

EABER CONFERENCE SUMMARY

ECONOMIC REFORM AND REGIONAL COOPERATION IN EAST ASIA

**HOSTED BY THE CHINA DEVELOPMENT RESEARCH
FOUNDATION**

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Economic Reform and Regional Cooperation in East Asia

China Development Research Foundation

Beijing, March 27, 2007

1. Conference Summary

China has come along way with its economic, social and political reforms but there is need for acceleration in reforms now that the economy is so open to the global economy. Steps are being taken but the tasks are daunting.

China, like the other economies in the East Asia region, had significant success with first generation reforms in which they committed to liberalisation of trade and other reforms to generate rapid trade-oriented growth. It is now recognised widely in the region and by Chinese policy makers that sustaining growth of productivity and competitiveness and deepening integration of the East Asian economy will require new policy strategy focused on reform of domestic institutions and regulatory systems. These types of reforms can be called second-generation reforms. These are domestic reforms aimed at making an economy more efficient, productive and competitive, and capable of in maximising opportunities presented from globalisation. The biggest impediments to trade and integration are behind the border domestic institutions and regulations which are emerging as a top policy priority throughout the region.

The first generation of reforms involved a different political economy from second generation reforms. First generation reforms involved the negotiation of domestic vis a vis foreign interests. The international institutional vehicle for this was the GATT (now the WTO). The early years of the Asia Pacific Economic Cooperation (APEC) process saw concerted unilateral trade liberalization based on commitment to trade reforms with peer support around the region and East Asian trade diplomacy gain influence in GATT during the Uruguay Round. Second generation reforms involve a political economy focused on the complicated mediation of domestic interests.

The priority for policymakers now is how to strengthen the institutional foundations of micro-economic and structural policymaking to help mediate those domestic interests. The payoffs are improved policy choice that reflects the public interest, improved policy implementation more sustainable economic performance.

The East Asia region is diverse with economies that have different policy priorities, different political circumstances, are at different stages of development and have different institutional settings. Each country's current institutional arrangements are the result of its own unique evolution and historical setting. The challenge is how to find appropriate ways to improve domestic policy making processes, in a way that is compatible with existing institutional arrangements.

The best policy options may not be implemented because of lack of capacity in carrying through reforms or understanding the best policy options. Often good policies will be frustrated because of resistance from vested interest groups. Sometimes the government

itself has direct interest in keeping bad policies in place. Constructing a policy process which incorporates a review institution or institutions that incorporate the key principles of independence, transparency and an economy-wide view can be useful to breaking down these resistances to better policy performance. Increased transparency in policy making and increased public understanding of the costs and benefits of policy intervention will clarify policy objectives, constrain vested interests and help lift policy performance. Policy reviews can set the agenda, set the parameters of the debate, raise the level of debate, name and shame vested interests and help marshal countervailing interests. Policy reviews and evaluations can help create coalitions for reform.

In Malaysia, regulatory and competition policy has been captured by vested interests and competition has suffered. Lack of transparency in policy decision making and lack of an independent policy review mechanism have meant that vested interests are significant cause of policy weakness, despite the fact that best policy is often identified and understood by policy makers.

Vietnam is continuing its reforms, and even accelerating the pace of reform, after very successful, comprehensive reform packages which saw private sector involvement grow and the transition of the Vietnamese economy to a rapidly growing economy firmly integrated into the global economy. These developments so far have culminated in its hosting of APEC in 2006 and achieving WTO membership. There is a strong recognition of the need to promote a level playing field for foreign and domestic firms as well as increasing private sector participation and reducing state involvement in State Owned Enterprises (SOEs) to an efficient level – all aimed at increasing competition. A task force approach has been successful in its reform policy process but there are problems of coordination, vested interest groups and principal-agent problems, all require reforms to the *policy process*.

Japan's reforms require dealing with entrenched vested and political interests. The Council for Economic and Fiscal Policy (CEFP) has allowed the policy makers to neutralise domestic vested interests through creating more transparency and an economy wide view in the policy making process. The CEFP was established in order to carry out large reforms and has played a big role in promoting the economic recovery of Japan. The nature of Japanese reform has gone from reactive (during stagnation) to more proactive, since the recovery. The CEFP is crucial in pursuing forward looking reforms but there remain risks since the CEFP is not yet deeply rooted in the Japanese political system.

Australia's reform experience, some institutions and institutional processes which help achieve difficult domestic reforms, are sometimes viewed in the region as exemplars. But Australia is still requires continued reforms and reforms to the policy processes as circumstances evolve and Australia is by no means achieving on the optimal policy frontier. The dynamism in the region means that Australia has to face new challenges - an example being the recent resource boom which has caused major structural adjustments that need to be managed well to avoid a hard landing post resource boom.

China's economic reforms have created very high growth but have also produced many problems and significant challenges – structurally and socially. The problems and obstacles are well recognised by policy makers but are difficult to solve. Reforms to the political system, narrowing the income gap between the rich and poor as well as between the provinces, liberalising the financial sector, creating a safety net and liberalising the exchange rate and other key prices are the largest challenges which require careful and technical reforms. Most reforms will need to be undertaken incrementally but will be under pressure (external and internal pressure) to be done rapidly. Sequencing is also important.

In China border liberalisation was politically difficult but technically easy. The rapid growth and powerful community interest in maintaining it at something like its current pace means that second generation reforms are politically easier but technically difficult. Unlike earlier reforms, where policy mistakes were internalised and contained, deep integration into the global economy puts external constraints on the economy and makes policy mistakes potentially a lot more costly. Gradual reform is now a costly and complex exercise, and a comprehensive new reform package is needed.

However, not all reforms need to be implemented rapidly. China has moved beyond policy slogans to era of sophisticated policy analysis and the policy making process is not entirely a top down approach any longer. As more players become involved in the economy and different sectors play more prominent roles, the interests of all of these will have to be balanced and taken into consideration for stability and continued prosperity domestically. Political institutional reform at the core is not practicable yet but this in an area where gradual reform is taking place and is necessary. Such institutional changes are crucial and helpful in progressing new structural reform issues in China.

Other institutional changes will have to be implemented to deal with reform resistances which have not been seen in China previously. Until now reforms have been directed at reforms that are relatively easy to implement but any reforms from now on will touch on vested interests that are becoming more entrenched and more powerful.

There needs to be thorough analysis of reform plans and issues. Many of these affect foreign participation in China as well as the regional economy. For example, a big issue in China currently is foreign investment – careful analysis will likely show that it is domestic distortions that cause the problems with foreign investment, not the foreign investment itself. Policy analysis and dialogue on these issues is likely to be helpful and should involve, to some extent, external capacity and input.

China's effect on the world economy is now substantial (for example, the impact of the recent Shanghai stock market dip) and growing, and this has to be recognised and kept in mind by policy makers. Domestic reforms and solving some of the above mentioned problems will have effects not only in China but for the region as well.

China, like all economies in East Asia, is facing impediments and barriers to domestic reforms, some unique and some shared. Many economies have come as far as they can

with their current institutional settings and some have started to realise there is scope for external assistance – assistance in capacity-building, sharing experience and advice.

How then can regional cooperation help with domestic reform agendas and issues?

A priority everywhere is for better policy processes to be entrenched in each country's policy making institutions. Countries with reasonably well established review and evaluation institutions (such the Productivity Commission in Australia) and transparent policy implementation mechanisms with an economy-wide view (the CEFP in Japan), as well as those where other institutions have played a useful role, are at a minimum able to share experience and cooperate regionally. The domestic nature of second generation reforms requires that any external support be non-intrusive and that any reform initiative using such external support have domestic ownership.

What regional forum is best suited to support member country domestic structural reforms?

The different regional organisations, though complementary, fill different roles. APEC would appear to have a strong advantage in supporting institutional reform of policy making processes for four reasons.

Firstly, APEC is based on principles which support market-oriented development and facilitates market institutions.

Secondly, APEC is not a negotiating forum and is voluntary and non-binding. Domestic reform issues are not easy to negotiate and sensitive internal issues are best addressed in non-negotiating forums that are voluntary and allow domestic policy ownership.

Thirdly, APEC has the ability to provide capacity building. APEC's diverse membership is a strength because its membership includes a wide range of experience and different levels of development. Technical assistance is available from developed countries and APEC can bring in support from other institutions such as the World Bank in a way that is relevant and does not intrude on domestic policy choice.

Finally, APEC has an established form and structure in place and structural reform is already firmly on its agenda, following the Japanese initiative of 2004. The Economic Committee (EC) is well placed to fill this role as it has been transformed from a research forum into a policy forum. Domestic reforms are ministry based and overall structural reform is the prerogative of different ministries in each member economy. EC uniquely brings together the ministers that are relevant for structural reform from different ministries in different member economies (the Cabinet Office in Japan, NDRC in China, the Treasury in Australia, the Prime Minister's Office in Malaysia and so on).

Sharing policy experience and capacity building will have to be done in APEC or any regional forum in a careful, non-intrusive way. The principal aim of regional support should be to improve policy processes, not the outcomes, which need to remain the result

of domestic political and economic choice. The possibility of ‘opting in’ for external assistance in policy review and evaluation could be a potentially useful voluntary external instrument to assist policy development. The recipients of such assistance could be held accountable for ensuring domestic follow-through, but should not be held accountable for final outcomes, which remain the prerogative of domestic governments.

While APEC seems to be the best forum for supporting second generation reforms, its structures need strengthening. The Economic Committee in APEC is a primary locus for developing this agenda in APEC. The Economic Committee needs an office and unit with some analytical capacity immediately to assist in this work.

The idea of developing an Economic Commission attached to the Economic Committee in APEC to facilitate strengthening the institutional foundations for policy making in APEC was also put on the table. This may not be immediately achievable but it is an idea that can be explored in the medium term.

Whatever external support can be made available through APEC to its members should be provided on a voluntary, non-binding and non-intrusive basis at individual member initiative. There is also scope for APEC Leaders or Ministers’ collectively requesting evaluation of policy options in areas of common policy priority.

There is a widely based view from around the region that these ideas are worth taking forward or exploring.

2. List of Participants

Name	Title
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Chinese Participants

Zhang Xiaoji	Director General, Foreign Economic Relations Department, Development Research Center of the State Council
Jia Kang	Director, The Institute for Fiscal Science Research, Ministry of Finance
Pei Changhong	Director, The Institute of Finance and Trade Economics, Chinese Academy of Social Sciences
Tang Min	Deputy Resident Representative and Chief Economist, PRC Resident Mission, Asian Development Bank
Liang Yanshun	Director, Research Office, Party School of the CPC Central Committee
Qi Jiazheng	Deputy Director, The World Development Research Department, Development Research Center of the State Council
Bian Xiaochun	Secretary General, The World Development Research Department, Development Research Center of the State Council

Zhou Xiaojing	Deputy Director, The Asian-African Development Research Department, Development Research Center of the State Council
Zhao Shusen	The Asian-African Development Research Department, Development Research Center of the State Council
Chai Yu	Research Fellow, The Institute of Asia-Pacific Studies, Chinese Academy of Social Sciences
Wang Zixian	Deputy Director, Policy Research Department, Ministry of Commerce
Zhang Xiaojing	Policy Research Department, Ministry of Commerce
Li Zhongmin	Research Fellow, The Institute of World Economic and Political Studies, Chinese Academy of Social Sciences
Gao Yan	Professor, Vice Director, Unirule Institute of Economics
Li Huilian	Deputy Chief Editor, China Economic Times
Zhou Ningyu	The Department of International Organizations and Conferences, Ministry of Foreign Affairs
Lu Mai	Secretary General, China Development Research Foundation
Cui Xin	Deputy Secretary General, China Development Research Foundation

International Participants

Peter Drysdale	Director, East Asia Bureau of Economic Research, Australia National University (ANU)
Ross Garnaut	Professor, ANU
Gary Banks	Chairman, Productivity Commission, Australia
David Parker	Executive Director, Macroeconomic Group, The Treasury, Australia
Philippa Dee	Visiting Fellow, ANU
Haryo Aswicahyono	Centre for Strategic and International Studies, Indonesia
Mitsuo Hosen	Executive Research Fellow, Economic and Social Research Institute, Japan
Yiping Huang	Managing Director & Head of Asia Pacific Economic And Market Analysis, Citigroup
Gregore Pio Lopez	Senior Research Officer, Malaysian Institute of Economic Research, Malaysia
Vo Tri Tranh	Department Director, Central Institute for Economic Management, Vietnam
Josef Yap	President, Philippine Institute for Development Studies, Philippines
Shiro Armstrong	Crawford School of Economics and Government, ANU
Luke Yeaman	The Treasury, Australia

3. Program of Events

Symposium on “Economic Reform and Regional Cooperation in East Asia”
March 27, 2007, Beijing

March 27 □ Tuesday □

Opening: Micro Policy Reform and Regional Integration: Perspectives

Chair: **Lu Mai**, Secretary General, China Development Research Foundation

9:00-9:30 Presenters: **Peter Drysdale** (Director, East Asia Bureau of Economic Research, ANU)

Philippa Dee (Visiting Fellow, ANU)

Session I: Institutional Foundations and Economic Reform: Regional Experience

Chair: **Peter Drysdale**, Director, East Asia Bureau of Economic Research, ANU

9:30-11:00 Presenters: **Mitsuo Hosen** (Executive Research Fellow, Economic and Social Research Institute, Japan)

Vo Tri Tranh (Department Director, Central Institute for Economic Management, Vietnam)

Gregori Lopez (Senior research officer, Malaysian Institute of Economic Research, Malaysia)

Gary Banks (Chairman, Productivity Commission, Australia)

General Discussion

11:00-11:15 *Coffee and Tea*

Session II: Chinese Experiences in Economic Reform and Open-up

Chair: **Pei Changhong**, Director, Institute of Finance and Trade Economics, The Chinese Academy of Social Sciences

11:15-12:45 presenters: **Zhang Xiaoji** (Director General, Foreign Economic Relations Department,

Development Research Center of the State Council, China)

Huang Yiping (Managing Director & Head Of Asia Pacific Economic And Market Analysis,

Citigroup)

Jia Kang (Director, the Institute for Fiscal Science Research, Ministry of Finance, China)

General Discussion

12:45-14:00 *Luncheon*

Luncheon Talk by Professor **Ross Garnaut** on *China and Regional Economic Reform*

Session III: Implications for Regional Cooperation in APEC

Chair: **Tang Min**, Deputy Resident Representative and Chief Economist, PRC Resident Mission, ADB

14:00-15:30 presenters: **David Parker** (Executive Director, Macroeconomic Group, The Treasury, Australia)

Josef Yap (President, Philippine Institute for Development Studies, Philippines)

Haryo Aswicahyono (Centre for Strategic and International Studies, Indonesia)
General Discussion

Conclusion

15:30-15:45 Speakers: **Lu Mai**, Secretary General, China Development Research Foundation

Peter Drysdale, Director, East Asia Bureau of Economic Research, ANU

18:00-19:30 *Dinner*