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Notes for Contributors

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The Role of the Private Sector in Bond Market Development Insights from the Work of ABAC and PECC

Julius Caesar Parrenas

The public and private sectors each have proper roles to play in development. A healthy market economy is normally one where the private sector engages in robust innovation and competition, while the public sector provides sound legal and policy frameworks, regulation and supervision. However, there is much scope for both sectors to help enhance each other's effectiveness in playing their respective roles. There are also areas where direct collaboration can be fruitful, such as in the development of markets and infrastructure.

One such potential area of collaboration, the development of bond markets, is highly relevant to the Asia-Pacific region's current situation. Deep and liquid local currency bond markets have a key role to play in financial stability and economic development. The Asian financial crisis of 1997-98 underscored the importance of long-term local currency funding for financial stability. The development of bond markets also addresses key issues such as the funding of infrastructure and small enterprises. Such markets provide opportunities to a range of market players, including institutional and retail investors, borrowers, intermediaries, and professional service providers.

Experiences of bond market development in East Asia and Latin America illustrate the importance of cooperation between public and private sectors. Policy-makers in the Asia-Pacific region are conscious of the need to design financial systems and market infrastructure in cooperation with the private sector, especially global, regional and domestic market players. The involvement of organized private sector-led groups such as ABAC and PECC in APEC initiatives, as well as that of regional industry groupings such as the Asian Bankers' Association (ABA) and the Association of Credit Rating Agencies in Asia (ACRAA), is part of this growing cooperation.

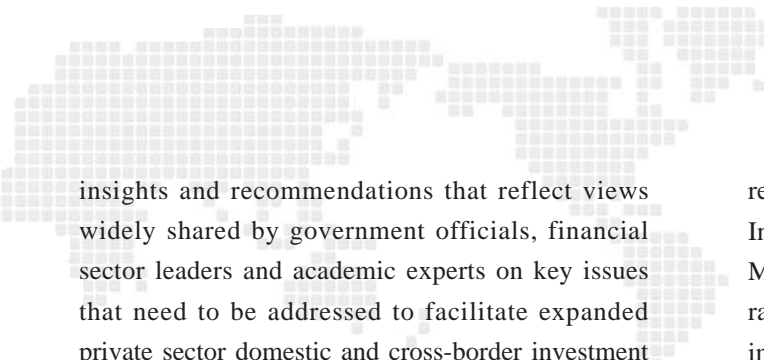
Within East Asia, there is a growing realization

that public sector priorities must be made to converge with private sector needs, if initiatives to develop bond markets are to succeed. Private sector needs are focused on having efficient markets providing liquidity and transparency, an enabling environment providing political and economic stability as well as a sound regulatory framework, and robust and efficient capital market infrastructure. Public sector priorities are focused on improving regulation and supervision and information disclosure and promoting regional settlement linkages, regional guarantee mechanisms and fiscal incentives.

To promote this convergence, ABAC and PECC have jointly undertaken significant work in cooperation with other international institutions to initiate dialogue among the private sector, academe and government on the development of local currency bond markets in the Asia-Pacific region. These efforts culminated in two major conferences - one in Taipei in May 2004 which attracted various experts and active private sector participants in the region's bond markets, and another in Tokyo in June 2005 which brought these private sector representatives together with regulators and officials from the Asia-Pacific Economic Cooperation (APEC) member economies and various international institutions.¹

In 2006, PECC also held a symposium in Washington, D.C.² aimed at promoting the participation of a wider circle of investors and issuers from both sides of the Pacific in the region's bond markets, as well as trans-Pacific collaboration in capacity-building to facilitate local currency bond market development in the region. It brought together current and potential investors, issuers and other participants in the region's bond markets, as well as relevant regulators and officials from both sides of the Pacific.

The reports of these conferences provided



insights and recommendations that reflect views widely shared by government officials, financial sector leaders and academic experts on key issues that need to be addressed to facilitate expanded private sector domestic and cross-border investment and issuance in the region's local currency bond markets. These views may be summarized as follows:

- The development of local currency bond markets in many developing APEC member economies is still at an early stage, and some are presently too small for effective bond issuance. There are wide disparities among developing APEC economies: a number of more developed emerging markets have made significant advances, while the others are still in the early stages of development. For the former, the main focus of concern is on enhancing market depth and liquidity. For the latter, the focus is on fundamental issues related to the depth and liquidity of capital markets (including benchmark yield curves, the investor base, savings) and the regulatory framework (such as disclosure, protection of creditor rights, enforcement).
- At present, intra-regional cross-border investment and issuance in emerging local currency bond markets are insignificant, owing to various restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies. Restrictions that apply to foreign firms, which impede their participation in domestic bond market making processes, also contribute to the insignificant flow of investor funds and issuance. Capital controls, where they are maintained, severely impact cross border investment and market liquidity.
- The underdevelopment of the local and regional institutional investor base is a major obstacle to the growth of local currency bond markets in a number of developing economies, particularly in Asia. Various long-term issues need to be addressed, including the underdevelopment of the private pension and mutual fund industries and limits on life insurance fund investment activities.
- While markets may evolve naturally, there is more than enough scope for accelerating their development through efforts of individual economies or

regional initiatives such as the Asian Bond Market Initiative (ABMI) or the Asian Bond Fund (ABF). Markets and institutions have developed more rapidly where the private sector has been properly involved in the design of regulation and market infrastructure, in promoting ethical and efficient market practices and conventions, market surveillance, and competitive pricing, and in providing physical infrastructure. The experiences of advanced economies also provide useful lessons and a body of continuously evolving international best practice that could benefit emerging markets, which makes it important for developed economies to participate actively in regional collaborative efforts. There is much to be gained from trans-Pacific cooperation, particularly in the development of pension funds, as well as in promoting cross-border investment and issuance in non-G3 currency bond markets to increase market liquidity. There should be more regular dialogues between officials and private sector market players,

- Bond market development is a complex issue, involving a broad range of policy areas and sectors and a large number of institutions and market players. Liquid bond markets require sound institutional frameworks and market infrastructure, as well as a robust investor and issuer base, a sufficient number of market makers, a wide variety of financial instruments, sound macroeconomic policies and an open economy and financial sector. Government bond markets play an important role in the development of private long-term debt markets, particularly in ensuring market liquidity and facilitating risk management. Properly sequenced concomitant reforms and capacity-building measures, undertaken in partnership with the private sector, are therefore needed in these areas.
- Efforts should focus on substantial improvement in width, depth and market infrastructure of local currency bond markets, and an enabling environment for expanded private sector activity in these markets. The ultimate goal for the Asia-Pacific region should be the emergence of a regional bond

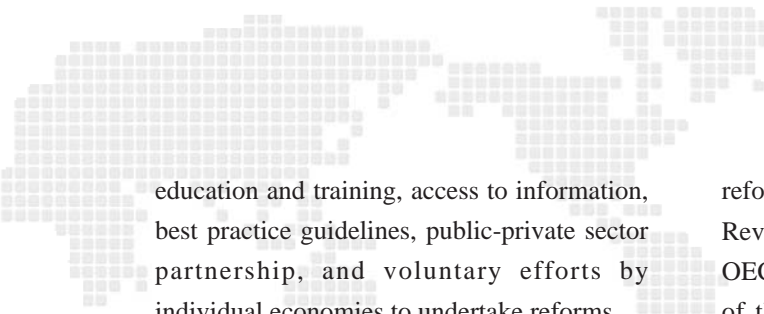
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market where bonds issued in local currencies can be freely invested in and traded by both domestic and foreign participants.

- To accelerate the process of bond market development, a number of critical **legal, policy, regulatory and administrative reforms** need to be given priority by governments. These include: (a) relaxing regulations on market participation, new financial products, repo transactions, short-selling and the use of derivatives; (b) reform of accounting and investment rules, tax and insolvency laws, banking and capital market regulations and administrative procedures, as well as pension systems; (c) addressing basic issues such as judicial independence, the application and enforcement of laws and property rights; (d) frequent regular issuance of public sector bonds to build a benchmark treasury yield curve across a broad range of maturities; (e) improving coordination among domestic agencies involved in bond market development; and (f) undertaking concrete steps toward flexible exchange rate regimes.
- To facilitate the expansion of domestic and cross-border investment and issuance in the region's bond markets, governments need to intensify **regional capacity-building efforts** in partnership with the private sector. Particular areas where APEC regional cooperation should play a significant role are the following:
 - a. *Expanding the region's institutional investor base.* APEC should undertake policy dialogue and cooperation involving the private sector to encourage broader cross-border investment by institutional investors in domestic bond markets. These efforts should focus on helping economies provide an enabling environment with respect to:
 - ◆ government bond issuance program to support the yield curve;
 - ◆ tax regimes;
 - ◆ documentation and practices in markets;
 - ◆ the environment for assessing risk and return in traded instruments; and
 - ◆ regulations governing markets and settlement systems.
 - b. *Developing a strong regional credit rating industry.* APEC should strengthen the credit

rating industry in the region and lay the groundwork for the commercial and technical viability of regional ratings. Efforts should focus on:

- ◆ analytical skills and best international practices in domestic credit rating agencies;
 - ◆ key areas crucial to the performance of rating agencies (corporate governance, accounting standards, disclosure, regulation and open markets);
 - ◆ harmonization of rating practices in the region to make ratings more comparable and understandable to cross-border investors;
 - ◆ cooperation among domestic rating agencies to develop regional default studies; cross-border rating exercises and regional ratings; and
 - ◆ deepening the understanding of credit culture and the role of credit ratings in capital markets within the region.
- c. *Promoting effective domestic and region-wide insolvency and creditor rights systems.* Much has been done to identify measures and develop principles for improving insolvency and creditor rights systems within the region. In particular, the ADB has developed in partnership with the Asian Bankers' Association a set of non-binding regional guidelines for informal workouts, with an accompanying model agreement that may be adopted by financial institutions to suit a particular jurisdiction or individual workout, as well as a set of proposals to support effective informal workout regimes in the region. APEC should focus on promoting the timely adoption of these measures and principles, particularly with respect to:
- ◆ cross-border recognition of insolvency administrations;
 - ◆ balance and consistency between the secured transactions and insolvency law regimes;
 - ◆ the wider adoption by financial institutions in the region of the non-binding regional guidelines for informal workouts and the accompanying model agreement, and the proposed policies to support the development of effective informal workout regimes; and
 - ◆ capacity-building projects involving



education and training, access to information, best practice guidelines, public-private sector partnership, and voluntary efforts by individual economies to undertake reforms.

d. Promoting region-wide convergence toward robust global accounting standards. APEC should address issues related to the development and adoption of global accounting standards and to accelerating convergence with these standards within the region. These efforts should include:

- ◆ promoting a regional forum of domestic accounting standard-setting bodies within APEC to help expand regional inputs into the further development of global accounting standards;
- ◆ a common policy statement on convergence; and
- ◆ a policy initiative to help document domestic convergence plans, develop a regional convergence plan, identify capacity-building resources, and provide technical and financial support for region-wide convergence.

The 2005 Tokyo conference co-organized by ABAC and PECC with the Asian Development Bank Institute suggested two measures by which governments may be able to facilitate progress in implementing the above measures.

1. Regional public-private sector forum on bond market development

Bond market development initiatives in the region are entering a critical stage, as governments move beyond goal-setting and into technical issues, where private sector inputs are of paramount importance. Successful resolution of these issues would be needed to sustain the momentum of these initiatives. This, however, would require effective mechanisms, which involve collaboration between the public and private sectors, to promote regulatory reforms, the growth of the region's investor and issuer base, and region-wide convergence toward global capital market standards and practices.

There are a number of existing international cooperation mechanisms for promoting policy

reforms and convergence, including the Trade Policy Review Mechanism of the WTO, peer review in the OECD and the Financial Sector Assessment Program of the IMF. Within APEC, the Individual Action Plan process, involving a type of peer review, is used to promote trade and investment liberalization and facilitation.

Such cooperation mechanisms have been successful where structured dialogues and activities have enabled participating economies to undertake systematic examinations and assessments of their own policies and eventually adopt internationally established best practices, principles and standards as well as policy and regulatory improvements. They offer models that APEC can consider in developing a regional cooperation mechanism to develop local currency bond markets.

The APEC Finance Ministers' process provides a potentially effective framework for such a mechanism. It includes all the significant financial markets in East Asia and North America (and a number from Latin America) and involves key international financial institutions, development agencies and the private sector. It also has a noteworthy track record of collaboration among its members in a number of areas.

Regional financial cooperation has reached a stage where it may begin to benefit more fully from a structured process. Over the years, the work of the APEC finance ministers has advanced with a considerable degree of consensus. Further progress in key areas, especially corporate bond market development, now require measures that will effectively enable the private sector to expand commercial activity and thus play its proper role in the development of financial markets.

An organization through which the participation of a wide section of private sector groups in the region may be secured for a regional cooperation mechanism is the Advisory Group on APEC Financial System Capacity-Building, which was jointly established in 2003 by PECC and ABAC. This advisory group brings together representatives of international financial and development institutions, as well as private financial sector

organizations, with the purpose of contributing ideas to promote capacity-building for the development of the region's financial markets.

A regional public-private sector forum on bond market development could best be designed in such a way as to:

- take the form of policy dialogues focused on the development of bond markets (especially corporate) in individual developing APEC member economies and the promotion of cross-border transactions in these markets;
- involve both developed and developing member economies of APEC, whereby participants share insights from their varied experiences in seeking possible solutions to the challenges faced by individual economies;
- utilize the Advisory Group on APEC Financial System Capacity-Building to provide advice based on inputs from relevant public and private sector institutions (including representatives of international financial and development institutions and the financial industry in the region, as well as ABAC and PECC); and
- provide a report of each policy dialogue, which would be helpful in facilitating the sharing of information and experiences among member economies.

At their meeting in Hanoi in September 2006, APEC Finance Ministers welcomed the proposal submitted by ABAC to facilitate in-depth discussions with individual economies on how the public and private sectors can collaborate to develop their respective bond markets (with special attention on corporate bond markets). This has resulted in the holding of the First APEC Public-Private Sector Forum on Bond Market Development in Melbourne in May 2007.

While this is an important step forward in promoting effective public-private sector collaboration in the development of the region's bond markets, its eventual success will be measured by the extent and quality of participation by relevant policy makers and regulators, private sector experts and financial market players, and experts from international financial and development institutions. The next several years will present a challenge and opportunity for governments, business and academe

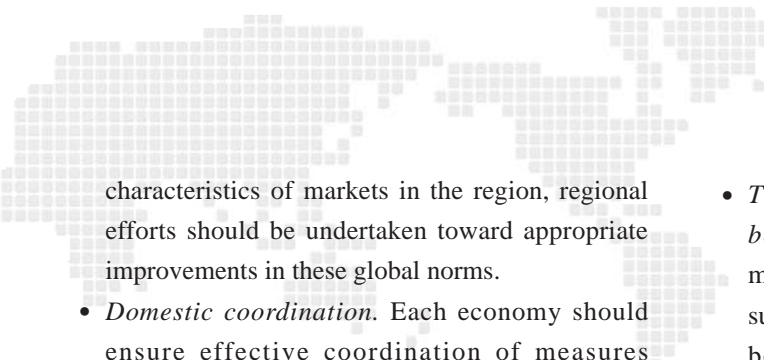
to make an important contribution to financial stability and economic development in the Asia-Pacific region.

2. Adoption of common regional principles for bond market development cooperation

Another issue to be addressed is the multiplicity of initiatives in the region involving different regional organizations and institutions.³ While these initiatives presently complement each other quite well, it is desirable to promote synergy, to ensure the consistency of these efforts with APEC's vision of free and open trade and investment throughout the region, and to effectively harness the potential for public-private partnership. To address this issue, governments in the region, through regional organizations, may consider adopting a common set of general principles for bond market development cooperation.

A set of general principles, based on extensive discussions initiated by PECC and ABAC at the Taipei and Tokyo conferences, has been submitted to the APEC Finance Ministers for consideration, and is attached as an annex to this paper. In outline, these proposed principles are as follows:

- **Public-private partnership.** The public and private sectors should work to enhance each other's effectiveness in playing their respective roles in the development of the market and collaborate in those areas, whether at the domestic or regional level, where partnership between them can be fruitful.
- *Global integration.* Economies should aim to eliminate unnecessary restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies that hinder cross-border investment and issuance in bond markets. Where they exist, capital account restrictions should be reduced and eventually removed, in tandem with measures to strengthen the domestic financial system.
- *Region-wide convergence.* In developing domestic and regional bond market infrastructure, economies should aim to achieve region-wide convergence toward relevant global standards and practices. Where current international norms do not sufficiently take into account important



characteristics of markets in the region, regional efforts should be undertaken toward appropriate improvements in these global norms.

- *Domestic coordination.* Each economy should ensure effective coordination of measures undertaken by various agencies related to the development of the bond market, establishing, where necessary, a high-level coordinating body with clear terms of reference for this purpose.
- *Regional cooperation mechanisms.* Economies should put in place effective mechanisms for regional policy coordination and cooperation to address the various interlocking measures required for the development of local currency bond markets and of cross-border investment and issuance in these markets.
- *Coordination among regional and sub-regional efforts.* Efforts should be coordinated among various regional and sub-regional organizations that are actively involved in regional cooperation for bond market development, with the aim of promoting complementation and synergy among their activities and ensuring the consistency of all efforts with the vision of free and open trade and investment throughout the broader Asia-Pacific region.
- *Strengthening market mechanisms.* Bond market development efforts should be focused on the development of efficient, transparent and competitive markets that are supported by a robust system of complete, timely and meaningful disclosure, open to many players, both domestic and foreign, and enable participants to properly price risk.
- *The role of government: providing an enabling environment.* Governments should provide an enabling environment for market participants to engage in bond investment, issuance and trading. This includes sound macroeconomic policies, tax regimes that are conducive to the growth of the market, the promotion of good corporate governance, the formulation and enforcement of clear and sound laws, market rules and regulations, and the development of robust clearing and settlement systems.

- *The role of government: maintaining a public bond issuance program.* Economies should maintain a government bond issuance program to support the yield curve, involving the issuance of bonds across a broad range of maturities in sufficient sizes to attract wide investor participation and effective communication with investors to understand their needs.
- *Cooperation in the context of regional diversity* Collaborative efforts should be designed to take into account the disparities in levels of market development among economies while promoting progress toward region-wide integration.

In conclusion, the private sector is both willing and able to play a significant role in the development of the region's local currency bond markets, as demonstrated by the degree and quality of market players' participation in recent public-private sector dialogues. The private sector, through various channels, has provided very useful insights that could help governments design effective policies, regulations and market infrastructure. There is also much potential for more direct public-private sector collaboration in projects that could stimulate market supply and demand as well as build market infrastructure.

Regional organizations such as ABAC and PECC and regional industry associations are key players that could facilitate the participation of private sector market players in these efforts and, working together with governments, promote public-private partnership. Given the increasing globalization of these market players' operations and the potential for harnessing trans-Pacific linkages to promote the deepening of domestic bond markets, APEC is in a position to play a more active role in providing a vehicle for regional public-private sector cooperation that could greatly enhance current efforts being undertaken at the domestic and sub-regional level.

¹ *Developing Bond Markets in APEC: Moving Forward through Public-Private Sector Partnership (May 10-11, 2004, Taipei)*, co-organized by PECC with the APEC Business Advisory Council (ABAC) in collaboration with

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the Asian Bankers' Association and the Association of Credit Rating Agencies in Asia; and Developing Bond Markets in APEC: Toward Greater Public-Private Sector Regional Partnership (June 21-22, 2005, Tokyo), co-organized by PECC with ABAC and the Asian Development Bank Institute.

² *Bond Market Development in the Asia-Pacific: Broadening Regional Business and Cooperation Opportunities (November 29, 2006, Washington, D.C., USA), co-organized under the umbrella of PECC by the Chinese Taipei Pacific Economic Cooperation Committee and the US Asia-Pacific Council.*

³ *These initiatives include the APEC Bond Market Initiative, the Asian Bond Market Initiative (ABMI) under the auspices of ASEAN Plus Three (composed of the ten members of the Association of Southeast Asian Nations, China, Japan and Korea), and the Asian Bond Fund under the auspices of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP).*



Annex

General Principles for Effective Bond Market Development Cooperation in the Asia-Pacific Region*

PREAMBLE

The development of local currency bond markets is essential to sustained economic growth in the Asia-Pacific region. Robust bond markets strengthen economies against financial instability. They play a crucial role in development, providing critical financing for infrastructure and meeting the needs of expanding enterprises and ageing populations. Increased cross-border investment and issuance in these markets would help accelerate their development and make the region more attractive to international investors by providing wider choice, diversification opportunities and higher returns.

The following general principles are being proposed as a guide to effective cooperation in developing these markets based on the views and experiences of public officials, private sector experts and market players. These principles are also intended to promote consistency among the number of initiatives that are currently being undertaken within various organizations, and to ensure the consistency of their outcomes with the broader vision of free and open trade and investment throughout the Asia-Pacific region.

I. PUBLIC-PRIVATE PARTNERSHIP

1. The public and private sectors should work to enhance each other's effectiveness in playing their respective roles in the development of the market and collaborate in those areas, whether at the domestic or regional level, where partnership between them can be fruitful.

In general, the public and private sectors each have proper roles to play in development. In a healthy market economy, the private sector normally engages in innovation and competition, while the public sector provides sound legal and policy frameworks, regulation and supervision. However,

there is much scope for both sectors to enhance each other's effectiveness in playing their respective roles.

Markets and institutions have developed more rapidly where the private sector has been properly involved in the design of regulation and market infrastructure, and where it has been engaged in promoting ethical and efficient market practices and conventions, market surveillance and competitive pricing. Policies that encourage the involvement of foreign expertise in bond market activities, such as in the development of the credit rating industry, bond indices and sophisticated financial instruments, reinforce these benefits.

There are also areas where direct collaboration between the public and private sectors can be fruitful. Experiences of emerging markets in the region illustrate that without a robust investor and issuer base, as well as a sufficient number of market makers and a wide variety of financial instruments, it would be difficult to achieve market depth and liquidity. Coordination between government and private sector can thus be instrumental in expanding the investor base and the variety of product types.

II. GLOBAL AND REGIONAL INTEGRATION

2. Economies should aim to eliminate unnecessary restrictions, omissions of law or practice and legal, fiscal and regulatory discrepancies that hinder cross-border investment and issuance in bond markets. Where they exist, capital account restrictions should be reduced and eventually removed, in tandem with measures to strengthen the domestic financial system.

Intra-regional cross-border investment and issuance in Asia-Pacific bond markets are limited by various restrictions, omissions of law or practice and

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legal, fiscal and regulatory discrepancies. Restrictions that apply to foreign firms, which impede their participation in domestic bond market making processes, also hinder the flow of investor funds and issuance. Cross border investment and market liquidity are severely impacted by capital controls aimed at restricting the movement of capital in and out of markets.

Reducing and eventually removing these restrictions will help promote long-term capital flows. However, they may also give rise to increased flows of volatile short-term capital, and should therefore be accompanied by measures to strengthen the domestic financial system against instability. In addition to capital account liberalization, each economy should also adopt a foreign exchange regime that best facilitates cross-border capital transactions within the context of its own development strategy.

3. In developing domestic and regional bond market infrastructure, economies should aim to achieve region-wide convergence toward relevant global standards and practices. Where current international norms do not sufficiently take into account important characteristics of markets in the region, regional efforts should be undertaken toward appropriate improvements in these global norms.

Capital flows from within and outside the region will be crucial for the development of the region's bond markets. Thus, economies should aim for convergence with global standards and practices that govern various aspects of bond market activity, including standards for financial reporting and auditing, market regulation and supervision and credit rating practices, among others, rather than the establishment of regional standards. However, in order to promote intra-regional capital flows, efforts should be made to coordinate convergence efforts on a region-wide basis.

Asia-Pacific economies should also be involved in the process of setting and further developing global standards and norms in order to ensure that these adequately reflect local realities and that they are effective in promoting stable and robust financial systems in the region. Economies should make use of regional collaborative mechanisms among relevant agencies, creating or expanding them where

necessary, to provide regional contributions to the work of global standard-setting bodies.

III. DOMESTIC-LEVEL COORDINATION

4. Each economy should ensure effective coordination of measures undertaken by various agencies related to the development of the bond market, establishing, where necessary, a high-level coordinating body with clear terms of reference for this purpose.

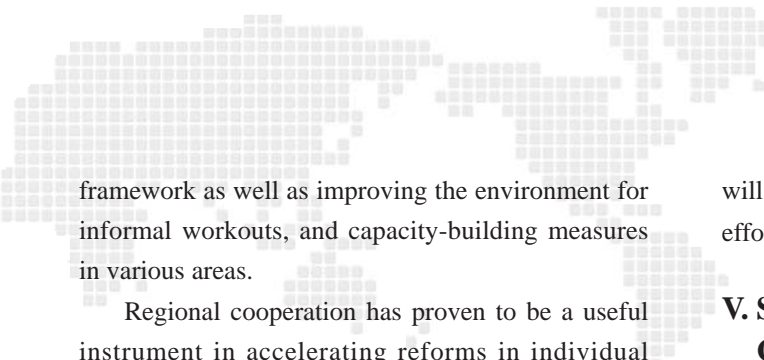
Coordinating bodies overseeing efforts to develop bond markets could be very useful given the fact that the range of issues involved spans a number of public sector agencies. Among these are agencies responsible for funding, debt management, taxation and macroeconomic management, economic planning agencies, central banks, securities market regulators, budget ministries, and public sector and local government debt issuers.

This reflects the fact that bond market development is closely inter-related with other economic activities and may involve trade-offs with sovereign debt management and macroeconomic policy objectives, as well as overall financial sector development strategy. The APEC Compendium of Sound Practices, endorsed by the APEC Finance Ministers in 1999, which outlined a road map for bond market development, suggests the creation of high-level coordination committees at the initial stage of the process, involving these various institutions.

IV. REGIONAL-LEVEL COOPERATION

5. Economies should put in place effective mechanisms for regional policy coordination and cooperation to address the various interlocking measures required for the development of local currency bond markets and of cross-border investment and issuance in these markets.

Regional policy coordination and cooperation are required to address a number of interlocking measures required for bond market development. Among these are the convergence of market infrastructure and practices including credit rating practices and accounting standards, the establishment of arrangements for cross-border recognition of insolvency administrations, promoting a regional



framework as well as improving the environment for informal workouts, and capacity-building measures in various areas.

Regional cooperation has proven to be a useful instrument in accelerating reforms in individual economies through peer pressure, in promoting convergence of standards and practices, and in addressing cross-border issues. Maintaining effective cooperation mechanisms within the framework of existing regional bodies, supported by adequate resources, is important for sustained progress over the long-term time frame of capital market development in developing economies.

6. *Efforts should be coordinated among various regional and sub-regional organizations that are actively involved in regional cooperation for bond market development, with the aim of promoting complementation and synergy among their activities and ensuring the consistency of all efforts with the vision of free and open trade and investment throughout the broader Asia-Pacific region.*

The existence of a number of regional organizations within the Asia-Pacific region, with different but overlapping memberships and activities, reflects the region's diversity and complex history. Several of these organizations undertake various activities that contribute to bond market development. Ensuring that these activities are mutually complementary, consistent with each other and well-coordinated are important to achieve smooth progress and the eventual success of their efforts. Of particular importance is the objective of ensuring the consistency of all these efforts with APEC's vision of free and open trade and investment throughout the broader region.

As the emergence of deep and liquid bond markets is dependent on the participation of a sufficiently large base of investors and issuers, as well as market makers and other key participants such as credit rating agencies, the involvement of economies from both sides of the Pacific should be encouraged. Mechanisms for continuous information exchange, coordination and undertaking of mutually-reinforcing activities among regional organizations

will be useful in ensuring the effectiveness of these efforts.

V. STRENGTHENING MARKET MECHANISMS

7. *Bond market development efforts should be focused on the development of efficient, transparent and competitive markets that are supported by a robust system of complete, timely and meaningful disclosure, open to many players, both domestic and foreign, and enable participants to properly price risk.*

Markets will attract investors if there is competition among market participants and if they are open to many players, both domestic and foreign. Such markets are generally characterized by a robust investor and issuer base, a sufficient number of market makers, a wide variety of financial instruments, sound macroeconomic policies and an open economy and financial sector. Open financial sectors also allow economies to benefit from foreign expertise in the development of market infrastructure and financial instruments. Ideally, jurisdictions should have a competition regulator with full authority to intervene against anti-competitive market activity.

Regulation should focus on maintaining and enhancing transparency and market integrity, which are important for the soundness of market-based structures with multiple participants such as bond markets, as well as for investor confidence. This involves maintaining a robust system of clear, complete, timely and meaningful disclosure and developing transparent processes and a conducive environment for assessing the risk and return in trade instruments.

Enabling the appropriate pricing of risk by market participants is a key objective that is crucial for facilitating genuine risk assessment and efficient capital allocation, avoiding moral hazard and ensuring financial stability. Subsidies that could distort market pricing signals should be avoided. Any credit enhancement scheme deemed necessary should be carefully designed to avoid moral hazard and corruption of markets.

VI. THE ROLE OF GOVERNMENT

8. *Governments should provide an enabling environment for market participants to engage in bond investment, issuance and trading. This includes sound macroeconomic policies, tax regimes that are conducive to the growth of the market, the promotion of good corporate governance, the formulation and enforcement of clear and sound laws, market rules and regulations, and the development of robust clearing and settlement systems.*

The success of bond market development efforts will depend on the extent to which liquid and efficient markets adequately providing cost-effective long-term capital to issuers and attractive financial instruments to investors are created. Necessary prerequisites to the creation of such markets include sound macroeconomic policies, a sound legal and institutional framework that offers adequate protection to investors' rights, and good corporate governance. Taxation treatment is highly influential in market players' decisions, and should be reviewed to determine whether tax regimes are conducive to the holding and trading of bonds.

Areas where government can support the development of the market include providing effective insolvency and creditor rights systems, supervisory arrangements; a framework for promoting corporate governance, financial controls and integrity through clear rules and penalties; robust accounting standards and practices, effective regulatory oversight, judiciary systems and civil procedures. The government also needs to promote the development of the supportive infrastructure (repurchase market, securities laws, documentation standards). Regulators must be able to balance the treatment of interests of all key market participants.

9. *Economies should maintain a government bond issuance program to support the yield curve, involving the issuance of bonds across a broad range of maturities in sufficient sizes to attract wide investor participation and effective communication with investors to understand their needs.*

Sound policies and institutional frameworks are not necessarily sufficient to ensure the provision of adequate market supply and demand by market

participants. A broad institutional and retail investor base is needed, and government bond markets usually play an important role in the development of private long-term debt markets through their role in ensuring market liquidity and facilitating risk management.

A common thread in the recent development of most markets in the region has been a steady development with sovereign bonds as the central focus of the market continuing as a major but diminishing component with the growth of commercial debt issues. Experiences of economies in the Asia-Pacific region illustrate how government bond issuance may be used for market development purposes even in a situation of fiscal surplus. However, care should be taken so that corporate borrowers are not crowded out by government bond issuance in times of large fiscal deficits and low savings.

VII. COOPERATION IN THE CONTEXT OF REGIONAL DIVERSITY

10. *Collaborative efforts should be designed to take into account the disparities in levels of market development among economies while promoting progress toward region-wide integration.*

There are wide disparities not only between developed and developing economies within APEC, but also among developing economies with respect to the level of development of local currency bond markets. A number of emerging markets have made significant advances in developing robust policy and regulatory frameworks, market infrastructure and key components of deep and liquid bond markets. Others are still in the early stages of development where many key requirements have not been adequately met.

For emerging markets that have reached a more advanced stage of development, collaborative efforts should focus on enhancing market depth and liquidity, as well as promoting reforms to facilitate cross-border investment and issuance. For the less-developed markets, the focus should be on addressing more fundamental issues such as disclosure and accounting standards, reducing barriers to issuance, protection of creditor rights, increasing the savings rate and enforcement of laws and regulations.



Let the PECC Take the Leadership Role

Darson Chiu

It has been theoretically proven and widely known that free trade can contribute to overall human welfare by optimizing the surpluses of producers and consumers. The ultimate goal of free trade has been pursued by numerous international organizations that include the rule-based World Trade Organization (WTO), the non-binding Asia-Pacific Economic Cooperation (APEC), and the business-government-academia tripartite forum known as the Pacific Economic Cooperation Council (PECC).

The recent collapse of the WTO ministerial meeting in Geneva indicates that the gap of opinions from developing and developed economies is huge. It would take tremendous efforts to close the existing gap and launch an agreement of eliminating excess trade barriers. Both rich and poor countries need to compromise on their vested interests in order to settle their differences. Can that be done in the WTO? If it can be done in this multilateral platform, it should have been done a long time ago.

Why is it so difficult to come up with an agreement in the WTO? Why do the trade talks in the WTO always progress at a limited pace? The answer is simply embedded in the nature of the WTO, because this organization is rules and regulation-oriented. That means what's said should be done and what's done cannot be undone to a certain extent.

As described and emphasized in the preamble of the WTO document, the objective of multilateral trade liberalization is mainly about enhancing the quality of life, ensuring full employment, efficiently allocating world resources and eliminating tariffs and other trade barriers so as to relieve potential discrimination and unfair treatment generally occurring among trading partners in the global system. It is obvious that the WTO serves as a

catalyst for globalization; however, developing economies generally consider globalization as a tactic utilized by developed economies to further exploit valuable resources in developing economies and to sustain their dominance. As an old saying goes, "what you see depends on where you stand", different standpoints regarding globalization have also slowed down the progress of the WTO in addition to its rules based nature.

The non-binding APEC is somewhat able to bridge the divide that the WTO has difficulty coping with. In the APEC Economic Leaders' Declaration of 2000, the Economic Leaders stated that, "our vision is to prepare each of our economies and all of our people to use the technology revolution as a passport to the fruits of globalization." Furthermore, the APEC Economic Leaders stressed in their declaration of 2001, "the goal is to build APEC towards a digital society, with higher growth, increased learning and employment opportunities, improved public services and better quality of life by taking advantage of advanced, reliable and secure information and communications technology and networks and by promoting universal access." With economic and technical cooperation as one of the organizational pillars, APEC stresses the anticipated benefit of globalization that is to bridge the gap between developed and developing economies via adopting appropriate policies, particularly the policies associated with community building.

However, APEC's intergovernmental character involuntarily provides certain constraints on the progress of free trade. Peer pressure disguised in the form of the individual action plan would be the main engine pushing APEC forward. However, the universal red tape embedded in governmental officials has delayed the progress of fulfilling the goal of trade liberalization. APEC has been accused

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of inefficiency, ineffectiveness, and problems in delivering policies.

On the other hand, PECC is a tripartite forum that is capable of collecting valuable information and feasible opinions from all angles. What stimulates PECC to provide sound policy suggestions are economic incentives favored by business, political motivations supported by governments, and academic arguments developed by the scholars. PECC's agenda is aimed at improving cooperation and policy coordination in all economic areas, including trade and finance. Its goal is to promote economic development and cooperation among Asia-Pacific countries. With its tripartite nature, PECC can pursue the goal freely without facing the same constraints encountered by the WTO and APEC. The main advantages that PECC has over the WTO and APEC are: a) PECC is not rules-based, b) PECC is not intergovernmental, and c) PECC conveys messages from business and academic sectors besides government policies. Therefore, it is time for PECC to take the leadership role by designing a viable roadmap for the WTO and APEC.

Taiwan has membership in the WTO, APEC, and PECC. With considerable probability of being excluded from ongoing free trade agreements, Taiwan ought to take full advantage of participating in these three organizations and playing a decisive role in PECC so as to move both the WTO and APEC towards their respective goals.

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The Misunderstandings about Cross-Strait Common Market

Shunyo Liao

The idea of launching a cross-strait common market proposed by Ying-Jeou Ma, the KMT presidential candidate, has drawn attentions from scholars, experts and mass media. Although interested parties have vigorously discussed and debated upon the cross-strait common market related issues, a significant gap of perceptions regarding the concept, definition, and operation of common market between academia and reality under WTO frameworks does exist. It is necessary to clarify the vague area before making a decisive closure on this matter.

When it comes to the scheme of common market, the European Union that operates in the form of a single market often comes to our minds. From a scholarly perspective, the scale of economic integration of a common market is relatively broader than a free trade agreement, a service agreement, and a preferential trade arrangement. In a politically correct sense, the extent of a common market is between a custom union and an economic union. All contracted member economies of a custom union adopt a common set of tariffs towards non-members. However, an economic union would go one step further by allowing the free flow of goods, humans, and capital within the contracted area whereas implementing collective fiscal and monetary policies in addition to a common set of tariffs. The European Union is an unprecedented example of the economic union.

The definitions above are theoretically correct, but they are inconsistent with the present reality under WTO framework. Instead of espousing the cliché and bookish definition, the WTO framework goes for a more matter-of-fact explanation of a common market. WTO illustrates all possible forms of regional economic integration as "regional trade agreements." There are only four types of regional

trade agreements posted in the WTO website, namely, custom union, free trade agreement, economic integration agreement, and preferential trade arrangement. Under the WTO framework, there exist at least five economic integration examples adopting the name of common market; nonetheless, their scales of economic integration show a considerable discrepancy. To name a few: WTO categories "The Common Market for Eastern and Southern Africa (COMESA)" as a free trade agreement with respect to the Enabling Clause. WTO groups "Central American Common Market (CACM)" as a custom union a propos GATT XXIV. Furthermore, WTO sorts "Caribbean Common Market (CARICOM)" as an economic integration agreement on the subject of GATS V.

All of these common markets above adopt the term, "common market," but differ in terms of the scale of economic integration. It is obvious that WTO recognizes all of them as regional trade agreements and leaves the contracting parties to freely characterize the integration scales. WTO grants all members a full degree of freedom to sign regional trade agreements whereas the contracting parties need to submit the agreements for WTO's inspection and approval. From this regard, the proposed cross-strait common market is not necessarily identical with a scholarly defined common market. Under the framework of WTO, European Union is not an apply-all prototype but a unique case. Therefore, the pattern of European Union is not the only one model for designing the cross-strait common market. It means that the proposed cross-strait common market does not automatically accelerate the pace of bilateral political integration such as the case in European Union.

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If the situation inevitably forces Taiwan to sign a custom union, free trade agreement, preferential trade arrangement, or service agreement with China, it is more feasible to conduct the agreement under the framework of WTO. The reasons are: first, a cross-strait common market exists under the WTO framework can prevent other WTO members from objecting to this agreement signed under table; and second, it is the way to secure Taiwan's status as an independent custom territory versus China's under the scaffolding WTO structure. Regarding another possibility of signing a "Closer Economic Partnership Arrangement (CEPA)" between Taiwan and China, Taiwan needs to reject the layout of China-Hong Kong CEPA. It is because the China-Hong Kong CEPA purposely includes the clause of "one country, two systems" in the text. Therefore, Taiwan will not accept a Cross-strait CEPA similar to the existing China-Hong Kong CEPA with the clause of "one country, two systems". In case China expresses goodwill and is willing to forgo the clause of "one country, two systems" in regional trade agreement with Taiwan, Taiwan may begin to seriously consider the feasibility of Taiwan-China common market, either in the form of free trade agreement, preferential trade arrangement, or services agreement. Moreover, the content of common market and other ongoing regional trade agreements make no distinct difference regardless of "one country, two systems."

Taiwan may start to negotiate with China regarding building a potential cross-strait common market under two conditions: first, the cross-strait common market shall follow the regional trade agreement rules under the WTO framework; and second, the clauses of cross-strait common market shall not incorporate terms related to political issues but remain a 100% economic dimension with mutual benefits.

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Investment Environment in China and Business Situation of Taiwanese Enterprises

Rida Yu

Introduction

With globalization, emergence of China's economy and movement of Taiwan's industries to China, these events bring the most crucial challenge for Taiwan's economy. Until the end of 2005, Taiwan's FDI had accumulated near US \$100 billion, which was 28.1% of GDP and was tantamount to 30% of industrialized countries or European Union. However, it is much higher than 4.6% of South Korea's GDP.

Furthermore, it is also higher than the global average of 24%.

Moreover, most of Taiwanese foreign direct investment (FDI) is newly established, which is different from M&A of industrialized countries' FDI. It implies that the model of Taiwan's FDI will certainly bring far-reaching impact on Taiwan's economy, such as welfare, employment and income distribution effects. Furthermore, profits from FDI have not been remitted back to Taiwan. It is absolutely not beneficial for Taiwan's economy.

The analytical framework of our research is comprised of three aspects: 1) the incentives, styles and strategies of Taiwanese enterprises' investments in China. 2) the evaluation of transitional causes, facts and trends of business in China, including international factors, policy environment, and market variance, such as RMB appreciation, wage rate acceleration, etc. 3) exploring the problems and future developments of Taiwanese enterprises in China, and studying the trends of Taiwanese investment and profit return, and offering suggestions about the related policies and absorptive capacity.

As a qualitative research, this project mobilizes methodologies including questionnaire analysis, in-depth interview of elites and fieldwork investigations for the purpose of China plus One Model.

Research Findings and Highlights

The major findings of our investigation and research are as follows:

1. The incentives, styles and strategies of Taiwanese enterprises' investment in China are as follows: 1) The reduction of operation cost, low wage and low land price are the priorities of Taiwanese enterprises' movement to China. 2) It is China's huge internal market, which reflects the export platform (assembly function) and huge potential market (end product). 3) It is influenced by the movement of Taiwanese and international enterprises to China. Most of investment in China is focus on electronic (30%), living (24%), metal and machinery and service industries, which most are focusing on Shanghai. 4) By area, most of Taiwanese companies invest in Provinces of Kwangtong (30%), Chiangsu (24%), Fuchiang (16%) and Zhehchiang (14%). For Taiwanese enterprises, Yangtze Delta (Chiangsu Province and Shanghai) is more important than Pearl Delta (Kwangtong Province). 5) The investment style of Taiwanese enterprises in China is sole proprietorship, and then joint venture.
2. Our evaluation of the transitional causes, facts and trends of business in China, including international factors, policy environment, market variance (RMB appreciation, wage rate increasing, etc) and cautious policy of foreign capital attraction is as follows: 1) With the good performance of China's economy growth, the profits of Taiwanese enterprises in China are satisfied. 58% of them have favorable balance, 19% have breakeven and only 23% suffer a loss. 2) Taiwanese enterprises would like to keep on doing business in China in the future. The main incentives include economy/market, policy and improving enactments. 3) For Taiwanese busi-

nesses in China, the most negative factor is wages acceleration, which results in serious labor shortage. The other two factors include RMB appreciation and cutthroat competition in internal market. 4) Looking into the future, the first and foremost investment consideration of Taiwanese enterprises is still in China, and then the investment Model of China plus One, which they increase investments in both China and other areas. From the questionnaire, we found that Vietnam is the premier choice for Taiwanese enterprises outside of China.

3. Our analysis of the trends of Taiwanese reinvestment in Taiwan and profit return, and suggestions about the related policies and absorptive capacity are as follows:

1) For Taiwanese enterprises in China, the most negative factor of reinvestment in Taiwan is the much higher labor cost (39%). The other factors include unstable cross-strait situation (14%), non-direct aviation (13%) and lack of investment opportunities. 2) For the profit return problem from Taiwanese enterprises in China, the main factor is that they would face double taxation (24%). The second is that they need to increase investment in China (19%). The third is much higher tax rate in Taiwan.

Suggestions

Based on the above analyses, in order to achieve the objective of attracting Taiwanese enterprises' reinvestment in Taiwan, the following six policy suggestions to the government are provided:

1. With the gradual great impact upon Taiwan's economy by the movement of Taiwanese enterprises to China, it is absolutely necessary to encourage them to come back for reinvestment in Taiwan in the future, especially in attracting the Taiwanese enterprises with better profits. However, this policy should be connected with industries' advancement.
2. To attract more reinvestment from Taiwanese enterprises in China, our government could consider the policy of non-relationship between lowest wages and foreign workers' wages. Thus without utilizing additional subsidies, our government could reduce the production cost in

Taiwan and strengthen the reinvestment attractiveness from Taiwanese enterprises in China.

3. The gradual localization of Taiwanese enterprises in China needs to be kept vigilant, especially the metal and machinery industry. This industry is of secondary importance to information and electronic industries. Furthermore, the great profits of metal and machinery industry operating in China should also be followed up continually, for it will bring great influence on the geographic arrangement of other Taiwanese enterprises in the future.
4. The Model of China plus One, which means to invest in China and another area, such as Taiwan, Vietnam or other countries, is limited to the portfolio of localization. It is beneficial for Taiwanese enterprises to look after both the potential business opportunities and risks. In the future, the portfolio of technology would be explored, especially deliberating upon how to elevate Taiwan's value-added and mitigating the negative impact for manufacturing in Taiwan, as a result of the gradual localization and purchasing in China.
5. Without attracting profit return from Taiwanese enterprises in China, double taxation is the main factor. In the face of non-double taxation avoidance agreement signed between both sides, how to establish a good mechanism for resolving this problem should be studied further.
6. There are some amendments which could be posed to our existing globalization policies. Rethinking "China plus One" strategy is of central concern and Taiwan's benefit including Taiwanese enterprises should be the objective, in order to develop our advantages.



APEC Finance Ministers' Process

Chen-Sheng Ho

APEC's Formation

As far back as the 1968 PAFTAD conference, academics were proposing the creation of a Pacific Free Trade Area. In 1978, Prime Minister Ohira of Japan suggested the idea of a "Pacific Basin Community" in his inaugural speech. The result of Prime Minister Ohira's calling was the creation of the Pacific Economic Cooperation Council (PECC) in 1980. PECC was created as a tripartite forum with the participation of scholars, government officials, and businessmen. There existed, however, regional interest in forming an inter-governmental grouping, although with little support from the United States (Petri 1999).

Australia and several Asian economies had been the driving force behind APEC in the beginning. The United States in 1989 was preoccupied with the U.S.-Canada Free Trade Agreement and on global initiatives. The birth of APEC was a surprise to the United States. The initial plan for APEC proposed by Prime Minister Hawke of Australia in 1989 did not include the United States. As a result of intense diplomatic discussions, the subsequent proposal added the United States to the membership list and contained Secretary of State James Baker's commitment of U.S. support (Petri 1999).

According to Aggarwal and Morrison, APEC was seen as an institution that would facilitate regional economic cooperation and continue the link between East Asia and North America in the aftermath of the Cold War era. Competing visions of the organizational structure of APEC were evident during the discussions before the establishment of APEC. One of the suggestions called for APEC to exist as a consultative forum. Another proposal insisted that APEC should eventually become a trade bloc with the possibility of undertaking security functions (Aggarwal and Morrison 1999).

After considerable deliberations between the founding members, APEC was finally established in 1989. The United States decided to become a member of APEC because it did not want to be excluded from an Asian bloc that might be greatly influenced by Japan. APEC's promise of regional economic dialogue was not the initial reason that persuaded the United States to join the forum. ASEAN leaders were concerned that APEC might become a challenge to ASEAN. Eventually, ASEAN saw APEC as an outstanding forum for disseminating regional ideas. ASEAN was given an important role in APEC. Initially, APEC ministerials were set to alternate between ASEAN and non-ASEAN economies. The APEC Secretariat was placed in Singapore, an ASEAN member (Petri 1999).

APEC Ministers in the 1989 First Ministerial Meeting stated in their Joint Statement that they recognized the important contribution of ASEAN to the development of APEC. They further indicated that ASEAN institutional mechanisms had a role to play in support of APEC effort to widen and strengthen economic cooperation in the region (APEC 1989). Aside from ASEAN, no other members were specifically recognized for their support of APEC in the Joint Statement. This event shows the importance of ASEAN in APEC's infancy.

One can infer from the above paragraphs that ASEAN, Australia, Japan, and the United States have been actively involved in the creation of APEC. These economies have diverse interests in wanting to be a part of APEC. They are cautious about APEC because they want to make sure that APEC does not conflict with their existing agenda. In order to accommodate the various interests of the economies, APEC has been set up as a forum, rather than as a more formalized trading bloc. The 1989 APEC

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Ministers' Joint Statement stated that: "every economy represented in Canberra relies heavily on a strong and open multilateral trading system, and none believes that Asia-Pacific Economic Cooperation should be directed to the formation of a trading bloc" (APEC 1989).

APEC's General Work Direction

In order to provide readers with a well-rounded understanding of APEC's work in recent years, it is necessary to start relating the story from the first meeting of APEC Economic Leaders in Blake Island, Seattle, USA during the month of November in 1993. The Economic Leaders believed that in the post Cold War era, they had an opportunity to construct a new economic foundation for the Asia-Pacific region that utilized the energy of the diverse economies, enhanced cooperation and promoted prosperity (APEC 1993).

During the meeting, the Economic Leaders produced a vision statement in which they made essentially four pledges. First, they agreed to search for solutions to the challenges posed by their fast changing regional and global economy. The second pledge was the maintenance of a growing global economy and an open multilateral trading system. Thirdly, the Leaders sought to continue with the work of reducing barriers to trade and investment, so that goods, services and capital can flow freely among members. Fourthly, they promised to ensure that the people within APEC shared the gains of economic growth, improved training and education, linked members through advances in telecommunications and transportation, and utilized their resources in a sustainable way (APEC 1993).

The importance of the Economic Leaders' Meeting in Blake Island is that APEC begins the process of building and clarifying its identity with the dissemination of the vision statement. The visions provide a rough guide to the understanding of APEC's intentions. The meaning of APEC became clearer with the announcement of the Bogor Goals during the 1994 Economic Leaders' Meeting in Bogor, Indonesia. The Leaders stated at the meeting that industrialized members will achieve free and open trade and investment by 2010 while developing members will do the same by 2020.

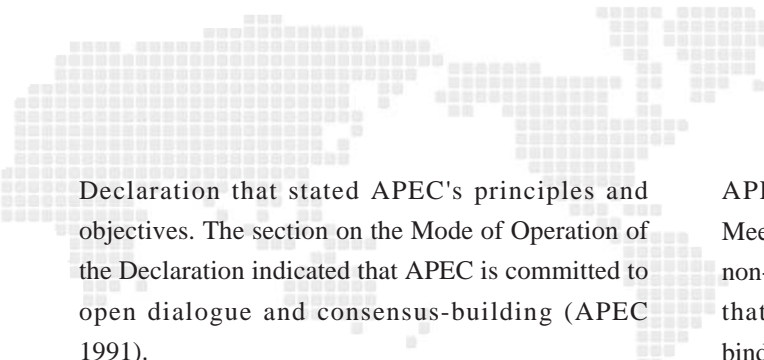
Another objective was that APEC members were requested to expand and accelerate trade and investment facilitation programs. In addition, the Leaders called for development cooperation among members in order to achieve sustainable growth, equitable development, and national stability (APEC 1994a).

Once APEC has related its objectives, momentum exists that continues to push members toward further elaboration of APEC's work. Therefore, in 1995, APEC created the plan titled Osaka Action Agenda (OAA). The purpose of OAA is to assist APEC with the attainment of Bogor Goals. The OAA is made up of trade and investment liberalization; trade and investment facilitation, that APEC has called TILF. Additionally, OAA has included economic and technical cooperation and is called ECOTECH. These three areas constitute the three pillars of APEC activities (APEC 1995a). One can infer that APEC has now produced a credible program for achieving Bogor Goals with the OAA. The next major step for APEC members is to follow the work to be done that is stated in the OAA.

In 1996, the fourth meeting of APEC Economic Leaders was held at Subic Bay, Philippines. The Leaders at this meeting established the Manila Action Plan for APEC (MAPA) which led APEC to the action phase for achieving the Bogor Goals. MAPA consists of individual action plans (IAPs) and collective action plans (CAPs) principally in the area of trade and investment liberalization and their facilitation (TILF) and activities for accomplishing ECOTECH (APEC 1996). In the case of IAPs, every APEC member has to produce an IAP that states each member's actions. As for the CAPs, they contain actions that APEC members would implement together. Thus since 1996, APEC has embarked on the task of achieving the Bogor Goals through these actions.

APEC Decision-Making Process

An important characteristic of APEC decision-making process is that all decisions made are achieved through consensus. The 1991 Third Ministerial Meeting held in Seoul produced the first concrete indication of this characteristic. The Joint Statement of the Ministers included the Seoul APEC



Declaration that stated APEC's principles and objectives. The section on the Mode of Operation of the Declaration indicated that APEC is committed to open dialogue and consensus-building (APEC 1991).

However, it is not always possible for all members to reach consensus on an issue. When this happens, APEC members could apply peer pressure to the uncooperative members, in order to achieve consensus. Therefore, peer pressure is another significant characteristic of the APEC decision-making process. The application of peer pressure has its limit, particularly when most members are against an initiative or issue. Thus APEC has the tendency of agreeing on issues and initiatives that are not controversial, such as the holding of seminars and training programs. Hadi Soesastro has stated that: "The APEC approach relies on 'peer pressure' to ensure members' adherence to their commitments" (Soesastro 1999).

In addition, it is voluntary for APEC members to participate in the implementation of an initiative. When APEC members start to discuss concrete proposals for achieving APEC goals beginning with the 1995 Osaka Action Agenda (OAA), the voluntary nature of the APEC process for implementing decisions make its official debut. The 1995 Leaders' Declaration in Osaka has related that APEC will promote efforts of voluntary liberalization in the region for the purpose of attaining the goal of free and open trade and investment (APEC 1995). The Introduction Section of 1996 Manila Action Plan for APEC (MAPA) has stated that "the individual action plans are voluntary submissions made by member economies. The voluntary nature of the liberalization initiatives that individual economies undertake to carry out gives these plans their most distinctive feature" (APEC 1996).

Finally, the implementation of decisions and initiatives are non-binding. This feature means that members will not be held accountable for any initiatives that they decide to implement but are not able to do so for any reasons. The earliest manifestation of the non-binding characteristic is found in the Non-Binding Investment Principles endorsed by

APEC Ministers during the 1994 Ministerial Meeting in Jakarta (APEC 1994). The inclusion of non-binding in the name of the Principles indicates that APEC members strongly support the non-binding nature of their initiatives.

APEC Finance Ministers' Process

1st Meeting of APEC Finance Ministers

During the first meeting of APEC Economic Leaders in 1993, the Leaders called for APEC Finance Ministers to hold a meeting to discuss general economic issues including macroeconomic developments and capital flows. The Leaders believed such discussions would assist with mitigating some of the regional challenges, such as ensuring non-inflationary regional growth, financing investment and infrastructure development, and promoting capital market development (APEC 1993).

In 1994, APEC Finance Ministers met for the first time in Honolulu, Hawaii. The purpose was to discuss the financial issues that APEC Economic Leaders had raised previously. The Finance Ministers came up with three principles to guide policy formation: 1) sound macroeconomic policies and stability are important for sustained and low-inflation growth; 2) increasing trade in goods and services and investment are needed for robust economic performance; and 3) the private/business sector are primary engine of growth. In addition, they agreed to enhance capital market development through: 1) implementing policies for promoting foreign direct investment; 2) strengthening cross-border equity and bond flows; and 3) discussing strategies for sustaining capital inflows that leads to growth and macroeconomic stability. The Finance Ministers also called for increasing the capacity for mobilizing capital through: 1) developing banking sectors and domestic securities markets; 2) promoting development of domestic bond markets; and 3) welcoming efforts of International Monetary Fund, the World Bank, the International Finance Corporation, and the Asian Development Bank to develop financial markets (APEC 1994b).

Recent Development of Finance Ministers' Process

The 2006 APEC Finance Ministers' Meeting took place in Hanoi, Vietnam. The major themes of the meeting are: 1) promoting public finance efficiency and sustainability for achieving stable and efficient revenue sources; and 2) encouraging financial sector reform to attract capital flows. In addition, they developed a set of strategic goals: 1) Sustainable, equitable, and broadly-based growth and development in the APEC region; 2) Macroeconomic stability in the APEC region; 3) Prudent public finance management; 4) Good corporate governance; 5) Stable and efficient financial markets; 6) Greater economic cooperation, integration, and openness among APEC economies; and 7) Facilitation of economic and technical cooperation within the region in pursuit of the above goals (APEC 2006).

The host of APEC meetings in 2007 is Australia. This means that most APEC meetings will be held in various locations in Australia. In the case of the Finance Ministers' Meeting, it will be held in Coolumb, Australia (APEC 2007). Since the APEC Finance Ministers had developed the strategic goals last year in Hanoi, the major issue to be discussed this year is to find ways to achieve the strategic goals.

Suggestions for Enhancing the APEC Finance Ministers' Process

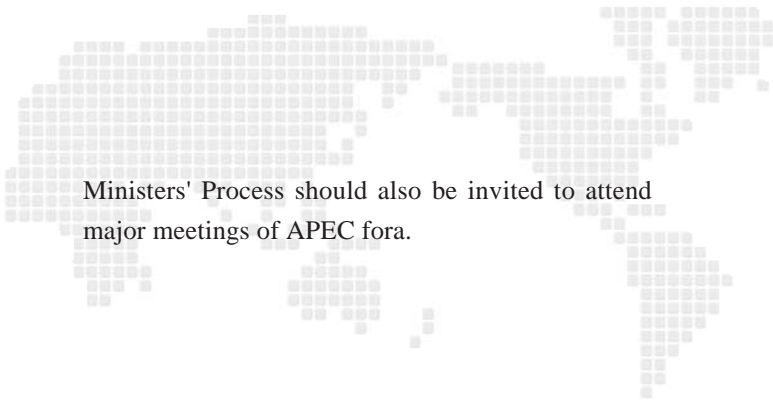
The most widely stated criticism of the APEC Finance Ministers' Process is that it has not resulted in concrete actions for strengthening cooperation among APEC members on financial issues. For example, APEC did not come up with any substantive actions in response to the Asian financial crisis in 1997. Since the creation of the APEC Finance Ministers' process in 1994, there existed numerous meetings and conferences to discuss financial issues. However, critics have pointed out that they are not enough. APEC has been considered to be a place for officials to talk to each other and nothing more. In addition, the Finance Ministers' Process has been criticized for being independent from the general APEC process. The point is that finance officials do not take into consideration the work of other APEC fora. The reason may be that

the Finance Ministry and Central Banks in most APEC economies have high degree of independence. Thus the same culture manifested itself in APEC.

In order to mitigate criticisms aforementioned, APEC could change its decision-making process to ensure the implementation of concrete actions. At present, APEC decision-making process is characterized by consensus building, voluntary participation, and non-binding principle. Essentially, APEC members have ample leeway for participating in APEC. The result is that APEC has not moved beyond the discussion stage for most issues. Therefore, changing the decision-making process means that voluntary participation becomes mandatory participation and the non-binding principle becomes the binding principle. If these changes are made, APEC actions would result in mandatory participation and any APEC member that does not participate would be punished. However, since APEC does not make changes rapidly, it is prudent to ensure that the changes in the decision-making process proceed slowly. Every APEC fora could select a few actions that would entail mandatory participation and the utilization of the binding principle. The APEC Finance Ministers' Process should also follow suit, so as to be similar to other APEC fora. With this evolutionary step, APEC's actions could become more concrete and useful.

Furthermore, the APEC Finance Ministers' Process could ensure that the goals and actions could be more focus. An analysis of the goals and the various actions has shown that they are extremely broad, since the first meeting of the APEC Finance Ministers in 1994. The major reason is that there exists a different host every year in APEC, so that the host always adds new issues for discussion in addition to previous issues.

Another suggestion is that the APEC Finance Ministers' Process could work with other APEC fora, so as to promote the image that it does not exist independently of APEC. Specifically, representatives of APEC fora could be invited to meetings related to the Finance Ministers' Process, when their work entails mutual support and cooperation. Representatives of the Finance



Ministers' Process should also be invited to attend major meetings of APEC fora.

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