



Asia POLICY  
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REPORT

# Charting a Course for Trade and Economic Integration in the Asia-Pacific

Independent Commission on Trade Policy



# Charting a Course for Trade and Economic Integration in the Asia-Pacific

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**A REPORT OF THE ASIA SOCIETY POLICY INSTITUTE  
INDEPENDENT COMMISSION ON TRADE POLICY**



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# CONTENTS

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Abbreviations	6
Membership Key	7
Figures and Tables	8
Foreword	9
Preface and Acknowledgments	11
Executive Summary	12
1. A Changing Trade Landscape	15
1.1 Five Key Developments in Trade and Investment	
2. Expanding Trade: Challenges and Opportunities	21
2.1 Trade and Globalization: Easy Targets for Misguided Criticisms	
2.2 TPP and RCEP: Pathways for Regional Economic Integration	
2.3 Contributions of International Economic Bodies	
3. Recommendations for Advancing Regional Trade and Economic Integration	27
3.1 Advancing the TPP's Standards in the Asia-Pacific Region	
3.2 Raising RCEP's Standards	
3.3 Pursuing Complementary Opportunities for Regional Trade Liberalization	
3.4 Rebuilding Support for Trade	
4. Conclusion	34

## ABBREVIATIONS

<b>AEC</b>	ASEAN Economic Community
<b>AIIB</b>	Asian Infrastructure Investment Bank
<b>APEC</b>	Asia-Pacific Economic Cooperation
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>ASPI</b>	Asia Society Policy Institute
<b>BIT</b>	Bilateral Investment Treaty
<b>FDI</b>	Foreign Direct Investment
<b>FTA</b>	Free Trade Agreement
<b>FTAAP</b>	Free Trade Area of the Asia-Pacific
<b>IPR</b>	Intellectual Property Rights
<b>IMF</b>	International Monetary Fund
<b>ITA</b>	Information Technology Agreement
<b>G-20</b>	Group of 20
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>GDP</b>	Gross Domestic Product
<b>GVCs</b>	Global Value Chains
<b>KORUS</b>	United States-Korea Free Trade Agreement
<b>NAFTA</b>	North American Free Trade Agreement
<b>OBOR</b>	One Belt, One Road
<b>SMEs</b>	Small and Medium-Sized Enterprises
<b>SOEs</b>	State-Owned Enterprises
<b>RCEP</b>	Regional Comprehensive Economic Partnership
<b>TPP</b>	Trans-Pacific Partnership
<b>WTO</b>	World Trade Organization

## MEMBERSHIP KEY

**Association of Southeast Asian Nations (ASEAN):** Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

**Asia-Pacific Economic Cooperation (APEC):** Australia, Brunei Darussalam, Canada, Chile, China (PRC), Hong Kong (China), Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Chinese Taipei, Thailand, United States, and Vietnam.

**Group of Twenty (G-20):** Argentina, Australia, Brazil, Canada, China (PRC), France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, and United States; plus the European Union.

**North American Free Trade Agreement (NAFTA):** Canada, Mexico, and United States.

**Pacific Alliance:** Chile, Colombia, Mexico, and Peru.

**Regional Comprehensive Economic Partnership (RCEP):** Australia, Brunei Darussalam, Cambodia, China (PRC), India, Indonesia, Japan, Republic of Korea, Lao PDR, Malaysia, Myanmar, New Zealand, Philippines, Singapore, Thailand, and Vietnam.

**\* Trans-Pacific Partnership (TPP):** Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.

\* On January 23, 2017, the United States announced its intention to withdraw from the TPP.

## FIGURES AND TABLES

<b>Figure 1:</b>	Growth of Free Trade Agreements in Asia	15
<b>Figure 2:</b>	GDP Growth Projections in the Asia-Pacific Region	16
<b>Figure 3:</b>	Five Key Developments in Trade and Investment	17
<b>Figure 4:</b>	SMEs in the Asia-Pacific: Selected Economies	19
<b>Figure 5:</b>	TPP and RCEP Membership	23
<b>Table 1:</b>	Summary of Commission Recommendations	28

# FOREWORD

**OVER THE PAST YEAR, THE GLOBAL AND REGIONAL TRADE LANDSCAPE HAS BEEN CHALLENGED AS NEVER BEFORE.** A growing number of people around the world are questioning the value of trade agreements, holding them accountable for slow wage growth, rising inequalities, and job losses. Exemplified by Brexit and the U.S. presidential election, a wave of anti-globalization has washed over the world. Further, global trade is slowing, and existing trade agreements have not kept pace with the changing nature of trade itself, owing to the increasingly important role of digital and services trades.

But trade has been one of the strongest drivers behind global growth and stability, particularly in Asia. In the past quarter century, the number of trade agreements in the region has increased dramatically. At the same time, Asian countries experienced average annual growth rates nearly 3 percent higher after liberalizing their markets.<sup>1</sup> The region's openness has been a critical ingredient in spurring growth, creating jobs, and lifting millions out of poverty. Trade has also helped nations develop stronger ties, giving them a greater stake in one another's economic success and reducing the likelihood of conflict. What the French philosopher Montesquieu wrote during the eighteenth century remains as relevant in the twenty-first: "Peace is a natural effect of trade."<sup>2</sup>

The course of trade is at a crossroads. The United States recently withdrew from the Trans-Pacific Partnership (TPP), a high-standard trade deal that would bring together 12 Asia-Pacific countries that represent nearly 40 percent of global GDP. This means that TPP, in its current form, will not enter into force. This backlash against trade and globalization is not unique to the United States; this is happening elsewhere around the globe. But just because the United States is now less supportive of trade and globalization does not mean that the rest of the world will follow suit. Those who do not participate in trade liberalization and the pursuant reforms are likely to be left by the wayside.

Should protectionism and isolationism prevail, the Asia-Pacific region could become less open and integrated, upsetting the regional economic and security balance. There is an opportunity to chart a better course. With the right policies that tackle these areas of concern, coupled with high-standard trade agreements that address emerging opportunities, such as the rise of digital trade and the integration of small and medium-sized enterprises (SMEs) into the global economy, Asia's growth can continue benefiting the world.

In light of these high stakes, the Asia Society Policy Institute (ASPI) established an Independent Commission on Trade Policy to examine the current state of play and potential opportunities and challenges ahead and offer practical recommendations for policy makers. Under the chairmanship of Wendy Cutler, Vice President of ASPI and former Acting Deputy U.S. Trade Representative, the Commission is composed of seven senior trade experts from across the Asia-Pacific, in line with ASPI's mandate to prominently feature voices and perspectives from the region. Combining decades of experience leading trade negotiations and years of academic expertise, the Commission Members are uniquely qualified to assess the current trends and prospects for greater trade, investment, and economic integration in the Asia-Pacific.

With this in mind, in the following pages, the Commission makes a number of pragmatic recommendations that aim to promote high standards and inclusiveness in trade agreements, drive forward regional economic integration, build support for trade agreements by better communicating their benefits, and work with multilateral fora to help assuage the concerns of those who may be disenfranchised by trade and globalization.

Such a valuable endeavor would not have been possible without the support of many people. The Commission's work was informed by consultations with public and private stakeholders throughout the Asia-Pacific region. It has benefited from the research and analysis of a wide range of scholars from academia, think tanks, and multilateral institutions.

In particular, I want to express my appreciation to the Hinrich Foundation for its generous support of this project. Hinrich Foundation founder Merle A. Hinrich and his extremely capable team provided outstanding assistance to the Commission, for which I am grateful.

I also want to congratulate the coauthors of this report for their dedicated efforts and wisdom. Commission Members Choi Seokyoung, Wendy Cutler, Gregory Domingo, Peter Grey, Shotaro Oshima, Mari Pangestu, and Wang Yong integrated diverse perspectives from across the Asia-Pacific into a truly compelling series of recommendations to chart the course of trade in this critical region.

As President of the Asia Society Policy Institute, an organization that seeks to build figurative bridges, I believe that trade agreements can play an instrumental role in advancing growth, development, and regional integration, leading to a more peaceful and prosperous Asia and world. But I am concerned with where we find ourselves today. My hope is that policy makers will heed the valuable advice presented in this report. With the right policies in place, Asia-Pacific economies, inclusive of the United States, can rise together, bringing greater growth and stability to the world. It's my belief that this report will make a useful contribution to this end.

**The Honorable Kevin Rudd**

President, Asia Society Policy Institute  
26<sup>th</sup> Prime Minister of Australia

# PREFACE AND ACKNOWLEDGMENTS

**LAUNCHED IN MARCH 2016, THE ASIA SOCIETY POLICY INSTITUTE INDEPENDENT COMMISSION ON TRADE POLICY** was created to explore key Asia-Pacific trade and investment initiatives and their resulting challenges and offer recommendations on a viable path forward. This report is the culmination of that effort.

Much has changed across the trade landscape since we started this project. The most salient development is an increasingly difficult political environment for trade. Skepticism about the benefits of trade has become stronger and more vocal, exemplified by the January 2017 exit of the United States from the Trans-Pacific Partnership. But these sentiments are exclusive neither to the United States nor to trade agreements. Indeed, people around the world have expressed anxieties about the ramifications of trade and globalization, and the income inequalities they are perceived to perpetuate.

Nevertheless, the Commission Members believe it is important to reassert that trade can be a force for good by promoting economic growth, creating jobs, reducing poverty, and advancing much-needed domestic reforms to modernize and open economies. Affirming that regional trade agreements are the best path forward to liberalize trade and raise standards, the Commission Members offer a compelling series of recommendations to regional policy makers to advance and rebuild public support for high-standard trade liberalization.

I am extraordinarily fortunate to chair such an esteemed Commission. Composed of seven senior trade experts from the Asia-Pacific, the Commission is a uniquely qualified group with a depth and diversity of experience, having collectively worked on trade policy as negotiators, researchers, and stakeholders for decades. After a year of lively deliberation and careful consideration, our work constitutes a true Asia-Pacific consensus on a path forward for regional economic integration.

I am also grateful for the considerable research and editorial assistance from colleagues within and outside of ASPI. In particular, I would like to thank ASPI Program Officers Alison Angoff and Jacob Bell for their work coordinating this project, as well as Jay Chittooran and Jonathan Hillman for their drafting support.

Further, this report has benefited from consultations with a wide array of former government officials, thought leaders, and other stakeholders across the Asia-Pacific. This report incorporates their wide-ranging inputs, for which I am deeply appreciative.

I am hopeful that this report, representing a newly formed consensus of perspectives from across the Asia-Pacific, can serve as a guiding light for policy makers in the region to work toward further economic integration and broad-based prosperity amid a fog of uncertainty.

## **Wendy Cutler**

Vice President and Managing Director, Washington, D.C. Office  
Asia Society Policy Institute

## EXECUTIVE SUMMARY

**THE RECENT U.S. WITHDRAWAL FROM THE TRANS-PACIFIC PARTNERSHIP (TPP) SHOOK THE ASIA-PACIFIC REGION.** It has prompted governments and stakeholders across the region to question why the United States walked away from an agreement offering substantial economic and strategic benefits. But it was not entirely unexpected. Indeed, the U.S. presidential election illuminated widespread skepticism about the benefits of trade agreements, as well as a broader backlash against trade and globalization—perceived causes of job losses, stagnant wages, and income inequalities. Meanwhile, global growth remains slow and uneven—both between and within countries. According to the International Monetary Fund, the global economy is projected to grow only 3.4 percent this year, with growth having stagnated in recent years. Similarly, according to the World Trade Organization (WTO), global trade is slowing, growing only by 1.7 percent in 2016, down from 2.7 percent in 2015.

Nevertheless, the Asia-Pacific is a bright spot amid global uncertainty and tepid growth. In 2016, nine of the fifteen fastest-growing economies were in this region.<sup>3</sup> Historically, trade has been one of the strongest contributors to growth and stability, particularly in Asia. The number of trade agreements

**Regional trade agreements offer the best path forward in the Asia-Pacific region to liberalize trade, raise standards, and promote broad reforms.**

in the Asia-Pacific has quadrupled since 2000, which has enabled these countries to grow their economies, introduce much-needed reforms, and provide better livelihoods for their citizens.<sup>4</sup> Meanwhile, key economic, technological, and institutional developments are rapidly changing the very nature of trade and investment. The emergence of global value chains (GVCs), the increasing importance of services in trade, the growth of digital commerce, the link between trade and foreign direct investment, and the rise of small and medium-sized enterprises' (SMEs) engagement in the global economy are creating new economic opportunities for businesses of all sizes.

With the TPP's future uncertain as a result of the withdrawal of the United States, its largest member, and with the Regional Comprehensive Economic Partnership (RCEP) negotiations entering their fifth year, Asia's trade landscape is at a critical juncture.

## TRADE POLICY COMMISSION FINDINGS AND RECOMMENDATIONS

### The Case for Regional Trade Agreements

**In evaluating the trade and investment trends and prospects in the region and around the world, the Commission Members arrived at a central finding: regional trade agreements offer the best path forward to liberalize trade, raise standards, and promote broad reforms.** Regional agreements allow countries to simultaneously tap into a number of markets at scales often unattainable through bilateral deals. Moreover, regional agreements lend themselves to greater utilization. Having the same standards and rules for all participating countries reduces confusion and encourages businesses, especially SMEs, to take advantage of the benefits of these agreements. Further, regional trade deals, with the advent of GVCs, better reflect the way business is actually conducted. In addition, regional agreements allow more countries to be on the same page regarding complex and emerging issues, such as data flows.

Recognizing that bilateral trade agreements will remain an important feature in the global trading system, the Commission Members urge that all deals, including bilateral agreements, be comprehensive, incorporate high standards, be WTO consistent, and enumerate clear accession provisions to encourage greater regional integration. This finding serves as a central thesis around which the Commission recommends action in four areas.

**1. The Commission affirms that policy makers should, in light of the U.S. withdrawal, advance the TPP's high standards in the Asia-Pacific region.** As such, the Commission Members:

- Urge the United States to reconsider its position on the TPP, even with possible adjustments;
- Encourage countries to advance the high standards found in the TPP through unilateral reforms, other trade negotiations, and WTO activity; and
- Welcome the potential for TPP countries to bring the agreement into force without the United States, including inviting additional Asian economies to join.

**2. The Commission concludes that member countries should work hard to raise RCEP's standards.** To accomplish this, the Commission Members:

- Advise RCEP members, in line with RCEP's own principles and objectives, to negotiate a high-quality agreement and not be tempted to adopt the lowest common denominator approach; and
- Recommend RCEP parties seek substantially stronger outcomes, particularly for SMEs.

**3. The Commission concludes that countries should pursue complementary opportunities for liberalization in the Asia-Pacific region.** Accordingly, the Commission Members:

- Advocate that countries collaboratively intensify multifaceted capacity-building efforts to help developing countries raise standards, to be included in their trade agreements;
- Urge multilateral trade fora to focus their work on emerging trade issues such as digital trade, state-owned enterprises, and GVCs, noting that the Asia-Pacific Economic Cooperation (APEC) is particularly well positioned to do so; and
- Recommend countries that are interested in pursuing regional trade agreements consider establishing a stand-alone SME agreement, based largely on the relevant provisions in the TPP.

**4. The Commission affirms that policy makers must rebuild support for trade amid growing skepticism about globalization.** To this end, the Commission Members:

- Counsel governments and multilateral bodies such as the Group of 20, WTO, and APEC forum to more effectively communicate the benefits of trade agreements, using concrete terms that are meaningful to the everyday interests and concerns of ordinary people, rather than explaining broad macroeconomic impacts;
- Urge countries to proactively pursue appropriate domestic policies, including robust adjustment assistance, retraining, and education programs—which are too-often viewed as after-thoughts—in parallel with trade agreements; and
- Advocate that multilateral fora serve as hubs for policy makers to exchange ideas and collaboratively generate best practices on how to help those impacted by trade and globalization.

## CONCLUSION

In addition to slowing trade worldwide, an emerging rebuke of trade and globalization threatens the potential for growth and liberalization. While trade has been a fundamental driver of global growth, raised standards, and created opportunity—particularly in the Asia-Pacific region—its potential is not yet fully realized. These recommendations encourage countries to promote high standards in trade agreements that go well beyond WTO rules and address emerging issues; build support for trade by tapping into underutilized areas, such as SMEs; and urge multilateral fora to elevate the discussion on requisite domestic policies to help those adversely affected by trade and globalization. As the global landscape changes, so too must trade policy. The Commission Members urge policy makers not to allow today's uncertainties to overshadow tomorrow's opportunities. With global growth lagging and global trade inching along, bold action is needed.

# 1. A CHANGING TRADE LANDSCAPE

**GLOBAL GROWTH REMAINS SLOW AND UNEVEN—BOTH BETWEEN AND WITHIN COUNTRIES.** According to the International Monetary Fund (IMF), the global economy is projected to grow only 3.4 percent this year, with growth having stagnated in recent years. Advanced economies are growing a modest 1.6 percent. Emerging and developing economies are growing 4.1 percent with considerable variation across countries.<sup>5</sup> Brazil and Russia are experiencing deep recessions, for example, while China, India, and some of the Association of Southeast Asian Nations (ASEAN) economies—Indonesia, Malaysia, Philippines, Thailand, and Vietnam—are experiencing strong growth.

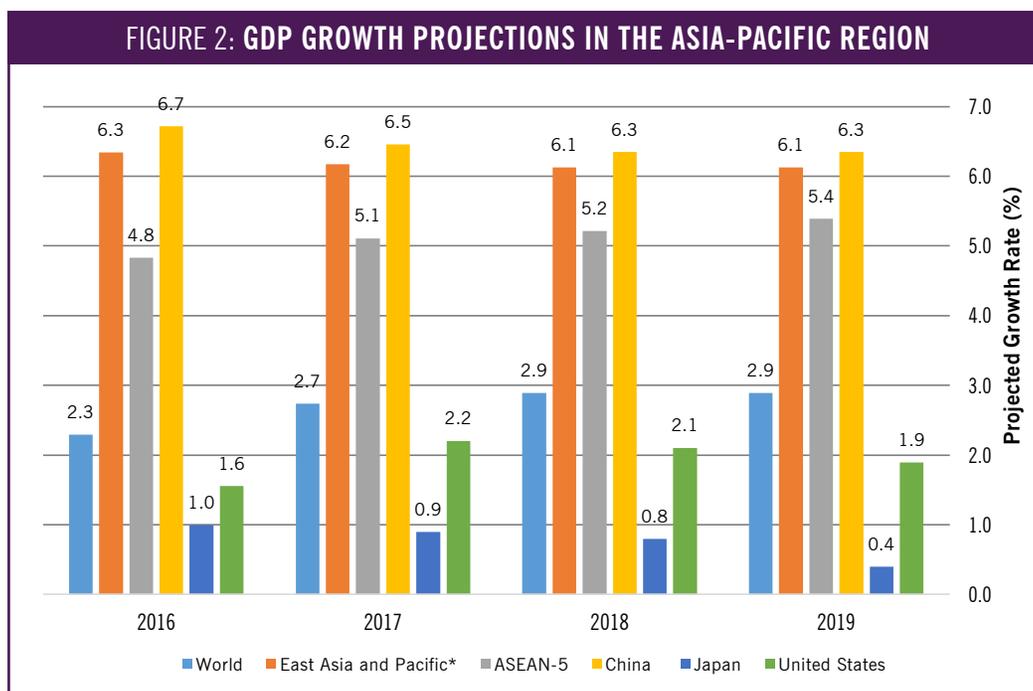
Moreover, global trade itself has been slowing. According to the World Trade Organization (WTO), global trade grew only 1.7 percent in 2016, down from 2.7 percent in 2015.<sup>6</sup> This continues a troubling trend. Between 1990 and 2007, global trade grew, on average, twice as fast as global GDP.<sup>7</sup> In the past five years, however, global trade growth has slowed, growing at roughly the same pace as global GDP.<sup>8</sup> The causes are both cyclical and structural and include (1) the economic slowdown in China; (2) the related decline in commodity trade and prices, particularly in the energy sector; (3) a persistently weak Europe; and (4) increasing reliance on domestic production.<sup>9</sup> These developments underscore the need for coordinated action to help revive global trade.

Nevertheless, the Asia-Pacific region remains a bright spot for both its recent economic growth and its untapped potential. In 2000, the region accounted for less than 30 percent of global GDP.<sup>10</sup> Today, it accounts for more than 40 percent. Asia's remarkable rise is not an accident, but the direct consequence of market-opening policies and other economic reforms, some as a result of unilateral action, others as part of commitments under trade agreements. Key among them is a greater openness to trade.



Source: Asian Development Bank. For definition of "Asia," see: "Free Trade Agreements." 2016. Asia Region Development Bank. <https://aric.adb.org/fta-country>

Between 1995 and 2013, for example, Asia-Pacific Economic Cooperation (APEC) economies' average applied tariff dropped by more than half, from 12 percent to 5.6 percent. Successive General Agreement on Tariffs and Trade (GATT) and WTO negotiations, accompanied by the accession of China and other countries, have addressed a range of non-tariff measures, including standards, licensing, and government procurement. At the same time, many behind-the-border issues are starting to be addressed, particularly in many free trade agreements (FTAs) concluded in the region, including competition policy, regulatory matters, transparency, and anti-corruption. As a result, Asian economies have benefited from the robust growth that liberalized trade and internal reforms promote.



\*For definition, please refer to The World Bank. Source: The World Bank. 2016.  
<http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>

The Asia-Pacific region will continue to drive global growth for years to come. In 2016, nine of the fifteen fastest-growing countries were in this region.<sup>11</sup> According to the IMF, the region is expected to account for nearly two-thirds of global growth in 2017.<sup>12</sup> By 2030, two-thirds of the world's middle-class consumers will live in the region. Looking out even further, one projection suggests that the region will be home to seven of the top ten fastest-growing economies between 2014 and 2050.<sup>13</sup> Greater economic integration would help increase and channel this growth in a positive direction, allowing more people to participate in, contribute to, and benefit from the region's incredible growth story. Of course, this growth is not just beneficial for the Asia-Pacific but also for the world.

## 1.1 FIVE KEY DEVELOPMENTS IN TRADE AND INVESTMENT

### Emergence of Global Value Chains

As the global economy evolves, so does the nature of trade and investment. One key development is that production is increasingly subdivided and based on tasks, forming global value chains (GVCs).<sup>14,15</sup> Even though products might be labeled as made in a single country, they may include inputs from

many others. For example, one economy might export a smartphone but only contribute a fraction of its overall value. The rest might come from designers, software engineers, chip manufacturers, and other workers based in a number of other economies.<sup>16</sup> While the advent of GVCs raises questions about the utility of bilateral trade agreements in the future, it is clear that these chains create new economic opportunities for businesses of all sizes and economies at all development stages. This allows for greater specialization around tasks, as well as leapfrogging over stages of development.

### FIGURE 3: FIVE KEY DEVELOPMENTS IN TRADE AND INVESTMENT

1. EMERGENCE OF GLOBAL VALUE CHAINS
2. THE GROWING IMPORTANCE OF TRADE IN SERVICES
3. GROWTH OF DIGITAL COMMERCE
4. LINKAGES BETWEEN INVESTMENT AND TRADE AGREEMENTS
5. SMALL AND MEDIUM-SIZED ENTERPRISES' ENGAGEMENT IN THE GLOBAL ECONOMY

However, trade agreements have not kept pace with these changes. Historically, countries have focused on moving their industries from low-end to high-end production. But as production has become more international, flows of goods and services have become more complex. Producing competitive exports requires sourcing low-cost inputs. This is a fundamental shift in how many countries approach competitiveness. To maximize their participation in GVCs, openness to trade and investment is key, and thus countries must not only lower barriers to imports and investment but also address non-tariff measures and other restrictions. Indeed, as tariffs have declined globally, non-tariff measures have increased.<sup>17</sup>

### The Growing Importance of Trade in Services

A second key development is the rise of trade in services. Enabled by advances in technology, services now account for more than 20 percent of global exports and closer to 40 percent in value-added terms.<sup>18</sup> This trend is expected to continue as production in many Asia-Pacific economies rebalances toward services. In China, for example, employment in services surpassed employment in agriculture for the first time at the start of the decade, and services now contribute half of total output.<sup>19</sup> Among APEC members, services make up approximately 67 percent of GDP.<sup>20</sup> Services are also critically important across all sectors of the economy, especially as the distinction blurs between the goods and services sectors. In the United States, nearly 20 percent of the value of manufacturing output is tied directly to services. And in some U.S. manufacturing industries, more than half of all employees work in service roles.<sup>21</sup> Furthermore, competitive inputs from the services sector are critical for participation in GVCs. Without efficient logistics services (such as transport, warehousing, and distribution), for example, trade can lag significantly.<sup>22,23</sup> Information and communications technology, finance, and knowledge-based services can have a major impact on trade flows as well.

As the line between services and goods continues to blur, trade negotiations that separate the two will increasingly become less impactful to business.

The incredible rise of trade in services has implications for both the substance and framework of trade agreements. Although a growing number of FTAs in the region include services provisions and market access commitments, there is ample room for further liberalization. According to one estimate of APEC economies, three-quarters of small and medium-sized enterprises (SMEs) are involved in services, but only a small fraction export.<sup>24,25</sup> Additionally, as the line between services and goods continues to blur, trade negotiations that separate the two will increasingly become less impactful to business. These distinctions, while used by governments, do not reflect how businesses operate. Put simply, more holistic approaches are needed as trade agreements are shaped for the future.

### **Growth of Digital Commerce**

A third key development is the rise of digital commerce. The growth of digital commerce has been particularly impressive in the Asia-Pacific region, which is now one of the world's leading e-commerce markets with nearly one-third of global transactions.<sup>26</sup> These trends will continue as mobile and Internet technologies spread. This year, mobile telephone subscriptions in the Asia-Pacific region are expected to exceed 4 billion for the first time.<sup>27</sup> By 2020, about half the region's population will have mobile Internet access. Meanwhile, more potential customers around the world are gaining access to the Internet, which is expected to expand from 2.7 billion to 5 billion users between 2015 and 2020.<sup>28</sup>

These digital trends are creating opportunities for businesses of all sizes. While SMEs often lack the capacity to navigate complex barriers to exporting, online platforms have helped level the playing field. According to eBay, the export rates of SMEs accessing these platforms exceed those in the traditional economy by at least fivefold.<sup>29</sup> Underscoring the Internet's potential to drive growth, a study by McKinsey found that SMEs utilizing the Internet for business functions grew at twice the rate of those that did not.<sup>30</sup> Looking specifically at the United States, although less than 5 percent of all SMEs export, some 97 percent of eBay commercial sellers, almost all of them SMEs, export.<sup>31</sup> Similarly, Jack Ma, founder of Alibaba, noted at the opening of his company's Australia and New Zealand headquarters the ability of globalization, in conjunction with digital commerce, to assist SMEs. These gains extend beyond the IT sector and across several sectors, including retail and manufacturing.

To help digital commerce thrive, trade agreements must strike a careful balance. New technologies have quickly outpaced the negotiation of trade agreements. Technology will continue evolving rapidly, and governments should promote an open framework, allowing free cross-border data flows while taking into account legitimate concerns about security and privacy. Unleashing digital commerce will require assessing what types of new rules, if any, are necessary, as well as refining current ones.<sup>32</sup> The Trans-Pacific Partnership (TPP) was one of the first trade negotiations that made digital trade a major feature, and the balance it strikes between ensuring openness and addressing security and privacy concerns is a model that could be considered for future agreements.<sup>33</sup>

### **Linkages between Investment and Trade Agreements**

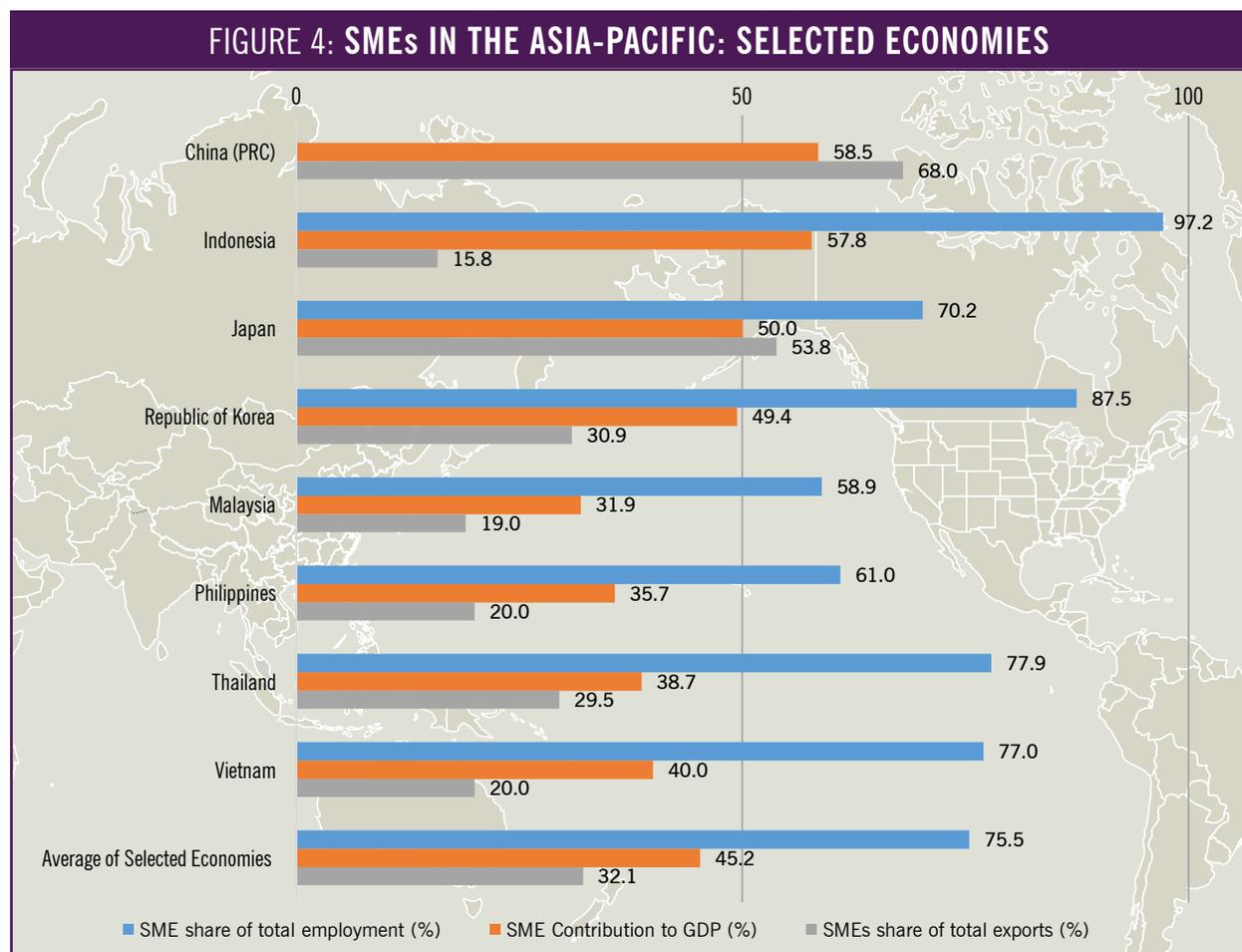
A fourth key trend is that foreign investment has linked economies to world markets and spurred competition that has stimulated domestic economic improvements among countries in Southeast and East Asia. While foreign direct investment (FDI) in the region has traditionally been concentrated among China, India, and Indonesia, this could change as countries compete for investment. This critical dimension of the regional economic landscape is occasionally overlooked in discussions about trade. In

addition, recent research shows that FDI plays a far greater role in supporting economic development than previously recognized.<sup>34</sup>

Trade agreements can play an important role in facilitating investment. A number of factors influence investment decisions by companies, including provisions of trade agreements on services, intellectual property rights (IPR), and investment protections. Trade agreements can also offer specific benefits for creating competitive global supply networks, as well as more general assurance of the overall business climate. Bilateral investment treaties (BITs) play an important role as well by promoting an environment conducive to inbound FDI. Indeed, the U.S.-China Economic and Security Review Commission noted that the conclusion of a U.S.-China BIT could have positive implications not only for the two participating economies but also for the broader region.<sup>35</sup> The literature suggests that the linkages between trade and FDI are strong. Indeed, in the United States, manufacturing is the greatest recipient of foreign investment, attracting the largest share by far—more than one-third (37.23 percent)—of total FDI inflow.<sup>36,37</sup>

### SME Engagement in the Global Economy

Finally, the landscape is changing as more SMEs engage in trade. In many Asian economies, SMEs employ the majority of workers, yet only a minority of those SMEs export.<sup>38</sup>



Note: SME employment data unavailable for China (PRC)

Sources: Asian Development Bank Institute. 2015. <https://www.imf.org/external/np/seminars/eng/2015/jica2015/pdf/1-B1.pdf>  
 Ministry of Commerce, People's Republic of China. 2012. <http://english.mofcom.gov.cn/article/zm/201205/20120508136044.html>

Meanwhile, trade agreements are beginning to incorporate substantive provisions that benefit SMEs. For example, both the TPP and the Regional Comprehensive Economic Partnership (RCEP) have chapters dedicated to SMEs, and the TPP also includes myriad provisions that benefit businesses of all sizes and are particularly meaningful for SMEs and new exporters.<sup>39</sup>

This is a useful basis on which future agreements can build. For example, in the TPP, e-commerce provisions can provide small businesses with more avenues to market their products and receive payment. Customs procedures, including expediting express shipments, raising *de minimis* thresholds, and implementing single-window systems, could remove cumbersome requirements.<sup>40</sup>

Greater regulatory transparency and more effective dissemination of information can help SMEs navigate complex trading regimes. Collectively, these measures can also address trade barriers that disproportionately impact SMEs and thereby help build critical support for trade agreements.

In sum, these trends point toward a world in which openness has never mattered more. Countries that are amenable to commerce can reap the benefits of access to better technology, less expensive inputs, and greater investment. With the proper domestic policies in place, these advantages can translate into higher productivity, wages, and growth.

## 2. EXPANDING TRADE: CHALLENGES AND OPPORTUNITIES

**IN TODAY'S LOW-GROWTH ENVIRONMENT**, the incentives for pursuing high-standards trade agreements are difficult to ignore. Under the right conditions, trade agreements can boost productivity, wages, and growth. But making the transition to greater openness is not without challenges, particularly as productivity improvements and technological advancements exacerbate domestic economic anxieties.

### 2.1 TRADE & GLOBALIZATION: EASY TARGETS FOR MISGUIDED CRITICISMS

In the current political environment, high-standards trade agreements are difficult to realize. Trade has always been a hard sell, but it has become even harder in recent years. In some countries, this stems from a growing backlash against globalization as stagnant wages and job losses have squeezed the working and middle classes. Reflecting these challenges, a recent poll found that 32 percent of Europeans and 49 percent of Americans view global economic engagement negatively.<sup>41</sup> In Japan, public support for promoting trade and investment liberalization has risen over the past two years but remains below 50 percent.<sup>42,43</sup> These concerns cannot be ignored, given that real incomes in advanced economies have stagnated over the past decade.<sup>44</sup> Rather than feeling empowered, many people feel left out from an increasingly connected world. Some have argued that Britain's vote to leave the European Union last year can in part be attributed to this phenomenon. Others have pointed to the 2016 U.S. presidential election as further proof of a rising wave of anti-globalization and anti-trade sentiments.

While trade has become an easy target for concerns about job losses and wage stagnation, this is misguided. Rather, these phenomena have been driven primarily by technological change and domestic policy choices. Manufacturing employment, for example, has declined in most major manufacturing countries during the past 25 years, with losses in Japan, Western Europe, and the United States being remarkably similar.<sup>45</sup> Since its peak in 1979, employment in the U.S. manufacturing sector has decreased by nearly 40 percent. At the same time, manufacturing output has never been higher.<sup>46</sup> The United States is producing more with fewer workers as a result of productivity gains and technological improvements.<sup>47</sup> Imposing higher tariffs and other restrictive measures will not bring these jobs back, nor will they address future disruptions from technological change. Too often, discussions about the benefits of trade are limited to exports while the gains to consumers and producers from cheaper imports are overlooked. Many observers would be surprised to learn that middle-class Americans gain more than a quarter of their purchasing power from trade. In fact, at the 50th percentile for income, trade is responsible for 29 percent of consumers' purchasing power in the United States. At the 10th percentile, that figure increases to 62 percent.<sup>48</sup> This is not a new challenge, but ignoring the import side of trade makes even less sense in the context of today's GVCs.

A closer look at public sentiment reveals a more complicated picture. For example, the majority of Americans across all income brackets say free trade agreements have been positive for the United States. Despite the U.S. exit from the TPP, a recent poll suggested that most Americans (60 percent) backed the trade deal.<sup>49</sup> Positive views of free trade agreements are even higher among young adults (67 percent) and other demographic subgroups, such as Hispanics (72 percent).<sup>50</sup>

The political dynamics in Asia are varied as well. For example, a 2015 poll found that only 38 percent of Malaysians support the TPP, although 31 percent of respondents admitted they had not heard enough to make a judgment.<sup>51</sup> The same poll found that majorities in Australia, Japan, and Vietnam, among other member countries, support the deal. Each country is also facing some internal opposition to the agreement, of course, which underscores the need to continue communicating the agreement's benefits.

**If trade becomes a scapegoat for globalization's challenges, nations risk forfeiting a powerful tool for growth and needed economic reform.**

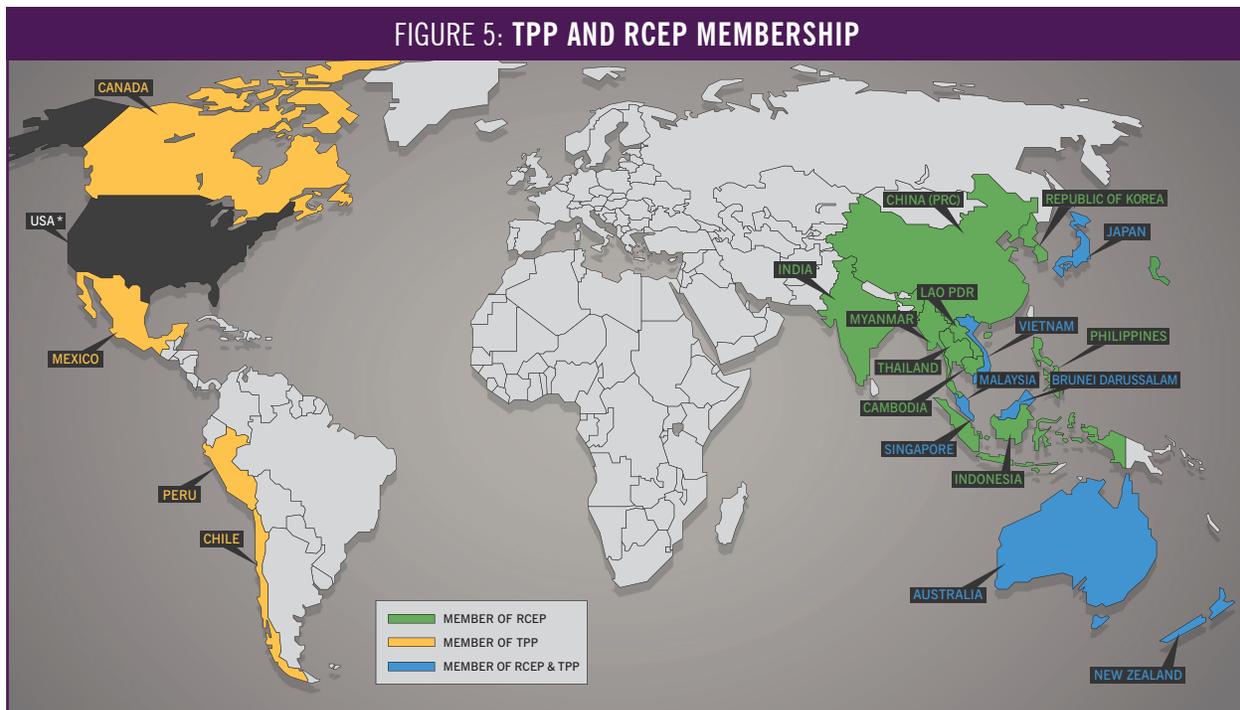
If trade becomes a scapegoat for globalization's challenges, nations risk forfeiting a powerful tool for growth and needed economic reform. Forward-leaning trade policies can serve as an anchor for much-needed domestic reform, which can help countries modernize and open their economies. Japan, for example, has used its participation in the TPP to advance important structural reforms in the agricultural sector. Korea, through the United States-Korea Free Trade Agreement (KORUS) as well as the Korea-EU FTA, undertook significant liberalization of its services sector to gain competitiveness in this important part of its economy. Developing countries such as Vietnam have linked joining the TPP with their domestic reform agenda. China, while not part of the TPP, has also sought to leverage trade liberalization to pursue market reforms. More generally, trade agreements not only spur growth but by raising standards, they also help shape the broader environment in which that growth takes place. After all, trade liberalization is not the end goal but rather a means for achieving sustainable growth and development.

## 2.2 TPP AND RCEP: PATHWAYS FOR REGIONAL ECONOMIC INTEGRATION

In the Asia-Pacific region, two regional agreements have the potential to define trade architecture going forward. Encompassing nearly 40 percent of global GDP—as originally envisaged with the United States as a signatory—the TPP sets high standards and introduces groundbreaking disciplines into a trade deal, including digital trade and state-owned enterprises (SOEs), while providing meaningful market access. Covering almost half of the world's population and nearly 30 percent of global GDP, RCEP holds great promise. Done appropriately, it could advance trade liberalization while bringing greater predictability, efficiency, and growth to participating economies, including many developing ones that will play an increasingly important role in the global economy.

Even though these two agreements have often been characterized as rivals, the TPP and RCEP are complementary pathways to achieve prosperity for citizens of the region, as well as greater regional integration. The agreements share the key objectives of trade liberalization and economic reform, while recognizing the importance of development and capacity-building components. Both agreements are also open platforms that can be expanded to include additional members. Of course, there are important and substantial differences in breadth and depth of liberalization, coverage of rules, approach, and membership. But overall, these agreements are capable of being developed in a complementary fashion.

The original aim of the TPP was to set a new bar for high-standards trade agreements while providing commercially meaningful market access to its 12 members that account for nearly 40 percent of the global economy. Beyond reducing tariffs, the TPP includes state-of-the-art provisions that reflect



Note: \*On January 23, 2017, the United States announced its intention to withdraw from the TPP.

current and emerging economic challenges, such as the digital economy and SOEs. Further, by including provisions to liberalize and protect investment, strengthen intellectual property rights provisions, and promote cumulative rules of origin, among other areas, the TPP will help members attract FDI and create high-paying jobs. Independent analyses underscored the broad benefits of the TPP. The Peterson Institute estimated that by 2030, the TPP would raise annual global incomes overall by USD \$492 billion.<sup>52</sup> Besides offering important economic benefits, the TPP provides far-reaching strategic value and presents an opportunity to establish high standards throughout the region in a wide range of areas including IPR, SOEs, and digital trade.

More than five years ago, RCEP negotiations were launched with strong guiding principles and objectives. On the sidelines of the East Asia Summit in Phnom Penh, Cambodia, leaders from RCEP countries agreed to pursue a “modern, comprehensive, high-quality, and mutually beneficial economic partnership agreement.”<sup>53</sup> They agreed that the negotiations should cover a number of areas, including trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, and dispute settlement. If its guiding principles and objectives are accomplished, RCEP will be a positive development for the region, especially as a catalyst for continued competitive liberalization.

**The TPP and RCEP are complementary pathways to achieve prosperity for citizens of the region, as well as greater regional integration.**

RCEP’s potential in many ways stems from the fact that it includes 16 Asian countries that represent about half of the world’s population. Membership consists of ASEAN’s 10 member economies plus ASEAN’s existing FTA partners (Australia, China, India, Japan, Republic of Korea, and New Zealand). These economies account for more than a quarter of global exports and nearly 30 percent of global

GDP.<sup>54</sup> Preliminary estimates suggest RCEP would increase global incomes by about USD \$260 billion over a decade.<sup>55</sup> Since many RCEP economies are growing at some of the highest rates in the world—in 2016, China grew at 6.6 percent, India at 7.6 percent, the Philippines at 6.4 percent, and Myanmar at more than 8 percent—realization of this trade deal can usher in greater regional and global growth.<sup>56</sup>

Yet, both the TPP and RCEP face their own distinct challenges. Since the TPP's signing in February 2016, many countries have been working to secure domestic approval for it. Regrettably, the United States announced it would withdraw from the TPP on January 23, 2017. Given that the TPP effectively requires ratification by the United States and Japan, the agreement in its current form will not enter into force. On the other hand, RCEP negotiations, having begun in 2012, are still underway in spite of efforts to wrap up the talks last year; thus, a final agreement has not yet been reached.

## 2.3 CONTRIBUTIONS OF INTERNATIONAL ECONOMIC BODIES

### World Trade Organization

Against this backdrop, we have witnessed trade liberalization increasingly moving from the multilateral to the plurilateral arena. At the WTO, a number of factors, including differences centered on levels of development, have constrained efforts to advance liberalization. In the WTO's two-decade history, only one multilateral agreement, the Trade Facilitation Agreement, has been concluded, and it still awaits ratification.<sup>57</sup> To be sure, the WTO remains a critical institution for monitoring trade policy developments, preventing protectionist measures, resolving trade disputes, and upholding the rules-based trading system. For the foreseeable future, however, multilateral negotiations have lost momentum and have ceased to become a viable option for trade liberalization. As a result, some members have instead chosen to focus on plurilateral negotiations, including the successful expansion of the Information Technology Agreement (ITA) in 2016.

Additionally, the region has witnessed a growing number of bilateral and regional free trade agreements in effect, under negotiation, and under study. Since 2000, the number of FTAs in Asia has more than quadrupled. This has created a web of different rules and market access commitments and in many cases has contributed to lower FTA utilization rates than expected. Trade agreements have also become more extensive and complex. As a result, the time required to conclude negotiations, ratify agreements, and begin implementation is significant.

### Group of 20

Beyond the WTO, other fora have become important venues for advancing international discussions on trade. The Group of 20 (G-20), which brings together representatives from the 20 major global economies covering some 80 percent of world trade, has given trade issues more attention in recent years. In July 2016, G-20 trade ministers met in Shanghai and agreed to convene regularly and provide political leadership to promote inclusive, robust, and sustainable trade and investment growth.<sup>58</sup> At the conclusion of the G-20 summit hosted by China in September, leaders pledged to ensure bilateral and regional trade agreements complement the multilateral trading system and are open, transparent, inclusive, and WTO consistent. They also committed to rolling back protectionist measures through 2018. While these and other statements are encouraging, they will require political will from G-20 leaders, combined with strong follow-up action to be effective.

## Asia-Pacific Economic Cooperation

Regionally, APEC remains an important venue for promoting economic integration. In 1994, APEC leaders committed to the “Bogor Goals” of free and open trade and investment for industrialized economies by 2010 and for developing economies by 2020. In 2006, APEC agreed to examine the long-term prospects for a Free Trade Area of the Asia-Pacific (FTAAP) and has since carried out analytical work to support this goal. Such an achievement would mark the logical endpoint of and an important achievement for regional economic integration.

In that spirit, APEC launched a collective strategic study on FTAAP during China’s APEC host year in 2014, which was released in November 2016. This study concluded that an FTAAP could promote economic gains and broaden regional economic integration, but negotiations for this trade deal should not yet start as additional work, aimed at resolving existing trade and investment barriers, needs to be done.<sup>59</sup> Moreover, APEC has engaged in useful efforts on emerging trade and investment challenges through the years. APEC’s work on trade facilitation, regulatory practices, investment principles, environmental goods, guidelines for regional trade agreements, and information technology products has helped advance trade and investment liberalization in the region; in numerous cases, it has contributed to binding commitments in trade agreements in the WTO and regionally. With the 2020 Bogor deadline less than three years away, the time is ripe for intensifying discussion on paths toward a more integrated region.

## Association of Southeast Asian Nations

ASEAN has served as another key platform for advancing the region’s trade and investment agenda. Working toward a single market, ASEAN has made significant progress in removing tariffs, with nearly 96 percent of tariff lines at zero. Other achievements include reducing technical trade barriers and promoting cross-border investment. These actions have produced significant economic gains. After the launch of the ASEAN Economic Community (AEC) Blueprint in 2006, ASEAN trade increased by nearly USD \$800 billion, and ASEAN’s share of global FDI more than doubled between 2007 and 2015. In principle, the AEC, which Asian leaders declared complete in 2015, holds great promise and potential, covering a market of USD \$2.4 trillion and nearly 630 million people.<sup>60</sup> But there is significant room for further progress. By one measure, only about half of ASEAN businesses have utilized ASEAN FTA tariffs reductions. Further progress will require actions on a number of fronts, including liberalizing services, removing non-tariff barriers, and addressing infrastructure gaps.

Many assert that RCEP is a China-led negotiation, but this is not the case. RCEP is an ASEAN-centered agreement, which builds on the ASEAN+1 FTAs.

ASEAN is also instrumental in driving forward RCEP, as this regional trade deal weaves together five separate ASEAN agreements with countries in the region and expands membership and commitments. Many assert that RCEP is a China-led negotiation, but this is not the case. RCEP is an ASEAN-centered agreement, which builds on the ASEAN+1 FTAs.<sup>61</sup> Just as ASEAN is the “glue” of the highly diverse subregion, RCEP has the potential to unify the broader Asia-Pacific region under a high-standards economic framework.

## Other Economic Initiatives

A number of other economic initiatives underway in the region, though not primarily focused on trade liberalization, could impact trade and investment flows. China's "One Belt, One Road" (OBOR) initiative, for example, includes ambitious plans for building new roads, railways, ports, and other infrastructure connecting China, its neighbors, as well as those further beyond, even Europe. These development initiatives are backed by a USD \$40 billion Silk Road Fund and complemented by the establishment of the Asian Infrastructure Investment Bank (AIIB). These efforts could help address the region's significant infrastructure funding gap, as well as enhance trade and investment flows when reinforced by FTAs among OBOR partners, as China has proposed. Another initiative is the Pacific Alliance, through which Chile, Colombia, Mexico, and Peru aim to increase trade and advance economic integration in the Asia-Pacific region.

While allowing groups of trading partners to deepen economic ties, bilateral and regional free trade agreements are also creating gaps that must be addressed. First, there are *ambition* gaps. Some agreements are aiming for a high degree of liberalization and breaking new ground on a range of issues, while others have relied on more incremental progress with a less comprehensive approach. Second, there are *membership* gaps. Some agreements have fewer members than others, leading some to call them more inclusive. Third, there are *relevance* gaps. Lengthy negotiating timeframes, differing levels of coverage, and divergent standards can make agreements less relevant when they come into force. Finally, differences in how agreements approach the same sectors, goods, services, opportunities, challenges, and so on can increase uncertainty as well as the cost of doing business.

### 3. RECOMMENDATIONS FOR ADVANCING ASIA-PACIFIC REGIONAL TRADE AND ECONOMIC INTEGRATION

**HAVING ASSESSED THE CURRENT STATE OF PLAY**, as well as the potential opportunities and challenges ahead, the Commission reached a number of conclusions and recommendations for policy makers. While recognizing current global realities, these recommendations are aimed at advancing trade liberalization, bridging gaps, building support for trade and globalization, and advancing economic integration in the Asia-Pacific. Foremost, the Commission Members recognize that multilateral liberalization still holds the greatest potential benefits, but deadlock at the WTO has led interested members to pursue other options.

#### The Case for Regional Agreements

With this in mind, the Commission affirms that regional trade agreements offer the best path forward to liberalize trade, raise standards, and promote broad reforms. Regional agreements allow member countries to simultaneously tap into a number of markets at scales often unattainable through bilateral deals. Further, regional agreements lend themselves to greater utilization. Having the same standards and rules for all countries reduces confusion and encourages businesses, especially SMEs, to take advantage of the benefits of the agreements. Moreover, with the advent of global value chains, regional trade deals better reflect the way business is actually conducted. Furthermore, regional trade agreements allow more countries to be on the same page regarding complex and emerging issues, such as data flows.

The Commission affirms that regional trade agreements offer the best path forward to liberalize trade, raise standards, and promote broad reforms.

#### The Role of Bilateral Agreements

Bilateral trade deals have merit, but they also have limitations. For instance, the benefits achieved by high-quality bilateral agreements may not be commensurate with the time and resources required. For some countries, the easiest and most economically relevant bilateral deals have already been completed.

Bilateral agreements, nevertheless, will continue to remain an important feature in the global trading system. Throughout the world, and in particular the Asia-Pacific region, countries are negotiating and concluding bilateral trade and investment agreements, such as the Australia-Indonesia FTA and the Canada-Vietnam FTA. Further, the United States, under the Trump administration, has recently made clear its preference for bilateral agreements.<sup>62</sup> The Commission believes that regional trade agreements are more relevant and promise greater value. At the same time, the Commission Members urge all deals, including bilateral agreements, be comprehensive, incorporate high standards, be WTO consistent, and enumerate clear accession provisions to encourage greater regional integration.

Higher-standards agreements offer stronger benefits across the board.<sup>63</sup> Higher and stronger standards will yield economic gains, more trade, better jobs, income increases, poverty reduction, as well as

other benefits. By reducing gaps and raising standards, these higher-standards agreements can not only promote economic growth but can also be a central pathway to institute reforms.

In light of the U.S. exit from the TPP, the Commission recommends that countries incorporate the TPP's high standards through other avenues, including advancing the TPP without the United States. Further, the Commission concludes that countries should focus on ensuring that a final RCEP agreement is of high quality. With this in mind, the Commission formed recommendations in four areas.

**TABLE 1: TRADE POLICY COMMISSION RECOMMENDATIONS**

<b>ADVANCING THE TPP'S HIGH STANDARDS IN THE REGION</b>	<b>RAISING RCEP'S STANDARDS</b>	<b>PURSuing COMPLEMENTARY OPPORTUNITIES FOR REGIONAL TRADE LIBERALIZATION</b>	<b>REBUILDING SUPPORT FOR TRADE</b>
<p>Urge the United States to reconsider its position on the TPP, even with possible adjustments</p> <p>Encourage countries to advance the high standards found in the TPP through unilateral reforms, other trade negotiations, and WTO activity</p> <p>Welcome the potential for TPP countries to bring the agreement into force without the United States, including inviting additional Asian economies to join</p>	<p>Advise RCEP members, in line with RCEP's own principles and objectives, to negotiate a high quality agreement and not be tempted to adopt the lowest common denominator approach</p> <p>Recommend RCEP parties seek substantially stronger outcomes, particularly for SMEs</p>	<p>Advocate that countries collaboratively intensify multifaceted capacity-building efforts to help developing countries raise standards, to be included in their trade agreements</p> <p>Urge multilateral trade fora to focus their work on emerging trade issues such as digital trade, SOEs, and GVCs, noting that APEC is particularly well-positioned to do so</p> <p>Recommend countries that are interested in pursuing regional trade agreements consider establishing a standalone SME agreement, based largely on the relevant provisions in the TPP</p>	<p>Counsel governments and multilateral bodies like the G-20, WTO, and APEC forum to more effectively communicate the benefits of trade agreements, using concrete terms which are meaningful to the everyday interests and concerns of ordinary people, rather than explaining broad macroeconomic impacts</p> <p>Urge countries to proactively pursue appropriate domestic policies, including robust adjustment assistance, retraining, and education programs—which are too often viewed as afterthoughts—in parallel with trade agreements</p> <p>Advocate that multilateral fora serve as hubs for policy makers to exchange ideas and collaboratively generate best practices on how to help those impacted by trade and globalization</p>

### 3.1 ADVANCING THE TPP'S STANDARDS IN THE ASIA-PACIFIC REGION

Recognizing the economic benefits and noting the strategic importance of the TPP, the Commission Members urge the United States, unlikely though it might be at this time, to reconsider its position on the TPP, including with possible adjustments, and to be open to exploring other avenues in which to incorporate the TPP's standards. The Commission also urges the TPP countries to continue ratification efforts at their own pace. This way, the TPP would be ready to enter into force if the United States were to change its position. At the same time, the Commission Members also note the possibility that the other TPP countries might be interested in bringing the TPP into force without the United States. Some

have also raised the possibility of inviting other Asian economies to join, including China. While this would require modifications to the entry-into-force provisions and might present other complications, the Commission sees value in pursuing this approach. While not within the scope of this report, there would clearly be different, broader strategic implications depending on the path followed.

### **Incorporating the TPP's Standards Elsewhere**

With the TPP's future uncertain, countries should look for other opportunities to pursue the high standards that are laid out in the agreement. These standards should be given significant weight, as they are the result of careful consideration among 12 countries that represent nearly 40 percent of global GDP. First, countries can accomplish this task by unilaterally undertaking reforms to raise their own standards. Indeed, even if the TPP does not go into force, Malaysia has announced that it will upgrade its laws to be in line with the TPP's standards. Vietnam will also be upgrading its laws because, as a leading Vietnamese official noted, even "if there's no TPP, the reforming process will still happen in Vietnam."<sup>64</sup> These two countries are poised to attract a greater share of FDI relative to countries that do not follow suit.

Second, a number of countries have recently announced plans to upgrade existing FTAs, including the New Zealand-China FTA and the Chile-Korea FTA. The United States has indicated its interest in renegotiating the North American Free Trade Agreement. Third, with new FTAs under negotiation, such as the Australia-Indonesia FTA, the Japan-EU Economic Partnership Agreement, and the China-Japan-Korea FTA, and more negotiations that may be announced in the near future, the Commission Members believe that relevant parties to these negotiations should incorporate the TPP's high standards. For instance, RCEP negotiators are considering TPP issue areas, such as e-commerce, which underscores the TPP's relevance as a benchmark. Fourth, the Commission Members also recommend the WTO utilize the TPP standards in the range of its activities.

**With the TPP's future uncertain, countries should look for other opportunities to pursue the high standards that are laid out in the agreement.**

### **Promoting Inclusiveness through Accession and Capacity Building**

With the view that the TPP may eventually enter in force, with or without the United States, the Commission considered how the TPP and the standards it espouses could be made more inclusive. Specifically, Commission Members encourage a forward-thinking approach on inclusiveness, which would mean expanding the membership of the TPP or broadening accession if it enters into force, as long as prospective members are ready to adhere to the agreed-upon high standards. If the TPP does not enter into force, pursuing other avenues to adopt the higher standards will require a plan to ensure inclusiveness.

To promote transparent and expeditious accession of new members, the Commission offers a series of recommendations. To begin, the Commission Members urge existing member economies to build on the current TPP accession provisions by establishing clearly defined procedures and requirements for accession at an appropriate time. The Commission also urges members to be flexible regarding whether to include new members into the TPP as groups or individually. The Commission recommends that the TPP members focus on TPP obligations in accession negotiations and refrain from seeking additional requirements. It also encourages member economies to be open, in specific cases, to the prospect of non-Asia-Pacific countries joining the TPP.

There should also be an expanded program of trade-related assistance and capacity building so interested developing countries in the Asia-Pacific region can move toward high standards, such as those contained in the TPP. Such assistance would benefit both developing and developed members, with faster access through custom entry points, better enforcement of intellectual property rights, and other improvements. These programs could be put under the APEC umbrella or other ongoing capacity-building initiatives and could be started now.

### 3.2 RAISING RCEP'S STANDARDS

Although RCEP countries had originally set a 2016 deadline for negotiations to conclude, they agreed in November 2016 to continue negotiating without setting a new deadline. The Commission welcomes the fact that RCEP members did not sacrifice substance to meet an artificial deadline. Now that the TPP is

The Commission Members urge RCEP member economies to negotiate a high-quality agreement and not be tempted to adopt the lowest common denominator approach.

sidelined, wrapping up RCEP negotiations, in accordance with RCEP's guiding principles and objectives, should have a new sense of urgency. Going forward, the Commission Members urge RCEP member economies to negotiate a high-quality agreement and not be tempted to adopt the lowest common denominator approach. The Commission Members recommend that additional work be undertaken to strengthen market access commitments on goods and services. Moreover, the Commission encourages any RCEP agreement to go substantially beyond a consolidation of existing "ASEAN plus one" agreements. Finally, the Commission Members urge RCEP to include predictable, consistent, and transparent provisions for accession to promote inclusiveness.

In light of this additional negotiating time, the Commission Members believe there is an enormous opportunity to negotiate substantially stronger outcomes. In particular, the Commission Members recommend that RCEP negotiators focus on provisions with the most profound impact on SMEs, given their immense contribution to Asian economies. While RCEP negotiators recently announced the conclusion of the SME chapter, the Commission Members believe that more can be done in other chapters of the agreement that will benefit SMEs. Specific areas could include, for example, e-commerce provisions that help SMEs market their products and receive payments, as well as provisions on cross-border data flows, which are increasingly important to SMEs in global markets. Red tape could be eliminated to make way for customs improvements and other trade facilitation measures, including expediting express shipments, raising *de minimis* thresholds, and implementing single-window systems. Transparency provisions could also assist SMEs navigating the regulatory process.

As RCEP negotiators pursue this work, the Commission Members urge them to develop an agreement that is complementary and avoids conflicting provisions with the TPP. Ideally, such an agreement would provide a stepping-stone for members to subsequently join higher-standards agreements when they are economically and politically ready. To enable developing economies to move toward higher standards and ensure the principle of inclusiveness, the Commission Members recommend that developed member economies of both the TPP and RCEP provide robust capacity building to developing members of RCEP.

In light of the challenges faced by the TPP and RCEP, the Commission Members conclude that at this time, it is premature to consider starting negotiations for an FTAAP. Following multi-year negotiations for two, separate regional trade agreements—one that will not enter into force as is, while the other faces an uncertain future—countries may be reluctant to enter quickly into another protracted negotiation to establish an FTAAP. Instead, the possibility of an FTAAP should be revisited sometime in the future. Additionally, APEC’s recently released collective strategic study on FTAAP noted that while this trade agreement could foster economic gains and broaden regional economic integration, further work to resolve existing trade and investment barriers needs to be completed before next steps are taken.

### **3.3 PURSUING COMPLEMENTARY OPPORTUNITIES FOR REGIONAL TRADE LIBERALIZATION**

#### **Bridging the Gaps between Regional Initiatives**

Bridging the gaps identified by the Commission—ambition, membership, and relevance—will require a range of actions. Even with RCEP in progress, some gaps are easy to anticipate. Differences in coverage, liberalization, and reform levels will be the biggest. Bridging them will require multifaceted capacity-building work, which will benefit interested developing countries in the region, as well as those countries that provide assistance in moving toward higher standards.

Other gaps will be significant as well. The Commission believes that digital trade, investment, and state-owned enterprises are likely to be among the most important areas. Digital trade is already central to Asian economies and will grow dramatically in the coming years. SOEs, while varying between countries, are creating challenges for the region’s competitive landscape. Rules for investment, whether negotiated bilaterally or in a regional setting, will determine whether the region receives the capital, technology, and know-how to drive further gains in productivity. In all three areas, the TPP and RCEP can be anticipated to diverge considerably.

In this sense, multilateral and regional organizations and entities will be critical. The Commission recognizes APEC’s important progress on issues that were once considered emerging and now have become well known, such as trade facilitation, supply chains, and good regulatory practices, and urges APEC to continue its work on these and other “gap” areas. The Commission Members also urge other multilateral and regional organizations, such as the WTO, World Bank, regional development banks, the G-20, and ASEAN, to undertake efforts in these areas, as appropriate. Such work can include the development of best practices, the sharing of experiences, technical workshops, and building the analytical base necessary to bridge gaps. Combined with capacity building, these efforts should help provide developing countries with the knowledge base and comfort level to embrace higher standards and ultimately contribute to greater regional integration.

#### **Building Support for Trade Agreements by Encouraging SME Utilization**

The TPP member countries, as well as other interested regional partners, may wish to consider moving forward with an agreement that includes a subset of the TPP’s full obligations, such as a stand-alone SME agreement. Given the importance of SMEs in the global economy, the Commission believes that on top of having an immediate and sizeable impact, such an agreement could also help build support for

trade. SMEs often lack the resources to successfully navigate these agreements; as a result, many SMEs opt not to take advantage of the benefits offered in them.

The TPP member countries ... may wish to consider moving forward with an agreement that includes a subset of the TPP's full obligations, such as a stand-alone SME agreement.

An SME agreement would encourage SMEs to use these trade agreements, so that these businesses could tap into foreign markets and reap the benefits of trade deals. Largely based on the provisions in the TPP that significantly benefit SMEs, this agreement could include e-commerce provisions that help SMEs bring their products to market and receive payments, as well as provisions on cross-border data flows. This agreement could create efficient and transparent customs processes and streamline other barriers, thereby making it cheaper, easier, and faster for SMEs to reach new markets. This could include expediting express shipments, raising *de minimis* thresholds, and implementing single-window systems. This agreement would also rely on greater transparency to assist SMEs in navigating the regulatory process. While a stand-alone SME agreement would offer important benefits, it would not be a perfect solution, particularly if market access commitments are not included.

### 3.4 REBUILDING SUPPORT FOR TRADE

Regardless of the progress made on promoting regional economic integration and narrowing gaps between the region's trade agreements, the Commission concludes that a stronger case for trade agreements must be made. Abstract explanations of the merits of trade agreements have historically not held up to criticisms relying on false narratives. Job losses and wage cuts—problems often ascribed to trade—have actually been largely the result of increases in productivity linked to automation and digitization.<sup>65</sup> In fact, trade often creates new economic opportunities for workers. In advanced economies, trade has roughly doubled real incomes for the average household, while raising real incomes by more than 150 percent for the poorest ones.<sup>66</sup>

#### Communicating the Benefits of Trade and Globalization

It is imperative that policy makers more effectively communicate the benefits of trade agreements, while making it clear what trade and trade agreements can reasonably be expected to achieve. At the same time, policy makers must emphasize that much public concern about globalization can best be addressed by reforms to domestic policies. Above all, these communications need to move beyond top-line statistics and focus on how trade helps workers, families, and communities in concrete terms. Governments should also consider taking additional steps, such as increasing the use of social media to improve public consultations, giving more citizens the opportunity to view and participate in these sessions. Such efforts would help increase awareness of the relevance of these agreements and dispel myths about how they are negotiated.

While the Commission Members appreciate that public communications have an important role to play, they believe that the substance of agreements matters even more. Around the world, too many people view trade agreements as benefiting big businesses while ignoring or disadvantaging smaller

actors. In particular, the Commission Members recommend that greater emphasis be placed on securing meaningful benefits for SMEs, which will help build critical support.

### Implementing Appropriate Domestic Policies

The Commission recommends that domestic policies empowering individuals and reducing income inequalities go hand-in-hand with trade agreements. This support should not be limited to citizens impacted by trade, but it should also protect those hurt by globalization more broadly, as well as by technological change and productivity improvements. Robust adjustment assistance, such as retraining and education programs, wage insurance, and relocation and job search allowances, coupled with other social safety net policies, are an important step in minimizing the adverse effects of trade.<sup>67</sup> These policies will contribute to building a more dynamic and flexible labor force in the long run.

### Combating Rising Anti-Globalization Sentiments through Multilateral Fora

With this in mind, the Commission Members believe multilateral institutions, including the G-20, APEC, and WTO, have an important role to better communicate the benefits of trade and globalization, as well as the potential dangers of backtracking from liberalization. These fora can credibly convey the value of trade agreements, showcasing how liberalization can help families and communities and lift countries out of poverty. At the same time, these fora must also be vigilant against overstating their benefits by setting reasonable expectations and identifying which concerns are more appropriately addressed by domestic policies.

The Commission also recognizes the role these three specific fora can play in advancing policies that can help offset the costs of globalization. To date, these multilateral bodies have undertaken important work in this area. For instance, the G-20, at its summit in September 2016, noted that strong economic growth relies on inclusive trade that lifts everyone, rather than policies that exacerbate inequalities.<sup>68</sup> APEC 2017, under the leadership of Vietnam, is focusing on championing policies that promote inclusive growth to ensure that benefits are more evenly shared, while reducing the costs.<sup>69</sup> Over the past year, the WTO has stressed the importance of creating a better, more inclusive trading system.<sup>70</sup> Similarly, WTO Director-General Roberto Azevêdo has implored countries to better leverage technology and the digital economy, so that everyone can operate on a level playing field, have the same opportunities, and secure the same resulting gains of globalization.<sup>71</sup>

Moreover, to help workers adversely affected by trade and globalization while also rebuilding a dynamic and flexible labor force worldwide, the Commission Members strongly urge these multilateral fora to serve as hubs for policy makers to exchange ideas and collaborate on domestic policies, including adjustment assistance and other social safety net programs. The Commission believes that countries should use these fora to learn from one another, exchanging information on what policies have worked and have not worked in helping those impacted by trade and globalization. Such a discussion could lead to the development of best practices that could serve as a useful tool for policy makers in all countries. At

The Commission recommends that domestic policies empowering individuals and reducing income inequalities go hand-in-hand with trade agreements.

a time of rising backlash against globalization and anger toward trade, the Commission Members believe that such work would be exceedingly important and relevant.

The Commission urges these fora to intensify efforts in these three areas—communication, inclusive policies, and best practices—placing these issues front and center on their agendas. The Commission Members recommend that work begin immediately, so the G-20 summit in Germany in July, the APEC economic leaders’ meeting in Vietnam in November, and the WTO trade ministers’ meeting in Argentina in December can result in meaningful outcomes in these important areas.

## 4. CONCLUSION

**IN SUM, TRADE AGREEMENTS ARE NEITHER THE PANACEA FOR NOR THE SOLE CAUSE OF EVERY ECONOMIC MALADY.** But they remain a critical tool for spurring growth, creating jobs, reducing poverty, and advancing much-needed domestic reforms to modernize and open economies. The Commission’s recommendations encourage countries to promote high standards in trade agreements that go well beyond WTO rules and address emerging issues; build support for trade by tapping into underutilized areas, such as SMEs; and urge multilateral fora to elevate the discussion on requisite domestic policies to help those adversely affected by trade and globalization.

Though the benefits of trade may not be immediately clear to the public at large, it is incumbent upon policy makers and all stakeholders to affirm support for advancing economic integration at this critical juncture in the trade landscape. Though the global backlash against trade and globalization may engender uncertainties about the course of trade in the Asia-Pacific region, particularly in the wake of the U.S. exit from the TPP, the Commission Members urge policy makers not to allow tomorrow’s uncertainties to overshadow today’s opportunities.

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