

Digital trade in the Asia-Pacific: Issues for 2021 and beyond

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Preface

This paper, written by the Asian Trade Centre, was generously supported by the Hinrich Foundation. It represents the first paper in a series for 2021 looking carefully at a range of digital trade issues that will be part of the trade agenda in Asia for 2021 and beyond. Future papers will include deeper investigations into digital tax issues, digitally delivered services trade, and competition policy concerns.

The Asian Trade Centre, based in Singapore, works with governments and companies across Asia to create better trade policies.

The Hinrich Foundation is pleased to support research on digital trade and regulatory policies that will lead to faster, more inclusive economic growth in Asia.

Contents

- PREFACE** 2
- EXECUTIVE SUMMARY** 4
- INTRODUCTION** 6
- KEY DIGITAL POLICY ISSUES FOR 2021 AND BEYOND** 8
 - 1. Digital services 12
 - 2. Digital taxation 16
 - 3. Cybersecurity and data protection 17
 - 4. Data or digital sovereignty 19
 - 5. Competition law/antitrust policies 20
 - 6. Digital payments 21
 - 7. New technologies and digital trade 24
 - 8. Digital trade and MSME development 27
- DIGITAL GOVERNANCE** 29
- CONCLUSIONS** 31
- ENDNOTES** 32
- RESEARCHER BIO: DEBORAH ELMS** 36

Executive summary

Since the public launch of the World Wide Web in 1995, trade has increasingly gone digital. While firms are innovating at a rapid clip to design, develop and deploy digitally-enabled goods and services, governments have struggled to keep up. For the first decades after the launch of the internet, regulations, rules and legal laws to manage digital-enabled trade were limited. However, as the digital economy has increasingly come to represent a greater and greater share of the economy, with compounding growth rates in digital trade, the situation has become less satisfactory.

Firms are rapidly shifting to develop or expand digital capabilities.

The Covid-19 pandemic and associated lockdowns and trade disruption have up-ended many longstanding business models. Firms are rapidly shifting to develop or expand digital capabilities to manage highly altered supply and demand pressures. The adjustment to digital tools applies to both large and small firms and has increasingly filtered to include citizens around the globe. An online presence can make the difference for companies between survival and extinction.

Despite the growing importance of digital trade, the ability of governments to tackle a range of issues of relevance to managing the online environment still lags behind the speed of innovation for firms. Headed into 2021, there are at least eight topics that are likely to be on the radar for government officials working on digital trade.

This paper outlines these eight issues: the growing rise of digital services, the application of tax to cross-border digital goods and services, the role of cybersecurity and data protection concerns, a rise in concerns of digital or data sovereignty, renewed emphasis on competition policy or anti-trust policies as applied to the digital world, challenges managing digital payments in cross-border settings, the growth of new technologies and applications that will increasingly challenge regulatory environments, and how the spread of digital trade facilitates or hinders the growth and development of the smallest firms in Asia.

Effective and efficient regulatory policies can support continuing economic growth in the digital economy.

The paper does not suggest solutions to this range of challenges. Instead, it highlights these topics to generate greater debate and discussions between firms and governments across the region. Effective and efficient regulatory policies can support continuing economic growth in the digital economy. Poorly managed or badly implemented policies, by contrast, can easily disrupt the continuing growth of digital trade. In particular, problematic policies and regulations can make it difficult or impossible for the smallest firms in Asia to continue to share in the fastest growing sectors of the economy.

Given the overwhelming importance of small firms to every country in Asia, failure to create supportive policies for the micro, small and medium-sized enterprises (MSMEs) will impede the region's attempt to create sustainable and inclusive trade for the future.

Digital trade is the future of trade.

Digital trade is the future of trade. Digital serves as the “connective tissue” increasingly running between and across sectors of all kinds. It binds countries together. Done well, it allows the smallest firm the opportunity to become a “micro-multinational” with customers and suppliers around the globe. Done poorly, digital policies can trap firms and customers into sub-standard outcomes.

Introduction

The digital economy has become paramount for continued economic growth and development across the Asia-Pacific region.¹ Inside six economies in Southeast Asia (Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam), for example, digital trade growth has expanded from 260 million internet users in 2015 to 400 million users in 2020.² A similar story of explosive digital growth can be told for every country in the region.

The Asia-Pacific has been the fastest growing region in global e-commerce marketplaces.

The Covid-19 pandemic has only accelerated these trends. The Asia-Pacific has been the fastest growing region in global e-commerce marketplaces and holds the largest share of the global business-to-consumer (B2C) markets.³ So-called “Singles Day” shattered records in China on 11 November 2020, with US\$115 billion in sales generated between the Alibaba and JD.com platforms.⁴ Transactions per second peaked at 583,000.⁵ Singles Day has spread across much of the region as well. Southeast Asia’s Lazada platform had more than US\$100 million in sales in the first hour of the sales from midnight to 1 am.⁶ By way of comparison, Americans spent US\$136 billion in a five-day period between Thanksgiving and “Cyber Monday” in 2019.⁷

Digital trade or the digital economy includes goods and services delivered in whole or in part through digital means. E-commerce has traditionally meant the delivery of goods ordered online, making it part of the larger category of digital trade.⁸ Of particular interest to the *Asia Digital Economy* series are issues in the digital economy stemming from digital goods and services delivery that is, or could be, traded across borders.

Effective management of the regulatory and policy environment to facilitate digital trade will become one of the most important aspects of trade policy in 2021 and beyond.

In the earliest days, the digital economy flourished with no regulatory oversight. As the portions of the economy driven by digital technology have continued to expand and as digital connectivity has increased, governments have increasingly been grappling with the appropriate ways to allow digital trade to grow while restraining harms that might flow to consumers and businesses. Effective management of the regulatory and policy environment to facilitate digital trade will become one of the most important aspects of trade policy in 2021 and beyond.

The digital economy clearly holds enormous potential. However, there has been relatively limited work on digital trade in Asia. Most of the research done to date has either focused on measuring the size of the digital economy or the readiness of countries to embrace digitalisation. The policy and regulatory environment in the region has not received the same levels of attention, with most existing thought leadership for digital trade drawn from North American and European experiences.

In order to stay ahead of the curve, governments and businesses need to prepare for the opportunities and challenges brought forth by digital trade. This paper highlights eight key digital trade areas that Asia-Pacific policy makers will likely

be considering in 2021 and beyond. These issues include digital services, digital taxation, cyber security and data protection, data sovereignty, competition policy, digital payments, the rise of new digital technologies, and micro, small and medium-sized enterprises (MSMEs) development. The paper will also review the current regulatory governance frameworks on digital trade.

Digital trade and e-commerce have become major drivers of economic development.

Digital trade and e-commerce have become major drivers of economic development by enhancing productivity and lowering costs of trade in goods. While digital trade promises new opportunities for individuals and firms of all sizes, it also raises new challenges. Policy makers and business leaders need to better understand the drivers of this paradigm for trade and find solutions for potential issues in dialogue with stakeholders so as to ensure digital trade policies that are more sustainable and inclusive for all.

The risks of incompatible policy frameworks across the Asia-Pacific cannot be discounted.

This paper is intended to raise more questions than it answers. These are all emerging topics, with limited existing regulations in place and with clear challenges ahead in designing effective and appropriate policy responses that effectively address each topic. The risks of incompatible policy frameworks across the Asia-Pacific cannot be discounted. Such regulatory fragmentation could destroy the promise of the digital economy and make it significantly harder for large and small firms across the region to participate in digital trade in the future.

The eight issues explored here are those that are on the policy radar for 2021 and beyond. Many will be explored by the Asian Trade Centre in greater detail across the *Asia Digital Economy* series sponsored by the Hinrich Foundation.

Key digital policy issues for 2021 and beyond

It is clear that Asia has seen explosive growth in the digital economy. The increasing size of the digital pie, however, has brought new scrutiny to the policy frameworks that facilitate or frustrate digital trade. In the earliest days of the internet, governments largely allowed digital to flourish without restrictions of any kind. As the technology was rapidly evolving and the penetration of the digital world into the offline world was limited, it made sense to take a hands-off approach to regulation. Where needed, officials adapted off-line policies to fit a new digitally-enabled world.

Governments are under increasing pressure to ensure “a level playing field” for all firms.

As the digital economy has grown, however, government officials from around the world have increasingly begun to grapple with a range of issues thrown up by digital trade. Some of the challenges come from comparing the situation of off-line companies to those operating largely or entirely digitally. Governments are under increasing pressure to ensure “a level playing field” for all firms. Other issues arise from government mandates to ensure public health, safety and security. Governments have to also address how to protect consumers’ interest in these new digital markets without stifling innovation.

Unlike traditional trade flows, the digital economy generally has paid less attention to geographic boundaries.

Many firms have also become increasingly uncomfortable with unregulated spaces. No rules can actually be problematic for firms, as there are no guardrails or clarity on allowable activities. Loose or non-transparent regulation can also lead to competitive advantages for locally-based firms that may receive earlier notice of any regulatory or policy rules changes ahead of foreign counterparts. Unlike traditional trade flows, the digital economy generally has paid less attention to geographic boundaries. Even the smallest firm can be “born global” from the outset and find buyers for goods and services around the globe. However, many obstacles remain. Regulatory uncertainty, complexity and inconsistencies, including differences in regulations across countries, affect micro, small and medium-sized enterprises (MSMEs) disproportionately more than large firms. Barriers to entry are especially high in services sectors, such as professional services, where MSMEs are abundant. For example, for cross-border exports of services, an average level of services trade-restrictiveness represents the equivalent of an addition 14% tariffs for MSMEs relative to large firms.⁹

An increasing challenge to firms of all sizes is the potential for regulatory incoherence.

An increasing challenge to firms of all sizes is the potential for regulatory incoherence, with policies related to digital trade that vary from one market to another. Given the porous nature of digital trade, policy frameworks that are inconsistent can be much more problematic to companies and consumers than conflictual policy settings in the off-line world. A “micro-multinational” firm that provides digital services like graphic design or sells e-commerce goods like wedding dresses to brides located around the world are more likely to experience challenges in cross-border trade than a traditional firm. The off-line vendor of graphic design may never, in fact, attempt to deliver services to any customers overseas. The wedding dress designer operating out of a physical retail shop or even a chain of shops may still never find buyers outside of the local community.

Cross-border rules matter deeply to even the smallest firms.

However, once such firms move online to become part of the digital economy, they may find purchasers around the globe. Suddenly, cross-border rules matter deeply to even the smallest firms.

As the year comes to a close, officials in Asia are cautiously optimistic about the prospects for a return to a “new normal.”

Covid-19 has not just disrupted companies as they have tried to adjust to both supply and demand shocks around the world. It has also altered government policymaking. While 2020 had been a year in which government officials had expected to more carefully grapple with a variety of digital issues, most of these conversations have been postponed or have proceeded more slowly than originally anticipated. Governments around the world have turned their attention to managing the fallout of the pandemic, including navigating various forms of shutdowns, altered transport options, and cratering demand for travel.

As the year comes to a close, officials in Asia are cautiously optimistic about the prospects for a return to a “new normal.” With variations across the region, the total number of cases in the region has been near zero in some economies, low and not rising in others, and a few countries still experiencing alarming increases in caseloads and concurrent shuttering of business activities to try to contain the virus. Assuming that the virus is managed in the region, it is likely that 2021 will see a strong resumption of efforts at the domestic, regional and international levels to try to create clarity around a range of digital rules.

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Given the diversity in the 16 economies in Asia under examination in this *Asia Digital Economy* series, governments will have a variety of topics to address. Some governments in the region already have in place significant regulations and legislation to manage aspects of the digital economy. Others are at an earlier stage of the journey.

There are, however, several issues that are likely to rise to prominence in the year ahead. Eight areas, in particular, are expected to be on the minds of policymakers and embedded into various negotiating agendas in the region. The eight key areas include:

- **Digital services:** While trade in e-commerce goods tend to grab headlines, with spectacular sales on Singles Day and increasing trackable purchases of everything from food to clothing online in a pandemic, significant growth is also happening in the digital delivery of services. The policy landscape, however, for managing digital services, especially across borders, is much less well understood and developed. As services grow in increasing importance, managing consistency in the space will become critical to ensuring success in a post-pandemic recovery period.¹⁰
- **Digital taxation:** Governments emerging from lockdowns and spending significantly on subsidies and a wide range of policy actions to encourage economic growth are likely to be looking for new sources of revenue in 2021 and beyond. The digital economy will present a promising target. Of particular importance will be the methods and manner in which government seek to collect tax from digitally delivered goods and services, especially in cross-border settings. Collection policies that are poorly thought out or ineffectively implemented can completely ruin the potential

The digital economy is increasingly bringing together tax and trade in cross-border settings in new ways that are insufficiently understood.

for firms—and especially the smallest companies—to continue to find new market opportunities overseas. In the past, trade was focused on trade and tax was considered a problem to be managed by other officials, especially from central banks and finance ministries. The digital economy, however, is increasingly bringing together tax and trade in cross-border settings in new ways that are insufficiently understood.

The movement of data across borders can deliver important, valuable contributions to trade.

- **Cybersecurity and data protection:** Legal and regulatory frameworks on data protection vary significantly across the region. Governments have always had the right to protect citizens from harm, including potential cyber intrusions, and to manage public interests and health. Getting these policies “right” in the digital space can be quite tricky, especially for cross-border flows of information.
- **Digital or data “sovereignty”:** The explosion of growth in the digital economy has led to an equally substantial shift in the volume of data collected, stored, analysed and used. Governments have concerns about what happens to data, beyond worries over cybersecurity threats or personal data protection. In particular, some governments appear increasingly keen to retain ownership or “sovereignty” over data collected in domestic settings and to mandate new rules on what can, and what cannot, happen to data. Data and data flows are an increasingly important source of value creation. Inhibited flow can further aggravate the digital divide. The movement of data across borders can deliver important, valuable contributions to trade. As an example, big data and data analytics are being incorporated in supply chain management, processes and technologies to catalyse sustainable objectives. For example, “once a product has been launched, big data can recommend marketing strategies, drive operations decisions, and forecast supply and demand. These metrics provide predictability in supply chain needs, proactively enabling sustainable sourcing and transportation.”¹¹
- **Competition:** Digitalisation and online platforms provide numerous benefits to firms and consumers, including increased choice and economic opportunity, but they can also raise market concentration and competition concerns. With competition governance questions entering mainstream political discourse, there is a need for a balanced, evidence-based reassessment of the appropriate role of competition policy in the digital space.
- **Digital payments:** As a key enabling factor for digital trade, digital payments play an important role in accelerating economic growth. At the moment, cross-border e-payment systems are often unnecessarily challenging to use, costly and often inefficient. Consumers without bank accounts or payment cards can be left out of the digital economy entirely. Policymakers need to facilitate the development of inclusive and efficient digital payments systems, ensure the safety and reliability of payments, improve the interoperability of bank and non-bank financial service providers, and enhance consumer trust. The rise of cryptocurrencies, and eventually the replacement of physical cash, has the potential to produce disruptive results in the digital payments arena.¹² While the adoption of blockchain

Policymakers need to facilitate the development of inclusive and efficient digital payments systems.

technology to process digital payments has allowed businesses to facilitate faster transactions, there are, of course, risks which may produce unintended consequences of disturbing the financial system.

The rise of new technologies can transform trade faster than trade policies can adapt.

- **New technologies:** The rise of new technologies can transform trade faster than trade policies can adapt. At the moment, to take just one example, even small firms are increasingly using artificial intelligence (AI) in their business operations to ensure faster, smoother delivery of services. Yet the regulatory landscape around AI, particularly for usage in cross-border trade, has yet to be developed. Disruptive technologies like AI, the Internet of Things (IoT), big data, and 3D or advanced manufacturing, have the potential to create new markets and products, significantly reduce transaction costs and facilitate the cross-border movement of goods and services. However, the rise of these innovative technologies per se are not a guarantee of greater trade growth and economic integration. They thrive in open digital markets. Managing the structural changes driven by technology is central to ensuring that everybody can benefit. Without careful attention to the underlying digital rules, it could be that innovation capacity and transformational opportunities will be lost.
- **MSME development:** Policymakers in Asia often assume that only large firms are set up to take advantage of the digital economy, leaving smaller firms at a competitive disadvantage. Yet many of the smallest firms are now, effectively, “micro-multinationals” in the digital world with suppliers and customers across the region and the world. Any regulatory and legislative changes planned for the digital economy will likely impact smaller firms significantly. Micro, small and medium-sized enterprises (MSMEs) typically do not have substantial resources to adapt and adjust to changing policies or to understand and manage differing policies in a cross-border landscape. The Covid-19 pandemic has called attention to the important role that digital can play in future economic recovery and the critical position of smaller firms to domestic economic growth and development.

Many of the smallest firms are now, effectively, “micro-multinationals” in the digital world.

These eight issue areas often have significant overlap. As an example, digital services trade requires information and data flows. A landscape architect needs to be able to send plans, drawings and plant lists to clients, suppliers and vendors to be able to create a dream garden in a cross-border setting. These need to be sent without risk of cyber breaches, including important client or company data. The architect needs to be paid at the end, which requires the movement of payments and financial data. The architect may be part of a small firm with an international client base or embedded in a larger global property developer.

Digital should be seen a cross-cutting enabler of a wide variety of economic activity rather than an end in itself.

One of the challenges, in fact, with tackling digital trade is precisely the overlapping nature of such trade. Digital should be seen a cross-cutting enabler of a wide variety of economic activity rather than an end in itself. This makes it tough for many governments to manage, as the structural or institutional approaches to handling trade policy can be divided into fiercely defended silos. Trade in goods, for instance, is usually managed with specific approaches to the topic by different departments, or even ministries, from trade in services. Both may not be involved in discussions on taxation or planned payments policy adjustments.

With this important caveat in mind, consider the following eight key policy challenges ahead:

1. Digital services

Until relatively recently, services trade lacked similar types of legal and regulatory arrangements.

Governments have been creating rules of one kind or another to handle the global flow of goods trade for centuries. Until relatively recently, however, services trade lacked similar types of legal and regulatory arrangements. This was driven in part by actual difficulties in delivering services across borders and an unclear understanding by governments about how services might be transferred between countries.

The first serious attempt to tackle trade in services did not take place until the 1980s and 1990s, under the auspices of the General Agreement on Tariffs and Trade (GATT).

The first serious attempt to tackle trade in services did not take place until the 1980s and 1990s, under the auspices of the General Agreement on Tariffs and Trade (GATT), which became the World Trade Organization (WTO) in 1995 when the Uruguay Round agreements were put into place. Services trade was divided then into what were called “modes” of supply depending on who or what moved—the service itself, the consumer of the service, the supplier of the service by investing in another economy to provide the service, or the individual supplying the service who could temporarily move across a border to deliver a service in another country. In the intervening 25 years, cross-border trade in services has exploded.

Many of these services are now delivered online, without suppliers or customers moving at all. The international system has adapted the “mode 1” category of services to trade to fit digital delivery of services. Mode 1 was originally crafted with the idea of sending services like architectural plans through the post or, perhaps, by the new-fangled fax machine. The internet was just becoming publicly available in 1995 when the WTO was starting implementation of new services rules.

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Because governments were cautious about addressing an entirely new area of trade, many WTO members made only limited services commitments. The paucity of commitments has increased many difficulties in clarifying the rules further for a wide range of services into many different WTO members.

In addition, the global rulebook to govern trade in services (beyond the specific legal commitments made in various WTO member schedules) was also relatively “thin” with limited rules in place as governments were simply uncertain about the potential impact of various regulatory options for services. This rulebook and the accompanying schedules were part of the WTO’s “built-in” agenda for the next round of negotiations. However, after a disastrous attempt to launch a new round in Seattle in 1998 and a promising effort in 2001 in Doha, limited progress was made on global rules for services (and, indeed, most aspects of global trade).

To address the growing gaps in coverage from existing services commitments, 23 members accounting for the largest shares of services trade launched Trade in Services Agreement (TISA) negotiations in 2013. Some of the negotiated elements on the table included digital services provisions. After several years of effort, however, the process stalled and has now been abandoned.

This has meant that governments have increasingly had to either adapt existing WTO services rules very liberally or to create cross-border rules for trade in

services through other settings at the regional or bilateral levels. Most of these arrangements are also relatively thin commitments and most do not explicitly address digital services trade.

Services are often largely overlooked in discussions on global trade.

The situation has left an incomplete policy landscape for addressing issues of digital trade in services. Services are often largely overlooked in discussions on global trade, yet it accounts for the majority of trade in many developed economies and are growing rapidly in many developing economies as well. This is perhaps because services are less tangible and the issues surrounding services trade are often more complex.¹³

Trade in services can create welfare gains for society through a more efficient allocation of resources, greater economies of scale, and an increase in the variety of services on offer. Because services providers must often be present in the area where the service is delivered, the quality of institutions in the importing country is of greater importance for services trade than for goods trade.

The service sector in Asia has the potential to become a new engine of economic growth for developing Asia.

The service sector in Asia has the potential to become a new engine of economic growth for developing Asia, which has traditionally relied on export-oriented manufacturing to power its growth. The transition from agriculture through manufacturing to a services economy has been the hallmark of economic development for many countries. Due to its labour-intensive nature, a large and growing service sector can generate millions of jobs for the region's huge workforce and thus promote more inclusive growth.¹⁴ Extensive synergies between the service and industry sectors mean that service sector development can lift productivity throughout the economy. Those synergies are all the more evident in modern, high value-added service industries such as finance, information and communication technology, and professional business services.

Countries such as India and Sri Lanka have headed straight to services without developing a significant manufacturing sector at all.

With the Asia-Pacific Economic Cooperation (APEC) forum and the Association of Southeast Asian Nations (ASEAN) renewing their focus on the importance of a competitive services agenda to realise overall growth and development across their respective regions, the services sector in these economies too will likely join the 60-plus-percent club soon.¹⁵ Countries such as India and Sri Lanka have headed straight to services without developing a significant manufacturing sector at all. The growth in services has likely transformed not only the composition of the world's economic production and employment, but also altered global trading patterns.¹⁶

The participation of developing economies in services trade is not yet inclusive. A close look reveals that trade is very concentrated, with the same five economies ranking both as leading services exporters and importers, although in a different order. In 2017, China was the leading services trader, followed by Hong Kong (China), the Republic of Korea, Singapore and India. Since 2017, services exported by these five economies through branches and subsidiaries abroad made up, on average, 55.9% of their services exports, a rise of 22 percentage points since 2005. In China and the Republic of Korea in particular, up to two-thirds of services were exported through foreign-controlled affiliates, more than half in Hong Kong, China, and around half in Singapore, too. In India, cross-border trade remains the dominant mode, with only 20% of services exported through foreign-controlled affiliates in other economies.¹⁷

For these countries, construction, finance and distribution are the sectors that contribute most to the remarkable growth of their services exports through foreign-controlled affiliates. However, in a variety of other sectors, from professional and business services, to ICT and transport, a shift in the way services are exported has already occurred. In others, such as tourism or health services, a change is well under way.¹⁸

Services are increasingly likely to be embedded in manufacturing activities.

Services are increasingly likely to be embedded in manufacturing activities. Research suggests that up to half of the value in a range of manufactured products comes from services inputs like warehousing and distribution, retail sales, intellectual property development, legal services and even catering.¹⁹ The digital economy allows some of these service activities to be delivered across borders and online.

An important trend is the process of adding services to products or known as “servicification.”²⁰ When manufacturers add service components to a connected product, it opens up new ways to generate value to customers and to firms. The addition of such services will be key to driving additional competitive advantage, especially in markets where product differentiation is blurring and customer expectations for product and service performance are expanding.²¹

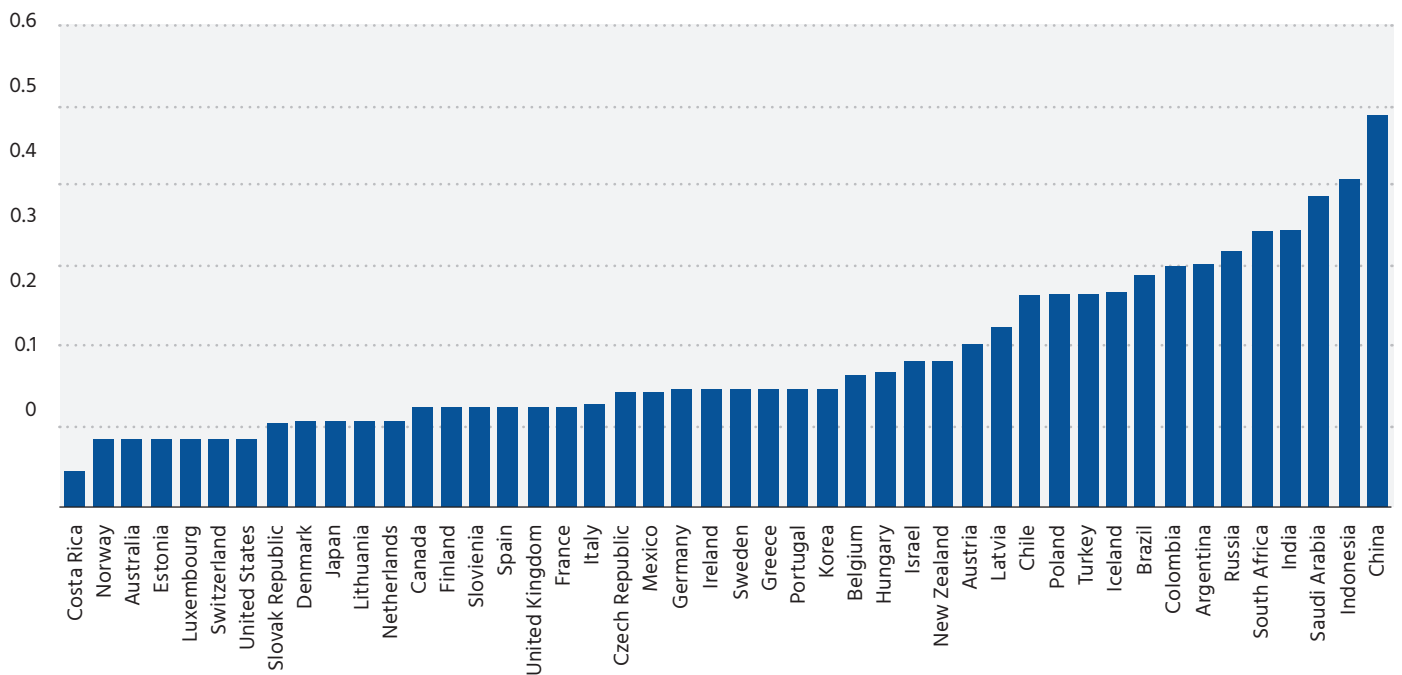
Technology has enabled a decline in trade costs in services.

Technology has enabled a decline in trade costs in services. A key effect is that global exports of services enabled by information and communications technology (ICT) have more than doubled between 2005 and 2018. Moreover, by enabling cross-border trade for services that have traditionally needed face-to-face interaction, digital technologies will reduce the cost of trading in services even further. Digital technologies will further blur the distinction between goods and services activities. Digital allows firms to reach larger numbers of suppliers and customers across the globe and to facilitate the outsourcing of activities. These trends will increase the importance of data flows, intellectual property and investment in digital infrastructure.

A key challenge for all Asian countries is to improve the quality of services sector data. Absent sufficient data and reliable statistics, it can be hard to see where specific obstacles and opportunities might lie. Overall, while services sector development can be a long and challenging process, creating more competitive services markets by removing a wide range of internal and external policy distortions is vital for improving services sector productivity. Moreover, complementary investments in physical infrastructure and human capital will also be necessary to achieve a strong services sector.

Globally, the barriers to digital services trade are sizable with connectivity and infrastructure being the most discussed.

Globally, the barriers to digital services trade are sizable with connectivity and infrastructure being the most discussed. In 2019, the level of services trade restrictions was 30% higher than the year before.²² Barriers especially affected service sectors that underpin digital trade, including telecommunications, computer services and audio-visual services. They include limiting foreign providers’ access to infrastructure and connectivity, hindering electronic transactions and international payments, and other restrictive measures.²³

Figure 1 – Digital Services Trade Restrictiveness Index, 2019

Source: OECD STRI database

Note: STRI indices take the value from 0 to 1. Complete openness to trade and investment gives a score of zero, while being completely closed to foreign services providers yields a score of one.

Across the regions, some of the fastest growing countries in Asia have the most restrictive policies in services.

Across the regions, some of the fastest growing countries in Asia have the most restrictive policies in services (Figure 1). According to the OECD Digital Services Trade Restrictiveness Index, which identifies, catalogues and quantifies barriers that affect trade in digital enabled services, China ranks the most restrictive among the 46 countries surveyed. In countries including Malaysia, the Philippines, Vietnam and China, restrictions on FDI in the communications sector are more stringent than the overall national averages across all sectors. In China, India and Indonesia, telecommunications and computer services face greater trade restrictions than the OECD average.

Countries also face regulatory challenges relating to the protection of intellectual property rights on traded digital goods and services.²⁴

In 2021 and beyond, governments in the region will increasingly be looking to clarify conditions for digital services trade.

In 2021 and beyond, governments in the region will increasingly be looking to clarify conditions for digital services trade. The pandemic has highlighted a significant shift in economic activities, with a growing share of services being delivered online. This includes everything from education conducted online for populations from school-aged children through skills development courses for working adults. Increasingly, medical services have also been delivered digitally. In fact, final figures for the pandemic period are likely to reveal a shift to the digital delivery of services that have never been traded online or cross-borders in the past. The policy landscape will need to adjust to catch up with the growing importance of the digital services sector.

2. Digital taxation

The growth of the digital economy over the last several decades has raised important questions about how to tax corporations that no longer need a physical presence in a country to turn a profit there. The OECD have been working towards a multilateral solution to this challenge, with the goal of developing a new international tax framework by the end of 2020. However, so far no consensus has been reached.²⁵

The rise of digital technologies has lessened the need for local offices in countries around the world.

The rise of digital technologies has lessened the need for local offices in countries around the world. Businesses can use digital means to reach across borders and into markets without local employees, offices, or operations.²⁶ While digital tools can enable the delivery of goods and services more easily, this trend should not be overstated. Firms are also discovering that consumers and customers increasingly expect to have goods or services delivered immediately and be adapted to the local marketplace. Instant gratification may, paradoxically, drive firms to have more local presence than previously and increasing personalisation of product offerings may require staff on the ground to ensure best fit with market conditions.

The rise of digital trade is likely to lead government tax offices to look for new sources of revenue in 2021 and beyond.

What is becoming increasingly clear, however, is that governments have been watching the growth of the digital economy with a wary fiscal eye. In the past, trade officials and tax authorities had relatively little coordination around policy responses. The rise of digital trade is likely to lead government tax offices to look for new sources of revenue in 2021 and beyond. Many of the forthcoming policies, designed to capture revenue may have trade implications. Firms that have to grapple with tax payments in distant markets may find the complexity too much to navigate, leaving them exiting foreign markets entirely. Or, alternatively, platforms that currently work for many business, including MSMEs, may struggle to manage tax collection for multiple jurisdictions on behalf of so many firms.

Rather than focus on corporate taxation, which has consumed most of the attention, it is also important to address new issues in taxation of digitally delivered goods and services in cross-border trade. Taxation of trade can fall on firms from large to small and poorly designed policies have the potential to dramatically slow or even undermine the growth of digital trade in the future. This includes disrupting trade in upcoming sectors as well as existing businesses.

Countries in Asia have already adopted different approaches to impose taxes.

Countries in Asia have already adopted different approaches to impose taxes. These approaches are varied depending on existing tax structures and revenues generated by the companies. For instance, Malaysia and Singapore are the first two countries in Southeast Asia to impose a tax on imported digital services. Malaysia Service Tax (STA) (Amendment) Act 2019 was introduced to enlarge the scope to tax B2C imported digital services.²⁷ Similarly, Goods and Services Tax (Amendment) Act 2018, in Singapore is imposed on B2C digital services, namely, the provision of digital services by overseas suppliers to non-GST registered customers in Singapore.²⁸

The approach taken in both jurisdictions is the same, that is to extend the ambit of a pre-existing tax regime which was originally applicable to only local suppliers, to foreign suppliers. By placing the responsibility and liability to charge and account

Tax collection may create outcomes that consumers may view unfavourably.

for tax squarely on their shoulders, the foreign suppliers or service providers are placed on an equal footing with local suppliers to the extent of the additional and onerous compliance obligations and costs to be borne by them. Although such costs may ultimately be passed on to the consumers, this may not be inconsistent with the stated objective of ensuring that foreign suppliers do not have an unfair competitive edge over local suppliers solely on account of tax.²⁹ Tax collection may create outcomes that consumers may view unfavourably.

Other countries like Australia, India, Japan, New Zealand and Republic of Korea, have also promulgated rules requiring online suppliers who sell in their domestic markets to register for VAT. Indonesia introduced Reg 48/2020 in May 2020, which will impose a 10% value-added tax on digital services provided by non-resident companies. The tax will apply to companies that have 'significant economic presence' in Indonesia operating in sectors, such as big data, multimedia, and software.³⁰ Indonesia's move came after Singapore introduced a 7% tax for overseas digital services and Malaysia imposed a 6% tax on imported digital services from the start of 2020.³¹

Developed for brick and mortar companies, tax rules do not seem adequate for managing online businesses.

There are likely to be a range of issues for consideration as governments take such steps to manage cross-border digital taxes. This includes the basic challenge that tax rules have been based on the principle of 'establishment' or physical presence. Developed for brick and mortar companies, tax rules do not seem adequate for managing online businesses. Different approaches to collecting tax will have differing impact on firms in the region.

Another issue is the risk of double or multiple taxation. Current bilateral tax treaties may not allow for deduction of digital service tax in the computation of tax liabilities in the home jurisdiction. Taxes on turnover instead of profit could be problematic as some businesses may have high turnover but low margins while others have high margins and low turnover. The design of an efficient tax structure in the digital space needs to ensure proper collection of taxes for income generated at source while avoiding over-taxation of digital activities when compared to other industries.

3. Cybersecurity and data protection

Keeping data flowing while ensuring the safety of citizens and firms represents significant challenges for governments.

The digital economy is underpinned, of course, by data. Keeping data flowing while ensuring the safety of citizens and firms represents significant challenges for governments. The balance between these objectives is hard to manage effectively and efficiently. As technology and digital trade evolves, it may be that specific policies put in place to handle threats to security and privacy need to be adjusted.

Sensible cybersecurity frameworks are clearly needed to help ensure that global trade flows can continue to flourish in the 21st century. Growing in volume, intensity and sophistication, cyber threats are global in nature and can pose serious risks to the regional and even global IT ecosystems on which economic growth and global trade depend. As a result, the need to protect information and identify the sources and nature of cyber threats have become important responsibilities of governments seeking to foster trust in the IT ecosystem that underpins the growth of the digital economy.

The implementation of cybersecurity policy regimes does not only concern critical economic and national security infrastructure, but also the growth of IT and trade ecosystems. Cybersecurity laws and regulations can affect trade facilitation measures, the structure and efficiency of global supply chains, and the exchange of digital products across markets. Thus, while it is important that policymakers take the risks seriously, it is instrumental that they ensure that measures implemented to improve security do not unnecessarily restrict trade and economic growth.

The Asia-Pacific region remains key to the world's business, technological and innovation value chains.

The Asia-Pacific region remains key to the world's business, technological and innovation value chains. Countries such as China, Taiwan, Japan and South Korea are pioneering technologies that leverage information to create new products and services offerings. Singapore, Hong Kong, Tokyo and Sydney are global banking and business hubs. India, the Philippines and Malaysia are leaders in global business support services. Understanding that the region must continue to compete in the global market, and at the digital frontier, has led to a rapid development in privacy law and governance.³²

The Asian region has taken a variety of approaches to the topic of data privacy.

Data protection is not all about ensuring cybersecurity. It also involves crafting suitable frameworks to protect citizen and corporate data in other ways. Governments are, understandably, concerned about the risks of exposing certain types of citizen data, such as confidential medical or financial information. The Asian region has taken a variety of approaches to the topic of data privacy. Some governments have data regulation laws in place. Others have more comprehensive data protection and privacy laws. Finally, some governments have elements of data privacy or protection regulations or legislation in place.

Getting appropriate data transfer rules into place to manage cross-border data flows has proven challenging. Some governments have opted to create rules requiring that data, or certain types of data, remain onshore and are not transferred between countries. While these rules, called data localisation laws, are seen to provide more safety and security for domestic data, they may not work as intended. The risks are many but include the potential for concentration of data in a smaller number of locations making the information an easier target for cyber theft and hacking to the possibility that a local event like an earthquake, storm or another disease could disrupt data locations managed within a more limited geographical scope.

A lack of harmonised practices across Asia creates hurdles for intra-regional data transfers and protection of data privacy.

A number of countries in the region — including China, India, Indonesia, South Korea, and Malaysia – have already introduced data localisation requirements, and there are efforts across Asia to introduce or enhance such regulation.³³ Other countries, such as Myanmar, Cambodia, Philippines, Hong Kong, Singapore, Thailand have not joined this trend. Singapore, as an example, has taken a different approach to data localisation. Instead of pursuing localisation, it is focusing efforts on promoting its digital economy, harnessing data analytics, and creating the best possible ecosystem for digital technologies to thrive across all sectors.³⁴ Overall, however, a lack of harmonised practices across Asia creates hurdles for intra-regional data transfers and protection of data privacy.

The region has in place a variety of policies designed to handle the cross-border transfer of data. Japan, South Korea, and Australia have policies to move

ASEAN has been working on a transfer regime for the region that will include contractual clauses and certification procedures.

information to recipient countries that have substantially similar data protection regimes, adhere to similar privacy principles, include safeguards for third party receivers of data (including through contracts), and grant individual consent to data transfers. ASEAN has been working on a transfer regime for the region that will include contractual clauses and certification procedures. Sorting out the specific details for both approaches has taken time, but ASEAN's data policies are meant to be in place by 2021.

In short, although Asian economies have made different steps towards resolving data transfer issues related to cybersecurity and the protection of data, the net effect remains fragmented. As with many digital policies, some countries in the region are further along in crafting regulations than others. Work in the future will include ensuring less regulatory fragmentation around issues of cross-border data transfers.

4. Data or digital sovereignty

Data ownership has not been clearly established, with some jurisdictions arguing that consumers "own" their data.

The growth of the digital economy has not only generated concerns about the collection of data, but also about allowable and prohibited uses of data. This is an area that has not, as yet, received as much attention or focus, but it is likely to become a growing topic of concern for Asian governments in 2021 and beyond. Part of the issue, of course, is that data ownership has not been clearly established, with some jurisdictions arguing that consumers "own" their data. Not all data is consumer generated, making ownership more complicated. If a firm generates "data" on energy usage in a warehouse, for instance, is such data owned by the warehouse operator or by the firm that installed the management sensors?

Once data is collected, some governments are beginning to argue that such information remains sovereign property. Although not yet clear, it may mean that such data collected from domestic citizens needs to remain onshore for processing, analysis, and any further use. As such, digital or data sovereignty rationales could become tied up with arguments for continued or increased data localisation.

It may also be the case that new forms of consent will be necessary to move information. If put into place, data sovereignty rules could make it difficult or even impossible for many firms to operate and many new services to be rolled out. As an example, many types of health devices such as insulin pumps currently collect a variety of different types of data. This information is used to determine whether or not insulin should be released into the patient's body and in what dosage. Data sovereignty could make it more challenging for firms to provide this support, particularly if the services provider is offshore or if the patient travels overseas and into new markets.

Strong data sovereignty rules could make it harder to detect fraudulent activities.

Some apparently domestic operations can involve overseas components. As a simple example, a cashless transaction in a market may appear to be purely local—the consumer buys an item from the corner shop. But the firm processing the payment information may send the transaction data overseas to check against fraud databases to ensure that the transaction is likely to be legitimate. Strong data sovereignty rules could make it harder to detect fraudulent activities.

Digitalisation and online platforms provide numerous benefits to firms and consumers.

5. Competition law/anti-trust policies

Digitalisation and online platforms provide numerous benefits to firms and consumers, including increased choice and economic opportunity, but they can also raise market concentration and competition concerns. With competition governance questions entering mainstream political discourse, there is a need for a balanced, evidence-based assessment of the proper role of competition policy in the digital space.³⁵

With the onset of an increasingly digital world across the APAC region and the interest of regulators in the sector, it is important to understand the unique antitrust issues raised by companies operating in the digital space.³⁶

Access to and control of data is crucial and confers market power.

Competition policy and anti-trust regulation have been used to prevent the development of monopolies, which are assumed to deliver poor outcomes to the marketplace. Digital trade, and especially the rise of digital platforms has given new life to arguments about the concentration of power and the economic implications that come from such monopolies. It may be the case that many digital markets are simply predisposed to become “natural” monopolies, where consumers gravitate to one platform because it delivers superior service. The collection of more information from customers may lead the platform to refine service even further, driving more customers onto the platform. Access to and control of data is crucial and confers market power, and this feature is further reinforced by network effects. Firms therefore “compete for the market instead of competing in the market, leading to ‘winner takes all’ outcomes.”³⁷ Attempts to disrupt this cycle may not automatically result in better results for consumers. Indeed, it could create significantly worse outcomes, as the quality of service from fragmented suppliers may decline.

Dominant platforms have expanded their businesses vertically into upstream and downstream markets, and become competitors to traders or application developers that use their platforms. Such expansion improves the platform’s capacities to collect more data and increase their competitiveness and confers on them the role of gatekeepers of online stores and application markets, in which they are both owners and users. This situation may at any time give rise to abusive and exclusionary conduct by dominant platforms.³⁸

For example, Amazon started as an online bookstore but later diversified, and sells music, audiobooks and other consumer goods, and has also moved into manufacturing and retailing its own brands, competing with other traders on its marketplace, thereby making it possible for the dominant platform to discriminate against independent traders that are its clients and competitors at the same time.

There are additional points of confusion around managing competition in the online space. It may make sense to regulate online and offline markets in the same way, but it can be harder than anticipated to determine whether both are the same “relevant market.” Advertising, as an example, may be viewed as similar but they are also quite different in the traditional media from digital approaches.

The fact that many digital platforms charge no monetary price to consumers renders traditional market definition tools unsuitable.

The fact that many digital platforms charge no monetary price to consumers renders traditional market definition tools unsuitable. In digital markets, it may

be impossible to provide well defined markets. Competition authorities need to employ additional criteria for the definition of the relevant market in digital sectors.

The challenges of appropriately regulating the digital economy is exacerbated in many developing countries.

The challenges of appropriately regulating the digital economy is exacerbated in many developing countries which have small competition authorities with limited resources for taking on competition cases in an increasingly concentrated global economy. Given the growth of e-commerce, appropriate e-commerce policies and regulations can help to ensure open access to platforms under fair terms and conditions by local small and medium-sized enterprises (SMEs). Getting the balance right has been difficult.³⁹ Conversations around competition policy and appropriate anti-trust rules are likely to continue to dominate many government meetings in 2021.

6. Digital payments

Digital payments are at the center of digital trade expansion and serve as a key enabling factor for digital commerce.

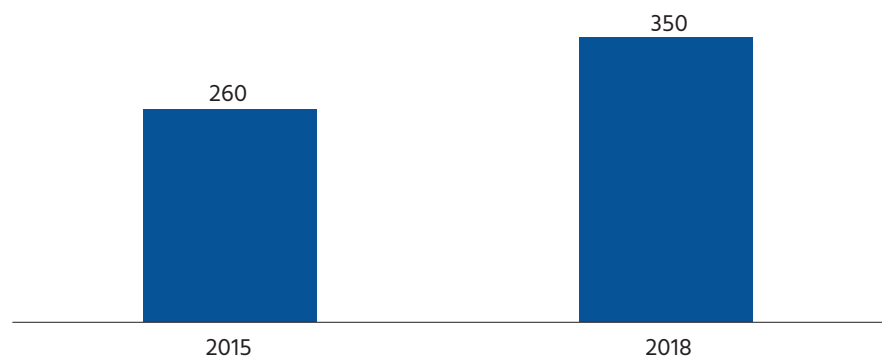
Opening up digital trade for business does not work if firms cannot get paid quickly, easily and at an affordable price. Digital payments are at the center of digital trade expansion and serve as a key enabling factor for digital commerce. Payment services are a critical component of the online services ecosystem that allows consumers to conveniently make purchases for goods and services from merchants globally and for firms to sell around the world far more easily and cheaply than ever before.

In recent years, the use of digital payment solutions has multiplied in the region. Asia-Pacific overtook Europe and North America to become the non-cash transactions volume leader at US\$234.6 billion in 2019, and this value is expected to reach US\$493.2 billion in 2023.⁴⁰ China, India and Southeast Asian economies are driving this growth, steered by increasing smartphone use, booming e-commerce, digital wallet adoption, and mobile/QR-code payments innovations.

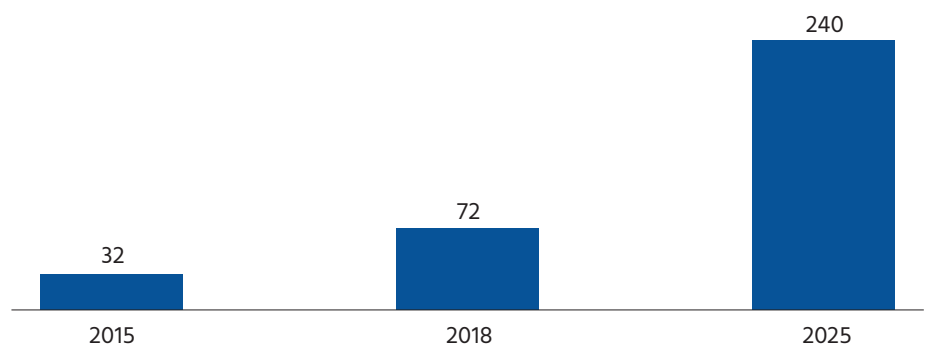
Making payments today requires a vast network of mutually interdependent networks.

Making payments today requires a vast network of mutually interdependent networks that connect firms, consumers, financial institutions, mobile applications, international and domestic payment networks, clearing and settlement systems, digital currencies and other important parts of the payment ecosystem. The cross-border payment process is complex and often requires multiple domestic and international or cross-border steps. In fact, many payments processes that appear to connect a purely domestic purchaser with a domestic seller may have international elements included in the transaction, as some elements like fraud protection may be performed outside of a specific domestic setting.

With the rise in cross-border transactions, cross-border flows now represent one-sixth of total transaction values and totals up to US\$200 billion globally. This equates to 27% of global transaction revenues and is increasing by 6% annually.⁴¹ Southeast Asia have the world's fastest growing online market, with over 350 million Internet users and an overall market size of US\$72 billion in 2018 (Figure 2).⁴² Southeast Asia's digital economy is expected to triple in size to US\$240 billion in 2025 (Figure 3). E-commerce is the most dynamic sector in the region. In the next five to 10 years, the regional e-commerce market is projected to grow at an average rate of 25% to 35% per year.⁴³ Increasing demand

Figure 2 – Internet users in Southeast Asia (millions)

Source: Hootsuite "Digital in 2018"

Figure 3 – SEA internet economy market size (GMV, billions)

Source: Google & Temasek/Bain. "E-Economy SEA 2019," 2019.

Note: GMV = Gross Merchandise Value

for e-commerce purchases across borders and need for international financial services has impacted the growth of cross border e-payments and the need for interoperability of e-payments.

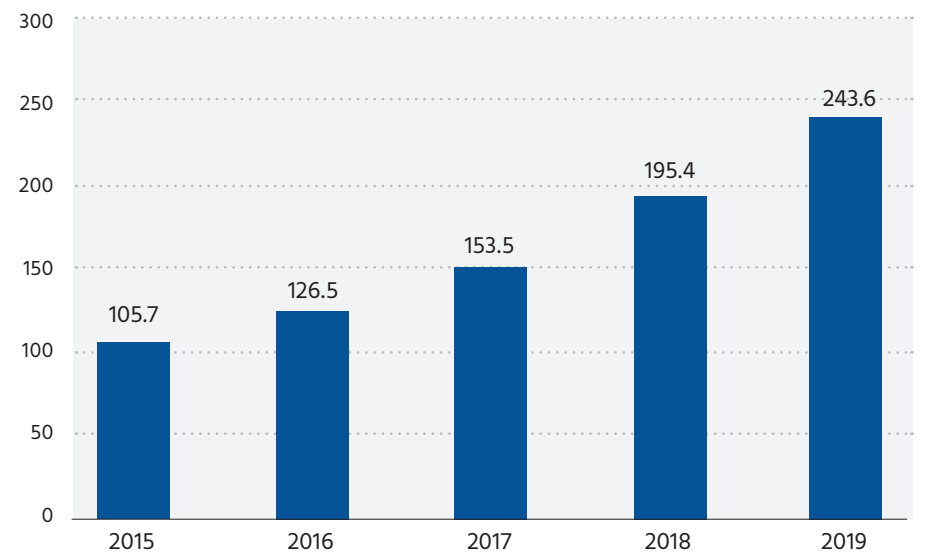
In the Asia-Pacific region, non-cash transactions have been growing even faster—at a rate of 20% per year, and 30% in emerging Asia.

In the Asia-Pacific region, non-cash transactions have been growing even faster—at a rate of 20% per year, and 30% in emerging Asia.⁴⁴ The number of worldwide non-cash transactions in Asia-Pacific has increased from US\$105.7 billion in 2015 to US\$243.6 billion in 2019 (Figure 4). Emerging markets are home to 85% of the global population and Asian countries—including India, China, and Indonesia—make up the majority.⁴⁵ As a whole, digital payments in Asia are forecast to grow 16.4% annually and reach a value of over US\$2.5 trillion per year in 2022—half of the estimated worldwide total value of US\$5.4 trillion.

The Covid-19 pandemic has accelerated the growth of digital payments in Asia.

The Covid-19 pandemic has accelerated the growth of digital payments in Asia. Driven by the rise in online shopping and increase in preference for contactless payments over cash, consumers are increasingly embracing electronic payments. In a three-month period in 2020 under Covid, 41% of consumers in Asia made five or more e-commerce transactions.⁴⁶ Three-quarters of consumers in the region have said they will keep using digital payments instead of going back to cash, even after the global pandemic has subsided.

The proliferation of payment solutions has encouraged MSME growth. Digital payments help micro and small merchants grow their revenue, manage their

Figure 4 – Number of worldwide non-case transactions in Asia-Pacific (billions), 2015-2019

Source: Cap Gemini, World Payment Reports 2019

business, and gain access to other financial services. A survey conducted by VISA found that 54% of smaller firms surveyed found that sales increased after adopting digital payment methods.⁴⁷ Within the cross-border payments market, MSME usage has been growing at two or even three times the rate of large corporates, being driven by MSMEs in emerging markets.⁴⁸

Despite the importance of digital retail payments to regional trade, significant logistical and governance challenges persist in regions like Asia.

Despite the importance of digital retail payments to regional trade, significant logistical and governance challenges persist in regions like Asia. Differences between economies in technological maturity, regulations, standards, cost, digital access, and security levels have made it difficult for service providers to create value-adding services that are interoperable across multiple locations.

Regulatory agencies that are responsible for consumer protection, financial stability, and other public interests are grappling with the legitimate challenge of updating policy frameworks to account for technological innovation and changes in consumer behaviour. A focus on protecting consumers and companies from undue risk appears to have limited the spread of efficient and effective means of driving e-payments, especially for cross-border mechanisms.

Despite the opportunities that the proliferation of inclusive and interoperable cross-border e-payment can provide the region's economic development, Asia nor ASEAN have policies in place to allow regional interoperability frameworks to standardise the processing of payments.

There are multiple challenges ahead for policymakers in 2021.

There are multiple challenges ahead for policymakers in 2021, including the importance of managing interoperability of payments networks. Advances in technology and regulatory reforms have led to a renaissance in digital payment innovation. While the appearance of new payment providers and technologies has led to new innovations and increased competition, it has also led to an

increasingly complex set of systems with significant variation in standards by region, making cross-border payments increasingly difficult. These two factors—new technologies and regulatory fragmentation—have created significant interoperability challenges and additional friction in making and receiving cross-border retail payment.

Broadly defined, interoperability enables all participants of the payment system (e.g. consumers, merchants and governments) to easily send funds between different payment networks and instruments. There are steps countries in the region can take to reduce existing frictions and move toward greater harmonisation and interoperability.

Similar collective approaches to a range of issues related to payments systems are likely to be part of the digital trade conversations in 2021.

7. New technologies and digital trade

Trade officials across Asia and beyond have been grappling with the evolution of new technologies since the start of the digital era.

Trade officials across Asia and beyond have been grappling with the evolution of new technologies since the start of the digital era. Trade and regulatory frameworks had to be adjusted or at least understood in the context of developments like the rise of smart, internet-enabled mobile devices, the growth of the “sharing” economy, or the proliferation of many new technologies embedded in internet platforms of all types.

Headed into 2021, five technologies seem particularly pertinent for official attention. They are starting to become embedded in a wider variety of goods and services rather than remaining interesting new innovations with limited application. These include the Internet of Things (IoT), artificial intelligence (AI), 3D printing, additive or new manufacturing models, blockchain and financial technologies (FinTech). Each has the potential to transform the way we trade, who trades and what is traded.⁴⁹ Many of these innovations have been under consideration for some time, but the growth of markets for AI or new manufacturing has grown significantly under the pressures of Covid lockdowns. Firms have, for instance, been increasingly 3D printing critical parts and components with travel and shipping disrupted. Many personal protective equipment (PPE) products have been 3D printed, including test swabs.⁵⁰

Disruptive technologies have already begun to penetrate regional and global value chains, and their impacts will grow in the years ahead.

These disruptive technologies have already begun to penetrate regional and global value chains, and their impacts will grow in the years ahead. Some of these technologies will reduce transaction costs and facilitate trade flows. Automation technologies and 3D printing in manufacturing, as examples, will change the way goods are made and the relative cost of different inputs, including labour. This could amplify the trend of more localised production near key consumer markets.

By reducing transaction costs, digital technologies have enabled trade in goods and services to soar. According to the WTO, global trade is projected to grow by 2 percentage points more than in the baseline scenario as a result of these trends, and the share of services trade is projected to grow from 21 to 25%.⁵¹ McKinsey & Company estimates the potential economic impact of 3D printing to be between US\$ 200 billion and US\$600 billion by 2025.⁵² AI could add around 16% or US\$13 trillion to global output by 2030.⁵³

Policymakers in Asia-Pacific have already recognised the importance of these new technologies and have made efforts to create conducive ecosystems for these technologies to thrive. Investment in innovation and research and design (R&D) has been, and will continue to be, a key priority for advanced Asian economies including Australia, New Zealand, Singapore, South Korea and China.⁵⁴ The large investments in technologies and R&D has helped build significant intellectual property stocks in the region. R&D corporations headquartered in Japan, Korea, Chinese Taipei and China have together “contributed to about 70% of all AI-related patents obtained by the world’s 2000 top corporate R&D investors and their affiliates, while US-based companies accounted for just 18% of the total.”⁵⁵ China, for example, accounts for 40% of global patent applications and has become a global force in the internet, AI, and the digital economy and is making headway in emerging technologies such as 5G and quantum computing.⁵⁶

Regulatory sandboxes provide an environment of reduced regulatory constraints on innovative financial products and services.

Asia-Pacific governments know how innovative technologies have the potential to deliver economic benefits by lowering the cost of transactions and enhancing competition. To accommodate the unprecedented pace of digital change in the region, financial regulators are considering paths to “optimal regulation” by implementing regulatory sandboxes.⁵⁷ Regulatory sandboxes provide an environment of reduced regulatory constraints on innovative financial products and services. They enable financial services innovators - both incumbents and startups - to test new products and services in a “safe area,” providing greater flexibility or even exemptions from existing regulation.

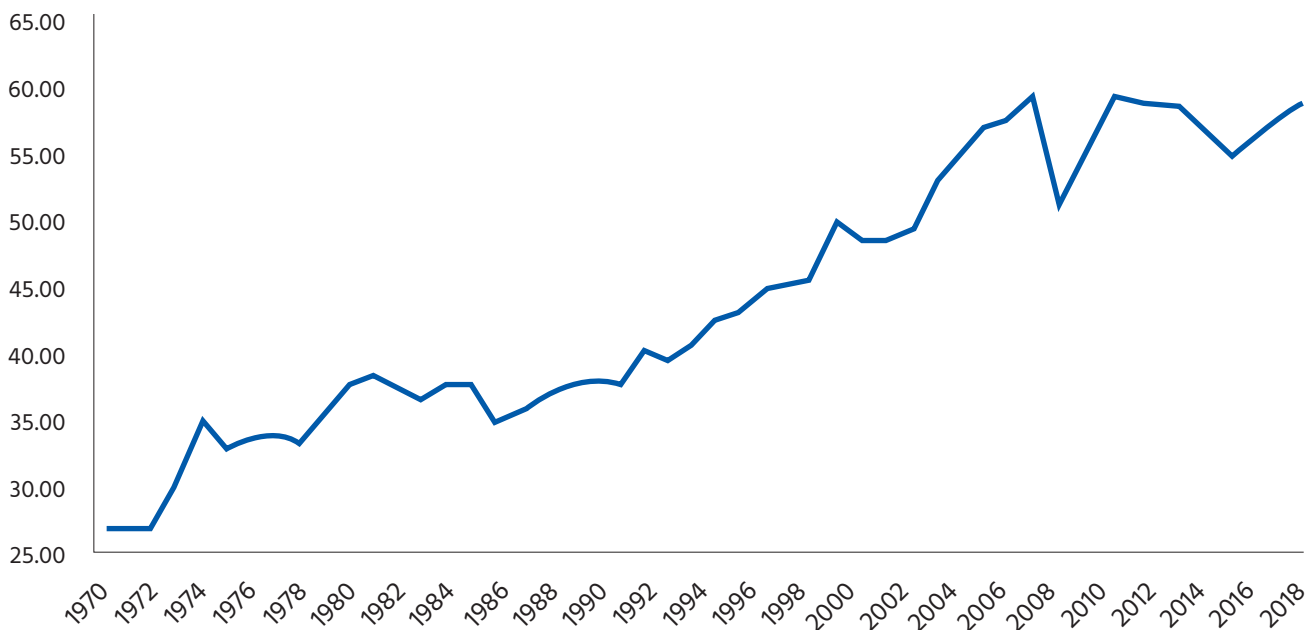
The region’s regulators appear united in their desire to facilitate innovation.

Asia-Pacific countries, including Australia, mainland China, Hong Kong SAR, Indonesia, Malaysia, Singapore, South Korea and Thailand, have all implemented regulatory sandboxes. The region’s regulators appear united in their desire to facilitate innovation while ensuring that society can enjoy the benefits of innovative FinTech offerings without undue risk. They are also aware of the need to protect the integrity of local financial markets while ensuring those markets remain globally competitive.

Asia-Pacific countries are also participating in innovative pilot projects that include the use of innovative technologies to facilitate international trade. In 2018, Maersk and IBM have launched TradeLens, a new shipping solution jointly developed by the two companies to apply blockchain to the global supply chain. TradeLens is designed to promote more efficient and secure global trade, bring together various parties to support information sharing and transparency, and spur industry-wide innovation. The customs authority of Singapore, Australia and Thailand have adopted the program.

Trade costs, including customs, transport and logistics costs, are a leading constraint for companies eager to engage in trade.

Trade costs, including customs, transport and logistics costs, are a leading constraint for companies eager to engage in trade. A significant share of these costs is derived from the time and money spent on paperwork and in multiple submissions of the same information, as required by various customs authorities to release goods for export and allow them to enter the importing country. Between 1996 and 2014, international trade costs declined by 15%.⁵⁸ New technologies, like blockchain and IoT, are expected to further reduce these costs. The WTO predicts that trade could grow yearly by 1.8 to 2 percentage points more until 2030 as a result of the falling trade costs, amounting to a cumulated growth

Figure 5 – World trade as a percentage of GDP

Source: World Bank data

of 31 to 34 percentage points over 15 years.⁵⁹ The ratio of trade to GDP – an indicator of trade openness – has increased across the world as a result of these trends including globalisation, trade liberalisation and lower trade costs (Figure 5).

Innovative technologies can reduce transportation and service costs.

Innovative technologies can reduce transportation and service costs as well. AI and IoT can speed up the movement of goods by tracking shipments, creating smart inventories and routing delivery vehicles based on the road conditions. Digital processing of documents can also help speed up goods through customs. New technologies have potential to improve transit times for traded goods by 16 to 28% by 2030.⁶⁰

Digital technologies have also transformed trade contracts.

Digital technologies have also transformed trade contracts. Blockchain can be used to make “smart contracts” to replace paper-based documentations in trade finance. Smart contracts are agreements between parties stored on a blockchain. They function on a basis of standard templates and are able to perform instant transactions. As transactions through a smart contract are permanently recorded in a distributed ledger, they are less susceptible to tampering, making them more secure. According to McKinsey Global Institute, advanced technologies could boost trade in manufactured goods and agriculture by US\$1.5 trillion to US\$2.6 trillion annually by 2030, an increase of 6 to 10%.⁶¹

A decline in trade costs allows for greater participation of MSMEs in international trade as smaller firms tend to trade in smaller quantities than larger firms. Logistics costs often make up a greater share of the unit cost of MSME’s goods as compared to their rivals which export in larger volume. Hence, cheaper and more reliable logistics services can disproportionately benefit MSMEs.

In short, there are a wide array of new technologies that are likely to proliferate in the region in 2021 and beyond. Many of these approaches or applications exist in policy vacuums or, at a minimum, in lightly regulated spaces. The increasing use of new tech in a wider variety of potential applications will leave government regulators and officials grappling with the most effective and effective means of creating sensible policy settings.

8. Digital trade and MSME development

Digital clearly has the power to transform trade.

Digital clearly has the power to transform trade. Many of the new technologies and digital applications that are coming into the mainstream have been developed by large firms with significant resources. But it is important to recognise that smaller firms can also be nimble and innovative producers of new technology as well as eager consumers of digital solutions. Making sure that digital trade benefits firms of all sizes is likely to be a critical task for governments.

Micro, small and medium-sized enterprises (MSMEs) support job creation and employment growth across the region. MSMEs in the Asia-Pacific region represent more than 98% of all businesses and contribute to a large share of employment in the region.⁶² In Indonesia, MSMEs employed 97% of the labour force and MSMEs in the Republic of Korea employed 89.8% of the total labour force.⁶³ The crucial role that MSMEs have in supporting economic activities and social development through provision of employment for local communities and marginalised groups has helped to enable social mobility and inclusiveness.

Digitalisation is a key driver for MSME development.

Digitalisation is a key driver for MSME development, functioning as enablers for even the smallest of firms to reach out and sell to customers globally and connecting MSMEs to global value chains (GVCs). The use of online platforms and e-commerce marketplaces to sell goods and services have reduced the cost of internationalisation for MSMEs and helped match buyers and sellers without a need for other intermediaries, thereby supporting the growth of MSMEs by expanding their market outreach.⁶⁴

Digital productivity tools and enterprise resource planning (ERP) software can help to automate many business processes and reduce the workload involved to track orders, inventory, and financial details. MSMEs can integrate their services with new digital offerings of electronic payments, mobile applications, and tracking services that provide added value to their business offerings.

The Covid-19 pandemic has severely affected small businesses who are facing major hurdles.

The Covid-19 pandemic has severely affected small businesses who are facing major hurdles arising from supply chain disruption and import/export measures and lockdown restrictions that impact the delivery of goods and services. According to a business survey conducted by the International Trade Centre (ITC), smaller businesses tend to be worse affected than larger businesses with those in the tourism and hospitality industry suffering the most from losses in revenue.⁶⁵ To cope with the crisis, governments in the Asia-Pacific have stepped up on activities to support MSMEs to go digital and find new opportunities for growth. There are many challenges however, that could limit MSME participation in the digital economy or render MSMEs in developing countries less competitive.

Various sociocultural, infrastructure and regulatory challenges have made participation in the digital trade difficult for MSMEs. Especially in developing

Access to a reliable information infrastructure and network is often a concern for many MSMEs in developing countries.

countries, MSMEs may not have the financial and resource capabilities to adopt new digital tools and train their workers to harness productivity from the use of new digital tools and software even though participation in digital trade provides new opportunities. Access to a reliable information infrastructure and network is often a concern for many MSMEs in developing countries. Furthermore, regulatory heterogeneity in data privacy laws, payment regulations, and taxation rules and how to manage competition in the digital space as well as the compliance burden on MSMEs to cope with new laws and regulations could also impede MSMEs from leveraging digital trade. Localisation measures and lack of trade facilitation support that obstructs cross-border trade could make it challenging for MSMEs to sell to overseas markets. Such challenges faced by MSMEs will often require policy intervention from governments to support MSMEs to transit to the digital economy and leverage digital trade to sell to larger markets.

High informality exists in the Asia-Pacific region amongst developing nations⁶⁶ which affects the effective delivery of policy initiatives that target MSMEs and support workers in the digital transformation. The share of informal employment in India is 88.6% and that of Indonesia is 80.4%.⁶⁷ Moreover, other developing Southeast Asian countries including Cambodia, Myanmar and Laos also have a rather high share of informality. A report by the World Bank also attributes constraints on MSME participation in the GVC on informality and resource constraints that MSMEs face relative to large firms.⁶⁸ Operating in the informal economy, unregistered businesses and informal workers could be disadvantaged when accessing finance and loans. Unregistered businesses also tend to be left out by government support schemes that provide tax benefits, wage, and rental subsidies etc. There are also MSME grants and credit schemes offered by governments to eligible MSMEs. Such credit schemes for MSMEs often provide low interest loans with no collateral and deferred interest payment options but could not be availed by informal businesses.

Supporting businesses to adopt new digital tools and technologies has become an increasingly important agenda item for governments across the region.

Supporting businesses to adopt new digital tools and technologies has become an increasingly important agenda item for governments across the region. Australia, Singapore and Thailand have introduced grants that support innovation and adoption of digital solutions by small businesses or start-ups. Australia provides funding of up to AUD 10,000 for purchase of hardware, software and services to enhance the digital capabilities of their business for small businesses with fewer than 20 employees.⁶⁹ Such grants and subsidies offered by governments to MSMEs help to encourage the adoption of digital technologies to enhance business productivity and help businesses stay competitive.

As governments try to figure out how to support MSMEs to “build back better” from the Covid pandemic, figuring out how to more effectively and efficiently support the smallest firms in the economy will become an increasingly important challenge. Every recent trade agreement has included a chapter specifically on MSMEs to harness trade opportunities for the smallest firms in the economy.

Digital governance

Asian governments have an array of potential platforms for discussions of digital trade.

As this paper has indicated, there are a wide array of issues on the digital trade policy agenda for 2021 and beyond. Some of these issues are likely to be tackled by governments in the region at the domestic level. Others will require or will include some level of coordination and cooperation. Fortunately, Asian governments have an array of potential platforms for discussions of digital trade and methods for locking in rules governing key aspects of the digital economy.

It would be best, particularly for MSMEs, if digital trade rules were harmonised across the largest group of countries. Digital is largely borderless and the growth of the internet over the past 25 years has allowed firms anywhere to locate suppliers and consumers across the world. Somewhat unfortunately, for much of this time period, the largest global trade body, the World Trade Organization (WTO), has been unable to craft new rules, provisions or commitments to address digital trade.

The WTO started with good intentions, launching a work program on electronic commerce in 1998. But the topic failed to move forward at the time and, other than imposing a moratorium on the use of customs duties (tariffs) on electronic transmissions, little substance came from these early talks. WTO members, as noted in the section on services, made a variety of commitments around delivery of services trade that could be adapted to fit or to address some digital trade challenges. Other existing rules have been reinterpreted in light of ongoing digital developments. The body as a whole, however, remained unable to move ahead with considerations of many key topics in digital.

Finally, in December 2017, a group of countries led by Australia, Japan and Singapore, launched a Joint Statement Initiative (JSI) on E-Commerce at the WTO ministerial conference in Buenos Aires in December 2017.⁷⁰ A separate JSI on Services Domestic Regulation also supports negotiations on facilitating trade in services by improving transparency of regulatory practices for service suppliers.⁷¹

The JSI on E-Commerce has seen an expanding agenda, as members grapple with different aspects of the digital economy.

The JSI on E-Commerce has seen an expanding agenda, as members grapple with different aspects of the digital economy. Much of the work in 2020 got disrupted by the pandemic and the switch to virtual meeting sessions. However, headed into 2021, the JSI initiatives are set to continue work with the goal of announcing some sort of deliverables at the next WTO Ministerial meeting (tentatively set for summer 2021).

There are at least two other multilateral groupings that are likely to touch on digital trade issues in the coming year: the G20 and APEC. The Covid-19 experiences have highlighted the importance of being online to all of the members of the G20 grouping. As the chair moves from Saudi Arabia to Italy, it will be useful to watch whether the Italians add digital to the agenda and how any potential talks are positioned.

APEC has had ongoing workstreams around the digital economy for several years. As much of the work in APEC is done at the working group level, by member economies that often share their domestic-level experiences, APEC can be a helpful supporting organisation to drive familiarity with new topics across the region. APEC meetings often focus on sharing out “best practices” which can be quite useful in debating rapidly evolving regulatory and policy landscapes.

Asian economies have been enthusiastically expanding digital rules in a variety of settings.

Given the slowness with which the WTO has been approaching digital trade, Asian economies have been enthusiastically expanding digital rules in a variety of settings. These include embedding digital rules inside new free trade agreements, adding digital rules to expansions of existing trade agreements during upgrade exercises, and even creating individual, stand-alone digital economy agreements.

The digital agenda in 2021 in the region will be busy with a variety of new implementation challenges. For instance, ASEAN members have agreed to start their e-commerce agreement. This deal, which was concluded in 2018 is now ready to enter into force. The region concluded the Regional Comprehensive Economic Partnership (RCEP) in November 2020 with a wide array of commitments in the digital space. This includes not only an e-commerce chapter, but also digital provisions inside the intellectual property rights chapter, new services commitments and so forth. As members figure out how to be ready for presumed entry into force in late 2021 or early 2022, this embedded digital agenda will be rolled out.

Asian economies will continue to sign digital-only agreements in 2021.

Finally, Asian economies will continue to sign digital-only agreements in 2021. First up will likely be one between Singapore and South Korea. Others may be in the works as the year progresses and potential member governments have greater comfort with the range of possible commitments.

Conclusions

The Covid-19 pandemic has reinforced the importance on the online world to businesses and consumers.

Governments in Asia will clearly be focused with greater intensity on building appropriate and supportive policy frameworks for the digital economy. The Covid-19 pandemic has reinforced the importance on the online world to businesses and consumers. It has also highlighted the challenges that stem from fragmented policies and the risks of potentially conflictual regulatory rules.

Sorting out these challenges will be difficult. The range of potential issues includes the eight topics noted in this paper: digital services, digital taxation, cybersecurity and data protection, data or digital sovereignty, competition law and anti-trust polices, digital payments, effectively managing the rise of new technologies, and supporting MSMEs in the digital space. Each of these eight issues appears ripe for further discussions in 2021 and beyond and all are important in crafting effective supporting policy infrastructures.

As the world continues to grapple with the fallout from the global pandemic and the associated economic disruption caused by illness and lockdowns, it is important that the digital economy remains a key engine of economic growth and recovery. This includes crafting sensible policy responses that are coordinated across the region to ensure that digital growth gets more evenly distributed. Fortunately, Asia has a variety of potential platforms available for such conversations and to anchor policy commitments to help lower the risks associated with the pandemic recovery and build in greater certainty over policy frameworks going forward.

The digital economy agenda will be challenging to craft but critically important to Asia in 2021 and beyond.

As difficult as the Covid-19 situation has been for firms and for citizens, it would have been much worse absent a wide variety of digital tools to help manage disruption, maintain visibility on key outcomes, and keep locked down populations connected and even entertained. The obvious importance of digital as a cross-cutting tool enabling economic activities of all types requires faster movement by many governments to ensure that the rulebooks governing digital trade match today's reality as much as possible. The digital economy agenda will be challenging to craft but critically important to Asia in 2021 and beyond.

Endnotes

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