



APEC

A decade of progress

**A report prepared for
APEC Ministers Responsible for Trade**

Darwin, Australia



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Summary

The emergence of Asia Pacific Economic Cooperation (APEC) in 1989 reflected a realisation by economies that the accomplishments achieved through deepening economic integration carried two important implications. First, given the scale of Asia Pacific economic transactions, policy decisions taken without awareness of their regional implications can damage the beneficial process of market integration. Second, there is considerable opportunity for further gains from a more certain and open environment for market exchange.

Recognising these implications, APEC members have been striving to open their economies further to international trade and investment, and to strengthen domestic and international architectures underpinning international flows of goods, services and capital.

These objectives have been pursued through unilateral, regional and multilateral actions to reduce barriers and to achieve more appropriate domestic regulation.

These actions have borne fruit, and it is no coincidence that APEC economies have constituted one of the most dynamic areas of rising prosperity and social improvement in the world. Despite the impact of the Asian financial crisis, APEC economies have grown rapidly, generated millions of new jobs, achieved significant reductions in extreme poverty, improved basic indicators of health, expanded investment in human capital and improved access to information technology. These achievements have occurred as trade has become more important in each economy and as inward and outward flows of capital have expanded rapidly. And, contrary to some claims, it does not appear to have been associated with unsustainable resource management.

The link between openness and good economic and social performance is clear. There is mounting evidence around the world that open economies achieve higher rates of productivity growth, which in turn fuels economic growth. Growth is typically a prerequisite to successful inroads into poverty, and provides government with an expanding revenue base to increase physical and human capital and address social issues by introducing safety nets to look after those people disadvantaged by economic change. And the evidence is there that prosperity is associated with improved environmental performance.

The evidence is also clear — and the Asian financial crisis provides compelling lessons on this — that openness without good public and private governance will not assure sustained improvements in prosperity. At one stage the crisis appeared to threaten to unravel decades of progress in social and economic development for several APEC members, and to shake confidence in the benefits of liberalisation. The crisis demonstrated that continued action to refine systems of governance — in this case related primarily to the financial and corporate sectors — is essential to assure sustained economic performance. The affected economies are now recovering from the recession caused by the crisis. However, the recovery will be fragile without continued attention to the broader policies and institutional framework that provide transparency, predictability and accountability in public, financial and corporate sector governance.

APEC cooperation has been an important vehicle for reinforcing the efforts of economies to design and implement the reforms that have underpinned good performance and that increase the resilience of economic systems. APEC's framework has provided a reference point as members open their economies and implement the domestic regulatory reforms necessary for sustainable long term growth. And APEC economies were heavily involved in supporting those affected by the crisis through various forms of cooperation targeting improved economic governance.

APEC economies have chosen the path of openness, integration, institutional reform and better governance and cooperation. With the benefit of hindsight it looks like that has been the right choice over the past decade. The one major hiccup — the Asian financial crisis — entailed a financial panic triggered by a reappraisal of investment returns that was intricately linked to concerns about the quality of economic governance. To address the challenges ahead and build robust economies capable of withstanding unforeseen risks requires yet more openness, integration and regional cooperation and better governance. The task is now to identify how best to support continued efforts by members to follow this path.

1 Growing prosperity and integration with the world economy

APEC economies have constituted one of the most dynamic areas of rising prosperity and social improvement in the world over the past decade. They have prospered at the same time as they have opened trade and become more integrated with the world economy. Facilitating the expansion of trade and investment has been one of the most important initiatives that many of the APEC economies have undertaken to enhance their prosperity. Cooperation among APEC members in developing sound policy frameworks and in capacity building to support implementation has played an important role in helping to secure economic gains.

Nevertheless, the rising prosperity of APEC economies has faced some serious challenges. The Asian financial crisis brought a dramatic reversal in the short term fortunes of some economies, and for a while appeared capable of undoing the achievements of many years of improvement across a broad range of social, economic and environmental indicators. Positive growth is now being recorded in the affected economies, which are in the process of working through the full implications of what occurred. While the crisis entailed an investor panic triggered by a reappraisal of investment returns (Stoeckel, McKibbin and Tang 1999), investor concerns about the quality of governance also played a role in the chain of events, as did institutional impediments to a rapid response that might have restored confidence more quickly.

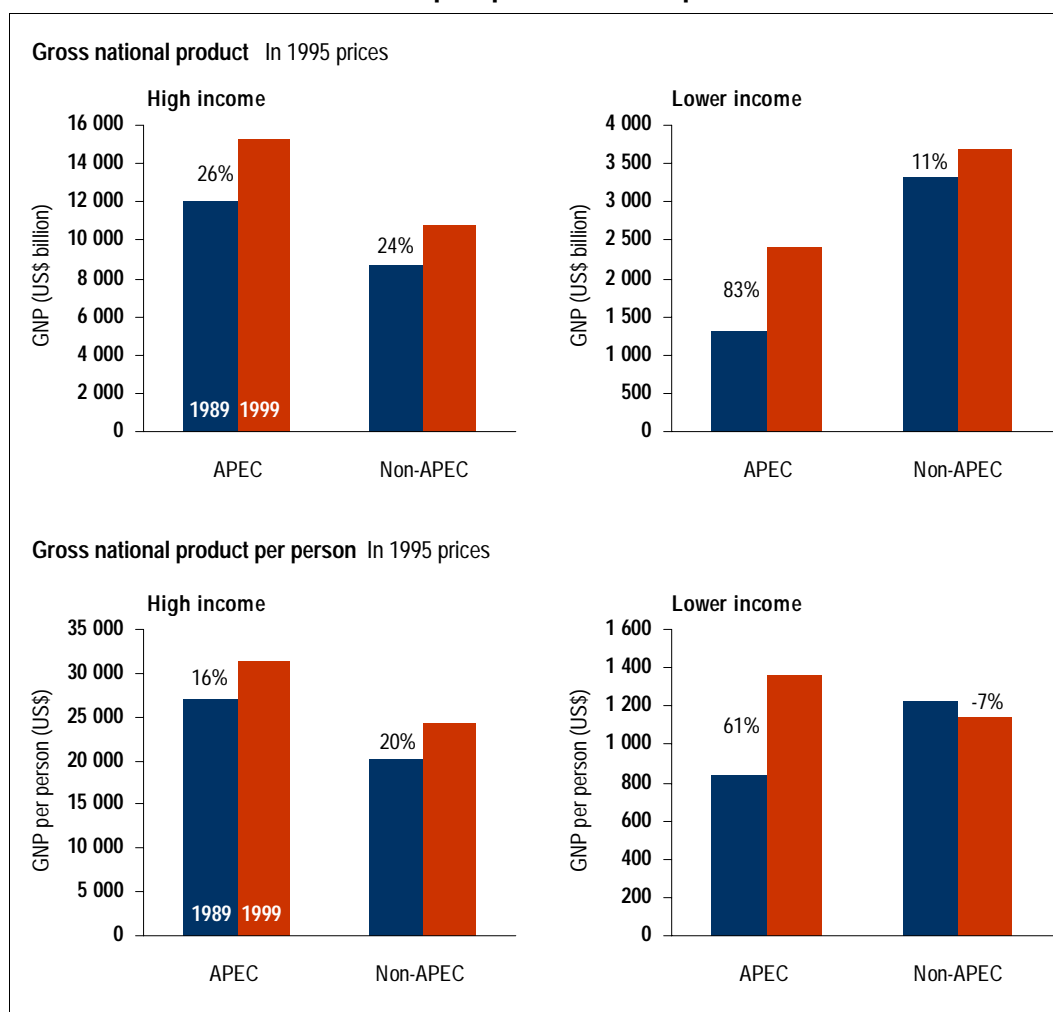
The social costs of the crisis and lessons learned about its causes have redoubled the resolve of the economies to consolidate and continue the economic and structural reforms that accompanied more than a decade of growth and development. Increasing global integration and the scope, speed and severity of the crisis have made it plain that economic openness alone does not guarantee sustained improvements in prosperity. The crisis exposed the risks from not refining systems of governance and broader policy and institutional frameworks to maintain robust financial and corporate sectors, and strong and responsive public sector management. Even now, despite strong recoveries in most affected economies, fragility may persist unless systemic improvements are implemented.

Substantial economic growth

APEC economies, whose combined real gross national product (GNP) grew by about a third between 1989 and 1999, have grown faster as a group than non-APEC economies. Lower income APEC economies have grown much more rapidly than their counterparts elsewhere in the world (chart 1.1).

Not only have APEC economies grown rapidly, but this growth has outstripped population expansion, so that GNP per person has increased substantially (by 16 per cent for high income economies and by 61 per cent for lower income economies). So over the past decade APEC economies as a group have become much bigger and much richer on a per person basis. In this regard lower income APEC economies have done much better than their counterparts elsewhere.

Chart 1.1 APEC economies have prospered over the past decade



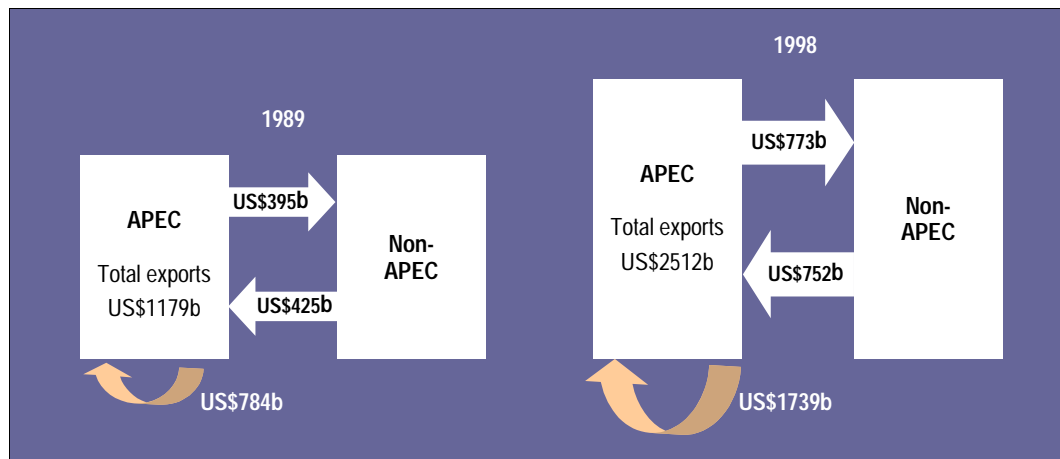
Data source: See technical note 1.

Expanding trade

The economic growth of APEC economies has been associated with a rapid expansion in trade — both within APEC and with other economies. Trade between APEC and non-APEC economies has doubled over the past decade and intra-APEC trade has more than doubled (chart 1.2).

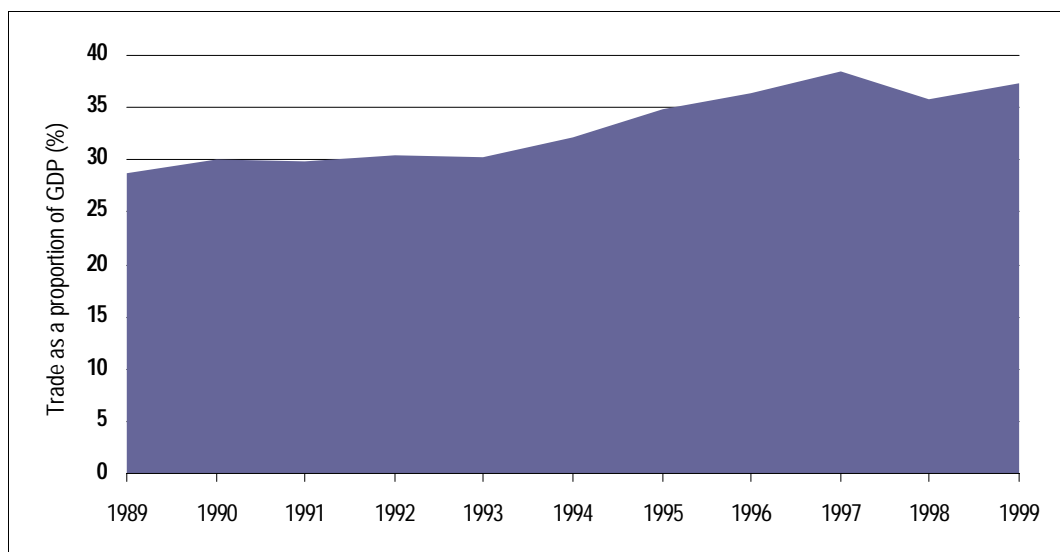
More telling about the expansion of trade of APEC economies is how the ratio of total trade to gross domestic product (GDP) has changed. This ratio rose from 27 per cent in 1989 to 33 per cent in 1999 (chart 1.3). This indicates the increasing integration of APEC economies with the world economy.

Chart 1.2 APEC trade has boomed ...



Data source: DFAT (1999a).

Chart 1.3 ... and APEC economies have become more trade oriented



Data source: See technical note 2.

Rising foreign direct investment

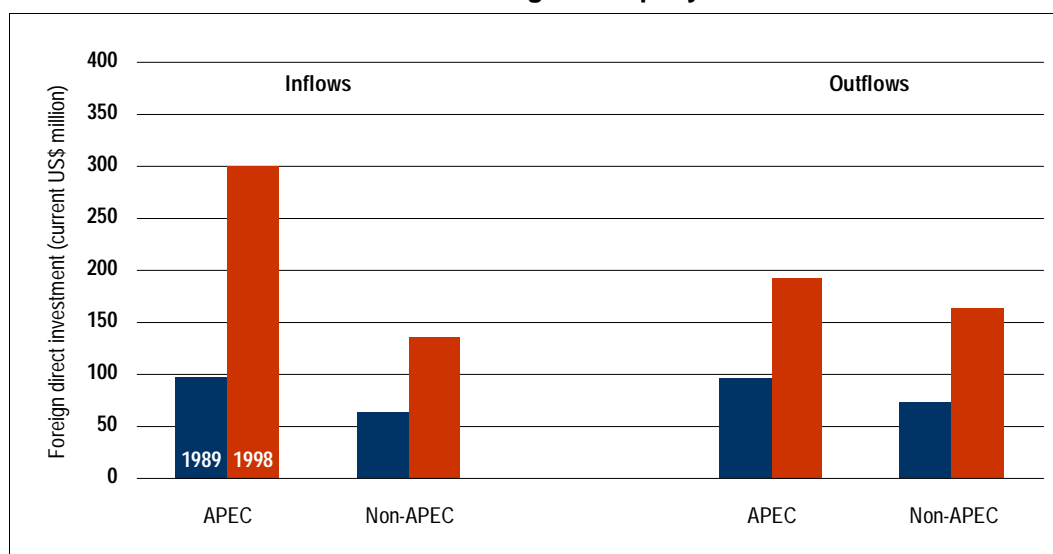
Another dimension of the deepening economic integration of the APEC economies with the world economy is the rapid growth of foreign direct investment (FDI) flows.

Foreign direct investment in APEC economies grew by 210 per cent over the period 1989–98 (chart 1.4). This expansion occurred despite the Asian financial crisis, which badly affected capital flows to the economies of several APEC members in 1997 and 1998. As well as being a major destination of foreign direct investment, APEC economies are a major source of such investment. Some US\$192 billion of world FDI flows originated in APEC economies in 1998.

Foreign direct investment has been much greater in lower income APEC economies than in their non-APEC counterparts; the Asian financial crisis did, however, impact on FDI flows to these APEC economies (chart 1.5).

Foreign direct investment has been very important for the developing APEC economies. Not only has it expanded the available capital for investment but it has facilitated the inflow of technology and technological know-how. The process of ‘catch-up’ whereby developing economies gain access to the technology and systems of more advanced economies has been an important explainer of the rapid growth of many of the lower income APEC economies.

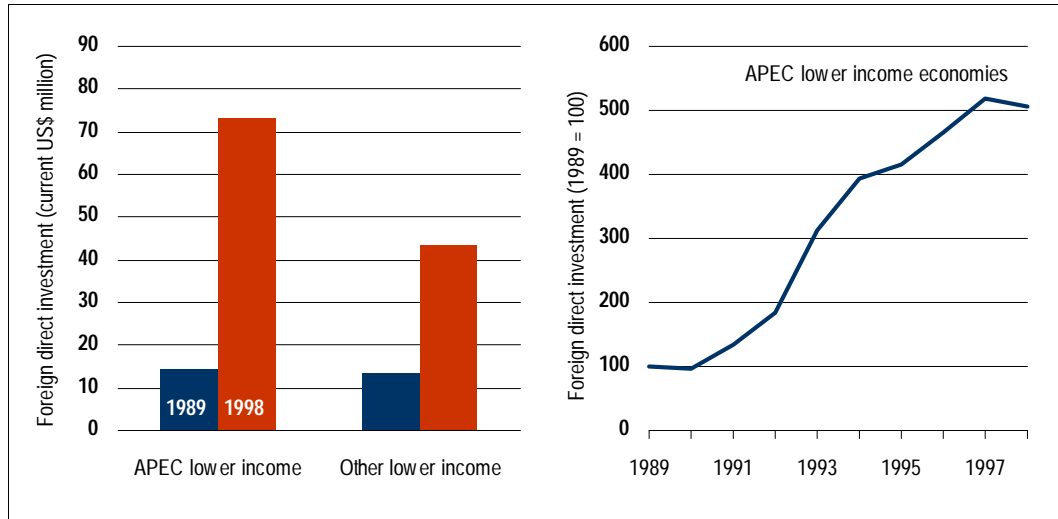
Chart 1.4 FDI inflows and outflows have grown rapidly



Data source: See technical note 3.

1 Growing prosperity and integration with the world economy

Chart 1.5 FDI flows to lower income APEC economies have grown particularly rapidly



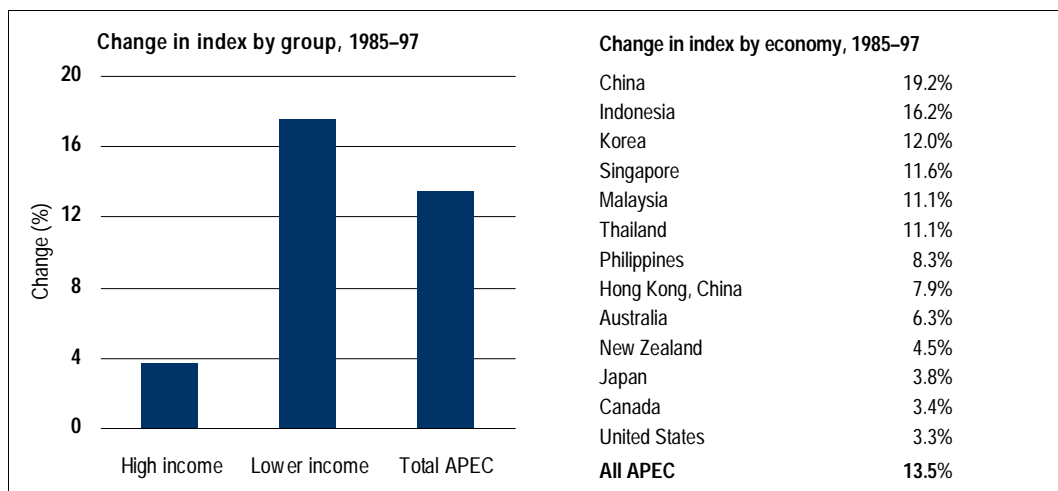
Data source: See technical note 3.

Positive social outcomes

Economic growth is an important indicator of improved welfare. But welfare has many dimensions. Besides rising average incomes, social progress is about the alleviation of poverty, improved health and education, better job opportunities and less unemployment.

As chart 1.6 shows, the UNDP Human Development Index — a measure of social progress that reflects income, education and life expectancy — increased between 1985 and 1997 for all APEC economies for which data are available.

Chart 1.6 Indexes of human development have improved



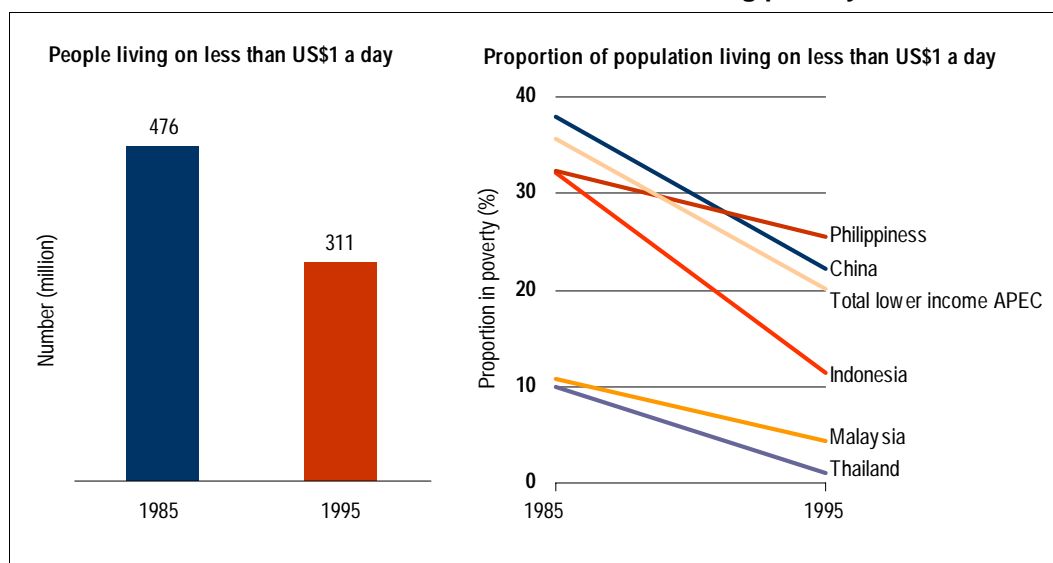
Data source: See technical note 4.

Success in alleviating poverty

World Bank figures show that there have been large reductions in the incidence of poverty in APEC economies, particularly in East Asia. The absolute number and proportion of people living on less than the World Bank’s uniform poverty line of US\$1 a day has fallen sharply in East Asian APEC economies (chart 1.7). This measure shows, of course, changes in only one dimension of poverty. But the success of APEC economies in improving a broader range of social indicators confirms a positive story about the wellbeing of the poor.

Even with this successful record, there are still large numbers of people in APEC economies living on less than US\$1 a day, and the crisis placed many more people at risk in some economies. Clearly APEC economies face an enormous challenge to make further progress on alleviating poverty.

Chart 1.7 East Asian APEC members have been alleviating poverty



Data source: Ajuja et al. (1997).

Generating new jobs

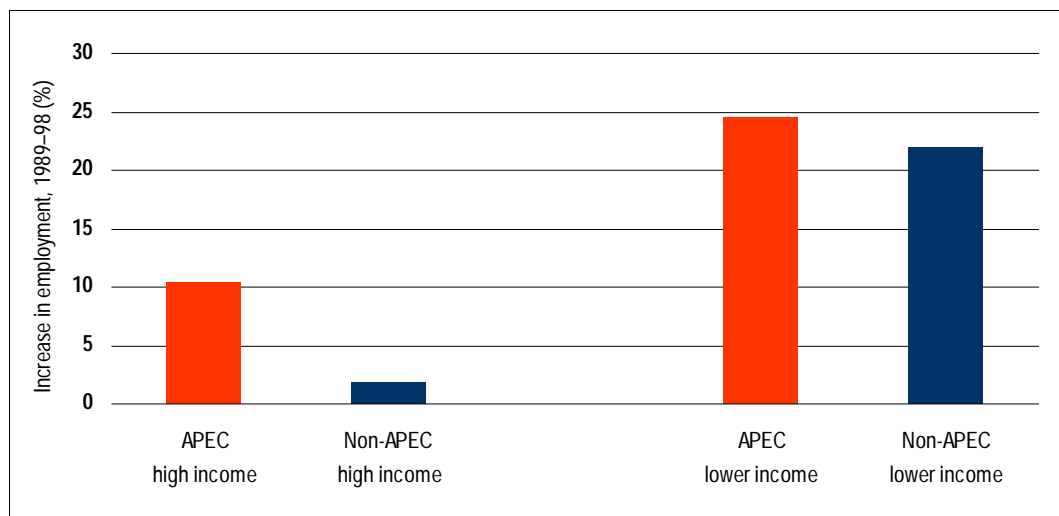
APEC economies generated 195 million new jobs in the period 1989–98. In this regard they considerably outperformed comparable economies in the rest of the world (chart 1.8).

One dark spot is unemployment, which increased in APEC lower income economies affected by the financial crisis. In addition, the average unemploy-

1 Growing prosperity and integration with the world economy

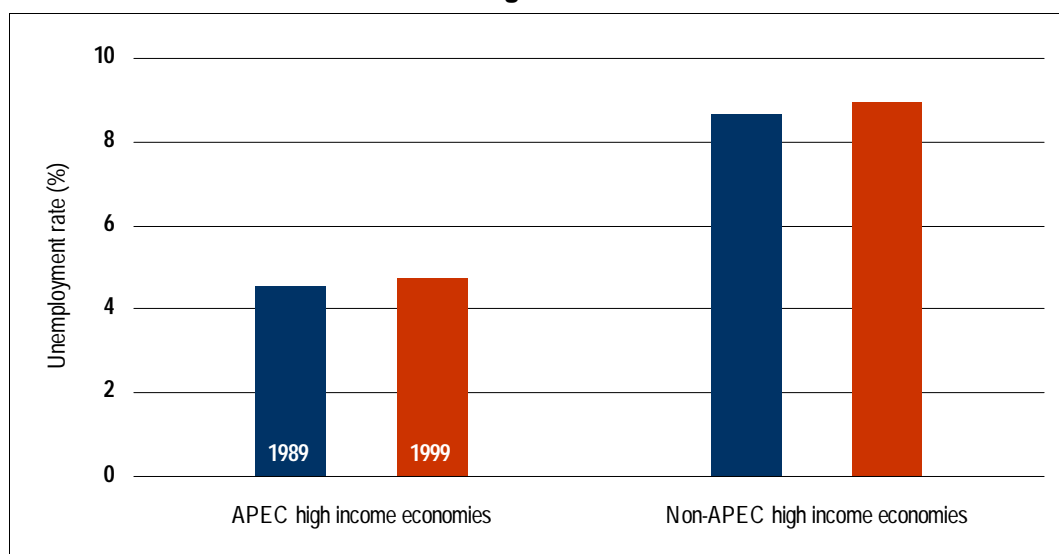
ment rate increased slightly in high income economies (chart 1.9). The aggregate change in high income economies disguises strong performance in some economies, and is partly linked to the effects of the crisis. Despite the mixed record in reducing unemployment, unemployment rates are generally much lower in these APEC economies than in other high income economies (chart 1.9).

Chart 1.8 New jobs have been created



Data source: See technical note 5.

Chart 1.9 Unemployment rates in APEC high income economies have increased but are lower than in other high income economies

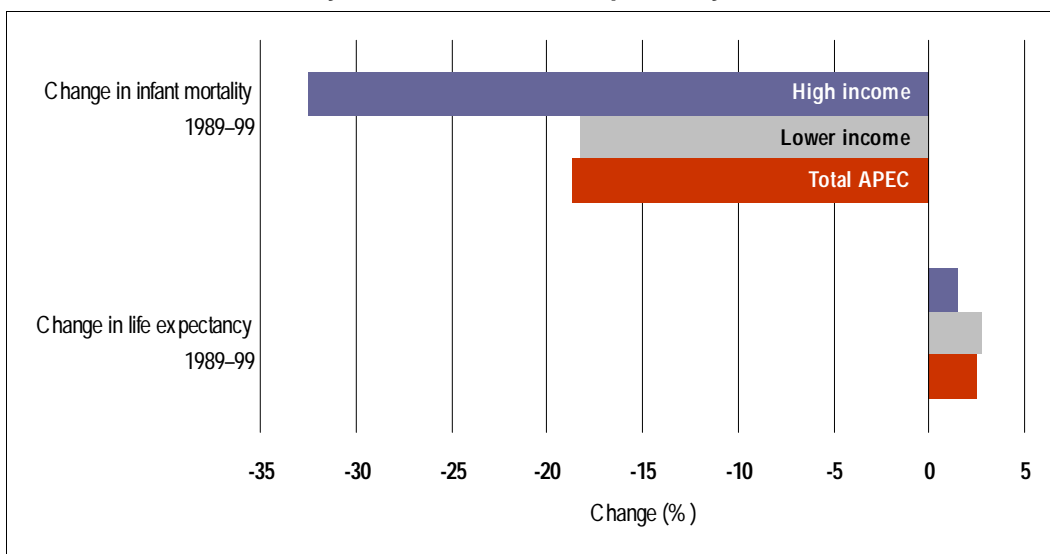


Data source: See technical note 5.

Improving health

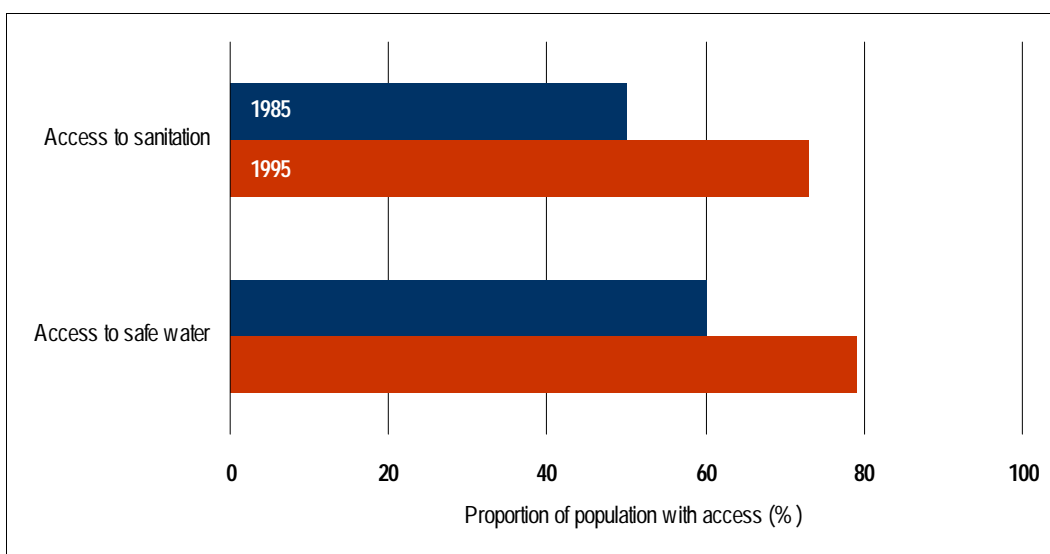
Despite the recent financial crisis, lower income as well as high income APEC economies have continued to improve basic indicators of health. Infant mortality has fallen and life expectancy has risen since 1989 (chart 1.10). Expanded access to safe water and sanitation has contributed to these improvements (chart 1.11).

Chart 1.10 Infant mortality has fallen and life expectancy has risen



Data source: See technical note 6.

Chart 1.11 Access to sanitation and safe water has expanded in lower income APEC economies

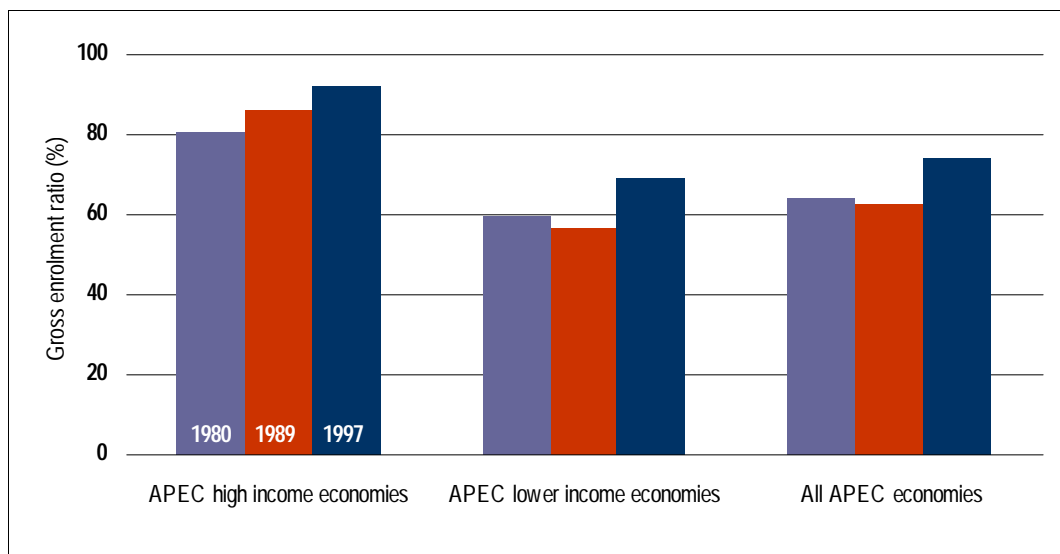


Data source: See technical note 7.

Continuing education achievements

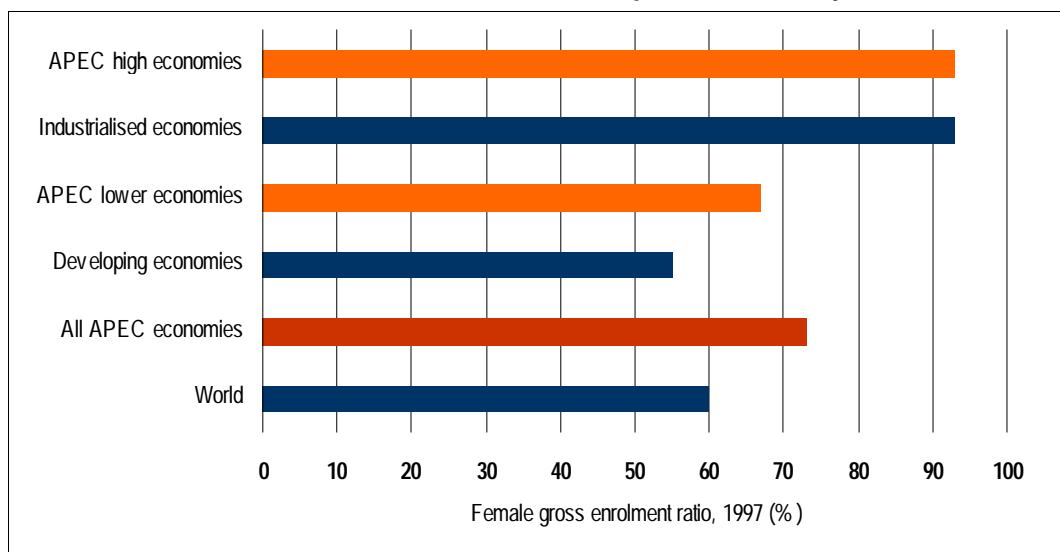
APEC economies have continued to expand investment in human capital as the combined enrolment rates in primary, secondary and tertiary education have increased in all lower income and most higher income economies (chart 1.12). Female enrolment rates in APEC economies compare favourably with those in counterpart economies (chart 1.13). Adult literacy rates in high and lower income economies are among the highest in the world (chart 1.14).

Chart 1.12 Education enrolment ratios have improved in APEC economies



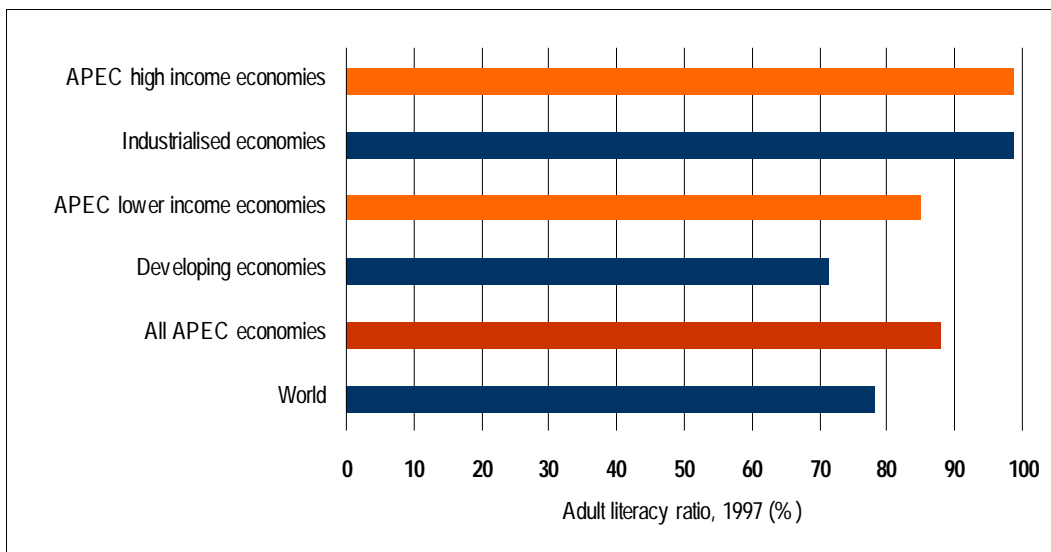
Data source: See technical note 8.

Chart 1.13 Women’s enrolment in education compares favourably



Data source: See technical note 9.

Chart 1.14 Adult literacy rates in APEC economies are high

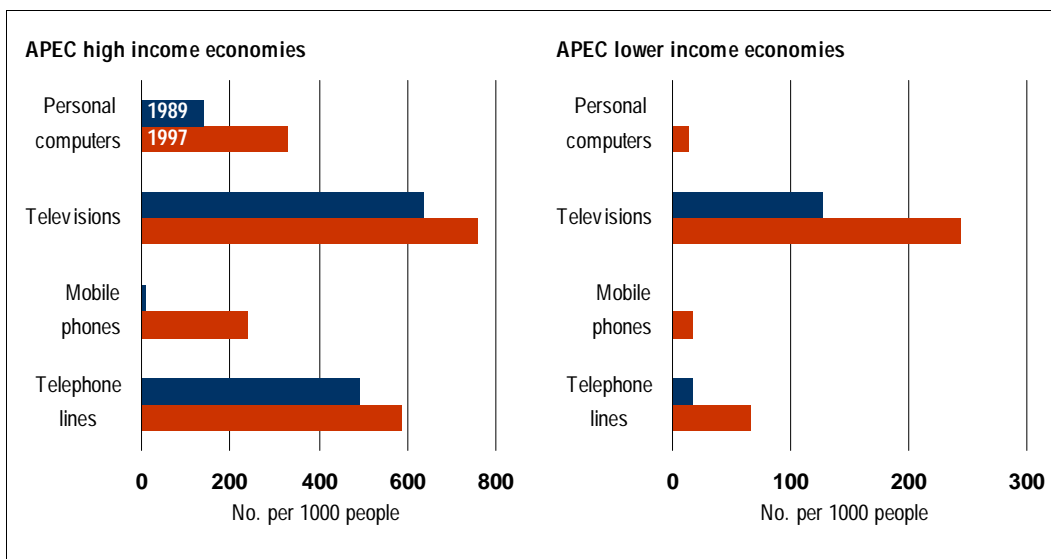


Data source: See technical note 9.

Expanding access to information technology

One aspect of both increased prosperity and growing domestic and international linkages in APEC economies is expanding access to information technology. The period from 1989 to 1997 saw rapid expansion in the use of telephone lines, mobile telephones, televisions and personal computers in all APEC economies (chart 1.15).

Chart 1.15 Access to telecommunications and computers has expanded rapidly



Data source: See technical note 10.

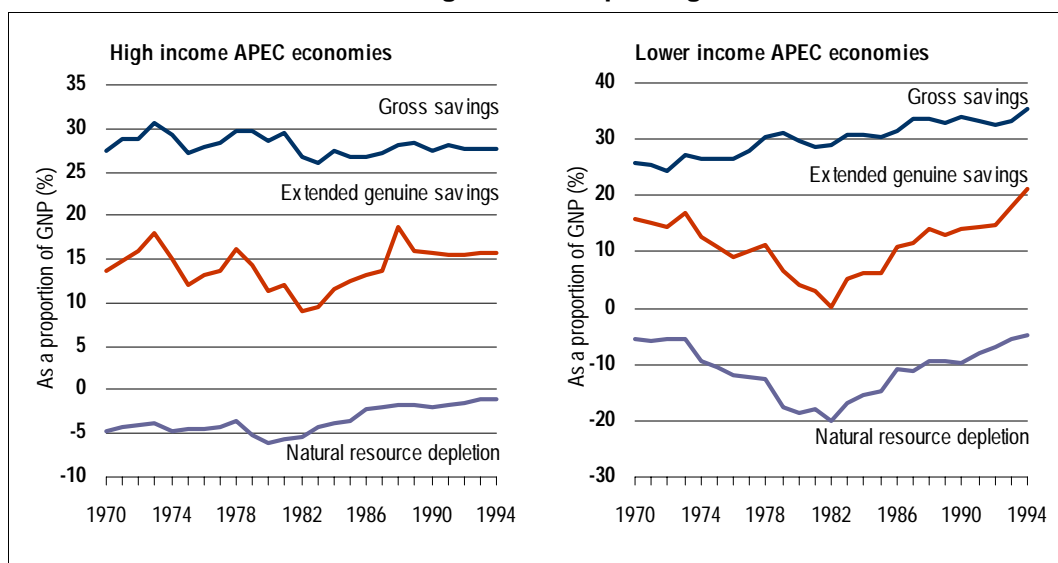
Improved resource management

APEC economies have been managing their natural resources more effectively as they have become better able to afford such management. According to readily available measures the rate of natural resource depletion has been declining in both high and lower income APEC economies. Chart 1.16 illustrates the improvement in terms of the savings of APEC economies adjusted for depreciation of physical capital, natural resource depletion and pollution damage. The ‘extended genuine savings’ — a measure developed by the World Bank — is positive for both high and lower income economies, so that the net increment to each economy’s capital stock is positive.

Clearly this indicator is only one of many that must be considered in determining improvements to resource management. Nevertheless, it is important to know that the available data suggest that in APEC economies current generations will pass on to future generations at least as much wealth per person as they now enjoy.

Chart 1.16 shows that in the lead-up to the mid-1990s both high and lower income APEC economies were saving more than they were depleting natural environmental assets. The change in APEC lower income economies after 1982 is particularly notable. From 1982 to 1994, their extended genuine savings rose to 20 per cent of GNP. That experience is opposite to the experiences in other parts of the world — notably Africa (World Bank 1997).

Chart 1.16 Natural resource management is improving

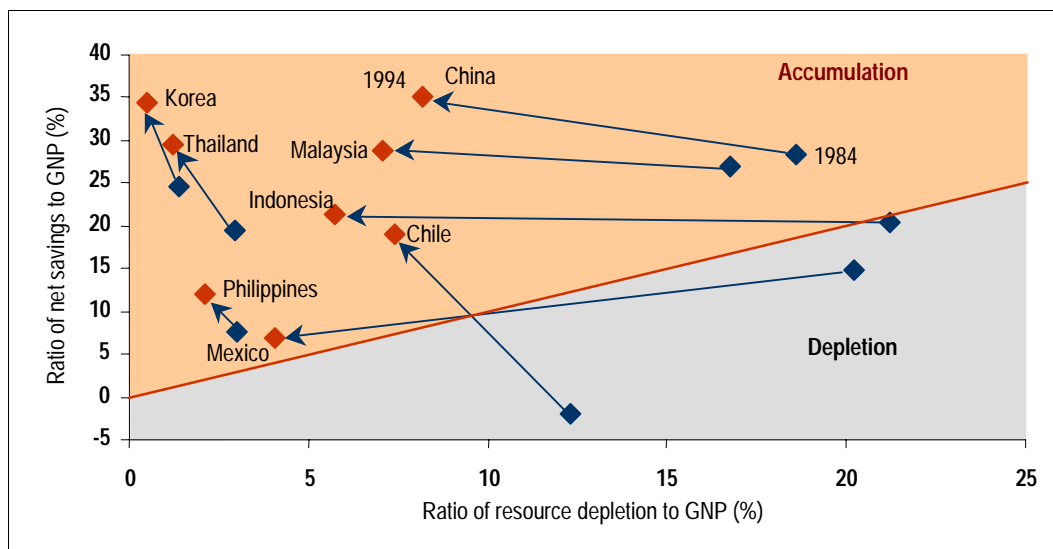


Data source: See technical note 11.

The evidence in chart 1.16 illustrates the improvements in resource management achieved by APEC economies, particularly developing economies. Moreover, other evidence suggests that no relatively affluent economy has lowered its environmental standards to increase the competitiveness of domestic producers (Vogel 1999).

Chart 1.17 shows a marked shift in resource management in developing APEC economies between 1984 and 1994. For each economy represented, the ratio of resource depletion to GNP fell below the ratio of net savings (gross savings less depreciation) to GNP. This evidence does not support the notion that environmental degradation has been 'exported' to developing APEC economies.

Chart 1.17 Resource management in lower income APEC economies improved between 1984 and 1994



Data source: See technical note 11.

2 Trade — the relationship between openness and performance

The strong performance of APEC economies over the past decade, and the quick rebound by economies affected by the Asian financial crisis are strongly linked to the policy and institutional directions they have been following.

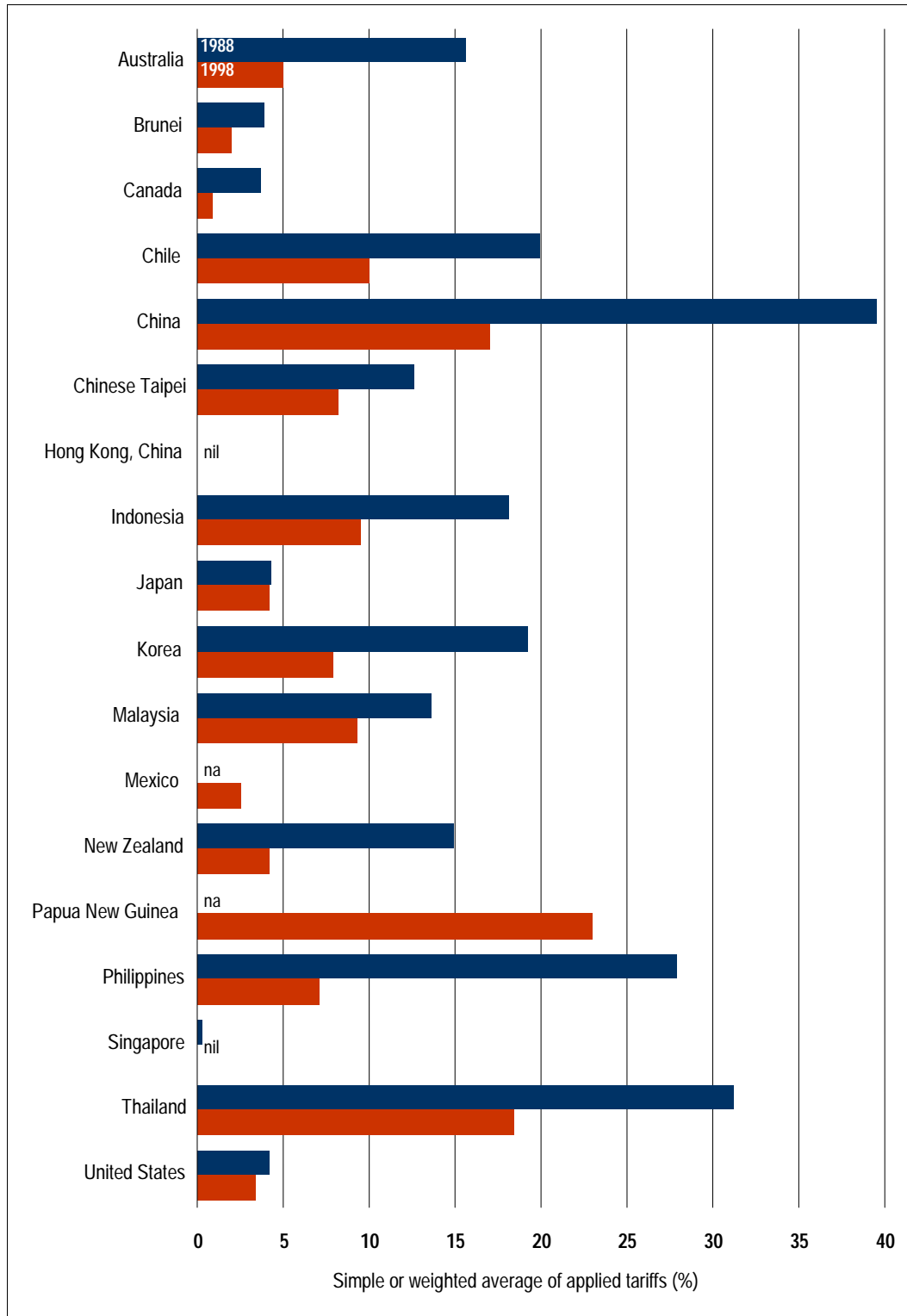
Unprecedented economic cooperation in the Asia Pacific region over the past ten years has produced results. APEC has provided the framework, and the Bogor goals a reference point, for the economic opening that has been indispensable for growth. APEC members have strengthened their economies — through unilateral, subregional and multilateral liberalisation paths and associated economic reforms — to create the sustainable growth and development needed to improve peoples' lives. This is the foundation and philosophy of APEC.

Trade barriers have fallen in APEC economies

APEC economies are liberalising trade and implementing economic reforms. Tariff barriers for all APEC economies have been progressively reduced over the past decade (chart 2.1). The fall has occurred for a variety of reasons and in a number of ways. Unilateral liberalisation, often considerably ahead of multilateral commitments, has played an important part. Other contributing factors have been the implementation of the Uruguay Round agreement and the formation of subregional trading arrangements.

APEC economies have been reducing barriers to trade unilaterally as they have assessed the benefits from open and competitive markets to be in their own best interest. A recent review by the Pacific Economic Cooperation Council (PECC 1999) shows that APEC members have taken significant steps to meet the Bogor declaration goal of free and open trade by 2010 for industrialised economies and 2020 for developing economies, with progress on key non-tariff measures as well as tariff reduction. That review also revealed, however, serious lagging in some sectors where there are domestic sensitivities and variable performance in addressing non-tariff barriers. As chart 2.2 shows, APEC economies still have major barriers to foreign direct investment.

Chart 2.1 Average tariffs in APEC economies fell between 1988 and 1998

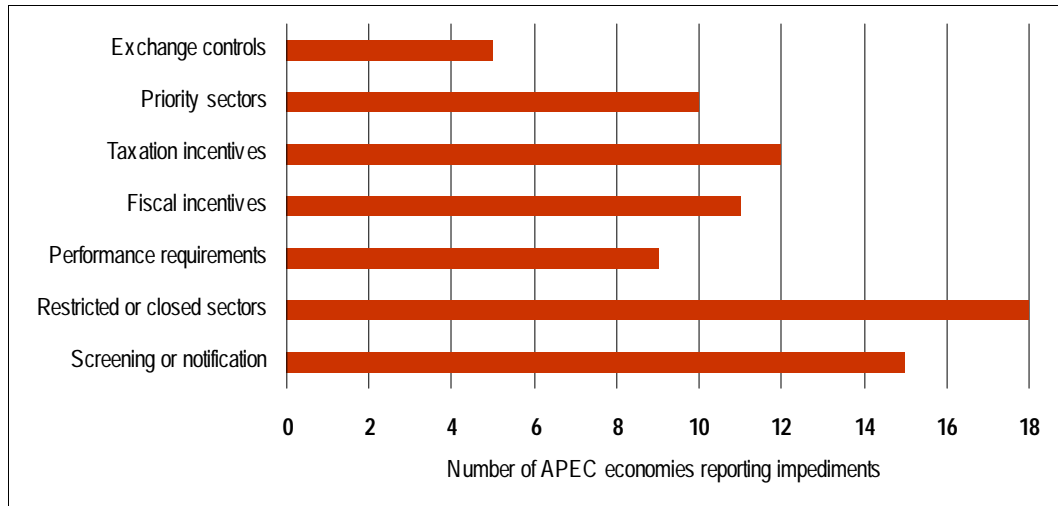


na Not available.

Data source: DFAT (1999b); see technical note 12.

2 Trade — the relationship between openness and performance

Chart 2.2 APEC economies still have major impediments to foreign direct investment

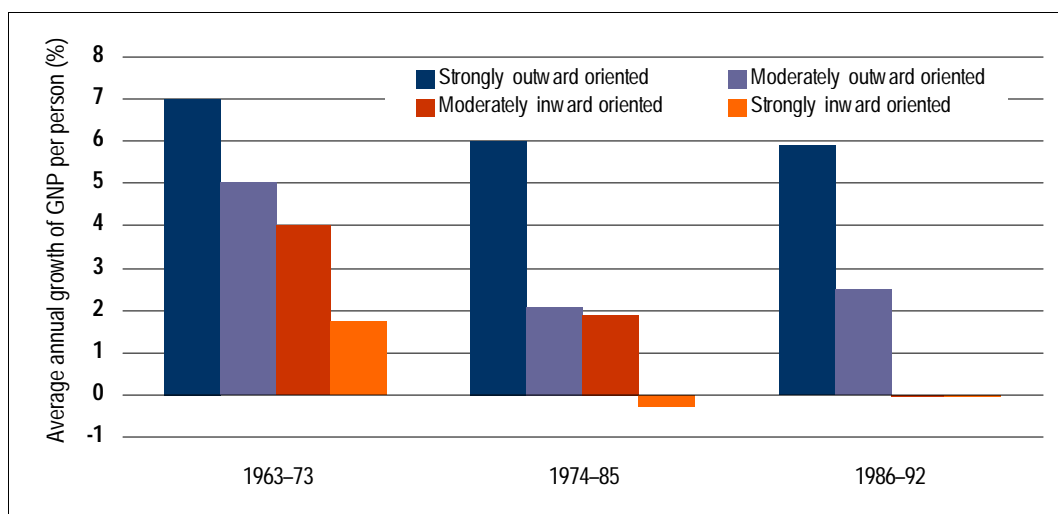


Data source: PECC (1995); see technical note 13.

Open economies grow faster

APEC economies have been liberalising trade with confidence that it will lead to increased prosperity. There is strong evidence of a positive link between openness and improved economic performance. The OECD (1999) recently reported a finding on this relationship from some earlier analysis of the relationship between trade orientation and living standards in developing economies (chart 2.3).

Chart 2.3 The rewards of openness in developing economies are higher living standards



Data source: OECD (1999).

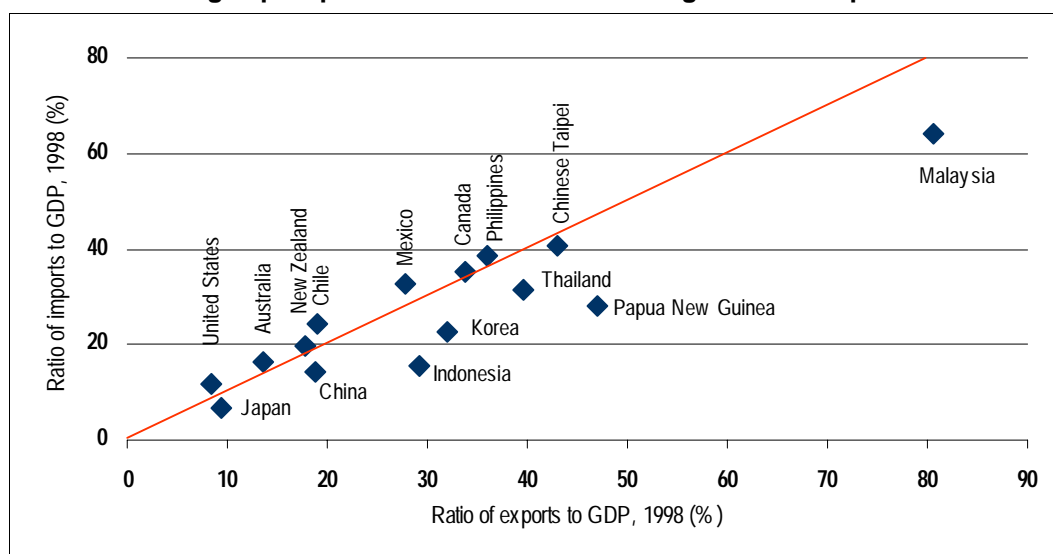
Those economies around the world with a strong outward orientation were found to have grown much faster than those economies with an inward orientation. Moreover, this relationship seems robust over different periods. Growth rates in strongly outward-oriented economies have been several times larger than those of strongly inward-oriented economies.

Reducing import barriers is the key to outward orientation

The strong focus on reducing barriers to imports in the APEC approach to integration with the world economy reflects a clear understanding of why economies trade and the source of the benefits from international trade.

It is no accident that the economies with the best export performances are those that devote a large share of GDP to imports (chart 2.4). Barriers to imports are a significant impediment to exports and outward orientation. One important way to achieve an outward orientation (in addition to avoiding measures that directly distort exports) is to address the impact on exports of the effects that restrictions on imports have on the exchange rate and input prices. Barriers to imports effectively tax exports and, in so doing, also curtail the capacity to finance foreign investment.

Chart 2.4 Strong export performance is linked to a high ratio of imports to GDP

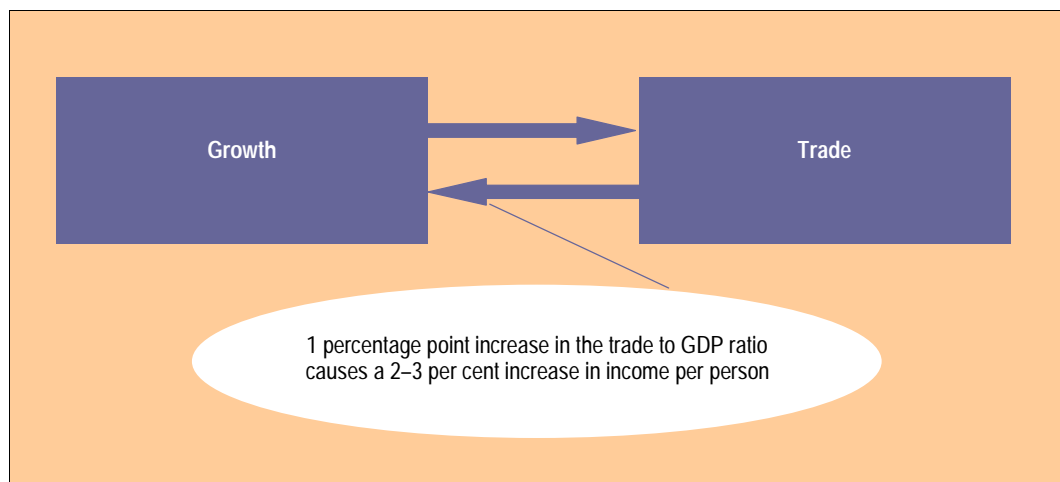


Data sources: DFAT (1999a); CIE calculations; see technical note 14.

Trade brings economic growth

Of course, a simple relationship between open trade and economic growth does not establish cause and effect. Trade is not the only determinant of growth and it could also be that as economies grow they trade more and so become more open. But recent work by researchers Frankel and Romer (1999) rejects this view. They rigorously examined the interdependency between trade and growth and found that, for every 1 percentage point increase in the ratio of trade to GDP, productivity (measured by GDP per person) is 2–3 per cent higher (chart 2.5).

Chart 2.5 Growth in trade leads to economic growth



Source: Based on Frankel and Romer (1999).

There are several reasons why being open to trade leads to rising productivity (and hence economic growth). Open markets encourage investment in those areas of each economy where there is a comparative advantage. With open trade each economy will concentrate on using its resources in those activities where it has an advantage relative to its trading partners. Trade between partners allows both parties to gain for mutual benefit.

Open markets also increase investment opportunities, and investment brings with it the technology and technological know-how of others. A large proportion of foreign investment is directly linked to trading opportunities, as multinational companies seek appropriate locations for segments of their global production networks.

Open markets also encourage competition while providing local firms with access to up-to-date equipment and high quality imports, and exposure to the

world's best management and production practices. The extra competition spurs innovation as producers seek to improve and differentiate their products in the marketplace ahead of their competitors. As new products or variations to old products are introduced or made in better ways, productivity in the economy rises.

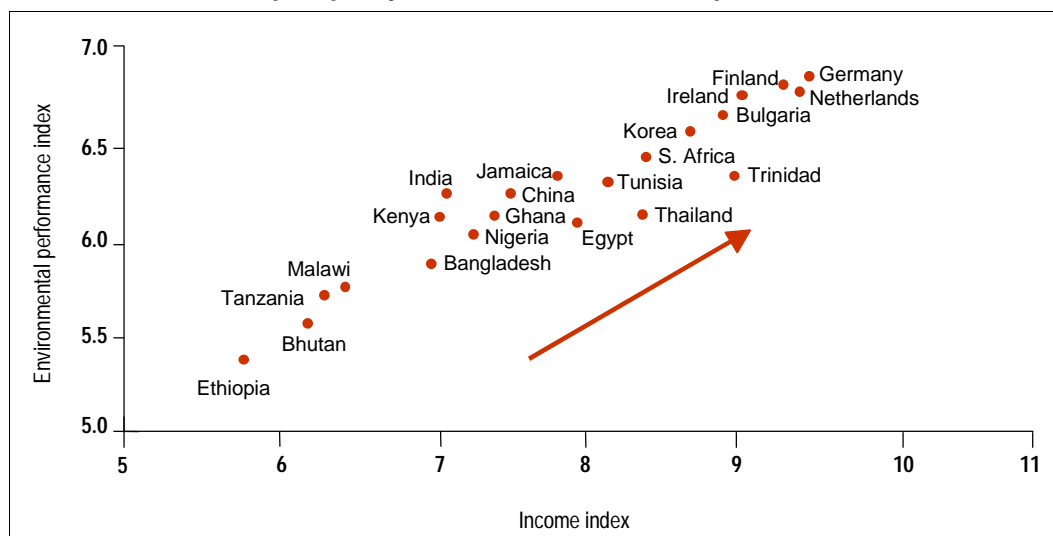
Trade leads to better social outcomes

Not only does more open trade cause higher economic growth, but higher growth leads to better social outcomes. The link between growth and other dimensions of society such as better health and education is self-evident — economic growth gives people and government the resources to tackle these issues. And it has been high growth, coupled with development-oriented policies, that has led to the large reduction in the incidence of poverty in APEC economies.

Another link between trade and social outcomes is less appreciated, however. That link is between economic growth and better environmental outcomes. Work undertaken at the World Bank shows that greater prosperity leads to better outcomes for the environment (chart 2.6).

The link between environmental performance and income is complex. But it appears that increasing prosperity need not come at the expense of the environment. Because open trade and investment policies have a big impact on

Chart 2.6 Economic prosperity need not come at the expense of the environment



Source: OECD (1999).

income growth, they can also facilitate the pursuit of environmental sustainability. The main reason for this is that, as people prosper, their capacity to afford better standards improves. Once people have adequate food and shelter they seek things such as transport and telephones. After that they start to want better health, entertainment, holidays and high quality goods. It has been found that, after a point, people start to demand a better environment. They want cleaner air, cleaner water, clean parks and so on.

That is not to say that consumers in all APEC economies are receiving their desired levels of clean water or clean air — clearly they are not. Nor is it to say that markets left to themselves will deliver these desired environmental outcomes — they will not. Successful outcomes for the environment can be achieved only with appropriate policies, the determination of which is a complex matter. The point to note here is that as incomes rise people increasingly demand that government delivers desirable environmental outcomes. Whether that occurs or how well it occurs introduces the next issue — the central role of good governance.

3 The APEC dimension

The emergence of APEC in 1989 reflected a realisation by economies that the accomplishments achieved through deepening economic integration carried two important implications.

First, the increasing scale of Asia Pacific economic transactions, and their expanding relative importance to all economies in the region, implied that policy decisions taken without awareness of their regional implications can damage the beneficial process of market integration. Second, the success of economic integration in the region points to the opportunity for further gains through the provision of a more certain and open environment for market exchange (Garnaut 1999).

The need for a framework to preserve and extend the processes that support openness and reform was and remains the rationale of APEC.

Box 3.1 The APEC framework supporting openness and reform

The APEC framework provides a three stage mechanism for Asia Pacific economic cooperation:

- identifying impediments to free and open trade and investment and obstacles to well-regulated domestic markets
 - done at the working level, through consultations, seminars, research and studies, to identify the impediments to open trade and investment, the obstacles to the development of efficient, flexible and competitive domestic markets and the avoidable costs imposed on business by administrative procedures that APEC cooperation can reduce or eliminate
- developing policy principles and options for implementing policies to achieve trade and investment liberalisation and facilitation, and domestic market reform
 - based on identifying the impediments, obstacles and avoidable administrative costs
- supporting the adoption of policy principles and the implementation of options through economic and technical cooperation (ecotech)
 - to develop the capacity of APEC economies to put in place the policies and best practices developed within APEC

Over the past decade APEC economies have continued to put into practice the basic lessons learned about achieving economic prosperity — one being that sustained prosperity depends on doing a number of things right, not just avoiding mistakes. What needs to be done was articulated in the commitment given by economic leaders in Bogor in 1994 to achieve free and open trade and investment.

APEC cooperation has provided a framework — through policy dialogue and economic and technical cooperation — to develop the capacity needed to implement trade and investment liberalisation and to strengthen domestic markets to achieve these goals (box 3.1).

The APEC framework acts as a reference point

APEC's framework has provided a reference point for members as they open their economies and implement domestic regulatory reforms necessary for sustainable long term growth. Each member has drawn on, and contributed to, the framework in pursuing the options for sustaining and expanding integration with the Asia Pacific — and global — economy. Economic and technical cooperation to support the implementation of growth generating policies has been an integral part of APEC cooperation.

At the most fundamental level of the framework is the record each economy has made of its own progress — reflected in Individual Action Plans updated annually. While there would appear to be enormous scope for improving the clarity of the information presented, these plans unambiguously record the significant changes that are occurring. They show that, while much remains to be done, APEC economies have held firm in their resolve to pursue reforms, even during the Asian financial crisis.

One compelling lesson from the crisis is that, to assure sustained growth, policy, institutional and governance structures must be continually refined to meet emerging challenges and evolving risks. In this regard, APEC provides a valuable forum for economies involved in the constant search for appropriate refinements, since it supports effective networking and the sharing of experiences between practitioners and decision makers (box 3.2).

Box 3.2 APEC and the process of institutional change

Institutional change is one of the most complex challenges that confront societies in their search for means of assuring sustained expansion in the wellbeing of their members. At the deepest level, institutions embody the formal and informal rules and norms that guide behaviour. Societies develop all sorts of mechanisms to codify, disseminate and ensure adherence to these rules and norms. These institutions are shaped by many factors and, while the purposes they serve may be common across many economies, their shape and functioning vary according to cultural, historical and other factors unique to different societies.

Institutions, especially those relating to economic transactions, must constantly evolve, as technological change and market innovation create new opportunities and risks.

But their evolution must be relevant to the specific context in which the institutions operate. So no one specific form or structure will apply to all economies, even if the challenge prompting change is the same.

Forums such as APEC can make a powerful contribution to the search for new institutional structures, because they facilitate a sharing of approaches and experiences to common problems. This can help those charged with encouraging and overseeing institutional change to explore alternative approaches and their ramifications. And it can help them to learn from how their counterparts have addressed similar issues, without receiving 'one-size-fits-all' prescriptions. APEC support for institutional capacity building also helps in the development of technical and managerial capabilities so that reshaped institutions can function effectively.

The financial crisis highlighted the value of APEC cooperation

The crisis brought home the particular value of APEC cooperation to strengthen the capacity of economies to implement liberalisation and domestic economic reforms. Negative perceptions about the quality of institutional aspects of economic governance played a particular role in the chain of events surrounding the crisis. Institutional impediments to a rapid response to the crisis and to actions to quickly restore confidence were factors in the subsequent contagion.

As the former Prime Minister of Thailand, Anand Panyarachun, noted:

... in our exuberance to reap the fruits of capitalism the need for such mechanisms [the checks and balances such as transparency and accountability] was unheeded. (ADB 1999, p. 1)

The Asian financial crisis particularly underlined the importance of capacity building to:

- strengthen economic governance, particularly in the banking, finance, regulatory and corporate sectors;
- deal with the social impacts of the crisis on vulnerable groups;
- promote the adoption of international standards and best practices;
- help economies cope with the transition to more open and competitive markets; and
- build capacity for further reform.

A survey of economic governance capacity building, submitted to the 1998 Leaders' Meeting as part of APEC's response to the crisis, confirmed that APEC economies are heavily involved in cooperation activities directed at improving economic governance in the region. This involvement is occurring through APEC initiatives, extensive bilateral programs and support for the programs and activities of the international financial institutions (CIE 1998).

The scope to broaden APEC's work in this area is recognised in work programs for coming years. The crisis has highlighted the need to acknowledge that openness — broadly defined — is a necessary, but not a sufficient, condition for growth and prosperity. Thus pursuit of APEC liberalisation objectives must be accompanied by actions to ensure that institutions of governance evolve to match changing demands and the imperative of managing risk.

APEC Finance Ministers have supported institutional change ...

An important component of APEC's response to the crisis has been developed through the APEC Finance Ministers process, which accelerated work on collaborative initiatives targeting the soundness of financial systems, the quality of corporate governance, and stronger accounting and financial reporting practices (box 3.3).

Box 3.3 APEC Finance Ministers and international financial reform

As part of APEC's response to the Asian financial crisis, APEC Finance Ministers established a range of collaborative initiatives to strengthen regional financial and capital markets and to support freer and stable capital flows in the Asia Pacific region.

These included:

- strengthening financial market supervision, by improving domestic training of banking supervisors and securities regulators and enhancing international cooperation in such training programs;
- assessing bank supervisory regimes, through a survey of key APEC economies which identified the need for closer contacts among APEC banking supervisors;
- reforming pension systems, through regional forums and seminars;
- improving credit rating agencies and disclosure, through workshops on best practices for domestic rating agencies and surveys of codes of conduct in rating agencies;
- developing domestic bond markets, through surveys, workshops and preparation of a compendium of best practices and guidelines;
- strengthening corporate governance, through symposiums and reports suggesting actions to raise corporate standards, strengthen accounting and financial reporting practices, and improve the regulation of the life insurance industry;
- promoting capital account liberalisation consistent with macroeconomic and financial stability, through work on a Voluntary Action Plan for Supporting Freer and Stable Capital Flows; and
- supporting privatisation, through the establishment of the APEC Privatisation Forum.

... as have other APEC activities

Many other aspects of work within APEC have also contributed — directly and indirectly — to facilitating the evolution of stronger governance institutions in the region.

APEC's framework for cooperative policy development has led, for example, to the development of principles on investment, principles to guide competition and regulatory reform and principles for government procurement. Work in other APEC forums has supported the development of harmonised standards (for example, the world's first Mutual Recognition Arrangement for Telecommunications Equipment and the Mutual Recognition Arrangement for Electrical and Electronic Equipment), the simplification of administrative

procedures (for example, with regard to customs processing and intellectual property rights regimes) and the development of energy policy principles to guide energy policy reform. APEC economic and technical cooperation activities and the work of the Human Resource Development Working Group have also targeted capacity building in important areas related to governance.

Why does APEC support for better economic governance and institutional capacity matter?

The importance of good economic governance for sustainable development — both economic and social — is not new to APEC. There is a longstanding record of cooperation in capacity building through economic and technical cooperation and human resource development activities among APEC economies.

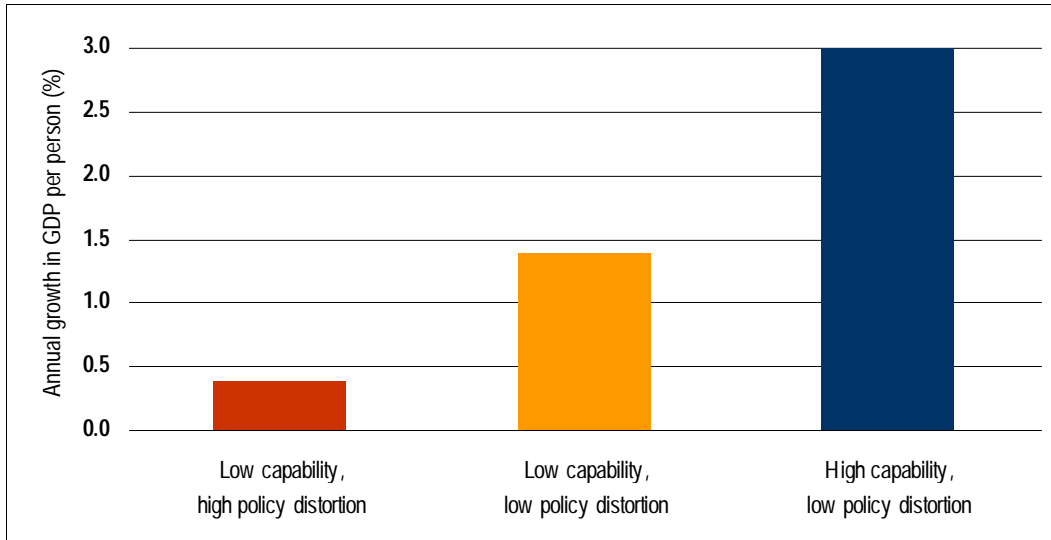
There is a strong link between governance and economic performance. Economic liberalisation must be embedded in an effective system of governance if risks are to be managed and economic and social development assured. In an increasingly integrated world, the avenues for consumers, producers and investors to respond both positively and negatively to policy and institutional developments are increasing. Open trade and open financial and capital markets mean that the consequences of poorly developed institutions, weak cultures of corporate governance and inappropriate systems of regulation and supervision can be transmitted rapidly, and sometimes can be quite drastic.

How important is governance and institutional capacity?

Research undertaken at the World Bank (1997) shows that in recent years economies with stronger institutional capability have grown twice as fast as those with lower capability (chart 3.1).

Of greater importance is that economies with high institutional capability that also had better policies grew nearly eight times as fast as those with low institutional capability but that also had a high degree of policy distortion. Good policies and more capable institutions to implement them produce better results. Inappropriate policies and weak institutions impede sustainable economic growth, poverty reduction and social development.

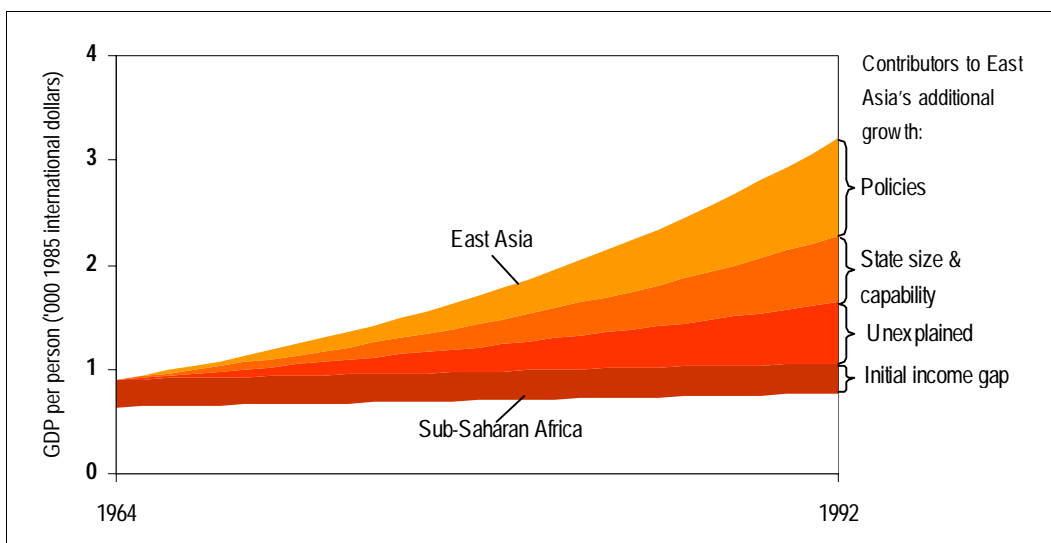
Chart 3.1 Economies with good economic policy and strong institutional capability grow faster



Data source: World Bank (1997).

Another example of the importance of good policies and capable governments is provided by a comparison of the performance of East Asian economies and those of sub-Saharan Africa. After controlling for variables such as initial income and education, researchers found that better policies and better state capabilities explain the largest part of East Asia’s superior economic performance from 1964 to 1992 (chart 3.2). ‘Policies’ include openness to trade and investment, lack of price distortions and high levels of education and investment.

Chart 3.2 Good governance helps to explain the income gap between East Asia and Africa



Data source: World Bank (1997).

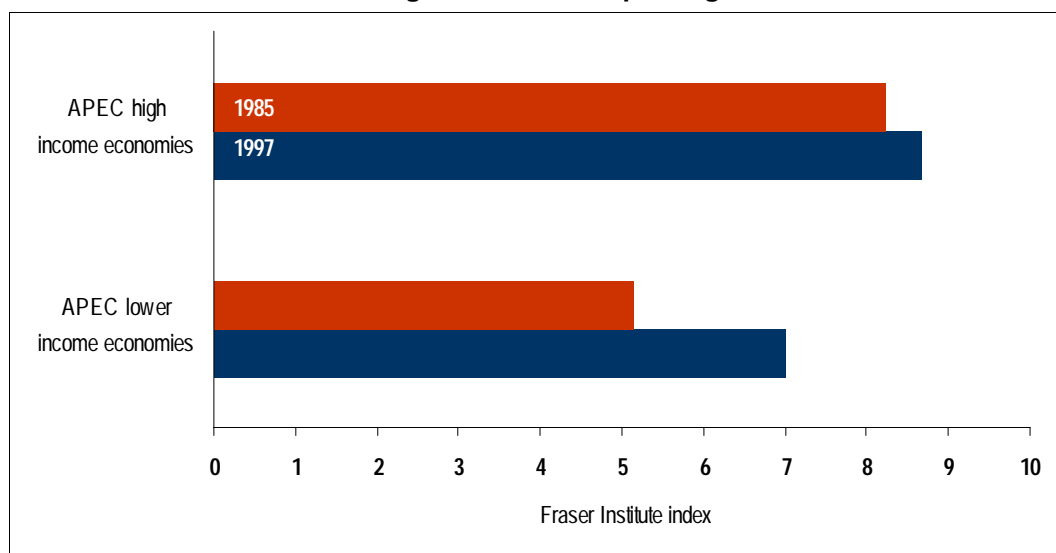
Good governance is not only important for economic progress; it is also essential for progress in social development. Provision of public health, infrastructure, social amenities and other public goods requires government intervention, whether by direct provision of the public good or service or by assignment of property rights and creation of a 'market' for private operators.

Governance in APEC economies is improving

APEC economies have been working hard to improve governance, especially in the aftermath of the Asian financial crisis. There are no simple measures of good governance and appropriate institutions — but some do reflect market and institutional judgments about the quality of governance across economies.

One well-known index, published by the Fraser Institute, placed nine APEC economies in the twenty (out of 123) highest ranked economies in 1997 (Gwartney, Lawson and Samida 2000). According to this index — which reflects aspects of government expenditures, monetary policy and price stability, access to foreign currencies, legal structures and property rights, and controls on international trade and exchange and on capital and financial markets — the ratings of APEC economies improved during the period 1985–97 (chart 3.3).

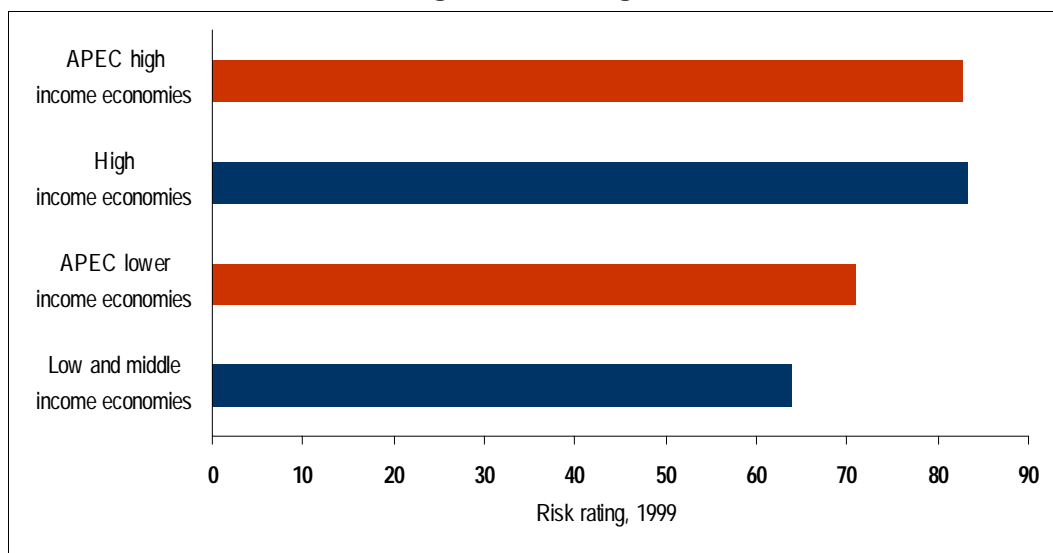
Chart 3.3 One measure shows governance is improving in APEC economies



Data source: See technical note 15.

APEC economies also have good risk ratings. As chart 3.4 shows, risk ratings for these economies are high, reflecting lower expectations of default on debt — a measure of the market valuation of the quality of governance.

Chart 3.4 **APEC economies have good risk ratings**



Data source: See technical note 16.

Economic governance offers a continuing opportunity for APEC

Because each society has its own culture and history, the economic and social outcomes and hence experiences of each society are different, so the best institutional structure will be different for each society. There is no ‘one-size-fits-all’. What should be common for each, however, is how well the search for better solutions is carried out, and how institutions evolve over time so that each society can perform at its best to achieve desired economic and social outcomes.

The 1998 survey of economic governance in APEC underscored the value attached to networking and sharing experiences among practitioners involved in various aspects of governance. APEC was seen to provide an ideal framework to support such networking. This is an area where APEC has a powerful and continuing role to play — identifying and disseminating the lessons to be learned and providing information and experiences that assist economies to refine their own institutions.

4 APEC cooperation — the challenges ahead

APEC economies have prospered over the past decade as they have opened up further to international trade and investment and become more integrated with the world economy. APEC cooperation in developing the necessary sound policy frameworks and in building government capacities to implement policies has played a fundamental role in creating this prosperity.

Nevertheless, economic, corporate and social systems in the region remain vulnerable to the underlying weaknesses revealed by the recent financial crisis. Sustained growth is needed to generate the resources to invest in areas such as health, education and environmental improvement, and to implement social safety nets to address the needs of those people adversely affected by change.

APEC cooperation can continue to support member economies to implement new strategies or modify old ones as they strive to:

- liberalise and facilitate trade and investment, and strengthen markets so that they are more efficient, flexible and competitive;
- maintain macroeconomic stability and sustain reform, particularly financial sector management and banking sector reforms;
- strengthen legal systems — particularly the laws governing business activity — as well as the enforcement of those laws to create the best possible conditions for private sector growth;
- adopt market-oriented policy frameworks to support technological upgrading and human resource development, and to enable economies to participate fully in the new economy; and
- deal with infrastructure bottlenecks by, for example, removing barriers to entry and other restrictions to competition in order to facilitate adequate private sector investment.

To address the challenges ahead and build robust economies capable of withstanding unforeseen risks requires yet more openness, integration and regional cooperation and better governance. The task is now to identify how best to support continued efforts by APEC members to follow this path.

Technical notes

To facilitate the graphical representation of data, in some instances APEC economies have been assigned to either a 'high income' or a 'lower income' group. The allocation of economies to income groups used in this report is based on the classifications used by the World Bank.

Only 17 of the current 21 APEC members have been included when reporting statistics. Four APEC economies — Brunei Darussalam, Peru, the Russian Federation and Vietnam — have been omitted from statistics reported in this publication. These economies were omitted either because they have only recently become members of APEC (Peru, the Russian Federation and Vietnam became members in 1998) or because of the difficulty of obtaining comparable data due to the economy's relatively small size (Brunei Darussalam). In cases where relevant data are not available for other economies, these too have been omitted.

Technical note 1 (chart 1.1)

Gross national product figures for APEC members and world income group aggregates for the years 1989–97 were obtained from the World Bank's World Development Indicators 1999 CD-ROM. GNP figures for 1998 and 1999 were estimated by applying anticipated real gross domestic product growth rates obtained from the International Monetary Fund's *World Economic Outlook 2000* to the reported 1997 data and (then derived) 1998 figures.

Population figures for APEC members and world income group aggregates for the years 1989–97 were also obtained from the World Bank's World Development Indicators 1999 CD-ROM. Population figures for 1998 and 1999 were estimated by applying the estimated annual population growth rates over the period 1995–2000 to the reported figures. The estimated annual population growth rates were taken from the World Development Indicators 1999 CD-ROM.

The World Bank does not report data for Chinese Taipei. Data for Chinese Taipei were derived from a range of sources, including the Australian Department of Foreign Affairs and Trade's publication *The APEC Region Trade and Investment* (various years) and the Asian Development Bank's *Asian Development Outlook 1999*, or were derived from other Australian Department of Foreign Affairs and Trade (DFAT) sources.

Technical note 2 (chart 1.3)

Trade and nominal GDP values for the years 1989–97 were obtained from the World Development Indicators 1999 CD-ROM. Trade and GDP figures for 1998 and 1999 were either obtained from DFAT sources or estimated using anticipated income group growth rates reported in the IMF's *World Economic Outlook 2000*. Trade and GDP estimates for Chinese Taipei were derived from a variety of sources (see above).

Technical note 3 (charts 1.4 and 1.5)

FDI inflow and outflow figures over the period 1989–98 were taken from the IMF's *International Financial Statistics 1999 Yearbook* (lines 78bed and 78bdd respectively) and/or from UNCTAD's *World Investment Report 1999*. In the few instances where data were not available, FDI inflow and outflow figures were estimated by assuming that the previous year's growth rates applied. Comparable inflow and outflow data for Chinese Taipei and Hong Kong, China, were not available prior to 1992, so these economies are excluded from the statistics for the APEC economies presented in chart 1.4.

Technical note 4 (chart 1.6)

Human Development Indexes for APEC economies for 1985 and 1997 were obtained from the UNDP's *Human Development Report, 1999*. APEC economies were then aggregated to income groups using population weights. The index is not reported for Chinese Taipei, and the index values for Chile, Mexico and Papua New Guinea are not available for 1985. Hence these economies were omitted from chart 1.6.

The Human Development Index reflects three indicators of development — life expectancy at birth, combined gross school enrolment ratio and adult literacy, and income per person.

Technical note 5 (charts 1.8 and 1.9)

Employment figures for chart 1.8 were obtained from the International Labour Organization's LABORSTA database (<http://laborsta.ilo.org>).

Unemployment rates and numbers of unemployed persons for 1989 for APEC high income economies and 'rest of world' high income economies were obtained from the LABORSTA database. Unemployment figures for 1999 were obtained from OECD's labour statistics database (<http://oecd.org/std/lfs>) and the IMF's *World Economic Outlook 1999*. Total APEC and rest of world unemployment figures were calculated using labour

force weights, which were derived using data on unemployment rates and the number of unemployed persons obtained from the LABORSTA database and IMF and OECD data sources.

Technical note 6 (chart 1.10)

Life expectancy and infant mortality for the years 1989 to 1997 were obtained from the World Development Indicators 1999 CD-ROM. Values for 1998 and 1999 were estimated by calculating the annual percentage improvement in life expectancy and infant mortality over period 1989–97, and then applying these rates to the 1997 (and the then derived) 1998 values.

Total APEC and APEC income group totals were derived by using population and crude birth rate weights for life expectancy and infant mortality respectively. Crude birth rates were not available for all APEC economies in 1989. However, a complete set of rates was available for 1990. These rates were used to weight individual 1989 infant mortality figures for APEC economies to derive aggregate estimates of infant mortality.

To check for consistency, the estimated 1998 and 1999 values were compared with life expectancy and infant mortality rates reported elsewhere — for example, in the World Health Organization's *1999 World Health Report*.

The World Bank does not report life expectancy and infant mortality rates for Chinese Taipei; hence Chinese Taipei was omitted from the chart.

Technical note 7 (chart 1.11)

The proportions of the populations of APEC economies with access to safe water and sanitation were obtained from World Development Indicators 1999 CD-ROM. Population weights were used to derive lower income group aggregates. Safe water and sanitation access values for 1985 and 1995 were not available for all APEC lower income economies. Where this was the case, 1985 and 1995 values were approximated by using the closest available year's data. China was not included due to a lack of data.

Access to safe water is the proportion of the population with reasonable access to an adequate amount of safe water (20 litres a day per person). In urban areas the water source may be a public fountain or standpost located not more than 200 meters away. In rural areas the definition implies that household members do not have to spend a disproportionate part of their day fetching water. The definition of safe water has changed over time.

Access to sanitation refers to the proportion of the population with at least adequate human waste disposal facilities that can effectively prevent human, animal and insect contact with excreta.

Technical note 8 (chart 1.12)

Combined primary, secondary and tertiary level education gross enrolment ratios were obtained from the UNESCO Institute for Statistics education database (<http://unesco.org>). The gross enrolment ratio is defined as total enrolment in a specific level of education, regardless of age, expressed as a percentage of the official school age population corresponding to the same level of education. Gross enrolment ratios are used to show the general level of participation in a given level of education and to indicate the capacity of the education system to enrol students of a particular age group.

A high gross enrolment ratio generally indicates a high degree of student participation in that education level, whether students belong to the official age group or not. Gross enrolment ratios can be in excess of 100 per cent due to the inclusion of over-aged and under-aged students because of early or late entrants, grade repetition or, as in the case of Australia in the 1990s, retraining of the long term unemployed.

Where the UNESCO education database did not report an economy's gross enrolment ratios for 1980 and 1989, the closest year's ratio was used as a proxy. The UNDP's *Human Development Report, 1999* was used to supply 1997 gross enrolment ratios when they were not available on the UNESCO education database.

Technical note 9 (charts 1.13 and 1.14)

Data on female gross enrolment ratios (chart 1.13) and adult literacy rates (chart 1.14) were taken from the UNDP's *Human Development Report, 1999*. Rates for individual APEC economies were aggregated using population weights.

Technical note 10 (chart 1.15)

Data on access to information technology — telephone mainlines, mobile phones, personal computers and televisions as a proxy — for 1989 and 1997 were taken from World Development Indicators 1999 CD-ROM. APEC income group aggregates were derived using population weights. Values for Chinese Taipei are not reported; hence Chinese Taipei was omitted from the chart.

Technical note 11 (charts 1.16 and 1.17)

Data on extended genuine savings and its various components — extended gross savings, depreciation, natural resource depletion and CO₂ emissions — were obtained from the World Bank’s internet site (<http://www.worldbank.org>), where it is possible to download genuine savings results for a range of economies over the period 1970–94. The genuine savings measure reported is calculated as follows.

Genuine savings calculation

Genuine savings =	Gross domestic investment	+	Current education spending	+	Net official transfers	-	Net foreign borrowing	(Extended gross savings)
	- Depreciation of capital							(Extended net savings)
	- Depletion of natural resources							(Extended genuine savings I)
	- Pollution damage							(Extended genuine savings II)

Current spending on education is included in the measure of genuine savings as it is considered to be an investment in human capital (rather than consumption as in the traditional national accounts). Natural resource depletion is limited to valuation of the resource rents for non-renewable resources (namely, minerals and fossil fuels) and the depletion of forests beyond replacement levels. Fisheries depletion is not included, nor are other environmental problems such as salinity or land degradation. As many pollution damages are localised and are therefore difficult to estimate without locational data, pollution damage estimates were restricted to the global damage caused by CO₂ emissions. The marginal social cost of a tonne of CO₂ emission was assumed to be US\$20 (Hamilton and Clemens 1999).

Where data were not available for a particular component of genuine savings, estimates were derived using growth rates calculated from World Development Indicators 1998 CD-ROM. For example, data on gross domestic investment in 1994 are not available for six APEC economies. For each economy a value was estimated by calculating the percentage change in domestic investment over the years 1993 and 1994 (for the appropriate economies) using data reported in the World Development Indicators 1998 CD-ROM. This growth rate was then applied to the reported value of 1993 gross domestic investment, thus deriving a 1994 value.

CO₂ emissions for Chinese Taipei are not reported. An estimate of the cost of CO₂ damage was derived by multiplying the tonnage of national Chinese Taipei CO₂ emissions from fossil-fuel burning, cement manufacture and gas flaring by US\$20. CO₂ emissions for Chinese Taipei were obtained from the Carbon Dioxide Information Analysis Centre internet site (<http://www.cdiac.esd.ornl.gov>).

Technical note 12 (chart 2.1)

The data were originally sourced from the Manila Action Plan for APEC and from various Individual Action Plans (1998). The data used vary between economies (that is, simple average or import weighted average) and are therefore not comparable. Data for Australia, Canada, Japan, Mexico and the United States are trade weighted. Similar MAPA and IAP data for Peru, Russia and Vietnam are not available.

Technical note 13 (chart 2.2)

Impediments identified in each category are only those that violate market access and national treatment. Thus, the figure excludes measures that apply consistently across domestic and foreign investment such as investment incentives and performance requirements.

Technical note 14 (chart 2.4)

Singapore and Hong Kong, China, which have large amounts of entrepôt trade, have been omitted from the chart.

Technical note 15 (chart 3.3)

The index was obtained from the Fraser Institute's publication *Economic Freedom of the World 2000* (Gwartney, Lawson and Samida 2000). The averages for high and lower income APEC economies were calculated using GNP weights.

Technical note 16 (chart 3.4)

The indexes of risk rating were compiled from the *Composite International Country Risk Guide* indexes for February 1999 reported in the World Bank's *World Development Report 1998–99* and *World Development Report 1999–2000*. Averages were compiled using GNP weights. The Composite International Country Risk Guide is an overall risk index based on 22 political, financial and economic risk components. Risk ratings range between 0 and 100. Ratings below 50 indicate very high risk and those above 80 very low risk.

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