

# **Collective Strategic Study on Issues Related to the Realization of the FTAAP**

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## ABBREVIATIONS

ABAC	APEC Business Advisory Council	GRIPS	National Graduate Institute for Policy Studies
ABS	Australian Bureau of Statistics	GSCNET	APEC Cooperation Network on Green Supply Chain
ABTC	APEC Business Travel Card	GTAP	Global Trade Analysis Project
APEC	Asia-Pacific Economic Cooperation	GVC	global value chain
APMEN	APEC Initiative on Asia-Pacific Model E-port Network	GVC	regional value content
ASEAN	Association of Southeast Asian Nations	HS	harmonized system
Austrade	Australian Trade Commission	IAP	individual action plans
AVE	ad valorem equivalent	ICT	information and communications technology
BIT	Bilateral investment treaty	IIA	international investment agreement
BPO	business process outsourcing	ILO	International Labor Organization
CAP	collective action plans	IMF	International Monetary Fund
CBNI	Capacity-Building Needs Initiative	IP	intellectual property
CGE	computable general equilibrium	IPR	intellectual property rights
CSR	corporate social responsibility	ISDS	investor–State dispute settlement
CTI	Committee on Trade and Investment (APEC)	IT	information technology
DFAT	Department of Foreign Affairs and Trade (Australia)	ITA	Expanded Information Technology Agreement (WTO)
EAEU	Eurasian Economic Union	ITC	International Trade Centre
EEC	Eurasian Economic Commission	I-TIP	Integrated Trade Intelligence Portal (WTO)
EFIC	Export Finance and Insurance Corporation	KPO	knowledge process outsourcing
EU	European Union	MAST	Multi-Agency Support Team
FDI	foreign direct investment	MFN	most favoured nation
FET	fair and equitable treatment	MOOC	massive open online courses
FTA	free trade agreement	MSME	micro, small and medium enterprise
FTAAP	Free Trade Area of the Asia-Pacific	MST	minimum standard of treatment
GATS	General Agreement on Trade in Services	MTN	multilateral trade negotiations
GATTS	General Agreement on Tariffs and Trade	NGeTI	next generation trade and investment issues
GDP	gross domestic product	NIE	newly industrialized economy
		NT	national treatment
		NTB	non-tariff barrier
		NTM	non-tariff measure
		NZIER	New Zealand Institute of Economic Research

OECD	Organisation for Economic Co-operation and Development
PA	Pacific Alliance
PSR	product specific rules
PSU	Policy Support Unit
R&D	research and development
RCEP	Regional Comprehensive Economic Partnership
ROO	rules of origin
RTA	regional trade agreement
SCFAP	Supply-Chain Connectivity Framework Action Plan
SDB	WTO Statistics Database
SME	small- and medium-sized enterprises
SMEWG	SME Working Group
SPS	sanitary and phytosanitary
SSG	sector-specific safeguards
STAR	Services Trade Access Requirements
STRI	Services Trade Restrictiveness Index
TBT	technical barriers to trade
TFA	Trade Facilitation Agreement (WTO)
TFAP	Trade Facilitation Action Plan (APEC)
TiVA	trade in value added
TPP	Trans-Pacific Partnership
TRIEC	Trade Import and Export Classification
TRIMS	Trade-Related Investment Measures Agreement (WTO)
TRIPS	Trade-Related Aspects of Intellectual Property Rights Agreement (WTO)
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WITS	World Integrated Trade Solution
WTO	World Trade Organization



# 1. OVERVIEW

## 1.1 INTRODUCTION

In recent years, the Asia-Pacific has become a major force in the global economy, and the number of regional and free trade agreements (RTAs/FTAs) has been rising rapidly.

The proliferation of such agreements within the region presents APEC with opportunities as well as challenges. On the one hand, the momentum toward liberalization through these agreements complements the multilateral trading system as embodied in the WTO. On the other hand, the region now faces complex, new challenges to regional economic integration and to business.

Recognizing that the movement toward economic integration in the region has reached a critical stage, APEC Leaders officially advanced the vision of a **Free Trade Area of the Asia-Pacific (FTAAP)** in 2006.

### 1.1.1 From Hanoi to Beijing: APEC Leaders' support for the FTAAP

APEC Leaders have played a strong role in driving the vision of an FTAAP forward. The Leaders' first formal statement with a reference on the FTAAP was made in 2006 at the APEC Leaders' meeting in Hanoi. That formal response was based on recommendations by the APEC Business Advisory Council (ABAC) in 2004.

Subsequent APEC Leaders' Declarations also incorporated instructions for promoting the FTAAP, reflecting the importance placed on the issue by APEC member economies and APEC's leading role in strengthening regional economic integration in the Asia-Pacific.

In their 2007 Declaration, APEC Leaders agreed to examine the options and prospects for an FTAAP through a range of practical and incremental steps. In 2008, Ministers and officials were instructed 'to undertake further steps' toward that end. These steps included a study entitled *Further Analytical Work on the Likely Economic Impact of an FTAAP*. The 2009 Leaders' Declaration stated that APEC 'will continue to explore building blocks towards a possible FTAAP in the future'.

In 2010, the APEC Leaders' Declaration provided further instructions through an annex titled 'Pathways to FTAAP'. Given that the full range of FTAAP issues had been explored through previous analytical work, the APEC Leaders agreed in 2010 to take concrete steps toward an FTAAP. According to them, the FTAAP should be pursued as a comprehensive FTA 'by developing and building on ongoing regional undertakings,

such as ASEAN+3, ASEAN+6, and the Trans-Pacific Partnership (TPP), among others'. APEC could make important and meaningful contributions as an incubator for the FTAAP, through providing leadership and intellectual input into the process of its development.

Between 2011 and 2013, APEC Leaders reaffirmed the importance of the FTAAP as a major instrument for furthering APEC's regional economic integration agenda. In 2014, the APEC Leaders' Declaration again underlined APEC's role as an incubator that would take the FTAAP from vision to reality.

The 2014 Beijing Roadmap for APEC's Contribution to the Realization of the FTAAP presented an important concrete step: the launch of the *Collective Strategic Study on Issues Related to the Realization of the FTAAP*. Officials working within the Committee on Trade and Investment (CTI) Friends of the Chair Group on Strengthening Regional Economic Integration and Advancing the FTAAP would set up a Task Force to assume the work.

Building on ideas initially conceptualized in 2010, APEC Leaders reaffirmed the following in 2014:

- The FTAAP should be pursued on the basis of supporting and complementing the multilateral trading system.
- The FTAAP should do more than achieve liberalization. It should be comprehensive and be a high-quality instrument that incorporates and addresses next generation trade and investment issues.
- Progress toward the Bogor Goals (an APEC objective to deepen trade and investment liberalization and advance regional economic integration) could substantially advance and help determine APEC's contribution to the eventual realization of the FTAAP.
- The FTAAP would be realized outside of APEC, in parallel with the APEC process. APEC should maintain its non-binding, voluntary cooperation principles in its contributions to the realization of the FTAAP.
- The FTAAP should aim to minimize any negative effects resulting from the proliferation of regional and bilateral RTAs/FTAs by building on current and developing regional architectures. For example, the TPP and the Regional Comprehensive Economic Partnership (RCEP).

### **1.1.2 Progress in 2015**

Remarkable progress on the Beijing Roadmap was achieved in 2015. The Meeting of APEC Ministers Responsible for Trade held in Boracay, Philippines, in May 2015 endorsed the Terms of Reference of the Collective Strategic Study on the FTAAP. The Terms of Reference stipulate the objectives, reporting responsibilities, research

structure, content of chapters and scope of work, key deliverables and concrete timelines. A Task Force and Core Drafting Group, a Consolidated Work Plan and an Editing Mechanism were established; and it was agreed that the Core Drafting Group could consult the APEC Policy Support Unit (PSU), ABAC, the Pacific Economic Cooperation Council (PECC) and the APEC Study Centers where appropriate.

In August 2015, China hosted the *Seminar on the Collective Strategic Study on Issues Related to the Realization of the FTAAP* in Cebu, Philippines. The seminar brought together the Task Force and government officials, as well as prominent experts on regional economic integration from the APEC member economies and from ABAC, APEC PSU, PECC, the APEC Study Centers and academia to exchange views on the substantial issues to be included in the study.

In November 2015, APEC Leaders reaffirmed that the FTAAP should be pursued as a comprehensive FTA by building on ongoing regional undertakings. In this context, they noted recent FTA developments in the region and the progress of possible Pathways to the FTAAP, including the finalization of TPP negotiations. They also encouraged the early completion of negotiations for the RCEP.

## **1.2 OBJECTIVES OF THE STUDY**

The Collective Strategic Study on Issues Related to the Realization of the FTAAP respects all the principles highlighted by APEC Leaders in the past. The study aims to present views on how the APEC economies can best participate in and contribute to the eventual realization of the FTAAP. It does not constitute a commitment by APEC member economies to engage in negotiations, nor does it prejudice the scope or content of any eventual negotiations.

## **1.3 STRUCTURE AND CONTENT OF THIS REPORT**

The final report of the Collective Strategic Study consists of nine chapters:

### **1. Overview**

This chapter introduces the background, objectives, structure and contents.

### **2. Review of the APEC Region's Economy**

This chapter looks at the APEC region's trade and investment relationships. It focuses on: (i) basic trends in intra-APEC and extra-APEC trade and investment since the mid-1990s, and the diversity of patterns around those trends at the economy level; (ii) factors behind evolving patterns of trade and investment specialization across the region, such as changes in revealed comparative advantage and factors that contribute to competitiveness; and (iii) the implications for the APEC region of the weakening relationship between growth

in world trade and economic growth since the 2009 global financial crisis.

### **3. Next Generation Trade and Investment Issues**

This chapter touches on the next generation trade and investment issues that should be considered in an eventual FTAAP. The potential issues identified in this chapter go beyond those previously identified by APEC member economies (APEC member economies have been involved in a process to identify such issues since 2011). Given this, the issues identified in the chapter should not be used to set and/or prejudge the scope/negotiation of the eventual FTAAP.

### **4. Measures Affecting Trade and Investment**

This chapter describes the current state-of-play in the Asia-Pacific in relation to the various measures that affect trade and investment, including tariffs and non-tariff measures, measures affecting services, and investment regimes. It also analyses the impact of those measures, reviews the work that APEC has done to address issues related to the measures, and considers what might be done by APEC in the future.

### **5. Stocktaking of Existing RTAs/FTAs in the Asia-Pacific Region**

This chapter evaluates the level of coverage and ambition of existing RTAs/FTAs in the region, and identifies how well they support the multilateral trading system. It examines the impact of overlapping FTAs in the region, which creates the so-called ‘spaghetti bowl’ effect, and identifies some recent trends.

### **6. Stocktaking of Initiatives and Outcomes Relevant to an FTAAP**

This chapter discusses selected APEC initiatives and outcomes that lay the foundation in support of the eventual realization of the FTAAP. It describes several initiatives on trade and investment liberalization and facilitation, including best practices for RTAs/FTAs, and looks at achievements in specific sectors, such as environmental goods, customs and next generation trade and investment issues.

### **7. Update of Other Analytical Work**

This chapter revisits APEC’s 2009 *Further Analytical Study on the Likely Economic Impact of an FTAAP*. This update, like the 2009 study, supports the view that deeper integration, through either enhanced trade facilitation or freer trade in services, is a more desirable outcome compared to shallow integration based solely on elimination of tariffs. It proposes that APEC set an ambitious liberalization goal that involve deeper integration beyond tariff elimination.

The second part of this chapter provides an update on the 2008 APEC report on *Identifying Convergences and Divergences in APEC RTAs/FTAs*. It reviews 10 recently concluded RTAs/FTAs based on the analytical framework of the 2008 report. While divergences remain in many areas, the level of convergence appears to be increasing. Common elements and practices in RTAs/FTAs across a wide range of trade issues could create a solid foundation for the future FTAAP.

## **8. Ongoing Regional Undertakings**

This chapter describes regional undertakings that could serve as pathways to the FTAAP: the TPP and the RCEP. Other regional initiatives covered are the Pacific Alliance, the Eurasian Economic Union (EAEU) and ASEAN economic integration initiatives. The chapter also briefly describes APEC's contribution to two recently concluded WTO agreements: the Expanded Information Technology Agreement (ITA) and the WTO Agreement on Trade Facilitation (TFA).

## **9. Opportunities and Challenges**

This chapter provides an analysis of the challenges and opportunities related to the realization of the FTAAP. Opportunities include maintaining the Asia-Pacific region as the engine of the global economy, creating positive externalities for the rest of the world, complementing the multilateral trading system, enhancing cooperation within APEC, improving the capacity of members and deepening structural reform, among others. Various challenges are also identified, such as accommodating diversity and imparity among APEC members, striking a balance between domestic policy and further opening up, and dealing with issues related to integrating non-APEC economies or/and agreements into an eventual FTAAP.

## **2. REVIEW OF THE APEC REGION'S ECONOMY**

### **2.1 INTRODUCTION**

The increasing links between international trade in goods and services, investment, technological change, and movement of skills means that openness in each of these areas is crucial for fostering economic growth, creating jobs and raising living standards, and for transmitting development opportunities regionally and globally. Openness provides access to economies of scale and avenues for lifting productivity and quickening the pace of innovation. Without it, the APEC region and the world more generally would be much poorer, and institutional arrangements promoting political and economic interdependence among economies would be much weaker.

In turn, economic growth has a powerful impact on trade. Growth rates of individual economies in the APEC region have varied considerably over the past 20 years, but the region in aggregate has continued to perform strongly. East Asia's developing economies in particular have grown strongly and their dynamism has been reflected in the APEC region's changing patterns of comparative advantage and the associated trade and investment flows.

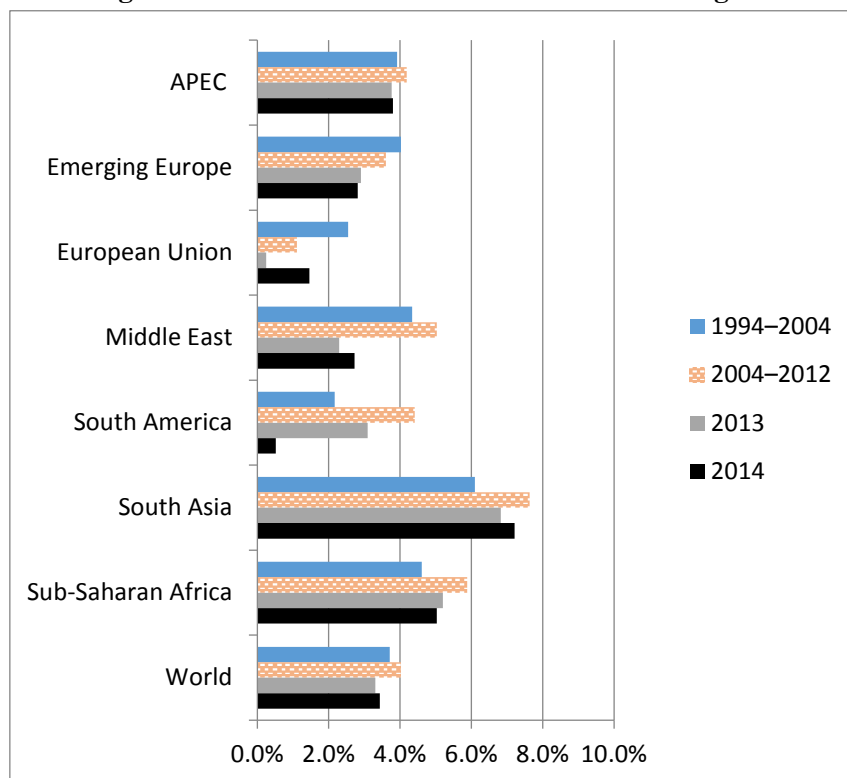
This chapter looks at the APEC region's trade and investment relationships to provide some insight into the short- and medium-term economic impact of an FTAAP for APEC economies amid current developments in regional integration. It focuses on:

- Basic trends in intra-APEC and extra-APEC trade and investment since the mid-1990s, and the diversity of patterns around those trends at the economy level.
- Factors behind evolving patterns of trade and investment specialization across the region, such as changes in revealed comparative advantage and factors that contribute to competitiveness.
- The implications for the APEC region of the weakening relationship between growth in world trade and economic growth since the 2009 global financial crisis. This covers implications for value chain trade and the transmission of regional development, as well as implications for trade and investment liberalization and facilitation.

### **2.2 ECONOMIC CHARACTERISTICS**

APEC economies account for over half of global output (whether measured in USD terms or at purchasing power parity). Developing East Asia in particular has been an engine of economic growth for the region and global economy. Rapid growth among this group is principally a reflection of very strong growth in China (at better than 9 percent for 13 of the past 20 years). APEC as an aggregate has also grown a little more rapidly than the rest of the world (Figure 2.1).

**Figure 2.1 Growth rates for APEC and various regions**



Percentages are compound annual growth rates in the various regions. The Middle East includes North Africa; Afghanistan; and Pakistan. South America excludes Chile and Peru, which are part of APEC, as well as Central America. Emerging Europe includes developing Europe and some European Union (EU) members. Figures for the EU are based on EU28. Some data include estimates by International Money Fund (IMF) staff.

Source: Calculated from data in IMF World Economic Outlook Database, October 2015.

APEC’s growth has occurred despite some relatively big shocks along the way, such as the 1998 East Asian financial crisis and the 2009 global financial crisis. Over both the longer term and in recent years, the growth rates of APEC economies have been highly uneven. The standout performers, apart from China, have been Viet Nam, growing at almost 7 percent annually over 1994–2014, and Singapore and Malaysia, both at over 5 percent. But six economies have grown at less than 3 percent annually and two at around 1 percent or less.

In global trade, the APEC region occupies a prominent position. Five of the top ten world exporters of goods and services are in the region and some of the world’s biggest bilateral trade flows occur between economies in the region. For example, US–Canada and US–China merchandise trade in 2014 was USD 660 billion and USD 590 billion respectively, not far behind US–European Union (EU) trade of USD 694 billion.

APEC economies differ considerably in their exposure to international trade and investment. Singapore and Hong Kong, China have particularly high ratios of total trade to gross domestic product (GDP) even when re-exports and re-imports are removed, while the US has a much lower trade exposure (as might be expected given the size of its economy). But APEC as a group has become more closely engaged in trade since 1994, with both exports and imports rising as a share of GDP.<sup>1</sup>

Some economies have risen up the ranks of world exporters and importers over the past two decades. China is again a standout, rising on the list of goods and services exporters from 11<sup>th</sup> in 1994 to first in 2014. As an importer, China has also moved up, also from 11<sup>th</sup> but this time to second (behind the US). Its increasing role as both an exporter and importer has profoundly shaped both global and regional trading patterns. Overall, APEC's share of world exports of goods and services was about the same in 2014 as in 1994. APEC accounts for almost half (46%) of global exports.

### **2.2.1 Intra-regional trade**

APEC economies' exports to other APEC economies are generally very high (Figure 2.2). In the case of North America, both Canada and Mexico depend very heavily on the US. Hong Kong, China is closely linked to China. More generally, Asia-Pacific regionalism is partly anchored in bilateral activity within the North American and East Asian spheres, albeit with big links between the major economies on each side and myriad smaller connections between other economies.<sup>2</sup> Factors like the 'gravity' effect of large economies on the trade patterns of proximate economies, lower transport costs between close neighbours, the effects of unilateral reform (particularly in East Asia), familiarity with 'local' business systems and ways of doing business, and stronger regional economic architecture (such as the ASEAN Free Trade Area and the North American Free Trade Agreement) have collectively encouraged the intensification of trade at the sub-APEC level.

In East Asia and also Oceania, China's role has grown massively. Its rapid growth over the past two decades means that it has become the biggest, or one of the biggest, export markets for a number of APEC economies. In 2014, for example, around a third of Australia's merchandise exports, a quarter of Korea's and a fifth of New Zealand's went to China, while China ran a very close second to the US as Japan's main export market. Further afield, the South American members of APEC have felt the impact of China's

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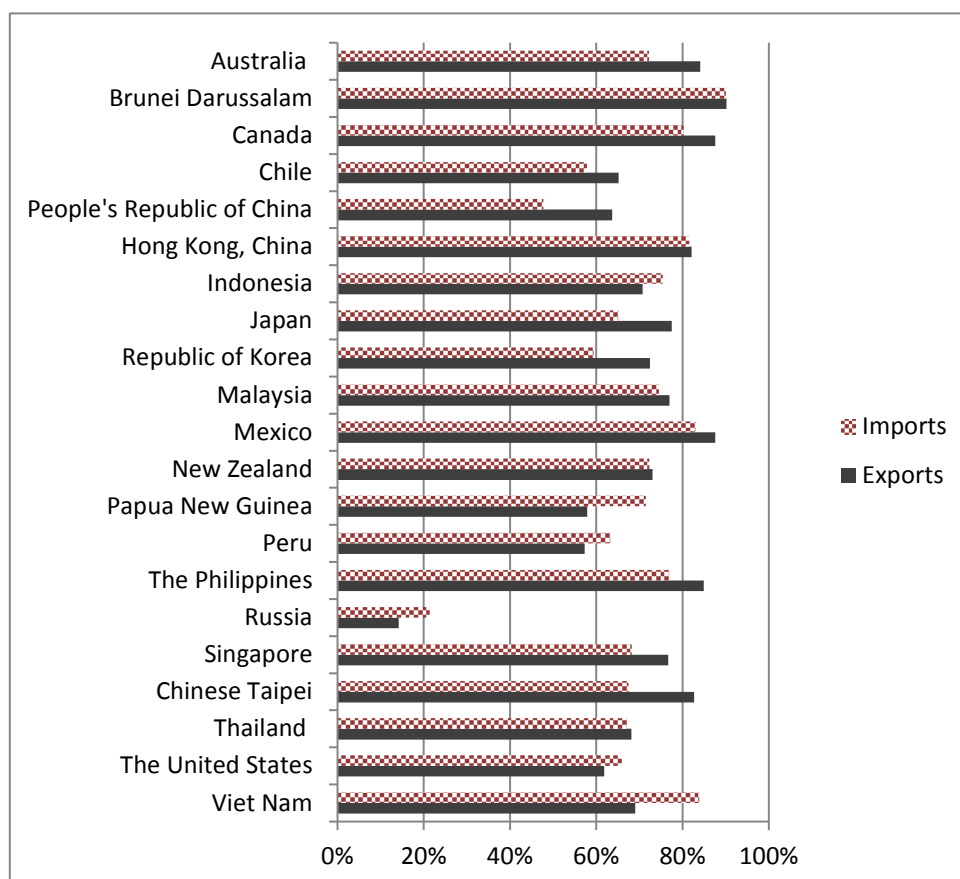
1 APEC Policy Support Unit, *Progressing towards the APEC Bogor Goals: Perspectives of the APEC Policy Support Unit* (Singapore: APEC, 2010), 22–3.

2 Trade links between Oceania and the Latin American members of APEC seem particularly underdeveloped. See the case of Australia's links with the Pacific Alliance, which includes three APEC members (Chile; Mexico; and Peru) and one non-APEC member (Colombia) in: M. Adams and N. Brown, 'Economic engagement with the Pacific Alliance: Why it should be a priority for Australia' (keynote address to the *Latin American Colloquium*, University of Queensland, 15 October 2015).



growth.<sup>3</sup> In 2014, China took around a quarter of Chile's merchandise exports (making it Chile's largest market for goods) and supplied a fifth of its imports. In that year, China was a bigger market for Peru than the US and provided about the same value of Peru's merchandise imports as the US.

**Figure 2.2 Share of merchandise trade with APEC, 2014**



Source: Department of Foreign Affairs and Trade, Australia (DFAT), based on data from the Australian Bureau of Statistics (ABS); International Monetary Fund (IMF), *Direction of Trade Statistics*; Global Trade Atlas; and UN Comtrade.

3 For a discussion of the burgeoning links between Latin America and China, see: ECLAC (Economic Commission for Latin America and the Caribbean), *Areas for Cooperation in the Americas: Building Opportunities for Inclusive Development* (Santiago: UN, 2015); S. George, *The Pacific Pumas: An Emerging Model for Emerging Markets* (Washington, DC: Bertelsmann Foundation, 2014). The more limited relations between Latin America and the Republic of Korea are discussed in: ECLAC, *Economic Relations between Latin America and the Caribbean and the Republic of Korea: Advances and Opportunities* (Santiago: UN, 2015).

The high level of intra-regional trade also partly reflects the fact that APEC is a big group with strong complementarities. Australia's position as an exporter of iron ore and coal to China and Japan is one example of a complementarity in operation. Chile's and Peru's roles as suppliers of copper ores and copper to China are others. In East Asia and North America, value chains<sup>4</sup> have emerged with division of tasks in the chain among different economies. Japan and the newly industrialized economies (NIEs) have become suppliers of capital equipment and relatively technologically advanced inputs to China, which has become the point of final assembly for communications technology and many other manufactures. However, despite this interconnectedness, intra-regional trade in the APEC region as an aggregate has slipped slightly over the past two decades, from around 73 percent of total merchandise exports in 1994 to 68 percent in 2014.<sup>5</sup>

Most of goods trade within the APEC region consists of manufactures. Since 1996, intra-APEC trade in these products has grown at around 6 percent per annum in USD terms to reach almost USD 4.7 trillion. The dominant supplier is China, which is now the source of almost a third of these exports, about double the share of the next largest exporter, the US, around three times that of Japan and well above those of second-tier regional manufacturers such as Canada; Mexico; and the NIEs (Figure B.1). Within the region, the big flows of Chinese manufactured exports are to the US; Hong Kong, China; and Japan. Much of what is supplied to Hong Kong, China is re-exported. Most – well over 90 percent – of China's manufactured exports have been elaborately transformed.<sup>6</sup> China is also a big importer of APEC manufactures, but its imports are well below those of the largest importer, the US. They are also well below those of its own exports to APEC.

Minerals and fuels is the second biggest of the broad sectors of intra-APEC merchandise trade (Figure B.2). Between 1996 and 2014, it was the fastest growing sector of intra-APEC merchandise trade, largely reflecting the huge increase in demand and prices for these commodities as China's industrialization gathered pace. By 2014, the value of intra-APEC trade in minerals and fuels was around USD 744 billion, with Canada, Australia and the US being the biggest suppliers and a wide range of other economies contributing. Some of APEC's smaller economies – including Brunei; Peru; and Chile – made valuable contributions. Peru, for example, is an important supplier of copper ores and, to a lesser extent, lead ores, to China, and is a significant supplier of

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4 On the concept of value chains and the related terms, supply chains and production chains, see: APEC Policy Support Unit, 'Concepts and trends in global supply, global value and global production chains' (issues paper no.1, Singapore: APEC, 2012).

5 The 1994 data include economies that joined APEC subsequently.

6 Elaborately transformed manufactures possess unique features and can be identified as differentiated goods. They differ from simply transformed manufactures such as basic metal manufactures. Both types of manufactures are defined using the Trade Import and Export Classification (TRIEC) developed by Australia's Department of Foreign Affairs and Trade.

crude oil and refined petroleum to the US.

At around USD 464 billion, intra-APEC trade in agriculture is about one tenth of that for manufactures, but it has been growing rapidly over the past decade – at almost 9 percent annually in USD terms. Supply is concentrated. The US; Canada; and China are the main exporters to APEC economies. Smaller suppliers include Australia; Thailand; Mexico; Indonesia; and New Zealand (Figure B.3). The biggest US markets in APEC are China; Canada; and Mexico. The US also is a big importer of regional agricultural products, especially from Canada and Mexico. A good deal of intra-APEC agricultural trade therefore occurs between the North American members of APEC. Of the three broad sectors of merchandise trade, agriculture remains the most distorted by trade barriers, profoundly affecting regional trade flows.

Reflecting these sorts of relationships and the natural tendency of neighbouring economies to trade closely with one another, trade intensities in the APEC region can be very high.<sup>7</sup> Merchandise exports to APEC are often more than 1.5 times the level that would be expected given these economies' share of world trade (Figure B.4). But bilateral intensities can be much higher. For example, the share of Australia's merchandise exports to New Zealand is over 14 times the level that would be expected from New Zealand's share of world imports.

Services is a highly important sector for intra-APEC trade and is critical to the development of sophisticated value chains across the region. Trade data on this sector are often lacking however, in terms of both flows between economies and the types of services involved. This is the case even where, as here, attention is confined to services flows directly measured in balance of payments statistics.<sup>8</sup> It is clear, however, that services trade patterns can be very different at times from merchandise trade patterns:

- The US appears to be much less engaged with APEC in services trade than in merchandise trade, partly because of trade with the EU. Total US exports of services to all countries in 2014 were around USD 710 billion, more than three times the next biggest APEC exporter, China. But less than 40 per cent of the total went to 15 other major APEC economies, well below the level for merchandise trade. The same APEC economies supplied less than a third of total services imported by the US.

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7 The export intensity of economy *i* with respect to economy *j* is defined as  $X(ij)/M(j)$  where  $X(ij)$  is the share of economy *i*'s exports going to *j* and  $M(j)$  is the share of economy *j* in world imports excluding economy *i*'s imports. The adjustment to world imports to exclude economy *i*'s imports is necessary because economy *i* cannot export to itself when it is an individual economy. See: P. Drysdale and R. Garnaut, 'Trade intensities and the analysis of bilateral trade flows in a many-country world: a survey', *Hitotsubashi Journal of Economics* 22(2) (1982): 62–84.

8 The following section on investment covers some services delivered through commercial presence, which shows up as income in the balance of payments rather than directly.

- For Canada, which is a very significant exporter and importer of services among APEC economies, 69 percent of its services exports in 2013 went to 17 major APEC economies, with the US far less important than for merchandise trade.
- Hong Kong, China has developed as a regional services hub, with its exports to 15 major APEC economies contributing over three quarters of its total services exports in 2013 and 80 per cent of its imports from the same economies. But exports of services to China are a much lower share than for merchandise trade, reflecting the broader role that Hong Kong, China plays in this area.

Information on the composition of services trade within APEC is limited. For the US, which provides significant detail on its trade with 15 APEC economies, exports of travel services (including business travel, education-related travel services, and tourism) is the biggest item, with charges for the use of intellectual property also very large. Transport services, financial services and ‘other business services’ are also substantial items. The last group of services includes key items related to modern trade in services, such as trade-related services, legal services, management consulting services and research and development. For Japan, data for 2012 for a group of 14 APEC economies suggest that transport services, royalties and licensing and ‘other business services’ were the most important services exports, with travel services a distant fourth.

### **2.2.2 Extra-regional trade**

APEC economies depend heavily on trade with other regions and have a strong interest in maintaining open trade regimes with them. For APEC as a group, almost a third of merchandise exports (about USD 2.9 trillion of a total of USD 9.1 trillion) are directed to economies outside the region and over a third of imports are sourced there. The EU is an important market and supplier, taking 13 per cent of APEC’s exports and providing 14 percent of imports.

Dependence on other regions varies widely. At one extreme, Canada and Mexico are highly dependent on the US and only about 12 percent of their merchandise exports go to economies outside APEC. At the other extreme, 86 percent of the Russian Federation’s exports and 42 percent of Papua New Guinea’s are directed to non-APEC economies. China, as a global exporter of manufactured products, is near the APEC average with 36 percent of its exports going to non-APEC economies – 16 percent to the EU.

As with intra-regional trade, manufactures is the biggest component of extra-regional trade, with exports amounting to around USD 2 trillion in 2014. Supply is highly concentrated. China’s massive transformation means that it now accounts for around 40 percent of manufactured exports from the region, well ahead of the US and Japan (Figure B.5). Indeed, a striking characteristic of the past two decades has been the declining shares of the US, Japan and Hong Kong, China in APEC manufactures exports and the even more striking increase in China’s share. This is even more

pronounced for extra-regional trade than for intra-regional trade.

Minerals and fuels is the second biggest component of APEC's extra-regional merchandise exports, amounting to around USD 516 billion in 2014. It has been the fastest growing of the three broad sectors since 1996 and growth has accelerated over the past decade. Supply is even more concentrated than for manufactures. Russia accounts for almost 59 percent of APEC's extra-regional exports in this product group, with the US and Australia having much lower shares. Russia's dominance reflects its position as a major exporter of oil and gas to global markets, including the EU.

Agriculture, the third big area of merchandise trade, is the smallest in terms of extra-regional exports, at around USD 202 billion in 2014. The US is the biggest exporter, supplying about a quarter of extra-APEC exports, mainly to the EU. Second-tier suppliers include Russia; China; and Indonesia. Thailand; Malaysia; Canada; Australia; New Zealand; Chile; and Viet Nam make up a third tier of suppliers, with New Zealand now almost as big a supplier as Australia.

These trade patterns mean that export intensities (for goods) with economies outside the region can be very low. Among APEC economies, Russia has the biggest export intensity with the EU, though in 2014 it was under 0.8, suggesting that the share of Russia's exports to that destination was appreciably less than might be expected from the EU's share of world imports.<sup>9</sup> Export intensities with the rest of the world (that is, excluding APEC and the EU) ranged widely for APEC economies. They were particularly low for Canada and the Philippines (0.25 or under) but a very high 3.1 for Russia.

Extra-regional trade in services has been discussed to some extent when looking at the pattern of intra-regional trade. For the US and Canada, extra-regional trade is appreciably more important for services trade than for goods. This partly reflects the significance of services trade with the EU, whether as a source of – or destination for – tourists, students or high-quality business services.

### **2.2.3 Trade in value-added terms**

The OECD-WTO Trade in Value Added (TiVA) Database makes it possible to examine a wide range of indicators of trade on a value-added basis (at the time of writing, the most recent data are for 2011). Analysing trade on the basis of value added at each point in the production process represents a paradigm shift and can provide powerful insights when used as a supplement to conventional measures. Such analyses would have important implications for potential negotiations on an FTAAP.

The direction of trade can be appreciably different when trade is measured in value-

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<sup>9</sup> The intensity was significantly higher in 2013.

added terms. For instance, China's shares of gross exports and domestic value added attributable to China's final demand diverge quite markedly in some cases. Chile's dependence on the China market in value-added terms (around 15%) is markedly lower than the share in gross exports (about 24%). There are even bigger differences for Chinese Taipei and Korea (Figure B.6). Bilateral trade imbalances can be significantly different. The US imbalance with China, for example, is about 35 percent smaller when measured in value-added terms, while those with Japan, Korea and Chinese Taipei are larger.

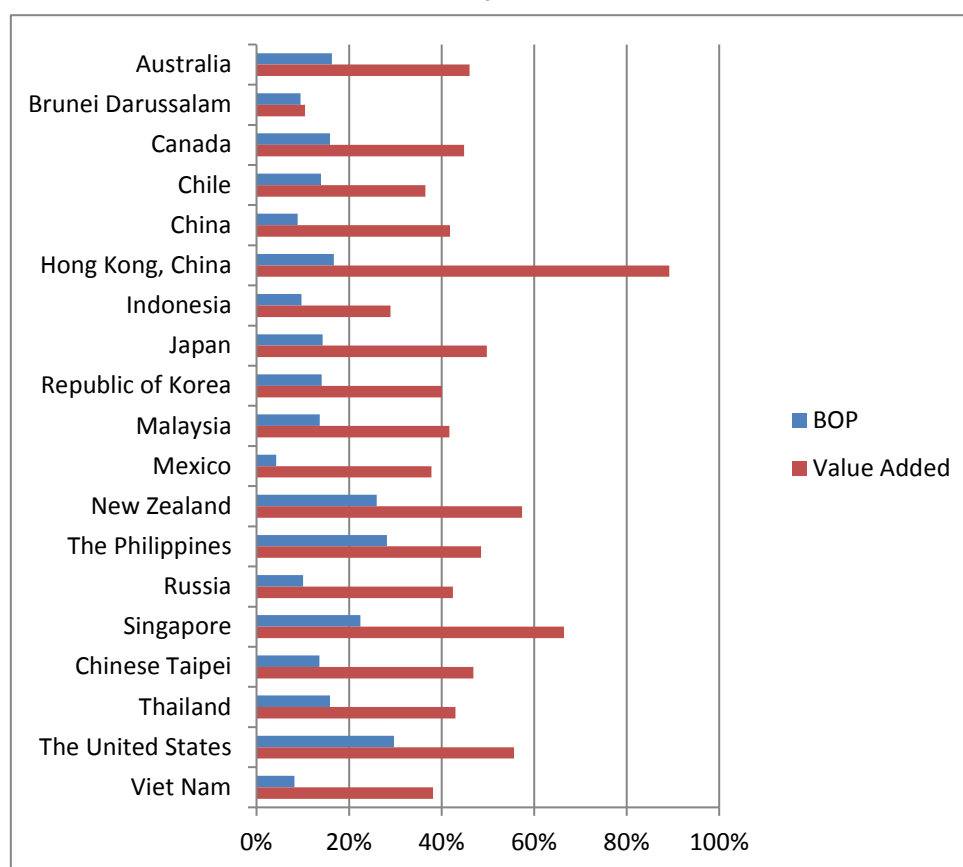
The composition of trade also differs on a value-added basis, with services making up a much larger share of trade than when measured in conventional statistics.<sup>10</sup> Figure 2.3 illustrates this by comparing services as a share of gross exports when these are measured in balance of payments statistics and as value added. The numbers resulting from the conventional measure are below – and sometimes well below – those produced using the value-added approach. In Australia's case, for example, services contributed 16 percent of gross exports in 2011 when measured in the conventional way, but about 46 percent in value-added terms. Some of these differences may be due to different ways of defining services and gross exports in the TiVA database,<sup>11</sup> but a major part can be attributed to the value-added approach.

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10 This observation is made in other sources, for example: APEC Policy Support Unit, *APEC, Services, and Supply Chains: Taking Stock of Services-Related Activities in APEC* (policy brief no. 9, Singapore: APEC, 2014).

11 For example, gross exports in the TiVA database exclude re-exports, which make a huge difference to the numbers in the cases of Singapore and Hong Kong, China.

**Figure 2.3 Services as a share of gross exports: Balance of payments and value added, 2011**



Value-added services include contributions from foreign value added.

Sources: OECD-WTO Trade in Value Added (TiVA) Database, October 2015;

Department of Foreign Affairs and Trade, Australia (DFAT), based on data from the Australian Bureau of Statistics (ABS), CEIC, Global Trade Atlas, International Monetary Fund (IMF), UN Comtrade and WTO.

## 2.3 FOREIGN INVESTMENT

Over the last quarter of a century, globalization and regionalization of international business and trade have been driven by a potent mixture of technological change – especially in information technology and communications and in transport systems – and by unilateral economic reform and coordinated market openings for trade and investment that have been a catalyst for the rise of modern value chains that are now central to global commerce. The outcome is an increasingly integrated economy at the global and especially regional levels, growing convergence between advanced and emerging economies, and unprecedented opportunities for proximate and more distant economies, industries and parts of industries to specialize in producing inputs to goods and services within value chains spanning continents and the globe.

Foreign investment – most importantly foreign direct investment (FDI), but also portfolio investment, overseas bank lending and even overseas development assistance – has played an influential role in transforming the global economy and the growth of regional commercial networks, including in the APEC region. These flows have contributed to the development of energy, transport and communications infrastructure; accelerated transfers of technology and management systems; boosted trading networks through investment in foreign affiliate companies; and improved information flows between exporters and importers.<sup>12</sup> And cumulatively, and to varying extents across economies, they have encouraged specialization and helped to shape comparative advantages by lowering trade costs, creating opportunities for new and established participants in international trade, and enabling economies to move faster up the value chain ladder.<sup>13</sup>

By volume, portfolio investment and overseas bank lending are the principal sources of foreign investment. They can strengthen trade flows by ‘reducing information asymmetries between exporters and importers’ and can lower the cost of capital by adding to the pool of domestic savings available to finance domestic investment.<sup>14</sup> But their role in supporting trade is not clear-cut: some empirical studies report a positive relationship between portfolio investment inflows and developments in the real economy; others report virtually no discernible relationship or a minor relationship.<sup>15</sup> The problem, to some extent, is whether increasing flows of portfolio investment and commercial bank lending into developing and emerging economies add uniquely to trade outcomes or are primarily a response to policy and regulatory reforms that typically reduce risk and encourage international engagement.

The relationship between trade and FDI is more clear-cut: it is strongly positive both

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12 WTO (World Trade Organization), *World Trade Report 2013: Factors Shaping the Future of World Trade* (Geneva: WTO, 2013), 134–52.

13 These and following assessments focus on overall trends and patterns indicated in foreign investment statistics compiled and published by the International Monetary Fund (IMF), the United Nations Conference on Trade and Development (UNCTAD) and the International Trade Centre (ITC). The quality, range and coverage of statistics vary appreciably between reporting economies and care needs to be exercised in interpreting them. Among APEC economies, for instance, statistics on foreign direct investment (FDI) by industry are patchy (see Figures C.3–C.5) and statistics for some economies are affected by partial reporting of inflows and outflows. Interpretation is also complicated by the extent to which statistics reflect immediate or ultimate destinations (e.g. investment to China via Hong Kong, China) and valuations used (e.g. historical or market values). Also, FDI figures by origin or destination may be affected as some investments are performed through firms registered in third-party locations (e.g. tax havens).

14 WTO, *World Trade Report 2013*, 135 and 140.

15 *ibid.*



globally and in the APEC region.<sup>16</sup> FDI and trade are often complementary because multinational companies use their overseas affiliates and subsidiaries as export platforms at different points along regional and global value chains. FDI helps to create new or improved plant and equipment that in turn produces intermediate products and services traded along value chains. Affiliates and subsidiaries often generate demand for inputs that can be sourced locally and become the basis for new areas of specialization and international competitiveness. And, more generally, FDI can produce agglomeration effects in certain sectors – for example, in electronics in East Asia or autos in North America – that lead to high levels of specialization among domestic firms and increased reliance on exports and dependence on imported intermediates.

### **2.3.1 Stock of FDI**

APEC's capital markets account for around half of global foreign investment. The US, which holds around 50 percent of APEC's foreign investment assets and liabilities, is dominant, but markets in other advanced APEC economies (especially Australia; Canada; and Japan); Singapore; Hong Kong, China; and China are also important in attracting and channelling funds for regional commerce. Together, these economies account for around 90 percent of foreign investment in APEC.

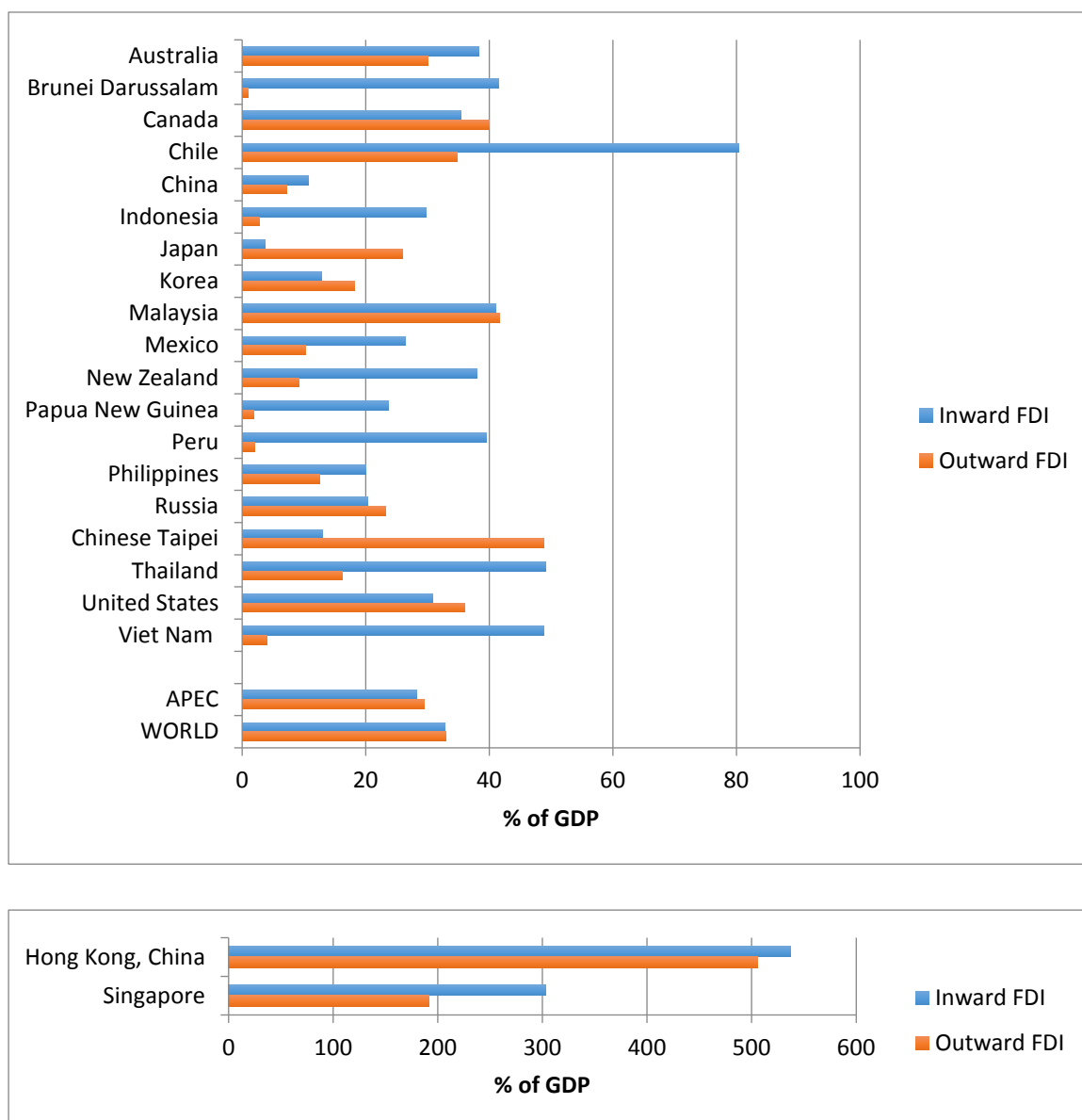
The picture is different if foreign investment stocks are scaled relative to the size of economies. The US does not stand out, with a significant number of APEC economies broadly in line with or ahead of it. And, reflecting their roles as regional and global financial hubs, the inward and outward stocks of Singapore and Hong Kong, China are much higher still, amounting to multiples of GDP. Much of the foreign investment flowing into and from these economies goes elsewhere. Hong Kong, China is especially prominent as a channel for funds to and from China; its stocks of inward and outward FDI amount to over 500 percent of GDP (Figure 2.4).<sup>17</sup>

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16 See: P. Love and R. Lattimore, *International Trade: Free, Fair and Open?* (Paris: OECD, 2009), Ch. 9; WTO, *World Trade Report 2013*, 134–52; OECD (Organisation for Economic Co-operation and Development), *Policy Priorities for International Trade and Jobs*, ed. D. Lippoldt (Paris: OECD, 2012).

17 China is very much the dominant partner for foreign investment into and out of Hong Kong, China. China accounts for over 40 percent of Hong Kong, China's outward FDI, and over 30 percent of its inward FDI.

**Figure 2.4 APEC foreign direct investment (FDI) stocks, 2014**



Source: UNCTADstat database.

During the 2000s, APEC’s FDI as a proportion of global stocks retreated from above, to below, 50 percent. Falls in APEC economies’ shares of aggregate holdings in global FDI were largely attributable to the falling US share of global FDI, though this was partially offset by rises in the holdings of other APEC economies, especially China: its USD holdings of outward FDI rose over 16-fold from 2004 to 2014. Since the late 2000s, further rises in the shares of global FDI of non-US APEC economies and a modest revival in the US share have supported a return in APEC’s global share of FDI to 50 per cent (Figures C.1 and C.2). These trends are consistent with the rising prominence of emerging and developing economies in foreign investment, especially

in Asia. Latin American APEC economies have also contributed.

Available FDI data by industry sector suggest that investment supports trade throughout the Asia-Pacific, as well as contributing significantly to domestic activity levels. They show Australia; Canada; Chile; and Russia as major destinations for investment in resources; and the US; Australia; Japan; China; and Malaysia as major APEC foreign investors in resources. China is the leading destination for FDI in manufacturing, and the US and Japan the major outward investors. The US dominates investment in the finance sector, especially outward investment, which approached USD 3 trillion in 2012. Australia; Canada; China; Hong Kong, China; Japan; and Singapore are also significant in this sector. Other industry data show that Hong Kong, China acts as a centre for both inward and outward investment in business activities that include investment and holding, real estate, professional and business services; and that Australia; Canada; China; Singapore; and the US have significant inward and outward investments (Figures C.3, C.4 and C.5).<sup>18</sup>

### **2.3.2 Flows of FDI**

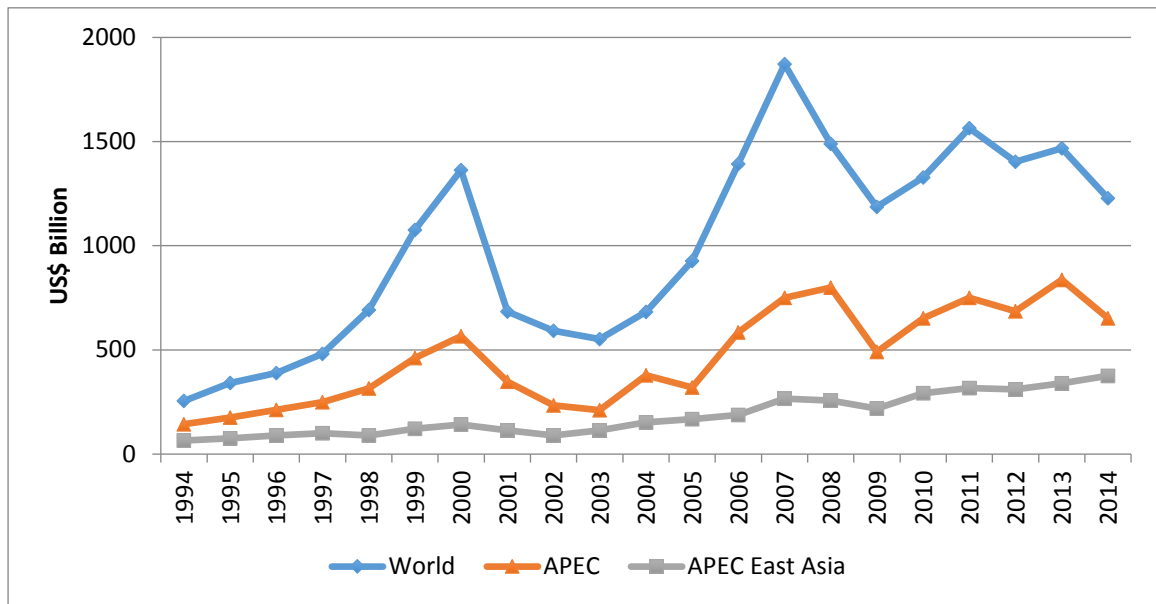
Inward and outward flows of FDI have fluctuated markedly in the APEC region since the early 2000s and were greatly affected by the global financial crisis. While aggregate global and APEC inward and outward flows are yet to fully recover from the effects of the crisis, FDI flows to and from East Asia have continued to grow. FDI flows into and out of East Asia have been markedly less volatile than for the world – and for APEC – as a whole.<sup>19</sup> Flows for APEC Latin American economies have also grown strongly from the early 2000s, though with more volatility. These trends have contributed to an increase in APEC’s share of global FDI flows. In 2014, APEC inward and outward FDI accounted for over 50 percent of global flows, after contributing less than 40 percent in the mid-2000s (Figure C.6). APEC’s share increased partly because FDI flows globally fell and were below their pre-global financial crisis peaks (Figures 2.5 and 2.6).

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18 The overall FDI flows of Hong Kong, China are significantly affected by large flows of funds (i) from and to tax havens in the Caribbean; (ii) from and to China; and (iii) to the Caribbean and back into Hong Kong, China. See: Census and Statistics Department, Hong Kong Special Administrative Region, *External Direct Investment Statistics of Hong Kong 2013* (Kowloon: Census and Statistics Department, 2014), 12.

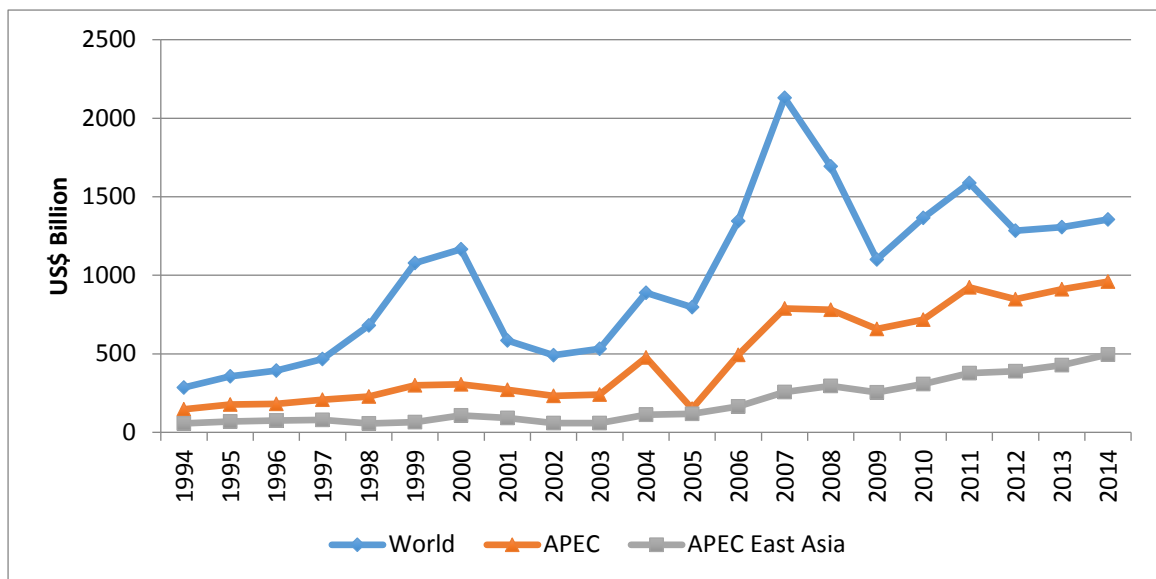
19 APEC FDI flow statistics are often skewed markedly by data for the US. When US data are excluded, APEC FDI flows are much less volatile. See: USCM (University of Southern California Marshall School of Business), ‘Foreign direct investment across APEC: Impediments and opportunities for improvement’ (report, Los Angeles, CA: USCM, October 2013).

**Figure 2.5 Flows of inward FDI**



Source: UNCTADstat database.

**Figure 2.6 Flows of outward FDI**



Source: UNCTADstat database.

## 2.4 SPECIALIZATION AND COMPETITIVENESS

More than ever before in a converging and more integrated economic system, differences between economies in their factor endowments, application of technologies and implementation of economic and social policies expose differences in the performance of different producers that can create opportunities for trade in line with

comparative advantage-driven specialization.

The ‘flying geese’ model, popularized in the 1980s by former Japanese Foreign Minister Saburo Okita, and used to symbolize the ‘miracle of East Asia’, is an accessible explanation of the phases and regional transmission of development.<sup>20</sup> According to this model, economies move toward higher value-added production in response to changes in comparative advantages; and other economies step in to fill the gap left by that shift (see Appendix D for more on this model). This model explains, for example, the relocation of certain production activities from more advanced economies to low-wage economies that have a comparative advantage in labour-intensive industries. By implication, this model has value in explaining structural changes across the broader Asia-Pacific.

In the real world, of course, the transmission of development opportunities between industries and economies is much more complex. Several economies at the same time are typically finding ways to gain comparative advantage in various sectors. Economies may only imperfectly resemble the ordered inverted ‘V’ formations of airplanes referred to by Akamatsu in his original work on flying geese in the early 1930s.<sup>21</sup>

The approach most widely used to measure changing patterns of comparative advantage was proposed by Balassa,<sup>22</sup> and is the share an economy holds in world exports of a commodity divided by that economy’s share of world exports. It should be high if the economy has a comparative advantage in the product or service.<sup>23</sup> It is, of course, possible to arrive at different results if sectors are defined differently, for example, if manufactures trade rather than world trade is used as a reference; or if trade is measured on a value-added basis.<sup>24</sup>

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20 K. Kojima, ‘The flying geese model of Asian economic development: Origin, theoretical extensions and regional policy implications’, *Journal of Asian Economics* 11(4) (2000): 375–401.

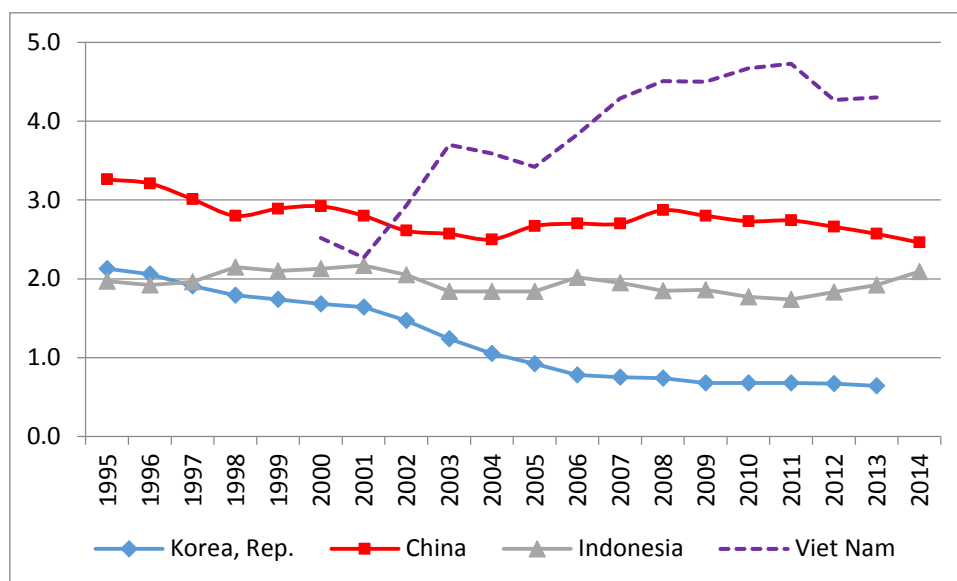
21 K. Akamatsu, ‘A historical pattern of economic growth in developing economies’, *The Developing Economies* 1 (1962): 3–25.

22 B. Balassa, ‘Trade liberalisation and “revealed” comparative advantage’, *The Manchester School* 33(2) (1965): 99–123.

23 This is not always the case. Subsidies or other market distortions can give an economy a higher share of exports in a commodity than would be expected from any genuine comparative advantage. See: E. Siggel, ‘International competitiveness and comparative advantage: A survey and a proposal for measurement’ (paper for the *CESifo Venice Summer Institute*, 20–21 July 2007), 13. We nevertheless rely on Balassa’s measure to sketch changes in comparative advantage occurring in the region, drawing on the World Integrated Trade Solution (WITS) database, which provides this measure for a large number of economies.

24 There are other approaches. For example, one could calculate the ratio of net exports for a commodity to total exports and imports of the same commodity. The thinking is that this is likely to be positive and high if a country has a strong comparative advantage in the commodity and negative if it

**Figure 2.7 Changing patterns of comparative advantage for textiles and clothing**



A value greater than 1 indicates a revealed comparative advantage.

Source: World Integrated Trade Solution (WITS) Database.

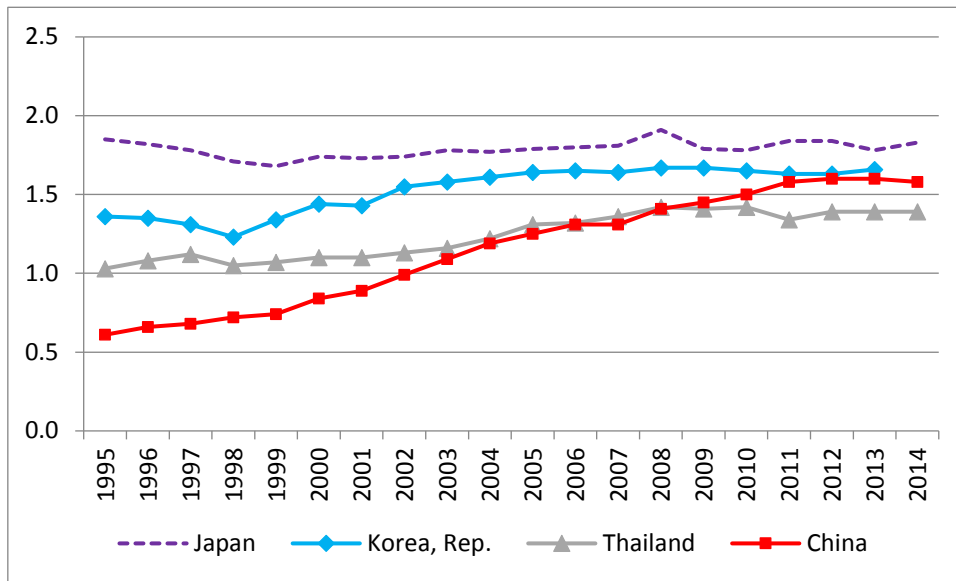
Figure 2.7 looks at textiles and clothing, which can be regarded as a proxy for labour-intensive products. Korea’s revealed comparative advantage in these products has declined fairly steadily over the past two decades as wages have risen and its economy has diversified into other goods and services. It now has a comparative disadvantage in these products, shown as a reading of less than 1. China continues to have a strong revealed advantage in this group of products, although the value has declined since 1995. The most striking trend has been the huge increase in Viet Nam’s reading as its export specialization has increased. Indonesia’s reading has remained relatively steady over two decades.

Figure 2.8 looks at machinery and transport equipment, which can in most part be assumed to represent more capital and skill-intensive products. Thailand’s revealed comparative advantage has increased appreciably as it has emerged as a major regional hub for motor vehicle and parts manufacture. Its revealed comparative advantage remains below Japan’s and Korea’s, however. The more striking change in the graph is China’s change from a comparative disadvantage to a revealed comparative advantage as its strengths as a manufacturer have increased.

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does not. Balassa’s index and the net exports approach are discussed in: M. Ariff and H. Hill, *Export-Oriented Industrialisation: The ASEAN Experience* (Sydney: Allen and Unwin, 1985), 219–29.

**Figure 2.8 Changing patterns of comparative advantage for machinery and transport equipment**



A value greater than 1 indicates a revealed comparative advantage.

Source: World Integrated Trade Solution (WITS) Database.

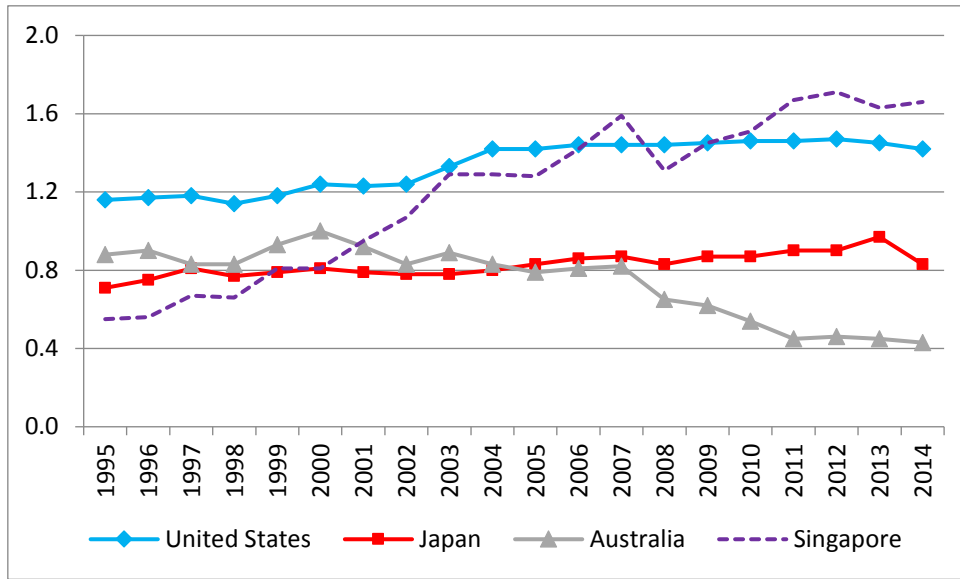
Figure 2.9 looks at chemicals. The outstanding feature is the strong rise in revealed comparative advantage for Singapore – to the point where it is greater than the US's. Australia's revealed comparative advantage has declined markedly, partly owing to increasing specialization in minerals and fuels.<sup>25</sup> This is shown in Figure 2.10, which examines revealed comparative advantage for minerals for Australia; Chile; Indonesia; and Peru. All of these economies have a strong revealed comparative advantage, although values for Australia; Chile; and Peru are much higher than for Indonesia. Values for Chile and Peru have fluctuated a good deal, possibly because of fluctuations in commodity prices.

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25 Increased specialization in minerals and fuels in Australia contributed to a decline in the share of chemicals in total merchandise exports between 2007 and 2014, and thus to a fall in revealed comparative advantage in this sector. In part, this is just a statistical consequence of mineral and fuel exports having grown so rapidly. But in part, it reflects links between the sectors in the real economy, with the appreciation of the exchange rate under the minerals boom having an adverse effect on exports of manufactures like chemicals.



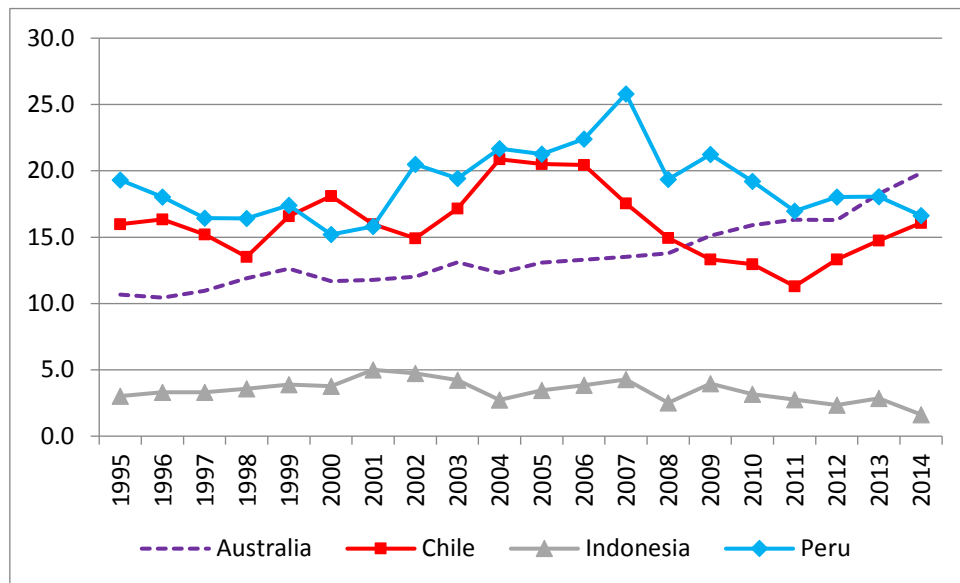
**Figure 2.9 Changing patterns of comparative advantage for chemicals**



A value greater than 1 indicates a revealed comparative advantage.

Source: World Integrated Trade Solution (WITS) Database.

**Figure 2.10 Changing patterns of comparative advantage for minerals**



A value greater than 1 indicates a revealed comparative advantage.

Source: World Integrated Trade Solution (WITS) Database.

Overall, the picture of changing comparative advantage in the region is complex. There is no simple transmission of industries from ‘leaders’ to ‘followers’. Rather some economies that have been thought of as followers show different patterns of export specialization – chemicals for Singapore; transport equipment for Thailand; and minerals for Chile and Peru. As the flying geese model suggests, followers may ultimately overtake leaders in specializing in specific industries. In a world where capital is mobile and skills increasingly dispersed, some economies appear to move more quickly to leading stages than the flying geese model would suggest. But this, and other models like the product life cycle still have value, particularly in terms of providing accessible insights into changing comparative advantage within economies and across broad regions, and in explaining how economies are becoming increasingly interdependent.

Whereas *comparative* advantage in a product or service exists where an economy can produce it more cheaply relative to other goods and services it produces than its trading partners, *competitive* advantage occurs if firms producing a product can compete effectively in the market either because of ‘lower costs or differentiated products that command premium prices’.<sup>26</sup> At the domestic level, competitiveness can be taken to mean a comparison of relative costs/prices as measured by the real exchange rate or, much more broadly, as ‘the set of institutions, policies and factors that determine the level of productivity of a country’.<sup>27</sup>

Movements in real exchange rates provide an indication of the evolution of an economy’s aggregate external price competitiveness, but not necessarily of the myriad determinants of productivity, standards of living and capacity to sustain and increase participation on world markets. Among APEC economies, Singapore for instance has experienced sustained appreciation in real exchange rates over recent years, which suggests that its competitiveness should have decreased, yet it has maintained its top ranking relative to other economies on broad-based measures. Conversely, Japan’s real exchange rate depreciated, assisting its competitiveness, though not necessarily increasing its ranking.

In applying broader definitions of competitiveness to the APEC region, the picture that emerges is of a group of dynamic economies with an enduring capacity to be competitive in world markets as economies move through different stages of development (Table D.1):

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26 M. Porter, *The Competitive Advantage of Nations* (London: Macmillan, 1990), 10. Balassa’s index of revealed comparative advantage can, however, be interpreted as a measure of competitiveness. See: Siggel, ‘International competitiveness and comparative advantage’, 13.

27 WEF (World Economic Forum), *The Global Competitiveness Report 2015–2016* (Geneva: WEF, 2015), 4.

- Singapore and Hong Kong, China have ranked consistently among the world's leading economies in widely used measures like the World Economic Forum's Global Competitiveness Index, the World Bank's Doing Business Initiative and the Economist Intelligence Unit's City Competitiveness Index. The US and its major cities are also in the leading group by these measures.
- In 2015–16, 19 APEC economies were in the top half of the 140 economies ranked by the WEF's Global Competitiveness Index.<sup>28</sup> Since the mid-2000s, increases in rankings have substantially outweighed decreases. Indonesia; Peru; the Philippines; Russia; and Viet Nam have made impressive progress.
- Singapore and New Zealand were ranked first and second respectively in the World Bank's 2016 Doing Business ranking of 189 economies. Nine APEC economies were in the top 20 and 18 in the top 100.
- Fourteen of the world's top 25 cities are in the APEC region, according to the Economist Intelligence Unit's City Competitiveness Index, both for 2012 and in projections to 2025.

There is a great deal of literature on factors at the domestic level that contribute to competitiveness. For example, two topics particularly relevant in an APEC context are regulatory reforms to provide greater ease in doing business and reduce trade costs.

APEC's Ease of Doing Business initiative, which keys off the World Bank's Doing Business rankings, aspires to improve APEC's performance by 25 percent in five key areas of doing business from 2009 to 2015. Up to 2014, overall performance improved by 12.7 per cent, well below the pace of improvement needed to meet the 2015 target. While the progress has been significant (making it easier, cheaper and faster to do business around the APEC region) and compares favourably with progress in the rest of the world, performance across APEC economies has been very uneven. For example, the time required to start a business in 2014 varied from half a day to 101 days.<sup>29</sup>

Trade costs also vary substantially across the region because of differences in the quality of hard infrastructure, such as multi-modal transport systems, and soft infrastructure such as customs procedures, and harmonization of regulations and standards. For example, the cost of exporting a container varied from USD 460 to USD 2,705 in 2014.<sup>30</sup>

As a general principle, economies with low trade costs are more firmly linked into value chains, are more competitive and have more diversified exports than economies with

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28 Brunei and Papua New Guinea were not assessed in the 2015–2016 WEF Global Competitiveness Index. Brunei was in the leading 50 economies in each of the years it was included from 2008–2009 to 2013–2014.

29 APEC Policy Support Unit, *APEC's Ease of Doing Business – Interim Assessment 2009–2014* (Singapore: APEC, 2015).

30 *ibid.*

higher trade costs. At the aggregate level, the APEC region is well integrated with regional and global trading networks. The average level of connectedness among APEC members is slightly greater than for the Organisation for Economic Co-operation and Development (OECD) as a group.<sup>31</sup> The region is central to the global trade network, where it functions somewhat like a bridge with strong connections to all other major regions, including Europe.<sup>32</sup> And APEC economies are, in general, increasing their backward and forward integration within global and regional value chains.

## **2.5 HAS TRADE REACHED A PEAK?**

Opportunities for exploiting the ‘advantages’ of backwardness, transmitting ‘flying geese’ development through substantial shifts in the comparative advantages of advanced and less advanced economies, and even for converging living standards between disparate economies have become part of the assumptions, expectations and landscape of a period – lasting roughly a quarter of a century – in which international trade and investment grew much faster than the global economy. In the second half of the 1970s and first half of the 1980s, growth in global exports exceeded global GDP by around 1 percent per year. From the mid-1980s to the dot-com bust of 2001, this increased to almost 4 percent per year, and remained over 2 percent higher in the period to the global financial crisis. Now, the difference has shrunk to an average of less than 1 percent, both globally (

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31 APEC Policy Support Unit, *Evaluation of Value Chain Connectedness in the APEC Region* (Singapore: APEC, 2014), vi.

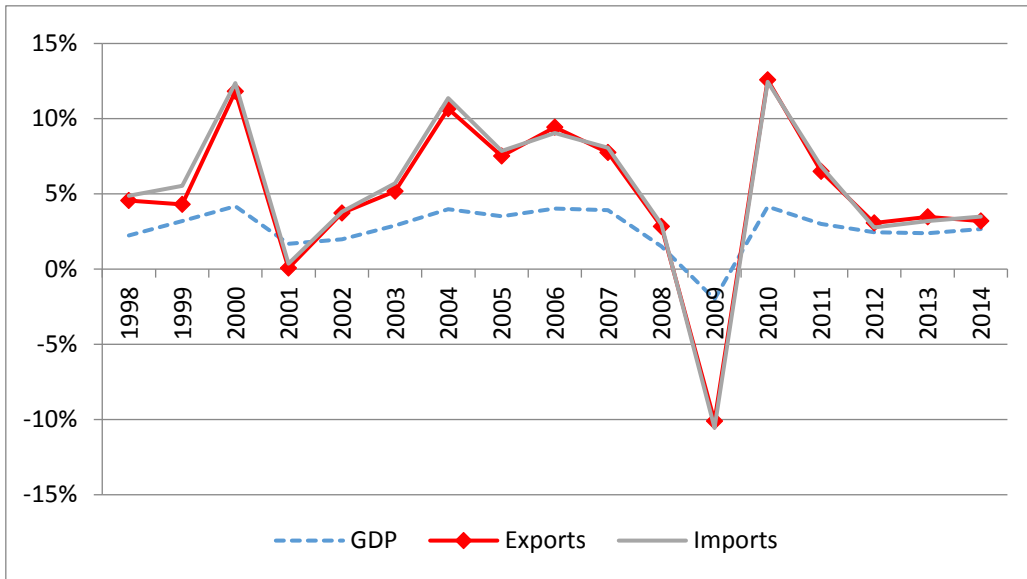
32 Ibid., 18 and 20.

Figure 2.11) and in the APEC region (Figure 2.12), and may well have shrunk further.<sup>33</sup> One result is that the share of global goods and services trade in global GDP has stagnated in recent years (Figure 2.13). This raises some perplexing questions: most importantly, has the relationship between trade and economic growth changed permanently; and, if it has, how has it changed, what does this imply for regional economic integration, and how must economies adjust if expectations of a good and prosperous future are to be achieved?

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<sup>33</sup> 'The trade that matters', *Financial Times*, 27 August 2015.

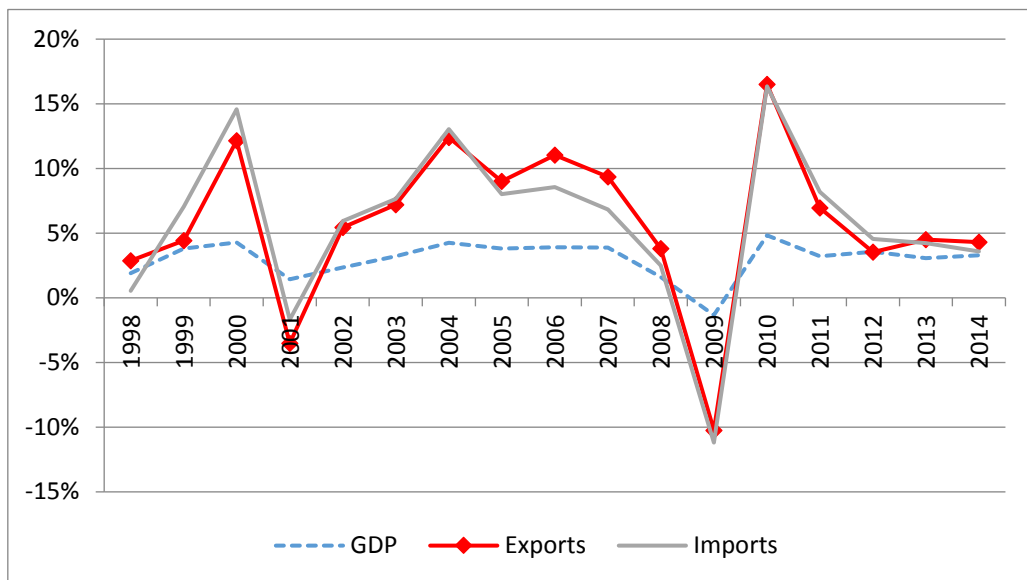
**Figure 2.11 World growth in GDP, exports and imports**



Exports and imports are for goods and services and are volume measures. GDP is weighted by economies' GDP at market prices (rather than at purchasing power parity).

Source: International Monetary Fund (IMF) World Economic Outlook Database, October 2015.

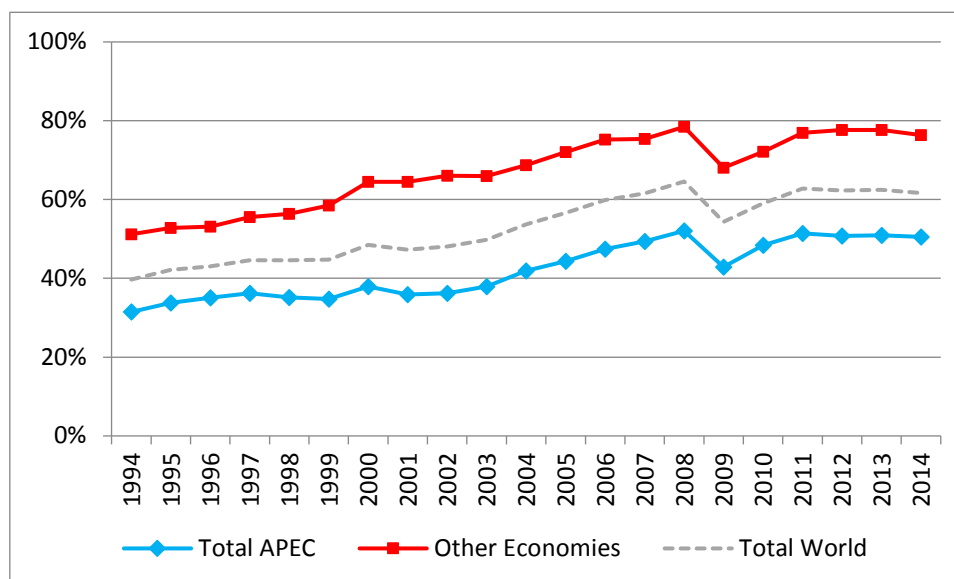
**Figure 2.12 Growth in APEC economies' GDP, exports and imports**



Exports and imports are for goods and services and are volume measures. GDP is weighted by economies' GDP at market prices (rather than at purchasing power parity). It was only possible to go back to 1998 because trade volume data are not available for China before that date.

Source: International Monetary Fund (IMF) World Economic Outlook Database, October 2015.

**Figure 2.13 Total trade in goods and services as a share of GDP**



Total trade is defined as the sum of exports and imports of goods and services.

Source: Calculated from data provided by the Department of Foreign Affairs and Trade, Australia (DFAT), and from the International Monetary Fund (IMF) World Economic Outlook Database, October 2015.

The slowdown in global trade has been variously attributed to predominantly structural influences and predominantly cyclical influences. The structural case is built around five observations:

- The trade–production/income elasticity peaked well before the stagnation of the world export–GDP ratio in the aftermath of the 2009 global financial crisis. The declining elasticity may have foreshadowed this stagnation (see Appendix F).
- Declines in demand for investment goods, particularly in the resources and energy sector, may explain some structural and cyclical aspects of falling trade elasticities and trade retardation.<sup>34</sup> The composition of world output also is gradually shifting toward services and is reflected in the increasing role of services in world trade. While positive for the world economy and world trade, this trend is unlikely to be strong enough to turn around the trade-to-global-GDP ratio while trade in services remains highly restricted in many economies.
- The trade slowdown may reflect the time-bound effects of re-integrating Central and Eastern Europe and especially China into the global economy. The resources-intensive phase of Chinese economic development is substantially over, and China

<sup>34</sup> B. Hoekman, ‘Trade and growth: End of an era?’ in *The Global Trade Slowdown: A New Normal?* ed. B. Hoekman (London: CEPR Press, 2015), 3–19.

is attempting to move to a more sustainable growth rate based more on domestic consumption-led growth and less on export-led growth. China's recent spectacular role in the wider economy cannot be replicated easily by other regions or major emerging economies.

- Trade retardation may reflect economic, managerial or environmental limits on the capacity of firms to profit from ever finer fragmentation of production in global and regional value chains.
- And while there was no generalizable outbreak of protectionism either during the 2009 global financial crisis or subsequently, it may have played a role at the margin in reducing the rate of trade growth.

There is general agreement in the literature that cyclical factors are a major explanation for the lack of trade dynamism in recent years, especially in the Eurozone and more recently in China.<sup>35</sup> But there is no consensus on the relative contributions of structural and cyclical factors to the recent stagnation of trade. In part this is because of difficulties in disentangling structural and cyclical influences. It is also because of weakness (particularly involving double counting of domestic and international content) in the gross trade numbers that underpin almost all of the analysis on peak trade. Value-added trade is a better measure of medium-to-long term trends in trade, but unfortunately the data are difficult to compile and only go up to 2011.

It would seem reasonable to expect that trade growth will exceed GDP growth once the global economy starts to experience more assured growth and confidence lifts. This probably will not happen quickly. It also seems reasonable to expect that the margin by which trade growth exceeds GDP growth will continue to be narrower than in the unusual circumstances of the 1990s and early 2000s. But on balance, there are solid reasons to expect that trade will continue to increase as a share of global GDP over the medium term (if not in the short term):

- Services trade should grow more quickly as barriers continue to be reduced, though reducing the substantial barriers to services trade delivered through commercial presence and movement of natural persons will not happen quickly.
- The role played in international trade and investment by foreign affiliates is not understood properly, but seems to have the potential to generate increased demand for goods and services and to increase trade through FDI flows.
- A large number of major regions and economies continue to be limited by high real trade costs through inefficiencies in soft infrastructure like customs procedures and hard infrastructure such as transport systems. This fact is recognized by central governments and regional bodies (e.g. APEC Leaders' Declaration 2015). The challenge increasingly is how to fund the institutional

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35 *ibid.*



capacity to plan, design, implement and manage projects, and how to improve business and investment environments to attract funding.<sup>36</sup>

- New technology and its applications will continue to provide opportunities for specialized production across countries. The potential for small- and medium-sized enterprises (SMEs) to participate in value chains and extract more income from them has largely not been tapped.
- Some new regionally based trade agreements delve deeper into behind-the-border issues affecting trade and investment. In combination with unilateral economic reform and resistance to protectionism, they have great potential to boost trade.

Whether peak trade has any real meaning over and above concerns provoked by the current stagnation of trade, will depend on the world's collective capacity to develop and harness the technologies that boost trade, and on the policy environment globally and in key countries. At a minimum, the policy challenge in the APEC region, as elsewhere, is to sustain current openness at a time of slowing economic growth. To be effective, governments will need to prepare for the next wave of growth in the region that, in all likelihood, will be linked to services and investment liberalization and behind-the-border structural reforms to enhance competition, innovation and productivity. APEC has a key role to play in this regard.

This points to at least three key policy challenges for governments:

- Building momentum behind domestic economic reform. In key respects, productivity-raising, competitiveness-enhancing micro-economic reform is the best trade policy. To have traction, it needs to be linked back to growth, jobs and higher living standards, as well as to practical actions that address issues like social inclusiveness, equity and connectivity.
- Making and re-making the domestic case for open trade and investment regimes and again linking it back to growth, jobs and higher living standards. Protectionism is self-defeating, particularly where the great bulk of goods and services are traded as intermediates, but it is never vanquished, only beaten back to be fought another day.
- Building on habits of reform-oriented collaboration among APEC members to advance the agenda on issues ranging from pathways to the FTAAP and trade facilitation to services trade and investment liberalization and improved labour mobility.

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36 E. Ferro et al. *Transport Infrastructure along APEC's Critical Supply Chains: Analysis for Informed Capacity Building* (Washington, DC: World Bank, 2014).

## 2.6 CONCLUSION

Trade and investment have increased strongly over the past quarter of a century in the APEC region and the region has become increasingly integrated by world standards. Trade has been a key driver of regional growth, development and prosperity – by taking advantage of differences in productivity and factor endowments between economies. And, in conjunction with investment flows, particularly within value chains, trade has played a dynamic role within the APEC region by encouraging innovation, disseminating knowledge and boosting productivity.

Value chains link together international production with goods, services, investment, skills, and knowledge flowing across multiple borders. And development opportunities are now transmitted much faster within and between economies than at any time in the last century. This has helped economies to gain comparative advantages. For example, China has turned a strong comparative disadvantage in capital and skill-intensive manufactures into a strong comparative advantage; Viet Nam has developed a strong comparative advantage in labour-intensive products; and Chile has broadened its specialization in primary products from copper ores to salmon to horticulture to wine.

The high level of integration within the APEC region at the aggregate level does not necessarily convert into high levels of integration for all economies. Some economies remain relatively isolated from main trade networks. This is a policy challenge notwithstanding that large economies are usually less trade-dependent than smaller ones and that structural reforms that are primarily concerned with the domestic economy can lead to significant welfare gains. It is a challenge because ‘no nation has developed and grown without the benefits of [international] trade’.<sup>37</sup>

Value chains are now central to global commerce. Participating in them and diversifying into areas that create more income are one of the keys to growth and jobs; but the location and potential of chain production depend on competitiveness. As new locations are opened up, and others scaled back, the distribution of jobs and economic opportunity across economies and regions will shift. The political economy related to those changes represents a challenge in the implementation of reforms.

The requirements of value chain trade place a big premium on policies at the economy level and the regional level that reduce trade costs and increase the ease of doing business. They also make more compelling the case for pursuing ambitious regional trade and investment initiatives if growth opportunities are to continue to be transmitted quickly across the region and transformed into jobs and higher living standards.

On balance, trade will continue to be an important driver of economic growth in the region. In all likelihood, the relationship may be weaker than in the period prior to the

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<sup>37</sup> WTO, *World Trade Report 2013*, 11.

2009 global financial crisis – this would seem reasonable from the slowing of the Chinese economy and continuing weakness in other key areas of the regional and global economy – but trade and trade liberalization will remain indispensable for long-term sustainable economic growth.

### 3. NEXT GENERATION TRADE AND INVESTMENT ISSUES

#### 3.1 INTRODUCTION

Against a backdrop of uncertainty amid recovery from the global financial crisis, APEC Leaders meeting in Yokohama in 2010 recognized that the transformation of the global and regional environment had increased the importance of not just advancing conventional at-the-border trade and investment issues, but also of addressing non-tariff behind-the-border barriers and other next generation trade and investment issues (NGeTI).<sup>38</sup>

At the 2010 meeting, the Leaders envisioned APEC making an important and meaningful contribution as an incubator of an FTAAP by providing leadership and intellectual input into the process of its development, and by playing a critical role in defining, shaping and addressing NGeTI that FTAAP should contain.

APEC economies agreed at the time that NGeTI are:

- Issues that have been considered to be traditional trade issues, but need to be addressed in new ways given changes to the global trading environment.
- Issues that either did not exist or were not considered trade issues 15 years ago, but that now have a real impact on companies' ability to do business in the region.<sup>39</sup>

APEC discussions identified a range of NGeTI, and supported the need to build the capacity of APEC economies to engage in discussions and tackle specific next generation issues. At the same time, they also revealed divergence among economies on the specific topics that should be included as NGeTI and the desired outcomes when including the topics in trade agreements.<sup>40</sup>

As APEC's NGeTI workstream is ongoing, a broad and forward-looking approach has been taken in drafting this chapter to illustrate how APEC's consideration of cutting-edge trade and investment issues may contribute to regional economic integration. This chapter includes sections on:

- Endorsed NGeTI within APEC.

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38 APEC, *APEC Leaders' Declaration* (2010) and its annex 'Pathways to FTAAP'.

39 APEC, *Next Generation Trade and Investment Issues to be Addressed in 2011* (2011/SOM2/021anx3, Singapore: APEC, 2011).

40 APEC CTI (Committee on Trade and Investment), 'APEC CTI first meeting for 2011: Chairs' summary record of discussion' (2011/SOM2/CTI/002, Singapore: APEC, 2011).

- Potential NGeTI for consideration by APEC.
- Examples of NGeTI in recent regional trade agreements and free trade agreements (RTAs/FTAs).

It should be noted at the outset that this chapter should not be taken as representing future commitments by APEC economies with regard to NGeTI in the context of negotiations on an FTAAP; nor should it be read as representing a commitment to, or endorsement of, future work.

### 3.2 APEC-ENDORSED NGeTI

Since 2011, APEC has had a workstream to identify NGeTI. The discussions resulted in five topics being endorsed as NGeTI, as shown in Table 3.1.

**Table 3.1 List of NGeTI endorsed by APEC Ministers**

Issues/measures	Year endorsed
Facilitating global supply chains	2011
Enhancing small and medium-sized enterprise (SME) participation in global production chains	2011
Promoting effective, non-discriminatory, and market-driven innovation policy	2011
Transparency in regional and free trade agreements (RTAs/FTAs)	2012
Manufacturing related services in supply chains/value chains	2014

#### 3.2.1 Facilitating global supply chains

Supply chains refer to a system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. Global supply chains, a key characteristic of today's globalized economy, consist of worldwide networks of suppliers, manufacturers, warehouses, distribution centres and retailers through which raw materials are acquired, transformed and delivered to customers.<sup>41</sup>

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41 APEC Policy Support Unit, 'Concepts and trends in global supply, global value and global production chains' (issues paper no.1, Singapore: APEC, 2012), 2.

Traditionally, the facilitation of supply chains was addressed through chapters on customs administration and trade facilitation in RTAs/FTAs. However, with the rising importance of global supply chains in the modern production process, a broader approach has become necessary. There is a need to also consider policies aimed at fostering an infrastructure framework, services-trade liberalization and e-commerce, as well as policies that cultivate entrepreneurship, foreign investment promotion and protection, research and development activities, among others. APEC economies agreed that further work to more fully address issues related to global supply chains was needed.

The rapid growth of global supply chains has important sectoral, geographic and economic implications that significantly contribute to the internationalization of services and the adoption of new business models made possible by information and communications technology (ICT). APEC has already started to address the logistics barriers faced by businesses through the APEC Supply-Chain Connectivity Initiative.

After APEC recognized this topic as NGeTI, APEC also undertook case studies to explore aspects of global supply chains that were not well understood, and to develop tools or options to guide APEC economies in creating an environment that would help businesses to proactively connect to global supply chains within the region.<sup>42</sup>

In addition to the specific work on this topic, APEC has actively worked on enhancing global supply chains and global value chains as a whole through (i) the APEC Strategic Blueprint on Promoting Global Value Chains, Development and Cooperation; and (ii) the APEC Connectivity Blueprint for 2015–2025 – a reflection of APEC’s great interest in tackling this new business situation.

### **3.2.2 Enhancing SME participation in global production chains**

In the past, small and medium-sized enterprises (SMEs) were mostly confined to local trade with comparatively small business volume. Globalization, the rapid adoption of ICT and the development of multilateral and international rules have made it technically possible for SMEs to engage in global trade. Supporting SMEs thus presents new challenges.

Recent RTAs/FTAs have begun to include chapters or provisions on cooperation and on addressing the development of SMEs. Nevertheless, more could be done to foster the participation of SMEs in global production chains with a view to promoting their

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42 The Policy Support Unit of the APEC Secretariat completed a case study on the *Global Supply Chain Operation of the Electrical and Electronics Industry in the APEC Region* in 2013. The study recommended that APEC economies build up human capital, assist and facilitate business, strengthen regional integration and build up physical and information and communications technology (ICT) capabilities.

capacity to serve as supporting industries.

In 2011, APEC Leaders adopted the document entitled ‘Enhancing small and medium-sized enterprises participation in global production chains’, which identified areas for further cooperation such as strengthening the ability of SMEs to identify commercial partners; promoting use of ICT and protection of intellectual property; and facilitating access to trade and investment-related information.<sup>43</sup>

In 2015, the APEC Ministers Responsible for Trade endorsed the Boracay Action Agenda to Globalize MSMEs (micro, small and medium enterprises). This document provided directions for future work on streamlining customs-related rules and regulations, providing timely and accurate information on export and import procedures, widening the base of Authorized Economic Operators, increasing utilization of e-commerce, etc.

Recent studies by the APEC Secretariat’s Policy Support Unit also recommended that APEC economies provide SMEs with an enabling business environment and improve their access to finance. The studies noted the need to strengthen global cooperation and networking, among SMEs as well as between multinational corporations and SMEs. SMEs’ knowledge of FTAs should also be improved.<sup>44</sup>

### **3.2.3 Promoting effective, non-discriminatory and market-driven innovation policy**

Innovation policy and trade are both important to strengthening regional economic integration and promoting knowledge-based economies. Work in APEC looks to advance innovative growth through adopting market-driven and non-discriminatory policies and promoting regulatory environments that best enable economies to support innovation and utilize ICT.

The 2011 Honolulu APEC Leaders’ Declaration highlighted several measures to promote effective innovation, including: (i) developing an open economy; (ii) enabling the development and adoption of new and innovative business models; (iii) ensuring a transparent and non-discriminatory regulatory system; (iv) promoting open investment; (v) using technical regulations for legitimate public policy objectives; and (vi) providing effective protection of intellectual property rights to create a favourable climate for innovation.<sup>45</sup>

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43 APEC, ‘Annex B – Enhancing small and medium-sized enterprises participation in global production chains’, in *APEC Leaders’ Declaration* (2011).

44 APEC Policy Support Unit, ‘SMEs’ participation in global production chains’ (issues paper no. 3, Singapore: APEC, 2013).

45 APEC, *APEC Leaders’ Declaration* (2011).

APEC has also been looking at innovation policy from other perspectives – such as regulatory reforms to promote research and development and innovation in a market-friendly manner – with the aim of creating a better climate for innovation, facilitating awareness and increasing the capabilities of APEC economies.

### **3.2.4 Transparency in RTAs/FTAs**

In order to promote due process in policymaking and facilitate the administration and exchange of information, APEC developed a Model Chapter on Transparency for RTAs/FTAs in 2012. The Model Chapter contributes to promoting high-quality and comprehensive FTAs in the Asia-Pacific region. The provisions in the Model Chapter reflect the general APEC principle of non-binding agreements and includes various elements such as the publication of measures of general application, public consultation, designated contact points and notification and provision of information.

Further discussion of transparency as addressed in APEC and in the RTA/FTA context is found in Chapter 4.

### **3.2.5 Manufacturing-related services in supply chains and value chains**

This topic was selected to reflect the increasing importance of the services sector in APEC economies. While major services sectors such as telecommunications and finance have been the focus of trade negotiations, services such as research, consulting, advertising and marketing throughout the supply chain or value chain are significantly contributing to create value added in manufacturing.

Recent work by the APEC Secretariat's Policy Support Unit noted the need to consider the impact of policies related to the services sector on the overall economy, since services are highly relevant to manufacturing operations as well as increasingly co-dependent with manufacturing sectors.<sup>46</sup>

The discussions in APEC motivated the preparation of a Manufacturing Related Services Action Plan in 2015. A key action agenda of this plan is the examination of trade-related measures affecting manufacturing-related services, with a view to increasing the availability and accessibility of services through progressive liberalization and facilitation of manufacturing-related services,<sup>47</sup> and cooperation and capacity building in areas such as enhancing transparency and sharing experiences and

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46 APEC Policy Support Unit, *Services, Manufacturing and Productivity* (issues paper no. 9, Singapore: APEC, 2015); APEC Policy Support Unit, *Services in Global Value Chains: Manufacturing-Related Services* (Singapore: APEC, 2015).

47 The types of manufacturing-related services covered by this Action Plan are: (i) Pre-Manufacturing Stage, including sourcing and importation of raw materials; (ii) Manufacturing Stage; and (iii) Post-Manufacturing Stage.



good practices.

### **3.3 POTENTIAL NGeTI (APEC MEMBER SUBMISSIONS)**

The topics in this section cover potential NGeTI submitted by APEC economies. These topics present opportunities and challenges for the future of regional economic integration in the Asia-Pacific, and have been the subject of previous work across a range of APEC fora.

It should be noted that recent developments in the Asia-Pacific, such as the emergence of global value chains, with consequent changes to internal business models and business requirements in order to make best use of trade agreements, suggest the need for further work in the future. As such, this section is non-exhaustive and should not preclude other NGeTI being raised in future.

At the same time, several topics presented here as potential NGeTI are not recognized as such by some economies, as those topics are not traditionally categorized as trade and investment issues, and are still in the process of identification within APEC.

#### **3.3.1 Cross-cutting themes**

There is interest within APEC to expand the scope of work on **global value chains** and **MSMEs**. Aspects related to these issues have already been selected as NGeTI, but many economies wish to continue exploring other related aspects as NGeTI. Considerable work is already taking place in APEC on these two issues:

- On global value chains, APEC Leaders endorsed the APEC Strategic Blueprint for Promoting Global Value Chains Development and Cooperation (2014), which identified workstreams covering areas such as trade and investment issues, services, SMEs, the construction of a trade in value added (TiVA) database, trade facilitation, and resiliency to advance cooperation on global value chains. They also agreed to implement a Strategic Framework on Measurement of APEC TiVA under Global Value Chains (2014) and an accompanying action plan.
- On MSMEs, meetings at the ministerial level have been held annually since 1994. In August 2012, the SME ministers endorsed the SMEWG Strategic Plan for 2013–2016, which provided a roadmap to address critical issues pertaining to the growth of SMEs and micro-enterprises in the APEC region. And, as mentioned earlier, the Boracay Action Agenda to Globalize MSMEs, which seeks to promote the internationalization of MSMEs and their integration into global value chains, was endorsed in 2015.

**Development and economic cooperation** were also raised for inclusion by some APEC economies due to their links with trade and investment. In 1994, APEC Leaders recognized that narrowing the gap in the stages of development among the Asia-Pacific

economies would benefit all members, and charted a course whereby APEC would lead the way on economic cooperation to strengthen the multilateral trading system, enhance trade and investment liberalization in the Asia-Pacific, and intensify Asia-Pacific development cooperation.<sup>48</sup> RTAs/FTAs in the APEC region have addressed development and economic cooperation issues through a variety of means, including capacity-building programmes in specific areas and exchange of information.

Similarly, there is interest to consider **gender issues** and **corporate social responsibility (CSR)** as part of the trade and investment agenda. They have featured highly on APEC's agenda in the past:

- The Policy Partnership on Women and the Economy was established in May 2011, creating a single public-private entity to streamline and elevate the influence of women's issues within APEC. RTAs/FTAs have begun to incorporate gender issues. For example, the Trans-Pacific Partnership's (TPP) Development Chapter contains provisions on women and economic growth, with cooperative activities to enhance the ability of women including exchange of relevant officials, information and experiences. With women tending to be more narrowly concentrated in certain sectors and over-represented in low-skilled, low-productivity roles within global value chains, the question of how RTAs/FTAs might contribute to women's economic empowerment and greater inclusion in the economy may be worthy of further consideration.
- In 2008, APEC Leaders agreed that CSR could reinforce the positive effects of trade and investment on growth, competitiveness and sustainable development. At the Meeting of APEC Ministers Responsible for Trade in 2014, it was agreed that the promotion of CSR principles is important to complement public policies that foster regional sustainable development. RTAs/FTAs may explore how to encourage CSR initiatives to help address social and environmental concerns associated RTA/FTA implementation.

Finally, **non-tariff measures, including regulatory issues**, were put forward for discussion as an important issue in the trade and investment agenda. When discussing the FTAAP, APEC has recognized the need to work more actively on addressing non-tariff or behind-the-border barriers.<sup>49</sup>

In discussing trade and investment issues, good regulatory practices and regulatory

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48 APEC, *APEC Leaders' Declaration* (1994).

49 The 2011 APEC Leaders' Declaration (Honolulu Declaration) stated that: 'Regulatory reform, including eliminating unjustifiably burdensome and outdated regulations, can boost productivity and promote job creation... In addition, as trade and investment flows become more globalized, greater alignment in regulatory approaches, including to international standards, is necessary to prevent needless barriers to trade from stifling economic growth and employment'.

coherence are two concepts that have to be kept in mind. Further discussion of these two concepts as addressed in APEC and in the RTA/FTA context can be found in Chapter 4.

### **3.3.2 Digital trade**

Adoption of digital technologies in traditional industry sectors (manufacturing, agriculture and services) as well as in emerging digital industries is contributing to new and innovative ways of economic cooperation in the region. As a result, in recent years, both global trade in digital products and services and the resultant movement of information and data across all borders have risen significantly. Data flows are a growing element of some commercial activity. For example, some manufacturers rely on the ability to transfer digital design and specifications throughout global value chains.

There is already an agreement that provides for a moratorium on customs duty on electronic transmissions in the World Trade Organization (WTO); and this is also a common feature of many RTAs/FTAs. Some RTAs/FTAs go further, and permanently prohibit the imposition of customs duties on electronic transmissions or digital products. Recently concluded RTAs/FTAs generally also address cross-border transfer of information and non-discriminatory treatment of digital products; and prohibit economies from making it mandatory for investors/companies to localize their computer facilities or to disclose their source code. Personal information protection, consumer protection and cyber security are also a concern for many APEC economies; and several proposals related to these topics are currently under discussion in APEC.

New trade policy is crucial for efficient digital trade development. Nevertheless, there is a wide range of impediments and rollbacks. APEC economies have initiated a number of important activities, including: developing ICT infrastructure; creating legal, regulatory and policy environments in the areas of e-commerce and digital trade; and ensuring predictability, transparency and consistency of regulation in all member economies. A comprehensive approach is crucial to achieving the key goal of enhancing digital trade in APEC region.

In 2015, APEC agreed on a Work Plan for Advancing ‘Facilitating Digital Trade for Inclusive Growth’ within the context of considering digital trade as a potential Next Generation Trade and Investment Issue. In 2016, APEC began work on areas such as enhancing the understanding of the scope of digital trade in the APEC region; exploring the opportunities and challenges that facilitating digital trade presents for stakeholders including SMEs; and identifying potential capacity-building activities.

In the context of addressing increasing adoption of digital technologies in economic activities, concepts such as e-commerce, e-economy and digital economy have been discussed in APEC. These concepts are not necessarily the same in scope, but all of

them aim to address the opportunities and challenges posed by new technologies.

Chapter 5 contains further discussion on how e-commerce is covered by RTAs/FTAs in the APEC region.

### **3.3.3 Environmental issues**

APEC has long recognized the potential for environmental issues to impact growth and prosperity in the Asia-Pacific region, with the Ministers Responsible for the Environment endorsing the APEC Environmental Vision Statement in 1994. Since then, understanding of the international nature of environmental concerns and the interface with trade and economic policy has deepened.

The 2007 Sydney APEC Leaders' Declaration on Climate Change, Energy Security and Clean Development includes a commitment to ensuring the energy needs of the economies of the region while addressing the issue of environmental quality and contributing to the reduction of greenhouse gas emissions. In 2015, the Leaders endorsed the APEC Strategy for Strengthening Quality Growth, which emphasizes adapting to climate change through disaster preparedness and risk reduction as a way to strengthen APEC cooperation on addressing environmental impacts in the region.

Different approaches to addressing environmental issues can be observed. Environmental provisions in recent RTAs/FTAs are meant to mutually support trade and the environment, and to encourage sound environmental policies as well as capacity building. The provisions also recognize the importance of enforcing environmental laws and regulations while reaffirming the right of Parties to pursue their own level of environmental protection. Also, many RTAs/FTAs prohibit the inappropriate use of environmental laws and regulations for protectionist purposes. Relaxing restrictions for the purpose of encouraging trade is also not allowed. Dispute settlement mechanisms applicable to this topic are also seen in some RTAs/FTAs.

An open global trade and investment system is necessary to the development of the environmental goods and services sector. APEC facilitates this through its Work Program on Environmental Goods and Services, which includes initiatives to: (i) increase the utilization and dissemination of environmental goods and services; (ii) reduce existing barriers, and refrain from introducing new barriers to trade and investment in environmental goods and services; and (iii) enhance the ability of economies to develop their environmental goods and services sectors. An example is the APEC List of 54 Environmental Goods, a commitment by APEC economies to reduce applied tariff rates to 5 percent or less by the end of 2015. The 2015 Environmental Services Action Plan<sup>50</sup> is another APEC initiative that could help APEC

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50 APEC, *Environmental Services Action Plan* (2015/SOM3/021anx04, Cebu: APEC, 2015).

economies to improve access to environmental services.

Further discussion on how RTAs/FTAs in the APEC region deal with environment-related provisions can be found in Chapter 5.

### **3.3.4 Labour issues**

Labour markets are increasingly internationalizing as global value chains grow in significance. To address this, the design of labour market policies and institutions should take account of the broader international context. Policies and investments in education, skills and training have to be geared toward achieving a better match between labour supply and demand. Developing adequate social safety nets (for those facing difficulties in adjusting to the changing labour market) and promoting labour cooperation are also important.

On the issue of labour markets and social protection, APEC has done considerable work to foster strong and flexible labour markets. In 2010, the APEC Ministers of Human Resources Development committed to emphasizing pro-employment labour market policies and fostering flexible, efficient and equitable labour markets supported with strong and effective public employment services.<sup>51</sup> The APEC 2010 Growth Strategy underlined the role of better-regulated and competitive markets and stronger social safety nets in achieving balanced and inclusive growth.

Many RTAs/FTAs have a chapter or provisions on temporary entry for business persons in order to facilitate the movement of workers to support increased trade and investment between the Parties to the agreements. APEC also has done important work in this area. The APEC Business Travel Card is one of the most important APEC achievements in terms of easing the mobility of business persons.

Some RTAs/FTAs between APEC economies include labour provisions and, referencing international standards, specify that labour laws should not be used for the purpose of trade protectionism, nor should they be weakened to encourage more trade. Some RTAs/FTAs include a mechanism for cooperative labour activities. In some, Parties also agree to promote public awareness of their labour laws.

Chapter 5 contains further discussion on the treatment of labour in RTAs/FTAs.

### **3.3.5 Food safety and security**

Factors such as the growth of the global population, the emergence of climate issues affecting food production, and the volatility of food prices have motivated APEC to pay

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<sup>51</sup> APEC, *Joint Ministerial Statement of the APEC Human Resources Development Ministerial Meeting* (2010), [http://www.apec.org/Meeting-Papers/Sectoral-Ministerial-Meetings/Human-Resources-Development/2010\\_hrd.aspx](http://www.apec.org/Meeting-Papers/Sectoral-Ministerial-Meetings/Human-Resources-Development/2010_hrd.aspx)

more attention to ensuring the security of the region's food systems to meet the growing demand for safe and nutritious food. The APEC Food Safety Cooperation Forum was established in 2007 to enable a cooperative approach among food safety regulators to build robust food safety systems in the region.

Since 2010, APEC Ministerial Meetings on Food Security have been held biennially and topics related to sustainable agriculture, including the commitment to engage in responsible agricultural investment, have been discussed. In 2011, the APEC Policy Partnership on Food Security was established to strengthen public-private cooperation on food security issues in the region. Currently, the APEC food agenda includes a number of initiatives to reinforce food security from various directions, such as fostering infrastructure investment; reducing food losses and waste; and enhancing food safety standards.

Effective food safety standards, from production through to the consumer, lie at the core of the global value chain and are integral to achieving food security and economic growth. Trade agreements can play a role in facilitating a secure and adequate supply of safe and nutritious food through establishing frameworks for regulatory alignment or mutual recognition of systems. Further consideration should be given to the potential role of regional economic integration in building coherent regulatory systems and supporting capacity development in order to provide long-lasting food security and sustainable agriculture development in the APEC region.

Regulatory measures related to food exports have been a point of discussion at the WTO and the issue of food export restrictions has been stipulated in the TPP in the context of stable food supply. The 2015 FTA between Japan and Australia also includes clauses on export restrictions on essential food.<sup>52</sup>

### **3.3.6 Trade facilitation**

APEC has emphasized the importance of making it easier, faster and cheaper to trade and invest in the region. Through simplifying and streamlining the procedures related to trade, the volume of trade could be enhanced.

APEC has been advocating reductions in trade transaction costs. Its two Trade Facilitation Action Plans, endorsed in 2002 and 2006 respectively, looked to reduce trade transaction costs by 5 percent. Moreover, since 2013, APEC has been playing an active role in encouraging the conclusion of the WTO Trade Facilitation Agreement as part of the wider Bali Package, and in supporting the implementation of the agreement. Currently, APEC is working on the implementation of the Supply-Chain Connectivity Framework Action Plan, with the aim of achieving a 10 percent improvement in supply

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52 See: Agreement between Japan and Australia for an Economic Partnership, which was signed on 8 July 2014, and entered into force on 15 January 2015.

chain performance and developing new capacity-building projects relevant to the implementation of the WTO Trade Facilitation Agreement.

APEC economies have also included provisions concerning trade facilitation in their RTAs/FTAs. They generally include clauses on transparency, impartial administration, consistency and predictability, release of goods, modernization and paperless trading, risk management, cooperation, fees and charges, confidentiality, express shipments, review and appeal, penalties and advance rulings.

### **3.3.7 Intellectual property rights**

An effective intellectual property rights (IPR) protection and enforcement system has been recognized by APEC as an important factor for promoting trade and investment, as well as for boosting economic development. IPR protection incentivizes firms to innovate, pursue research and development, and commercialize leading technologies. Balanced IPR helps facilitate trade and investment.

Within APEC, the Intellectual Property Group was established in 1996 and was reconstituted in August 1997 as the Intellectual Property Rights Experts' Group. The group has served as a forum for members to share experiences and identify common challenges in the APEC IPR systems. In this context, the group established a series of IPR tools and Model Guidelines. They initiated a survey on copyright limitations and exceptions; and did work on topics such as reducing trade in counterfeit and pirated goods; protecting against unauthorized copies; preventing the sale of counterfeit and pirated goods over the Internet; providing effective public awareness campaigns on IPR; securing supply chains against counterfeit and pirated goods; and strengthening IPR capacity building.

Nowadays, global value chains include not only contributions of physical components or added services, but also contributions of intellectual property at different points of the chain. Studies of global value chains will often show that the most valuable parts of the chain involve intellectual property. Many RTAs/FTAs signed by APEC economies include provisions related to the topics addressed by the IPR Model Guidelines developed by the Intellectual Property Rights Experts' Group. IPR provisions include obligations that cover patents, trademarks, copyrights, industrial designs, geographical indications, trade secrets, other forms of intellectual property, and IPR enforcement. Some of the agreements also include clauses related to capacity building and transfer of technology.

Further discussion on the treatment of intellectual property in RTAs/FTAs in the APEC region can be found in Chapter 5.

### **3.3.8 Competition policy**

APEC's Competition Policy and Law Group, formerly known as the Competition

Policy and Deregulation Group, was established in 1996. The group seeks to strengthen markets in the region by promoting an understanding of regional competition laws and policies; examining the impact on trade and investment flows in the markets; and identifying areas for technical cooperation and capacity building among economies.

In recent years, APEC members have introduced or amended legislation to strengthen competition policy in their markets as well as forge bilateral anti-trust cooperation agreements with partner economies. Some APEC economies have also included chapters or clauses on competition policy in recent RTAs/FTAs,<sup>53</sup> with some economies opting to include clauses to promote competition; establish conditions for the operation of monopolies and state-owned enterprises; and create consultation or cooperation links between competition authorities.

Further knowledge-sharing and capacity building may assist government officials on ways to promote open and competitive markets and fight against anti-competitive activities undermining the economy. Topics such as conducting fair and effective administration and implementing competitive neutrality are issues that could be discussed in future RTAs/FTAs, including the FTAAP.

A discussion on the treatment of competition policy in RTAs/FTAs can be found in Chapter 5.

### **3.3.9 Government procurement**

Government procurement constitutes a considerable part of GDP, amounting to 10–15 percent in member states of the Organisation for Economic Co-operation and Development (OECD) and even more (20–30%) in developing economies.<sup>54</sup> APEC has been active on government procurement in the past, establishing a Government Procurement Expert Group in 1995.

In 1999, APEC developed the APEC Non-Binding Principles for Government Procurement, which were endorsed by APEC Leaders. In 2002, APEC Leaders stipulated in the Statement to Implement APEC Transparency Standards that economies would follow the transparency standards in the Non-Binding Principles. Two studies on

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53 APEC Policy Support Unit, *Trends and Developments in Provisions and Outcomes of RTA/FTAs Implemented in 2014 by APEC Economies* (Singapore: APEC, 2015).

54 R.D. Anderson et al. 'Assessing the value of future accessions to the WTO Agreement on Government Procurement (GPA): Some new data sources, provisional estimates, and an evaluative framework for individual WTO members considering accession' (working paper, Geneva: WTO, 2011).



green government procurement were completed in 2013 and 2015.<sup>55</sup>

The importance of government procurement to economic growth highlights opportunities to consider this issue through the optics of global value chains and regional economic integration. Some existing RTAs/FTAs in the region have included chapters or clauses regarding the scope and coverage of public procurement, tendering, qualification of suppliers, and bid challenges, among others. Differing approaches to government procurement make relevant the sharing of experiences and capacity building in the APEC region.

The treatment of government procurement in RTAs/FTAs is further discussed in Chapter 5.

### **3.3.10 Anti-corruption**

Corruption is a complex economic, political and social problem with negative repercussions in every sphere of society. It impedes economic sustainability and development, increases the risk of social unrest, harms the integrity of institutions and social values, undermines the rule of law, and erodes government accountability as well as public trust.

Fighting against corruption has been a priority for APEC. In 2004, APEC Leaders issued The Santiago Commitment to Fight Corruption and Ensure Transparency and The APEC Course of Action on Fighting Corruption and Ensuring Transparency, which were regarded as an important milestone in this area for APEC. In doing so, APEC economies committed to developing effective actions to fight all forms of bribery, taking into account the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions or other relevant anti-corruption conventions or initiatives.

Currently APEC has an Anti-Corruption and Transparency Working Group that seeks to strengthen its capacity to prevent, investigate and prosecute corruption in APEC. This is in line with the recognition by APEC Leaders in 2015 that it is imperative to combat illegal economic activities; promote cultures of integrity across borders, markets and supply chains; encourage open and accountable governance; and promote international cooperation in the areas of repatriation/extradition of corrupt officials, asset recovery, criminalization and prevention of corruption among APEC economies.

The importance of anti-corruption measures has become widely recognized. Recent

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55 APEC CTI (Committee on Trade and Investment), *Green Government Procurement – China's Practice* (2013/SOM1/CTI/WKSP/004, Jakarta: APEC, 2013); APEC CTI, *China Environmental Labeling Program and Government Green Procurement* (2015/SOM2/CTI/DIA1/009, Boracay: APEC, 2015)

bilateral and multilateral trade agreements (e.g. the TPP) have included a chapter on anti-corruption and transparency.

### **3.4 CONCLUSION**

APEC's NGeTI-related activities are important to raise awareness of the impact of cutting-edge trade and investment issues on businesses operating in a modern business environment. Policymakers need to understand these issues and the policy options available for resolving them. This could also trigger ideas within economies about how an FTAAP may also contribute to solutions in these areas.

The process of securing the necessary consensus within APEC to endorse a topic as NGeTI has been challenging, as can be seen from the limited number of endorsed NGeTI so far. This reflects the diversity of views and circumstances within the APEC membership on new issues.

Nevertheless, the range of issues covered in this chapter indicates that many aspects are significant for the Asia-Pacific's future regional economic integration. APEC has been addressing many of them in different ways, but more work is clearly needed to understand these issues and contribute to the eventual realization of the FTAAP as a comprehensive and high-quality FTA.

APEC can continue to make a significant contribution to promoting mutual understanding of emerging trade and investment issues in the region by sharing knowledge and experiences, coupled with capacity-building activities in a variety of forms. Such discussions could play a useful role in ensuring that the process of regional economic integration remains responsive to changing economic, social and environmental conditions and business needs. Working on these issues presents an opportunity for APEC to continue its leadership and exert its influence over the developing trade agenda.

## 4. MEASURES AFFECTING TRADE AND INVESTMENT

### 4.1 INTRODUCTION

Despite considerable liberalization efforts since the formation of APEC, tariffs and non-tariff measures (NTMs), measures affecting services, and investment regimes continue to affect trade and investment in the Asia-Pacific region. Cross-cutting structural issues such as transparency and good regulatory practice also have an impact. In thinking about how to address these issues, we must also take account of the changing nature of economic integration.

Economic integration looks very different now to how it did even just two decades ago. Modern economic integration is characterized by fragmented international production networks forming global value chains. Intermediate goods and services cross numerous borders before ending up as a final product.

The sustained economic growth experienced by APEC economies can be attributed to higher specialization and value-added international economic activities, with a more direct relationship among tradable goods, services and foreign direct investment (FDI) flows, particularly through the importance of regional and global value chains. In many economies, between 30 and 60 percent of exports consist of intermediate inputs traded within global value chains, particularly in the cases of China; Japan; Korea; and the Asian emerging economies. There has been faster growth of trade in intermediate inputs than of trade in final goods. APEC Leaders recognized this when they stated in 2014 that global value chains ‘have become a dominant feature of the global economy and offer new prospects for growth, competitiveness and job creation for APEC economies at all levels of development’.<sup>56</sup>

In a regional economy dominated by global value chains, ‘unusual demands’<sup>57</sup> are made on policy since complex cross-border movements of products, services, capital, people and information are required. This is because transaction costs imposed by policy and non-policy factors at and behind the border accumulate along value chains. By the time the final good or service is purchased by the end user, these accumulated costs will have the effect of pushing up prices and/or eroding margins for businesses.<sup>58</sup> This has two key impacts:

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<sup>56</sup> APEC, *APEC Leader’s Declaration* (2014).

<sup>57</sup> P.A. Petri et al. *The FTAAP Opportunity: A Report to ABAC* (Manila: APEC Business Advisory Council, 2015), 2.

<sup>58</sup> WTO (World Trade Organization), *World Trade Report 2012: Trade and Public Policies: A Closer Look at Non-Tariff Measures in the 21st Century* (Geneva: WTO, 2012), 140.

- It acts as a brake on growth in households' purchasing power and thus living standards.
- It constrains APEC businesses' competitiveness, particularly that of micro, small and medium enterprises (MSMEs), which are less equipped to absorb the transaction costs.

For both of these reasons, it makes economic sense for policymakers to reduce these accumulated transaction costs as much as possible without compromising legitimate policy objectives. The aim should be to remove the grit from APEC's economic engine, allowing it to run more smoothly. This theme has been picked up by APEC business leaders and influencers in the Pacific Economic Cooperation Council (PECC) 2015 *State of Trade in the Region* survey. The top five issues identified by the PECC were heavily centred on global value chains:

- The facilitation of participation of SMEs in global value chains.
- The achievement of the Bogor Goals and the FTAAP.
- Services sector reforms and liberalization.
- The design of trade policy in response to global value chains.
- How economies can move to upgrade their participation in global value chains.<sup>59</sup>

These findings highlight the critical importance of the services sector to trade in the twenty-first century. Moreover, the analytical work also suggests the importance of competitive service supply in goods and agriculture as well because of the way in which global value chains operate.<sup>60</sup>

In recognition of the importance of global value chains and of reducing transaction costs in the APEC region, APEC Leaders endorsed The APEC Strategic Blueprint for Promoting Global Value Chains Development and Cooperation in 2014. The blueprint has 10 key initiatives under way, recognizing that an 'overall policy direction guiding improved cooperation and a more focused GVC [global value chain] evolution is essential to facilitating sustainable, inclusive and balanced growth in the Asia-Pacific

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59 PECC (Pacific Economic Cooperation Council), *State of Trade in the Region 2015* (Singapore: PECC, 2015).

60 Ibid., 2.

region’.<sup>61</sup> Progress to date has been ‘remarkable’, according to a 2015 progress report.<sup>62</sup>

This Collective Strategic Study provides a further opportunity to consider ways of reducing transaction costs on trade and investment, with a view toward the realization of an eventual FTAAP. This chapter provides a description of the current situation in the Asia-Pacific in relation to measures affecting trade and investment, an analysis of the impact of these measures and a review of the work APEC has done to date to address issues related to these measures; and it considers what might next be done by APEC.

## 4.2 TARIFF ANALYSIS

Tariffs play an important role in the global trade arena. Through their effect on trade cost, tariffs can not only influence trade patterns but also an economy’s gross domestic product (GDP).<sup>63</sup> By making products more expensive to consumers, tariffs can reduce demand for imports, alter the relative prices of products, and can protect uncompetitive companies and their overpriced products. The Organisation for Economic Co-operation and Development (OECD) has estimated that scrapping all tariffs on merchandise trade and reducing trade costs by 1 percent of the value of trade worldwide would add the equivalent of up to 2 percent to the present annual GDP in some economies.<sup>64</sup>

The inception of the WTO in 1995 saw a decline in average applied and bound most favoured nation (MFN) tariff rates and a corresponding increase in merchandise trade (Figure 4.1). In 2013, the average tariff applied by WTO members was 9 percent.<sup>65</sup> Around one-third of world trade was free under MFN, with an additional one-third free under preferential access.<sup>66</sup> However, as can be seen in Figure 4.2, tariff peaks continue

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61 APEC, ‘Annex D – Progress report on implementation of the APEC Strategic Blueprint for Promoting Global Value Chains Development and Cooperation’, in *Joint Statement of the APEC Ministerial Meeting* (2015). The 10 initiatives are: (i) addressing trade and investment issues that impact global value chains; (ii) cooperating on improving statistics related to global value chains; (iii) realizing the critical role of trade in service within global value chains; (iv) enabling developing economies to better participate in global value chains; (v) assisting small and medium-sized enterprises (SMEs) to benefit from global value chains; (vi) improving the investment climate for global value chain development; (vii) adopting effective trade facilitation measures; (viii) enhancing the resiliency of global value chains; (ix) encouraging public–private partnerships for global value chains; (x) strengthening collaboration with other stakeholders on global value chains.

62 *ibid.*

63 P. Love and R. Lattimore, ‘Protectionism? Tariffs and other barriers to trade’, in *International Trade: Free, Fair and Open?* (Paris: OECD, 2009).

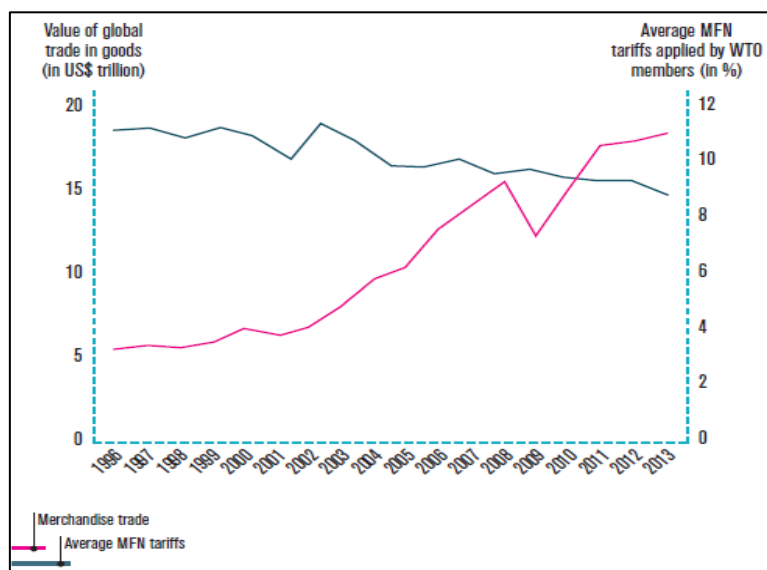
64 *ibid.*

65 WTO, ‘Trade and tariffs: Trade grows as tariffs decline’ (brochure, Geneva: WTO, 2014).

66 UNCTAD (United Nations Conference on Trade and Development), *Key Statistics and Trends in Trade Policy 2014* (Geneva, UNCTAD, 2014).

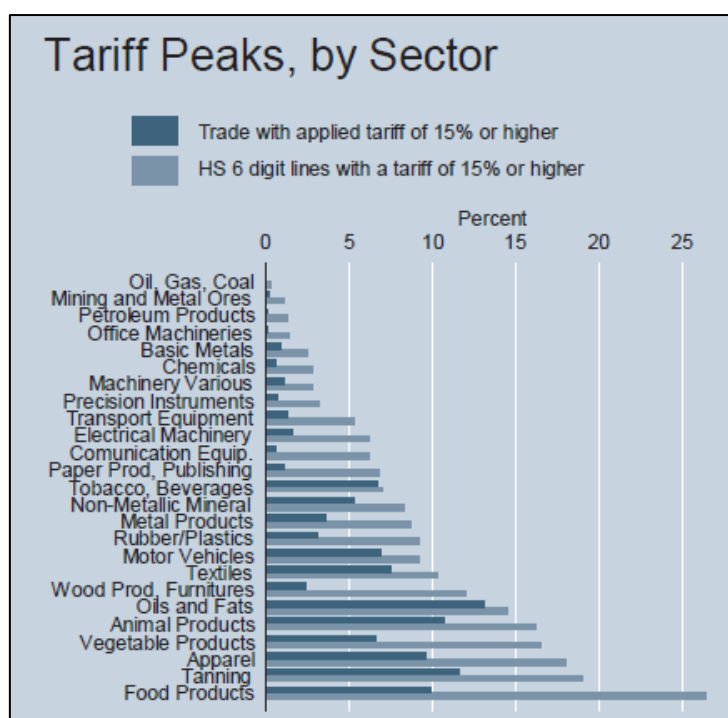
to affect important sectors, including agriculture, apparel, textiles and leather products.

**Figure 4.1 Tariffs applied by WTO members and global trade in goods, 1996–2013**



Source: WTO (World Trade Organization), ‘Trade and tariffs: Trade grows as tariffs decline’ (brochure, Geneva: WTO, 2014).

**Figure 4.2 Percentage of trade and tariff lines affected by tariff peaks**



Source: UNCTAD (United Nations Conference on Trade and Development), *Key Statistics and Trends in Trade Policy 2014* (New York: UN, 2014).

The trend toward liberalization, along with the growing technological complexity of products, and lower transportation and communications costs, has reshaped the landscape of global trade.<sup>67</sup> The APEC region, which accounts for 39 percent of the world's population and 49 percent of world trade,<sup>68</sup> had a significant part to play in shaping these global trends. The value of APEC members' aggregate trade increased threefold to USD 18.5 trillion in 2014 from USD 6.4 trillion in 2000, growing at an average annual rate of 10.4 percent during the period. Intra-regional trade also kept pace, expanding by around 2.7 times during the same period, from USD 4.5 trillion to USD 12.1 trillion. The average MFN applied tariff rate for all products in the APEC region declined from 6.6 percent in 2008 to 5.7 percent in 2012 (Table 4.1).

In 1994, APEC Leaders agreed to the Bogor Goals, a set of targets for realizing free and open trade in the APEC region by 2020. While it has been widely accepted that preferential trade agreements could contribute to success in achieving those goals (provided that certain conditions<sup>69</sup> are met), bilateral preferential trade agreements are unlikely to, by themselves, lead to the achievement of the Bogor Goals.<sup>70</sup> One study calculated that 210 such agreements would be needed to cover all the bilateral trading relationships between the 21 APEC economies.<sup>71</sup> While tariffs have generally been on the decline, as illustrated above, much work remains to be done in order to reach the Bogor Goals, and relying solely on bilateral FTAs would not be a practical option. In 2013, the share of products subject to tariffs in the APEC region was 54 percent, with tariff peaks still found in several product categories.<sup>72</sup>

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67 K.C. Cheng et al. 'Reaping the benefits from global value chains' (working paper no. 15/204, Washington, DC: International Monetary Fund, 2015).

68 See: APEC Policy Support Unit, 'APEC in charts 2015' (Singapore: APEC, 2015). In 2014, intra-regional trade accounted for 65.3 percent of APEC economies' total exports.

69 The PECC has proposed a 'common understanding' on the features that should be found in PTAs that can be regarded as contributions to achievement of the Bogor Goals. See: PECC, *PECC Trade Forum Proposal for an APEC Common Understanding on RTAs* (Singapore, PECC Secretariat, 2003).

70 R.D. Scollay, 'Preliminary assessment of the proposal for a Free Trade Area of the Asia-Pacific (FTAAP)' (issues paper for the APEC Business Advisory Council, 2004).

71 P.J. Lloyd, 'New regionalism and new bilateralism in the Asia Pacific' (paper presented at *PECC Trade Forum* meeting, Lima, May 2002).

72 APEC Policy Support Unit, *Services in Global Value Chains: Manufacturing-Related Services* (Singapore: APEC, 2015). Based on 6-digit subheadings.

#### 4.2.1 Tariff landscape of the APEC region

According to the APEC Policy Support Unit's 2014 Bogor Goal Dashboard (Table 4.1), MFN applied tariffs declined for both agriculture and non-agriculture tariff lines. The percentage of zero-tariff product lines also increased, from 42.4 percent in 2008 to 45.4 percent in 2012.

**Table 4.1 Most favoured nation (MFN) rate trends in the APEC region, 2008–2012**

	2008	2009	2010	2011	2012
<b>MFN applied tariff</b>	6.6	6.2	5.8	5.7	5.7
<b>MFN applied tariff – agriculture</b>	13.1	12.0	11.8	12.2	12.0
<b>MFN applied tariff – non-agriculture</b>	5.7	5.3	4.9	4.7	4.7
<b>Zero-tariff product lines (%)</b>	42.4	43.1	45.5	45.3	45.4

Simple average MFN applied tariffs were calculated based on pre-aggregated averages of the harmonized system (HS) subheadings at the 6-digit level.

Source: APEC Policy Support Unit, *APEC's Bogor Goals Dashboard* (Singapore: APEC, 2014).

Rates for certain categories have remained relatively stable in recent years. Agricultural tariffs, with the exception of sugar and confectionery, and beverages and tobacco, have remained relatively constant in the APEC region,<sup>73</sup> in terms of both average applied MFN rates (Table 4.2) as well as percentage of duty-free lines (Table 4.3). Beverages and tobacco registered a substantial decline, from 32.2 percent to 24.1 percent from 2009 to 2013. Sugar and confectionery registered a moderate decline, from 15.3 percent to 13.8 percent over the same time period.

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73 While tariffs fell during the 2006–2009 period for dairy products, oilseeds, fats and oils, the net change for the larger 2006–2013 period was negligible. One possible explanation for the fluctuation in 2009 could be the 2008 financial crisis. The return to high rates in 2013 could support the idea of a one-off trigger, rather than a change in policy.



**Table 4.2 Average applied most-favoured nation (MFN) rates in APEC region, by product category**

Product categories	Average		
	2006	2009	2013
<b>Agricultural</b>			
<b>Animal products</b>	12.0	11.7	11.8
<b>Dairy products</b>	31.9	23.8	30.4
<b>Fruit, vegetables, plants</b>	12.8	12.3	12.9
<b>Coffee, tea</b>	14.0	13.3	13.4
<b>Cereals and preparations</b>	20.5	18.3	19.3
<b>Oilseeds, fats and oils</b>	8.4	7.5	8.4
<b>Sugars and confectionery</b>	15.3	13.5	13.8
<b>Beverages and tobacco</b>	32.2	25.7	24.1
<b>Cotton</b>	3.3	2.4	2.5
<b>Other agricultural products</b>	5.2	4.5	5.0
<b>Non-agricultural</b>			
<b>Fish and fish products</b>	9.1	7.8	7.5
<b>Minerals and metals</b>	4.8	4.3	3.9
<b>Petroleum</b>	3.7	2.6	2.2
<b>Chemicals</b>	3.8	3.2	3.0
<b>Wood, paper, etc.</b>	5.8	5.1	4.5
<b>Textiles</b>	8.5	7.1	6.5
<b>Clothing</b>	16.0	14.1	12.8
<b>Leather, footwear, etc.</b>	8.4	7.2	6.6
<b>Non-electrical machinery</b>	3.8	3.1	2.8
<b>Electrical machinery</b>	5.5	4.7	3.8
<b>Transport equipment</b>	8.2	7.3	6.7
<b>Manufactures, n.e.s.</b>	5.8	5.4	4.7

Data are from 2006, 2009 and 2013 or the next closest year where data were not available. These years were chosen with the intention of capturing snapshots in as wide a time period as possible on the basis of data availability. Product categories are based on the multilateral trade negotiations (MTN) categories.

Simple average MFN rates were calculated on the basis of the 21 APEC economies with the exception of 2013, where no data was available for Brunei and a simple average was taken for 20 economies.

Sources: Data are collated from the WTO World Tariff Profiles for 2006, 2010 and 2014.

**Table 4.3 Average percentage of duty-free tariff lines in the APEC region, by product category**

Product categories	Average % of duty-free tariff lines		
	2006	2009	2013
<b>Agricultural</b>			
Animal products	39.2	39.7	37.3
Dairy products	28.7	33.0	32.6
Fruit, vegetables, plants	31.8	33.2	30.2
Coffee, tea	28.7	32.1	31.0
Cereals and preparations	30.2	33.4	33.2
Oilseeds, fats and oils	41.6	44.2	42.0
Sugars and confectionery	29.7	30.8	30.7
Beverages and tobacco	23.3	26.0	22.4
Cotton	61.7	66.5	69.9
Other agricultural products	49.1	52.6	50.2
<b>Non-agricultural</b>			
Fish and fish products	36.6	41.7	39.1
Minerals and metals	44.4	48.8	51.0
Petroleum	48.5	53.6	60.6
Chemicals	44.0	48.6	50.0
Wood, paper, etc.	46.8	49.7	50.9
Textiles	26.9	27.7	26.5
Clothing	15.9	16.0	16.1
Leather, footwear, etc.	30.0	33.3	36.5
Non-electrical machinery	48.6	56.3	56.2
Electrical machinery	41.4	46.9	52.1
Transport equipment	39.3	45.2	45.7
Manufactures, n.e.s.	42.8	44.3	46.0

Share of duty-free harmonized system (HS) six-digit subheadings in the total number of subheadings in each product group. Partially duty-free subheadings are taken into account on a pro-rata basis.

Sources: Data are collated from the WTO World Tariff Profiles for 2006, 2010 and 2014.

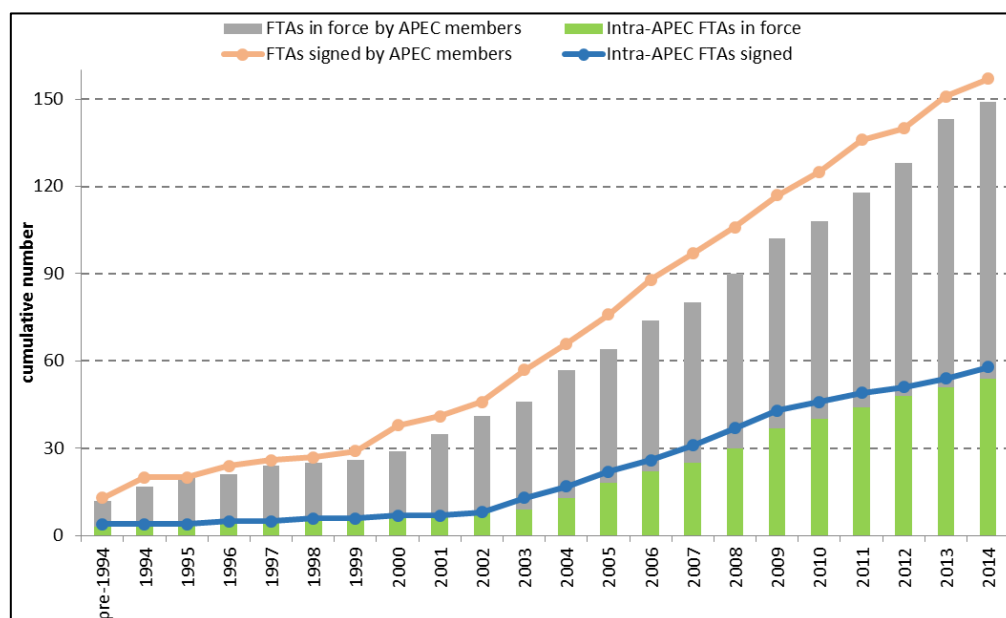
Non-agriculture tariffs on the other hand, decreased across the board, with the steepest declines registered in the categories of clothing, textiles, leather and footwear, and electrical machinery. While non-agricultural tariffs are comparatively lower than agricultural tariffs, it is interesting to note that the lowest percentage of duty-free lines is found in a non-agricultural category, namely clothing (16.1 percent in 2013).<sup>74</sup>

<sup>74</sup> The lowest percentage for agriculture in 2013 was 22 percent (beverages and tobacco).

## 4.2.2 Opportunities for further tariff liberalization

Among APEC economies, the share of products (based on 6-digit subheadings) that were duty-free (applied MFN rates) steadily increased from 39 percent in 2006 to 46 percent in 2013.<sup>75</sup> The number of FTAs signed by APEC members expanded 12-fold over the past 20 years (Figure 4.3). As of 2014, APEC members had signed a total of 157 FTAs, 58 of which were with at least one other APEC member. Of the FTAs signed, 149 are still in force, 54 of which are with at least one other APEC member. While this has been a significant achievement, there are still opportunities for further liberalization.

**Figure 4.3 Free trade agreements in APEC (cumulative number), pre-1994–2014**



Source: APEC Policy Support Unit, 'APEC in charts 2015' (Singapore: APEC, 2015).

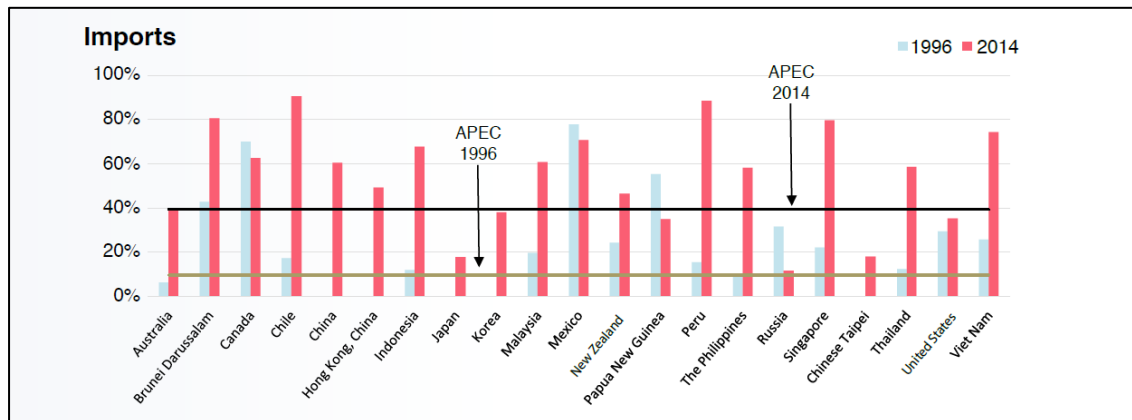
Tariffs for agricultural products have remained largely stable since 2006, with tariff peaks still remaining in dairy, cereal and preparations, and beverages and tobacco. For non-agricultural products, while tariffs have been on the decline, there are still a few categories with average rates above 5 percent which would benefit from further liberalization, namely, clothing, fish and fish products, leather and footwear, transport equipment, and textiles.

A significant amount of intra-APEC trade is not duty-free. This reflects the global trend described in the 2014 United Nations Conference on Trade and Development

<sup>75</sup> APEC Policy Support Unit, *Services in Global Value Chains*.

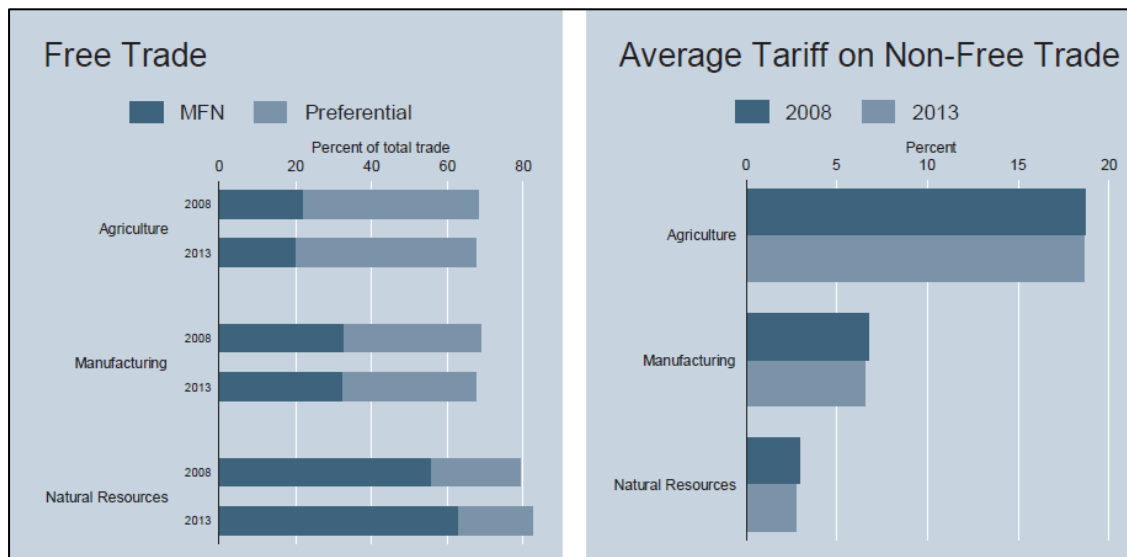
(UNCTAD) report, *Key Statistics and Trends in Trade Policy*, where non-free trade (taking into account preferential and MFN zero trade) had agricultural and non-agricultural tariffs averaging close to 18 percent and 7 percent respectively in 2013 (Figure 4.5). In 2014, only around 39 percent of APEC members' imports were traded under FTAs (Figure 4.4). In 2013, only 46 percent of the tariff lines were duty-free.

**Figure 4.4 APEC share of trade by value covered by FTA partners (percent), 2014**



Source: APEC Policy Support Unit, 'APEC in charts 2015' (Singapore: APEC, 2015).

**Figure 4.5 Free trade and remaining tariffs, by broad category**

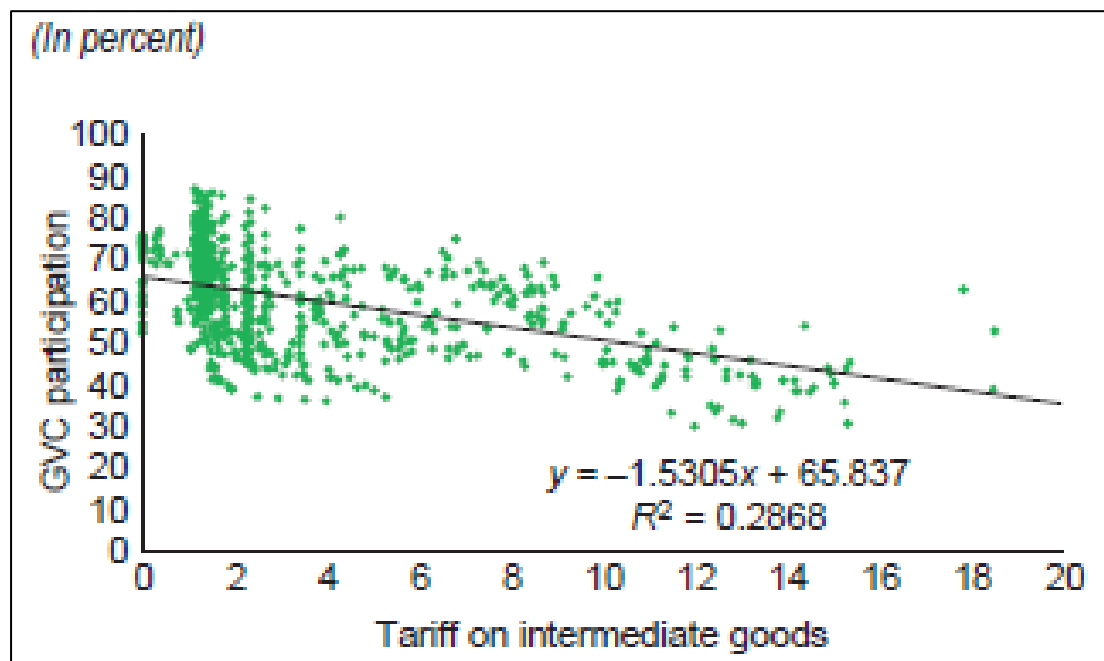


Source: UNCTAD (United Nations Conference on Trade and Development), *Key Statistics and Trends in Trade Policy 2014* (New York: UN, 2014).

Beyond potential tariff savings, liberalization would also lead to greater participation in global value chains. This would yield benefits beyond those traditionally associated with international trade in final goods, reflecting the more granular division of

production and task specialization, which would enable each participating country to exploit comparative-advantage niches and increase the benefits from economies of scale and scope, as well as significant gains in productivity.<sup>76</sup> Cheng et al. also found that countries with higher tariffs on their intermediate goods imports were less likely to participate in global value chains (Figure 4.6). Higher tariffs on intermediate goods have been found to be more pervasive in agriculture and textiles.

**Figure 4.6 Global value chain participation and applied tariff rates on intermediate goods**



Source: K.C. Cheng et al. 'Reaping the benefits from global value chains' (working paper no. 15/204, Washington, DC: International Monetary Fund, 2015).

### 4.2.3 The way forward on tariffs

As the above discussion shows, while overall MFN tariffs have been on the decline in the APEC region, there remain areas of opportunity for further liberalization under an FTAAP. They include:

- Agricultural products such as dairy, cereal and preparations, and beverages and tobacco, where tariff peaks are still evident.

<sup>76</sup> Cheng et al. 'Reaping the benefits from global value chains'.

- Non-agricultural products such as clothing, fish and fish products, leather and footwear, transport machinery, and textiles, for which tariff rates still average more than 5 percent.

### 4.3 NON-TARIFF MEASURES ANALYSIS

NTMs have been highlighted by the business sector as a major impediment to trade and investment in the region.<sup>77</sup> NTMs are ‘policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices, or both’.<sup>78</sup> In other words, NTMs impose costs on doing business.

In the past, NTMs were thought of primarily in terms of quantitative restrictions on trade, such as quotas, voluntary export restraints, and import licensing, which is reflected in the non-exhaustive list of NTMs that appears in the Osaka Action Agenda. There is now recognition that NTMs include a broader range of policies applied to goods and services that impose transaction costs along supply chains.<sup>79</sup>

NTMs include but are not limited to: technical barriers to trade (TBT) such as technical regulations or conformity assessment procedures; sanitary and phytosanitary (SPS) regulations; quotas; price controls; export restrictions; contingent trade protective measures; and also other behind-the-border measures, such as local content requirements, trade-related investment measures, measures related to government procurement or distribution restrictions. UNCTAD’s MAST classification provides a good overview of the wide range of NTMs in use.<sup>80</sup>

It is important to note that NTMs vary considerably in terms of their intended purpose and their impact on the business environment. Some are legitimately imposed for the purpose of protecting public health, safety, the environment, animal welfare, etc. Others act more like traditional trade barriers, unnecessarily raising costs for businesses and households.

Governments have the sovereign right to regulate in the public interest. While acknowledging this right, it should also be recognized that regulations and policies invariably impose costs on doing business or participating in a market. Those costs are

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77 In its report to APEC Leaders in 2015, ABAC discussed NTMs as being ‘of real concern to business’. See: ABAC (APEC Business Advisory Council), ‘Resilient inclusive growth: a fair deal for all’ (report to APEC Economic Leaders, Manila: ABAC, 2015).

78 UNCTAD, *Key Statistics and Trends in Trade Policy 2014*.

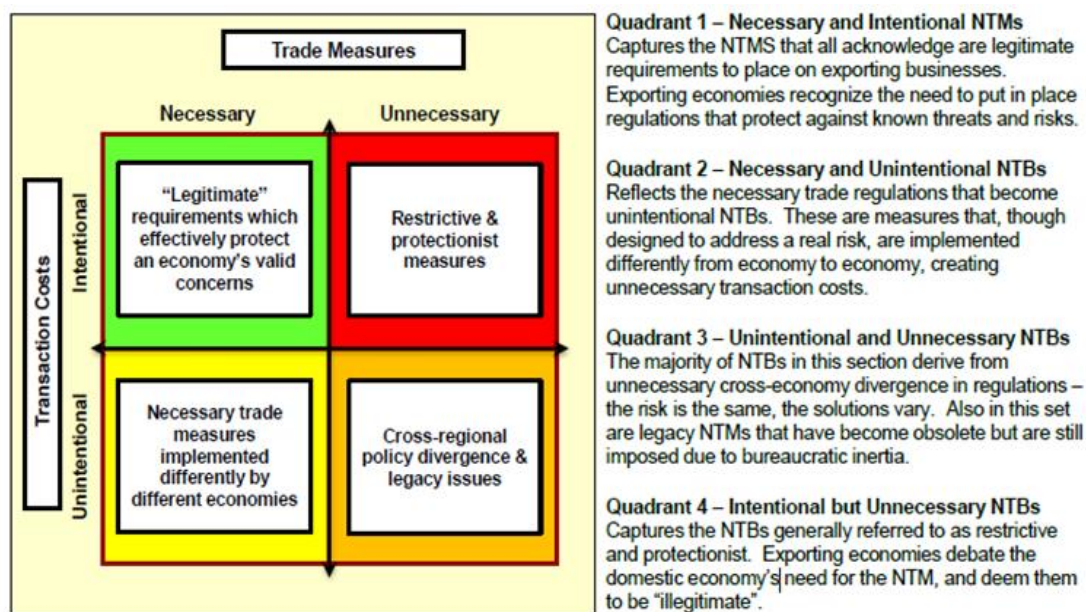
79 UNCTAD, *Non-Tariff Measures to Trade: Economic and Policy Issues for Developing Countries* (New York: UN, 2013).

80 *ibid.*, 3–4. The MAST classification has been adopted by UNCTAD, the International Trade Centre (ITC) and WTO.

likely to have a greater impact on MSMEs, which are typically less equipped to mitigate such costs. In implementing a measure, a government should consider the net welfare benefit of the policy – that is, the benefit of the policy against the inevitable cost of imposing such a policy – and ensure it is implemented in the least trade-restrictive manner (this concept is further discussed in Section 4.6.2 on good regulatory practice).

In a report commissioned by the APEC Business Advisory Council (ABAC), the University of Southern California Marshall School of Business suggests that NTMs can be conceptualized in quadrants for the purpose of considering how best to address them (Figure 4.7). The Marshall School analysis draws a distinction between ‘legitimate’ measures (NTMs) and other types of non-tariff barriers (NTBs). For the purpose of this study, we use the broad term NTMs to cover all types of measures, without judgment as to their purpose.

**Figure 4.7 Non-tariff measures (NTMs) and transaction costs**



Source: USCM (University of Southern California Marshall School of Business), *Non-Tariff Barriers to Trade in the APEC Region: When Non-Tariff Measures Become Non-Tariff barriers: Insights from Agriculture and Accounting* (Manila: ABAC, 2008), 20.

While the inclination of the business community, officials and APEC may be to focus on those critical trade-distorting measures in the top right-hand quadrant (i.e. restrictive and protectionist measures), focusing specifically on them may inadvertently ignore where significant improvements can be made in reducing transaction costs associated with all types of NTMs, including ‘legitimate’ measures, through the sharing of best practice. While APEC is an experienced forum at sharing best practice policies, the

business community is well placed to identify measures that have the greatest impact on their activities. APEC members should look to ABAC to provide further advice in this area.<sup>81</sup>

### **4.3.1 Growth of NTMs in the APEC region**

As discussed in Section 4.2 on tariffs, the proliferation of FTAs in APEC and the wider global economy has seen global tariffs fall steadily in recent decades. Having made progress on tariff liberalization, policymakers are now increasingly shifting their attention to NTMs.

Figure 4.8 shows trends in the use of NTMs within the APEC region based on the frequency of measures or notifications by governments in four fields covered by the WTO Integrated Trade Intelligence Portal (I-TIP).<sup>82</sup> SPS measures (largely falling on agricultural trade) and TBT measures (largely in manufactures trade) are by far the most commonly used NTMs within APEC. The trend for import licences is more difficult to substantiate.

The total number of all reported NTMs within APEC increased by 68 percent from 814 in 2004 to 1,364 in 2014. The use of NTMs rose particularly sharply in the aftermath of the 2009 global financial crisis.

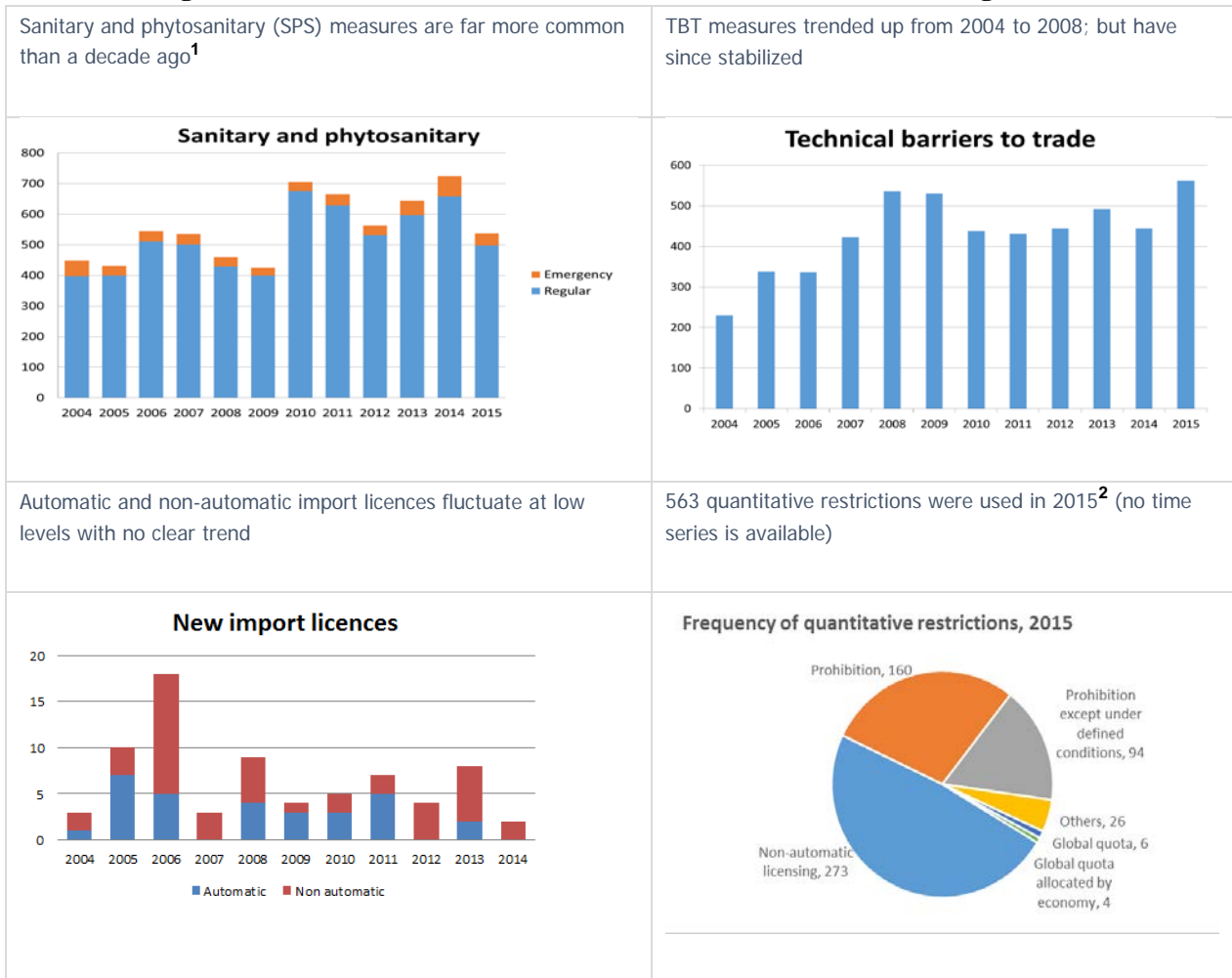
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81 ABAC has commissioned the Marshall School to undertake further, specific research on NTMs.

82 NZIER (New Zealand Institute of Economic Research), 'Non-tariff measures (NTMs) in the APEC region: Literature review and data analysis' (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015). The WTO I-TIP is the most complete NTM database available, covering: anti-dumping, countervailing, quantitative restrictions, safeguards, special safeguards, SPS measures and TBT. Recently, it included import licensing, and in a few months, information on rules of origin and pre-shipment inspection will also be available. The NZIER does not explore trade remedies such as anti-dumping, countervailing duties or safeguards. UNCTAD briefly discusses trends in these measures at a global level. See: UNCTAD, *Key Statistics and Trends in Trade Policy*, 19–21.



**Figure 4.8 Overview of selected non-tariff measures in the APEC region**



1. ‘Emergency’ SPS terminology comes from the recommended procedures for implementing the transparency obligation of the WTO SPS agreement (Art. 7). See: G/SPS/7/Rev.3 (20 June 2008), Committee on Sanitary and Phytosanitary Measures, World Trade Organization (WTO).
2. Due to a lack of historical data, the full suite of quantitative restrictions is shown for 2015 only. Sources: WTO Integrated Trade Intelligence Portal (I-TIP); WTO; NZIER (New Zealand Institute of Economic Research), ‘Non-tariff measures (NTMs) in the APEC region: literature review and data analysis’ (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015).

While the increasing use of NTMs is a clear trend within the APEC region, the precise reasons for the proliferation of NTMs are less clear. Economies face pressures to implement NTMs to deal with new products and services, new health and safety risks, and emerging issues such as environmental degradation. Yet it should also be emphasized that declining tariff protection has certainly led some economies to make

more creative and extensive use of NTMs for protectionist purposes.<sup>83</sup>

The Marshall School suggests a number of factors contributing to the proliferation of NTMs, including the lack of harmonized standards leading economies to develop their own conflicting standards; the lack of accessibility and transparency of requirements, leading to duplication of regulations; and the involvement of multiple regulatory agencies, resulting in inconsistencies in administration of policies and increasing the difficulty of finding and interpreting import requirements.<sup>84</sup>

While there is little hard evidence to explain precisely why NTMs are becoming more prevalent, various international organizations are grappling with this shift:

- APEC's 2014 Bogor Goals Progress Report reported that new NTMs have been introduced in recent years and noted that the accumulation of NTMs along supply chains continues to restrict trade.<sup>85</sup>
- The OECD notes that 'one reason may be that the reduction or elimination of import tariffs has made NTBs relatively more conspicuous, and for some sectors the main form of government intervention in trade today consists of such barriers'.<sup>86</sup>
- UNCTAD argues that the proliferation of NTMs plays a crucial role in shaping global trade patterns: 'with falling tariffs, non-tariff measures have moved to the forefront of trade policymaking'.<sup>87</sup> It notes that the contribution of NTMs to restricting market access globally is more than twice that of tariffs.

#### 4.3.2 Measuring the cost of NTMs

From an economic standpoint, some NTMs (such as quotas, voluntary export restraints and non-automatic licensing) unambiguously lower import volumes, while others (such as TBT and SPS measures) may have in certain cases welfare-enhancing effects that outweigh the cost of compliance. Similarly, some finance, anti-competitive and investment measures have indirect effects on trade that are difficult to assess.

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83 J. Oliver and M. Malouche, 'Rise of non-tariff protectionism amid global uncertainty' (blog, World Bank, January 2015), <http://blogs.worldbank.org/growth/rise-non-tariff-protectionism-amid-global-uncertainty>

84 USCM (University of Southern California Marshall School of Business), *Non-Tariff Barriers to Trade in the APEC Region: When Non-Tariff Measures Become Non-Tariff Barriers: Insights from Agriculture and Accounting* (Manila: ABAC, 2008)

85 APEC Policy Support Unit, *APEC's Bogor Goals Progress Report* (Singapore: APEC, 2014).

86 Love and Lattimore, 'Protectionism? Tariffs and other barriers to trade'.

87 UNCTAD, 'Non-tariff measures and sustainable development goals: direct and indirect linkages' (policy brief no. 37, New York: UN, 2015)

Developing economies in particular are more likely to be exposed to the negative effects of NTMs because they may experience higher compliance costs.<sup>88</sup> Production process technology may be less advanced and trade-related infrastructure weak. As a result, more rigorous administrative procedures are often applied to imports originating in developing economies.<sup>89</sup> In addition, capability, capacity and regulatory coherence challenges may be more prevalent in developing economies, which makes imports into those economies more costly. This further hinders the integration of developing economies into regional value chains. There is also evidence that economies that apply higher MFN tariffs are also those that have a larger number of products and a larger extent of imports affected by NTMs.<sup>90</sup>

A number of attempts have been made to assess the impacts of NTMs by estimating their ad valorem equivalent (AVE). This enables comparison with levels of tariff protection and better assessment of the welfare implications of various trade policy measures.<sup>91</sup> The New Zealand Institute of Economic Research (NZIER) estimates the weighted average AVE of NTMs in the APEC region to be 9.7 percent (Figure 4.9).<sup>92</sup> This is similar to Cadot and Gourdon's estimate of the global average AVE of 8.8 percent.<sup>93</sup> The largest AVEs are in the highly protected agri/food and gas sectors.<sup>94</sup> By comparison, the average weighted applied tariff rate in the APEC region is 2.9 percent,<sup>95</sup> indicating that NTMs are likely to have much more significant effects on trade than on

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88 D. Rial, 'Study of average effects of non-tariff measures on trade imports', *Policy Issues in International Trade and Commodities Research Study Series* 66 (2014): 7.

89 UNCTAD, *Non-Tariff Measures to Trade*, viii.

90 *ibid.*

91 WTO, *World Trade Report 2012*.

92 See Appendix G for an overview of NZIER's methodology.

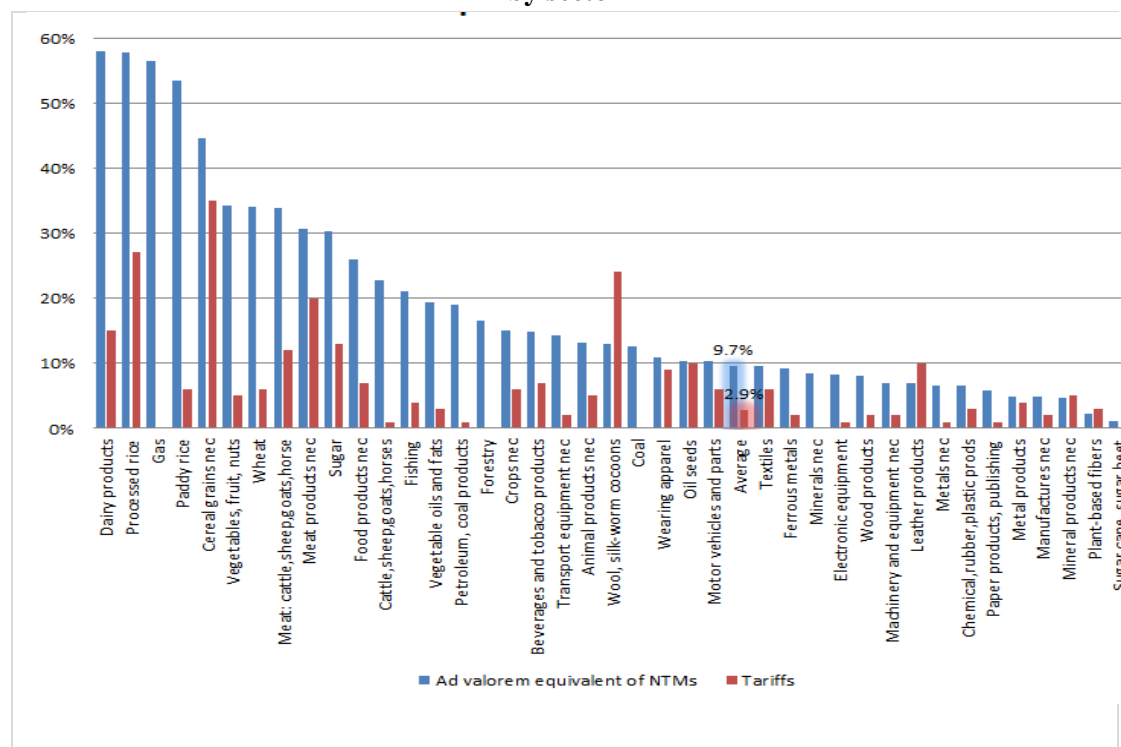
93 O. Cadot and J. Gourdon, 'NTMs, preferential trade agreements, and prices: new evidence' (working paper no. 2015-01, Paris: CEPII, 2015). The differences in estimates will be due to the period analysed (Cadot and Gourdon use 2000–2008; NZIER uses 2011); commodity aggregation (Cadot and Gourdon use 20 commodities; NZIER uses 41); and country coverage (Cadot and Gourdon look at the global average; NZIER looks at APEC only).

94 Note that NZIER's estimates of AVEs are based on data from around 2000. There is a risk that the AVEs could be different from those estimates. The AVE of NTMs in a sector is a function of the count and severity/cost of the various NTMs in place. There does not seem to be any significant decrease in their use (i.e. count) within APEC.

95 This 2.9 percent estimate is taken from the Global Trade Analysis Project (GTAP) v9 database, and so considers applied tariffs (i.e. those used in practice, including through FTAs) rather than economies' MFN-bound tariffs (which are the maximum they can charge). The figure is also trade-weighted rather than a simple unweighted average across tariff lines. By comparison, the APEC Policy Support Unit's 2014 Bogor Goals Dashboard measure of average MFN applied tariff of 5.7 percent does not apply any weighting. Weightings can be important when discussing the overall impacts of tariffs and NTMs on the APEC regional economy.

tariffs in the APEC region.

**Figure 4.9 Ad valorem equivalent (AVEs) of NTMs and tariff rates in the APEC region, by sector**

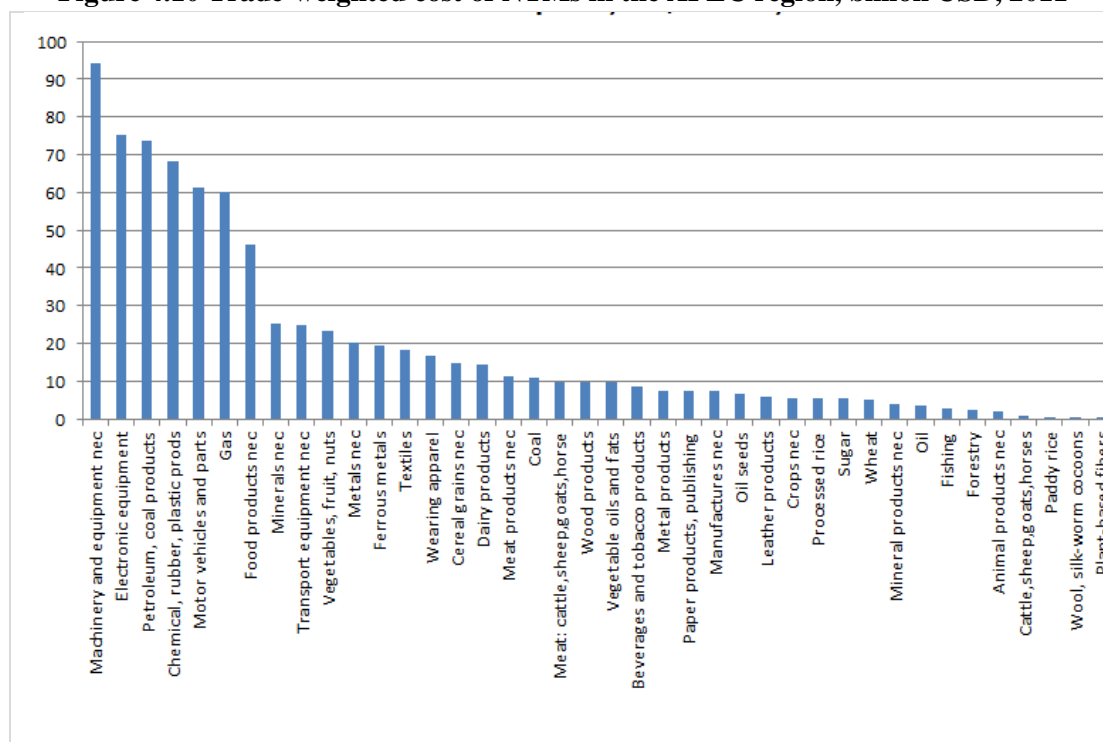


Source: NZIER (New Zealand Institute of Economic Research), ‘Non-tariff measures (NTMs) in the APEC region: Literature review and data analysis’ (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015).

Figure 4.10 shows the estimated cost of NTMs by sector in terms of APEC imports. The total cost of NTMs amounts to around USD 790 billion, based on estimates of AVEs by sector and 2011 trade flows from the Global Trade Analysis Project (GTAP) v9 database.<sup>96</sup> This analysis does not attempt to split NTMs out according to their nature or intended purpose; it covers both ‘necessary’ and ‘unnecessary’ NTMs. But the key message here – with all data caveats duly acknowledged – is that NTMs are significant in APEC relative to average tariffs.

96 NZIER (New Zealand Institute of Economic Research), ‘Non-tariff measures (NTMs) in the APEC region: literature review and data analysis’ (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015).

**Figure 4.10 Trade-weighted cost of NTMs in the APEC region, billion USD, 2011**



Source: NZIER (New Zealand Institute of Economic Research), ‘Non-tariff measures (NTMs) in the APEC region: Literature review and data analysis’ (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015)

On a sectoral level, the highest costs of NTMs fall on the machinery and electronic equipment sectors. While their AVEs are relatively low at 7–8 percent, their heavy trade weight within APEC means the overall impacts are very large at around USD 170 billion combined across the two sectors.

In comparison, the sectors with the highest AVEs – dairy and processed rice, both at 58 percent AVE – have a lower impact on trade because much less is traded, comparatively speaking. The cost of NTMs for dairy imports is USD 14 billion and for processed rice is USD 6 billion.

Quantifying the estimated cost of NTMs on a trade-weighted basis may undervalue the deterrent effect on trade volumes in those sectors with high NTM rates. If the trade thus suppressed is substantial, the trade-weighted estimates would be correspondingly biased. For example, most agricultural sector products face high NTM-related costs, along with tariff costs, yet show a low AVE cost to import (see

Figure 4.10). The opportunity cost of not being able to import those products due to the higher barriers against them is difficult to quantify.<sup>97</sup>

It is important to note that the NZIER's analysis looks only at the first-round impacts of NTMs.<sup>98</sup> Given the development of regional production networks in the APEC region, where raw materials and intermediate inputs cross numerous borders before being sold as a final product to end users, these costs accumulate or multiply along supply chains. The eventual impact is that consumer welfare across the APEC region is diminished by the presence of trade-distorting NTMs – prices are higher and quantities lower than would otherwise be the case.

The welfare impacts of 'legitimate' NTMs (see Figure 4.7) are harder to determine, as they will likely deliver benefits to households (improved health and safety, better environmental outcomes, etc.) that at least partially offset the costs to businesses of complying with the measures. But even legitimate NTMs can often be streamlined to achieve their purpose at the lowest possible cost, thus reducing transaction costs and increasing the competitiveness of firms engaged in international trade.

According to the Marshall School, businesses in the APEC region generally accept that NTMs in some circumstances constitute the best approach to pursuing a legitimate public objective, but what 'raises the ire of business executives' is that the costs of implementing legitimate NTMs may be unintentionally higher than necessary. Further, APEC 'economies do admit that some regulations have had unintended consequences and some NTMs remain after their effectiveness is no longer needed'.<sup>99</sup>

In an Asia-Pacific trade and investment environment dominated by global value chains, technological advancements are changing the way goods and services are demanded and supplied. The enhanced connectivity between buyers and sellers resulting from ever-increasing use of the Internet to carry out business makes it imperative that regulatory systems do not lag behind technological advances. Inconsistent or non-transparent regulatory systems add transaction costs to global value chains and act as a form of NTM.<sup>100</sup>

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97 The same would be true for high tariffs on low-volume traded goods.

98 The GTAP v9 database was used to estimate the first-round impact of NTMs on trade (where the flow-on effects are the indirect and induced effects on other sectors and households respectively) rather than the GTAP model itself (which would have estimated wider flow-on impacts as well).

99 USCM, *Non-Tariff Barriers to Trade in the APEC Region*, 18.

100 This point is also made by: O. Cadot, E. Munadi and L.Y. Ing, 'Streamlining NTMs in ASEAN: the way forward' (discussion paper, Jakarta: Economic Research Institute for ASEAN and East Asia, 2013), 1.

The importance of addressing NTMs to reduce unnecessary transaction costs is supported by the views of business in the APEC region. ABAC notes that a lack of transparency in regulations as ‘the most important issue for Asia-Pacific free trade agreements’<sup>101</sup> and that:

*For businesses, and in particular MSMEs, higher compliance costs hinder international competitiveness and complicate the most efficient deployment of economic resources. Enhancing regulatory cooperation within APEC economies will lower the costs of doing business, shorten supply chains and help achieve a seamless commercial environment.*<sup>102</sup>

### **4.3.3 Dealing with NTMs in trade negotiations**

While it is generally more challenging to address NTMs through negotiation (compared to tariffs), the multilateral trading system has developed increasingly effective rules to do so. Through successive negotiating rounds in the WTO, the most protectionist measures have been prohibited, the use of discriminatory and unnecessarily trade-restrictive measures reduced, and transnational regulatory cooperation and convergence encouraged.<sup>103</sup>

The APEC Leaders’ ‘standstill’ commitment to resisting pressure to raise new trade and investment barriers until the end of 2018 and their pledge to roll back protectionist and trade-distorting measures build upon these multilateral efforts to address NTMs.<sup>104</sup>

The negotiation of preferential trade arrangements presents an opportunity to reduce and streamline NTMs, though the extent to which this is achieved depends on the depth of integration aimed for. There is currently a spectrum of approaches to addressing NTMs in FTAs. Shallower integration approaches to addressing NTMs are typically limited to reaffirming or replicating key obligations in WTO agreements, such as national treatment, and might be complemented by relatively simple rules of general application designed to enhance transparency and predictability of NTMs.

A deeper integration approach would typically introduce provisions relating to particular kinds of NTMs or around specific products, including mechanisms to increase cooperation on issues related to SPS and TBT measures. Such cooperation could take many forms, from promoting harmonization of standards to mutual recognition arrangements and information sharing.

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101 ABAC, ‘Resilient inclusive growth’, 21.

102 Petri et al., *The FTAAP Opportunity*, 3.

103 WTO, *World Trade Report 2012*, 46.

104 APEC, ‘Statement on supporting the multilateral trading system and the 10th WTO Ministerial Conference’, in *APEC Leaders’ Declaration* (2015).

FTAs with provisions relating to the harmonization or mutual recognition of technical regulations dampen the price-raising effect of NTMs, with provisions on mutual recognition of conformity assessments having the strongest dampening effect.<sup>105</sup> They also underline the importance of mutual recognition of basic paperwork like origin and SPS certificates, highlighting the contribution that cooperation and technical assistance in regulatory policymaking can make toward reducing trade costs.<sup>106</sup>

In the most recent example, the Trans-Pacific Partnership (TPP) has established a committee that aims to strengthen joint work relating to standards, technical regulations and conformity assessment procedures. This committee will be a valuable forum to address NTMs through technical discussions. In addition, the goods chapter of the TPP provides a mechanism for ad-hoc discussions on issues that may adversely affect goods trade, including NTMs.

#### **4.3.4 The way forward on NTMs**

Much remains to be done in terms of how Asia-Pacific FTAs might deliver results on NTMs that actively seek to reduce the transaction costs of trade-distorting NTMs. As ABAC members note, there is the question of how modern FTAs take account of cross-cutting regulatory issues that increase transaction costs for businesses:

*Trade agreements often handle value chains incoherently, and crucial provisions appear in many chapters of an agreement. For example, a value chain business process may require streamlined customs and border formalities, unrestricted data flows, common standards and certification requirements, strong intellectual property rights, investments that enable a company to locate some operations abroad, and the mobility of some personnel.<sup>107</sup>*

Given the estimated USD 790 billion cost of NTMs on trade in the APEC region identified by the NZIER's analysis, there is a strong, growing desire in the business sector to see these costs decrease to enhance supply chain connectivity and competitiveness.

In its 2015 report to APEC Leaders, ABAC made five recommendations to address NTMs: (i) joint business–government dialogue on NTMs; (ii) identification by APEC of NTMs that have a significant impact on trade and the efficient functioning of global value chains; (iii) empowering businesses to identify and address NTMs; (iv) stronger implementation of good regulatory practice; and (v) 'leadership and support for high-standard multilateral, bilateral and regional trade agreements, including FTAAP that

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105 Cadot and Gourdon, 'NTMs, preferential trade agreements, and prices: new evidence', 4.

106 *ibid.*, 20.

107 Petri et al., *The FTAAP Opportunity*, 37



seek to minimize the range of potential barriers behind the border'.<sup>108</sup>

As APEC takes concrete steps to lay the foundations for an eventual FTAAP, NTMs and their effects on global value chains could be a central focus of APEC efforts moving forward. APEC Leaders previously have stressed the need for the FTAAP to be comprehensive, and cover non-tariff issues, in order to deepen economic integration in the region.

#### **4.4 SERVICES TRADE ANALYSIS**

Services trade is significant globally and for APEC economies, constituting a major and increasingly important share of international trade and investment. As such, we can anticipate that services will be prominent in eventual FTAAP negotiations. In APEC, work on trade and investment liberalization, and on facilitation issues related to trade in services, is undertaken by the Group on Services, the Investment Experts Group, the Committee on Trade and Investment, and in other forums such as ABAC.

This section discusses the characteristics of trade and investment in services, reviews current patterns and trends of trade and investment in services within the APEC region, and assesses the incidence of regulatory policy measures affecting trade and investment across the region. It also examines the nature and type of measures present in the key service sectors of financial services, telecommunications and distribution.

##### **4.4.1 Characteristics of trade and investment in services**

The services sector is diverse. Services include a broad range of economic activities that are generally either embedded or embodied in the manufacture or distribution of a physical product (e.g. logistics) or provided direct to consumers (e.g. education, financial, tourism and health services). They may be traded or non-traded internationally through a variety of means. WTO members employ a range of categories for services.<sup>109</sup> The General Agreement on Trade in Services (GATS) recognizes four modes of supply or delivery of traded services: cross-border trade, consumption abroad, commercial presence and movement of natural persons.<sup>110</sup> With manufacturing firms

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108 ABAC, 'Resilient inclusive growth'.

109 Examples include: business, communications, construction, distribution, education, environmental, financial, transport, health-related and social services, tourism and travel related services, recreation, sporting and cultural services and 'other services not included elsewhere'. See: WTO (World Trade Organization), *Services Sectoral Classification List* (MTN.GNS/W/120, Geneva: WTO, 1991).

110 Mode 1: Cross-border trade, where the services are delivered from the territory of one economy to that of another (e.g., software purchased from one economy is downloaded in another). Mode 2: Consumption abroad, where the consumer (or their property) rather than the service crosses the border (e.g., tourism or ship repair). Mode 3: Commercial presence, where a service is supplied via an establishment in one economy belonging to a firm in another (e.g., banking services provided through a

increasingly buying services from other companies, the measured size of the manufacturing sector may shrink even as that of the services sector rises.<sup>111</sup>

Measures regulating services are designed to achieve policy objectives, usually in a particular economic sector, though they may be economy-wide; and they may also relate to public policy objectives, for example, in health, education and the environment. Regulation of services may be aimed at ensuring that gains in productivity resulting from liberalization are not entirely absorbed in producers' profit margins but also translate into lower prices for consumers. The regulation may be aimed at reducing rent-seeking, but may also be designed to address market failures resulting from natural monopolies, information asymmetries, or equity considerations.

Regulatory measures can have adverse impacts on trade and investment where they restrict market entry or foreign providers, impede direct cross-border services delivery or are used to protect domestic providers. Regulatory transparency is important and third-party tools, such as the APEC Services Trade Access Requirements (STAR) Database,<sup>112</sup> are useful in providing accurate and accessible information on regulation within APEC.

Based on a PECC survey of regional opinion leaders in 2015, impediments to trade were ranked on a scale of 1 to 5, with 5 being a very serious impediment to trade (Figure 4.11). Regulatory measures affecting service sectors were ranked the top trade impediment, followed by restrictions on investment and then other non-tariff measures.

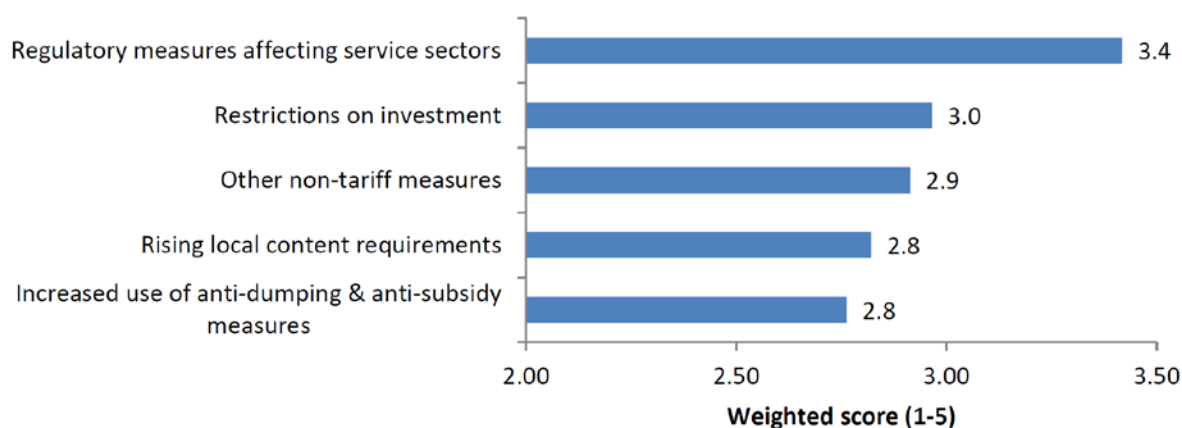
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foreign branch). Mode 4: Movement of natural persons, (e.g., a lawyer who is a national of one economy travels to another to supply services).

111 SCB (Standard Chartered Bank), 'Global supply chains: new directions' (London: SCB, 2015).

112 The STAR Database is available at <http://www.servicestradeforum.org/>

**Figure 4.11 Seriousness of impediments to trade**



Source: PECC (Pacific Economic Cooperation Council), *State of Trade in the Region 2015* (Singapore: PECC, 2015).

#### **4.4.2 Services trade in the APEC region**

Liberalization of trade in services, accompanied by appropriate regulation and competition policies has led to significant improvements in economic performance.<sup>113</sup> Because current levels of protection in services are higher than in goods, and because liberalization of services would also create positive externalities from the freer movement of capital and labour, the potential gains from liberalizing services are substantially greater than those from merchandise trade liberalization. There is a strong linkage between openness to trade and investment in the services sector, and international competitiveness in services. As a result, economies with more open regimes for services are likely to do better in the global services trade.

Services account for about 63 percent of FDI stock globally, almost 70 percent of APEC output and about 52 percent of regional employment, but with considerable variation across economies.

The share of services in trade is substantially lower in the APEC region, but is increasing and service exports are growing faster than those of goods. In 2013, commercial services trade (in terms of balance of payments) for APEC was a small share of output (8.4%) and below the world average (11.9%). Similarly, services' share of total APEC exports of 17 percent remains below the world average of 19.8 percent.

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113 I. Hapsari and D. MacLaren, 'The growth effects of services trade liberalization in ASEAN', *Journal of Southeast Asian Economies* 29(2) (2015): 85–100; L. Walmsley and L.A. Winters, 'Relaxing the restrictions on the temporary movement of natural persons: A simulation analysis', *Journal of Economic Integration* 20(4) (2005): 668–72.

The data point to the importance of making the opening of services markets an APEC priority.

Globalization, the internationalization of services value chains, technological innovations, and liberalization of trade across markets, have seen the trade in services sector expand over time. There has also been noticeable growth in services exports and imports over the last decade. In real terms, services exports increased 53 percent between 2005 and 2014. Major increases were recorded in information and communication technology (ICT), construction, insurance, pension, and financial services (Table 4.4). Rises in global income and policy reforms, particularly in Asia, have been key drivers of global demand for services exports.<sup>114</sup>

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114 Australian Government Productivity Commission, *Study into Barriers to Growth in Australian Services Exports* (submission by the Department of Foreign Affairs and Trade (DFAT), Australian Trade Commission (Austrade) and Export Finance and Insurance Corporation (EFIC), 2015).

**Table 4.4 Services exports in APEC: strong sectoral performers 2005–2014**

	2005	2010	2014	Growth 2005–2014
<b>EXPORTS (million USD, constant 2005 prices)</b>				
<b>Services</b>	956,490	1,221,525	1,460,702	52.7%
<b>Goods-related services</b>	35,450	39,324	47,555	34.2%
<b>Transport</b>	221,160	264,088	271,137	22.6%
<b>Travel</b>	255,190	310,071	391,519	53.4%
<b>Other services</b>	444,690	608,050	750,492	68.8%
<b>Construction</b>	22,140	39,054	43,672	97.3%
<b>Insurance and pension services</b>	15,090	23,138	28,383	88.1%
<b>Financial services</b>	64,390	93,011	116,143	80.4%
<b>Charges for the use of intellectual property</b>	99,590	118,437	140,522	41.1%
<b>Telecommunications, computer and information services</b>	34,260	52,600	72,736	112.3%
<b>Other business services</b>	179,540	251,539	321,909	79.3%
<b>Personal, cultural and recreational services</b>	6,390	5,760	6,555	2.6%
<b>Government goods and services</b>	23,800	24,364	25,636	7.7%
<b>Memo item: commercial services</b>	932,690	1,197,153	1,435,067	53.9%
<b>Memo item: other commercial services</b>	420,890	583,678	724,856	72.2%
<b>IMPORTS (million USD, constant 2005 prices)</b>				
<b>Services</b>	996,270	1,213,632	1,485,180	49.1%
<b>Goods-related services</b>	36,090	36,954	36,126	0.1%
<b>Transport</b>	288,010	321,493	365,649	27.0%
<b>Travel</b>	261,030	288,730	413,877	58.6%
<b>Other services</b>	411,140	566,447	669,536	62.9%
<b>Memo item: commercial services</b>	960,680	1,175,820	1,454,980	51.5%
<b>Memo item: other commercial services</b>	375,550	528,634	639,336	70.2%

Sources: UNCTAD, 2015, based on the IMF *Balance of Payments Manual 6<sup>th</sup> Edition* (BPM6); Australian APEC Study Centre.

#### **4.4.3 Changing boundaries of services tradability in the APEC region**

Technological advances have created new links between geographically dispersed economic activities and facilitated market and production connectivity within APEC. These advances have reduced communication, transportation and production costs and expanded the boundaries of tradability of services. Many services once considered non-tradable are now being traded actively. Digital networks are reinforcing the internationalization of services and expansion of business process outsourcing (BPO) and knowledge process outsourcing (KPO) service markets. They have enabled the unbundling of production and consumption and created new possibilities for long-

distance trade in services such as education, training, R&D and software development.<sup>115</sup> Innovation in the financial services industry is facilitating the movement of trade finance toward digital automated systems, which permit more cost-effective, error-free and efficient finance for clients.<sup>116</sup>

According to Subramanian and Kessler, the ‘dematerialisation of trade’ as a result of the rising importance of global value chains will lead to trade in services overtaking trade in goods.<sup>117</sup> Reduced digital costs from technological innovation and development will facilitate access to modern services such as ICT, finance and professional services, and enhance trade in traditional services such as education, tourism and health. Trade in banking, education and tourism are still dominated by developed economies, although export of health services is rising in emerging economies (Mexico; Thailand; Malaysia; and the Philippines are seeing a strong rise in the number of medical tourists coming to their economies; the Philippines is experiencing a net export of services due to its strong IT-Business Process Management sector). A rise in services exports is transforming trade patterns. For example, Australia is known as a commodity exporting economy, but earned more from services in 2014 than from iron ore exports, which had been its single largest source of export earnings over the past decade.

Labour productivity in services shows a higher contribution to GDP growth than labour productivity in manufacturing.<sup>118</sup> Most service sectors are knowledge-intensive and more R&D is now taking place in services than in manufacturing. Higher wage service sectors require higher skilled workers (with correspondingly higher productivity) and high-skilled jobs are growing faster than low-skilled jobs, highlighting the importance of human capital development in general and education in particular. Physical infrastructure for information technology also helps to leverage capabilities in many other service areas.

Greater digitalization of both business and consumer activity is impacting on trade through e-commerce, automated machines, massive open online courses (MOOCs), electronic health records and personalized medicines and social networks. The convergence of fixed, mobile and broadcast networks with machine-to-machine communication, the cloud, data analytics, sensors, actuators and people is paving the way for machine learning, remote control, and autonomous machines and systems. Devices and objects are becoming increasingly connected to the ‘Internet of Things’,

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115 Other examples include inventory management, quality control, accounting, personnel, secretarial, marketing, advertising, distribution, and legal services.

116 SCB, ‘Global supply chains’.

117 A. Subramanian and M. Kessler, ‘The hyperglobalization of trade and its future’ (working paper no. 3, London: Global Citizen Foundation, 2013).

118 PECC (Pacific Economic Cooperation Council) and ADBI (Asian Development Bank Institute), *Services Trade: Approaches for the 21st Century* (Singapore: PECC and ADBI, 2011).

leading to penetration of ICT in the economy on a massive scale.<sup>119</sup> It is expected that mobile internet users will grow from 31 percent to 57 percent of the population in the Asia-Pacific and from 60 percent to 81 percent in North America between now and 2019. The fixed internet user base will grow as well but at a lower speed compared to mobile users.

For consumers, cloud services offer ubiquitous access to content and services, on multiple devices, delivered to almost anywhere network users are located.<sup>120</sup> A forecast by Cisco shows that more than four-fifths (86%) of workloads will be processed by cloud data centres while 14 percent will be processed by traditional data centres by 2019.<sup>121</sup>

These developments are transforming established industries such as banking, transportation, retail, energy, health, and publishing and media. For example, digital content is contributing to dematerialization in some industries, notably in the case of books and videos. And, new business models such as peer-to-peer lending based on a 'sharing economy' have been made possible through platforms allowing people to rent, exchange or share their apartment or car.<sup>122</sup>

#### **4.4.4 Measures affecting trade in services**

Realizing the benefits of more open services trade and investment across the APEC region requires regulatory policies that encourage investment and competition in trade in services in key economic sectors. Despite this, foreign providers of services and investment are regulated by a range of measures across the major service sectors of APEC economies (see Figures 4.12 and 4.13).

Residency, citizenship and local presence requirements are most prevalent in the financial services sector, in both banking and insurance, across almost all APEC economies. They tend to be in the form of residency/nationality requirements for senior managers and boards of directors, as well as local presence requirements to deliver commercial banking and insurance services in the market. The telecommunications sector is also affected by similar measures, although in far fewer economies. In the transport sector, measures predominantly affect investment in and delivery of air services. The least affected sectors are distribution and road and rail transport, in which there are a fewer number of measures in fewer economies.

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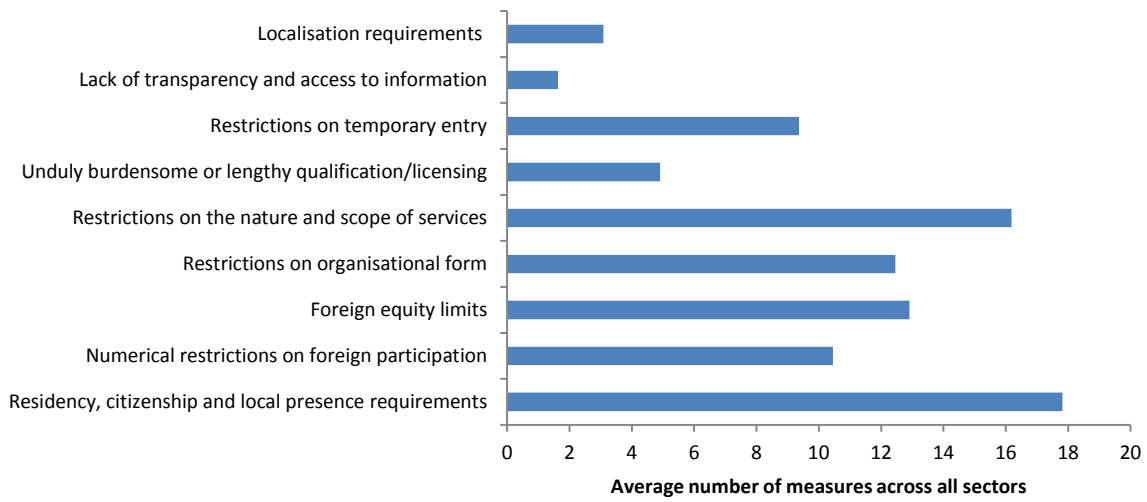
119 OECD (Organisation for Economic Co-operation and Development), *OECD Digital Economy Outlook 2015* (Paris: OECD, 2015).

120 Cisco, 'Cisco Global Cloud Index: Forecast and methodology, 2014–2019' (white paper, San Jose, CA: Cisco, 2015).

121 *ibid.*

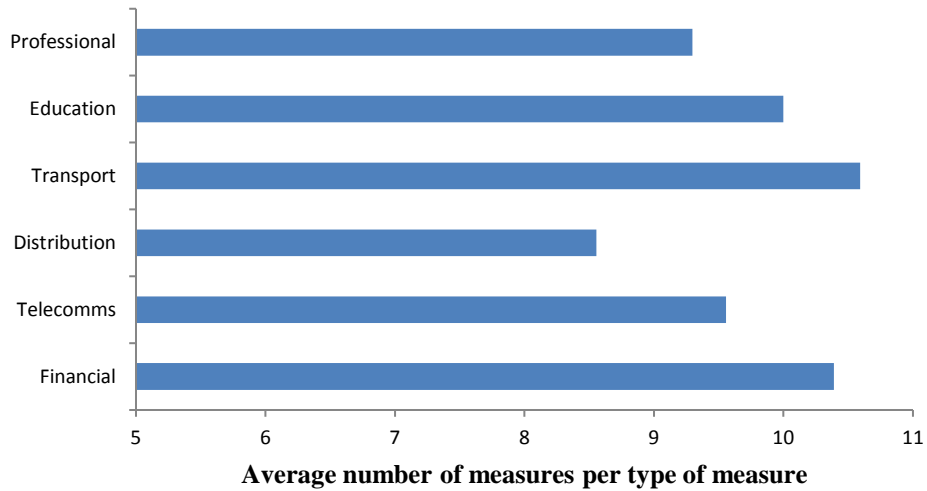
122 OECD, *OECD Digital Economy Outlook 2015*.

**Figure 4.12 Average number of measures across all sectors, by type of measure**



Sources: ITS Global using APEC Services Trade Access Requirements (STAR) Database, OECD Services Trade Restrictiveness Index (STRI).

**Figure 4.13 Average number of measures per type of measure, by service sector**



Sources: ITS Global using APEC Services Trade Access Requirements (STAR) Database, OECD Services Trade Restrictiveness Index (STRI).



#### ***4.4.4.1 Restrictions on nature and scope of services***

Measures that restrict the nature and scope of services by foreign providers are found in all sectors (Figure 4.14), with the bulk of them in the transport, financial and professional services sectors.

Maritime transport is heavily regulated. Services such as cargo handling, storage and warehousing are subject to restrictions, or closed to foreign competition. Almost all economies maintain prohibitions on cabotage.

Numerous measures constrain professional services that can be delivered by non-nationals, most notably in legal services. For example, foreign lawyers are commonly precluded from the practice of domestic law. Controls on branch networks, the types of investment products that can be offered in the market and the types of activities that can be conducted (such as marketing) impede the delivery of commercial banking and insurance (see also Box 4.1).

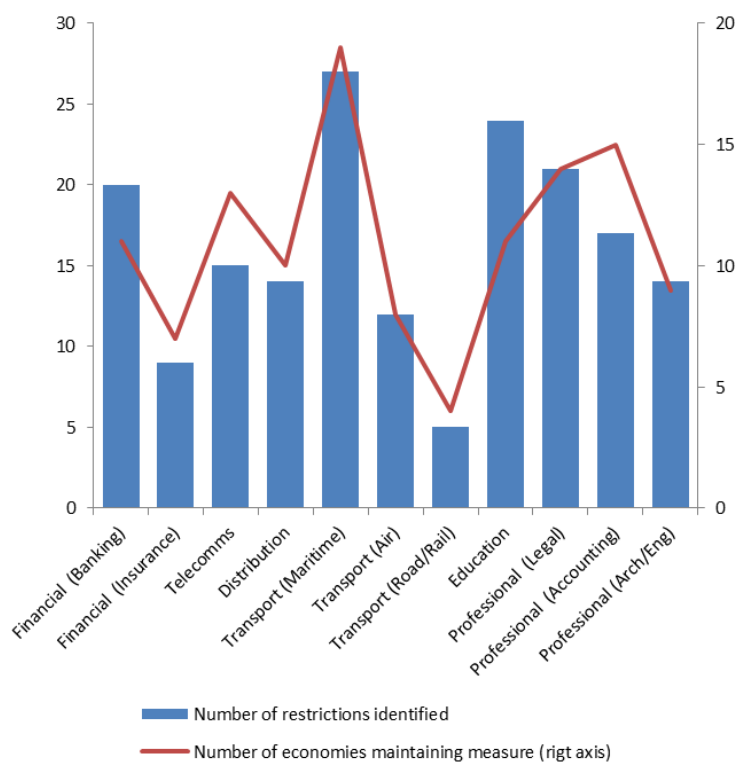
While less widespread in the APEC region, some economies also regulate foreign providers of education services, through measures such as controls on teaching of nationals and prohibitions on repatriation of profits.

#### ***4.4.4.2 Restrictions on foreign equity participation***

Limits on foreign equity participation are also seen in all service sectors, though the incidence varies among sectors (Figure 4.15). Limits tend to be greater in service sectors that are of strategic policy interest to governments.

Equity limits are most prevalent in the transport sector, particularly air and maritime services. Foreign equity in airlines, airports and air services is subject to limitations in nearly every APEC economy. Limits also apply to investment in financial services, particularly banking, and in telecommunications. About two-thirds of economies limit foreign investment in telecommunications (see Box 4.2). Roughly one-third of economies similarly limit commercial banking and insurance. Professional services (most notably legal services) are also affected, with limits applied by between a third and a half of APEC economies.

**Figure 4.14 Restrictions on the nature and scope of services, by sector and economy**



Sources: ITS Global using APEC Services Trade Access Requirements (STAR) Database, OECD Services Trade Restrictiveness Index (STRI).

#### **Box 4.1 Measures affecting foreign providers of financial services in APEC economies**

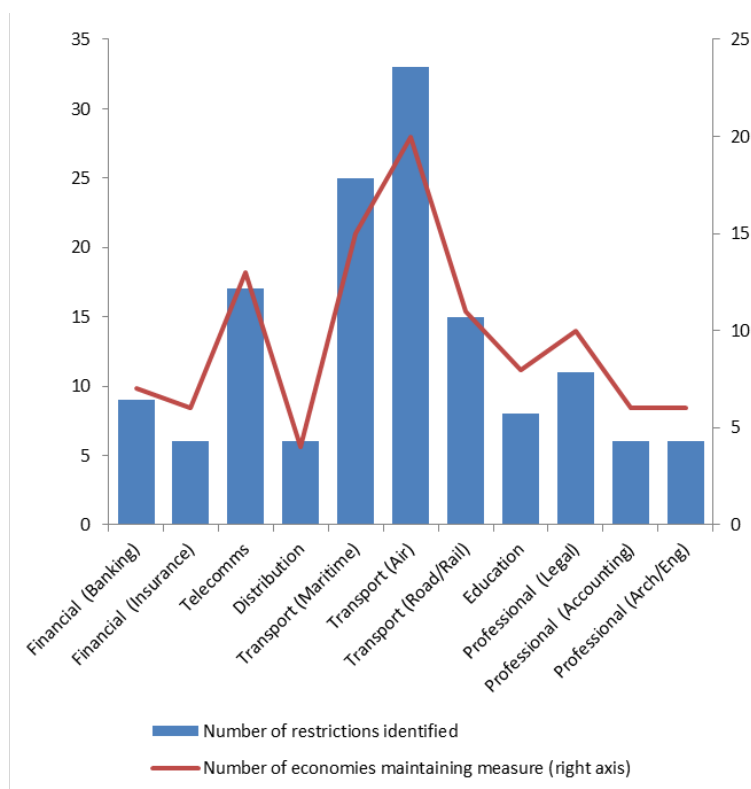
In the financial sector, both the commercial banking and insurance services sectors face measures that impede foreign participation.

**Establishment.** Most prevalent are conditions for establishment, which may include local presence, controls on branch networks, mandated joint venture arrangements and residency/nationality requirements for boards of directors and holders of voting shares. At least half to two-thirds of APEC economies apply these measures.

**Post-establishment.** Post-establishment, foreign providers face restrictions on the scope of services that can be supplied. Numerous controls limit the temporary movement of workers, including labour market testing, quotas, and qualification and nationality requirements. These measures are prevalent in about half of the APEC economies.

Licensing and approval processes also create undue burdens and compliance costs for business in about one-third of the APEC economies.

**Figure 4.15 Foreign equity limits, by sector and economy**



Sources: ITS Global using APEC Services Trade Access Requirements (STAR) Database, OECD Services Trade Restrictiveness Index (STRI).

#### **Box 4.2 Measures affecting foreign telecommunication service providers in APEC economies**

In the telecommunications sector, foreign providers are mostly constrained by limits on commercial presence. Cross-border trade is less restricted.

**Types of controls.** Controls are generally of two types: those that restrict new entrants to competitive segments of the market; and those that permit the incumbent operator of the network to restrict competition in the competitive segments. The former is the most prevalent. Constraints on foreign investment are applied by almost half of the APEC economies. They comprise foreign equity limits, economic needs tests for approval of investments and residency/nationality requirements for boards of directors.

**Regulatory measures.** Regulations that serve to protect incumbents and limit competition in the market – such as price regulations, conditions and controls – are less numerous but are maintained by a similar number of economies. Lack of regulatory transparency and predictability in some markets also impacts on business.

#### ***4.4.4.3 Numerical restrictions on foreign participation***

Numerical restrictions on foreign participation also occur in all service sectors. They include economic needs tests; quotas for suppliers; services closed to foreign investment or services delivery; and reservation of the supply of services to exclusive, or government, suppliers.

Measures are most numerous, and most widespread across APEC economies, in the distribution and (maritime and air) transport sectors. Professional services and financial services also have a high incidence of measures, though they are maintained by fewer APEC economies. Foreign providers of distribution services face restrictions in just over half of the APEC economies; measures include limits on the number, size and location of stores and sales outlets (see Box 4.3). In the transport sector, maritime and air transport in particular, some services (such as pilotage) are closed to foreign competition. Economic needs tests for the operation of vessels, airlines and crews are widespread.

#### ***4.4.4.4 Other restrictions***

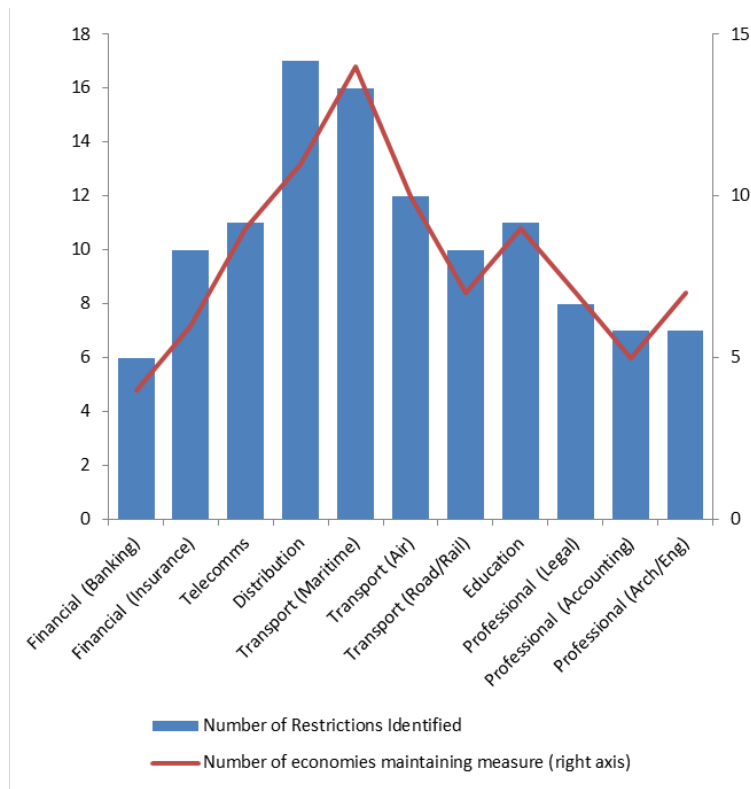
Restrictions on the temporary entry of service suppliers are most prevalent in professional services (legal, accounting, banking and insurance). In some economies, these services are reserved for domestic providers. Where entry is permitted it tends to be limited to specific categories of personnel (intra-corporate transferees, contractual service suppliers and independent service suppliers). The permitted duration of stay varies among economies. Economic needs tests and quotas apply for the appointment of staff and there may be nationality requirements for directors and managers. Generally, foreign professionals must comply with nationality requirements, labour market testing, and local qualification and licensing conditions in order to fully participate in the market.

Localization requirements are most common in transport and distribution services, where sourcing of local goods or employment of domestic personnel is required.

Licensing and qualification requirements impede financial, maritime transport and professional services. In some economies, domestic licensing criteria discriminate against foreign providers. Processes can be lengthy and complex. Requirements for local qualifications may exclude foreign professionals.

Lack of transparency and access to information was identified as a concern in a few economies, principally in the banking sector. Notably the incidence may be understated as measures of this type are more difficult to identify than regulatory measures set out in law.

**Figure 4.16 Numerical restrictions on foreign participation, by sector and economy**



Sources: ITS Global using APEC Services Trade Access Requirements (STAR) Database, OECD Services Trade Restrictiveness Index (STRI).

**Box 4.3 Measures affecting foreign providers of distribution services in APEC economies**

Foreign suppliers face regulatory constraints when establishing a commercial presence. Foreign equity limits apply for the establishment of chain stores, hypermarkets and department stores. Certain activities are reserved for nationals. Licences for the supply of retail and wholesale services are subject to economic needs tests. There are limits on the number, size and location of franchise and sales outlets. Over half of the APEC economies apply these measures though they are greatest in a few economies.

Foreign providers face restrictions on direct selling, franchising activities and advertising in the local market. Prescriptive conditions can apply for operation of retail outlets. Local content requirements for products and product inventory exist in some economies. Investment is also limited by restrictions on land ownership.

#### **4.4.5 The way forward on services trade**

Through bilateral agreements on trade and investment, APEC economies underscore the importance of reducing and restricting barriers to services trade. The eventual realization of the FTAAP could provide a broader regional framework to address services trade and investment.

Without services, there would be minimal trade in goods, as well as less production, lower incomes, and a reduced standard of living globally. Although it is generally understood that services are increasingly important in the global economy, their significance remains understated. The impact of services on supply and value chains, and the relevance of embedded or embodied services, are not sufficiently taken into account in most analyses. This makes the substantial impacts of services on economic activity arising from factors such as technological changes difficult to assess and effective regulation difficult to design.

Regulatory measures that restrict services trade are applied in varying degrees in all APEC economies. Restrictions on foreign firms are common. Not only do the various restrictions slow down or impede economic relationships between partner members of APEC, they also constrain economic development and competition in the domestic economy. On a broader scale, they inhibit further regional integration. This is why APEC's structural reform agenda focuses sharply on ways to reduce or eliminate services barriers both at the border and behind the border.

We need to recognize that services liberalization is an important facilitator of foreign investment, which in turn drives overall investment in the APEC region. An eventual FTAAP's treatment of services trade and investment could have a critical role in growing trade in services in the region. Liberalization of services is challenging, requires sequencing and warrants support through technical assistance.

#### **4.5 INVESTMENT ANALYSIS**

The sustained economic growth experienced by APEC economies has been attributed to higher specialization and value-added international economic activities, with a more direct relationship among tradeable goods, services and FDI flows, particularly through the importance of regional and global value chains. Global value chains are typically coordinated by multinational companies, with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers. Global value chains coordinated by multinational enterprises are estimated to account for some 80 percent of global trade. Economies with a higher presence of FDI relative to the size of their economies tend to have a higher level of participation in global value chains and to generate relatively more domestic value added from

trade.<sup>123</sup>

The growth dynamics, mostly evidenced in Southeast Asian economies and China, has been attributed to the relevance of increasing FDI flows in manufacturing in industries with different technological intensity (low-tech and medium-tech) and the development of the services sector. Foreign affiliates in those economies have increased value-added exports of goods relying on foreign inputs for their own firm exports, that have been further processed in partner economies. At the same time, the service component of the goods exported by these affiliates have been increasing. Investments by multinational enterprises tend to lead to job creation and higher employment growth, and stimulate linkages with local firms and institutions, such as industry associations and universities, in the development of local industry.

In recent years, several APEC economies have introduced policies to boost investment, including through the liberalization of existing restrictions, as well as through promotion actions. Developing and transition economies have had a predominant role in this process. Measures to promote investment have included establishing tax incentives for investments or facilitating investment procedures. New investment restrictions for foreign investors are based mainly on strategic or national security considerations, for example, restrictions on investment in the weapons, aircraft or nuclear power industries, or restrictions on foreigners acquiring land within an economy's borders.

A major trend in international investment agreements (IIAs) is the inclusion of provisions to safeguard a State's right to regulate for legitimate public policy objectives. While IIAs contribute to a favourable investment climate, they can involve the contracting Parties accepting disciplines on their domestic policymaking in regard to potentially discriminatory or unfair treatment of investors.

Given the rising concerns about the extent of Parties' obligations in IIAs, the contracting Parties need to ensure a careful balance between investor protections and the preservation of their regulatory space for legitimate public policy interests, including sustainable development objectives and implementing economic or financial policies. At the same time, policymakers must be vigilant that providing the necessary policy space for governments to pursue bona fide public good does not inadvertently provide legal cover for investment protectionism or unjustified discrimination.

Options to safeguard the right to regulate include clarifying or circumscribing provisions such as MFN treatment, fair and equitable treatment (FET) and indirect expropriation, as well as including exceptions, e.g. for public policies or national

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123 OECD (Organisation for Economic Co-operation and Development), WTO (World Trade Organization), UNCTAD (United Nations Conference on Trade and Development), *Implications of Global Value Chains for Trade, Investment, Development and Jobs* (2013), 21.

security.

Over 3,300 IIAs have been signed throughout the world. Some 2,500 are currently in force, and more agreements are constantly being negotiated; in 2015, 28 IIAs were concluded.<sup>124</sup> APEC economies are particularly active negotiators of IIAs. As of 2015, China and the Republic of Korea are the most active negotiators within APEC and account for 15 percent and 10 percent respectively of all agreements signed by APEC economies. Additionally, while there are close to 150 agreements among APEC economies, the number of agreements between APEC members and non-APEC economies is well over four times that.<sup>125</sup> Concluded IIAs identified by UNCTAD in the region are shown in Table 4.5.

Considering the coexistence of so many IIAs and such fragmentation, this section will review the practice of APEC economies when negotiating these agreements and the specific provisions that affect investments, in order to help identify areas of convergence between APEC economies in investment treaty practice. One of the possible difficulties toward a possible FTAAP resides in the fact that two general schemes seem to exist within APEC economies with regard to approaches to regulating foreign investment. While many economies have a general foreign investment law or regime, other economies may simply address the issue and elements relevant or specific to foreign investment in sector- or issue-specific legislation such as tax codes, privatization laws, and investment incentives.<sup>126</sup>

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124 UNCTAD, 'International investment agreements', *Investment Policy Hub*, accessed 13 July 2016, <http://investmentpolicyhub.unctad.org/IIA/MostRecentTreaties#iaInnerMenu>

125 UNCTAD, *Core Elements of International Investment Agreements in Domestic Investment Frameworks in the APEC Region* (Singapore: APEC, 2011).

126 Ibid., 7.



**Table 4.5 Concluded IIAs in the APEC region**

<b>Economy</b>	<b>Bilateral investment treaties (BITs): total (in force)</b>	<b>Other international investment agreements (IIAs): total (in force)</b>
<b>Australia</b>	21 (21 in force)	18 (17 in force)
<b>Brunei Darussalam</b>	8 (5 in force)	18 (15 in force)
<b>Canada</b>	38 (30 in force)	19 (17 in force)
<b>Chile</b>	49 (37 in force)	11 (10 in force)
<b>P.R. China</b>	129 (110 in force)	19 (18 in force)
<b>Hong Kong, China</b>	18 (17 in force)	4 (4 in force)
<b>Indonesia</b>	48 (32 in force)	15 (13 in force)
<b>Japan</b>	27 (20 in force)	20 (17 in force)
<b>Rep. of Korea</b>	90 (85 in force)	19 (16 in force)
<b>Malaysia</b>	68 (49 in force)	23 (19 in force)
<b>Mexico</b>	32 (29 in force)	17 (14 in force)
<b>New Zealand</b>	4 (2 in force)	14 (13 in force)
<b>Papua New Guinea</b>	6 (5 in force)	3 (3 in force)
<b>Peru</b>	29 (29 in force)	27 (19 in force)
<b>Philippines</b>	37 (31 in force)	14 (12 in force)
<b>Russia</b>	74 (59 in force)	5 (2 in force)
<b>Singapore</b>	44 (37 in force)	29 (25 in force)
<b>Chinese Taipei</b>	23 (16 in force)	6 (6 in force)
<b>Thailand</b>	39 (36 in force)	22 (19 in force)
<b>United States</b>	47 (40 in force)	13 (13 in force)
<b>Viet Nam</b>	61 (45 in force)	22 (16 in force)

Data on IIAs for Canada, Chile, Chinese Taipei and the United States have been updated by the respective economies.

Source: UNCTAD, 'International investment agreements', *Investment Policy Hub*, accessed 13 July 2016,

<http://investmentpolicyhub.unctad.org/IIA/MostRecentTreaties#iaInnerMenu>

#### **4.5.1 Measures affecting investment**

The majority of IIAs contain all or a combination of the following elements:

- Non-discrimination: national treatment
- Non-discrimination: MFN treatment
- Establishment
- Positive or negative list approach
- Minimum standard of treatment (MST) and fair and equitable treatment (FET)
- Freedom of transfers

- Performance requirements
- Expropriation
- Dispute settlement: State–State and investor–State
- Transparency
- Other measures affecting investment

#### ***4.5.1.1 Non-discrimination: national treatment***

National treatment is a core element in IIAs. Most IIAs afford national treatment to the investors of each Party as to their investments. Exceptions to national treatment are the basis for discrimination with regard to foreign investors. Distinctions between treatment of national investors and foreign investors can range from simple registration requirements that apply only to foreign investors, to screening or to outright exclusions or limitations on foreign investors in sectors or subsectors.

The scope of national treatment provisions is tied directly to whether or not the IIA in question grants establishment rights (as discussed in Section 4.5.1.3). Many economies provide for national treatment of foreign investors in either their constitutions or other legislation, but generally include caveats or exceptions, especially with regard to investment. All economies have provisions that limit this treatment.

In the context of investment negotiations, economies may agree to afford new market access by opening formerly closed or restricted sectors to investors from the other Party, or to simply maintain existing levels of access in all sectors, or even to provide access to sectors formerly closed to non-nationals of that Party. In the last case, the agreement can have a direct impact on domestic legal frameworks. IIAs generally tend to not require changes in domestic legal frameworks, though any subsequent measures taken by a contracting Party would have to be considered vis-à-vis the obligations committed in a treaty.

#### ***4.5.1.2 Non-discrimination: MFN treatment***

MFN treatment typically derives from international agreements, where economies reciprocally provide to investors or investments from the contracting Party the best treatment given to investors or their investments from any other economy. Some IIAs (e.g. the Australia–Peru Bilateral Investment Treaty (BIT) of 1997) only extend MFN treatment to investments, rather than to investors. As with national treatment, economies can make exceptions to this general commitment.<sup>127</sup> Also, the scope of MFN provisions is tied directly to whether or not the IIA in question grants establishment rights (as discussed in Section 4.5.1.3).

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<sup>127</sup> UNCTAD, *Most-Favored-Nation Treatment* (New York: UN, 2010).

Most economies do not have domestic requirements for MFN, because it is normally provided on a reciprocal basis through IIAs. By definition, core investment protection elements discriminate in favour of investors from economies that have IIAs with a host economy vs. those that do not. Market access concessions in investment may however be implemented on an MFN basis, or provide special or more favourable conditions for investors from one home economy.

Most IIAs tend to have MFN clauses that provide investors with treatment at least as favourable as the best granted to investors from any other economy, whether the agreement follows a pre- or post-establishment model.

With regard to BITs, a common exception to MFN treatment is with respect to the benefits conferred by virtue of a regional economic integration organization or similar arrangements, as well as taxation treaties (e.g. the Philippines–Thailand BIT of 1996).

Finally, it is increasingly common for the Parties to an IIA to clarify that the MFN obligation in the base treaty only covers the substantive treatment of investor and investments and does not encompass dispute settlement provisions and, thus, does not allow the ‘import’ of more favourable dispute settlement provisions from another treaty concluded by the host economy with a third economy.

#### ***4.5.1.3 Establishment***

Establishment refers to the timeframe from which an IIA grants protection to an investment or investor. IIAs may refer to pre-establishment or post-establishment.

**Pre-establishment** rights afford protections to investments and investors at the market entry phase of an investment (i.e. regarding the ‘establishment’ or ‘acquisition’ of an investment in the territory of the host Party). Reservations and exceptions to pre-establishment rights may be conferred either through a negative or positive list approach (see Section 4.5.1.4). In the case of the provision on performance requirements, pre-establishment refers to the prohibition against imposing certain performance requirements as a condition for the establishment of an investment. Pre-establishment is rarely granted without exceptions since every economy has sensitive sectors where foreign investment is not permitted. In fact, members of a trade or investment agreement usually list a number of measures (e.g. laws and regulations) or entire sectors where pre-establishment does not apply.<sup>128</sup> It should be noted that of the 10 economies or economic unions in the world with the highest number of pre-establishment IIAs, eight are APEC members.

**Post-establishment** rights afford protections to investments and investors once they

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128 Organization of American States, ‘Dictionary of trade terms’, *SICE*, accessed 13 July 2016, [http://www.sice.oas.org/dictionary/IN\\_e.asp](http://www.sice.oas.org/dictionary/IN_e.asp)

have established in the territory of the host Party (i.e. regarding the expansion, management, conduct, operation and sale of other disposition of the investment). It guarantees that foreign investors and/or their investments (those of another member economy of the trade or investment agreement), once established or admitted, are accorded national treatment or MFN treatment.<sup>129</sup>

An IIA may cover investment or investors from the pre-establishment phase or exclusively the post-establishment phase. As UNCTAD noted recently:

*The number of agreements that include pre-establishment rights is on the rise. As of the end of 2014, about 10% of all IIAs included pre-establishment commitments. Among those IIAs concluded in 2014, about half extend national treatment and most-favoured-nation treatment (MFN) obligations to the acquisition and establishment of investments.*<sup>130</sup>

#### **4.5.1.4 Positive or negative list approach**

IIAs commonly include lists whereby the contracting Parties reserve certain sectors or existing measures, or potential future measures, from the application of some of the agreement's obligations. There are two approaches for doing this: the positive list approach, and the negative list approach.

The positive list approach provides a closed listing of sectors or measures to which a certain IIA obligation applies, such as national treatment and MFN. Any sectors or measures left off the list are not covered by the agreement.

The negative list approach, by contrast, is more ambitious, as it assumes that all measures and economic sectors are subject to the disciplines of the agreement, except those that are specifically listed. In this approach, certain existing and/or future measures are listed as reservations against specific obligations of the agreement. Reservations are usually made against the following disciplines: national treatment, MFN, market access, senior management and boards of directors, performance requirements and local presence. Negative-list agreements can require a complete map of all measures that may be incompatible with IIA provisions, and therefore an exhaustive review of domestic legislation in all sectors.

While in theory, the same level of liberalization is available under either a positive or negative list approach, it appears that negative lists do more to promote foreign investment.<sup>131</sup>

It is important to note that while it is a common practice to reserve existing and some

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129 *ibid.*

130 UNCTAD, 'Recent trends in IIAs and ISDS' (issues note no. 1, New York: UN, 2015).

131 UNCTAD, *Preserving Flexibility in IIAs: The Use of Reservations* (New York: UN, 2006), 18.

future measures against certain obligations in the IIAs, many countries prefer to lock in the restrictiveness of existing non-confirming measures (the so-called ‘standstill’ mechanism) and to ensure that any future liberalization of the subject measure will also be locked in (the so-called ‘ratchet’ mechanism).

#### ***4.5.1.5 Minimum standard of treatment and fair and equitable treatment***

Traditionally, two of the most common forms of protection afforded to investors and investments are the minimum standard of treatment (MST) and fair and equitable treatment (FET).

MST is generally accepted to include FET and full protection and security. This provision is invoked in many international investment arbitration cases, and has therefore been the subject of ample arbitral analysis. The concept of FET provides a basic standard that is not generally related to the domestic law of the host economy, but does commit a State to refrain from, for example, acts that constitute denial of justice. FET is an absolute, not relative, standard of treatment. Its objective is to guarantee a certain minimum standard of treatment that does not require comparison with the treatment that the host State accords to its own investors or to any other foreign investors. The content of this obligation varies and depends on the formulation adopted by the contracting Parties when concluding the treaty.<sup>132</sup>

In some IIAs, FET provisions do not make reference to any normative source, either domestic or international (i.e. Papua New Guinea–Australia BIT of 1991). Others give content to the standard by requiring that investors or investments be accorded ‘fair and equitable treatment in accordance with principles of international law’.<sup>133</sup> Still others flesh out the standard by reference to customary international law (e.g. Japan–Chile FTA of 2007).

Some recent IIAs do not have any reference to FET. One international source notes:

*The absence of the FET obligation may be perceived as a signal that the Contracting States are not willing to subject themselves to an internationally enforceable minimum absolute standard of treatment of foreign investors.*<sup>134</sup>

#### ***4.5.1.6 Freedom of transfers***

The right to freely transfer investment capital and payments related to the investment is a core element of an IIA. Some economies retain the possibility of exchange controls in IIAs for balance of payment reasons or as a general economic policy instrument, as

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<sup>132</sup> Ibid., 49.

<sup>133</sup> Canada–El Salvador BIT (1999).

<sup>134</sup> UNCTAD and APEC, *International Investment Agreements Negotiators Handbook: APEC/UNCTAD Modules* (Singapore: APEC, 2012).

well as temporary safeguards. The issue of transfer of funds is addressed in the APEC Non-Binding Investment Principles specified in Jakarta in November 1994:

*Member economies will further liberalise towards the goal of the free and prompt transfer of funds related to foreign investment, such as profits, dividends, royalties, loan payments and liquidations, in freely convertible currency.*

In the majority of cases, the provision on free transfers refers exclusively to outbound transfers (i.e. repatriations). Some IIAs, on the other hand, include a right to transfers into the host economy. Other IIAs subject the right to transfer to the fulfilment of all fiscal obligations by the investor.

A number of IIAs make reference to the currency in which transfers may be made. Normally, a treaty refers to a ‘freely convertible currency’, that is, a currency that has immediate value on the foreign exchange market, or a ‘freely usable currency’, that is, a currency designated as such, from time to time, by the International Monetary Fund (US Dollar, Japanese Yen, Euro, British Pound and Chinese Yuan). An example of the former is the Viet Nam–Philippines BIT (1992), and of the latter, the Singapore–United States FTA (2004).

It is noteworthy that the freedom of transfers obligations is typically not subject to reservations of existing or future non-conforming measures.

#### ***4.5.1.7 Performance requirements***

Performance requirements refer to measures that impose a requirement on the investor or investment, such as local content, export performance, domestic equity, joint ventures, technology transfer and employment of citizens of the host Party. These measures can be mandatory (condition for entry or access to a sector) or voluntary (condition for benefiting from an incentive).<sup>135</sup>

The WTO Trade-Related Investment Measures Agreement (TRIMS) specifically prohibits certain types of performance requirements. All WTO members made notifications of the policies and measures that were considered inconsistent with these provisions, referencing specific pieces of domestic legislation for each measure.

The APEC Non-Binding Investment Principles (1994) address the issue of performance requirements: ‘Member economies will minimize the use of performance requirements that distort or limit expansion of trade and investment’.

Not all APEC IIAs deal with performance requirements, and those that do either reiterate (e.g. Japan–Malaysia Economic Partnership Agreement of 2006) or expand on

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<sup>135</sup> UNCTAD, *Key Terms and Concepts in IIAs: A Glossary* (New York: UN, 2004).

measures banned by TRIMS.

Under certain circumstances, some performance requirements may be permitted in an IIA, and some IIAs include language that address this, such as the Chile–Republic of Korea FTA (2004).

As discussed in Section 4.5.1.4 on the approach to reservations, existing non-conforming measures with respect to performance requirements can be maintained subject to standstill and ratchet provisions, where included. Furthermore, in certain sensitive parts of the economy, policy flexibility may be preserved with respect to future potentially non-conforming measures, including those constituting otherwise prohibited performance requirements.

#### ***4.5.1.8 Expropriation***

Expropriation, be it direct or indirect, is one of the central elements of international investment law, and one of the oldest issues in IIAs. The legitimacy of taking of property is generally recognized as long as certain conditions are met.

Most IIAs require that expropriations be carried out in a non-discriminatory manner, for a public purpose, in accordance with due process and accompanied by prompt payment of compensation that should be freely transferable, among others. These concepts are well established in international law.

The concepts of direct and indirect expropriation are included in the 1994 APEC Non-Binding Investment Principles:

*Member economies will not expropriate foreign investments or take measures that have a similar effect, except for a public purpose and on a non-discriminatory basis, in accordance with the laws of each economy and principles of international law and against the prompt payment of adequate and effective compensation.*

Many economies have provisions in their constitutions that allow for expropriation, prior payment of compensation, as well as laws or regulations that define the details of valuation and procedure.

In general, conditions for direct expropriation are set out and are mostly verifiable. On the other hand, indirect expropriation often arises through a series of indirect and different types of measures. According to UNCTAD, “indirect” expropriation/nationalization involves acts that effectuate the loss of management, use or control, or a significant depreciation in the value, of assets’.<sup>136</sup> Many IIAs specifically include reference to indirect expropriation (e.g. Art. 10.9(1) of the Chile–

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<sup>136</sup> UNCTAD, *Key Terms and Concepts in IIAs*, 68.

US FTA). Some IIAs go further, by providing guidance on what should be considered indirect expropriation.

#### ***4.5.1.9 Dispute settlement: State–State and investor–State***

Generally, IIAs contain provisions for the settlement of disputes between the contracting Parties, and provide investors with access to international arbitration to resolve investment disputes with the host Party. While State–State dispute settlement in IIAs is rarely used, the use of the investor–State dispute settlement mechanism has increased considerably in the last two decades.

Access to international arbitration is an important element in IIAs and generally continues to be included in them. The ability of economies to take part in international arbitration is generally derived from a law, or the economy’s participation in an international convention such as the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) or the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

The consent of the respondent Party (i.e. the host economy facing the claim) to submit to international arbitration in cases of dispute is generally expressed in the IIA itself; and many IIAs list specific arbitration rules (such as the New York Convention, the ICSID Convention, the Additional Facility Rules of the ICSID, or the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules) for the investor to choose from. While this is the general rule, some IIAs require explicit consent from the parties to the dispute. Others provide the host economy with the option of denying consent in individual disputes, and others simply omit an investor–State dispute settlement provision altogether.

IIAs may identify the scope of issues that may be subject to investor–State dispute settlement. Typically, a claim can be brought either by an investor on its own behalf or on behalf of an enterprise that the investor owns or controls. Other IIAs give broader scope to the issues subject to investor–State dispute settlement (e.g. China–Peru FTA of 2009) and yet other IIAs exclude specific issues from investor–State dispute settlement.

A number of IIAs include a fork-in-the-road provision, whereby investors must choose between domestic proceedings or international arbitration. Once the choice is made, the investor cannot generally resort to the other mechanism, with some exceptions. Other IIAs include a similar provision, requiring a waiver of the right to use domestic courts before proceeding to international arbitration (see for example the Mexico–Singapore BIT of 2009). Alternatively, some IIAs require that investors first go through domestic courts, either for a certain amount of time or until local remedies are exhausted.



Most IIAs include a limitation period, beyond which claims may no longer be submitted, for example, the ASEAN–China Investment Agreement of 2009 sets the limit at three years. Similarly, many IIAs exclude arbitration relating to acts or facts that took place or any situation that ceased to exist before the date of entry into force of that treaty (e.g. China–Peru FTA of 2009). Others exclude current disputes that arose before the entry into force of the treaty (but not subsequent disputes arising out of prior investments or acts); see for example article XX of the Iceland–Mexico BIT of 2005.

#### ***4.5.1.10 Transparency***

A review of APEC-economy IIAs shows a broad range of approaches with regard to transparency provisions and commitments. Some older IIAs have no mention at all of transparency issues; and other IIAs have full chapters (e.g. Chapter 11 of the North American Free Trade Agreement of 1994). In general, IIAs and FTAs tend to have more detailed provisions on transparency than BITs.<sup>137</sup>

In recent years, transparency is emerging in the form of investor responsibility and in the context of investor–State dispute settlement. Features of this approach include: the obligation to make publicly available submissions and arbitral decisions relating to investor–State dispute settlement and other documents relevant to the proceedings; obligations to make hearings open to the public; and provisions allowing tribunals to consider submissions by third parties (e.g. civil society stakeholders).

In December 2010, the United Nations Convention on Transparency in Treaty-based Investor–State Arbitration (Mauritius Convention on Transparency) was adopted. The Convention is an instrument by which Parties to investment treaties express their consent to apply the UNCITRAL Rules on Transparency in Treaty-based Investor–State Arbitration (effective as of 1 April 2014). The UNCITRAL Rules set procedural rules for making publicly available information on investor–State arbitrations arising under investment treaties.

#### ***4.5.1.11 Other measures affecting investment***

There are other measures affecting investment (and included in some IIAs) that are beyond the scope covered in this chapter, e.g. restrictions related to senior management and boards of directors, treatment in cases of armed conflict and civil strife, subrogation and denial of benefits.

Most if not all APEC economies, to a greater or lesser extent, have restrictions on foreign property ownership and on foreign participation in specific sensitive sectors. Most economies restrict the exploitation of natural resources to protect key sectors of the economy, such as mining, fishing, agriculture, energy. For example, in Canada, fish

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137 UNCTAD, *Core Elements of International Investment Agreements*.

processing companies that have more than 49 percent foreign ownership are not permitted to hold Canadian commercial fishing licences.<sup>138</sup>

Many economies place restrictions on foreign investment when there are issues of national security, public order, public health and/or social issues. For example, Japan only applies ex-post-facto reporting for FDI, except in the case of industries related to national security (weapons, aircraft, nuclear power, spacecraft, and industries manufacturing dual-use items with a high probability of being converted to military uses). In the United States, the Committee on Foreign Investment reviews mergers, acquisitions and takeovers that could result in control of businesses by foreign persons, in order to identify and mitigate any risk to its national security posed by any such transaction.<sup>139</sup>

Additionally, a number of APEC economies impose restrictions on domestically sensitive service activities, such as air transportation, telecommunications and banking, to name a few. For instance, Brunei and Indonesia have restrictions on liquor, armaments and gambling. In Hong Kong, China a sound broadcasting licence may be granted to or held only by a corporation that is formed and registered in that economy. The management and control of the licensee shall be bona fide exercised in Hong Kong, China.<sup>140</sup> In Singapore, any foreign acquisition of a designated financial institution requires approval to be sought at the thresholds of 5 percent, 12 percent and 20 percent. Any proposed increase in the stakes of designated financial institutions is judged on a case-by-case basis and on its merits.

An increasing treaty practice is to include corporate social responsibility standards in IIAs. A number of international instruments have been developed by international agencies and organizations with the aim of promoting the positive effects of companies on social progress and avoiding, as far as possible, the negative effects that their operations could generate in host economies. These instruments set out non-binding guidelines for corporate social responsibility. An example where we find this type of provision is in article 9.17 of the TPP.

#### **4.5.2 Strategies for promoting investment in the APEC region**

As a counterpoint to measures restricting investments taken by economies to protect certain sectors or strategic interests, many economies put in place special regimes and/or incentives to attract investment. In 2013, according to UNCTAD's count, 59 countries and economies adopted 87 policy measures affecting foreign investment. Of these, 61 were related to liberalization, promotion and facilitation of investment; and

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138 APEC, *Guide to Investment Regimes of APEC Member Economies*, 7th edn. (Singapore: APEC, 2010).

139 *ibid.*

140 *ibid.*

almost half of the policy measures applied across the board. Most of the industry-specific measures addressed the services sector.<sup>141</sup>

New FDI liberalization measures were reported by a number of APEC economies. Several of them pertained to the telecommunications industry. For instance, Mexico increased the threshold for foreign investment in telecommunications to 100 percent in all areas except radio and television broadcasting, where the limit is 49 percent under certain conditions. Indonesia amended the list of business fields open to foreign investors and increased the foreign investment ceiling in several industries, including pharmaceuticals, venture capital operations in financial services and power plant projects in energy generation. The Philippines amended its Rural Bank Act to allow foreign individuals or entities to hold equity of up to 60 percent in rural banks.

Other measures to promote and facilitate foreign investment have been actively pursued. The Republic of Korea introduced a new system lowering the minimum required area to designate an investment zone. Special Economic Zones have also been popular throughout the region. For instance, China launched the China (Shanghai) Pilot Free Trade Zone, introducing various new policy measures on trade, investment and finance.

Incentives are in increasing use throughout the region as a means to attract new investment and to avoid disinvestment. According to UNCTAD, the main objective of investment incentives is job creation, followed by technology transfer and export promotion, while the most important target industry is information technology (IT) and business services, followed by agriculture and tourism.<sup>142</sup> For example, Malaysia's National Automotive Policy 2014 grants fiscal incentives to attract investments in the manufacturing/assembly of energy-efficient vehicles and their high value added parts and components – in line with the objective of promoting Malaysia as the regional hub for energy-efficient vehicles.

### **4.5.3 Investment and environmental, health or other regulatory objectives**

As the OECD noted, 'a stocktaking exercise has shown that specific references to the environment are included in a limited number of investment agreements. However, the number is increasing'.<sup>143</sup> This emerging trend suggests that economies are increasingly recognizing that there is a need to achieve a balance between foreign investment protection and the right of economies to continue to regulate to address environmental issues. This linkage is explicit in different investment agreements such as the Chile–

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141 UNCTAD, *World Investment Report 2014: Investing in the SDGs: An Action Plan* (New York, UN: 2014).

142 Ibid.

143 OECD, *Harnessing Freedom of Investment for Green Growth: Freedom of Investment Roundtable, 14 April 2011* (Paris: OECD, 2011).

USA FTA, the Chile–Australia FTA and, recently, the TPP, which encodes new perspectives regarding the right to regulate by stating that nothing in the investment chapter:

*shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives.*

This and similar provisions in other FTAs, are derived from article XX, paragraph (b) of the General Agreement on Tariffs and Trade (GATT).

#### **4.5.4 The way forward on investment**

International investment rules are constantly evolving, from the basic provisions included in early bilateral treaties in the 1960s, to the modern and substantive provisions incorporated into modern FTAs, such as the recently signed TPP.

Although there is quite a fragmented international investment law regime, it can be safely said that investment liberalization is a cross-cutting objective for APEC economies. While practice may differ across APEC economies, there is convergence in a number of areas of recent investment treaty practice, especially with respect to substantive obligations in IIAs such as national treatment, MFN, MST, expropriation, transfers and the investor–State dispute settlement mechanism. This convergence may be attributed to the efforts the economies have made to be part of current ‘mega regional agreements’.

There is great potential for the APEC region to build upon recent agreements toward a future FTAAP. An eventual FTAAP has the potential to not only contribute to the harmonization of the international investment regime, but also help to build a deeper integration process creating the most important free trade zone in the world for investments, and for trade in general.

#### **4.6 CROSS-CUTTING STRUCTURAL ISSUES**

In looking at the barriers to trade and investment it is important to acknowledge the significant impact of cross-cutting issues such as transparency and good regulatory practice. Open, effective and transparent markets are vital for ensuring the ongoing growth and prosperity of APEC economies. APEC has done a great deal of good work progressing initiatives related to transparency and good regulatory practice, notably through work on structural reform led by the Economic Committee.<sup>144</sup> However, as APEC moves toward the realization of an eventual FTAAP, there is more that could be

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144 See: APEC, *Joint Statement of the 2015 Structural Reform Ministerial Meeting* (Singapore: APEC, 2015).

done on these cross-cutting issues.

As acknowledged in the 2014 APEC Economic Policy Report on Good Regulatory Practices, building a high-quality regulatory environment is central to promoting free and open trade and investment in the region. At issue is not necessarily the regulation itself, but the way in which it is developed and applied.

#### **4.6.1 Transparency**

As noted in previous sections, the growth of global value chains has highlighted the need to enhance competitiveness by reducing the regulatory burden on business. Tariff liberalization on its own is not enough to ensure the integration of economies into international markets.<sup>145</sup> Businesses in the APEC region have voiced frustration with the multiple layers of bureaucracy and complex and uncertain processes. PECC's 2014 survey of policy opinion leaders found that of 17 issues to be addressed in Asia-Pacific FTAs, transparency in regulations was rated the top priority for business and government respondents in both emerging and advanced economies.<sup>146</sup>

The economic cost of policy interventions, from the point of view of individual business people or companies, can be exacerbated when those policies are implemented in an uncertain or non-transparent manner. The burden of operating in such environments is felt heavily by MSMEs and it could constrain their ability to grow their businesses and participate in global value chains. Consumers could also suffer, facing higher costs for goods and services and fewer choices. Non-transparent policies could make it harder for consumers to make fully informed decisions about the products available to them.

Transparency and public consultation are important components of good regulatory practice. They ensure that essential information about the need for regulation and the impacts of different regulatory proposals are available to decision-makers. Transparency and consultation also promote greater accountability, improve public awareness and understanding, and encourage compliance with regulatory requirements.

There are at least four core elements of regulatory transparency that are of value to policymakers: (i) transparency about what the existing law is; (ii) transparency about the processes adopted for administering the existing law; (iii) transparency about proposed changes to the law; and (iv) transparency about the performance of the law.

In 2002, APEC Leaders recognized the important role that transparency plays in supporting regional economic integration and agreed to the *Statement to Implement APEC Transparency Standards*. The agreed principles called on APEC economics to

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145 M. Helble, B. Shepherd and J.S. Wilson, *Transparency & Trade Facilitation in the Asia Pacific: Estimating the Gains from Reform* (Canberra: Department of Foreign Affairs and Trade, 2007), 1.

146 PECC, *State of the Region 2014–2015* (Singapore: PECC, 2014), 55.

publish all laws and regulations, provide opportunity for consultation or feedback and establish appeal mechanisms for administrative decisions.

The strides taken by APEC member economies over the last decade to enhance e-government, both in terms of government portals for regulatory information and those providing avenues for the provision of government services, have made an important contribution to transparency. The 2014 APEC Actions on Public Consultations on Proposed Regulations in the Internet Era have shared best practice approaches to using e-tools for more effective consultation and feedback loops in regard to regulation.

In addition, APEC initiatives such as the Services Trade Access Requirements (STAR) database <sup>147</sup> and the new APEC Trade Repository<sup>148</sup> have sought to provide greater accessibility and transparency of regulations to businesses and governments in the APEC region.

FTAs in the APEC region commonly build on existing WTO disciplines around transparency and set out some obligations regarding timeliness in notifying of new regulations and accessibility of regulations.

While there have been many useful APEC initiatives, further work can be done to strengthen transparency principles and capacity with a view toward greater regional economic integration, including an eventual FTAAP. The 2011 Good Regulatory Practice in APEC Member Economies Baseline Study noted that, based on their findings, regulatory transparency should be a high priority for additional attention. The study noted that, with regard to the consultation process, there was wide variance in who was consulted, how they were consulted and how feedback was dealt with. Correspondingly it also found little predictability for stakeholders in how they could meaningfully engage in a regulatory process.

#### **4.6.2 Good regulatory practice**

Governments usually use regulations as one of three key levers alongside tax and spending to achieve important outcomes such as social welfare, environmental protection and sustainable inclusive economic growth.<sup>149</sup> Governments should ensure that their regulations are implemented in such a manner that they can determine the objectives are being met and the policy is delivering its intended outcomes.

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147 APEC, *The APEC Services Trade Access Requirements (STAR) Database*, accessed 13 July 2016, <http://servicestradeforum.org/>

148 APEC, *Trade Repository*, accessed 13 July 2016, <http://tr.apec.org/>

149 OECD, 'ASEAN-OECD Good Regulatory Practice Conference 2015: connectivity, competitiveness and regulatory coherence', accessed 13 July 2016, <http://www.oecd.org/gov/regulatory-policy/asean-oecd-good-regulatory-practice-conference-2015.htm>

Studies by the APEC Policy Support Unit have found that there are significant gains to be made in focusing as much effort on behind-the-border reform as on the traditional areas of trade facilitation and liberalization.<sup>150</sup> Services in particular – which account for between 60 and 80 percent of GDP growth in APEC economies – are subject to a diverse range of regulations which can have adverse impacts on trade and investment, leading to a dampening effect on the growth of the economy as a whole. As noted in Section 4.1.1 on services, regulatory measures affecting services were ranked by regional opinion leaders in 2015 as the top impediment to trade. It is for these reasons that the Economic Committee has chosen the topic of ‘structural reform and services’ for its 2016 APEC Economic Policy Report.

Good regulatory practice (often also referred to as GRP) involves processes, systems, tools and methods for improving the quality of regulation.<sup>151</sup> This has been part of APEC’s work since the founding of the Economic Committee in 1994. Since then, good regulatory practice has gained significance through ongoing measured steps in the form of work plans and deliverable targets.

In 1999 APEC Leaders endorsed the APEC Principles to Enhance Competition and Regulatory Reform, which provided four principles to guide good regulatory practice: non-discrimination, comprehensiveness, transparency and accountability. These principles have been built on in successive action plans on structural reform covering regulatory reform, competition policy, public sector governance, corporate governance and strengthening economic legal infrastructure, among other issues.

In recent years one of the key areas of focus for the Economic Committee has been improving the regulatory environment for business growth. A new APEC Ease of Doing Business (EoDB) Action Plan 2016–2018 was endorsed by Leaders in 2015 and sets an aspirational target of a 10 percent improvement in the five key priority areas.<sup>152</sup> Focusing on these Ease of Doing Business targets in conjunction with APEC’s traditional work on trade liberalization and facilitation will contribute significantly to

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150 See: APEC Policy Support Unit, ‘The links between trade, investment and structural reform’ (Singapore: APEC, 2008).

151 Core GRP elements include: (i) mechanisms to assess the impact of regulations, including assessing the need for a regulatory proposal, examining feasible alternatives and relying on the best available evidence (these should extend to a review of existing regulations); (ii) processes for public consultation on the development of new regulation or the review of existing regulation that ensure, among other things, that interested parties in other economies can participate and have their views heard; (iii) publication of information about new regulations, ideally online, to ensure they are publicly accessible; (iv) mechanisms and processes to ensure a whole of government approach to the development of regulations (this would include mechanisms to increase interagency consultation and coordination); (iv) mechanisms to increase cooperation between regulators from different economies.

152 See: APEC, *APEC Leaders’ Declaration* (2015), para. 1e.

behind-the-border wins.

In recent years, international regulatory cooperation workshops have been delivered as part of the Economic Committee's work programme. These workshops aimed to increase awareness among member economies of why international regulatory cooperation is important, the different options that economies can choose from, and the costs and benefits of each option. Some of the objectives of international regulatory cooperation are to lower barriers to trade and investment, and enhance regulatory capability and capacity. The workshops have also involved member economies sharing their practical experiences with international regulatory cooperation.

The APEC Policy Support Unit has also supported work in the area of good regulatory practice, particularly focusing in recent years on the Ease of Doing Business work. It notes that while APEC is doing well internationally in these areas, it is still lagging behind in others. It takes, on average, 21 days to start a business in the APEC region compared with only 12 days in Eastern Europe or Central Asia.<sup>153</sup> The 2011 Good Regulatory Practice in APEC Member Economies Baseline Study found that APEC economies were strong in terms of systematically reviewing regulations for cost and effectiveness, but weaker in terms of a consistent regulatory impact analysis process, meaningful consultation on draft regulation and publication of legislative plans.

#### **4.6.3 Regulatory coherence**

The importance of good regulatory practice is recognized in other fora and international trade policy mechanisms. Taking it one step further is regulatory coherence, which has become a term for 'domestic regulatory systems that interface as seamlessly as possible with the systems of other countries'.<sup>154</sup> It involves the use of GRP in the development, implementation and review of regulation to support domestic policy objectives and also to promote international trade and investment.

Regulatory coherence also requires that policymakers be cognizant of regional trends as well as their own domestic concerns, and the importance of managing the overall stock of regulations as well as the flow of new regulations.

Free trade agreements can have a role in promoting regulatory coherence. In the most recent example, the TPP contains a chapter on regulatory coherence (Chapter 25). It stresses, under article 25.5, the importance of implementing good regulatory practices. It notes that regulatory impact assessment and sharing regulatory information in an easily accessed medium are key aspects of good regulatory practice. It encourages TPP

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153 See: APEC Policy Support Unit, *Research Outcomes: Summary of Research Projects 2014* (Singapore: APEC, 2014).

154 P. Mumford, 'Regulatory coherence: blending trade and regulatory policy', *Policy Quarterly* 10(4) (2014): 8.



Parties to consider each other's regulatory measures, as well as relevant developments in international, regional and other fora when looking at new regulation. It also establishes a TPP-wide Committee on Regulatory Coherence.

All APEC economies are on differing regulatory paths, but further work to improve understanding and best practice in the area of good regulatory practice will assist in deepening regional economic integration and creating the pathway to an eventual FTAAP.

#### **4.7 CONCLUSION**

This chapter has identified a range of measures that affect trade and investment in the Asia-Pacific region, and, where possible, has sought to quantify the frequency of those measures in the APEC region.

Both globally and in the APEC region, applied MFN tariff rates have fallen over time, corresponding with an increase in trade in goods. Progress, however, has not been even. Tariffs on agricultural products (with the exception of beverages and tobacco) have not achieved the same scale of reduction as non-agricultural products; and have in fact increased in the most recent period measured.

As tariff levels have fallen over time, the use of NTMs has become more common. Some NTMs serve legitimate purposes; others act more like traditional trade barriers. Considerable effort has already gone into identifying and reducing trade-distorting NTMs through APEC processes, regional FTAs and the WTO. Even legitimate NTMs impose costs and it is important for governments to find ways to reduce those costs. Analysis suggests that NTMs cost APEC economies three times as much as tariffs<sup>155</sup>.

Services form an increasingly important part of APEC economies' output, including as intermediate inputs in the value chain of traded goods, yet APEC's trade in services (as a percentage of total exports) lags behind the world average. There is a strong link between openness to trade and investment in the services sector and international competitiveness in services. However, restrictions in services trade remain.

Each APEC economy applies its own investment regime, and this extends to restrictions on certain types of investment. The proliferation of IIAs, either in the form of investment treaties or as part of an RTA/FTA, has seen a variety of approaches to the regulation of direct investment develop in the Asia-Pacific region. Investment regimes matter: a major driver of growth in global value chains has been the expansion of multinational enterprises (MNEs) through direct investment. MNE-coordinated global

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155 NZIER (New Zealand Institute of Economic Research), 'Non-tariff measures (NTMs) in the APEC region: literature review and data analysis' (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015).

value chains are estimated to account for around 80 percent of global trade.

It is clear that, despite APEC's efforts in a number of areas related to the measures addressed in this chapter, further work is required to reduce the barriers to trade and investment faced by businesses in APEC and to reduce the costs borne by consumers. The analysis in this chapter should assist APEC economies in identifying issues that can be taken up as part of APEC's ongoing regional economic integration agenda and with a view to the realization of an eventual FTAAP. Capacity building, further exchanges on best practice, and targeted initiatives or work plans will be important elements in developing APEC's collective understanding of the issues presented in this chapter and how to address them.

## **5. STOCKTAKE OF EXISTING RTAs/FTAs IN the ASIA-PACIFIC**

### **5.1 INTRODUCTION**

The chapter begins by evaluating the coverage and ambition of existing free trade agreements (FTAs) and regional trade agreements (RTAs) in the APEC region, noting how they support or diverge from the goals of the multilateral trading system, and identifying recent trends in these agreements.

The latter part of the chapter addresses the so-called ‘spaghetti bowl’ effect, or the impact of overlapping FTAs on trade creation or diversion, an emerging concern as more and more agreements are signed; and presents a study that looks at the issue.

### **5.2 ADVANCING TRADE LIBERALIZATION AND REGIONAL INTEGRATION**

#### **5.2.1 New RTAs and FTAs in the Asia-Pacific**

One goal of the multilateral trading regime embodied in the World Trade Organization (WTO) is to liberalize trade in a comprehensive manner. The effects of RTAs/FTAs often vary in size and distribution depending on the level of liberalization, how integration takes place and the size of the trading partners.<sup>156</sup> While APEC economies have participated in a growing number of RTAs/FTAs in recent years, certain APEC economies have entered into comparatively few agreements in comparison to others, and that disparity could create challenges for an eventual FTAAP. Over time, however, the move toward more ambitious and comprehensive FTAs has advanced regional economic integration.

As of December 2015, APEC member economies have completed 145 RTAs/FTAs, including the recently concluded Trans-Pacific Partnership (TPP), encompassing both agreements within APEC and agreements with economies outside of APEC. Since November 2008, at least 30 new intra-APEC RTAs/FTAs either entered into force or were concluded (Table 5.1; Figure J.1).

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<sup>156</sup> See Appendix K for a review of the literature on these interactions.

**Table 5.1 Intra-APEC trade agreements concluded since 2008**

<b>Agreement</b>	<b>Date of conclusion or entry into force</b>
Brunei Darussalam–Japan	2008
Indonesia–Japan	2008
Australia–Chile	2008
Canada–Peru	2008
China–New Zealand	2008
China–Singapore	2008
Peru–Singapore	2008
Japan–Viet Nam	2009
China–Peru	2009
Malaysia–New Zealand	2009
Chile–Malaysia	2010
Hong Kong, China–New Zealand	2010
Chile–Vietnam	2010
Korea–Peru	2011
US–Korea	2012
Japan–Peru	2012
Australia–Malaysia	2012
Chile–Hong Kong, China	2012
Chile–Thailand	2013
New Zealand–Chinese Taipei	2013
Singapore–Chinese Taipei	2013
Australia–Japan	2014
Australia–Korea	2014
Canada–Korea	2014
China–Korea	2015
Australia–China	2015
Trans-Pacific Partnership (TPP)	2015
ASEAN–Japan	2008
ASEAN–India	2010
ASEAN–Korea	2010
ASEAN–Australia–New Zealand	2010
Regional Comprehensive Economic Partnership (RCEP)	ongoing

This list is not exhaustive and does not use the agreements' formal names.

### 5.2.2 WTO+ and WTO-X

Based on a review of RTAs/FTAs in the region, these arrangements have evolved to include deeper integration in areas covered by WTO agreements (WTO+

commitments)<sup>157</sup> and address policy areas not covered in WTO agreements (WTO-X commitments).<sup>158</sup>

Recent RTAs/FTAs concluded by APEC members contain substantial WTO+ and WTO-X commitments (Figure J.2). More recent RTA/FTAs include WTO+ type issues such as greater liberalization in services (e.g. through ‘negative listing’ for commitments), deeper intellectual property protection, and enhanced standards. They also cover WTO-X issues such as e-commerce and digital trade, additional regulatory provisions in certain sectors, sections on competition and government procurement, and binding obligations in areas such as labour or the environment.

### **5.2.3 Levels and sectors of coverage**

In 2014, around 44 percent of APEC’s total exports took place with FTA partners while 39 percent of the region’s imports did the same (Figure J.3).<sup>159</sup> Upon implementation of the TPP, these numbers will increase significantly. The various agreements vary in the level of coverage for goods, services, investment and behind-the-border issues.

#### ***5.2.3.1 Tariff reductions: scope and speed of liberalization***

The majority of recent bilateral trade agreements reduce at least 90 percent of tariff lines to zero within five years of the agreement’s entry into force (Figure J.4). A smaller number of bilateral trade agreements liberalize at a slower pace, while other agreements take a mixed approach.

For example, Chile in its bilateral agreements with Australia; Hong Kong, China; and

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<sup>157</sup> WTO+ areas include: industrial goods; agricultural goods; customs administration; export taxes; sanitary and phytosanitary (SPS) measures; state-trading enterprises; technical barriers to trade; countervailing measures; anti-dumping; State aid; public procurement; investment measures (WTO Agreement on Trade-Related Investment Measures, or TRIMs); services (General Agreement on Trade in Services, or GATS); and, intellectual property rights (WTO Agreement on Trade-Related Aspects of Intellectual Property Rights Agreement, or TRIPS), and GATS are additional provisions on traditional trade issues, which is what classifies these as WTO+ areas. Agricultural goods contain additional provisions to traditional agriculture WTO standards.

<sup>158</sup> WTO-X provisions include: anti-corruption; competition; environment; intellectual property rights (IPR); investment measures; labour; movement of capital; consumer protection; data protection; agriculture; approximation of legislation; audiovisual; civil protection; health; human rights; illegal immigration; illicit drugs; industrial cooperation; information society; mining; money laundering; nuclear safety; political dialogue; public administration; regional cooperation; research and technology; innovation policy; cultural cooperation; economic policy dialogue; education and training; energy; financial assistance; small and medium-sized enterprises (SMEs); social matters; statistics; taxation; terrorism; and visa and asylum issues.

<sup>159</sup> APEC Policy Support Unit, ‘APEC in charts 2015’ (Singapore: APEC, 2015).

Malaysia reduces virtually 100 percent of its tariff lines to zero within five years of the agreement's entry into force. However, in its bilateral agreement with Viet Nam, Chile takes a more gradual approach and reduces only 75 percent of its tariff lines to zero within five years. Chinese tariffs on goods imported from New Zealand and Singapore are reduced at a much quicker pace than goods from Peru. Australia reduces 100 percent of its tariff lines on imports from Chile within five years, but reduces only 86 percent of tariff lines on Korean imports within the same time period.

Agricultural products represent a particular sector often excluded from zero tariff agreements, as seen recently in agreements between Australia–Korea (rice), and Chile–Viet Nam (wine, dairy and fruits, among others).

### ***5.2.3.2 Services coverage: negative and positive lists***

Of the 30 bilateral and regional trade agreements concluded since 2008, 27 include a chapter on services, but there is a diversity of approaches in those chapters (Table J.1).

In the WTO, services commitments are scheduled on a positive-list basis so that obligations apply only to those services sectors and modes of supply that a WTO member has listed in its schedule of commitments. In many FTAs, starting with the North American Free Trade Agreement (NAFTA) and continuing with the vast majority of FTAs signed by the US and Canada, services commitments are scheduled on a negative-list basis so that all sectors are covered by the obligations of the agreement unless an exception has been specifically identified and listed. Other FTAs in the region also adopt the negative-list approach.

Furthermore, commitments undertaken in the region's FTAs typically relate to more than simply market access (narrowly addressed in the General Agreement on Trade in Services, or GATS), national treatment or most favoured nation (MFN) treatment. They also extend to additional obligations, such as performance requirements and board of directors requirements, and tend to provide broader sectoral coverage than that provided under the typical GATS classification scheme.<sup>160</sup>

Of the 27 agreements that include a separate chapter on services, 14 use a positive-list approach while 12 use a negative-list approach. The Australia–China FTA uses a hybrid approach. Member economies such as Japan use a positive list in some agreements (Indonesia; Viet Nam), and a negative list in others (Peru; TPP). Economies like Chile and Australia follow the same pattern as Japan, relying on a positive approach in some agreements and a negative approach in others. For Viet Nam and Malaysia, the TPP represents their first significant negative-list commitments (Table J.1). The 2011 World

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<sup>160</sup> The typical classification scheme in GATS schedules is reflected in a document known as the W.120, which is based on the provisional Central Product Classification code (CPC rev. 1). The W.120 is close to 25 years old.

Trade Report published by the WTO clearly demonstrates that economies, including non-APEC economies, significantly improve upon GATS commitments in their subsequent RTAs/FTAs (Figure J.5).

Most FTAs that cover services provide additional rights for service suppliers over those provided for under GATS, and beyond the simple expansion of sectoral coverage. Several FTAs, notably the TPP, go beyond existing WTO and FTA commitments. For example, there are additional GATS-plus obligations related to services-related investment, including providing a minimum standard of treatment for investments (including protections against denial of justice); barring specified performance requirements (including local content requirements and technology transfer requirements); and ensuring that investors have the ability to appoint senior managers without regard to nationality or undue restrictions on an investor's control over its investments related to the appointment of board members. In the area of domestic regulation, the TPP enhances the rules for fair and transparent processing of licensing applications.

Many FTAs also contain service-sector specific disciplines, such as those covering telecommunications or financial services, which address regulatory issues as well as market access. Certain FTAs in the region (e.g. China–Peru and China–Australia) incorporate the GATS Telecommunications Annex and Basic Telecommunications Reference Paper disciplines, *mutatis mutandis*, thus making them legally binding within the text of the agreement.<sup>161</sup> However a number of new agreements, including the TPP, set out deeper disciplines in the area of licensing, submarine cable landing access, transparency (notice and comment periods for regulatory rulemaking), judicial review of decisions, mobile termination rates, and resale, among others.<sup>162</sup>

### ***5.2.3.3 Services coverage: movement of natural persons/temporary entry***

The majority of FTAs that cover services also include GATS-plus commitments on 'mode 4', that is, movement of natural persons/ temporary entry, for example by providing for broader categories for temporary entry than contained in GATS market access schedules. Many FTAs also include WTO+ obligations in regard to timely processing of applications, prompt supply of information on the progress of visa applications and transparency of procedures and requirements.

The 2010 ASEAN–Australia–New Zealand FTA illustrates how RTAs/FTAs in the APEC region have dealt with commitments on the movement of natural persons. The FTA provides WTO+ market access commitments accompanied by additional

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<sup>161</sup> See: Ch. 8, Art. 105(8) of the China–Peru FTA.

<sup>162</sup> See generally all US FTAs since 2003 and the TPP. The China–Korea FTA has a separate chapter on telecommunications (Chapter 10), but it does not contain the same degree of obligations as those in US–Korea FTA.

commitments around transparency of processes, prompt processing and reasonable fee structures. Each Party's mode 4 commitments are listed in schedules. These schedules outline the categories of natural persons to be covered, along with the conditions and limitations governing those commitments, including the permitted length of stay and the criteria for admission under different visa categories.

In addition, the TPP's chapter on temporary entry for business persons aims to ensure efficient visa processing procedures and transparency in the application process related to the requirements for temporary entry. The TPP chapter provides greater transparency and opportunities for enhanced cooperation among the TPP countries on these issues.

#### **5.2.3.4 E-commerce**

Many recent FTAs address the area of electronic commerce. A growing area of commerce, and of particular importance to Asia-Pacific, estimations indicated that e-commerce sales in 2015 were going to represent 33.4 percent of total sales.<sup>163</sup> Asia-Pacific trade agreements have been leading global efforts to include e-commerce sections. The WTO has yet to address e-commerce in any substantial manner,<sup>164</sup> beyond a political commitment by Members not to impose customs duties on electronic transmissions which is extended every two years at the WTO Ministerial Conferences.

Beginning with the US–Singapore and US–Chile FTAs, disciplines in the area of e-commerce have become features of FTAs. Among the 30 assessed RTAs/FTAs, 14 contain separate chapters on e-commerce. For example, the China–Peru FTA does not contain a separate set of disciplines on e-commerce, nor does the Japan–Peru FTA, but the China–Korea FTA has a separate chapter on e-commerce. Of the FTAs that have e-commerce chapters, 12 explicitly call upon Parties to prohibit customs duties on electronic transmissions, and seven agreements contain provisions on the non-discrimination of digital products.

In the China–Korea FTA and the China–Australia FTA, the Parties simply agreed to maintain the current 'WTO practice' on customs duties with respect to electronic transmissions, and added some provisions on electronic authentication and signatures, protection of personal information, and paperless trading. The US–Korea, US–Peru and US–Australia FTAs, as with all recent US FTAs, bound parties to not impose customs duties on digital products, as well as to accord non-discriminatory treatment to digital products from the other party.<sup>165</sup> The Australia–Chile FTA, concluded in 2008, includes

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<sup>163</sup> eMarketer, *Worldwide Ecommerce Sales to Increase Nearly 20% in 2014*, 23 July 2014.

<sup>164</sup> The Work Programme on Electronic Commerce in the WTO was established in 1998 but has yet to deliver anything meaningful in this area. It is a non-negotiating programme which has raised awareness about issues associated with trade and e-commerce.

<sup>165</sup> In the TPP, digital product is defined as a computer programme, text, video, image, sound recording or other product that is digitally encoded, produced for commercial sale or distribution, and that can be



a separate chapter on e-commerce and commits to a moratorium on customs duties on electronic transactions and prohibits discrimination against electronic commerce to the maximum extent possible. However in Chile's subsequent agreements with Malaysia; Viet Nam; Hong Kong, China; and Thailand, e-commerce was not included. The Canada–Peru FTA, concluded in 2008, and the Korea–Peru FTA included a chapter on e-commerce that prohibits customs duties on trade in digital products, but e-commerce is not covered in Peru's subsequent agreements with Singapore, China or Japan. The Korea–US FTA and numerous agreements involving Canada include provisions for cross-border data flows and privacy protections. Each of the eight most recent agreements include chapters on e-commerce, but are not uniform in their approach (Table J.2).

The TPP addresses e-commerce more broadly than in the past agreements referenced above. It addresses cyber security, prohibits the imposition of customs duties on digital products, and deters forced localization of data and servers. The TPP also includes consumer protections while ensuring that companies and consumers can access and move data more freely.

#### ***5.2.3.5 Technical barriers to trade***

Many FTAs in the region cover technical barriers to trade (TBT) given their potentially pernicious effect on trade in goods. While some build upon the WTO TBT Agreement, many simply reiterate the provisions from that agreement. Dealing with TBT has been a priority of ASEAN economies since the ASEAN Consultative Committee for Standards and Quality was formed in 1992 with a goal of assisting ASEAN in creating a single market. ASEAN has already begun, where possible, to adopt WTO TBT standards.

In general, the TPP TBT chapter goes beyond the WTO TBT agreements in the area of conformity assessment, regulatory transparency, and regulatory cooperation, including provisions related to specific sectors. The TPP requires (as opposed to encourages) national treatment for conformity assessment bodies. It also requires regulatory authorities to be more transparent in their development of technical regulations. For example, the TPP TBT chapter ensures a reasonable interval (normally six months) between publication of regulations and entry into force so that businesses have sufficient time to meet the new requirements. Finally, the TPP has seven sectoral annexes that establish obligations related to the regulation of specific sectors. The seven sectoral annexes are: wine and distilled spirits; proprietary formulas for certain food products; information and communications technology; cosmetics; medical devices; pharmaceuticals; and organics. These sectoral annexes go beyond what has been

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transmitted electronically. Digital product does not include a digitized representation of a financial instrument, including money.

covered in existing FTAs in the region.

### **5.2.3.6 Investment**

Provisions encouraging foreign investment have become increasingly popular in FTAs, liberalizing the flow of capital and enabling broader growth. Economies in the Asia-Pacific have long been party to trade agreements addressing measures on investment openness, and some have prescribed measures on corporate social responsibility. In addition to previous commitments, 17 of the 30 most recent trade agreements between APEC economies have included separate chapters on investment. While some chapters simply reaffirm commitments made in the WTO Agreement on Trade-Related Investment Measures (TRIMs), other agreements have adopted innovative measures to promote and protect investment in foreign markets.

The older trade agreements examined, such as the Brunei Darussalam–Japan FTA, simply affirmed that the article of performance requirement could not be inconsistent with TRIMs. The Canada–Peru FTA, however, builds upon TRIMs commitments and contains provisions on national treatment, MFN treatment, senior management, boards of directors, and performance requirements. The New Zealand–Chinese Taipei Economic Cooperation Agreement and the Korea–Peru FTAs include investment provisions prohibiting performance measures and restrictions on senior management. Nine of the twelve most recent RTAs/FTAs in APEC contain investment provisions and approaches to expand investment are becoming more common.

The TPP contains a negative-list approach to investment measures, protects the intellectual property of foreign investors and prohibits technology sharing requirements. The TPP also includes investor–State dispute settlement procedures. In general, the TPP and other recent FTAs are more prescriptive of the rights of parties, ensuring openness and ease of settlement where disputes arise.

### **5.2.3.7 State-owned enterprises**

State-owned enterprises are common throughout APEC and globally; generally in sectors where public financing provides stability to markets. However, such enterprises may present unique challenges in terms of fair competition for foreign companies in a given market. State-owned enterprises in certain cases may distort global and domestic markets, block foreign exports and undercut foreign workers with subsidies and preferential regulatory treatment. Some recent RTAs/FTAs have attempted to outline fair policies on state-owned enterprises and competition, without eliminating the possibility of public investment in industries domestically.

To date, the APEC region has largely refrained from addressing the negative impact of state-owned enterprises in RTAs/FTAs. Competition policies and measures aimed at levelling the playing field for companies competing with state-owned enterprises have

been incorporated in recent FTAs. However, the TPP is the only of the 30 most recent RTAs/FTAs in the Asia-Pacific with a separate chapter addressing state-owned enterprises as a new trade and investment challenge.

The TPP chapter expands on WTO principles by applying rules on subsidies to the services exports of state-owned enterprises and to the operations of state-owned manufacturers outside their home territory. It also broadens and strengthens non-discrimination rules to apply to all commercial purchases and sales made by state-owned enterprises wherever they operate in the TPP trade area. Consistent with the practice in other high-standard agreements, the chapter is fully enforceable through dispute settlement.

### *5.2.3.8 Sanitary and phytosanitary measures*

Demand for high-quality food will increase in the Asia-Pacific in coming decades. By 2030, the Asia-Pacific region will be home to 3.2 billion middle-class consumers, which will account for the largest consumer base for staple grains, fresh fruit and vegetables, dairy products, and meats in the world. Increasingly, scientific advancements are allowing for safer food inspection practices and are helping to assure a consistently high standard for animal and agricultural products throughout the APEC region and global markets.

To begin addressing the coming demand, many recent RTAs/FTAs have included sanitary and phytosanitary (SPS) measures, expanding interconnectivity of food safety and supply chains in the Asia-Pacific. In particular, 12 of the 30 most recent RTAs/FTAs examined contained separate chapters on SPS measures, beginning with the Canada–Peru FTA, which affirmed the 1995 WTO SPS Agreement and expanded upon previous WTO commitments.

The Australia–Korea FTA contained an affirmation of previous commitments to the WTO SPS Agreement, as well as new steps on technical meetings and cooperation on SPS measures. The New Zealand–Chinese Taipei Economic Cooperation Agreement also affirmed the WTO SPS Agreement, but additionally set renewed standards for equivalence and adapting to regional conditions, and offered methods for verification and certification. The China–Peru FTA separately addressed SPS measures, affirming many WTO commitments and presenting unique approaches in other sectors, similar to other recent trade agreements in the Asia-Pacific. While each of the agreements addressing SPS measures had similarities, none were identical in approach. As a mechanism to protect farming and agricultural supply chains and standards, these trade agreements, as well as others not specifically listed here, have promoted safe food supplies above the requirements of past agreements and WTO precedent.

The TPP addresses SPS measures through increased use of innovative testing methods and standards. It promotes risk assessments through scientific and transparent

mechanisms to determine food supply chains in the TPP region. Additionally, the TPP provides for numerous other unique measures, including a new consultative measure for swift resolution of disputes on importation.

#### ***5.2.3.9 Labour***

Labour provisions are included in three of the ten recently concluded RTAs/FTAs in the APEC region. These provisions commit Parties to adopt and maintain in national laws internationally recognized labour rights, in order to ensure a level playing field for workers and businesses, higher paying jobs, minimum wages and better occupational safety and health.

For example, the Canada–Korea FTA contains provisions guaranteeing internationally recognized labour rights, including the right to freedom of association and collective bargaining, the elimination of all forms of forced or compulsory labour, the effective abolition of child labour, the prohibition on the worst forms of child labour, and the elimination of discrimination in respect of employment and occupation. The agreement also specifies acceptable minimum employment standards, with provisions for protection with regard to minimum wages, occupational injuries or illnesses, and non-discrimination in respect of working conditions for migrant workers.

The most recent regional attempt to strengthen labour protections in trade agreements has been the TPP. It goes beyond previous commitments for many of its participants: in addition to the abovementioned internationally recognized labour rights, it includes acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health. These provisions are all enforceable and backed by trade sanctions.

#### ***5.2.3.10 Environment***

Over the past two decades, APEC economies have increasingly used FTAs to advance environmental protection. While early FTAs between APEC economies, such as the ASEAN Free Trade Area of 1992, include some environmental provisions, the 1994 NAFTA was the first to include a parallel environmental agreement, the North American Agreement on Environmental Cooperation. The agreement includes a range of environmental obligations, such as commitments to pursue high levels of environmental protection and effectively enforce environmental laws, as well as a framework for trilateral environmental cooperation and mechanisms for dispute settlement, public participation and public accountability. It was an important early benchmark in environmental commitments in trade agreements.

Many recent FTAs negotiated by APEC economies include environmental provisions in dedicated chapters within the FTA or in parallel environmental agreements. Core obligations continue to focus on effective enforcement of environmental laws and the

pursuit of high levels of environmental protection, with some FTAs including provisions prohibiting parties from derogating from these environmental laws to promote trade or attract investment. Beyond the core obligations, some FTAs, like the New Zealand–China FTA, the US–Korea FTA and the Canada–Korea agreement, have included frameworks for environmental cooperation, capacity building or technical assistance. Certain FTAs, such as the US–Korea FTA, also provide that all environmental obligations are subject to the same dispute settlement procedures as commercial obligations, while others establish a separate dispute settlement mechanism for environmental provisions.

Some FTAs have also expanded into new issue areas linking trade and environment, with commitments in areas such as promoting corporate social responsibility or trade in environmental goods and services. The TPP builds on past agreements, and includes some of the most ambitious environmental commitments in an FTA to date. In addition to core commitments on environmental governance, it reaffirms Parties' commitments to implement Multilateral Environmental Agreements they have adopted, and includes commitments to combat illegal fishing, illegal logging and illegal wildlife trade; to prohibit certain harmful fisheries subsidies; and to promote conservation of the ozone layer and the marine environment. FTAs like the TPP offer opportunities for APEC members at all levels of development to contribute to the overarching goal of responsible, sustainable growth that increase both environmental and economic prosperity throughout the region.

#### ***5.2.3.11 Intellectual property***

As a region, APEC is a global leader in innovative economic and business developments. As such, strong and effective protection and enforcement of intellectual property rights (IPR) is necessary for APEC's continued economic growth. Further, small and medium-sized enterprises (SMEs) rely on IPR to protect innovative ideas and designs from burdensome and costly legal challenges. SMEs and developing economies gain the most from strong IPR protections in RTAs/FTAs. In certain RTAs/FTAs, APEC economies have implemented measures to protect patents, trademarks, copyrights, etc. and to prevent theft of trade secrets, including cyber theft of trade secrets. This is a core discipline of the TPP.

IPR protections remain one of the most impactful provisions of modern trade agreements. The China–Korea FTA provides for non-discriminatory protections of intellectual property. Further, as with many chapters in RTAs/FTAs around the APEC region, China and Korea confirmed a commitment to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), as well as other international norms. The Canada–Korea FTA contains provisions dealing with public health concerns and updates to TRIPS. In addition, national treatment, information disclosure that does not impede law enforcement, and trademarks are covered in this agreement, among

other strong IPR provisions.

In the most recent example, the TPP includes comprehensive provisions for IPR protections. The TPP covers patents, trademarks, copyrights, industrial designs, geographical indications, trade secrets and other forms of intellectual property; enforcement of IPR; and areas in which Parties agree to cooperate. The TPP sets strong regional standards for the protection and enforcement of IPR, reflecting and building upon TRIPS.

#### ***5.2.3.12 Government procurement***

Governments represent some of the largest purchasing entities in many APEC economies. Therefore, many APEC economies have adopted trade principles in line with the Bogor Goals for government procurement. As long as governments remain significant buyers of goods and services in APEC economies, strong procurement provisions representing a commitment to the Bogor Goals will remain part of high-quality and comprehensive trade agreements.

Recent RTAs/FTAs throughout the APEC region have incorporated chapters on government procurement. These chapters vary in scope, yet they address the fundamental concepts of transparency and non-discrimination in covered procurements. The New Zealand–Chinese Taipei Economic Cooperation Agreement includes a substantial chapter on government procurement utilizing a positive-list approach for covered government entities and applying to nearly all goods and services and government construction procured by these agencies. The Japan–Australia Economic Partnership Agreement guarantees suppliers access to government procurement markets, and contains transparency commitments to facilitate participation in procurement processes. The agreement includes minimum standards for public notices, requirements limiting conditions that can be imposed on tenders as well as reasonable tender timelines.

The TPP includes many provisions relating to government procurement. There are core commitments on national treatment, which requires that Parties extend to bidders on covered government procurement contracts the same treatment as domestic bidders. The TPP also specifies transparency procedures, including publication of information, minimum timelines for phases of the tender process, and domestic review mechanisms for bidders to appeal tenders they believe were conducted in a manner inconsistent with the obligations. The TPP also sets forth guidelines on non-discriminatory technical specifications and conditions for participation in procurement. Its government procurement chapter also requires that each Party has measures to address corruption in its government procurement. These procurement commitments will enhance good governance and promote greater value and decreased corruption in government purchasing. For some Parties, such as Viet Nam and Malaysia, these government procurement commitments are the first of their kind with other Parties.

### ***5.2.3.13 Competition policy***

Modern RTAs/FTAs throughout the APEC region have addressed the persistent challenge of fair competition policies for international companies. Non-discriminatory treatment through strong competition policies levels the playing field for foreign workers and businesses, increasing trade and improving competitive prices in the marketplace. As the importance of trade to the growth of the global economy increases, fair competition policies are necessary instruments of high-quality RTAs/FTAs.

Competition policy provisions have taken many forms in recent RTAs/FTAs throughout the APEC region. The China–Korea FTA includes numerous references to fair competition practices. It addresses, for example, the practice of pricing services in a manner that is likely to unreasonably restrict competition, such as predatory pricing. The competition chapter in the Korea–Australia FTA seeks to accelerate the implementation of policies that promote competition, economic efficiency and consumer welfare, and cooperation. Each Party is to address anti-competitive practices in its territory and promote policies supporting competitive neutrality. The Parties specifically recognize the importance of ensuring that governments at all levels do not provide competitive advantages to any state-owned enterprise. This, and other RTAs/FTAs in the region have built a strong platform for competition policy provisions in trade agreements for the APEC region.

Building upon previous work, the TPP is the latest example of a high-quality and comprehensive agreement, incorporating a chapter with substantial provisions covering competition policy. This chapter will help ensure that Asia-Pacific markets have a foundation in principles of fair competition, consumer protection, and transparency through rules that require TPP partners to maintain legal regimes that prohibit anti-competitive business conduct, as well as fraudulent and deceptive commercial activities that harm consumers. The TPP's provisions ensure that effective competition and consumer protection laws are implemented, and provide for a high level of procedural fairness in competition law enforcement proceedings. TPP Parties are also required to provide a private right of action to seek redress for injury caused by violations of competition policy provisions. It is the first agreement in the region to require Parties to adopt laws proscribing fraudulent and deceptive commercial activities.

### ***5.2.3.14 Customs and administration procedures***

Customs and administration procedures are traditional trade provisions that have received heightened attention due to developments in technology for streamlining the customs process. To fully achieve the Bogor Goals, fast and efficient clearance through customs, as well as procedures to ensure compliance with import and export laws, is increasingly important to APEC economies. As such, economies have undertaken numerous agreements to strengthen existing commitments on customs and administration procedures. Unnecessary customs and import procedures pose great

challenges to exporters, specifically to SMEs through additional cost, time and uncertainty. Some APEC economies have taken great strides to address these challenges through recent RTAs/FTAs.

Under the China–Korea FTA, a separate customs chapter outlines measures to simplify and harmonize the customs procedures of the signatories. This agreement also strives to address trade facilitation issues by promoting cooperation between customs authorities. The New Zealand–Chinese Taipei Economic Cooperation Agreement contains provisions to ensure predictability, consistency and transparency in the application of customs laws. This agreement ensures that each customs administration shall provide a single point, electronic or otherwise, through which traders may submit required information. The Korea–Australia FTA provides for the use of automated systems and a paperless trading environment. Additionally, customs authorities are directed to focus resources on shipments of high-risk goods to facilitate the clearance and possible early release of low-risk goods.

The TPP further modernizes customs agreements by taking additional steps from previous agreements, ensuring that trade in goods among Parties is efficient. With effective and transparent procedures that help move goods as quickly as possible across borders, TPP is heightening the commitment to the Bogor Goals for Parties. This is particularly important to SMEs, which often find complex customs and border procedures among the most serious obstacles to increasing their exports. TPP Parties commit to publish all customs laws, regulations and procedures on the Internet to increase transparency. They also provide expedited customs procedures for express shipments and expands cooperation among Parties on preventing customs offenses.

### **5.3 ADDRESSING THE SPAGHETTI BOWL EFFECT**

The complicated web of overlapping FTAs could lead to high costs for verifying rules of origin (ROO). These additional administrative costs and the resulting trade diversion effect may offset the initial welfare gains of FTAs. Estimates put the administration costs at 3 percent of the value of goods traded for the European Free Trade Association; between 4–4.5 percent and 6–8 percent for other European Union schemes; and around 6 percent in the case of NAFTA.<sup>166</sup> To reduce the trade diversion effect of strict ROOs, regime-wide ROOs such as ROOs with diagonal or full cumulation can be applied to complement restrictive ROO with bilateral cumulation.

This section examines the difficulties presented by complex and different ROO requirements in FTAs – termed the ‘spaghetti bowl’ effect – in the APEC region by

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<sup>166</sup> E.M. Medalla, ‘Rules of origin: Regimes in East Asia and recommendations for best practice’ (discussion paper no. 2008-19, Manila: Philippine Institute for Development Studies, 2008); as surveyed by: I. Park and S. Park, ‘Best practices for regional trade agreements’, *Review of World Economics (Weltwirtschaftliches Archiv)* 147(2) (2011): 249–68.



estimating the trade creation and diversion effects, incorporating the most recent data and using a gravity regression analysis.<sup>167</sup> In the analysis, three ROO cumulation schemes are considered: (i) bilateral cumulation;<sup>168</sup> (ii) diagonal cumulation;<sup>169</sup> (iii) full cumulation.<sup>170</sup>

### 5.3.1 Data<sup>171</sup>

We quantitatively estimate the trade effect of the three different ROO cumulation schemes by using a modified gravity equation with panel data on 252,159 country pairs covering 179 countries for 24 years from 1990 to 2013.

The data for the gravity model in this section come from various sources. The trade flow data come from the *Direction of Trade Statistics* by the International Monetary Fund. Nominal value of bilateral trade is measured by the sum of bilateral exports. These data are deflated by gross domestic product (GDP) deflators to generate real trade flows. The data for real GDP at purchasing power parity (PPP) are from the World Bank's *World Development Indicators*. Data on country pair-specific variables, such as distance, colonial ties, common land border, and common languages, are obtained from the Centre d'Etudes Prospectives et d'Informations Internationales (CEPII). Information on various FTAs is obtained from the World Trade Organization.

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<sup>167</sup> There are various factors in ROO incurring transaction costs in international trade but it is almost impossible to incorporate all of them in an analytical model. Thus, this study adopts one of the most widely used measures on the restrictiveness of ROO, cumulation. By comparing the trade creation effects of each cumulation, the spaghetti bowl effect can be estimated as the opportunity cost of the restrictiveness of cumulation.

<sup>168</sup> Bilateral cumulation operates between two countries where an FTA or autonomous arrangement contains a provision allowing them to cumulate origin. This is the basic type of cumulation and is common to all origin arrangements. Only originating products or materials can benefit from it. See: [http://ec.europa.eu/taxation\\_customs/customs/customs\\_duties/rules\\_origin/preferential/article\\_774\\_en.htm](http://ec.europa.eu/taxation_customs/customs/customs_duties/rules_origin/preferential/article_774_en.htm)

<sup>169</sup> Diagonal cumulation operates between more than two countries provided they have FTAs containing identical origin rules and provision for cumulation between them. As with bilateral cumulation, only originating products or materials can benefit from diagonal cumulation.

<sup>170</sup> Full cumulation allows the parties to an agreement to carry out working or processing on non-originating products in the area formed by them. Full cumulation means that all operations carried out in the participating countries are taken into account. While other forms of cumulation require that the goods be originating before being exported from one party to another for further working or processing, this is not the case with full cumulation. Full cumulation simply demands that all the working or processing in the list rules must be carried out on non-originating materials in order for the final product to obtain origin.

<sup>171</sup> Technical note on the methodology and estimation techniques are available upon request.

### 5.3.1 Empirical results

#### 5.3.1.1 Gravity regression analysis

**Table 5.2 Spaghetti bowl effects of restrictive ROO in general**

	Full cumulation	Diagonal cumulation	Bilateral cumulation
<b>Estimated coefficients</b>	0.451	0.152	0.014
<b>Trade effects (%)</b>	57.0*	16.4	1.4
<b>Spaghetti Bowl Effects: Opportunity Costs (% deviation)</b>			
<b>Full vs diagonal</b>		40.6	
<b>Full vs bilateral</b>			55.6
<b>Diagonal vs bilateral</b>			15.0

\*Since  $\exp^{0.451}=1.570$ , an increase from zero (no membership) to one (membership) in the *FTA\_Full* dummy variable raises bilateral trade by 57.0 percent.

Table 5.2 compares the trade effects by cumulation schemes. When cumulation rules are more comprehensive, the positive impact on trade creation is greater. If a full cumulation scheme is applied, trade would increase by 57 percent. The trade creation impact would be smaller with diagonal and bilateral cumulation schemes: trade would increase by only 16.4 percent and 1.4 percent respectively.

When we factor in the concept of opportunity cost, our results can be interpreted as follows. The spaghetti bowl effect of restrictive ROO is 55.6 (or 15.0) percent loss of trade creation effect as we compare the *FTA\_Full* (or *FTA\_Diagonal*) with *FTA\_Bilateral* ( $55.6=57.0-1.4$  or  $15.0=16.4-1.4$ , respectively). The FTA with diagonal cumulation is also costly compared to the one with full cumulation by incurring 40.6 ( $=57.0-16.4$ ) percent loss of trade creation effect. That is, the spaghetti bowl effect of restrictive ROO ranges from a low of 15.0 percent to a high of 55.6 percent loss of intra-bloc trade.

#### 5.3.1.2 Hypothetical analysis

Table 5.3 reports the likely impacts of an FTAAP on intra-APEC trade volume by the

three cumulation schemes.<sup>172</sup> We found that there is no significant difference among the results of different estimation techniques. When we compare the trade creation effects of full and diagonal cumulation with that of restrictive bilateral cumulation, full (diagonal) cumulation creates approximately 54.4 percent (14.5 percent) more trade on average compared with bilateral cumulation.

**Table 5.3 Effect of the FTAAP on intra-APEC trade by cumulation schemes: ratio (%) to bilateral**

1990–2013 on average			
	Random effect estimation (1)	Fixed effect estimation (2)	Simple average ((1)+(2))/2
<b>Full</b>	54.1	54.9	54.4
<b>Diagonal</b>	14.3	14.9	14.5

### 5.3.2 Summary

In this section, we conducted a gravity regression analysis in order to quantitatively estimate the trade creation and diversion effects of different ROO cumulation schemes (bilateral, diagonal, and full cumulation) for FTAs around the world and the APEC-wide FTA, the FTAAP. For the FTAs around the world, we found that:

- (i) Full cumulation is optimal as it results in the biggest intra-bloc trade.
- (ii) The spaghetti bowl effect of restrictive ROO is estimated to incur 55.6 (15.0) percent loss of trade creation effect when compared with full cumulation (diagonal cumulation).
- (iii) FTAs with diagonal cumulation are also estimated to cause 40.6 percent loss in trade creation in contrast to FTAs with full cumulation.

The results suggest that simplification of ROO across trade agreements could address the spaghetti bowl effect by reducing transaction costs, and contribute to creating more

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<sup>172</sup> We calibrated the bilateral trade by applying the estimated coefficients of the gravity regression analysis for all the 20 member economies of the FTAAP, except for Papua New Guinea. We used the average values of dependent variables from 1990 to 2013 to calibrate the bilateral trade volume. We also calibrated the effect by applying the estimated coefficient with both random effect and fixed effect estimation techniques.

trade in the APEC region.

## **5.4 CONCLUSIONS**

This chapter evaluates the level of coverage and ambition of various issues in existing RTAs/FTAs in the region. It identifies how they complement the multilateral trading system, and in some instances go beyond the existing coverage of the WTO. The chapter examines the impact of overlapping RTAs/FTAs in the region, which creates the so-called ‘spaghetti bowl’ effect, creating challenges to the eventual realization of the FTAAP. In addition, the chapter identifies trends and provisions included in emerging various RTAs/FTAs and outlines areas where capacity building and convergence would be beneficial to APEC economies in order to advance toward an eventual FTAAP represented by the highest standard and most comprehensive of RTAs/FTAs.

## **6. STOCKTAKE OF APEC INITIATIVES AND OUTCOMES RELEVANT TO AN FTAAP**

### **6.1 INTRODUCTION**

Since its establishment, APEC has been making a variety of efforts to promote trade and investment liberalization and facilitation in the Asia-Pacific region. A non-exhaustive list of important APEC initiatives and outcomes relevant for the FTAAP will be reviewed in this section.

### **6.2 THE BOGOR GOALS**

The Bogor Goals were adopted in 1994 with the aim of deepening trade and investment liberalization in APEC and speeding up regional economic integration. Through the Osaka Action Agenda in 1995, APEC set out the roadmap to achieve the Bogor Goals through reducing trade and investment barriers in the region and promoting the free flow of goods, services and capital among APEC economies.

Recognizing the diversity of APEC member economies, APEC put forward differentiated timelines for an open and free trade and investment liberalization system: by 2010 for developed economies and by 2020 for developing economies. APEC adopted the preparation of individual action plans (IAPs) and collective action plans (CAPs), embodying the concepts of voluntarism, consensus and flexibility. The IAPs and CAPs describe what APEC economies and working groups are doing and are planning to do in order to get closer to the Bogor Goals. In this regard, the FTAAP is one of a range of avenues for achieving the Bogor Goals.<sup>173</sup>

In 2010, an assessment of APEC's progress toward the Bogor Goals showed that substantial progress had been made by the developed and developing economies in the region, but more work needed to be done en-route to 2020. Therefore, APEC members agreed to conduct a periodic assessment of the progress toward the Bogor Goals every two years starting in 2012 through IAPs.

Both the 2012 and 2014 assessments showed that APEC member economies were gradually becoming more open. Trade and investment barriers were being reduced and non-tariff barriers gradually eliminated. Market transparency was also improving. From 1989 to 2014, the average applied tariffs of APEC economies fell by more than 10

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<sup>173</sup> The Bogor Goals are not prescriptive and allow APEC member economies to pursue them by implementing policies that are WTO-consistent. These measures could be either unilateral or negotiated (i.e. bilateral, regional or multilateral negotiations).

percentage points, contributing to a sevenfold increase in both intra-APEC merchandise trade and APEC's total trade, as well as higher economic growth compared to the rest of the world.<sup>174,175</sup> In addition, much progress has been made toward the liberalization of services trade in the region through unilateral reform measures in the services sector and the conclusion of RTAs/FTAs.

APEC economies have relaxed conditions to attract foreign direct investment (FDI). They simplified administrative procedures, offered lower taxes or entered into agreements aimed at avoiding double taxation. Furthermore, many economies have made great efforts to enhance legal stability for FDI through signing bilateral investment treaties (BITs).<sup>176</sup>

APEC member economies have also made encouraging progress in many other areas under the Bogor Goals, such as customs procedures, government procurement, competition policy, intellectual property rights (IPR), regulatory reform, and mobility of business people.

In the area of customs procedures, the implementation and expansion of Single Window and Authorized Economic Operator programmes and advanced customs systems using modern scanners as well as improvements in risk management techniques have reduced time to export/import.

APEC economies have also been working on initiatives to improve government procurement practices to help ensure value for money, open and effective competition, fair dealing, accountability and transparency. Electronic public procurement systems have been commonly implemented to streamline processes and make them more transparent.

In the area of competition policy, many APEC economies have applied new bills or amendments of existing regulations to promote competition, as well as guidelines on topics such as mergers and competition compliance programmes to reduce the incidence of anti-competitive practices in the market. It is also common to find APEC economies establishing specialized tribunals or courts for competition-related cases, and highlighting administrative progress in completing investigations and addressing alleged cases of anti-competitive practices.

In order to achieve a balanced intellectual property (IP) system, many APEC economies proceeded by creating or amending laws and regulations, signing international IP

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<sup>174</sup> APEC, 'Statement on the 25th Anniversary of APEC – shaping the future through Asia-Pacific Partnership', in *APEC Leaders' Declaration* (2014).

<sup>175</sup> However, it had been noted in the 2010, 2012 and 2014 Bogor Goals assessments that progress had been uneven across economies and areas.

<sup>176</sup> APEC Policy Support Unit, *APEC's Bogor Goals Progress Report* (Singapore: APEC, 2014), 4.

treaties and improving the collaboration with authorities to investigate cases of alleged IPR violations. Efforts were also made to create awareness in society about IP, improve law enforcement and enhance the operational capacity of the institutions responsible for IPR matters.

In the area of regulatory reform, APEC members have implemented various initiatives to reduce the regulatory burden for individuals and companies, and reduce the cost and time involved in doing business.

As for mobility of business people, 19 APEC members have fully implemented the APEC Business Travel Card (ABTC) system, with the remaining two APEC economies (the US and Canada) as transitional members of the scheme. The number of ABTC cardholders has increased rapidly in recent years and the validity of the card has been extended from three to a maximum of five years beginning 1 September 2015. Additionally, an increasing number of APEC economies have started to offer automated e-systems to facilitate immigration clearance at major airports. Some economies have also implemented more flexible conditions for business visas or extended the length of stay for business visitors.<sup>177</sup>

### **6.3 PROMOTING TRADE FACILITATION COOPERATION**

Recognizing the importance of trade facilitation, APEC has implemented initiatives to reduce or eliminate obstacles that hinder trade in the Asia-Pacific region.

In response to the goal set by APEC Leaders to achieve a regional reduction in trade transaction costs by 5 percent between 2002 and 2006, the APEC Trade Facilitation Action Plan (TFAP I) was developed in 2001. TFAP I consisted of a menu of actions and measures to reduce trade transaction costs and simplify administrative and procedural requirements in four priority areas, namely, customs procedures; standards and conformance; business mobility; and electronic commerce. At the conclusion of TFAP I, APEC economies had selected over 1,400 actions and measures in total, of which over 62 percent had been completed.

Basing on the successful experiences of implementing TFAP I, and in response to the goal set by APEC Leaders in 2005 to achieve a further reduction of trade transaction costs by 5 percent between 2007 and 2010, APEC developed its Second Trade Facilitation Action Plan (TFAP II).

An assessment of TFAP II provided strong evidence that the APEC Leaders' goal of a 5 percent reduction in total trade transaction costs between 2007 and 2010 had been

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<sup>177</sup> Ibid., 8.

achieved, resulting in total savings of USD 58.7 billion.<sup>178</sup> Substantial progress had been made at both the aggregate and sub-fora levels.

After TFAP II, trade facilitation was viewed through a broader lens by looking at supply chain performance. The Supply-Chain Connectivity Framework Action Plan (SCFAP) was endorsed in 2010, with a target of a 10 percent improvement in supply chain performance in terms of time, costs and uncertainty by 2015.

The SCFAP identified eight chokepoints in regional supply chains, where public and private sector actions could be combined to ensure that supply chains operate in a quick, efficient and reliable manner.<sup>179</sup> These chokepoints are related to transparency, infrastructure, logistics, clearance, documentation, connectivity, regulations and standards, and transit.

To help achieve the goal, APEC implemented the Capacity Building Plan to Improve Supply Chain Performance, which focuses particularly on pre-arrival processing, expedited shipments, advance rulings, release of goods and electronic payments.

Significant progress has been made by APEC in the field of supply chain connectivity in recent years and the final assessment of the SCFAP is taking place in 2016.

Also of note is the APEC Initiative on Asia-Pacific Model E-port Network (APMEN), which established the APMEN Operational Center in Shanghai, China with the aim of promoting supply chain connectivity in the region. APMEN has engaged in capacity building, planned trial projects among ports and explored best practices to promote trade facilitation since its inception in 2014.

The APEC Cooperation Network on Green Supply Chain (GSCNET) was also established in 2014 to strengthen capacity building and information sharing on green supply chain and to contribute to the green development of the region. Its first pilot centre was established in Tianjin, China in 2015.

#### **6.4 BEST PRACTICES AND MODEL MEASURES FOR RTAs/FTAs**

The Best Practices for RTAs/FTAs were adopted by APEC in 2004 with the aim of promoting high quality standards, comprehensiveness, transparency and broad consistency in RTAs/FTAs. Thirteen best practices were identified: (i) consistency with APEC principles and goals; (ii) build upon work being undertaken by APEC; (iii) consistency with the World Trade Organization (WTO); (iv) go beyond WTO commitments; (v) comprehensiveness; (vi) transparency; (vii) trade facilitation; (viii)

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<sup>178</sup> APEC Policy Support Unit, *APEC's Achievements in Trade Facilitation 2007–2010: Final Assessment of the Second Trade Facilitation Action Plan (TFAP II)* (Singapore: APEC, 2012), 1.

<sup>179</sup> APEC Policy Support Unit, *The 2013 Interim Assessment for Supply Chain Connectivity Framework Action Plan* (2013), 3.



mechanisms for consultation and dispute settlement; (ix) simple rules of origin that facilitate trade; (x) cooperation; (xi) sustainable development; (xii) accession of third parties; and (xiii) provision for periodic review.

Between 2005 and 2008, APEC developed and endorsed a total of 15 Model Measures for RTAs/FTAs:

- 2005: Trade Facilitation
- 2006: Trade in Goods; Technical Barriers to Trade; Transparency; Government Procurement; Cooperation; Dispute Settlement
- 2007: Electronic Commerce; Rules of Origin and Origin Procedures; Sanitary and Phytosanitary Measures
- 2008: Safeguards; Competition Policy; Environment; Temporary Entry for Business Persons; Customs Administration and Trade Facilitation (revised)

The Model Measures serve as a reference for APEC member economies seeking to negotiate RTAs/FTAs. They are not necessarily in legal language but provide guidance to the kinds of provisions that could be included in RTAs/FTAs. However, they are neither mandatory nor exhaustive and reflect the general APEC principle of voluntarism as they do not prejudice the positions of APEC member economies in any of their current or future trade negotiations.

## **6.5 APEC LIST OF ENVIRONMENTAL GOODS**

The APEC List of Environmental Goods is part of the multi-pronged efforts to get closer to the Bogor Goals. In 2012, APEC Leaders endorsed the list, with APEC member economies resolving to reduce the applied tariff rates to 5 percent or less by the end of 2015. The list consists of 54 environmental products, accounting for around USD 600 billion in world trade.

As of 1 January 2016, the majority of APEC members have implemented their tariff reduction plans. Tariff reductions on the goods included in the list are helping APEC businesses and citizens to access to important environmental technologies at lower cost. This initiative also contributes to APEC's efforts to pursue green and sustainable growth in the Asia-Pacific region. Furthermore, it paved the way for the launch of plurilateral negotiations in 2014 toward a WTO Environmental Goods Agreement as part of the multilateral efforts to promote green growth and sustainable development.

## **6.6 MODERNIZATION OF ORIGIN CERTIFICATION PROCEDURES**

As a key logistic step in trade, Origin Certification Procedures are required to attest that goods are originating in a specific economy in order to obtain tariff concessions agreed

in RTAs/FTAs. Electronic Certificates of Origin facilitate the application and approval process for preferential tariff treatment. Not only they reduce documentation costs, but also those associated with customs procedures, including verification. Furthermore, they allow customs clearance processes to be streamlined and also facilitate cross-border transactions. APEC Leaders endorsed Electronic Certificates of Origin as a pathfinder initiative in 2002.

Self-certification is another effective tool for facilitating trade. This one-step process greatly reduces the administrative burden of trading for APEC-based businesses, particularly micro, small and medium enterprises (MSMEs), and enables them to qualify for preferential tariff rates offered under FTA arrangements. The APEC Ministers endorsed the APEC Pathfinder Initiative for Self-Certification of Origin in 2009.

In 2015, APEC Trade Ministers released the Boracay Action Agenda to Globalize MSMEs, which agreed on the following actions concerning Certificates of Origin:

- To consider as an option a commercially significant threshold value for the waiver of Certificates of Origin.
- To encourage the adoption of the self-certification system for rules of origin as a best practice in trade facilitation and participation in the APEC Pathfinder for Self-certification of Origin.
- To promote greater use of information technology (IT) and automated systems and implement Electronic Certificates of Origin.

## **6.7 APEC PRINCIPLES FOR CROSS-BORDER TRADE IN SERVICES**

In 2009, APEC Ministers endorsed the APEC Principles for Cross-Border Trade in Services, developed as part of efforts to create a comprehensive policy framework to support the expansion of services trade in the APEC region.

To promote an open market in services, this initiative encourages most-favoured-nation treatment to services suppliers from another APEC economy in like circumstances to suppliers from any other economy. Also, it fosters the application of national treatment to services suppliers from other APEC economies in like circumstances to domestic services suppliers.

Similarly, APEC economies should not, to the extent possible, require suppliers of services to have local presence, or be resident in their territory, in order to provide a service in their territory. In the same way, APEC economies are discouraged from placing limits on the number of suppliers of any service provided within their territories, whether in the form of numerical quotas, monopolies or exclusive service suppliers.

APEC acknowledges that existing domestic policy restraints may prevent some economies from adhering to all these principles. Instead, APEC economies should endeavour to refrain from introducing new measures that are not consistent with these principles and would make things more restrictive for services suppliers. They should also strive to eliminate existing measures not consistent with these principles, or make those measures progressively less restrictive for services suppliers from other APEC economies.

The APEC Principles for Cross-Border Trade in Services initiative also recognizes the right of each member to regulate and introduce new regulations for a legitimate purpose, including the protection of consumers; the protection of human, animal or plant life or health; the protection of public morals; the maintenance of public order; and for prudential reasons or to ensure the integrity and stability of the financial system.

The initiative highlights the need for APEC economies to work cooperatively to address regulatory matters and enhance regulatory capacity so as to ensure effective, high-quality regulation that supports trade and economic development. Measures relating to licensing requirements and procedures, qualification requirements and procedures, and technical standards should be consistent with GATS's Article VI.

Economies should enhance transparency and predictability by publishing relevant laws and regulations, with a reasonable timeframe between final publication of regulations and their effective date. Regulatory procedures to obtain authorization to provide a service should be publicly available. Regulatory proposals should be published, with suppliers given a reasonable amount of time to comment on them, to the extent possible. Additionally, the initiative covers the provision of information from one APEC economy to another, under request, on existing or proposed measures that affect cross-border trade in services. The establishment of mechanisms to respond to enquiries from interested persons regarding regulations on services trade is also encouraged.

Regarding services delivered electronically, the initiative seeks to enhance consumer protection for electronic transactions by encouraging cooperation among economies' respective national consumer protection agencies; facilitating cross-border information flows in accordance with economies' respective laws and regulations; and enhancing copyright protection under the APEC Anti-Counterfeiting and Piracy Initiative. Economies should adopt and maintain transparent and effective mechanisms to protect consumers from fraudulent and deceptive commercial practices when they engage in cross-border services trade through electronic channels.

With regard to services delivered through the presence of natural persons, APEC considers that its members should enhance the mobility of business persons subject to their domestic regulations by implementing transparent, streamlined temporary entry procedures, and immigration and related border systems, while recognizing the need to ensure the safe and secure movement of people. APEC members should make available

the information on requirements and procedures for temporary entry, as well as renewal of entry status. The initiative also includes provisions to encourage APEC members to recognize the education or experience obtained by a natural person in another APEC member economy. This recognition could be made on a unilateral basis or based on agreements reached among the APEC members involved.

## **6.8 APEC NON-BINDING INVESTMENT PRINCIPLES**

The APEC Non-Binding Investment Principles represent a good reference for member economies to pursue actions consistent with the Bogor Goals. These principles were endorsed in November 1994 in Jakarta, Indonesia, but their relevance has been maintained across time. In fact, most of the APEC members have reported that their investment regimes and FTAs and investment agreements are fully or mostly consistent with the principles.

This initiative encourages transparency in order to make laws, regulations, procedures and policies related to investment more accessible. It also promotes the application of non-discrimination and national treatment principles to investors from other APEC economies. In other words, the treatment that each APEC member grants to domestic investors should be extended, in similar circumstances, to investors from other APEC economies.

The initiative also highlights that APEC members should not relax health, safety and environmental regulations as an incentive to encourage foreign investment. It encourages APEC members to minimize the use of performance requirements that distort or limit the expansion of trade and investment.

In terms of expropriation and compensation, this initiative considers that APEC members will not expropriate foreign investment, except for public purposes and on a non-discriminatory basis in accordance with the laws of each economy and principles of international law and against the prompt payment of adequate and effective compensation.

The initiative also makes a declaration on investor behaviour, in which it mentions that ‘the acceptance of foreign investment is facilitated when foreign investors abide by the host economy’s laws, regulations, administrative guidelines and policies, just as domestic investors should’.

Regarding financial issues, APEC members are encouraged to further liberalize toward the goal of free and prompt transfer of funds related to foreign investment, such as profits, dividends, royalties, loan payments and liquidations, in a freely convertible currency. Furthermore, the principles mention that APEC members should minimize regulatory and institutional barriers to the outflow of investment. Also, in terms of taxation, APEC members will endeavour to avoid double taxation related to foreign

investment.

The principles also accept that disputes in connection with foreign investment will be promptly settled through consultation or negotiation between the parties involved. In case of failure to solve the dispute in that way, it recognizes the right of the parties to proceed with arbitration in accordance with their international commitments or any other approach acceptable to both parties.

As with the APEC Principles on Cross-Border Trade in Services, APEC member economies will permit the temporary entry and sojourn of business persons. In this case, it is about key foreign technical and managerial personnel for the purpose of activities connected with foreign investment, subject to domestic laws and regulations.

In addition, APEC has been undertaking other important initiatives that may contribute to the eventual realization of the FTAAP, such as existing and potential next-generation trade and investment issues (NGeTI) and global value chains, which has been outlined in other chapters of this study.

## **6.9 CAPACITY BUILDING AND OTHER ACTIVITIES IN PURSUIT OF THE FTAAP**

Considering the diversity and different stages of development of the member economies, APEC has made substantial strides in helping its members meet possible challenges when negotiating trade agreements, such as the FTAAP, so as to fully realize the potential benefits of RTAs/FTAs. The various capacity-building activities and other cross-cutting initiatives implemented by APEC, and their outcomes, are laying a solid foundation for APEC members to jointly pursue the eventual realization of an FTAAP, which will surely bring tangible benefits for all APEC members.

### **● Action Plan Framework of the 1st and 2nd Capacity Building Needs Initiatives**

In response to the APEC Leaders' instruction to enhance capacity-building activities on the FTAAP, Korea, in cooperation with Chile, Peru and the Philippines, proposed the Regional Economic Integration Capacity-Building Needs Initiative (CBNI) Action Plan Framework, which was endorsed at the 2011 APEC Ministerial Meeting. The main objectives were to narrow the gaps in the capacities of APEC member economies to negotiate RTAs/FTAs, enhance trade policy capacity by sharing best practices, identify challenges to the FTAAP, and explore possible ways to overcome them.

Between 2012 and 2014, under the first CBNI Action Plan Framework, 12 capacity-building programmes in 13 different areas were successfully held.<sup>180</sup>

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<sup>180</sup> APEC, *Action Plan Framework for the 2nd REI Capacity Building Needs Initiative (2nd CBNI)* (2014/CSOM/004, *Concluding Senior Officials' Meeting*, 5–6 November 2014, Beijing, China)

During the 2014 APEC Leaders Meeting held in Beijing, the Action Plan Framework for the second CBNI (2015–2017) was endorsed with the view of designing additional targeted and tailor-made capacity-building programmes for specific sectors in order to facilitate the eventual realization of the FTAAP.

A series of seminars and workshops targeting various FTA-related topics chapters have been held since the end of 2014 in areas such as non-tariff measures, intellectual property, rules of origin, and trade facilitation.

- **APEC Information Sharing Mechanism on RTAs/FTAs**

In recent years, the Asia-Pacific region witnessed a rapid proliferation of RTAs/FTAs. It is recognized that an effective information sharing mechanism on RTAs/FTAs involving APEC member economies provides an intellectual and policy foundation to work toward a comprehensive and high-quality FTAAP.

In 2014, an APEC Information Sharing Mechanism on FTAs/RTAs was endorsed, with the aim of enhancing transparency of these agreements through four activities: (i) enhancing access to information on RTAs/FTAs; (ii) sharing and assessing information on WTO+ elements of RTAs/FTAs; (iii) holding annual dialogues and reports on RTAs/FTAs; and (iv) reinforcing and intensifying use of the WTO RTA Transparency Mechanism.

This initiative has been helpful in increasing transparency on RTAs/FTAs and achieving a better understanding on RTA/FTA topics and possible pathways toward the eventual realization of a truly beneficial FTAAP.

- **Other activities**

Since 2013, comprehensive connectivity and infrastructure development has become a priority of APEC. The APEC Connectivity Blueprint for 2015–2025 was endorsed by APEC Leaders in 2014. Through the Blueprint, APEC members committed to strengthening physical, institutional and people-to-people connectivity by taking agreed actions and meeting agreed targets by 2025, with the objective of achieving a seamless and comprehensively connected and integrated Asia-Pacific. The Blueprint contains existing connectivity-related initiatives; encourages reviving those initiatives that require further progress; and, proposes future initiatives for more efficient flows of goods, services, capital and people to drive APEC progress, some of which can carry great significance for the realization of the FTAAP.

Initiatives to enhance tripartite cooperation among governments, business and academia are also regarded by APEC as an important capacity-building activity for the realization of the FTAAP. APEC has intensified its efforts to foster cooperation to promote regional economic integration via the APEC Business Advisory Council (ABAC), APEC Policy Support Unit (PSU), Pacific Economic Cooperation Council

(PECC), APEC Study Center Consortium (ASCC) and other related fora. Multiple public–private sector dialogue mechanisms have been initiated. Some members actively provide financial support to APEC, as well as training and technical assistance to APEC developing members, all of which have helped strengthen the members’ capacity in FTA negotiations.

## **6.10 CONCLUSION**

As a major economic cooperation platform in the Asia-Pacific, APEC has achieved significant outcomes through the implementation of several initiatives in various trade and investment areas. Despite the diversity and different stages of development of member economies, APEC has successfully set up the common aspiration of Bogor Goals; delivered concrete achievements in trade in goods, such as reducing tariffs on environmental goods; built up consensus on trade in services and investment issues; adopted best practices for RTAs/FTAs; and endorsed next generation trade and investment issues. Capacity building and close cooperation among governments, business and academia have been an important driver of APEC cooperation. These previous undertakings have laid a good foundation toward the realization of a comprehensive and high-quality FTAAP.

APEC has demonstrated the ability to address emerging trade and investment issues. In fact, its record as an incubator of ideas for the global trading system, and its capacity to deliver targeted capacity building puts it in a unique position to support its members in their efforts to undertake domestic reform and to participate in high-quality and comprehensive FTAs. These are solid foundations that could facilitate the realization of the FTAAP in the future. The collaboration of APEC economies rooted in consensus-based, non-binding cooperation principles has supported APEC in advancing work on issues that have failed to get traction in other settings.

Based on the outcomes of the previous initiatives in various fields, APEC should continue to carry out endeavors that are highly relevant to the region and supportive to APEC economies in their efforts for the realization of the FTAAP.

## 7. UPDATE OF OTHER ANALYTICAL WORK

### 7.1 INTRODUCTION

This chapter presents updates on previous APEC studies on a possible FTAAP, namely, the 2009 *Further Analytical Study on the Likely Economic Impact of an FTAAP* and the 2008 *Identifying Convergences and Divergences in APEC RTAs/FTAs*.<sup>181</sup>

While acknowledging the difficulties involved in realizing a regional trade agreement such as the FTAAP, the 2009 study found that such an agreement could contribute significantly to achieving trade and investment liberalization as set out in the Bogor Goals. Accordingly, in this chapter, we revisit the 2009 study and examine the economic impact of an FTAAP using the computable general equilibrium (CGE) model, as in the 2009 study. We also update the data and information on the RTAs/FTAs entered into by APEC economies.

The 2008 study on *Identifying Convergences and Divergences in APEC RTAs/FTAs*<sup>182</sup> is updated here by including the following additional RTAs/FTAs: Australia–New Zealand–ASEAN; Australia–Japan; Canada–Peru; Chile–Hong Kong, China; Chile–Thailand; China–Korea; Korea–US; Japan–Viet Nam; New Zealand–Chinese Taipei; and Singapore–Chinese Taipei.<sup>183</sup> These additional FTAs were reviewed based on the analytical framework of the 2008 report.

The objective of this update is to identify common ground among the FTAs entered into by APEC economies and thereby the possible building blocks of an FTAAP, as well as to understand the convergences and divergences in the structure and content of existing FTAs in the APEC region.

Specifically, this update includes an analysis on the convergences and divergences in the following topics: market access for goods, rules of origin, customs procedures, technical barriers to trade (TBT), sanitary and phytosanitary standards (SPS), trade remedies, competition policy, services, environment and labour. To reflect the latest undertakings and directions of economic integration between APEC economies,

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<sup>181</sup> APEC, *Further Analytical Study on the Likely Economic Impact of an FTAAP* (Singapore: APEC, 2009); APEC, *Identifying Convergences and Divergences in APEC RTAs/FTAs* (Singapore: APEC, 2008).

<sup>182</sup> APEC, *Identifying Convergences and Divergences*.

<sup>183</sup> For the purpose of reducing confusion in reading, this chapter uses the overarching terminology of ‘free trade agreement (FTA)’ to refer to all 10 agreements reviewed in the chapter. It does not reflect the official title of a number of the agreements discussed. For instance, the agreement between Australia and Japan is an ‘economic partnership agreement’ and the one between New Zealand and Chinese Taipei is an ‘economic cooperation agreement’.



additional chapters on e-commerce and economic cooperation are analysed. To the extent possible, the analysis includes a comparison between the findings of the 2008 report and the update.

## **7.2 UPDATE: FURTHER ANALYTICAL STUDY ON THE LIKELY ECONOMIC IMPACT OF AN FTAAP**

### **7.2.1 Basic model**

The model aims to estimate the impact of trade liberalization and facilitation in the APEC region by using a CGE model analysis (for more on the methodology used, see Appendix L). This study includes 15 economic sectors, 19 APEC economies with data available and two non-APEC blocks (Table 7.1).

The model uses social accounting from the most recent GTAP v9 database.<sup>184</sup> Data are representative of the world for year 2011.<sup>185</sup>

**Table 7.1 Model aggregation**

<b>Economies</b>	<b>Sectors*</b>
Australia	Agriculture/fishery
Canada	Food products
Chile	Textile
China	Chemical products
Chinese Taipei	Steel and metal products
Hong Kong, China	Vehicle
Indonesia	Other transport equipment
Japan	Electronic products
Korea	Machinery
Malaysia	Other manufactures
Mexico	Construction
New Zealand	Trade
Peru	Transportation/communication
Philippines	Business/financial services
Russia	Other services
Singapore	
Thailand	
United States	
Viet Nam	
European Union 27	
Rest of the world	

\* The distinction between agriculture/fishery and food product is based on whether the product is processed or not. Other manufactures include leather products, wood products, paper

<sup>184</sup> Purdue University, Global Trade Analysis Project, accessed 13 July 2016,

<https://www.gtap.agecon.purdue.edu/>

<sup>185</sup> Two APEC member economies, namely, Brunei Darussalam and Papua New Guinea, are not included as it is not possible to use their relevant data set.

products, publishing and manufactures not elsewhere classified.  
Construction, trade, transportation/communication,  
business/financial services, and other services are categorized as  
services sectors.

## 7.2.2 Scenarios

In order to investigate the economic effects of an FTAAP, three scenarios are analysed.

- **Scenario I:** Trade liberalization through tariff elimination (full elimination of tariffs in agricultural and manufactured goods<sup>186</sup>)
- **Scenario II:** (I) + enhanced trade facilitation (reduction of trade costs by 5 percent through enhanced trade facilitation<sup>187</sup>)
- **Scenario III:** (II) + liberalization of trade in services (reduction of tariff-equivalent barriers in services by 10 percent<sup>188</sup>)

## 7.2.3 Simulation results<sup>189</sup>

The detailed results of Scenario I are shown in Appendix M, Table M.2. In general, they show that liberalization of goods trade promotes long-term growth. It is expected that the real GDP of the APEC region would increase by 0.40 percent, welfare would increase by 0.38 percent and exports and imports would do the same, by 2.45 and 2.49 percent, respectively.

For Chile, Peru and Singapore, the effects on these indicators would be marginally negative should the FTAAP just include most-favoured nation (MFN) tariff reductions for trade in goods. The reason is that these three APEC economies already have low

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<sup>186</sup> Scenario I assumes full utilization of preferences and does not take rules of origin into account.

<sup>187</sup> The 2009 study also assumes a reduction of trade costs by 5 percent through enhanced trade facilitation.

<sup>188</sup> The reduction of trade costs by 5 percent in Scenario II and tariff-equivalent barriers in services by 10 percent in Scenario III are applied unilaterally among FTAAP members. The reduction of tariff-equivalent barriers in services is applied to the construction, trade, transportation, telecommunication and business/financial sectors. Tariff-equivalent barriers in services sectors are adopted from: B. Hoekman, 'Assessing the General Agreement on Trade in Services', in *The Uruguay Round and the Developing Economies* ed. W. Martin and A. Winters (Washington, DC: World Bank, 1995). Moreover, in order to avoid overestimation, we do not apply the policy shocks to liberalize trade in goods and services to the trade between APEC economies that have FTAs already entered into effect as of December 2015.

<sup>189</sup> More detailed results are presented in Appendix M. In this study, we report results from the capital accumulation model only in order to avoid unintended confusion.

average tariffs and have implemented FTAs with most APEC economies and their most important trade partners outside APEC.

Likewise, similar to the prediction reported in the 2009 study, we found that the positive gains from a shallow integration achieved by eliminating tariffs alone may not generate significant enough gains and would be unevenly distributed among the members.<sup>190</sup>

In contrast, the results of Scenario II (see Table M.3) shows the economic effects of a tariff elimination and a 5 percent reduction in trade cost through enhanced trade facilitation. Compared to Scenario I, the FTAAP in Scenario II yields higher economic gains for all individual APEC members and they are much higher for APEC as a whole in terms of real GDP, welfare and trade flows in comparison to Scenario I in which only tariffs are removed. All the 19 APEC economies would benefit from a positive effect on real GDP, welfare, export, and import. Among APEC member economies, Hong Kong, China; Korea; Malaysia; Singapore; Chinese Taipei; Thailand; and Viet Nam would be the biggest beneficiaries in this new scenario. These results confirm that enhancing trade facilitation accompanied with full tariff liberalization has a more significant impact on real GDP, welfare and trade.

Scenario III, which consists of adding a partial liberalization of trade in services by 10 percent to full liberalization of trade in goods and enhanced trade facilitation, shows that the positive effect on real GDP, welfare and trade could expand even more. The economic effects of an FTAAP in Scenario III are reported in Table M.4. Comparing these results with those of Scenarios I and II, the magnitude of increases in real GDP, welfare and trade for all APEC member economies is greater in Scenario III. In this respect, the liberalization of services trade leads to increased competitiveness and efficiency in the whole economy since services contribute directly to primary and industrial production. For small economies with already low MFN tariffs and/or a wide network of FTAs, such as Chile; Hong Kong, China; Peru; and Singapore, the inclusion of services liberalization and trade facilitation is critical to obtain economic gains from an FTAAP.

The relative additional gains to APEC economies as a whole are shown in Table M.5. This implies that the non-discriminatory preference by enhancing trade facilitation is one of the most important catalysts of economic growth, trade and welfare. When moving from Scenario I to II, that is when a fall of 5 percent in trade transaction costs is added to the elimination of tariffs, average income (or real GDP) increases by an additional 3.45 percent. Welfare also increases by an additional 3.09 percent and trade also goes up further, increasing 9.31 percent in the case of exports and 9.24 percent in

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<sup>190</sup> Our estimates on the impact of tariff elimination are conservative since the scenario does not consider other dynamic gains such as potential positive effects on productivity through increased competition. On the other hand, long-term phase-outs for some industries under FTAs might potentially have negative impacts on our estimates.

the case of imports.

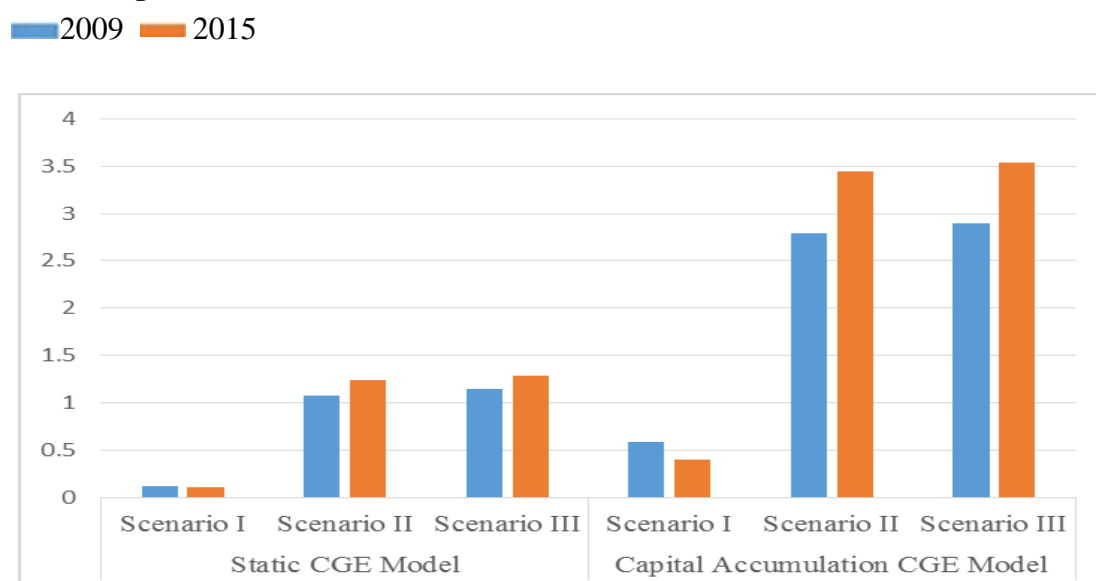
Moving further from Scenario II to III by adding a 10 percent elimination of barriers in services trade will improve even more real GDP, welfare and trade, even though not as much as the effect obtained when trade transaction costs were reduced by 5 percent. However, it is possible that the impact will be more significant if more barriers in services trade are eliminated, for example 50 percent elimination instead of 10 percent.

#### **7.2.4 Comparing results: updated study vis-à-vis original study**

Table L.6 compares the trade effects of an FTAAP in the APEC region in the updated and original 2009 study. The results of both studies show similar patterns in terms of FTAAP's effect on trade, real GDP and welfare, but different magnitudes (Figure 7.1). Both studies equally support that deeper integration through full trade liberalization together with enhanced trade facilitation and freer trade in services (Scenarios II and III) are a more desirable cooperation scheme compared with a shallow integration achieved by eliminating tariffs only (Scenario I). Probably, the magnitude of the benefits may be even bigger had higher (50 percent elimination instead of 10 percent) liberalization of services trade been taken as the assumption in the model.

Both studies also corroborate that: (i) tariff preferences alone will not generate significant additional gains now, due to the existence of an already proliferating sub-regional FTA network in the region; (ii) shallow integration with only tariff liberalization may cause some welfare losses to some individual APEC economies; and (iii) deeper integration through enhanced trade facilitation and services liberalization is a more desirable policy option for an FTAAP as it generates much bigger gains.

**Figure 7.1 Effect of an FTAAP on real GDP (% Deviation from the Base)**



Source: APEC, *Further Analytical Study on the Likely Economic Impact of an FTAAP* (Singapore: APEC, 2009) and authors' calculations.

### **7.3 UPDATE: IDENTIFYING CONVERGENCES AND DIVERGENCES IN APEC RTAS/FTAS**

#### **7.3.1 Trade liberalization**

In line with the global trend toward regional economic integration, the past 15 years have seen intensive integration efforts in the Asia-Pacific region. By 2015, the number of bilateral FTAs involving APEC economies had risen to over 155. Among these, 30 new agreements entered into force after 2008. As found in the 2008 study, the examined FTAs present some differences in terms of the coverage and rules. However, the objectives are very similar across the examined FTAs and there are some commonalities across many of them.

The review of tariff liberalization schedules of the FTAs that have come into effect after 2008 shows that the pace of tariff liberalization in agreements where Asian economies participate tends to be slower than those by the US, Australia and New Zealand, and their coverage excludes a larger number of tariff lines. In most cases, this is due to the desire to protect sensitive agricultural products. Some FTAs include groups of products that could be fully liberalized only more than 10 or 20 years after the FTA comes into effect.

With the continuous upward trend of FTAs being implemented in the APEC region, more trade in APEC is subject to lower or no tariffs. In other words, a higher proportion of APEC's trade now enjoy preferential market access. It is noticeable that trade liberalization through FTAs after 2008 has been deeper than that of FTAs before 2009.

### 7.3.2 Rules of origin and related procedures

To determine the origin of a product, most FTAs signed before 2009 used set product specific rules (PSR) for each product and only a small minority of FTAs adopted a single criterion applying to all products. All post-2008 FTAs examined in this section incorporated PSR as well. In addition, there is a trend among new FTAs to simplify rules of origin and their implementation procedures in order to keep low the cost of issuing the certificate of origin and of origin verification by customs authorities.

The major differences in the findings between the original and updated study are summarized as following in Table 7.2.

**Table 7.2 Convergence and divergence in rules of origin and related procedures**

Issues	2008 study	2016 update
<b>Product specific rules (PSR)</b>	Set PSR for individual tariff codes in most FTAs.	Set PSR for tariff codes in all 10 FTAs.
<b>Regional value content (RVC)</b>	Require 20%–80%.	9 of 10 FTAs require 30%–50% RVC; while China–Korea FTA requires 60% RVC on 310 products.
<b>De minimis</b>	7%–10% of non-originating materials.	Most allow 10%. Only 1 FTA for specific goods allows 7% of non-originating materials.
<b>Cumulation</b>	Bilateral and extended cumulation.	8 of 10 FTAs permit bilateral cumulation; 2 permit extended or full cumulation.
<b>Declaration and certification</b>	Issued by authorized institute or agency, or declared by exporter or importer.	Same as 2008, but the percentage of FTAs allowing simple declaration is higher.
<b>Validity of certificates</b>	From 4 months to 4 years.	From 1 year to 4 years.
<b>Other issues</b>	Vary with different FTAs.	Same as 2008.

### 7.3.3 Customs procedures

All post-2008 FTAs examined contain provisions relating to customs procedures. The content of these provisions is quite similar. Only in the provisions related to penalties, release of goods and transparency do a higher degree of difference appear. Beyond that, the differences between FTAs are no more than variations in the level of detail.

**Table 7.3 Convergence and divergence in customs procedures**

Issues	2008 study	2016 update
<b>Customs chapters</b>	25 of 30 include this chapter.	All 10 FTAs include this chapter.
<b>Temporary admission</b>	Low level of divergence. Only minor differences among the FTAs.	Same as 2008. 1 FTA specifies time limitation.
<b>Confidentiality</b>		Same as 2008.
<b>Review and appeal</b>		Same as 2008.
<b>Penalties</b>		4 FTAs specify penalties for breaching customs law/regulation.
<b>Trade facilitation</b>		Low level of divergence.
<b>Express shipments</b>	Medium level of divergence. Some FTAs provide more stringent obligations and go into different level of details.	5 FTAs contain this. Certain degree of difference exists.
<b>Cooperation</b>		All 10 FTAs contain such provisions. 3 FTAs contain custom consultation provisions.
<b>Committee</b>		8 FTAs contain similar provisions.
<b>Advance rulings</b>		9 FTAs contain such provisions. Some of the FTAs provide more details than others.
<b>Transparency</b>	High Level of divergence. 17 of 30 FTAs express a strong position on transparency while the others have no such provision.	7 FTAs contain Transparency provisions. Most of them do not provide strong transparency requirements.
<b>Release of goods and financial and non-financial securities</b>	High level of divergence. Different levels of commitment between the FTAs.	Medium level of divergence. 6 FTAs contain similar provisions.

#### 7.3.4 Sanitary and phytosanitary standards

All post-2008 FTAs examined in the present study include SPS provisions. The SPS provisions within these FTAs seldom go beyond the obligation under the WTO SPS agreement. Only in the dispute settlement and regionalism provisions is it possible to observe a noticeable deviation from the WTO SPS agreement and divergences among FTAs.

**Table 7.4 Convergence and divergence in sanitary and phytosanitary standards (SPS) provisions**

Issues	2008 study	2016 update
<b>SPS chapter</b>	19 of 30 FTAs contain SPS chapter.	All 10 FTAs contain SPS chapter.
<b>Rights and obligations</b>	Low level of divergence. Only minor differences among the FTAs.	1 FTA made a stricter requirement on the 'rights and obligations' provision. No difficulties on future convergence. Only 1 FTA contains risk assessment provision.
<b>Risk assessment</b>		
<b>Transparency</b>		
<b>Technical consultation and committee</b>		
<b>Equivalence and harmonization</b>	Medium level of divergence. Several FTAs contain requirements additional to the SPS agreement.	1 FTA contains requirements additional to the SPS agreement.
<b>Control, verification and approval</b>	High level of divergence. Different requirements across the FTAs.	1 FTA contains requirements additional to the SPS agreement.
<b>Regionalism</b>	High level of divergence. 8 of 30 FTAs contain such provision.	1 FTA contains requirements additional to the SPS agreement.
<b>Dispute settlement</b>	High level of divergence. Some FTAs allow the parties to utilize the 'dispute settlement' chapter.	3 FTAs allow the parties to utilize the 'dispute settlement' chapter.

### 7.3.5 Technical barriers to trade

Obligations aiming to remove unnecessary non-tariff barriers are becoming increasingly important in recent FTAs within the APEC region. TBT provisions in all post-2008 FTAs reviewed converge in adopting stronger obligations regarding the acceptance or recognition of conformity assessment results and offering national treatment to conformity assessment bodies from FTA partners with respect of designation, authorization or certification, and on transparency requirements.



**Table 7.5 Convergence and divergence in technical barriers to trade (TBT) provisions**

Issues	2008 study	2016 update
<b>Objective and scope</b>	Basically following the WTO TBT Agreement.	Same as 2008, but clearer language ( <i>mutatis mutandis</i> ) used to link with the TBT Agreement.
<b>Use of international standards</b>	Reiterate the TBT Agreement.	Reiterate the TBT Agreement, but 1 FTA identified ISO/IEC etc. as international standards.
<b>Technical regulations</b>	Encourage equivalency.	Same as 2008.
<b>Conformity assessment procedures</b>	Reiterate the six types of mutual acceptance/recognition as included in the WTO discussion.	In addition, some FTAs also require providing national treatment to conformity assessment bodies from FTA partners with respect of designation, authorization or certification.
<b>Transparency</b>	Reiterate the TBT Agreement, with requirement of 60 days commenting period.	Same as 2008.
<b>Sector/issues specific cooperation</b>	Rare.	Common feature in all FTAs.
<b>TBT committee and other provisions</b>	Most FTAs establish a TBT Committee.	Same as 2008, all FTAs establish a TBT Committee or TBT Coordinators.

### 7.3.6 Trade remedies

The majority of all post-2008 FTAs reviewed in this update include chapters on trade remedies. While the common approach is to reaffirm the Parties' existing rights and obligations under WTO provisions, divergences are noticeable especially regarding multilateral and bilateral safeguard measures, as well as in sector-specific special safeguards.

**Table 7.6 Convergence and divergence in trade remedies**

Issues	2008 study	2016 update
<b>Anti-dumping measures</b>	Most FTAs reiterate the WTO relevant rights and obligations, but also consider some marginal modifications.	<ul style="list-style-type: none"> <li>▪ Same as 2008, but some new requirements included in the investigation proceedings.</li> <li>▪ 2 FTAs (Japan–Viet Nam and Australia–New Zealand–ASEAN) do not have specific provisions.</li> </ul>
<b>Countervailing measures</b>	Reiterate the WTO Agreement.	<ul style="list-style-type: none"> <li>▪ Same as 2008, but some new requirements included in the investigation proceedings.</li> <li>▪ 2 FTAs (Japan–Viet Nam and Australia–New Zealand–ASEAN) do not have specific provisions.</li> </ul>
<b>Multilateral safeguards</b>	Mainly reaffirm following the WTO Agreement.	<ul style="list-style-type: none"> <li>▪ Same as 2008, but some FTAs require that bilateral safeguard measures are prohibited if multilateral safeguard measures are already implemented.</li> </ul>
<b>Bilateral safeguards</b>	Most FTAs contain such provisions.	<ul style="list-style-type: none"> <li>▪ Same as 2008.</li> <li>▪ 2 FTAs (New Zealand–Chinese Taipei and Chile–Hong Kong, China) do not include rules on bilateral safeguard measures, while 3 FTAs (Canada–Peru, Chile–Thailand and Australia–New Zealand–ASEAN) allow bilateral safeguards only within transitional period.</li> </ul>
<b>Sector-specific safeguards (SSG)</b>	Most FTAs incorporate SSG provisions on agricultural, textile and clothing sectors.	<ul style="list-style-type: none"> <li>▪ In addition to agricultural products and textile-related sectors, an SSG mechanism in the auto sector is also observed in 1 FTA.</li> <li>▪ 4 FTAs do not have any SSG clause.</li> </ul>

### 7.3.7 Competition policy

While WTO has yet successfully to include competition as a multilateral negotiation agenda, a competition chapter is becoming a basic feature in FTAs as seen in all post-2008 FTAs reviewed.

**Table 7.7 Convergence and divergence in competition policy**

Issues	2008 study	2016 update
<b>Laws, regulations and institutions</b>	Requirements (in some cases, best endeavours) for the maintenance or adoption of measures to counter anti-competitive activities and an enforcement agency.	Same as 2008, but obligations in 6 FTAs are mandatory. 4 FTAs do not include such provisions.
<b>The implementation of competition policy and law</b>	Some FTAs include obligations to ensure non-discrimination, transparency, procedural fairness, and provide opportunity for judicial review. Details vary.	All except 1 FTA (Chile–Hong Kong, China) include these obligations.
<b>Designated monopolies and state enterprises</b>	Some FTAs include requirements, for example, to avoid acting in a manner inconsistent with the obligations of the agreement and to act in accordance with commercial considerations.	6 FTAs include these obligations.
<b>Cooperation and consultation</b>	Most FTAs contain such provisions.	All except 1 FTA (Chile–Hong Kong, China FTA) include the obligations.
<b>Cooperation on consumer protection</b>	Most FTAs contain such provisions.	Only 5 FTAs include such provisions.
<b>Dispute settlement</b>	Many FTAs exclude dispute settlement from the chapter on competition policy.	7 FTAs exclude dispute settlement from the chapter on competition policy.

### 7.3.8 Trade in services

All post-2008 FTAs among APEC economies examined in this report contain a chapter on trade in services. Generally, the structure of the FTAs follow the APEC Principles on Cross-Border Trade in Services, with additional provisions on local presence requirements and the facilitation of services delivered electronically.

In addition, six FTAs include chapters on specific services sectors: four of them include chapters on financial services and telecommunications services; one has chapters on, professional services and express delivery services; and another has chapters on air transportation services and film and television co-production. Most sector-specific chapters clarify what the scope of the sector is. Five of all post-2008 FTAs use a negative-list approach for sectoral coverage, whereas the other five FTAs use a positive-list approach.

A relatively new trend among the examined FTAs is the inclusion of contact points to

facilitate communications between the Parties on any matter covered by the chapter on trade in services. The China–Korea and the ASEAN–Australia–New Zealand FTAs include a provision on business practices. The aim of the provision is to eliminate certain business practices of service suppliers, other than monopolies and exclusive service suppliers, which may restrain competition and restrict trade in services.

Most of the provisions in the chapter on trade in services, including market access (refrain from adopting certain quantitative restrictions), recognition, amendment/withdrawal of commitments, provisions regulating monopolies and exclusive service suppliers, cooperation/committees, have become common elements in recent APEC FTAs. The inclusion of emergency safeguards is relatively rare. There are some new contents included in all post-2008 FTAs, such as provisions on transparency (and anti-corruption), transfers and payments (disclosure of information, measures to safeguard the balance of payments, prudential measures).

**Table 7.8 Convergence and divergence in trade in services**

Provisions		2008 study	2016 update
<b>Scope and coverage</b>	Mode of coverage	10 include all 4 modes. 13 include only modes 1, 2, 4 (mode 3 is covered in the FTA's investment chapter)	8 (4 modes). 2 (modes 1, 2, 3).
	Approach to sectoral coverage	15 negative lists. 8 positive lists.	5 negative lists. 5 positive lists.
	General exceptions	3 general exceptions, i.e. taxation, public health and safety, and essential security measures (14 of 23 FTAs).	In addition to the 3 general exceptions, 3 additional exceptions are included, i.e. disclosure of information, measures to safeguard the balance of payments, prudential measures (10 of 10 FTAs).
<b>National treatment (NT)</b>		High level of convergence (23 of 23 FTAs).	High level of convergence (10 of 10 FTAs).
<b>Most favoured nation (MFN)</b>		High level of convergence (18 of 23 FTAs).	High level of convergence (7 of 10 FTAs).
<b>Market access</b>		15 FTAs include this provision on refraining from the adoption of certain quantitative restrictions.	High level of convergence (10 of 10 FTAs).
<b>Local presence</b>		FTAs concluded by Canada, Chile, Mexico and the United States require this (14 of 23 FTAs).	5 FTAs (China–Korea; Japan–Vietnam, Hong Kong, China–Chile; Chile–Thailand; Australia–New Zealand–ASEAN) do not require this.

<b>Domestic regulation</b>	12 FTAs include provisions on domestic regulation: 5 include provisions pertaining to licensing and certification, while 3 include authorization and related provisions.	10 FTAs include provisions on domestic regulation.
<b>Transparency</b>	13 FTAs include this provision: 7 focus on publication of measures and response to enquiries, while 6 include obligations on transparency in the development and implementation of regulations.	10 FTAs focus on publication of measures and response to enquiries.
<b>Recognition</b>	17 FTAs contain provisions relating to recognition of professional qualifications.	High level of convergence (10 of 10 FTAs)
<b>Transfers and payments</b>	12 FTAs contain provisions that restrict Parties from applying restrictions on international transfers and payments for current transactions.	10 FTAs include provisions under which Parties may restrict transfers in the event of serious balance of payments or external financial difficulties, or threat thereof.
<b>Specific commitments</b>	9 FTAs include commitments on professional services. 3 FTAs include commitments on express delivery services. 1 FTA contains commitments on land transportation and air transportation services.	8 FTAs include commitments on financial services. 6 FTAs include commitments on telecommunications services. 3 FTAs include commitments on professional services. 1 FTA includes commitments on express delivery services. 1 FTA includes commitments on air transportation services. 1 FTA includes commitments on film and television co-production.
<b>Temporary entry</b>	Only the Chile–China FTA includes this provision.	8 FTAs include this provision. The Korea–US and Singapore–Chinese Taipei FTAs do not.
<b>Denial of benefits</b>	20 FTAs include this provision. There is broad convergence among these FTAs with respect to the language of these provisions.	High level of convergence (10 of 10 FTAs)
<b>Amendment / withdrawal of commitments</b>	Only 9 FTAs include this provision.	High level of convergence (10 of 10 FTAs)
<b>Review / future liberalization</b>	17 FTAs include this provision.	9 FTAs include this provision. The Korea–US FTA does not.
<b>Cooperation / committees</b>	Only 10 FTAs include this provision.	8 FTAs include this provision. The Korea–US and New Zealand–Chinese Taipei FTAs do not.

<b>Other</b>	Emergency safeguards	Only the Japan–Malaysia and Japan–Thailand FTAs include this provision.	3 FTAs (Japan–Viet Nam, Chile–Thailand, ASEAN–Australia–New Zealand) include this provision.
	Subsidies	Only the New Zealand–Singapore, P4 and Chile–Peru FTAs include this provision.	6 FTAs, include this provision. The US–Korea, Japan–Viet Nam, Chile–Thailand and Singapore–Chinese Taipei FTAs do not
	Monopolies and exclusive service suppliers	The New Zealand–Singapore, Singapore–Australia, Japan–Singapore, Japan–Malaysia, Japan–Thailand, and Japan–Philippines FTAs include this provision.	7 FTAs include this provision. The Hong Kong, China–Chile, Chile–Thailand and ASTEP FTAs do not.
<b>Definitions</b>	High level of convergence (23 of 23 FTAs)	High level of convergence (10 of 10 FTAs)	

### 7.3.9 Investment provisions

The majority of all post-2008 FTAs include an investment chapter except the Chile–Thailand and Chile–Hong Kong, China FTAs, where a separate Investment Agreement will be negotiated at a later time. Consistent with the discussions on the elements commonly found in International Investment Agreements (IIAs) in chapter 4, investment chapters in all post-2008 FTAs share a very high level of similarity with respect to the structure and elements, as they tend to follow the guidelines described at the APEC Non-Binding Investment Principles as well as the OECD Multilateral Agreement on Investment (non-binding guideline). One of the main divergences is in granting national treatment to pre-establishment phases.

**Table 7.9 Convergence and divergence in investment provisions**

Issues	2008 study	2016 update
<b>Definition of investment</b>	Mainly adopt expansive definition of investment.	Same as 2008.
<b>National treatment (NT)</b>	All FTAs that have an investment chapter provide NT; the majority (17 of 22 FTAs) offers both pre-establishment and post-establishment investment through a negative-list approach.	Same as 2008.
<b>Most favoured nation (MFN) treatment</b>	Most FTAs (18 of 22 FTAs) that have an investment chapter provide MFN for both pre-establishment and post-establishment investment, but with different exceptions/carve-outs on MFN.	All except 2 FTAs (Australia–New Zealand–ASEAN FTA and Singapore–Chinese Taipei FTA) include similar MFN provisions (i.e. for both pre-establishment and post-establishment investment, with different exceptions/carve-outs).
<b>Other general treatments</b>  (e.g. performance requirements, minimum standard of treatment, transfer of capital)	Convergences in the treatment in the transfer of capital. Divergences in the scope and level of obligations for other treatments.	Same as 2008.
<b>Expropriation and compensation</b>	Different approaches to stipulate indirect expropriation.	Convergence in defining the concept of indirect expropriation.
<b>Investor vs state dispute settlement (ISDS)</b>	Most FTAs provide an ISDS mechanism following ICSID arbitrations or under UNCITRAL rules.	Same as 2008.

### 7.3.10 Environment

Five of all post-2008 FTAs (Canada–Peru; Chile–Hong Kong, China; China–Korea; Korea–US; New Zealand–Chinese Taipei) reviewed in this update include an environmental chapter and/or parallel agreement on the environment. The environmental provisions in most of these FTAs contain some broadly similar commitments, in areas such as promoting and maintaining a high level of environmental protection, engaging in environmental cooperation and providing opportunities for public participation, among others, but also differ in some respects as detailed in Table 7.10.

**Table 7.10 Convergence and divergence in environment provision**

Issues	2008 study	2016 update
<b>Enforceability of commitments on environmental protection</b> <sup>a</sup>	10 of 30 FTAs include non-enforceable commitments. 7 of 30 FTAs include enforceable commitments.	5 of 10 FTAs include non-enforceable commitments. Only 1 FTA includes enforceable commitments
<b>Cooperation</b>	18 of 30 FTAs include environmental provisions that specify environmental cooperation mechanisms of various types.	5 of 10 FTAs include cooperation provisions.
<b>Transparency and public participation and environmental awareness</b>	10 of 30 FTAs addressed the issues of public participation.	3 of 10 FTAs include provisions on public participation.
<b>Institutional arrangements</b>	14 of 30 FTAs include environmental provisions that address institutional matters.	5 of 10 FTAs include environmental provisions that address institutional matters.
<b>Consultations (other than through dispute settlement)</b> <sup>b</sup>	3 of 30 FTAs include provisions on consultations.	4 of 10 FTAs include provisions on consultations.
<b>Submissions system (citizens petitions)</b>	3 of 30 FTAs include provisions for a submissions system (citizens' petitions).	1 of 10 FTAs includes such provision.
<b>Levels of environmental protection</b>	9 of 30 FTAs include provisions on levels of environmental protection.	5 of 10 FTAs include provisions on levels of environmental protection.
<b>Procedural guarantees for domestic remedies (for violations of environmental law)</b>	7 of 30 FTAs include procedural guarantees.	2 of 10 FTAs include such provisions.
<b>Voluntary mechanisms to enhance environmental performance</b>	5 of 30 FTAs include provisions of voluntary mechanisms to enhance environmental performance.	2 of 10 FTAs include provisions on encouraging voluntary mechanisms to enhance environmental performance.
<b>Relation to multilateral environmental agreements (MEAs)</b> <sup>c</sup>	8 of 30 RTAs/FTAs include provisions defining relations with MEAs.	2 of 10 FTAs include such provisions.

<sup>a</sup> Enforceability of commitments denotes whether the FTAs' commitments on environmental protection are subject to any party-to-party dispute resolution mechanism. Non-enforceable commitments include non-binding commitments as well as commitments only subject to consultations between the Parties.

<sup>b</sup> Consultations denote whether FTAs offer an arrangement for Parties to resolve differences between or among them concerning whether a party is fulfilling its obligations under the agreement other than the consultation process in a dispute settlement case.



<sup>c</sup> Relation to MEAs denotes whether the FTAs contain provisions that recognize the importance of certain MEAs in protecting environment and that the provisions can contribute to reaching the objectives of the MEAs.

### 7.3.11 Labour

The labour chapter is one of the areas that show the highest degree of divergence. In this update, 3 out of all post-2008 FTAs contain labor provisions. 1 of them merely reaffirms the parties' obligation under the International Labor Organization (ILO) states that labor issues are handed in a side agreement, while the other 2 agreements have labor provisions that share a broadly similar framework. Also, all post-2008 FTAs examined display a high degree of divergence with regards to dispute settlement of labor issues.

**Table 7.11 Convergence and divergence in labour provision**

Issues	2008 study	2016 update
<b>Labour chapter</b>	13 of 30 contain such a chapter.	3 of 10 contain such chapter.
<b>General statement</b>	Low level of divergence.	Same as 2008.
<b>International Labor Organization (ILO) declaration</b>	Low level of divergence.	Only 1 FTA refers to ILO declaration.
<b>ILO standards</b>	Low level of divergence.	2 FTAs mention these standards.
<b>ILO standards and labour law</b>	Low level of divergence. Most of the FTAs regulate this issue in a similar, non-binding fashion.	1 FTA provides binding obligation to ensure the adoption and enforcement of labour law consistent with standards.
<b>Labour law and trade</b>	Low level of divergence. Most of the FTAs provide the 'inappropriateness' of using labour law for protectionist purpose.	2 FTAs regulate that the parties 'shall' not use labour law for protectionist purpose.
<b>Procedural rights</b>	Low level of divergence.	1 FTA goes into more detail.
<b>Labour cooperation</b>	Medium level of divergence. Some FTAs require public participation.	1 FTA goes into more detail.
<b>Dispute settlement</b>	High level of divergence. Significant differences appear on procedure, applicability and scope of the dispute settlement chapter.	2 FTAs provide consultation as means of dispute settlement. But only 1 allows access to the dispute settlement chapter.

### **7.3.12 E-commerce**

The rapid growth of Internet-based digital trade indicates new trade rules are required in the twenty-first century trade and investment environment. While digital trade involves a broad range of issues, it has become a common practice among APEC FTAs to include a dedicated chapter on e-commerce to provide the basic framework for regulating digital trade. Due to these new developments, this update has included an analysis of e-commerce chapters in recent FTAs, despite the original 2008 study not covering this topic.

Eight of all post-2008 FTAs (with the Chile–Hong Kong, China and the Japan–Viet Nam FTAs being the exceptions) reviewed included either a dedicated chapter or specific provisions on e-commerce. Common to most of them is the obligation to refrain from imposing customs duties on electronic transmissions between the Parties. Three FTAs (Australia–Japan, Korea–US and Singapore–Chinese Taipei) go further and require products distributed electronically to receive non-discriminatory treatment. Also, eight FTAs include provisions encouraging FTA parties to promote paperless trading between businesses and the government as well as to provide for electronic authentication and signatures for commercial transactions.

The e-commerce chapters in all eight FTAs encourage Parties to elevate the level of consumer protection and privacy protection. Specifically, most FTAs require regulators to at least endeavour to adopt or maintain consumer protection laws related to fraudulent and deceptive commercial activities online, as well as to implement privacy protections. Cooperation and consultation between regulators, and exchange of information requirements are also included in all eight FTAs. The Korea–US FTA includes specific commitments on the freedom for companies and consumers to have access to data and, subject to privacy protection and other conditions, to allow the free movement of data.

### **7.3.13 Economic cooperation**

The updated study notes that a number of recent FTAs are extending of the scope of FTAs beyond traditional trade and investment liberalization to include provisions promoting bilateral cooperation in a variety of economic activities. Five out of all post-2008 FTAs reviewed include cooperation provisions aiming to promote closer economic relationships with a view of maximizing the potential benefit from these FTAs.

The chapters on cooperation in APEC FTAs tend to vary significantly. Some chapters are very general and establish a framework or/and create a committee in charge of those matters. Others include a chapter focusing on specific sectors such as the development of business and trade opportunities in tourism, education, renewable energy and fisheries. These chapters could also cover a wide range of arrangements in facilitating

bilateral industrial cooperation, extending from agriculture, textile, science and technologies, small-and-medium enterprises, to the development of joint industrial parks.

## 7.4 CONCLUSION

The original 2009 *Further Analytical Study on the Likely Economic Impact of an FTAAP* examined the net trade creation effects of an FTAAP, and concluded that the FTAAP could be a valuable complement to APEC economies' efforts to achieve the Bogor Goals of a free and open trade and investment system. Since then, we have been experiencing a proliferation of bilateral and sub-regional FTAs. Creating an FTAAP could expand the benefits of mega-FTAs such as the recently concluded TPP and any future RCEP.

The update to the 2009 study shows patterns similar to the original in terms of the FTAAP's effect on real gross domestic product (GDP), welfare and trade. Both the 2009 study and the update support deeper integration, through either easier trade with enhanced trade facilitation or freer trade in services, as a more desirable scheme compared to a situation in which only tariffs are eliminated.

Consequently, the updated study also supports the policy implications proposed by the 2009 study. The FTAAP could be the world's largest FTA in terms of membership and economic coverage, but to make it high-quality and comprehensive, it is important to set an ambitious liberalization goal of removing not only tariffs but also non-tariff barriers, especially in the services sector, and introducing enhanced trade facilitation provisions.

The update to the 2008 study on *Identifying Convergences and Divergences in APEC RTAs/FTAs* shows that the level of convergence appears to be more obvious among APEC across the new FTAs reviewed. Common elements and practices in FTAs across a wide range of trade issues create a solid foundation for any future FTAAP. Nevertheless, the new trade issues identified in previous chapters of this report warrant APEC economies maintaining their ability and flexibility in including new agendas regarding the scope of a future FTAAP. At the same time, divergences in many areas persist among FTAs and they reflect the specific concerns and reservations by the signatory parties. Special attention needs to be paid in those areas in any future FTAAP negotiation.<sup>191</sup>

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<sup>191</sup> It is of note that due to time and resource constraints, not all post-2008 FTAs (see Table 5.1 for the complete list) are included in the update. Nonetheless, best efforts have gone toward enhancing coverage and representation in the selection of FTAs: the 10 post-2008 FTAs reviewed in the current update covers at least one agreement concluded by all APEC economies that have participated in FTA negotiations after 2008. That said, caution should still be given to the interpretation of the results of the

## 8. ONGOING REGIONAL UNDERTAKINGS

### 8.1 INTRODUCTION

This chapter provides an overview, based on publicly available information, of the status of several ongoing regional undertakings that could contribute to the eventual realization of an FTAAP.

In selecting the regional undertakings for this analysis, this chapter builds on the 2010 APEC document, ‘Pathways to FTAAP’, as well as the 2014 Beijing Roadmap for APEC’s Contribution to the Realization of the FTAAP, in which APEC Leaders highlighted the importance of ASEAN+3, the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Pacific Partnership (TPP).<sup>192</sup>

The initiatives selected for this analysis are the TPP agreement and the RCEP negotiations which had previously been referenced by APEC Leaders as possible pathways to the FTAAP. Other initiatives reviewed are the Pacific Alliance (PA), the Eurasian Economic Union (EAEU) and ASEAN economic integration initiatives. Recognizing APEC’s championing of liberalization at the multilateral level, this chapter also refers to two recently concluded plurilateral or multilateral WTO agreements, namely, the Expanded Information Technology Agreement and the Agreement on Trade Facilitation.

Table 8.1 identifies participation in APEC, TPP, RCEP, PA, EAEU and ASEAN initiatives.

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update, as it does not cover all post-2008 APEC FTAs.

<sup>192</sup> APEC, ‘Pathways to FTAAP’, in *APEC Leaders’ Declaration* (2010); APEC, ‘Annex A – The Beijing Roadmap for APEC’s Contribution to the Realization of the FTAAP’, in *APEC Leaders’ Declaration* (2014).

**Table 8.1 Participation in selected regional initiatives**

APEC	TPP	RCEP	PA	EAEU	ASEAN
Australia	√	√			
Brunei Darussalam	√	√			√
Canada	√				
Chile	√		√		
China		√			
Hong Kong, China					
Indonesia		√			√
Japan	√	√			
South Korea		√			
Malaysia	√	√			√
Mexico	√		√		
New Zealand	√	√			
Papua New Guinea					
Peru	√		√		
Philippines		√			√
Russia				√	
Singapore	√	√			√
Chinese Taipei					
Thailand		√			√
USA	√				
Viet Nam	√	√			√
		Cambodia	Colombia	Armenia	Cambodia
		India		Belarus	
		Lao PDR		Kazakhstan	Lao PDR
		Myanmar		Kyrgyzstan	Myanmar

APEC=Asia Pacific Economic Co-operation; TPP=Trans-Pacific Partnership; RCEP=Regional Comprehensive Economic Partnership; PA=Pacific Alliance; EAEU=Eurasian Economic Union; ASEAN=Association of Southeast Asian Nations

## 8.2 POSSIBLE PATHWAYS TO THE FTAAP

### 8.2.1 Trans-Pacific Partnership (TPP)

The TPP preparatory phase began in the last quarter of 2008, when the US proposed to launch negotiations for a new, high-quality, twenty-first century free trade agreement (FTA) with the four members of the Trans-Pacific Strategic Economic Partnership Agreement (P4 – Brunei; Chile; New Zealand; and Singapore) and Australia; Peru; and Viet Nam.

The first formal round of TPP negotiations was held in March 2010 among these eight countries. Others joined the negotiations – Malaysia (2010); Canada (2012); Mexico (2012); and Japan (2013) – bringing the total number of participating economies to 12. The conclusion of the TPP negotiations was announced on 5 October 2015. The TPP was subsequently signed by TPP Ministers on 4 February 2016 in Auckland, New Zealand. As of May 2016, the ratification of the TPP agreement is under process.

In 2014, the TPP market represented nearly 805.4 million people and a combined gross domestic product (GDP) of USD 28.04 trillion.

#### ***8.2.1.1 Key features***

The TPP agreement takes up next-generation issues alongside traditional issues covered in preferential FTAs. The five key features of the agreement are:

- **Comprehensive market access.** The TPP includes commitments to eliminate and reduce tariff and non-tariff barriers across substantially all trade in goods and services, covering the full spectrum of trade, including goods and services trade and investment.
- **A regional approach to commitments.** The TPP includes provisions to facilitate the development of production, supply chains and cross-border integration, promoting efficiency and enhancing conservation efforts, and opening domestic markets.
- **Addressing new trade challenges.** The TPP includes provisions that promote innovation, productivity and competitiveness by addressing new issues, such as the development of the digital economy, and the role of state-owned enterprises in the global economy.
- **Inclusive trade.** The TPP includes new elements that seek to ensure that economies at all levels of development and businesses of all sizes can benefit from trade. It includes commitments to help small and medium-sized businesses understand the agreement, take advantage of its opportunities, and bring their unique challenges to the attention of the TPP governments. It also includes specific commitments on development and trade capacity building, to ensure that all Parties are able to meet the commitments in the Agreement and take full advantage of its benefits.
- **A platform for regional integration.** The TPP is intended as a platform for regional economic integration and is thus designed to include additional economies across the Asia-Pacific region.

#### ***8.2.1.2 Structure and scope***

The key features of the TPP (outlined in the previous section) mark it as an ambitious and important agreement for the Asia-Pacific region and globally, one that sets new international trade rules and standards. The obligations and commitments of the agreement apply plurilaterally to all the TPP Parties, with some limited exceptions.

The TPP unites a group of economies that are diverse in terms of geography, language

and history, size, and levels of development. All TPP economies recognize that diversity is a unique asset, but also one which requires close cooperation, capacity building for the lesser-developed TPP economies, and in some cases, special transitional periods and mechanisms which offer some TPP partners additional time, where warranted, to implement new obligations.

### ***8.2.1.3 Level of ambition***

The TPP includes 30 chapters covering trade and trade-related issues. Schedules and annexes are attached to the chapters related to goods and services trade, investment, government procurement, and temporary entry of business persons. Economy-specific exceptions are found in the annexes to the chapter on state-owned enterprises. The following provides an overview of the level of ambition of each of its chapters.

#### **1. Initial Provisions and General Definitions Chapter**

This chapter recognizes that the TPP can coexist with other international trade agreements between the Parties, including the WTO Agreement, and bilateral and regional agreements. It also provides definitions of terms used in more than one chapter of the agreement.

#### **2. Trade in Goods Chapter**

The TPP Parties agreed to eliminate and reduce tariffs and non-tariff barriers on industrial goods, and to eliminate or reduce tariffs and other restrictive policies on agricultural goods. Most tariff elimination in industrial goods will be implemented immediately, although tariffs on some products will be eliminated over longer timeframes as included in each Party's tariff elimination schedules. In addition, the Parties agreed not to use performance requirements and not to impose WTO-inconsistent import and export restrictions and duties. If the TPP Parties maintain import or export licence requirements, they will notify each other about the procedures so as to increase transparency and facilitate trade flows.

On agricultural products, the Parties agreed to eliminate or reduce tariffs and other restrictive policies. Parties also agreed to promote policy reforms, including by eliminating agricultural export subsidies, working together in the WTO to develop disciplines on export-oriented state trading enterprises, export credits, and limiting the timeframes allowed for restrictions on food exports so as to provide greater food security in the region. The TPP Parties have also agreed to increase transparency and cooperation on certain activities related to agricultural biotechnology.

#### **3. Textiles and Apparel Chapter**

The TPP Parties agreed to eliminate all tariffs on textiles and apparel, most of which will be eliminated immediately upon entry into force, although tariffs on some sensitive products will be eliminated over longer timeframes as agreed by the TPP Parties. The chapter also includes specific rules of origin that require the use of yarns and fabrics from the TPP region, which will promote regional supply chains and investment in this sector, with a ‘short supply list’ mechanism that allows use of certain yarns and fabrics not widely available in the region. In addition, the chapter includes commitments on customs cooperation and enforcement as well as a textile-specific special safeguard.

#### **4. Rules of Origin and Origin Procedures Chapter**

Parties have agreed on a single set of rules of origin, with product-specific rules of origin annexed to the text of the agreement. These rules define whether a particular good is originating and, therefore, eligible to receive TPP preferential tariff benefits. The TPP provides for ‘accumulation’, so that in general, inputs from one TPP Party are treated the same as materials from any other TPP Party, if used to produce a product in any TPP Party. The Parties have also set rules that ensure businesses can easily operate across the TPP region, by creating a common TPP-wide system of showing and verifying that goods made in the TPP meet the rules of origin.

#### **5. Customs Administration and Trade Facilitation Chapter**

Complementing WTO efforts to facilitate trade, the TPP Parties have agreed on rules to enhance the facilitation of trade, improve transparency in customs procedures and ensure integrity in customs administration. These rules will help TPP businesses, including small and medium-sized businesses, by encouraging smooth processing in customs and border procedures, and will promote regional supply chains.

#### **6. Sanitary and Phytosanitary (SPS) Measures Chapter**

This chapter advances the shared interest of TPP Parties in ensuring transparent, non-discriminatory rules based on science, building on WTO SPS rules. It reaffirms the right of TPP Parties to protect human, animal or plant life or health in their economies. Emergency measures to ensure such protection may be taken when necessary, provided that the Party implementing them notifies all other Parties. The Party adopting an emergency measure will review the scientific basis of that measure within six months and make available the results of the review to any Party on request. The TPP also allows the public to comment on proposed SPS measures to inform their decision-making and ensures that traders understand the rules they will need to follow.



## **7. Technical Barriers to Trade (TBT) Chapter**

This chapter provides transparent, non-discriminatory rules for developing technical regulations, standards and conformity assessment procedures, while preserving the TPP Parties' ability to fulfil legitimate objectives. The TPP includes annexes related to regulation of specific sectors to promote common regulatory approaches across the TPP region. These sectors are cosmetics, medical devices, pharmaceuticals, information and communications technology products, wine and distilled spirits, proprietary formulas for prepackaged foods and food additives, and organic agricultural products.

## **8. Trade Remedies Chapter**

The trade remedies chapter does not affect the TPP Parties' rights and obligations under the WTO agreements. The chapter also provides for a transitional safeguard mechanism, which allows for transitional safeguard measures (e.g. temporary tariff increases) in exceptional circumstances to protect domestic industry from injury following a surge in imports as a result of tariff reduction or elimination pursuant to the TPP agreement. It also promotes transparency and due process in anti-dumping and countervailing measures proceedings through recognition of best practices.

## **9. Investment Chapter**

This chapter sets out rules requiring non-discriminatory investment policies that assure basic rule of law protections, while protecting the ability of Parties' governments to achieve legitimate public policy objectives. The TPP provides the basic investment protections found in other investment-related agreements. The Parties adopted a negative-list approach to non-conforming measures, meaning that their markets are fully open to foreign investors, except where they have taken an exception (non-conforming measure). The chapter also provides access to an independent international investor-State dispute settlement mechanism that is neutral and transparent, and has strong safeguards to prevent abuse and frivolous claims. It also ensures the right of governments to regulate in the public interest, including on health, safety and environmental protection.

## **10. Cross-Border Trade in Services Chapter**

This chapter includes core obligations found in the WTO and other trade agreements: national treatment, most-favoured nation treatment, market access and local presence. The TPP Parties accepted these obligations on a negative-list basis, meaning that their markets are fully open to services suppliers from TPP countries, except where they have taken an exception (non-conforming measure). The Parties

also agreed to administer measures of general application in a reasonable, objective, and impartial manner; and to accept requirements for transparency in the development of new services regulations.

### **11. Financial Services Chapter**

This chapter includes core obligations found in other trade agreements, including: national treatment; most-favoured nation treatment; market access; and certain provisions under the investment chapter, including the minimum standard of treatment and investment arbitration. The TPP Parties have economy-specific exceptions to some of these rules in two annexes attached to the TPP. The Parties also set out rules that formally recognize the importance of regulatory procedures to expedite the offering of insurance services by licensed suppliers and procedures to achieve this outcome. In addition, the TPP includes specific commitments on portfolio management, electronic payment card services and transfer of information for data processing.

### **12. Temporary Entry for Business Persons Chapter**

This chapter encourages authorities of the TPP Parties to provide information on applying for temporary entry, to ensure that application fees are reasonable, and to make decisions on applications and inform applicants of decisions as quickly as possible. Almost all Parties have made commitments on access for each other's business persons in economy-specific annexes. While the coverage varies by Party, the commonly covered categories are business visitors, intra-company transferees, investors and certain highly-skilled professionals.

### **13. Telecommunications Chapter**

This chapter provides access to telecommunication services suppliers and enhances regulatory certainty for them when operating or investing in TPP markets. TPP's pro-competitive network access rules also cover mobile suppliers. The TPP Parties commit to ensure that major telecommunications services suppliers in their territory provide interconnection, leased circuit services, co-location, and access to poles and other facilities under reasonable terms and conditions and in a timely manner.

### **14. Electronic Commerce Chapter**

This chapter includes commitments to facilitate digital trade by ensuring that the Parties do not impose customs duties on electronic transmissions or discriminate against the digital products of other TPP parties. The chapter supports the free flow of information and data that drive the digital economy, subject to legitimate public policy objectives such as personal information protection. In addition, the Parties

agreed to refrain from requiring companies to locate their computing facilities within their territories or provide access to their software source code.

### **15. Government Procurement Chapter**

This chapter ensures access to the TPP Parties' large government procurement markets through transparent, predictable and non-discriminatory rules. It commits Parties to national treatment. Parties are to publish relevant information in a timely manner, giving suppliers sufficient time to obtain the tender documentation and submit a bid. They are to treat tenders fairly and impartially, and maintain the confidentiality of tenders. Each Party agreed to a positive list of entities and activities that are covered by the chapter, and these are listed in the annexes.

### **16. Competition Policy Chapter**

This chapter ensures a framework of fair competition in the region through rules that require the TPP Parties to maintain legal regimes that proscribe anti-competitive business conduct, as well as fraudulent and deceptive commercial activities that harm consumers. TPP Parties agreed to adopt or maintain domestic competition laws that proscribe anti-competitive business conduct and work to apply these laws to all commercial activities in their territories. This chapter also recognizes the importance of cooperation and coordination between the Parties' domestic competition authorities.

### **17. State-Owned Enterprises and Designated Monopolies Chapter**

This includes enforceable provisions for state-owned enterprises, in order to ensure a level playing field when such enterprises compete commercially with private industry. The TPP Parties agreed to ensure that their state-owned enterprises make commercial purchases and sales on the basis of commercial considerations and do not discriminate against the enterprises, goods and services of other Parties. The TPP Parties also agreed not to cause adverse effects to the interests of other TPP Parties in providing non-commercial assistance to state-owned enterprises, or injury to another Party's domestic industry by providing non-commercial assistance to a state-owned enterprise that produces and sells goods in that other Party's territory. The chapter includes exceptions, for example, where there is a domestic or global economic emergency, as well as economy-specific exceptions (that are set out in annexes).

### **18. Intellectual Property Chapter**

This chapter includes obligations that cover patents, trademarks, copyrights, industrial designs, geographical indications, trade secrets, other forms of

intellectual property and enforcement of intellectual property rights, as well as areas in which Parties agree to cooperate. The TPP sets strong regional standards for the protection and enforcement of intellectual property rights, reflecting and building upon WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

## **19. Labour Chapter**

This chapter recognizes the importance of promoting internationally recognized labour rights. The TPP Parties agreed to adopt and maintain in their laws and practices the fundamental labour rights as recognized in the 1998 ILO Declaration.<sup>193</sup> These rights include: freedom of association and the right to collective bargaining; elimination of forced labour; abolition of child labour and a prohibition on the worst forms of child labour; and elimination of discrimination in employment. Parties also agreed to promote public awareness of labour laws, including providing mechanisms to obtain public input.

## **20. Environment Chapter**

The chapter includes commitments on protecting and conserving the environment. The Parties agreed to pursue high levels of environmental protection; effectively enforce their environmental laws; and not weaken their environmental laws in order to encourage trade or investment. The chapter also includes commitments to address global environmental challenges, such as illegal wildlife trafficking, logging, and fishing. These include innovative obligations to prohibit harmful fisheries subsidies that negatively affect overfished fish stocks. There are also provisions that are intended to recognize the importance of promoting the conservation of biodiversity, protecting the marine environment, combatting invasive alien species, and transitioning to low-emissions and resilient economies.

## **21. Cooperation and Capacity Building Chapter**

This chapter recognizes that the TPP's lesser-developed Parties may face particular challenges in implementing the agreement and in taking full advantage of the opportunities it creates. To address these challenges, the chapter establishes a Committee on Cooperation and Capacity Building whose objective is to identify and review areas for potential cooperation and capacity building.

## **22. Competitiveness and Business Facilitation Chapter**

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<sup>193</sup> International Labour Organization (ILO), *ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up* (1998).

This chapter creates formal mechanisms to review the impact of the TPP on the competitiveness of the Parties, through dialogues among governments and between government, business and civil society. The review mechanisms have, as their particular focus, TPP impacts on deepening regional supply chains, assessing progress, taking advantage of new opportunities and addressing any challenges that may emerge once the TPP is in force.

### **23. Development Chapter**

This chapter ensures that the TPP will be a high-standard model for trade and economic integration, particularly that all Parties are fully able to implement their commitments. The chapter establishes a TPP Development Committee, which will meet regularly to promote voluntary cooperative work in specific areas (broad-based economic growth; women and economic growth; and education, science and technology, research, and innovation) and new areas as they arise.

### **24. Small and Medium-Sized Enterprises (SMEs) Chapter**

This chapter promotes the participation of SMEs in trade to ensure that they share in the benefits to be generated by the TPP. Complementing the commitments made in other chapters of the TPP, this chapter includes commitments by each TPP Party to create accessible, user-friendly websites that present information on the TPP, and the ways in which small firms can take advantage of it.

### **25. Regulatory Coherence Chapter**

This chapter aims to facilitate regulatory coherence in each TPP Party by promoting mechanisms for effective interagency consultation and coordination, and encouraging widely accepted good regulatory practices.

### **26. Transparency and Anti-Corruption Chapter**

This chapter aims to promote the goal of strengthening good governance and addressing the corrosive effects bribery and corruption can have on economies. Under the provisions of this chapter, the Parties need to ensure that their laws, regulations and administrative rulings of general application with respect to any matter covered by the TPP are publicly available and that, to the extent possible, regulations that are likely to affect trade or investment between the Parties are subject to notice and comment.

### **27. Administrative and Institutional Provisions Chapter**

This chapter sets out the institutional framework by which the Parties will assess

and guide implementation or operation of the TPP. It establishes the Trans-Pacific Partnership Commission, composed of Ministers or senior level officials, to oversee the implementation or operation of the agreement and guide its future evolution.

## **28. Dispute Settlement Chapter**

This chapter is intended to allow the Parties to expeditiously address disputes between them regarding the implementation of the TPP. Modelled on the WTO dispute settlement system, the chapter also contains remedy provisions, which provide a complaining Party with options it can use to encourage compliance. While complaining Parties have recourse to trade retaliation, the TPP also includes a cooperative mechanism, which enables the creation of a monetary fund. The fund is then jointly leveraged for initiatives that will improve compliance and eventually resolve the issue.

## **29. Exceptions and General Provisions Chapter**

This chapter ensures that flexibilities are available to all TPP Parties, guaranteeing the right to regulate in the public interest, including for a Party's essential security interest and other public welfare reasons. The chapter also incorporates Article XX of the General Agreement on Tariffs and Trade (GATT) 1994 to the goods trade-related provisions; and Article XIV of the General Agreement on Trade in Services (GATS) with respect to the services trade-related provisions. The TPP also allows a government to deny an investor recourse to investor-State dispute settlement for claims challenging a tobacco control measure.

## **30. Final Provisions Chapter**

This chapter defines the way the TPP will enter into force, the way in which it can be amended, the rules that establish the process for other States or separate customs territories to join the TPP in the future, the means by which Parties can withdraw and the official languages of the TPP. It also designates New Zealand as the Depository for the TPP agreement; it is responsible for receiving and disseminating documents.

### ***8.2.1.4 Next steps***

On 4 February 2016, TPP Ministers signed the TPP agreement in Auckland, New Zealand. The intent was to provide two years for the signatories to bring the agreement into force together. After two years, should all 12 Parties not be ready, the agreement can be brought into force by at least six signatories, together accounting for at least 85 percent of the total TPP GDP.

## **8.2.2 Regional Comprehensive Economic Partnership (RCEP)**

ASEAN, which consists of 10 member states (Indonesia; Malaysia; Philippines; Singapore; Thailand; Brunei Darussalam; Viet Nam; Lao PDR; Myanmar; and Cambodia) aims to accelerate economic growth, social progress and sociocultural evolution among its members and protect regional peace and stability.

In November 2011, ASEAN proposed its own model for an ASEAN-centred regional FTA called the RCEP, composed of the 10 ASEAN members and its six FTA partners (China; Japan; India; Korea; Australia; and New Zealand); and this was subsequently endorsed by ASEAN leaders. The RCEP negotiations were officially launched at the 21<sup>st</sup> ASEAN and Related Summit in November 2012 in Phnom Penh, Cambodia, and negotiations commenced in May 2013 in Brunei Darussalam. As at 15 March 2016, there have been 11 rounds of negotiations and 3 RCEP Ministerial Meetings.

With 3.3 billion people, covering over half of the world's population and almost 30 percent of the world's output and trade, the RCEP offers significant potential to improve the standard of living across the region and to serve as a growth driver and a key pathway for broader economic integration.

### ***8.2.2.1 Key features***

The RCEP represents an effort to achieve a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement among participating economies. It will expand and intensify the benefits of existing ASEAN+1 FTAs,<sup>194</sup> together with the recently established ASEAN Economic Community, which came into force at the ASEAN Summit of November 2015. However, the ASEAN+1 FTAs and the bilateral/plurilateral FTAs between and among participating countries will continue to exist.

The RCEP is envisaged as a cohesive economic partnership among members with emphasis on supporting and contributing to economic integration and equitable economic development, as well as strengthening economic cooperation.

The RCEP is in line with the fourth pillar of the ASEAN Economic Community Blueprint to make ASEAN a single market and production base, a highly competitive economic region and a region of equitable economic development. In 2014, RCEP economies, which cover a region of more than 3 billion people, registered a combined

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<sup>194</sup> The five ASEAN+1 FTAs are: ASEAN–China FTA, ASEAN–Japan Comprehensive Economic Partnership, ASEAN–Republic of Korea FTA, ASEAN–Australia–New Zealand FTA and ASEAN–India FTA.

GDP of USD 22.7 trillion and represented 28.4 percent of world trade.

#### ***8.2.2.2 Structure and scope***

The RCEP covers trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, legal and institutional matters, dispute settlement, electronic commerce and other issues.

Sub-working groups have also been established to discuss other issues related to trade and investment, including: rules of origin; SPS; customs procedures and trade facilitation standards; standards, technical regulations and conformity assessment procedures; financial services; and telecommunication services.

As negotiations for the RCEP are ongoing, it may be difficult at this point to gauge its final scope. Outside the RCEP Guiding Principles and Objectives for Negotiating the RCEP, areas such as SMEs, food security and government procurement are also being discussed.

#### ***8.2.2.3 Level of ambition***

Under the Guiding Principles and Objectives for Negotiating the RCEP endorsed by RCEP Ministers on 30 August 2012, the level of ambition for each area has been described as follows.

##### **1. Trade in Goods**

The RCEP aims to progressively eliminate tariff and non-tariff barriers on substantially all trade in goods in order to establish a free trade area among the Parties. Tariff negotiations will be conducted on a comprehensive basis. The negotiations seek to achieve a high level of tariff liberalization, through building on the existing liberalization levels between RCEP participating countries, and through tariff elimination on a high percentage of tariff lines and trade value. The scheduling of tariff commitments seeks to maximize the benefits of regional economic integration. Priority will be attached to early tariff elimination on products of interest to the least developed ASEAN member states.

##### **2. Trade in Services**

The RCEP will be comprehensive, of high quality and substantially eliminate restrictions and/or discriminatory measures with respect to trade in services between RCEP participating countries. Rules and obligations on trade in services under the RCEP will be consistent with GATS; and the RCEP will be directed toward achieving liberalization goals by building on the RCEP participating



countries' commitments under GATS and the ASEAN+1 FTAs. All sectors and modes of supply will be subject to negotiations.

### **3. Investment**

The RCEP aims to create a liberal, facilitative and competitive investment environment in the region. Negotiations on investment under the RCEP cover the four pillars of promotion, protection, facilitation and liberalization.

### **4. Economic and Technical Cooperation**

Economic and technical cooperation under the RCEP aims to narrow the development gaps among the Parties and maximize mutual benefits from RCEP implementation. The provisions in this chapter are built upon existing economic cooperation arrangements between ASEAN and its FTA partners participating in RCEP. Areas of cooperation include e-commerce and other areas that would be mutually agreed upon by the RCEP participating countries.

### **5. Intellectual Property**

The focus is in reducing intellectual property-related barriers to trade and investment. This is done through the promotion of economic integration and cooperation in the utilization, protection and enforcement of intellectual property rights.

### **6. Competition**

The provisions provide the basis for cooperation, in promoting competition, economic efficiency and consumer welfare, and in restricting anti-competitive practices. At the same time, differences in the capacity and national regimes of members will be recognized.

### **7. Dispute Settlement**

The dispute settlement chapter provides an effective, efficient and transparent process for consultations and dispute resolution.

### **8. Electronic Commerce**

To facilitate and promote e-commerce, the Working Group on Electronic Commerce was established at the 8<sup>th</sup> round of RCEP meetings.

### **9. Other Issues**

The RCEP also takes into account and considers issues covered by FTAs among RCEP participating countries, which may be identified and mutually agreed on in the course of negotiations, including new and emerging issues relevant to present business realities.

#### **8.2.2.4 Next steps**

On 22 November 2015, at the 27th ASEAN Summit in Kuala Lumpur, Malaysia, RCEP Leaders released a Joint Statement on the negotiations. RCEP Leaders gave a new mandate to RCEP Ministers and Negotiators to intensify their efforts and to conclude the negotiations in 2016.

The conclusion and implementation of this regional initiative is expected to bring about substantial change to the economic landscape of the region and the global economy. The success of the RCEP will draw other trading partners to join the grouping as the RCEP will provide greater momentum for the development of sophisticated supply chain activities among ASEAN and her FTA partners.

### **8.3 OTHER REGIONAL OR SUBREGIONAL UNDERTAKINGS**

#### **8.3.1 Pacific Alliance (PA)**

The PA is a subregional integration initiative comprised of Chile, Colombia, Mexico and Peru. On 28 April 2011, in Lima, Peru, Heads of State met for the first time and signed the *Presidential Declaration for the Pacific Alliance* (known as the Lima Declaration). On 6 June 2012, during the Presidential Summit in Antofagasta, Chile, the Framework Agreement was signed (Declaration of Paranal). The agreement entered into force on 20 July 2015. This agreement establishes the institutional basis of this regional initiative.

##### **8.3.1.1 Key features**

In accordance with the objectives established on the Framework Agreement, the PA aims to:

- Build, in a participatory and consensual manner, an area of deep integration in order to progressively advance toward the free movement of goods, services, resources and people.
- Promote an increase of growth, development and competitiveness in its member economies, that is focused on achieving greater wellbeing, overcoming socioeconomic inequality and promoting social inclusion among its inhabitants.

- Become a platform of political articulation, and of economic and commercial integration, with international outreach emphasizing on the Asia-Pacific region.

### ***8.3.1.2 Structure and scope***

The PA is a process led by competent authorities in trade and foreign affairs.<sup>195</sup> Periodically, the four member countries' Heads of State gather to review progress and determine the future agenda.

Non-members may participate as observers if they share the principles and objectives set out in the Framework Agreement of the Pacific Alliance. In particular, Article 2 of this agreement establishes the following essential requirements for participation in the PA as observers: (i) respect for the rule of law, democracy and constitutional order; (ii) separation of powers; and (iii) respect for human rights and fundamental freedoms. In addition, if an observer has FTAs with at least half of the member countries; it may request to be a candidate to become a member of the Pacific Alliance. The PA currently has 42 observers and two candidates to become members (Costa Rica and Panama).

The PA seeks to achieve a deeper integration of goods, services, capital and people's mobility in order to create and consolidate a free trade area among the grouping's members. These goals are addressed in the Additional Protocol to the Framework Agreement and the First Modifying Protocol (signed on 10 February 2014 and 3 July 2015 respectively, and entered into force on 1 May 2016). The Additional Protocol covers areas related to market access, trade in services, rules of origin, TBT, SPS measures, trade facilitation and customs cooperation, government procurement, e-commerce, financial services, maritime transportation services, telecommunications, investment and dispute resolution, and institutional issues.

### ***8.3.1.3 Level of ambition***

According to the Additional Protocol, Chile; Colombia; Mexico; and Peru agreed to:

- Eliminate 92 percent of their tariffs when the agreement enters into force. The remaining 8 percent will have tariff reduction periods of between 3 and 17 years (except for sugar).
- Establish a 'cumulative rules of origin mechanism' to promote regional value chains among PA members.

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<sup>195</sup> Pacific Alliance, *Presidential Declaration for the Pacific Alliance* (28 April 2011); Pacific Alliance, *Framework Agreement of the Pacific Alliance* (6 June 2012), Art. 4.1 'Objectives'.

- Develop trade facilitation actions, such as reduction of customs procedures (through the development of a framework for the interoperability of their foreign trade single windows, among others), customs cooperation, and mutual assistance in data interchange.
- Open public procurement markets.

To liberalize movement of people, members have agreed to:

- Establish a migration security platform. This is in order to prevent and control organized transnational crime, among others.
- Eliminate visas. PA welcomes initiatives and commitments toward the elimination of visa requirements among its member. PA members have granted unilateral access and/or have signed previous bilateral agreements with other members. Mexico eliminated visitor's visa requirements for travellers from Colombia and Peru. Peru eliminated Temporary Business Visas for visitors from Mexico; Chile; and Colombia. Colombia and Peru signed a Memorandum of Understanding eliminating Business Visas.

#### ***8.3.1.4 Current agenda***

PA members are working closely together to accomplish various PA strategic objectives, through developing projects and programmes in areas of interest to the members (see Appendix N). These initiatives are in principle not binding, unless member countries reach an agreement. The areas of cooperation include innovation, SME support, trade promotion, human capital training, students and academic exchange, entrepreneurship, environmental protection, financial integration, youth volunteering and cultural cooperation. Some of these initiatives are set out in Annex A of the Framework Agreement.

#### **8.3.2 Eurasian Economic Union (EAEU)**

The Eurasian Economic Union (EAEU) is a regional undertaking that includes the Republic of Armenia, the Republic of Belarus, the Republic of Kazakhstan, the Kyrgyz Republic and the Russian Federation. The EAEU replaces international agreements concluded previously within the Customs Union and Common Economic Space.

The EAEU has international legal personality and is established by the Treaty on the EAEU. The Treaty on the EAEU within the framework of its capacities ensures free movement of goods, services, capital and labor. In this regard, a Customs Union takes effect within EAEU members. The Treaty on the EAEU ensures common trade policy in the economic sectors as specified therein in international agreements within the

Union.

The Eurasian Economic Commission (EEC) has supranational regulatory body status. A number of issues related to international trade have been submitted to the supranational level. Decisions of the Commission are obligatory for execution in the territory of the EAEU member states. Russia will participate in the eventual FTAAP in accordance with its obligations within the EAEU.

At the moment the EEC is responsible for the assignment and distribution of import customs duties, customs tariff and non-tariff regulations, the establishment of trade regimes in goods for third parties, macroeconomic policy, competition policy, financial markets, industrial and agricultural subsidies, energy policy, natural monopolies, etc. The issues of services and investments are not delegated to the EEC. The EAEU is an ongoing undertaking with a growing scope of competence. A number of other tasks and functions that were traditionally handled by national governments of the EAEU member states can be delegated to the EEC in the future.

### **8.3.3 ASEAN Economic Integration**

ASEAN is an intergovernmental organization established in August 1967, and conferred a legal personality with the adoption of the ASEAN Charter in 2008. ASEAN comprises 10 member states, namely, Brunei Darussalam; Cambodia; Indonesia; Lao PDR; Malaysia; Myanmar; Philippines; Singapore; Thailand; and Viet Nam. Collectively, ASEAN is recognized to be the third-largest market in the world with 622 million people, just behind China and India. ASEAN is the world's 7th largest economy with a combined GDP of USD 2.57 trillion in 2014, a near doubling of the 2007 figure of USD 1.33 trillion.

The ASEAN Economic Community was formally established on 31 December 2015 following the signing of the Kuala Lumpur Declaration on the Establishment of the ASEAN Community on 22 November 2015. Under the ASEAN Economic Community, ASEAN continues to accelerate economic integration and enhance intra-ASEAN trade by reducing barriers to trade, investments, capital and mobility of skilled people as well as enhancing intra-regional connectivity.

ASEAN has eliminated the import duties on 96 percent of the tariff lines under the ASEAN Trade in Goods Agreement. Simultaneously, as at December 2015, ASEAN has also concluded nine services liberalization packages covering over 100 sub-sectors. ASEAN continues to pursue the liberalization of services sector under the 10th (or Final) Package of the ASEAN Framework Agreement on Services. The discussions on the 10th Package is still ongoing. In addition, barriers to extra and intra-ASEAN investment in the region have been reduced or eliminated through the implementation of the ASEAN Comprehensive Investment Agreement.

The ASEAN Economic Community is a work in progress. ASEAN has commenced implementation of the ASEAN Economic Community Blueprint 2025. Launched at the 27<sup>th</sup> ASEAN Summit in Kuala Lumpur in November 2015, the 2025 blueprint builds on the achievements and early gains of the ASEAN Economic Community Blueprint (2008–2015), while taking into consideration the dynamics of regional economic integration and evolving domestic and external environments. The 2025 document is the outcome of a year of planning and intense discussions, and reflects the determination of member states to forge ahead with the next phase of ASEAN's evolution.

The 2025 blueprint is an ambitious and forward-looking successor document that outlines the strategic measures that will be implemented by the region over the next 10 years. The aim is to achieve by 2025 an ASEAN Economic Community with the following main characteristics: (i) a highly integrated and cohesive economy; (ii) a competitive, innovative and dynamic ASEAN; (iii) enhanced connectivity and sectoral cooperation; (iv) a resilient, inclusive, people-oriented and people-centred ASEAN; and (v) a global ASEAN.

The blueprint aims to ensure that the 10 member states are economically and sustainably integrated and are able to gainfully participate in the global economy; that they are stable and resilient in the face of economic volatility; and that they are contributing to the mutual goal of shared prosperity among all.

The implementation of this 10-year plan will further deepen economic integration and enhance economic connectivity within the region. Further liberalization and facilitation measures will be implemented to sustain ASEAN's global competitiveness and economic growth.

ASEAN has also continued to engage its Dialogue Partners, namely, China; Japan; Republic of Korea; India; Australia; New Zealand; the United States; the European Union; Canada; and the Russian Federation, in the pursuit of building a cohesive and vibrant region that is fully integrated into the global economy. One ongoing initiative is the RCEP negotiations (Section 8.2.2).

#### **8.4 APEC'S CONTRIBUTION TO RECENT WTO AGREEMENTS**

The WTO Information Technology Agreement is a tariff elimination agreement on information technology products which was concluded in 1996. It is a plurilateral agreement, meaning that it involves a subset of WTO members. Negotiations to expand the agreement's product coverage for tariff elimination began in May 2012 and concluded in December 2015, at the 10th WTO Ministerial Conference in Nairobi, Kenya. Fifty-three WTO members, including APEC economies such as Canada; China; Chinese Taipei; Japan; Korea; and the US, agreed to eliminate tariffs on an expanded

list of 201 information and communications technology and related products. APEC has served as a forum for encouraging member economies to participate and conclude an expanded Information Technology Agreement.

The WTO Agreement on Trade Facilitation was concluded in 2013. WTO members adopted the Protocol of Amendment for the agreement on 27 November 2014, which will enter into force once two-thirds of members have submitted their instruments of acceptance to the WTO, signalling that they have completed their domestic ratification procedures. The agreement will expedite the release and clearance of goods, cut red tape, enhance the predictability of trade and reduce trade costs and delays at borders. APEC works alongside other international organizations to support implementation of the Agreement on Trade Facilitation to enable businesses in the APEC region to realize its benefits.

## **8.5 CONCLUSION**

This chapter has looked at the TPP and the RCEP, seen by APEC Leaders as possible pathways to the FTAAP. It has also provided a brief overview of the PA, EAEU, ASEAN economic integration and APEC's contribution to recent WTO initiatives.

The TPP stands out for the comprehensiveness of its coverage, with ambitious outcomes in substantially all goods and services trade and investment. This includes the elimination or reduction of tariffs and non-tariff barriers affecting in substantially all trade, as well as regional accumulation, and the elimination or reduction of all discriminatory measures in substantially all services sectors unless specifically excluded by a Party. The TPP takes up next-generation issues alongside traditional ones covered in preferential FTAs. It also stipulates provisions on new and cross-cutting issues, such as government procurement, competition policy, state-owned enterprises, labour, environment and horizontal issues (e.g. development, SMEs, cooperation), which are not addressed in most FTAs. At the same time, the TPP recognizes the different levels of development and members' diversity by establishing close cooperation, capacity building and mechanisms to implement new obligations.

The RCEP will include provisions to facilitate trade and investment and to enhance transparency in trade and investment relations between the participating countries, as well as to facilitate the participating countries' engagement in global and regional supply chains. Taking into consideration the different levels of development of the participating countries, the RCEP will include appropriate forms of flexibility, including provision for special and differential treatment, plus additional flexibility to the least-developed participants. Provisions for technical assistance and capacity building may be made available to all parties, including the developing and least-developed ones, to enable them to fully participate in the negotiations, implement obligations under the RCEP and enjoy the benefits from the RCEP.

The PA, EAEU and ASEAN economic integration initiatives also provide potential lessons toward the eventual realization of an FTAAP. The Expanded WTO Information Technology Agreement and the WTO Agreement on Trade Facilitation illustrate the contributions that APEC economies can make to further liberalization through the multilateral trade system, and the economic benefits they can achieve through supporting WTO initiatives.



## 9. OPPORTUNITIES AND CHALLENGES

### 9.1 INTRODUCTION

In 1994, the APEC Leaders meeting in Bogor, Indonesia established the ambitious long-term objective of achieving ‘free and open trade and investment in the Asia-Pacific’ no later than the year 2020. The Bogor Goals have underpinned much of the work that APEC economies have undertaken since that time. Achieving these goals requires a sustained effort on the part of APEC economies to engage in efforts to intensify development cooperation, identify capacity-building projects and promote important policy objectives through, for example, best practices or guidelines. These efforts are core APEC strengths. Thus, APEC’s focus through the years has identified that economic and technical cooperation is essential to promoting a collective vision of achieving trade and investment liberalization and facilitation. It is through these efforts that regional economic integration is enhanced, for example, by accelerating unilateral domestic reform, supporting progress at the WTO, or through greater participation in regional or bilateral free trade agreements.

The APEC Leaders’ vision of the FTAAP emerged as a long-term prospect for advancing regional economic integration in 2006. In subsequent years, APEC Leaders have cited FTAAP as a means to help spur greater regional economic integration. The steps to be taken have been both practical and incremental in advancing work on issues relevant to an eventual realization of the FTAAP. In 2010, APEC Leaders identified possible pathways to an FTAAP, including such regional undertakings as the Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP), among others (‘Pathways to FTAAP’). Leaders saw APEC’s role as an incubator of an FTAAP through leadership and intellectual input on measures necessary for a high-quality trade agreement, within the framework of its non-binding, voluntary approach. Within that context, APEC has contributed significantly to this endeavour.

In recent years, the Asia-Pacific region has witnessed an explosive growth of FTAs/RTAs. So far APEC member economies have completed 145 FTAs/RTAs, encompassing both agreements within APEC and with economies outside APEC. Since November 2008, at least 30 new intra-APEC FTAs/RTAs either entered into force or were concluded. The proliferation of FTAs/RTAs, and the resulting cumulative rules of origin, has created favourable liberalizing momentum for regional economic integration; however it has also resulted in a ‘spaghetti bowl’ effect, posing complex new challenges to regional economic integration and to business. It is commendable to note that APEC member economies have made efforts to address the ‘spaghetti bowl’ effect through the promotion of regional economic integration, which lays out a solid foundation for the eventual realization of the FTAAP.

In 2014, APEC Leaders provided additional guidance on advancing issues related to the FTAAP and decided to kick off and advance the process in a comprehensive and systematic manner toward the eventual realization of the FTAAP, including by endorsing the *Beijing Roadmap for APEC's Contribution to the Realization of the FTAAP*. The Beijing Roadmap states that APEC will pursue the FTAAP through a step-by-step, consensus-based approach, and affirmed APEC's commitment to its eventual realization as early as possible by building on ongoing regional undertakings, which will contribute significantly to sustained growth and overall prosperity in the Asia-Pacific region. The Beijing Roadmap puts forth that FTAAP should do more than achieve liberalization in its narrow sense; it should be comprehensive, of high quality and incorporate and address 'next generation' trade and investment issues. The Collective Strategic Study plays a critical step in this direction. Leaders then connected the vision of the FTAAP with the progress on the possible pathways to FTAAP in 2015 including the finalization of the TPP negotiations, and the encouragement to complete the negotiations on the RCEP.

## **9.2 SUMMARY OF THE COLLECTIVE STRATEGIC STUDY**

The previous eight chapters of this Study provided a review of the APEC region's economic characteristics, trade and investment relationships, value chains and regional development. As trade and investment continues to drive economic growth in the region, a broad trade and investment liberalization platform, such as the FTAAP, could play a key role in promoting regional economic integration. The Study also went through the role of 'next generation' trade and investment issues that APEC has identified and/or addressed over the past several years.

The Study examines various measures affecting trade and investment in the region, including tariffs, non-tariff measures, measures affecting services, and investment regimes. It takes stock of existing FTAs and RTAs in the region and the impact of the so-called 'spaghetti bowl' phenomenon. The Study reviews previous initiatives and its contribution to the realization of the FTAAP. The Study updates APEC's past work on the *Likely Economic Impact of an FTAAP* (2009) and *Identifying Convergences and Divergences in APEC RTAs/FTAs* (2008). Based on publicly available information, the Study examines the status of ongoing regional undertakings, including the RCEP and the TPP as possible pathways to the eventual realization of the FTAAP. Other regional initiatives in the Asia-Pacific have also taken roles to advance regional economic integration. Each of these pathways helps in raising awareness and the ability of participating economies to adopt reforms necessary to achieve an FTAAP as set out by Leaders.

The Study demonstrates the robust nature of APEC's work to advance regional economic integration and promote high-quality trade agreements, trends in

international trade, as well as examines other issues that are important to an eventual FTAAP. In particular, this work reflects the challenges of addressing rapid change in the region. Indeed, since the establishment of the Bogor Goals, trade in the APEC region has grown steadily, though it has recently slowed. Likewise, as the Pacific Economic Cooperation Council (PECC) has noted, the speed of innovation in the region has created an ever-increasing gap in the ability of economic governance to keep pace. The voluntary nature of APEC's outcomes, and its openness to economic stakeholders, makes it well suited to undertake the preparatory work needed to meet the challenges of a rapidly changing economy.

APEC has played an active and supportive role in promoting Asia-Pacific economic integration. FTAAP is a major instrument to advance APEC's economic integration toward and potentially beyond the Bogor Goals. FTAAP could deliver gains to all member economies on both sides of the Pacific and invigorate economic growth. The path toward an eventual FTAAP is a substantial and challenging undertaking, but one that presents an opportunity for APEC economies to advance important policy objectives that will enhance regional economic integration.

### **9.3 OPPORTUNITIES AND CHALLENGES**

The world economy is in the midst of a slow but vulnerable recovery. Economic growth in the region has remained relatively more stable than the rest of the world. This results from the synergy of all APEC member economies, which strengthens the region's willingness to enhance cooperation towards regional economic integration. Over the past 25 years, APEC economies have made great strides in the pursuit of free and open trade and investment. APEC's role in facilitating regional economic growth and cooperation has proven essential in efforts to achieve greater common prosperity and stability, and has greatly contributed to the region's reputation as an engine of world economic growth. From 1989 to 2014, the average applied tariffs of APEC economies fell by more than 10 percent, and as a result, there has been a seven-fold increase in both intra-APEC merchandise trade and APEC's total trade, as well as higher economic growth compared to the rest of the world. The efforts to further advance trade and investment liberalization in the Asia-Pacific region led by the goal of an eventual FTAAP could also make a significant contribution to the WTO's multilateral trading system. Indeed, multilateral, plurilateral and bilateral trade and investment liberalization and the APEC regional economic integration processes are complementary.

An eventual FTAAP could bring great opportunities for the Asia-Pacific region and create positive externalities for the rest of the world. It could boost the growth of trade and investment by reducing barriers, particularly addressing emerging trade and investment issues, and could also help resolve the complications presented by the 'spaghetti bowl' effect, resulting in a new landscape of Asia-Pacific economic

integration. It could increase connectivity and help to bring many enterprises and workers into the mainstream of the global production system so as to lead to inclusive economic progress.

A strong foundation built upon unilateral liberalization of economic and investment policies, trade facilitation, and economic and technical cooperation is essential to demonstrate APEC's continued commitment towards achieving the Bogor Goals of free and open trade and investment in the Asia-Pacific which contributes to the eventual realization of FTAAP.

APEC's ability to address emerging trade and investment issues, its history as an incubator of ideas for the global trading system, and its demonstrated ability to deliver targeted capacity building put it in a unique position to support member economies as they aspire to undertake domestic reform, to participate in FTAs that will eventually result in a high-quality and comprehensive FTAAP as envisioned by Leaders in 2006. It is a testament to APEC's strength rooted in consensus-based, non-binding cooperation principles, and to the solid work of APEC economies, that has resulted in APEC's advancing work on issues that have failed to get traction in other settings.

In addition, achieving the Bogor Goals and the realization of an eventual FTAAP largely rest on the ability of APEC economies to continue to adopt the necessary domestic reforms in areas that truly enhance regional economic integration, which thereby create the conditions for meaningful participation in FTAs/RTAs. It also requires a sustained effort on the part of APEC to engage in efforts to intensify development cooperation, build capacity, and promote important policy objectives in these areas.

Advancing regional economic integration that facilitates the eventual realization of FTAAP should continue to be at the centre of APEC's work. APEC recognizes the vast opportunities that furthering regional economic integration can bring to APEC economies – lower costs for goods and services, greater innovation, enhanced development, improved human capacity, and inclusiveness. The challenges outlined below also present APEC economies with opportunities to explore policy options that help to maintain economic growth and embrace technological advances without undermining an open trade regime. Trade agreements are one such mechanism to promote policies that enhance economic growth, and the plethora of bilateral trade agreements in the region is a testament to the fact that many APEC economies are embracing market openness. Indeed, these trade agreements are expanding to cover barriers that go beyond traditional tariffs and seek to address a broader range of barriers to trade and investment.

One challenge of an eventual FTAAP is addressing the needs and interests of all participants. This challenge is particularly acute among APEC economies which feature great diversity in terms of politics, economic development, history and culture. APEC should continue to address issues that can help bridge the various gaps that prevent

economies from advancing policies that enhance regional economic integration.

The global economic slowdown has contributed to a negative perception of globalization and prompted various policy responses designed to address domestic political concerns, which may or may not be at odds with supporting the global trading system. Growing economic trends and developments in technology have created challenges to policymakers as they try to balance legitimate public policy concerns while maintaining an open trade environment. APEC economies are diverse, both in terms of levels of development, but also in terms of trade capacity and interests. All of these factors may present challenges in terms of each economy's readiness to participate in a high-quality and comprehensive FTAAP.

Some identified pathways as well as other regional groupings include several non-APEC members which create both challenges and opportunities for the realization of the FTAAP. This should be taken into consideration for future work in determining how the pathways can bring about the realization of FTAAP.

Despite the challenges identified in this Study, APEC should seize various existing opportunities to further contribute to economic growth and stability in the Asia-Pacific region, through sustained, well-targeted and meaningful capacity-building projects, technical assistance and the development of important policy-based solutions to advancing regional economic integration. Projects and assistance that contribute to fostering a robust, competitive business environment should be provided so that new growth opportunities are realized and advanced.

## APPENDICES

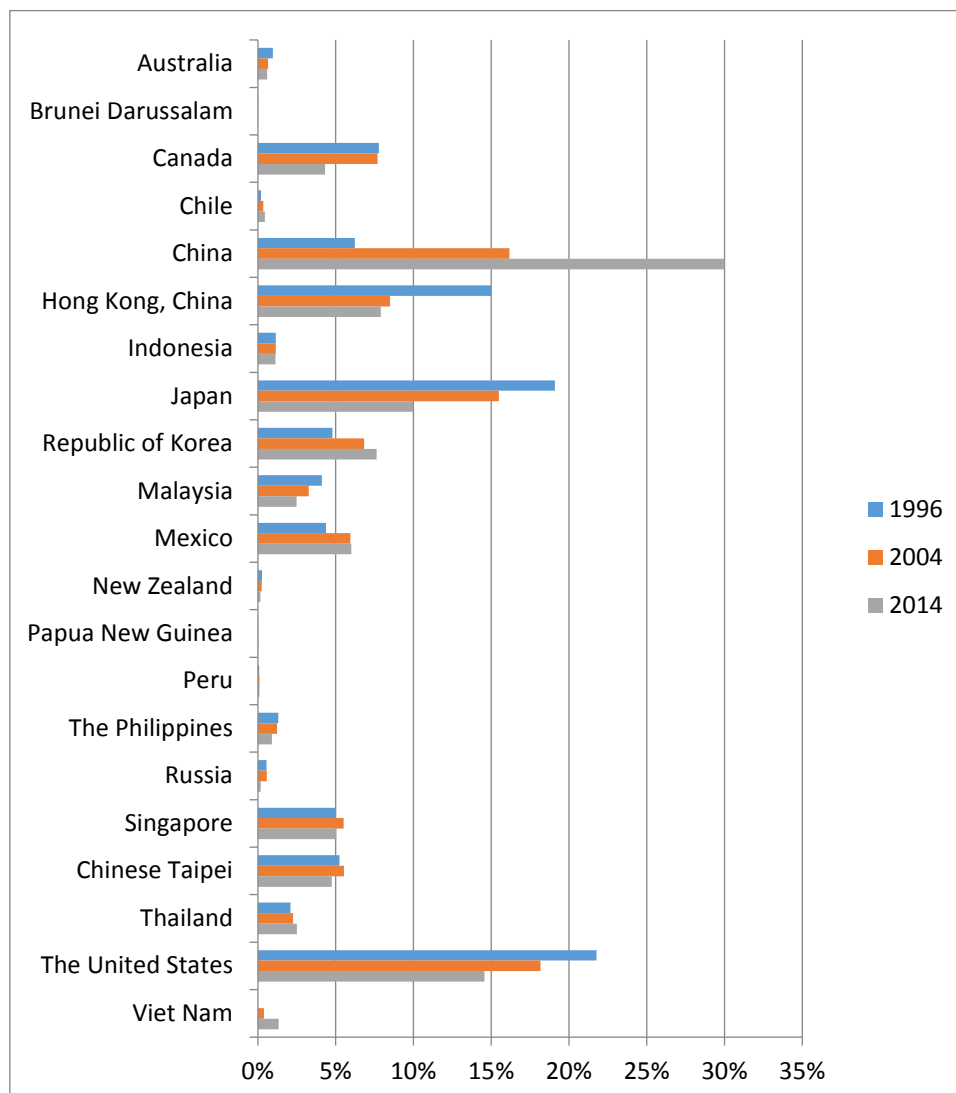
### Appendix A. Mechanism of the Study

The Collective Strategic Study on Issues Related to the Realization of the FTAAP has been carried out based on the following:

1. All APEC member economies are part of the Task Force undertaking this study.
2. A Core Drafting Group made up of volunteer Task Force members produced the first draft of the report on the Collective Strategic Study, and circulated it to other Task Force members for comments.
3. Taking into account initial comments, the Core Drafting Group produced revised drafts of the report.
4. Throughout the drafting process, the Core Drafting Group has, individually or collectively, consulted the APEC Policy Support Unit (PSU), APEC Business Advisory Council (ABAC), Pacific Economic Cooperation Council (PECC) and APEC Study Centers, where appropriate.
5. To facilitate transparency, the Committee on Trade and Investment's APEC Collaboration System within the APEC Secretariat website was used to upload all papers relevant to the preparation of the report, including draft chapters from Task Force members; relevant submissions from the PECC, ABAC and the APEC Study Centres; papers and presentations from the *Seminar on the Collective Strategic Study*; and outcome reports from activities conducted under the FTA/RTA Information Sharing Mechanism.
6. The Task Force is responsible for producing the final version of the report on the Collective Strategic Study and the Executive Summary.

## Appendix B. APEC Trade Relationships

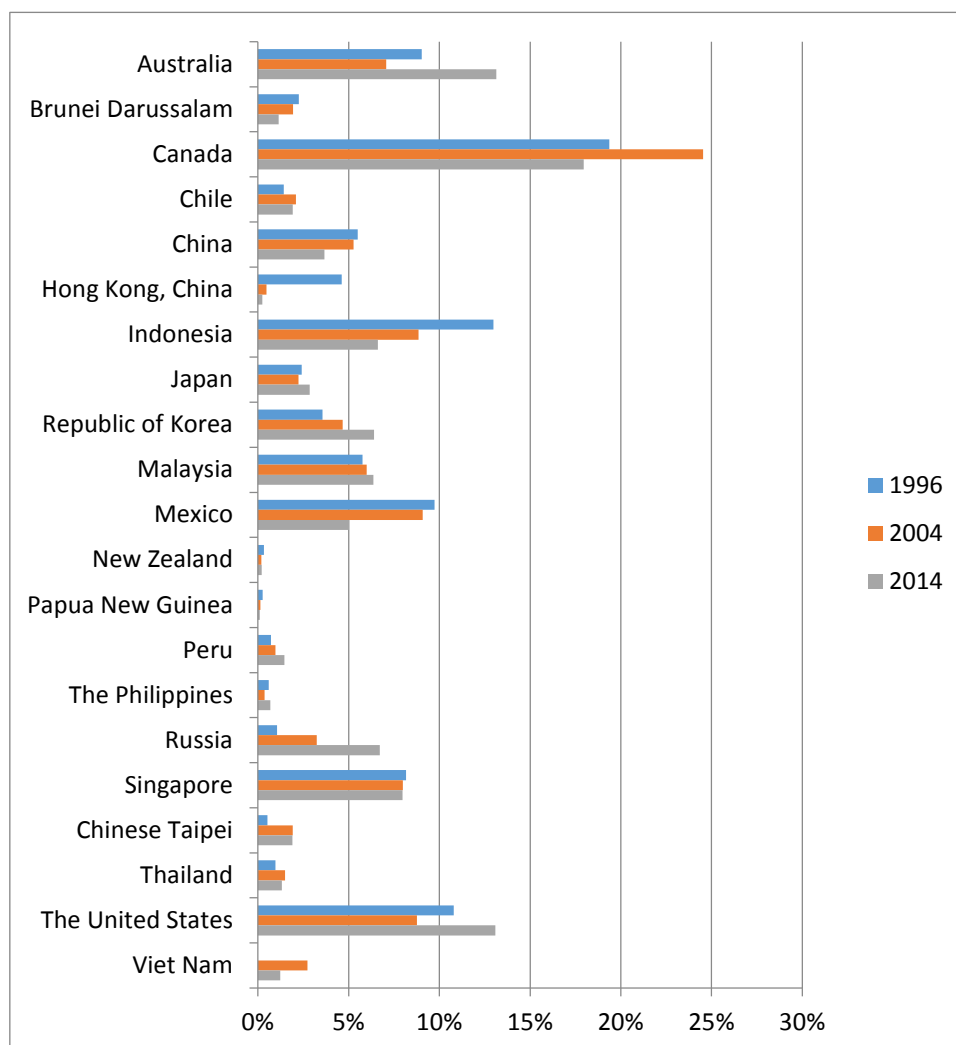
Figure B.1 Intra-APEC trade in manufactures: shares of each APEC exporter



For Brunei Darussalam and Papua New Guinea, 1997 and 1998 are the earliest available data respectively, and for Papua New Guinea the latest available datum is for 2012. For Viet Nam, 1996 datum is not available and 2013 is the latest available. This does not greatly affect the results.

Sources: Department of Foreign Affairs and Trade, Australia (DFAT) STARS database, based on Australian Bureau of Statistics (ABS) and UN Comtrade data; and the Global Trade Atlas.

**Figure B.2 Intra-APEC trade in minerals and fuels: shares of each APEC exporter**

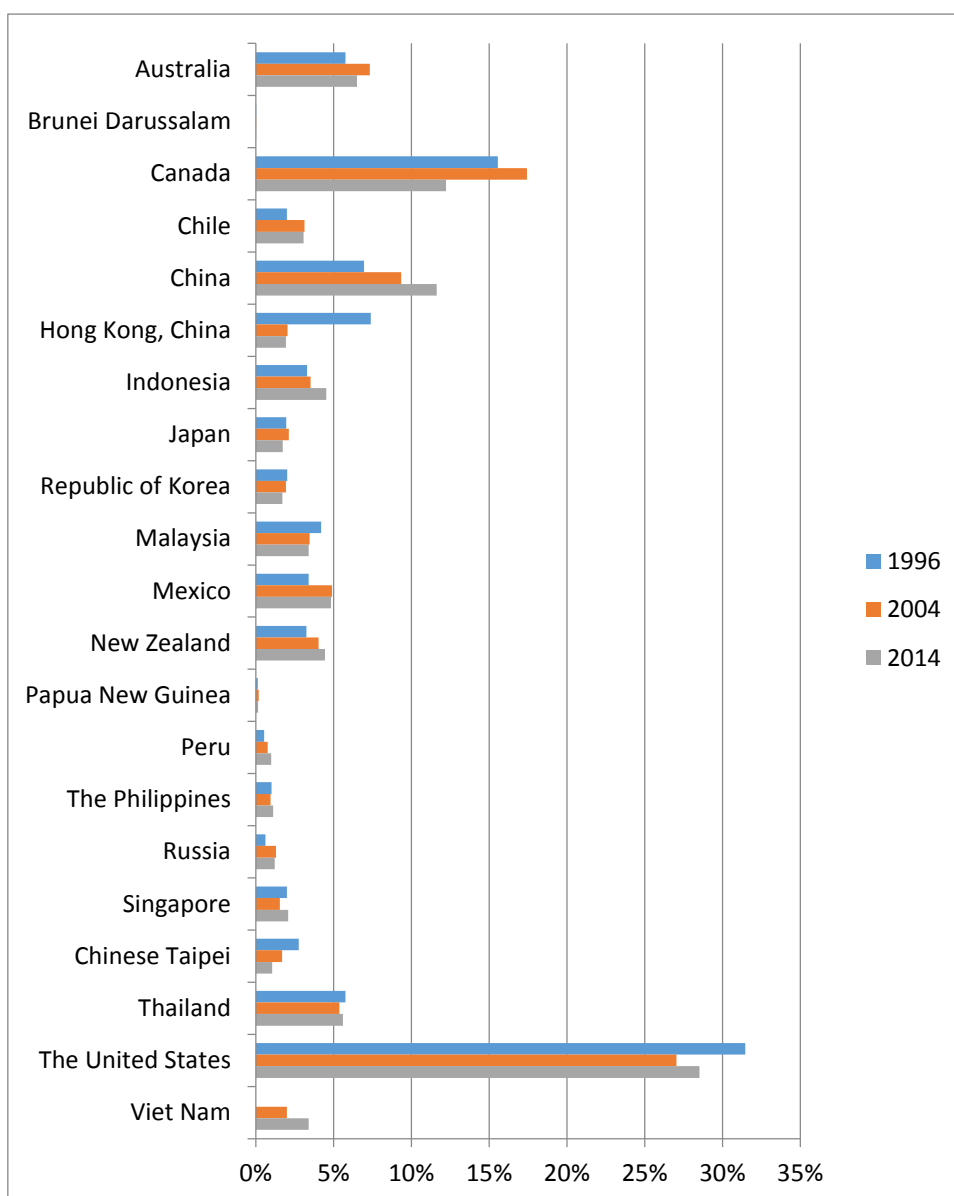


For Brunei Darussalam and Papua New Guinea, 1997 and 1998 are the earliest available data respectively, and for Papua New Guinea the latest available datum is for 2012. For Viet Nam, 1996 datum is not available and 2013 is the latest available. This does not greatly affect the results.

Sources: Department of Foreign Affairs and Trade, Australia (DFAT) STARS database, based on Australian Bureau of Statistics (ABS) and UN Comtrade data; and the Global Trade Atlas.



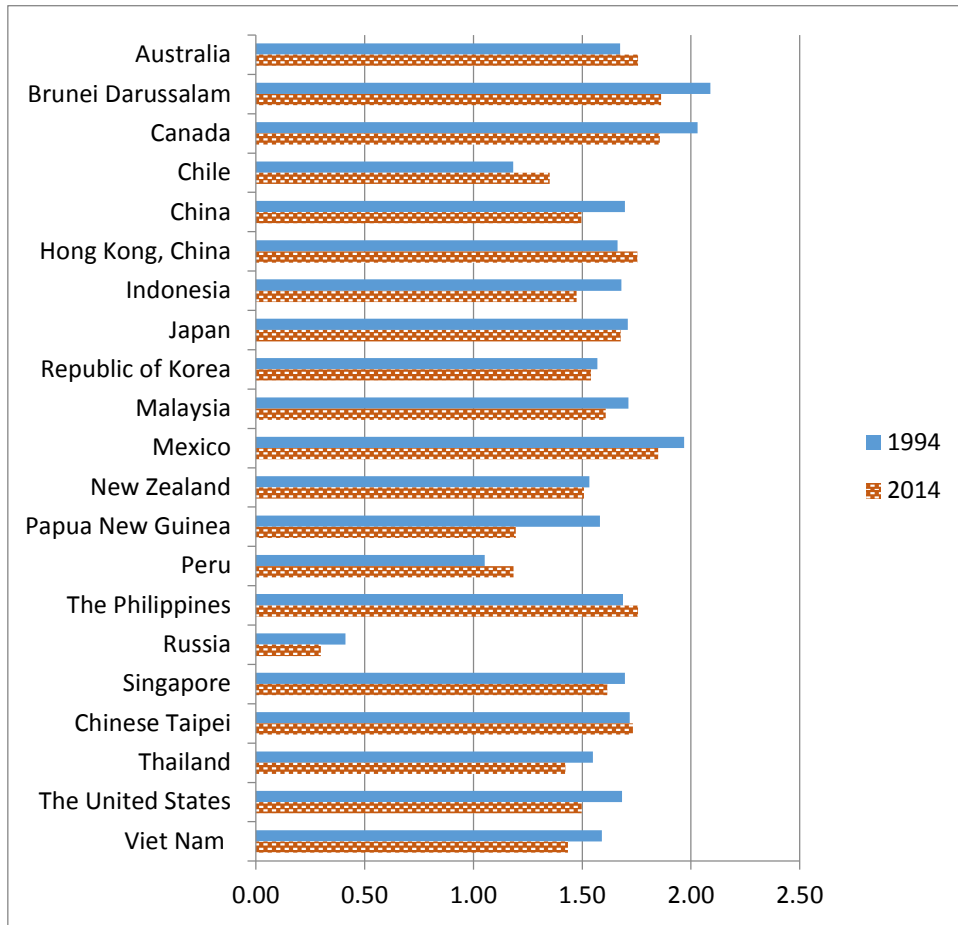
**Figure B.3 Intra-APEC trade in agriculture: shares of each APEC exporter**



For Brunei Darussalam and Papua New Guinea, 1997 and 1998 are the earliest available data respectively, and for Papua New Guinea the latest available datum is for 2012. For Viet Nam, 1996 datum is not available and 2013 is the latest available. This does not greatly affect the results.

Sources: Department of Foreign Affairs and Trade, Australia (DFAT) STARS database, based on Australian Bureau of Statistics (ABS) and UN Comtrade data; and the Global Trade Atlas.

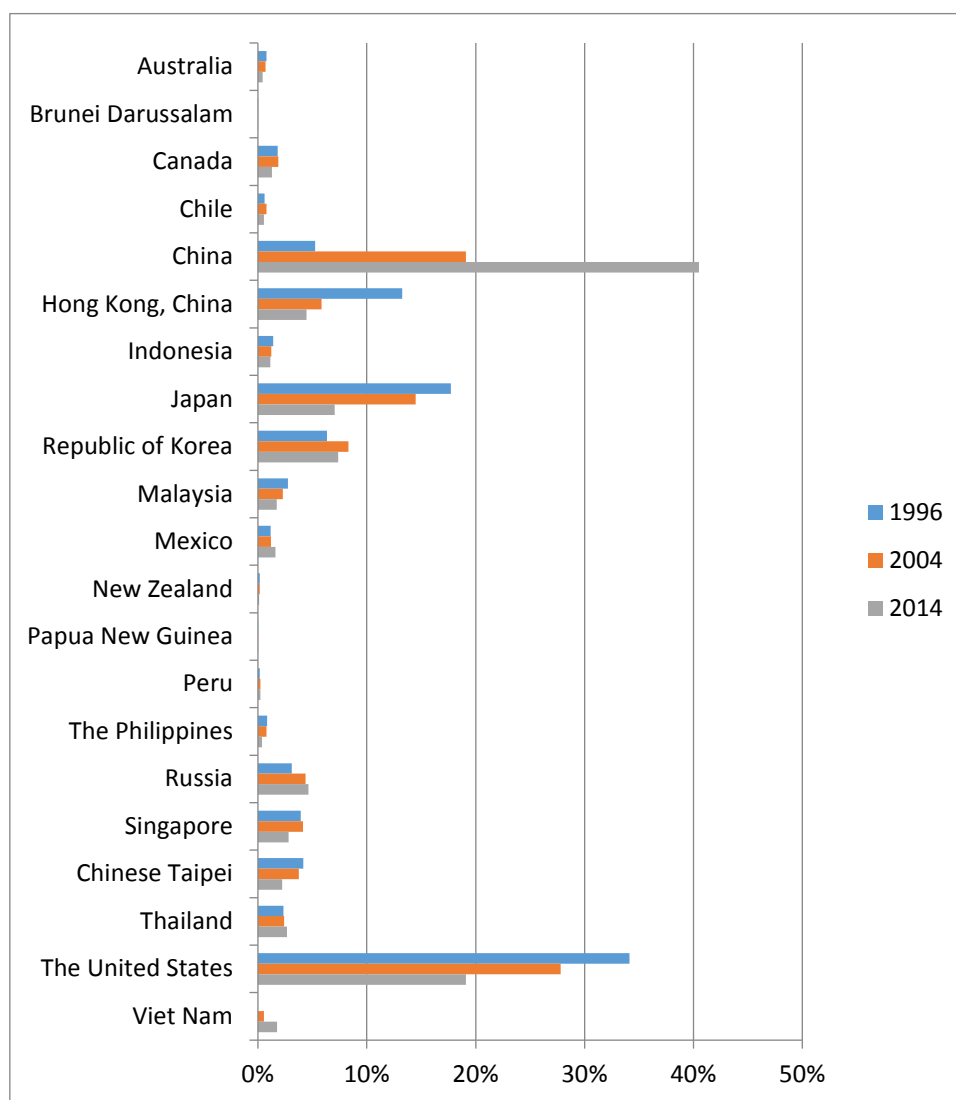
**Figure B.4 Export intensities with the APEC region**



An entry greater than 1 indicates a relatively intensive trading relationship.

Sources: Calculated from data provided by Department of Foreign Affairs and Trade, Australia (DFAT), based on the sources listed in Figure 2.2 and the WTO Statistics Database (SDB).

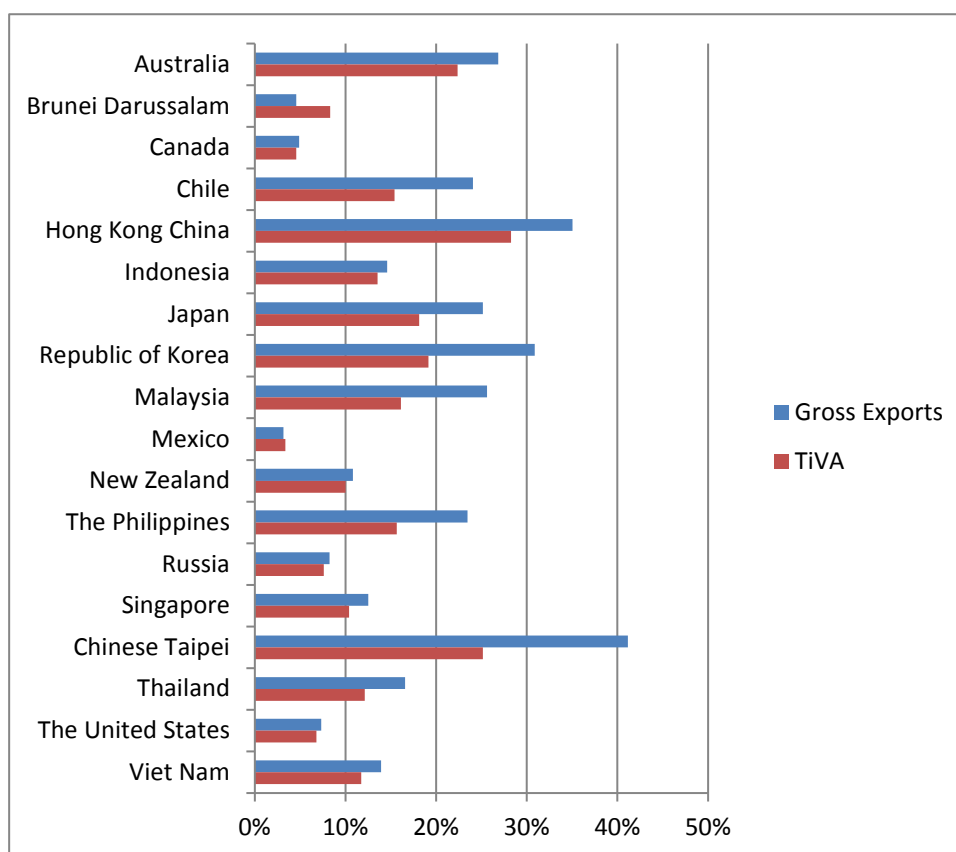
**Figure B.5 Extra-APEC trade in manufactures: share of each APEC exporter**



For Brunei and Papua New Guinea, 1997 and 1998 are the earliest available data respectively, and for Papua New Guinea the latest available datum is for 2012. For Viet Nam, 1996 datum is not available and 2013 is the latest available. This does not greatly affect the results.

Sources: Department of Foreign Affairs and Trade, Australia (DFAT) STARS database, based on Australian Bureau of Statistics (ABS) and UN Comtrade data; and the Global Trade Atlas.

**Figure B.6 Exports to China as a share of the total, 2011**

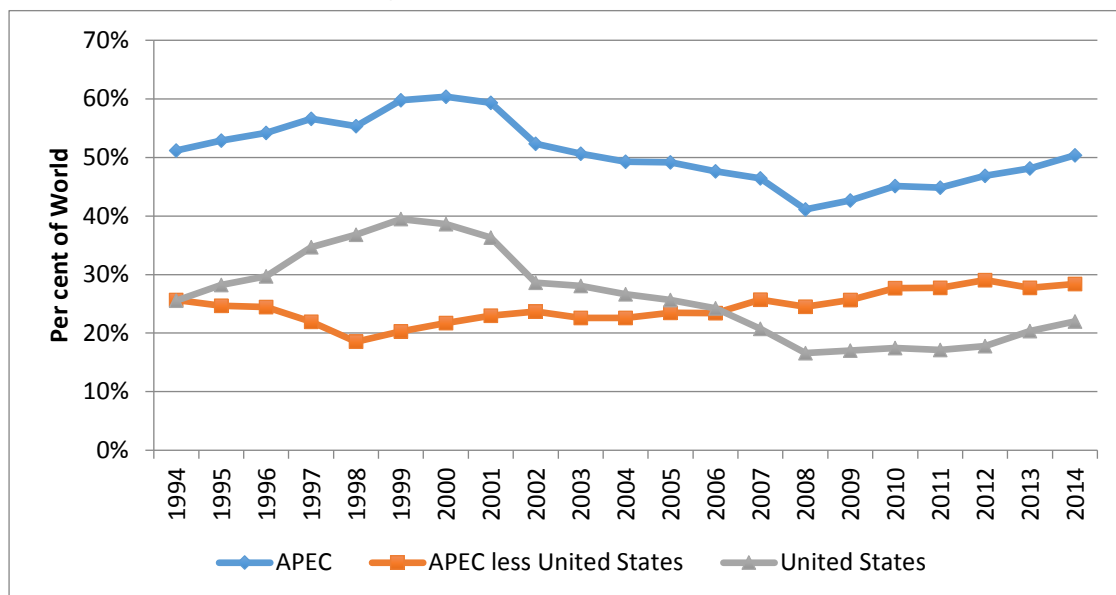


TiVA = Trade in value added. TiVA ‘exports’ in the above are more correctly referred to as domestic value added in foreign final demand.

Source: OECD-WTO TiVA Database.

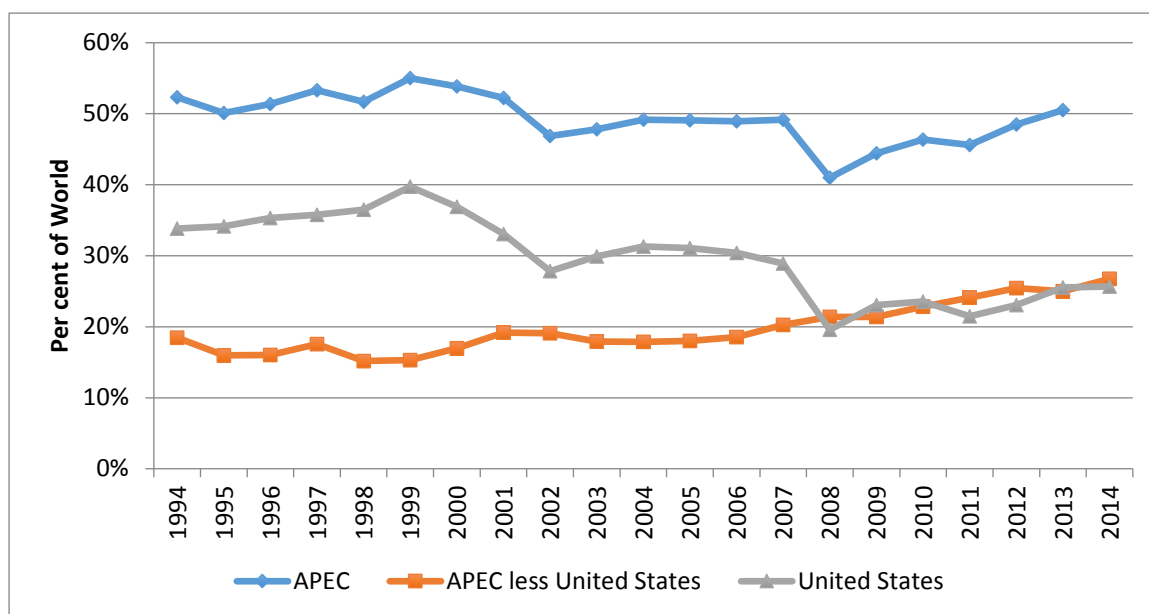
## Appendix C. APEC Foreign Investment

### Figure C.1 Stocks of inward FDI



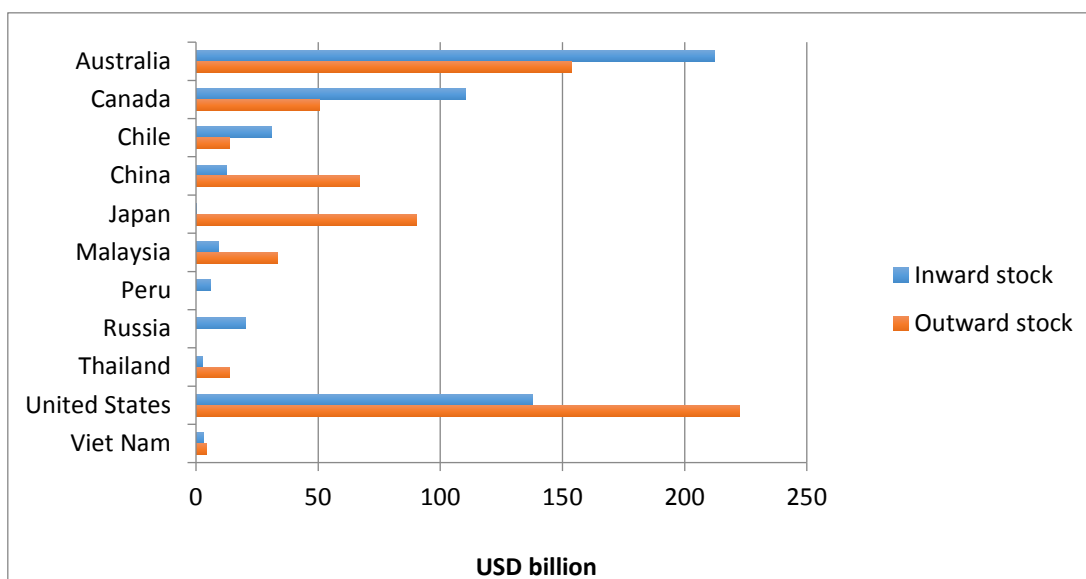
Source: UNCTADstat database.

### Figure C.2 Stocks of outward FDI



Source: UNCTADstat database.

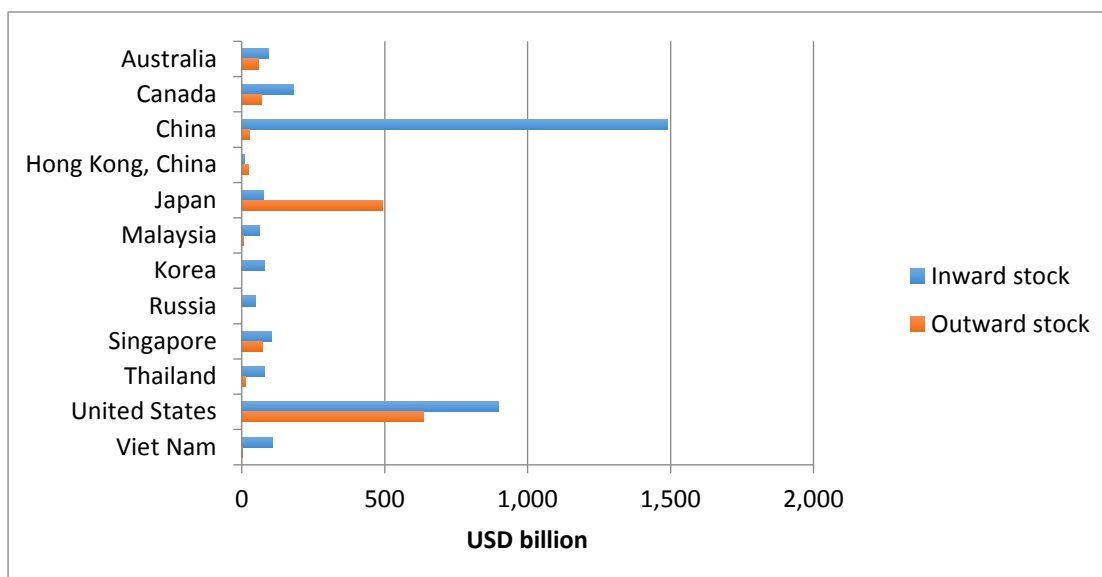
**Figure C.3 Selected APEC economies: FDI in mining and energy\***



\*Includes quarrying and petroleum. Data are for 2012, except for China (2010), Peru (2011), Russia (2010) and Thailand (2011).

Sources: International Trade Centre (ITC) Investment Map database; OECD.Stat (United States data).

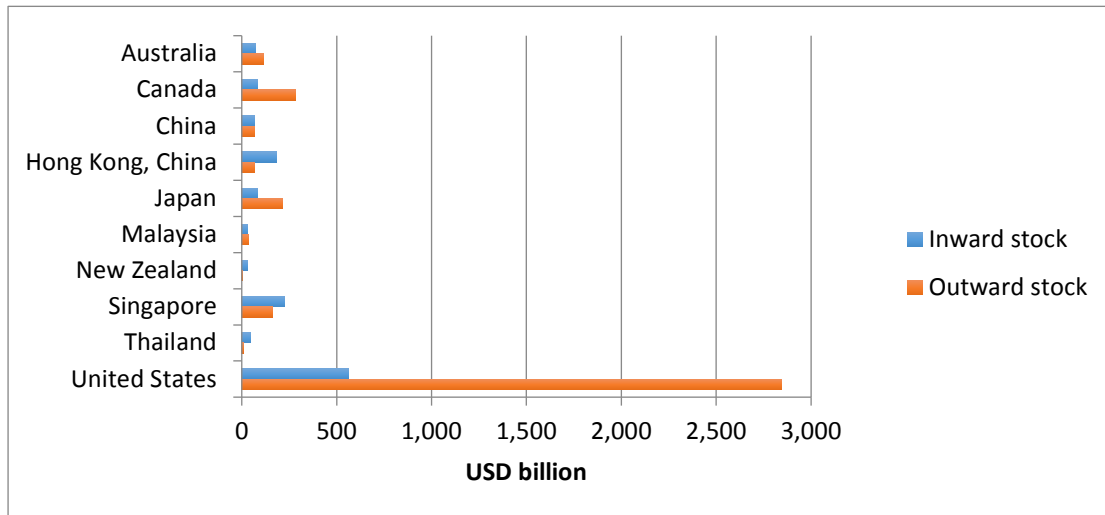
**Figure C.4 Selected APEC economies: FDI in manufacturing**



Data are for 2012, except for China (2010); Hong Kong, China (2010); Russia (2010); and Thailand (2011).

Source: International Trade Centre (ITC) Investment Map database.

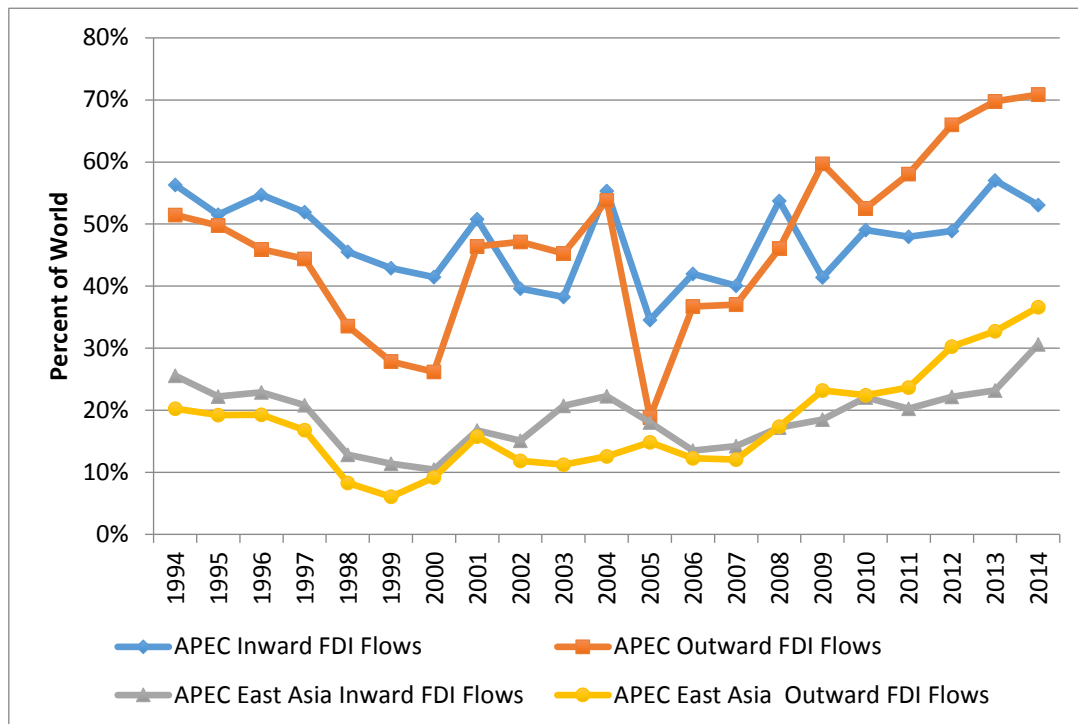
**Figure C.5 Selected APEC economies: FDI in finance**



Data are for 2012, except for China (2010); Hong Kong, China (2010); and Thailand (2011).

Source: International Trade Centre (ITC) Investment Map database.

**Figure C.6 APEC flows of FDI**



Source: UNCTADstat database

## Appendix D. The Flying Geese Model in the APEC Region

The ‘flying geese’ model has been used to illustrate the evolving pattern of development characteristic of the ‘miracle of East Asia’. Figure D.1 illustrates this model through the rise and fall in competitiveness of key Japanese industries; showing how latecomers to industrialization catch up through the sequential relocation of industries across economies as comparative advantages evolve and developing economies converge with the industry leader.

According to Kojima, the model includes some of the following elements:<sup>196</sup>

- Economies diversify as they accumulate physical and human capital. Industries rationalize as they adopt more efficient production methods. Diversification and rationalization occur continuously as economies move to higher stages of development.
- Regional transmission of industrialization is facilitated through trade and investment liberalization. For various reasons, lead economies lose comparative advantage in certain sectors or tasks, and activities shift to economies that have stronger comparative advantages or potential advantages.
- Improvements along the ladder of industrial development potentially stretch from advanced economies to many less advanced economies. Value chains involve agreed specialization between firms at different points on the ladder and increased trade in an integrated region. This builds comparative advantages, and potentially contributes to boosting productivity through spillover effects (for example, through opportunities to use improved technology and superior business approaches).

The model is useful in providing insight into contemporary questions such as: are the geese flying within China as well as from China, and how are they flying in the Americas? A good deal has been written on flying geese in China. It has been shown that China followed the classic model of progressive industrial upgrading and shifts in the sophistication of exports as its comparative advantages change over time.<sup>197</sup> These shifts have accelerated since China joined the World Trade Organization (WTO) in 2001, and especially since surplus rural labour supplies started to dry up in the mid-2000s, forcing up wage rates for unskilled labour in major coastal cities.<sup>198</sup>

The relocation of industry to low-wage economies elsewhere in Asia and Africa that

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<sup>196</sup> K. Kojima, ‘The flying geese model of Asian economic development: Origin, theoretical extensions and regional policy implications’, *Journal of Asian Economics* 11(4) (2000): 375 and 385.

<sup>197</sup> K. Zhang, ‘China’s manufacturing performance and industrial competitiveness upgrading international comparison and policy reflection’, in *China’s Domestic Transformation in a Global Context*, ed. L. Song et al. (Canberra: ANU Press, 2015), 306.

<sup>198</sup> R. Garnaut, ‘The new model of growth and the global resources economy’, in *China’s Domestic Transformation in a Global Context*, ed. L. Song et al. (Canberra: ANU Press, 2015), 24.

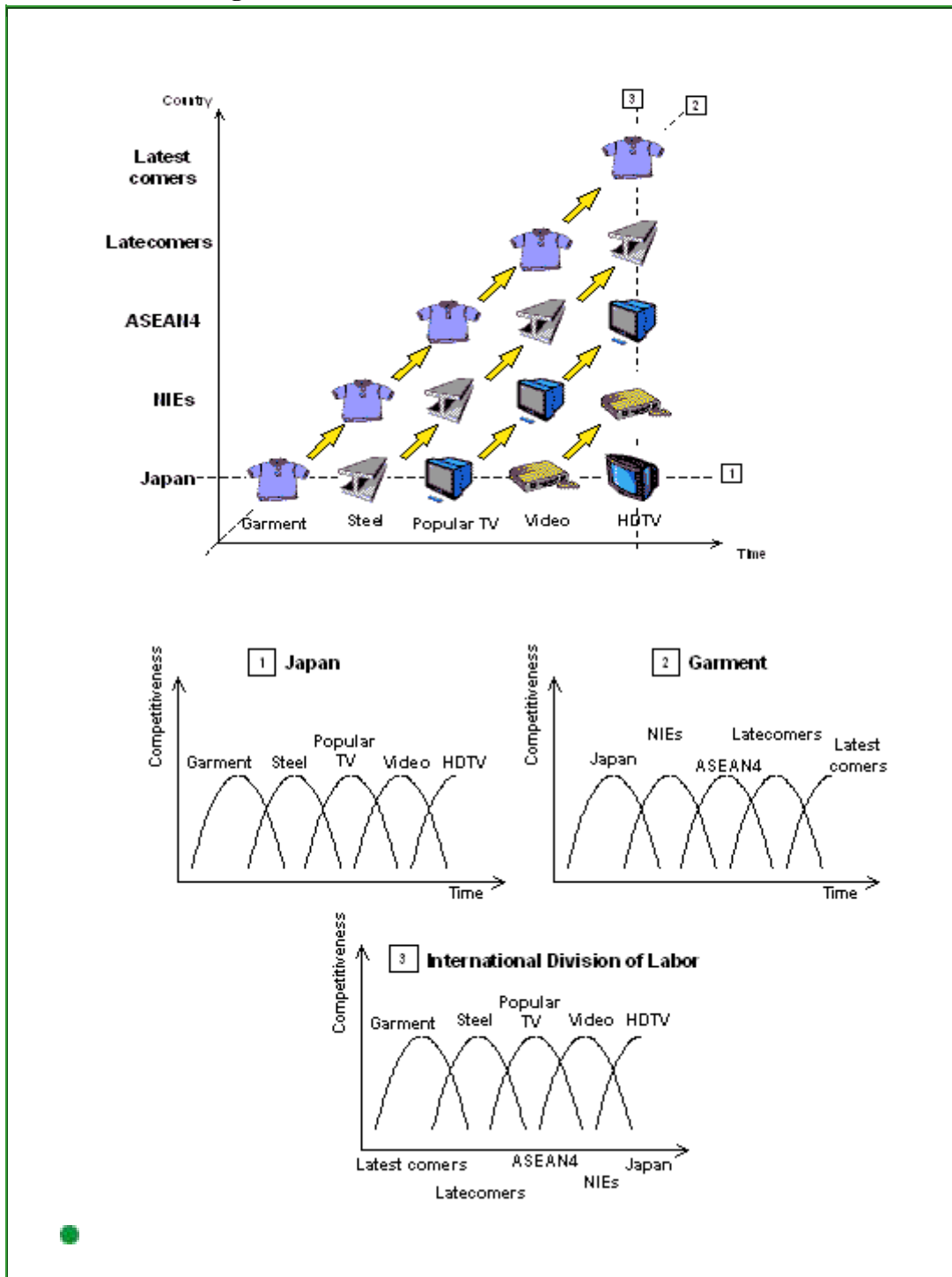


have a comparative advantage in labour-intensive industries is at the heart of the flying geese model. What is not at the heart of the model is whether the geese are flying within China. There is good evidence that at least some geese are migrating within China in response to large regional variations in wages and other costs. Ruan and Zhang found this in the textile and apparel industry; and Qu et al. reported a similar finding in a much larger study of China's manufacturing sector.<sup>199</sup>

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<sup>199</sup> J. Ruan and X. Zhang, 'Do geese migrate domestically: Evidence from the Chinese textile and apparel industry' (discussion paper no. 01040, Washington, DC: IFPRI, 2010); Y. Qu, F. Cai and X. Zhang, 'Has the "flying geese" phenomenon in industrial transformation occurred in China?' in *Rebalancing and Sustaining Growth in China*, ed. H. McKay and L. Song (Canberra: ANU E Press, 2012).

Figure D.1 Structural transformation in East Asia



ASEAN4 refers to Indonesia; Malaysia; Philippines; and Thailand. Newly industrialized economies (NIEs) comprise Hong Kong, China; Korea; Singapore; and Chinese Taipei. Source: National Graduate Institute for Policy Studies (GRIPS) in Tokyo for the GRIPS Development Forum, 2002, [www.grips.ac.jp/module/prsp/FGeese.htm](http://www.grips.ac.jp/module/prsp/FGeese.htm), as cited in J.Y. Lin, 'From flying geese to leading dragons: New opportunities and strategies for structural transformation in developing countries' (policy research working paper no. WPS 5702, World Bank, 2011).

Much also has been written about flying geese in the Americas. Three points seem particularly noteworthy. First, Crandall examined shifts in the production of automobiles, steel and machine tools from the northeastern states of the United States to the Sun Belt states of the south and west between the 1960s and early 1990s.<sup>200</sup> His main insight was that higher wage rates and high levels of unionization compared with the south and west had a consistently negative impact on manufacturing growth in the northeast.

Second, Mexico has emerged as by far the largest manufacturer in Latin America, producing more manufactures than the rest of Latin America combined. This is associated with the impact of the North American Free Trade Agreement (NAFTA) over the last two decades and, in particular, Mexico's integration into 'Factory North America' through a combination of outward US investment to take advantage of lower production costs in Mexico and relatively easy access to the US market.

And third, the US has its own flying geese model: Raymond Vernon's International Product Life Cycle model.<sup>201</sup> The model is popularly applied to products like the personal computer. These products are developed and innovated in a developed economy for domestic consumption and exported to other advanced economies, but become commoditized over time. Production moves to low-cost economies; and the advanced economy that introduced the sophisticated product eventually becomes a net importer supplied by firms in developing economies and by parent firms' overseas affiliates.

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<sup>200</sup> R. Crandall, *Manufacturing on the Move* (Washington, DC: Brookings, 1993).

<sup>201</sup> R. Vernon, 'International investment and international trade in the product cycle', *The Quarterly Journal of Economics* 80(2) (1966): 190–207.

## Appendix E. Competitiveness Rankings

Table E.1 APEC economies: competitiveness rankings

	WEF Competitiveness Report 2015–2016 (140 economies)	World Bank Doing Business 2016 (189 economies)	EIU City Competitiveness Index 2012 (120 cities)	
			Ranking	Cities
<b>Australia</b>	21	13	8, 14	Sydney, Melbourne
<b>Brunei Darussalam</b>	26*	84		
<b>Canada</b>	13	14	10,23,28	Toronto, Vancouver, Montreal
<b>Chile</b>	35	48	68	Santiago
<b>China</b>	28	84	32, 36, 53, 66, 69, 78, 81, 82, 83, 88, 90,	Shanghai, Beijing, Shenzhen, Guangzhou, Tianjin, Chengdu, Dalian, Suzhou, Chongqing, Qingdao, Hangzhou
<b>Hong Kong, China</b>	7	5	4	Hong Kong
<b>Indonesia</b>	37	109	76, 113, 115	Jakarta, Surabaya, Bandung
<b>Japan</b>	6	34	=3, 50, 55,71,	Tokyo, Osaka, Nagoya, Fukuoka
<b>Republic of Korea</b>	26	4	22, 60, 63	Seoul, Incheon, Busan
<b>-Malaysia</b>	18	18	39	Kuala Lumpur
<b>Mexico</b>	57	38	73, 95, 112	Mexico City, Monterrey, Guadalajara
<b>New Zealand</b>	16	2	31	Auckland
<b>Papua New Guinea</b>		145		
<b>Peru</b>	69	50	83	Lima
<b>Philippines</b>	47	103	91	Manila
<b>Russia</b>	45	51	59, 107	Moscow, St Petersburg
<b>Singapore</b>	2	1	1	Singapore
<b>Chinese Taipei</b>	15	11	11	Taipei
<b>Thailand</b>	32	49	71	Bangkok
<b>United States</b>	3	7	2, 12, 16, 17, 19, 24, 29, 33, 34, 40, 42, 50	New York, Chicago, Boston, Washington, San Francisco, Los Angeles, Houston, Dallas, Seattle, Philadelphia, Atlanta, Miami
<b>Viet Nam</b>	56	119	93, 96	Hanoi, Ho Chi Minh City

\*2013–2014 ranking, Brunei was not included in subsequent WEF Competitiveness Reports.

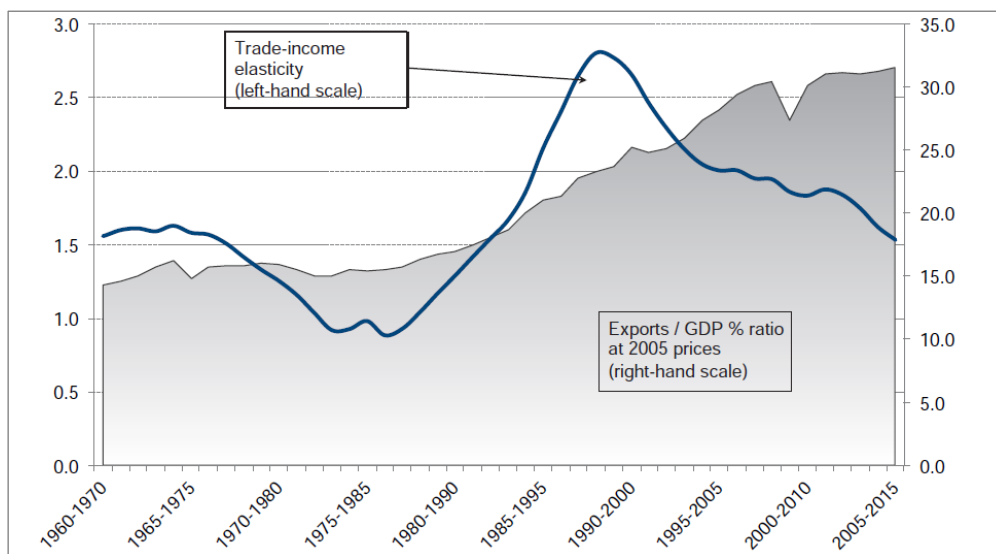
Sources: WEF (World Economic Forum), *The Global Competitiveness Report 2015–2016* (Geneva: WEF, 2015); World Bank, *Doing Business 2016: Measuring Regulatory Quality and Efficiency* (Washington, DC: World Bank, 2015); EIU (Economist Intelligence Unit), *Hot Spots 2025: Benchmarking the Future Competitiveness of Cities* (London: EIU, 2013).

## Appendix F. Relationship between Trade and Income Elasticities

Trade–income elasticities since the 1960s are charted in Figure F.1. The outstanding feature is that the trade–production/income elasticity peaked in the second half of the 1990s when a 1 per cent increase in GDP was associated with an increase in trade of almost 3 per cent.<sup>202</sup> This was doubtless underpinned by the re-integration of Central and Eastern Europe with Western Europe, the integration of China into the global economy and the rapid development of ever finer value chains.

The peak pre-dates by about a decade the stagnation of the world export–GDP ratio in the aftermath of the 2009 global financial crisis. This suggests that there is a longer-term, structural dimension to the changing trade/production relationship. It may also provide some justification for suggesting that the contribution of trade to GDP growth has been declining for some considerable time.

**Figure F.1 World trade–GDP ratio and trade–income elasticity, 1960–2015**



Merchandise exports only; world GDP and trade at constant 2005 prices; dollar figures for GDP are converted from domestic currencies using official exchange rates. Long-term elasticity is based on a 10-year rolling period from 1960–1970 to 2005–2015 (2015 is based on forecasts).

Source: H. Escaith and S. Miroudot, ‘World trade and income remain exposed to gravity’, in *The Global Trade Slowdown: A New Normal?* ed. B. Hoekman (London: CEPR Press, 2015).

<sup>202</sup> H. Escaith and S. Miroudot, ‘World trade and income remain exposed to gravity’, in *The Global Trade Slowdown: A New Normal?* ed. B. Hoekman (London: CEPR Press, 2015).

## Appendix G. Summary of the NZIER AVE Analysis

NZIER's ad valorem equivalent (AVE) data are taken from Adler and Hufbauer, which is itself based on the AVEs created by Kee, Nicita and Olarreaga, and various studies.<sup>203</sup> The types of non-tariff measures (NTMs) in the analysis include non-automatic licences, quotas, prohibitions, administrative pricing, voluntary export price restraints, variable charges, monopolistic measures, technical regulations, and domestic support subsidies.

AVE estimates of NTMs are made for one year for each economy, using data from the most recent year available. The underlying NTM data roughly corresponds to the year 2000 for every economy. While there have been some more recent economy-specific updates completed by the United Nations Conference on Trade and Development (UNCTAD), and more are planned, more recent data that cover all APEC economies and sectors are not available.

Note that estimated AVEs of Australian NTMs are used as a proxy for New Zealand NTM data. This is not ideal, but there is a lack of comprehensive New Zealand-specific data on AVEs. Similarly Brazil is used as a proxy for Chile; Thailand for Viet Nam; and the European Union for Russia.

For the smaller countries, these assumptions will have little material impact on the APEC average due to their low trade-weighting in the calculations. So even if the actual NTMs in these countries are quite different from those assumed, it will not make a significant difference when they are averaged out across the APEC region.

By way of illustration, even if Chile's and New Zealand's NTMs were twice as high as those assumed in the NZIER analysis, the average APEC NTM AVE would increase only marginally from 9.7 percent to 9.9 percent. If Russia's NTMs were twice as high as those assumed here, the average APEC NTM AVE would rise to 10 percent.

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<sup>203</sup> NZIER (New Zealand Institute of Economic Research), 'Non-tariff measures (NTMs) in the APEC region: Literature review and data analysis' (note to New Zealand Ministry of Foreign Affairs and Trade, Wellington: NZIER, 2015); M. Adler and G.C. Hufbauer, 'Policy liberalization and US merchandise trade growth, 1980–2006' (working paper, Washington, DC: PIIE, 2009); H.L. Kee, A. Nicita and M. Olarreaga, 'Estimating trade restrictiveness indices', *The Economic Journal* 119(534) (2009): 172–99.

## Appendix H. Legal Regimes Governing FDI in the APEC Economies<sup>204</sup>

**Australia** encourages foreign investment consistent with its national interest. To ensure that national interests are protected, Australia continues to apply a screening process under the framework of the Foreign Acquisitions and Takeovers Act 1975 and the 2013 Foreign Investment Policy. The concept of ‘national interest’ is not defined under the Act or Policy and is interpreted on a case-by-case basis, inter alia, taking into account a range of factors, typically including: national security; competition; the impact on other government policies (including taxation); the impact on the economy and the community; and the character of the investor. Screening of residential real estate applications is considered in light of the principle that foreign investment should serve to increase the housing stock in Australia. The Commonwealth Government prefers a flexible approach to hard-and-fast rules, since rigid laws that prohibit a class of investments too often stops valuable investments. The case-by-case approach is deemed to maximize investment flows while protecting Australia’s national interest.

The investment regime of **Brunei Darussalam** is governed by administrative policies and regulations on a sectoral basis. Foreign ownership restrictions are maintained mostly in cases where the investment requires access to government incentives or subsidies, or where the investment uses natural resources. The Companies Act provide the legal framework for the establishment of companies in Brunei Darussalam. The Investment Incentives Order 2001 sets out the incentives that are accorded to investors. In January 2016, the Foreign Direct Investment (FDI) and Downstream Committee was established to look into facilitating the entry of foreign investments into Brunei Darussalam. Protection for foreign investors is guaranteed through various investment treaties that Brunei Darussalam has entered into.

In **Canada**, the Investment Canada Act is the primary tool for the regulation of FDI. The Act provides for the review of the acquisition of control of Canadian businesses by non-Canadians for their likely net benefit, and for the review of investments in Canada by non-Canadians that could be injurious to national security. An investment is reviewable for net benefit if there is an acquisition of control of a Canadian business and the value, calculated in the manner prescribed in the Investment Canada Act and supporting Regulations, of the Canadian business being acquired equals or exceeds the relevant threshold under the same.

**Chile** has traditionally had the following two legal instruments to regulate foreign investment: Chapter XIV of the Central Bank’s Compendium of Foreign Exchange Regulations and the Foreign Investment Statute (Decree Law No. 600 of 1974, hereinafter DL 600). To bring capital into Chile, foreign investors could choose either of these two instruments. DL 600 established the rights and obligations of the State and

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<sup>204</sup> Information extracted from the WTO Trade Policy Reviews, except as noted.

the foreign investor with respect to investors who choose to sign a foreign investment contract with the State. In June 2015, Law 20.848 established a new investment framework, which phases out new contracts under the DL 600 scheme. Investors with previously existing DL 600 contracts retain their rights and duties for the duration of those contracts. Exceptionally, during a maximum period of four years from the promulgation of the law, foreign investors will be able to seek authorization for foreign investment under the terms of DL 600, with the rights and duties envisaged under this decree law, but with a locked-in tax rate totalling 44.45 percent.

**China's** investment policy is regulated through a number of legal instruments, including the central government's Five-Year Plans, and sectoral and provincial Five-Year Plans. Article 18 of the Constitution states that China permits foreign enterprises and other economic organizations or individuals to invest in China. The China-Foreign Equity Joint Venture Enterprise Law of 1979 marked the beginning of China's foreign investment legal regime. Since then, China has established a foreign investment legal regime based on three central laws: the China-Foreign Equity Joint Venture Enterprise Law, the China-Foreign Cooperative Joint Venture Enterprise Law and the Foreign-Invested Enterprise Law. Under this legal regime, China generally approves foreign investments on a case-by-case basis after review by multiple government agencies (with the exception of the Shanghai Free Trade Zone).<sup>205</sup>

In **Hong Kong, China**, under the Basic Law, there is no investment approval procedure directed specifically toward foreign investors. The Basic Law safeguards free movement of goods, intangible assets and capital. All businesses must comply with the registration requirements of the Companies Ordinance.

In the case of **Indonesia**, there have been significant legal and institutional changes to Indonesia's foreign investment regime. A new foreign investment law (Law No. 25) was enacted in 2007. Indonesia has an approval and investment review process applicable to foreign investors. The criterion for approving FDI will depend on the types and forms of business. The Capital Investment Coordinating Board (BKPM) has the authority to approve/reject all foreign investments.

**Japan** takes a liberalized approach to inward FDI, and in general, foreign investments are not subject to restrictions. In accordance with specific business laws, thresholds on foreign ownership may apply in limited cases; and, under the Foreign Exchange and Foreign Trade Act, investors who intend to make an investment in certain sectors are required to provide prior notification should their proposed investment be likely to be subject to certain criterion. Prior notification is required for inward direct investment in specific industries related to national security, public order and public safety, and to the smooth management of the Japanese economy.

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<sup>205</sup> Extracted from: US Department of State, '2014 Investment climate statement – China' (2014)



The **Republic of Korea** regulates foreign investment through the Foreign Investment Promotion Act. This Act was enacted on 16 September 1998 as Act No. 5559. The Act and related regulations categorize business activities as either open, conditionally or partly restricted, or closed to foreign investment. Its features include simplified procedures, including those for FDI notification and registration. Multinational companies may invest in all but a handful of protected industries, although some sectors still require local joint venture partners. Notification rather than approval is the norm for foreign investment.

**Malaysia** has no comprehensive law governing FDI and containing general principles for foreign participation in local business. In the absence of an all-encompassing foreign investment statute, FDI is regulated under sector-specific legislation. Investment activity in Malaysia (both domestic and foreign) is regulated under the Promotion of Investments Act (PIA) and the Industrial Co-ordination Act (ICA). The PIA sets out rules on corporate income tax relief for the establishment and development in Malaysia of certain economic activities, as well as for the promotion of exports (Section 3.4.1 of the Act). The ICA was enacted in 1975 with the objective of maintaining orderly development and growth in Malaysia's manufacturing sector, and requires manufacturing companies of a certain size to be licensed, although equity restrictions had been fully lifted since 2003. Under this new policy, 100 percent foreign equity will be allowed for all new investments, as well as for investments for expansion and diversification by existing licensed manufacturers.

Foreign investment in **Mexico** is governed by the Foreign Investment Law (LIE) and its implementing regulations, and by the Constitution (Articles 27 and 73). The LIE establishes, as a rule, that foreign investors may hold 100 percent of the capital stock of any Mexican corporation or partnership, except in those few areas expressly subject to limitations under the LIE.

In **New Zealand**, the foreign investment regime is regulated by the Overseas Investment Act 2005, the Overseas Investment Regulations 2005, and sections 56 to 58B of the Fisheries Act 1996, which are in turn administered by the Overseas Investment Office (OIO). Overseas persons may need to apply to the OIO for consent if they wish to acquire sensitive land or an interest in sensitive land (e.g. by buying shares in a company that owns sensitive land), business assets worth more than NZD 100 million, or a fishing quota or an interest in fishing quota. In the five years to June 2013, 10 out of a total of 755 screened applications were declined (i.e. approximately 1.3 percent were declined).

**Papua New Guinea** has a generally open FDI regime regulated through the Investment Promotion Act (1992). A foreign business conducting business in Papua New Guinea must obtain certification from the Investment Promotion Authority, unless an exemption applies (i.e. religious, charitable, educational activities). Prior to making an

application for certification by the Investment Promotion Authority, the foreign business must either register the foreign company or establish a new company.

The Constitution of **Peru** (1933) provides regulations that constitute essential principles to guarantee a favourable legal framework to private investments in general and to foreign investments in particular. The main regulations on the treatment of private investments are Legislative Decree No. 662, which approves the Legal Stability Scheme for Foreign Investments; Legislative Scheme No. 757, which approves the Framework Law for Private Investment Growth; and the Regulations on Private Investment Guarantee Schemes, as approved by Supreme Decree 162-92-EF. Other important laws include the Private Investment in State-Owned Enterprises Promotion Law (DL 674), the Private Investment in Public Services Infrastructure Promotion Law (DL 758), and specific laws related to agriculture, fisheries and aquaculture, forestry, mining, oil and gas, and electricity. Foreign investment is not subject to a screening process.

The main laws regulating foreign investment in the **Philippines** is the 1991 Foreign Investments Act, as amended by Republic Act 8179, the Omnibus Investment Code and their respective implementing regulations. The Foreign Investments Act governs the entry of foreign investments and the doing of business by foreigners without incentives.

In the case of the **Russian Federation**, the principal law in the area of foreign investments is Federal Law No. 160-FZ as of 9 July 1999 ‘on foreign investments in the Russian Federation’. The legal regulations for the foreign investments within the territory of the Russian Federation are also carried out as provided for by other federal laws, regulatory acts and international conventions of the Russian Federation.

**Singapore** does not have an overarching investment law although some investor protection provisions are contained in the Companies Act, and the Securities and Futures Act. Singapore maintains FDI restrictions in only a few sectors: broadcasting and domestic news media, retail banking, and legal services. Foreign ownership restrictions also apply to Singapore-designated airlines, depending on the requirements of Singapore’s air services agreements. In recent years, there has been some liberalization of legal services.

In **Chinese Taipei**, the government has maintained a policy of attracting FDI as part of its growth strategy. Initially, the main objective of this investment policy was to attract export-oriented investment based on the competitiveness of an educated workforce. Recently, the target has been adjusted to focus on attracting FDI into technology-intensive areas as well as to promote spillovers. Two laws designate the regulatory authority for specific types of foreign investment: the Statute for Investment by Overseas Chinese and the Statute for Investment by Foreign Nationals. There are no restrictions on foreign investment except in certain industries that are stipulated in the Negative List for Investment by Overseas Chinese and Foreign Nationals. The negative

list now consists of 10 prohibited industries and 16 restricted industries. Those interested in investing in an industry that is restricted by law or by an order given under the applicable law must first obtain approval or consent from the competent industry authority. The Executive Yuan will review and modify the list periodically or when required.

In **Thailand**, the main law on foreign investment is the 1999 (B.E. 2542) Foreign Business Act, which lays out the framework governing foreign investment in Thailand. Under the Act, a foreigner (defined as a person who is not a Thai national, a company which is not registered in Thailand, or a company in which foreign ownership accounts for 50 percent or more of total shares) is required to obtain an alien business licence from the relevant ministry before commencing business in a sector restricted by the Act.

While the **United States'** investment regime is generally open, restrictions remain in place in certain sectors or industries, including agriculture, equity investments, maritime, aircraft, mining, energy, lands, communications and banking. The Committee on Foreign Investment in the United States reviews 'covered' foreign investment transactions to determine whether the transaction threatens national security.

**Viet Nam's** investment regime is based on the Enterprise Law (No. 60/2005/QH-11) and the Investment Law (No. 59/2005/QH-11), both adopted in November 2005, and in force since 1 July 2006. The Enterprise Law provides for enterprises to be established in the form of limited liability companies, shareholding companies, partnerships or sole proprietorships.

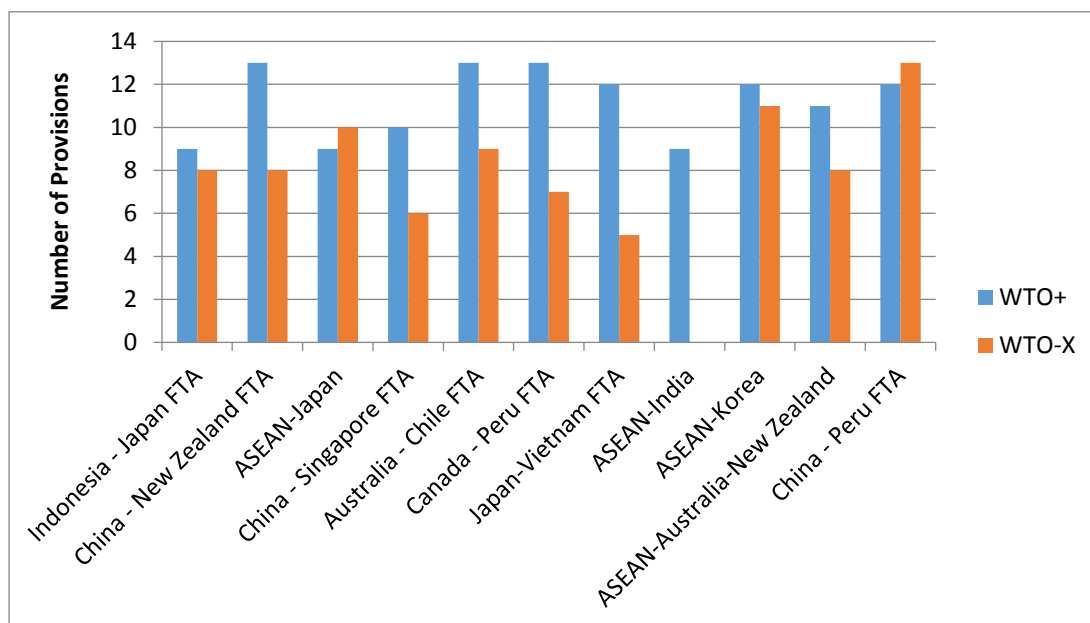
## Appendix J. Statistics and General Features of Trade Agreements by APEC Economies

Figure J.1 Growth in APEC FTAs



Source: APEC Policy Support Unit, *Key Trends and Developments Relating to Trade and Investment Measures and Their Impact on the APEC Region – Do FTAs Matter for Trade?* (Singapore: APEC, 2015).

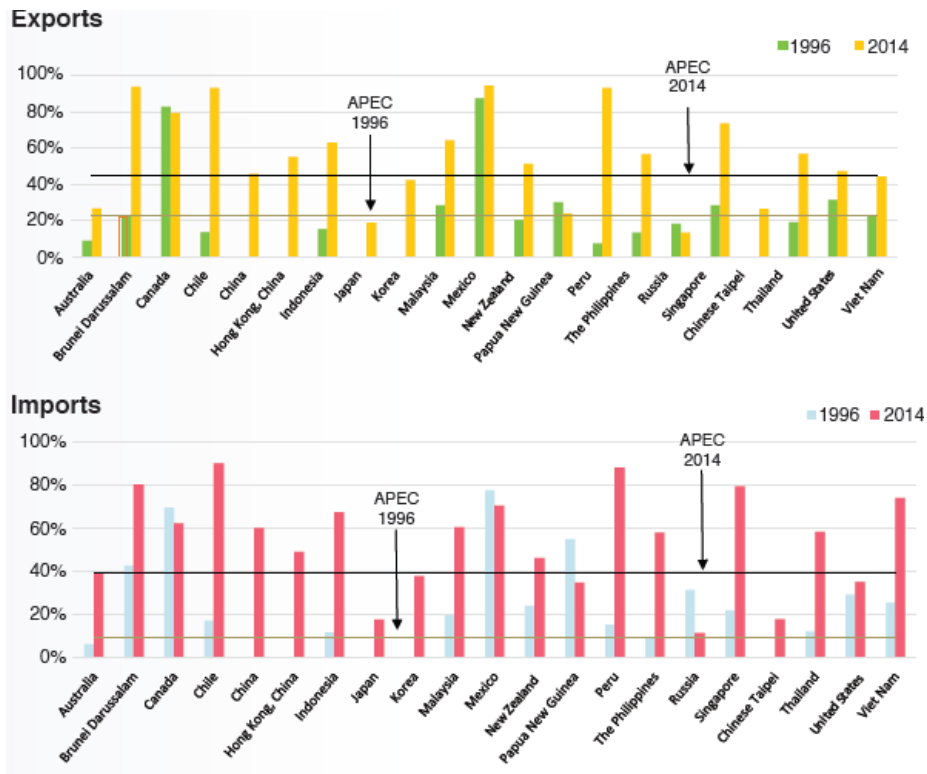
Figure J.2 Commitments beyond WTO



WTO+ refer to policy areas covered by WTO agreements; WTO-X refer to policy areas policy areas not covered in WTO agreements.

Source: WTO (World Trade Organization), *World Trade Report 2011* (Geneva: WTO, 2011) – as interpreted by author.

**Figure J.3 Tradable goods covered by FTAs in APEC**



Source: APEC Policy Support Unit, 'APEC in charts 2015' (Singapore: APEC, 2015).

**Figure J.4 Scope and speed of tariff liberalization: percentage of duty-free tariff lines at 5 years after entry into force**



Bottom line (blue) represents first economy listed. Top line (red) represents second economy listed.

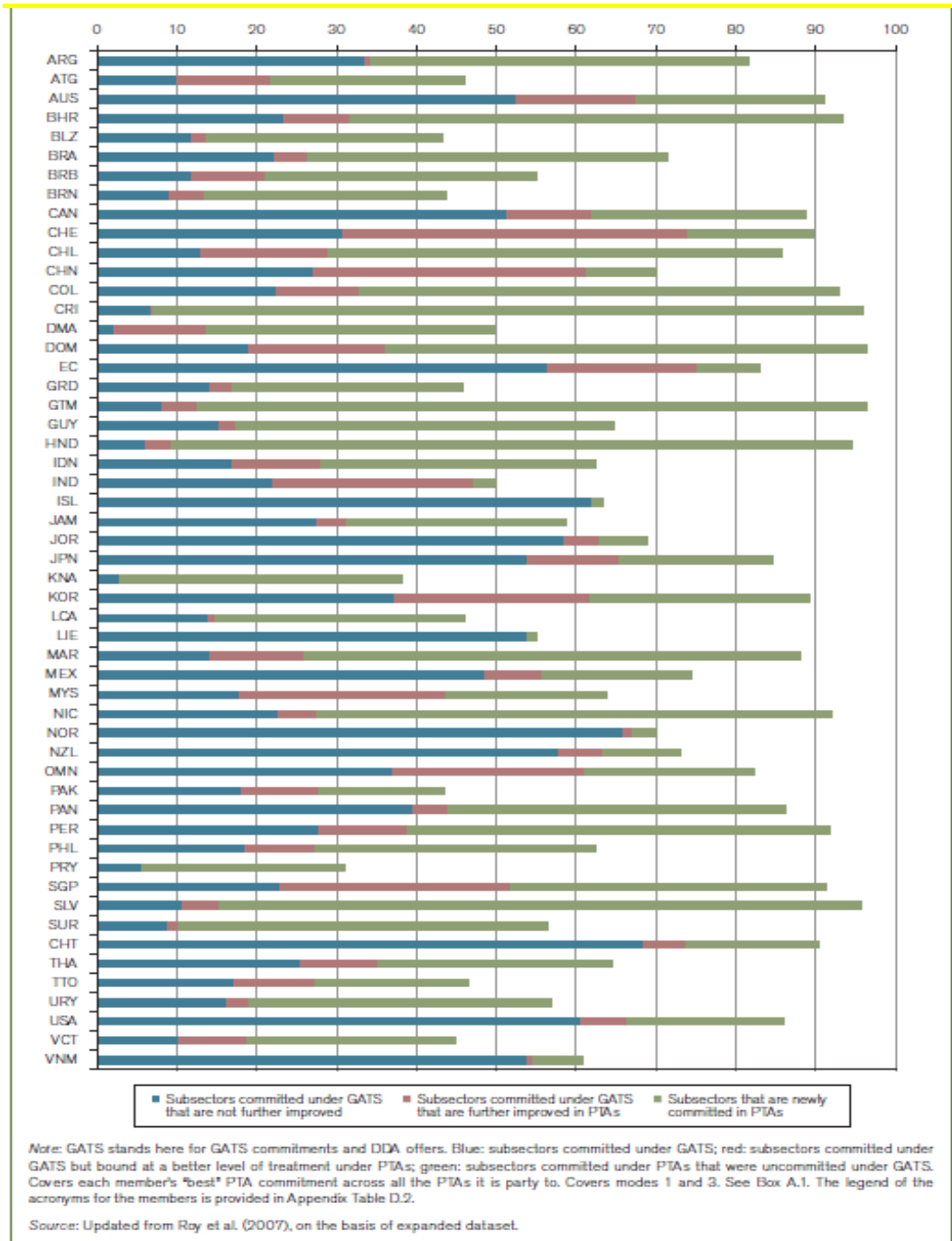
Source: WTO Factual Presentations, as calculated by the author.

**Table J.1 Services – negative and positive lists**

Agreement	Date of Signature into Force OR Conclusion	Services			
		Negative/Positive list approach	Local presence requirements	National treatment	Prohibits limitations on market access
Brunei Darussalam - Japan FTA	2007				
Indonesia - Japan FTA	2007				
Australia - Chile FTA	2008				
Canada - Peru FTA	2008				
China - New Zealand FTA	2008				
China - Singapore FTA	2008				
Japan-Vietnam FTA	2008				
Peru - Singapore FTA	2008				
China - Peru FTA	2009				
Malaysia - New Zealand FTA	2009				
Chile - Malaysia FTA	2010				
Hong Kong, China - New Zealand FTA	2010				
Chile - Vietnam FTA	2010				
Japan-Peru FTA	2011				
Korea - Peru FTA	2011				
Australia - Malaysia FTA	2012				
Chile - Hong Kong, China FTA	2012				
Chile - Thailand FTA	2013				
New Zealand - Chinese Taipei FTA	2013				
Singapore - Chinese Taipei FTA	2013				
Australia - Japan FTA	2014				
Australia - Korea FTA	2014				
Canada - Korea FTA	2014				
China - Korea FTA	2015				
Australia-China	2015				
Trans-Pacific Partnership	Nov-15				
ASEAN-Japan	2009				
ASEAN-India	2010		n/a		
ASEAN-Korea	2010		n/a		
ASEAN-Australia-New Zealand	2010				
			negative list approach		
			positive list approach		

Source: WTO Factual Presentations, as interpreted by the author (list not conclusive).

**Figure J.5 Proportion of services subsectors subject to new and improved commitments in PTAs, compared to GATS, by member (percentage)**



Source: WTO (World Trade Organization), *World Trade Report 2011* (Geneva: WTO, 2011).

**Table J.2 E-commerce commitments**

Agreement	E-commerce	
	Customs duty moratorium	Covers non-discriminatory treatment
Brunei Darussalam–Japan		
Indonesia–Japan		
Australia–Chile		
Canada–Peru		
China–New Zealand		
China–Singapore		
Japan–Viet Nam		
Peru–Singapore		
China–Peru		
Malaysia–New Zealand		
Chile–Malaysia		
Hong Kong, China–New Zealand		
Chile–Viet Nam		
Japan–Peru		
Korea–Peru		
Australia–Malaysia		
Chile–Hong Kong, China		
Chile–Thailand		
New Zealand–Chinese Taipei		
Singapore–Chinese Taipei		
Australia–Japan		
Australia–Korea		
Canada–Korea		
China–Korea		
Australia–China		
Trans-Pacific Partnership (TPP)		
ASEAN–India	n/a	n/a
ASEAN–Korea	n/a	n/a
ASEAN–Australia–New Zealand		
ASEAN–Japan		

Black cells refer to commitments included in the e-commerce chapter. Grey cells refer to commitments included in other chapters of the agreement.

Source: WTO Factual Presentations, as interpreted by author.



## **Appendix K. Literature on Trade Agreements in the Asia-Pacific**

Regionalism, characterized by a sharp increase in regional trade agreements (RTAs) and free trade agreements (FTAs), only reached Asia within the past two decades. Yet whether RTAs/FTAs are building blocks or stumbling blocks for multilateral liberalization remains a matter of academic debate. Some argue that they could lead to increased regional cooperation, encourage inward foreign direct investment (FDI) and stimulate welfare-enhancing growth. Others contend that they reduce trade barriers in a preferential way, which could discourage multilateralism and distort the pattern of international trade. The literature suggests that in practice the effects of RTAs/FTAs vary in size and distribution depending on the level of liberalization, how integration takes place and the size of the trading partners.

### ***K.1 Evaluating RTAs/FTAs in the Asia-Pacific region***

- a. M. Okabe, 'The impact of ASEAN+1 FTAs on ASEAN's trade', in L.Y. Ing (ed.), *East Asian Integration* (ERIA research project report 2014-6, Jakarta: ERIA): 27–66.

This paper conducts an ex-post evaluation of FTAs in East Asia, and indicates that tariff elimination under an ASEAN FTA promoted regional trade among ASEAN economies. Similarly, bilateral FTAs in East Asia show positive impacts on trade as a result of tariff elimination as well as other liberalization measures. This paper also presents an empirical analysis of the impact of ASEAN FTAs. The author finds that trade creation effects of imports under the ASEAN–China FTA and ASEAN–Korea FTA appear in industrial supplies, capital goods and consumption goods between members. Overall, results show that, to be effective, an RTA/FTA needs increased levels of liberalization, lower utilization costs, and already developed production and sales networks among members.

- b. A. Islam, H. Bloch and R. Salim, 'How effective is the free trade agreement in South Asia? An empirical investigation', *International Review of Applied Economics* 28(5) (2014): 611–627.

This paper investigates the efficacy of preferential trade liberalization among the South Asian economies that have entered into the South Asian Free Trade Agreement (SAFTA). The results suggest no empirical evidence of trade creation among SAFTA members. This could be due to the fact that tariff concessions in SAFTA are small and are offset by complicated rules of origin. However, the authors do find a substantial and statistically significant increase in exports from SAFTA members to the rest of the world.

- c. V. Aggarwal and S. Urata, *Bilateral Trade Agreements in the Asia-Pacific: Origins, Evolution, and Implications* (New York: Routledge, 2006)

This book outlines the bilateral trade agreements in the Asia-Pacific and presents case studies. It looks at why economies establish FTAs, the shifts in the paradigm from bilateralism to multilateralism, and the impact of bilateralism on Asian economies. The authors propose that bilateral agreements can pave the way for future multilateral agreements through the following mechanisms: nested links in which arrangements conform to broader accords; horizontal connections in which arrangements reflect a division of labour among institutions; overlapping agreements, which create conflict among institutions; and agreements that deal with different issues and are therefore independent of each other. This book also discusses the possible negative impact of preferential trade agreements on liberalization due to the protection of politically sensitive industries and the vagueness of Article 24 of the World Trade Organization (WTO). At the same, the authors address several positive impacts of preferential trade agreements, including redistributive welfare effects, the domino theory (small agreements lead to more and bigger agreements later) and the possibility for an expansion of geographic scope to include new partners.

- d. J.T. Jalles, 'Openness, regional trade agreements and growth: Evidence from Asia', *Asian Economic Journal* 26(1) (2012): 63–85.

This paper examines the relationship between RTAs, trade integration and economic growth in 21 South and Southeast Asian economies from 1980 to 2004. It assesses the growth effects of RTAs and the broad trade liberalization of developing economies in South and Southeast Asia. It examines four RTAs established in this region in the 1980s and 1990s: the Global System of Trade Preference among Developing Economies (GSTP); the Laos–Thailand Partial Scope Agreement; the ASEAN Free Trade Area (AFTA); the South Asian Association for Regional Cooperation (SAARC) Preferential Trade Agreement (SAPTA). The results of this paper indicate that openness of either a country or its neighbours does not affect a nation's growth. With the regression models in the paper showing mixed results, the impacts of RTAs are unclear.

- e. N.J.M. De Silva and J. Johnson, 'Trade liberalization, free trade agreements, and economic growth: The case of Sri Lanka', *Journal of International Agricultural Trade and Development* 8(2) (2012): 242–257.

This paper examines whether regional FTAs like the South Asian Free Trade Agreement (SAFTA) or the India Sri Lanka Free Trade Agreement (ILFTA) create economic benefits for participating economies. It uses regression models to assess the impact of trade liberalization on economic growth in Sri Lanka. The results suggest that RTAs increase trade openness, which has positive benefits for economic growth and can therefore lead to increased FDI and domestic investment.

- f. K. Zeng, 'Multilateral versus bilateral and regional trade liberalization: explaining China's pursuit of free trade agreements (FTAs)', *Journal of Contemporary China* 19(66) (2010): 635–652.

This paper examines China's recent embrace of multilateral trade negotiations through the WTO and FTAs. The author explains that this could be a way to gain influence in the Asia-Pacific region and capture the economic gains of FTA participation, while also minimizing trade and investment diversion. This paper also highlights the impact of domestic politics on China's FTA negotiations in general through a discussion of how pressure from protectionist seeking interests influences the scope and depth of China's FTAs.

- g. D. Ariyasajakorn et al., 'ASEAN FTA, distribution of income, and globalization', *Journal of Asian Economics* 20(3) (2009): 327–335.

This paper uses the Global Trade Analysis Project (GTAP) model to examine the impact of FTAs on income distribution within ASEAN. The results indicate that trade liberalization in ASEAN economies stimulates economies' output according to their comparative advantage. Since trade liberalization tends to increase output of capital-intensive goods more than labour-intensive goods, less developed economies within the region tend to get smaller benefits. This unequal distribution causes FTAs to widen the income gap between high and low-income households in ASEAN economies. This paper also examines the effects of income distribution between ASEAN members and their partners in two different scenarios: FTAs within ASEAN and potential agreements between ASEAN and other economies. The results suggest that economies experience a real gross domestic product (GDP) expansion after joining FTAs. Model estimates indicate that the largest improvement occurred in Korea while the smallest improvement occurred in non-ASEAN developing economies, namely China and India. Additionally, the results suggest that at the household level, FTAs improve incomes for all economies participating in the agreements, except for the least developed economies in ASEAN and for India.

- h. UNCTAD (United Nations Conference on Trade and Development), 'South–South trade in Asia: The role of regional trade agreements' (Geneva: UN, 2008).

This paper analyses trends in South–South trade in Asia and the evolving RTAs. It discusses sectoral specializations, geographical distributions and tariff treatment. The authors consider the 'hub and spokes' pattern of South–South trade and compare the varying templates of RTAs depending on participating economies' levels of development. They also include a comparative analysis of RTAs in Asia in terms of scope and coverage, impact on global and regional production strategies and assess their contribution to South–South trade growth in Asia. The analysis indicates that the level of preferential trade liberalization is relatively the most dominant issue; tariff line coverage and preferential margins vary depending on the type of RTAs and signatory

economies; and only a limited number of RTAs can be regarded as genuine ‘free trade agreements’. This paper also looks at India’s RTAs and ASEAN-related RTAs as a strategic scenario for development and as strong features of business strategies for global competition. Analysis indicates that the creation of ASEAN-related RTAs would have a positive impact on GDP for all signatory economies.

### ***K.2 Convergences and divergences***

- a. R. Hicks and S.Y. Kim, ‘Reciprocal trade agreements in Asia: Credible commitment to trade liberalization or paper tigers?’ *Journal of East Asian Studies* 12 (2012): 1–29.

This paper analyzes 57 RTAs in Asia that have been signed or in effect as of 2006. It focuses on the degree to which these RTAs act as mechanisms for a credible commitment by tying the hands of the governments with respect to trade policy. The authors argue that RTAs differ widely and use a 19-point coding scheme to code the quality of commitments in RTAs to develop a comprehensive index. Results of the gravity model analysis support the hypothesis that stronger institutional commitments in an RTA produce greater expansions of trade between participant economies. They argue that some agreements are weaker than others in terms of trade liberalization due to trade-distorting measures. The authors also find that some aspects of agreements are associated with an increase in trade: liberalization for a wider range of products and a formal dispute settlement process.

- b. K. Suominen, ‘The changing anatomy of regional trade agreements in East Asia’, *Journal of East Asian Studies* 9(1) (2009): 25–56.

This paper describes the structure of 48 RTAs by their inclusion of tariff liberalization schedules, rules of origin, competition policy, customs environment, investment procedures, and service provisions. While worldwide RTAs differ in some important respects, including in the setup of the tariff liberalization programmes, the speed and trajectory of tariff liberalization and the employment of exceptions, there are important commonalities among the East Asian RTAs. Their results suggest that intra-Asian RTAs are rapidly liberalizing, with the exception of agriculture. However they are also less encompassing in trade-related disciplines when compared to more in-depth RTAs such as the TPP.

- c. J. Asafu-Adjaye and R. Mahadevan, ‘Regional trade agreements versus global trade liberalisation: implications for a small island developing state’, *The World Economy* 32(3) (2009): 509–529.

This paper analyses the impacts of regional integration on a small developing country, using Fiji as a case study. The authors use a dynamic Computable General Equilibrium (CGE) model to empirically examine the effects of RTAs on Fiji in four different

simulations. Through this process they investigate two comparative effects of two key strategies for trade liberalization: a regional trade agreement versus global trade liberalization. They find that the Pacific Island Economies Trade Agreement (PICTA) does not have the greatest benefits to the macro economy of Fiji compared to Pacific Agreement for Closer Economic Relations (PACER) and Economic Partnership Agreements (EPAs), but full trade liberalization provides the greatest benefits for Fiji.

- d. APEC, 'Identifying convergences and divergences in APEC RTAs/FTAs' (*20th APEC Ministerial Meeting*, Lima, Peru, 2008)

This paper identifies some of the economic opportunities that a FTAAP could provide, as a means of addressing the proliferation of RTAs/FTAs in the Asia-Pacific region as well as promoting a higher level of convergence and consolidation of RTAs/FTAs in a comprehensive and WTO+ manner. It also identifies some of the challenges an FTAAP could present. This paper covers 30 RTAs/FTAs within APEC and provides a better understanding of the levels of commonality across trade agreements in the region. It also highlights policy challenges in cases where divergences are identified.

- e. P. Tumbarello, 'Are regional trade agreements in Asia stumbling or building blocks? Implications for the Mekong-3 economies' (Washington, DC: International Monetary Fund, 2007).

This paper assesses the implications of the following RTAs in Asia: ASEAN; the South Asian Association for Regional Cooperation (SAARC) Preferential Trading Arrangement (SAPTA); the APEC forum; and the Australia–New Zealand Closer Economic Relations (CER). It uses a gravity model to assess the impact of RTAs on the patterns of bilateral trade flows. The results suggest that during 1984–2005, membership in major RTAs in Asia (ASEAN, APEC and SAPTA) did not generally appear to have led to trade diversion.

- f. B. Jugurnath, M. Stewart and R. Brooks, 'Asia/Pacific regional trade agreements: an empirical study', *Journal of Asian Economics* 18(6) (2007): 974–987.

This paper analyzes whether RTAs enhance welfare by examining five different RTAs using annual data from 26 economies from 1980 to 2000. The authors use a gravity model to see if the RTAs have been trade creating or trade diverting. The results show that the effects of the different RTAs varied remarkably. ASEAN and the Australia–New Zealand Closer Economic Relations (CER) fostered greater trade with trading partners and with the rest of the world; while APEC, the Southern Cone Common Market (MERCOSUR) and the North American Free Trade Agreement (NAFTA) tended to be trade diverting, that is, they expanded intra-bloc trade at the expense of trade with others.

### ***K.3 Direction of standard-setting***

- a. R. Baldwin and M. Kawai, 'Multilateralizing Asian regionalism' (Tokyo: Asian Development Bank Institute, 2013).

This paper discusses the Asian trade pattern and notable FTAs, ongoing multilateralization efforts and options for extending the ASEAN+ approach in the future. The authors explain how the costs of the so-called Asian 'noodle bowl' effect can be reduced, how Asian FTAs can be made consistent with the WTO global liberalization process, and how Asia can remain integrated with the major markets in North America and Europe. They also evaluate the pros and cons of various approaches including the ASEAN-centred trade agreements and cross-regional agreements with the US and the European Union.

- b. S. Hanamaka, 'Evolutionary paths toward a region-wide economic agreement in Asia', *Journal of Asian Economics* 23(4) (2012): 383–394.

This paper attempts to streamline the policy arguments over sequencing issues by clarifying the pros and cons of various paths toward a future region-wide agreement in Asia. The APEC 2010 Summit Statement states that members should pursue an FTAAP by building on various ongoing regional cooperation frameworks including the ASEAN+3, ASEAN+6 and the TPP. This paper presents two possible approaches for this: consolidation versus expansion. It then identifies how the two approaches differ in terms of evolutionary parameters including the timing of negotiations, scope of agreement and development of membership. The driving forces behind the evolution of regional agreements in each approach are also clarified. The second half of the paper analyses three possible paths toward a region-wide agreement: ASEAN+3 free trade agreements, TPP and the Asia-Pacific.

- c. M. Kawai and G. Wignaraja, 'Asian FTAs: Trends, prospects and challenges', *Journal of Asian Economics* 22(1) (2011): 1–22.

This paper discusses key trends and challenges in Asian FTAs using evidence from firm surveys, CGE estimates, and the analysis of specific agreements. The authors discuss recent growth and intensity of FTAs in Asia and propose four main underlying factors: deepening market-driven economic integration in Asia, European and North American economic integration, the Asian financial crisis and slow progress at the WTO Doha negotiations. This paper also presents challenges posed by FTAs in Asia including firm-level use of FTAs, the so-called 'noodle bowl' effect, coverage of agricultural trade, including WTO+ elements, and political-economy considerations for a regional trade agreement. Results suggest that policymakers should maximize the benefits of FTAs while minimizing the costs through the following methods: strengthen the support system for using FTAs; rationalize rules of origin and upgrade their administration; ensure better coverage of agricultural trade; forge comprehensive WTO+ agreements; and encourage a region-wide FTA.

- d. I. Park (2008) 'Regional trade agreements in East Asia: Will they be sustainable?' *Asian Economic Journal* 23(2) (2009): 169–194.

This paper assesses the sustainability of RTAs for East Asia by evaluating the quantitative impact of proposed RTA strategies on the East Asian economies and the world economy with respect to consumption, production, volume of trade and terms of trade effect. The paper applies a multi-country and multi-sector CGE model. The specific strategies evaluated are: (i) an ASEAN hub RTA (a hub-and-spoke type of overlapping RTA strategy) (ii) AFTA versus a China–Japan–Korea RTA (a duplicating or competing RTA strategy); (iii) an ASEAN+3 RTA (an expansionary RTA strategy). The paper's findings indicate that an expansionary ASEAN+3 RTA could be a sustainable policy option because the members' gains would be significantly positive, with more equitably distributed gains between members than when using other strategies. The effect on world welfare would also be positive and the negative effect on non-members would not be very strong.

- e. APEC Policy Support Unit, 'Key Trends and Developments Relating to Trade and Investment Measures and Their Impact on the APEC Region: Do FTAs Matter for Trade?' (Singapore: APEC, 2015).

This paper discusses the growth of FTAs in the Asia-Pacific region and the potential role for an FTAAP in enhancing the benefit of trade to the region. The authors discuss factors that contribute to the impact of FTAs on exports and present an empirical analysis of whether FTAs actually affect trade flows. Their results indicate that FTAs do lead to rising exports in Asia. Lastly, they discuss possible conditions that can maximize an FTAAP's impact on intra-APEC trade and investment.

- f. S. Suvannaphakdy and T. Toyoda, 'Impact of regional trade agreements in East Asia on Members' trade flows', *Journal of Southeast Asian Economies* 31(3) (2014): 361–378.

This paper examines bilateral trade flows to study the determinants of two-way trade for Australia, China, India, Japan, New Zealand, Korea and 10 ASEAN economies from 1990 to 2009. Using a gravity model, this paper analyses the impact of import tariffs on trade flows in member economies of several trading blocs; these include ASEAN, ASEAN+3 and ASEAN+6. Results suggest that the expansion of an East Asian FTA (from ASEAN to ASEAN+3 and ASEAN+6) could be important for promoting intra-regional trade and eliminating tariff barriers.

## Appendix L. Methodology

We use the same methodology, specification and scenarios as Kim et al. in their 2013 study and APEC in its 2009 Further Analytical Study on the Likely Economic Impact of an FTAAP.<sup>206</sup> As such, this section quotes extensively from relevant parts of these two studies.

### *L.1 Static and capital accumulation CGE models*

In order to conduct a quantitative assessment on the effects of an FTAAP on both member and non-member economies, the two CGE models are used.

The first is the standard CGE model, in which the gains from trade liberalization stem mainly from increased efficiency in resource allocation. It is referred to as the static CGE model. The CGE model used in this study is based on the standard Global Trade Analysis Project (GTAP) model,<sup>207</sup> which has been extensively used in existing literature to examine a wide variety of trade policy issues.

The second model is designed to capture not only the static effects, but also the capital accumulation effects. It is referred to as the capital accumulation CGE model.<sup>208</sup> This model takes into account the positive relationship between trade, investment and growth (the so-called trade-induced, investment-led growth) that is fairly well-established in a number of empirical studies.

The standard GTAP model has been modified in order to identify medium-run growth effects of trade liberalization. Baldwin suggests that static efficiency gains lead to higher savings and investment, which in turn yield more output.<sup>209</sup>

Francois et al. presents a useful approach capturing the capital accumulation effects of trade liberalization in the context of the neoclassical growth model.<sup>210</sup> Following Francois et al., we assume that economies are initially in a steady state. Under this

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<sup>206</sup> S. Kim, I. Park and S. Park, 'A Free Trade Area of the Asia Pacific (FTAAP): Is it desirable?' *Journal of East Asian Economic Integration* 19(1) (2013): 3–25; APEC, *Further Analytical Study on the Likely Economic Impact of an FTAAP* (Singapore: APEC, 2009);

<sup>207</sup> Purdue University, *Global Trade Analysis Project*, accessed 13 July 2016, <https://www.gtap.agecon.purdue.edu/>

<sup>208</sup> In this study, we report results from this capital accumulation model only in order to avoid unintended confusion.

<sup>209</sup> R.E. Baldwin, 'The growth effects of 1992', *Economic Policy* 4(9): 247–83; R.E. Baldwin, 'Measurable dynamic gains from trade', *Journal of Political Economy* 100(1) (1992): 162–74.

<sup>210</sup> J.H. Francois, B. McDonald and H. Nordstrom, 'Trade liberalization and investment in a multilateral framework', in *Dynamic Issues in Commercial Policy Analysis*, ed. R. Baldwin and J.F. Francois (London: CEPR: 1999).



assumption, the magnitudes of changes in the capital stock and output can be measured by comparing them in two steady states. The relationship between capital stock (K) and investment (I) is as follows<sup>211</sup>:

$$K = \frac{I}{\delta} \quad (1)$$

where  $\delta$  is the depreciation rate.

Incorporating equation (1) into the CGE model gives a description of the relationship between capital stock and investment, and controls the closure according to equation (1) so that the change in capital stock and investment converge. That is, this second CGE model is constructed to take into account possible changes in capital formation that may be generated by an FTAAP.

### ***L.2 Specification for trade facilitation***

To estimate the effects of trade facilitation, the standard CGE model has been modified to adopt the simple ‘iceberg’ model of trading costs, introduced by Samuelson (1954).<sup>212</sup> Some units of the goods ‘melt’ in transit, which can be thought of as a cost of trading the goods. Then, an effective price of the goods  $i$  imported from economy  $r$  at domestic prices is introduced in the destination economy  $s$ :  $P_{irs}^*$ . This is associated

with the observed price,  $P_{irs}$ , as follows:

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<sup>211</sup> Equation (1) refers to the steady state, under  $FT \frac{\dot{K}}{K} - \frac{\dot{L}}{L} = 0$ . For derivation details, see: N. Choi, S.

Park and C. Lee, *Analysis of the Trade Negotiation Options in the East Asian Context* (policy analysis 03-02, Seoul: Korea Institute for International Economic Policy, 2003).

<sup>212</sup> P.A. Samuelson, ‘The transfer problem and transport costs, ii: Analysis of effects of trade impediments’, *Economic Journal* 64(254) (1954): 264–89.

$$P_{irs}^* = \frac{P_{irs}}{A_{irs}} \quad (2)$$

where  $A_{irs}$  reflects the trade facilitation costs for the good  $i$ . An increase in  $A_{irs}$  by enhanced trade facilitation means a fall in the effective price of the goods  $i$  imported from  $r$  to  $s$ , thus encouraging an expansion of imports. To ensure a balanced data set, a quantity adjustment equation is required. Similar to the definition of the effective price, the adjusted effective quantity is as follows.

$$Q_{irs}^* = Q_{irs} \cdot A_{irs} \quad (3)$$

Incorporating equations (2) and (3) into the standard CGE model, the effects of trade facilitation, which reduces trade costs, can be estimated.

### ***L.3 Specification for trade in services***

In order to capture the effects of trade liberalization in services, the methods of Hertel et al. and Anderson et al. have been used.<sup>213</sup> Brown et al. suggested a modelling method that constructs the base data to include the tariff equivalents.<sup>214</sup> In this model, trade liberalization in services generates tariff revenue; although, in reality, there are no tariffs. Hertel et al. and Anderson et al. assume instead that barriers to trade in services reduce the actual volume of services trade that can be delivered at a given cost.<sup>215</sup> In contrast, trade liberalization in services leads to the increase of the amount of services and reduction of price of imported services in the domestic market. These effects can be captured by introducing a services import-augmenting component into the CGE model.

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<sup>213</sup> T. Hertel, K. Anderson and J. Francois, 'Agriculture and non-agricultural liberalization in the millennium round' (working paper no. 16, Adelaide: CIES, 2000); K. Anderson et al., 'Potential gains from trade reform in the new millennium' (Adelaide: CIES, 2000).

<sup>214</sup> D. Brown et al., 'Computational analysis of goods and services liberalization in the Uruguay Round', in *The Uruguay Round and Developing Economies*, ed. W. Martin and L.A. Winters (Cambridge: Cambridge University Press, 1996).

<sup>215</sup> Hertel et al., 'Agriculture and non-agricultural liberalization'; Anderson et al., 'Potential gains from trade reform'.

## Appendix M. Statistical Updates of the Further Analytical Study on the Likely Economic Impact of an FTAAP

**Table M.1 Tariff equivalents in services**

	Construction	Trade	Communication/ Transportation	Business/ Finance
<b>Australia</b>	12	7.4	183.4	24.8
<b>Canada</b>	6	9.0	117.7	25.9
<b>Chile</b>	40	34.4	82.2	45.2
<b>China</b>	25	35.5	191.1	39.8
<b>Hong Kong, China</b>	32	31.5	149.8	39.0
<b>Indonesia</b>	16	34.8	190.4	43.1
<b>Japan</b>	5	4.6	142.0	28.9
<b>Korea</b>	16	21.4	184.9	36.3
<b>Malaysia</b>	10	34.8	175.8	36.1
<b>Mexico</b>	24	21.3	152.3	40.9
<b>New Zealand</b>	5	13.4	181.5	30.5
<b>Peru</b>	40	30.3	190.9	48.7
<b>Philippines</b>	40	32.8	110.2	41.7
<b>Russia</b>	25	35.5	191.1	39.8
<b>Singapore</b>	12	34.4	138.8	35.9
<b>Thailand</b>	28	32.5	189.6	42.2
<b>Chinese Taipei</b>	16	21.4	184.9	36.3
<b>USA</b>	5	4.6	111.4	21.7
<b>Viet Nam</b>	16	34.8	190.4	43.1

The tariff equivalents of Korea, China and Indonesia are used for Chinese Taipei, Russia and Viet Nam as proxy, respectively, as Hoekman does not provide tariff equivalents for the three economies. See: B. Hoekman, 'Assessing the General Agreement on Trade in Services', in *The Uruguay Round and the Developing Economies* ed. W. Martin and A. Winters (Washington, DC: World Bank, 1995).

**Table M.2 Effects of an FTAAP: Scenario I\* (% deviation from the base)**

	<b>Real GDP</b>	<b>Welfare</b>	<b>Export</b>	<b>Import</b>
<b>19 APEC economies</b>	0.40	0.38	2.45	2.49
<b>Australia</b>	0.42	0.43	1.91	2.06
<b>Canada</b>	0.11	0.06	0.19	0.20
<b>Chile</b>	-0.01	-0.11	-0.45	-0.43
<b>China</b>	0.71	0.67	3.90	4.44
<b>Hong Kong, China</b>	0.27	0.38	0.63	0.63
<b>Indonesia</b>	0.24	0.16	1.14	1.18
<b>Japan</b>	0.66	0.82	4.94	4.90
<b>Korea</b>	0.41	0.14	1.51	1.57
<b>Malaysia</b>	0.53	0.22	0.74	0.85
<b>Mexico</b>	0.99	0.82	1.22	1.30
<b>New Zealand</b>	0.44	0.53	1.32	1.39
<b>Peru</b>	-0.02	-0.08	-0.54	-0.55
<b>Philippines</b>	0.43	0.32	1.24	1.01
<b>Russia</b>	0.76	0.71	1.94	3.25
<b>Singapore</b>	-0.07	-0.16	-0.47	-0.51
<b>Thailand</b>	0.36	0.02	0.64	0.67
<b>Chinese Taipei</b>	0.74	0.68	2.11	2.46
<b>USA</b>	0.11	0.09	2.61	1.80
<b>Viet Nam</b>	1.62	1.45	4.14	3.68
<b>EU27</b>	-0.01	-0.06	-0.51	-0.49
<b>Rest of world</b>	-0.03	-0.09	-0.63	-0.61

\*Scenario I assumes tariff elimination only.

**Table M.3 Effects of an FTAAP: Scenario II\* (% deviation from the base)**

	Real GDP	Welfare	Export	Import
<b>19 APEC economies</b>	3.45	3.09	9.31	9.24
<b>Australia</b>	2.66	2.65	5.82	6.17
<b>Canada</b>	3.16	2.95	5.56	5.59
<b>Chile</b>	5.32	5.14	3.96	3.94
<b>China</b>	3.98	3.51	11.17	12.70
<b>Hong Kong, China</b>	9.17	8.82	6.68	6.67
<b>Indonesia</b>	3.94	3.77	7.17	7.34
<b>Japan</b>	2.99	2.88	9.87	9.79
<b>Korea</b>	7.56	6.65	8.28	8.34
<b>Malaysia</b>	11.52	10.27	11.33	11.72
<b>Mexico</b>	8.94	8.36	9.51	9.76
<b>New Zealand</b>	4.69	4.59	6.24	6.47
<b>Peru</b>	2.06	1.99	4.24	5.19
<b>Philippines</b>	9.69	8.63	12.93	11.98
<b>Russia</b>	3.94	3.93	5.75	8.25
<b>Singapore</b>	11.47	9.97	9.14	9.12
<b>Thailand</b>	14.06	11.70	13.64	13.72
<b>Chinese Taipei</b>	8.45	7.80	9.65	10.09
<b>USA</b>	1.69	1.37	9.62	6.81
<b>Viet Nam</b>	11.64	10.22	13.53	12.80
<b>EU27</b>	0.74	0.60	-0.03	0.13
<b>Rest of world</b>	0.95	0.94	0.28	0.66

\*Scenario II assumes tariff elimination + 5% reduction in trade cost by trade facilitation.

**Table M.4 Effects of an FTAAP: Scenario III\* (% deviation from the base)**

	<b>Real GDP</b>	<b>Welfare</b>	<b>Export</b>	<b>Import</b>
<b>19 APEC economies</b>	3.54	3.18	9.55	9.48
<b>Australia</b>	2.73	2.73	6.08	6.44
<b>Canada</b>	3.22	3.02	5.71	5.74
<b>Chile</b>	5.38	5.21	4.02	3.99
<b>China</b>	4.05	3.57	11.30	12.85
<b>Hong Kong, China</b>	10.86	10.58	8.85	8.87
<b>Indonesia</b>	4.04	3.86	7.36	7.53
<b>Japan</b>	3.12	3.00	10.25	10.16
<b>Korea</b>	7.74	6.82	8.43	8.49
<b>Malaysia</b>	11.77	10.52	11.58	11.97
<b>Mexico</b>	9.03	8.45	9.62	9.88
<b>New Zealand</b>	4.83	4.73	6.50	6.75
<b>Peru</b>	2.09	2.03	4.33	5.30
<b>Philippines</b>	9.87	8.81	13.21	12.25
<b>Russia</b>	4.06	4.06	5.99	8.58
<b>Singapore</b>	11.84	10.25	9.37	9.35
<b>Thailand</b>	14.35	12.02	13.87	13.95
<b>Chinese Taipei</b>	8.72	8.08	9.90	10.34
<b>USA</b>	1.73	1.41	9.83	6.97
<b>Viet Nam</b>	11.79	10.37	13.67	12.93
<b>EU27</b>	0.74	0.59	-0.07	0.09
<b>Rest of world</b>	0.96	0.94	0.23	0.61

\*Scenario III assumes tariff elimination + 5% reduction in trade cost by trade facilitation + reduction in tariff equivalents of services by 10%.

**Table M.5 Effects of an FTAAP on APEC as a whole: comparison by scenarios, capital accumulation CGE model**

	Real GDP	Welfare	Export	Import
<b>Absolute effects (% deviation from the base)</b>				
<b>Scenario I</b>	0.40	0.38	2.45	2.49
<b>Scenario II</b>	3.45	3.09	9.31	9.24
<b>Scenario III</b>	3.54	3.18	9.55	9.48
<b>Relative effects to Scenario I (Ratio)</b>				
<b>Scenario I</b>	1.00	1.00	1.00	1.00
<b>Scenario II</b>	8.63	8.13	3.80	3.71
<b>Scenario III</b>	8.85	8.37	3.90	3.81
<b>Relative effects to Scenario II (Ratio)</b>				
<b>Scenario I</b>	0.12	0.12	0.26	0.27
<b>Scenario II</b>	1.00	1.00	1.00	1.00
<b>Scenario III</b>	1.03	1.03	1.03	1.03

Scenario I – Tariff elimination; Scenario II – Tariff elimination + 5% reduction in trade cost by trade facilitation; Scenario III – Tariff elimination + 5% reduction in trade cost by trade facilitation + reduction in tariff equivalents of services by 10%.

**Table M.6 Effects of an FTAAP on APEC as a whole: comparison between original study (2009) and updated study (2015), capital accumulation CGE model**

	2009 (16 economies)				2015 (19 economies)			
	Real GDP	Welfare	Export	Import	Real GDP	Welfare	Export	Import
<b>Absolute effects (% deviation from the base)</b>								
<b>Scenario I</b>	0.59	0.58	6.51	6.59	0.40	0.38	2.45	2.49
	2.79	2.57	15.05	14.34	3.45	3.09	9.31	9.24
<b>Scenario II</b>	2.9	2.69	15.42	14.73	3.54	3.18	9.55	9.48
<b>Relative effects to Scenario I (Ratio)</b>								
<b>Scenario I</b>	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
	4.73	4.43	2.31	2.18	8.63	8.13	3.80	3.71
<b>Scenario II</b>	4.92	4.64	2.37	2.24	8.85	8.37	3.90	3.81
<b>Relative effects to Scenario II (Ratio)</b>								
<b>Scenario I</b>	0.21	0.23	0.43	0.46	0.12	0.12	0.26	0.27
	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>Scenario II</b>	1.04	1.05	1.02	1.03	1.03	1.03	1.03	1.03

Scenario I – Tariff elimination; Scenario II – Tariff elimination + 5% reduction in trade cost by trade facilitation; Scenario III – Tariff elimination + 5% reduction in trade cost by trade facilitation + reduction in tariff equivalents of services by 10%.

**Table M.7 Comparison of analytical framework between original study (2009) and updated study (2015)**

	Original study (2009)	Updated study (2015)
Base year	2004	2011
<b>Excluded economies</b>	Brunei Darussalam Chinese Taipei Hong Kong, China Papua New Guinea Russia	Brunei Darussalam Papua New Guinea
<b>Controlled subregional FTAs*</b>		ASEAN–Australia–New Zealand Peru–China New Zealand–Malaysia Peru–Korea Peru–Mexico Chile–Malaysia Japan–Peru Korea–US Malaysia–Australia New Zealand–Chinese Taipei Chile–Viet Nam Singapore–Chinese Taipei Korea–Australia Canada–Korea Japan–Australia Korea–China Australia–China

Subregional FTAs that have been effective since 2011, the base year of this study. Elimination of tariffs and reduction of tariff equivalent barriers in services between the listed bilateral FTA members will not be considered when we calibrate the policy effect of Scenarios I and III for the FTAAP experiment. Instead, each of the listed subregional FTAs will be considered as a separate FTA from an FTAAP and the trade effects are contained in the base value of this study.



## Appendix N. Initiatives under the Pacific Alliance

The following projects and programmes in areas of interest to members are being developed within the Pacific Alliance (PA):

**The Innovation Technical Group (GTI):** The GTI aims to establish a public–private agenda to develop and promote innovation activities in areas such as business, education, government and investment. Its work is based on five strategic pillars: (i) support of associative human capital development and training for innovation and entrepreneurship; (ii) support of the development of a culture and mindset for innovation and entrepreneurship; (iii) support of technology and knowledge transfer; (iv) funding; and (v) regulatory framework.

**Small and Medium Enterprises (SMEs) Group:** This technical group defines support mechanisms for SMEs to benefit from the opportunities offered by the PA. As part of its activities, and with the cooperation of the Organisation for Economic Co-operation and Development (OECD), it has identified policy options available to member countries for promoting the internationalization of SMEs and their integration into regional and global value chains. Five areas of intervention are outlined: (i) finance; (ii) business environment; (iii) firm capabilities; (iv) market access; and (v) trade and trade-related policies.

**Trade Promotion Entities:** Trade promotion agencies, commercial offices and embassies of the four member countries cooperate to launch events aimed at promoting trade activities. They also hold joint presentations at international fairs, business rounds and business seminars around the world.

**Cooperation Group:** The objective of this group is to promote cooperation mechanisms to develop the Pacific Platform for Cooperation, such as:

- **The PA’s student and academic mobility platform:** This programme funds academic exchange for undergraduate and graduate students as well as professors and researchers in areas such as finance, tourism, economy, international trade, management and others.
- **Integration for sustainable production and consumption:** The programme focuses on the following issues: environment, business development, clean production, and sustainable consumption (eco-labelling and sustainable procurement).
- **Scientific Research Network on Climate Change:** The PA has a Scientific Committee, made up of four representatives per country, in charge of ensuring

the coherence of scientific research conducted based on the public policies of the member countries.

**The Working Groups of the Ministry of Finance:** There are four working groups to develop financial integration issues. Stock market integration among member countries through the Latin American Integrated Market (MILA) is one of the main topics.

**The Working Group on External Relations:** This group aims to develop a strategic relationship between the PA and its observer states as well as third parties, so as to promote the objectives of the PA through dialogue and cooperation activities based on free movement of people, goods, services, and capital and related issues.