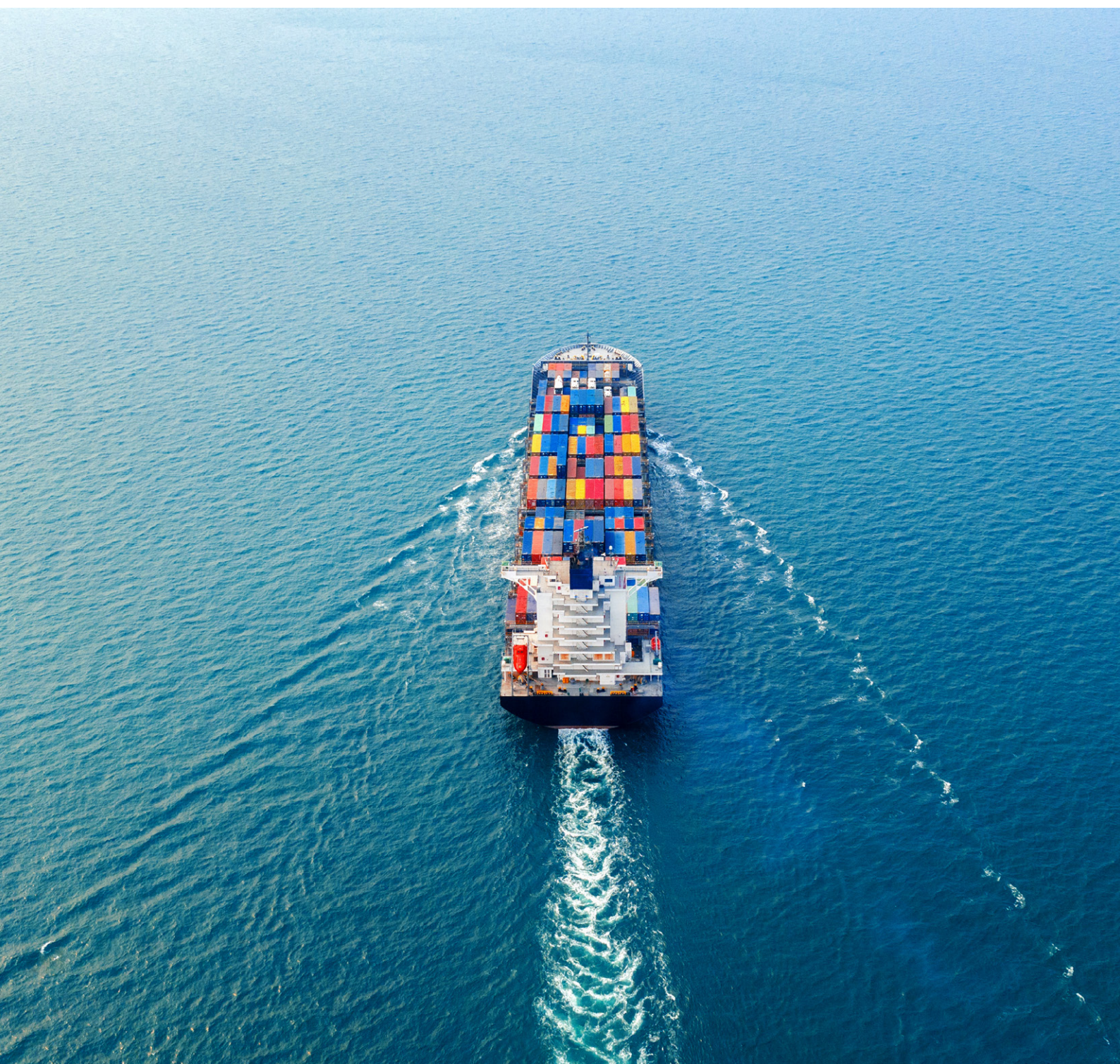


Making Globalization Work Better for Asia

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Executive Summary

Asia's economic growth and development have been unparalleled over the past 75 years. Poverty has declined continuously and more rapidly than at any time in recorded history, and significant welfare gains have been achieved. These achievements have been driven by Asia's growing participation in international trade and global value chains (GVCs), which underpin the globalization process. More broadly, globalization refers to the integration of economies that has been achieved through growing levels of international trade, finance, and investment, and through the mounting exchanges of people, ideas, and data.

Asia's economic integration continues to hold significant promises for the region's future growth, prosperity, and stability. Yet geo-economic and geopolitical developments of the last decade, the COVID-19 pandemic, and the Ukraine-Russia conflict showed how GVCs could transmit and amplify shocks across economies, making emerging markets more vulnerable. They reinforced pre-existing concerns about external dependencies and reignited discussions about self-sufficiency and strategic decoupling for the supply of critical goods and technologies. At the same time, they also highlighted the important role that trade and GVCs could play in accelerating the recovery from external shocks.

Trends toward slower international trade growth have also been magnified over concerns that globalization have not gone hand in hand with prosperity of the planet and of broader populations. The gradually eroding support for international trade in many countries is hitting Asia at a time when the region also faces mounting economic, political, geopolitical, socioeconomic, and climate challenges, which threaten to undermine economic recovery and growth following the pandemic crisis.

This briefing argues that resilience to the confluence of external risks can be built through openness and diversification. Furthermore, Asia's future growth will greatly depend on "upgrading" globalization, to meet the United Nations Sustainable Development Goals (SDGs), particularly those that pertain to environmental sustainability, economic equality, and digital inclusion. Part I describes a confluence of risks making Asia's globalization-driven growth more vulnerable. Part II looks at how improved trade and investment policies and business practices could help strengthen the resilience of Asian economies to external shocks. Part III looks at how Asia can transition to more sustainable, equitable, and digitally inclusive growth through better trade and investment policies.

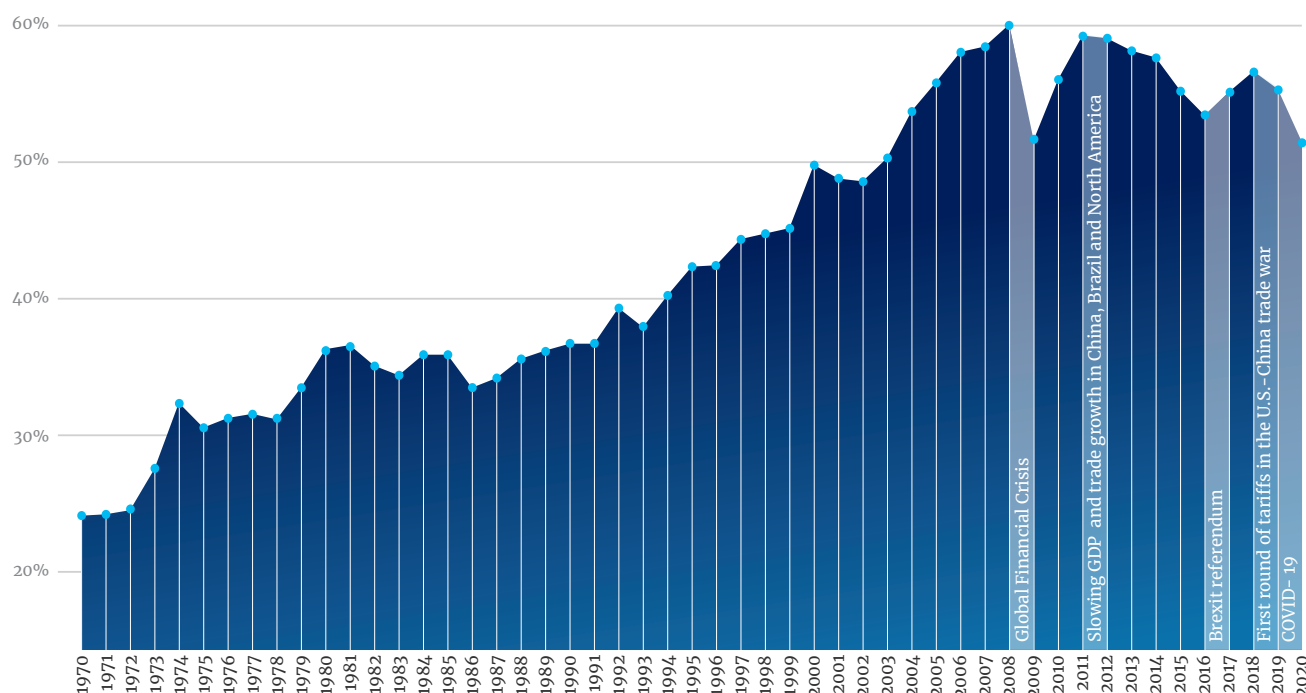
PART I – A NEW CONFLUENCE OF RISKS

Globalization has been Asia's growth engine. The significant decline in tariffs and global shipping and communication costs, and the deregulation of capital flows from the 1980s onwards, enabled global firms to invest and operate wherever it was most efficient, which helped facilitate the emergence of Asia's successful trade- and investment-driven growth model. Economies in Asia started playing a central role in global value chains (GVCs) thanks to their openness to trade and low labor costs. Trade grew almost unbridled for nearly four decades, increasing from 39 percent of world GDP in 1990 to 58 percent in 2018 (see Figure 1). The world today is more integrated than it was in 1914, when the previous age of globalization peaked. An estimated 70 percent of international trade flows through GVCs.¹

Yet from the earliest days of the World Trade Organization (WTO), globalization has been the subject of controversy. The dramatic increase in world trade and cross-border economic integration that began after the founding of the WTO in 1995 drove significant gains in productivity, global economic development, and welfare, but these gains came at increasingly high and visible costs.² Even as globalization lifted millions out of poverty, countries also grappled with imbalanced growth, income inequality, increases in carbon emissions, nature degradation, and the export of pollution to developing countries in Asia and elsewhere. The significant shifts in economic activity brought about by the growing integration of many Asian economies into GVCs also widened rural-urban development gaps and increased the divergence in economic prospects between skilled and non-skilled workers.³ While average income levels increased, extreme poverty and informality have remained widespread in many countries.

Global trade as a percentage of GDP stalled beginning in 2009

(Value of global trade as a % of GDP)



The move to shorten GVCs started after the global financial crisis of 2008, well before the heating up of U.S.-China trade tensions. An era of “slowbalization” followed—a gradual but sustained period of decline in the share of trade in global GDP and global integration more generally.⁴

Despite the overall slowing of trade, Asia continued to grow its share of global trade during this period, from 24 percent in 2008 to 36 percent in 2019.⁵ This significantly contributed to the region’s economic resilience during the pandemic.⁶ Asia also retained its position as the most attractive foreign direct investment (FDI) destination as a region, capturing 54 percent of global FDI in 2020. Global FDI decreased 35 percent in 2020, but inward FDI into Asia declined only 1.3 percent.⁷

Trade and investment flows also became more regional. In 2009, a third of FDI into Asia came from other Asian economies. In 2019, half did.⁸ Intra-Asian trade’s share in the region’s total trade reached 59 percent in 2020, its highest level in three decades.⁹

Asian economies have continued to pursue free-trade agreements that foster greater economic integration. Notably, a group of 15 regional economies signed the Regional Comprehensive Economic Partnership (RCEP), which came into force in January 2022. RCEP has created the largest free-trade area in history, with a population of around 2.1 billion and a 30 percent share of global GDP. In 2018, 11 economies also signed a Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Seven Asian economies have since applied or declared their intention to join the agreement. Together, the 11 signatories account for 13.4 percent of global GDP.

With its outsized role in global trade and FDI and high levels of regional economic integration, Asia is well-positioned to work toward reviving globalization. However, a confluence of geopolitical and climate, and socioeconomic risks, amplified by the pandemic, is now threatening the global connectedness that has underpinned Asian growth and prosperity.



Geopolitical risks

Concerns about China's geopolitical ambitions and rise as a strategic competitor led the U.S. and other economies to take a more security-driven approach and to start restricting access to critical technologies.¹⁰ In 2018, the U.S. Congress required the Department of Commerce to evolve the licensing requirements for firms working in multiple high-tech fields, including artificial intelligence and machine learning. Discussions about self-sufficiency and strategic decoupling also started gaining prominence on both sides of the Atlantic, leading to an escalation of geopolitical risks for global and regional companies.

The COVID-19 pandemic heightened concerns about strategic dependencies. It highlighted the extreme vulnerability of long and deeply enmeshed, just-in-time value chains, and the role that these could play in propagating economic shocks.

Confronted with shortages, inflation, and other pandemic-induced disruptions, governments implemented tariffs, restricted immigration, controlled exports of food, medicines, and medical devices, and hoarded critical supplies. Data from the International Trade Center shows that between March and May 2020, almost 90 countries implemented temporary trade measures restricting or banning exports.¹¹ The E.U. and India clamped down on vaccine exports. Germany prohibited the export of medical masks and respirators. The French and Chinese governments seized all their available masks. Import restrictions were also implemented, which delayed the response to the pandemic.

Some economies also issued calls to reshore the production of strategic commodities and to accelerate the decoupling of supply chains, notably from China. In April 2020, the Japanese government announced that it would allocate \$2 billion to help Japanese multinationals leave China.¹² Authorities in the U.S. and the E.U. ordered security reviews of their supply chains and critical materials. U.S. President Joe Biden signed Executive Order 14005 to create a future "Made in America" and pledged to spend \$300 billion in research to achieve technological self-reliance and expand the U.S. military-industrial base. Indian Prime Minister Narendra Modi started promoting self-reliance with his *Atmanirbhar Bharat* policy. While China remains the world's largest manufacturer of consumer electronics, tech firms are increasingly diversifying their supply chains. Apple and Google have shifted iPhone and Pixel phone manufacturing from China to Vietnam, for example, while Amazon's Fire TV devices now ship from India.

The world is dividing into competing geo-economic blocks, with different trade rules and standards, and increasingly separate technological value chains, notably in the semiconductor industry. The U.S. envisions sourcing critical materials and technologies from allies—economies whose views and values align with its own. It has reached agreements with Asian and European economies to cooperate on a new semiconductor strategy. The Quad, a group of four economies including Australia, India, Japan, and the U.S., have agreed to launch a Semiconductor Supply Chain Initiative.¹³ The E.U. is evolving its trade and investment policy to defend its strategic and economic interests "in a new geo-economic environment."¹⁴ Its draft European Chips Act and new Industrial Strategy aim to encourage the production of critical

materials in Europe using public subsidies. Japan has rolled out an economic security law to safeguard and subsidize critical technology sectors such as semiconductors. China is accelerating the development of its domestic semiconductor industry. Defensive trade instruments are increasingly being developed to address security concerns.

The Ukraine-Russia conflict that erupted in February 2022 is accelerating the divisions already under way and has further elevated discussions about supply chain resilience and national security.¹⁵ According to the International Food Policy Research Institute, more than 20 countries have implemented food export restrictions which could cover as much as 17 percent of globally traded calories in 2022.¹⁶

These developments show that geopolitical competition is now superseding international economic cooperation. As economies increasingly compete for strategic resources and technological leadership, global trade and investment flows will be reshaped in unprecedented ways. This could weigh heavily on the growth prospects of Asian economies, particularly those that are highly externally dependent. Risks of sanctions, export controls, and investment restrictions will increase. The bifurcation of technology standards will raise the cost and complexity of doing business. The competition over resources will increase the volatility of input prices, heightening the risks of resource shortages.

Climate risks

Climate change will affect production patterns and the comparative export advantage of some Asian economies. For example, a World Bank report estimates that the climate-related decrease in agricultural productivity in Vietnam could reduce the economy's GDP by more than 6.5 percent, assuming adjustments to changing weather patterns, and by up to 11 percent otherwise.¹⁷ Extreme weather events are expected to disrupt supply chains and global transportation routes at an increased frequency. A 2021 Disclosure Insight Action report indicates that the financial impact of climate change on global supply chains will reach almost \$1.3 trillion over the next five years.¹⁸

The COVID-19 pandemic has heightened the focus on climate change—another crisis threatening human lives and health, and the foundations of economic prosperity. Companies are under increasing pressure to intensify their environmental stewardship activities and to comply with growing environmental requirements.

Socioeconomic risks

Border closures, supply disruptions, and global demand shocks triggered by the pandemic led to reduced labor demand in many economies. In 2020, the first year of the pandemic, more than 80 million jobs were wiped out in Asia, according to an International Labor Organization (ILO) report.¹⁹ These losses have decimated incomes and pushed millions into working poverty, reversing progress in poverty reduction in the region. Widening economic inequalities coupled with soaring inflation have fueled greater populism in many countries that had already been

brewing, as populations became even more susceptible to narratives that exploited fear and confusion.

Pandemic-hit labor markets are also coinciding with demographic and workforce challenges in rapidly aging economies including China, Japan, and the four Asian Tigers of Hong Kong, Singapore, South Korea, and Taiwan. These economies will have to transition to more productive and skill-intensive economies, to generate new sources of growth, or else face the risk of declining growth prospects and downwardly mobile workforces, which threaten economic stability and social cohesion.



PART II: A BETTER APPROACH TO RESILIENCE

Building resilience through openness and diversification

The confluence of risks has heightened the focus on building resilience, defined here as the ability of an economic system to withstand external shocks like financial crises, pandemics, wars, or extreme weather events. Such events tend to disrupt supply, demand, transportation linkages, financial flows, and/or the movement of people across borders. Most recently, the COVID-19 pandemic triggered widespread and persistent supply chain disruptions. In response, a number of governments in Asia and beyond imposed trade restrictions and shortened GVCs. If these restrictions become long-lasting, they may instead undermine resilience rather than strengthen it. This section argues for building resilience through openness and diversification, with trade restrictions only used in a limited way to address legitimate security concerns, and with due consideration of their long-term geopolitical and sustainability impacts.

International trade plays a key role when essential items such as food and medicines are in short supply. Imports help overcome critical shortages, and provide access to the equipment, materials, and skills that are required to rebuild essential infrastructure and economies following natural disasters. Research has shown that export restrictions during multiple overlapping crises increase global economic losses. They disrupt global markets and create global product shortages, particularly in concentrated and specialized sectors where substitution is more difficult.²⁰ The stronger the export restrictions, the bigger the losses. During the COVID-19

pandemic, the hoarding of masks, personal protective equipment (PPE), vaccines, medical equipment, and food by some economies hampered the global crisis response. As climate change continues to intensify risks to food security, the most vulnerable countries and populations, such as those in developing economies in South Asia, will become more dependent on food imports to reduce food insecurity, food prices, and malnutrition during future periods of domestic shortages.

Export controls and bans also tend to have unpredictable negative effects on the economies that implement them. For instance, the decision to cap domestic prices and to ban exports of palm oil in Indonesia in early 2022 led mills to stockpile oil to sell it later at higher prices.²¹ Farmers and domestic consumers paid the price. When the U.S.-mandated export controls of semiconductor equipment to China, it created a global chip shortage that eventually affected U.S. consumers of cars and technology products.

Reducing strategic dependencies by reshoring and ally-shoring the production of strategic goods may be justified for critical national security technologies and military equipment. But the definition of strategic goods tends to be broadened unnecessarily in some cases. For example, the European Commission's study of strategic dependencies completed in 2021 found that the E.U. was highly dependent on external imports for only 137 products of the 5,000 products it reviewed, and these were mostly raw materials and related commodities that could easily be stored.²² Out of these 137 products, only 34, accounting for 0.6 percent of the value of all European imports, would be difficult to source in the E.U. or to substitute. For those specific goods, it was found that the E.U. could build up strategic stockpiles, which tends to also be the case for food, medical equipment, and energy resources.

While tariffs and other trade barriers are sometimes seen as a way to incentivize domestic production, such measures increase prices for companies or for consumers as producers must either pass on the cost of import tariffs in the form of higher prices or accept lower profit margins. Research shows that the costs of the U.S.-China trade war, estimated at some \$46 billion, were mostly borne by U.S. companies.²³ Higher import prices also increase domestic inflation, lowering real wages for households and spreading the economic pain.²⁴

Calls grew in the U.S. in mid-2022 for President Joe Biden to lift the import tariffs on Chinese-produced goods to address surging inflation. If the experience of the U.S. is any indication, tariffs and other trade measures, once levied, become hard to remove because of inertia and opposition from groups that benefit from the protectionist measures. Policymakers should therefore carefully consider the costs and benefits to ensure that policies intended to achieve specific objectives do not become a drag on growth.

A better approach is to build resilience through openness and diversification. Governments should aim to diversify and expand their sources of supply geographically, to enable substitutability and avoid reliance on single sources. Upgrading economies from low-value-added commodities and natural resource dependence, as well as investing in technologies that add value to basic

commodities, can also open up more sustainable sources of export revenue, in particular for developing Asian countries that need trade revenue to pay down the debt burdens they have built up during the COVID-19 pandemic. The UN has warned that developing economies face the risk of a “lost decade” if the debt burden is not addressed.

In addition, policies that promote investment, business creation, and innovation, combined with an openness to trade and support for human capital development in relevant sectors, can put countries on a path to expanding higher value-added and skill-intensive industries, which help economies capture more of the value of GVCs and reduce vulnerability to external shocks and price volatility.

Enforceable trade rules should be created to discipline the use of import and export controls and to facilitate access to essential products during emergencies.²⁵ Doing so could stem the otherwise negative economic and humanitarian impact of such restrictions. Some economies have taken positive steps in this regard. New Zealand and Singapore have committed to eliminate tariffs and to avoid controlling exports of 124 essential goods, including food and health care products. In 2020, 22 WTO members committed to avoiding the restriction of agricultural exports and agreed that emergency export restrictions should be targeted, proportionate, transparent, and temporary.²⁶ The WTO’s 12th Ministerial Conference concluded in June 2022 also produced a “Geneva Package,” which contains a provision to exempt food from export restrictions when purchased for humanitarian purposes.²⁷ Export controls targeting food products and inputs essential to their production such as seeds and fertilizers should also be disciplined. As recommended by the E.U., OECD, and the UN Economic and Social Commission for Asia, better information systems to encourage information sharing on product availability could help limit panic-driven policy decisions and drive coordinated responses during crises.

By the same token, the targeted transfer of intellectual property should be facilitated during emergencies to increase access to medicine, medical devices, and vaccines. The WTO’s TRIP-Plus IPR provisions include a waiver that enables emerging economies to manufacture medicines, essential medical equipment, or vaccines without patent licensing when there is an emergency. The WTO’s “Geneva Package” contains a new waiver of some license requirements for COVID-19 vaccines.²⁸ Developing economies should leverage these waivers to increase their access to critical supplies at an affordable cost during emergencies.

Finally, calls for ally-shoring should be considered carefully. Policymakers should consider whether global trade and supply chain challenges can be addressed through regional and multilateral forums, even as they carve out limited exceptions for technologies that are critical to national security and essential military equipment. Countries should work through existing multilateral institutions to form clearer guidelines and standards to identify such critical technologies, to help guard against an expansive view of critical goods and potentially the formation of a trade and investment bloc among rich, developed economies that would reduce the participation of some developing countries in GVCs, making GVCs less resilient and reducing the benefits of multilateral trade and investment.

PART III: MAKING TRADE AND INVESTMENT MORE SUSTAINABLE, EQUITABLE, AND DIGITALLY INCLUSIVE

Asia has the opportunity to play a more prominent role in making trade and investment work better, by being more sustainable for the planet, more equitable for broader populations, and more prepared for digital inclusion in the future. Doing so will improve and broaden support for globalization, especially amid the above confluence of risks to which Asia is not immune. The following sections of the briefing will address each of these areas and provide overall recommendations for policy and business decision makers.

Fostering greener trade and investment

Trade and investment have lifted millions out of poverty in Asia and will continue to deliver economic benefits. Yet Asia's rapid growth through integration into GVCs has come at a steep and exponentially rising environmental cost. Around a quarter of global greenhouse gas (GHG) emissions are linked to international trade flows, either at the point of production or in the transportation process. Asia emits 45 percent of global GHGs, 35 percent of which comes from Asia's heavily export-oriented industrial sector. The carbon intensity of Asia's industrial sector per unit of GDP is about 60 percent higher than the global average.²⁹ This section considers what changes would be required to fully realize the potential of trade and investment in achieving sustainable growth, which is a key part of the United Nations Sustainable Development Goals (SDGs).

To reach this goal, a large and growing coalition of countries are working toward transitioning to a net-zero future, which refers to the goal of lowering carbon emissions to zero or close to zero, with any remaining emissions being removed from the atmosphere by carbon sinks such as oceans or forests.³⁰ It will not be an easy task, as climate change will alter the comparative advantage of Asian economies, in particular the ability of some to continue exporting agricultural commodities.³¹ The export competitiveness of other Asian economies may decline as western economies begin to implement carbon pricing policies and strengthen due diligence requirements to meet their Nationally Determined Contributions.

But some economies could also see new growth opportunities, particularly those that grow their domestic capacity to produce environmental goods and services. Trade will also facilitate the transfer of technologies required to adapt to climate change and access to the raw materials needed to decarbonize. Conversely, escalating trade frictions could constrain access and slow down the low-carbon transition.

Trade and supply chains can lower the costs and accelerate the diffusion and uptake of low-carbon technologies by scaling their production and distribution. Trade can also give emerging economies, which will be important drivers of GHG emissions growth in years to come, access to the critical environmental technologies, services, and know-how needed for decarbonization. Research

shows that by 2040, the emissions of emerging economies could be 10 percent lower than they otherwise would have been by that year—resulting in 600 metric tons of CO² equivalent avoided—with better access to renewable energy sources, low-carbon technologies, and carbon capture and storage.³² Expanding access to environmental goods and services in emerging markets also creates new jobs related to the distribution, implementation, and maintenance of these technologies.

For all these reasons, higher trade flows are positively correlated with good environmental practices.³³ Well-designed trade agreements can also usher in better environmental practices. A recent E.U. law requires that new trade and investment agreements be linked to sustainable development, and new agreements with South Korea and Vietnam include strong, legally binding commitments to environmental protection.³⁴ The E.U. is also about to implement a set of trade measures, including the E.U. Carbon Border Adjustment Tax and the Corporate Sustainability Due Diligence Directive Deforestation Initiative, that will likely have an even greater transformative impact on the environmental practices of Asian commodity exporters and suppliers to E.U. companies.

Asia will require more investment to transition to net-zero carbon emissions and build climate-resilient economies. While China, Japan, and South Korea have invested regionally in renewable energy and digital infrastructure projects, intra-Asian investments still lag. In 2020, Asian investors held two-thirds of their assets and liabilities outside of Asia. Additionally, greenfield FDI into Asia fell 38 percent in 2020.³⁵ The ADB estimates that Asia will need to invest annually in infrastructure through 2030 to eradicate poverty, build resilient infrastructure, and adapt to climate change.

Tariff structures and non-tariff trade barriers are biased toward carbon-intensive fuels and industries, amounting to an implicit fossil fuel subsidy of \$550 billion to \$800 billion per year. That indicates that significant emissions gains could be made by implementing greener tariff structures.³⁶ But Asia is falling behind on promoting sustainability through trade and investment. Only one-third of Asian trade and investment agreements address environmental issues. The Asia-Pacific Economic Cooperation (APEC) regional forum in 2012 pledged to phase out inefficient fossil-fuel subsidies. Instead, they are on the rise. Therefore, trade agreements need to move beyond such aspirational goals to include relevant provisions that are substantive, measurable, binding, and enforceable.³⁷

The recently signed RCEP also falls short in terms of promoting sustainable development. Although the agreement states that sustainable development is one of its goals, its sustainable development provisions lack an enforcement mechanism. The agreement also lacks provisions dealing with environmental and labor protection, and falls short in reinforcing investor obligations with respect to corporate governance.

Despite the lack of ambition and enforceable standards in regional trade agreements, Asian businesses increasingly see strong sustainability standards as

important to their future export competitiveness. In July 2022, a group of Asia Business Council members comprised of close to 50 CEOs and Chairmen of the region's largest private sector companies issued a statement arguing that climate change and nature loss are putting Asia's future growth and competitiveness at risk. They committed to drawing up concrete pathways to net-zero, working toward effective climate and sustainable governance on their boards, leveraging private capital for climate mitigation and natural capital solutions, and contributing to innovation to address climate change and nature loss. The public and private sectors must work together to foster greener development.

The following are priority measures that could help foster sustainability in trade and investment:

- **Removing trade barriers on essential goods and green products and services.** Trade agreements should prioritize removing import and export restrictions on essential goods. They should also lower tariffs on green products and services to eliminate tariff biases toward carbon-intensive products. Research shows that equalizing tariffs on carbon-intensive and low-carbon goods would reduce CO₂ emissions on a scale comparable to the estimated impacts of some of the world's most significant actual or proposed emissions reductions policies, while leaving global real income unchanged or slightly higher.³⁸ Trade agreements should simultaneously liberalize trade in the technical assistance and ancillary services increasingly required to install, operate, and maintain environmental goods and facilitate the transfer of green technologies internationally.³⁹ These steps would allow developing economies to build competitive industries and become global suppliers of environmental goods. While negotiations to liberalize tariffs for environmental goods have thus far proven difficult, countries could consider first moving ahead with the lifting of "nuisance tariffs" that cost more to collect than the revenue generated.⁴⁰
- **Easing access to investment financing and insurance, and providing tax credits and other forms of industry support to attract new inbound investments, particularly in low-carbon technologies.** Projects that deliver on social and environmental goals tend to have a higher risk profile and/or a lower and longer return on investment. Policies should promote public-private risk-sharing and co-financing to improve the risk-return and profitability profile of these projects. While promoting new investments, governments should also phase out restrictive investment policies implemented during the pandemic.
- **Making trade rules fit for purpose and intensifying efforts to support liberal trade and investment regimes.** Some of the regional trade agreements in Asia have not yet incorporated rules that are fit to address issues that arose during the pandemic, such as export bans and trade restrictions. To amplify the trade creation effect of RCEP, the region's largest trade agreement, policymakers should cultivate RCEP's potential as a "living document" by activating the built-in work plan of the agreement, which contains a roadmap for deepening its provisions and expanding its coverage in the future.⁴¹

- **Strengthening business efforts to meet climate goals through the development of concrete and measurable business pathways to net zero.** These pathways should align businesses with the Nationally Determined Contributions of their home economies, while also generating new employment opportunities in the green economy and fostering continued progress toward the SDGs.

Japan's Embrace of Free-Trade Agreements

For Japan, the launch of the Regional Comprehensive Economic Partnership (RCEP) in January 2022 marked an important milestone in its regional and international trade policy. Since the late 2010s, Japan has consolidated its status as a key player in trade integration in Asia and globally, as reflected in its participation and leadership in multiple free-trade agreements (FTAs). Japan, which is a key beneficiary of trade in the past, is today a staunch supporter of free trade. As macro risks and rising protectionism in countries worldwide threaten to reverse globalization, Japan can help advance broader goals that have been outlined in this briefing, namely sustainability, equality and digital inclusion. This is particularly true in the realms of setting labor standards and addressing environmental issues. Indeed, the country stands to benefit from trade in the future as it continues to embrace trade integration through major FTAs and economic frameworks.

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

A prominent example of Japan's central role in promoting free trade is its staunch support of the Trans-Pacific Partnership (TPP). Externally, an important factor was China's growing influence in global rulemaking through institutions such as the Asian Infrastructure Investment Bank, which the U.S. and Japan did not join.⁴² In the domestic arena, it was the late Prime Minister Shinzo Abe's political determination that placed Japan in a leadership position for pushing forward the FTA.⁴³

Indeed, Japan emerged as a strong advocate for the TPP in the spring of 2017, despite U.S. withdrawal under President Trump in January 2017.⁴⁴ Almost all the TPP-11-related meetings from July 2017 to January 2018 were led by Japan, which expanded the TPP headquarters and sent negotiators to other countries for discussions.⁴⁵ In March 2018, the Abe administration successfully facilitated an agreement by 11 countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam) in what became the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP).⁴⁶

Compared to bilateral FTAs, the CPTPP offers higher protection of proprietary technology and intellectual property rights to Japanese companies in addition to facilitating market access.⁴⁷ This is important to Japanese manufacturers which are seeing a steady rise in overseas production, a trend that is expected to continue because of Japan's demographics and the slowing growth in domestic consumption.⁴⁸ For the Abe administration, the CPTPP was an avenue to set higher standards and more stringent rules as a precedent against China, in areas such

as electronic commerce, government procurement, state-owned enterprises and designated monopolies, and the environment.⁴⁹ At the time, the CPTPP was also a bulwark against the Trump administration's "America First" foreign policy, an issue that has arguably been overtaken by recent developments such as the Indo-Pacific Economic Framework (IPEF) under the Biden administration (see discussion below).

Japan-E.U. Economic Partnership Agreement

Apart from the CPTPP, another important pillar of Abenomics was the Japan-E.U. Economic Partnership Agreement which came into force in February 2019. With an emphasis on the removal of tariffs as well as the elimination of non-tariff trade barriers, such as by simplifying approval procedures for medical technology and recognizing European product standards for hydrogen-powered vehicles, the Agreement is seen as creating new opportunities in trade for Japanese and European companies.⁵⁰ In terms of sectors, the key beneficiaries are Japan's automotive, electronics, and fine chemicals industries and the European Union's agriculture, food manufacturing, pharmaceuticals, and mechanical and electrical engineering industries.⁵¹ The FTA also sent a strong signal from Japan and the E.U. supporting the modernization of global trade rules in sustainability, industrial standards, and intellectual property rights.⁵²

Regional Comprehensive Economic Partnership (RCEP)

While the RCEP has been criticized for its low degree of trade liberalization and lack of provisions for the protection of workers and the environment, RCEP signatories have arguably made more inroads than what was achieved at the WTO negotiations, opening more than 100 service sectors such as finance, telecommunications, and tourism, and championing new business models in e-commerce, fintech, and more.⁵³ Apart from Japan, the RCEP includes 14 other countries in the Asia-Pacific region (Australia, Brunei, Cambodia, China, Indonesia, South Korea, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, Thailand, and Vietnam) that collectively account for 30 percent of global GDP, meaning that 90 percent of tariffs will be eliminated within one of the world's largest trading blocs.⁵⁴

For Japan, the RCEP is noteworthy for several reasons. First, when quantifying the effect of the RCEP on export changes, Japan is expected to benefit the most from tariff concessions. A study by the United Nations Conference on Trade and Development (UNCTAD) calculates that Japan's exports would rise by about \$20.2 billion overall, compared to an increase of \$11.2 billion for China and \$6.7 billion for South Korea.⁵⁵ Japan's gains in exports include \$15.7 billion driven by trade diversion away from non-RCEP economies and \$4.5 billion driven by trade creation due to lower tariffs, with the total figure equivalent to 5.5 percent of Japan's exports to RCEP countries in 2019.⁵⁶

Second, the RCEP has the potential to stabilize Japan's economic relations with China and South Korea, both of which suffer from political tensions and historical animosity. In fact, among the 15 RCEP signatories, the only countries that had not entered into economic partnership agreements with each other were Japan and China, and Japan and South Korea.⁵⁷ Under RCEP, tariffs will be eliminated in phases on 86 percent and 83 percent of Japanese exports to China and South Korea respectively, a significant leap from the tariff-free rate of 8.4 percent and 16 percent prior to the agreement.⁵⁸ RCEP is thus seen to rectify a missing link in the supply chains of East Asia by bringing Japan, China, and South Korea into a single trade bloc.

Third, RCEP is seen as a “living agreement” with prospects of future evolution.⁵⁹ The establishment of an RCEP Secretariat, along with RCEP Ministerial and Joint Committee meetings, presents an opportunity for Japan to lead discussions on environment and labor issues that are not currently found in the RCEP. Ongoing discussions under the auspices of the RCEP can build on previous attempts to standardize Environmental, Social, and Governance (ESG) regulations in the region.⁶⁰ Japan’s potential leadership role would also be consistent with Prime Minister Fumio Kishida’s “New Form of Capitalism,” which includes a pillar on green and digital initiatives and emphasizes the importance of the transition to carbon neutrality.⁶¹

Indo-Pacific Economic Framework (IPEF)

In addition to the FTAs discussed above, also relevant is the Indo-Pacific Economic Framework (IPEF), which was launched in May 2022 and is led by the United States. While not an FTA, IPEF seeks to establish common rules to achieve robust digital connectivity, strong labor and environmental standards, clean energy practices, resilient supply chains, and fair business.⁶² Japan and other signatories (Australia, Brunei, Fiji, India, Indonesia, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Thailand, and Vietnam) may welcome IPEF as a counterbalance to China, which was excluded from the economic framework, though IPEF has been described as “a hamburger without the beef” because it does not offer more access to the vast market in the United States when Congress is unlikely to support tariff reductions.⁶³ On a positive note, some argue that a “talking shop” may be preferable to not talking at all.⁶⁴



Improving livelihoods and narrowing economic inequalities

As Asia looks to rebuild from the economic damage of COVID-19, fostering more equitable trade-related growth and improving the livelihoods of all will be key. The role of trade as an engine of economic prosperity and driver of poverty reduction for many Asian economies is well documented. Trade was the special ingredient that transformed some Asian economies into “tigers” and “dragons,” enabling them to emerge on the global scene as a new force of economic gravity. Other economies in Asia also saw remarkable progress, with continuously falling poverty rates and substantial increases in socioeconomic welfare.⁶⁵

At the same time, decades of unfettered globalization have created winners and losers. For example, trade can increase the premium earned by skilled workers while suppressing the wages of lower-skilled workers, if labor markets are not responsive.⁶⁶ The benefits from trade need to be distributed more evenly among all rungs of society, in order to not only spread prosperity more broadly but also to ensure that societies remain open to trade. The COVID-19 pandemic has exposed and worsened pre-existing socioeconomic inequalities from Asia's growing integration in GVCs between economies, rural and urban areas, skilled and non-skilled workers, and those employed in the informal sector. Both the pandemic and its containment measures have resulted in unprecedented socioeconomic disruptions and accentuated income inequality. Workplace closures and mobility restrictions have severely affected employment and incomes throughout Asia. Millions of workers were driven below the extreme or moderate poverty line. The poor and other vulnerable groups, including low-skilled workers, young people, and women, were disproportionately affected. These developments also aggravate social tensions, as described in the earlier section in this briefing on socioeconomic risks.

The ripple effects of the Ukraine-Russia conflict, including increased inflation and disruptions in global supply chains, are further affecting labor markets, posing the risk that the number of hours worked globally could continue to fall through the remainder of 2022.⁶⁷ These economic headwinds could further dampen popular enthusiasm for global economic integration, where it is perceived as benefiting a select few, and lead to calls for protectionist measures to shield jobs and livelihoods. Policymakers and businesses have a role to play in ensuring that the benefits of trade are spread more widely, including by:

- **Investing in human capital development to enable workers to take advantage of new outward-oriented economic opportunities.** This will require building frameworks for public-private cooperation to identify and predict current and future skill gaps in the export sector. These analyses should shape longer-term educational strategies as well as targeted training programs. Education should be made accessible to people from all backgrounds, with incentives for selecting educational programs that coincide with areas of future export sector demand growth. Training programs should involve upskilling as well as reskilling for workers whose jobs are likely to be affected by trade-related employment changes. At the same time, there should be an emphasis on transferable skills such as teamwork and problem-solving to prepare workers for the rapid changes that come with globalization and technological advancements.⁶⁸ Where further trade liberalization occurs, it should be communicated clearly and phased in gradually to allow industry and labor markets time to adjust.⁶⁹
- **Promoting greater labor mobility by lowering barriers such as limits on migration and burdensome licensing requirements, while compensating workers whose jobs are affected by globalization.** Projections carried out for ASEAN economies have found that regional trade integration can go further in promoting overall welfare if, at the same time, labor mobility is made

less costly for all workers.⁷⁰ Labor mobility can also ease the adjustment to structural and demographic changes in the wake of the pandemic and as populations in many Asian countries grow older. Government revenue from trade-related growth should be funneled toward aid for workers in sectors affected by import competition, in particular on supporting them as they receive retraining and/or seek new employment.⁷¹

- **Removing export barriers that disproportionately affect certain groups.** “Pink tariffs,” for example, are barriers to export on industries that are disproportionately produced and consumed by women, such as textiles and agriculture.⁷² Regulatory barriers in agriculture largely impact poor agricultural workers. Fixed trade costs and restrictive standards tend to have an outsized effect on small and medium enterprises (SMEs)—which make up two out of three private-sector jobs in Asia.⁷³ Conversely, trade facilitation programs can help SMEs with fewer resources access international markets.

Bridging the digital divide and ensuring digital readiness

With the growth of online platforms facilitating the exchange of good and services with the click of a button, digital trade growth can enable a greater number of people and firms to participate in globalization and reap its benefits. Data from the ADB shows that the growth of digital trade and digitally enabled services exports (DSTs) is associated with higher GDP and GNI per capita in Asia.⁷⁴ Globally, the region is the world’s second largest trader of digital services after the E.U. and has experienced the fastest DST growth of all regions.⁷⁵ In 2019, business-to-consumer digital platform revenues in Asia reached \$1.8 trillion, about 6 percent of regional GDP.⁷⁶ The ADB has estimated that a 20 percent increase in the size of the digital sector over the five years from 2021 to 2025 would increase the value of Asia’s trade by over \$1 trillion per year, or the equivalent of nearly 7 percent of the value of the region’s trade in 2020, and create about 65 million additional jobs annually, equivalent to nearly 4 percent of the region’s 2020 baseline.⁷⁷

Additionally, between 2003 and 2020, 24 percent of Asia’s inbound FDI went into digital services.⁷⁸ Greenfield FDI in digital services contracted only 9.7 percent during the pandemic, against 57.9 percent for non-digital services and 28.6 percent for manufacturing, indicating the strong attractiveness of the digital services sector and potential for future growth.

DST and digital services FDI can accelerate growth and convergence between Asian economies, enabling emerging economies to acquire the knowledge, services, and technologies that can help them move up the value chain. It also facilitates their broader participation in international trade. Some economies like Nepal, whose services exports contributed 60 percent to the nation’s GDP in 2019, have even been able to bypass traditional industrial development pathways thanks to DST.⁷⁹ Evidence suggests that lowering regulatory barriers to the expansion of DST also leads to gains in backward and forward GVC participation in manufacturing and services.⁸⁰

DST offers opportunities for geographically remote or less industrialized economies to integrate into global markets, thus fostering growth that is more inclusive of broader populations. Online marketplaces also create avenues for micro and small and medium enterprises (MSMEs) to grow by expanding their access to export markets, to the market data that can drive their export competitiveness, and to critical financing, insurance, and business advisory services. As MSMEs account for a very significant share of employment in Asia, enabling their success is critical for achieving inclusive growth. DSTs also enhance inclusivity by creating new jobs, bringing improvements to agricultural productivity and farmers' incomes, increasing average disposable incomes, and by supporting the financial inclusion of poor communities and their access to health, insurance, and education.

Given the size of its economy, Asia still has a relatively small share of digital services exports.⁸¹ Despite significant gains in internet access over the past few years, nearly 40 percent of the population in the Asia-Pacific region remains offline, and access to high-quality broadband services is still limited.⁸² To fully realize the potential gains of DSTs and digital services FDI, Asian economies should manage the distributional impact of digital trade growth. Key recommendations include:

- **Bridging the digital divide and enhancing the readiness of workers to participate in the digital economy.** Governments should prioritize investing in digital infrastructures and connectivity, to give broader access to mobile and broadband services at an affordable cost, and to secure cross-border payment solutions that are required to spur the growth of e-commerce and DST. What's more, the globalization of digital services is fostering a new international division of labor. Workers who are less prepared to participate in the digital economy could be left behind. A recent OECD study shows that the length of education and worker skills are positively correlated with greater DST. To spread the gains from DST more broadly, governments should therefore upskill or reskill their workers, helping them expand their digital and language skills.⁸³ This will help mitigate negative distributional impacts for DST expansion.
- **Removing barriers to digital trade and FDI.** Barriers to the growth of DST and FDI should be reduced. These include data access and transfer limitations, and restrictions on FDI in digital services such as limitations on foreign equity and ownership, licensing requirements, and the absence of mutual recognition of qualifications for legal and other professional services.
- **Making data governance rules fit for purpose.** Policies that protect personal data and enhance cybersecurity are legitimate and important. But governments should balance national security, economic growth and inclusivity objectives when designing data governance rules, to avoid unduly restricting cross-border data flows and impeding the development of DST. Data localization rules should focus on data specifically related to national security.

- **Reducing regulatory heterogeneity.** Data governance rules are also increasingly heterogeneous. The trade costs associated with the regulatory complexity, and with the various data localization requirements, are increasingly minimizing the export prospects of MSMEs. Six digital trade agreements (DTAs) involving Asian economies have been signed and bilateral discussions to create others are underway. This could increase the divergence of rules and create a “digital noodle bowl.” Data governance rules need to be better aligned across Asian economies.
- **Protecting digital workers’ rights:** The extraterritoriality or precarity of many digital services jobs reduces workers’ rights and their access to social security. The issue should be addressed to avoid worsening socioeconomic inequalities among workers in formal and informal sectors.

Businesses are well-positioned to help governments keep pace with emerging needs for skills and infrastructure development to facilitate digital trade, and to help design rules that will be fit for upcoming evolutions in the digital economy.



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Conclusion

Globalization has enabled decades of socioeconomic progress in Asia, and international trade and investment will remain essential to the region's growth prospects and future prosperity. But the cumulative disruptions of the past five years have exposed inherent risks of economic integration and the fragility of global value chains, thereby reinforcing protectionist trends that were already underway. The world's major economies are turning inwards, forming trade blocs with allies, and value chains are becoming increasingly regional.

Trade regionalization presents significant growth opportunities for Asia, and intra-Asian trade will continue to generate improvements in productivity and living standards in the region. From an economic standpoint, the regionalization of international trade is preferable to its entire collapse.

At the same time, Asia, and the world, are facing a confluence of risks, from intensifying geopolitical rivalries to devastating consequences of climate change to growing socioeconomic tensions within economies, not to mention the potential emergence of new and more deadly zoonotic diseases. Many solutions to these challenges are global public goods, and these may become harder to attain. The division of the world into competing geo-economic blocks is forcing Asian economies to take sides and threatening to destabilize the region. These developments will deter trade and investment and influence Asia's future growth prospects. The growing heterogeneity and regionalization of standards is also elevating trade costs and disadvantaging MSMEs and Asia's weaker economies.

A revived globalization that works better for the environment and for all of society will be essential to drive Asia's future prosperity. Its balance of costs and benefits will not improve without concerted efforts by policymakers and businesses. Trade and investments will need to support the attainment of sustainability goals, especially decarbonization, as greener trade produces better growth and development outcomes. Trade will have to be more inclusive of low-skilled workers everywhere and deliver benefits for all. Workers need to be prepared for growing digital services trade in the future.

Despite its shortcomings, the international trade and investment system has been the primary driver of the relative peace and prosperity that Asia and the world have enjoyed for 75 years. Its revival and reworking should become a priority.

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