

APEC STUDY CENTER



Structural Reform, Policy Institutions: The Regional and International Agenda

Columbia University, June 20, 2008

This international workshop brought together a small but high-level group of academics to explore possibilities for the structural reform of East Asian economies, divided into three panels: "Institutional Foundations for Economic Reform," "American Agendas of Structural Reform," and "The Way Forward on Structural Reform in Asia: Principles and Strategies for Regional and International Cooperation." It was the final workshop in a series of similar meetings in China, Japan, Southeast Asia, and Australia led by Peter Drysdale, Emeritus Professor of Economics and Visiting Fellow, the Crawford School of Economics and Government at The Australian National University, under the sponsorship of the East Asian Bureau of Economic Research (EABER).

Professor Drysdale undertook this project because in APEC, and especially in East Asia, there has been increasing attention paid to structural reform, especially in the business sector. These beyond-the-border policy issues gained prominence in APEC's 2005 meeting in Busan, Korea. The current goal is for APEC and regional economies to take that focus further and establish an effective regional cooperation agenda.

A new framework is needed. It is widely recognized now that most gains are not from trade negotiations but from domestic reforms. Scholars and policymakers are now trying to establish an effective regional cooperation model to take the agenda further. Thus, the structural reform initiative, although not developed significantly in APEC's 2006 meeting in Hanoi, Vietnam, was given more concrete substance in its 2007 Sydney, Australia, meeting. Participants agreed to strengthen APEC's Economic Committee and to host a ministerial meeting in Melbourne to boost structural reform initiatives. They also made a commitment to beefing up the Singapore secretariat and its analytic capacity on structural reform issues.

The research program of EABER, the co-sponsor for this workshop, has helped to inform discussion in the APEC process. This project aimed to provide input into APEC's ministerial meeting in Melbourne in August 2008.

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Regional cooperation in structural reform can assist national institutions and governments to create better policy. A major aim in many economies in the region is to reform institutions in order to enhance economic policy performance, or improve policy efficiency. This project looks at ways in which to do this under the many different circumstances present in the region.

In China, structural reform covers everything in microeconomic policy that shapes macroeconomic policy and outcomes. However, in this workshop the focus is on microstructural reform. The advanced industrial countries of APEC face problems of poor policy performance as well. Similar problems, albeit with a different nature, are faced in the United States, Australia, and Japan.

THE ISSUES DISCUSSED

Institutional Foundations for Structural Reform

The main purposes of this workshop were, first, to look at how to enhance policy efficiency, and second, to examine the suitability of the regional cooperation vehicle of APEC to pursue this objective. APEC is not the only vehicle in thinking through these issues, but it is one with very suitable features, as previous workshops have highlighted.

Both border and behind-the-border reforms are related, and there is no clear distinction—an extreme example of which is North Korea, which effectively has no border barriers but does not trade or interact externally due to its behind-the-border economic rigidities. Thus the gains from improving contestability of markets through beyond-the-border reforms are generally recognized as significantly larger than border liberalizations.

The challenge is improving policymaking institutions. In order to improve policy efficiency, transparency, an economy-wide view, and independence must all become core principles of a policymaking or policy review institution.

Institutions currently in place are a product of history and circumstance. An example is the Productivity Commission in Australia, which now promotes economic efficiency and acts as a policy review institution but evolved out of a protectionist institution in the form of a tariff board.

Institutions depend on the starting point and stages of development, and exporting off-the-shelf institutional solutions is not an option.



Peter Drysdale

The focus of domestic structural reform has to be on domestic ownership and how regional processes can help a deeply domestic agenda and processes. The politics are such that conflicts are often not those of domestic versus foreign interests, but rather incumbent interests versus new entrants into the market. Domestic politics are difficult as the gains are often dispersed and not obvious while losses are concentrated and quickly apparent.

Constructing a policy process incorporating a review institution or institutions that unite the key principles of independence, transparency, and an economy-wide view can be useful to breaking down these resistances to better policy performance. Policy reviews should not be done by the institution that is carrying out the reform, as there is an implicit interest in status quo. Increased transparency in policymaking and increased public understanding of the costs and benefits of policy intervention will clarify policy objectives, constrain vested interests, and help lift policy performance. Policy reviews can set the agenda, set the parameters and raise the level of debate, name and shame vested interests, and help marshal countervailing interests. Policy reviews and evaluations can help create coalitions for reform and can provide not only technical solutions but also packages of reform over time.

One area that has been left behind or lagging in regional debates is the services sector reforms. Trade negotiating is not suitable for services liberalization, as it entrenches special interests and does not entrench competition.

Ongoing work and the World Bank have both concluded transparency and structural reform should be at the top of government agendas for improving economic and trade efficiency.

Transparency

Transparency is very important in structural reform. The study of transparency in trade reform, for example, has had considerable amounts of empirical work done on it. One way to view transparency in trade is in the increased predictability and simplification achieved through transparent rules and regulations and increased knowledge of practices in other countries, which reduces uncertainties and creates an improved business environment. This also applies to general economic activity. In order to quantify and better understand the effects of non-transparent policies and other information asymmetries in trading, the World Bank has a continuing project on creating and measuring such indexes.

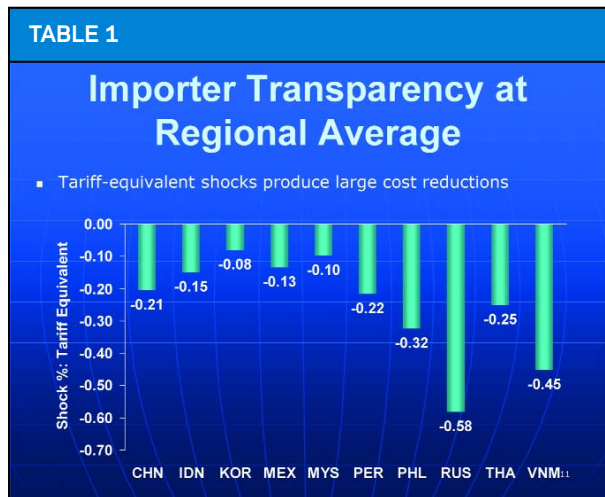
Ongoing work and the World Bank have both concluded transparency and structural reform should be at the top of government agendas for improving economic and trade efficiency. Also, it is clear that collective action matters. Recent World Bank work has shown technical change and transparency increases result in gains of up to 60 to 80 per cent. These are gains from reduced “grey market” activities and also from reductions in the dead-weight loss of inefficient institutions. Such gains result in improvements in the time to cross borders and a lowering of transactions costs.

Transparency has been an early commitment in the WTO accession process for many countries. Transparency can take the form of clearer legislation, the extent of enforcement of rules, publication of fees and other barriers, as well as transparency in the way certain important institutions operate.

Transparency, then, has a number of benefits. It reduces uncertainties that otherwise can act as the equivalent of large business or trading costs. In addition, transparency in policy-making and implementation has the benefit of being able to expose special interest groups.

Impetus for Reform

Can certain pressures in the market and pressures aimed at policymakers lead to reforms? Should the pressures come exter-



nally or domestically? These are not easy questions to answer, as there have been successful reform outcomes from external pressure, internal pressure, and crises. The most important conclusion from past experience would suggest that wherever the shocks come from, policy processes should be ready to maximize reform opportunities. Thus, it is important to figure out how to assist in the implementation of reform and policy decisions as well as ascertain how to induce reforms.

The experience of the airline industry in many countries highlights the fact that increasing pressure to open competition to domestic carriers can be a catalyst for reform. There is resistance at first, then pressures from international bodies lead to opening up, which then leads to a subsequent improvement in service from increased competition.

However, knock-on effects can start not just from international pressures but domestic pressures as well.

In Australia's reforms in the 1980s, farmers became supporters of manufacturing reforms, as assistance in manufacturing was recognized as a tax on agriculture. Manufacturers then became supporters of infrastructure and transport sector reforms,



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as they would improve the efficiency of manufacturing by reducing bottlenecks and transport costs. Reform and better performance in one area of an economy will put pressure on other areas for improvements in performance.

International pressure has worked in some situations but is not sufficient for reform. The policymaking institutions have to be ready domestically. Regulatory regimes must be effective in order to attain the maximum benefits of engaging in international competition.

The Form of Regional Assistance

There are two ways to proceed immediately. One is by reforming and strengthening the current institutions that already exist. These include the Productivity Commission in Australia, the Council of Economic and Fiscal Policy in Japan, BAPPENAS in Indonesia, and NEDA in the Philippines. There are also other mechanisms in economies around the region, such as a task force approach used in Vietnam.

The other way to improve policy performance is to make use of regional and international cooperation. This is useful for sharing experiences about technical solutions and strategies, peer pressure, and lending capacity. However, it is important to respect the outcomes of domestic political processes. The processes by which decisions are made can be second-guessed, but not the policy outcomes. A regional cooperation mechanism can help identify institutional gaps, either by a self-help approach or score-card method. Interference in a domestic process will have to be done carefully and in a nonintrusive manner—most likely an opt-in process. This is why APEC, with its voluntary, nonintrusive, and nonbinding nature, is suitable in assisting with regional assistance.

The questions are whether the APEC Economic Committee is a step toward an OECD model, and whether there are areas where APEC is useful and other areas where it is not.

This model envisions APEC giving assistance, in the form of analytic capacity, on a case-by-case basis on either country-specific issues or issues that involve groups of countries. There

will be areas where peer pressure can work, and other areas where capacity lending will be helpful. It is important to identify which is which, and it is necessary to be clear about when international institutions can and cannot help.

The external assistance should have no independent agenda itself—it will inform discussion. There is no model that fits all. The assistance will be independently and domestically initiated to borrow capacity, or else groups or subsets of countries can put up issues of common interest. A regional body can provide the necessary framework to see what binding constraints exist in each economy. Each economy will provide its own priorities, and APEC can potentially provide the framework.

The experience sharing so far has been on an ad hoc basis. The region needs to create a process so there is a mechanism to learn from other countries in order to inform national policies.

Although difficult to generalize, as policy priorities will vary from country to country, some specific areas are especially important. These include accounting standards and regulations in the distribution sector.

The regional assistance will be helping countries fight their domestic battles so there has to be buy-in from countries for this to work. This is mainly a process issue, and each country that requests assistance should be able to define the agenda and define outcomes. It should not threaten domestic ownership.

Different Approaches for Different Circumstances

Recognizing the different political circumstances of each APEC member is important. There are established democracies, new democracies, and centrally planned economies in the middle of political reform throughout the region. Each require sensitivities in approach, but all share the fact that domestic reforms require domestic ownership.

As has been the case in Indonesia, reforms often follow crises. The lesson from this is to be ready in time of crisis to act to minimize the adverse shocks and to reform effectively. This requires robust institutions that can produce high quality policy performance.

The region needs to create a process so there is a mechanism to learn from other countries in order to inform national policies.

For many countries it will be confidence building to have examples of successful external assistance. Champions for reform are also very important. This has been the case in finance in Indonesia and with Prime Minister Koizumi's reforms in Japan. These reforms were suited to those political systems, but they provide examples or "instances" showing how these reforms can work.

THE UNITED STATES EXPERIENCE

Policy analysis, policy reviews and policy ideas are mostly born from academia and think tanks in the United States. The infrastructure is the education system. Unlike most countries in East Asia, including the developed countries, there are vast resources that make this possible in the United States. Much of their research and analysis is a public good for the rest of the world.

For example, finding distributional implications of trade can inform domestic reform in the United States but also beyond. Much of the analysis in academia looking at domestic distributional issues in the United States feeds into the domestic debate.

However, there are problems with this system. Studies can be captured by interests in that funding sources and other pressures can influence research outcomes, and studies are often performed on an ad hoc basis. So there is a need for a more institutionalized and robust system.

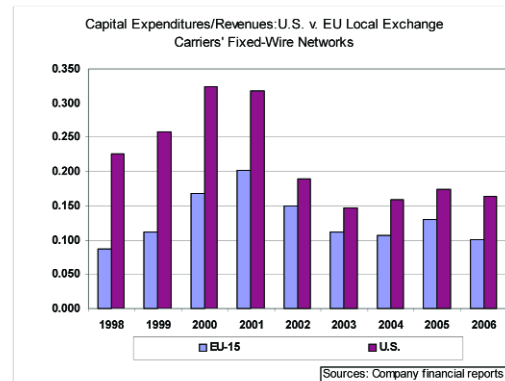
There is also a need for a system that enables other countries to draw on the huge intellectual resources in the United States effectively and systematically; at this point it is costly to transfer knowledge to the relevant forums such as APEC. Drawing together resources in the region and being able to systematically and effectively bring in outside resources are important initial exercises.

The Telecommunications Industry

Previously, liberalization in the telecommunications industry involved transforming nationally-owned telecom carriers that grew out of the postal system and telegraph system into first a national monopoly and then into efficient organizations subject to contestability from outside competitors. The United States

TABLE 2

Less Regulated U.S. Carriers Have Been Investing Far More than EU Carriers



and Canada, unlike economies in East Asia, had no such problems as telephone companies were never state-owned. Now it is very different, with technological advances rapidly changing the industry. Until recently, the competition was between fixed wire and wireless services, but now the focus is on advanced services—broadband services—with new ways of delivering large amounts of information.

This is a completely different debate. It is no longer just about having an independent regulator; rather, it is desirable to have infrastructure competition. The United States, for example, has been able to rely on infrastructure competition. The regulatory institutions for telecommunications in the United States are transparent but not independent.

Telecom liberalization was achieved not because of changes in knowledge, or because of decisions by the independent regulatory commission, or decisions by the political authorities and the Congress. Rather, it was through the federal appellate courts. In the past, appeals have been taken to court to allow entry into the telecommunications market and thus promote competition.

It is clear to policymakers that investment in information and communications are important for productivity gains. So the question is how to provide incentives to invest to build wireless and fixed wire networks? In countries without infrastructure competition, which includes most countries, what incentives are there for market dominant suppliers to invest?

The key is not in regulators getting prices right, but how to make all markets contestable at all stages of the industry. For example, the United States chose ahead of time to allow industry to decide to charge for receiving calls, not just making calls, unlike most other industries worldwide. That has meant the overall service and competition is better in the United States, as there is competition in more areas. Yet negative examples also abound. An example of bad policy in United States is subsidy programs for phones and broadband, which create vested interests. These are distortions aimed at splitting the pie differently, but better policy would be to let the pie grow bigger.

Thus, it can be seen that telecommunications is an area where there is less regulation, and infrastructure competition has produced substantial gains.

Financial Markets

Some structural reform has come out of a small number of Congressional legislative initiatives (airline and telecom deregulation, Internet tax policy). However, a far larger number have come out in response to private sector actions such as merger and acquisition (M&A) deals and venture capital takeovers.

Creating new businesses is an American strength, and an important aspect of this is the ability of universities to become nurturers of high-tech start-ups that make everybody better off: academics, graduate students, business partners, and consumers.

The New York Stock Exchange fundamentally changed because of the institutionalization of the retail investor—and this dynamic continues today. Households in the United States have large exposure to the equity market, so corporate governance and the role of the SCC in protecting individual investors is a constant pressure.

In the United States, structural reform in finance has been spurred by regulatory failure, including failure by Congress and other regulators that are now no longer in existence. Structural reform has also come about through misunderstandings between regulatory institutions and industries.

The latest subprime mortgage crisis and credit crunch were mainly due to regulatory failure stemming from nontransparency and regulators being captured by special interests or regulatory gaps in jurisdiction.

Reform Experience in the United States

Do governments learn and improve policy performance, or do reforms occur uniformly when government withdraws? This is a difficult question to answer, as it is difficult to isolate policy effects and create counterfactuals. In some circumstances, market type mechanisms such as deregulation or privatization are the most beneficial in getting government out in order to further reforms. Yet, when there is market failure, government intervention is required. The difficulty is in deciding when this is appropriate. The balance is then between government failure and market failure.

Regulatory reform has been very successful in the United States. Gains have been especially large in certain areas such as transportation, communication, finance, and energy. However, the economy continues to change, and the external environment affects these areas in a variety of ways as well, often unantici-





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pated ones. Sectors in which reforms have brought significant gains still face new problems, a very visible example being the financial industry.

One problem with reform is that there is often a focus on static gains, but what matters most are the dynamic gains. This is because gains take time to accrue and to be realized. Thus gains from reforms are often understated, while the losses are immediate and up front.

An important part of the reform process is constructing reform packages. Reform packages, or complementary reforms carried out together, are very important, as often reforms in one area will not produce ideal outcomes. The term “cabatoge” reflects the situation where one industry is deregulated but depends on another industry. However, this other industry may still be heavily regulated and fraught with inefficiencies, adversely affecting the efficient industry. This can be seen in privatized airlines and inefficient publicly owned airports, or in a deregulated trucking industry using public roads run by the public sector. In both cases, congestion is not priced and resources are not allocated where they are most productive or beneficial.

As was the case in Australian reforms, knock-on effects can happen, as many reforms are complementary. Reform packages, regulatory cooperation and coordination are important. Complementary policies are most obvious in areas such as infrastructure cooperation. Excessive regulation at an early stage of an industry’s development can have long-lasting and detrimental effects and have led to infrastructure incompatibilities, such as those in the United States as outlined above.

When opening up markets, it is important to get the right signals and incentives for capital spending and investment. One such example in the United States was realizing that it was good to lower barriers and import Japanese cars to increase competition, but better to create incentives to move capital in and increase capital formation and competition.

The microeconomics of growth has extensive interdependencies and changes over time, but the underlying driver of overall growth is technological change. The source of the technological

progress is not from the government but often from private investment. The fund-raising ability of the university sector is unique to the United States, but the United States and other economies should continue to subsidize the university sector.

The one policy that the United States has succeeded in is competition to facilitate dynamic adjustment after shocks or reforms, which has been especially apparent in previous financial crises. Competition has been the answer to past problems.

THE EAST ASIAN EXPERIENCE

Indonesia

Since the Asian financial crisis, Indonesia’s economic policymaking environment has changed in a number of important respects.

There is a weakened presidency, subject to a variety of checks and balances. Also, there is currently a disunited and weak cabinet. Members are drawn from a variety of political and technical backgrounds with vested interests—they owe allegiance to disparate power sources—and disagreements in public are not uncommon. Without strong leadership or at least a strong cabinet, initiative for reform is lacking, and the ability to carry reform through is severely limited.

Concomitantly, the legislature has become much more powerful and civil society has become much more active, further complicating the policymaking process and dynamics. This is a significant contrast to the top-down approach in earlier times in Indonesia, which was efficient in terms of implementing and carrying through policy.

The role of the bureaucracy has also changed over time. During the Soeharto era, it was an arm of the president, accountable directly to him, and subject to few pressures from the parliament and civil society. The bureaucracy continues to be a powerful organ of the state, but it is now subject to a wide range of checks and balances. The number of competing interests has increased substantially and has to be managed more purposefully.

To further complicate the reform process, the historically underdeveloped legal system has not yet been able to perform

TABLE 3

GLOBAL WELFARE EFFECTS OF APEC FREE TRADE

(Millions of U.S. Dollars and Percentages)

	Exports (U.S. \$)	Imports (U.S. \$)	Terms of Trade (%)	Welfare (U.S. \$)	Welfare (% of GDP)	Real Wage (%)	Return to Capital (%)
APEC countries							
Japan	73,916	73,916	0.7	209,736	2.8	1.2	1.3
United States	69,547	69,547	0.2	217,438	1.2	0.3	0.3
Canada	5,691	5,691	0.1	17,855	1.4	0.5	0.6
Australia	11,924	11,924	1.8	15,427	2.4	1.7	1.7
New Zealand	2,930	2,930	2.6	5,042	5.7	2.9	2.7
China	88,937	88,937	-2.3	77,988	3.8	3.5	3.0
Hong Kong	25,663	25,663	3.0	27,820	10.1	8.7	9.0
Indonesia	11,439	11,439	0.4	16,929	6.6	3.1	2.5
Korea	35,710	35,710	-0.5	47,814	6.5	5.2	5.1
Malaysia	13,236	13,236	-0.5	18,860	12.4	10.2	8.2
Philippines	6,463	6,463	-0.9	8,632	6.8	3.5	3.1
Singapore	10,415	10,415	0.7	9,216	6.5	6.3	6.7
Taiwan	23,848	23,848	-0.1	37,779	7.6	3.9	3.5
Thailand	17,094	17,094	-0.7	16,885	8.3	7.4	2.0
Vietnam	7,321	7,321	-5.1	3,225	5.6	10.9	4.5
Russia	7,461	7,461	-0.7	17,909	3.3	1.7	2.0
Mexico	5,066	5,066	-0.5	23,408	2.1	0.3	0.4
Chile	2,111	2,111	0.1	4,189	3.6	1.7	1.9
Peru	2,895	2,895	-2.4	3,877	1.7	-0.0	1.0
Non-APEC countries							
EU and EFTA	-1,708	-1,708	0.1	-6,377	-0.0	0.1	0.1
India	-918	-918	-0.2	-699	-0.1	-0.1	0.1
Rest of Asia	-509	-509	-0.3	-347	-0.1	0.1	0.2
Turkey	-405	-405	-0.0	1	0.0	0.1	0.1
Rest of Middle East	4,039	4,039	0.4	7,197	0.6	0.3	0.4
Argentina	-461	-461	-0.2	-1,105	-0.2	0.0	-0.0
Brazil	-1,065	-1,065	-0.2	80	0.0	0.1	0.2
Colombia	-21	-21	0.1	148	0.2	0.1	0.1
Uruguay	-58	-58	-0.0	-28	-0.1	0.1	0.1
Rest of Central and Latin America	-993	-993	-0.0	162	0.0	0.2	0.1
South Africa	-7	-7	0.0	748	0.4	0.3	0.4
Africa	-478	-478	0.1	562	0.1	0.1	0.1
Total	419,084	419,084		780,371			

TABLE 4

WELFARE EFFECTS OF APEC FREE TRADE AND UNILATERAL AND GLOBAL FREE TRADE

(Billions of U.S. Dollars and Percentages)

APEC Free Trade			Unilateral Free Trade			Global Free Trade		
	Welfare (U.S. \$)	(% of GDP)		Welfare (U.S. \$)	(% of GDP)		Welfare (U.S. \$)	(% of GDP)
Japan	209.7	2.83	Japan	156.3	2.11	Japan	343.3	4.63
			Global	192.9				
United States	217.4	1.21	United States	362.0	2.01	United States	619.4	3.45
			Global	474.9				
Canada	17.9	1.41	Canada	33.3	2.63	Canada	46.3	3.65
			Global	55.1				
Australia	15.4	2.42	Australia	4.7	0.74	Australia	26.4	4.15
			Global	24.8				
New Zealand	5.0	5.66	New Zealand	2.1	2.35	New Zealand	8.8	9.83
			Global	8.1				
China	78.0	3.78	China	107.1	5.19	China	131.4	6.37
			Global	253.4				
Hong Kong	27.8	10.06	Hong Kong	5.6	2.04	Hong Kong	41.1	14.86
			Global	24.6				
Indonesia	16.9	6.55	Indonesia	12.1	4.7	Indonesia	26.6	10.30
			Global	40.0				
Korea	47.8	6.48	Korea	33.8	4.59	Korea	86.2	11.68
			Global	92.2				
Malaysia	18.9	12.36	Malaysia	6.6	4.33	Malaysia	34.5	22.61
			Global	34.1				
Philippines	8.6	6.82	Philippines	7.2	5.66	Philippines	13.1	10.37
			Global	20.3				
Singapore	9.2	6.51	Singapore	1.1	0.74	Singapore	18.9	13.36
			Global	7.9				
Taiwan	37.8	7.57	Taiwan	23.6	4.73	Taiwan	55.6	11.15
			Global	60.7				
Thailand	16.9	8.32	Thailand	14.6	7.18	Thailand	30.0	14.76
			Global	52.0				
Vietnam	3.2	5.57	Vietnam	2.4	4.12	Vietnam	5.8	10.00
			Global	22.8				
Russia	17.9	3.27	Russia	24.9	4.53	Russia	41.0	7.48
			Global	83.1				
Mexico	23.4	2.12	Mexico	52.7	4.78	Mexico	59.1	5.36
			Global	64.3				
Chile	4.2	3.64	Chile	4.9	4.28	Chile	9.4	8.13
			Global	12.5				
Peru	3.9	1.74	Peru	7.1	3.17	Peru	9.7	4.33
			Global	20.8				
Global	780.4					Global	2,870.1	



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Philippa Dee



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the heavy responsibilities suddenly thrust upon it after the crisis beginning in 1997.

Finally, a major decentralization program was introduced in January 2001, shifting power and resources from the central government to the second-level districts. New developments and changes in policymaking settings take time to adjust.

Often government is treated as a single entity. However, with very fragmented institutions as in Indonesia, it is useful to distinguish different actors and to assess their effectiveness in different aspects of policy making and structural reform.

Economic ministers in general have high analytical expertise and receive low rents from poor policy, so they have less incentive to rent-seek. However, they have limited influence or authority outside macroeconomic policy. On the other hand, line ministers generally have sector-specific knowledge with incentive and authority to rent-seek.

Local governments and parliament generally have weak analytical expertise, or capacity, but both can capture high rents from bad policy with a higher degree of authority and influence.

Think tanks have little to gain from poor policy outcomes, and their analytic capacity and influence vary substantially. The media and civil society have limited analytic capacity but are influential and some have the potential to benefit from poor policy.

Due to the uneven distribution of costs and benefits of reform, it is necessary to build a good distribution mechanism to deal with the adjustment costs. However, a developing country typically has fewer resources and safety nets in place to adequately deal with adjustment costs.

Almost all reforms in Indonesia have been initiated by crises. Therefore, Indonesia needs a more systematic, sustained, and institutionalized structural reform program. However, Indonesia's experience with the IMF Structural Adjustment shows that reliance upon international frameworks to facilitate structural reform also entails some risk, especially that of popular backlash. The use of international frameworks to drive structural reform, therefore, remains a matter for careful political judgment based on domestic considerations. The APEC forum is an

appropriate venue, since commitments are made by each country voluntarily.

Japan

Japan has been promoting structural reform in the context of APEC for the last five years. Japan is the driving force behind what we call the Leaders' Agenda to Implement Structural Reform (LAISER) Project in the APEC economies. This project includes aspects of structural reform important to Japan, especially in regulatory reform, competition policy, and public sector governance.

The cumulative consumer benefits of structural reforms in Japan are estimated to have been approximately 5 per cent of GDP for the period from 1990 to 2005. The sectors that have benefited greatly are electricity, trucking, mobile telecommunications, and petroleum products. As a result, overall total factor productivity (TFP) growth also accelerated from 0.1 percent in 1995 to 0.4 percent in 2002.

The Council for Economic and Fiscal Policy in Japan started as a mechanism to strengthen the Prime Minister's ability to carry through structural reform in 2001. The Council's creation included a restructuring of the central government and benefited greatly from initiative and strong leadership in policymaking during the Koizumi government. The Council is made up of six ministers associated with economic policymaking, the Bank of Japan governor and four private sector members, two academic economists, and two CEOs of major corporations.

The Council has been successful in accelerating structural reform and improving economic and fiscal policymaking because of its transparency, economy-wide view, and integrated approach. In the case of Japan, the Ministry of Finance—responsible for fiscal policy—and the Cabinet Office's Economic and Social Research Institute were responsible for economic policy. Prior to the Council they were separated, but now, under this institutional structure, both fiscal and economic policies are discussed with cooperation in the Council.

The Council is much less effective under the weaker leadership of the Fukuda cabinet. The challenge now is to find a way to



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Roger Kubarych



Clifford Winston

strengthen the CEFP and institutionalize reforms to a greater extent.

Japan has taken part in an OECD study on the political economy of structural reform that has in part drawn on the Japanese experience. It found several factors that have encouraged reforms: a balanced government budget, a government that has been in office for a substantial amount of time, and an economy that has experienced a crisis.

China

The first generation of reforms in China involved the transfer to a market economic system, and the current reforms are aimed at deepening the markets. The current stage is much more complex, since China started its reforms without institutional foundations of market economics. Also, almost all interests benefited from the first generation of reforms and resistance was limited, whereas now it is less obvious which groups benefit and which groups lose, so policy formation and reform are more complex.

Almost every aspect of the Chinese economy and political system is undergoing reforms. The largest ones are reforms to the political system, which limits the government's involvement in the economy and markets. This is a long-term goal of the government.

The first stage of this is currently under way, with public participation, grass-roots democracy, and the transformation of government functions. These reforms are not well recognized outside China, but significant reforms are indeed under way, some of which are difficult to reverse. The government is concerned with public perception and its legitimacy, so transparency in the policymaking process is starting to take place and becoming a governmental priority at all levels. This process is not easily reversible.

The deregulation of the investment system is also under way. The current system, while significantly different from even a few years ago, is still constraining both private and public sector growth.

One development that is perhaps a step backwards is in state-owned enterprise (SOE) reform. SOEs are now very profitable and are expanding, which is making it harder to reform or privatize them. This will have to be watched closely in the near future.

Land and migration worker reform, banking and financial sector reform, and climate change mitigation are also all high priority areas for sustaining Chinese development.

Urban land is owned by the state, but rural land is owned by villages, which restricts land use. Agricultural efficiency has been hurt as a result. This illustrates the problem of regulatory gaps, which are also found in the tax and health care systems. Such regulatory gaps are found in other countries in the region with different levels of government without clear jurisdictions. They can also be found in the examples of financial and insurance market failures previously witnessed in the United States.

State banks have been in good condition, but private firms are not able to access them, and banking reform is urgently needed. Small and medium enterprises have not been able to expand, as private banks are yet to be opened.

Finally, the mitigation of climate change involves many issues and affects all aspects of the Chinese economy. One big question is what sort of policies will be taken up in terms of international trade and emissions-intensive products.

A big question is whether China's reforms are reversible. Most of the reforms are not, since they are entrenched and momentum is strong. However, some developments, such as the slowing of SOE reform due to increased economic power, have been undesirable.

In the past, external assistance has provided a driving force for reform in China. The most well-documented case is China's use of the WTO accession process to implement politically difficult domestic reforms. If external assistance is carried through effectively, it can have the effect of reducing the bargaining space for domestic vested interests.

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