The Asia-Pacific Economic Cooperation Forum

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APEC in 2014

Meeting New Challenges

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The Asia-Pacific region represents 40 percent of the world's population, 50 percent of global GDP, and 44 percent of the world's trade, which includes the three largest global economies—the United States, China, and Japan—as well as some of the most high-potential and dynamic developing economies. The region clearly stands in the center of global economic developments and other affairs. Unlike the EU, the Asia-Pacific region finds its own way in the realm of regional community building. APEC is a unique regional grouping that brings together developing, newly industrializing, and advanced industrial economies into one regional framework. Under this framework, all members are committed to reducing barriers to trade and investment and enhancing economic and technical cooperation following the approach of concerted unilateral and collective actions.

As APEC provides a framework for bringing all members together to work on shared interests, and especially as it provides an annual meeting opportunity for leaders in the region to exchange ideas about policy concerns and pressing challenges, all members realize its importance. Although APEC faces difficult issues, it is still an irreplaceable institution for the Asia-Pacific region. APEC has been strongly backed by member governments and business communities, and it continues to

be a pivotal platform to conduct policy dialogue, to initiate agendas, and even to test new ideas in economic and trade cooperation, including on various global issues.

The Asia-Pacific economies are highly integrated and interdependent, which is based on their open development strategy and supported by production networks of active trade and investment flows. The agendas of liberalization, facilitation, and cooperation under the APEC framework represent the common will of the member economies to strengthen regional integration and cooperation for sustainable economic development and prosperity. The Bogor Goals, which were set up in the early 1990s, aim at realizing an open and cooperative region in the Asia Pacific. As stated by APEC leaders at their first meeting on Blake Island, Seattle, in 1993, "The spirit of openness and partnership deepens, enabling us to find cooperative solutions to the challenges of our rapidly changing regional and global economy." Although great progress has been achieved in regional economic integration, and production networks continue to expand, the first phase of the Bogor Goals—realizing the commitments to liberalization and opening up to all APEC members by 2010—has not been achieved. In facing the new environment of emerging FTAs, the role of APEC and, especially, the means for achieving the Bogor Goals have been questioned.

APEC enters its new phase of development, and it needs to have its priorities and agendas readjusted to meet the new challenges. Currently, the Asia-Pacific region is also facing some vital challenges: the lingering impact of the 2008–2009 global financial crisis, the need to rebalance and restructure the supply-demand chains, the impact of climate change, and the need for sustainable development, as well as emerging tensions of security and international relations, among other issues. The major challenge for the Asia-Pacific region now is sustaining economic dynamism by further concerted commitments and actions in the areas of macroeconomic policy, economic restructuring, financial reforms, and the development of green economic sectors. APEC should become more active and effective in dealing with the impact of the financial crisis, reforming the international financial system, and implementing domestic reforms of both financial and economic structures. APEC should show that it values its original mission to help the member economies realize

sustainable growth by improving their policies and strengthening cooperation. APEC's credibility lies in its strong role promoting change and reform that creates a more balanced economic development model and structure, while maintaining an open and integrated region.

In the face of slow progress implementing the commitments required to realize the Bogor Goals, further efforts were made by APEC to facilitate enforcement in the past years. For example, the 2001 Shanghai Accord, which aims to broaden APEC's long-term vision, sought to clarify the roadmap to the Bogor Goals and strengthen the implementation mechanism; the 2005 Busan Roadmap was set up as a midterm stocktaking of progress toward the goals; and, again, the 2006 Hanoi Plan of Action identified specific actions and milestones needed to implement the goals. However, in facing the emerging FTAs, both bilateral and subregional, APEC's role in binding the regional framework together seems very weak.

Looking back at the APEC agenda, the priority used to be one of guiding all members to keep markets open and to improve policy and business environments. APEC should continue to play this major role. As recommended by the APEC Business Advisory Council (ABAC), "a new vision is needed." In a set of recommendations for APEC trade ministers that were created in Sapporo, Japan, on June 1, 2010, the council urged APEC to build on the Bogor Goals to "reflect the changing nature of modern Asia-Pacific regional supply chains and value chains." It is clear that APEC needs to readjust the approach and roadmap of the Bogor Goals.

The diversified efforts of APEC members to develop FTAs pose major challenges to the APEC-led process of regional integration and cooperation, a process whose most significant value is to bring the region together and share prosperity. In the past, APEC has tried to coordinate the existing, complex "spaghetti bowl" of free trade agreements into a more consolidated framework. For example, in 2004, APEC adopted best practices for regional trading agreements (RTAs) and FTAs, which consisted of "model FTA/RTA chapters." APEC has also implemented many initiatives, which range from self-certification of rules of origin (ROO) and a supply chain connectivity framework (SCCF) to public-private partnerships (PPP) and capacity building.

The Trans-Pacific Partnership (TPP), led by the United States with 12 negotiation partners, has brought about serious challenges to all these efforts. The TPP was initiated by four small and open economies (Singapore, Chile, New Zealand, and Brunei). As it extended to more members and became a key strategy for the United States to achieve a high-standard FTA for the twenty-first century, APEC's principles of open regionalism and its gradual approach seem to be abandoned.

However, it is not realistic that the TPP can become an alternative to a Free Trade Area of the Asia-Pacific (FTAAP), or to upend the Bogor Goals. The TPP may attract more economies, but it will not include all APEC economies in the final negotiation process. APEC, on the other hand, is by nature diverse, and provides a flexible and inclusive institution for all of its members.

To keep the region integrated and dynamic, it is vital for APEC to emphasize its role as an intergovernmental dialogue and cooperation mechanism. While a region-wide FTA in the Asia Pacific is of pivotal interest to all members, APEC could readjust its approaches and priorities on other broad agendas. These include connectivity, clean energy, climate change, supply chain, and Phase II tariff reduction of green products. Functional cooperation becomes a key factor in APEC's ability to successfully promote these broad goals.

In facing a multitude of diverse FTAs, especially large groupings such as the TPP and the RCEP, APEC leaders have reemphasized the Bogor Goals in their annual declarations made since 2010. The leaders have reaffirmed their desire to realize the Bogor Goals by 2020, and to work out a blueprint for doing so. This shows that the Bogor Goals are still serious political commitments by the 21 economies of APEC. Considering that 2014 is the twentieth anniversary of the Bogor Goals, it may be a good time to establish a working group to develop a blueprint for the FTAAP. As stated in the leaders' declaration, the FTAAP will be built upon ongoing regional undertakings, such as ASEAN-Plus-Three, ASEAN-Plus-Six, and the TPP. However, if the FTAAP is an APEC-led agenda, APEC will need to change roles from being only a forum to actively urging all members to participate in the negotiations. Some members may not agree to this change. As to the approach that should be taken to create an FTAAP, simply merging the TPP and the RCEP

together seems unfeasible, given their differences. One of the more practical approaches may be to think of the FTAAP as a general framework covering liberalization, facilitation, and cooperation, with differential processes and arrangements.

China has actively participated in all APEC agendas, since the Asia-Pacific region is of great importance both in economic terms and in terms of international relations and security. APEC engagement has been essential for China, as it provides a broad regional framework on the one hand, and a gradual approach on the other.

China adopted an active FTA strategy after joining the WTO. FTAs help China not only achieve market access, but also make rules and align interests among members. FTA agreements, either bilateral or subregional, give China opportunities to forge close partnerships through broad frameworks for market liberalization and cooperation. Immediately after joining the WTO, China took the initiative to establish the China-ASEAN FTA (CAFTA), and then played a leading role in the East Asia FTA (EAFTA, or ASEAN-Plus-Three) feasibility study. The China-ASEAN FTA helps to create a comprehensive framework between China and ASEAN members, which facilitates trade and other economic relations significantly. China now serves as the largest market for ASEAN's external trade, and many cooperative programs have been implemented, from enhanced trade with GMS (Greater Mekong Subregion) economies, to infrastructure connectivity, to capacity building for human development. China hopes that East Asia will establish a region-wide FTA, initially under the framework of ASEAN-Plus-Three (China, Japan, and South Korea). However, due to complex factors, consensus seems difficult to achieve among the ASEAN-Plus-Three members on how to establish a single institutional framework in East Asia.

Actually, regional integration and cooperation in East Asia is characterized by multilayered frameworks, including ASEAN-Plus-One, ASEAN-Plus-Three, and ASEAN-Plus-Eight (East Asia Summit). In 2011, ASEAN initiated the Regional Comprehensive Economic Partnership (RCEP) as an integrated FTA framework among the ASEAN-Plus-Six economies (China, Japan, South Korea, India, Australia, and New Zealand). China quickly adjusted its policy and has actively engaged

in negotiations of the RCEP, while at the same time continuing to participate in the trilateral FTA among China, Japan, and South Korea.

In general, multilayered frameworks give China more flexibility and room to maneuver. On the one hand, China is a leading exporter with special advantages in various areas of production, but on the other hand, it is still a developing economy. As such, China finds it difficult to conclude FTAs with many of its trading partners, especially with the developed economies. In fact, the TPP has presented a serious challenge to China's FTA strategy. Since the initial round of TPP negotiations excludes China, there is worry that the TPP will intentionally be designed to bypass China. This puts China in a difficult position. The exclusion creates concern that it is not playing a role in the rule-making process, and that the new rules will have negative effects on China's trade and investment with TPP members. Although China keeps an open attitude about the TPP, it was unable to surmount the difficulties of becoming an early negotiation partner, given that the TPP has been labeled a high-level FTA for the twenty-first century, with little flexibility for entering.

As China has vital interests in the Asia-Pacific region, it sees APEC as a unique platform to engage the United States and all other members of the region. China is organizing the APEC meetings in 2014, which it sees as a good opportunity to get APEC back on the right track. China hopes that the 2014 meetings might serve as a launching pad for the FTAAP process, although consensus will be difficult to reach, especially as the TPP is struggling to conclude and the RCEP is still in the early stages of negotiation.

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US Economic Strategy in the Asia-Pacific Region

Promoting Growth, Rules, and Presence

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INTRODUCTION

Economics is at the heart of US engagement in the Asia-Pacific region. This statement is as true today as it was in 1784, when the first US merchant ship set sail from New York bound for Canton; or in 1853, when Commodore Perry arrived in Tokyo Bay in his "black ships," seeking not territory but refueling rights for the American whaling fleet.

A few statistics make clear why the United States is drawn to Asia today. The 21 member economies of the Asia-Pacific Economic Cooperation group (APEC) account for roughly 55 percent of global GDP and 44 percent of world trade.[1] According to the International Monetary Fund (IMF), developing Asia is expected to grow by an average of 6.7 percent in 2014, making it the fastest-growing region in the world.[2] US exports to APEC economies totaled nearly $1.2 trillion in 2012, accounting for over half of total US exports.[3]

Economic exchange with this dynamic region makes a vital contribution to US growth and jobs. In the wake of the financial crisis of 2008–2009 and resulting shifts in the structure of the US economy, exports to the Asia-Pacific region have become an increasingly important source of demand and employment. By one estimate, roughly 2.8 million American jobs were supported by exports to Asia in 2012.[4]

With this much at stake, it is not surprising that the United States has been an active participant in Asia-Pacific economic integration efforts over the past 25 years, going back to the decision of the George H.W. Bush administration to co-found APEC in the late 1980s and seen today in the Obama administration's focus on completing a Trans-Pacific Partnership (TPP) trade agreement. Linking these efforts over the years, and the subject of this paper, are a number of common objectives and characteristics that distinguish the American approach to regional economic integration from that of other economies in the region.

US ECONOMIC POLICY OBJECTIVES IN ASIA

In designing and implementing economic policy toward the Asia-Pacific region, recent US administrations have been animated by three broad objectives: promoting growth and jobs; strengthening the global rules-based system; and underpinning America's long-term presence in the region.

The first priority is growth. As mentioned above, the Asia-Pacific region is one of the world's largest and most dynamic economic areas. It is an increasingly important source of demand for the global economy. Stronger demand and greater purchasing power in Asia mean (among other things) more US exports to the region, which are an important source of growth and jobs at home.

For more than 30 years, successive US administrations have worked to promote strong domestic-demand-led growth in the major surplus economies of Asia. Japan, then the world's second-largest economy, was the initial target of this policy in the 1970s and 1980s, but attention has broadened in recent years to other large, growing economies with persistent current-account surpluses, notably China. With US and European

consumers and governments alike forced to borrow less and save more in the wake of the 2008–2009 financial crisis, Washington argues that large surplus economies need to consume and import more, or global growth will suffer. This is why the Obama administration has made "strong, sustainable, and balanced growth" the mantra of its policy engagement with China and other large Asia-Pacific economies in both the G-20 and bilateral channels.

United States trade policy has also supported the macroeconomic growth agenda. Recent administrations have pursued an active trade agenda in the region, including President George W. Bush's negotiation of a Korea-US free trade agreement (commonly known as the KORUS FTA) and the Obama administration's launch of the TPP negotiations. Enforcement of existing trade agreements has also been an increasingly important feature of trade policy in the past two administrations. A core objective of all these efforts has been to reduce barriers to US exports, enhance America's own competitiveness, and boost growth and jobs at home.

Regional trade policy also supports the second broad objective of US economic strategy in Asia: upholding and updating the rules of the international economic system. As discussed further below, the TPP (like its sister negotiation launched this year with the European Union, the Transatlantic Trade and Investment Partnership, or TTIP) is aimed at establishing "twenty-first century" trade and investment rules. These cover not only tariffs and other border measures, but also behind-the-border conditions governing trade and investment, such as intellectual property protection, regulatory transparency, labor and environmental standards, and competition.

As a region representing roughly half of global GDP and trade, the Asia Pacific is an important testing ground for developing and implementing these new rules. After a decade of failing to conclude a comprehensive, multilateral agreement under the Doha Development Round, the United States and willing trade partners have been forced to pursue other more targeted approaches, including mega-regional agreements like the TPP and the TTIP. The hope is that, if successful, these agreements will become the de facto template for a new multilateral system of rules.

The third consistent objective of US economic strategy in the Asia-Pacific region is to support a long-term American presence in the region. The United States is a Pacific power by nature (geography) and necessity (the pull of historical, security, and economic forces)—but also by design. Successive administrations since World War II have worked deliberately to embed the United States firmly in the region through an array of political, security, and economic arrangements.

The US network of alliances in the region—with Japan, South Korea, Australia, and others—and the troops and ships deployed in support of those alliances are the most visible manifestation of that policy. Binding trade arrangements like the KORUS FTA and the TPP can be seen as the economic equivalent of America's security alliances in the region. That is, they enmesh the United States in regional affairs through expanded trade and investment and give Asia-Pacific economies an increased stake in each other's prosperity and security.

REGIONAL ECONOMIC INTEGRATION: THE US APPROACH

In support of all three objectives described above—growth, rules, and presence—recent US presidents going back to George H.W. Bush have invested in Asia-Pacific regional economic integration (REI). Bush's secretary of state, James Baker, embraced his Australian counterpart's proposal to create APEC in 1989 as a venue for foreign ministers from the region to discuss trade and investment liberalization and capacity building. President Bill Clinton invited his APEC counterparts to a summit on Blake Island off Seattle in 1993, giving the forum's REI mission top-level political imprimatur. George W. Bush launched and completed the KORUS FTA negotiations and initiated the TPP at the end of his term. President Barack Obama renegotiated KORUS and passed it through Congress, then embraced and launched the TPP negotiations.

Washington's approach to REI in this region has been marked by two key characteristics that distinguish it from approaches championed by other economies: it is trans-Pacific versus Asia-centric; and it emphasizes high standards of liberalization and rule-making.

The first characteristic is driven first and foremost by the fact that the United States is a Pacific but not an Asian economy. But higher-level policy considerations also play a part. In pushing APEC to the fore, Secretary of State Baker was clearly animated by concerns about East Asian aspirations for community building that would exclude the United States; he later noted that such efforts would "draw a line down the middle of the Pacific."[5]

The second distinguishing feature of the US approach to REI is a preference for comprehensive trade and investment liberalization and high-standard rules of the road. This has inspired Washington's approach to APEC since the inception, but took on new substance with the launch of "twenty-first century" treaty negotiations with South Korea and the TPP partners. Both the George W. Bush and Obama administrations have insisted on the broadest and deepest possible liberalization and state-of-the-art disciplines on trade and investment-related policies, both at and behind the border. By contrast, Asia-only integration initiatives, including bilateral and subregional FTAs, have generally covered only border measures, with numerous exceptions to full liberalization.

Both economic and political considerations lie behind this second feature of US regional integration policy. Washington believes that removing most impediments to trade and investment and imposing tough rules of the road maximize economic efficiency and growth. It feels that the narrower and "shallower" agreements reached to date in Asia have done little to improve efficiency and may cause trade diversionary effects that outweigh their trade-creating benefits.

Of course, the persistence of its own market-access restrictions on imports of some agricultural and other sensitive items shows that Washington does not always practice what it preaches with regard to high standards. This highlights the role of domestic politics in US REI policy: to win congressional support for trade agreements it has negotiated, the White House must achieve the best possible results for US export interests, uphold US labor and environmental standards, and minimize the damage to domestic vested interests. Washington's insistence on high standards in the negotiating room to a great extent reflects these political realities back home.

THE TRANS-PACIFIC PARTNERSHIP

The priority that Washington places on negotiation of a TPP trade agreement illustrates the objectives and characteristics of US economic strategy enumerated above. The TPP's three-part purpose is to stimulate American growth and jobs, strengthen the rules of the regional (and global) trading system, and lock the United States more deeply into regional affairs. As its name and membership suggest, it is trans-Pacific in nature, incorporating most of the Pacific-facing economies of the Western Hemisphere, as well as a number of Asian economies. And it is explicitly designed to produce, as President Obama said in announcing his embrace of the TPP in late 2009, "the high standards worthy of a twenty-first century trade agreement."[6] In addition to lowering border barriers such as tariffs, the TPP aims to establish disciplines on an array of behind-the-border measures that impede trade and investment, such as excessive or nontransparent regulation; preferences for domestic, especially state-owned, enterprises; and inadequate intellectual property protection.

As this author has argued elsewhere, a number of myths cloud regional perceptions of the TPP.[7] One is that the negotiations are "splitting Asia," since not all Asian economies are eligible to join, while those that are eligible must choose between joining the TPP, which is viewed as being led by the United States, and the Regional Comprehensive Economic Partnership (RCEP), which is preferred by China. Yet in principle, the TPP is open to any APEC economy willing to strive for high-standard rules; indeed, US strategy from the outset was to begin the negotiations with a small group of "like-minded" economies and to incentivize others to join over time—a strategy that is ostensibly working. Conceptually, there is no reason that even non-APEC economies like India and Myanmar should forever be excluded; in fact, the logic of the US-ASEAN Expanded Economic Engagement (E-3) initiative is to help all ASEAN economies meet the high standards being sought in the TPP.

As for having to "choose" between the TPP and the RCEP, the seven Asian economies participating in both tracks clearly view the two approaches as not mutually exclusive. And as discussed further below, the TPP and the RCEP could one day converge in a region-wide agreement,

or at least become interoperable, with enormous potential gains to world income.

Another myth that until recently was popular in Beijing is that the TPP is part of an effort by Washington to "contain" China. Yet no Asia-Pacific economy—including the United States—wants to exclude China from regional economic integration; on the contrary, all want to deepen their economic ties with that economy. True, one goal of the TPP is to create a level playing field that, among other things, allows other economies to better compete with China, but this is a far cry from "containment." Over the past few months, elite opinion in Beijing has shifted noticeably from rejecting the TPP outright to seeking a better understanding of it; indeed, there are some signs—such as Beijing's embrace of a comprehensive bilateral investment treaty (BIT) with the United States and its launch of the Shanghai Free Trade Zone—that China's leadership is preparing the ground for eventual membership in a high-standard regional agreement.

A third myth is that the high standards that Washington is espousing in the TPP are too ambitious for Asia. Yet all participants—including less-advanced members like Vietnam—have made clear that they believe there are substantial welfare gains to be had from a high-standard agreement that opens up new market opportunities and helps each economy address structural impediments in its own system. Moreover, participating economies understand the political dynamics in Washington that, alongside the economic benefits, drive US ambition in the talks. And most welcome an active US role in championing high-standard rules and norms in the region.

The prospect of an early conclusion of the TPP negotiations remains very much in doubt. Although most of the agreement's 29 chapters have been closed, by all accounts significant differences remain on a number of challenging issues, notably intellectual property, competition, and environmental standards, as well as the market-access provisions.

One of the greatest sources of uncertainty is whether the Obama administration will be able to persuade the US Congress to support a final agreement without so-called trade promotion (formerly "fast track") authority, which is traditionally required to provide the political clarity US negotiators need to close trade deals. Although there is a clear

majority in favor of trade liberalization in Congress—including among "Tea Party" members—there is concern that not even broadly supported legislation could pass Congress in the current environment of mutual distrust and dysfunction.

However, negotiators in the talks themselves report a shared sense of urgency and determination among all participating economies to complete the agreement quickly, and a basic accord in the next few months remains possible. Trade negotiations are always darkest before the dawn, as differences are narrowed to the most politically difficult issues. But insofar as they involve political rather than technical decisions, the final deals can be done quickly if the will is there.

The stakes could not be higher for the Obama White House. Conclusion of the TPP is the sine qua non of success not only for the administration's regional economic policy, but also, arguably, for the broader strategy of "rebalancing" toward the Asia-Pacific region. In addition to its economic benefits, a successful agreement would anchor the United States more firmly in the Asia Pacific and bolster American leadership there. Without the TPP, the rebalancing strategy would contain little of substance that is new.

THE PATH TO FTAAP

The parallel negotiation of two major regional trade agreements in the Asia-Pacific region—the TPP and the RCEP—raises the prospect of harmful trade diversion and a patchwork of inconsistent rules that could hamper rather than facilitate regional economic integration. This concern is heightened by the plethora of other arrangements being negotiated in the region, including the trilateral China-Japan-Korea FTA.[8] Competition between the different tracks could also accentuate geopolitical strains in the region as economies line up in one economic camp or another.

A more benign interpretation of these trends is that the various trade agreements under negotiation are not mutually exclusive and may eventually converge at the broader APEC vision of a Free Trade Area of the Asia-Pacific (FTAAP). Petri et al. have shown that the potential

economic benefits of such a region-wide agreement are enormous, with annual global income gains on the order of $1.3 to $2.4 trillion by 2025.[9]

Full convergence of the TPP and the RCEP may be impossible given their different scope and the varying standards each will produce. However, there may be ways to harmonize important parts of the two agreements that would make them interoperable in practice.

As argued in a recent Center for Strategic and International Studies (CSIS) report, common rules on value-chain management would be one promising place to begin.[10] The emergence of global value chains as the defining feature of twenty-first century trade and investment patterns—in which a product idea is conceived in one economy, inputs are procured and produced in others, assembly occurs in yet another, and the final product is shipped and marketed around the world—has fundamentally altered the stakes in trade negotiations. Rather than bargaining primarily for market access for their goods and services exports, economies must also ensure unrestricted value chains, i.e., the smooth flow of investment, technology, and inputs across and behind borders.

All of the regional arrangements under negotiation, including the TPP and the RCEP, will likely cover an array of value-chain disciplines, including logistics procedures, services and investment liberalization, and information/communications technology facilitation. Consistency and high standards across these efforts would facilitate regional integration and promote better economic outcomes. One major report has estimated that, were all countries to reduce value-chain barriers in a few key areas even halfway to established best practices, it could boost global GDP by $2.6 trillion.[11]

As the oldest and arguably most successful forum for trade and investment integration in the Asia-Pacific region, and one that works by nonbinding consensus, APEC could serve an important role in facilitating value-chain harmonization. Since adopting the Bogor Goals of free trade and investment in 1994 and in its more recent FTAAP vision, APEC has served for a quarter century as an incubator for regional integration efforts. As host in 2014, China has a unique opportunity to launch a process aimed at making the value-chain provisions of the region's numerous trade arrangements interoperable at a high standard.

APEC has so far focused specifically on key cross-border logistics issues in work programs on "supply-chain connectivity." For instance, APEC economies set a goal in 2010 of achieving a 10 percent reduction in the time, cost, and uncertainty of cross-border transactions by 2015. This has been important—and little heralded—work. The CSIS report recommends that China lead a broader initiative on value chains, building on APEC's existing work but incorporating a number of other policy issues along the value chain, including investment, data flows, and regulatory coherence.

CONCLUSIONS

From Washington's perspective, a successful economic strategy in the Asia-Pacific region is essential to sustaining American growth and jobs in the twenty-first century. It is also central to Washington's efforts to remain a champion of the international rules-based order. And it underpins America's long-term presence in the region, which in turn contributes importantly to the region's security and prosperity, and thus to America's own. For all these reasons, the United States is likely to remain an active—even impatient—participant in regional economic integration efforts, through APEC, the TPP, and other regional arrangements.

NOTES

1. US Department of State, "21st Annual APEC Economic Leaders' Meeting Fact Sheet," October 8, 2013.
2. International Monetary Fund, "World Economic Outlook Update," January 2014.
3. US Department of State, op. cit.
4. Scot Marciel, "Economic Aspects of the Asia Rebalance," Statement before the US Senate Committee on Foreign Relations Subcommittee on East Asia and Pacific Affairs, December 18, 2013.

5. Cited in Claude Barfield and Philip I. Levy, "Tales of the South Pacific: President Obama and the Transpacific Partnership," American Enterprise Institute, December 2009.

6. White House, "Remarks by President Barack Obama at Suntory Hall," news release, November 14, 2009.

7. Matthew P. Goodman, "Five Myths about TPP," CSIS, April 30, 2013.

8. According to the Asian Development Bank's Asia Regional Integration Center, there were 75 FTAs involving at least one ADB member under negotiation, and another 51 either proposed or under consultation and study, as of October 2013.

9. Peter Petri, Michael G. Plummer, and Fan Zhai, "The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment," Peterson Institute for International Economics, November 2012.

10. Matthew P. Goodman, Scott Miller, and David A. Parker, "Enhancing Value Chains: An Agenda for APEC," CSIS, November 2013.

11. World Economic Forum, Bain and Company, the World Bank, "Enabling Trade: Valuing Growth Opportunities," Geneva, 2013.

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Where to with Cooperation Across Asia and the Pacific Now?

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China's hosting of the APEC Summit in November 2014 is a timely opportunity to provide new direction to economic integration across Asia and the Pacific. In the past five years, the launch of the Trans-Pacific Partnership (TPP) negotiations (organized in APEC's backyard by the United States) and the Regional Comprehensive Economic Partnership (RCEP) (organized under the umbrella of ASEAN) have dominated thinking about regional integration. In APEC, some still believe that these initiatives might provide the foundations for a broader regional free trade agreement, a Free Trade Area of the Asia-Pacific (FTAAP). This is a pipe dream that diverts policy energy and attention away from a more important agenda for APEC: to encourage national reforms behind the border and build connectivity and deeper integration among the Asia-Pacific economies. Transregional free trade agreements like the proposed TPP may be small steps along the way, but they are incidental to the main APEC game and what needs to be done to achieve free trade and integration across Asia and the Pacific.

THE MAIN GAME FOR APEC

There are three big goals that APEC can achieve in Beijing in November. The overarching APEC objective for 2014 is to raise the vision of economic cooperation in the Asia-Pacific region beyond the preoccupation with a narrowly defined concept of free trade, and to work toward realizing the full potential of the region. APEC needs to pursue three vital, interrelated dimensions of cooperation:

- ensuring the global environment needed for sustained growth;
- encouraging the efficient structural transformation of Asia-Pacific economies;
- fostering regional economic integration.

Right now, the most important threats to realizing the potential of Asia-Pacific economies are global threats—including the still weak and uncertain recovery from the global financial crisis and global warming. The Asia-Pacific economies need to work to overcome these threats. Other important threats to continued growth and rising living standards are weaknesses in the structures, regulations and institutions of all APEC economies. The region has experienced steady growth and dynamism, which requires continuous structural change and adjustment.

The region's future is threatened by the erosion of respect for the core principles of the multilateral regime that underpin the successful management of trade and other international commerce. APEC, as well as the RCEP, should work to restore the centrality of the WTO, rather than try to replace it.

The Asian economies are already highly integrated. Their interdependence has grown under the global trading regime, not through bilateral or regional trading arrangements. Deeper regional economic integration remains a worthwhile first objective, but it involves more than pursuing mega-regional trade deals. The RCEP governments, for example, should not be content with negotiating a "single undertaking" for a trade deal, along the lines of the TPP. A comprehensive RCEP can aspire to be a model for an ultimately global set of principles-based rules for managing trade and many other forms of international commerce in the

twenty-first century. These rules should take account of the interests of all emerging economies, not just the currently most powerful. A first objective should be for APEC to lead the definition of those principles and rules.

A second objective is to ensure an effective follow-up of the 2013 commitment to the APEC Framework on Connectivity. Accelerating investment in the economic infrastructure needed to boost connectivity can contribute to all of the three dimensions of economic cooperation identified above. Driven by a determination to improve infrastructure, APEC can seize the opportunity created by the establishment of the Asian Infrastructure Investment Bank (AIIB). China's welcome decision to contribute to better regional infrastructure through the AIIB will more likely lead to success if the proposed multilateral development bank is positioned to reinforce the efforts of Asia-Pacific economies, which are implementing structural reforms in an effort to mobilize new external and internal funds for infrastructure development. It can also promote APEC's connectivity agenda. The participation of APEC members in establishing the facility and its mode of operation will also ensure that the AIIB's work achieves international best practice, that its funding is productively disbursed, and that there is a sense of regional and international ownership and participation.

There is a third goal, one that is a corollary to the infrastructure initiative. The time has also come to connect the economic architecture that has developed in APEC to the economic architecture that has emerged around the ASEAN-Plus-Six economies. The ASEAN-Plus arrangements in East Asia include both India and economies in Asia that are not members of APEC but are critical to enhancing Asia-Pacific integration, connectivity, and infrastructure across the region. It is important that these economies now be routinely engaged in dialogue with APEC leaders to build broader regional cooperation outcomes in a positive geopolitical environment. The organizational infrastructure and engagement that has been developed in APEC over the past 25 years will facilitate that. The question is how to achieve this objective, given the constraints on the expansion of APEC membership and the risks of undermining the value and centrality of the ASEAN-Plus arrangements. A way forward that can achieve this objective is set out below.

THE REGIONAL INTEGRATION AGENDA

Currently, the regional integration agenda is focused on transregional FTAs, and APEC's explicit goal is to ultimately achieve an FTAAP. This is a serious misdirection of APEC efforts and energy. Even if a region-wide trade deal could be achieved, after years of politically painful negotiations, it would not lead to the investments in infrastructure that can deliver greater gains in terms of regional economic integration. A 2013 study by the World Economic Forum (WEF) points to the huge potential gains of investment to improve connectivity, explaining that supply chain barriers to international trade are far more significant impediments to trade than tariffs. In fact, reducing supply chain barriers could increase world GDP over six times more than removing all tariffs.

The large number of bilateral FTAs signed to date have been useful at the margin, but they have not brought significant commercial or domestic reform in the region and, with the difficulties in concluding the Doha round, the hiatus in trade reform puts weight on making the most of region-wide trade initiatives. Region-wide trade initiatives should be used to pursue regional economic and political cooperation and to build a stronger global economic system.

In the field of geopolitical cooperation, tensions in Northeast and Southeast Asia over territorial and other issues threaten constructive cooperation and regional stability.

The rapid growth of trade and investment in East Asia was driven by unilateral trade and investment liberalization and opening up. This was the foundation for the deep integration that has emerged in Asia around the development of production networks and value chains. APEC was a leader in this. It was the forum that promoted concerted unilateral liberalization, including the massive liberalization by China in the lead-up to its accession to the WTO at the APEC Summit in Osaka in 1995. APEC also took leadership in laying the foundation for the Information Technology Agreement, and more recently, the Environmental Goods Agreement. These developments built the foundations of comprehensive Asian and trans-Pacific economic integration, and the beginnings of multilateral political cooperation that was no longer based on old hub-and-spokes security relationships.

Until recently, China was not ready or willing to take an active leadership role on issues at a regional or global level, but now appears able and ready to join a coalition for trade reform. While China should remain open to eventual participation in the TPP, a more effective way forward immediately will be through the ASEAN-Plus arrangements, which provide a framework for mobilizing middle powers to affect real change in regional institutions.

No single nation can significantly influence regional political or economic outcomes in bilateral dealings with any of the principal parties, though China has potentially more sway than any other. There is a greater prospect of shaping regional outcomes positively by mobilizing efforts at building regional political and economic cooperation among a coalition of players. Initiatives that seek to build an open Asian economic community through the RCEP could be encouraged, particularly those that entrench the rules and commitments that will sensibly need to be incorporated in the TPP, while also reinforcing its own goals through those mechanisms. A comprehensive regional cooperation initiative at this time would also encompass much broader strategic interests.

For the RCEP to effectively complement the TPP in this way, the overriding interest must be to shape the RCEP, over time, so that it sets sound principles-based rules for managing contemporary trade and other international commerce. If emerging economies in other regions see the merit of sound rules agreed upon by China, India, Indonesia, and other RCEP economies, those rules could form the basis for a global regime, rather than standard rules or rules set under other arrangements, including those under the proposed TPP.

The goal of a high-standard agreement would be to have developing economies commit to standards they aspire to reach in reasonable time frames, and not to exclude them and punish them for not starting with developed-economy standards immediately. China and other RCEP economies are absolutely integral parts of Asian supply chains, which are driving economic integration and growth in East Asia and globally. It is through these supply chains that the newer emerging economies in Southeast Asia and South Asia can join the globalization process and embrace the rules of an open trade and investment regime.

The RCEP involves more participants than the TPP, including all of Asia's main economies, such as China, Indonesia, and India. The RCEP is a way forward with economic cooperation, underpinned by the ASEAN-Plus framework, despite all the region's political problems. Bringing together the ASEAN-Plus-One trade agreements with Japan, China, South Korea, Australia and New Zealand, and India will be difficult even with ASEAN as the fulcrum. Pursuing negotiations in the same manner as the TPP or traditional FTAs would mean a long, drawn-out negotiating process. There is growing recognition that consolidating the Plus-One FTAs may be politically and technically very difficult. There is a palpable appetite in the region and beyond for new ideas on how to move forward with the many overlapping FTAs and the regional agreements that seem destined to become bogged down in low-productivity negotiations.

The RCEP is also a strategic opportunity to create a more favorable geopolitical environment in the region. It will need re-branding to engage high-level political efforts to that end, and it will need ramping up quickly around the ASEAN Economic Community (AEC) and Asian economic community conceptions of the RCEP.

A productive strategy is to see a streamlined economic cooperation agreement as one of several steps needed for ultimately achieving a RCEP that embraces a comprehensive agenda of regional economic integration, development, and political cooperation. This would parallel the strategy for creating the AEC. Upgrading of the ASEAN Free Trade Area (AFTA) of the 1990s to the more comprehensive ASEAN Trade in Goods Agreement (ATIGA) was one of the first steps taken to implement the AEC, alongside a broader program that included work to implement the Master Plan for ASEAN Connectivity. Negotiating an innovative umbrella FTA among RCEP participants could be pursued in parallel with the other steps needed to achieve deeper economic integration, regional development, and political goals.

RCEP participants should not have to wait until a "single undertaking" on trade liberalization, with a whole set of new rules, is agreed upon before seeking other opportunities for beneficial economic integration. It can strive to achieve significant initial commitments on trade liberalization and lock in progress toward ambitious end-point goals.

Institutional support for the several dimensions of economic integration to be pursued under the RCEP should be created as soon as possible. The thinking about how to do this has been well developed by ASEAN as it progresses toward the AEC, and is also consistent with the achievement of APEC's Bogor Goals.

In this conception, the most effective strategy to achieve these ambitions on the determined timeline will be a creative combination of agreed and binding targets for 2025; initial commitments (the down payment) negotiated by 2015; and further cooperation and negotiations to implement these targets by all members, starting from 2015 onward and conducted within the newly established institutional framework.

A strategy along these lines would address economic and political worries that are widely shared across the region. It would make it easier to involve India and other less-developed economies in Southeast Asia, contribute to connecting South Asia with East Asia, and deliver a major and successful mega-regional cooperation initiative. Ramping up the process would itself deliver significant improvements in the regional political environment. The achievement of real economic integration and cooperation across East Asia and South Asia, and its WTO principle-led delivery, can also present a way forward for dialogue (in the G-20, for example) on WTO reform.

The experience with the TPP and the RCEP prompts the question of how these and other regional and transregional trade and investment arrangements impact the global trade and investment regime. Whichever conception of progress on regional integration through negotiation prevails—through the RCEP or TPP—it is clear that the idea of the FTAAP, as traditionally conceived, will be irrelevant to the outcome. The FTAAP cannot be superimposed on what is already evolving across Asia and the Pacific through the TPP and RCEP efforts. These arrangements will be difficult, if not impossible, to unravel; they will determine the future shape of trade and economic cooperation throughout the Asia-Pacific region.

How should APEC, then, help shape the global outcome and the global regime? APEC, with its proud history of open regionalism and its vital interest in the WTO-based multilateral trading rules, should lead the way in answering that question.

What APEC could most usefully do is work to define the principles that should dominate the conclusion of transregional arrangements and shape reform of the WTO and the international investment regime. This will not be easy since APEC includes all the vested interests against change and reform of the international economic system. This reality, however, has not blocked creative policy innovation in the past. The formation of an APEC task force or eminent persons group to articulate a *global* strategy on trade and investment reform would be both timely and welcome and better secure free trade in Asia and the Pacific in its broadest sense.

THE INFRASTRUCTURE AGENDA

Promoting infrastructure investment is a priority in Asia and the Pacific for two reasons. The steady but fragile recovery of the global economy needs a boost of investment demand that will sustain productive growth in the longer term. Meeting the large deficit in infrastructure demand in the region is critical to the continuing growth and development of regional economies through deeper regional integration and connectivity.

Currently, very low rates of interest globally provide an excellent opportunity to invest in economic infrastructure that raises long-term productivity and serves to integrate economies with that objective. Members of both APEC and the G-20 are trying to accelerate investment in economic infrastructure for these reasons, but it will not be easy to go beyond declarations of good intentions and studies to actually achieve a significant boost in infrastructure investment.

Finance is not the immediate constraint. Economies with a sound, enabling environment for investment can mobilize financing for well-prepared projects that are expected to earn adequate economic rates of return. There are many viable projects, including ones that have been identified by the multilateral development banks, but the institutional and regulatory weaknesses in many economies delay bringing projects to fruition, if they get up at all.

Of course, the governments of individual economies bear the principal responsibility for improving policy environments and the capacity to

prepare viable projects. But there is scope for cooperation by coordination between groups such as APEC and the G-20, which can assist with infrastructure delivery. APEC is beginning to help regional governments to develop the necessary human capital and institutional capacity, and to overcome the policy and administrative obstacles to accelerating investments.

Improving the enabling environment and capacity to manage investments in infrastructure is essential, but it is not sufficient to guarantee success. A strategy to accelerate investments in economic infrastructure needs to complement policy development. Decisions to implement well-conceived infrastructure initiatives must be backed by a political commitment to solve problems in implementation. Experience is the most effective means of underlining the policy changes and institutional upgrading needed to expedite investment in subsequent projects.

The best example in the Asia-Pacific region is ASEAN's determination to create an ASEAN Economic Community. Southeast Asian governments are beginning to invest in the necessary transport, communications, and energy networks, with support from the ASEAN Infrastructure Fund.

APEC officials are drawing up a blueprint for a comprehensive upgrading of physical, institutional, and people-to-people connectivity among Asia-Pacific economies in line with their commitment to the APEC Framework on Connectivity approved by APEC leaders at their 2013 meeting. The next step might be to draw up an APEC Master Plan on Connectivity to translate the hopes set out in the blueprint into a pipeline of investments, backed by a serious, long-term process for working together to create essential skills and institutional capacity.

APEC is not, and should not become, a financing or implementing agency, so there is no established procedure for financing work in the APEC Master Plan on Connectivity, or for conducting feasibility studies for any regional initiative to achieve better connectivity. This problem could be overcome by support from the new Asian Infrastructure Investment Bank (AIIB), which is expected to be formally launched by China to coincide with its hosting of the APEC annual meeting in 2014. This work might be done in tandem with the Asian Development Bank (ADB) and the World Bank.

The new AIIB, open to shareholding by any government and by private investors, is designed to narrow gaps in the region's economic infrastructure. Helping to finance some of the investments needed to achieve the aims of the APEC Framework on Connectivity fits neatly into this mandate. It would be appropriate to commit a very small part of the AIIB's expected capital base to finance the preparation of the APEC Master Plan on Connectivity and feasibility studies of some pilot projects.

Short-term support would make it possible to launch the decades of capacity building and investment needed to create and sustain adequate transport, communications, and energy networks, as well as build institutional links among the Asia-Pacific economies. G-20 leaders could welcome these Asia-Pacific initiatives and draw them to the attention of others.

The G-20 can also lead the way to ensure that financing does not become a constraint to investment in economic infrastructure once more governments improve their ability to prepare and implement projects. G-20 leaders have already set up a working group, backed by expertise from several international organizations, to look for ways to tap global capital markets for investment in infrastructure on a much larger scale than now.

This working group will study alternative means to attract private savings, including public-private partnerships, bond issues, and lending for individual infrastructure projects, either directly to governments or intermediated through international financial institutions. This policy-oriented research is likely to raise new issues and policy challenges.

It is necessary to boost the capacity to attract investment by reducing the actual, and then the perceived, risk of investment in infrastructure in various economies. The most important determinant of that risk is the track record of governments—that is, the quality and predictability of their policy and institutional frameworks, combined with their willingness to invest public resources and to work with the private sector to anticipate and/or respond to the inevitable practical problems of upgrading infrastructure.

The share of private financing of investment in infrastructure will need to increase, but public sector investment will remain dominant and essential to leveraging finance from global capital markets. Policy development

to encourage private sector investment, therefore, needs to be complemented by work to identify when public investment in infrastructure is justified, and to ensure that the capacity of governments to borrow is assessed as objectively as possible. An announcement at the APEC Summit that the AIIB would help to embed public-private partnership (PPP) centres throughout Asia, including in China, would be a positive way of providing reassurance of this.

Individual or institutional private investors cannot be expected to acquire the expertise needed to estimate the potential benefits and risks of many specific infrastructure projects. The existing multilateral development banks were created to reduce the transaction costs of making these assessments, as well as to reduce the risks of these investments. But, at present, they are not making a significant contribution to the commercial financing of investment to upgrade or extend essential economic infrastructure, partly due to their limited financial capacity.

The establishment of the AIIB will spur existing development banks to consider expanding the financing capacity. The AIIB will create new competition for existing development banks. At the same time, the new bank will have a strong incentive to cooperate with them. Tapping into the expertise of banks that have accumulated knowledge and experience is the most effective way to build up the capacity of new international financial institutions. The APEC Summit is an excellent opportunity to launch the AIIB.

At their 2014 meeting, G-20 leaders can welcome the initiative to create the AIIB and encourage existing multilateral development banks to share information, experience, and expertise to help them succeed. Leaders can also ask the World Bank and other multilateral development banks to prepare strategy papers during 2015. These papers would set out how international financial institutions can step up their capacity for leveraging private sector finance for infrastructure, and how they could increase their own commercial lending to meet a much larger share of the financing needed to narrow gaps in economic infrastructure. These strategies should also recommend ways in which G-20 governments could help to overcome the current constraints facing multilateral development banks.

EVOLVING REGIONAL ARCHITECTURE

China's leadership of APEC in 2014 presents the opportunity to shape the evolution of more effective regional architecture. There is no quick fix to this, and there will need to be creative adaptations of the present regional architecture. The challenge will be to use established regional arrangements, within which there is a great deal of flexibility, to entrench gradual but purposeful change.

The first step would be simple. China can convene a high-level dialogue to connect the APEC forum to the East Asia Summit (EAS) membership around the APEC Summit. It is important to connect the premier regional economic dialogue (in APEC) to the political dialogue (that has been the character of the EAS). Bringing together economies in the ASEAN-Plus process that are not APEC members with APEC leaders is an initiative the APEC chair can take without broaching vexed membership questions. The rationale in organizing such a meeting around the Beijing summit would justifiably be the trans-Asian interest in China's infrastructure initiative and ASEAN centrality to regional cooperation principles.

The two economies in APEC most easily capable of affecting this kind of de facto architectural extension without fuss are the United States and China. China would obviously have to clear the way with the United States and explain the value of the initiative to other APEC and EAS members.

At the Vladivostok summit in 2012, the Russian Presidential Executive Office invited the Eurasian Economic Commission to join related meetings. What was important about this invitation was that the chairman of the Council of the Eurasian Economic Commission (the Customs Union's governing body) was given the opportunity to participate in APEC ministerial meetings, as well as others, during the summit week to explain the vision of a Eurasian Economic Union. This was a perfectly sensible and very strategic move, totally consistent with the spirit of APEC's open regionalism. And it helpfully opened the way to doing things rather differently in APEC. APEC's open and flexible framework can be routinely used in this way to connect with the EAS.

Some have argued that eventually there will need to be a choice made between APEC and EAS as to which venue the Asia-Pacific leaders would in future "strut their stuff." As a recent US Congressional Research Service report observes: "The Obama administration frequently has portrayed APEC as the premier economic and trade organization in the Asia-Pacific region, and views the EAS as the main geopolitical association in the region. This view is not shared by all of the other members of these two associations." But the Russians, without anyone much noticing, have opened an innovative new play. APEC can be transformed into a platform on which anyone with anything to contribute on economic cooperation can be invited to join.

As host in 2014, China can invite India, Myanmar, and other non-APEC members of the EAS to the APEC party to do important regional business, especially if it is connected to the summit's infrastructure agenda. Connecting India and Myanmar, this year's ASEAN chair, to such a meeting around the APEC Summit would be an important step forward in architectural evolution. This way of thinking about the APEC process is an effective game changer for welding the APEC and EAS processes together, and avoids the unnecessary choice of downgrading one or the other regional arrangement.

16

Placing Increased Priority on Services in APEC

Sherry Stephenson, Senior Fellow, International Centre for Trade and Sustainable Development

INTRODUCTION

Services sectors have a tremendous weight in modern economies. They account for two-thirds of world GDP, employment, and inward foreign direct investment (FDI), on average. Formerly, it was understood that services accounted for only 22 percent of world trade; however, when measuring trade in value-added terms, services constitute nearly 50 percent of global trade in goods and services since they are incorporated as inputs into the production of primary and manufacturing products, adding significant value.

In APEC, services have reached 67 percent of the region's GDP and 52 percent of its employment. Nevertheless, there is still high potential for increasing trade in services in APEC, as well as for diversification of the services that are traded.

Achieving this will depend upon enhanced services liberalization at the global level and, of course, at the APEC level. This paper argues that services should be a key priority for APEC members in order to promote connectivity and regional economic integration. There are several reasons

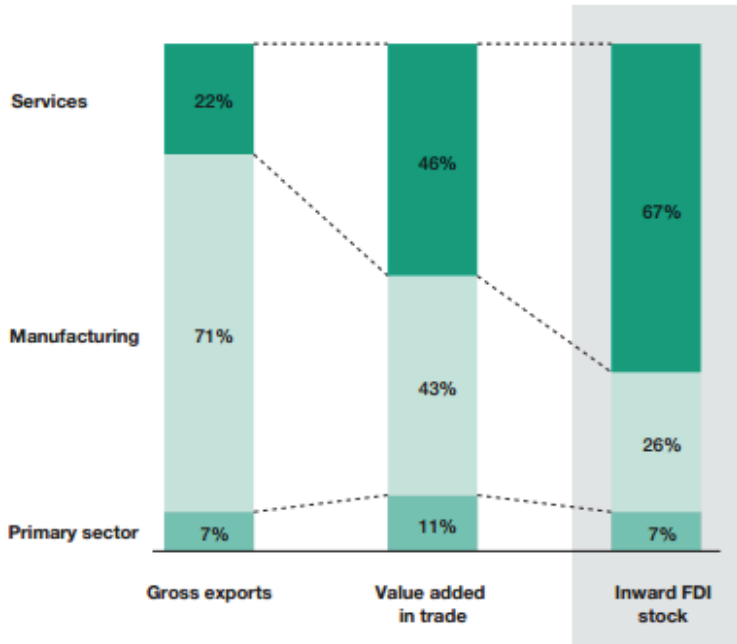
for prioritizing services. First, services are still the most restricted sector in APEC economies, which means that services liberalization would achieve the biggest trade gains for the region. Second, it is well known that efficient services account for the greatest productivity increases, with spillovers for all other economic sectors. Finally, services and investment are the two main areas that still constitute unfinished business from the Bogor Goals. Treating these issues at the regional level would be a plus, moving the region a step forward.

IMPORTANCE OF SERVICES AT THE GLOBAL LEVEL

Under traditional measurements of cross-border services trade, services are shown to account for around 22 percent of global trade. However, this percentage share does not take into account the share of services that goes into the production of goods, agricultural products, and natural resource products, and which are incorporated into the final value of these exports. A new understanding of the importance of services in international trade—and probably a more accurate one—is now available with the publication of the new WTO-OECD trade in value-added (TiVA) database. This takes into account the contribution of services as intermediate inputs, and can measure the value of intermediate goods and services as they cross borders before final products are completed, through the operation of global value chains (GVCs). The services that are both "embodied" and "embedded" in the production of the primary sector and manufacturing, as well as other services sectors, add much of their value. This is shown in Figure 1, where the weight of services in global exports is measured in both gross and value-added terms, and with the contribution varying from 22 percent to 46 percent. The actual importance of services in global trade in value-added terms is, therefore, more than double that of the traditional estimate. And services constitute fully two-thirds of the inward stock of foreign direct investment (FDI), a figure that continues to increase dynamically. This is particularly notable given the tendency of FDI to lead trade flows in modern economies.

This new way of understanding the role of services underscores its importance in goods trade as well, and highlights the fact that economies

wishing to strengthen their competitiveness in goods must also improve the productivity of their services sector, including liberalizing services trade and emphasizing regulatory reform.



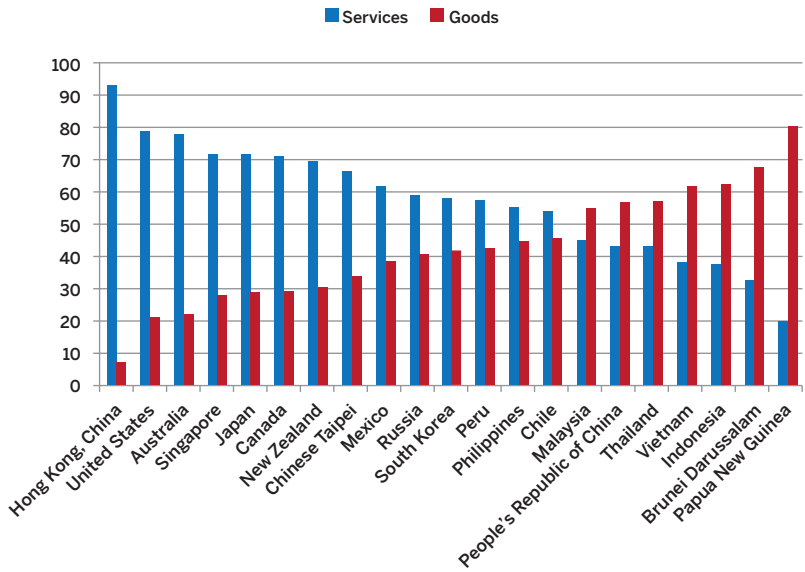
Source: UNCTAD-Eora GVC Database, UNCTAD FDI Database. Graph taken from UNCTAD, World Investment Report 2013.[1]

FIGURE 1 *Contribution of Services to Gross Exports, Value-Added in Trade, and Inward FDI Stock*

IMPORTANCE OF SERVICES IN APEC

Services are of great importance for APEC, accounting for 67 percent of GDP on average. Many APEC member economies demonstrate a much larger proportion of services in GDP, with Hong Kong and Singapore as the most services-intensive APEC economies (approaching 90 percent of GDP), followed closely by the United States and Australia at almost 80 percent of GDP. Services accounted for 52 percent of total employment

in APEC in 2012, and are estimated to be the largest driver of job creation over the next decade.[2]

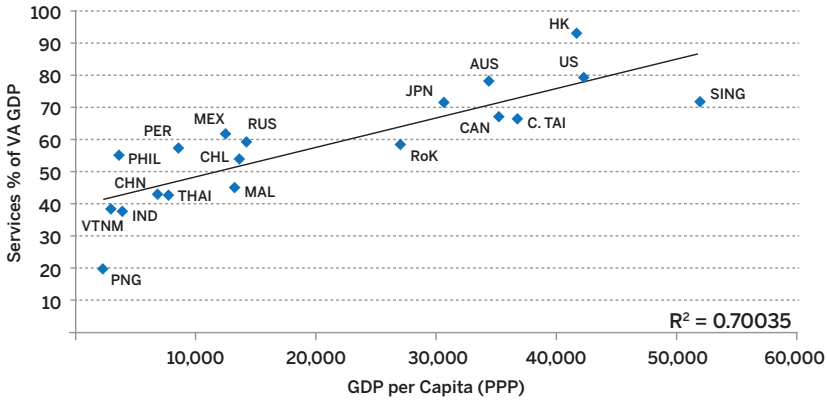


Source: USC and APEC, Trade in Services in the APEC Region, 2012.[3]

FIGURE 2 *Composition of GDP (Services/Goods) in APEC Economies*

It is interesting to note that there is a correlation between the contribution of services to GDP and the GDP per capita in APEC economies, as shown in Figures 2 and 3, with the more developed APEC economies showing higher services intensity. It has been noted by many trade analysts that increasing the density of services activities toward a greater "servicification" of the economic structure is associated with higher rates of economic development.

A greater services intensity, as measured by services as a percentage of GDP, can be shown to be positively correlated with GDP per capita of time, as shown in Figure 3. APEC economies have been moving toward greater services intensity in their productive structures over the past two decades.



Source: USC and APEC, Trade in Services in the APEC Region, 2012.[4]

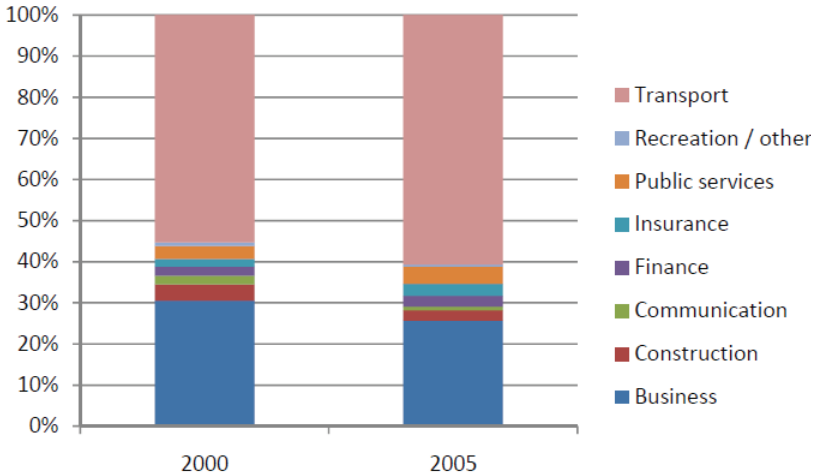
FIGURE 3 *GDP per Capita and Services Contribution to GDP*

Although individual APEC members have achieved high levels of services intensity in their economies, intra-APEC trade in services remains low in comparison with trade in goods. In 2010, only 6 percent of total services produced within APEC were exported, while 63 percent of total goods were exported.

Figure 4 shows that the majority of intra-APEC services trade tends to be in transport and in business services. All other services sectors (communication, finance, insurance, construction, recreation, etc.) show very modest amounts of intra-APEC trade and, therefore, still have a high potential for expansion.

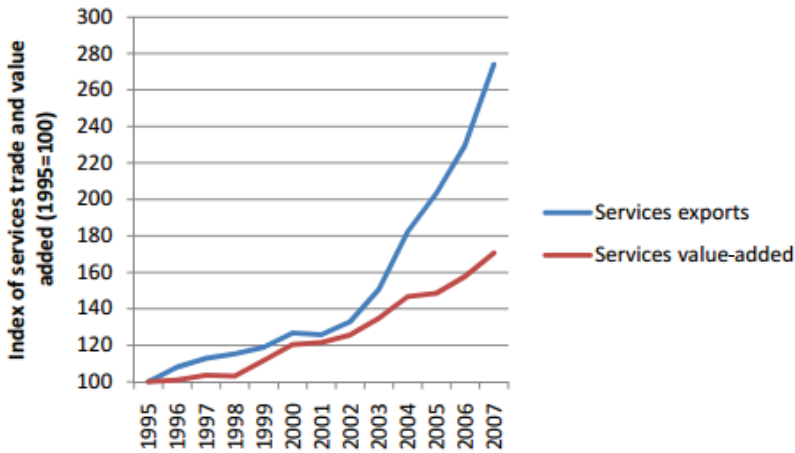
The following figure presents APEC services exports in gross terms and in services value-added terms, showing that services exports have increased at a much faster rate than services output since 2002. This tendency underlines the fact that the region is highly involved in the operation of global value chains (GVCs).

The new WTO-OECD trade in value-added (TiVA) database mentioned earlier divides the share of services in gross exports into three contributing sources: (1) direct domestic services industry, (2) indirect domestic services content, (3) services that were embodied in imported



Source: Trade in services database developed by Joseph Francois, 2009 and author's calculations. Graph taken from APEC Policy Support Unit, Trade in Services in the APEC Region, 2010.[5]

FIGURE 4 *Intra-APEC Trade in Services by Sectors*

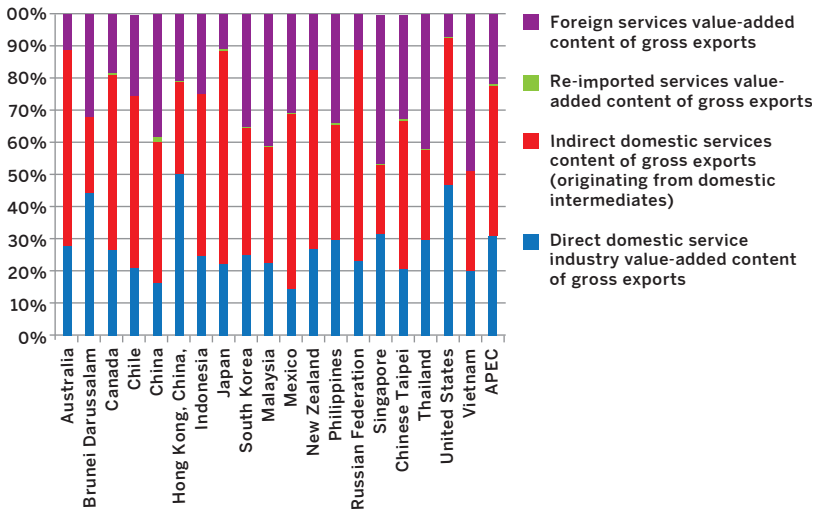


Source: World Development Indicators and author's calculations. Graphic taken from APEC, Trade in Services in the APEC Region, 2010.[6]

FIGURE 5 *APEC Services Exports and Value-Added (1995 = 100)*

intermediate goods, which can be either re-imported domestic services or foreign services content.

As shown in Figure 6, more than 20 percent of the services component of APEC exports comes from imported services that originate abroad, 30 percent from direct domestic services input, and almost 50 percent from indirect domestic services inputs that originate from intermediates. The value of re-imported domestic services value-added content of gross exports is extremely small.



Source: PSU computation based on WTO-OECD TiVA database. Data is for 2009, and APEC total does not include Papua New Guinea.
Graph taken from Pasadilla, "Taking Stock of Services-Related Activities in APEC," 2014.[7]

FIGURE 6 *Services Value-Added Component of Gross Exports*

On the services value-added spectrum, there are wide-ranging positions within APEC. The United States has the least amount of foreign content in its services exports, at less than 10 percent. In contrast, Singapore has the largest foreign content in its services exports, accounting for nearly 50 percent. The large share of domestic services content could be explained in different ways. This is partly a result of the remaining and

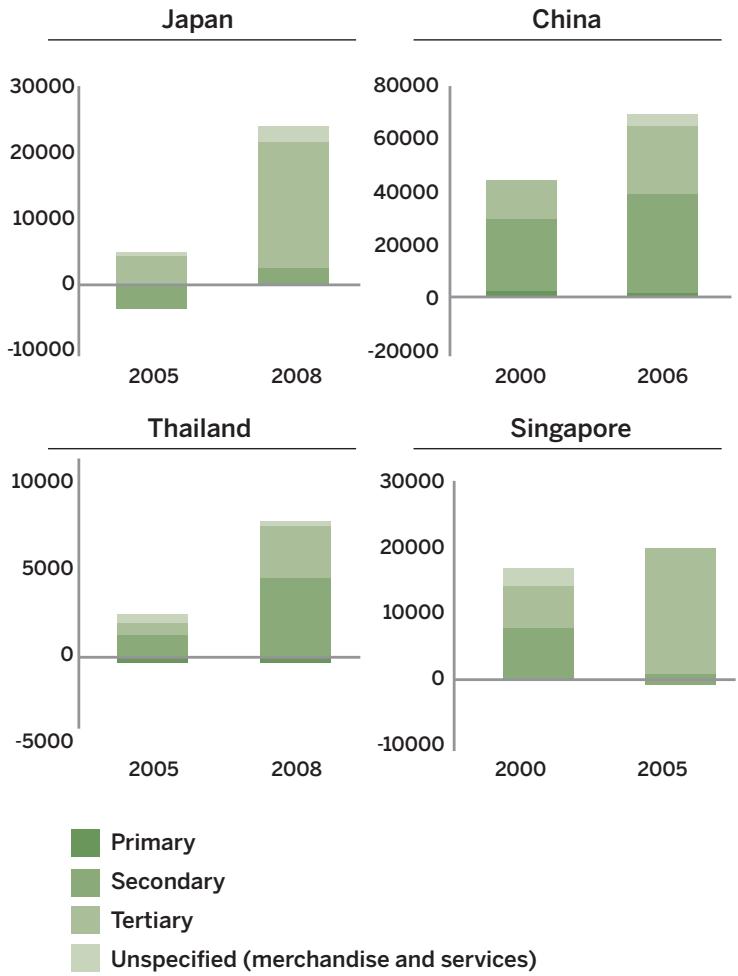
still significant barriers to services trade in many sectors, as well as to the fact that many services still require proximity between seller and buyer, giving preference for local service providers.[8]

Similar to what has been occurring in trade, or perhaps accounting for the change in trade patterns, FDI inflows in APEC have also increasingly shifted from manufacturing to services. Figure 7 shows that this is clearly the case for Japan, China, Thailand, and Singapore. Increased services FDI flows to APEC economies underline the growth of producer services that support global value chains, as services are the fastest area of growth for FDI flows in APEC.

IMPEDIMENTS TO SERVICES TRADE WITHIN APEC

Services trade tends to be highly restricted in many regions of the world. Liberalization of services trade is challenging, especially since this often has to do with the reform of regulatory structures and behind-the-border discrimination. As shown in Figure 8, all regions in the world—including the APEC region of East Asia and the Pacific—show relatively high indexes of protection in services, according to the World Bank's services trade restrictiveness index. This is especially the case for professional services and transportation. In East Asia and the Pacific, services trade is still highly restricted, with barriers to services trade much more significant in the five sectors canvassed than in OECD economies.

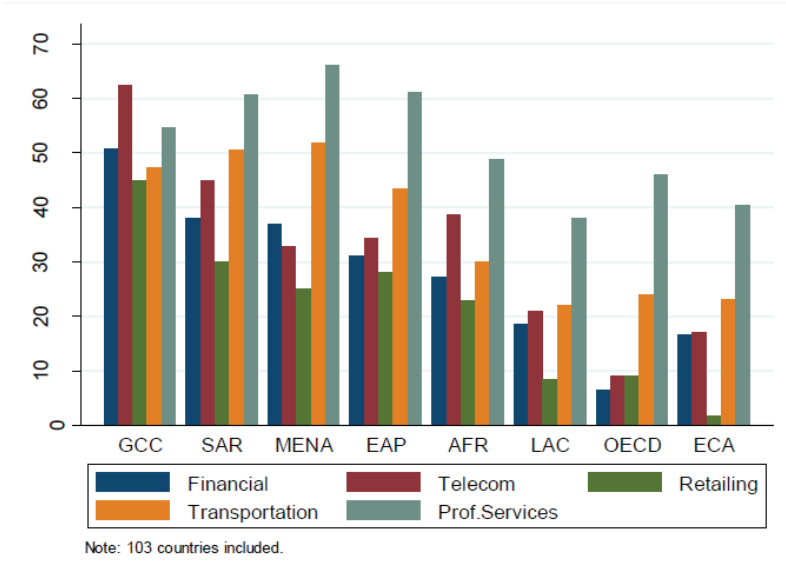
Behind-the-border barriers and impediments are the most significant problems for trade in services. Domestic regulations, industry standards, professional requirements, and efficiency of government agencies have a larger impact than market-access barriers. As Figure 9 from the USC Marshall School of Business report shows, the market-access restrictiveness index varies for the four services sectors that were canvassed in the study (retail and distribution, transportation, professional services, and financial services). However, the market-access restrictiveness on the whole tends to be less important than the other three barriers, which are of a regulatory nature. This information was obtained through interviews and a survey conducted by USC researchers.



Source: WTO and IDE-JETRO, Trade Patterns and Global Value Chains in East Asia, 2011.[9]

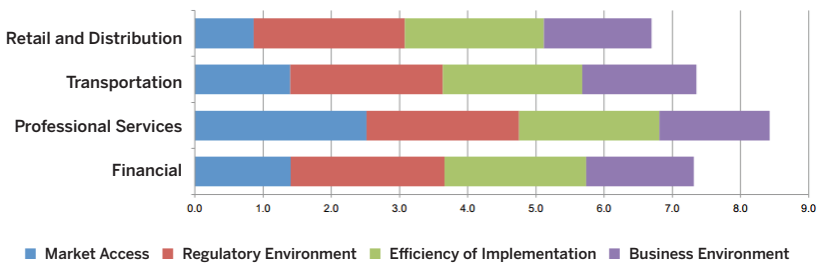
FIGURE 7 *FDI Inflows in Some APEC Member Economies by Sector (2005; 2008)*

Among APEC member economies, Singapore, Hong Kong, and New Zealand are the most open to trade in services; Indonesia, Vietnam, and the Philippines are currently among the least open APEC economies to services trade.[12] There appears to be a general correlation between



Note: The services trade restrictions index (STRI) at the regional level is calculated as a simple average of individual country's STRIs. The STRI in the cross-border air passenger transportation sub sector comes from the QUASAR database of WTO (2007). Regional abbreviations: HNO – High income non-OECD, SAR – South Asia, EAP – East Asia Pacific, MENA – Middle East and North Africa, AFR – Sub-Saharan Africa, LAC – Latin America and Caribbean, ECA – Europe and Central Asia, OECD - High income OECD. Source: Borchert et al., Policy Barriers to International Trade in Services. 2012.[10]

FIGURE 8 *Services Trade Restrictiveness Index (STRI) by Region*



Source: USC and APEC, Trade in Services in the APEC Region, 2012.[11]

FIGURE 9 *Impediments by Services Sectors in APEC*

services exports and the level of restrictiveness of the sector in APEC economies. The largest services exporters in the region (United States, Singapore, Hong Kong, and Malaysia) show a relatively open regulatory environment for trade in services.[13]

GAINS FROM LIBERALIZING SERVICES TRADE WITHIN APEC

Since services sectors are among the most restricted components of APEC economies, the potential for their contribution to economic growth through liberalization is significant. Several studies have shown that far greater benefits can be derived from trade liberalization in services rather than in goods. According to the World Economic Forum's 2013 report *Enabling Trade*, improving supply chain operations and services barriers even halfway to the world's best practices could increase global GDP up to six times more than removing tariffs.[14]

Liberalization of trade in services in APEC also has huge potential. It is estimated that a 10 percent reduction in trade costs could result in US$100 billion of additional services-related GDP within APEC.[15] Furthermore, studies on reforms in services sectors by the APEC Policy Support Unit[16] show that restrictions in key services sectors such as transportation, telecommunications, and energy considerably drag down economic growth and trade within the region. Structural reforms in just these sectors could generate about US$175 billion in annual savings for APEC.

PLACING INCREASED PRIORITY ON SERVICES IN APEC

Although services are economically important for the region, there is still much work that must be done to strengthen policy focus and policy initiatives in the services area in APEC. Between 2006 and 2012, 38 percent of APEC-funded projects—just over one-third—were related to services. From these initiatives, around 64 percent of the spending was on workshops and capacity-building seminars, while the rest involved

research studies or survey and database projects.[17] Given that services represent on average nearly half of world trade in value-added terms, there is a strong argument for increasing spending on APEC-funded projects to match this relative importance.

Among the challenges that APEC faces, similar to economies in all regions, is the scarcity of data on trade in services. Differences in definitions and measurements, and the lack of detailed services trade statistics for all economies, make it difficult to identify trends in trade patterns, as well as to measure the effectiveness of services-oriented policies. Another challenge has to do with the lack of focus on regulations that affect services while negotiating trade agreements. From the FTAs concluded by APEC members, 80 percent of the services provisions in these agreements focus on market-access barriers, while only 20 percent have to do with behind-the-border issues such as regulatory heterogeneity between economies.[18] Working on the liberalization of trade in services with the intent of harmonizing regulations and reducing behind-the-border impediments should be complementary and equal in importance to scheduling market-access obligations.

More efficient services sectors could generate many spillovers in APEC economies since services are embodied in the output of all economic sectors. Hence, better services lead to better competitiveness. Therefore, policies focused on improving services are also indirectly addressing issues such as the capacity to export, as well as the possibility of participating in global value chains. More efficient services would also contribute to:

- more inclusive growth, through employment effects and gender opportunities for women;
- greener growth, reducing the natural resource and material content of the economic growth path through services innovation. A focus on services within APEC can help to leverage energy from ongoing domestic reforms and generate momentum for the entire region (e.g., China, Latin American APEC economies);
- greater participation in global value chains, especially for small- and medium-sized enterprises (SMEs), which constitute the large majority of services exporters.[19]

This paper advocates for services to be given a higher profile within APEC. Services should be elevated in importance in APEC's agenda, and efforts made to reorient the prominence of services in its work. Specifically, the following is recommended for APEC:

First, discussion of services should be elevated to the Senior Officials level within APEC for examination of crosscutting key issues to raise awareness and understanding. Senior Officials should produce statements annually that recognize the importance of services. This could be done through maintaining an annual public-private dialogue on services, which could ideally be organized in proximity to the meeting of APEC Trade Ministers. This would reinforce the fact that APEC is treating services as a priority issue. It would also facilitate addressing crosscutting issues related to trade in services, and coordinating diverse APEC working groups and committees that deal with different services-related initiatives, often at the sectoral level.

Second, the APEC Senior Officials should develop a services policy framework and a stand-alone work program on services, which could be a multi-year priority program with several components. Among the crosscutting issues of focus for the APEC services work program, the following could be considered:

- services, competitiveness, and SMEs;
- contribution of services to value-added in APEC domestic economies;
- services and productivity growth in APEC;
- examining the role of services in global value chains and services as global value chains on their own;
- services and regulatory reform (on an economy-wide basis);
- services and innovation;
- services, employment, and more inclusive growth;
- services contribution to a more sustainable growth path.

Third, a section on services should figure each year in the APEC Leaders' Declaration.

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Connecting APEC Economies through Infrastructure, Governance, and Social Inclusion

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INTRODUCTION

Globalization is still the correct pathway for both developed and developing economies to promote growth, enhance regional economic integration, and raise the standard of living. Export-led growth has enriched millions of people in East Asia as manufacturing and labor-intensive industries have relocated to developing economies. This relocation has been aided by international trade and international investment, resulting in industrial restructuring and technological upgrading (Tan, Yuan, Yoong, and Yang 2013).

These processes continue today as economic power shifts among the world's major engines of growth—namely, the United States, the European Union (EU), China, and Japan. Resource-rich ASEAN is strategically located at the trading pathway between the East and the West. With a population of close to 600 million people, ASEAN has never been so important and attractive to investors and global powers.

However, as established by the Asia Competitiveness Institute (ACI) at the National University of Singapore, ASEAN economies do not trade actively with one another, except for Singapore's strong bilateral trade with Indonesia, Malaysia, and Thailand (see Table 1). Indeed, bilateral trade between China and ASEAN has risen sharply since 2000. With a moderate annual 10 percent projected growth, it would exceed US$800 billion by 2020, overtaking other major trading relationships as the biggest bilateral trading partnership in the world (Tan, Low, Tan, and Lim 2013).

It is most interesting to quantitatively observe the importance of major economic engines on the growth of ASEAN-5—Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Contributions of the United States, the EU, and Japan to the growth of ASEAN have been declining relative to China over the decades. For example, in terms of trade and investment, the United States and the EU used to be 9.2 times and 4.49

TABLE 1 *Engines of Growth among ASEAN-5 for 1990–1999 and 2000–2010*

	Indonesia	Malaysia	Philippines	Singapore	Thailand
Indonesia	1.31	0.09	0.03	0.13 (0.17)	0.06
Malaysia	0.15	1.23	0.06	0.33^ (0.49^)	0.16 (0.20^)
Philippines	0.01	0.03	1.07	0.03	0.02
Singapore	0.26^ (0.16)	0.30^ (0.43^)	0.07	1.18	0.15 (0.22^)
Thailand	0.14	0.18 (0.24^)	0.07	0.21^ (0.30^)	1.27

Note: ^ Denotes stronger bilateral trade between ASEAN members; figures in brackets refer to the period 1990–1999.
Source: Tan, Yuan, Yoong and Yang, 2013.

TABLE 2 *Relative Importance of China, EU, Japan, and the US as Engines of Growth for ASEAN-5, 1980–2020*

Title	Relative Importance of US vs. China as an Engine of Growth for ASEAN-5	Relative Importance of China vs. Japan as an Engine of Growth for ASEAN-5	Relative Importance of EU vs. China as an Engine of Growth for ASEAN-5
Period	**Ratio**	**Ratio**	**Ratio**
1980–89	9.17	0.31	4.49
1990–99	4.30	0.71	2.41
2000–10	1.53	1.88	1.02
2011–20	*0.65	*4.52	*0.51

Note: China's importance as a major engine of growth for ASEAN economies has been rapidly increasing over the past three decades.
*Source: *Forecasted by ACI; Tan Yuan, Yoong, and Yang, 2013.*

times more important, respectively, than China in the 1980s, but that level has declined steadily throughout the 1990s and 2000s. By 2020, the projected US and EU impact will be merely 0.65 times and 0.51 times, respectively, of China's impact. Meanwhile, the impact of China's trade and investment on the ASEAN-5 economies used to be merely 0.31 times that of Japan in the 1980s; by 2020, its impact is projected to be 4.52 times more important than Japan (see Table 2).

We can also observe a similar rise in importance of China in terms of trade and investment in disaggregate to 11 Asian economies over the past three decades. However, the United States and Japan, if taken together, would remain important engines of growth for some Asian economies (see Table 3). Compared to China, the EU still maintains its impact as an engine of growth for several Asian economies, such as India, Malaysia, the Philippines, Thailand, and Indonesia. As for recent Japanese efforts to reorganize its value-chain networks into ASEAN, coupled with the latest attempt to relocate production out of China, we can expect to see a reshuffling of trade and investment in relevant ASEAN economies by Japanese multinational corporations (see Table 3).

Because so much of ASEAN's trade is with regional partners, it will have to play a critical role in the region's newly emerging free trade

TABLE 3 *Relative Importance of China, EU, Japan, and the US as Engines of Growth for Asian Economies*

	Relative Importance of US vs. China as an Engine of Growth for 11 Asian Economies, 2000–2010	**Relative Importance of US plus Japan vs. China as an Engine of Growth for 10 Asian Economies, 2000–2010**	**Relative Importance of EU vs. China as an Engine of Growth for 11 Asian Economies, 2000–2010**	**Relative Importance of China vs. Japan as an Engine of Growth for 10 Asian Economies, 2000–2010**
Economy	Ratio	Ratio	Ratio	Ratio
India	1.94	2.28	1.61	2.98
Malaysia	1.69	2.18	1.03	2.04
Philippines	1.59	2.14	1.05	1.75
Thailand	1.57	2.16	1.06	1.75
Japan	1.53		0.91	
Indonesia	1.47	2.20	1.03	1.37
Singapore	1.34	1.74	0.94	2.52
Australia	1.15	1.81	0.92	1.52
South Korea	1.09	1.40	0.76	3.20
Chinese Taipei	0.99	1.26	0.63	3.73
Hong Kong	0.70	0.86	0.46	6.33

Note: Relative to China, the US and Japan, if taken together, would remain important engines of growth for quite a few Asian economies. Relative to China, the EU still maintains its impact as an engine of growth for a few Asian economies. Japan's influence, however, is rapidly declining, but will likely undergo an overhaul due to renewed Japan-ASEAN connectivity. Source: Tan, Yuan, Yoong, and Yang, 2013.

agreements. It is useful to ask how ASEAN might promote a comprehensive strategy that brings together multiple regional economic architectures, including the Regional Comprehensive Economic Partnership (RCEP), the Trans-Pacific Partnership (TPP), and the Free Trade Area of the Asia-Pacific (FTAAP). As we move toward the ASEAN Economic Community (AEC), we must also work simultaneously to further

strengthen the multilateral trading system and regional economic integration.

Globalization would be further enhanced by improving ASEAN connectivity with the United States, China, and Japan. Later sections of this paper will elaborate on the connectivity and infrastructure requirements of ASEAN growth as the region considers entering wider free trade agreements. Indeed, the Asia-Pacific Economic Cooperation (APEC) forum is committed to a multi-year plan on infrastructure development, as stated in the 2013 APEC Economic Leaders' Declaration: "Under Physical Connectivity, we commit to cooperate in developing, maintaining, and renewing our physical infrastructure through a Multi-year Plan on Infrastructure Development and Investment. The plan will assist APEC economies to improve the investment climate, promote public-private partnerships, and enhance government capacity and coordination in preparing, planning, prioritizing, structuring, and executing infrastructure projects."

The paper will also discuss the urgency, principles, modality, participation, and support needed by the Asian Infrastructure Investment Bank (AIIB), an important initiative proposed by President Xi Jinping at the 2013 APEC Leaders' Meeting in Bali. The AIIB, together with the Asian Development Bank (ADB), could potentially play an instrumental role in bringing to fruition the RECP, the TPP and an FTAAP.

FREE TRADE AREA OF THE ASIA-PACIFIC: RECOMMENDATIONS

Given the social turmoil currently taking place in several ASEAN economies, the targeted objective of achieving a full ASEAN Economic Community by 2015 seems unlikely. The process of regional economic integration will also likely be delayed, as the ASEAN-Plus discussions for the RCEP is progressing more slowly than expected.

Similarly, several recent rounds of negotiations for the TPP experienced difficulties, including lack of decisive support from the US Congress and disappointing results from President Obama's April 2014 visit to Asia, which failed to secure a comprehensive solution from Japan and

Malaysia. It looks like the TPP is also unlikely to be concluded in the near future.

Yet greater globalization in trade and investment still remains the most viable pathway to sustainable, balanced, and inclusive growth and development. Renewed WTO momentum toward strengthening the multilateral trading system is crucial. Given the proliferation of free trade agreements, such as the TPP and the RCEP, which are progressing in parallel, it is important to ensure renewed WTO momentum in the multilateral trading system.

An FTAAP was first suggested in 2004 by the APEC Business Advisory Council during its meeting in Chile, and a concretized pathway to an FTAAP was outlined in Japan during the APEC Leaders' Meeting in 2010. Some thoughts on how an FTAAP can proceed, such as linking the TPP and the RECP, was suggested in Singapore in 2014, and is likely to be revisited during the APEC Leaders' Meeting in Beijing, China, later this year.

At the APEC 2013 gathering, President Xi Jinping actually stated that China welcomes the "mushrooming of regional free trade agreements as a positive sign" and that "the ocean is vast because it admits hundreds of rivers." In order to accelerate regional economic integration, some steps that might be taken to move toward an FTAAP are enumerated below.

First, all APEC members have an interest in ensuring that the commitments toward achieving the Bogor Goals are implemented, and the most likely route to that goal is achieving an FTAAP. Whether this FTAAP is "to be led" or "supported" by APEC can be discussed further among members. Pacesetters are needed to retain focus and steadily move toward the longer-term goals.

Second, APEC needs to prioritize. Some have commented that APEC is not doing enough, and have even suggested that APEC be downgraded to the ministerial level instead of the leaders' meeting level. We disagree because there is still a lot more APEC can do. APEC should work toward specifically defined objectives in a well-coordinated manner.

Implementation of the following objectives is especially important to businesses: (1) the 2012 APEC List of Environmental Goods (EG list), which aims to reduce applied tariffs to 5 percent or less on a list of 54 products by 2015; (2) the Supply Chain Connectivity Initiative (SCI), which

aims to achieve a 10 percent improvement in supply chain performance by 2015, and (3) the Ease of Doing Business Initiative (EODB), which set targets of a 25 percent improvement in ease of doing business by 2015.

Third, APEC should ensure that some of its initiatives feed into the WTO's work activities. The WTO conducts much practical work that is useful to the business sector. Yet the WTO continues to struggle with decision making and implementation, despite majority desires for further trade investment. It is now imperative for platforms such as APEC to lead the way, as it has done in the past. APEC's comprehensive agenda covers trade in goods, services, and investment. Some of this can feed into the WTO's agenda. For example, APEC might extend its EG list to other sectors, or it might propose nontariff measures and improve transparency of regulations.

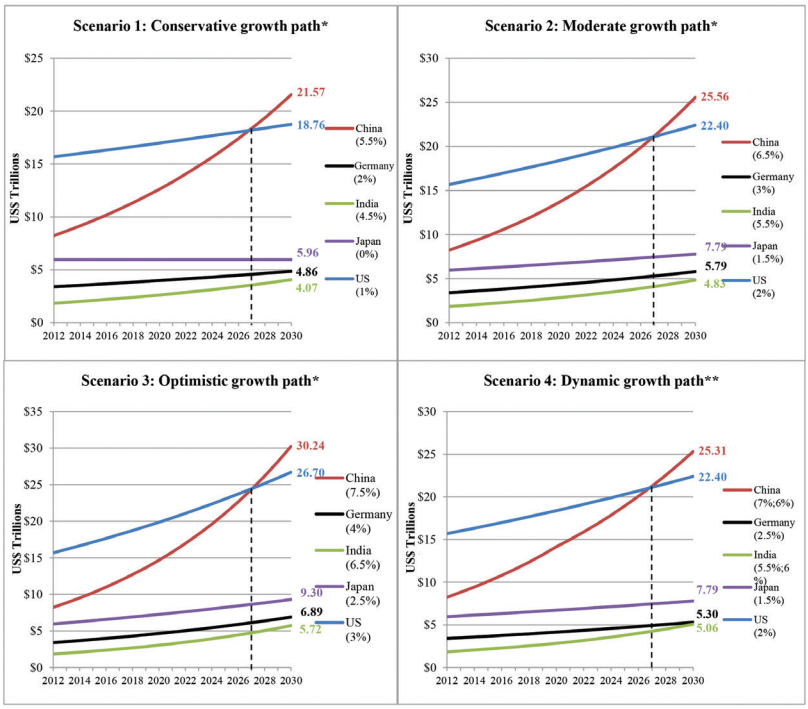
Finally, APEC must seek to harmonize current trade agreements such as the TPP and the RCEP. By ensuring that the highest yet still realistic standards are met, they might lead successfully to an FTAAP. In the words of Lim Hng Kiang, Singapore's minister for trade and industry: "China's 2014 chairmanship will be crucial for achieving our 2015 targets. Faltering on this means we falter in our path towards our FTAAP aspirations" (Lim 2014).

ASEAN CONNECTIVITY AND INFRASTRUCTURE REQUIREMENTS

China-ASEAN Connectivity

The rapid growth in GDP and regional development imbalances in China over the past three decades have led to factor market distortions, environmental degradation, infrastructure constraints, governance issues, and public policy contradictions. These experiences offer valuable lessons for policymakers in developing economies, and are of considerable academic interests in terms of public policy debate.

Furthermore, as China attempts to rebalance its external demand–driven, export-oriented, quantitative growth model to a more domestic-driven, consumption-led model that includes quality growth adjustments, the mammoth rebalancing task is expected to have profound impacts



^ *Projected by ACI at LKYSPP, NUS;*
* *Constant average growth rates for period 2012–2030; source for 2012 data: World Bank;*
** *For China 2012–2020, 7% per annum and 2021-2030, 6% per annum; for India 2012–2020, 5.5% per annum and 2021–2030, 6% per annum; for Germany, Japan, and the US, steady-state growth, at 2.5%, 1.5%, and 2% per annum respectively.*

FIGURE 1 *Projected Nominal GDP Growth Paths for China, Germany, India, Japan, and the US: 2012–2030*^

and far-reaching implications to global trade and regional economic integration.

China's progression into the world's largest economy is projected to happen by 2027 at the latest, with stable GDP growth per annum of 6 percent to 7 percent for the next two decades or so (see Figure 1). China is fully aware of its growing economic prosperity, and is keen to share that prosperity, especially with its immediate ASEAN neighbors.

Prosperity sharing, in fact, is vital. By increasing regional economic integration and business opportunities through China-ASEAN connectivity, China's peaceful rise will become more meaningful, and its reception by people of the region more positive.

Nondemocratic systems tainted with corruption are still very much the reality in some Asian economies. These sociopolitical systems tend to create environments that value patronage over performance and connection over ability. Nevertheless, the paramount issue is the ability to govern effectively, and to formulate and execute public policies that are beneficial and inclusive to the majority of citizens. In fact, *discipline* is essential before *democracy*, which we believe will eventually come, even for China.

With closer government cooperation between China and ASEAN—along with increasing economic openness, greater market accessibility, and conducive initiatives—the resiliency of private sector business potential can be further galvanized, given the rich natural resources, abundant labor supply, and vast regional landmass. The challenge ahead is how to work toward achieving the goal of greater regional connectivity in infrastructure, institutions, and people-to-people contact.

Japan-ASEAN Connectivity

During the late 1980s and early 1990s, manufacturing activities by Japanese multinational corporations (MNCs) had been steadily moving out of ASEAN to the coastal provinces of China because of lower land costs and production facilities; an efficient infrastructure consisting of highway, air, and sea ports; and an abundant supply of relatively cheap labor, both skilled and unskilled.

Since 2010, Japan and China have been going through an increasingly difficult phase in their bilateral relationship, due to complex factors that include the decades-long stagnation of the Japanese economy, China's overtaking of Japan as the world's second-largest economy, unsettled historical baggage, and disputes over sovereignty. This strained bilateral relationship between the two Asian giants is expected to continue, remaining unresolved for decades, or at least for the medium term.

Japanese MNCs are, thus, actively planning for production relocation from China. As part of their business risk diversification process, they

plan to reestablish manufacturing value chains in the new, competitive ASEAN, which has undergone transformational changes since the 1997 Asian financial crisis.

In view of the latest geopolitical developments, coupled with the implications of the United States' return to the Asia-Pacific region to balance China, ASEAN is positioned to entice foreign direct investment from the world's major economies, including Japan, China, the United States, and the EU. It is paramount for Japanese MNCs, in particular, to identify the appropriate investment destinations, regional headquarters, and manufacturing capabilities and capacities within ASEAN.

Overcoming Financing Bottlenecks: The AIIB

APEC should promote regional connectivity on three fronts. Infrastructure, financing, and human development are three bottlenecks that the APEC community currently face. Failing in any of these areas would risk the emergence of wider pockets of permanent economic underclasses, notwithstanding the great progress APEC has achieved in terms of globalization in trade and investment.

Both physical and soft infrastructure connectivity are, therefore, vital for improving connectivity, economic linkages, and social inclusivity within APEC economies. Physical connectivity should be comprehensive across the region, especially for connectivity over air, sea, and land. Connectivity of institutions in terms of good public governance, transparency, and the rule of law would lead to closer cooperation between governments. It would also serve to encourage private sector collaboration, which is crucial for enhancing economic efficiency. Connectivity among people could be promoted through social inclusivity, with the most critical needs being more equitable distribution of income, affordable public healthcare, housing, education, and transportation.

The thrust of the East Asian model for economic development is essentially infrastructure connectivity, which serves to relieve production bottlenecks and incorporate longer-term targets. The experience and success of East Asian economic development have shown that releasing production bottlenecks through investing in a comprehensively planned infrastructure program is a major prerequisite for economic takeoff, and a useful vehicle for sailing through the middle-income trap.

Due to the relatively massive capital required, the long gestation period, and the longer-term nature of returns on investment for infrastructure projects, financing costs tend to be expensive, and funding sources are often in keen competition with other funding commitments. As such, there are existing financial bottlenecks as well.

Government must play a facilitating role in harnessing and promoting infrastructure investment to ensure that regional economic and social integration is balanced, sustainable, and inclusive. Both physical and soft infrastructure provisions for greater connectivity are increasingly viewed as forms of regional public goods.

A longer-term roadmap for Asia-Pacific connectivity should be planned, and stronger economies that have comparative advantages in terms of capital, technology, and competitive skills should play an active role in meeting the pressing infrastructure bottlenecks causing growth inertia and imbalanced regional development.

President Xi Jinping proposed at the 2013 APEC Leaders' Meeting in Bali that an AIIB be established, which is an excellent idea and a proactive move that should be welcomed. In his proposal, it was stated that the AIIB initiative aims to promote interconnectivity and economic integration in the region, including—though not confined to—the ASEAN region. Therefore, it is paramount to cooperate with existing multilateral development banks (MDBs) to make full use of their advantages and to jointly promote the sustained and stable growth of Asia (Tan 2013).

The scale of infrastructure investment needs in Asia is enormous, as well as long overdue. Slow and uneven regional economic recovery adds pressure on fiscal budgets. In 2012, the total official development assistance package was about US$125 billion. Existing funds are insufficient for the region's needs. The ASEAN Infrastructure Fund (AIF) stands at US$485 million, yet according to a 2009 study by the ADB, infrastructure requirements in Asia for the period 2010 to 2020 amount to US$8 trillion! (Table 4) A lack of bankable projects is the main bottleneck. Based on anecdotal estimates from industry players and data from Project Finance International, the estimated share of bankable projects and infrastructure needs for the period 2010–2020 is shown in Figure 2.

The prime minister of Singapore, Lee Hsien Loong, commented at the China-ASEAN Summit of October 9, 2013, that Singapore

TABLE 4 *Infrastructure Needs for Asia and ASEAN Economies**

	Total	Non-bankable	Marginally bankable	Bankable
Asia	trillion^	~ 4–5 trillion	~ 2–4 trillion	~ 1 trillion
ASEAN ex Singapore	trillion^	–600bn	–450bn	–100bn
Selected ASEAN economies*	billion*	–350bn	–300bn	–60bn

*Note: *Economies included are Indonesia, the Philippines, Thailand, and Vietnam. ^ Estimates by Asian Development Bank.*

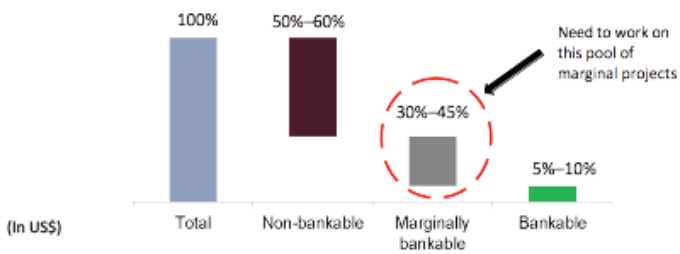


FIGURE 2 *Shares of Bankable and Non-bankable Projects for Infrastructure Needs*

welcomes the proposal to establish the AIIB. Given the enormity of infrastructure investment needs in Asia over the next decade and beyond, the World Bank, the ADB, and the newly established AIF are working with Asian economies to meet these needs. However, in view of the pressing need to resolve production and financing bottlenecks, regional governments could do more, and the AIIB can help to complement these organizations.

It would be ideal if the AIIB has an inclusive membership, covering member economies of ASEAN and enabling non-ASEAN economies to join as well. The right profile of members and major investors would ensure a strong credit rating for the new institution. An inclusive membership would also encourage participation of private sector funds. Singapore is open to participating in the AIIB, in the same way it participates in the ADB and AIF, and looks forward to studying the details in partnership with ASEAN members.

For investing in bankable projects, the ability to attract private sector investments over time is paramount. Bankable projects could be assessed on (1) macroeconomic, legal, and regulatory contexts; (2) technical and environmental viability; (3) economic and financial viability; (4) project implementation and management capacity; and (5) overall risk profile. The AIIB can facilitate improvements to the regional legal and regulatory environment. With the World Bank and the ADB already active in disbursing development grants, focusing on bankable infrastructure projects is an area where the AIIB can play a complementary and differentiated role (Tan, Tang, and Yao 2014).

The AIIB can catalyze private sector participation by lowering the risk of participation. For example, the AIIB can invest in mezzanine debt tranches or provide credit guarantees for project bonds, among other strategies. The private sector should be invited to participate in financial/technical advisory and structuring work. The AIIB could co-invest in projects directly with the private sector. The European Investment Bank (EIB), for example, only finances up to 50 percent of total project costs, leveraging its capital with funding from private sector financial institutions. AIIB capital could be leveraged by raising bonds purchased by the private sector. The AIIB could issue bonds for its own financing after it has established a successful track record.

In addition, infrastructure initiatives could be complemented by forming cooperative institutional and operational links with other multilateral development banks (MDBs). An existing network of MDBs already cooperate by exchanging information on their respective priorities and action plans, joint project appraisal missions, and co-financing projects. The AIIB can structure its involvement in particular projects jointly with other MDBs. For example, the AIIB can provide loans, while the other MDBs provide grants. In the future, the AIIB can also complement the roles of some existing regional initiatives, such as the AIF.

CONCLUSIONS

The economic impact and influence of the United States, the EU, and Japan in ASEAN economies have been overshadowed by China's rapid

economic involvement since the 1980s, and have declined steeply in the new millennium. Lee Kuan Yew, the founding father of Singapore, was the first to call for economic repositioning of the United States in Asia, and in ASEAN in particular. Strategically it makes sense for ASEAN to discourage dominance by any economic heavyweight. Hence, the return of the United States, hopefully followed by the recovery of the EU and the production relocation of Japanese MNCs to ASEAN, would serve to revitalise ASEAN, which is different from containing China (Tan, Yuan, Yoong, and Yang 2013; Tan, Yoong, and Yuan 2014).

ASEAN should manage US participation in the Asian regional economic grouping. As of now, the United States is still an important engine of growth for all the Asian economies, except for Chinese Taipei and Hong Kong. The active participation of the United States—in APEC, in the East Asia Summit, and in its TPP leadership role—are critical for ensuring the ongoing engagement of this major engine of growth in Asia.

It is important for ASEAN to balance its economic interests not just with China and the United States, but also with the EU and Japan. The Asia Competitiveness Institute (ACI) has identified several new developments impacting China's position as the factory of the world: costs in China are rising, multinational corporations are considering relocations from China to ASEAN, and Chinese markets have become more accessible. The ACI feels that the window of opportunity for ASEAN is about five years. Indonesia, Malaysia, and Thailand are in good positions to capitalize on this latest development, while Singapore could serve as a regional financial center and logistic-transportation hub to service the emerging, buoyant regional trade and investments (Tan, Low, Tan, and Lim 2013; Tan and Tan 2014).

The proposed AIIB is another institution that can reinforce ASEAN's key role in the region. Asia is moving into an era of unprecedented urbanization, and there is now much interest in developing livable townships and cities. The AIIB could quickly demonstrate its ability to implement successful projects, tapping into both China's and Singapore's relevant experiences in developing comprehensive urban solutions. To support the development of the AIIB, the Pacific Economic Cooperation Council (PECC) should form a task force to conduct comparative studies of other MDBs and infrastructure funds, focusing on governance,

structure of investments, and best practices that the AIIB might adopt. It is time to study the most effective approaches that the AIIB might use to tap into private sector monies and achieve a positive credit standing (Tang et al. 2014).

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18

APEC's Role in Promoting Asia-Pacific Regional Economic Integration

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The Asia-Pacific region, which approximately accounts for 40 percent of the world's population, 55 percent of world GDP, and 44 percent of world trade, has been playing an important role in the development of the world economy and international trade in recent years. The process of Asia-Pacific regional economic integration (REI), therefore, will further promote economic development and create greater prosperity not only for the region, but also the world.

As one of the world's largest regional economic cooperation entities, APEC contributes significantly in promoting the economic development, equitable growth, and shared prosperity of the Asia-Pacific region, thus manifesting itself as a highly effective mechanism to strengthen the Asia-Pacific REI process. The year 2014 marks the twenty-fifth anniversary of APEC. It means APEC is no longer a teenager, but an energetic young person who should make a new "career plan." With the changing international and regional environment, APEC is called upon to play a more active role in promoting the future process of Asia-Pacific REI.

A REVIEW OF APEC'S CONTRIBUTION TO THE PROCESS OF ASIA-PACIFIC REI

The adoption of the Bogor Goals in 1994 built a lighthouse for APEC's process of trade and investment liberalization and accelerated the voyage of Asia-Pacific REI. Through the launching of the Osaka Action Agenda in 1995, APEC set out the road map to achieve the Bogor Goals with the adoption of individual action plan (IAP) and collective action plan (CAP) mechanisms.

Meanwhile, several key factors have been taken into consideration by APEC in choosing the ways of promoting Asia-Pacific REI, including the complex regional geopolitical structure, the diversity of APEC members' economic development levels, and their aims to participate in regional cooperation. As a result, a unique APEC approach was created. While recognizing the diversity of APEC member economies, it reflects the concepts of voluntarism, consensus, openness, and inclusiveness. The APEC approach has proven to be adaptable to the development of APEC, and it has played a key role in keeping the momentum of Asia-Pacific REI.

During the past two decades, APEC has pursued its many visions with the Bogor Goals at the heart.[1] The markets of APEC member economies became more and more open, demonstrated by the significant reduction of trade and investment barriers, the gradual elimination of nontariff barriers, and the improvement of market transparency. Thus benefiting from the improvement of the business environment, a vibrant regional market for services has emerged. The APEC region has also become much more open to foreign direct investment (FDI).

Achievements have also been made in the area of trade and investment facilitation, and the implementation of the Trade Facilitation Action Plan (TFAP) has successfully reduced the costs of trading. Effective cooperation has been carried out to promote paperless trading, transparency, business mobility, alignment of standards with international standards, improved competition, and anti-corruption policies and regulatory reform.

Furthermore, the development of APEC's ECOTECH process has set up priorities for the economic and technical cooperation in the Asia-Pacific region, and has encouraged the developed and developing APEC

member economies to participate in capacity building and technology assistance in a strategic way. Human resource development cooperation and related capacity-building activities have also played an important role in narrowing the economic development disparity among APEC member economies and promoting the stable economic development of the Asia-Pacific region.

APEC understands that the development of Asia-Pacific integration should be based on mutual understanding, friendship, and the sense of community among APEC member economies. In this sense, intercultural exchange is another important area in which APEC can promote the Asia-Pacific integration process. During the past two decades, APEC has made great efforts to encourage member economies with different cultural and faith backgrounds to develop social interaction and achieve mutual understanding, acceptance, and trust, which are essential to address social, legal, governance, and economic challenges and to promote a harmonious community in the region.

APEC has also been making great efforts in coordinating the development of regional trade agreements (RTAs) and free trade agreements (FTAs) in the Asia-Pacific region. To ensure that the proliferation of RTAs/FTAs does not add to the complexities of the international and regional trading environment, APEC has established best practices and model measures for RTAs/FTAs with the aim of promoting high quality, comprehensiveness, transparency, and broad consistency. They are neither mandatory nor exhaustive, but serve as a guide to the kind of provisions that might be included in a RTA/FTA, where appropriate. In addition, APEC has undertaken a range of capacity-building activities—including policy dialogues, seminars, and workshops—in order to promote broad consistency in agreements through the adoption of best practices and model measures.

INTERNAL AND EXTERNAL DRIVING FORCES FOR APEC TO FURTHER PROMOTE ASIA-PACIFIC REI

These achievements clearly demonstrate that APEC has played an active and supportive role in promoting Asia-Pacific REI since its establishment.

APEC economies, however, have acknowledged the rapidly evolving international and regional environment in the new century, as well as the opportunities and challenges ahead. Consequently, there are both internal and external forces driving APEC to play a more active role in further promoting Asia-Pacific REI.

First, APEC is expected to push for a healthy recovery of the sluggish world economy. Now, the world economy is on the whole moving forward in a positive direction, yet uncertainties and destabilizing factors have remained prominent. The structural problems of major developed economies are far from being resolved, and it has become more imperative to enhance macroeconomic policy coordination. With growing external risks and pressure, some emerging economies in the Asia-Pacific region are experiencing a slowing of economic growth. As well, trade and investment protectionism has resurfaced. Obviously, the world economy faces daunting challenges before achieving full recovery and sound growth. During the past three decades, the energetic Asia-Pacific economy has been an important engine of world economic growth. APEC, which is entrusted with the important mission to promote regional and global growth, must face the challenges head-on with courage and resolve.[2] It is undoubted that the deepening REI will pour new vigor into the Asia-Pacific economy, which will then give stronger impetus for a healthy recovery of the world economy.

Second, considering the fact that the FTAs/RTAs in this region are advancing in parallel with different rules and standards, APEC is capable of playing a more active and effective role in coordinating the development of FTAs/RTAs in the Asia-Pacific region. The rapid proliferation of FTAs/RTAs in recent years is happening amidst rapid economic growth in the Asia-Pacific region and greater interdependence among economies through trade and investment. For many economies, participation in FTAs/RTAs is not simply a second-best choice following the WTO negotiation standstill, but also an effective approach to regain or enhance their economic competitiveness. And, the influence of the "Domino Effect" has also stimulated some economies to join FTAs/RTAs as a passive corresponding activity. It should be emphasized that through participating in various Asia-Pacific economic integration mechanisms, many economies want to gain not only economic benefits,

but also noneconomic benefits, such as strengthening political relations and comprehensive strategic partnerships with other economies. In this sense, an FTA or RTA is by no means just an economic agreement among the parties, but also an integral part of their overall strategy of diplomacy, security, and foreign economic relations and trade. At present, it seems that the Asia-Pacific REI process has achieved a kind of balance with a unique mutual incentive and competitive relationship among different tracks, especially the "TPP track" and the "Asian track" led by the RCEP. However, the balance is not stable but somewhat fragile. If some REI mechanisms are utilized as tools of political speculation or strategic games among regional powers, the balance will be easily broken.[3] A malignant competition among different tracks is never wanted by any economy in the region. Therefore, APEC has the responsibility to coordinate the development of FTAs/RTAs through promoting Asia-Pacific REI in a region-wide scope.

Third, APEC should strengthen its role as a strong supporter of the WTO from the plurilateral level. In fact, APEC has a tradition of leadership on WTO matters. To support the Doha Development Agenda (DDA) remains one of the top priorities of APEC in recent years. Although the future of the WTO Doha round negotiation is still uncertain, it should be emphasized that the multilateral trading regime is charged with the heavy responsibility of coordinating national trade policies, balancing international trade relations, reducing trade frictions, and promoting world economic growth, and it plays an important role in countering the effects of the international financial crisis and opposing protectionism. It should also be realized that the multilateral trade liberalization and the Asia-Pacific REI processes are complementary. The future of APEC is closely linked with a strong and energetic multilateral trading system. Likewise, a more open and liberalized international trade and investment environment will significantly promote the Asia-Pacific REI process. Therefore, it is of great significance and importance for APEC members to fulfill their commitments to firmly oppose and jointly resist protectionism of all forms, and work to make the multilateral trading regime a balanced and inclusive one that benefits all.

Fourth, APEC should further promote Asia-Pacific REI to better comply with the trend of global value chain (GVC) cooperation. In re-

cent years, GVCs have greatly transformed international trade. To be concrete, GVCs make exports depend more and more on imports. In East Asia, for example, about 65 percent of total manufacturing exports are GVC-related. In quite a few APEC member economies, foreign value-added is about a third or even half of the total value of exports.[4] So, GVCs clearly reward open borders and nondiscrimination in trade and FDI. However, they may also trigger "systemic risk," which means that a single incident in one sector or economy will probably give rise to an obstacle or even disruption of the whole system of value chains. Both of these opposite yet interlinked scenarios intensify the necessity of APEC members to enhance GVC cooperation, which forms the internal driving force for APEC to further promote REI in the long term.

PATHWAYS FOR APEC TO FURTHER PROMOTE ASIA-PACIFIC REI

Promoting the Establishment of the FTAAP

First of all, APEC should set up a mid-term goal for the post–Bogor Goal era, which will clarify the overall direction of APEC's efforts in promoting Asia-Pacific REI in the next decade. In this regard, the establishment of a Free Trade Area of the Asia-Pacific (FTAAP) would be the most rational choice. As a matter of fact, APEC leaders have affirmed their commitment to achieve an FTAAP in several declarations during the past few years, and now it is time for APEC members to carry out their leaders' instruction. Besides, an FTAAP will be a free trade arrangement that includes all APEC member economies, and nobody would worry about membership qualifications. It should also be pointed out that an FTAAP could be realized through several approaches, such as collective negotiation, enlargement, or convergence of existing RTAs in the Asia-Pacific region, which means that it would be practical. In the short term, it is important for APEC members to embrace the principles of openness, inclusiveness, and transparency, as well as the spirit of flexibility, and to establish and launch as early as possible an information exchange mechanism for FTAs/RTAs in the Asia-Pacific region. The aim should be to improve communication and

exchange of views, and to create favorable conditions for pursuing an FTAAP.

Enhancing GVC Cooperation to Foster a Big Asia-Pacific Market

With an FTAAP as an overall target, APEC should take more effective measures than before to facilitate the free flowing of goods, services, capital, and people in the region, actions that will not only deepen Asia-Pacific REI, but also significantly promote Asia-Pacific GVC cooperation. Accordingly, APEC member economies should give full play to their comparative advantages, optimize the economic resource allocation, improve the industry layout, and make joint efforts to foster a big Asia-Pacific market where benefits are shared by all. Priorities in this aspect should include, but not be limited to, enhancing trade facilitation and supply chain management, improving logistics infrastructure network construction, and facilitating cross-border movement of natural persons.

Attaching More Importance to Investment Liberalization and Facilitation

Optimizing regional industrial specialization and economic resources allocation are also of great importance for APEC if it is to achieve a high level of REI. In this aspect, FDI of transnational corporations plays a key role. Therefore, APEC should be more ambitious to promote investment liberalization. APEC could conduct a stocktaking of the achieved outcome documents on investment in recent years, such as *Non-binding Investment Principles* and *APEC Investment Facilitation Action Plan,* and use them to strengthen enforcement procedures. Effective measures could be taken to enhance capacity building of member economies to reduce investment barriers, especially behind-the-border barriers. Meanwhile, it is recommended that APEC attach more importance to investment facilitation, which is less sensitive and more easily yields results and progress. APEC should also strengthen private-public cooperation through listening to the views of business about the investment climate, and by building and maintaining effective public-private dialogues.

Promoting Connectivity and Infrastructure Development Cooperation

Connectivity and infrastructure development will help to increase trade and investment opportunities in the Asia-Pacific region, improve

regional production networks, and consolidate the foundation for a big Asia-Pacific single market. Cooperation in this area will improve the quality and effectiveness of Asia-Pacific REI, substantially strengthen the implementation efficiency of the FTAs/RTAs in the region, and help to create a transparent, stable, and efficient trade and investment environment with lower transaction costs. APEC member economies are in consensus on the importance of connectivity and infrastructure development cooperation. Their resolve could be proved by the endorsement of the APEC Framework on Connectivity and the APEC Multi Year Plan on Infrastructure Development and Investment, both developed at the 21st APEC Economic Leaders' Meeting held in Bali in 2013.

At present, several Asia-Pacific regional or subregional cooperation organizations have already been formulated, or have set about to formulate, and they have identified connectivity cooperation frameworks with infrastructure development as a priority. These cooperation frameworks share a certain degree of similarity in targets, mechanisms, key areas, or memberships, which lay a foundation for the development of cross-region infrastructure networks. In this regard, APEC could play an active coordinating role. For example, APEC may consider establishing an online Asia-Pacific Connectivity Cooperation Information Platform. The platform will collect and release information on the overall plans and projects of connectivity cooperation carried out under different mechanisms of the Asia-Pacific region, aiming to enhance communication and attract more stakeholders to participate.

To sum up, APEC has not only the responsibility but also the capability to make a larger contribution to the future process of Asia-Pacific REI. Guided by the principles of openness, inclusiveness, and win-win cooperation, APEC member economies should try to foster closer partnerships and make joint efforts to meet challenges and achieve sustainable development and long-term prosperity in the Asia-Pacific region.

NOTES

1. Wang Yi, "Building on Past Achievements to Make New Progress and Shaping the Future through Asia-Pacific Partnership," remarks presented

at the APEC Informal Senior Officials' Meeting, December 10, 2013, in Beijing, China.

2. Xi Jinping, "Give Full Play to the Leading Role of the Asia-Pacific Maintain and Advance an Open World Economy," address at APEC Economic Leaders' Meeting (Session I), October 8, 2013, in Bali, Indonesia.

3. Liu Chenyang, "New Trend of Asia-Pacific Economic Integration," paper presented at the CNCPEC Seminar on TPP 2012 Progress and Challenges, December 7, 2012, in Beijing, China.

4. Razeen Sally, "Global Value Chains, Trade Policy and Asia." *East Asia Forum*, June 13, 2013, http://www.eastasiaforum.org/2013/06/13/global-value-chains-trade-policy-and-asia/.