

Talking points (Draft)

At the Panel Session 2 :

New Issues of Regional Trade and Investment Liberalization

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1. Connectivity enhancement in Asia-Pacific: frameworks, steps, and contemporary challenges

The rapid development of transportation and communication technologies has enormously enhanced intra-regional connectivity in Asia Pacific economies. As a result, intra-regional movements of goods, services and tourists have increased a great deal in the past decades. Until very recently, East Asian regionalism had been nurtured not by political and institutional arrangements but by sheer market forces such as a geographical proximity, the increasingly liberal trade regimes of East Asian economies, and exceptionally high growth of China in the past few decades, active utilization of natural supply chains and production fragmentation prevailing especially in East Asia as the global manufacturing power house, and East Asia's self-help response against global hedge funds originating from financially advanced economies.

At the trans-border regional micro level, significant regional cooperation schemes have been developed as evident in the Great Mekong River Development Area and formulation of Pan-Yellow Sea economic sphere. Both supply chain and production fragmentation have been reinforced by geographical proximity and differential factor endowments to generate closer economic linkages at the cross-border level particularly when neighboring countries develop open cross-border regions and supra-regions as a new national development strategy.

While observing significant functional and formal integration processes in terms of deepening trade interdependence and cross-border investment flows through a web of intra-regional FTAs and intra-regional self-help financial cooperation as institutionalized in the Chiangmai Initiative (CMI), the recent unprecedented global financial crisis has slowed down the expansion of intra-regional economic connectivity and but also made the concept of the East Asian Community regain its momentum to recover from global "new normal" phenomenon. Against this backdrop, the conclusion of TPP in 2015 and on-going RCEP negotiation provided a great potential birth of the largest mega economic blocs in the world. Together with the APEC movement toward trade and investment facilitation and liberalization, Asia Pacific economies have progressed consistently toward a closely linked economic mega region.

Toward this goal of East Asian community building, it is very important that both the bottom-up and top-down developments need to be discussed because of their inherent complementary nature and subsequent mutual reinforcement. Both developments have contributed a great deal to foster East Asian regionalism. Although a formal framework of “East Asian Economic Community” has emerged in the ASEAN+3(China, Japan, and Korea; hereafter named CJK) entity, the real driving force toward an East Asian Community needs to come from the ‘Big Three’ economies in Northeast Asian in terms of economic size and political influence, namely China, Japan and Korea. Until recently, ASEAN has played more of a leadership role than the other three countries by developing an active regional cooperation mechanism via ASEAN plus CJK framework and recently the Regional Comprehensive Economic Agreement (RCEP) particularly after the Asian financial crisis. In May 2010, they agreed to establish a secretariat’s office in Seoul to work for the trilateral summit meetings. Most importantly, the big three agreed to elevate hitherto on-going trilateral FTA studies at a think tank level to an official study format with participation of respective government officials. Finally, CJK have begun negotiations for the CJK trilateral FTA. In due course of formalizing the trilateral FTA, CJK would agree on diverse trans-border cooperation mechanisms, which would lead to a conclusion of the RCEP.

An economic integration involves unifying economic policies through the partial or full abolition of tariff and non-tariff barriers to trade, investments and factor movement across borders. It ranges typically from preferential trade arrangements, to custom unions, to fuller economic integration with some diverse forms, including capital and labor movement, and finally to a supra national entity as seen in the European Union. In the course of upgrading and deepening of economic integration, economic communities naturally evolve into political unions over time.

Perhaps, the greatest challenge to increase significantly the intra-regional connectivity in the region would be the sudden rise of anti-globalization and return to protectionist trade regime as Mr. Donald Trump was elected recently the next President of the United States. Together with the BREXIT, the election of Mr. Trump has rocked steadily practiced liberalism in the international trade and investment system in the post-war era. The TPP being scrapped by Mr. Trump and the US congress at least for the time being, dose the Asia Pacific mega deal lose its steam entirely? How much and to what extent the emerging anti-globalization sentiment would affect on-going functional and formal integration efforts in East Asia remains to be seen. In order to push an East Asian formal integration forward, the RCEP although far lower than TPP in terms of its quality needs to be concluded as a building block to a wider and deeper formal integration such as Free Trade Area of the Asia-Pacific (FTAAP). Then, it can help revive the scrapped TPP and eventual amalgamation of RCEP and TPP down the road.

2. Participation in GVCs: any risks from the web of FTAs in Asia Pacific

In the process of deepening GVCs, both input and output devices in finer technological segmentation have been increasingly crossing the borders of the three countries. In Particular, production has become increasingly fragmented as a result of growing regional

and global value chains (GVCs), with components and parts crossing numerous international borders as market forces dictate. This trend has resulted in faster growth in intermediate inputs than in the trade in final goods. This new pattern of production has also been prevalent in Asia. The IMF provided empirical evidence that from 1995 to 2013 to indicate that Asia's trade in intermediate goods grew by a factor of six, while trade in final goods grew almost four-fold. This trend in Asia compares with fourfold and threefold increases of trade in intermediate and final goods, respectively, in the rest of the world.

IMF evidence (2015) also suggests that integration into GVCs brings benefits to participating economies beyond those traditionally associated with international trade in final goods. This outcome was made feasible through exploiting finer competitive advantages and both economies of scale and scope. The rise of GVCs has two important macroeconomic implications: One relates to the increase in interconnectedness among countries, the other to the impact of the exchange rate, which could be dampened or amplified depending on an economy's position in the GVC because the import of intermediate goods in GVC are also inputs into exports. A standard GVC encompasses a number of production stages, from upstream products conception to midstream assembly and then downstream branding and marketing.

Given the growing interconnectedness of countries through GVCs and joint ventures, free trade deals have reinforced trade and intra-regional cross-border FDI flows in East Asia to take advantage of geographical proximity, differential factor endowments, and the attractiveness of huge consumer markets. As a result, the Asian trade network is increasingly fragmented and results in higher dependence on supplies of goods and services between ASEAN and East Asian countries on the basis of the OECD input-output Bilateral Trade Databases. As a consequence, production fragmentation of major companies on the one hand, and cross-border investments in the form of joint ventures among multinational firms and local ones on the other, have been more visible. This pattern is likely to be a characteristic of a viable East Asian economic community.

Joint ventures among multinational companies originating in different countries have also become more common and aim to realize win-win solutions in global competitions. Despite ongoing diplomatic uneasiness about historical issues between Korea and Japan, the companies of the two countries have continued to conduct joint investments to maximize their complementarity. Both participation in GVCs and joint ventures have been an important driving force to increase FDI across nations, especially in East Asia.

Out of the complex web of regional FTA networks, TPP should be viewed as the most significant in accelerating GVCs and cross-border FDI flows in the Asia-Pacific region. Indeed, the TPP is a game changer in that it will usher in new trade rules that will qualitatively shift the scope of market liberalization and tariff elimination for trade and investment flows. Cross-border investment creates jobs. It also invigorates the regional value chains, assigning diverse functions to different locations for competitive advantages. The TPP will propel investment through public-private partnerships between countries, and investor-state disputes will escalate.

However, the much heralded TPP appears to be scrapped for the time being or entirely as the US President-elect Donald Trump and the Republican Party decided not to ratify the TPP. Whatever forms Mr. Trump's policies might take once he takes office, his worldview suggests based on his election campaigns and policy agenda that the US will no longer attempt to play a central role in shaping the world's trading system. A mercantilist zero-sum view of the world in which economies are intrinsically in competition and current account deficits *prima facie* reflect cheating by trade partners is deeply worrying development.

However, it is very important to bear in mind the new trade rules embedded in the TPP as highlighted below. They need to be adopted by Asia-Pacific economies selectively and even in step by step fashion and as best practices of private companies' to follow in the years ahead:

- Lower tariff and nontariff barriers on goods through eventual elimination of all tariffs on industrial products and most tariffs and quotas on agricultural products;
- Greater service sector liberalization with enhanced disciplines, such as nondiscriminatory and minimum standard of treatment, along with certain exceptions;
- Additional intellectual property rights protections in patent, copyrights, trademarks, and trade secrets; first specific data protection provisions for biologic drugs and new criminal penalties for cyber theft of trade secrets;
- Investment protections that guarantee nondiscriminatory treatment, minimum standard of treatment and other provisions to protect foreign investment, balanced by provisions to protect a state's right to regulate in the public interest;
- Enforceable provisions designed to provide minimum standards of labor and environmental protection in TPP countries;
- Commitments, without an enforcement mechanism, to avoid currency manipulation, provide transparency and reporting concerning monetary policy, and engage in regulatory dialogue among TPP parties;
- Digital trade commitments to promote the free flow of data and to prevent data localization, except for data localization in financial services, alongside commitments on privacy and exceptions for legitimate public policy purposes;
- Enhanced regulatory transparency and due process provisions in standards-setting
- The most expansive disciplines on state-owned enterprises ever in a U.S. FTA or the WTO, albeit with exceptions, the advance fair competition with private firms based on commercial considerations.

In the medium term, the quality of RCEP needs to be enhanced on a par with the trade rules contained in the TPP to expedite a genuine free trade regime in the region. Then, it would be ready to get combined with TPP when it revives down the road.

Given new normal era characterized secular stagnation, massive unemployment, and rising income inequality, we need to recognize why anti-globalism has been increasingly popular. The US presidential election result indicates that a vast majority of common people believe that they are victims rather than beneficiaries of free trade regime as they suffer from income polarization. Therefore, a new international trading system needs to be inclusive by making doors more open for small and medium sized enterprises. We need to address “inclusive trade policy” in a regional scale as well as global scale.

Given the global “new normal”, characterized by slow growth, low employment and subsequent income polarization, the leaders of major economies, advanced and developing, have started to discuss policy priorities for inclusive growth. Social and economic inclusion lies at the heart of the World Bank’s goals to eliminate poverty and boost shared prosperity. Trade and investment liberalization measures must consider distributional impacts to various economic agents due to globalization.

3. Phasing out TBT and SPS: Room for Meaningful Progress;

Technical barriers to trade (TBTs), a category of nontariff barriers to trade, are the widely divergent measures that countries use to regulate markets, protect their consumers, or preserve their natural resources (among other objectives), but they also can be used (or perceived by foreign countries) to discriminate against imports in order to protect domestic industries.

The 2012 classification of non-tariff measures (NTMs) developed by the Multi-Agency Support (MAST), a working group of eight international organizations, classifies TBTs as one of 16 NTMs Chapters. Here, technical barriers to trade refer to measures such as labelling requirements, standards on technical specifications and quality standards, and other measures protecting the environment. They also include all conformity-assessment measures related to technical requirements, such as certification, testing and inspection. Other examples of TBTs are rules for product weight, size, or packaging; ingredient or identity standards, import testing and certification procedures.

Sanitary and phytosanitary (SPS) measures are measures to protect humans, animals, and plants from diseases, pests, or contaminants. The Uruguay Round Agreement on the Application of Sanitary and Phytosanitary Measures applies to all sanitary (relation to animals) and phytosanitary (relating to plants) measures that may have a direct or indirect impact on international trade. The SPS agreement includes a series of understandings (trade disciplines) on how SPS measures will be established and used by countries when they establish, revise, or ally their domestic laws and regulations. Countries agree to base their SPS standards on science, and as guidance for their actions, the agreement encourages countries to use standards set by international standard setting organizations.

According to the 2012 classification of non-tariff measures (NTMs), SPS measures are defined as “Measures that are applied to protect human or animal life from risks arising from additives, contaminants, toxins or disease-causing organisms in their food; to protect human life from plant-or animal- carried diseases; to protect animal or plant life from pests, diseases, or disease-causing organisms; to prevent or limit other damage to a country from the entry, establishment or spread of pests; and to protect biodiversity”. Examples of SPS are tolerance limits for residues, restricted use of substances, labeling requirements related to food safety, hygienic requirements and quarantine requirements.

However, trade experts widely view TBTs and SPSs as having great potential for being misused by importing countries as nontransparent obstacles to trade. The SPS agreement needs to ensure that SPS measures will not arbitrarily or unjustifiably discriminate against trade of certain other members nor be used to disguise trade restrictions. In this SPS agreement, countries maintain the sovereign right to provide the level of health protection they deem appropriate, but agree that this right will not be misused for protectionist purposes nor result in unnecessary trade barriers. A rule of equivalency rather than equality applies to the use of SPS measures.

In the absence of formal treaties like bilateral or multi-lateral preferential trading arrangement, regional multilateral fora like APCE should address continuously issues relating to TILF (trade and investment facilitation and liberalization). For example, the Shanghai accord adopted by the APCE in 2000 to reduce cross-border transaction cost by 2% within five years has been effective to gradual phasing out TBT and SPS. There need to be regular ministerial meetings in the various regional fora to address these issues including effectuation of mutual recognition systems between countries with similar technical and scientific standards. They could serve as a pathfinder approach to spread out to other countries.

4. Dispute settlement in FTAs: too formalistic, or too asymmetrically restrictive?

Investor-state dispute settlement (ISDS) or investment court system (ICS) is a system through which individual companies can sue countries for alleged discriminatory practices. ISDS is an instrument of international public law contained in a number of bilateral or multilateral investment and trade treaties in NAFTA (chapter 11) and the proposed TTP (chapter 9 and 28).

While ISDS is often associated with international arbitration under the rules of ICSID (the international Centre for Settlement of investment disputes of the world bank), it often takes place under the auspices of international arbitral tribunals governed by different rules or institutions, such as the London Court of international Arbitration, the international Chamber of Commerce, the Hong Kong international Arbitration, the international Chamber of Commerce, the Hong Kong international Arbitration Centre or the UNCITRAL Arbitration Rules.

ISDS has been criticized because the United States has never lost any of its ISDS cases, and that the system is biased to favor American multinational companies and American

trade over other Western countries, and Western countries over the rest of the world. It is well known that through the Philip Morris v. Uruguay case, where the tobacco company Philip Morris sued Uruguay after having enacted strict laws aimed at promoting public health. Furthermore, judges are not elected in most countries outside the US, so that “public accountability of judges” may not be considered a standard of public international law. Empirical evidences suggest that ISDS have been too asymmetrically restrictive in favor of powerful multinational companies of the advanced economies including the US and EU to inhibit the capacities of the domestic governments, largely smaller and less advanced economies, to implement reforms and legislative and policy programs to address legitimate public concerns such as health, environmental protection, labor rights or human rights.

Proponents of ISDS argue that states and their governments are bound by public international law, which includes bilateral investment treaties and international investment agreements. Opponents also argue that arbitrations are sometimes carried out in secret by trade lawyers who do not enjoy the typical safeguards of judicial independence and procedural fairness, who earn income only if a case is brought and proceeds, and who are not accountable to the public or required to take into account broader constitutional and international law and human rights norms.

In general, ISDS or ICS or arbitration takes time consuming and costly process. In Korea, there exists system, so-called foreign investment ombudsman who serves as the trouble shooter for foreign invested companies to resolve their grievances while doing businesses in Korea. I personally served three terms as the Foreign Investment Ombudsman to realize that preemptive aftercare services for foreign invested companies tend to prevent a potential dispute from escalating into a big ISDS cases.