



Asia-Pacific
Economic Cooperation

APEC Economic Policy Report

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Economic Cooperation

The APEC Secretariat

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PREFACE

The Economic Committee's (EC) annual publication, the *APEC Economic Outlook* has been modified beginning this year, in response to the Economic Committee's new mandate on structural reform. The *APEC Economic Policy Report* is the new main publication of the Economic Committee, which focuses on structural reform issues within APEC.

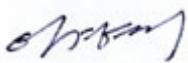
The first chapter provides Leaders, Ministers and policymakers with a brief summary of the work that APEC has undertaken on structural reform and its policy implications. The chapter introduces structural reform and regional changes, including the Leader's Agenda to Implement Structural Reform (LAISR) in APEC, the whole-of-government approach that can increase the effectiveness, support and potential of a structural reform program, and lastly provides specific examples of EC and other fora's work already undertaken on structural reform.

The second chapter is drafted by the respective host economy. This year, Viet Nam, host of APEC 2006 carried out a study titled, "Structural Reform and Sustainable Development in the APEC Region: Emerging Issues." The project examined sustainable development issues with an emphasis on the role of structural reform. A symposium of the same title was held on August 30. The outcome of which has been included in the structural reform chapter of the publication.

Finally, the third chapter reviews individual economies' domestic structural reform activities over the last 10 years.

The APEC Economic Policy Report was produced through a collaborative effort of all member economies, the APEC Secretariat and the Economic Committee Chair's Office. I am more than happy to present the main outcome of the Economic Committee's effort for this year.

A very special thanks goes to Canada and New Zealand for drafting the first chapter, Viet Nam for contributing the second chapter, and member economies that submitted the Individual Reports on Structural Reform. I would also like to mention Dr. Peter Thurlow from Canada, Ms Carmen Mak from the APEC Secretariat and Dr. Sangkyom Kim for leading the production of the entire publication.



Kyung Tae Lee
Chair, APEC Economic Committee
Seoul, September 2006

Chapter One:

Structural Reform and the Role of the Economic Committee in APEC

APEC has worked since its inception in 1989 to increase the prosperity of member economies by cooperatively acting to strengthen the Asia-Pacific community. It has worked to secure the sustainable economic growth necessary to boost members' prosperity by encouraging free and open trade within developing global marketplaces.

This was, and continues to be, an ambitious goal given that the region, which contains over half the world's population, is as culturally diverse as it is broad in geographical scope.

In what has become known as the "Bogor Goals," APEC Leaders agreed in Bogor Indonesia in 1994, to set the target of free and open trade and investment in the APEC region to be achieved by 2010 for industrialized economies and 2020 for developing economies. Good progress has been made toward achieving the Bogor Goals, but much still needs to be done if the people of the APEC economies are to continue to benefit from the region's historically strong growth. Average tariff rates fell from 16.9 percent in 1989, to 5.5 percent in 2004, with over half the tariff lines within the APEC region now sitting below 5 percent.¹ To maintain the growth that this progress has stimulated, APEC's ongoing challenge is to continue to advance new and innovative ways to encourage economic development.

As tariffs have declined, the spotlight has naturally shifted to the structural and regulatory obstacles that inhibit cross-border trade by creating behind-the-border barriers to doing better business. The region's historic growth performance, which doubled between 1989 and 2003, defined the region as one of the world's most dynamic, but APEC Leaders recognized in the late 1990s that "*structural and regulatory weakness had contributed to... [the Asian] economic downturn*"² of that time. Thus, APEC acknowledged that the "*full potential for improved economic and social well-being*" was reliant on how competitive the region was within international markets and that competitiveness is influenced not only by an openness to trade and competition, but also by the region's regulatory and structural architecture.

The objective of this chapter is to provide leaders, ministers and policymakers with a brief summary of the work that APEC has undertaken on structural reform and its policy implications. In 2006, this chapter will act as a high-level introduction to the new APEC structural reform work program, setting the scene for the more specialised chapters that are intended to follow in subsequent years' publications. A key goal of this year's chapter is to draw together and synthesise the relevant work that has already been done on the topic of structural reform.

The chapter is divided into three main sections. The first section introduces structural reform and the regional changes that have been acting as drivers for the new structural reform focus. This section will also discuss the Leaders' Agenda to Implement Structural Reform (LAISR) which has broken the broad topic of structural reform into five priority areas. The LAISR statement will form the basis of the Economic Committee's (EC's) ongoing work agenda and will be the subject of the more specialized chapters that will follow this chapter in subsequent years' publications.

¹ APEC (2005) A Mid-Term Stock Take of Progress Toward the Bogor Goals: Busan Roadmap Toward the Bogor Goals.

² APEC (1999) Leaders' Declaration: The Auckland Challenge.

The second section will examine how a whole-of-government approach can increase the effectiveness, support and potential success of a structural reform program. It will discuss how economies may address the short-term costs that reforms may generate by first, displaying commitment to implementing reforms across the whole of government and second, by transparently communicating the longer-term benefits to the population.

The final section will look at some specific examples of the work that the EC and other fora have already undertaken. To date most of this work has focused on regulatory reform. The OECD regulatory reform checklist and private sector development plan will also be discussed as examples of APEC's work to date.

1. THE IMPORTANCE OF STRUCTURAL REFORM

1.1 What is Structural Reform?

Structural reform consists of improvements made to institutional frameworks, regulations and government policies such that the economic environment supports the efficient functioning of markets, and ultimately enhances living standards in a sustainable way. Thus, the immediate goal is to create markets that are stronger and more efficient. Ultimately, the goal is the sustainable improvement of the well-being of citizens. Structural reform is an evolutionary process that can provide ongoing benefits for all APEC economies. While sweeping reforms may at times be necessary, even economies with highly efficient markets can benefit from precisely targeted reforms.

1.1.1 Why is market efficiency important?

Efficient markets ensure that domestic resources are used to obtain the highest sustainable output levels and growth rates. Resources, which are always scarce, can act as a constraint on a domestic economy's growth potential. By ensuring that resources such as land, labour and capital are efficiently utilised, an economy ensures that both output and the welfare of an economy's citizens may be maximised³.

Efficient markets use prices to facilitate the optimal allocation of resources by providing firms and consumers with timely and reliable information. Prices rise as a good becomes scarcer relative to its demand. This encourages consumers to economise on the good in question, and producers to seek new sources of it. Thus, not only does a good's market value act as an accurate signal of its scarcity value, it acts to encourage appropriate responses to changes in its value. The ability of prices to convey information has led them to be labelled price signals. Rapid and more complete responses to shocks and opportunities minimize the negative impacts of the former and maximize the benefits of the latter. More efficient markets transfer this information into prices at a higher speed and with greater reliability.

The efficient market that structural reforms aim to create can produce numerous benefits. With efficient markets, consumers benefit from the lower prices and the increased choice that competition creates. Firms also benefit from being able to make more informed decisions that increase their competitiveness, reduce their costs and eventually maximise their profits. Moreover, the structural reforms themselves often give firms greater scope to make these adjustments at lower cost. The economy as a whole benefits from a more efficient allocation of resources to industries in which it has a comparative advantage; increased competition

³ Urata, S. (2005), *The Impacts of Structural Reform on Trade, FDI, and Economic Growth*, presentation at the "APEC-OECD Symposium on Structural Reform and Capacity Building" (held 9.9.2005).

that encourages innovation and productivity gains; and a higher level of macroeconomic stability and economic growth.

In an increasingly globalized world, structural reform has benefits that spill across borders. Structural reforms in one economy can enhance economic outcomes in other economies. This results from reductions in costs and prices, increasing competitive pressures and rationalizing supply chains. The existence of these spillover effects is a good reason for structural reform to enter the agenda of multilateral forums, and increasingly it is doing so. For example, the World Bank, the OECD and the European Union have all been active in studying and pursuing structural reform. It is appropriate that APEC is joining these institutions in encouraging structural reform.

1.1.2 Why is there a government role in the economy?

If efficient markets support the well being of citizens, then why are governments involved in markets in the first place? The answer is that there are occasions where free markets are not efficient due to market failures, which create price distortions. Classic examples of market failures are where business or workers exploit monopoly power, or where production processes create unpriced damage to third parties, but there are many others also. Market failures can cause markets to collapse altogether, or to fail to come into being in the first place.⁴ Moreover, often market failures create situations whereby individuals, groups or businesses are able to benefit from rents at the expense of others.⁵ Rents can continue to be reaped only if competitive pressures are impaired, otherwise new entrants to the market, who are attracted by the existence of the rents, would dissipate those rents. The existence or possibility of rents encourages rent-seeking behaviours, which are counter-productive from an economy-wide viewpoint, particularly as it often involves undermining competitive pressures.⁶

Governments have attempted to counter market failures through their powers to enact laws, to regulate, to tax and to grant subsidies. While often governments have been able to mitigate the impacts of market failures, sometimes these interventions have had economic impacts that go beyond the specific market failure they were designed to address. Furthermore, it sometimes happens that rent-seekers have been able to lobby or otherwise influence governments such that their interventions have actually reinforced rent-seekers' positions. Even where government interventions are individually well managed, the aggregation of interventions across an economy may not be coherent, and may lead to economy-wide rigidities which slow adjustment processes. Thus, it is extremely important that governments review their interventions, in light of the market failures they were designed to address, and engage in appropriate structural reforms.

Thus, market failures are inherent, and there is often no other means besides government intervention (broadly speaking) that can address them. However, the ideal interventions are economically efficient at the individual, business and aggregate levels.

⁴ The classic case of market collapse, due to informational asymmetries, is Nobel laureate, Akerlof's (1970) market for lemons example.

⁵ Economic rents are returns to labor or capital above and beyond what a well-functioning market would offer.

⁶ Rent-seeking behaviour is distinguished from profit-seeking behavior in that the former seeks benefit from the manipulation of the economic environment rather than from increasing trade and production, which increases total wealth.

1.1.3 Why are structural reforms so difficult to implement?

Given that structural reform is all about changing the arrangements that support markets, and any change in those arrangements implies a redistribution of wealth arising from the relevant markets, it is almost inevitable that there will be some who would be financially hurt by structural reforms and therefore resist them. Thus, some sort of conflict, usually political, is almost intrinsic to structural reform. Moreover, given resistances to structural reform, many reforms end in either outright failure, or in diluted versions that have impacts that are reduced or negligible relative to what was originally planned. Also, the prospect of conflict can often deter even the attempt at structural reform.

Since structural reform is about ensuring that market forces function properly, it is not only about investment and building new and stronger businesses. It is also about letting, and indeed encouraging, inefficient businesses to exit. This means bankruptcies and people losing their jobs. This, in turn, makes human and other resources available for absorption into the expanding sectors of the economy. However, the transition period can be stressful.

Therefore, successful structural reform needs political support from the highest levels and a well-planned strategy. A significant element of any structural reform strategy often involves conflict management. This can include either galvanizing support for reform by educating people about its benefits and building broad coalitions to support it, or by undermining resistance by developing transition programs and assisting the adjustments of those who stand to lose immediately.

1.1.4 Structural reform aims to create effective institutions

Structural reform is commonly associated with the adaptation of, or the creation of, the organisations that form the underlying economic framework within which the economy must operate. Organisations are important as they channel the behaviour of individuals within the economy via internal protocols and the regulations that they enforce. For example, an agency tasked with monitoring commerce aims to prevent anticompetitive behaviour by ensuring that its employees are effectively enforcing competition regulation.

However, structural reform in practice reaches far beyond just organisations to the wider institutional structures that support these organisations. Institutions within the context of structural reform were more broadly defined by the Nobel Prize-winning economist Douglas North as the *“rules of the game... [or the] humanly devised constraints that guide... behaviour.”* North maintained that these rules create *“the incentive structure of society.”* Organizations are commonly referred to as institutions as they are able to channel behaviour. But regulation, government policy and laws are able to affect how individuals behave and so may be defined as institutions that affect how efficient an economy is. Thus, structural reform does not only consider organisations, such as agencies tasked with monitoring commerce, but also the laws, regulations, and government policies that affect these organisations as well as the public and private sectors broadly. Ultimately structural reform is very broad in scope.

1.1.5 Structural reform and economic development

Structural reform and economic development are closely linked. Economic development generally involves substantial and sustained increases in private sector investment in physical capital and increases in output. The benefits of development then radiate out to all sectors of society. The private sector, however, reacts to the economic environment. Well designed and implemented structural reform can bring forth an unleashing of the private

sector which strongly supports economic development. Indeed, those economies that have implemented substantial structural reform in the past tend to be the most developed, and those that are undergoing the most rapid sustained growth have engaged in significant structural reform in recent years.

1.1.6 Structural reform complementarities

Given that the elements of structural reform are broad and diverse, what does economic theory have to say about the implementation of structural reform? According to Lipsey and Lancaster's (1956) theory of the second best, where there are large numbers of distortions an individual reform may not be beneficial, and could even be counter-productive. However, according to Foster and Sonnenschein (1970), a more radical strategy of proportional reductions in all distortions is welfare improving. The insight behind this theoretical result is that there are complementarities in individual structural reforms. That is, implementing one reform increases the value of implementing other reforms. An alternative view cited by Braga de Macedo and Martins (2006) suggests that rather than focus on broad based reform, it is important to concentrate on the key barrier(s) to growth. Unfortunately however, in practice it might be difficult to conclusively determine precisely what the key barriers might be.

1.1.7 Only targeted adjustments may be necessary

While in some economies there may be scope for broad and sweeping reforms, in others structural reforms may only need to include small and more targeted adjustments. These adjustments can ensure that the economy continues to benefit from ongoing changes that may occur in the global economy. Case studies often focus on the dramatic benefits that resulted from the sweeping reforms undertaken by economies such as New Zealand or the United Kingdom throughout the 1980s. However, many of the dramatic reforms undertaken by these two economies were prompted by domestic economic crises that had arisen as a result of prolonged and inflexible responses to ongoing changes in the international economy. However, there has been a growing recognition that economies that have engaged in broad reforms in the past can opt for more a more flexible approach that adopts frequent and timely structural adjustments. This approach can ensure that crises are less likely to occur and make the economy more flexible and allow it to adjust more rapidly and completely to shocks that do develop.

1.1.8 The benefits of well targeted reforms should outweigh the costs

Blanchard and Giavazzi (2003) suggest that structural reform is fundamentally about reducing and redistributing rents. Thus, it is almost inevitable that some individuals and businesses may bear the costs of structural reform, at least in the short run. However, these should be offset by the net benefits that well targeted structural reforms produce. Often, this creates an initial period of uncertainty as resources are reallocated. In the long term, the reallocation of resources will be toward projects that will produce stronger economic growth. Therefore, in the longer term, per-capita incomes rise.

1.1.9 How do we know structural reform supports growth?

While there is not a great deal of empirical literature linking structural reform to macroeconomic variables, some studies have started to appear. For example, Bassanini, Scarpetta and Hemmings (2001) found some evidence that stringent regulations and administrative burden in product markets has a negative effect on economic growth. Similarly, Nicoletti and Scarpetta (2003) found that reforms to private sector governance and

competition policy have a positive impact on total factor productivity, which is a key determinant of economic growth.

Recently, empirical literature has appeared which focuses on the interactions between income, institutions, geography and trade. Conventional wisdom holds that geography drives trade and that trade and institutions drive income. The problem is that standard techniques are subject to causality questions (that is, does institutional quality cause growth or does growth cause institutional quality?), which can lead to biased results. Thus, more indirect econometric techniques, such as instrumental variables and identification through heteroscedasticity are necessary.⁷ Within this literature Rodrik, Subramanian and Trebbi (2002) and Rigobon and Rodrik (2004) find strong support that institutional quality is a significant determinant of growth, Levechenko (2004) finds that institutions drive trade flows, and Desroches and Francis (2006) find that institutions drive comparative advantage. While the weight of the literature cited above support the conclusion that institutions are important, Sachs (2003) is unconvinced.

1.2 Key Drivers of Structural Reform

Changes that have occurred throughout the region have created challenges and provided opportunities that provide the incentive to adopt an ongoing structural adjustment program. These changes have in many cases increased the importance of the structural reform agenda for member economies. Even economies that have undertaken extensive reforms may find ways in which they can respond to ongoing regional changes within the business environment. While these changes have been broad and diverse, three distinct trends are clearly discernable: trade and investment have continued to be liberalised; technology has advanced at an ever accelerating rate; and economies have increasingly been subjected to economic shocks that originate beyond their borders. The following sections will discuss how each of these trends creates an incentive for structural reform.

1.2.1 Trade and investment liberalisation

The benefits that trade and investment provide include strong incentives to address structural and regulatory weaknesses, and these incentives have grown as liberalization has progressed.⁸ Structural and regulatory arrangements have increased in relative importance as their impact on trade strengthens and tariff barriers fall. Trade is sensitive to the business environment, the cost of trade, and the time that it takes to trade, and each of these three items can act as a behind-the-border barrier. Moreover, in order to gain entry into the WTO often economies are required to engage in structural reforms that support the openness of their economies.

A decrease in the cost of trading within an economy can increase that economy's relative competitiveness. This can create benefits that help to offset the short-term costs that may be associated with structural reform. As an economy's compliance costs rise relative to neighbouring economies, its relative competitiveness falls. In this way, higher compliance costs decrease the relative profitability of its firms and raise costs, which could price an economy's businesses out of certain foreign markets. Structural reforms that decrease

⁷ See Rigobon and Rodrik (2004) for an intuitive discussion of these techniques.

⁸ The Busan Roadmap to the Bogor Goals includes: support for the WTO; more effective and ambitious IAPs and CAPs; a more intensive focus on trade facilitation including the behind the border business environment; a more focused and action-oriented cooperation on ECOTECH and a strategic approach to capacity building; a comprehensive work plan on RTAs/FTAs.

compliance costs offer economies the opportunity to further benefit from trade. It has been estimated that a five percent decrease in the costs of doing business could create growth in GDP across the APEC region worth over US\$154 billion.⁹

The time that it takes to trade may also act as a barrier to obtaining the benefits of trade. New manufacturing and production techniques, such as the use of just-in-time inventories, have boosted the importance of delivery times within global supply chains. Firms that are unable to provide goods or services within required timeframes are unable to participate in these supply chains. Structures that expose both exporters and importers to fewer government departments may encourage trade as any decrease in delivery times may make domestic firms more competitive. According to one study, a doubling of the time that it takes to get goods to markets could decrease the price exporters receive by eight percent.¹⁰

The domestic business environment may also affect the attractiveness of an economy to foreign firms and investors. Ineffective structures that allow anti-competitive behaviour may act as a barrier for firms. For example, if competition regulation allows practices such as price fixing, firms may find it difficult to compete. Firms in the APEC region can now choose to compete in many different domestic markets, but may still need to prioritise which markets they enter. Thus, if one market has a more favourable business environment compared with its neighbours it will probably be seen as a more desirable and less risky economy to trade with, or invest in.⁸

Increasing international trade and investment opportunities have increased competitive pressures everywhere. Firms are realizing a growing scope to locate their productive and other facilities anywhere on the earth. Critics of globalization contend that this is facilitating a sort of regulatory “race to the bottom.” This concern is clearly overblown, as there are so many other factors involved in location decisions, beyond “easy” regulation, and at any rate, raw market failures do not necessarily make an economy more attractive to locate in. However, the growing locational flexibility of firms imparts an extra incentive to ensure that potential market failures are dealt with effectively, in ways that impose minimal burdens on businesses and society as a whole.

While rising trade and international investment flows have increased competitive pressures that have created an incentive to support structural reform, a lingering issue remains. Some governments continue to engage in policies that support various elements of their economies. These measures can include such things as agricultural subsidies and those on other elements of the production process or factors of production, support for non-competitive domestic market practices, or unduly resisting upward exchange rate pressures. These are contentious issues that the international community must try to resolve.

1.2.2 Technology

Technology, which has advanced at an ever-increasing pace, has also created a strong incentive to undertake structural adjustments because technology can drive economic growth. Technological innovation in transport, communication and information technologies has changed the way that economies have chosen to regulate, structure and develop many sectors of the economy. For example, improvements in telecommunications technology have facilitated an increase in the ability of the private sector to compete in this sector. This has allowed governments to privatise state owned firms and also further encourage private sector

⁹ See Wilson et al. (2002).

¹⁰ Hummels, D (2001) *Toward a Geography of Trade Costs*, Purdue University, Dept. of Economics.

⁸ The APEC Private Sector Development plan discussed in section 3.5 discusses this.

competition. Privatisation often encouraged further structural reforms as the needs for regulatory policy and competition policy receded in this sector.

Any structural adjustments that open an economy to international trade and investment will also allow an economy to better capitalize on technological growth. Trade exposes an economy to competition that encourages firms to adopt the new practices and products that are available within the global market. This can drive strong productivity growth that allows economies to produce more with the same scarce resources.

Structural adjustments, which strengthen property rights, can also encourage both technological and economic growth. Firms invest in research and development in order to earn profits, and these profits are essential if firms are to recoup the cost of developing new products. The economies that have benefited from the highest levels of innovation are increasingly the economies that allow firms to profit from innovation through patents and effective intellectual property rights protection.⁹

Structural reforms may also be able to encourage technology growth by reducing compliance costs. Small firms that have a limited ability to absorb costs are often responsible for the development of new product lines. Poorly designed structures that impose high costs on small firms may prevent these innovative new product lines from developing into new industries. Thus, structural impediments may impact not only on the incentive to innovate, but also on the ability of an economy to capitalise on innovation.

1.2.3 Economic shocks

Structural reform can help an economy to maintain macroeconomic stability when exposed to large, often international, economic shocks. These shocks might involve large capital flows; changes in the price of important commodities such as oil; and political crises that affect the confidence of markets. Adjustments that create stronger economic structures may encourage macroeconomic stability for two reasons.

First, structural adjustments seek to boost market efficiency. Efficient markets rapidly transfer economic shocks into prices, encouraging all members of an economy to react and adjust promptly to the changing economic environment. When the investment community has confidence that an economy with efficient markets will adjust rapidly to a shock, then expectations of changes to longer-term impacts on financial market variables are alleviated, which mitigates the short-term impact on financial market prices, such as the exchange rate. This can help to prevent market participants from panicking and precipitating large and damaging capital flows when economies are exposed to shocks. The APEC Finance Ministers' Process, which has done extensive work around financial and macroeconomic stability, notes that the "*contagion [of economic shocks] can be reduced by the adoption of effective transparent arrangements with sound and credible economic and financial policies.*"¹⁰ This may help to prevent a shock from turning into a crisis.

Second, market structures that restrict the ability of price signals to convey accurate information risk encouraging relatively less efficient, or sub-optimal, capital investment decisions. These decisions can lead to overpriced assets and excess capacity in particular sectors that may create macroeconomic instability if the economy readjusts in a disorderly fashion at a later point in time.

⁹ The APEC Intellectual Property Rights Export Group (IPEG) has done work around this area.

¹⁰ *The Voluntary Action Plan for Promoting Freer and More Stable Capital Flows*, undertaken by the APEC Finance Ministers' Process, Pg. 24.

1.2.4 Case Study: Singapore during the Asian Crisis

When the currency and financial crisis erupted in Thailand in July 1997, and swept through East Asia, no economy was unaffected. Despite Singapore's strong macroeconomic and financial fundamentals at that time, Singapore also felt the shock. The immediate impact was a fall in demand for Singapore's exports, but equally worrying was the fact that the exchange rate of numerous trading partners fell with respect to the Singaporean dollar, which adversely impacted on competitiveness.

Serendipitously, Singapore had formed the Committee on Singapore's Competitiveness in May of that year. In November of the following year the committee released a report outlining a number of short-term responses to the crisis. These included cost- and tax-cutting measures to improve wage competitiveness, improve business access to working capital, to support skill upgrading, and to support international marketing, both to support Singaporean enterprises to break into new international markets, and to attract foreign firms to locate in Singapore.¹¹

The important point is that Singapore's advanced state of structural reform at that time sheltered it from the worst of the storm. Nevertheless, Singapore's high degree of economic integration with the region meant that impacts were felt. However, the appropriate response could afford to be incremental, rather than dramatic and sweeping.

1.3 Principles and Practices

There are many different types of markets, from real estate to stock markets, from wholesale computer chip markets to farmers' produce markets. However, despite the myriad differences, when markets work well, they conduct some basic functions that are common to all markets, and there are certain elements of the institutional environment that are necessary for well functioning markets, no matter what the market is, or where it is, or who is transacting on the market. For example, buyers and sellers must have enough of a sense of the product in order to engage in a transaction in confidence. Thus there would seem to be some universal principles involved in well functioning markets. It is therefore probably not too much of a stretch to imagine that there are some basic principles that underlie structural reform.

However, APEC is a vast and enormously diverse region, with economies that span the entire spectrum of economic development, where people of vastly different cultures and histories dwell. Thus, institutional arrangements that are effective and appropriate in one APEC economy could be grossly ineffective and inappropriate in another. Therefore diversity is to be expected.

It would seem that universal principles underlying structural reform could be well met by any one of a wide range of different practices. Thus in its work to support structural reform in the APEC region, the Economic Committee is seeking to uncover and understand the core principles in each of the key elements of structural reform, but also to encourage member economies to support these principles with the practices that make the most sense given their particular customs, culture, history and general situation.

¹¹ For more details of this report, see http://app.mti.gov.sg/data/pages/885/doc/NWS_CSC.pdf.

1.4 The LAISR Statement and APEC Priority Areas

Structural reform is a broad and far reaching topic with many different facets. In order to give impetus to, as well as focus and guide APEC's work on structural reform, APEC Leaders have developed the Leaders' Agenda to Implement Structural Reform (LAISR), which suggested five possible priority areas.¹² APEC aimed to discover good practice principles within each of these priority areas that may be applicable to the more specific reforms that individual economies may choose to voluntarily adopt. The five LAISR priority areas are:

- regulatory reform;
- competition policy;
- public sector management;
- strengthening economic and legal infrastructure, and
- corporate governance.

In practice even targeted structural adjustments will draw on principles specific to each of the five LAISR priority areas. Competition policy, corporate and public sector governance all use regulation as a fundamental tool. But, without a suitable economic and legal infrastructure that has the capacity for the enforcement and implementation of regulation, even well-designed policy will fail. Thus, in practice the LAISR areas all interact and act to complement one another. As mentioned above, in general the elements of structural reform, both within the five LAISR elements and outside of them too, are mutually reinforcing.

An important precursor to the LAISR statement was the APEC High Level Conference on Structural Reform that Japan hosted in Tokyo in September 2004. This conference, which attracted over 200 delegates, featured very high level speakers from many key APEC economies, including Japan, the United States and Australia. Key discussions included the Japanese special zones for structural reform, corporate restructuring and corporate governance, and the promotion of structural reform.

In 2005, APEC Leaders decided to create the LAISR 2010 "roadmap" which started to define plans for APEC's ongoing work on LAISR. At present the Economic Committee is responsible for overseeing this agenda. To date much of the work has considered the broad structural reform agenda and regulatory reform as an important subset of structural reform.

1.4.1 Regulatory reform

Regulation is one of the primary tools that can be used to implement government policy. Regulation helps to define the "rules of the game." These rules partially define the interface between society, the state and the wider economy. Regulation is most useful when the presence of market failure would allow an unfettered market to produce undesirable outcomes.

Many types of regulation exist and a number of APEC fora are working on these various aspects of regulation. One level of regulation can be targeted at ensuring appropriate health and safety standards within APEC, which is discussed within the Sub-Committee for Standards and Conformance (SCSC). The private sector development plan and work undertaken by the SME Working Group consider another level of regulation that is targeted at the smooth operation of smaller businesses.

APEC Economic Committee work on regulatory reform is outlined in section 4.4 below.

¹² The LAISR statement is attached at end of Chapter One (See page 25).

1.4.2 Competition policy

Competition is fundamental to the efficient operation of markets. A lack of competition, or practices which seek to limit competition, may need to be addressed by competition policy to create desirable outcomes. The Competition Policy and Deregulation Group (CPDG) have done extensive work on competition policy which has included:

- the *APEC Training Course on Competition Policy*;
- the *Competition Policy and Law Database*;¹³ and
- the *OECD/APEC regulatory reform database*.

This work has addressed how to build and strengthen the domestic institutions needed to support effective competition in markets, the interaction between regulatory restrictions and competition, and how to ensure competition in factor markets, including labour and natural resource markets.¹⁴

1.4.3 Public sector management

Good public sector management encourages the wider public sector to work efficiently toward the achievement of a government's goals. The public sector is critical as it is often the largest employer in an economy and controls a large percentage of an economy's assets. The APEC Economic Committee initiated discussions on public sector governance in 2006. Three areas considered were:

- setting performance targets;
- designing of organisations, and
- how to monitor progress.

A symposium was held in 2006 and a good practices paper, which sets out high level principles for public sector governance, will be produced in 2007.

1.4.4 Strengthening economic and legal infrastructure

Economic and legal infrastructure protects property rights and enforces the contracts and regulations that are fundamental to the operation of the market. The APEC Strengthening Economic and Legal Infrastructure (SELI)¹⁵ coordinating group is responsible for this area of the APEC work program and has undertaken work in areas such as:

- capacity and institution building;
- corporate law/policy;
- competition law/policy;
- insolvency law;
- accounting systems and standards, and
- international dispute resolution.

¹³ <http://www.apeccp.org.tw/>

¹⁴ CPDG has created and undertaken a series entitled the "APEC training program on competition policy", these have run since 2002 and are expected to continue until 2009.

¹⁵ SELI ran a conference in 2004 on "strengthening investor confidence"; in 2007 they will run a seminar that will encourage APEC economies to share experiences on how they have strengthened economic and legal infrastructure.

1.4.5 Corporate governance

Corporate governance seeks to certify that corporations, which generate the majority of economic activity within the APEC region, hold the resources of their investors in good stewardship. Good governance ensures that corporations act in the interests of shareholders by transparently ensuring that investments create the highest possible rate of return. This also creates benefits for the wider economy as it encourages stronger growth and macroeconomic stability.

There is no one group within APEC that will be entirely responsible for the corporate governance work agenda. However, SELI, CPDG, FMP and the EC may all undertake relevant work in this area. Topics that could be addressed in future include:

- the specification of shareholder rights;
- accounting and disclosure standards that encourage transparent business practice and the provision of appropriate information to the market;
- clearly defined duties for directors that ensure they behave in a transparent manner to protect shareholders' investments;
- clearly defined procedures that define how boards may come to a decision and manage risk, and
- a regulatory, judicial and legal system capable of enforcing breaches of good corporate governance practices.

2. WHOLE-OF-GOVERNMENT APPROACHES TO STRUCTURAL REFORM

2.1 The Importance of a Whole-of-Government Approach

A whole-of-government approach to structural reform can benefit society. Structural reforms span the public sector, affecting numerous departments and agencies. The barriers to trade that exist in practice are often determined not by a single department, but by the interaction of several different departments. The benefits of removing these impediments and improving policy coherence can include a reduction in uncertainty, increases in public sector productivity, and a reduction in the cost to the government which can lead to stronger economic growth.

A whole-of-government approach requires an overriding strategy, or roadmap that defines the direction that structural adjustments will take in order to achieve an economy's long-term goals. A well formed and credible strategy can signal to both the public and private sectors what changes may be necessary in future.¹⁶

Defining how each part of the public sector contributes to this overriding strategy can boost public sector productivity. Clear accountabilities create a defined area for which each department is responsible. Accountable departments can then work to streamline processes within their area and be recognised for their results. This encourages public sector productivity gains. Egypt, for example, created a single department to oversee trade documentation. This clear accountability allowed the department to streamline procedures, which reduced the documentation required to trade from 26 to five pieces.¹⁷

¹⁶ Salas, F & Kikeri, S., (2005) Regulatory Reform-Institution building: Lessons from Mexico, *Public Policy Journal*, pg. 282.

¹⁷ World Bank (2006) *Doing Business: Creating Jobs*.

Mapping out clear accountabilities across the public sector also allows economies to identify policy overlaps and conflicting work agendas. Policy overlaps create waste as work is replicated across numerous public sector departments, while conflicting work agendas reduce the effectiveness of public policy as departments expend scarce financial resources working against other departments. By removing these overlaps, departments can specialise, thereby allowing them to work together to implement an economy's strategy. This can reduce government budgets and private sector uncertainty. The World Bank noted that one of the most popular reforms in 2004 was to introduce a single point of contact for entrepreneurs. This has cut the time to start a business in some economies from 51 days to 15 days. ABAC has noted that the ease of starting a business was one of the primary inhibiting factors on doing business in the APEC region.

2.1.1 Case Study: Canada's Privy Council Office

In Canada, regulation is coordinated through the Privy Council Office (PCO). The PCO stands at the heart of the Canadian government, and acts as the ministry for the prime minister and as the cabinet secretariat. In that context the PCO is the focal point of action of the Canadian public service and requires close and continuous interaction with other federal departments and agencies. The head of the PCO, the clerk, acts as the deputy minister to the prime minister, as the secretary to the cabinet and as the head of the federal public service.

The PCO is therefore responsible for ensuring that the analysis provided by the line departments on policy and regulatory proposals is consistent with the Directive on Regulating, and that there is coherence among new proposals, existing regulation and the government's policy agenda. Moreover, the PCO provides a challenge function, to ensure high quality analysis, with regard to new and existing regulation. In addition to the PCO, two other central agencies are involved in regulatory issues. The Department of Justice provides legal advice to federal departments and agencies on the legality of proposals for enabling and subordinate legislation and the legal requirements of the regulatory process. In addition, the Treasury Board, as the government's management board, advises departments and agencies on resource management related to regulatory proposals.

The centralization aims to create regulatory and policy coherence across a broad range of regulation overseen by federal departments and agencies, and to support cooperation with provincial and territorial governments in the development and implementation of regulation.¹⁸

2.1.2 Case Study: Japan's Council on Economic and Fiscal Policy

The Council on Economic and Fiscal Policy (CEFP) is a consultative organ placed within the cabinet office, whose purpose is to facilitate full exercise of the prime minister's leadership while sufficiently reflecting the opinions of private-sector experts in economic and fiscal policy formation. The CEFP is chaired by the prime minister, and its members include the Chief Cabinet Secretary, the Minister of State for Economic and Fiscal Policy, other relevant ministers, and private-sector experts. The CEFP deliberates on and drafts the basic policy of economic management including structural reform, fiscal management, budget formulation and other important issues in economic and fiscal policy, which then become the government's formal policies after the adoption by the cabinet.

¹⁸ For more details on the Canadian system, see www.regulation.gc.ca.

There are three chief advantages of the CEFP:

- (i) *It enhances the consistency and comprehensiveness of economic policy making.*
The CEFP has promoted the establishment of a new budgeting cycle, in which the linkage between economic policy and fiscal policy is strengthened, and the direction of major issues of structural reform is decided. Also, there has been an innovation in government policies because the private-sector experts of the CEFP have proposed various policies, making full use of their management know-how.
- (ii) *It enables policy achievement evaluation and feedback to new policy making.*
Following managerial methods used in private companies called PDCA (Plan-Do-Check-Action) cycles, clear and concrete numerical targets and timetables have been set up in formulating these policies. This makes it possible to evaluate the achievement of individual policies and to feed back the results to new policy making.
- (iii) *It increases the transparency of the decision-making process.*
Transparency of the decision-making process has been improved significantly because the results of the discussion are open to the public immediately. (Almost all of the materials used in the meetings are disclosed on the day of the meetings. The minutes are released three days after the meetings.)

In this way the CEFP has drastically changed the decision-making processes related to Japan's structural reform and acted as a driving force to promote the structural reforms of the Koizumi Cabinet.

2.2 Overcoming Short-Term Adjustment Costs

Structural reform can create short-term adjustment costs, but in the longer term these costs should be more than offset by the benefits that well targeted reforms can create. An initial challenge for economies undertaking reforms is to generate enough support and commitment to ensure that the wider benefits of reforms are allowed to become apparent.

Some economies maintain social safety nets, which ensure that individuals who lose their jobs, for example, do not fall into extreme poverty. Moreover, time-limited employment insurance schemes and job retraining programs can assist individuals with their transitions. In some cases, whole physical regions within economies could lose significant employers. In such cases, regional governments or regional economic development institutions could be financially supported in determining alternative viable strategies. While all of these programs might require financial support from central governments, it is important that these programs be temporary in nature and not create dependency, and the incentives should always be to support the transition.

The design of reforms may be able to mitigate some of the short-term cost of reforms. There may be many potential reforms, or ways to sequence the implementation of the elements that can create the same desired end result. By giving consideration to the costs that each option may generate, an economy may be able to reduce the short-term costs associated with a proposed set of reforms, which in turn can help to alleviate any resistance to the reforms that may exist. Some economies have created policies to accompany reforms that help to reduce any residual costs. Explicitly addressing these costs can help to guarantee the success of reforms.

2.2.1 Whole-of-government commitment

Whole-of-government commitment is essential if any short-term adjustment costs are to be minimised and overcome. This commitment can ensure that the longer-term benefits of stronger economic structures are allowed to become apparent. Uncertainty accompanies reforms in the short term as many sectors of an economy adapt to changing prices and increased competition. In the long term, however, the benefits of reform become clearer and public support for the reforms grows. According to one study, well-targeted structural reforms can increase growth within two to three years.¹⁹

2.2.2 Transparency

Transparency can assist in generating the public support that economies require to successfully undertake reforms²⁰ at a much earlier stage in the process. On balance, well-targeted reforms should produce net economy-wide benefits that far outweigh the initial adjustment costs of implementation. Transparency can also highlight what measures that have been taken to reduce the cost of reforms. Transparency can mobilize the support of the population who stand to gain from the proposed reforms. In New Zealand, the government undertook significant reforms which transformed the economy from one of the most protected in the OECD into one of the most open in a matter of a few years. Prior to the commencement of the reform process in 1984, an initial step undertaken by the then-incoming administration was to publicise why regulatory changes were a necessity, what the goals of the reforms were, and what the reform strategy was. Although strong debate existed, both inside and outside of the government, to date most of the reforms have not been repealed.

2.2.3 Case Study 1: Japanese Financial Sector Reform

By the mid 1990s, many Japanese financial institutions were faced with high levels of non-performing loans and instability of the financial system became the largest concern of the time.²¹ As a first step, the newly created Financial Supervisory Agency (FSA, now called the Financial Services Agency) let the banking sector improve their disclosure of balance sheet information, with widening coverage of non-performing loans. Then, it was found that the non-performing loans problem was more severe than expected and it was recognized that rapid disposal of bad loans by banks was fundamentally important in order to restore confidence in the financial system. However, significant capital injections accompanied with the failures of some banks allowed financial institutions to take a step-by-step approach rather than drastic reform of their management. Partly because of deflation, non-performing loan problems had not improved for a couple of years.

Finally, the FSA urged banks to take a number of measures to effect a prompt and complete resolution of the problem. These included placing sufficient reserves, securing adequate levels of capital and improving the corporate governance of the banks. The Industrial Revitalisation Corporation of Japan was set up, parallel with the enhancement of the Resolution and Collection Corporation to facilitate efforts to revitalize borrower companies through the purchase of these loans. Consequently, the Japanese financial sector re-established its resilience. The non-performing loan ratios of the major banks were lowered from 8.4 percent (March 2002) to 1.8 percent (March 2006) which allowed the banks to

¹⁹ Rodik, D., (1996), Understanding Economic Policy Reform, *Journal of Economic Literature*, 34: pp 9-41.

²⁰ Salas, F & Kikeri, S., (2005). Regulatory Reform-Institution building: Lessons from Mexico, *Public Policy Journal*, pg. 282.

²¹ The Long-Term Credit Bank of Japan and the Nippon Credit Bank both failed in late 1998.

expand their business. Also, full deposit guarantees for possible bank failures were removed in March 2005.

2.2.4 Case Study 2: Japanese Special Structural Reform Zones

Structural reform is hard work. Not only is it analytically difficult, it is also politically difficult. Given the difficulties involved, special mention should be made regarding innovative new approaches. The Special Zones for Structural Reform that went into effect in Japan in April 2003, is just such an approach.

According to this initiative, a special zone for structural reform is to be created where a local government and the private sector have a proposal to exempt the region from one or more specific regulations. In this way, the region becomes a pilot project for a particular initiative, and the overall economy becomes a giant structural reform laboratory with multiple experiments. Moreover, the specific proposals arise from the local level and not from a centralized authority, which allows those who are closest to the issue to develop the ideas, and also support the building of a diversity of experiments. Where a proposal is shown to have good results, the experiment is studied for broader implementation. Shortly after this initiative was launched, hundreds of proposals came forward.

2.2.5 Case Study 3: Mexico's "Government with Quality" Strategy

In coordination with the productive sector and civil society organizations, the Mexican Ministry of Public Administration has taken major steps to guarantee that government services and procedures are performed with quality and with the least red tape for citizens and businesses. This is based on an inventory of services and procedures with high citizen impact, which represents 80 percent of all procedures that government requires from citizens, collected between January 2004 and August 2006. The Mexican government has improved and simplified the procedures, resulting in time and cost savings in 436 of these procedures which were the most important.

The Mexican government has also published 216 citizen charters on behalf of 64 government agencies, which are public documents, written in plain language, that give citizens all necessary information on how to carry out a procedure or request a service, clearly stating the quality standards that the government institution is committed to.

2.2.6 Case Study 4: Malaysia's Vision 2020

Malaysia has a very clear goal to be a fully developed nation by the year 2020. This means that Malaysia will comprise a united and mature democratic society, with an economy that is competitive, dynamic, robust and resilient. The recently launched National Mission, which charts the course of the remaining 15 years until 2020, focuses on moving the economy up the value chain in high-tech and knowledge-intensive activities, raising the capacity for knowledge and innovation, while addressing socio-economic inequalities constructively and productively. This effort will seek to improve the quality of life, as well as strengthen the institutional and implementation capacity of both the public and private sectors.

2.3 Building Capacity for Each Step of Structural Reform

Structural adjustments, no matter how small, require departments to have or to develop the capacity to undertake the work necessary to implement the desired changes. While departmental capacity requires resources such as finances, suitably qualified staff and infrastructure, this section focuses primarily on human resources. Allocation of sufficient financial resources is a necessary condition to building and maintaining human resource capacity. This capacity allows results to be achieved at minimal cost, within the desired timeframes.

Structural reform is an ongoing process whereby reforms are designed, implemented and monitored.²² The four stages are: problem definition; solutions development; implementing solutions, and monitoring or reappraisal. By monitoring reforms economies are able to highlight how effective reforms have been, and how they may be refined by smaller and perhaps more targeted adjustments. Capacity is needed at each step of this reform process.

2.3.1 Capacity is needed to define the problem

If economies are to achieve their structural adjustment goals they need to first accurately define what the problem is with existing structures. By correctly identifying the problem, solutions can be more precisely targeted. This can reduce the cost of the reforms, as resources may be focused on addressing the key issues involved. However, if the wrong problem is identified then resources are wasted on reforms that may be unnecessary, ineffective, or even damaging. By allocating sufficient resources to problem definition, the net cost of reforms may be decreased.

2.3.2 Capacity is needed to form effective solutions

Effective solutions create a map for how structural adjustments will solve the problem that has been identified. The most effective solution will be the one that manages to address the problem at the lowest possible cost to the government and the wider public. Although solutions should be focused on the long-term, they can gain more support if they also attempt to ease the adjustment costs in the short-term. The design of effective solutions requires capacity, especially with the provision of experienced staff.

Expertise and experience aid the creation of targeted solutions, but for economies that have relatively little experience with structural adjustments this experience may not exist. APEC has provided a forum where economies may share their lessons and experiences with the wider APEC community. By sharing experiences in APEC's fora member economies have been able to compile a list of good practice principles which may be voluntarily adopted into economies' reform agendas.²³

2.3.3 Capacity is needed to implement solutions

Any structural adjustment, no matter how small, will require departments that have the capacity to implement the reforms. Even well-designed solutions will be ineffective unless resources are allocated to implementing them. The development of economic and legal infrastructure can prove essential to successfully implementing these reforms.

²² Carpinter, P., (2005), *Public Sector Management- Building Capacity for Reform*. Presented to the EC 9.11.2005 (2005/SOM3/EC/APEC-OECD/007).

²³ Examples of some of APEC's work on good practice principles are the "Osaka Action Agenda" or the "APEC Principles to Enhance Competition and Regulatory Reform."

2.2.4 Capacity is needed to monitor results

Ongoing monitoring can ensure that resources are not needlessly wasted on ineffective reforms. If the initial problem was ill-defined, or the solution poorly targeted, then the result, once implemented, could be ineffective or damaging. In the worst case scenario the solution may have been worse than the initial problem. Ongoing monitoring allows economies to appraise how effective their solutions are at achieving their economy's goals. If the solution is ineffective, economies may choose to curb wasted ongoing expenditure, by either refining the definition of the problem or designing a new solution.

In this way the four-step process creates a dynamic loop that allows economies to undertake a series of ever more targeted adjustments. This iterative process acts to continually refine the economy's structure.

3. REGULATORY REFORM

To date most of the work that APEC has done on structural reform has focused on regulatory reform. Regulatory reform was a natural starting point for APEC's work as it is arguably the core of structural reform and contributes to all of the four other LAISR priority areas. Moreover, poor regulatory policy can be one of the major inhibiting factors on doing business and trade. Regulation is also one of the fundamental tools of government as it allows governments to influence the behaviour of firms and consumers by changing the incentives that individuals face. Regulation can be used to protect a group or a resource; to encourage or discourage certain actions; or to prevent specific actions altogether. By changing the action of individuals, governments can change the behaviour of the economy. This section will look at regulatory reform as an important subset of structural reform.

3.1 The Link between Regulatory and Structural Reform

Regulatory policy has much in common with structural reform. Broadly speaking, the goal in both cases is to ensure that the operation of the market creates the best possible outcome for society.²⁴ While structural and regulatory reform concur that competition and prices create the fundamental mechanism by which resources may be best allocated they, however, approach the market in slightly different ways.

A primary assumption associated with structural reform is that a free and efficient market will create the best possible outcome. However, regulatory reform aims to identify as specifically as possible the instances when a free market does not yield an efficient nor desirable outcome. These specific instances are called market failures. Structural reform aims to liberalise the economy to ensure that prices can reflect changes in relative scarcity as quickly as possible, regulatory reform aims to rectify the market failure and to ensure that these prices create economically desirable outcomes. Regulatory reform in this way acts as a complement to structural reform.

Structural policy may also act as a substitute for regulatory policy. For example, in the event of a monopoly regulatory policy may seek to limit the rate of return that the monopolist is allowed to earn, which then affects the price and quantity produced. However, structural policy might seek to

²⁴ To be precise, regulatory reform aims to correct a market failure effectively and efficiently, whereas structural reform would seek to ensure that regulatory policy is coherent with all other government interventions and that together they are effective, efficient and generate the best possible outcome for society.

break up the monopoly and ensure that the resultant elements compete with each other. An example of the dissolution of a large company for these reasons was the break-up of the Standard Oil Trust in the United States in 1911.

There are several general types of market failures, which include externalities, and lack of competition, which regulation is often brought in to control. Externalities occur when production or consumption produces an unpriced by-product, which affects uninvolved people. Thus there is an economic impact which is external to the market. The classic example is pollution. Monopoly power typically occurs when there is a so-called natural monopoly. Natural monopolies exist where there are very high fixed costs and low marginal costs. An example is a pipeline, where it makes sense to install one large capacity pipeline, and not multiple small pipelines for the sake of competition. In the externality example, regulatory authorities could directly regulate the quantity of the externality that may be produced. However, other ways to address the issue could include taxation, compensation of the injured parties, or extension of property rights to the external agent, and the development of a market in that agent. So in the pollution example, this would involve the creation of a market in pollution rights. Where natural monopolies exist, regulation of the rate of return is typical.

The privatization of government-owned enterprises can highlight the link between regulatory and structural reform. Privatised firms in competitive markets can produce lower prices, better services and a higher level of innovation within the industry. However, many government-owned enterprises are natural monopolies that are protected from strong competition by large start-up costs.²⁵ Industries that require a large amount of infrastructure and provide essential services such as the electricity or telecommunications industries are classic examples of such natural monopolies. Privatised firms may be able to use their market position to exclude competition by the use of anti-competitive practices. As the government can no longer directly control these firms they may instead use regulation that protects or introduces market forces. This regulation can act as a complement to privatisation by ensuring that privatised firms do not use their market dominance to stifle innovation and competition, to the detriment of the overall economy.

3.2 Regulatory Reform and Management

Regulatory reform aims to boost the effectiveness of an economy's existing regulatory framework. Effective regulation targets specific market failures at the minimum possible cost. Thus, any reform agenda has two aspects. First, it should be results-focused. Second, it should try and ensure that the regulatory arrangements produce these results at the lowest possible cost to both the government and the private sector. The benefits that can result from this process can create a strong incentive for reform.

Regulatory reform is focused on how well regulation targets market failures. Reform could create new regulation, or it could retarget old regulation. However, in situations where no market failure would exist within an unfettered market, it would involve removing unproductive regulation.

3.2.1 The costs of ineffective regulation

Effective reforms will ensure that a government's regulatory costs are more than offset by net benefits for the economy. Effective reforms will also attempt to ensure that the revised regulations achieve their goals while minimising the burden that they exert on the private sector.

²⁵ APEC (2005a), *A Mid-Term Stock Take of Progress Toward the Bogor Goals: Busan Roadmap Toward the Bogor Goals*.

Governmental regulatory costs include the cost of monitoring behaviour, prosecuting offenders and imposing sanctions. Effective regulation would minimise these costs. For example regulation that addresses corporate governance may change the behaviour of firms by ensuring that they provide sufficient information to investors and the market. This allows the market to monitor firm's behaviour rather than the government. The cost of monitoring reporting standards in easily obtainable reports costs less than directly monitoring behaviour that may not be directly observable.

Regulation also creates compliance costs for firms, and as the number of regulations increases the compliance cost for the private sector also increases. The costs in terms of time can be extreme. Many top executives spend up to 25 percent of their time attempting to comply with regulation.²⁶ This draws resources away from productive activities and reduces business profitability. The reduction in private sector profitability may discourage investment, reduce competition and discourage innovation which can slow the economy's potential and actual growth rate.

Excessive or ineffective regulation may also prevent firms from entering an economy's formal sector. This creates an indirect cost specific to many developing economies because they lack the resources to closely monitor the firms and individuals operating within the economy. Firms that remain within the informal sector in order to avoid regulation and tax remain small and uncompetitive within global markets. The reluctance to move into the formal sector restricts both tax revenues and the tax base, impeding infrastructure development and restricting potential growth. The World Bank notes that less developed economies often have higher compliance costs, in terms of time and money, associated with their regulation.²⁷

Regulatory reform is primarily focused on how effectively regulation targets market failures, and this often includes substantial deregulation. When no market failure exists there is no benefit to justify the cost of regulating. Further, regulation in the absence of market failure can create problems that may invite further regulation if the cause is misdiagnosed. This can create a growth in regulation that is focused on fixing regulatory failure rather than market failure at a cost to the government and the economy.

3.2.2 Regulatory management

Increasingly, regulation has come to be seen as having a shelf life. Regulation may need to be updated, replaced, or removed in response to ongoing changes in government objectives, the actions of firms, or the evolving external environment. Regulation, like structural reform, has come to be seen less as a one-time event rather than as an ongoing dynamic process which is responsive to the outcomes that it achieves. The OECD has labelled this process regulatory management.

The process of regulatory management and the process of structural reform have much in common. First, they both require the problem to be accurately defined if the solutions that are implemented are going to be effective. Accurately defining the problem and assessing whether it is a long-term issue is essential if regulatory inflation is to be avoided. Regulatory inflation occurs when problems are blamed on market failure when they are actually the result of regulatory failure.

²⁶ Australian Government (2006), *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*.

²⁷ World Bank (2006) *Doing Business in 2006*, World Bank, Washington

However, the key similarity is that regulatory management, like structural reform, recognises that the world is constantly changing and so adopts a feedback loop that facilitates a process of constant refinement. This feedback loop is created when economies monitor how well their new regulatory arrangements are performing and then seek to repeat the process of implementing solutions for any problems that are identified. This has two benefits. First, it allows regulation to evolve alongside global changes and secondly, it builds in an ex post appraisal of how successful past changes have been.

3.2.3 Case Study: New Zealand's Ministry of Economic Development

While New Zealand implemented an extensive and wide-ranging set of structural reforms during the 1980s, the government recognizes that structural reform is not an event but a process. Thus, the elements of structural reform must be continuously monitored and adjusted as the situation warrants. In New Zealand the ministry that oversees this function is the Ministry of Economic Development. This ministry is responsible for regulatory policy, competition policy, insolvency and financial reporting and so on. It reviews regulatory frameworks, compliance costs, the legal frameworks and penalties and fees. Importantly, this ministry engages in regular reviews and consultations, which allows the elements of structural reform to be the subject of continuous debate. In this way, New Zealand is able to be continuously looking forward, and to rapidly react to changes in the economic environment that have implications for structural reform.

3.3 Examples of APEC Work on Regulatory Reform

3.3.1 The APEC/OECD Integrated Checklist

The Competition Policy and Deregulation Group (CPDG) and the OECD have worked together to create a regulatory reform checklist which may be of use to economies as they seek to create a regulatory management system to complement their structural reform agenda. This may help economies achieve the goals which they set for themselves. The checklist explicitly recognises that every economy faces a different set of circumstances and so no one-size-fits-all reform agenda exists. Instead, the checklist is structured as a qualitative self-assessment tool that economies may use to voluntarily investigate their own regulatory management systems.

The checklist is a policy-focused tool which encourages a qualitative assessment of an economy's regulatory management system. It provides qualitative questions which consider practical measures that may be able to contribute to the success of an economy's reform agenda.

The first section of the checklist supports a whole-of-government approach. The remaining sections consider three broad aspects that economies may choose to consider when redesigning their regulatory management system. The three sections are: regulatory policy; competition policy, and market openness.

Regulatory policy

To be effective, regulatory policy needs to be well designed and founded in law. It should adopt an ongoing process of appraisal and reappraisal with suitable attention being given to non-regulatory alternatives. To ensure that this occurs, regulation should be situated within a wider management system that reviews the performance of existing and new regulations.

This management system, the regulations, and the organisations created to enforce and manage regulations should all be transparent.

The competitive nature of policy

Competition can produce desirable outcomes at little cost to the government, the private sector, or the economy as a whole. However, while unfettered markets are often able to provide desirable outcomes, situations do arise where it needs to be supplemented by regulation. Market failure or unfair competitive practices justify the cost of regulating as these results can create socially undesirable results. This section of the OECD regulatory reform checklist encourages consideration as to whether regulation distorts competition, is discriminatory against private sector firms, or is inefficient.

Market openness

If economies are to reap more of the benefits of globalization they need to be open to international trade and competition. The regulatory reform checklist considers regulation's role as a potential behind-the-border barrier to trade. Economies can benefit from giving consideration to how trade-friendly their regulations are and whether they may place an undue burden on cross-border economic activity.

3.3.2 Private sector development plan

In May 2006, APEC and ABAC held a private sector development workshop that considered the ease of doing business by drawing upon the World Bank's 2006 *Doing Business: Creating Jobs* report. The report was used to highlight potential ways in which the APEC regulatory environment could be improved. The World Bank *Doing Business* reports examine the link between the quality of business regulation and private sector business growth. The studies may be used to analyze economic outcomes and identify what reforms have worked, where and why. It provides a series of quantitative indicators grouped into 10 different categories. These categories are:

1. starting a business;
2. dealing with [building] licenses;
3. hiring and firing workers;
4. registering property;
5. getting credit;
6. protecting investors;
7. paying taxes;
8. trading across borders;
9. enforcing contracts; and
10. closing a business.

The ABAC representatives recognised that the regulatory burden was a strong inhibiting factor on their businesses. The content, transparency and administration of regulation within the APEC region could be improved to make it easier to both start businesses and reduce the compliance costs of running those businesses. ABAC specifically identified the regulatory burden associated with both tax and labour laws, as well as access to financing as prominent inhibiting factors on doing business in the APEC region. The World Bank, in analysing APEC's performance compared to the rest of the world, noted three regulatory areas where APEC could benefit from improvement: the ease of starting a business, dealing with licenses

and accessing credit. APEC is currently developing a plan for further work on how the APEC business environment may be enhanced in order to encourage private sector development.

4. CONCLUSIONS

Structural reform is important for APEC. A well-implemented structural reform agenda can stimulate business profitability, encourage economic growth and boost productivity. Further, structural reform has the potential to build on the growth in prosperity that trade liberalisation has already brought to the hundreds of millions of people who live within both the developed and developing economies throughout the APEC region. By building strong and efficient markets that are capable of stable and sustainable growth, member economies may utilise resources for maximum gain.

The structural reform work agenda has already started with many of the APEC fora contributing valuable work. This work agenda is going to continue at least until 2010. The Economic Committee's new mandate is to coordinate and cooperate with APEC's specialist fora to produce good practice principles for economies interested in capturing the benefits of structural reform.

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**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 and 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.

Chapter Two:

Structural Reform and Sustainable Development in the APEC Region – Emerging Issues

PREFACE

During its 15 years of existence, APEC has consistently worked toward its original goals and the specific objectives defined in the founding Bogor Statement. The substance of those activities reflects the central pillar and prime focus of the organization: trade liberalization and trade and investment facilitation, moving toward the achievement of trade and investment liberalization in the Asia Pacific by 2010 for industrialized economies, and by 2020 for developing economies. The APEC Work Plan on the Leaders' Agenda to Implement Structural Reform toward 2010 (LAISR 2010) adopted by the Ministers in 2005 demonstrates a collective determination to implement structural reform in member economies along the line of Bogor Statement's Goals. The theme, sub-themes and priorities of APEC Year 2006 reflect the resolution of member economies to build APEC into a community that not only achieves high economic growth, but also ensures the required conditions for socially and environmentally sustainable development for individual economies and for the region as a whole. As such, to fully attain the goal of building a Community for Sustainable Development and Prosperity, structural reforms will need to be closely linked to the conditions that ensure sustainable development for each member economy and for the entire region.

Chapter One of the APEC Economic Policy Report 2006 introduces a policy-oriented structural reform program and clarifies the whole-of-government approach to structural reform, emphasizing the linkages between institutional reform and structural reform, and how to open the economy in an efficient manner. While Chapter One discusses relatively specific issues relating to structural reform and recommends the related policies, Chapter Two, under the title "Structural Reform and Sustainable Development: Emerging Issues," provides deeper analysis from the perspective of the sustainable development of the region.

Chapter Two is composed of three parts as follows:

I. General Issues about the Relationship between Structural Reform and Sustainable Development in APEC Region

International integration is a continuing trend. The aim of structural reform is to facilitate trade and investment liberalization, bringing into play member economies' respective comparative advantages while fully exploiting external opportunities. However, there is a concern that the differences in the level of economic development among APEC economies may lead to disparity in the benefits of liberalization and economic integration. Part I of Chapter II clarifies the conditions and requirements for sustainable development for each of APEC's economies and the region as a whole.

II. Emerging Issues in Sustainable Development in the APEC Region

Moving toward trade and investment liberalization, each of APEC's economies will face challenges, challenges which may threaten sustainable development. Part II provides a thorough analysis of the potential for unsustainable development in each of the economies,

with particular emphasis on income disparities between different regions within an economy as well as those between different economies.

III. Solutions and Recommendations

Part III recommends policy measures to ensure that structural reform in favor of trade and investment liberalization does not have an adverse impact on the conditions for sustainable development.

As such, Chapter Two focuses on reconciling sustainable development with structural reform and trade and investment liberalization, ensuring that the process of structural reform can take place in an efficient and realistic manner.

I. General Issues about the Relationship between Structural Reform and Sustainable Development in APEC Region

1.1 Sustainable Development - a Goal of APEC

Sustainable development can be briefly defined as that which ensures equity in the conditions of production and welfare between present and future generations living in the same territory or between different economies in the region. Therefore, economic growth and economic development cooperation should not be pursued at any cost, and the ramifications of development should be carefully considered. International economic integration appears to be an inevitable trend, and development cooperation must bring about benefits to all parties concerned. Rich economies need to invest their capital and transfer technology overseas, especially in and to underdeveloped economies, exploiting the latter's comparative advantages. To achieve sustainable development there needs to be an understanding of the scope of cooperation which will ensure mutual benefits to all the parties concerned. This will help bridge the development gap between economies, and more importantly, guarantee equal development opportunities for future generations while avoiding irreversible environmental and ecological harm.

Sustainable development is one of APEC's founding principles. The goals set forth in the 1991 Seoul Statement, the 1994 Bogor Statement, the Busan Road Map and many other APEC documents stipulate the overarching objective of sustainable development for the region.

At the APEC Ministerial Meeting on Sustainable Development on 9 June 1997, the Ministers emphasized the need to maintain a balance between economic development, population growth and environmental protection, considering it a key criterion for evaluating the level to which the trade liberalization and cooperation is achieved.

The Summit Meeting, held in Phnom Penh in November 2001, put forward a general Sustainable Development Platform for the entire Asia-Pacific region, including six initiatives:

- i) Poverty reduction;
- ii) Organic production and sustainable use of energies;
- iii) Land management and preservation of bio-diversity;
- iv) Safeguarding, management and provision of opportunities for accessing fresh water sources;
- v) Water resources in oceanic and coastal areas for sustainable development of small island and developing economies; and
- vi) Responses to climate and atmosphere changes.

The meeting explicitly acknowledged that although APEC is a region that includes many wealthy economies it also contains many of the world's poorest people. Cooperation between rich and poor economies in the region should therefore consider poverty eradication a primary objective and an urgent priority.

The threat of terrorism is undermining the stability of the region and adversely affecting the attainment of APEC goals. APEC Economic Outlook 2005 analyzed and quantified the impacts of terrorism on economic development cooperation in the region.

In parallel with the activities to implement the goals of the Bogor Statement and Busan Road Map, the theme of APEC this year once again reaffirms the determination of APEC member economies to advance the conditions for sustainable development for the region as a whole as well as for individual economies.

1.2 Issues Relating to Structural Reform and Sustainable Development in the Region

APEC is a large community which accounts for more than 41 percent of the world's population (2.64 billion inhabitants) and is composed of 21 Asia-Pacific member economies, namely Australia; Brunei Darussalam; Canada; Chile; the People's Republic of China; Hong Kong, Indonesia; Japan; the Republic of Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; the Republic of the Philippines; the Russian Federation; Singapore; Chinese Taipei; Thailand; the United States of America; and Viet Nam. This is also a community with differing natural, historical and cultural conditions, characterized by different levels of economic development and different economic structures. The APEC economies share a common commitment to the aims of structural reform, even as they take different paths to this end.

An analysis of Gross National Income (GNI) within APEC reveals also some generalized characteristics of structural reform, according to three levels of economic development.

Group One consists of high-income economies, namely the seven OECD members (Australia, Canada, Japan, Republic of Korea, Mexico, New Zealand and the United States of America) plus four non-OECD high-income economies: Brunei Darussalam; Hong Kong, China; Singapore; and Chinese Taipei.

Group Two is composed of five middle-income economies: Chile, Malaysia, Peru, the Russian Federation, and Thailand. The Russian Federation is a G8 member with advanced scientific and technological capabilities, but it is a transitional economy subject to a range of stresses. In terms of income level, this economy is classified among the middle-income economies. [9]

Group Three includes the five remaining low-income economies: China, Indonesia, Papua New Guinea, Philippines, and Viet Nam.

**Table 1: Sectoral Contribution to Growth by APEC Economies by Income Group
1970–2003 (%)**

		1970-1980	1980-1990	1990-2000	2000-2003
11 high-income economies	GDP growth rate	3.8	3.5	2.9	1.0
	Sectoral contribution:				
	Agro-forestry-fishery	0.6	2.3	-0.3	0.4
	Manufacturing	21.8	22.7	15.1	9.0
	Services	77.6	74.9	85.1	90.6
5 middle-income economies (Chile, Malaysia, the Russian Federation, Thailand and Peru)	GDP growth rate	5.3	4.6	13.9	2.9
	Sectoral contribution:				
	Agro-forestry-fishery	9.6	9.6	12.8	12.9
	Manufacturing	28.4	33.6	34.1	32.0
	Services	61.9	56.8	53.1	55.1
5 low-income economies (China, the Philippines, Indonesia, Papua New Guinea and Viet Nam)	GDP growth rate	5.8	7.5	8.7	4.4
	Sectoral contribution:				
	Agro-forestry-fishery	15.9	19.7	8.1	5.3
	Manufacturing	47.3	35.2	64.9	67.2
	Services	36.8	45.2	27.0	27.4

Source: WB, GDP/breakdown at constant 1990 prices in US Dollars (all countries and regions) data [23]

Group One economies are industrialized or newly industrialized, highly developed and high productivity economies using advance technology. Their service sectors are mature and account for a large proportion of the overall economy and economic growth. To generalize, the structural reforms pursued by Group One high-income economies tend to focus on resolving specific shortcomings, especially as they relate to: (1) the service sector; (2) foreign investment and foreign equity ownership; (3) educational and vocational training; (4) labor and employment; (5) the financial system; (6) the tax system; and (7) agricultural subsidies. The first two of these issues mainly involve interactions between developed economies (both within and beyond the APEC region). The issues of education and training and labour reform, however, will impinge on Group Two middle income economies as well as Group One economies, through labour migration.

Policies relating to financial and tax systems, as well as agricultural subsidies will most likely also have a considerable and direct impact on middle income economies and non-APEC developing economies. Agricultural subsidy reform is the area in which policy change can impact most seriously on developing economies.

The economic development of low and lower middle income economies is typically involves lower productivity activities such as primary production and labour-intensive industries (the Russian Federation being an exceptional transitional economy). Structural reform for this group of economies should be more comprehensive in scope, covering a range of socio-economic issues. The more affluent economies can assist in this process through support from their parallel structural reforms, or using separate assistance programs.

1.3. Impact of Structural Reform, Trade and Investment Liberalization on Sustainable Development

Structural reform is a crucial aspect of the economic development process. To ensure sustained and stable economic development, structural reform must be a continuous and comprehensive process covering all policy areas, from institutional reform to policies that effect business and industry. In the context of globalization, trade and investment liberalization have become popular targets for structural reform. This is in line with the Bogor commitment: “to continue to reduce barriers to trade and investment to enable goods, services and capital to flow freely among our economies”.

At the present stage of international economic integration, in addition to ensuring stable economic development, structural reform, especially institutional reform, is necessary for economies to comply with international trade conventions, creating a favorable investment and business climate to help achieve the common goals of the region.

Trade and investment liberalization is the immediate objective of APEC member economies. Structural reform is a necessary step toward this goal. Different levels of economic development reflect differences in labour productivity. However, with a level playing field, some low productivity economies may suffer unduly during the liberalization process. Therefore, structural reform should take into consideration differences in labour productivity. Practical experience shows that APEC member economies succeed when they gradually shift their production and business focus from low productivity activities to higher productivity activities that make a greater contribution to economic development. Industrial development is an evolutionary process, starting with the full exploitation of natural advantages to create initial savings, the development of new comparative advantages and more competitive industries (i.e. higher value-add manufacturing) and subsequently, or simultaneously, expanding the service industries.

The increased number of economies that are fully industrialized has resulted in the strong development of the capital market goods and equipment market. International trade led to the establishment of an international labour division based on differences in labour productivity between industrialized and non-industrialized economies. This phenomenon is making economies increasingly more interdependent, but may also gradually widen the income gap between economies.

Structural reforms help economies maintain macroeconomic stability, bringing into full play their comparative advantages, better mobilizing domestic savings, creating wealth, and consolidating economic potentiality, all of which contribute to accelerating economic growth and resiliency. Many APEC economies have mobilized sources of capital to achieve remarkable accomplishments, especially the NIEs during the 1970s and 1980s. However, these achievements have been interrupted by trade wars and instabilities in the regional financial system. The Asian economic and financial crisis of 1997 took a heavy toll on regional economies. It also showed that the risk of such financial turbulence is higher for underdeveloped economies and that there is a significant role for the international community to play in overcoming the consequences of financial crises. Guaranteeing a stable financial market in the region should be regarded as an important objective of structural reform and sustainable development.

Structural reform solely concerned with raising rates of economic growth is insufficient to ensure sustainable development. In conducting trade and investment liberalization, two fundamental requirements for structural reform must be met. First, the economy should ensure it is not overly vulnerable to external shocks, and able to make full use of external development opportunities. Second, highly competitive manufacturing and services industries should be gradually established.

These two conditions are also needed to ensure sustainable development for developing member economies.

The development stage that relies mainly on the exploitation of natural resources is often characterized by relatively slow structural reform, which rarely makes a great contribution to economic growth. As development progresses, the accumulation of domestic savings and application of technology helps raise productivity and speeds the restructure and transformation of the economy. A liberal free trade and investment environment may enable some economies to accelerate their rate of development, and close the gap on the more developed economies, while others continue to lag behind, resulting in widening disparity. According to a report in November 1999, conducted by the External Committee of the French National Assembly, following the spread of globalization “over 80 economies have a level of per capita GDP lower than it was 10 years ago,” and the income gap between “the lowest population quintile and the highest one has increased: the ratio was 1 to 30 in 1960, 1 to 60 in 1990 and 1 to 74 in 1997.” There are three to four APEC economies whose per capita GDP has declined or remained unchanged in the decade to 2000 (in real terms). The requirements for sustainable development that will ensure equity among different economies in the region as well as different generations should be carefully considered in the process of devising and implementing structural reform toward trade and investment liberalization.

Given this approach, there are many interrelated issues impacting structural reform and sustainable development that call for thorough study and detailed solutions, including as the direction of sectoral transformation, the system of international division of labour in the region, the exploitation of comparative advantage of individual economies, the reduction of severe competition among economies; measures to bridge income gaps between different regions within an economy; measures to build a stable financial system in the region; measures to ensure a balance between energy supply and demand; the measurement of the level to which environmental degradation harms human health and sectors such as agriculture, forestry and fishing; raising popular support for environmental protection; the establishment of an international framework for studying issues relating to the global environment, cooperation in establishing general warning systems for natural calamities, epidemics, etc.

II. EMERGING ISSUES IN SUSTAINABLE DEVELOPMENT IN THE APEC REGION

2.1 Economic Issues

The APEC region is characterized by disparities in the level of economic development.

Large populations, diversities in natural, historical and cultural conditions, and inequitable income distribution, are outward signs of many features of sustainable development in the APEC region. Structural reform among APEC member economies should not only aim to build a community with free trade and investment, but also needs to squarely address the issue of sustainable development in the region.

The per capita income gap between the high-income economies and the lower-income economies dropped from a multiple of 26 in 1995 to 19 in 2004. The composition of each of the group as ranked by income did not change greatly over the same time period, only Mexico temporarily fell from the ranks of “high-income economies” (due to the impact of the financial crisis), before subsequently regaining its position. The developmental features of the two groups are noteworthy. The high-income economies have already completed their industrialization, using different

development models. In addition to economies that have a strong and long-standing industrial base (e.g. the US and Japan), others have based their development on the exploitation of natural resources. The emerging newly industrialized economies have grown rapidly thanks to their successful adoption of an export-oriented development model. Sparsely-populated but resource-rich economies like Australia, Canada, New Zealand and Brunei have accumulated savings, and quickly shifted to high productivity manufacturing and services industries, which now contribute the lion's share of economic growth. As a result, a high proportion of their exports still originate from the primary sector and the technologies applied are less than in other economies.

Hong Kong, China; Republic of Korea; Mexico; Singapore; and Chinese Taipei are so-called newly industrialized economies, which prospered by following an export-led development model, initially supplying light manufactured goods to the world market, before moving on to even higher value added products. The economies of Hong Kong, China; and Singapore leveraged their geographic location as natural trading hubs and rapidly developed their services sub-sectors, achieving a high proportion of re-exports among their total exports. Some middle income economies (Chile, Malaysia and Mexico) have emulated the open-market newly-industrialized approach, but have yet to achieve the same success.

Structural reform in densely populated and low-income economies contributes to the sustainable development of the region.

Although the population density of the region is below the world average (APEC occupies 46 percent of total land area, but has only 41 percent of total world population), APEC includes many economies with high population density. In 2004, Chinese Taipei had a population density of 629 inhabitants per square km which is the highest in the region, followed by the Philippines, Viet Nam, China and Indonesia. Other member economies possess large land areas and abundant natural resources, but enjoy low population density. These economies include Australia (2.6 inhabitants per square km), Canada (3.2) and New Zealand (14.7).

While globalization appears inevitable, a considerable number of economies have been made poorer by this process. For each APEC member economy and for the community of member economies as a whole, structural reform toward trade and investment liberalization needs to ensure that member economies are able to establish and consolidate the conditions for sustainable development.

Over the past 30 years, the four APEC economies at the low-income or lower-middle income levels have been those with large populations and high population density, i.e., China, Indonesia, the Philippines and Viet Nam. Except for China, the population growth rate of other economies has been declining, but has remained relatively high, particularly in the Philippines and Viet Nam. In the meantime, the population growth rates of high-income economies have remained very low: 0.14 percent per annum in Japan, 0.9 percent in the US, and about 1 percent per year in Australia and Canada.

Table 2: Population Growth Rates of Five Low-Income Economies (%)

	1993	1995	2000	2001	2002	2003	2004	2004 pop. density (inhabitant/km ²)
China	1.05	0.97	0.78	0.72	0.68	0.64	0.62	134
Philippines	2.29	2.20	1.98	1.94	1.90	1.86	1.81	272
Indonesia	1.52	1.44	1.31	1.30	1.29	1.27	1.25	116
Papua New Guinea	2.68	2.64	2.35	2.27	2.19	2.12	2.06	12
Viet Nam	2.05	1.79	1.38	1.39	1.39	1.39	1.37	251

Source: *The World Bank, Table 07 World Population and GDP* [23]

In 2004, the combined population of Indonesia, the Philippines and Viet Nam made up about 15 percent of the total regional population (64 percent if China is included). Given their above average population growth rates, this proportion will continue rising in the coming years. This will constitute a challenge, both economic and social, for those three economies. The low per capita agricultural land area; limited investment available for agriculture; and low land profitability have constrained the productivity of agricultural labour in these economies. A comparison of agricultural production between sparsely and densely populated economies shows that while there are not big differences in terms of food production per hectare between them, their productivity levels measured in US\$ per agricultural labourer are very different.

Table 3: A Comparison of Agricultural Productivity between Selected APEC Economies and Viet Nam in 2000

Economies	Food production (kg/ha)	Compared to Viet Nam (multiples)	US\$ per labourer	Compared to Viet Nam (multiples)
China	4,789	1.16	333	1.3
Indonesia	4,026	0.98	747	2.9
The Philippines	2,581	0.63	1,440	5.7
Viet Nam	4,113	1	254	1
Australia	1,962	0.48	35,789	141
New Zealand	6,273	1.53	28,265	111
Canada	2,812	0.68	44,136	174

Source: *Tatyana P. Soubbotina, Beyond Economic Growth, WB 2005* [9]

Clearly, to achieve further improvement in people's living standards, the structure of densely populated economies must be shifted in favor of manufacturing and services industries, by improving the quality of human resources, and reducing population growth rates. The improvement of human resources depends on many factors, such as the rate of domestic savings, access to education, training and health care services. Of particular importance is the level of productive investment that can generate new jobs. This should be a primary target of structural reform so as to ensure the economic dynamism necessary to achieve sustainable development.

The mobility of labour between economies can bring about mutual economic benefits for the countries concerned, and for the region as a whole. In the case of temporary labour migration, labour-exporting economies benefit in terms of remittances, knowledge and skills transfer, while labour-importing economies can quickly make up for any shortfall in their labour supply, especially in respect of lower skilled workers. However, there is a tendency for highly skilled workers from

developing economies to seek employment and residency in developed economies. Through their remittances, these workers may make a great contribution to their home economies' foreign exchange earnings by choosing to work abroad. Nonetheless, in the longer term this "brain drain" could impede the overall pace of development among low-income economies.

Trade liberalization and its impact on sustainable development of the region

Currently, one obvious feature of the APEC region is the huge disparity between the high-income economies and all the other economies. Bridging this inequitable income gap will bring about benefits to all members and promote the attainment of the principle aim of "building APEC in to a dynamic community for sustainable development and prosperity."

In the 13 years following APEC's formation in 1990, developing member economies in the region enjoyed economic growth 1.3 times higher than the average annual GDP growth rate of developed members. Unfortunately, the developing economies' annual average population growth rate was 1.65 times higher than that of the developed economies during the same period. Consequently, the annual average growth rate of real per capita GDP of the developing economies has been relatively low (2.8 percent compared to 2.45 percent for the developed economies).²⁸ The income gap between developed and developing economies in the APEC region has been reduced, but only marginally. Estimates based on World Bank data show that per capita GDP in current US\$ term in the five richest economies was 22 times larger than that of the five poorest ones in 1970, 25 times larger in 1975, 36 times larger in 1989, 34 times larger in 1995, and 34 times larger in 2004. When purchasing power parity is applied, this ratio drops to 7.8 times in 1991 and 6.8 times in 2004. The US and Japan are the two largest economies in the region, making up only 16 percent of the total regional population, but representing 71 percent of APEC GDP.

In the context of trade and investment liberalization, there has been a tendency for low-income economies to specialize in low-income industries and high-income economies to invest in high-technology industries, making it more difficult to bridge the development gap.

²⁸ Computed from World Development Indicators 2005 (WB) and Human Development Report 2005 (UNDP) The World Bank, Beyond Economic Growth, p. 152

Table 4: APEC Economies' Ranking by Per Capita GDP

Rating	1992	1995	2000	2004	2004 per capita GDP (in US\$)
1	Japan	Japan	Japan	United States	39,650
2	United States	United States	United States	Japan	36,501
3	Canada	Singapore	Hong Kong, China	Australia	31,598
4	Australia	Hong Kong, China	Canada	Canada	31,031
5	Hong Kong, China	Australia	Singapore	Singapore	25,002
6	Singapore	Canada	Australia	New Zealand	24,499
7	Brunei Darussalam	Brunei Darussalam	Chinese Taipei	Hong Kong, China	23,641
8	New Zealand	New Zealand	New Zealand	Brunei Darussalam	14,454
9	Chinese Taipei	Chinese Taipei	Brunei Darussalam	Korea, Republic of	14,266
10	Korea, Republic of	Korea, Republic of	Korea, Republic of	Chinese Taipei	13,516
11	Mexico	Chile	Mexico	Mexico	6,397
12	Chile	Malaysia	Chile	Chile	5,838
13	Russian Federation	Mexico	Malaysia	Malaysia	4,731
14	Malaysia	Thailand	Peru	Russian Federation	4,047
15	Thailand	Russian Federation	Thailand	Thailand	2,519
16	Peru	Peru	Russian Federation	Peru	2,439
17	Papua New Guinea	Philippines	Philippines	China	1,283
18	Philippines	Indonesia	China	Philippines	1,059
19	Indonesia	Papua New Guinea	Papua New Guinea	Indonesia	1,022
20	China	China	Indonesia	Papua New Guinea	824
21	Viet Nam	Viet Nam	Viet Nam	Viet Nam	551

Source: UNCTAD's database, Table "Per Capita GDP at current prices in US Dollars (all countries and regions)" [23]

Technology is a key driver of economic growth and facilitator of structural reform. The share of high-tech exports among total export volume in APEC high-income economies is 35 percent and 36 percent for the US and the Republic of Korea, respectively; and 28 percent and 29 percent for Japan and Mexico. Economies with exports dominated by primary commodities usually have a smaller share of high-tech exports. Moreover, economies with rising proportions of high-tech exports appear better able to maintain high, stable growth rates (e.g. Korea after the 1997–98 crisis and China in recent years).

Table 5: Differences in Technology Adoption among APEC Economies

	1990	1995	2000	2001	2002	2003
Share of low-tech manufactured exports (%)						
Australia	34.6	32.1	32.9	34.2	34.6	32.4
Canada	27.5	28.3	25.2	25.7	25.7	25.7
Japan	6.3	5.2	5.4	5.6	5.4	5.1
Korea	..	21.0	15.2	15.4	13.6	11.4
Mexico	14.6	15.4	15.9	15.3	15.7	15.3
New Zealand	76.1	71.6	70.8	73.1	72.9	69.6
United States	16.9	17.0	14.0	14.3	14.4	14.4
Share of high-tech manufactured exports (%)						
Australia	8.8	12.0	13.2	13.5	13.5	11.8
Canada	11.3	10.9	16.1	14.3	12.2	12.1
Japan	30.4	31.9	33.0	30.8	29.1	28.9
Korea	..	29.2	37.1	32.4	35.1	36.1
Mexico	7.0	23.2	28.7	29.9	28.4	28.4
New Zealand	1.5	2.6	3.0	3.0	3.3	5.4
United States	33.6	32.6	38.4	37.9	36.4	35.8

Source: UNCTAD database [23]

Hence, to narrow development and income gaps between economies, structural reform should not simply aim to achieve the goal of trade and investment liberalization, it also requires each member economy to upgrade its technology level and human resource quality, thereby ensuring competitiveness, and rapid and stable growth.

A key ingredient in the success of APEC member economies has been the opening -up of their economies. Since the late 1980s, the development of many APEC member economies has heavily relied on export performance: the ratio of exports to GDP has rapidly risen over the years, especially for the developing economies. During a period of almost 20 years between 1986 and 2004, the ratio of exports to GDP for developing economies rose from less than 50 percent in 1986 to 67 percent in 1990, and over 72 percent in 2004.

Table 6: Export to GDP Ratio for Selected APEC Member Economies, 1986–2003 (%)

	1986	1990	1995	2000	2001	2002	2003
Australia	34.28	33.48	39.81	45.74	42.96	41.76	n.a.
Canada	55.22	52.01	72.28	86.78	82.46	n.a.	n.a.
China	31.85	31.85	45.68	49.06	48.54	54.77	65.0
Indonesia	39.97	49.06	53.96	76.39	77.11	65.09	56.94
Japan	18.38	19.81	16.74	20.1	20.09	21.0	n.a.
Korea	65.83	57.4	58.75	78.49	73.31	69.12	73.81
Malaysia	104.95	146.96	192.11	229.28	214.48	210.68	204.78
Mexico	30.77	38.31	58.07	63.94	57.26	55.46	58.53
New Zealand	53.78	53.78	57.77	70.8	68.2	64.82	n.a.
Papua New Guinea	94.93	89.57	105.62	n.a.	n.a.	n.a.	n.a.
Peru	29.27	29.6	30.7	34.14	33.63	33.77	34.99
Philippines	48.68	60.8	80.54	108.9	100.3	98.38	99.01
Chinese Taipei	52.84	41.96	42.15	51.8	43.97	46.39	50.41
Thailand	49.17	75.78	90.43	124.91	125.4	122.16	122.35
United States	17.51	20.62	23.46	26.31	24.13	23.63	n.a.
Viet Nam	23.22	81.32	74.72	112.53	111.56	115.01	114.09

Source: *The World Bank's database, Vietnam Statistical Year Book 2005* [23]

At present, the APEC region accounts for approximately 47 percent of total world trade volume. Intra-regional trade between member economies represents over 70 percent of total regional foreign trade. The APEC region now plays a leading role in international trade. In years to come, further expansion of trade relations with the rest of the world should be regarded as a common goal of the APEC community, particularly for the less developed economies.

Table 7: Commodity Export Volume in APEC and EU during 1970–2003

	1970	1980	1990	1995	2000	2003
Percentage Share of World Exports						
APEC	36	33.7	39	46.3	48.5	44.5
EU	45.6	41	44	39.7	35.9	38.7
Percentage Share of Regional Exports						
APEC	57.8	57.9	68.3	71.8	73.1	72.5
EU	59.5	60.8	65.9	62.4	61.6	61.1
Export Volume (Million US\$)						
APEC	58,633	357,697	901,560	1,688,708	2,262,091	2,419,912
EU	76,451	456,857	981,260	1,259,699	1,409,464	1,768,984

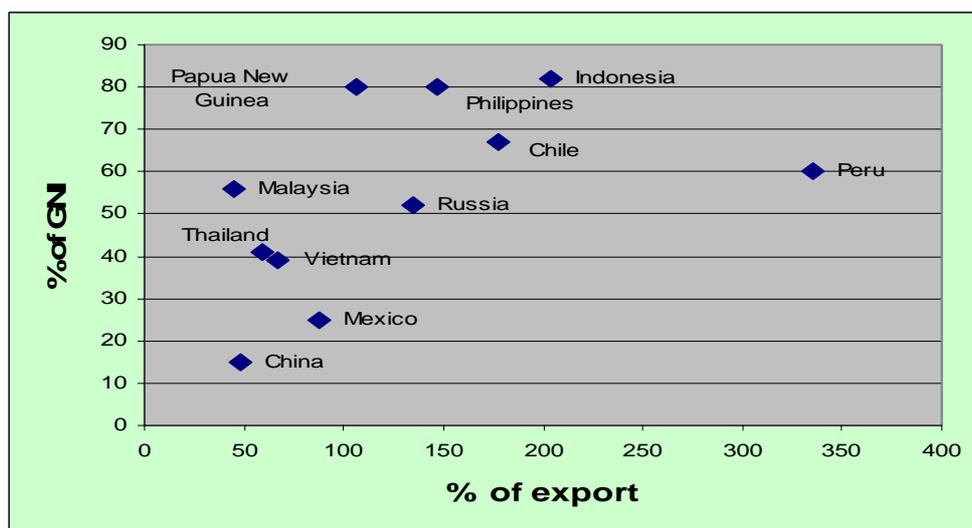
Source: *World Bank, World Development Indicators 2005, p. 334*

The level of foreign debt affects the sustainable development of some economies in APEC region

The foreign indebtedness of APEC's developing economies has been increasing over time. In a period of 13 years, from 1990 to 2003, the total foreign debt of APEC's developing economies rose from US\$368.7 billion to US\$898.1 billion. However, the foreign debt-to-GDP ratio has been gradually declining: in 1990, it accounted for about 29 percent of GDP, by 2003, the figure had declined slightly to 28.2 percent. The trend in the size of long-term debt relative to total debt was less positive; long-term debt accounted for 80.4 percent of total foreign debts of the developing economies in 1990, but declined to only 78.8 percent in 2003, indicating an increase in the

proportion of short-term and medium-term debt. In the short run, this can put pressure on debt servicing for the poor economies in the region. According to the World Bank's classification, among developing and less developed economies in APEC, only two economies fall into the most heavily indebted group, namely Indonesia and Peru, six economies are in the group of medium-indebted economies (Chile, Malaysia, Papua New Guinea, the Philippines, Russia and Thailand), and three economies can be categorized as low-indebted countries (China, Mexico and Viet Nam).²⁹

Figure 1: Foreign Indebtedness of APEC's Developing Economies in 2003



Source: World Bank, *World development indicators 2005*, p. 262 [11]

2.2 Social Aspects

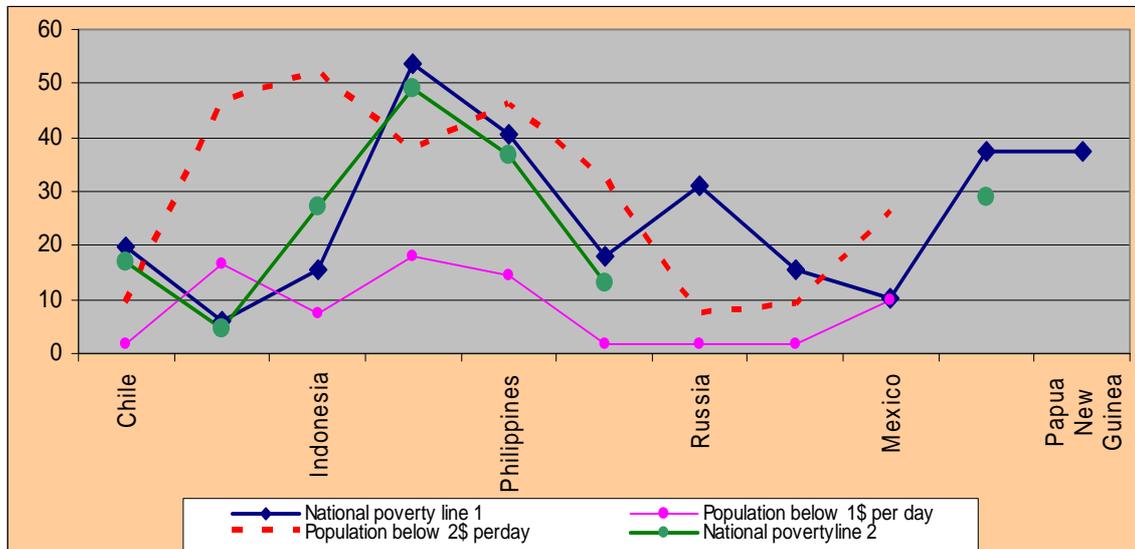
Poverty and inequality are non-sustainable factors for APEC's developing economies.

Almost all developing economies that are members of APEC have recorded remarkable progress in poverty reduction and, at the same time, have maintained relatively high rates of economic growth. The proportion of persons below the poverty line in respect of national standards has been declining over time in every economy, except for Indonesia.³⁰ Moreover, the national standards relating to poverty in some of APEC's developing economies are higher than the international norms. This means that those that are considered poor in these economies often enjoy a better standard of living than those categorized as poor in many poor economies, which apply a poverty standard of less US\$1 (PPP)/day. Some economies like Chile, Peru, Russia and Malaysia have set poverty standards higher than the international norm of US\$2 (PPP)/day, indicating the great strides made in poverty reduction among APEC member economies. The governments of APEC member economies have been relatively successful in implementing the policies in support of economic growth and poverty reduction.

²⁹ According to the World Bank's classification, economies that have foreign debts exceeding 220 percent of exports or 80 percent of GNI are considered heavily indebted; countries with more debts than 132 percent of exports or 48 percent of GNI and less than 132 percent of exports or 48 percent of GNI are considered medium indebted and low indebted, respectively (World Bank, *World Development Indicators 2005*)

³⁰ National poverty lines 1 and 2 indicate the percentage of the poor of the economy according to two different surveys conducted by the World Bank.

Figure 2: Poverty in APEC Developing Economies

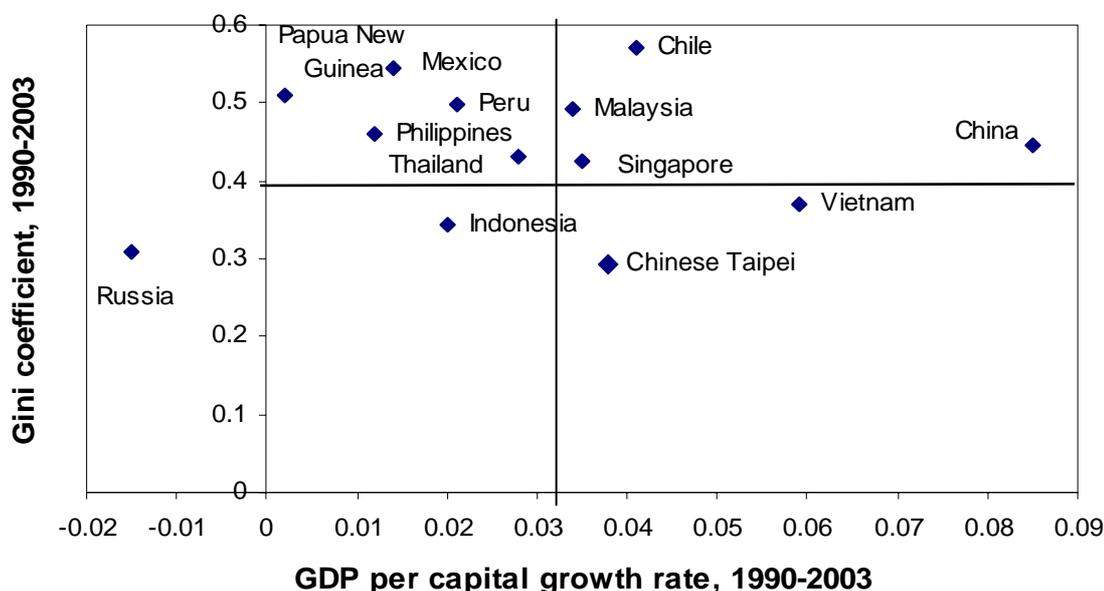


Source: World Bank, *World development indicators 2005*, p. 64 [11]

However, progress on reducing income inequality in APEC's developing economies has not been as successful as the accomplishments in poverty reduction. Income disparity is relatively large among APEC's developing economies. Latin American economies have high degree of income inequality compared with the East Asian economies. Those with highest inequality in income distribution are Chile, Papua New Guinea, Mexico and Peru, all of which have Gini coefficient above 50,³¹ (the higher the Gini coefficient, the smaller the share of national income for the poorest members of society). At the same time, and with the exception of Chile, these countries' per capita GDP growth rates have been modest at best (less than 3 percent a year). Indonesia and Viet Nam are the two economies that enjoy the lowest degree of income disparity. The poorest 20 percent of society in these two economies have 8.4 percent and 7.5 percent of total income, respectively. This is almost three times higher than the situation in Peru and Mexico, where the poorest 20 percent have only 2.9 percent and 3.1 percent respectively of income. Viet Nam is one of the few economies that enjoy both high economic growth and relatively equal income distribution.

³¹ Although there is no clear-cut threshold, economies with a Gini coefficient of over 50 can be considered as having highly unequal income distribution (UNDP-Human resource development 2005).

Figure 3: Gini Coefficient and GDP per Capita Growth Rate in 1990–2003



Source: World Bank, *World development indicators 2005*, p. 72 [11]

2.3 Utilization of Energy and Land Resource

Energy consumption in some APEC member economies requires structural reform

APEC is the largest energy consumer in the world. In addition to major industrialized economies consuming large amounts of energy, like America and Japan, the high economic growth in the remaining economies has strongly pushed up the demand for energy. APEC's energy consumption in relation to global consumption increased from 57.3 percent in 1991, to 58.7 percent in 2003. Although the contribution to energy demand by the United States and Japan declined, these two economies still account for more than one quarter (26.7 percent) of total global energy consumption. Higher energy demand from the rest of APEC saw their share of energy consumption jump from 24 percent in 1990, to 32 percent in the same period, of which China accounts for 41.7 percent [23]. High economic growth rates and accompanying high consumption of fossil fuels have been the experience of many APEC economies. Fossil fuels are non-renewal and their exploitation can have negative impacts on the environment and ecological systems.

In the near future, with further rapid economic growth expected, the exploitation and utilization of fossil fuels in the region will continue to increase, not only to meet industrial demand but also for domestic residential use. According to a long-range forecast on energy supply and demand released by the Institute for Energy Economics (Japan), primary demand for energy in 11 economies (ASEAN, the NIEs, China and Japan) will be about three billion tons (oil equivalent), of which the demand for oil alone will be about 980 million tons [6]. According to [10], in 2020, China's need for primary energy will be 2.5-3.3 billion tons of standard coal equivalent (including 2.1-2.9 billion tons of coal, 0.45-0.61 billion tons of petroleum as well as natural gas).

Higher and more volatile energy prices may result in the development of more sustainable energy substitutes, eventually changing the structure of energy consumption. This bright prospect will depend on many factors such as the level domestic savings by the economies as well as scientific

and technological breakthroughs. Moreover, any major change in the mix of energy sources will not be immediately forthcoming. In the meantime, energy policy will continue to be dominated by issues of energy security at the economy level. In the coming years, increased energy utilization and reserve requirements by economies will add to the upward pressure on energy prices, threatening to derail socio-economic development in the region.

Trade and investment liberalization will accelerate the process of technology transfer with positive and negative effects. The importation of outdated technology by developing economies may push up the demand for energy consumption and possibly exacerbate environmental degradation. APEC's economies need to take collective action to ensure the current massive use and exploitation of fossil fuels do not conflict with sustainable development goals.

Depleted agricultural land area is a threat to sustainable development in many developing economies

Land use is a major issue in densely populated economies with limited agricultural land per capita. The over-exploitation that sometimes results can lead to land degradation, resulting in lower yields. Deforestation has caused in landslides, flash floods and depleted ground water reserves.

Industrial development, the construction of economic and social infrastructure and urbanization are reducing agricultural land area. From 1990 to 2002, agricultural land area in many economies declined, especially in the economies with limited agricultural land to begin with: in Korea agricultural land declined by 11.3 percent, in Japan by 8.8 percent, and in Thailand, 5.7 percent [23]. As economies develop and require more land for industry and services, this tendency will spread to other densely populated economies such as China, Indonesia, the Philippines and Viet Nam. This worrisome trend represents a direct threat to sustainable development.

To combat this loss agricultural productivity needs to be increased, food security improved and the pressure on arable land reduced. The establishment of integrated programs to create the harmony between production and consumption, and among regions in each economy is required. Proper protection for various types of natural resources such as water, forests and mineral resources are also needed.

2.4 The Environment

Increased environmental pollution, especially air pollution is an unwanted byproduct of industrial development

Higher industrial output and rising energy usage by consumers will inevitably lead to increased air pollution, especially in developing economies that are more reliant on basic heavy industrial processes and that are less able to afford clean technologies. The emissions that contribute to the so-called greenhouse effect are on the increase. The volume of CO₂ emissions continues to rise, even among the more affluent APEC economies: between 2000 and 2003, CO₂ emissions increased by 5.4 percent in Australia, 4.2 percent in Canada and 9.7 percent in New Zealand. Among APEC's developing economies the rates of increase have been much higher: from 2000 to 2003, CO₂ emissions in China increase by 26.7 percent, in Viet Nam by 38.5 percent and in Thailand by 19.3 percent.*

* Calculation based on CO₂ Emission from Fuel Combustion, IEA statistics, 2003.

Pollutants like SO₂ and NO₂ have been declining in developed APEC economies. Between 1990–2002, emissions in the United States fell by 35 percent and in Japan by 16.4 percent, although in some economies, like Australia and New Zealand, they continued to increase. Among the low-income economies in the region, the increase was negligible.

Estimates by the Institute for Energy Economics in Japan indicate that emissions of SO₂ and NO₂ from 11 Asian economies (including Japan) will increase from about 30 percent of the total global emissions of these gases (in 1992) to 50 percent and 47 percent respectively, by 2010. Almost half of global SO₂ and NO₂ emissions will come from the East Asian economies. APEC economies will account for about three quarters of CO₂ and SO₂ emissions [6]. Equipment and systems to reduce the level of polluting emissions are not used in Asia due to their high cost, nor are they likely to be in the near future. This issue needs to be included in any structural reform agenda.

Table 8: APEC Emissions of CO₂

	Economies	Emissions of CO ₂ (million tons)		Emissions of CO ₂ Per Head (tons)	
		2000	2003	2000	2003
1	Australia	329.2	347.1	17.07	17.35
2	Brunei	4.4	5.3	13.11	14.75
3	Canada	530.9	553.3	17.3	17.49
4	Chile	53.2	52.9	3.5	3.36
5	China	2,934.5	3,719.4	2.32	2.89
6	Hong Kong, China	38.7	40.5	5.8	5.94
7	Indonesia	278.8	318.1	1.35	1.48
8	Japan	1,159.0	1201.4	9.13	9.41
9	Korea	427.7	448.4	9.0	9.36
10	Malaysia	107.5	122.8	4.62	4.49
11	Mexico	360.9	374.3	3.66	3.64
12	New Zealand	29.8	32.7	7.69	8.09
13	Papua New Guinea		2.5		0.4
14	Peru	26.4	25.8	1.02	0.95
15	Philippines	68.9	70.5	0.9	0.86
16	Russia	1,513.5	1,526.8	10.4	10.65
17	Singapore	38.6	38.2	9.6	8.9
18	Chinese Taipei	215	245.2	69.65	10.85
19	Thailand	157.9	188.4	2.6	3.64
20	United States	5,706.6	5,728.5	20.21	19.68
21	Viet Nam	43.8	60.6	0.56	0.75

Source: CO₂ Emission from Fuel Combustion, IEA statistics, 2003; World Bank, World Development Indicators 2006 (for PNG).

In each economy, different levels of industrial production and urban development result in varying degrees of air and water pollution. Underinvestment in environmental protection in low-income economies can exacerbate the effects of pollution, storing up problems for future generations. Many economies in the region have enacted strict laws relating to environmental protection, but all too often they are not fully enforced. While enforcement is important, it is equally important to educate industry and the public about the seriousness of the issue.

Cooperation between economies to resolve specific environmental problems is often complicated by the conflicting vested interests of an economy or a group within an economy. When discussing institutional reform, it is necessary, at a policy level, to reach a common position among member economies.

2.5 Natural Calamities and Epidemics

The APEC region is highly susceptible to natural calamities and epidemics, with some economies—for example, China, Japan, the Philippines and Indonesia—at particular risk from natural disasters.

The APEC region is disproportionately endangered by natural calamities

From 1900 to the present day, 3,700 natural calamities have occurred in APEC economies, accounting for 37 percent of all natural calamities around in the world. These unfortunate events have caused the deaths of an estimated 13 million people, seriously disrupted the lives of another 2.4 billion people and caused economic losses of US\$888 billion. On average, the region is afflicted by 37 natural calamities annually, with heavy loss of life and property.³² These statistics indicate that the highest frequency natural calamity are storms (1,425 storms or nine per year on average) followed by floods with 910 occurrences.

Almost all the economies in the APEC community are affected by natural disasters with the possible exception of Singapore.³³ Severe natural calamities have been occurring more frequently in recent years and with more destructive force. At the end of 2004, the region witnessed a terrible tsunami that damaged 11 Asian economies, of which Indonesia, Thailand and Malaysia, all members of APEC, were among the most seriously affected. These three economies (plus Myanmar) accounted for more than 75 percent of the total loss of life resulting from the tsunami. In the period 2004–2005, the US experienced three devastating hurricanes—Ivan, Charley and Katrina—causing damage of more than US\$100 billion. These three storms ranked first, third and fourth in the list of the most destructive storms ever to hit the US economy. China is also prone to storms and floods. In the 10-year period 1990–99, there were around 35 serious floods, but this number increased to 55 in just the last five years (2000–2005).³⁴ In 2005, after having swept through Southeast Asia causing 40 deaths, the storm Damrey hit the cities of Guangxi and Hainan provinces in China, causing damage estimated at more than US\$1 billion. It was the most destructive storm experienced by China in the last 30 years. In the same year, three APEC member economies were unfortunate enough to be on the list of countries most affected by natural disasters in terms of human loss: the US ranked third (more than 1,300 people killed by hurricane Katrina), Indonesia ranked sixth (915 people were killed in an earthquake in March 2005); and China (771 people were killed in the flood in June).³⁵

³² Calculated based on CRED data. [18]

³³ Based on CRED data.

³⁴ Based on CRED data.

³⁵ CRED data.

Table 9: Summary of Natural Disasters that Occurred in APEC Member Economies (1900–2005)

Natural disasters	No of Events	Number of affected people (people)				Damage (US\$ million)
		Killed	Injured	Homeless	Affected	
Drought	146	3,511,702	39	n.a.	290,149,674	22,516.7
Earthquake	407	1,144,058	692,400	5,450,359	36,636,505	204,707.6
Flood	911	6,637,243	1,094,317	43,831,722	1,592,422,473	235,628.0
Hot temperature	89	8,097	1,806,201	16,000	7,604,635	15,477.6
Snow slide	185	19,632	2,862	103,953	807,978	1,614.5
Volcano	110	26,441	4,938	162,600	2,911,059	2,728.5
Tide	35	185,065	10,014	543,394	70,761	4,924.9
Forest fire	179	2,133	1,500	54,902	3,442,455	22,789.9
Storm	1,425	327,740	222,734	27,387,674	434,150,805	377,518.0
Others	12	260	n.a.	n.a.	162,200	120.9
Total	3,631	13,498,741	3,914,730	77,550,604	2,376,452,229	888,026.6

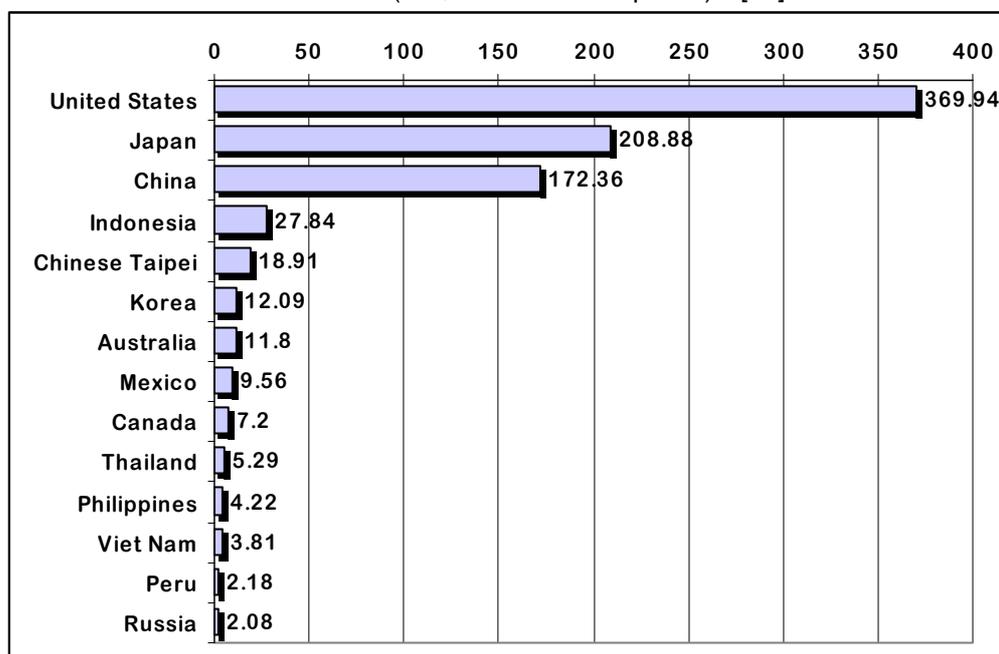
Source: Calculated based on CRED database. [18]

Natural disasters not only interrupt production and destroy the physical infrastructure needed to facilitate trade and support growth, they can also undermine investor confidence in a region, severely impairing the prospects for sustainable development.

According to ISDR statistics, from 1993 to 2005, eight APEC member economies including Australia; China; Indonesia; Japan; Korea; Mexico; the US and Chinese Taipei were among those economies listed as most affected by natural calamities, with the total damage valued at US\$880 billion (at 2005 prices). The US, Japan and China were the worst hit economies with losses of US\$365 billion, US\$209 billion and US\$172 billion, respectively. Some natural calamities have been so severe that they have significantly reduced the productive output of economies. One case in point was the earthquake that occurred in Papua New Guinea which depressed GDP by 7.5 percentage points. The 1997 forest fires in Indonesia had a similar economic impact on that economy.

Figure 4: Economic Loss Suffered by APEC Member Economies from Natural Disasters (1993–2005)

(US\$ billion at 2005 prices)³⁶ [20]



The costs of repair and rebuilding as well as economic rehabilitation in areas affected by natural calamities place an unexpected burden on state budget expenditures, negatively influencing investment in economic development programs. In 2005, humanity witnessed hurricane Katrina, the world's most destructive storm since 1900. The damage sustained by the US was estimated at US\$75 billion; the total cost of reconstruction US\$105 billion.

Most natural disasters affect places inhabited by the poorest and most vulnerable groups in society, those least able to contend with, and recover from, such calamities.

The human loss is the most serious cost to society, debilitating the labour force along with the local economy of the affected areas. ISDR* statistics reveal that between 1900 and 2005, several APEC member economies were among the most seriously affected in terms of human suffering. In China, 1.3 billion people were affected; in Viet Nam 30 million; in Thailand, 29 million; and in the Philippines, 21 million. In June 2006, the Chanchu storm killed hundreds of Vietnamese fishermen most of whom were the main breadwinners in their families. These kinds of events can easily tip families and even whole communities into poverty.

According to the International Committee of the Red Cross, children are often the most vulnerable. One third of the victims of the 2004 tsunami in Southeast Asia were children. This may result in a labour imbalance in the affected areas in the future. The state must take on an additional financial and social burden because of the need to care for large numbers of orphans.

With manufacturing facilities destroyed, transportation systems in collapse, raw material supplies

poorer access to healthcare services). Disasters cause many people to fall into homelessness and they wreak havoc on social infrastructures such as hospitals, schools and housing.

Indeed, the negative impact of natural disasters on people's living conditions may persist for many years. Droughts and forest fire may have destroyed arable land. Tidal surges and tsunamis may have seriously damaged coastal ecosystems, in the process making these areas more vulnerable to further damage by tsunamis and cyclones. Contaminated water supplies due to the destruction of waste disposal systems may threaten people's health and well being. The long-term impact of the destruction caused by tsunami to coastal mangrove forests has not yet been fully evaluated. These forests have been partially destroyed, leading to the changes in the salinity of the soil and harming ecological systems and coastal aquaculture.

The Impact of New Diseases on APEC's Sustainable Development

Despite advances in medicine, in this the 21st century, mankind continues to be threatened by extremely dangerous and highly contagious diseases. The recent outbreaks of SARS (Severe Acute Respiratory Syndrome) and avian flu have threatened APEC economies in particular.

Over the last 100 years, all 21 economies in APEC had been affected by outbreaks of various diseases, negatively impacting the lives of over eight million people.

Table 10: Impact of Epidemics in APEC Member Economies (1900–2005)

	No of events	Affected people (people)			
		Killed	Injured	Homeless	Affected
Epidemic diseases	132	1,636,370	79,725	0	8,093,684

Source: Calculated based on CRED data.

In 2003, SARS spread to 30 countries, infecting 8,096 infected people and killing 774. Half of APEC's member economies were hit by the epidemic with 8,048 infected and 772 deaths, of which China; Hong Kong, China; and Singapore were the most seriously affected.

Then came avian flu. The first case appeared in Viet Nam and then spread to neighboring economies (Thailand, China, Indonesia, Cambodia and Laos). And by October 2005, the disease had reached Europe and Africa.³⁷ The spread of the disease may be due to the migration of wild water-birds and seabirds. The results of a WHO investigation into the case of seven members in one family who died of the H5N1 strain in Sumatra indicate that the disease had mutated to become communicable from person to person. While the WHO says that avian flu is not yet an epidemic, if an epidemic does break out, it could kill two million to seven million people within a 12-month period. At present, the fatality of this virus is relatively high (over 50 percent).³⁸

Epidemics such as SARS and avian flu can have an immediate impact on economic growth. SARS lowered GDP growth in the APEC economies by 0.5-1 percentage points.³⁹ But the economic fallout varied by economy. Economic growth in Hong Kong, China; Singapore and Indonesia dropped by 1.8, 1.1 and 0.9 percentage points,⁴⁰ respectively.

So far, the impact of avian flu on affected economies' GDP growth has been relatively minor as poultry farming in these economies accounts for a negligible percentage of economic output. Viet

³⁷ FAO.

³⁸ Based on WHO data.

³⁹ APEC.

⁴⁰ ADB statistics.

Nam was the first to be hit, and is the most seriously affected economy. The FAO estimated that the economic growth rate of Viet Nam dipped by about 0.12 percentage points as a result. In the case of Thailand, the biggest poultry exporter in Asia, its poultry exporting industry suffered a loss of US\$500-700 million, leading to a loss of 0.1 percentage point off economic growth.

Epidemics most severely impact industries that involve the movement or gathering of people, industries such as tourism, aviation, retailing, etc. The airlines of many economies in the APEC region faced a massive drop in demand for air travel resulting in many flight cancellations. The World Tourism and Travel Corporation (WTTC) conducted an analysis of SARS-affected economies (China; Hong Kong, China; Singapore; and Viet Nam). According to its findings, impacts by SARS on tourism earnings were most serious in the case of China, while Hong Kong, China; and Singapore suffered from the biggest reduction in GDP.

Table 11: Impacts by SARS on Tourism Industry of Selected Economies

Economies	Visitors (%)	Demand on travel and tourism (%)	Loss of tourism industry (% GDP)
Viet Nam	-41.0	-4.9	14.5
Singapore	-45.2	-13.4	43.0
Hong Kong, China	-46.5	-10.4	41.1
China	-55.2	-13.4	24.5

Source: WTTC, 2003.

The impact of SARS on air travel was catastrophic. Singapore, Korea and Viet Nam reported sharp declines in passenger traffic in the early months of 2003, with many international and domestic flights cancelled. In China, official statistics reveal a massive 81.2 percent slump in the number of airline passengers in the first 10 months of 2003, in comparison with the same period of the previous year. In Hong Kong, China it has been estimated that if SARS had persisted for three more months, one third of the city's 10,000 restaurants would have been forced to close. In Chinese Taipei, as elsewhere, the hotel occupancy rate during the SARS epidemic fell by half.

Trade shows, exhibitions and conferences also suffered a huge loss of business. In Guangzhou, business was only one fifth of that of the previous year and the value of contracts signed was 26 percent down on 2002. In Hong Kong, China only 460 companies took part in an exhibition on appliances and gifts in comparison to 5,000 the year before. On the first day of the exhibition, there were only 3,000 buyers, and most of them were locals. In 2002, the number of sellers had been 80,000, and more than 50 percent of them were foreign buyers.

The ever-present risk of a new epidemic can undermine the confidence of investors, resulting in the reduction of foreign investment and capital inflows. Moreover, delay in the transportation of components and finished products can create obstacles to cross-border trade.

Though the contribution of poultry farming to GDP is small, it nonetheless plays an important role in the economy. In many economies, this industry is a major source of protein, and it creates jobs and incomes for farmers. Because of avian flu, people stopped eating poultry in fear of contracting the virus. Many governments ordered a cull of poultry in order to stop the spread of H5N1. WHO indicates that more than 140 million birds were either culled or died as a result of the virus. This placed an enormous financial strain on many poultry farms, especially smaller ones. Moreover, treatment costs are always a major burden for poor households. Thus, not only was the spread of bird flu a serious danger to the poultry industry, it also undermined efforts to reduce poverty in some Asian economies.

Avian flu also adversely affected the environment because of the ways in which dead poultry was disposed of, the most common of which in many economies were burying and/or burning. However, technical safety standards could not always be met, leading to environmental problems. Burial pits were located too close to surface water sources and roads. Protective clothing was not always adequate and sometimes insufficient soil was used to cover the birds. These problems contributed to water and air pollution. In future, if these problems are not dealt with in a timely manner, surface and underground water sources may become seriously contaminated.

Another concern relates to the treatment of fecal waste from poultry farms; if there is no processing of these wastes prior to their being used on crops, the risks of environmental pollution and disease will persist.

III. SOLUTIONS AND RECOMMENDATIONS

3.1 Closer Coordination of Structural Reform and Sustainable Development Policy is Required

Trade and investment liberalization promotes economic growth, but it may also widen income disparities, both within and between economies. If this imbalance becomes too great, the risk of social instability will rise, leading to the need for corrective policy prescriptions. Developing economies are struggling to narrow income disparities, but face many challenges.

Implementation of structural policy reform in favour of a free trade and investment area remains a priority. However, any policy change should be compatible with the aims of sustainable development. In parallel with maximizing the competitive advantages released through trade and investment liberalization, governments should implement the necessary reforms to integrate its development programs, and adopt appropriate technological advances in order to rapidly create new advantages and enhance national competitiveness.

3.2 Strengthening International Cooperation for Sustainable Development

International cooperation in the region can make a strong contribution to sustainable development; cooperation can be achieved through various bilateral or multilateral fora; or between sectors and individual businesses.

The APEC forum is held annually and in the meetings of subcommittees, socio-economic and environmental issues are discussed. This is a good opportunity for economies to exchange their experiences with structural transformation policies for sustainable development.

Business fora for specific sectors should exchange information on market, investment and business environment conditions; to strengthen the mutual understanding among businesses, governments and to jointly implement common solutions for sustainable development.

If the largest APEC member economies maintain their high economic growth rates, the energy demand of the region could quickly overwhelm global supply. Thus, it is vital to restrict energy demand through energy saving and recycling, as well as through policy constraints on overall economic growth. The concept of energy demand management has been applied in the United States' electricity industry and has attracted interest in Japan. It will be more difficult for APEC's developing economies that need to generate jobs and create employment opportunities to accept

the concept of slower growth as a general principle. Nonetheless, it is a subject of increasing concern in the next 10–12 years.

Energy is a key industrial input and a significant determinant of living standards. A stable and cheap supply is an important target of any energy policy. In an economy with rapidly increasing demand, energy security requires large investments. As energy sectors are liberalized, energy planning becomes more complex. Thus, energy consumption in the APEC region should be considered a priority agenda item for APEC.

3.3 Enhancing Awareness of Sustainable Development Issues

The rural population of APEC's developing economies account for a large share of the total population in APEC member economies. The awareness of issues around sustainable development differs from region to region within an economy as well as between economies. For lower income per capita economies, their priority is high economic growth, leading to a relatively lower regard for social and environmental issues. But in the context of globalization, environmental protection is no longer solely the responsibility of individual economies. It is necessary to increase the awareness of issues relating to sustainable development—as they affect individual economies and the region—of every citizen and enterprise. Recently, people in many regional economies have become more aware of the problem of pollution and have actively participated in anti-pollution programs. This suggests that simply enhancing people's awareness can make a difference. Dialogue between governments, ministries, enterprises, NGOs and individuals to ensure environmental protection is also beneficial.

The program to encourage the private sector to implement environmental protection measures on a voluntary basis, through the adoption of international standard ISO 14000, has been quite successful. The success of ISO 14000 derives from its ability to create enhanced international competitiveness by taking advantage of the market mechanism.

3.4 Improving Sustainable Development Management Systems

Many APEC economies have established Agenda 21 programs. Provinces and industries have also launched Local Agenda 21 or Sectoral Agenda 21 programs. Many economies now have a set of sustainable indicators for monitoring sustainable development. APEC economies should be supported in realizing their initiatives with respect to the implementation of sustainable development goals or Agenda 21 program.

3.5 Supporting the Establishment of Information Systems to Monitor Sustainable Development in APEC's Member Economies

Regional financial instability (e.g. the Mexico crisis in 1995, and the crisis in South East Asia in 1997–1998), disasters, epidemics and terrorism recently have demonstrated that these largely unforeseeable external shocks affect the whole region as well as individual economies. Their impact is potentially devastating, especially for low-income economies. In accordance with the theme of APEC 2006, establishment of information systems to monitor sustainable development for APEC's member economies is recommended. Through such an information system, economies in the region could receive early information of impending external shocks from a regional alert center.

Financial risks could be reduced through greater information exchange among major international

financial centers, especially on the inflow of short-term loans to developing economies. Enhanced information exchange on the outbreak and transmission of diseases on a regular basis is needed. Centers for monitoring the risk of epidemics should be established across the region. Greater coordination of action and financial support to combat epidemics is also needed.

Coordination in the setting up of early warning systems for natural disasters such as tsunamis, earthquakes, hurricanes and landslides, especially in the most vulnerable areas, is necessary. Developed APEC member economies should provide financial support to build this system, which would supply predictive data and analysis in a timely manner.

Past experience shows that regional cooperation is very important for establishing effective early warning systems for the following reasons [8]:

- Cooperation combines the best knowledge, skills, technologies and practices; it helps to promote knowledge sharing and the dissemination of best practices; and
- Integrated national systems promote redundancy and reliability, and increased information flow for accurate analysis and decision-making.

Effective regional cooperation requires the political and financial commitments of national governments; donor assistance is important, but regional and international cooperation is more critical for long-term sustainability.

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Chapter Three:

Individual Economy Reports

AUSTRALIA

Australia has undergone major macroeconomic and microeconomic reform over the course of the last two decades, which has contributed significantly to strong and sustained economic performance since the early 1990s. Notable areas of reform have included the introduction of a medium-term fiscal framework and monetary policy framework, competition reform in many product markets, labour market reform, significant changes to taxation arrangements, financial sector reform, welfare reform, reducing tariffs and opening Australia to international trade, as well as reform in energy, communications and transport.

1. Improving the Efficiency of Capital and Labour Markets

Improved efficiency of capital markets in Australia is attributable to a series of reforms undertaken over two decades. Australia experienced significant financial “deepening” in the 1980s and 1990s, a result of financial deregulation, liberalization and reform. This included the floating of the exchange rate and the removal of exchange controls in 1983. It also involved changes directed at financial intermediaries to increase competition.

Reform in the second half of the 1990s focused on strengthening regulatory regimes to increase competition and improve the efficiency of the financial system, while preserving its integrity, security and fairness. A central aspect was the move to a functional objectives-based framework rather than a sectoral-based regulatory framework. There are three peak regulators under the functional objectives framework—a single prudential regulator (Australian Prudential Regulation Authority), a regulator for conduct and disclosure (Australian Securities and Investment Commission) and an institution responsible for systemic stability and payments systems (the Reserve Bank of Australia).

The Financial Services Reform Act 2001, established within the Corporations Act 2001, provides an improved regulatory regime for the financial services industry. It includes a harmonized licensing, disclosure and conduct regime for providers of financial services such as banks, insurers and advisers. In May 2005, the government released a proposals paper containing a number of refinements to financial services regulation. It is anticipated that further regulatory amendments will follow, particularly in relation to disclosure-related issues.

Effective from October 2006, new measures were introduced for governance and “fit and proper” requirements for Approved Deposit-taking Institutions and insurers. Further prudential standards were also put in place for general insurers.

In terms of the labour market, Australia has pursued a range of initiatives over the past two decades to improve the flexibility of wages and conditions of employment and to improve the connections of the unemployed with the workforce.

Since the early 1990s there has been a shift away from centralized wage fixation and industrial arbitration. The primary responsibility for determining matters affecting wages and conditions was placed with the employer and employees at the workplace level, with the introduction of registered agreement-making between an employer and individual employee. The role of awards was redefined with the intention that they act as a safety net of minimum standards. The reforms also provided a framework of rights and responsibilities for employers, employees and their organizations, ensured freedom of association and enabled employers and employees to choose the most appropriate form of agreement for their particular circumstances.

Australia introduced further changes in 2006 to improve the flexibility of employer-employee agreements about wages and conditions, with a simplified safety net of minimum standards, and to reduce unwarranted barriers to further employment.

In mid-2006, Australia also implemented a range of initiatives to encourage people to participate in the labour force and move into work, which involves tighter work testing of welfare benefits, improved financial incentives and enhanced employment assistance tailored to the labour market needs of the jobseeker concerned. This builds on previous reforms to labour market assistance in the mid 1990s, including the development of the Job Network, a system of non-government job placement agencies.

The regulation of workplace relations remains complex. In part, this is due to a lack of harmonization of regulations across the six different state jurisdictions applying in Australia. The Australian labour market will need to have greater flexibility to respond to the challenges of an ageing population.

2. Investing in Human Capital

Australia continues to pursue its National Reform Agenda in the area of human capital. This is a long-term and integrated agenda to increase the nation's productivity and workforce participation. The Australian government has made significant investments in the nation's human capital, including increased funding for schools, increased numbers of places at universities and vocational training centers, and increased flexibility for universities in setting course fees and improved access for full-fee paying students.

Work continues on specific reform proposals in four initial priority areas of early childhood, diabetes, literacy and numeracy, and child care.

3. Improving Regulatory Quality and Enforcement

In response to business concerns about compliance burdens, the government commissioned the Taskforce on Reducing Regulatory Burdens on Business in October 2005 to identify areas of government regulation that impose undue costs on business. While the report raised no fundamental concerns about the financial sector regulatory framework, it did raise concerns with the compliance burden of some regulations and suggested ways to improve scrutiny and cost-benefit analyses of regulatory proposals. In August 2006, the government announced that it will take steps to address the recommendations relating to financial sector regulation through a package of financial services and corporations law reform proposals. These reforms are aimed at ensuring the policy objectives of regulation are met while reducing compliance costs for financial sector participants.

For those areas where the regulatory burden is imposed by different levels of government in Australia, they have been placed on the National Reform Agenda (agreed by the Council of Australian Governments in February 2006) for comprehensive and integrated solutions to the problems.

4. Ensuring Competitive Markets

In April 1995, Australia agreed to promote enhanced competition through the National Competition Policy (NCP). The NCP provided for extension of the Trade Practices Act to previously excluded businesses and reformed government businesses to make them more

commercially focused and more exposed to competitive pressure. The NCP also provided for arrangements to secure third-party access to essential infrastructure services and it incorporated reforms for the electricity, gas, water and road transport sectors. Furthermore, competition assessment and, where appropriate, reform were carried out on approximately 1,700 pieces of legislation across all levels of government. The report prepared by an independent commission, the Productivity Commission, indicates that Australia's real GDP increased by 2.5 percent due to the NCP reforms.

Notwithstanding these achievements, there are still inefficiencies and performance gaps which, if removed, could yield substantial benefits.⁴¹ A new competition policy agenda, as part of the National Reform Agenda, is aimed at providing a supportive market and regulatory framework for productive investment in energy, transport and other export-oriented infrastructure, and for its efficient use by improving pricing and investment signals and establishing competitive markets.

5. Enhancing Macroeconomic Stability

Australia has been well served by a combination of stable and robust macroeconomic policy frameworks, along with continuing microeconomic reform programs.

Reform has continued since the floating of the exchange rate in 1983, which has acted as a critical absorber of economic shocks. An essential development in Australia's macroeconomic policy regime was the monetary policy agreement by the government and the Reserve Bank in August 1996, which endorsed the medium-term inflation targeting regime, which targets consumer price inflation of between 2-3 percent on average over the course of the economic cycle. This reform has helped contribute to low and stable inflation in Australia.

The Charter of Budget Honesty Act, introduced in 1998, laid out the principles for sound fiscal management, including a key objective to maintain budget balance over the economic cycle. The government's fiscal strategy has a number of supplementary objectives, including: maintaining budget surpluses over the forward estimates period while growth prospects are sound; not increasing the overall tax burden as a share of GDP from 1996-97 levels; and improving the Australian government's net worth position over the medium to longer term. The government's sound fiscal management has resulted in the elimination of net debt and the prospect of positive net worth.

Australia's macroeconomic policy settings are well placed to deal with current and expected medium-term developments. Australia is well advanced in its preparation to meet potential longer-term fiscal challenges arising from increasing healthcare costs and population ageing through a broad range of reforms, including the establishment of a Future Fund to cover future public-sector pension payments.

6. Improved Corporate Governance

Australia's corporations law has been substantially modernized since the launch of the Corporate Law Economic Reform Program (CLERP) in 1996. In particular, the CLERP 9 Act 2004 (Audit Reform and Corporate Disclosure) enhances the financial reporting framework by improving regulations relating to auditing, financial disclosure and shareholder participation. The Act contains significant reforms in the area of auditor independence and covers other

⁴¹ The 2005 Productivity Commission report noted that further reforms were required in Australia. The Productivity Commission is the Australian government's principal review and advisory body on microeconomic policy and regulation.

audit-related issues such as standard setting, oversight and liability. It also deals with aspects of the disclosure framework for shares, debentures and financial product advice which improves the quality of information that market participants use in making investment decisions. Most of the reforms took effect in the latter half of 2004, with some commencing in early 2005. From 1 January 2005, Australia also adopted International Financial Reporting Standards for financial reporting purposes.

Continuing reform proposals include reducing the regulatory compliance burden, corporate social responsibility and the treatment of corporate groups.

7. Improving Public Sector Governance

In November 2002, Australia commissioned a review of the corporate governance of statutory authorities and office holders (the Uhrig Review). The main objective was to identify issues surrounding existing governance arrangements and to provide options for the government to improve the performance of statutory authorities and office holders.

The review was asked to develop a broad template of governance principles and arrangements that the government could extend to statutory authorities and office holders, and potentially to a wider range of public-sector bodies. The governance templates were developed to delineate between statutory authorities whose major activities were commercial and those undertaking regulatory and service provision operations. Both templates detail measures for ensuring that the boundaries of responsibilities are better understood and that the relationship between Australian government authorities, ministers and portfolio departments is clear.

Australian government ministers are assessing the governance arrangements of 160 Australian government statutory authorities and office holders within their portfolios against the report's governance templates and principles. Assessments have been prepared on a rolling basis throughout 2005 and have continued in 2006.

8. Strengthening Economic and Legal Infrastructure

In 2007, Australia is expected to implement law reforms to improve its domestic framework for corporate insolvency that have been developed through a comprehensive review process. It is also expected to adopt the UNCITRAL (United Nations Commission on International Trade Law) model law on cross-border insolvency.

Structural Reforms in Canada, 1989–2006

The need for structural reform in the Canadian economy was evident by the early 1990s. As in other industrialized countries, GDP growth had slowed considerably, reflecting a downturn in productivity growth that began in the 1970s and persisted until the mid-1990s. As a result, growth in real household income stagnated. Unemployment increased from an average of 4.9 percent during the 1960s to 9.4 percent during the 1980s, and over 10 percent by the early 1990s. Inflation exploded following the oil shocks of the 1970s and years of chronic deficits, used to finance current spending, had pushed Canada's debt-to-GDP ratio to levels above the G7 average. By 1992, net lending in Canada had reached over nine percent of GDP and net financial liabilities⁴² had reached 68 percent of GDP (compared to the OECD average of 49 percent). The impending retirement of the baby-boom generation gave added impetus to fiscal reforms lest both current debt and unfunded liabilities be passed on to future generations.

In the early 1990s, decisive action was taken to stop the vicious cycle of deficit and debt accumulation and to improve economic fundamentals. Trade liberalization, tax reform and inflation targeting were supplemented by pension reform spending reallocation and labour market policies designed to foster income growth and job creation. The following provides an account of some of the key structural reforms over the past 15 years that contributed to the improved economic environment Canada has today.

1. Improving the Efficiency of Capital and Labour Markets

1997 PENSION REFORM

Inaugurated in 1966, the Canada Pension Plan (CPP) underwent a major set of reforms in the mid-1990s to place the plan on a long-term sustainable path. Contribution rates—shared equally between employer and employee—were increased over six years from the 1998 rate of 5.85 percent of contributory earnings to 9.9 percent in 2003.

The year's basic exemption—the first \$3,500 of earnings in any year on which no contributions are paid—was maintained and frozen. Effective April 1998, an arm's-length investment board was created to increase plan returns, tighten the provision of benefits and keep contribution rates down. The reserve fund is invested prudently in a diversified portfolio of securities and managed by a new Canada Pension Plan Investment Board, acting at arm's length from government.

Financial Sector Reforms

The financial sector framework has undergone significant reform in the last two decades. The move to allow foreign bank branching in the late '90s and to open the banking sector to small, closely-held entrants for the first time in 2001, has contributed to making the Canadian financial services sector more competitive, while enhancing choice for consumers. The demutualization legislation in 1999 has made it possible for Canada's largest insurance companies to significantly increase their share value and become some of the largest life insurance companies in North America. In addition, the 2001 legislation introduced increased flexibility in

⁴² Net lending and net financial liabilities are the measures of the deficit and debt commonly used by the OECD.

terms of investments and structural organization for Canadian financial institutions and established measures to ensure that Canadian consumers and SMEs were appropriately served and protected.

The government's commitment to conducting regular reviews of the financial sector framework has been key to Canada's success in ensuring that its financial services sector is efficient, competitive and poised for growth.

As part of the 2006 legislative review of the financial institutions, which is currently underway, the government is making selective changes aimed at enhancing the interests of consumers, increasing legislative and regulatory efficiency and adapting the financial sector framework to new developments, while maintaining the safety and soundness of the sector. The government has proposed several changes such as developing a new consumer disclosure regime, limiting cheque-hold periods, raising the loan-to-value ratio requiring mortgage insurance from 75 percent to 80 percent, simplifying the foreign bank entry framework and reducing regulatory burden by narrowing the framework to focus on real foreign banks, streamlining certain regulatory approvals and allowing financial institutions to use electronic cheque images in the cheque clearing system. Legislation will be introduced this fall to implement these refinements to the legislative framework.

Currently, efforts are underway to simplify securities regulation in Canada.

Canada has taken steps to ensure confidence in Canadian markets in the wake of the Enron affair and subsequent corporate scandals. The Canadian Public Accounting Board (created July 2002) administered and enforced a new system of auditor oversight. New draft guidelines by the Accounting Standards Board (AcSB) and securities regulators aim at improving the transparency of financial statements.

1996 Labour Market Reform

In the early 1990s, labour market policies contributed to a high level of structural unemployment and a pattern of repeat use, particularly among seasonal workers. The Unemployment Insurance program underwent a series of major reforms during the 1990s, which made the program less generous. The 1990s reforms increased the number of weeks required to qualify for benefits and reduced weeks of benefit entitlement. The replacement rate was reduced from 60 percent to 57 percent, and those who left their jobs voluntarily were disentitled to benefits. The 1994 reforms increased qualifying weeks, reduced benefit durations and further adjusted replacement rates.

With the 1996 Employment Insurance Act, income benefits were redesigned to promote greater labour force attachment and to introduce stronger insurance principles into the system. Eligibility was changed to hours of work rather than weeks worked, a new benefit structure was introduced and eligibility requirements were tightened.

2. Improving Regulatory Quality and Enforcement

2003–2006 Regulatory Reform

The Government of Canada established the External Advisory Committee on Smart Regulation (EACSR) in May 2003 to provide advice on how it could redesign its regulatory system to better serve the needs of Canadians in the 21st century. In September 2004, the Advisory Committee released its report entitled *Smart Regulation: A Regulatory Strategy for Canada*. The report

recognized that good regulation is essential to a robust economy, and an appropriate regulatory framework should help to protect the health and safety of Canadians and the environment, at the least possible economic cost. The report called for a regulatory system, from the design stage to compliance and enforcement, that was effective, cost-efficient and timely, as well as transparent and one where the regulators were accountable for their performance.

The government launched its Smart Regulation initiative in March 2005 to strengthen regulatory management through the development of new policies and tools, including an open, consultative lifecycle approach to regulation, and building capacity and expertise within the regulatory community. Canada is also improving coordination on regulation development and management, both within the federal government as well as working with other governments, both nationally and internationally. The goal is to create a regulatory system that is highly responsive to the dynamic nature of the domestic and global economies, and provides Canada with a competitive advantage.

The federal government's Smart Regulation initiative has already yielded concrete results:

- The review backlog for pharmaceuticals has been eliminated and review times substantially reduced, improving access to safe and effective new drug therapies.
- Development of a faster and more efficient system for assessing new chemical substances while maintaining environmental and human health standards.

As part of the Smart Regulation Initiative, the government has also created the Paper Burden Reduction Initiative, whose mandate is to develop a plan for measuring and reducing administrative costs. The final results of the first small business survey of administrative compliance costs will be released in late 2006. The government is also reviewing and updating the 1999 Government of Canada Regulatory Policy. The new Government Directive on Regulating will strengthen federal regulatory governance by making clear commitments regarding how the government will regulate, and by outlining clear analytical and process responsibilities for departments and agencies at all stages of regulatory management, including development, implementation, evaluation and review.

3. ENHANCING MACROECONOMIC STABILITY

1991 Inflation Targeting

Low inflation facilitates long-term planning and encourages business investment that ultimately boosts productivity. In 1991, the Bank of Canada and the Government of Canada agreed to a targeting framework in order to bring inflation down to low and stable levels. In 1991, inflation stood at 5.9 percent. The targets sought to bring inflation first to 3 percent, then to 2.5 percent and ultimately to the mid-point of the bank's 1-3 percent target range. Despite a run up in year-over-year total inflation recently due primarily to energy price increases, core inflation and inflation expectations remain firmly anchored at 2 percent.

1995 Fiscal Consolidation

During the mid-1990s, the Finance Committee of the House of Commons held hearings across Canada and subsequently recommended to parliament that immediate and decisive action be taken to halt the government's fiscal deterioration. Canadians accepted that the process of fiscal consolidation would involve difficult decisions but felt that the continued accumulation of debt to fund current programs was unacceptable.

In 1995, the government implemented Program Review, a year-long, top-to-bottom review of all departmental programs, covering about C\$52 billion in spending. The main objective of the program was to review all categories of federal government spending—except certain statutory programs—in order to bring about the most effective and cost-efficient way of delivering programs and services to Canadians. In 1994, current expenditures of the federal government stood at 16 percent of GDP, by 2002, after several major reinvestments, current expenditures stood at 12.7 percent. Programs that were deemed inefficient or no longer relevant to current conditions were eliminated or drastically cut, and funds were reallocated toward those programs that worked well and would foster economic growth and job creation.

As part of Program Review, subsidies were reduced to limit distorting effects on economic activity. Furthermore, the government's interest in Cameco, Canadian National Railways, Petro-Canada, the Air-Navigation System and Canada Communication Group was privatized or commercialized.

Together with spending reductions, deficit targets were established, and a prudent approach to budget planning was implemented to ensure that targets would be met. In the space of four years, the federal government eliminated a deficit of C\$42 billion and placed the federal debt on a permanent downward track. To ensure continued balanced budgets, the government uses prudent economic assumptions to develop fiscal projections for budget-planning purposes. Economic prudence, which rises over time, is built in to the five-year fiscal projections to provide further assurance against falling back into deficit. Finally, the annual Contingency Reserve is set aside to guard against unforeseen circumstances. If it is not needed, the Contingency Reserve is applied against the federal debt.

In 1990, debt charges absorbed 35 percent of federal revenues. By 2002, interest payments on the federal debt took less than 20 percent of federal revenues, freeing revenues for other priorities of Canadians.

Sustained budgetary surpluses finally put the debt burden on a downward track. In 1997, the federal net public debt-to-GDP ratio recorded its first significant decline in 25 years, falling to 64.7 percent from 68.3 percent in 1996 (National Accounts Basis). Federal net public debt stood at 38.7 percent as of the end of the fiscal year 2004-05.

2003 Expenditure Review

Following the success of the 1995 program review, the government launched an ongoing review of all non-statutory programs in 2003 to ensure they continue to be relevant, effective and affordable. Over a five-year cycle the treasury board will examine the programs of federal departments and agencies, to determine systematically whether the program is still relevant to the needs of Canadians and whether the program's resources are being used in the most efficient and effective way to deliver appropriate results.

2006 EMS Reform

In 2006, the government launched a review of its expenditure management system. The three guiding principles for this review are that government programs should focus on results and value for money; that government programs must be consistent with federal responsibilities, and that programs that no longer serve the purpose for which they were created should be eliminated. The objectives of this review are to ensure that the growth of program spending is sustainable and that the federation works better for all Canadians.

4. Other – Trade

1989 CANADA-US AGREEMENT ON FREE TRADE

In 1989, Canada signed a free trade agreement with the United States to promote productivity improvements, full employment and encourage foreign direct investment. The agreement would also promote competitiveness and ultimately boost living standards in Canada.

Although there were some inevitable job losses during the transition period, trade with the United States has increased substantially, as has productivity, direct foreign investment and growth in Canadian living standards. Exports to the United States, as a share of total exports, increased from 73 percent in 1988, to 84 percent in 2005.

1994 NAFTA

In 1994, the Canada-US Free Trade Agreement was expanded to include the phased elimination of tariffs between Canada, the United States and Mexico. The agreement created, at the time, the largest free trade area in the world. As a result, Canadian exports to Mexico have grown by almost three-fold between 1994 and 2005.

1995 Domestic Trade Liberalization

With a view to removing internal barriers to trade and investment within Canada, the federal and provincial governments are partners under the Agreement on Internal Trade (AIT), which came into effect on 1 July 1995. The signing of the AIT led to important strides in liberalizing trade and factor flows, especially with respect to labour mobility. However, some barriers remain, particularly with respect to trade in energy, government procurement and business regulations. In recent years, provinces have recommitted to addressing remaining internal trade barriers, with the strong support and participation of the federal government. Progress includes recent bilateral agreements between the states of British Columbia and Alberta, and between Quebec and Ontario, addressing long-standing trade irritants between these provinces.

Continued Trade Liberalization

As of January 2003, all products from the Least Developed Countries (LDC) became eligible for duty and quota-free entry, with the exception of certain dairy, poultry and egg products. Further, in 2004 Canada completed implementation of its Uruguay Round tariff reduction commitments and eliminated all quotas on textiles and apparel.

5. Other – Tax Reform

1988 Personal Income Tax Reform

Fundamental reforms to the personal income tax system were undertaken in 1988, at which time seven of 10 tax brackets were eliminated, most deductions were converted to non-refundable credits (an approach that is more progressive because it gives the same tax benefit to all taxpayers regardless of their income), the tax base was broadened (e.g., mainly through increased taxation of capital income) and certain tax preferences were reduced or eliminated (e.g., elimination of the C\$1,000 annual deduction for interest income). The second phase of the 1988 reform—the introduction of the Goods and Services Tax (GST) in 1990—addressed

many of the distortions of the Manufacturers' Sales Tax it replaced, by removing taxes on capital inputs, and providing a more neutral treatment in the taxation of goods and services.

1991 Sales Tax Reform

In January 1991, the GST replaced the outdated Manufacturers' Sales Tax (MST), which had been in effect since 1924. The MST was highly complex in that it was subject to no fewer than 22,000 special provisions and administrative arrangements. The GST, a multi-stage, value-added tax, is simpler, fairer and more visible than its predecessor.

Businesses are entitled to receive a fully refundable credit (i.e., an input tax credit) for the GST they pay on the goods and services they purchase as inputs into their production and distribution processes. To offset the regressive impact of a broader taxation base on low-income Canadians, the GST credit, a refundable income tax credit, was introduced along with the tax.

The replacement of the MST by the GST has helped to make Canadian manufacturers more competitive. The GST applies to all imported goods and services, but does not apply to Canadian manufactured goods and services that are exported to other international markets. The GST has also made consumption tax rates more equal across commodities, thereby reducing relative price distortions in the economy.

On 1 April 1997, three of the Atlantic provinces—New Brunswick, Nova Scotia, and Newfoundland and Labrador—combined their provincial sales taxes with the GST to create a single harmonized value-added tax structure. In partnership with the Government of Canada, these three provinces introduced a new 15 percent joint federal-provincial Harmonized Sales Tax (HST).

Recent Tax Initiatives

As federal finances were placed on a healthy and sustainable track in the late '90s, the government began to reduce taxes on individuals and businesses, to reduce distortions in the economy and to foster job creation and economic growth.

For individuals, this included certain structural reforms to the federal personal income tax system such as the restoration of full indexation and the elimination of the deficit-reduction surtax in 2000. Foremost, however, significant personal income tax relief was provided, largely within the prevailing tax structure, through higher credit amounts, lower tax rates and higher tax brackets.

More recently, in 2006, broad-based tax relief was provided by a one-percentage point reduction in the GST, increases in the basic personal amount—the amount that all Canadians can earn without paying federal income tax, and a reduction in the lowest federal personal income tax rate from 16 percent to 15.5 percent.

A number of targeted personal income tax measures were also introduced in 2006 to reduce barriers to paid employment and support a more skilled and educated workforce. These include:

- The introduction of the Canada Employment Credit (CEC) in recognition of work-related expenses incurred by employees.

- A commitment to developing a Working Income Tax Benefit (WITB)—an earned income tax credit—which will enable more low-income individuals to become self-reliant by improving their incentives to work.
- A new deduction of up to C\$500 for trades people for the costs of tools in excess of C\$1,000 that they must acquire as a condition of employment.
- A new tax credit for the cost of textbooks.
- The elimination of the current dollar limit on the amount of scholarship, bursary and fellowship income a post-secondary student can receive without paying federal income tax.

For business, significant action has been taken since 2000 to improve the competitiveness of the federal corporate tax system, especially vis-à-vis the U.S. These actions include:

- Reducing the general corporate income tax rate to 21 percent from 28 percent, which will be followed by a further two-percentage point reduction, to 19 percent, by 2010;
- Eliminating the corporate surtax for all corporations in 2008, and
- Fully phasing out the federal capital tax in 2006.

As a result of these actions, Canada established a solid corporate statutory tax rate advantage over the U.S. in 2004 and set the course to increase that advantage to over five-percentage points by 2010. These measures will also achieve a slight overall tax advantage for business investment over the U.S. by 2010, as measured by the marginal effective tax rate on investment.

Important steps have been taken to support the growth of small businesses since 2000. In particular, the amount of small business income eligible for the reduced federal tax rate was raised to C\$300,000 from C\$200,000 in 2005, and will be raised further, to C\$400,000, by 2007. The rate that applies to this new threshold will also be reduced to 11 percent from 12 percent. These steps will help to ensure that Canadian small businesses continue to face lower tax rates on income above C\$85,000 than their counterparts in the U.S.

6. Other – Social Assistance Reform

Social Assistance Reform

During the 1980s reforms to provincial social assistance programs generally made the system more generous and tended to encourage repeated and long-term use. Major and far reaching changes were subsequently implemented motivated by a desire to counteract the dramatic increase in program expenditures that occurred during the early 1990s (between 1989 and 1994 real social assistance expenditures in Canada doubled). These reforms represented a systematic change from those in the 1980s, involving not only changes in program parameters such as benefit levels, but also measures aimed at restricting eligibility through tightened administrative procedures.

Results

Canada has made a number of structural reforms over the past 15 years with an eye to improving the efficiency of the economy, and ultimately, long-term growth. Government spending was reduced and deficit targets were established to halt the vicious cycle of deficit and debt. The resulting surpluses were used to reduce taxes on individuals and businesses. The Bank of Canada established the credibility of its inflation targets that facilitated the conduct of monetary policy and allowed the bank to respond quickly and effectively to changing economic conditions. Economic and social policies were structured to help Canadians acquire

skills, adapt to change and participate in the labour market with confidence. Trade agreements allowed Canadian businesses to make the most of opportunities in foreign markets. Employment insurance reform reduced and restructured benefits with a view to strengthening incentives to work. Fiscal discipline and a stronger economy allowed the government to make strategic investments in research and innovation. Increased funding was provided to support the development of new ideas and to help businesses bring new concepts to market.

The structural reforms implemented in Canada together with a favourable international climate have led to renewed income and productivity growth. Today, the Canadian economy is much better placed to weather an economic downturn than it was in the early 1990s. Economic imbalances have given way to solid fundamentals, which will help support the economy through any future slowdown.

CHILE

STRUCTURAL REFORMS

Decentralization and the government's Digital Agenda were priority targets for reform in 2005. For Chile, the modernization of the state includes the policy goals of greater decentralization, and the wider use of technology. The Chilean government has progressively increased investment in decentralized decision-making. The 2006 budget was raised by 6 percent in real terms and assigned to regional decision-making organizations. Consequently, the Investment for Regional Decision-Making will reach an historic high, having jumped from 44.4 percent of total investment in 2000, to 57 percent in 2006.

To continue the reform progress provided for with the framework of the 2003 political agreement, the government sent three new bills to Congress in 2005:

- (1) to establish an internal auditing system for the government and strengthen the rules of transparency in the management of public services;
- (2) to enhance fiscal responsibility, and
- (3) to establish ground rules for administrative contract bidding for investment studies and projects.

An Innovation Fund for Competitiveness was created representing a 35 percent increase in public expenditures for innovation. The objective of this fund, which is available as a result of the congressional approval of the mining royalty in 2005, is to develop public programs that promote innovation and increase the country's competitiveness by applying more resources to science, technology and supporting innovation. To guarantee the transparency and efficiency in the allocation and use of resources, the Innovation Fund will function through competitive processes and will be subject to constant evaluation. The strengthening of basic research and the development of regional projects in innovation and entrepreneurship are important pillars of this program. Within this context, significant resources will also be devoted to the development of human capital, support for research into excellence, business innovation and the development of innovative SMEs.

Another important initiative in the area of competitiveness is the creation of a budget allocation for the "Chile Gets Moving" program. This government initiative, which seeks to facilitate and empower the development of business opportunities for micro and small business in predefined areas in different regions of the economy, establishes a system of coordination between the relevant players in the productive chain, both in the public and the private sectors.

INDONESIA

Over the last few years, the Indonesian economy has enjoyed robust growth. The economic growth rate during the 2000s has been on an upward trend, although the rate is still lower than that which prevailed before the economic crisis in 1998. Clearly, this achievement cannot be separated from reforms that have been implemented over the past seven years. This report will briefly discuss some of those reforms.

1. Improving the Efficiency of Capital Market and Labour Market

In the 2000s, Indonesia has enacted several reforms relating to the financial and capital markets. These reform policies were launched in order to provide and improve a “safety net” in the financial sector. To implement this strategy, in 2004 Law No.3/2004 concerning the function of the central bank (UU Bank Indonesia) was amended to include the requirement and conditionality for Bank Indonesia to act as “lender of last resort.” In the same year, Law No.24/2004 concerning the establishment of Deposit Insurance Agency (Lembaga Penjaminan Simpanan/LPS) was enacted. This law is expected to improve the efficiency of commercial banks, to promote the practice of prudence management among commercial banks, as well as to eliminate the burden on the state budget of guaranteeing commercial bank deposits.

The reform of the capital market has several facets, including strengthening the financial capacity and operation of securities companies, restructuring the stock exchange and regulations governing securities companies, improving corporate governance practices, and reorganizing the Capital Market Supervisory Agency (BEPEPAM)-Ministry of Finance (MoF). In 2005, the government merged the BAPEPAM-MoF with the Directorate General of Financial Institutions into one Directorate General responsible for managing the financial and capital market sectors. This measure is a first step toward the long-term aim of establishing a new independent body called the Financial Service Authority (Otoritas Jasa Keuangan (OJK)).

An efficient and competitive labour market is important in order to maximize the benefits of globalization. In this regard, the government has launched several policies to improve the efficiency of the domestic labor market. These policies include measures to accelerate the licensing process for labor competency certification, training institution accreditation, the promotion of a productive and flexible labour market and enhanced labor market information through electronic and other media channels, as well as regulations regarding working contracts in order to provide a better and fairer relationship between employees and employers. With regard to the regulation for foreign workers, the government has taken several measures to simplify visa and working permit procedures.

2. Investing in Human Capital

The importance of the national development strategy for human capital is reflected in the share of education expenditure in the state budget. The government has progressively increased state spending on education in order to improve educational facilities as well as the curriculum of national education programs.

As a consequence of democratization and the trend toward regional autonomy in Indonesia, the central government has ceded authority to local government in designing education programs that are best suited to local conditions and requirements. The central government has implemented a national policy on free compulsory elementary education in order to

improve the quality of human capital in Indonesia. However, with democratization, education financing is now shared between the central and local governments.

In line with the strategy to strengthen the micro, small and medium enterprises, the government has conducted training and workshop for micro enterprise and SME practitioners in order to improve their competitiveness so that they may benefit from globalization and liberalization.

3. Ensuring Competitive Markets

The government believes that unhealthy and unfair business practices contributed to the domestic financial and economic crisis of 1998. In line with liberalization and reform, the government has acted to improve the competitiveness and impose fair business practices. In 1999, Law No.5/1999, concerning Prohibition of Monopolistic Practices and Unfair Business Competition, was enacted in order to abolish unhealthy business and monopoly practices in the domestic market. One important aspect of the law is the establishment of a Commission for Supervision of Business Competition (Komite Pengawas Persaingan Usaha (KPPU)), which is not only authorized to oversee competition and prosecute monopolistic and unfair business practices, but also to provide advice to the government on policies that may conflict with the principle of free competition.

4. Enhancing Macroeconomic Stability

The government and Monetary Authority of Indonesia remain committed to enhancing the domestic macroeconomic stability. The government has taken several measures to improve fiscal sustainability. A series of fiscal reforms have been enacted to improve the effectiveness and efficiency of the government's budget management. After the financial crisis in 1998, the government privatized several state-owned enterprises (SOEs) as part of a wider strategy to strengthen the state budget. Since 2003, further financial reform has taken place and new laws (Law No.17/2003, Law No.1/2004 and Law No.15/2004) have stipulated the implementation of the Unified Budget System, Performance Based Budgeting, Medium Term Expenditure Framework, Treasury Single Account on Fiscal Management and Government Accounting Standard. These policies are expected to help improve the effectiveness and efficiency of the financial management of development programs. At the same time, the government remains committed to reducing the budget deficit and to achieve a balanced budget. It has been very successful in this regard; the budget deficit has been reduced from 3.7 percent in 2001, to less than 1 percent in 2005.

On the revenue side, the government has reformed tax and customs administration in order to increase government revenue. This strategy has included the modernization of the tax system using information technology, public service improvement and tax rate reductions. On the expenditure side, the government has reviewed existing expenditures and made several adjustments to improve budget efficiency. Certain types of subsidies have been gradually reduced, most notably the domestic oil price.

The government realizes that its commitment to achieve a balanced budget will constrain its direct involvement in development programs. Accordingly, the government is promoting private sector participation in development projects.

5. Improved Corporate Governance

In 1999, the OECD launched its good corporate governance principles and, in the following year, the National Committee of Good Corporate Governance Policy was established in order

to promote and supervise the implementation of good corporate governance in Indonesia's domestic corporate sector. The committee issued Guidelines on Good Corporate Governance based on the OECD's principles. The guidelines consist of fundamental principles such as the rights of shareholders, the equitable treatment of shareholders, the roles of stakeholders in corporate governance, disclosure and transparency, and responsibility of the board. In 2004, the committee was revitalized and became the National Committee of Governance Policy (Komite Nasional Kebijakan Governance).

6. Improving Public Sector Governance

The practices of collusion, corruption and nepotism (Korupsi, Kolusi, Nepotisme (KKN)) contributed to Indonesia's deep recession following the financial crisis of 1998. Acknowledging the problem, the Government of Indonesia has taken several measures to eradicate collusion, corruption and nepotistic practices, including in 2002, the Law No.30/2002 concerning corruption eradication. The Corruption Eradication Commission (Komisi Pemberantasan Korupsi (KPK)) was established in 2003.

With the revitalization of the National Committee of Governance Policy in 2004, the government demonstrated its strong commitment to adopt the principles of good corporate governance in public sector management. Today, the government monitors and evaluates the implementation of good governance practices in the public sector, especially as relates to fiscal transparency, and reports findings in the Report on the Observance of Standards and Codes (ROSCs). The government uses the report as a basis to conduct reforms and adjust public policies, including the resolution of conflicting local and central governments regulations.

7. Strengthening Economic and Legal Infrastructure

Both the government and Bank Indonesia are conscious of the need to maintain the momentum behind economic growth. The Government of Indonesia has launched several policy packages to improve the domestic investment climate, to accelerate the infrastructure development, and, in coordination with Bank Indonesia, to strengthen and improve the financial sector.

The Policy Package for Improvement of Investment Climate aims to bolster domestic sector competitiveness in the face of continued globalization and the acceleration of investment activity in order to create job opportunities and support economic growth. This policy package consists of several aspects such as strengthening the public service institutions for investment and synchronizing the local and central government regulation, reforming the customs and tax regulation and service to promote investment, reforming the labor regulations, and strengthening micro, small and medium enterprises. The implementation of these policies will include reforms to administer dispute settlement, reforms to provide clearer distribution of authority between local and central government, reforms to accelerate administrative processes in handling the flow of goods and materials through customs offices, the development of bonded zones, tax incentives in support of investment, the promotion of transparency and disclosure principles, the simplification of working permit issuances, and providing consultancy and advocacy services for small and medium size enterprises.

The Policy Package for the Acceleration of Infrastructure Development is aimed at infrastructure recovery and capacity improvement. The package consists of consolidated inter-sectoral reforms, sectoral and corporate reforms to promote fair competition in infrastructure development, reform policies to abolish the misuse of natural monopoly situations, and a clearer distribution of authority between the policy makers (ministers, head of agencies, head

of local government) and SOEs. A committee consisting of officials from related ministries will monitor the achievement and progress of the policy packages periodically.

In the Financial Sector Policy Package, the government and Bank Indonesia agreed on several action plans to improve the financial market and institutional infrastructure, enhance market access to equity, and strengthen and stabilize the financial market structure. This policy package consists of several policy categories, i.e., policies to strengthen the domestic financial system, policies to strengthen the banking sectors and state-owned banks, policies to strengthen non-bank financial institution, policies to strengthen the domestic capital market, and other policies related to privatization and export financing.

Since the 1998 crisis triggered the fall of the “new order” regime, a “wind of reform” has swept the country. The government realizes that an integral aspect of liberalization is to reform the legal infrastructure. Consequently, a series of policies have been enacted to restore the economy’s independent legal structures. Policy changes in this regard have included reforms relating to the Supreme Court, the evaluation and amendment of laws and regulations related to human rights and judicial authority. The government has established independent committees to help usher in an era of “clean government.” These include the Ombudsman Committee, the National Law Commission (Komisi Hukum Nasional), and the Government Apparatus’ Wealth Audit Committee (Komisi Pemeriksa Kekayaan Penyelenggara Negara).

JAPAN

1. Improving the Efficiency of Capital and Labour Markets

(i) Major Achievements

As a result of efforts to dispose of non-performing loans (NPLs), negative legacy of the bubble economy, during the concentrated consolidation period (from FY2001 to FY2004), the major banks' NPLs problems have been alleviated; the major banks' NPL ratio dropped by 6.6 percent (from 8.4 percent in Q1 2002 to 1.8 percent in Q1 2006).

As for the labour markets, in order to inspire young workers to work toward their vocational independence, and thus reverse the trend of an increasing number of the underemployed, called "freeters", the government strengthened and promoted the "Independence and Challenge Plan for Young Workers". Through the cooperation of the each related ministry, it has succeeded in reversing the "freeters" trend.

(ii) Continuing Challenges

As for the capital markets, the government will take measures including supports for the stock exchanges to construct a world-class, state-of-the-art stock exchange system, also to improve function as a center of flow of funds in Asia by promoting listing of foreign companies including utilization of the "Japan Depositary Receipt (JDR)."

The government will strengthen functions and management systems of Securities and Exchange Surveillance Commission (SESC), in order to strengthen market monitoring through further cooperation of the SESC with the self-regulatory organization.

In order to realize a society where the people's abilities and experience are fully exploited and their efforts rewarded, the government will build systems to provide alternatives at every life stage without dividing people into "winners" or "losers." For example, the government will expand job opportunities to people other than recent graduates; secure balanced treatment of temporary part-time workers and regular full-time workers, and support employment in the provinces.

2. Investing in Human Capital

(i) Major Achievements

With a view to raising the participation rate of women and elderly people, the government introduced measures to cope with the declining birth rate and aging society and to support employment. The measures include the "Child-Care Support Plan," established in December 2004; strengthening linkages between employment and pension, and providing guidance on the elimination and alleviation of maximum recruitment age requirements in support of employment for the elderly.

(ii) Continuing Challenges

In order to realize a "nation of human capital", the government will build up a society enabling all the society members to use their talents to the fullest. To strengthen the international competitiveness of human resources, for example, the government will revise the Courses of

Study to improve the quality of education. It will promote career education by making use of technicians and engineers in local companies, enhance practical education in higher education institution such as professional graduate schools and specialized upper secondary schools, and encourage collaboration between industry and academia. The government will also enhance its foreign exchange student programme.

3. Improving Regulatory Quality and Enforcement

(i) Major Achievements

More than 1,500 items have been covered by regulatory reforms during the five years to March 2006. Some 847 "Special Zones for Structural Reform," in which regulatory exceptions are established in accordance with the zones' specific circumstances, have been approved.

(ii) Continuing Challenges

The government will follow up the outcomes of regulatory reform implemented thus far, and encourage collaboration among the relevant organizations. In addition, it will review the entire system for regulatory reform and complete this process by the end of FY2006.

4. Ensuring Competitive Markets

(i) Major Achievements

Relaxing the regulation on minimum capital requirement for business start-ups has led to a 10 percent annual increase in the number of business start-ups. The minimum capital requirement was abolished by the new "Corporate Code" in May 2006.

(ii) Continuing Challenges

In order to eliminate cartel activity and collusive bidding and thus improve the competitive environment, the government will strengthen enforcement of the "Amended Anti-monopoly Act." In addition, it will review the Act in areas such as system settings on surcharges, investigation and judicial proceedings, and violation of unfair trade policies, including abuse of dominant bargaining position, and unjust low price sales. Based on the conclusion, the government will consider the necessity of further amendments to the Act.

5. Enhancing Macroeconomic Stability

(i) Major Achievements

Renewed economic expansion, which began in 2002, has enabled Japan to finally overcome the negative legacy of the collapse of the asset price bubble in the early 1990s. The GDP growth rate in FY2005 was 3.2 percent in real terms, and 1.8 percent in nominal terms as corporate profits are improving and new resiliency in the corporate sector has spilled over into the household sector. The employment situation is also improving; the unemployment rate fell to 4.0 percent in May 2006, the lowest level in eight years. The fiscal primary balance is projected to improve to -2.4 percent (relative to the nominal GDP) in FY2006 from -4.4 percent in FY2001.

(ii) Continuing Challenges

The government will implement measures for the Integrated Expenditure and Revenue Reform. The government aims to achieve a primary budget surplus for the combined central and local governments by FY2011 and to steadily decrease the debt ratio relative to GDP between early 2010s and mid 2010s. On the revenue side, the government will strive to prepare for fundamental and comprehensive tax system reform.

Under the recent monetary policy framework, the Bank of Japan (BOJ) disclosed a level of inflation rate that its Policy Board members currently understand as price stability: from a medium- to long-term viewpoint, which is described as an approximate range between 0- and 2 percent as measured by the consumer price index. The BOJ examines economic activity and prices from two perspectives, which examines not only the outlook deemed most likely by the BOJ, but also various risks in the medium- to long-term. In the light of deliberations from the two perspectives, the BOJ will outline its thinking on the conduct of monetary policy for the immediate future, and, as a rule, disclose it periodically.

6. Improved Corporate Governance

(i) Major Achievements

To enhance the investors' understandings of public companies, disclosure of the state of the internal governance and risk management systems has been obligated since 2003. The penalties for data falsification in a financial report have been stiffened.

The Corporate Code, which came into force in May 2006, requires all "large corporations" (as well as "corporations with committees" as required under the previous Commercial Code) to adopt a basic policy with respect to the establishment of internal control systems. This is to ensure appropriate operations of such corporations, including a system to ensure that all actions by directors or statutory officers (as the case may be) conform with applicable laws and regulations as well as the articles of incorporation of the corporations. Together with requirements under the "Financial Instruments and Exchange Law" enacted in June 2006, the Corporate Code has also strengthened certain corporate disclosure requirements.

(ii) Continuing Challenges

The government will implement measures related to internal control under the "Corporate Code" and the "Financial Instruments and Exchange Law." Based on the results of this implementation, and other related factors, the government will take measures to maintain environment enhancing the corporate governance of individual companies.

7. Improving Public Sector Governance

(i) Major Achievements

Major Achievements by the government include:

- Through the Privatization of the Postal Services, Japan Postal Services Holding Company was established in January 2006.
- The four Highway-Related Public Corporations were privatized in October 2005.
- Concerning the Reform Package of Three Issues, to realize a "shift from central to local government," the government implemented a transfer of tax revenue resources of three

- trillion yen, the reform of local allocation tax, and the reform of 4.7 trillion yen of subsidies.
- The “Law on Public Service Reform” was enacted in May 2006 to introduce public-private competitive bidding.

(ii) Continuing Challenges

The government will:

- steadily implement the Privatization of the Postal Services;
- reform policy-based finance and review independent administrative institutions;
- increase the number of municipalities without local allocation tax;
- reform government assets and debts;
- prepare public accounting system for the management of government assets and debts;
- promote Special Accounts Reform;
- reform the budget system;
- implement Market Testing promptly in accordance with the “Law on Public Service Reform;”
- promote efficiency in administration through more IT utilization;
- reform the statistical system; and
- promote personnel exchanges between public and private sectors.

8. Strengthening Economic and Legal Infrastructure

(i) Major Achievements

The government has improved the policy framework for national development based on a foundation of intellectual property. This included the enactment of the Basic Law on Intellectual Property (December 2002), the establishment of the “Strategic Program for the Creation, Protection and Exploitation of Intellectual Property” (July 2003). The Strategic Program is annually revised and the latest version “Intellectual Property Strategic Program 2006” was released in July 2006. In addition, 27 bills in relation to intellectual property laws were enacted, including “The Law for Establishment of the Intellectual Property High Court,” by July 2006.

(ii) Continuing Challenges

The government will promote measures for the creation, protection and use of intellectual property; including speedy and appropriate patent application at the highest level, and an early adoption of a Counterfeits/Pirated Goods Non-proliferation Treaty.

9. Others

(i) Major Achievements

To realize the objective of making Japan an “advanced science and technology-oriented nation” of the highest global standard, R&D budgets have been concentrated in four priority areas: life sciences, information and communications technology, environmental sciences, and nanotechnology and materials. This initiative successfully increased the number of patent registrations in these areas from 24,193 in 2001, to 27,478 cases in 2004. The cumulative stock of foreign direct investment in Japan increased 1.5 times, from 6.6 trillion yen in March 2001, to 10.1 trillion yen in March 2004.

(ii) Continuing Challenges

The government will take measures to encourage innovative R&D, create coordination among different areas, and to develop innovative venture corporations in order to promote continuous innovation and to strengthen domestic agriculture by reforming management structures. In addition, the government wants to double the stock of inward FDI in Japan, so that it reaches 5 percent of GDP by 2010.

1. Improving the Efficiency of Capital and Labour Markets

Labour Market Efficiency

After three years of intense discussion, on September 11, 2006, the three-party panel of labor, management and government reached an agreement on a new labour reform bill, aimed at promoting forward-looking measures to enhance labour-management relations. While ensuring that Korea's labour-management systems comply with international standards, the agreement also contained clauses providing for labour market flexibility through enhanced systems of protection against unfair dismissal, and simplified procedures for dismissals of regular workers for managerial reasons. The Korean government plans to design a bill based on the above agreement, to be submitted to the National Assembly for approval this November.

Among other key tasks to be addressed is the issue of polarization of the labour market, including the rigidity of the labour market for regular workers and the rising proportion of non-regular workers. The government's plan is to ensure high levels of labour market flexibility and employment security, through the expanded coverage of social safety nets that include coordinating employment services for regular workers, enhancing wage flexibility and increasing employment protection for non-regular workers.

Capital Market

The government's vision is to integrate Korea's financial system into the global economy, by developing Korea into a financial hub for Northeast Asia. At present, the plan rests on two main pillars, the first of which is the complete liberalization of the foreign exchange system. Recently, a major step in this direction was taken when the government swept away many of the lingering restrictions on capital account transactions, and accelerated the timetable for complete liberalization.

The second pillar is the deregulation of the capital market. The "Consolidated Capital Market Act" will be put to the National Assembly later this year. By removing the restrictions that currently separate various types of securities companies, breaking down barriers and moving to a negative list system of regulation, the Act will promote competition and innovation.

2. Investing in Human Capital

Korea's high-quality human resources have played a crucial role in the economic development of Korea. Over the past 10 years, the rate at which graduates have obtained higher education has consistently increased. Since 2004, the system of free and compulsory middle school education has been implemented nationwide with the aim of expanding the coverage of primary and secondary education. In 2005, 82.1 percent of high school graduates entered university, showing that tertiary education has become common in Korea. According to international assessments, Korea's first and secondary education made a huge quantitative and qualitative leap forward.

In fact, the 2003 OECD Programme for International Student Assessment (PISA) Survey showed that Korea's 15-year-old students ranked first in problem-solving skills, and second in terms of reading proficiency. As for mathematics and science, they were placed third and fourth, respectively.

One of the key challenges for improving human capital development in Korea is that the number of elementary, junior high and high school students going abroad to study continues to increase. There is also the challenge of tackling Korea's increasing reliance on private tutoring as a supplementary form of education.

In addition, the competitiveness of Korea's tertiary education is still low compared to its qualitative expansion. Thus, the key is to adapt the qualifications of graduates to meet the demands of relevant industries for higher-level skills.

3. Improving Regulatory Quality and Enforcement

To create a regulatory environment that supports market competition, the Korean government implemented full-scale regulatory reform by establishing the Basic Act on Administrative Regulations (BAAR) and the Regulatory Reform Committee (RRC). The RRC has made significant progress in eliminating unreasonable regulations by conducting preliminary reviews on new or reinforced regulations. Since the establishment of the RRC in 1998, the number of regulations registered has decreased from 11,125 in 1998 to 7,960 in 2005.

The government's ongoing regulatory reform effort has earned plaudit from many citizens and businesses. However, there still remain a number of tasks including the improvement of implementation procedures and the activities of regulatory agencies in the front-line.

The government is trying to shift its focus from "deregulation" to quality-based "better regulation" by reinforcing RIA, as in other advanced OECD member countries. It is also necessary to upgrade the quality of regulations by giving priority to reform regulations which lag behind market changes, bundling regulations and regulations of local governments and enhancing public awareness of regulatory reform. To provide businesses and the general public with more diverse and well-organized information on government regulations, the RRC plans to overhaul the current system of regulation registration in a more user-friendly manner.

4. Ensuring Competitive Markets

Korea's competition policies have contributed to consumer welfare and economic development over the past 10 years. The Korea Fair Trade Commission has continuously pushed for reforms of anti-competitive government regulations, competition advocacy, the strengthening of law enforcement against cartels, and the promotion of competition in the monopolistic/oligopolistic markets.

To overcome the 1997 financial crisis, competition policies on large business groups, regulatory reforms and the privatization of public companies have been rigorously pursued. In particular, in 1999, the Omnibus Cartel Repeal Act was enacted. Meanwhile, as part of the policies to reform monopolistic/oligopolistic market structures, the Clean Market Project was launched in 2001 and 2002; and in 2003, the Three-Year Market Reform Roadmap was established and implemented with the goal of promoting a fair and transparent economic system.

2006 will see the end of the implementation of the roadmap, and currently, Korea's competition laws are being reviewed. Competition law enforcement will be strengthened in the areas of intellectual property rights and in services created from the convergence of telecommunications and broadcasting. The Korea Fair Trade Commission will endeavor to help large companies

and small- and medium-sized enterprises compete on a level-playing field, cooperate on a mutual basis, and enforce consumer protection laws in harmony with competition laws.

5. Enhancing Macroeconomic Stability

From 1995 to 1996, while actively pursuing globalization strategies as shown by Korea's accession to the OECD, the government launched a wide-ranging national reform program, including the Real-Name Property Ownership System (July 1995), Three-Step Liberalization of Interest Rates (November 1995), and the Financial Industry Structure Improvement Act (1996).

Nonetheless, factors such as economic structural weaknesses and a delay in advancing economic reforms in the Korean economy prompted the financial crisis of 1997. Consequently in 1998, the government chose to adopt macroeconomic adjustment as the core basis of its economic policies and undertook a series of forward-looking initiatives, such as financial and corporate restructuring together with an expanded coverage of social safety nets. After 2003, however, Korea, experienced a long-term decline in domestic consumption as a result of debt adjustment from domestic overheating, which arose from the creation and collapse of the stock market bubble coupled with a rise in housing prices and market confidence during the years 2000–2002. Despite such unfavorable external conditions, the Korean government was able to manage the economy and pursue policies focused on resolving structural problems.

6. Improved Corporate Governance

During the last decade, the Korean government implemented an array of corporate governance reforms. A number of innovative systems and institutions, which correspond to global standards, was introduced. Two key policies are the Outside Director and Audit Committee systems. In 1998, it became obligatory for at least one-fourth of the board of directors of listed companies to comprise of external directors. This obligation has been rigorously applied to large conglomerates with over two trillion won in aggregate assets. In 2000 and 2003, the large asset corporations were required to appoint at least one-half and more than one-half, respectively, of outside directors to the board. In 2001, it became compulsory for large corporations to have two-thirds of the board be comprised of external directors.

The rights of minority shareholders have been consolidated as well. In 2005, the class action act for securities-related matters was adopted. In order to strengthen transparency, accounting laws were amended in 2003. These amendments included the prohibition of non-auditing business by accounting firms, the requirement of certification on disclosure document by the CEO and CFO, and requirement to change accounting firms used for regular audits every six years.

There have also been efforts to improve corporate governance in the private sector. In 1999, the Committee on Corporate Governance was set up by the Korea Stock Exchange and other stock market participants. This committee published the Code of Best Practice for Corporate Governance (hereinafter referred to as “the Code”) as a model for reforming general practices of corporate governance. In 2002, the Korea Corporate Governance Service (KCGS), which is an independent and nonprofit organization, was established under the joint sponsorship of the Korea Exchange, the Korea Securities Dealers Association, the Asset Management Association of Korea, the Korea Listed Companies Association and the Kosdaq Listed Companies Association. KCGS has strived to provide institutional services to Korean companies to improve corporate governance systems. Since its inception, KCGS has been working to improve corporate governance by evaluating all listed companies, revising the Code, conducting research and studies, publishing magazines and articles, developing optimal

governance practices for Korean companies and policies, and promoting distinguished companies.

Though, as mentioned above, our listed companies have improved their governance through public and private methods, Korea is constantly looking for opportunities to enhance corporate governance in order to emulate global practices.

7. Improving Public Sector Governance

Non-departmental public entities have been criticized for inefficient management practices. Thus, the government has been drawing up a scheme to amend their governance structures since 2004.

A clear definition will be agreed to identify whether an institution is a public entity or not.

Economically important entities will have their governance structures amended. First of all, they will be reclassified as state-owned enterprises (SOEs, commercial SOEs and quasi-commercial SOEs) and nonprofit public entities (nonprofit public entities managing government funds and nonprofit public entities with government delegated responsibilities) according to their characteristics.

They will be placed under the supervision of the Steering Committee on Public Entities. The committee will be responsible for the performance management of the public entities and guidelines on the general management of these entities.

The responsibilities of the board members and chief internal auditor in each of the entities will be enhanced so that they can act as a counterbalance to the CEO. The processes used to appoint board members, the CEO and chief internal auditor will be improved.

A proposed Framework Act on the Management of Non-Departmental Public Entities, which contains the key issues mentioned above, has been submitted to the National Assembly. Parliamentary deliberation and review of this proposed Act should be finalized soon, hopefully by the end of this year.

8. Strengthening Economic and Legal Infrastructure

Since the financial crisis, the Korean government has pursued reforms in four major sectors: corporate, financial, labour, and public sectors. As a result, the Korean economy has resolved its 30-year-old structural maladies and established a foundation for free and fair competition in the market economy.

The corporate sector has benefited from the strengthening of the rights of minority shareholders, the adoption of outside director system, tougher accounting standards, corporate governance and transparency in management. The practice of debt guarantees by large business groups has been removed, thus improving companies' financial health. As corporate restructuring is carried out whenever it is deemed essential, even big companies cannot shield themselves from the possibility of restructuring if their performance is poor. As for financial organizations, with input of large-scale public funds, financial institutions' financial soundness and profitability have improved and financial regulatory authorities' supervision over them has been enhanced as well. Efficiency in the public sector has been increased thanks to the continuous pursuit of government innovation and privatization of public companies. As for labour issues, improvements have been made to legal frameworks and institutions to increase

flexibility in the labour markets, and employers and employees have cultivated a "culture of co-prosperity" by abiding by the prevailing laws and regulations.

In corporate restructuring, the Korea Fair Trade Commission has played a pivotal role in improving the ownership/control structure of large business groups and encouraging accountability and transparency in their management practices through strong policies on large business groups. It also actively participated in competition advocacy on regulatory reform and privatization to bolster competition, thereby strengthening the market economy in Korea.

Any country aiming to join the ranks of advanced economies must commit to continuous economic development, rigorous reform of anti-competitive regulations and practices, adoption of sophisticated corporate governance measures as well as global standards.

MALAYSIA

1. Enhancing Macroeconomic Stability

(i) Major Achievements

1991–2000

- In the early and mid-nineties Malaysia experienced several years of rapid economic growth. Gross Domestic Product (GDP) grew at 8.5 percent between 1991 and 1997 with per capita income increasing two-fold and the incidence of poverty falling from 16.5 to 6.1 percent. The favorable macroeconomic environment, which attracted large capital flows, contributed to economic growth and improved the economic prospects of the nation.
- The 1997/1998 Asian Financial Crisis disrupted this growth momentum. On the strength of existing fundamentals as well as the swift and pragmatic measures undertaken by the Government, the country was spared from more the extreme effects experienced within the region such as high unemployment, mass poverty and massive bankruptcies.
- Essentially, the Government undertook measures to stabilize the ringgit, restore market confidence, maintain financial market stability, strengthen economic fundamentals, continue its equity redistribution and socio-economic agenda, and revive adversely affected sectors.
- The Government also undertook measures to strengthen the resilience of the financial sector to avoid systemic risks and ensure the continued efficient functioning of the intermediation role of the banking system. Measures were introduced to restructure and consolidate the financial sector with the aim of relieving the banks of their non-performing assets, strengthening and recapitalizing banking institutions, improving the efficiency of the intermediation process and facilitating corporate debt restructuring. Among the measures implemented to restructure corporate debt were the setting up of Pengurusan Danaharta Nasional Berhad (Danaharta), the national asset management company; Danamodal Nasional Berhad (Danamodal), a special purpose vehicle to recapitalise viable but undercapitalized banking institutions; and the Corporate Debt Restructuring Committee (CDRC).
- The measures introduced ultimately resulted in the recovery of the real economy, surplus in the current account of the Balance of Payments, an increase in foreign investment and an overall restoration of public and investor confidence. Although the economy registered negative growth rate of 7.4 percent in 1998, it grew at an average of 7.2 percent during 1999 and 2000. Per capita income in current terms, which declined in 1998, rebounded to RM13,359 in 2000, surpassing the pre-crisis level, while the unemployment rate remained at 3.1 percent.

2001–2005

- In the earlier part of 2001–05, global economic growth slowed due to a decelerating US

economic growth. The four strategies contained in the Package were aimed at promoting private sector investment, strengthening the nation's competitiveness, developing new sources of growth and enhancing the effectiveness of the delivery system.

- The Malaysian economy continued to expand during the 2001-2005 period due to stronger macroeconomic fundamentals and increased resilience following the lessons learnt from the Asian financial crisis. Gross Domestic Product (GDP) in real terms grew at an average rate of 4.5 percent per annum during the period.

(ii) Continuing Challenges

- Maintaining macroeconomic stability continues to be a challenge, particularly in the context of the onslaught of external factors such as escalating oil prices, the possibility of a sudden correction to global imbalances as well as heightened geopolitical tensions. To ensure that the economy continues on a sustainable growth path, the objective is to strengthen further the economic fundamentals necessary in dealing with downside risks, removing imbalances and enhancing economic resilience and competitiveness while, at the same time, maximizing opportunities derived from the process of globalization and liberalization.
- Malaysia, an open economy, continues to operate in an extremely competitive, fast-moving and challenging global marketplace. The country continues to strive to rise to the various challenges: the opening up of China and India has changed the economic landscape dramatically for both developed and developing countries alike; information and communications technology has changed the speed and spread of transactions; labour- and capital-intensive modes of development have given way to productivity- and knowledge-based growth.

2. Investing in Human Capital

(i) Major Achievements

- Malaysia has accorded high priority to human capital development and has accordingly invested heavily in education and training. During the 8th Malaysia Plan Period (2001–2005), more than 20 percent of development expenditure was channeled to education and training. As a result, accessibility to education and training has increased greatly. At primary school level, the participation rate among the 6–11 age group increased to 96 percent in 2005, while at secondary school level (12–16 age group), the participation rate increased to 85 percent. The participation rate at the tertiary level also increased, reaching 29.2 percent in 2005. The corresponding figure at postgraduate level increased to 41.5 percent in 2005.

(ii) Continuing Challenges

- Bearing in mind Malaysia's goal to attain developed nation status by 2020, the fundamental challenge is to produce world class human capital that is knowledgeable and highly skilled, flexible and creative, as well as imbued with positive work ethics and spiritual values to sustain economic resilience and growth as well as drive a knowledge-based economy. Towards this end, efforts will be expended to ensure that the training and education delivery system remains relevant, responsive and flexible to meet the changing needs and challenges of the nation within the context of globalization. Access to quality education, training and lifelong learning at all levels will also be continually improved to meet the rising demand for such services.

3. Improved Corporate Governance

(i) Major Achievements

- Measures to build the legal and institutional framework necessary for good corporate governance in Malaysia date back to 1965, with the passing of the Companies Act 1965. The 1997/98 financial crisis, however, provided the impetus for considerable enhancement of the corporate governance framework in the country, leading to a holistic approach to corporate governance reform.
- In March 1998, the High Level Finance Committee was established to assess the corporate governance framework in the country. The Committee comprised high-level representation from the Treasury, the Central Bank, Securities Commission, the stock exchange and various industry organisations. The *High Level Finance Committee Report on Corporate Governance* was subsequently published containing 70 recommendations for reform targeted at the laws, rules and regulations; education and training; and the development of a Malaysian code on corporate governance. An Implementation Project Team was set up in 1999 to lead the implementation of these recommendations.
- The work of the High Level Finance Committee was followed and complemented by reforms to existing rules and regulations. Beginning from 1998 onwards, revisions and changes were made to listing requirements, securities laws as well as the fund-raising framework to enhance the standards of transparency and disclosure in the corporate sector and increase the effectiveness of the implementation of corporate governance measures.
- The introduction of the Malaysian Code on Corporate Governance in March 2000 marked another significant milestone in corporate governance reform. The code was brought into full effect following the revision of Bursa Malaysia's Listing Requirements in June 2001 requiring mandatory disclosures by listed companies on the state of compliance with the code. The release and implementation in 2001 of the Capital Market Masterplan – a long-term blueprint for Malaysia's capital market development – also included recommendations to further reinforce corporate governance reform.
- Corporate governance reform in Malaysia has also been supported by efforts to improve the financial reporting framework. The enactment of the Financial Reporting Act 1997, the establishment of an independent accounting standards-setting board in the form of the Malaysian Accounting Standards Board, the introduction of quarterly reporting by listed companies, and the establishment of the Financial Reporting Foundation contributed significantly towards a stronger and more streamlined financial reporting framework for the corporate sector.

Other aspects developed to further raise the standard for good corporate governance include the following:

- a) The Corporate law reform program was established by the Companies Commission of Malaysia (CCM) to provide a modern corporate law framework conducive to current and future needs of the corporate and business environment. Steady progress was recorded for a review of multiple aspects of corporate law, all within deadlines and in line with the mission to promote and cultivate a conducive and dynamic business and regulatory environment. It was acknowledged that benchmarking against the current regional and international practices would help enhance the national economic competitiveness;

- b) In addition to institutions with approved training rights, the CCM also started conducting the Corporate Directors Training Programme (CDTP) in 2005 at the CCM training center. The Center, which now serves as the incubator for the upcoming Training Academy, focuses on promoting good ethics in order to inculcate good corporate governance. Continued emphasis on training stakeholders is part of efforts to educate company directors and officers on good corporate practices as well as instill awareness of conflict of interests amongst directors, when there is focus on personal gain or when substantial shareholders fail to declare their interests in the course of setting up and managing a company. While acknowledging that the laws might not cover some of these non-legislated codes or provisions, CCM continues to educate company officials on the types and needs for due diligence practices; and
- c) The establishment of an electronic complaints system on consumerism and non-ethical business activities, namely, e-report, e-business licence and e-tribunal.

(ii) Continuing Challenges

- CCM is looking into effecting technology-driven changes to ensure the delivery of better and faster services. With the Company and Business System (CBS) for both the Registrar of Businesses (ROB) and Registrar of Companies (ROC) in place, CCM has, as a start, embarked on a 'data cleansing' project to enhance the integrity and accuracy of data.
- CCM continues to serve as the Secretariat to the National Integrity Plan Steering Committee for Economic Institutions, undertaking research for five working groups comprising over 50 members including representatives from the public sector (Ministries, co-regulatory bodies, etc.), private bodies (non-governmental organizations, trade associations, professional bodies, practitioners, consumers, etc.) and industries (officers of companies, trade unions, etc.). The challenge is to come up with recommendations to implement the National Integrity Plan (PIN) for economic institutions with the aim of promoting and raising the standards of accountability and transparency among corporate players and industries across the nation.
- The challenge is a technical one, i.e., to equip the electronic complaints system with an appropriate back-up system.

MEXICO

1. Improving the Efficiency of Capital and Labour Markets

See point 2.

2. Investing in Human Capital

During the present administration, an inclusive labour policy oriented to provide better opportunities for all the population was developed. Among the main actions to enhance human capital investment are the following:

- Modernization of the National Employment System. From 2001 to 2006, 10.5 million people were attended to (52.6 percent more than in the period 1995–2000) and three million placed in jobs (48.1 percent more than in the previous period).
- Creation of the Labour Market Projection Service of Mexico (Labour Observatory). The Labour Observatory of Mexico is a public, online, permanent and free information service offered by the Secretariat of Labor and Social Welfare.

This service provides information on the characteristics, trends and dynamics of specific jobs and occupations in the Mexican labor market. The service offers information for the general public, particularly young people, to make informed career choices and to identify the best areas for occupational development and job opportunities. The Labour Observatory web site (www.observatoriolaboral.gob.mx) has information on the 53 most representative occupations in the country and more than 500 different jobs.

- Council for Dialogue with the Productive Sectors. The Council was established in February 2001. It is a plural and permanent body of consultation, participation and collaboration directed to foster economic growth as well as sustained development.

Within the Council for Dialogue with the Productive Sectors, representatives of workers, employers, academia, the legislative branch, media, the public and governments exchange points of view to identify solutions to the challenges faced by the country. Social Dialogue facilitates consensus in the definition of common goals and in the agreement of joint actions.

- Worker's Consumption Fund (FONACOT). FONACOT is a government trusteeship that offers credits to workers to buy goods and services in affiliated businesses at the lowest interest rate.

FONACOT supports workers income providing access to credit consumption at low competitive market rates and without subsidies. At the same time, FONACOT supports employers, particularly small and medium size enterprises that register their workers to receive this benefit without any cost to them.

- Other programs dedicated to strengthen human capital, implemented during the present administration, are: The National Labour Award, the National Labour Research Award, the Recognition of Inclusive Businesses, the Systems to Assess and Improve Productivity and the Programs for Productive Insertion.

3. Improving Regulatory Quality and Enforcement

In 2005, legislators of Mexico's two biggest parties presented a bill to the House of Representatives to amend the Federal Law of Economic Competition (FLEC). This proposal was the result of a joint effort between legislators and the Federal Competition Commission (CFC), aimed at strengthening competition policy and enforcement in Mexico. The proposed amendments have not changed the core analytical principles of FLEC. They do, however, enhance the CFC's operative tools and provide higher sanctions for anti-competitive behavior. The most important additions include:

- **Efficiencies:** the reform includes economic concepts for a firm to argue that there are efficiency gains that offset a practice's anticompetitive effects.
- **Merger Notification:** thresholds increase by 50 percent, in order to focus on transactions most likely to raise competitive issues in Mexican markets. The amendments also contemplate early termination of merger reviews in cases that clearly raise no competitive concerns.
- **Relative practices:** five additional conducts that may constitute relative monopolistic practices are specified: predatory pricing, exclusive dealing, cross subsidization, price discrimination and raising rivals' costs.
- **Verification visits:** the CFC acquires powers to conduct searches for specific information in the course of law enforcement investigations.
- **Leniency Program;** the CFC is given authority to grant leniency to cartel members that cooperate with this agency.
- **Binding opinions.**
- **Sanctions:** higher economic sanctions; new language providing that an agent who violates the law more than once may be fined up to twice the applicable monetary amount, or up to 10 percent of annual sales, or of total assets, whichever is bigger; and a market power, if an agent fined more than two times.

The Mexican Commission on Regulatory Improvement (COFEMER) made important strides in enhancing competitiveness in Mexico by promoting, jointly with the private sector, the implementation of 36 specific actions. It recognizes that it is not just a matter of reducing procedures or formalities, but that it is necessary to improve the whole regulatory system where these formalities exist, using a "systemic" approach. These actions were formalized by a Presidential Decree enacted on 11 August 2005, that deals with several important sectors such as: international trade and customs, standard-related measures, health, finance, telecommunications, transport, energy, labor, migration, social security and the regulatory improvement of states and municipalities. The successful outcome of this ongoing work has been institutionalized in the Federal Counsel of Regulatory Improvement where the public and private sectors jointly analyze the regulatory changes that are to be implemented in order to promote competitiveness.

The Regulatory Moratorium Agreement issued by President Vicente Fox on 12 May 2004, and valid until 30 November 2006, reversed the past tendency of issuing new regulations with attendant costs of compliance for citizens and enterprises. At the present time, federal

ministries and agencies developing regulatory projects must prove, in a clear and adamant way that such regulations are drafted according to the Regulatory Moratorium Agreement.

COFEMER's enhanced efforts toward the support of local governments in regulatory improvement matters, resulted in the issuing of seven new local laws on regulatory improvement and the implementation of the Rapid System for Opening Business (SARE) in 101 municipalities. This system eases the establishment of low risk businesses, by the effective coordination of the three levels of government and the simplification of applicable procedures and formalities. Thanks to SARE, municipalities have been able to reduce the average time needed to open a small and medium enterprise, to 72 hours.

COFEMER's future tasks include working jointly with the World Bank on the project "Doing Business in Mexico 2006". This project extends the four indicators of the study "Doing Business in Mexico" to all of Mexico's states (one municipality per state will be evaluated). "Doing Business" will investigate the scope and modalities of the regulations that enhance business activity and those that constrain it. The indicators can be used to analyze economic outcomes and identify what reforms have worked, where and why.

4. Ensuring Competitive Markets

In 2005, the Federal Competition Commission (CFC) issued opinions on several proposals to amend the following sectoral regulations (only the most relevant are listed):

- Telecommunications Law and Radio and Television Law: proposal to redefine the structure of the Federal Telecommunications Commission (COFETEL), to extend its powers to radio and TV and radio concessions. The law was passed. Amendments addressing CFC's concerns are currently before Congress.
- Law to Promote the Book and Reading: proposal to allow editors and importers to fix a single retail price for books. The law was passed.
- Commercial Practices Law: proposal to regulate retailers, including minimum distances (geographic market segmentation) as a mandatory requirement for the establishment of commercial stores. The law was rejected.
- Airport Law: proposal to establish new criteria in concession-granting procedure and considering the CFC's favorable opinion. A decision is pending.

In the period under review, 92 investigations registered activity, 59 of which had been initiated in previous years, with the remaining 33 initiated during 2005. The CFC concluded 66 files and imposed sanctions in five cases involving absolute monopolistic practices (hard core cartels) and in six investigations on relative monopolistic practices (vertical agreements).

5. Enhancing Macroeconomic Stability

Under this administration, economic policy has been focused on the consolidation of macroeconomic stability. A stable macroeconomic environment preserves households' wealth and purchasing power, promotes economic growth, reduces poverty, helps real wages to recover, and improves income distribution. In this regard, the evolution of public finances has been a key element for the consolidation of macroeconomic and financial stability.

In 2006, the expected GDP growth and inflation rate are 3.6 percent and 3 percent, respectively. A public sector surplus of 0.2 percent of GDP is estimated.

This administration's expenditure strategy has focused on maintaining the consistency between expenditures and revenues. The federal government will give priority to social programs focused on improving the living conditions and encouraging the development of those households whose income is lower than the minimum required to satisfy their basic needs. In addition, public expenditure will also focus on promoting economic growth.

The general objective of the public debt policy has been to obtain the financial resources required to meet the current debt obligations and the financial needs at the lowest possible cost, while keeping a prudent risk level. The average net financial cost of the federal government in 2001-2006 is estimated at 2.5 percent of GDP, 0.8 percentage points lower than the one observed in the previous administration.

6. Improved Corporate Governance

See part 7.

7. Improving Public Sector Governance

The national agenda in matters regarding the improvement of Public Sector Governance has prioritized the construction of a government that responds to the needs of society. Hence, President Fox's administration implemented the Good Government Agenda, which constitutes the strategic platform that guides the actions of all institutions and public servants of the federal government. Through the Good Government Agenda we have carried out deep, long-term structural reforms, substituting old paradigms and innovating the way in which government works.

The Good Government Agenda encompasses six fundamental strategies:

- **Honest and Transparent Government:** In these past six years very significant progress has been made, such as the creation of the Intersecretarial Commission to Fight Corruption and Foster Transparency, established in January 2001; the Freedom of Information Act (Federal Law on Transparency and Access to Government Information), a historical landmark passed by Congress on June 2002; and the creation of the Institute for the Access to Public Information. We have partnered with society to raise awareness of the manifestations of opacity, the costs of corruption and to assist the creation of corruption-free environments by signing various agreements with major academic institutions, non-governmental organizations (NGOs), business and professional organizations to promote the adoption of integrity programs and codes of conduct.
- **Professional Government:** For the first time in its history, Mexico has a civil service, a fundamental reform that will transform the image and operation of the Federal Public Administration.
- **Digital Government:** The application of modern information technologies for the improvement of administrative systems and practices in federal institutions has contributed to a more efficient and transparent government and to innovation in the way public services are offered.

- **Government with Improved Regulations:** We are analyzing, improving and, if necessary, eliminating internal regulations. We have catalogued all federal laws and regulations with a user-friendly technology that facilitates access; we have enhanced transparency in government contracting through the revision of the laws on government acquisitions and public works; we are seeking to use simple, clear and direct language in all government communications.
- **Quality Government:** Based on the inventory of services and procedures with high citizen impact, which represents 80 percent of all procedures that the government requires from its citizens, we have improved and simplified 406 of them. Additionally, we have published 216 citizen charters that provide citizens all the necessary information on how to carry out a procedure or request a service, clearly stating the quality standards to which the relevant government institution should comply.
- **Government that costs less:** Our objective is to do more with less, without sacrificing quality. During the present administration, budgetary disciplinary actions operated under a strategy oriented toward optimizing the use of public resources in social programs.

These achievements represent the combined effort of all sectors of society. In recent years a new precedent has been set for citizens to take a more proactive role in the process of governmental decision-making; to share, along with their government the struggle to combat corruption and create a more transparent and efficient government. The future challenge will be to ensure the continuation of these achievements and the continued active and conscious involvement of all members of society.

8. Strengthening Economic and Legal Infrastructure

See part 3

NEW ZEALAND

Structural Reform from 1995 to 2005

1. Improving the Efficiency of Capital and Labour Markets

Capital Markets

New Zealand has embarked on a significant program of financial sector reform over the past 10 years to promote confidence and participation in its financial markets. In particular, securities trading law has improved with the addition of: a Takeovers Code; a continuous disclosure regime; enhanced regulation of securities exchanges; and improved enforcement of securities laws. There has also been significant change to the Securities Commission with the addition of more functions, powers and funding. Further, the New Zealand stock exchange (NZX) demutualised in 2002 and a number of improvements have been made in relation to the NZX listing and business rules. Finally, a new insider trading regime and market manipulation regime are also near implementation. All of these reforms and developments have enhanced participation in financial markets with record highs for trading on the NZX over the past couple of years and a notable improvement in the market's reputation both domestically and internationally.

There are still a number of improvements being undertaken in relation to the regulatory regime, which are targeted at improving participation in financial markets. Examples include a review of financial intermediaries and a review relating to securities offerings and other financial products.

Labour Markets

Over the past 10 years, the New Zealand labour market has been characterized by strong employment growth and labour force participation coupled with a low growth rate in labour productivity compared to other OECD countries. There have been a number of changes to employment regulations in the past six years. The Employment Contracts Act 1991 was replaced with the Employment Relations Act 2000, which was further amended in 2004. The new legislation promotes collective bargaining, introduces a duty of good faith, and made changes to employment institutions and dispute resolution processes. Nevertheless, OECD and World Bank indicators continue to show that New Zealand's labour market is among the least regulated of developed countries.

Amendments to the Holidays Act in 2003 increased the minimum annual leave provisions from three to four weeks starting in 2007, and penal rates for work on statutory holidays. Significant increases have also been occurring to minimum wages. The adult rate has increased from NZ\$7.00 in 1999 to NZ\$10.25 in 2005, an increase in nominal terms of 46 percent. As a consequence, minimum wages relative to median earnings are now relatively high compared with other OECD countries.

2. Investing in Human Capital

Over the past decade, major reforms have been, or are in the process of being undertaken in all sectors of education. In early childhood education (ECE), the reforms emphasize improvements to quality through raising teacher qualification requirements and increasing participation through expanding the number of places and increasing subsidies, particularly for

the over three year olds. It is too soon to judge the success of these reforms, but the main challenges looking ahead will be around ensuring that participation by disadvantaged children continues to improve and that new funding and teacher registration requirements do not exacerbate supply constraints.

In schooling, there have been three key developments over the last 10 years—the push for a stronger focus on literacy and numeracy, improvements to schools' planning and reporting around student achievement, and more recently, major changes to the secondary school qualifications system. We are beginning to see some improvements in student achievement as a result of these changes such as in literacy skills in primary schooling, although it is too early to assess the impact of the qualifications reform. The key challenges ahead will be finding cost-effective ways to lift the performance of the significant group of students who are leaving with no or low qualifications, and to generally improve the performance focus of the education sector.

In tertiary education, New Zealand's focus in the 1990s was on improving participation through expanding places, opening up competition and increasing private contributions. Since 2000, there has been a continued focus on expanding places, but more emphasis has been placed on reducing the costs to students, ensuring a better match between provision and economic and social needs, and improving adult literacy and numeracy. This has sought to create a greater balance between a system driven largely by student demand and one which will allow the government to direct funding and delivery more toward its priorities, and to improving quality of teaching and outcomes for students rather than on continued expansion of participation. Continuing challenges in this sector include improving the responsiveness of institutions to national and local needs, and meeting the ongoing demand for quality lifelong learning while keeping down costs to students.

3. Improving Regulatory Quality and Enforcement

In 1998, New Zealand approved a Code of Good Regulatory Practice and a Generic Policy Development Process and introduced a requirement for Regulatory Impact Statements in relevant Cabinet papers. Then in 2001 it was decided that all policy proposals submitted to Cabinet which require a Regulatory Impact Statement (RIS) and which have compliance cost implications for business need to include a Business Compliance Costs Statement.

In considering a report from the Ministerial Panel on Business Compliance Costs' entitled "Finding the Balance: Maximizing compliance at minimum cost," the New Zealand government in 2001 indicated it would implement 155 of the report's 181 recommendations. As at mid-2005, 90 percent of the recommendations agreed to had been or were being implemented. Included in this group were all the recommendations surrounding tax, electronic technology, and the Health and Safety in Employment Act 1992, among others. The focus in the near future will be around the effective implementation of the remaining recommendations.

4. Ensuring Competitive Markets

New Zealand introduced the Commerce Act and Fair Trading Act in 1986. These Acts were developed to encourage competition and to protect consumers from misleading and deceptive conduct and unfair trading practices. The last 10 years has seen New Zealand rely less on general competition law and enforcement and more on industry-specific regulation. The Electricity Industry Reform Act 1998, the Telecommunications Act 2001 and the Commerce Amendment Act 2001 strengthened New Zealand's regulatory regime, particularly in relation to utilities, and emphasised that markets would be regulated, where necessary, for the benefit of

consumers. The Electricity Commission was established in 2003 to oversee, and where necessary regulate, New Zealand's electricity industry and markets. More recently the New Zealand government has chosen to introduce regulation to allow new entrants access to the incumbent's network in the telecommunications industry.

General competition law enforcement has remained robust. The Commerce Commission maintains a rigorous approach to analysing mergers and anticompetitive conduct. Recently, the commission has focused on cartel-busting and developing a more sophisticated approach to merger analysis. The government is currently reviewing certain parts of the Commerce Act 1986 to ensure that they are helping to achieve national goals of growth and investment. The key challenge for New Zealand in the future will be the effective implementation of these new regulations.

5. Enhancing Macroeconomic Stability

New Zealand underwent a major period of macroeconomic reform in the 1980s, including moving to a floating exchange rate and creating an independent central bank. Two significant pieces of legislation are the Reserve Bank Act 1989 and the Public Finance Act 1989 which both operate on principles of transparency, accountability and responsibility, and together provide a strong base for a stable macroeconomic environment. Macroeconomic outcomes have improved significantly in New Zealand since the early 1990s. This is evidenced by low inflation on average, less volatility in inflation and output, the fiscal position moving from deficit to sustained surplus, and the reduction in public debt and accompanying move into a net financial asset position.

A floating exchange rate is another significant feature of New Zealand's macroeconomic environment, providing an important channel of adjustment for the economy and playing a key role in delivering improved macroeconomic outcomes. However, there are challenges. The exchange rate continues to move through large cycles, and this can be a source of uncertainty that hampers investment in exposed industries. There are signs that 20 years of experience with the floating exchange rate regime has increased firm recognition of the need to take into account its cyclical nature when making business decisions.

New Zealand's current account deficit is at its highest level in almost 20 years and among the highest in the OECD when measured as a proportion of GDP. The high level of external indebtedness reflects private sector decisions rather than government decisions. Even though it is held by the private sector, the large net external liability position means that there are macroeconomic risks to be managed if we are to maintain the confidence of financial markets. Maintaining our current macroeconomic framework and running fiscal surpluses will help to manage the risks of a sharp change in investor confidence. Higher aggregate private saving could help to reduce the macroeconomic risks through a reduction in net external liabilities.

6. Improved Corporate Governance

In 1993, New Zealand substantially revised its Companies Act to make it consistent with the OECD Principles for Corporate Governance. Since then, law reform in this area has focused on further refining some key areas such as director's duties. New Zealand is currently considering a number of changes to increase duties on directors in relation to phoenix companies and is introducing a voluntary administration regime into the Companies Act to provide a further rehabilitation option for companies in financial difficulty.

Another major change that New Zealand is considering in the context of amendments to Partnerships legislation is a new corporate form for investors to use to facilitate venture capital investment into New Zealand. This concept is based on international best practice.

7. Improving Public Sector Governance

Key elements of the New Zealand public sector management system were established in the late 1980s; and the system's legislative underpinning has been provided by the State Owned Enterprises Act 1986, the State Sector Act 1988, the Public Finance Act 1989 and the Fiscal Responsibility Act 1994. The design and operation of the system has been evaluated since then and a number of areas were identified at the margin as requiring attention. These areas included: more integrated service delivery; fragmentation caused by a proliferation of agencies and ministerial responsibilities, and the people and culture of the state services.

In response to these reviews, legislative reform in 2004 set out to:

- strengthen and merge the Public Finance Act and the Fiscal Responsibility Act to provide more flexibility in the rules for managing public resources, and improved accountability mechanisms to Parliament, including a requirement for disclosure of a broader range of information about intended and actual performance;
- amend the State Sector Act to strengthen integration, build capability, and provide strong leadership on values and standards in the state sector; and
- create a new Crown Entities Act to improve governance and accountability and strengthen the integration of Crown entities with the rest of the state sector.

As a result of the reforms, ministers, supported by their departments, have greater opportunities to influence agencies to achieve the results they seek, and to ensure that information is provided to Parliament and to the public in relation to those results. Ministers have expressed clear expectations for increased performance as a result of the legislative reforms. Subsequently, state sector agencies face a continuing challenge in specifying the results expected by ministers, managing their resources to achieve them, and reporting those results via ministers to Parliament and to New Zealanders in an environment of rising public expectations for high quality, responsive services.

8. Strengthening Economic and Legal Infrastructure

Over the last 10 years, there have not been any major reforms completed in New Zealand in this area; however New Zealand is currently in the midst of a major series of reforms to modernise its legal frameworks, taking account of international developments. This includes a suite of reforms relating to property law (including reform of the Property Law Act, Unit Titles Act and Residential Tenancies Act) and a major reform of the law and regulation of financial products and providers. New Zealand is also looking to improve international connectivity through greater linkages with other jurisdictions (particularly Australia) by way of enhanced recognition and enforcement of court proceedings and regulatory processes. This also includes greater participation and uptake of model laws and conventions developed by international fora such as the Hague Conference and the United Nations Commission on International Trade Law.

MAJOR ACHIEVEMENTS AND CONTINUING CHALLENGES

1. Improving Regulatory Quality and Enforcement

The Independent Consumer and Competition Commission Act 2002 (ICCC Act 2002) contains a provision on product safety standards and unsafe goods. The provision protects consumers from imports of unsafe goods and products. In enforcing the provision, an MOU has been signed between the National Institute of Standards and Conformance and the Independent Consumer and Competition Commission to address these standard issues.

2. Ensuring Competitive Markets

Tariffs

PNG's tariff rates are low and will be reduced further according to the Tariff Reduction Program.

Non-Tariff Measures

There are no import restrictions, export licenses or import quotas. Impose an export tax on unprocessed wood.

Foreign Investment Liberalisation

The Reserved Activities List has been replaced by the Cottage Business Activities List.

Specific Sector/Industry

Mining and Petroleum

Foreigners may own 100 percent equity. However, where the state participates, it will own 30 percent equity in mining and 22.5 percent equity in petroleum enterprises. In all cases, if the state does not participate, the foreign company may take up 100 percent equity, of which 2 percent will be earmarked for the benefit of the landowners.

Telecommunications

Currently, this sector is fully owned by the state. However, a review is currently being undertaken with the aim of issuing mobile licenses, which would provide competition with the existing mobile provider.

Air Transport

Based on its commitment to an open skies policy, a review is currently being undertaken to improve the operating efficiency and the overall competitiveness of this sector.

Domestic Shipping

A comprehensive review has been undertaken by the government in the domestic shipping industry to identify regulatory impediments and competition constraints. This is included in the 2006 Budget Strategy of the PNG Government.

Financial Sector

The foreign exchange controls and gold regulations have been eased, liberalizing the policies on the transfer of currency, foreign securities, the issue and dispatch of securities, borrowings from outside residents, etc. The entry and level of foreign equity participation in banks,

insurance, investment and financing companies and investment houses have been liberalized through various laws.

Law and Justice

Law and order continue to be hindrances to economic development. The sector is now using an effective integrated system to address law and order issues in line with the PNG Law and Justice Sector Strategic Framework. The sector-wide approach aims to improve sector coordination through a more rationalized and coherent framework for promoting equal distribution of resources and unifying efforts in addressing crime.

3. Enhancing Macroeconomic Stability

The Medium Term Fiscal Strategy 2002–2007 lays out a four-point plan to put public finances on a sustainable footing by implementing the following measures:

- 1) immediate cuts in discretionary funds in order to break the cycle of deficit and debt;
- 2) a systematic review of government expenditure to ensure limited resources are effectively utilized in delivering public goods and services;
- 3) structural improvements in government budget processes, and
- 4) establishing an environment supportive of sustained private sector economic growth.

The Medium Term Debt Strategy 2005–2009 has been formulated with the objective of minimizing the debt service burden while containing the government's exposure to risk and achieving a sustainable level of debt in the medium to long term. It will also ensure the development and maintenance of a well functioning market for domestic government securities.

4. Improved Corporate Governance

The Central Bank Act 2000 strengthened the Central Bank's information gathering and investigative powers. The Banks and Financial Institutions Act 2000, the Life Insurance Act 2000 and the Superannuation (*General Provisions*) Act 2000 gives full responsibility to the central bank for licensing and supervising banks, superannuation funds, life insurance companies and other authorized deposit-taking institutions.

5. Improving Public Sector Governance

The Ombudsman Commission, Auditor General and the Parliamentary Public Accounts Committee were established to provide external oversight of the public sector spending, supporting transparency of public sector policies and processes and strengthening accountability and compliance.

The Financial Management Improvement Program (FMIP) aims to improve financial management at all levels of government. The program also aims to upgrade the infrastructure in support of the new Integrated Financial Management System, which in turn supports all government finance and payroll systems.

Amendments have been made to the Public Finance Management Act 1995 to improve governance, accountability and transparency in the procurement of services and to tighten control over expenditure.

Adopted and implemented in 2004, the Customs Code of Ethics and Conduct prescribes minimum standards of conduct to govern all aspects of both personal and professional conduct of officers in the performance of their duties and relationships with clients and fellow officers.

6. Strengthening Legal and Economic Infrastructure

Only one government-owned or controlled corporation was successfully privatized. The privatization program has been amended in favor of partial privatization under the Public-Private Partnership.

Deregulation

The ICCC Act 2002 allows for the Independent Consumer and Competition Commission to conduct regulatory reviews with a view to deregulation, thus promoting economic efficiency in industry structure, investment and business conduct. Shipping, aviation, tourism, telecommunications and power are industries currently under review.

Intellectual Property Rights (IPRs)

The Trade Marks Act 2000, Patents Act 2000 and the Regulation on Copyrights & Related Rights have been reviewed to be fully consistent with TRIPs obligations and the Madrid Protocol. They are in process for a National Executive Council decision and passage by the National Parliament.

Competition Policy

The establishment of the Independent Consumer and Competition Commission came as a direct result of major regulatory reform in 2001. It is predicated upon a number of important policy considerations and factors including:

- The importance of, and the need for, economic regulation as a means of correcting market failures and distortions, the aim being to maximize industrial efficiency through measures such as promoting competition, price surveillance and monitoring, ensuring consumer protection, providing third party access and setting minimum service delivery standards;
- The recognition by the government of the shortcomings of existing economic regulatory frameworks, and
- The recognition by the government that well functioning markets require a strong foundation in effective governance, and public institutions that perform their mandated activities with predictability and in a transparent manner.

7. Others

Customs Procedures

Progress is being made in the implementation of risk management, passenger processing systems, electronic data interchange in cargo clearance, the setting up of a website, the adoption and implementation of a post-clearance audit system and a provision for Appeals Against Customs Decisions.

Standards and Conformance

Approximately 95 percent of the standards adopted by PNG are based on international standards. The government will maintain the WTO-TBT Contact and Enquiry Point in Papua New Guinea for all Technical Barriers to Trade (TBT) matters and issues relating to standards

and conformance. It will establish and maintain the PNG-APEC SCSC Contact and Enquiry Point for all APEC SCSC issues and matters.

Signed a Memorandum of Understanding in 2005 and 2006 to address standard issues with the Independent Consumer and Competition Commission (ICCC), Papua New Guinea Power (PNG Power) – National Electricity and Power Regulator

Papua New Guinea's Standards and Conformance regime is now readily accessible through this website: www.nisit.gov.pg

1. Improving the Efficiency of Capital and Labor Markets

Capital Markets

(i) Achievements

- The reform of the Peruvian capital market started at the end of 1991. This reform process established the following targets: i) to increase the development of different sources of financing and financial instruments, and ii) an expansion of liquidity in the securities market.
- In 1996, the government extended these reforms and made the securities market more flexible and reliable for private investors.
- The most important achievement has been the consolidation of the domestic capital market (through the use of sovereign bonds in domestic currency), strengthened by the “*Market Makers*” financial program (started in March 2003). This program allowed: a) the change of public debt’s structure, by increasing ratio of internal debt to total public debt, which reduced the overall debt portfolio risk), and b) the development of a yield curve in fixed rates (2–20 years), and a yield curve for inflation-indexed bonds VAC (7–30 years), both in Nuevos Soles, to be used as benchmark for private investors.
- According the Ministry of Economy and Finance (MEF), at the end of 2005, foreign non-financial institutions held 28.6 percent of sovereign bonds.

(ii) Challenges

- The Peruvian capital market still shows signs of weakness. Non-financial institutions are still borrowing significant amounts from the banking system,⁴³ mainly because the presence of issuing and transactional costs and asymmetric information in capital markets, which produces a gap between available funds and loanable demand.
- Some challenges in this field are the promotion of *risk capital*,⁴⁴ the elimination of inefficient regulations and the improvement of tax incentives.

Labour Markets

(i) Achievements

- 1996–1998: rising employment rates in an environment of economic growth.
- 1999–2001: economic stagnation and a lower employment, as a result of the adverse international environment.
- Due to renewed economic expansion, labour indicators have improved since 2002. Nevertheless, the impact on employment rates has been uneven, mainly affecting urban

⁴³ In 2005, banking system credit to private sector was 17.8 percent of GDP.

⁴⁴ Financial activity in which specialized financial institutions help increase small firms’ capital for financing productive and financial activity.

areas (outside of Lima) and labor-intensive industries. Stronger growth has benefited mainly larger firms, leaving employment in small firms and informal employment almost unchanged. Moreover, wages increased only in sectors with qualified employment.

- Although unemployment is not a problem in the Peruvian labor market, “invisible” underemployment—people working more than 35 hours per day below the minimum wage—is around 30 percent of total employment (total underemployment is 51.4 percent). Moreover, there is a high proportion of informal work, especially in small and micro enterprises in which only one in five employees has access to social benefits. Therefore, although labor rates have been recovering in recent years, employment conditions remain precarious.

(ii) Challenges

- The main challenges for Peru are to increase productivity on a sustainable basis and to reduce the role of informal work. In this respect, Peru should improve the quality of human capital formation by increasing access to, and the quality of, basic education. Additionally, generating business opportunities for small and micro-enterprises, and the improvement of the regulatory system should underpin further labor market reform.

2. Investing in Human Capital

(i) Achievements

- The Peruvian government has taken steps to increase human capital, particularly that of poor and disadvantaged groups. Examples of this policy include the implementation of social programs like the Comprehensive Health Insurance (SIS), the conditional cash transfer program “JUNTOS,” and social projects undertaken by regional and local governments. Unfortunately, these efforts have not been very effective in reducing poverty. Poverty in rural areas, disproportionately affect infant malnourishment and maternal mortality remains high. The quality of basic health services and education is still inadequate.

(ii) Challenges

- The government should improve the coverage and quality of social services (mainly basic health and education), and increase investment in basic social infrastructure (water and sewerage, and electricity). These efforts should be focused on the poorest areas.
- Additionally, the effective articulation of health, education and nutrition programs, including budgeting (based on appropriate targeting mechanisms) and the implementation of surveillance and monitoring systems are necessary for improving the performance of social programs.

4. Enhancing Macroeconomic Stability

Fiscal Policy

(i) Achievements

- During 1995–98, Peru's economic model stressed market policies, trade liberalization and openness. Consequently, by 1997, the Non-Financial Public Sector (NFPS) showed a surplus, and the economy was growing robustly.
- Between 1998 and 2000, a recession took hold, triggered by adverse international events (the Asian and Russian financial crises) and the onset of the climatic phenomenon called "El Niño." This led to reduced per capita GDP growth, a contraction of consumption and investment, an NFPS deficit (equal to around 3.3 percent of GDP), and a sharp decline in private investment (-15.2 percent real growth between 1998 and 1999).
- To recover from the crisis and recover economic dynamism, while combating inflation, the incoming administration embarked upon fiscal expansion. In 2003, MEF approved the Ley de Responsabilidad y Transparencia Fiscal (LRTF), which reformed the old Ley de Prudencia y Transparencia Fiscal. In this way, the MEF reinforced its commitment to sound fiscal policy, preserving macroeconomic stability while promoting fiscal transparency.

(ii) Challenges

- To ensure sustainable growth with fiscal discipline, including a commitment to use fiscal resources and external savings in a more flexible and viable manner.
- Improve information systems relating to resources and expenditures (SIAF), including the provision of complete data for local and regional government's programs and resources (taxes and/or transfers from central government). This will help the evaluation and policy making by fiscal authorities.
- Continue promoting Public-Private Partnership (PPP) models for infrastructure projects; through the development of suitable methodologies for quantifying contingent liabilities and potential fiscal risks.

Trade Policy

(i) Achievements

- In last 10 years, trade policy in Peru has been characterized by an increasing openness and liberalization. In this respect, average nominal tariffs have decreased from 16.3 percent in 1996, to 10.15 percent in 2006, mainly as a result of trade agreements and unilateral decisions.
- Trade negotiations are viewed as a means to improve international market access for Peruvian goods and services. Consequently, Peru has participated actively in the World Trade Organization (WTO) and other regional and bilateral initiatives.

Peru is member of the Andean Community (together with Bolivia, Colombia and Ecuador), and has signed free trade agreements with Chile (1998), MERCOSUR (2003), an early harvest protocol with Thailand (2005) and the United States of America (2006).

- Peru is also negotiating trade agreements with Singapore and Mexico, and widening the agreements with Chile and Thailand in order to include disciplines related to trade in services. As a member of the Andean Community, trade negotiations with the European Union will start in 2007.

(ii) Challenges

- Peru should continue supporting WTO negotiations and begin discussions with other trading partners, especially with Asian economies. Meanwhile, Peru should work on increasing the competitiveness of its goods and services in order to be able to maximize benefits from trade liberalization and to attract investment in strategic sectors.

5. Improving Public Sector Governance

(i) Achievements

- To enhance Peru's development, a fiscal decentralization process⁴⁵ has been implemented since 2002. This process implies more participation of civil society in budget formulation and evaluation.⁴⁶ Indeed, local government plays an important role in the development of regions, providing high-quality public goods and services, and social programs⁴⁷. The decentralization process will be gradual and orderly so as to reduce fiscal risks and preserve macroeconomic stability.⁴⁸

(ii) Challenges

- One main goal for the future is the creation of inter-related regions that use their resources efficiently, and also contribute to the development of the local economy.

7. Improving Regulatory Quality and Enforcement

(i) Achievements

- In the 1990s, parallel to the process of privatization, which was mainly concentrated in sectors like telecommunications, energy and sanitation, Peru implemented a regulation of monopolistic sectors with the purpose of promoting competition and the expansion of public services.
- Regulation, based on transparency, legal and technical support, permitted broader access to public services by consumers. The legal framework allowed regulatory agencies the necessary independence to drive and manage their policies.

⁴⁵ Guidelines of decentralization progress are included in "*Ley No. 27783, Ley de Bases de la Descentralización.*"

⁴⁶ The role of the civil society is established in "*Ley No. 28056, Ley Marco del Presupuesto Participativo.*"

⁴⁷ The objective of *Ley No. 28273, Ley del Sistema de Acreditación de los Gobiernos Regionales y Locales* is to guide the transfer of the competence, functions and resources from the central government to sub-national level and to improve the quality of the public services implementing a system that evaluates the capacities to supply public services.

⁴⁸ *Ley de Descentralización Fiscal, Decreto Legislativo No. 955* regulates the distribution of resources to sub-national governments in order to realize their functions. Moreover, it establishes incentives to improve their tax collection, and fiscal rules to maintain fiscal responsibility.

(ii) Challenge

- In the process of achieving more efficient regulation, the challenge is to create more mechanisms to further increase competition by means of establishing a regime of penalties which will deter anticompetitive conduct and attract investment in regulated sectors.

8. Ensuring Competitive Markets

(i) Achievements

- In the past decade, Peru has started to develop and promote competition policy. With the issuance of the Competition Law, Legislative Decree 701, and the creation of the Competition Agency INDECOPI, Peru has also advanced in terms of intellectual property protection, as well as competition and consumer protection.

(ii) Challenges

- The main objective is to create an improved legal framework in which INDECOPI will have greater independence, transparency and credibility, by means of institutional reform.

9. Improved Corporative Governance

(i) Achievements

- In the process of achieving economic liberalization and economic growth, the Peruvian government has been promoting investment between investors and the state. These contracts lifted investment and provided a continuity of investment that generated job growth. However, intervention by different government levels has sometimes created problems, resulting in the need for arbitration between the parties involved.
- To bolster corporate governance the state has reformed the management and control systems of state-owned companies, increasing transparency and service quality.

(ii) Challenges

- The main objective, relative to contracts between investors and the state, is to develop an administrative mechanism for managing these contracts, from the start of the contract to dispute settlement, if needed. For the public sector, the main governance goal is to consolidate the management and control systems and introduce better governance mechanisms.

10. Strengthening Economic and Legal Infrastructure

(i) Achievements

- Over the last decade, the need to undertake additional regulatory and institutional reform, over and above “first generation reforms,” has been acknowledged. Beyond the defense of the market economy it is recognized that there is a need for improved institutional performance by the public sector, which implies a reduction in the level of corruption, greater respect for human rights, greater civic participation and democratic governance.

- The urgency to managing these issues increased with the deterioration in social indicators, persistent high levels of corruption and social pressures, among others. The need for a mechanism that increases transparency and access to public information has been incorporated in public institutions, in addition to the promulgation of a strong legal frame. Key principles underpinning the policy framework are: a) the promotion of regulatory efficiency, b) fiscal discipline and stability, and c) the strengthening of democracy. Adherence to these principles should improve the investment environment.

(ii) Challenges

- Principal efforts will be directed toward the continuous fight against corruption and the promotion of transparency in all areas of government. These endeavors will contribute to the legitimization and credibility of public institutions, themselves key determinants of private investment and growth.

11. Reform Public Pension System (PPS)

(i) Achievements

- Relaunch of Private Pensions System (PPS) pending reorganization of, the Public System (PS): 1996–2000
Between 1995 and 1996, the PPS was relaunched with the introduction of several new measures, including the reduction of the contribution rate from 10 percent to 8 percent, the adjustment of PS's retirement age to 65 years old, and the increase in contribution rates from 11 percent to 13 percent in PS.
- PPS Reform and PPS consolidation: 2000-2006
In past five years, the government has been studying and implementing important pension reforms. Firstly, the pensions of mining workers in PPS and in PS were converged. Secondly, several distortions in equity and fiscal sustainability were corrected. Additionally, improvements to PPS were introduced (e.g., minimum pension, advanced retirement special regime).

(ii) Challenges

Discussion on pension reform also implies the movement toward a multi-pillar system. Studies on structural reform that will unify the pension system are being developed.

THE PHILIPPINES

Major Achievements and Continuing Challenges

1. Improving Regulatory Quality and Enforcement

The General Banking Act of 2000 aligned domestic banking standards with international best practices and improved regulatory oversight.

An MOU signed by the Bangko Sentral ng Pilipinas (BSP) and the Securities and Exchange Commission (SEC) in July 2002 clarified the supervisory and regulatory responsibilities of each agency in the financial sector.

2. Ensuring Competitive Markets

Tariffs

Rates are relatively low compared to those of the other developing economies of the APEC.

Non-Tariff Measure

The import licensing system is open except for quantitative restrictions on rice.

Foreign Investment Liberalization

To date, six Regular Foreign Investment Negative Lists have been issued specifying the few areas in which investments is limited to Filipinos as provided in the Constitution and other laws.

Specific Sectors/Industries:

Manufacturing and agro-business

There is no limitation on foreign investment. However, the Constitution prohibits foreign nationals from owning land.

Mining

Foreigners may own 100 percent equity in the firm under certain conditions but environmental concerns have been raised.

Telecommunications

This industry is open to competition, but foreign equity is limited to 40 percent under the Constitution.

Air Transport

Domestic air services have been liberalized since mid-1999. Domestic routes have been opened for entry (a minimum of two operators on each route). Two international carriers have been designated as official carriers.

Domestic shipping

The entry of operators and the fixing of domestic shipping rates have been deregulated.

Shipbuilding/Repair

No foreign investment ceilings.

Downstream Oil Industry

The deregulation of the industry brought about the entry of new players and investments. Enforcement of competition-related provisions of the law, however, has to be strengthened.

Retail Trade

Foreign investment is allowed subject to certain categories and qualifications. So far, eight wholly foreign owned companies have entered the Philippines, between 2000 and 2005.

Financial sector

The entry and level of foreign equity participation in banks, insurance firms, investment and financing companies and investment houses have been liberalized through various laws.

3. Enhancing Macroeconomic Stability

The Special Purpose Vehicle Act allowed the creation of private asset management companies to enable banks to dispose of their non-performing assets.

Major tax reforms were undertaken in 1997, but revenue gains were not sustained. A comprehensive fiscal reform program was initiated in mid-2004 culminating with the passage of the e-VAT law, which further expanded the tax base and raised the VAT rate from 10 percent to 12 percent.

4. Improved Corporate Governance

Under the Securities Regulation Code minority stockholders are afforded better protection with mandatory tender offers, defined listing rules, a prohibition on insider trading and the separation of broker and dealer functions.

New regulatory frameworks for financial reporting based on international standards have been implemented by the SEC.

The SEC issued a Manual on Corporate Governance in 2002; compliance of covered companies with their corporate governance commitments started in 2003.

Guidelines were laid out by the BSP governing the development and implementation of banks' internal credit risk rating systems to ensure sound and effective credit management processes.

Guidelines have been laid out by the SEC for the eventual shift to a risk-based capital adequacy framework among regulated and monitored entities.

5. Improving Public Sector Governance

The new government procurement law redefined procedures in government purchasing. An e-Procurement System has also been implemented to enhance transparency, competitiveness and public accountability in government.

The new government accounting system aims to simplify government accounting rules and procedures based on international accounting standards and facilitate the consolidation of financial reports.

6. Strengthening Legal and Economic Infrastructure

Privatization Program

A number of government-owned or controlled corporations were successfully privatized and certain acquired assets returned to private sector hands. The program is still to be completed.

Deregulation

Measures were undertaken on sectoral and industry bases. The regulatory regime will continue to be reviewed and improved to increase the competitiveness of the economy.

Electric Power Industry Reform

The law, enacted in 2001, restructured the sector into generation, transmission, distribution and supply. However, implementation and privatization has proved difficult.

Intellectual Property Rights (IPRs)

An adequate legal and institutional basis for protecting and implementing IPRs has been put in place, but enforcement needs to be strengthened.

E-Commerce

An appropriate legal framework to govern commercial transactions over the internet has been put in place.

Competition policy

Relevant provisions are dispersed throughout various domestic laws and there is no central implementation body to enforce competition on an economy-wide basis.

7. Other

Standards and Conformance

Philippine National Standards should be 100 percent harmonized with international standards by 2010.

Customs Procedures

There has been significant progress in the use of risk assessment methods and use of information technology, which require steady incremental improvement.

WTO Obligations

The Philippines is WTO compliant. Commitment to eliminate duty on information technology products was completed on schedule. The GATS Fourth Protocol entered into force for the Philippines on 25 April 2006.

SINGAPORE

1. Investing in Human Capital: Moulding Singapore's Future through Education

(i) Major Achievements

Singapore believes that the wealth of a nation lies in its people. We have taken steps to build a robust education system, with good schools, capable school leaders and teachers, and infrastructure that are among the best in the world. We have a strong curriculum focus on the holistic development of the child, balancing cognitive, physical, aesthetics, character and leadership development. As testimony to these efforts, the World Competitiveness Yearbook 2006 has put Singapore first for an education system that "most meets the needs of a competitive economy."

(ii) Continuing Challenges

Going forward, we will build on our high averages and develop peaks of excellence within the system. Our approach is to continually enhance the quality of education, retain our strong common core curriculum and encourage greater diversity in our education landscape. This will cater to individual aspirations of Singaporeans and maximize their potential, as well as enable the country to be more responsive to a rapidly changing global economy. The next wave of improvements for Singapore will come from ground-up initiatives from our schools responding to the needs and interests of students. To achieve this outcome, schools will be given more autonomy and support for school-based innovations.

2. Ensuring Competitive Markets: Competition Act (Chapter 50B)

(i) Major Achievements

A new Competition Act (Chapter 50B) ("Act") was passed in 2004 to reinforce Singapore's pro-enterprise and pro-competition policies, enhance the efficient functioning of our markets, and thus enhance the competitiveness of the economy. The Competition Commission of Singapore (CCS) was set up on 1 January 2005 to administer and enforce the Act. In the same year, the CCS issued 11 sets of guidelines to provide a general conceptual and analytical framework within which the CCS will conduct its assessment and investigations. The provisions on prohibitions against anti-competitive agreements and the abuse of dominance came into effect on 1 January 2006.

(ii) Continuing Challenges

In enforcing the Act, the CCS will need to balance regulatory and business compliance costs against the benefits from effective competition, so as to ensure that the government does not inadvertently constrain innovative and enterprising endeavours in Singapore. Education, outreach and advocacy programs will continue to be a key part of the CCS' work. This is to provide guidance, and raise the awareness of businesses on how CCS would interpret and administer the provisions of the Act.

3. Enhancing Macroeconomic Stability

(i) Major Achievements

The government is committed to promoting sustained non-inflationary economic growth, so as to create jobs and achieve higher standards of living for all. Despite the volatile years following the Asian financial crisis, Singapore's average inflation rate from 1995–2005 was 0.8 percent per annum, lower than what was reported for many developed countries. Even though Singapore went through a period of economic restructuring in the past decade, the average GDP growth rate was maintained at 5.1 percent per annum, with the average unemployment rate kept to a respectable 2.8 percent per annum.

(ii) Continuing Challenges

As the exchange rate is the principal tool of monetary policy in Singapore, the Monetary Authority of Singapore will continue to closely monitor the foreign exchange market, and intervene from time to time to prevent excessive fluctuations in the Singapore dollar exchange rate. Likewise, the Ministry of Trade and Industry will continue to source new expansion opportunities for the economy in order to create new value and new jobs for the workforce.

4. Improving Public Sector Governance

(i) Major Achievements

The Public Service for the 21st Century (PS21) movement continues to commit the Singapore Public Service to anticipate, welcome and execute change. Significant changes have been implemented over the years to ensure an efficient and effective public service that meets the needs of the people. The accomplishment of the public service in providing government services online is a case in point. Singapore is rated as one of the leading countries in terms of e-government, with more than 1,600 government services available online on a 24/7 basis. Internally, significant human resource and financial functions have also been progressively devolved and delegated to the public agencies, so that agencies would have greater autonomy to respond to challenges they face.

(ii) Continuing Challenges

As globalization progresses, challenges will become more complex. Increasingly, issues do not fit neatly into any of the agencies' narrow scope of responsibilities. There is a growing need for public agencies to network with one another and act in a coordinated and concerted manner. To facilitate a networked government, all public agencies and public officers need to identify with a set of core values—integrity, service and excellence—which serve as the basis for all agencies to work together as one government.

5. Strengthening Economic and Legal Infrastructure: Planning, Promoting and Developing Vibrant Industrial Space

(i) Major Achievements

Jurong Town Corporation (JTC), a statutory board under the Ministry of Trade and Industry, is Singapore's leading provider of industrial space solutions. Over the past three decades, JTC has developed some 7,000 hectares of industrial land and 4 million square meters of ready-built factories for more than 7,000 local and foreign companies. More recently, JTC has begun

building specialised parks and facilities for critical growth industries in high technology and biomedical sciences.

(ii) Continuing Challenges

To meet the demands of the knowledge-based economy (KBE), JTC will have to continually reinvent itself and think of new ways to satisfy the needs of companies. For example, it has come up with innovative solutions such as the massive reclamation project to join seven islands into the Jurong Island chemicals hub; stack-up factories using a revolutionary concept of factory design to optimize land usage; experimentation with a new planning approach at one-north that incorporates work, live, play and learn elements; and more recently, planning of underground oil storage caverns to free up land for high value-added manufacturing industries. JTC will also continue to promote more private sector participation in the development of industry property in order to create a more vibrant and competitive industrial property market.

1. Improving the Efficiency of Capital and Labour Markets

Chinese Taipei has established a sound and integrated capital market through such efforts as adopting a new underwriting mechanism, stepping up the efficiency of stock and bond markets, continuing to develop new financial products, strengthening the protection of investors, and so on.

Amendments to the Securities and Exchange Act promulgated in January 2006 will underpin the continuing drive to foster a capital market that is more liberalized in line with international practices, so as to enhance its international competitiveness and attractiveness.

Various measures have been taken to enhance the protection of workers' rights, both during their working lives and after retirement, in the context of wider efforts to improve the efficiency of labour markets. To this end, new laws include the amendment of the Labor Standards Act in 2001 to reduce standard working hours from 48 per week to 84 every two weeks, as well as the passage of the Employment Insurance Law in 2003 and the Labor Pension Act in 2005.

Since 1 July 2005, a new pension system has been implemented alongside the existing one. Under the newly adopted defined contribution plan, workers are entitled to receive a pension upon retirement regardless of how long they have remained with an employer. This gives them greater freedom to change career or pursue higher education according to their own plans.

2. Investing in Human Capital

A wide variety of vocational training is provided through subsidies to local governments and the utilization of private training resources. Schemes include pre-employment and short-term training, localized training to meet local industry needs, job transfer assistance and collaboration with private enterprises to organize in-service training for their employees.

Spending on education accounted for 6.26 percent of GNP in 2004, of which 73.0 percent was borne by public sector. In the same year, expenditure on R&D accounted for 2.54 percent of GDP, and is expected to reach the target of 3 percent by 2007.

Further steps toward upgrading the quality of human capital include the development of mid- to long-range vocational training programs and the establishment of a vocational training evaluation system.

An E-Generation Manpower Cultivation Plan, under the Challenge 2008: National Development Plan, aims to enhance the information technology skills, foreign language proficiency and creativity of the people of Chinese Taipei. In addition, in 2004, Chinese Taipei has allocated US\$1.45 billion in the Top-Notch Universities and Research Centers Project to assist top universities to rank among the world's first-class institutions, hoping to have at least 15 top academic departments, colleges or inter-university research centers become leaders in their respective fields in Asia within the next five years, and to enable at least one of the country's top universities to rank among the world's top 100 universities within 10 years.

3. Improving Regulatory Quality and Enforcement

Chinese Taipei has been carrying out regulatory reform since mid-1980, when it began doing so as part of its effort to achieve WTO accession, and these efforts have already borne substantial fruits. For example, several hundred laws and regulations have been revised to bring them in line with international norms and standards.

As steps toward improving regulatory quality and enforcement, Chinese Taipei has passed the Administrative Procedure Act, the Freedom of Government Information Law, the Guidelines on Central Administrative Agencies' Legal Matters and related executive orders, laying down requirements for openness, transparency and related pre-announcement procedures for the introduction and amendment of laws and regulations.

To meet the needs of globalization, international trade competition and human rights protection, Chinese Taipei is already undertaking planning, research and training in respect of conducting regulatory impact assessments (RIA) for the introduction, amendment and repeal of laws, with reference to the practices of advanced members of APEC and the OECD. However, there is still a need for ongoing experience in conducting RIAs in actual cases in order to familiarize the government and the public with assessment procedures and enable the RIA process to be put into practice effectively.

4. Ensuring Competitive Markets

The Fair Trade Act was promulgated in 1991, with the aim of maintaining trading order, protecting consumer interests, ensuring fair competition, and promoting economic stability and prosperity. An independent Fair Trade Commission (FTC) was officially established in 1992 to take charge of the important mission of formulating competition policy and enforcing the Fair Trade Act. Considering the need for greater transparency and fairness, the Act was amended in 1999, 2000 and 2002. To meet new needs generated by the progressive liberalization and globalization of Chinese Taipei's economy, the FTC is working on the formulation of clear rules for joint venture R&D and the introduction of measures to bolster law enforcement against illegal cartels.

5. Enhancing Macroeconomic Stability

Over the past 50-some years, Chinese Taipei has achieved rapid economic growth accompanied by price stability. From 1953 to 2005, the economy grew at an average rate of 7.9 percent, one of the fastest growth trends seen in the world, with CPI rising by an average of only 4.5 percent per year (2.4 percent if the energy crisis years in the 1970s are excluded).

The main challenges currently faced by Chinese Taipei include other emerging economies' quick growth and strong competition, the formation of regional trading blocs, and soaring energy prices. Chinese Taipei's per capita GDP is targeted to reach US\$30,000 in 2015, with the unemployment rate staying below 4 percent.

6. Improving Corporate Governance

Chinese Taipei amended the Securities and Exchange Act on 11 January 2006, for the purpose of strengthening corporate governance and promoting the sound development of financial

markets. The amendments include new requirements for independent directors and an audit committee system.

As Chinese Taipei pushes ahead with efforts to promote the sound development of its capital market and of its financial system as a whole, it will lay great stress on promoting the better corporate governance of publicly listed companies, and will set up a corporate governance rating system as one of the measures for achieving this purpose.

7. Improving Public Sector Governance

In the *Global Competitiveness Report 2005–2006* issued by the World Economic Forum (WEF), Chinese Taipei climbed 30 places from 61st to 31st in terms of time spent by company officers communicating with government officials.

In the future, the government will need to focus on meeting four key challenges: moving out, which means entrusting the delivery of public services to private entities; moving down, which means endowing lower level agencies with authority to provide speedy solutions to citizens' problems; moving up, which means emphasizing global governance and the need for international interaction and interchange; and joining up, which means integrating the functions of agencies at different levels to make optimum use of their collective resources.

To create an energetic government that is globally competitive, Chinese Taipei has reviewed the tasks and organizational makeup of its executive agencies and drawn up a comprehensive plan for government re-engineering, which is now awaiting legislative approval. Meanwhile, the government will continue its vigorous efforts to put into practice the principles of deregulation, decentralisation, corporatisation and outsourcing.

An important objective on the agenda for improving public sector governance is e-participation in policy making. Currently, the government provides multiple channels for the public, businesses, interest groups, etc., to express their views, lodge complaints, make inquiries, submit applications, and so on, through e-mail and online service portals.

8. Strengthening Economic and Legal Infrastructure

Following Chinese Taipei's WTO accession on 1 January 2002, further deregulation has been carried out in areas such as financial services, investment, and mobility of business personnel and the privatization of state-run enterprises.

In order to fulfill our WTO accession commitments, tariff rates for some 5,000 tariff lines were amended in 2002, reducing the average nominal tariff rate from 8.2 percent in 2001, to 5.67 percent in 2005; in particular, the average nominal tariff on agricultural products was reduced from 20.02 percent to 13.46 percent, and on industrial products, from 6.03 percent to 4.16 percent during the same period. Moreover, from 1 January 2004, tariffs on pharmaceuticals, toys, furniture, medical equipment, agricultural equipment, construction equipment, paper and steel were all eliminated in accordance with our accession commitments.

In 2002, Chinese Taipei embarked on the first phase of financial reform, after the two-year efforts for cutting the NPL ratio of domestic banks and raising their capital adequacy ratio (CAR) had been achieved and surpassed, with the former down to 3.8 percent and the latter up to 10.1 percent by the end of 2004. The government followed up by launching the second phase of financial reform, aimed at building up the strengths of the financial sector and promoting Chinese Taipei as a regional financial services center. Through our efforts, NPL had

been decreased to 2.4 percent in June 2006, and CAR added to 10.3 percent at the end of 2005.

Chinese Taipei has used the “APEC-OECD Integrated Checklist on Regulatory Reform” as a guiding tool for the self-assessment on its regulatory, competition and market openness policies since 2006. In the meantime, via an award-granting mechanism (i.e. the Golden Axe Awards), various government agencies have conducted several trainings for civil servants with the aim of deepening the understanding toward this policy tool.

THAILAND

Thailand, in coping and adjusting with globalization, has continuously taken various reform measures in the financial sector, labour market, trade, and public sector. These reform efforts have been progressing well and have begun to bear fruits. Key achievements and remaining challenges are presented as follows:

1. Improving the Efficiency of Capital and Labour Markets

Capital Market

(i) Achievements

Non-Performing Loans (NPLs) in the Thai financial system have been declining steadily from the peak of 2,729.3 billion baht in May 1999 or 47.70 percent of outstanding loans to 484.7 billion baht or 8.23 percent at the end of June 2006. To tackle the NPL problems, the informal workout process has been established and is supported by various measures, including guidelines for debt restructuring, the Bangkok Framework, Inter-Creditor Agreement, Debtor-Creditor Agreement, Court Mediation Center guidelines, and other incentives such as relief on asset transfer fees, and the formal process in court has been amended. The government has also amended the Bankruptcy Law to allow qualified debtors to restructure their bad debts through the judiciary process. A number of workout mechanisms have been established such as the Central Bankruptcy Court, Asset Management Corporations, Thai Asset Management Corporation (TAMC), Corporate Debt Restructuring Advisory Committee (CDRAC), and SMEs Financial Advisory Center, all of which with the intention to ease the problem of assets in distress.

Since the economic crisis in 1997, the development of the capital market has been accelerated to provide alternative sources for business financing, investment, and choices for people's saving. The Capital Market Master Plan I was implemented during 2002 to 2005 to enhance the quantity and quality of securities, enlarge and strengthen the investor base, and enhance efficiency of the infrastructure in order to reduce transaction costs. The Capital Market Master Plan II (2006–2010) aims to enhance the attractiveness of the capital market as an alternative source of fund-raising and savings choice in order to increase the size of equity and debt markets to be comparable to that of the banking sector and to encourage more institutional investor's participation in the equity market and more individual investors in the debt market.

(ii) Continuing Challenges

Market capitalization in the Stock Exchange of Thailand has grown quite significantly from 1.268 trillion baht at the end of 1998 to 5.046 trillion baht on September 29, 2006. Thailand has to ensure that the capital market remain an attractive alternative choice for both investors and savers. To this end, public outreach, including education and training programs, on capital market issues will need to be strengthened and expanded to cover every province and every academic institution. More importantly, rules and regulations will be reviewed to ensure that they are relevant to the current situation and sufficient to immunize the market from excessive volatility caused by speculative transactions. Furthermore, risk mitigation instruments will be developed to help reduce down-side risks. On the development of futures market as a tool for risk management, the Thailand Futures' Exchange (TFEX) was granted license in February 2005. It is essential that its operation, which has begun since April 2006, run and be regulated effectively.

Labour market

(i) Achievements

Daily minimum wages are reviewed annually by the National Tri-partite Committee comprising representatives of employers, employees, and government, so that living standards of workers will be maintained despite the rising costs of living. Review of daily minimum wages for 2006, for example, has resulted in new rates of daily wage, effective since 1 January 2006. Social Security Scheme has been extended to cover businesses with at least one employee since 1 April 2002 and as of August 2006, the number of insured workers stood at 8.5 million persons, as compared to 4.97 million persons at the end of 1994. An extension of the Social Security Scheme to cover the informal sector on a voluntary basis is now under consideration. The quality of life of the workforce is also being addressed through “Labour Standards” and “Decent Work” measures which are recognized by the ILO.

The government has ensured a safe working environment through standards and effective enforcement. The cabinet resolution on 10 January 2006 approved the draft ministerial order on management of occupational safety, health, work conditions and environment relating to heat, lights, and sounds. Furthermore, the government also provides career services and job placement to facilitate and enhance efficiency of the labour market. To resolve the shortage of unskilled labour in certain industries, the cabinet resolution on 20 December 2005 agreed on the proposal by the Committee on Illegal Migration Management, allowing the quota of 500,000 migrant workers from Lao PDR, Cambodia, Myanmar, with appropriate labour registration, to work in Thailand. Moreover, the Tri-partite working committee is in the process of reviewing bail-out fees for the new quota of migrant workers.

(ii) Continuing Challenges

Poverty eradication is a leading priority of the government and it is evident that people’s access to funds, land and improved skills and knowledge are vital for employment and income generation. To increase the productivity of the workforce, Thailand has enacted the Skill Development Promotion Act which aims to encourage businesses to take responsibility for training and upgrading the skills of their workforce in order to develop more highly qualified workers. The incentives and compulsory measures have been implemented where businesses can fully deduct the training cost from their annual tax payment. Furthermore, businesses with at least 100 employees have to train at least 50 percent of their employees.

2. Investing in Human capital

(i) Achievements

Investing in human capital covers a comprehensive scheme including educational reform, nationwide health care program, and development of social protection with compulsory education increased to 9 years for all children. The Ministry of Education subsidizes students from pre-primary to university levels. Up to 2006, over 185 billion baht has been provided to over 2.18 million students through the Student Loan Fund and Income Contingent Loan Program. Coverage for social protection has also been expanded with the Cabinet having approved 3 draft amendments of ministerial order, proposed by the Ministry of Labour, pertaining to an improvement of criteria, procedural claims, and monthly entitlement of child benefits and an extension of the scheme coverage to cover a wider range of chronic diseases eligible for claims. Human security has also improved, as evidenced by the increasing

proportion of people covered by health care scheme from 78.2 percent in 2000 to 96.25 percent in 2005. In addition, the school enrolment rate rose from 57.4 percent in 2000 to 64 percent in 2005, while the proportion of labourers with high school degrees or higher has increased from 19.7 percent in 2000 to 25.9 percent in 2006.

(ii) Continuing Challenges

During the upcoming Tenth National Plan (2007–2011), Thailand positions itself to become a knowledge-based economy with higher value creation. Investing in human capital will not only focus on fostering the knowledge, but also comprehensively address ethics, morality and good health. A higher proportion of the government budget than in previous years will be allocated for human development that will cover an innovative development in health care, a nationwide healthcare system, further educational reform, and development of new researchers. Human development will also aim to improve the quality of basic and secondary education, hone scientific and engineering talent, and promote life-long learning, vocational training, organizational learning and innovation.

3. Improving regulatory quality and enforcement

(i) Achievements

After the economic crisis in 1997, the government amended and enacted several new laws based on the agreement with the IMF and reform of legal and judicial regime has been progressing well. The National Committee on Legal Development was appointed in July 2004 to oversee the reform of legal and judicial regime under the National Laws Development Plan, 2005-2008. In March 2005, 10 sub-committees of the National Legal Framework and Policy Committee were set up to review the 377 laws identified by line ministries as being redundant, outdated, or in need of replacement. As of 2005, 13 laws have already been reviewed while 28 laws were under revision. It is targeted that at least 50 percent of the 377 laws will be completely reviewed and revised by the end of 2008. Furthermore, there have been some initiatives in infrastructure regulatory reform such as the corporatisation of SOEs, and the establishment of independent regulators in the utility/infrastructure sector, for example, the National Communications Commission (NCC), and the National Broadcast Commission (NBC).

(ii) Continuing Challenges

Certain essential laws will need to be more effectively enforced under a more competitive environment in the years to come. Many of these are very modern in structure and very much up to par with international standards. Each law is even supervised by the Joint Public and Private Sector Committee, however, there is a mandatory periodic review and a simple mechanism to make certain adjustments so that these laws will be adapted to changing conditions without going back through the parliamentary process. They are, for example; (i) Labour Protection Act (1998); (ii) Anti-Dumping Law and Countervailing Act (1999); (iii) Trade competition Act (1999); and (iv) Foreign Business Act (1999).

4. Ensuring competitive market

(i) Achievements

In principle, the Thai Foreign Business Act (1999) allows foreign companies to conduct business in all sectors except those enumerated in one prohibitive list and two others where specific approval are required. There is no restriction in manufacturing sectors in general. The

Investment Promotion Act (1977) authorizes the Investment Promotion Committee to waive foreign ownership restrictions for investment projects that are deemed beneficial to the Thai economy. Trade liberalization that ensures Thailand remains competitive has been progressing well with the tariff structure recently reformed and simplified. Moreover, Thailand is a founding member of the ASEAN Free Trade Area (AFTA), where 98.99 percent of products in the CEPT inclusion list of the original ASEAN-6 are already subject to 0-5 percent tariff range. Completion of tariff elimination of products in the CEPT inclusion list is expected in 2010 for the original ASEAN-6 and 2015 for new members. In compliance with e-ASEAN Framework Agreement, signed in November 2000, Thailand abolished the tariff duties for the imports of 150 ICT products, the last portion, in December 2005 with a retroactive effect to 1 January 2005. Furthermore, to date, Thailand has two comprehensive free trade agreements with Australia and New Zealand, an “Early Harvest Program” with China under the Framework Agreement on comprehensive economic cooperation between ASEAN and China that covers fruits and vegetables, an ASEAN-China free trade agreement for trade in goods, and an “Early Harvest Scheme” under the Framework Agreement to establish an FTA between Thailand and India, all of which have entered into force and started to bear fruits.

(ii) Continuing Challenges

Under the Tenth National Plan, promoting a competitive market is one of the development guidelines, but in so achieving, new mechanisms must be further developed in order to prevent the abuse of monopoly power. Although Thailand has had a rather advanced competition law since 1999, its effective application can be further improved in the area of identifying a dominant player in the market and a merger, especially through the market share and share volume thresholds that would require permission from the competition authority. In addition, effective e-auction procedures will be required to encourage competition in public procurement.

5. Fostering Macroeconomic Stability

(i) Achievements

Economic stability, both internal and external, has been restored and maintained since 1999 due to:

- the change of the monetary policy regime to the managed float system of exchange rate and an adaptation of inflation-targeting regime as a framework to ensure price stability;
- the financial sector reform which encompasses the improvement of risk management standards for financial institutions, the amendment of the Credit Information Business Act, effective in February 2006, reducing the onerous legal risks for the Credit Bureau/their members and providing greater flexibility for the operators; as evidenced by strengthened Thai commercial banks, with their average capital adequacy ratio increasing from 9.23 percent in 1997 to 13.53 percent in July 2006; and
- the Fiscal Sustainability Framework was successfully implemented under which public debt to GDP ratio were set not to exceed 50 percent during the Ninth National Plan (2002–2006), and will be limited to 45 percent during the upcoming Tenth National Plan (2007–2011), and the promulgation of the Public Debt Management Act in February 2005, which provides more flexibility, prudence, and coverage on public debt creation and management and allows certain financing of existing debt, which could not have been done in the past. Net international reserves have been replenished from merely US\$2.5 billion in August 1997 to over US\$65 billion on September 2006.

(ii) Continuing Challenges

To maintain economic stability in the medium and long-term, Thailand will continue with certain guidelines which include:

- development of renewable energy and bio-fuels as targeted by the New Energy Strategic Plan (2005), e.g. about 25 percent of petrol consumption for the transportation sector to be substituted by the use of natural gas, gasohol and bio-diesel by 2009, a total replacement of all gasoline⁹⁵ by gasohol by the end of 2008, and about 10 percent of diesel consumption to be substituted by bio-diesel by year 2012; whereby the use of renewable energy is expected to reach 8 percent of total energy use by the end of the Tenth Plan and the production of maize, cassava, sugar cane and oil palm would consequently become an important source of energy supply;
- further financial sector reform to strengthen financial institutions, which require the BOT to update and enhance the quality and effectiveness of financial supervision, particularly the supervision regime of financial conglomerate on a consolidated basis, the implementation of Basel II standard by 2008, covering minimum capital requirement, supervisory review, and market discipline, and the establishment of limited "Deposit Insurance Scheme" which should replace the current government guarantee; and
- promotion of savings in order to provide sources of finance for investment as well as strengthening the national pension fund and reinforcing the social safety net, especially as the country is becoming an aging society.

6. Improving Corporate Governance

(i) Achievements

During the past few years, Thailand has continued to move up the IMD's ranking from the 38th position in 2001 to the 27th position in 2005. It has improved its reporting, disclosure, and auditing standards and practices, in consistence with international standards. Accounting Profession Act (2004) was put into effect to enhance the quality of financial reports. The Thai Accounting Standards (TAS) are in line with the International Financial Reporting Standards (IFRS) in all material respects. At present, 29 out of 36 TAS are consistent with the IFRS, while 6 are in the drafting process. In this connection, Thailand has announced its plan to fully adopt the international accounting standards by the end of 2006. Amendments of the Public Companies and Securities and Exchange Act has improved minority shareholders' rights, clarified accountability of boards of directors and officers; and strengthened enforcement mechanism to impose sanctions for violation of law. Moreover, the Security Exchange Commission has introduced a "Director's Handbook" as a working manual to assist listed company directors in the performance of their duties and in protection of both companies' and shareholders' best interests.

(ii) Continuing Challenges

Laws governing corporate governance are being reformed, including the SEC Act, the Public Companies Act. A Class Action Act is now being drafted to allow shareholders and investors to sue directors for breach of their duties more easily and with less concern about the costs. In addition, corporate governance standards can be fostered through 1) education and public outreach to raise corporate governance awareness and 2) better incentive structure, such as providing fast track services to companies with high corporate governance rating. Additionally, the Institute of Certified Accountants and Auditors of Thailand (ICAAT) will be promoting the

Continuing Professional Education (CDE) program for accountants and auditors, including the development of accounting practice guidelines for SMEs.

7. Improving Public Sector Governance

(i) Achievements

Since 1999, public sector reform has made some headway. In May 1999, the Cabinet announced its Public Sector Management Reform Plan, which laid out the Government's vision for the need of institutional change. The government also appointed a high-level Public Sector Reform Committee (PSRC) to carry out the reforms under the Public Sector Reform Program which highlighted Thailand's medium term agenda for improving public sector governance. In 2003, the Public Sector Reform Program received renewed impetus with the establishment of the Public Sector Development Strategy which aims to increase the efficiency of the public sector in services delivery, improve budgetary and financial management, modernize the public sector through the use of ICT, promote public participation in monitoring and decision making and strengthen the management capability of local authority. Some of the key results of the reforms include:

- Establishment of the National Counter-Corruption Commission to enforce standards for integrity and transparency in investigating the Government;
- Establishment of Administrative Courts, which provides citizens a judicial forum to uphold their rights vis-à-vis the state;
- Amendments of the Public Organization Law (1999) to enhance management efficiency and flexibility including (i) clearer definitions of characteristics and functions; (ii) agreement on the structure and duties of public organization committees; and (iii) strengthened result-based management and accountability;
- Approval of E-Government Action Plan (2005–2007) on 6 August 2005 in order to promote e-services and develop a government portal, enhance efficiency of infrastructure and networks, and improve laws and regulation related to e-commerce, security and computer crime.
- Amendments of the state-enterprises' financial and accounting rules and regulations and amendments of the rules and regulations on public debt; in order to improve public financial and debt management.

(ii) Continuing Challenges

Decentralization has been delayed. In FY2006, only 24.1 percent of central government revenue was allocated to local administrations, compared to the original target of 35 percent specified under the Decentralization Act (1999). Since 2003, only 0.4 percent of government officials have been transferred to local government, partly due to limited capacities of local authority to carry out new responsibilities. In January 2006, the Local Administration Law was drafted, identifying responsibilities of all local administrations and specifying financial management and budgetary procedures. Meanwhile, the government provides support to local administrations on capacity building regarding how to handle new responsibilities in the future.

8. Others

Thailand remains determined to improve her competitiveness, although more remains to be done to sustain the momentum of reform and ensure the continual and effective implementation of reform measures. Inadequate and underdeveloped infrastructure was reported by firms as one of the major constraints to their operation and expansion. To address

this, it is expected that public investment in infrastructures and logistics system will start from year 2007 after careful consideration. Several other reform projects are also being carried out, including reform in education, improvement of business environment to reduce cost, promotion of increase in R&D expenditure at the firm-level, promotion of innovation systems, improvement of skills, and encouraging the increasing use of ICT.

UNITED STATES

1. Improving the Efficiency of Capital and Labour Markets

In 2005, two million payroll jobs were added to the U.S. workforce. Unemployment dropped to 4.9 percent, and real GDP increased by 3.5 percent, building on strong GDP growth in 2003 and 2004. The service sector has generated the bulk of new employment, accounting for 88 percent of job growth in 2005. To further increase employment, the administration has proposed measures such as strengthening job training and community-based Job Training Grants and Career Advancement accounts.

Productivity growth has averaged a strong 3.5 percent annual rate since the first quarter of 2001. Productivity has grown over the past five years at the fastest rate in nearly four decades, the result of improved technology and business practices. The U.S. is striving to increase opportunities for unemployed youth as well as disabled and displaced workers, while confronting demographic challenges of an aging workforce and the need to make the social benefit systems more efficient.

2. Investing in Human Capital

For more than a half-century, the U.S. experienced a rise in education levels, resulting in one of the best-educated populations in the world. To remain competitive, the U.S. continues to seek ways to improve its citizens' education and skills to prepare them for the workplace of the future. Congress passed education reforms known as the "No Child Left Behind Act" (NCLB) in 2002 that mandate educational accountability. Studies suggest that student achievement is rising as a result. The Nation's Report Card released in 2005 shows elementary school reading and math levels at all-time highs, along with a narrowing in the achievement gap between minority and disadvantaged children and their more advantaged peers.

However, less than half of American students who graduate at the secondary level are prepared for college-level math and science, a potential threat to U.S. higher education and competitiveness. In 1970, half of the world's holders of science and engineering doctorates were Americans, but projections show that by 2010 that figure will have dropped to just 15 percent. Such trends prompted the administration to launch the American Competitiveness Initiative, which aims to boost research and development spending and improve education in math, science, engineering and critical foreign languages.

3. Improving Regulatory Quality and Enforcement

The administration's extensive agenda for improving regulatory quality and enforcement is outlined in the Presidential Management Agenda. In 2003, agencies began tracking and working to reduce erroneous payments in major programs. Another initiative, the Accountability of Tax Dollars Act of 2002, calls for federal agencies to prepare audited financial statements, essential for any well-managed organization. Finally, a rigorous cost-benefit approach to regulation has resulted in measurable net benefits to society: during the decade from fiscal year 1996 to fiscal year 2006, the Office of Management and Budget (OMB) found that estimated benefits of federal regulations ranged from US\$94 billion to US\$449 billion per year, compared with estimated costs in the range of roughly US\$37 billion to US\$44 billion per year for the same 10-year period.

4. Ensuring Competitive Markets

The U.S. nurtures a sound business climate that can support high growth and foreign capital inflows by pursuing trade liberalization at the global, regional and bilateral levels. Over the long run, reducing obstacles to trade fosters rapid growth and greater efficiency and creates better, higher-paying jobs, but in the short run global competition can lead to hardships. Appropriate social and political response to these hardships is a critical issue. A comprehensive set of pro-growth government policies such as those outlined here can help create a favorable climate for economic growth and job creation, while other appropriate policies can help displaced workers train for and find new work and increase the portability of all workers' pension and health benefits.

5. Enhancing Macroeconomic Stability

The expansion of the U.S. economy continued for its fourth full year in 2005. Although the outlook is for a continued healthy expansion for the U.S. economy, challenges remain, including sustaining the present strong performance of the housing sector and coping with rising energy costs. Additionally, the U.S. continues to run mounting international trade and current account deficits. Despite these potential risks and challenges, the current outlook continues to be one of a gradual and orderly transition that will support the ongoing expansion in the U.S. economy. Other challenges include the need to continue federal budget deficit reduction efforts and to strengthen the three major components of retirement security: Social Security, pensions and personal savings.

6. Improved Corporate Governance

The administration significantly strengthened corporate governance and restored confidence through the Sarbanes Oxley Act of 2002. Among other things, the Act established a new quasi-public Public Company Accounting Oversight Board to oversee, regulate, inspect and discipline accounting firms auditing public companies. The Act also covers issues such as auditor independence and enhanced financial disclosure. It is considered one of the more significant changes to U.S. securities laws since the 1930s.

7. Improving Public Sector Governance

Under the President's Management Agenda, the U.S. has been striving to improve public sector governance. Federal agencies have become more disciplined and results-oriented about managing their programs, people, costs and investments through a framework of five government-wide initiatives including management of human capital, competitive sourcing, improved financial performance, expanding electronic government, and budget and performance integration designed to ensure programs achieve expected results. An agency earns "green" status when it has successfully adopted all the desired disciplines in the initiative; "yellow" for mixed results, and "red" for unsatisfactory results.

Today, all federal agencies are showing steady improvement in achieving the important goals of the President's Management Agenda. While 85 percent of the status scores were red on the first scorecard, today 75 percent of status scores are green or yellow. Eliminating improper payments alone will save roughly US\$40 billion annually.

8. Strengthening Economic and Legal Infrastructure

The U.S. pursues a wide range of other pro-growth policies. For example, the bipartisan Advisory Panel on Federal Tax Reform recommended options to make the U.S. tax system simpler, fairer and more pro-growth. Other reform proposals include changes to U.S. immigration policies to ensure the U.S. remains attractive to the best and brightest. Also under evaluation are legal reforms that would reduce the burden of torts on the U.S. economy. The U.S. seeks to work with partner nations around the world to protect intellectual property rights (IPR) through international cooperation to strengthen legislation, enforcement capacity, training and technical assistance on IPR.

Annex:
Abbreviations and Acronyms

Abbreviations and Acronyms

AcSB	Accounting Standards Board
AFTA	ASEAN Free Trade Area
AIT	Agreement on Internal Trade
ASEAN	Association of Southeast Asian Nations
BAAR	Basic Act on Administrative Regulations
BOJ	Bank of Japan
BSP	Bangko Sentral ng Pilipinas (the Philippines)
CAR	Capital Adequacy Ratio
CBS	Company and Business System
CCM	Companies Commission of Malaysia
CCS	Competition Commission of Singapore
CDE	Continuing Professional Education
CDRAC	Corporate Debt Restructuring Advisory Committee (Thailand)
CDRC	Corporate Debt Restructuring Committee (Malaysia)
CEC	Canada Employment Credit
CEFP	Council on Economic and Fiscal Policy
CEO	Chief Executive Officer
CFC	Federal Competition Commission
CFO	Chief Financial Officer
CLERP	Corporate Law Economic Reform Program
COFEMER	Mexican Commission on Regulatory Improvement
CPDG	Competition Policy and Deregulation Group
CPI	Consumer Price Index
CPP	Canada Pension Plan
EACSR	External Advisory Committee on Smart Regulation
ECE	Early Childhood Education
FLEC	Federal Law of Economic Competition
FMIP	Financial Management Improvement Program
FONACOT	Worker's Consumption Fund (Mexico)
FSA	Financial Supervisory Agency (now called the Financial Services Agency)
FTC	Fair Trade Commission
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GMIS	Government Financial Management Information Systems
GST	Goods and Services Tax
HST	Harmonized Sales Tax
ICAAT	Institute of Certified Accountants and Auditors of Thailand
ICCC	Independent Consumer and Competition Commission
IMF	International Monetary Fund
INDECOPI	Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual (Peru)
IPR	Intellectual Property Rights
JDR	Japan Depositary Receipt
JTC	Jurong Town Corporation
KBE	Knowledge-Based Economy
KCGS	Korea Corporate Governance Service
LDC	Least Developed Countries

LRTF	Ley de Responsabilidad y Transparencia Fiscal (Peru)
MEF	Ministry of Economy and Finance
MERCOSUR	Mercado Común del Cono Sur (Southern Cone Common Market) (Peru)
MoF	Ministry of Finance
MST	Manufacturers' Sales Tax
NBC	National Broadcast Commission
NCC	National Communications Commission
NCLB	"No Child Left Behind" Act (US)
NCP	National Competition Policy
NESDB	National Economic and Social and Development Board
NFPS	Non-Financial Public Sector
NGOs	Non-Governmental Organizations
NPL	Non-Performing Loan
NTM	Non-Tariff Measure
NZX	New Zealand stock exchange
OJK	Otoritas Jasa Keuangan (Indonesia)
OMB	Office of Management and Budget
PCO	Privy Council Office
PIN	National Integrity Plan
PISA	Programme for International Student Assessment (OECD)
PPP	Public-Private Partnership
PPS	Private Pensions System
PS21	Public Service for the 21st Century
PSRC	Public Sector Reform Committee
RIA	Regulatory Impact Assessments
RIS	Regulatory Impact Statement
ROB	Registrar of Businesses
ROC	Registrar of Companies
ROSCs	Observance of Standards and Codes
RRC	Regulatory Reform Committee
SARE	Rapid System for Opening Business
SARS	Severe Acute Respiratory Syndrome
SCSC	Sub-Committee for Standards and Conformance
SEC	Securities and Exchange Commission
SELI	Strengthening Economic and Legal Infrastructure
SESC	Securities and Exchange Surveillance Commission
SOEs	State-Owned Enterprises
TAMC	Thai Asset Management Corporation
TAS	Thai Accounting Standards
TBT	Technical Barriers to Trade
TFEX	Thailand Futures' Exchange
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TVQs	Thai Vocational Qualifications
UNCITRAL	United Nations Commission on International Trade Law
VAT	Value-Added Tax
WEF	World Economic Forum
WITB	Working Income Tax Benefit
WTO	World Trade Organization
WTTC	World Tourism and Travel Corporation