

STATE OF THE REGION

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STATE OF THE REGION 2006 - 2007



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The Pacific Economic Cooperation Council (PECC) is an independent, multi-stakeholder organization committed to the promotion of cooperation and dialogue in the Asia Pacific. Founded in 1980, PECC is a network of member committees composed of individuals and institutions dedicated to this mission. The Council is one of the three official observers of the APEC process.

The PECC provides a forum through which its members and broader stakeholders can influence the development of policies affecting the Asia Pacific region.

The State of the Region Report is a product of a task force established by the governing body of the PECC. While efforts are made to ensure that the views of the PECC's membership are taken into account, the opinions and facts contained in this report are the sole responsibility of the authors and editorial committee and do not necessarily reflect those of the member committees of the PECC or their individual members.

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Message from the Chairman of PECC	3
Executive Summary	5
1.0 Economic Outlook	7
2.0 Regional Dynamics: Challenges for Asia Pacific Cooperation	11
Challenges to Integration	11
Short and Long Term Risks	11
Policy Priorities for Regional Cooperation	17
3.0 The Future of Regional Cooperation	19
Sub-Regional Integration	19
APEC Membership	22
Trans-Pacific Ties	22
Annex 1: Economic Outlook Data Tables	25
Annex 2: Survey Results	35
Annex 3: Pacific Economic Outlook Forecasters	43
Annex 4: PECC Member Committees	47

Table of Contents

Message from the Chairman of PECC

It is my pleasure to present, on behalf of the 23 member committees that make up the Pacific Economic Cooperation Council (PECC), our new flagship publication - the State of the Region. This report provides our assessment of the key issues affecting the region and of the principal challenges standing in the way of stronger trans-Pacific ties. In addition to an overview of the major forces currently driving regional cooperation, the report presents an up-to-date economic outlook for the Asia Pacific, based on the forecasts of our Pacific Economic Outlook (PEO) panel of experts.

A groundbreaking feature of this report is the findings of a survey that we conducted in August 2006. The Survey on the State of the Region drew on the views of 370 opinion leaders and policy specialists from the Asia Pacific region. By tapping into the extensive networks of our member committees, we were able to access the views of senior policy-makers, scholars and business people on key questions facing the region. This kind of survey is unprecedented in the quality of respondents and in its coverage of issues, and we hope to make it an annual feature of the State of the Region report.

This report is the work of many people and all member committees have contributed to its success. However, it is not a consensus document as such and the responsibility for the views expressed in the report rests with the editorial team, whose names appear on the inside cover. I would like to express my appreciation to all member committees, to the PEO forecast panel, and to the editorial team, led by Yuen Pau Woo, for putting together the publication. I would also like to recognize the role of the International Secretariat and Secretary General Eduardo Pedrosa in providing critical support and advice for the production of this document.

I look forward to your feedback on the State of the Region Report and on how PECC can continue to support the work of trans-Pacific economic cooperation.



Charles E. Morrison
International Chair
PECC

Executive Summary

By and large, the Asia Pacific region today enjoys growing prosperity and relative peace. The region's GDP is set to expand by 5.0 percent this year, and possibly 4.3 percent next year, while some economies will be spectacularly above that. There has been no international conflict in the region for more than a quarter century, although in some areas there is internal unrest.

Some of the potentially serious risks that PECC has warned of in earlier studies have been avoided, including a serious currency crisis, the growth of protectionism, or an avian flu pandemic. There are positive indications that, for the first time in several years, the major economies are beginning to reduce the large current account imbalances across the Pacific, increasing the chances of successful adjustment. Regional cooperation in such areas as health risks, disaster preparedness, and terrorism has increased.

downside risks include weaknesses in the financial system and the potential impacts on China's trade of a slowdown in the U.S. economy or increased protectionism

Despite this positive environment, the region faces a number of continuing and emerging challenges that, unless effectively addressed, could substantially change the future outlook. Some of these are associated with the previous decades of success in economic reform and trade liberalization. Growing inequalities and resurgent protectionist sentiments remain challenges that need to be addressed if the economies of the region are to have the political and public support for further reform and market opening. Energy security and resource sustainability are of high concern around the region.

Other challenges have to do with relations among the Asia Pacific economies, which can inhibit cooperation. Moreover, there is considerable disenchantment with regional institutions, including APEC. PECC's first survey of its membership on regional cooperation issues shows that among a group that strongly supports regional cooperation, there is concern that economies have not sufficiently invested in regional institutions and that the work of these institutions is not adequately meeting the needs of the region.

No significant issue in the region can be resolved solely by unilateral action. Regional cooperation and well-functioning regional institutions are essential to meet the challenges of the early 21st century. We believe that Asia Pacific economies need to renew their commitment to institutions such as APEC, and to take a fresh look at the architecture of regional institutions across the Pacific.

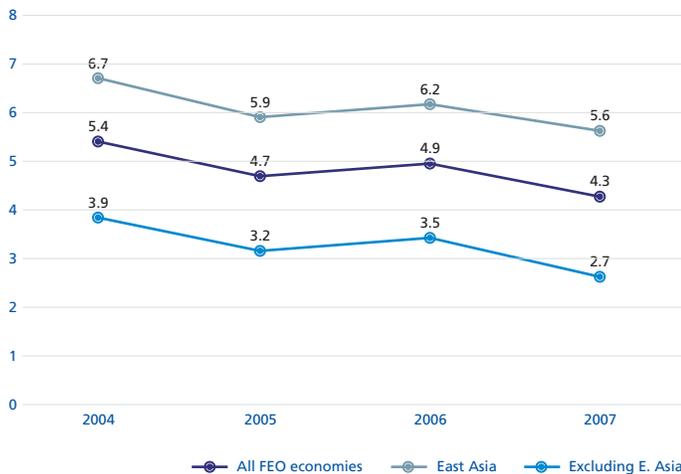
This first PECC State of the Region Report consist of three main parts: (1) the near-term economic outlook, drawing on the up-to-date forecast of PECC's Pacific Economic Outlook panel of experts, (2) issues for the medium-long term, drawing on contributions from our editorial committee and on a survey of regional opinion leaders, and (3) a discussion on the future of regional cooperation.

Section 1: The Asia Pacific Economic Outlook

Growth will slow in 2007 – as expected

The PECC Pacific Economic Outlook team believes that following a year of upside surprises in the Asia Pacific growth outlook for 2006, the forecast for 2007 is for a modest slowdown across the region. Our team's weighted average real GDP growth for 2006 is projected at 5.0 percent, slowing to 4.3 percent in 2007. Most of this growth will be in East Asia. Still East Asia will see a decline in real GDP growth from 6.2 percent in 2006 to 5.8 percent in 2007, compared to the rest of the region which is forecast to grow by 3.5 percent in 2006 and by 2.7 percent in 2007.

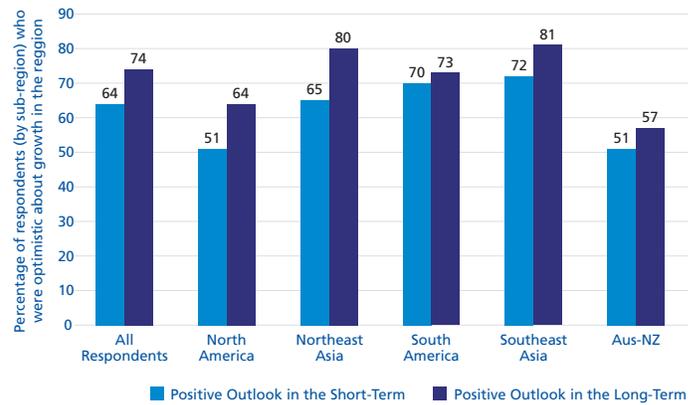
Chart 1: Real GDP Growth (%)



The survey results on the economic outlook are generally consistent with PECC's forecasting panel. Respondents are less bullish on the 1-2 year outlook than on a 3-5 year horizon. Sixty-four percent of respondents feel that the Asia Pacific economic outlook will improve somewhat in the next one to two years, compared to 74 percent who are positive about the outlook in three to five years.

A slowdown in 2007 has been widely anticipated, and is largely due to faltering demand in the United States and the effect of monetary tightening around the world. Despite lower growth across the region, the economic outlook remains healthy and Asia will remain the most dynamic growth region in the global economy. However, there are a number of risks that could precipitate a more severe downturn.

Chart 2: Confidence in the Asia Pacific Economic Outlook



Trans-Pacific Imbalances to Improve

The region continues to be characterized by an acute imbalance in trade and financial flows, with the U.S. current-account deficit on the one side, and current-account surpluses in many East Asian economies on the other. This imbalance remains a risk, but there are increasing and positive signs that it is no longer likely to grow, and in fact, is beginning to be reduced, at least in percentage of GDP terms.

Deficits at a Peak

The U.S. current-account deficit is expected to peak in 2006 at US\$840 billion and remain at roughly the same level in

Chart 3: Current Account Balance (US\$)



2007. As a share of GDP, however, the U.S. deficit will finally show improvement in 2007, falling to around 6.0 percent of GDP. East Asia's collective surplus is expected to be around US\$455 billion in 2007, more or less the same as the 2006 level. China's current account balance will rise to US\$171 billion in 2006 before falling back to around US\$165 billion in 2007. As a share of GDP, the surplus reached a peak of 7 percent in 2005 and is expected to fall to about 5.0 percent of GDP in 2007.

In 2006 and 2007, import growth in East Asia is expected to exceed export growth, in sharp contrast to the very low rate of import growth in 2005. This forecast assumes steady appreciation of the yuan, from an average of 8.2 to the U.S. dollar in 2005 to 7.7 by 2007. Thus while we cannot discount a hard landing as a result of trade and current account imbalances, the direction has begun to turn. This has come less through government policy action than through natural market forces.

Chart 4: Export Growth (%)

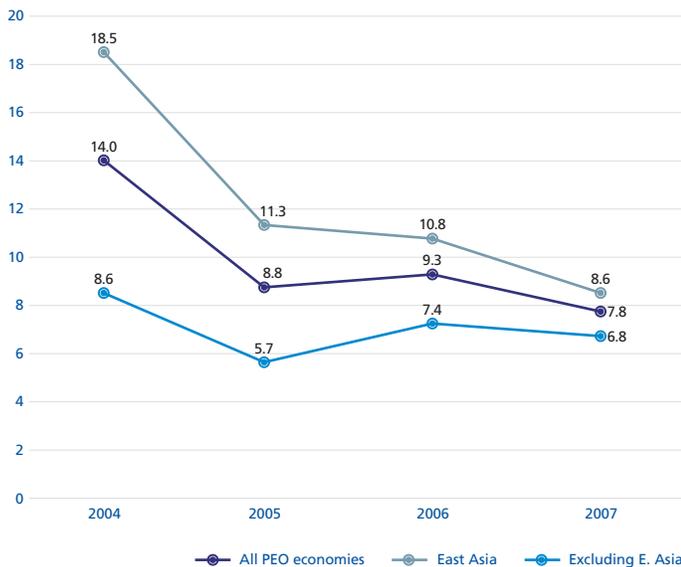


Chart 5: Import Growth (%)



U.S. Domestic Demand to Weaken

Turning to the biggest Asia Pacific economies, all enjoy relatively strong growth, but there remain significant downside risks. Whereas a majority of respondents believe that the Chinese, Japanese, and Indian economies will improve in the short and medium term, only 19 percent are optimistic about the U.S. economy over a 1-2 year time frame and 28 percent over a 3-5 year outlook. Pessimism about the U.S. economy also dominates the 3-5 year outlook, even though the gap between pessimists and optimists is much smaller.

Lower growth in the United States – 2.3 percent in 2007 as against 3.3 percent in 2006 – reflects significantly weaker domestic demand. This has been foreshadowed by two key indicators: sales of light vehicles, which fell by 1 million last year, and housing starts, which are down from 2.1 million in the second quarter of 2005 to 1.9 million a year later.

Higher energy prices and increases in short-term interest rates, reflected in mortgage rates, are having an enormous impact on the perceived wealth of American consumers, who have been one of the principal drivers of Asia Pacific and world economic growth.

Another terrorist attack, continued oil price volatility, inflation pressures rising from non-energy crude materials used in construction and manufacturing, and unruly adjustment in currency markets are all factors that could bring the U.S. rate even lower.

China Still Soaring

The other driver of regional economic growth has been the rapid expansion of China. We expect the Chinese economy to grow at double digit rates in 2006 and 2007. Chinese growth continues to be led by fixed asset investment, which is expanding at an annual rate of around 28 percent.

Measures put in place in the summer have failed to bring this down to a more moderate pace, raising concerns about overheating, the over-expansion of capacity, and misallocation of resources. Consumer expenditures have been strong in 2006, buoyed by solid income growth. In the first half of the year, total retail sales of consumer goods expanded by 12.4 percent in real terms, an increase of 0.4 percentage points over the previous year. Inflation remains modest, despite pressures on some materials.

downside risks include weaknesses in the financial system and the potential impacts on China's overseas trade of a slowdown in the U.S. economy or increased protectionism in U.S. and other foreign markets

Aside from over-heating, other downside risks include weaknesses in the financial system and the potential impacts on China's overseas trade of a slowdown in the U.S. economy or increased protectionism in U.S. and other foreign markets. Sixty-four percent of those surveyed by PECC believe the economic outlook for China will be positive in the short term, with another 72 percent who are positive about the three to five year outlook. Whereas respondents from Southeast and Northeast Asia are the most upbeat about China's prospects, North American and South Pacific respondents were more circumspect.

Japanese Economy on Track

The Japanese economy is on track to expand by 2.7 percent in 2006, more or less in line with our previous forecasts. Even though real GDP growth during April-June 2006 was only 1.3 percent (annualized), nominal GDP growth in that quarter outpaced real growth for the first time in three years. Indeed, respondents to our survey are also optimistic about a continuation of the current economic recovery in Japan, with a majority of respondents agreeing that the outlook is positive in the short and medium-term.

The GDP deflator inched up 0.1 percent in April-June, marking the first departure from deflation since 2003. Other data suggesting the end of a prolonged deflationary period include a rise in unit labor costs for the first time in four quarters. We expect upward price pressures to continue, leading to a rise in CPI of 0.8 percent for 2006 as a whole and by the same amount again in 2007. As the demand-supply gap narrows, the corporate sector will be able increasingly to pass on cost increases. Corporate profits will remain at a high level, even though the pace of growth is expected to slow.

Business sentiment continues to be upbeat, which should translate into stronger investment. Non-residential investment in 2006 is expected to grow by a robust 9.4 percent in real terms, exceeding the previous year's growth of 7.7 percent.

Private Consumption to Surge

The outlook for Japan's real GDP growth in 2007 has been revised sharply upwards from 1.6 percent to 2.2 percent because of continued strong private consumption. Private domestic demand alone is expected to contribute 1.9

percentage points to GDP growth in 2007. On the other hand, exports will slow and non-residential investment will also lose steam.

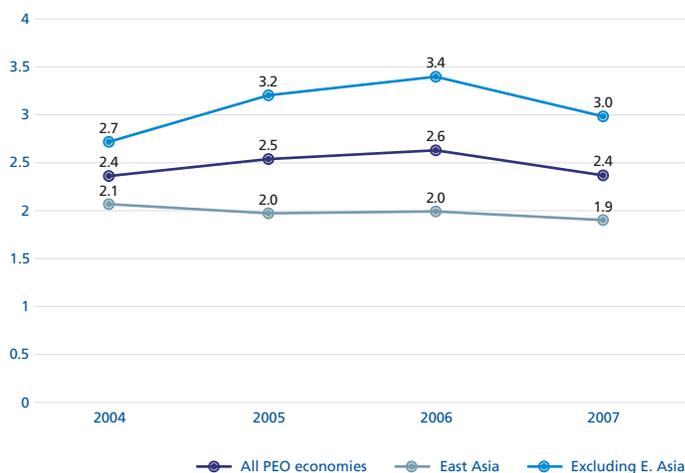
The major risks to the Japan forecast are threefold: Higher oil prices, hard-landing of the U.S. economy, and a possible premature tightening of monetary policy by the Bank of Japan.

Modest Slowing Elsewhere

Other Asian economies, as well as Australia and New Zealand, will also, in general, see a slowing of real GDP growth in 2007. Inflation has been exacerbated by high energy prices, but remains muted throughout the region. The weighted average CPI for the East Asian economies is expected to fall slightly, from 2 percent in 2006 to 1.9 percent in 2007. Latin American member economies of PECC will see a slowdown in real GDP growth from 4.5 percent in 2006 to 3.9 percent in 2007. Price pressures are more acute in Latin

America than in other parts of the Asia Pacific region, with CPI expected to rise sharply from an average of 3.4 percent in 2006 to 4.3 percent in 2007.

Chart 6: CPI Inflation (%)



Section 2: Regional Dynamics: Challenges for Asia Pacific Cooperation

Despite what seems like a benign environment, the region faces a number of emerging challenges. Some of these challenges derive in part from the previous decades of success in economic reform and trade liberalization. The ability to pursue further reform and market opening and achieve APEC's longer-term vision of a prosperous and peaceful Asia Pacific depends on economies addressing these challenges.

These issues include potential political and social tensions arising from a backlash against globalization, resource vulnerabilities and constraints, and international rivalries. While individual economies are seeking to address these issues, we are concerned that there has not been sufficient urgency attached to cooperative endeavors through regional institutions.

2.1 Challenges to Global and Regional Integration

Inequality a Threat to Continued Integration

In the face of growing inequality in many Asia Pacific economies, there is increasing debate on the costs and

there has been a broad and pronounced rise in income inequality across Asia over the last ten years

benefits of globalization and on the role of government in mitigating the negative effects of openness to the global economy. According to the IMF, there has been a broad and pronounced rise in income inequality across Asia over the last ten years. Inequality has increased in 13 of the 18 Asian economies studied by the IMF, with four economies unchanged and only one showing an improvement.

Economies have also become more polarized, with distinct economic groups emerging in many low and middle income countries in Asia. Furthermore, there is evidence of a shrinking middle class in most of Asia's low and middle income economies.

Benefits of Globalization Need to Be Spread

In response to this worrying trend, APEC leaders agreed at their meeting in Busan, Korea in November 2005 to "launch a study of ways to confront the challenges and impediments related to socio-economic disparity issues". The Chairman of the U.S. Federal Reserve, Ben Bernanke argues that further progress in global economic integration should not be taken for granted and that policy-makers need to do more to ensure that the benefits of globalization are more widely spread within their countries. China's leaders are also placing great importance on this issue, stressing social harmony as a goal of Chinese society.

Marginalization Adds to International Tensions

Even in the absence of growing inequality, the region as a whole continues to be home to vast pockets of people living below the poverty line. Despite decades of high growth and a sharp fall in absolute poverty in many economies, a large proportion of the region's population in East Asia, Southeast Asia, and Latin America continues to subsist on very low incomes. In places where poverty is concentrated among minority ethnic or religious communities, there is an added

risk of marginalization and social conflict. These communities are also more susceptible to terrorist recruitment.

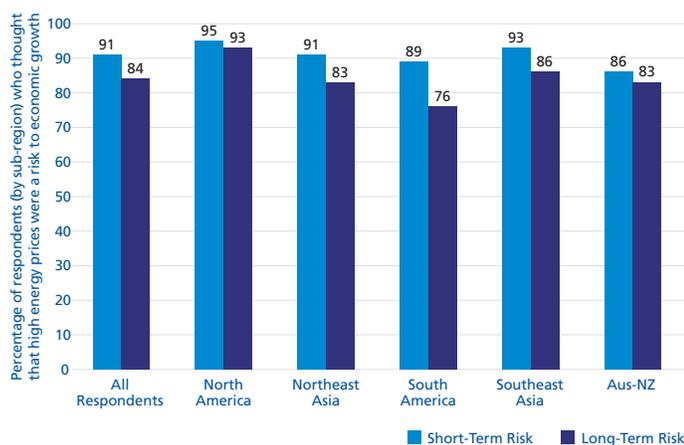
2.2 Short and Long-Term Risks

Resource Sustainability

Our PECC survey of regional opinion suggested that the greatest single issue of concern is energy security. Eighty-four percent of respondents to PECC's 2006 survey of opinion leaders chose this item as a major long-term risk, with North

American respondents expressing the most concern, at 95 percent. Adequate supplies of clean water are also of deep concern coming second to energy at 78 percent.

Chart 7: The Risk of High Energy Prices in the Asia Pacific Economic Outlook



Energy security implies adequate supplies at reasonable prices. Despite some surplus economies such as Russia, Canada, Brunei and Malaysia, the PECC region runs a huge oil deficit, most of which is supplied from the Middle East. While the region’s economic performance has continued in the face of the oil price increases of the past three years, the tight markets have resulted in competitive efforts to secure longer-term contracts for both oil and natural gas.

In fact, supply issues are best addressed cooperatively. Much effort has to be devoted to ensuring that “energy security” is conceived in international and regional terms so that the focus is on the compatibility of national policies towards investment in exploration production, and distribution, and not on a misleading identification of “security” with autarky. Energy efficiency is another area of common interest.

Still, the underlying longer-term questions need more attention: What is the best adaptation path, national and regionally, to the likely rise in the relative price of energy? How will relatively more valuable resource supplies impact regional and international relations? Will a need to have good relations with oil producers alter national interests and the foreign

policies of countries and economies in the region, and exacerbate tensions in the region? Will innovation change the potential influence of oil and gas producers?

As serious a problem as air pollution is for many cities in developing Asia Pacific economies, water may be the biggest longer-term environmental issue. Industrialization, more intensive agricultural use, deforestation, urban pollution, and population growth have increased the stress on water supplies throughout the region. Water tables are falling in many areas, such as northern and northeastern China, where 44 percent of China’s population lives, but which has only 14 percent of China’s total water resources.

Access to potable supplies is a problem for many of the region’s poor, including an estimated 100 million in Indonesia and 300 million in China, according to statistics in these economies. This is a major health hazard, as in Peru, which has been battling cholera outbreaks. Most of the region’s economies have made water a priority issue and can learn from each other’s experiences.

Regional Views Diverge on Other Risks

The next most serious long-term risks cited in our survey were financial market volatility closely followed by terrorist acts and policy responses to such threats. However, there was some divergence between the sub-regions on their top 3 risks, while all sub-regions ranked energy as the highest risk, respondents from Southeast Asian economies were most concerned about water and then terrorism, opinion leaders from North America and Northeast Asia ranked water and financial market volatility as the more serious. Both Australia and New Zealand and South America included protectionism as a top 3 risk.

Despite the substantial media attention on avian flu and other health pandemics, respondents generally did not rank this issue as a major risk for the region. The exception is in Southeast Asia, where 82 percent of experts chose avian flu as a risk in the short-term economic outlook. (see sidebar: The Threat of Avian Flu)

The Threat of Avian Flu

Avian flu has now spread from Asia to Europe and Africa, affecting more than 50 countries. The World Health Organization has reported 59 laboratory-confirmed human cases and 47 casualties in Asia in the first eight months of 2006. Indonesia alone has had 43 cases and 35 casualties, compared with 17 cases and 11 casualties for the full year 2005.

An Asian Development Bank (ADB) study estimates that the potential cost of a pandemic in Asia could reach \$283 billion (or about 6.5% of GDP) in one year. Consumer spending on a wide range of services would contract significantly, as affected populations cut back on economic activity to reduce exposure to the virus.

The psychological impact of an outbreak is likely to be an important factor in economic losses, as was seen in the SARS outbreak of 2003. The decline in demand would result in business failures and spillover into lower investment and employment. Loss of human and physical capital would in turn reduce the region's long-run economic growth potential. Since Asia is an integral part of the global economy, even a localized pandemic can have far reaching effects.

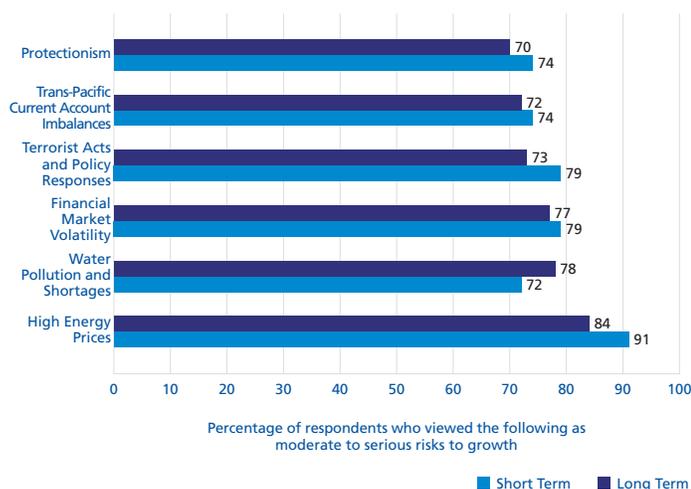
On the social front, a pandemic flu would impact families and children in various ways. Many families in Asia depend on backyard poultry as a source of protein and income. A serious outbreak would affect the nutrition and earning prospects of these families. Nearly half of the reported cases of avian flu involve children, which suggest a special vulnerability on the part of the young. A pandemic could push households below the poverty line and lead to greater overall inequality and social conflict.

There are a number of challenges in stopping the virus, which spreads primarily through poultry trade, and to a lesser extent through the migration of birds. The risk of poultry to human transmission is high due to the prevalence of backyard chicken farms in rural areas, and wet markets in urban areas where birds are openly slaughtered and displayed. The problem is exacerbated by inadequate health infrastructure, especially in rural areas, which increases the chance of an outbreak going undetected and rapidly spreading out of control.

There is a widespread agreement on the need for regional collaboration to fight the spread of Avian flu. Donor countries and international funding agencies have pledged substantial sums for disease prevention and control. In January 2006, a high-level conference on bird flu was held in Beijing, at which the international community pledged \$1.9 billion for such activities. Despite these commitments, the risk of a pandemic in the region remains high, whether from avian flu and another future virus.

Longer-Term Risks

Chart 8: Risks to Economic Growth



Threat of Protectionism

The combination of an economic slowdown, a stubbornly high current account deficit, the suspension of Doha negotiations, and political factors could also result in renewed protectionism, with major effects for the economies of the region.

Trade liberalization remains an important tool for addressing questions of poverty. In this respect, the suspension of the Doha Development Round is a major blow to the economies of Asia Pacific, especially the developing economies. We believe that leaders of the major APEC economies should take coordinated action to achieve a satisfactory outcome. APEC as a whole could make a great contribution if it could come up with an APEC set of offers, but the United States, China, and Japan must lead the way.

The Doha Round and Its Alternatives

The much lamented but not entirely unexpected breakdown in the WTO Doha Round negotiations has thrown into sharp relief the absence of a credible non-discriminatory route to the achievement of APEC’s Bogor goals of free trade and investment.

Despite the widespread calls for an early resumption of negotiations, it is not clear that sufficient political will exists to achieve a conclusion of the round in 2007, before the expiry of Trade Promotion Authority in the United States. The sheer volume of technical work that needs to be completed if a conclusion is to be reached by mid-2007 also presents a formidable challenge. On the other hand, a lengthy suspension of negotiations carries serious risks: Trade Promotion Authority may not be renewed and the political climate for the negotiations may deteriorate instead of improving.

Achieving a successful conclusion to the Round remains a vital objective for the Asia Pacific region and for the global economy. World trade continues to be plagued by problems, especially in agriculture, that can probably only be resolved in the WTO. A still more important reason is the need to sustain confidence in the WTO on the part of its members. Commitment by large and small economies alike to a rules-based multilateral trading system remains a vital element underpinning the global economic architecture.

Meanwhile, preferential trade agreements (PTAs) continue to proliferate in the Asia Pacific region. Counting agreements currently under negotiation, there are soon likely to be over 40 PTAs, most of them bilateral FTAs, operating in the region, and proposals for still more PTAs continue to emerge. Although few if any observers claim that proliferation of PTAs represents a sensible basis for the organisation of regional and global trade, the trend is driven among other factors by the powerful “domino effect” that is created by competition between economies for market access. Foreign policy and political objectives are also major driving forces.

The Asia Pacific Noodle Bowl



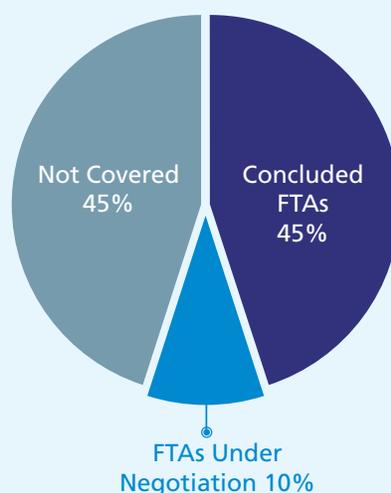
- | | | | |
|---|--|--------------------------------------|--------------------------------------|
| In Force: | | Under Negotiation: | |
| — Closer Economic Relations | — Closer Economic Partnership Arrangement | — Free Trade Area | — Comprehensive Economic Partnership |
| — Free Trade Agreement | — Free Trade Agreement on Agricultural Produce | — Free Trade Agreement | — Economic Partnership Agreement |
| — Free Trade Area | — Free Trade Agreement | — Comprehensive Free Trade Agreement | — Closer Economic Partnership |
| — Economic Partnership Agreement | — Strategic Economic Partnership | — Closer Economic Partnership | — Trade Promotion Agreement |
| — Closer Economic Partnership | — Trade Promotion Agreement | | |
| — Framework Agreement on Comprehensive Economic Cooperation | — TLC | | |
| | — Trade and Investment Framework Agreement | | |

One hopeful development is the gathering debate over the negative effects of market fragmentation and increased business transaction costs created by a “spaghetti bowl” of PTAs. APEC’s project to develop “model measures” for the design of PTA chapters is one potential contribution toward convergence of existing agreements, although some argue it is a case of “too little too late”. PECC is working to develop more accurate assessments of the impact on business.

Another avenue to convergence is offered by the proposals for region-wide PTAs that are at various stages of exploration and that could in principle subsume many of the region's bilateral FTAs. An East Asian FTA (EAFTA) covering the "ASEAN Plus Three" group has been under study for several years, and a further study has this year been prepared for the group's ministers and leaders. More recent proposals have been for an FTA extending beyond the "ASEAN Plus Three" group to include the additional participants in the East Asian Summit process (Australia, New Zealand and India) and for a Free Trade Area of the Asia Pacific (FTAAP) potentially embracing all APEC members.

Resistance to the liberalisation of trade between the major APEC economies, heavily grounded in political sensitivities, tensions and rivalries, remains a formidable obstacle to realisation of each and any of these proposals. Meantime, more limited "ASEAN Plus" FTAs – concluded already by ASEAN with China and Korea, and under negotiation with Japan, Australia and New Zealand, and India – have emerged as alternatives, or possibly precursors to region-wide FTAs based on the "ASEAN Plus Three" or East Asian Summit groupings. In the trans-Pacific context, negotiations for an FTA between the USA and Korea are an important development that could, if successful, catalyse further important preferential trading initiatives among the major APEC powers.

Coverage of PTAs of APEC Member Exports to Other APEC Economies
(2002-4 Trade Data)



Source: IMF Direction of Trade Statistics

Relations among Large Economies

Strong relations among the economies of the region, particularly the three major North Pacific economies of Japan, China, and the United States are key to effective regional action. The continued rapid growth of the Chinese economy is the most important single transformational force in the Asia Pacific region in the first decade of the 21st century.

This is a powerful and positive element of dynamism for the region as a whole, but it also requires political and economic adjustments of the other economies. Cooperation and cooperative leadership among the larger economies, especially China, Japan, and the United States, are essential to smooth economic and political adjustment processes, and ensure the viability and strengthening of trans-Pacific and East Asian regional cooperation institutions. With its steady

rise as a major political and economic player in the region, China intends to play a commensurately greater leadership role. Japan, too, is taking a more active interest in regional affairs as its economy shows signs of renewed vitality.

The challenge for both great East Asian powers is to ensure that these roles are compatible with each other and with the aspirations of other economies in the region. This is not only important for economic progress, but also to help resolve troubling regional issues, such as the North Korean nuclear issue.

The relationship among the larger powers has recently improved, and we hope this trend will continue to be consolidated, both bilaterally and through cooperation in sub-regional and regional activities. The main recent development has been the resumption of leaders meetings between China and Japan. Moreover, all the major powers were able to agree on a common approach through the United States following the North Korean nuclear explosion.

American perceptions of China's rise and China's perceptions of U.S. responses will be critical to the future of trans-Pacific relations. The two economies have strong economic and political relations, but there are nationalist instincts on both sides that will jump at any opportunity to advance a narrow domestic agenda, at the expense of diplomatic and economic ties. While other economies have little influence over this relationship, there is a role for regional institutions to make space for the deepening and broadening of Sino-American ties.

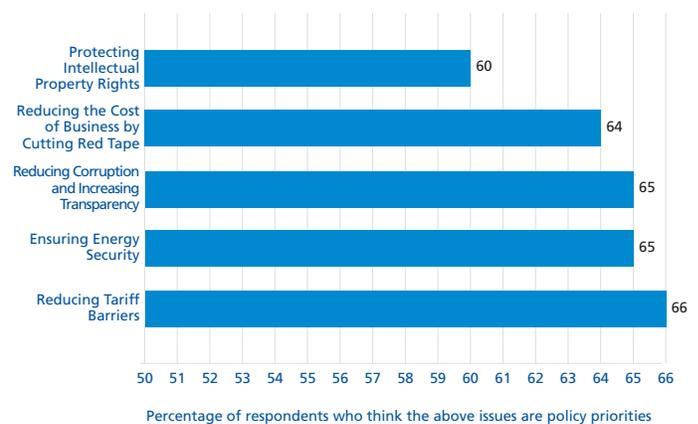
there is a role for regional institutions to make space for the deepening and broadening of Sino-American ties.

2.3 Policy Priorities for Regional Cooperation

Looking to the future, the survey provides some guidance on key policy priorities for regional cooperation. There is little to separate the top four priorities, which are reducing tariff barriers, ensuring energy security, reducing corruption

and improving transparency, and cutting red tape. Tariff reduction and cutting red tape (which is related to trade facilitation and regulatory reform) are traditional areas of strength for APEC. Based on the survey findings, there is a case for APEC to place more emphasis on energy security and transparency in its work program.

Chart 9: Policy Priorities for Asia Pacific Regional Cooperation



There was considerable regional variation in the results. Whereas North American respondents chose corruption/transparency and intellectual property rights as the most important policy priorities, Southeast Asian respondents were more concerned about cutting red tape and ensuring energy security. Energy security was the top pick for Northeast Asian respondents, whereas Australia/New Zealand respondents put this item at the bottom of their priority list.

By a wide margin, South American respondents identified tariff barriers as the top policy priority, which likely reflects the widespread concern over impediments faced by exporters from the region in getting their products, especially manufactured goods, to market.

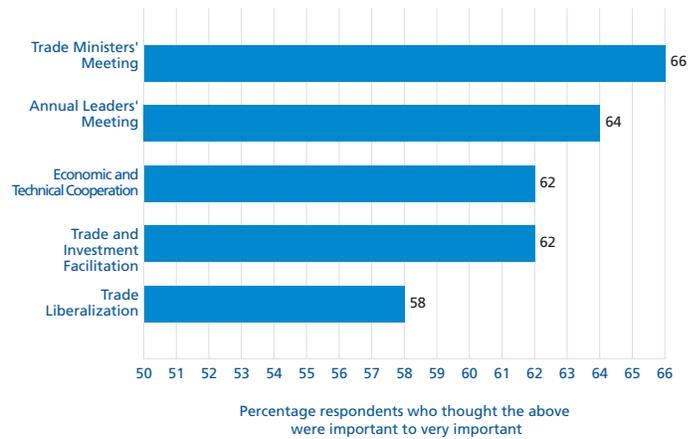
APEC Activities – need for reform?

When asked about various aspects of APEC’s agenda, the trade ministers’ and leaders’ meetings were selected as “important or very important” by the largest number of respondents. Reform of APEC’s internal processes, strengthening its implementation track record, stepping up trade and investment facilitation and ecotech and capacity-building initiatives, all of which have been mooted within the organization, are a start to reinvigorating APEC.

Respondents to our survey placed more importance on economic and technical cooperation as well as trade facilitation than on trade liberalization. Fewer than half the respondents chose the APEC CEO Summit, Peer Review, and the Individual Action Plans as important or very important agenda items. In fact, the number of respondents who felt the Individual Action Plans were not important or only somewhat important was more than double that of those who felt they were important.

However, large numbers of respondents to our survey doubted the commitment member economies have to the APEC process and therefore the ability of regional institutions to manage the risks outlined above which is discussed in the following sections.

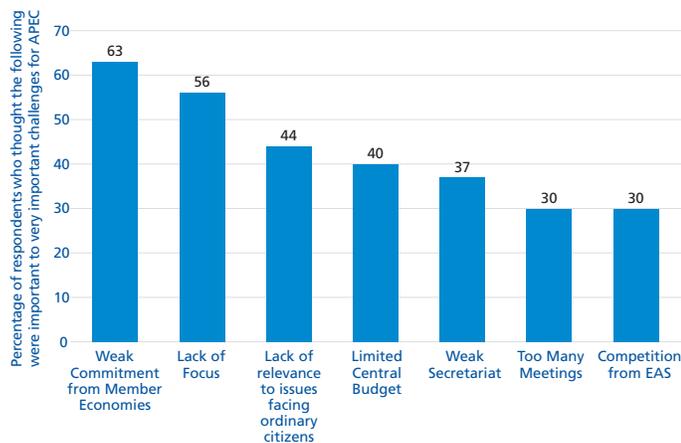
Chart 10: APEC's Most Important Activities



Section 3: The Future of Regional Cooperation

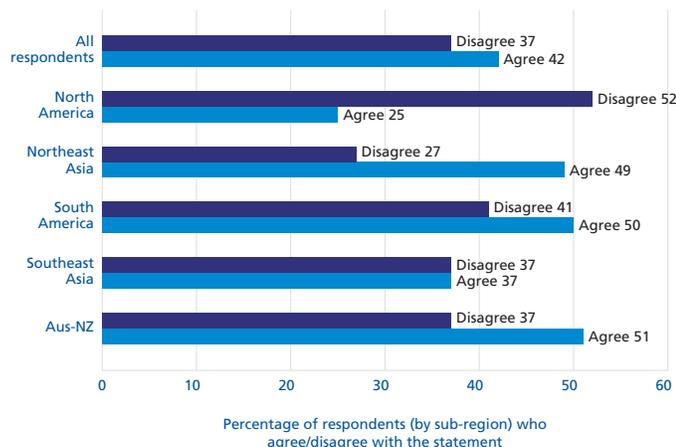
According to the survey, the principal challenges facing APEC are “weak commitment from member economies”, and “lack of focus”, which were the choices of 63 percent and 56 percent of respondents respectively. Of potentially greater concern is the fact that 43 percent of respondents feel APEC’s greatest challenge is its “lack of relevance to issues facing ordinary citizens”.

Chart 11: Challenges facing APEC



Furthermore, nearly 40 percent of respondents identified APEC’s “limited central budget” and “weak secretariat” as major challenges for the regional forum. When asked if “APEC is as important today as it was in 1989”, only 42 percent of respondents agreed. Support for this statement was the lowest among North American respondents (25 percent) and highest in Australia/New Zealand (51 percent).

Chart 12: “APEC is as important today as it was in 1989”



3.1 Sub-Regional Integration

East Asian Regionalism Rising

One by-product of trade and investment liberalization in the last two decades has been the greater integration of East Asian economies. More than half the trade that takes place in East Asia is conducted among East Asian economies. Until recently, East Asian integration was principally driven by business decisions. Since the Asian financial crisis, however, there has been a move to forge institutional arrangements for deeper integration in the region, in part as a response to deeper economic integration in Europe and the Americas.

Only 27 percent of respondents agreed with the statement “The East Asia Summit will eventually overshadow APEC”

Examples include the “ASEAN plus Three”, China’s initiative for a free trade area with ASEAN, Japan’s proposed “Comprehensive Economic Partnership in East Asia,” and the “East Asia Summit” process which includes not only ASEAN and Northeast Asia, but also India, Australia, and New Zealand. (see sidebar: East Asian Regionalism: From Integration to Identity?)

Respondents to our survey were generally not concerned about the East Asia Summit as a potential threat to APEC, which is consistent with the lukewarm assessment of the EAS that came across in other questions. Only 27 percent of respondents agreed with the statement “The East Asia Summit will eventually overshadow APEC”.

East Asian Regionalism: From Integration to Identity?

East Asia is on a path of regional integration that has been led principally by market forces. Trade and investment, particularly foreign direct investment (FDI) have been the main drivers. It is important to recognize, however, that the expansion of intra-regional trade in East Asia has not been at the expense of trade with the rest of the world.

The liberalization of trade and investment in many East Asian economies took off at a time when outward investment from Japan was increasing rapidly, starting in the mid 1980s. The combination of push and pull factors resulted in a sharp expansion of intra-regional trade and investment, and the emergence of a “trade-FDI nexus”, namely the simultaneous expansion of trade and FDI, and the mutual reinforcement of both economic drivers. This phenomenon has been accompanied by the fragmentation of production in many industries, resulting in complex supply chains that involve multiple economies in the region.

East Asia is beginning to establish an institutional identity. The idea of an EAFTA (East Asian Free Trade Area) is on the agenda of the ASEAN Plus Three (APT) process. The East Asian Vision Group (EAVG) raised the possibility that EAFTA be formed through a building block approach and by consolidating existing bilateral and sub-regional FTAs in the region. ASEAN is at the center of this process as has embarked on bilateral initiatives with the three partners in Northeast Asia as well as with Australia and New Zealand, and with India. The goal of the APT process is the creation of an “East Asian Community”.

A second vehicle for the promotion of an East Asian community was created in December 2005, in the form of the East Asia Summit (EAS). The EAS has a broader membership (APT plus Australia, India and New Zealand) and is a forum for dialogue not only on economic issues but also on political and strategic questions. The Kuala Lumpur Declaration describes the EAS as “an open, inclusive, transparent and outward-looking forum”, with ASEAN as the driving force.

Financial Cooperation Deepening

East Asian economies have implemented a series of measures to enhance their resilience to external shocks, including financial sector restructuring, resolution of corporate debt, and the adoption of greater exchange rate flexibility among the crisis-affected economies.

Regional financial cooperation has also been strengthened in recent years, under the aegis of the ASEAN+3 finance ministers. Key measures include:

- Regional Surveillance: Through the ASEAN+3 Economic Review and Policy Dialogue (ERPDP) process, finance

ministers meet regularly to review financial and economic issues affecting member countries. Many members have set up national surveillance units for economic and financial monitoring and are developing their own early warning systems.

- Reserve Pooling: In May 2005, finance ministers agreed to substantially strengthen the Chiang Mai Initiative (CMI) by increasing bilateral currency swaps, linking them to regional economic surveillance, raising the level of disbursement permitted without an IMF program from 10% to 20%, and incorporating a collective decision-making mechanism for swap activation (a step towards multilateralization). The total swap size reached US\$75

billion as of May 2006. In May 2006, finance ministers tasked their deputies to further study various possible options toward an advanced framework of the regional liquidity support arrangement.

- The Asian Bond Markets Initiative (ABMI). The Asian Development Bank has been fostering a process of regional bond market development. Current discussions include the creation of multi-currency bonds, establishment of a regional credit guarantee mechanism, exploration of an Asian settlement system, strengthening Asian credit rating agencies in conjunction with Basel II implementation, and development of Asian Bond Standards. For its part, PECC has been working with private sector partners on bond market development in areas not covered by the ADB. These include providing private sector input into policy formulation, regional aspects of insolvency and informal workouts, and promoting awareness and interest in regional bond markets on both sides of the Pacific.

Further work is needed in regional financial cooperation, not only for the benefit of the region, but also for the stability of the global financial system as a whole. The region's experience of excess savings is likely to continue for some time, and governments should seek to use measures to allocate them optimally between regional investment and global investment. The appropriate measures might include:

- Further enhancing resilience and soundness of national financial systems so that national savings are channeled to productive investment;
- Prudently managing financial globalization at the national level (avoiding volatile capital flows and adopting sustainable exchange rate arrangements); and
- Strengthening regional financial cooperation to reduce financial vulnerabilities and to prevent and manage financial crises through regional economic surveillance, regional reserve pooling, and development of local-currency bond markets.

First Steps to a Common Asian Currency?

Since October 2005, the Asian Development Bank has been working on the idea of an Asian currency index, which is a tracking mechanism for a weighted average of Asian currencies. The creation of this index, also known as the Asian Currency Unit (ACU), has contributed to the debate on coordination of exchange rate policy in Asian economies.

The ACU can be used as an indicator of how Asian currencies are moving collectively vis-à-vis key external currencies, such as the U.S. dollar and the Euro, as well as how each Asian currency is moving against a regional benchmark. The ACU is not currently used as a policy instrument for Asian governments, but could begin to perform this function as the importance of intra-regional trade and investment expands, and as financial cooperation deepens.

The ACU index also has the potential for use in denominating the prices of bonds and other financial instruments issued in the region. In the event of a disorderly unwinding of global payments imbalances, an ACU has the potential to serve as a regional benchmark for exchange rate realignment.

The notion of a common Asian currency is still very far off, but the ACU represents a few small steps towards closer cooperation among Asian governments on monetary and exchange rate issues.

Integration in the Americas at an Impasse

Deeper economic integration in the Americas appears to have stalled, with the negotiations for a Free Trade Area of the Americas (FTAA) at an impasse. NAFTA is now well established but it is not without problems -- particularly in the area of dispute settlement. It is unclear if the current discussions on a Security and Prosperity Partnership (SPP) covering the United States, Canada, and Mexico will amount to another avenue for deeper economic integration in North America, and if it will be based on openness to the rest of the world, or on a fortress mentality.

3.2 Membership in APEC

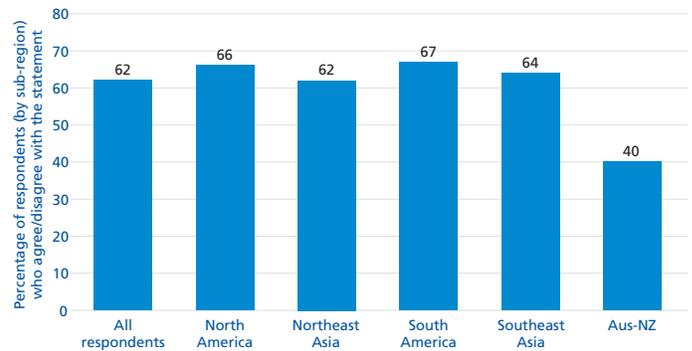
A ten-year moratorium on membership expires in 2007. Non-APEC PECC members – Colombia and Ecuador are obvious candidates. So are associate member Mongolia and the non-APEC members of ASEAN. India has also been knocking at the door of APEC since the early 1990s and was turned down at least three times, most recently in 1997, however, it is unclear if a) APEC will extend the moratorium, and b) India is still interested in becoming a member. Despite a historical chariness about the role of India in Asia Pacific institutions, a robust majority of respondents (66 percent) now believes that the emerging South Asian giant should become a member of APEC.

The findings of this survey suggest that the question of Indian membership deserves serious attention. Views about Indian membership, however, vary across the region. Whereas around 65 percent of respondents from North America, Southeast Asia and South America believe India should be included in APEC, only 40 percent of experts from Australia and New Zealand held the same opinion.

In an acknowledgement of India's growing economic clout, 74 percent of respondents from Southeast Asia and 76 percent

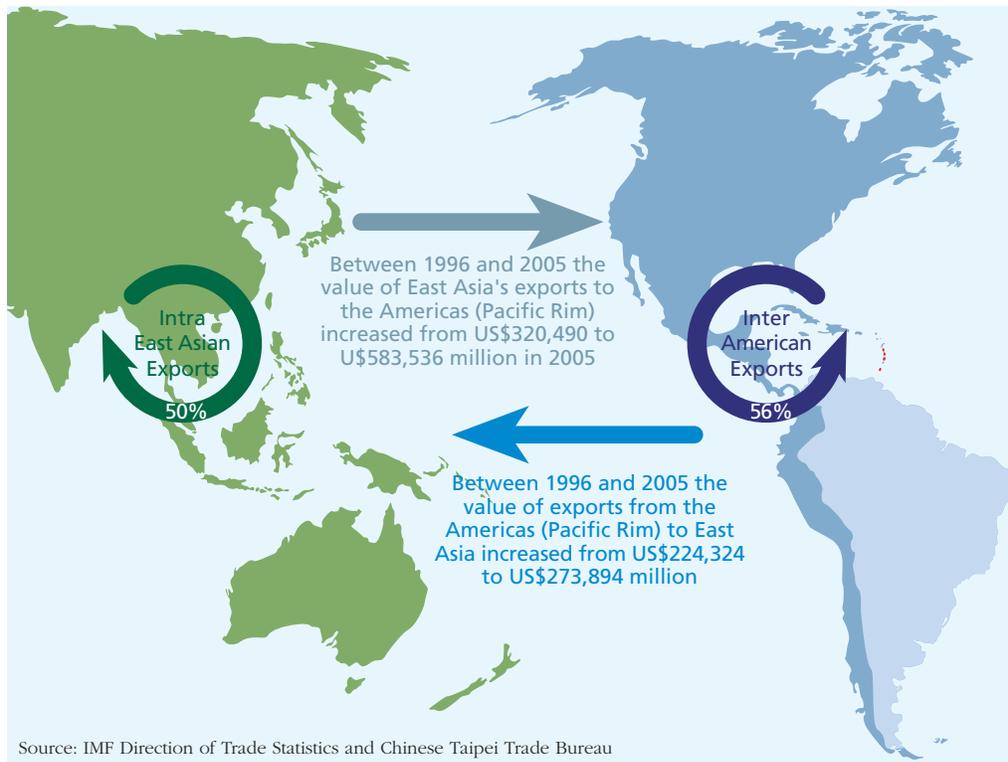
from Northeast Asia believe that India should be a member of any Asia Pacific regional organization.

Chart 13: "India Should Be a Member of APEC"



3.3 Trans-Pacific Ties

Chart 14: Asia Pacific Trade Flows: Increasing Interdependence



A defining feature of APEC - and PECC - is the trans-Pacific composition of its membership. The fact that leaders of economies from both sides of the Pacific meet annually under the auspices of APEC is an essential political anchor

for trans-Pacific cooperation across a broad range of issues. Despite the rise in intra-Asian trade and investment, the health of trans-Pacific ties continues to be critically important

did. This is in part because of the heavy emphasis in the United States on the Middle East and on security-related issues following the September 11 attacks. While these are

APEC should embrace the discussions on new regional architecture as an opportunity to reform and to renew the organization

for the world economy. East Asian integration is characterized by its outward orientation, with much of the intra-regional trade in intermediate products leading to final exports intended for the rest of the world.

The United States in particular is still a very important source of final demand for products from Asia, especially China, and trans-Pacific investment has been an important factor in the expansion of production networks in Asia. East Asia's exports to the United States in 2005 totaled over US\$500 billion, close to 90% of all of Asia's trans-Pacific trade and more than double the United States' exports to Asia.

The massive current account deficit between the United States and Asia has a financial counterpart in the substantial holdings of US treasury bills by Asian central banks. There is also a substantial volume of foreign direct investment from Asia into the Americas. Japanese companies have led the way with their extensive holdings in the automobile sector, and Chinese enterprises have more recently shown interest in acquisitions throughout North and South America, especially in the resource sector.

There is, however, considerable concern on the Asian side of the Pacific that the North American countries, particularly the United States, give less attention to APEC than they once

very important issues, Asia has by far the greater impact on America's society and future. We believe the United States needs to clarify and revitalize its APEC commitments

APEC Should Embrace Discussions on New Regional Architecture

APEC may or may not be in a position to directly address the challenges to economic growth in the previous sections, but the need for Asia Pacific economic cooperation is as important as ever. It used to be said that APEC has a future because it is the only trans-Pacific regional institution and therefore cannot be allowed to fail.

As economies on both sides of the Pacific Rim contemplate new forms of regional and sub-regional architecture, APEC can no longer be complacent. On the contrary, APEC should embrace the discussions on new regional architecture as an opportunity to reform and to renew the organization.

As the results of PECC's survey show, opinion-leaders appreciate the continued importance of APEC, but are doubtful about the commitment of member economies to the regional forum. APEC leaders meeting in Hanoi should send a clear message to dispel such doubts, and then follow up with the political will, financial resources, and institutional support to prove the doubters wrong.

T1: Real economic growth and increase in consumer prices for PEO economies, 2004-2007 (%)

	Real GDP				CPI			
	2004	2005	2006	2007	2004	2005	2006	2007
Australia	3.6	2.5	3.2	3.4	2.3	2.7	3.4	2.8
Canada	3.3	2.9	3.3	2.9	1.8	2.2	2.2	1.8
Chile	6.2	6.3	4.9	5.8	1.1	3.1	3.7	3.0
China	10.1	9.9	10.5	10.0	3.9	1.8	1.3	1.5
Colombia	4.8	5.2	4.8	4.8	5.9	5.0	4.7	4.2
Ecuador	7.9	4.7	4.3	3.0				
Hong Kong, China	8.6	7.3	6.3	5.1	-0.4	0.9	2.0	2.5
Indonesia	5.1	5.6	5.6	6.2	6.4	17.1	7.5	6.5
Japan	2.3	2.6	2.7	2.2	0.0	-0.3	0.8	0.8
Korea, Republic of	4.7	4.0	5.0	4.5	3.6	2.7	2.6	2.4
Malaysia	7.2	5.2	5.8	6.0	1.5	3.0	3.7	3.1
Mexico	4.2	3.0	4.3	3.4	4.7	4.0	3.5	3.6
New Zealand	4.1	2.9	1.9	1.4	2.3	3.0	3.9	3.4
Peru	5.2	6.4	6.9	6.3	3.7	1.6	2.6	1.9
Philippines	6.2	5.0	5.1	4.8	6.0	7.6	6.6	5.6
Singapore	8.7	6.4	7.1	5.1	1.7	0.5	1.4	1.2
Chinese Taipei	6.1	4.1	3.9	4.3	1.6	2.3	1.8	1.2
Thailand	6.2	4.5	4.5	4.5	2.8	4.5	4.7	3.8
United States	3.9	3.2	3.3	2.3	2.7	3.4	3.7	3.1
Weighted Average	5.41	4.69	4.95	4.29	2.36	2.54	2.63	2.37
WA: excl. U.S. & Japan	6.78	5.83	6.20	5.68	2.71	2.71	2.50	2.33
WA: East Asia	6.67	5.93	6.17	5.64	2.07	1.99	2.00	1.90
WA: Latin America	4.59	3.67	4.54	3.85	4.19	3.73	3.43	4.30
WA: excl. East Asia	3.89	3.20	3.47	2.65	2.72	3.21	3.40	3.00
WA: ASEAN 5	7.20	5.52	5.93	5.31	2.80	4.58	3.78	3.19
WA: Australia & New Zealand	3.65	2.54	2.96	3.05	2.33	2.73	3.49	2.91
WA: North America	3.83	3.14	3.44	2.52	2.75	3.25	3.40	2.95

Note: National currency based. The weighted average is based on the respective economies' 2003-2005 total trade merchandise (see Appendix Table 8).

Source: PEO forecasters.

	GDP GROWTH				CPI				
	2004	2005	2006	2007	2004	2005	2006	2007	
All PEO economies	5.41	4.69	4.95	4.29	All PEO economies	2.36	2.54	2.63	2.37
Excl. U.S. & Japan	6.78	5.83	6.20	5.68	Excl. U.S. & Japan	2.71	2.71	2.50	2.33
East Asia	6.67	5.93	6.17	5.64	East Asia	2.07	1.99	2.00	1.90
Latin America	4.59	3.67	4.54	3.85	Latin America	4.19	3.73	3.43	4.30
Excluding E.Asia	3.89	3.20	3.47	2.65	Excluding E.Asia	2.72	3.21	3.40	3.00
WA: ASEAN 5	7.2	5.52	5.93	5.31	ASEAN 5	2.8	4.58	3.78	3.19
WA: Australia & New Zealand	3.65	2.54	2.96	3.05	Australia & New Zealand	2.33	2.73	3.49	2.91

T2: Real export and import growth for PEO economies, 2004-2007 (%)

	Exports				Imports			
	2004	2005	2006	2007	2004	2005	2006	2007
Australia	4.0	2.0	4.0	10.0	15.0	8.5	5.7	4.5
Canada	5.2	2.1	4.2	5.3	8.2	7.1	6.0	6.2
Chile	11.8	6.1	4.7	6.1	18.0	20.4	9.0	5.5
China	26.5	20.3	14.7	13.0	26.4	10.7	16.4	16.3
Colombia	11.3	6.3	5.0	5.7	15.8	22.6	17.2	10.1
Ecuador	15.8	7.4	7.3	1.0	11.1	13.5	7.4	4.1
Hong Kong, China	15.8	10.7	8.6	8.1	14.2	8.1	8.2	7.8
Indonesia	13.5	8.6	7.1	11.3	27.1	12.3	10.9	14.5
Japan	13.9	7.0	8.3	5.1	8.5	6.2	4.8	3.2
Korea, Republic of	19.6	8.5	12.9	10.0	13.9	6.9	13.2	10.5
Malaysia	16.3	8.6	7.7	7.4	20.7	8.0	10.0	8.4
Mexico	11.6	6.9	10.0	6.5	11.6	8.7	12.0	7.4
New Zealand	5.6	-0.2	1.9	2.8	16.6	6.5	-0.7	3.8
Peru	14.7	14.1	3.1	9.2	10.6	10.0	16.6	11.5
Philippines	14.4	4.2	5.9	5.1	5.8	2.4	1.1	7.5
Singapore	20.6	11.0	13.0	8.7	23.2	10.3	13.8	8.7
Chinese Taipei	15.0	7.3	9.0	4.7	18.6	3.8	6.1	2.4
Thailand	9.6	4.3	8.7	5.4	13.5	9.4	3.1	5.0
United States	9.2	6.8	8.2	7.1	10.8	6.1	6.4	6.4
Weighted Average	14.02	8.79	9.32	7.78	14.56	7.68	8.75	7.81
WA: excl. U.S. & Japan	16.39	10.14	9.93	8.64	17.65	8.75	10.69	9.44
WA: East Asia	18.50	11.33	10.80	8.56	17.59	8.16	10.18	9.00
WA: Latin America	11.90	7.08	8.72	6.36	12.52	11.05	12.08	7.45
WA: excl. East Asia	8.61	5.72	7.35	6.83	10.89	7.09	7.03	6.38

Note: Export/Imports of goods and services. National currency based. The weighted average is based on the respective economies' 2003-2005 total trade merchandise (see Appendix Table 8).

Source: PEO forecasters.

	Exports				Imports				
	2004	2005	2006	2007	2004	2005	2006	2007	
All PEO economies	14.02	8.79	9.32	7.78	All PEO economies	14.56	7.68	8.75	7.81
Excl. U.S. & Japan	16.39	10.14	9.93	8.64	Excl. U.S. & Japan	17.65	8.75	10.69	9.44
East Asia	18.50	11.33	10.80	8.56	East Asia	17.59	8.16	10.18	9.00
Latin America	11.90	7.08	8.72	6.36	Latin America	12.52	11.05	12.08	7.45
Excluding E.Asia	8.61	5.72	7.35	6.83	Excluding E.Asia	10.89	7.09	7.03	6.38

T3: Current account of the balance of payments for the PEO economies, 2003-2007 (US\$B and % of GDP)

	2003	% of GDP	2004	% of GDP	2005	% of GDP	2006	% of GDP	2007	% of GDP
Australia	-28.5	-5.6	-39.8	-6.3	-42.4	-6.0	-41.0	-5.5	-43.8	-5.4
Canada	10.1	1.2	21.3	2.1	26.7	2.3	36.7	2.9	29.9	2.4
Chile	-1.0	-1.3	1.6	1.7	0.7	0.6	5.0	3.6	3.9	2.2
China	45.9	3.0	68.7	4.0	160.8	7.0	171.3	6.0	165.1	5.0
Colombia	-1.0	-1.2	-0.9	-1.0	-2.0	-1.6	-1.6	-1.2	-3.5	-2.4
Ecuador	-0.4	-1.5	-0.6	-1.7	-0.1	-0.2	0.7	1.8	0.8	0.9
Hong Kong, China	16.5	10.4	15.7	9.5	20.2	11.4	20.1	10.5	21.4	10.4
Indonesia	8.1	3.4	3.1	1.2	0.3	0.1	4.8	1.4	6.6	2.8
Japan	136.3	3.2	172.7	3.8	167.5	3.7	159.0	3.5	177.9	3.5
Korea, Republic of	11.9	2.0	28.2	4.1	16.6	2.1	4.0	0.5	1.1	0.1
Malaysia	13.3	12.8	14.9	12.6	20.0	15.3	23.9	16.0	25.8	15.9
Mexico	-8.6	-1.3	-6.7	-1.0	-4.6	-0.6	-1.9	-0.2	-9.0	-1.0
New Zealand	9.4	4.2	10.0	4.8	15.6	7.4	22.9	9.3	24.7	8.6
Peru	-0.9	-1.5	0.0	0.0	1.1	1.4	1.3	1.5	0.3	0.3
Philippines	3.3	4.2	2.1	2.4	2.4	2.4	2.0	1.7	1.3	1.0
Singapore	22.3	24.1	26.3	24.5	33.3	28.5	38.3	29.0	39.3	28.0
Chinese Taipei	29.3	9.8	18.5	5.7	16.1	4.6	17.1	4.8	16.7	4.4
Thailand	7.9	5.6	6.8	4.2	-3.6	-2.0	1.3	0.6	-0.6	-0.3
United States	-512.3	-4.7	-649.1	-5.5	-771.4	-6.2	-840.7	-6.3	-840.7	-6.0
Total		-238.3		-307.3		-342.9		-376.8		-382.9
Total: excl. U.S. & Japan		137.7		169.1		261.0		304.9		279.9
Total: East Asia		294.9		356.9		433.5		441.7		454.6
Total: Latin America		-11.9		-6.6		-4.9		3.6		-7.5
Total: excl. East Asia		-533.2		-664.2		-776.4		-818.6		-837.4

Note: The weighted average is based on the respective economies' 2002-2004 total trade merchandise (see Appendix Table 4).

Source: PEO forecasters.

Current Account Balance

	2003	2004	2005	2006	2007
All PEO economies	-238.3	-307.3	-342.9	-376.8	-382.9
U.S.	-512.3	-649.1	-771.4	-840.7	-840.7
East Asia	294.9	356.9	433.5	441.7	454.6
Rest of PEO	-20.9	-15.1	-5.0	22.1	3.2

T4: Forecast of contributions to real GDP/GNP growth rate for PEO economies, 2006-2007 (% per year)

		GDP growth rate	Personal consumption expenditure	Gross private domestic expenditure	Government purchasing investment	Net exports
Australia	2006	3.2	1.9	1.7	0.5	-0.6
	2007	3.4	1.8	0.6	0.5	0.7
Canada	2006	3.3	2.1	1.0	0.8	-0.7
	2007	2.9	1.6	1.1	0.7	-0.4
Chile	2006	4.9	4.1		-10.7	-2.0
	2007	5.8				
China	2006	10.5	7.5	8.4		0.3
	2007	10.0	5.6	7.6		-0.4
Colombia	2006	4.8	3.0	3.2	1.7	-3.0
	2007	4.8	3.0	1.9	1.4	-1.5
Ecuador	2006	4.3	2.7	1.6	0.3	-0.3
	2007	3.0	2.3	1.8	0.3	-1.4
Hong Kong, China	2006	6.3	2.1	2.0	0.0	2.2
	2007	5.1	1.7	1.6	0.0	1.8
Indonesia	2006	5.6	2.3	1.3	1.0	-0.8
	2007	6.2	2.2	2.7	0.7	-0.5
Japan	2006	2.7	1.0	1.3	-0.2	0.6
	2007	2.2	1.0	0.9	0.0	0.4
Korea, Republic of	2006	5.0	2.1	1.3	0.5	1.0
	2007	4.5	2.0	1.2	0.5	0.8
Malaysia	2006	5.8	3.5	1.8	2.4	-1.9
	2007	6.0	3.3	1.4	2.0	-0.6
Mexico	2006	4.3	3.8	1.5	0.2	-1.2
	2007	3.4	2.8	1.2	0.1	-0.7
New Zealand	2006	1.9	2.5	0.9	1.0	0.9
	2007	1.4	0.8	-1.5	1.0	-0.5
Peru	2006	6.9	3.4	4.2	1.7	-2.4
	2007	6.3	3.1	1.7	1.9	-0.4
Philippines	2006	5.1	3.8	-0.2	0.6	2.0
	2007	4.8	3.8	0.4	0.4	-1.3
Singapore	2006	7.1	1.7	3.0	-0.1	2.2
	2007	5.1	1.1	1.3	0.1	2.8
Chinese Taipei	2006	3.9	1.1	0.3	0.0	2.6
	2007	4.3	1.5	0.7	0.2	1.9
Thailand	2006	4.5	2.0	-1.7	0.1	4.0
	2007	4.5	2.2	1.7	0.3	0.9
United States	2006	3.3	2.3	1.0	0.3	-0.2
	2007	2.3	2.3	0.2	0.1	-0.3

Note: National currency based. Components of GDP/GNP do not add up to overall growth rates for some economies, due to statistical discrepancies.

Source: PEO forecasters.

T5: Actual and forecast levels of short-term, long-term interest rates for PEO economies, 2004-2007 (%)

	Short-term interest rates					Long-term interest rates				
	Type	2004	2005	2006	2007	Type	2004	2005	2006	2007
Australia	90-day Dealer Bill rate (period average)	5.47	5.63	5.63	5.81	10-yr Government bond yield (period average)	5.61	5.40	5.41	5.67
Canada	Overnight Rate	2.25	2.75	4.13	4.13	Canada 10-Yr	4.50	4.03	4.39	4.31
Chile	30-day deposit rate	1.92	3.86	4.89	\	10-yr Central Bank bond	6.25	6.01	6.34	\
China	1 yr. Deposit	2.25	2.25	2.52	2.50	5-yr + Deposit	3.60	3.60	4.14	4.10
Colombia	DTF-90 days (Corresponds to 90 days certificate deposit nominal interest rate)	7.80	7.01	6.09	\	TES-Largo plazo (Corresponds to long term (9 yrs to 16 yrs) nominal interest rate for Colombian treasury bills)	13.42	10.60	8.59	\
Ecuador		3.80	4.30	4.47	4.50		6.64	6.78	7.44	8.00
Hong Kong, China	3-mth HIBOR	0.42	3.15	4.30	4.50	HK Ex FB 10 yrs	4.06	3.98	4.80	5.00
Indonesia	1-mth Bank Indonesia certificate (end of year)	7.40	12.75	10.50	9.00	10-yr government bond	10.00	13.20	11.50	10.50
Japan	3-mth CD rate	0.01	0.01	0.20	0.66	10-yr govt bond	1.51	1.37	1.82	2.15
Korea, Republic of	1 yr. treasury bond yield	3.92	3.97	4.60	4.80	10-yr treasury bond yield	4.73	4.95	5.30	5.60
Malaysia	3-mth	3.00	3.02	3.10	\	5 years	3.64	3.73	4.08	\
Mexico	Cetes 28 days end, annual average	6.84	9.19	7.17	6.52	10-yr FR bond, annual average	9.59	9.44	8.37	7.83
New Zealand	90 day, avg calendar yr	6.13	7.11	7.50	6.91	10-yr, avg calendar yr	6.07	5.87	5.87	6.16
Peru	Central bank reference interest rate	2.68	3.05	4.61	5.28	Discount rate more than 360 days	26.52	24.94	24.67	25.33
Philippines	91-day T-bill	7.32	6.13	5.88	6.15	364-day T-bill	9.24	8.66	7.29	7.22
Singapore	3-Mth Interbank Rate (End of Period)	1.44	3.25	3.56	3.70	15-Yr Bond Yield (End of Period)	3.03	3.41	3.63	3.80
Chinese Taipei	Interbank overnight rate	1.06	1.31	1.60	1.84	10-yr Gov.t Bond	2.66	2.05	2.19	2.95
Thailand	Inter Bank average	1.23	2.62	0.60	4.50	MLR	5.63	5.95	7.60	7.75
United States	3-Mth T-bill	1.38	3.15	4.76	4.90	10-Yr T-bond	4.27	4.29	5.06	5.67

Source: PEO forecasters.

T6: Exchange Rates, 2004-2007 (Local Currency Per US\$)

	2004	2005	2006	2007
Australia	1.37	1.31	1.33	1.30
Canada	1.30	1.19	1.16	1.22
Chile	609.53	559.77	\	\
China	8.28	8.19	7.95	7.71
Colombia	2628.47	2321.49	2426.11	2312.03
Ecuador	1.00	1.00	1.00	1.00
Hong Kong, China	7.80	7.80	7.80	7.80
Indonesia	8985.42	9750.58	9200.00	9300.00
Japan	108.15	110.13	112.93	104.50
Korea, Republic of	1143.70	1024.10	962.00	950.00
Malaysia	3.80	3.78	3.68	3.68
Mexico	11.29	10.89	10.91	11.14
New Zealand	1.51	1.42	1.59	1.80
Peru	3.41	3.30	3.29	3.25
Philippines	56.04	55.08	52.50	53.08
Singapore	1.69	1.66	1.60	1.60
Chinese Taipei	33.42	32.17	32.48	31.89
Thailand	40.3	40.3	38.1	38.00
United States	1.00	1.00	1.00	1.00

Source: PEO forecasters.

T7: GDP Deflator Index

GDP Deflator Index					
	Base Year	2004	2005	2006	2007
Australia	2003-04*	101.50	106.09	110.78	113.22
Canada	1997	114.80	118.40	121.08	123.06
Chile	1996	\	\	\	\
China	2001	110.30	114.50	117.90	120.90
Colombia	1994	303.95	322.59	336.96	348.01
Ecuador	2000	166.86	178.12	186.34	191.88
Hong Kong, China	2000	88.52	85.31	86.50	88.20
Indonesia	2000	137.20	156.02	167.10	113.66
Japan	2000	94.55	93.33	92.91	93.79
Korea, Republic of	2000	112.30	111.80	111.50	112.60
Malaysia	1987	180.60	188.90	197.80	203.00
Mexico	1993	452.21	476.84	502.21	530.03
New Zealand	1995/6	114.22	118.66	121.81	123.94
Peru	1994	170.51	176.25	188.97	191.03
Philippines	1997	155.21	164.90	174.96	188.26
Singapore	2000	99.92	100.47	102.08	103.41
Chinese Taipei	2001	95.49	94.99	94.26	94.03
Thailand	1988	176.80	184.90	194.00	201.80
United States	2000	109.43	112.74	116.38	120.43

Note: Base year = 100 unless otherwise noted.

* Australian financial year, covering Q3-Q4 of 2003 and Q1-Q2 of 2004.

Source: PEO forecasters.

T8: Trade Weights, 2003-2005 average (%)

	All countries	East Asia	Excluding United States and Japan	Excluding East Asia	Latin America	ASEAN 5	Australia & New Zealand	North America
Australia	2.39%		4.05%	5.29%			82.25%	
Canada	7.32%		12.38%	16.18%				17.96%
Chile	0.69%		1.17%	1.53%	10.80%			
China	14.00%	25.58%	23.65%					
Colombia	0.42%		0.71%	0.92%	6.50%			
Ecuador	0.20%		0.33%	0.43%	3.04%			
Hong Kong, China	6.51%	11.89%	10.99%					
Indonesia	1.59%	2.90%	2.68%			13.03%		
Japan	12.20%	22.29%						
Korea	5.70%	10.42%	9.64%					
Malaysia	2.76%	5.04%	4.66%			22.64%		
Mexico	4.83%		8.16%	10.67%	75.21%			11.85%
New Zealand	0.52%		0.87%	1.14%			17.75%	
Peru	0.29%		0.48%	0.63%	4.44%			
Philippines	1.00%	1.84%	1.70%			8.25%		
Singapore	4.48%	8.19%	7.58%			36.81%		
Chinese Taipei	4.14%	7.56%	6.99%					
Thailand	2.35%	4.29%	3.97%			19.28%		
United States	28.62%			63.21%				70.19%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Compiled from WTO Statistics. Trade Weights is the total merchandise (imports and exports) of each country over the total trade merchandise of PEO economies.



Annex 2: Survey Results

SURVEY OF EXPERTS ON THE STATE OF THE REGION

Number of Respondents: 370

NGO: 20

Media: 9

Government: 68

Business: 91

Academic: 178

Other: 4

Regional Breakdown:

North America: 61

Northeast Asia: 113

South America: 66

Southeast Asia: 95

Australia/New Zealand: 35

Regional Views on the Asia Pacific Economic Outlook for the next 1-2 years:

	Much Stronger	Somewhat Stronger	About the Same
Asia Pacific	15%	49%	23%
Southeast Asia	3%	44%	29%
South America	1%	21%	46%
Australia/New Zealand	2%	24%	49%
The United States	3%	16%	36%
China	36%	28%	25%
Japan	8%	47%	35%
India	24%	49%	21%

Regional Views on the Asia Pacific Economic Outlook for the next 3-5 years

	Much Stronger	Somewhat Stronger	About the Same
Asia Pacific	22%	52%	18%
Southeast Asia	17%	52%	21%
South America	3%	29%	43%
Australia/New Zealand	3%	27%	45%
The United States	3%	25%	39%
China	34%	38%	17%
Japan	9%	52%	28%
India	29%	50%	14%

Regional Views on the Short-Term Risks to the Economic Outlook

	Very Serious Risk	Serious Risk	Moderately Serious Risk
Avian Flu and Other Health Pandemics	12%	24%	28%
Natural Disasters	7%	25%	35%
Water Pollution and Shortages	8%	27%	38%
High Energy Prices	27%	42%	23%
Proliferation of Preferential Trade Agreements	7%	20%	33%
Failure of the Doha Developments Round	13%	24%	34%
Protectionism	11%	28%	36%
Financial Market Volatility	8%	31%	41%
Trans-Pacific Current Account Imbalances	7%	25%	42%
Conflict in the Korean Peninsula	9%	22%	31%
Cross-Straits Relations	4%	15%	35%
Major Power Rivalries	5%	17%	38%
Terrorist Acts and Policy Responses to Them	13%	34%	32%

Regional Views on the Long-Term Risks to the Economic Outlook

	Very Serious Risk	Serious Risk	Moderately Serious Risk
Avian Flu and Other Health Pandemics	8%	24%	29%
Natural Disasters	8%	23%	36%
Water Pollution and Shortages	16%	34%	28%
High Energy Prices	23%	36%	25%
Proliferation of Preferential Trade Agreements	8%	22%	33%
Failure of the Doha Developments Round	11%	21%	32%
Protectionism	9%	32%	29%
Financial Market Volatility	9%	26%	41%
Trans-Pacific Current Account Imbalances	7%	26%	39%
Conflict in the Korean Peninsula	6%	19%	37%
Cross-Straits Relations	3%	12%	35%
Major Power Rivalries	6%	25%	30%
Terrorist Acts and Policy Responses to Them	13%	27%	32%

Effectiveness of Regional Institutions

The Association of Southeast Asian Nations (ASEAN)

	Highly Effective	Effective	Moderately Effective
Liberalization of Trade and Investment	7%	27%	33%
Political and Security Dialogue	8%	33%	31%
Economic Cooperation / Technical Assistance	6%	30%	33%
Allowing Leaders to Discuss Immediate Economic Issues	17%	39%	25%
Community Building	11%	33%	29%
Building Regional Institutions	8%	28%	35%
Addressing the Needs of the Business Community	3%	20%	39%

The East Asian Summit (EAS)

	Highly Effective	Effective	Moderately Effective
Liberalization of Trade and Investment	5%	14%	27%
Political and Security Dialogue	8%	22%	29%
Economic Cooperation / Technical Assistance	4%	21%	29%
Allowing Leaders to Discuss Immediate Economic Issues	14%	27%	29%
Community Building	7%	17%	30%
Building Regional Institutions	4%	16%	25%
Addressing the Needs of the Business Community	3%	15%	28%

The Asia Pacific Economic Cooperation process (APEC)

	Highly Effective	Effective	Moderately Effective
Liberalization of Trade and Investment	4%	23%	38%
Political and Security Dialogue	4%	24%	36%
Economic Cooperation / Technical Assistance	8%	24%	40%
Allowing Leaders to Discuss Immediate Economic Issues	21%	35%	26%
Community Building	7%	21%	38%
Building Regional Institutions	6%	18%	34%
Addressing the Needs of the Business Community	7%	25%	35%

The ASEAN Regional Forum (ARF)

	Highly Effective	Effective	Moderately Effective
Liberalization of Trade and Investment	2%	13%	25%
Political and Security Dialogue	8%	32%	25%
Economic Cooperation / Technical Assistance	1%	15%	27%
Allowing Leaders to Discuss Immediate Economic Issues	11%	27%	21%
Community Building	5%	16%	29%
Building Regional Institutions	5%	14%	28%
Addressing the Needs of the Business Community	2%	13%	23%

The Asian Development Bank

	Highly Effective	Effective	Moderately Effective
Liberalization of Trade and Investment	2%	13%	29%
Political and Security Dialogue	1%	6%	14%
Economic Cooperation / Technical Assistance	14%	32%	27%
Allowing Leaders to Discuss Immediate Economic Issues	3%	11% ²	2%
Community Building	3%	13%	24%
Building Regional Institutions	4%	21%	28%
Addressing the Needs of the Business Community	5%	18%	32%

Asia Pacific Regional Organizations

	Strongly Agree	Agree
The EAS process will eventually overshadow APEC	3%	24%
APEC is an important today as it was in 1989	9%	33%
India should be a member of APEC	15%	46%
India Should be part of any Asia Pacific regional organization	17%	52%

How important are the following APEC activities?

	Very Important	Important
Trade and investment liberalization	29%	29%
Trade Facilitation	33%	28%
Economic and Technical Cooperation	21%	41%
Individual Action Plans	10%	19%
Peer Review	12%	21%
Annual Leaders' Meeting	35%	28%
Trade Ministers' Meeting	26%	41%
Finance Ministers' Meeting	22%	35%
APEC CEO Summit	22%	28%

What are the challenges for APEC?

	Very Important	Important
Lack of focus on relevant issues	25%	30%
Competition from the East Asian Summit	8%	22%
Weak international secretariat	12%	24%
Lack of commitment from key member economies	28%	35%
Lack of relevance to issues facing ordinary citizens	14%	29%
Excessive number of meetings	11%	20%
Limited central budget for APEC activities	12%	28%

What are the policy priorities for regional cooperation?

	Very Important	Important
Reducing corruption and increasing transparency	32%	33%
Reducing tariff barriers	31%	35%
Protecting intellectual property rights	26%	34%
Reducing the costs of doing business by cutting red tape	32%	32%
Ensuring energy security	25%	40%
Preparing for disease pandemics	18%	34%
Reducing distortions to trade due to the proliferation of bilateral trade agreements	16%	31%
Strengthening regional financial architecture	17%	41%
Reducing the digital divide	9%	25%
Engaging in counter-terrorism	19%	23%
Ensuring the safety and security of trade	21%	32%
Investment in physical infrastructure to facilitate trade	21%	33%

Annex 3: Pacific Economic
Outlook Forecasters



Pacific Economic Outlook Forecasting Panel, 2006-2007

Chair

Yuen Pau Woo
President and co-CEO
Asia Pacific Foundation of Canada

Australia

Professor Philip Adams
Director, Centre of Policy Studies
Monash University

Canada

Dr. Jim Storey
Senior Manager, Portfolio Strategy
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Sergio Daniel Lehmann
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Dr. Mun Heng Toh
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Dr. Pattama Teanravisitsagool
Executive Director of Macroeconomic Policy Office
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Prof. Saul H. Hymans
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Annex 4: PECC Member Committees



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Glossary

ABMI	Asian Bond Markets Initiative
ACU	Asian Currency Unit
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
APEC	Asia Pacific Economic Cooperation
APFC	Asia Pacific Foundation of Canada
APT	ASEAN Plus Three
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEAN + 3	Association of Southeast Asian Nations plus China, Japan and Korea
ASEAN5	Indonesia, Malaysia, Philippines, Singapore and Thailand
CMI	Chiang Mai Initiative
CPI	Consumer Price Index
CSIS	Centre for Strategic and International Studies (Jakarta)
EAFTA	East Asian Free Trade Area/Agreement
EAS	East Asia Summit
EAVG	East Asian Vision Group
EMEAP	Executive Meeting of East Asia Pacific
ERPD	Economic Review and Policy Dialogue
FDI	Foreign Direct Investment
FED	United States Federal Reserve
FTAs	Free Trade Agreements
FTAA	Free Trade Agreement of the Americas
FTAAP	Free Trade Area of the Asia Pacific
GDP	Gross Domestic Product
KISER	Kansai Institute for Social and Economic Research
IMF	International Monetary Fund
Latin America	Chile, Colombia, Ecuador and Peru (Latin American PECC member economies)
NAFTA	North America Free Trade Agreement
North America	Canada, United States of America and Mexico
Northeast Asia	China, Hong Kong (China), Japan, Korea, Chinese Taipei
PECC	Pacific Economic Cooperation Council
PEO	Pacific Economic Outlook
PPI	Producers' Price Index
PTAs	Preferential Trade Agreements
SARS	Severe Acute Respiratory Syndrome (SARS)
SOTR	State of the Region
Southeast Asia	Indonesia, Malaysia, Philippines, Singapore and Thailand (in this publication)
SPP	Security and Prosperity Partnership
UN	United Nations
USAPC	United States Asia Pacific Council
WTO	World Trade Organization

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