Asia-Pacific Trade and Investment Report 2017

Channelling Trade and Investment into Sustainable Development

EXECUTIVE SUMMARY

Trade and investment have been powerful engines of growth, especially in Asia and the Pacific, where many developing countries grew at impressive rates between the 1990s and the 2008-2009 global financial crisis. Trade and investment were instrumental in the region, halving poverty five years ahead of the 2015 Millennium Development Goals deadline. This success shows that trade and investment will play a critical role in pursuing the Sustainable Development Goals going forward. However, economic gains must not come at the expense of social and environmental goals. It is hoped that this report can help steer trade and investment policies so that they can promote balanced economic, social and environmental development for achievement of the 2030 Agenda for Sustainable Development.

The report consists of two parts. Part I assesses trends and developments in region's trade and investment flows and policies. Part II explores how trade and investment can be better channelled into sustainable development.

PART I – TRENDS AND DEVELOPMENTS IN TRADE AND INVESTMENT

Despite a weak performance in 2016, Asia-Pacific remained the largest trading region in the world.

Global and regional trade remained weak in 2016. Global trade declined by 3.2%, while Asia-Pacific trade fell by 4.3%. Trade contraction in China was a major factor for this poor performance. China's exports represented more than one third of the region's exports, and it contracted by 7.7%. In the rest of the developing Asia-Pacific region, exports decreased by 3.6%. Nevertheless, despite a decline of trade, Asia- Pacific region still accounts for 40% of global exports and 35% of global imports.

2017 looks optimistic for merchandise exports and imports.

Global and regional trade growth has improved in 2017. As global and regional demand recovers, both the volume and value of the region's exports and imports are projected to increase. Volume of exports by the Asia-Pacific region is expected to grow by 4.5% and import growth may reach nearly 8%. Exports and imports by developing Asia-Pacific countries are predicted to grow faster than those by developed countries in the region. Countries previously affected by the slowdown of global value chain activities, such as the Republic of Korea and the Philippines, are expected to enjoy significantly better trade prospects in this year. At the same time, the rising prices of industrial commodities and fuel will contribute to dynamic growth for commodity exporters such as Australia, India, Indonesia, Islamic Republic of Iran, Kazakhstan and others.

However, there are some grey clouds on the horizon.

Although the improved performance of global and regional trade during the recent period is promising, several factors may impact the recovery continuing into 2018. Structural factors that have contributed to weak trade performance since the 2008-2009 global financial crisis persist. While import demand in developed economies has not fully recovered, import demand in China, especially for intermediate inputs, will also moderate due to the structural rebalancing of China from export orientation to domestic consumption. Hence, intraregional demand may not be sufficient to bring trade growth back to pre-crisis level. The protectionist rhetoric in some developed economies also creates additional risks. While many of the fears about renewed trade protectionism may not be realized, rising uncertainties could be a disincentive for long-term investment and trade.

These may hinder trade growth in 2018.

Thus, the prospect of global and regional trade recovery will still be fragile for a few years ahead. ESCAP anticipates that export volume of Asia-Pacific region in 2018 will grow more modestly than in 2017 at 3.5%, while the import volume will increase by less than 3%. In addition, export and import prices, especially commodity prices, are also not likely to increase, and in fact, may trend downward due to the slowdown of investment and consumption precipitated by rising uncertainties. The sluggish prices will cause trade value in 2018 to grow much slower than in 2017.

Trade in commercial services in the Asia-Pacific region saw a mild recovery in 2016.

Commercial services trade recovered modestly in 2016, with exports and imports growing by 0.1% and 1.3%, respectively. This growth was driven by the “other commercial services” sector which grew by 1.7% in 2016. Stronger recovery is expected in 2017 due to the growth improvement of major service sectors. The transport sector, which contracted by 6.8% in 2016, registered more than 3% growth in the first quarter of 2017, promising a strong recovery in 2017. Tourist arrivals also increased 3.3% in 2016 in the region, with further growth prospects for 2017.

Nevertheless, the continued rise of the region as a major trader of commercial services depends on a handful of economies.

The share of world trade in commercial services captured by the Asia-Pacific region has grown from 24.9% in 2005 to 30.3% in 2016, with growth in all sectors outperforming global averages. Trade in commercial services has also increased in importance relative to merchandise trade during that period. However, exports from only four countries (China, Japan, India and Singapore) represent more than half of the region’s total exports of commercial services. In terms of imports, a group of seven economies (China; Japan; Singapore; India; the Republic of Korea; Hong Kong, China; and the Russian Federation) captures over three quarters of the region’s imports of commercial services, with China alone representing nearly a third.

Asia-Pacific countries are embracing trade in new services.

Travel services and transport services accounted for 29% and 19% of all services exports from the region, respectively, in 2016. The region provides half of the world’s exported construction services and is increasing its share in insurance services, telecommunications, computer and information services, financial services and charges for the use of intellectual property. One increasingly important trend in the region is the impact of digital trade relative to merchandise trade. Proliferation of Internet access means that some goods that were previously traded as merchandise goods, such as books and music, are now increasingly traded as services.

Barriers to trade in services are gradually falling.

Trade policies affecting commercial services were discussed using the Services Trade Restrictiveness Index of the Organisation for Economic Co-operation and Development. The index shows a gradual fall in barriers to trade in services over the last three years in the region for most countries covered by the index. Further liberalization of service sectors could help increase the competitiveness of domestic service providers as well as export-oriented manufacturers due to the interconnectedness of value chains.

Despite mixed performance on FDI, the region attracts more greenfield investment.

In 2016, foreign direct investment (FDI) inflows to the region contracted as a result of timid growth, low commodity prices, and economic uncertainty. FDI inflows declined in most major economies in South-East Asia except for the Philippines and Viet Nam. Hong Kong, China experienced a particularly sharp decline. However, greenfield inflows to the region as a whole have increased significantly. This signals investors' continued interest and confidence in the region.

FDI inflows are shifting to services and technology-advanced sectors.

While the primary and manufacturing sectors remain important in the region, the importance of the services industry is increasing. The region is shifting to more advanced and technology-based production as regional production networks become more sophisticated and capital-intensive, both in major economies, such as China, and smaller economies, such as Viet Nam. FDI flows in alternative/renewable energy have also increased in the region, showing the region's interest in and strategic focus on more advanced industries.

Outward investments are increasing.

Selected economies from the region are establishing their position as major outward investors. Despite decreasing globally, FDI outflows increased in the region in 2016. Consequently, the region accounted for a bigger share of global FDI outflows at 34%. China led the trend with FDI outflows increasing by 44%, as Chinese multinational enterprises increased foreign investments in a wide range of strategic industrial sectors. As a result, China FDI outflows exceeded its inflows.

Investment liberalization continues.

A review of national policies on investment and international investment agreements from the Asia-Pacific region shows that the region is continuing to pursue investment liberalization and promotion. Regional integration efforts have further led to improved business environments, which not only attract investment but also help countries maximize the positive spillovers. Subregional initiatives, such as the ASEAN Comprehensive Investment Agreement and the Treaty of the Eurasian Economic Union are examples of integration efforts that are likely to contribute to further increases in sustainable inflows of FDI to the region.

Economic restructuring in major developing economies creates new opportunities.

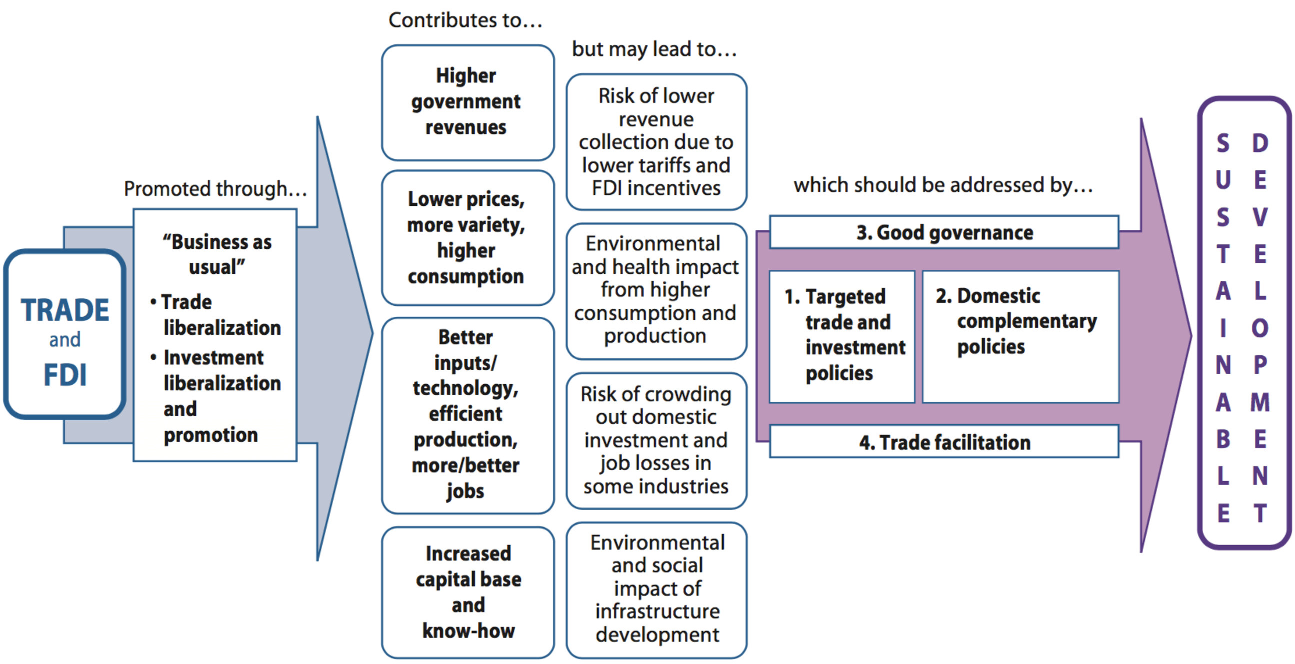
A significant trend in the region is the shifting and restructuring of leading economies. In particular, China, which once was the production-base for manufacturing labour-intensive products, is now undertaking structural reforms towards higher value-added industries. This change could temporarily disrupt established regional value chains and slow down FDI inflows. However, it also presents new opportunities. For instance, selected countries in South-East Asia are now attracting investors seeking lower wages for labour-intensive production. These countries have benefited from a relatively stable political and business environment, and they have been fortified by economic integration efforts within the framework of the Association of Southeast Asian Nations.

PART II – CHANNELLING TRADE AND INVESTMENT INTO SUSTAINABLE DEVELOPMENT

There is a need to rethink trade and investment policies for sustainable development.

Trade and investment are key to implementing the 2030 Agenda for Sustainable Development. The positive links between trade and economic growth, and to a lesser extent between FDI and economic growth, are well established. Although trade and investment liberalization are necessary, the social and environmental impacts of trade and investment liberalization are less clear. In addition, there is growing recognition that liberalization creates both winners and losers even when economies grow in aggregate.

A framework for channelling trade and investment into sustainable development



Tariff cuts and non-tariff measures can be targeted towards sustainable development.

In this context, this report introduces a framework on channelling trade and FDI into sustainable development. The framework suggests that traditional trade and investment policies, which are typically focused on generating aggregate economic gains, should be complemented by trade and FDI policies targeted towards sustainable development. Such targeted policies may include cutting tariffs on green goods, adopting non-tariff measures based on relevant sustainability standards, or prioritizing FDI for Sustainable Development Goal-related sectors such as the renewable energy sector. However, the impacts of such targeted measures should be carefully assessed to avoid distorting the markets unnecessarily.

Complementary domestic policies remain essential to achieving sustainable development.

The framework also stresses, however, that targeted trade and FDI policies alone are not sufficient to channel trade and FDI into sustainable development. Complementary domestic policies are also essential. These include not only environmental policies to encourage more sustainable consumption and production, but also social and labour policies to enable workers from uncompetitive sectors to adjust and find work in other sectors. Other domestic policies, such as education policies, tax policies and competition policies, are also essential to fully capture the sustainable development benefits of trade and investment.

Progress cannot be achieved without trade facilitation and good governance.

The framework highlights the importance of two other key enablers in achieving more sustainable trade and FDI: trade facilitation and good governance. Without cutting red tape and reducing trade transaction costs, attracting FDI and facilitating participation of more firms and people in international trade will not be possible. Without good governance, enabled by effective public institutions as envisaged in Sustainable Development Goal 16, policies will not be enforced, no matter how sustainable they may be.

FDI is clearly linked to higher trade and economic growth in Asia and the Pacific.

An empirical analysis of the contributions of FDI to trade, investment and growth in the Asia-Pacific region confirms that they are both positive and large. The Asia and the Pacific economy is at least 7% larger than it would be without FDI. At the regional level, FDI inflows are positively linked with real gross domestic product per capita changes and also increase exports. However, the impact of FDI on economic development varies greatly among individual countries within the region as it depends on each country's absorptive capacity and policy environment.

However, FDI policies need to incorporate the social and environmental dimensions.

FDI does not automatically contribute to sustainable development. Policies, laws, regulations and institutions need to be established or reformed to guide FDI towards sustainable development and motivate transnational corporations to invest in the Sustainable Development Goals. This will require strong government and improvements in the domestic business environment, as well as the development of absorptive capacity in developing countries. Businesses also need to embed sustainability in their daily operations and management, and governments need to provide the necessary enabling environment.

An integrated approach to trade and investment liberalization yields impressive results.

The effects of regional tariff liberalization, investment liberalization, and trade facilitation on economic growth, trade, CO_2 emissions, inequality and undernourishment were analysed both individually and in an integrated policy package. The analysis reveals that an integrated approach is superior as it boosts trade by over $175 billion annually while also partly reducing the negative social and environmental impacts associated with stand-alone liberalization policies. The results suggest that lowering trade and investment barriers regionally in an integrated manner increases the competitiveness of regional firms in the global market and enables them to effectively participate in global value chains.

The results of the integrated approach largely depend on cutting trade costs.

Gains from integrated liberalization are mainly driven by trade facilitation, whose economic impact significantly outweighs that of tariff and investment liberalization. Trade facilitation may be interpreted broadly as reduction in non-tariff related trade costs, including the implementation of the WTO Trade Facilitation Agreement and the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific. The analysis suggests that trade facilitation will result in an increase in net exports of $16 billion annually. This large trade increase is accompanied by a reduction of inequality within the region, while causing less CO_2 emissions than stand-alone investment liberalization.

However, combining liberalization policies with environmental and social policies is even better.

While the social and environmental impacts from liberalization are typically not large at the regional level, they vary substantially across subregions in both significance and direction. This confirms the need for complementary social and environmental policies to better channel trade and investment into sustainable development. This report accordingly analyses the effects of two such policies: the emission reduction commitments under the Paris Agreement and domestic income transfers within Asia-Pacific countries. Importantly, integrated liberalization combined with these two policies leads to a higher level of economic growth in Asia and the Pacific than the integrated liberalization policy produces alone. Moreover, this combined approach also mitigates the inequality and CO_2 emissions resulting from an integrated liberalization policy. Enhancing multilateral and regional cooperation on trade and investment as well as social and environmental issues is key to achieving positive outcomes across all three pillars of sustainable development.

A WAY FORWARD

Pursuing trade and investment liberalization and facilitation

The analysis presented in the report confirms that openness to trade and investment are a necessary condition for sustainable development in Asia and the Pacific. Trade and FDI are typically complementary, providing much needed sources of growth and financing for development. Together, they enable allocation of resources to their most productive use and enhance access to new technologies and markets. In that context, a long- standing but important recommendation is to avoid resorting to protectionism and to facilitate trade. The review of policy trends included in the report confirms that most countries, especially in this region, have continued to follow this recommendation so far.

Tackling the social and environmental impacts of liberalization

Possible undesirable side effects of trade and investment, such as increased inequality, short-term unemployment, drop in real wages, and environmental degradation, need to be more fully acknowledged and tackled in future policymaking. National-level policy recommendations for channelling trade and investment into sustainable development include the crafting of Sustainable Development Goal-targeted trade and FDI policies complemented by social, environmental and other domestic policies. However, the design of the national policies is likely to vary significantly from country to country, as there cannot be a one-size- fits-all policy when balancing economic, social and environmental needs.

Strengthening regional cooperation and integration

Continued efforts should be made to strengthen regional cooperation and integration as an important means of sharing the benefits of trade and investment, which would contribute to reducing the development gap between countries of the region, as well as to maintaining peace and stability in Asia and the Pacific (Sustainable Development Goal 16). Finding new ways to cut trade costs, including as part of the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific, will be important. Regional trade agreements of wider scope and membership should also be pursued, such as the Regional Comprehensive Economic Partnership. Finally, regional connectivity should be prioritized and promoted, building on voluntary initiatives such as the Belt and Road Initiative of China. It will be important, however, that all such initiatives and agreements fully integrate the social and environmental dimensions of sustainable development.

Enabling evidence-based trade and investment policymaking for sustainable development

Finally, regional collaboration on the collection of more and better trade- and investment-related data and corresponding socio-economic and environmental data should be pursued. Such data will be essential to further deepen understanding of the complex trade-offs and complementarities between trade, FDI and the Sustainable Development Goals, as well as to ensure that new trade and investment barriers are not falsely established on sustainable development ground.