EXECUTIVE SUMMARY

INTRODUCTION

Trade growth in Asia and the Pacific continued to weaken in 2013. In the final two quarters of 2013, growth rates for exports and imports in the region were below global averages for the first time in a decade. Despite this slowdown, Asia and the Pacific has become the largest trading area in the world, accounting for close to 37% of world trade. More than half the total trade in the region is with other Asia-Pacific economies. China is the second-largest merchandise exporter and third-largest merchandise importer globally.[1] More than 10 other developing economies of the region are in the global top 25 exporters and importers, alongside Japan and Australia. The overall economic performance of the region continues to outpace other parts of the world.

Although Africa is now also growing rapidly. Growth remains lower than in the pre-crisis era, but there is no doubt that rising trade and investment flows continue to be behind much of the region's relative success. Economies in the region continue, however, to re-examine the long-term viability of reliance on exports to traditional markets. The sharp collapse of world trade in 2008 and 2009 illustrated the need to reduce dependence on external sources of demand. Instead, growth strategies need to focus on identifying more diversified and stable sources of demand growth, which will include fostering domestic and regional sources of demand through deeper integration, enhanced connectivity and reform of trade policies.

The Asia-Pacific Trade and Investment Report (APTIR) 2014 analyses recent regional trends and provides an analysis of developments in: (a) intraregional trade in goods and services; (b) foreign direct investment; (c) trade facilitation measures; (d) trade policy measures; and (e) preferential trade agreements. The main findings of the report are summarized below.

A. CONTINUING SHADOW OF CRISIS HIGHLIGHTS THE ONGOING NEED FOR REBALANCING

Developments in 2013 and, so far, in 2014 show that the prolonged consequences of the 2008-2009 global financial crisis have cast a shadow over the trade prospects of Asia and the Pacific. Intraregional demand is evidently vulnerable to the ongoing global economic slowdown. It is expected that the growth of merchandise trade by developing Asia-Pacific economies will continue to be slow-paced in the remainder of 2014, compared with the pre-crisis period, with average export growth of 5% in real terms. This growth is expected to range from a low of 2% (Russian Federation) to a high of 7% (Singapore and the Philippines).

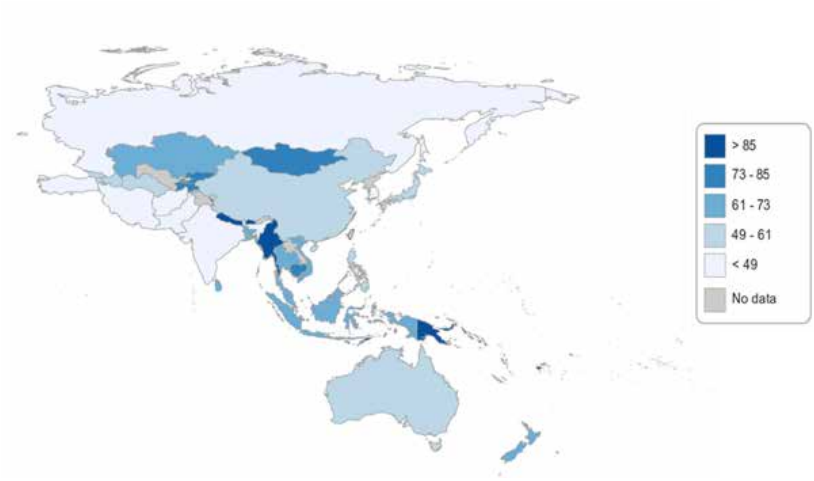
Analysis of individual country performances confirms that most otherwise dynamic trading economies in Asia and the Pacific are experiencing an export growth slowdown compared with the same period in 2013. China experienced trade stagnation during the first five months of 2014. Exports from India, the second-most populous country in the region, increased marginally by 1.9% while its imports fell by more than 13%. Nevertheless, several economies that are labour- and resource-intensive exporters, registered double digit export growth in 2013. They included Afghanistan (20%), Bangladesh (16%), Cambodia (19%), the Cook Islands (50%), Georgia (22%), Kiribati (29%), Myanmar (26.5%), Uzbekistan (13%), and Viet Nam (15%).

Intraregional trade increased in importance during the past decade, especially on the export side. The share of intraregional exports increased from 44% of total Asia-Pacific exports in 2000 to 52% in 2013. However, intraregional trade patterns are not uniform across subregions. In fact, the largest trading partner of most subregions is East and North-East Asia (see table 1.2 in chapter 1), mainly because China figures so prominently in these countries' trade. Furthermore, heavy reliance on a few trading partners yields an extreme level of intraregional trade dependence in the cases of the Asia-Pacific's least developed countries and landlocked developing countries (figure A).

The export performance of the Asia-Pacific region is expected to improve in 2015 to reach a growth rate of 7% in real terms. However, considerable uncertainties in the trade outlook remain. On the economic side, these

FIGURE A Intraregional import dependency by Asia-Pacific economies, 2012

(Percentage of total merchandise imports)



Source: Figure 1.7 in chapter 1.

stem from fluctuations in the economic recovery of the United States and the risks of a Chinese economic hard-landing. Politically, the risks of increased geopolitical tension and instability remain high with possible spillovers for trade and investment.

As the region is not immune to global economic uncertainties, the need to focus on long-term strategies for increasing competitiveness has never been greater. Policies should be adjusted to secure benefits from new and emerging forms of trade and production. These encompass growing connections between countries through participation in global value chains (GVCs). Dispersed production across many locations is fuelling both growing trade in intermediate inputs and rising demand for services related to coordination of production, such as logistics. In a world where most countries participate increasingly in GVCs, raising the value-added of exports is more important than increasing gross exports. APTIR 2014 uses a simple indicator of revealed comparative advantage to demonstrate that the value-added by domestic producers is the key to enhancing overall competitiveness and facilitating entry to international production networks or GVCs. As explained in chapter 1, failure in the world of globalized production to distinguish between gross exports and domestic value-added in exports can lead to misguided trade and industrial policies.

B. REGIONAL POTENTIAL IN SERVICES TRADE GOING UNEXPLOITED

Growth in commercial services exports from the Asia-Pacific region lagged behind the world average in 2013. This slowing of overall services export growth was driven by the diverse performances of leading regional services exporters. While China and India performed quite strongly, other exporters - especially the advanced economies - were unable to maintain their export growth momentum.

Although the divergence in export performance is discouraging, of more general concern is the uneven use of services trade opportunities in the region. The concentration of services exports and imports is extremely high, with 65% of services exports attributable to just six economies in the region: China, India, Japan, the Republic of Korea, Singapore and Hong Kong, China. This implies that a large gap exists in trade competitiveness between these leading performers and the rest of the region.

Given that the main component of regional service exports is business services, which contribute significantly to the value-added of industrial exports, the performance gap is quite alarming for the rest of the Asia-Pacific. This gap in business service exports could also indicate a bottleneck in improving the competitiveness of an

economy's industrial exports. The removal of restrictions on trade in services could raise the efficiency of service industries and provide support for exports.

Travel services are also an important growth sector, particularly for small island economies and least developed countries. Through strong backward and forward linkages with domestic activities, the sector's expansion has significant consequences on employment and environmental prospects. It is encouraging that, in contrast to services trade in general, Asia-Pacific trade in travel services has continued to grow strongly during recent years. Yet there remains considerable scope for further improvements to tourism infrastructure to boost arrivals in emerging economies, especially Pacific islands countries.

While trade in commercial services amounts to only 15%-17% of total Asia-Pacific trade – less than the share globally – this measurement underrepresents the true importance of services in trade.[2] As discussed in chapter 2, services are increasingly becoming embedded in manufacturing production. The expansion of global value chains involving multiple Asia-Pacific economies has contributed to the increasing importance of business, communications and transportation services as critical components that link and facilitate these international production networks for industrial exports. While the role of services value-added in industrial exports has been increasing, detailed evaluations are still very limited because of a lack of data. Chapter 2 uses the most recent OECD-WTO Trade in Value Added (TiVA) database, launched in May 2013, to shed further light on the extent of this so-called "servicification."

According to the trade value-added data, services contributed 29% to the value of global industrial output in 2009. Exports by industrial sectors included services content of more than 30% by value (figure 2.6 in chapter 2). Exports from high-tech industrial sectors participating in global value chains, especially transport equipment, tend to have higher services content (37%) than other sectors. In contrast, gross exports by traditional industrial sectors typically contain a lower value of embodied services at not more than 30% of total value. For example, in the case of mining and quarrying, the exports services share was only 10%, while in agriculture, forestry, hunting and fishing it was 24%, and in textiles, textile products, leather and footwear it was 25%.

Although domestically-provided services dominate the service content in manufacturing exports, it is expected that imported services will supply an increasing share among those industries that are characterized by international product fragmentation. Available data, although still limited at present, appear to support this conjecture. Overall, domestic services content accounts for about 19% of the value of industrial exports while foreign content accounts for about 10%. Foreign services content appears to be relatively higher than average in those industrial sectors perceived to be part of fragmented international production networks, including electrical and optical equipment and transport equipment. The foreign services content in exports from those two sectors was 15% and 13%, respectively.

C. NEW LOCATIONS AND SECTORS CAPTURE GROWING INTEREST FROM ASIA-PACIFIC INVESTORS

In 2013, global foreign direct investment (FDI) showed signs of recovery from the weaker performance recorded in 2012, reaching a total value of $1.46 trillion. Developing economies, in particular, continued to attract an increased share of global FDI and were recipients of more than a half of global FDI inflows. The Asia-Pacific region experienced a 7% increase of FDI inflows – lower than the 9% global increase. Although the Asia-Pacific region remained attractive to investors, accounting for 38% of total global FDI, growth in FDI lagged behind the performance of recent years and was lower than in other fast-growing regions such as Latin America.

Whether this represents a longer-term slowdown in regional investment or is a temporary trend remains uncertain. Nonetheless, there does appear to be a shift in the destination of FDI within the region, traditional major recipients are expectedly seeing slower growth with smaller players now attract more foreign investors and on a larger scale. As a result, investments across the region are characterized by increasing diversification in locations and sectors.

Government policies that encourage or hinder FDI play an important role in explaining performance in attracting investment. Indeed, FDI inflows varied greatly among different subregions and countries. The East and North-

East Asia subregion experienced the biggest growth of FDI inflows, attracting 36% more compared with 2012. However, the South-East Asia subregion has proved to be the most resilient, experiencing undisrupted growth in FDI inflows since 2009.

Many Asia-Pacific economies are also significant external investors. In terms of FDI outflows, in 2013 the Asia-Pacific region experienced a significant increase of 15.1%. The region accounted for a 38% share of global FDI outflows. China is undoubtedly one of the most important players in the region, not only as an investment destination but also as a source of investment. China's outward FDI flows have risen continuously during the past decade, encouraged by explicit government support for businesses to internationalize. Investment from Japan also rose by 33% in 2013.

The usage of different modes of investment is also changing. Traditionally, within the Asia-Pacific region, greenfield FDI was the most significant mode of entry for investors. However, since 2008 there has been a decline in the relative importance of greenfield FDI and an increase in mergers and acquisitions (M&A). Between 2011 and 2013, intraregional greenfield FDI inflows in the region dropped by 43% with the downward trend visible in most major destination countries.

Intraregional FDI continues to be shaped by global macroeconomic changes. Reflecting the shift in the global centre of economic gravity towards the Asia-Pacific region, intraregional FDI investors are increasingly replacing investors from European countries and the United States – traditionally the top investors in the region. Intraregional M&A deals accounted for a significant share of total FDI inflows in several major markets. Although global FDI inflows through M&A to the Asia-Pacific region decreased in both 2012 and 2013, intraregional FDI inflows through M&A remained substantial at a total of $153.8 billion, accounting for almost one third of total FDI inflows and a much higher share in certain economies, for example, in China (71.5%), Hong Kong, China (66%), and the Republic of Korea, (45.1%).

Intraregional FDI investors are also investing in a broader range of industries – diversifying away from natural resource-heavy industries to more knowledge-based industries and services. FDI increased in industries such as health care, pharmaceuticals and biotechnology, building and construction, consumer products and business services.

Looking ahead, a number of the "mega-regional" trade agreements under negotiation (see below) also include discussions on investment. These treaties, if agreed, could further improve the investment climate and support more open trade and investment regimes, thereby improving future economic prospects in the region.

D. INEFFICIENT REGULATIONS DRIVE UP TRADE COSTS

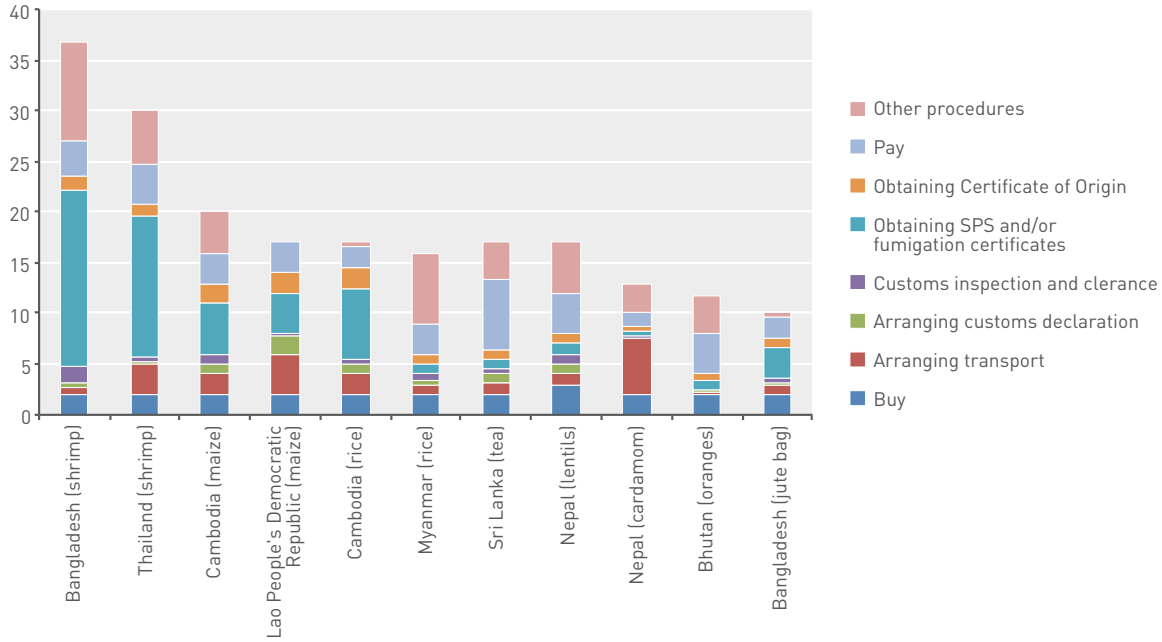
The WTO Trade Facilitation Agreement (TFA), concluded at the ninth WTO Ministerial Conference in December 2013, is the first major global trade agreement to be concluded since the establishment of WTO in 1995. Although implementation of the TFA remains uncertain, the Agreement provides evidence of a global consensus on the importance of trade facilitation for sustainable economic development, as well as a narrow, but concrete framework through which countries may simplify and enhance the transparency of their trade procedures.

At the regional level, progress is being made towards a regional arrangement on the facilitation of cross-border paperless trade, since the adoption by ESCAP member States in May 2012 of a resolution on enabling the cross-border recognition of electronic data and documents for inclusive and sustainable intraregional trade facilitation. This also suggests that the region is committed to make significant progress in this area in the coming years.

Chapter 4 provides a preliminary regional assessment of the implementation of trade facilitation measures included in the TFA as well as the development of trade services and systems for paperless trade facilitation based on surveys carried out by the ESCAP secretariat since 2012. Because of the great importance of the agricultural sector for inclusive trade and development on the one hand and the fact that agricultural trade costs on the other are typically twice as high as those for manufacturing goods,[3] this year's APTIR presents findings from country- and product-specific agricultural trade process analyses. It reveals significant and

persistent barriers to trade. For example, in Myanmar, no less than 20 actors are involved in the export of rice (see table 4.1 in chapter 4). In the Lao People's Democratic Republic, visits are required by three agencies to the premises of the animal feed importers to provide three separate reports for verifying the request for import. In Nepal, local administration still charges an export fee even though there is a national policy of not imposing such fees. Furthermore, in Bangladesh and Thailand it can take up to 17.5 days and 14 days , respectively, to obtain the sanitary and phytosanitary (SPS) certificate, including laboratory tests, necessary for exporting shrimp (see figure B). This accounts for more than half of the total time required to complete export procedures within these two countries. In Cambodia, it takes between five to seven days to complete the same procedure. In Nepal, Cambodia, Myanmar and Sri Lanka, it takes only one day to obtain the SPS certificate.

FIGURE B Days required for export of agricultural products



Source: Figure 4.6 in chapter 4.

These findings have important implications for policymakers and other stakeholders involved in trade facilitation. First, they confirm that many agricultural trade procedures are not only complex but also specific to the sector or product, suggesting the need for trade facilitation support programmes dedicated to agriculture and food products.

Second and more generally, the trade process analysis studies suggest that a whole-supply-chain approach is essential to making significant progress in reducing trade transaction costs and improving competitiveness. This is because the most important bottlenecks may not be at the border and may also relate to inefficient services by the private sector rather than by government agencies. Accordingly, this requires policymakers to monitor the performance along the entire supply chain and to identify solutions to streamline trade process continuously, as proposed in previous issues of APTIR. The chapter also proposes some concrete actions as a way forward for countries and the region in three areas of immediate importance: (a) implementation of the TFA measures; (b) development of cross-border paperless trade; and (c) establishment of sustainable trade facilitation monitoring mechanisms.

E. DANGEROUS DRIFT AWAY FROM OPENNESS NEEDS TO BE REVERSED

Trade policies in the Asia-Pacific economies show signs of both protectionist and liberalizing tendencies with the overall outlook remaining uncertain. The latter half of 2013 and the first half of 2014 have seen some

positive signs of renewed interest in liberalization, suggesting that post-2008 crisis pressures for protection of domestic producers may be weakening. In the major G20 economies, the pace of introducing new trade-restrictive measures recorded by WTO had at least plateaued in the six months up to May 2014.

However, regional trade policy continues to show worrying signs of a drift away from openness. While Asia-Pacific countries adopted both liberalizing and trade-restrictive measures, from October 2012 to November 2013 the balance tipped further towards trade-restrictive measures, when 72 new trade-restrictive measures were recorded compared with 37 liberalizing measures. Overall, tariff increases were the most common trade-restrictive measure (see table 5.1 in chapter 5); the period saw 106 tariff increases globally, 28 of these in the Asia-Pacific region (of which all but three were in the region's developing countries).

Usage of trade remedies is also increasing barriers to trade; during the above period 70 new measures were introduced in the Asia-Pacific region. This was greater than the number of terminations meaning that the overall number of barriers to trade increased, although this trend may be turning (see box 5.1 in chapter 5). Anti-dumping initiations were by far the most common form of action, with India being the largest initiator. China was the country most targeted by trade remedies.

New energy is needed to reverse this trend and seize opportunities to boost trade, growth and prosperity. In the near-term, many temporary trade barriers introduced in the immediate aftermath of the global financial crisis are approaching their "sunset clauses". By choosing not to renew these trade restrictive measures, Governments could send a strong signal in favour of openness. In the longer-term, real progress is needed both through the negotiation of effective regional trade agreements and through a commitment to implement the WTO "Bali Package" as a first step towards further multilateral liberalization.

Likewise, securing greater market access for least developed countries' products and ensuring that they do not suffer impacts unduly from trade restrictive measures should be a high priority for regional policymakers. The total number of new less-transparent measures having an impact on at least one Asia-Pacific least developed country was at its highest in 2009 immediately after the financial crisis as many countries took measures to protect domestic industries. Worryingly, despite a fall in new measures in 2010 and 2011, there has been a recent rebound in trade-restrictive measures that have had an impact on Asia-Pacific least developed countries (see figure 5.6 in chapter 5). In 2013, the total number of measures introduced was more than 60% higher than in 2011. New measures in 2013 were dominated by behind-the-border non-tariff measures, which present particular obstacles for small and medium-sized exporters from the least developed countries.

It is important that least developed countries gain meaningful market access to not only to developed country markets but also to large, growing emerging markets. For example, more could be done in the "BRICS" economies (Brazil, the Russian Federation, India, China and South Africa) to remove barriers to least developed countries' products. While trade volumes have grown substantially between these groups of economies, there is scope for increasing trade further by lowering tariff and non-tariff barriers on both sides, reducing tariff escalation, extending preferential access for least developed country exports, and making rules of origin more liberal in the existing preference schemes. For example, China and India have introduced duty-free quota-free access for many products from least developed countries; however, while this is to be welcomed, coverage could be extended further.

In addition to greater commitment to tackling the most significant tariff and non-tariff barriers through international coordination, scaled-up technical assistance - for example, through Aid for Trade - can also help least developed countries realize their trade and development potential.

F. MEGA-REGIONAL DEALS CAN HELP UNTANGLE THE "NOODLE BOWL"

The proliferation of preferential trade agreements (PTAs) continues, although there is evidence of a plateau being reached, especially with regard to the involvement of Asia-Pacific economies. Whether this is due to positive movement in the WTO Bali Ministerial Conference or to the fact that most of the countries have already concluded PTAs with their most desired trading partners, is undetermined.

However, some economies may be expected to revisit existing agreements and to negotiate deeper integration

as well as expanding coverage. This could follow the trend in recent PTAs, of including additional issues such as competition, government procurement and investments – which were dropped from the Doha agenda. There are already a number of examples of current members repeatedly expanding bilateral commitments (for example, China and Hong Kong, China and Macao, China, respectively; Australia and New Zealand; and the plurilateral agreements moving towards creating economic communities such as the ASEAN Economic Community and the Euro-Asian Economic Community). Efforts appear to be underway to forge a consensus for including these WTO-plus areas in future multilateral discussions by first building a critical mass of PTAs that incorporate such provisions.

The Asia-Pacific region has been the nexus of PTA activity; of a total of 253 global physical trade agreements in force, 150 agreements involve regional economies. Many agreements are between developing economies, thus establishing a foundation for stronger South-South trade. The economies in the North and Central Asian subregion were the major contributors to Asia-Pacific PTAs in the 1990s. However, success in reformulating of some of the arrangements in that subregion into ambitious customs unions - for example, the one between Belarus, Kazakhstan and the Russian Federation - and plans to move towards an economic community might re-energize the drive by those countries towards regional integration.[4] Since the early 2000s, South-East Asia, through ASEAN, has played a dynamic role in expanding the web of PTAs.

Almost as many Asia-Pacific PTAs involve partners outside the region as countries within within the region - 72 of the total 150 agreements are with external countries. Judging from the total number, it appears that the agreements in the region are mostly bilateral in nature; however, but most subregions also have significant initiatives with multiple members, with the exception of East and North-East Asian economies.

The Asia-Pacific region suffers from a multiplicity of PTAs with complex and overlapping rules – a problem known as the "noodle bowl". Regional economies therefore need to start reducing the complexity of terms negotiated in PTAs and to try to consolidate their numerous PTAs. This will simplify trade transactions and reduce costs for exporters. At present, the usage of PTAs by businesses is often low because of excessive complexity. A few such efforts in the Asia-Pacific region appear to be under way.[5] The Asia-Pacific Trade Agreement (APTA) is expanding its membership and provides an open-ended agreement that any developing member State of ESCAP can join. It remains to be seen if the agreement can also be opened to the three developed countries in the region and if, at the same time, it can be converted into a more progressive type of free trade agreement covering more areas.

Other agreements that are emerging as strong alternatives are the Regional Comprehensive Economic Partnership (RCEP), which involves 16 Asia-Pacific economies, and the Trans-Pacific Partnership (TPP) between 12 economies from Asia and the Pacific Rim. It is important to note that there are seven economies opting for membership between both mega-blocs (figure 6.5 in chapter 6). It is not certain whether, after the implementation of RCEP and TPP agreements, the ASEAN+1 agreements and other existing agreements (more than 50 in total) will be nullified or not. Only when RCEP and TPP become open-ended agreements and replace all other existing bilateral agreements between their members can a true consolidation be achieved that will genuinely address the "noodle bowl" problem.

ENDNOTES

1. When excluding intra-European Union trade and when the European Union is not treated as a single entity, China becomes the largest trader when measured by the sum of merchandise exports and imports.

2. Economic and Social Commission for Asia and the Pacific, *Asia-Pacific Trade and Investment Report 2013 - Turning the Tide: Towards Inclusive Trade and Investment*. Sales No. E.14.II.F.2. Available from www.unescap.org/resources/asia-pacific-trade-and-investment-report-2013-turning-tide-towards-inclusive-trade-and.

3. Ibid.

4. This process might be complicated in the near future due to political problems that deepened in some parts of the subregion during 2014.

5. The most recent example is the one among those members of the ASEAN-Australia-New Zealand FTA (AANZFTA) that signed the First Protocol to Amend the Agreement Establishing the AANZFTA on 27 August 2014. The Protocol will provide for improved administrative efficiency by customs authorities as well as encourage business utilization of AANZFTA.