2015 PECC-SINCPEC-PPECC Conference on

Achieving Inclusive Economic Growth in the New Normal

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Edited By

Tan Khee Giap

Eduardo Pedrosa

Blake H. Berger

Foreword

When we talk of the new normal it tends to be in terms of the slower growth many economies in the region are facing today and inclusive growth has been defined in terms of ensuring that more citizens have the opportunity to benefit from and contribute to economic activity. This was the intent of the way this conference was framed. However, there is another way to think about these concepts and whether intentionally or not this became apparent through the course of our discussions.

Another characteristic of economic policy making today is that it is no longer sufficient to continue to think in terms of discrete policy areas such as ‘health’, ‘education’ or even ‘trade’. The need to break down silo thinking is most evident in thinking about the policies needed to ensure that regional economies can benefit from the internet economy. What was once considered a phenomenon we could conveniently classify as ‘information and communication technology’ policy now impacts every aspect of human existence. From the delivery of education and healthcare services to providing platforms for small and medium enterprises to access the global market, the internet cuts across all

The challenge of inclusive growth is enormous. While we continue to struggle with finding new growth engines in the aftermath of the Global Financial Crisis the internet – again – is changing the way policy-making process works. When the region set the Bogor Goals it was a top down process – regional leaders – on advice of eminent persons agreed that the best path to achieving prosperity was through free and open trade and investment. Today, policies are just as likely to come up from the bottom. One side of the story is that policy-makers are now playing a catch up game reacting to the rapid transformations taking place in the business world, while another side of the story is the way in which social networks are facilitating an ever greater level of participation in the policy process – from crowdsourcing ideas to online social movements. This might be better defined as inclusive policy processes rather than inclusive growth itself.

These phenomena present enormous opportunities for new ideas and cross-sectoral fertilization of innovation but they are challenges. Governance was already hard enough but the need to think and act horizontally now as well as vertically requires not only a shift in mindset but also changes in processes and mandates. Turf battles over whose responsibility a particular issue are as old as government itself but in today’s rapidly evolving environment the costs are large. Economists have long argued that rationale decision making requires perfect access to information but information asymmetries have meant all kinds of market failures. Today we are confronted with an overload of information. For this reason we continue to believe that there remains a vital role for organizations like the Pacific Economic Cooperation Council to sort through the information and transform it into actionable knowledge.

We would like to express our appreciation to all of those who worked to organize this event, especially Ambassador Antonio Basilio and Prof Tan Khee Giap and their able teams for putting together this event as well as the Singapore government without whose invaluable support this series of conferences would not be possible.

Jusuf Wanandi
Co-Chair

Don Campbell
Co-Chair

Executive Summary

The Asia-Pacific region is undergoing a historic transition period. First, many of the region's economies are rapidly aging which has implications on labor and movement of people at regional and global levels. Secondly, powerful technological innovations and inventions are changing business models, the ways in which goods and services move across borders. Thirdly, mega-cities are emerging in various parts of the Asia-Pacific driving huge demand for infrastructure development, public services, and other areas that necessitate improvements in physical and institutional connectivity. Fourthly, environmental concerns remain a priority where adverse effects from climate change and emissions of greenhouse gas require concerted global action in order for growth to be sustainable. While the overall incomes have risen and hundreds of millions of people freed from poverty in some parts of the region, income inequality continues to worsen both domestically and among the region's economies, many of which are also grappling with the middle income trap. When APEC was established in 1989, the main concern was the different levels of development among economies but now the more urgent issue is to deal with inequality within economies.

In the meantime, progress on the WTO Doha Round has been slow and discouraging, while bilateral preferential trade agreements take precedence over furthering the goal of a region-wide economic integration.

During the APEC Leaders' Meeting held in Beijing in November 2014, decisions were taken to make progress on key elements of the regional agenda, including on a Free Trade Area of the Asia-Pacific (FTAAP) and improving connectivity. With the ASEAN Economic Community (AEC) being launched this year and work continuing with regional and plurilateral trade negotiations, most notably the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP) – the so-called 'pathways to FTAAP' - the challenge is how the region's economies can implement these plans while ensuring that the resulting regional growth is not only steady and balanced but also inclusive.

One challenge facing the region is the impact of natural disasters on growth. Between 1990 and 2009, the actual average was 0.29% of GDP but the average between 1990 and 2014 has escalated to 0.52%. Policy intervention can play a constructive role in mitigating the impact of these disasters including through the adoption of comprehensive land use plans, building new and safer settlements. Even with such plans in place, there is a need for contingency plans that increase awareness amongst local people of where they need to be in the event of a disaster – this requires continual updating and preparation as well as early warning systems.

In order for growth to be sustainable, it is imperative that the benefits of trade and quality of growth be shared by all. This means more investments are needed in human capital development in the form of education and vocational training as well as increasing access to knowledge and digital tools, building infrastructure and increasing connectivity, improving financial inclusion, facilitating entry of SMEs to compete in the global market and enhancing their abilities to participate in the global value chains (GVCs).

Larger firms with established access to global markets have traditionally been seen to dominate the GVCs. There is now a very strong case to increase participation by Asian economies in GVC by helping SMEs enhance their ability to meet international standards and requirements. There are implications for the less-skilled compared to high-skilled labor, implications for small firms versus large firms, and the choice or opportunity of moving from low value-added to high value-added activities. In particular, SMEs with unique niches in different stages of manufacturing or different tasks of services could provide significant driving force for one economy to boost its participation in GVCs.

The services sector accounts for the largest share of employment at 46% and economic output at 70% in the region, largely involving SMEs. Constraints for SMEs are found in the general lack of access to finance, advanced technology, skilled workforce, networks and market information, as well as their concerns with economy of scale. As APEC economies move towards shaping a new trade regime such as the long-term goal of FTAAP, it would be a good time to rethink what constitutes a trade agreement in the future given the new business environments, practices, and challenges. While there is a general agreement among ASEAN member states and APEC member economies that the benefits of open and free trade and investment in the region outweigh the challenges, there is a need to ensure that growth is more inclusive – how to make sure more people participate in this growth, and how to ensure the benefits are spread across the people in the region.

Looking at trade as an engine of growth in the region, overall trade openness in APEC has increased compared to close to a quarter century ago. From 1989 to 2013, APEC economies' total merchandise trade as a share of the region's GDP increased from 23.1% to 42.8%, the share of trade in services has increased from 4.8% to 8.4%, trade among APEC economies has tripled since 1989 and now covers 2/3 of APEC's total merchandise trade.

Addressing connectivity gaps in the region is one important way in which to ensure that more people in the region can benefit from trade. In October 2013, Chinese President Xi Jinping announced that China would initiate Asian Infrastructure Investment Bank (AIIB) to mobilize more resources to invest in the region in terms of infrastructure financing. Since then, a temporary multilateral secretariat has been established; experts have been invited from international institutions such as the World Bank, ADB, IMF, and the European Investment Bank (EIB) to join the preparation work. Importantly, unlike the World Bank, ADB and the IMF, which prioritize poverty reduction, the AIIB focuses on infrastructure. Also established at the same time is the Silk Road Fund, which will be used to provide investment and financing support to infrastructure, as well as other resources and industrial cooperation. The Fund will be open to active participation by investors both from this region and out of the region. This Fund is more of an investment fund in Asia, and will hold the principle of marketization, internationalization, and specialization.

The Singapore National Committee for Pacific Economic Cooperation (SINCPEC) and the Philippine Pacific Economic Cooperation Committee (PPECC) co-organized annual Singapore PECC conference, "Achieving Inclusive Economic Growth in the New Normal," on 27 February 2015 in support of APEC 2015 chaired by the Philippines. While the 2015 APEC priorities touch upon a wide range of policy areas and the related projects currently underway are numerous, they are closely interconnected and mutually supportive. Effective and timely cross-sectoral coordination on the part of the policy-makers and ministries would be essential for the region's economies to harness the dynamic changes and innovations taking place in various sectors and industries.

The conference addressed the following themes through five plenary sessions:

1) Asia-Pacific Economic Cooperation in a Changing Global Context: Risks and Opportunities
2) Inclusive Growth: Building Capacity at Individual and Community Levels

3) Connectivity and Regional Economic Integration: Reaping the Benefits of Economic Integration
4) Financing Inclusive Growth
5) Making Regional Economic Integration More Inclusive

Acknowledgements

The PECC, SINCPEC and PPECC are grateful to all who have contributed in one way or another towards the successful publication of this report. In particular, the organizers would like to thank all contributors and participants of the event who have helped to make the event a huge success.

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Conference Programme

Program for

2015 PECC-SINCPEC-PPECC Conference

"Achieving Inclusive Economic Growth in the New Normal"

Co-Organized by SINCPEC & PPECC, 27 February 2015

Overview

The Philippines takes on the chairing of APEC at a time of tremendous change in the regional and international economy. The recovery from the Global Financial Crisis remains fragile and to a large extent dependent on extraordinary economic stimulus. During the APEC leaders' meeting in Beijing, key decisions were taken to make progress on key elements of the regional agenda, including on a Free Trade Area of the Asia-Pacific and improving connectivity. The challenge is how regional economies can implement these plans to ensure that regional growth is not only sustainable but also inclusive.

Friday, 27 February 2015	
0830 – 0900	**Registration of participants**
0900 – 0930	**Welcome Remarks:** • Dr Tan Khee Giap, *Chairman,* Singapore National Committee for Pacific Economic Cooperation (SINCPEC) • Mr Jusuf Wanandi, *Co-Chairman,* Pacific Economic Cooperation Council (PECC) • Ambassador Antonio I. Basilio, *Chairman*, Philippine Pacific Economic Cooperation Committee (PPECC)
0930 – 0950 0950 – 1000	**Opening Speech** • Ambassador Laura Q. Del Rosario, *SOM Chair 2015* • Mr Emmanuel F. Esguerra, *Deputy Director-General,* National Development Office for Policy and Planning, National Economic and Development Authority, Republic of the Philippines **Q&A Session** **Moderator:** • Mr Ian Buchanan, *Chairman*, Australian Pacific Economic Cooperation Committee (AUSPECC)
1000 – 1015	**Coffee Break**
1015 – 1120	**Session 1: Asia-Pacific Economic Cooperation in a Changing Global Context: Risks and Opportunities** APEC 2015 will take place in a rapidly changing regional and global context. Several mega-trends are changing not only the shape of the global economy but also the way in which economic interactions take place. Energy prices have slumped increasing uncertainty in international markets, income inequality is on the rise and with it the risk of increased trade protectionism, while

	middle class consumption in the region's emerging economies and rapid technological advances and adoption present both risks and opportunities for future economic growth.
1015 – 1020	**Moderator:** • Dr Manfred Wilhelmy, *Chairman*, Chilean National Committee for Pacific Economic Cooperation (CHILPEC)
1020 – 1040	**Lead Panellist:** • Dr Narongchai Akrasanee, *Minister of Energy* & *Chairman*, Thailand National Committee for Pacific Economic Cooperation (TNCPEC)
1040 – 1110	**Panel Discussion:** • Dr Il Houng Lee, *President*, Korean Institute for International Economic Policy & *Chairman*, Korea National Committee for Pacific Economic Cooperation (KOPEC) • Mr David Carbon, *Managing Director, Chief Economist*, DBS Bank • Dr Peter Lovelock, *Director,* Technology Research Project Corporate (TRPC)
1110 – 1120	**Q&A Session**
1120 – 1300	**Lunch**
1140 – 1200	**Distinguished Luncheon Speaker:** • Mr Roberto Tan, *Treasurer of the Philippines*, Department of Finance, Republic of the Philippines
1200 – 1210	**Q&A Session** **Moderator:** • Dr David Hong, *Chairman*, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC)
1300 – 1405	**Session 2: Inclusive Growth: Building Capacity at Individual and Community Levels** In 2010 APEC leaders adopted a growth strategy to provide a comprehensive long-term framework for promoting high-quality growth in the region. The Growth Strategy focused on the five desired attributes of balanced, inclusive, sustainable, innovative, and secure growth. How much progress has been made on the strategy? What additional actions should APEC economies take to ensure quality growth in the future?
1300 – 1305	**Moderator:** • Mr Denis McNamara, *Chairman*, New Zealand Committee of the Pacific Economic Cooperation Council (NZPECC)
1305 – 1325	**Lead Panellist:** • Ambassador Laura Q. Del Rosario, *SOM Chair 2015*
1325 – 1355	**Panel Discussion:** • Singapore Education Model: Ms Indranee Rajah, *Senior Minister of State,* Ministry of Law & Ministry of Education (TBC) • Dr Djisman Simandjuntak, *Chairman*, Executive Board of Prasetiya Mulya Foundation; *Chairman*, Board of Directors, Center for Strategic and International Studies Foundation, Jakarta & *Chairman*, Indonesian National Committee for Pacific Economic Cooperation (INCPEC) • The Challenge of Building Resilient Communities in the Ring of Fire: Mr Joey Salceda, *Governor* of Albay, Republic of the Philippines
1355 – 1405	**Q&A Session**
1405 – 1510	**Session 3: Connectivity and Regional Economic Integration: Reaping the Benefits of Economic Integration** In 2013 APEC leaders stated that seamless physical, institutional, and people-to-people connectivity are critical prerequisites in attaining the APEC community vision. By connecting the

	region's developed and emerging growth centers around and across the Pacific Ocean and within APEC's archipelagic and continental regions. In 2014, APEC leaders endorsed a detailed Blueprint for Connectivity. What actions should APEC economies take to implement the Blueprint?
1405 – 1410	**Moderator:** • Tan Sri Rastam Mohd Isa, *Chairman*, Malaysia National Committee for Pacific Economic Cooperation (MANCPEC)
1410 – 1430	**Lead Panellist:** • Mr Adrian Cristobal, *Undersecretary for Industry Development*, Department of Trade and Industry, Republic of the Philippines
1430 – 1500	**Panel Discussion:** • Dr Mari Elka Pangestu, Center for Strategic and International Studies • Mr Li Shan, *Chief International Business Adviser*, China Development Bank • Mr Hugh Stephens, *Vice Chairman*, Canadian National Committee for Pacific Economic Cooperation (CANCPEC) & *Executive-in-Residence*, Asia Pacific Foundation of Canada
1500 – 1510	**Q&A Session**
1510 – 1525	**Coffee Break**
1525 – 1630	**Session 4: Financing Inclusive Growth**
	Since 2010 regional economies have emphasized the need for inclusive growth – which includes ensuring that the benefits of the economic integration process are more spread out. The challenges are multifaceted – from the lack of infrastructure to connect second and third tier cities to the need to reform and broaden the education system and providing sufficient but sustainable social safety nets. This session will tackle the financial aspects of inclusive growth strategies.
1525 – 1530	**Moderator:** • Dr Alan Bollard, *Executive Director*, APEC Secretariat
1530 – 1550	**Lead Panellist:** • Mr Cledan Mandri-Perrott, *Head of Infrastructure Finance and PPP*, Singapore Infrastructure Hub, The World Bank Group •
1550 – 1620	**Panel Discussion:** • Mr Mark Rathbone, *Partner*, Advisory CP&I Capital Projects & Infrastructure, PwC Singapore • Mr Mario Artaza, *Chief Representative*, Hong Kong Representative Office, Banco Security • Mr Zhou Qiangwu, *Executive Deputy Director General*, Asia-Pacific Finance and Development Center Beijing Office, Ministry of Finance, China
1620 – 1630	**Q&A Session**
1630 – 1735	**Session 5: Making Regional Economic Integration More Inclusive**
	Regional economic integration initiatives are gaining pace – the ASEAN Economic Community is due to be completed by the end of 2015, the Regional Comprehensive Economic Partnership is supposed be concluded by the end of the year and the TransPacific Partnership may gain momentum from President Obama's request for Trade Promotion Authority. While these initiatives promise large economic gains, the challenge is to ensure that businesses, especially small and medium enterprises are prepared to benefit from them.
1630 – 1635	**Moderator:** • Ambassador Tang Guoqiang, *Chairman*, China National Committee for Pacific Economic Cooperation (CNCPEC)
1635 – 1655	**Lead Panellist:**

1655 – 1725 1725 – 1735	• Ambassador Ong Keng Yong, *Executive Deputy Chairman*, S. Rajaratnam School of International Studies **Panel Discussion:** • SMEs in Global Value Chains: Dr David Hong, *President*, Taiwan Institute of Economic Research (TIER) & *Chairman*, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC) • Global Value Chains and Imperatives for Regional Integration Initiatives: Professor Christopher Findlay, *Executive Dean*, Faculty of the Professions, University of Adelaide & *Vice-Chairman*, Australian Pacific Economic Cooperation Committee (AUSPECC) • European Experience: Dr Filippo di Mauro, *Senior Adviser*, Research Department, European Central Bank **Q&A Session**
1735 – 1745	**Conference Closing Remarks:** • Ambassador Donald Campbell, *Co-Chairman,* Pacific Economic Cooperation Council (PECC)
1745 – 2000 1745 – 1815 1830 – 1850 1850 – 1900	**Conference Dinner** **Cocktail Reception** **Distinguished Dinner Speaker:** • Professor Naoyuki Yoshino, *Dean*, Asian Development Bank Institute **Q&A Session** **Moderator:** • Dr Charles E. Morrison, *President*, East West Center
END OF CONFERENCE	

Welcome Remarks

Speakers:

- **Dr Tan Khee Giap**, *Chairman,* Singapore National Committee for Pacific Economic Cooperation (SINCPEC)
- **Mr. Jusuf Wanandi**, *Co-Chairman,* Pacific Economic Cooperation Council (PECC)
- **Ambassador Antonio I. Basilio**, *Chairman*, Philippine Pacific Economic Cooperation Committee (PPECC)

Dr Tan Khee Giap:

Good morning, ladies and gentlemen, our guests of honor, Ambassador Laura Del Rosario, APEC Senior Official Meeting (SOM) Chair, Mr. Adrian Cristobal, Undersecretary Department of Trade and Industry Philippines, Dr. Emmanuel Esguerra, Deputy-Director General National Economic Development Authority, Mr. Bobby (Roberto) Tan, Treasurer of the Philippines, Minister Narongchai from Thailand, and distinguished guests and your excellencies. A warm welcome to Singapore, as you know today is a ninth day of the Chinese Lunar New Year and I wish all of you a happy, healthy, and prosperous new year ahead.

From the Lee Kuan Yew (LKY) School, we only make three points, not more than that. First point, we from the Pacific Economic Cooperation Council (PECC) families should be proud that we have such a thing and impactful activities especially since 2009, it has become a tradition over the last five years including this being our sixth year; we have had a PECC - Singapore National Committee for Pacific Economic Cooperation (SINCPEC) conference and together with the Asia Pacific Economic Cooperation (APEC) host PECC, like in this instance the Philippines, to have the pre-APEC seminar so that we can discuss issues that can later on help APEC to form ideas and advance the various issues. I think that over the past five years including this year I did a rough calculation, the Singapore government has contributed one million Singapore Dollars to organize the six conferences including this one. I would like to thank our Ministry of Foreign Affairs, Ministry of Trade and Industry for their support and I think that is very important.

Second point, we also manage to have a conference proceeding every year and of course the conference proceeding is important for us to make sure that there is continuity in the issues being discussed. I remember 2009 when Singapore was the host of APEC, and we advanced the theme called inclusivity. I think as of the conference this year, we touch on issues on inclusive growth within the economies and across the economies. I think such things are possible because of the proactive leadership of co-chairs of PECC, plus very strong support from the PECC member economies to help SINCPEC over the last five years including this year, so I really want to say thank you.

Final point, for this 2015 PECC, SINCPEC and PPECC conference, I must in particular thank Ambassador Antonio and his team for helping us to source important speakers, and also the PECC secretariat, headed by Eduardo and his team members, that helped us source so many speakers with so many changes that we eventually we were able to put up a very good program I think. I cannot forget to mention first, usually you do this at the end of the conference but I would like to do it now, I want you to understand that if SINCPEC team members have not served you in the best way you expected, we apologize, but I think they put up a very good show, and I hope that we should give them a round of applause. I think I will stop here, as there are so many speakers. Today is one very full day, and I know you will be very tired, and we'll make sure that the dinner will be scrumptious to you too. Thank you very much.

Mr. Jusuf Wanandi:

On behalf my co-chair, Ambassador Don Campbell and all of us here, let me express our gratitude to our guest of honor Ambassador Laura Del Rosario, APEC SOM Chair 2015 for her presence, as well as that of her colleagues from the Philippines:

- Mr. Adrian Cristobal, Undersecretary, Department of Trade and Industry
- Dr. Emanuel Esguerra, Deputy Director General, National Economic Development Authority
- Mr. Bobby Tan, Treasurer of the Philippines

These are the key people charged with shepherding the APEC process this year, and that is an enormous responsibility that you have and we are honored that you have taken the time out of your busy schedules to be with us here today. Your presence here is a testament to the enduring relationship between the APEC process and PECC. Many of us here have watched APEC from the very beginnings – both myself and my colleague and friend Ambassador Antonio Basilio attended the first APEC Ministerial Meeting in Canberra a quarter of a century ago. The Asia-Pacific region is in a period of historic change. To illustrate the enormity and complexity of the transition to a new equilibrium let me list a few punctuated shifts, which are going to preoccupy us for an extended period of time. Our own region, the Asia Pacific is heading, first of all, toward an aging population at different speeds with far-reaching implications on regional and global divisions of labor and the movement of people in their wake. Secondly, some powerful technologies such as synthetic biology with its tremendous potentials for food and healthcare, big data and its likely huge impacts on almost everything in human life, including robotics, and 3-D manufacturing with its potential for continuous reinvention of all human-made things, are getting closer to commercial stage, mutually reinforcing each other to redefine how we live and work across national and borders. Third, the games of technology catching up has turned very successful in a few cases but remained elusive to the big majority of economies and people living therein. This unequal success in catching up is perhaps the deepest root of rising inequality of the recent kind, which we are used to referring to whenever we are gathering.

Fourth, super-cities are emerging in the Asia Pacific which are relatively well connected with one another but only poorly so with their respective peripheries. Physical and social infrastructures in these super-cities are strained to the utmost and relief is slow to progress.

Fifth, the elements that we emit as consequence of growth is biting us back in a poorly understood mechanics. Preventing such revenge effects from getting out of hand requires nothing less than global actions, but they too are hard to bring to fruition.

Sixth, while income has risen at an unprecedented pace in some parts of the Asia Pacific and hundreds of millions of people are freed from abject poverty we observe with great concern how the speed of development is decelerating throughout our region despite the recent brightening spot in the United States. Not only is output growth rate falling, green-field foreign investments in the Asia Pacific also suffers from a deep fall. Even trade is losing steam. In other words the engine of economic development in our part of the world is showing signs of fatigue at a time when most of us are yet to cross safely over the middle income trap.

The illustration can extend on and on. We know that such a drama is not new in human history. People who lived before us had dealt successfully with shifts that are even more dramatic than the ones facing us today. The human race is smart enough to find ways of reinventing its culture, though at times with huge learning costs such as wars. Interestingly, a wider and deeper openness is almost invariably part of the reinvention, partly because of the recognition that a retreat from openness usually ends up self-destruction. It is connection with the recent apparent weakening of confidence in open policies that we at PECC need to remind our leaders in APEC of the urgent need to return to the basic open policy architecture which we all have profited a great deal in the last forty years or so.

Let me amplify my message by drawing attention to a few discouraging conditions. The Doha Development Agenda (DDA) has been dragging on and on with little prospect of being re-ignited. Even the Bali Package is yet to turn into a concrete progress with sufficient political support for implementation. Therefore, APEC 2015 under Philippine leadership has to instill a sense of urgency among leaders that a progress in crafting global agreements on trade and investment is indispensable in a world where ideas and technologies move very fast across borders. Without such re- ignition the recent deceleration in our region may exacerbate to our surprise.

Another discouraging trend relates to the proliferation of preferential agreements of which some are bilateral and have nothing to do with regional integration. This trend
has lasted for 20 years since the conclusion of the Uruguay Round and is yet to be reversed. With the preferential agreements of the narrow scope the world economy is fragmented rather than integrated. Therefore, the APEC process of 2015 has to step up beyond the commitment made at APEC 2014 on pursuing the Free Trade Agreement of the Asia Pacific (FTAAP) as a converging force of Asia-Pacific integration and cooperation.

We at PECC have always been a voice of opening throughout our history. When development was stumbling on the tight limits of import substitution we successfully inspired politicians to switch to open trade and investment policy, unilaterally, regionally and multilaterally. Now that the inward-looking policy is threatening to reincarnate it is our duty to look for ways of arresting arrest drifting and of reversing it as soon as possible.

We do know well that policy opening is never a panacea. It needs complements in form of capacity building and facilitation to be able to a development which is both more inclusive and more sustainable. That the APEC agenda has widened and continues to do so is a simple reflection of the diversity of our region. We appreciate the leadership of the Philippine in choosing the theme: “Building Inclusive Economies, Building a Better World” for APEC 2015. Based on the theme the agenda has clearly taken shape with priorities being attached to enhancement of regional integration, mainstreaming small and medium enterprises (SMEs) in global and regional markets, investing in human capital as it relates to alignment of workforce with future technologies, health and women, and advancement of education, science and technology, and, the fourth priority, building sustainable and resilient economies.

We observe continuity in the APEC agenda of the last few years. We also recognize the very extensive nature of the agenda, which may still extend to other issues as the 2015 APEC process evolves. While accepting such scope as fact we do somehow need to agree on a focus. Knowing the human capital development edge that the Philippines has nurtured in our region over the years it does seem sensible to place human capital development as pivot for the 2015 APEC works. By forging effective integration and cooperation in human-capital related services the capacity to benefit from trade and investment liberalization is distributed less unequally between APEC economies and between classes of people in respective economies. A growing stock of human capital and its better distribution are also a condition-sine-qua-non for the adoption sustainable development among politicians and business communities.

Education and vocational training, structural reforms to improve the functioning of markets and trade-related infrastructure are mentioned as priority issues in our State of the Region survey. All three of these are due to be addressed by APEC this year. Today is our opportunity to discuss these issues and suggest ways in which to deliver concrete outcomes for the stakeholders of integration – everyone one of us, but most especially those who are yet to benefit from it.

In closing, I would like to take this opportunity to express our gratitude to Dr. Tan Khee Giap and his staff at SINCPEC and Ambassador Basilio and his Philippine Pacific Economic Cooperation Committee (PPECC) team for putting together this event. I also wish to acknowledge and thank the Singapore government for their support of what is now the 7th of our conferences here.

While PECC is an official observer of APEC, we try to look at the region more broadly and to undertake research and make recommendations that we believe important for the future development of the Asia-Pacific. This event enables us to think more specifically about the APEC agenda and to provide ideas and suggestions on how to make progress on the priorities set by the APEC host.

In that vein I hope that all of you will take the time to share your ideas and views on the issues we have put forward today. Between now and the Concluding Ministerial we should be able put together a set of realistic recommendations on making Asia Pacific integration and cooperation a force of greater inclusion and sustainability.
Thank you.

Ambassador Antonio Basilio:

Good morning everyone – colleagues from the PECC community, distinguished officials from the Philippine government, resource persons and guests.

This is the fifth in the series of conferences that Singapore PECC, under the leadership of Khee Giap, has co-sponsored with PECC International and the host PECC National Committee of the APEC Chair, to provide a forum for contributing to the richness of the ongoing discussion of regional issues of priority to the host APEC economy. This is in keeping with PECC's traditional role of providing substantive inputs to the various economic policy and governance issues confronting the region. The conference provides a direct and very public avenue for PECC to participate in the APEC process by engaging government officials from the host economy and from other APEC members in a dialogue on the burning issues of the day – APEC wise that is.

From the Philippine National Committee's perspective, this year has been unprecedented in terms of the interaction and of the opportunities provided for mobilizing the PECC community to provide substantive support to the host APEC economy. I think this support is appreciated because its provides a substantive foundation based on research and best practices for the advocacy effort to get the various publics – that includes the general public, interest groups, the legislature and the bureaucracy - to understand and support the causes and actions espoused by the host economy.

SOM Chair Undersecretary Lullah del Rosario has from the outset of the Philippine year, engaged PECC in efforts to get a buy-in from stakeholders. This began with the Informal Senior Officials Meeting (ISOM) held last December followed by the holding of the Public-Private Sector Dialogue on Services, the first of which focused on Business Process Management (BPM), the creative industry and Research and Development (R&D). The second one, which will be held on the margins of SOM II, will focus this time on manufacturing- related and agriculture-related services. This engagement will continue with the PECC

General Meeting which, will be held in September in Manila, where hopefully we can share some of the findings of ongoing projects of PECC, give updated views of issues of relevance to the Philippine hosts particularly since this takes place two months before the APEC Leaders' Week, and begin discussion on issues likely to be of priority to the incoming chair Peru.

The Philippine host economy narrative which PECC has been providing inputs to is on the need to address the widening gap between the "haves and the have not's". This inequality is the unintended consequence of the unprecedented rise in wealth as a result of globalization which itself is driven by quantum leaps in technology and market-oriented reforms. When APEC was established in 1993, one of the founding principles was to "develop more effectively the human and natural resources of the Asia-Pacific region so as to attain sustainable growth and equitable development of APEC economies, while reducing economic disparities among them and improving the economic and social well- being of our people." At that time, the concern was the inequality between economies. Now the more urgent issue is the inequality in the distribution of wealth within economies. This has become a major political challenge – a hot button - shared by all economies in the region, developed or emerging.

Inclusive growth was one of the five attributes of high quality growth that APEC Leaders enunciated in 2010. The other attributes are balanced, sustainable, innovative and secure. While these attributes can stand alone, as Dr. Bollard has shown in a remarkable chart at ISOM of APEC 2015 priorities and tasking, that these attributes are interconnected and mutually supportive. The correlation was highest between inclusiveness and innovation. This was totally in keeping with one of the conclusions of the ISOM discussion, which is that of the importance of empowering individuals, companies and communities to take advantage of the opportunities of regional economic integration and withstand economic shocks. Innovation – which implies not only technology but innovative ways of doing things – is a key to empowerment.

This also explains why the focus on human capital development, mainstreaming SMEs, growing the services industry and enhancing participation in the Global Value Chains (GVC) as a way to provide equal access to growth opportunities that regional economic integration provides. If people lack the skills and mindset to fully participate in the global economy, then the removal of barriers and the facilitation of connectivity will not provide the dynamism for inclusive growth to prosper. Promoting SME growth has a direct and significant impact on inclusion because SMEs account for the most number of business and employment in the region. But despite their importance, SMEs have not been major participants in international commerce. From an economic activity standpoint, services account for the biggest number of employment (46%) and output (70%) and involves SMEs. So promoting the adoption of policies that will be conducive to the development of the service sector as well as enhance their global competitiveness particularly where GVC dominate are deemed as pro-active measures to promote inclusion.

Since our region is the most vulnerable to disasters – natural, health and financial – and since the poor are the least able to cope and recover from their impact, building resilience in the system makes eminent sense. This therefore is also one of the priority issues that APEC is addressing this year. Connectivity and financial inclusion are likewise included here because they also are key facilitators of inclusive growth.

This is the narrative that PECC and the PPECC in particular are supporting the Philippines in developing. Our tri-partite nature (embodied by distinguished members like Mari Pangestu and Khun Narongchai whose career has shifted from academic, business and government) makes our views I think more relevant and well-rounded and hopefully appreciated.

I do not think I can add anything more to what has been said previously – without risk of repetition – so what remains for me to do is to thank our officials from the Philippine Government for taking time off from their packed schedule to join us here and share their views. We are very grateful for your presence.

Opening Speech

Speakers:

- **Ambassador Laura Q. Del Rosario**, SOM Chair 2015
- **Mr. Emmanuel Esguerra**, *Deputy Director-General,* National Development Office for Policy and Planning, National Economic and Development Authority, Republic of the Philippines

Moderator:

- **Mr. Ian Buchanan**, Australian Pacific Economic Cooperation Committee (AUSPEC)

Mr. Ian Buchanan:

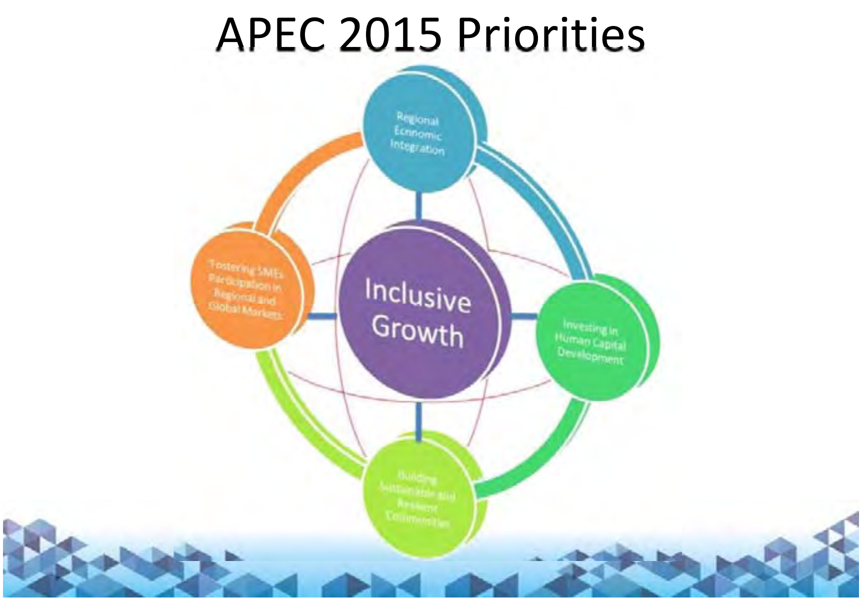
Thank you, welcome, old friends. This session illustrates two special aspects of PECC. First, Philippines' commitment to inclusiveness - we have two opening speeches. Secondly, the tripartite, both of them have prominent academic and public service careers, and I bring the business, so you have the tripartite here. We have complete descriptions in the handouts; we only have half an hour for this so both speakers, Ambassador Laura Del Rosario and Mr. Emmanuel Esguerra, will try to keep their talks to 10 minutes, and said might speak quickly in order that we might try to have 10 minutes for Q and A afterwards. So with no further ado, let me introduce Ambassador Laura Del Rosario for her opening speech. Thank you.

Ambassador Laura Q. Del Rosario:

Good morning, Dr. Tan Khee Giap, Mr. Wanandi, Ambassador Tang and all those who are involved in APEC, PECC, and the leadership. It is always humbling to me to be speaking before such an audience because I know that they will emerge so well informed and better prepared in the field of economics and policy making, and I know I am sometimes overwhelmed by their academic degrees. Only reason that I am here is because I know I am the SOM Chair and there is nothing anyone can do about that, whether people like it or not, you have to listen to me. I also wish to say to my fellow colleagues in the Philippine Government, Ambassador Basilio and Undersecretary Mr. Adrian Cristobal, and Mr. Esguerra, they are policy giants in my government and again the only reason that they listen to me is because I am a woman, and in the Philippines, the woman always has the last say, especially if they are married.

Let me now go into our own priorities, this is our theme building inclusive economies and a better world, and as mentioned before by Mr. Wanandi, these are our priorities, what we want to focus on, and definitely focus on regional economic integration and keeping the openness principle, and helping SMEs, and then building sustainable and resilient communities, but there's something that I want everyone to be aware of in investing in human capital development. For me, the three others will not be possible without human capital investment. Whatever we do and no matter the economic policies we do, it will not matter if you do not have the people who will really do what needs to be done. What's inclusive growth? This started with PECC in 2013, and Ambassador Basilio already mentioned the five aspects of sustained growth; balance growth, inclusive growth, sustainable growth, innovative growth, and secure growth. In that study, people were least happy about what was being done in inclusive growth, and that's the second one you see on the graph.

Figure 1.1.1



And of course inclusive growth is also very much evident in the study done by the Organization for Economic Co-operation and Development (OECD), when it says that when it comes to the

Gini coefficient of household incomes, APEC economies somehow have already started to show growing inequalities. According to another study, they said that income inequality has been going on for the past 20 years, moving slowly until here we are where incomes are an important issue.

Figure 1.1.2

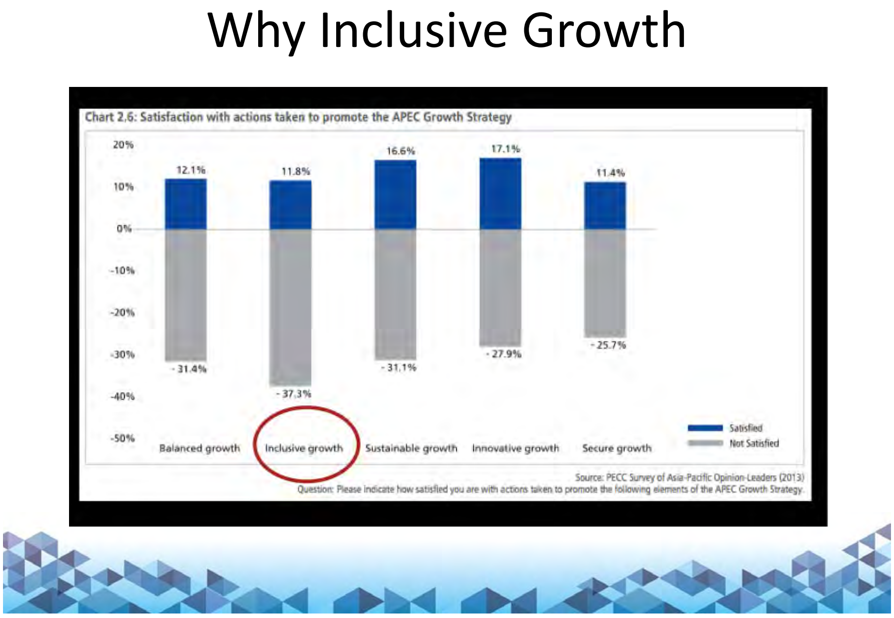
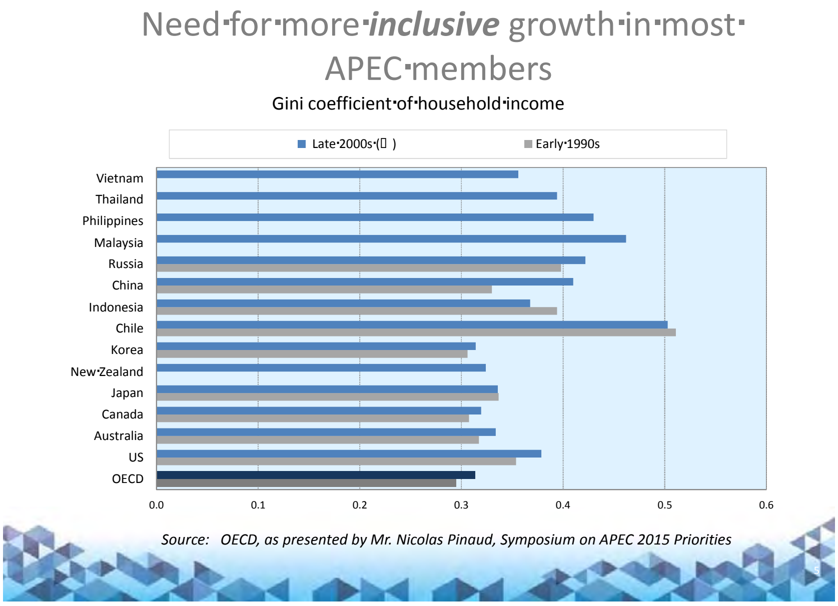
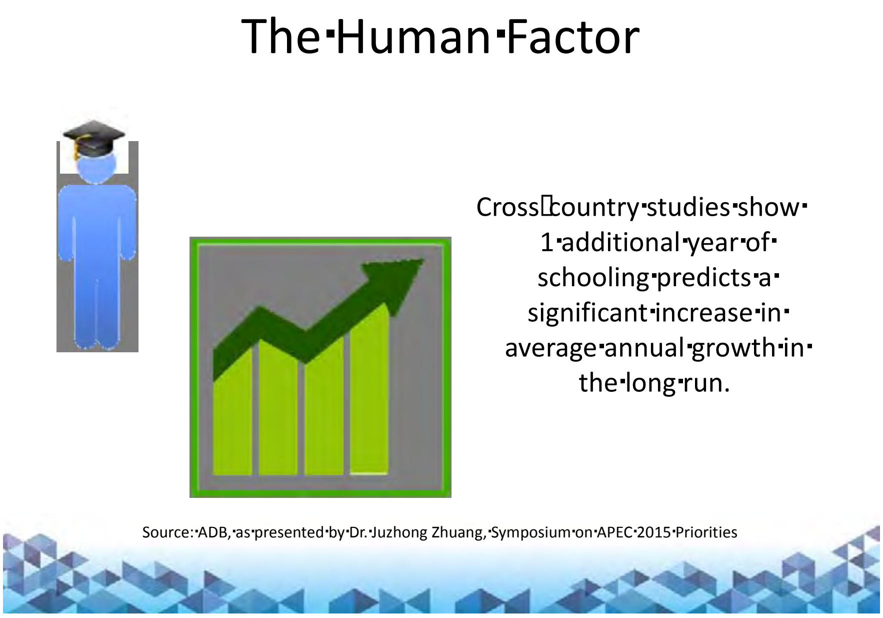


Figure 1.1.3



Now why is it important to the Philippines to do this? Because for us, it can be a social issue. We know that whenever there is income disparity, it becomes a class divide that could lead to social unrest. I think for developing countries especially, it becomes more and more urgent. Of course there has been hollowing of the middle class, when the middle class becomes poorer or join the lower income that can also cause some political dissatisfaction. Of course, people have said that right now 1% of the world's wealthy people control 50% of the global wealth and it is supposed to grow to 54% and higher and higher. What also shows that part of this, whether it is income inequality within an economy is because the labor income growing smaller because labor is getting cheaper and at the same time capital income is also increasing. This is actually the main reason I was invited here, I was supposed to talk on a panel on capacity building except that Secretary of Planning Dr. Wisarang could not make it. Therefore I will divide my presentation this morning, and I'll stop at a certain point to talk about the new normal.

Figure 1.1.4



If you look at my background, I focused on education. I've become a little bit afraid of what schools can do. For us in the Philippines, the new normal involves climate change. We saw that in 2013 when typhoon Haiyan devastated many of our provinces. We are now aware of the role of technology and how destructive it can be. The more I think about it, the more I worry because I also know there is correlation between poverty and intelligence. If we have to look at the new normal and what it will look like, people will have to have an IQ of at least 100 to survive in this world, and they also have to handle technology so that they can handle the changes brought about by this structure. And of course, then I go into the genetics of it, and then they say it is genetics? It is environment? It is training? More and more I begin to appreciate what former Prime Minister Mr. Lee Kuan Yew said: you are only intelligent once you are married, or I said, maybe people will start really thinking in terms of making people a little more aware of the need for increasing brain power. Now of course, this will go into human lives and all that, at the same time, I'm trying to think here, ok, if poverty really contributes to a less intelligence then it's a vicious cycle so that you can address poverty so that you can address intelligence and also address the way families are run. Of course, it goes without saying, an educated mother will also raise a more educated and intelligent child. Later on I will discuss technology, innovation and education, maybe we do need in APEC a deeper discussion on methodologies of education on how do we teach people to think, how do we teach people to innovate? Can innovation be taught? Can teachers right now handle the challenges of education? What appropriate policies should be and adopt to support innovation? And what appropriate methodology to we support education to promote innovation?

Figure 1.1.5

The "New Normal"

Disruptions caused by technological innovations and climate change require:

On Technology

1. Innovation and education – *training people to innovate and manage innovation*
2. Appropriate policies to support innovation

On Climate Change

1. New services and jobs related to emergency planning, sustainability, planning
2. Developing expertise in environmental-related services and technologies

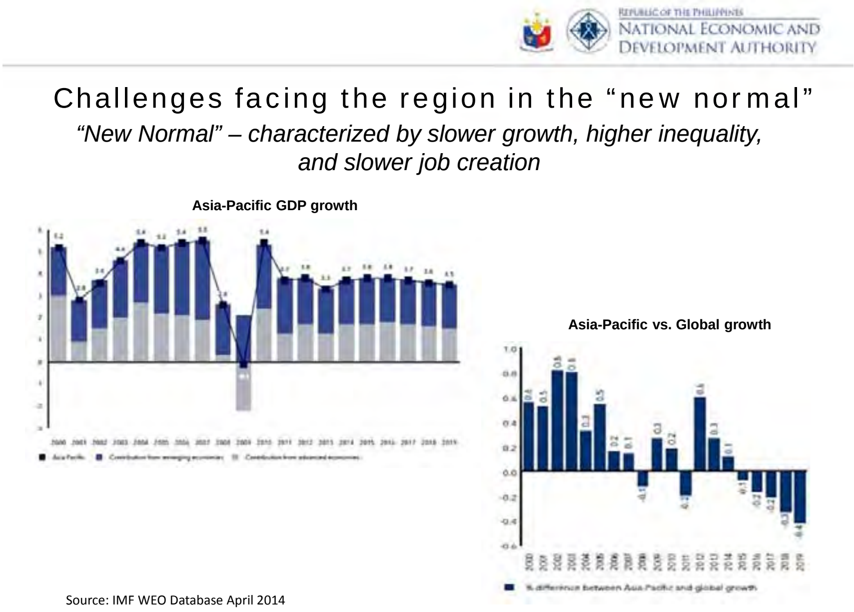
Now on climate change, of course we have to think about the new services and jobs related to emergency planning. That means even our curriculum should be able to handle these. We have to develop expertise in environment related services and technology. In other words, if we have to think of the new normal, we think of this, technology and climate change. Thank you very much.

Mr. Emmanuel Esguerra:

Ladies and Gentlemen, good morning. First of all, I would like to thank the organizers of 2015 Conference of the PECC for this opportunity to speak before you about the challenges facing the Asia-Pacific in the so-called “new normal”, the priorities of APEC in 2015 in response to these challenges, and how the Philippines itself has been addressing the issue of inclusive growth in recent times.

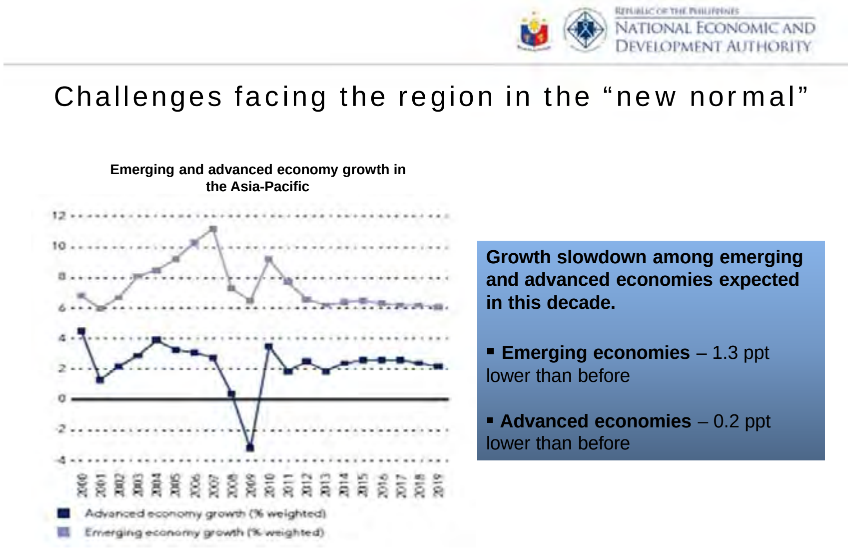
This year, the Philippines is chairing the APEC amid tremendous changes in the regional and international economic landscapes. Despite impressive growth recorded at the beginning of this century, growth in Asia-Pacific after global financial crisis of 2008 to 2009 seems to have entered into a “new normal”, characterized by slower growth, higher inequality, and slower job creation. For instance, in the first decade of this century, the Asia-Pacific grew at around 0.4 percentage points higher than the world economy. But this is projected to change in the current decade, with growth seen to be a par or even increasingly below the global average. This was in no small measure explained by the impact of the Global Financial Crisis, after which average growth in the region was recorded at around 2 percentage points lower. The overall slowdown in the region is expected to continue, driven further by slower growth rates in China and Japan.

Figure 1.2.1



The nature of regional growth is also changing. For instance, while both emerging and advanced economies are expected to experience lower average growth in this decade, the slowdown is expected to be larger among emerging economies than in advanced economies. Although some of this slowdown can be attributed to some countries' graduation from low- to middle-income status, many countries--especially those in Asia--are at risk of being caught by the "middle-income trap", facing greater difficulty in joining the ranks of advanced economies.

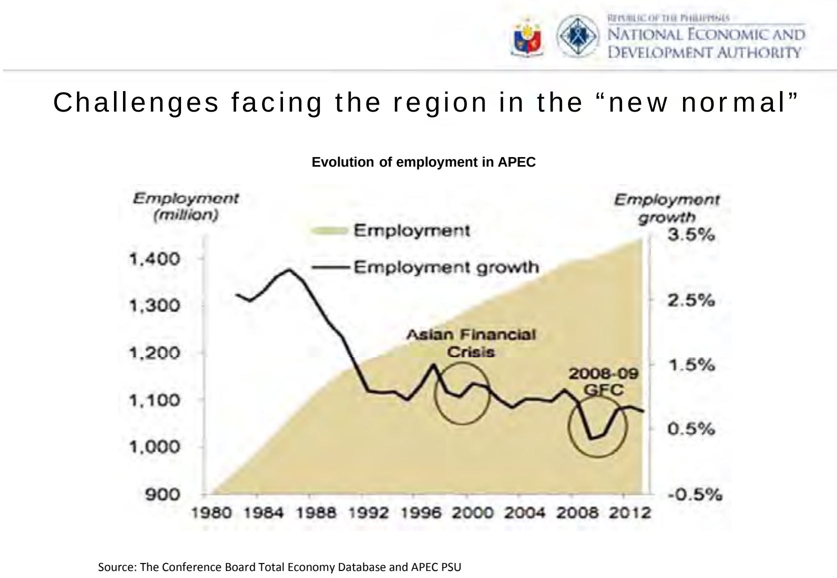
Figure 1.2.2



Source: IMF WEO Database April 2014

This overall slowdown in growth in the "new normal" is undoubtedly hampering APEC's objective of promoting inclusive growth in terms of employment generation and poverty reduction. For instance, while employment growth has been decreasing in the region since the 1980's, the drop in employment after the Global Financial Crisis was more pronounced than the drop in employment then right after the Asian Financial Crisis in the late 1990s. There is also a widening gap between the rich and the poor within Asia-Pacific, with the bottom quintile accounting for less than 10 percent of national income, and ultra-high net worth individuals accounting for more than half of GDP in some member economies. Finally, despite the successful halving of the extreme poverty in the region from 1990-2010, slower growth in the region will undoubtedly affect welfare improvements among the hundreds of millions of people still living in poverty.

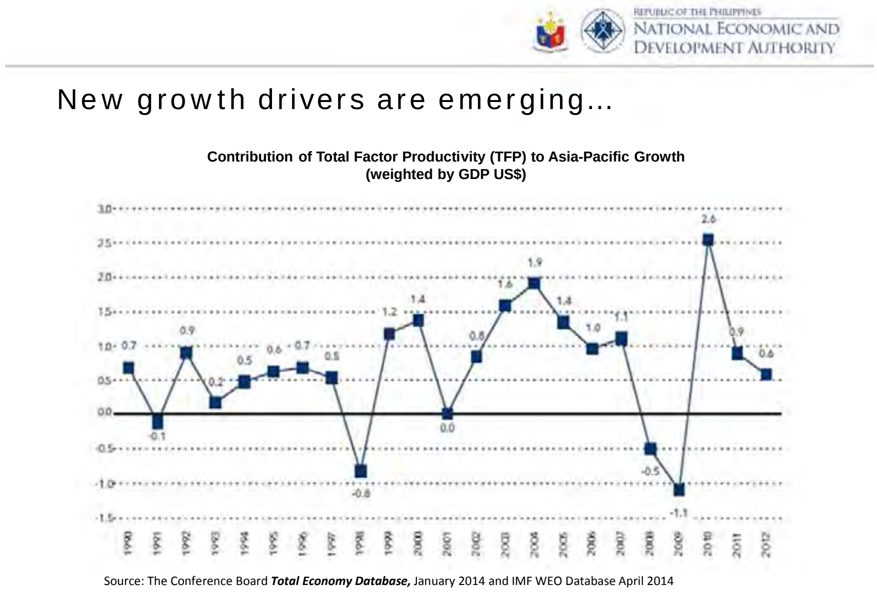
Figure 1.2.3



All in all, the region's entrance into a "new normal" in the wake of the Global Financial Crisis presents new challenges, not only in terms of promoting higher and more sustainable growth but also in making sure that such growth translates to welfare improvements among the people of the Asia-Pacific. For APEC 2015, in light of our regional and national pursuit for inclusivity, the search for new alternative drivers of high quality and inclusive growth must certainty be at the forefront of priorities for APEC meetings this year. Hence, the theme "Building Inclusive Economies, Building a Better World."

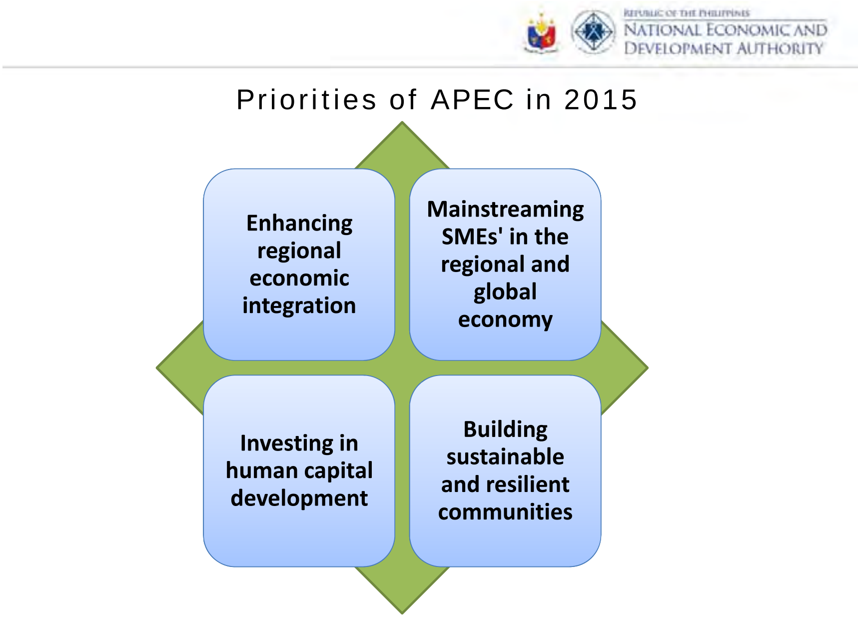
The good news is that some of these new growth drivers are already emerging. In terms of boosting economic growth, one such viable and forceful driver could be large improvements in productivity and innovation, as measured by total factor productivity (TFP). From 2000 to 2007, TFP's contribution to growth was around 1.1 percent, but declined to 0.6 percent in 2011 to 2012. Since TFP can but understood as a catch-all for the efficiency of resource management and technological progress, promoting innovation within the region must certainly be higher on APEC's agenda moving forward. To be sure, APEC is already home to the world's most conducive economies for innovation. However, there are still many where vast improvements could be made. These can be achieved through higher GDP spending on research and development, larger investments in information communication technologies, promoting higher education in science and technology, and fostering collaboration between universities and industries.

Figure 1.2.4



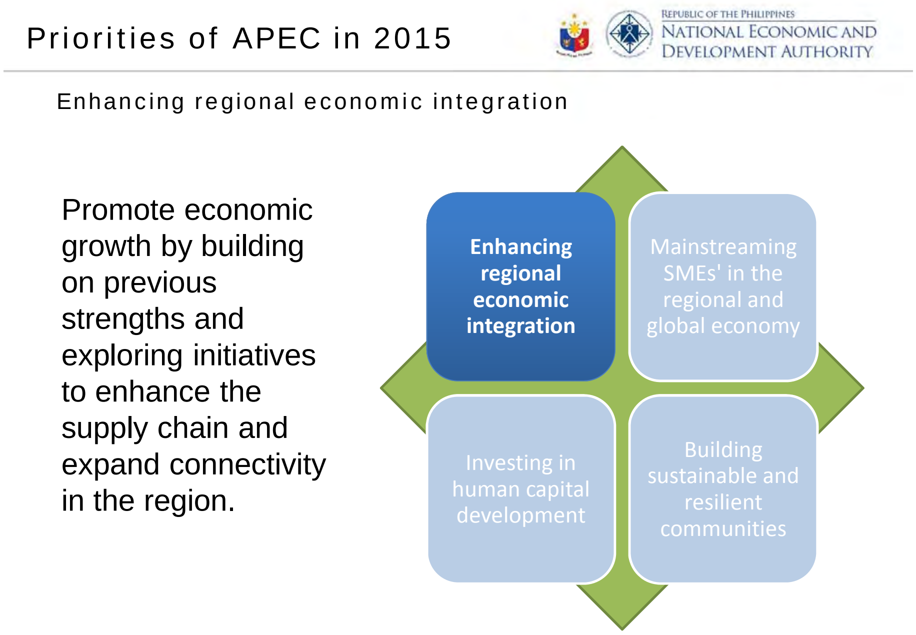
In terms of promoting development within the region, one will note that APEC 2015--chaired by the Philippines--is in fact centered on this very theme of promoting inclusive growth in the "new normal", and finding possible drivers of such inclusive growth.

Figure 1.2.5



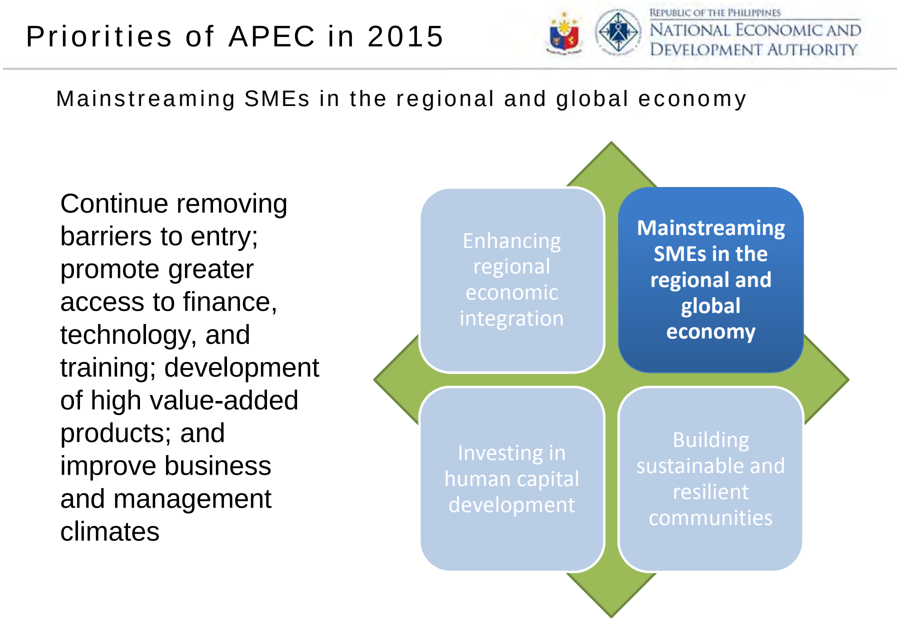
To this end, the Philippines has identified four key priority areas to building inclusive economies within APEC. First, we believe that enhancing the regional economic integration agenda in the Asia-Pacific will further strengthen and facilitate trade and investment among APEC member economies. However, the challenge for the region is to promote economic growth amid the slow recovery from the Global Financial Crisis and the projected sluggish growth of world trade over the next two years. For this reason, we need to remain resolute in our efforts towards greater economic integration by building on previous strengths and exploring initiatives that will further enhance the supply chain and expand connectivity in the region.

Figure 1.2.6



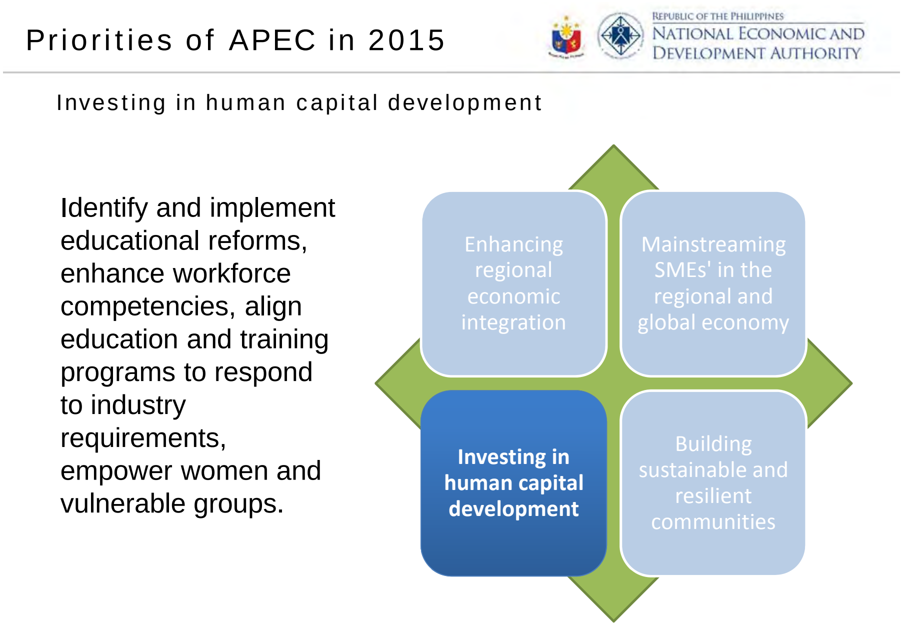
Second, boosting SMEs' participation in regional and global markets is especially crucial in promoting inclusivity since they account for 97 percent of businesses and over 50 percent of employment in APEC economies. In this regard, continued removal of barriers to entry; promoting greater access to finance, technology and training; development of high value-added products; and improving business and management climates will prove to be crucial measures. Such initiatives will have immense multiplier effects in terms of employment creation, product innovation through establishment of new industries, and rural development through backward and forward linkages in the supply chain.

Figure 1.2.7



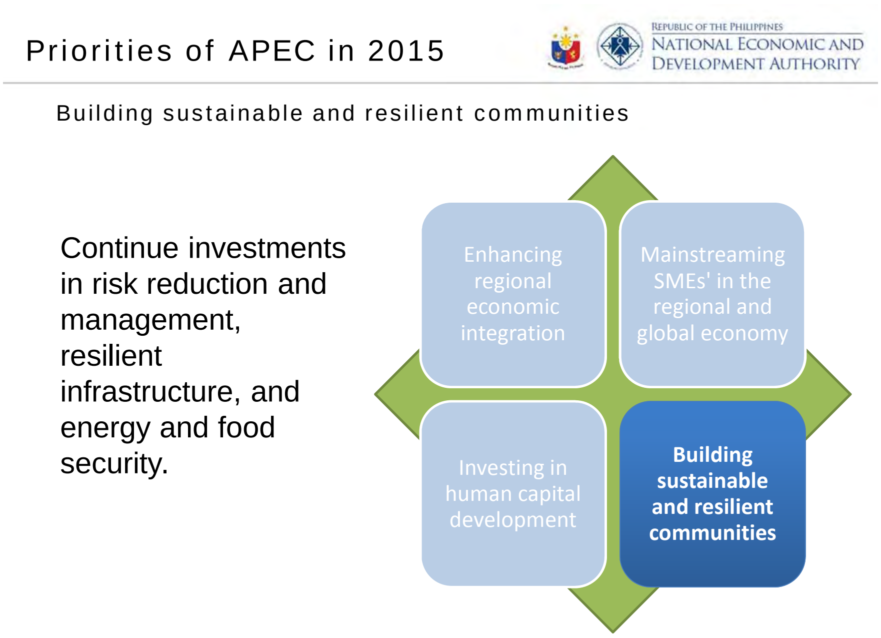
Third, investing in human capital is another priority we have set for APEC 2015 given the significance of enhancing human capital to poverty reduction and economic growth. As economies and regions become interconnected, the evolving needs of constantly innovating industries and services sectors require a more competitive and better-equipped labor force. To address these needs, we should continuously identify and implement educational reforms, enhance workforce competencies, align education and training programs to respond to industry requirements, provide training for skills upgrading that can reduce job-worker mismatches, and further equalize opportunities by empowering women and vulnerable groups.

Figure 1.2.8



Finally, strengthening our economies' resilience to disasters and shocks whether natural or man-made and promoting their sustainability through food security and energy stability will also be critical toward promoting inclusivity, especially in this day and age where our understanding of addressing vulnerability is becoming increasingly important in ensuring the poor's participation in overall growth and development. Hence, investments in risk reduction and management, resilient infrastructure, and energy and food security across Asia-Pacific economies are also high on the agenda for this year.

Figure 1.2.9



At the same time, we need to be recognizant of behind-the-border concerns and address current and emerging structural reform issues, such as rapidly changing demographics, regulatory and policy constrains to innovation, burgeoning skills mismatch in the labor market, impediments to growth of efficient livable cities, and increasing development divides across landscapes. Adequately addressing such issues relevant to economic growth and development will be crucial as we collectively strive to achieve our end-goal of inclusive development.

Figure 1.2.10

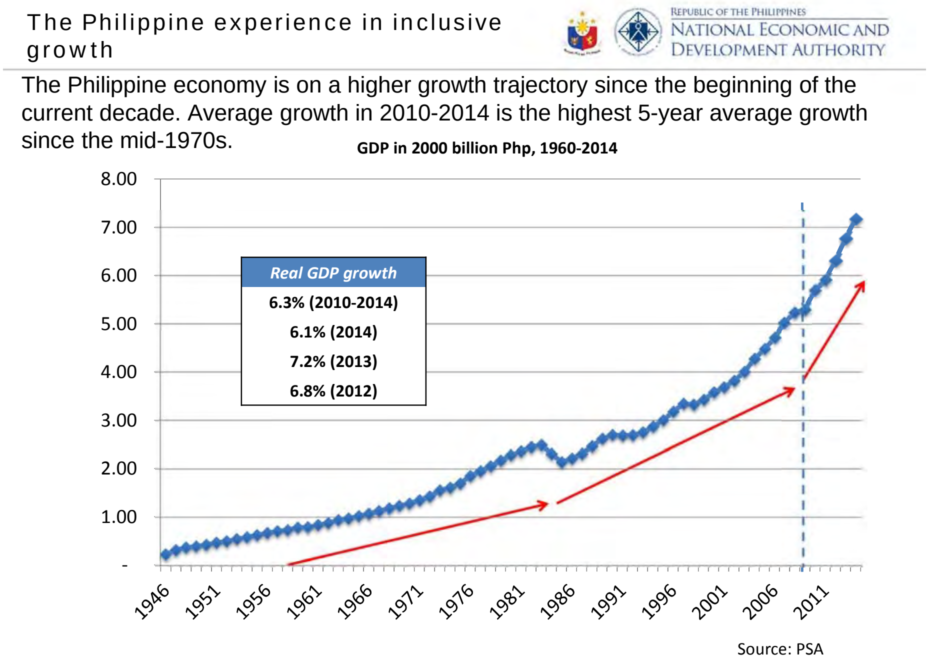
REPUBLIC OF THE PHILIPPINES
NATIONAL ECONOMIC AND DEVELOPMENT AUTHORITY

We need to address current and emerging structural reform issues…

- Rapidly changing demographics
- Regulatory and policy constraints to innovations
- Burgeoning skills mismatch in the labor market
- Impediments to growth of efficient and livable cities
- Increasing development divides across landscapes

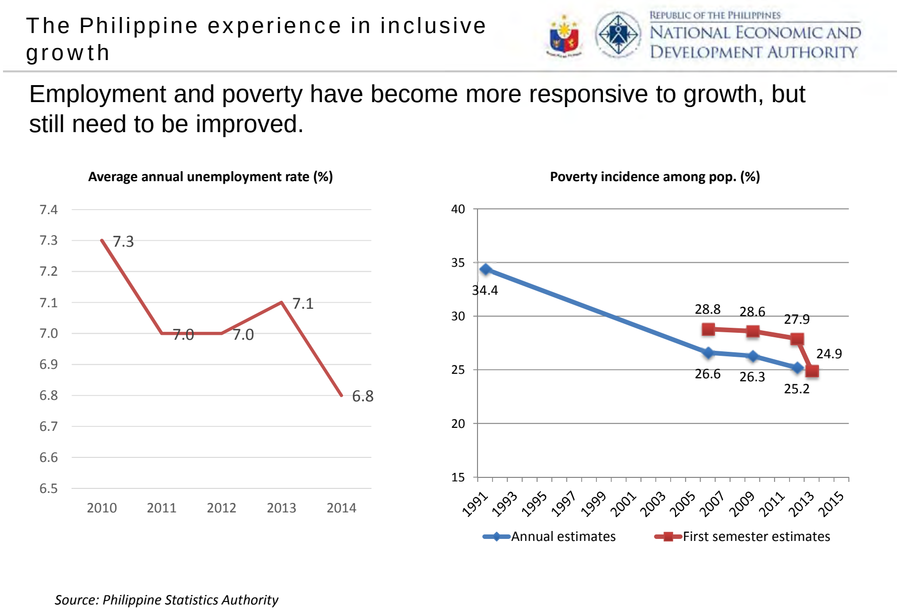
Finally, a few points about the Philippines experience in inclusive growth. The Philippines is indeed one of the countries in the region and the world most invested in promoting inclusive growth and shared prosperity. Specifically, the Philippine vision for APEC 2015 is to sustain a prosperous and cohesive region that places inclusive development at the heart of the economic integration in the Asia-Pacific. The Philippines has been on a higher growth trajectory since the start of the current decade, with an average real GDP growth of 6.3 percent from 2010 to 2014, even reaching 7.2 percent in 2013. In fact, growth from 2010 to 2014 is the highest five-year average growth since the mid-1970s. Our rapid growth in recent years is also the second highest in Asia. This recent resurgence of the Philippine economy has been accompanied by structural changes as seen in the growing contribution of investment and industry, sound macroeconomic fundamentals, lesser vulnerability to external shocks, a wider fiscal space and an unprecedented level of confidence in the international business community. Indeed, the Philippines has come a long way from being the “Sick Man of Asia”, poised to benefited greatly from greater regional integration.

Figure 1.2.11



Despite the stellar growth performance, however, much more remains to be done to make growth more inclusive. In particular, high poverty and unemployment threaten to undermine the sustainability of economic growth we have enjoyed in recent times. Poverty incidence has declined only slowly from 34.4 percent in 1991 to 25.2 percent in 2012, albeit with considerable progress in poverty reduction recorded between 2012 and 2013. Furthermore, even as employment creation has gained traction in recent years, the unemployment rate in the country is still high at around 7 percent, way above the Southeast Asian average of 3-4 percent.

Figure 1.2.12



This is why the current administration, under President Benigno Aquino III, is focusing on implementing strategies and interventions that address poverty and inequality throughout the country, especially in regions that are being left behind amid high national growth.

In particular, the Updated Philippine Development Plan recognizes that different interventions are necessary to address the different constraints faced by these regions. Under this strategic framework, "Category 1" provinces are those provinces with the highest number of poor people. The Philippine Development Plan acknowledges that it is in these provinces where the rapid generation of high quality improvements matters the most, coupled by improved physical infrastructure and enhanced trade and labor mobility. These can be achieved through the promotion of new growth drivers like agro-industry, food manufacturing and logistics, which make use of geographic and comparative advantages of these areas.

Figure 1.2.13

The Philippine experience in inclusive growth

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Addressing poverty in the Philippines requires consideration of specific constraints faced by the poor and implementing the necessary interventions.

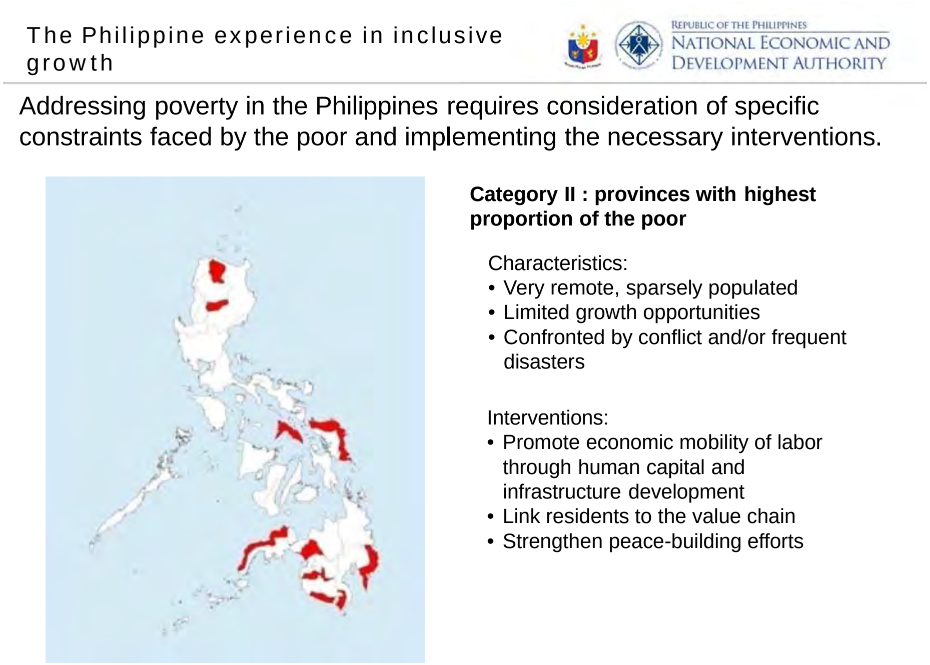
Category I : provinces with highest number of the poor

Characteristics:
- Rapid growth opportunities exist but not for the poor
- In-migrants are attracted but they cannot participate in the growth process as well

Interventions:
- Create more growth opportunities
- Undertake skills training, employment facilitation
- Encourage flexible work arrangements

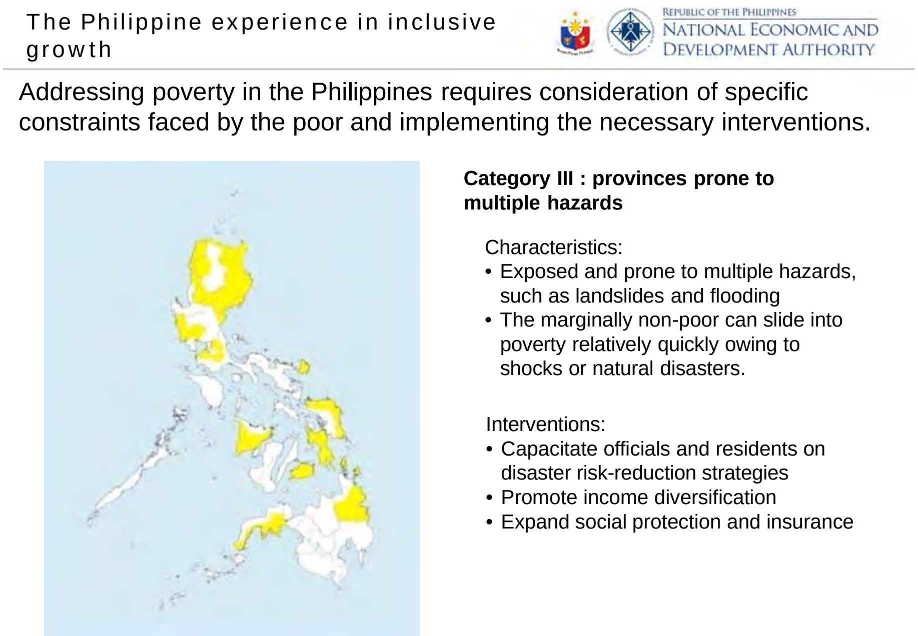
Meanwhile, "Category 2" provinces are those with the highest incidence of poverty, and these are where greater access to basic social services and great investments in infrastructure and human capital are believed to make the most difference in reducing widespread poverty. Increased connectivity to high value-added activities to supply chains is also crucial in improving employment and incomes for the poor in these areas.

Figure 1.2.14



Finally, “Category 3” provinces are those that at are most at-risk to multiple hazards, and it is in these areas where disaster risks reduction and mitigation, social insurance and social protection, and income diversification should be focused.

Figure 1.2.15



Despite steady gains in recent years, the Philippine government recognizes that the task of promoting inclusivity of growth in the country remains a work in progress. Going forward, we should embark on deepening reforms to sustain our recent economic gains. APEC can facilitate this process of deepening reforms by providing a platform for us to interact with and learn from other economies, forge partnerships based on mutually-beneficial goals and build inclusive economies together.

Figure 1.2.16

With the Philippines chairing of APEC 2015, you can be assured that amidst these challenges, promoting inclusivity in this "new normal" will be on top of the agenda. No less than President Aquino himself has stressed the singular importance of promoting inclusive growth in the region, and making sure that growth has tangible effects on the lives of all our people. Only by underscoring this notion of shared prosperity will we ensure that long-term growth in the region will be rapid, sustained and inclusive. Thank you for your attention.

Question and Answer Session

Mr. Michael Enright:

My question is not to the content and list of things that both speakers spoke to in terms of enhancing inclusive growth, my question is one of priorities because it's always great address multiple issues but the reality is that most countries can only take on a few major key issues at a time. My question to both panelists is what do they view as the number one and number two priorities in their own country and in APEC in terms of enhanced inclusive growth.

Dr. Mari Elka Pangestu:

I just had a question regarding more about how APEC meetings are going to be conducted this year in the Philippines. Being a bit of a veteran of APEC meetings, I think all the issues, conceptually and substantively, that you want to address requires coordination between the different ministerial processes. So for instance, SMEs, if you had the SME ministers' meeting, just meeting on its own, is not as useful as if it was back-to-back with the trade ministers or even the finance ministers, so how much thought has been put in terms of the links between the ministerial processes just because the issues are going to be so interconnected.

Mr. Ian Buchanan:

Well I think those two are both very deep issues, let's go into them. Just on Mari's issue of the governance of APEC because all of these issues as they come up are cross-sectoral and cross-institutional, and so beginning to rethink that is a great question. So what I am going to do is put both questions on the table; one about priorities for the Philippines and the region, and the other one about how to begin going from the aspirations to solutions, to get in those solutions, and different ways of managing the governments of APEC process. Perhaps Laura you would like to go first.

Ambassador Laura Q. Del Rosario:

I think for the three of us thought also about referring to Undersecretary Cristobal's own way of thinking and Dr. Esguerra, I think we all believe that somehow that structural reform and improvements in policy will really help open up the economy. For me coming from the field of education, for me, you really have to do something about human capacity; as I said, this would not be possible unless we build up institutions and we build up individuals, I will speak more about that in the afternoon. Now talking about cross cutting issues and how all of these issues are interrelated, when we planned the ministerial meetings, we have been meeting with all the ministry's one-by-one I think for two years, we asked them when you decided on your agenda, when you decide on the meeting process, when you decide on the discussions, please made sure that all four of these priorities are still there. So in essences, we will take up the whole agenda, and definitely discuss the salient sustainable growth because they know that they have to help SMEs to address and adjust to shocks, whether it is brought about by nature or brought about by man. Definitely, they will go into capacity building also, training human resources for SMEs and they'll definitely go into the policy of how they will be involved or affected by Regional Economic Integration (REI) and everything else. So whether it is transportation ministry all the way to the time when we talk about the ramping up of everything, and under all of this is our other priority which really doesn't show as one of the four circles which is the expansion of services because we think that services is one of the connectivity instruments that will connect all of these priorities together.

Mr. Emmanuel Esguerra:

I think I will have very little to add to that, I wanted to say that structural reform was critical but then the content of that of course will have to rely so much on the availability of a skilled work force, and when you see in that connection the critical role of developing services industries because that is a cross-cutting concerns. If you try to think of it, it actually addresses all the four priorities that have been talked about under the Philippines priorities.

Mr. Ian Buchanan:

We've come in with a minute or two of time left. Those of you who follow Australian politics may become familiar with Prime Minister Abbot's PM captain's pick that has gotten him in so much trouble, and I need to do a chairman's pick. To augment Mari's question, having worked 40 years in the region on complex cross-cutting issues, I think PECC should consider taking up a review of the structure of the APEC meetings in order to link them to hypotheses and solutions to these complex issues. Secondly, one issue that hasn't come up yet, I'm sure it will later, which may cut across a lot of this and may be seen as biggest problem to get integration and inclusive growth, is infrastructure. So we talked about slowing growth, the Asian Development Bank (ADB)'s 10 trillion dollar bank loan for infrastructure, the Asian Infrastructure Investment Bank (AIIB). AIIB has been announced, and it's usually not the money it's the lack of linked up institutional capacity across the economy in order to be able to get the planning and authorities, and get the corruption out of the way. Figuring out how to deal with that is a cross-cutting issue through PECC and APEC, and some hypotheses on that and might well be the biggest way to get inclusive growth in the economy. For many economies in this region, cement costs 10 to 20 times in the outlying islands than what it does in the center, and getting goods to market competitively in order for them to develop an integrated market so that they can become competitive internationally – these are the big issues that the captain/chair sees. Thank you very much.

Session 1: Asia-Pacific Economic Cooperation in a Changing Global Context: Risks and Opportunities

Lead Panelist:

- **Dr. Narongchai Akrasanee**, *Minister of Energy* & *Chairman*, Thailand National Committee for Pacific Economic Cooperation (TNCPEC)

Speakers:

- **Dr. Il Houng Lee**, *President*, Korean Institute for International Economic Policy & *Chairman*, Korea National Committee for Pacific Economic Cooperation (KOPEC)
- **Mr. David Carbon**, *Managing Director, Chief Economist*, DBS Bank
- **Dr. Peter Lovelock**, *Director*, Technology Research Project Corporate (TRPC)

Moderator:

- **Dr. Manfred Wilhelmy**, *Chairman*, Chilean National Committee for Pacific Economic Cooperation (CHILPEC)

Dr. Manfred Wilhelmy:

Thank you to the organizers of this very successful seminar for inviting me to have the responsibility of leading this session with the title of 'Asia-Pacific Economic Cooperation in a Changing Global Context: Risks and Opportunities'. As has been said in the introductory speeches, the Bogor goals set a long term roadmap for APEC that was 21 years ago in Indonesia and since then the international setting for APEC has changed in dramatic ways. There has been one large and mostly regional financial crisis, and in the following decade a massive global financial crisis. The World Trade Organization (WTO) has stagnated after the Uruguay round, the Doha Development Agenda has not been accomplished, and this has given bilateral and plurilateral agreements a much more relevant role which in turn has changed the meaning of open regionalism and has affected APEC in many ways. Trade itself is different, what is trade that supply chains have become much more complex, the role of services today is much more prominent, China has emerged in dramatic ways and joined the WTO since 2001, and this second Bogor Goals 2020 just five years away, the stakes for the region I believe are very high.

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This morning we are very fortunate to have a great lead panelist, Dr. Narongchai, he does not need an introduction before a PECC audience, he's widely known as one of the most motivating and effective speakers in this part of the world. In Chile, we had the privileged of having him visit last year, and we benefitted very much from his insights. PECC is tripartite and Dr. Narongchai is in government of course, he has been a minister as he is now, and he has been an advisor to many Thai governments, also a central banker. He is very prominent in private business, in asset management and in other areas. In the academic world, he chairs the board of trustees of Khon Kaen University, and is involved in many other academic initiatives. He will address us for 20 minutes, and then we will have the panel with Dr. David Carbon, Dr. Il Houng Lee, and Dr. Peter Lovelock.

Dr. Narongchai Akrasanee:

Thank you Manfred.

Good morning friends, ladies and gentlemen. I feel like this is an annual family reunion. We meet every year and the reason we can do that is because we have a rich relative in Singapore sponsoring it. So when you have family, make sure you have one rich relative.

I am back in the government, so I have to be careful what I say. Particularly, it's a government by selection and not election. You know what I mean.

The title of my presentation is ‘Asia-Pacific Economic Cooperation in a Changing Global Context: Risks and Opportunities’. What are these global contexts that I would like to address, the ones that affect APEC? I’d like to address four of them, four new global contexts.

Number one, low growth; we have to live with this era of low growth, persistent economic problems of the European Union (EU), particularly growth in the West, and even if some of this is offset by the United States (US) recovery. I think that the conclusion is that no matter how hard you try, it’s not possible to have high growth. But luckily in terms of Asia, it is a little bit better, as you can see in the numbers shown earlier. So in relative terms, the West and Asia, I think Asia will do a little bit better.

Second context that I would like to address is the emergence of the middle class of Asia, which signifies rapid demand growth of goods and services, so further enhancing Asia as a higher growth market.

Third, digital technology development is making the world to become, what Eric Schmidt calls, the Internet of things (IOT), allowing the emerging markets to be able to catch up with the advance economies more quickly. If you add the second and third contexts together, emergence of the middle class and the emergence of IOT, perhaps we would have the new normal of trade growth and Gross Domestic Product (GDP) growth.

Fourth, and as energy minister I must address this one, the oil price slump of mid-2014, with prices still remaining very low, is causing changes in political and economic geography of APEC, particularly in terms of “power rivalry between China and the US”.

Let me elaborate on this Asia-Pacific as the new center of the world economy. Because of this, we talked about the so-called new millennium being the Pacific century, it is becoming more and more a reality compared with other areas of the world. We have very strong areas, which we can mention and rely upon for economic growth and prosperity. There are countries with different characteristics;

- The US, Canada, and Japan are mature economies, which are strong in institutional factors giving good or bad examples for other emerging economies to learn from or not to follow.
- Australia, New Zealand, Chile, and Peru are resource rich, with advanced know-how on how to properly utilize natural resources.
- China is continuously adjusting its economy from being mainly the factory of the world to being a more market driven economy, both in real and financial sectors.
- Then South Korea, Chinese-Taipei, and Hong Kong are small but very advanced in innovation and creativity.
- Finally, for Southeast Asia, the original Association of Southeast Asian Nations (ASEAN) 6 economies are very much a part of the Asia-Pacific economy in terms of production supply chain and provision of certain foods and natural resources. And new members, Cambodia, Lao PDR, Myanmar and Vietnam (C.L.M.V.), all provide additional trade and investment opportunities for all of us. I should also mention Thailand, despite the fact that you hear of all the news of internal political conflicts, I think the country will remain the natural hub and gateway to ASEAN.

So relative to all areas of the world, Asia-Pacific still has good potential.

Second, I would like to talk about the emergence of the middle class of Asia. This phenomenon of the middle class of Asia is changing all of the commercial vista. By number, there must be more than a billion. I don't know what statistics we can rely upon, but must be more than a billion people which are considered to belong to the middle class, or at least they behave that way. They may not have the middle class income but they behave like middle class. What is this new behavior? Based on Maslow’s theory of psychology, there is this so-called hierarchy of needs, which are as follows;

- First, physiological;
- Second, safety and securities, when you move up;
- Third, love and belonging;
- Fourth, when you move up to the middle class, self-esteem;
- And finally, self actualization.

So the people are expected to move up the ladder according to their income. The middle class behavior is reaching level four, which are self-esteem, confidence, and achievement. The behavior changes as below, as this is what I observe,

- From buying to shopping;
- From eating to dining;
- From talking to communicating, meaning lining, chatting and facebooking;
- From dressing to beautifying. In Thailand they say if you make merit you may be beautiful next life, but if you make up your face you are beautiful this life;
- From travelling to touring. A big part of my family is touring Europe;
- From health and home renting to condominium dwelling;
- From saving to investing and insuring.

So such behavior is creating a very high growth in tourism, retailing and urban property business. This is how and why they behave like that, contributing to Asia growth. I am the chairman of a property development company and we could not build enough condominiums to accommodate this new middle class.

Third, I move to digital economy. Asia in leap frogging by means of digital technology. The development of cloud computing means easy access to data, and platform for doing everything. That's the IOT, meaning that you can control everything by your mobile phone. This digital revolution is happening in Asia very fast, faster than the industrial revolution.

Comparing the industrial revolution, which was achieved from command from above, the digital revolution is driven by demand from below. I shall elaborate. We can recall that the industrial revolution in Asia has leader names identified with each country. I would like to mention some of the countries; South Korea, Pak Chung Hee; Singapore, Lee Kuan Yew; Malaysia, Mahathir; Indonesia, Suharto; Thailand, Prem. So this is the command from above.

But when we talk about the digital revolution, it is from the demand of the people, and the demand for faster and faster, and ubiquitous communication. So the governments must respond by organizing infrastructure including broadband, gateway, data center and frequency management. I am under extreme pressure. My nine years old granddaughter is doing e-commerce through the internet, acquiring raw materials, selling her products. Every evening she complains to me “grandpa, why so slow? Why is the Internet so slow? You’re in the government, why can’t you make it faster?”

This is what I call demand from below, and I am sure it is happening in every other country that the people want faster and faster internet. So the economic landscape of Asian countries will be shaped very much by the ability of how we manage the digital economy. In the Thai government, we made that a top priority at the moment.

Finally, the last one, petroleum prices. For APEC the global energy context formerly has been as follows; Supply and prices were determined by national oil companies of Organization of the Petroleum Exporting Countries (OPEC), and the traditional international oil companies most of which are owned by the West. For fuels, oil has been the leader followed by natural gas. Coal has been a source of low cost power production, keeping cost low but carbon emission and pollution high. Finally, prices of oil and gas have been high relative to income of developing APEC economies, creating political pressure for subsidies and price distortion.

That was the old context. Now today, we have entered into a new global context about oil.
First, the US has become the biggest producer of petroleum in the world. Can you imagine that back 10-15 years ago? US production is averaging 12 million barrels of oil per day, more than Saudi Arabia now. This has been due to the production of shale oil and gas. Shale oil, known as light tight oil (LTO), is easy to produce but with continuous need of working capital. It usually only takes six months to install this production facility compared with years of other productions.

This is why we call it LTO. But when you do that it would not last very long and therefore demand for working capital. Fortunately for the US, the Fed has created this liquidity for many years, by way of Quantitative Easing (QE). So you turned money liquidity to oil liquidity. That's how it happened and that's why they could produce 12 million barrels of oil per day.

Second, prices of oil and gas have come down due largely to the new supply from the US, and OPEC’s not cutting supply. You may recall the cover page of the Economist recently about the US and OPEC fighting and competing. The prediction is that oil and gas prices will remain low for 2015 and the new normal will be about $70 USD per barrel.

Finally, liquefied natural gas (LNG) has become a more important source of fuel because of technological improvement in gas liquefaction and transportation.

What are the implications of the new energy scenario? Net importing countries of course benefit from this new petroleum prices, also allowing them to abolish subsidies. Indonesia and Thailand have abolished subsidies almost completely. And they can restructure prices for different types of fuels. The power sector has more options in terms of their usages. LNG will become increasingly more important, through pipelines.

These have political implications. The US will be more powerful. China and Russia will become closer. For the first time they may become very friendly towards each other. Renewable energy may be faced with more resistance and less support because of higher expected relative costs. For ASEAN, cooperation in power production and usage through ASEAN grid and gas pipeline, will have more chance of development. Because of savings from energy costs, we have already achieved a lot of these savings.

Let me just mention a few risks that I have identified, a lot that are related to this energy scenario. Risks are in political tensions between some countries due to territorial issues, particularly maritime disputes. China historically never sought power. Now it is exercising its sovereignty, which is being resisted by many concerned countries. We have what we call a bridge over troubled water, the song sung by Simon & Garfunkel. And this Scarborough shoal is exactly like it is in the song, that's in the Philippines.

US -Asia pivot policy is being interpreted differently by different countries, causing concern about the rivalry between the US and China in the region. The dispute about the South China Sea and related areas could be due to the need to ensure energy security. Some people have theorized it that way, particularly for China. And there is a story about potential petroleum resources under the area where China is claiming. But we don't know whether it’s true.

With the development of oil shale in the US and with the need of Russian oil and gas having access to East Asian markets, partly because of the Ukrainian problem, this could lead to a new approach on how to handle disputes about the South China Sea.

So we can identify new factors affecting political relationships because of the power scenario.

Another view is that ASEAN could be a mitigating force to keep China from going to the extreme, and to bring China to the talking, not negotiating, table. China never negotiates on the South China Sea. If the US works mainly with ASEAN, particularly Indonesia and Thailand, on this issue the chance of territorial disputes growing to disrupt economic progress of the Asia-Pacific will be contained.

Thank you very much.

Dr. Manfred Wilhelmy:

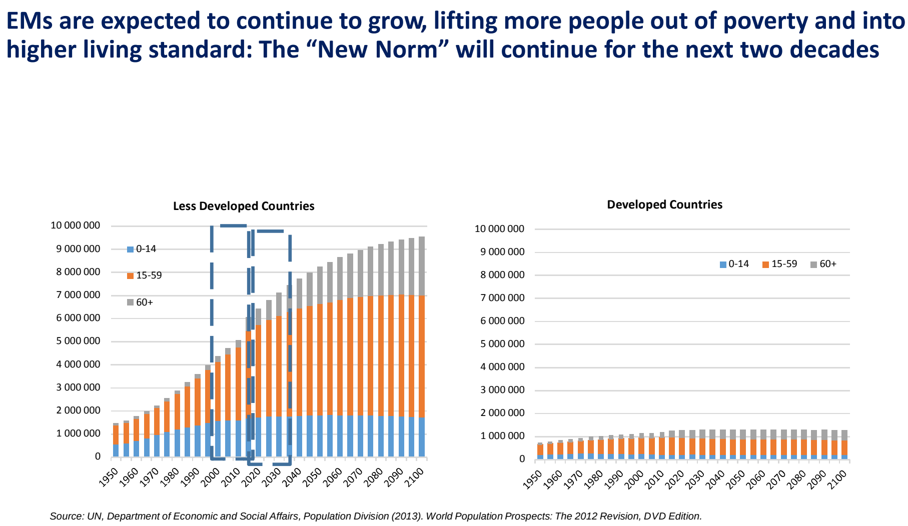
Thank you very much Dr Narongchai for this very interesting presentation. It is now the turn of Dr. Il Houng Lee, President of the Korean Institute for International Economic Policy, a position he has held since August 2013, he has the responsibility of coordinating Korean involvement in the G-20 process and has been with the International Monetary Fund (IMF) for 20 years, he has had important teaching responsibilities at universities in Vietnam and China. The floor is yours.

Dr. Il Houng Lee:

Thank you for inviting me to speak during this session. I have essentially three points to make. First, what is the normal? Or rather, what is the norm? Second question is, is this sustainable? Can we maintain the status quo? Last question, if not, what can be done? I'll structure my speech around these three points, and I'll try to spend three minutes on each point.

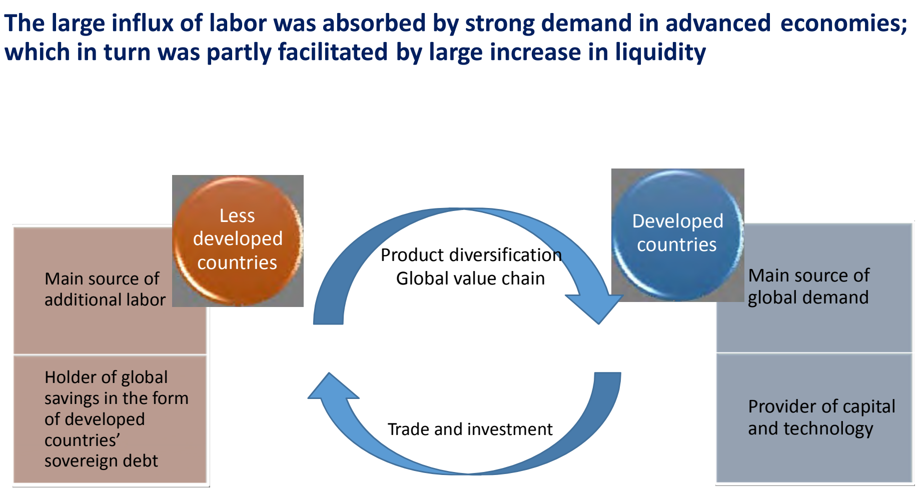
To me, the normal is a world where we have an influx of huge labor into the global market. If you look at this chart, from the United Nations (UN), if there are any mistakes blame the UN, this is the equal scale; you can see the advanced economies' total labor force is around 750 million. In the last couple of decades, the total labor entrants in the world market equals about four times the total of the labor market in the advanced economies. The good news is this entrants influx of the labor force will continue for another two decades. The reason I started looking at this was because I wanted to find out what kind of aging problem the global economy had, and according to this chart, we don't have an aging problem but an entry problem.

Figure 2.1.1



The question that I've been asking is can we, the world, actually sustain this large influx of labor, provide decent jobs and make sure that they don't fall into the poverty trap or advance to middle income, and then at the same time push the lower middle income groups to the higher middle income groups, and in the end, move everyone out of poverty.

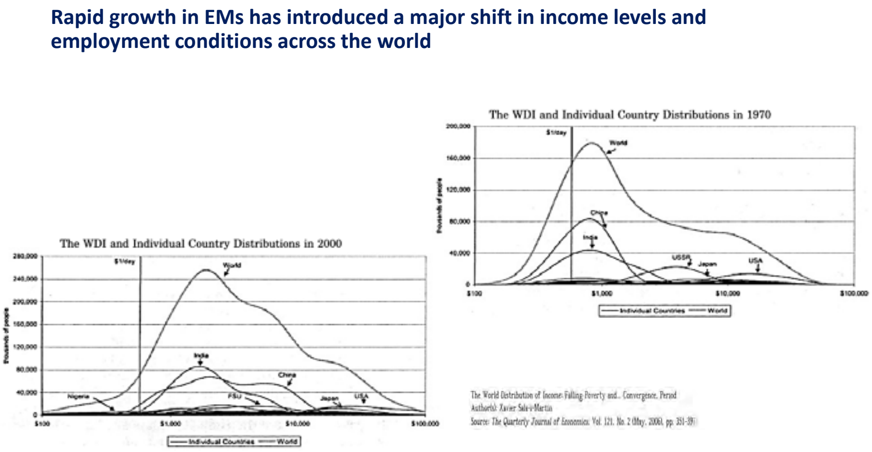
Figure 2.1.2



If you balance that act, and look at how we did it in the last couple of decades, particularly the past decade and a half, we had things working for us; first, we had globalization process; second, we had innovation helping us; and third, we had the advanced economies with very expansionary macro policies providing the engine of growth and pulling the global economy forward. Fourth, we did not have tax on negative externalities, and so we burnt part of the planet where we are now. So the big question is then now we are living with the overhang of our past two decades of mistakes, we can't afford to further burn the planet, yet we have continued influx of labor force into the world, so what do we do? That's essentially the question I am asking.

This is a chart that shows income distribution at the global level and some subdivisions into countries and regions, and as you can see, we did achieve a significant improvement in the pulling people out of the poverty trap and pushing people into the middle-income groups. So the global economy as a whole has seen an improvement in income inequality over the last few decades.

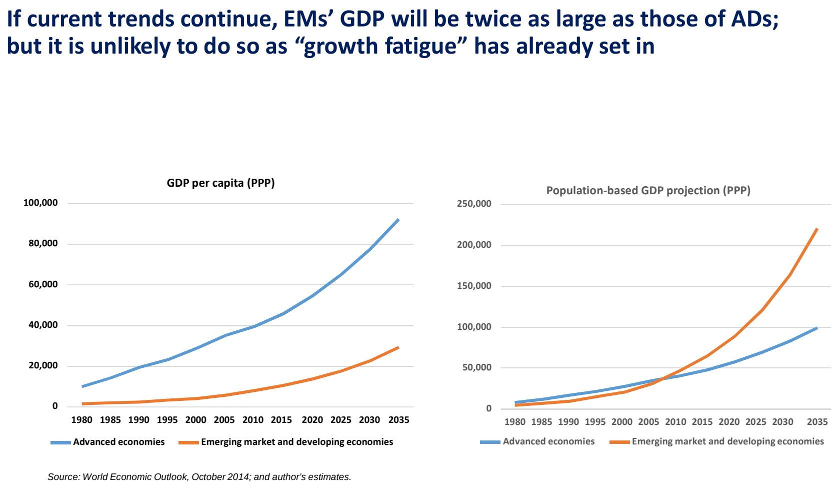
Figure 2.1.3



The problem is as countries moved up the income ladder, it sort of happened that some countries benefitted more and some less from globalization and innovation, but overall the global economy faces more equal distribution of income. Within countries, there are people that benefitted, depending on the skill type people had. If you looked at average advanced economies characteristics, we now have high youth unemployment and long-term structural unemployment essentially a phenomenon that you observe if you have rapid structural changes in a system without having the open economy problem. So that's a problem in advanced economies, and emerging and low income countries we still have huge influx continuing even at this moment, that is creating a problem for policy makers because they have to provide jobs.

As of now, the Gross Domestic Product (GDP) per capita in the rest of the world against the advanced economies is about 1/5th, even in Purchasing Power Parity (PPP) terms, and you know how PPP is calculated essentially assumes the same prices for the consumption basket across countries that actually has its own problem, still it tends to overestimate the actual purchasing power in developing countries, but even measured against this indicator we have the advanced economies having five times higher GDP per capita. In terms of the total GDP, I think according to the PPP, we have the rest of the world slightly exceeding those of the advanced economies.

Figure 2.1.4



As I mentioned at the beginning, we now have growth fatigue and this growth fatigue can be divided largely into too high debt and liquidity overhang. Income inequality and high unemployment in individual country levels, and that also means that you have a higher threshold where new entrants into labor market need to exceed to actually enter the formal labor market because if a country is poor you need very little capital, both financial and human, to enter the formal labor market but once you have a higher income society you need higher skills and more capital to actually enter the formal sector, and that's creating another dimension of problems.

Then we have the change and rapid depletion of resources, and here I'll show you a chart that simply shows the change in the temperature from 1960's and how successful we have been in burning the planet. The objective is therefore, if we have this continual influx of labor in developing countries, how are we going to ensure this total income distribution at the global level improves rather than deteriorates, not only at the individual country level but at the aggregate level, that is the question we have.

Figure 2.1.5

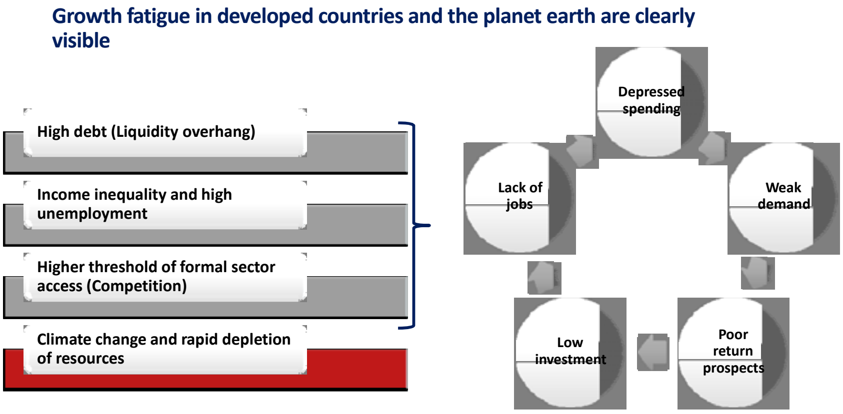


Figure 2.1.6

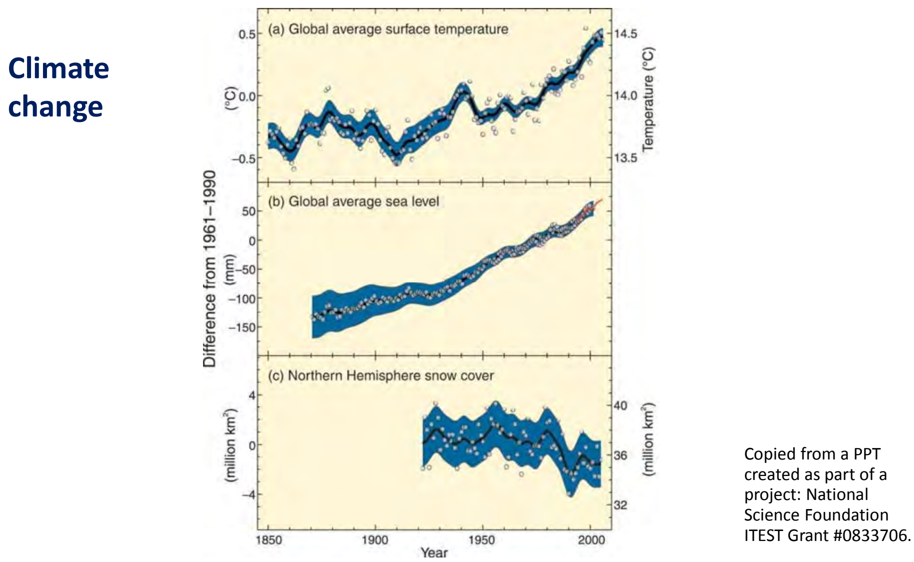
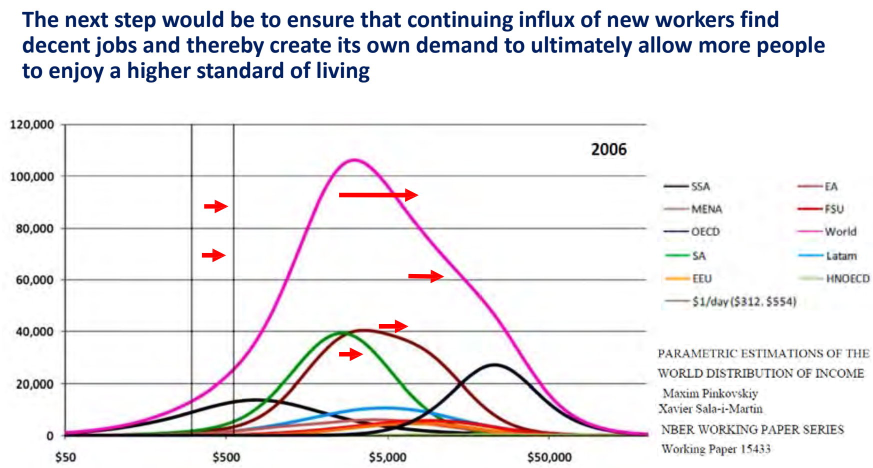
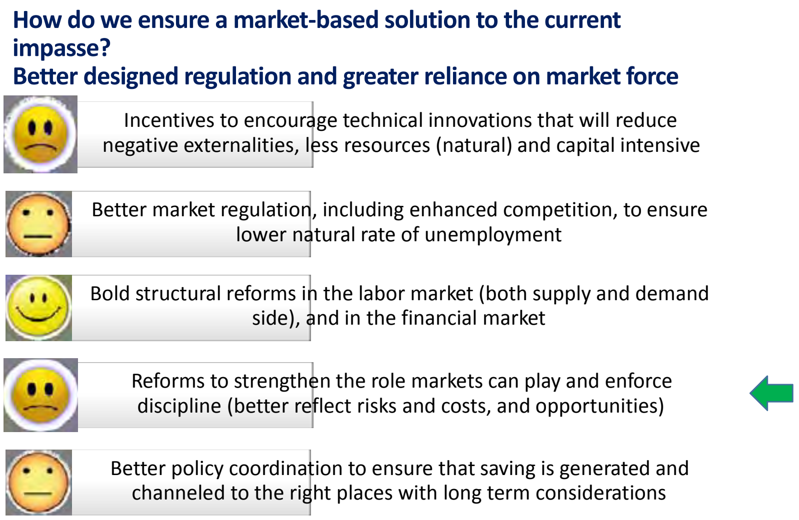


Figure 2.1.7



These are the solutions that I came up with; first, we need incentives to encourage technical innovation that reduces negative externalities, meaning heavy tax negative externalities and less resource and capital-intensive production methodologies. Second, we need better regulation including enhancing competition to ensure lower natural rate of employment, this is one way of achieving the first step of reducing youth unemployment. Both structural reforms, both on the supply and the demand side of labor, and strengthen the role of markets and lastly policy coordination.

Figure 2.1.8

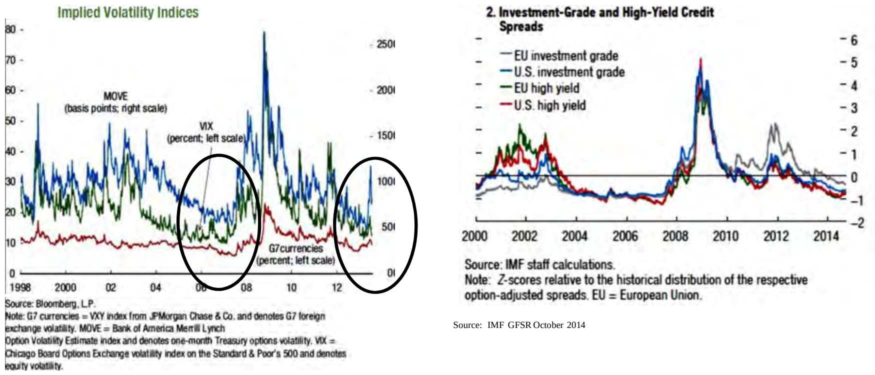


How can we strengthen market discipline? My take there are many problems that were created as we advanced in the last couple of decades, but one thing was that regulations fell behind partly because we didn't know what was happening and also we didn't have the expertise at the government level to catch up with what was happening in the real world. This is the key; we need the new labor entrants to create value added, it’s not a simple matter of creating or finding a job for them, because if you were in the downturn in a normal business cycle that would be the solution, but if you have a situation where you are in the downturn because of a structural change then to simply create a job won’t actually generate itself to creating a virtuous cycle.

These are some examples of mispricing in the past, risks were mispriced, and the cost of borrowing was mispriced because in economics 101 we learned that if you borrow too much there is a certain limit that starts to kick in, you have budget constraints and you restrain. But we didn't have that system. At the global level, we have this problem where you had widening current account deficits and surpluses and there was no mechanism to actually correct itself.

Figure 2.1.9

What is not working properly: Risks were mispriced and likely to be the case again



Therefore I propose one solution. We need to at least start thinking about how to strengthen market discipline, and one way of solving this through institutional changes is starting to think about reforming the international monetary system. Here what I am proposing is a two-tier, two-step approach; the first step is to have a three polar system of international monetary system consisting of the Euro, Dollar and Renminbi (RMB) used for international transaction purposes of current account transactions, and that we can do over the next couple of years. Then over the next few decades, we can generally move towards venturing into covering the store of value aspects.

Figure 2.1.10

One Example:
Ways to allow greater independence of US monetary policy and flexibility of nonconvertible currencies vis a vis the USD

Dr. Manfred Wilhelmy:

Thank you Dr. Lee for a great start to the panel, and now hand the floor to Dr. David Carbon, who is with DBS bank and has the responsibility of directing the work on economics and currency research. He began his career working at J.P. Morgan bank in 1994 and has been voted the best economist in Southeast Asia in an investor poll in 2012. He has taught international trade and finance at Fudan University in Shanghai and has also been a fellow at the Korean Development Institute in Seoul.

Mr. David Carbon:

I was asked to say a few words on oil, and that's what I'll do for ten minutes. How long will prices stay low? We had this big drop in oil prices, and one of the first things everyone asks is who is benefitting from all of this? My answer immediately is we don't know of anybody who is benefitting unless we talk about why it has fallen. Is it a supply issue? Is it a demand issue? If we have a big boost in supply then everyone is happy of course, except the producers, but if prices have fallen because demand has fallen then maybe nobody benefits from this. You get a little more cash in your pocket but demand out there is weak and everything slows down, so what you get over here you lose over there and maybe you don't get any benefit at all. That the question that has to be answered before anyone can talk about 'who's benefitting'. Our sense is that it looks like 50-50 in terms what drove this big drop, about half of it due to a surge in shale production in the US, and about half of it due to a drop in demand, mainly from Japan and Europe. Whether driven by supply or demand, my sense is the drop in price won't last long. Let me spend my ten minutes talking about why.

There are a few reasons why I don't think prices are going to stay low for very long, two or three technical reasons and then I want to go into the important fundamental reason. The first technical reasons is we had a 60% drop in oil prices over a period of six months – this was the second sharpest drop in history, almost as sharp as the drop during the Lehman Brothers crisis. Now you have to ask yourself is the global economy today anywhere close to what it was during the Lehman Brothers time? The answer is no, the global economy isn't anywhere close to that condition. So if you look for a 60% drop in prices, and ask how this can happen, you sort of come to the suggestion that well its financial markets doing something, traders doing x or y, or speculators doing x, y, or z. You suspect that if prices dropped that fast with no big change in the fundamental backdrop then prices are probably going to bounce back pretty quickly too.

Figure 2.2.1

Price drop: Supply or demand?

Global shifts in crude supply and demand: 2014
thous barrels per day except where noted

Supply increases	
US shale prod'n	1,018
as % of 2014 global demand	*1.1*
Demand increases	-776
Europe	-572
Japan	-204
total as % of 2014 global demand	*0.8*
Net excess supply	1,794
Due to supply (%)	57
Due to demand (%)	43
as % of total global demand 2014	*2.0*
Total demand 2014	91,554

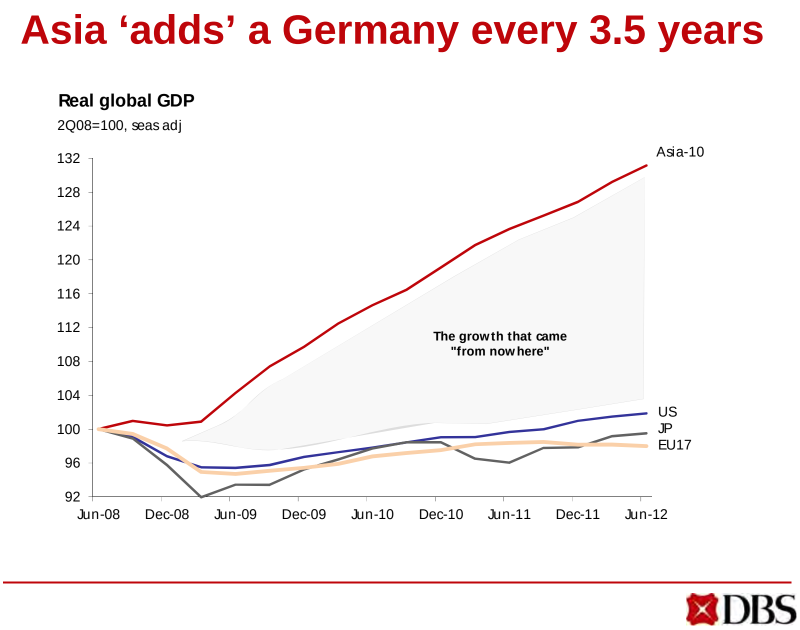
DBS

Another technical reasons is the degree of change in supply and demand that purportedly drove prices south. Everyone talks about the boost in shale supply we had last year. It was about a million barrels per day, and you ask yourself, was that a lot? Not really. It amounted 1% of total global demand and supply, really a small amount. On the demand side, the drop from Europe and Japan was also about a million barrels per day. So a million bbl/day surge from supply and a million bbl/day drop in demand – that's two million barrels per day gap and amounts to 2% of global supply and demand. How do you get a 2% gap in global supply and demand giving you a 60% drop in prices? It doesn't make sense at all. Once again you come back to the conclusion that something funny must be going on in financial markets and there, what goes down rapidly can bounce back even more quickly.

The other kind of technical answer and another way to look at it is the following: go back to August or July, think about this second largest price drop in history, and nobody predicted it – not the oil companies, not the analysts, not the investment banks, not the airlines, nobody predicted it would happen. But it did, and now everyone is saying, "prices aren't going to go back up". Well if no one predicted that they were going to fall, why should we believe today when they say that prices won't go back up? It brings you to the question, did we know anything about oil back then or not? The cynical answer we didn't. But if not, then we don't anything about oil today either. And there's no reason for us to be talking about it today. The less cynical answer is, we did indeed know something about oil back in mid-2014. And if no one predicted the fall, and no one can explain it, then we ought to believe prices will go go back up again a lot more quickly than most people think.

Anyway, those some technical ways of looking at the question. Now let me spend a few minutes here on the fundamental side of things. What are people overlooking here? I think the answer is clear, and it's Asia. We've overlooked before. We over looked Asia in a huge way back in 2008-2012. I want to show you this picture. It's a picture of how much demand is being generated in Asia. Go back to 2008-2012, this is in some sense the front and back of of the global financial crisis. It's a picture of the US going nowhere for four years, Japan going nowhere for four years, Europe going nowhere for four years. And Asia continuing to grow and grow. In this four year time frame, Asia put an entire Germany on the map right here in Asia. This is a big deal. In the middle of the biggest crisis in 100 years, Asia puts a Germany on the map, and it does so with no help from the US, no help from Japan, and negative help from Europe. A Germany in four years.

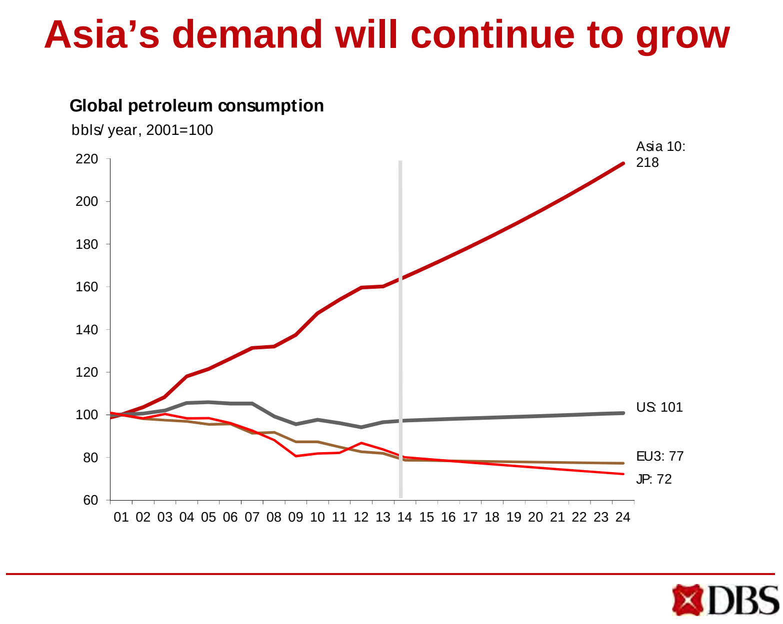
Figure 2.2.2



People not only over looked this, many argued it was impossible and could never happen. If you go back to 2006-2007 and think about what you read in the papers everyday was that the US drove the global growth, the US bought everything, Asia didn't buy anything, all Asia did was produce, sell and save, and Asia ran a huge surpluses, the US ran big deficits, and it all depended on the US. If the US consumer ever died and demand died, then Asia would die a death even worse. But it didn't happen. When Lehman went down, the US consumer did die, Japan's consumer died, Europe's died. But Asia put Germany on the map. Everyone completely overlooked Asia's ability to generate demand back then, and we continue to overlook it today.

The same sort of picture can be seen with oil demand, but this picture extends back to 2000 and goes up to 2024. It's almost the same picture as the one of GDP. Asia's demand is growing by leaps and bounds while demand from the US, Europe and Japan is running sideways to slightly downward. Asia is where the demand growth is being generated. Every year in Asia, demand growth today is about 750,000 to 800,000 barrels per day, this kind of a growth rate absorbs this supply and demand gap, and will absorb it in about one year to a year and a half. And as you move out through the coming years, it only goes up.

Figure 2.2.3



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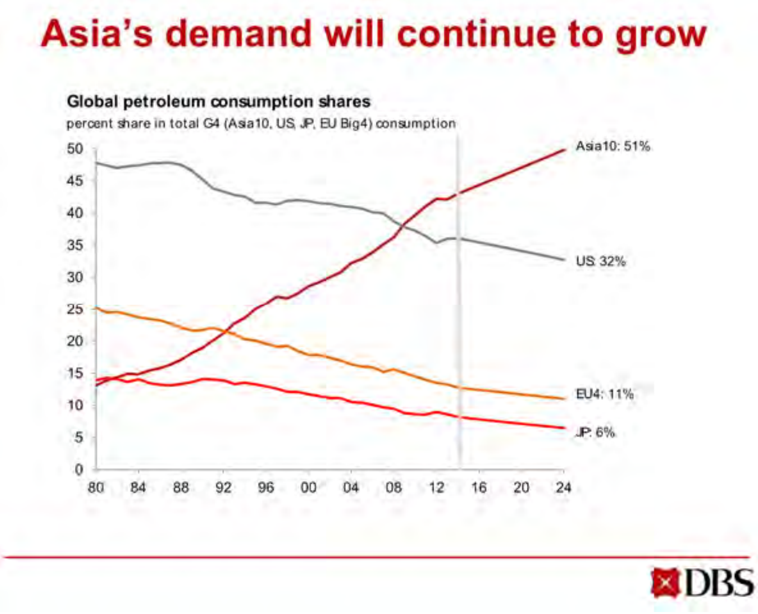
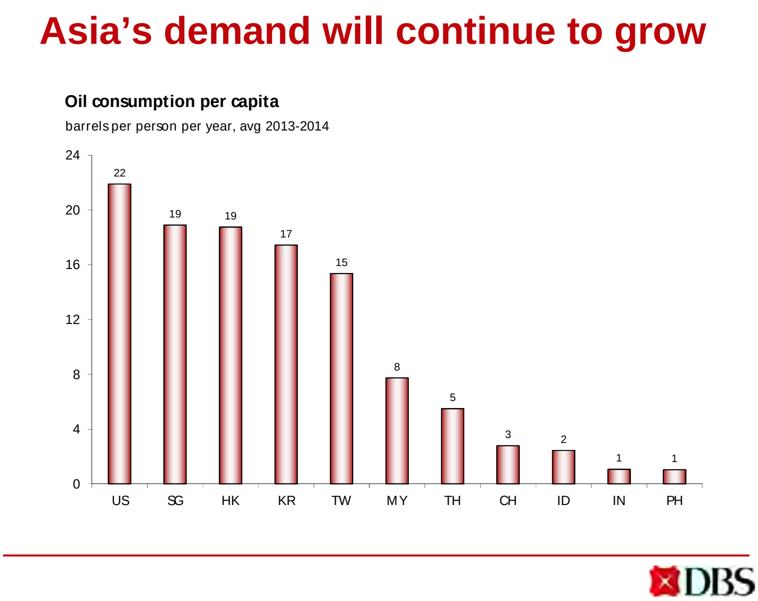


Figure 2.2.5



Even with zero to negative demand growth coming out of the three key regions of the world, global demand for oil is going to be accelerating because Asia is increasingly the world's biggest consumer, that's it. This is what tells me what's going on with oil, what will continue to occur with oil, and why you should not expect to see prices staying low for very long. People completely overlooked Asia's ability to generate GDP growth in 2008-12. We are overlooking Asia's ability to generate demand for crude oil today.

Dr. Manfred Wilhelmy:

Thank you very much David for your comments on this crucial dimension of oil, which I think is a very central consideration to the general outlook. Last but not least, we are going have comments on the area of ideas and telecommunications, Dr. Peter Lovelock is uniquely qualified for this, he is the director of techology research project corporation (TRPC) that provides advice to governments, regulatory agencies, and businesses on such complex issues as broadband policies, and cloud computing. He sits on the board a the national institute of communications. I am only mentioning some of the more important aspects. Thank you have the floor.

Dr. Peter Lovelock:

Good morning. Thank you to PECC for the invitation. Can I just say how much I am enjoying being here, back in these meetings again. In my world, I am invariably one of the oldest guys in the room. So, this is pleasant. Can I also, in thanking PECC, remark on the cleverness of this whole session you have, following from Dr. Narongchai and his four key points, and I guess I get to touch on digital technology because we have touched upon everything else - and we hadn’t talked about this logical flow beforehand! I am supposed to talk about technology but I have no technology, as I don't like power points anymore.

And, just so you understand where I am coming from, I thought that the answer to David’s question was that none of us know the answer, ie, none of us know anything; I didn't think that there was actually an answer to his question, but that kind of shows where I am coming from in my world.

Rather than do the high level growth drivers stuff that you are going to get all day, we came at this from a slightly different perspective, and will do so a little more anecdotally.

There is an economy nearby to this region that has been enjoying around 8% GDP coming in by remittance, the vast majority of which is from foreign domestic workers and overseas workers, totalling some 6-10 billion dollars coming into their economy. I was there a couple of years ago, and was talking with the Minister for Social Welfare. At that point in time he had an initiative that was just getting launched as part of the training for the foreign domestic workers. He would give them their insurance, their training packages, and their preparation for going to the countries that they were being sent to. Now, they've been having a few problems with foreign workers in the recipient countries; there were cases of abuse of some of the maids, and some issues with racial intolerance, so this was a very big thing for the economy. One of the things the Minster was very proud of was that he was now going to give them all a mobile phone, and he was going to load the mobile phone up with the equivalent of 2-3 dollars, so that when they got there they could ring home, set themselves up and be in contact with home. So I asked him: was he allowing them, with that SIM, to transfer money back home? Because that was what the foreign domestic workers all do. He said that he kept asking his department about this, and had got the answer that the Central Bank said no. So I said, "Well this is great, I'm meeting with the Central Bank this afternoon." (They are in the same building; in fact, they were downstairs.) "Come with me."

We went down to the Central Bank, and we got the Deputy Governor of the Bank who was also trying to promote this idea of empowering foreign domestic workers and driving remittances. Now, there is a whole set of regulatory framework to drive mobile payments in that country, that had only been recently released. We had been spending a lot of time going over and over these regulations, and so I said to the Central Bank Deputy Governor, "Can we do this?" And he said, "You come with me. There are two departments that are relevant; one is the Department of Payments, and one is the Foreign Exchange Department. You ask the question to them."

The Social Welfare Minister said, "What question should I ask? I am *planning* on saying, 'are foreign domestic workers allowed to transfer money from overseas?'" The Central Bank Deputy Governor said, "Nope. Don't ask that question. The question you *need* to ask the Payments Department is: 'Are P2P transfers of digital value by digital communication customers able to be done?'"

So, we went to the Department of Payments and asked that question. They said, "Sounds fine to us. It's coming from one customer on a domestic [telecoms] network into the country, so no problem at all."

Then we went to the Foreign Exchange Department, which oversees the only other regulation that is relevant, because they had been told categorically that this was not allowed to happen. As we were walking over, the Minister said, “I’m planning on asking whether foreign domestic workers can transfer funds from outside the country.” “Nope,” said the Deputy Governor, “don’t ask that. The question you want to ask the Foreign Exchange Department is: Can local customers receive local currency once it’s in the country?” They [the Foreign Exchange Department] asked him why he was even bothering them with this question, because if it was already in the country, it wasn't their problem. Did the telecommunications company have the relevant license for remittance of domestic international transfers, they asked. If so, then it was not a problem. Were the telecoms companies abiding by the handling of floats requirements and all other related issues, they also wanted to check? Again, as long as that was handled within license terms it wasn’t going to be a problem.

In reality there was nothing stopping the enabling this transfer of monies. Overnight we enabled 8 billion dollars worth of money to start to flow from foreign domestic workers back to their families.

Western Union, which is a *wonderful* company, enables a lot of international transfers of funds. If you’re a foreign domestic worker, the last time I looked, you go up to a Western Union counter, where it can cost you 25 dollars before you even start the transfer and it's a rolling scale of percentages depending on how much you then want to transfer. Do you know how much they take out of a foreign domestic workers pay packet that the workers are trying to send home? The real cost of that transfer today is somewhere between 0.3 and 1 cent. This is what we can enable with technology. But we are not.

On a different point, I was in Bali over the weekend. It was raining and I went down to the local DVD store. It’s been a while since I’ve been to the DVD stores around the region, they’ve now got catalogues, not just of DVDs of films and TV shows, they now do e-books. You can order any e-book that you want, and you can give them a list of the books you would like transferred to your device. They’re beginning to give you promises of doing domestic reproduction of art; you can go say what kind of art you would like to have and have it blown up, they’ll do that for you and even have it packaged for you to take home and put it on your wall. I told them as we were chatting, that my daughter, who is 8 years old, and who watches movies with me, has never actually seen ads in TV shows, and she doesn't know what her mother complains about all the time when she talks about the ads. So I said to them, could you put the ads *back in* the show that you're ripping down from the U.S? And given that she needs to practice her Chinese, could you do it in Chinese? Well, they said they have 95 languages that they can put the dub in or the subtitling on to any of those DVDs. That sounded rather innovative. So I went back to my villa, and I powered up one of the VPN networks, because I needed to do some work in the US, and that VPN network as I powered it up threw me up several ads that said, "If I, or my friends, wanted to transfer my location virtually, these would be the savings I could get on TVs, Microsoft software, jeans and everything else." Their tagline is, and I will read it to you, "have you friends virtually fly abroad too by referring them and receive virtual credit on your transfers".

This is the world we live in, or at least some of us. This is powerful. Let me give you the statistics.

The Internet is estimated to account for 3.4 percent of GDP growth globally; GDP contributions from the Internet are now larger than the economy of Spain or Canada, and faster growing than Brazil. McKinsey said that there were 2.6 jobs created for each job lost due to tech created efficiencies. The mobile eco-system alone contributed one trillion dollars to APEC GDP in 2012, generating 16 million jobs in the mobile eco-system, maybe three times that in other industries. Another study claims more than 3.3 trillion dollars of added value across mobile value chains in just six economies in 2014, 1.2 trillion dollars in mobile GDP and 11 million jobs in the value chain, 1.8 trillion dollars in investments and 37 billion dollars of funding in these six economies. These are the wonderful big numbers. Then of course, there is the contribution to innovation that these technologies keep generating and reaping in. We've had *Gangnam Style* from South Korea, *Flappy Bird* from Vietnam, the Umbrella Revolution over Firechat in Hong Kong; the world's biggest IPO from the weirdest company in China, and from the company Little Rice, the entire mobile chain is getting disrupted and so on. The point is that these businesses ideas or movements go global while being based in a home jurisdiction because of the Internet. This platform that has enabled cross-border trade.

There are two key points that I simply want to make in this presentation.

One, we focus on these numbers, by and large, about the Internet and IT impact upon growth, upon GDP, upon employment, upon innovation, and all the numbers that APEC and PECC (and everyone else) likes to focus on – primarily from a national jurisdiction perspective. But the real impact, and the misery of my world, as I am a IT-and-tech guy, is that I do not get to do IT any more. I do health, education, logistics, payments, financial business process, inclusion, empowerment. So let me give you those numbers. In education, there is 50% improvement across APEC economies in key subjects in 2012 where they have been connected to the internet. The Philippines has 84% of secondary schools still unconnected to the network. We can now use TV white spaces and spectrum allocations to put all of those secondary schools on the network almost overnight for a fraction of what the roll out cost used to be. In health, there are studies showing 20-30% enablers of savings, not including the impact of remote connectivity on saving lives. In finance, I'll run through the numbers, but both savings and revenue generation are simply enormous, financial inclusion official statistics says 1% of added inclusion from people otherwise not included by 2012, the predictions are 36% for 2020. Here's the point, continuing to look at IT as you all do has a vertical, has a silo, is a mistake, it is a horizontal enabler at this point in time and it is adding value add and empowering all those other sectors. It is crucial to setting us up to move these economies in to being digital economies. The majority of these studies and statistics are focused on national numbers, but these all require the free flow of data and access to infromation and data to work and cross-border data transfers and transactions. The problem is we have the issuing of new national laws regarding data privacy, data protection, data localization, and mandatory data retention is not only threatening to impede if not dramatically slow this growth, its already happening.

Some suggestions to rather than just harp at you, I have 10 very quick suggestions on how to take this forward; five domestic and five international. Access, you must promote proactively access to wireless network, particularly for the unserved and underserved, the economic drivers and multipliers from getting people on the network is shown over and over again, but it must be affordable access, we must make ensure that they have access to broadband or wireless access networks affordably. We have problems of monopolization because of that wonderful privatization and globalization movement through the 1990's, we must make sure that they have affordable access and most importantly of all because of the revolution we are going through hence Dr. Narongchai's ancedotes, we must have affordable devices. They are there, they are available, they need to get them into the hands of all of the population across APEC. Promote infrastructure sharing and equal access including specturm allocation issues. Most importantly of all, promote capacity building as a key point of empowerment and this means for all of you folks, you do not understand this technology crap, and we're all using and it's not that difficult. Two weeks ago when we were in APEC, I counted 12 professionally qualified economists in the room, and we talked about economics all day. How many economist in the room today? How many trained technologist in the room? Alright you will all talk economics all day, there is nothing stopping us from understanding the empowerment that technology drives.

Five international things you need to considered being APEC and PECC; a framework for cross-border data and transaction flows; that one, sets and defines common technical terminology so that we can compare apples with blackberries with jellybeans. Minimize compliance and compliance differences across economies, a compliance alliance, if you will, because compliance costs are now crippling my world, which is harming your world. Look at unintended consequences and costs of current and emerging regulatory policies in data privacy, protection and localization. We have a vast array of these things coming on, people think that they are doing them for the right reasons to protect privacy, its good but it is stopping cross-border data transfers in their tracks right now. Revisit and update and have all economies sign on to the APEC cross-border data privacy rules, which is one of the greatest things APEC ever did, and revist and have all the economies sign on to deminimalist levels of trade. To finish, KPEC in 2011 leading into the Honolulu meeting, did a study that suggested that a 200 US dollar threshold at that point, 2011, would add 30 billion dollars per annum to APEC economies, approximately 1% of APEC GDP, that's now at least quintupled in size.

Dr. Manfred Wilhelmy:

Thank you very much Dr. Lovelock, this is a real revolution that we heard about. Now for the question and answer session, in which we will take one question.

<u>Question and Answer Session</u>

Dr. Narongchai Akrasanee:

Just quickly, just to put our discussion in perspective for myself also. When we were working on PECC and APEC way back in the 1980's and 1990's, we were undergoing industrialization followed by commercialization, that was why the Bogor Goals in order to help us through the process of industrialization and commercialization. Now that we heard from David and Peter, we are now undergoing digitalization, undertaking digitalization, and we have to undertake this so-call petroleum resource optimization because Asia demand is growing and we have to accept the fact that we must undertake petroleum resource optimization. These two subjects I don't think are on the agenda of APEC. So unless APEC adopts the ideas about digitalization that Peter said, and accepts the fact that Asia's demand for petroleum will continue, then maybe APEC is not relevant.

Mr. Ian Buchanan:
Question for David Carbon, just two words I didn't hear in your talk to help me understand what was very valuable, one was OPEC and the other was Putin. What is the possible hypothesis, those of us who grew up in the Cold War here tend to head that way very quickly given that one of the biggest losers of oil price fall is Russia's government revenue and given that the revenue goes heavily into military which is spending a lot of time in the Ukraine, has a deal been done between Washington and Saudi Arabia to stop OPEC from cutting the supplies?

Dr. David Carbon:
I don't know. Perhaps we'll watch it in a movie in a couple of years, I'm not sure. People ask a lot about OPEC response and that they're not cutting production and so on, are they trying to drive the US producers out of business or something like that. My take is that, maybe naive or too simplistic, it looks to me that the "aggressor" was the US shale production which went up by a million barrels per year last year, and you look at that from the Saudi perspective, and people say why don't you cut supply? Would you expect them to cut supply? I didn't start this. The US shale guys went up by a million barrels per year, and now you're asking me to cut supplies? I wouldn't cut supply if I was in their shoes, I'd say "you boosted supply, I'm not happy about it, but why should I cut my production to support your "aggression"?" With supply prices down, ouch that hurts, but we'll all live with it and see where the chips fall. It's that simple.

Distinguished Luncheon Speaker

- **Mr. Roberto Tan**, *Treasurer of the Philippines*, Department of Finance, Republic of the Philippines

Moderator:

- **Dr. David Hong**, *Chairman*, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC)

Dr. David Hong:

First of all, I would like to thank Dr. Tan for such a nice arrangement that before we enjoy our formal lunch, we have the chance to enjoy luncheon speech presented by Mr. Roberto Tan on the topic of the Philippines hosting priorities for the APEC Finance Ministers' Process 2015.

Mr. Roberto Tan was reappointed Treasurer in January 2015; currently, he is the officer in charge of international financial group of the department of finance. Mr. Tan was first appointed treasurer of the Philippines in July 2008 and became The World Bank Executive Director in November 2012. Mr. Tan has an extensive experience in public finance having assumed several key positions in the department of finance including Under-Secretary from 2005 to 2008, Assistant Secretary from 1999 to 2005, and director in the early 1990s of the international finance group. Mr. Tan assumed the post of advisor to the executive director of ADB. His professional background includes treasury management, international finance, retail credit, and management consulting; Mr. Tan holds a Master degree in Economics from Fordham University, New York, where he also pursued his Doctorate studies. He obtained his MBA from the Ateneo de Manila University, where he likewise received his Bachelor degree in Economics. Please Mr. Tan.

Mr. Roberto Tan:

Thank you David for a very generous introduction. I'll be concentrating my statements on the area of the Finance Ministers' Process. Right now we are hosting the APEC Leaders' Meeting this year and this is really a very significant event for us. I'm sure that if there are questions on other socio-economic sectors, many of my colleagues who are here will be able to answer that as well.

Let me first thank the Chair of SINCPEC, Dr Tan, Mr. Wanandi, the Co-Chair of the PECC, and also Mr. Antonio Basilio, our own Philippines Pacific Economic Cooperation Council Chairman, for an excellent conference that we are having today.

We continue to observe currently an uneven global recovery, with the US showing a strong growth rebound while other major economies are on a continued slowdown. The effects of the recent global financial crisis appear to persist most observably from the high levels of fiscal imbalance, private and public debt, and unemployment, particularly in developed economies. Meanwhile, the APEC economies, especially those identified as emerging markets, are seen driving global growth for the rest of the global economy. However, amidst this optimistic growth prospects of emerging market economies, greater inclusiveness remains elusive. We recognize the importance of sharing prosperity as an imperative for sustainable growth and must embed this in our development path as APEC economies, especially the developing ones as they continue to generate more wealth. The episode of interest rate spikes and capital flow reversals last year, especially in emerging markets and such risks emerging again in the horizon, are creating a lot of worry for many of us. It is with this backdrop that we are moving forward with measures to ascertain financial resiliency among the region's economies in the next Finance Ministers' Process of the APEC.

We believe that addressing these risks effectively and making growth more inclusive could be achieved by boosting global trade and cross-border investments, good governance and infrastructure development. Given this, the Philippines, as host of the APEC Finance Ministers' Process, has proposed a roadmap called the Cebu Action Plan. This was firmed up late last year and was adopted in the Senior Finance Officials' Meeting in January, and we will be waiting for our meeting next week with the Finance and Central Bank Deputies to adopt a final version of the Cebu Action Plan.

Allow me to describe more comprehensively the Cebu Action Plan.

The plan is envisioned to be a stepping stone towards a more financially integrated, transparent and resilient APEC community. A more financially integrated community can facilitate inter-regional trade, financial innovation and mobilization of resources from aging savers in developed APEC economies, to facilitate infrastructure development in the emerging APEC economies. Fiscal transparency, which promotes good governance, leads to more efficient use of resources for social expenditures, investment and better infrastructure. Meanwhile, building resilient economies by strengthening fiscal buffers and developing financial markets to create risk transfer facilities provides the ability to sustain growth in the midst of economic shocks.

Figure 3.1.1

The Cebu Action Plan

Roadmap towards a more **Financially Integrated**, **Transparent** and **Resilient**, APEC Community.

Vision

APEC Community with harmonized policies, rules and practices that enable:

- free trade and free flow of investments
- greater financial inclusion
- well-developed financial markets
- quality infrastructure
- good governance
- resilient economies

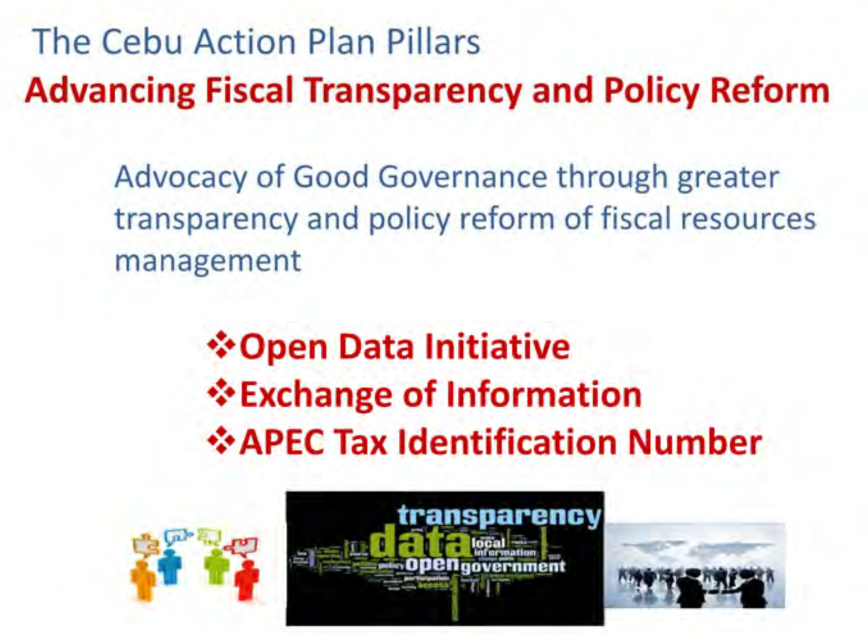
Our vision is that with the Cebu Action Plan, being a key agenda in the APEC Finance Ministers' Process beginning this year, we can forge an APEC community that has harmonized policies and rules and practices that can enable and facilitate the following; free trade and free flow of cross-border investments; access to financial services by low-income households (that is, micro and SME not being turned back); good governance that results in inclusive economic growth; reducing risks from financial shocks, climate change and other natural disasters(which is a new normal particularly for countries like the Philippines); rapidly growing financial markets with diversified financial instruments and risk transfer facilities; and of course, the development of quality infrastructure to sustain growth.

Figure 3.1.2

To implement the plan we have identified four action programs or pillars, elements of which I shall be discussing individually. One of the pillars is Promoting Financial Integration, in this pillar we seek to encourage APEC economies to develop facilities and further enhance the supply chain financing, such as credit information bureaus (CIB) and moveable collateral registry (MCR). These instruments across the Asia-Pacific region would allow for the sharing of credit information that consequentially eases the access to finance as borrower credit risks becomes easier to analyze. Currently, there are eight APEC countries with CIB, and 11 with MCR. Our aim is to increase these numbers and make the CIB and MCR in the region. These initiatives will be mostly beneficial to the micro and SMEs that are part of the regional supply chain, because credit histories still need to be established and moveable assets have been estimated to account for about 78% of their capital stock.

Besides the enhancement of the supply chain financing, we also intend to move forward the initiative of financial inclusion and literacy in APEC, which was championed by the Russian Federation when it hosted APEC finance minister process in 2012.In this initiative we look to APEC to work on facilitating remittance flows so that migrants could have access to less costly remittance services. The areas where we invite APEC economies to collaborate on includes strengthening of remittance markets and improvement of consumer protection, as well as reduction of costs of remittances. We will also call on the APEC economies to further their efforts on regional financial integration, especially in making financial arrangements for the implementation of the Asia Region Funds Passport. Looking at the long-term perspective, we also asked APEC economies to consider working on the liberalization of the financial services sectors, removal of restrictions on capital flows, and the development of regional financial infrastructure.

Figure 3.1.3



The next pillar is Advancing Fiscal Transparency and Policy Reform. Fiscal transparency is an important component of good governance that can support policy reforms to achieve greater inclusiveness. Fiscal transparency allows for an improved degree of scrutiny of tax revenues, subsidies, government expenditures and liabilities that lead to more efficient use of resources for development priorities such as the social services, and public goods including infrastructure. We have enjoined the APEC economies to cooperate in practices towards transparency and policy reforms, such as reporting of fiscal data to the public, exchange of information and financial transactions across borders to avoid tax leakages and base erosion, and improving the quality of public infrastructure spending, and making information and the conduct of government procurement processes more accessible to the public. Among the initiatives, we particularly seek the economies to support is the open data initiative, which aims for APEC economies to open government data portals that will eventually be linked into one main website. These portals will include, but will not be limited to the information on national budgets, government sources and uses of funds, government borrowing and lending data. In the Open Budget Survey conducted by the International Business Partnership, seven APEC economies have been rated as offering significant information about the national budgets, five have been rated as having some or minimal information, and two have been rated as having scant or no information. Through the Open Data Initiative in the APEC Finance Ministers' Process, we look forward to the 21 APEC economies being rated as having high levels of fiscal transparency and reap the benefits of more efficient resource use and quality public investments.

Other initiatives in fiscal transparency that we have put forward to the APEC economies are exchange of information and the development of APEC tax identification number (APEC-TIN). The APEC-TIN is being assigned as a TIN system across APEC economies and jurisdictions with three key features:

1. Convention of tax identification numbers that will provide a unique code to each jurisdiction to link entities to its tax residence;
2. Mutual recognition of tax identification numbers, such as APEC TIN holders can use such TIN across participating APEC jurisdictions; and
3. Automatic exchange of information across participating APEC jurisdictions in relation to the APEC TIN. By adopting this, we anticipate that the participating economies' tax authorities will gain enhanced oversight capabilities against tax evasion, smuggling, and illicit activities. This will consequently reduce tax leakages from cross-border flows and boost fiscal resources.

Figure 3.1.4

The third pillar is enhancing financial resiliency. This concerns among others the creation of fiscal space that could be used during shocks and having financial market that are capable of absorbing these shocks. Initiatives under this pillar are: 1. the adoption of sound market policy frameworks, this involves the close review and adoption of sound fiscal policies that contribute to better subsidy targeting, improvement of tax revenue mobilization and tax base administration. Another initiative is the development of Disaster Risk Financing and Insurance strategies among APEC economies, which will cover national and sub-national levels as well as individual levels, meaning micro insurance. Having a debt and risk analysis and insurance strategy can help governments anticipate and quickly respond to the effects of disasters and at the same time, reduce the need to reallocate and borrow funds to cover costs of calamities. It has been estimated that 70% of natural disasters that occurred between 2003-2013 have hit the Asia-Pacific region, estimates have also shown that APEC region bears about US$68 billion in annual losses from natural disasters. In 2012, the APEC region bore 80% of the top ten economic damages due to natural disasters. On these points, it is of great necessity for APEC economies to collaborate on developing disaster risk finance and insurance strategies.

Figure 3.1.5

Lastly, the fourth pillar is Accelerating Infrastructure Development and Financing. The ADB estimates that the APEC region needs annual financing of around $800 billion for infrastructure development. The most recent global competitiveness survey by the World Economic Forum (WEF), indicated that the average rating for APEC economies for infrastructure is 4.56 out of a rank of 7, with a wide divergence between high-income APEC economies with an average of 5.55, and low-income APEC economies with an average of 3.75. This indicates a need for improvement in infrastructure in APEC economies, especially those in the low-income and emerging group. During Indonesia's chairmanship of APEC Finance Ministers' Process in 2013, the multiyear agenda for infrastructure development and investment was introduced and the APEC PPP experts advisory panel was established in the Indonesia PPP center. In 2014, China as the host of APEC Finance Ministers' Process continued the agenda of PPPs for infrastructure development and investment, by introducing an implementation roadmap that develops successful PPP projects, which was endorsed at the Finance Ministers Meeting; and I guess it is also a result of the initiative right now of the Asian Infrastructure Investment Bank (AIIB).

We carry over the PPP modality on developing and financing infrastructure through initiatives of building PPP knowledge portals and developing the convention of standardized PPP terms and practices. The PPP knowledge portal will serve as an online one-stop-shop for undertaking PPP infrastructure projects. This repository of data on PPP infrastructure projects in APEC economies includes policies, legal and regulatory frameworks, tender process, and sample projects. The portal will also feature a list of private firms, managers, and consultants involved in PPP infrastructure projects. Through this PPP knowledge portal, the development of PPP infrastructure projects could be easier and could also have higher success rates. As such, this could motivate both the public and private sectors to invest more in infrastructure. Meanwhile, a convention of standardized PPP terms and practices will be introduced to identify and compile commonly used PPP terms and practices, and develop templates for PPP contracts. Having this standardisation, could make negotiations and restructuring of deals more precise, which in turn, lessens the probability of future disputes and claims on those private sector interests in PPP infrastructure development.

Aside from the PPP initiatives, we are also proposing to APEC economies initiatives on long-term investment in infrastructure, urban development and regional connectivity. In long-term investment in infrastructure, we aim to develop infrastructure as an asset class for long-term institutional investors. For Urban Development, we are looking to continue The World Bank development networks established in the APEC Finance Ministers Process in 2014, while our Regional Connectivity Initiative is intended to support the APEC Connectivity Blueprint for 2015-2025, which includes finding solutions to financing bottlenecks in infrastructure development.

Figure 3.1.6

The Mission Statement of APEC cites that the forum’s primary goal is to support sustainable economic growth and prosperity in the region. It is our firm belief that as host of the APEC Finance Ministers’ Process for this year and with the Cebu Action Plan, we can shepherd the 21 APEC economies towards this goal. Thank you very much.

Dr. David Hong:

Thank you Mr. Tan for the excellent speech and organizing the Philippines hosting priorities for the APEC finance ministers process 2015 into a solid Cebu action plan, a very clear cut and calls for those things about promoting financial integration, advancing fiscal transparency and policy reform, enhancing the financial resilience and excellent infrastructure financing. With that we can work together to the direction to achieve sustainable and inclusive growth in the Asia-Pacific region, which is the theme of our conference. With that, Mr. Tan will entertain a few questions.

<u>Question and Answer Session</u>

Mr. Jusuf Wanandi:

We have listened to a number of presentations on the agenda for APEC 2015 covering a lot of areas that are all very important for future growth in our part of the world. My question is very simple, how are we to place Asia-Pacific wide integration into the entire program? I think following up on China last year, progress in Manila in respective FTAAP is very important. We have so many initiatives already taking place, as our co-chair said this morning, many of the initiatives actually were fragmenting rather than integrating and we really need the converging initiative that can bind us together, I think FTAAP is that. The idea behind FTAAP is not that it is going to address silo's of issues like trade in goods, trade in services, investment, flows of people; the idea is that it addresses the silo's in an integrative manner. My question would be how are FTAAP ideas going to be integrated into this very important issue of finance.

Mr. Roberto Tan:

First of all, I think, in a way, there needs to be some sort of overall oversight body on the initiatives that are being pushed by the different sectors, and the way that I look at it is to really determine where are the commonalities in terms of progress by the different APEC economies in the different sectors towards integration in the region. Prioritize these commonalities where progress is advanced because this is where the low hanging fruits are; even in the finance ministers process there are very high stumbling blocks particularly on the legislative front, on how integration can be pursued in financial services. There are of course an effort to determine where the easiest routes are for a group of economies can go through in the different subjects of financial services. There are other ways of thinking about it in the finance ministers process. For example, when there are legislative obstacles or stumbling blocks towards integration of financial services, there are other ways like using existing legislation and allowing for cross-border trading of securities; the second level, meaning the credited or the licensed exchanges securities and equity exchanges in APEC or ASEAN economies to agree among themselves and come up with ways by which they can recognize cross-border trading of securities in the region. Those are the ways I think we can move forward, rather than coming up with a slew of initiatives some in a very advanced stage and some in probably just in the infancy, and there's really not much that can be done with them. Coming up with a set of priorities where we can really move forward as a region, and of course, innovative ways of looking at things would be very useful, like what the private sector is doing on the next level, where in regulatory environments can allow them to integrate better and more openly among the different economies of the region.

Ambassador Laura Del Rosario:

Each time we meet in APEC, especially during the host year, before we go into the formal SOM we start discussing FTAAP, we have friends of the chair on the FTAAP, then we have the friends of the chair on connectivity, which my friend Undersecretary Cristobal talked about. Now why are we doing this? We know that FTAAP will provide eventually the whole framework for integration of the Asia-Pacific, however, we already agreed that before we go into the negotiations of it, we should go into a collective and strategic study on the matter.
For one thing right now under APEC, there are two major FTAs that are being negotiated; first, RCEP, which is actually ASEAN plus their partners, and the TPP, they are different. Of course, the provisions of our ASEAN Plus FTAs are different. If you want to ask questions later, Undersecretary Cristobal can reply to that. Assuming you have all of this differences, where is the common base line of all of this? How high do we want to go? How ready are we? Just a reading along the RCEP negotiations, I could sense difficulty in integrating all the various FTAs. There's a lot of talk on technical cooperation and capacity building and that goes to show that trade and investment and other issues are more complicated than we think. Having said that, once we go into this, we move into SOM.

What are our priorities are about? Our priorities are about making sure that while we are doing FTAAP, TPP or RCEP, inclusive growth will continue so that when we are there our people will be ready. So in effect our priorities are really ramping up our capacity and leveling up our institutions, so that when the time is right according to the study we are not left behind.

Mr. Roberto Tan:

Well, of course, I am very supportive of that. As you know, as Ambassador Del Rosario has expanded, I just came from the ADB, the new strategy is based on two-twin goals that are eliminating extreme poverty and sharing prosperity. The issue of inclusiveness is now a crying issue as studies are showing there is a growing gap between the rich and the poor over the past 50 years rather than the gap closing, this just indicates very seriously how the world is moving, while its becoming prosperous on a macro level, on the micro level, meaning the beneficiaries of growth, it is not reflecting that goal. I fully support the Ambassador's intervention where she is saying, while we should move forward in trying to proceed with the integration, I think it has to be under the umbrella of how it can improve the lives particularly of the bottom 40% that is The World Bank category of societies in the developing countries particularly.

Dr. Alan Bollard:

Do you think that fast growth and inclusive growth are complements or substitutes?

Mr. Roberto Tan:

Well it depends on which side of the economic school you are in. Decades ago, we were talking that growth is necessary and fast growth is definitely necessary for us to increase the economic pie to distribute to the poor. I think it can be complementary to each other, and I think growth is definitely necessary and fast growth is definitely desired for us to expand the economic pie for poorer populations of the society to benefit. This is where I think that social policy and public policy is very important, even in the Philippines there is now an issue on whether the distribution policy is in fact working. We have experienced high growth during the past five-ten years, but during the past five years it was excellent growth. But it seems that it is really the big interests where the benefits of growth are going, and therefore, the government has to find ways including in public expenditures and regulatory policies, where the benefits of growth have to flow down to the poorer sections of the society. This is going to be what will sustain that growth. There will be a time where growth becomes politically disruptive because the poor will find themselves left behind, I think this is happening even for the middle classes segments in the society. What happened in Brazil during the riots was really a middle class upheaval, where infrastructure development was only being initiated right now because of the football and the Olympics; during the past year, it has been a dismal performance of infrastructure and social services being shared to the lower segments of the population.

Dr. David Hong:

Thank you. Again a very interesting question; I’m sure every country would like to over the long run to work on both fast growth and inclusive growth. Maybe not the same speed but over the long run that should be the ultimate goal for every country.

Session 2: Inclusive Growth: Building Capacity at Individual and Community Levels

Lead Panellist:

- **Ambassador Laura Q. Del Rosario**, *SOM Chair 2015*

Discussion Panellists:

- **Dr. Djisman Simandjuntak**, *Chairman*, Executive Board of Prasetiya Mulya Foundation; *Chairman*, Board of Directors, Center for Strategic and International Studies Foundation, Jakarta & *Chairman*, Indonesian National Committee for Pacific Economic Cooperation (INCPEC)
- **Mr. Joey Salceda**, *Governor* of Albay, Republic of the Philippines

Moderator:

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

Mr. Denis McNamara:

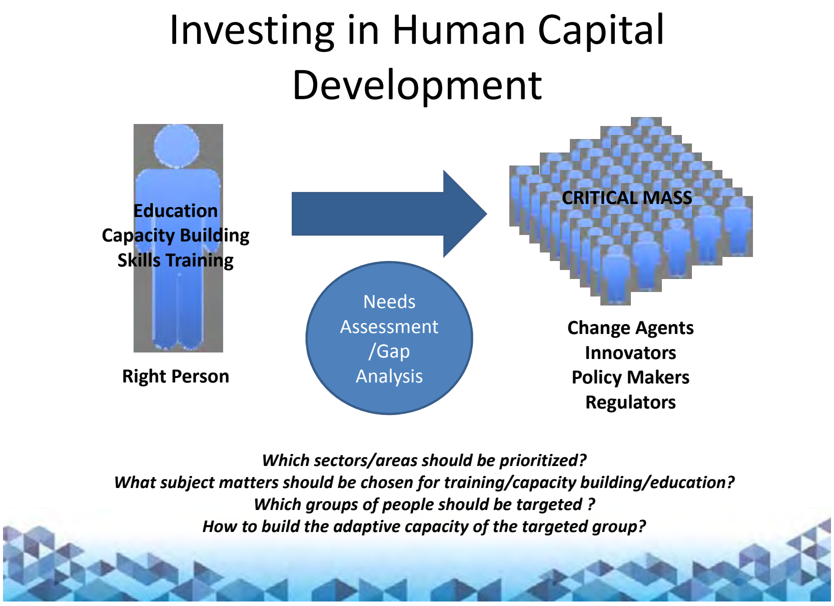
First of all, I would like to start like the other people have by congratulating and thanking Tan Khee Giap and SINCPEC and PPEC for organizing these sessions. I am quite overawed by this panel having an ambassador, a professor, and a governor; it's a bit scary. The topic is Building Capacity at Individual and Community Levels, and really asks the question how far have we come and how far do we need to go? I'm reminded of the anecdote told by Dr. Peter Lovelock earlier on about remitting money back to the home country and all the problems that were encountered. As a practicing lawyer, I can assure you that no matter what it decided unless you have laws and regulation that are clear, unequivocal and are harmonized or converged, very little will get achieved. Our lead speaker is Ambassador Del Rosario.

Ambassador Laura Q. Del Rosario:

Just a subtle introduction, Dr. Il Houng Lee already spoke about the issue of climate change and issued a map of countries going into orange and then red and redder color, meaning its really warming. I wanted to connect with what Dr. Peter Lovelock said this morning about the role of technology. When I talked about the new normal, I was talking about climate change and technology changes. We will show you a video put together by my team for the Senior Officials Meeting (SOM); I hope it will make us think a little bit more about the future.

I think it gives us a clear picture of what we are facing right now. Technology is good for SMEs so that they can reach a bigger market, but for those of us involved in human capital development it presents a big challenge, especially if knowledge is produced every 12 hours in 2020. So this is where I started this morning and now I want to continue.

Figure 4.1.1



I want to say that when we talk about human capital development, I always talk about the right person. When you talk about capacity building, especially I am talking about post-college when people enter the labor force, people are going to institutions, the government and the private sector. I've given an example when I've talked about the right person who will really be a part of the change, who will be part of the critical mass, because for me change cannot be done unless you appoint the right person, who has the right position, who is in a leadership making position, who can change policies, and make change within his own institution, and if you have a critical mass then you can definitely change will come.

There were three secretaries from a multinational tobacco company who called me a few weeks ago and said that they wanted to be involved in APEC. So I asked them, “I have to be frank, I really admire people who use their own products, do you use your own product as you are a tobacco manufacturing company?” There was silence, and they said, “no, we don’t.” I said, “if that is the case and you don’t use it, then why do you sell it?” They said, “actually we don't sell it, it’s our marketing people who sell it” In other words, they tend to divide the responsibility. “All right” I said, “how is that?” They said, “we are corporate people, we don't deal with marketing.” They don’t see that, what I am trying to say here is that they should have seen the dots; whatever you’re doing in the company, you are still earning from people who smoke, earn from people who might be having cancer in the future. Of course for those of you who read about climate change, people also said that smoking tobacco was linked to climate change, close to a billion people light up a cigarette every day, there is still a lot of smoke going up. Now of course, people you can’t attribute this to climate change, apologies to my friends who smoke, those who smoke say it can’t be because I am alone, this is what they do when they kill people in the electric chair, there are two people who pull the switch, so no one person feels guilty, that's what smoking is about. So when you don't feel guilty about climate change, it’s like smoking, just because you’re just one of 7 billion people, it’s still contributing to it.

When you need critical mass and change agents and innovators, we have to figure out which sectors and areas should be prioritized because as Dr. Pangestu said so many people are interconnected. We do really need to make sure there are connections and changes in what we do. When we talk about new ways of thinking and new ways of doing things, we need to think in terms of not think in silos; right now we are always thinking our issues in SMEs and finances and so therefore it’s related to the government. It’s a challenge for us in Asia, when we teach students we have to teach them not in a way that they will silo there knowledge of history separate from their analysis of science and technology, those things should be connected. As I talked about this morning, methodologies of teaching that they should be able to do that.

If you need change agents, they have to be in the leadership position. Sometimes we let people attend programs, but they are not in a position to create that change, because sometimes they are the people who are the least busy and attend training courses, or sometimes they are in middle positions and not really introducing changes in their own institutions. Now when talk about institutional changes, I am really talking about not just government but also the private sector. One should change institutional behavior indefinitely.

Figure 4.1.2

When we talk about a virtuous cycle when you talk about human capital development, and then of course, it leads to changes in institutions, and of course it leads to more changes; it's a cycle, except that this should not be a closed system. I think this is the reason why as someone who has been in the education sector and services, I want educational services in my country to open. Right now, they're closed. I wanted to say that knowledge cannot be contained, somehow people who do research, contribute knowledge to other economies, they should be part of the virtuous cycle so that the knowledge and innovation will go around.

This is where we talk about inclusive growth, policy and reforms that will lead to competitiveness as part of capacity building and of course, we are talking about structural reform this morning. Of course, my colleague Undersecretary Cristobal talked about the private sector. Right now, we are doing a lot of work with the private sector, we helped them and work with them on jobs scaling. When we are scaling our own work, we talk to them and ask them what they really need. The private sector is also involved now in ranking universities. They have in fact entrepreneurs in the Philippines who are buying universities so that they can improve the way the universities are run.

Figure 4.1.3

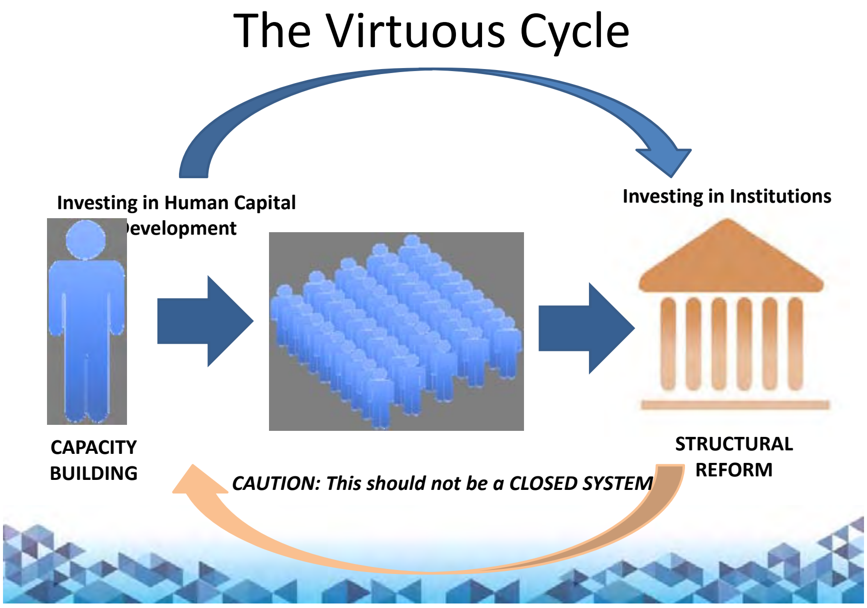
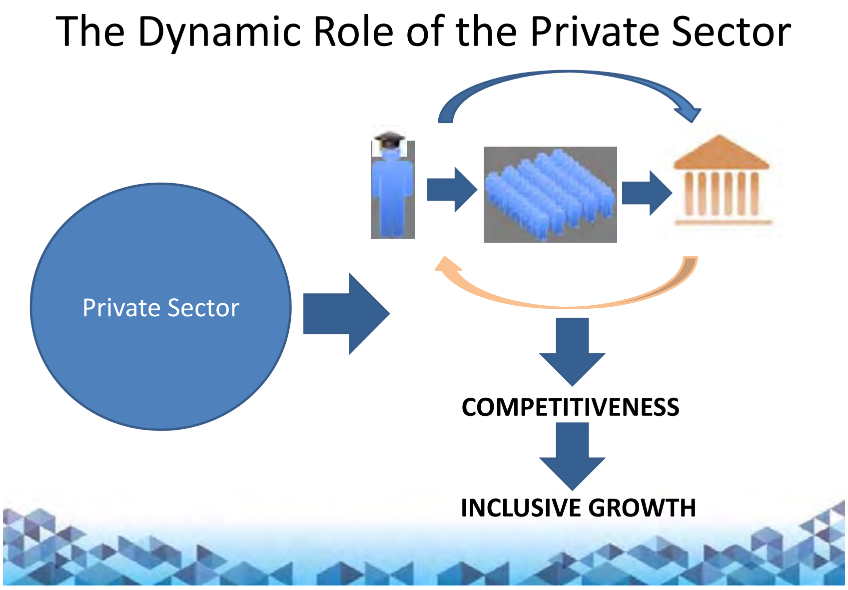


Figure 4.1.4



From 1996 to 2015, what's new? This is the statement of the Manila Action Plan in 1996, when we described what eco-tech should be; it says that economic and technical cooperation in APEC in particular complements liberalization and trade facilitation by addressing structural and institutional bottlenecks to sustain growth. Strengthening mechanisms that broaden the benefits of sustained growth, reduce disparities in income within and among member economies, and deepening cooperation in the Asia-Pacific region. Sometimes I wonder have we moved since 1996 to where we are right now? But right now this is the role of APEC and eco-tech, we have decided to really put front center developing human capacity through capacity building as the main product of eco-tech, we are working on harnessing technologies for the future and supporting innovation, which actually addresses one of the factors of the new normal, developing and strengthening the dynamism of SMEs, which you said is a part of inclusive growth, and as a whole, promotes inclusive growth.

Figure 4.1.5

APEC for me is really a very exciting field to be involved in, and it's not just a talk shop for me. To me it somehow predicts the future or somehow leads a light towards the future. For eco-tech projects in 2014, you will see that we have the vision of the three projects; for instance for the SEA working groups, these are the working groups that really go into the human capacity building, you have 36 projects in all. That's for us to be conscious about that we have to do more on trade facilitation, there are only certain projects. When we talk about the priority area for inclusive growth, you look at the chart to the right; it looks like when it comes to inclusive growth, we have just about 19%. We can continue discussing eco-tech in APEC, and we continue to work on this through the senior committee on eco-tech, and I think so far we are trying to move beyond what we have been doing so far. Thank you.

Mr. Denis McNamara:

Our next speaker is Mr. Joey Salceda from the Philippines.

Mr. Joey Salceda:

Good afternoon to all. I am from the province of Albay, and was for nine years a congressman, for nine years governor, and for many years I was also the president's economic advisor and presidential chief of staff. I'll talk about what I am doing in my province. Essentially, it's all about adaption, which builds capacity in the human endeavor enables development in the face of resistance. In other words, just because there are risks, just don't stop.

This is where I come from. I represent 1.2 million people, as big as Timor Leste. First thing you have to know is to know your risk, I have everything, I am the Vatican of disasters, but I also want to say I am the capital of solutions. So there are 19 to 21 typhoons, five of which hit my province, I have 200,000 due to poverty threatened by wind destruction; common sense when you are poor your house is made of light materials and the wind as part of a typhoon essentially destroys that. We have a volcano that erupts - which just erupted last year - predictably erupts almost every five years. I just want to clarify our geography has more to do about risk; look at this, China only has 11.3 million school children studying in areas prone to earthquakes, India has 1.3 billion people has 13.7 million; well, the Philippines with 105 million has 15.6 people studying in areas prone to earthquakes, so do the math, its more about geography. My people don't want to leave, they just want to work abroad and come back.

Figure 4.2.1

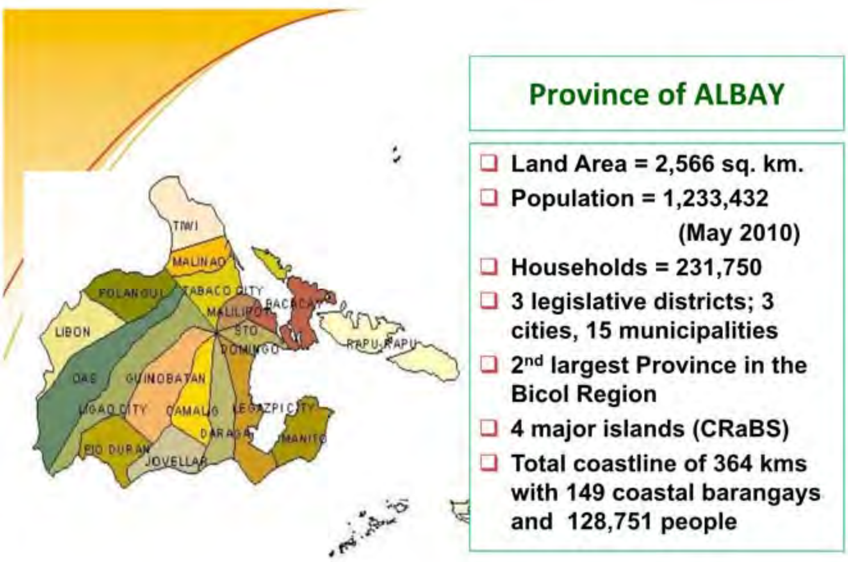
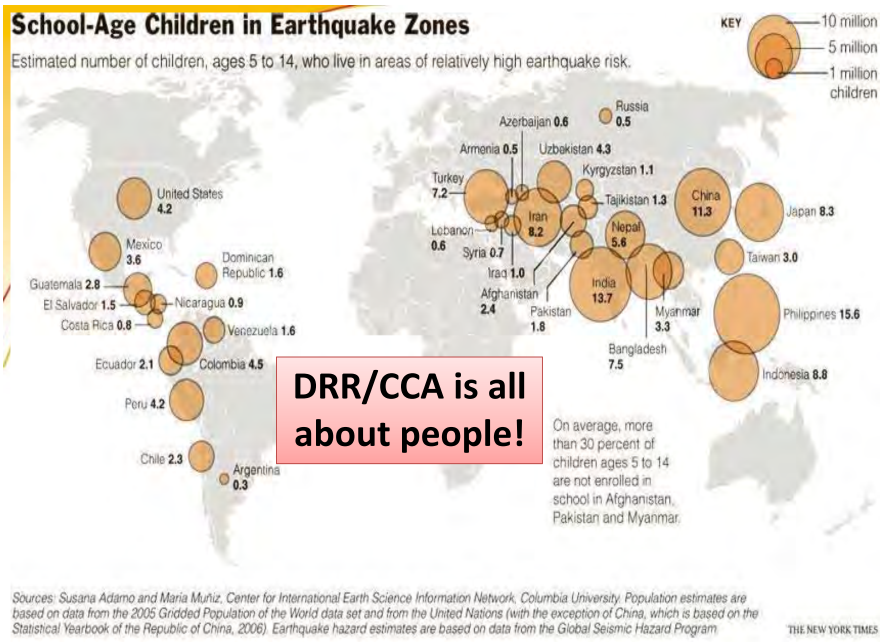


Figure 4.2.2

Figure 4.2.3



One thing worth worrying about is that there has been an escalation in the damages to GDP. If you look at the average between 1990 and 2009, the actual average was 0.29 but the average between 1990 and 2014 has escalated to 0.52%, you just do the numbers and see there’s been a right trajectory of damages as a percentage of GDP. 80% of disasters in the Philippines are essentially are from tropical typhoons or climate change; in terms of dead people and in terms of incidents, its almost 80-20. Despite all this, look at what I did in my province; in 18 of the 20 years, zero casualties. I had 300 typhoons to deal with, but in only 2 years I have had casualties.

Figure 4.2.4

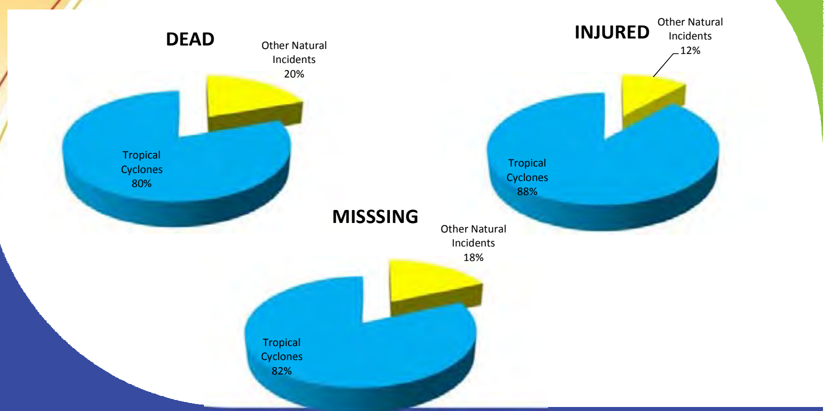
Total Disaster Damages to GDP

	TOTAL DAMAGES (Pm)	GDP (Pm)	Damages to GDP
1990	27,212.0	1,193,528	2.28%
1991	17,746.0	1,382,738	1.28%
1992	10,898.0	1,497,464	0.73%
1993	21,340.3	1,633,630	1.31%
1994	5,245.9	1,875,690	0.28%
1995	19,001.6	2,111,705	0.90%
1996	1,678.4	2,406,388	0.07%
1997	3,556.7	2,688,718	0.13%
1998	28,368.0	2,952,762	0.96%
1999	6,728.0	3,244,197	0.21%
2000	9,775.8	3,580,714	0.27%
2001	9,223.0	3,888,801	0.24%
2002	3,534.5	4,198,345	0.08%

	TOTAL DAMAGES (Pm)	GDP (Pm)	Damages to GDP
2003	5,345.0	4,548,102	0.12%
2004	13,841.8	5,120,435	0.27%
2005	3,445.6	5,677,750	0.06%
2006	21,938.6	6,271,157	0.35%
2007	4,532.1	6,892,721	0.07%
2008	23,512.6	7,720,903	0.30%
2009	45,222.0	8,026,143	0.56%
2010	25,281.5	9,003,480	0.28%
2011	25,294.3	9,703,333	0.26%
2012	50,022.8	10,567,336	0.47%
2013	105,458.9	11,548,191	0.91%
2014	70,318.4	12,634,062	0.56%
Total	**558,521.6**		**0.52%**

Figure 4.2.5

INCIDENTS	CASUALTIES		
	DEAD	INJURED	MISSING
Other Natural Incidents	5,925	7,476	2,062
Tropical Cyclones	24,372	57,255	7,106
Grand Total	30,297	64,731	9,168



We are the fastest growing region boasting 9.4% GDP, my health Millennium Development Goals (MDG) has been achieved. People were asking on how to look at inclusiveness. There are certain minimums, just achieve it first. The minimum of the MDG it's all there for everyone to see. I don't know why we have to reinvent the whole thing. People must have health, women must have diets when giving birth, children must have diets when being born, there are so many things, and these were the first points on my mind on inclusion. I have achieved all my MDGs early in 2011, ahead of the 2015 deadline. Despite the disruptions, our rice production increased from 147 to 228 through the proper use of water resources. Sure, there's a typhoon that destroys my farm so we plant again. So how come we were able to grow rice production? Despite all this, we grew our rice production by 80%. In 6 years, I've increased by forest cover by 88%, expanded my mangrove forest by 4 times from 700 hectares to 2000 hectares, in other words, we invested in nature. For the Philippines, this is actually quite exceptional.

Figure 4.2.6

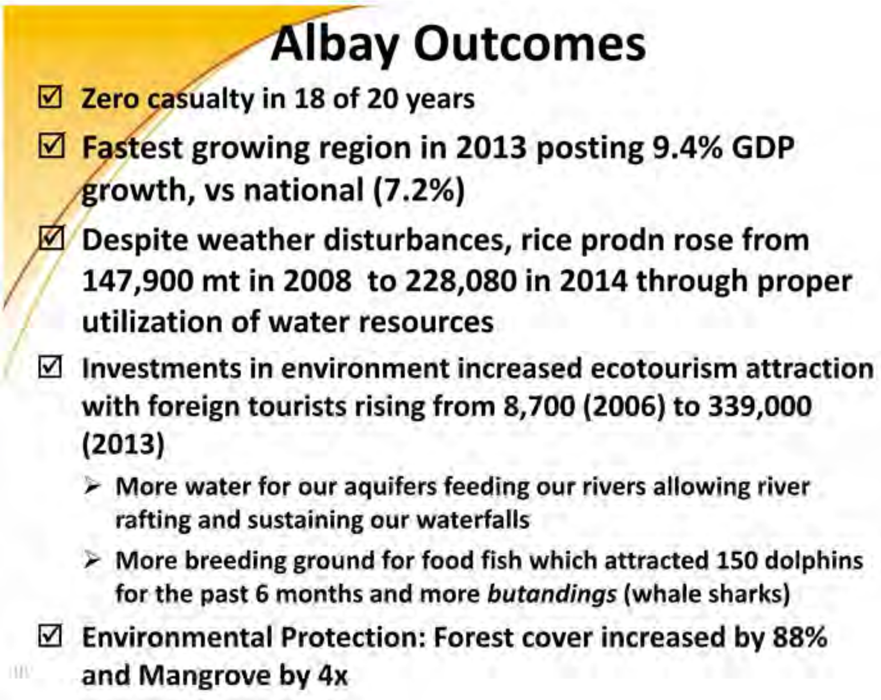


Figure 4.2.7

Let me talk about the investments in the environment. Those increased my eco-tourism attractions therefore my foreign tourists increased from 87 to 239,000 essentially, I had more water in my aquifers and rivers were strong and waterfalls were more attractive. My mangroves had green grounds; you had whale sharks, where before we didn't, we have dolphins now, and virtually every conceivable animal in the seas all around my province all because I took care of the seas for them.

So, what did we do? One, you have a problem which is risk, then you have an outcome which is essentially positive, so how do you go from here to there? What did we do? Essentially it was through strategic intervention. After knowing the risk, we had a comprehensive land use plan, and therefore, we built new settlements and safer settlements as anchors for business formation and as well as for settlements; safer from the effects of the typhoon and devastation, safe from floods, safe landslides, safe from eruptions, in other words, a safe area. They have also been a source of growth.

Figure 4.2.8

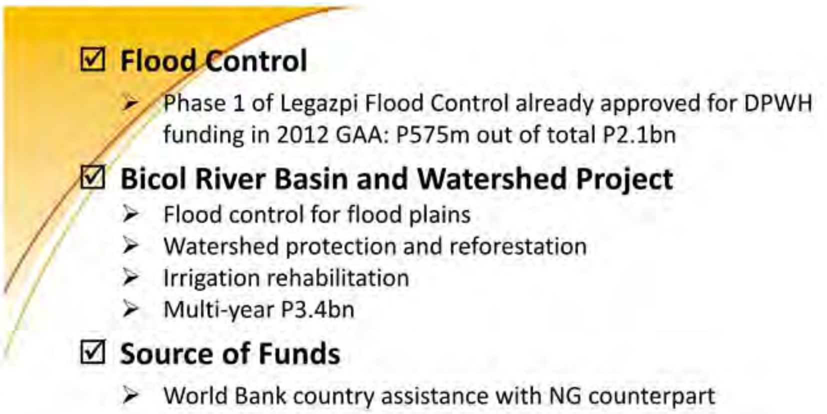
Reducing Risks and Building Resilience: Geostrategic Intervention – New Albay

- **Geostrategic Intervention**: Guicadale Economic Platform
  - Both the flagship economic project and main DRR strategy of Albay
  - Redirection of centers of business and residential activities towards safe area
  - Components:
    - **Relocation of 10,076 households** in high-risk areas
      - Cost- P2bn for 8 resettlement sites
      - Source of Funding- NHA, province, INGOs
    - **New international airport** (ongoing)
      - Cost- P4.9bn
      - Source of Funding- DOTC national government
    - **Road networks**
      - Cost- P1.3bn
      - Source of Funding- Organic annual budget of DPWH, national transfers, JICA, multi-year from 20% economic development fund of the province
    - **New government center**
      - Cost- P176m
      - Source of Funding- province to acquire via long term loan from Philippine Veterans Bank

To reduce risk, we are reallocating everybody who is at risk. How did I do that? It’s social cohesion. I’ve been hearing about methodology changes being the solution and sources of change in the new normal. There are still the old school social anthropological school of thought, which says that there is only one god and makes us all brothers. Liberal arts is my distinctive comparative advantage in the way that I approach problems - there are less people that have studied philosophy, and that's why this world is going somewhere else. If you look at the Oxford University study, it said that it was the best in the world. I built the markets with the people, and suddenly businesses were crowed with people, they built everything. I gave them the money and it was beneficial procurement, and they built it themselves. What you cannot move, you defend. We had strategic intervention essentially funded by the national government and the help of the World Bank and ADB.

Figure 4.2.9

Figure 4.2.10



If you cannot defend, then it’s called evacuation. Every year I have a planning instrument and know how many people will die if I do nothing because people tell me that there will be five typhoons and earthquakes, we need to make a budget and it can be planned. You plan the contingency, you don't have a contingency to the plan that is probably the only thing I can say that is a new normal in the way we do things. You plan the contingency. You ask people where are you in the plan? They do their own mapping, and a map only shows you the hazard, but becomes a risk when someone owns it. I built evacuation centers learning from the Spaniards and Japanese. We also had social preparation continuously; we have at least three villages being trained in what to do. We train the trainers and the rescuers and we train them early.

Figure 4.2.11

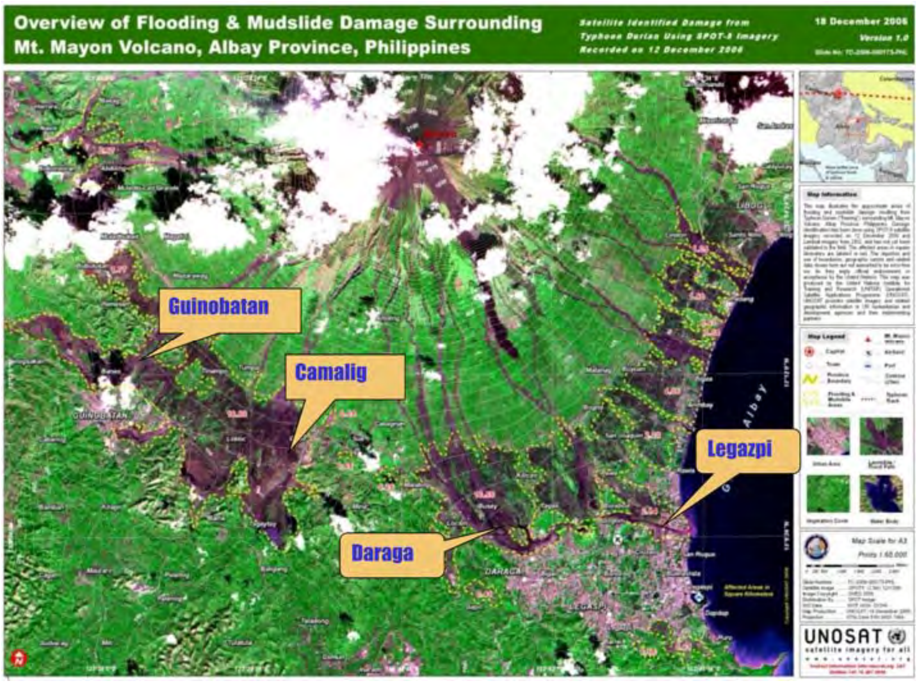


Figure 4.2.12

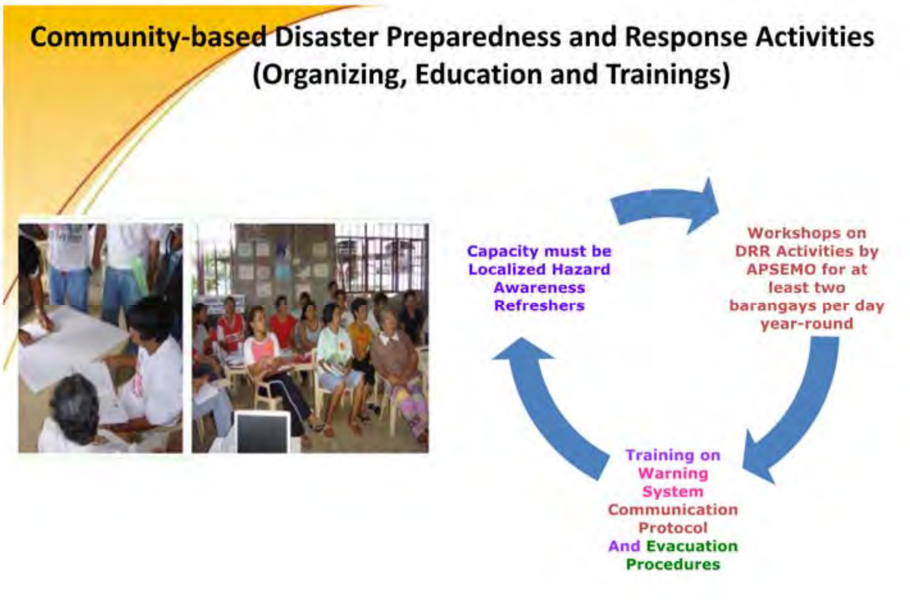


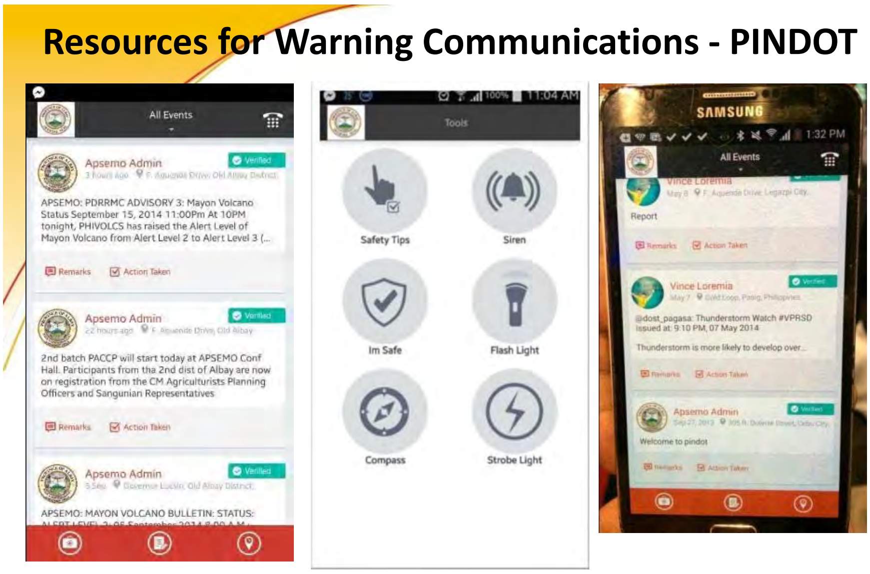
Figure 4.2.13

We have an early warning system and we have a community-based early warning system. People know what to do once you train them, because I will not be there to protect them, but they are already use to using technology. We acquired Doppler. Once you have the warning, you have to communicate; we have the tsunami warning, which comes from me to the people who will be affected as you only have 30 minutes to respond. We train people. We have an information board, where almost everyone who lives in Albay has their number submitted so once there is something we want to tell them, everyone knows it. We have an app, its provincial information disaster. Every day it's updated and tells you what's happening around the province; it's free, so take advantage of it. Thank you.

Figure 4.2.14

- ☑ **Close coordination with warning agencies**
  - Pagasa is sole authority
  - Establishment of Regional Weather Bureau in Legazpi
    - Upper air balloon to improve detection
  - JICA Reming assistance: Doppler radar in Virac
- ☑ **Community-based warning system**
  - Rainfall monitoring at village level
  - Continuous training
- ☑ **Doppler Radar and Satellite Imagery**

Figure 4.2.15



Dr. Djisman Simandjuntak:

This is partly the reason Indonesians elected a successful governor into the presidency; local wisdom and I think we have a lot to learn to how governors and regents do things locally. Let me remind us of the very sticky nature of inequality and the difficulties involved in moving into inclusive development. 20 years ago, a book was published in the west called, “Tyranny of the Bell curve”; it was actively discussed and was very controversial. The book actually argued among others that inequality is partly in our genes, and if it is in our genes then it is very hard to attack. This morning the Executive Director of APEC, Alan Bollard raised a very important question that I think we need to answer, how is speed related to inclusion? I tend to agree that the higher the speed the less inclusive the outcome is.

Perhaps, partly the problem we are facing now is the increasing speed in which technologies are adopted and get diffused, leaving us very little time to learn, and learn important lessons from the speed of the adoption and diffusion. Now let me provide you with a few anecdotes about these inequalities and possible of ways of addressing them. Number one, geography; if you look into the GINI coefficients, there is geography inequality. We in Asia can be considered moderately unequal economies; Europe is even less unequal than us; but Latin America is the extreme case of inequality, why is this? I do not know. It is not because of capitalism. Two of very capitalist economies are also showing very good inclusiveness; one is

Germany, which is very capitalistic, the other one is Japan. The two economies are very capitalistic, but they show a relatively good inclusion in participation as well as in outcome.

On the other hand, we have the socialist Indonesia, I always count Indonesia as socialist at least in our mindset, and India really performed worse than the two economies in terms of participation and the way development outcomes are distributed. We are less inclusive.

Now the question is, are the instruments to reduce exclusiveness or increase inclusiveness, I agree with our friends from the Philippines, perhaps the so-called instrument is increased in human capital, and human capital means to me is the product of health, literacy, skills, and entrepreneurship; the four have to come together to produce outcomes. They must have the health capacity to perform productively. Literacy, master of mathematics and statistics, reading skills - both hard and soft skills; entrepreneurship and enterprises, I think it is very important to really create a conducive environment for the development of SMEs to unleash entrepreneurship capacity of the society.

The question is whether there is anything that APEC economies can do together. This is our issue. National governments are doing many things, but the question to us, PECC included, is common initiatives in pushing the development of human capital, and this is where connectedness comes in. How do we encourage human capital development and best practices in one place and get diffused in other places? The way European human capital got diffused into the Americas long ago. I think the ideas such as FTAAP, or to allow human capital development practices to get diffused into other economies, we have to have a good integration scheme in place. Of course, there are other things that we can count on to improve inclusiveness, such as social policy. In my own country, social policy has been elevated very strongly lately, and I am worried about the sustainability of that policy. We know the problems of Greece, Spain or Portugal; there are tight limits to what social policy can do, but I think we should focus attention on human capital development. I agree with our friends from the Philippines, perhaps this needs to serve as a kind of a call or program and the rest should follow this core agenda, but the question again is what is it that APEC economies can do together? National initiatives are there, how do we amplify these national initiatives so that best human capital practices get diffused beyond borders, and if that happens I believe we are going to enjoy a more inclusive development on a more sustainable basis. Thank you.

Question and Answer Session

Dr. Charles Morrison:

I have two questions to the governor. First question, would he move to the US and run for office? Second, how did you do it? To move from a national position to a local governorship and then to achieve the achievements that you indicated there. What are the leadership skills that you say you need and the kind of support base in order to achieve the achievements.

Mr. Joey Salceda:

I was betraying my democratic socialist credentials. I truly and still believe in an enlightened elite that would essentially be able to see far beyond the narrow interests that bond political classes. Talking about your encouragement to running the US, it is precisely the point - that it is so unequal because a political democracy is probably not what we are talking about. You see you may think that you are able to vote and say something, but it’s so amorphous, so disorganized and unable to affect policy. An example in the Philippines in terms of our policies, you have rich people making those policies for you. The whole gamut I think starts really from one single root, political democracy and how democratic is your politics? I’ve looked at it and probably the European would make it but the rest of the world won’t. It’s probably the reason why it is so unequal because politics is not democratic. Even in my country, I don't think it’s democratic because the poor are not organized. The rich people legislate for them.

What are the skills? I would start with; one, philosophy, I am a product of a Jesuit education and from my family was taught about a lesson called constant kindness. Categorical imperative is what I learned from Immanuel Kant. The concept of will and the ability to create before nothing and create something, I learned that from Nietzsche. I would think that the liberal arts matters as much to do with the skill sets that I have. I would blame my mother and the Jesuits.

Dr. Peter Lovelock:

Two very quick comments to Joey. Wow, that was a great presentation and should be everywhere as far as I am concerned. The point you made when you questioned technology, absolutely and that's part of my problem out there. It’s not technology for technology’s sake and it never should be, it should be solving problems and addressing human concerns, and that's the problem I have with the equation right now. Thank you for the presentation. Secondly, I also agree with Alan [Bollard]’s question earlier today of whether fast growth or inclusive growth, I think it's a great question. I would go in a different direction. I am terribly in fear that in these institutions right now, we are spending way too much time solving yesterday’s problems and looking backwards instead of looking forwards. I think you are at a point now where with increasing digital divides, increasing income divides, increasing wealth divides that we are all conscious of and that’s only growing and increasingly in repetition. Dr. Narongchai mentioned this this morning the whole equation is changed around now in that you are seeing demand from the bottom. Top-down models are very problematic and we actually have to get more nimble in being able to be responsive to the demands being seen from the bottom and being able to capture it and respond to it. The technology or any other solutions are supposed to be there to address that and we actually need to move faster or all those gaps are going to increase. I would challenge that actually inclusive growth and speed growth, fast growth are no longer complementary but a necessary nexus right now that needs to be addressed. I think it is a fundamentally important question that we are not looking at.

Dr. Djisman Simandjuntak:

Just one sentence to Peter; if you draw a graph of technology adoption and diffusion on the one hand, and the distribution of outcomes on the other hand, pace is increasingly and time is getting shorter, but the outcome is getting more skewed to the right. This is my problem. Maybe if we can imagine something like the future oriented learning perhaps this problem can be alleviated.

Mr. Eduardo Pedrosa:

Pak Djisman, you just alluded to concerns that you had about health care reforms in Indonesia. I was wondering if you could speak a little more to that? We read in the papers that now you have this health card that is universally provided, but as everyone else is thinking about this, could you just articulate a little bit more what those specific concerns you have are. For Governor Salceda, I wished you had more time to spend on that one slide on the early warning system. What it seemed to me is that you had a very sophisticated IT infrastructure there that went through these screens. Where do those screens come from? How are they all connected? Is there a wireless internet system or a LAN that connects these? Once it becomes disconnected from the internet, you don't have your information mechanism anymore. I just wanted a little more operational detail on that warning system that you have.

Mr. Joey Salceda:

Well I always believe in surplus, so we maintain other systems in case one fails. I think I have three levels of surpluses. Mutual replication of resources but that's what risk reduction is all about, you have to invest. That I think answers it.

Dr. Djisman Simandjuntak:

I will be very brief. Number one, we aimed at doing overnight what other societies did in decades and that is universal coverage. Number two, it’s based on amplifying benefits, I think this is the problem that may arise any time soon.

Participant:

Just a number of quick comments. Number one, very different attitude if one assumes one can succeed rather than one is doomed to failure. Very different attitude that things are impossible to plan for, many things if not most things, if they cannot be planned for they can at least be estimated. Inclusive growth, even if it’s thought of nationally, has to be delivered locally and countries where all of the firepower in terms of decision making and policy at the national level will find it very difficult to do the sort of things that you saw. Last one, it’s great to talk about and again I am a university professor and a scientist in a previous life, one can talk about the interaction of government and companies and universities and research institutes, but the vast majority of people at least in the Asian portion of APEC are in economies where per capita income is well below US$10,000 per person, and where are you going to get the growth when the impact is at the local level. Seemingly simple things rather than the highfalutin things that the rest of us tend to talk about.

Session 3: Connectivity and Regional Economic Integration: Reaping the Benefits of Economic Integration

Lead Panellist:

- **Mr. Adrian Cristobal**, *Undersecretary for Industry Development*, Department of Trade and Industry, Republic of the Philippines

Speakers:

- **Dr. Mari Elka Pangestu**, Center for Strategic and International Studies
- **Mr. Li Shan**, *Chief International Business Adviser*, China Development Bank
- **Mr. Hugh Stephens**, *Vice Chairman*, Canadian National Committee for Pacific Economic Cooperation (CANCPEC) & *Executive-in-Residence*, Asia Pacific Foundation of Canada

Moderator:

- **Tan Sri Rastam Mohd Isa**, *Chairman*, Malaysia National Committee for Pacific Economic Cooperation (MANCPEC)

Tan Sri Rastam Mohd Isa:

We know what the topic is about; it's on connectivity. We have the APEC connectivity blueprint 2015-2025, which was endorsed by the leaders at the last summit. The question I think that we need to pose here is how to implement that. Without further ado, may I invite Mr. Cristobal to make his presentation.

Mr. Adrian Cristobal:

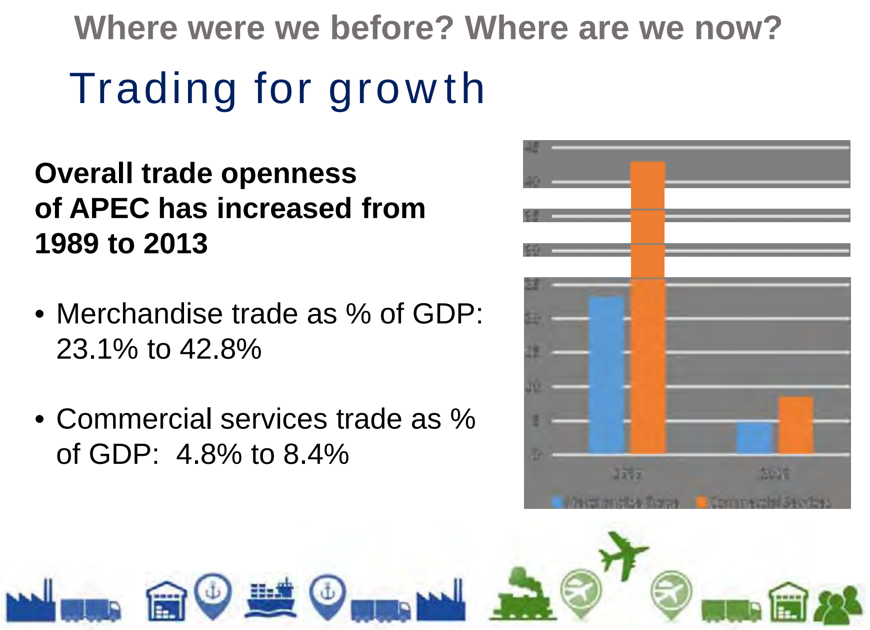
Good afternoon distinguished panelists, guests, ladies and gentlemen. I have the unenviable task of talking to you after lunch. There's intense effort now on regional economic integration in the Asia-Pacific, for APEC and ASEAN. So the region is seeing a closer integration and the topic for today is really timely, so I would like to commend the organizers of this conference and to thank them for giving me the honor of addressing you today. There's a general agreement among ASEAN member states and APEC member economies that the benefits of open and free trade and investment in the region outweigh the challenges we must hurdle. The challenge mainly is how to make this growth inclusive, how to make sure more people participate in this growth, and how to ensure the benefits are spread across the people in the region. Now last year's APEC, China did an excellent job in boosting these two areas of APEC cooperation, in regional economic integration and connectivity mainly through giving a much needed push to the idea of a Free Trade Area of the Asia-Pacific (FTAAP), and the connectivity blueprint, which was adopted in Beijing.

Just to give you some background, one of the first things the Philippines did late last year/early this year was to have bilateral meetings with China just to make sure that there would be continuity in APEC's initiatives, and that includes the FTAAP, the connectivity blueprint and so on. And we also met with Peru, who will be hosting APEC next year, just to make sure that the inclusive growth ideas and initiatives are also continued to next year and the years to come; that's I think one of the main things that the Philippines wants to achieve is not so much adding new things in its hosting of APEC, but to ensure continuity, and to try and consolidate different initiatives. For instance, the SME initiatives and the services sector, which I will explain later, to try to consolidate and improve coordination and cooperation.

Many people still comment that APEC is a talk shop except for those engaged in policymaking and the business sector, so for many of our people it's not relevant. Maybe to help, we should take a look where we were and where we are now just to get some perspective, and then I'll talk briefly about where we want to go and how we intend to get there.

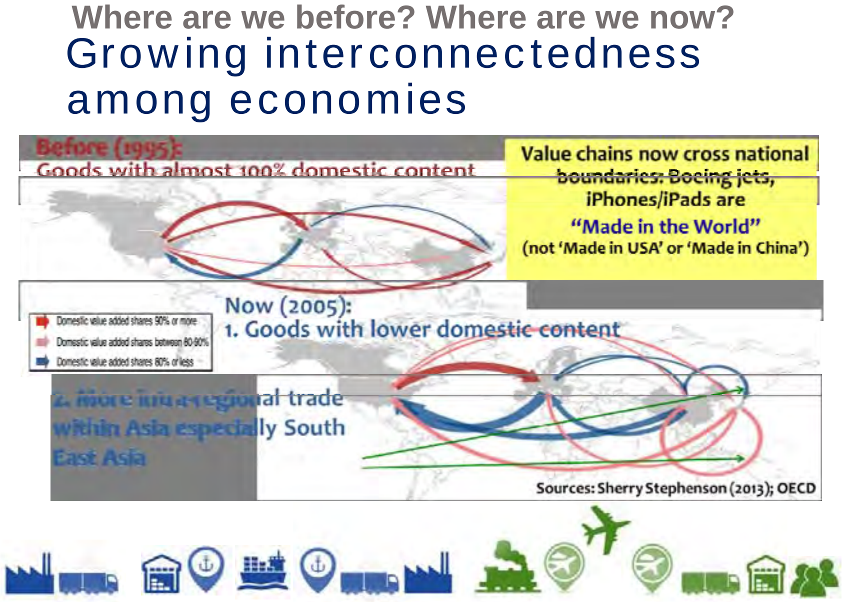
Looking at trade as an engine of growth in the region, overall trade openness in APEC has increased compared to close to a quarter century ago. From 1989 to 2013, APEC economies total merchandise trade as a share of the region's GDP increased from 23.1% to 42.8%, the share of trade in services has increased from 4.8% to 8.4%, trade among APEC economies has tripled since 1989 and now covers 2/3 of APEC’s total merchandise trade. In 2013, 90.7% of valued added embodied in APEC’s total exports was supplied by fellow APEC members, so here we also see the growth of the supply of value chains, which I will show later in the slides. Now the confidence to open up domestic economies would not have been possible without APEC, and without the commitment of its leaders to open its economies confident that others would follow suit. Now this has made steady progress in the Bogor Goals possible.

Figure 5.1.1



A lot has changed in the region, notably the development of extensive supply in value chains and the rapid adoption of information and communications technology (ITC), with these changes the APEC region has become more integrated and interdependent. In 1995, majority of trade in the region wasn't finished goods as shown by the red lines, and minimal trade in intermediate goods as shown by the blue lines; but today, when in 2005 as the graph shows, the blue line shows more intermediate goods being traded across the region, and today that picture is even bigger. So with these transformations has brought about economic dynamism in the region, it has also made us realize how vulnerable each of our economies can be in case of a crisis in one or other economies, it would affect the whole region and even the global economic system.

Figure 5.1.2



So where do we want to go? The APEC vision and mission remains unchanged, we envision an Asia-Pacific region that can embrace and overcome challenges and make full use of opportunities to be more fully connected and integrated. We continue to be guided by these missions through our efforts in strengthening the foundations of our own economies and that of the multilateral trading system. These efforts are geared towards building strong, sustainable and high quality growth, and in a safer and more secure economic and social environment. To guide APEC's vision there are initiatives to help integrate the region's economies and promote trade while addressing sustainability and social equity.

Figure 5.1.3

The Supply-chain Connectivity Framework Action Plan (SCFAP) identified choke points that range from cumbersome custom procedures to lack of infrastructure that impedes trade flows. Now the target is to have a 10% improvement in time, cost, and uncertainty in the supply chain. Ease of doing business focuses on the five priority areas for reforming APEC; that's starting a business, getting credit, trading across borders, enforcing contracts, and dealing with government or regulatory permits. The target is to make it 25% cheaper, faster and easier to do business within APEC economies. The growth strategy and aim is to achieve a balanced, inclusive, sustainable, innovative, and secure growth. These high-level targets are iterations of the Bogor Goals; as part of the work to achieve these goals, APEC also adopted the goal of a seamless and comprehensively connected and integrated APEC by 2015 in the APEC connectivity blueprint. Connecting APEC will bring real dividends for the field of open trade by bringing diverse markets, businesses and people closer together to facilitate trade and investment, and delivering greater long-term growth. Now the recent work of APEC in connectivity is guided by the connectivity framework, which was adopted in Indonesia in 2013 and by the connectivity blueprint, which was adopted in Beijing last year.

Figure 5.1.4

Where do you want to go? The aspiration is to reach a seamless and comprehensively connected and integrated Asia-Pacific region through more efficient flow of goods, services, capital, and people, and the long-term commitment to accelerate physical, institutional, and people-to-people connectivity. To achieve this we are guided by the three pillars; physical connectivity, APEC members will focus actions that will improve the business climate and among others to tap the Public-Private-Partnership (PPP) as a means of financing infrastructure, this was mentioned earlier by my colleague. Second, institutional connectivity, APEC will address trade facilitation, transport and logistic facilitation, and structural and regulatory reform including among others a customs single window system by 2020 that's interoperable and is also to strengthen the SCFAP by implementing targeted capacity building programs.

On pillar three, people-to-people connectivity, issues of business travel and mobility, cross-border education, tourism facilitation, and skilled labor mobility will be addressed, and should also include improvements in the APEC business travel card, business education cooperation and the target is to achieve one million intra-APEC student exchanges by 2020, and increase tourist arrivals by 2025. Here’s just a snapshot of the different issues that need to be addressed under the three pillars of connectivity blueprint. Many of the issues are being addressed through initiatives with targets and timelines. Now the connectivity blueprint gives the momentum, we believe, in indicating deadlines to achieve this target. This year will note the deliverables is for APEC Senior Officials to set up a monitoring review and evaluation system to look over the blueprint.

Figure 5.1.5

On the work streams under the physical connectivity covering PPP, APEC established a PPP Expert Advisory Panel and there’s a pilot PPP center in Indonesia. Infrastructure development again mentioned earlier is the APEC multi-year plan on development and investment and there are proposals to set up more PPP centers in the region. ICT, it’s estimated that 10% involved in internet access will translate to growth in per capita GDP by about 0.02% only if we can address the regulatory policies on information flows, which vary among the differing economies in the region.

Figure 5.1.6

Energy is a strategic concern, APEC is a net energy importer covering about 60% of world energy demand, the world's largest energy producers are located in APEC with the region producing ¾ of the world energy demand. Transportation, 80% of globally traded goods by weight are traded through maritime channels in the region. Travelers in the Asia-Pacific region reached one billion in 2014, these are the facts and factors that force us to take a closer look and address these connectivity issues.

For institutional connectivity, trade facilitation, customs and border administrations, supply-chain performance, regulatory coherence and cooperation, broad regulatory practices and structural reforms are the main areas that have to be addressed. In people-to-people, another important pillar, I've mentioned some of the initiatives but I didn't mentioned yet establishing an APEC wide mechanism to monitor and respond to regional skills and gaps, the PricewaterhouseCoopers (PwC) and APEC has an initiative to try to define the concept of 21st century worker, maybe it's something we can look at the APEC to anticipate the kind of skills that our region will need. Increasing the number of APEC wide mutual recognition agreements (MRA) for skilled workers so that they can more or less move freely in the region.

Figure 5.1.7

How do we get there?

Connecting physical infrastructure

- Work streams:
  - Public-Private Partnership
  - Infrastructure development
  - ICT
  - Energy
  - Transportation

Figure 5.1.8

How do we get there?

Connecting APEC

- PILLAR 1: Physical Connectivity
  Improves supply chain performance by connecting and integrating logistics, transport, energy, and telecommunications infrastructure
- PILLAR 2: Institutional Connectivity
  Advances regulatory and procedural cooperation and coherence
- PILLAR 3: People-to-People Connectivity
  Enhances interaction, mobility, and joint endeavor

Figure 5.1.9

Elements of Connectivity

PHYSICAL	Trade routes and corridors; and regional quality transport networks
	Cross-border energy networks and interconnections
	Universal and high-speed broadband access
	Well-designed, sustainable, and resilient infrastructure via multi-year plan on infrastructure development and investment
INSTITUTIONS	Logistics and transport facilitation
	Regulatory coherence and cooperation
	Advance APEC's agenda on structural reforms
	Modernize customs & other border procedures; Single Windows
	Promote cross-border financial cooperation
	Safe and trusted ICT and e-commerce environment
PEOPLES	Widened and deepened cross-border education, science, technology, innovation, and services
	Movement of tourists, business people, professionals and workers, women and youth

Now as host of APEC 2015, the Philippines proposed and chose the theme, "Buliding Inclusive Economies, Building a Better World". The priorities as already mentioned are in enhancing the regional economic agenda, SME participation in regional and global markets, new human capital devleopment, and building resilient and sustainable communities.

Figure 5.1.10

How do we get there?

Connecting institutional frameworks

- Work streams:
  - Trade facilitation
  - Customs and border administration
  - Supply chain performance
  - Regulatory coherence and cooperation
  - Good regulatory practices
  - Structural reforms

To support the connectivity goals, the Philippines initiatives include what we would call an 'SME action plan,' it's a shortcut for trade facilitation for SMEs. These action plans puts emphasis more on cross-border issues of concern that would affect SMEs rather than the conventional SMEs interventions we often heard in APEC in the past of building capacity and enhancing, now these we believe are still important but they are domestic concerns. At APEC, we should address the cross-border concerns. So the plan of action was on barriers in regional and international trade in areas of rules of origin (ROO), customs administration, transparency, and financing. One component is easing the access to preferential markets; often these cumbersome customs rules discourage or prevent SMEs from trading across borders; they have to find a way to simplify and streamline these customs rules. For those with preferential agreements, if there's a way to waive the certificates of origin (COO) requirements for SMEs, we could put a threshold or minimum amount maybe at US$2000. The other is a trade depository for transparency and information on trade rules, tariffs and so on. A study on authorized economic operator (AEO) programs find that often the rules are favorable to big companies. The more you export, the more we can trust you and facilitate trade; we want to look for a facilitator that allows SMEs to trade. A services cooperation framework, an e-commerce, establish an Internet-based trading portal for SMEs, we would also likely include the inclusive business to ensure resiliency of communities.

Figure 5.1.11

Now guiding these actions moving forward we had to remain committed to these goals, forward looking to ensure broad based participation and mobilize financial and in-kind resources, not just from economies but the private sector. I think the economic and technical cooperation initiatives should not be limited to economies but also the private sector should be more involved in these capacity building. We all have a role to play, government and private sector; I think what we should also bear in mind is that it really would benefit the small and marginalized different economies of APEC. Thank you.

Tan Sri Rastam Mohd Isa:

Thank you very much Mr. Cristobal. Ladies and gentlemen, we have three panelists who will follow on with the discussion on this particular topic. May I invite the panelists, starting with Dr. Pangestu.

Dr Mari Elka Pangestu:

Thank you and good afternoon ladies and gentlemen. Like Narongchai, I am no longer in government so I can say whatever I want. I've thought that my value added to this meeting and hopefully to the Philippine chair is to reflect on being asked a comment on the APEC connectivity blueprint; I would like to comment not just on the substance but also on the process, and how it links with what you are trying to achieve in services as well as SMEs. I'd like to begin by making five lessons on reflection on how we can actually achieve good outcomes in APEC as well as domestically, the impact it has domestically on our policies.

First of all, what my question was this morning about the importance of cross-sectorial because all the issues of connectivity and many of the issues we discuss in APEC is cross-sectorial domestically, it involves a lot of ministries as well as in the APEC processes. Second, when you want to prioritize an issue by getting buy-in domestically or in APEC, you need to quantify the benefits very clearly and link to the bigger picture. Third, what is APEC good at? I think we all still believe this, peer-pressure, so quantifying and having this blueprint and targets, and being able to quantify and compare where you are in the process is important, so it's linked to quantifying the benefits. Fourth, the advantage of APEC is that we are linked normally to some bigger target whether it's multilateral agreement or a regional agreement, and while we are doing this, it's actually capacity building. We have found that as Indonesia, whenever you are talking about customs conformance, it's actually helping you when you talking about the WTO or ASEAN. And finally, you need quick wins and pragmatism with pilot projects to get support and to get the continuance of meeting your targets.

I am going to use two examples in the APEC connectivity blueprint to illustrate these five lessons, one is the single window and the second is the tourism visa facilitation example. For single window, the target is single window by 2020, actually in 2010 we had this target of single window, it was actually a little bit inspired by that there was already a national single window (NSW) and the ASEAN single window (ASW) in process at the same time. What's the benefit? You can look at all the numbers and show how trade facilitation addressing this will give you higher trade numbers and now it's also one of the chokepoints in the GVC, and this is where you can put in the SMEs because it's surely going to help the SMEs. Inside the story of trade facilitation when you talk about green lanes, I'm very glad that the Philippines is looking at SMEs specifically in the trade facilitation agenda, you know the minimum threshold for ROO, the trusted trader shouldn't be just the priority but it should also be the small guys, these are important links to the SME agenda.

How do you measure it? There are all these openness indexes, logistics index and so on, these can be used to compare where APEC countries are. The cross-sectorial is also very important, reflecting on the Indonesian experience having to meet the ASW, it pushed the three key ministries, which are finance, trade and transportation ministries, to get together and get to 25 agencies involved in clearing goods to get together, and it took about three years. I am not underestimating the challenge of this; it took three years just to get all of us together to agree on what we needed to do. You start with a pilot project, you start with the biggest port and then you expand to the other 26 ports. You have to have ownership in the system, having bigger international commitments helped us; I think we are now actually having a lot of capacity building in that process and have two big agenda's now; we have the trade facilitation agenda in the WTO, and as well as the APEC Single Window, so they should all be clubbed in, that means in your APEC processes it could also be integrated between the customs, the trade and SMEs and as well as the transportation sector, and obviously the private sector.

On tourism and services link to liberalization in logistics and transportation, Open Skies in the case of ASEAN. On the tourism, people-to-people agenda, here is where in 2013 Indonesia as the chair worked hard on this, first of all that tourism is important, and that visa facilitation is important. I have all the numbers but basically it is showing that one out of 11 jobs is being created in tourism, and 30% of your services exports is coming from tourism. The impact of improving visa and removing visa restrictions is very significant in terms of job creation. We did this study with the United Nations World Tourism Organization (UNWTO) and the World Travel and Tourism Council (WTTC) to show that in APEC, of the world population traveling to APEC 63% still needed visas, 20% still needed traditional visas papers, and if you actually remove those restrictions the additional tourists would go up by 12-18%, or 38-57 million. You would get between 60-89 billion dollars more in foreign exchange receipts, and most importantly, you would have total jobs created 1.8-2.6 million; this is just to convince that this is important and you can get the domestic numbers.

In terms of openness, we also had an openness index comparing the APEC countries in terms of visa, between no visa to visa-on-arrival to e-visa to visa required in terms of traditional paper. APEC wide it is 32 being kind of restrictive. Guess who the champion is with 84? Philippines. 84% don't need a visa to go to the Philippines. This is why I think the Philippines should take on these visa facilitation and the wider travel facilitation initiatives agenda in APEC, and again when you talk about visa its cross-sectorial coordination between the transportation people, the security people, the immigration, tourism, customs, and this needs to be coordinated. My experience in 2013, because I wanted to achieve this APEC travel facilitation initiative, I manage to get all those different departments to come together. It was the first time even in my own country that we talked about the important of tourism and the importance of travel facilitation and the importance of the coordination. So again this is where all the different working groups working on this should come together under the APEC travel facilitation initiative.

Besides visa, I would just mention APEC you have this very interesting title that has other programs to ensure safe, secure, efficient travel, it's called the tourism friendly airport. You have also the advance passenger information checked baggage facilitation, trusted traveller program, which I hope can be an extension of the successful APEC business travel card. So there is a lot of opportunity there, it's institutional, it's using technology, it's being smart about it, and sharing data. So hopefully that can be a concrete action plan for APEC. Thank you.

Tan Sri Rastam Mohd Isa:

Thank you very much Dr. Mari Pangestu, in fact the point of yours about tourism I think is very important because if you look at the blueprint, leaders agreed that we should make the effort to achieve 800 million APEC tourist arrivals by 2025, and this can only be done with those things that you just mentioned being out in place I believe.
Now we move on to the next speaker, Mr. Li Shan, you have the floor.

Mr. Li Shan:

Good afternoon! This is my first time attending a PECC meeting. Thank you for giving me the opportunity to participate in the discussion.

Connectivity, as being broadly defined, has three pillars. One is institutional connectivity, one is physical connectivity, and another one is people-to-people connectivity. Today I would like to focus on just physical connectivity, which is a prerequisite to achieve the goal set up by last year's APEC meeting in Beijing, i.e., to establish the FTAAP. Such an economic integration will allow the whole Asian region to unlock its great growth potential.

This morning I listened to one speaker talking about the growth rates of the Asia-Pacific in the past. According to his forecasts, the peak is over. For the next several years, the Asia-Pacific growth rate will be lower than that of advanced countries.

How to deal with this serious problem? As I said earlier, connectivity is a precondition to maintain high growth in the Asia-Pacific region. However, physical connectivity is very costly. According to a report by the ADB, by 2020 if we were to allow Asia's infrastructure to reach the standard of world average we need to spend another 8 trillion US Dollars and in addition we need another 300 billion US Dollars to finance regional connectivity infrastructure.

However, the current economic slowdown of Asian countries and varying fiscal conditions from one country to the next pose huge challenges to infrastructure financing. How to deal with these challenges? I think China has some valuable lessons to share with other Asian countries.

More than 30 years ago, when China just started its reforms, the Chinese leaders made infrastructure investment and physical connectivity within the country a top priority. By that time, China's fiscal condition was very bad, much worse than most Asian countries today. China simply didn't have sufficient financial resources to achieve its ambitious goals.

As a result, Chinese leaders correctly adopted an open-door policy to attract foreign investment into China. They also welcomed help from multilateral institutions such as the World Bank, International Finance Corporation (IFC) and ADB. To facilitate foreign investment, the Chinese government paid huge attention to create an environment which is friendly to foreign investors.

30 years ago, when China didn't even know the concept of rule of law, the country rigorously enforced contracts with foreign investors. People were educated about the importance of honoring contracts with foreign investors. Chinese authorities took contracts with foreign investors very seriously. If a company cannot honor its contract with foreign investors, the government will step in. China also adopted international best practice, such as the build-operate-transfer (BOT) model, to attract foreign capital. The government often used its fiscal revenue to guarantee rates of return, with very high risk premium, to foreign investors. During 1980's, These efforts created a very good environment to attract foreign investment into China’s infrastructure and other sectors.

In the 1990’s, as the country became more developed, largely due to the good infrastructure built in the 1980's, Chinese leaders started to make bigger use of domestic financial resources. Firstly, they used expansionary monetary and fiscal policy to support infrastructure development. Secondly, they created financial institutions to focus on this area, Specifically, China Development Bank was established in 1990s to exclusively finance infrastructure development and connectivity within China.

CDB has done a wonderful job, in my view. It has made lots of financial innovations. As we all know, infrastructure projects have two important features: First, they are often very long-term, therefore most commercial banks would not be willing to finance them; Secondly, their returns are often low and may even negative returns in the short-term. So how do we make their financing viable? Banks are not charity organizations and need to make money to sustain. What CDB has done is to pool risks of different projects together and ask local governments to provide guarantee on these projects' return.

After a good infrastructure was developed, land value of cuties usually increase very significantly. When necessary, the local government can easily use the land it owns to honor its guarantee to the bank. This created a virtuous cycle. As a result, CDB financed more than 50% of China’s infrastructure projects while enjoyed a very low bad loan ratio. Its total assets grew over 1.5 trillion US Dollars. CDB became the largest development finance institution in the world, with a balance sheet larger than that of the World Bank, IMF and ADB combined.

To achieve higher economic growth, other Asian countries may learn from the experience of China. In particular, to establish an environment which is friendly to foreign investment.

Being the biggest beneficiary of the globalization, it is time for China to pay back. CDB has already provided more than 300 billion US Dollar international loans, include loans to many Asian countries. Recently, China made good progress to establish the Asian Infrastructure Investment Bank (AIIB) and the Silk Road Fund. These are important initiatives. But I think what China can provide to its Asian neighbors are not only financial resources, but also lessons of development, both good and bad. For inclusive growth in Asia, China has its share of responsibility to fulfill. Thanks!

Tan Sri Rastam Mohd Isa:

Thank you Mr. Li Shan for sharing with us the experience of China and the promise that China will continue to share experiences and resources with the other countries in APEC for infrastructure development, in particular. Now, may I have the pleasure of inviting Mr. Hugh Stephens to take the floor. Thank you.

Mr. Hugh Stephens:

Good afternoon, first I would like to thank SINCPEC and Khee Giap for the opportunity to speak and congratulate them on another very successful and well-organized event. As you can see, I've also been asked to speak on the issue of physical infrastructure, which of course is a key element of economic activity and tied into the very important question of oil and energy prices, which have been very much a topic today. In fact, I feel a bit diffident having to follow Minister Narongchai, who already outlined a number of factors related to this and David Carbon, the best economist in Southeast Asia, who gave us his thoughts on where prices are going to go. What I will attempt to do nonetheless is pull together some analysis from both sides of the Pacific and try to draw some conclusions.

Clearly oil prices, although they are highly unpredictable, and, as we have heard, potentially rapidly changing, are going to be a key factor as we go into 2015. While energy is a key element in growth, the infrastructure to get energy to market can either be a unifying bond across the region or it can be a barrier that divides the region, leaving the resources in areas where they are not most effectively utilized and depriving markets that need that commodity.

Last year here at this conference I presented some thoughts on physical connectivity and the energy challenge. Looking at some of the challenges in getting North American, particularly Canadian energy to Asia, it is important to recall that Asia has a relative short fall in energy endowment compared to its demand. A potential answer to that is of course North American supply of gas and oil, but there are a number of physical connectivity challenges to getting the infrastructure in place. Particularly in western Canada, I noted last year there are three major challenges; one is physical, the distance, the terrain, building pipelines and LNG terminals; the second is environmental, the public policy perceptions around this, the social license that needs to be obtained; and the third is the legal question which seems to be particularly challenging given the opposition of First Nations in those areas. I could have added a fourth, which is very relevant today, financial issues; taxation, labor costs and in particular, pricing issues.

We've talked already today about the slide in pricing. This chart was put together in early January. At that time, based on West Texas Intermediate (WTI), the price was down to $53.42 a barrel. I checked this morning and it's $48.17. If you look at Brent, the other major commodity index, it's gone from $115 to as low as $45 a barrel. Today it is about $60. Of course, we don't know where these prices are going, as was pointed out earlier this morning, but we've certainty seen the impact over the last six months. Gas prices in Asia are tied to oil prices and this chart illustrates how the gas price and the Japanese average LNG price tracks the oil price, and is consequently also dropping. The line at the bottom is the so-called Henry Hub price, the North American gas price. You can see the huge differential between Asian prices and the North American price (in 2012-2014), but that differential is rapidly disappearing. If we were to look at another snapshot of gas prices, you can see how gas prices dropped by almost half in the Japanese market. This differential between the Asian price and the North American price is not only rapidly disappearing, it is undercutting much of the economic case for developing infrastructure in North America to supply Asia.

Figure 5.2.1

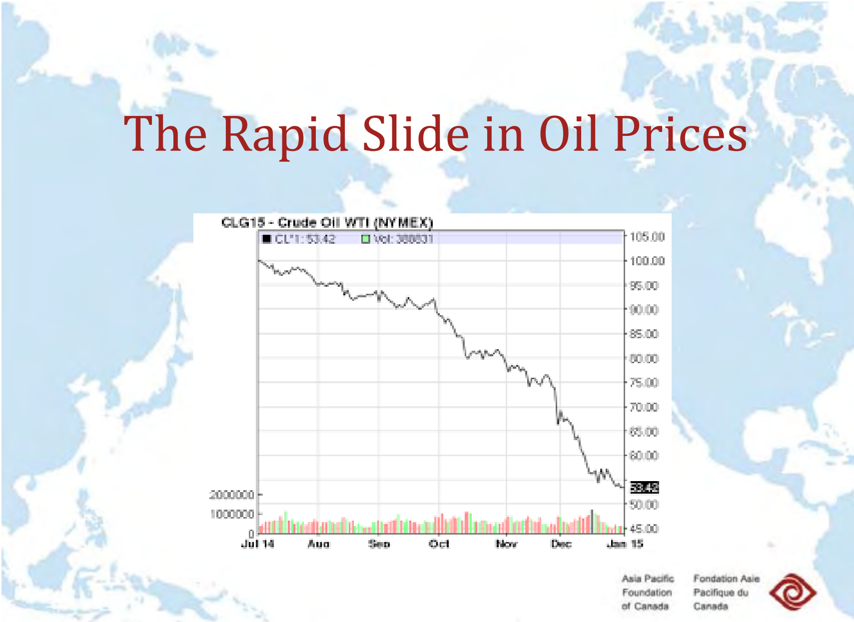


Figure 5.2.2

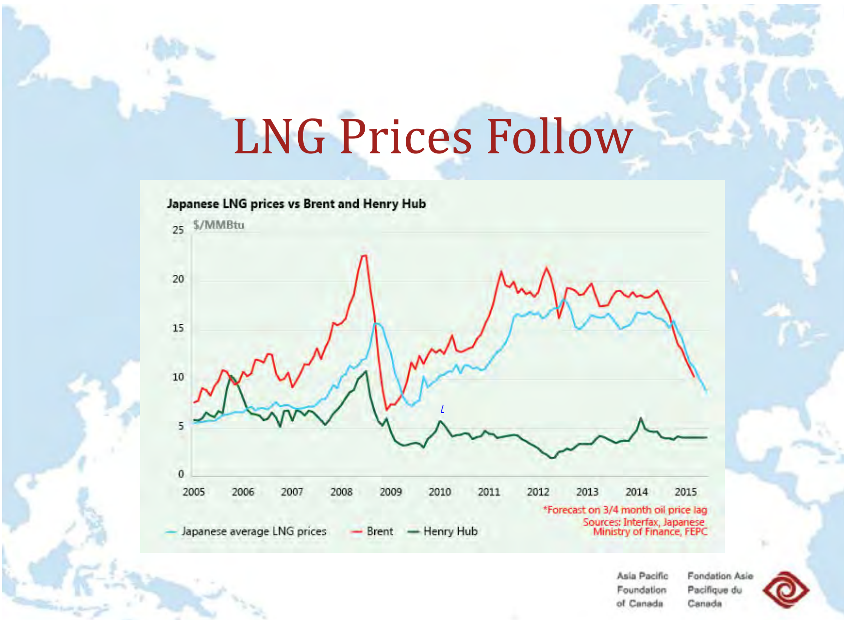
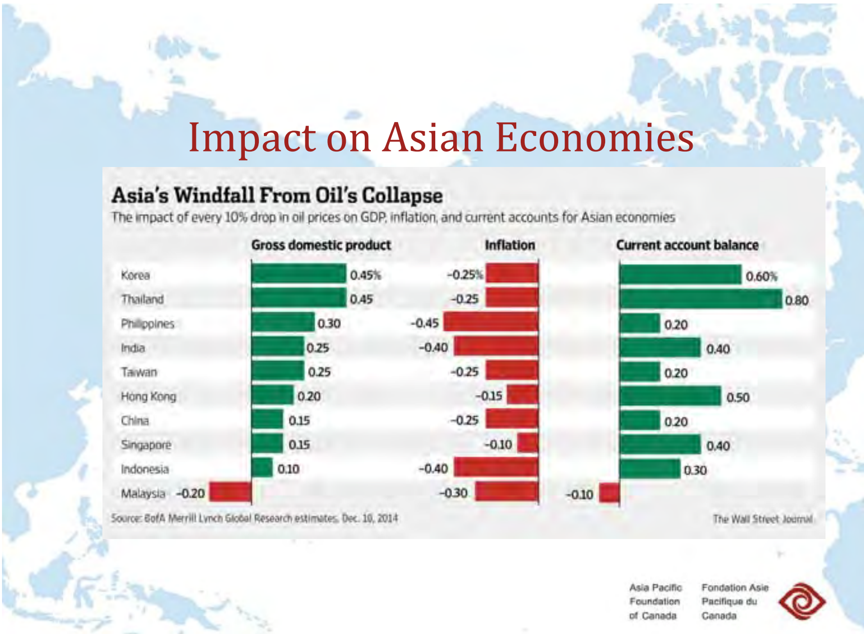


Figure 5.2.3



While we don't know where prices are going to go, and there is no doubt that there will be a self-correction as supply drops and demand picks up, the real question will be when and by how much. So let’s take a quick snap shot look at what the impact of dropping prices is in terms of infrastructure. Clearly, the drop in prices has affected North American production, which surged but is now slowing down. This is really affecting North American production in shale oil and gas primarily produced in the US but also in Canada. The US rig count has gone from roughly 1,600 in September to 1,300 in January and is still falling, so there is a pretty quick impact on shale gas exploration and production which has certainly slowed down. The other major area impacted is the oil sands in Alberta, the bitumen extraction, Here the impact has been less clear. In fact, studies have shown that the price of production in the oil sands ranges between $26 and $42 per barrel, so still production cost is still below current prices. These are huge projects; with the amount of sunk costs, production, must and will continue. The real impact really comes on new exploration and new development, and there are clear signs that it is drying up. Suncor, one of the biggest producers, has cut its exploration budget by over a billion dollars this year. The third area is in LNG, a lot coming from the US Gulf. On the west coast of Canada there actually 12 projects on the board to supply Asia, most of them if not all of them invested by Asian companies. The largest one, the one that the betting is on, is the Petronas project but that has been put on hold because of the drop in prices.. We’ll see what happens. There are going to be further discussions next month.

The overall impact clearly is negative on the oil producing economies. I’ll show you this graph illustrating the impact on various Asian economies. There's an impact on the producers, as you can see clearly with Malaysia, but also a chilling impact on new infrastructure. Clearly it is positive for the oil importing countries. This is the other side of the infrastructure equation, this GDP windfall, which the ADB has estimated, could add between a quarter to half a point of GDP to Asian economies. Worked out another way, a 30% fall in oil prices could add a full 1% to China's GDP. Clearly there are some positive impacts of the decline in prices. Minister Narongchai also mentioned the fact that some of the subsidies on fuels are now being phased out and countries like Indonesia and Malaysia are taking advantage of the lower prices of oil to bring in these reforms.

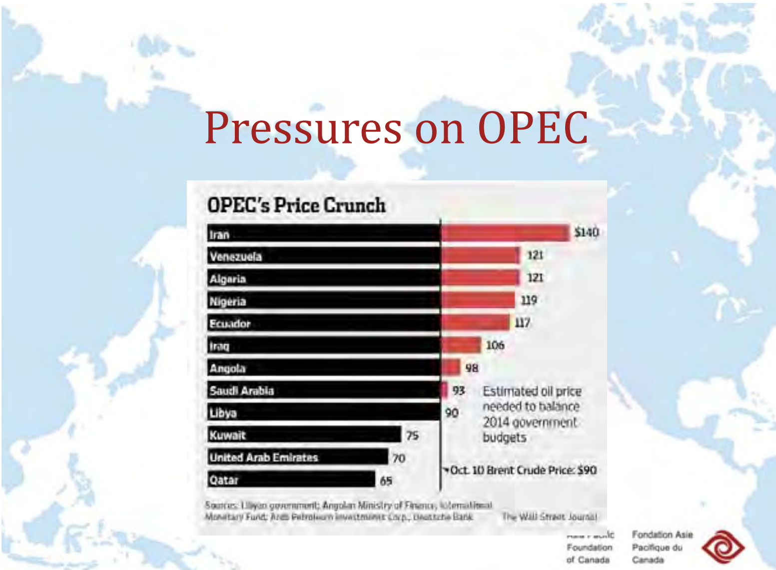
In fact, even for the oil producing economies there are some potential benefits in terms of bringing down costs. If you look at Australia, this country has a history of extremely high costs. In fact, the estimate is that its labor costs are something like 35% higher than comparable costs in the U.S, so a slowdown will wring out some of these costs and allow the existing projects to be completed. A recent Harvard study has looked at Australian projects on both the east and west coast and has concluded that these will be completed. The gas will be sold at whatever the price is available at that particular point because the companies must cover their operating costs. However, this scenario poses a major threat to the feasibility of expanding LNG capacity beyond the projects that are already under construction. That's where we come to our final conclusions.

The prices are unpredictable, but reduced prices are likely to be in place long enough to have a chilling impact on the long-term energy infrastructure. The existing infrastructure will be completed, new infrastructure will be deferred or cancelled and that is going to have an impact down the road when demand really picks up. That is when we'll see a real negative impact. There is an offset, as I pointed out, in terms of a bonanza or a windfall for the oil importing countries. So in a sense there is a balance across the region but an uneven balance.

Finally, of course, the other impact is to expect the unexpected. We really don't know what is going to happen; there are many things that could change the equation. One of them could be pressures on OPEC. If you look at this last slide you will see that a much higher price than the market is currently offering is required for the OPEC countries to balance their budgets. There could be issues within Saudi Arabia, there are security issues in the Middle East, and even the issues of Russia and the Ukraine. There is a wild card out there we don't know what can happen.

Clearly however the issue of lower overall prices has a big impact on the region and on PECC's work, especially on our work on inclusive growth and capacity building.

Figure 5.2.4



I would like to conclude by suggesting that in our State of the Region (SOTR) report this year, we need to focus on this. I think we need some references in the questionnaire on the potential impact so that we can assess this and we will also need to address it in the narrative of the SOTR. Thank you very much.

Question and Answer Session

Dr Maxensius Tri Sambodo:

I have two questions; first, if you look on the access and model of energy, I think that the Philippines and Indonesia are two of the ASEAN countries that a lot of people have liken to have modern energy services because people are sharing the characteristics of the country. So in the context of APEC, how can infrastructure connectivity be used to alleviate the poverty in Indonesia and the Philippines? Are there any experiences that the Filipinos can share with us? Second question regarding the SMEs, that is good news coming that the facilities for the SMEs has been provided, it is such a relief to us to pick up the label of champions. Which sectors do you think can become champions over other sectors?

Dr. Peter Lovelock:

Quick question for Dr. Pangestu, of the five points you mentioned the fifth one had an emphasis on quick wins. Maybe you could elaborate on that just a little bit? That strikes me as potentially very powerful, it tends to run against the processes in multilateral organizations, PECC, ASEAN and so on, to be able to plan these agendas out such as the ones you flagged, but then seek quick wins. But then to get the momentum going and PPP going, those quick wins tend to be very important it seems. Maybe you could just elaborate a little?

Ambassador Rodolfo Severino:

I have two questions; one, the assumption that has been running through this conversation from this morning down to now, is that the decision makers in each country are motivated by the good of the country involved, but we find that in my years after I left the ASEAN Secretariat, I noticed that decision makers in each country are motivated by physical, by political if not physical survival and the legacy that they are going to leave for the nation and for his family and friends.

Mr. Adrian Cristobal:

Actually, I am not quite sure I am suited to answer the question. The first question, since Indonesia and the Philippines are both archipelagos, we have the same challenges in energy requirements and there is something that the Philippines could share with Indonesia. Between Indonesia and the Philippines, you guys have oil and more oil than us, we hardly have any. The only thing we can share I think is, we have a healthy energy mix in our dependencies and sources, we are the number two geothermal energy producers in the world, next to the US. We make use of other renewable sources but still make use of fossil fuels. We could also share our technology and experience in renewable energy, particularly geothermal energy.

Dr Maxensius Tri Sambodo:

Regarding the SMEs, what I would like to know is that are there any possibilities to picking the winners? There are a lot of SMEs and limited resources, is it possibility to pick the winners and then see how they go?

Mr. Adrian Cristobal:

I think yes it's possible, I don't think it's easy, it's probably the same for other economies. In the Philippines, you know where the SMEs are, you know more or less what fields that they work in, its processed foods, cottage industries, handicrafts, and the like. It’s just setting up the necessary programs to build up capacity internally and identify SMEs who are ready growing and capable enough to trade already or to participate in a particular supply-chain. The inclusive business model I think is a good example that's gaining popularity in the Philippines. We have companies for instance Nestle, we have set targets on sourcing, large part of their supply of coffee beans comes domestically in the Philippines, so they’re quite engaged and connected in coffee farmers and also providing technical support and assistance to raise the quality and standards of the coffee beans. That's what I was referring to earlier when I said that the private sector should perhaps get more engaged in these kind of technical assistance and cooperation, and not just government’s. That's one example where it’s not really always choosing winners, there are really areas, what we call clusters in the country, where there is strong potential for particular products.

Dr. Mari Elka Pangestu:

Thank you Peter for your question. I think its quick wins and having pilot projects in the APEC language its called pathfinder initiative, in domestic reforms we also do that. Of course, when you are talking about multilateral or regional trade agreements, it doesn't lend itself to quick wins but this is the beauty of APEC that if you have pathfinder initiatives or quick wins sometimes but not necessarily involve all the APEC economies, it can convince countries to take unilateral action, that's part of the APEC spirit, that it gives you confidence to undertake unilateral actions towards the more eventually more regional or multilateral commitments or best practices. So I can give you a few examples that are in the top of my head, and hoping that some of this can be useful for the APCE this year.

On infrastructure, both for the Indonesian context and possibly for the APEC context, I am all for these best practices and PPP, all the financing questions, these are all very important question and I’m glad we are going in that direction. I would say a quick win will take a long time for all this infrastructure to be built, a quick win would be let’s take the existing infrastructure, can we make it more effective and more efficient, even without building new infrastructure, and that's where you get into the regulatory and institutional and financial services liberalization and all that, and corporatization of airports, lets get the private sector to manage your airports. What’s the experience in that in APEC, I think you could get a big impact on your growth just through that.

In ASEAN, we have a similar example the NSW and the ASW, not all the ASEAN countries are on board, we started out with three countries to begin with, and in the case of Indonesia, you start with one or two ports first; just to convince everyone to get on board. For the movement of people for the single window, I think that for APEC, you could start with what has already been done in ASEAN, is it possible to build on what has been achieve in ASEAN? I don't know the answer but that's one way to do it. When you talk about interoperability of the systems, don't think about one system that everyone's going to be using, it's just important that the systems can talk to each other and how do you do that.

Finally on the movement of people, if you can get the APEC business mobility travel card, which is the biggest success of APEC, to work better and more efficiently. I am applying for a APEC business travel card for the first time; it's taken me six months, because you have to go to every country to get approval and I'm sure if there was a better sharing of the database there must be a faster way to do it. Once you can solve that, you can expand the definition not just for business people but for trusted travelers, frequent travelers. I think that would give you a big boost for APEC growth and regional integration without building any new infrastructure, it's just the system.

Tan Sri Rastam Mohd Isa:
I believe the question is related to decision making when sometimes there's a conflict between national or group interests versus political and personal and public interest.

Dr. Mari Elka Pangestu:
Well it's always a conflict. I wasn't a politician so I didn't really had that conflict, I always had the bigger picture in mind, you know at the end of the day you do have to make that compromises. You don't become a politician even though you're a politician; you have to be political because you have to understand the political constraints. The way I work is I know what is first best, but if I know I can't get it because of political or institutional constraints then I go for second or third best. I know I'll always have the first best in mind, and sometimes you have to move backwards to move forwards. I believe in evidence based policy making and still do, despite after 10 years I still do, I think winning the battle by showing the benefits and getting those who benefitted, you have to get your show and tell out there and get an SME who's benefitted from the AEC to stand up and say, "I've benefitted"; those are the kinds of things that we need to do to win the battle, but recognize that there are these political and

institutional constraints.

Mr. Adrian Cristobal:

I think it's really on the leadership level, the APEC leaders, and the personal motivation of leaving a legacy and also ensuring institutional progress of APEC are not contradictory for APEC leaders, so we're here now after more than a generation, it's still moving and we have Mr. Wanandi to keep watch over the leaders from the very start until now, so he will keep minding them.

Dr. Mari Elka Pangestu:

Since we are at an APEC forum, I would just like to add one more point because we always believe that APEC moved countries domestically to undertake reforms, and that was true in the case of Bogor in 1994 and China in 1995 and so on. Even China last year. I think APEC helps to and with peer pressure be taking a leadership role. It is still an important factor on the leadership.

Session 4: Financing Inclusive Growth

Lead Panellist:

- **Mr. Cledan Mandri-Perrott**, *Head of Infrastructure Finance and PPP*, Singapore Infrastructure Hub, The World Bank Group

Panel Discussion:

- **Mr. Mark Rathbone**, *Partner*, Advisory CP&I Capital Projects & Infrastructure, PwC Singapore
- **Mr. Mario Artaza**, *Chief Representative*, Hong Kong Representative Office, Banco Security
- **Mr. Zhou Qiangwu**, *Executive Deputy Director General*, Asia-Pacific Finance and Development Center Beijing Office, Ministry of Finance, China

Moderator:

- **Dr. Alan Bollard,** *Executive Director*, APEC Secretariat

Dr. Alan Bollard:

Welcome to this session of Financing Inclusive Growth. You have followed a story today where APEC economies enjoyed strong economic growth driven by strong trade growth. Then things changed after the global financial crisis. Since then APEC host economies have led a search for other engines of growth. This year the Philippines proposed an overarching theme of inclusive economies. All the economies of the region think that inclusion is a good theme, but it is not an easy topic because it means different things to different people, and it i very hard to define and measure. One aspect is the topic of this session, although we know that talking about inclusion potentially means discussing a whole range of questions around demography, various fiscal issues and capital markets, and of course around education and social services. We are going to focus particularly on the role of governments, starting with an overview of the infrastructure environment.

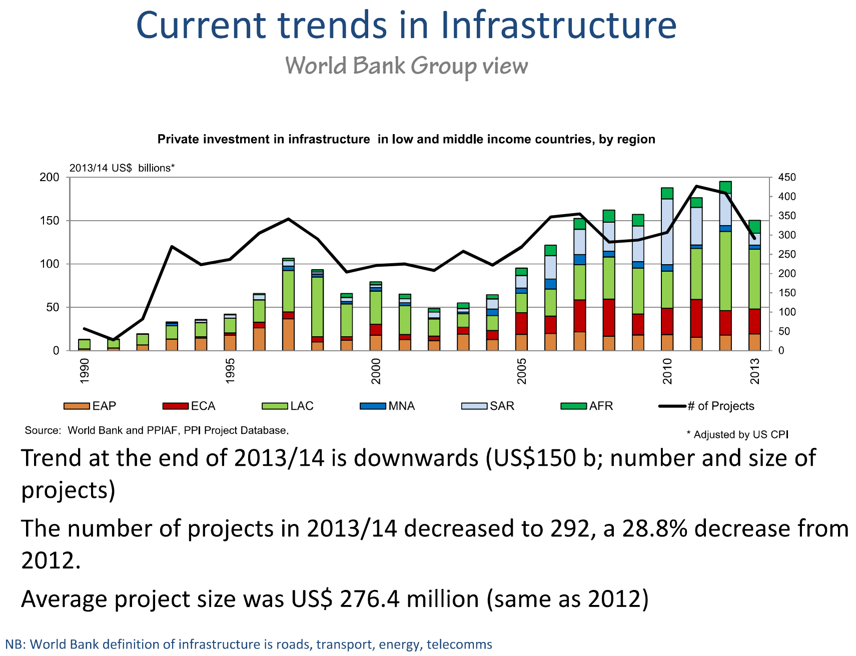
This panel will commence with our lead speaker Mr. Cledan Mandri-Perrott, Head of Infrastructure Finance and PPP, Singapore Infrastructure Hub at The World Bank Group. Then we follow with a panel discussion involving Mark Rathbone, who is Partner at the Advisory CP&I Capital Projects & Infrastructure for PwC Singapore; he will be followed by Mario Artaza, Chief Representative, Hong Kong Representative Office, Banco Security; and finally, Mr. Zhou Qiangwu, who is the Executive Deputy Director General, Asia-Pacific Finance and Development Center Beijing Office, Ministry of Finance, China. Thank you all.

Mr. Cledan Mandri-Perrott:

Thank you and good afternoon ladies and gentlemen. Thank you very much for inviting me to be here. What I thought I would do was to give a little bit of perspective from The World Bank group in terms of infrastructure, in terms of growth, and how we see that as part of a strategy for inclusive growth. I also hope to raise some areas of where APEC can think strategically how it can use the variety of experiences that the different member countries have as part of their own strategies that they can tap. Of course as a world banker, I cannot start anything without a graph and some numbers.

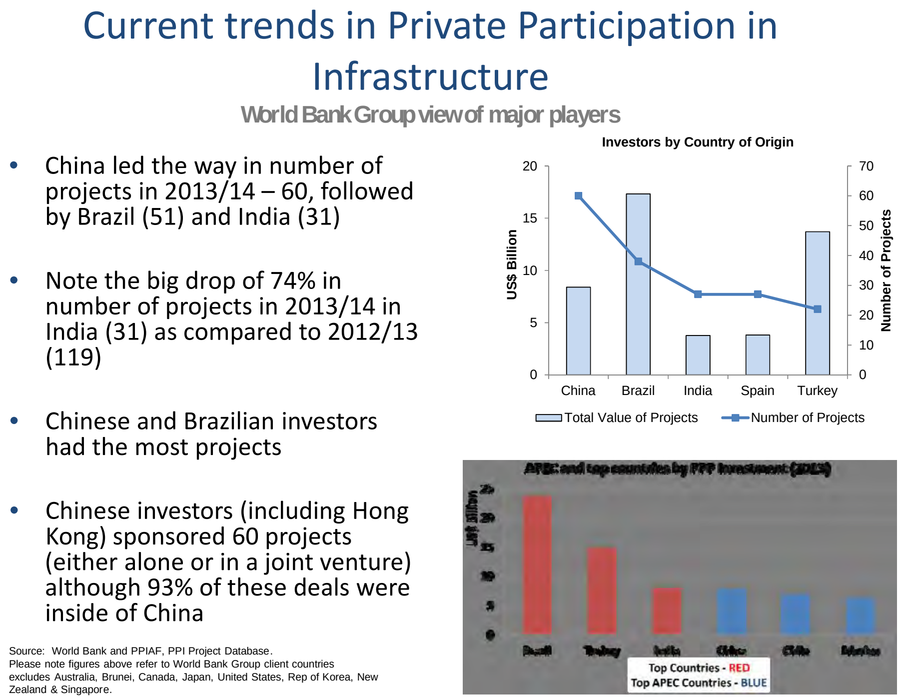
Here's a little bit of a view from our perspective in terms of what's happening in terms of private sector participation in infrastructure. It's not just PPP, it is actually boarder than that. What's interesting about these numbers is that we've seen a downward trend. From 2013-2014, we go down in terms of a number and the size of projects; we've come down in the number of projects by a fair amount. What's interesting is that the size of projects out there continues to be the same. Our view of that is that some of the projects in infrastructure are beginning to become bigger. We're seeing big-ticket items out there. If you're looking Peru, for example, they are developing their metro, and it is a project that is $5 billion dollars and also a PPP, and about 65-70% of which is going to be funded publicly. So the numbers in terms of what's out there are pretty big. The thing that I wanted to show you here is one of the key players: China continues to be huge in terms of the number of projects that it has done. Brazil also leads the ranking tables. The Brazilian's have had a strategy that is very much about building infrastructure that is being driven by amongst other things, the World Cup, and the Olympic games. The other thing that is interesting that I wanted to draw your attention to, is where do the APEC countries fall in here? That's what we have here.

Figure 6.1.1



You've got Chile, Mexico, and Peru, that interestingly show that APEC countries positioning is very strong. A little bit of perspective here, what's happening in the ASEAN region is an actual increase in private participation in infrastructure as compared to the previous year. What's interesting about the number is that there is an increase in total private participation in infrastructure but if you look at it from the growth perspective, it's below the economic growth number. What does it mean? It means that infrastructure could play a much greater role in terms of how these countries grow. The other thing to note is the number of projects: Most of the projects that are happening are in the energy sector and it is a natural big recipient of investment with other big areas being transport and much less so in terms of water and sanitation. In terms of the ASEAN region, China was the country that did the most number of projects followed closely by Indonesia. In China we see a much more broad distribution of projects in terms of sectors. As in Indonesia, that number that you see there of US$3.8 billion is mainly in energy, and a little bit in transport. The Philippines of course has a very strong robust program, particularly in PPPs, and Malaysia also has a strong representation there.

Figure 6.1.2



Looking on the other side of the Pacific; Chile has done a tremendous amount of investments coming from the private sector. They have a traditional dating from the late 1980s with a very sound regulatory structure and sound regime for investment. We continue to see that. What we are seeing in the Chilean example, and Mario will talk a lot more about this, is what it takes to evolve a market. What we are seeing now is a second and third generation of investments, so those investors that were there in the early days, for example in the water sector, today are no longer there as the original investors. The water sector in Chile is actually owned by institutional investors, and that's a good thing, that's the natural transition. The transition that you see happening at the top and very successfully are both in Canada and Australia. There are several interesting points there. Mexico has done a lot of infrastructure, it has been a late entrant into the whole PPP debate, they only passed a PPP law about two years ago, but there is a very big thrust to opening towards the private sector and getting their monies into infrastructure. Peru has a tradition of PPP and has been very successful; they have done some very interesting projects with a strong recognition that in many instances they've got to overcome some of the regulatory constraints that they or investors see; and the fact, that they recognized that as a government, they're going to have to help lower the risks of projects as they develop their pipeline.

Figure 6.1.3

ASEAN & APEC Perspective

2013/2014 data

- ASEAN investment grew by 8.5% over the previous year to US$19.4 billion and comprised 12.9% of global investment
- PPI growth of approx. 3% for the region since 2003 did not keep pace with 8.2% annual regional GDP growth
- Most regional investment was in the energy sector (US$8.8 billion), with nearly US$8.4 billion in electricity generation
- ASEAN Region implemented 85 new projects and attracted investments of US$19.4 billion
  - Energy (62) followed by water and sewerage (14) and transport (8)
  - China was followed by Indonesia (US$3.8 billion), Thailand (US$3.4 billion), Malaysia (US$2.6 billion) and Philippines (US$2.04 billion)
- APEC
  - Chile (US$6.6 b energy and transport exc telc, H12014 aprox US$1.5 b
  - Mexico (US$6 b, H1 2014, US$3.9 b, 7 deals averaging US$563 m mainly energy)
  - Peru (US$3.2 b, H1 2014, US$1.1 b – energy & transport)

What's happening around the world? That's something that does merit reflection. If you look at project finance numbers, after the crisis evidently things dried up but today, and Mark will probably speak to this, we're seeing the same levels of numbers of transactions as in the heyday of 2007-2008 level. Now, that's an interesting result, it's a result that reflects increased confidence, but the landscape of how projects are done and how private monies are being brought into infrastructure has changed, and its changed significantly. It has changed because of the rules of engagement, for example with banks through the solvency three act (Basel III), means that commercial lenders are no longer doing long-term dated finance (at least for American or European-based banks, I think the Japanese have a different approach on that). What we are now seeing is capital markets stepping into the PPP front, and stepping in much earlier in the development curve, and that's a very good development. The question for APEC is how do we bring that into some of the transactions in the region?

Figure 6.1.4

Current trends in Infrastructure

Where are we today globally?

- Project finance volumes are back at 2008 levels/close to 2007 levels, but leverage levels remain significantly lower
- Deal activity continues to be driven by disposals of corporates, privatizations and increasingly from maturing funds (ie little greenfield)
- Funds, SWF etc targeting primarily US/Europe
- Current deals over past year / 18 months:
  - PPPs increasingly using capital markets to source debt despite retreating bank lending due to Solvency (Basel) III
  - Major focus on brownfield assets (large caps are over valued)
  - Transactions in developed jurisdictions traded at a significant premium (implies few deals in EMs)
  - In Developed Markets: valuations are high (given low real interest rates)
  - Infra managers move up the risk curve
- Many new infra manager entrants; but 'smart' money (eg Australian supers etc) focusing on large players only

The other thing to look at is the focus of capital markets into infrastructure means that there's still a lot of reticence to come into, what I refer to as, greenfield projects. The expectation that a pension fund will come in and take construction risk from day one is not going to happen. You have to think about how do we develop a structure or partnership that can work better to attract those early monies. Other point that is happening in the landscape of infrastructure is that sovereign wealth funds are coming in, they're coming in and coming in aggressively. The question is what do they call / label as infrastructure. When you look at what some of the terminology on infrastructure is, you'll see everything from real estate assets to, what I would term as a world banker the hardcore infrastructure i.e., energy, transport, water; and they're not there yet. We've got to find a way to get them there.

A little bit of the traditional analysis that we've done in terms of what are the critical bottlenecks for infrastructure development? It is all about developing a pipeline of projects that can be brought to market; for example, we're not able yet to get, particularly in the ASEAN region, the right projects to market. We need to get projects that are well developed, where the risks are well understood and that you're able to go to market, reach financial closure, and there's not enough of them. Despite of the existing liquidity in the region, it doesn't mean that that liquidity is actually going into infrastructure. So an important point to make there.

The other issue also relates to the whole enabling environment, and I think it's an interesting reflection for the APEC context, is that there's a lot of experience that has been done but is not circulated properly. Every country wants to recreate the wheel, but if we already have some standardized contracts that work reasonably well, for example in Canada and Australia, could we not apply some of the principles, not all, but some of the basic principles of risk allocation into other jurisdictions? This is an important point isn't it, because lenders here or somewhere else, the basic principles of risk allocation are going to be the same ones. So a little bit of an approach to think about how we can leverage knowledge that already exists in the region. We have a diversity of knowledge there and we have to use that better.

Figure 6.1.5

Current critical bottlenecks in Infra

What are investors looking for and market is not providing?

Current critical bottlenecks identified for ASEAN and Japan:

- Lack of quality and standardized project preparation + weak contractual and enabling environments
- Risk aversion to infrastructure-specific uncertainty (e.g., ramp-up in greenfield, currency devaluation, regulatory and political, capital repatriation, public payments)

More generally:

- Pre-feasibility financing (i.e. assessments, patient capital for geological, exploration, technology works)
- Support for Project Preparation (e.g. due diligence and feasibility, transaction structuring, bidding, contracting and management process)
- Enabling Environment (e.g. legal and regulatory framework, tariff regime and demand forecasts, off taker viability, weak planning and prioritization process, local currency financing etc.)
- Financing (concentration risk in Philippines):
  - gap during construction (e.g. CAPEX)
  - gap during operations (e.g. Government payments to cover OPEX and debt service)
- Land Acquisition and Resettlement (i.e. Process and funding major concern in Indonesia)

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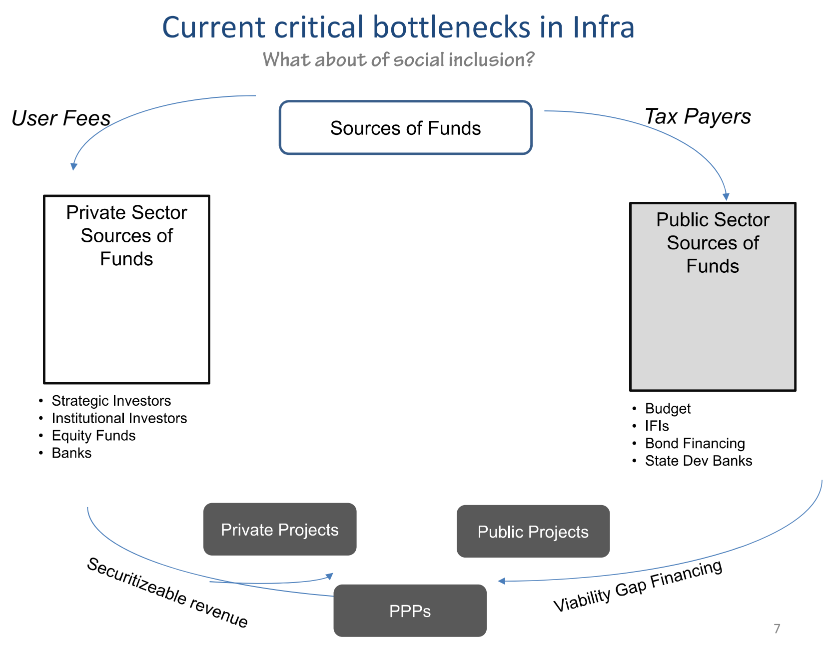
Figure 6.1.6



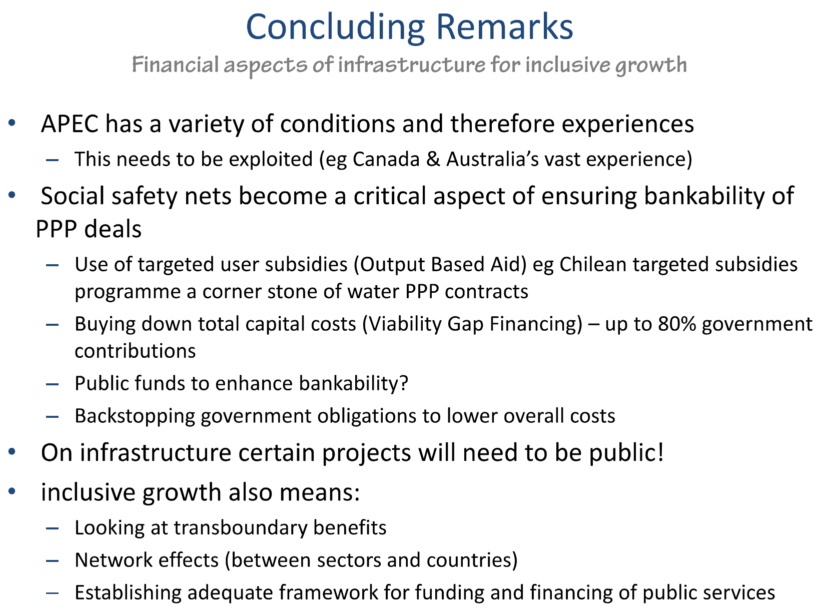
A reflection on the basics of regulation and basics of what we are trying to do. At the end of the day, infrastructure is going to be funded either through taxpayers or through user fees. Taxpayers, which is the traditional way, or user fees, then you have issues of affordability, issues of social inclusion, how to manage that? I think what we have in the region is an experience, again, the very successful ensuring of social inclusion, while still being able to do a bankable deal. The Chilean example of having a PPP where the private sector is obliged to provide the service to the poorest segments of the population, and the poorer segments of the population are being subsidized by the government. The manner in which that subsidies work actually enhances the bankability of the deal, so subsidies are not a bad thing per se, but how we manage the subsidies; that is, what we need to make sure makes sense.

Just to wrap up a little bit of the ideas; as I mentioned, we have a multitude of experience, we have multitude of circumstances in the APEC countries, so the challenge is using that diversity and using it better in terms of knowledge, experience and actually things that I can piggy back on. I gave the example of standardisation of contracts as something that could be done. The other point is that whether the social safety nets are ineffective is a critical aspect of how you ensure bankability of a deal. There is no point in trying to create a structure when I provide social services or I provide services, such as water or sanitation, if I am not taking note of inclusion of the poorest segments of the population. That doesn't have to be something that lenders are not interested in. Governments will continue to play a significant role in infrastructure development that's the truth and when you look at the numbers of infrastructure needs, versus what has been funded by the private sector, the private sector is doing between 18-20%, at least in the World Bank member countries, so it’s very small comparatively speaking. The trick is how we use the private sector to enhance the fiscal space that a country has and also, at the same time, how you ensure that safety net and that part of social inclusion that is so important. Because if all things fail, as we saw in the water concession in Argentina which was a major failure. The other point I wanted to mention to you is this whole notion of buying down capital costs as a strategy for bringing in private monies. That’s something that we are understanding much better and that goes back to this whole notion of combining public and private resources. So using subsidy money to buy down the capital cost can be a very effective technique. The Brazilians are getting very good at doing this. They’re funding most of their infrastructure through PPP’s and you look at some of them, 80% of the total cost is public money. The question then is an issue of efficiency and how do I ensure efficiency of the private portion of the monies that is being used? The Peruvians are doing the same thing, the

Lima metro is one example, it is a massive project, $5 billion dollars for one project, and the government will pick up a significant portion of the bill; but they're bringing the private sector for the bits that are about better operations and sustainable operations.

The other point is that individual subsidies – whether we can use individual subsidies as part of that whole financial architecture that is developed, and I think it's part of that inclusion notion to create that structure from day one. It's not incompatible with a private sector approach, it's complementary and that's what we want to try and achieve.

Figure 6.1.7

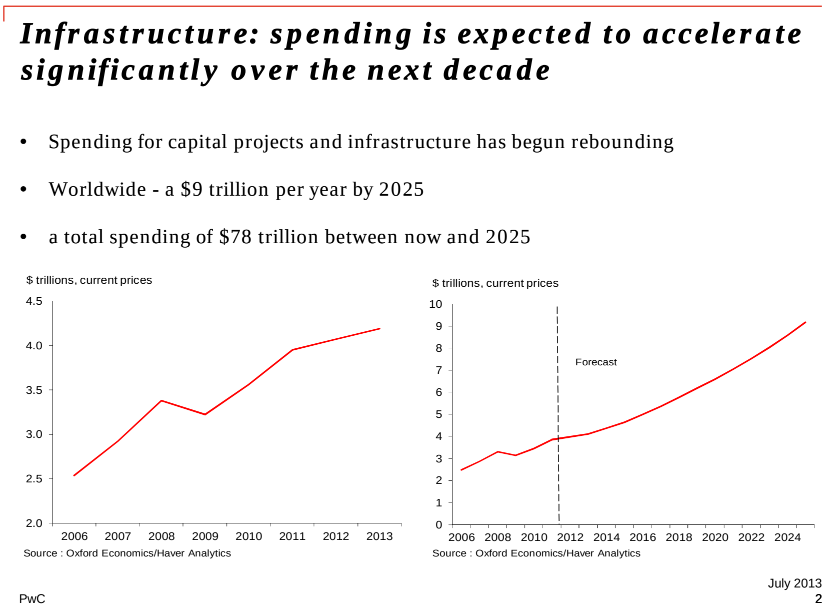


As a final comment and remark, the truth is we are not going to be able to do all projects as a partnership with the private sector, there are going to be projects that simply will have to be publicly funded. The trick then is to understand and recognize what do I fund publicly? Could I fund, for example, the construction of an asset, and once it's constructed could someone else operate it? China, for example has a great challenge going ahead, they've built a lot of assets, now the challenge is sustainability of those assets. Is the private sector an option to create that sustainability? With that sort of concluding remark I will stop. Thank you very much.

Mr. Mark Rathbone:

Good afternoon everyone. Thank you very much for the invitation to speak this afternoon, hopefully I could add something to Cledan's analysis. I'll look at some different numbers, the key thing here is to understand why the numbers are different, and I'll try to explain as we go through this. We've recently published a report in conjunction with Oxford Economics that looks at the global spending in infrastructure over the next 10 years to 2025. What that has done is analyzed all infrastructure spending across public and private sectors, not necessarily where the capital has come from, so if we are looking at PPP spending numbers, which represents a very small part of the total spending, then you're looking at numbers that Cledan was talking about.

Figure 6.2.1



In our report, we've estimated that by 2025 globally we'll be spending around US$9 trillion on infrastructure. Currently, or in the last year, we've spent around US$4 trillion, so if you look at that growth rate it's very high. One must then look at where it is growing and how it is growing. By far the largest growth engine behind those numbers is the Asia region. With an annual growth rate of around 7-8%, one would expect that the Asian region will spend about US$5 trillion per annum on all forms of infrastructure. We've got on the screen here how that is segmented across everything from extraction, manufacturing, through to big transport infrastructure programs and other things. If you look at the Singapore market for example, over the last year their PPP spending has been very small, indeed almost negligible to nothing. If you look at the broader infrastructure spending in Singapore it was around 13 billion dollars, and that was primarily in transport and transport networks in our market. Singapore alone is looking to increase their spending as their budget came out on Monday, from 12 billion to 30 billion in 15 years' time. So that's a very substantial increase in their spending and that's in a country that has a very strong infrastructure stock.

Figure 6.2.2

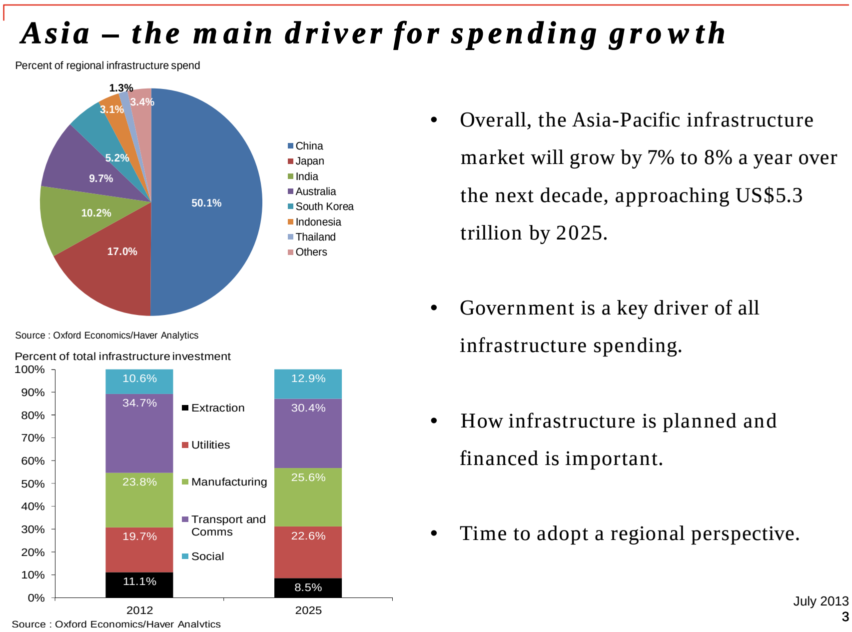
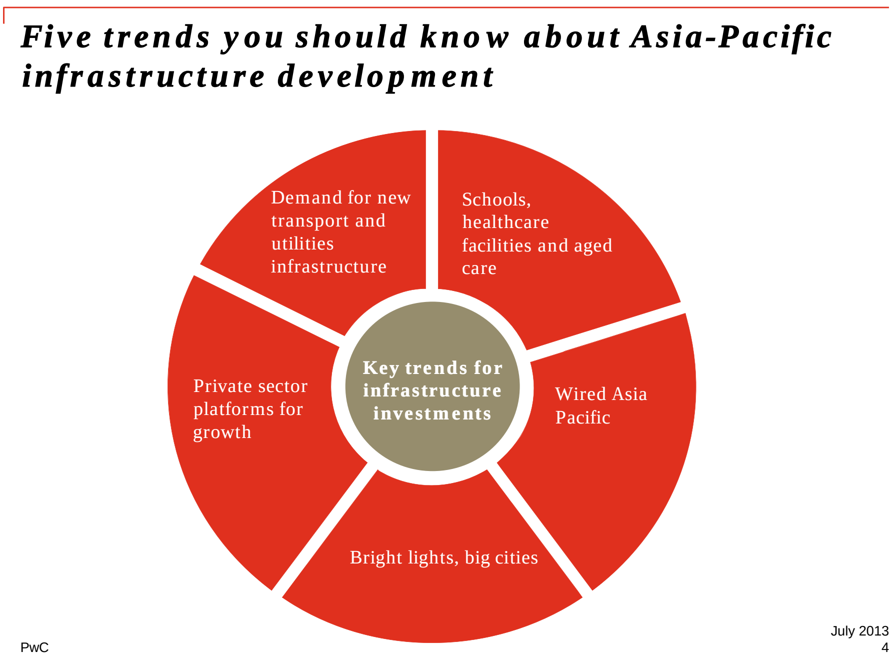


Figure 6.2.3

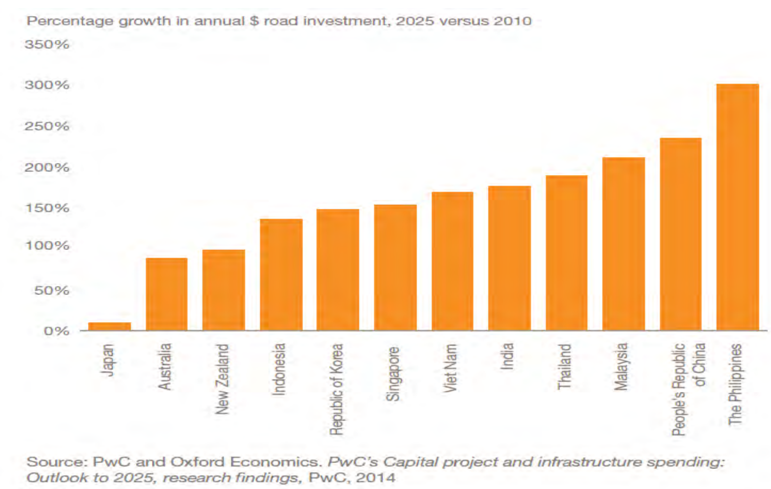


As was mentioned earlier, China is driving most of that growth. What we're finding and the work that we are doing is on very substantial outbound schemes, which are done more to a government-to-government level than private sector level. Most of those projects are very strategic in nature; so for example, it might be a set of Japanese companies coming in for an economic zone in Myanmar, or a Chinese grouping for new central business district (CBD) or mass rapid transit (MRT) networks in Jakarta.

The next part of my speech and what I am going to talk about is where we think the big trends are and how that will affect how governments approach their spending on infrastructure such that it is inclusive for growth. If you look at Indonesia, and this is a little bit from a year or so ago in a piece of work we did, the Indonesian economy spent around 33% on capital assets in 2012. Of that 33% only 3% went to infrastructure, as we would classify it, so roads, transport networks, ports, health care and that type of thing. A very big disparity certainly that level of spending is not inclusive, the majority of that spending is high level manufacturing, processing plants, real estate, offices, condos and malls. It's not helping the vast majority of the people in Indonesia.

Figure 6.2.4

Demand for new transport & utilities infrastructure



PwC

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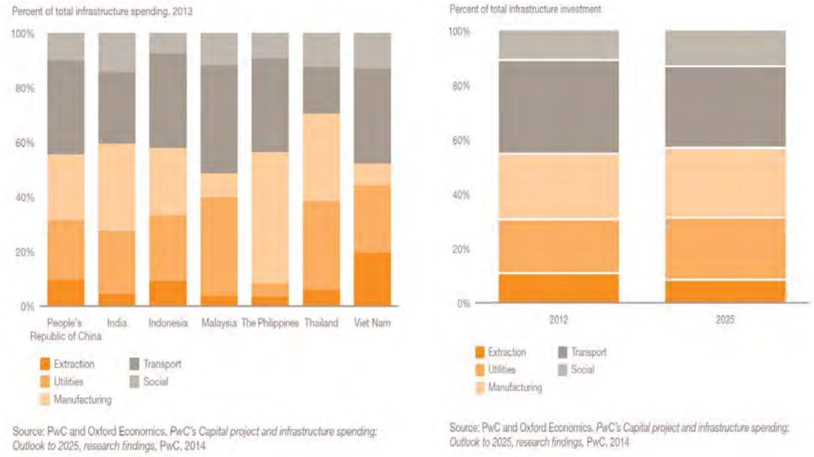
Figure 6.2.5

Schools, healthcare facilities and aged care

In emerging Asia, social investment contributes a much lower share of total infrastructure spending.



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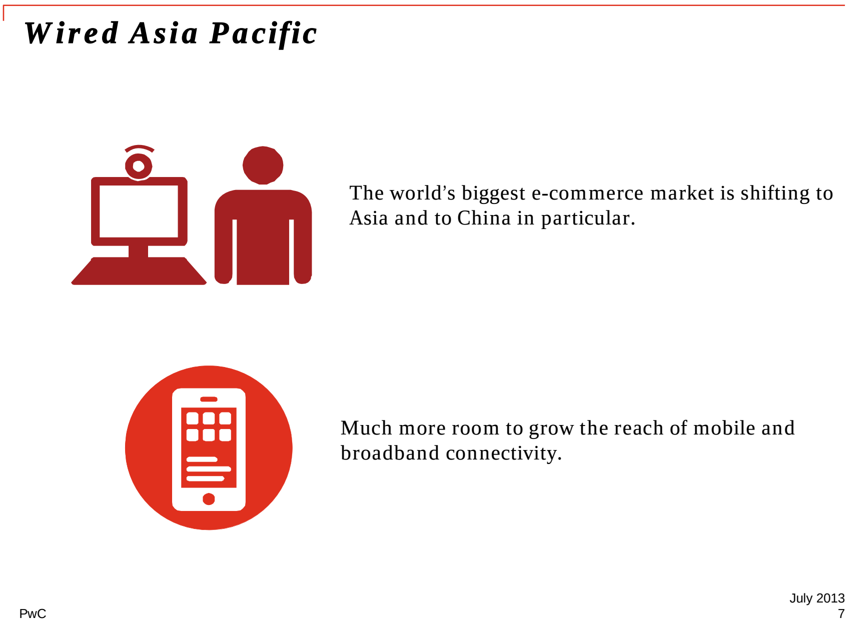
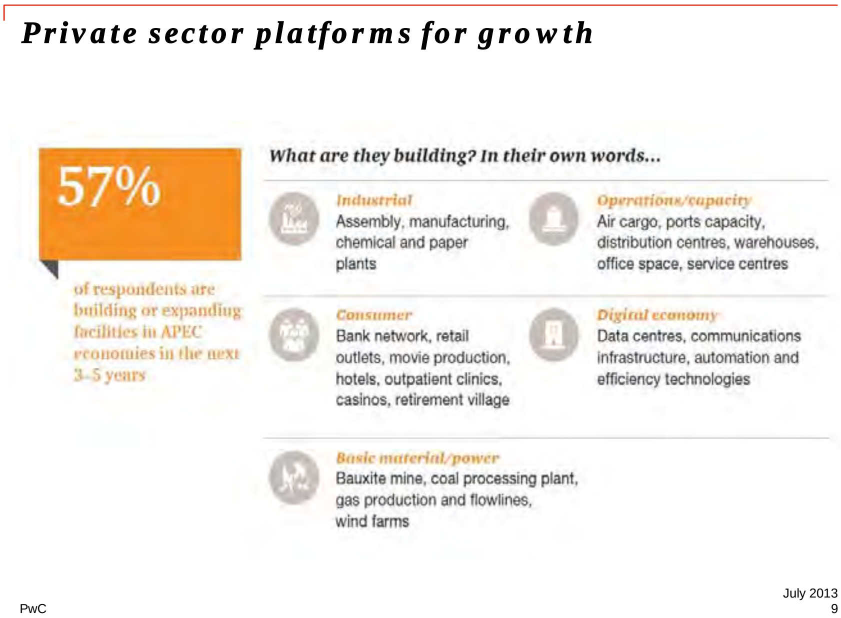
Of these five mega trends, of course, we now know about the utilities and need for more power as the economies grow, we need more power and more water to fuel the economy as populations move to cities, so you see bigger pressure on urban centers and urban transport, urban utilities, so urbanisation trend is very substantial. E-commerce and the ITC boom is very substantial and becoming more prominent in our region. There is already the biggest e-commerce market globally, Asia, again fuelled by China, but if you look at the Chinese market only about 20-25% of small businesses have access to the internet in China. If you look at the US market, 70-75% of small businesses have access to the internet as a portal. The level of growth across e-commerce should be very substantial.

Figure 6.2.6



In terms of the private sector, we've done some recent surveys on CEOs, which I am very happy making available to everyone in the PECC grouping, estimates between the next 3-5 years about 60 billion dollars will be spent in our region, Southeast Asia, specifically on extraction, logistics and transportation networks, a little bit more consumer type infrastructure, real estate and malls and that type of thing, but also of course, your broadband networks and cable. Going into a little bit of detail, this is the amount to expect on roads over the next few years across different countries, and as you would expect the more mature territories will spend less on those infrastructure assets then you would in the emerging markets. Why do we need more roads? As people get wealthier, so they want to get more cars. So as you increase GDP by about $1000 dollars, you increase the amount of cars on the road by about 15 cars per 1000 people. What that means as Indonesia, Philippines, Vietnam, Myanmar and China growing wealth, you'll see more and more cars being delivered to the roads, which puts more and more pressure on the transport networks. Not only that, but with all the connectivity discussions that are happening at the APEC level around getting people and goods across territories is so that they work more effectively. What you will see is a very substantial uptick in investment across the emerging markets on urban transport networks within cities.

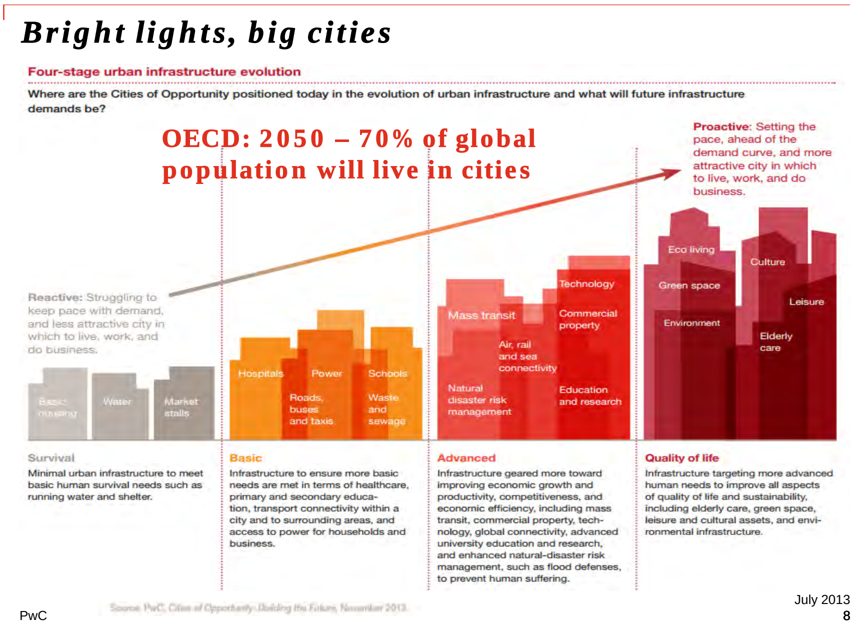
Figure 6.2.7



Social infrastructure is something that is very close to my heart, and certainty if we're talking about inclusive growth for infrastructure, and financing for infrastructure that is inclusive, one must look at the social infrastructure around our region. Historically, there has been a very substantial under-investment in public health care and public education; I think that is very clear. If you contrast the market here with a market like Australia or Western Europe or North America, where there is substantial spending on public health care and public education, what you would expect as people grow in wealth in the emerging economies here, they will demand far better health care and will demand far better education for their children. Within the mature markets in contrast to that, you have aging populations in Japan and South Korea, which will be looking for aged health care facilities. As familial structures change around the region, which we are seeing more dramatically, you'll see safety net requirements being required by the population.

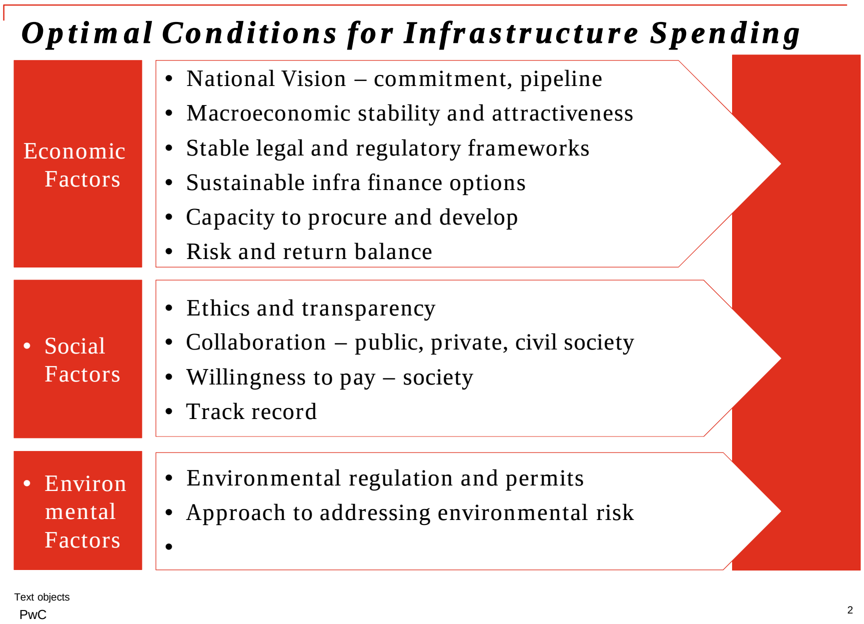
In terms of urbanisation, OECD estimates that about 70% of the world's population with live in cities by 2050, clearly that places a very substantial pressure on urban infrastructure, whether it be roads, MRT lines, that type of thing; more importantly, waste and water management, power and power consumption, people have flat screen TVs now and consume a lot more power than in the past. That type of impact is very substantial, and that will continue. Most of our cities around our region, and bear in mind we have seven of the big mega-cities globally in Asia, sitting at the early stage of development of this. Not many are sitting in the quality of life stage of development; if you think of Jakarta, Manila and places like that, you have growing cities, which have relatively big requirements for investments in infrastructure.

Figure 6.2.8



Probably to conclude, what I'll is that say that it is an investment or a very large sum of money that we have been talking about. If you look at other forecasts from the ADB, you have between $8 trillion between 2010 and 2020; there are very substantial barriers to getting that capital into the projects. Firstly, project preparation and Cledan talked about that. Secondly, project prioritization, there is no point in having tons of projects in the market if no one is going to finance them, so prioritize and choose the right projects, prepare them properly, and take them to market. Regulatory frameworks and capacity building needs work on, but more importantly I think is the capital needs go into these projects is substantial. Governments do not have that amount of money to spend on infrastructure, even if you exclude all the extraction, mining, private sector dominated infrastructure that you need, the inherently governmental infrastructure that we need to invest in Asia is far lacking, and we need a lot more money. In order to attract that money, you need better procurement frameworks, you need decent structured projects, and you need to use precedent from other territories that are doing it well. These are all very important and critical foundation parts of creating an infrastructure market that is sustainable and addresses all the needs of the population.

Figure 6.2.9



I think connectivity remains very important in terms of inclusiveness, making sure that people from all parts of the population can get to work effectively and save money. The mega-trends in my mind are a key part of inclusive infrastructure growth. If you think about the five things that I mentioned, all of those impact very heavily on all different parts of society, whether you are a poor person living in the rural areas or a very wealthy person living in the city that needs to get to work. I think private participation is critically important, PPP is the reason I came out to Asia, and personally I have been very disappointed that is has taken so long to get so far. I think the Philippines and Indonesia are making fantastic ground in terms of the way that they are approaching it; new regulations are being passed, PPP centers are putting out projects effectively and projects are being awarded. Thank you.

Mr. Mario Artaza:

Good afternoon everybody, it's a pleasure and privilege to be able to share this afternoon with each and every one of you. Firstly, I would like to express my sincere thanks to SINCPEC, PECC and PPECC and at the same time, given the fact that I do come from the farthest economy of the APEC realm of reality, which is Chile, and furthermore I am also only the second banker to be present today at this enlightening conference. Allow me to take a few seconds to recognize Professor Manfred Wilhelmy, who heads the Chilean Pacific Foundation, who has been a steadfast contributor to the APEC process and at the same time, he is in fact one of my mentors, and I wanted to publicly recognize Professor Wilhelmy in front of his peers and friends.

This afternoon, I wanted to share some thoughts with regards to an issue that pertains to populations everywhere in the world. Never in human history have people demanded solutions from governments, private institutions, or from the academia as they do today. Today, everyone feels or seems to be apparently but some may say they are, empowered. They are empowered by using a device, which come in all shapes, colors and sizes. You can use them 24 hours a day, and rather than talking about infrastructure development and other issues that have been talked before, my brief words, I wanted to bring down the issue of financial inclusion and how people are feeling empowered today to buy, to learn, to contribute to society using the financial institutions web within the Asia-Pacific region, and within my experience, the Chilean system; because connectivity is the new normal. It is important to keep in mind as we move forward in the Philippines APEC year, how Chile, which is today the world's seventh freest economy, has been able to attain a social cohesion society in a positive manner including within the strategy of inclusive financing in the new normal.

There is a close relationship between financial inclusion, financial institution development and economic development. There are many words that are used in APEC that are also relevant in financial inclusion; good governance, sound institutions, transparency, accountability, access, availability, education, integration, regulations and policies all of these empower people today, not only in what we do but also in banking. And without banks, we really cannot do anything today. Without paying your light bills, you have no electricity; without paying your water bills, you can't take a shower; you can't go to the store and get clothes. Today, there are more than 25 million hand phones active in Chile for a population of over 16 million. 76% of these are intelligent phones and smart phones. The smart phone revolution is not happening in China, it's happening in Latin America, and specifically, in Chile. There are more smart phones being sold today in Latin America than anywhere in the world, and 9% more than the US, 11% more than in Western Europe, and close to more than 30% in Asia.

What I would like to discuss at the same time is about a definition for what financial inclusion is. According to Chile's superintendent of banks and financial services, based on the financial inclusion center, Action International, financial inclusion is the state where upon all who are working age can enjoy access to a complete set of quality financial services, which includes savings, credits, loans, insurance, and payments. These services are offered at rates, which are accessible, convenient, and offered with dignity to the client. Chile's government furthermore states and declared that financial inclusion is to be identified as a policy for empowerment to its citizens, in particular its most vulnerable ones so that they can obtain with greater facility access quality financial services, ones that are adequate to their needs, which offer protection to their families, opportunities to elevate their conditions, and a greater participation in their social environment. Banks are in the equation. How? Through access, through use, through financial education, and through consumer protection. These are issues that have been brought about before in other areas that we have seen today in the conference. Remember the governor in regards to education, in terms of emergency preparedness, there's also an important part of education that you want to use your bank correctly, and be part of economic development.

Latin America's most connected economy today is Chile, more than 20 free trade agreements (FTA) with over 60 countries in the world. The benefits of these FTAs, some may argue, has been for example, that the purchasing power parity of Chile is Latin America's highest. Amongst the key players within the Chilean financial system there are around 20 banks, one of them Banco Security, which I represent today in Hong Kong, we're Chile's only bank in Hong Kong operating with a representative office. They have a very interesting program were upon every individual who has a national identity card is able to access financial services today in Chile; 5.3 million clients, 55 million transactions, 25% of these in rural and hard to access zones. 52% of the users of this card are women, and more than 60% of Chilean youth, 18 and over, have it. It's a nondiscriminatory card and more than 100,000 foreigners who reside in Chile also have the access to the use of this card.

The issue of internet finance is something that we should also dwell upon because there are programs that are in place today, that for example, in Hong Kong, Asia's richest man Li Ka Shing his Tom Group in China and the Ule group are going to have a joint venture with China Post for peer-to-peer lending through the internet and offer online finance. Last year, online finance was around 940 million dollars; this year the objective is 7.8 billion dollars. Chile along with three other APEC member economies occupy the top 10 places in the world with regards to financial inclusion; the Philippines being within the top three.

It should be noted at the same time, that a high degree of inequality is a threat to the quality of the institutions, so by having financial inclusion, you're diversifying and at the same time including the population in the growth process. Today, 58% of Chilean adults have at least one debit card, 47% of Chilean adults save, 23% of them for a new home, 63% of all transactions in Chile are done today with a debit card, and 36% of people use e-connectivity to transfer money. Of all the people today in debt in Chile, out of 10,000 adults, around 3,600 are in Chile and 4,500 of them are in the US. So the level of participation in the financial scheme in Chile has allowed people, maybe not earning the same amount of money in developed economies, but their behavior with regards to the banking system seems to be very similar. The debit card, the use of your own ID card for transactions, the use of ATM cards are all part also of the equation of financial inclusiveness.

This morning there was a professor talking about technology moving forward and how APEC must confront the challenges of technology in order to safeguard people's prosperity. I am of the belief that there is a generation which is changing, and the way that we are doing banking today is allowing the younger generation to incorporate themselves, and feel part of the solution and no longer of the problem. That in fact is financial inclusiveness. Thank you very much.

Mr. Zhou Qiangwu:

Thank you. Dear friends, good afternoon. Happy Chinese New Year. It is my pleasure to be here for this PECC conference, this is my third time to attend a PECC meeting; the first one was in Bali two years ago, last year I attended the Beijing PECC meeting, and I would like to thank the hosts of this meeting, in particular Professor Tan from SINCPEC, and also thanks go to Ambassador Tang for your invitation.

What we have been discussing here this morning and this afternoon tells us that we need to be working more closely and to be more innovative to achieve inclusive economic growth in this new normal, in particular in this region. In terms of financing inclusive growth, to be quite frank, there is a lot that could be touched upon; in the interest of time, I will only focus on two important issues; one, the AIIB, and also the Silk Road Fund.

First, AIIB. Actually, there are many aspects which I could share with you, I would only single out two issues; one is the very recent progress, the other is, the characteristics of the AIIB. Since October 2013, when Chinese President Xi Jinping announced that China would initiate the AIIB to mobilize more resources to invest in the region in terms of infrastructure financing, much progress has been made in the past one year. First, we've got a temporary multilateral secretariat; experts with different nationalities have been invited from existing international institutions, such as the World Bank, ADB, IMF, and the European Investment Bank (EIB) to join in the preparation work. Among them, one could be worth mentioning, the former chief counsel of the World Bank Group. She is from the US and now joins in the drafting work of the AIIB.

The second is that we have been conducting hundreds of bilateral and multilateral consultations with different groups and institutions and different economies. Meanwhile, two rounds of chief negotiators' meetings have been held, one in China and the other in India just last December. There is much consensus including the rules and procedures for accepting new founding members, and actually, we have been receiving more applications. We are currently reviewing the applications.

The third, until now we have 27 founding members, which in our view is enormous; for the EIB, there are only five founding members. I think more economies and countries, not only from this region but also from other regions will be joining. It is agreed that any economy or country that applies for the AIIB membership by the end of March this year could be a founding member. Among these 27 economies, nine are PECC members.

The fourth point I want to share with you is that so far we have got strong support from the World Bank, ADB, the UN, and some other international agencies. Both Presidents of the World Bank and ADB have expressed strong wishes to cooperate with this new bank. Again here I want to say, this new bank is to cooperate rather than to compete with the WB and ADB. The fifth point, as you all know is that the headquarters of the AIIB will be in Beijing. The sixth point, what will we do next? The negotiations on articles of agreement will be conducted and agreed upon by the end of this May, followed by internal approval procedures by these founding members; we are pretty sure that by the end of this year this bank will go into operation.

The second aspect of the bank that I wish to share with you is the characteristics of this new bank. The first point is that is intergovernmental body and is a new development bank. The second is specialization; it is only targeted on financing infrastructure, not like The World

Bank, ADB and the IMF who focus more on poverty reduction. The third point is high standards; we will try to learn experiences from The World Bank, ADB, and other multilateral development banks (MDB). The fourth is that openness; we are trying to observe not only members from this region but also other regions, and very likely some of the countries from Europe could be members and founding members. The fifth, transparency - all the processes are conducted in a very transparent way, just like what I mentioned just now, and the chief counsel is from the US; I believe the US will be fully informed. The sixth, innovation; there will be some new innovations and mechanisms, and those founding members will have more voting rights and privileges for being on the board of directors and governors. These are the few points I would like to share on the AIIB.

I will now share some information with you on the Silk Road Fund. This Silk Road Fund will be used to provide investment and financing support to infrastructure, and of course other resources and industrial cooperation. The fund will be open to active participation by investors both from this region and out of the region. This fund is more an investment fund in Asia, and will hold the principle of marketization, internationalization and specialization. Just right before the lunar spring festival, these 40 billion Silk Road Fund is moving forward as its management team has taken shape; Madam Jin Qi is the assistant governor of the Peoples Bank of China will be the president of this new fund. Others including China Investment Corporation (CIC) and my colleagues will also be joining. The funding resources, the initial funding scale of the fund is US$10 billion, with about 65% of this fund to come directly from the Chinese US$4 trillion foreign exchange reserves, and as I mentioned just now, the CIC, the Chinese Sovereign Wealth Fund will take up 15% and China Export-Import (EXIM) Bank and the CDB will take another 20%. In general, this Fund will be viewed as a good alternative to the AIIB for financing infrastructure projects across the region.

Finally, I will discuss the new development bank headquarters in Shanghai. These new initiatives has quite the similar intergovernmental function, structure and size, and also having capital of US$100 billion, and have a similar timetable for going into operations, which means that by the end of this year these new MDBs will also go into operation. I believe the three new initiatives will form joint efforts to finance infrastructure in the Asia-Pacific region. Thank you.

Question and Answer Session

Dr. Naoyuki Yoshino:

Thank you very much for all of your presentations. I have two questions; some of the infrastructure investment may not go so well, and someday make create some losses. What kind of remedies could be taken in those cases? There are some good success stories. Secondly, we have experienced the Lehman Shock, there are some external shocks, then some of the infrastructure projects may not be going well in those shocks, what kind of reactions have been taken in those temporary external shocks? Thank you very much.

Participant:

My questions is centered on China and the infrastructure development, basically China's PPPs have traditionally been done with SOEs, and very little with private and foreign participation. In view of the recent reforms policies that are in place in 2015, what is the scope and to what extent do you think this PPP participation with non-SOE private sector and onto the foreign private sector? Also, in view of this and the larger broader view of the global infrastructure development, what do you think the scope for other countries with deeper and more involvement in private sector to follow China's SOE PPPs? Thank you.

Mr. Zhou Qiangwu:

Thank you for the question. This initiative as I mentioned just now, there will be some innovations, and I fully understand financing the infrastructure in this region will have to be broad enough to involve not only funds from the government and intergovernmental institutions, but also from the private sector or private-owned funds. As far as I know, starting from next year, we will try to finance some of the projects by paralleled financing and co-financing and three party financing and even four party financing; for example, some of the big projects could be financed by the AIIB, ADB, and The World Bank together. And certain projects could be co-financed by these MDBs and public funds. In particular, the Silk Road Fund will be open in particular to those private funds so that more fund will be absorbed into the fund and I think if people here have the will and have enough funds, you will be more than welcomed.

Mr. Mark Rathbone:

Regarding the question about projects going well or badly and mechanisms that can be used; I think that if we look back at projects that have failed or gone wrong, they are normally due to a couple of reasons. Firstly, bad due diligence, so people bidding on projects that don't understand the risks that they are taking on, and don't understand the technical delivery that is required or the services that they need to provide. For example, if you look at Spencer Street Station in Australia that was very substantially delayed and cost overrun primarily because the technical consultant didn't understand that the tracks would take time to power down and workers got on the tracks and that caused a big delay in the construction program, which caused a cost increase. I think poor due diligence is one. Bad project preparation is a fundamental contributor, so if a project is not prepared effectively and people still go in and do the project, you will find it will go wrong at some stage. Because risks will be misallocated, so if a risk does arise and isn't mitigated effectively that will cause costs to increase and failures in the project. Examples might be the National Physics Laboratory in the UK, which is a very mature market where that project caused the failure of one big construction company because they didn't understand the technical specifications that were required to deliver, but on the governmental side of things, they over specified the project, no company could of satisfied the requirements that they had put in place under that contract; so that led to the failure of a whole company and the project effectively.

In terms of once a project is started of course, you got the standard things that you would expect on a project; you expect it to be well governed, strong reporting through to the owners and construction company, and often that linkage is just not there. So project directors' report to constructors but the owner of the assets don't get information that they need to deliver projects effectively. What mechanisms should be in place to address those shortcomings? Firstly, I think people need to understand what they are getting into with a project, so do the right due diligence. From a government perspective, prepare the project effectively, and from the private sector perspective, understand what you're bidding for and try and understand all the risks that you will be exposed to on the project. Once you're in the contract, you look at mechanism like compensation on termination, which are very important for bankers, responses, and for government and insuring all peoples interests are kept whole. Arbitration mechanisms need to be robust and you need to have decent arbitration centers that can do that, so when you are looking around our market, most of the arbitration is either done in Hong Kong or Singapore, as a trust worthy and independent arbitration center.

In terms of the shocks in bad times and the two recent ones are the global financial crisis in 2008 and the commodity price spike in 2007 and early 2008, and I was working on projects both in procurement and delivery stage, and people or governments address it differently, its almost like a force majeure when something like that happens, its such fundamental re-shift in the market that people need to go back and rethink how to approach a project. For example, with things like the commodity price spike during procurement, what that does and I was working on a project that was very heavy on steel and the price of steel went from $750 dollars a ton to $1600 dollars a ton in the space of a month and a half. That created an enormous funding gap in the project, so what we had to do is go back and acknowledge that this was not something that was normal or expected, that could be dealt with through hedging or understanding what you're going to be buying in the future and pre-buying it or that type of thing; we then put in mechanisms to adjust the price based on the commodity price index within that market. If the price of steel dropped down, the price of the project would drop down, and that would be passed back to the government who was paying for it. In terms of a liquidity shortfall like the global financial crisis, a whole lot of the things have to change. On one hand, there are some issues that you cannot resolve, so if you look at the mono-lines in the European market who wrapped tons of projects in the 2000s and late 1990s, they all failed simply because there was not enough liquidity to take all that risk on. What the UK government did was put in place a UK treasury bank that acted in a fund gap role, in that if a commercial lender dropped out of a project that was mid-procurement that bank would step in on a government level and lend to the project commercially. What that created was a bit of nervousness amongst the commercial lenders, who then didn't want the government meddling in their affairs and so it created more liquidity in the market. Within Singapore, when we were procuring a lot of projects, a lot of projects just simply got put on hold, and that's one way of dealing with it. There are other ways of looking at the government stepping in and providing loans structures that can be refinanced once liquidity comes back to the market.

Mr. Zhou Qiangwu:

Just one more point that I forgot to mention is on the scope. We are targeted on physical connectivity, at least in the upcoming five to ten years, and later we would also focus on those people-to-people connectivity. In terms of the physical one, the AIIB would provide funds for projects on roads, highways and high-speed railways; in particular, those regional projects. Thank you.

Mr. Cledan Mandri-Perrott:

Just two suggestions building on what we had been said before. In terms of remedies, I think that the notion of creating the right back stopping mechanisms inbuilt in to the contract and has to be there from the very beginning. So this thing that makes lawyers so nervous and by the way I am a lawyer so I am self-critiquing here is wanting to have all of the details completely pre-agreed. If you a have a long-term relationship such as PPP contracts which are for 30 years or 25 years, you're not going to be able to preempt everything. So the contract has to have a degree of flexibility and an element of pragmatism is required between the two parties. Issues that would allow a change in scope for example, if there has been some external factors that create a liquidity shortfall as Mark was talking about, you could reduce the scope of that contract. You could do a number of very practical measures that you build into the contact, that is a very important tool that one has is to create flexibility within the contract to renegotiate. Renegotiating a contract is not a bad thing per se, it is how you do it and that is the important thing.

The other quick point I want to make is the whole notion of the right supervision. If I can preempt actions, if I can preempt problems right that means as a government or guarantor I am taking a much more active role to foresee potential problems. That's fundamental in terms of the relationship. The last point on the SOE question, I think that from a Chinese perspective, you are seeing that China is taking some very strong actions in terms of changing some of the rules of engagement that will allow other private sector actors in the marketplace. The whole notion of being able to take long-term debt and not having to restrictions that we had from the 1990s when you could only borrow up to 13 years on infrastructure, those things are changing fundamentally and there's a big shift there. Other SOEs in the PPP space, I think that's the right space to go. If you look at Pelindo for example, the port operator in Indonesia, from a credit rating perspective it's really to pierce the sovereign rating because that entity is so well run. The notion of using an SOE in a PPP is not a contradictory one but one of what are the rules for that engagement. Thank you.

Mr. Mario Artaza:

I have some points that are issues to note. Latin America is a player within APEC, be it Mexico, Peru or Chile, we are participating in new ventures within the APEC region. Point in turn, we are talking about infrastructure development, there are Chilean companies that are interested in developing infrastructure in China, for example building airports, designing airports, designing commercial buildings or schools or other infrastructures which are capable of passing earthquakes. We have strong earthquakes in Chile and we have the technology which is used in Chile is being exported and applied in China. On the other side, there are certainty teething issues with regards to Asia going to Latin America, and point in turn, for example, with what happened in Mexico recently, or what's happened in Bolivia a few days ago with regards to a train project. Asia is learning with regards to infrastructure development projects in Latin America in the same way that Latin America is looking into Asia, its Asia that is no longer just for the US or Western Europe or Australia or New Zealand, Latin America also has a place in this issue.

Session 5: Making Regional Economic Integration More Inclusive

Lead Panellist:

- **Ambassador Ong Keng Yong**, *Executive Deputy Chairman*, S. Rajaratnam School of International Studies

Panel Discussion:

- **Dr. David Hong,** *President*, Taiwan Institute of Economic Research (TIER) & *Chairman*, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC): SMEs in Global Value Chains
- **Professor Christopher Findlay**, *Executive Dean*, Faculty of the Professions, University of Adelaide & *Vice-Chairman*, Australian Pacific Economic Cooperation Committee (AUSPECC): Global Value Chains and Imperatives for Regional Integration Initiatives
- **Dr. Filippo di Mauro**, *Senior Adviser*, Research Department, European Central Bank: European Experience

Moderator:

- **Ambassador Tang Guoqiang**, *Chairman*, China National Committee for Pacific Economic Cooperation (CNCPEC)

Ambassador Tang Guoqiang:

Thank you very much everyone for attending this conference at this very late stage. We've come to the last but not least session. We're going to discuss "making regional economic integration more inclusive". REI initiatives are gaining pace; the ASEAN Economic Community (AEC) is due to be completed by the end of this year. Regional Comprehensive Economic Partnership (RCEP) is supposed to be concluded by the end of this year as well. The Trans-Pacific-Partnership (TPP) might gain momentum if President Obama can get the Trade

Promotion Authority (TPA) he wants. I think it's more significant that more than three months ago APEC leaders decided in Beijing to kick off and advance the process of the realization of the FTAAP in a comprehensive and systematic manner, and endorsed the Beijing Roadmap. Through the implementation of this roadmap, the APEC leaders decided to accelerate efforts on realizing the FTAAP on the basis of the conclusion of the ongoing pathways, and affirm commitment to the realization of the FTAAP as early as possible by building on ongoing regional undertakings.

The topic that we are going to discuss today is how we should ensure that businesses, especially the SMEs, are prepared to participate in and benefit from the REI. With us today are distinguished panelists, they are Ambassador Ong Keng Yong, *Executive Deputy Chairman*, S. Rajaratnam School of International Studies; Dr. David Hong, *President*, Taiwan Institute of Economic Research (TIER) & *Chairman*, Chinese Taipei Pacific Economic Cooperation Committee (CTPECC); Professor Christopher Findlay, *Executive Dean*, Faculty of the Professions, University of Adelaide & *Vice-Chairman*, Australian Pacific Economic Cooperation Committee (AUSPECC); and Dr Filippo di Mauro, *Senior Adviser*, Research Department, European Central Bank (ECB). Now let's first invite Ambassador Ong Keng Yong to kick off the discussion.

Ambassador Ong Keng Yong:

Thank you Mr. Chairman. Good afternoon ladies and gentlemen. As a former Secretary-General of ASEAN, I have to sell ASEAN. If you allow me I have a few slides to go through to let you know some of the key elements. ASEAN is an important part of the APEC region and ASEAN is an important part of the PECC operation, so if you allow me I will go through this and make a few point to conclude my presentation.

The AEC is happening now, and the key reason is to get a grouping of economies together so that we can have a bit more space, voice, more benefits for everyone. The situation today is that we have actually not a bad record in my opinion, although the politicians want some more. We have reduced tariffs significantly, we have signed some liberalization of trade in services, and we have maintained foreign investor confidence in ASEAN. ASEAN's strength remains that it is a very big market and one of the things that people tend to forget is that we have a lot of natural resources in the region and we are actually geographically well situated to connect with the other parts of Asia and Middle East, as well as the South Pacific where Australia and New Zealand are located. The problem is that we have gaps in the development of ASEAN member countries; quite significant gaps in some cases. We are slow in moving our respective domestic reform to change our structures and the way we do business in our member countries, and then there is not enough knowledge about ASEAN and what the AEC can do for business sector.

Figure 7.1.1

Figure 7.1.2

The two lower bullet points about the ageing population as well as weaker institutional capacity require us to do more in various initiatives beyond just the economic arena, and we can talk about it in another context later on. The one point that people always talk about when discussing inclusive growth and inclusivity is that we forget that actually there has been a significant achievement, namely in the growing middle class. Today in ASEAN, there is a growing middle class; no matter how you number it, 5,000 dollars per year, 8,000 dollars per year, 11,000 dollars per year or 25,000 dollars per year in household income, there is a middle class that is growing.

Figure 7.1.3

Figure 7.1.4

Figure 7.1.5

The challenges going forward are all here. The most important thing is that we need the political will, and also to bring our ASEAN institutions deeper down in to our respective ASEAN societies. At the end of 2015, the AEC is supposed to be in place and the AEC is supposed to be up and running. What will happen on 1st January 2016? We go home, rest and declare victory? It is my contention that these things are happening but more importantly we cannot officially finish everything, we have to continue on the agreed plans and initiative so that we can bring more and more of the so-called slow moving sectors into the AEC.

Figure 7.1.6

Mr. Chairman, let me make a few quick points and then I will conclude. There are five points I wish to put across; the fundamental point about having inclusive growth is that we must have the resources to develop our respective economies and our countries and societies; if we don't have resources, how can we be standing here talking about inclusive growth? The key point number two, having more economic growth is to have more prosperity and progress. The third strategic point is how to do we attract more foreign investment and more growth in ASEAN? We want a bigger space in the economic development on an international stage. How do we get there? The fourth point, people forget that outside of ASEAN things are happening and not happening; for example, we talk about the new normal but the WTO is moving very slowly. We had one Uruguay Round then after that the Doha Round, but nothing has come out of it yet. Although some technical achievements have been accomplished in the WTO context. What ASEAN is trying to do is to keep the ball rolling, we may be accused of having a lot of visions and talk shops, but the fact is that we have to keep hope and keep showing that there can be the possibility of growing the economy in ASEAN. If you grow the economy, you will have more resources, you can develop your social sector, and ensure more equitable distribution of wealth across the region. This is SINCPEC and PECC joint venture with the PPECC and we are talking about achieving inclusive economic growth in the new normal. If the Philippines had not grown economically by more than 6% in the last five years, how can we talk about inclusive growth? So do not forget that the fundamental point is that whatever we say here and discuss here about inclusivity, we need to have more resources and to have more resources means we have to find ways to attract investment and job opportunities to ASEAN. How do we do this in a situation where there is so much competition out here? China, India, Latin America, you just heard now what Mario said about how Latin America is the smartphone paradise on earth, what do we do? ASEAN leadership is silent, let talk about the AEC and about economic integration and so forth. The unfortunate thing in my opinion is that while they are doing this, they have not yet moved beyond the elite bureaucratic level, to try to ‘ra-ra’ the people in our respective countries to rally and support this idea of the AEC and to get better systematic benefit out of this concept.

Figure 7.1.7

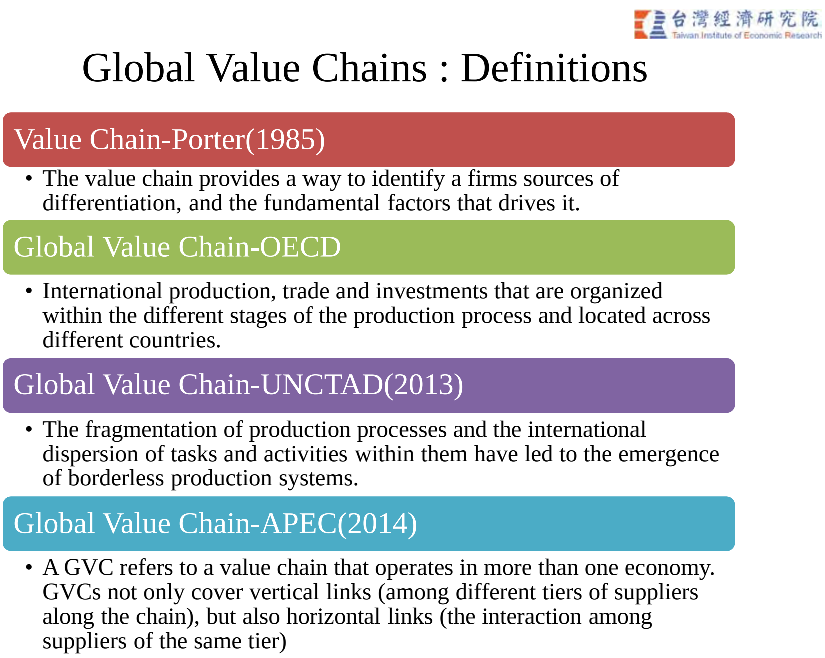
Moving forward, the main thing really is that there will be inclusivity if ASEAN member countries can exert political will and shape up their respective domestic agendas. We have all these big things at the regional level, but at the respective country level we are not yet doing enough. We need to fix certain things in our respective countries. The good news is that Myanmar is moving towards a minimum wage law; in the case of Singapore, fortunately we have some resources so we are now looking at social services to help the aged and lower income families. Hopefully, we can see more initiatives across ASEAN member countries to reduce the dependence on cheap labor and go for more high productivity activities. Hopefully we can, as you heard just now, do more in infrastructure development and other kinds of social safety nets for the other vulnerable sectors of our societies. As you have also heard earlier today on the development of SMEs and the need for us to grow SMEs, I think this is an area that ASEAN can do more, we have many plans but unfortunately, implementation is slow and not systematic and so we are not getting the desired outcome. That doesn't mean that ASEAN as a whole is not paying enough attention to inclusive growth, we have all these in our own vision plans.

Looking ahead, there are two things we have to do; one, ASEAN member countries have to exert more political will to achieve what has already been agreed and laid down; and two, much more targeted engagement of specific stakeholders involved in each of the sectors in the respective arenas should be undertaken. Thank you Mr. Chairman.

Dr. David Hong:

Thank you Ambassador Tang and thank you SINCPEC for allowing me the chance to speak on important issues about GVC, and especially the SMEs, and how they are related. Before I start, I think we all agree on the concept of so called GVC, which actually has many dimensions. For example, Porter indicated value chains providers were to identify a firm's source of differentiation and the fundamental factors that drive it. The OECD idea of GVC is the nature of production of trade and investment that are organized within the different stage of production process and are located across different countries. The United Nations Conference on Trade and Development (UNCTAD) defines GVC as global fragmentation of production processes and international dispersion of tasks and activities within them lead to an emergence of a borderless production systems. Last year at APEC 2014, they referred to GVC as a value chain that operates in more than one country; GVC not only covers vertical links among tiers of suppliers on the chain but also horizontal link interactions among suppliers of market tiers. I would like to touch upon a few areas: GVC in APEC economies, the effect and examples of GVC, and the role of SMEs in GVC, and a few remarks after that.

Figure 7.2.1



GVC and the APEC economies, there exists a great divergence about the value added ratio of exports by each economy. Bigger economies with larger supply chains enjoy a higher ratio effect. The whole world value added exports are equal to about 70-75% of the gross exports today, down from about 85% in the 1970s and 1980s. While ranging in value added terms, the manufacturing sector trade is relatively smaller and the service trade is relatively larger. Let's compare among the different sectors. About the GVC evolution, the value added share of the small open economies is lower than the bigger economies; for example, Chinese Taipei 58.48% in 2009, Singapore is 50.08%, and Korea is 59.36%. By participating in the GVC, small economies can also enjoy the higher economic growth. Japan and the US have a high global value added share of exports, which means both economies leave more value to themselves than other economies.

. Let's look at some examples. Here I use airport suppliers in 2014. This is a study by a Japanese institute in 2014, which says that about 792 factories with locations identified, among them 349 or 44% of them are located in China. Large part of the value would be added at the headquarters, in terms of headquarters, shares of Japan and Chinese Taipei are relatively high. Factor level comparison underestimates the other economies' competitiveness, especially in regards to Chinese Taipei. Looking at GVC is to examine the concept of market share. The market share of the key economies in the chain of imports, since most of the global supply chains moved to China, the market share in China's imports for one economy could be proxy by the extent of participation in GVC. Chinese Taipei and Japan have many connections in the China market since 2008, and on the contrary, Korea's market share has kept growing, up to 9.38% in 2013

Figure 7.2.2

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Global value chains and the APEC Economies

There exists great divergence about value-added ratios of export by each country. Bigger countries with larger supply chains enjoy higher ratio.

Unit : $ Million USD

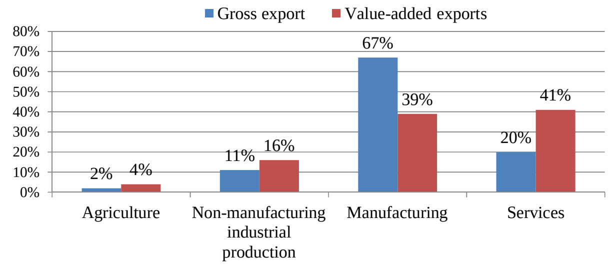
Economies	Gross export	VA in Gross export	VA/Export ratio
EU27	2,228,065	1,924,502	86.38%
United States	1,458,183	1,293,570	88.71%
China	1,283,964	864,984	67.37%
Germany	1,159,444	850,566	73.36%
Rest of the World	967,022	838,841	86.74%
Japan	618,022	526,587	85.21%
France	584,015	439,480	75.25%
United Kingdom	559,729	462,846	82.69%
Italy	499,540	399,220	79.92%
Korea	401,162	238,123	59.36%
Canada	367,569	295,733	80.46%
Netherlands	363,330	232,870	64.09%
Russian Federation	331,375	308,530	93.11%
Spain	312,612	247,803	79.27%
India	255,032	199,121	78.08%
Belgium	253,648	164,794	64.97%
Switzerland	243,842	174,423	71.53%
Mexico	231,899	161,572	69.67%
Taiwan	225,657	131,964	58.48%
Singapore	212,449	106,401	50.08%

Source : OECD, Trade in Value-Added(TiVA) Database. 3

Figure 7.2.3

Facts about Value-Added Ratios of Exports

- World value-added exports are equal to about 70–75 percent of gross exports today, down from about 85 percent in the 1970s and 1980s
- When measured in value-added terms. manufacturing trade is relatively smaller, and services trade relatively larger
- Across countries, value-added exports range from 50 to 90 percent of the value of gross exports.
- Gaps between bilateral value-added and gross exports are large and heterogeneous across trade partners.
- Changes in value-added relative to gross exports have been heterogeneous across countries and bilateral trade partners.



Source : Robert C. Johnson(2014), Five Facts about Value-Added Exports and Implications for Macroeconomics and Trade Research, Journal of Economic Perspectives.

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Let’s look at this issue from another point of view that is the intermediate input share of a product market, so that means the GVC evolution of the industries. Taiwan and Japan both had a recession in the intermediate input market share of value chains in the machinery industry, electrical industry, and equipment industry. Intermediate input in chains electrical and optical equipment industries have slightly increased, while the shares of Chinese Taipei and Japan have decreased. Nonetheless, Chinese Taipei is still the key intermediate goods supplier of ICT industry in China.

Figure 7.2.4

The market share of the key countries in China's import

- ✓ Since most of the global supply chains move to China, the market share in China's import for one country could be a proxy to measure its participation extents of GVC.
- ✓ Taiwan and Japan have many tough year in the China market since 2008. On the contrary, Korea's market share keeps growing, 9.38% in 2013.

Countries	2008	2009	2010	2011	2012	2013	Performances
Taiwan	9.12%	8.52%	8.29%	7.18%	7.27%	8.03%	Growth after recession
Korea	9.90%	10.16%	9.89%	9.29%	9.17%	9.38%	Stable
Japan	13.30%	13.00%	12.63%	11.17%	9.77%	8.31%	Lower and lower
Hong Kong	1.14%	0.82%	0.68%	0.60%	0.60%	0.44%	Stable
Singapore	1.78%	1.76%	1.76%	1.60%	1.56%	1.54%	Lower and lower
Malaysia	2.83%	3.21%	3.61%	3.57%	3.21%	3.08%	Increasing
Thailand	2.26%	2.48%	2.38%	2.24%	2.12%	1.95%	Slightly lower
Indonesia	1.27%	1.36%	1.49%	1.80%	1.76%	1.61%	Incresing
Vietnam	0.38%	0.47%	0.50%	0.64%	0.89%	0.87%	Higher and higher
Germany	4.93%	5.54%	5.33%	5.33%	5.06%	4.83%	Recession after growth
U.S.A.	7.19%	7.70%	7.26%	6.79%	7.03%	7.48%	increasing

Source : TIER, Customs Databases.

Figure 7.2.5

The evolution of GVC in the world

- The value added share of the small open economies are lower than big countries. For example, Taiwan is 58.48%, Singapore is 50.08%, and Korea is 59.36%. By participating the GVC, small countries can also enjoy the higher growth.
- Japan and USA keep high value added share of gross exports, which means both countries leave more value to themselves than other countries.

Total domestic value added share of gross exports.

Countries＼Year	1995	2000	2005	2008	2009
Taiwan	64.16	64.63	57.76	52.24	58.48
China	88.13	81.19	63.61	66.73	67.37
Japan	93.15	90.09	86.25	80.65	85.21
Korea	76.29	67.07	62.28	56.58	59.36
Singapore	53.3	49.28	47.65	46.9	50.08
USA	91.64	91.12	88.88	85.39	88.71
Germany	81.31	75.6	74.39	72.19	73.36

Source : OECD, Trade in Value-Added(TiVA) Database.

Figure 7.2.6

The GVC evolution of the industries

- ✓ Taiwan and Japan both have recession in the intermediate input share of China's machinery industry and electrical and optical equipment.
- ✓ The intermediate input from Korea in China's electrical and optical equipment have slightly increased, while the share of Taiwan and Japan have decreased.
- ✓ Even though, Taiwan is still the key intermediate goods supplier of ICT industries in China.

China's intermediate input from JKT : Machinery

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	
Japan	2.06%	2.19%	3.42%	2.94%	2.61%	2.22%	1.45%	1.18%	1.34%	1.72%	16% ↓
Korea	0.93%	1.19%	1.69%	1.56%	1.43%	1.25%	1.01%	0.96%	1.05%	0.93%	
Taiwan	1.28%	1.32%	1.72%	1.58%	1.30%	1.10%	0.67%	0.55%	0.61%	0.73%	44% ↓

China's intermediate input from JKT : Electrical and Optical Equipment.

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	
Japan	3.76%	4.35%	4.75%	4.11%	3.46%	3.13%	2.55%	1.99%	2.06%	1.89%	50% ↓
Korea	2.15%	2.75%	3.49%	3.73%	3.10%	2.86%	2.55%	2.29%	2.63%	2.23%	3.7% ↑
Taiwan	4.46%	5.27%	6.34%	6.33%	5.50%	5.00%	3.98%	3.56%	3.95%	3.53%	20% ↓

Source : European Commission, World Input Output Database.

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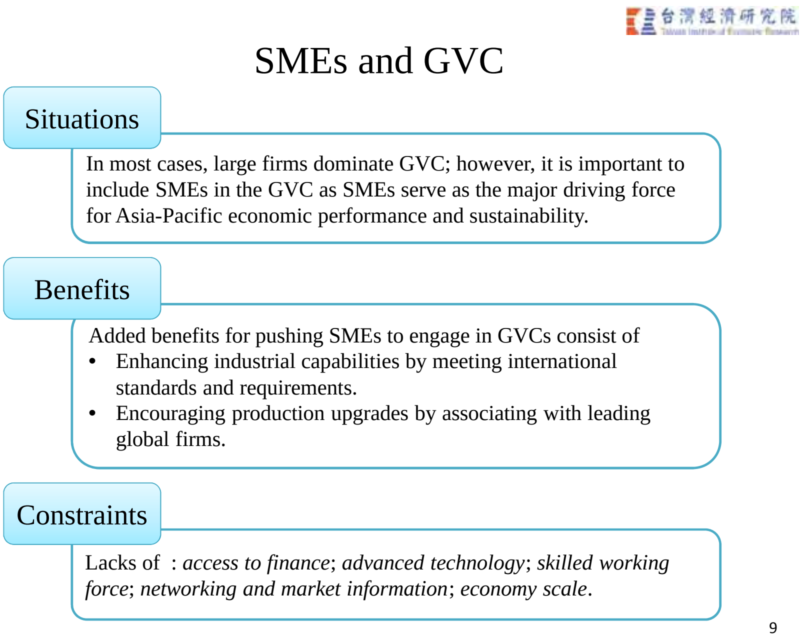
Let's look at the issue of SME and GVC, and the role of SMEs in the GVC. In most cases, the theory is large firms dominate GVC, however it is important to include SMEs in the GVC. SMEs serve as a major driving force for Asia-Pacific economic growth and stability. What the benefit for aiding SMEs in engaging in GVC consists of enhancing industrial capabilities by meeting international standards and requirements; encouraging production upgrade by associating with leading global firms. However, on the other side of the token, the constraint is the lack of access to finance, advanced technology, skilled working forces, networking and market information, and economies of scale for SMEs. It is important to promote SMEs to join the GVC for the previous discussion.

Figure 7.2.7



Chinese Taipei, as I will use as an example here, has identified five key operational measures to help advance its SMEs; for example, creating healthy environment for nurturing SMEs, strengthen SMEs management and guidance functions, building a platform for enterprise start-ups and incubation, enhancing ICT capability of SMEs, integrating the SME financing mechanism, those operational measures aim at addressing the constraints facing SMEs. Therefore, the policies also seek to help SMEs engage in cross-border production networks, which is a critical move for SMEs to join the GVC. According to the OCED GVC participation index measure, which calculates the extent each country exports connect with others; Chinese Taipei is about 71%, top among the Asia-Pacific economies. In contrast to Korea, dominated by big firms, and Japan with industrial keiretsus - there are few globally famous firms and brands in Chinese Taipei. The SME sector is strong in Chinese Taipei and makes it one of the industrial powerhouses in the world. The proportion of SME by firm number is 98% about 30% by domestic sales in Chinese Taipei, and export contribution by SMEs is about 30% in 1980, which grew to 50% in 2014, but there are still tons of challenges facing SME in joining GVC even for Chinese Taipei SMEs.

Figure 7.2.8

Promote SMEs to join GVC

- Chinese Taipei has identified 5 key operational areas to help advance its SMEs
  - *Creating a healthy environment for nurturing SMEs*
  - *Strengthening the SMEs management guidance function*
  - *Building a platform for enterprise start-up and incubation*
  - *Enhancing information technology capabilities of SMEs*
  - *Integrating the SMEs financing mechanism*.
- These operational areas aim at addressing the constraints facing SMEs, therefore the policies also help SMEs to engage in cross-border production networks, a critical move for SMEs to join GVC.
- According to the OECD "GVC Participation Index", which was calculated based on the extent of each economy's export production connected with others, Chinese Taipei is about 71%, top among the Asia-Pacific economies.

Figure 7.2.9

SMEs' contributions in GVC for Taiwan

- In contrast to Korea with dominant big firms and Japan with vertical industrial Keiretsu, there are few globally famous firms and brands in Taiwan. However, SMEs sectors are strong in Taiwan and make Taiwan a hidden industrial powerhouse in the World.(WEF 2012)
- The proportion of SME by firm number is 98%, and 29.44% by domestic sales value in Taiwan.
- The export contributed by SMEs is 30% in 1980s, while it lowered to 14.48% in 2014. That is , it is also full of challenges for SMEs to participate in GVC even for Taiwanese SMEs.

Year	2007	2008	2009	2010	2011	2012	2013
Number of firms	1,237,270	1,234,749	1,232,025	1,247,998	1,279,784	1,306,729	1,331,182
proportion(%)	97.63	97.7	97.91	97.68	97.63	97.67	97.64
Domestic sales value (million TWD)	10,481,910	10,462,696	9,189,463	10,709,005	11,226,933	11,381,770	11,321,842
proportion(%)	28.34	29.69	30.65	29.55	29.64	30.23	29.44
Export Value (million TWD)	1,638,927	1,644,707	1,316,352	1,620,033	1,649,985	1,748,080	1,424,225
proportion(%)	17.06	17.36	16.87	16.16	16.29	17.74	14.48

Source：White Papers of SMEs in Taiwan, 2013, 2014。

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For SMEs in developing economies, they face more difficulties in being part of the GVC; on quality financial services and geographic location are critical factors for the food processing and automobile industry. For SMEs in developed and newly industrialized economies, most of the key factors to participate in GVC are satisfied except the product price.

Figure 7.2.10

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Potential for SMEs to participate in GVC for APEC economies

- For SMEs in developing economies, they face more difficulties to be part of the GVC when product quality, financial soundness, and geographic location are critical factors, such as food processing and automobiles.
- For SMEs in developed and newly-industrialized economies, most of the key factors to participate in electronics GVC are satisfied, except the product price.

Key factors	SMEs in developed and newly-industrialized economies			SMEs in developing economies		
	Food processing	automobiles	Electronics	Food processing	automobiles	Electronics
Product quality	v	v	v	x	v	v
Product price	x	x	x	v	v	v
Product delivery	v	v	v	x	v	v
Financial soundness	v	x	v	x	x	v
Production capacity	v	v	v	v	x	v
Flexibility	x	x	v	v	x	v
Geographic location	x	v	v	x	x	x
ICT level of business operation	v	v	v	x	v	v
Talent and innovative capacity	v	v	x	v	v	x

Source : APEC Policy Support Unit(2014), " Integrating SMEs into Global Value Chains: Policy Principles and Best Practices ".

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To conclude, the evolution of GVC in price globalization is unbundling. The production stage previous performs in close proximity will disperse geographically. Traditionally in the cases of globalisation by trade varied by each country and maybe was misleading because that export are double counted for one country to another, to trace the domestic value added of the exports can be the better measure. Higher valued exports are associated with higher growth rate, part of which comes with participating in GVC. The SMEs with unique needs in different stages of manufacturing or different tasks of services could be the driving force for one country to participate more in GVC. Policy makers need to fully understand how GVC could be all linked with the domestic economy so as to help SMEs to help participate in GVC.

Figure 7.2.11

Concluding Remarks

- The evolution of GVC implies globalization's second unbundling : production stages previously performed in closed proximity were dispersed geographically(Baldwin, 2013)
- Traditional indicators of globalization by trade value of each country may be misleading, because the export value are double-counted from one country to another. To trace the domestic value-added from the export can be the better measures.
- Higher value-added exports are associated with higher growth rates , part of which come from participating in GVCs.(IMF, 2013)
- The SMEs with unique niche in different stages of manufacturing or different tasks of service could be the driving force for one country to participate more in GVCs.
- Policymakers need to fully understand how GVCs are or could be linked with the domestic economy, so as to help SMEs to participate in GVCs.(APEC 2014)

Professor Christopher Findlay:

Thank you to the hosts for the invitation to join you today. There is, I'll put it to you ladies and gentlemen, very strong evidence of increasing participation by Asian economies in GVC. Using the measure that David referred to, the OECD's participation rate, which looks at the extent which output from one location goes into a production process downstream or the extent to which that location procures inputs which goes into its own production. That participation rate over the period from 1995 to late last decade showed universally an increase in participation in value chains. Businesses in our region are doing things differently, and they're doing things that refer to goods but I think the same processes are happening in the services sector as well, and I think that's why the case studies are revealing. So businesses are doing things differently, but there are questions about the consequences of this significant change for the inclusive nature of growth.

I will spend a few minutes on each of the following; the implications for the lesser skilled worker compared to the high skilled worker; the implications for small firms compared to large firms; and the choice or opportunity to move from low value added activity to high value added activity. I am going to argue to you that the responses to those issues are going to demand us to take a new way of doing things.

First, the question of the lesser skilled compared to the high skilled. It’s a really interesting phenomenon that generally, we see that in the value chains in manufacturing that takes place within value chains, the share of value added that's attributed to high skilled labor has increased. It’s increased in the high-income economies as you would expect, but it’s increased in other economies at earlier stages of economic development as well. It’s almost a universal phenomenon, that if you take the chain data and check out how the value of output is distributed, more of it is going to high skilled workers; this was contrary to expectations. What was thought was going to happen was, you think about the production process as a tasks some higher than others that high skilled tasks would remain in the high income countries that other tasks would relocate to a lower wage country, and in those countries the lower skilled labor would become busier and receive a larger share of the income and benefit in the process. What we are seeing instead is the high skilled labor, both in high-income countries and emerging economies where the demand seems to be growing. This is a really hot topic in the empirical trade research community, and there is a variety of explanations for this phenomenon. It is a worry because the people we might be relatively more interested, the people with lower skill levels, are not necessarily the ones who are capturing significant benefits from its relocation of activity.

One explanation is that what is happening is that the tasks that are being transferred out of the high income economies are those that are undertaken by those you would call mid-skilled workers, and that their tasks require a level of skill but still relatively routine, and they’re the ones who can actually be substituted for by capital, which embodies a degree of digital technology. At the same time, that sort of capital complements high-skilled workers because they have the capacity to work with that technology. As the tasks are relocated, mid-skilled workers are not being required, capital is being invested and higher-skilled workers are becoming more productive and that might contribute to the distribution of the value of the output that we see. The lower-skilled workers are not involved in this process actually, there out somewhere else in the service sector doing manual tasks, which can’t be substituted for by capital, which involve some personal interaction. They are not part of this GVC story at all, but nor do their wages rise as a result of the relocation. It’s that middle skilled group that might be missing out in this process.

How can we respond to this? One, within the framework of itself is to think about how the skill levels of those mid-skilled people can be increased and that's the story of human capital strategy developing the right training systems that deliver the skills that are required and that's the story and a whole bunch of recommendations on what can be done on that front. Another interesting observation about this phenomenon is that we might be getting over anxious about something because we're looking within the value chain process and the manufacturing process itself, and a further suggestion is that we look more widely and think about well there's more valuing adding activity going on in different locations but there's a whole lot of things that have to be done to join them together; in other words, there's an increasing demand for services which link those value adding activities and that's where a lot of jobs are also being created as a result of the relocation of tasks. So one further message is that don't forget those services when you're think about inclusiveness because that's where the mid skilled people might be going if they're being displaced from manufacturing. There is hand-waving anxiety about the climate of manufacturing but what's really happening is a relocation of tasks within the economy. The policy implications of that seems to me to be make sure that there are no impediments to investment in those service sectors that support the value chain process.

David talked about the issues related to SMEs and their participation in value chains, and I won't reiterate that. Another issue that people are concerned about is the scope for upgrading economies into these value chains at a point of low value added in terms of say a assembly process, and their ambition is to move beyond that to some point where they can capture more value, but the risk is that they are going to get stuck at that entry point or languish there and they're looking for options for upgrading. More than just upgrading in the sense that they'll be able to use a more sophisticated production process, but the big benefits according from the research come from completely moving into a new chain or moving to a different functional point in a chain, and that's quite a significant shift. It seems to me that the same framework is relevant for thinking about the issues of SME participation and also upgrading, at least let me make that argument today.

The case studies of successful upgrading suggest that all the things David was talking about are important; the productive capacity, the human capital, the standards, the systems of innovation, the infrastructure, the business environment, and the nature of coordination and cooperation within industries, these are the sorts of things you see on a list.

What also matters, and let me finish with this, is trade and investment policy. If you think about the nature of the value chain process involving the movement of outputs of these value adding activities between countries and what's involved; policy on the movement of goods will be involved; policy on services is going to be involved; these chains are often organized by FDI, so policy on FDI is going to be involved. When we talk about goods policy is not just about tariffs, it's also non-tariff barriers (NTB), it's also about the predictability of policy, a lot of intellectual property (IP) around the world and the construction of these chains, the IP regime matters; standards are important; trade facilitation matters because things move across borders, it's a big list. What it points to if we're going tackle these issues is an integrated approach to these policies is important.

When you heard conversations with colleagues in the last 24 hours here, it seems to me that the implications of this integrated approach is really quite significant. Dr. Mari Pangestu pointed out this morning that if you think about packages of policy measures there are a lot of domestic institutions that are involved in resolving those issues and the difficulty of that kind of coordination. Also if you think about trade agreements, they don't generally approach it in that integrated way and when we talked this morning about the value of an integrated approach to trade and services policies; will the standard approach to negotiating a FTA give you that cross-cutting outcome, which is so important for resolving these issues. Discrimination in FTA, that's not going to help you at all in dealing with these questions; so discriminatory arrangements drives sets of ROOs, which adds to the costs of moving things around. Discriminatory arrangements are not good at dealing with NTBs. Formal agreements with limited membership won't allow for the natural evolution of chains and the arrival of new entrants with ease. In fact the ADB recently concluded that GVC prospered despite the overlapping FTA's in Asia, not because of them.

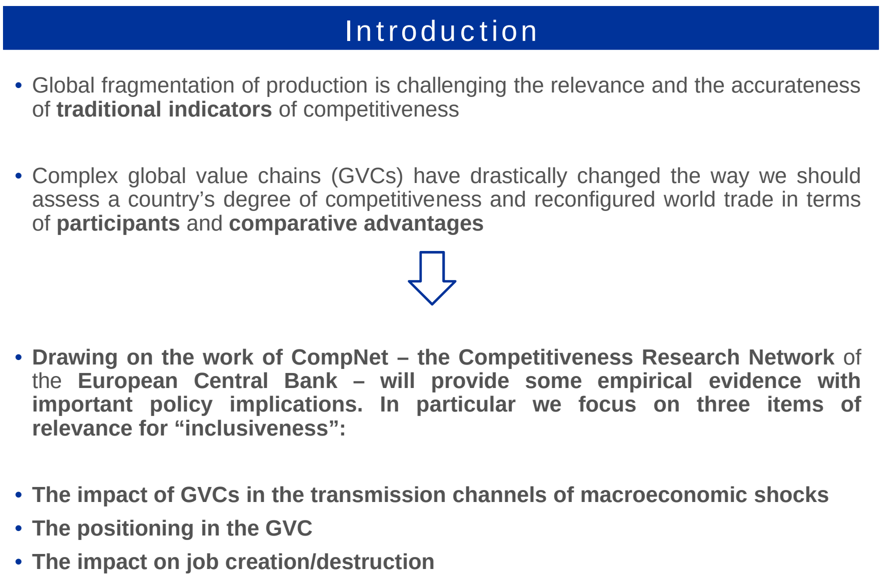
Chairman, I've argued that if we think about three aspects of inclusiveness; lesser skilled versus higher skilled; SMEs versus large firms; and the risk of languishing on a point of entry to low value added; the response to all those things require a more integrated way of thinking about policy, if we can do that and reflect the way that business is done and to do that will help deal with and make a contribution to the resolution of issues of inclusion. But that also raises some significant challenges for the way that things are normally done. There's no immediate solution to how we should do things differently, but I'm pretty sure the normal way of doing things isn't going to resolve those issues, and this I guess is a topic worthy of further attention and effort, and that's where the PECC can be make a significant contribution. Thank you.

Dr. Filippo di Mauro:

I am bit of an outsider here, so coming from Europe, which is by the way a fascinating conference and thank you very much to the organizers, I really learned a lot. Being an outsider, my apologies for the generic remarks. What I am going to do is take two perspectives, which maybe I can provide some value added; first is the European perspective, and second and parallel, the economic research perspectives coming from the research department of the ECB.

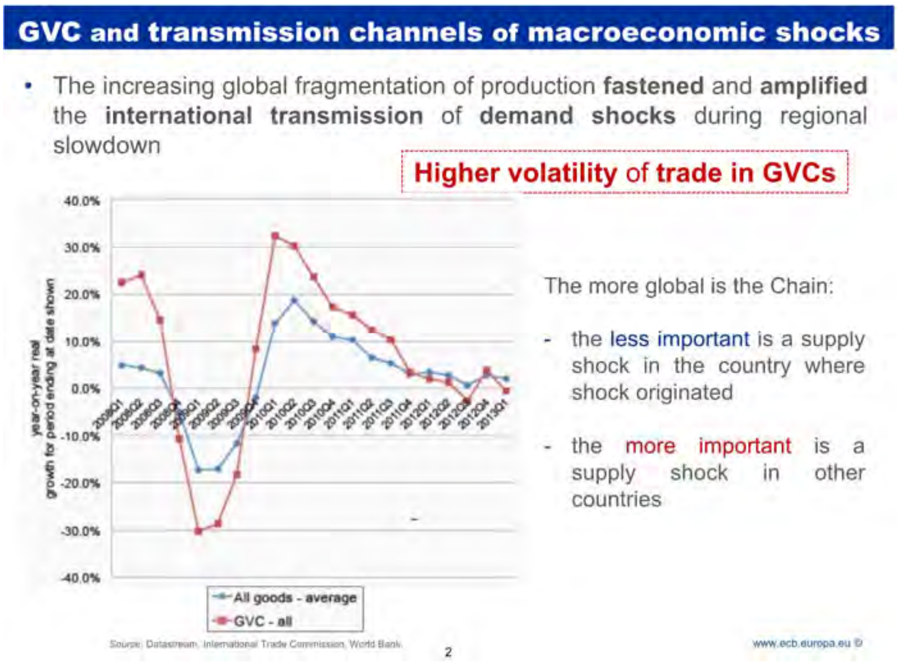
What I am going to do is to give this perspective in the context of product integration and inclusion; what is the issue here? Global fragmentation of production is basically challenging, as Professor Findlay already alluded to, the relevance of traditional indicators of competitiveness. There are complex value chains that have drastically changed the way we have been thinking about trade, negotiations, trade economics in general, and development policies. I will be drawing from the research that is done at the ECB in the context of the Competitiveness Research Network (COMPNET), and we particularly focus on three items, there are going to be three slides for the three take home messages; first, the empirical research on the impact of GVC on the traditional channels of macroeconomic shocks; second, the issue of positioning in the GVC; and third, the issue of the impact on job creation and destruction.

Figure 7.3.1



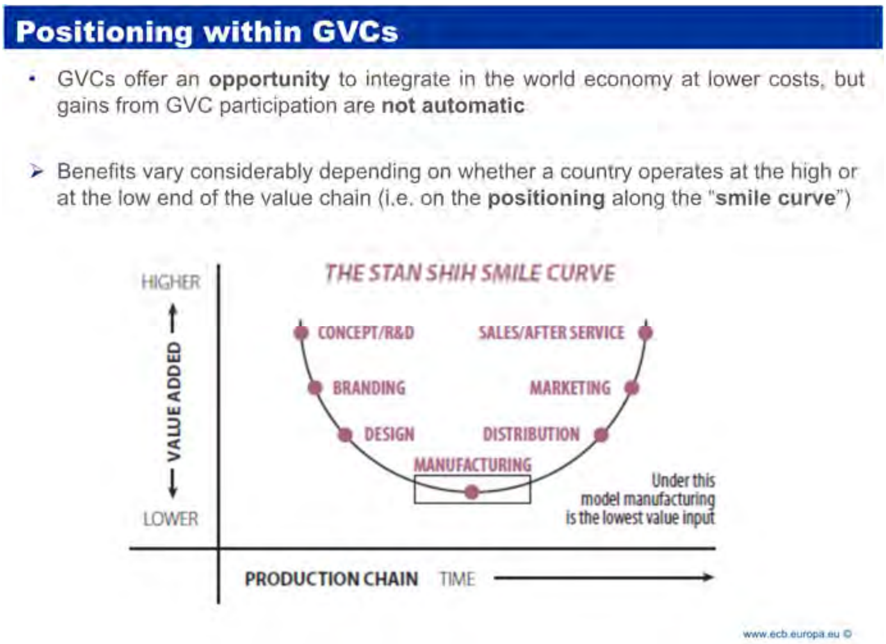
First message, the increasing global fragmentation of production is actually accelerated and amplified the international transmission of shocks. In the chart, you are actually seeing the comparison between trade development, the blue line, and the trade associated with GVC; you can see that around the crisis, trade collapsed in 2009-2010, that trade associated with GVC actually collapsed much stronger and the industry recovered much more strongly compared to the rest. What is the message here? The message is that in principal participation in GVC can be seen as a way of diversifying activities in being better in the global picture, but there is also risk, and that is that you are open to external shocks, you are more fragile. The message is that policy makers have to take into consideration of this trade-off between the advantage of being part of the GVC, and the risk is associated with the fact of fragility empirically being evidenced in the participation in GVC; that's the double sword.

Figure 7.3.2



Going into the second message, which I guess very many complements what Professor Findlay was just mentioning before; GVC offers an opportunity to integrate in the world economy at lower costs, but the gains on GVC participation, a part of that risk on macroeconomic shocks exposure is also not automatic, because again it depends where you are in the GVC. Here I remind you of one picture that you may have seen, which is the ‘smile curve.’ This is basically on the y-side, you see the value added, which is related to a certain process, and on the other side is the timing of the production line. What you can see is that value added is associated at the top in the upstream part of the production chain, so at the time at the creation of the product, and then also decreases over time as soon as you get into more machine manufacturing and low cost stuff; but then revamps again in the value added as soon as you get into the sale and after-services line. This is basically telling you that participation in GVC is fine but where are you located. Again, here taking a bit what of what Professor Findlay was saying, is the message that you want to get in a situation where you participate in the high value added part of the chain, and how you can do that is basically by through educational efforts; this is the way to go in order to grab the most benefits from participation.

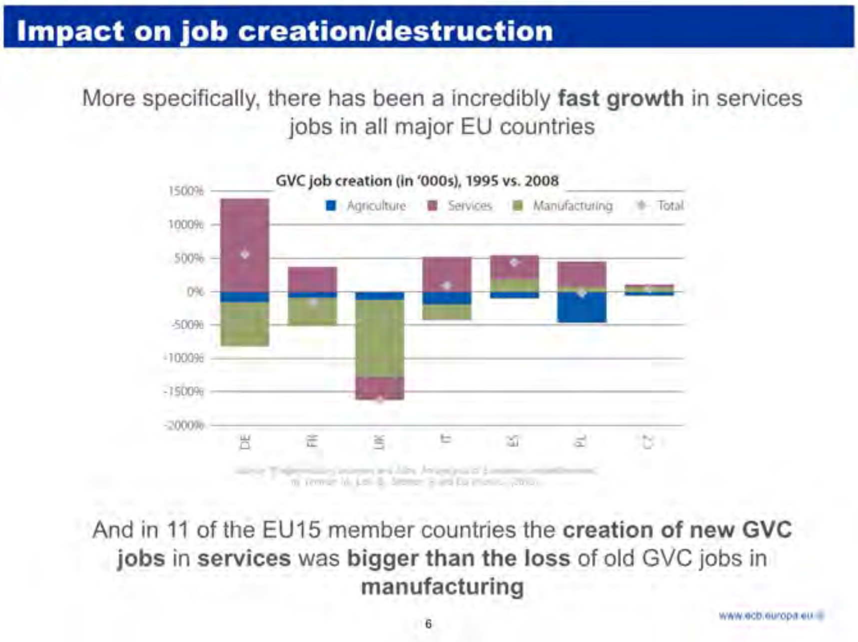
Figure 7.3.3



The second item is that of course you are better off in sort of being absorbent as possible, because as we know is that to be a good exporter you must be a good importer; so you want to make sure that in the regional area you are actually opening up and making sure that there is a facilitation, and not a temptation of actually substituting the import of domestic products, but rather the contrary, you want to be open to make sure to increase the competitiveness of the firms, including their ability and capacity to import more.

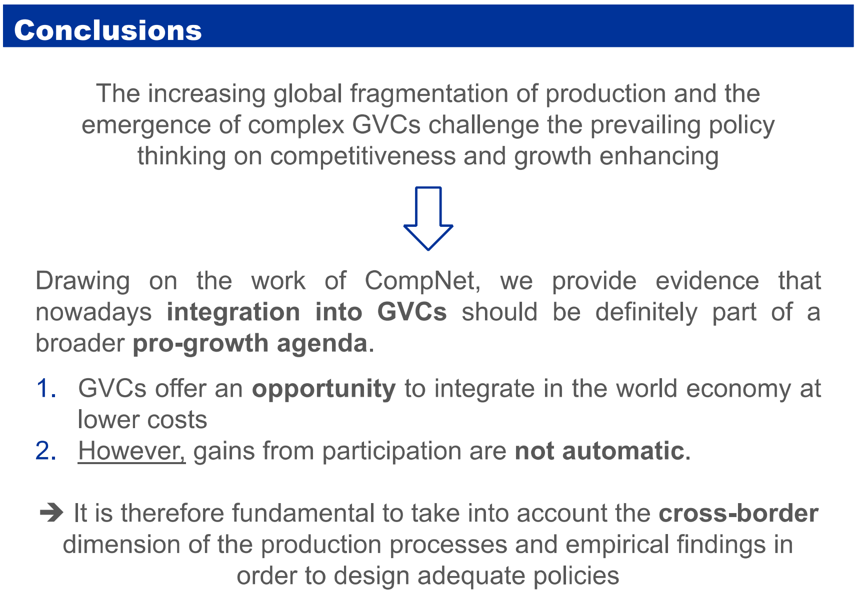
Final message is related to the issue, which is particularly relevant in Europe, is GVC participation is related to the fact that you will lose jobs; again here, we need to mention yet again to look at different kinds of statistics in order to access what is the impact on the jobs. What we have been developing in the COMPNET is a measure called GVC income and GVC labor. Basically, the creation of the structure of labor, which is internalized by participation in GVC, particularly that takes into consideration services, which is very important. The issue here and the lesson that we got from Europe is that in fact if we look at a more comprehensive version of job creation, which includes embedded services into manufacturing in general, these are the stars, between 1995 and 2008, actually you had a net increase in job creation associated with the GVC integration. Why was this so? Basically, services creation and job creation was in fact overcoming the negative impact that was taking place in manufacturing, this is not the case for the UK, which lost on both accounts, fortunately they're not part of the Euro-area.

Figure 7.3.4



Finally to conclude, I think what we have the increasing global fragmentation of production and the emergence of complex GVC challenge the prevailing policy thinking on competitiveness in general on growth enhancing. What I showed you are three examples of work taken out of the COMPNET, and we provide some evidence that nowadays, integration into GVC should be definitely part of the growth agenda. However, the participation of SMEs is not exempt from risk but is an opportunity, but as we know, is also a cost and a risk because of the larger exposure to shocks and also gains, recall the smile curve, are not automatic it depends upon where you are on the smile curve. Therefore, it is fundamental to take into account the cross-border dimension and/or production process, and what I found very relevant was what Dr. Pangestu was saying, the policy advise must be evidence based and I share that, so we should utilize this and other information which is empirically based to provide better and more accurate policy advise.

Figure 7.3.5



<u>Question and Answer Session</u>

Dr. Alan Bollard:

Thank you that was very interesting. Do GVC, question to Professor Findlay, principally or do they still apply when you have primary producing economies? Iron ore from Australia, dairy production from New Zealand, cooper from Chile, and plenty of other big primary producers in APEC; shouldn't we be taking lessons out of these?

Professor Christopher Findlay:

Yes, absolutely. I think it’s well worth looking across the range from agricultural products to manufacturing, my colleagues let me focus on agriculture as an example; I have colleagues who work on whether and how small holder farmers can have access to modern distribution systems and retailing systems, and I think it's the same framework. What do I have to do in order to have value adding stage in a chain from production to the retail outlet? All the issues that you hear about standards, consistency, delivery, and speed, all those issues apply. I think that there is a universal framework here, but the case studies I’ve seen suggest the relative importance of different issues and skills vary between the sectors, but the structure is worth applying across the sectors.

Dr. Tomoo Kikuchi:

I want to ask one question that nobody has asked today; in 2007, Joe Studwell from the Financial Times wrote a book on Asian godfathers and he illustrated how only 50 families in the region of 500 million dominate the wealth of this region. We are talking here about economic integration, and for me that means a bigger market, and the theory of economies of scale will tell you that the bigger players will get even bigger. My question is do we eventually need in Southeast Asia, or in the framework of ASEAN, anti-monopoly commission like the one that exists in Europe?

Ambassador Ong Keng Yong:

I believe that many of the ASEAN countries have already competition policy instituted; under the competition policy legislation there is a process of anti-monopoly or a kind of good governance against the rule of big companies and domination of companies in the market place. I believe that this is a healthy development. I recall one or two other countries with anti-monopoly laws in ASEAN. Perhaps in the coming years as the legislatures in the respective ASEAN member countries become more sensitive towards the developments in the market, more relevant legislation will be adopted. Thank you.

Dr. Deborah Elms:

I would just caution the panel and the folks in this room about using the smile curve to suggest value added because there are at least two problems from my perspective; one is that it says that manufacturing always has lower value added than other kinds of things, and that's not empirically true. We can find a lot of manufacturing sectors that are high value added. Second, the thing that I would point out about manufacturing is that a lot of our case studies now show that manufacturing value added also includes an awful lot of services. So even in manufactured products, we're finding that the services component can be 40-80% of the value of the manufactured product, so it reinforces what the panel suggested about the importance of services because a lot of the value in manufacturing is not just in manufacturing but also in the services associated with producing those kinds of goods.

Dr. Filippo di Mauro:

I agree with you, this was a simplification for a 30 second slide. The point was actually exactly what you were saying in the sense that regardless of where is the bottom line, if it is manufacturing or something else, the point was that there are different degrees in the time of production of value added; the policy advise was basically saying as much as possible try to make sure that you are in the upper part of the value added and therefore do investment in education and so on that can favor this. We are not disagreeing on that.

The second point on services is extremely relevant in what you're saying and let me take this opportunity to reiterate the point further. I think that we are using in the central banks and international institutions the wrong statistics as simple as that, because the services in trade, as you know, are basically the global trade in goods is 20-30% of global trade, and while we know that the embedded services, whatever is sold as manufacturing, is actually very much manufacturing plus services. So there are a lot of services, which is embedded in the manufacturing statistics, which in fact is something that we should target as you said because it is already value added. I think the message that we have is the same, so lets favor services, so to make sure that there is a 'serviceisation' of the economy because that is where the value added is and also try to make sure when we make policy advise we suggest that policy makers use at the very least complementary statistics in order to make up for obvious mistakes in the valuations.

Professor Christopher Findlay:

Just to follow on here, there is research to suggest that the services share of the value of a manufactured product is also related to the policy environment applying to services in that economy. If the services policy environment is more restrictive, the services share in the value of output will be smaller, in other words, there will be less contracting out and a smaller service sector, so there is a very powerful policy story to tell there.

Mr. Wang:

Nowadays it seems that GVCs are so popular; developed economies like GVC, developing economies seem to also embrace GVC, and all organizations CIC, OECD, UNCTAD, ADB, IMF, and The World Bank like GVC. Multinational corporations (MNC) like GVC and SMEs have their comparative advantage in GVC. My question is, is GVC a panacea to today's problems of world trade?

Professor Christopher Findlay:

No, they're not and that's what I was trying to say; that yes everyone loves GVC, they seem to be a very important phenomenon but my observation was that they are not automatically associated with an outcome, which you could describe as inclusive. There looks like there are some challenges in the labor, some challenges for small firms, and some challenges for upgrading, but we can understand what drives those outcomes. My proposition to you is that they are policy related, so GVC, as I put it to you, are more likely to produce a positive outcome in the context of good policy. The challenge then is how to get there and I think the traditional way of deriving policy and regional cooperation and formal trade agreements is probably out of the window in this environment. As APEC moves into thinking about a new regime, FTAAP, this would be a really good time to think hard about what is the constitution of a trade agreement, which makes sense in this context.

Conference Closing Remarks

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

Good evening, as the last person between dinner and drinks, I will be very brief. I think we've had a very rich discussion and debate on achieving inclusive economic growth in the new normal and we've attacked that issue from a great number of perspectives. I came away with two very simple takeaways; one, I am convinced there is no new normal given the technological advances that we've heard about today and the way the world will be developing as we go forward; and secondly, inclusive economic growth probably an even bigger public policy challenge to economic growth itself, and I think that the discussion we had today was very illustrative of that and the need for integration at the regional level and the national level and at the community level.

On behalf of my co-chairman Pak Jusuf Wanandi, I would like to very much thank all of the speakers who made very important contributions to this discussion. I must say that the issue of inclusive growth has been very much on the PECC agenda for some time and we are very pleased that is coming to the center of the APEC agenda in the Philippine year of hosting APEC, leaders and ministerial meetings, and in that regard, I am very appreciative of the very significant participation today from the Philippines. I think the day's discussion has been a vivid illustrative of the importance of the PECC process to APEC, and I think that's reciprocal presence and contribution of Dr. Alan Bollard, who is the Executive Director of the APEC Secretariat here today. Again, I would like to thank our host, in particular Dr Tan Khee Giap of SINCPEC and the Singapore government for their participation, and Eduardo Pedrosa and the PECC Secretariat here in Singapore for the organization of what I think is a very successful day. We've run over with an abundance of substance and it only remains for me to ask you to enjoy your dinner, and you're not through yet as we have a speaker for dinner as well. Thank you very much.

Distinguished Dinner Speaker

- **Professor Naoyuki Yoshino**, *Dean*, Asian Development Bank Institute

Moderator:

- **Dr. Charles E. Morrison**, *President*, East West Center

Dr. Charles E. Morrison:

We have a very distinguished dinner speaker and that may become the new normal. Professor Yoshino has had a distinguished career as an academic, government advisor, and now he is Dean at the Asian Development Bank Institute (ADBI), the think tank for the ADB serving our region. Of course, when I looked at this bio the thing that really leapt out at me was that like on of our earlier speakers, Dr. Narongchai, he had an outstanding education at John Hopkins University.

Professor Naoyuki Yoshino:

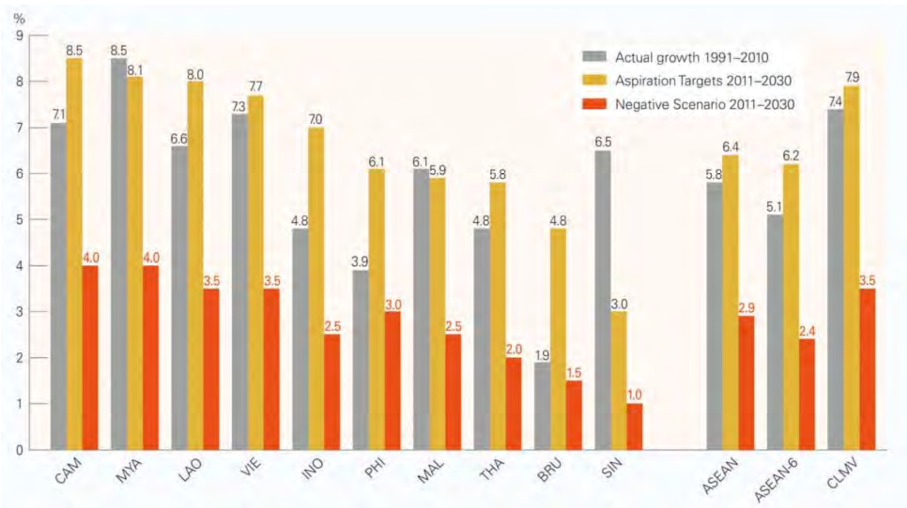
Thank you very much for having me and for allowing me to speak at the dinner. I've always believed that a dinner speech should be short, to the point, and not so serious, and I hope that you will enjoy my presentation.

There are three major topics that I would like to discuss with you today; one, how to create innovation from China's inside; second, how to provide good human capital development for the SMEs; and lastly, sustainable growth. Those are the three topics I'll be making a presentation on. I graduated from John Hopkins University along with Dr Narongchai, who was my senior. Unfortunately, I could not surpass him at all. He's a great entertainer, and my presentation is so serious. I have to apologize that my presentation is much more serious than his.

These are the prospects of various Asian countries; there are three lines, a red line, a yellow, and a white line. Don't look too carefully for each country because there are a lot of complaints about their economies on the prospect of ASEAN 2030. Among all of them if continuous growth will continue in 2050, the GDP of Asia will become 50% of the world. However, we need various conditions to achieve this kind of sustainable growth. Number one, maintain political and macroeconomic stability; second, support inclusive growth, and I think income inequality is essentially important in Asia countries, and tax policy will be very important. Tax policy should be two aspects, one for flow income, and the other for stock income. Japan has been a very equalized society because we have very high inheritance tax, so that has brought the rich people into the local level.

Figure 8.1.1

ASEAN GDP Growth to 2030: Aspirations vs. Negative Scenario
Actual 1001-2010 growth; aspiration targets and negative scenario for 2010-2030



Source: ASEAN 2030: Toward a Borderless Economic Community
Asian Development Bank Institute 2014

Figure 8.1.2

Conditions for Sustainable Growth

1 Maintain political and macroeconomic stability
Sound monetary & fiscal policy and exchange rate policy

2 Support inclusive growth (income equality)
Housing policy, Inheritance tax (but savings kept abroad)
Equalization --- TAX (inheritance tax) & Transfer

3 Strengthen Central–Local government relations
Fiscal sustainability; Local government bonds

4 Promote competitiveness and innovation
Financing facilities for venture business and SMEs
→ Hometown Investment Trust Funds
→ Banks -> difficult to lend start-up business

5 Protect the environment and ensure stable energy supply

6 Develop financial market
Financial Inclusion, financial regulation and financial education (access to finance)

7 Education and Healthcare
Good public school → Equal education
quality of teachers

8 Enhance seamless connectivity
Infrastructure investment, free trade
→ Pension funds and Insurance → long term investment

9 Improve governance and transparency 4

Housing policy is another important issue for the middle-income class. Some countries introduce tax incentives for housing policy, like the US, but with tax policy, you have to have your own money, and then with tax reductions you can invest in your own home. Japanese housing policy is different, Japan has provided low interest loans to the middle-income class, and for the lower-income class the government provides low rental housing. So if you are in the lower-income level, you can stay in the government housing for 10-15 years and when your income increases, you can borrow money from the government financial institutions and you can own your own home. By survey, about 90% of the Japanese population view themselves in the middle-income class; so I think housing policy and tax policies are very important in many Asian countries.

Number three, the center versus local government relations. In China, I found out lots of local income revenue comes from property tax or land-related tax, and that means it's very good for the local government if the price of property keeps rising; income tax and corporate tax in the local setting is very small because they are hiding it in their pocket. Because no one can hide, the property tax becomes affluent. So I think the relationship between the local and central government will be very important.

Number four, to promote competitiveness and innovation. Many Asian countries are dominated by the banking sector, and banks are very much reluctant to make loans to start-up businesses and innovative small businesses because of capital requirements in this region. Japan has started hometown investment trust funds about ten years ago, and they are providing money to start-up businesses and so on; the same thought now is applied to Cambodia, Vietnam and Peru. We can talk later about new methods to finance start-ups in businesses and innovative small businesses.

Number five, environment and stability. Number six is development of financial markets, and many people discussed this today with the discussion of financial inclusion, regulation and education. There are lot of issues and controversies about financial inclusion. Now, I am working together with the Myanmar government to utilize the post office as a channel to collect deposits and insurance. In Myanmar, only 20% of people hold bank accounts but post offices are located all over; so how to utilize those post office to collect deposits is one way in order to allow people access to finance.

Number seven, public education and health care will be very important, especially in many Asian countries. Income disparity is growing and I think the role of public schools is very important. Some countries are dominated by private schools, I came from a private university in Japan, but in public schools the tuition is much lower and everyone can go to those public schools. Unfortunately, the quality of teachers at public schools in many countries is not so high because of low salaries and so on. I think to establish a good public school system that anybody can have access to education will help deal with income equality. Number eight; we've discussed infrastructure investment and free trade. Number nine is to improve governance and transparency. If these nine conditions are satisfied Asia will keep on growing up until 2050.

The Asian character can be summarized into six points; one, bank dominated; two, the small share of the home market and the need for long term financing. Today we have discussed infrastructure investment but if each country relied too much on outside capital, that will possibly lead to the resurgence of the 1997 Asia financial crisis. We have to borrow money from outside but domestic savings have to be an insurance. Long-term investment comes from number three, pension funds and life insurance. Many Asian countries are facing an aging population, and good pension funds systems are now required, so that contribution of pension funds will become a very good source of finance for infrastructure. Number four, many Asian countries require a benchmark for the bond markets, and that comes from government bonds or sovereign bonds. Number five, high percentage of SMEs, which we discussed a lot today and I think it is difficult to borrow money from banks so they are going towards micro-credit and very high rates of interest that they have to pay. These figures show savings divided by GDP on the left hand side, and on the right hand side, investment divided by GDP; if Asian savings are circulated within Asia, we can finance almost all that investment, but unfortunately a lot of that money goes to US capital markets or European capital markets. We have to develop the domestic and Asian capital markets much more because the demands for infrastructure investment are huge in the Asia region.

Figure 8.1.3

Asian Financial Markets' Main Features

1. Bank-dominated financial system
2. Small share of bond markets --->
   Needs for long term financing
3. Lack of long-term investors such as
   pension funds and Life insurance
4, Bench mark bond market (sovereign bond)
   Infrastructure bond, corporate bond
5. High percentage of SMEs
6. Large share or Microcredit (finance
   companies); Lack of venture capital

Figure 8.1.4

Where do Asian savings go?

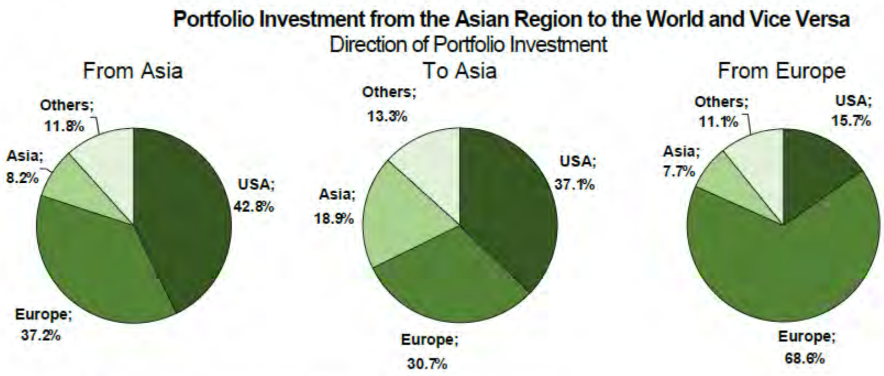
Savings and Investment Ratios in Asia

Economy	Savings/GDP Ratio (%)			Investment/GDP ratio (%)		
	2007	2010	2011	2007	2010	2011
PRC Mainland	51.9	53.4	53.8	41.7	48.2	48.7
Hong Kong, China	33.3	29.9	29.2	20.9	23.7	23.8
Indonesia	27.3	33.3	31.1	24.9	32.5	32.9
Japan	28.5	23.8	23.9	23.7	20.2	21.4
Republic of Korea	31.5	31.9	29.6	29.4	29.2	28.2
Malaysia	37.5	32.9	33.1	21.6	21.4	21.8
Philippines	22.1	24.8	22.3	16.9	20.5	20.5
Singapore	48.4	46.0	45.8	21.1	23.8	26.0
Thailand	32.8	30.6	30.4	26.4	25.9	25.6

Note: Savings rate = gross national saving/GDP; Investment rate = gross capital formation/GDP.
Source: IMF, *World Economic Outlook Database*.

Figure 8.1.5

Portfolio Investment Flows: To and From Asia (2011)



Source: IMF, Coordinated Portfolio Investment Survey (CIPS).

Next I would like to talk about SMEs, many people discussed SMEs. I have an equation Y_{SME}=A*F(N,K); Y is the output of SMEs, A is technological progress, N is labor and K is capital. Capital consists of ($K=K_p + K_g$), private capital and government infrastructure. As far as capital looks, K_p and K_g are concerned they require long-term capital for infrastructure and also financing for new developments and economies on K_p. On the labor market, Japan uses local government facilities, in small businesses they hire only one or two people, that is part of N, they don't have the training system; but large companies they hire 50-100 people every year, so they have a very good education system. The small businesses only hire one or two people every year, and the local government in Japan provides education for those local SMEs; many local SMEs come together to receive education. So I think of the role of the public sector in SME employee education is very important.

Figure 8.1.6

Analytical Framework for ASEAN SMEs

1. Human resource **development** **(Local government)**
   (skills, entrepreneurship, Public School, teachers)
2. **Financial market development (SME financing)**
3. Technology policy and R&D (**Hometown Trust**)
4. Marketing SMEs products and services
   (**market access, Use of Internet**)

$Y_{SME} = A \cdot F(N, K)$ *where* $(K = K_p + K_g)$

K_p = Banks, Bond Markets, Stock Markets, Own Capital

K_g = Infrastructure

Also Important

- *Business-enabling environment and entry barriers for new firms*
- *Presence of industrial clusters/production networks*
- *Networking and dissemination of information*

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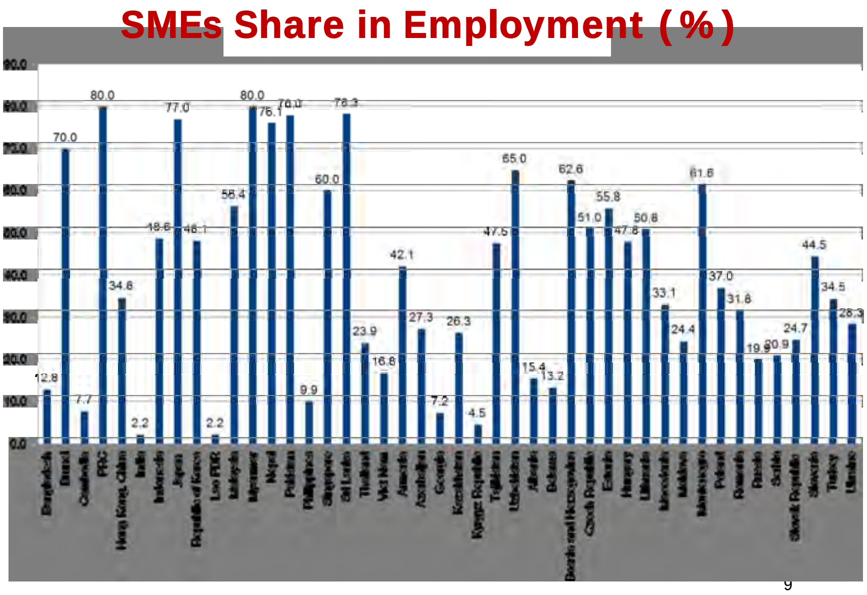
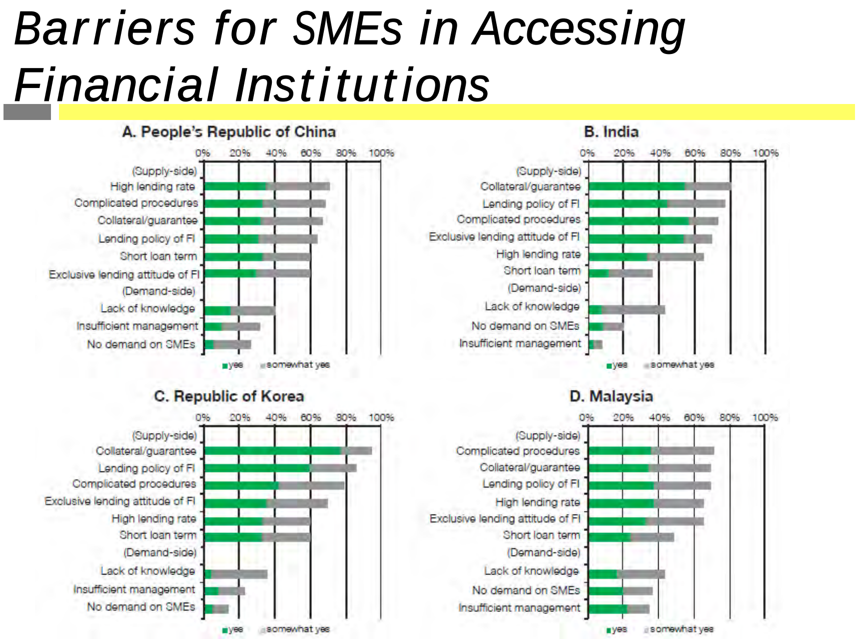
Figure 8.1.7



The next two figures talk about how large SME employment is, and what barriers SMEs face. These are the survey data from the Bank of China, India, Korea and Malaysia; many of them have a high rate of interest rate and when they want to borrow, collateral is needed and credit guarantees are very difficult to receive for SMEs. That is why SMEs always suffer so much;

in Japan there is a joke, SMEs have four accounts; one, to show the bankers; second account to show the tax authorities; third account is his own account; and fourth is to show to his wife. In Japan, SMEs accounting is not at all reliable and that is why banks always charge very high rates of interests, as academics say there is information asymmetries coming from these four bank accounts. This is a chart of small business versus large companies; if this line is above zero, it is easy to borrow money, and if the line is below zero it is very difficult to borrow money. As you can see almost all the time SMEs have difficultly, even large companies in 1998 during the financial crisis and in 2008 had difficulties, but almost all other times large companies have easy access to finance, while for SMEs it is always difficult.

Figure 8.1.8



Source: ADB–OECD study on enhancing financial accessibility for SMEs: Lessons from recent crises. Mandaluyong City, Philippines: Asian Development Bank, 2013

Figure 8.1.9

Four Accounts by SME

1, Account to show Bankers

2, Account to show tax authority

3, His own account

4, Account to show to his wife

Figure 8.1.10

Access to Finance by SMEs and Large Firms in Japan

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Despite that, we know there are many different SME databases, I tried to collected SME data from one Asian country, and today I would like to show the database from one country. There are 11 data from various SMEs, and the data comes from about 1,362 data. The central bank of this country has allowed me to use this database to analyze. This is the cluster analysis; you can see the three groups of SMEs are differentiated, group one, two and three. We can look at the principal component of what kind of variables differentiate these three groups, Z1, Z2, Z3 and Z4; Z1 component comes from sales, Z2 is assets, Z3 is liquidity and Z4 is total debt. These kinds of variables will differentiate one group from another. Then by the chart, the right hand side is very good SMEs and the left hand side is very risky SMEs, and in the middle are the inbetweens. This is, in a sense, a credit rating for SMEs; if the SME belongs to the right hand side then collateral is not needed, the banks can lend at a very low rate of interest. If they are coming from the blue area then they are in decline, and then they have to be careful on lending their money. From time to time the blue dot comes into the red dot, if the businesses do well, and sometimes the red dot comes into the blue, it depends year-to-year. Also in the same database in Thailand, I got the similar results, there are five groups of SMEs and this country has three groups, it depends on the database; however, we can keep collecting an SME database then it is possible to differentiate one group from another. This shows it is applicable for the credit rating even for SMEs.

Figure 8.1.11

Examined Variable

No.	Symbol	Definition	Category
1	Equity_TL	Equity (book value)/total liabilities	Leverage
2	TL_Tassets	Total liabilities/total assets	
3	Cash_Tassets	Cash/total assets	Liquidity
4	WoC_Tassets	Working capital/total assets	
5	Cash_Sales	Cash/net sales	
6	EBIT_Sales	Ebit/sales	Profitability
7	Rinc_Tassets	Retained earnings/total assets	
8	Ninc_Sales	Net income/sales	
9	EBIT_IE	Ebit/interest expenses	Coverage
10	AP_Sales	Account payable/sales	Activity
11	AR_TL	Account receivable/total liabilities	

Note: Retained earnings = the percentage of net earnings not paid out as dividends, but retained by the company to be reinvested in its core business or to pay debt. It is recorded under shareholders' equity in the balance sheet. Ebit = earnings before interest and taxes. Account payable = an accounting entry that represents an entity's obligation to pay off a short-term debt to its creditors. The accounts payable entry is found on a balance sheet under current liabilities. Account receivable = money owed by customers (individuals or corporations) to another entity in exchange for goods or services that have been delivered or used, but not yet paid for. Receivables usually come in the form of operating lines of credit and are usually due within a relatively short time period, ranging from a few days to a year.

Figure 8.1.12

Cluster analysis: the average linkage method

Dendogram Using Average Linkage

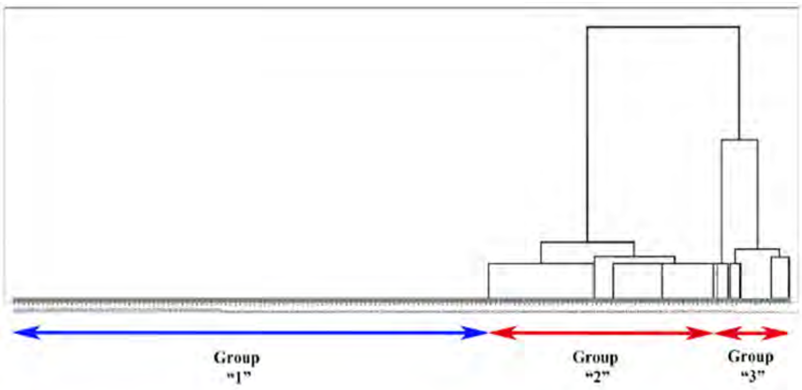

Figure 8.1.13

Factor Loadings of Financial Variables

Variables (Financial Ratios)	Component			
	Z1	Z2	Z3	Z4
Equity_TL	0.009	0.068	0.113	**0.705**
TL_Tassets	-0.032	**-0.878**	0.069	-0.034
Cash_Tassets	-0.034	-0.061	**0.811**	0.098
WoC_Tassets	-0.05	**0.762**	0.044	0.179
Cash_Sales	**-0.937**	0.021	0.083	0.009
EBIT_Sales	**0.962**	0.008	0.024	-0.004
Rinc_Tassets	0.014	**0.877**	0.015	-0.178
Ninc_Sales	**0.971**	-0.012	0.015	0.014
EBIT_IE	0.035	0.045	**0.766**	-0.098
AP_Sales	**-0.731**	-0.017	-0.037	-0.016
AR_TL	0.009	-0.041	-0.104	**0.725**

Note: The extraction method was principal component analysis, The rotation method was direct oblimin with Kaiser normalization.

(i) Sales Z1
(ii) Assets Z2
(iii) Liquidity (Cash) Z3
(iv) Total Debt Z4

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Figure 8.1.14

Grouping Based on Principal Component Analysis (Z1-Z2) and Cluster Analysis

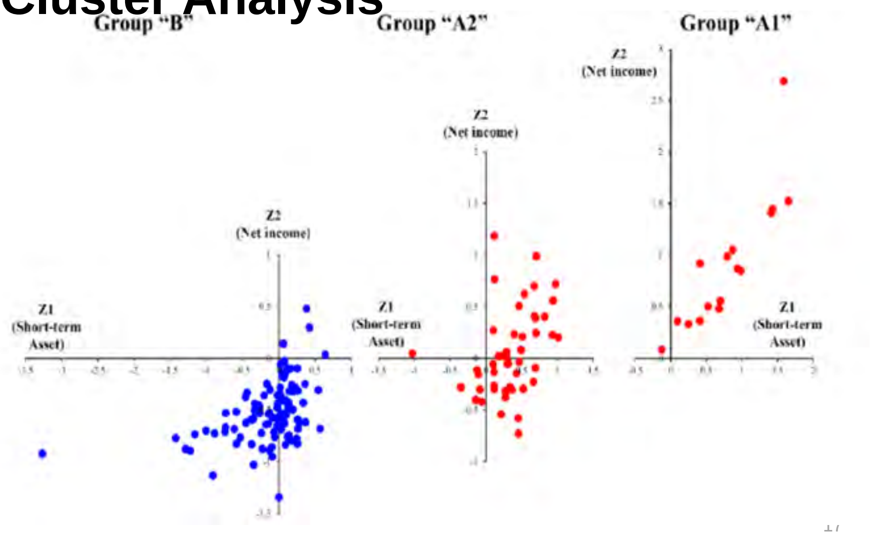

Figure 8.1.15

Credit Rating for SMEs and financial education by Use of SME Database

1, Credit Rating is only applicable to large companies

2, Credit Rating for SMEs based on SME Data

3, Three ranking of SMEs (Asian country)
Five ranking of SMEs (Japan's case)

4, Credit Guarantee ratio is determined

5, SME data can produce default risk ratio

6, Risk based Interest rate

7, Financial education for SMEs

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The next topic is how to finance and provide money to start-up businesses, and we call it the hometown investment trust funds. Many Asian countries are dominated by banking businesses, which are green, banks they have to follow capital requirements so they can lend money to large businesses and SMEs in the safer category, and they cannot lend money to start-up businesses or risky SMEs. In Asia, we have to have a start to financing; in Europe or the US, there are a lot of venture capital markets, but in Asian markets unfortunately, the Asian capital market are not as well developed.

What we started in Japan was the hometown investment trust funds and this is an example. These are the small businesses that started a shark fin soup, and the next one are agricultural farmers who are growing beans and wine. They can post these products on the Internet and many people who like wine started to invest in these agriculture farmers, and now the farmers have customers and they are providing between 100 to 300 USD to each project. At the same time, hometown investment trust funds apply to earthquakes and tsunami. As you can see, many fishermen lost their boats to the tsunami and earthquakes, and then many people started to help them by fixing their ships, and help them get back to fishing in order to repay the principal. These kinds of new hometown investment trust funds can be one way to help SMEs and start-up businesses. Since all of these are coming either through the larger banks, we can see the products on the Internet, and that can help the transparency; for example, if the wind is not enough then the rate of return becomes lower, and if the fisherman cannot catch enough fish then the rate of return becomes lower. These hometown investment trust funds are one-to-one correspondences, so we know who is borrowing our money.

Figure 8.1.16

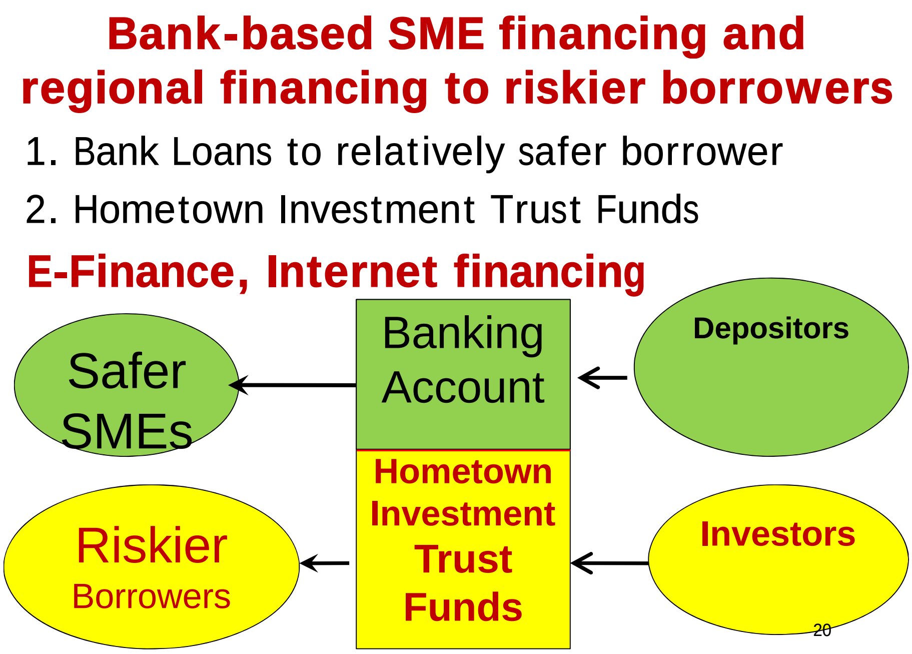
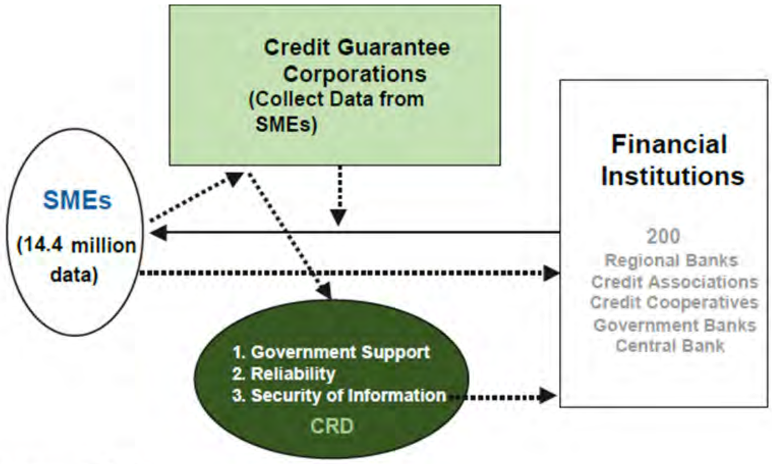


Figure 8.1.17

Credit Risk Database of Credit Guarantee



Source: Yoshino (2012).

The last point, I just want to talk about the regulations of moneylenders in Japan. In many Asian countries, SMEs are using moneylenders because banks cannot lend money. In Japan, the interest rate used to be 96% about 10-15 years ago, and gradually we have lowered it, and number three, new finance company flows were created several years ago and now the highest interest rate is 20%. For the borrowing, it has to be 1/3 of annual income and minimum capital is required for the loan. This red line shows the number of defaults of the SMEs, and after the new law was implemented, the defaults of SMEs have drastically diminished. Regulations of moneylenders and loan sharks are another important point for Asian countries, and we can bring those illegal or moneylenders into the regulation of financial system. Lastly, there are two types of investments needed; one, large projects for infrastructure, which come from sovereign funds or the mutual funds, and other one is the community type of start-up businesses. I hope these dual or triple financial systems can provide the Asian economy sustainable growth for Asia. Thank you very much.

Question and Answer

Dr. Charles E. Morrison:

Thank you Professor Yoshino, I think you covered an awful lot of ground in a short period of time. I was rather worried when I saw the formula slide, but the in fact it was very clear and I am very grateful for that.

Mr. Ian Buchanan:

Thank you very much for that. I spent most of my career working in developing in Southeast Asia, and looking at Japan, I can trace the modern development back to the Meiji Restoration in the 19860s. Most of the suggestions you had made perfect sense, but would require strong institutional capability throughout the country. Your hometown investment trusts, if you launched these in the towns of Indonesia, not a lot of the money would get through to the borrowers. Given that you said that you were doing work using this formula in places like Myanmar and Cambodia, can you help us understand how you might be able to help governments in developing Asia-Pacific apply some of this in areas where the institutional capacity is immensely weak, where the tax receipts are extremely low, and disbursements tend to disappear between the federal government and the regions. Thank you very much.

Dr. Tomoo Kikuchi:

Somewhat related to hometown investment trust funds, could you tell us a little bit more on how it was organized, especially the data that you are collecting, you said that you can rank SMEs, how do you differentiate the interest rate when they develop those. Thank you.

Professor Naoyuki Yoshino:

Whenever I present this paper in Indonesia, the Philippines or Myanmar, I will ask always if these hometown trust funds if it were created in your countries, there could be fraud and misconduct of the management. The difference between crowd funding and these hometown investment trust funds is we know who is borrowing this money; in the Cambodian case, several agricultural farmers they started their education and crops, and several agricultural farmers required some money. Investors in the community know who is borrowing the money and whether it is properly used. Community-type investment can be watched by the local individuals, and furthermore, they want to help each other in the region. I think while it worked well, but if it became nationwide then it may create some problems. In the Japanese case, financial services agencies the license system and the company wants to start a business only happens once a year whether the business is going well or not. In developing Asia, initial start is the community level, then mutual assistance and also transparency will be very important, and that can graduate to the central bank and other agencies who will watch those activities.

The SME data came from Iran. Many people including me thought that Iranian data may not be very reliable, but the governor of the central bank of Iran and deputy governor gave me

1,362 SME data. They thought that the statistical analysis would be very diversified, but as I have showed today there are three groups of differentiation, and in Thailand, there are about four or five categories; in Japan it is about nine; what the asset banks are doing is based on those five different categories, they change the interest rate and it is actually used as collateral and differentiation from one group to another.

Mr. Raymond Kwok:

Can you share with us your thoughts because Japan has one of the largest financial institutions that is not commercialized, sometime back the prime minister was going to close the postal savings system, but that didn't come to pass; if it did, it would've created the largest bank and insurance. Can you share with if that had come to pass, how would it have affected growth in the new normal?

Dr. Charles E. Morrison:

This is a question about young people in Japan and getting jobs in the first place. It used to be that most educated young Japanese got jobs for long periods, but today it seems like we have so many young people accepting temporary positions that are unprotected by the traditional social safety net. Do you have any thoughts on this issue?

Dr. Narongchai Akrasanee:

It is not a question, if the audience does not mind a John Hopkins speaker, I would like to make a contribution, which is very much what Professor Yoshino has told us; I have been working on SMEs for over 40 years, I would like to make two points. Number one, we have all the policy support for financial access for SMEs, but what we are finding again is that western practice of risk control through Basil One, Two and Three and so on, which means that there will be no way that many financial institutions can lend to SMEs according to the presentation that we have seen. Number two, we are trying new things and acknowledging it, the new technology will provide us with two options mentioned my Professor Yoshino, these are all the funds and pensions, in financing its called crowd financing, allowing people to participate in a financing and lending to SME without having to calculate into the risk factor required by the central bank. Second is to do platform transactions, again because of these new technologies, we can use could computing for transactions, with financial institutions can set up platforms, just like railway platform, for SMEs and companies to join in to do their transactions with that financial institutions providing insurance that things are transparence. That means the second way; we are trying to do that in Thailand at the moment. I’m glad that Professor Yoshino is telling us about people joining funding and this is the only way to help SMEs when we are under Basil control.

Professor Naoyuki Yoshino:

As you pointed out, Japanese Postal savings is one of the biggest in the world. Currently, the post office savings are almost all of them invested into government bonds, that is the reason that despite the huge Japanese budget deficits, we are still suffering. Greece budget deficit to GDP ratio is lower than Japan, and Greece is borrowing money from the outside of the country, so capital inflow and outflow is very quick; but in the Japanese case, all the government bonds are held domestically. I think even after it is privatized, the post office should not play with the money. The post office does not know how to lend money, they wouldn't even know how to collect money. So one way after the privatization, private financial institutions should utilize the post office as a sales channel then private insurance companies can sell their products through post offices, then they can get a commission on these. I think that will be the best way to privatize the post office, because the post office will be utilized as a sales channel of various private financial institutions; so I don't think that they will start lending money.

As for the Japanese young people, there are two or three interesting stories. About 20 years ago when I started to teach, many students came to see me after they graduated from university. One case was they wanted to get married, and please attend my wedding, that was my case when they came. Secondly, after two or three years, students come to see me, I want to quit this job and change my job; 20 years ago, I would say don't change your job, Japan is based on a seniority system and Japanese case is that bosses rotate every 2-3 years, so if you can survive three years a new boss will come. Nowadays, after three days, students call me and say I want to quit this company. Three days, three months, and three years, because the Japanese labor market had so much liquidity and many people started to changed their job from one place to another much more frequently. Big change has been coming in the Japanese market.

Dr. Charles E. Morrison:

Thank you. In closing, I just wanted to mention some research that I did. I was quite intrigued by phrase “the new normal,” and it turns out that Google has done some analytics on this phrase and another term called “the new plateau.” When the usage of the term new normal goes up in books, the term new plateau goes down in books. It seems that the term new plateau is used by the more optimistic, while “new normal” is associated with a lower rather than a higher elevation. It was after 2007-2008 that we started using the term new normal, and by 2009 Bloomberg News rated the new normal as the top most used cliché that year. I think what we want to do is get our thinking hats back to the more optimistic idea of higher rather than lower elevation.

We would like to thank the Philippine government for giving attention to inclusivity as a value in the APEC process and making it the theme this year. I would like to thank Tan Khee Giap and SINCPEC for making it a theme of this conference and our distinguished speaker for this evening for having addressed this topic.

Appendix: List of Abbreviations

ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
AEC	ASEAN Economic Community
AEO	Authorized Economic Operators
AIIB	Asian Infrastructure Investment Bank
APEC	Asia Pacific Economic Cooperation
APEC-TIN	APEC Tax Information Number
ASEAN	Association of Southeast Asian Nations
ASW	ASEAN Single Window
AUSPECC	Australian Pacific Economic Cooperation Committee
BOT	Build-Operate-Transfer
BPM	Business Process Management
CBD	Central Business District
CDB	China Development Bank
CHILPEC	Chilean National Committee for Pacific Economic Cooperation
CIB	Credit Information Bureaus
CIC	China Investment Corporation
C.L.M.V.	Cambodia, Laos, Myanmar, Vietnam
COMPNET	Competitiveness Research Network
COO	Certificate of Origin
CTPECC	Chinese Taipei Pacific Economic Cooperation Committee
DDA	Doha Development Agenda
DBS	Development Bank of Singapore
ECB	European Central Bank
EIB	European Investment Bank
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreements
FTAAP	Free Trade Area of the Asia-Pacific
GDP	Gross Domestic Product

GVC	Global Value Chains
IFC	International Finance Corporation
IMF	International Monetary Fund
I.O.T	Internet of Things
IP	Intellectual Property
ITC	Information and Communications Technology
ISOM	Informal Senior Officials Meeting
KOPEC	Korea National Committee for Pacific Economic Cooperation
LKY	Lee Kuan Yew
LNG	Liquefied Natural Gas
LTO	Light Type Oil
MCR	Moveable Credit Registries
MDB	Multilateral Development Banks
MDG	Millennium Development Goals
MNC	Multinational Corporations
MRA	Mutual Recognition Agreements
MRT	Mass Rapid Transit
NSW	National Single Window
NTB	Non-Tariff Barriers
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PECC	Pacific Economic Cooperation Council
PPECC	Philippine Pacific Economic Cooperation Committee
PPP	Public-Private-Partnership
PWC	PricewaterhouseCoopers
QE	Quantitative Easing
R&D	Research and Development
RCEP	Regional Comprehensive Economic Partnership
REI	Regional Economic Integration
RMB	Renminbi
ROO	Rules of Origin
SCFAP	Supply-chain Connectivity Framework Action Plan
SINCPEC	Singapore National Committee for Pacific Economic Cooperation

SME	Small and Medium Enterprises
SOE	State-Owned Enterprises
SOM	Senior Officials Meeting
SOTR	State of the Region
TIER	Taiwan Institute of Economic Research
TNCPEC	Thailand National Committee for Pacific Economic Cooperation
TPA	Trade Promotion Authority
TPP	Trans-Pacific-Partnership
TRPC	Technology Research Project Corporate
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade And Development
UNWTO	United Nations World Tourism Organization
US	United States
WEF	World Economic Forum
WTI	West Texas Intermediate
WTO	World Trade Organization
WTTC	World Travel and Tourism Council