



TRADE IN TROUBLE: How the Asia Pacific Can Step Up and Lead Reforms

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SUMMARY

Over the past year, the U.S.-China trade dispute has overshadowed most other trade developments in the Asia-Pacific region. The tariffs have disrupted trade and investment flows and caused uncertainty at a time when the global economy is already facing headwinds. The negative impacts of the dispute—which began to manifest in late 2018, and grew more acute in the first half of this year—will likely worsen following the announcement of new tariffs in May 2019.

The conflict has left many countries in the Asia-Pacific region feeling caught in the U.S.-China crossfire, given the importance of their trade and investment ties with the world’s two largest economies. As a result, they have sought to manage these critical relationships without alienating either country.

The World Trade Organization (WTO) would ideally help reduce friction between the United States and China, but it is not up to the task given its outdated rules and governance challenges. The crisis in the WTO’s Appellate Body points to this deeper problem: the failure to keep up with developments in the trading and investment landscape. An equally pressing issue is the WTO’s slowness to respond to technological advancements, particularly the digital economy. Simply put, the trade regime is in trouble and in urgent need of reform.

The United States has put forward some constructive proposals for WTO reform, but it has largely retreated from its leadership role in driving agreements on new trade rules and initiatives since the organization’s creation nearly 25 years ago.

No part of the world has benefited more from the rules-based trading system than the Asia-Pacific region, where trade has exploded since the creation of the WTO. In light of the U.S. retreat, it is time for the countries of the Asia Pacific, particularly those that are “middle powers” and trade-dependent economies, to step up and lead reform efforts in the WTO and elsewhere.

This issue paper, authored by a commission of senior trade experts from the Asia-Pacific region, reflects on the developments in the Asia-Pacific trade landscape since 2018. It updates and expands the findings presented in two previous annual Asia Society Policy Institute (ASPI) publications.¹



Even if the United States and China eventually strike a deal that includes provisions on longstanding, substantive, and strategically-relevant issues of concern, this will not be the end of the story.

This issue paper also offers recommendations to policymakers across the region on how they can continue to benefit from the economic gains and high-paying jobs created by trade. Key among the recommendations are the following:

- The countries of the Asia-Pacific region should lead efforts to reshape the WTO by updating rules and existing agreements, pursuing new plurilateral agreements on urgent matters, and improving the dispute settlement system.
- The United States and China should conclude a meaningful trade deal that addresses fundamental issues of concern. Following the conclusion of the agreement, the two countries should continue to work with each other and with other countries in the Asia-Pacific region to set international rules in areas such as digital trade and advanced technologies, the role of the government in the economy, and investment and competition.
- The countries of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership should conclude ratification and expand membership to economies that are ready to meet its standards. The participants in the Regional Comprehensive Economic Partnership should conclude negotiations by the end of 2019 and consider practical alternatives, if necessary, to facilitate agreement.
- The Asia-Pacific region should anticipate the disruptions that new technologies and digital business models will pose to trade rules. An independent group of senior experts from across the Asia Pacific should be convened to assess which existing trade rules and principles need to be updated and to propose a path forward on trade as well as on issues generally beyond its scope such as consumer privacy, data protection, international taxation, competition, and cybersecurity.

INTRODUCTION

The U.S.-China trade dispute has dominated headlines over the past year. Even if the United States and China eventually strike a deal that includes provisions on long-standing, substantive, and strategically relevant issues of concern, that will not be the end of the story. The challenges that gave rise to the tensions in the first place—particularly the failure of the international trading system to keep up with developments in the global economy and technological advancements—will remain.

In this challenging environment, no other region has a greater stake in and is better

equipped to step up and lead reform than the Asia Pacific. The countries of the region depend heavily on trade and have the most to lose from a breakdown of the rules-based trading system. Indeed, the Asian Development Bank (ADB) believes that tariff escalations are the most significant risk to growth in developing Asia.²

Recognizing that they have a vested interest in reform, Asia-Pacific countries have already worked to establish high standards through regional and bilateral deals while taking a stand against protectionism. The conclusion of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the push to finish



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the Regional Comprehensive Economic Partnership (RCEP), and the urgency to advance other deals point to that trend.

This issue paper provides recommendations for how the Asia-Pacific region can build on that experience and take an active leadership role in getting the trading system back on track. It also analyzes the biggest challenges in the trade and investment landscape and why these challenges may disproportionately affect the Asia-Pacific region.

TRADE ACTIVITY IN ASIA

The State of Trade

U.S.-China trade tensions continue to contribute to lower regional and global economic growth by disrupting trade flows and causing uncertainty, which have delayed or diverted investment decisions and reduced business confidence. This has coincided with a broader economic slowdown in China, driven in part by growing debt and rising production costs.

The Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) have both cut their global economic growth forecasts for 2019 to 3.3 percent, down from their projections before the tariff escalations of around 4.0 percent.^{3,4} The ADB similarly lowered projected growth in the developing countries of Asia for 2019 from 5.9 percent to 5.7 percent, and it forecasts a further decline to 5.6 percent in 2020. Other macroeconomic factors, including China's economic slowdown, have contributed to the downward revisions, but both organizations note that the trade tensions have been more damaging than previously thought.

According to the ADB, the escalation of tariffs between the United States and China

is the greatest risk to future growth in the Asia Pacific. The OECD projected in May 2019 that future escalations could reduce annual gross domestic product (GDP) by up to 0.8 percent in the United States and 1.1 percent in China by 2021-2022, and cost the global economy up to USD \$600 billion.⁵

Unsurprisingly, the tariffs have had the most direct effect on global trade. The WTO partly attributes the prolonged slowdown in global trade to disruptions to U.S.-China trade. The growth of global trade dropped from 4.6 percent in 2017 to 3.0 percent in 2018 and is now projected to reach only 2.6 percent in 2019.⁶

The Effects of the U.S.-China Trade Dispute on the Asia Pacific

The Asia-Pacific region is exceptionally vulnerable to U.S.-China trade tensions. Supply chains in the region are extensively integrated, and virtually every Asia-Pacific country has significant trade and investment ties with both China and the United States.

Many of these countries feel caught in the U.S.-China crossfire. For instance, China and the United States are Japan's top two trading partners, and in 2017, they accounted for more than a third of its total imports (36 percent) and exports (38 percent).⁷ For the Association of Southeast Asian Nations (ASEAN), China and the United States together accounted for more than a quarter of its aggregate imports (28 percent) and exports (27 percent) during the same period. These are likely conservative estimates since they do not include trade flowing in and out of China through Hong Kong.

For countries in the Asia-Pacific, the U.S.-China trade dispute has highlighted the



Asian countries have worked hard to maintain a positive trading relationship with both the United States and China and to avoid alienating either country.



Note: 2017 trade data for Vietnam, Thailand, Cambodia, and Lao PDR based on estimates from the BACI International Trade Database.

possible pitfalls of over reliance on one or two export markets. According to Vietnam’s Trade Minister Trần Tuấn Anh, for instance, his country has sought “to reduce risks from [the] concentration of commercial activities on major partners,” looking to “other markets such as the EU, South Korea, Japan and ASEAN.”⁸

Asian countries have also worked hard to maintain a positive trading relationship with both the United States and China and to avoid alienating either country. Singapore’s Trade and Industry Minister Chan Chun Sing expressed that view when he said that “we [do not] want to be in the position whereby we are only dealing with one and not the other, and I believe this is the same position for the rest of the Asian countries as well.”⁹

In October 2018, during a historic visit to Beijing, Japanese Prime Minister Shinzo Abe

declared his wish to “take bilateral relations to a new era, from competition to cooperation.”¹⁰ The summit with President Xi Jinping, which would have seemed unlikely until recently, signaled that Japan’s close alliance with the United States does not preclude a positive relationship with China.

Indonesia, Malaysia, Thailand, Vietnam, and other countries with low manufacturing costs expect to benefit from the trade tensions as some companies shift production out of China to reduce exposure to the trade war fallout. Foreign direct investment figures do not yet clearly reflect this trend, but when Citi, the U.S. bank, surveyed 64 of its largest trade clients in November 2018, more than half said they had plans to adjust their supply chains, including shifting manufacturing to Southeast Asia.¹¹

Shifting supply chains to third countries is logistically difficult, however, and compa-



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panies are also reluctant to make major investment decisions during a period of high uncertainty. While a November 2018 report by the American Chamber of Commerce in China found that 30 percent of American businesses in China surveyed were considering sourcing components or moving assembly to third countries, a later survey found that fewer companies reported they had moved or were considering moving capacity out of China in 2018 than in the previous year.^{12,13}

The IMF also notes that even for the potential beneficiaries of diverted trade and investment in Asia, the adverse effects of the U.S.-China tensions are likely to outweigh the benefits. The resulting increase in uncertainty, decrease in business confidence, and tightening of global financial conditions will negatively impact most countries. Slower demand growth in China, the United States, and around the world would hit these potential beneficiaries especially hard since they are some of the world's most trade-dependent economies. In 2017, trade as a percentage of GDP reached 200 percent for Vietnam, 136 percent for Malaysia, and 123 percent for Thailand.¹⁴

An eventual U.S.-China trade deal would be welcome news for the region, but it would not solve everything. While it could reduce tensions, remove tariffs, and produce market access and structural reforms, some degree of uncertainty would continue to weigh down regional economic growth. The Trump administration insists on retaining the right to reimpose tariffs if it believes China has not lived up to its obligations under the deal. Tensions between the two countries are likely to continue, particularly on issues related to technology and investment decisions. Some countries also remain concerned that anticipated commitments

by China to purchase specified U.S. goods and services would come at their expense.

Furthermore, possible U.S. tariffs on autos and auto parts would be even more disruptive than the current measures on China. Global automotive trade makes up 8 percent of all global trade, more than double the 3 percent that U.S.-China bilateral trade represents.

On the positive side, a U.S.-China trade agreement could include provisions on longstanding issues of concern for the United States and many other countries, including discriminatory practices, technology transfer, intellectual property rights, and industrial subsidies. The agreement could serve as a basis for further negotiations in the WTO or elsewhere toward broader and deeper reform.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

Countries in the Asia Pacific have responded to the U.S. retreat from its leadership role in opening markets by forging ahead together. There is no better example of this than the CPTPP.

After the Trump administration withdrew from the Trans-Pacific Partnership (TPP), few expected the remaining countries to go back to the negotiating table. Having already made hard political decisions during the TPP negotiations, however, the countries recognized that they should not forgo its potential benefits on trade, investment, and economic and job growth. With Japan, Australia, and others filling the leadership void, the remaining 11 members successfully reached a deal that was signed in March 2018 and came into effect for six of those countries in December of that year,



KEY UPCOMING MEETINGS

8–9 June 2019

G20 Trade Minister Meetings in Japan

20–23 June 2019

34th ASEAN Summit in Thailand

28–29 June 2019

G20 Summit in Japan

28 June to 3 July 2019

26th Round of RCEP Negotiations in Australia

25–27 August 2019

G7 Summit in France

18–20 October 2019

World Bank and IMF Annual Meeting in the U.S.

31 October to

4 November 2019

35th ASEAN Summit in Thailand

11–17 November 2019

APEC Leaders' Week in Chile

8–11 June 2020

WTO Ministerial in Kazakhstan

and for Vietnam a few weeks later. It largely reflected the original TPP agreement, with a relatively small number of adjustments. At the first meeting of the CPTPP Commission in January 2019, the group reaffirmed its stance against protectionism and the need for “an effective, open, inclusive and rules-based trading system.”¹⁵

Ratification is still pending in Brunei, Chile, Malaysia, and Peru, but the other seven signatories have started implementing the agreement, with two rounds of tariff cuts in place. The CPTPP countries are already looking to expand membership, issuing clear and well-defined accession guidelines for new entrants during the January meeting. To date, several countries, including Colombia, Indonesia, Korea, Thailand and the United Kingdom (UK), have expressed varying degrees of interest in joining.

Those accession candidates see the CPTPP as yielding substantial economic benefits. The Thai government, for instance, completed a study that found that accession would increase trade and investment and secure its position as a manufacturing base. These countries also see the CPTPP

as helping them diversify trade ties and hedge against future disruptions caused by U.S.-China tensions. Korea’s Economy and Finance Minister Hong Nam-ki said in February 2019 that joining the CPTPP could be part of his country’s strategy to cope with the growing uncertainty surrounding global trade.¹⁶

At this juncture, Thailand seems closest to formally starting the accession process. The government stated that it would apply to join the CPTPP after its March 2019 elections, but at the time of this writing, no announcement had been made. Colombia gave official notice of its intent to join in June 2018, but since a new president took office in August 2018, accession plans appear to be on hold.

Korea, which has free trade agreements (FTAs) with all CPTPP countries except Japan and Mexico, announced in February 2019 that it would hold informal discussions with some CPTPP members, but it cautioned that such talks are preliminary. Indonesia is prioritizing concluding the RCEP agreement before deciding on accession.

FIGURE 2: PERCENTAGE OF TOTAL IMPORTS FROM AND EXPORTS TO CPTPP COUNTRIES - SELECT ACCESSION CANDIDATES

CANDIDATE	IMPORTS FROM CPTPP	EXPORTS TO CPTPP
United States	37.5% (USD \$902.5b)	45.0% (USD \$694.8b)
Thailand	35.8% (USD \$66.5b)	30.3% (USD \$74.6b)
Indonesia	33.7% (USD \$52.9b)	28.3% (USD \$47.8b)
Republic of Korea	26.2% (USD \$125.5b)	23.3% (USD \$133.6b)
China	27.8% (USD \$476.4b)	19.1% (USD \$431.4b)
Colombia	16.8% (USD \$7.7b)	14.7% (USD \$5.5b)
European Union	12.7% (USD \$265.4b)	13.0% (USD \$280.0b)
United Kingdom	7.5% (USD \$48.0b)	7.3% (USD \$32.3b)

Source: UN Comtrade International Trade Statistics Database



Additional participants would increase the CPTPP's economic value and move its rules closer to becoming the regional and possibly global standard on intellectual property, investment, digital trade, state-owned enterprises (SOEs), and other areas.

Finally, the United Kingdom has held public consultations on whether to join following Brexit. Japanese Prime Minister Shinzo Abe has said the UK would be welcomed “with open arms.” Accession could save the UK capacity and human resources relative to a series of bilateral trade deals, but trade with the 11 CPTPP countries makes up a relatively small share of overall British trade (see Figure 2).

Adding participants would increase the CPTPP's economic value and move its rules closer to becoming the regional and possibly global standard on intellectual property, investment, digital trade, state-owned enterprises (SOEs), and other issues. The influence of the CPTPP, however, already extends beyond its signatories' borders. The participating countries that negotiated TPP, the basis of the CPTPP, designed it as a model for future agreements, and early signs suggest they have succeeded.

Although the United States withdrew from TPP in January 2017, it included many of the original TPP provisions—now in the CPTPP—in the United States-Mexico-Canada (USMCA) agreement, including provisions covering digital trade, SOEs, labor, and the environment. The Japan-EU Economic Partnership Agreement (EPA), which went into effect in February 2019, also has provisions similar to those of the CPTPP in areas such as SOEs, competition policy, regulatory practices and cooperation, and the environment.

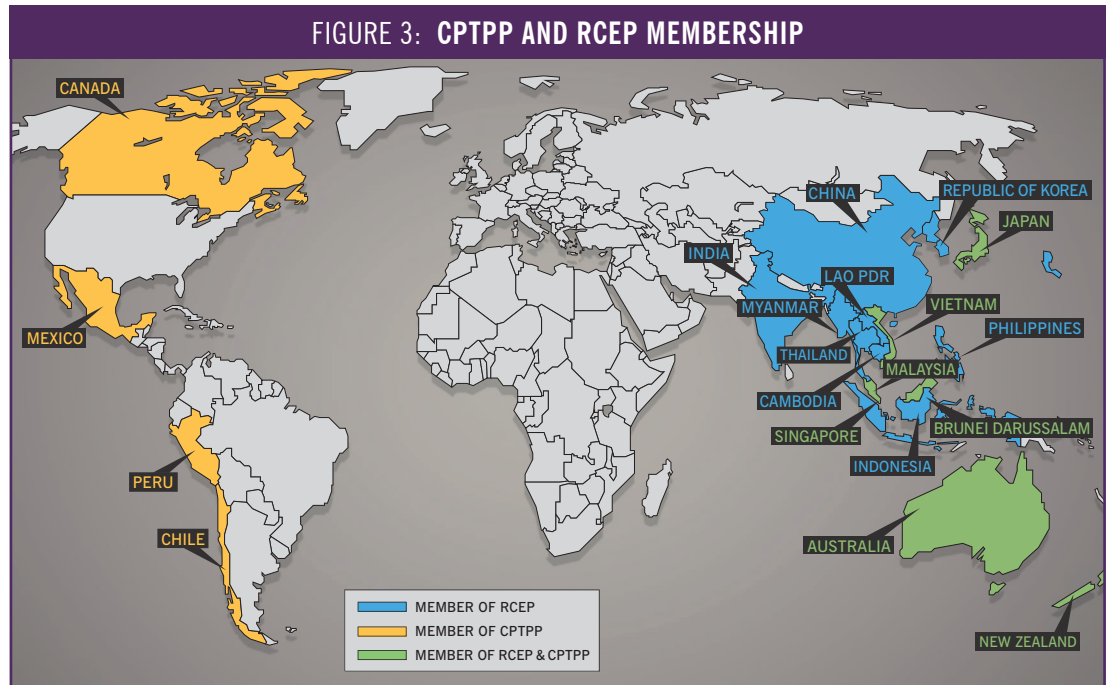
The similarities between certain provisions of the USMCA and the CPTPP, and the fact that tariff cuts among CPTPP members are making U.S. exports less competitive in Asia-Pacific markets, have led to some renewed calls for the United States to rejoin the agreement. That possibility remains

unlikely under the Trump administration. U.S. Trade Representative Robert Lighthizer told the U.S. Congress in February 2019 that “getting out of the TPP was the right decision” and that it “was a bad agreement.”¹⁷ Instead, the Trump administration has focused on negotiating a bilateral FTA with Japan.

The possibility of China joining the CPTPP has slowly become a topic of conversation in China and abroad. The Center for China and Globalization, a Beijing-based think tank, has suggested that the agreement could facilitate domestic economic reforms and benefit China's growing service and technology industries.¹⁸ If China were to join, the Peterson Institute for International Economics projects that global income gains from the CPTPP would quadruple to USD \$632 billion, with China gaining half the benefits.¹⁹ The possibility of China acceding still seems remote, however. Some of the CPTPP provisions fit with the reforms proposed by President Xi Jinping, but chapters on intellectual property, digital trade, labor, and SOEs likely go too far for China at this juncture.

Not much has been written about the EU and the CPTPP joining forces, but it is worth consideration, since the EU currently has agreements in place, under negotiation, or awaiting entry into force with all CPTPP members except Brunei. Joining the CPTPP, either through a bilateral agreement or another legal mechanism, would offer the EU a chance to consolidate and update those FTAs and become part of the CPTPP's regional supply chain. Agriculture would likely be the major sticking point of an eventual deal, but the EU's ongoing negotiations with CPTPP members Australia and New Zealand could provide a path toward agreement.

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The Regional Comprehensive Economic Partnership

The RCEP agreement, whose negotiations launched in 2012, would significantly advance trade liberalization by linking the 10 ASEAN members with six other countries in the Asia-Pacific: China, Japan, Korea, Australia, New Zealand, and India. RCEP members make up nearly a third of global GDP and half the world’s population.

While RCEP will not include standards as high as those in the CPTPP, it encompasses large economies such as China and India, which are not yet prepared to meet the CPTPP standards but are ready to move forward with narrower but meaningful reforms and market opening. According to the Peterson Institute, the agreement could generate USD \$284 billion in global income gains, USD \$259 billion of which would go to the 16 RCEP members.

The participants have held more than 25 rounds of negotiations over seven years—

long by any trade negotiation standard—but the number of participants and their different levels of development have prevented agreement thus far. Under Singapore’s leadership, negotiators worked hard to conclude talks by the ASEAN Summit in November 2018 but were only able to finalize 7 of the 18 RCEP chapters.

Divergent positions on market access commitments and rules on services, investment, and other areas have stalled progress. In e-commerce, for instance, the more developed countries have pushed for high standards, but other countries were not ready to agree to rules on data regulation and electronic transactions.

The participants now aim to conclude negotiations by the November 2019 ASEAN Summit in Thailand. To reach that goal, negotiators have agreed they will not consider new issues. Some participants have also suggested allowing India, which is concerned that the RCEP would drasti-



The countries in the Asia-Pacific region have started, continued, and concluded numerous trade negotiations since 2018. Some of this activity was likely accelerated by a desire to diversify trade ties in light of the U.S.-China trade dispute and to make a stand against growing protectionism.

cally increase its trade deficit with China, to make less substantial market access commitments than the other 15 members.

While several national elections in RCEP countries during the first half of 2019 could slow the talks, RCEP members seem determined to work hard in the second half of the year to bring the agreement to a successful conclusion. If negotiators cannot meet that deadline, it would be very challenging to keep up momentum past 2019. They should consider practical alternatives if it becomes apparent the talks would otherwise stall. Those measures could include inserting non-application clauses, taking a “minus-x” approach with members not ready to meet commitments joining later, or putting contentious issues aside while agreeing to revisit them within three to five years.

Other Trade Activity

Beyond the CPTPP and RCEP, the countries in the Asia-Pacific region have started, continued, and concluded numerous other trade negotiations since 2018. Some of this activity was most likely accelerated by a desire to diversify trade ties in light of the U.S.-China trade dispute and to make a stand against growing protectionism and unilateral trade restrictions. Talks have not been confined to within the region. For instance, Asia-Pacific countries have looked to the EU as an important and relatively stable partner, even with the uncertainty surrounding Brexit.

The United States, in contrast, has made limited progress on forging new agreements. In 2018, it concluded amendments to the U.S.-Korea Free Trade Agreement (KORUS) and the renegotiation of the North American Free Trade Agreement, which is now the USMCA. While the Trump administration notified the U.S.

Congress in October 2018 that it intends to negotiate new bilateral deals with Japan, the EU, and the United Kingdom, only the Japan talks have gotten off the ground.

The following list highlights the most noteworthy recent FTA developments, while the appendix includes a more comprehensive list.

- In April 2019, Korea and the Philippines agreed to launch negotiations on a bilateral FTA.
- In April 2019, China, Korea, and Japan held the 15th round of negotiations on a trilateral FTA.
- In March 2019, Indonesia and the EU held the 7th round of negotiations on a bilateral FTA.
- In March 2019, China and Korea held the 4th round of talks on expanding their existing agreement to cover investment and services.
- In March 2019, Australia and Hong Kong signed the Australia-Hong Kong Free Trade Agreement and an associated investment agreement.
- In March 2019, Korea and Malaysia agreed to launch negotiations on a bilateral FTA.
- In March 2019, Thailand said it would seek to update FTAs with Australia and New Zealand.
- In March 2019, Australia and Indonesia signed the Indonesia-Australia Comprehensive Economic Partnership Agreement.
- In March 2019, India and Peru held the 4th round of negotiations for a bilateral FTA.
- In February 2019, Indonesia and Korea resumed bilateral FTA talks.



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- In February 2019, New Zealand and the EU held the 3rd round of FTA negotiations. Australia is also negotiating an FTA with the EU.
- In February 2019, the European Parliament passed the EU-Singapore FTA, which is expected to come into force later this year.
- In February 2019, the Japan-EU Economic Partnership Agreement entered into force.
- In December 2018, India and Korea held the 7th round of negotiations to update their Comprehensive Economic Partnership Agreement.
- In November 2018, China and New Zealand held the 6th round of negotiations on upgrading their FTA.

CHALLENGES TO THE TRADE SYSTEM

The World Trade Organization in Crisis

While the Asia-Pacific region has moved forward with bilateral and regional deals, the WTO's negotiating track record has been dismal. With a few exceptions, it has been unable to conclude agreements on further tariff cuts, agriculture, and other longstanding issues. It has also failed to adopt new rules to address developments in international trade, including digital trade, the next generation of technologies, and the emergence of some developing economies as significant forces in the global economy.

Another WTO core function, dispute settlement, is also in jeopardy. With the United States blocking the appointment of new Appellate Body members, the dispute settlement system could grind to a virtual halt by the end of the year. Although the lack of new and updated rules and the Appellate Body

troubles seem like distinct problems, they are closely related. Without adequate rules to address emerging issues, the Appellate Body in some important cases has chosen to extrapolate existing rules when making findings. This tendency to "overreach" has dissatisfied some WTO members, with the United States being particularly vocal.

Moreover, governance issues are affecting the WTO's ability to fix these problems. Amending and updating WTO rules requires consensus by all members, which has become virtually impossible among 164 countries at varying levels of development. As a result, WTO members have increasingly turned to plurilateral agreements, which include subsets of WTO members with shared interests. With few exceptions, however, the WTO principle of most-favored-nation (MFN) makes those plurilateral agreements more difficult to negotiate as members are required to provide benefits from such agreements to all WTO members, regardless of their participation in the negotiation. Nonparticipants can thus claim the benefits of the deal without incurring its obligations.

The principle of special and differential treatment for developing countries also presents serious challenges. Approximately two-thirds of WTO members currently declare themselves developing countries, making them automatically eligible for weaker obligations and extended transition periods. Given the GDP, development level, and trade performance of many of these countries, the distinction between developed and developing countries in the WTO is increasingly blurred and hard to sustain. It has become less and less appropriate to treat all developing countries alike without considering their relative level of development.



The world is getting closer to a breakdown in trade rules in which every country would become its own judge, jury, and executioner. Without an impartial adjudicator, retaliation could quickly get out of hand and the U.S.-China tit-for-tat tariff war could repeat itself across many economies.

The growing crisis at the WTO and its negative implications for the global economy may mobilize WTO members to break the stalemate. The world is getting closer to a breakdown in trade rules in which every country would become its own judge, jury, and executioner. Unchecked by WTO rules, governments could raise tariffs at will, discriminate against imports, and provide unfair and unfettered support to local producers. Without an impartial adjudicator, retaliation could quickly get out of hand and the U.S.-China tit-for-tat tariff war could repeat itself across many economies, with much more extensive effects. As a result, the world could lack any semblance of stability and certainty, business confidence could plummet, and trade and investment sharply decline.

Even critics of the WTO, including U.S. Trade Representative Lighthizer, recognize that the WTO remains critical and that “if we didn’t have [the WTO], we’d have to invent it.”²⁰ A number of countries have put forward proposals to strengthen and reform the WTO. These proposals include changes suggested by the United States, Japan, and others to encourage full compliance with the notification system for subsidies. Canada and the EU have also put forward broader proposals to reform the Appellate Body and update outdated rules.

The Asia-Pacific region, which has benefited enormously from the multilateral trade system, has the most to lose if it stops working. Since 1994, the year before the establishment of the WTO, exports of goods in Asia have grown by 462 percent, faster than in any other region.²¹ For the countries of developing Asia, exports have exploded over the same period by more than 800 percent. Today, the Asia-Pacific region accounts for nearly 40 percent of

global trade in goods and is the world’s most important destination and source of foreign direct investment.²²

Consequently, the Asia-Pacific region must play a leading role in revamping and revitalizing the WTO. Japan, as the G20 chair in 2019, can build on the group’s agreement at the 2018 Buenos Aires summit to reform the WTO. Finalizing proposals that are in more advanced stages, such as the notification requirement proposal, can serve as a stepping stone to broader reforms. As chair of ASEAN, Thailand can play a role by forging consensus in Southeast Asia. As co-chairs of the WTO e-commerce negotiations, Australia, Japan, and Singapore have an opportunity to drive these talks to a quick and meaningful outcome.

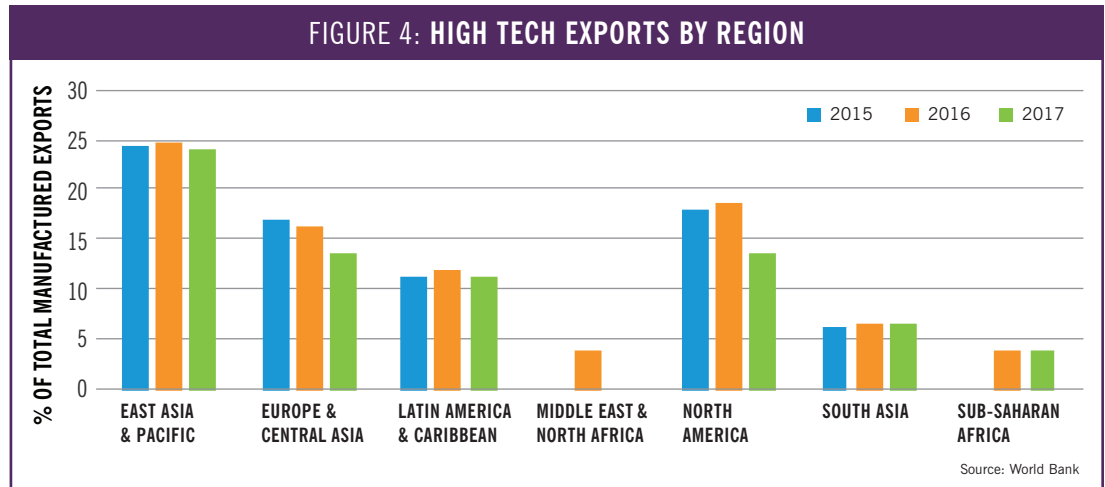
Advanced Technologies May Soon Make Trade Rules Obsolete

Advanced technologies and the growth of digital business models present an equally pressing challenge for the international trading system. The WTO rules were first created to deal with trade in goods and were later updated in a separate agreement to cover trade in services. Issues related to investment, competition policy and data privacy have become increasingly difficult to separate from other aspects of trade. WTO members recognized this problem nearly 20 years ago at the start of the Doha Round, which quickly stalled. The need to address those issues is even more pressing today.

These concerns are particularly acute for the countries of the Asia Pacific, given that many are at the forefront of developing and adopting new technologies and business models. No part of the world exports more high-technology products as a share of manufactured exports than the Asia-Pacific region.²³ The Asia Pacific accounts for nearly



New patterns of production, driven by 3D printing, robotics, and artificial intelligence (AI), challenge the current rules and blur the distinction between goods and services.



Note: Data not available for MENA region in 2015 and 2017, and for Sub-Saharan Africa in 2015.

half of global business-to-consumer (B2C) e-commerce sales.²⁴ Three of the top five countries in terms of density of industrial robotics—Korea, Singapore, and Japan—are in Asia.²⁵ Therefore, it is critical that the Asia-Pacific region lead in this area.

New patterns of production, driven by 3D printing, robotics, and artificial intelligence (AI), challenge the current rules and blur the distinction between goods and services. Intangibles that can be transmitted electronically, such as designs and internet-enabled services, will grow in importance, while trade in goods may come to be increasingly confined to agricultural products, raw materials, and other commodities.

Those developments present several challenges. First, they blur the line between imported and locally produced goods, raising the question of whether those products are subject to tariffs and other border measures and making the current measurement of trade flows increasingly meaningless. They also cloud the distinction between goods and services and call into question the relevance of WTO rules on issues such as intellectual property rights, standards, subsidies, and investment, among others. Additionally,

they may require the adoption of global rules on data flow and consumer privacy and raise issues that are typically beyond the scope of trade agreements, such as cybersecurity and taxation. Finally, although technologies such as robotics and 3D printing are creating some high-skill jobs, they will likely lead to the loss of lower-skilled jobs. As noted in our 2018 report *Shifting Trade Winds: U.S. Bilateralism and Asia-Pacific Economic Integration*, there is growing public skepticism of the benefits of trade. As technology advances, this trend will continue, and it may become even more difficult to differentiate between job losses from technology and the impacts of trade.

The countries of the Asia-Pacific region are relatively well positioned to tackle these challenges. They have led many of the efforts to-date to develop new rules around emerging technologies, including the digital chapters of the CPTPP and RCEP, the Asia-Pacific Economic Cooperation (APEC) Cross-Border Privacy Rules, and ASEAN’s recent work on advanced technologies.

The pace of technological advancement, however, can quickly outstrip progress on trade negotiations. Only recently, more



Only recently, more than two decades after Amazon and Alibaba launched, did the WTO start negotiations on e-commerce. The WTO members should not wait another two decades to set the rules for the next generation of technologies.

than two decades after Amazon and Alibaba launched and when digital trade already makes up 12 percent of all trade, did the WTO start negotiations on e-commerce.²⁶ Concluding a deal will be harder now as countries already have a patchwork of domestic regulations in place to address such matters as cross-border data flows, requirements for source code disclosure, and the protection of personal data and consumer privacy.

The WTO members should not wait another two decades to set the rules for the next generation of technologies. To avoid that outcome, an independent group of high-level experts should take a long-term view of the impact of those technologies and advise policymakers on how to address them. In years past, eminent persons groups have counseled trade and finance officials on emerging challenges like recovering from inflation and stagnation or reforming the global finance architecture.²⁷ A similar group, composed of stakeholders at the cutting edge of advanced technologies drawing from the private sector, academia, and civil society, could take a step back from the immediate issues that occupy trade officials and provide a broader vision for updates and reforms required to address the disruptions that advanced technologies will bring. This group would also provide recommendations on how to best address matters that go beyond what has traditionally been seen as a part of trade rules, such as consumer privacy, data protection, international taxation, and cybersecurity.

Recommendations

Despite the challenges of the past year on the trade front, the United States, China, and the other countries of the Asia-Pacific region

share certain objectives. They have a strong common interest in restoring certainty to the regional and global economy and pursuing trade agreements that produce economic gains and high-paying jobs. They also agree on the need to reform the WTO so that the institution remains relevant in the future.

The following recommendations can help the countries of the Asia Pacific advance these goals and lead the rest of the world in putting trade back on a stable growth path and making trade rules more relevant:

1. The United States and China should reach a meaningful trade deal and work with each other and with other countries to address common challenges.

- The United States and China should conclude a trade deal that addresses fundamental issues of concern, such as technology transfer, intellectual property rights, and industrial subsidies, and that restores some certainty to the global and regional economy as soon as possible. Once they reach an agreement, both countries should do the following:
 - Make a full-fledged effort to live up to its obligations.
 - Avoid the reimposition of tariffs to the maximum extent possible.
- The United States and China should work with each other and with other countries in the Asia-Pacific region to update or introduce new trade rules in such areas as:
 - Digital trade and advanced technologies.
 - The role of the government in the economy.
 - Investment and competition.



WTO members, particularly those in the Asia-Pacific region, should leverage upcoming regional and multilateral meetings, including the G20, APEC, and ASEAN meetings, to build momentum for WTO reforms.

2. The CPTPP should be fully ratified, and membership should expand.

- The four remaining countries of the CPTPP—Brunei, Chile, Malaysia, and Peru—should ratify and implement the agreement as soon as possible.
- The CPTPP countries should encourage accession by candidates ready to meet the deal’s high standards. Possible candidates include Thailand, Korea, Indonesia, Colombia, and the UK.
- The United States should consider rejoining the TPP at some point, as U.S. exporters are losing out without preferential access to important CPTPP markets and the United States has already adopted many TPP provisions in the USMCA.
- China should consider eventually joining the CPTPP, in light of the large potential gains and the opportunity the CPTPP presents to advance reform efforts.
- The EU should join forces with the CPTPP given that it has agreements in place, under negotiation, or awaiting entry into force with all CPTPP members except Brunei.

3. RCEP participants should conclude negotiations by the end of 2019.

- RCEP negotiators should consider one of the following three strategies for finalizing the agreement in 2019:
 - Asking participants not ready to meet market access commitments and rules in line with other RCEP countries to postpone their participation and consider rejoining at a future date.

- Allowing for non-application clauses regarding market access commitments for countries that have not reached a mutually satisfactory conclusion to their bilateral market access negotiations.
- Concluding a deal this year based on what is on the negotiating table while building in a mechanism for reviewing, expanding and updating the agreement within three to five years, using CPTPP obligations as one benchmark.

4. The Asia-Pacific region should lead efforts to update the WTO rules.

- WTO members, particularly those in the Asia-Pacific region, should leverage upcoming regional and multilateral meetings, including the G20, APEC, and ASEAN meetings, to build momentum for WTO reforms, including the following:
 - Strengthening the notification system using the proposal tabled by the United States, Japan, and others as a basis for agreement. The outcome should encourage full compliance through both incentives, including technical assistance, and disincentives.
 - Launching negotiations to update the Subsidies and Countervailing Measures (SCM) agreement to address trade-distorting policies. The talks should aim to expand the list of prohibited subsidies, and clarify the definition of “public bodies” covered under the agreement to better address the role of SOEs.



Given that trade officials are busy dealing with the immediate and serious problems facing trade today, an independent group of senior experts from the Asia-Pacific region should be convened to advise the WTO and policymakers on the challenges presented by new technologies and digital business models.

- The countries of the Asia-Pacific region should pursue new plurilateral agreements with like-minded countries on matters of urgency, particularly around new technologies and state-led economies.
 - While efforts should be made to apply the MFN principle to these agreements, the time may have come to reconsider this principle, as it allows nonparticipants to free ride.
 - Future agreements should abandon the distinction between developing and developed countries, except for those countries designated by the United Nations as least-developed countries. When negotiating future agreements, WTO members would instead individually make a case for exceptions and longer transition periods.
- The WTO members, led by the Asia-Pacific countries, should reform the Appellate Body to address issues such as judicial overreach, prevent deliberations from exceeding agreed timelines, and limit the types of cases subject to appeal.
 - Reforms to the dispute settlement system should accompany efforts to address the broader underlying issues of the WTO.
 - If WTO members cannot reach agreement on reforms before December 2019, they should agree on interim emergency measures, including a one-year extension of the terms of the two current Appellate Body members whose terms will expire at the end of 2019 and a one-year moratorium on filing new appeal cases.

5. The Asia-Pacific region should lead efforts to anticipate trade rule challenges presented by new technologies and digital business models.

- Given that trade officials are busy dealing with the immediate and serious problems facing trade today, an independent group of senior experts from the Asia-Pacific region should be convened to advise the WTO and policymakers. This group should do the following:
 - Provide guidance on how new technologies such as 3D printing, robotics, and AI and digital business models will disrupt and be affected by trade rules and offer suggestions on how to overcome such disruptions;
 - Include stakeholders from the private sector, academia, and civil society;
 - Assess which existing trade rules and principles need to be updated, including intellectual property rights, standards, subsidies, investment, services, and other regulatory areas, and what those updates might be;
 - Propose a path forward, including whether a new framework must be developed to cover issues beyond the scope of trade rules such as consumer privacy, data protection, international taxation, competition, and cybersecurity.
- The countries of the Asia Pacific participating in the recently launched negotiations on trade aspects of e-commerce, under the leadership of Australia, Japan, and Singapore, should push for the conclusion of a plurilateral agreement by the next WTO Ministerial Meeting in June 2020.



The Asia-Pacific region would have the most to lose from a breakdown of the international trading system. Fortunately, it may also be the region best positioned to help.

- Japan, as G20 chair, can help lay the groundwork for the negotiations by building consensus around data governance and other issues related to e-commerce.
- The plurilateral negotiations should remain open to additional participants, and operate in a transparent manner, so that nonparticipant countries can decide whether and when to join an eventual agreement.

CONCLUSION

For the past year, the U.S.-China trade dispute has preoccupied policymakers in the region, while other important issues have been put on the back burner. Given the pressing trade challenges facing the region, it is critical for the countries of the Asia Pacific, including the United States and China, to pursue a positive and forward-looking agenda focused on updating trade rules, including the structural problems that led to the dispute in the first place.

The United States, which in the past would have led efforts to develop a solution, has retreated from its leadership role on trade. Other countries in the Asia Pacific have shown some promising signs of becoming more engaged, but they should step up and

take an even more active role, particularly considering how much they have gained and depend on trade's rules-based system.

The Asia-Pacific region would have the most to lose from a breakdown of the international trading system that would leave countries free to impose restrictions, from tariff increases to voluntary export restraints, and take dispute resolution into their own hands.

Fortunately, it may also be the region best positioned to help the WTO implementation reforms that address existing issues and anticipate future challenges. As one of the fastest growing and most open to trade regions in the world, the countries of the Asia-Pacific understand the importance of the international trading system. Furthermore, their experience negotiating complex deals with multiple countries such as the TPP/CPTPP and RCEP can help them push for meaningful changes and build consensus among economies of varying sizes and development levels.

At a time when trade looks like it is being derailed, the countries of the Asia Pacific, particularly those that are “middle powers” and trade-dependent economies, can help get it back on track.



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APPENDIX

FIGURE 5: KEY FTA ACTIVITY IN ASIA 2018/2019 - REGIONAL FTAS

FTA NAME	LATEST DEVELOPMENTS	CURRENT STATUS/NEXT STEPS
ASEAN-Australia-New Zealand Free Trade Agreement (ASEAN-ANZ FTA) Update	In September 2018, recommendations for upgrading the agreement endorsed at meeting of economics ministers from ASEAN, Australia and New Zealand.	Parties in process of discussing updates to agreement.
ASEAN-Hong Kong Free Trade Agreement	In November 2017, an agreement was concluded after three years of negotiations.	Pending ratification, expected to be implemented in 2019.
ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEP) Update	In March 2019, ASEAN Economic Ministers and Japan signed amendment to agreement to incorporate chapters on services and investment after two years of negotiations.	Pending ratification, expected to be implemented in 2019.
China-Japan-Korea Free Trade Agreement	Three rounds of negotiations were held in 2018 and 2019, the most recent held in Beijing in April.	Negotiations remain ongoing.
Comprehensive & Progressive Agreement for Trans-Pacific Partnership (CPTPP)	Agreement signed in March and entered into force in December 2018.	Pending ratification in Brunei, Peru, Chile, and Malaysia.
Eurasian Economic Union-China Free Trade Agreement	Agreement signed in May 2018.	Pending ratification
Eurasian Economic Union-Singapore Free Trade Agreement	Seventh round of negotiations held in March 2019.	Negotiations remain ongoing.
European Free Trade Association-Indonesia Comprehensive Economic Partnership Agreement	After several rounds of negotiations in the first half of the year, the agreement was signed in December 2019.	Pending ratification.
European Free Trade Association-Philippines Free Trade Agreement	In October 2018, the Philippines fully implemented the agreement, which was signed in 2016.	In force.
European Free Trade Association-Vietnam Free Trade Agreement	Sixteenth round of negotiations held in June 2018.	Negotiations remain ongoing.
MERCOSUR- Korea Free Trade Agreement	Negotiations officially began in May 2018, with two rounds of negotiations held so far.	Next round of negotiations scheduled for July.
MERCOSUR-Singapore Free Trade Agreement	First round of negotiations held in April 2019.	Negotiations remain ongoing.
Pacific Alliance Associate Memberships	Negotiations launched with Australia, Canada, New Zealand, and Singapore, with multiple rounds held in 2018. In July 2018, South Korea announced plans to launch negotiations for associate membership.	Negotiations remain ongoing.
Regional Comprehensive Economic Partnership (RCEP)	The 25th round of negotiations took place in February 2019.	Next round of negotiations scheduled May 2019, with goal to conclude by ministerial meeting in November 2019.
US-Mexico-Canada Free Trade Agreement (USMCA)	Agreement signed in November 2018.	Pending ratification.

FIGURE 6: KEY FTA ACTIVITY IN ASIA 2018/2019 - BILATERAL FTAS

FTA NAME	LATEST DEVELOPMENTS	CURRENT STATUS/NEXT STEPS
Australia-Hong Kong Free Trade Agreement (AHKFTA)	Agreement signed in March 2019.	Pending ratification.
Australia-Indonesia Comprehensive Economic Partnership Agreement (IA-CEPA)	Agreement signed in March 2019.	Pending ratification.
Australia-Peru Free Trade Agreement (PAFTA)	Agreement signed in February 2018.	Pending ratification.
Australia-United Kingdom Free Trade Agreement	Working group meetings held in mid-2018 to explore post-Brexit agreement.	Waiting for outcome of Brexit.
China-Chile Free Trade Agreement Update	In March 2019, updated agreement came into force	In force.
China-Israel Free Trade Agreement	Five rounds of negotiations held, most recent in February 2019.	Negotiations remain ongoing, with Israel pushing for completion in 2019.
China-Korea Free Trade Agreement Update	Fourth round of negotiations to update agreement held in April 2019.	Negotiations remain ongoing.
China-Mongolia Free Trade Agreement	Two joint feasibility meetings held, most recently in February 2019, paving the way for negotiations.	Under consideration.

(Continued on next page)



FIGURE 6: KEY FTA ACTIVITY IN ASIA 2018/2019 - BILATERAL FTAS (Continued)

FTA NAME	LATEST DEVELOPMENTS	CURRENT STATUS/NEXT STEPS
China-New Zealand Free Trade Agreement Update	Six rounds of negotiations to update agreement held, most recently in November 2018.	Negotiations remain ongoing, expected to be held in first half of 2019.
China-Pakistan Free Trade Agreement Update	In April 2019, the parties signed an update to their existing bilateral FTA.	Pending ratification.
China-Panama Free Trade Agreement	Fourth rounds of negotiations held in November 2018.	Negotiations remain ongoing.
China-Peru Free Trade Agreement Update	First round of negotiations to update agreement held in April 2019.	Negotiations remain ongoing.
China-Singapore Free Trade Agreement Update	Negotiations to update agreement concluded in November 2018.	Pending ratification.
China-Switzerland Free Trade Agreement Update	Joint study held in March 2018 to examine possible updates to existing FTA.	In force, waiting for negotiations to update agreement to begin.
EU-Australia Free Trade Agreement	Negotiations officially began in June 2018. Since then, two rounds of negotiations have been held, the most recent in November.	Negotiations remain ongoing.
EU-India Free Trade Agreement	In November 2018, the parties reportedly considered resuming negotiations that stalled in 2013.	Negotiations stalled.
EU-Indonesia Free Trade Agreement	Seventh round of negotiations held in March 2019.	Negotiations remain ongoing, expected to conclude by end of 2019.
EU-Japan Economic Partnership Agreement (EPA)	Agreement signed in July 2018 and entered into force in February 2019.	In force.
EU-Malaysia Free Trade Agreement	In May 2018, European Commission published an impact assessment of a prospective FTA, paving the way for resuming negotiations which have stalled since 2012.	Waiting or negotiations to resume.
EU-New Zealand Free Trade Agreement	Negotiations officially began in June of 2018. Since then, three rounds of negotiations have been held, the most recent in February, 2019.	Next rounds of negotiations scheduled for May and July 2019, with goal to conclude by end of 2019.
EU-Philippines Free Trade Agreement	In May 2018, European Commission published an impact assessment of a prospective FTA. Negotiations began in 2017.	Negotiations remain ongoing.
EU-Singapore Free Trade Agreement (EUSFTA)	Agreement signed in October 2018, and approved by European Parliament in February 2019.	Pending ratification.
EU-Vietnam Free Trade Agreement and Investment Protection Agreement (EVFTA and IPA)	In July 2018, the parties agreed on final texts, which the European Commission presented to the European Parliament in October of that year.	Parties expected to sign as early as June 2019.
Indonesia-Chile Comprehensive Economic Partnership Agreement	In November 2018, Chilean government approved agreement.	Pending ratification in Indonesia.
Indonesia-Korea Free Trade Agreement	In April 2019, negotiations resumed after talks stalled in 2014.	Negotiations remain ongoing.
India-Peru Free Trade Agreement	Fourth round of negotiations held in March 2019.	Negotiations remain ongoing.
India-Singapore Comprehensive Economic Cooperation Agreement	In September 2018, parties launched third review of existing agreement for possible updates.	Parties in process of consultation.
Japan-Turkey Economic Partnership Agreement	Fourteenth round of negotiations held in April 2019.	Negotiations remain ongoing.
Korea-Central America Free Trade Agreement (Costa Rica, Panama, Honduras, El Salvador, & Nicaragua)	Signed in February 2018, ratified by Costa Rica in March 2019.	Pending ratification by other parties
Korea- Chile Free Trade Agreement Update	In November 2018, negotiations launched to update existing agreement.	Negotiations remain ongoing.
Korea- Israel Free Trade Agreement	Sixth round of negotiations held in March 2018.	Negotiations remain ongoing.
Korea-Malaysia Free Trade Agreement	In March 2019, negotiations launched for a new bilateral FTA.	Negotiations remain ongoing, conclusion expected in 2019.
Korea-Philippines Free Trade Agreement	In April 2019, officials announced plans to launch negotiations	Waiting for negotiations to begin, parties aim to conclude in 2019.
Korea- Russia Free Trade Agreement	In June 2018, plans announced to launch negotiations.	Waiting for negotiations to begin.
US-Korea Free Trade Agreement Amendment (KORUS)	Amendments to KORUS ratified by Korea in December 2018.	In force.
Singapore-New Zealand Closer Economic Partnership Update	In November 2018, negotiations to update agreement concluded.	Pending ratification of update to agreement.



ENDNOTES

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