

Update to The FTAAP Opportunity: a Report to ABAC¹

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Abstract

The regional economic integration and policy context in which the last ABAC Report on the scope and pathway to an FTAAP was submitted to APEC leaders has changed significantly.

For the first time since the global financial crisis, there are favorable winds for regional economic integration over the short-term but with risks. The Asia-Pacific is witnessing its strongest growth upturn since 2010 with growth increasing to 4.0% in 2017, up from 3.4% in 2016. The IMF projects regional growth of 4.0% in both 2018 and 2019. The broad-based upturn covers both advanced and developing economies. It reflects a rising global momentum, an expected increase in business investment, stronger external demand for Asia's exports and better consumer confidence.

Asia-Pacific trade and foreign direct investment (FDI) is generally supportive of the growth upturn. Trade volumes increased by 4.6%, the fastest rate in four years. Of the 21 regional economies, 16 saw better trade growth in 2017. A modest increase in FDI is also expected in 2017. Intra-regional trade is at historically high levels, driven partly by sophisticated global value chains (GVCs). The digital economy has exploded in the region bolstered by rising mobile phone penetration rates across the region, driving internet adoption and changing consumer behavior; it is transforming the way business is being done across manufacturing and services and will continue to do so.

But a fragile recovery the Asia-Pacific faces various risks – e.g., increased protectionism, a slowdown in China, rising interest rates, geopolitical tensions and natural disasters, among others. The jury is still out as to whether the current upturn represents the start of a cyclical recovery or a short-term blip on the road to a lower growth trajectory.

Over the past two years, populism coupled with nationalism in OECD economies and elsewhere, underpinned by anti-globalization sentiments, has dampened the enthusiasm for economic integration in general and free-trade areas in particular. Some economies have suggested that the depth and quality of free-trade agreements need to be improved and the benefits more fairly spread both within and across countries. In Europe, for example, the new Italian government is comprised of euroskeptic parties, and the UK is currently in the process of withdrawing from the EU in the wake of its “Brexit” referendum. Furthermore, the United States signed but then withdrew from the Transpacific Partnership (TPP) agreement. Yet other economies are pursuing development strategies aimed at

¹ This report was prepared by an independent group of experts. The views expressed here are those of the authors and do not necessarily reflect the views of ABAC.

boosting domestic industrialization, e.g., the “Made in China 2025” program and the “Make in India” initiative. Barriers to digital trade erected by some non-TPP signatories in the Asia-Pacific region have also raised concerns about the ability to expand economic cooperation. The December 2017 WTO Ministerial Meeting made limited progress with the launch of the e-commerce framework agreement among 70 countries but failed to issue a ministerial declaration.

Yet, the economic arguments for closer economic integration in the APEC region outlined in the last report continue to be at least as strongly compelling as they were in 2015, if not more so. Promoting economic cooperation initiatives that build on ABAC’s “four pillars” of inclusivity, comprehensiveness, consultation, and transparency, to energize the private sector at all levels and generate sustainable economic growth and development still constitute a key aspiration for the region and would provide a bulwark against any further rolling back of open markets for trade and investment.

Since deeper and wider economic integration has demonstrated its abilities to enhance growth, reduce poverty, and improve socio-economic prospects, developing a comprehensive, modern, rules-based approach to global economic governance is necessary to regional success in the 21st century. In addition, building coalitions among smaller economies via liberalization “pathways”, such as the CPTPP, RCEP and the Pacific Alliance, and in other fora to support concerted liberalization is essential to ensure that the Bogor Goals can be fully realized.

Despite some setbacks, the region is still moving forward with its economic cooperation efforts: the TPP has been reconstituted under the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) agreement among its remaining eleven members; RCEP is moving forward with the goal of being completed at the end of 2018; and the Pacific Alliance continues to deepen internal and external cooperation, including entering into free-trade area negotiations with potential “associate members” Australia, New Zealand, Singapore and Canada in June 2017.

Nevertheless, the high expectations of deepening cooperation via pathways towards an FTAAP have been tempered by new political realities. Structural adjustment is needed to ensure that opportunities to gain access and enjoy a share in the economic benefits that derive from enhanced trade and investment flows, new business models, the digital economy, new services made possible by the ICT revolution, and artificial intelligence have entailed structural adjustment that can negatively affect individual workers and communities. Moreover, there is the risk that some economies themselves may be left behind and a greater “digital divide” may emerge between advanced and developing economies.

Hence, this ABAC report update includes not only a survey of new trends in economic integration and critical policy developments over the past two years but also analysis of the new political- economy challenges facing the APEC region as it considers practical approaches in deepening integration toward the FTAAP. Given APEC’s long-held Bogor Goals citing an ambitious aspiration of 2020 for open trade and investment among APEC economies, these new realities require a re- evaluation of some of the original report’s predictions and a greater focus on inclusivity in the design of new trade policy initiatives.

I. Introduction

Since our last report, much has changed in terms of the global policy context in which deeper and wider Asia-Pacific economic cooperation is evolving. In particular, in the OECD and beyond, the rise of populism on the political right has breathed new life into the anti-trade forces on the political left, which has a long tradition of populism. While in the making for some time, this new reality made its first major headlines with “Brexit,” i.e., the dramatic decision, via a referendum, of the United Kingdom to exit from the European Union (EU). This was especially significant since the United Kingdom was once the most pro-free trade country in the EU, e.g., it was instrumental in the launching of the Single Market Program that transformed the region into a truly integrated market. Populist, anti-trade parties have made considerable gains in other EU member-states as well, most recently in March 2018 when populist parties on the left and the right were the main winners of the Italian elections. This is also true for some APEC member-economies; elections in one member-economy, for example, featured trade-skeptical candidates among all parties and most candidates expressed an interest in withdrawing from the Transpacific Partnership (TPP).

This trend obviously poses significant challenges to the ABAC-supported APEC vision of global trade free of policy obstacles. The prospect of realizing the Free-trade Area of the Asia-Pacific (FTAAP), proposed by ABAC in 2004 and adopted by APEC itself, may be more distant at this historical juncture than was the case when our earlier report was released. The potential gains—economic and non-economic—of the FTAAP, therefore, continue to beckon for closer integration; indeed, the current political winds underscore why the world requires Asia-Pacific leadership now more than ever in forging a more prosperous, inclusive and fair world.

Three significant events since our report have had important bearings on the analysis of the previous report. The first was the exit of the United States from the Transpacific Partnership (TPP) agreement, based on a view that the agreement did not significantly advance its interests. Since then, it has reopened NAFTA and KORUS² negotiations to modernize both agreements to better reflect the realities of trade. The United States has also said that it wishes to pursue bilateral FTAs, including with Japan and Southeast Asian economies (with the Philippines ostensibly first on the list), but it is unclear if this interest is mutual. Japan, for example, would prefer that the United States return to the TPP. Besides, as underscored at length in our report, the very strength of mega-regional agreements comes from their being large, multi-economy accords; bilateral FTAs tend to be less efficient.³

The second event was the signing in March 2018 of the successor to the TPP, the Comprehensive and Progressive Agreement on Transpacific Partnership (CPTPP) among the remaining 11 TPP economies. The CPTPP is remarkably similar to the TPP, with only changes in about two dozen measures that were relegated to “suspension” status (these measures, more than half of which related to intellectual property protection, were kept in the agreement in case the United States wishes to return). While the CPTPP is much smaller in terms of economic size than the TPP¹², the decision by the region to continue to move forward without the twelfth member underscores the commitment of member-economies to deepening Asia-Pacific economic integration and to pursuing deep integration as a pathway to realizing the APEC Yokohama Vision of an FTAAP. It also demonstrates what can be achieved in the area of ‘next generation’ trade and investment elements among a diverse group of economies at different levels of economic development and regulatory sophistication.

² On 23 March, 2018 an agreement on a slightly-revised KORUS was reached.

³ The APEC Strategic Blueprint for Promoting Global Value Chains Development and Cooperation also emphasizing an APEC-wide approach, underscoring that, “Reducing trade and investment barriers will improve economies’ access to global production networks and allow firms to source less expensive inputs globally, which in turn would lower costs, increase efficiency and enhance competitiveness.” https://www.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014_aelm/2014_aelm_annexb.aspx

Another pathway to the FTAAP is the Regional Comprehensive Economic Partnership (RCEP), which has been in negotiation since it was launched in November 2012. At the time of our previous report, RCEP negotiations were still in their infancy. Since then, considerable progress has been made, with a strong possibility of an agreement by the end of 2018. It is still unclear as to how comprehensive the agreement will be in terms of scope and ambitions in terms of “depth”. As anticipated in our earlier report, it would appear that the agreement will be “shallower” than the TPP but still significant in terms of the signal it potentially sends about the importance of continuing regional economic integration, although for credibility reasons this does require a certain level of ambition. It continues to have great potential as a pathway to the FTAAP. The Pacific Alliance, which has evolved as a looser arrangement that prioritizes open regionalism, continues to deepen internal and external cooperation, including entering into free-trade area (FTA) negotiations with Australia, New Zealand, Singapore and Canada in June 2017.

The third event is the adoption by some non-TPP signatories of new barriers to digital commerce and the movement of data. Such barriers include requirements to locate data repositories in certain jurisdictions, prohibitions on the movement of data cross borders, and limits on ownership of (and investment in) certain types of technologies – such as cloud computing. Given the clear benefits of digital trade to creating more inclusive growth, such barriers are a growing concern.

Our earlier report focused on the economics of the FTAAP, included business experiences with economic integration to underscore its potential, and considered how it could be realized. It argued that economic integration and next-generation agreements to facilitate it have not only delivered remarkable results, but also address critical aspects of the emerging global and regional business environment.

The main conclusions of the report, all of which echo the importance of the ABAC pillars of inclusiveness, comprehensiveness, consultation and transparency, can be summarized as follows:

1. A high-quality, ambitious and comprehensive FTAAP would have the potential to reinforce the sustainable growth of trade and lead to inclusive economic progress, bringing hitherto excluded enterprises and workers into the mainstream of the global production system.
2. The future of the Asia-Pacific economy is bright, as long as it remains united; the private sector can offer pragmatic advice on how to reduce barriers to economic integration and bridge cultural and political differences.
3. The FTAAP would yield significant gains in terms of economic welfare, mainly by opening markets and facilitating access to resources, including capital, workers, information and technology. These are central to achieving high productivity, which in turn promotes a higher standard of living. Business is increasingly organized around global value chains (GVCs) that require excellent connectivity and especially low trade, investment and regulatory barriers. The FTAAP can deepen technological links, support business innovation, and expedite adoption of technology by consumers. It can chart new, inclusive paths of growth.
4. In terms of realizing the FTAAP, the “pathway approach” whereby the TPP, RCEP and Pacific Alliance allow the region to test ideas and develop its thinking for FTAAP negotiations makes good economic and political sense. They are already addressing business interests with rules hammered out by key Asia-Pacific economies. Business needs a “living” FTAAP that accommodates change in

the business environment, encourages consultation, and admits new members. These features will ensure that benefits from an FTAAP continue to grow as technology and the world economy evolve.

5. Business must help to build a persuasive case for the FTAAP. Economic integration, despite its extraordinary record, faces resistance. Business has an incentive to make the case for continued integration, based on its first-hand knowledge of impediments to regional trade and investment and the benefits from resolving them.

While the political context is more challenging, the wisdom imparted by business experiences and informed economic analysis regarding the potential benefits of deeper Asia-Pacific economic integration continue to be valid. The case for the FTAAP is more compelling than ever, given the current political headwinds, and the potential for the private sector to create jobs, enhance welfare, and support sustainable growth over the long-run is bright. The main challenge is how to get there.

Hence, the goals articulated in our earlier report continue to be as relevant as ever. In fact, as will be evident from the analysis below, the need to stress the importance of regional integration has even become more pressing for at least two reasons. First, it is essential to keep the rules-based approach to economic integration alive, as it is critical to the future competitiveness and prosperity of the region. Second, in the new political context of strong nationalism and populism, building coalitions among smaller economies in favor of reducing obstacles to welfare-enhancing economic interchange is essential to ensure that the Bogor Goals moves forward.. If such a path doesn't take root, even without a trade war economies may become more inward-looking simply to minimize risk, to the great detriment of the region and the global economy more generally. The CPTPP and its possible enlargement are significant in their own right, but the indirect benefits of being a beacon for outward-oriented policy reform and deterrence against unilateralism are also vital to highlight.

In this update, we focus on what has changed since the first report was released at the end of 2015. Section II considers trends in economic integration since the last report, including general growth trends and short-term macroeconomic forecasts, developments related to trade and foreign direct investment (FDI), global supply chains, and the digital economy, which featured prominently in our earlier report. Section III focuses on the new policy context in which the FTAAP is being considered, including changes in trade policy and new developments in regional cooperation. Finally, in Section IV challenges to the FTAAP moving forward and emerging opportunities are addressed.

II. Trends in Economic Integration

A. Growth Trends: Favorable Winds over the Short-term but with Risks

The Asia-Pacific economy is experiencing its strongest growth upturn since 2010. Growth in the region is expected to have increased by 4.0% in 2017, which is significantly higher than the 3.4% in 2016 (Figure 1). While the January 2018 IMF *World Economic Outlook Update* suggests that global growth pessimism may have been misplaced, the jury is still out as to whether the current upturn represents the start of a cyclical recovery in the region or a short-term blip on the road to a lower growth trajectory.

The upside growth surprises in 2017 have been wide-ranging. Growth in the region's developed economies--led by a solid performance by both the United States and Japan--is projected to have increased from 1.5% to 2.3% between 2016 and 2017, while that of developing economies is expected to be even higher (4.8% to 5.2%). Much of the latter group's revival derives from strong growth in Asian developing economies (Table 1). While the expansion is projected to increase in Korea and in major Southeast Asian economies, China's growth is expected to moderate somewhat to around 6.6%

this year. Reflecting an improved performance from Mexico, the recovery in Latin American developing economies is also expected to strengthen. Furthermore, in another encouraging development, Russia is expected to move from negative to positive growth.

Upward revisions by the IMF to its short-term forecasts suggest that the Asia-Pacific economy will continue to grow at a 4.0% clip in both 2018 and 2019 (Table 1). Developed economies are expected to moderate slightly from 2.4% in 2018 to 2.2% in 2019. Meanwhile, developing economies are expected to maintain growth of 5.2% in 2018 and 5.1% in 2019. The improved economic outlook in the region is largely attributable to rising global momentum, the expected effect of a cut in the US corporate profit tax on investment, and stronger external demand for Asia's manufactured exports (IMF, 2018). The expected fiscal impact of Japan's 2018 supplementary budget and the favorable effects of higher prices for commodity-exporting developing economies will also play a supporting role.

The upturn in the Asia-Pacific economy in 2018-2019, however, could be undermined by several lingering downside risks, which have fueled concerns about the fragility of the cyclical recovery. According to the most recent annual PECC survey of 722 representatives of business, government and non-governmental organizations, the top five risks to growth in the Asia-Pacific economy are: (1) increased protectionism, (2) lack of political leadership, (3) a slowdown in China, (4) a possible slowdown in world trade growth and (5) a failure of economies to implement structural reforms (PECC, 2017). While the related risks of slowdowns in growth in world trade on the one hand and China on the other have not been as serious as expected in early 2018, the risk of increasing protectionism has become a particularly serious concern in the current trade-policy environment, with a potential trade war looming. Additional emerging risks include monetary tightening and rising interest rates in developed economies, geopolitical tensions (e.g. over North Korea's nuclear ambitions), political uncertainty in some economies and a rising economic toll from natural disasters.

B. Trade and FDI

The Asia-Pacific economy's trade and FDI flows are expected to be supportive of the upturn in growth. The region's estimated growth in trade volumes increased by 4.6% in 2017, the fastest in four years (see Figure 2). This represents a significant improvement above the 1.0% growth in 2016. Improved trade growth is due to a cyclical pick up in investment spending in developed economies, rising import demand in the United States (US), increased intra-regional shipments across Asia, and somewhat higher consumer confidence (WTO, 2017).

Over 2016 to 2017, the region's developed economies are projected to have significantly increased their trade volumes from 0.5% to 4.1% and developing economies from 2.4% to 4.8%. Of the 21 Asia-Pacific economies, 16 are likely to have experienced better trade volume growth in 2017 than in 2016 (see Table 2). This includes most of the region's largest traders such as China, the US, Japan, Hong Kong, Singapore, Indonesia, Australia and Canada. However, Korean trade growth has stagnated, and Brunei, Peru, the Philippines and Papua New Guinea may have experienced lower trade growth.

As Table 3 indicates, in 2016 the Asia-Pacific economy exported goods and services valued at \$9.5 trillion (45% of world exports) and imported goods and services worth \$9.4 trillion (46% of world imports). These figures are notably higher than those in 2010. During this period, China emerged as a major global exporter on par with the US. Over 2010-2016, its share of world exports increased from 8.5% to 10.6%, while that of the US rose from 9.8% to 10.6%. The next largest exporter, Japan, saw its share fall from 4.5% to 3.8% over the same period. Meanwhile, the world export shares of

Korea (2.9%), Canada (2.3%), Hong Kong (2.9%) and Singapore (2.5%) were largely unchanged. Russia's world export share fell from 2.4% to 1.6%, and Mexico's share rose from 1.7% to 1.9%.

Flows of FDI in the Asia-Pacific economy are expected to have experienced a modest increase in 2017, fueled by higher growth expectations, faster trade growth and a recovery in corporate profits (UNCTAD, 2017). However, no projections on the value of FDI flows in 2017 are yet available for individual APEC economies. As Table 4 shows, FDI inflows into the region amounted to \$926 billion (or 53% of world FDI inflows) in 2016, while FDI outflows from the region came to \$876 billion (60%). These figures are significantly higher than those in 2010. The US is by far the region's largest recipient of global inward FDI, with a 22% share, as well as its largest source of outward FDI flows (21%). China and Hong Kong combined are the second largest recipients of world FDI inflows (14%) and sources of FDI outflows (17%). Although Japan receives little inward FDI (under 1% of world FDI inflows), it is a major outward investor (10% of global outflows). Conversely, Australia receives notable inward FDI inflows (3% of global inflows) but constitutes a small share of global outward FDI flows (less than 0.5%). The remaining Asia-Pacific economies account for relatively small shares of FDI inflows and outflows.

C. Global Value Chains (GVC)

As noted in our earlier report, GVCs have been instrumental in reorganizing industrial production in the 21st century, first in manufacturing but increasingly in services. Value chains make business more productive, deliver lower-cost and higher-quality products to consumers, and enable low-income economies to plug into world markets with far less capital, technology and skills than in the past.⁴ The Asia-Pacific region has been a pioneer in hosting these value chains. Empirically, this is demonstrated by the fact that the Asia-Pacific economy is characterized by an unusually high degree of intra-regional trade. Studies suggest that almost three-fourths of the region's exports and imports in 2016 were intra-regional (APEC, 2017). The major intra-regional exporters were found to be China, Japan and the US, while the main intra-regional importers were China, Hong Kong and the US.

The high degree of intra-regional trade in the region reflects the geographical spread of sophisticated GVCs with assembly operations occurring in low-wage economies and more developed economies specializing in higher value-added intermediate and capital goods. China has become the central GVC assembly hub in Asia and the US is the main market for final goods. This makes the prospects of a potential trade war across Asia-Pacific economies particularly worrisome. Japan, Chinese Taipei, Korea, Singapore and Thailand have become major suppliers of intermediate and capital goods. This complex pattern of specialization and trade in intermediate goods in the Asia-Pacific economy has been influenced by—and reflected in—rising FDI flows, falling barriers to trade and investment, declines in trade logistics costs and rapid technological change.

A revival in intra-regional trade has accompanied the increase in trade volumes in the Asia-Pacific since 2010. The Asia-Pacific economy's share of intra-regional trade rose from 64% to 66% between 2010 and 2016 (see Table 5), higher than, for example, intra-EU trade flows. This is attributed in part to a rise in the intra-regional trade share of the US from 62% to 65%, Japan from 67% to 69% and Korea from 64% to 68.0%. Southeast Asian economies and Chinese Taipei also saw rising intra-regional trade shares. Notable is the fall in China's intra-regional trade share from 58% to 57%. Slower growth and China's structural transformation away from exports and investment have translated into reduced demand for imports from the region including intermediate and capital goods.

⁴ Also, GVCs can enable micro, small and medium enterprises (MSMEs) to participate more in trade, by creating opportunities at low-cost/low volumes that would not otherwise exist.

China's transformation has had two important implications for GVCs in the region (Wignaraja *et al.* 2017). One is that some of China's production stages--particularly labor-intensive ones--are beginning to migrate from China to lower cost locations, as evidenced by a rise in China's outward-oriented FDI into manufacturing particularly in developing economies in Asia. This means that new manufacturing opportunities will be available for lower cost economies in Asia as well as in Latin America in a range of labor-intensive items, from clothing to electronics. There is also the phenomenon of "onshoring" – technology enabling what were originally higher labor-cost economies to regain manufacturing capability at lower cost.

Another is that China is following the model of higher domestic value added and building of innovation capability first seen in Asia through Japan and later Korea. This entails the development of more technologically sophisticated regional value chains and related services in East Asia, which can power a new phase of regional and global trade growth in the future. The spread of robotics, advances in miniaturization, developments in internet connectivity and research and development are increasingly likely to feature in GVCs in this new phase of trade growth.

D. The Emerging Digital Economy

Digital technologies can be a powerful enabler of trade and growth in Asia and the Pacific. As noted at length in our earlier report, the Asia-Pacific economy is leading the development of the global digital economy and seems likely to continue to do so in the medium term. This is both as producers and consumers of digital economy goods and services, including information and communications technology (ICT) products, electronic commerce (e-commerce), digital banking, analysis of big data, benefits of digital technologies for multinational corporations (MNCs) and many other digital applications. Governments are increasingly investing in public infrastructure (like smart cities), which help to overcome gaps in infrastructure development and provide e-government services which improve the efficiency of public service delivery for business and consumers. Digitally-provided services and other digital trade facilitation tools are increasingly reducing trade costs around the region.

The region's pivotal role in driving global digital economy development is indicated by the following:

- The development of sophisticated GVCs have positioned China as the global assembly hub for ICT goods with parts and components being supplied by several regional economies including the US, Japan, Korea, Chinese Taipei and Southeast Asia. A huge trade in final ICT goods and parts and components exists with as much as 84% of world exports of ICT goods in 2015 coming from the region's economies (UNCTAD, 2017).
- The Asia-Pacific is home to many of the world's leading MNCs in the digital economy including Amazon, Apple, Alphabet and Alibaba. By market capitalization, about one-third of the largest 135 MNCs in the digital economy are based in Asia alone.
- E-commerce has increased significantly with the US, Japan, China and Korea becoming the world's largest markets for business-to-consumer (B2C) e-commerce. Online payment platforms such as Alipay, Apple Pay, PayPal and eBay developed by MNCs have significantly reduced trade costs of cross-border trade.⁵ Online shopping is increasingly becoming a major competitor to physical shopping. As noted by Ecommerce Europe: *With a total B2C e-commerce turnover of \$567.3bn in 2013, Asia-Pacific was the strongest e-commerce region*

⁵ There are, however, rising concerns that some economies may be taking steps to favor domestic companies in managing payment platforms, which could significantly limit competition and consumer choice.

*in the world in 2013, as it surpassed Europe (\$482.3bn) and North America (\$452.4bn). In comparison with 2012, the Asian-Pacific B2C e-commerce turnover grew by 44.6%, which was the highest growth rate of all the regions.*⁶

- Digital banking using smart phones and internet banking have increasingly benefitted consumers and businesses across the region. More and more people appear willing to move some of their holdings to banks that offer a compelling digital offer and good IT security. Surveys suggest that digital banking penetration rates exceed 90% in Korea, Australia, Singapore and Chinese Taipei; over 80% in Japan; and over 55% in China.⁷ Mobile banking can also improve financial inclusion particularly in rural areas where there are few physical bank branches. In Papua New Guinea, for instance, mobile network operators have been exempt under the Banks and Financial Institutions Act 2000 to conduct mobile phone transfers.
- We predicted in our earlier report that digital technology will drive new strategies and designs in new as well as conventional sectors, such as automobile manufacturing. For example, technology companies such as Google and Apple are already devoted to building cars based on self-driving technologies. Changes are on the way even in mundane services such as auto repair, since consumers will know more about repair issues and options, supported by manufacturers and perhaps a new industry of repair advisors.
- E-government services have progressed with some economies becoming world leaders in one-stop platforms and on-line transactions. For instance, the 2016 UN e-Government Survey ranked six Asia-Pacific economies—namely, Australia (2nd), Korea (3rd), Singapore (4th), New Zealand (8th), Japan (11th) and the US (12th)—among the top dozen leaders on its global e-Government Development Index.⁸

Reflecting these impressive changes, mobile phone penetration rates are increasing rapidly across the region and driving internet adoption and changing consumer behavior. Mobile cellular subscriptions per 100 people in Asia and the Pacific rose sharply from 107.5 to 128.6 between 2010 and 2016 (see Table 6). Furthermore, the share of internet users in the region's total population increased from 51% to 67% over the same period. However, it seems that the digital economy is evolving at different speeds in the region particularly for internet adoption. In 2016, the share of internet users in developing economies (61%) was significantly lower than that in developed economies (87%). The leaders in internet use are Korea (93%), Hong Kong (87%) and Singapore (81%). Meanwhile, Mexico (60%), Peru (46%), Indonesia (25%) and Papua New Guinea (10%) are at the bottom.⁹ When GDP per capita is taken into account, the relatively high cost of internet access and relatively low levels of IT literacy remain obstacles to internet use in the region.

In lagging economies, digital technologies can help trade by supporting the efforts of small and medium enterprises (SMEs) to access world markets. SMEs comprise the bulk of business in Asia and the Pacific. They are likely to have a greater appetite for risk than larger firms and thus are better placed to adopt new digital technologies. A study by Deloitte prepared for Google examined the

⁶ <https://www.ecommerce-europe.eu/news-item/with-a-turnover-of-567-3-billion-asia-pacific-is-the-largest-e-commerce-region-in-the-world/>, accessed 23 March, 2018.

⁷ <https://www2.deloitte.com/insights/us/en/economy/voice-of-asia/may-2017/digital-role-economic-growth.html>.

⁸ <https://publicadministration.un.org/egovkb/en-us/reports/un-e-government-survey-2016>.

⁹ It is noteworthy that these four economies have relatively low ranks on the UN e-Government Development Index. Their ranks are: Mexico (59th), Peru (81st), Indonesia (116th), and Papua New Guinea (179th). Other low ranked regional economies include: Brunei (83rd) and Vietnam (89th). ⁹ <https://publicadministration.un.org/egovkb/en-us/reports/un-e-government-survey-2016>

potential gains from SMEs in Indonesia from adopting digital technologies.¹⁰ It reported that less than one in ten SMEs considered themselves as having advanced online capabilities while 73% are offline or had very basic capabilities. The study suggests that Indonesian SMEs could reap several gains from embracing digital technologies including up to 80% higher revenues, 17 times the current potential for innovation and greater international competitiveness. Somewhat ambitiously perhaps, it concludes that improving SMEs' digital engagement could increase Indonesia's annual economic growth by as much as 2% and enable it to make the jump to middle-income economy status by 2025.

Several risks face developing economies in the Asia-Pacific that under-invest in preparing for the fast-moving digital economy. First, the gains from higher productivity arising from digitalization typically go to a relatively small number of skilled workers, which may exacerbate income inequality. Second, jobs in a wide spectrum of manufacturing (e.g. textiles and garments) as well as services (e.g. retail trade and business process outsourcing) are likely to become obsolete with digitalization and the associated automation technologies like robotics and artificial intelligence. This structural change could lead to significant job losses.

Third, there are concerns about data privacy, security and cyber-crime with the increasing spread of the internet and data flows. This worry is vividly illustrated by the on-going Facebook data privacy scandal involving the misuse of personal data by Cambridge Analytica's election ad targeting toolset. Digital openness (including free cross-border flows of data and information) boosts productivity and investment, helps to create jobs and expand economic growth – and can in fact enhance both consumer protection and cybersecurity by enabling innovative approaches such as cloud-based storage and encryption and collaborative approaches to cybersecurity threats. Restrictions on digital trade undermine the capacity of economies (and MSMEs, as well as other businesses) to reap the benefits of the digital transformation and risk creating a new “noodle bowl” of restrictions for business.

Asia-Pacific economies are at the forefront of the world's digital revolution and leading a wide range of digital engagement across business, consumption and government sectors. While overall results are impressive, different economies are evolving different speeds. Downside risks of marginalization during the digital revolution are emerging and will necessitate approaches to ensure that emerging economies have a 'future-ready workforce' with the necessary digital literacy and skills and adequate infrastructure and regulatory settings to take full advantage of the opportunities that the digital economy offers. There are opportunities for economies to increase their trade and growth by learning from each other's experiences.

III. New Policy Developments

A. Global and Regional Trends in Applied Policy Measures: Contained, but Clouds Ahead

Protectionism remains a salient threat to the world trading system. Although the rate of application of new restrictive measures in world trade has slowed and the applications of trade-remedy measures (like anti-dumping duties) have also not apparently risen, a large stock of trade-restrictive measures has accumulated since the Global Financial Crisis. The WTO Trade Policy Review Body (TRBD) found that, in the year to October 2017, 108 new trade-restrictive measures were put in place, including new or increased tariffs, customs regulations, quantitative restrictions and local content measures. This rate of application is 9 measures per month compared to 15 in the previous year. Over

¹⁰ <https://www2.deloitte.com/id/en/pages/financial-advisory/articles/smes-powering-indonesia-success-report.html>

2012-2017, the number of new measures averaged 14 per month (although in some periods it was over 20 per month).¹¹

However, the bad news is that the absolute numbers are large, and the stock of measures has increased significantly over time, even though the rates of increase have been relatively steady. The Australian Productivity Commission reports that the stock of new measures quadrupled between 2010 and 2015.¹² The WTO Director-General Roberto Azevêdo remained concerned about protectionism and said that, while these 2017 numbers were welcome, substantial risks that threaten the world economy remain in place and could easily undermine any trade recovery. He notes that much work needs to be done to help facilitate trade, including avoiding measures which can hamper and restrict trade flows.

The Director General's reference to trade facilitation is related to the implementation of the Trade Facilitation Agreement (TFA) in February 2017. This was an important achievement by the WTO and a major event since our last report. According to the WTO Secretariat, the full implementation of the TFA will see an average decrease in transaction costs by around 14.3 percent (WTO, 2015). This impact is significant, since it amounts to a real saving of resources; reducing a tariff of the same order, for example, may have a similar effect on trade but would include a reduction in revenue collection for the government. The TFA would have many advantages especially for small businesses and their ability to participate in trade, a major priority of ABAC. There are also benefits from less uncertainty in moving goods across borders.

Since our 2015 report, there has been an increase in the protectionist rhetoric and action in the Asia-Pacific region. Unilateral actions to restrict trade flows create uncertainty for business and trading partners, could undermine multilateral economic governance, and risk the stability and sustained economic growth of the region.

In other WTO-related matters, the December 2017 Ministerial Meeting in Buenos Aires produced disappointing outcomes, other than bolstering some work programs.¹³ No statement by Ministers was forthcoming. There was no concrete progress in limiting even illegal fishing subsidies, as some had hoped, and no consensus was reached on future work on agriculture including trade-distorting subsidies. There was some progress to continue to apply a moratorium on tariffs on electronic transactions and a group of members agreed to undertake a project on trade-related aspects of electronic commerce, including a number of APEC members. Other programs of work included initiatives related to small and medium enterprises and to domestic regulation, as well as an informal Declaration on gender and trade.

At the time of this writing, there are growing worries about rising protectionism that could lead to an all-out trade war among major global economies. The decision to impose steel and aluminum tariffs for national-security reasons on June 1 has led to threats of retaliation with tit-for-tat measures from major global economies. Other economies are seeking to take up these issues in the WTO context.

These developments create a dilemma for the WTO, particularly when they involve large and influential member-economies. There may be a challenge in the WTO to their legitimacy (e.g., on the basis that they abuse the intention of Article 21 of GATT regarding "essential security interests"), but such a challenge poses a dilemma for the WTO: if accepted, it could lead to others emulating the approach. If not, the central role of the WTO in global trade governance might be challenged.

¹¹ https://www.wto.org/english/news_e/news17_e/trdev_04dec17_e.htm

¹² <https://www.pc.gov.au/research/completed/rising-protectionism>

¹³ <https://www.ictsd.org/bridges-news/bridges/news/wto-ministerial-in-landmark-move-country-coalitions-set-plans-to-advance>

B. Update on Regional Agreements

The interest in FTAs as a vehicle of liberalization continues to grow. Among its members, the Asian Development Bank reports that since 2015, the number of FTAs signed and in effect has risen from 144 to 151, those signed but not yet in effect from 5 to 10, and those in negotiation from 68 to 78. Even more significant is the rise in the number proposed FTAs from 67 to 91.¹⁴ Most of these agreements in force (80%) are bilateral, but the share of multi-member agreements is rising, comprising 44% of FTAs over the 2011-2015 period. Asian FTAs are also increasingly global, with nearly two-thirds of FTAs launched over 2010-2015 being with non-Asian partners. Given the scale of the potential benefits involved and the revealed interest in the movement in favor of FTAs across the whole region, our focus in this section is on emerging major regional agreements.¹⁵ This trend continues along the path described in our first report.

As noted above, the most significant recent event with respect to regional arrangements was the signing in March 2018 of the CPTPP, which includes 11 economies (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam). The CPTPP is substantially smaller in terms of economic than the original TPP; the TPP members accounted for 37% of global GDP and 26% per cent of global trade, while the current CPTPP accounts for 14% and 15%, respectively.¹⁴ A number of the members already had agreements with each other but there are additional impacts from deeper tariff cuts and new services trade liberalisation, new commitments in non-traditional areas including non-tariff measures (NTMs) and regulatory coherence, and rules governing a wide-variety of trade-related activities, from state-owned enterprises (SOEs) to the digital economy, as well as coverage of relationships where previously no agreement existed. While smaller than the TPP, therefore, its important contribution to regional regulatory- and norm-setting, particularly in ‘new’ areas such as the digital economy and regulatory coherence, remains.

A number of provisions of the TPP have been suspended under the CPTPP¹⁶, including the coverage of patents on some pharmaceutical products, policy changes affecting express delivery services and procedures related to investor-state disputes. These remain in the agreement but are suspended from implementation. Other changes relate to obligations to reform SOEs and labor commitments by Malaysia and Vietnam, plus there is a side letter about Canadian continued protection of its cultural industries.¹⁷ In our earlier report we identified a series of business trends, and areas we recommended should receive attention in any further efforts towards integration. The TPP and now the CPTPP have good coverage of these issues including e-commerce. Despite the suspensions, the CPTPP remains remarkably similar to the original TPP and certainly is a milestone agreement for the Asia Pacific.

Economies not participating in the CPTPP will be negatively affected not only because of foregone income and trade benefits but also the negative effects of trade diversion and preference erosion in acceding economies (Petri and Plummer 2016). Could other economies possibly join the CPTPP? The “suspended” measures, all of which are of particular interest to advanced economies, were included as an incentive to return to the TPP12 and beyond. Indeed, new members may join (and existing members have expressed a desire to see the agreement expanded to others prepared to make

¹⁴ <https://aric.adb.org/database/fta>

¹⁵ <https://aric.adb.org/blog/the-resurgence-of-bilateralism-and-asias-evolving-fta-landscape>

¹⁶ There are various summaries of these suspensions and their significance: see for example <https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-concluded-but-not-in-force/cptpp/tpp-and-cptpp-the-differences-explained/>; <http://dfat.gov.au/trade/agreements/tpp/news/Documents/annex-2.pdf>; <http://www.asiantradecentre.org/talkingtrade//tpp11-unpacking-the-suspended-provisions>; <https://static1.squarespace.com/static/5393d501e4b0643446abd228/t/5aa0eb3c9140b75cb2070691/1520495424652/Policy+Brief+17-11a+TPP11+Suspensions+%28with+amendments%29.pdf>; <https://www.ictsd.org/bridges-news/bridges/news/tpp-11-trade-talks-approach-finish-line-under-a-new-name>

¹⁷ <https://piie.com/blogs/trade-investment-policy-watch/tpp-redux-why-united-states-biggest-loser>

the same kind of ambitious commitments) but subject to the conditions negotiated and agreed with existing members:

After the date of entry into force of this Agreement, any State or separate customs territory may accede to this Agreement, subject to such terms and conditions as may be agreed between the Parties and that State or separate customs territory.¹⁸

Economies expressing a possible interest in joining include Korea, Indonesia, the Philippines, Chinese Taipei, and Thailand. The UK has also said it would like to consider entering into negotiations after its Brexit transition period (most likely after 2020).

The other major project in the region is the negotiation of the Regional Comprehensive Economic Partnership (RCEP). The most recent Ministerial statement¹⁹ said that the goal remains to come up with a “good, commercially meaningful RCEP agreement that meets the commitment to achieve a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement”. The Ministers have set a new goal to complete an agreement in 2018. The statement underscores that some of the chapters have already been completed (Economic and Technical Cooperation and Small and Medium-sized Enterprises) and others were nearly finished.

The Ministers also indicated a difference in opinions about the end point of the negotiations and proposed to accommodate that by consideration of “landing zones”. They referred to both the role of transition periods and the provision of capacity building. The Ministers also referred to work on tariffs, services, investment and rules, in fact:

- “welcomed progress made in the discussions on the tariff modality and its parameters, and the further intensification of the request and offer process.
- instructed negotiators (on services) to continue resolving outstanding issues and improving offers across all modes of supply, while working together to address specific sensitivities faced by (participating countries, or RPCs).
- expressed appreciation on the growing convergence among RPCs on the outstanding issues on investment and instructed RPCs to consider to improve reservation lists.
- reiterated the commitment to expedite negotiations on rules, geared towards facilitating trade and investment in support of the expansion and deepening of regional value chains.”

Clearly there is substantial work required to complete the RCEP agreement. It is important to have a target date for completion so as to maintain the program of work and the negotiating process, but the quality of the agreement is also critical for regional economic integration. There is likely to be a trade-off between the two but better quality is worth waiting for, given the following three points of significance about RCEP.

The first is that RCEP is centred on ASEAN and would thereby be expected to reflect its principles of integration. As Menon (2018) says, “ASEAN’s success lies in its almost unique use of regionalism as a means towards a greater end—maximising the welfare of its citizenry through the pursuit of global integration” (p.7). The evident commitment to this principle is important in the current environment, particularly given the new leadership void at the global level.

The second is that RCEP can be used to send an important signal. A commitment to economic integration and to the principles of the world trading system is critical to structural change and thereby growth in the region. A successful conclusion of RCEP can demonstrate the commitment of its

¹⁸ <http://dfat.gov.au/trade/agreements/tpp/official-documents/Documents/tpp-11-treaty-text.pdf>

¹⁹ <http://asean.org/storage/2018/03/JMS-4th-RCEP-ISSL-MM-FINAL-0303181.pdf> 3 March 2018

members to these goals. But RCEP has to be sufficiently credible to have this effect, and a test of credibility would be, for example, that the opportunities it creates through the commitments of its members in all areas attract the attention and mobilise the interests of businesses in OECD economies, energizing the policy debate in these countries regarding the value of openness. The CPTPP will have some effect in that respect, as indicated in the modelling results discussed below. RCEP can add to that impact.

The third is the relationship of RCEP with the CPTPP. As noted above, a salient contribution of the CPTPP is its treatment of key issues related to the evolution of international business, such as digital transactions, e-commerce, the updating of rules, and other issues which we stressed in our earlier report. Meeting the expectations of the agreement will be demanding for some economies. For example, the levels of commitment on tariff reduction are higher in CPTPP than is immediately likely in RCEP. CPTPP covers matters that will demand considerable institutional development in many economies. These include matters related to state-owned enterprises, government procurement, regulation and data flows. Some transition period may be required for all RCEP members to move toward the CPTPP commitments. One way of managing that transition is via the processes of RCEP itself, which includes an understanding of and provisions for capacity building. In other words, the complementarity of the agreements is becoming clearer. With the CPTPP now signed, the next big milestone for regional integration will be the RCEP agreement.

What forces might drive RCEP to make these contributions by reaching a credible conclusion within a reasonable period of time? How can the RCEP process deliver a satisfactory result? Leadership will be required, and more than one economy may be required to take that role. Size helps in this situation, but the larger economies among the current membership face considerable domestic challenges in making the commitments required for success. A team effort is more likely to be effective: ASEAN, given its history, size, ambition and commitment to global integration is drawing attention as the first place where that effort might be sought.²⁰ The signs of this contribution are positive; in the Joint Statement of the ASEAN-Australia Special Summit on 18 March 2018, the Leaders said that they would “commit to intensify efforts in 2018 towards a swift conclusion of a modern, comprehensive, high quality, and mutually beneficial Regional Comprehensive Economic Partnership (RCEP).”²¹ After all, when it was launched in November 2012, RCEP negotiations were slated to be led by “ASEAN Centrality”. APEC has an essential and complementary role as a forum for dialogue on RCEP.

Another major initiative in the region is the Pacific Alliance, the most recent development of which is its active engagement with Associate Members. The original members were Chile, Colombia, Mexico and Peru (all except Colombia being CPTPP members). Other economies which have trade agreements with at least half the members can apply for full membership, as have Costa Rica and Panama. A new category of associate membership has also been created, and negotiations about its conditions occurred in February 2018. Those currently in negotiating with the Pacific Alliance include Canada, Australia, New Zealand and Singapore, also all CPTPP members. Clearly, the Pacific Alliance has significant potential to deepen trans-Pacific links.

The original members of the Pacific Alliance, all with a Pacific orientation (in contrast to Mercusor members), have been working on the traditional matters of an FTA--such as coverage of tariff reductions, rules of origin and investment provisions--but have also done interesting work in integrating financial markets (e.g., stock markets) and facilitating people movement (including cooperation among policing and customs agencies on cross border illegal activities), as well work on

²⁰ <http://www.afr.com/opinion/columnists/asean-must-be-bulwark-of-free-trade-20180314-h0xg7r>

²¹ <https://aseanaustralia.pmc.gov.au/Declaration>

e-commerce, air transport and infrastructure. The original members point to the value of the current negotiations with the proposed associate members in terms of the coverage of the discussions in areas not yet included in the intra-Pacific Alliance process, such as small and medium-sized enterprises, labor and the environment.

C. Empirical Literature Related to Asia-Pacific Integration

The “size of the prize” from deeper economic integration remains significant according to the empirical literature, although there are interesting differences in the magnitude of impacts from various scenarios among economies. The original TPP might be a useful benchmark. Kawasaki (2017) uses a standard Computable General Equilibrium (CGE) model and finds significant benefits, especially from reductions in NTMs: the total increase in real GDP relative to the baseline for all members would be 0.15% from tariffs reductions and 1.73% from reductions in NTMs. For the CPTPP, he finds that these impacts fall to 0.05% and 1.09%, respectively. Excluded economies tend to lose due to the CPTPP via trade diversion and preference erosion.

Kawasaki (2017) shows even larger gains from RCEP implementation, relative to baseline GDP of participating economies, with benefits of tariff reductions of 1.89% and those from tariffs plus NTM reductions, 4.19%. He points out the variation in these values across economies, ranging from small in a large economy like China to very large in some ASEAN economies. The scale of these benefits reinforces the earlier point about the value of ASEAN leadership. The negative effects on excluded economies are mitigated via an increase in market access due to the non-discriminatory reductions in NTMs (e.g., reductions in trade costs due to trade facilitation measures are reaped by all economies, not just members).

Petri, et. al. (2017) also use a CGE model to examine the outcomes of CPTPP and RCEP, but with a different scenario in terms of policy change compared to that assumed by Kawasaki. They find that real income of member economies would be 1.0% higher in CPTPP and 0.4% higher in RCEP relative to the 2030 baseline. These are significant impacts but the outcomes differ compared to Kawasaki (2017) in relative terms due in part to underlying parametric assumptions; Petri, et. al. (2017) are more pessimistic about the capacity of RCEP to deliver significant changes in openness and assume smaller non-discriminatory spillover effects of NTMs in both agreements. In addition, they assume that the CPTPP will entail a lesser degree of liberalization than under TPP (in which they estimate that long-term increase in the real income of member-economies would be slightly higher, 1.1%, as opposed to the 1.0% for members of the TPP12). Some CPTPP members benefit significantly less than they do in TPP (for example, Japan, Malaysia and Vietnam). Moreover, Petri, et. al. (2017) point out that, related to the question of accession, adding the five economies who have expressed interest in joining the TPP/CPTPP (that is, Indonesia, the Philippines, Korea, Chinese Taipei and Thailand) would more than double the benefits as a percentage of regional income. Also because of their assumptions about the quality differences, the benefits of CPTPP with 16 members is close to double that of RCEP. These results point to the benefits of quality (i.e., deeper coverage) and quantity (i.e., wider membership).

Ciuriak, et. al. (2017) present another set of estimates of these arrangements, with the same overall direction of results but with smaller magnitudes. They find that TPP and CPTPP would increase over the long-run members’ GDP by 0.098% and 0.075%, respectively. They, too, find that Malaysia, Vietnam and Japan benefit much less from CPTPP than in the TPP.

In our earlier report, we included estimates of the economic effects of the FTAAP itself, defined as a group that included all APEC member-economies, and this form of an FTAAP was then compared to RCEP and TPP, based on Petri, Plummer and Zhai (2012). These numbers are summarized in Figure

3. Although both the RCEP and TPP pathways generate significant positive net benefits, the gains from the FTAAP are much greater. Petri, Plummer and Zhai (2012) estimate that the aggregate income benefits from the FTAAP could range from \$1.3 to \$2.4 trillion dollars per year by 2025, and show the region's trade (in a middle scenario) 26% higher than it would be otherwise. These gains would be considerably larger than from completing any individual pathway. Because the region is already well integrated, the vast majority of the gains would be due to trade creation rather than trade diversion from excluded economies. Three-fourths of the gains would come from the liberalization of regulatory barriers in manufacturing, services, and investment.

The large, positive results from an FTAAP are echoed in Shephard (2018), which uses a gravity model approach to show that the gains from an FTAAP are much larger than the TPP and RCEP. The paper emphasizes that these mega-regionals have great potential to deepen value chains in the region.

IV. Moving forward: Overcoming Challenges to Promoting the Pathways to an FTAAP

The FTAAP should do more than achieve liberalization in its narrow sense; it should be comprehensive, high quality and incorporate and address 'next generation' trade and investment issues.

APEC Secretariat 2015

APEC comprises 21 economies that account for about half of world GDP and trade. The region has lifted hundreds of millions of people out of poverty, and has built a prosperous middle class, which is likely to expand to more than two billion people by 2030. The region is growing faster than the rest of the world and remains a key engine of global prosperity. Despite uncertainties over the short-term, the 21st century is shaping up as the Asia-Pacific Century.

It is well documented that much of the Asia-Pacific success story is due to regional economic integration and openness to trade and investment. As we noted in our earlier report, the private sector ultimately drives growth, and this growth has been made possible via a global market, rather than just national ones. But business requires strong institutions and predictable and open policies to enable it to flourish. APEC has contributed to supporting predictable and open policies since its creation in 1989; ABAC has been a key source of ideas and vehicle for progress. The Bogor Goals envisioned an Asia-Pacific market that would be characterized by "open trade and investment". It established a goal that was further articulated by the 2010 Yokohama Vision, which sought the creation of an FTAAP, with a trans-Pacific pathway and an Asian pathway leading to it. The former has now been manifested in CPTPP and the Pacific Alliance, and the later in RCEP. The Yokohama Vision emphasizes the determination of APEC member-economies to "...further promote regional economic integration, working toward the target year of 2020 envisaged by the Bogor Goals for all APEC economies to achieve free and open trade and investment."²²

Our earlier report underscores the key role that ABAC plays in promoting integration across all its membership via four pillars: *inclusivity*, ensuring benefits also for low-income economies and for small- and medium-sized enterprises; *comprehensiveness*, covering all industries (including oft-neglected areas such as services) and all types of business operations; *consultation*, seeking input from many stakeholders, including business; and *transparency*, ensuring clear and predictable rules and regulations.

²² Quote taken from the White House release, *APEC Leaders Declaration: The Yokohama Vision – Bogor and Beyond*, available at: <https://obamawhitehouse.archives.gov/the-press-office/2010/11/13/apec-leaders-declaration-yokohama-vision-bogor-and-beyond>

Since our last report, the regional economy has gained momentum. This is true for growth in GDP, trade, and FDI. The digital economy continues to boom, and new transformative technologies—from self-driving automobiles to artificial intelligence—continue to shape the future of the Asia-Pacific economy. While growth in these areas has not been linear, their key importance was in evidence two years ago and were treated at length in our report.

Hence, in this update we have discussed new risks that could have a negative bearing on the generally optimistic growth forecasts, as well as to the future of Asia-Pacific economic cooperation. Certainly, the most pressing challenge relates to the rise in nationalism, populism and anti-trade sentiments in key economies. Critically, the looming trade war is a prominent concern for all economies in the Asia-Pacific region.

But despite these emerging challenges, there continues to be a strong interest among regional economies to pursue deeper economic integration. An important testimony to this is the decision to move forward with the CPTPP after the TPP could not be realized. The strong interest in enlarging the CPTPP is also encouraging and could yield great benefits.

The RCEP also continues to move forward and could reach an agreement by the end of the year, albeit likely at a lower standard than CPTPP. Hence, the pathways moving toward an FTAAP are progressing, with the Pacific Alliance serving as an additional platform for deepening intra-APEC cooperation.

This update has underscored that deeper economic integration enhances growth prospects and that a comprehensive, modern, rules-based approach to global economic governance is necessary to success in the 21st century. Additionally, building coalitions among smaller economies via liberalization “pathways” and in other fora to support concerted liberalization is essential to ensure that the Bogor Vision moves forward and to preclude a retreat from regional and global markets.

Moreover, the above analysis stressed that there are significant costs to remaining outside of the integration process in which virtually all APEC member-economies are now intricately bound. In addition to the foregone benefits of integration, excluded countries suffer from trade and investment diversion, as well as preference erosion in markets in which economies already have preferential access. There also could be disruptions in the supply chains of MNCs, or at least businesses will forego the tremendous economic potential that mega-regionalism holds for GVCs. Further, excluded economies will be outside the 21st century rule-making process that was such an important advantage of—and motivation for--the TPP. This cost is in evidence from the fact that essentially all “suspended” provisions in the CPTPP are of interest to advanced economies.

In any event, the economic and political costs of staying out of the process of integration will be made clear over time. Economic studies stress that the TPP is, in fact, a good agreement for all; perhaps this will be more evident once countries outside of the CPTPP start to bear the costs of being isolated from the process. Domestic politics in certain economies might also play a key role, with pro-trade parties and interest groups making their cases. In addition, the private sector will continue to press its case, particularly since firms in excluded economies could have to compete at a disadvantage.

Expansion of the CPTPP to include additional economies could yield large benefits. Petri, et. al. (2017) show that a CPTPP that includes the five economies expressing an interest in joining would generate gains on par with the original TPP—despite the fact that it would still be much smaller in aggregate—and almost double RCEP benefits. It could be that an expansion of the CPTPP will take place before FTAAP negotiations. Indeed, a CPTPP+RCEP configuration could yield global gains that would be considerably more than the TPP itself, though less than an FTAAP.

In terms of sequencing, it is not clear when negotiations that would lead to an FTAAP would begin, though given the Yokohama Vision of open trade and investment by 2020 one would expect it to be not too far in the future. Still, since the CPTPP and RCEP will enter into effect in 2019 in the most optimistic scenario, 2020 would be ambitious. And given the many uncertainties noted above, it would be difficult to predict how these arrangements will play out.

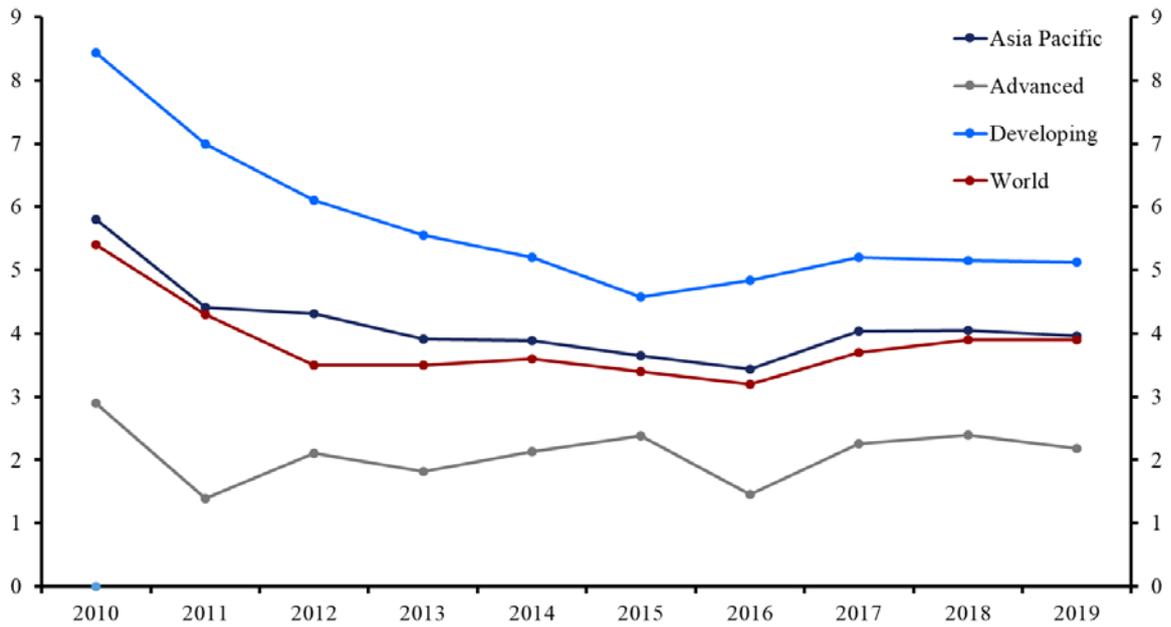
In the meantime, much will need to be done in order to underscore the gains from trade in all economies, while also addressing the key policy challenge of being inclusive. Populism essentially argues that trade hurts an economy because of this effect. Indeed, increasing efficiency requires the shifting of resources including labor, a process that is costly to those who are displaced. This is as true for trade as it is for disruptive technological change or automation. Rather than block structural change, public policy needs to support those who are negatively affected. Economic liberalization needs to be accompanied by well-resourced and targeted active government policies that provide training and compensation to displaced workers, and support the most vulnerable.

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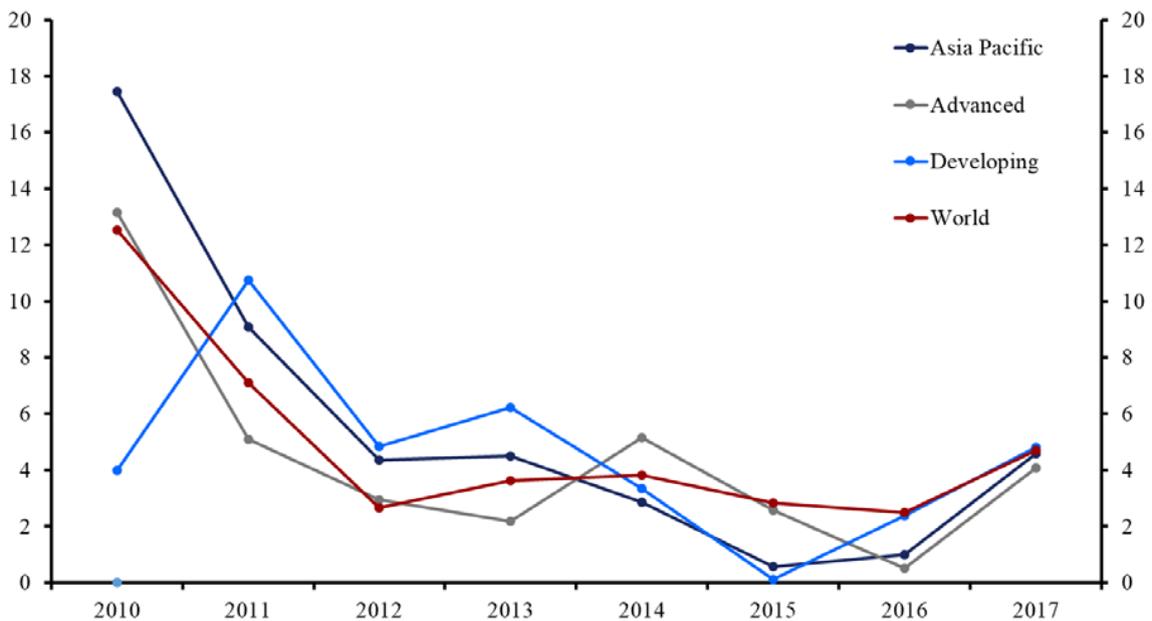
Appendix

Figure 1. Annual GDP Growth Rate (%)



Source: IMF, World Economic Outlook Database and WEO January 2018 Update. Accessed on January 2018

Figure 2. Trade Volume Growth (%)



Source: IMF, World Economic Outlook Database. Accessed on January 2018

Note: Simple sum of the weighted averages of export volume growth and import volume growth (goods and services)

Table 1. Annual GDP Growth Rate*Percentage Change (%)*

Economy	2010	2011	2012	2013	2014	2015	2016	2017 (b)	2018 (b)	2019 (b)
Australia	2.3	2.7	3.6	2.1	2.8	2.4	2.5	2.2	2.9	3.0
Brunei Darussalam	2.7	3.7	0.9	-2.1	-2.5	-0.4	-2.5	-1.3	0.6	8.7
^(a) Canada	3.1	3.1	1.7	2.5	2.6	0.9	1.5	3.0	2.3	2.0
Chile	5.8	6.1	5.3	4.0	1.9	2.3	1.6	1.4	2.5	2.7
^(a) China	10.6	9.5	7.9	7.8	7.3	6.9	6.7	6.8	6.6	6.4
Hong Kong SAR	6.8	4.8	1.7	3.1	2.8	2.4	2.0	3.5	2.7	2.9
Indonesia	6.4	6.2	6.0	5.6	5.0	4.9	5.0	5.2	5.3	5.5
^(a) Japan	4.2	-0.1	1.5	2.0	0.3	1.1	1.0	1.8	1.2	0.9
Korea	6.5	3.7	2.3	2.9	3.3	2.8	2.8	3.0	3.0	3.0
Malaysia	7.5	5.3	5.5	4.7	6.0	5.0	4.2	5.4	4.8	4.8
^(a) Mexico	5.1	4.0	4.0	1.4	2.3	2.7	2.3	2.0	2.3	3.0
New Zealand	2.0	1.9	2.5	2.1	2.8	3.2	3.6	3.5	3.0	2.5
Papua New Guinea	10.1	1.1	4.6	3.8	12.5	9.2	2.4	3.1	2.9	2.6
Peru	8.5	6.5	6.0	5.8	2.4	3.3	4.0	2.7	3.8	4.0
Philippines	7.6	3.7	6.7	7.1	6.1	6.1	6.9	6.6	6.7	6.8
^(a) Russia	4.5	5.1	3.7	1.8	0.7	-2.8	-0.2	1.8	1.7	1.5
Singapore	15.2	6.2	3.9	5.0	3.6	1.9	2.0	2.5	2.6	2.6
Chinese Taipei	10.6	3.8	2.1	2.2	4.0	0.7	1.5	2.0	1.9	2.0
Thailand	7.5	0.8	7.2	2.7	0.9	2.9	3.2	3.7	3.5	3.4
^(a) United States	2.5	1.6	2.2	1.7	2.6	2.9	1.5	2.3	2.7	2.5
Vietnam	6.4	6.2	5.2	5.4	6.0	6.7	6.2	6.3	6.3	6.2
Asia Pacific	5.8	4.4	4.3	3.9	3.9	3.6	3.4	4.0	4.0	4.0
Advanced	2.9	1.4	2.1	1.8	2.1	2.4	1.5	2.3	2.4	2.2
Developing	8.4	7.0	6.1	5.6	5.2	4.6	4.8	5.2	5.2	5.1
World	5.4	4.3	3.5	3.5	3.6	3.4	3.2	3.7	3.9	3.9

Source: IMF, World Economic Outlook and WEO Update 2018. Accessed January 2018**Notes:** (a) Includes latest figures from the World Economic Outlook Database, January 2018 Update. (b) Projections

Table 2. Trade Volume Growth
Percentage Change (%)

Economy	2010	2011	2012	2013	2014	2015	2016	2017 ^a
Australia	10.5	5.6	5.6	1.9	2.9	4.0	3.7	5.2
Brunei Darussalam	4.3	2.9	3.9	-6.7	-15.0	-11.3	-3.7	-6.1
Canada	10.2	5.2	3.1	2.2	4.0	1.9	0.1	3.5
Chile	14.0	10.3	2.7	2.7	-3.1	-2.3	-0.8	2.1
China	22.8	16.2	6.2	9.7	6.0	-1.3	3.0	5.0
Hong Kong SAR	18.0	5.2	3.7	8.1	1.0	-1.6	1.0	4.8
Indonesia	10.9	11.7	8.0	2.2	0.2	-3.1	1.2	4.2
Japan	18.0	2.8	2.7	2.0	8.8	1.9	-0.6	4.6
Korea	15.0	14.7	3.7	3.0	1.7	1.0	3.3	3.3
Malaysia	7.9	5.9	-3.5	1.0	5.2	2.9	2.5	5.7
Mexico	20.5	8.1	5.7	2.5	6.5	9.5	1.2	4.7
New Zealand	7.0	4.8	2.3	3.5	5.5	5.4	2.6	3.0
Papua New Guinea	21.5	7.0	9.5	-6.9	13.1	13.3	-3.0	-3.6
Peru	14.3	10.0	7.5	-0.2	-1.3	1.3	4.3	4.1
Philippines	18.1	-1.2	13.4	2.4	13.0	7.1	13.0	6.2
Russia	18.7	9.9	4.0	3.4	-4.8	-12.7	-2.1	4.6
Singapore	16.9	3.4	2.5	6.2	4.2	5.7	1.6	2.6
Chinese Taipei	26.7	2.0	1.0	4.1	5.3	0.8	2.2	2.4
Thailand	18.6	11.0	5.3	2.2	-2.6	1.3	-0.7	5.7
United States	12.3	6.2	2.8	2.3	4.4	2.7	0.5	3.9
Vietnam	5.5	-0.2	12.4	17.0	11.5	13.0	11.0	12.7
^(b) Asia Pacific	17.4	9.1	4.4	4.5	2.9	0.6	1.0	4.6
Advanced	13.1	5.1	3.0	2.2	5.1	2.6	0.5	4.1
Developing	4.0	10.8	4.8	6.2	3.3	0.1	2.4	4.8
World	12.5	7.1	2.7	3.6	3.8	2.8	2.5	4.7

Source: World Bank, World Development Indicators Database. Accessed January 2018

Notes: (a) 2017 figures are estimates. (b) Simple sum of the weighted average of export and import volume growth rates (goods and services)

Table 3. Exports and Imports of Goods and Services

Exports						
Economy	2010		2015		2016	
	Trade Value (US\$ Millions)	World Share (%)	Trade Value (US\$ Millions)	World Share (%)	Trade Value (US\$ Millions)	World Share (%)
Australia	222,103	1.17	264,829	1.24	227,285	1.09
Brunei Darussalam	9,240	0.05	6,751	0.03	5,652	0.03
Canada	469,066	2.48	490,372	2.30	474,344	2.28
Chile	82,487	0.44	71,975	0.34	70,314	0.34
Hong Kong SAR, China	469,445	2.48	606,075	2.85	601,311	2.89
China	1,602,475	8.47	2,431,264	11.42	2,199,968	10.57
Indonesia	183,481	0.97	182,167	0.86	177,884	0.85
Japan	857,110	4.53	772,994	3.63	797,490	3.83
Korea, Rep.	540,896	2.86	626,899	2.94	596,084	2.86
Malaysia	221,687	1.17	209,287	0.98	200,658	0.96
Mexico	313,989	1.66	404,706	1.90	399,504	1.92
New Zealand	44,356	0.23	48,916	0.23	48,811	0.23
Papua New Guinea						
Peru	41,052	0.22	40,298	0.19	43,144	0.21
Philippines	69,464	0.37	83,135	0.39	85,267	0.41
Russian Federation	445,513	2.36	391,556	1.84	329,938	1.58
Singapore	472,246	2.50	528,176	2.48	511,239	2.46
Chinese Taipei						
Thailand	226,788	1.20	275,818	1.30	280,450	1.35
United States	1,852,335	9.79	2,264,916	10.64	2,214,566	10.64
Vietnam	83,474	0.44	173,490	0.81	192,188	0.92
Asia Pacific	8,207,207	43.39	9,873,624	46.38	9,456,096	45.43
NON – Asia Pacific	10,707,798	57	11,416,049	54	11,360,216	55
World	18,915,005	100	21,289,673	100.00	20,816,311	100

Imports						
Economy	2010		2015		2016	
	Trade Value (US\$ Millions)	World Share (%)	Trade Value (US\$ Millions)	World Share (%)	Trade Value (US\$ Millions)	World Share (%)
Australia	233,202	1.26	284,286	1.36	253,979	1.24
Brunei Darussalam	3,833	0.02	4,226	0.02	4,303	0.02
Canada	499,993	2.71	527,476	2.53	510,595	2.50
Chile	68,443	0.37	72,242	0.35	68,237	0.33
Hong Kong SAR, China	456,013	2.47	598,683	2.87	594,477	2.91
China	1,380,075	7.48	2,045,761	9.81	1,950,367	9.53
Indonesia	169,158	0.92	178,472	0.86	170,658	0.83
Japan	773,860	4.20	787,152	3.77	745,652	3.64
Korea, Rep.	506,037	2.74	530,642	2.54	500,172	2.44
Malaysia	181,099	0.98	186,603	0.89	180,820	0.88
Mexico	326,637	1.77	426,990	2.05	418,274	2.04
New Zealand	40,993	0.22	47,671	0.23	48,326	0.24
Papua New Guinea	..					
Peru	35,181	0.19	44,863	0.22	42,974	0.21
Philippines	73,083	0.40	100,405	0.48	112,613	0.55
Russian Federation	322,367	1.75	281,420	1.35	263,747	1.29
Singapore	410,658	2.23	451,233	2.16	434,389	2.12
Chinese Taipei						
Thailand	207,270	1.12	229,553	1.10	220,486	1.08
United States	2,364,992	12.83	2,788,958	13.37	2,735,805	13.37
Vietnam	92,995	0.50	171,962	0.82	186,929	0.91
Asia Pacific	8,145,887	44.18	9,758,599	46.80	9,442,805	46.15
NON – Asia Pacific	10,293,147	56	11,094,707	53	11,016,717	54
World	18,439,034	100	20,853,306	100	20,459,522	100

Source: World Development Indicators Database, World Bank. Accessed on January 2018

Table 4. Foreign Direct Investment

Inward Foreign Direct Investment						
Economy	2010		2015		2016	
	Value (US\$ Millions)	World Share (%)	Value (US\$ Millions)	World Share (%)	Value (US\$ Millions)	World Share (%)
Australia	36,443	2.63	19,477	1.10	48,190	2.76
Brunei Darussalam	481	0.03	173	0.01	-150	-0.01
Canada	28,400	2.05	41,512	2.34	33,721	1.93
Chile	17,227	1.24	15,866	0.89	11,266	0.65
China	114,734	8.29	135,610	7.64	133,700	7.66
China, Hong Kong SAR	70,541	5.10	174,353	9.83	108,126	6.19
Chinese Taipei	2,492	0.18	2,413	0.14	8,333	0.48
Indonesia	13,771	1.00	16,641	0.94	2,658	0.15
Japan	-1,252	-0.09	-2,250	-0.13	11,388	0.65
Korea, Republic of	9,497	0.69	4,104	0.23	10,827	0.62
Malaysia	9,060	0.65	11,121	0.63	9,926	0.57
Mexico	27,263	1.97	33,181	1.87	26,739	1.53
New Zealand	-62	0.00	-337	-0.02	2,292	0.13
Papua New Guinea	29	0.00	28	0.00	-40	0.00
Peru	8,455	0.61	8,272	0.47	6,863	0.39
Philippines	1,298	0.09	4,937	0.28	7,912	0.45
Russian Federation	31,668	2.29	11,858	0.67	37,668	2.16
Singapore	55,076	3.98	70,579	3.98	61,597	3.53
Thailand	14,555	1.05	5,700	0.32	1,554	0.09
United States	198,049	14.31	348,402	19.64	391,104	22.39
Viet Nam	8,000	0.58	11,800	0.67	12,600	0.72
Asia Pacific	645,725	46.66	913,441	51.49	926,274	53.04
NON-Asia Pacific	738,054	53.34	860,560	48.51	820,150	46.96
World	1,383,779	100	1,774,001	100	1,746,423	100

Outward Foreign Direct Investment						
Economy	2010		2015		2016	
	Value (US\$ Millions)	World Share (%)	Value (US\$ Millions)	World Share (%)	Value (US\$ Millions)	World Share (%)
Australia	19,804	1.43	-1,672	-0.10	6,012	0.41
Brunei Darussalam	1,179	0.09	58	0.00	-60	0.00
Canada	34,723	2.51	67,037	4.20	66,403	4.57
Chile	10,534	0.76	12,139	0.76	6,165	0.42
China	68,811	4.96	127,560	8.00	183,100	12.61
China, Hong Kong SAR	86,247	6.22	71,821	4.50	62,460	4.30
Chinese Taipei	11,574	0.84	14,709	0.92	17,843	1.23
Indonesia	2,664	0.19	5,937	0.37	-12,463	-0.86
Japan	56,263	4.06	128,654	8.07	145,242	10.00
Korea, Republic of	28,280	2.04	23,760	1.49	27,274	1.88
Malaysia	13,399	0.97	9,899	0.62	5,601	0.39
Mexico	15,145	1.09	10,733	0.67	-787	-0.05
New Zealand	716	0.05	90	0.01	-44	0.00
Papua New Guinea	0	0.00	174	0.01	0	0.00
Peru	266	0.02	127	0.01	303	0.02
Philippines	616	0.04	5,540	0.35	3,698	0.25
Russian Federation	41,116	2.97	27,090	1.70	27,272	1.88
Singapore	35,407	2.55	31,405	1.97	23,888	1.64
Thailand	7,940	0.57	1,687	0.11	13,229	0.91
United States	277,779	20.04	303,177	19.02	299,003	20.59
Viet Nam	900	0.06	1,100	0.07	1,388	0.10
Asia Pacific	713,364	51.47	841,027	52.75	875,529	60.28
NON-Asia Pacific	672,698	48.53	753,290	47.25	576,934	39.72
World	1,386,061	100	1,594,317	100	1,452,463	100

Source: UNCTAD, Foreign Direct Investment Database Accessed January 2018

Table 5. Intra-Regional Trade Share (%) ^(a)

Economy	2010	2015	2016
Australia	68.9	70.8	69.7
Brunei Darussalam	92.2	82.9	85.7
Canada	81.1	83.6	83.2
Chile	58.3	61.9	62.8
China	57.9	58.9	57.2
Hong Kong SAR	78.6	77.8	74.7
Indonesia	72.7	70.4	71.3
Japan	66.8	70.1	69.4
Korea	63.9	66.5	68.0
Malaysia	73.3	72.6	72.6
Mexico	84.7	85.4	85.7
New Zealand	71.4	71.4	71.5
Papua New Guinea			82.1
Peru	56.3	61.3	61.9
Philippines	74.7	76.1	78.8
Russia	23.9	27.4	31.3
Singapore	69.7	70.8	70.1
Chinese Taipei			
Thailand	67.0	67.3	67.9
United States	61.6	64.5	64.9
Vietnam	70.5	70.9	72.0
Asia Pacific	64.2	66.0	66.0

Source: WITS. Accessed January 2018

Note: (a) Percentage of intra-regional trade to total trade of the region

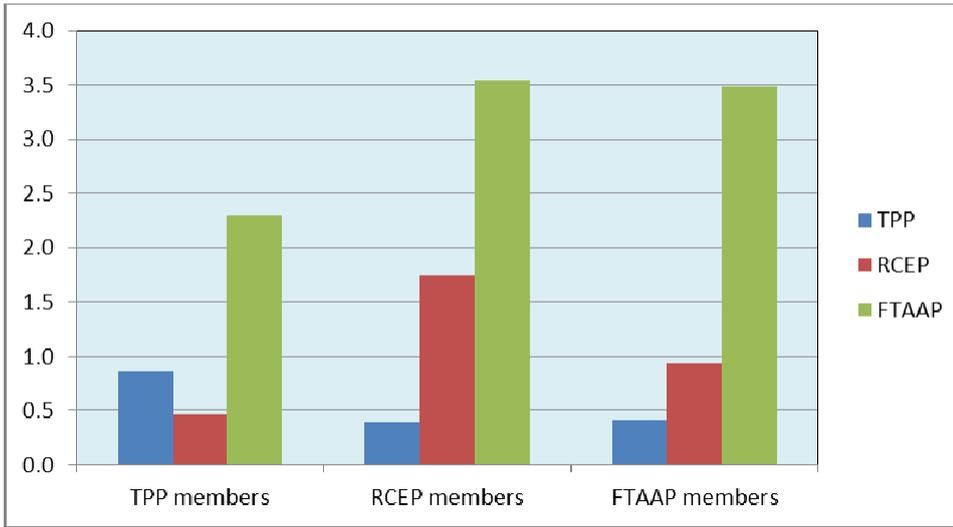
Table 6. Digital Economy Indicators

Economy	Mobile cellular subscriptions (per 100 people)			Individuals using the Internet (% of population)		
	2010	2015	2016	2010	2015	2016
Australia	100.4	107.7	109.6	76.0	84.6	88.2
Canada	75.7	83.0	84.1	80.3	88.5	89.8
Japan	96.8	126.5	129.8	78.2	91.1	92.0
New Zealand	107.8	121.8	125.0	80.5	88.2	88.5
United States	91.3	117.6	127.2	71.7	74.6	76.2
Brunei Darussalam	108.6	108.1	120.7	53.0	71.2	75.0
Chile	115.8	129.5	127.1	45.0	64.3	66.0
Hong Kong SAR, China	195.7	228.7	234.0	72.0	84.9	87.3
Indonesia	87.8	132.6	149.1	10.9	22.0	25.4
Korea, Rep.	104.8	118.5	122.7	83.7	89.6	92.7
Malaysia	119.7	143.9	141.2	56.3	71.1	78.8
Mexico	77.5	86.0	88.2	31.1	57.4	59.5
Papua New Guinea	27.8	46.6	48.6	1.3	7.9	9.6
Peru	99.5	109.9	117.1	34.8	40.9	45.5
Philippines	89.0	115.8	109.2	25.0	53.7	55.5
Russian Federation	165.5	160.0	163.3	43.0	73.4	76.4

Singapore	145.4	146.5	146.9	71.0	79.0	81.0
Thailand	108.0	152.7	172.6	22.4	39.3	47.5
Vietnam	125.3	128.8	128.0	30.7	43.5	46.5
Asia Pacific	107.5	124.4	128.6	50.9	64.5	67.4
Advanced	94.4	111.3	115.1	77.3	85.4	86.9
Developing	112.2	129.1	133.5	41.4	57.0	60.5

Source: World Bank, World Development Indicators Database. Accessed 2018

Figure 10. Effects of TPP, RCEP and the FTAAP on different groups (% of income)



Source: Authors, based on Petri, Plummer and Zhai (2012) and asisapacifictrade.org