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# Contents

## Table of Contents

### Articles

- Trade with China and its Effect on Wages in Latin America within a Heckscher-Ohlin Framework** ..... 4  
Alberto Posso ( )  
*School of Economics, Finance and Marketing, RMIT University*
- Europe's Debt Crisis and Its Impacts** ..... 13  
Eric Chiou (邱奕宏) *Associate Research Fellow, TIER*
- A different Perspective on Poverty** ..... 18  
Enrique Panameño ( )
- A Quick Look at the 2012 APEC Hosting Economy-Russia** ..... 23  
Darson Chiu (邱達生)  
*Director General, CTPECC*
- Seeking cooperation with Russia through APEC** ..... 30  
Rida Yu (余慕蕓)  
*Associate Research Fellow, TIER*



# Trade with China and its Effect on Wages in Latin America within a Heckscher-Ohlin Framework

*Alberto Posso* ( )

## **Introduction**

The late 1980s saw a decisive shift in the focus of national development policy in the majority of developing countries, away from import substitution and towards greater outward orientation. It is expected that the liberalisation of trade will result in a rise in the relative price of the good in which an economy has a comparative advantage. Consequently, firms will switch their resources towards the production of this good. In developing countries, one of these resources is unskilled labour. As firms switch their production towards more unskilled labour-intensive methods the demand for unskilled labour rises relative to that of skilled. This results in an absolute and relative increase in the wages of the unskilled. The outcomes summarised above follow the predictions of the Heckscher-Ohlin-Stolper-Samuelson theorem based on the two-goods and two-factors.

The experiences of several East Asian economies in the aftermath of trade liberalisation served to reaffirm the belief in this theory amongst development economists. Outward-orientated policy reforms in the so-called Asian "Tigers" (Taiwan, China; Singapore; South Korea; and Hong Kong, China) during the late 1950s and 1960s, and in the Asian "Cubs" (Malaysia, Thailand, the Philippines, and Indonesia) during the mid-1970s

and early 1980s, coincided with higher employment, wages, growth rates, and living standards and lower wage inequality. A number of studies on the experiences of these nations concluded that outward orientation, coupled with macroeconomic stability and labour market flexibility, is the key to a successful development strategy <sup>1</sup>.

In a series of comparative studies, the success of the Tigers and Cubs also prompted various analysts to conclude that the high degree of protection granted to manufacturing in Latin America resulted in serious discrimination against exports, misallocation of resources, inefficient investment, and deteriorating income distribution. The system of protection in Latin America discouraged exports and thus did not permit the effects of the Heckscher-Ohlin-Stolper-Samuelson theorem to take residence.

The differences in performance between the Tigers and Latin America became more evident when the former group of countries rapidly recovered from the debt crisis of the early 1980s. Following the onset of the debt crisis, the World Bank and the International Monetary Fund recommended policy reforms based on the so-called Washington Consensus for these countries. Consequently, in the early 1990s most Latin American economies began to embark upon reforms geared towards outward orientation, the implementation of major stabilisation programs, and the privatisation of state-owned enterprises. The reforms ushered in rapid export earnings and productivity growth in most of these countries. However, in contrast to the predictions of the Heckscher-Ohlin-Stolper-Samuelson theorem and the experience of Tigers and Cubs, reforms in Latin America coincided with stagnant or falling real wages, higher wage inequality, and few gains in employment.

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<sup>1</sup> See for instance Balassa (1965, 1971, 1998) and World Bank (1993).



The contrasting experience of the late-reforming countries in Latin America compared to the highly publicised economic achievements of the Asian Tigers and Cubs sparked a new debate amongst economists who argued that the dominating paradigm is either wrong or inapplicable to Latin America. One prominent argument, championed by Wood (1997), is that Latin American countries, which embarked on liberalisation reforms in the late 1980s, did not experience a fall in skilled/unskilled manufacturing wage inequality following trade liberalisation due to the timing of reforms. Wood describes the world as having both developed and developing countries. Where, developed countries have an abundant stock of skilled labour while the developing world is endowed with unskilled workers. Wood postulates that in the 1960s the economic world (that is, open economies) virtually consisted of developed nations. Consequently, when developing countries liberalised trade they had a clear comparative advantage in goods of low skill-intensity. Therefore, trade liberalisation lowered wage inequality.

However, by the 1980s and 1990s this situation changed as low-income Asia (especially China) liberalised trade. China alone was larger — in terms of unskilled labour — than both those economies that liberalised in the 1960s and, more importantly, the ones that remained closed until the 1980s. The liberalisation of China, thus, resulted in an inflow of goods of low skill-intensity towards the rest of the world. Therefore, when the remaining nations liberalised trade, they no longer retained the comparative advantage they would have had in the 1960s. The point is that since they had relatively less workers than China they had to shift their production towards goods of intermediate skill-intensity.

Consequently, the effect on relative wages in countries with a relative endowment of unskilled labour greater than the developed world but less than China, such as Latin America, changed over time. In the 1960s, increased

openness would have caused sectors of high skill-intensity to contract, whilst expanding sectors of low skill-intensity. On the contrary, from the 1980s greater openness would have *conflicting effects* on relative wages. Firstly, liberalisation would cause a relative contraction of sectors of high skill-intensity, as imports from developed and newly industrialised countries would flood the market. Secondly, openness would also cause a contraction of sectors with low skill-intensity as imports from China flood the market. The net effect on wages might be in either direction, but trade liberalisation could widen the wage gap between skilled and unskilled workers, as happened in Latin America during this period.

A large number of studies have used this hypothesis to explain their empirical results<sup>2</sup>. However, this hypothesis is yet to be formalised theoretically. This is an important omission because only with a sound theoretical framework can one begin to fully understand the implications of this conjecture and how it should be tested empirically. This paper takes the first step towards filling this gap in the literature.

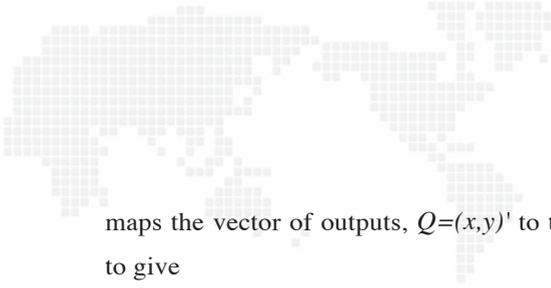
## **The Entrance of China in a Heckscher-Ohlin Framework**

The rest of this paper aims to formalise within the Heckscher-Ohlin model what happens to the world economy in the aftermath of the entrance of China. This section formalises the hypothesis, first introduced in Wood (1997), using models developed by Horiba (1974), Harkness (1983), Vanek (1968), Debaere (2003), Balistreri (1997) and Leamer (1980).

Assume that a country's production can be characterised by a Cobb-Douglas system where the inverse of a 2X2 matrix of production functions,  $A$ ,

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<sup>2</sup> For a review of such studies see Goldberg and Pavcnik (2007).



maps the vector of outputs,  $Q=(x,y)'$  to the vector of endowments,  $E=(S,L)'$ , to give

$$E=AQ. \quad (1)$$

In this model trade is balanced, so defining  $\sigma$  as the share of a country in world GDP, and given identical homothetic tastes, implies that consumption,  $C$ , is proportional to world output,  $Q_m$ , such that  $C=\sigma \cdot Q_m C^3$ . Defining a country's trade as  $T=Q-C$ , then the factors embodied in trade,  $AT$ , can be defined as  $AT=A(Q-C)$ , then using Equation (1) it can be shown that

$$AT = E - \sigma E_m, \quad (2)$$

where  $E_m=AQ_m$ , this simply states that the world is a closed economy, and therefore exports from the world are equal to zero. Hence,  $E_m$  is defined as the world's vector of endowments.

This system can be decomposed into two equations representing skilled and unskilled labour, respectively. Concentrating on just two factors of production — skilled labour,  $S$ , and unskilled labour,  $L$  — one can follow the intuition of Equation (2) to derive equations of the amount of skilled and unskilled labour embodied in net exports in a specific country:

$$S_T = S - \sigma S_m, \quad (3)$$

and

$$L_T = L - \sigma L_m, \quad (4)$$

where  $(S_T, L_T)$  are skilled and unskilled labour embodied in net exports,  $(S, L)$  are factor endowments of a specific country, and  $(S_m, L_m)$  are the world's

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<sup>3</sup> That is, if investment is not introduced into the model then the current account of the balance of payments must be equal to zero for equilibrium to be maintained. In this case, consumption must be equal to GDP ( $Q$ ), where by definition  $s=(Q/Q_m)$ .

factor endowments. Given this, one can define a country as relatively unskilled labour abundant if *the share of the world's unskilled labour force located in this country exceeds the share of the world's skilled labour force in that same nation*. The following equation formalises this definition. A nation is unskilled labour abundant if:

$$\frac{L}{L_m} > \frac{S}{S_m}. \quad (5)$$

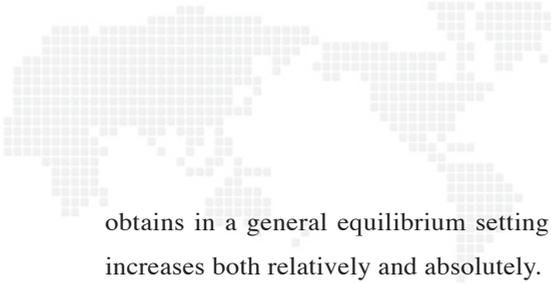
To formalise the analysis in Wood (1997) I make a simple extension to this model, that is include a third factor, semi-skilled labour ( $\Omega$ ). In this case if a country is an exporter of unskilled labour-intensive goods then Equation (5) can be rewritten as:

$$\frac{L}{L_m} > \frac{\Omega}{\Omega_m} \leq \frac{S}{S_m}. \quad (6)$$

Wood (1997) postulates that the entrance of China into the world economy in the late 1970s occurred simultaneously with a continuous increment in the level of skilling in the East Asian Tigers, such that the world experienced an increase of both  $L_m$  and  $S_m$  (relative to  $L$  and  $S$ , respectively). These alterations led to permanent changes in Latin America's comparative advantage. This region now faced the following condition:

$$\frac{\Omega}{\Omega_m} > \frac{L}{L_m} \text{ and } \frac{\Omega}{\Omega_m} > \frac{S}{S_m}.$$

Ethier (1974) proves that the Stolper-Samuelson theorem will hold in models with more than two goods and two factors. Consequently, in this model, trade liberalisation in Latin America is expected to lead to an absolute increase in  $w_\Omega$ , and a fall in  $w_L$  and  $w_S$ . Where  $w_k$  is the reward factor  $k$



obtains in a general equilibrium setting. That is, reward of abundant factor increases both relatively and absolutely.

Let skilled/unskilled wage inequality be defined as

$$\eta = \frac{w_{\Omega} + w_S}{w_L}, \quad (7)$$

Such that the effect on manufacturing wage inequality due to changes in  $w_{\Omega}$ ,  $w_L$  and  $w_S$  can be determined by the total derivative of Equation (7),

$$d\eta = \frac{-(dw_{\Omega} + dw_S)}{dw_L^2},$$

which highlights that whether inequality increases or falls will depend on the magnitude of the absolute value of the increase in  $w_{\Omega}$  compared to the magnitude of the absolute value of the fall in  $w_S$ . Assume that trade is Pareto-optimal, such that the increment in wages to semi-skilled workers is enough to compensate skilled labour for its loss and still remain better-off. If so, *it must be the case that the absolute value of the increase in  $w_{\Omega}$  is greater than the absolute value of the fall in  $w_S$ , such that inequality increases unambiguously.* That is, as long as this economy's relative endowment of semi-skilled workers is greater than its relative endowment of both unskilled and skilled labour, then trade liberalisation will lead to both a relative and absolute increase in the rewards to semi-skilled labour and a fall in the wages of the others.

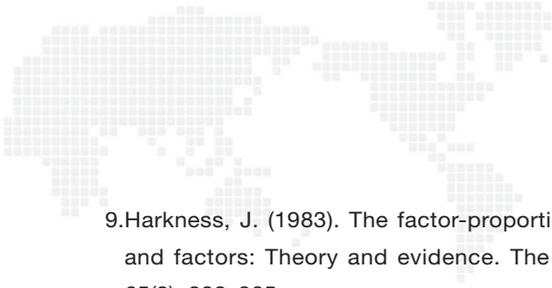
## Conclusion

This paper demonstrates how the predictions of the Heckscher-Ohlin-Stolper-Samuelson theorem could break down due to the timing of the

reform process. The entrance of large nations with large endowments of unskilled workers can lead to substantial changes in comparative advantage. This mirrors movements in the world endowment of unskilled workers in the 1980s. The model shows that for some nations that could be previously identified as unskilled labour-intensive, the entrance of a country like China into the world production system will shift its comparative advantage to semi-skilled labour-intensive goods. And by the general effects of the Stolper-Samuelson theorem, this will lead to an unambiguous increase in inequality and a fall in wages.

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# Europe's Debt Crisis and Its Impacts

*Eric Chiou (邱奕宏)*

## **Introduction**

Since October 2009, the fire of the European Sovereign Debt Crisis, first ignited in Greece, has been spread to Ireland and Portugal in 2010, and extended to Italy and Spain in 2011. Until February 2012, this wild fire has not shown any sign of being put out. Another wave of Greece's debt default is imminent. In order to effectively stop the escalation of the debt crisis, the European Union (EU) Summit, held in December 2011, decided to take active measures to deal with this crisis. 17 countries in the Euro Zone agreed to adopt strict fiscal policies that limit government's deficit below 3% of a country's GDP and restrict the percentage of total debt under 60% of GDP. Furthermore, with 500 billion euros funds, the European Stability Mechanism (ESM) was scheduled to initiate in July 2012, aiming to provide financial assistance to members affected by the crisis.

As one single market, EU's total output of goods and services in 2010 amounted to 12.2 trillion euros, surpassing the world's largest economy, the United States. Although EU's population is merely 7% of the world population, its trade amount is 20% of the total world trade. Meanwhile, EU is the largest export and import entity. Furthermore, the importance of euro in the global economy is only lesser than the significance of US dollar



and euro is also the second largest reserve currency in the world. Due to interconnectedness of the global economy, the consequences of the debt crisis in Europe have not only devastated Europe's economy, but have also brought some severe impacts on the Asia-Pacific countries and dragged down the fragile world economy. The goal of this article aims to articulate the significance of the EU and the Euro Zone in the global economy and to analyze the impacts of the Europe's Debt Crisis on the world economy.

### **Why are EU and Euro Zone important?**

The birth of euro was in 1999. Now, euro is the second largest international currency in the world. In 2007, the percentage of euro in the global foreign exchange reserves had reached 25.8% and the amount of its world-wide circulation was up to 864.4 billion euros. In February 2012, only 18 EU members are accepted to become the members in the Euro Zone, since the Euro Zone members have to satisfy some strict fiscal disciplines. According to the International Monetary Fund's (IMF) 2010 statistics, total GDP in the Euro Zone had reached \$14.67 trillion and EU's GDP was \$20.21 trillion, higher than America's \$15.91 trillion. Moreover, in terms of purchasing power parity (PPP), total GDP in the Euro Zone in 2010 was 15% of the global GDP and EU's GDP was 21%, which was better than US's 20% of the world GDP.

According to the World Trade Organization (WTO), EU's trading amount outnumbered the US's and China's trading amount and was ranked No. 1 in 2010. The ratio of EU's trade to its GDP reached 29.8% during the 2008-2010 period. Its exporting amount was \$1.78 trillion and importing amount was \$1.99 trillion, respectively representing 15% of the global exports and 16% of the global imports. Therefore, it is not difficult to find

that not only euro has played a crucial role in the global financial system, but also the significance of the EU as the largest trading bloc should not be underestimated.

## **Four Aspects to Review the Impacts of Debt Crisis**

In December 2011, the IMF president, Christine Lagarde warned that with the rise of the debt crisis in Europe, the global economy is likely to face economic austerity, protectionism and isolationism. The situations during the Great Depression in the 1930s may emerge again. She also emphasized that no economy can escape from this daunting crisis. In addition, The Economist also pointed out that the collapse of the Euro Zone may trigger more severe economic downfall than the 2008-9 global financial crisis, since the breakdown of the Euro Zone implies the total fiasco of the most financially and economically integrated region, which will trigger a series of bankruptcies, stringent fiscal austerity, dropping consumer expenditure, stagnation of capital markets, etc., and eventually dive into economic recession.

Even worse, if the Euro Zone were torn up into two parts, there will be no way to sustain the common currency for European countries and euro will finally come to the end. This economic blow will not only pose a critical challenge to the cohesion of the EU, but can also radically topple the foundation of EU integration. Hence, every country has been keeping a wary eye on the development of the debt crisis in Europe.

Concisely speaking, the Europe's debt crisis affects the global economy at least through the four following channels.

1. Finance: If some countries in the Euro Zone default, banks in Europe will refuse to loan each other, companies will withdraw their capital from



affected banks, and capital markets will be drained out of cash. Due to mutual debts-holding among banks in Europe, the US, Japan, and other countries, the fallout of one country's default in Europe will inevitably affect banks overseas and lead to capital flight from Europe.

2.Production: The debt crisis will aggravate the dire situations of Europe's manufacturing sector. To reduce debts, governments will slash public spending, cut down infrastructure, and raise tax, which will compel consumers to shrink their consumptions to the daily needs. Meanwhile, corporations will also stop hiring and delay investment, given declining demands and uncertain economy climate.

3.Trade: The slow economic growth of the EU will negatively affect many countries which target at the EU as their major exporting market. Rising unemployment rate, sluggish economic growth, and declining consumption will decrease the demands from overseas. Furthermore, the depreciation of euro will also weaken competitiveness of foreign products in the EU market and therefore result in the decline of import goods.

4.Business Confidence: Arguably, the psychological effect of the debt crisis in Europe may be one of the most influential and devastating consequences. As the bankruptcy of the Lehman Brothers heavily hit the consumer confidence in Wall Street in 2008, the collapse of the Euro Zone may trigger another round of consumer confidence downfall around the world. This worst scenario can gradually evolve and eventually bring the global economy into the second recession.

## **Conclusion: Lessons for Asia-Pacific Countries**

To sum up, the impacts of the Europe's debt crisis on the world economy reveal the characteristics of economic interconnectedness across

regions in the global economy. Meanwhile, the adverse influences of the debt crisis on Asia-Pacific region also highlight the vulnerability of the Asia-Pacific countries being over-dependent on European markets for their economic growth. Despite the fact that the global economy has become more intertwined and integrated, the best solution to lessen the negative influences of the debt crisis on Asia-Pacific countries is to strengthen its regional economic integration and to facilitate domestic markets. With the robust development in domestic markets, Asia-Pacific countries could gradually dilute the importance of export-led economic growth and enhance the overall competitiveness of products in the global markets. This approach can pave the solid foundation for economic prosperity and meanwhile ameliorate the economic shocks from other regions.



# A different Perspective on Poverty

*Enrique Panameno ( )*

I came to Taiwan almost five years ago from El Salvador, the smallest country in the American continent, where 15.2% of the population lives under USD \$2 per day<sup>1</sup>. One of the main reasons for coming here was to understand the island's incredibly rapid economic growth. Even when historical circumstances between Central America and the Asia Pacific regions are very different from each other, Taiwan has come out of poverty in an amount of time that seems almost impossible for other countries to achieve.

In my personal opinion, transformational leadership (Yang, 2006) in Taiwanese entrepreneurship is one of the keys of the country's economic success. This factor, along with other beneficial market and social sector circumstances, and government initiatives (TZENG, 2006) such as the stimulation of the High Technology Industry for during the late 80's and 90's, created very high entrepreneurial orientation, high business performance and high outcomes of leadership among Taiwanese SMEs, which constitute the vast majority of enterprises in Taiwan.

After witnessing firsthand the economic phenomenon that is occurring in Taiwan, not only my understanding of the region's economy increased

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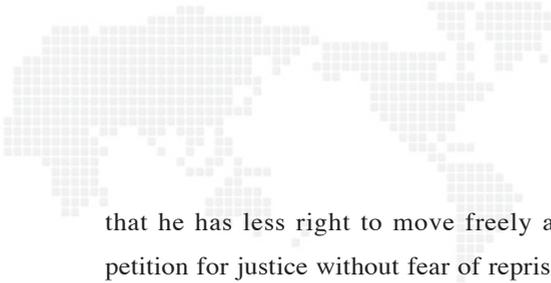
<sup>1</sup> "Poverty headcount ratio at \$2 a day (PPP) (% of population)". World Bank. Retrieved January 29, 2011.

but most importantly, my concept of poverty changed. I have come to the conclusion that the main difference between developed and non developed nations is that in the former people are able to identify the causes for poverty as something external to their own self, or as a consequence of bad decisions, if anything. This is not the case for countries of the so called "Third World." I believe that poor people in developing nations feel and think different than poor people from developed ones. The main issue resides in the fact that they interpret the reality that surrounds them according to what they have learned from that reality. When this reality antagonizes the main principles of human dignity, poverty becomes something that comes from within the human mind.

A simple inquiry on Dictionary.com can tell us that the word *lacking* means "being without; not having; wanting; less. *Lacking* is a deficiency, a deprivation, an empty hole in which the word *having* fits perfectly but it is simply nowhere to be found. *Lacking* is a smoky and pale negative word. *Lacking* is, at the end of the line, the rod humans use to measure each other.

Above the median, people are generally sized up for what they don't lack and are easily judged by the plenteousness in their lives. Inside an individual's mind, wealth is not attained by the possession of material goods as much as it is by the experience of possessing intangible ones. The higher someone stands, the more intangible things they possess: resourcefulness, social connections, gender equity, independence, dignity and power.

Below the median, people are usually measured by what they lack. Below the median though, things work in a different and twisted way. Among the macrocosm below the median is the poverty line; that winding line that traps with no mercy whoever gets in the way. Below the poverty line people go beyond lacking things, they lack worth. Let's imagine two naked men of the same ethnicity standing next to each other, one feels worthy and the other feels worthless. The one with "less worth" will strongly believe



that he has less right to move freely and to speak out; less deserving of petition for justice without fear of reprisal; to the right to privacy; and to the guarantee of the rights to adequate food, shelter, clothing, health care and education.

Although humanity has agreed that all men and women are equal and worth the same, the "worthless" don't believe so because they simply don't *feel* worthy, and that is an alarming truth. To understand this, the fact that poverty is multidimensional (Narayan, 2000) has to be comprehended. Poverty provokes a lack of resourcefulness, social connections, gender equity, independence, and other variables that render in a way that end up in completely demoralizing a human being. Let's get facts of three of these variables to illustrate how they are interwoven.

Chiragh Ali, a 56 year old farmer from Shimshal, Pakistan talks about *Mirgichig*, a traditional festival celebrated by his community. "On the fourth day, [...] men gather in a central place where every household brings milk, cream and *seman* (local sweet dish). [...] After this gathering, everyone is invited by their close relatives where special food is served to them. [...] But ...today nobody is available even to irrigate their crop fields, then who will afford time to celebrate these festivals?"<sup>2</sup>

The fact is that social connections are great assets for the poor because these connections are one of the main sources of help in times of need. That's why people need to be active in social festivities such as *Mirgichig* in Shimshal. If Chiragh wasn't able to afford his participation on this festival, he simply couldn't be part of it. This means that he would eventually become socially isolated because he is never involved in the social life of his

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<sup>2</sup> CHIRAGH ALLI, personal testimony, retrieved from <http://www.mountainvoices.org/Testimony.asp%3Fid=600.html>

community. His *lack of* social connections could go as far as costing him his life or the life of a family member.

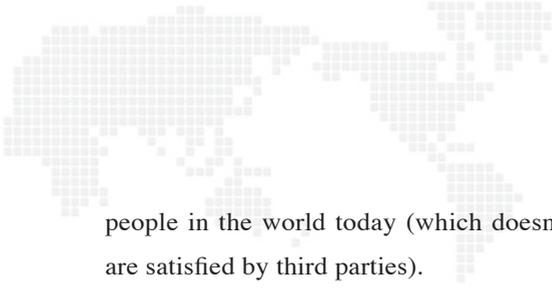
Let's take a look at this Bangladeshi woman and her disabled son. "In October 1999, Maymana and [her son] Mofizul occupied a one room, mud walled house with an old iron roof. They also had a small kitchen hut with mud walls and plastic sheeting on the roof. This, and its 0.06 acres of homestead land, was their main asset. They had no furniture, equipment or livestock (not even chickens) and only few cooking utensils. [...] Maymana did not know her age but was probably in her late 40s, had only two years schooling and was illiterate. She was also hearing impaired [...] and often tired or ill. Mofizul was 13 with no education, as is the norm for children with impairment in Bangladesh, and being disabled was part of his social identity."<sup>3</sup>

Maymana and Mofizul are dependent. In their circumstances, there is absolutely no way in which they can possibly survive by their own means. "In October 1999, Maymana was able allocated a Vulnerable Groups Development (VGD) card entitling her to 30 kilograms of wheat each month. This is World Food Programme grain provided to female-headed households identified by the local government councillor as being vulnerable to hunger."<sup>4</sup> This dependency leads to depression and a sense of powerlessness that makes people question their will to live. Can anyone imagine how humiliating is to depend on a food program? Wikipedia tells us that 1.4 billion live with less than US\$1.25 per day. That means that there is it at least 1.4 billion dependant

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<sup>3</sup> KOTHARI UMA AND HULME DAVID, Global Poverty Research Group, Narratives, Stories and Tales: Understanding Poverty Dynamics Through Life Histories, GPRG-WPS-011, by. Retrieved from <http://www.gprg.org/pubs/workingpapers/pdfs/gprg-wps-011.pdf>

<sup>4</sup> Ibidem.



people in the world today (which doesn't necessarily mean that their needs are satisfied by third parties).

The lack social connections and dependency are only two of the many variables that lead the poor into hunger and eventual death. Any of these variables leads to the rest, making poverty a complex and multidimensional phenomenon that leads millions of people into the depression, shame and despair. Poverty is happening right now, to most people in this planet, and it all goes back to *lacking*. Lacking is deficiency, and they, the poor, lack everything including worth. They, in their minds, are worthless, and helping them to change this very single thought could make all the difference in the world.

### **Other sources**

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# **A Quick Look at the 2012 APEC Hosting Economy-Russia**

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The 2012 APEC is hosted by Russia. Four priorities are already specified and announced: a) trade and investment liberalization, regional economic integration, b) strengthening food security, c) establishing reliable supply chains, and d) intensive cooperation to foster innovative growth. Accordingly, the Russians are looking forward to placing herself into the system of economic ties in the APEC region through "organic integration" and much desired modernization- and innovation driven economic development. Accordingly, Siberia and Far East area are specific locations where Russia would like to fulfill these wishes.

It's further mentioned that Russia intends to make a contribution to achieving APEC's objectives, including trade and investment liberalization, facilitating business, intensifying regional economic integration, and ensuring personal security. However, Russia also plans to propose that APEC member economies ought to focus on practical issues as bolstering food security, improving transport and logistics systems, and cooperating in the interests of modernization and innovation. More details regarding the Russia's APEC goal are about economic and technical cooperation (ECOTECH).



## Common and Specific Interests

In general, APEC priorities mainly mirror two types of interests that are a) common interests and b) the host's specific interests. The common interests are much related to APEC's institutional objectives such as regional economic integration and the three pillars. The hosting economy's specific interests would be different pending on different hosting economies' economic performance and conditions.

The hosting economy's interests could be a good reference to detect the particular economy's economic strengths or weaknesses. For example, Singapore wanted to promote and enhance business supply chains in the year of 2009 due to the fact that Singapore was world number one logistics center ranked by the World Bank. Japan strived to sell the idea of the new growth strategy in 2010 because Japan was one of the advanced economies that suffered the most from the most recent global financial crisis. The United States placed an emphasis on regulatory conversion in 2011 for the reason that the US tried to eliminate rules-oriented barriers, so she could sell more US made products to mostly emerging countries in Asia and Latin America.

As for the 2012 APEC hosting economy-Russia, Russia would very likely also embed her specific national interest in the APEC priorities with respect to her economic circumstances. Basic economic data of Singapore, Japan, the United States, and Russia, 2009-2012 APEC hosts in 2011, estimated by the IMF are listed in table 1. And from table 1, we can see that Russia has a very different economic structure and a diverse set of conditions from the previous 3 hosting economies.

In 2011, Russia also suffered from a much higher inflation level compared with the other 3 economies. With relatively lower income per capita and higher inflation, Russia's economic style is more of an emerging

economy. With a 7.3% unemployment rate, Russia is experiencing a very high index of misery. The total value of oil exports stands as roughly 15% of Russia's annual GDP implying how significant Russian economy relies on a good market price of crude oil. However, Russia has a healthy fiscal condition, which can be examined by looking at the fiscal balance and national debt over GDP ratio.

**Table 1. 2011 Basic Data of 2009-2012 APEC Hosting Economies**

Economies	Singapore	Japan	US	Russia
GDP (USD)	267 billion	5,855 billion	15,065 billion	1,885 billion
Population	5 million	127.9 million	313 million	142 million
Per capita income (USD)	50,714	45,774	48,147	13,236
Inflation	3.7%	-0.37%	3.0%	8.88%
Unemployment	2.3%	4.9%	9.1%	7.3%
Oil exports (USD)	95 billion	0	98 billion	277 billion
Oil imports (USD)	109 billion	182 billion	439 billion	0
Investment/GDP	26%	21.4%	15.8%	22.7%
Saving/GDP	45.8%	23.8%	12.8%	28.2%
Fiscal balance/GDP	3.2%	-10.3%	-9.6%	-1.1%
National debt/GDP	93.5%	233.1%	100%	12%
Current account balance/GDP	19.8%	2.5%	-3.1%	5.5%

Source: IMF data and statistics, retrieved on January 18, 2011.

## Overview of Russian Economy

The former Soviet Union was a globally isolated country, but Russia has been a more internationally integrated nation. It is therefore sensible that a more internationally integrated Russia would be interested in placing herself into the system of economic ties of the region as stated in the 2012 priorities. Russia has been the world's biggest exporter of natural gas, the second largest



exporter of oil, and the third largest exporter of steel and primary aluminum. However, other industries in Russia such as textiles, plastic products, electric and electronics, semi-conductors manufacturing and so on are still at the very immature phase.

Over relying on natural gas and crude oil and other commodities exports makes Russia extremely vulnerable to regular business boom and bust cycles that follow the highly volatile swings in global commodity prices. The 1998 Russian Financial Crisis was a big frustration for the Russians. After that big setback, Russia had a good recovery by achieving averaged 7% real GDP growth from 1999 to 2007. The excellent economic performance during that period had helped double Russians' real disposable incomes and earn Russian economy a seat among the BRIC. However, Russia was one of the hardest hit by the 2008-09 global economic crisis. The recovery from this crisis started in 2010; however, Russia also experienced a new disaster in the same year. A very severe drought and fires in central Russia seriously hurt Russia's agricultural production. Russia had no choice but to prompt a ban on grain exports for part of the 2010. That's why strengthening food security is an issue.

High crude oil prices did help push for the Russian growth in the first quarter of 2011. Thanks to the growth, Russia was able to reduce the fiscal deficit caused from adopting expansionary actions during the years of 2008 and 2009. However, the bad news was that the hot money also invited inflation. Russia experienced high inflation in 2011 like most emerging economies did. The inflation limited the positive impact of increased revenues and growth.

## Russia's Economic Goals and APEC Priorities

**Figure 1. 2000-2011(e) Real GDP Growth Rates**



Source: IMF data and statistics, retrieved on December 23, 2011.

Russia is a unique economy that is neither a typical emerging economy nor an advanced economy. Russia's per capita income is low by advanced economies' standard, but somewhat higher than other emerging and developing economies. On average, a Russian can make as much as US\$ 13,236 a year. A Chinese can be paid approximately US\$ 5,184 per year. In terms of inflation, Russia had dealt with surging good prices for the first 2 quarters of 2011 like most emerging economies did. Therefore, from the angle of weights of good price, Russia is more of an emerging market.

**Table 2. Correlation Coefficients estimated for Russia versus Advanced Economies & Russia versus Emerging and Developing Economies**

2000-2011	Advanced Economies	Emerging and Developing Economies
Russia	0.9143	0.6829

Source: IMF data and statistics, retrieved on December 23, 2011, and calculated by the author.



Can Russia be considered as an advanced economy or be categorized into the group of developing countries? Why does it matter to tell if Russia is more of an advanced or developing type in this article? To answer the 2<sup>nd</sup> question first, it is because in general APEC developed economies favor trade and investment liberalization and facilitation issues more due to the fact that advanced economies' industry tends to be more capital and technical intensive. In experience, APEC developing economies are more interested in promoting ECOTECH, because their industry would be at the beginning stage and requires assistance from the advanced cohort.

To look for answer of the first self-posing question, I retrieved real GDP growth data of 2000-2011 from the IMF for comparing how Russian economy has been moving along with advanced economies or with emerging & developing economies. Data are plotted and shown as figure 1, we can see that the Russia's economic growth pattern seemed moving in company with emerging and developing economies before the 2008-2009 global financial crisis. However, Russia joined advanced economies as one of the most seriously hit victim during the crisis. To further test if the Russian economic growth pattern is more correlated to advanced group or developing cohort, correlation coefficients are calculated based on 2000-2011 time series growth data. In table 2, it seems Russia has been more correlated to the economic growth pattern of advanced group. The other possibility is that Russia is operating in both styles.

In the 2012 APEC priorities, it is mentioned that Siberia and Far East area are specific locations to be further integrated with the region. By comparison, the Far East area of Russia is less developed than the European area of Russia. Therefore, Russia is the economy that owns both somewhat developed and a bit emerging qualities. To sum up, Russia is trying to seize the momentum as an APEC host to upgrade her Far East area and utilize

others' innovative growth means to resolve her own ingrained economic problem, over reliance on exports of commodities.



## Seeking cooperation with Russia through APEC

*Rida Yu ( )*

Russia has vast experience in hosting expert-level APEC events, including those on transport, energy efficiency and energy conservation ((Vladivostok & Moscow,2005 and Yuzhno-Sakhalinsk, 2006), industrial science and technology (Vladivostok, 2007). In 2010, Russia organized a number of seminars/symposiums, particularly, on establishing Multilateral Cooperation in Fighting Wild Fires in the Asia-Pacific region, using Marine Energy Resources of APEC Economies' Coastal Zones as Sustainable Source of Green Electric Power in Asia-Pacific (Vladivostok, 2010), Transport Control and Monitoring on the Basis of Satellite Navigation Systems in APEC Region (Vladivostok, 2011).

However, Russia is still very far and strange to Taiwan for a long time. Few people in Taiwan understand the real Russia, which is also one of Brics. Joyfully, Russia has taken over the rotating chair of the Asia-Pacific Economic Cooperation forum in 2012 and will host this year's APEC Leaders' Week in Vladivostok the first time since 1989, which APEC was established. It is attracting more attention from all the world,Taiwan included. Chinese Taipei's participation in APEC offers good opportunity to seek collaboration with Russia and there are several crucial reasons why it needs and how to seek economic cooperation with Russia. This article offers some answers for the above question.

First, why we need to seek cooperation with Russia? What are the changes that have occurred recently in Russia and what benefits will they have on economic relations with Taiwan?

The Asia-Pacific region became and still remains one of the top priorities of Moscow's external strategy. Russia's participation in APEC also comes with a great sense of its responsibility. Just as Russia is an integral part of the vast and forward-reaching Asia-Pacific region, that is crucial for the socio-economic development of Russia, especially Siberia and the Far East. Therefore, one of the country's top priorities is to promote trade and investment cooperation with Asia-Pacific countries and to actively participate in regional integration.

In addition, the Russian government has launched a massive program of state-funded investments in the social and economic development of its Far Eastern areas. The objective is not only to upgrade the economy and infrastructure but also to reinforce Russia's geopolitical position in the Pacific. Russia's more vigorous policy is generally seen in the region as a positive factor. Most important, Moscow has established a "strategic partnership" with China, both in bilateral and multilateral (the Shanghai Cooperation Organization) formats. The good interaction between Russia and North-East Asia was also evolved through 6 parties Conference.

In other words, Russia is taking the pragmatic neomercantilism, which would do no harm to countries of the region or to the rising Asian regionalism. The Russia's ongoing economic integration with Asia Pacific, which aims to generate economies of scale and to connect the region to the world market, brings Taiwan a great opportunity for market expansion to North-East region.

Second, various strategies employed by different countries have bolstered mutual cooperation with Russia. What were the strategies that were



implemented and what are their implications? Cases involving the United States, China, Korea and Japan are exemplified. We may find that actual cooperation and strategies vary depending on the country. Political, diplomatic or economic concerns provided the basic rationale for such strategies. Taiwan has no formal channels to bolster mutual concrete economic cooperation with Russia due to a lack of the diplomatic or political relationship. Taiwan should adapt a cooperation strategy that accords with our own need and capabilities, as different countries cooperate for different reasons. The example most pertinent and applicable to Taiwan is the economic and trade approach. Although Taiwan has been engaged in APEC's activities, there is yet been no clear measures that can actually be termed a strategy. However, Chinese Taipei's keen participation in APEC can help our government and industries to propose new collaboration project through pathfinder mechanism in APEC. It's a valuable option for Chinese Taipei to seek cooperation with Russia.

The third question concerns obstacles for the expansion of business between Taiwan and Russia. Although bilateral trade between Russia and Taiwan has increased recently, it is not significant as a proportion of total world trade. Furthermore, the two parties are not taking full advantage of the competitiveness or complementarity of their products or industries. Although Taiwan's electrical and electronic equipments are very much competitive in the world market, their exports to Russia, however, is lower than expected. Russia has competitiveness in a range of products or industries such as agriculture products or hi-tech industries. Nevertheless, products that are actively exported to Taiwan are limited and mutual cooperations of different industries are rarely promoted between Russia and Taiwan.

The trade and non-trade barriers between Russia and Taiwan still exist. The trade barriers include the lack of marketing ability toward Russia, exchange rate volatility and high tariff rate and etc. The non-trade barriers

include requirement of complex custom procedures or import license, additional tax aside from formal tariffs and restrictions on exchange transaction, etc. Chinese Taipei may take the following measures to facilitate trade towards Russia:

- To increase the awareness of Chinese Taipei's activities and contributions in APEC.
- Early conclusion of economic and technological cooperation with Russia.
- Collaborating with Russia for expedited customs procedures, especially sharing our experiences in establishing our supply chains, such as AEO (Authorized Economic Operator) system and RFID technology.
- To further simplifying the process for visa issuance.
- Setting up permanent consultative channels to respond to export barriers.
- Various cooperative channels and regular meetings should be established as a basis for closer relations.

Fourth, what are the sectors where Taiwan and Russia have potential for greater cooperation and how can both parties earnestly engage each other in cooperation? According to Russian Prime Minister Vladimir V. Putin, "to restore our technological leadership we must choose our priorities carefully. We should look at sectors like pharmaceuticals, high-tech chemicals, composites and non-metal materials, the aviation industry, information and communication technologies and nanotechnologies." Accordingly, cooperation in ICT industry should be the first priority consideration for Taiwan because it not only complies with the actual needs of Russia, but also can to be done in the sectors where Taiwan has actual needs and possibilities.

In addition, Russia has been actively involved in APEC efforts in the field of human security, especially in counter-terrorism and disaster



preparedness. Russia also made a great of contributions to the initiatives on providing international information security, fighting cyber terrorism and improving protection of key energy infrastructure. However, it still lacks the system of trade security to prevent any incidental risk from harming the supply chains. Chinese Taipei should utilize the great opportunity in APEC for contributing our ICT technology and precious experiences in establishing the reliable supply chains.



