

Trade and regional integration in Asia and the Pacific and the Arab States



International
Labour
Organization

Introduction¹

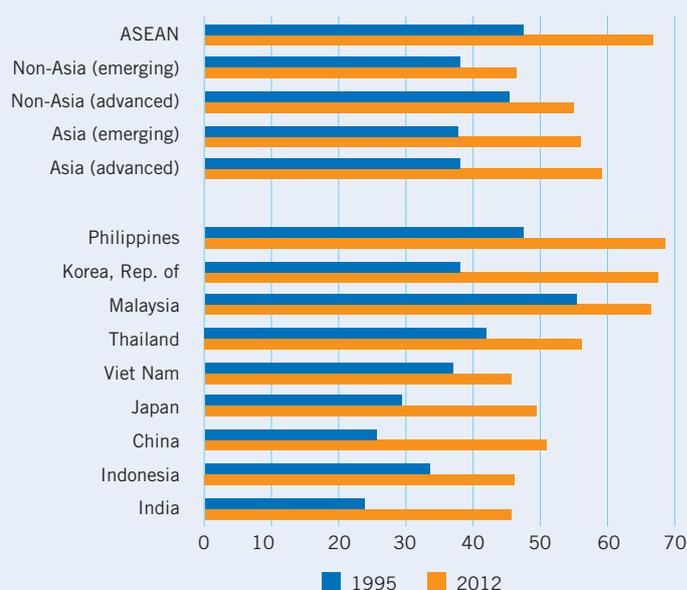
Supported by a “noodle bowl” of trade agreements and regional integration initiatives such as the Association of Southeast Asian Nations (ASEAN) Economic Community (AEC), the share of intra-regional trade and foreign direct investment (FDI) in Asia and the Pacific (excluding Arab States) has risen in past decades to account for more than half of total trade and FDI in the region. The Regional Economic Partnership (RCEP) if concluded, and the Trans-Pacific Partnership (TPP) when it comes into force, are likely to further influence trade flows and the global and regional value chains operating in the region, with consequent effects on labour markets. Simulations using a computable general equilibrium (CGE) model suggest that implementation of trade liberalization and facilitation among RCEP and TPP countries, and among Asia-Pacific countries, should bring benefits in terms of aggregate output and total employment, but the gains will not be evenly distributed across gender, sectors or occupations. Furthermore, as a result of trade diversion, non-participating countries in regional integration initiatives are forecast to experience losses in real GDP and total employment.

Ensuring that regional integration leads to more inclusive outcomes will require appropriate industrial and employment policies. These should be coordinated with skills development policies, thereby: (a) enabling workers and enterprises to participate and benefit from international trade; (b) integrating labour provisions, including fundamental principles and rights at work, in trade agreements and closing the governance gap in countries; and (c) continuing efforts to build nationally defined social protection floors and extend the coverage and quality of social security, helping workers and their families adjust to structural change while ensuring that the benefits of trade are more widely shared.

Trends

Intra- and inter-regional economic integration has been, and continues to be, a key development strategy for Asia-Pacific countries. Inter-regional integration played the more substantive role in the twentieth century for the Asia-Pacific region, providing the basis for the Asia-Pacific region (excluding Arab States) to currently account for around 40 per cent of world exports and 43 per cent of global FDI inflows.²

Figure 1. Participation in global value chains (%)



Note: Participation in global value chains is defined as the sum of foreign value added in domestic exports and domestically produced intermediates used in third countries' exports as a share of total gross exports.

Source: IMF: *Regional Economic Outlook Asia and Pacific* (Washington, DC, 2015), p. 75.

¹ For the purposes of this note, 'Asia and the Pacific' refers to the region that includes 47 countries, plus the Occupied Palestinian Territory, across all income levels from East Asia, South-East Asia, South Asia, the Pacific Island countries and the Arab States of West Asia, unless explicitly stated otherwise.

² United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP): *Asia-Pacific Trade and Investment Report 2015: Supporting participation in value chains* (Bangkok, 2015).

³ Ibid.

⁴ Asian Development Bank (ADB): *Asian Economic Integration Report 2015: How can special economic zones catalyze economic development?* (Manila, 2015).

In the past few decades however, intra-regional integration has played an increasing role in the Asia-Pacific region, and intra-regional exports now account for more than half (54 per cent) of all Asia-Pacific (excluding Arab States) exports, compared to 46 per cent in 2002.³ The share of intra-regional FDI inflows to total FDI inflows in Asia-Pacific also increased to around 52 per cent in 2014, compared to around 35 per cent in 2001.⁴ Furthermore, some countries in the region have increasingly leveraged global value chains, in particular trade in components, as the vehicle for trade, and their participation in global value chains expanded significantly between 1995 and 2012 (figure 1).

Free trade agreements have played an important role in driving trade and investment flows and the growth of global and regional value chains. Currently, some 155 preferential trade agreements involving at least one Asia-Pacific economy are in force, leading the region to be described, due to their overlapping nature, as a “noodle bowl” of agreements.⁵ Some of the agreements, in particular those between East Asia/South-East Asia and South Asia, also have as an objective stronger links with the Arab States. This includes, for example, the free trade agreement between Jordan and Singapore as well as the free trade agreement between the Gulf Cooperation Council (GCC) countries and Singapore, which covers trade in goods and services, customs procedures, e-commerce, economic cooperation, government procurement, rules of origin and other matters. Likewise, the Comprehensive Economic Partnership Agreement (CEPA) between India and the Republic of Korea seeks to support India’s growth as a manufacturing hub where Korean electronics enterprises can produce goods destined for the Arab States.⁶

Trade and economic agreements have increasingly gone beyond traditional trade measures such as tariffs to also cover related features such as competition policy, intellectual property rights and others, leading these agreements to be described as the “next generation” of agreements. Labour issues are those least likely to be covered in these agreements; only about 20 per cent of agreements by Asia-Pacific countries (excluding Arab States) address labour issues, while about one-third cover the environment, some 70 per cent cover competition, and almost all cover dispute settlement.⁷

The AEC is among the “next generation” of agreements. Established in 2015, the AEC provides for the free flow of goods, services, and investment plus a freer flow of skilled labour.⁸ Building on the AEC, ASEAN member countries are also in the process of negotiating the RCEP, involving the 10 ASEAN member countries and six of its dialogue partners (Australia, China, India, Japan, the Republic of Korea, and New Zealand). In October 2015, negotiations were completed for the TPP, which includes seven Asia-Pacific economies (Australia, Brunei Darussalam, Japan, Malaysia, New Zealand, Singapore, and Viet Nam) and five countries from the Americas (Canada, Chile, Mexico, Peru, and the United States). The TPP is widely viewed as one of the most ambitious economic integration initiatives entered into by Asia-Pacific countries, with coverage broadened from traditional trade and investment issues to labour and environment issues.

Meanwhile, the GCC countries have reached an advanced level of economic integration. In 2015, the common market was further integrated providing new economic opportunities for GCC citizens. However, some barriers remain in the free movement of goods and services. Regional and intra-regional trade faces some challenges due to a lack of cohesion in collective negotiations and individual countries signing separate trade agreements, generating gaps in the GCC common external tariff.⁹

Potential employment and economic impacts of RCEP, TPP, and trade integration

What is the potential economic and labour market impact of the RCEP and the TPP? Furthermore, if countries in the region were to consolidate the “noodle bowl” of trade agreements currently in place, and undertake trade liberalization among themselves, what would be the potential economic and labour market impact?

Simulations using a CGE model suggest that implementation of trade liberalization and facilitation among RCEP countries could lead to real GDP in these countries rising by 1.5 per cent relative to the baseline in 2030, while total employment would rise by 0.5 per cent

⁵ UNESCAP, op. cit.

⁶ “The noodle bowl”, in *The Economist* (London), 3 Sep. 2009.

⁷ UNESCAP, op. cit.

⁸ For a comprehensive analysis of AEC impacts on the labour market, see ILO and ADB: *ASEAN Community 2015: Managing integration for better jobs and shared prosperity* (Bangkok, 2014).

⁹ United Nations Economic and Social Commission for Western Asia: *Arab integration: A 21st century development imperative* (Beirut, 2014); “GCC ‘common market achieves most goals’”, in *The Peninsula* (Doha), 9 Jan. 2015.

(or 9.5 million jobs).¹⁰ Some of the lower-income ASEAN members could benefit the most, with GDP in Cambodia and Viet Nam rising above the baseline in 2030 by 5.5 per cent and 6.2 per cent respectively, and total employment by 2.2 per cent (230,000 jobs) and 2.0 per cent (1.3 million jobs) respectively (see annex table 1). Some higher-income RCEP countries are also expected to see large economic benefits. As of 2030, real GDP in the Republic of Korea and Malaysia, for example, would rise, relative to the baseline, by 3.7 per cent and 4.0 per cent respectively, while total employment would increase by 1.6 per cent (425,000 jobs) in the Republic of Korea and by 1.9 per cent (323,000 jobs) in Malaysia.

Modelling results also indicate that trade liberalization and facilitation among TPP countries could yield substantial welfare gains in participating economies, with real GDP above the baseline in 2030 in TPP countries by 1.7 per cent and total employment by 1.1 per cent (or 4.9 million jobs).¹¹ Malaysia and Viet Nam would gain considerably, with GDP exceeding the baseline in 2030 by 7.6 per cent in both. Total employment in Malaysia would be higher by 2.6 per cent (or 452,000

jobs) and by 3.3 per cent (2.0 million jobs) in 2030 relative to the baseline in Viet Nam.

Should trade liberalization and facilitation be extended to all Asia-Pacific countries (excluding Arab States), results indicate that real GDP in Asia-Pacific (excluding Arab States) could rise above the baseline in 2030 by 1.7 per cent, while total employment would stand 0.8 per cent higher in countries for which data is available. Such a scenario shows Pakistan to be a major beneficiary, with real GDP and total employment above the baseline in 2030 by 7.9 per cent and 4.1 per cent respectively.

Moreover, should all Asia-Pacific countries and Arab States achieve economic integration, this could yield gains in real GDP of 2.0 per cent for Asia-Pacific (excluding Arab States) and 4.6 per cent for the Arab States relative to the baseline in 2030, while total employment in Asia and the Pacific for which data is available could be 0.9 per cent and 1.8 per cent higher, respectively. Under such a scenario, Kuwait could benefit significantly, with real GDP and total employment 20.6 per cent and 7.2 per cent above the baseline, respectively, in 2030.

Box 1. Impact of trade integration on gender and skills

Gender issues. Behind potential aggregate gains (and losses) in total employment arising from facilitating trade liberalization, the CGE model simulations reveal important dynamics that warrant gender-sensitive employment and skills policies. For example, while the implementation of the TPP's trade liberalization measures points to total employment gains of 3.3 per cent relative to the baseline in 2030, the rate of gain among men is 3.7 per cent compared to 2.8 per cent for women. Similarly, economic integration between Asia-Pacific and the Arab States could lead to an increase of total employment in Kuwait of 7.2 per cent, relative to the 2030 baseline, but employment for men would expand by 8.5 per cent compared to just 2.9 per cent for women.

Skills development. Gains in employment may be driven primarily by low-skilled jobs in some countries. In Thailand for example, implementation of RCEP trade measures could lead to total employment expanding by 1.5 per cent in 2030 relative to the baseline, but the category of "agricultural and unskilled workers" expands by 2.1 per cent compared to 1.3 per cent for "service/shop workers" and 1.1 per cent for "clerks". Within a scenario of Asia-Pacific integration, Nepal could achieve total employment gains of 2.3 per cent in 2030 relative to the baseline, but this would be driven by gains of 2.7 per cent for "service/shop workers", 2.5 per cent for "agricultural and unskilled workers", and 1.8 per cent for "clerks".

¹⁰ The CGE model used in this paper builds on the model used by the ILO and ADB, op. cit. Key differences include using the updated GTAP 9 database and assuming a fixed supply of skilled labour, while a unitary elasticity of labour supply with respect to its real wage is assumed for all other groups of workers. The RCEP simulation includes the reduction, by 2020, of tariffs among RCEP countries by 45.6 per cent and bilateral non-tariff barriers (NTBs) and fixed trading costs by 36 per cent for merchandise sectors and by 27.7 per cent for services sectors. For further details see F. Zhai: *Modelling results of deeper trade integration in Asia and the Pacific and the Arab States* (Bangkok, ILO, forthcoming).

¹¹ The TPP simulation includes a 58.7 per cent reduction, by 2020, of tariffs among TPP members and a 53 per cent reduction in bilateral NTBs and fixed trading costs.

Recommendations

Coherent employment and industrial policies. Trade has been a key driver of growth and development for many economies in the Asia-Pacific region. The global economic crisis of 2008–09, which collapsed demand in the advanced economies of the European Union (EU) and the United States, has supported further growth in intra-regional trade in the region. With continued weakness in the EU and a slow recovery in the United States, intra-regional trade is likely to gain even more prominence in the years ahead.

Slowing growth in China, however, poses an obstacle to that prospect. Rebalancing their economies will continue to be a key policy consideration for countries in the region that rely heavily on exports for growth. This will in turn require policies to strengthen wages and incomes, with the aim of achieving growth that is better balanced between exports, domestic consumption and productive investment.

For lower-income economies seeking to further leverage trade for development and decent jobs, China's efforts, to rebalance its economy by moving from exports and investment towards more consumption and services, provide opportunities to support manufacturing. Appropriate industrial and employment policies that are coordinated and coherent with skills development policies suggests one way of taking advantage of these opportunities. Sustainable Development Goal No. 9.2 in particular notes the need to “promote inclusive and sustainable industrialization and, by 2030, significantly raise industry's share of employment and gross domestic product, in line with national circumstances, and double its share in least developed countries.”

Strengthening governance gaps in global supply chains. Many countries in the region have increased their participation in global value chains (GVCs), which has brought benefits such as increased foreign exchange earnings, technology transfers, and skills upgrading. Benefitting further from participation in GVCs will require concerted investment to move up the value chain. This presents a challenge for all countries, but in particular for those seeking to overcome the “middle-income trap”.

Capturing a bigger slice of value added along the chain will require a focus on raising labour productivity. While the region has posted robust labour productivity growth in recent years, the level of output per worker is only around a quarter of the level in North America.¹² At the same time, to ensure that workers also benefit from their rising productivity, efforts will be required to strengthen the productivity-wage link through collective bargaining and supporting mechanisms for minimum wage setting.

Integrating labour provisions in trade agreements. Labour issues have not featured in many Asia-Pacific free trade and economic agreements. The TPP, which calls on countries to adhere to the fundamental principles and rights at work, may serve to spur the inclusion of labour issues in future agreements, particularly as a number of countries in the Asia-Pacific region (for example, Indonesia, the Republic of Korea, the Philippines, and Thailand) have already expressed interest in joining the TPP, and other countries may wish to do so in the years ahead. In addition to influencing the contents of future trade and economic agreements, the TPP is likely to affect the GVCs in the region, potentially placing greater focus on working conditions and standards in the value chains of the region, for one thing, and accelerating the ratification of the fundamental Conventions in the region.

Continued efforts to strengthen social protection. The regional integration initiatives in the region, including the RCEP if concluded and the TPP when it comes into force, are likely to affect the region's labour market. While countries participating in these initiatives stand to benefit in terms of aggregate output and total employment, within a given economy workers in competitive sectors will benefit while non-competitive sectors will suffer job losses. Furthermore, as a result of trade diversion, non-participating countries in regional integration initiatives are forecast to experience losses in real GDP and total employment. For example, real GDP in the Republic of Korea and Thailand, both non-participating countries in the TPP, is expected to decline by 0.6 per cent in 2030 relative to the baseline, while total employment declines in Thailand by 0.4 per cent.

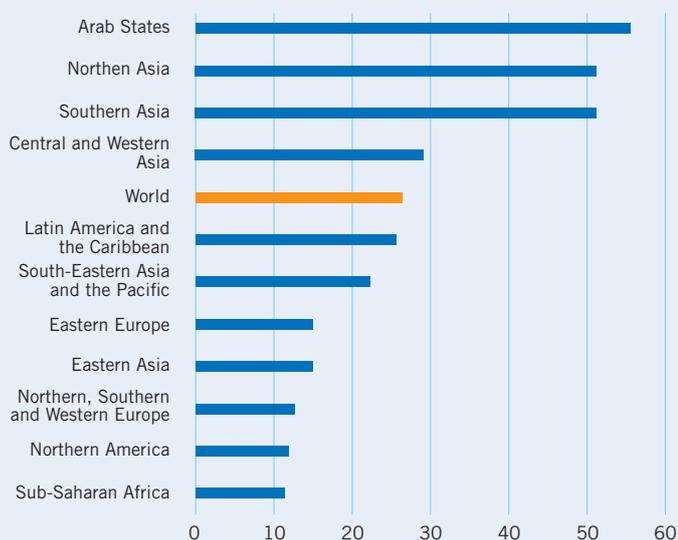
¹² Calculated as real output per worker, purchasing power parity (PPP)-adjusted, and based on the ILO Research Department: Trends Econometric Models, Nov. 2015.

Similarly, if the RCEP is concluded and comes into force, non-participating countries, including those in South Asia and the Arab States, may face economic and job losses relative to the baseline. For example, if the RCEP is concluded and its trade measures come into force, in 2030 real GDP and total employment is seen to decline in Nepal (a non-participant in RCEP) relative to the baseline by 0.1 per cent and 0.5 per cent respectively. The labour market churning that occurs in both participating and non-participating countries, in regional integration initiatives, highlights the critical need for all countries in Asia and the Pacific to continue efforts to build nationally defined social protection floors, and to extend the coverage and quality of social security, including for migrant workers.

Promoting gender equality. As trade agreements are implemented and regional integration initiatives progress, countries in the region will need to carefully assess the effects on the labour market by gender, and design appropriate policies to reduce disparities and promote gender equality. This is all the more important in the South Asia and Arab States regions, which have some of the highest gender gaps in labour force participation globally (figure 2).

Support for skills upgrading. Trade liberalization and regional integration are expected to spur structural change and shifts in occupational demand beyond those that would occur in their absence. In particular, some countries may find job gains driven by low-skilled jobs, including in the informal economy. To facilitate structural change from less productive activities to more productive ones, as well as to support skills upgrading, countries in Asia and the Pacific need to make appropriate investments in skills and training systems. These regions are experiencing high rates of youth unemployment. Improving access to and the quality of education and technical training to better meet industry demand, and strengthening labour market policies and institutions to better prepare young people for the world of work, are likely to yield a double dividend: (a) addressing the youth employment challenge, while (b) investing in movement towards more productive and value-added activities.

Figure 2. Gender gap in labour force participation rates, 2015 (percentage points)



Source: ILO Research Department: Trends Econometric Models, Nov. 2015.

Annex table 1. Change in real GDP and total employment in 2030 relative to the baseline under different scenarios (%)

	RCEP		TPP		APFTA		APARFTA	
	Real GDP	Total emp.						
ASEAN								
Brunei Darussalam	1.9	0.9	2.3	1.9	1.8	0.8	1.9	0.9
Cambodia	5.5	2.2	-2.0	-0.3	5.4	2.1	5.5	2.1
Indonesia	0.4	1.3	-0.2	-0.1	0.4	1.4	0.5	1.4
Malaysia	4.0	1.9	7.6	2.6	4.3	2.4	6.0	2.8
Philippines	2.0	0.6	-0.2	-0.1	2.0	0.6	2.3	0.7
Singapore	1.0	0.1	2.3	0.3	1.5	0.2	3.0	0.2
Thailand	2.5	1.5	-0.6	-0.4	2.8	1.8	3.3	2.0
Viet Nam	6.2	2.0	7.6	3.3	6.3	2.1	6.7	2.2
Other RCEP								
Australia	0.4	0.1	0.5	0.1	0.5	0.2	0.6	0.2
China	0.5	0.4	-0.2	-0.1	0.6	0.4	0.8	0.5
India	2.5	0.2	-0.1	-0.1	2.5	0.2	3.0	0.4
Japan	2.6	0.4	3.3	0.5	2.7	0.4	2.8	0.5
Korea, Rep. of	3.7	1.6	-0.6	0.0	3.9	1.6	4.3	1.7
New Zealand	0.9	0.4	3.1	1.1	1.1	0.5	1.4	0.5
Other South Asia								
Bangladesh	-0.1	-0.1	-0.3	-0.2	4.4	1.8	4.6	2.0
Iran	-0.4	0.0	-0.2	-0.1	-0.4	0.0	5.1	1.2
Nepal	-0.1	-0.5	0.1	0.0	3.8	2.3	3.8	2.3
Pakistan	-0.1	-0.1	0.0	-0.1	7.9	4.1	9.1	4.7
Sri Lanka	0.1	0.0	0.0	-0.1	4.6	1.6	5.0	1.8
Arab States								
Bahrain	0.1	0.2	-0.4	-0.1	0.0	0.2	5.6	3.5
Kuwait	0.8	0.4	-1.9	-0.5	0.3	0.3	20.6	7.2
Oman	-0.9	-0.2	-0.3	-0.3	-0.9	-0.2	1.1	3.7
Qatar	-0.2	-0.1	-0.5	-0.4	-0.2	0.0	2.6	2.2
Saudi Arabia	-0.3	0.1	-0.7	-0.2	-0.3	0.1	1.5	2.0
Other TPP								
Canada	0.0	0.0	3.2	0.9	0.0	0.0	0.0	0.0
Chile	0.0	0.0	0.7	0.4	0.1	0.0	0.1	0.0
Mexico	0.0	0.0	5.7	2.5	0.0	0.0	0.0	0.0
Peru	-0.1	0.0	0.4	0.2	-0.1	0.0	-0.1	0.0
United States	0.0	0.0	0.6	0.1	0.0	0.0	0.0	0.0

Note: The RCEP scenario refers to trade liberalization and facilitation among RCEP countries; the TPP scenario refers to trade liberalization and facilitation among TPP countries; APFTA refers to trade liberalization and facilitation among all Asia-Pacific countries; and APARFTA refers to trade liberalization and facilitation among all Asia-Pacific countries and Arab States.

Source: ILO estimates based on F. Zhai, op. cit.

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