

# PART ONE: REGIONAL SECURITY TRENDS AND EMERGING ISSUES

## Chapter One

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### **Economic Security in the APEC Region: Knowns and Unknowns**

*There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – there are things we do not know we don't know.<sup>1</sup>*

#### **Executive Summary**

Is managing the economy in the APEC region an exercise of managing unknowns? While there is ample uncertainty today, several observations on economic security in the region can be made with sufficient confidence. To begin with, a strong economy is and will continue to be a necessary component of national security. Among other knowns:

- Key demographic factors have an indelible impact on economic security throughout the APEC region.
- While incomes are on the rise, so, too, is the inequitable distribution of those gains.
- An important percentage of the labor fueling APEC economies is mobile and, when the economic asset deployed abroad is a nation's people, security issues become increasingly complex.
- The most recent financial crisis will not be our last.

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<sup>1</sup> Statement by US Secretary of Defense Donald Rumsfeld at a Press Briefing (February 12, 2002).

The key known, however, is perhaps the most important: despite what we do not yet know, in this fast-paced, globalized world, we need to keep learning from the past – and from each other – if we hope to understand the complexity of the global economy and achieve an acceptable level of economic security.

Since February 2002, analysts have debated which national security factors are known, unknown, or a combination thereof. For those concerned with economic security, the past few years have been riddled with unknowns as individuals, businesses, and governments were caught short when the global economy tumbled from its record-breaking highs in 2008. While the United States was at the epicenter of the collapse, some APEC<sup>2</sup> economies were spared the worst effects, yet no one was completely insulated from the consequences of this global economic readjustment. The millions of people who lost their jobs, savings, or homes may consider management of the economy the biggest unknown, as they have asked, “How could this happen?” and “Who was in charge?”

But is managing the economy in the APEC region in fact an exercise in managing unknowns? What do we know about the future of the economy in APEC with sufficient certainty to classify as “known knowns,” and what remains unknown?

To begin with, we know a strong national economy is and will continue to be a necessary component of national security. Without a strong economy, a nation’s ability to project power – hard, soft, smart, or any other variety of power – is constrained. Within the APEC region, several national security strategies or national

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<sup>2</sup> According to its website, Asia Pacific Economic Cooperation (APEC) is “the premier Asia-Pacific economic forum. Currently, twenty-one economies are members of APEC: Australia, Brunei Darussalam, Canada, Chile, the People’s Republic of China, Hong Kong China, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Chinese Taipei, Thailand, the United States, and Vietnam (names of economies are per the APEC designation). This chapter uses publicly available databases such as those of the World Bank, the United Nations, and Organization for Economic Co-operation and Development. These databases do not have separate entries for “Chinese Taipei.” When referring to that economy, separate sources are used and cited accordingly.

security policies specifically underscore the relationship between the economy, security, and power:

- The May 2010 *National Security Strategy* of the United States declares, “At the center of our efforts is a commitment to renew our economy, which serves as the wellspring of national power...” and American prosperity “serves as a leading source of our influence in the world.”<sup>3</sup>
- The 2009 document, *National Security Strategy of the Russian Federation to 2020*, proclaims, “The state of national security of the Russian Federation is directly dependent on the economic potential of the country and the effectiveness of the system of provision of national security.”<sup>4</sup>
- In *Securing the Gains of Democracy: National Security Policy 2011-2016*, the Philippines aims to “collectively pursue and build the economy to be strong, capable of supporting national endeavors, and derives its strength from the solidarity of our people who have an organic stake in it through participation and ownership. This is the core interest of the national vision to ensure that Filipinos become stakeholders in economic and business enterprises so that they will collectively defend, protect, and improve the economic system for themselves and the future generations of Filipinos.”<sup>5</sup>
- Vietnam also puts the economy at the forefront of national security. The 2009 paper, *Vietnam National Defences*, asserts the nation “always regards the maintenance of peaceful and stable environment for socio-economic development, industrialization and modernization, building the socialism-

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<sup>3</sup> Office of the President, United States of America, *National Security Strategy* (Washington, DC, 2010), available at:[http://www.whitehouse.gov/sites/default/files/rss\\_viewer/national\\_security\\_strategy.pdf](http://www.whitehouse.gov/sites/default/files/rss_viewer/national_security_strategy.pdf).

<sup>4</sup> Decree of the President of the Russian Federation. *National Security Strategy of the Russian Federation to 2020* (Moscow, 2009), available at: <http://rustrans.wikidot.com/russia-s-national-security-strategy-to-2020>.

<sup>5</sup> Office of the President, Republic of the Philippines. *National Security Policy: Securing the Gains of Democracy* (Manila, Philippines, 2011).

oriented market economy as the top national interest, and the consistent goal of its national defence policy.”<sup>6</sup>

- New Zealand’s national security system is based on “seven key objectives [which] underpin a comprehensive concept of National Security,” one of which is “sustaining economic prosperity: maintaining and advancing the economic well being of individuals, families, businesses, and communities.” The threshold for central government engagement on national security includes conditions in which “risks are such that they could... adversely and systematically affect” not only the nation’s borders and citizen safety, but also its economy.<sup>7</sup>

While not all of the national security strategies of APEC nations openly state this connection between economic and overall power, it is hard to imagine an APEC leader who would not agree on the role the economy plays in defining national power.

We also know that, barring a major catastrophe, population trends for the next fifty years foretell a dramatic aging of society in many APEC economies and that these demographic factors will have an indelible impact on economic security throughout the region. Aging affects an economy in two primary ways: On the supply side, there is the reduction of productive labor for the workforce. On the demand side, there are increased costs, particularly for the payment of pensions and the provision of health care.

Forward-looking government policies during the period of a demographic dividend (when decreased fertility rates create a “bulge” in the population in the productive fifteen-to-sixty-four age group) also portend how well a country can deal with the demographic shift to dependence (when those in the nonworking ages exceed the fifteen-to-sixty-four-year-old cohort). However, for many countries in Asia, the ability to deal proactively with the inevitable issues of aging was disrupted by the previous financial

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<sup>6</sup> Minister of National Defense, Socialist Republic of Vietnam, *Vietnam National Defense*, (Hanoi, 2009).

<sup>7</sup> *New Zealand’s National Security System* (2011), available at: <http://www.dpmc.govt.nz/sites/all/files/publications/national-security-system.pdf>.

crisis of 1997. Even without the prior crisis, many governments find it difficult to fully prepare for effects that will occur a generation in the future. After all, economic policies are not solely a function of the market, they are political developments. Demands to immediately deliver upon political promises limit both the incentive and the ability to plan for the future.

With a population that has the highest percentage of elderly in the world, Japan is already facing the dual economic challenge of absolute population decline and relative population aging. We know that the demographic picture will not improve for the next generation of Japanese either: according to United Nations estimates, by 2050, the absolute number of Japanese of productive working age (fifteen to sixty-four years old) will be less than the dependent population of the country (those under fifteen years of age, or sixty-five and older).<sup>8</sup>

Korea is likewise aging: At the founding of APEC in late 1989, senior citizens comprised less than 5 percent of Korea's population. Today, that percentage has more than doubled and stands at nearly 12 percent of the nation's population. Over the same period, the percentage of Thailand's over-sixty-five population has also doubled, from 4.5 percent to 9 percent. As of the latest comparable statistics (2010), nine APEC economies report senior populations that exceed 10 percent of their populations: Japan, Canada, Australia, the United States, New Zealand, the Russian Federation, Hong Kong, Korea, and Chinese Taipei.<sup>9</sup>

China has enjoyed the benefits of a demographic dividend for a generation, but the dividend is transitory. The introduction of the one-child policy in 1979 reduced the overall population size, but also set in place both a forty-year dividend and the inevitable ag-

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<sup>8</sup> United Nations Department of Economic and Social Affairs. *World Population Prospects: The 2010 Revisions* (New York, 2011), [http://esa.un.org/wpp/unpp/panel\\_indicators.htm](http://esa.un.org/wpp/unpp/panel_indicators.htm).

<sup>9</sup> APEC figures from World Bank Databank, <http://databank.worldbank.org/data/home.aspx>; Taipei figures from National Statistics, ROC (Taiwan) <http://eng.stat.gov.tw/point.asp?index=4>.

ing of Chinese society to follow. “In 1980 China’s median age (the point where half the population is older and half younger) was twenty-two years, a developing-country figure. China will be older than America as early as 2020 and older than Europe by 2030. This will bring an abrupt end to its cheap-labor manufacturing. Its dependency ratio will rise from 38 to 64 by 2050, the sharpest rise in the world.”<sup>10</sup>

Fueled in part by the demographics of where labor is needed versus where excess labor supply exists, we also know that an important percentage of the labor fueling the APEC economies is mobile. The officially reported value of their remittances can exceed more than 10 percent of GDP in labor-sending economies; given that many remittances are sent home via informal networks, this figure is likely to be much higher. According to the International Organization on Migration, not only is the number of South and East Asian labor migrants increasing, increases are also seen in the numbers finding employment within the region, doing so in an undocumented status, and in the percentage that are women,<sup>11</sup> all factors that limit wages and therefore limit the economic impact of these remittances.

Nonetheless, for countries deploying their labor resources, the value of the officially reported remittances traditionally exceed the levels of any official development assistance received, and frequently rivals or exceeds the amount of foreign direct investment. Within APEC, this is seen most strongly in the Philippines and Mexico but is also experienced in Indonesia, Korea, and Vietnam. Jobs in the Middle East attract the bulk of APEC’s labor migrants, but, among the APEC economies, Hong Kong, Singapore, and the United States are key receiving countries. Malaysia, Australia, and New Zealand also receive significant numbers of overseas workers from nearby nations, such as Indonesia and the Pacific Islands, respectively.

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<sup>10</sup> “A Tale of Three Islands,” *The Economist* (October 22, 2011), available at: <http://www.economist.com/node/21533364>.

<sup>11</sup> International Organization for Migration, *World Migration Report* (Geneva, 2005).

While having investments in physical infrastructure overseas raises complicated issues related to national economic security, we know when the economic asset deployed abroad is a nation's people, security issues become increasingly complex. The Philippines' extensive infrastructure of the Department of Labor and Employment, the Philippine Overseas Employment Administration, the Overseas Workers Welfare Administration, and multiple nongovernmental organizations concerned with workers' rights and skills training creates a substantial base of support for the export of Philippine labor. In 2010, official figures indicated nearly 9.5 million Filipinos were abroad for labor purposes.<sup>12</sup> Indonesia is also increasing its export of labor to help the domestic economy. However, the Indonesian program of official support is not as deep and diversified as the Filipino effort. Estimates indicate more than 1 million Indonesian women are working as domestic housekeepers in Kuala Lumpur alone, out of the estimated 700,000 undocumented and 1.3 million documented Indonesian workers in Malaysia.<sup>13</sup> While these women's labors may provide some economic advancement for their families, their contributions to Indonesia's GDP is a fraction of their Filipino counterparts, as Filipinos are seen around the world in various higher-paying service industries and, with nearly 350,000 sea-based Filipinos, hold a dominant position in the seafarer community.

We know that the phenomenon of labor migration is both a reflection of lack of sufficient economic opportunities in the sending countries, which creates an available supply, and market demand in the receiving countries. It is also affected by the policies and attitudes of the receiving countries. Korea, with an aging

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<sup>12</sup> Department of Labor and Employment, *Current Labor Statistics 2012*, Republic of the Philippines, <http://www.bles.dole.gov.ph/PUBLICATIONS/Current%20Labor%20Statistics/STATISTICAL%20TABLES/Tab33.pdf>.

<sup>13</sup> World Bank, *The Malaysia-Indonesia Remittance Corridor*, World Bank Working Paper 149 (2008), <http://siteresources.worldbank.org/INTAML/Resources/Malaysia-Indonesia.pdf>.

population, has been officially accepting more overseas workers since the early 1990s, and seeing an influx of undocumented workers as market demand for labor exceeds official channels. Japan, on the other hand, remains resistant to large-scale import of foreign labor, despite the aging economy and the shortfall of domestic labor for key industries. Globalization and the lengthening of supply chains have allowed Japan to maintain this stance by employing foreign labor, but in factories overseas rather than bringing them to Japan. While the resistance to accepting foreign labor within Japan itself may be rooted in longstanding cultural norms, the negative economic impact is seen in an insufficient labor supply, particularly in service industries – ranging from nursing to domestic construction – which cannot be physically outsourced to another land.<sup>14</sup>

We know that there is a decline in the agricultural workforce, which is concurrent with an increase in urbanization as people move off the farms and into the cities. There has not been a dramatic change in the percent of agricultural land, but several countries in the APEC region, particularly Vietnam, the Philippines, and China, have witnessed marked declines in the contribution of agriculture to the nations' economies. However, this relative decline speaks more to the dramatic increase in other sectors of the economy, rather than an absolute drop in agricultural production or agricultural value. Furthermore, despite fewer workers, agricultural production has been sustained with technological and biological advances. In fact, while hunger remains a non-eradicated problem throughout the developing world, global net calorie consumption is up, and, with it, a rise in obesity and related lifestyle diseases that negatively impact the economy through lower productivity and increased healthcare costs.

We know that the APEC region is beset with a wide range of natural disasters that have lasting impacts on the region's economy. The triple disaster of an earthquake, a tsunami, and a nuclear

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<sup>14</sup> Hiroko Tabuchi, "Japan Keeps a High Wall for Foreign Labor" *The New York Times* (January 2, 2011), available at: <http://www.nytimes.com/2011/01/03/world/asia/03japan.html?pagewanted=all>.

event in Japan in 2011 is estimated to have negatively impacted the Japanese economy by trillions of yen. The Japanese government estimates the material loss alone to exceed USD 300 billion. For some major Japanese manufacturers, such as Toyota, the situation was further negatively impacted by a fourth crisis 4,600 kilometers away – the 2011 monsoon floods in Thailand, where many of the company’s component parts are produced. Due to these natural phenomena, Japan’s already-weak economic forecasts in 2011 were revised further downward from a pre-quake figure of 1.4 percent GDP growth to a post-quake figure of 0.4 percent.

Of course, the constant unknown is where and when the next disaster will strike. Regardless of its location, it is a given, if not a known, that nearly every government of the region is under-prepared and under-financed to deal with major multiple disasters, because budgets are not robust enough to include mitigation measures. This is particularly true at a time when government budgets throughout the region are being slashed and limited funds are being redirected to issues of the “here and now” rather than devoted to preparedness measures for disasters that only “might be.”

Whether due to natural disasters, fewer farmers and less farmland, increases in the cost of inputs such as fuel, or changes in government agriculture subsidies, we know that fluctuation in food prices is often the breaking point for public tolerance. Price changes can also come from reduced subsidies or increased taxes on key agricultural items. Across the globe and throughout history, events that have become associated with political upheaval have often begun as protests over the price of key commodities. News reports from recent times remind us:

- “After all, it was concerns about spiraling prices that first stirred protests in the run-up to the 1989 occupation of Tiananmen Square.”<sup>15</sup>

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<sup>15</sup> David Pilling, “Why Beijing Must End Inflation – or Else,” *Financial Times* (May 18, 2011), available at: <http://www.ft.com/intl/cms/s/0/1bf6dc04-817c-11e0-9c83-00144feabdc0.html?ftcamp=rss#axzz1pSladapK>.

- “Nearly 100 people were detained after a peaceful protest [in Jakarta] over the rising prices and food shortages that are forcing shoppers to spend hours in search of basic items like cooking oil and baby formula.”<sup>16</sup>
- “Toward the end of last year, prices of basic commodities began rising sharply in Burma. Rice, eggs, and cooking oil all went up by around 30–40%. For a population that on average spends 70% of its income on food, this was very difficult to absorb... Within days activists were out on the streets in protest. When they were arrested, the monks who can accurately measure economic distress by the food put into their begging bowls every morning – took their place.”<sup>17</sup>

Based on these observations, we add another “known known” to the list: When economic hardship moves to the dining table, the follow-on steps can go beyond economic adjustments to focus on political change.

The persistence of hunger concurrent with growing obesity points to another known with economic roots: While incomes are on the rise, so, too, is the inequitable distribution of those gains. Today, nearly 60 percent of the population of developing Asia is considered middle class, meaning they live on an amount ranging between USD 2 to USD 20 per day. This compares to 1990, when only 21 percent of developing Asia was middle class. Forecasts indicate that by 2030, two-thirds of the global middle class will live in Asia-Pacific, compared to less than one-third today.<sup>18</sup>

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<sup>16</sup> Seth Dyans, “Indonesia Cracks Down as Protests Hit Capital,” *The New York Times* (February 12, 1998), available at: <http://www.nytimes.com/1998/02/12/world/indonesia-cracks-down-as-protests-hit-capital.html?pagewanted=all>.

<sup>17</sup> Jonathan Head, “The Hardship That Sparked Burma’s Unrest,” BBC News (Bangkok October 2, 2007), available at: <http://news.bbc.co.uk/2/hi/asia-pacific/7023548.stm>.

<sup>18</sup> Homi Kharas, “The Emerging Middle Class in Developing Countries” (Brookings Institution, June 2011), available at: <http://siteresources.worldbank.org/EXTABCDE/Resources/7455676-1292528456380/7626791-1303141641402/7878676-1306699356046/Parallel-Session-6-Homi-Kharas.pdf>.

While these figures indicate that Asia as a whole is getting richer, the concurrent rise in Asia's Gini coefficients<sup>19</sup> indicate the rich are getting richer at a faster rate, widening the gap between rich and poor. To complicate matters, periods of rapid development are generally accompanied by inflationary increases, and inflation in food prices disproportionately affects the poor. In addition to stirring political unrest, suppressing the ability of the poor to advance creates a vicious circle by limiting the ability of the market to expand, in turn limiting growth. Therefore, despite continued developmental advances within the APEC economies, we cannot forget there are still millions of people living in poverty. In just three APEC economies with current World Bank reporting data – Indonesia, the Philippines, Vietnam – nearly 170 million people live on less than USD 2 per day. Adding Chinese living below the poverty line can nearly double that number, depending on which statistics are being used.<sup>20</sup>

That inequalities and imbalances exist is inherent in an economic system based on the concept of competitive advantage; there will be relative winners and relative losers. Fortunately, there is a demonstrated level of situational public tolerance for these inequities: We do not riot in the streets when a sports celebrity makes a multimillion-dollar salary, compared to the rest of us, who do not. We may even cheer the entrepreneur who strikes it rich with a unique invention. However, wealth that is neither earned nor deserved, perhaps gained through greed or corruption, creates problems.

Likewise, an increasing concentration of economic power in the hands of a few is problematic. When tolerance levels are exceeded, the results are jeers, not cheers, and street protests are

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<sup>19</sup> The Gini coefficient measures the inequality among values of a frequency distribution (for example, levels of income). A Gini coefficient of zero expresses perfect equality, where all values are the same (for example, where everyone has an exactly equal income). A Gini coefficient of one (100 on the percentile scale) expresses maximal inequality among values (for example, where only one person has all the income).

<sup>20</sup> Jin Zhu, "China to Raise Its Poverty Line," *China Daily* (October 28, 2010), available at: [http://www.chinadaily.com.cn/china/2010-10/28/content\\_11467561.htm](http://www.chinadaily.com.cn/china/2010-10/28/content_11467561.htm).

indeed likely: Witness the “Occupy” movement that has gotten traction in various parts of the globe. Occupy protesters use “We are the 99 percent” as a rallying cry, isolating the 1 percent who hold a disproportionate share of the wealth as the cause of the problem. In the United States, for instance, the top 1 percent of households possesses 22 percent of the total national income. In Asia, “income disparities are now rising faster than before and increasing more sharply than elsewhere. Questions over political tensions aside, this matters for growth. First, it’s a drag on productivity. Second, it makes harmful populist policies very tempting.”<sup>21</sup> For economic and political reasons, the ability to keep the inequalities within public-tolerance levels is a necessary skill for security practitioners.

Regrettably, a key known for those in the field of economic security is that the most recent financial crisis will not be our last. Whether a factor of inventive forms of greed, the inability of oversight to keep up with an evolving global economy, or simply a cyclical inevitability of a market economy, something akin to the events in 2008 will, unfortunately, happen again. When it will happen, triggered by what, and who will be hit the hardest remain unknowns to even the most self-confident economic pundit. This leads us to our final known: Despite what we do not yet know, in this fast-paced, globalized world, we need to keep learning from the past – and from each other – if we hope to understand the complexity of the global economy and achieve an acceptable level of economic security throughout the APEC region.

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<sup>21</sup> Frederich Neumann, “Asia’s Perilous Inequality,” *The New York Times* (March 6, 2012), [http://www.nytimes.com/2012/03/07/opinion/asias-perilous-inequality.html?\\_r=1&ref=incomeinequality](http://www.nytimes.com/2012/03/07/opinion/asias-perilous-inequality.html?_r=1&ref=incomeinequality).