

# MICROECONOMIC POLICY REFORM: STRATEGY FOR REGIONAL COOPERATION

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## **Microeconomic Policy Reform: Strategy for Regional Cooperation**

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### **Introduction**

East Asian economies have made use of regional cooperation to advance their domestic economic reforms. But by the same token, at least in its initial stage regional economic cooperation in East Asia has also been driven by economic reforms that have been independently undertaken by regional economies.

The “first generation” economic reforms in East Asia have been characterized by measures to gradually open up the economies, initially manifested in the efforts to promote exports through various measures other than the liberalization of trade. In Korea, for example, the policy of so-called “double distortions” was the way to expand exports while continuing to seal off the economy. In such countries as Malaysia and the Philippines, export processing zones were formed to promote exports from certain production locations that were managed under special policies. China successfully invented special economic zones that encompass large areas, even entire provinces in the coastal regions.

Trade liberalization was only a matter of time. In the case of the (original) ASEAN countries, their involvement in the Uruguay Round of multilateral trade negotiations

brought home the message that to secure greater market access for their exports they too need to allow others greater access into their markets. ASEAN countries accepted the notion of “graduation” to becoming newly industrializing economies (NIEs). It was this promise of moving up the ladder of development, and of becoming members of an East Asian “flying geese” formation, that led them to adopt progressively more open economic policies. The ASEAN economies became more integrated to their neighbors in the North.

Subsequently, the ASEAN economies in particular embarked on investment liberalization to attract capital and technology to expand and up-grade their production capacity. ASEAN began to entertain the idea of forming a regional production platform for the global markets. This policy coincided with the strong drive on the part of Japanese companies to migrate to the South in response to the sharp Yen appreciation following the Plaza Agreement. The strong investment pull and push factors resulted in a new, dynamic regional division of labor that became progressively more horizontal in nature. This has led to the emergence of regional production networks.

The dynamic developments in the region provided the argument for committing the countries to adopting and sustaining open economic policies as manifested in the efforts to continue with a program of trade and investment reforms. They have achieved a great deal but they continue to struggle with the problem of “sensitive sectors”.

Regional cooperation has helped to strengthen the commitment to open economic policies. The ASEAN Free Trade Area (AFTA) is seen by members as a means to lock in domestic economic reforms. Vietnam has been able to promote domestic economic reforms in part by using its commitments in ASEAN as a pretext. In view of its spectacular development performance it is not surprising that Vietnam has become the main champion of ASEAN.

Regional economic integration, or “economic regionalization”, in East Asia has been largely market driven. Governments have entered the picture by promoting “economic

regionalism” with the adoption of agendas that focus on trade and investment liberalization and facilitation. In ASEAN, with the formation of AFTA in 1993, the action plan has focused on the Common Effective Preferential Tariffs (CEPT) to be introduced by member economies and gradually reduced to 0-5% by a date certain. An exclusion list and a sensitive list were introduced to deal with the “sensitive sectors”. An assessment of the impact of AFTA suggests that intra-ASEAN trade only increased slightly and that only about 5% of it has used the CEPT. What is often overlooked is the fact that together with the reduction of CEPT rates, ASEAN members have also lowered their MFN tariffs, making the whole of ASEAN a more open economic region for the world.

In 1994, APEC produced one of the most significant initiatives thus far, namely the Bogor Goals of free and open trade and investment in the region by 2010/2020. It is not a free trade area (FTA). Trade and investment liberalization has been pursued through the adoption of a modality known as “concerted unilateral liberalization” that is voluntary in nature, manifested in annual Individual Action Plans (IAPs). Progressive liberalization is to be achieved through peer pressure. APEC trade liberalization has been underestimated because members’ commitments to reduce tariffs are seen to have come largely from initiatives outside of APEC and because the attainment of the Bogor Goals is being questioned. But APEC is about creating an environment that encourages members to maintain a strong commitment to open economic policies. In fact, average tariffs of APEC members have declined significantly, from 16.6% in 1988 to 6.4% in 2004. Trade and investment liberalization efforts are also accompanied by trade and investment facilitation measures as well as economic and technical cooperation. They form the three main pillars of APEC cooperation. A fourth pillar, human security, has been added since 2003.

APEC is much more than trade and investment liberalization. It is about community building. However, its achievements have been measured mainly in terms of trade and investment. Although average tariffs have gone down significantly, the APEC region still faces difficulties to remove barriers in a number of “sensitive sectors”. Experience now

clearly shows that the real sensitive sectors, such as agriculture for a number of developed and developing countries, that are difficult to deal with multilaterally also cannot easily be removed through a regional (or bilateral) agreement. In fact, it appears that they can only be dealt with at the global level (WTO).

APEC's inability to overcome this difficulty is not due to its voluntary nature. Therefore, suggestions to transform V-APEC (voluntary APEC) into B-APEC (binding APEC), as prominently manifested in the idea of a Free Trade Area of the Asia Pacific (FTAAP), are totally misguided. In fact, as shown by the experiences in negotiating the various ASEAN+1 FTAs (such as the ASEAN-China FTA or the ASEAN-India FTA), the binding nature of the agreement tends to increase the number of sectors considered to be "sensitive."

East Asia definitely has become a more open economic region because of significant progress in the removal of border barriers. The first generation economic reforms have achieved this. Regional cooperation (ASEAN and APEC) has assisted in the process, but as it is currently structured it can only go so far as reducing and removing most border barriers. This can be seen as the characteristic of what can be called "first generation" regional cooperation.

So long as the issue of "sensitive sectors" is not effectively dealt with, barriers to protect those sectors tend to be pushed deeper into the economy. They become more complicated and are less transparent.

### **Into an Era of "Second Generation" Economic Reforms and Regional Cooperation**

The notion of "second generation" economic reforms and "second generation" regional cooperation follows directly from the above examination. Economic well-being and competitiveness are not influenced only by openness to trade and competition but also by the region's regulatory and structural architecture.

Second generation economic reforms refer to efforts to tackle the many behind-the-border barriers. It is beyond the scope of this paper to elaborate on this. Tackling behind-the-border barriers requires improvements made to institutional frameworks, regulations and government policies. A major objective of these reforms is to make the functioning of markets more efficient.

In the context of regional cooperation, these reforms could include, but certainly go much farther beyond, so-called trade facilitation measures. Trade facilitation also aims at making markets more efficient by reducing costs to business operating in and especially between markets. Trade facilitation measures to reduce “transaction costs” include simplification of administrative and procedural requirements (such as customs procedures and port logistics), standards and conformance, improving transparency, and developing e-business.

ASEAN, APEC and ASEAN Plus Three (APT) have introduced various trade facilitation measures in their agenda. In 2001 APEC set targets on trade facilitation when APEC Leaders agreed to reduce average business transactions costs by 5% by 2006. To this end APEC developed Trade Facilitation Principles and a Trade Facilitation Action Plan (TFAP). At the Ha Noi meeting in November 2006 APEC agreed on a framework to continue the trade facilitation work beyond 2006 to reduce business transaction costs by another 5% by 2010. These are laudable efforts, but they do not go to the heart of the second generation economic reforms.

Beyond-the-border barriers are not always erected to protect a sensitive sector. They may result from institutional or regulatory deficiencies, sometimes due to erroneous or misguided policies. Lack of capacity to design and administer policies may be overcome by introducing restrictions and rigidities.

In any case, tackling these structural problems is generally found to be difficult because of complex political economy factors, but the pay-offs can be significant for the domestic economy as well as for the regional economy. This could be the reason why issues of structural reform have been brought into the APEC agenda.

In 2003, as stated in the Chair's Summary, APEC Leaders shared experiences on their efforts in domestic structural reform, "which can be painful but is necessary and beneficial in the long-term." In 2004, they reaffirmed their political commitment to promote structural reform. They adopted the Leaders' Agenda to Implement Structural Reforms (LAISR) that was drafted and submitted by Japan (see Attachment).

In 2005, the Leaders instructed Ministers to work on behind-the-border issues and welcomed the adoption of the APEC Work Plan on the LAISR towards 2010 (LAISR 2010) "as a policy-oriented approach to bring about needed structural reforms." In the 2006 Ha Noi Declaration the Leaders "recognized the need to intensify work on structural reforms." Australia as chair of APEC 2007 indicated that the work on economic reform "will focus on promoting high-quality economic policy dialogue, strengthening economic infrastructure and improving regulatory efficiency."

In comparison to APEC, the two other regional cooperation arrangements in East Asia (ASEAN and APT) have not yet introduced economic (structural) reform issues into their agenda. The priority areas of APEC's LAISR are: (a) regulatory reform; (b) competition policy; (c) public sector management; (d) strengthening economic and legal infrastructure; and (e) corporate governance. The modality of its work is to discover good practice principles within each priority area that may be applicable to the more specific reforms that individual member economies may choose to voluntarily adopt.

The APEC Work Plan on LAISR 2010 proposed that from 2006 to 2010, 2 to 3 coordinating economies, ideally from developed and developing economies, will take the lead on a particular policy issue. The coordinating economies will undertake policy-oriented work in this area, which may include policy dialogue ..., capacity-building projects and a recommendation or good practice paper. This work will be conducted

within a one to two-year time frame. The key findings of this work will be submitted to Ministers and Leaders.

The APEC Economic Committee (EC) has been given the mandate to promote structural reform within APEC by undertaking policy analysis and action-oriented work. It is also responsible for overseeing LAISR, and undertakes coordination with other relevant APEC fora, e.g. the Strengthening Economic and Legal Infrastructure (SELI) group, the Competition Policy and Deregulation Group (CPDG) and the Finance Ministers' Process.

There is thus already an opening in APEC to undertake systematic efforts in the area of microeconomic policy reform. However, from the brief examination above it can be said that the new APEC agenda (LAISR) has introduced the concept of "second generation" economic reform but is short of developing second generation regional cooperation arrangements that can lend strong support to successful microeconomic reform efforts in member economies.

### **Towards an Effective Strategy for Regional Cooperation**

Regional cooperation can help improve national capacity for policy development and policy implementation by instituting mechanisms for: (a) sharing policy experience; (b) drawing upon international expertise in relevant policy areas; (c) developing a regional vehicle that can be used for independent review and evaluation of policy performance.

The following are elements of an effective strategy for APEC cooperation to promote microeconomic reform:

- (1) Strengthen the work of the APEC Economic Committee (EC) and relating it to the broader APEC agenda at Ministerial level. The EC should have the capacity to undertake review of policies in some key areas by establishing an Office that serves the EC. This

can take the form of an on-going APEC Productivity and Efficiency Commission (APPEC).

(2) APPEC should have the capacity to respond to requests by APEC and member economies for analysis of micro-policy and regulatory issues.

(3) This Commission could draw in capacities and research networks from around the region (EABER and NBER), and be associated with the APEC Secretariat.

(4) A strengthened EC should be coupled with provision for Ministerial-level direction and responsibility for follow-through.

(5) Leaders might commission research and analysis of costs and benefits of policy regimes, and Ministerial Sub-Committees charged with follow-up and formulating responses to the implications of the work.

### **Concluding Note**

The importance of microeconomic reform for East Asian economies cannot be overstated. APEC provides a useful forum for the East Asian economies to support their efforts to effectively respond to the challenges of second generation economic reform. For APEC's own sake it should make microeconomic reform a priority. This is so because to remain relevant it will have to progress on all fronts, including in its trade agenda, which includes a leadership role in strengthening the multilateral trade regime.

APEC's microeconomic reform agenda must have a strong Ecotech element, namely capacity building. In fact, APEC's Ecotech program can become much more coherent and coherent than it now is if structured within the structural reform work program. In fact, a meaningful Ecotech program should consist of information sharing, policy development and capacity building.

To conclude, as described above, APEC's strategy to support microeconomic reform in its member economies should have the following essential elements:

- (a) An arrangement to produce independent analysis with transparency in reporting and discussion of results.
- (b) Delivery mechanisms to assist in the enhancement of capacity of member economies for policy development and implementation.
- (c) Follow-through mechanisms to ensure implementation of commitments by member economies.

Attachment

**LEADERS' AGENDA TO IMPLEMENT STRUCTURAL REFORM (LAISR)  
SANTIAGO, CHILE  
NOVEMBER 2004**

The APEC Leaders reaffirm their sustained political commitment made in Bangkok 2003 to promote structural reform and their determination to demonstrate leadership to strengthen implementation of structural reform in the APEC region. They recognize the value of well-executed structural reform, underpinned by institutional capacity building, for achieving sustainable economic growth and supporting APEC's goal of trade and investment liberalization.

The APEC Leaders fully recognize that structural reform improves the functioning of market in order to sustainably enhance living standards and realize the economic potential of the APEC region by raising our economic efficiency and increasing our competitiveness. They stress the importance of structural reform, which provides a crosscutting perspective and potential for greater synergy across APEC's traditional approach to APEC's wide-ranging economic development agenda.

With a view to advancing structural reform initiatives in APEC, the APEC Leaders commit to addressing the following agenda by priority.

- Focus APEC's structural reform-related work on the following as possible priority areas based on its ability to add value to build on its existing work: regulatory reform, strengthening economic legal infrastructure, competition policy, corporate governance and public sector management.
- Identify an institutional mechanism to address structural reform as a major APEC priority, in consultation with the relevant APEC fora and the Finance Ministers' Process, in order to promote APEC's structural reform-related activities in a more enhanced and effective manner.
- Stimulate policy-oriented discussions on structural reform with a view to providing further clear guidance on APEC work.
- Foster understanding of the benefits of structural reform among APEC economies through better reporting process and sharing of good practices.
- Promote further capacity building, including for regulators.
- Strengthening cooperation and collaboration, where appropriate, with relevant international fora, notably the OECD, to deepen and expand structural reform-related activities and measures.

For continued structural reform in each APEC economy, the APEC Leaders acknowledge the relevance to:

- Accelerate domestic efforts and enhance communication with business on priority areas to be identified by each member economy.

- Develop pioneering policies/measures with a view to encouraging the initiation of reforms and promoting domestic regulatory reform.
- Enhance transparency to realize the predictable business environment through reversing those actions that perpetuate corruption.