



The Challenge of Structural Change in APEC Economies

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Abstract

Improving New Zealand’s economic performance is one of the key outcomes driving the work of the New Zealand Treasury and international connections are an important means of achieving that. The promotion of sustainable economic growth and improved living standards in the Asia-Pacific region through enhanced trade and economic integration lies at the heart of APEC’s mission. While APEC’s focus has traditionally been on trade and investment liberalisation and facilitation, it is increasingly turning its attention also to the role played by “behind-the-border” policies in enabling or impeding regional economic integration (also commonly referred to as “structural policies” or “structural barriers”). This paper surveys the theoretical and empirical literature on economic growth and income convergence processes in the Asia-Pacific region. The review suggests that structural policies are impeding growth and convergence, and that structural policy reforms could bring about large economic gains to the region. The paper also looks at the role that APEC can play in promoting and managing the challenges of structural change in the region. It concludes that structural change is an important challenge facing the Asia-Pacific region, and APEC provides New Zealand and other member economies with an important forum to promote improvements in economies’ domestic structural policies.

JEL CLASSIFICATION F15 - Economic integration
O19 - International linkages to development, role of international organisations
R11 - Regional economic activity: growth, development, and changes

KEYWORDS Structural reform, APEC, income convergence, economic growth, regional integration, Economic Committee

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The Challenge of Structural Change in APEC Economies

1 Introduction

Improving New Zealand's economic performance is one of the key outcomes driving the work of the New Zealand Treasury. New Zealand's international connections with the rest of the world, through trade and investment flows, the movement of people and ideas, contribute to our overall economic performance, and are particularly important because we are a small, open economy. Forums such as Asia-Pacific Economic Cooperation (APEC) help promote New Zealand's connections with the Asia-Pacific region.²

The promotion of sustainable economic growth and improved living standards in the Asia-Pacific region through enhanced trade and economic integration lies at the heart of APEC's mission. While APEC's focus has traditionally been on trade and investment liberalisation and facilitation, it is increasingly turning its attention also to the role played by "behind-the-border" policies in enabling or impeding regional economic integration (also commonly referred to as "structural policies" or "structural barriers"). Behind-the-border barriers refer to domestic measures which can impede the efficient operation of markets and the capacity of businesses to operate. These can take the shape of domestic regulatory systems, competition frameworks and governance structures.

The Asia-Pacific region is economically important to New Zealand. The "Which Countries" work undertaken by the New Zealand Treasury, which focussed on the link between new growth theories and international integration, identified major economies along the Asia-Pacific Rim (most notably Australia, the United States, Japan, Korea and China) as the core group of economies with which New Zealand should deepen its economic relations (Rose and Stevens, 2004). The region is a major force of global economic growth. In its first decade, APEC member economies generated nearly 70 percent of global economic growth and the APEC region consistently outperformed the rest of the world, even during the 1997-98 Asian financial crisis.³

APEC provides New Zealand and other member economies with a forum to pursue measures promoting a stronger, more integrated and flexible regional economy. From a New Zealand perspective, APEC has the additional advantage of including a number of economies that are economically important to New Zealand.

APEC's focus on trade and investment liberalisation and facilitation and on technical cooperation towards these ends are important, particularly given the significant tariff

¹ New Zealand Treasury Statement of Intent 2007-2010 <http://www.treasury.govt.nz/soi/2007-10/>

² APEC is a grouping of "economies" on the Asia-Pacific Rim. APEC currently has 21 members: Australia; Brunei Darussalam; Canada; Chile; People's Republic of China; Hong Kong, China; Republic of Indonesia; Japan; Republic of Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Republic of the Philippines; Russia; Singapore; Thailand; Chinese Taipei; United States; and Viet Nam.

³ See APEC's Achievements and Benefits available from http://www.apecsec.org.sg/content/apec/about_apec/achievements_and_benefits.html

peaks remaining on some products in the food and primary production sectors that are economically important to New Zealand. However, there is a growing body of evidence which suggests that the APEC region is not realising the full benefits of regional economic integration due to barriers both at and behind the border.

Outward-orientation and strong growth performances have resulted in impressive economic growth in some low-income economies in recent years.⁴ However, progress across the APEC region has been patchy and evidence suggests that convergence mechanisms may not be operating as well as expected in some economies due to barriers at and behind the border. Furthermore, recent thinking suggests that what it takes to achieve growth at lower income levels may be different from what it takes to sustain growth at higher levels of income, and over the long term. This raises the question of not only how to lift performance in the slower growing economies but also whether, and how, the recent impressive growth performances of some economies in the region can be sustained in the future. This paper focuses on behind-the-border structural policies, in light of their economic importance and the greater emphasis now being placed on them by APEC.

There are, of course, a number of international and regional organisations that promote structural policy change, such as the Organisation for Economic Cooperation and Development (OECD), and the World Bank. APEC aims to draw on the work of these other organisations, but it also “adds value” in a number of ways.⁵ APEC’s cooperative, voluntary and informal manner of operations means that it is a good place to discuss economic policy challenges facing the Asia-Pacific region in an informal and non-adversarial environment. Because structural policies are behind the border they cannot easily be negotiated between economies. APEC has to date sought to promote improvements in an economy’s domestic structural policies through policy dialogue. APEC promotes structural reform by providing a forum for senior officials across the region to discuss economic policy challenges, share experiences, discuss good practices and provide technical support where necessary.

The plan of the paper is that Section 2 will discuss the processes of economic growth and income convergence in the region. To do this, the paper draws on models of economic growth to provide a framework for thinking about how economic growth and income convergence takes place. Section 3 assesses where economic growth is occurring in the region and Section 4 discusses some possible impediments and future challenges to economic growth and the convergence of incomes, including structural policies. Section 5 looks at the role of APEC in promoting structural reform and providing members with the tools to manage it. The final section draws out some general lessons from the discussion.

⁴ China has experienced rapid economic growth since the 1970s and Viet Nam has experienced strong growth since the early 1990s. Several other APEC economies have shown periods of rapid, but unsustainable growth such as Korea in the mid-1980s to mid-1990s, Malaysia, Indonesia, Thailand, Singapore and Chile for periods in the 1990s, and Hong Kong China prior to the mid-1990s.

⁵ APEC draws on the work of other organisations by, for example, collaboratively developing tools such as the “APEC-OECD Integrated Checklist on Regulatory Reform”, by inviting participation from the OECD and World Bank in APEC seminars and workshops, by drawing on the research these organisations have undertaken (such as the World Bank’s “Ease of Doing Business” indicators), and contracting research work from specialists from these organisations.

2 Processes of Economic Growth and Income Convergence

2.1 Growth and convergence in neoclassical and endogenous growth theories

Economic growth models provide a framework for thinking about how economic growth processes and income convergence take place. A starting point for understanding growth processes tends to be neoclassical and endogenous growth theories.

A characteristic of traditional neoclassical growth models, as originally developed by Solow (1956) and Swan (1956), is that savings and physical and human capital investment influence the level of income per capita. In seeking the highest possible returns, capital moves from places where it is abundant to where it is scarce, bringing with it new products, processes and technologies. By operating across economies, this process of economic integration can facilitate the convergence of incomes.

As pointed out by Barro (1991), in neoclassical growth models an economy's per capita growth rate tends to be inversely related to its starting level of income per person. Low-income economies will tend to grow faster than high-income economies, due to the movement of capital across borders, thereby promoting economic integration and convergence in the levels of per capita income across economies. It is of course possible, according to this model, that economies do not converge to the same level of per capita income because of impediments to convergence, such as structural policies that are ineffective at improving market efficiency. However, this is not to say that a one-size-fits-all approach to structural policy settings is always appropriate. As highlighted by Rodrik (2003), a range of institutional settings can bring about growth and income convergence and the most appropriate institutional settings will depend on local conditions.

In modern endogenous growth theories, by comparison with traditional models which focus on factor accumulation, the main driver of growth and convergence is ideas. It is possible to construct endogenous growth models that exhibit convergence in per capita incomes. In such models, convergence can be driven by a number of factors. Barro and Sala-i-Martin (1997), for example, develop an endogenous growth model in which long-term growth is driven by discoveries of new technology. In this model "follower" economies catch up to "leader" economies by copying technology. As the pool of uncopied ideas diminishes, the cost of imitation increases and the growth rate of followers accordingly declines.

2.2 Convergence mechanisms

Traditional and modern growth theories imply there are various factors that could bring about income convergence. Convergence in the neoclassical growth model is driven by capital flowing from places where it is abundant (high-income economies) to where it is scarce (low-income economies) to achieve the highest possible returns. In this way, economic integration can bring about growth and income convergence. However, empirical evidence suggests that capital flows from high-income to low-income economies are very modest and much less than predicted by the neoclassical growth model. Lucas (1990) canvasses theoretical explanations for these observed differences, including differences in economic fundamentals across economies that lower the rate of return on

capital in low-income economies relative to high-income economies (such as technological differences, government policies and institutional structures) and capital market imperfections. Subsequent articles have attempted to test the relative importance of these explanations empirically. Alfaro, Kalemli-Ozcan and Volosovych (2005), for example, find that low institutional quality is the leading explanation for the actual capital flows between low-income and high-income economies.

Endogenous growth models emphasise the spillover of ideas and technological knowledge as a key mechanism driving growth and income convergence. The transfer of scientific knowledge may occur through foreign direct investment (FDI) in low-income economies bringing with it the skills of investors, or through international trade. Economies may “learn by exporting” by interacting with foreign customers and learning how to meet higher product standards, or through technology embodied in imports. Keller (2004) surveys the literature on the extent of international technology diffusion and the channels through which technology is spread. He concludes that there is no evidence that international learning is inevitable, or that it is easier for relatively undeveloped economies. Evidence suggests that importing is associated with technological spillovers, but evidence of benefits associated with exporting is weaker. The literature suggests that there can be spillovers from FDI but they vary between economies, regions, sectors, and firm structures. Similar conclusions are drawn in the surveys by Greenaway and Kneller (2007) and Wagner (2007).

Migration from low-wage to high-wage economies could also bring about higher economic growth and income convergence. Migration will cause labour to become scarcer in low-income economies and more abundant in high-income economies and will tend to reduce wage differentials between economies. Restrictions in the movement of persons, rigid labour markets and overly generous and/or poorly designed welfare policies will limit the extent to which this mechanism is able to operate. Sinn (2007) assesses the impact of the emergence of “Asian tigers” and ex-Communist economies in world trade on factor price convergence in Europe. He concludes that labour market rigidities and welfare policies in Western Europe are impeding adjustment and factor price convergence. These policies may be causing greater immigration and more capital-intensive exports from Western Europe than would otherwise be the case and could be contributing to unemployment and sluggish growth in Europe.

Trade and specialisation is another mechanism that could drive economic growth and income convergence. Trade between high-income and low-income economies will allow high-income economies to specialise in capital-intensive production processes, and low-income economies to specialise in labour-intensive production processes (as per their comparative advantage). Both specialisation processes tend to reduce wage differentials as the demand for unskilled labour in high-income economies falls, while it rises in low-income economies. Estimating the effects of trade on economic growth is challenging because of the joint determination of empirical measures of economic growth and international trade. Frankel and Romer (1999) use instrumental variable estimation to help overcome some of these estimation problems, and find that trade has a large, positive (although only moderately significant) effect on income.

In addition to “static” gains from trade (arising from economies exploiting their comparative advantage and economies of scale), there are also potential “dynamic gains” from trade. Dynamic gains from trade refer to trade-related improvements in an economy’s productivity growth rate that arise from increased integration in the global economy. A recent OECD (2006) study identified three interconnected channels through which trade may increase productivity: by increasing investment; aiding technological diffusion; and

promoting the competitive impetus to innovate. The empirical evidence on dynamic gains from trade is mixed. Research has not established a robust link between trade policy and long-run productivity growth rates. However, at the economy-level there is strong empirical evidence of the link between openness to trade (measured by actual trade flows) and productivity levels.

Traditional and modern growth theories imply that there are potential benefits for all economies, not simply the lower-income economies, through specialisation, better allocation of skills and other resources, the dynamic interaction of learning, and the two-way spillover of knowledge. According to these models, in the Asia-Pacific region we would expect to find lower-income economies growing faster than higher-income economies, thereby bringing about the convergence of per capita incomes. The following section examines the growth and convergence performances across the APEC region. This is followed by a more detailed discussion of evidence drawn from the research literature of factors that may be impeding these processes.

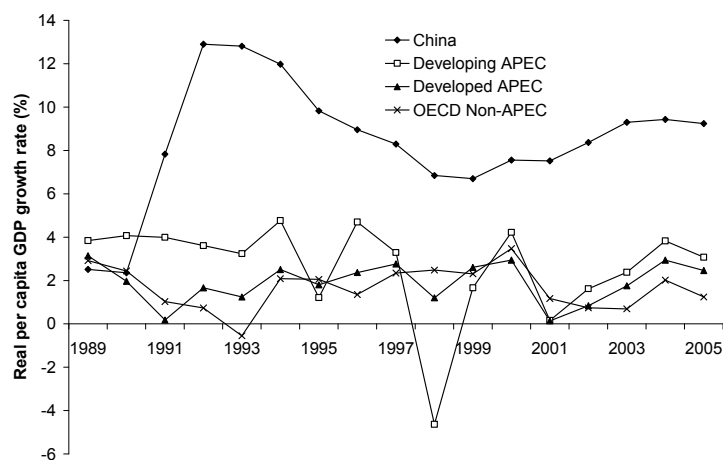
3 Prospects of Economic Growth and Income Convergence in the Asia-Pacific Region

3.1 Where is growth occurring?

The growth performance of the Asia-Pacific region has been stronger on average than that of Organisation for Economic Cooperation and Development (OECD) countries over the last two decades or so, although significant variation in economic performance exists within the Asia-Pacific region. The economic performances of East Asian economies and China in particular have been key drivers of growth in the Asia-Pacific region since the 1980s. Figure 1 shows the real per capita growth rate of China compared with population-weighted real per capita growth rates of APEC economies (developing and developed) and OECD countries that are not in APEC, since APEC was formed in 1989.⁶

⁶ Chile, Republic of Indonesia, Malaysia, Mexico, Papua New Guinea, Peru, Republic of the Philippines, Thailand, and Viet Nam are classified as developing APEC economies. The remainder (excluding Russia and Chinese Taipei due to data gaps, and the People's Republic of China as its growth rates are graphed separately) are classified as developed APEC economies.

Figure 1: Real per capita GDP growth rates, 1989-2005



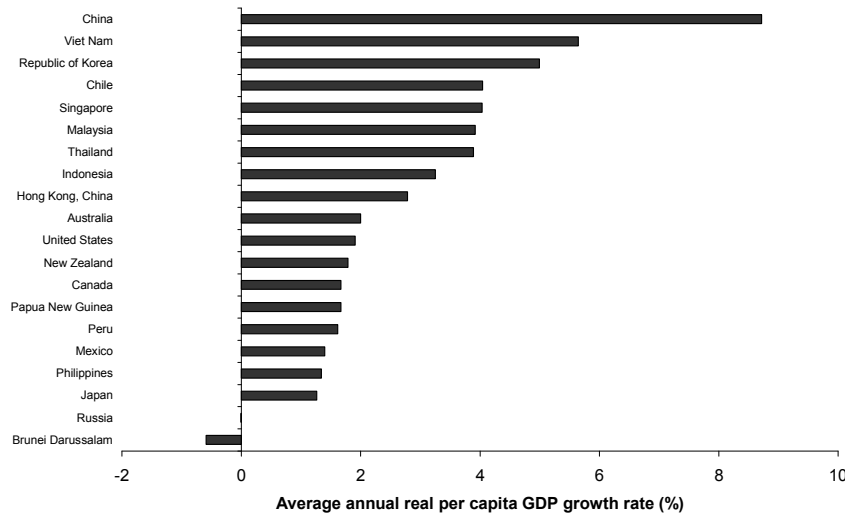
Source: United Nations Statistical Database.

Note: Excludes Russia and Chinese Taipei due to data gaps. Data for groups of economies (ie, developed APEC, developing APEC and OECD Non-APEC economies) are population-weighted.

Growth rates per capita in APEC economies have been higher on average than those in OECD countries over the past two decades. The lower growth rates in 1997-98, particularly for developing APEC economies, reflect the impact of the 1997-98 Asian financial crisis on economic performance. This period was a harsh illustration of how weak institutions (in particular weak financial institutions) and poor governance structures can eventually impact on growth. While crisis-affected economies did rebound quickly from the Asian financial crisis, growth rates in the post-crisis period have been running at around 2% less than during the two decades before the crisis. The experience is still impacting on investment in the region as a result, at least in part, of higher risk premiums on projects due to greater uncertainty (World Bank, 2007).

Lower-income APEC economies are growing more rapidly on average than higher-income APEC economies, although the gap has been narrowing, especially since the Asian financial crisis. However, these aggregate figures hide a great variation in economic performance across the APEC region. Figure 2 shows the average annual real per capita GDP growth rates in APEC economies from 1989 to 2005. Average annual growth rates of real per capita incomes over the period range from -0.6% in Brunei Darussalam to 8.7% in China. Brunei Darussalam's economy is heavily dependent on revenue from oil and gas production. The poor economic growth performance of Brunei Darussalam since the mid-1970s was driven by relatively low world oil prices, and also the cut back of petroleum production since 1979, which was done in order to extend the life of its oil reserves. Brunei was also affected by the 1997-98 Asian financial crisis. Brunei Darussalam's economy has recovered recently, as a result of the recovery of world oil prices (Anaman, 2004). Russia has also had a poor growth performance over this period, as a result of negative growth rates during the 1990s.

Figure 2: Average annual real per capita GDP growth rates of APEC economies, 1989-2005



Source: United Nations Statistical Database.

Note: Data for Russia for period 1990-2005 due to data gaps. Excludes Chinese Taipei due to data gaps.

The real per capita GDP growth rates of APEC economies from 1975 to 2005 are included in Appendix 1. It is evident from these graphs that only China and the Republic of Korea have sustained growth rates above 2% over the past three decades.⁷ Viet Nam has lifted and sustained growth above 2% in the post-1990 period. The impact of the 1997-98 Asian financial crisis is particularly evident in Hong Kong, China; Indonesia; the Republic of Korea; Singapore; Thailand; and Malaysia.

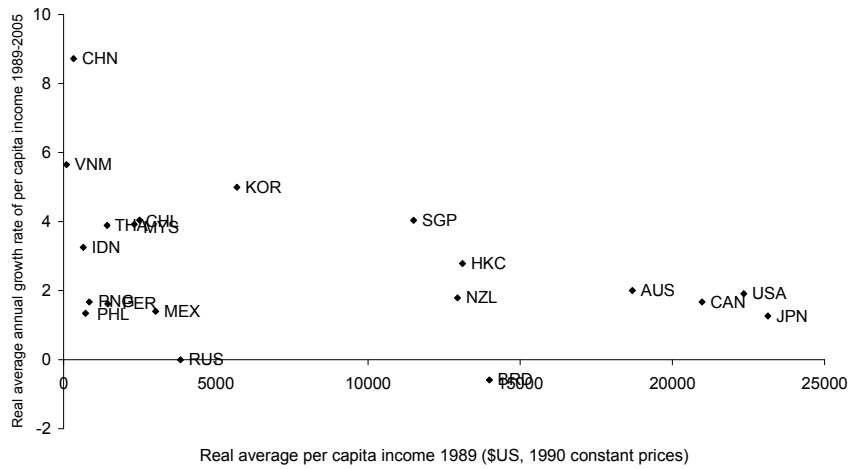
3.2 Evidence of convergence

Evidence from the APEC region is somewhat consistent with the convergence hypothesis that under certain conditions low-income economies will tend to grow faster than high-income economies. However, evidence is mixed and some economies are converging while others are not.

If incomes of APEC economies were converging we would expect to see a negative correlation between initial income levels and the subsequent growth rate of incomes, since low-income economies would be growing faster than high-income economies. Figure 3 plots the real average per capita income level of APEC economies in 1989 against the real average annual growth rate of per capita income for the period 1989 to 2005. The figure shows some evidence of convergence in the region. However, progress is patchy and there is a cluster of economies with low initial incomes that are not “catching up”.

⁷ Real per capita GDP growth of 2% is often used as a benchmark because it is approximately the long-run average growth rate of real per capita incomes of developed economies, such as the United States.

Figure 3: Convergence of APEC economies' incomes, 1989-2005

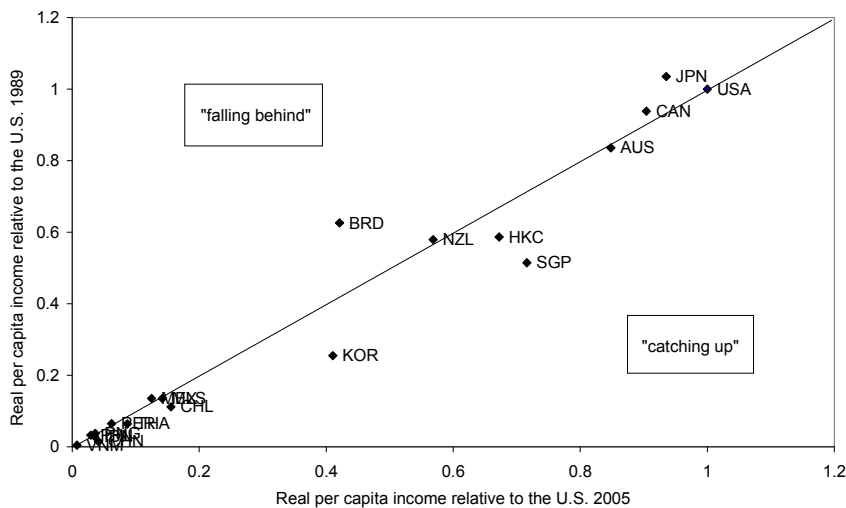


Source: United Nations Statistical Database.

Note: Data for Russia for period 1990-2005 due to data gaps. Excludes Chinese Taipei due to data gaps. Key included in Appendix 2.

Figure 4 plots the real average per capita income levels of APEC economies relative to the United States in 1989 and 2005. If an economy was “catching up” to average income levels in the United States over the period then they would appear to the right of the 45° line, and if they were “falling behind” they would appear to the left of the 45° line. Again, while there is some evidence of convergence in the region, there are a number of economies whose per capita income levels have fallen behind relative to the United States over the period 1989 to 2005.

Figure 4: Relative income levels of APEC economies, 1989 and 2005



Source: United Nations Statistical Database.

Note: Excludes Chinese Taipei and Russia due to data gaps. Key included in Appendix 2.

Of the higher-income economies, the relative incomes of New Zealand, Canada and Australia have stayed broadly the same over the period. Brunei Darussalam and Japan have performed relatively poorly. Brunei Darussalam’s growth performance has been poor since the early 1980s and Japan’s economic performance has slowed substantially

since the early 1990s. Average per capita incomes in The Republic of Korea; Hong Kong, China; and Singapore have moved ahead relative to the United States.

Of the lower-income economies, per capita incomes in China, Chile, Indonesia, Malaysia, Thailand and Viet Nam moved ahead relative to the United States. However there are some low-income economies that are making little progress or are continuing to fall behind, such as Papua New Guinea, Peru and the Philippines.

It is evident from Figure 4 that economies starting from a low base of average income per capita, will, even with very high growth rates, take a very long time to converge toward income levels of developed economies. For example China's very high annual average growth rate of 8.7% from 1989 to 2005 has moved their relative income from 1.5% to 4.2% of that of the United States over the period.

It is possible to empirically test whether convergence is occurring in the APEC region. We can do this by estimating the following cross-economy regression model, derived from the neoclassical growth model:

$$\frac{1}{t} \ln \left(\frac{y(t)_i}{y(0)_i} \right) = a + b \ln(y(0)) + \varepsilon_i, \quad (1)$$

where t is the time period (annual), $y(0)$ is the initial level of per capita income and $y(t)$ is the level of per capita income in the final period. This model has been used by various researchers (for example, Baumol, 1986).⁸ If per capita income convergence (often described as “catch-up”), was occurring, then we would expect to see a negative relationship between initial per capita income levels and subsequent growth rates (ie, we would expect the b coefficient in regression model (1) to be negative).

The results of regression (1) are summarised in Table 1. Looking at the 16 years prior to the formation of APEC (1972-1988), there is no evidence of per capita income convergence in APEC or the rest of the world. However, in the period since APEC was formed in 1989, there is evidence of convergence in the APEC region. The estimates suggest that the annual average rate of convergence in the APEC region over the period 1989-2005 is 1.47%. This means that the estimated “half-life” (the time taken to close half of the gap between income levels of high- and low-income economies) for APEC is 47 years. These results are based on real per capita incomes expressed in \$US.

If per capita GDP data are measured in purchasing power parity (PPP) terms (to account for differences in the relative prices of goods and services in different economies) then the estimated speed of convergence is slower. For the period 1989-2005, the annual average rate of convergence in the APEC region (for the 18 APEC economies for which data are available) is 0.52%. This means that the estimated half-life is 134 years.⁹

⁸ “Absolute β -convergence” is the notion that low-income economies will tend to grow faster than high income economies, independent of any other characteristics of the economy. It is also possible to estimate “conditional β -convergence”: the notion that low-income economies will tend to grow faster than high income economies, if other factors are held unchanged (such as initial levels of human capital). We have estimated absolute β -convergence in this paper.

⁹ The GDP per capita purchasing power parity (PPP) data comes from the World Development Indicators Database. The sample of 18 economies excludes Russia, Brunei Darussalam and Chinese Taipei due to data gaps.

Table 1: Per capita income convergence: 1972-1988 and 1989-2005

	Estimated absolute β -convergence			
	1972-1988		1989-2005	
	APEC Economies*	Rest of the World**	APEC Economies*	Rest of the World**
GDP (b)	-0.0044 (0.1542)	0.0003 (0.8488)	-0.0131 (0.0021)	0.0023 (0.1988)
Annual average rate of convergence	0.456%	-0.030%	1.470%	-0.235%
Half-life	158 years		47 years	
R ²	0.1157	0.0003	0.4363	0.0104

Note: Probability values are in parentheses.

* APEC member economies excluding Russia and Chinese Taipei due to data gaps.

** Economies from the rest of the world (excluding APEC economies) where data are available for the period 1972-2005 from the United Nations Statistical Database.

Engelbrecht and Kelsen (1999) also empirically test whether there is evidence of convergence amongst APEC economies during from 1965 to 1990. They find that APEC economies were indeed converging towards one another over the sample period. This result holds for both “conditional β -convergence” (ie, convergence conditional on institutional and structural characteristics) and “unconditional or absolute β -convergence”.¹⁰ This suggests that APEC constitutes a “convergence club” similar to the OECD and the European Union. This result is of particular note, given the diversity of APEC economies.

Our regression results suggest that in general convergence has continued. However, Figures 3 and 4 indicate that the process is characterised by some low-income economies achieving very high growth, some merely matching the growth of higher-income economies, and some economies falling behind.

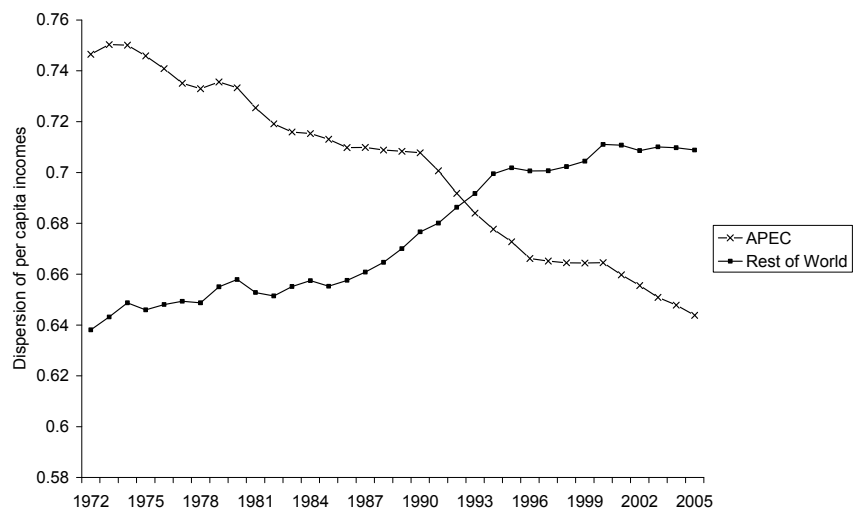
Another way to think about income convergence is in terms of how the dispersion of per capita income levels changes over time. This is commonly referred to as σ -convergence, and is calculated as the standard deviation of the log of per capita income. σ -convergence is exhibited among a group of economies when the dispersion of per capita income decreases over time, ie, where:

$$\sigma(t) < \sigma(0). \quad (2)$$

¹⁰ Engelbrecht and Kelsen (1999) obtain estimates of the rate of absolute β -convergence that range around our estimate (from -0.0079 to -0.0178) depending on the method of estimation that they use. Their results are likely to be different from ours due to the different time periods examined, as well as the different estimation methods used. We use Ordinary Least Squares (OLS) estimation.

Figure 5 graphs the dispersion of per capita income levels (σ) for the period 1972-2005. The graph shows that the dispersion of per capita income is falling in APEC, while it is increasing in the rest of the world, ie, there is evidence of σ -convergence in APEC, but not in the rest of the world.

Figure 5: Dispersion of per capita income levels



Source: United Nations Statistical Database.

Note: Excludes Chinese Taipei and Russia due to data gaps. Includes 161 economies from the rest of the world (excluding APEC), where data are available for the period 1972-2005 from the United Nations Statistical Database.

3.3 Impact of structural policies

It is clear from Figures 3 and 4 that while there is some evidence of income convergence, there is still considerable scope to enhance standards of living in the region by both lifting growth in laggard economies and by lifting growth in general. Furthermore, even for the currently high-growth economies there is evidently no assurance that the economic structures and processes that propelled their initial growth are necessarily the solution to ongoing convergence.

Recent thinking suggests that what it takes to achieve growth at lower income levels may be different from what it takes to sustain growth at higher levels of income, and over the long term (World Bank, 2007; Rodrik, 2003; Gill and Kharas, 2007). This implies that structural reform is an ongoing challenge, and raises the question of not only how to lift performance in the slower-growing economies but also whether the recent impressive growth performances of some economies in the region can be sustained in the future. The World Bank (2007) identifies a number of transitions that economies may need to make to move from middle-income toward higher-income status, including: transition from being able to absorb knowledge to becoming a source of innovation; developing deeper financial systems; and managing greater urbanisation. There are many cases of economies succeeding in reaching middle-income status but not meeting the challenges of transitioning to high-income levels (eg, many economies in the Middle East and Latin America). However, there are examples of economies in the region that have made this transition successfully (eg, Japan; Hong Kong, China; Singapore; The Republic of Korea; and Chinese Taipei).

Evidence also suggests that convergence mechanisms may not be operating as well as expected in some economies due to barriers behind the border. Addressing these sorts of issues is the challenge of structural policy. The following section considers the implications of structural policies for the convergence mechanisms outlined in Section 2.2: capital flows, technological spillovers, migration, and intraregional trade and specialisation.

3.3.1 Capital flows

For most of the 1980s, emerging Asia was a net importer of financial capital, in line with the predictions of economic theory. However, since the 1997-98 Asian financial crisis emerging Asia has become a net capital exporter. Recent analysis suggests the explanation for this lies in investment performance rather than an excess of saving. Kramer (2006) notes that, excluding China, savings have been relatively stable over the past 10 to 15 years and, according to some studies, broadly consistent with economic fundamentals. By contrast, private investment declined sharply after the Asian financial crisis and some recent studies suggest that investment in emerging Asian economies is low relative to fundamental determinants. To some extent, this could be seen as “making up” for the previous over-investment (see for example Chinn and Ito, 2005; Eichengreen, 2006; and IMF, 2005).

Kramer considers three possible reasons for the investment decline in emerging Asia: financial and corporate sector restructuring following the 1997-98 financial crisis, competition from China, and changes in perceptions of risk. He concludes that financial and corporate sector stresses and restructuring following the financial crisis impacted on investment, but these effects were not enduring. China’s success in attracting FDI has raised questions as to whether China may be attracting capital inflows at the expense of other economies. However, Kramer notes that recent studies have not found any evidence of China diverting FDI from other Asian economies.

Concern has also been expressed that FDI into China is diverting FDI flows away from Latin America. Garcia-Herrero and Santabárbera (2007) empirically investigate how Chinese inward FDI affects FDI flows into Latin America. They find no diversion of FDI away from the six largest Latin American economies studied to China during the period 1984 to 2001.¹¹ However, during the more recent period (1995 to 2001), FDI in China appears to have impeded FDI in Mexico and Colombia, but not the four other Latin American economies studied (including Chile). They conclude that Latin American economies will benefit from China’s increasing demand for raw materials in terms of both increased exports and inward FDI from China into sectors related to raw materials. Latin American economies will need to further open these sectors to foreign investors to reap the full benefit of opportunities presented.

Perceived risks in emerging Asia are higher than in the pre-crisis period and could explain the sluggish recovery of investment in the region. The perceived increase in risk, despite moves to reduce vulnerabilities after the crisis (eg, by making exchange rates more flexible, strengthening banking and corporate sectors, and the accumulation of large foreign exchange reserves) could reflect more realistic perceptions by investors in the post-crisis period. For example, a World Bank study finds that the ranking of the perceived governance environment is weaker now than in the pre-crisis period across the

¹¹ The six Latin American economies included in the study are Argentina, Brazil, Colombia, Mexico, Venezuela and Chile.

six dimensions of voice and accountability, political stability, governance effectiveness, regulatory quality, the rule of law, and control of corruption (Kaufmann, Kraay and Mastruzzi, 2005).

Kramer concludes that while it is impossible to identify the “right level” of investment with any precision, investment may be enhanced by moves to increase certainty, such as implementing prudent monetary and fiscal policies, structural improvements in the investment environment at the microeconomic level, notably in governance frameworks, and by broadening and deepening financial systems.

The World Bank (2007) notes that cyclical explanations for the slower growth in investment among East Asian economies (excluding China) in the post-crisis period have become less convincing as time has elapsed since the crisis. Analysts have identified increased uncertainty and the quality of the investment environment as likely to have played an important role in the slow investment recovery. This in turn suggests that investment climate and governance reforms to reduce the scope for uncertainty about policies and laws are likely to have payoffs for investment and growth in the region.

In contrast to other Asian economies, the level of investment in China is high, and consumption levels low, relative to international comparisons and economic fundamentals. Aziz (2006) uses a standard neoclassical growth model to investigate these compositional issues and finds that the low cost of capital is an important explanatory factor for low consumption levels, and could be caused by nonperforming loans, borrowing constraints, and uncertainty over changes in government guidance in bank lending. Aziz concludes that if China wants to “rebalance” toward greater levels of consumption, then banking sector reforms and financial market development are likely to be important. The 11th Five Year Plan approved in March 2006 placed the broad long-term challenge of rebalancing of the pattern of growth on the Chinese government’s agenda (World Bank, 2007).

One of the consequences of low investment and high saving in the Asian region is for large current account surpluses and deficits across the Asia-Pacific region. Kennedy and Slok (2005) examine whether structural reforms are the answer to global current account imbalances. They find that growth-enhancing structural reform may have impacts on current accounts. However, the empirical evidence suggests that links may be tenuous and specific to individual types of reform. They conclude that such structural reforms should be undertaken because they allow economies to grow faster and improve general welfare. The potential for structural reform to help to reduce external imbalances should be thought of as a welcome by-product, rather than a specific or central policy objective.

3.3.2 Technological spillovers and migration

Trade and FDI can lead to technological spillovers which increase productivity in three key ways (Keller, 2004). “Learning-by-doing” benefits suggest that trade liberalisation can result in firms accessing larger markets allowing greater production experience, which in turn increases productivity. “Learning-by-importing” arises when productivity is increased by drawing on the foreign stock of knowledge embodied in imported goods. Lastly, “learning-by-exporting” stems from experience interacting with foreign buyers and consumers and competing with foreign firms, which overtime increases productivity. Studies have found that exporting firms have higher levels of productivity. However, it is difficult to find evidence of causation between exporting and productivity as firms could be exporting *because* they are more efficient. Indeed, most studies of the relationship attribute higher productivity of exporting firms to a self-selection effect rather than due to exporting causing higher productivity (Greenaway, Gullstrand and Kneller, 2005).

Case studies on East Asian economies since the early 1960s have strongly emphasised technological spillovers from learning-by-exporting (see for example Rhee, Ross-Larson, and Pursell, 1984). However, these results do not seem to be supported by international evidence from econometric panel studies which find little evidence of learning-by-exporting effects (Keller, 2004; Greenway and Kneller, 2007; Wagner, 2007).

FDI is generally considered the main way in which technology is spread internationally, because it creates a large amount of interactions between foreign and domestic firms (Saggi, 2002). Nevertheless, there is mixed evidence as to whether there are technological spillovers from FDI and international trade. Studies have found evidence that technology travels with imports (ie, “learning-by-importing”), but the magnitude of the spillovers has not yet been firmly established (Keller, 2004).

Taylor (1995) examines the relationship between trade, openness and migration in the Asia-Pacific region since the 1970s and finds that migration played little part as a determinant of growth or income convergence. This result is perhaps unsurprising given restrictions on migration during this period.

The World Bank (2007) identifies the facilitation of migration within economies (particularly from rural to urban areas) as having the potential to contribute to a more flexible business environment and to encourage greater equity within economies. There are a number of factors that inhibit internal migration including *de facto* restrictions on the movement of people across regions, and the poor access to services (eg, education, housing and health services) for migrants in destination areas. For example, while China has removed controls on population movements, the right of people to settle is still restricted. The household registration (“hukou”) system will not permit rural residents to claim State benefits in urban areas. Similarly Viet Nam has a registration system where by if an individual is not a resident of the district in which they reside they do not have full entitlements to government services (Deshingkar, 2006).

3.3.3 Intraregional trade and specialisation

Traditional trade models were developed at a time when production processes were not fragmented. Such models therefore focused on the trade in final goods, where goods produced in one economy, were sold as finished products to consumers either domestically or internationally. This form of production reflected the costs and logistical difficulties associated with locating separate parts of the production process in different locations.

With the advent of lower transportation costs and improved communication networks it is now often more cost effective to locate separate parts of the production process in different locations in order to take advantage of lower production costs. Production is becoming increasingly fragmented into a number of discrete tasks, and international trade is becoming progressively more based on a “trade in tasks”, rather than a trade in goods.

Grossman and Rossi-Hansberg (2006) have developed a variant of traditional trade models that allows for the trade in tasks (the “GRH model”). The GRH model treats offshoring of production in the same way as technological progress. In the model, as the cost of offshoring declines, firms that use tasks that are offshored intensively, are more profitable and are able to expand more than firms that rely more heavily on tasks that cannot be easily offshored. This process is similar to technological progress where an improvement in production techniques allows greater output for the same level of inputs.

The literature suggests that increased intraregional trade and vertical specialisation of production processes have increased the importance of economies having markets that are flexible enough to adjust in line with their evolving comparative advantage.

The share of emerging Asian economies in world exports has increased substantially over the past 25 years (from 8% to 19% between 1978 and 2002).¹² This is in large part due to increased intraregional trade of intermediate goods, which in turn seems to be driven by greater geographical dispersion of production processes and vertical specialisation (Zebregs, 2004). This intra-industry trade has been closely associated with flows of FDI and the establishment of regional production networks (World Bank, 2007).

The integration of China into the world economy has had a major impact on trade flows, and has played a large part in the rise of intraregional trade. Between 1995 and 2005 almost all of the increase in emerging East Asia's share of world exports (15.5% to 17.9%) came from China (including Hong Kong China), which increased from 4.5% to 7.7% of world trade.¹³ World trade shares among other East Asian economies either fell or only increased slightly over the period (World Bank, 2007). This raises both challenges and opportunities for economies in the region. The challenge for those economies with competing trade structures is that they will need to have the flexibility to reorganise away from sectors in which China has a comparative advantage. The ongoing relocation of production processes across borders highlights the importance of economies in the region making further progress with structural reforms, including in corporate and finance sectors, product markets, strengthening public sector governance, and taking other steps to create a good business and investment environment.

Lall and Weiss (2007) show that the trade structure of most Latin American economies generally complements that of China. China's increased demand for raw materials has resulted in an export boom in Latin America. However, they conclude that China may pose a serious threat to Latin America's long-term economic development. A heavy reliance on primary and resource-based products is not conducive to technological upgrading and diversification, and any such upgrading may face a strong competition threat from China, because China may have already "taken" (ie, China may have already moved into producing) the kind of products that Latin American economies may feasibly move to. Latin American economies are a high-wage location relative to China and will therefore need to invest in higher levels of skills and/or technology to offset this.

This section examined growth and convergence mechanisms identified by traditional and modern economic growth models and discussed possible domestic structural policy impediments to these mechanisms in the Asia-Pacific region. The next section uses economic indicators to identify specific micro-level impediments to growth and convergence, such as regulation, taxation and property rights.

¹² Zebregs (2004) defines "emerging Asia" as China; Hong Kong, China; India; Indonesia; Korea; the Philippines; Singapore; Chinese Taipei; and Thailand.

¹³ The World Bank study defines "emerging Asia" as China; Hong Kong, China; Malaysia; the Philippines; Singapore; Korea; Chinese Taipei; and Thailand.

4 Impediments to Growth and Convergence in the Asia-Pacific Region

Impediments to enhancing growth and convergence in the Asia-Pacific region lie both at and behind the border. Significant progress in tariff reduction has been achieved. Exports of goods and services now make up 18.5% of GDP for APEC economies compared with 13.8% in 1989, and average applied tariffs in APEC economies have been reduced from 16.6% in 1988 to 6.4% in 2004 (APEC Secretariat, 2005). However trade reforms remain important, because significant tariff peaks still exist in some areas (particularly in areas of economic importance to New Zealand, such as the food and primary production sectors).

A number of commentators are of the view that while benefits from trade and investment reform are far from being exhausted, a complementary focus in the APEC context should be given to behind-the-border barriers to regional economic integration. For example, Oxley (2006) maintains that the importance of trade liberalisation to growth in the APEC region is diminishing and that the core mission of APEC should be to ensure economies are structured to maintain growth. In a similar vein, a recent OECD (2007) paper highlights the interaction between trade reforms and other economic policies, including competition and investment policies.

This section looks at empirical evidence on the benefits of structural policy reform vis-à-vis trade liberalisation before looking at internationally comparable economic indicators of micro-level impediments to growth and convergence – the World Bank “East of Doing Business Indicators”, the “Index of Economic Freedom”, and the IMD Business School “World Competitiveness Yearbook”.

There has been a lot of research and discussion about the economic impacts of the “spaghetti bowl” of bilateral and plurilateral trade agreements that have emerged in the APEC region. In this context, the concept of a Free Trade Area of the Asia-Pacific (FTAAP), ie, a preferential trade agreement (PTA) covering APEC economies, is currently being discussed within APEC. Preliminary analysis suggests that an FTAAP would deliver more favourable outcomes for APEC members than PTAs among smaller groups of APEC members (Scollay, 2004).

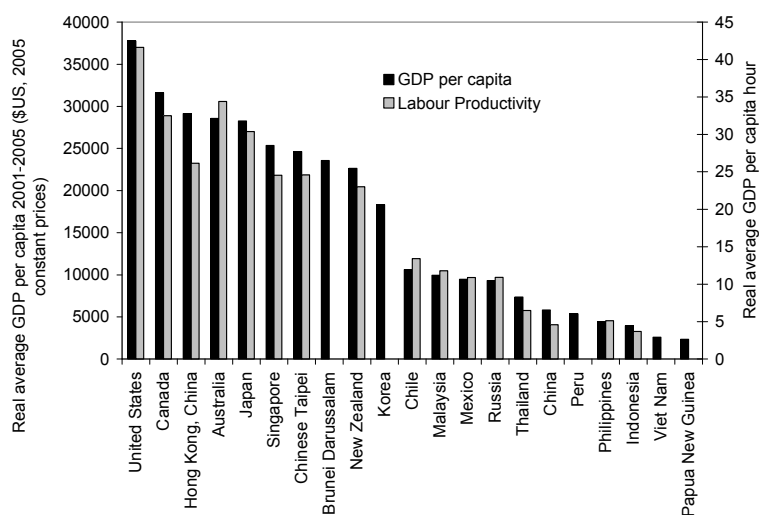
Dee (2005) empirically examines the payoffs from structural policy reform vis-à-vis trade liberalisation in the East Asian region.¹⁴ She examines three scenarios: a regional preferential trade agreement (including trade liberalisation and the elimination of regulations that discriminate against foreigners), the successful completion of the Doha round of World Trade Organisation (WTO) negotiations, and unilateral regulatory reform. Dee’s estimates show that preferential trade liberalisation and preferential reform of regulations would add US\$16.6 billion per annum and US\$2 billion per annum respectively to regional income. The successful completion of the Doha round would result in much larger gains of over US\$30 billion per annum. However, by far the largest gains result from unilateral regulatory reform, which is estimated to result in gains of over US\$100 billion per annum for the region. Dee’s research therefore indicates that there are large potential gains from structural reform. This is a very compelling result. However, it

¹⁴ The study includes nine APEC economies: China, Japan, Korea, ASEAN 5 (Indonesia, Malaysia, Philippines, Singapore, Thailand), and Australia.

should be treated with some caution, given the difficulties in quantifying the extent of domestic regulatory “restrictiveness” – and hence measuring the gains from reforming.

The variation in levels of GDP per capita is closely related to labour productivity levels across the region. Figure 6 shows the close relationship between average per capita levels of GDP and the level of labour productivity in APEC economies. An implication of this is that convergence mechanisms that increase labour productivity levels (relative to those in high income economies) will be potentially important.

Figure 6: GDP per capita and labour productivity of APEC economies, 2001-2005



Source: World Economic Outlook Database, International Monetary Fund.

Note: Excludes productivity data for some economies due to data gaps. Some recent data based on forecasts.

Economic indicators are a tool that can be used to identify specific micro-level impediments to growth and convergence, such as regulation, taxation and property rights, which may be suitable for unilateral reform, as applied for example by Dee (2005).

The World Bank’s “Ease of Doing Business” indicators data set provides internationally comparable measures of business regulation and enforcement across 175 economies. For example, it provides international comparisons of the number of days to register a business, the number of days to close a business and the ease of enforcing contracts.¹⁵ The report currently ranks economies across 10 indicators of the ease of doing business and also comes up with an overall ranking. The partial correlation between the 10 rankings and the overall ranking ranges between 0.85 for ease of closing a business to 0.59 for ease of trading across borders.¹⁶ The full set of correlation coefficients are provided in Appendix 3. The relatively high degree of correlation between the 10 doing business indicators suggests that they may be indicative of broader structural policy settings and reform of individual components (eg, reducing the number of days to register a business), may not be as important as more comprehensive reforms (eg, improving the regulatory system).

Another commonly referred to indicator of domestic economic policy settings is the “Index of Economic Freedom” which provides internationally comparable measures of 10

¹⁵ Further information on the World Bank Cost of Doing Business Indicators is available from <http://www.doingbusiness.org/>

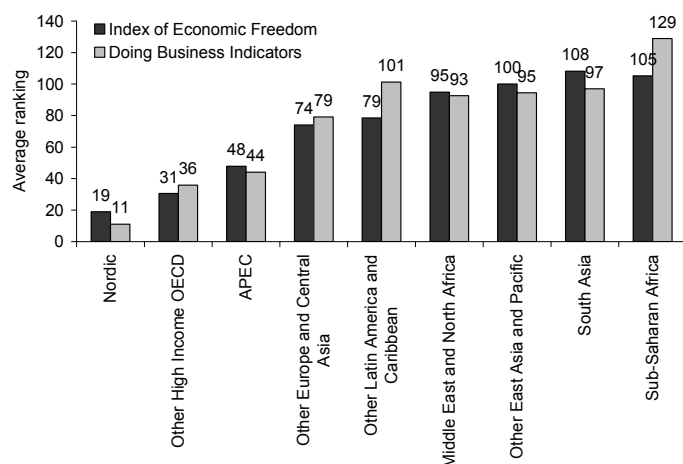
¹⁶ A partial correlation of “0” reflects no correlation and a partial correlation of “1” reflects perfect correlation.

“economic freedoms” across 161 economies. For example, it provides comparisons of the freedom of movement of labour, capital and goods as well as the enforcement of property rights across economies.¹⁷ The report ranks economies across 10 indicators of economic freedom and also comes up with an overall ranking. The partial correlation between the 10 rankings and the overall ranking ranges between 0.923 for property rights to 0.088 for fiscal freedom. The full set of correlation coefficients is provided in Appendix 3.

The “World Competitiveness Yearbook” of the IMD Business School provides internationally comparable indicators of the economic competitiveness across four main criteria of economic performance, government efficiency, business efficiency and infrastructure, for 55 economies. APEC economies rank an average of 24th and rank similarly across the five criteria. The partial correlation between the four rankings and the overall ranking ranges from between 0.939 for business efficiency and 0.756 for economic performance. The full set of correlation coefficients is provided in Appendix 3.

Figure 7 shows the average ranking in the “Ease of Doing Business” index and the “Index of Economic Freedom” across different regional groupings. The world competitiveness rankings are not included in the graph because of their more limited regional coverage. In most cases there is a close correlation between the two indices. APEC performs quite well on average as a group, but in general the costs of doing business are higher, and economic freedoms less, than the average for Nordic and high-income OECD economies.

Figure 7: Ease of doing business and economic freedom indices, regional groupings



Source: Ease of Doing Business Database, World Bank 2006; and Index of Economic Freedom Database 2007.
 Note: Includes only economies surveyed in both the Index of Economic Freedom and the Ease of Doing Business reports.

According to the “Ease of Doing Business” indicators, APEC economies perform most strongly in the areas of “employing workers”, which measures the flexibility of labour regulations, and “protecting investors”, which measures the protections afforded to minority shareholders. On average, APEC economies perform least strongly in “paying taxes” which measures the level and administrative burden of taxes on businesses, and “dealing with licences” which measures the number of procedures, time and cost of building a warehouse.

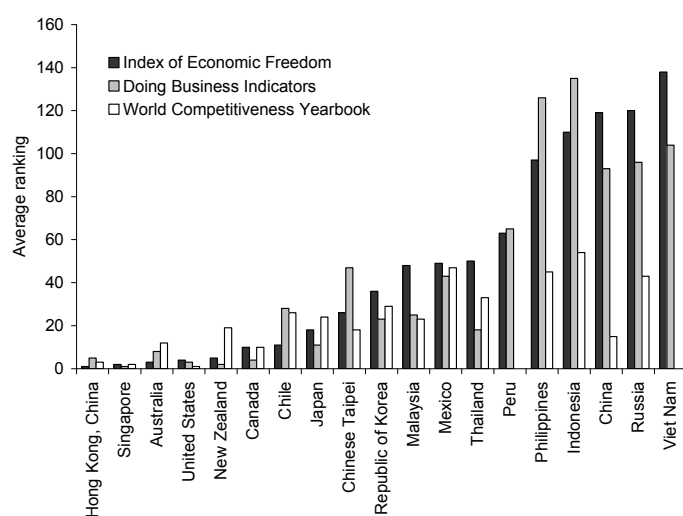
¹⁷ Further information on the Index of Economic Freedom is available from <http://www.heritage.org/index/>.

According to the “Index of Economic Freedom”, on average APEC economies perform most strongly in the areas of “business freedom” and “property rights”. Business freedom refers to the ability to create, operate, and close an enterprise quickly and easily. Onerous regulatory rules are often the major barriers to business freedom. Property rights refer to the ability of individuals to accumulate private property, secured by clear laws that are well enforced by the state. APEC economies perform least strongly in the areas of “fiscal freedom” and “financial freedom”. Fiscal freedom refers primarily to government taxation (tax rates and the tax revenue as a proportion of GDP), and financial freedom measures banking security and the independence of the financial sector from government influence and control.

According to the “World Competitiveness Yearbook”, on average APEC economies perform most strongly in the area of “government efficiency”, which measures the extent to which government policies are conducive to competitiveness. APEC ranks most poorly according to the criteria of “infrastructure”, which measures the extent to which basic technological, scientific and human resources meet the needs of business.

Figure 8 shows the ranking of individual APEC economies according to the three indices. There is significant variation in rankings across APEC economies, ranging from 1st to 135th out of 175 economies in the ease of doing business, from 1st to 138th out of 161 economies in terms of economic freedom, and from 1st to 54th out of 55 economies in terms of economic competitiveness.

Figure 8: Ease of doing business, economic freedom, and world competitiveness indices, APEC economies



Source: Ease of Doing Business Database, World Bank 2006; Index of Economic Freedom Database 2007; World Competitiveness Online, IMD Business School 2007.

Barriers to business tend to be highest and economic freedoms lowest, in lower-income APEC economies. This is evidenced by the strong correlation between per capita GDP levels (and labour productivity) and economies’ rankings across indicators of the business environment and economic competitiveness. The correlation coefficients of GDP per capita (or labour productivity) and the ranking of APEC economies in these indices range from 0.752 and 0.814. The full set of correlation coefficients is provided in Appendix 3.

As discussed in Section 3, the APEC region is not realising the full benefits of economic growth and income convergence due to remaining barriers at the border as well as

behind-the-border barriers to economic growth and regional integration. While outward-orientation and strong growth performances have resulted in catch-up progress in some economies, progress across APEC has been patchy.

The above section examined economic indicators in order to identify specific micro-level impediments to the operation of convergence mechanisms. This analysis again highlighted that while APEC performs well on average as a group, significant variation exists in performance across APEC. The following section outlines general lessons from the literature on the challenge of bringing about structural change and the role of APEC in progressing structural reform across the APEC region.

5 The Role of APEC in Encouraging Structural Change

5.1 Goals of APEC

The promotion of sustainable economic growth and improved living standards in the Asia-Pacific region through enhanced trade and economic integration lies at the heart of APEC's mission. As mentioned in the introductory section, APEC's focus has traditionally been on trade and investment liberalisation and facilitation, and technical cooperation towards these ends. However, in recent years it is increasingly turning its attention also to the role played by "behind-the-border" policies in enabling or impeding regional economic integration. These barriers can come in the form of high transactions costs and risks that arise from poor domestic regulatory systems, competition frameworks and governance structures.

In 1993, APEC Economic Leaders met for the first time (in Blake Island, United States) to outline APEC's vision of "stability, security and prosperity for our people". The following year APEC Economic Leaders adopted the "Bogor Goals", of "free and open trade and investment in the Asia-Pacific by 2010 for developed economies and 2020 for developing economies".¹⁸

In 2004, APEC Economic Leaders highlighted the importance of behind-the-border impediments to economic growth and higher living standards by adopting the "Leaders' Agenda to Implement Structural Reform Towards 2010" (LAISR 2010). LAISR identified five priority areas: regulatory reform, competition policy, public sector management and governance, corporate governance, and strengthening economic and legal infrastructure. The following year the "APEC Work Plan on LAISR Towards 2010" was developed which outlined a road map for addressing structural reform issues in APEC. This work plan sought to develop a "whole of APEC approach" for carrying out structural reform activities.¹⁹ LAISR gave the Economic Committee (EC) of APEC the responsibility for leading and coordinating APEC's structural reform work programme.²⁰ LAISR recognises

¹⁸ Key APEC Milestones is available from http://www.apecsec.org.sg/content/apec/about_apec/history.html

¹⁹ Leaders' Agenda to Implement Structural Reform (LAISR 2010) is available from http://www.apec.org/apec/documents_reports/annual_ministerial_meetings/2004.html, and APEC Work Plan on LAISR Towards 2010 (LAISR 2010) is available from http://www.apec.org/apec/documents_reports/senior_officials_meetings/2005.html

²⁰ In addition to the Economic Committee (EC) there are a number of APEC fora that have a focus on structural reform issues including the Competition Policy and Deregulation Group (CPDG), Strengthening Economic Legal Infrastructure (SELI)

that structural reform in APEC economies is essential for realising the full benefits of trade and investment liberalisation, thereby contributing to the achievement of the “Bogor Goals”.

A number of commentators are of the view that while the benefits from trade and investment reform are far from being exhausted, a complementary focus in the APEC context should be given to behind-the-border barriers to economic integration.²¹ This sentiment has been reflected by APEC Senior Officials in 2007. The APEC Business Advisory Council (ABAC) has also expressed strong support for the structural reform agenda, as a complement to the trade and investment liberalisation and facilitation agenda.²² Insights from Sections 3 and 4 highlight the importance of structural policy reforms to improvements in economic growth and income convergence in the region.

5.2 New Zealand’s involvement in APEC

New Zealand is a founding member of APEC and is represented at all levels of APEC, from the Annual Economic Leaders’ Meeting which the New Zealand Prime Minister typically attends, to the various officials’ committees and sub-committees of APEC.

New Zealand has long been a strong advocate for APEC’s structural reform agenda, and recently assumed the Chair of APEC’s Economic Committee which has responsibility for leading and coordinating APEC’s structural reform work programme.²³

As a small open economy, global connections matter for New Zealand. Trade policy is an important facet of New Zealand’s external linkages strategy. This is particularly so given the tariff peaks that exist in many food and primary production sectors which are economically important to New Zealand. However, economic policy also has a role to play in New Zealand’s external linkages strategy. The economic policies of our trading partners can impact on their growth rates and their desirability as places to do business. Furthermore, economic policies that diverge markedly from our own can increase the cost of doing business across borders and lead to New Zealand businesses foregoing what might otherwise be viable market opportunities.

Coordinating Group, the Finance Ministers’ Process (FMP), Small and Medium Enterprises Working Group (SMEWG) and the Investment Experts Group (IEG).

²¹ See for example presentations by Oxley (2006) and Parker (2006).

²² See for example ABAC (2006).

²³ A key theme of APEC during New Zealand’s 1999 host year was “strengthening markets”, which stressed structural reform. New Zealand was also the inaugural Chair of APEC’s Competition Policy and Deregulation Group (CPDG) which also pushed a focus on structural reform.

An external linkages strategy that addresses economic policy structures in addition to trade policy has a number of benefits for New Zealand, including:

- *Improved growth prospects for the region:* Structural policy reforms will promote stronger and more sustainable economic growth among our key trading partners (identified as the major economies on the Asia-Pacific Rim, most notably Australia, the United States, Japan, Korea and China) (Rose and Stevens, 2004).
- *Domestic policy development:* Greater dialogue with our key trading partners on international policy developments will also assist New Zealand in developing our own domestic policies.
- *Complementarity to trade agenda:* Consistent with the “Which Countries” work, New Zealand’s preferential trade agreement strategy focuses on the Asia-Pacific region. Under-developed economic policies may make some economies reluctant to open up some of their markets to greater competition (eg, services and investment markets), which impacts on the comprehensiveness of PTAs and the benefits that we can secure for New Zealand businesses.
- *Providing a platform for deeper regional integration:* Greater regional integration in the Asia-Pacific will support the development of more integrated markets for goods, services and factors of production.

From a New Zealand perspective, the APEC Economic Committee is a useful forum to promote structural reforms in the region. It is an existing institutional structure in which New Zealand has an equal voice and where the majority of our key Asia-Pacific trading partners are represented.

5.3 Role of APEC in progressing structural reform

APEC’s cooperative, voluntary and informal manner of operations means that it is a good forum for discussions on economic policy challenges facing the Asia-Pacific region. Because structural policies are behind the border they cannot easily be negotiated between economies. Therefore, APEC has sought to promote improvements in an economy’s domestic structural policies through policy dialogue rather than a “target-setting” approach. APEC promotes structural policy reform by providing a forum for senior-level officials across the region to discuss economic policy challenges, share experiences, discuss good practices and provide technical support where necessary.

By comparison, a target-setting approach would involve setting targets to improve structural policies (eg, targeting a 5% reduction in structural reform indicators over five years). While a target-setting approach would allow greater measurement of the progress of economies in improving structural policy settings, such an approach also has a number of potential drawbacks. An agreement may be difficult to reach given the subjectivity of structural reform indicators, such as measures of governance. This approach may also result in a number of difficult (yet potentially important) domestic policy concerns being “taken off the table” and little progress being made in certain areas. A “policy dialogue” approach potentially creates a better platform for discussion of more difficult economic policy issues.

Because of APEC’s voluntary nature, and its avoidance of setting target-type goals in the area of structural policies, identifying quantifiable structural policy reform outcomes can be

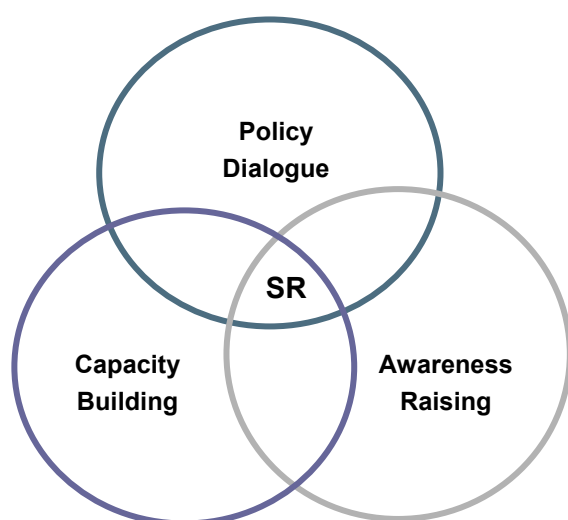
difficult. However there are examples emerging of how APEC has assisted in promoting improved structural policies. For example, APEC has assisted economies in identifying areas of domestic regulatory policy that could be enhanced, through the application of regulatory self-assessment tools, such as the “APEC-OECD Integrated Checklist on Regulatory Reform”.²⁴ For APEC to progress its work on structural policy reform, it will take concerted input from APEC economies, particularly developed economies, given the resources and expertise that they have at their disposal.

In addition to the Economic Committee (EC), there are a number of APEC fora that have a focus on structural policy issues, including the Competition Policy and Deregulation Group (CPDG), the Strengthening Economic Legal Infrastructure (SELI) Coordinating Group, the Finance Ministers’ Process (FMP), the Small and Medium Enterprises Working Group (SMEWG), the Anti-Corruption and Transparency Taskforce (ACTTF), and the Investment Experts Group (IEG), as well as a number of sectoral working groups. The EC has the mandate to lead and coordinate APEC’s structural reform work to ensure consistency and prevent unnecessary overlap across APEC fora.

The literature identifies a number of challenges and strategies for managing the ongoing process of structural policy change for APEC economies. While the benefits of structural policy change are becoming increasingly clear, reforms often involve quite fundamental changes to how markets operate, and so can face resistance from groups that have a vested interest in the status quo. Reform can also involve transitional dislocations. Hence there are potentially significant social and political tensions and challenges involved in undertaking structural reform.

Figure 9 illustrates a framework for thinking about how the set of desirable and feasible structural policies (zone “SR”) can be expanded by making improvements across the three dimensions of policy dialogue, capacity building and awareness raising. The next three sub-sections provide an overview of lessons from the literature and the role of the EC in providing tools to manage structural change.

Figure 9: Framework: Increasing the set of feasible structural policy improvements



Source: Adapted from World Development Report (2005).

²⁴ The “APEC-OECD Integrated Checklist on Regulatory Reform” is available from <http://www.oecd.org/dataoecd/3/53/36326815.pdf>

5.3.1 Policy dialogue

The pervasiveness of structural policies makes identifying and setting priorities a key challenge of structural reform. Given the diversity of situations there is no standard formula for identifying priorities. However, the World Development Report (2005) suggests that governments may wish to start by:

- *Assessing current conditions:* Comparing performance with other economies (eg, by using the World Bank's "Ease of Doing Business" indicators, the "Index of Economic Freedom" and/or the IMD Business School's "World Competitiveness Yearbook" to benchmark performance).
- *Assessing potential benefits from improvement:* There may be a greater impact from addressing constraints that affect a large share of economic activity (eg, macroeconomic stability).
- *Implementation constraints:* Administrative and political constraints should be taken into account when setting priorities (eg, a high level commitment and process for managing change may be necessary).

An EC Seminar on "Priorities in Structural Reform in APEC Economies" held in January 2007 aimed to promote understanding of the national and common regional priorities in structural reform across APEC member economies to help inform the focus of the EC's future work. It was evident from the discussion at the seminar that economies are able to identify specific priority areas in their local contexts. Where the EC can add value is by providing a forum for discussion and sharing of experiences of the tools for assessing and implementing reforms.

5.3.2 Capacity building

Economies need the financial resources and technical expertise to drive structural change. The World Development Report (2005) suggests that governments may wish to start strengthening capacity by improving the expertise of the civil service and the quality of information available to guide and administer reforms.

The Report identifies the importance of economies creating a skilled, professional and accountable civil service and drawing on specialist expertise where necessary. Some economies have established more autonomous administrative structures to make it easier to recruit and retain staff with the necessary skills. For example, research has found that autonomous tax authorities can bypass restrictive civil service rules and pay better salaries to attract and retain well-qualified professionals; and can therefore promise better performance than traditional ministries (Bird, 2004).²⁵

Many economies have also tried contracting-in or contracting-out specific functions to outside experts. For example, a recent survey of developed economies undertaken on behalf of the World Bank found that three-quarters of regulatory agencies for infrastructure engaged consultants or other external parties in regulatory tasks. Furthermore, the study found that in more than 90% of these cases, contracting-out improved the competence of regulatory agencies (Environmental Resources Management, 2004).

The Report also highlights the importance of economies improving processes for ongoing learning from within economies and from overseas experiences. This can be achieved

²⁵ Bird (2004) sites cases from Latin America and elsewhere.

through greater access to reliable data, introducing consultation processes or by introducing or improving enterprise surveys to gather information on factors such as productivity and job creation.

The work of the EC has a capacity-building dimension. For example, the Australian APEC Study Centre ran a training course in May 2007 on “Strategies to Promote Structural Reform by Focusing on the Drivers of Economic Growth in APEC”, which was endorsed by the EC.²⁶ This course aimed to enhance the capacity of participants to appreciate the key drivers that improve productivity and to devise policy responses to improve economic performance.

Another activity that has a capacity-building aspect is the “APEC-OECD Integrated Checklist on Regulatory Reform”. The Checklist is a voluntary tool that member economies may use to evaluate their regulatory reform efforts. The Checklist highlights key issues that should be considered during the process of development and implementation of regulatory policy. This year Australia and the Republic of Korea undertook a self-assessment using the Checklist. The results were reported and discussed at a joint EC-CPDG-SELI Roundtable session. In 2006 the United States; Chinese Taipei; and Hong Kong, China undertook a self-assessment using the Checklist, the results of which were also discussed at a Roundtable session.²⁷

A seminar was held in Indonesia in early June 2007 on “Utilizing APEC-OECD Integrated Checklist on Regulatory Reform in Competition and Deregulation Aspects”. This seminar was attended primarily by officials from Indonesia and other member economies that are considering undertaking the self-assessment exercise in the future.

5.3.3 Awareness raising

The benefits of structural policy reform are not generally well understood by the public. For reforms to be successful it is important that the costs and benefits of policy approaches are well communicated and understood by key stakeholders.

While recognising that the appropriate awareness-raising strategies will differ across economies, the World Development Report (2005) identifies some practical steps economies can take to raise awareness about structural reform:

- *Communicating to build support:* Raise public awareness and mobilise a broader range of support (eg, by using tools like World Bank “Ease of Doing Business” indicators and the “Index of Economic Freedom” to benchmark performance).
- *Maintaining momentum:* Establish institutions to sustain progress of reform. Institutions can facilitate consultation and coordination and review existing and proposed policies (eg, institutions such as Mexico’s Economic Deregulation Unit and the Australian Productivity Commission).

It will often be important for policy makers to clearly communicate to key stakeholders why structural policy changes are necessary. While the most appropriate form of communication will vary among economies, a good example of the use of communication

²⁶ Further information about the APEC Study Centre is available from http://www.apec.org/apec/apec_groups/other_apec_groups/apec_study_centers_consortium.html

²⁷ Further information on the “APEC-OECD Integrated Checklist on Regulatory Reform” is available from <http://www.oecd.org/dataoecd/41/9/34989455.pdf>

to build support is the New Zealand reform experience of the 1980s. New Zealand went through radical reforms in the 1980s that transformed its economy from one of the most regulated to one of the least regulated in the OECD in a matter of a few years. The incoming administration extensively publicised why regulatory changes were necessary, what the goals of reforms were, and what the strategy was. While strong debate existed, most of the reforms have not been repealed. History also tells us that programs of structural change often involve taking advantage of opportunities as they present themselves. New Zealand's 1980s structural reforms were implemented when the New Zealand economy was undergoing severe financial stress, following a decade of very poor economic growth.

The main publication of the EC, the "APEC Economic Policy Report", is a tool for raising awareness of the benefits of structural reform.²⁸ Last year's report focused on the importance of structural reform and captured the experience of member economies with structural reform over the past 10 years. The report is provided to APEC Economic Leaders and is available to the public on the APEC website. The 2007 report will focus on the LAISR priority area of public sector governance and aims to capture general principles of good public sector governance and economy experiences with public sector governance reforms over the past 10 years. Future reports will focus on other LAISR priority areas, such as competition policy, regulatory reform, corporate governance and strengthening economic and legal infrastructure.

6 Summary

The Asia-Pacific region is a major engine for global growth, comprising 57% of world GDP (US\$20.7 trillion) and 46% of world trade (US\$7 trillion) (APEC Secretariat, 2004). However, there is a growing body of evidence which suggests that the APEC region is not realising the full benefits of income convergence due to remaining barriers at the border as well as behind-the-border barriers to economic growth and regional economic integration. While outward-orientation and strong growth performances have resulted in a catch-up process in some economies, progress across the APEC region has been patchy. Consequently there is a growing consensus that, as a complement to the trade and investment liberalisation and facilitation agenda, focus in the APEC context should also be given to structural policies.

While the benefits of structural policy reform are becoming increasingly well understood, there are of course significant challenges to undertaking structural reform. While the most appropriate policy responses will differ across economies, the literature identifies a number of challenges and strategies for managing structural change. These can be conceptualised as increasing the set of desirable and feasible reforms by making progress across the three dimensions of policy dialogue, capacity building and awareness raising.

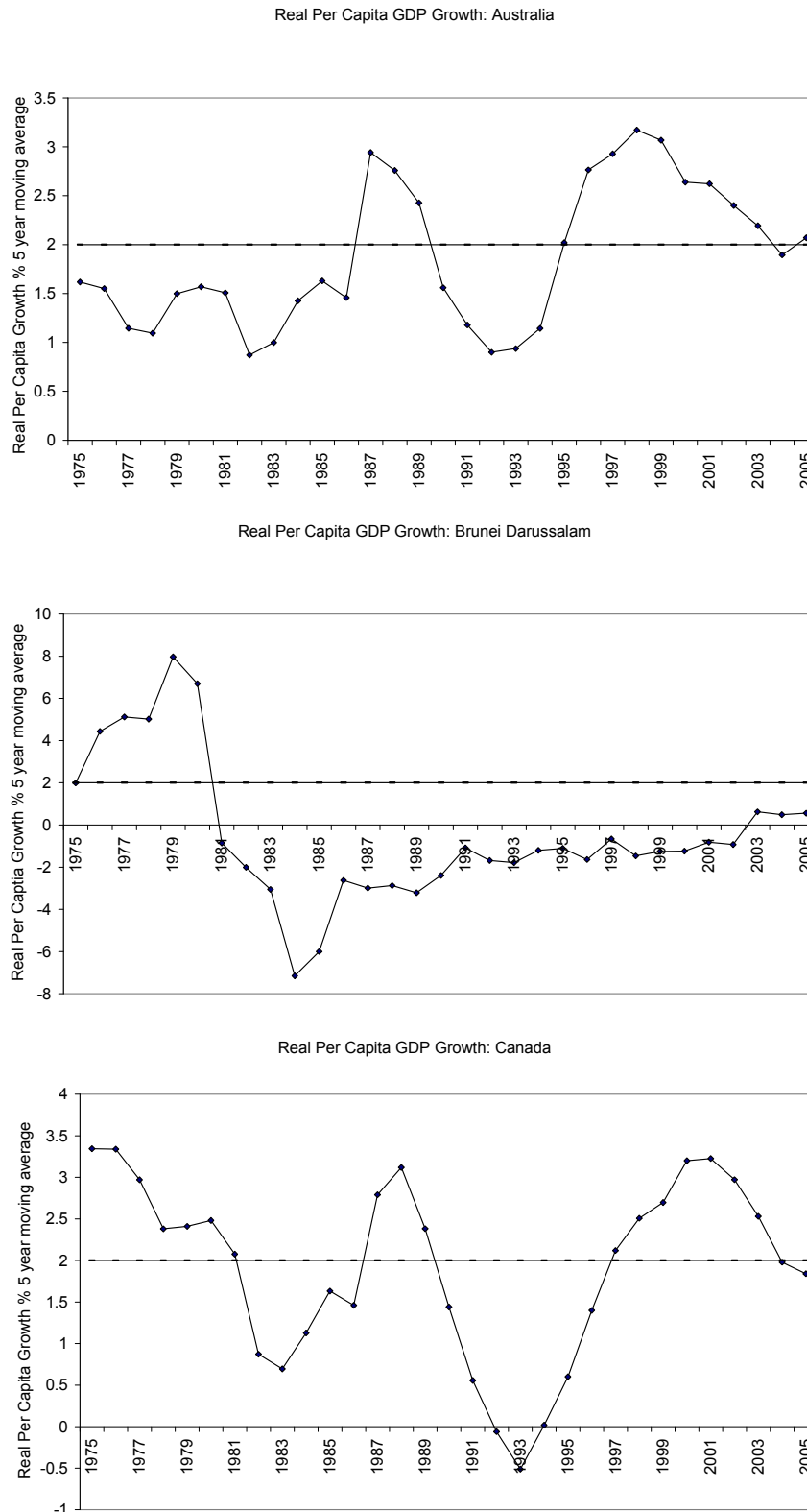
APEC provides New Zealand and other member economies with a forum to promote improvements in economies' domestic structural policies. Where APEC and the Economic Committee can add value to the work being undertaken by other international organisations, such as the OECD and World Bank, is by providing a forum for the discussion and sharing of experiences on good practice principles and practical lessons

²⁸ The "APEC Economic Policy Report" is available from http://www.apec.org/apec/apec_groups/committees/economic_committee.html

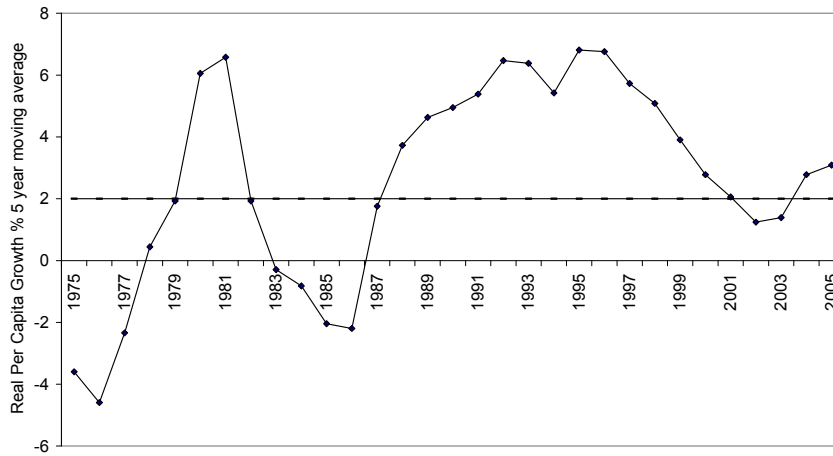
on policy implementation, as well as technical assistance where necessary. Structural policy change is a long-term process, which complements the trade and investment liberalisation and facilitation agenda. It will take concerted input, particularly from developed APEC economies, to deliver on APEC's structural reform work.

Appendix 1

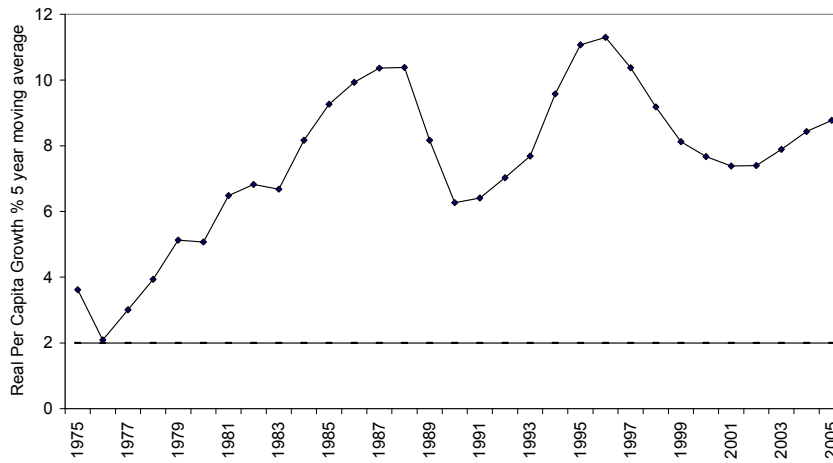
Figure A1: Real average per capita GDP growth of APEC economies, 1975-2005



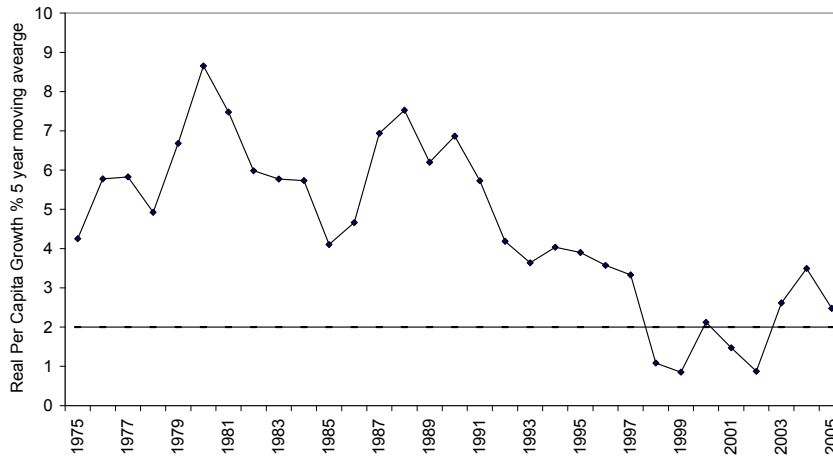
Real Per Capita GDP Growth: Chile



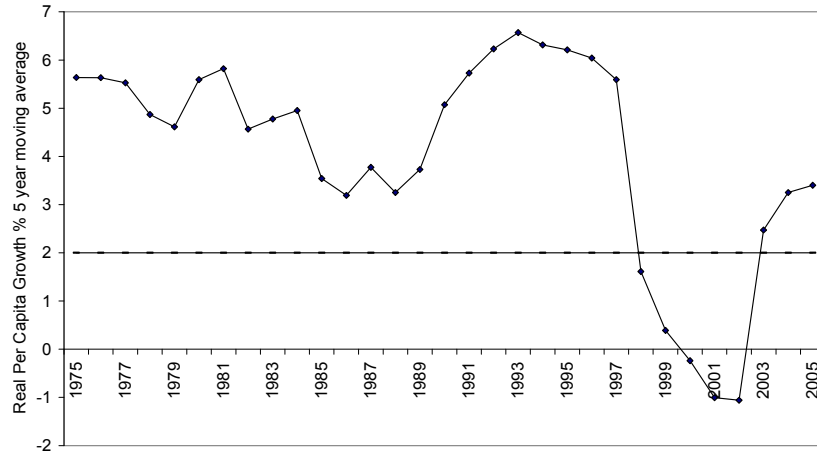
Real Per Capita GDP Growth: China



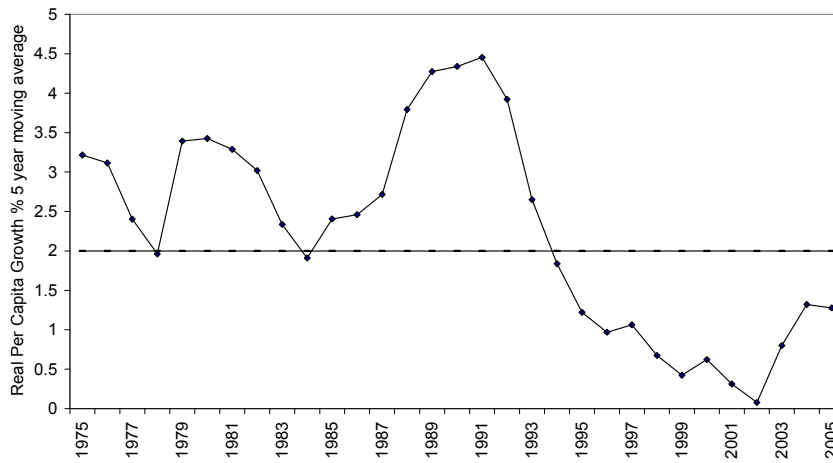
Real Per Capita GDP Growth: Hong Kong, China



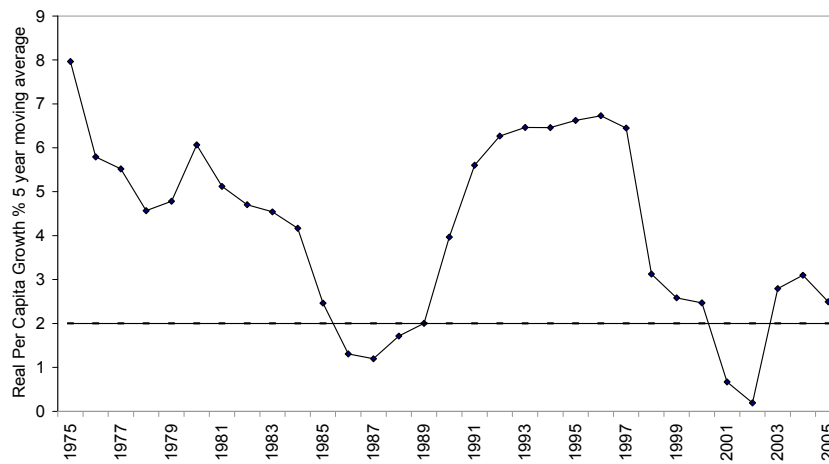
Real Per Capita GDP Growth: Indonesia



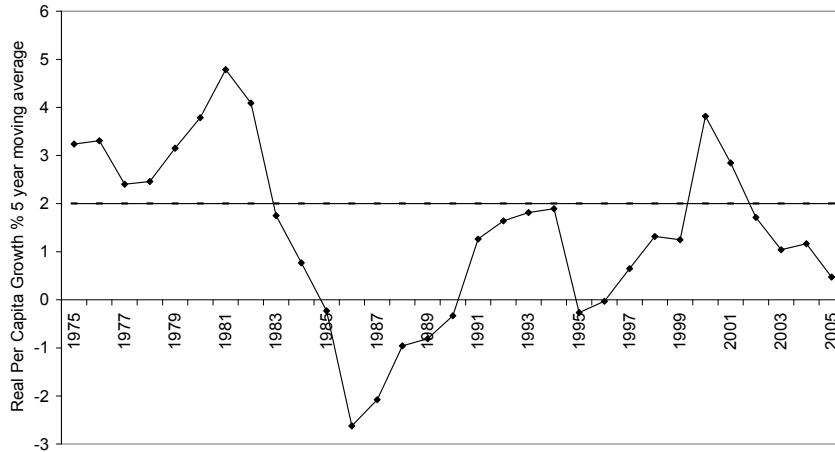
Real Per Capita GDP Growth: Japan



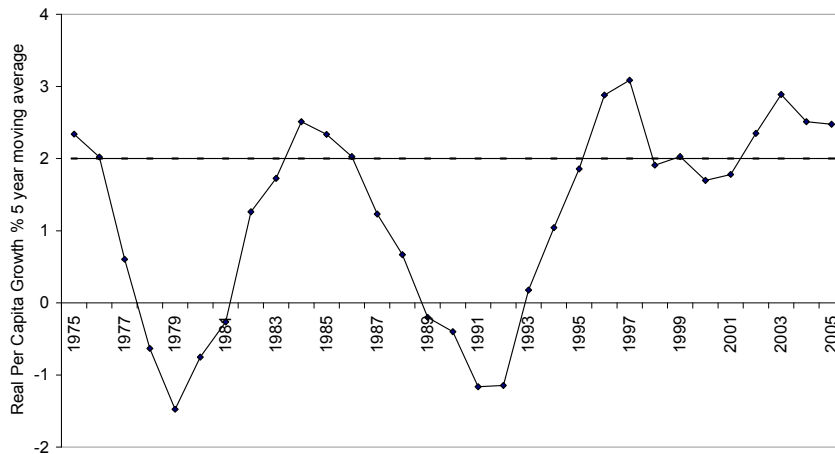
Real Per Capita GDP Growth: Malaysia



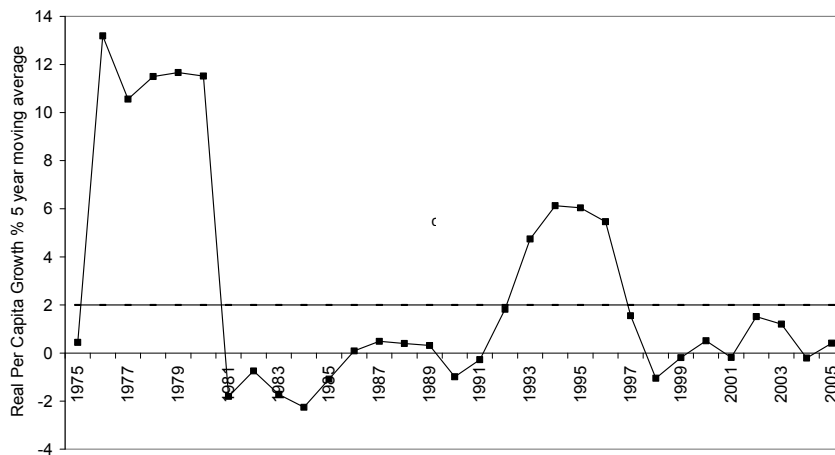
Real Per Capita GDP Growth: Mexico



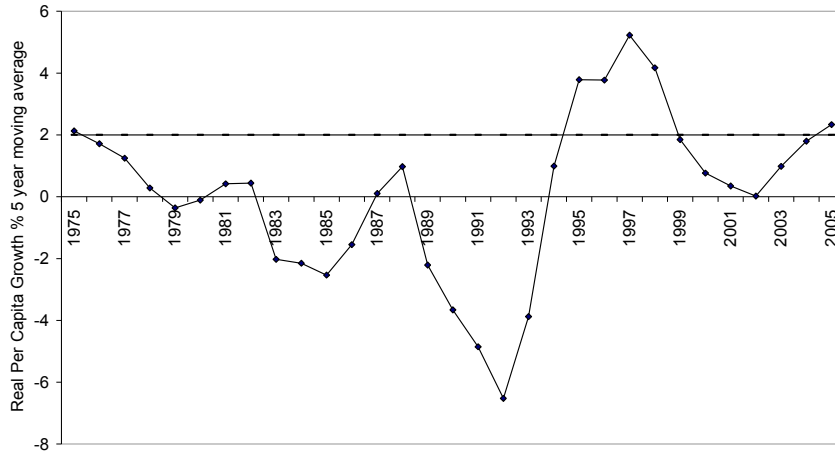
Real Per Capita GDP Growth: New Zealand



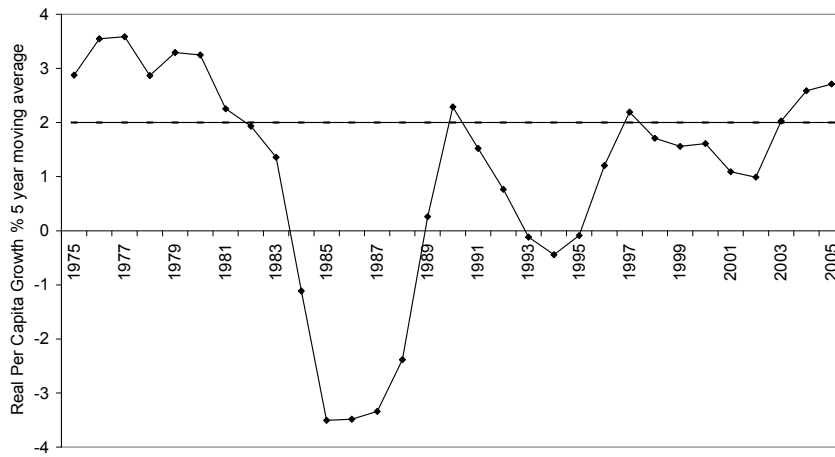
Real Per Capita GDP Growth: Papua New Guinea



Real Per Capita GDP Growth: Peru



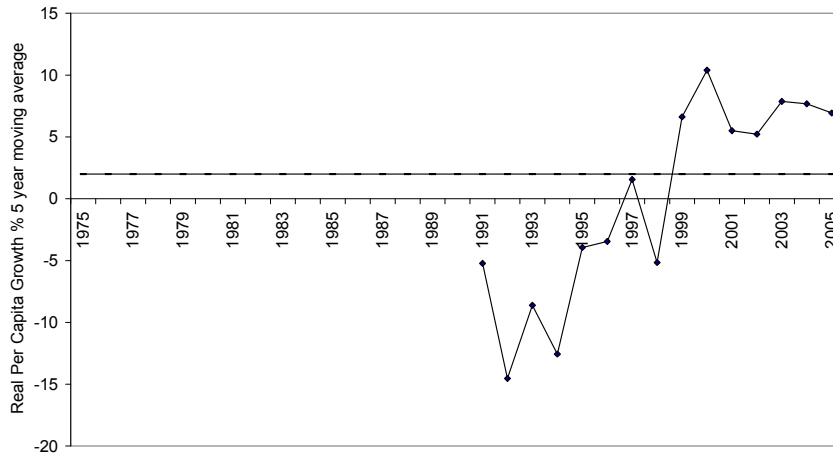
Real Per Capita GDP Growth: Philippines



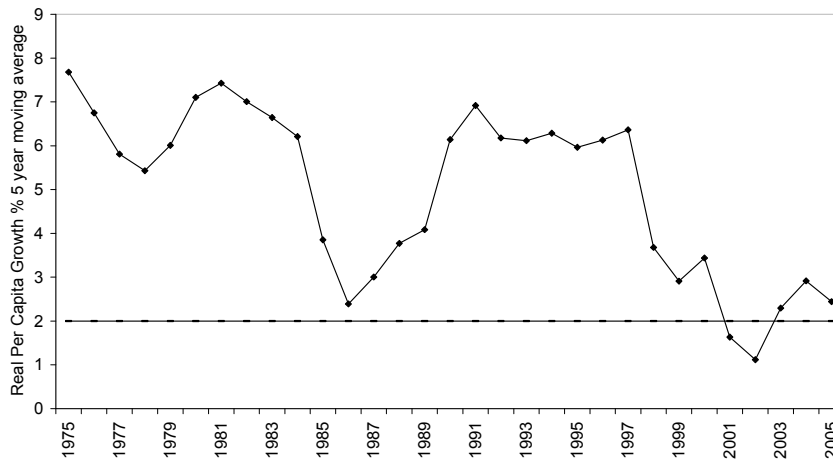
Real Per Capita GDP Growth: Republic of Korea



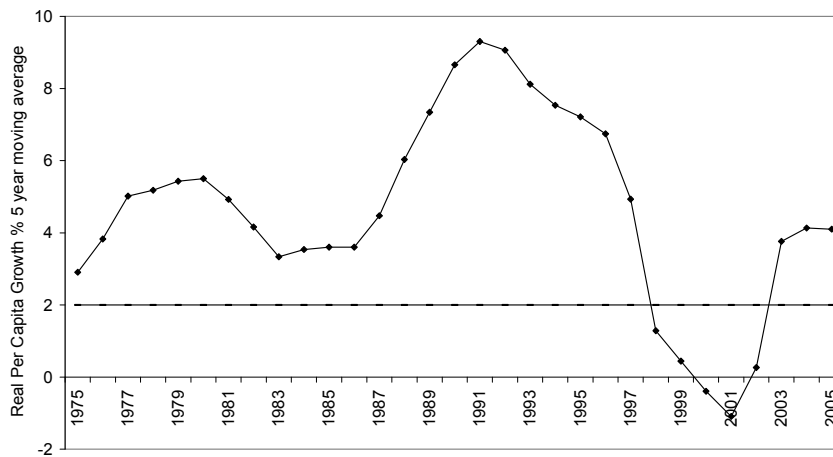
Real Per Capita GDP Growth: Russia



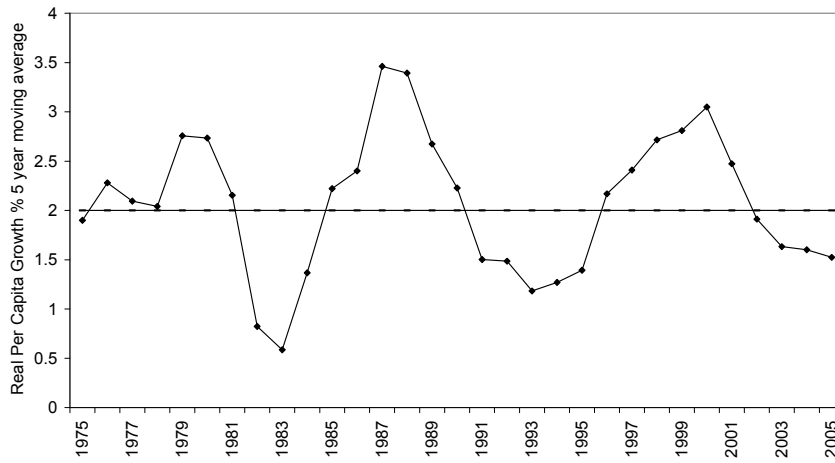
Real Per Capita GDP Growth: Singapore



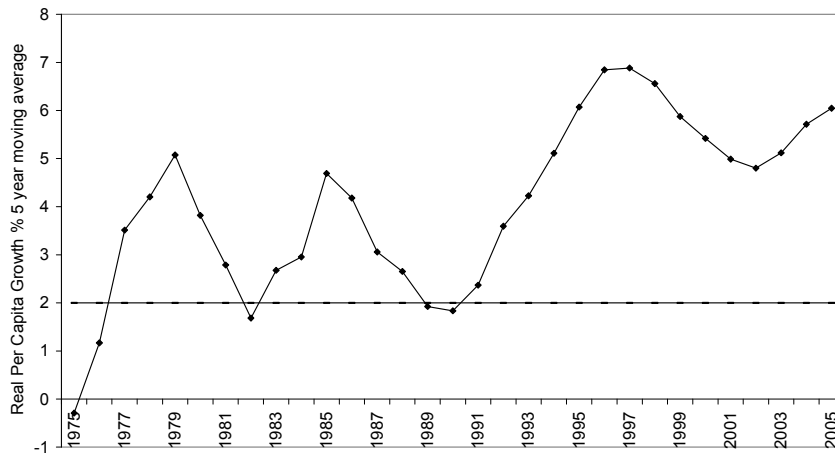
Real Per Capita GDP Growth: Thailand



Real Per Capita GDP Growth: United States



Real Per Capita GDP Growth: Viet Nam



Source: United Nations Statistical Database.

Note: Excludes Chinese Taipei due to data gaps.

Appendix 2

Table 2: Key for abbreviations

Economy	Abbreviation
Australia	AUS
Brunei Darussalam	BRD
Canada	CAN
Chile	CHL
People's Republic of China	CHN
Hong Kong, China	HKC
Republic of Indonesia	IDN
Japan	JPN
Republic of Korea	KOR
Malaysia	MTS
Mexico	MEX
New Zealand	NZL
Papua New Guinea	PNG
Peru	PER
Republic of the Philippines	PHL
Russia	RUS
Singapore	SGP
Thailand	THA
United States	USA
Viet Nam	VNM

Note: Excludes Chinese Taipei due to data gaps.

Appendix 3

Partial correlation coefficients: “Ease of Doing Business”, “Economic Freedom” and “World Competitiveness” rankings

The first two columns of the table present the partial correlation coefficients between the ranking of APEC economies in each of the 10 individual “ease of doing business” indicators and the composite overall ranking.

The second two columns present the partial correlation coefficients between the ranking of APEC economies in each of the 10 individual “economic freedom” indicators and the composite overall ranking.

The last two columns present the partial correlation coefficients between the ranking of APEC economies in each of the 4 individual “work competitiveness” indicators and the composite overall ranking.

Table 3: Partial correlation coefficients: “Ease of Doing Business”, “Economic Freedom” and “World Competitiveness” rankings

Ease of Doing Business Index, 2006		Economic Freedom Index, 2007		World Competitiveness Yearbook, 2007	
Starting a Business	0.792	Regulation	0.828	Economic performance	0.756
Dealing with Licenses	0.649	Trade	0.778	Government efficiency	0.894
Employing Workers	0.706	Fiscal	0.088	Business efficiency	0.939
Registering property	0.581	Government	0.267	Infrastructure	0.863
Getting credit	0.842	Monetary	0.854		
Protecting investors	0.765	Investment	0.879		
Paying taxes	0.784	Financial	0.813		
Trading across borders	0.590	Property Rights	0.923		
Enforcing contracts	0.694	Corruption	0.918		
Closing a business	0.854	Labour	0.682		
Overall ranking	1.000	Overall ranking	1.000	Overall ranking	1.000

Note: Economies included where data are available.

Table 4: Partial correlation coefficients: Economic performance and “Ease of Doing Business”, “Economic Freedom” and “World Competitiveness” rankings

	Labour productivity, 2005	Real average GDP per capita, 2000-2005
Ease of Doing Business ranking	0.789	0.756
Economic Freedom ranking	0.796	0.814
World Competitiveness yearbook ranking	0.752	0.766

Source: World Economic Outlook Database, IMF; Ease of Doing Business Database, World Bank; Index of Economic Freedom Database; and World Competitiveness Yearbook, IMD Business School.

Note: Economies included where data are available.

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