

Open Economies Delivering to People, 2005

Regional integration and outcomes in the APEC region

A report prepared

as a contribution to APEC's Mid-term

Stocktake of the Bogor Goals



Australian Government

Department of Foreign Affairs and Trade



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CANBERRA

Centre for International Economics
Ian Potter House, Cnr Marcus Clarke Street & Edinburgh Avenue
Canberra ACT 2601

GPO Box 2203
Canberra ACT Australia 2601

Telephone +61 2 6245 7800 Facsimile +61 2 6245 7888
Email cie@TheCIE.com.au
Website www.TheCIE.com.au

SYDNEY

Centre for International Economics
Suite 1, Level 16, 1 York Street
Sydney NSW 2000

GPO Box 397
Sydney NSW Australia 2001

Telephone +61 2 9250 0800 Facsimile +61 2 9250 0888
Email ciesyd@TheCIE.com.au
Website www.TheCIE.com.au

About this report

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1

Highlights

Trade and investment liberalisation improves social outcomes

- ❑ Trade and investment liberalisation policies drive regional and world integration.
- ❑ Trade and investment generate economic growth.
- ❑ Economic growth alleviates poverty and improves access to basic services.

Trade and investment barriers have fallen across the APEC region

- ❑ Tariff barriers in the APEC region have fallen from 16.6 per cent in 1988 to 6.4 per cent in 2004.
- ❑ Non-tariff barriers have been converted to tariff barriers.
- ❑ Investment barriers have fallen.

Trade and investment flows have grown

- ❑ Exports of goods and services made up 18.5 per cent of GDP for APEC economies in 2003 compared to 13.8 per cent in 1989.
- ❑ Foreign direct investment inflows have increased by more than 50 per cent and outflows have more than doubled, but have fallen significantly since 2000.

Trade and investment policy has generated economic growth

- ❑ APEC real GDP per capita grew by 26 per cent from 1989 to 2003.
- ❑ APEC lower-income economies have grown particularly strongly.

APEC has contributed to structural reform and improved domestic governance

- ❑ APEC economies have improved their governance and are ahead of the rest of the world.
- ❑ APEC's Economic and Technical Cooperation is contributing to the reform process.

Economic outcomes have been transformed into social outcomes

- ❑ The APEC region is meeting the Millennium Development Goals.
- ❑ The proportion of the APEC population in poverty has more than halved.
- ❑ Unemployment in the APEC region is low.
- ❑ Measures of health and sanitation have improved.
- ❑ More of the APEC population is receiving primary and secondary education.
- ❑ Environmental outcomes are mixed.

2

The APEC Framework

IN 1994, ONE OF THE MOST POWERFUL statements on free trade emerged from the APEC leaders' declaration. APEC leaders agreed to a common goal of free and open trade and investment – by 2010 for industrialised economies and 2020 for developing economies. These targets are now known as the Bogor Goals. This declaration built on the work of APEC aimed at regional and world integration, since its inception in 1989.

Trade and investment liberalisation was not to be achieved within the APEC region within a closed preferential system, as has occurred in the European Union. Instead, APEC would aid in the pursuit of global free trade. This was termed 'open regionalism'. The aim of increased integration of the APEC region and the world was "accelerated, balanced and equitable growth" (APEC 1994, p1).

The world is now a very different place than it was in 1989 and 1994. Extensive liberalisation of trade and investment flows has occurred, but some of this may have been negated as security tensions have increased the costs of trade. As directed by the Leaders at their Summit Meeting in Shanghai in 2001, it is now time to step back and evaluate how far APEC has moved towards its goals, and whether this has brought the economic and social outcomes that were expected.

This report finds that APEC economies have achieved significant liberalisation of trade and investment, aided by APEC. APEC economies have also improved policy in a range of other areas such as competition policy, governance and social policy. The rewards of these policy choices have been substantial. Strong economic growth has driven reductions in poverty, improvements in health and education and increased access to basic services. The APEC region has been the engine of world growth.

APEC has also expanded since the Bogor declaration, with the inclusion of Russia, Vietnam and Peru.

In more recent years there has been some rebalancing of regional integration from multilateral to bilateral agreements. The Doha

Development Agenda (DDA) negotiations will not be completed as originally planned. This year will, however, be critical for progress. Agreement in 2004 to phase out agricultural export subsidies and to start negotiations on trade facilitation is encouraging but much more will need to be done to make the Hong Kong Ministerial Conference a success.

3

Open trade and investment policies deliver growth

APEC ECONOMIES have actively pursued the benefits of economic integration, since APEC was founded in 1989. Tariff barriers have been removed in many cases and lowered in many others. Hidden import barriers have been made more explicit and steadily removed, and foreign investment has been liberalised. This has led to rapid regional economic integration, through burgeoning trade and investment flows. Free and open trade has allowed resources to be used more effectively and foreign investment has disseminated skills and technology. Matching the aims of these reforms, income has expanded at a rapid pace.

Openness leads to economic growth

Few countries have grown without being open to trade.

World Bank 2005, p64

The link between openness and growth is now widely accepted by policymakers and international organisations, although the form and size of this link is still hotly debated. The view that has come closest to universal acceptance is that openness is a necessary but not a sufficient condition for economic growth (Baldwin 2003, World Bank 2005). Sound exchange rate, fiscal and monetary policies, financial stability, low corruption and micro reform are also important in driving economic outcomes. But openness can have more than just a direct impact on growth, with evidence building that openness can also drive growth by providing discipline to domestic policy.

Openness delivers benefits through a number of channels:

- Increased openness leads to improved resource allocation and productivity growth
- Technology and skills transfer boosts productivity

- Competition and contestability boosts productivity and reduces market power
- International scrutiny and obligations provide discipline for domestic policy, both at the macro and micro level
- Increased trade leads to increased product choice
- Access to foreign markets allows diversification and improves risk management.

Openness allows economies to focus on producing the goods and services that best suit their resources and skills. But even more, it bolsters production technology through the dissemination of technology and best practice management techniques.

The benefits of openness are not independent of other policies. Domestic policies can help spread the benefits of globalisation. But domestic policies are also influenced by the degree of openness. Free trade and investment disciplines domestic policy both through the set of rules that govern the multilateral trading system and through the interaction of domestic policy and foreign trade and investment. For example, the impact of fiscal policy on investor sentiment may inhibit governments from recording substantial fiscal imbalances.

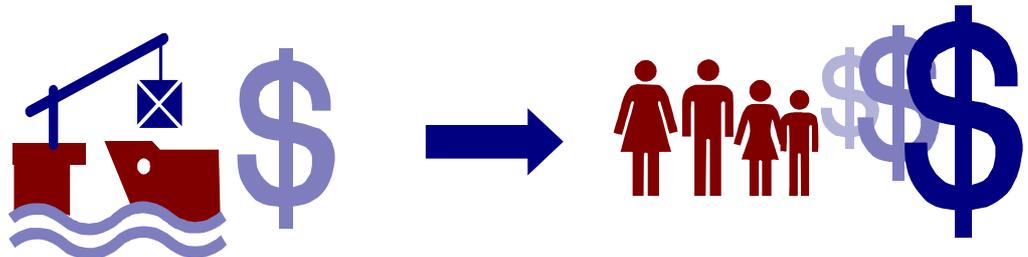
There have been a number of attempts to quantify the impact of openness on economic growth. Most recently, research by Frankel and Romer (1999) rigorously examined the interdependency between trade and growth across economies and found a strong causal link between openness, growth and income. Their results indicate that, for every 1 percentage point increase in the ratio of trade to gross domestic product (GDP), income per person is 2–3 per cent higher (chart 3.1).

3.1 A 1 percentage point increase in openness leads to 2-3 per cent growth in income per person

A 1 percentage point increase
in the ratio of trade to GDP ...

leads to

... a 2–3 per cent increase in
income per person

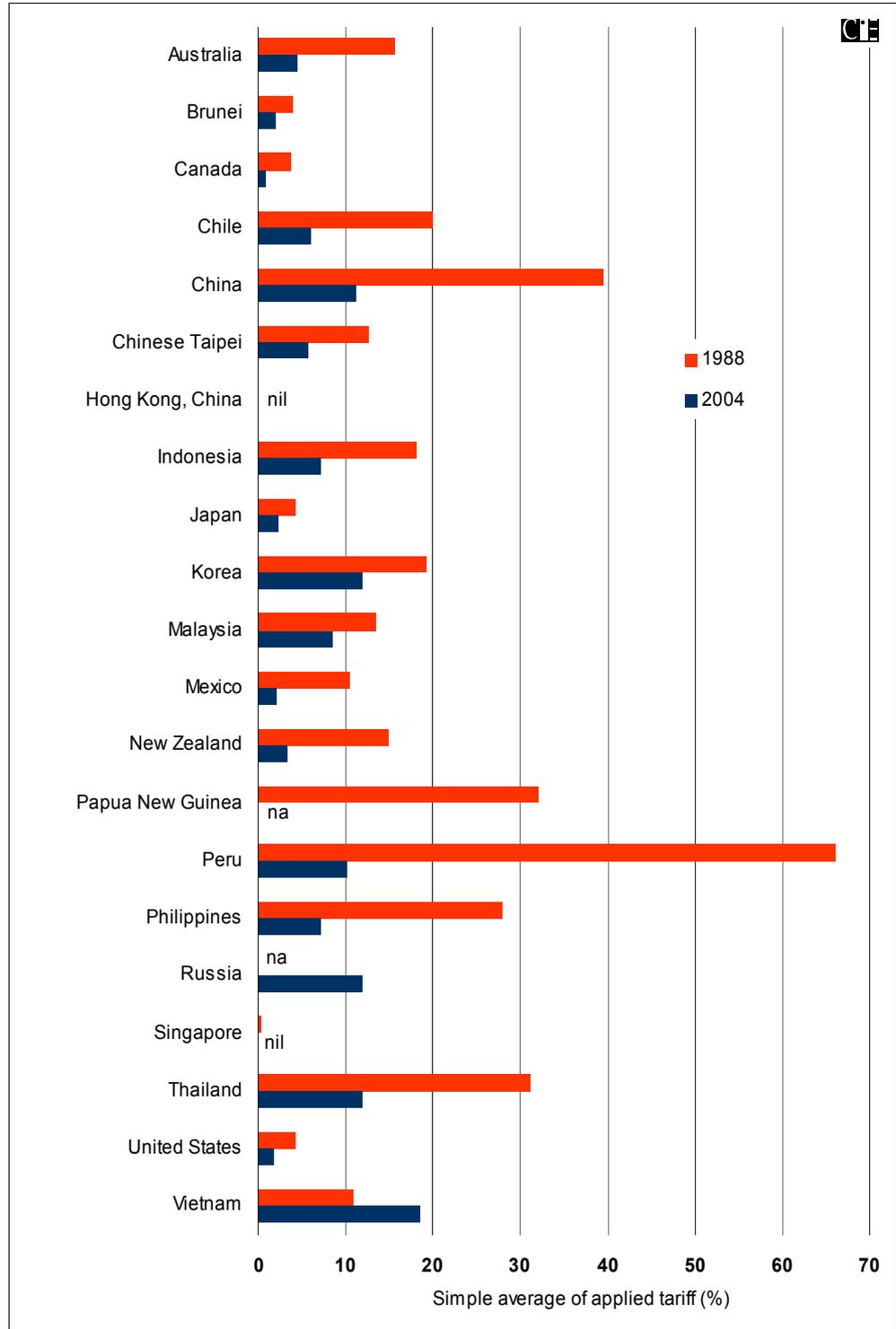


For investment, research suggests that foreign investment can boost productivity through skills transfer, improved allocation of capital and financial sector development (World Bank 2001). However, to be most effective, foreign investment needs to be associated with reasonable education levels, open trade policies and good physical infrastructure. Attempts to quantify the link between foreign direct investment (FDI) and growth have found that a one per cent increase in FDI typically leads to a 0.4 to 0.7 per cent increase in incomes (Borenstein, Gregorio and Lee 1998). Similar to trade, the magnitude of the gains from FDI is still an open question empirically (Carkovic and Levine 2002). Once again consensus has emerged in that foreign investment will generate growth in a positive policy environment.

Barriers have fallen

The formation of APEC reflected an appreciation among the member economies of the gains from openness. The Bogor declaration codified this appreciation, and has seen members moving towards the goal of free and open trade and investment. All APEC economies have been progressively reducing barriers to trade over the past decade and a half. The average tariff barrier across APEC economies has more than halved since 1988 from over 16 per cent to just over 6 per cent in 2004. Most economies have substantially reduced tariffs (chart 3.2), while others have significantly reduced levels of protection by converting non-tariff distortions into tariffs. In cases where non-tariff barriers have been converted, average tariff rates may have risen, even though levels of protection (and associated distortions) have fallen (for example, Vietnam's tariffs have increased but trade barriers from the control of state owned enterprises involved in trade have fallen). Some examples of the types of non-tariff liberalisation of particular APEC economies are outlined in Box 3.3.

3.2 Average tariffs in APEC economies fell between 1988 and 2004



Data source: See technical note 1.

3.3 Non-tariff liberalisation in APEC economies

APEC economies are required to report on changes in non-tariff barriers in their Individual Action Plans (IAPs), as well as cumulative changes since 1996. In APEC economies, non-tariff barriers have either been removed or converted into tariffs across many sectors. Some examples of non-tariff barriers that have been removed include the following.

- Quantitative import and export restrictions (quotas)
- Import and export levies
- Import and export licensing
- Voluntary export restraints
- Export subsidies
- Other measures (quarantine restrictions, restrictions imposed for health and safety reasons)

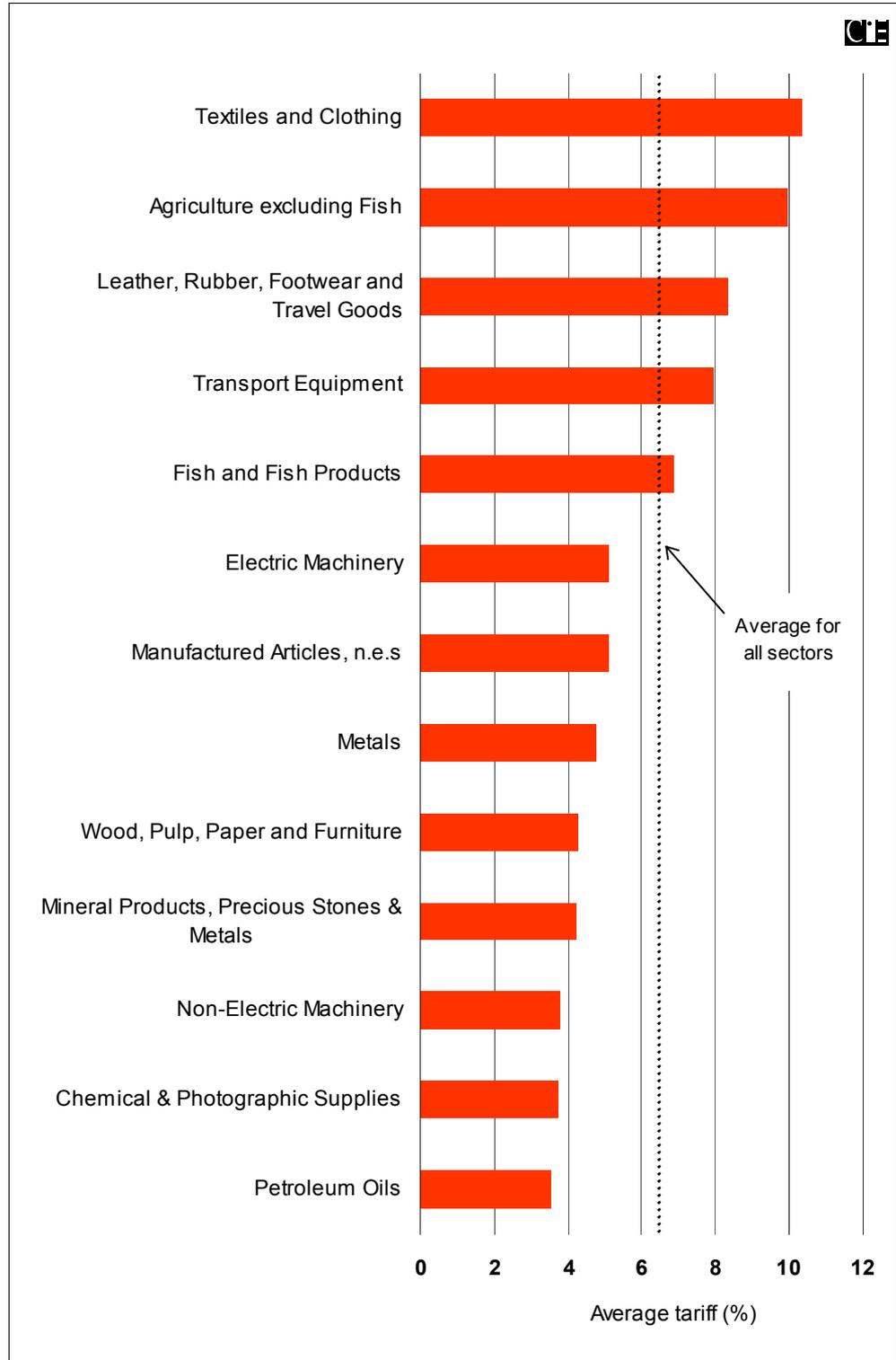
For example, China removed non-tariff measures in 1174 tariff lines, including the removal of non-tariff measures in 24 tariff lines in 2004; Malaysia has removed import bans on a number of Indonesian and Philippine agricultural products in 2004; Taiwan is promoting paperless trading to decrease the costs of trade; and Viet Nam is eliminating all import quotas, except those on sugar and petroleum. The United States, one of the world's largest textile markets, became quota-free on 1 January 2005 when the Agreement on Textiles and Clothing expired.

Barriers have not been removed uniformly across sectors of the economy (chart 3.4). In particular, significant barriers remain in textiles, clothing and footwear, motor vehicles and agriculture. This reflects the labour intensive nature of these manufacturing industries and the political sensitivity of agriculture, combined with higher initial tariff rates in these sectors.

Reductions in tariffs are only one way of measuring trade liberalisation, and often understate the true extent of liberalisation due to the conversion of non-tariff barriers into tariffs. The Fraser Index attempts to measure freedom to trade more generally, by considering:

- taxes on trade - measured through revenue from taxes on trade and average and standard deviation of tariff rates;
- regulatory barriers to trade - assessing hidden import barriers and administrative and time costs;
- actual size of trade compared with the expected size from a statistical model;
- the difference between official and black market exchange rates; and
- capital market controls measured by use of foreign and domestic capital markets and restrictions on capital markets.

3.4 Tariffs are not spread evenly across sectors (2004)^a

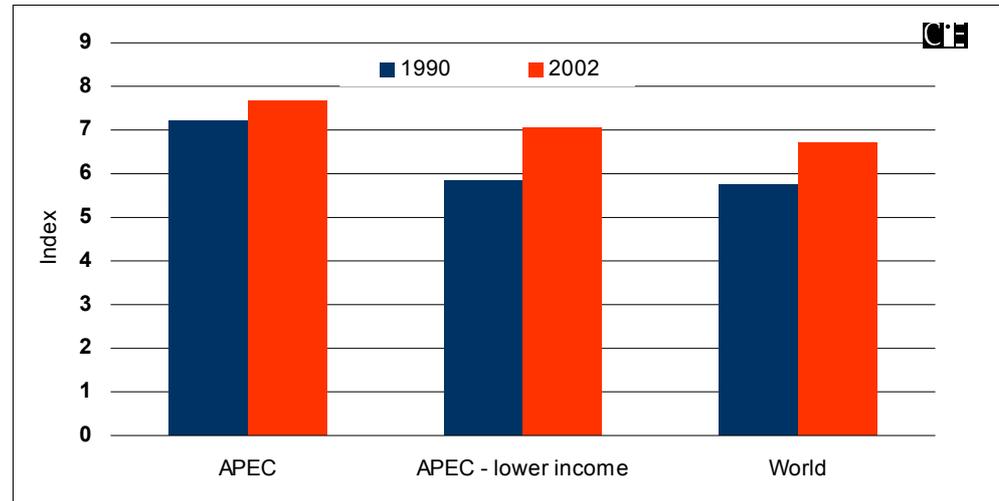


^a Simple average of economy tariff rates. Tariffs are for 2003 for the economies as outlined in technical note 1.
 Data source: 2004 Individual Action Plans and CIE calculations.

The aggregated index shows that APEC is now substantially more open than it was in 1990 (chart 3.5). In particular APEC lower income economies

have opened up rapidly. And while on average all economies have opened up, according to this measure, freedom to trade is higher in APEC economies.

3.5 Another indicator of openness – the Fraser Index



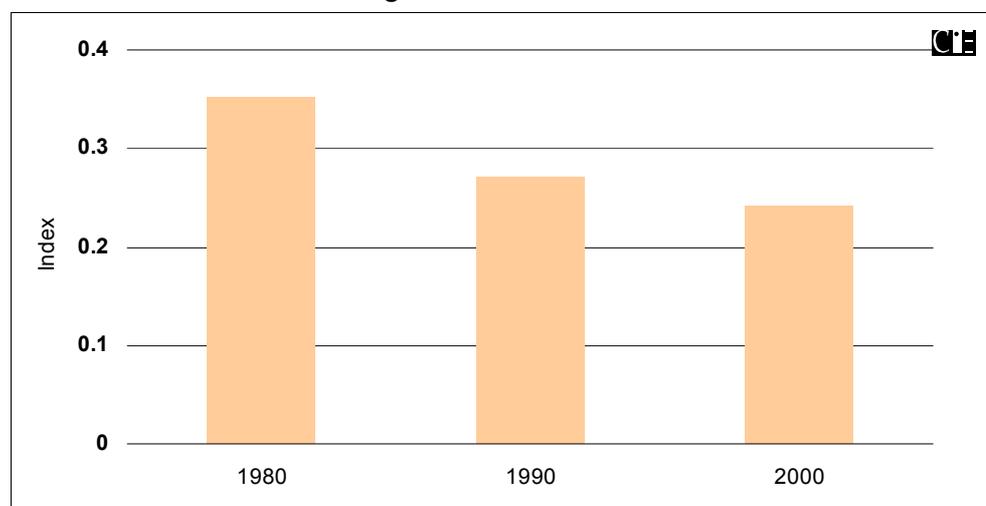
Data source: See technical note 2.

Investment barriers and services barriers have also fallen in APEC economies. These areas have received more attention in recent years, as merchandise trade barriers have become less significant. While service and investment barriers can be difficult to disentangle from each other, APEC reports efforts to lower barriers to investment as:

- allowing easier movement of people;
- non-discriminatory policy towards domestic and foreign investment;
- removing double taxation; and
- improving contractual mechanisms.

In higher-income APEC economies, investment and service barriers have fallen considerably (chart 3.6). PECC 2001 indicates that a similar process has occurred across the APEC region. In particular, it finds that the APEC economies most affected by the Asian Financial Crisis undertook significant investment liberalisation in the wake of the crisis.

Services sectors have been liberalised through a sectoral specific focus. Telecommunications, transport, business services and energy are all areas with substantial barriers and areas where APEC economies have reformed.

3.6 Investment barriers in higher-income APEC economies ^a

^a Simple average of barriers in Australia, Canada, Japan, New Zealand and the US.

Data source: Golub (2003).

International links have strengthened

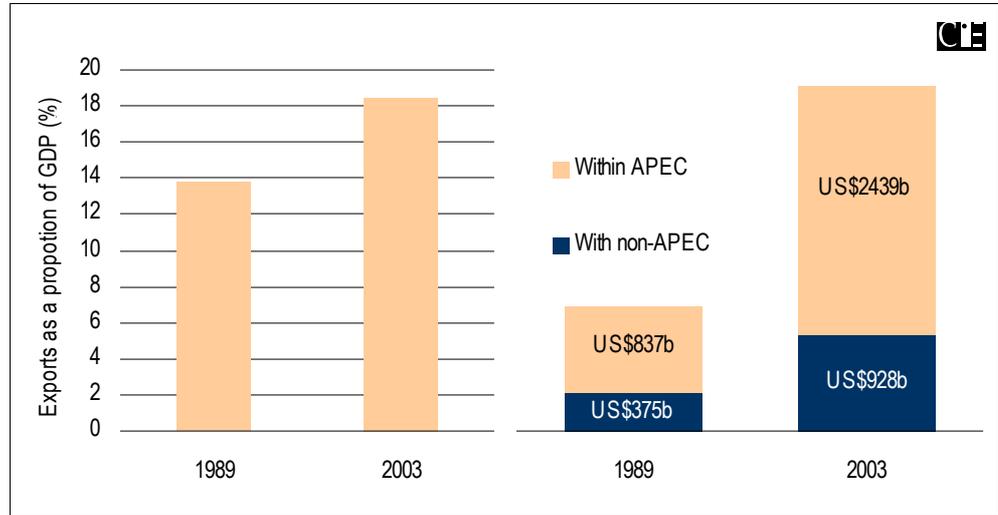
Reflecting the increased openness of APEC economies, international linkages such as trade and investment flows have strengthened. Exports of goods and services accounted for 18.5 per cent of the GDP of APEC economies in 2003, compared to 13.8 per cent in 1989 (chart 3.7).

In dollar terms, exports have boomed within APEC, more than tripling between 1989 and 2003. But trade between APEC economies and the rest of the world has also strengthened, with exports more than doubling since APEC was formed. This reflects the strong multilateral focus of APEC. The trade channel linking APEC economies and the world is now both larger in dollar terms (as GDP has grown) and more important to APEC economies.

Much of the growth in trade has come from services, with APEC economies' exports and imports of services more than doubling from 1989 to 2003.

Foreign investment flows have also increased, supplementing domestic savings and facilitating transfer of technology, skills, improved management techniques and better production processes.

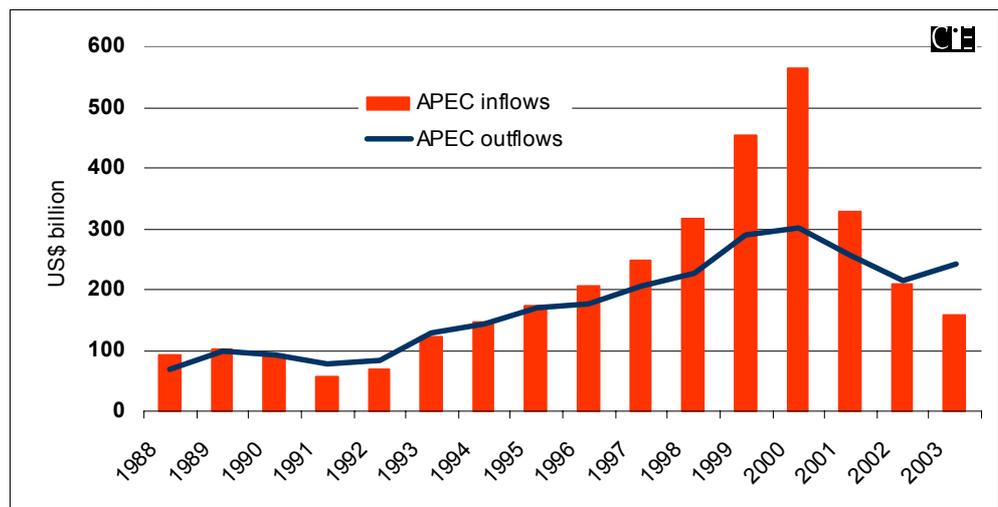
3.7 APEC trade has grown as APEC economies have become more open



Data source: See technical note 3.

In the APEC region, FDI outflow more than doubled from 1989 to 2003 (chart 3.8). FDI inflows to APEC economies rose to a maximum of \$565 billion in 2000 but have fallen off considerably since then to be about 50 per cent higher than in 1989. The recent slowing in FDI inflow was driven by the US recession in 2001, a shifting of FDI to European economies and heightened security concerns following the September 11 terrorist attacks. APEC economies accounted for 28 per cent of world FDI inflows in 2003, but accounted for 42 per cent of FDI inward stocks.

3.8 APEC inflows and outflows of foreign direct investment have grown rapidly

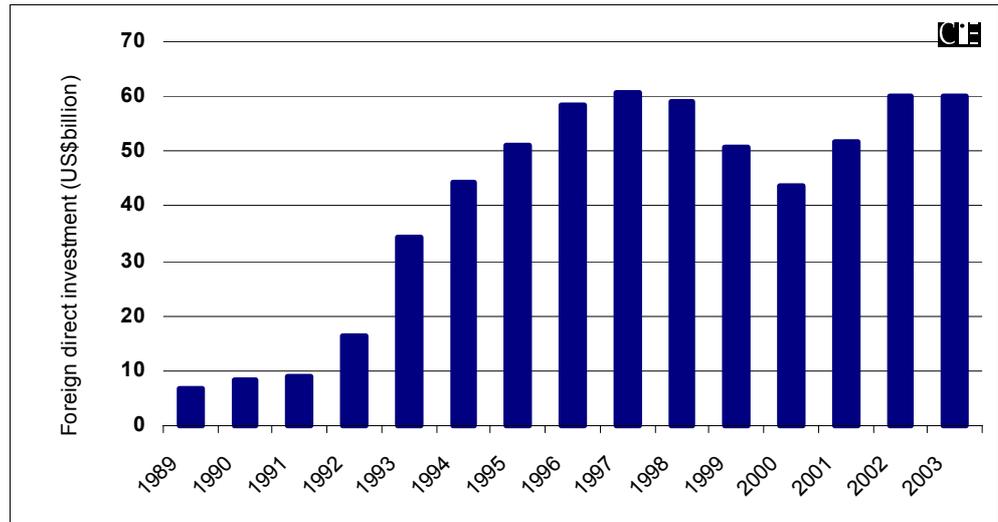


Data source: UNCTAD Investment Database

Lower income countries were particular beneficiaries of foreign direct investment (chart 3.9). Note that even during the Asian crisis, inflows into

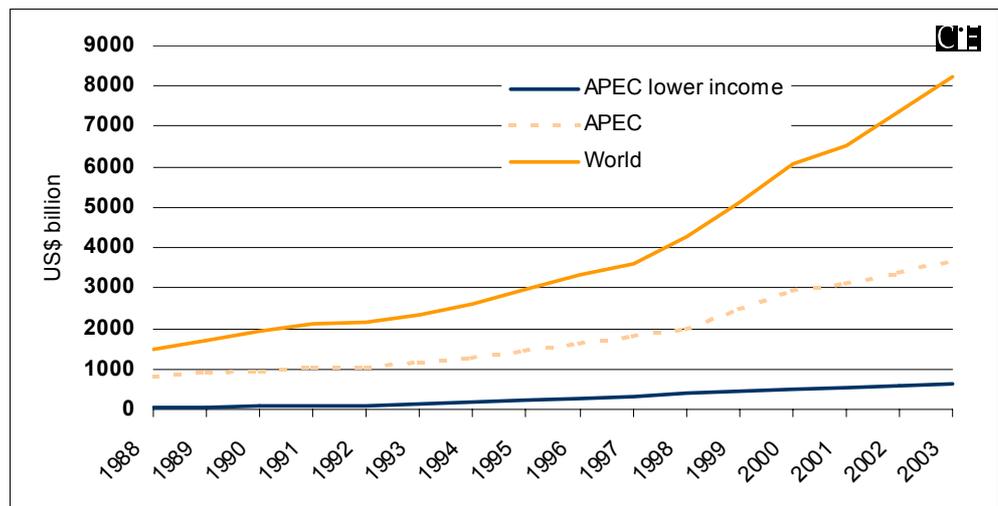
lower-income APEC economies were positive overall as investment continued to increase into many countries, offsetting negative FDI inflows in the countries most heavily affected by the crisis. FDI inflows into APEC lower-income economies have recovered in recent years, and inward stocks of foreign investment are at record highs – both worldwide and for APEC economies (chart 3.10).

3.9 FDI flows to lower income APEC economies grew particularly rapidly



Data source: UNCTAD investment Database

3.10 FDI inward stocks

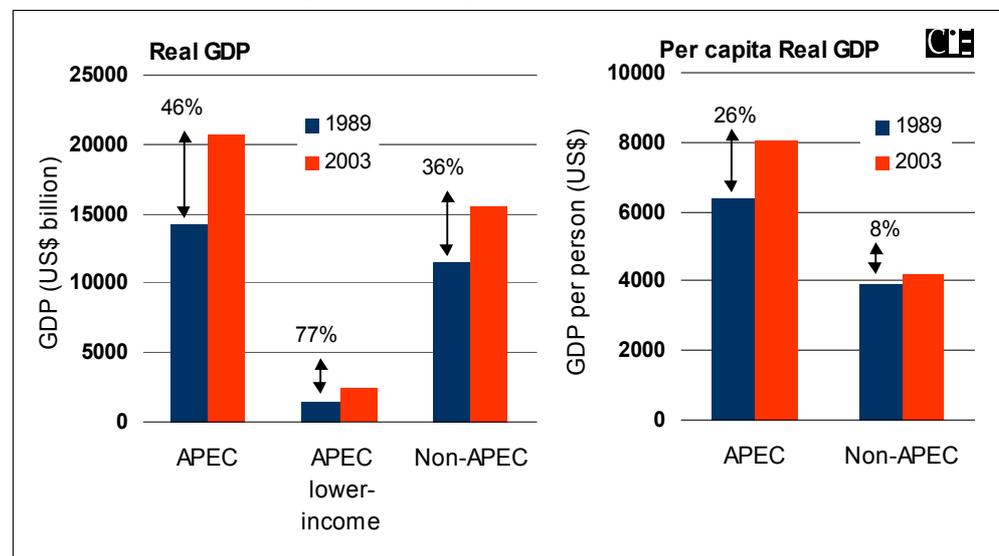


Data source: UNCTAD Investment Database

Liberalisation and integration have brought strong economic growth

APEC economies have grown strongly since the inception of APEC, making up 61 per cent of world growth from 1989 to 2003. By 2003, APEC economies made up 57 per cent of the world economy. Real GDP in the APEC region grew by 46 per cent between 1989 and 2003 (chart 3.11). APEC's lower income economies have grown particularly strongly, outpacing both their counterparts worldwide and higher-income APEC economies. Per capita GDP in APEC economies grew by 26 per cent from 1989 to 2003, or about 1.7 per cent per year.

3.11 APEC economies grew strongly



Data source: See technical note 4.

APEC's contribution

The impressive achievements recorded in the APEC region are largely a result of each individual economy's policy choices. Economies have chosen to liberalise their trade and investment regimes reflecting the potential gains of such policy actions. Furthermore, economies have achieved substantial domestic reform, which has made it easier to reap the gains from economic integration, as well as achieving other domestic goals.

APEC has made a contribution to this process. It has promoted multilateralism through its commitment to open economies, its peer support role helping set the agenda for WTO negotiations and providing a forum for Leaders and Ministers to discuss ideas and develop links. APEC forums have allowed member economies to develop ideas and programs

within the region before promoting them in a broader arena. Furthermore, as the APEC International Assessment Network noted

APEC was among the first international institutions to closely link economic and technical cooperation to trade and investment liberalisation. APIAN 2000, p v.

APEC's technical cooperation program has aided the implementation of best practice policy and helped to avoid significant distortions through the interaction of domestic policies and international integration.

APEC has contributed to:

- multilateral and unilateral reform;
- improved transparency of tariff, non-tariff and investment barriers;
- best practice policy through economic and technical cooperation;
- regional goodwill; and
- regional cooperation.

Most of the achievements of APEC are difficult to quantify or evaluate, reflecting the difficulty of identifying the APEC specific impact on trade and investment liberalisation, and the intangible nature of goodwill and cooperation. But this does not mean that they are not there.

As the DFAT 2000 report (p15) notes

When APEC was formed in 1989, the Uruguay Round negotiations were stagnating and there was concern that, if the round did not proceed expeditiously, the world could fragment into competing exclusionist regional trading blocs.

The weight of the APEC region – representing more than half of world GDP and about 40 per cent of the world's people – was a significant force in bringing the Uruguay Round negotiations to a conclusion. Since these auspicious beginnings APEC has continued to work as a conduit for multilateral trade negotiations. It has fostered ideas and programs for the WTO, such as the Information Technology Agreement (ITA), pursued measures related to trade facilitation, improved the transparency of trade barriers and aided in the implementation of best practice domestic policies. As well as this, it has provided a forum for increased regional cooperation.

The value of increased cooperation and goodwill can be directly seen in recent security measures agreed upon by APEC economies, aimed at addressing the heightened security tension following the September 11 terrorist attacks (box 3.12). Security measures within APEC have improved

the safety of trade and investment, but also foster broader security links between APEC economies.

3.12 APEC and security

Managing flows of goods and people, and in particular the security aspects of such flows, has become an increasingly important issue across the globe. In October 2002, APEC Leaders agreed to implement the Secure Trade in the APEC Region initiative (STAR) to secure and enhance the flow of goods and people through measures to protect cargo, ships, international aviation and people in transit. This included the following measures.

- Border security
 - Agreement of standards for the implementation of Advance Passenger Information (API) systems.
 - Development of a regional movement alert system to detect persons of concern and lost, stolen and fraudulent travel documentation.
 - Introduction of a highly effective screening procedure and equipment at all APEC international airports no later than 2005.
- Customs
 - Implementation of common standards for an electronic customs reporting system developed by the World Customs Organisation (WCO).
 - Simplification and harmonisation of customs procedures.
 - Using better technology to raise the level of integrity of customs administrations.
- Supply Chain Security
 - Approval of voluntary private sector supply chain security guidelines.
 - Assisting in the adoption of the International Maritime Organisation's international ship and port security codes.
 - Increasing cooperation between APEC fora and organisations such as the International Maritime Bureau's Piracy Reporting Centre.
 - Supporting the development and use of Intelligent Transportation Systems (ITS), including electronic cargo seals and sensors and Global Navigational Satellite Systems.

In 2003 and 2004, APEC continued to emphasise security by:

- creating the APEC Counter-Terrorism Task Force;
- enhancing human security with financial contributions made to the Asian Development Bank's Regional Trade and Financial Security Initiative, and strengthening the public health system to respond to regional health threats;
- calling for and providing advice on strengthening domestic controls on Man-Portable Air Defence Systems (MANPADS); and
- fostering closer cooperation to counter money laundering and terrorist financing.

The ongoing threat of terrorism has been one of a number of factors that have impacted adversely on international trade and investment flows (DFAT 2003, DFAT 2004). APEC has been one of the few organisations to

focus on the trade aspect of heightened security, making efforts to minimise the impact of terrorism on trade such as through business mobility initiatives and a focus on trade security initiatives that also reduce trade facilitation costs. Other contributing factors included economic weakness in 2001 and 2002 and substantial diversity in the current goals of negotiating countries. In the place of multilateralism, there has been a proliferation of bilateral agreements, including between APEC economies, in the hope that common ground can be found on a smaller scale. APEC has played a role in this process through developing guidelines for best practice regional and bilateral free trade agreements, endorsed by Ministers and welcomed by leaders in the 2004 APEC Leaders' Declaration.

4

Greater growth by getting the domestic environment right

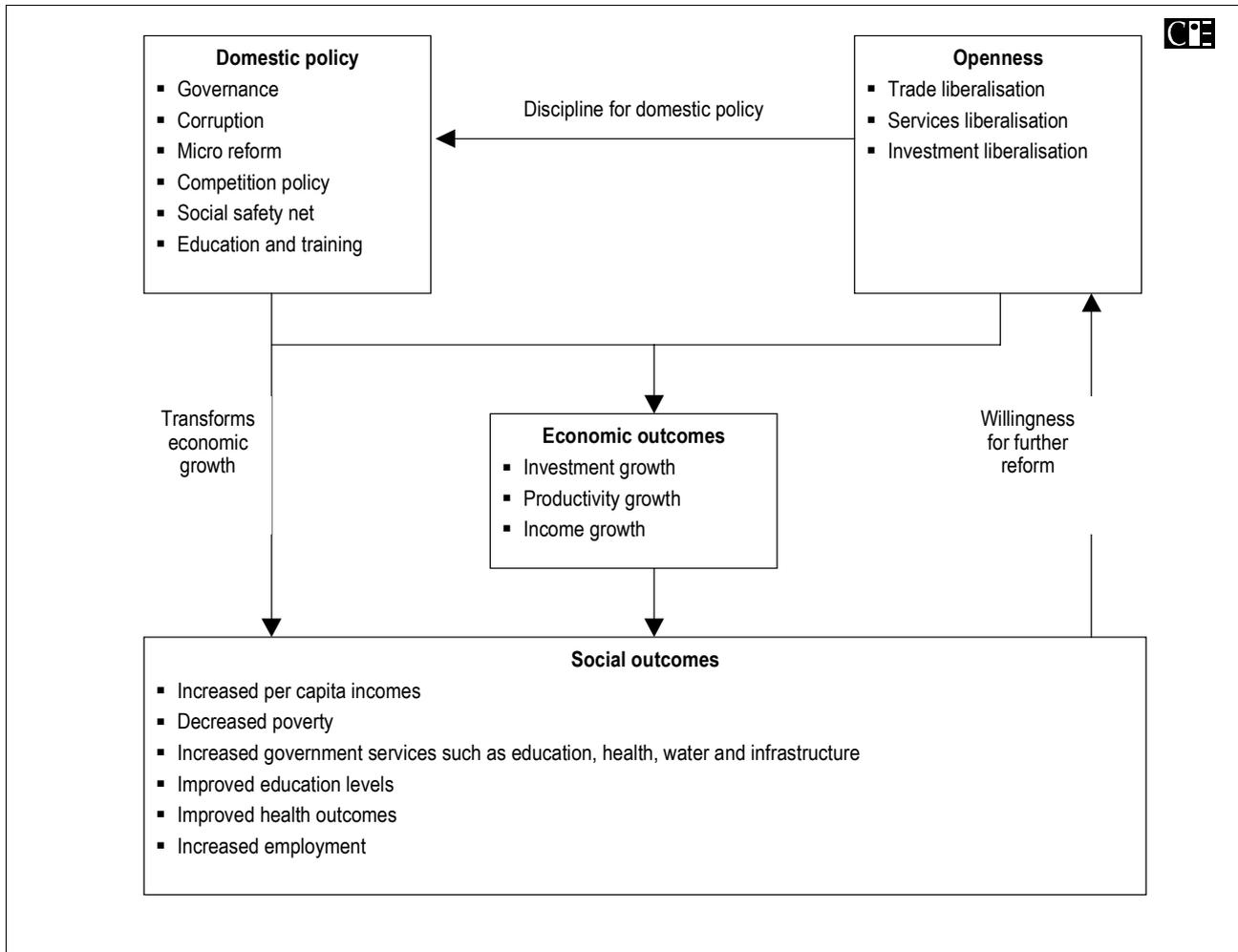
OPENNESS IS NECESSARY FOR ECONOMIC GROWTH but it does not guarantee it. Strong domestic policy is needed to maximise the benefits of international integration and to ensure that these benefits are widely distributed (chart 4.1).

Domestic policy can ensure that globalisation does not bring distortions into the economy. For instance, the Asian financial crisis demonstrated the potential detrimental outcomes of inadequate supervision and regulation of the financial sector and the need to manage exposure to foreign borrowing. Having access to foreign investment can lead to economic growth if used properly and having the right domestic policies in place makes a good outcome more likely. The challenge domestically is to ensure that the right policies are in place to provide local operators with the capacity to respond to foreign competition and market opportunities.

For instance, the substantial flow of short-term capital following the Asian financial crisis was partly a result of domestic policies that generated incentives for foreign investment in particular instruments and sectors. With foreign investment playing such an important role in these economies, this left many economies vulnerable to changes in sentiment. Good domestic policies can ensure that foreign investment will move to the sectors where it can achieve the greatest returns for both the home economy and the investors. Similarly, trade can provide substantial gains through increasing contestability of markets, but this will only happen with the right domestic policy setting.

Most importantly, domestic policy can strengthen the political will for further reform by ensuring that the benefits of globalisation are realised by all. The most entrenched, although misleading, criticism of globalisation is that the structural adjustment that globalisation brings leads to unequal outcomes for the poor and the rich. The more domestic policy can dampen these claims through the provision of social safety nets and retraining, the greater will be the benefits – there will be less inequality in outcomes, there

4.1 Domestic policy interacts with openness in achieving social outcomes



Data source: CIE

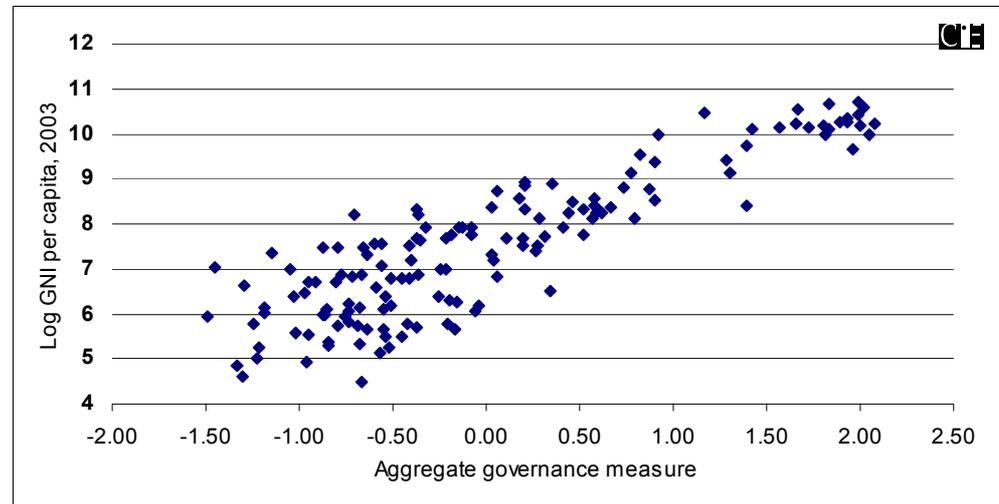
will be higher employment and income and there will be the will for further reform. APEC has played an important role in developing and promoting social safety nets, flexible labour markets and education and training through the Human Resources Development Working Group. In these aspects, APEC's holistic approach to trade and investment liberalisation means that its role extends further than for similar organisations.

Governance matters

The link between domestic governance and income has been well documented by the World Bank (chart 4.2). The index that they have compiled presents an aggregate picture using measures of the rule of law, government effectiveness, regulatory quality and control of corruption. This work confirms previous findings that linked the economic divergence

of APEC's Asian economies and African economies to policy choices, as highlighted in DFAT's previous report *Openness Delivering to People*.

4.2 Governance matters



Data source: Kaufman, Kraay and Mastruzzi (2003) and World Bank WDI (2004)

APEC economies have strengthened their domestic policy

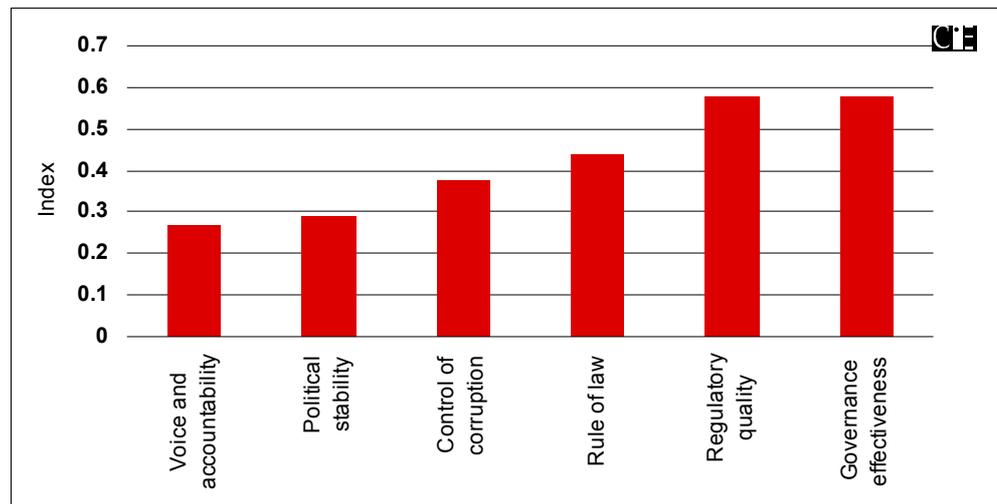
According to the measures collected by the World Bank, APEC economies out-perform the world in governance (chart 4.3). APEC economies have stronger voice and accountability and political stability. But APEC economies are particularly strong in the areas of regulatory quality and governance effectiveness, in part reflecting the considerable amount of work that APEC does in these areas.

APEC economies have placed significant emphasis on improving their economic governance, particularly following the Asian financial crisis. This includes restructuring distressed financial institutions and reinforcing the institutional framework for prudential regulation and supervision, and strengthening business law and the legal and judicial systems in order to enforce these laws. APEC has played a significant role in this process, reaffirmed by the adoption of the APEC Leaders' Agenda to Implement Structural Reform in 2004 (APEC 2004b). APEC's work in structural reform and governance includes:

- documenting progress in structural reform;
- undertaking training and education programs to improve knowledge of structural reform issues and solutions;
- promote measures to reduce private and public sector corruption;

- improving the capacity of legal institutions; and
- promoting competition reforms, particularly in telecommunications and financial services.

4.3 APEC outperforms the world in governance indicators

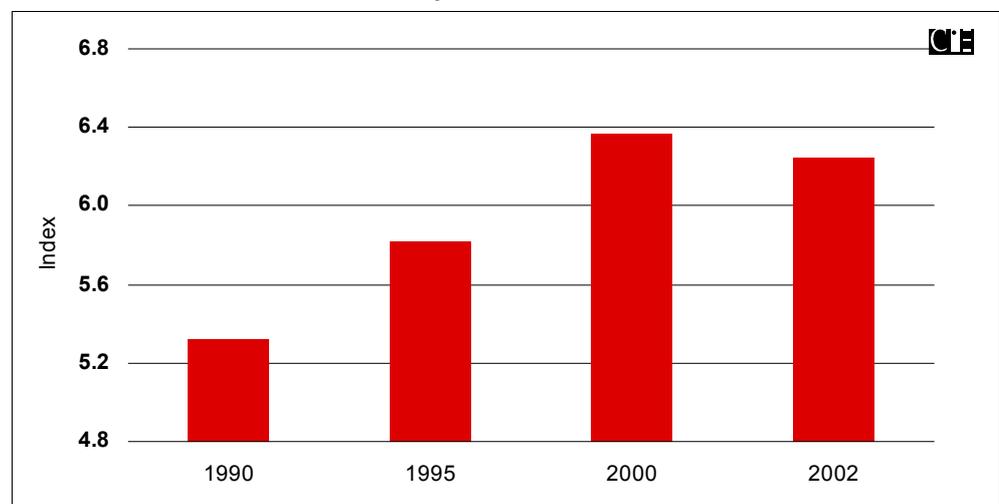


^a World average equals zero and standard deviation equals 1. Simple average of APEC economies.

Data source: Kaufman, Kraay and Mastruzzi (2003).

The work of APEC has contributed to the improvement in corporate governance achieved by the APEC region. A well-known and widely accepted index of governance, published by the Fraser Institute, shows that APEC economies have improved their governance since 1990 (chart 4.4). The Fraser index captures a broad range of indicators including regulation of credit, labour and business, freedom to trade, access to sound money, legal and property rights and the size of government.

4.4 Governance in APEC has improved



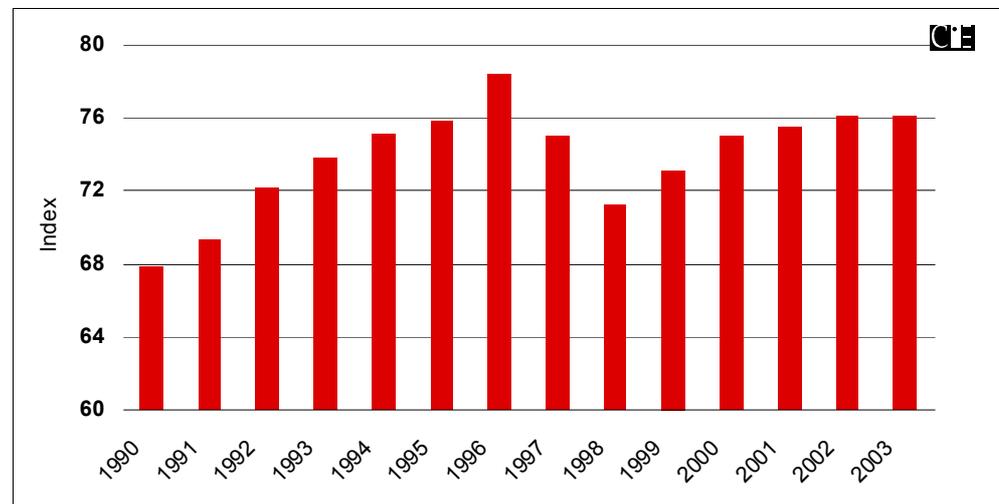
Data source: See technical note 5.

Examples of some of the recent developments in corporate governance regulation in the APEC region include the introduction of class actions to enforce corporate governance rules in Korea, representative actions in Chile and reform in Australia under a number of corporate law reform bills. In addition there has been significant regulatory reform within the APEC region to reduce barriers to competition, adoption of market approaches to regulation of natural monopolies, and creation of opportunities for private provision of infrastructure and utility services.

Finally, the World Bank reports an index of each economy's risk rating. This indicator is aimed at measuring financial, economic and political risk. Risk in the APEC region has improved markedly since it began in 1989, despite a significant increase in risk (decrease in the indicator) following the Asian financial crisis (chart 4.5).

A consequence of many of these reforms is a reduction in the risk investors face when investing. Reducing risk has significant implications for interest rate differentials between APEC economies and the rest of the world and the cost of capital in the longer term.

4.5 APEC's risk rating has improved ^a



^a Simple average over APEC economies.

Data source: World Bank WDI (2004).

Transforming economic growth into social outcomes

Domestic policy also has an important role to play in converting the benefits of openness and economic growth into better social outcomes. This, in turn, allows reform to continue much longer than it would otherwise, as the political will for reform remains strong. Social safety nets

provide a strong counter to the main criticism of globalisation, by ensuring that the benefits of structural adjustment are achieved at the lowest cost. While APEC economies have done much in this area, the World Commission on the Social Dimension of Globalisation (2004) shows that such policies can be used to even greater effect.

APEC economies have been actively pursuing policies to ensure that the benefits of economic growth are effectively distributed. The first collective initiative on social safety nets was launched at the APEC economic leaders meeting in 1998 and a number of other initiatives have followed. The APEC Social Safety Net Capacity Building Network (APEC SSN CBN) was established in early 2002 and it was later decided that six issues would be addressed on a priority basis, including:

- pre-crisis social safety net planning and preventative measures;
- capacity building for evaluating effectiveness of policy action;
- collecting disaggregated data and aiding access to current data;
- identifying at-risk populations;
- designing response institutions and financing; and
- strengthening transparency and accountability in social safety net operations.

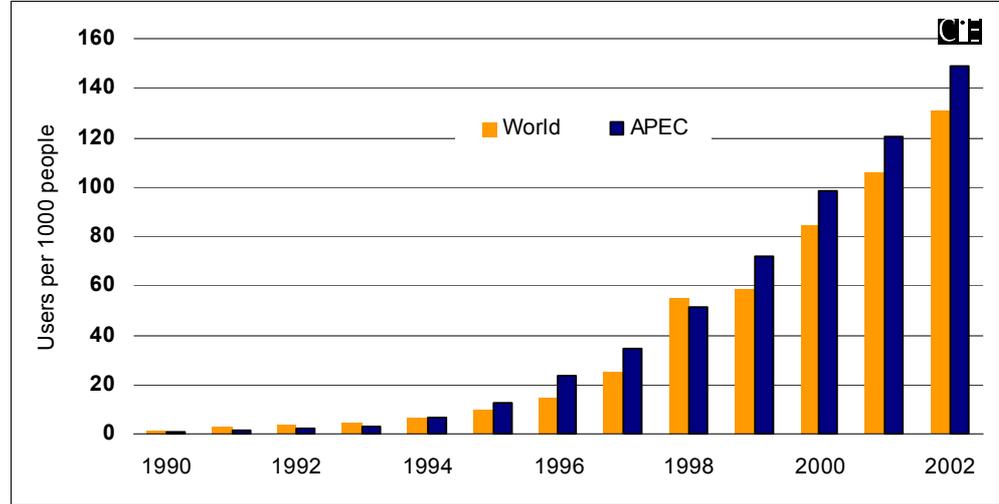
For example, the Philippines has combined anti-poverty programs into a comprehensive social service program through the Comprehensive and Integrated Delivery of Social Service (CIDSS). The primary goal of the CIDSS is to empower impoverished and disadvantaged families, sectors and communities.

Microeconomic reform is linked to innovation and the new economy

The microeconomic reforms embraced by the APEC economies and supported by the APEC framework have boosted productivity and economic growth and have also paved the way for innovation. The World Bank has shown that effective competition policy, which limits market power, enhances the likelihood of innovation (World Bank 2005). In APEC, the new economy has boomed, with APEC economies leading the world in the uptake of the Internet (chart 4.6). More recent technologies such as broadband have also been rapidly accepted by higher-income APEC economies, in part reflecting the strong competitive frameworks encourage by the APEC economic and technical cooperation program. Korea and

Canada have had the highest broadband uptake rates in the world according to the OECD (2003).

4.6 APEC is leading the way with the new economy



Data source: World Bank WDI (2004).

5

Open economies deliver social advancement

THE BOOM IN APEC ECONOMIES since APEC was founded in 1989 has also delivered on social outcomes. While many claimed that globalisation was delivering benefits only for the very rich, and at the expense of the poor, the outcomes achieved by APEC strongly negate this claim. It is true that globalisation will lead to structural change and this can result in social displacement. However, the solution is not to stop structural adjustment, but to put in place policies that reduce the problems of transition. This is what APEC economies have done, implementing social safety nets and programs to aid industry restructuring.

Economic growth has benefited people across all income levels in APEC economies, driving reductions in poverty and increases in education, health and access to basic services. Growth has enabled governments to better provide the services that people want and individuals to be better able to satisfy their own wants.

The Millennium Declaration by the UN in 2000, aimed at reducing poverty in its many dimensions, is a good yardstick for the progress that APEC economies have made (box 5.1). APEC is one of the few regions on target to meet the goals outlined by the UN.

The relationship between income and absolute poverty is strong (box 5.2). In fact, the relationships between income and many measures of poverty, such as education levels and health outcomes is much stronger than the relationship between government spending in these areas and outcomes. In the 2004 World Development Report, some startling evidence on the relationship between public spending and poverty outcomes – there is little relationship after accounting for income growth.

5.1 APEC and the Millennium Development Goals

The best way to assess the many dimensions of poverty is through the criteria set out in the eight Millennium Development Goals – an agreement by UN countries to tackle poverty made in 2000. The goals relate to achieving outcomes by 2015, typically as a proportion of 1990 levels.

1. Halve the proportion of the world population living on less than \$1 a day.
2. Achieve universal primary education.
3. Eliminate gender disparity at all levels of education.
4. Reduce the under-five child-mortality rate by two-thirds.
5. Reduce the maternal mortality rate by three-quarters.
6. Reverse the spread of HIV/AIDS.
7. Halve the proportion of people without access to drinkable water, significantly improve the lives of at least 100 million slum-dwellers and reverse the loss of environmental resources.
8. Raise official development assistance and expand market access.

APEC has gone a long way towards these goals, largely driven by economic growth. However, as the World Development Report 2004 notes, economic growth will not be enough by itself in many parts of the world.

APEC has:

- reduced the proportion of its population living on less than \$1 a day by approximately 60 per cent since 1990;
- achieved near universal primary education in nearly every economy, with the net primary enrolment ratio moving above 97 per cent in all but three economies and a primary completion rate for the APEC region of over 100 per cent (UN Millennium Development Goal Indicators 2004, World Bank WDI 2004)¹;
- closed the gap between male and female literacy rates, with the proportion of literate females aged between 15 and 24 matching the proportion of literate males in the same age group in 2002 (World Bank World Development Indicators 2004);
- reduced the under five mortality rate by approximately one third since 1990 (World Bank World Development Indicators 2004);
- increased access to improved sanitation and water (see chart 5.7); and
- improved many aspects of environmental performance (see charts 5.9 and 5.10).

Source: UN Human Development Indicators, World Bank World Development Indicators, CIE.

¹ Primary completion rates can be greater than 100 per cent for short periods due to students repeating year levels. Completion rate data still appears to be quite preliminary.

5.2 The relationship between economic growth and poverty

Economic growth is closely associated with reductions in poverty. World Bank 2005, p3.

In an extensive report, the UN analysed the relationship between growth and poverty (United Nations 2003). A number of key points came out of this report.

- There is a strong link between economic growth and reductions in absolute poverty. Absolute poverty is defined as a set real income level. The link between economic growth and relative poverty is weak, because relative poverty represents the distribution of income.
- A one per cent increase in per capita income was associated with a decrease in absolute poverty of 1.2 per cent in East Asia through the 1990s. In many areas per capita incomes have fallen and driven increases in poverty. A one per cent decrease in per capita income was associated with an increase in absolute poverty of 0.7 per cent in South Asia, 0.8 per cent in Africa and 5.9 per cent in Europe and Central Asia through the 1990s.
- Falls in aggregate GDP have a particularly strong effect on poverty during economic contraction.
- Long economic expansions, like that experienced by many East Asian economies, are a key driver of poverty reduction.
- Macroeconomic stability is important for reducing poverty.
 - Poverty increases more in downturns than it decreases in booms.
 - Many of the poor will not survive economic downturns.

The impact of economic growth is not limited to just the income dimension of poverty. As the World Bank's World Development Report 2004 shows, income also impacts on many of the other dimensions of poverty outlined in the Millennium Development Goals (in the context of government action needing to supplement growth to achieve the Goals). For example, a one per cent increase in per capita income is associated with a:

- 1.5 per cent reduction in absolute poverty;
- 0.6 per cent increase in the primary completion rate; and a
- 0.5 per cent decrease in the under-five mortality rate.

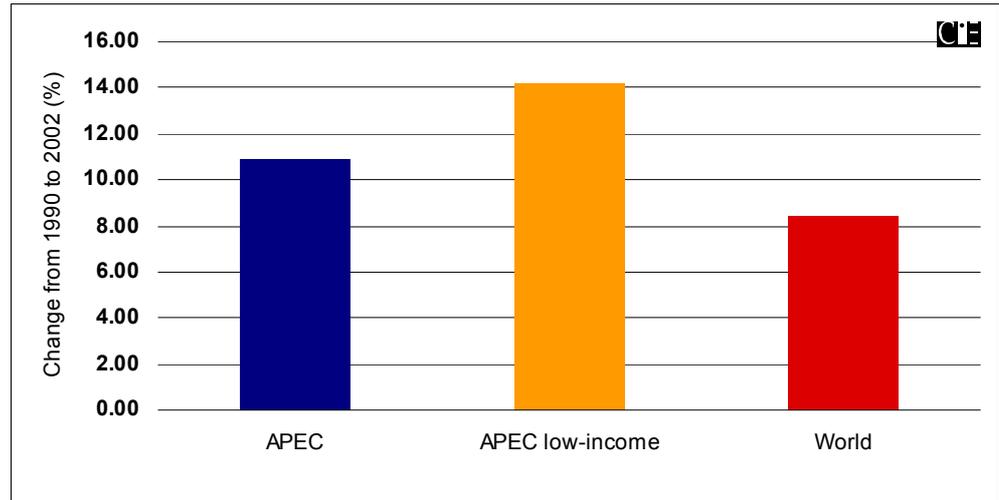
The UNDP Human Development Index – a summary measure of social progress that captures income, education and life expectancy – charts APEC's advancement (chart 5.3). APEC economies have advanced slightly faster than the world as a whole, but most marked is the improvement in lower-income APEC economies. Gains have been experienced by all APEC economies covered by the index since they have joined APEC.

Another indicator of where the benefits of integration have been felt is through poverty. Contrary to the claims of critics of free trade, the benefits of openness have been spread across all income groups. Poverty in APEC economies has fallen markedly, underpinned by strong economic growth. Since 1988, the proportion of the population of APEC economies living on

less than \$1 a day has declined from 25 per cent to 10 per cent in 2000 (chart 5.4).

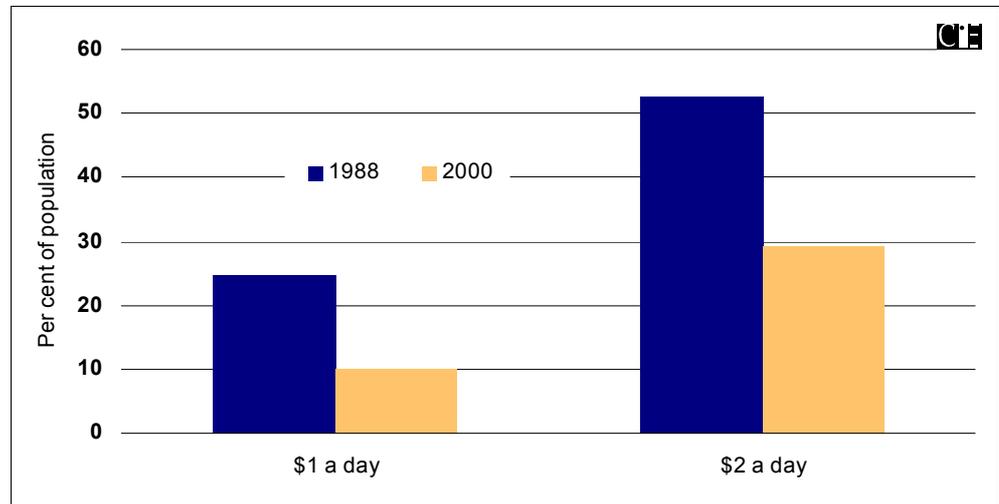
Similarly, in 1988 around half of people living in APEC economies were on less than \$2 a day, while the latest figure (2000) is much less than a third.

5.3 Indexes of human development have improved in APEC economies



Data source: See technical note 6.

5.4 Poverty has fallen in the APEC region



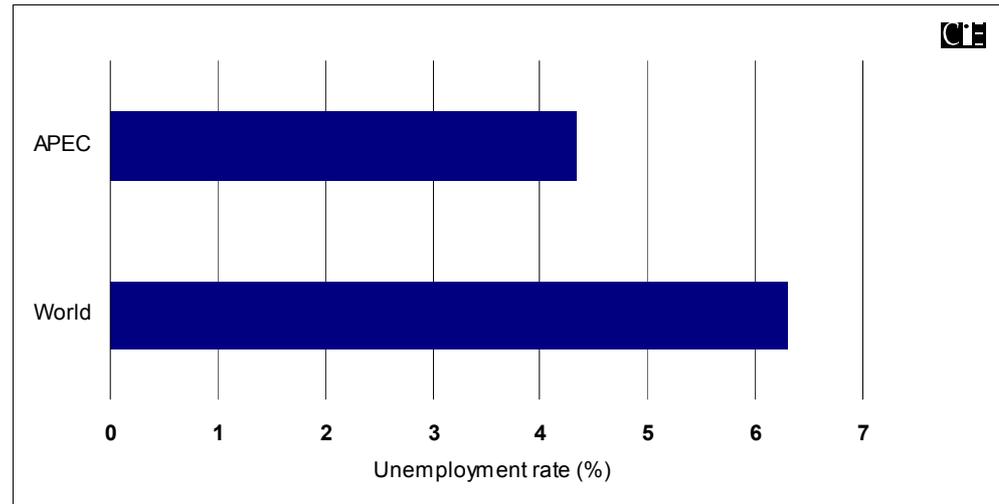
Data source: See technical note 7.

Employment

Employment growth is a good indicator that structural adjustment is being achieved as painlessly as possible through the creation of new jobs. In the APEC region, employment grew by 18 per cent between 1990 and 2002. And while unemployment edged slightly higher, it remains at a

particularly low level given the enormous changes that have occurred in APEC and the negative impact of the Asian financial crisis on employment in some APEC economies. Unemployment in the APEC region is also well below the world average, with an average rate of 4.3 per cent compared to 6.2 per cent for the world in 2003 (chart 5.5).

5.5 Unemployment is low in APEC economies

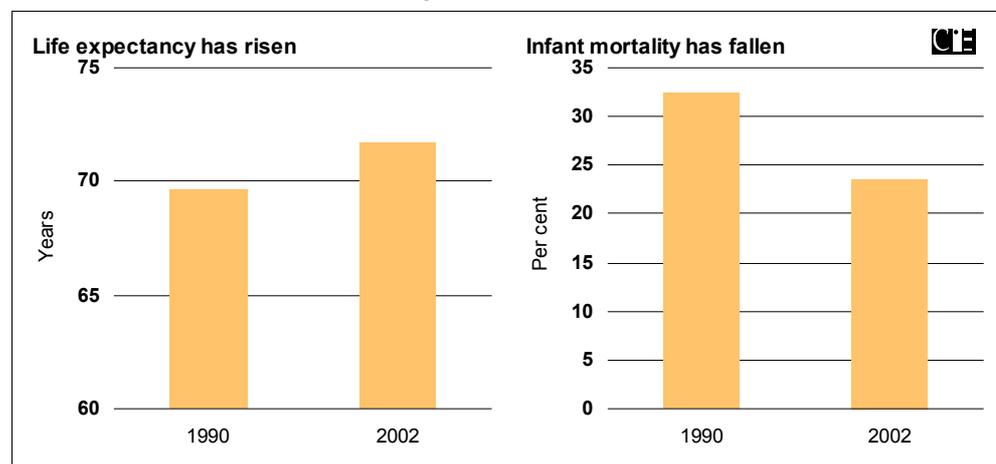


Data source: International Labour Organisation LABORSTA Internet 2005.

Health

Basic indicators of health have improved in APEC economies since the inception of APEC. Governments have been better able to provide health services, through economic growth and increased revenue. And individuals have been better able to supplement government services through higher incomes. Infant mortality has fallen considerably and life expectancy has risen (chart 5.6). Governments have also contributed

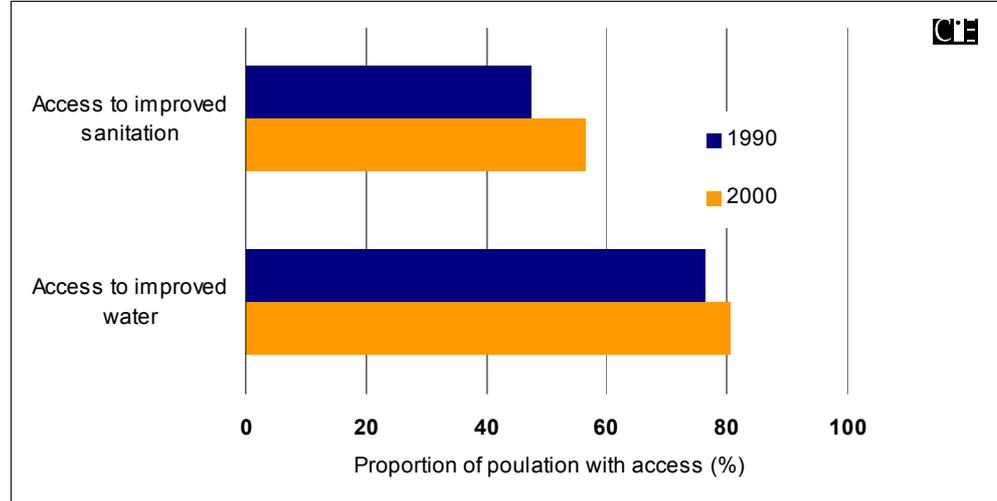
5.6 Measures of health have improved



Data source: See technical note 8.

through more widespread access to improved sanitation and water facilities (chart 5.7).

5.7 There is more widespread access to improved water and sanitation

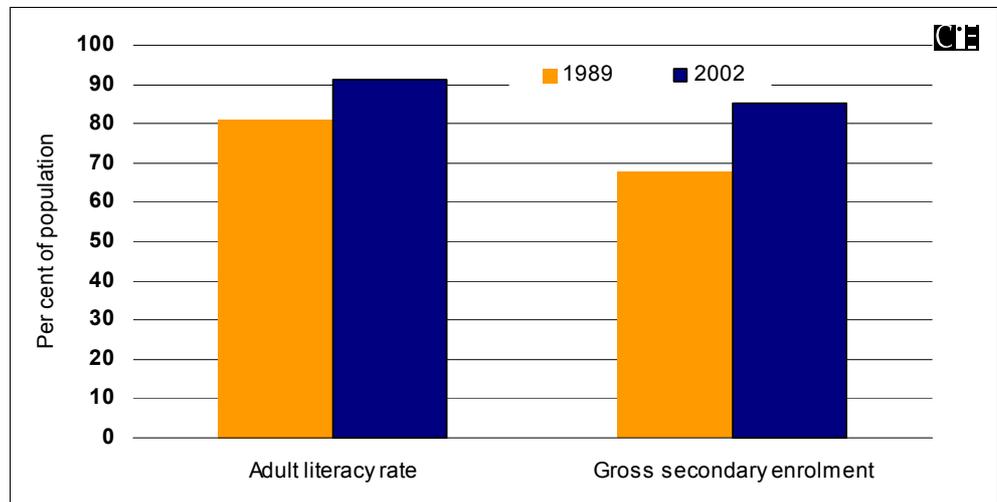


Data source: See technical note 9.

Education

APEC economies have continued to improve their educational outcomes. Enrolment in primary, secondary and tertiary education has risen since APEC began. Nearly all APEC economies are achieving close to 100 per cent primary completion rates for both males and females, achieving the Millennium Development Goal. This has generated higher literacy rates amongst both adults and the young. Adult literacy rates in APEC economies have risen and are amongst the highest in the world

5.8 Education rates have improved



Data source: See technical note 10.

(chart 5.8).

Rising education levels in APEC economies is a benefit in and of itself. But it is also likely to drive productivity gains and increased per capita incomes in the future.

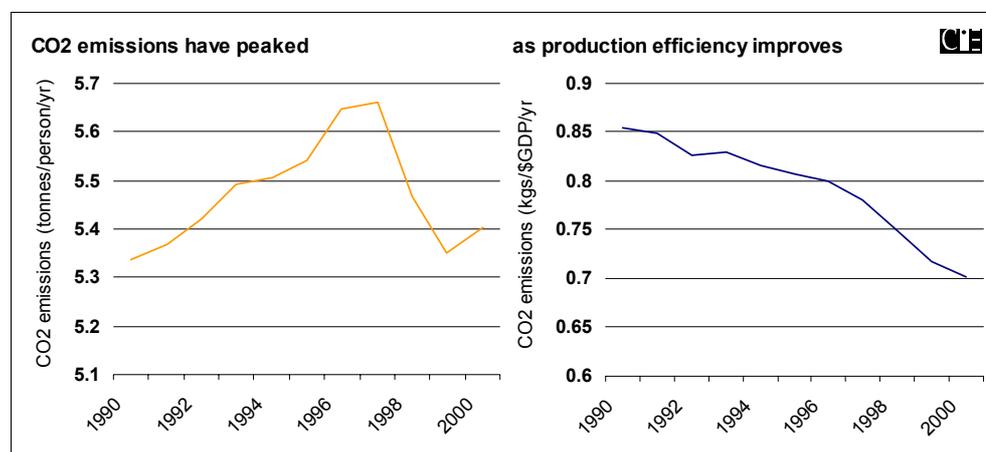
Environment

A number of recent studies have negated the common view that economic growth brings worsening environmental outcomes, or alternatively, that environmental policy brings lower economic growth (World Bank 2003, OECD 1999). Economies can often achieve better environmental performance and economic growth through win-win policy options. Moreover, as economies develop, the high polluting sectors such as manufacturing tend to be replaced as demand for services increases. This can lead to an inverted U shaped pattern of environmental performance.

International organisations, including APEC, have focused attention on the environmental sustainability of growth. A number of methods are developing to account for the environment in a manner consistent with an economy's National Accounts. In addition, market based instruments for addressing environmental externalities, such as carbon trading, are developing to help ensure environmental targets are met. APEC has been involved through increasing accountability for sustainable development through an annual stocktake of each economy's initiatives and coordinating developments across the region.

For the APEC region, environmental outcomes have been mixed. While absolute emissions from APEC economies continue to grow, there are some

5.9 Environmental outcomes reflect more efficient use of resources

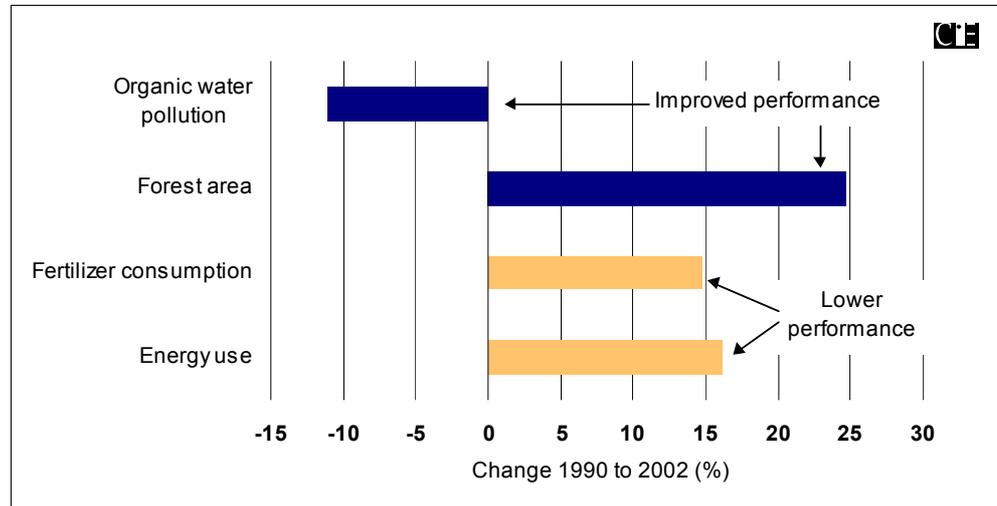


Data source: See technical note 11.

promising trends. For CO₂ emissions there is evidence of an inverted U shaped pattern, as emissions per capita increased till 1997 but have since fallen back to 1990 levels. More promising is that production efficiency is improving as each dollar of production is associated with lower emissions (chart 5.9).

Other environmental indicators also show APEC's mixed performance (chart 5.10). Water pollution has decreased and forest area has increased. Other indicators, such as fertilizer consumption and energy use, suggest an increase in reliance upon non-renewable natural resources (as well as being indicators of continued economic growth).

5.10 APEC has mixed achievements in other environmental areas



Data source: World Bank WDI (2004).

Technical notes

APEC economies are divided into upper and lower income groups using the World Bank's classification 2004. Lower income economies are those in the World Bank's low-income and lower-middle income groups. Other APEC economies are classified as higher income.

The World Bank's World Development Indicators 2004 and the UNCTAD Investment Database do not include Chinese Taipei. Data for Brunei is also often unavailable in the databases used.

Data that is reported as a percent of GDP is calculated using APEC GDP as the denominator. Data that is reported as a percentage of the population is calculated by using the APEC population as a denominator. Data that is reported as a proportion of land area is aggregated by land mass.

Technical note 1

Tariff data for 1988 is from DFAT (2000). The Papua New Guinea figure is for 1995 and the Viet Nam figure is for 1993. The data used vary between economies and are therefore not comparable. Tariff data for Australia, Canada, Mexico and the United States are trade weighted. Tariff data for the other economies are a simple average. The 2004 figures are from each economies 2004 Individual Action Plan. The 2004 IAP's of Chile, China, Mexico and the United States uses 2003 tariff data. The 2004 IAP for Japan uses 2002 tariff data.

Technical note 2

This data is sourced from Gwartney and Lawson 2004. The index used is the Freedom to Trade. The numbers reported are a simple average over economies – for each of the classifications presented.

Technical note 3

Trade is measured using exports of goods and services as a proportion of GDP. Data is sourced from the World Bank's World Development Indicators 2004. If no figures were available for 2003, interpolations were made using previous years' data.

Exports within the APEC region and outside the APEC regions are sourced from Market Information and Analysis Unit, Department of Foreign Affairs and Trade, Australia.

Technical note 4

Real GDP is in 1995 US dollars, sourced from the World Bank's World Development Indicators 2004. Per capita GDP is calculated by dividing GDP for the region by the population of the region.

Technical note 5

The Fraser index of economic freedom is taken from Gwartney and Lawson 2004. The index is aggregated using population weights. It excludes Viet Nam and Brunei.

Technical note 6

The human development index is from the UN online database. Data is aggregated using population weights from the World Bank's World Development Indicators. The world human development index is also aggregated using population weights for all economies for which there was data in both 1990 and 2002.

Technical note 7

Economies for which the World Bank WDI 2004 had data on the proportion of people living on less than \$1 or \$2 a day were Chile, China, Malaysia, Mexico, Peru, Philippines, Russia and Thailand. It was assumed that other APEC economies had none of their population living on less than \$1 or \$2 a day. Data were not collected for the same year. For the 1990 data point the closest available figure was used. Similarly, the most recent figure was taken for 2000. Interpolation was not possible due to the limited number of

data points for each economy. Data was aggregated using population weights from the World Bank's World Development Indicators 2004.

Technical note 8

Infant mortality data is from the World Bank's WDI 2004. Infant mortality data was not available for Hong Kong, China. The change is measured from 1990 to 2002.

Life expectancy data is from the World Bank's WDI 2004. Change is measured from 1990 to 2002. Life expectancy for each year was aggregated using population weights for the same year. For Singapore, the 2001 life expectancy figure was used as the 2002 figure was unavailable.

Technical note 9

Improved sanitation and water source data was available for 13 APEC countries including Australia, Canada, Chile, China, Indonesia, Mexico, Papua New Guinea, Peru, Philippines, Singapore, Thailand, United States and Viet Nam from the World Bank's WDI 2004. Data for each country was aggregated using population weights for each year also from the World Bank's WDI 2004.

Technical note 10

The literacy rate measures the proportion of the population over 15 years that is literate. Literacy rate data is from the World Bank's WDI 2004. It covers Chile, China, Indonesia, Malaysia, Mexico, Peru, Philippines, Russia, Singapore and Thailand. These countries were aggregated using population weights. The most recent data point is for 2000 as this is when there is the greatest coverage of economies.

Gross secondary enrolment data is typically from 2001. If 2001 data was missing, the next most recent value was used.

Technical note 11

CO2 emissions per capita are aggregated using population weights. The 1990 emissions data point for Russia is interpolated using later data.

CO2 emissions per dollar of GDP are aggregated using real GDP (1995 US\$).

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