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Review of the implementation of the 2030 Agenda for Sustainable Development in Asia and the Pacific: trade and investment**Growing challenges for trade and investment****Note by the secretariat***Summary*

The present document provides a summary of the growing challenges for trade and investment as important means of implementation of the 2030 Agenda for Sustainable Development. Trade and investment are stagnating in an environment of heightened uncertainty due to growing trade tensions, increasing use of protectionist measures, including non-tariff measures, weakening of the multilateral trading system and increasing complexity of overlapping trade agreements.

The present document contains a number of policy recommendations to address these challenges. In particular, the Asia-Pacific region could find sustainable solutions through collectively playing a greater role in defending the principles of the multilateral trading system, pursuing trade and investment liberalization and facilitation complemented by appropriate social and environmental protection policies, rationalizing the use of non-tariff measures, strengthening regional integration, consolidating trade and investment agreements in the region, simplifying and digitalizing trade, improving the business environment and providing incentives to foreign direct investment in sectors contributing to sustainable development.

The Commission may wish to consider the issues contained in the present document and provide guidance to the secretariat on the future direction of its work to support economies in the region in their efforts to promote and harness trade and investment as engines of sustainable development.

* ESCAP/75/L.1.

I. Introduction

1. International trade and foreign direct investment (FDI) have been an engine for broad-based development in many developing Asia-Pacific countries. Therefore, trade and FDI were identified as key means of implementation of the 2030 Agenda for Sustainable Development and of the Addis Ababa Action Agenda for financing for development. The regional road map for implementing the 2030 Agenda for Sustainable Development in Asia and the Pacific emphasizes the importance of improvements in regional connectivity, including trade, to boost economic growth and achieve sustainable development. Various estimates indicate it could cost the region between \$2.1 trillion and \$2.5 trillion per year¹ to close infrastructure gaps, expand basic social protection and address climate mitigation and adaptation. To meet these investment requirements, public sector resources must be complemented with increased private sector investments, including FDI.

2. High expectations were set for trade and investment in delivering the 2030 Agenda, premised on continuous progress in building a global partnership for sustainable development and based on aspirations for shared global prosperity supported by the multilateral trading system. In recent months, however, this premise has faced a serious test. Besides long-standing challenges, such as high trade costs, additional challenges have grown recently as a result of the increased level of trade tensions and protectionism. These have placed tremendous pressures on countries relying on trade and investment as means of implementation of the Sustainable Development Goals.

3. The present document contains a review of these challenges to the effectiveness of trade and investment as means of implementation of the 2030 Agenda. It also contains an outline of possible actions economies of the region may take to counteract these challenges and to fully harness the potential of trade and investment in implementing the 2030 Agenda.

II. Recent trends challenging trade and investment

A. Growing uncertainties due to increased trade tensions

4. Since the global financial crisis, international trade has not grown at the same rate as it did in previous decades. Trade growth has further slowed since the second half of 2018 because of rising uncertainties associated with increasing trade tensions between the United States of America and China. Trade in 2018 recorded slower growth than in 2017. Merchandise export volume growth decreased from 8 to 4 per cent, while import volume growth decreased from 8 to 6 per cent. Trade performance in the region in 2019 is set to further slow if trade tensions between the United States and China, and possibly other economies, remain or deepen. The Economic and Social Commission for Asia and the Pacific (ESCAP) estimates that the regional growth of export and import volume may decrease to only 2–3 per cent in 2019. The trends of trade in services tend to highly correlate with the trends of trade in goods.

¹ This is explained in figure 3.1 of *Financing for Transformation. From Agenda to Action on Sustainable Development in Asia and the Pacific* (United Nations publication, Sales No. E.15.II.F.6). The Commission is currently conducting a costing exercise, which will result in more up-to-date estimates of the investments needed to achieve the Sustainable Development Goals by 2030 in Asia and the Pacific. These figures will be available by mid-2019.

5. Rising economic uncertainty created by growing trade tensions have also affected FDI and other capital investments. Global FDI inflows, in particular greenfield FDI, fluctuated in 2017 and 2018. Greenfield FDI inflows suffered a sharp drop by 30 per cent to \$645 billion in 2017 before picking up in 2018 to reach \$886 billion.² In the Asia-Pacific region, where trade and investment are closely interlinked through a vast network of value chains, greenfield FDI inflows declined at an even steeper rate of 45 per cent to \$219 billion in 2017 before bouncing back up to \$405 billion in 2018. The large fluctuations in global greenfield FDI in 2017 and 2018 have been driven to a large extent by the political uncertainty over global trade, which may have deterred and delayed investment decisions, particularly in 2017.³

B. Rapid increase of protectionist measures

6. The number of trade restrictions increased in 2018. At the global level, the number of new discriminatory measures reached a record figure (88 per month) and far exceeded the number of new liberalizing measures (32 per month) implemented in the same period. Similarly, the number of new harmful measures introduced by countries of the Asia-Pacific region (33 per month) was more than double the number of new liberalizing measures.

7. The Asia-Pacific region is an important target of as well as a contributor to discriminatory trade measures, in part because the region is a major exporter of some of the products subject to trade conflicts. More than 30 per cent of the newly implemented discriminatory measures affected the Asia-Pacific region. Notably, approximately a third of these measures were introduced by countries of the region. Australia, China, India and Indonesia contributed more than 70 per cent of them.

8. Similarly, restrictions on trade in services have increased from an already high level. Trade in services is predominantly affected by “behind the border” measures, mainly related to domestic regulations. These measures can range from restrictions on foreign ownership to the degree of competition or the movement of people that affects different modes of service delivery to varying degrees.

9. With respect to FDI, there was also an increase in the adoption of more restrictive investment measures in the region during the same period. Out of 74 policy measures adopted between January 2017 and June 2018, 16 measures introduced restrictions or regulations on investment. In comparison, in 2016, 52 new measures were adopted in the region, of which nine were related to investment restrictions or regulations.

C. Intensification of non-tariff barriers

10. Non-tariff forms of trade distortion measures have been used much more often than tariffs. Subsidies provided to producers and exporters collectively represented more than 40 per cent of trade distortion measures introduced in 2018. In contrast, import tariffs accounted for only 17 per cent of newly implemented measures, while contingent trade-protective measures represented approximately 15 per cent.

² ESCAP calculations based on data from fDi Intelligence. Available at www.fdiintelligence.com/ (accessed on 31 January 2019).

³ Financial Times, *The fDi Report 2018: Global Greenfield Investment Trends* (London, 2018). Available at <http://report.fdiintelligence.com/>.

11. Technical non-tariff measures, such as product labelling standards and sanitary and phytosanitary measures, also increased rapidly in 2017. The trend continued during the first 10 months of 2018. Asia and the Pacific represented about 28 per cent of sanitary and phytosanitary measures and 22 per cent of technical barriers to trade initiated globally in 2017. The region's contribution to those measures decreased to 26 per cent and 20.5 per cent, respectively, during the first 10 months of 2018.

12. Non-tariff measures have significant trade costs associated with compliance with regulations and complex trade procedures. They are now believed to pose a greater impediment to trade and to be a more important cause of higher trade costs than ordinary customs tariffs. Part of the costs associated with non-tariff measures and regulations are paid in the home country, even when the underlying regulations are imposed by partner countries. For example, an exporter that manages to comply with a regulation often faces additional delays or costs due to administrative inefficiencies in documenting its compliance. Estimates produced by ESCAP show that the improvement of a country's own trade facilitation can reduce trade costs by up to 16 per cent, while similar improvements made in the trading partner country reduced trade costs by up to 12 per cent.

D. Weakening of the multilateral trading system

13. Rapid economic development in developing countries has shifted the balance of world economic power towards developing countries in Asia and the Pacific. However, the lack of adequate social policies to support those affected by the reallocation of resources inherent to the opening up of trade and investment has resulted in a backlash against multilateralism in some developed economies. Strong disagreements have emerged on how and even whether to implement target 17.10 of Sustainable Development Goal 17 on promoting a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the World Trade Organization (WTO).

14. For several years, WTO members have raised concerns about the effectiveness of its main functions: monitoring trade policies of its members, providing a rules-setting and negotiation platform and arbitrating trade disputes. The increase in unilateral trade restrictions, which may not adhere to WTO rules, and tit-for-tat strategies have also threatened the credibility of WTO.

15. The threats to moving the multilateral agenda forward appear to be greater than ever in the current policy environment. In particular, the dispute settlement system of WTO is under great pressure, with a significant increase in disputes and the ongoing impasse over the filling of vacancies on the WTO Appellate Body. As protectionism has started to gain momentum, the number of requests for consultation increased more than double from 17 cases in 2017 to 38 cases in 2018. The continued blocking of the appointment of new judges to the WTO Appellate Body has made the binding dispute settlement mechanism almost completely ineffective in addressing the growing trade tensions or in clearing the backlog of old disputes. The disfunction of the Appellate Body means that WTO is unable to fully resolve trade conflicts between its members. This could result in more bilateral trade disputes as individual States take it upon themselves to resolve conflicts through retaliation. Although a number of WTO members have put forward reform proposals to address growing concerns about the multilateral trading system and the future of WTO, there are major divisions among them. Achieving consensus will take time, during which trade tensions are unlikely to ease and may actually further escalate.

E. Increasing reliance on bilateral and plurilateral agreements

16. There are indications that trade tensions as well as uncertainties about the future of the multilateral trading system have given new impetus to bilateral and plurilateral initiatives. Stipulated by a policy change of the United States to reduce participation in multilateral and plurilateral agreements in favour of bilateral agreements, countries that see the benefit of trade and investment ties with the United States may increasingly turn to bilateral trade agreements with the world's largest economy. In addition, countries may use bilateral and plurilateral trade agreements to diversify risks and strengthening economic resilience to face growing trade tensions.

17. In Asia and the Pacific, this is evidenced by the number of new agreements initiated since 2017. Asian and Pacific economies have signed 18 new free trade agreements since 2017, including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. In addition, negotiations of another mega-regional agreement between 16 regional economies, the Regional Comprehensive Economic Partnership, have also gathered pace. Newly initiated agreements include both potential intraregional agreements and potential agreements with trade partners outside the region, particularly with economies in Europe and Latin America.

18. The trend is similar in international investment agreement making. Despite a global slowdown in the conclusion of international investment agreements in 2017 and 2018, countries in the Asia-Pacific region have continued to be active in concluding new international investment agreements, with 25 bilateral investment treaties that were signed or that entered into force in 2018.⁴

III. Implications for sustainable development

19. A surge in uncertainties against the background of a global trade slowdown would create great challenges for trade to continue as an engine of inclusive growth and poverty reduction. A continued escalation of trade tensions would threaten jobs and growth in all countries but would hit the poorest the hardest.⁵ At a minimum, the Asia-Pacific region will face a net loss of 2.7 million jobs if trade tensions are not resolved. Employment losses will be 66 per cent higher for unskilled workers, compared with those for skilled workers. As production shifts take place and resources are reallocated across sectors and borders, tens of millions of workers will see their jobs displaced and be forced to seek new employment. Those with lower skill sets or who are less mobile – often women – will face higher risk of unemployment.

20. In addition, the potential impacts of tensions on greenfield FDI inflow are particularly worrying because greenfield FDI would have important impacts on long-term economic development through job creation, skills development, and capital and technology transfer. Finally, trade tensions may have potentially serious impacts on resource allocation, efficiency and the environment in the region. The trade conflict will push production to more expensive locations, reducing resource efficiency globally. Some of the production activities may, for example, shift from China to economies with

⁴ United Nations Conference on Trade and Development, Investment Policy Hub. Available at <https://investmentpolicyhub.unctad.org/IPM> (accessed on 4 February 2019).

⁵ See chapter 4 of *Asia-Pacific Trade and Investment Report 2018: Recent Trends and Developments* (United Nations publication, Sales No. E.19.II.F.3).

lower environmental standards, leading to higher global greenhouse gas emissions.

21. An increasing global and regional protectionist attitude to trade policy does not bode well for the 2030 Agenda. In particular, Goal 17 (Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development) provides the main link between the Sustainable Development Goals and trade policy. This Goal stresses the importance of a universal, rules-based, open, non-discriminatory and equitable multilateral trading system and the timely implementation of duty-free and quota-free market access on a lasting basis for all least developed countries, supported by rules of origin that are transparent, simple and that facilitate market access. The absence of progress in the Doha Development Round has raised doubts about the ability of WTO to move decisively in areas of the negotiations relevant to achieving the Sustainable Development Goals, such as reducing trade-distorting agricultural subsidies and other barriers, in particular non-tariff barriers to trade in environmental goods and services, and dealing with new issues related to technology and e-commerce. The impasse related to the dispute settlement system in WTO adds uncertainties to the trade and investment policy environment, which consequently may cause delays in future investment in the sectors related to the Sustainable Development Goals.

22. While non-tariff measures often have legitimate non-trade policy objectives, they tend to be more complex, less transparent and more difficult to monitor than tariffs. As a result, they may significantly harm trade, especially in developing and least developed economies, where the facilities to ensure compliance with testing or certification standards are often lacking or inadequate. Consequently, developing countries have to resort to outsourcing services, such as laboratory testing or certification, in order to meet standards, which can erode any cost advantages they have. Most notably affected are the agricultural and food sectors. The use of human rights and labour standards are also sometimes perceived as strategic instruments to protect domestic producers in labour intensive industries. This is particularly disadvantageous for developing economies, which often have comparative advantages in those sectors.

23. The need for and scope of increased participation in international trade remains strong in many developing countries, in particular the least developed countries and small and vulnerable economies. It is therefore important to establish robust multilateral trade rules and to provide predictability, transparency and stability in market access. However, there are mounting concerns over the ability and practicability of multilateralism to address global problems and promote sustainable development through a strengthened global partnership. There is a high level of uncertainty as to how multilateral cooperation and the multilateral trading system will evolve in the coming years, as a more polarized international rule-making approach has continued to progress at bilateral and regional levels.

24. A proliferation of preferential trade agreements is likely to create a set of mutually inconsistent rules, which may interfere with multilateral rules. Implementing multiple trade and investment agreements would also mean the introduction of many different sets of rules. It underscores the need for more coherence and coordination in making international trade and investment agreements. In this regard, the importance of ensuring that new agreements are consistent with established rules under WTO and that they serve as building blocks towards a new and stronger multilateral system needs to be emphasized.

25. Most regional trading arrangements exclude small and vulnerable economies, such as the least developed countries. The exclusion of the smallest and most vulnerable countries shows that regional and mega-regional agreements, although important, are not a substitute for the multilateral trading system. The fact that most least developed countries have limited participation in preferential trade agreements with their major trading partners implies that maintaining their comparative advantage in international trade after graduation may be challenging. Also, those preferential trade agreements reduce the real value of the preferential market access that least developed countries are receiving in world markets.

IV. Way forward

26. The growing challenges for trade and investment call for individual and concerted actions from all Asia-Pacific economies in the following key areas to ensure that trade and investment continue to be an effective means to achieve sustainable development.

27. Asian and Pacific economies should be more vocal and collectively play a greater role in defending the principles and rules of the multilateral trading system, including non-discrimination, gradual liberalization through negotiation, transparency and predictability, promoting fair competition and more benefits for less developed countries. To that end, regional platforms, such as ESCAP, should be better utilized to build the capacity of developing countries in the region, to forge alliances and voice joint actions in defence of multilateral options.

28. Asian and Pacific economies should pursue trade and investment liberalization and facilitation, complemented by appropriate social and environmental protection policies. Successful sustainable development depends on maintaining and improving an environment in which business activities and innovation can flourish. Openness to trade and investment is a necessary condition for sustainable development in Asia and the Pacific. This requires that Governments keep the level of regulation and intervention in the economy low while emphasizing greater transparency and protection of property rights and a favourable investment climate. In addition, as trade tensions and regional integration lead to resource reallocation both within and across borders, complementary policies will become critical. Complementary policies, such as social protection, labour and education policies to support people negatively affected by trade frictions and integration efforts, must also be placed high on the policymaking agenda if the region is to continue its progress towards the Sustainable Development Goals.

29. Concerted efforts should be made to strengthen regional integration and consolidate trade and investment agreements in the region. ESCAP simulations suggest that, for the region as a whole, regional integration could more than offset the impacts of the ongoing trade war. Implementation of mega-regional deals, such as the Regional Comprehensive Economic Partnership, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the European Union-Japan Economic Partnership Agreement, could boost regional exports by 1.3 to 2.9 per cent, depending on the severity of global trade tensions. Regional integration could actually lead to an increase of 3.5 million jobs, even with escalating tariff threats. However, countries need to strive towards a consolidation of the many trade and investment agreements that already exist, and often have overlapping and conflicting provisions, and mainstream the Sustainable Development Goals into regional partnership strategies in order to move towards the adoption of a simpler but more development-friendly framework of regional integration. Flexible rules of

origin should be adopted in preferential trade agreements to help less developed countries foster industrialization, innovation and infrastructure, reduce inequalities and increase decent work, achieve economic growth and participate more fully in world trade.

30. Countries need to ensure that non-tariff measures are not undue barriers to trade. The use of non-tariff measures can help countries achieve the Sustainable Development Goals, however, even a legitimate non-tariff measure can lead to trade distortions when the regulatory distance between an exporting country and its trading partner is large. Regional economic cooperation for regulatory convergence among Asia-Pacific economies and promoting the use of international standards will help countries achieve an appropriate balance.

31. Countries should strive to further reduce trade costs by accelerating the implementation of the Agreement on Trade Facilitation of WTO and the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific. The competitiveness of developing countries and least developed countries is undermined by the high transaction and transport costs associated with international trade. The pressures are being exacerbated by trade tensions and rising protectionism. The use of trade facilitation measures, including full implementation of the Agreement on Trade Facilitation of WTO and regional initiatives, in particular the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific, will simplify the procedures associated to trade and in dealing with the growing incidence of non-tariff measures. Finally, reducing trade costs through digitalization of trade procedures makes it easier for exporters, in particular small enterprises, to participate in international markets.

32. Countries need to mainstream trade and investment into sustainable development. Trade and FDI policies must be designed appropriately to mobilize resources for sectors that provide the greatest benefits in terms of sustainable development. Examples include reducing tariffs on environmental goods and services, adopting non-tariff measures based on relevant sustainability standards, allowing tax deductions in environmentally sustainable sectors or in sectors that generate more jobs. However, the impacts of targeted measures should be carefully assessed to avoid unnecessary distortions of market forces. In addition, the coherence of national and international policy frameworks is required. At the national level, this requires proper coordination mechanisms across various ministries and agencies for the crafting and implementing of trade and FDI policies complemented by social, environmental and other domestic policies. At the international level, it will be important for trade and investment agreements to integrate social and environmental dimensions of sustainable development. For example, the scope and principle of fair and equitable treatment should be clearly set out in international investment agreements. The reform of international investment agreements must also take into consideration the balanced design of investor-State dispute settlement systems.

V. Issues for consideration by the Commission

33. The Commission may wish to deliberate on the issues and recommendations contained in the present document and provide guidance to the secretariat on its role in promoting and facilitating the implementation of these recommendations. The Commission may also wish to discuss how Asia-Pacific countries can take initiatives, individually and collectively, with the support of ESCAP, in the following areas:

- (a) Formulating an appropriate response to unilateral protectionist actions while avoiding retaliatory actions;
 - (b) Promoting an open and well-functioning multilateral trading system and pursuing regional trade agreements that are complementary to this system;
 - (c) Pursuing deeper regional economic integration to maximize sustainable development gains, including through trade adjustment assistance, complementary domestic policies such as education and tax policies, supporting effective integration of small and vulnerable countries into the global and regional economy;
 - (d) Facilitating trade and investment for sustainable development, including the implementation of the Agreement on Trade Facilitation of WTO and the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific; reduction of trade distorting non-tariff measures; rebalancing of international investment agreements and improvement of the environment for doing business.
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