

**1995  
APEC  
Economic Outlook**



**APEC Economic Committee  
November 1995**

**1995 REPORT ON THE APEC REGIONAL ECONOMY**

**PERFORMANCE, STRUCTURE, OUTLOOK AND  
CHALLENGES**

**SUMMARY**

**APEC Economic Committee**

**Coordinated by the  
Economic Planning Agency of Japan**

## Foreword

The 1995 APEC Economic Outlook was prepared by the Economic Committee for presentation to the Seventh APEC Ministerial Meeting 16-17 November 1995 in Osaka. It was coordinated by Japan with information provided by APEC member economies, and finalized at the Economic Committee meeting held on 6-8 October, prior to the Ministerial Meeting.

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## SUMMARY

As a result of the strong economic growth in recent years, the APEC region has increasingly become the center of gravity of the global economy. The region now contributes over half the world's GNP, includes the world's two largest economies, and features the world's fastest growing regional economies. The APEC developing economies, in particular, have been widely recognized as the "global center of growth". Accordingly, developments within the APEC region have become a matter of concern not only for the region itself but for the world economy as a whole.

In this regard, the APEC economic leaders' "Declaration of Common Resolve", which calls for the establishment of free and open trade and investment in the APEC region by 2010, for the industrialized economies, and by 2020, for the developing economies, is an important challenge for the region. Successful implementation of this initiative will help maintain the economic dynamism of the region, over the medium and long-term, and provide growth momentum to the global economy. The formulation of the "Action Agenda", which sets out the framework for liberalization and facilitation of trade and investment and economic and technical cooperation, is a vital step in that direction.

This report provides a backdrop to the increasing cooperation among APEC economies by providing an outline and analysis of the short- and medium-term economic outlook. It also explores the key factors explaining the region's increasing economic interdependence.

### **Recent Macroeconomic Performance and Short-term Outlook**

At the beginning of the 1990s, there was a divergence in economic performance among the economies in the region; a downturn was experienced in the industrialized economies while developing economies sustained their relatively high growth. By 1994, economic recovery was firmly established in most of the industrialized economies while the developing economies generally managed to continue their high growth without a serious

worsening of inflation. The overall trend in the region suggested, therefore, a transition to low-inflationary, sustainable growth.

Developments in 1995 have been heavily influenced by a few events, including the Mexican crisis at the end of 1994 and the major yen/dollar exchange rate fluctuations that have been experienced so far in 1995. Nevertheless, the macroeconomic outlook for the APEC region in 1995 and 1996 points toward further progress in the transition to low-inflationary, sustainable growth. In 1995, the average real growth rate for the region is expected to be 3.1 percent, only slightly lower than the 3.5 percent of the previous year. The average inflation rate for the region will remain moderate at 4.0 percent (Table 1).

#### APEC Developing Economies as a "Global Center of Growth"

The developing economies in the APEC region have maintained relatively high growth since the 1980s by, *inter alia*, attracting foreign direct investment and expanding exports. This was made possible by the adoption of policies that were conducive to growth, including policies that contributed to a stable macroeconomic environment and policies that contributed to improving the efficiency of resource allocation. The latter included domestic liberalization policies such as privatization and deregulation and outward-looking policies such as the liberalization of trade and capital movement.

The high growth of the APEC developing economies promoted economic growth in other economies, including those in the non-APEC region, by increasing imports from them and thereby stimulating production in these economies. The acknowledgment of the developing economies in the APEC region as the "global center of growth", therefore, not only recognizes their relatively high growth, it also recognizes that their economic growth tends to provide stimulus to the growth of the others.

## Deepening of Economic Interdependence

The strong macroeconomic performance of the APEC region in recent years has both facilitated, and been facilitated by, a deepening of economic interdependence within the region through growing trade and financial linkages.

In merchandise trade, the ratio of intra-regional trade to total trade rose from approximately 60 percent to 70 percent between the early 1980s and the early 1990s (Chart 2). The significant interdependence within East Asia and the Oceania sub-region and the North and Latin American sub-region is increasing, as is the interdependence between the two sub-regions. The structure of intra-regional trade, by product, in the APEC region is evolving from one that reflects “vertical” linkages in the stages of production to one that reflects “horizontal” linkages established by growing intra-industry trade.

The deepening interdependence in capital transactions can be seen in the pattern of foreign direct and portfolio investment. The share of the APEC member economies’ outward foreign direct investment flowing into other economies in the APEC region in their total outward foreign direct investment has risen between 1980 and 1992, on an accumulated stock basis, from approximately 41 percent to 51 percent (Chart 3). The rising significance of “dragon bonds” (floated in Asian markets, other than the Tokyo market) suggests a similar deepening of intra-regional interdependence in portfolio investment.

## Driving Forces Behind the Deepening of Economic Interdependence

The deepening of economic interdependence has been driven by the growth of foreign direct investment as firms internationalized their production within the region. This has not only contributed to the deepening interdependence in capital transactions, but also contributed to intensifying trade links within the region. Another driving force for the

deepening of economic interdependence has been the growth of financial flows within the region due to more liberalized investment regimes and the evolution of capital markets, particularly in the developing economies in the region. Financial integration, as such, has also been supported by the emergence of Hong Kong and Singapore as international financial centers, which not only acted as intermediaries for the region, but also encouraged the flow of investment from the non-APEC region.

The driving forces behind the deepening of economic interdependence have been a growth in trade and investment, fostered by trade liberalization, and reflecting the ability of increasingly competitive developing economies to access open export markets, and a hospitable climate for foreign and domestic investment. A characteristic pattern of economic development in the region has been the "flying geese formation" where production of labor-intensive goods has migrated progressively to emerging economies in the region, thereby promoting economic interdependence.

#### *Prospective Change in Economic Interdependence*

The deepening of economic interdependence in the region is expected to continue in the future.

First, rapid economic growth in the developing economies is increasing labor and land costs, changing the basis of their export competitiveness. In an environment of further liberalization of trade and investment and increasing competition from other liberalizing economies, these trends pose a challenge for the APEC developing economies. They need to seize the changing and expanding trade opportunities to secure their future economic growth.

Second, increases in income levels in the region have not only expanded the size of the domestic market but also have increased sophistication of consumer demand. These provide new business opportunities and promote expansion of domestic demand,

strengthening this source of economic growth.

Third, the development of domestic demand in these economies will stimulate new types of foreign direct investment in the domestic demand-oriented manufacturing industries and non-manufacturing industries aimed at securing shares of the domestic market. This is in addition to the already significant foreign direct investment in export-oriented manufacturing industries.

### **Medium-term Economic Outlook**

The prospects for sustaining the recent high growth of the APEC region over the medium-term are good. This is important not only for the region but also for the world economy as a whole.

Following the 2.7 percent average annual growth rate for the region in the first half of the 1990s, a sustained steady growth of around 3 1/2 percent is expected for the region in the five years up to the year 2000. This would result in the APEC regional economy expanding by a cumulative 20 percent over the period (Chart 4).

In the industrialized economies, growth is expected to rise from approximately 2 percent in the first half of the 1990s to approximately 3 percent in the second half. Meanwhile, the developing economies are expected to continue to enjoy high growth; a projected 6 1/4 percent in the second half of 1990s, following the 7 percent achieved in the first half of the decade.

### **Growth Potential and Relevance of Economic Interdependence**

The outlook is supported by the strong growth potential of the region. The contribution to growth from the mobilization of capital and labor can be expected to be maintained in the medium-term due to the high rates of domestic savings, increasing accessibility of foreign savings, and the large reserves of labor.



Qualitative improvements of capital and labor in the medium-term are also expected to contribute to sustained growth. Large inflows of foreign direct investment facilitate the introduction of plant and equipment embodying the latest technology, while the improvement of school education and vocational training further raise the quality of labor, for which the region has already built up an excellent reputation. Moreover, expected increases in total factor productivity should provide additional momentum to growth.

To realize the region's strong growth potential, it is essential to have an effective incentive structure in the APEC region. The fundamental driving force in this regard is provided by competition. In the APEC region, the liberalization and the deepening of economic interdependence is an important source of competition. The deepening of economic interdependence contributes to sustained growth by providing incentives to mobilize inputs, to improve their quality, and to raise total factor productivity. In this respect, implementation of the "Bogor Declaration" and realization of free and open trade and investment in the APEC region are of fundamental importance to the achievement of the region's economic potential.

#### *Medium-term Challenges for Sustained Economic Growth*

The realization of sustained economic growth in the region over the medium-term also requires that various challenges be appropriately addressed. The initiatives to address these challenges can be grouped in four categories. First, there are initiatives to seize new growth opportunities, including opening markets and introducing further competition in these areas. Second, there are initiatives to secure growth potential, including the mobilization and improvement of capital and labor, and technological transfer and innovation. Third, there are initiatives to establish foundations for future development, including the elimination of factors that might constrain future growth. Lastly, there are initiatives to secure a stable macroeconomic environment in which firms

and consumers can pursue their economic activities with minimal uncertainty.

This report highlights the growing integration within the APEC region, good prospects of strong growth over the medium-term in the context of generally low inflation, and the importance of the APEC region in the global economy. In this respect, an agreement in Osaka on an APEC Action Agenda will facilitate realization of the region's economic potential and enhance its contribution to global prosperity.

Table 1 Recent Development and Short-term Outlook <sup>1</sup>

Economies	Real GDP growth rate (%)			CPI Inflation Rate (%)			Current Account Balance (US\$ billion)		
	1994	1995	1996	1994	1995	1996	1994	1995	1996
Canada <sup>2</sup>	4.3	2.3	2.5	0.2	2.4	1.8	-24.8	-11.3	-
United States	4.1	2.8	2.3	2.6	3.0	3.2	-155.7	-	-
North America	4.1	2.8	2.3	2.4	3.0	3.1			
Chile	4.2	7.5	6.5	8.9	7.0-7.5	-	0.0	-	-
Mexico	3.5	-5.0	3	7.1	47	20-25	-28.8	-2.4	-
Latin America	3.6	-3.5	3.4	7.3	42.3	18.6			
Western Hemisphere	4.1	2.4	2.4	2.7	5.0	3.9			
China <sup>3</sup>	11.8	10.2	9.5	24.1	15.0	13.0	4.7	12.7	6.2
Hong Kong <sup>3</sup>	5.4	5.0	-	8.1	9.0	-	2.4	-	-
Japan <sup>4</sup>	0.6	2.8	-	0.4	0.9	-	12.3	11.9	-
Korea	8.4	9	7	6.2	5	5	-4.5	-8.0	-
Chinese Taipei	6.5	6.6	6.8	4.1	3.9	3.6	6.0	4.0	4.2
Northeast Asia	2.2	3.6	3.4	3.2	2.5	2.1			
Brunei	1.8	2.0	2.5	2.4	3.2	3.4	0.8	0.8	0.9
Indonesia	7.3	7.8	7.5	9.2	9.4	8.4	-3.2	-4.4	-5.3
Malaysia	9.2	8.5	-	3.2	3.5	-	-4.5	-5.5	-
Philippines	4.3	5.6-6.0	6.8-7.2	9.0	7.5	6.5	-2.9	-3.0	-2.7
Singapore	10.1	7-8	-	3.1	-	-	12.0	-	-
Thailand	8.5	8.6	8.7	5.0	5.2	5.1	-8.2	-8.9	-8.8
Southeast Asia	7.8	7.7	7.9	6.4	6.4	6.0			
Australia <sup>5</sup>	4.1	4.8	3 3/4	1.8	3.2	4	-16.8	-26.9	27.0
New Zealand <sup>6</sup>	6.2	3.5	3.5	1.8	3.5	0.5	-1.2	-0.7	-0.5
Papua New Guinea	0.8	-	-	6.1	-	-	0.3	-	-
Oceania	4.8	4.1	3.8	2.4	3.6	2.9			
Eastern Hemisphere	2.8	3.9	3.7	3.3	2.9	2.4			
APEC	3.5	3.1	3.0	2.9	4.0	3.2			

Notes: <sup>1</sup> Figures for individual economies are those provided by the authorities. Regional averages are calculated from the figures for individual economies weighted by 1993 nominal GDP. In cases where official figures are not available, forecasts by international organizations etc. (Attachment Table 1) were used for the weighted average. Fiscal year figures were also converted to calendar year figures.

<sup>2</sup> Figures for Current Account Balance are in billion Canadian dollars.

<sup>3</sup> Figures for Current Account Balance were substituted by combined visible and invisible trade balance.

<sup>4</sup> In fiscal years beginning April, and figures for Current Account Balance are in trillion yen.

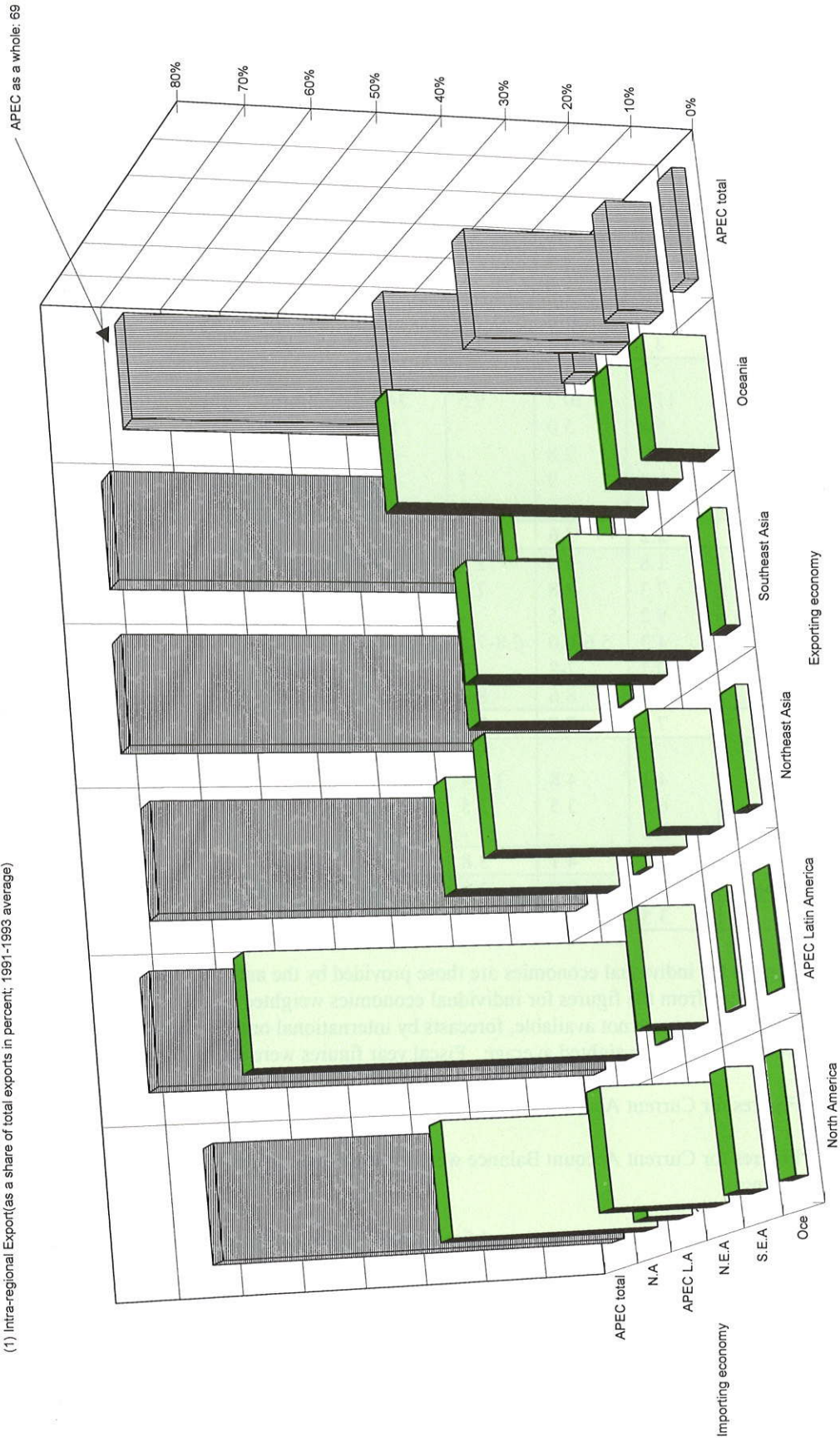
<sup>5</sup> In fiscal years beginning July of the previous years; and figures for Current Account Balance are in billion Australian dollars.

<sup>6</sup> Figures for Current Account Balance are in fiscal years beginning April (1995, 1996).

(Original table - summary of Table 1-1-3 of main text)

Chart 2 Intra-regional trade of APEC region

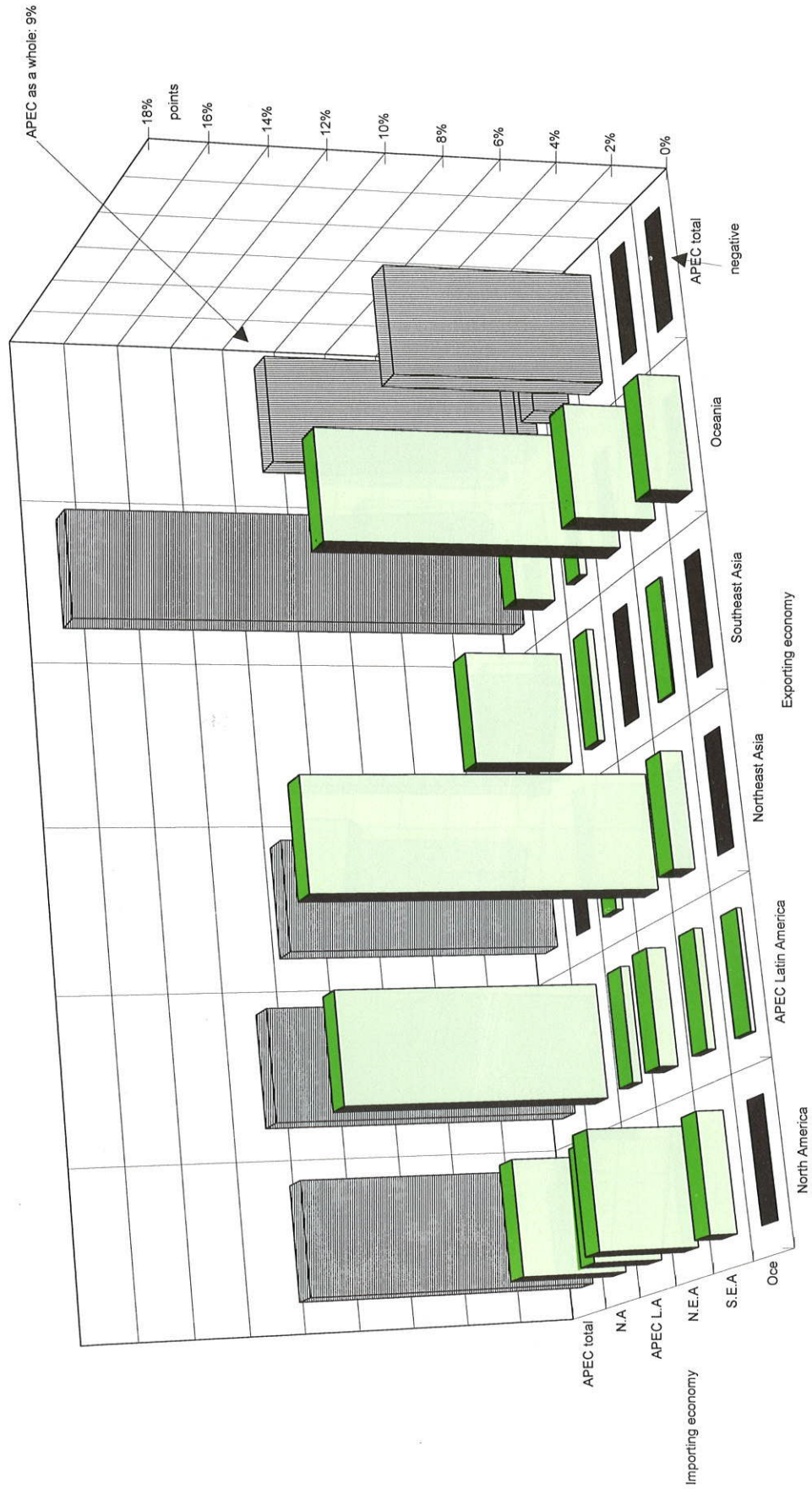
(1) Intra-regional Export(as a share of total exports in percent; 1991-1993 average)



(Source) Industry Canada compilations using data from various sources.  
 (Note) N.A.: North America, L.A.: Latin America, N.E.A.: Northeast Asia, S.E.A.: Southeast Asia, Oce: Oceania.  
 (Original chart) Chart 2-1-1 of main text.

Chart 2 Intra-regional trade of APEC region

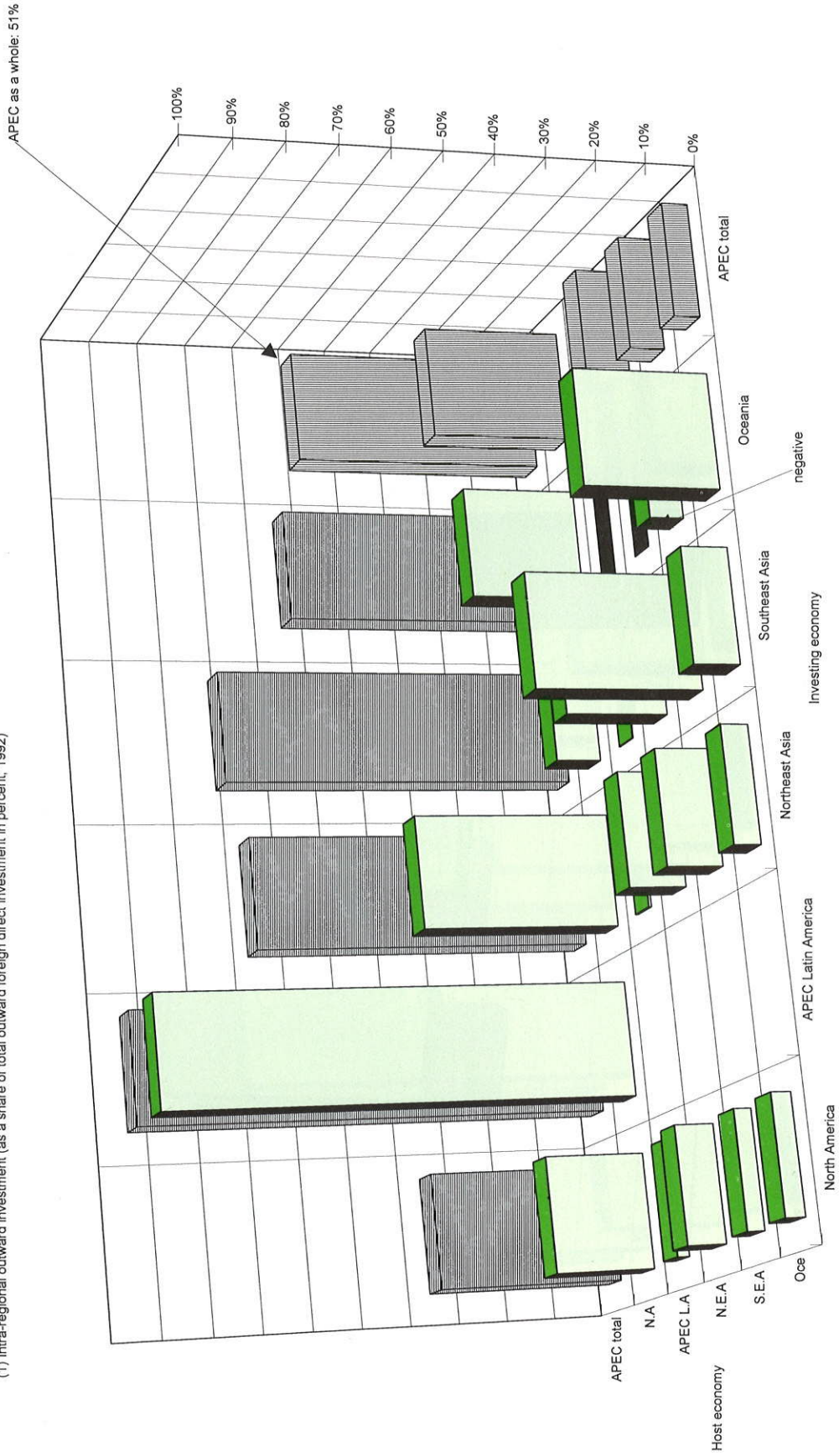
(2) Intra-regional Export (as a share of total exports in percent; change between 1981-1983 average and 1991-1993 average)



(Source) Industry Canada compilations using data from various sources.  
 (Note) N.A.: North America, L.A.: Latin America, N.E.A.: Northeast Asia, S.E.A.: Southeast Asia, Oce.: Oceania.  
 (Original chart) Chart 2-1-1 of main text.

Chart 3 Intra-regional foreign direct investment of APEC region

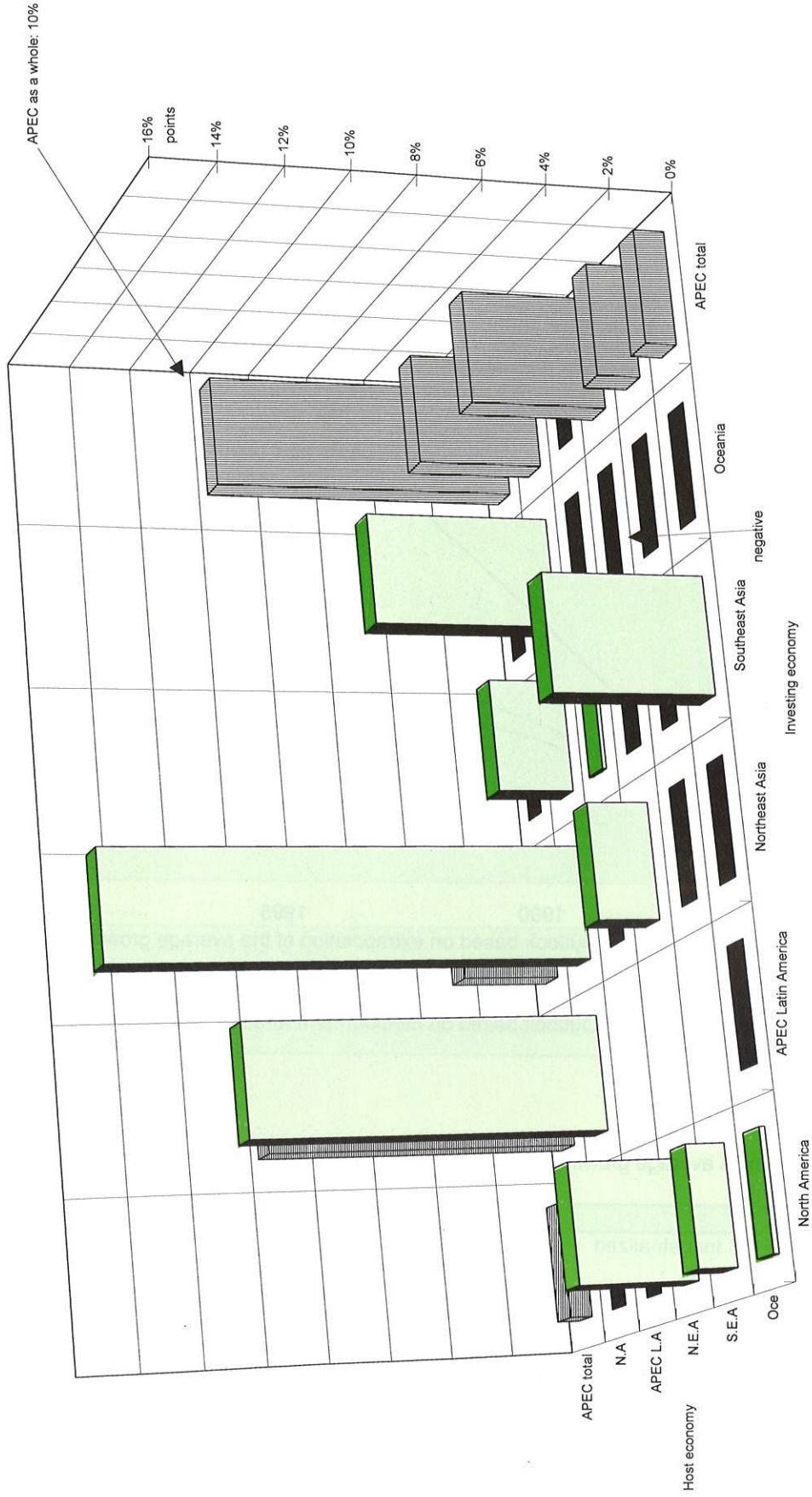
(1) Intra-regional outward foreign direct investment (as a share of total outward foreign direct investment in percent; 1992)



(Source) Industry Canada compilations using data from various sources.  
 (Note) N.A.: North America, L.A.: Latin America, N.E.A.: Northeast Asia, S.E.A.: Southeast Asia, and Oce: Oceania  
 (Original chart) Chart 2-1-10 of main text

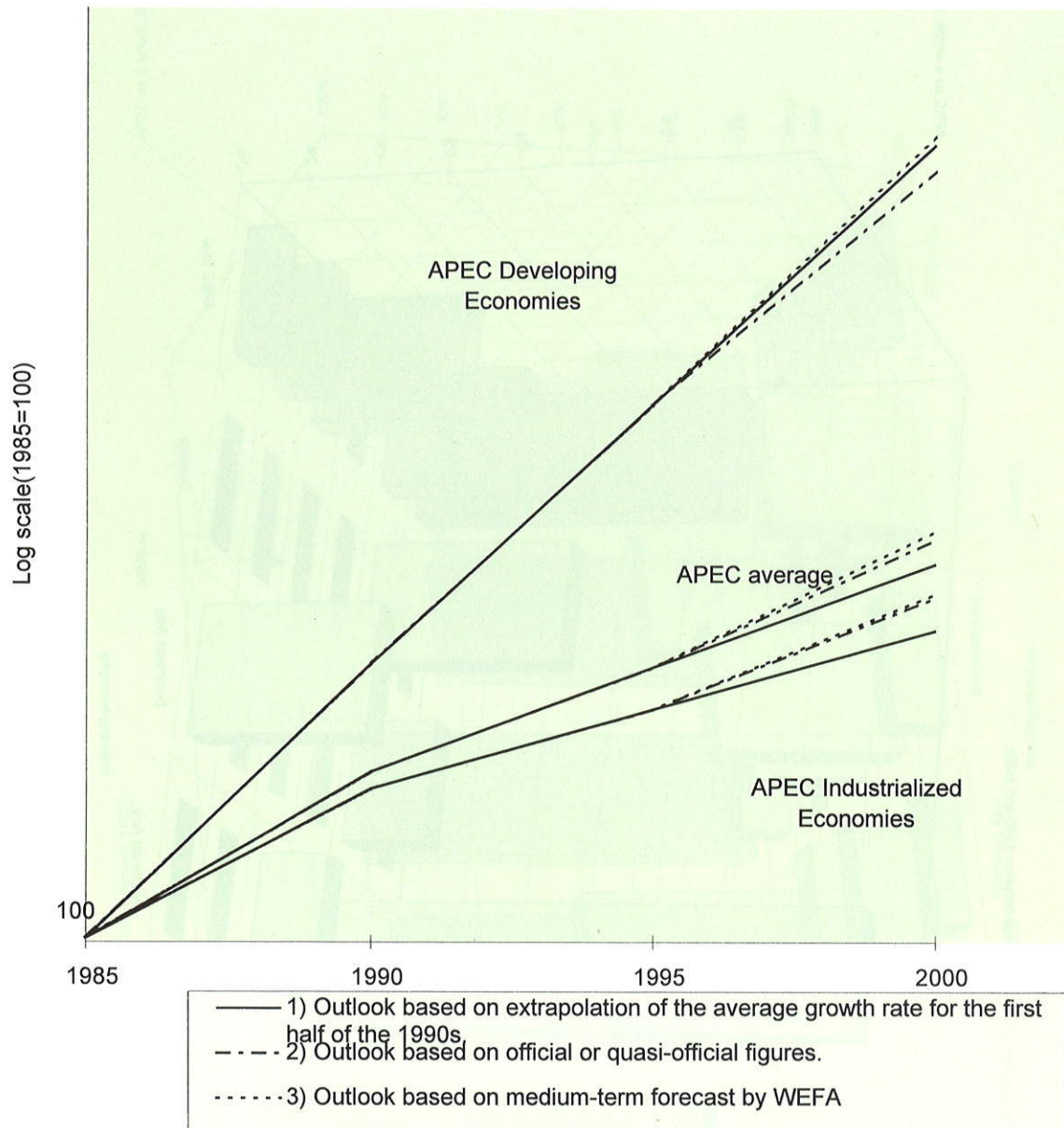
Chart 3 Intra-regional foreign direct investment of APEC region

(2) Intra-regional outward investment (as a share of total outward foreign direct investment in percent; change between 1980 and 1992)



(Source) Industry Canada compilations using data from various sources.  
 (Note) N.A.: North America, L.A.: Latin America, N.E.A.: Northeast Asia, S.E.A.: Southeast Asia, Oce: Oceania.  
 (Original chart) Chart 2-1-1 of main text

Chart 4 Simulation of medium-term economic growth



Annual average growth rates

	Annual average growth rates (%)		
	1985-90	1991-95	1996-2000
APEC Industrialized Economies	3.9	2.1	1) 2.1
			2) 2.9
			3) 3.0
APEC Developing Economies	7.3	6.9	1) 6.9
			2) 6.2
			3) 7.2
APEC Average	4.4	2.7	1) 2.7
			2) 3.4
			3) 3.6

(Original chart) Chart 3-1-3 of main text





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