meaning that all my work can be summarized into one page. What a pity. But I think it tells a lot. The main message is this: when we were contemplating economic cooperation in Southeast Asia, it was never an exclusive kind of idea.

[For Dr. Narongchai’s complete Power Point presentation, please click here.]

Origins of ASEAN – One can see the evolution of ASEAN starting way back from 1967 and the schemes that we have been trying to implement. At the same time, if you look at the horizontal axis, you can see that ASEAN membership has been expanding from ASEAN-5 to ASEAN-6 and to ASEAN-10 in 1999, which was the year that Cambodia joined ASEAN.
We started to move towards ASEAN-10 when the Soviet Union gave up the idea behind the Cold War. We then added on ASEAN+3, ASEAN+6, and so on. At the same time, you can see at the bottom, APEC was launched in 1993 and ASEM in 1995. So you can see that this is the non-exclusive approach.

The evolution of ASEAN was well-designed by people like myself and Jusuf Wanandi. We think highly of ourselves and how we decide things, but basically ASEAN happened according to political developments.

If you look at the years on the vertical axis, we have AFTA in 1993. We tried to conclude a Free Trade Agreement. In fact, I could start in 1977, when we concluded the Preferential Trading Arrangement [PTA] following the Vietnam War.

**Preferential Trading Arrangement** – We thought we must do something to convince the world that we were united. So we had a summit in Bali and came up with PTA, but we were not serious about giving preferential trade benefits. For example, we would give free trade benefits to the Philippines for the importation of snow mobiles. Anything on the PTA lists really was not meant to be traded. But in 1991-1992, it became clear to us that the Uruguay Round was about to be concluded. So we agreed on the AFTA. We pre-negotiated AFTA very quickly. Talks began in September 1991 and the AFTA was signed in February 1992 in Singapore.

At first, we thought that we would achieve free trade. This process has been accelerated to move further and further and, then if you follow the left-hand vertical axis up, the biggest milestone was the signing of the ASEAN Charter in 2008.

**Impetus for ASEAN Charter** – Again, that came about because we heard rumors from the United States about growing support for a Free Trade Area of the Asia Pacific [FTAAP]. By then, the FTAAP was an interesting concept after the failure of the Doha Round and the proliferation of FTAs [free trade agreements] among the ASEAN countries. Immediately after the Doha Round was launched, we knew that it would not result in a comprehensive agreement. So we started negotiating FTAs with everybody.

continued on page eight
Session 3: The Future of Regional Economic Cooperation

When we learned more about the FTAPP and the TPP negotiations, which would both be very comprehensive, we decided to develop a Charter in the ASEAN community by 2015. It would cover trade in goods, services, professional movement, intellectual property, and so forth. In fact, most of the items listed under TPP are listed under the AEC [ASEAN Economic Community].

ASEAN+3 Evolution – But at the same time, we started adding other countries, knowing that among ourselves we do not have enough economies and financial resources. So the ASEAN+3 was a logical evolution.

It came about in November 2001 at a meeting in Brunei, where the Chinese initially proposed conclusion of a China-ASEAN FTA. I think the Chinese were concerned about the Doha Round and wanted to move quickly on an FTA with ASEAN.

ACFTA – On the right-hand axis, you can see that the ASEAN-China FTA went into effect in October 2003 before anyone else’s trade agreements. Do you know which country was the second one to conclude an FTA with ASEAN? Whenever the Chinese do something, the Japanese followed suit, as they did in June 2009. You know, this is what has happened in Southeast Asia. These two countries are constantly trying to compete for our love.

Subsequent FTAs – After the ASEAN-Japan Comprehensive Economic Partnership [AJCEP] was concluded, other countries followed with their own FTAs, including India. Therefore, this second vertical line on the right includes the agreements that we have signed with China, Japan, India, Korea, Australia, and New Zealand — and we are in the process of negotiating with the European Union.

Hopefully, at the end — I don’t know when — we would have the FTAAP. When we talk about free trade, everybody says that they like it and support it. But they also say that free trade is like heaven. Everyone likes to go to heaven, but always says, “I’m not going to heaven so soon.” So I don’t know when or if the FTAAP can be realized in the future. So this graphic basically presents the scheme that is in progress.

Economic Side of EAS – With respect to the EAS, Jusuf Wanandi already has talked about the security and other aspects. Let me talk a little bit more about the economic side. This process was first established in 2005. At the 5th EAS meeting in 2010, we decided to invite the leaders of the United States and Russia to join the discussions and, indeed, these two countries will attend the upcoming EAS meeting in Bali, Indonesia.

ASEAN+3 Work Plan – With respect to the ASEAN+3, we have agreed on a work plan that will address political and security issues, economic and financial issues, energy, environment, climate change, and sustainable development, socio-cultural developments, and institutional support and a follow-up mechanism. These topics will be under negotiation.

Now how far can we go? I think it depends on two factors. The first one concerns the on-and-off success of AEC 2015. The second concerns how each country wants to treat or behave toward China.

Concerning AEC 2015, as I said before, things are moving unevenly. In fact, there are two serious political problems that must be addressed: one is the so-called Myanmar factor; the second is the Thailand factor.

Myanmar/Thailand Factors – The Myanmar factor is about too much militarization. The Thailand factor is about too much democratization. When we had the summit in 2009, the leaders had to leave the site by helicopter because of all of the “democratic” demonstrations. That was proof of what Plato said 2000 years ago that democracy is no good.

There have been some positive developments in Myanmar. I think the generals seem to be more accommodating to the lady. This is what I observe. In Thailand, the lady seemed to be more accommodating towards the generals. Maybe we can move from 2011 towards our AEC 2015 goal, hoping that the generals in Myanmar do not change their mind and the lady in Thailand doesn’t change her mind. This is something that we have to be aware of.

ASEAN China Policy – Concerning policy toward China, while we have the ASEAN-China FTA, in terms of political relations, some of us feel differently about
China depending upon whether a country has any border disputes with China — such as Vietnam, the Philippines, Malaysia, and even Laos. So how China accommodates these countries will be very important to the success of the ASEAN+3.

**Asia in Global Trade** – Looking briefly at this slide [see slide below], you can see that if you examine global economic and trade development, Asia itself is about one-third of the world in terms of trade. The ASEAN+3 is about one-quarter. Trade from the ASEAN area is growing faster than world trade. Intra-regional trade statistics show clearly that about 40 percent now is among ourselves.

**Financial Dimension** – Finally, I want to talk about the financial dimension. In addition to creating a bigger market for trade and investment, what is really important about the ASEAN+3 scheme is finance. We thought that if we added the three to ASEAN [China, Japan, and Korea], the financial sector would become very big and would help to propel regional development. During the last 10 to 15 years, trade has been growing very fast, but our financial sector has not.

It turns out that all the money we had, we basically wasted — so much so that a few years ago, Alan Greenspan blamed the crisis in the United States on us. In 2007, Greenspan said to me, “Narongchai, because your people did not know how to use your money and you gave it all to us, now we have to spend it. That’s why we have this problem.” Of course, he said it jokingly, but I think there was some truth to that. ASEAN needed to develop a financial sector for itself.

**Chiang Mai Initiative** – We have developed two schemes: one was the Chiang Mai Initiative, launched in May 2009 with $120 billion. Its two objectives are (1) to address short-term liquidity problems and (2) to supplement the existing international financial arrangements.

This slide [see top slide on page 10] details the principle about how a country agrees to use the money, what kind of multiple a country can claim, and so forth. This is aimed at ensuring that ASEAN countries have enough liquidity if there is a financial problem in some of our member countries. This slide lists ASEAN members and their contribution and the ratio with a multiplier that they can borrow [see bottom slide on page 10].

**Asian Bond Markets Initiative** – The second scheme is the Asian Bond Markets Initiatives. We believe that in order to better use our savings, we need to develop a bond market, meaning a market that can issue bonds in our own currencies. This is how the local currency bond market of ASEAN+3 has been growing over the years [see top slide on page 11]. This is still not enough, but we believe it is growing more or less in the right direction.

![Progress Chart](image-url)
Session 3: The Future of Regional Economic Cooperation

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### Progress (6)

- Maximum amount each country can borrow is based on its contribution multiplied by its respective borrowing multiplier
- Decision-making mechanism

<table>
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<td>Consensus</td>
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<td>Lending, renewal, default</td>
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- ASEAN +3 Macroeconomic Research Office (AMRO), a regional macroeconomic surveillance and crisis management unit based in Singapore, started operations on May 16, 2011.

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Moving Toward CEM 2015 – In sum, as ASEAN cooperates in addressing its concerns, we seem to be moving towards CEM 2015 — hopefully without too many political problems along the way to prevent us from achieving the goal. At the same time, the ASEAN+3, in addition to giving us a larger market for goods, services, and investment, will also help us to develop the financial sector for bond and equity markets. Thank you very much.

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Dr. C. Fred Bergsten

Good afternoon. My assignment today is uncontroversial, not to talk about the alphabet soup in Asia, but simply to talk about the G-20 and the role of Asia in the G-20.

As Kurt [Tong] mentioned, the G-20 will be the first of the series of meetings that will take place in November and, in many respects given the state of the world economy, is

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### Progress (7)

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<td>China</td>
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<td>China 0.5</td>
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Source: The Joint Media Statement of the 12th ASEAN Plus Three Finance Ministers’ Meeting, Bali, Indonesia, 3 May 2009, ASEAN Secretariat
the most important. So let me say a few words about the role of the Asian countries in the G-20 and indicate three areas where I think they may be asked to play critical, even decisive, roles in the G-20’s effort to grapple with the global economic and financial problems.

A background point as indicated already, the APEC countries more broadly are close to having half of the total membership of the G-20. That’s an accurate reflection of the sharp change in the make-up of the world economy that we’ve experienced over the last decade.

**Importance of Emerging Market Countries** – The emerging market countries as a whole now make up half the world economy. If you convert the purchasing power parity, those emerging markets are growing more than three times as fast as the traditional high-income, so-called advanced countries.

Therefore, their share of the global economy is rising 2 or 3 percentage points a year. This means that when we discuss this topic a decade from now, the emerging market countries will be two-thirds of the world economy.

They are the drivers of growth. They’ve accounted for 80 percent of world growth during the last decade, they are more than half the world economy, and they are critical for trade and international finance as well, as Narongchai’s charts just showed.

**China’s Economy** – First in the group, of course, is China. China by itself accounts for about 10 percent of the world economy. It’s been growing about 10 percent per year. Just by itself, China accounts for 1 percentage point of global economic growth and of total growth, 4 percent.

So China by itself accounts for one quarter of all world economic growth and therefore plays a pivotal role in anybody’s outlook for what’s going to happen.

That’s much more than the United States, incidentally. The United States has about 20 percent of the world economy, but is only growing at about 2 percent per year. It accounts for less than half of a percentage point of world growth compared with China’s 1 percent. So in that sense, the United States must be half as important as China in the global growth outlook picture.

The world economic situation as we all know is sputtering. And there will be at least three big problems that the G-20 will be facing when leaders convene in Cannes, France.

**Global Growth Problem** – The first problem is global growth, which is weak and is clearly going to need a push. The London G-20 Summit in April 2009 played a critical role in promoting global recovery from the great recession. That was through the concerted fiscal and monetary stimulus programs that all countries undertook together in order to promote recovery from the global turndown.

Note: Excluded Myanmar, Laos, Cambodia, Brunei

Source: Asian Bonds Online, ADB

continued on page 12
Session 3: The Future of Regional Economic Cooperation

Problem of Imbalances – The second and continuing big problem is the imbalances. They are growing again. The US external deficit is rising. China’s external surplus is rising again. And as the G-20 summits have said repeatedly, it’s necessary to correct those problems to achieve sustainable growth that will be continued over a long period of time.

Financing for Imbalances – The third problem facing the G-20 is, of course, financing for the imbalances that will continue for some time. The focus will be on the Eurozone, where Greece remains unresolved. Too, there are big question marks about whether there will be financing available to carry over Italy and Spain and avoid serious banking crises as well as a severe disruption of the global economy.

Even if the countries carry out their adjustment programs in full faith and great skill — which is in question — substantial financing will be needed to tie them over for a substantial period and deal with large debt over-hangs so these economies can be put back on a reasonably stable basis for the longer run.

Financing also will be necessary to provide debt relief to Greece. This will be pivotal for the world economy.

So those are the big challenges that leaders will face at Cannes. How can Asia help? How can Asia play an important role in dealing with those three problems? I would suggest in every case Asian countries may be asked to play a pivotal role.

Bifurcated Global Picture – In terms of world growth, I already mentioned we have essentially a bifurcated global picture. The emerging markets, including Latin America and few others but mainly in East Asia and to some extent South Asia, are growing on average more than 6 percent. The industrial countries are growing 2 percent or less.

In addition, the space for policy modification and particularly policy stimulus is practically non-existent in the United States, Europe, and Japan — but reasonably available in China and many of the other Asian countries. The reason policy stimulus is not available in the OECD countries is because of the huge fiscal over-hangs.

Fiscal Over-Hangs – We recently did a study at the Peterson Institute on the fiscal positions of all groupings and major countries in the world for the next 20 years. The results were stunning. The trajectory that we’re now on would see Japan’s debt to GDP ratio rise to 300 percent by 2030. The US ratio would rise to 240 percent and the Europeans’ ratio, which is great by comparison, would increase to only 270 percent.

Of course, anything greater than 90 or 100 percent is totally unsustainable. I characterize these numbers as trajectories because they can’t happen. They are so far off the chart. They can’t and won’t happen. In the meantime, there will be a combination of constructive adjustments and more likely crises that will prevent those trajectories from being realized. But those are the pathways on which the high income, so-called advanced countries now stand.

Fiscal Space – By comparison, the number for the emerging markets is 50. Not only are those countries now growing three times as fast, but their projected fiscal positions also are so much better. They are the ones that have room for additional policy action, to take new initiatives, to cope with unforeseen crises and the like. In the short run, what that means is if the world needs a boost to stimulate growth and avoid falling back into another great recession, the emerging markets can do it.

Again, China is by far the biggest factor in global economic growth, with a strong fiscal position and, therefore, plenty of room for additional expansionary policy measures. China, in particular, but also Korea, Indonesia, and India to some extent, and a few others, are the ones that can legitimately be asked to provide the kind of global support that all the G-20 countries were able to provide at London two-and-a-half years ago.

China’s Need for Stimulus – China worries about inflation, and I’ll come to a remedy for that in a moment. But the fact that the global economy is slowing sharply and therefore China’s export markets are slowing suggests that China probably will need additional stimulus for domestic reasons.

In this regard, I think China’s national goals and international responsibilities would be quite coincident.
So I think the emerging markets — Asia more broadly and China in particular — could turn out to be the heroes of the Cannes G-20 Summit in the growth context.

The second issue is the famous imbalances. I won’t rehash that debate that we all know so well, only to say that as I mentioned already, the trends are going in the wrong direction. The US external deficit is rising again; China’s external surplus also is increasing. The IMF projects that it will double over the next five years.

RMB Valuation — China has let its exchange rate rise a little bit against the dollar over the last year. And since the dollar went down against everything else and China retains its peg, the real effective exchange rate of the RMB, its trade-weighted rate, has not risen at all. The undervaluation of the RMB, in fact, is greater today that it was one, two, or even five years ago.

China continues to intervene in the currency markets to the tune of $1 to $2 billion every day, buying dollars to keep the dollar overvalued, selling RMB to keep the RMB undervalued. That undervaluation is now estimated at between 20 to 30 percent, so the imbalances are getting worse.

The good news is that this provides China with an excellent opportunity to couple stimulus measures to expand its growth and help keep world growth going with a potent anti-inflation device — namely a more rapid appreciation of the RMB. We all know that’s a very potent anti-inflation device. It’s particularly effective in the Chinese context because it enables the central authorities in China to control the provinces.

Provincial Interference – When China tries to alter the economy through the traditional command-and-control devices and direct policy changes from Beijing, they are often rendered impotent by the offsetting actions of the provinces. But use of macroeconomic policy tools, like interest rates or the exchange rate, cannot be rejected by the competing provincial officials. It’s a more effective device for Beijing to us in managing policy.

Fiscal Stimulus, Plus RMB Appreciation – Coupling the additional fiscal stimulus with a more rapid appreciation of the RMB would support international goals but in ways that strongly promote China’s domestic economic objectives. This is the kind of cooperative program that the G-20 countries might fashion to support world economic needs, which would include a big role for Asia.

Need for a War Chest – The third and final question is financing. That focus is on Europe. The Europeans currently are in the process of working out an internal procedure, the European Financial Support Facility, which will provide a big war chest of about $600 billion.

This is not enough, so it probably will be leveraged with European Central Bank lending to increase that war chest to somewhere between €3-5 trillion. That would be more than enough to cover even serious problems in Italy and Spain, plus enable big new credits to Greece to enable them to buy back a lot of their debt and restore greater stability.

That’s the game plan in Europe. I think it is underway to successful resolution. But if it fails, there is a Plan B. And Plan B is where the Asians would contribute in a big way.

Plan B Role for Asia – If the Europeans fail to come up with a purely regional response to problems in Greece, Italy, and Spain, they will have to come back to the International Monetary Fund [IMF]. Only this time, the IMF will not have enough money.

The IMF currently has about $300 or $400 billion, but that would not be enough to provide a convincing war chest to deal with the whole range of potential European problems. That would require something on the order of at least a $1 trillion or more.

At that point, the IMF would have to go around the world to raise money as it frequently has done in the past. It never has enough money itself, so it always goes out and borrows from the countries that are rich at that time. And right now, of course, that’s mainly the Asian countries.

Conversion from Dollars to IMF Paper – The IMF mission likely would first go to Beijing and offer Chinese authorities the opportunity to convert $1 trillion of their $3 trillion of foreign exchange out of dollar assets and into IMF paper, which is guaranteed above all other debts in the world. It is a currency basket created for you, and actually pays much better interest rates than US Treasuries, so it would be very effective.

One would think that China, Singapore, Hong Kong, Korea, and other Asian countries that are flush with huge reserves would be able to put them into the IMF and be in much better shape. That also would provide the IMF with the funding that could then be lent to European or other

continued on page 14
debtor countries that need the money in order to avoid global financial difficulty.

Again, I think that would be a nice coincidence between the national interests of the big reserve holders to diversify their holdings with global needs for additional financing mechanisms to deal with the crises of today. And we should know by the Cannes G-20 Summit whether the Europeans got their collective act together well enough to provide their own rescue funds in the way I describe, or whether Plan B, with an IMF fund-raising exercise, will be required.

[Click here for G-20 Summit Final Communique.]

So it may turn out that on all three accounts — global growth, imbalances, and financing needs — the Asian countries may play a big role. 2010 was a historic year. Korea chaired the G-20 and it was the first time an Asian country other than Japan had ever done so.

2011 could turn out to be the year in which the Asian countries actually save the world economy through their initiatives at the G-20 summit. Thank you.

Morrison

Thank you very much. In fact, Dr. Bergsten’s presentation emphasizes a theme that we began with, which is the importance of global leadership — not just regional cooperation. We have a few remaining minutes for questions and interaction between the speakers. Let’s take several questions from the audience, and then allow the appropriate speaker to address them.

Question #1

I have two questions for Dr. Bergsten. Do you think China ultimately will allow its currency to appreciate?

And second, I think it will be very difficult to solve the Euro zone problem. Perhaps ASEAN countries can aid the European financial crisis, but at the same time the Europeans must think of themselves. They should consider some kind of mechanism to enable countries, like Greece, to get out of the Euro zone. What do you think of this?

Question #2

My question also is for Dr. Bergsten. Although in theory, the Chinese can do a major fiscal and monetary expansion, they seemed to be quite worried about inflation that has lasted one year and have tried to slow growth. Do you think they’ll find it in their interest to follow your prescription and stop intervening as much in the currency markets?

Question #3

We now have the East Asia Summit and the ASEAN+3 and there is some overlap of their memberships. How do you see the relationship between these two groups, and in what way can they complement and support each other?

Question #4

This question is for Dr. Bergsten concerning so-called Plan B. If we go that route, what can Asian countries bargain for? Would the bargain be different for large countries, like China, versus smaller countries like Singapore and Hong Kong?

Question #5

I have a very naive question for Ambassador Tong. Now that you are promoting TPP and President Obama is going to attend the East Asia Summit, is there enough space for the United States and others to remain formally committed to the APEC process after 2011?

Question #6

This morning Assistant Secretary Campbell said, and I quote, “This is the last chance we have to reinvigorate APEC.” Do you all agree?

Morrison

Thank you. Now let’s allow the speakers to address the questions.

Bergsten

I can’t resist addressing the last question — “Is this the last chance for the United States and others to reinvigorate APEC?”

APEC’s Last Chance? – The answer is no. That same comment has been made by at least half a dozen Assistant Secretaries of State for East Asian and Pacific Affairs during the last 20 years. And APEC, like most international institutions, has been very hard to kill off.
Now if he means will it have much vigor going forward? That’s more conjectural, but it really does depend on the policy requirements of the time and the leadership from different key countries.

APEC has had a series of ups and downs over the years. I suspect it will have more, but with all due respect to Kurt whom I think very highly of, I don’t think this is the last chance. I think APEC will exist beyond this.

**Bargaining Under Plan B** – With respect to Plan B and what the Asians can ask for — that’s a very good question. As I said, the Asians would get some financial advantages by diversifying their reserves from low-paying, sure-to-depreciate US dollars into the best currencies with higher interest rates at the IMF. So the Asian countries would realize some financial gain.

But I agree — in addition the Asians can ask for more. And what they should ask for is a serious, not incremental change in the IMF’s governing arrangements.

**IMF Governing Changes** – The quota shares of the big Asian countries are still ridiculously low. On any reckoning, China is the number-two global economy and within shouting distance of the leaders. So its quota at the IMF should be much larger. Though the absolute numbers are smaller, this also is true for Korea, Singapore, Hong Kong and others.

However — and there’s a big however — those of us who have consistently argued that China and other countries should have a bigger role with the IMF confront a formidable problem. The problem is that China and many of those countries in the neighborhood are violating the most fundamental rule of the IMF — that is, competitive under-evaluation.

**Competitive Under-Valuation** – The fundamental role of the IMF and the entire reason it was created was to avoid the disaster of the 1930s and competitive devaluation. If anything is clear in this world economy, it is that China has practiced competitive devaluation for at least five years, probably 10 years.

As I said, Chinese authorities buy $1-2 billion in the foreign currency markets every day. This adds $340 billion to China’s foreign exchange reserves per year. They are doing this in order to hold down the value of the RMB. That violates the fundamental rule of both the IMF and the World Trade Organization, which has a similar provision.

So it’s a little hard to argue that this big economy should have a big role in this institution, particularly when this big economy doesn’t respect the rules of the institution. China would have to address that issue as part of negotiations aimed at changing the IMF’s governing structure.

**China’s Inflation** – With respect to the other questions, China certainly worries about inflation. But the inflation pressure already has diminished sharply with the slowdown of the world economy and the very sharp decline in commodity prices.

Much of China’s inflation problem was a problem of commodity prices — food prices, in particular, but also energy prices to some extent. Those prices of primary food products have dropped very sharply, which has relieved inflation pressures.

In addition, the extent to which the world economy slows down in the second half of 2011 will take a lot of pressure off the demand side and therefore decrease inflation pressures. Indeed, I suspect China, irrespective of the global issues I’ve mentioned, will be prompted to take expansionary measures to keep its growth up in the 8-plus percent range. But as insurance, I suggested that China could deal with the inflation risks by allowing its currency to appreciate more rapidly. That would be a policy mix that would promote growth as well as price stability.

**Exiting the Euro zone** – With respect to the first question about countries exiting the Euro zone, devaluing, and getting back to prosperity that way, that certainly is a policy option.

But the Europeans, including the Greeks, are absolutely committed to remaining in the Euro. If you listen continued on page 16.
to [French President Nicholas] Sarkozy or [German Chancellor Angela] Merkel, it's quite impressive how emotionally and intellectually committed they are to Europe. And today, Europe means the European Union and the Euro as a currency and the expansion of an economic and monetary union that they are now negotiating.

**Full Union in Europe** – When the thoughtful people of Europe created the EU 12 years ago, they all knew they were creating a half-way house. They called it an economic and monetary union. The monetary union was complete by creating a common currency at the European Central Bank. But there was no economic union — no fiscal union, no government institutions, no common regulatory or supervisory devices, even in finance. So it was a half-way house.

The Europeans thought that momentum would continue, but the times were too good. There was no pressure. Now under the pressure of crisis, they are doing it. I suspect that a decade from now, the countries of Europe will have a pretty complete economic and monetary union.

I think the countries of Europe are all committed to realizing this union and only in the worst of all contingencies would any of them exit. It’s not even clear that exiting, even though it would permit devaluation, would actually solve their problems better than staying in and going through the admittedly difficult process of adjustment.

**Problem of Greece** – Greece is admittedly the question mark. Greece could leave the Euro zone without much adverse effect on Europe as a whole, but many fear that such an exit would have a contagion effect and spill over to others. You can count on the Europeans, including the Germans, to do whatever is necessary to keep the Euro zone together and try to get as much economic adjustment as possible in order to put the union in sustainable shape for the long run.

**Narongchai**

I just want to say that I support Fred Bergsten’s comments about the potential Plan B. The trends seem to be in that direction. This is about Asia’s growth, our spending, investing, and stimulating both domestic and regional demand.

**The trend in Asia is towards infrastructure investment, which comports with the G-20 theme of encouraging countries in Asia to do more**

It’s pretty obvious that we are infrastructure-deficit economies but liquidity-surplus economies. The worst situation to be in would be infrastructure-surplus and liquidity-deficit.

If we look at current development plans, all of us will be focusing more on infrastructure spending. Government, of course, can borrow a little bit more. We still have fiscal space to do so, but now there is a push to mobilize local regional liquidity for investment and infrastructure in the form of infrastructure finance, and so on.

So the trend is towards infrastructure investment, which comports with the G-20 theme of encouraging countries in Asia to do more. This could lead to a solution, maybe not quickly, but we would be moving in the right direction.

**Wanandi**

First, I’d like to offer a sentence or two about APEC. I think the global economic crisis presents APEC with an opportunity to do really great things.

**APEC Lacks Leadership** – But for that we need real great leadership, and I must say there is a limit as to where that is coming from. So maybe we will miss this chance to move APEC as we should — not only for the region, but also for the world. That is my observation about the evolution of APEC.

**Boosting EAS** – Second, with respect to the ASEAN+3 and the East Asian Summit, as I said, the EAS is a newer forum because we added Russia and the United States as members. Also, there will be a summit in November.

For that reason and given the participation of national leaders, the EAS could really decide and act on strategic issues in all fields — economic, political, and security. So that is why I think the EAS should be taken seriously. If we can do and put the EAS right, it could become the main venue for regional leaders to meet.

Concerning implementation of EAS decisions, it would be useful to look at the ASEAN+3 process. It already has gone very far in functional and economic cooperation. ASEAN+3 should be the basis for economic cooperation and implementation of the EAS decisions. But at the same time, of course, the ASEAN+3 should be opened up
in the future for other members as needed.

**Tong**

I’d like to comment on three threads actually. A lot has been said about China and its role. And I think Dr. Bergsten mentioned that there’s a big role for Asia. I think by that he means primarily China in growth rebalancing and price management.

**China’s and Rebalancing** – It’s a big question whether this is going to happen, whether China or any of the major emerging economies would see themselves as responsible stakeholders — or see themselves as developing countries that deserve a break. That’s our remaining $1 trillion question, and I don’t have the answer.

On the different organizations, I think there will be a gradual process of sorting out what different regional groupings will focus on.

**APEC and Trade Policy** – My own expectation is that APEC will increasingly delve into trade policy because it’s the most technically proficient and ambitious of the regional organizations on trade policy. I believe the EAS will head in the direction of security policy and general confidence-building discussions for exactly the reasons that Mr. Wanandi explained. The membership and the presence of the United States and China and the flexibility in the conversation is possible within the EAS.

**ASEAN+3 Role** – The ASEAN+3 will continue to play a really important role in capacity-building on trade and other economic issues and on financial issues. It also will serve as perhaps the most important conduit between the global financial system and financial policy in the region.

**G-20 and Macroeconomic Policy** – The G-20 will assume the main role of debating issues related to macroeconomics and finance, as it already has. So that is my view of the natural progression of these regional groups over the coming years, but it may take some time for all of that to shake up.

**APEC and Delivering Results** – To the question of whether APEC is on its last legs, I also take Fred’s point that institutions do have their own inertia and they can continue even if they’re not accomplishing as much as they might. But I would like to be a little less sanguine about APEC because if it doesn’t perform, it could be the first victim on this list of organizations because it is a voluntary, mission-oriented organization.

APEC could drop by the wayside either by not accomplishing anything, or if at some point its mission were deemed accomplished. If we had a Free Trade Area of the Asia Pacific pact, then APEC might not be regarded as quite so necessary. That’s the way I’d like to see APEC graduated to the heaven of regional organizations, because that would occur after everything on its plate has been fulfilled and achieved.

**Morrison**

**Asian Imperative** – Thank you very much. I think what the panel has really illustrated is the imperative behind your architecture. The countries of Asia need cooperation among themselves to have stable and healthy economies.

The economies across the Pacific need to have cooperation to deal with some of these very big issues like the imbalances. This is how they would demonstrate global leadership. I think that’s really the function of APEC to make sure that the cooperation continues.

**Closing Comments** – I want to thank the panel very much for their toil and work, and I thank the audience for your thoughtful questions. We’ve had a very good meeting, a very informative meeting, which reminds me of the rich agenda that we have in PECC.

**Wanandi**

**Closing Comments** – I would like to thank you all for being with us for the day-long program. Thank you especially to the students and the younger generation who have been with us for the whole day and we are looking forward for your participation in the future.

Again, I would like to thank the East-West Center and the US Asia Pacific Council for organizing a very effective and efficient conference. Last, but not least, I would like to thank Charles for taking up the challenge of hosting another PECC General Meeting in Washington, DC.

**Morrison**

Special thanks also to the PECC Secretariat staff — Eduardo Pedrosa, Jessica Yom, Zakiah Kassim, Betty Ip, and Nor Irdawaty. This meeting could not have happened without your invaluable help.

Thank you PECC Delegates and audience members, and have a good day.
The Pacific Economic Cooperation Council (PECC)

PECC is a track-two, tripartite organization in the Asia-Pacific region composed of senior individuals from business and industry, government, academic, and other intellectual circles. All participate in their private capacity, and thoughtfully discuss and consider areas of cooperation and policy coordination aimed at promoting economic growth and development in the Asia-Pacific region.

PECC was founded in 1980 because of the need to facilitate policy dialogues among the economies of this region, which were becoming increasingly interdependent. There are currently 26 Member Committees, including two institutional members, the Pacific Trade and Development Conference (PAFTAD) and the Pacific Basin Economic Council (PBEC), and one associate member, the France Pacific Territories National Committee for Pacific Economic Cooperation (FPTPEC). PECC’s regional community-building efforts led to the establishment of the official APEC process in 1989. The Council is one of the three official observers of the APEC process. PECC has provided information and analytical support to APEC ministerial meetings and working groups. Also it channels and facilitates private sector participation in the formal process.

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