



# Asia Pacific Bulletin

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## The State of Asia Pacific Free Trade

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**Eduardo Pedrosa, Secretary General of the Pacific Economic Cooperation Council, explains that “The introduction of more border taxes will raise costs for consumers, and is unlikely to create the kinds of jobs people hope for.”**

On January 23, three days after taking office, President Donald Trump issued a memorandum to permanently withdraw the United States from the Trans-Pacific Partnership (TPP), fulfilling one of his campaign promises. The decision came amidst rising concerns about the future of globalization. Since 2006, the Pacific Economic Cooperation Council (PECC) has been undertaking an annual survey of policy experts to provide insights into the debate about free trade and globalization. The belief that the best route to growth is through freer trade is under siege, with accusations from seemingly opposite poles of the political spectrum, that globalization only benefits the top ten or even 1 percent of citizens of a particular country.

Trade-skeptic sentiments are strongest in high income economies. As seen in the PECC survey, respondents from high income economies like the United States gave the lowest assessment of the political environment for freer trade with a net favorability rating of only +16 percent, compared to +41 percent in emerging economies. While the decision to withdraw the US from the TPP may have been driven by opposition to this particular trade deal rather than free trade generally, it will nonetheless hamper attempts to modernize trade rules already out of synch with commercial reality.

In place of the TPP, the Trump administration has said that it will pursue a series of bilateral deals, an approach that runs counter to a trend to consolidate multi-member trade deals in the Asia-Pacific region. The Regional Comprehensive Economic Partnership (RCEP) negotiations, for example, are an attempt to consolidate ASEAN’s existing bilateral agreements, and the Pacific Alliance (PA) consolidates a series of bilateral agreements among Latin American economies.

The reason for this consolidation was that the “spaghetti bowl” of bilateral agreements was making it harder and more costly to do business, especially for smaller firms. Much of the increase in global trade in recent years has come from the emergence of global value chains. These international chains of production require components to cross borders multiple times. Global value chains have led to a significant reduction in the prices of goods such as cars and mobile phones, making them more affordable for consumers. However, complex rules of origin in bilateral deals made them hard to use and hence costs were passed on to the consumer.

The introduction of more border taxes will raise costs for consumers, and is unlikely to create the kinds of jobs people hope for. Where businesses choose to base production depends on a variety of factors – proximity to the market, availability of skills, ease of doing business, and the applicable tax regime. The current uncertainty over policy is adding to the economic volatility evident since the 2008 Global Financial Crisis, with businesses taking a ‘wait and see’ attitude towards hiring and capital expenditure. One reason for this attitude is uncertainty and negative expectations for future global growth.

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Increased trade frictions are likely to lead to even greater caution from members of the corporate sector, encouraging them to keep even more cash on their balance sheets. Concerns about protectionism are rising dramatically, with 32 percent of respondents to the PECC survey selecting it as a top five risk to economic growth compared to 16 percent two years ago. North Americans were the most worried about the impact of rising protectionism on their economies with 52 percent of respondents picking it as a top five risk to growth (making it the 2<sup>nd</sup> highest risk).

If progress is made on trade deals such as the RCEP and PA, businesses will view the economies involved as beneficial locations to operate because of lower costs, a predictable trade environment, and proximity to the world’s fastest growing markets. A fifth of North American respondents to the PECC survey thought that the RCEP would have a negative impact on their economy — echoing a concern from an earlier era about ‘drawing a line down the Pacific.’ This uncertainty about transpacific cooperation comes at a critical juncture — over the next 5 years the Asia-Pacific is expected to account for almost two-thirds of all global growth.

The PECC survey results also give some indication of the challenges to freer trade today. Respondents were asked to rate different factors that influence attitudes toward freer trade: income inequality, job security, failure to communicate the benefits of trade, slower global economic growth, and sustained political leadership. Two findings stand out: First, North American respondents were much more concerned about all factors compared to all other survey respondents; and second, there are problems with perceptions about trade (the failure to communicate) and other deeper problems such as rising income inequality and job insecurity.

While a lot of energy and time will be expended on the future of globalization, the critical question is: where are jobs and growth going to come from? Over the past 4 years two thirds of the region’s growth has come from the services sector, compared to 28 percent from the manufacturing sector. At an average of 57 percent of total output, the services sector in the region’s emerging economies is smaller compared to 80 percent of total output in more advanced economies. Moreover, the way in which services are being delivered is changing - 70 percent of respondents to PECC’s survey thought that digital trade, e-commerce, and the internet economy would be very or extremely important to the future growth of their economies.

While tariffs and border taxes have come down from an average of 17 percent to less than 6 percent, many of the barriers that remain are regulatory in nature. Two-thirds of respondents to PECC’s survey selected transparency, multiple layers of authority, and predictability of regulations as serious or very serious impediments to services trade. These issues are not easily dealt with in the context of trade negotiations — for the most part they are not designed with foreign trade in mind, but are put in place to protect other concerns such as consumer safety. A forward looking trade agenda needs to find ways to reduce the burden on businesses to allow them to grow — creating jobs and lowering prices.

The Asia Pacific is undergoing a period of historic change and its trajectory, now more than ever, is unclear. Given the large populations and rising incomes, it is most likely to remain the center of global growth for decades. While the Asia Pacific policy community remains committed to freer trade, there are significant differences on the domestic political economy of freer trade. A trade agenda that addresses the concerns of those negatively impacted by trade will be critical to continuing the forward momentum in making free trade more desirable and sustainable.

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