

## **A fresh core economic mission for APEC**

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### **Summary**

APEC is at a crossroad. Its position as the leading forum for summitry in the East Asian region is now contested with the inauguration of the East Asian Summit. Its core economic focus, building growth through trading into open markets, is losing momentum. Trade liberalization, while important is no longer a high public policy priority for Leaders, rhetoric to the contrary notwithstanding. The relevance of the organization is being questioned.

APEC is important to member countries. Unlike other regional intergovernmental groups which were established to create a process, it was established with a purpose – to promote growth based on open markets. A significant network of collaboration on technical matters that support development of open markets has developed and commands a substantial annual workload.

The transfer of APEC's traditional focus on trade liberalization to trade facilitation and other "beyond the border" issues demonstrates an increasing focus on domestic issues that are essential to build growth based on free markets. APEC's entrée to these issues is mostly through the "trade policy" window. This is indirect and therefore inefficient and of only limited effect. The domestic policy issues which are central to growth need to be front and centre. APEC needs a new economic policy mission.

Growth matters to APEC members. APEC members have lead growth in the world economy for half a century. While in other regions there is debate on whether or not growth should be traded off to meet other policy objective, the predominant view among APEC economies is that other policy issues cannot be satisfactorily addressed unless there is growth first.

"Building Sustainable Growth" – is an obvious new core mission for APEC. Recent work by the OECD has demonstrated the value of examining productivity when determining what creates growth - what is it and how is it improved? APEC could embark on major study of what contributes to productivity in APEC economies.

This would lay the basis for a new agenda for reviewing the economic fundamentals of what is necessary to sustain growth. This would be a natural mission for APEC. It would manifest the core value APEC represents to members. That is the economic benefit they all derive from cooperating in a framework predicated on open economies which includes the world's fastest growing and most productive economies.

## **APEC at the crossroad**

“The Economist” has consistently mocked East Asian summitry for five years. It has scolded ASEAN Summits for setting unrealistic targets, the East Asia Summit as pointless and APEC for lacking practicality.

It has a point. ASEAN has practised “achievement by Declaration” rather than action for a long time. Just last month ASEAN Trade Ministers decided to reduce by 5 years the target date set in 2004 (now 2015) for creating the ASEAN Economic Community. The original goal to build an economic community comparable to the European Union with a common ASEAN currency and a regional monetary institution by 2020 was very ambitious and has been criticized by leading analysts in Southeast Asia, such as Hadi Soesastro, goal as impractical.<sup>1</sup>

Creating institutions without clear purpose is another manifestation. The Asian European Mechanism (ASEM) was created to build dialogue between East Asia and the EU. It has foundered because of lack of common purpose. The forum ranges across political issues and the Europeans regularly want to talk about human rights. This has been a divisive issue for East Asian Governments and ASEM has searched for a purpose. The Bangkok Post has written scathing editorials about it. Yet this has not reduced the appetite for new institutions.

### *The East Asian Economic Summit*

Now the ASEAN Leaders, with Chinese encouragement, have set up the East Asian Summit (EAS). It has no clear goal; it is a “process”. But there is controversy about whether or not the US should have been invited to participate. The genesis of the idea was Dr Mahathir’s proposal for an East Asian Economic Caucus. The goal was an East Asian only grouping to foster economic cooperation. The new Summit process realizes it in part – it does not include the US or Canada – but now Australia, New Zealand and India are part of it. The Summit does not have a specific mandated. Dr Mahathir has commented that this was not what he had in mind.<sup>2</sup>

The capacity of the EAS to create new institutions is weak. It is unlikely to forge common approaches on diplomatic issues. It is commonly seen as group shaped by Chinese leadership, but there are several members of the Summit (Japan, Vietnam, Indonesia and Australia) who prefer the Summit to be forum for consultation, not a vehicle advancing common diplomatic positions. Diplomatic interests divide, not bind, Summit participants.

Can EAS be the basis for a hemisphere wide Free Trade Area? Japan has proposed this but so far there is little support. The ASEAN plus 3 process has already set for itself the ambition of building first a free trade area and then an economic community. Setting aside the practicality of these ambitions, an Asia Summit FTA would serve simply to add

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<sup>1</sup> “ASEAN’s Future, 2004, ISEAS

<sup>2</sup> Hurewitz, Jeremy op. cit.

Australia, New Zealand and India to the ASEAN plus 3 FTA. This attracts India which has few effective free trade agreements, but the inevitably weak trade rights such a wider grouping would create is unlikely to appeal to Australia and New Zealand who are already negotiating FTAs with ASEAN and China.

The political feature of the EAS is that it supports China's emerging ambition to become the hub, if not the leader, of economic integration in East Asia.<sup>3</sup> This is advanced somewhat by not having the US in the group.

The practical effect of the EAS is that it crowds East Asian summitry. With the ASEAN Summit and now the East Asian Summit, the uniqueness of the APEC Summit for bringing East Asian Leaders together is significantly reduced. In addition, members of APEC have established new economic relationships with each other through a dizzying array of bilateral and regional free trade agreements. This has stimulated the question, "What about APEC?" Is it becoming redundant?

#### *Is APEC becoming redundant?*

Some reference points to evaluate the importance of these fora and institutions to governments are required. Two are proposed. The first is "does the body increase economic welfare?" The tests for that are does it create institutions which increase economic welfare through formal integration or which foster general economic policies that advance growth? The second point of reference is "does it serve political interests?" The tests for that are does it strengthen political relations or/or protect rights of access in trade?

The importance of distinguishing between economic and political interests arises when they are used to evaluate Free Trade Agreements (FTAs). On the surface an FTA may appear to advance economic welfare. The effect however might do little to enhance welfare and may even reduce it. Governments enter FTAs to strengthen political relations or protect against the erosion or perceived erosion of right of access to markets. The upsurge in FTAs in East Asia is principally accounted for by political rather than economic interests. Of themselves, they do not render APEC redundant.

APEC was established to foster the value of building growth on open economies. Its primary focus was on trade liberalization. There is more to building growth with open economies than that, but APEC consolidated at a time when trade liberalization was a widely supported global priority.<sup>4</sup>

Part of the deal in getting APEC established was not to institutionalize it. The Secretariat was kept small and members financed a lot of its activity directly. An effort was made to

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<sup>3</sup> This was described to the author as the point of Boao Forum for Asia, the annual Davos-style business and economics forum by Long yong-tu, the Director and a former Vice Minister of China's Ministry of Commerce.

<sup>4</sup> The Uruguay Round of trade negotiations was in full swing, the EC was completing its Single Market program and negotiations for the North American Free Trade Area were underway.

institutionalize a process of trade liberalization to demonstrate how members would achieve the goals of the 1993 Bogor Declaration.<sup>5</sup> This failed in 1998, damaging the standing of the organization in the eyes of onlookers – the media, business and observers in other regions.

But by that time, APEC had acquired other momentum. The Leaders' Annual Summit drove the organization. Where else did the leaders of the Pacific Rim economies meet? They broadened the APEC agenda with human security and impacts of terrorism following the September eleven terrorist attacks in New York. The trade agenda shifted focus to trade facilitation. And over time, the work programs in a range of technical areas questions central to building open economies – financial management, energy, telecommunications, transport, tourism, standards and customs administration broadened.

This technical work is generally not recognized outside the set of officials who work on it, and is not likely to be appreciated by Leaders – they are not likely to read the voluminous annual statement by APEC Ministers reporting on all the activities of APEC. The focus of APEC Leaders is on strategic and contemporary issues. In recent years, Summits have produced headline declarations on international trade (usually to boost the WTO), human security, pandemics and related questions. Privately they complain about lack of focus in Summit discussions. What keeps them meeting is who they will meet. There is always something to talk about with the Presidents of the United States and China and the Prime Minister of Japan. Is this enough of a mission to keep APEC relevant?

The first meeting of the East Asian Summit should have rung a warning bell. It was reportedly not a very focused meeting. This is not surprising. It was convened to meet, not to do anything in particular. But it did issue a statement on action to address the threat of Avian flu.<sup>6</sup>

This is the sort of issue that has become policy heartland for the Leaders at the APEC Summit. What is the difference between the EAS and the APEC Summit if much the same group of leaders discusses the same issues? One answer is membership. APEC has more leaders and in particular includes the President of the United States.

Japan has proposed that the US President should be invited to attend the East Asian Summit as a guest. This was how the annual meeting of ASEAN Leaders spawned the bigger summit. Each year ASEAN leaders invited leaders of “dialogue” partners to join them for exchanges. If the US President started to become a regular attendee at the EAS Summit, what then the value how valuable will the APEC Summit become? Is there room for two such Summits?

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<sup>5</sup> By establishing a system to report progress towards implementing the Bogor goals through the IAPs (Individual Action Plans), monitoring that implementation and then establishing the EVSL process (Early Voluntary Sectoral Liberalization) in which an effort was made to negotiate packages of commitments to advanced liberalization. Leaders failed to endorse this at the APEC Summit in Kuala Lumpur in 1998.

<sup>6</sup> Soesastro, Hadi, 'East Asia: Many Clubs, Little Progress' *Far Eastern Economic Review*, Jan/Feb 2006, Vol 169, Issue 1,

APEC's original core mission, promoting growth based on free trade, has also lost steam. After the failure to operationalize an APEC program of trade liberalization, the focus shifted to "trade facilitation". The agenda is valuable, but the work is technical and does not warrant the attention of heads of governments. It is not appropriate or effective for them to focus on issues such as management of customs procedures or recognition of procedures for verifying the safety of toys.

APEC is at crossroad. It is in danger of being lost in the static of the reportage of communiqués from a seemingly endless round of Summits among leaders. Today, the unique value of its Summit is the presence of the US President.<sup>7</sup> There is much more to APEC than that and very a significant economic role for the institution lies currently unrealized.

### **Why APEC is different**

APEC Summits are very expensive. The Australian Government has budgeted \$250 million to host the Summit in 2007. Yet Governments still queue to host the Summit and showcase it. Beijing showcased APEC the way it showcased WTO membership and is showcasing the Olympic Games. Thailand staged the first Royal Barge procession for 50 years to celebrate the Summit and effectively closed down Bangkok for three days to host the meeting and Thai International redecorated a 747 to advertise the Bangkok Summit. Bunting about APEC will festoon the streets of Hanoi for twelve months before the Hanoi Summit.

This does reflect a basic reality which people in East Asia take for granted but those outside do not. The reality is that the Pacific Rim is the dynamic heart of the world economy. The core is not just China's relentless growth and the pull effect it has had on other East Asian economies, it is the combination of that prolonged record growth in the US economy and the prospect of economic revival in Japan. It is a constant preoccupation in Brussels and other European capitals to work out how to tap into it.

There has been a strong demand from members for APEC's most dreary offering. This is collaboration on technical work in specialist areas. This spans improvement in regulation of life assurance, cross recognition of systems for conformance to technical standards, management of genetically modified organisms and use of paperless systems in management of border controls. Each year there is an average of 70 meetings on APEC affairs. ASEAN demonstrates that large numbers of meetings does not necessarily indicate progress. APEC is different in two respects. Most programs are jointly sponsored by developed and developing economy members of APEC and the meetings are usually funded by the developed country sponsor. Second, the meetings entail transfer of technology and enhancement of capacity.

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<sup>7</sup> This is not strictly true. APEC is also attended by Canada, Latin American Pacific Rim economies and Russia. But with China's growth fixing attention in East Asia, they do not add much contemporary value to the organization in East Asian eyes.

So while APEC has a weak central administration, it has spawned extensive collaboration among a large number of officials. Many identify their relationships with each other through APEC collaboration.

APEC was established for a purpose - cooperation to promote growth based on open economies. It is the only inter-governmental organization in East Asia or the Pacific Rim established for that purpose.

APEC reflects the economic reality of Trans Pacific trade. East Asia's trade flows with the United States are significantly larger than those with Europe. Access to the US market, notwithstanding conflicts over trade, has been a key feature of the growth of the East Asian economies over the last 20 years. The US has been central to the fastest growing industrial sector in the world and in East Asia, namely IT and communications products. Manufacturing of components and computers has been one of the growth drivers in East Asia. The United States has been the leading market. China today is using the blueprint of the history of economic growth in the US to support its own pace of development.<sup>8</sup>

The result is that APEC includes the largest of the fastest growing industrialized economies<sup>9</sup>, the leading global high growth developing economies and the developing economies which have joined the OECD. It is a heady mix of success which members value. Yet, there is sense of uncertainty if not weariness about APEC at senior political levels in at high levels of APEC member states. APEC has lost its zip. The reason is clear. Its economic core mission, trade liberalization, is no longer a high priority policy concern in APEC economies.

### **Trade is no longer enough**

The struggle to secure tangible results from the WTO Doha Round shows that many countries do not consider liberalization of trade is a major reform required to secure consistent growth. Ministers and Leaders of APEC ritually announce the need to secure action to liberalize trade, but when it comes to taking concrete action, little is seen.<sup>10</sup>

ASEAN members have found it difficult to secure tangible commitments to liberalize trade among themselves. This is not that significant. Trade among ASEAN economies is a small share of their total trade. China and Vietnam are the standouts. They have used trade liberalization to buttress the transition to market economies as evidenced by the actions taken to secure membership of the WTO.

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<sup>8</sup> James Krynge in "China Shakes the World" Weidenfeld and Nicolson, London 2006, shows how Chinese planners studied the US transcontinental highway system and its role in supporting growth in designing China's transcontinental system

<sup>9</sup> Australia, Canada and the United States

<sup>10</sup> Trade officials in Geneva joke about the lack of flow through to officials in Geneva of commitments by APEC leaders to break logjams.

Overall, ASEAN economies have achieved substantial liberalization over the past two decades. Important gains from liberalization remain to be captured, particularly in services sectors and agriculture. The fact remains, however, that trade liberalization is not seen as central to growth prospects.

This is reflected by the trend of the trade agenda in APEC. The focus is extending beyond the reduction of trade barriers. Investment barriers, trade facilitation, competition policy, reduction of regulation now occupy at least as much attention. We should note that these matters are matters for domestic policy. They are all important for getting economies to operate efficiently and productively.

But efforts to improve the operation of the domestic market by trying to leverage changes as a consequence of trade policies to reduce restrictions on foreign goods and services is an inefficient way to achieve these changes. Little wonder that not much progress is made. And in APEC the wrong Ministers are discussing them. Programs are settled by Foreign and Trade Ministers. Yet they are not responsible for these “beyond the border” issues - domestic competition policy, de-regulation of services industries or implementation of policy on customs administration or standards.

If APEC is to be effective in these areas, they need to put front and center on the APEC agenda, not effectively introduced as subsidiary matters

To argue this is not to say efforts should not be made to improve trade policy in APEC economies. As has been argued time and time again, the proliferation of FTA's is risky public policy. The risk of results which reduce not enhance the economic welfare of national economies is significant. It is important that APEC continue to try to improve trade policy and to stress the need for further trade liberalization.

But maintaining this as a leading priority will not appeal to leaders as matters of major, public importance. In truth it is a matter of minor public importance. On the other hand economic growth and how to achieve it is a matter of leading public interest to APEC economies.

### **Growth matters**

There is no APEC economy where growth is unimportant. Over the last decade and a half, average growth the US, Canada and Australia (3.5 per cent) has been double the OECD average – one to one point five percent. Japan appears to be emerging from its prolonged slump.

East Asia has had the highest growth rate of any region of developing countries for nearly half a century. China is achieving consistently higher growth for a longer period than any economy in recent history. The Latin American members of APEC have enjoyed higher rates of growth compared to Latin America at large.

APEC Governments agree growth is not everything. There is work in APEC on social welfare safety nets. A recent priority in APEC is to understand strategies to manage the impact of trade liberalization. These are not however major preoccupations. A leading reason is that if economies enjoy consistent growth, policies to manage adjustment are less important. Economic growth creates its own process of adjustment. New industries grow and new jobs are created.

In other regions, there is debate about the relative importance of growth. Europe (Finland and Ireland excepted) has had consistently lower growth over the last decade than the US and Canada. Rigid labor markets, high public sector welfare costs, regulated services sectors, and environmental regulation are all issues regarded in Europe as justifying in some way or another acceptance of lower growth than might otherwise be achieved.

In Latin America, there is a rising trend for governments to place political goals and social issues ahead of growth. The role of private sector as the leading engine of growth is being questioned in several countries.

For so long as governments ponder if growth should be the leading national priority, instead of perceiving it as an essential pre-requisite for meeting other national priorities, their economies will under perform.

In APEC the importance of growth is not contested. The focus is on how to maintain it. Economies in the APEC region have experienced extraordinary rates of structural change. Groups of economies have passed through development phases in succession. Because of technology, each new phase, like China's today as it moves up the value adding ladder in manufacturing, is different from the phase passed through by others who went before them, like Japan and Korea.

This process is not restricted to developing economies. The United States has shown how economies need to adjust to new technologies to maintain growth. A recent comprehensive review by the OECD of what creates growth and the role of productivity in that demonstrates how the embrace of IT has been an important driver in the US.

The fundamentals of what enables the US economy to maintain competitiveness are the same in other economies. Government interference in business should be restricted; property rights should be strong and legal institutions need to be independent and effective at protecting property rights. The emphasis on respective fundamentals will of course vary according to the circumstances of each economy.

### **“Building Sustainable Growth” – an obvious new core mission for APEC**

The set of issues that need to be addressed to improve growth is large. An organizing idea or principle against which to examine these issues to give deliberation focus and direction. The OECD has recently undertaken a major study on growth which sets an interesting precedent.

In 2003, it commenced a major review of what contributed to growth in OECD economies, with a particular focus on the role of information technology.<sup>11</sup> The question it addressed was “Was Information Technology responsible for the higher rates of growth and high levels of productivity enjoyed by the US and several other OECD economies during the previous decade?” The methodology it employed was to assess the relative performance in productivity by OECD countries and to analyze what contributed to it.<sup>12</sup>

An interesting lesson emerged from the study. A systematic examination of productivity is a very effective organizing idea to examine how the fundamentals in an economy are contributing to growth. The results of the first study produced two follow up projects to identify what should be the focus in each OECD country to increase growth.

The concept of a comparative analysis of productivity and its relevance to growth should have strong appeal to APEC economies. It is widely recognized that productivity is a key factor in competitiveness. All APEC economies have experienced how competitiveness alters as costs, particularly labor costs, rise and the balance of dependence on performance in sectors change as economies change. Lower income economies depend more on agriculture, higher income economies depend more on services. But all sectors have to be competitive if growth is to be sustainable. How to maintain competitiveness is a common interest throughout APEC.

Securing sustainable growth is an obvious, prospective, new mission for APEC. It could be launched with a large study of productivity in APEC economies. It could draw on the OECD work as a point for departure. That already includes work on a number of APEC economies. Another point of reference is a review last year by the World Bank on the drivers of growth.<sup>13</sup> While there has been considerable work done on these issues in the

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<sup>11</sup> The OECD Growth Project Sources:

- OECD (2003) *The Sources of Economic Growth in OECD Countries* and *The Policy Agenda for Growth* (summary document) both available from the Growth Project homepage. [www.oecd.org](http://www.oecd.org). [Going for Growth 2005](#) identified structural policy priorities to enhance GDP per capita for all member countries, on the basis of cross-country comparisons of policy settings.
- [Going for Growth 2006](#) This second issue takes stock of the progress made in implementing policy reforms, and provides comparative indicators covering structural policy areas such as labor markets, education and product market regulation. Special feature: a focus on innovation, which is a key driver of economic growth.

<sup>12</sup> The answer was a qualified yes. It demonstrated that increased productivity did not necessarily derive from being active in developing IT software or manufacturing IT hardware, but that application of IT was also a major factor. It also pointed out that improved performance from labor was also a major factor in lifting productivity. In addressing why growth and productivity was lower in the major economies in Europe, it stressed the importance of getting the fundamentals right. It finally observed that a great deal more needs to be known about what contributes to productivity and how to measure it.

<sup>13</sup> Economic Growth in the 1990s: Learning from a Decade of Reform, 2005 World Bank [http://publications.worldbank.org/ecommerce/catalog/product?item\\_id=4386199](http://publications.worldbank.org/ecommerce/catalog/product?item_id=4386199). This book is part of a larger effort undertaken by the World Bank to understand the development experience of the 1990s, an extraordinary eventful decade. Each of the project’s three volumes serves a different purpose. *Development Challenges in the 1990s: Leading Policymakers Speak from Experience* offers insights on the practical concerns faced by policymakers, while *At the Frontlines of Development: Reflections from the World Bank* considers the operational implications of the decade for the World Bank as an institution. This volume,

OECD economies, work on developing economies in East Asian and Latin America has been limited (as a literature search in a companion to this paper shows).

This would be a two or three year study and would probably require some ground breaking research on how to measure productivity as well as measures relevant to developing economies. This is work that is not being done in any other forum. This is a natural mission for APEC.

The results of such work would open up a large agenda of issues for APEC members to consider. There would be ample scope for Leaders to address issues that were strategically important to strengthening open economies securing consistent growth among APEC economies.

This is not a project for Foreign and Trade Ministers. It is clearly a project for Leaders. APEC's institutions would need to be adjusted if this work were to become a new leading agenda item for APEC. If Leaders decided to adopt such a leading economic priority for APEC, the institutional changes required to support it would become self-evident.

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*Economic Growth in the 1990s: Learning from a Decade of Reform*, provides comprehensive analysis of the decades development experience and examines the impact of key policy and institutional reforms of growth.