Document: REIWG 35-051A
Draft: SECOND
Source: REIWG
Date: 12 November 2015
Meeting: Manila, Philippines

The FTAAP Opportunity
A Report to ABAC

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October 2015

DRAFT: PLEASE DO NOT QUOTE

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The FTAAP Opportunity: Executive Summary

The Asia-Pacific economy has thrived through economic integration, growing faster than the rest of the world, driving poverty rates lower and many social indicators higher. But the region's business environment is changing and old growth models are fading. The Free Trade Area of the Asia Pacific (FTAAP), long an aspiration of the APEC Business Advisory Council (ABAC), offers a response to these challenges. If successful, the FTAAP will realize the Bogor Goals of an integrated, inclusive Asia-Pacific economy; align the region's trading system with profound changes in its business models and technology; connect the world's three largest economies and some of its most dynamic emerging markets under open rules; and recharge a powerful locomotive of world growth.

Business welcomes the APEC Beijing Roadmap, adopted in 2014, to help turn the FTAAP from concept into reality. Business also has much to contribute to this process. This report builds on business experiences in the forefront of economic integration to examine why the FTAAP is so important, what its contributions might be, and how it can be realized.

Supporting revolutionary change in the business environment

Asia-Pacific business is evolving so rapidly in so many ways that listing changes by importance is impossible. Still, four major trends—the rise of global value chains, the spread of the Internet/digital economy, the emerging middle class, and improving connectivity—highlight opportunities and challenges that nearly every business faces, whether it is small or large, located in a wealthy metropolis or a remote village, and engaged in farming or cloud computing.

First, global and regional value chains have transformed manufacturing and are beginning to do so in services. This business model is an Asia-Pacific innovation, thanks to breakthroughs in information, communication and transport technologies, differences in wages, and reduced trade barriers. Value chains make business more productive, deliver lower-cost and higher-quality products to consumers, and enable low-income economies to plug into world markets with far less capital and technology than in the past. New analysis suggests that value chains may be nearing a saturation point in manufacturing, barring further increases in connectivity, but they remain central to the region's economy and are just beginning to penetrate service industries. Value chains make unusual demands on policy since they depend on complex cross-border movements of products, services, capital, people, and information.

Second, the Internet/digital revolution is penetrating and sometimes disrupting wide swaths of the economy. There are 7 billion mobile phones in the world today and global sales of smartphones rose by 14 percent in 2014 alone. The Asia-Pacific region is leading the world in adopting these technologies and developing applications for them. This trend is still in its infancy, but it has already created new generations of products and services, and enabled new entrants to leapfrog older technologies. At times, latecomer firms and economies enjoy advantages over established competitors—for example, they can bypass fixed-line telecommunications and brick-and-mortar retailing with mobile, wireless transactions. At the same time, the Internet/digital revolution is also creating challenges in securing information and privacy, and raises the risk that inappropriate regulation will thwart innovation and entrepreneurship.

Third, the middle class of the Asia Pacific will exceed two billion people by 2030. This staggering number suggests unprecedented opportunities. The Asia-Pacific middle class will be concentrated in urban centers, will enjoy rapidly growing discretionary incomes, and will demand better and more varied products and services. It will dramatically expand markets for housing, health care, education, finance, transport and travel, entertainment and more. Businesses serving the middle class, in turn, will benefit from exceptional economies of scale, scope and agglomeration. To help realize these benefits, the region's policy environment also has to change, enabling growth in service industries and in public-private partnerships that support massive infrastructure requirements.

Finally, gains in connectivity in the Asia Pacific are multiplying all of the opportunities above. Better communications, ports, airports, railroads, roads and other transport services are shrinking distances in the Pacific. Jack Ma of Alibaba predicts that in ten years any business will be able to "buy it anywhere and sell it anywhere" (Ha 2015) and reach any customer in no more than 72 hours. This level of connectivity demands excellent soft infrastructure, including access to world-class logistics, insurance, data and other services, and administrative processes that speed up and simplify trade. Business needs a strong policy environment to invest in connectivity and to realize the full benefits of the economic integration it facilitates.

Energizing business through deeper integration

Entrepreneurs and investment ultimately drive growth, but open and predictable policies enable them to flourish. ABAC has noted that the FTAAP can promote such policies by building on four pillars: *inclusivity*, ensuring benefits also for low-income economies and for micro, small, and medium enterprises (MSMEs); *comprehensiveness,* covering all industries and types of business operations; *consultation*, seeking input from many stakeholders, including business; and *transparency*, ensuring clear and predictable rules and regulations, accessible also to MSMEs with limited resources.

The ABAC pillars and contemporary business trends have important implications for regional trade policy. First, *scope matters.* The changing business environment strengthens the case for economic integration across diverse economies. Second, *comprehensiveness* matters. New business models involve multifaceted operations, not just trade, and all obstacles must be tackled at once. Third, the *presumption of openness* should be the benchmark. Change is so fast that businesses must be able to respond quickly and freely, subject only to appropriate, necessary rules. Fourth, *good governance* must be the foundation of policy. Effective, transparent and predictable regulation is essential. Finally, policy makers need to *think new and big.* The FTAAP must be ambitious, comprehensive, simple and forward-looking.

Beyond these principles, business has advocated specific priorities to advance critical elements of the integration agenda. This report compiles a list of these, based on surveys of executives, studies conducted by ABAC and other groups, and hundreds of interviews with regional executives conducted over the past decade by business students at the University of Southern California. The list includes:

- *Trade liberalization*
- *Investment liberalization*
- *Service sector liberalization*
- *Value chain facilitation and development*
- *Intellectual property protection*
- *Labor mobility and skills transfers*
- *Easily understood and accessible benefits from trade agreements*
- *Promotion of e-commerce and the digital economy*
- *Inclusiveness*
- *Adoption of good regulatory practices*

Each priority is dissected further in the report. This list is neither definitive nor exclusive; it is intended, rather, as a starting point to be amplified in consultations between business and policy makers in the future. It begins the arduous task of defining an agenda for a next-generation FTAAP.

Pathways to the FTAAP

If realized, the FTAAP will be the largest and most diverse trade agreement the world has ever known. Pathways—earlier, similar agreements—have proved essential in Europe and in other large integration efforts, and are necessary also for a project as ambitious as the FTAAP. ABAC has identified three pathways that could lead to the FTAAP, the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP), and the Pacific Alliance (PA). The twelve-nation TPP reached an agreement in October 2015. The RCEP, composed of ten ASEAN economies and six economies that have free-trade agreements with them, began negotiations in 2012. The PA, also launched in 2012, includes four Latin American economies and aspires to deep integration.

The pathways offer different models. The TPP has defined a comprehensive, high-quality template, with explicit provisions on many issues that business has prioritized for next-generation agreements. The RCEP is developing an alternative approach, with greater focus on the sensitivities of low-income economies. Finally, the PA provides lessons on how leaders at the highest levels of government can target exceptionally deep integration. There is substantial overlap in the membership of the pathways: the TPP and RCEP share seven members; three of the four PA members are also in the TPP; and nearly all economies in these groups are also members of APEC.

Multiple options exist for using the pathways. One is to enlarge one of them until it becomes effectively the FTAAP. Another is to combine provisions from different pathways; for example, ABAC recommended in 2014 that the FTAAP converge around the highest standards on the pathways. Still another is to launch the FTAAP as a new agreement with its own standards, in the expectation that it will initially co-exist with other agreements, but will eventually subsume them. It is premature to recommend one or another of these alternatives; greater consensus and more progress on the pathways is needed to decide what will work best. In the meantime, pathways should be encouraged to evolve rapidly and consistently, avoiding exclusionary features that would prevent consolidation.

Whatever route the region takes, the contributions of economic integration to its success need to be well understood by businesses, policy makers and citizens. Economic integration is not the only driver of growth, but it is an important one. The region's diversity is not an obstacle to integration; it is one of the strongest arguments for it. With free trade and investment, differences—in incomes, resources, technical capabilities, and good models of governance—undergird production systems that are unusually productive. Progress will continue to depend on integration in the future, even as it shifts to a wider range of business activities in technology, investment and services, aided by high levels of physical and data connectivity.

How big are the potential gains from the FTAAP? A project on this scale is difficult to translate into numbers, but the best estimates suggest large benefits. Aggregate benefits from the FTAAP could range from $1.3 to $2.4 trillion dollars per year by 2025, and show the region's trade (in a middle scenario) 26 percent higher than it would be otherwise. These gains would be considerably larger than from completing any individual pathway. Because the region is already well integrated, the vast majority of the gains would be due to trade creation rather than trade diversion from excluded economies. Three-fourths of the gains would come from the liberalization of regulatory barriers in manufacturing, services, and investment.

Implementing the Beijing Roadmap

Business wants fast progress on the FTAAP because it sees enormous opportunities—greater, more predictable, and more widely shared benefits for the region than could be achieved under any other comparable policy initiative. This is why the Beijing Roadmap and the APEC Strategic Study now underway are critical milestones. Some of the many challenges ahead are addressed in this report.

A first important task for the Strategic Study will be to sharpen and clarify the objectives of the FTAAP. In the Beijing Roadmap, APEC Leaders concluded that "The FTAAP should do more than achieve liberalization in its narrow sense; it should be comprehensive, high quality and incorporate and address 'next generation' trade and investment issues" (APEC Secretariat 2015). This report, in turn, identifies pragmatic, business priorities. There will be other voices to consider as well. The Study has the daunting responsibility of melding inputs into clear, practical and consistent objectives.

The second challenge will be to recommend actions for realizing the FTAAP. Even if the FTAAP cannot enter negotiations now—consensus on an ambitious agenda will not be easy to achieve—businesses, investors and the people of the region need to see progress. A clear work plan must emerge to build consensus, deepen consultations with business and other critical groups, and create capacity to enable all economies to participate in the negotiation and implementation of the FTAAP. APEC is best positioned to launch such activities. The plan does not need to be laid out in detail at the outset, but can establish a process that sets intermediate goals and is further defined as milestones are reached.

A third challenge will be to encourage rapid, coherent progress on pathways to the FTAAP, which will be essential for this large project. The TPP, RCEP and the PA are particularly important, but valuable contributions could be also made by other initiatives that include APEC members, such as the ASEAN Economic Community, the China-Japan-Korea FTA, the China-US Bilateral Investment Treaty, and plurilateral negotiations on services, government procurement, information technology products, and environmental goods underway in Geneva.

The FTAAP is a game-changing idea that will promote prosperity and cooperation in more than half of the world economy. If realized, it will help to sustain the dynamism of the Asia-Pacific region and create a locomotive for world growth. The FTAAP Roadmap and the FTAAP pathways make the realization of the FTAAP achievable. Business is eager to contribute to its design and implementation.

The FTAAP Opportunity: A Report to ABAC

I. Introduction

An integrated Asia-Pacific economy, free of barriers to trade and investment—as envisioned in APEC's 1994 Bogor Goals—will span the world's three largest economies and some of its most promising emerging markets. Free trade and investment among them would open unprecedented economic opportunities for more than nearly three billion people and spur better trade policy elsewhere. The region's business community has long supported this vision and, for more than a decade, the APEC Business Advisory Council (ABAC) has argued that a Free Trade Area of the Asia Pacific (FTAAP) would be a critical step toward it. The FTAAP concept gained new momentum in 2014 as APEC Leaders adopted *The Beijing Roadmap for APEC's Contribution to the Realization of the FTAAP.* In turn, ABAC has called for:

> *an ambitious approach to a comprehensive regional free trade area (FTA) which has become encapsulated in the concept of a Free Trade Area of the Asia-Pacific. FTAAP will be the ultimate expression of the achievement of APEC's Bogor Goals. To achieve regional economic integration, we need to complete the Bogor Goals of free and open trade and investment in the region; to achieve Bogor, we need FTAAP and to achieve FTAAP, we need to complete one or more of the various negotiating pathways including TPP, RCEP and PA [Trans-Pacific Partnership, Regional Comprehensive Economic Partnership, and Pacific Alliance]* (ABAC 2014a).

The FTAAP would become the world's largest free trade area, encompassing economies that now account for 58 percent of its GDP, 47 percent of its trade, and 40 percent of its population. It is an important opportunity for three reasons. First, the FTAAP would update the rules of world trade, which have failed to keep pace with dramatic changes in the business environment. Second, it would make it easier for business to serve the region's vast markets, a task now complicated by many overlapping agreements. Third, it would bring the world's three largest economies under coherent, open rules, preventing blocs that would raise the costs of trade and exacerbate political frictions.

As the Beijing Roadmap brings the FTAAP into focus, the time is right for business to restate the case for regional integration and to explore how it could be realized. This study—an input into ABAC's deliberations—does not recommend any specific way for creating the FTAAP. Nor does it underestimate the complexity of this project. But it does provide the optimistic assessment, based on a thorough analysis of issues and possible pathways, that attractive outcomes are achievable, provided the FTAAP process remains consistent with basic principles of economic openness and inclusivity.

The report is structured as follows. Section II examines ABAC's role in promoting economic integration and the current status of the FTAAP. Section III develops the "business case" for this vision and explores its practical implications for policy. Section IV describes how these priorities relate to next-generation trade agreements. Section V discusses the realization of the FTAAP, including the pathways that might lead to it. Section VI concludes.

II. ABAC and the FTAAP

a. The 2014 Beijing Roadmap

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

These are—and will be—hard won achievements. APEC economies have strong business sectors, are unusually open, and have built a giant, connected market. They lead the world in absorbing new technologies and in organizing multinational production systems.

Yet obstacles to international business remain in the region, both at borders and especially behind them. Some threaten to grow rather than diminish. Burdensome regulations and unpredictable policies challenge the skills and patience of large companies, not to mention millions of smaller firms. As the growth rate of world trade decelerates and the drivers of globalization change, a new vision is needed to sustain economic integration and progress toward the Bogor Goals. In 2006 APEC Leaders concluded that the FTAAP could play a valuable role in that vision. In 2014, APEC turned its concerted attention to the FTAAP by adopting the APEC Beijing Roadmap, which will:

> *launch a collective strategic study on issues related to the realization of the FTAAP by building on and updating existing studies and past work, providing an analysis of potential economic and social benefits and costs, performing a stocktake of RTAs/FTAs in force in the region, analyzing the various pathways towards the FTAAP, assessing impacts of the "spaghetti bowl" phenomenon on economies, identifying trade and investment barriers, identifying challenges economies may face in realizing the FTAAP, and considering any recommendations based on the study's findings.*[1]

The APEC Committee on Trade and Investment (CTI) and the Friends of the Chair Group on Strengthening Regional Economic Integration and Advancing FTAAP were tasked with organizing the study and collecting input. The CTI and the APEC Senior Economic Officials (SOM) will review the progress of the study and finalize it by the end of 2016, when it will be submitted to Ministers and Leaders. The terms of reference for the Strategic Study call for building on existing work, including assessments of the economic and benefits and costs of the FTAAP, conducting a stock-take of existing trade agreements, and analyzing potential pathways for the realization of the FTAAP. China and the United States are co-chairing the drafting process based on contributions from member economies. Input has been also solicited from:

[1] http://m.apec.org/Meeting-Papers/Leaders-Declarations/2014/2014_aelm/2014_aelm_annexa.aspx

- APEC Policy Support Unit (PSU), the analytical office of the APEC Secretariat;
- Pacific Economic Cooperation Council (PECC), a "think tank" with private, academic, and government experts serving in a private capacity;
- ABAC, APEC's business advisory body; and
- APEC Study Centers, a network of universities and research organizations.

The drafting process is thus likely to yield an inclusive and authoritative report representing regional perspectives.

b. ABAC's role in the FTAAP initiative

APEC has noted that "commerce is the lifeblood of the region and business is the engine of economic growth."[2] Thus, the FTAAP can be successful only to the extent that it improves the region's business environment and incorporates business input. This ABAC study was endorsed by ABAC in Hong Kong in January 2015 in order to generate a final report in Manila in November 2015. Throughout this period, ABAC members have generously contributed to this work, including at meetings in Mexico City in April 2015 and Melbourne in August 2015.

ABAC has advocated for the FTAAP since 2004, as noted in Box 1. It has stressed that "quality, ambition, and comprehensiveness" must be the goals driving the FTAAP if it is to meet the needs of business.[3] In addition, ABAC has developed four pillars to be embraced in the FTAAP: inclusiveness, comprehensiveness, consultation, and transparency.

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[2] http://www.apec.org/Groups/Other-Groups/APEC-Business-Advisory-Council.aspx
[3] ABAC Report to the APEC Economic Leaders, 2014.

ABAC and the FTAAP

The pursuit of the Bogor Goals of free and open trade and investment have created employment and social stability and helped reduce poverty in the region. It has become imperative for APEC to give renewed commitment to achieving deeper regional economic integration in view of economic uncertainty and the resulting protectionist pressures that threaten to reverse these gains….In our view, the FTAAP is the most practical means to achieve this.

- Gempachiro Aihara, ABAC Chair, November 2010

The Bogor Goals have been pursued in APEC through voluntary, non-binding initiatives, which have helped to lower trade costs and promote open regionalism. APEC has also provided support for binding initiatives, such as the Information Technology Agreement (ITA) and the completion of the Doha Development Agenda at the WTO. APEC does not attempt to negotiate binding agreements, but has served as an incubator for initiatives such as the Trans-Pacific Strategic Economic Partnership (TPSEP, the predecessor of the TPP), a high-standard free trade area (FTA).

Despite much progress under APEC on various integration initiatives, in 2004 ABAC concluded that wider priorities could be addressed through an ambitious, comprehensive and inclusive region-wide FTA. With the help of the Pacific Economic Cooperation Council, ABAC conducted a study of the FTAAP, finding that it would be second only to full, global liberalization in its potential benefits (Scollay 2004, Morrison and Pedrosa 2006). Leaders adopted the idea in 2006. ABAC continues to emphasize that the private sector, in its full regional diversity, needs to play a central role. A brief timeline of its involvement is presented in Table B1.

ABAC intensified its interest in the FTAAP in 2009 as the outlook for the Doha Development Agenda worsened. In 2010, it proposed using pathways—regional agreements such as the TPP and subsequently RCEP and the Pacific Alliance—to build foundations for FTAAP. In 2014, new opportunities for the FTAAP began to take shape. Ning Gaoning, ABAC Chair in 2014, stressed that given “the approaching 2020 deadline for achieving the Bogor Goals, ABAC now sees the need for APEC to provide more ‘top-down’ direction in the FTAAP process. … This should comprise further articulation of the overall vision, robust economic analysis of possible gains and a dialogue with stakeholders aimed at increasing transparency and identifying business needs.”

These recommendations were adopted by APEC Leaders in Beijing in November 2014 as Leaders issued the “The Beijing Roadmap for the FTAAP” discussed in the text. Work is now underway on the study initiated by the Roadmap, to which this report is a contribution.

Table B1-1. ABAC involvement in the FTAAP

Year	Host City	Recommendations in ABAC Reports to Leaders
2004	Santiago, Chile	Proposes the FTAAP
2006	Ha Noi, Viet Nam	Finds the FTAAP attractive but challenging
2009	Singapore	Declares the FTAAP urgent due to Doha impasse
2010	Yokohama, Japan	Suggests establishing the FTAAP through pathways
2011	Honolulu, Hawaii	Identifies ASEAN+3, ASEAN+6, TPP as pathways
2012	Vladivostok, Russia	Applauds advances in TPP and RCEP
2013	Bali, Indonesia	Adds Pacific Alliance as pathway
2014	Beijing, China	Calls for concrete steps, roadmap and analytical study

Inclusiveness implies that economic integration must reach into all corners of FTAAP members, extending benefits to firms in less-developed economies and regions as well as developed ones, and across the full range of enterprises from micro, small, and medium enterprises (MSMEs) to large ones. MSMEs constitute 97 percent of enterprises in APEC and over half of its employment[4] but underperform in international markets, accounting for only one-third of the region's exports. Closing this gap is a critical objective for future agreements. APEC's 2015 "Boracay Action Agenda to Globalize MSMEs" recommends a wide range of steps to foster the participation in global and regional markets,[5] including identifying appropriate e-commerce platforms. Vulnerable firms and workers will need additional support as integration deepens. Achieving the full objectives of the Bogor Goals requires not merely deeper integration, but also extensive capacity building throughout the region to help people realize the opportunities it generates.

"Not everyone is equipped to take advantage of opportunities arising in an increasingly seamless global market. This needs to change. People must be able to enjoy the benefits of the region's growth."[6]

- Doris Ho, ABAC Chair 2015

Comprehensiveness implies that the FTAAP must be ambitious enough to achieve the Bogor Goals of free trade and investment. It will have to address tariffs and non-tariff barriers, regulations and mechanisms for implementing them, labor mobility and investment policies. It will also have to cover all economic sectors from agriculture to e-commerce and services. As Dennis Nally, the CEO of PwC, also noted, "business leaders have again identified inconsistent regulations and standards as the single biggest barrier to their company's growth in the Asia-Pacific region." FTAAP cannot shy away from handling regulatory issues. Tony Nowell, former Chair of the ABAC Regional Integration Working Group, concluded that "quality, ambition and comprehensiveness need to be the goals driving such negotiations if they are to meet business needs."[7]

Consultation implies that the FTAAP must not be a traditional, top-down trade agreement negotiated behind closed doors but rather should include input from all stakeholders. Not all aspects of negotiations can be made fully public, but policymakers must find ways to engage the public. These should involve businesses that will be most directly affected by new rules. APEC created ABAC in 1995 to solicit such advice, and ABAC can play an invaluable role in designing FTAAP. Consultation should be also built into agreements themselves, to ensure that implementation takes into account feedback from the field.

Finally, *transparency* implies that rules and regulations must be clear even to small firms that cannot easily penetrate bureaucracies. Business surveys cited below show that lack of transparency is one reason why many FTAs are underutilized. Lack of transparency also undermines public support and increases risk. The Boracay Action Agenda argues that

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[4] Data on SMEs in APEC can be found at: http://www.apec.org/Groups/SOM-Steering-Committee-on-Economic-and-Technical-Cooperation/Working-Groups/Small-and-Medium-Enterprises.aspx

[5] http://www.apec.org/Meeting-Papers/Ministerial-Statements/Trade/2015_trade/2015_mrt_stand alone.aspx

6 https://www.abaconline.org/v4/download.php?ContentID=22612236

7 http://www.apec.org/Press/News-Releases/2014/0508_fta.aspx

regulatory transparency is necessary to "provide greater opportunities for MSMEs to comment on new regulations, regulatory reviews, and regulatory impact assessments, regardless of their geographic location." Tools to achieve transparency—such as models for good regulatory practices—have been developed by APEC and should be included in new regional agreements.

c. Business leadership for FTAAP

The four ABAC pillars define key qualities that will make the FTAAP valuable. But the devil will still be in the details. Tariffs will be easy for policymakers to measure and perhaps address, but constitute less significant obstacles to business today than in the past. Standards, technical barriers and associated regulations are more difficult to identify but also more consequential. When does a national standard promote necessary consistency, and when does it raise a barrier against foreign products? When does an approval process create insurmountable obstacles for investors? When does a professional qualification ensure expertise, and when does it define qualifications that cannot be reasonably met by foreign practitioners?

Input from the private sector is essential for balancing the goals of non-discrimination and national sovereignty. Practitioners understand the consequences of decisions and have much to contribute in the formulation of policy. The success of the European Single Market is a case in point; business was intensely involved in the harmonization of standards and rules that became the hallmark of the common market, which ultimately added 2 to 3 percent to the size of the European economy. Europe's current plans for a "Single Digital Market" also involve the private sector, including through private-public partnerships in building infrastructure. In gearing up for this work, the European Commission began by introducing a web portal to collect information and recommendations from business.[8] Similarly, ASEAN policymakers have actively sought private-sector input in designing the ASEAN Economic Community.

Private sector input and an active government role are not mutually exclusive. While all businesses benefit from conditions that allow them to become more efficient, some will also want to protect their markets from competitors. Thus, judgements have to be made on whether any particular recommendation is aligned with the best interests of society. Business understands the need for such decisions, but argues that they be carried out transparently and based on clear rules.

To provide leadership, business must find ways to present its views effectively in the public arena. This is urgent in the new communications environment, where reasoned views and careful logic are often drowned out by extreme positions. The challenge of communications sets high expectations for institutions like ABAC. Since business knows most about the direct effects of trade agreements and their practical implications, it has a special responsibility for explaining how they work. In other words, business must use its unique knowledge to make a compelling, public case for an integrated regional economy.

[8] http://www.ecommerce-europe.eu/news/2015/european-commission-seeks-business-input-on-digital-issues.

III. The FTAAP opportunity

At no time since the adoption of the Bogor Goals has the case for regional integration been stronger than now, or its realization more possible. It may still take time to achieve the FTAAP, but pathways toward it are taking shape. This is not by accident—fundamental trends are driving firms and economies toward deeper cooperation in production and greater commitments to regional markets. These forces—technology, integration in production and the consolidation of markets—define the opportunities for economic integration.

a. The new landscape of Asia-Pacific business

International business is multi-dimensional, and ABAC has repeatedly stressed parallel work on issues such as trade barriers, impediments to investment flows, and trade facilitation. But the challenges of international business are even broader today than just trade and capital flows. Businesses engage in more varied activities, with a wider range of partners, and in more markets than ever. Major technological and economic trends are disrupting the business environment, including the emergence of global value chains, the digital/Internet revolution, the rise of a giant middle class, and dramatic improvements in connectivity. This section reviews the implications of these trends for the FTAAP.

The rise of global value chains

Global value chains are now ubiquitous, especially in the production of manufactured goods but increasingly also in services. Definitions vary, but as the OECD explains:

> *International production, trade and investments are increasingly organised within so-called global value chains (GVCs) where the different stages of the production process are located across different countries. Globalisation motivates companies to restructure their operations internationally through outsourcing and offshoring of activities. Firms try to optimise their production processes by locating the various stages across different sites. The past decades have witnessed a strong trend towards the international dispersion of value chain activities such as design, production, marketing, distribution, etc.*[9]

The significance of GVCs is confirmed by many indicators. In Figure 1, the amounts of *foreign value added* from various regions that are embodied in another region's *exports* of goods and services for final demand are illustrated by arrows pointing from the originating economies to the exporting economies. These arrows become dramatically thicker between 1995 and 2009, demonstrating the rapidly expanding contributions of imported intermediate goods and embedded services to various regions' exports.

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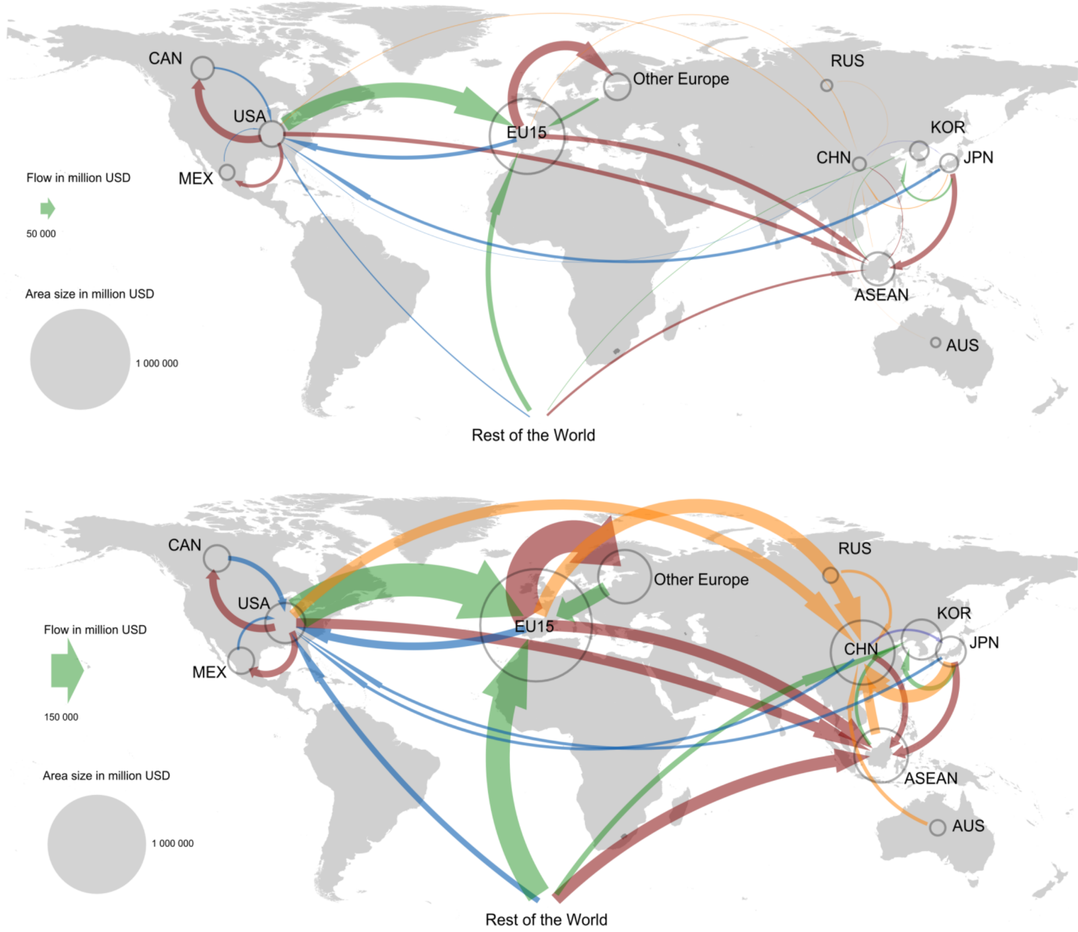
[9] http://www.oecd.org/sti/ind/global-value-chains.htm

Figure 1 Foreign value added content of exports, 1995 (upper) and 2009 (lower)



Source: http://www.oecd-ilibrary.org/docserver/download/9213051ec071.pdf?expires=1443938511&id=id&accname=guest&checksum=FFF3F215632EF34A4A6AA24329570D83

The share of intermediate products in trade offers another measure of the importance of GVCs.[10] That share in world trade was around one half in 2006 and has grown significantly since. Moreover, the share of GVC trade—as measured by the share of intermediate goods trade—is higher in Asia than world-wide (around 60 percent) and it is especially high in Asia's intra-regional trade. GVCs have large regional components, with concentrations of firm linkages in Asia, North America and Europe. They are also organized around hubs (China and Japan in Asia, the USA in North America and Germany in Europe). As Figure 1 shows, China's growth has led to the expansion of component trade from East Asia into China, but there have been also important increases in component trade into ASEAN.

The growth of GVCs has made business more productive. By choosing an efficient location of production for each link in the chain, a firm that coordinates the chain can raise its overall

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[10] The following paragraphs draw on Nordas, H. (2008), 'Trade paradigms for developing countries: some old, some new, some borrowed, some out of the blue', ch. 1 in TID/ESCAP, *Emerging Trade Issues for Policymakers in Developing Countries in Asia and the Pacific*, Studies in Trade and Investment No. 64, available at http://www.unescap.org/publications/detail.asp?id=1313, Baldwin, R. E. (2012), WTO 2.0: Global governance of supply-chain trade. London, Centre for Economic Policy Research, CEPR Policy Insights No. 64 and Athukorala, P-C (2010), 'Production Networks and Trade Patterns in East Asia: Regionalization or Globalization?', ADB Working Paper Series on Regional Economic Integration, No. 56.

productivity, delivering lower-cost or higher-value products to consumers. This has given businesses in high cost locations more adjustment options, since they may continue to operate despite low-cost foreign competition by outsourcing costly links to more efficient locations. GVCs have also generated larger capital flows among the links of their chains. As a result, export firms now have large stakes in the international investment environment, and chain members host more inward investment with associated benefits for employment and technology transfer.

GVCs depend on efficient services to link businesses in an international production system. A wide range of services are often required, ranging from logistics, finance, communications and transportation services, to legal, accounting, and consulting services that support specialized business functions. Given that only a fraction of the value of a final good is produced at each link in the chain, the quality and cost of services that provide connectivity is very important. Yet there is evidence that impediments to service trade are larger than for goods trade. Removing these barriers not only improves the performance of the service sector itself, but also supports the efficiency of GVCs in manufacturing.

Value chains emerged rapidly due to improvements in information and communication technologies, gaps in wage rates between economies, and increased efficiencies in trade and transportation.[11] Nevertheless, recent analysis suggests that the use of GVCs, at least in manufacturing, may be reaching a plateau. Liberalization has slowed, with tariffs now relatively low except in the highly sensitive areas. The benefits from communications breakthroughs may be nearly exhausted. Economies like China, that used to specialize in low-value-added production, have moved to higher value added production and now produce more of the products in the chain domestically. Production is also concentrating near points of consumption, as a result of concerns about interruptions in sourcing and technological advances such as 3D printing. Thus, the relationship between trade growth and GDP growth is changing – in the 1990s trade grew much faster than GDP, but today it is growing at or below the rate of GDP.[12]

"The production of a good or provision of a service no longer takes place exclusively within one economy but incorporates inputs from all over the world. The ease with which inputs move across national borders impacts on the final cost of the product to the consumer. Physical infrastructure, including ICT infrastructure for emergency and disaster preparedness and services like transportation are key, but domestic regulations and standards are also equally important. Economies which can provide the best conditions are more likely to benefit from these global supply chains."[13]

- *Ning Gaoning, ABAC Chair 2014*

[11] This review is based on material in He Xiaobo and Christopher Findlay, 'Value Chains and Trade Policy', University of Adelaide, November 2014, and drawn from Baldwin, R. E. (2013), 'Global value chains: why they emerged, why they matter, and where they are going', chapter 1 in D.K. Elms and P. Low (eds.), Global Value Chains in a Changing World. Geneva: WTO Publications.

[12] See the presentation by Aaditya Mattoo to APEC meetings in Cebu in September 2015: http://mddb.apec.org/Documents/2015/SOM/CONF/15_som_conf_010.pdf

[13] http://www.scoop.co.nz/stories/BU1402/S00405/apec-to-be-pressed-to-accelerate-economic-intergration.htm

The new trends are not yet firmly established, and certainly do not suggest the demise of GVCs. They may mean that the expansion of GVCs in manufacturing will slow. But GVCs remain productive, drive massive volumes of trade, and continue to enable economies to "kick-start industrialization" by offering low-cost ways to enter the global manufacturing trade. GVC-based arguments for the benefits of economic integration remain compelling.

Nor do these scenarios imply slower growth in *value added* trade. *Gross* trade, the statistic normally cited, is an exaggerated measure of economic integration—it counts trade in inputs embedded in exports twice, both as an import and as part of an export. Value added trade, on the other hand, only counts the net revenues that an economy receives for exports, after subtracting the cost of imported inputs. Gross trade grew faster than value added trade while GVCs expanded, but now the two growth rates have become similar. In addition, as final goods are produced by more companies in more places, greater opportunities will open up in two-way trade in varieties. Whether the future of manufacturing trade lies in deeper value chains or more trade in product varieties remains to be seen, but in either case integrated markets enable businesses to choose the best technological and market options available.

In the services sector, GVCs are just beginning to take root.[14] The benefits of new technologies are just beginning to be felt in this sector, where impediments to trade tend to be high. For example, online marketing platforms offer new opportunities to sell services in distant, high-income markets. Continuing advances in technology are also helping service firms in different economies to partner with each other, establishing service GVCs much as manufacturing firms had done earlier. These developments could lead to large savings in service costs, as well as expand the range of exporters to economies that are not participating in services trade today.

In sum, GVCs will continue to develop and support deeper integration among Asia-Pacific economies. Business is especially interested in removing barriers to service trade and investment, which offers opportunities for boosting GVCs in manufacturing and in services themselves.

[14] This point is also discussed by Mattoo: http://mddb.apec.org/Documents/2015/SOM/CONF/15_som_conf_010.pdf

Participation in GVCs

Participation in GVCs and upgrading within them continues to inform policy review and reform.[1] Participation is associated with significant benefits, including diversification of exports, productivity growth and greater demand for skilled labor.

Not all economies may be competitive enough to participate in value chains. Some factors that affect competitiveness—such as size (large economies are less likely to participate) and location (which affects transport costs)—are not easily changed. But others can be the subject of reform:

- The OECD highlights enabling factors such as low tariffs, an environment open to foreign investment, and good infrastructure and logistics.
- Intellectual property protection and contract enforcement matter. The value chain is managed through the extensive transfer of information and these assets must be safe.
- Predictability of policy is critical. Host economies need to assure investors of their commitment to current policy and favorable reforms.
- Meeting production standards set by chain managers is essential. Standardization and streamlined certification processes are important.

These factors have led observers to conclude that the success in connecting with global value chains depends on closing a "governance gap," especially in low income economies not yet connected to global markets.

High quality services are a major facilitator of value chains. Competitive and open services markets result in more contracting-out specialists and a higher share of service inputs in exports. Value chain principles also apply to services, such as architectural design. Studies indicate that service firms usually operate several of modes of supply at once, moving people and data around to connect their operations.

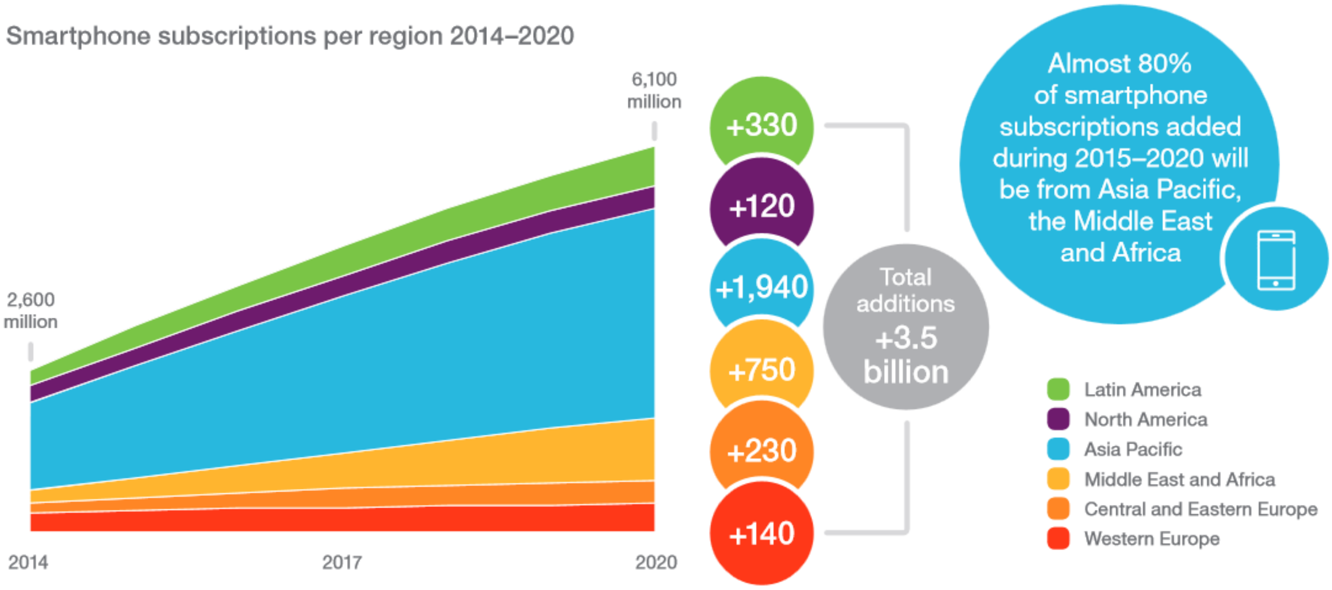
As a result of efforts by ABAC and sectoral bodies, services are now a part of the trade policy agenda. They also suggest an agenda for future trade agreements. As Shell Australia Chairman, Andrew Smith recently commented in a debate on Australia's free trade agreement with China:[1]

It is important [that] we regularly develop new agreements because industry is dynamic — there are industries employing Australians today that didn't even exist when previous agreements were struck. The growth of the services economy is a great example of this shift in Australia's export potential.

The growth of GVCs generates significant opportunities and argues for a comprehensive trade policy framework that includes investment flows, service trade liberalization, strong IP regimes, and compatible standards. Capacity building may be needed to help to make such ambitious policies feasible for low income countries.

There are 7 billion[15] mobile phones in the world today, one for every person on earth. One third of these are smartphones, and global sales of smartphones rose by 14 percent in 2014. The fastest growth was in China, India and Indonesia, and most of the top 10 world markets for smartphones are in the Asia-Pacific. The factors driving this trend include lower prices, new devices, and more reliable access to the internet. Ericsson (see Figure 2) forecasts that these extraordinary trends will continue at least through this decade.

Figure 2: Smartphone Subscriptions by Region, 2014-2020



Source: http://www.ericsson.com/res/docs/2015/ericsson-mobility-report-june-2015.pdf

What will we do with these devices? Shop is one answer. The Asia Pacific has already become the largest business-to-consumer e-commerce market in the world:

> *With a total B2C e-commerce turnover of $567.3bn in 2013, Asia-Pacific was the strongest e-commerce region in the world in 2013, as it surpassed Europe ($482.3bn) and North America ($452.4bn). In comparison with 2012, the Asian-Pacific B2C e-commerce turnover grew by 44.6%, which was the highest growth rate of all the regions. This position and growth is largely due to the emergence of China, which has really established itself as a powerful e-commerce market.*[16]

Many businesses will be affected. Online purchases will increase the demand for delivery services and financial services, and national postal systems, once threatened by the demise of letters, may be rejuvenated by parcel delivery. New mobile apps will provide a first stop for medical diagnosis[17] while other apps will monitor health statistics and medication

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[15] See https://www.bcgperspectives.com/content/articles/telecommunications_connected_world_growth_global_mobile_internet_economy/

[16] http://www.ecommerce-europe.eu/news/2015/with-a-turnover-of-567.3-billion-asia-pacific-is-the-largest-e-commerce-region-in-the-world

[17] http://www.sciencedaily.com/releases/2014/03/140319103612.htm

dosages. Eel farmers in Korea receive real-time alerts on water quality in their fish tanks, eliminating large losses from sudden changes in chemical balances.[18] In the meantime, powerful demand is generated for infrastructure that makes broad-band connectivity ubiquitous.

Digital technology will drive new strategies and designs also in conventional sectors, such as automobile manufacturing. One company is working on one-to-one relationships between cars and their owners, so that the owners will know when parts are wearing out and can organize a service.[19] Technology companies such as Google and Apple may build cars based on self-driving technologies. Changes are on the way even in mundane services such as auto repair, since consumers will know more about repair issues and options, supported by manufacturers and perhaps a new industry of repair advisors.

These innovations are not just the province of global technology giants, but also create opportunities to people once far removed from the world of international business. At a recent PECC meeting, Google executive Barbara Navarro described the YouTube channel "Kids Toys," created by a family in a village in the Philippines.[20] The plot line is simple—each episode features kids opening boxes of toys, but the business is big, with more than one million subscribers around the world (see Figure 3). [21] It generates much needed income for the family. Nor is the digital revolution limited to customer transactions. Interest in B2B transactions is still small but also expected to grow – buyers can read product reviews, compare features, get quotations.

Figure 3. The "Kids Toys" Youtube channel

[18] http://www.bbc.com/news/business-34390356
[19] http://www.mckinsey.com/insights/marketing_sales/marketing_the_mercedes_way
[20] http://www.pecc.org/resources/infrastructure-1/2253-web-and-mobile-as-growth-engines-in-apec-how-to-foster-innovations-through-partnerships-and-policy-reforms
[21] http://www.abc.net.au/news/2015-07-26/youtube-unboxing-videos-a-lucrative-business/6649130

Source: https://www.youtube.com/results?search_query=kids+toys

Digital technology often disrupts existing business models and makes room for new entrants. Online courses challenge bricks-and-mortar education institutions; Uber and similar companies challenge taxis; and Airbnb challenges hotels. In some cases, international alliances are at work, involving combinations of innovative Silicon Valley startups, service trade, foreign investment, and large doses of local entrepreneurship, job creation and income opportunities in the host economy. New technologies enable consumers—and producers—to find ways around costly regulations. In fact, regulations encourage entrepreneurs to find technologies to beat them.

Economies at earlier stages of development often have an advantage in these new business areas—for example, they can leapfrog fixed-line telecommunications technology to exploit mobile opportunities. Mari Pangestu, Indonesia Trade Minister from 2004 to 2011, gave this example of how rural villagers used the Internet to access global markets:

> *A website called 99designs.com [was] started by a young Australian. It is a website for the design of logos needed by small/medium sized companies who post their needs. There is then a competition to design the logo and the winner gets paid through Paypal. Indonesia has been the main source of designers in a one of the world's major design-task marketplace. Indonesia was the biggest source of designers in 2013, and was the second in 2014. By February 2015, there are more than 129,000 registered Indonesian designers in 99designs.com. In Java, the outspread of designers is the most striking. These designers do not only come from urban and educated group but rather mostly come from rural area with no formal training in design. Their incomes have gone up by 10 times compared to the minimum wage, and there has been less social problems in the village.*[22]

These anecdotes illustrate significant trends. BCG estimates that business innovation spurred by the Internet has already increased employment and income substantially. Counting employment in telecommunications, enabling services like billing and payment systems, the production of devices, and the creation of apps and content, they find that a 10 percent increase in mobile broadband penetration increased GDP by 1.4% in low and middle income economies. Greater use of 3G compared to 2G technology also affected GDP positively.[23]

What policy regime provides the best foundations for these benefits? The first important link is between the quality of infrastructure and the growth of the communications sector. An OECD study demonstrated that economies with an open telecommunications market (as measured by low values of the Services Trade Restrictiveness Index) had systematically higher rates of internet penetration (see Figure 4). In other words, services market reform accelerates internet penetration.

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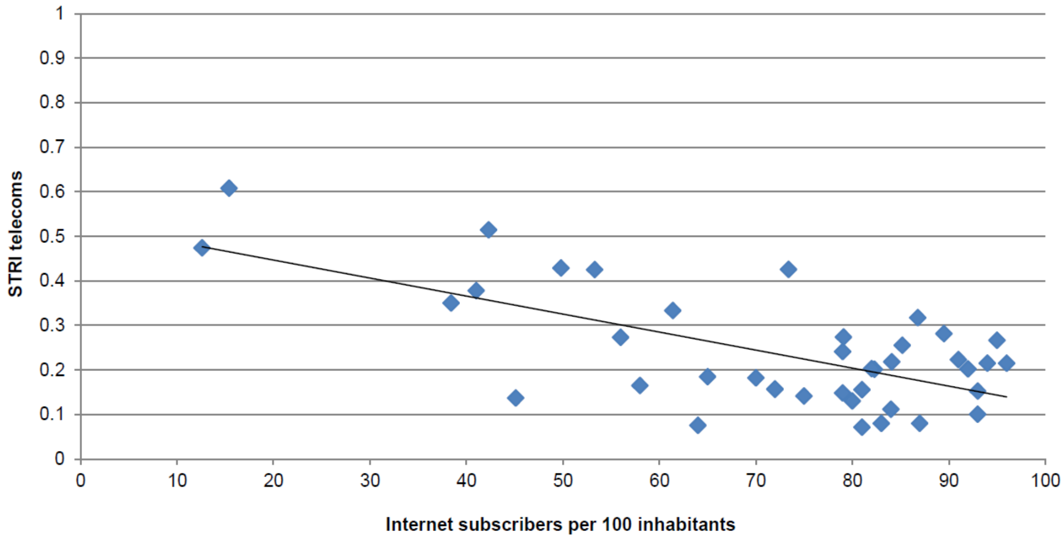
[22] Mari Pangestu, 'A Window into Indonesia: Recent Past, Present and Future' OzAsia ICAS 9 Keynote Presentation, Adelaide, Australia, July 8, 2015

[23] https://www.bcgperspectives.com/content/articles/t elecommunications_connected_world_growth_global_mobile_internet_economy/ quoting this report: http://www.gsma.com/publicpolicy/wp-content/uploads/2012/11/gsma-deloitte-impact-mobile-telephony-economic-growth.pdf

Figure 4: Internet Subscribers (per 100 inhabitants)



Source: http://www.oecd.org/tad/services-trade/STRI_telecommunications.pdf

A second important link is between the quality of Internet environment, as reflected in the freedom and security it offers to businesses and consumers, and the utilization of new technologies. Navarro provides a checklist:[24]

1. "Consumer protection is key: users [must] feel protected when they shop online, access content or make other digital transactions;

2. [The environment must provide] intellectual property and copyright rules which protect the rights of creators (large and emerging) without choking off the opportunities;

3. [Since] cross-border data flows are inherent to the Internet [and] by definition it's international [then if] we want the benefits of the web and mobile as users … we need to enable cross-border data flows rather than restrict them."

Technology businesses are especially concerned by restrictions on data transfers across borders, which are sometimes imposed in the interest of keeping data safe. A prominent current issue is forced localization, where foreign companies have to establish data centers or data processing activities in a host economy.[25] Both increase the costs of doing business. The Swedish National Board of Trade noted that "data security is an essential issue for all companies handling data [and] digital infrastructure and cyber security solutions are key ingredients when ensuring that data is safe." It went on to say that:

> *Trade agreements could be helpful by, for example, including provisions about trade with cyber security solutions, including crypto-issues, and working on common*

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http://www.pecc.org/resources/infrastructure-1/2253-web-and-mobile-as-growth-engines-in-apec-how-to-foster-innovations-through-partnerships-and-policy-reforms

[25] 'No transfer, no production' – a report on cross-border data transfers, global value chains and the production of goods, Kommerskollegium 2015: 4, http://www.kommers.se/In-English/Publications/2015/No-Transfer-No-Production/

standards, and training. In addition, addressing digital infrastructure in negotiations could help countries become more attractive as GVC partners and ensure that the state of that infrastructure does not need to become a central object when companies decide where to locate tasks and with whom to partner. 26

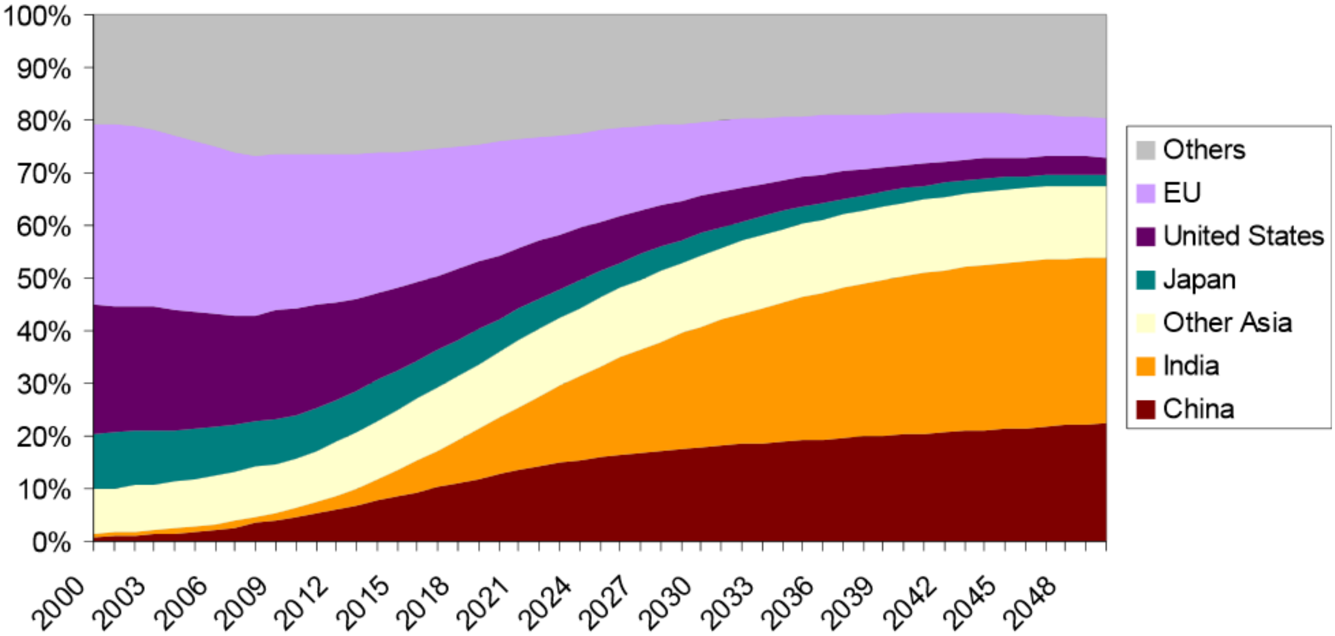
As these quotations suggest, business does not argue that data transfer should be free from regulation; indeed, it depends on an online environment that is safe from violations of privacy and data security. It argues, rather, that regulation should ensure security while also maximizing opportunities for efficiency and innovation in this critical sector.

The urban middle class

Asia-Pacific business is also bracing for the emergence of a massive, moderately prosperous middle class. People in the middle classes of middle income economies are often just beginning to experience comforts and luxuries beyond their basic subsistence needs, and are demanding, sophisticated and enthusiastic consumers. According to the OECD[27]

The size of the "global middle class" will increase from 1.8 billion in 2009 to 3.2 billion by 2020 and 4.9 billion by 2030. The bulk of this growth will come from Asia: by 2030 Asia will represent 66% of the global middle-class population and 59% of middle-class consumption, compared to 28% and 23%, respectively in 2009 (see Figure 5).

Figure 5: Global middle class consumption, 2000-2050



Source: http://www.oecd.org/dev/44457738.pdf

Middle class consumers differ from poorer consumers in many ways. They are likely to be urban residents, they are more productive and better educated, and their discretionary

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[26] No transfer, no production' p. 19.
[27] http://www.oecdobserver.org/news/fullstory.php/aid/3681/An_emerging_middle_class.html

consumption grows faster than their income. For example, research indicates that every 10 percentage-point increase in a nation's middle class results in a 0.5 percentage-point rise in its growth rate. When an economy hits its "sweet spot"—that is, when significant numbers enter the middle class, estimated to be approximately US$6,000 per capita income on average—its patterns of growth change.[28] Ernst and Young offers the following example:

> *China's automobile market in 2001 was tiny, with total annual sales of less than a million units. As per capita incomes increased, reaching US$6,000 in 2008, the automobile market underwent massive expansion. In 2004, General Motors sold 1 car in China for every 10 in the US; by 2009 this ratio reached parity…Business opportunities will not be confined to consumer goods: the emergence of a wealthy middle class will also open up the markets for financial services or the health sector, for instance.*

The Economist reports that the middle class consumers "want more travel, improved health services, private schools and better public infrastructure…they are also keen on self-improvement."[29] The middle class has a preference for branded products which yields returns to product differentiation. It tends to drive social and political reform, including attention to international relationships and matters of importance within them (e.g. environmental issues).

From a business perspective, serving the large cities and prosperous middle classes of the new Asia-Pacific is an unprecedented opportunity. It opens particularly attractive markets for services, ranging from restaurants and specialty retailers to business services ranging from accounting and advertising to the design of computer systems and software. It permits strong competition to raise the quality of products. And if innovators can reach markets across the region, their gains from growth will be multiplied by the economies of scale, scope and agglomeration.

Connectivity

Business has benefited from, and contributed to, large advances in connectivity in the Asia-Pacific region. Many economies, frequently building on private capital, have made massive investments in telecommunications, ports, airports, railroads and other transport services. The resulting gains in connectivity have improved the quality of life, helped to advance the operations of GVCs, and allowed businesses from many countries to cooperate through international production chains.

As the OECD has observed, the costs of moving goods across borders are cumulative, and reductions in the costs of individual transactions generate powerful magnification effects. At stake are not only tariffs, but also trade-related formalities, such as pre-shipment inspections, export licensing, payments of fees or taxes, security or drug enforcement inspections, documentation requirements and physical inspections. The cost of delay has been estimated

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[28] See EY, 'Hitting the sweet spot: the growth of the middle class in emerging markets', http://www.ey.com/Publication/vwLUAssets/Hitting_the_sweet_spot/$FILE/Hitting_the_sweet_spot.pdf which quotes Surjit Bhalla, The Middle Class Kingdoms of India and China (Washington DC: Peterson Institute for International Economics, 2010)
[29] http://www.economist.com/sites/default/files/special-reports-pdfs/13092764.pdf

to be significant and more important for intermediate goods than for final goods. Uncertainty in administrative arrangements adds to costs and in response firms may hold a higher inventory which is also costly. A World Economic Forum (2013) study finds that

> *if all countries reduce supply chain barriers halfway to global best practice, global GDP could increase by 4.7% and world trade by 14.5% far outweighing the benefits from the elimination of all import tariffs. According to the report, lowering supply chain barriers is effective because it eliminates resource waste and reduces costs to trading firms and, by extension, lowers prices to consumers and businesses. Supply chain barriers can result from inefficient customs and administrative procedures, complex regulation and weaknesses in infrastructure services, among many others.* [30]

In a study of the WTO trade facilitation package deal, the OECD found that:[31]

- "Harmonising and simplifying documents would reduce trade costs by 3% for low-income countries and by 2.7% for lower middle-income countries;
- Streamlining procedures would bring further trade cost reductions of 2.8% for upper middle-income countries, 2.2% for lower middle-income countries and 1% for advanced economies;
- Automating processes would reduce trade costs by more than 2% for all countries studied; ensuring the availability of trade-related information would generate cost savings of 2% for advanced economies, 1.4% for lower middle-income countries and 1.6% for low-income countries."

ABAC has also commended APEC on its work on supply chain performance and its valuable contributions to sustained reductions in border costs. Meanwhile, the infrastructure agenda continues to widen beyond the movement of goods, services and people. ABAC observed that "the rapid increase in the use of mobile devices and the development of the Internet of Things will require the efficient use of radio frequency spectrum" (ABAC 2014a). The capacity to manage information flows will rise sharply as an element of international business. Data flows are important for integration in the goods sector, and still more so in making new forms of trade possible in the services sector.

The business community supports APEC initiatives that now prioritize connectivity issues. Senior Officials have focused on connectivity since Indonesia hosted APEC in 2013, and last year launched an APEC Connectivity Blueprint (APEC Secretariat 2014) to outline priorities in this area. Although many aspects of connectivity focus on physical links among economies, the Blueprint also describes the central role of policy and identifies regulatory issues that could be usefully addressed in next-generation trade agreements.

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[30] http://www.worldbank.org/en/news/press-release/2013/01/23/report-reducing-supply-chain-barriers-could-increase-global-gdp-6-times-more-than-removing-all-import-tariffs

[31] http://www.oecd.org/trade/trade-facilitation-agreement-would-add-billions-to-global-economy-says-oecd.htm

"Today there are close to three billion people in the Asia-Pacific region and about four billion people globally without Internet access. The ability to close that gap is more achievable than ever with technology that is readily available and affordable today in many parts of the world. In addition to a welcoming regulatory framework, the speed of implementation relies on a willingness for fresh approaches to public-private partnerships and new business models and technologies that match social, environmental and human needs."

- Peggy Johnson, Executive Vice President of Business Development at Microsoft

Business welcomes the information revolution, and especially the technologies that connect producers and consumers. These sectors also generate demand for telecommunications facilities, and raise the stakes for regulatory policy. Business depends on the unobstructed flow of information to coordinate production systems and to develop innovative services. It also needs a secure communications environment to protect producers and consumers from digital threats. The communications revolution is not costless; its new security implications require effective policy responses. Threats can and should be mitigated through sophisticated technological solutions and national and international policies that ensure basic rights to privacy and property.

b. Business decisions and the policy environment

Interviews with executives, surveys and other tools tell us that businesses apply a holistic decision-making logic to opportunities.

International projects involve many factors that make an initiative viable—the growth and changing characteristics of demand, the business climate and the legal environment, the extent of competition, and access to relevant labor skills and business partners. And even if policy and regulation are not the main determinants of whether a project will be successful, it can make a big difference. If transactions are difficult, business will operate inefficiently or be forced to seek opportunities elsewhere. Obstacles to doing business are harmful even if applied to all competitors in a market. For example, the 2014 report by the Marshall School[32] on accelerating services investment cites cases of rules requiring excessive capital requirements in life insurance, locally licensed staff in accounting firms, and domestic storage for cloud computing services, making it costlier to deliver services. These restrictions try to generate domestic benefits, but instead raise the costs of sectors and consumers dependent on them.

Policy differences across countries fragment markets and production systems, at borders and within them. Businesses are much more concerned with varied and unpredictable regulations than with consistent and stable regulations. With fragmented markets, products have to be

[32] This report is another in a remarkable series of research projects by MBA students at the University of Southern California, undertaken with ABAC support since 2003, which has involved interviews with thousands of business executives in the region. For a detailed list of these studies, see https://www.abaconline.org/v4/content.php?ContentID=22610773

adapted to multiple requirements, the same products have to be processed differently depending on destination, and multiple processes have to be created to handle conformity assessment and regulatory paperwork. All of these work-arounds raise costs and cut into economies of scope and scale. These costs are inevitably passed on in higher prices and ultimately reduce living standards.

Below, we summarize "ten commandments" that business leaders have identified for deeper regional integration.[33] These priorities are derived from ABAC's report to leaders in 2014 and other sources, and echo other efforts to identify business goals, including the interviews of the Marshall School and various business surveys. Since the scope of Asia-Pacific business ranges widely across sectors and types of businesses, these priorities highlight general rules that apply in different ways to economies and sectors. They will define a framework for reviewing options for next generation trade agreements in Section IV. These are:

1. *Trade liberalization*. Despite much progress through regional agreements and APEC, significant barriers remain. Tariffs and non-tariff measures are becoming increasingly burdensome in complex international production systems.

2. *Investment liberalization.* Investment generates value for investors and their hosts, and transfers resources, technology and expertise. Investment is essential for many production networks and especially so in services. Barriers to investment also reduce the potential for other types of business linkages.

3. *Service agenda.* Services account for a growing share of economic activity, and technological advances are now making more services tradeable. Services are critical in organizing modern manufacturing trade and global value chains.

4. *Value chain development.* Global value chains are expanding more rapidly in the Asia Pacific than elsewhere and require excellent physical and "soft" connectivity, including associated services and policies.

5. *Intellectual property.* Not all businesses agree on how to handle intellectual property, but it's important to many. Investors in intellectual property argue for strong protection; users of technology prioritize access at lower cost.

6. *Labor mobility and skills transfers.* Strong business linkages require regulatory policies that facilitate access to labor skills, including compatible standards and practices for training, assessment and certification.

7. *Making trade agreements accessible.* Businesses find existing trade agreements very complicated and often fail to utilize them. Agreements should be simpler, more transparent, and more easily accessible.

Our sources include work by ABAC itself, as presented most recently by its report to Leaders in 2014. They also include recent surveys of executives by the EIU, PWC and PECC as well as the Marshall School reports.

8. *E-commerce/digital economy.* Many businesses depend on e-commerce and data flows to offer products and services. Regional rules should allow these new areas of commerce to develop free of barriers except those necessary to ensure security. .

9. *Inclusiveness.* A vast majority of Asia-Pacific businesses are MSMEs and trade agreements need to represent their interests. Transparency, simple agreements, capacity building, regulatory streamlining, and online commerce are good for all businesses and disproportionately so for MSMEs.

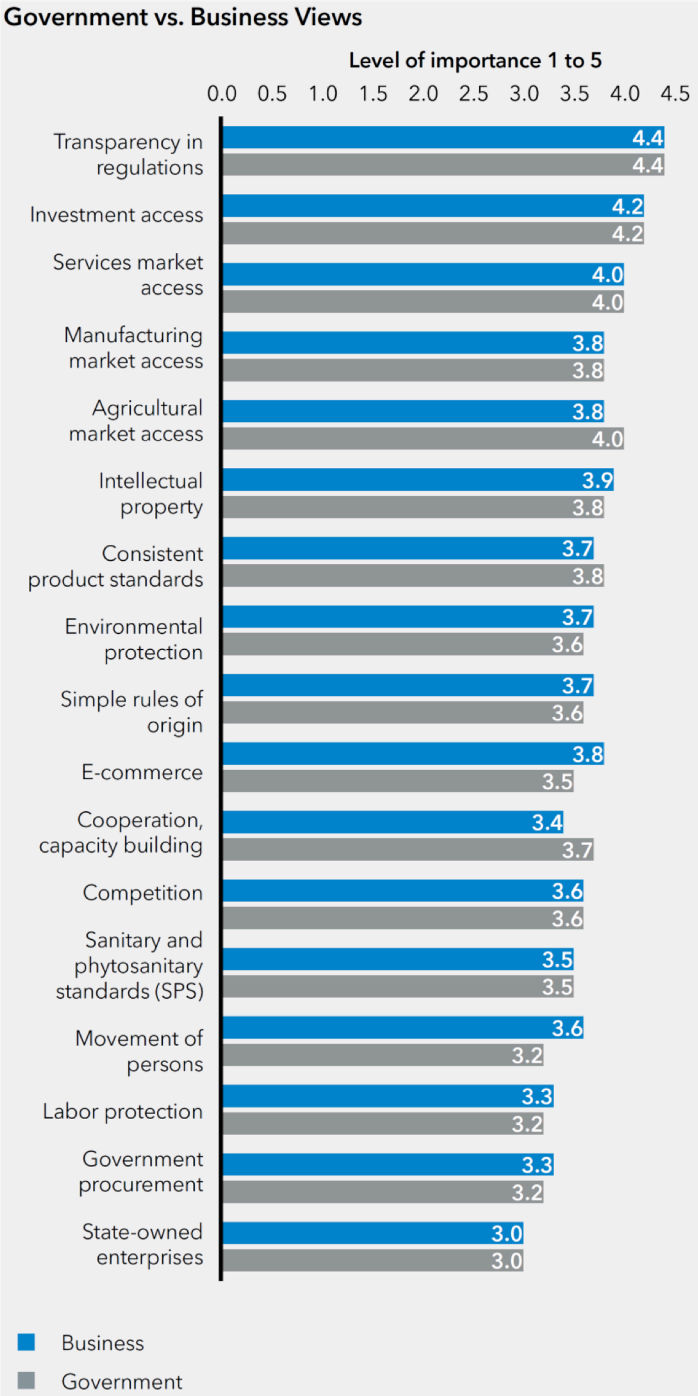
10. *Good regulatory practices.* Executives typically find regulatory impediments to trade and investment more frustrating than even high, transparent barriers. Trade agreements should promote good regulatory practices.

Of course, additional priorities emerge in specific areas of business—the energy and infrastructure sector, for example, will be concerned with rules that govern land acquisition and community involvement, and the regulation of public-private partnerships. Box 4 highlights the results of surveys of executives conducted by PECC.

PECC SURVEY OF VIEWS ON TRADE AGREEMENTS

In 2014, PECC surveyed 602 opinion leaders from government, business and non-governmental organizations in 25 Asia-Pacific economies, including all 21 APEC economies (PECC, 2014), to determine their priorities for FTAs. Priorities were scored according to importance, ranging from 1 (lowest) to 5 (the highest). Some 17 issues were examined, broadly corresponding to chapters of megaregional FTAs. Transparency in regulations emerged as the top-rated priority for both business and government respondents. There was also remarkable agreement on deep integration issues, including investment and services market access. Intellectual property also ranked highly. In contrast, competition, government procurement and state-owned enterprises received low ratings.

Figure B4-1 Relative importance of FTA priorities



Source: Pacific Economic Cooperation Council (2014).

Size and scope matter. The changing landscape of international business strengthens the case for reform in various ways. Service businesses need better options for entering international markets, GVC operators need a comprehensive approach to removing barriers, and technology firms need broad freedoms to explore innovation. A bundled approach to trade agreements—which cuts across the interests of economies, sectors and types of firms—will maximize business interest, economic benefits, and the likelihood of success. Larger membership also matters since benefits grow when more economies participate. Bigger, wider, deeper agreements are better.

Start with the presumption of openness. International business will not stop evolving. Business needs a policy environment that accommodates change, rather than one that must be reconfigured every time new technologies emerge or the composition of demand changes. This argues for a presumption of openness, rather than a specification of what is open. In technical terms, it points to a "negative list" approach where restriction apply only to selected, narrowly identified items, while new goods or services are unrestricted.

The focus is now on good governance. The cost of moving goods across borders remains important, but the agenda is shifting to what happens behind borders. This ultimately means, especially for complex value chains, reforms in governance. The goal should not be merely to remove regulations, but to design good regulations. Integration also requires cooperation among regulators to connect each other's systems and operations.

Reform will be resisted and must be supported. Resistance to reform is inevitable, and business has to make the case for integration in an increasing complex environment. But its case is strong—integration benefits society by contributing to productivity, resilience, diversity and income growth. Business can point to its own experience in how openness facilitates adjustment and provides new options for managing change.

"Think new and think big" about trade agreements. Trade agreements have a role to play, but it is a new role. The key issues today no longer involve trading "a slice of my market for a slice of yours," but rather reforms that make it easier to conduct business seamlessly across the region, by removing outright barriers to trade and investment, developing standards that are compatible across economies, and making regulations more transparent and easier to meet. Small and narrow agreements will not offer such comprehensive solutions.

IV. Shaping next-generation agreements

Given the priorities outlined in Section II, what can the FTAAP do to improve the business environment of the Asia Pacific? ABAC and APEC have contributed a substantial body of analysis on "next generation" trade and investment issues. In addition to tariffs, these issues range over non-trade measures, services, investment and regulatory systems. This is why ABAC has argued that "quality, ambition and comprehensiveness need to be the goals driving such negotiations if they are to meet business needs" (ABAC 2014a).

The structure of trade agreements is not well aligned with business needs. Negotiations are conducted in legally distinct categories—such as goods, services, investments, intellectual property, and competitive policy—and result in complex legal documents that are difficult to navigate without legal expertise. Negotiators save time by building on existing text and ensure consistency with prior agreements, but the approach generates inertia. At a minimum, it means that much additional effort is needed after negotiations end to translate results into language useful to business.

"Investors build businesses and employ people, whether they are local or come from abroad, and regardless of sector and organizational structure. If they are welcomed with the full benefits and full responsibilities that come with operating in a host economy, they will make large contributions through the technologies, connections, and resources they bring from across the world."

- *Sir Rod Eddington, Chair JP Morgan Australia and New Zealand*

As already emphasized, goods trade, services trade, investment flows and a host of other issues are now closely intertwined in business decisions. Next-generation agreements will have to address clusters of these issues holistically and consistently. The TPP, for example, includes “cross cutting” chapters that focus on the perspective of SMEs and regulatory coherence in order to coordinate provisions and to fill in missing elements. This is a hopeful development that will be hopefully refined in consultations with business in the design of the pathways and eventually FTAAP.

This section examines how trade agreements are addressing business concerns identified in the priorities listed in Section III.b. It describes some provisions emerging in the pathways underway, including the TPP, RCEP and PA, but does not attempt to judge them or to identify best practices.

a. Enabling trade in goods

A core interest of business—and a central Bogor goal--is unimpeded access to regional markets. In practical terms, this means no tariffs, or at most low, predictable tariffs, and transparent non-tariff measures (NTMs) that reflect essential regulations. Much progress has been made on these issues. APEC economies reduced most favored nations (MFN) tariffs extensively in the past, due in part to global agreements and regional free trade agreements (FTAs), and changing views of government’s role have encouraged substantial regulatory reform throughout the region.

The pace of trade liberalization, however, has markedly slowed in recent years. Table 1 shows simple average MFN tariff rates on imports and the share of tariff lines with average tariffs greater than 15% for in 2008 and 2013.[34] During this period, the simple average MFN tariffs for APEC economies fell from 6.4% to 5.0%, more slowly than before the crisis. There is much variation across counties; the region’s developing economies typically had higher tariffs than its developed economies, and five economies (Korea, the PRC, Russia, Thailand and Viet Nam) had tariffs in excess of 9% in 2013. Three among them raised tariffs relative to 2008.

[34] This data comes from *World Tariff Profiles*, a joint publication of WTO, ITC and UNCTAD.

Economy	Simple Average MFN Tariff (i)		Duties > 15% (ii)		Services Trade Restrictions Index (Year policy information collected, either 2008 or 2011) (iii)	Number of non-tariff measures affecting the country, 2009-2014 (iv)
	2008	**2013**	**2008**	**2013**		
Australia	3.5	2.7	4.1	0.1	20.2	563
Brunei Darussalam	2.5	-	9.3	-	21.6	-
Canada	4.7	4.2	6.7	6.8	21.6	702
Chile	6.0	6.0	0.1	0	23.4	-
(the) PRC	9.6	9.9	14.7	15.6	36.6	1805
Hong Kong, China	0	0	0	0	-	-
Indonesia	6.9	6.9	2.7	1.7	50.0	635
Japan	5.4	4.9	3.6	3.7	23.4	913
Republic of Korea	12.2	13.3	8.3	10.4	23.1	357
Malaysia	8.8	6.0	22.1	15.1	46.1	-
Mexico	12.6	7.9	26.3	15.7	29.5	606
New Zealand	2.2	2.0	0	0	11.0	-
Papua New Guinea	4.9	4.7	13.8	16.1	-	-
Peru	6.1	3.4	16.5	0	16.4	-
(the) Philippines	6.3	6.3	3.2	3.2	53.5	-
Russian Federation	10.8	9.7	17.8	10.1	25.7	578
Singapore	0	0.2	0	0	-	-
Chinese Taipei	6.1	6.0	6.2	6.5	-	-
Thailand	10.5	11.4	24.2	25.5	48.0	-
(the) United States	3.5	3.4	2.9	2.7	17.7	995
Viet Nam	16.8	9.5	40.7	24.8	41.5	-
Average	**6.4**	**4.7**	**10.6**	**7.9**	**28.3**	**715.4**

Notes

(i) simple average of the *ad valorem* or AVE HS six-digit duty averages

(ii) share of HS six-digit subheadings subject to *ad valorem* duties or AVEs greater than 15 per cent. When only part of the HS si-digit subheading is covered by such duties, the calculation is done on a *pro rata* basis

(iii) the index is constructed at the most disaggregated level for any subsector-mode combination.

In essence, within each subsector-mode policy regimes were assessed in their entirety and bundle of applied policies were mapped into five broad categories (with associated scores):

1. Completely open (0);
2. Virtually open but with minor restrictions (25);
3. Major restrictions (50);
4. Virtually closed with limited opportunities to enter and operate (75);
5. Completely closed (100).

After assigning a score to a subsector-mode, the scores can be aggregated into sector, modal or regional indices using, at each step, the following types of weights:

1. Modal weights: a sector-specific set of weights reflecting expert judgment as to the relative importance of alternative modes of supplying a specific service;

2. Sector weights: a set of weights derived from the average share of a given services sector in value-added for an average industrialized country. Sector weights are constant across countries to ensure comparability;

3. Country weights: equal weights within a region. Equal weights avoid a regional average score becoming completely dominated by one very large economy such as China or India, as would happen with, for instance, any kind of GDP-based weight.

(iv) a sum of two indicators: (1) Total number of foreign implemented measures that are likely to harm the economy's commercial interests and (2) Total number of foreign measures that have been implemented and which almost certainly discriminate against the economy's interests

Sources:

World Tariff Profiles 2009 and World Tariff Profiles 2014, WTO ITC UNCTAD:
https://www.wto.org/english/res_e/reser_e/tariff_profiles_e.htm

Services Restriction Database, Development Economics Research Group, the World Bank:
http://iresearch.worldbank.org/servicetrade/aboutData.htm

Global Trade Alert database: http://www.globaltradealert.org/site-statistics

Business also places high priority on improving the regional investment environment. Investment barriers are more extensive and less predictable than barriers to trade, and the investment option is especially important for connecting supply chains. It is critical for service industries, since many types of services trade require a delivery platform in the host market. An ideal investment regime will enable businesses to invest freely abroad, subject to clear and limited exceptions. It will also protect their property once investments are made.

ABAC supports the APEC Non-Binding Investment Principles, which are summarized in Table 2. This document sets out important features of a sound investment regime, including non-discrimination among partners, and between domestic and foreign investors. These two principles should apply both before and after investments are made. Businesses are also troubled by varied restrictions on investments, such as joint ownership, local performance requirements, or local content requirements. Approval processes should be fair, clear and fast, and consistent across levels of government. The APEC Investment Principles address all of these issues, but sometimes use words that limit obligations, for example with respect to performance requirements ("minimize"), double taxation ("endeavor") and barriers to capital exports ("minimize"). New bilateral investment agreements (BITs) and the TPP have made firmer commitments in some of these areas.

Table 2. Summary of APEC Non-Binding Investment Principles

Provision	Description
Transparency	Provide publicly available information on investment regulations
Consistency of Interpretation and Implementation	Offer consistent interpretation of regulations across all levels of government
Non-discrimination	Offer treatment no less favorable, in establishment and operations, than accorded to any other economy
National Treatment	Offer treatment no less favorable, in establishment and operations, than accorded to domestic investors
Regulatory Protections	Avoid relaxation of health, etc. standards
Investment Incentives	Avoid use of investment incentives
Performance Requirements	Minimize use of performance requirements
Expropriation and Compensation	Avoid expropriation of investments or similar measures, except for a legal, public purpose, and against payment of compensation
Transfers and Convertibility	Maintain goal of free transfer of funds related to foreign investment, such as capital contributions
Settlement of Disputes	Accept that disputes will be settled promptly through negotiations or arbitration
Protection and Enforcement of Rights	Provide access to dispute resolution mechanisms and timely enforcement and delivery of arbitration awards
Entry and Sojourn of Personnel	Allow temporary entry and sojourn of key foreign technical and managerial personnel
Avoidance of Double Taxation	Endeavour to avoid double taxation
Investor Behaviour	Recommended that CSR guidelines be taken into account
Removal of Barriers to Capital Exports	Minimize regulatory and institutional barriers to investment outflow

Source: Authors, based on APEC Committee on Trade and Investment (2011).

Business expects next generation investment agreements to provide wider and stronger protection for investment than the GATS agreement within the WTO. That agreement addresses only investments related to cross-border services, and its provisions may be further weakened in the case of sales to government entities. While many WTO+ investment agreements have now been concluded in the region, including the important China-Japan-Korea agreement, a common framework in the FTAAP would provide greater predictability and comparability, expanding opportunities for both investor and host economies.

The ASEAN-Australia New Zealand FTA is the first ASEAN agreement to include a comprehensive investment chapter. It has several important investment protection provisions, including obligations on national treatment, fair and equitable treatment and full protection and security. In some areas the agreement goes beyond the APEC Principles—for example it provides for the free transfer of capital and profits and other payments relating to investments. It also prescribes compulsory investor-state arbitration rather than leaving the method open. In other areas, however, it falls short of the Principles; for example, it protects investments only post-establishment, rather than also dealing with pre-establishment policies.

The TPP has provisions similar to those listed in the Principles, but in several areas more ambitious rules. It will provide for both pre- and post-establishment protection for investments subject to a negative list of exceptions. It prescribes compulsory arbitration, albeit with improvements in the arbitration process—it will suspend the protection of capital inflows and outflows in macroeconomic emergencies, and will strengthen exemptions for health and safety regulations, for example by specifically excluding tobacco-related regulations.

c. Enabling service businesses

Business has an especially large stake in low and predictable barriers on services trade. Not only is this a large sector—accounting for half to 80 percent of GDP in the economies of the region—but it also touches many other business and consumer objectives. Critical services include logistics, transportation, wholesale and retail trade, finance and insurance, business and technology consulting, health, education and entertainment. Research shows that high quality services contribute not just directly to productivity and consumer benefits, but also indirectly to the productivity of every other sector of an economy. Service liberalization that improves service quality can be as important for manufacturing exports as the liberalization of foreign markets.

"The FTAAP, whatever its final shape, would need to take much fuller account of the need for services trade and investment liberalization and facilitation than most past FTAs have achieved. Expensive or inefficient services put all sectors of an economy, such as manufacturing, agriculture or mining, at a disadvantage. So liberalization of trade and investment in services is not just important if we want to trade services – it is indispensable to the fundamental competitiveness of all of our economies."

- *Anthony Nightingale, Director at Jardine Matheson Holdings Limited*

Trade in services frequently requires investment and the movement of workers, and is subject to many types of regulations that affect domestic and foreign firms. These issues cut across the usual divisions of trade agreements and need to be addressed in coherent ways. Examples of the complexity of regulatory impediments in services, based on a large number of interviews with service sector executives are illustrated in Table 3, demonstrating that different service sectors can face very diverse barriers. Services, more than other sectors, illustrate the need for involving business experts in defining what obstacles they need to have addressed.

Table 3. Impediments in service sectors

Service subsector	Major impediments cited by executives
Trucking	Lack of coordinated national policies, powerful competing stakeholders, regulatory inconsistencies, uncoordinated oversight, unregulated informal trucking markets, corruption. In emerging economies, also poor infrastructure and limits on foreign ownership.
Container port services	Lack of access to land and long-term leases, bureaucratic and biased permitting and enforcement processes, multiple powerful stakeholders including local municipalities and community activists.
Retail and restaurants	Licensing requirements, difficult access to land, needs/benefits tests, biased enforcement, approval processes by local governments, tariffs, customs delays, lack of well-capitalized domestic partners, unregulated informal markets.
Telecom & broadband infrastructure	National policies on the ownership of backbone infrastructure determine openness to FDI in other areas. Impediments include foreign ownership limits, barriers to competition against incumbents and SOEs, access to spectrum, and stability and predictability of regulations.
Accounting	Resistance to full adoption of IFRS, resistance from self-regulating professional organizations, and complex and time-consuming accreditation processes.
Software, Platform, and Cloud services	Lack of: adequate IP protection, high-quality ICT infrastructure, high-quality skilled talent, supportive venture capital industry.
Life Insurance	Limits on foreign ownership and requirements for joint ventures, inefficient approval processes, restrictive prudential rules, limits on movement of capital, limits on foreign workers, shortage of skilled labor.
Source: Authors, based on University of Southern California (2014)	

Measuring service barriers is correspondingly difficult. Important contributions have been made by the World Bank, which developed a service trade restrictiveness index (STRI) to measure discrimination against foreign services and service providers, and the OECD, which offers a similar, but broader measure of regulations that affect trade in services. Table 1 shows that the average services trade restrictiveness index[36] for APEC economies is 27.6, indicating that services trade remains highly protected in APEC economies. This average masks a wide range of values, from economies with low restrictions (Australia, Canada, Japan, United States and New Zealand with an average score of 19.5) to those with high ones (developing APEC economies as a group averaged 35.7). Such restrictions appeared to be particularly high in large developing APEC members.

Are FTAs liberalizing services? A recent study investigated whether key services sectors in the WTO General Agreement on Trade in Services (GATS) were included in FTAs involving Asian economies (Kawai and Wignaraja 2013). It found that only 28% of 69 Asian FTAs were

[36] The services trade restrictiveness index from the World Bank's *Services Restrictiveness Database*. This attempts to capture the policies and regulations that discriminate against foreign services or foreign services providers as well as certain key aspects of the overall regulatory environment that have a notable impact on trade in services. A high score suggests greater restrictiveness.

comprehensive agreements that covered at least 5 key services[37] and another 36% covered some of these sectors. Meanwhile, 16% of Asian FTAs had little or no services provisions.

This leaves much room for improvement. Matoo (2015) has shown that countries in practice have more liberal service regimes than they have committed in the WTO system. Their *actual* service trade restrictiveness index (STRI) is on average less than half as large as their *committed* liberalization in the GATS. In other words, they could reduce uncertainty in access to their service markets simply by agreeing to sustain what they already do in practice.

Next-generation agreements will have to strengthen service liberalization commitments and expand the list of service sectors covered. The TPP, for example, prescribes rigorous market access rules on a negative list basis, meaning that all present and future service sectors will be covered, except for those explicitly excluded. RCEP is likely to work with a positive list, but also aims to improve commitments beyond those included in GATS.

Financial services are difficult to address since system-wide risks may be involved. The Asian Financial Crisis of 1997-98 and the Global Financial Crisis offer stark reminders that strong regulations are needed to forestall a crisis, and to manage it should it occur. The ASEAN Economic Community, which seeks a "unified market and production base" only superficially addresses financial sector liberalization (Plummer and Chia 2009). Yet the region's capital needs are large and its regional financial networks are weak, despite highly competitive in global financial services centers on both sides of the Pacific. It is essential for next generation agreements to pursue financial services liberalization, while preserving the right of regulators to restrict financial flow on an emergency basis.

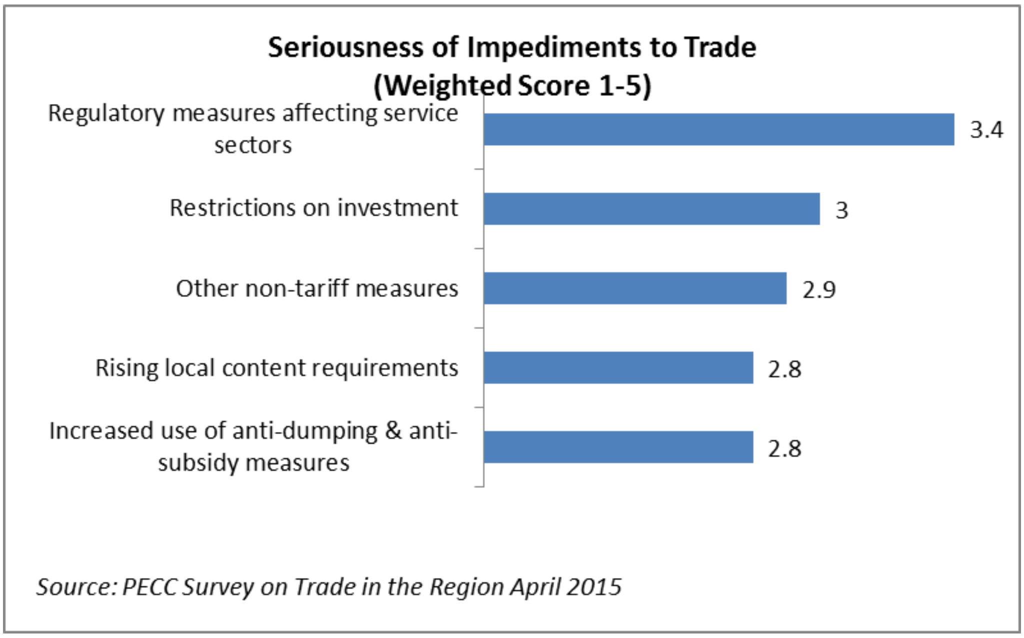
d. Value chain development

The highly tuned business networks of the Asia Pacific involve many types of cross-border transactions, and are especially sensitive to regulations at the border and behind it. Businesses report that value chains are held back by varied behind-the-border impediments. This concern is reflected in a 2015 Pacific Economic Cooperation Council (PECC) survey of impediments to trade involving value chains (see Figure 6, from PECC, 2015).[38] Regulations affecting services sectors (e.g. telecommunications, finance and transport) were regarded as the leading trade impediment. Restrictions on investment came second, and more traditional trade impediments such as local content requirements and anti-dumping and anti-subsidy duties came third.

[37] These are: business and professional services, communications services, financial services, transport services and labour mobility/entry of business persons. These sectors were chosen as references as they are the largest sectors in terms of the value of services trade in Asia and subject to multiple regulatory barriers on foreign services and service providers.

[38] The Pacific Economic Cooperation Council (2015) survey conducted in April 2015 covered 304 opinion leaders (government, business and non-governmental organizations) from 25 Asia-Pacific economies including all 21 APEC members.

Figure 6 – Seriousness of impediments to trade



Trade agreements often handle value chains incoherently, and crucial provisions appear in many chapters of an agreement.[39] 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. Each of these issues is typically addressed in a different chapter of a trade agreement.

Progress has been made in recent trade agreements, but more needs to be done to support the development of value chains. A recent study examined the extent to which key provisions of Asia-Pacific FTAs (not yet including the TPP) support value chain development. Provisions such as competition, intellectual property, investment and public procurement, sometimes referred to as deep integration measures, were included in 69 Asian FTAs (Kawai and Wignaraja 2013). They were covered comprehensively in only 23% of the Asian FTAs, while another 37% had some coverage. Some 16% of Asian FTAs had no deep provisions and focused simply on goods and services trade.

To help businesses develop and deepen value chains, next-generation agreements will have ensure not only that the necessary component activities are covered, but also that the coverage is consistent and simple, for example through “single window” investment and trade facilities. Value chains have to be covered in a coherent manner—say through a cross-cutting chapter—that fills in gaps and streamlines processes from the perspective of value chain participants.

[39] To coordinate work on these provisions the TPP negotiations identified value chains as one of several cross-cutting issues that received continuing attention in the negotiations (Lim, Elms and Low 2012).

e. Intellectual property

The role of intellectual property (IP) is growing across the full spectrum of economic sectors: geographical indications matter in food and agriculture, patents in electronic devices and pharmaceuticals industries, trademarks in markets for branded consumer goods, and copyrights for creative products from movies to software. As the share of IP rises in total capital, many countries are addressing IP protection as an essential part of growth strategy.

The business case for IP protection is well known: without it firms would be unable to recover costs and justify additions to the stock of knowledge. The case for international collaboration on IP regimes is more complicated. How much should small economies, that do not have a large IP-generating sector, contribute to the cost of innovation? The narrow response is that the small contributions they would make to the profits of large foreign firms will not generate enough new knowledge to make it worth their while. But this argument adds up to a serious free-rider problem: in an increasingly global economy, fewer and fewer economies will bear the costs of innovation. The threat of the free rider problem, coupled with the spread of innovation, has led to international rules on intellectual property, beginning with the TRIPS agreement in the WTO, but now encompassing also many other international agreements.[40]

At the same time, the owners of IP and their governments can be expected to argue for extensive protection, to help increase the resources flowing into the sector. The extent of IP protection in these agreements has led to vigorous debates within countries and among them. As demonstrated by the concluding drama of the TPP negotiations, these debates are especially intense for pharmaceutical products, which are unusually expensive to develop and test and are therefore developed by very large companies that are concentrated in high-income economies.

There is no simple way to determine the optimal level or consistency of IP protection across countries.[41] Too little protection—which would seem advantageous for technology-importing economies—will reduce international investment and the range of products valued by people everywhere. Too much protection—which would seem advantageous to innovators—could create rents for incumbent firms and curtail investments in better products. There is no alternative to reasoned negotiations to balance the interests of producers and users of IP. What business efficiency does require, however, are clear, predictable and consistent regimes over time and across markets—in other words, transparent rules.

In trying to find its golden rules, the TPP has gone beyond WTO trade-related intellectual property rights (TRIPS) by requiring criminal penalties for unlawful commercial exploitation of copyrighted work, prescribing measures to reduce illegal online distribution of copyrighted material, and protecting data developed by pharmaceutical firms in testing biologic products from being used by generic competitors for a period of time. It also established more transparency in choosing medicines by national health plans. At the same time, it fell short of the expectations of pharmaceutical firms with large investments in IP. Whether or not the

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[40] These include the WIPO etc.

[41] The effects of IP protection on economic development are examined in empirical surveys by Maxwell and Riker (2014), Fink and Maskus (2005); and Maskus (2000).

rules the TPP ultimately negotiated are optimal, they show that solutions can be achieved that are broadly acceptable to both IP-exporting and IP-importing economies.

f. Enabling temporary labor mobility

Businesses that invest in foreign operations, especially when delivering a sophisticated service, often require skilled employees to work abroad temporarily. These transactions benefit both the investing and host economies, but face resistance from national labor organizations and others concerned about immigration. Businesses need simple, reliable rules to facilitate the movement of temporary workers, permitting the rapid implementation of initiatives that often have other, higher stakes. Thus, next-generation agreements should include reasonable provisions for assuring business visits and for certifying expertise in host economies. Such rules would go beyond current WTO provisions, which do provide predictability for worker mobility, but only in regard to delivery of services abroad. In this context, WTO provisions are limited by the positive list commitments that economies have made on services.

g. Making trade agreements accessible to business

Trade agreements have to become easily more accessible. A frequent concern expressed by exporters and importers, and especially small companies, is that FTA texts are long, legal documents that few firms can understand and most find difficult and expensive to use. This problem is compounded by the so-called "spaghetti bowl" phenomenon[42] – the proliferation of overlapping FTAs that multiplies administrative burdens.

Business organizations are concerned by the practical impact of these issues. The Australian Chamber of Commerce and Industry (ACCI) found recently that "more than two in three respondents said they do not understand Australia's free trade agreements (FTAs) and approximately one in three respondents have no awareness of FTAs currently in force."[43] The ACCI also pointed to inconsistent rules across agreements and provided this example:

> *(An) Australian wine exporter, exporting wine produced in Australia using bottles from outside Australia might qualify for a tariff concession under the Korean agreement by using a certain mathematical formula. But the same wine is subjected to a totally different formula under the ASEAN-Australia-New Zealand Free Trade Agreement. Same wine same bottle. And our exporter members rightly ask: why didn't Australia negotiate consistent rules for exporting wine in each of its agreements? And why do I need to learn and apply a new mathematical formula every time we do a new trade agreement for each market?*

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[42] The term spaghetti bowl of FTAs is originally attributed to Bhagwati (1995) who coined this insight in the context of the North American Free Trade Agreement (NAFTA).

[43] http://www.acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Businesses-hungry-for-more-information-on-free-tra

The Chamber adds that we "are now seeing multiple agreements covering the same markets and this is leading to confusion."[44]

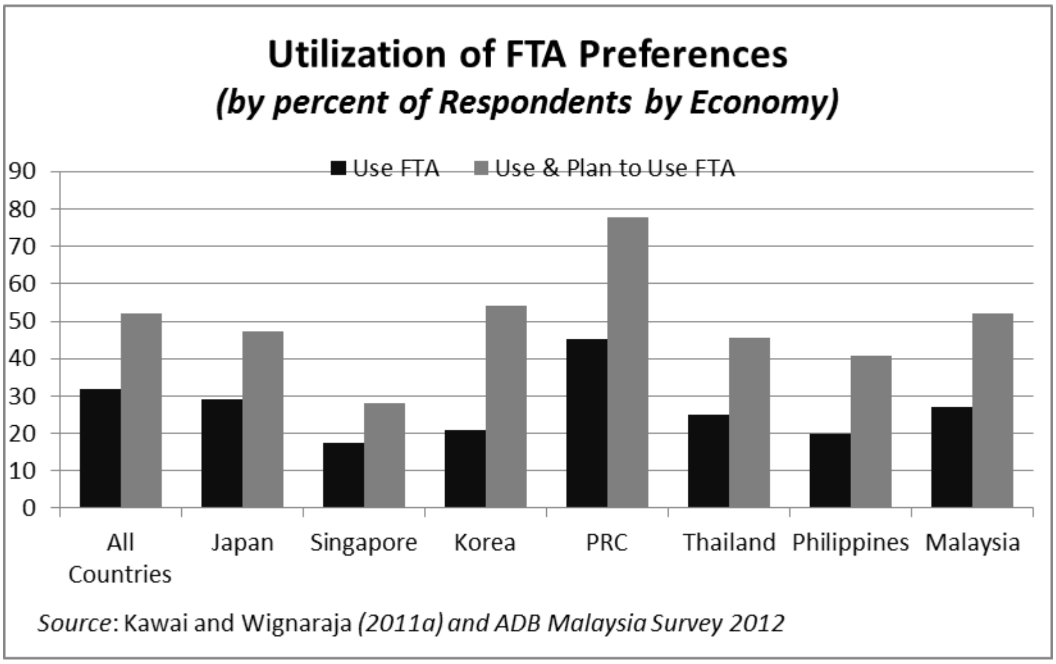
Measuring the utilization of FTA preferences is more difficult than might be expected. Most APEC economies do not publish such information, and the insights we have are based on special enterprise surveys for some APEC economies. These surveys report utilization of FTA preferences using an "incidence of firms" measure, that is, the share of firms in the survey that indicate use of FTA preferences. Information on shares of exports or imports that benefit from such preferences are not usually available, but the surveys do yield data on the characteristics of FTA users and reasons why firms use, or fail to use, FTAs.

Three major surveys of this type are available. Between 2007-2012, an Asian Development Bank (ADB) and Asian Development Bank Institute (ADBI) randomly surveyed 1, 075 firms across a variety of manufacturing sectors in seven East and Southeast Asian countries[45] (Kawai and Wignaraja 2013, Kawaii and Wignaraja 2011). In 2013-2014, an Economic Intelligence Unit (EIU) team surveyed 400 firms in several manufacturing and services sectors in four Southeast Asian countries[46] (Economist Intelligence Unit 2014). Finally, in 2007-2008, the Inter-American Development Bank (IDB) surveyed 345 firms in four Latin American countries[47] (WTO, 2011). Both groups of economies are important regions within APEC and the world economy. Latin America has a long experience of FTAs while East and Southeast Asia is a relative latecomer, but has also seen significant growth in FTAs over the last decade.

The evidence paints a mixed picture of FTA use and suggests much room for improvement. The ADB and ADBI survey shows that the average utilization rate of FTAs by firms in the seven East and Southeast Asian countries is 32% (Figure 7). When plans for using FTA preferences are also factored in, 52% of firms either plan to, or already use FTA preferences. Japanese and Chinese firms use FTA preferences more than firms from Malaysia, Philippines, Singapore, South Korea and Thailand. This geographical pattern is consistent also with the EIU's finding of lower utilization rates in four Southeast Asian countries (just 26%). Meanwhile, the IDB survey of firms in four Latin American countries shows much higher FTA use than in East and Southeast Asia, with only 18% not using any FTA, and many firms using more than one FTA (WTO, 2011, p. 82). If firms in Panama, an outlier, are removed from the dataset, nearly all remaining firms—those from Chile, Mexico and Columbia—indicate that they are using FTAs.

[44] http://www.acci.asn.au/getattachment/6542a465-0dcd-4d74-950f-0d141ebceabb/Bryan-Clark---Joint-Select-Committee-on-Trade-and-.aspx
[45] Japan, Peoples Republic of China, Republic of Korea, Malaysia, Philippines, Singapore and Thailand.
[46] Indonesia, Malaysia, Singapore and Vietnam.
[47] Chile, Colombia, Mexico and Panama.

Figure 7 – Utilization of FTA Preferences

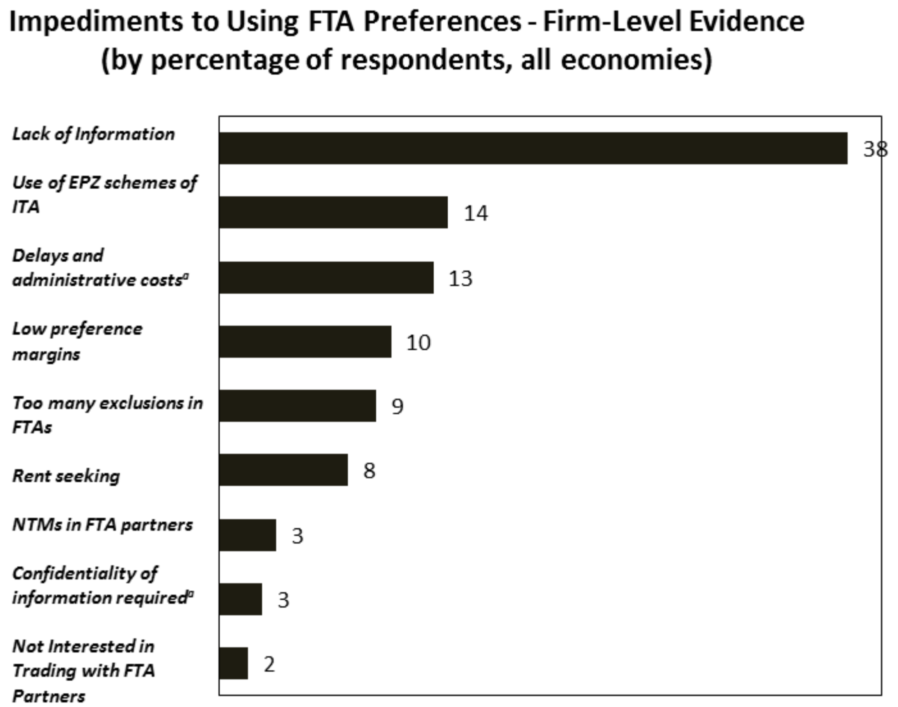


These surveys and other studies identify several factors that raise FTA utilization rates. Using a sample of Japanese firms, Takahashi and Urata (2008) found that firm size and firm experience in trading with FTA partners were positive and significant determinants of FTA utilization. Wignaraja (2014) found that the utilization of FTAs in Southeast Asia[48] was positively associated with a firm's age, research and development expenditures, investments in acquiring information on FTAs, and membership in industrial clusters. Wignaraja (2014) noted that firms that use FTA apparently make considerable investments in learning how to use them, and that interpreting FTAs often requires specialist skills such as consultants in trade law, customs procedures, and business strategy.

The surveys also explain why many firms fail to use FTAs (Figure 8). The ADB and ADBI survey find that lack of information on FTAs is the reason firms give for not using FTAs (38% of enterprises surveyed). The second and third most common reasons are low margins of preference (14%) and delays and administrative costs associated with the rules of origin (13%). With somewhat lower frequency, firms also reported that other programs, such as export processing zones, provide alternative incentives (10%) and concerns about corruption by customs or other regulatory authorities (10%). The EIU surveys of Southeast Asian firms identified similar problems. Nearly half of the firms they surveyed (48%) were discouraged by the complexity of agreements, while 29% mentioned that the benefits were too low to compensate for the costs of using them. Some 28% already benefited from duty-free access through other programs.

[48] Indonesia, Malaysia and the Philippines.

Figure 8 – Reasons for Not Using FTAs



Notes:
EPZ = Export processing zone, NTM = Non-tariff measures, ITA = Information Technology Agreement, PRC= People's Republic of China
[a] Rules of origin requirement
[b] Multiple responses were allowed
- Indicates the category was not included in the survey for the country under consideration.
***Source:** Author's calculations based data from Kawai, M., and Wignaraja, G., (2011 ed.), Asia's Free Trade Agreements: How is Business Responding?, Edward Elgar: Cheltenham (UK) available at: http://www10.iadb.org/intal/intalcdi/PE/2011/07394.pdf; Wignaraja, G. (2014), "The Determinants of FTA Use in South East Asia", Journal of Asian Economics. 35(2014) 32-45*

Based on these findings, raising the utilization of FTA preferences requires 1) clearer and more easily understood trade agreements, 2) greater awareness of FTA provisions, including the phasing out of tariff schedules; 3) significant margins of preferences at the product level; and 4) simpler and more transparent administrative procedures for compliance with rules of origin.

Thus, a high priority for next-generation agreements is to enable firms to use the benefits they offer. To be sure, preference utilization measures underestimate the value of trade agreements, because they only involve the use of tariff-related preferences, rather than provisions that address many other types of barriers. In any case, governments will have to step up the availability of public information, reduce bureaucratic impediments, and upgrade the ability to support business in using trade agreements. Businesses and industry associations, in turn, should redouble their efforts to support members in using FTAs. Helping MSMEs upgrade their quality and technical standards would also aid their participation.

h. The Internet and the digital economy

The Internet and digital technologies are creating stronger linkages among firms, suppliers and markets, and change how customers perceive value and service. New personalized and continuing transactions are now possible by mapping customers and their past transactions, and platforms are emerging to help MSMEs reach large, distant markets. Regardless of size, firms are reinventing their business strategies and to harness technological change.

The ecosystem of technology businesses includes, on one hand, companies that focus on delivering Internet-based services and related digital products, and need excellent connectivity, unimpeded data flows, and good access to markets. However, it also includes other firms and individuals that want to be able to use information and/or innovate without legal concerns about the technologies and content they use. In addition, many forms of Internet activity generate private information that may be misused. Regulations within countries and across them have not yet caught up with this complexity and divergence of interests. Meanwhile, rules on privacy, intellectual property, and data flows have been regulated on an inconsistent, unpredictable and piecemeal basis. The processes of regulatory decision-making are far slower than the speed of change, frustrating the many businesses on which future productivity depends.

The priority for business is an environment that helps entrepreneurs realize the enormous potential of new technologies. APEC's "Checklist for Digital Prosperity" (summarized in Table 4) provides insight on how this might be done, highlighting policies that help economies prepare for new waves of digital technology. They involve, for the most part, domestic measures to build the infrastructure and skillsets for a digital world. But they also list policy measures that enable economies to connect effectively with innovations around the world. The policies mentioned include keeping markets free of duties and restrictions on transactions; enabling the free flow of information; ensuring privacy and consumer protection from fraud; and strengthening intellectual property rules for digital works.

Table 4. Summary of APEC Digital Prosperity Checklist

Objective	Policies
Infrastructure	Encourage competition among telecommunications services operators and facilitate the build-out of networks. Promote e-government and collaborative Internet tools; create opportunities for knowledge exchange.
Intellectual capital	Educate ICT professionals and users using varied training programs; promote e-commerce systems and their use by SMEs; encourage information literacy and e-learning at all levels of education.
Investment	Promote foreign direct investment through liberal investment provisions; adhere to the highest financial data quality standards; support the development of electronic payments and mobile telephones for transactions.
Innovation	Maintain environment for the free flow of information and innovation; promote ICT innovation through commercial "clusters" around universities; encourage basic and applied research; develop comprehensive intellectual property system; provides IPR capacity building; improve consumer awareness of the importance of IPR; facilitate high quality patents.
Information flows	Promote frameworks to maximize privacy protection and facilitate cross-border information flows, establish data privacy protection, participate in cross-border privacy rules and enforcement; promote consumer protection and dispute resolution; promote security and authentication; explore public-private partnerships for online security.
Integration	Implement the WTO ITA agreement; eliminate duties on additional IT products and digital products; facilitate "Single Windows" for trade; support digital signature technologies and electronic documents; allow outside-borders testing of IT equipment; reduce restrictions on ICT-related services, including support for electronic commerce (e.g., advertising, distribution, and express delivery).
Source: Authors, based on APEC Technology Investment Workshop (2010)	

Business welcomes APEC's expanding work program on the Internet, the digital economy, and new issues such as the "Internet of Things" (IOT). For example, the new "Steering Group on the Internet Economy" established by Senior Officials in 2015 could play a valuable coordinating role across the many difficult policy issues that arise in this area, ranging from ensuring consumer protection and data privacy, on one hand, to encouraging innovation in an extremely fast-paced technological setting, on the other.

The Internet and digital commerce will need to be covered in next-generation agreements as well, given their importance in the business environment. The AANZFTA has taken a step in that direction, but recognizing that some ASEAN member countries do not have all the necessary legal frameworks in place for electronic commerce, it takes a mainly capacity-building approach. The TPP, on the other hand, includes extensive disciplines on the protection of intellectual property, privacy, and data flows across borders.

i. Inclusiveness

Issues that enable next-generation agreements to broadly distribute the benefits of trade are a critical priority in most countries, but especially in a region as large and diverse as the Asia-Pacific. As already noted, 97 percent of businesses in the region are MSMEs. But even larger businesses have a direct interest in these issues, because the very success of trade agreements depends on their ability to unite diverse groups of people.

An inclusive trade agreement will offer smaller businesses and wider groups of workers tangible, direct benefits. Since many provisions of an agreement affect this objective, inclusiveness must be addressed through cross-cutting approaches and special chapters that maintain the focus on smaller enterprises. An MSME focus requires, for example, provisions for capacity building, technology development, transparency, and access to and predictability of the regulatory environment. MSMEs also benefit from provisions that make technology and online information widely available to firms and consumers across markets.

Smaller enterprises will be further supported by provisions—usually included in a chapter on development—that provide for capacity building, training, and mechanisms that promote market access (such as trade shows) and technology transfer (such as industrial training institutes). Both the TPP and RCEP will include such chapters although their content is not yet known. According to some reports, the TPP will establish a committee on development, to share best practices and to promote joint activities, such as capacity building among women entrepreneurs.

All businesses, and especially small ones, are concerned with the implications of having to adjust to a new trade agreement. Many firms, especially those in economies at early stages of development, will face difficult and time-consuming challenges in raising technologies and skills to globally competitive levels. Even if those adjustments ultimately lead to very positive outcomes, the speed of adjustments will be an important factor in determining their cost. Trade agreements recognize this problem through differential implementation. For example, the Blueprint for RCEP outlines a commitment to offer flexibility and special and differential treatment to low-income economies. The TPP, by contrast, does not provide for general differential treatment, but it does offer longer implementation periods for low-income economies in the case of several sensitive provisions.

Finally, business also has a general interest in policies that promote broad progress on environmental quality and working conditions, and these areas are specifically included in some next-generation agreements. Business respondents rated environmental protection as the most important among such issues in a recent survey, followed by cooperation and capacity building, and then labor protection and the movement of persons (2015 PECC survey). Nevertheless, business views diverge on whether these issues should become part of a trade agreement.

With respect to environmental sustainability, business is primarily interested in rules that are predictable and transparent, and do not represent hidden barriers to trade. Countries naturally differ in environmental regulations, due to differences in threats as well as priorities. Some past trade agreements required members to enforce rules that they had themselves adopted. However, given growing concerns about global environmental quality, some next-generation agreements such as the TPP will include rules based on the enforcing international conventions. The TPP references a special list of international environmental agreements that its members will need to follow. By contrast, the AANZFTA did not include environmental provisions, although side agreements between New Zealand and several ASEAN partners did provide a framework for related cooperation. The RCEP guidelines do not mention environmental objectives.

With respect to workers' rights, business has a strong self-interest in treating workers fairly, and is responsible for following national laws. International markets may expect that businesses selling in them apply higher standards, as typically followed in more advanced economies. Such standards may benefit low-wage economies as they try to enter global value chains. Yet rules that imply ambitious changes, or changes that fail to recognize relevant systemic differences, could mean jarring adjustments and higher production costs. Ultimately, the partners of an agreement with an unusually diverse membership have to find solutions to fit the views represented by their members.

j. Good regulatory practices

Asia-Pacific businesses often voice frustrations with regulatory barriers to trade and investment (University of Southern California 2014). Their concerns cover many areas and address many factors that affect the ability to do business abroad, including not only discrimination but also the transparency and predictability of the regulatory environment. They are especially frustrated by having to deal with multiple divisions and layers of government which increases the complexity and uncertainty of the regulatory process and to strengthen institutions and governance for implementing regulatory reforms.[49] These issues also affect MSMEs

Business needs disciplined, coherent regulatory policy. Efficiency is compromised whether obstacles stem from poorly designed regulations, or inconsistent administration by different layers of government, government agencies, or national authorities, both at home and in operations abroad. These dimensions of regulatory policy need to be coordinated and consistent. Of course, they are difficult to address in an integrated framework, but making

[49] The importance of providing assistance to developing economies to help implement regulatory reform is a point made by made by (Matoo 2015).

improvements—achieving greater regulatory coherence—would make large contributions to most economies.

Work on translating these objectives into practical guidelines is underway in APEC, the OECD, the World Bank and other organizations, but the results so far target mainly the consistency of policy within countries. The APEC framework for "Good Regulatory Practices" (GRP), which ABAC supports, emphasizes three areas of activity that affect the quality of a regulatory system: (i) effective intra-governmental coordination of regulatory activity across ministries, sectors and layers of government; (ii) systematic use of regulatory impact assessment based on information and empirical analysis; and (iii) public consultation to improve the transparency, efficiency and effectiveness of regulations.

Since national regulatory policy and international economic integration are interdependent, efficient business operations also require consistency between these areas of policy. At an ambitious extreme, Bollyky and Bradford (2013) proposed that future trade agreements should integrate trade and regulatory policies by pursuing common or mutually recognized standards, mutual recognition agreements for conformity assessment, and information-sharing across national regulatory operations. They argue that these activities could be promoted, as in the APEC model, by shared institutions and ad hoc working groups that bring regulators together.

These issues are beginning to be addressed in next-generation agreements. The TPP's regulatory coherence chapter may include proposals such as the establishment of regulatory coordinating agencies within governments, and mechanisms for performing regulatory impact analysis to ensure that objectives are being met with minimal adverse side-effects on business. These proposals in turn build on the APEC-OECD regulatory framework.

V. Realizing the FTAAP

What practical ways are there for approaching the FTAAP? A key idea, noted in a succession of ABAC contributions, is that realizing the FTAAP is likely to require pathways, that is, other regional agreements that prepare the ground by connecting smaller groups of economies. Several current negotiations are potential pathways—they could advance FTAAP either by building a framework that non-members could join, or by contributing model provisions.

a. Why are pathways needed?

Few large agreements as large as the FTAAP are negotiated without prior agreements as a base—most build on the foundations of existing, proven accords. This was the case, for example, with the European Union's transformation into a Single Market, in the development of NAFTA from a Canada-US agreement, in initiatives to develop RCEP from ASEAN integration efforts, and in building the TPP on the foundations of TPSEP or the P4 agreement.

Pathways make three essential contributions to a new agreement. First, because some members will have formulated and agreed to the rules on a completed pathway, their provisions provide concrete solutions for the multidimensional puzzles that make trade negotiations difficult. Second, because pathways offer a step-wise approach to policy changes, they test the practical effects of provisions and familiarize business and policy makers with them. Third, pathways stimulate the dynamic of competitive liberalization—that is, they generate competition among agreements and create incentives for countries to join a larger regional community. Although much discussion focuses on trade agreements as single outcomes, experience tells us that the strongest agreements on every continent have been built gradually, from agreements that represent prior pathways.

Yet pathways could become stumbling blocks, rather than building blocks, on the road toward more inclusive agreements. In one influential paper, Paul Krugman (1991a) demonstrated that at one extreme, the enlargement of trade blocs could lead to three giant blocs that erect high barriers against each other. In this formulation, economies formed blocs for mercantilist reasons, attempting to increase their market power and raise their prices against one another. The end result was a configuration that *minimized* world welfare. However, Krugman and other have also shown that blocs can have very positive effects when they remove barriers to business relations among countries that already trade extensively with each other, or comprise "natural blocs."

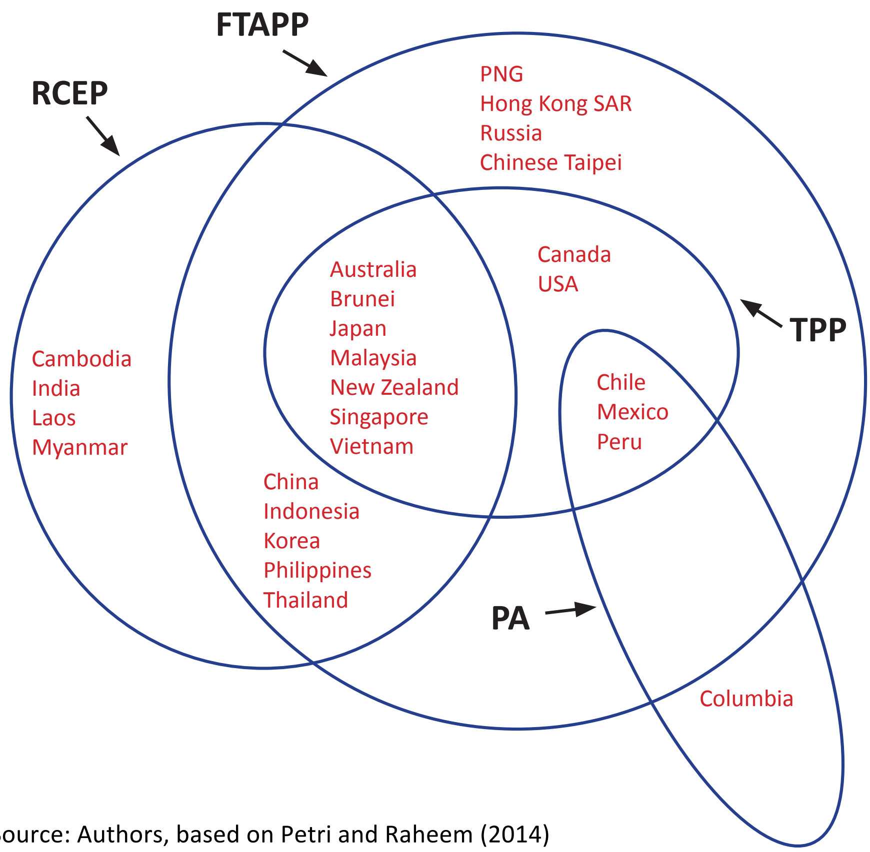
The implication of economic analysis and common sense is that pathways are promising, but not automatic routes to regional integration. The lesson for the Asia Pacific is to keep pathways compatible with each other, and the provisions of new agreements consistent with a potentially larger membership in the future. The key lies in the design of agreements. The phrase open regionalism, although not easily defined, captures the idea that agreements must be structured to create stronger opportunities for business without harming excluded economies, and should be open to enlargement by admitting new members willing to accept the responsibilities of participation.

In practice, many regional trade agreements appear to have followed the kind of positive route advocated by ABAC and APEC. They have done so partly because business has lobbied for strong regional relationships and for rules that remove obstacles that stand in the way of successful companies. Also, new business opportunities and consumer benefits associated with new agreements have generated further domestic support for market-friendly policies. Research shows that most new regional trade agreements have positively affected business and consumer welfare, and many have expanded over time.

b. Status of current pathways

The three major pathways identified by ABAC in the past are the TPP, RCEP and the PA. The current configuration of these pathways is described in Figure 9. The TPP was concluded on October 5, 2015, although its ratification and implementation will take additional time. RCEP is in negotiation, but its scope and timing are not yet clear; this pathway may involve a series of agreements rather than a comprehensive initial agreement. The PA is also developing in stages through agreements adopted at successive summits of leaders. In addition, several APEC economies are not yet included in pathways, but would be excepted to participate in the FTAAP.

Figure 9. Current configurations of possible Asia-Pacific FTAs



Source: Authors, based on Petri and Raheem (2014)

Trans-Pacific Partnership. The TPP is itself built on a pathway, the P4 agreement among APEC members Brunei Darussalam, Chile, New Zealand and Singapore, but many of the provisions of the original agreement have been changed. The TPP began active negotiations with an expanded membership in 2008 and several countries were later added. Business has strongly supported the TPP in most member economies, and several economies have now indicated an interest in joining the TPP in future. The full details of the agreement are not yet public, but much progress has been reported in many areas of interest to business, including regulatory coherence, investment, services and intellectual property. At the same time, the final agreement is likely to be very complicated, and even so, may not adequately consolidate the "noodle bowl" of regional trade rules. But it should make a major contribution by adopting a single set of rules of origin, albeit complicated and sector-specific. Market access concessions have been also negotiated on a bilateral rather than regional basis.

Regional Comprehensive Economic Partnership. The RCEP negotiation caps more than two decades of discussion of an Asia-centered trade agreement. Launched in 2012, the negotiations are based on ASEAN's "Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership," and define the goal as "a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement… [to] cover trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement" (ASEAN 2012). The Principles emphasize flexibility and special and differential treatment for developing members. A recent round of negotiations in in August 2015 resulted in decisions targeting the elimination tariffs on 65 percent of tariff lines as the agreement enters into force, and 80 percent after ten years (Elms 2015a). These rates, to be sure, are below those achieved in prior ASEAN agreements. Modalities for negotiations in other areas remain to be settled.[50] The deadline for RCEP was originally end-2015, but in July 2015 RCEP Ministers agreed that this was unlikely (Elms 2015b).

Pacific Alliance. The Pacific Alliance (PA) is unusual in its negotiating form and high ambition. Launched in 2012, it includes Chile, Colombia, Peru, and Mexico, and aims to create a market in which goods, services and factors eventually flow freely across the region. The group constitutes approximately 35 percent of Latin America's population and GDP and one-half of its trade (Ramirez 2013), but intra-PA trade is low, ranging from 3-8 percent of the trade of member-states (World Economic Forum 2013). Heads of state meet periodically; by the end of 2013 members had abolished 90 percent of tariffs on intra-regional trade. They have also agreed to integrate stock exchanges and are working on integration in various sectors. The PA plans to address other, arguably more difficult, rules in later stages.

These pathways offer different, useful models. The TPP provides a comprehensive, rigorous template, with explicit provisions on many issues that business has prioritized for next-generation agreements. RCEP will offer insights on how a common framework of rules can be built by incorporating the priorities and sensitivities of low-income economies. Finally, the PA provides lessons on how action at the highest levels of government can lead economic integration hopefully toward deep integration in the longer run.

In addition to the pathways explicitly identified by ABAC, significant contributions to the development of the FTAAP could be also made by other major trade and investment agreements that are concluded by APEC members. For example, the ASEAN Economic Community, the China-Japan-Korea FTA, and the China-US Bilateral Investment Treaty all address issues that are likely to be included in the FTAAP. These negotiations and agreements involve large economies with critical roles in the FTAAP process, and their successful conclusions would add momentum to the FTAAP project.

Similarly, many APEC economies are involved in plurilateral initiatives within or alongside the WTO framework, such as agreements on information technology products, government procurement, environmental goods, and services. The results of these agreements could also set important benchmarks for the FTAAP and accelerate its realization. Conversely, progress on the FTAAP would be also likely to stimulate progress in multilateral venues, as well as other larger regional agreements.

c. How the pathways might converge

ABAC has noted that the FTAAP could emerge along the pathways above.[51] From a business perspective, the simplest outcome would be the enlargement of one pathway until it includes all APEC members. This would end the proliferation of regional rules and offer a single

[50] New Zealand Ministry of Foreign Affairs, http://www.mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/RCEP/, accessed 25 July, 2015.

[51] Noteworthy examples include the 11 November, 2014 APEC Economic Leaders' Declaration ("Beijing Agenda for an Integrated, Innovative, and Interconnected Asia-Pacific"); 14 November, 2010 APEC Economic Leaders' Declaration ("Pathways to the FTAAP"); and the 15 November, 2009 APEC Economic Leaders' Declaration ("Sustaining Growth, Connecting the Region).

framework for supply chains under cumulative rules of origin. Since globally efficient suppliers of most products are in the APEC region, even strict rules of origin would not present a serious obstacle to integration. To be sure, the enlargement approach would mean that some economies will join an agreement that they had not negotiated. But most trade agreements have built-in flexibilities to admit some non-conforming policies.

Alternative approaches are also possible. A new FTAAP agreement could combine provisions from different pathways. For example, at the 2014 APEC meetings in Chile, ABAC recommended that the "FTAAP should converge around the highest standards from each of the pathways" (ABAC 2014b).

Finally, the FTAAP could become a newly negotiated agreement, a kind of "umbrella agreement" that sets its own standards but continues side-by-side with other agreements among subsets of members. These and other options are discussed by Petri and Raheem (2014) and Schott (2014). While easier to achieve, fragmented scenarios would leave in place aspects of the noodle-bowl that reduces the FTAAP's value for business.

It is premature to recommend one or another of these alternatives; greater consensus and more progress on the pathways is needed before APEC economies can decide what works best. In the meantime, pathways should be encouraged to evolve rapidly and consistently, avoiding conflicts that would prevent consolidation. Fortunately the pathways have overlapping members that can prevent inconsistent results. But even without explicit conflicts, there could be large differences among agreements—for some may include provisions that other do not. Differences can be narrowed by making sure that the priorities of business and other groups are included in the pathway negotiations through active consultations. APEC can serve as an especially important intermediary for sharing such information among pathways.

d. The FTAAP as a living agreement

Since business faces accelerating changes, trade policies will need to be updated more frequently than in the past. Elms (2014) argues that every major new trade agreement should incorporate workable procedures for updating the agreement over time. The absence of such procedures explains, for example, the erosion of the value of the Information Technology Agreement (ITA) concluded in 1996. The review provisions in that agreement were not effective and, and as the agreement initially uses positive list of products to be covered, its effectiveness diminished when technological changes generated new products outside its bounds. Reopening the negotiations proved difficult and a new deal was not concluded until 2015.

Opportunities for limited improvements in an agreement can be built into the original text, as in the Uruguay Round agreements. These could occur as a result of scheduled reviews by committees or a secretariat. Business input should be regularly collected to understand how the agreement is working and what changes are necessary.

The admission of new members is another high priority; business does not stop at the boundaries of APEC. While launching deeper integration with like-minded economies makes practical sense, the value of an agreement grows as additional economies join. Business has an interest in keeping the FTAAP open to new members who are willing to accept existing obligations and negotiate reasonable mutual market access with existing members.

The case for a living agreement is different from the case for an agreement constructed in stages. A living agreement is comprehensive, if not infallible with respect to future needs. A comprehensive agreement is one of ABAC four pillars. A phased agreement, on the other hand, is incomplete, and assumes that complex issues can be solved later. It rests on the assumption that benefits from easier steps can flow right away without sacrificing deeper integration in the future. Some argue for multiple stages also because the nature of the bargaining process on market access (at the border) issues may be different from that on deep integration ("behind the border") issues. But difficult issues do not always become easier to solve, and sometimes "easy" and "difficult" issues are more solvable together than separately. Finally, the political approval process in democracies may make staged strategies impractical.

e. How business can help to make the case for the FTAAP

The Asia-Pacific region is remarkably diverse—high and low-income, resource rich and resource poor, centralized and laissez-faire—but all of its economies rely on markets as their main engine of growth. Integration has transformed this region into the world's most vibrant economy, making diversity its chief asset. As Doris Ho, ABAC Chair for 2015 noted, "With the elimination of barriers to trade and investment, more opportunities arise to create jobs and greater prosperity for our communities. The removal of barriers and the facilitation of physical, human and institutional connectivity to allow all our communities to participate fully in the global economy will encourage inclusive growth."

This history of progress needs to be well understood by the region's citizens in the emerging, more difficult era of growth. Although the contribution of trade varies across economies and over time, deeper linkages among economies are a critical driver of growth and living standards. These principles may be intuitive to business, but are often lost in political debate. Given the importance of sustained economic progress, they need to be clearly articulated.

- Economic integration raises living standards. It provides access to low-cost imported goods and improves the quality and range of products people can buy.

- Economic integration improves productivity. It makes better inputs available at lower costs, exposes firms to new products and technologies, and enables them to specialize in products that they make best. These gains are mostly passed on to consumers and workers.

- Economic integration creates higher-paying jobs. It moves workers and capital to an economy's most efficient industries. In developing countries, it also pulls workers from informal jobs into the formal sector, where jobs are more secure and wages are higher.

- Economic integration attracts investment, technology and high-quality inputs and services. When firms join global value chains, foreign partners bring in the capital and technology needed to meet global standards. World-class services in turn connect economies to global production systems.

- Economic integration reduces risk. Economies with access to a wide range of international markets can achieve more secure food, energy and raw material supplies than they would by relying only on their own resources.

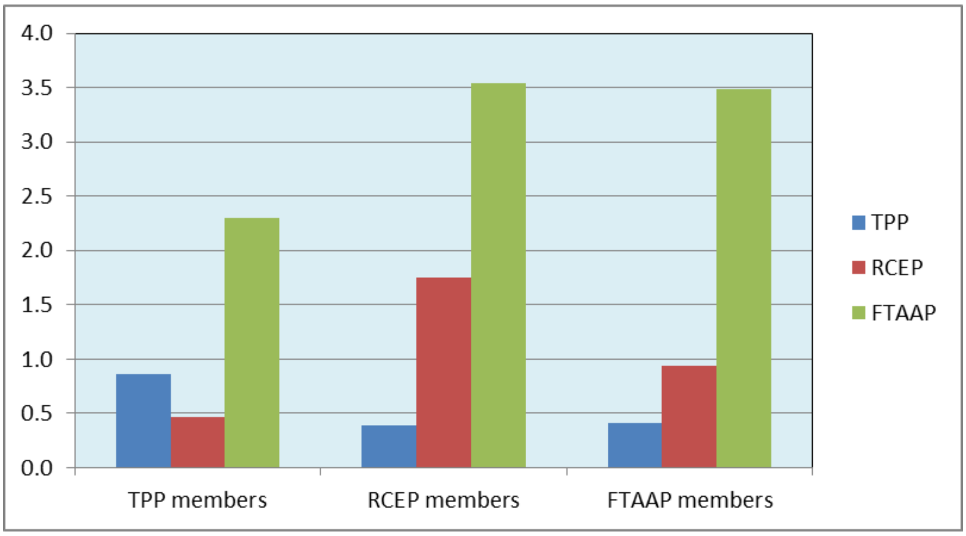
- Economic integration enables economies to adjust more easily. International trade and investment make it possible for firms with strong capabilities in one area of production to partner with others that have complementary strengths.

These benefits do not come without costs. Economic integration, like technological progress, causes productive industries to grow and less productive ones to contract. This side-effect creates losers as well as winners. Governments therefore need to facilitate change and support people who are unable to shift to new economic opportunities. The benefits, however, are usually many times as large as adjustments, making generous assistance possible. Many economies have handled massive changes smoothly—for example, as trade between Mainland China and Hong Kong opened in the 1990s, Hong Kong rapidly turned from a manufacturing economy into a service economy, without unemployment and with rapidly rising wages.

Economic estimates suggest large gains from the FTAAP. Depending on the eventual quality of the agreement, the FTAAP could add from $1.3 to $2.4 trillion in income to the world economy by 2025.[52] Benefits from the TPP and RCEP would be substantial but much lower, at $223 billion and $451 billion, respectively. (These estimates will be updated in the near future and will change, but their qualitative patterns are unlikely to change.) Figure 10 compares these estimates to the incomes of three groups of economies: members of the TPP, members of RCEP, and all members of APEC. It shows that incomes in TPP economies (the left-most group of bars) would rise by 0.9 percent under the TPP agreement, 0.4 percent under the RCEP agreement (since many TPP members are also RCEP members), and 2.3 percent under an FTAAP agreement. In other words, for TPP members, FTAAP would be more than twice as beneficial as their own narrower agreement. Similarly, RCEP members would gain more under the FTAAP than the RCEP. FTAAP economies, in turn, would gain more under the FTAAP than under the two smaller agreements combined (as seen in the right-most group of bars).

[52] The details of the model cannot be included here, but they are fully described in Petri, Plummer, & Zhai (2012) and on the website asiapacifictrade.org. The estimates rely on new data on the provisions of trade agreements in order to make the trade policy simulations realistic. Detailed information on issues covered in nearly 50 regional trade agreements has been used to assign "scores" to the quality of these agreements in 24 dimensions. Future agreements are assumed to use templates comparable to those used in the past by similar economies. For example, the TPP's template is based on that of the Korea-US free trade agreement, and RCEP's template on those included in recent agreements by ASEAN. The templates differ significantly on issues such as government procurement, intellectual property rights, investment, and competition, as well as the depth and scope of liberalization of tariff and non-tariff barriers.

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



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

While the TPP scenario would favor economies that do not yet have FTAs already with all large TPP partners—including Japan, Malaysia and Vietnam—it would generate trade diversion or losses for China and some other Asian economies. The RCEP scenario, in turn, would do little for economies on the eastern shore of the Pacific. The FTAAP scenario stands in contrast with these narrower gains, and would benefit all major subdivisions of the region. And it would generate especially large benefits for China and the United States, since these two large economies have much to gain from being jointly included in a regional agreement.

A disproportionate share of the benefits of integration would accrue to lower income economies that often have high initial internal barriers. It is sometimes argued that low income economies should be sheltered from high quality agreements, but economic theory generally argues that economies with larger barriers benefit the most from reducing them, by improving the efficiency of resource allocation in their own economy. Long phase-in periods can prevent excessively rapid adjustments in these cases, while preserving the possibilities for large productivity gains.

Nevertheless, like other trade agreements, the FTAAP is bound to attract criticism. Trade is often seen as a zero-sum game that benefits some group or economy to the detriment of others. That trade can raise the incomes of *all* participating economies and a large majority of citizens is not intuitive. As Nobel Laureate Paul Samuelson said, the economics of trade—the productivity-increasing effects of comparative advantage—constitutes an idea that is powerful because it is both true and non-trivial. That this idea is not trivial "is attested by the thousands of important and intelligent men who have never been able to grasp the doctrine for themselves or to believe it after it was explained to them" (Samuelson 1969). To be sure, trade debates are unavoidable in a democracy and often lead to useful results.[53] In the

[53] For example, perhaps in response to public pressure, the agreement has substantially improved the investor-state dispute settlement process by making it more transparent, setting stronger qualifications for arbitrators, and excluding tobacco companies from the process.

United States, for example, such debates have built support for adjustment assistance for workers negatively affected by trade.

Business voices need to be prominent in these debates. Business has direct expertise with the nuts and bolts of trade agreements, but few business leaders have time for a public role on these issues. Business associations help to articulate business views, but their focus is often narrow. So far, neither business nor governments have been effective in answering critics in the social media, and the burden of defending trade policy has fallen on a few top political leaders. The case for economic integration—and the positive contributions of business to economic welfare—has to explain, on a truly personal level, how business and trade create jobs, raise wages, and make communities stronger. This case also has to be made in the new media in order to counter much misinformation.

Political Economy of Free Trade Areas*

Since the Bogor Goals in 1994 were launched, APEC member economies enjoyed significant growth and development due to open trade and investment flows in a relatively open trading system. However, since the global financial crisis public support for trade has waned. While 81% polled around the world believed that trade was good for their country, only 54% believed that trade created jobs, 45% believed that it raised wages and only 26% thought it reduced prices. Perceptions were more positive in developing compared with developed countries.[1] In a recent polling, the support for TPP in APEC economies varied from Vietnam (89%), Peru (70%), Chile (67%), Mexico (61%), Japan (53%), Canada (52%), Australia (52%) and Malaysia (38%).[2]

It is clear that getting sufficient domestic support for greater opening up under free trade agreements is not going to be an easy sell. We are no longer in the "low politics" era of state led integration whereby in the lead up to the Bogor Goals in 1994, the then President Suharto of Indonesia pronounced that globalization was already a fact of life and that whether we were ready or not, whether we liked it or not, the process of opening up was a necessity. This was followed by a series of bold unilateral reforms in trade and investment, culminating in the agreement on the Bogor Goals during the historic APEC Economic Leaders Meeting in Bogor in 1994.

Now most of the APEC member economies have democratic systems and greater transparency. There has to be greater public outreach and more importantly ensuring that the broad benefits are inclusive. Business as stakeholders need to play a role and be unified on this call, and in the case of business showing benefits to SMEs for instance would be important.

A few important reflections are in order on this broader issue of political economy of FTAs in today's context based on experience.

First, the nature and type of domestic conflicts vary depending on the economic structure of the country, the degree of openness and its long-term development goals. Thus, integrating the benefits of joining free trade agreements or international commitments with the reform agenda of the country is an important dimension. Some examples are the experience of APEC in the 1990s with the unilateral reforms as was done by Indonesia and other countries; use of ASEAN commitments to

[1] Pew Research Center, "Faith and Skepticsm about Trade and Foreign Investment, September 16, 2014.
[2] Bruce Stokes, Pew Research Center, Americans' Views on Trade, TTP & TTIP, October 7, 2015.

shape reforms by ASEAN members; and a number of the APEC members of course have used their accession process to the WTO[3] and currently to TPP to shape reforms. A word of caution is to use this reasoning in a balanced way so as not to be seen that the reforms are "driven" by outsiders.

Second, progress on opening up is often a result of sectoral vested interests, including the state owned enterprises and the related government Ministries. In particular the opening of the services sector, especially for many of the APEC developing economies remains slow. This implies that a comprehensive approach becomes necessary so that trade-offs can be made. A comprehensive approach that allows for trade-offs will also reduce the amount of "water" or gap between what is offered and the actual policy. Businesses and other stakeholders need to make a stronger case for more efficient services which is based on the benefits competitiveness in other sectors (e.g. manufacturing); for inclusiveness and equity (e.g. transportation, logistics); human capital development (e.g. health and education); and economic and development opportunities (e.g. business services in the context of outsourcing).

Third, lack of broad support is often due to insufficient consultation processes with all stakeholders, which is partly due to the limitations on the number and representation of stakeholders, and lack of transparency in the consultancy process. There is also a seemingly glaring outcome that the low utilization of lower tariff preferences under the various ASEAN agreements for instance and other surveys, show that firms (especially SMEs) and the wider public do not have a good understanding of the benefits of regional integration. This again implies a role for the business sector in ensuring that the benefits and utilization of any opening up is enjoyed by a broader segment of business and sectors.

Finally, how should one respond to the backlash against existing free trade agreement? For instance, an imbalance in trade has led to tensions in the case of the ASEAN-China FTA and backlash in a number of ASEAN countries in recent years, including a call for renegotiating the agreement in Indonesia. While that did not happen, what is clear is that APEC had it right from the beginning. At the same time the Bogor Goals of liberalization and facilitation were pronounced, the need for the third leg of economic and technical cooperation or capacity building was identified. This has now become the norm in all trade agreements, including in the TPP. However, concrete delivery that can really tip the balance so that the benefits of joining the free trade agreement are felt more broadly remains a challenge. Getting this right and expanding the role of business in implementing this aspect of agreements is imperative. One important dimension of capacity building and inclusiveness is to focus on physical and soft infrastructure, which foster connectivity and are often built on public-private partnerships.

* This box was contributed by Dr. Mari Pangestu of the University of Indonesia, formerly Minister of Trade and Minister of Tourism and the Creative Economy of Indonesia.

[3] It is interesting to note that the "debut" of a number of APEC economies as Chair of the APEC year coincided with their accession to the WTO (2001 for China, 2006 for Vietnam and 2011 for Russia).

VI. Conclusions and recommendations

The vision of the FTAAP—realizing the Bogor Goals for an integrated Asia-Pacific economy—is powerful because it will advance regional prosperity and peace. It will bring unprecedented exchanges of products, ideas, capital and people, sustaining critical drivers of Asia-Pacific economic progress in the past half century. The FTAAP Roadmap, and the pathways toward it, now make this vision more achievable than ever.

This report has argued that economic integration, and next-generation agreements to facilitate it, have not only delivered remarkable results, but also address critical challenges in the emerging business environment. The conclusions and recommendations of the analysis can be grouped under three headings: the case for the FTAAP, its main elements, and ways to achieve it.

The business case for the FTAAP

1. At a difficult juncture in the world economy, a high-quality, ambitious and comprehensive FTAAP would reenergize the growth of trade and lead to inclusive economic progress. It would update world trade rules that have fallen far behind technological and other changes. And it would help to bring many enterprises and workers and, including those that have not benefited fully in past growth, into the mainstream of the global production system.

2. The future of the Asia-Pacific economy, including the world's three largest economies, is bright, provided the region remains united. The FTAAP would facilitate such cooperation. Business can offer pragmatic advice on how to reduce barriers and play a critical role in bridging cultural and political differences.

3. The business case for the FTAAP is aligned with the interests of society. Business interests often coincide with those of workers, consumers, and even the public sector (through the taxes business generates). Productivity gains achieved by business are mostly passed on to consumers through lower prices and to workers as higher wages.

Elements of the FTAAP

4. The FTAAP can ensure open markets and access to resources, including capital, workers, information and technology. These are central to achieving high productivity. Business is increasingly organized around global value chains (GVCs) that require excellent connectivity and especially low trade, investment and regulatory barriers.

5. The FTAAP can strengthen economic linkages in services and investment. Services already provide the majority of jobs in the region and facilitate productivity in all sectors. FDI, in turn, supports the development of world-class services and manufacturing GVCs. Both services and FDI would benefit from bold liberalization and improved regulatory oversight.

6. The FTAAP can build technology even more firmly into the DNA of the Asia-Pacific economy. The Asia-Pacific is in the forefront of technological change due to business innovation and the rapid adoption of technology by consumers. Trade rules are out of date; FTAAP must take pioneering steps to create a safe, innovation-friendly technological environment.

7. The FTAAP can chart new, inclusive paths of growth. Its provisions can ensure that MSMEs profit from opportunities created by new business practices and technology. This is a tall order, but targeted policies—transparent and accessible trade rules and regulations, and new online tools to expand the reach of small companies—can make a big difference.

Realizing the FTAAP

8. Practical routes to the FTAAP will likely involve the TPP, RCEP and PA pathways. These already address business interests with rules hammered out by key Asia-Pacific economies. It is premature to decide how the pathways will be used, but this report argues that there are ways multiple solutions that could generate substantial benefits for the region.

9. Business needs a "living" FTAAP that accommodates change in the business environment, encourages consultation, and admits new members. These features will ensure that benefits from an FTAAP continue to grow as technology and the world economy evolve.

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

These findings echo the ABAC pillars noted at the outset of this study: inclusiveness, comprehensiveness, consultation and transparency. The FTAAP is a powerful tool for achieving the Bogor Goals and for knitting together the unmatched human, technological and capital resources of the Asia Pacific to ensure prosperity for its nearly three billion citizens.

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