



# MERCHANDISE TRADE: A CAUTIOUS RECOVERY<sup>1</sup>

Buoyed by stronger demand by major economies within and outside the region, global and regional trade growth improved in 2017 from the weak performance in 2016. However, downside risks loom over the trade recovery. The structural factors that caused the weak after-crisis trade performance persist, threatening the chance of a full recovery. Following the trend in developed countries, the aggregate demand of developing countries in the region indicates weakening trade intensity. In addition, heightened uncertainties in the trade policy directions of developed economies have raised concerns about a potential relapse in global trade. While fears about rising protectionism have not materialized, the near-term prospect of trade recovery is still fragile.

This chapter first discusses the Asia-Pacific region's merchandise trade performance in 2016. Subregional performances and intraregional trade linkages are discussed next. The chapter then presents the positive developments in early 2017. After taking full account of the upside factors, the existing downside risks are explored. The chapter concludes by examining the near-term trade prospects of the Asia-Pacific region.

## A. MERCHANDISE TRADE IN 2016 REMAINS SUBDUED

*“Trade performance of the region lagged behind that of the world for the first time since the global financial crisis. The region’s trade decreased by 4.3% in 2016 while the global trade fell by 3.2%.”*

Global and regional trade in 2016 remained weak, although it improved from 2015. After a double digit fall of trade in 2015, global trade in 2016 declined by 3.2% while exports and imports in the region fell 4.3% (figure 1.1). Trade contraction in China was a major factor for this poor performance. In China, whose exports represented more than one third of the region’s exports, exports contracted by 7.7% in 2016. In the rest of the developing Asia-Pacific region, exports decreased by 3.6%. Japan, whose exports accounted for about 10% of total merchandise exports by the region, was a bright spot

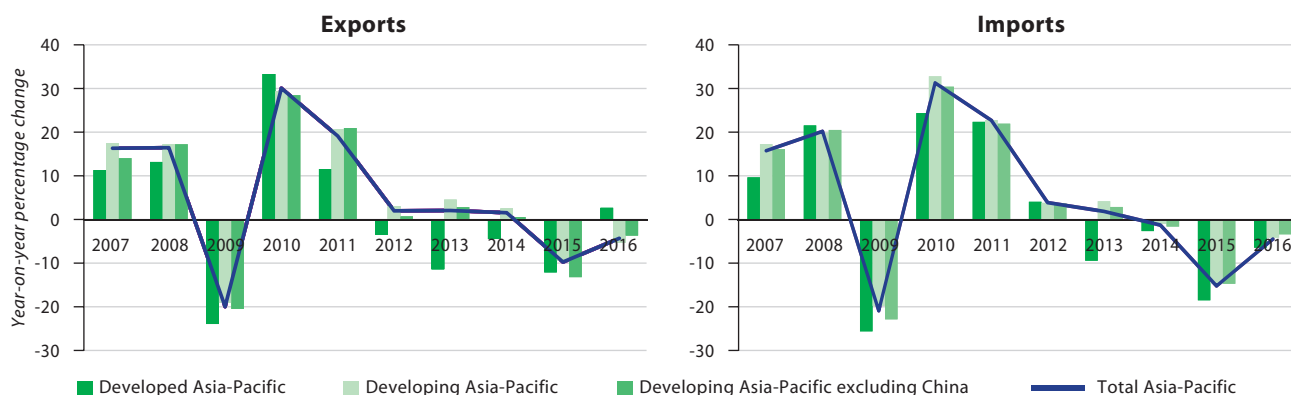
in 2016. Export by Japan drove the growth of developed Asia-Pacific countries’ exports to 2.7%. Import performance did not improve in the whole region. China’s imports, which represented 28% of total imports by the region from the world, decreased by 5.5% in 2016. At the same time, imports by other developing economies in the region fell by 3.9% and imports by developed Asia-Pacific economies fell by 6.3%.

*“Despite its weak trade growth in 2016, Asia-Pacific remains the world’s largest trading region. It constitutes 40% of world exports and 35% of world imports.”*

Despite weaker growth in the region, the Asia-Pacific region is still the world’s largest trading region. Exports and imports by the region amounted to \$6.3 trillion and \$5.7 trillion, respectively. The region’s share in global exports remained at about 40%, while its share of global imports fell slightly to 35%.<sup>2</sup>

**Figure 1.1**

**Growth of merchandise trade by Asia and the Pacific, 2007-2016**



Source: ESCAP calculations based on country data from WTO International Trade Statistics Database (accessed June 2017).

*“Nearly three quarters of manufacturing trade is associated with the sectors with strong global value chains linkages.”*

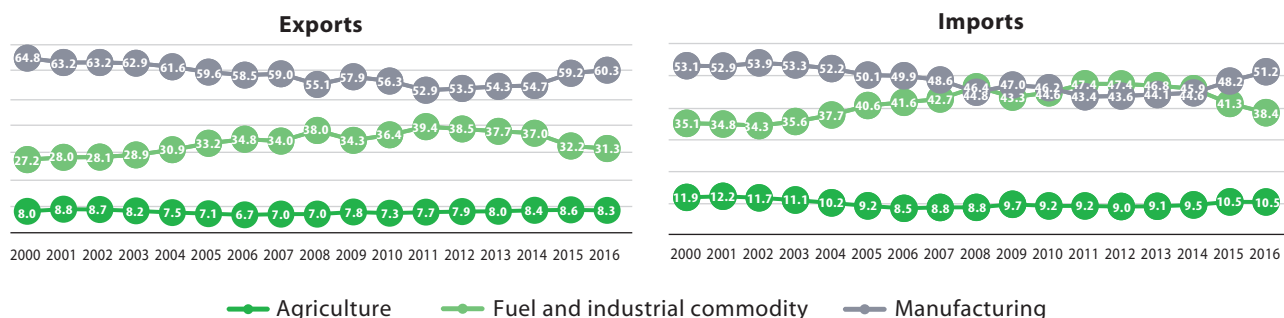
Manufacturing products are the dominant component of the region’s exports and imports. The sector accounted for 60% of total exports and 51% of total imports in 2016 (figure 1.2). About 70%-80% of the manufacturing trade is associated with the sectors

that have strong global value chains (GVCs) linkages, including electrical machinery, electronics and transport equipment products. In addition to trade in manufacturing products, about 30% of trade by the region was in fuel and industrial commodities, while agriculture trade accounted for about 10%. Sectoral patterns of Asia-Pacific trade did not change much over the past two decades. Although there were some fluctuations in the sectoral shares, they



**Figure 1.2** Sectoral composition of trade by Asia and the Pacific, 2000-2016

(Percentage of exports and imports)



Source: ESCAP calculations using data from UN Comtrade accessed through World Bank, WITS (accessed September 2017).

reflect the price volatility, especially of fuel and industrial commodities, more than changes in the share of sectoral trade volume.

## B. SUBREGIONAL PERFORMANCE: EAST AND NORTH-EAST ASIA MAINTAINS ITS DOMINANCE

*“Trade is concentrated in a handful of economies: 13 economies accounted for more than 90% of regional trade.”*

Trade was not evenly distributed across all the countries in the region. More than 90% of the Asia-Pacific exports and imports came from 13 economies in the region. The four largest exporters of the region were from East and North-East Asia, they were China; Japan; Hong Kong, China; and the Republic of Korea (figure 1.3). These economies together accounted for more than 60% of the region's total trade.

*“East and North-East Asia accounted for more than 60% of Asia-Pacific region's total trade.”*

Due to the dominance of China and other large economies in the same subregion, East and North-East Asia captured the majority of the region's trade. In 2016, East and North-East Asia accounted for more than 64% of the region's exports and 59.5% of its imports. South-East Asia was the second-largest trading subregion in Asia and the Pacific. It

represented about 18%-19% of the region's exports and imports. Apart from these two subregions, the trade contributed by other Asia-Pacific subregions was quite small. For example, the share of South and South-West Asia was 8% for exports and 12% for imports. North and Central Asia accounted for 5%-6%, while the Pacific's share accounted for only about 4% of the region's trade.

As illustrated in figure 1.3, trade concentrated in large economies in the subregions. Australia and the Russian Federation accounted for about 80% of exports from the Pacific and North and Central Asia regions, respectively. Exports by China and India represented about a half of the exports from their own subregions. Export share is relatively more dispersed in the South-East Asia: five economies accounted for 90% of the subregion's exports, while the other six economies captured the remainder.<sup>3</sup>

There are two possible causes for the geographic concentration of trade. First, the difference in trade shares corresponds to the divergence of trade competitiveness and supply capacity between economies. This means that the dominant economy is more competitive, and thus can crowd out other economies from the market. Second, trade concentration in a subregion may reflect the hub and spoke trade relationship within the subregion. In this relationship, spoke economies rely on the hub as their major (direct and indirect) export market. The next section, which looks at intraregional trade, will explore these issues further.



Major exporters in Asia and the Pacific and its subregions, 2016

(Percentage of total exports)




Source: ESCAP calculations based on data from ESCAP online Statistical Database (accessed October 2017).

Notes:

(1) The area of each box represents the percentage share of a country in total exports from a respective subregion/region.

(2) Some economies' names are not shown in full due to space limitations. Economies having very small share are not featured in the figure, but their shares are combined as part of "others" in each respective area.

## C. INTRAREGIONAL TRADE: REGIONAL TRADE NETWORKS DO NOT COVER ALL SUBREGIONS

 *“The share of intraregional trade in 2016 was about 56% for exports and 58% for imports.”*

In Asia-Pacific region, intraregional trade is more important than trade with the rest of the world. In terms of its share of the total trade, it has remained stable for the past five years. In 2016, it was about 56% for exports and 58% for imports. In addition, about 30% of the region's exports and 21% of the region's imports went to the United States and the European Union. The remainder of less than 10% went to the rest of the world.

While several factors may influence the size of intraregional trade, two stand out as the most relevant. One factor is associated with the relatively robust economic growth of populous developing Asia-Pacific economies, which boosts the purchasing power, especially for the goods and services from the region. The other factor is linked to the growing number of actors in the international network of production in the region. This increases the trade flow in raw materials and intermediate inputs within the region.

 *“Subregions trade less with themselves than they trade with East and North-East Asia.”*

Exports to East and North-East Asia were equivalent to more than half of total intraregional exports (table 1.1). Trade with China alone accounted for about a quarter of intraregional imports and exports combined.<sup>4</sup> Notably, there were less exports within subregions than exports to East and North-East Asia. These figures suggested that East and North-East Asia, especially China, was the hub of intraregional trade.

The interconnected production in East and North-East Asia and South-East Asia tends to create a hub-spoke relationship between the two subregions. Nearly one third of the exports from South-East Asia went to the East and North-East Asia. For example, parts and components for

electronics and automotive products were an important element of exports to China from major trading economies in South-East Asia. Similarly, China was also the most important export market of commodities from small countries in the South-East Asian subregion.

 *“South and South-West Asia, North and Central Asia, and developing Pacific are not integrated sufficiently into the regional trade and production networks.”*

In contrast, South and South-West Asia, North and Central Asia, and developing Pacific have not integrated well into the regional trade and production networks. The share of intraregional exports was only 31% and 35% of exports from South-West Asia, and North and Central Asia, respectively. In the case of the Pacific, the extremely high intraregional export share was driven by exports from Australia to the region.

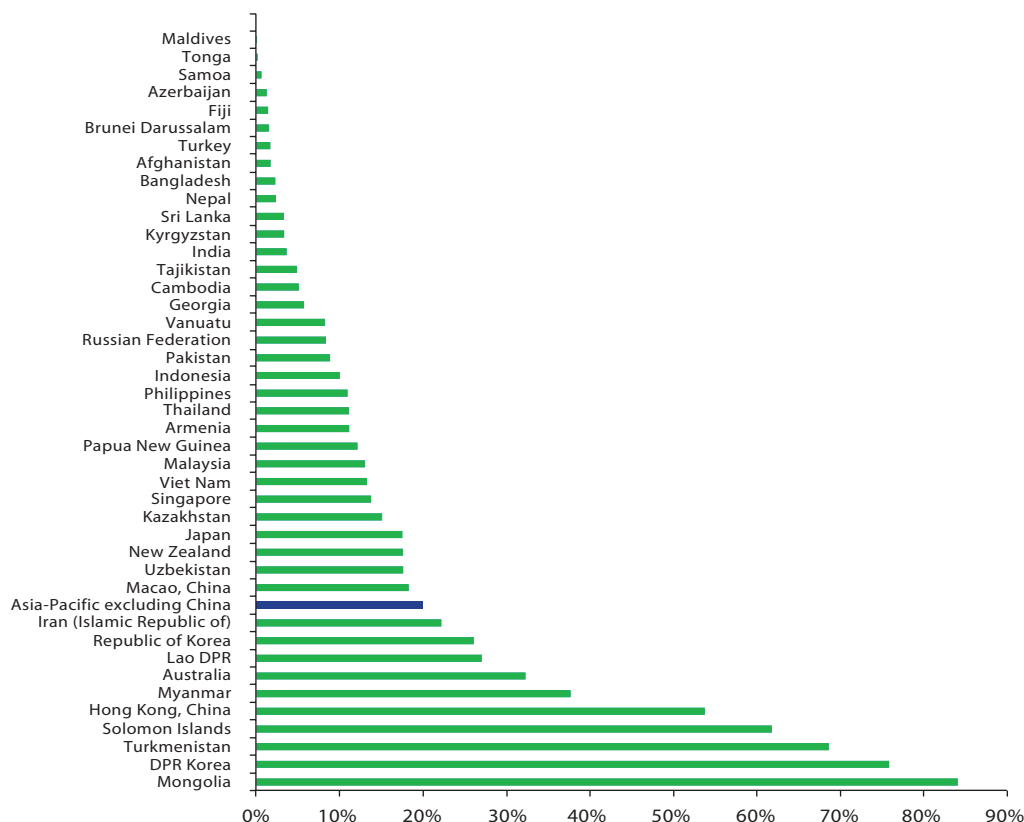
For small economies, their major export destinations are large neighbouring economies in the same subregion, extraregional markets where their exports can enjoy non-reciprocal preferential trade treatments (such as the European Union), and China. For example, Bhutan and Nepal rely on exports to India. Fiji, Samoa, and Tonga export mainly to Australia. Bangladesh relies on exports to the United States and countries in the European Union. Mongolia, Solomon Islands, and Turkmenistan depend on exports to China.

As mentioned, China is a major intraregional market and the most important global export destination for 21 Asia-Pacific economies. There are 10 Asia-Pacific economies that sent more than 20% of their total exports to China (figure 1.4). Of those 10 economies, China is the destination of more than 50% of total exports by Mongolia; the Democratic People's Republic of Korea; Turkmenistan; the Solomon Islands and Hong Kong, China. For all of the economies except Hong Kong, China, the strong reliance on exports to China reflects their high dependence on commodity exports, of which China is the world largest importer. This means that those economies are highly vulnerable to both commodity-price fluctuations and changing economic dynamics in China.


**Intraregional merchandise exports, by Asia-Pacific subregion, 2015-2016**
*(Percentage of total exports)*

Subregion	Year	Destination of exports							Asia-Pacific	Rest of the world
		ENEA excl. China	China	ENEA	SEA	SSWA	NCA	Pacific		
East and North-East Asia (ENEA)	2016	18.5	13.2	31.7	12.6	5.0	1.8	2.1	53.1	46.9
	2015	19.1	12.9	31.9	12.4	4.8	1.6	2.1	52.8	47.2
South-East Asia (SEA)	2016	19.6	12.2	31.8	24.0	5.1	0.5	3.6	65.0	35.0
	2015	19.5	12.0	31.6	24.5	5.3	0.4	3.8	65.6	34.4
South and South-West Asia (SSWA)	2016	6.2	5.5	11.7	6.0	10.1	2.1	1.0	30.9	69.1
	2015	5.8	5.8	11.6	5.8	10.0	2.7	1.0	31.2	68.8
North and Central Asia (NCA)	2016	6.5	11.0	17.5	1.7	7.9	7.5	0.1	34.7	65.3
	2015	7.5	10.2	17.7	1.7	8.1	7.4	0.1	35.0	65.0
Pacific	2016	19.0	28.3	47.2	11.7	4.2	0.2	7.4	70.7	29.3
	2015	22.1	29.4	51.4	10.5	4.8	0.3	7.3	74.3	25.7

Source: ESCAP calculations based on IMF Direction of Trade Statistics (accessed May 2017). Country data are available from the ESCAP online statistical database. Data given in percentages (rows show percentage of export to each destination from each source, e.g. 13.2% of East and North-East Asian exports go to China).


**Share of exports from selected economies to China, 2016**
*(Percentage of total exports)*


Source: ESCAP calculations, based on IMF Direction of Trade Statistics (accessed April 2017). Country data are available from the ESCAP online statistical database.



*“East and North-East Asia, especially China, continues to be the largest source for intraregional imports”*

Similar to what is observed for intra-subregional exports, countries import much less from within their subregions than they import from East and North-East Asia. Imports from East and North-East Asia, especially from China, accounted on average for over 30% of total imports by the Asia-Pacific region, or equivalent to 60% of intraregional imports. For each subregion, imports from East and North-

East Asia accounted for 22% to 38% of their total imports (table 1.2). Imports from China alone contributed 50% to 75% of those imports. Due to high export similarity between countries in the subregions, imports from countries in the same subregion accounted for only 7% of the total imports in the Pacific and South and South-West Asia and less than 11% in North and Central Asia. In all subregions the large share of trade was with East and North-East Asia, especially with China, and this suggests that China is the hub of trade in the region as a whole.



**Intraregional merchandise imports, by Asia-Pacific subregion, 2015-2016**

(Percentage of total imports)

Subregion	Year	Source of imports								
		ENE excl. China	China	ENE	SEA	SSWA	NCA	Pacific	Asia- Pacific	Rest of the world
East and North-East Asia (ENE)	2016	14.7	15.8	30.5	13.1	2.1	2.2	4.3	52.2	47.8
	2015	14.4	16.0	30.4	12.4	2.1	2.4	4.2	51.5	48.5
South-East Asia (SEA)	2016	17.7	19.9	37.6	21.7	2.3	0.6	2.1	64.4	35.6
	2015	17.1	19.6	36.7	22.2	2.2	1.1	2.2	64.4	35.6
South and South-West Asia (SSWA)	2016	7.0	15.9	22.9	8.6	7.5	3.9	1.6	44.5	55.5
	2015	6.6	15.2	21.7	8.3	6.7	4.3	1.7	42.7	57.3
North and Central Asia (NCA)	2016	6.5	19.2	25.7	3.6	4.9	10.9	0.3	45.4	54.6
	2015	6.2	17.9	24.1	3.3	6.0	12.0	0.3	45.7	54.3
Pacific	2016	12.5	22.3	34.8	16.1	2.5	0.1	6.9	60.3	39.7
	2015	12.7	21.9	34.7	16.7	2.4	0.2	6.3	60.4	39.6

Source: ESCAP calculations based on IMF Direction of Trade Statistics (accessed May 2017). Country data are available from the ESCAP online statistical database. Data in percentages (rows give percentage of imports from each source; e.g. East and North-East Asia sources 15.8% of the subregion's imports from China).

## D. RECENT TRADE IMPROVEMENTS

*“Global trade has bounced back in 2017 and is expected to grow at more than 3% in real terms this year.”*

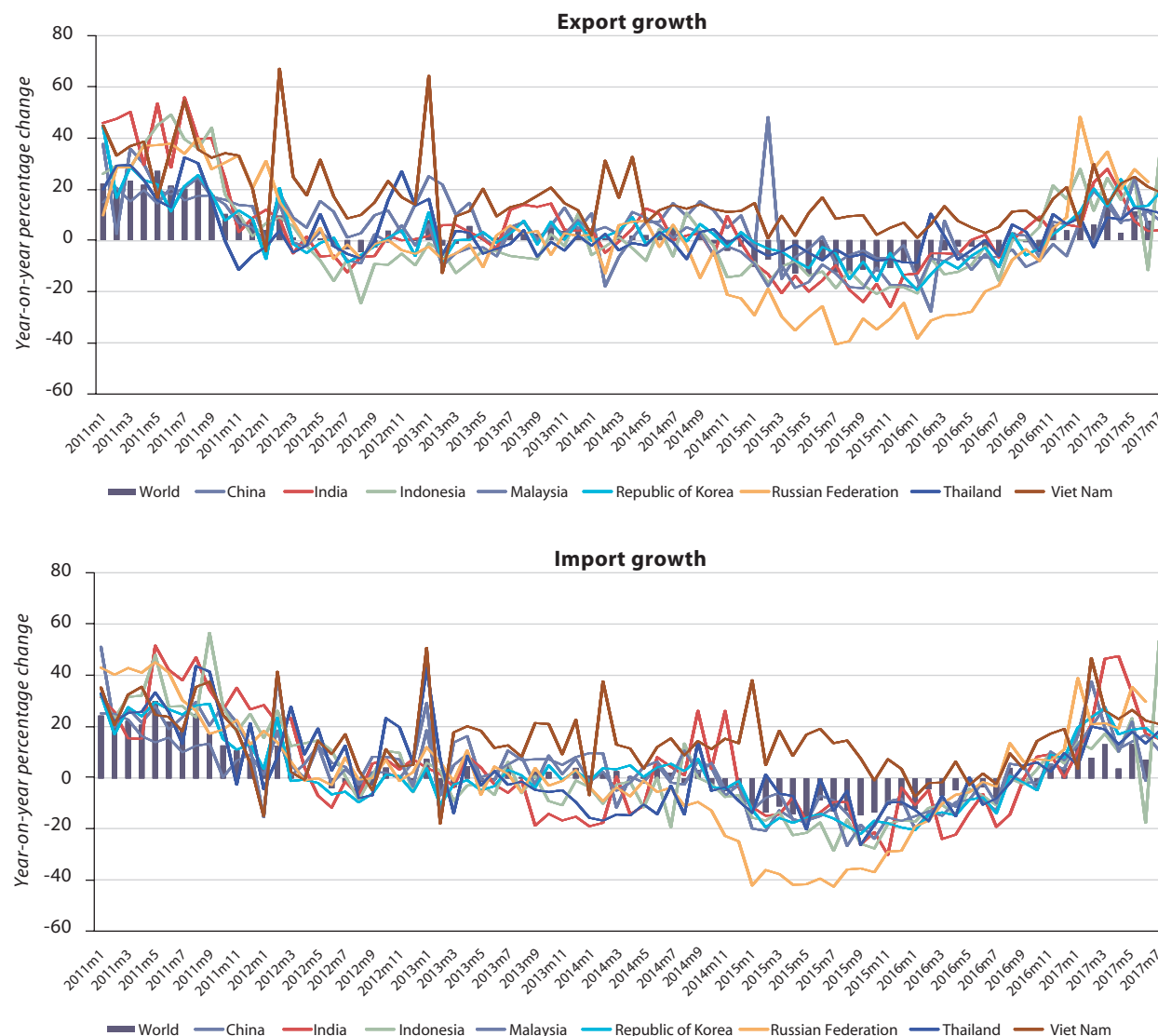
After the weak performance during the first ten months of 2016, global and regional trade have picked up since the last two months of 2016 (figure 1.5). Forward-looking economic indicators also suggest continuing signs of a trade recovery in 2017.<sup>5</sup> The indicators include the expansion of global trade volume export orders, container shipping and air freight. World export volume is projected to increase by 3.6% in 2017, up from an increase of 1.3% in 2016 (WTO, 2017b).

*“Intraregional demand is picking up with the return to double-digit growth of China's imports.”*

Monthly trade growth in 2017 shows a strong recovery of China's import demand. China's monthly imports grew by 18.9% during the first six months of 2017 compared to the same period in last year, while exports grew by 8.5% during this same period. The increased demand for inputs to produce exports is partially responsible for driving this import recovery. The recovery of commodity imports by China helps explain why prices of energy commodities, including natural gas and coal, are projected to increase by 26% in 2017 (World Bank, 2017). Metal prices are also expected to rise by 16% in 2017 due to China's



**Figure 1.5** Monthly trade growth in selected developing Asia-Pacific economies, 2011-2017



Source: ESCAP calculations based on WTO online short-term statistics (accessed September 2017).

Note: Change in United States dollar value year-on-year, encapsulating volume and price changes.

demand and supply constraints, including mine disruptions in Chile, Indonesia and Peru. The rising commodity prices also feed into the cost of production, affecting export and import prices in general. Therefore, trade in 2017 is expected to increase both in volume and value terms.

Also encouraging are the IMF (2017) and ESCAP (2017) projections for global and regional economic growth in 2017 and 2018. Boosted by fiscal initiatives, infrastructure projects and optimistic

financial markets in the major economies, global gross domestic product (GDP) growth is projected to rise modestly to around 3.5% in 2017 and 3.6% in 2018, from 3.2% in 2016.<sup>6</sup> The projected growth in Euro-zone countries is 1.9% and 1.7% in 2017 and 2018, respectively. Meanwhile, the economic forecasts for the United States are expected to be resilient at 2.1% over the same period, which is an improvement from 1.6% in 2016. The Asia-Pacific region is likely to lead global growth with regional GDP growth registering around 3.8% in 2017 and



2018 (ESCAP, 2017). A solid, although slower, pace of China's economic growth at 6.7% in 2017 and 6.4% in 2018 helps ensure robust intraregional demand.

The recent improvement of economic activity brightens up the economic and trade prospects in the Asia-Pacific region. The trade recovery of China will benefit many economies in East and North-East Asia and South-East Asia as they are closely linked to China through global and regional production networks. The recovery in commodity prices will also help improve the trade performance of emerging economies, especially commodity exporters. In addition to China, other major regional economies are also expected to have robust economic growth. India should be able to maintain its dynamic growth performance with a growth rate above 7%. This will boost exports from countries in South and South-West Asia, which are linked to India through a network of preferential trade agreements and geographical advantages. The Russian Federation is forecasted to bounce back from a negative to a moderate growth path in the near future. This will benefit countries in North and Central Asia, which have the Russian Federation as their major export markets. Finally, Australia and New Zealand should maintain their robust growth and their strong demand for exports from developing island in the Pacific.

## E. THE MODERATION IN THE USE OF NEW TRADE-POLICY MEASURES

*“The last seven months saw worldwide moderation in the use of new trade measures.”*

Alongside the recent recovery of trade, there has also been a moderation in new trade restrictive and trade liberalizing measures over the last seven months.<sup>7</sup> Between October 2015 and May 2017, new trade-restrictive measures peaked in 2015 and then fell in number. Over this period, 256 trade-restrictive measures were introduced at the global level, equivalent to 13.5 new trade-restrictive measures per month (table 1.3). The monthly average of new trade-restrictive measures then fell to 10.6 measures during the last seven months of the reporting period. However, there was also a corresponding slowdown of new trade-liberalizing measures. During the same 18-month period, 15.6 new measures per month were introduced globally, but the monthly average fell to 11.4 measures during the last seven months of the period (table 1.4).

*“Asia and the Pacific contributed 27% of the new trade-restrictive measures introduced globally.”*



**Table 1.3** New trade and trade-related restrictive measures, October 2015 to May 2017 and October 2016 to May 2017

(Number of measures)

Type of measure	October 2015 to May 2017		October 2016 to May 2017	
	World	Asia-Pacific region	World	Asia-Pacific region
Import	189	52	56	14
of which tariffs	113	31	32	8
Export	44	8	10	3
Other	23	9	8	3
<b>Total</b>	<b>256</b>	<b>69</b>	<b>74</b>	<b>20</b>
Measures per month	13.5	3.6	10.6	2.9

Source: ESCAP calculations based on data from WTO Trade Monitoring Database (accessed July 2017).



**New trade liberalizing measures, October 2015 to May 2017 and October 2016 to May 2017**


(Number of measures)

Type of measure	October 2015 to May 2017		October 2016 to May 2017	
	World	Asia-Pacific region	World	Asia-Pacific region
Import	241	58	68	18
of which tariffs	185	47	57	15
Export	52	12	12	3
Other	3	5	0	2
<b>Total</b>	<b>296</b>	<b>75</b>	<b>80</b>	<b>23</b>
<i>Measures per month</i>	15.6	3.9	11.4	3.3

Source: ESCAP calculations based on data from WTO Trade Monitoring Database (accessed July 2017).

During the analysed period, Asia-Pacific economies contributed substantially to the global stock of trade measures. The region accounted for 27% of the trade-restrictive measures introduced globally and 25% of liberalizing ones. India and Indonesia added the largest number of new trade-restrictive measures, with 21 and 16 measures, respectively. India and China added the largest number of new liberalizing measures, with 17 and 12 measures, respectively.

Similar to the global trend, new trade-restrictive measures imposed by Asia-Pacific countries decreased from 3.6 new measures per month during the 18-month period to 2.9 measures in the last seven months of the period. The region also saw a decrease of new trade-liberalizing measures from 3.9 to 3.3 measures per month.<sup>8</sup>

 *“More than half of trade-restrictive measures were non-tariff measures.”*

Non-tariff measures (NTMs) have been increasing. NTMs accounted for 56% of the new trade-restrictive measures introduced globally and 55% regionally during the 18-month period. “Technical NTMs”, such as product labelling standards and “sanitary and phytosanitary” (SPS) measures, which cover regulations on plant and animal health, have become the most common form of NTMs. In the Asia-Pacific region, 370 sanitary and 355 phytosanitary measures and technical barriers to trade were initiated in 2016.

While most new trade-restrictive measures are NTMs, trade liberalizing measures are mainly tariff reductions.<sup>9</sup> Average applied tariff rates of Asia-

Pacific countries have decreased substantially during the past few decades. Tariff reductions have been achieved through a combination of: (a) unilateral liberalization, with countries adopting more open trade-oriented development strategies; (b) preferential trade agreements, with countries allowing greater market access to partners; and (c) multilaterally, through liberalization within the WTO framework. In general, tariff levels in the Asia-Pacific region were on par with that of major developed economies (figure 1.6).

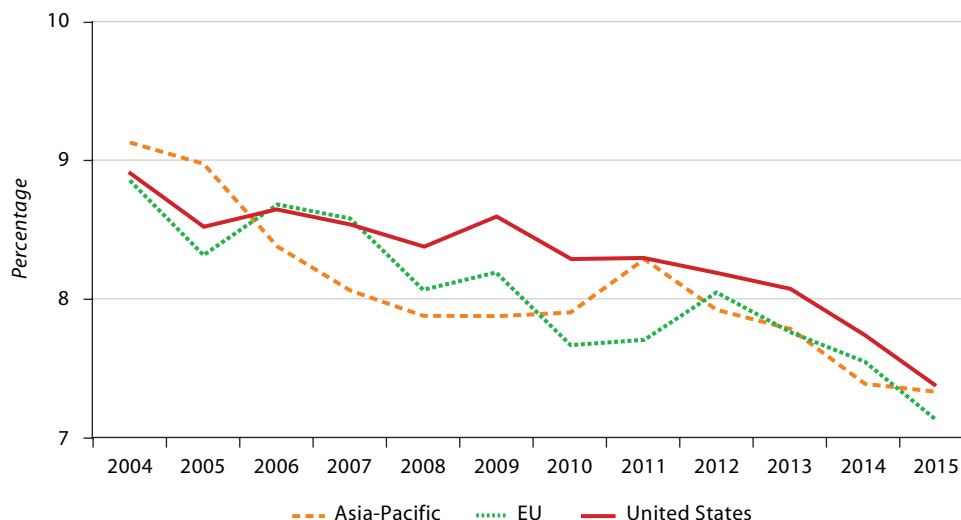
 *“The region contributed 66% of the trade agreements in force worldwide.”*

The region is now a major contributor to the worldwide build-up of preferential trade agreements.<sup>10</sup> Currently, 170 out of 274 trade agreements in force worldwide involve Asia-Pacific economies. On average, an Asia-Pacific economy is signatory to 7.6 trade agreements. Many of these agreements cover intraregional trade. In 2016, over 72% of the intraregional trade between Asia-Pacific economies was covered by agreements. Several economies in the region are also participating in mega-regional trade agreements that are currently under negotiations, including the Trans-Pacific Partnership (TPP-11) and the Regional Comprehensive Economic Partnership (RCEP).

Despite the recent drop in new measures introduced, there is no certainty that the trend will continue or that trade will be less restrictive. Although the rate of growth has slowed, the stock of trade-restrictive measures is still growing.<sup>11</sup> Moreover, the negative



**Effectively applied tariffs of Asia and the Pacific and selected major economies, simple average**



Source: ESCAP calculations based on data from World Bank, WITS (accessed July 2017).

effects of the measures will continue to accumulate until they are removed. In light of this new climate, monitoring trade policy needs to consider the following:

First, the actual number of trade-restrictive measures may be higher than those reported to the World Trade Organization (WTO). Despite this concern, data from the Global Trade Alert (GTA) initiative, which comprises a broader range of trade measures, corroborates the WTO's numbers.<sup>12</sup>

Second, a small number of trade-restrictive measures could have an oversized effect on trade volume. For example, Evenett and Fritz (2017) indicate that half of imports by the United States would be affected if the country-imposed trade-restrictive measures targeting only 72 product categories of the over 5,000 types of products currently imported. In addition, a small reduction of imports by a large economy could have a huge negative impact on small trading partners.<sup>13</sup>

Finally, protectionist actions may be hidden behind regulations and NTMs with legitimate socio-economic objectives. NTMs are less transparent and harder to monitor than tariff measures, so they tend to pose a greater impediment to trade than tariffs (UNCTAD, 2012). Despite often serving legitimate and important public policy objectives, as discussed in

chapter 4, they may also become a convenient means for governments to discriminate against imported products while avoiding dispute. The sectors most notably affected by NTMs are the agricultural and food sectors. Such actions could harm trade significantly, especially in developing and least developed countries.

## F. EXISTING DOWNSIDE RISKS

Although the improved performance of global and regional trade during the recent period seems to be more than transitory, risks threatening the world economy remain. Structural factors contributing to the weak trade performance since the 2008-2009 financial crisis persist; the increase of output still stimulates less trade growth than in the pre-crisis period (WTO, 2017a). Moreover, while import demand in developed economies has not fully recovered, the structural rebalancing of China could also lead to decreased import demand by China.

China's restructuring economic activity will have important implications for the rest of the region. To move away from assembly and processing activity, China will be sourcing an increasing amount of intermediate goods domestically. This trend can already be seen. Over the last 15 years, the share of intermediate goods in China's imports decreased by

half from 40% to 20% (ESCAP, 2016). Similarly, the import content of China's investment spending fell from 30% to 18% over a period of ten years (WTO, 2017b). The decreasing import intensity of China's demand together with the low import intensity of India, the hub economy of South and South-West Asia, means these economies may not generate adequate intraregional demand for the exporters in the rest of the region.

Another threat to the region and the global economy is the uncertainty from the sharp increase in protectionist rhetoric. It seems that the rhetoric has not converted into policies, and in fact, the number of new trade-restrictive measures have moderated recently. However, there are also fewer new liberalizing measures introduced. Moreover, anti-globalization movements in developed countries stoke fears that more restrictive trade measures will be employed in the future (box 1.1). A study by ESCAP indicated that

“economic growth for the major developing countries in the region in 2017 could be up to 1.2 percentage points slower than the baseline if an increase in trade protectionism and global economic uncertainty is steeper than anticipated” (ESCAP, 2017, p. viii).<sup>14</sup>

Looking ahead, uncertainties coming from technological change will have higher impacts on economic structure and welfare than policy uncertainties. Despite a major ingredient of long-term economic growth, technological change is also characterized by a high degree of uncertainty. The prospects for the increased use of automation will have great impacts the world economy due to the rise of new jobs demanding new skills and the disappearance of jobs replaced by innovations. To understand the potential risks from technological change, future research of ESCAP will go into how new technologies are devised, how rapidly they diffuse, and the ultimate extent of that diffusion.



### Concerns about economic policy uncertainty<sup>a</sup>

Since the 2008-2009 global economic crisis, there has been concerns that a long period of low economic growth will generate trade tensions and lead to trade restrictions. Recently, anxiety about protectionism has increased following the opening of the re-negotiation of the North American Free Trade Agreement and the negotiation of post-Brexit trade arrangements between the United Kingdom and the European Union. The fear is that “the recent shifts by the United States of America in its policies concerning trade, currency and immigration together with the so-called Brexit have increased global policy uncertainty and could have negative impacts on the region. Any foregone trade and investment in turn could harm employment prospects and act as a drag on productivity growth in the years to come” (ESCAP, 2017, p. viii).

Uncertainties about global trade policy may reduce investment and increase trade costs. For example, wary private investors may delay or reduce investments, especially on capital goods and irreversible investment, such as investing in research and development, and innovation, hiring labour to expand or entering new markets. While these policy uncertainties are harmful to all businesses, concern about policy uncertainty increases proportional to the share of exports in total sales and the number of export markets. Consequently, this mood of uncertainty is especially troublesome for exporting firms, who also incur more substantial fixed costs before exporting than non-exporting firms (Melitz, 2003; Melitz and Ottaviano, 2008).<sup>b</sup> In addition, exporting firms are exposed to policy uncertainties both at home and in foreign countries. Since most exporters also import raw materials, intermediate goods, and capital goods,<sup>c</sup> the effect of policy-related uncertainties on exporting firms often comes from both exporting and importing fronts.

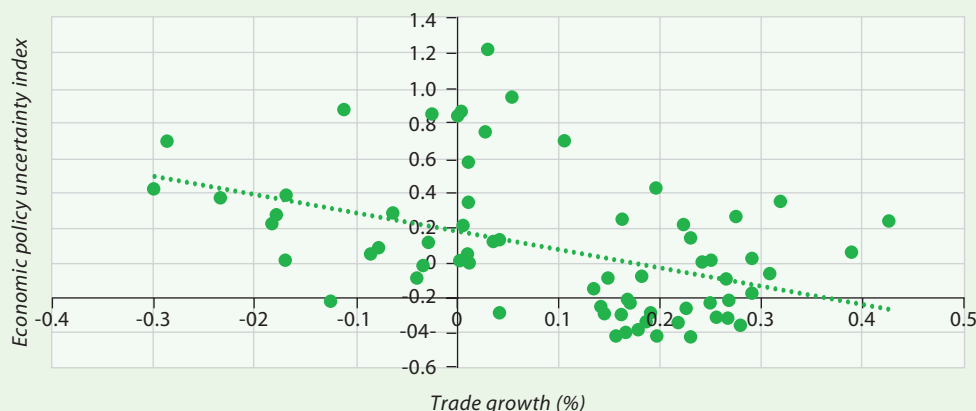
These policy uncertainties also have indirect effects on trade. For example, policy changes can generate exchange rate volatility. The subsequent risks from exchange rate volatility translate into higher financial costs to exporting and importing firms. Consequently, exporters and importers can be indirectly affected by uncertainties in policymaking even if they are not specifically tied to trade policy.

Due to these potential negative impacts on aggregate demand, increased uncertainty may also lead to a reduction of demand for imports. Using the technique proposed by Baker and Bloom (2016), ESCAP finds


**Box  
1.1**
*(continued)*

that the rising economic policy uncertainty in major economies of Asia-Pacific region seems to be associated with the decrease of the region's trade growth (figure). In addition, the slowdown of the region's trade growth is correlated with the rising economic policy uncertainty of the United States. The negative correlation between trade growth and economic policy uncertainty implies that the region's trade growth often slows down as uncertainties about policy direction in the large economies increase.

**Figure. Asia-Pacific economic policy uncertainty and the region's trade growth**



Source: ESCAP calculations based on CEIC foreign trade data and uncertainty frequency data available from Economic Policy Uncertainty Index database on selected economies.

Notes: Indices in these graphs are interpreted as (percentage) deviation from its mean over the period 1985-2015. For example, the peak at the end of 2016 for the Asia-Pacific economic policy uncertainty can be interpreted as 90% higher than the average level of uncertainty in the Asia-Pacific region between 1985-2015.

<sup>a</sup> This box is based on a forthcoming issue of ESCAP Trade Insight series.

<sup>b</sup> The higher sunk cost of exporting firms than non-exporting firm is suggested by heterogeneous firm models.

<sup>c</sup> Evidence shows that trade policy uncertainty will delay the entry of exporters into new markets and make them less responsive to applied tariff reductions. Reduction or elimination of trade-policy uncertainty, such as binding trade policy commitments at the WTO, can increase the entry even when applied protection is unchanged (Handley, 2014).

## G. CONCLUSIONS AND NEAR-TERM PROSPECTS

*"In 2017, export growth was 6% in volume, while import growth was about 8%. Trade growth is expected to remain robust at 3% in 2018 and 2019."*

The merchandise trade performance data for 2017 and the preliminary trade statistics available for 2018 suggest the following:

- Global and regional trade growth in 2017 rebounded from its weak performance in 2016. As global and regional demand recovered, both the volume and value of the region's exports and
- Trade growth prospects for 2018 are expected to maintain this momentum. The volume of exports and imports by the Asia-Pacific region are expected to grow by 3-4% this year. A soft moderation may occur in 2019, but will be mainly

imports increased. In 2017, exports by the Asia-Pacific region grew by 6.1% in volume and imports increased by 7.6% (table 1.5). Trade value grew faster than trade volume due to price increases. Trade improved across the region, with higher performance in developing Asia-Pacific countries than in the developed Asia-Pacific countries. Exports by developing countries in Asia and the Pacific increased by 6.6% while exports by developed countries in the region increased 3.6%.



ESCAP forecast for merchandise trade growth, by selected Asia-Pacific economy, 2017-2019<sup>a</sup>

(Annual percentage change)

	Exports						Imports					
	2017			2018 <sup>a</sup>			2019 <sup>a</sup>			2017		
	Value	Price	Volume	Value	Price	Volume	Value	Price	Volume	Value	Price	Volume
Australia	18.3	9.0	8.5	-4.0	-9.3	5.9	5.6	0.6	4.9	8.2	2.8	5.3
Bangladesh	5.0	3.6	1.4	7.2	1.4	5.7	6.0	1.7	4.2	18.8	0.7	18.0
China	9.4	4.0	5.2	7.9	3.9	3.8	7.6	3.2	4.3	16.2	6.6	9.0
Hong Kong, China	8.1	1.5	6.5	7.0	2.2	4.7	6.8	2.3	4.4	8.2	1.6	6.5
India	11.9	-4.7	17.4	10.3	-5.5	16.7	3.3	-2.1	5.5	18.2	6.4	11.1
Indonesia	16.4	5.7	10.1	16.1	6.2	9.4	10.9	3.5	7.2	15.5	6.6	8.4
Iran (Islamic Rep. of)	18.0	9.3	8.0	10.3	7.1	3.0	6.0	-1.0	7.1	21.0	25.9	-3.9
Japan	7.7	5.6	2.0	8.4	5.6	2.6	9.8	12.0	-2.0	9.4	10.0	-0.6
Kazakhstan	32.2	21.7	8.6	16.7	10.7	5.4	1.0	-2.1	3.2	13.1	8.3	4.5
Malaysia	14.3	4.4	9.5	11.5	3.3	8.0	9.5	3.1	6.2	16.9	5.2	11.1
New Zealand	13.7	13.2	0.4	0.6	-4.9	5.8	3.8	-0.8	4.6	11.0	5.3	5.4
Pakistan	6.4	2.0	4.3	6.2	1.2	4.9	4.5	0.7	3.8	21.9	5.2	15.9
Philippines	14.3	-5.8	21.3	16.8	4.2	12.1	13.7	2.5	10.9	13.3	-5.1	19.4
Republic of Korea	25.5	15.5	8.6	11.7	8.7	2.7	3.1	-0.7	3.8	24.2	3.9	19.5
Russian Federation	10.0	9.5	0.4	8.5	6.7	1.7	4.2	3.4	0.8	14.8	8.2	6.1
Singapore	12.8	8.9	3.5	6.5	9.1	-2.4	7.2	5.3	1.8	16.4	9.3	6.4
Sri Lanka	10.6	5.6	4.8	8.6	3.4	5.0	7.6	2.1	5.4	9.6	6.6	2.9
Thailand	13.4	6.2	6.8	4.8	2.7	2.0	2.7	1.0	1.6	15.8	5.4	9.8
Turkey	10.9	1.3	9.4	9.0	4.0	4.8	6.6	2.1	4.5	17.7	7.5	9.5
Viet Nam	20.2	5.5	13.9	10.1	3.2	6.7	8.7	2.4	6.1	26.8	9.3	16.1
Asia-Pacific <sup>b</sup>	11.8	5.6	6.1	8.0	4.0	3.9	6.8	3.4	3.4	14.9	7.3	7.6
Developed Asia-Pacific <sup>b</sup>	10.3	6.7	3.6	5.1	1.5	3.6	8.6	8.5	0.1	9.2	8.2	1.0
Developing Asia-Pacific <sup>b</sup>	12.0	5.4	6.6	8.4	4.4	4.0	6.5	2.5	4.0	15.9	6.9	9.0

Source: ESCAP calculation based on the Economist Intelligence Unit (EIU), (accessed February 2018).

Notes: The estimated growth rates are calculated based on constant prices (in 2010 terms).

<sup>a</sup> Projections.

<sup>b</sup> Regional trade growth is the trade-weighted, time-varying average growth rate.



reflected as lower prices. The rising prices of industrial commodities and fuel, which contributed to the strong trade growth of commodity exporters in the earlier periods, are expected to gradually decline.

- Although the performance of global and regional trade continues to firm up, risks threatening the world economy remain in place and could undermine the process of trade recovery. Structural factors that have contributed to weak trade performance since the 2009 economic crisis are persisting. While import demand in developed economies has not fully recovered, import demand in China – especially for intermediate inputs – will also lessen due to the

structural rebalancing of China from export orientation to domestic consumption. Hence, intraregional demand alone will not be sufficient to bring trade growth back to the pre-crisis level.

- Furthermore, there are additional risks related to the protectionist rhetoric that has resulted from a long period of low economic growth and the inequitable distribution of trade benefits. While many of the fears about trade policy uncertainties may not be realized, the prevailing mood still creates definite risks. At the minimum, rising uncertainties could be a disincentive for investment, especially in the long term. Thus, the prospect of global and regional trade recovery will still be fragile for a few years ahead.

## Endnotes

- <sup>1</sup> The numbers for merchandise trade performance were compiled by the ESCAP secretariat, based on data available from the World Trade Organization and International Monetary Fund at the time of preparing this report. More recent revisions of trade data performed by those data sources may result in different trade balance values. The aggregate numbers for Asia and the Pacific include trade data for Taiwan Province of China, which is not a United Nations ESCAP member, but represents 4.3% of merchandise exports in the Asia-Pacific region. The use of other sources of trade data may produce different estimates. Individual economic data for ESCAP member States are available from the ESCAP online statistical database, [www.unescap.org/stat/data](http://www.unescap.org/stat/data).
- <sup>2</sup> This includes both intraregional trade flows and flows with the rest of the world.
- <sup>3</sup> The concentration on the import side is almost identical to the export side.
- <sup>4</sup> In 2016, trade with other developing economies in the region accounted for 63% of intraregional exports and 54% of intraregional imports. On the other hand, trade with developed economies, mainly Japan, represented the remaining 13% of intraregional exports and 17% of intraregional imports.
- <sup>5</sup> This is based on World Trade Outlook Indicator (WTOI). The WTOI is a leading indicator of world trade, designed to provide information on the trajectory of merchandise trade ahead of trade volume statistics. A reading of 100 indicates trade growth in line with medium-term trends, while readings greater or less than 100 suggest above or below trend growth. The latest reading of 102.6 in August 2017 is the highest since May 2011.
- <sup>6</sup> The IMF projected growth figures are taken from IMF, World Economic Outlook Update, July 2017.
- <sup>7</sup> This section maps and tracks the trade measures that affect global trade by counting the absolute number of trade measures, both restrictive and liberalizing, that have been implemented over a period of time. This helps identify trends in the usage of restrictive measures at the global and regional levels.
- <sup>8</sup> Trade-policy measures affecting trade in goods also include trade remedy. There has been a substantial increase in the number of initiations of trade remedy measures. Between mid-October 2015 and mid-May 2017, 514 new trade remedies were initiated worldwide, of which 271, or 53%, of them were initiated by Asia-Pacific economies. India introduced the most trade remedies in the region, followed by China, which introduced seven measures during the reporting period. The most common form of trade remedies pertained to anti-dumping. Measures directed towards metal products, particularly steel products, and chemicals, plastics and rubber accounted for a large share of this increase. The initiations substantially outstripped terminations. There were only 232 and 113 terminated measures worldwide and within the region, respectively.
- <sup>9</sup> Based on the analysis presented in chapter 6 of this report, the impact of these tariff cuts may have only small impacts on overall trade and sustainable development.
- <sup>10</sup> These preferential trade agreements differ in terms of depth of liberalization and integration as well as sectoral coverage.
- <sup>11</sup> Trade policy measures are not additive. The larger number of trade liberalizing measures than trade restrictive measures does not necessarily imply that global trade is moving toward liberalization.
- <sup>12</sup> Global Trade Alert comprises a broader range of trade measures than those indicated by the WTO report. The database codes a measure as “red” if it almost certainly discriminates against a foreign commercial interest; an “amber” if its implementation is likely to discriminate against foreign commercial interests or if the measure has not been implemented yet but, should that happen, it would almost certainly be discriminatory; and a “green” if the measure either improves the transparency of the national trade policy regime, or it improves or has no effect on the relative treatment of foreign versus domestic commercial interests (Evenett and Fritz, 2017). Using Global Trade Alert (GTA) data, which, the number of trade-restrictive “red” measures implemented by G20 countries in the first six months of 2017 is 204, substantially fewer than the 320 registered in the same period in 2016 or the 249 implemented in the second half of 2016.
- <sup>13</sup> In order to assess the impact of individual trade measure, price and income elasticities as well as price impacts must be observed or estimated. This is often impossible due to data constraints, making it difficult to quantify commercial impacts of individual measures.
- <sup>14</sup> Chapter 6 in this report (annex 2) simulates effects of the global trade wars by all countries increasing their tariffs to the WTO bound level commitments. The global GDP falls by \$380 billion a year. For further results see table A.2 in chapter 6, annex 2.

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