

APEC Economies: Why Many Are Rich and Most of the Others Are Getting Rich

Edward C. Prescott

June 4, 2007

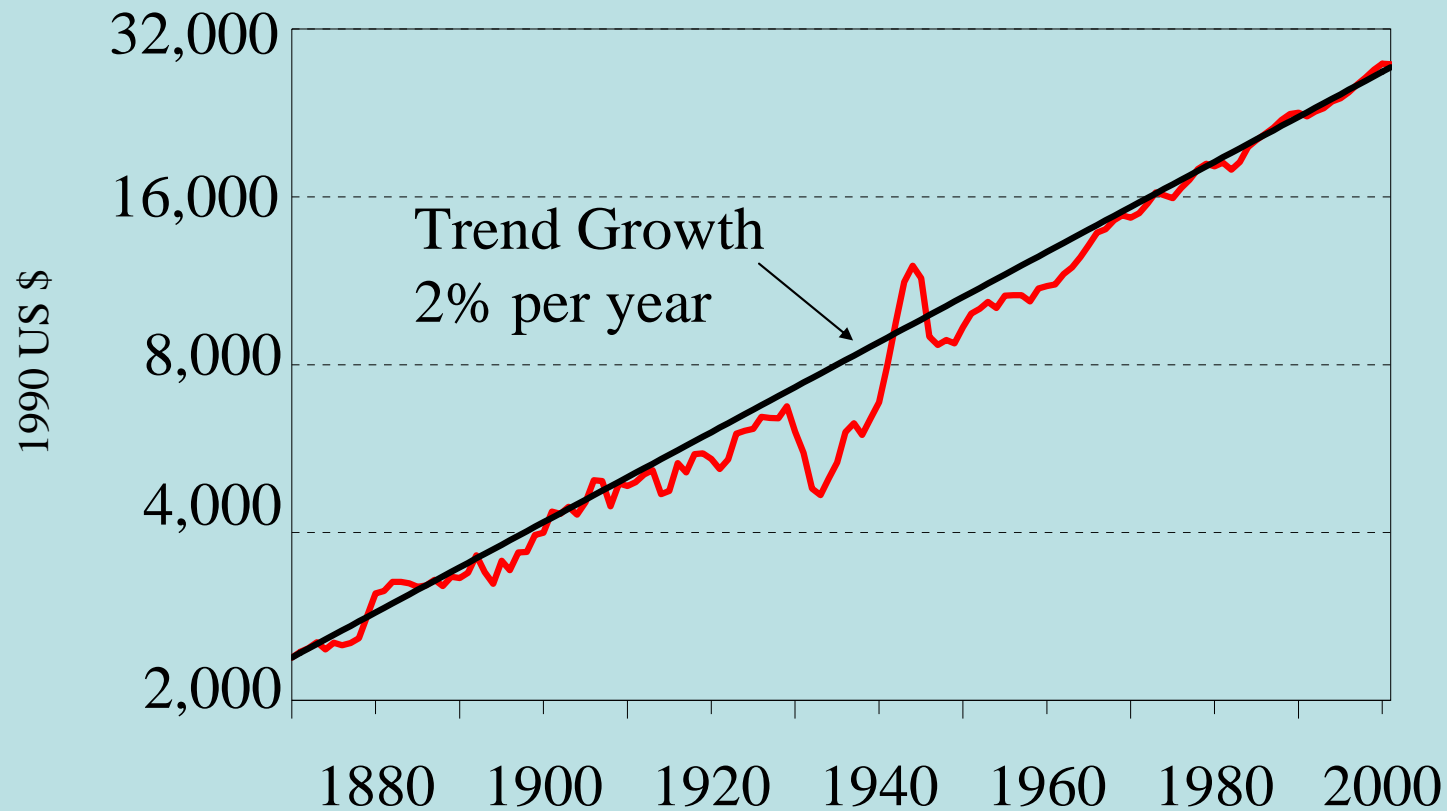
APEC Symposium on Trade Facilitation 2007

What Does Rich Mean?

- Rich is a relative concept
- Here rich means relative to industrial leader
 - I say an economy is rich if its per capita income is more than half that of the U.S.
- APEC economies
 - Have over 40% of world population
 - Have more than their share of the rich and near rich

U.S. Rich and Staying Rich

U.S. GDP per capita



Source: Maddison

Other Long-Time Rich APEC Economies

GDP per Capita, Percent of U.S.

	1955	1980	2005
Australia	74	78	80
Canada	75	87	79
New Zealand	80	66	60

New Rich APEC Economies

GDP per Capita, Percent of U.S.

	1955	1980	2005
Hong Kong	24	57	91
Singapore	22	49	81
Japan	25	72	73
Chinese Taipei	11	32	63
South Korea	11	22	57

Catching Up But Some Way to Go

GDP per Capita, Percent of U.S.

	1955	1980	2005
Malaysia	13	20	30
Thailand	9	14	26
China	5	6	18

Theory of Pre-1700 Period

- Land crucial to production
- Trade-off between living standards and population size
- Increases in stock of useable knowledge led to increase in output
- But, it was offset by population increase
- Living standards differed little across regions and time

Theory of Post-1850 Period

- No trade-off between increases in living standards and population size
- Increases in stock of useable knowledge led directly to increases in living standards
- Key features
 - Land no longer vital input into production
 - Use of fossil fuels for energy
 - Solar energy is on its way

Problem with Theory

- Why aren't all economies equally rich?
- Why didn't all start economic growth at the same time?
- Why have some caught up?
- Why are others catching up?
- And why are some others not?

Answers

- Early openers first to enter into sustained growth
 - Australia, Canada, New Zealand, and U.S.A.
- Others entered sustained growth later
- Those that opened up experienced rapid growth and became rich
 - Japan, Hong Kong, Republic of Korea, Chinese Taipei, Singapore
- Or are experiencing rapid growth
 - Malaysia, Thailand, Vietnam, China

Competition Overcomes Barriers to Riches

- If adopting more efficient work practices hurts industry insiders, barriers to their adoption arise
- No barriers arise when it helps industry insiders
- For export industries, adoption helps industry insiders
 - This is why Japanese exporters are so efficient
 - And Japanese service sector is not efficient

Free Trade Is Only a Part of Openness

- Also important is being open to foreign multinationals
- Gain by having access to foreign know-how, which I call technology capital
- Rents on this capital are only a small part of the value of what is produced by a foreign subsidiary
- Many goods and services are not tradable and must be produced locally

Openness Is a Two-Way Street

- Only with economic integration is openness between countries sustained
- Why?
- Exporters and a country's multinationals have a vested interest in their economy remaining open

FDI Gets Around Trade Restrictions

- U.S. has “voluntary car import quotas” for Japan
- To get around them, Toyota in 1985 located an automobile plant in Kentucky
- Was not blocked because
 - Construction industry wanted the construction project
 - Kentuckians wanted high paying jobs in auto plant
 - Decision made in Kentucky, not in Washington, D.C.
- The same thing happened in Wales
- Kentucky & Wales not part of an industrial heartland

Latin America Is Not Open



- Latin America is not catching up
- If it opened up it would, and it would become rich
- Chile has moved in the openness direction and has benefited

Chile Has Been Doing Well

Why?

- Retirement savings accounts lead to
 - Broad based private-ownership
 - People having an equity position in their country
- Openness policy followed

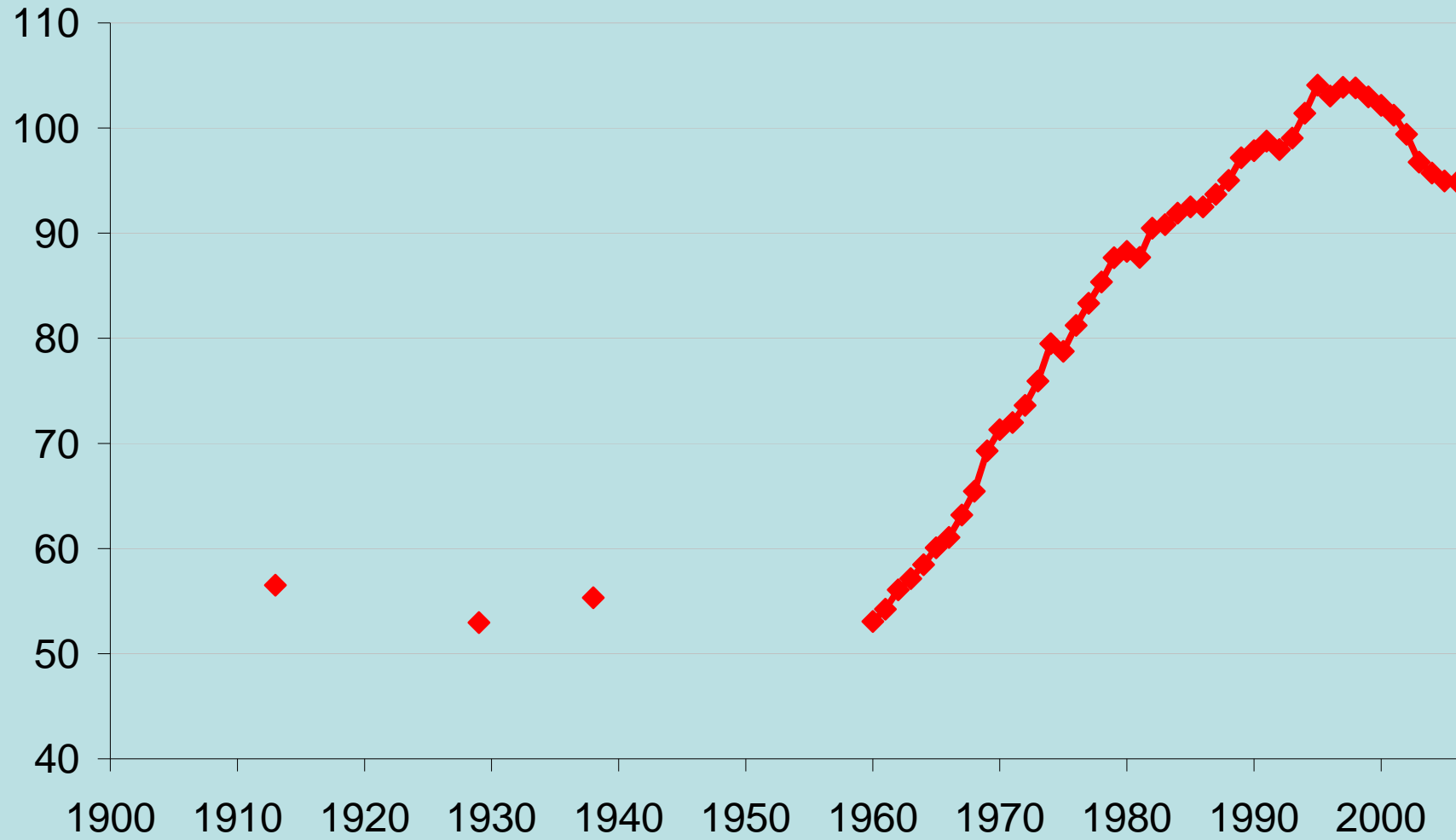
Mexico Will Do Well

- Introduced savings accounts
 - On path to broad-based private-ownership
- Mexicans beginning to invest in Mexico
- Opened up to FDI in banking and retailing, and these industries became efficient
- Making FDI in Canada and U.S.
- Takes long time to develop good economic and political institutions

EU a Success

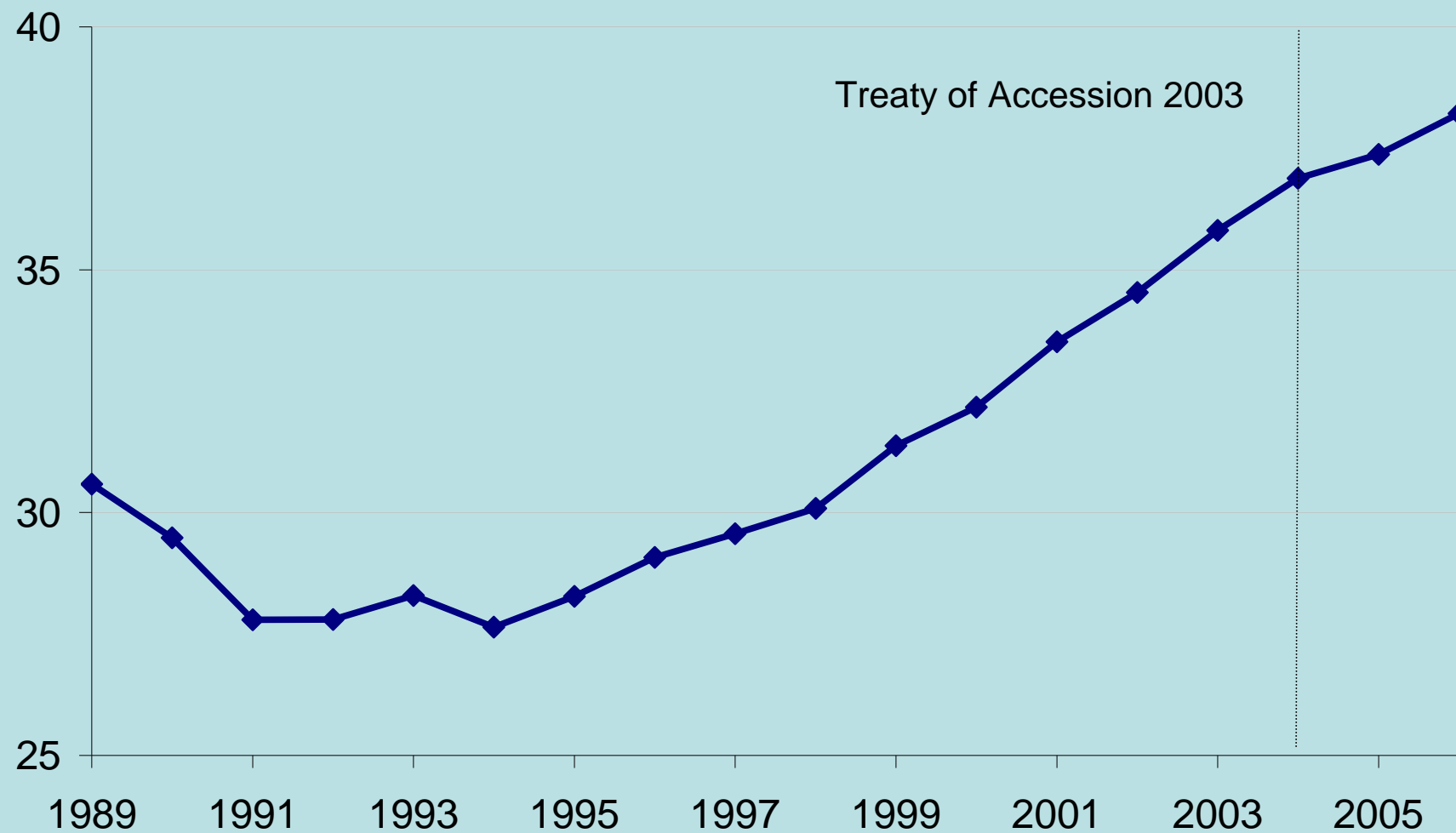
- Virtually all of pre-2004 EU countries lagged U.S. and were not catching up in the first half of the 20th Century
- Caught up in terms of productivity after forming EU
- The 2004 joiners are catching up rapidly

Original EU Members Productivity % of US 1900 - 2006



EU 6: France, Italy, West Germany, Belgium, Luxemburg, Netherlands

2004 EU Joiners Productivity % of EU-6: 1989-2006



CE-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia

Concluding Comments

- An open country becomes rich
- APEC is fostering openness
- And in the not-too-distant future most of the APEC economies will be rich