EXECUTIVE SUMMARY

The stakes on international trade have been raised considerably by the adoption of the 2030 Agenda for Sustainable Development, which identifies trade as one of its key means of implementation. The expansion of global trade and the adoption of trade-led development strategies by countries such as China (Asia-Pacific Trade and Investment Report 2013) was one of the key factors contributing to reducing absolute poverty prior to the adoption of the 2030 Agenda. Can we continue to rely on trade to drive economic growth and lift the remaining 600 million poor in our region out of poverty? Recent trends and short-term prospects discussed in this Report do not give a reassuring message. Merchandise and services export growth weakened further in 2015 despite relatively robust economic performance in many Asia-Pacific economies. By now, most of Asian exporter economies have at least partially decoupled from the economic cycles in the traditional export markets of North America and the European Union. However, as they have been reorienting to export-demand from the region, and especially China, they now face the need to further adjust to the transition of the Chinese economy to domestic consumption and services-sector driven growth. The Asia-Pacific region is expected to exhibit a 5.2% and 4.9% decline in nominal export and import values, respectively, in 2016. The volume of trade in the region is expected to grow in 2016, although only feebly, by 0.7% and 0.1% for exports and imports, respectively; this is far from the heights of around 7% seen globally in the early 2000s. The main causes for trade faltering in 2015 and previous years range from cyclical to structural – sluggish global economic growth, a downward movement of commodity prices, adverse movements of exchange rates, capital flow volatility, maturation of global value chains and a decline in productivity growth. Most of these factors will have also been at work in 2016, although later in the year some economic indicators signaled more robust performance and return of stability, at least in emerging markets in Asia. Thus, expectations are that nominal exports and imports will bounce back in 2017 with a 4.5% growth in exports and 6.1% growth in imports. The 2017 expansion of trade will be due to a mixture of expected increased prices and expected real growth; export and import price indices are expected to grow by 3% and 2.3%, respectively, while export and import volumes are projected to increase by 1.5% and 3.8%, respectively. Nevertheless, deceleration of merchandise and services trade in 2015 and so far in 2016 has had an impact on greenfield foreign direct investment (FDI) flows as well, with upward changes mostly seen in mergers and acquisitions (M&A) flows. The Asia-Pacific region recorded only a 5.6% increase in FDI inflows in 2015, resulting in a 10 percentage point decline in the region's share of global FDI inflows from its 2014 share of 42%. This overall reversal was not felt equally in the region and it is mainly attributed to a sharp decline in FDI in the North and Central Asia as well as the Pacific subregions and somewhat to a slowing of FDI activity in South-East Asia. Amid these disconcerting trends, a positive aspect is that the share of intraregional greenfield FDI inflows in total flows reached 52% in 2015. ASEAN, including its least developed economies, and India have been attracting an increasing portion of FDI inflows, both from outside and inside the region. Further deepening and broadening of regional cooperation and integration through initiatives such as the One Belt-One Road are expected to create growth in demand for FDI across the region. A similar effect is expected from infrastructural investment in support of improved trade facilitation and implementation of the WTO Trade Facilitation Agreement, which is moving steadily towards ratification in WTO. While economies in Asia and the Pacific continue to make improvements in trade facilitation, large gaps among subregional economies remain; there is much more to be done to reduce trade costs of those economies that are greatly in need of more intense trade with the rest of the region and the world. Regrettably, the efforts undertaken to reduce trade costs by improving trade facilitation have been partially offset by the imposition of a large number of new trade distortive measures globally and regionally. The rhetoric of protectionism that is gaining popularity among G20 economies, together with events such as "Brexit" and uncertainty arising from the presidential election results in the United States, does not raise *much hope for a reversal of these practices soon. Economies of Asia-Pacific alone have introduced, on average, 6.6 restrictive measures per month since 2014. Most of these new measures belong to the non-tariff category, often decreasing transparency in trade policy of countries and thus contributing even more to trade costs. This applies especially to measures affecting agricultural and food trade but also trade in services, which supply an increasing proportion of industrial exports and are thus one of the key enablers of economic diversification and sustainable development. In addition, it appears that the increasing number of preferential trade agreements (PTAs) have not shown a strong potency in dealing with such non-tariff barriers to trade. Almost 170 PTAs are being implemented in 2016 by the regional economies, and they are steadily encompassing new areas such as investment, government procurement or competition. Nevertheless, not much information is available on their utilization by businesses and the jury is still out on determining if the multiple PTAs among the same members (the so-called "noodle bowl" phenomenon) is also adding to trade costs, thus working against the primary aim of PTAs to enable trade. More and more of these PTAs include provisions of e-commerce. In general, there is an expectation that further digitalization of trade and the growth of e-commerce will have a positive effect not only on the volume of trade but also on making the benefits from trade more broadly felt; in fact, e-commerce is hailed as a great "equalizer" by many of its advocates in the region. However, much work on collecting evidence on the extent and distributional effects of e-commerce is needed before suggesting specific policy reforms. It would be very useful to have these sooner rather than later to complement policy responses to challenges in mainstream trade and associated investment to strengthen their effectiveness in shielding the region against the headwinds in its path to trade-led sustainable development.*

Merchandise trade in trouble

Trade in the Asia-Pacific region experienced a major slump in 2015, with the United States dollar value of exports and imports declining significantly by 9.7% and 15%, respectively. Little improvement, if any, is expected in 2016 as trade is estimated to contract by around 5% in nominal terms. Despite these bleak numbers, the region is still being hailed as the best performer in the global environment in which trade recorded a fall of around 13% in nominal terms in 2015. Therefore, despite contractionary trends, the Asia-Pacific region has consolidated its share of global exports at 40% mark and thus retained its position as the largest exporter in the world. However, the share in global imports still declined. Altogether, 2015-2016 capped a five-year period in which the Asia-Pacific region's trade grew below the pre-crisis average. Such a long and uninterrupted trade slowdown is unprecedented, and is a cause for concern that the world is now reaching a new normal of weaker trade growth.

The relative success of the Asia-Pacific region is again largely due to the contribution by China, whose exports declined by only 2.9%. China accounts for 34% of the region's merchandise exports, so when it is excluded the developing Asia-Pacific region performs similarly to the global economy, with a 13% decline in exports.

Falling prices were mainly responsible for the fall in trade values in 2015. While the quantity (volume) of exports in fact still grew at 3% in 2015, there was a sharp fall in export and import prices by 10% and 12%, respectively. The plunge in prices was due to a number of factors, both from the demand and the supply side. Slower growth in emerging markets, particularly in China, has led to sharp drops in commodity prices across the board. These, in turn, lower the cost of production which is then passed on to the price of manufacturing products. Furthermore, the appreciation of the United States dollar in 2015 added significant weight to other factors in import demand by developing economies, and affected the value of trade transactions, which are customarily expressed in United States dollars.

For the second year in a row, the Asia-Pacific region has seen a decreasing importance of intraregional demand from developing regional economies. The share of exports to the developing Asia-Pacific region fell from a peak of 48.2% in 2013 to 47.6% in 2015.

A major factor in the slowing intraregional demand is related to the ongoing economic rebalancing of China towards consumption and services, which is the largest individual trading partner for the rest of the region, taking nearly 20% of exports. China's economic slowdown is especially affecting commodity exporting countries whose exports to China are substantial, e.g., more than 80% in the case of Mongolia. Also, the country's economic rebalancing is affecting manufacture exporting countries tied to China through global value chains, as the region has seen a gradual decline in China's import dependence, especially in intermediate products.

Looking ahead, there are headwinds to trade in the Asia-Pacific region and worldwide. Countries that export primary commodities – largely low income economies – are still exposed to the risks of declining commodity prices, due to declining global demand for energy and non-energy commodities, especially in China. The expected decline in growth rates within the region and in key world importing economies in 2016, together with falling price indices, means that a regional trade recovery is not expected in the near future.

The Asia-Pacific region as a whole is expected to exhibit a 5.2% and 4.9% decline in nominal export and import values in 2016, before bouncing back in 2017 with 4.5% growth in nominal exports and 6.1% growth in nominal imports. In real terms, the trade volume of the Asia-Pacific region in 2016 is still growing but only slightly, with the estimated growth rates of 0.7% and 0.3% for exports and imports, respectively. A slow recovery of export demand is anticipated for 2017 when the growth may return to 1.5%. The growth of import volume will be higher than export volume, reflecting an import recovery from the low-base level and a side effect of the shifting of growth strategy from export-driven to consumption-driven models in major Asia-Pacific economies.

Trade in commercial services sliding downhill

The performance of the Asia-Pacific region's commercial services sector, following the global trend, dropped dramatically in 2015 compared with the previous year, due to the global economic slowdown and prevailing economic uncertainty. Export growth declined from 5.1% in 2014 to -4.5% in 2015, while import growth fell from 6.1% to -4.9% during the same period. However, the Asia-Pacific region continued to improve or at least hold its share of global exports and imports of services (29.2% and 31.8%, respectively).

Intraregional demand for services in 2015 has severely declined, reflecting the regional trade contraction and economic slowdown. Trade in Asia and the Pacific commercial services was dominated by a small number of countries, especially China, India, Japan and Singapore, which represented more than half of the region's trade. Specifically, business and travel services together accounted for about 53.4% of total commercial services exports. However, the continuation of China's economic slowdown, together with global trade stagnation, is creating gloomy prospects for services exports in 2016 and beyond, especially in the tourism sector.

The share of services trade in total trade of least developed countries continues to be negligible yet concentrated in only few service sectors, mainly tourism. Overall, in 2015, least developed countries in the Asia-Pacific region exported commercial services worth $13 billion and contributing 36% of the exports by the whole group of least developed countries. Myanmar was the largest services exporter in the Asia-Pacific group with a share of 32%, followed by Cambodia at 30%. These two Asian least developed countries recorded an extraordinary growth in tourism in more recent years which has been largely driving the overall services export growth of the Asia-Pacific group of least developed countries. Furthermore, Bangladesh has become an emerging exporter of information and communications services and a hub for freelance IT services, including simple data entry to more complex IT services, via online sites.

Foreign direct investment makes a modest comeback

Global foreign direct investment (FDI) inflows, at $1.76 trillion in 2015, reached their highest level since the financial crisis of 2008-2009. However, the increase was attributable to cross-border mergers and acquisitions (M&A) used for corporate reconfiguration, including tax inversions.

The Asia-Pacific region continued to receive a significant amount of FDI inflows, totalling $559 billion in 2015. However, the region experienced weaker growth in FDI inflows, mainly resulting from a sharp decline in North and Central Asia, due to low commodity prices, economic contraction, and the direct and indirect impacts of geopolitical tensions. Asia and the Pacific also experienced a reduced level of FDI outflows, with $435 billion in 2015, a 22% decrease compared with the previous year. Still, the outflows in 2015 were close to the region's average recorded since the recovery after the global financial crisis.

Contrary to the overall FDI flows, greenfield FDI inflows to the region increased sharply by 26% in 2015, to $352 billion in total. Greenfield FDI outflows from the Asia-Pacific region in 2015 also increased by 15% to $263 billion. In addition, intraregional greenfield FDI inflows have continuously increased recent years – replacing FDI from the traditional big investors such as the United States and countries in Europe – as the economic relevance and dynamism of the Asia-Pacific region increases.

In recent years, the Association of Southeast Asian Nations (ASEAN) has become a popular destination for intraregional FDI. In 2015, $83 billion was received from countries in the Asia-Pacific region, amounting to 46% of total greenfield intraregional inflows. As production costs are rising in labour-intensive industries in China, these industries in the smaller and less developed countries in ASEAN are benefiting from a shift of FDI despite the overall poor investment climate of those economies.

There were no universal tendencies observed in the composition of industries and sectors with regard to FDI inflows in the region. Instead, with some mixed experiences of individual economies in different industry sectors, many economies in the region are paying more attention to attracting FDI to technologically more advanced industries, in order to move away for reliance on labour-intensive manufacturing. It is believed that such FDI inflows will bring about desired spillover effects to the economy alongside capital inflows, and thus contribute to sustainable development.

Asian and Pacific countries are in the lead in investment liberalization and promotion policies. In 2015, the region adopted 46 investment policies affecting foreign investment; of these measures, 43 were related to liberalization, promotion and facilitation of investment, while only 3 introduced new restrictions or regulations on investment. In particular, two of the largest emerging economies in Asia, China and India, were the most active in opening up various industries to foreign investors in 2015. Special economic zones (SEZs) were used in many economies as one of the modalities to attract FDI.

Increasingly, economies in Asia and the Pacific have assumed a crucial role in shaping the global international investment agreements (IIAs) universe. In 2015 alone, the Asia-Pacific region witnessed the signing of 18 IIAs and an additional 13 IIAs entering into force, including movement towards the formation of so-called “mega-regional” agreements such as the Trans-Pacific Partnership (TPP), the ASEAN Economic Community (AEC) and the Eurasian Economic Union (EAEU). The region is also leading the shift in the paradigm of IIAs, moving to a more balanced investment regime that serves the interests of foreign investors and host countries.

Trade facilitation in the region helps to reduce trade costs

Trade facilitation and the reduction of international trade transaction costs remain an important priority for many countries of the Asian and Pacific region. Two thirds of the Asia-Pacific members of WTO have now ratified the WTO Trade Facilitation Agreement and are well on their way towards implementation. In addition, ESCAP member States, after several years of deliberations and negotiations on how to facilitate the electronic exchange of trade-related data across borders, in May 2016 finalized a regional treaty on cross-border paperless trade facilitation. Open for signature at the United Nations Headquarters in New York until 30 September 2017 to all member countries of ESCAP, this innovative United Nations treaty is expected to greatly support the region in maintaining its trade competitiveness and reaping the benefits from the fast-growing digital economy.

While no economy in the Asia-Pacific region has fully realized cross-border paperless trade, strides are being made at the national, regional and global levels in that direction as well as towards more comprehensive trade facilitation reform. Overall, steady improvements are being made in reducing trade costs and facilitating trade, although great diversity remains across countries and subregions. Key indicators measuring the ease of trading across borders and logistics performance show that some of the best performers in the region (and the world) are continuing to make progress in this regard. However, other economies in the region, such as landlocked countries or small island developing States (SIDS), still face multiple challenges and thus have achieved more mixed results.

In order to reduce this regional trade cost and facilitation gap, countries will need to implement more comprehensive trade facilitation reforms that address both “hard” and “soft” infrastructure bottlenecks, including by: (a) establishing effective institutional arrangements to enhance cooperation between relevant trade agencies as well as with the private sector to facilitate trade; (b) ensuring greater transparency and predictability of trade regulatory procedures; (c) increasing efforts to harmonize and automate trade procedures across borders; and (d) effectively monitoring implementation of trade facilitation measures and their impact.

Regional trends in trade policies: Building taller fences?

Trade policies reflected the general trends in terms of increased sentiment towards globalization. During the reporting period (mid-October 2014 to mid-May 2016), there has been an increase in restrictiveness of trade policies within the region. In fact, the region introduced more restrictive than liberalizing trade policy measures overall, while the opposite was true globally. Furthermore, both in the region and globally, policymakers got busier on a monthly basis as there was a noticeable surge in the number of trade restrictive measures adopted per month from mid-October 2015 to mid-May 2016. In 2015, trade-restrictive State measures (that extend beyond WTO disciplines) outnumbered trade-liberalizing ones by three-to-one; the region was responsible for 60% of these measures. Analyses of trade policies of the G20 economies have revealed that the major G20 economies of the region also showed strong protectionist tendencies, nudging Christine Lagarde, the head of the International Monetary Fund, to state that such policies restricting trade were a form of “economic malpractice” that would choke growth, hit jobs and reduce wages. In addition to exposing the role of Asia-Pacific countries in the most recent rising tide of protectionism, this Report delves deeper into the escalation of trade policy tensions in the global steel industry and contends that the rise in tensions can be partly attributed to the long-term impacts of trade distorting measures of the past as well as excess capacity in many industries.

In 2015, the region also registered a record increase in number of certain key non-tariff measures (NTMs); such NTMs are increasingly becoming a bigger impediment to international trade when compared to tariffs.

The services sector is gaining importance in international trade in its own right as well as through its role in facilitating global value chains, especially in the manufacturing sector. Analysis of the trade policies in the services sector, although plagued by severe data limitations, shows there was no substantial increase in protectionism in the sector.

Role of preferential trade agreements still strong

The negotiation of preferential trade agreements (PTAs) all around the world continues to grow amid the current global economic slowdown (and the consequent lower growth of trade) and the stagnation of multilateral trade negotiations. The Asia-Pacific region is now the major contributor to the build-up in the number of PTAs. More and more economies are becoming involved in agreements that not only allow liberalization in trade in goods, but also commitments in trade in services as well as harmonization of rules in many other areas, whether they are covered by WTO Agreements or not. The region lacks efforts to fulfil the obligations of transparency in WTO that are related to preferential trade agreements. There are several PTAs that should have been notified to WTO; however, this has not yet happened. Similarly, some agreements have been nullified and have become inoperative, yet have not been notified as such to WTO, and thus continue to create doubt about their operations.

An important message to policymakers involved in PTA negotiations is that the analysis here finds no strong links between the number of PTAs, trade intensity among the partners in those agreements and the actual utilization of preferences. While some economies have rationally chosen the partners with which to conclude trade agreements, with much of their trade being covered under such agreements, it is still not certain how much trade utilizes negotiated preferences. Data on preferential utilization rates is very scarce (typically available for trade by developed countries). By using the examples of Turkey, Thailand and Sri Lanka, it is argued that more efforts are needed to fully use existent PTAs. A strong argument is made for better statistics on utilization of preferences. This will not only help policymakers to better evaluate the benefits of each PTA; it will also help them to learn how to negotiate new PTAs that are more easily used by the private sector. Furthermore, an audit of PTAs by using the extent of utilization of preferences would indicate which agreements could be terminated without any loss of trade. Finally, information will also be useful for the private sector in seeking redress through trade defence mechanisms under PTAs.

Globally, but particularly in the Asia-Pacific region, there has been a lack of effort by economies to abolish or annul bilateral agreements between economies that have moved on and signed regional or plurilateral agreements among the same set of economies (ESCAP, 2015). The proliferation and overlapping of PTAs, a phenomenon called the "noodle-bowl", continues to impose challenges for, and additional burdens on firms; this is particularly the case when data show that there is no correlation between the number of PTAs and the share of trade and its expansion under PTAs. In order to reduce that impact, several economies are involved in mega-regional initiatives aimed at consolidating their multiple and overlapping network of PTAs. The most important efforts in the Asia-Pacific region that are underway are the TPP, RCEP and EAEU. While each initiative has its own characteristics and challenges, all have the potential to reduce the complexity of PTA networks in the region. Once a larger PTA with additional countries is signed, it is necessary that the bilateral PTAs and partial scope plurilaterals should be nullified. Such a phenomenon was seen in the past in the process of consolidation by the European Union, but only recently and somewhat reticently in in the Asia-Pacific region.

Looking forward towards digitalization of trade

Despite world-wide recognition of its importance, there are no official statistics on e-commerce or digital trade. Existing studies, mainly based on unofficial data, are difficult to generalize. As a consequence, key questions for proper policy design and regulation remain unanswered.

Using available official statistics, chapter 7 aims, to some extent, to fill the knowledge gap by highlighting major trends and policy implications within cross-border digital trade. This chapter also focuses on a factual exploration of digital trade at the global and Asia-Pacific levels. Although major policy implications are mentioned, suggesting comprehensive policy actions is beyond the scope of the chapter.

Growing digital intensity has caused fundamental changes in trade, and thus there is the need for the improvement of trade statistics to catch up with this process. The study shows that data requirements for analyses on digital trade issues need a combination of data on trade in services, input-output linkages and merchandise statistics at the most detailed level that are comparable across countries.

Through a careful selection of the proxy for digital trade, exporters in the Asia-Pacific region are rapidly increasing the use of digital technology to support their export activities, both directly and indirectly. The growth of digital intensity in exports by the Asia-Pacific region increased faster than that of the world, with the growth rate ranging between 11% and 15% annually, depending on the proxy used.

The growth of digital trade has a relatively stronger impact on service trade than merchandise trade. The digital-intensive industries are relatively high-tech or high value-added. The digital-intensive services sectors include financial services (for example, Internet banking), telecommunication services, R&D and business services, and renting of machinery and equipment (car rental services etc.). For manufacturing, the publishing industry, chemical products, computer equipment, and electrical machinery and transport machinery are among the sectors with high digital intensity.

The availability of digital infrastructure is important for the development of digital trade. Imports of telecommunication and computer equipment play an important role in digital trade, especially for Asia and the Pacific. This has opened intraregional trade opportunities as intraregional sourcing for those digital infrastructure products has been growing. However, the export opportunities are mainly clustered in large economies, especially China, India, Japan and the Republic of Korea.

The digitalization of international trade brings about a greater need for an open environment and international cooperation. Non-discriminatory principles and international harmonization of rules and regulation are essential. The concept of open environment is not new, but what is added by the digital trade is that "openness" not only means free flows of goods or services, but also the need for the free flow of data across national borders. In addition, the growing importance of digital trade brings to the fore a greater need for international cooperation, as a supportive environment for digital trade is more dependent on multilaterally-agreed policies than on unilateral ones.