Globalization, Growth, Inequality, and Social Safety Nets in APEC Economies
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This paper examines the forward linkage between trade liberalization and economic growth, economic growth and income inequality, and income inequality and economic growth, and inequality and social safety nets. It then suggests the directions for strengthening the social safety net in APEC member economies. The paper reviews major studies in recent years and concludes that in many countries trade openness is associated with more rapid growth, and economic growth with increased inequality. In addition, it shows that inequality is harmful for growth, and social safety nets are necessary for dealing with negative effects of growth engendered by trade and investment openness.

I. APEC’S AGENDA: ECONOMIC OPENNESS AND GROWTH

The Asia-Pacific Economic Cooperation (APEC) is an organization that pursues member economies’ growth and economic prosperity through economic integration. All advanced member economies agreed to liberalize trade by 2010, and developing economies by 2020. These give rise to two questions: How is economic integration linked to economic growth and prosperity, and, why and how are the social safety nets related to economic integration and growth? These are the main topics in this paper.

Using a review of empirical studies to date, this paper will, first, show that there is a forward linkage between trade liberalization and growth, between growth and inequality, between inequality and growth, between inequality and social safety nets, and between social safety nets and growth. APEC’s agenda of globalization or economic openness promotes economic growth, but it sometimes results in worsening inequality, which is proven to be harmful for economic growth. This economic linkage, in addition to social and political reasons, justifies why social safety nets should be strengthened in those economies pursuing economic openness. Second, the paper will suggest the directions for strengthening social safety nets in APEC member economies.
The growing integration of economies and societies around the world (i.e., globalization), by means of trade, foreign investment, and migration, is a complex process, and its effects remain highly controversial. Ever since Ricardo advanced his theory of comparative advantage and the division of labor in the late 1800s, much has been said of free trade helping achieve greater efficiency, an important factor contributing to economic growth (Solow 1956). However, this is a one-time gain in allocative efficiency. In the long run, the question is whether free trade would promote higher growth rates.

Conceptually, trade liberalization can affect an economy’s growth rate by creating incentives for greater domestic investment. In addition, trade reform could encourage foreign direct investment (FDI), with attendant spillovers of advanced technologies and new business practices that increase overall productivity and growth in domestic firms (Bannister and Thugge, 2001).

There have been a number of attempts to relate trade policy variables to growth rates empirically (Frankel and Romer 1999, Sachs and Warner 1995, Dollar 1992, Edwards 1992). These studies find that trade openness is positively associated with more rapid growth.

Nevertheless, a recent study by Rodriguez and Rodrik (2000) points out that there is no clear-cut relationship between trade liberalization and growth and that the previous studies have not adequately controlled for the influences of other policies on growth. In particular, the effects of trade reform on growth depend on the existence of other complementary macroeconomic and structural policies and the creation of appropriate institutions, such as privatization, exchange rate reform, private property rights, fiscal stabilization, rule of law, etc. In other words, undertaking trade reform without implementing appropriate macroeconomic and exchange rate policies to improve competitiveness will be less effective in promoting growth.

The experience of the World Bank also confirms the positive relationship between trade and growth, and the findings of Rodriguez and Rodrik. During the period 1980-1993, the World Bank helped member countries implement macroeconomic stabilization and structural adjustment reforms. About 25 percent of the total number of conditions related to macroeconomic stabilization policies, and 40 percent consisted of measures to improve market-oriented economic development (trade liberalization, public enterprise reform, and privatization). The remaining 35 percent of the conditions were related to sector reform, with a focus on financial and agricultural sector reforms. Of the adjustors sampled by the World Bank, about two thirds implemented the suggested integrated policies, thereby reducing inflation, improving the resource balance, and stabilizing foreign exchange reserves. These adjustors also posted improved growth rates in the post-adjustment period (Jayarajah et al. 1996).

However, a more recent study finds a definitively positive relationship between international trade and growth even after taking into account the effects
of other complementary policies and measures mentioned by Rodriguez and Rodrik. A study by Dollar and Kraay (2002) using a panel data of 100 countries and four decades confirms that integrated economies tend to grow faster. Per capita income growth of the top third developing countries in terms of the increases in the ratio of trade to gross domestic product (GDP) was accelerating in the last three decades, catching up to the rich countries and leaving other developing countries much further behind. They also find strong positive effect of trade on growth even after controlling for changes in other economic policies and variables mentioned by Rodriguez and Rodrik (2000). The top one third also experienced a large increase in trade: from 16 percent of GDP to 33 percent, compared to an increase from 37 to 50 percent for the rich countries. The remaining two thirds of developing countries have actually experienced a decline in the trade to GDP ratio over the same period. The developing globalizers experienced an increase in their growth rates from 2.9 percent per year in the 1970s to 3.5 percent in the 1980s, and 5.0 percent in the 1990s, while rich country growth rates slowed down over this period from 3.1 to 2.2 percent. The average growth rate of the developing nonglobalizers declined from 3.3 percent per year in the 1970s to 0.8 percent in the 1980s, recovering to only 1.4 percent in the 1990s. The new globalizers among developing countries include People’s Republic of China (PRC), Malaysia, and Thailand in East Asia; Bangladesh and India in South Asia; and several Latin American economies such as Argentina, Brazil, and Mexico.

II. ECONOMIC GROWTH AND INEQUALITY

Economic integration opens up opportunities for the old and new globalizers, but it also creates tensions and risks, both between countries and within each of them. Between countries, globalization is now mostly reducing inequality. Among some 5 billion total developing country populations, about 3 billion people live in “newly globalizing developing countries.” During the 1990s this group grew at 5 percent per capita, compared to 2 percent for the rich countries. The average income gap between the new globalizers and the rich countries has narrowed. The number of extreme poor living on less than $1 per day in the new globalizers has declined by 120 million between 1993 and 1998 (The World Bank, 2002).

However, the gap between the rich and the new developing globalizers on the one hand and the developing nonglobalizers on the other has widened. Many poor countries with about 2 billion people have been left out of the process of globalization. Many of them are becoming marginalized in the world economy, often experiencing declining incomes and rising poverty. The least developed countries account for less than 0.5 percent of the world’s exports and receive less than 1 percent of the world’s total FDI.
Within countries, some analysts argue, globalization has not affected inequality (World Bank 2002, Fraser Institute 2002). For example, the Economic Freedom of the World Report 2002 concludes that: first, economic freedom (and therefore globalization) led to greater wealth creation than under more restrictive systems; and second, globalization did not produce marked income inequality.

The Freedom Report does confirm that economic freedom and growth are positively correlated. The most liberal economies enjoyed higher average annual growth rates (2.5 percent) than the least liberal ones (-1 percent per year) during the 1990s (see the right scale of Figure 1).

However, the conclusion on income inequality is misleading. In examining the effects of globalization, the report shows only a static situation for income and income distribution in freer economies and less free economies in the year 2000. In particular, the conclusion indicates that the poorest fifth of the population in both groups of countries received around 2-3 percent of national income in 2000. It shows neither dynamic change in income and income distribution over time, nor a comparative static situation between 1990 and 2000, when globalization accelerated.

Contrary to the conclusion, the Freedom Report does not lend any basis to debunk the argument that globalization also led to such vast inequality that the poor are excluded. This paper therefore analyzes the period 1997-2000 for which data are available from the Freedom Report. The result of the analysis shows that
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During the period 1997-2000 income distribution worsened in more liberal or open economies. During the same period, the ratio between incomes of the richest 10 percent and the poorest 10 percent of people became greater in more liberal or open economies than in more restrictive economies (from 13 to 15 times in restrictive economies versus 18 to 30 times in freer economies, respectively; see the left scale of Figure 1). This means that as globalization proceeded, income inequality worsened in more liberal or open economies than in more restrictive economies.

Another example of studies that reject any relationship between trade liberalization and inequality is “Growth is Good for the Poor” (Dollar and Kraay 2001). The paper examined the impact of growth-enhancing policies including trade reform on the income of the bottom 20 percent of the income distribution, after controlling for their impact on mean income, using a panel covering 80 countries and four decades. There is a one-to-one relationship between the growth rate of income of the poor and the growth rate of per capita income. In other words, percentage changes in incomes of the poor on average are equal to percentage changes in average national incomes. Therefore, they argue that the changes in the share of income that accrues to the poorest fifth of society are not systematically associated with the growth rate of a national economy, and all segments of society equally benefit from growth. However, the authors acknowledge that there were a lot of variations around that average relationship. Moreover, the comparison between percentage changes in average national incomes and percentage changes in incomes of the poor on average is inappropriate in terms of income distribution. The percentage changes in average national incomes and those of the poor can be the same at different income inequality levels (e.g., various Gini coefficients). The reason is akin to a case in which two countries with the same percentage changes in average per capita income can have different income distribution profiles. A more proper comparison would be between the percentage changes in incomes of the poor and the percentage changes in incomes of the rich. To the extent that the losers from trade liberalization come from the poor, the national income distribution will surely worsen unless an equal proportion of losses is made from the rich, which is highly unlikely in actuality. Since the Asian economic crisis in 1997, for example, the Government of the Republic of Korea (Korea) has opened up its economy more drastically. This liberalization has been associated with increases in the gap between the rich and the poor. During the period 1996-2000, incomes of the top 10 percent of households increased by 31.9 percent, while incomes of the poor 10 percent of households decreased by 18.7 percent (Park 2002).

Although trade liberalization raises the average standard of living in the medium term, groups that have been favored by protection will see their incomes decline, and the resulting restructuring of the economy may create economic dislocations in the short term.
This finding has also been confirmed by the experience of the World Bank. Among the countries that received World Bank assistance for implementing structural adjustment including trade reform during the period 1980-1993, only about 60 percent of the countries that adopted the right policies and reduced poverty also reduced inequality. This result was common to most low-income countries, but a few middle-income countries, such as Mexico and Thailand, have also had similar experiences (World Bank 1996).

Even in Europe and North America where economic openness originated, there have been concerns regarding social inequity. A key factor underlying this phenomenon has been increasing inequality between unskilled and skilled workers in terms of income and/or employment opportunities (Brenton 2000). A little less than one fifth of the population of the European Union (EU) still lives on less than 60 percent of national median incomes, the threshold used in the EU to identify relative poverty. Globalization may not be the only potential source of such social inequity. Technological progress has led to the automation of many of the tasks previously undertaken by unskilled workers in the industrialized countries. Popular perception, however, has been that trade liberalization and increasing flows of FDI to developing countries, coupled with improvements in transportation and communications, have resulted in products formerly produced by unskilled workers in industrial countries being increasingly purchased from low-wage countries.

Trade liberalization can affect the welfare of the poor and the income distribution within a country through the following channels of causation (Bannister and Thugge 2001):

(i) changing the prices of tradable goods and improving access to new products;
(ii) changing the relative wages of skilled and unskilled labor, and the cost of capital, thereby affecting the employment of the poor;
(iii) affecting government revenue from trade taxes and thus the government’s ability to finance programs for the poor;
(iv) changing incentives for investment and innovation, thus affecting economic growth; and
(v) affecting the vulnerability of an economy to negative external shocks.

There is an increasing awareness that some of those losing from trade reform might be the poorest members of society who have fewer assets to draw on to protect themselves during restructuring, and are thus less able to absorb adjustment costs. Even a transitory loss of income can cause the poor to lose opportunities to acquire human capital through education, health care, and better nutrition, which can reduce their chances of escaping poverty (Bannister and Thugge 2001). The vulnerability of the poor to trade liberalization justifies the
concern for the effects of trade liberalization on poverty in the short run and, therefore, deteriorating income inequality in the medium or long run.

III. INCOME INEQUALITY IS HARMFUL FOR ECONOMIC GROWTH

Concern for the adverse effects of trade liberalization on poverty and income distribution is not confined to humanitarian reasons alone. Historically, many social scientists have debated the consequences of economic integration on the development of a more peaceful world. Liberals argue that countries heavily dependent on the global economy are likely to experience higher economic growth, greater affluence, more democracy, and increasingly peaceful conditions at home and abroad. In stark contrast, most dependency theorists argue that high levels of trade and investment tend to generate greater economic inequality. The relative deprivation theory suggests that such inequality will increase the risk of political instability.

Gissinger and Gleditch (1999) sought to test the hypotheses derived from those two perspectives, using data from 96 countries for the years 1965-1993. They found that both the liberal and globalist views are partly supported by their empirical analysis. Liberals are correct in focusing on the relationship between openness and welfare (development or growth), while dependency theorists are correct in arguing that openness leads to income inequality. However, their analysis indicates that trade does not have precisely the same effect as FDI. FDI boosts inequality and political instability, while trade creates favorable conditions for peace. Moreover, their analysis shows that the types of trade are also significant. Exports of agricultural products are associated with poverty and inequality, while exports of manufactured goods go hand-in-hand with welfare and equality. This last point is similar to the finding of Spilimbergo, Londono, and Szekely (1999), who concluded that the effect of trade openness on income inequality depends on factor endowments. In particular, trade openness tends to result in more equal income distributions in skill-intensive countries than in land and capital-intensive countries. These similar findings may come from the fact that agriculture is land-intensive while manufacturing is skill-intensive.

Is inequality, then, related only to political instability? Is inequality harmful for growth as well? A group of political economists argue that the latter is true. They argue that inequality affects investment or economic growth negatively through one of the following channels: social conflicts, human capital accumulation, aggregate consumption or savings, and chances for adopting liberal economic policies.

Jeffrey Sachs (1990) postulated a hypothesis that income inequality creates social conflicts, which in turn force the government to adopt distorted macro-
economic policies, such as populism, and consequently the economic growth performance in Latin America has lagged behind, repeating the boom and bust cycle.

Jasperson (1997) reasoned differently to explain Latin America’s slow economic performance in comparison to that of East Asia. He argued that, on one hand, the severe income inequality in Latin America deprived the masses of opportunities to accumulate human capital through basic education and health, and forced the governments to adopt such inward-looking development strategies as import-substitution industrialization. East Asian countries, on the other hand, were able to make a heavy investment in human capital through basic education for the masses owing to a better income distribution system, and as a result, they could develop skill-intensive exports and an export-oriented development strategy. However, neither Sachs nor Jasperson carried out any empirical studies to confirm their hypothesis.

Others carried out simulation exercises or empirical studies to back up their argument. Kaminski and Pereira (1996), for example, found across countries that the share of aggregate consumption in GDP was inversely related to the nationwide enrollment rates at basic and secondary education levels and life expectancy, which are proxy variables for equitable income distribution. They also found that the share of aggregate consumption in GDP was positively related to political instability, which is a proxy for inequitable income distribution. They concluded that unequal income distribution in Latin America forced governments to maintain a high level of aggregate consumption, at the expense of aggregate investment, producing low growth rates, especially during the debt crisis in the 1980s.

Likewise, Persson and Tabellini (1994), using both historical panel data and postwar cross sections, show a significant and large negative relationship between inequality and economic growth in democracies. They argue that in a society where distributional conflict is important, political decisions produce economic policies that tax investment and growth-promoting activities in order to redistribute income, and thereby hampering growth since investment is a primary engine of growth.

Combining the lines of thought of Kaminsky Pereira (1996) and Persson and Tabellini (1994), Alesina and Perotti (1996) successfully test the two-stage hypothesis: first, income inequality, by fueling social discontent and unrest, increases sociopolitical instability; second, political instability, by creating uncertainty in the political-economic environment, reduces investment, and therefore growth. On a sample of 71 countries for the period 1960-1985, their test identifies an inverse relationship between income inequality and growth through a channel of political instability. Since the channel of the negative relationship between inequality and investment is political instability, this study is different from the one by Persson and Tabellini, which identifies fiscal redistribution as a channel of the inverse relationship between inequality and investment in physical capital. This
study is also different from a Kaldorian view (Kaldor 1978), which argues for a direct positive link between inequality and investment since the rich save more than the poor. The effects of fiscal redistribution and savings on investment would go in opposite directions and, in principle, they may cancel out. In fact, Alesina and Perotti do find that income distribution has little additional effect on investment after controlling for political instability.

Finally, a group of scholars argues that there are entirely economic reasons for inequality being harmful for growth—not through the channel of political instability and uncertain investment environment, but by adversely affecting the chances for making open trade policies, which have been proved promoting growth. As shown in the lobby formation model (Grossman and Helpman 1994, and Mitra, 1999), a greater inequality in asset distribution leads to greater number of lobbies and more protection. The size and number of organized lobbying groups in an economy can be determined by the income distributions, and a smaller number of big potential gainers have much greater incentive to lobby for securing more trade protection than a large number of small potential losers. In other words, a small number of rich producers can produce a greater number of lobbies in setting more trade protection than a large number of consumers. Mitra suggested that industries with large stocks of capital, more inelastic demand, fewer capital owners, and smaller geographic dispersions could be organized in equilibrium.

Using 47 cross-country data on asset and income distribution and trade openness measures during the period 1960-1995, Hwang (2002) found that both initial asset and income distributions have strong and significant impact on the formation of trade openness: a higher asset and income inequality is associated with a lower level of trade openness. The test results were robust to the inclusion of some independent variables (such as the size of the economy and population) and for various openness measures.

Many economists apparently take it for granted that global inequality is falling since poverty is declining (World Bank 2002). Others believe it is sufficient to focus on poverty, and ignore inequality. However, both of these views need to be challenged. New evidence suggests that global inequality is worsening rapidly. There are good reasons to worry about that trend now, quite apart from what it implies about the extent of world poverty (Wade 2001). Trade liberalization would promote growth in income, but would often result in increased income inequality, which in turn would hurt the growth performance of both developed and developing economies through various channels as examined above. A vicious cycle would set in from growth: engendered by globalization (openness); moving over to inequality; and then from inequality to poor growth performance; passing through a high level of political instability and aggregate consumption or a low level of basic education/health, and trade openness, or all of above; and finally from poor growth to further inequality.
At the beginning of the 1990s, the Bretton Woods institutions (World Bank and IMF) and other regional development banks placed emphasis on poverty reduction, but did not yet focus on equality and income distribution as a cause, rather than consequence, of economic growth. They have followed the tradition of Kuznets (1955) and Chenery and his colleagues (1974), who saw changes in inequality as a consequence of growth. More concern with the causes as well as the consequences of income inequality should be high on development banks’ priority research list.

IV. INCOME INEQUALITY, SOCIAL SAFETY NETS, AND GROWTH

Income inequality can be traced to many causes, such as unequal endowment of physical and human capital. However, today we are more concerned with inequality caused by free trade and foreign investment.

A natural question to ask is whether there are ways of liberalizing trade and foreign investment restrictions that might be friendlier to the poor. Firstly, there is need to designate or establish a national research unit, which will develop tools to analyze who might be the winners and losers from the reform.

Secondly, based on this analysis, the design of the trade and investment liberalization regime might be changed. It might be possible to change the breadth of liberalization and modify the sequencing of liberalization between sectors. Further still, it might be possible to set liberalization at different speeds across sectors to ameliorate the costs of adjustment. In particular, for sectors or markets where adjustment is likely to be very difficult and to take a long time, it might be possible to phase in the reform gradually, so that poor people can have more time to adjust to the new policy environment. A good example is the maize sector in the NAFTA, which was liberalized over a much longer period than other sectors because of the importance of maize farming for Mexico’s rural poor (Bannister and Thugge 2001).

Thirdly, integrated and complementary reforms should be designed to reduce the costs of adjustment and facilitate the creation of markets that will benefit the poor. Trade and investment reform cannot succeed in promoting growth if isolated from other reforms (Bannister and Thugge 2001, Rodriguez and Rodrik 2000). Complementary reforms would typically include exchange rate flexibility, privatization of public enterprises, infrastructure development, domestic markets development, and labor mobility and training promotion.

Even the best-designed trade and investment reform will create winners and losers. However, barriers and restrictions on trade and long-term capital flows are inappropriate responses to the problems of inequality. The reason is that trade and capital movements bring benefits to the economy, i.e., growth and prosperity, and there are policies that can address the issue of inequality while
preserving the gains from trade. Moreover, those policies can also reduce inequality and thereby enhance economic growth.

In order to mitigate the possible adverse effects of transitory, short-term adjustment costs on the poor and ease the tension between growth and inequality, developing countries need to have well-functioning social safety nets. Social safety nets are necessary not only to protect the losers of the liberalization policies, but also to help implement the liberalization policies themselves and other complementary adjustment programs. Without social harmony and cohesion, those programs would face serious opposition and challenges, and consequently growth will be undermined.

When a society is not well equipped with social safety nets for its people, corporate structural adjustment, for example, becomes a very controversial issue and suffers setbacks due to reactions from labor unions and those most vulnerable to the layoffs. Conversely, when a society has a strong social safety net for its people, specific programs, including employee insurance and public assistance, can provide durable livelihood protection, and employees would tend to have less apprehension concerning their own rights, and the company can execute structural adjustments comparatively easily. The result is accelerated economic growth. Past records of massive employee layoffs in the advanced countries, with a lack of accompanying protest, demonstrate this logic.

Recently there has been a number of antiglobalization demonstrations led by international NGOs at international organizations' general assembly meetings, such as those of the IMF and WTO. Demonstrators assert that globalization widens the gap between rich and poor countries. On this issue, the Organisation for Economic Co-operation and Development (OECD) has recently issued a paper stating that globalization would bring benefits to some countries and suffering to others (Kohl 2001). Thus, generalizing the effect of globalization is difficult, but it should be realized that a certain country or certain stratum within a country suffers from globalization. Hence, any investor country that benefits from the liberalization of trade and investment should pay special attention to strengthening its social safety nets in partner economies. The simple reason is that any effort seeking only short-term interests (e.g., economic openness and growth) without focusing on strengthening social safety nets will generate much more negative responses to the process of globalization than the recent reaction of NGOs.

V. DIRECTIONS FOR STRENGTHENING SOCIAL SAFETY NETS

A. Scope of Social Safety Nets

Social safety nets have been defined differently depending on scholars and international organizations; however, the core concept is fundamental. That is, the definition of social safety nets can encompass all kinds of social devices to
protect people from poverty, unemployment, disease, disaster, etc. Recently, social safety nets tend to focus on emergent situations caused by socioeconomic crisis or natural disaster. However, the definitions of social safety nets differ by some degrees between different institutions. The varied definitions can be summarized as follows.

Generally the following are considered as formal social safety net programs: social assistance; social insurance including national pension, health insurance, employment insurance, and industrial injury insurance; public works; microcredit for the poor or the unemployed; food subsidy, etc.

As is well known, many APEC member economies, especially those in East Asia, rely on informal (or traditional) social safety nets provided by the family or community. However, the informal social safety network, so heavily relied on in the past, has gradually diminished with increased industrialization and urbanization. The informal support mechanism is especially ineffective when a great number of people are similarly affected. In the shift toward modernization, the role of policy-mandated formal social safety nets is increasingly important, and the commitment of long-term public policies and their administration are serious issues. Asian countries hit by the 1997 economic crisis have social insurance schemes such as health care, workers injury compensation, and pensions. However, it is difficult to say that social insurance in Indonesia, Malaysia, Philippines, and Thailand plays a role as a social safety net due to the low ratio of insurance premium contributors to total labor force or to total population.

The social assistance system is one type of social safety net. More prevalent social assistance programs in Asian countries are price control and food or nutrition subsidies, which could protect the purchasing power of vulnerable households for essentials. Also, free or low-priced textbooks, and student loans or subsidies for tertiary education are frequently used policy tools contributing to basic human resource security. During a period of emergency, free shelter and meals for those temporarily affected are necessary interim relief. Ancillary social service provisions are also included as a type of social safety net. Those with responsibility to care for family members (most often women) still may not be able to enter the labor market. Making available childcare services and long-term care facilities at affordable prices are strategies for responding to the change in family structure in the modern labor market. Furthermore, job-related programs such as training programs for job transitions, making available employment information, and extending credit lines for farmers or small and micro enterprises are included as types of social safety nets, and these are effective in coping with changes in the structure of industry. Public works play a safety net role by conferring transfer and stabilization benefits to the poor.
B. Social Safety Net Activities in APEC

The 1997 Asian economic crisis provided an opportunity for the APEC member economies to realize the importance of social safety nets, because many people were adversely affected by the economic crisis (Lee 1999).

Since then, many member economies have learned that economic reform cannot be achieved without lessening the current problems of poverty and inequality. They came to consider that social safety nets are necessary for dealing with those problems, and that strengthening of the social safety net programs is essential to cope with the crisis, which may occur again unexpectedly.

However, they also learned that it is very difficult to enhance social safety nets in a short period of time. Although social safety nets of the APEC member economies have been reinforced to some degrees with the support from international organizations and through bilateral cooperation, a systematic and consistent establishment of a new system or reform of the existing systems is inevitable and required for a long-term. Under this premise, strengthening social safety nets within the APEC is given top priority.

The first collective initiative on social safety nets was launched at the APEC Economic Leaders Meeting in November 1998. Since then, a number of initiatives and proposals have taken place in various fora within APEC (ECOTECH, Ad Hoc Task Force on Strengthening APEC Social Safety Net, and HRD Working Group, among others), as well as collectively with other regional and international organizations. In accordance with the 2001 APEC Ministers’ Meeting agreement to strengthen the social safety net activities in the APEC region, the APEC Social Safety Net Capacity Building Network (APEC SSN CBN) was established in early 2002 and the Korea Institute of Health and Social Affairs was selected to serve as the Head Institution. Subsequently, at the Senior Official Meeting in 2002, it was agreed that the APEC/SSN CBN should address the following six issues on a priority basis:

(i) pre-crisis social safety net planning and preventive measures;
(ii) capacity building for evaluating effectiveness of policy action;
(iii) collecting disaggregated data and access to current data;
(iv) identifying at-risk populations;
(v) designing response institutions and financing; and
(vi) strengthening transparency and accountability in social safety net operations.

Also, at the APEC Social Safety Net International Meeting held in Seoul, Korea on 25-26 July 2002, participants discussed ways to strengthen SSNs in APEC member economies. On the basis of such discussions, APEC economies should strengthen their social safety nets as follows.
1. Expanded Concept of Social Safety Nets

One of the major thrusts of the discussion at the meeting was to conceive the future activities of the SSN in a broader sense to cushion the impact of structural adjustment caused by trade and investment liberalization. Along this line, complementary programs, such as an active labor market policy and a temporary income subsidy program, should also be considered as globalization-related social safety net programs.

As globalization agenda are broadened and deepened, the concept of social safety nets in APEC economies should also be defined more broadly. First, in the short run, compensatory policies and social assistance programs can be designed to help the losers, especially the poor, to deal with the transition costs of adjustment and to benefit from the new open trade and investment regime.

Second, in the medium term, public spending on social services, such as basic education, primary health, and nutrition, should be strengthened to expand the coverage of their services and improve their efficiency. Basic social services serve as an effective social safety net, and therefore expenditures for basic social services should be protected. During economic crisis, malnutrition may rise and children may drop out of school, limiting their ability to emerge from poverty in the future. Moreover, earlier experience with crisis situations suggests that during a period of crisis the poor tend to cut back on their consumption of basic social services primarily because their incomes have been reduced. This suggests that basic public social services should be protected during times of crisis. Targeting human development programs like Mexico’s PROGRESA program have proved to be successful in Latin America. These programs transfer income in cash or in kind to poor households with a condition that their children undertake productivity-enhancing activities such as school attendance and hospital visits.

Thirdly, in the long run, the social security and productive welfare system should be developed in a comprehensive manner to cushion negative shocks from a global economy. It is both inefficient and impractical to protect the poor who are vulnerable to the adverse effects of trade and investment liberalization, relying mainly on emergent social assistance programs or temporary compensatory programs in the long run. Planning and organization of social assistance programs in anticipation of negative external shocks is both imperfect and time-consuming. The state of art does not permit precise forecasts of external shocks. In addition, collection of data and designing of social assistance programs usually require substantive lead-time and emergency funds. Even when the adjustment shocks are anticipated, people would not have a sense of security or social protection if they have to rely on social assistance programs, which are not legally binding. In the long run, member economies would require a more comprehensive and reliable social security system in a global economy.
2. Planning and Management Capacity

For successful economic growth engendered by trade and investment liberalization, certain conditions are prerequisites. An adequate social safety net should be established with optimal budget and administrative infrastructure for targeting and delivery, and capacity for monitoring, system management, and evaluation. However, this has not been done so far in most developing countries for various reasons. Park et al. (2001) pointed out corruption, lack of transparency, and leakage of funds as core problems that stand in the way of fair and equitable delivery of social safety net programs. These are often deeply ingrained and interrelated in a country and difficult to address. Transparency in implementation of social safety net programs is critical and often reveals some leakage of budget. The leakage of funds does not necessarily originate from the lack of transparency or presence of corruption alone; it can be a result of mis-targeting, low capacity of management, insufficient preparedness, and misled public spending priorities.

As a means of enhancing the efficiency of service delivery, some argue for the use of diverse executing agencies, at central and local levels, and public and private levels, since it will generate competition for state funds and bypass existing ineffective state bureaucracy. Others see the suggestion, however, as amounting to a disavowal of traditional social responsibilities of a state. Involvement of diverse agencies in the implementation process is surely an effective alternative. However, there should be a leading agency to coordinate and control them.

Participation of diverse agencies, especially of civil societies in social safety nets has faced stiff opposition by the social ministries of member economies. However, participation by local organizations in the design and implementation processes is one sure way to ensure that resources are used effectively, efficiently, equitably, and in keeping with local needs. It has been argued further that enabling NGOs to demand and execute projects helps build their capacities and enhances their chances to make other demands on the state on behalf of their constituents, especially the poor. Where beneficiaries’ participation in the design and operation of social safety nets is not allowed, they may fail to reach the poor, or even undermine those organizations of the poor that already operate in this field (Ortiz 2001).

One way to address the complicated problems, such as corruption, lack of transparency, and leakage of funds, would be to enable civil societies to participate as watchdogs in the entire decision-making process of social safety net design and delivery. To this end, civil societies should be trained in best practices and problem-solving through practical hands-on exercises.
3. Collection of Data

To better design and implement safety net programs, reliable data is needed on who the poor are and where they are. In addition, information should be collected on whether they are part of the intended vulnerable group. In targeting populations with low income, it is necessary to have national criteria for eligibility established by a nationwide survey of the minimum living cost and a measure to identify individual or household income. However, even though a poverty line is established, surveying individual or household income from self-employment or the informal sector is difficult in most developing countries. The self-employed and those working in the informal sector often under-report their income, and their proportion to total population is relatively high in these countries.

To ensure cost-effectiveness and sustainability, social safety net programs have to undergo improvements in targeting; however, means-tested targeting presents major difficulty and is often inadequate. In conjunction with the means tests, other approaches should be considered such as categorical and geographic targeting, community-based targeting, and proxy means-tested targeting (Blomquist 2001). The problems of mis-targeting and exclusion of the poor—which are closely related to low capacity of management—can be mitigated through more investment in capacity building of civil servants in charge of social safety net programs.

4. Monitoring and Evaluation

In order to help inform policymakers in programmatic tradeoffs, as well as to improve the design and implementation of individual schemes, safety net programs should be systematically and rigorously evaluated in terms of targeting efficiency, cost-effectiveness, and coverage. Many social safety net programs that have been adopted by member economies have served as general subsidy programs benefiting both poor and rich groups, rather than focusing on the poor, and are much more costly. Good examples are food price subsidy or support programs and food rationing programs. A food coupon program, which allows the recipients to purchase foods at private stores proved to be less costly, administratively easier, and promote private markets more (e.g., Torti-bonos in Mexico and food coupons in Honduras). Credit-based livelihood programs are well targeted, but government nonfinancial agencies and public corporations have crowded out the private sector credit institutions by providing nontransparent subsidies to the poor directly. The social investment fund should ensure that beneficiaries actually participate in the construction of physical or social infrastructure, rather than simply benefiting from the use of the infrastructure, so that only the poor get the benefits. The pension and health insurance systems have focused on the relatively higher income groups and have excluded lower and marginal income earners. They do
not serve as a good safety net unless the system expands their coverage. None of the Asia-Pacific member economies has yet adopted an unemployment insurance system except for Korea. This system would serve as a more cost-effective social safety net, as it has the feature of self-targeting and automatically stabilizing the economy.

Periodic evaluation of the effectiveness of social safety net programs in meeting program goals should be given high priority. Mexico’s PROGRESA program is a good example. It is undergoing a formal impact evaluation with external evaluators. Many APEC member economies have carried out some form of program monitoring and evaluation, but these efforts have not always been timely or sufficiently comprehensive. Dissemination of the results of impact evaluations could help raise awareness of the cost-effectiveness of the social safety net and to increase the accountability and political support for successful programs.

5. **Capacity Building through International Cooperation**

As a measure to mitigate the effect of external shocks on member economies’ domestic areas, a series of APEC reports has already emphasized the importance of strengthening social safety nets. Moreover, as the best way to strengthen social safety nets, capacity building has been repeatedly proposed.

Major shortcomings of the social safety nets in APEC member economies hit by the 1997 economic crisis resulted from mistargeting or exclusion of the poor, lack of poverty monitoring systems and program evaluation systems, poor governance, low capacity of management, fund misallocation, and inefficient welfare delivery system, among others. These areas should be focused and prioritized as the programs of capacity building.

An effective way of building capacity in each member economy is to exchange information on the best practices and the lessons learned from each member economy’s experiences through international cooperation. A good example is the Australian activities through AusAid for some East Asian economies such as Thailand and Vietnam. Also, currently a number of international financial organizations including the World Bank, ADB, and ADBI contribute to the international cooperation projects.

VI. **CONCLUSIONS**

This paper examined the link between openness (through the means of trade and foreign investment liberalization) and growth, and has found that openness has invariably led to faster growth in both developed and developing countries. However, the paper also observed that growth, engendered by openness, has often aggravated poverty and inequality, which in turn has adversely
affected the growth performance of many economies, especially in democratic societies.

APEC’s agenda of economic openness will therefore most likely lead to economic growth, but will not automatically bring forth social development, more egalitarian societies, and sustained economic growth in member economies. Special attention should be given to inequality issues. Incidence of short-term economic dislocations or losers due to the economic openness policies should be prevented or compensated with public policies and funds, so that they can also benefit from the economic restructuring in the long run. If not, short-term losers will likely become long-term losers, and economic restructuring will not be implemented successfully or will likely result in other economic and social ills, such as worsening inequality. There is strong economic evidence that equity promotes sustained growth, generating a virtuous circle of economic and social development of APEC economies.

To ameliorate the negative effects of international trade and foreign investment liberalization, several possible lines of policy action in the short, medium, and long-term perspectives were presented. Strengthening the social safety net is an effective approach to mitigate the negative effects of poverty and inequality generated by the liberalization policies. The paper suggested the policy direction for strengthening social safety nets in developing members of the APEC. The policy direction should cover not only short-term or temporary social assistance programs, but should also develop sound medium-term public social spending programs and a long-term productive welfare system including social security programs.

The debates and empirical analyses presented in this paper have yielded seemingly solid and firmly established analytical and policy conclusions. However, it is recognized that those debates and empirical analyses have been based on macroeconomic data (i.e., national income and its components, savings and investments, exports and imports); labor markets; poverty; and income distribution data, which are fraught with potentially serious pitfalls. They suffer from serious conceptual problems, measurement biases, and errors, and lack of intertemporal and international comparability (Srinivasan 1994, Fields 1994). Moreover, those conclusions are subject to the inference that has been made about the causality from statistical associations among endogenous behavioral variables in the presence of the measurement problems. Continuous efforts should be made to improve the development economics data and analytical tools, and their application to the topics discussed in this paper.
REFERENCES


