



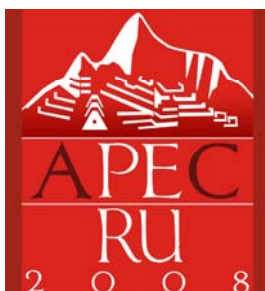
**Asia-Pacific  
Economic Cooperation**

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**2008/ASCC/017**

## **Economic Structural change in APEC – Economic integration beyond trade liberalization**

Purpose: Information  
Submitted by: Australia



**APEC Study Centres Consortium Conference  
Piura, Peru  
19-21 June 2008**



## **“Economic Structural change in APEC – Economic integration beyond trade liberalization”**

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APEC Peru 2008 ASSC Conference  
Piura, Peru  
June 2008

### **Executive Summary**

APEC has not fully achieved its goal of liberalization of all trade and investment barriers as laid down at the Bogor Summit in 1992, although it is well advanced. Achieving that remains a leading requirement in APEC.

The goal is to achieve continuing economic growth. The strategy is economic integration and the means is continuing improvement in productivity.

Achieving continuing growth now depends more on implementation of domestic policies which build flexibility and openness into the systems for governing economies.

APEC's mission of promoting economic integration among member economies will not be completed until that has been achieved. The creation at the Sydney Summit of a new Committee to promote Economic Structural Change creates the machinery to foster and craft this new mission for APEC.

A need has emerged to respond to new pressures, such as hikes in prices of key inputs, and anticipated pressures, such as recession in some key economies and inflation, which would diminish productivity in many economies. The political case to address those impacts offers APEC Governments the political opportunity to set in place long term commitments to achieve economic structural reform

### **APEC's Mission incomplete**

APEC was formed to foster open markets and economic integration among the economies of the Pacific Rim. The economic transformation of the developing economies in APEC is now a matter of record. APEC economies have achieved record economic growth and important former command and control economies have made significant progress transforming to free market economies.

APEC economies have moved a long way to achieve their goal of fostering economic integration by removing all barriers to trade and investment. Trade liberalization has been significant and the persistent out performance of other countries by members of the APEC region is clear.

Free trade is simply the application of liberal economics to policy governing the movement of goods and services across borders. While very effective at demonstrating the benefits available from pursuit of liberal economics, policies to apply liberal economics in domestic policy is just as important, and is critical if the full benefits of free trade are to be secured and are to endure.

While further action to advance liberalization of trade and particularly investment is required, of greater long term importance is the need to deepen the foundations for liberal economies among APEC members. Some measures require long term strategies.

Recent changes in the global economy and the prospect of some further shocks will require short term responses. As APEC economies respond, they should also ensure these policies also are consistent or even begin to introduce the domestic economic form which will deepen these foundations.

## **Continuing growth is the issue**

Continuing growth is important to all APEC economies. The key imperative for industrialized economies is to make their economies more productive and more flexible by adopting policies to promote structural change. With few controls remaining on barriers to trade and investment, the focus should be on domestic policies. For developing economies, they need both to reduce barriers to trade and investment (still higher on average than in developed economies) as well as focus on domestic policies. They also need to institutionalize in their laws and policies the foundations for liberal economies.

The policy challenges to be overcome differ in some basic ways between developed and developing economies.

### *Challenge to industrialized economies*

The biggest long term challenge facing industrialized economies is aging populations and the problem of meeting the social consequence with a workforce which is a relatively smaller share of the population. They need economic growth to manage this change, although some seem to behave as if economic growth is not so important. In Europe, average annual growth of two percent is considered satisfactory in some leading economies. The US economy (and some others – in Canada and Australia) have had consistently higher growth in the last decade and a half than most industrialized economies in Europe.

The faster growing economies are by and large the more liberal economies, the most obvious difference being more open services sectors. They have secured greater productivity from utilization of information technology, particularly because financial, distribution and telecommunications sectors have been more open. It is probably also significant that, as migrant societies, they have a steady stream of new arrivals to expand labor resources.

Despite these differences, a key requirement for meeting the challenge of aging societies and securing growth is further domestic liberalization of the economy and removal structural impediments to change.

### *Challenge to developing economies*

The battle against poverty among APEC developing economies is not won. They have been more successful than other developing economies in reducing absolute poverty. Consistent, high growth has been fundamental to this. Anti-globalization NGOs argue against trade liberalization in the WTO and in Free Trade Agreements and insist that the capacity to use protection is essential to achieve social equality. Some are upfront about their position – equality in society is more important than elimination of poverty. It is morally untenable that poverty should be tolerated for any reason. Fortunately most Governments in APEC economies agree.

Numerous studies by public International Financial Institutions demonstrate the critical relationship between higher growth and reduction of poverty. More people have been lifted out of poverty and in greater numbers among the economies which have pursued high growth and open markets.

Removal of remaining barriers to trade and investment is important to maintaining and accelerating economic growth. So is reduction of regulation of the domestic economy. Finally the foundations for liberal economies – strong property rights, independent judiciaries, reduction of the role of government in the economy and ensuring competitive neutrality between government enterprises and private enterprise – need to be strengthened.

Like industrialized economies, developing economies also need to increase productivity to achieve continuing growth.

#### *A new short term imperative*

Recent developments in the global economy have now created a short term imperative to make these changes. Key threats are emerging to continuing growth in APEC economies. Prices for oil, mineral and metal commodities and now agricultural products have risen rapidly. There is now the prospect of a slowdown in the US economy and the looming threat of inflation in major economies.

There is a widely expressed view that growth in China is now of such a dimension and has such momentum that it can cushion the impact of a slowdown in the US economy. It has emerged as a major trading partner of every member of APEC. All have benefited from China's increasing industrial capacity and the demand it has generated for goods as the Chinese economy has continued to expand.

The propagators of this view overlook the importance to the Chinese economy of earnings from the US economy. Export earnings currently contribute around 30 percent of Chinese GDP. 22.5 percent of export earnings come from the US economy. Another 40 percent is earned from other Asian economies that would also be adversely affected by a slow down in the US economy.

Finally there is the new and recently emerged challenge to producers in export industries in other economies which is presented by the steady decline in the US dollar. US exporters are going to become increasingly more competitive in global markets. This is a long term trend as the dollar finally starts to respond to the significant external imbalance in payments which has been generated by persistent US budget deficits.

All this means that APEC economies face significant and emerging challenges to maintaining growth. The best long term response is to make the domestic economy more competitive. Those whose economies will not be able respond flexibly to the sort of challenges emerging will suffer most. All should note what to expect in the US economy if it goes into recession. It will reveal its remarkable capacity to absorb shocks and recapture growth in a comparatively short period. It is the world's most flexible economy.

#### **Maintaining the traditional response**

The APEC program to eliminate barriers to trade and investment should be completed. Given that trade barriers among developing APEC economies are on average higher than industrialized economies, this should be a higher priority for them.

The emerging threats to productivity and competitiveness strengthen the argument to accelerate the necessary action.

Rationalizing the regional infrastructure for economic integration which is being shaped by emerging regional and bilateral agreements to liberalize trade should also remain a high priority. This includes in particular the anomalies which might arise from overlapping obligations in bilateral agreements among parties and regional agreements,

APEC Ministers have long recognized that domestic policies need to be adjusted to ensure the benefits of trade liberalization are fully secured. These have been recognized in the "beyond the border" agendas which include introduction of competition policy, removal of domestic restriction on the operation of foreign enterprises and liberalization of investment policy.

But this approach has been shaped by a trade policy agenda and is more limited than it should be. While important, the “beyond the border” issues are a selection of issues relevant principally to improving the capacity of foreign actors, products and services to be utilized more efficiently after they have entered a domestic economy. It is time to do more. Policies to enhance the capacity of economies to adjust to new circumstances will improve further productivity in the domestic economy.

### **Elevating the priority of Structural Economic Reform**

APEC Leaders at Sydney recognized the importance of structural reform and altered the APEC policy machinery to give it higher priority. A new standing body to address the question has been established and permanent policy support has been created. A new Ministerial forum of Economic Affairs Ministers will meet in Sydney in August to give direction to this new field of work in APEC.

The original concern of APEC officials when this forum was developed was to lay down a long term approach to enhance productivity performance and secure continuing growth.

#### *The essence of Economic Structural Reform*

The key measure of success in structural reform is acceleration of the rate of growth of productivity over time and thereby the rate of economic growth.

Taking action now to achieve this will enhance the capacity of the economy to adjust to shocks.

Policy can be changed quickly, such as establishing competition policy, but the reforms are usually fundamental and difficult to implement because, like removing tariffs or restrictions on foreign investors, they dismantle or challenge significant interests which have benefited from preference. Such benefits include monopolies which may or may not operate under government privilege, and public sector entities which enjoy formal public preference.

Measures which would achieve structural reform include those which:

- strengthen, secure and extend property rights
- enforce the rule of law, including the honouring of contractual promises
- reinforce the independence of the judiciary
- minimize the role of government as a supplier of those goods and services that can be provided by the private sector
- ensure competitive neutrality between government and private suppliers of goods and services
- reduce the barriers to entry by new suppliers of goods and services; and
- ensure regulatory neutrality between domestic and foreign suppliers of goods and services

Advancing the economic integration of the APEC economies so that all economies can perform better requires implementation of these changes. If all APEC economies moved in those directions, the prospects of achieving sustained stronger economic growth would be greatly advanced and the gains from completing the liberalization of goods, services and investment would be significantly increased.

A logical step for APEC Economic Affairs Ministers would be to ask the Structural Adjustment Committee to develop a program for them and Leaders to adopt to implement a set of measures such as those set out above.

Recent steep and prompt increases in prices of inputs, such as energy, minerals and metals, and food are creating pressures on governments to take action to address the impacts. These changes will adversely impact productivity in some industries in some economies.

There may be other adverse impacts on productivity in prospect. There is concern about recession in the United States and increases in inflation in major economies. Governments will also begin to implement measures to anticipate these impacts.

The best antidote to such changes is to improve productivity to create the durability to manage these impacts.

The requirement to address these impacts also give APEC governments political grounds to set economic structural change as a major economic reform program

### **Moving to the next phase of economic integration.**

It is time for APEC to operationalize the next step in building economic integration among APEC economies and go beyond trade liberalization. They have been gesturing in this direction for some time with the “beyond the border” program. It is very much a Trade Ministers perspective on how to deliver fully the liberal economic benefit of managing controls at the border to achieve free trade.

Economic Affairs ministers would look at those “beyond the border” issues which are core economic policy questions, such as competition policy, and observe they are not a complete enough approach to building the domestic economic policy platform on which a liberal economy must sit.

It is time to make construction of that base the leading strategy to advance high, continuing growth among APEC economies – that outcome is why economic integration was adopted by the APEC economies as the primary purpose of the organization.