ASIA-PACIFIC TRADE AND INVESTMENT REPORT 2013

TURNING THE TIDE: TOWARDS INCLUSIVE TRADE AND INVESTMENT
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ASIA-PACIFIC TRADE AND INVESTMENT REPORT 2013

Turning the tide: Towards inclusive trade and investment

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For further information on this publication, please contact:
Mr Ravi Ratnayake
Director
Trade and Investment Division
UNESCAP
Rajadamnern Nok Avenue
Bangkok 10200, Thailand
Tel: (+66-2) 288-1902
Fax: (+66-2) 288-1027, 288-3066
e-mail: escap-tid@un.org

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The Asia-Pacific Trade and Investment Report and supporting online documents are the sole responsibility of the ESCAP secretariat. Any opinions or estimates reflected herein do not necessarily reflect the opinions or views of members and associate members of the Economic and Social Commission for Asia and the Pacific.
Turning the tide:
Towards inclusive trade and investment
As we enter an era of more inclusive, sustainable, and resilient development, we must abandon outdated growth paths premised on an approach of “trade and invest now, and distribute gains later”.

Orthodox trade- and investment-led development strategies produced high growth rates for many economies in Asia and the Pacific. Where this was maintained, the growth contributed significantly to reducing absolute poverty, but not all countries benefited equally. Some even saw their numbers of relative poor rise over this period.

Apart from the unequal impact on poverty alleviation, another troubling aspect of traditional approaches to growth has been worsening levels of income inequality, especially during the 2008 financial crisis.

The 2013 Asia-Pacific Trade and Investment Report shows that while the gains created by growth have been significant, the majority of poor people in many Asia-Pacific countries have often not shared in this prosperity. Inclusive regional trade- and investment-led growth is yet to be fully realized, but the 2013 Report underscores that trade and investment continue to be important engines of Asia-Pacific growth.

The Report also investigates the conditions for making trade and investment benefits more inclusive, outlining transmission channels through which gains from trade, trade facilitation, FDI, and related policies, could be directed into the reduction of poverty and inequality.

While the findings are based on macro level econometric analysis, a special feature of the Report is a number of concrete case studies and best-practice examples, illustrating how combined trade, investment, and complementary policies can work to improve the lives of all. These findings are used to propose policy options and actions at national, regional, and international levels.

Some of these proposals will require countries to work even more closely together, especially at the regional level. ESCAP, as the largest and most inclusive intergovernmental platform for Asia and the Pacific, has a critical role to play in strengthening the voices of our member States in the regional and global fora. ESCAP has also been working to improve regional economic integration by building capacity to use WTO membership and accession to regional blocs and value chains, as trade-led engines of growth.

The region has gained a significantly larger share of world merchandise trade over the past 10 years. It surpassed Europe, to become the world’s largest trading region in 2012. The 2013 Report notes the growing importance of intraregional trade, as its share in total trade from the region increased from about 40% to over 50% in the period 2000-2012.

The 2013 edition of the Report also argues that the real challenge for Asian and Pacific policymakers is to find ways to boost growth, without relying on unstable demand from large economies within and outside the region. The uneven and vulnerable economic
recovery of Asia-Pacific’s traditional developed economy trading partners, combined with a slowdown of growth in the major power-houses of the region, has accentuated the importance of regional cooperation and of strengthening South-South economic linkages.

Though FDI inflows to the region were affected by the weaker global economy, for the first time developing economies world-wide (led by those in Asia and the Pacific), absorbed more FDI than developed countries in 2012, accounting for 52% of global FDI inflows. The developing countries in Asia-Pacific account for 33% of global FDI inflows, reflecting the solid position of the region, led by China, as the world’s preeminent investment destination.

The overarching message of this year’s Report is that securing continuing growth of trade and investments remains among the top economic priorities for the region, but this comes with the realization that the quality and patterns of growth must also be enhanced. To some extent this must be connected with a more careful balancing of sources of growth, greater inclusivity, and closer alignment of trade and investment policies with development goals.

The data, analysis, and policy options presented in the 2013 Report will certainly make an important contribution to ensuring that Asian and Pacific trade and investment leave no-one behind as we move towards the next important phase of global development.

Noeleen Heyzer
Under-Secretary-General of the United Nations
and Executive Secretary of ESCAP

November 2013
Asia-Pacific Trade and Investment Report 2013 (APTIR 2013) was prepared under the substantive direction and guidance of Ravi Ratnayake, Director, Trade and Investment Division (TID) of the Economic and Social Commission for Asia and the Pacific. The core team of authors led by Mia Mikic, comprised (in alphabetical order) Witada Anukoontwattaka, Yann Duval, Adam Heal, Khan Salehin, Marc Proksch, Rajan Ratna, and Heini Salonen of TID. Martina Ferracane and Johannes Fritz were key contributors to chapters 5 and 9, respectively, while Teemu Alexander Puutio and Martin Wermelinger contributed substantive inputs to and commented on several chapters. The papers prepared as background studies are available as Trade and Investment Working Papers at www.unescap.org/tid. Masato Abe, Joong-Wan Cho, Jun Ho Shin and Tengfei Wang of TID contributed by providing useful comments on a concept note or some inputs for the Report. The following research assistants of the Asia-Pacific Research and Training Network on Trade (ARTNeT) and TID interns contributed to the Report through the compilation and tabulation of statistical data and preparation of country trade briefs, referencing, and background material: Panit Buranawijarn, Carissa Faulkner, Theo-Phil Glockner, Simi Rose George, Sang-Ok Han, Ruben Hernandez, Fiona Jing Huang, Sarah Huelser, Danbee Kim, Cherry Law, Zhou Lu, Lorenzo Mancini, Mary Matthews, Yumiko Noguchi, Janika Rath, Aaron Soans, McKenzie Strobach, Alda Tsang, Chorthip Utoktham, Yue Wang and Hua Yu. Contributors of case studies were Prabir De, Chris Guersten, Deanna Morris, Mia Overall, Ajitava Raychaudhuri, Matthew Stephenson, Tham Siew Yean and Andrew Kam Jia Yi; their work benefited from additional revisions and comments received from Marit Nilses and Heini Salonen. Thanks are extended to Mana Southichak and Alay Phovisay, and Celia Reyes for granting permission to use their papers as case studies in the Report.

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<th>Full Form</th>
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<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AEC</td>
<td>ASEAN Economic Community</td>
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<td>AFTA</td>
<td>ASEAN Free Trade Area</td>
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<tr>
<td>APTA</td>
<td>Asia-Pacific Trade Agreement</td>
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<tr>
<td>APTFF</td>
<td>Asia-Pacific Trade Facilitation Forum</td>
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<td>APTIAD</td>
<td>Asia-Pacific Trade and Investment Agreements Database</td>
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<td>ARTNeT</td>
<td>Asia-Pacific Research and Training Network on Trade</td>
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<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>ATIGA</td>
<td>ASEAN Trade in Goods Agreement</td>
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<tr>
<td>BFC</td>
<td>Better Factories Cambodia programme</td>
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<tr>
<td>BIMSTEC</td>
<td>Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation</td>
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<tr>
<td>BRICS</td>
<td>Brazil, Russian Federation, India, China and South Africa</td>
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<tr>
<td>CGA</td>
<td>Cocoa Growers Association of Vanuatu</td>
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<tr>
<td>DFQF</td>
<td>duty-free quota-free</td>
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<td>EFTA</td>
<td>European Free Trade Association</td>
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<td>EPA</td>
<td>economic partnership agreement</td>
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<td>EPZs</td>
<td>export processing zones</td>
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<td>EU</td>
<td>European Union</td>
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<td>FAO</td>
<td>Food and Agriculture Organization of the United Nations</td>
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<td>FDI</td>
<td>foreign direct investment</td>
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<td>FTA</td>
<td>free trade agreement</td>
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<td>GATS</td>
<td>General Agreement on Trade in Services</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<tr>
<td>GSP</td>
<td>Generalized System of Preferences</td>
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<td>GTA</td>
<td>Global Trade Alert</td>
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<tr>
<td>GVCs</td>
<td>global value chains</td>
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<tr>
<td>HS</td>
<td>Harmonized Commodity Description and Coding System</td>
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<td>ICT</td>
<td>information and communications technologies</td>
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<tr>
<td>ILO</td>
<td>International Labour Organization</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPS</td>
<td>Index of protectionism severity</td>
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<tr>
<td>ISLFTA</td>
<td>India-Sri Lanka Free Trade Agreement</td>
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<tr>
<td>ISCCI</td>
<td>International Supply Chain Connectivity Index</td>
</tr>
<tr>
<td>IT</td>
<td>information technology</td>
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</table>
LPI Logistics Performance Index
LSCI Liner Shipping Connectivity Index
M&As mergers and acquisitions
MFN most-favoured-nation
NAFTA North American Free Trade Area
OECD Organisation for Economic Co-operation and Development
OEM original equipment manufacturing
PICTA Pacific Island Countries Trade Agreement
PTA preferential trade agreement
RCEP Regional Comprehensive Economic Partnership
RGFS Really Good Friends of Services
ROO rules of origin
SAARC South Asian Association for Regional Cooperation
SAFTA Agreement on South Asian Free Trade
SAPTA SAARC Preferential Trading Agreement
SMEs small and medium-sized enterprises
SOE state-owned enterprise
SPS sanitary and phytosanitary
TAB trading across border
TBT technical barriers to trade
TISA Trade in Services Agreement
TNCs transnational corporations
TPP Trans-Pacific Partnership
TPRB Trade Policy Review Body
UNCTAD United Nations Conference on Trade and Development
UNWTO United Nations World Tourism Organization
WTO World Trade Organization
INTRODUCTION

The Asia-Pacific region continues to outperform the rest of the world in the pace of overall growth. Trade-led expansion continues to feed the region’s economic dynamism. The strong recovery in exports since 2009 has helped the region overcome the slowdown caused by the global economic and financial crisis, but this strategy of export-reliance is coming under increasing scrutiny. Continued overdependence on uncertain external demand creates risks and vulnerabilities. Increasing attention is therefore being given to fostering domestic sources of demand through investment in infrastructure and social sector and reforms aimed at addressing rising inequality.

The social impacts of focusing exclusively on economic growth are being increasingly questioned. While high growth rates are important, not least for their direct and positive contributions to poverty reduction, evidence of growing disparities in income and social well-being are prompting a re-evaluation of policy. Unequal access to employment opportunities, education, medical care and basic amenities, such as energy, are causing serious concern and threaten future social stability and development.

Much of this year’s Report is devoted to an examination of the circumstances under which trade, investment, and trade facilitation can support inclusive growth: that is, growth which benefits all. We label the set of policies that bring this about as “inclusive trade and investment”. The main message of the Report is that the region’s dominant export-led growth model should not be abandoned but needs to be supplemented by a range of complementary measures and policies, not the least social protection and employment policies to make trade and investment more inclusive. While regional economies have largely succeeded in achieving sustained economic growth, additional policies are required to spread the benefits of that growth more fairly: to reduce poverty; limit rises in inequality; widen access to opportunities; and bring excluded groups in from the margins. It is not enough simply to hope that rising wealth will eventually work for the benefit of all. The era of “trade and invest now, distribute gains later” has thus come to its end; we need to think of a new model to turn the tide towards “inclusive trade and investment”.

EXECUTIVE SUMMARY
TRENDS AND DEVELOPMENTS IN TRADE AND INVESTMENT

Asia-Pacific is learning how to live and prosper without double-digit export growth

Developments in 2012, and thus far in 2013, prove that regional demand is not immune to the persisting weak economic performance of major developed economies. Indeed, even previously strong performers like China and India continue to be buffeted by economic headwinds from outside the region. In both cases, the era of double digit growth appears to be over (ESCAP, 2013). In China, ongoing weakness in key destination markets, continues to adversely affect the country’s exports and economic growth. This, in turn, will have knock-on effects for other economies in the region which are major suppliers to China. The same linkages are at work between India and economies linked to its market, although to a lesser degree given the smaller presence of India in global manufacturing exports.

It is estimated that the merchandise exports and imports of the region’s developing economies will see growth below 6% in real terms in 2013. A modest improvement to 7% is expected in 2014. Today, China absorbs more than 30% of the exports of Asia-Pacific developing economies, in particular raw materials and inputs for processing. Therefore, the region’s trade prospects depend strongly on China’s growth. Given some recovery in import demand in the United States, exports from China are expected to improve from the sluggish growth of 2012 to reach about 8% growth in 2013. Exports by most of the developing Asia-Pacific trading partners of China are thus forecasted to expand in 2013 in real terms. This growth is expected to range from a low of 2% (Singapore) to a high of 8% (Thailand). However, this forecast is uncertain, and risks remain on the downside. The fragile recovery in the United States could be derailed, and the European Union is unlikely to return to strong growth in the near-term.

Slow growth presents another challenge to the “factory Asia” model of regional integration. Policymakers have to boost growth without relying on unstable demand from larger economies within and outside the region. This suggests the urgency of reforms to both the demand and supply sides of the economy: first, to strengthen domestic demand by boosting consumption, and in some cases, investment; and second, to increase efficiency and productivity in order to raise competitiveness. International openness will be an important element of growth strategies. But, as this Report argues, liberalization must also be matched with measures that enhance the inclusiveness of growth as well as strengthen productive capacity.

Growth in commercial services trade lost pace in 2012

Asia and the Pacific registered the highest growth rates for commercial service exports and imports in the world, at 5.2% and 5.9%, respectively. These rates were, however, less than half of the rates achieved in 2011. Nevertheless, Asia-the Pacific increased its share of global exports in several services sectors including: construction; computer and information services; and personal, cultural and recreational services.

Commercial service export performance varied widely by subregion. In 2012, the Pacific, and South and South-West Asia, saw the lowest growth in commercial service exports (0.1% and 0.8%, respectively) of all Asian and Pacific subregions. Imports of commercial services into South and South-West Asia contracted by close to 13% in 2012. In contrast, the same year, North and Central Asia recorded the highest growth in commercial service exports and imports of all Asian and Pacific subregions (11.4% and 17.5%, respectively).
Despite volatility resulting from global economic uncertainties, the developing economies of the region have shown more resilient growth in service exports than the developed economies. This has been mainly driven by strong growth in exports of computer and information services, communication, and travel services.

Tourism was one particular bright spot. After some uncertainty, the first half of 2013 showed better than expected growth of tourist arrivals globally and in the Asia-Pacific region, with South-East and South Asia leading the way. The region captured almost 23% of total global international tourist arrivals. But worryingly Pacific islands’ share of arrivals fell to just 1.2% of the region’s total. The most dynamic growth in international tourist arrivals was recorded in Bhutan and Georgia (39%), Sri Lanka (31%), Myanmar (26%), Cambodia, Thailand and Viet Nam (20%). After the 2011 disasters, Japan made a comeback: increasing tourism receipts by 37% in 2012.

Services are an integral part of production networks and global value chains and, as such, an essential driver of efficiency and competitiveness. The rise of global value chains has been attributed to the reduced costs of service links, as those chains depend on the availability of affordable and efficient services such as transport, logistics, communications, finance, and business and professional services in general. The recognition of the true value directly or indirectly created by services in manufacturing production, distribution and marketing, has become known as “servicification”. It is now recognized that services constitute a much higher share of world trade than the 20 to 25% previously calculated using gross value measures. These new higher estimates are more in line with the recognized contributions of services to employment and GDP. This better understanding of services’ huge contribution to growth highlights the importance of developing countries improving their service sector efficiency.

**Asia and the Pacific remains a leading investment hub**

Developing countries in the Asia-Pacific region account for 33% of global foreign direct investment (FDI) inflows, reflecting the established position of the region as a leading investment destination. FDI inflows to the East and North-East Asian subregion were $215 billion in 2012, down 8% from the previous year. The decline can be attributed to weaker inflows to China, the Republic of Korea and Hong Kong, China.

China, however, continues to attract impressive levels of FDI; investments in 2012 totaled $121 billion. Rising production costs and weakening export markets have been pushing foreign companies to relocate from China to lower-income countries, but China is still the leading FDI recipient in the developing world and is attracting investments from other developing countries as well.

In 2012, inflows to the South-East Asian subregion amounted to $111 billion, up by 2% compared to the previous year, making it the only subregion in Asia and the Pacific that continued to experience FDI growth. This growth has been supported by FDI into labour-intensive sectors and value chain activities in low-income countries such as Cambodia, the Philippines and Viet Nam.

The South-East Asian subregion is likely to benefit from the establishment of the ASEAN Economic Community (AEC), which aims to create a single market with free flows of goods, services, skilled labour and investments by 2015. One of the goals of AEC is to further improve connectivity in the subregion and integrate industries in order to promote regional sourcing. This will also likely increase FDI flows within the subregion.
Despite efforts of India to reform FDI policy and simplify investment procedures, FDI inflows to the country dropped by 29% in 2012. To reverse this trend India would need to upgrade infrastructure and strengthen ties with key investment and trade partners.

In Japan, growth in FDI nearly tripled in 2012, with the value of FDI inflow rising to $1.7 billion. Continuing uncertainty over the Japanese economy going forward is likely to affect the volatility in FDI levels to the country in the years ahead, although recent economic stimulus measures by the Government might bring about economic growth and attract new FDI.

As the economic relevance and dynamism of the Asia-Pacific region is increasing, intraregional FDI flows are replacing those from the developed economies. East and North-East Asian countries have become major investors in other Asia-Pacific countries; China and the ASEAN region being the most attractive destinations.

**Unacceptably high trade costs undermine benefits for least developed and landlocked developing countries**

The objective of trade facilitation is to reduce the cost of international trade transactions through simplification and harmonization of trade procedures. Along with improving the availability of, and access to trade related infrastructure, streamlining trade procedures has become essential for firms in developing countries to participate effectively in the regional and global production networks that are responsible for an increasing share of global trade flows. This Report uses three different metrics to track the progress of regional economies in terms of trade facilitation. Based on the findings of ESCAP’s survey, despite the significant overall progress observed, implementation of specific trade facilitation measures in the region’s developing economies is generally lacking.

Not surprisingly, implementation of trade facilitation and paperless trade varies significantly across Asian countries: Singapore, Japan and the Republic of Korea lead the way, followed closely by Thailand. In contrast, the least developed countries and landlocked developing countries from the region generally remain far behind in overall implementation of trade facilitation and paperless trade. It is encouraging, however, that many of these countries have established national trade facilitation bodies to facilitate both inter-agency and public-private sector collaboration on trade facilitation (including Azerbaijan, Bangladesh, Cambodia, the Lao People’s Democratic Republic, Mongolia and Nepal).

Another metric used to monitor progress in trade facilitation is by using comprehensive trade costs. This Report uses the most recent version of the ESCAP-World Bank Trade Cost Database to review the performance of economies in the Asia-Pacific region. In most cases, it remains costlier to trade between Asian subregions than between Asian subregions and countries or regions outside Asia and the Pacific. For example, the cost of trading between the ASEAN-4 economies (Indonesia, Malaysia, the Philippines and Thailand) and SAARC-4 (Bangladesh, India, Pakistan and Sri Lanka) is almost double that between the ASEAN-4 and the United States. Similarly, trade costs between North and Central Asia and the ASEAN-4 are more than twice those between North and Central Asia and the France, Germany and the United Kingdom (the EU-3). Similarly, trade costs between Pacific island developing economies and the ASEAN-4 are much higher than between those economies and the United States. An exception to the general lack of intraregional trade connectivity between Asia-Pacific subregions is the connectivity between East and South-East Asia. Indeed, trade costs between these two subregions are found to be similar to those prevailing in intra-ASEAN trade.
The third metric used in the Report is a newly designed index measuring the overall trade facilitation performance of a country along the international supply chain. This index is based on the Trading Across Border indicators from the World Bank Doing Business Report and the Liner Shipping Connectivity Index of UNCTAD. The top five world performers (out of 180 economies) in terms of their connectivity to international supply chains are all Asia-Pacific economies, namely, Singapore; Hong Kong, China; the Republic of Korea; China; and Malaysia. In general, countries from East and South-East Asia have better Connectivity Index scores than those from other subregions in Asia and the Pacific. Mongolia, although landlocked, obtains a higher ranking compared to many other developing countries since it uses China’s maritime ports. South Asia and Central Asia subregions fare much worse, with Sri Lanka the only country that ranks within the top tier of the 180 countries included in the ranking. The landlocked Central Asian countries rank lowest.

In summary, both the enormous performance gaps between the countries of the region and the significant scope for further reducing trade costs and enhancing supply chain connectivity are highlighted in the Report. While trade facilitation begins at home, a successful outcome of the WTO negotiations on trade facilitation would be useful in providing guidance and a renewed mandate for countries to engage in trade facilitation reform. Similarly, a regional arrangement on the facilitation of cross-border paperless trade, as envisaged in ESCAP resolution 68/3 adopted by ESCAP member States in May 2012, would certainly be helpful in reducing the trade facilitation gaps between countries of the region as well as to confirm the region’s leadership in using information and communication technologies for inclusive and sustainable trade and development.

**Prolonged crisis has not caused a massive recourse to protectionism**

Despite still dealing with the challenges of a prolonged economic crisis, many countries have refrained from introducing protectionist measures. This has been in large part due to the changed nature of global production and trade, in particular the rise of global production networks. The rise of these networks has also prompted countries to take further efforts towards trade liberalization in certain sectors, especially for intermediate goods.

Trade liberalization has been pursued mainly via tariff reductions. In contrast, measures that restrict trade have been implemented using more opaque procedures mainly targeting imports of minerals, machinery, vehicles and food items. The manufacturing sector, followed by agriculture, has been most affected by these less-transparent trade restrictive measures. Trade remedy measures have also been used as a tool of protection particularly against steel, organic chemicals, machinery and mechanical appliances, paper and man-made staple fibres. On balance, it appears that the global financial crisis has not caused a massive recourse to trade remedies as an instrument to deal with market pressures. However, some countries have been affected more significantly. For instance, products originating from China have faced substantially higher anti-dumping duties than those imposed on products from other countries. In the Report, it is also noted that the use of anti-dumping measures is increasingly becoming a South-South phenomenon, with China being again the main target.

Even as the trade impacts of import restrictions on the aggregate remain low, the tendency to use discriminatory measures to protect domestic markets is discernible in many poorly performing economies in the region. These measures and tariffs, certainly undermine the participation of many developing countries in international and regional trade.

**Reforms to preferential trade policies needed in order to promote development of countries with special needs**

The global economic crisis of 2008-2009 does not appear to have derailed the use of preferential trade agreements (PTAs) by Governments to secure access to foreign markets
and defend domestic markets, however the pace of signing new PTAs is slowing. The total number of agreements involving economies in Asia and the Pacific is estimated to be above 220, of which 150 are in force and the remainder is at various stages of negotiation.

A growing number of agreements have overlapping memberships but retain different provisions on: the timetable for tariff reductions; product coverage of preferences; rules of origin; and the inclusion of “WTO-plus” provisions. This resulting complexity has been dubbed the “noodle bowl” phenomenon and is largely blamed for increased trade costs and reduced opportunities for new trade and investment. A large number of the least developed countries and landlocked developing countries in the region remain excluded from preferential agreements or are not able to utilize them fully. Therefore there is a clear and rather urgent need to improve the regional integration of these countries. The least developed countries are also recipients of a number of unilateral tariff concession schemes. While these schemes provide preferential market access, more effort is needed to improve the supply capacity of beneficiary countries. More liberal rules of origin, in particular with regards to the issue of “cumulation” is also of critical importance to assist the least developed countries. Cumulation refers to allowing inputs sourced in one least developed country to be used in production without affecting the final products’ originating status and thus jeopardizing its qualification for preferential access to export markets. “Open cumulation” would permit all the beneficiaries to use each others’ intermediate materials in production. This would allow better integration of the least developed countries and further the establishment of regional supply chains.
This Report reviews whether international trade and investment policies have supported inclusive growth in the Asia-Pacific region and considers how more inclusive growth can be fostered in future.

The findings are not predominantly encouraging. The region has achieved dynamic economic growth matched with significant reductions in absolute poverty. However, there has not been similar success on other aspects of inclusiveness. In particular, inequality within many countries has worsened. Moreover marginalized and vulnerable countries did not succeed in capturing a proportionate share of the benefits created by the region’s growth. Put simply, the orthodox approach which emphasized using trade and investment to increase overall growth, and considered distributional issues as secondary, has not produced fully inclusive societies. Continuing to pursue trade and investment under that model risks heightened social instability and weakened resilience.

Inclusive trade and investment could have lifted even more millions of people out of poverty

The expansion of trade and investment in the Asia-Pacific has helped lift millions out of poverty, permitting the global success of halving poverty five years ahead of the MDG target timeframe. But more than half of the world’s poor still live in Asia. If the trade- and investment-led growth pursued to date had been more geared towards inclusiveness, the number of poor would today be even lower. For instance, some sectors generate more jobs than others for a given increase in exports – they have greater export elasticity of employment. Policies targeting these sectors and encouraging their expansion would thus do more to create jobs and be more pro-poor. Similarly, most poor people still work in the informal sector or within countries or regions that are not well connected to economic centers. Better connectivity through improved hard and soft infrastructure would assist deeper integration and enhance opportunities for economic participation. Linking trade and investment policy to national development strategies, and explicitly addressing the challenges of poverty, is one important recommendation for policymakers in the region.

The shift towards inclusive trade and investment requires a new vocabulary...

The Report sets out to investigate the conditions and policies under which trade and investment will instead deliver more inclusive outcomes. While literature abounds on “inclusive growth”, “inclusive trade and investment” is less explored. Following on the preliminary work of ESCAP (2009, 2012), the recent work of ECLAC (2013) and incorporating recent literature, this Report makes a further contribution towards the conceptualization of inclusive trade and investment. It considers trade and investment inclusive if all people can contribute to and benefit from those activities. Also, more importantly, by identifying the main drivers of inclusive trade and investment, the Report helps frame the issues in front of policymakers.

To be consistent with the principles of inclusive growth, trade and investment should: promote equality; enhance social responsibility; and spread widely the opportunities for participation in international transactions. Inclusive trade and investment are necessary but not sufficient condition for inclusive growth. Trade and investment liberalization needs to be supported by complementary policies if it is to deliver inclusive growth.
...and a new policy mix

The Report offers a framework describing the linkages between trade and investment and inclusive outcomes. A coherent and integrated set of policies, coordinated at different levels, needs to be in place to deliver inclusiveness. The framework, first, introduces three specific but interdependent aspects of international openness related to trade and investment: (1) trade policy; (2) trade facilitation measures and policies, and (3) foreign direct investment and related promotion policies. Second, it recognizes that inclusiveness or inclusivity is multifaceted comprising: reduction of poverty and inequality, creation of specific groups in the labour force; decent pay, and the creation of new (micro) firms and innovation in high-tech sectors. Additionally, the quality of life (well-being) are also included in the notion of “inclusivity” (see also the fold-out table).

Access to education, investment especially in information technology and functioning labour markets could spread the benefits of trade and investment more widely

To explore the relationships between international openness and inclusiveness, a macro-level econometric analysis was undertaken. This empirical analysis examined potential linkages between openness and inclusiveness, across four different dimensions, namely (i) aggregate employment in the formal economy and its distribution, (ii) aggregate productivity, (iii) poverty and income inequality, and (iv) equal employment opportunities between genders. The analysis used aggregate data from the Asia-Pacific region for the period 1988 to 2010.

The results clearly show that sustained growth in trade and investment flows do not necessarily translate into inclusive development. An important implication from the results is that a range of complementary policies are required to foster more inclusive economic development in the presence of international openness. Among these are measures to: improve functioning of labour markets; increase aggregate investment; raise information and communication technology expenditure; and equalize access to education.

Indeed, the countries that target exports to high-income countries and have labour markets that are able to provide flexible conditions for employment did the best in terms of inclusiveness. Flexible conditions for employment do not mean that internationally recognized labour standards that provide decent working conditions should not be observed. In contrast they comprise, among other features, cooperative employee-employer relationship, payment of redundancy costs and taxation with no adverse impact on incentives to work (see more in chapter 9). Furthermore, the gains from expenditure on information and communications technology seemed to be an increasing function of international openness. The promotion of aggregate investment may also provide a boost to domestic productivity. Basic and equal access to education was further found to be especially beneficial in the presence of international openness. But numerous further complementary measures can also play a role in enhancing the inclusiveness of growth. The case studies at the end of the Report show the diversity of policy experimentation across the region.

From cocoa export cooperatives in Malekula and garment exporters in Cambodia, to IT and electronics FDI in Penang and services outsourcing in India – good policies and practices in the region already point the way towards inclusive trade and investment

In addition to a macro-level econometric analysis, a number of sectoral and country-level cases and examples are presented to enrich the evidence base of this Report and showcase the diversity of experiences across the region. These cases examine specific-challenges at the sectoral level and identify how policy influences who the beneficiaries are from trade, FDI and trade facilitation. The cases are grouped in five different areas by
the main driver of change: trade integration; trade facilitation; foreign direct investment; promotion of responsible business practices; and sectoral cases where the broader context of international openness is considered. The Report also includes a number of specific examples, presented as text boxes, of inclusive results achieved through trade and investment with the assistance of complementary policies.

**Securing the benefits of inclusive trade and investment: policy recommendations**

The 2013 Report also offers guidance for Asia-Pacific policymakers. In the Report are outlines of steps that will support the trade and investment needed for economic growth while at the same time contributing to more inclusive outcomes. Below are measures, policies and initiatives that can be undertaken at:

(a) a country level (or sometime below-national level); and

(b) a regional and/or global level.

Of course, the suggested policy measures will not be applicable to all countries in all circumstances. However what is valid for all countries is that trade opening, FDI and trade facilitation measures must be carefully designed and managed as they cannot be decoupled from overall development strategy. As many policies of importance for inclusivity are not directly related to trade, policymakers need to find additional strategies to influence these factors.

**National policies and actions**

1. **Trade policy measures**

   ● Further trade opening including the use of preferential agreements to expand markets for exports needs to be carefully calibrated according to a long-term vision for economic diversification and the development of new higher value-added export products.

   ● Whenever possible, consider a sectoral approach to trade opening (including FDI), focusing on sectors with high potential for employment (especially of women and youth), and income creation and poverty reduction.

   ● Improve negotiation of preferential trade agreements with more attention given to building-in productive potential by negotiating more flexible and "open cumulation" rules of origin, as well as other disciplines to allow better utilization of local productive capacity.

   ● Developing and putting in place trade adjustment programmes, in addition to social protection systems (and possibly supported by Aid-for-Trade funding), to facilitate workers’ mobility between economic sectors and firms, retraining and mobility between the regions especially where labour markets are underperforming.

   ● Expand support for organizations and schemes that link micro-firms (and service providers), small farmers or vulnerable groups with export potential, such as One Tambon One Product (OTOP) in Thailand.

   ● Strengthen linkages between educational providers, especially the public sector, and new or promising export sectors. Give particular attention to building the skills requirements into vocational training programmes to
2. **Trade facilitation measures**

- Improve opportunities for country’s participation in global value chains (GVCs).

Facilitate transmission and sharing of benefits from trade opening to micro, small and medium-sized enterprises (MSMEs) by improving (behind-the-border) domestic business environment as well as availability and access to logistics and financial infrastructure and services.

- Improve access to and use of information and communications technology based services to support stronger business linkages between large buyers in or serving international markets and small scale enterprises, as well as to improve access to trade-related information for small traders.

- Develop a harmonized and conducive environment for cross-border paperless trade, with a view to increase transparency and simplify trade procedures, facilitating and enhancing regulatory compliance, and reducing the use of paper along the supply chain.

- Facilitate transfer of technology and build capacity for adoption of paperless trade and e-commerce, especially for MSMEs.

- Facilitate development of economic corridors for increased participation of the local communities in providing trade support services.

- Develop logistics services connecting rural areas to urban collection centres that will benefit local producers or enterprises.

- Facilitate agricultural trade as part of an overall strategy to address food security, safety, nutrition issues, taking into account the need for increased income as well as cheaper imports for the poor.

3. **Foreign direct investment promotion policies**

- In order to ensure an inclusive outcome in the area of employment generation, Governments should align employment-generation programmes with FDI opportunities to meet the specific needs of different groups such as women, youth and people with disabilities. They should also coordinate and consult with workers’ and employers’ organizations, civil society organizations, the private sector and youth to ensure that employment-generating reforms are effective and relevant.

- To alleviate any possible negative impacts from increased competition brought by FDI, similar to the case of trade liberalization, countries should adopt measures to soften the negative impacts of structural change, which would often be growth generating in the long-term but may have a negative impact on employment in certain sectors in the short term. These measures could include strengthening social security and other safety net programmes, and offering trade adjustment programmes with retraining opportunities, and undertaking employer-worker matching efforts.

- To ensure an inclusive outcome in terms of wages and non-wage working conditions, both domestic and foreign companies should follow internationally accepted labour standards as articulated by the International Labour Organization. Furthermore, mechanisms that verify working conditions follow these standards should be instituted. Workers
should also be made aware of these standards, and have easy avenues to safely express problematic conditions.

In order to understand the needs of foreign investors, Governments should increase dialogue with private sector representatives, including business associations, industry groups and chambers of commerce (see also point 7 below).

4. Policies for SME development

- Reduce entry barriers (and thus costs) for new businesses by use of competition policies.

  Foster SMEs’ understanding of the importance of cash flow management – the major reason most new and small businesses fail is not a lack of profits but a lack of cash – and develop and implement proper policies to enhance the cash flows of SMEs perhaps through effective financial instruments, such as bank loans and credit guarantee schemes.

- Strengthen business networking and information dissemination, given the fact that a lack of networks and information hinders effective deployment of technology and business development services as well as collaboration with other firms.

- Further facilitate technology and skills transfer from foreign to local companies; domestic entrepreneurs with experience in foreign companies should be encouraged to start new business using the technologies and expertise gained from this experience.

- Offer support to SMEs, through, for example, finance, market information and managerial knowledge, and help facilitate linkages between foreign and domestic companies. This may stimulate increased backward and forward linkages between domestic and foreign firms, thereby increasing the possibility of technology transfer.

5. Policies to encourage companies to operate in more socially responsible and inclusive ways

- Governments can also support companies that seek to operate in inclusive ways by providing information on available corporate social responsibility (CSR) instruments and related standards and outlining the benefits so implementing these. Such benefits can take the form of increased customer loyalty, more sustainable operations, improved community relations, reduced risk, and improved access to foreign markets and deepening of supply chains. When promoting the use of CSR instruments, individual country, sector, and firm-level differences should be taken into account and sufficient flexibility and adaptability provided such that CSR instruments can be tailored to particular needs at various points in time.

- To promote impact investment, one can provide business incubation, linkages facilitation and support services – such as access to capital, partners, mentors, information and infrastructure – for early-stage impact ventures so they can survive the start-up phase and become attractive investment targets for foreign investors. Countries policies
and business measures should take into account the unique social and economic landscape of a particular economy, and adapt the initiatives that support inclusive investment to these conditions.

6. Selected complementary policies for inclusive trade and investment

- Improve the inclusion of workers in the formal economy and enhance the functioning of labour markets. While increased trade and investment create new opportunities, they also disrupt existing production and require reallocation of labour. Functioning labour markets combined with trade adjustment programmes allow workers to migrate faster to growing industries, shortening the time spent under- or unemployed (ESCAP, 2007).

- Balance labour market flexibility with a protection of low-income workers through implementing laws that guarantee a (preferably indexed) minimum wage; this wage should be a “living wage” while still allowing firms to be cost competitive. In order to improve the bargaining position of workers, collective bargaining and unionization of workers should be guaranteed.

- Increase expenditure on information technology. The world economy is digitizing at a rapid pace. Providing technological equipment and training will help the work force tap into regional and international markets by opening new opportunities through e-commerce and by reducing cost of trade thereby increasing workers’ productivity.

- Increase aggregate investment. Investment-led growth has been an acclaimed success story in many countries. Upgrading production facilities and infrastructure levels the playing field against international competition.

- Provide gender balanced access to education. No country can reach its full potential without the successful integration of women into the labour force (ESCAP, 2007). Equalizing educational attainment lays the foundation for a rewarding professional life.

7. Need for consultation and coordination

- Inclusive trade and investment outcomes may also require the existence of a social dialogue among and consultation with all stakeholders to make sure that all interests have been considered before decisions on policy changes have been made. It is possible to explicitly monitor inclusivity and transparency in policymaking by designing specific performance indicators.

- ESCAP secretariat can assist member States to put in place such monitoring processes. They would require that all stakeholders (national policymakers, other relevant government ministries and departments, key non-state actors and donors) be involved or at least consulted in the process.
Regional and international responses

Initiatives and actions requiring cooperation at a regional and/or global level are put forward throughout this Report (as well as in previous issues of the Asia-Pacific Trade and Investment Report) and include the following inclusivity-enhancing initiatives:

- Simplified negotiation for accession to WTO for all least developed countries, to secure fair and free market access for their producers.
- Generalized System of Preferences (GSP) schemes to automatically offer 97 to 100% (in three years’ time) unconditional duty-free quota-free market access to all least developed countries and other marginalized developing countries, without use of non-tariff barriers. Furthermore establishing so-called “open cumulation” (as explained in chapter 6 of part I) for the regional least developed countries’ exports to GSP providers.
- Regional trade agreements in the region to allow any interested least developed country from the region (or globally) to accede to their trade agreements under the Doha Development Agenda terms for the least developed countries (i.e. without reciprocity for preferential access).
- A regional patent license pool to be established and, ad interim, managed by ESCAP secretariat in order to allow countries with weak institutional and innovative capacity to get easier access to patented technologies or goods through exchange of patent licenses via the pool mechanism.
- Strengthen the regional technology bank already set up by the ESCAP Asian and Pacific Centre for Transfer of Technology to broaden the membership and areas of operation so to enhance access to affordable and energy-efficient technologies, especially in areas with underdeveloped infrastructure and for SMEs.
- Conclude and implement a regional cross-border paperless trade facilitation arrangement, in line with ESCAP resolution 68/3 on enabling paperless trade and the cross-border recognition of electronic data and documents for inclusive and sustainable intraregional trade facilitation.
- Develop a regional trade finance mechanism to facilitate micro and SMEs integration into regional trade and production networks.
- Establish a framework for a labeling of products and processes of production in support of inclusive and socially responsible trade and investment.
- Promote Aid-for-Trade projects to build capacity to engage in inclusive trade and investment.
- Promote regional/subregional (corridor level) public-private-partnerships in support of the formation of agribusiness and manufacturing value chains.

ESCAP, as the most inclusive intergovernmental platform for the region, has been assisting member States with many of the above initiatives aimed at strengthening non-market cooperation. The secretariat also responded to member States’ demand for strengthening their policymaking capacity through developing local research capacity and promotion of knowledge sharing in the region and between different stakeholder groups. Encouraged by the positive contributions which already established communities of knowledge and practice ARTNeT and UNNExT have offered, the secretariat will continue to support
development of ESCAP-led communities of knowledge and networks to promote the creation of expertise, analytical tools, datasets, procedural toolkits and environments for knowledge sharing, communication and fostering a culture of change.

The relationships between economic openness, poverty and inequality are complex and multi-directional. Therefore, a single report cannot provide a definitive and generalized assessment. Instead, this Report conveys a number of experiences of how openness has impacted on people’s lives and influenced the developmental prospects of wider communities or societies. It also exposes those issues and areas in need of further research. It is hoped that from these concrete examples, others exploring how to harness international trade and investment for inclusive growth, will be steered towards useful ideas, or at least, will be guided away from possible potholes on the road.

REFERENCES


PART 1
RECENT TRENDS AND DEVELOPMENTS
The sluggish growth in developed economies and uncertainty linked to the European economic crisis continue to suppress global demand. Less than five years after the previous trade contraction, Asian and Pacific economies once again went through a fall in trade during 2012. Exports by developing economies in the region contracted by 1% in that year (figure 1.1). Regional export contraction would have been worse if it was not for exports from China, whose growth partially cushioned the average performance. Excluding Chinese exports, exports from Asia-Pacific developing economies decreased by 7% in 2012. Imports of developing Asia-Pacific countries also decreased from the previous year, at the rate of about 11%. In contrast with exports, the Chinese import contraction drove the downward average trend for Asia and the Pacific. Excluding China, developing Asia-Pacific imports in fact grew slightly, by 0.4% through the year.

Excluding China, developing Asia-Pacific economies’ exports contracted by 7% in 2012
Since the last quarter of 2011, global trade has been progressively slowing, and underwent contraction in the second and third quarter of 2012 (figure 1.2). During 2012 and 2013, weak global demand has increasingly and adversely affected Asia-Pacific trade, causing swings in performance. Recent data indicate export growth stagnation in the second quarter of 2013, while import growth hovers around 1%.

Looking at individual countries’ performances, it is clear that most of the major Asia-Pacific trading economies were not able to maintain their export growth in 2012. Developing Asia-Pacific countries’ recent export performance shows quarterly swings with relatively low average annual growth rates, compared to those in 2011 (figure 1.3).

Import trends are very similar to those identified on the export side. In China, the softness of industrial output and fixed investment performance has resulted in lackluster import demand for commodities and intermediate goods from the rest of the region. For countries highly involved in global value chains, such as the Republic of Korea, Malaysia, Thailand and Taiwan Province of China, imports of electronic parts and components slowed significantly due to weak final demand in global markets.

**Source:** ESCAP calculation, based on World Trade Organization online short-term merchandise trade statistics (accessed September 2013).
B. SECTORAL PERFORMANCE

Increasing demand for raw materials and the strengthening productive capacity of emerging economies (especially in activities linked to the extraction of natural resources) have affected the region’s trade composition. A sector-based analysis reveals that while industrial products still contribute more than 80% of global trade, during the period 2002-2012, the share of petroleum products increased, while agriculture maintained a relatively constant share (table 1.1).

This de-industrialization was also reflected in both exports and imports in the Asia-Pacific region. The industrial sector’s share in the region’s total exports dropped from 91% in 2002 to 85% in 2012, while the share in total imports contracted from 86% to 80% during the same period.

The share of petroleum products in Asia-Pacific exports doubled from 5% to 10%, while its share in the region’s imports rose from 8% to 14.5%. The share of agriculture in Asia-Pacific exports remained at about 4% to 5%. However, note that calculation of shares is based on nominal dollar values and the changes in shares are, therefore, influenced by the long-term trend of increasing petroleum prices.

Considering the economic uses of traded products, the Asia-Pacific region is a net exporter of capital and consumer goods, while being a net importer of raw materials and intermediate products (figure 1.4). The differences in trade balances between product groups has recently grown: consumer goods show a clear surplus (shown as net exports) whereas raw materials show a deficit (shown as net imports). These patterns reveal that still-growing consumption and investment in the Asia-Pacific economies wash partially offsetting weak global demand during 2012. On the other hand, the ballooning import bills for energy and commodities have increased the deficit of Asia-Pacific trade in raw materials. Overall, there was a net trade deficit between the Asia-Pacific region and the rest of the world in 2011 and 2012; the deficit grew from about $100 billion to $190 billion during those years.

Asia and the Pacific, as a whole, has been running a trade deficit with the rest of the world over last two years (2011-2012).

<table>
<thead>
<tr>
<th>Sector</th>
<th>World</th>
<th>Asia-Pacific region</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural products</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Petroleum products</td>
<td>6.1</td>
<td>11.4</td>
</tr>
<tr>
<td>Industrial products</td>
<td>86.9</td>
<td>81.7</td>
</tr>
</tbody>
</table>

However, these trade patterns are mainly visible in the dominant trading economies of East, North-East and South-East Asia, which together account for about 75% of Asia-Pacific trade. The smaller and less advanced trading economies may have much less favourable trade patterns, with lower shares of exports from high-value added sectors.
C. SUBREGIONAL PERFORMANCE

The Asia-Pacific region has gained a significantly larger share of world merchandise trade over the past 10 years. The region has surpassed Europe to become the world’s largest trading region in 2012, accounting for almost 37% of world exports and 36% of the world imports. The region’s growing dominance in world trade is driven by the large economies in East and North-East Asia (figure 1.6).

Since 2004, China has been the largest exporter in the region. It accounted for 11% of world exports in 2012. Japan and the Republic of Korea are the second and third largest exporters, contributing 4% and 3% of world exports, respectively, in 2012. Combined, the economies of East and North-East Asia account for 21% of world exports and imports. South-East Asia’s share of world exports in 2012 was around 7%. Most of the South-East Asian exports are contributed by five members of the Association of Southeast Asian Nations (ASEAN) namely Singapore (2.2%), Thailand (1.3%), Malaysia (1.2%), Indonesia (1%), and Viet Nam (0.6%); they account for similar shares of world imports. North and Central Asia capture about 4% of world exports, while the subregion accounts for about 3% of world imports. South and South-West Asia contribute around 3% of world exports, and 4% of world imports. Notably, India contributes around half of total trade by the South and South-West Asian subregion. The Pacific region, including Australia and New Zealand, represents a relatively minor share of regional and global trade. In 2012, the Pacific’s contribution to world trade remains less than 2%, with Australia and New Zealand accounting for about 96% of that amount. Despite the very small total volume, several developing Pacific islands recorded impressive double-digit export growth in 2012, including Northern Mariana Islands (50%), Samoa (40%), Federated States of Micronesia (25%), Palau (17%), Kiribati (16%), Solomon Islands (13%) and Tonga (11%).

D. TRENDS IN INTRAREGIONAL TRADE

From 2000 to 2012, intraregional trade, both in terms of its value and share, has been increasing, especially on the export side. The total share of intraregional exports jumped from about 40% to 50%, while the share of exports to the United States decreased from 20% to around 10%. The total share of exports to the European Union did not change significantly remaining around 17%.

**FIGURE 1.6**

Geographical breakdown of Asia-Pacific subregion’s share in world trade 2000-2012

On the import side, developments were not fully symmetrical: the share of intraregional imports remained at 51% during the whole 12 year period. There was, however, a shift from sourcing imports from traditional markets outside the region, such as the United States, to sourcing imports from the rest of the world (tables 1.2 and 1.3).

Developments in 2012, so far in 2013, send mixed signals on the performance of important traditional export markets for Asia and the Pacific, most notably the European Union and the United States of America. There are indications of a soft economic recovery in the United States, while the European Union and Japanese economies remain fragile. Additionally, the Chinese economy appears to be settling into a new trend of slower growth (IMF, 2013). Consequently, exports from the rest of Asia and the Pacific to China, to developed Asia-Pacific economies, and to the European Union, declined overall, by about 3 percentage points in 2012 from the previous period.

A general decline in import demand in developed countries has also contributed to the strengthening of South-South trade in recent years. China is the largest individual export market and import source for developing countries in the region (table 1.4). However, the importance of the Chinese and Indian markets to other developing Asia-Pacific economies decreased somewhat in 2012. Due to the slowdown of China’s domestic and indirect export demands, there was a fall in the share of other developing Asia-Pacific countries’ exports to the country of more than five percentage points in 2012.

### TABLE 1.2

Shares of Asia-Pacific exports by destination, 2000, 2008 and 2012

(Percentage of total merchandise exports)

<table>
<thead>
<tr>
<th>Asia-Pacific exports</th>
<th>World</th>
<th>Total</th>
<th>Developed</th>
<th>China</th>
<th>Developing excl. China</th>
<th>United States</th>
<th>EU25</th>
<th>Rest of World</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>100</td>
<td>43.0</td>
<td>10.6</td>
<td>4.9</td>
<td>27.5</td>
<td>21.1</td>
<td>18.3</td>
<td>17.6</td>
</tr>
<tr>
<td>2008</td>
<td>100</td>
<td>47.1</td>
<td>8.6</td>
<td>7.9</td>
<td>30.7</td>
<td>12.7</td>
<td>20.2</td>
<td>19.9</td>
</tr>
<tr>
<td>2012</td>
<td>100</td>
<td>50.7</td>
<td>8.6</td>
<td>8.1</td>
<td>34.0</td>
<td>12.2</td>
<td>17.3</td>
<td>19.7</td>
</tr>
<tr>
<td>Change from 2011</td>
<td>-1.7</td>
<td>-0.5</td>
<td>-2.0</td>
<td>0.9</td>
<td>0.3</td>
<td>-0.3</td>
<td>1.7</td>
<td></td>
</tr>
</tbody>
</table>

**Developing Asia-Pacific exports**

| 2000 | 100 | 45.1 | 13.4 | 4.4 | 24.7 | 18.1 | 19.5 | 17.2 |
| 2008 | 100 | 45.9 | 9.0  | 6.0 | 31.0 | 12.1 | 22.1 | 19.9 |
| 2012 | 100 | 48.3 | 8.7  | 5.0 | 34.6 | 11.7 | 19.3 | 20.6 |
| Change from 2011 (percentage points) | -2.0 | -0.8 | -2.3 | 1.0 | 0.0 | -0.2 | 2.2 |

**Source:** ESCAP calculation, based on United Nations Comtrade data, from WITS database (accessed May 2013).

### TABLE 1.3

Shares of Asia-Pacific imports by source, 2000, 2008 and 2012

(Percentage of total merchandise imports)

<table>
<thead>
<tr>
<th>Asia-Pacific imports</th>
<th>World</th>
<th>Total</th>
<th>Developed</th>
<th>China</th>
<th>Developing excl. China</th>
<th>United States</th>
<th>EU25</th>
<th>Rest of World</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>100</td>
<td>51.2</td>
<td>14.7</td>
<td>11.9</td>
<td>24.6</td>
<td>13.5</td>
<td>14.6</td>
<td>20.8</td>
</tr>
<tr>
<td>2008</td>
<td>100</td>
<td>52.2</td>
<td>12.3</td>
<td>13.7</td>
<td>26.2</td>
<td>8.2</td>
<td>14.0</td>
<td>25.6</td>
</tr>
<tr>
<td>2012</td>
<td>100</td>
<td>51.0</td>
<td>10.7</td>
<td>13.8</td>
<td>26.5</td>
<td>7.4</td>
<td>13.3</td>
<td>28.2</td>
</tr>
<tr>
<td>Change from 2011 (percentage points)</td>
<td>-2.1</td>
<td>-2.0</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.5</td>
<td>-0.4</td>
<td>3.0</td>
<td></td>
</tr>
</tbody>
</table>

**Developing Asia-Pacific imports**

| 2000 | 100 | 53.7 | 17.7 | 11.3 | 24.6 | 11.3 | 14.8 | 20.3 |
| 2008 | 100 | 52.7 | 13.3 | 12.6 | 26.8 | 7.5  | 14.7 | 25.1 |
| 2012 | 100 | 50.5 | 11.4 | 12.0 | 27.1 | 6.9  | 13.8 | 28.8 |
| Change from 2011 (percentage points) | -2.5 | -2.4  | 0.0 | -0.1 | -0.6 | -0.5 | 3.6 |

**Source:** ESCAP calculation, based on United Nations Comtrade data, from WITS database (accessed May 2013).
**Intraregional trade of developing Asia-Pacific countries, 2000, 2008 and 2012**

### Shares of intraregional exports by destination

(Percentage of intraregional exports)

<table>
<thead>
<tr>
<th>Exports to</th>
<th>East and North-East Asia</th>
<th>South-East Asia</th>
<th>South and South-West Asia</th>
<th>North and Central Asia</th>
<th>Pacific</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>China</td>
<td>Rest</td>
<td>Total</td>
<td>Singapore</td>
</tr>
<tr>
<td>2000</td>
<td>44.0</td>
<td>13.8</td>
<td>32.2</td>
<td>40.2</td>
<td>13.8</td>
</tr>
<tr>
<td>2008</td>
<td>45.9</td>
<td>16.2</td>
<td>29.7</td>
<td>31.4</td>
<td>8.4</td>
</tr>
<tr>
<td>2012</td>
<td>44.6</td>
<td>12.5</td>
<td>34.0</td>
<td>32.3</td>
<td>7.1</td>
</tr>
<tr>
<td>Change from 2011 (percentage points)</td>
<td>-2.0</td>
<td>-5.3</td>
<td>3.3</td>
<td>1.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

### Shares of intraregional imports by source

(Percentage of intraregional imports)

<table>
<thead>
<tr>
<th>Imports from</th>
<th>East and North-East Asia</th>
<th>South-East Asia</th>
<th>South and South-West Asia</th>
<th>North and Central Asia</th>
<th>Pacific</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>China</td>
<td>Rest</td>
<td>Total</td>
<td>Singapore</td>
</tr>
<tr>
<td>2000</td>
<td>50.4</td>
<td>31.4</td>
<td>18.9</td>
<td>37.0</td>
<td>11.1</td>
</tr>
<tr>
<td>2008</td>
<td>48.7</td>
<td>31.9</td>
<td>16.8</td>
<td>32.8</td>
<td>8.8</td>
</tr>
<tr>
<td>2012</td>
<td>49.4</td>
<td>30.8</td>
<td>18.6</td>
<td>32.9</td>
<td>8.0</td>
</tr>
<tr>
<td>Change from 2011 (percentage points)</td>
<td>-0.4</td>
<td>-1.0</td>
<td>0.6</td>
<td>-0.9</td>
<td>-0.3</td>
</tr>
</tbody>
</table>


*Notes:* ASEAN5 – Indonesia, Malaysia, Philippines, Thailand and Viet Nam; SAFTA – Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka; Rest – rest of the world.

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**The real challenge for policymakers in the region is to find ways to boost growth without relying on unstable demand from large economies within and outside the region.**

In contrast, North and Central Asia benefited from the relatively strong demand for energy and mineral resources and, therefore, trade of that subregion rose in 2012.

Trends in subregional trade patterns point to intraregional demand as one of the most important factors in Asia-Pacific trade-led growth. However, developments in 2012 reveal that intraregional demand is being impacted by the subdued economic outlook in developed economies. In particular, the global economic slowdown continues to affect China’s export and economic growth. In turn, this is causing a dent in exports by the other regional economies in their supply to China. Further, China is showing signs of another economic downturn in 2013 (see box 1.1 on China’s economic slowdown). This creates real challenges for policymakers in economies that are part of regional supply chains: they will need to find ways of boosting growth despite unstable demand from large economies within and outside the region. To remain resilient during these difficult periods, reforms must deal with both the demand- and the supply-sides of the economy. A key issue on the demand side is how to strengthen domestic consumption and investment in order to create sufficient domestic demand to support overall growth. At the same time, increasing efficiency and productivity will be necessary on the supply side to reduce costs and increase competitiveness. Private and public investment to strengthen medium-to-long term competitiveness is the key, as this brings benefits on two fronts. On one hand, increasing investment is an effective tool to manage near-term risks to economic growth; on the other hand, investments in structural reform increase productivity and efficiency and are thus essential to achieving sustainable growth in the long term.
After several years of ups and downs, the Asia-Pacific region's trade still faces threats. While direct pressures from the financial crisis in the Eurozone are intensifying, the world is also worried that the Chinese economic slowdown is opening the door to a new global crisis. Recent data show that China is experiencing difficulties in maintaining its high economic growth rate. China’s quarterly GDP has grown less than 8% year-on-year since the second quarter of 2012, ending the first quarter of 2013 with growth of 7.7% (IMF, 2013). For a country that routinely had double digit growth rates over the past decade, the recent performance is a worry.

Lackluster export growth adversely affected China’s manufacturing activities and further affected domestic spending. Exports grew by only 7.5% in 2012 - the lowest rate over the past 10 years, with the exception of during the 2009 global trade collapse. So far in 2013, export growth picked up to 18% over the first quarter. This positive development may reduce pressures on China’s domestic economy if it proves to be a sustained recovery. However, the spillover effects of this local recovery to other regional economies supplying inputs to China remain uncertain. For example, considering China’s important role in processing trade, the knock-on effects on Asia-Pacific economies which export indirectly through China could be significant. To identify imports which can be qualified for duty exemption, the Chinese customs authorities distinguish between processing trade and ordinary trade. According to Manova and Yu (2013), processing trade is officially defined as “business activities in which the operating enterprise imports all or part of the raw or ancillary materials, spare parts, components, and packaging materials, and re-exports finished products after processing or assembling these materials/parts”. A processing firm can only claim import duty exemption if, at the time of importing, it shows proof of a contractual agreement with a foreign buyer to whom it will export the processed goods.

Customs data indicate that the country’s pure-assembling processing trade is slowing down. This is more pronounced than for other types of trade, whose domestic value added is higher i.e. ordinary trade and processing trade with imported materials (see figure below). Processing trade involving purely assembling activities has experienced a growth contraction since the second quarter of 2011. The slowdown in China’s processing trade has thus caused a serious contraction in China’s imports of raw materials and intermediates from the rest of the world, including from the Asia-Pacific region.

There has not yet been clear evidence of recovery in China’s processing trade. Thus, the slowdown of the Chinese economy continues to place pressure on the region’s exports to the Chinese market. This is currently the largest individual export market for the rest of the region, accounting for about 13% of its exports in 2012.
**E. SHORT-TERM PROSPECTS FOR MERCHANDISE TRADE**

Merchandise exports of developing Asia-Pacific economies grew by 2%, in real terms, during 2012. While global uncertainties remain a threat to trade recovery in 2013, encouraging trends, attributed to a partial recovery of demand in the United States and some emerging economies, lead to a forecast of soft improvement in Asia-Pacific trade.

The prospects for trade recovery remain uncertain. However, encouraging signs in the United States and emerging economies lend a forecast of soft improvement in 2014.

It is expected that merchandise exports and imports of developing Asian and Pacific economies will grow less than 6%, in real terms, during 2013, with a modest improvement to 7% in 2014 (table 1.5). However, the prospects of the regional growth depends heavily on the prospects for China’s export growth, as China accounts for over 30% of the exports of Asia-Pacific developing economies.

This is especially so for economies that supply China with raw materials and intermediate goods. Exports by China are expected to improve from sluggish growth in 2012 to 8% growth in 2013, on the back of a recovery in import demand from the United States. The Government of China also plans to resume some policy-easing to prevent an economic hard landing. For example: benchmark interest rates were cut and the bank’s reserve requirement ratio has been reduced; the national development and reform commission has sped up approval of investment projects;
and the Government has introduced subsidies to stimulate household consumption of energy-saving products. The recovery of exports from China, and demand for imports, may result in a potential increase in imports of raw materials and intermediate inputs from the rest of the region to China, but uncertainty remains.

The “China factor”, combined with direct impacts of the economic recovery in the United States, is expected to improve growth prospects in 2013 for major trading economies, such as India, Indonesia, the Republic of Korea, Malaysia, Thailand and Taiwan Province of China. But continued uncertainties in the trade outlook stem from the ongoing fluctuations in final demand from outside the region.

One risk is that, the recovery in Chinese demand driven for now by its stimulus packages, may not continue in 2014, unless the economic recovery in the United States gains momentum and proves robust. With the export growth of China expected to slow to just below 5% in 2014, this could add more pressure in economies depending on exports to that country. For example, Australia and to a lesser extent Thailand, may, in turn, experience a deceleration in exports growth during the same period.

**CONCLUSION**

The developments in 2012 and so far in 2013 proved that intraregional demand is not immune to persisting weak economic performance of developed economies. In particular, the integration of the global economy continues to provide transmission channels through which extra-regional economic weakness impacts on even strong emerging economies such as China and India. Exports by most developing Asia-Pacific trading partners of China are projected to expand in 2013 in real terms. This growth is expected to range from a low of 2% (Singapore) to a high of 8% (Thailand). However, this forecast is uncertain at best. The uncertainty in the trade outlook stems from the fluctuations in final demand from outside the region. Unless the economic recovery in the United States proves to be more robust and gains momentum, and without better growth prospects for the European Union, China could experience export growth of just below 5% in 2014. This will be another challenge to the “factory Asia” model of regional integration and produce added pressure on those economies sending parts and components, or metals and commodities, for processing in China to find alternative sources.

**TABLE 1.5**

Real merchandise exports and imports growth for the Asia-Pacific region and selected economies\(^a\): results and prospects (percentage)

<table>
<thead>
<tr>
<th>Economy</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>Japan</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Australia</td>
<td>4.9</td>
<td>7.0</td>
</tr>
<tr>
<td>China</td>
<td>3.3</td>
<td>8.0</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>2.6</td>
<td>5.0</td>
</tr>
<tr>
<td>India</td>
<td>4.6</td>
<td>6.3</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.2</td>
<td>6.8</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>3.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-0.4</td>
<td>1.3</td>
</tr>
<tr>
<td>Philippines</td>
<td>22.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>0.8</td>
<td>1.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>-0.2</td>
<td>1.5</td>
</tr>
<tr>
<td>Taiwan Province of China</td>
<td>-1.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>-0.4</td>
<td>8.0</td>
</tr>
<tr>
<td>Turkey</td>
<td>18.4</td>
<td>-1.2</td>
</tr>
<tr>
<td>Asia and the Pacific</td>
<td>2.6</td>
<td>4.7</td>
</tr>
<tr>
<td>Developing Asia and the Pacific</td>
<td>2.8</td>
<td>5.3</td>
</tr>
</tbody>
</table>


\(^a\)The growth rates are estimated based on constant prices and exchange rates, and regional trade growth is the trade-weighted average growth rates. In making the estimates, 2012 was taken as the base year.
of growth. Under the scenario of lower Chinese growth, some might experience a deceleration of export growth in 2014, such as Australia (from 7% to 5%) and to a lesser extent Thailand (from 8% to 7%).

The real challenge for Asian and Pacific policymakers is to find ways to boost growth without relying on unstable demand from larger economies within and outside the region. Furthermore, to remain resilient during these difficult periods, reforms need to be undertaken or completed on both the demand and supply sides. A key issue on the demand side is how to strengthen domestic consumption and investment in order to create sufficient domestic demand to support overall growth. At the same time, increasing efficiency and productivity is needed on the supply side to reduce cost and increase competitiveness – necessary components for long-term growth and employment creation.

While developing countries should not turn away from economic and trade liberalization - because economic growth, crucial for poverty reduction is positively linked to increased economic openness - the real challenge is how to match the dynamics of trade development with the development of human-capital. In the policy formulation context, different targets and supporting policies should be chosen strategically for different stages of industrialization.

REFERENCES


ONLINE DATABASES


The Asia and Pacific region’s exports and imports of commercial services showed signs of a slowdown in 2012. This followed a quick recovery in 2010 and 2011 from the global economic crisis. Growth rates of services exports and imports almost halved in 2012 compared to the previous year (from 11.8% to 6.3% for exports and from 13.8% to 7.7% for imports). In relative terms, the region has been performing better than the rest of the world since the early 2000s, and this is reflected in its growing share of world exports and imports of commercial services. For exports the share rose from 23% to 28% and for imports from 27% to 31%. With the exception of the global economic crisis dip, exports grew steadily. However, in 2012 the region still had an overall deficit in services trade (figure 2.1).

After the crisis, developing economies of Asia and the Pacific recorded faster growth in export of commercial services than the region’s developed economies.
While export growth of developing Asia-Pacific economies slowed from 14.2% in 2011 to 6.4% in 2012, developed Asia-Pacific economies contracted in 2012 by -0.43% against 4.9% growth in 2011. Despite added volatility from global economic uncertainties, service exports from developing Asia-Pacific economies recorded 8% annual average growth rate during 2009 to 2012. In contrast, exports from developed Asia-Pacific economies, on average, stagnated during the same period (figure 2.2). This was driven particularly by the contraction in financial services exports. In the aftermath of the global economic recession, developing countries’ services exports demonstrated higher resilience, especially in the sectors of computer and information services, communication and travel.

The more dynamic developing economies are the leading exporters of commercial services from the Asia-Pacific region. These economies include China, India, Singapore, Hong Kong, China and the Republic of Korea (in order of the value of exports in 2012). As a result, exports of commercial services in the region performed

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**FIGURE 2.1**
Exports and imports of commercial services by the Asia-Pacific region


**FIGURE 2.2**
Developing economies outperform developed ones in exports of commercial services, 2008-2012

*(in billions of United States dollars)*

better in 2012 than in the previous year (WTO, 2013). In contrast, Japan recorded a fall in exports of commercial services (-2%), pulling down the average for developed Asian economies.

Services as a determinant of competitiveness and global value chain participation

The Asia-Pacific Trade and Investment Report (ESCAP, 2011 and 2012) emphasized the importance of services in improving the efficiency and resiliency of traditional merchandise export-led economies in the Asia-Pacific region, as well as enhancing prospects for its inclusive and sustainable growth. The reports argued that despite the increasing role of services in generating employment and GDP, services remain less than one fifth of the region’s merchandise trade value (a few percentage points less than for the world average). Those estimates were based on the so-called ‘gross value’ of trade. However, recent advances in the measurement of trade, in value added terms, is shedding new light on the role of services. This method of measurement enables proper valuation of the many services involved in the production of goods.

The new database of the Organisation for Economic Co-operation and Development (OECD) and WTO Trade in Value Added (TiVA) shows that in 2009 the services content of trade reached 40% or more in G20 economies. In the United States, the United Kingdom of Great Britain and Northern Ireland (here forth United Kingdom), India, Japan, Turkey and the European Union as a whole, the services value added content of trade exceeded 50%. (figure 2.3).

*The inter-linkage between services, on one hand, and production and marketing of goods, on the other, has become much stronger. Services value added in gross export values is increasing fast.*

Services are an integral part of production fragmentation and global value chains (GVCs). In fact, the rise of GVCs was built on reduced costs of service links, inter alia. None of these chains can exist without efficient services such as transport, logistics, communication, finance, and business and professional services. Recognition of the value created, directly or indirectly, by services in the process of

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**FIGURE 2.3** Services value added in gross export values (percentage)

*Source:* OECD/WTO TiVA database, May 2013 release; p.11.
manufacturing, distribution and marketing of goods has become known as “servicification”. More realistic accounting for the role of services in manufacturing trade (often deemed to be more than 30%) allows a better understanding of the importance of improving service sector efficiency in developing economies. This also includes improvements through further liberalization of services trade. Controlled opening of the service sector can allow for more efficient and higher quality services. In turn, this would enhance the competitiveness of manufacturing firms, allowing them to better participate in global production networks.

Interlinking of services with manufacturing is particularly important for some economies of the Asia-Pacific subregions (e.g. South and South-West Asia, North and Central Asia), as they are not well integrated in regional and global value chains and production networks. Improving this connectivity is very important for regional integration in Asia and the Pacific.

**Box 2.1 Servicification: Some illustrations**

Servicification is a phenomenon of increased use of services in manufacturing. This is both in terms of production processes and sales and may, in part, reflect the separation of services functions in manufacturing from core production functions. A significant feature of servicification is the opportunity it offers for strategic firm behaviour, including efforts by firms to move up the value chain. While some of the bundling or modularization occurring along supply chains, as a result of servicification, may be occasioned by the exigencies of locational dispersion in production and consumption, or by regulatory requirements; these tendencies are also likely to be fed by strategic motivations internal to firms (Sundin and others, 2009; Sweden, National Board of Trade, 2012). Firms may seek to customize their offerings (in terms of after-sales services, warranty services, easy financial options etc.) so as to differentiate themselves in the marketplace and earn higher returns or to spread risk by diversifying their output mix.

Depending on the product in question, significant scope may exist for the provision of after-sales services as an additional source of product differentiation and profit. These services can take many forms, including technical assistance and training, maintenance, provision of spare parts and repair services, and a range of other customer care services (Saccani, Johansson and Perona, 2007). The means of delivery of after-sales services by a lead firm will vary from direct supply, subcontracting arrangements, agency relationships and franchising (see more details in Low, 2013).

The case study of the Nokia95 phone, undertaken by Ali-Yrkkö and others (2011), produces a detailed breakdown of the value chain for the product. The parts (including processors, memories, integrated circuits, display and camera) accounted for 33% of the product’s retail price (excluding taxes). Assembly only accounted for 2%. The remaining two thirds of the product was accounted for by Nokia’s internal support services (31%), licences (4%), distribution (4%), retailing (11%) and operating profit (16%). Despite the relatively fine detail on breakdown of invisibles in this case study, some value remained still unaccounted for: not all of the different services that went into the production were recorded. This "missing services" issue also applies to the manufacturing part of the operation, notwithstanding its small share.

*Source: ETLA, the Research Institute of the Finnish Economy, as cited in Ali-Yrkkö and others (2011).*
B. SUBREGIONAL AND SECTORAL BREAKDOWN OF SERVICES TRADE

In 2012, the Pacific, and South and South-West Asia subregions saw almost no growth in commercial services exports (rates reported were 0.1% and 0.9%, respectively). Imports of commercial services into South and South-West Asia continued to contract in 2012, with this subregion being the only one to record a fall in imports since 2009. In contrast, that same year, North and Central Asia recorded the highest growth in commercial service exports (11.4%) and imports (17.5%) of all Asian subregions (figure 2.4).

The relative contributions of individual subregions to services trade has not changed much since the late 1990s (figure 2.5). East and North-East Asia consistently contribute about half of the region’s trade (50.2% in 2012). The other half is split between South-East Asia (22%), South and South-West Asia (16%), North and Central Asia (6%) and the Pacific (5%). South and South-West Asia, and North and Central Asia are continuing their very gradual climb in total share at the expense of the Pacific.

At the individual economy level there have been winners and losers, in terms of the share of total Asia-Pacific exports of services. Between 1999 and 2012, Kyrgyzstan, Azerbaijan, Macao, China, Georgia, India and Mongolia saw the highest growth. India more than doubled its share to reach 12%, while China increased its share to 16% of regional exports. On the other hand, the share of Japan continued to decline and in

![commercial services trade growth of Asia-Pacific subregions 2008-2012 (Year-on-year percentage change)](chart)

**Source:** Based on WTO-UNCTAD-ITC data accessed through ESCAP Online Statistics Division data, accessed June 2013.
In terms of sectors, commercial services are broadly categorized as transportation, travel and other commercial services. In 2012, other commercial services captured more than 54% of total services exports. Globally, during 2002-2012, travel and transportation services lost their shares to other commercial services. However, the dynamic for the Asia-Pacific region as a whole was different. The travel services export share in the Asia-Pacific region increased from 22% to 33% while the transportation services share in 2012 was just over 12%, compared with a share of more than 21% in 1999. Despite this, in 2012 Japan regained second place among the leading Asian service exporters and importers. The increase in services exports of China and India also saw a significant increase of their share in world services exports during the period under review; data for 2012 shows that China captured 4.3% and India 3.2% of world services exports. These two countries were ranked as sixth and eighth leading exporters in 2012.3

**FIGURE 2.6**
Repositioning of the Asia-Pacific region in exports of commercial services (changes over 2011/2001 and 2012/2002)


**FIGURE 2.5**
Commercial services trade: subregional shares in total Asia-Pacific trade in services (percentage)

export share moved up from 29% to 33% (figure 2.6). Other commercial services also registered strong growth in the Asia-Pacific region; after more than tripling export value in the observed period, the share also increased by 6 percentage points to reach 26% in 2012. Nevertheless, commercial services exports from the region are still half of their relative size globally. The Asia-Pacific region’s most dynamic sector is still travel services, where growth is mostly driven by intraregional demand. Box 2.2 provides further details on the performance of the tourism segment of services trade. As tourism opens many opportunities for inclusive growth, it is encouraging that the region, as a whole, shows resilient performance in the sector. However, some smaller Pacific economies, which are highly dependent on this sector for foreign exchange earnings and household income generation, experienced difficulties in maintaining growth.

**The most dynamic sector of commercial services in Asia and the Pacific is travel, with the growth driven by intraregional demand.**

Box 2.2

**International tourism in the Asia-Pacific region**

International tourism is one of the 12 sectors covered by the WTO General Agreement on Trade in Services (GATS), and it is also often included in preferential trade agreements. However, it does not feature as a self-standing service activity in trade statistics; rather, it is subsumed under travel services. In national accounts it does not often appear as a well-defined category, even though it is an important source of income and employment for many developing and least developed countries, especially in Asia and the Pacific. There was some recovery in tourist arrivals in 2010 after the sharp decline in 2009, but the global economic environment in 2011 and 2012 was not supportive of strong tourism growth. The downturn of 2009 was caused by the combined effect of the global economic crisis, pandemic threats and factors related to disasters and international security. However, the first half of 2013 shows promising growth of tourist arrivals of 5% and it is expected that this growth will be maintained throughout the year (UNWTO, 2013b). Asia and the Pacific, especially South-East and South and South-West Asia, still leads in this renewed tourism growth.

**Asia and the Pacific will continue to see the highest growth in tourists’ arrivals in 2013.**

Asia and the Pacific captured almost 23% of total global international tourist arrivals; more than half of those visits are linked to North-East Asia, while the Pacific’s share fell to 1.2% of the region and now captures a smaller share than South Asia (1.4%). The most dynamic growth in international tourist arrivals was recorded in Bhutan and Georgia (39%), Sri Lanka (31%), Palau and Myanmar (26%), Cambodia, Thailand and Viet Nam (20%). After the adverse impact of 2011 disasters, Japan made a comeback by increasing tourism receipts by 37% in 2012.
While there are no detailed and long-term data series on the bilateral flows of travel services, this category appears to be contributing towards an expansion of intraregional trade in Asia. According to the World Tourism Organization (UNWTO) (2012), more than 60% of the travel receipts of China are sourced from Asian economies, particularly Hong Kong, China, as well as Japan, the Republic of Korea and Taiwan Province of China. More than two thirds of the travel exports of the Republic of Korea travel were destined for other Asian economies, with more than 30% of those exports going to Japan. In the case of Hong Kong, China, the share of Asian receipts is even higher (more than 84%), with China being the largest recipient of travel services exports. Asian economies accounted for some 77% of travel exports of Japan and 60% of travel receipts of Australia in 2008. At the same time, Asian economies contributed between 6 and 9% of the total travel exports of the European Union-27, and between 5% and 12% of the exports from the United States of America.


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<tbody>
<tr>
<td>World</td>
<td>6.4</td>
<td>4.8</td>
<td>4.0</td>
<td>3.9</td>
</tr>
<tr>
<td>Europe</td>
<td>3.0</td>
<td>6.5</td>
<td>3.5</td>
<td>4.0</td>
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<tr>
<td>Asia and the Pacific</td>
<td>13.2</td>
<td>6.5</td>
<td>6.9</td>
<td>5.2</td>
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<tr>
<td>Americas</td>
<td>6.6</td>
<td>3.6</td>
<td>4.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Africa</td>
<td>8.7</td>
<td>-0.8</td>
<td>5.4</td>
<td>4.7</td>
</tr>
<tr>
<td>Middle East</td>
<td>11.6</td>
<td>-5.6</td>
<td>-5.4</td>
<td>1.1</td>
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</tbody>
</table>

Source: UNWTO (2013a), World Tourism Barometer, August 2013. 2013 rates are forecasts.

Note: UNWTO’s definition of Asia-Pacific comprises the following economies – Australia; Bhutan; Cambodia; China; Cook Islands; Guam; Fiji; French Polynesia; Hong Kong, China; India; Indonesia; Japan; Kiribati; Macao, China; Maldives; Malaysia; Marshall Islands; Myanmar; Nepal; New Caledonia; New Zealand; Niue; Northern Mariana Islands; Pakistan; Palau; Papua New Guinea; Republic of Korea; Samoa; Singapore; Solomon Islands; Sri Lanka; Taiwan Province of China; Thailand; Tonga; Vanuatu; and Viet Nam.

Source: UNWTO (2013a), World Tourism Barometer, June 2013.

GATS schedules refer to sector 9, known as “Tourism and travel related services”, which is broken down into four subsectors: hotels and restaurants (including catering), travel agencies and tour operators services, tourist guides services, and others.

Several transportation services exporters in the region saw some recovery in 2012. Exports of China rose by 8% compared with 4% in 2011. In the Republic of Korea, exports of transportation services increased by 7%. India and Singapore, in contrast, saw their exports grow at a reduced rate of 2% and 3%, respectively (compared to high growth in 2011, which was 32% and 13% respectively).

The other commercial services category is made up of eight subcategories. However, data are not readily available for all countries, although with the available data from WTO International Trade Statistics Database it is possible to provide further details of export developments under these eight subcategories during 2002 to 2012 (table 2.1). In this period, the Asia-Pacific region increased the value of its other commercial services exports by almost fourfold, pushing its share up to 26% in 2012.

Despite improvements in data collection, more than half of the other commercial services category is within the broad subcategory of “other business services”. The remaining part is split into seven other subcategories, some of which have recorded marked increases in their share, such as construction (by 18 percentage points), and computer and information services (by 12 percentage points). Notably, the Asia-Pacific region’s share in both of these subcategories surpasses its average share for all categories; the region exported more than 50% of global exports of construction services and over 29% of computer and information services in 2012. Similarly, exports of insurance and financial services, both closely associated with merchandise trade, increased by more than four times in value, although their relative size increased less. Categories whose shares suffered a contraction in total Asia-Pacific exports are communication services (down by 2.7 percentage points) and personal, cultural and recreational services (down by 13.4 percentage points).

### C. DEVELOPMENTS IN THE SERVICES NEGOTIATIONS UNDER THE DOHA ROUND

The creation of the General Agreement on Trade in Services (GATS) was one of the landmark achievements of the Uruguay Round, which entered into force on 1 January 1995. GATS mandates WTO member Governments to progressively liberalize trade in services through successive rounds of negotiations (Article XXIX). Negotiations to further liberalize services began in January 2000. At the Doha Ministerial Conference in November 2001 the

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**TABLE 2.1**

*Other commercial services exports breakdown*

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</thead>
<tbody>
<tr>
<td>Other commercial services total</td>
<td>152.17</td>
<td>619.42</td>
<td>100.0</td>
<td>100.0</td>
<td>20.14</td>
<td>26.37</td>
</tr>
<tr>
<td>Communications services</td>
<td>6.83</td>
<td>16.91</td>
<td>4.49</td>
<td>2.73</td>
<td>19.19</td>
<td>16.52</td>
</tr>
<tr>
<td>Construction</td>
<td>11.66</td>
<td>58.51</td>
<td>7.47</td>
<td>9.45</td>
<td>33.42</td>
<td>50.24</td>
</tr>
<tr>
<td>Insurance services</td>
<td>3.02</td>
<td>13.01</td>
<td>1.98</td>
<td>2.10</td>
<td>6.87</td>
<td>13.13</td>
</tr>
<tr>
<td>Financial services</td>
<td>13.50</td>
<td>50.54</td>
<td>8.87</td>
<td>8.16</td>
<td>13.70</td>
<td>16.76</td>
</tr>
<tr>
<td>Computer and information services</td>
<td>10.68</td>
<td>77.24</td>
<td>7.02</td>
<td>12.47</td>
<td>17.85</td>
<td>29.11</td>
</tr>
<tr>
<td>Royalties and license fees</td>
<td>12.99</td>
<td>42.85</td>
<td>8.54</td>
<td>6.92</td>
<td>13.01</td>
<td>14.93</td>
</tr>
<tr>
<td>Other business services</td>
<td>88.84</td>
<td>352.66</td>
<td>58.38</td>
<td>56.93</td>
<td>24.24</td>
<td>30.74</td>
</tr>
<tr>
<td>Personal, cultural and recreational services</td>
<td>4.65</td>
<td>55.54</td>
<td>3.06</td>
<td>0.89</td>
<td>28.53</td>
<td>15.09</td>
</tr>
</tbody>
</table>


*Note:* ESCAP AP – the Asia-Pacific region.

The values of 2001 exports for the Asia-Pacific region are biased downwards due to the lack of data for several Central Asian economies. For detailed country-by-country data, consult the WTO International Trade Statistics Database.
services negotiations became part of the “single undertaking” under the Doha Development Agenda, whereby all subjects under negotiation are to be concluded at the same time. As structured in GATS, as of July 2002 the processes of bilateral negotiations are being held on the basis of the “request and offer” and “positive list” approach. The collapse of the Ministerial Conference in Cancun, Mexico brought a halt to negotiations. However, the General Council meeting on 1 August 2004 (commonly known as July 2004 Framework Agreement) brought negotiations back on track. The Hong Kong Ministerial Declaration of December 2005 reaffirmed key principles and objectives of the services negotiations and called on members to intensify the negotiations in accordance with the objectives, approaches and timelines set out in Annex C to the Declaration. Its view was to expand sectoral and modal coverage of commitments and improve their quality, with particular attention to the export interests of developing countries.

The lack of progress in the Doha Round is causing damage to not only services trade liberalization efforts but also to other initiatives, including the implementation of the Least Developed Countries Waiver for Services.

With the failure of the WTO multilateral approach, some countries have turned to discussions among a limited amount of participatory countries. In 2012 more than a dozen countries and country-blocs established a subgroup called “Really Good Friends of Services”, aimed at facilitating closed negotiations on services trade liberalization. The subgroup approach is not without its difficulties, however, as painstakingly seen by the meltdown of the Anti-counterfeiting Trade Agreement in 2012.

As services represent the fastest growing sector of the global economy and account for two thirds of global output, one third of global employment and nearly 20% of global trade, many countries are interested in exploiting this dynamic sector. This is for the purpose of strengthening and improving the quality of their economic growth. The impasse in concluding the Doha Round led some members, who promoted the liberalization of services, to explore other ways to achieve their objectives. Consequently, the Hong Kong Ministerial Declaration included provisions for plurilateral negotiations in addition to the request-offer negotiations which still remain the main method of negotiations. However, it clearly stated that the results of such negotiations shall be extended on a most-favoured-nation (MFN) basis.

Under plurilateral negotiations, a group of members with a common interest can make a joint request to individual members to improve specific commitments in a particular sector or mode of supply. Subsequently, they meet collectively with the countries that have received this request. It is up to each member to respond individually to the collective request. Several developments have taken place since the Hong Kong Ministerial Conference: two rounds of plurilateral negotiations were conducted in early 2006, based on 21 collective requests formulated, mostly, along sector lines. The results of the plurilateral negotiations, as well as additional bilateral meetings, were expected to be reflected in a second round of revised offers. While the submission of these offers was expected by 31 July 2006, all negotiations under the Doha Development Agenda were suspended just one week earlier. This was mostly due to a stalemate over agricultural and non-agricultural market access.

A new group of “Really Good Friends of Services” (RGFS) promotes the Trade in Services Agreement (TISA) as a separate plurilateral agreement, and the most promising opportunity to improve and expand trade in services. This group is neither an exclusive nor a stable group of WTO members, but an ad-hoc coalition of the WTO members that have shown a willingness to advance the services negotiations in the Doha Round. Initiated by Australia and the United States of America, TISA is supposed to be negotiated in Geneva. Since it is structured as a plurilateral agreement, it is not under the auspices of the whole WTO membership. In July 2012, RGFS intensified discussions around a “high ambition” international agreement on a wide range of services, in order to reinforce and strengthen the multilateral trading system. Participants stated that a new TISA should be: comprehensive in sectoral scope; contain new and enhanced rules that countries have developed since the WTO GATS entered into force in 1995; increase market access commitments to be as close as possible to countries’ current practices; and produce new market access improvements.
The present modalities on plurilateral negotiations are not very clear, especially on the issue of multilateralization of commitments. A report by the WTO Chairman of Council for The “Really Good Friends of Services”-driven negotiation approach, even if successful in delivering an agreement, is not without its difficulties as shown by the example of the Anti-counterfeiting Trade Agreement.

Trade, to the Trade Negotiating Committee said that there are still wide gaps which need to be covered in order to conclude the plurilateral negotiations. The report was on the basis of those submitted by coordinators of the plurilateral groups, as negotiations operate behind “closed doors”. Several issues need to be addressed in the context of these plurilateral negotiations, especially within the overall architecture of WTO framework, but more especially within the Doha Round mandate:

- First, the entire process of plurilateral negotiations are held behind “closed doors” and therefore, unlike other issues of negotiations, not much information is available to other WTO members. Transparency is one of the pillars of the Doha Round negotiations, with the entire modalities and discussions documented. This does not appear to be the case of plurilateral negotiations in services. The WTO members not participating in these negotiations do not have a clear picture, especially on modalities and outcome of discussions.

- The second issue relates to the plurilateral negotiations approach. In WTO there are two different approaches followed in plurilateral agreements. One is in the form of Annex 4 of the General Agreement on Tariffs and Trade (GATT), which limits the liberalization commitments to be extended to only those who are part of the plurilateral agreement (conditional plurilateral). This is on the basis of the principles of reciprocity of “give and take”. The other form of plurilateral agreement is exemplified by the Information Technology Agreement (ITA), which is an “open plurilateral”. This is where the commitments made are extended to the entire WTO members on MFN basis – that is, they are multilateralized. The purpose of the “closed plurilateral” approach adopted by RGFS is to ensure that other WTO members join the plurilateral negotiations. This is especially applicable to major emerging economies Brazil, India and South Africa, whose services markets are deemed as attractive but closed for the United States and European Union services industries. However, this closed plurilateral approach violates GATS. Even the Hong Kong Declaration clearly states that “The results of such negotiations [i.e. plurilateral, added by author] shall be extended on an MFN basis”.

Another systemic issue that needs to be revisited relates to ‘limited extension of concessions’ for only those who will participate in plurilateral negotiations. GATS allow such discrimination under the “Economic Integration” provision of Article V. There are separate processes of negotiations outside WTO for economic integration, whereby some countries negotiate a preferential trade arrangement in services and offer preferential market access to each other. The current architecture of TISA appears to be drawing parallels to Article V (since this would mean that the offer will be preferential in nature), but would come from the multilateral process of negotiation and not as a preferential trade agreement. It is still debatable if an outcome of multilateral negotiations can be extended to only a limited number of countries which participate in TISA, and such negotiations did not lead in a formation of “regional integration” per se (see also Sauvé, 2013).

It is, therefore, doubtful if the current form of plurilateral negotiations, if accepted, would be able to pass the GATS test. If so, the entire exercise would be futile as the purpose, which is to liberalize the services under the Doha Round, would be defeated. In order to make negotiations implementable, TISA will require an exception to the multilateral framework of GATS, and the agreement will need to be amended accordingly. Will this be in the spirit of multilateral trade liberalization, which has been one of the fundamental principles of the WTO?
Lastly, the issue relating to market access for least developed countries, which was mandated in the form of “Least Developed Counties Waiver for Services”, needs to be addressed as soon as possible. As explained earlier, it appears that the process has been derailed. There has been no substantial progress on giving least developed countries market access on a preferential basis within sectors that are of export interest to them. On this issue, disagreements still continue. This is mainly around the scope of the waiver, and rules of origin for services and service suppliers. The way the current architecture of services plurilateral agreements are designed, it appears that there will not be automatic extension of these commitments to least developed countries. Participants in the plurilateral negotiation will have to wait for emerging economies to join before considering further steps. Therefore, it is vital to ensure the Hong Kong Ministerial Conference mandates for extending these concessions on an MFN basis.

CONCLUSION

The Asian and Pacific region registered the highest growth of commercial service exports and imports in the world, at 5.2% and 5.9%, respectively. Despite these rates being lower than in 2011, the region increased its share of the global exports of several services, such as construction, computer and information services, and personal, cultural and recreational services.

In 2012, the Pacific and South and South-West Asia saw the lowest growth in commercial service exports of all Asian and Pacific subregions. Since 2008, the imports of commercial services into South and South-West Asia continued to be affected by economic uncertainty, and imports contracted by close to 13% in 2012. In contrast, that same year, North and Central Asia recorded the highest growth in commercial service exports and imports of all Asian and Pacific subregions (11.4% and 17.5%, respectively).

Despite added volatility resulting from global economic uncertainties, the developing economies of the region have shown more resilient growth in service exports than have the developed economies. This has been mainly driven by growth of computer and information services, communication and travel services trade.

Services are an integral part of production networks and global value chains and as such, an essential driver of efficiency and competitiveness. The rise of global value chains has been attributed to the reduced costs of service links, inter alia, as those chains depend on availability of affordable and efficient services such as transport, logistics, communication, finance, and business and professional services in general. The recognition of the value directly or indirectly created by services in a process of manufacturing production, distribution and marketing of goods is become known as “servicification”. It is now recognized that services constitute a much higher share of world trade than the 20 to 25% as previously calculated using gross values of trade. This new higher estimates are much more in line with the recognized contributions of services as employment and GNP generators. Services trade thus should play a stronger role in reducing poverty through creating efficiency, higher employment opportunities, higher incomes, increased consumer choice and quality of life. With proper understanding of the role of services, it is important to increase efforts for improving efficiency in services sectors in developing economies, including through further managed liberalisation of services trade.

REFERENCES


Raghavan, Chakravarthi (2012). The plurilateral services agreement game at the WTO. *Economic and Political Weekly*, vol. XLVII, No. 43.
ENDNOTES

1The lack of data on trade in commercial services remains a problem for many economies in Asia and the Pacific, particularly with regard to sectoral and regional breakdowns. Therefore, for the purposes of analysis in this chapter, data were compiled from different sources, including mirror data. However, even so it is not possible to provide an up-to-date and detailed account of intraregional services trade flows.

2The current classification of countries following the World Trade Organization broad groups of developed and developing lists only Australia, Japan and New Zealand as the region’s developed countries.

3The ranking is based on world trade, excluding intra-EuropeanUnion-27 services exports.

4See annex to chapter 2 in ESCAP (2012) for a more detailed explanation of the “other commercial services” category, pp. 43-44.

5These are communications, construction, insurance, financial, computer and information, royalties and license fees, other business services, and personal, cultural and recreational services (see annex of chapter 2 in ESCAP, 2012).

6The General Council is WTO’s highest-level decision-making body in Geneva, meeting regularly to carry out the functions of WTO. It has the authority to act on behalf of the Ministerial Conference, which only meets about every two years.

7This share is based on gross trade valuation. New measurements of net value added of services indicate that share of services in global trade value is much higher. See also box 2.1 on servicericification in this chapter.


9As of June, 2013, participants in the TISA include Australia, Canada, Chile, Colombia, Costa Rica, European Union, Iceland, Israel, Japan, Mexico, New Zealand, Norway, Pakistan, Panama, Paraguay, Peru, Republic of Korea, Switzerland, Turkey, the United States, Hong Kong, China, and Taiwan Province of China. China has also indicated that it is ready to participate in TISA negotiations, and is likely to make offer on market access on 4 November 2013 (Drake-Brockman 2013).


11The Trade Negotiations Committee operates under the authority of the General Council.

12Neither the WTO Secretariat nor the Chairman attends meetings between Members in the request/offfer process. Exchanges in those meetings are strictly private, unless otherwise provided for by the participants.

13The WTO agreements on Civil Aircraft, Government Procurement, International Dairy Agreement and International Bovine Meat Agreement come under this category.

A. RECENT TRENDS IN FOREIGN DIRECT INVESTMENT INFLOWS AND OUTFLOWS

1. Global trends

Following what seemed to be a swift recovery from the global financial crisis in 2010-2011, global foreign direct investment (FDI) inflows have again taken a downward turn. As the world economic recovery continues to be uncertain and fragile, global FDI inflows have declined by 18%, from $1.65 trillion in 2011 to $1.35 trillion in 2012.

Inflows decreased both in developed and developing economies. However, while the majority of developed countries experienced a significant reduction in their FDI inflows, by 32% on average, those to developing economies remained relatively resilient, declining by only 4% on average. More importantly, for the first time developing economies alone absorbed more FDI than developed countries, accounting for 52% of global FDI inflows (figure 3.1).
In 2012, for the first time, developing economies absorbed more FDI than developed countries, accounting for 52% of global FDI inflows.

Mirroring global FDI inflows, global outflows declined by 17% in 2012. The continued economic uncertainty, especially in developed countries, has led companies from these locations to scale back their operations. As a result, most of the global decline can be attributed to developed economies, which saw a 23% decline in FDI outflows. Since peaking in 2007 at $2.3 trillion, global FDI outflows have decreased by almost 40%, while outflows from developed economies...
in 2012 amounted to less than half of what they were in 2007. In contrast, apart from a small dip in 2009, developing economies have been slowly but steadily increasing their outward investments since 2007. Developing countries have made advances in catching up with the developed countries as a source of FDI. In 2012, developing countries provided 31% of global FDI outflows, whereas developed countries supplied 65% of global outflows and transition countries accounted for the remaining 4%. Compared to 2007 the difference is striking. In 2007, only 15% of outflows originated in developing countries compared to 83% in developed countries and 2% in transition countries (figure 3.2).

2. Regional trends

Much of the relative success of developing countries can be attributed to the Asia-Pacific region, which has shown notable resilience in the challenging economic climate. Asia-Pacific countries attracted $510 billion of FDI in inflows in 2012. Although FDI volumes received in 2012 fell short of the record set in 2011 ($550 billion), they exceeded the annual average for the decade.

In terms of FDI inflows, the developing Asia-Pacific region has significantly outpaced other developing regions in the world. This reflects the solid position of Asia and the Pacific as a leading investment destination for transnational companies looking for investment opportunities. The developing countries in the Asia-Pacific region account for 33% of global inflows compared to the 18% share of countries in Latin America and the Caribbean, and the 4% share of countries in Africa (figure 3.3).

![The developing countries in the Asia-Pacific region account for 33% of global FDI inflows, reflecting the region’s solid position as a leading investment destination.](image)

**FIGURE 3.3** Foreign direct investment inflows to major world developing regions and their share of global foreign direct investment inflows, 2010-2012 (billions of United States dollars and percentage)

*Source:* ESCAP calculations, based on UNCTADStat.
FDI outflows from the region in 2012 totaled $481 billion compared to $484 billion in 2011. The share of the Asia-Pacific region in total world FDI outflows increased from 29% in 2011 to 35% in 2012. Not only are the Asia-Pacific countries proving to be attractive investment destinations in the current economic climate, they are also becoming increasingly important as sources of investment.

3. Subregional trends

Among the developing Asia-Pacific subregions, East and North-East Asia continues to attract the largest amount of FDI inflows, although the South-East Asian subregion is progressively catching up (figure 3.4). FDI inflows to the East and North-East Asian subregion reached $215 billion in 2012, down 8% from the previous year. The decline can be attributed to weaker inflows to China, Hong Kong, China and the Republic of Korea. Mongolia attracted large FDI inflows in 2010 and 2011, mainly driven by investments in the mining sector. In 2012, however, it witnessed a 6% reduction in FDI inflows. This may be due to the new Strategic Foreign Investment Law passed in March 2012, stating that the parliament must approve foreign takeovers in strategic sectors, such as mining. Investors have stated that this law has brought about regulatory uncertainty that weakens Mongolia’s position in attracting FDI.18

The South-East Asian subregion is exhibiting a robust growth trend, which is supported by labour-intensive FDI and value chain activities in low-income countries, such as Cambodia, the Philippines and Viet Nam. In 2012, inflows amounted to $111 billion, up by 2% compared to the previous year. This makes it the only subregion in Asia and the Pacific region that has continued to experience FDI growth despite the slowdown of the global economy.

The year 2012 proved to be tough for South and South-West Asia, as FDI inflows to the subregion dropped by almost a quarter. This development can be largely attributed to India, given its size in the subregion, although several other countries in the subregion also suffered declines in FDI inflows. For example, Sri Lanka and Turkey both saw their FDI inflows fall by a little more than 20%, whereas those of Pakistan fell by 36%.

In 2012, FDI inflows to South-East Asia increased by 2%, making it the only Asia-Pacific subregion that continued to experience FDI inflows growth.

![FIGURE 3.4](image)

Foreign direct investment inflows to Asia-Pacific developing subregions and developed economies, 2010-2012

**Source:** ESCAP calculations, based on UNCTADStat.

**Note:** Due to the small share of inflows to the Pacific subregion, that subregion is not represented in this figure.
North and Central Asia attracts the third largest amount of FDI inflows after East and North-East Asia, and South-East Asia. Inflows to the subregion fell by 5% in 2012, to a value of $74 billion. Accounting for a 70% share of inflows, the Russian Federation has a major impact on subregional developments. Another important destination for FDI is Kazakhstan, inflows to which grew by 1% in 2012. Kazakhstan has traditionally attracted large investments in the natural resources sector, although in 2012 the largest announced greenfield projects were in the tourism, communications and transportation industries.

The developing Pacific subregion attracts less than 1% of FDI inflows to developing countries in the Asia-Pacific region. In 2012, inflows to the subregion increased by 6% and amounted to slightly over $2 billion. Growth in inflows can be mainly attributed to Papua New Guinea and Samoa, although the Marshall Islands and the Northern Mariana Islands experienced larger FDI inflows as well.

FDI inflows to Asia-Pacific least developed countries (LDCs) reached a new peak of almost $5.5 billion in 2012. Driven by increasing inflows to the largest FDI recipient countries among the LDCs, namely Cambodia and Myanmar, inflows to the group increased by almost 10%. FDI inflows to landlocked developing countries (LLDCs) in the region remained at a high level of $26 billion, although they fell, somewhat, from the previous year.

Similar to other developed countries in the world, FDI inflows to the Asia-Pacific developed countries fell by 9% to $62 billion in 2012. Of the three developed countries in the region, only Japan attracted higher FDI inflows than the previous year. After two years of foreign investors scaling down their investments, FDI into Japan reached $1.7 billion. Australia continues to dominate as the largest destination for inflows among developed countries, drawing in $57 billion in 2012. Australia’s resource sector has proven to be highly attractive; however, falling commodity prices mean that investments into areas such as mining could have already reached their peak (Capital Economics, 2013a).

The subregional division of FDI outflows from developing Asia-Pacific countries is not uniform (figure 3.5). The East and North-East Asian subregion accounts for the lion’s share of total outflows from developing countries in the region. Recently, its share has edged up further from 59% in 2011 to 63% in 2012, with total outflows from the subregion at $214 billion. A similar

**Figure 3.5**

Foreign direct investment outflows from Asia-Pacific developing subregions and developed economies, 2010-2012

*Source:* ESCAP calculations, based on UNCTADStat.

*Note:* Due to the small share of outflows from the Pacific subregion, that subregion is not represented in this figure.
increase has taken place in the South-East Asian subregion, with its share of total outflows from developing Asia-Pacific countries increasing from 16 to 18%. Outflows from the subregion now amount to $61 billion. FDI outflows from both South and South-West and North and Central Asia have declined.

The developed countries continue to be a notable source of FDI, increasing their share of outflows from the whole region from 26% in 2011 to 29% in 2012. This increase is largely the result of an increase of outflows from Japan, which contrary to other developed countries in the world has boosted its outward investments. Japan is almost solely responsible for investments from the developed countries in the Asia-Pacific region. Japanese overseas investments have been characterized by being weighted towards the Asia-Pacific region, particularly in the member countries of (ASEAN), and focused heavily on manufacturing projects.

FDI outflows from each of the developing subregions are highly influenced by one dominating economy, just as with FDI inflows. For East and North-East Asia the dominating economy is China, along with Hong Kong, China. In South-East Asia, Singapore remains the largest investor, although outflows from Malaysia are on the rise. In South and South-West Asia, India accounts for 65% of outflows. However, Turkey is catching up, increasing its outflows by 73% in 2012 and now accounting for 31% of total outflows from the subregion. In North and Central Asia the Russian Federation has an even stronger hold on the top position as its share of total outflows is over 90%. Together, these five so-called “FDI giants” supply 73% of FDI originating in the developing Asia-Pacific region.

4. Country highlights

CHINA

China continues to attract high levels of FDI. Investments in 2012 remained at the level of $121 billion, falling slightly short of the peak of $124 billion reached in 2011. Abundant low-cost labour and close proximity to trade networks have been major factors in attracting FDI into China. The country has also taken steps to become more market-friendly and to improve infrastructure. However, recent rising production costs and weakening export markets have pushed foreign companies to relocate from China to lower-income countries. This is reflected in the lack of increase of inward FDI to the country. Despite this, China is still the leading FDI recipient among developing countries and competes with the United States for the position of the largest destination for FDI in the world.

A critical change is the country’s increasing engagement in higher value-added activities. FDI into its high-tech and advanced manufacturing sectors has been on the rise with the country looking to directly compete with more advanced countries, such as Japan or the Republic of Korea. This development is due to the country’s wide-open FDI stance, which has proven to attract valuable new technology and know-how (Capital Economics, 2013b).

Despite rising production costs and weakening export markets, China remains the leading recipient of FDI in the developing world and is attracting investments from developing countries.

China receives an increasing amount of investments from developing countries, especially those in Asia (China Ministry of Commerce, 2013). Moreover, foreign companies are opting for a wholly controlled ownership structure as opposed to previously mandated joint ventures with Chinese partners (Li, 2013). This development may be a reaction to a more liberal investment environment. Additionally, it may be an indication that foreign companies are becoming more familiar with the business culture in China.

In recent years, FDI out of China has mirrored trends in FDI inflows to China. In the past decade FDI outflows from China have grown from a meagre $2.9 billion in 2003 to more than $84 billion in 2012 (figure 3.6). This now makes China the third largest source of FDI in the world, after the United States and Japan.

State-owned enterprises continue to be the most active investors from China, although private companies are also showing interest in investing abroad. While Chinese state-owned enterprises are motivated with the need to secure access
to natural resources, private companies are looking into accessing new and growing markets. Many private companies are also interested in gaining access to new technology and buying brands, which makes developed countries more attractive as investment destinations for Chinese companies (Economist Intelligence Unit, 2013).

![Foreign direct investment inflows and outflows of China, 2003-2012](chart)

**FIGURE 3.6** Foreign direct investment inflows and outflows of China, 2003-2012 (billions of United States dollars)

Chinese investors still largely target other Asian countries; investors looking to expand into new markets prefer to invest in South-East Asia (Hong, 2013). At the same time, Chinese investments in Africa remain strong. These investments have been mainly resource-seeking, but Chinese investors are also involved in several infrastructure upgrading and construction projects in Africa. As for Latin America and the Caribbean, Chinese FDI in Brazil has risen due to the active involvement of Chinese investors in the Brazilian mergers and acquisitions (M&A) market (UNCTAD, 2013a).

**INDIA**

India continued to be the dominant recipient of FDI inflows to South and South-West Asia in 2012. However, inflows to the country dropped by significant 29% in 2012, which is a much bigger decline than the average for all developing economies (-4%) and Asia-Pacific developing countries (-7%). The economy of India experienced its slowest growth in a decade in 2012, and also struggled with risks related to high inflation. In addition to the overall economic situation, a research study conducted by the Reserve Bank of India on FDI flows into the country notes that complex policies and cumbersome procedures could have dampened FDI flows. This relates to land acquisition and environmental regulation, for example. The Government of India has been recently addressing these issues with gradual liberalization of FDI policy. In September 2012, the Government allowed FDI in multi-brand retailing under certain conditions. With the conditions governing multi-brand retail relaxed, foreign retailers are allowed to invest in cities with less than one million inhabitants. They are also given five years to reach the requirement of sourcing 30% of products from small Indian firms. Also, government approval is no longer needed for up to 49% FDI in single-brand retail or petroleum refining. India has also relaxed its rules for FDI in aviation and television broadcasting and 100% foreign ownership in telecommunication companies has been approved (India, Department of Industrial Policy and Promotion, 2012 and 2013). These policy reforms, while preserving...
a desirable policy space to ensure long-term developmental benefits from FDI, together with complementary initiatives to improve the investment environment, will be important to attract FDI flows with high impact in the future. India would also greatly benefit from upgrading its infrastructure and strengthening of ties with key investment and trade partners.

The recent efforts of India to reform FDI policy and simplify investment procedures could not stop FDI inflows falling by 29% in 2012.

The services sector continues to account for the largest share of FDI equity inflows to India (India, Ministry of Commerce and Industry, 2013). Ongoing efforts to open economic sectors, such as retailing, are likely to increase inflows to services. Inflows to manufacturing are expected to increase as well, with a number of major investing countries, including Japan and the Republic of Korea, establishing country or industry specific industrial zones in India (UNCTAD, 2013b). In fact, during 2012 some of the largest greenfield projects in India originated from the Republic of Korea and Japan, targeting the manufacturing industry. Additionally, in 2012 single-brand Swedish retailer IKEA announced that it is planning to invest almost $1.5 billion in opening stores in India.

Investors from Mauritius top the list of investors in India, accounting for 38% of cumulative inflows since 2000. This is mainly due to fiscal incentives that make it advantageous to funnel FDI through Mauritius to India. Singapore and the United Kingdom also increased their investments, taking the second and third place on the list of investing countries and accounting for 10% and 9% of cumulative equity inflows, respectively (India, Ministry of Commerce and Industry, 2013).

India continues to be the leading source of FDI outflows from the South and South-West Asian subregion. It accounts for 65% of the total, despite a 31% decline in outflows in 2012. According to the Reserve Bank of India (2012), outward investments from India tend to take the form of M&A when targeting developed countries and the form of greenfield investments when targeting developing countries. In 2012, the value of M&A deals by Indian companies dropped by over a half, suggesting a reduced interest in investing in developed countries. However, the value of greenfield projects also fell by 28%. A large share of Indian investment is channeled through financial centres, such as Mauritius, Singapore and the Netherlands. This round-tripping, whereby funds are sent out of a country and through another country to take advantage of fiscal measures before returning to the country of origin, over-represents these countries as investment destinations. According to the Reserve Bank of India (2012), in recent years Indian companies have become increasingly interested in the resource sectors in Australia, Indonesia and Africa. In 2012, some of the largest greenfield projects have been the $4.5 billion investment in coal extraction by Adani Enterprises in Australia and the $2 billion investment in natural gas manufacturing by Bharat Petroleum in Mozambique.

JAPAN AND THE REPUBLIC OF KOREA

Following two consecutive years (2010 and 2011) of negative foreign investment flows (disinvestment by foreign investors exceeded FDI inflows), Japan experienced significant growth in FDI in 2012. This brought the value of FDI inflows back into the positive range at $1.7 billion. Despite this, the latest figure is still very weak compared to the levels in the period 2007-2009 (ranging from $12 billion to $24 billion). Continued uncertainty over the Japanese economy is likely to influence the volatility in FDI flows in the years ahead. However, the Government’s recent economic stimulus measures show signs of bringing about renewed growth and could potentially boost FDI flows.

The inflow of FDI remains relatively resilient in the Republic of Korea, with a mild 3% drop in 2012. This is less than the average decrease in East and North East Asia, which was 7% for the same period. In the years ahead, FDI is expected to gradually rise as investors take advantage of the United States-Korea Free Trade Agreement that came into effect in early 2012 and removed tariffs across many sectors.

Japan and the Republic of Korea are also important sources of FDI to the rest of the region.
RUSSIAN FEDERATION

Following a notable 28% increase in 2011, FDI inflows to the Russian Federation fell in 2012 by 7% to $51 billion. The financial and manufacturing sectors received the most investments. Although the latest figure is lower than the country’s record high of $75 billion in 2008, it is still significantly higher than the average over the last ten years ($39 billion). The Foreign Investment Advisory Council (2012) expects FDI in the Russian Federation to rise steadily in the long term; helped by the size of its consumer market, skilled labour force and availability of natural resources. Additionally, accession of the Russian Federation to WTO in 2012 is anticipated to attract new investment into the country.

Round-tripping is one of the characteristics of FDI into the Russian Federation. This process involves the recycling of funds from the Russian Federation to another country, usually a financial hub, and then back to the home country. Many companies find this beneficial for fiscal reasons. Traditionally, Cyprus has been a favoured round-tripping location, although recent economic events have encouraged Russian investors to redirect investments elsewhere. Data from the Central Bank of the Russian Federation (2013) show that net FDI inflows from economies, such as the Bahamas, British Virgin Islands, and Cyprus, continue to be significant. Additionally, European Union members, such as France, Germany, Luxembourg and the Netherlands, have become large investors in the Russian Federation. In terms of sectoral distribution of inward investments, the financial and manufacturing sectors attracted a large share of inflows. The wholesale and retail activity for motor vehicles also attracts investments from abroad.

FDI outflows from the Russian Federation decreased by 24% in 2012, amounting to $51 billion. As discussed above, a large part of investments from the Russian Federation is recycled back into the home country. Therefore, outflows mostly target the same countries where inflows originate. Data from the Central Bank of the Russian Federation (2013) confirm this, showing 43% of net outflows going to Cyprus in 2012.

ASSOCIATION OF SOUTHEAST ASIAN NATIONS

As mentioned earlier, the South-East Asian subregion was the only subregion in Asia and the Pacific to enjoy FDI inflow growth in 2012. Recently, economic integration in ASEAN has intensified, adding to the dynamism of the subregion. With the opening of the ASEAN-5 common trade market in 2014, Indonesia, Singapore, Malaysia, Thailand and Viet Nam are poised to benefit further. Inflows to ASEAN increased by 2% in 2012 to $111 billion, fuelled partly by higher flows to Singapore, which rose by slightly more than 1% to $57 billion. Inflows to low-income countries such as Cambodia, Myanmar, the Philippines and Viet Nam also added to this increase. Cambodia proves to be an attractive destination, especially for labour-intensive FDI and value-chain activities. In 2012, inflows to Cambodia rose by 73%. The level of inflows to Viet Nam remains below the peak of almost $10 billion reached in 2008. Despite this, FDI flows were higher in 2012 than in the previous year. Viet Nam would have to pay more attention to reforming investment policies in order to attract more FDI.

Cambodia, Myanmar, the Philippines and Viet Nam were important contributors to the growth in FDI inflows to ASEAN in 2012.

According to the Organisation for Economic Co-operation and Development (OECD, 2013), each member country of ASEAN appears to specialize in attracting FDI in specific sectors, depending on each country’s comparative advantage and natural endowments relative to regional neighbours. As mentioned, Viet Nam mainly attracts investments in export-oriented manufacturing industries, and also in the real estate and service sectors. Cambodia focuses on garment manufacturing, financial services and agriculture. Investments in the Lao Peoples’ Democratic Republic tend to target the service sector, and in Myanmar the natural resources sector dominates FDI inflows.

Indonesia and Thailand continued to attract high levels of greenfield investments in 2012, particularly in the automotive and metals industries. Indonesia became a star attraction, due to its large and growing population.
Increase in the number of multinationals from Thailand

Over the last decade Thai companies have become increasingly international. This expansion abroad began in the 1990s, but was interrupted by the Asian financial crisis in 1997. In recent years, outward FDI from Thailand has surged (see figure below) as Thai companies look to invest abroad. With this, Thailand is beginning to take on the characteristics of a developed country by becoming a net investor.

Foreign direct investment inflows and outflows to and from Thailand 2005-2012

*Source:* ESCAP calculations, based on Bank of Thailand (2013).

The changing position of Thailand can be linked to broader developments taking place in the Asia-Pacific region. Due to the emergence of global value chains and increased economic integration, intraregional investment flows have increased in significance. As countries’ industries advance and move up the value chain, they start outsourcing and looking for investment opportunities in other countries. Thai investors have chiefly been targeting other member countries of ASEAN, of which Singapore has been a major destination. Thai investments have been driven by companies looking for expansion into new markets, as well as the need to improve efficiency by relocating to countries with lower labour costs.

Additionally, a number of Thai companies have joined the ranks of what may be called the emerging-market multinational enterprises. These companies originate from emerging markets and have acquired a significant international presence. Despite lagging behind countries such as China and India in terms of international expansion, some major Thai companies have been involved in large M&A deals in recent years. These include PTT, Banpu PLC (both in the energy industry), The Siam Cement Group and Thai Beverage PLC. One of the largest deals to date involved PTT buying a stake in a Canadian oil sands project for $2.3 billion in 2011. PTT also bought a United Kingdom-based platinum and nickel exploration company, Cove Energy PLC, in 2012 for close to $2 billion following a bidding withdrawal from Royal Dutch Shell. Through this purchase, PTT gained access to natural gas reserves in Mozambique. Another large deal was Thai Beverage PLC’s acquisition of a $2.2 billion stake in a Singaporean producer and seller of soft drinks, Fraser & Neave Ltd, in 2012. In addition, in 2010 Banpu PLC purchased an Australian coal mining company for $1.6 billion.

While most Thai companies still aim to expand to other markets and look to improve production efficiency by investing in neighbouring countries, there is a rising number of Thai enterprises that focus on international expansion in order to move up the value chain, acquire strategic assets and become global players in their industry. While some companies have already established a strong foothold in international markets, there are many others with the potential to follow.

Furthermore, it is a G20 country with an annual growth rate of about 6% year-on-year, and $1.4 trillion GDP in purchasing power parity terms. Also, in the last decade the country's middle class has expanded from 81 million to 131 million people, indicating increases in domestic purchasing and consumption power within the country (Ernst and Young, 2012).

FDI outflows from the South-East Asian subregion increased in 2012, although the growth rate has slowed compared to the previous year from 24 to 3%. Nevertheless, the value of outflows reached a new record of $61 billion. Singapore, a major contributor to outward FDI flows, accounted for 38% of the total from the subregion. The Philippines and Viet Nam also witnessed increasing outflows in 2012, although far behind those of Singapore. While flows from the Philippines tripled over the course of one year and have been volatile in the past, outflows from Viet Nam have been steadily increasing since 2005. Intraregional FDI flows have increased in recent years, especially among member countries of ASEAN. This has potential to increase further with the establishment of the ASEAN Economic Community in 2015. Recently, FDI outflows from Thailand have also been on the rise, increasing by 45% in 2012 and reaching a record-breaking $12 billion. Thailand is a significant investor in its neighbouring countries; however, lately Thai companies have shown growing interest towards acquiring strategic assets from outside the subregion (see box 3.1).

These developments show that FDI has been, and remains, a critical component of the growth strategy of regional economies. FDI plays an important role in virtually all Asian economies, and working to ensure its inclusive impact should therefore be a policy priority for Governments throughout the region.

B. INTRAREGIONAL FOREIGN DIRECT INVESTMENT

As the economic relevance and dynamism of the Asia-Pacific region increases, intraregional FDI flows are replacing those from the developed economies. These have traditionally supplied the bulk of FDI in the region. East and North-East Asian countries have become major investors in other Asia-Pacific countries, with China and the member countries of ASEAN being the most attractive destinations (figure 3.7). In fact, due to rising levels of integration, ASEAN is becoming a central player in the investment landscape.

The increased economic relevance and dynamism of the Asia-Pacific region has boosted intraregional FDI flows.

The three industries to attract the largest share of intraregional FDI are the coal, oil, and natural gas industry, metals, and real estate. From 2010 to 2012, $66 billion was invested in coal, oil and natural gas, accounting for a 16% share of total intraregional greenfield FDI. Investments in the metals industry for this three-year period were $44 billion, a share of 11% of total investments. Greenfield FDI into the real estate industry more than doubled from 2011 to 2012, reaching $17 billion in 2012, pushing it into third place. Over the period 2010-2012, greenfield investments in the real estate industry totaled $35 billion, a 9% share of total intraregional greenfield FDI.

Overall, total intraregional greenfield FDI flows amounted to $414 billion in 2010-2012. Japan continues to be the main source of investments, accounting for a 26% share ($108 billion) of total intraregional FDI. Japanese investments have targeted automotive industries as well as other component production industries, with automotive original equipment manufacturing (OEM) holding the top investment position.

China is one of the main destinations for Japanese investments, which amounted to $30 billion in 2010-2012. Japanese investors have also shown much interest in the ASEAN region. which attracted over $44 billion in greenfield FDI from Japan during the period 2010-2012. The main investment destinations within the ASEAN region are Indonesia ($11 billion), followed by Thailand ($9 billion) and Viet Nam ($8 billion).

Intraregional greenfield FDI flows from the Republic of Korea declined from $20 billion in 2010 to $13 billion in 2012. However, the country remains a significant source of intraregional greenfield FDI; in the period 2010-2012, $43 billion (10%) of total intraregional greenfield FDI in Asia and the Pacific originated from the Republic of Korea. China attracted close to $11 billion in FDI from the Republic of Korea in that period, and member countries of ASEAN received
$13 billion in investments. India was also a major investment destination, attracting $9 billion of greenfield FDI from the Republic of Korea during the period 2010-2012. Korean companies have been especially attracted to the metals industry in India. One of the largest greenfield projects in India in 2012 was a $1.5 billion manufacturing project in the metals industry by Pohang Iron and Steel. Recently, investors from the Republic of Korea have broadened their focus to Central Asia, Uzbekistan in particular. In 2012, Korea Gas Corporation invested $4 billion in a manufacturing project in the chemicals industry, making Uzbekistan the second largest destination for greenfield FDI from the Republic of Korea in that year.

For the period 2010-2012, China accounted for 10% ($42 billion) of total intraregional greenfield FDI despite the fact that in 2012 outflows from China were less than half of those in 2011. China is a large investor in the ASEAN region, reaching $21 billion in investments over the course of 2010-2012. One of the main destinations, Indonesia, attracted close to $9 billion. Chinese investments are said to be resource-seeking; however, investments targeting South-East Asia are more often motivated by market access or efficiency considerations. The focus appears to be shifting from the resource sector to the service sector (Hong, 2013), and greenfield data supports this, with investments in both the metals and coal, oil and natural gas industries falling significantly in 2012. Apart from the ASEAN region, Chinese investors have shown interest in India and the Russian Federation. India attracted $6 billion and the Russian Federation $4 billion in greenfield FDI. However, China attracted a larger share of intraregional greenfield FDI than it has supplied. During the period 2010-

**FIGURE 3.7** Intraregional greenfield foreign direct investment flows between selected countries and total inflows and outflows to and from those countries, 2010-2012 (billions of United States dollars)

*Source:* ESCAP calculations, based on fDi Intelligence (2013) data.
2012, China attracted $117 billion in greenfield FDI, which accounts for a share of 28% of total intraregional FDI flows. China is attracting investments from throughout the region, with Japan and ASEAN both accounting for close to $30 billion each. Within ASEAN, Singapore is the largest investment source, accounting for a half of the $30 billion.

Due to strengthening integration, ASEAN is becoming a central figure in the investment landscape.

ASEAN, as a group, is an important supplier of intraregional greenfield FDI. In 2010-2012, Singapore and Malaysia both invested a little over $30 billion in greenfield projects within the Asia-Pacific region. Together, they accounted for close to 80% of the $79 billion worth of flows from the member countries of ASEAN. Thailand and Indonesia accounted for $8 billion and $6 billion, respectively. Similar to China, the ASEAN region attracts more intraregional greenfield FDI than it supplies. During the period 2010-2012, a total of $140 billion worth of investments were destined for the ASEAN region. Indonesia, Viet Nam and Singapore were the main destinations, attracting $39 billion, $28 billion and $21 billion, respectively. Also like China, the ASEAN region attracts investments from multiple sources. Japan is the largest investor by far, investing over $44 billion during 2010-2012. In the same period, Chinese investments amounted to over $20 billion, and investment flows from India and the Republic of Korea remained at a more modest $11 billion and $13 billion, respectively.

Since the 1990s, investments among member countries of ASEAN have increased dramatically, with $24 billion having been invested between member countries of ASEAN from January 2010 to December 2012. This trend is anticipated to continue with the establishment of the ASEAN Economic Community, which will create a single market with free flow of goods, services and investments. One of its goals will be to further improve connectivity in the subregion, by integrating industries in order to promote regional sourcing.

CONCLUSION

While developed countries experienced a sharp drop in both in- and outward FDI, developing countries were significantly less affected by the decline in global FDI flows in 2012. In fact, in 2012 developing countries for the first time attracted more FDI than developed countries and they also provided almost one third of global investment outflows. Asia and the Pacific is by far the leading investment destination among the world’s developing regions and at the same time the region is becoming an increasingly important investor on the global level.

Although East and North-East Asia remains the largest recipient and provider of FDI within Asia and the Pacific, South-East Asia was the only subregion to witness growth in both inward and outward FDI in 2012. Low-income countries such as Cambodia, Myanmar, the Philippines and Viet Nam were especially attractive investment destinations. The establishment of the ASEAN Economic Community by 2015 could stimulate further FDI growth. The strong decline of almost one quarter in investment inflows to South and South-West Asia was mainly due to a dramatic drop in FDI inflows to India, where recent FDI liberalization policies have yet to show their effect.

Unlike other developed countries, Japan not only experienced higher FDI inflows in 2012, it also boosted its outward investments, focusing in particular on the member countries of ASEAN. However, continued uncertainty over the economy of Japan is likely to influence the volatility in FDI levels in the years ahead.

Intraregional FDI flows within Asia and the Pacific are on the rise and the region is becoming less dependent on investments from developed economies. Member countries of ASEAN, due to increased regional integration, and China, are attractive destinations for East and North-East Asian investors, which account for the largest share in intraregional investments in the Asia-Pacific region. Thanks to the increasingly dynamic business environment in Asia and the Pacific and the region’s growing economic importance, intraregional investment ties are likely to further be strengthened.
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ONLINE DATABASES


ENDNOTES

15 All FDI data from UNCTADStat, except for greenfield FDI data which is from FDI Intelligence, and data on mergers and acquisitions, which is from Thomson Reuters.

16 Developed and developing economies as defined in UNCTAD (2013b).

17 The Asia-Pacific region here refers to the regional ESCAP member States, plus Taiwan Province of China.

18 See chapter 10 of this Report for a more thorough discussion about regulatory reform in Mongolia.
19 China; India; the Russian Federation; Singapore and Hong Kong, China.

20 Literature indicates a gradual liberalization in FDI policy in China. The Law on Wholly Foreign-Owned Enterprises was adopted in 1986, allowing for full foreign ownership. The rules regarding the implementation of the law were approved in 1990. China’s accession to WTO led to further liberalizations; however, there are still a number of conditions placed on full foreign ownership.

21 The data used in this section are provided by fDi Intelligence, which tracks greenfield FDI project announcements on a global basis. The data are based on information available at the time of the project announcement and, therefore, differ from official FDI flows often based on balance of payments statistics. Discrepancies may arise from the timing of the investment, as the database does not take any phasing of the investment into account. fDi Intelligence also uses its own estimates of capital investment if those data have not been given in the announcement. Finally, there is the question of how capital for the projects is raised. Some of the announced investment may be raised locally, meaning that only a part of the capital invested may manifest itself as actual FDI flows.
INTRODUCTION

The key objective of trade facilitation is to reduce the cost of international trade transactions. This can be achieved through simplification and harmonization of trade procedures. Along with improving the availability of, and access to trade related infrastructure, streamlining trade procedures has become essential for firms in developing countries. It enables them to effectively participate in the regional and global production networks responsible for an increasing share of global trade flows. In this context, this chapter will, first, present selected findings of the recent Asia Pacific Trade Facilitation Forum (APTFF) trade facilitation implementation survey. Second, review the performance of Asia-Pacific economies, based on the ESCAP-World Bank Trade Cost Database. Third, discuss international supply chain connectivity of regional countries. This uses a new index based on data from the World Bank’s Doing Business Report and UNCTAD’s Liner Shipping Connectivity Index (LSCI).
A. TRADE FACILITATION AND PAPERLESS TRADE IMPLEMENTATION IN ASIA-PACIFIC COUNTRIES

Significant progress has been made in trade facilitation in the Asia-Pacific region. However, information on the implementation of specific trade facilitation measures is generally lacking. Which trade facilitation measures have the countries already implemented and are they ready for paperless trade? These are some of the questions that the recent expert survey (Wang and Duval, 2013) attempted to address. The survey was commissioned by ESCAP and the Asian Development Bank as part of the APTFF 2012.

The survey was carried out between September 2012 and January 2013, and results show that implementation of trade facilitation and paperless trade vary significantly across Asian countries (figure 4.1). Not surprisingly, Singapore, Japan, and the Republic of Korea lead in overall implementation, followed closely by Thailand, with the region’s least developed countries and landlocked developing countries generally far behind. But, it is encouraging that many of the countries from the Asia-Pacific region have established national trade facilitation bodies to enable both inter-agency and public-private sector collaboration in trade facilitation.

The survey also covered implementation of some of the measures considered in the WTO draft consolidated negotiating text on trade facilitation. Many countries have made good progress on implementing the eight related measures included in the survey. Figure 4.2 shows that all the countries have, at least partially, implemented some of these measures. More fully implemented measures include the publication of regulation on the Internet, stakeholder consultation on proposed new regulations or procedures and independent appeal mechanisms on rulings of customs and other trade-control agencies. The least implemented measures are pre-arrival clearance and advance ruling. Less than half of the countries surveyed have fully, or partially, implemented advance ruling.

![Figure 4.1: Trade facilitation and paperless trade implementation score of selected Asian countries](image-url)


Note: A large score means advanced level of implementation.
Nearly all Asia-Pacific countries already have some form of electronic customs or other paperless trade systems in place, at least at key border crossings.

The survey also assessed the readiness of countries in terms of implementing paperless trade. Findings are quite encouraging in that regard, as nearly all countries have electronic or automated customs systems in place or under development. At least some customs declarations are submitted electronically in all but one of the country surveyed, and 90% of customs declarations are received in electronic form in half of the countries. However, automation and use of electronic documents beyond the customs declaration is found to be more limited, with 54% of the countries either having or being actively engaged in the development of “single-window systems” for one time submission of information to all trade regulatory agencies. A quarter of the countries still lack a legal framework to support electronic transactions and paperless trade. A little more than one third are involved in cross-border electronic data and documents exchange, essentially on a pilot basis.

B. COMPREHENSIVE TRADE COSTS: AN UPDATE

Last year’s Asia Pacific Trade and Investment Report (ESCAP, 2012a) provided a comparison of intra and extraregional comprehensive trade costs in goods. This is based on the ESCAP-World Bank international trade costs database. Apart from a slight increase across-the-board, relative trade costs among and between subregions remain broadly unchanged.

It remains costlier for Asian subregions to trade with each other than with countries or regions outside Asia and the Pacific.

The closest to the EU-3 (Germany, France and the United Kingdom) trade costs benchmark are the intra-East Asia-3 (China, Japan and the Republic of Korea) and AUS-NZL (Australia-New Zealand) followed by the intra-ASEAN-4 (Indonesia, Malaysia, the Philippines, and Thailand). Interestingly, while trade costs among the East Asia-3 fell between 2000-2005 and 2006-2011, there has been limited progress in further reducing trade costs among the main ASEAN economies during those periods. This is despite a series of agreements aimed at facilitating trade and forming an ASEAN Economic Community. Intraregional trade costs for North and Central Asian countries are the highest of all Asia-Pacific subregions, at more than three times intra-EU-3 trade costs. However, trade costs among both South Asian (SAARC-4) and Pacific island developing economies also remain excessively high, at twice the usual costs in the three largest European Union economies.
Table 4.1 also shows that in most cases, it is still more costly to trade between Asian subregions than between Asian subregions and countries, or regions outside the Asia-Pacific region. For example, the cost of trading between ASEAN-4 and SAARC-4 is almost double than between ASEAN-4 and the United States. Similarly, trade costs between North and Central Asia and ASEAN-4 are more than twice those between North and Central Asia and EU-3. Similarly, trade cost between Pacific island developing economies and ASEAN-4 is much higher than between those economies and the United States. An exception to the general lack of intraregional trade connectivity between Asia-Pacific subregions is the link between East and South-East Asia. Trade costs between these two subregions are found to be similar to those prevailing in intra-ASEAN trade.

There are considerable disparities in trade costs between countries. This is highlighted when comparing the comprehensive trade costs (excluding tariffs) between selected economies and both China and the United States (figure 4.3). More than half of the countries find that trading with the United States is still cheaper than with the regional power-house China. For some landlocked and Pacific island developing economies, full trade costs with China are significantly higher, up to one and half times their trade costs with the United States. The Republic of Korea has the lowest trade costs with China, while it also has the lowest trade costs with the United States of America.

Small island and landlocked developing economies often have trade cost twice as high as those of other developing countries in the Asia-Pacific region.

Expectedly, it is the small islands or landlocked developing countries that incur the highest trade costs with both China and the United States. For example, trade costs of Bhutan with China and the United States are 10 times and five

### TABLE 4.1

<table>
<thead>
<tr>
<th>Region</th>
<th>ASEAN-4</th>
<th>East Asia</th>
<th>North and Central Asia</th>
<th>Pacific Islands Developing Economies</th>
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<th>AUS-NZL</th>
<th>EU-3</th>
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<td>308 (17)</td>
<td>107 (-31)</td>
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<td>268 (36)</td>
<td>308 (17)</td>
<td>107 (-31)</td>
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<tr>
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<td>124 (2)</td>
<td>270 (-10)</td>
<td>342 (13)</td>
<td>107 (4)</td>
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</tr>
<tr>
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<td>323 (-5)</td>
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<td>189 (2)</td>
<td>228 (19)</td>
<td>107 (8)</td>
<td>97 (2)</td>
<td>67 (1)</td>
</tr>
</tbody>
</table>


*Notes:* Trade costs may be interpreted as tariff equivalents. Percentage changes in trade costs between 2000-2005 and 2006-2011 are in parentheses.

ASEAN-4: Indonesia, Malaysia, Philippines, Thailand; East Asia-3: China, Japan, Republic of Korea; EU-3: Germany, France, United Kingdom; SAARC-4: Bangladesh, India, Pakistan, Sri Lanka; Pacific island developing economies: Fiji, Papua New Guinea, Tonga, Vanuatu; North and Central Asia: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Russian Federation.
times more than those of the Republic of Korea, respectively. For some small island economies the average cost with China is about three to four times to those of South-East Asian countries (such as Malaysia, Viet Nam and Thailand). Most of the least developed countries in Asia have significantly higher trade costs than developing countries. Even Bangladesh, the best performer among least developed countries, has close to double the trade costs of Malaysia with both China and the United States.

Disparities in international trade costs are not only significant across countries, but also across sectors. Agricultural goods’ trade costs are much higher than trade costs for manufacturing goods, even after excluding tariff costs (figure 4.4). This could be attributed to the fundamental nature of agricultural and food products and, in many cases, their perishability. In many of the region’s developing countries agricultural trade costs have not decreased much between 2000 and 2005 and 2006 and 2011. Given the importance of the agricultural sector in reducing poverty, as well as sustainable and inclusive development, and the persistence of often complex regulatory procedures involved in trading agricultural and

**FIGURE 4.3** Bilateral trade costs (excluding tariffs): selected economies with China and the United States, 2006-2011

food products, implementing trade facilitation reforms specifically targeted at this sector ought to be considered. This may be particularly important in some of the least developed countries of the region. Currently, many are not able to meet required standards in prospective export markets for their agricultural and food products. They also face the challenge of high costs due to their underdeveloped logistics sector.27

On that basis, an International Supply Chain Connectivity Index (ISCCI) calculates the overall trade facilitation performance of a country along the international supply chain. This index is based on the trading across border (TAB) indicators from the World Bank Doing Business Report and the Liner Shipping Connectivity Index (LSCI) of UNCTAD. The Index provides an overall performance score for a particular country based on its performance in terms of (1) TAB underlying import indicators (i.e. number of documents, time, and cost involved in import); (2) TAB underlying export indicators (i.e. number of documents, time, and cost involved in export); and (3) the UNCTAD LSCI score.29 Equal weight (one third) is given to import, export and liner shipping performance.

C. INTERNATIONAL SUPPLY CHAIN CONNECTIVITY

In its simplest form, an international supply chain involves moving goods from a production facility in one country to a distribution center (or warehouse) in another country. In a regional and global production network context, facilitating trade for a given country involves (1) facilitating import of parts and components and their movement to a production facility, as well as (2) facilitating export of the processed good from the production facility to the port. Taking into account that around 80% of international trade still takes place via seaports, a country’s participation in international supply chains therefore depends not only on the efficiency of the procedures associated with moving goods from (to) factory to (from) the port but also on how well that port is connected to other countries (figure 4.5).

FIGURE 4.4 Comprehensive trade costs (excluding tariffs) in agricultural goods with Japan, 2000-2005 and 2006-2011

The world’s top five best connected economies to international supply chains are all Asia-Pacific economies.

The top five world performers (out of 180 economies), are all Asia-Pacific economies, namely: Singapore; Hong Kong, China; Republic of Korea; China; and Malaysia in terms of their connectivity to international supply chains, and based on ISCCI, those top performers are followed by developed economies from other regions in the world – France, the Netherlands, the United States, Germany and the United Kingdom. In general, East and South-East Asian countries have better ISCCI than those from other subregions in Asia and the Pacific. Mongolia, although landlocked, ranks higher than many of the other Asia-Pacific countries, as it uses China’s maritime ports – and according to the LSCI, China ranks first. South Asia and Central Asia subregions fare much worse, with Sri Lanka being the only country within the top tier of the 180 countries included in the ISCCI ranking. The landlocked Central Asian countries rank the lowest.

When looking at ISCCI, TAB and LSCI individually, the contrast in performance among Asia-Pacific countries is as evident in all three. However, the relative performance of countries as measured by ISCCI is sometimes quite different from that implied from TAB or LSCI alone. Although performance (in terms of export procedures, import procedures and liner shipping connectivity) is weighted equally in ISCCI, the relative contribution of these three components differs in the final score. This is due to each country having achieved different performance levels in each area (figure 4.6).

A country that has efficient at- and behind-the-border trade procedures (as measured by TAB indicators) may not have access to efficient international maritime logistics and shipping services (as measured by LSCI), or vice versa. Table 4.2 provides some indication how countries differ in their rankings based on the World Bank TAB ranking 30 and UNCTAD LSCI.

Overall, the international supply chain connectivity of Asia-Pacific countries has improved. Figure 4.7 shows the evolution of an economy’s performance between 2006 and 2012. The highest ranked economies have been able to improve or retain their strong performances over time. These economies are Singapore; Hong Kong, China; and Malaysia. Thailand and the Republic of Korea have done exceptionally well, improving their connectivity scores by more than 30% between 2006 and 2012. Among the low income economies in the Asia-Pacific region, Viet Nam made the most progress, in particular from 2009 to 2012. Although the ISCCI trend has been positive for most countries in the region, there was little improvement in least developed economies and landlocked developing economies scores from 2006 to 2012.

ISCCI provides some useful insights on how to improve international supply chain connectivity. In contrast to the other top five economies (whose import, export and liner shipping connectivity performance appear well balanced), the strong performance of China is essentially due to its international seaport connectivity. This suggests that increasing attention to efficiency of at- and behind-the-border procedures may be most beneficial [see figure 4.6 and table 4.2]. The Philippines, on the other hand, could focus...
Contributing to export, import and liner shipping connectivity performance to international supply chain connectivity

Source: ESCAP, ISCCI data for 2012.

Performance rankings according to trading across border indicators, Liner Shipping Connectivity Index and International Supply Chain Connectivity Index, 2012

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
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<td>4</td>
<td>1</td>
<td>Philippines</td>
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<td>94</td>
<td>59</td>
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<tr>
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<td>3</td>
<td>2</td>
<td>Pakistan</td>
<td>85</td>
<td>69</td>
<td>61</td>
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<tr>
<td>Rep. of Korea</td>
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<td>5</td>
<td>3</td>
<td>India</td>
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<td>71</td>
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<tr>
<td>China</td>
<td>68</td>
<td>1</td>
<td>4</td>
<td>Azerbaijan</td>
<td>169</td>
<td>26</td>
<td>86</td>
</tr>
<tr>
<td>Malaysia</td>
<td>11</td>
<td>6</td>
<td>5</td>
<td>Lao People’s Democratic Republic</td>
<td>160</td>
<td>48</td>
<td>114</td>
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<td>United States</td>
<td>22</td>
<td>7</td>
<td>8</td>
<td>Russian Federation</td>
<td>162</td>
<td>53</td>
<td>118</td>
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<tr>
<td>Germany</td>
<td>13</td>
<td>9</td>
<td>9</td>
<td>Nepal</td>
<td>171</td>
<td>43</td>
<td>119</td>
</tr>
<tr>
<td>Japan</td>
<td>19</td>
<td>20</td>
<td>17</td>
<td>Iran (Islamic Republic of)</td>
<td>143</td>
<td>80</td>
<td>125</td>
</tr>
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<td>Thailand</td>
<td>20</td>
<td>49</td>
<td>33</td>
<td>Bangladesh</td>
<td>119</td>
<td>137</td>
<td>137</td>
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<tr>
<td>Viet Nam</td>
<td>74</td>
<td>29</td>
<td>37</td>
<td>Cambodia</td>
<td>118</td>
<td>182</td>
<td>138</td>
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<tr>
<td>Sri Lanka</td>
<td>56</td>
<td>38</td>
<td>41</td>
<td>Kyrgyzstan</td>
<td>174</td>
<td>52</td>
<td>144</td>
</tr>
<tr>
<td>Indonesia</td>
<td>37</td>
<td>72</td>
<td>46</td>
<td>Kazakhstan</td>
<td>182</td>
<td>51</td>
<td>151</td>
</tr>
<tr>
<td>New Zealand</td>
<td>25</td>
<td>88</td>
<td>48</td>
<td>Uzbekistan</td>
<td>185</td>
<td>54</td>
<td>160</td>
</tr>
<tr>
<td>Australia</td>
<td>44</td>
<td>67</td>
<td>49</td>
<td>Tajikistan</td>
<td>184</td>
<td>70</td>
<td>171</td>
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<td>Mongolia</td>
<td>175</td>
<td>2</td>
<td>57</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: ESCAP, ISCCI data for 2012.

Notes: TAB rankings are based on World Bank Doing Business data and LSCI rankings are from UNCTAD. The data reported in the World Bank Doing Business Report 2013 are from June 2012. The data reported in UNCTAD LSCI 2012 are from 2012.

Notes: LSCI ranking of a landlocked country is based on the rank of the main transit country; ISCC rankings are based on ESCAP calculations.
more on improving its international maritime infrastructure and services. The country’s performance, in terms of import and export procedures, is relatively better than its LSCI performance. Bangladesh, Cambodia and Papua New Guinea also seem to be in particular need of improving maritime connectivity. There is also significant room for improvement in import and export procedures for all three countries.

The ISSCI performance of landlocked countries, including Bhutan, Nepal, the Lao People’s Democratic Republic, Mongolia and those in Central Asia is largely supported by their LSCI performance namely international connectivity of ports in their respective transit countries. These countries have no direct control over the transit ports. Therefore, improving supply chain connectivity for these countries will crucially depend on enhancing their import and export procedures. This includes streamlining documentation requirements: technical and customs controls and inland transport, as well as handling of both within their borders and in the transit country.

Notably, improving liner shipping connectivity may not be easily feasible for small countries. There is a lack of an economic rationale for developing the infrastructure to accommodate large ships, and also for shipping lines to service the ports in these countries. This is particularly true for small isolated countries, such as Fiji, Solomon Islands and Maldives as seen by the generally marginal contribution of LSCI to their overall ISCCI performance.

CONCLUSION

This chapter provides an overview of the trade facilitation situation in Asia and the Pacific. It highlights both the enormous performance gaps between regional countries and the significant scope for further reduction of trade costs and enhancement of supply chain connectivity. Successful WTO trade facilitation negotiations would be useful in providing guidance and a renewed mandate for countries to engage in reform. A regional arrangement on facilitation...
of cross-border paperless trade, would be helpful in reducing gaps between the region’s countries. It would also be helpful to confirm the region’s leadership in use of information and communication technologies for inclusive and sustainable trade and development. This has been similarly envisaged in ESCAP resolution 68/3 of 23 May 2012 on enabling paperless trade and cross-border recognition of electronic data and documents for inclusive and sustainable intraregional trade facilitation.

As the importance of reducing trade transaction costs continues to grow, the need to measure trade facilitation performance from various perspectives is evolving. This chapter presented a variety of country-level indicators to evaluate the trade facilitation situation and progress made. These indicators and other indices, such as the World Bank Logistics Performance Index (LPI), are useful in providing a general view of where a country stands relative to others. However, they do not provide the level of details or accuracy needed for policymakers to identify the actual reforms needed or the trade facilitation measures to be prioritized. Therefore, it is important that countries develop their own trade facilitation monitoring mechanisms. This will provide the micro-level information needed to make concrete progress and identify bottlenecks along the international trade transaction chain.31

REFERENCES


ONLINE DATABASES


ENDNOTES

31 Data were collected for 26 Asian countries in the survey. Refer to figure 4.1 for the list of countries.

23 These include the following countries: Azerbaijan, Bangladesh, Cambodia, Lao People’s Democratic Republic, Mongolia and Nepal.


25 See Arvis and others (2012) for an introduction to this database.

26 In words, the data suggest that, on average, trading goods between ASEAN-4 and SAARC-4 would involve, on average for all tradable goods, additional costs amounting to approximately 124% of the value of goods – as compared to when the two countries trade these goods within their borders. Using the same approach, costs of trade between ASEAN-4 and the United States are approximately 84%.

27 See ESCAP (2012b).

28 This may include Document preparation, Inland transportation, Technical & Customs clearance and Port and terminal handling.

29 TAB indicators only cover documentation, time and cost involved in moving goods from (to) the factory to (from) the port. In contrast, UNCTAD LSCI measures the level a country’s integration into global shipping networks and is based on (1) the number of ships, (2) the total container-capacity, (3) the number of port services, (4) maximum vessel size, and (5) the number of companies involved in container shipping services from and to the country’s seaports.

30 TAB ranking is issued by the World Bank based on three import and three export indicators. They are available from http://www.doingbusiness.org/rankings

31 The BPA+ methodology may be considered for developing such systems. For details refer to ESCAP (2013).
INTRODUCTION

Governments have been actively using various trade policy instruments in the aftermath of the global financial crisis but there has not been a widespread resort to protectionism. The result has been a mix of trade protectionism and trade promotion. This chapter explores how Governments in Asia and the Pacific adjusted the scale and composition of their trade policies in response to the uncertainties present in the aftermath of the global financial crisis. It also looks at the rationales behind these adjustments. The impact of some of these measures on trade flows and affected sectors are assessed. This evaluation is complemented by an Index of Protectionism Severity, which aims to provide a simple measure of the impact of protectionist policies.
A. TRADE POLICY DEVELOPMENTS

The apparent slowing in the introduction of new trade restrictions which was noted in two recent WTO reports (2012, 2013a) does not necessarily imply a policy shift away from protectionism. These new restrictions, even if fewer in number, get added to those already in place. Experience shows that, once implemented, measures are rarely removed.

Turning to the monitoring of protectionist activity, it needs to be noted that the new measures observed in the latest period (that is, mid-October 2012 to mid-May 2013) are not fully comparable with those in earlier periods. This is particularly so in terms of their trade restrictiveness and potential impact on trade flows. Some measures may apply to only one specific product or place of origin, while others may affect a basket of products from many places of origin. Moreover, some measures do not apply to partners in trade agreements. Therefore, it is difficult to accurately assess the protectionist impact of measures introduced in one period compared to those from another period.

While the pace of adding new trade restrictions has been lessening, the removal of already imposed measures remains slow too.

Based on the new methodology used in the WTO reports,32 the category “other trade and trade-related measures” includes new tariffs and tariff hikes. Also included are other restrictive measures related to customs procedures, other taxes on imports, quantitative restrictions for imports or exports and export duties.33 During the period from mid-October 2011 to mid-May 2013 (the reporting period), a total of 232 measures were recorded in this category. Out of this total, 182 apply to imports, (which covers around 1.6% of world merchandise imports, see table 5.1). However, one also has to keep in mind that trade restrictive measures are not the only measures distorting trade.

The Asia-Pacific region introduced 99 of the import measures34 recorded by WTO and the Global Trade Alert (GTA).35 Tariff increases in the region mainly affected the import of minerals, machinery, vehicles and food items.

However, there were more tariff reductions than tariff increases (table 5.2). Tariff liberalization covers the bulk of liberalizing measures presented by WTO (2012 and 2013a): 163 measures out of a total of 214. In addition to tariff reductions, the group of liberalizing measures also includes the streamlining of customs procedures and the elimination or reduction of import taxes, quantitative restrictions and export duties. It is estimated that the 185 reported liberalizing measures cover around 3.5% of world merchandise imports.

In Asia and the Pacific, 82 liberalizing measures have been recorded; out of which 54 imply decreases in or elimination of tariffs. Implemented measures are concentrated in import facilitation of: food products, minerals, raw materials and components used in the production of other goods. This reflects the efforts of importing countries to lower prices for goods used by domestic industries and/or consumed by households. Governments seeking to contain food price increases in their domestic markets opted to pursue a reduction of tariffs on food products (World Bank, 2011).36

### TABLE 5.1

New trade and trade-related restrictive measures

<table>
<thead>
<tr>
<th>Type of measure</th>
<th>World</th>
<th>Asia-Pacific region</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import</td>
<td>168</td>
<td>66</td>
</tr>
<tr>
<td>of which Tariffs</td>
<td>91</td>
<td>37</td>
</tr>
<tr>
<td>Export</td>
<td>42</td>
<td>24</td>
</tr>
<tr>
<td>Other</td>
<td>22</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>232</td>
<td>99</td>
</tr>
</tbody>
</table>

Source: ESCAP calculations, based on data from WTO (2012 and 2013a).
Trade liberalization, mainly through reduction of tariffs, reflects efforts to lower prices of food and/or intermediate goods.

Trade restrictive measures other than tariffs are generally less transparent, and therefore likely to generate greater distortions. Table 5.1 shows that more than two thirds of the measures imposed (both regionally and globally) belong to this category. Only a small portion of these measures have been terminated, as shown in table 5.2. Moreover, a significant proportion of these measures were imposed on exports, especially on food products, raw materials and minerals. This, again, can be related to efforts by governments to contain product price hikes in the domestic market.

The GTA database shows a higher number of measures, other than tariffs, compared with estimations presented in WTO reports. The gap is due to different methods of data collection used by the two institutions, as well as to the wider range of categories considered in GTA database. In the period reviewed, 178 of these less-transparent measures have been implemented by countries in Asia and the Pacific, while 55 have been removed or have involved liberalization.

To restrict trade, more opaque measures are often preferred; these are mainly affecting the import of minerals, machinery, vehicles and food items.

### TABLE 5.2

<table>
<thead>
<tr>
<th>Type of measure</th>
<th>World</th>
<th>Asia-Pacific region</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import</td>
<td>185</td>
<td>67</td>
</tr>
<tr>
<td>of which Tariffs</td>
<td>163</td>
<td>54</td>
</tr>
<tr>
<td>Export</td>
<td>21</td>
<td>12</td>
</tr>
<tr>
<td>Other</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>214</td>
<td>82</td>
</tr>
</tbody>
</table>

Source: ESCAP calculations, based on data from WTO (2012 and 2013a).

### FIGURE 5.1

Sectoral composition of less transparent measures

According to GTA data, since mid-October 2011, the countries responsible for the majority of protectionist measures using less-transparent means are the Russian Federation (63 measures), Japan (33), Indonesia (24), Australia (15), China (9) and Kazakhstan (9). Liberalizing measures, other than tariff liberalization, have been implemented mainly by China (15), India (15) and the Russian Federation (11). The manufacturing sector is the most affected by these less-transparent measures, both in the region and globally. This is followed by the agricultural sector (figure 5.1).

The manufacturing sector is the most affected by less transparent measures, both in the region and globally, followed by the agricultural sector.

Regarding trade remedies at the global level, 427 measures were recorded by WTO over mid-October 2011 to mid-May 2013. Of these, 139 were implemented in the Asia-Pacific region (table 5.3). More specifically, 92 measures initiated trade remedy investigations and 47 measures terminated either investigations or duties.

The products targeted by trade remedy measures are steel, organic chemicals, machinery and mechanical appliances, paper and man-made staple fibres. As the products targeted by trade remedies have not changed in the aftermath of the financial crisis, we infer that firms have not been demanding trade defence actions to deal with the crisis-induced market pressures (World Bank, 2011). However, this is not uniform and some countries have been significantly affected by these pressures. China faces considerably higher anti-dumping duties on its products than other countries (Bown, 2010). Bown (2011) also finds that the use of anti-dumping measures is increasingly becoming a South-South phenomenon, with China being the main target.

Despite the large number of trade remedy instruments initiated, their impact on trade volumes is modest. According to WTO (2012 and 2013a) estimations, around 0.5% of world merchandise imports have been affected by these initiations and 0.2% of imports have benefitted by termination of trade defence measures. The vast majority of trade remedies concern anti-dumping actions. They are product and firm specific as opposed to safeguards, which tend to affect broader industries and trading partners.

WTO reporting and monitoring initiatives also include sanitary and phytosanitary (SPS) measures, as well as technical barriers to trade (TBT). SPS measures can often be appropriately imposed to ensure public safety, but they usually have a negative impact on trade. From October 2011 to September 2012, 885 SPS notifications (regular and emergency) were submitted to the WTO (2012). From this total, 252 have been regionally implemented, mainly by China (64 measures), the Republic of Korea (32) and Australia (30). The SPS Information Management System allows for the analysis of the most recent trends. Since October 2012, 246 SPS notifications (regular and emergency) have been submitted.

### TABLE 5.3

<table>
<thead>
<tr>
<th>Trade remedies</th>
<th>World</th>
<th>Asia-Pacific</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initiation</strong></td>
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<td></td>
</tr>
<tr>
<td>Antidumping</td>
<td>244</td>
<td>64</td>
</tr>
<tr>
<td>Safeguards</td>
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<td></td>
</tr>
<tr>
<td>Countervailing</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td><strong>Termination</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Antidumping</td>
<td>183</td>
<td>47</td>
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<tr>
<td>Safeguards</td>
<td>37</td>
<td></td>
</tr>
<tr>
<td>Countervailing</td>
<td>9</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** ESCAP calculations, based on data from WTO (2012 and 2013a).
to the WTO from countries in the region. China leads with 79 of those notifications.45

From 1 October 2011 to 30 September 2012, more than 2,300 TBT notifications were reported to WTO; 404 of those were implemented by the Asia-Pacific region (WTO, 2012).46 According to the TBT Information Management System, 1,723 new notifications have been reported since October 2012; 316 are in the region.47

SPS and TBT can be particularly detrimental for the least developed countries due to the relatively higher cost of adjusting to the different standard requirements. When SPS and TBT target the agriculture sector, least developed countries are especially vulnerable to market exclusion, as this sector is more important to the economy and export composition of these countries (WTO, 2013b). OECD (2013) estimates that savings from a reduction of these measures could cover a significant portion of the import value of agriculture trade in selected countries (69.1% for the Russian Federation, 44.8% for China, 37.9% for the Republic of Korea, 36.5% for India).

For a more comprehensive assessment, an analysis of the measures implemented can be complemented with an assessment of their coverage in terms of the basket of trading partners, tariff lines and sectors affected as well as reflecting the total number of “red measures”48 undertaken since November 2008 (table 5.4). The Index of Protectionism Severity (IPS) summarizes these four aspects into a single indicator, whose value ranges from a maximum of 1 (most severe) to 0 (no harm caused). The index covers all the measures implemented since November 2008, and table 5.4 and figure 5.2 illustrate the scores for some Asia-Pacific countries.49

To quantify the impact of the post-crisis wave of trade policies, analysis that goes beyond stocktaking is needed. So far, only Henn and McDonald (2011) have attempted to provide a comprehensive quantitative assessment of the trade impact of post-crisis protectionism. They matched discriminatory measures from GTA database50 with HS 4-digit level bilateral trade data from the Global Trade Information Services. They found trade flows of products affected by restrictions decreased between 5 and 8%, with behind-the-border measures distorting trade seven times more than a typical border measure.51 Their findings also support the consensus emerging in recent literature, which focuses on non-tariff barriers as the main distorters of trade. Impact of tariff measures has been found to be statistically insignificant, although the number of implemented measures is relatively high. Border measures other than tariffs are found to have a stronger impact at the product level when narrowly focused (as in the case of anti-dumping measures). There is also a stronger impact on aggregate trade when measures are diffused (as in the case of consumption subsidies and local content requirements). Behind-the-border measures seem to have the same impact both at the product level and in aggregate. As for the sectors affected, border measures show statistically significant reductions in imports of the textile and machinery industries.

### TABLE 5.4

<table>
<thead>
<tr>
<th></th>
<th>Tariff lines affected</th>
<th>Sectors affected</th>
<th>Trading partners affected</th>
<th>Total “red measures” implemented</th>
<th>Overall index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russian Federation</td>
<td>0.51</td>
<td>1.00</td>
<td>0.76</td>
<td>1.00</td>
<td>1.00</td>
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<tr>
<td>China</td>
<td>0.75</td>
<td>0.98</td>
<td>1.00</td>
<td>0.34</td>
<td>0.94</td>
</tr>
<tr>
<td>India</td>
<td>0.58</td>
<td>0.68</td>
<td>0.89</td>
<td>0.58</td>
<td>0.84</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>1.00</td>
<td>0.74</td>
<td>0.78</td>
<td>0.14</td>
<td>0.81</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>0.78</td>
<td>0.94</td>
<td>0.56</td>
<td>0.31</td>
<td>0.79</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.59</td>
<td>0.79</td>
<td>0.88</td>
<td>0.29</td>
<td>0.78</td>
</tr>
<tr>
<td>Japan</td>
<td>0.21</td>
<td>0.58</td>
<td>0.70</td>
<td>0.30</td>
<td>0.55</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>0.21</td>
<td>0.64</td>
<td>0.64</td>
<td>0.09</td>
<td>0.48</td>
</tr>
<tr>
<td>Australia</td>
<td>0.05</td>
<td>0.75</td>
<td>0.39</td>
<td>0.18</td>
<td>0.42</td>
</tr>
<tr>
<td>Iran, Islamic Rep.</td>
<td>0.18</td>
<td>0.60</td>
<td>0.35</td>
<td>0.04</td>
<td>0.36</td>
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</tbody>
</table>

Source: ESCAP calculations from GTA database (see annex1). Accessed 31 July 2013.
(with estimates of -7% and -5%, respectively). Behind-the-border measures mainly obstruct imports of machinery and transport equipment, reducing affected flows by 12%, on average. However, complete removal of protectionist measures that were implemented up to early 2010 could boost annual world trade by 0.2%. This is a small, though not negligible, impact.\(^52\)

The stimulus effect of liberalizing measures has been quite strong.

In the latest WTO Report on G-20 Trade Measures (WTO, 2013c), the WTO secretariat has, for the first time, given an estimate of the trade impact of import-restrictive measures used since October 2008.\(^53\) The cumulative trade impact of these import restrictions is estimated to be around 0.2% of world merchandise imports. As stated in the report, this low aggregate percentage illustrates that, most countries, overall, seem to have resisted resorting to widespread protectionism.

It is also important to consider the effect of liberalizing measures against the negative impact of trade protectionism. Fiscal and monetary stimulus measures have also benefitted many countries by generating demand for imports (ESCAP, 2013; World Bank, 2011 and WTO, 2013a). The WTO reports a change in the composition of government support measures, with fewer measures involving big stimulus packages and more involving economic assistance and support to specific sectors. From mid-October 2011 to mid-May 2013, reported measures were mainly in the form of rescue aid for specific industries, restructuring aid, export support, general financial support in the form of insurance, guarantee and credit, and support to innovation and energy efficient technologies. In many cases, assistance was aimed at small and medium-sized enterprises. The sectors that benefitted from this were motor vehicles, textiles, coal, shipping, transport and tourism, and selected agricultural sub-sectors (e.g. pig meat processing, rice, and dairy producers). Out of the 165 measures presented in the WTO reports (2012 and 2013a), 33 have been implemented in Asia and the Pacific.
B. INTERDEPENDENCY AS A DETERRENT

Recent trade policy developments responding to the crisis do not appear to reflect traditional political economy dynamics, where domestic actors lobby for protection. As argued by many contributors in Baldwin (ed.) (2009), the trade collapse was actually triggered by the fall of demand rather than by the imposition of restrictive measures.

WTO trade rules and disciplines alone cannot explain why countries did not resort to protectionism. In the case of developing countries, there is a notable policy space guaranteed by the difference between binding ceiling and applied tariffs which allows countries to raise levels of protection without fear of retaliation by trading partners. Countries seem to have not taken advantage of this in response to the crisis. Further, actual coverage of WTO regulation is limited, given that part of global trade is not subject to effective binding disciplines.

However, the role of international institutions and trade agreements has been essential in fostering a liberal international trade (and investment) environment, allowing countries to be more interconnected. The decades-long process of multilateral and unilateral liberalization and increased stability in the trade environment have facilitated the proliferation of global supply chains. These have been a potent force for maintaining open markets and diminishing the commercial and political appeal of protectionism. The consequently changed nature of global production and trade seems to have restrained countries from implementing protectionist measures, as well as encouraged trade liberalization in certain sectors. Trade in intermediates intrinsically discourages protectionism, as it penalizes the downstream domestic industries that rely on these imports.

In general, the increased interest of retailers and consumers in the internationalization of production, and the rise of intra-firm trade, have resulted in decreased influence for the import-competing sector, and therefore produced trade policies less skewed in favour of these sectors.

Not only have international and non-governmental institutions succeeded in creating a general and strong consensus that protectionism is generally bad for overall country welfare, but they have also actively organized trade policy monitoring initiatives which have played an important role recently in restraining countries from engaging in protectionism.

Changing global production and trade have played an important role in fomenting trade liberalization in certain sectors.

FIGURE 5.3

Weakened growth and protectionist pressures tend to move together

Source: ESCAP calculation, based on data from UN ESCAP Statistical Yearbook 2012 and World Bank, World Development Indicators.
FIGURE 5.4
Difference in average bound and MFN-applied rates for Asia and the Pacific economies, 2011-2012

Another reason that there has not been a surge in protectionism is related to the availability of macroeconomic tools to stimulate aggregate demand. During the Great Depression, countries that remained in the gold standard resorted to tariffs and similar measures to shift demand toward domestic production and tackle the urgent problem of rising unemployment because the lack of perceived alternatives. However, these constrains did not hold during the recent global financial crisis. Therefore, countries could benefit from flexible exchange rates and were able to respond by using macroeconomic stimulus. The concerted macro-policy responses played an important role in the sharp recovery of trade by late 2009. These measures contributed in containing the length and strength of the recession, and therefore the appeal of protectionism. Moreover, automatic stabilizers and social safety nets (that were almost absent in the 1930s) helped maintain macroeconomic stability, and cushioned the shock on the most vulnerable (Dadush, Ali and Odell, 2011, ESCAP 2013).

C. TARIFFS STILL REMAIN AN OBSTACLE TO TRADE FOR DEVELOPING COUNTRIES

Even though there was no major surge in discriminatory actions, protectionist pressures are far from gone. The slowdown of the global economy since 2011 has revived pressures on Governments to promote domestic economic activities. The ratio of discriminatory to liberalizing measures\(^57\) has recently moved together with the falling of GDP growth rates (figure 5.3).

The ratio of discriminatory to liberalizing measures implemented by countries in Asia and the Pacific has been decreasing from its peak in late 2008 to 2011. Since then it has started to increase again, following the deterioration in average GDP growth rate in the region. The incentives to engage in traditional protectionism still continue to prevail, and continue to be tied to the countries’ structure of production (World Bank, 2011). In particular, Governments may have an incentive to raise tariffs on inputs and/or final products when the country has a significant parts and components industry, but is less integrated into global value chains.

Tariffs continue to affect trade costs and still distort international trade. This is despite having been significantly reduced by the combined impact of unilateral, regional and multilateral tariff liberalization. In industrialized countries, where average applied MFN tariff rates are relatively low, tariff peaks in certain sectors represent a considerable hindrance to economic efficiency and are a matter of concern to many economies. In general, tariff protection is still higher in developing countries, reflecting existing use of tariffs as an incentive to industrialization or a source of budget revenues. Figure 5.4 shows the levels of so-called policy space for both all and agriculture products. Generally, there have not been major changes in the levels of bound and MFN applied tariffs in the region. The only exceptions have been Japan and Cambodia. In Japan, the level of bound tariffs has increased by 1.9% and the level of MFN applied tariff rate by 6%. In Cambodia, the level of bound tariffs remained the same, but the level of MFN applied rate decreased by almost 3%. For all product, the average bound tariff rate did not change significantly while the only countries to report a notable change in the average MFN applied tariff rate are Malaysia (which reported a slight decrease of 1.5%) and Fiji (with an increase of 5.8%).

CONCLUSION

Trade policies implemented by Governments in the region mixed protectionist policies and trade promotion initiatives, with hard to predict net impacts on trade and welfare. These recent developments are the result of the interaction of different factors. Among these, the changed nature of global production and trade seems to have played a central role, restraining countries from implementing protectionist measures as well as fomenting trade liberalization in certain sectors, especially for intermediate goods and food products.

While less transparent measures have been preferred when restricting trade (affecting mainly the import of minerals, machinery, vehicles and food items), trade liberalization has been conducted mainly through tariff reduction or elimination.
The manufacturing sector is the most affected by less-transparent measures both in the region and globally, followed by the agricultural sector. The most targeted products by initiations of trade remedy measures in the region have been steel, organic chemicals, machinery and mechanical appliances, paper and man-made staple fibres. The unchanged product coverage before and after the crisis, coupled with only small increase in the use of trade remedies compared with non-crisis periods, suggests that these actions have not been used by firms as an effective instrument to deal with crisis-induced market pressures. However, some countries have been affected significantly, as in the case of China that faces substantially higher anti-dumping duties than those imposed on products from other countries. It is also found that the use of anti-dumping measures is increasingly becoming a South-South phenomenon, with China being the main target.

Even though the cumulative trade impact of import restrictions has been low especially because protectionist measures have been narrowed to specific products or firms, protectionist pressures are far from extinct. There were relatively more discriminatory measures with the worsening of economic performance and tariffs remain an obstacle to participation of developing countries and their small and medium-sized enterprises in international trade.

REFERENCES


ONLINE DATABASES


The Index of Protectionism Severity is based on the values of four variables presented by Global Trade Alert database: (1) number of tariff lines affected by discriminatory measures implemented; (2) number of sectors affected by discriminatory measures implemented; (3) number of trading partners affected by discriminatory measures implemented, and (4) total number of red measures implemented since November 2008.

For each country, the values of the four variables are normalized by scaling them between 0 to 1 and then summed up assigning to the variables the same weight. The result is then normalized by scaling it between 0 to 1. As a result, the Index of protectionism severity ranges between 0 (no harm caused) to 1 (highest degree of severity of the measures implemented).

### Index of protectionism severity

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<tr>
<th>Country</th>
<th>Tariff lines affected</th>
<th>Sectors affected</th>
<th>Trading partners affected</th>
<th>Total red measures</th>
<th>Overall index</th>
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</table>

Asia-Pacific Trade and Investment Report 2013

ENDNOTES

32At the Trade Policy Review Body (TPRB) meetings in July and October 2012, members requested measures recorded in the trade monitoring reports be presented separately; according to a different categorization than the one used up to mid-May 2012. The WTO TPRB 2012 (WTO, 2012) includes six annexes (instead of two in the past) on: (i) trade-facilitating measures, (ii) trade remedy measures, (iii) other trade and trade-related measures, (iv) general economic support measures, (v) sanitary and phytosanitary (SPS) measures and (vi) technical barriers to trade (TBT) measures. While WTO TPRB Report 2013 (WTO, 2013a) includes four annexes (instead of six in the past) on: (i) trade-facilitating measures, (ii) trade remedy measures, (iii) other trade and trade-related measures and (iv) general economic support measures.

33This group covers only part of the protectionist measures implemented.

34The measures implemented by more than one country are counted separately for each country.

35An independent monitoring initiative providing information on state measures likely to affect world trade taken since 2008, available from www.globaltradealert.org/.

36For example, this is the case of Turkey, having increased tariffs on certain grains to 130% in May 2009, and then eliminated them in February 2011.

37Information on the measures included in WTO Report is collected from inputs submitted by Members and Observer Governments, as well as from other official and public sources. On the other hand, GTA database draws upon expertise from independent research institutes in seven regions, which are responsible for monitoring state measures introduced. GTA also encourages third parties to submit measures for scrutiny.

38WTO Report includes restrictive measures related to custom procedures, other taxes on imports, quantitative restrictions for imports or exports and export duties. Under GTA categorization, the following are considered protectionist measures that are other than tariffs (and trade defence measures): bail-out/state aid measures, competitive devaluations, consumption subsidies, export subsidies, export taxes or restrictions, import bans, import subsidies, intellectual property protection, investment measures, local content requirements, migration measures, non-tariff barriers (not otherwise specified), other service sector measures, public procurements, quotas (including tariff rate quotas), sanitary and phytosanitary measures, state trading enterprises, state-controlled companies, sub-national government measures, technical barriers to trade and trade finance.

39Since mid-May 2013, four new discriminatory measures considered less-transparent have been reported. As for the liberalizing measures, no new measures have been reported.

40Data accessed 31 July 2013.

41India is the main initiator (12 measures), followed by China (8 measures).

42The average ad valorem duty imposed by the United States on Chinese exports during the post-crisis period was 149%. This is compared to 45% on the products of other exporters. Where data are available, the same pattern is observed for ad valorem duties imposed by other countries on China.

43For the period from October 2011 to September 2012, WTO (2012) estimates that the trade coverage of the 372 SPS measures (out of a total of 885 SPS measures), for which HS codes were provided and import data was available, is around 1.4% of world merchandise imports.

44Generally, Governments are required to submit advance notification for the implementation of a newly proposed regulation. This is to provide trading partners an opportunity to comment (regular SPS). The emergency measures are adopted when Governments feel the necessity to act without delay. In this case, the government must immediately notify other Members, through the WTO secretariat.


46From October 2011 to September 2012, WTO (2012) estimates that the trade coverage of the 569 TBT measures (24% of total notifications), which HS Codes were provided and import data was available, represent around 5.2% of world merchandise imports.


48Red measures are those already implemented and almost certainly discriminating against foreign commercial interest.

49All Asia-Pacific countries for which data are available and index is higher than 0 are listed in annex 1.

50Only measures which affected trade partners and product categories are available, have been considered in the analysis.

51Henn and McDonald (2011) suggest considering this result as a lower bound because of the use of 4-digit tariff lines (due to data availability reasons). With the more appropriate use of 6 or 8-digit tariff level for these measures, the estimates would, in all likelihood, be higher. This is due to the largest part of trade in the corresponding 4-digit category being unaffected by protectionism and should therefore not exhibit a correlation with the protectionist dummy.

52Also, supposing that the excluded measures were exactly as restrictive as those in the estimation sample, the impact would rise to 0.34%.

53The basics of this econometric analysis is to match data on import restrictions with detailed data on actual bilateral trade flows.

54The former Director-General of WTO, Pascal Lamy (2012),
has stated in his address to the 59th session of UNCTAD Trade and Development Board, “of course, regional and global value chains are not new (...) but what is new are their unprecedented scale, scope, sophistication and speed. Today, trade in intermediate products accounts for more than half of world merchandise exports. Shrinking transport and communication costs (...) have enabled industrial production to be fragmented across regions as never before”.


56 Examples of these initiatives are those led by the World Bank, GTA and WTO.

57 The data are collected from GTA database, accessed 27 May 2013.
PREFERENTIAL TRADE POLICIES AND AGREEMENTS

INTRODUCTION

The proliferation of preferential trade agreements (PTAs), which began in the early 1990s, continues today with ever more countries getting engaged in the process. The main drivers for this are a combination of (a) contracting demand resulting from the economic crisis and the need to find new markets and (b) a lack of progress in securing lower trade barriers through multilateral trade negotiations. Over the years, the content of PTAs as well as their membership composition have also been changing. For example, recent PTAs increasingly include several areas that continue to be outside multilateral obligations, such as competition, government procurement and investment. Also, geographical proximity has declined as a factor in PTA membership, as many agreements are interregional or even intercontinental in nature. Globally there are 375 “physical” trade agreements in force, and 150 involving Asia-Pacific economies.

The ESCAP secretariat has continuously monitored the PTA landscape in Asia and the Pacific. It provides regular assessments of trends in the creation of new PTAs, as well as changes in the patterns and nature of regionalism involving Asian and Pacific economies. Following previous analyses, this investigation into the features of preferential trade policies and their impacts has been extended to cover the most recent period. This chapter revisits some stylized facts and features of PTAs which are common across the region’s economies. Agreements are routinely classified with respect to the number and level of development partners, and their regional proximity and contiguity. Other agreement features of interest to analysts and decision-makers are linked to their liberalization content and the range of areas covered. By looking at all these characteristics, this chapter explores how effective preferential trade policies have been in connecting countries in the region.
This is not only in terms of establishing PTA networks but also considering the coverage of overall exports and imports with partners in the enacted PTAs. The least developed countries in the region, though entitled to preferential access to markets of countries granting Generalized System of Preferences (GSP) schemes, face serious challenges in developing thriving export industries. In this regard, the WTO Hong Kong Ministerial Declaration in 1995 mandated for a duty-free quota-free (DFQF) regime to be established for the least developed countries. This chapter comments on the DFQF schemes introduced by the Asian developing countries, and explores the main features of the schemes.

With the rise of production fragmentation, PTAs were not only seen as tools for removing trade barriers but also to remove them strategically so as to help countries to integrate into the existing supply chains. The effectiveness of PTAs in delivering on this depends greatly on the Rules of Origin (ROO). Therefore, this chapter comments on the PTA’s role in facilitating economies’ integration into regional and global value chains.

### A. TRENDS IN PREFERENTIAL TRADE AGREEMENTS: STYLISTED FACTS

#### 1. The reliance of developing economies on preferential trade policies continues

As part of the search for new trade opportunities (markets and products), countries have continued to pursue preferential trade policies in the post-crisis years. There were 223 agreements associated with economies from Asia and the Pacific in August 2013, of which 150 were in force and the rest were at various stages of negotiations or consideration (figure 6.1). During the period 2008-2012, regional economies have put into force an average of 8.2 trade agreements per year. In the five-year period before the crisis (2003-2007), the average annual addition to the PTA tally was 9.8. Most of these were bilateral agreements, but recently a number of economies in the region have joined the Trans-Pacific Partnership (TPP) negotiation. Meanwhile, negotiation on the Regional Comprehensive Economic Partnership (RCEP) officially began in July 2013 (see also ESCAP, 2012b).

#### FIGURE 6.1

Cumulative number of preferential trade agreements enacted by Asia-Pacific economies, 1973-2013 (August) notified and non-notified to WTO

Source: ESCAP calculation, based on data from Asia-Pacific Trade and Investment Database (APTIAD).62

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**Preferential trade agreements are reaching a plateau – negotiation fatigue or just a pause?**
2. Number of partners, contiguity and regional proximity

Bilateral deals are clearly preferred, often with partners from the same subregion. Bilateral PTAs among developing countries, and between one developing and one developed country have also increased over the years, totaling 114 in August 2013. The four bilateral PTAs involving least developed countries include three with India (Afghanistan, Bhutan and Nepal), and one between Thailand and the Lao People’s Democratic Republic. However, other least developed countries are involved in regional blocs. The desire for preferential market access is so strong that even countries which are already members of an established trading bloc, still pursue bilateral deals with partners within as well as outside the bloc. This is, perhaps, most evident for, but not exclusive to, members of ASEAN. While committed to building the ASEAN Economic Community by 2015, ASEAN members continue to seek additional bilateral agreements.

Different rules of trade in different agreements with common members continue to play an obstacle to intra-ASEAN trade and investment flows.

This proliferation of bilateral (and other) PTAs contributes to multiple overlapping agreements: the so-called “noodle bowl”. This impacts adversely on the efficiency of trade among partners in the agreements. In the Asia-Pacific “bowl”, there are currently 118 bilateral agreements in force, 56 of which are PTAs signed with partners outside Asia and the Pacific. More specifically, there are 11 enacted agreements with countries in Africa and the Middle East, and 15 in Latin America. Turkey has the largest number of bilateral trade agreements with “non-regional” partners (although all of them are geographically relatively close to Turkey). Central Asian economies are a distant second. Other Asian countries, when signing agreements with partners outside the region, target mostly: Latin America (Peru and Chile); the United States; Canada and Mexico (the other two North American Free Trade Area (NAFTA) members); and two European blocs (European Free Trade Association (EFTA) and the European Union). After accounting for all these inter-continental and intraregional bilateral partnerships, the number of bilateral agreements comprising contiguous countries is small: only 21 bilateral PTAs involve countries who share borders, with North and Central Asian countries contributing the most. This is, of course, largely a consequence of many Asia-Pacific countries being islands without land borders. It can also be attributed to a spirit of “open regionalism” and a willingness to negotiate with partners outside the immediate neighborhood.

There are 15 plurilateral trade agreements with an average of 8.1 countries per agreement (the highest number of members is 15). As mentioned above, most plurilateral deals are subregional...
initiatives which have achieved varying degrees of progress. They range from ASEAN, which is preparing to transform from a free trade area into an economic community by 2015, to the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), whose members have not been able to finalize negotiations so that trade under preferential terms can begin.

More than half of all trade agreements put into force by Asia-Pacific economies refer to free trade agreements or areas for trade in (merchandise) goods, while almost a further 30% of deals allow free trade of both goods and services (figure 6.2). Therefore, more than 85% of bilateral PTAs are presented as free trade deals on goods or goods and services. In contrast, only 11% (17 agreements) are declared as having partial scope, and only 2% of all PTAs are customs unions. Of these three customs unions, two involve Central and West Asian countries.

Countries are becoming increasingly creative in their effort to label their deals differently, and not as “free trade agreements”.

As a result, many agreements are named as economic and/or comprehensive partnership agreements. This is to indicate the intention of engaging in wider integration. Of these “comprehensive economic partnership” appears to be the most popular appellation. The new names signal intent in opening markets beyond goods and services trade, and making commitments in other areas of cooperation. However, the actual immediate speed of liberalization remains slow and coverage shallow. The average tariff liberalization timetable is five to seven years among developing countries and ten years for the least developed country members.

**B. TRADE BETWEEN MEMBERS OF PREFERENTIAL TRADE AGREEMENTS**

It is difficult to exactly evaluate PTAs’ contributions to trade and growth. Often trade between parties to an agreement is simply tracked before and after a deal. Using current European Union intra-bloc trade as a benchmark, ASEAN shows very slow growth in intra-PTA trade, as a share of total trade, despite the rapid increase in the overall volume of trade. Intra-ASEAN imports account for only 22% of its members global imports. Indeed, across regional PTAs the speed of increase in shares of intra-PTA imports from 2005 has been glacial, as can be observed in figure 6.3. Most of the ASEAN plus 1 agreements (e.g. with China, India and the Republic of Korea) are achieving intra-PTA imports in the total range of 20% to 23%. A slightly higher import share of 24% to 25% is achieved under Australia-New Zealand-ASEAN, and Japan-ASEAN agreements. The highest intra-PTA share will emerge from RCEP, which represents approximately half of imports coming from within the block. Other blocs have significantly lower level of intra-regional imports: Asia Pacific Trade Agreement (APTA) lingers between 14% and 15%, while SAARC Preferential Trading Agreement (SAPTA) struggles to keep the intraregional trade share from falling below 1% of their total trade.

**FIGURE 6.3**

Intra-preferential trade agreement import share of selected preferential trade agreements in Asia and the Pacific since 2005 (percentage)

Source: ESCAP calculation, based on data from WITS database (accessed August 2013).
However, for individual countries, especially small ones, trade with partners could be much more important than aggregate bloc averages may indicate. For example, for Bhutan or Nepal, the dependence on trade with partners within SAFTA is much higher than for a large country such as India.

*Mega Asian bloc will still leave half of members’ trade to be done with the partners outside the bloc.*

Also, it is not necessarily true that countries primarily sign agreements with partners with whom they already have substantial trade. Figure 6.4 presents coefficients of export and import dependence on PTA partners relative to total exports and imports. The numbers are average shares over the period 2009 to 2011 for those Asia-Pacific economies for which trade data are available, including all enacted agreements for those countries. There is great variability in PTAs’ coverage of exports and imports among the developing economies of the region. On the export side, Brunei Darussalam directs almost 100% of its exports to its PTA partners. On the other hand, some of the Pacific island States export less than 10% of their total exports to PTA partners (including Australia and New Zealand). While averages can hide important specifics (i.e. the liberalizing quality of the PTAs), it is worth noting that North and Central Asian countries export only 16% of their total exports to the PTA partners. At the other end of spectrum are some of the South-East Asian countries with much higher dependence on trade with PTA partners.

Developed economies are also dissimilar, with Australia and Japan obviously still relying on much of their trade with non-partners, while New Zealand’s PTAs cover half of its trade. Four of the least developed countries in the region [Bhutan, the Lao People’s Democratic Republic, Myanmar and Nepal] have very high shares of exports going to PTA partners, which could be mainly due to their trade dependence on large neighbouring countries.

There is no correlation between the number of PTAs to which a country is a signatory and its share of trade attributed to those agreements. For example, the nine agreements currently in force involving the Lao People’s Democratic Republic capture a much larger share of the country’s trade than the 20 trade agreements involving Singapore do for that country. Another example is Japan, which is a member of almost the same number of PTAs as Malaysia, but which has a significantly lower trade share attributable to its PTA partner countries. Therefore, what is important is identifying how business and economic potential and linkages are placed, and then trying to deepen those through PTAs. This also explains why many countries continue to depend on trade with countries that are not PTA partners such as Japan and the United States, Australia and the European Union. It also shows why similar linkages established through global value chains and other business and investment deals will often determine trade flows over and above the directions envisaged under signed PTAs.

Several economies registered much higher shares of trade with PTA partners compared to previously observed period (ESCAP, 2012). This is due to new agreements taking effect in 2010 and 2011 between the ASEAN nations and their new PTA partners – India, the Republic of Korea, Australia and New Zealand. The Republic of Korea also showed a marked increase in both import and export values to PTA partners, which could be attributed to the enactment of the agreements with ASEAN, India, the European Union and the United States.

C. NON-RECIPROCAL PREFERENTIAL TRADE AND THE LEAST DEVELOPED COUNTRIES

The grant of tariff preferences for developing countries, including the least developed countries, through the GSP scheme, has been in place for more than three decades now. However, as GSP entailed unilateral (non-reciprocal) preferences from donor countries to recipient countries, the list of items for tariff concessions and the rules of origin vary from one donor country scheme to another. Also, these were not formulated as a part of negotiations. The GSP scheme has been criticized for not being generalized despite its name. There is also criticism that most of the items that were of export interest to the least developed countries were excluded from the coverage, including agriculture and textiles. GSP was mandated by the Enabling Clause
Decision of 1979 of the General Agreement on Tariffs and Trade (even though GSP management remains UNCTAD’s responsibility), demanding an improved preferential market access for all exporting items by the least developed countries. This continued to be raised in WTO and has been a subject for discussion in the Doha Round negotiations.

The decision to provide DFQF access for the least developed countries is a significant outcome of the WTO Hong Kong Ministerial Conference, held in December 2005. This decision (as given in Annex F of the Hong Kong Ministerial Declaration inter alia) requires all developed country Members, and developing country Members declaring themselves in a position to do so, to

**FIGURE 6.4**

Trade share with preferential trade agreement partners,

2009-2011 average percentage

*Source:* ESCAP calculations, based on United Nations Comtrade data downloaded from WITS database and APTIAD, accessed July 2013
provide DFQF market access on a lasting basis. This is for all products originating from all least developed countries by 2008 or no later than the start of the implementation period in a manner that ensures stability, security and predictability. Developing country members were permitted to phase in their commitments and were given flexibility in product coverage. The declaration also stipulated that the preferential rules of origin, which are applicable to imports from the least developed countries, are required to be transparent and simple, and contribute to the facilitation of the market.

A number of developed countries came up with revised GSP schemes to meet the needs of the least developed countries, for example the European Union introduced its “Everything but Arms” scheme in 2001, covering 97% of the items under tariff concessions. However, the United States never implemented a similar scheme covering all least developed countries [see Edo and Heal, 2013]. Several developing Asia-Pacific economies – India, China, the Republic of Korea, Turkey and Taiwan Province of China – have also started to introduce DFQF schemes, notifying WTO, accordingly. Indonesia and Thailand also indicated their intent to implement schemes in future. The briefly summarized features of these schemes are in box 6.1.

Due to their small economic size, remoteness, geographical dispersion, vulnerability to natural disasters, ecosystem fragility, and lack of natural resources, least developed countries are highly dependent on international trade as a driver of inclusive and sustainable development. The DFQF market access was introduced to address some of the constraints faced by the least developed countries; however there are challenges with DFQF implementation by some of the developed and emerging economies in the region. China, India, Indonesia and Russian Federation, as well as the Republic of Korea, are at different stages in implementing their DFQF schemes. Figure 6.5 shows the scale of market access received by the Asia-Pacific least developed countries. Several countries already give DFQF access on over 90% of product lines.

As described in Edo and Heal (2013, Box 6.1) and annex 2 to this chapter, the scheme does not universally apply to all least developed countries, and in certain cases applies to only selected least developed countries. The benefits of these schemes need to be extended to all least developed countries, irrespective of whether they are WTO members or not, or whether they belong to the Asia-Pacific region or not. It is also important to note that these various schemes stipulate different rules of origin, this can present exporters in the least developed countries with the additional burden of complying with the

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**Box 6.1**

**Duty-free quota-free schemes of developing economies of Asia and the Pacific**

**India’s duty-free tariff preference scheme**

Following Prime Minister Dr. Manmohan Singh’s announcement at the 2008 India-Africa Forum, India became the first developing country to extend DFQF access to the least developed countries. The first stages of implementation took place in August 2008. India’s Duty Free Tariff Preference-least Developed Countries scheme calls for implementing a 20% annual reduction in applied customs on 85% of total tariff lines, in order to achieve a full 100% reduction over a period of five years. Additionally, margins of preference, ranging from 10% to 100%, are available on about 9% of tariff lines (covering 458 items). The accompanying exclusion list accounts for 6% of tariff lines (covering 326 items). This comprehensive scheme provides preferential market access for tariff lines that represent 92.5% of total least developed countries’ exports. In addition, India recognizes the necessity of providing technical assistance, stipulating that it be demand-driven in order to effectively meet the needs of its least developed country partners.

In order to qualify for preferential duties, products under tariff lines included in the scheme must meet the following rules of origin requirements, if not wholly obtained: (1) total value of non-originating materials...
should not exceed 70% of the value of the product; (2) the product so produced or obtained is classified in a heading (at 4-digit HS level), which is different from those that all the non-originating materials used in its manufacture are classified under; and (3) the final manufacturing stage is performed within the beneficiary country’s territory. All least developed countries are eligible for the above-mentioned preferences.

**Note:** A proposal to increase coverage of items under duty free list to close to 97% (from 85% at present) of the total tariff lines at 6 digit level and to further liberalize the Rules of Origin is under consideration of the Government of India.

**Source:** Ratna (2009) at http://wtocentre.iift.ac.in/discussion_papers/01.pdf.

**China’s duty-free quota-free programme**

At the 2007 Forum for China-Africa Cooperation, Premier Wen Jiabao announced that China intended to take steps to improve preferential access to the least developed countries. As of January 2008, 33 African least developed countries had already been provided DFQF market access. On 1 July 2010, the non-reciprocal DFQF programme for the least developed countries was launched, granting preferential coverage for 60% of tariff lines (a total of 4,788 at the 8-digit level) and plans for future extension to cover 97% of all tariff lines. A November 2011 revision notification to WTO noted that the scheme accounted for $42.2 billion in 2010 and covered 98.7% of imports of China from 40 least developed countries.

In order to qualify for preferential duties, products under tariff lines included in the scheme must meet the rules of origin. This requires that if products are not wholly obtained or produced, substantial transformation must take place within the territory, under the criterion of change in tariff item classification or “ad valorem percentage” (under which the value added portion may not be less than 40% of resulting goods).


**The Republic of Korea preference scheme for the least developed countries**

Following the Presidential Decree on Preferential Tariffs for the least developed countries in January 2000, the Republic of Korea lifted tariffs on 80 items (HS 6-digits) originating in 48 least developed countries (see annex 2 for list). In January 2008, preferential duty-free access was expanded to include 2,790 tariff items. Coverage of tariff lines has been extended significantly, from only 1.8% in 2007 to 75% in 2008 and 95% by January 2012. Further concessions to the least developed countries are made under the ASEAN and APTA free trade agreements.

In order to qualify for preferential duties, products under tariff lines included in the scheme must meet the rules of origin. This requires that if products are not wholly obtained or produced, the value of the inputs does not exceed 50% of the F.O.B. price of the final products. However, the value of input products originating from the Republic of Korea is excluded from the calculation.

**Source:** http://ptadb.wto.org/ptaList.aspx and WTO Document WT/COMTD/N/12/Rev.1/Add.1 20 March 2012.

**The Taiwan Province of China’s duty-free quota-free scheme for the least developed countries**

Taiwan Province of China first notified its least developed country preferential tariff scheme to WTO in 2003. In April 2012 the country reaffirmed its commitment to increase DFQF access for a total of 48 least developed country economies (see annex 2 for list). The scheme currently covers 32% of tariff lines.

**Source:** http://ptadb.wto.org/ptaList.aspx and WTO document WT/COMTD/N/40.

**The GSP of Turkey for the least developed countries**

Turkey’s general system of preferences came into force on 31 December 2005, and benefits the least developed countries on the basis of the European Union’s Everything But Arms DFQF Scheme. Turkey’s DFQF access covers almost 80% of tariff lines and most of the agriculture products are excluded from concessions.

Indonesia: moving towards implementation

As of April 2013, Indonesia has announced its intentions to shortly extend DFQF access to least developed country members of WTO (see annex 2 for list). This is particularly in the context of preparations for the ninth WTO Ministerial conference to be held in December 2013 in Bali, Indonesia. The planned duty-free tariff preference scheme would cover between 32% and 95% of tariff lines on key products such as cotton and wheat. Implementation is expected to follow the closing of the conference in December 2013.


* The list of beneficiaries for each scheme is in annex 2.


different norms prescribed in order to obtain certificates of origin. Often, exporters can meet rules of origin requirements for one destination market, but not for another, affecting the efficiency and predictability of their exports. It is vital that the advanced trading partners of the least developed countries attempt to consolidate the rules of origin used for DFQF access. This will allow for each exporting country, using the same product processing practices, to be eligible for preferences in all countries providing DFQF. Given that debate on this question has not begun at a multilateral level, as well as Asia-Pacific least developed countries’ ongoing trade dependence, ESCAP deems it necessary to open this debate at the regional level, at least.

FIGURE 6.5 DFQF market access in terms of tariff lines covered and percentage of imports from Asia-Pacific least developed countries, 2011

Source: Edo and Heal, 2013 Based on data downloaded from TRAINS and Comtrade using WITS Online Tool [Effectively Applied Rates].
Box 6.2  

ABC’s of cumulation in PTAs

**Bilateral cumulation**

Bilateral cumulation is the most basic form of cumulation, as it operates between two parties and allows producers in either partner country to use materials and components originating in the other’s country as if they originated in their own country.

**Diagonal cumulation**

Diagonal cumulation operates between more than two countries, allowing producers to use materials and components originating in either country that is part of the agreement. In one sense, this is an extension of bilateral cumulation to the regional level.

**Partial cumulation**

Partial cumulation is the most common form of cumulation, under which an input originating in one member of the PTA will be considered as originating input from other member country(ies) of that PTA. In such a case, the full value of the input/material is taken as originating, and not the actual value content of processing, in the PTA partner. On the other hand, if the input is not originating the value added in one country is totally disregarded, as it does not meet the origin criteria.

**Full cumulation**

Full cumulation takes into account all of the operations conducted within the countries who are members to PTA - even if they are carried out on non-originating material. Thus, there is no restriction to only use originating materials and components for the final good. This concept allows more fragmentation of the production process among members of a trade agreement and increases economic linkages and trade in PTAs.

Source: Das and Ratna, 2011
A manufacturer in Viet Nam produces a transmission line for motor vehicles. He plans to export the transmission line to the ASEAN market and uses inputs which are sourced from Indonesia (another member of ASEAN and from outside ASEAN). The process of manufacturing by using different inputs are as follows:

<table>
<thead>
<tr>
<th>Description of Materials/Others</th>
<th>Origin</th>
<th>Origin Status</th>
<th>Value ($)</th>
</tr>
</thead>
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<tr>
<td>a. Part A</td>
<td>Viet Nam</td>
<td>Originating</td>
<td>1,500</td>
</tr>
<tr>
<td>b. Part B</td>
<td>Indonesia</td>
<td>Originating</td>
<td>1,500</td>
</tr>
<tr>
<td>c. Part C</td>
<td>China</td>
<td>Non-originating</td>
<td>2,000</td>
</tr>
<tr>
<td>d. Other costs + profit</td>
<td>Viet Nam</td>
<td>Originating</td>
<td>500</td>
</tr>
<tr>
<td>F.O.B Price (a + b + c + d)</td>
<td></td>
<td></td>
<td>5,500</td>
</tr>
</tbody>
</table>

The ASEAN FTA rules of origin prescribe for a regional value content (RVC) at least 40%.

Part B which is produced in Indonesia is considered to be originating in Viet Nam due to the cumulation rules. In this case, due to cumulation, the transmission line will be considered as originating due to the following calculation:

$$RVC = \frac{(5,500 - 2,000)}{5,500} \times 100 = 63.6\%$$ and thus it will get preference in ASEAN market.

However, if the cumulation was not allowed in ASEAN rules of origin, the calculations would have been:

$$RVC = \frac{(5,500 - 3,500)}{5,500} \times 100 = 36.3\%$$ and therefore it would not get preference when exported from Viet Nam.

For those least developed countries which suffer from limited supply capacity, both in terms of quantity and quality and variability of products, the expansion of intra-PTA trade and integration in supply chains could be even better promoted by allowing for cumulation provisions in the ROO (see box 6.2 for the definition and typology). Cumulation provisions allow producers to import materials from a PTA partner(s) without undermining the origin of the product. Effectively, imported inputs from PTA partners are treated as being of domestic origin of the country requesting preferential access. It extends the possibility of using low-cost sources of inputs without compromising the originating status of a final product. This is done by allowing inclusion of intermediate products and operations to count as originating status for the final product, even when they are not produced domestically. In the case of the least developed countries, if cooperation could be achieved in the production of a single product by cumulating the origin among themselves, all would benefit.

Unfortunately, the current situation in the region is such that ROO vary significantly among the several types of frameworks that are in existence. There is even variation in the rules applying to a single country which is a member of different PTAs. Even among the ASEAN+1 agreements there are 22 different ROO types, with only 30% of the tariff lines sharing a common rule. In each PTA there are several criteria that are used for determining origin and, therefore, coordinating them is a difficult task (Menon, 2013). This is despite it being almost certain that such an
exercise would contribute to intraregional trade and facilitate sourcing from the least developed countries. The nature and composition of provisions of cumulation are different in different agreements. These provisions are also becoming more and more complex – the so-called “noodle bowl” phenomenon. The lack of uniformity in these rules is now becoming a major discussion point. The different cumulation provisions that apply in different Asia-Pacific PTAs are summarized in box 6.2. Box 6.3 illustrates how cumulation works.

A particularly important point that ought to be stressed in the case of determining the origin of a product under the cumulation provisions, especially in case of Asia and the Pacific, relates to the minimal value added criteria in the exporting country. In SAFTA, the overall regional value added under the cumulation provision is 10% higher than the single country obligation of 40%. Additionally, for regional cumulation the agreement prescribes that within the aggregate regional content of 50% at least 20% value added must come from the final exporting country. This means that the other country is allowed to contribute a value addition of only 10% under the regional cumulation. Similarly in APTA, the regional value added content for cumulation is 60% (15 percentage points higher than single country value added). In case of ASEAN FTA, there is no such obligation on the final exporting country to have a minimal value added -being a total of 40% value added. In ATIGA, ASEAN has used a combination of partial and full cumulation by allowing alternative routes. However, the full cumulation has some qualification restrictions through minimum value added content requirements of at least 20%. It would, therefore, appear that the provisions of cumulation are not designed to create a true 'regional or PTA identity’ for product, thereby acting against the actual objective of regional integration in terms of creating supply chains within the bilateral/plurilateral/regional PTAs. Baldwin and Kawai (2013) point out that small nations need to import many inputs from different countries in order to manufacture products for export, and, therefore, the bilateral cumulation rules hinder their prospects of sourcing inputs. Broader rules for cumulation would allow less restrictive regionalization.

In the revised EU GSP rules, which were made effective from 2011, the cumulation rules prescribe a concept of “regional origin” instead of single country origin or “global cumulation”. This is especially intended for the least developed countries. Products are deemed to originate in the last regional country group where final processing took place. Regional cumulation between countries in the same regional group applies only under the condition that the work or processing carried out in the beneficiary country, where the materials are further processed or incorporated, goes beyond “minimal” operations. Under the European Union rules for partial and regional cumulation, materials or parts imported by a member country of one of the four notified groupings from another member country of the same grouping for further manufacture are considered as originating products of the country of manufacture and not as third-country inputs. This is provided that the materials or parts are already “originating products” of the exporting member country of the grouping. Originating products are those that have acquired origin by fulfilling the individual origin requirements under the basic rules of origin for GSP purposes. For example, European Union rules of origin require cotton jackets (HS 6203) to be produced from “originating” yarn. However, with regional cumulation, preference-receiving country A may utilize imported fabrics from country B (note that these fabrics must already have originating status from B), which is a member of the same regional grouping. The finished jacket will be considered as an originating product. This is because the imported fabric, which, again, must already have come from an originating producer in the same grouping, is counted under the cumulation rules as a domestic input and not as an imported input.
A “Made in Asian least developed countries” label may provide an incentive for new production and employment where is greatly needed.

Given the nature of manufacturing process in the least developed countries, the DFQF-based schemes must provide for a provision of cumulation which is not bilateral in nature. Instead, it would facilitate trade among the least developed countries assisting integration among themselves. The European Union’s Everything But Arms, or other GSP Schemes, by offering a full cumulation scenario for all the least developed countries would produce products whose identity would be “Made in least developed countries”, rather than having a single country of origin. An ideal situation in terms of promoting regional value chains and establishing international production network, would only emerge if the cumulation provisions provide for a full cumulation scenario without any additional requirements. Secondly, it may also be important for the PTA blocks, like ASEAN and SAARC, to allow cumulation provisions, such as in the European Union’s GSP; where the product loses its national origin and has, instead only the identity of the PTA where it was produced. With ASEAN consolidating its PTAs with trading partners, especially through RCEP, it is important to consider having a product with an origin mark of “Made in ASEAN”, rather than the origin mark of an individual ASEAN member. Having such a provision of cumulation is likely to facilitate better intra-regional trade and integration of industries than is currently provided for in SAFTA. Otherwise, the individual country obligation of 20% may sometimes be very difficult to achieve, and even if a product has a regional content of more than 50% it may not qualify for preferences.

CONCLUSION

It appears that the global economic crisis of 2008-2009 has not derailed the use of PTAs by Governments to secure access to foreign markets and defend domestic markets, although new PTAs are being added at a slower rate. The total number of agreements associated with economies in Asia and the Pacific is estimated to be above 220, of which 150 are in force and the remainder are at various stages of negotiation or consideration. The majority of the preferential deals are associated with developing countries from the region, but it must be noted that some high-income OECD members also are active participants in PTAs.

There is great variability in coverage of exports and imports by PTAs for developing economies of Asia and the Pacific. For instance, Brunei Darussalam directs almost 100% of its exports to its PTA partners. However, there are also Pacific island States whose PTA partners absorb less than 10% of their total exports (including when exporting to Australia and New Zealand). While averages hide important specifics, it is also useful to note that for North and Central Asia PTAs appear to be of limited utility as partners’ markets account for only 16% of that region’s exports. At the other extreme is South–East Asia, which has been able to translate long-term work on building linkages between economies into concrete integration.

Because of the growing number of agreements that have overlapping memberships but have different provisions relating to trade, especially paths for tariff reductions, coverage of preferences, rules of origin, and WTO plus provisions, it is more likely that increasing complexity will increase the costs of trade within the bloc and reduce opportunities for new trade and investment. Despite the strong recommendations made by the ESCAP secretariat to Governments to consider rationalization and consolidation in the area of PTAs, among others, recently only two concrete steps have been taken in this regard: (a) the Trans-Pacific Partnership led by the United States, and (b) the Regional Comprehensive Economic Partnership led by ASEAN and its partners. It is yet not clear if with these agreements concluded, the other agreements (bilateral or plurilateral but with fewer members) will cease or will still continue to be operative. In the latter case, efforts towards consolidation will have proved futile as different rules for trade will continue to play an adverse role and thereby act as a deterrent to intra-PTA trade and investment.

Another issue which needs further attention from policymakers relates to providing opportunities for the least developed countries to increase production and trade integration among themselves. This can only happen when the provisions of cumulation, either in GSP or DFQF schemes allow the use of each others’ inputs and resources for the production of goods. This could
be easily done by allowing cumulation for the least developed countries in the region. “Open cumulation” would permit all the beneficiaries to use each other’s intermediate materials in production which will also allow better integration and the establishment of regional supply chains.

REFERENCES


ONLINE DATABASES

CEIC Database. Available at http://ceicdata.securities.com/cdmWeb/.


## ANNEX 1

Number of agreements in force and under negotiations per Asia-Pacific economy

<table>
<thead>
<tr>
<th>Economy</th>
<th>Number of agreements</th>
<th>Agreements in force</th>
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*Number of agreements in force and in total includes the GSTP (a global agreements). American Samoa, French Polynesia, Guam, New Caledonia, Northern Mariana Islands and Timor Leste do not report any trade agreements. Total number of agreements also includes pending agreements when they exist. Average calculated only for economies with one or more agreements.

**ANNEX 2**

Eligible countries for DFQF preferences of selected developing Asian economies

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<thead>
<tr>
<th>Eligible LDCs</th>
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## ANNEX 2 (continued)

Eligible countries for DFQF preferences of selected developing Asian economies

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Total 48 countries
Asia-Pacific Trade and Investment Report 2013

ENDNOTES

58 For example, Mongolia, the only WTO member without PTA under implementation, is progressing steadily towards acceding to the Asia-Pacific Trade Agreement (APTA) and negotiating an economic partnership agreement with Japan.

59 This number refers only to the so-called “physical” agreements. Normally, WTO reports the number of trade agreements based on notification requirements, which means that if a trade agreement includes both goods and services, it will be counted as two notifications – one for goods and the other for services, even though it is physically one trade agreement. To prevent unnecessary inflation of the number of agreements, only the physical number of trade agreements is reported here, counting goods and services between the same partners as one.

60 In addition to these notified and enacted agreements, Asia-Pacific Trade and Investment Agreements Database (APTIAD) records agreements that have not been notified to WTO, which has resulted in the increased number. See annex 1 for the number of agreements per country.

61 For example, previous issues of the Asia-Pacific Trade and Investment Reports (ESCAP, 2009, 2010, 2011a, 2011b, 2012a and 2012b), as well as other publications by the ESCAP Trade and Investment Division, including APTIAD Briefing Notes.

62 The numbers presented in figure 6.1 are based on the established WTO practice of a self-classification by countries with regard to their development level. Following that, Asia-Pacific economies include only three developed countries and the remaining countries are “developing”. This is despite a number of them having high GDP per capita and significant share in world trade.

63 In the Asia-Pacific region, ESCAP secretariat distinguishes Central and North Asia, South and South-West Asia, South-East Asia, East and North-East Asia and Oceania as subregions.

64 There are 83 between developing members and 31 between developing and developed members.

65 In the Agreement of South Asian Free Trade (SAFTA), in addition to already mentioned Afghanistan, Bhutan and Nepal, there are also Bangladesh and Maldives (which recently graduated from the least developed country group); ASEAN includes Cambodia and Myanmar (in addition to already mentioned Lao People’s Democratic Republic); and the Pacific Island Countries Trade Agreement (PICTA) involves all least developed countries from the Pacific.

66 There are 83 PTAs between developing countries and 31 between developing-developed members and 4 between developing and the least developed countries (total 118).

67 Despite the official titles given to the agreed texts, WTO members are able to choose only among four different “types” when notifying their agreements. These four types are: free trade agreement and customs union (for goods), economic integration agreements (for services) and partial scope agreements (only for agreements between developing countries).

68 Which is misleading as when EU-15 integration started, intra-bloc trade was already close to 50% (http://unesdoc.info/publication/wsp109.pdf) and intra-EU15 trade, as a share in total trade, increased only by several percentage points. It was adding the new members to EU which really pushed the share of intra-EU trade up, similar to the case of ASEAN plus values.

69 Since many developing countries have not yet posted trade data for 2012, these share averages may underestimate real levels.


71 Also, some of these economies have historically provided a better preferential market access to the least developed countries within their PTAs: India, China and the Republic of Korea within the APTA framework, ASEAN members to the CLM countries (Cambodia, Lao People’s Democratic Republic and Myanmar), etc.

72 Data is for 2011 where available: Canada and Republic of Korea, 2010; India, 2008.

73 Developed countries are known for using the ROO to promote development of certain activities, and also as a form of NTBs. NAFTA is a case in point, wherein for the automotive sector different percentages of the regional value content are laid down for various phases, for instance, 56% between 1998 and 2002 and 62.5% thereafter for some categories of motor vehicles. In the case of textiles and apparel, there is a “triple-transformation test” that requires fabrics or clothing items to be spun from yarns or fibres produced in North America, as well as to be cut and sewn within the territory of the free trade agreement (Das and Ratna, 2011).

74 Nag and De (2013) noted that ROO play a significant role in promoting backward and forward linkages. ROO is more helpful in promoting trade in low value components. While tariff reduction is the most important tool for making a trade agreement work efficiently, ROO can act as a catalyst even if tariff rates are not particularly low. It is further noted that through the regression analysis a higher ROO restriction index inhibits the positive growth of intra-industry trade.

75 Regional cumulation between countries within the same group applies to the following four separate regional groups: (a) Group I: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Philippines, Singapore, Thailand, Viet Nam; (b) Group II: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru, Venezuela; (c) Group III: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka; (d) Group IV: Argentina, Brazil, Paraguay and Uruguay.

76 There are currently 49 countries designated by the United Nations as LDCs. South Sudan was included in the group in 2012.
Despite a claim that the level of (individual/national) happiness is unrelated to a country’s economic growth, or, similarly, that absolute income does not affect subjective well-being, (according to the so-called “the Easterlin paradox”) some recent research offers evidence to the contrary. It appears that money after all does buy happiness, or at least, is a major factor in determining subjective feeling of well-being.

Using the World Database of Happiness, which covers close to 70 countries, over periods of 10 to more than 40 years, Veenhoven and Vergust (2013) reveal a positive correlation between GDP growth and rise of happiness in nations. Both GDP and happiness have gone up in most nations, and average happiness has risen more in nations where the economy has grown the most. They conclude that a gain in happiness of a full point would take 60 years with an annual economic growth of 5%.

Similarly, Sacks, Stevenson and Wolfers (2012) find that well-being rises with income, irrespective of analysis comparing people in a single country and year, across countries, or over time for a given country. Through these comparisons they show that richer people report higher well-being than poorer people; that people in richer countries, on average, experience greater well-being than people in poorer countries; and that economic growth and growth in well-being are clearly related. Moreover, the data show no evidence for a satiation point above which income and well-being are no longer related. This would suggest that economic growth has impact on happiness, and that some part, but fortunately not all of it, has to do with material comfort.

A report for a 2012 United Nations conference on happiness, edited by John Helliwell, Richard Layard and Jeffrey Sachs, provides some further clarification on which factors other than difference in income affect happiness. These include personal factors, such as mental and physical health, family relationships and education; and social factors, including job stability and quality, networks of social support, the degree of corruption in government and business, and the extent of personal freedom and security.

Furthermore, Dunn and Norton (2013) show that while it is true that having more money does not usually make us less happy, it is also true that simply having more money does not guarantee happiness – for the feeling of happiness, what we buy is more important than how much we spend.

**Source for the figure:** Helliwell, Layard and Sachs (eds) (2012), Figure 2.4.

**Sources:** Dunn and Norton (2013); Helliwell, Layard and Sachs (eds) (2012); Sacks, Stevenson, and Wolfers (2012); Veenhoven and Vergunst, (2013).
PART 2

TURNING THE TIDE

towards inclusive trade and investment
The interplay of several factors was behind the choice of theme for this year’s issue of the Asia-Pacific Trade and Investment Report. First, the global economic crisis has caused a departure from the previous trend of high and sustained economic growth among the Asia-Pacific developing economies. This has prompted a rethink over the sustainability of an export-led growth model which depended on continuing strong demand in advanced economies. More fundamentally, the slowdown also exposed other weaknesses in the region’s dominant development approach including: a high dependency on low-priced labour; lax adherence to labour standards; high resource-intensity of production; and weak regulatory regimes with inconsistent enforcement. Second, the international community has agreed on the Rio+20 outcome document “The Future We Want” as a framework for achieving internationally accepted development goals. The document stresses the need for inclusive and equitable growth and will shape the global agenda following the United Nations campaign to achieve the Millennium Development Goals which draws to a close in 2015. Trade and investment are instrumental parts of that framework. Third, there is increasing awareness of, and objections to, the rising inequalities in the region. This points to the risks inherent in pursuing trade and investment under “business as usual” conditions; further increases in inequality are a growing threat to social stability and sustainability. Trade and investment are intimately linked with issues of employment, income distribution and inequality; hence any change in approach to trade policy will have important implications on the overall development of any market-oriented economy.
Therefore, turning the tide and making trade and investment inclusive has become extremely important for the region, which, globally, is home to the largest number of absolute poor. Delivering on this involves consideration of all aspects of inclusive development which trade and investment\textsuperscript{78} affect. In the first place, it is about the fair and free access of producers and consumers to global and regional markets for goods, services, capital, finance and labour.\textsuperscript{79} This is especially critical for micro and small and medium-sized enterprises as well as individual producers or service providers. But it is also about consultative decision-making processes on trade, investment and related policies at the local, national, regional and global levels. In other words, achieving inclusive trade and investment requires giving a voice to those who have been so far excluded from sharing in the benefits of trade and investment-led economic growth.

A. STYLIZED FACTS

There are plenty of stylized facts supporting the notion that greater economic openness (through trade and investment) is an important element in explaining higher economic growth. In many countries, greater openness and integration has been the critical factor behind successful development.\textsuperscript{80} Openness is normally understood as the size of international transactions (that is, mostly trade and investment) in the overall economy. This is usually measured by the share of overall trade value in a country’s gross domestic product (GDP).\textsuperscript{81} Empirical evidence supports the argument that the fastest growing countries have been those associated with an expansion of their share in the global merchandise and services trade. Few countries have grown over the long term without experiencing a large expansion of trade. This is especially so for developing Asian economies, which have, on average, outperformed other developing economies in terms of real GDP and trade growth over the period 1990-2011 (figure 7.1). Thus, growth is often associated with openness to trade and investment; indicating that, in principle, higher openness leads to higher growth.

![Evidence supports the existence of strong linkages between economic growth and sustained poverty alleviation.](image)

Similarly, there is ample evidence on the relationship between strong economic growth and sustained poverty alleviation (for example, Bhagwati and Srinivasan, 2002; Giordano and Li, 2012). Asia’s strong growth over the past two decades was translated into a significant decline in poverty\textsuperscript{82} (table 7.1). This was a major contributor to the global success of halving poverty five years ahead of the MDG target timeframe.\textsuperscript{83} Whereas in

**FIGURE 7.1**

Fast growth of trade and real GDP go hand-in-hand, 1990-2011

1990 the region accounted for 81% of the world’s poor, this had fallen to 62% just two decades later. While all developing countries contributed to this achievement, China led the way. In China, the share of the population in extreme poverty dropped from 60% in 1990 to 12% in 2010. In South Asia, poverty rates fell by an average of one percentage point annually, from 54% in 1990 to 31% two decades later. While these falls in poverty in South Asia are encouraging, because of better performances elsewhere, the subregion now accounts for a higher share of the world’s poor than in 1990. The largest number of the world’s poor still live in Asia, with Bangladesh, China, India and Indonesia together being home to more than half. Furthermore, there is some evidence that inequality among the poor is worsening: some countries report more people living on less than $1.25 a day, while the number of people just above them at the next income tier shrinks (figure 7.2). This suggests that growth, which mostly was of trade-led type, is not benefitting the very poorest.

Asia-Pacific economies have differential performance records in alleviating poverty. Another concern they face is worsening inequality despite having enjoyed sustained periods of economic growth. Inequality (measured by different metrics) has increased across the region in the past two decades (figure 7.3). More worryingly, the 2008/2009 global economic crisis exacerbated the inequalities in economics which until then were thriving on export-led growth. The number of people without full, or even partial, access to productive employment and social services has been rising over the last decade. Many developing countries are becoming familiar with the phenomena of jobless growth, under-employment, and insecure jobs. This reflects a failure to share the benefits of the larger overall economic pie created by international openness. Continuing risks to growth in many major global economies, alongside increasing environmental pressures and vulnerabilities to natural disasters, raise concerns about the future development prospects for the poorest and most vulnerable. It is clear that the paradigm of trade and investment-led growth needs to change.

Traditional economic theory and policy were based on the belief that opening an economy to international trade and investment was justified on the basis it would produce aggregate gains.

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</tbody>
</table>

While undeniably some groups would lose out from trade, these losers, it was argued, should be dealt with through distributional policies after the overall gains from opening had been secured. Redistribution could take the form of fiscal transfers to affected groups, or re-training and adjustment assistance to enable people to shift employment away from sectors adversely affected. In other words, it was expected that the gains created through enhanced economic growth will be sufficient to outweigh losses accruing to certain sectors. Society as a whole was expected to benefit. In contrast, what has been observed is that gains have been evaporating from the bottom of the social pyramid and been accumulating at the top; much like the idea that money is like helium and floats upwards if not restrained. As the stylized facts show, in many countries, and especially in the Asia-Pacific region, growth has benefited the rich faster than it benefited the poor. While the gains and prosperity created by dynamism and openness have been undeniably large, they are not producing inclusive outcomes.

FIGURE 7.2
Changes in poverty headcount, measured at $1.25 and $2 per day a
(in percentage points since 1990)

Source: Based on data from Balakrishnan, Steinberg and Syed (2013), p.5.
a At 2005 PPP prices. In parentheses are the latest available year and corresponding poverty headcount ratios at $1.25 and $2 per day, respectively.

FIGURE 7.3
Stylized facts: Asia’s experience in addressing inequality over last two decades

Today inequality is higher in many economies ... than pre-19901

Asia: Change in Gini Index, last two decades 1(in Gini points, since 1990)

Source: World Bank, national authorities and IMF staff calculations.
1In parenthesis the latest available year and corresponding Gini Coefficients.

Asia: Change in Gini Index, pre-1990 1
(in Gini points)

Source: Milanovic (2012), and IMF staff calculations.
1In parentheses, the time period and end-value for the Gini coefficients.
... and more pronounced than elsewhere in most other emerging economies... leaving parts of Asia less equitable than the Middle East and closer to Sub-Saharan Africa and Latin America.

Emerging economies: Change in Gini Index (in Gini points)

Latest Gini Index (population-weighted, in Gini points)

Source: CEIC Data Company Ltd; World Bank, PovcalNet database; WIDER income inequality database; Milanovic (2010); National authorities and IMF staff calculations.

Source: Based on data from Balakrishnan, Steinberg and Syed (2013, p.5).

B. TOWARDS A NEW MODEL OF INCLUSIVE TRADE AND INVESTMENT

To understand all the potential benefits of trade and investment, this report investigates the conditions under which international openness would deliver inclusive growth. As the orthodox approach of “trade and invest first, and distribute gains later” does not produce the necessary and desirable inclusive outcomes, the missing elements in the model need to be explored. First the report examines the transmission channels through which trade, investment and other policies affect household welfare. This is done based on review of theoretical and empirical literature on the linkages between trade, investment and growth; and growth and poverty and inequality. Subsequently, the role of trade and investment in producing inclusive growth is also assessed through a macro-level econometric analysis. This analysis also identifies important complementary policies, for instance related to public investment, which can be deployed alongside trade and investment policy and which can produce more inclusive outcomes. In addition to econometric analysis which is primarily at the aggregate level, the report also uses a number of real world case studies and examples illustrating how the combination of trade and investment, with adequate complementary policies, can work together for the betterment of people’s lives. These findings from these different strands of analysis are the basis for proposed policy options and actions at the national, regional and international levels.

Some of these proposals require countries to join forces, at least at the regional level, and cooperate in pursuing solutions. This could be through a regional trade-financing scheme or open cumulation rules of origin for least developed countries. Here, the role of ESCAP as the leading United Nations regional organization, can be best utilized. ESCAP has been working on giving voice to the countries in regional and global forums, through its mandate to strengthen regional cooperation in the Asia-Pacific region. The organization has also been working to improve regional integration by building capacity to use WTO membership and accession to regional blocs and value chains, as trade-led engines of growth.

In fact, “Asia-Pacific Trade and Investment Report 2009: Trade-led recovery and beyond” examined the role of transparent and inclusive processes in forming trade, investment and related policies. This highlighted the need for countries to be able to easily access the international trading system through accession to WTO, or regional markets by participation in regional trade blocs [see ESCAP, 2009b, Part II in particular chapter 1]. It also considered how trade policymaking could adequately represent all segments of society.
This year’s Report is a small step in providing further insights into factors and circumstances driving the inclusive impacts of various trade and investment policies and activities. Its objectives are: (1) to gain a better understanding about how trade, investment, facilitation and integration policies can support inclusive development, and, wherever possible, to measure the progress of countries in this regard; and (2) to propose a mix of policies for Asia-Pacific economies towards achieving inclusive development results, nationally and regionally.

The Asia-Pacific Trade and Investment Report 2013 Part II comprises chapters 7 to 10. Following this introduction, chapter 8 deals with definitional issues, and introduces concepts such as inclusive growth and inclusive trade and investment, which will be used in the report’s analysis. Chapter 9 is a macro-level econometric assessment of the significance of some of the more obvious trade and investment-related drivers of inclusiveness. Chapter 10 introduces sectoral and micro studies as real-world stories showing trade and investment working towards inclusive growth. Policy recommendations and proposed initiatives for regional action that have been identified through the report’s analysis are outlined in the concluding chapter and are summarized in the executive summary.

REFERENCES


Fritz, Johannes (2013). What supplementary policies may contribute to the inclusiveness of international openness? ESCAP Trade and Investment Division, Staff Working Paper No. 02/13, October. Bangkok.


ONLINE DATABASES


ENDNOTES

77See, for example, the document entitled “Thematic Think Piece on Trade” issued by UN System Task Team on the Post-2015 UN Development Agenda (United Nations, 2012). The document also brings due attention to the interdependence between the principles of inclusivity and sustainability. However, the Asia-Pacific Trade and Investment Report addresses only inclusiveness aspect, while readers are invited to refer to “Climate-Smart Trade and Investment in Asia and the Pacific”, which explores linkages between trade and sustainability (Ratnayake, Proksch and Mikic (eds), 2012).

78A note on terminology: while the Report uses a phrase “trade and investment” when discussing the issues, this phrase is also meant to encapsulate all relevant international activities and related policies. This includes international flows of merchandise and services, capital and labour, transfer of technology, knowledge, ideas and information and policies instrumental to these flows as trade policies (border and behind-the-border measures influencing trade flows), trade facilitation procedures and measures, foreign direct investment policies and promotion, policies related to promotion of small and medium-sized enterprises, transfer of technology, etc.

79Notwithstanding, it is also important to address fair and free access of marginalized and vulnerable developing and least developed countries to the global and regional markets, affecting distribution of gains from international openness among countries. These issues have been addressed in previous APTIR issues and also mentioned in this report.

80Here are some of the comprehensive reviews of literature on openness and growth, openness and employment, and growth and poverty in alphabetical order: Balakrishnan, Steinberg and Syed (2013), Berg and Krueger (2003), Bhagwati and Srinivasan (2002), Dollar (1992), Dollar and Kray (2004), Lee, Syed and Wang (2013), Edwards (1998), Jansen, Peters and Salazar-Xirinachs (2011), Newfarmer and Sztajerowska (2011); also see a background paper for chapter 8 of this report (Fritz, 2013). Given this rich literature with re-examined empirical evidence, this report does not attempt to provide independent stylized facts on these linkages, nor to test relationships between openness and growth, or growth, poverty and inequality. Instead, it attempts to add value by providing additional insights into context ensuring that openness leads to inclusive growth outcomes. In addition to macro level econometric analysis, this is done by relying on case studies and community experiences of complementing trade and investment policies.

81Of course, this will be determined by a large number of factors; most importantly by trade and investment restrictions like tariffs, non-tariff barriers, foreign exchange regimes, non-trade policies and the structure of national economies. Some commentators refer to this indicator as reflecting a country’s trade dependence. For more, see ESCAP (2009a).

82Poverty can be measured in several different ways; based on income per day or consumption (headcount), poverty-gap, inequality among the poor or as the multidimensional concept. Giordano and Li (2012) provides further discussion on issues in relation to alternative measures.

83According to the MDG 2013 Report, the world reached the MDG poverty (goal 1) target five years ahead of the 2015 deadline. Globally “in developing regions, the proportion of people living on less than $1.25 a day fell from 47 per cent in 1990 to 22 per cent in 2010.”

84Similar to measuring poverty, inequality can be measured in terms of income, wages, consumption or assets. There are different metrics in measuring inequality, from the most frequently used Gini coefficient, Theil index, decile dispersion ratio, to the share of income/consumption of the poorest share of population etc. Furthermore, addressing inequality concerns, in the context of international exchange, implies not only distribution among the groups within the country, but also distribution among the countries.
A. FROM GROWTH TO INCLUSIVE GROWTH

Inclusive growth refers to growth that is accessed and shared equitably by all segments of society (Kamel, 2013). Inclusive growth should be broadly based; involving all economic sectors and large parts of a country’s labour force, both as contributors and beneficiaries (Ianchovichina and Lundstrom, 2009).

Growth that is classified as pro-poor and “only” reduces poverty does not necessarily meet the inclusive growth criteria, as it may not affect existing inequalities. Likewise, there are concerns that if the focus of policymakers shifts from confronting poverty to improving the distribution of income, in situations of low growth (as in recent years) the focus on poverty alleviation would be lost. Jorge and Rafalowicz (2013) argue that making strict distinctions between different types of economic growth may, in the end, not be helpful, as policymakers and stakeholders could end up more concerned with terminology than actions and results. Instead, they propose a concept of sustained growth which holistically captures and takes account of concepts of growth, poverty and inequality at the same time and promotes also stability of growth to reduce vulnerability and economic insecurity of poor. For instance, high levels of poverty and/or inequality may make it hard to sustain fast economic growth in the long-term. Therefore, this Report opts to treat inclusive growth in a holistic sense, linking it with: the principles of equality and social responsibility; poverty reduction; enhanced economic security; reduced vulnerability; and improving general well-being.
B. WHAT MAKES TRADE AND INVESTMENT INCLUSIVE?

However dynamic economic growth may be, the benefits will not be automatically or equally shared by all contributors - we need policies to achieve that outcome.

Despite the term “inclusive growth” only being forged about a decade ago, there is already much literature on the topic. The term is now recognized in both professional and public circles. On the other hand, this is not the case for “inclusive trade and investment”. A recent publication of ECLAC lists the various definitions of concepts involving inclusive growth and trade, in the broadest sense, put forward by international organizations. These concepts also incorporate links among inclusive growth, trade, globalization and economic openness. Table 8.1 presents the concepts with their concise definitions; none of which defines “inclusive trade and investment” directly.

### TABLE 8.1

Approaches to defining inclusive growth from a perspective of trade and globalization

<table>
<thead>
<tr>
<th>Concept</th>
<th>Organization</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>To promote trade for inclusive growth and development</td>
<td>World Bank [2011]</td>
<td>Trade that facilitates the adaptation and movement of both workers and firms towards sectors with growing demand, and the incorporation of new technologies with the objective of promoting productivity and employment growth of a wide group of workers and firms.</td>
</tr>
<tr>
<td>Globalization and inclusive development</td>
<td>UNCTAD [2007]</td>
<td>A process of globalization that brings more benefits for countries and population sectors previously excluded.</td>
</tr>
<tr>
<td>ILO declaration on social justice for an egalitarian globalization</td>
<td>ILO [2008]</td>
<td>Globalization that obtains better results through a more equitable distribution, in order to respond to the universal aspiration of social justice, achieve full employment, secure the sustainability of open societies and the world economy, achieve social cohesion and fight against poverty and inequality.</td>
</tr>
</tbody>
</table>
### TABLE 8.1  Approaches to defining inclusive growth from a perspective of trade and globalization (continued)

<table>
<thead>
<tr>
<th>Socially-sustainable globalization</th>
<th>ILO and WTO (2011)</th>
<th>Trade that improves access to employment, salaries and stability.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade and growth to benefit the poor</td>
<td>OECD (2010)</td>
<td>Trade that generates the kind of growth that will reduce poverty. Five policy categories are listed: trade policy and regulations, trade development, trade-related infrastructure, enhancement of the productive capacity, and trade adaptation facilitation.</td>
</tr>
<tr>
<td>Growth of inclusive markets</td>
<td>United Nations Development Programme (<a href="http://www.growinginclusivemarkets.org">www.growinginclusivemarkets.org</a>)</td>
<td>The contribution of firms to human development through the inclusion of the poor in the value chain as consumers, producers, business owners or employees.</td>
</tr>
<tr>
<td>Inclusive value chains</td>
<td>Food and Agriculture Organization of the United Nations (n.d.)</td>
<td>Value chains that include the small farmers, especially in the African, Caribbean and Pacific regions.</td>
</tr>
<tr>
<td>Inclusive businesses</td>
<td>Inter-American Development Bank (IDB) (2011)</td>
<td>Activities that promote an improvement in the quality of life of sectors with few resources through the supply of basic services or products, as well as the inclusion in value chains of disadvantaged productive groups.</td>
</tr>
<tr>
<td>Fair trade</td>
<td>FINE (Fairtrade Labeling Organizations International (FLO), World Fair Trade Organization (WFTO), Network of European Worldshops! (NEWS!) and European Fair Trade Association (EFTA))</td>
<td>Trade that contributes towards more sustainable development, offering better trading conditions and securing the rights of marginalized producers and workers, especially in the South.</td>
</tr>
<tr>
<td>Trade and inclusive development</td>
<td>ECLAC (2013)</td>
<td>Trade that generates a virtuous circle between the reduction of structural differences and growth that improves the wellbeing of a majority and reduces inequality.</td>
</tr>
</tbody>
</table>

Source: ECLAC, 2013; pp. 28-29 (informal translation from Spanish by ESCAP staff.)

Further, the Asia-Pacific Trade and Investment Report 2009 (ESCAP, 2009; pp. 54-57) offered a description of “inclusive trade policy”. This effort is summarized in Box 8.1. While the description is given in terms of “pro-poor trade policy”, the objectives of such a policy are consistent not only with reducing poverty but also with providing fairer and more equitable access to benefits of economic openness.

**Pro-poor trade policy would prevent the poor from bearing the burden of trade reforms and will equip them to maximize benefits from trade and investment.**

Following the preliminary work of ESCAP (2009) and ESCAP (2012), recent work by ECLAC, and building on the body of knowledge in available literature, this Report hopes to make a further contribution towards conceptualization of inclusive trade and investment. Also, and more importantly, it seeks to identify the main drivers of inclusive trade and investment, and by doing so help frame policymaking.

**Inclusive trade and investment imply that all people can participate in, and benefit from those activities.**
Box 8.1  An early attempt by the United Nations to define inclusive trade

In order to make trade work for development, trade should be pro-poor and contribute to human development (UNDP Regional Centre in Colombo, 2006). The 2007 United Nations report clarifies that a pro-poor trade policy should be formulated so that it: (a) prevents the poor from bearing the burden of trade disciplines and liberalization; (b) equips poorer people to derive maximum benefit from trade and globalization; and (c) contributes to achieving the Millennium Development Goals.

In particular, trade policy should aim at: (a) enabling poorer people to compete in a globalized world market by increasing their productivity; (b) ensuring that the benefits of trade are shared in the most equitable manner; (c) ensuring that poor people, women and other disadvantaged groups can draw benefits from exports and that equality within the country and between social groups, regions and genders can be promoted; (d) shielding vulnerable groups from the impact of trade liberalization when this threatens their livelihoods; and (e) ensuring that the liberalization of goods and services effectively contributes to these objectives (Gibbs, 2007, see also a diagram below).

A pro-poor trade policy would pursue market access for products and services where production is dominated by the poor and develop their supply-side capacity. Such a policy would preferably not include trade distorting measures which may have negative effects in the long run. Such a policy would target underdeveloped areas within countries, in particular rural areas, boosting agricultural and industrial production. The agricultural sector has often been overlooked in favour of industrialization but it remains an essential sector not just in terms of development and economic growth, but in particular in reducing poverty. It has also been a traditional stumbling block in multilateral trade negotiations. This has prevented better access to developed country markets for agricultural products from developing countries.

In addition to agriculture, trade policy should increasingly focus on the services sector (ESCAP, 2008). Trade in services has grown rapidly as discussed in part I of this Report. Developing countries have developed strong competitive advantages in selected services sectors such as information technology (IT) and tourism. While services do not always directly help the poor such as the IT industry in India, the revenue generated from such industries helps Government invest in trade-related infrastructure which does benefit the poor. But there are many more possibilities. Improving services related to transport and communications yield an immediate development dividend and indirectly strengthen the supply-side capacity of domestic industry. Here again, Governments need to ensure that the promotion of the services industry is inclusive and sustainable.

While trade and trade liberalization generate winners and losers, Governments need to ensure that ultimately society at large benefits in the long run, and that in the short run trade at least does not disproportionately affect vulnerable groups. This is particularly important for women. In most developing countries in Asia and the Pacific, women still constitute the majority of temporary, casual, seasonal and contract labourers and low-skilled workers. In South Asia, agriculture remains the biggest employer of female workers, whereas in East Asia, South-East Asia and the Pacific, the majority of women workers have moved into industry and services. These workers are the most vulnerable to job losses because they are unlikely to be covered by formal unemployment insurance or social protection schemes. As a result, women, especially those working in export-oriented industries such as textiles, garments and electronics, have been disproportionately affected by the crisis (ILO, 2009). Women also represent a large proportion of the workers in the informal economy. They are assuming increasing roles as owners and managers of SMEs but face routine discrimination when applying for finance or Government support. Their vulnerability increased with the recent global economic crisis, as when formal sector workers switch to the informal economy during crises, it depresses the wages of the informal economy. As a result, women are considered as part of the “flexible” workforce that can be easily discarded during economic downturns. Inclusive trade policies therefore need to include gender appropriate measures and specifically target export-oriented enterprises which are owned or managed by women. Women entrepreneurship needs to be promoted and access to credit, including micro-credit should proceed on a non-discriminatory basis.
Trade and investment will only be inclusive if it is fully consistent with the principles of inclusive growth, explained above. These principles imply that all people can contribute to and benefit from international transactions. However, more often than not, trade and investment will not be enough to create inclusive growth; rather trade and investment policies must be nested in an enabling environment and accompanied by complementary policies. Only then can inclusive growth be achieved. Similarly, a pre-requisite for inclusive trade and investment is equal opportunity for all and often positive discrimination for those most vulnerable and presently excluded, particularly in terms of access to employment, entrepreneurship, technology and finance; as well as in terms of access to social services, such as education, health and information. Equality of opportunities may then contribute to inclusiveness. Inclusiveness or inclusivity combines aspects related to the creation of employment, the integration of specific groups in the labour force such as women, young and unskilled workers, as well as migrants, the compensation and productivity of workers (including an appropriate balance between compensation and productivity, and “decent pay”), and the creation of new (micro) firms and innovation in high-tech sectors. Furthermore, inclusivity is related to the level and variety of consumption, as well as the price of consumption (with respect to food, health and education). Lastly, poverty and inequality as well as quality of life (well-being) dimensions are also included in the concept of inclusivity (see also foldout table presenting a status of inclusivity indicators, as well as openness indicators, for the Asia-Pacific economies).

Inclusivity is multifaceted comprising reduction of poverty and inequality, creation of decently paid jobs especially for those previously excluded, enhanced entrepreneurship, improved consumption choices, and quality of life in general.
Orthodox approaches have prioritized trade liberalization on the assumption that global markets are efficient and greater openness to them will increase overall economic efficiency. As it is accepted that trade liberalization produces both winners and losers, these approaches suggest using the tax system to redistribute the gains that emerge from the overall rise in efficiency. This, however, ignores the other dimensions of inclusivity mentioned above. For instance, employment creation and decent wages do not emerge automatically as a result of liberalization. Wage earners may also not get a proportionate share of the value created by trade (cf. UNCTAD, 2012). Displaced workers often cannot find equally well-paying jobs and may remain unemployed. Adjustment to shocks caused by trade opening can be slow, leading to more significant and long-lasting negative impacts on the health and education prospects of workers and their families, as the Philippines’ experience with trade liberalization shows (Intal, 2008). The orthodox prescription simply does not go far enough to tackle all aspects of inclusiveness.

C. HOW DOES IT WORK?

So what are the linkages between trade and investment and inclusive outcomes? Here we have to keep in mind multidimensionality of inclusivity, which includes, as discussed, the following outcomes: productive, stable, decent and gender-balanced employment; enhanced entrepreneurship; improved consumption choices; reduced poverty and inequality; greater well-being.

The literature on interlinkages between trade and investment liberalization, growth, poverty and inequality has grown significantly in the last 15 years. However, a large portion of the work is based on, or responding to, the transmission framework described in Winters (2000), McCulloch, Winters and Cirera (2001) and Winters, McCulloch and McKay (2004). Our framework (shown in figure 8.2) builds on these original representations of transmission channels. This is done by adding details on the

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**FIGURE 8.2**

Direct and indirect impacts of international openness policies on inclusiveness

Source: ESCAP, based on Winters (2000).
How a country participates in the regional and global economy and if it is part of global value chains or not, goes a long way to determine impacts on poverty and inequality.

It is important to remember that there can be both pro- and anti-poor effects from each channel; therefore there must be caution in making generalizations about whether a particular type of international openness increases or decreases poverty, and how it might then affect inequality. While in the long-run growth is expected to benefit the poor, the effects are likely to vary between households and across countries. Therefore, due attention has to be given to a country’s specific mode of participation in the regional and global economy as well as understanding their position in global value chains. For example, are they mostly suppliers of manufacturing goods,
services or raw materials? Are they linked to reciprocal or non-reciprocal preferential trading agreements? Is the country landlocked or a small island economy?

The framework illustrates the complex linkages at work in transmitting benefits from trade- and investment-led growth through to households. This clearly points to putting in place a coherent and integrated set of policies, coordinated at different levels, in order to deliver inclusiveness. To better understand how different areas of openness contribute to inclusiveness and poverty eradication (and to formulate coherent policy mixes) their impacts are analysed separately through three specific aspects: (1) trade policy related changes, including preferential trade liberalization; (2) trade facilitation measures and policies, and (3) FDI and related promotion policies. Additional insights are then brought through the case studies in chapter 10.

1. Trade policy measures

Trade policy refers to measures undertaken by national Governments to influence the movements of goods and services (as well as factors of production) across its borders. This can include: various measures and instruments; regulations; international agreements and negotiating positions. Trade policy mostly aims at enhancing the market access of domestic firms (producers) in both national and foreign markets, while attempting to also provide access to imported goods, services, and technology, under the best conditions for domestic producers and consumers. To meet these objectives, trade policy frequently turns to restrictions, limiting the free flows of goods and services. However, limitation on cross-border flows can have costs as there are many known benefits of free exchange between individuals, communities, and nations. This is not only due to its effects on prices and therefore, incomes. International exchange enables production specialization, thus increasing efficiency; and it makes available goods, services and resources that are not available locally (or are more expensive), including intermediates. In turn, this improves both consumption and productive potential.

Consequently, restrictions on exchange reduce economic opportunity and limit potential improvements in welfare. Sen (1999) argues that the freedom to transact is an important aspect of a well-functioning market system. Curtailment of that freedom through, say, trade taxes or quotas, imposes not only efficiency costs, but the freedom lost should also be valued in-and-of-itself. Thus, trade restrictions are considered to reduce efficiency as well as denying opportunities, and possibly leading to higher poverty. Sen (1999) suggests that people have a right to transact and improve their condition; denying them that right must be adequately justified.

Possible legitimate justifications for limits on exchange do exist. For instance they may include negative externalities from trade that flow onto third parties, such as: pollution, loss of biodiversity, destruction of natural habitat, unemployment and structural adjustment costs. It is claimed that many of these costs fall disproportionately on the poor and, therefore, exacerbate poverty rather than ameliorate it (Bhagwati and Srinivasan, 2002). Likewise, if some trade policies create market imperfections, rent-seeking and policy-related distortions, these could cause inequality, in addition and above those that would have existed in a textbook “free market based economy”; where inequalities are considered a natural byproduct of productivity and preference differences (Mankiw, 2013). When imperfections exist, they can create inefficiency; removing distortions, including in asset ownership, is thus expected to increase the overall size of the economic pie, and hence reduce poverty and inequality.

Importantly, literature points to trade being an ally in the fight against poverty, as it increases average incomes and, thus, provides more resources to mobilize in the struggle. However, trade policy changes will hurt someone. Therefore, the fundamental challenge is how to implement policy changes in a way that maximizes its benefits for poverty alleviation; and concurrently what to do about any poverty created or exacerbated by those policy changes (McCulloch, Winters and Cirera, 2001). How
to expand the benefits of international trade to more people, while minimizing the costs it imposes, so that trade liberalization and increased engagement of the domestic economy with the rest of the world ends up being growth inclusive? The analysis here, and in the literature, reinforced by real world case studies, shows that the resolution of this challenge rests on the quality of complementary policies. Thus it should be possible for policymakers to develop suitable responses to ensure that the poor gain from trade liberalization (cf. Winters, 2000).

The contribution of trade liberalization to inclusiveness is measured by the increase in households’ welfare. This depends on behavioural responses to the changes in relative prices within two dimensions: (1) for firms, the change in relative prices affects the cost/profit ratio and influences the production mix, the sourcing of inputs, and also employment and wages; (2) for households, changes in prices have a direct effect on the price of the consumption basket and indirectly affect the sources of a household’s income (box 8.3). Firms and households’ reaction

**Box 8.2**  
Trade and jobs: some Illustrations from the region

The trade-led growth of the Asian and Pacific economies has led to a marked increase in import penetration measured as a share of imports of goods and services in GDP. This has risen from low double-digit figures in the early 1990s to close to 30% just prior to the beginning of the global economic crisis in 2008. This rise in import penetration did not, on the whole, adversely affect unemployment; it stayed between 4 and 5% from 1992 to 2012 (figure A). However, the rate of job creation did decline during that period. Average employment growth was around 1.45%, which barely accommodated the rise in the region’s labour force.

**Figure A**  
Import penetration and jobs in the  
Asia-Pacific region, 1992-2011

![Graph showing import penetration and jobs in the Asia-Pacific region, 1992-2011](chart)

*Source: ESCAP based on data from ESCAP Online Statistics Division data (accessed October 2013).*

Empirical studies in general do not offer much evidence that international openness matters either for overall employment or for aggregate unemployment. In line with these findings, Asian and Pacific economies do not display clear relationships between trade opening and levels of employment or unemployment. However, while aggregate employment may remain broadly stable, this can conceal large impacts on workers affected by import competition in individual sectors and companies. When domestic production is displaced by imports, it is hoped that workers will be able to shift quickly, and with little cost, into other sectors that are expanding – typically related to exports. In reality, this
jobless export growth. Furthermore, it is also important to understand what is happening at the sectoral and firm levels. It appears that industrial and services employment might be more responsive to exports than agriculture. For example, a 1% increase in industrial exports is associated with a rise in the industrial sector employment of 0.08% and 0.30% in India and China, respectively. Similarly, a services export growth of 1% is associated with an average employment growth of 0.06% and 0.56% in India and China, respectively. In contrast, agriculture employment shows a different sensitivity to changes in agricultural exports. Sensitivity indices are lower than for the industrial and services sectors, and are negative on average in China, Indonesia, Kazakhstan and Viet Nam, despite the high share of agricultural exports by Indonesia and Viet Nam.
There are several possible explanations for these results. In order for agricultural exports to rise, products must be competitive; often, this means a shift from labour- to technology-intensive production (akin to jobless growth). In addition, export growth is sometimes unrelated to production increases, as in the case of surplus stocks being exported. Often, jobs in other sectors offer higher monetary or other returns, so even if agricultural exports grow, employment might not. Agriculture appears to be the sector most affected by structural adjustment as countries continue to industrialize and enjoy dynamic growth. Even when growth slows or contracts, workers who are laid-off from the industrial sector find it more difficult to move back to the agricultural sector because of the cost of reallocation or other reasons. These workers therefore often remain unemployed or, while waiting for a new job, end up taking unskilled and lower paid jobs in the services sector.

In efforts to strengthen the role of agriculture in inclusive development, in addition to introducing policies related to improvement of productivity and a reversal of disincentives, linking that sector more closely to domestic and foreign markets through specific enabling measures – including training, marketing and access to credit, together with trade reforms and trade facilitation – would enable the benefits of trade-created jobs to be shared with the majority of the populations of many countries.  

1 See the cases in chapter 10 in which new jobs and/or higher productivity and wages were realized from exports of agricultural products following the implementation of trade promotion and trade facilitation measures. For econometric testing see also Chapter 9, section A in this Report.

to the price changes such as their adjustment to new incentives depends on many factors, most notably existing capabilities, mobility costs, access to finance, operation of labour and financial markets, upgrading of skills, incentive framework for product innovation and technology adoption. These are in turn dependent on access to various markets and public sector services.

Removal of trade obstacles changes the prices of tradable versus non-tradable goods and services, as well as the cost of capital. Since this creates incentives to engage in international transactions with trading partners, it is likely that the share of trade and investment will be boosted and, in turn, the country will become more trade dependent. Subsequently, the country may be more vulnerable to shocks, which, when they occur, can be easily transmitted from trading partners to the local economy. Transmission is increasingly through shared production and participation in global value chains (GVCs) (see  

Box 8.3  
Removal of barriers to trade  

Removal of barriers to trade is expected to change:

(1) Households consumption, through changing the prices of tradable goods and services and improving access to new products and services;

(2) Firms’ production, through changing the prices and availability of inputs;

(3) Firms’ production, by changing the relative wages of skilled and unskilled labour and the cost of capital, thereby affecting the decisions on amount and structure (gender, skill) of employment (and affecting a household income generation);

(4) Government revenue from trade, corporate and other taxes, and thus its ability to transfer income to adversely affected segments of population, finance trade adjustment programmes and those for the poor;

(5) Productive capacity and growth, by changing incentives for investment and innovation, and affecting economic growth.
The interdependency brought about by production fragmentation and GVCs can be weakened or intensified depending on sophistication of the country’s traded products, and the level of concentration in its export and import markets. Less sophisticated export baskets (cf. Hausmann, Hwang and Rodrik 2007), and as applied to some Asian least developed countries in Freire (2012) could be associated with a weaker capacity to supply higher value added components, thus also adversely affecting the share of income captured by national producers. Similarly, the greater the geographic concentration of exports and imports, the stronger will be the pass-through of shocks to domestic economy from affected overseas markets. This was well observed during the recent global economic crisis, where economies which were more dependent on exporting parts and components to China (the centre of the “factory Asia” model of production sharing) experienced more serious contractions of exports and therefore had to deal with tougher adjustments (ESCAP 2009, 2011 and 2012). However, their relatively high vertical integration and participation in GVCs also helped their fast recovery, as it complemented domestic demand by balancing export demand sources of demand from traditional Northern markets with the new demand in the South.

(a) Is South-South trade likely to be more inclusive?

South-South trade has grown considerably faster than North-South growth (see figure 8.3). This has led some commentators to propose that South-South trade has some other characteristics which may have higher propensity to deliver inclusive outcomes than traditional trade flows.

According to the UNDP (2013), South-South exports of merchandise and manufacturing have surpassed South-North exports in volume, while also increasing the intensity of skills and technology embodied in them. Although, most of the South-South trade used to be driven by demand and supply emanating from so-called BRICS countries, recently this trade has spread to other parts of the South. According to Bartels and Vinanchiarachi (2009), these trading BRICS countries include: Brazil, agribusiness; the Russian Federation, technology; India, services; China, manufactures; and South Africa, auto-aerospace and minerals. An example of the spread

**FIGURE 8.3**

South-South trade as a share of world trade

![South-South trade as a share of world trade](image)

*Source:* ESCAP, calculated based on WITS database, accessed September 2013.
of trade linkages among the South can be seen in China and India capitalizing on new opportunities in Sub-Saharan Africa, which has now become a major source and destination of South-South trade. China has increased its trade in the region, from $1 billion to more than $140 billion during 1992 to 2011. Indian companies have invested in a range of industries, including infrastructure, hospitality and telecommunications (UNDP, 2013).

However, if South-South trade is measured in terms of value added, a slightly different picture emerges. Namely, gross data often suffers from double counting as products cross borders multiple times and it can ignore the role of intermediates in global or regional value chains. Thus, when using the OECD Trade in Value Added (TiVA) data, South-South trade appears to be significantly lower than South-North and North-North trade (BBVA, 2013; Canuto, 2013). Lower values for South-South trade when using value added terms are the result of general lower value retention when Southern countries export to other Southern countries, rather than when they export to the North (e.g. 35% vs. 47% of gross figures in manufacturing activities according to BBVA, 2013). Moreover, the manufacturing share of South-South trade falls from 71% on a gross value basis to 42% on a value added basis, indicating higher than previously accounted share for services and commodities. These revised figures then suggest that South-South trade should not be viewed as a substitute but rather as complement to South-North trade.

Notwithstanding the necessary revisions of trade dollar values, the benefit of South-South trade is that the goods supplied are often more affordable, more appropriate to needs, and more closely aligned with energy conservation and sustainability principles when compared with those originating from richer countries. Therefore, these products offer more development potential if appropriately acquired, adopted and imitated (UNDP, 2013). Least developed countries also benefit from such trade; importing from China many inputs that improve productive capacity and infrastructure, for example road vehicles, industrial machinery and equipment, chemicals, iron and steel. Leather and textiles, such as yarn and fabric, dominate other import categories. These are used as inputs into apparel for export from the least developed countries to the North. Therefore, cheaper imported inputs may allow least developed countries a more competitive position in global production networks.

Trade in services also provides opportunities for developing countries, which many have seized. These may include lower-skill employment, such as work in call centres and data entry; medium-skill work, such as back office accounting and programming; and high-skill work, such as architectural design and software development. The services sector is expected to expand rapidly as domestic consumer markets grow, allowing the benefits of scale to promote even more trade.

Tourism has become one of the world’s largest services exports, accounting for almost 30% of all commercial services. The most popular destinations include many developing countries in the Asia-Pacific region. The United Nations World Tourism Organization projects that by 2020 almost a billion tourist arrivals will occur within this region (UNDP, 2013).

An emerging South-South trade profile indicates windows of opportunity for converting relatively static comparative advantages into dynamic competitive advantages, especially through development of more vibrant South-South value chains.

(b) Preferential trade

For national producers, international trade not only brings easier access to imported goods and services but also the ability to export to larger and often richer, overseas markets. This can increase their earnings and encourage greater employment - bringing benefits to the wider community. Therefore, access to foreign markets (as well as protection from foreign competition at home) matters for firms and can be crucial in their survival. As a result, national firms expect their Governments to work on their behalf to secure the best terms in both domestic and foreign markets.
Governments thus pursue preferential trade terms through the negotiation of trade agreements. These can be bilateral, regional or plurilateral. Recent years have seen rapid growth in the number of these reciprocal preferential trade agreements (as reported in chapter 6). Additionally, developing countries may also be eligible for trade preferences under unilateral preference schemes, known as the Generalized System of Preferences (GSP).

Following decisions at the WTO 2005 Hong Kong Ministerial Conference, most developed economies and several developing countries (including some in the Asia-Pacific region) have introduced additional duty-free quota-free (DFQF) access schemes explicitly for least developed countries’ products.

However, while securing preferential market access can provide important advantages to producers from least developed countries, tariff reduction alone is often not sufficient to secure access to a foreign market. Non-tariff measures can create even more significant border barriers to small exporters from the poorest countries. These often consist of regulatory standards, such as sanitary and phytosanitary measures (SPS). “Behind the border” barriers (including unnecessary regulations) can seriously reduce or limit market access by increasing the costs of trade (this will be discussed in relation to trade facilitation later). Furthermore, as tariffs have also fallen under multilateral liberalization (in some cases to zero) the margin of preference for products by the least developed countries’ exporters gets squeezed with adverse impacts on their relative competitiveness (Edo and Heal, 2013).

Nevertheless, preferential trade access is still necessary and desirable to enable countries and producers, who rely on trade as engine of growth, to participate in trade. It is important to improve these schemes, and bring maximum benefits to the least developed countries’ producers. Preferences providers should, therefore, consider adapting existing schemes to better meet least developed countries’ needs. This could be done by:

(i) Ensuring that preferences cover export products in which least developed countries have a present comparative advantage or clear development potential in the future;

(ii) Offering “true” preferential market access – over and above what is offered to other developing countries through GSP or via most-favoured-nation;

(iii) Simplifying Rules of Origin to reflect the current reality of international commerce. This is especially necessary where much trade is in parts rather than in finished goods. Well designed Rules of Origin are: easy to comply with; sensitive to sectors of importance now and in the future; and allow cumulation over least developed countries by adopting of so-called “open cumulation” (see chapter 6 in this Report).

Current DFQF schemes have further to go in meeting these requirements. DFQF schemes offered by other Asia-Pacific developing countries, notably China and India, are to be welcomed and it is hoped they will expand product coverage in future. All schemes should aspire to the best practices in product coverage and rules of origin regimes.

Trade agreements can lower barriers but should include provisions to enhance supply capacity and ease adjustment shocks to have an inclusive outcome.

In addition to the unilateral preferential schemes, negotiated reciprocal exchange of preferential treatment through regional or bilateral free trade agreements have become, somewhat paradoxically, very popular since the establishment of the WTO in 1995. This type of liberalization may deliver more inclusive outcomes when compared with either autonomous or multilateral liberalization. Firstly, preferential trade agreements are typically done with partners selected for some specific reasons. This may allow for either more gradual or selective liberalization (as in APTA) or a complete exclusion of some items, thus sheltering those most vulnerable to import competition. Secondly, inclusion of provisions for economic cooperation may deliver wider benefits. This co-operation may include: human capital development; mobility of labour; and financial cooperation, thus directly contributing to more inclusive gains. Moreover, in the case of regional trading or economic blocs, such as ASEAN, countries may also stipulate provisions with a more direct...
impact on closing the development gaps among the members. These types of agreements may allow for intra-bloc mobility of labour and FDI, as well as extending public-private partnerships to the regional level and improving access to various important markets, such as IT, energy, and finance. Projects also combine resources for infrastructure development and exchange or access to education and health services.

While trade liberalization creates many opportunities for inclusive growth, increased import competition may create adjustment problems for certain companies and workers. These adverse effects are expected to be short-term as resources are reallocated across the economy. In order to prevent this restructuring worsening poverty and inequality, a country can put in place so-called trade adjustment assistance programmes (see box 8.4 for the case of the Republic of Korea). Such programmes assist companies, and thus individual workers, undergo restructuring while minimizing vulnerabilities and unpredictability.

2. Trade facilitation measures

Trade facilitation aims at increasing the cost effectiveness of international trade transactions by streamlining regulatory and other trade procedures (see ADB-ESCAP, 2013 for a list of definitions by various international organizations). Trade facilitation measures are expected to reduce trade costs and make trade processes simpler and more predictable, while maintaining appropriate levels of regulatory controls of goods flowing across borders. Such measures are often considered essential for firms in developing countries to participate effectively in regional and global production

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**BOX 8.4**

Trade Adjustment Assistance Programme of the Republic of Korea

The Government of the Republic of Korea introduced the Trade Adjustment Assistance (TAA) program to facilitate restructuring of domestic companies which are exposed to adverse impacts from Free Trade Agreements (FTAs). TAA is designed to provide domestic companies which have been harmed or are expected to be harmed from the increase of imports resulting from liberalization of trade with the FTA trading partners with loans or consulting service to support their smooth restructuring. The Act on Trade Adjustment Assistance following FTAs was enacted in 2006 and the TAA has been in place since 2007.

To receive the benefit of TAA, companies which are designated by the Act need to meet several criteria. First, they should have been harmed or to be harmed for at least six months. Second, damage need to be attributable to the increase in imports of the same or a directly competitive product or service. Third, the companies’ restructuring plans should be enhancing their competitiveness. If the companies meet the conditions, the Government makes a decision on offering a loan based on the company’s credit (up to a maximum of KRW 4.5 billion for facilities per company and a maximum KRW 0.5 billion for operations). The evaluation on trade damage is done by the Korea Trade Commission and the assessment on the award of benefits is done by the Small and Medium Business Corporation. The companies can also be provided with consulting services to assist with the restructuring plan covering 80% of the total cost (maximum KRW 40 million).

Strict eligibility has led to low utilization of the scheme and triggered domestic criticism. Consequently the Government revised the enforcement decree in 2012. The criterion of damage (the decrease in sales volumes or production compared to the previous year) was lowered from more than 20% to 10%, and new activities related to consultancy and application preparation were added. Up to 8 Oct 2013, KRW 7.6 billion (approximately USD 7.2 million) for 23 companies have been provided by TAA. Despite these improvements, it has still been suggested that the TAA program should be reformed to encourage more substantial structural adjustments in the affected companies.

networks. They can be expected to not only increase trade but also revenue collection as trade procedures and controls at the border become more transparent through automation and the application of modern information and communication technologies. Beyond simplification of regulatory requirements and “at the border” procedures, trade facilitation reforms increasingly include enhancing access and efficiency of trade-related services, such as logistics and financial services, as well as improving the overall business environment.

How can trade facilitation lead to inclusive outcomes? One way is through its positive impact on trade flows. Improved trade facilitation significantly contributes to increased trade (e.g. Layton, 2008). As argued earlier, increased trade, in turn, can have positive impacts on the poor or vulnerable groups. These trade-led impacts are certainly wide in scope and can operate through multiple channels (Higgins and Prowse, 2010).

Trade facilitation can also deliver inclusive outcomes because various social and economic groups benefit from trade facilitation or use the services offered by trade facilitation (ODI, 2010). Generally, trade facilitation can be expected to have a positive effect on the inclusiveness of trade given that simplification of procedures can be expected to make it easier for small traders and firms to participate in international trade. However, this is only the case if simplified procedures are offered in a non-discriminatory manner to both small and large traders, which is not always the case. Accordingly, inclusive outcomes can be further increased through specific trade facilitation measures targeted at “excluded” groups or sectors. Benefits can range from enhanced access to trade-related information for agricultural producers, to women’s ability to participate in trade, or to easier access to trade-related services (e.g. financing) previously only available to big traders. Because they are often restricted to a certain geographic area or sectoral in nature, these benefits may also be smaller relative to those arising through increased trade, although the very limited literature available in this area precludes any definitive conclusion on the matter.

(a) Impact of trade facilitation through trade

Increased international trade from trade facilitation initiatives can achieve inclusive gains. As noted, the key purpose of trade facilitation is to reduce trade transaction costs and time, both for exports and imports. Costs can be reduced by faster processing of trade documents, higher predictability of goods supply, and improved information exchange. In turn, this increases international competitiveness and trade.

Assuming that trade facilitation reforms in port and customs efficiency, domestic regulations, and the e-business environment can bring countries in Asia and the Pacific with below-average performance closer to the regional average, it is estimated that intraregional trade could increase by over $250 billion (Mann, Wilson and Otsuki, 2004). More recent analysis suggests that reducing direct export costs in Asia to OECD levels (a 14% reduction on the average across the region) could increase Asian exports by up to 14%, translating in an expected 2.5% rise in per capita GDP in Asia and the Pacific countries (ADB-ESCAP, 2013).

Increased exports could also lead to additional employment and higher incomes for the poor. In India, organic spice exports increased from $290,000 in 2000 to $1.13 million in 2003, due to support measures for: improving production techniques; organic certification; and standards development. This led to an increase in small-scale organic spice producers. In some areas, producers tripled their income (DMI Associates, 2006). Bangladesh’s export-oriented textile industry employs more than 3.5 million factory workers, with most being women who have migrated from villages (Ahamed, 2012). Increased exports can also lead to higher income opportunities for other actors along the supply chain.

Costs associated with inefficient trade procedures are estimated to account for up to 15% of the cost of goods traded (ADB-ESCAP, 2013). Savings from reduced trade transaction costs can be shared by the producers, wholesalers and other players.

It is the small traders who should benefit the most from simplified trade procedures.

Reducing direct export costs in Asia to OECD levels could bring a 2.5% rise in per capita GDP in Asia and the Pacific countries.
Improving access to domestic markets is part of the solution to making trade and investment inclusive.

Reduced transaction costs from trade facilitation can contribute to lowering consumer prices through imports. In particular, cheaper food commodities for mass public consumption are extremely important for many regional developing countries. Ensuring food security and nutrition to the poor and vulnerable groups, including women and children, can be achieved through accessibility. Cheaper food commodities imports can also stabilize consumer prices for essential goods. Cheaper imports of raw materials, machinery or intermediate products also mean lower input costs for export-oriented industries.

Time and cost reduction in “behind the border” trade procedures should also result in greater benefits for SMEs and poor individual traders, who are more vulnerable to delayed deliveries, order rejections or corrupt practices. In comparison to larger enterprises, this group faces greater challenges in accessing information and/or knowledge. A survey in Bangladesh found that SMEs mostly use customs agents because of their lack of knowledge about customs procedures and resources (Hossain, Deb and Amin, 2010). On the accrual of benefits, a Philippines study showed that 65% of SMEs experienced a reduction in lodgment time for customs documents after electronic submission of information was implemented (de Dios, 2010).

(b) Importance of international and domestic trade linkages

An important contribution of trade facilitation to inclusive growth is through its impact on domestic trade and business practices. Duval and Uthoktham (2010) found that improving the domestic business (investment) environment has a similar or greater impact on export competitiveness than implementing international trade specific facilitation measures (e.g. reducing export time). In other words, a firm’s international trade efficiency is strongly linked to domestic trade efficiency and the business environment in its own country. Given such a strong link, it is reasonable to expect that efficient international trade practices may also have positive spill-over effects on domestic trade and practices, contributing to more inclusive trade. This argument is supported by recent research (e.g. Shepherd and Stone, 2013) which provides evidence that knowledge flows from global value chains can contribute to industrial upgrading of quality standards in developing countries’ domestic markets.

Domestic markets are a significant source of economic growth in many developing economies in the Asia-Pacific region. For example, in Indonesia, micro, small and medium enterprises (MSMEs) are 99% of the total enterprises and drive local economic activities (Tambunan, 2013). These MSMEs are made up of a few employees, or are family-run. They are not generally linked with international trade. However, Tambunan in ESCAP-ARTNeT (2013) study shows that improvements in international trade benefits MSMEs involved in domestic trade. This is essentially through spill-over effects on business environment, transport regulations, access to trade-related information and logistics, and financial services.

logistics and transportation in the Dongfeng village of Eastern China, in addition to increasing income of villagers making the furniture (Chinese Academy of Social Sciences, 2010). Increased growth can also attract new domestic players into international trade. In developing countries, many exporting companies cater both to international and local markets. Domestic trade facilitation measures, such as developing a warehouse in a rural area for food commodities, can be used for storing products for local producers. In turn, producers are able to respond to price fluctuations, and can gain from selling products when market prices are high (Higgins and Prowse, 2010).

Growth of a specific export industry can develop local support services and contribute to higher incomes for communities. A case in China (more in chapter 10), shows that through e-commerce, furniture exports created opportunities for development of support services. This includes
Improved logistics services that connect rural areas to urban collection centres also act as boosters to local producers by reducing post-harvest loss. For example, the e-choupal in India established by a large food export and retail company, provides improved logistics services, which reduce handling loss of soy beans (there is further detail of the e-choupal case study in chapter 10).

In another forthcoming ESCAP-ARTNeT study, Karunaratne and Abaysekara (2013) found that in Sri Lanka, export processing zones (EPZs) considered as a trade facilitating measure, have created economic opportunities for SMEs to open up hotels, restaurants and business support services, such as printing and telecommunication, to cater to the needs of zones employees. To serve the businesses inside EPZs, logistics service providers, freight forwarders and recruiting agencies have opened offices in the area. These enterprises have created additional employment for people from the surrounding areas, as well as other locations across the country.

Measures based on improving access to and use of information and communications technologies (ICT) are often seen as a big component of trade facilitation. ICT applications can include: computer automation of operations; use of mobile technology; risk management systems; track and trace systems; e-commerce; Electronic Data Exchange (EDI); and development of electronic Single Windows. Economic gains for the poor from the widespread use of mobile communication technology are noteworthy. One UNCTAD report (2010) indicates that reduction in information search costs and improved communication within supply chains and overall improvement in market efficiency as the biggest gains for the poor through ICT enabled services or application. There are examples where dairy farmers in Bhutan or “mobile ladies” in Bangladesh have improved their livelihoods using mobile phone based services.104

Finally, economic corridors are a good example of local communities benefiting from increased economic activity. As shown in the forthcoming ESCAP-ARTNeT study by Cheewatrakoolpong, Mallikamas and Phupoxsakul (2013), the construction of the second Thai-Lao Friendship bridge has resulted into more jobs (in addition to trade), and, in turn, a reduction in people under the poverty line for Thailand’s Mukdahan province.105 Jobs have been created to support the greater economic activity taking place in the province. However, the study concluded that the economic opportunities created by the bridge can be better utilized with the provision of micro-finance facilities, which can be considered a domestic trade facilitation measure.

3. Foreign direct investment and related promotion measures

Foreign direct investment (FDI) can generally lead to economic growth, as well as providing revenues for the host country (through capital and tax returns) that can be used for development financing. To encourage FDI, government intervention is required in order to establish an enabling and conducive investment climate. To create such an investment climate, Government must put a set of rules and regulations in place, which guarantee a stable and predictable system. The Government must also find a balance between regulation and liberalization, as too much of either can lead to undesirable results (ESCAP, 2009). Too much regulation may prevent the market from functioning efficiently or FDI benefits from fully accruing to the host economy; too little regulation may give companies the opportunity to exploit the host economy. Governments need to pay attention to the rules and regulations, including the legal framework, stipulating the minimum wage and standard working conditions. This can range from the protection of private (including community) property rights to labour laws. Also to be put in place are social safety nets that protect the society’s most vulnerable. Moreover, environmental standards are important to ensure that companies operate and use resources in a sustainable manner.

Both the public and private sectors have a role to play in making FDI inclusive. On one hand, Governments can secure policies that channel FDI to support marginalized groups, place limitations on damaging business activities, and use increased revenue to provide redistributive social benefits. On the other hand, businesses can provide overall employment and training, while also providing direct benefits to disadvantaged groups.

Improved employee motivation is an important gain from inclusive development promotion. This could be done either directly through wages or indirectly through non-wage working conditions. Foreign investors can enhance worker motivation, while contributing to
Inclusive development, through established fair working conditions, chances for upward employee mobility and training schemes for local employees. Governments are responsible for ensuring implementation of decent standards of work and income.

Foreign and domestic investors can benefit from actively contributing to inclusive growth in host countries. Inclusive growth can empower larger segments of the local population to become consumers, in turn, increasing the size of local markets. Consequently, companies can increase revenue by selling their services and products to a larger segment of the local population. Therefore, it makes good business sense to offer training to people who may become potential customers, productive workers or suppliers. For example, companies that offer irrigation or other farming products could also offer training to local farmers in order to increase productivity. This may, in turn, increase purchases of a company’s goods and services. Additionally, it would also make business sense for foreign companies to involve local suppliers as much as possible in their supply chain. This could increase local employment, as well as increase the potential for more customers of goods and services offered by foreign investors. FDI can also contribute to inclusive growth through adoption of inclusive business models and the implementation of responsible business practices, or corporate social responsibility (CSR). Inclusive business models refer to core business activities, which have a tangible impact on economic and social opportunities for low-income groups (Business Innovation Facility, 2011). Inclusive business models help to promote inclusive growth as they involve socially-disadvantaged groups in the value chain of companies’ core business. This can be as suppliers, distributors, retailers, or customers. Responsible business practices (CSR) involve ensuring implementation of the good governance principles. These are related to human rights, labour, environment, and anti-corruption in core business activities.

Impact investment has the potential to channel private capital flows where they have the greatest effect on inclusive growth.

Another pathway for FDI to facilitate inclusive growth is through engagement of foreign investors in impact investment and social enterprises. At the heart of impact investment and social enterprise is the specific objective of improving social development, instead of solely maximizing profit. ADB defines impact investment as investment that aims not only to secure financial returns, but also to generate positive social and environmental impacts. Impact investment has the potential to channel substantial private capital flows into initiatives that address challenges faced by developing countries. Through its potential for promoting inclusive businesses and social enterprises, impact investment can contribute to inclusive growth. Social enterprises are characterized as business-oriented not-for-profit or for-profit enterprises, with the latter putting primary focus on social impact as well as focusing on financial objectives (ADB, 2013). Additionally, foreign investors can make positive contributions to community and social development by supporting and initiating efforts in fields such as infrastructure, education and health. What have been particularly promising, in this regard, are private-public partnerships.

Making FDI inclusive requires action both from the private and the public sector.

In summary, as with other dimensions of international openness, FDI needs to be supported by a host of complementary policies to lead to inclusiveness. With such support, FDI can lead to increased employment, wages, productivity, and skills that all have the potential for benefiting marginalized groups. This requires complementary policies and regulations that channel FDI to inclusive areas, guide investor behaviour in line with inclusive activities, and/or use FDI revenue to finance social development objectives. Flows from foreign investment have
the potential to help groups such as women, youth, minorities or the disabled. Flows from foreign investment have the potential to help groups such as women, youth, minorities or persons with disabilities with the right set of national policies and regulations in place. FDI could have more direct impact by engaging businesses in more socially responsible behaviour. This can be done through the adoption of international standards for responsible business practices, social and impact investment, and public-private partnerships.

**CONCLUSION**

Analysis of the linkages between international openness and households’ welfare offers many different paths through which households can be affected. Clearly, it is difficult to isolate the role of individual effects, as more than one can be at work at the same time. However, several themes recur across all three dimensions of openness: (1) opportunities for employment are critical as employment affects the income that a household can spend on consumption – of both basic commodities and purchases that improve well-being (2) productivity gains can be driven by exports as well as access to new technology through FDI; (3) wages impact directly on poverty and income inequality; and (4) equal employment opportunity between genders is one indicator of access. Therefore the next chapter turns to exploring the linkages of those inclusivity indicators and trade and investment in more detail.

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ENDNOTES

See later part of this chapter as well as chapter 9 for details on complementary policies.

This does mean that those who could not have contributed (for multiple reasons) should still be included in sharing the gains.

The first mention of “inclusive growth” is linked to a paper by Lin (2004). Previously this concept was known as “growth with equity” (Fei, Ranis and Kuo, 1979).

ESCAP organized an expert group meeting on 14 December 2012, calling upon a number of experts in the field of development and international economics, as well as from all sectors and including international organizations. This Report benefited greatly from deliberations in the Expert Group Meeting on Inclusive and Job-Enhancing Trade: Asia-Pacific opportunities. Materials from the meeting are
available from www.unescap.org/tid/projects/ijet.asp. Additionally, a number of background papers and written contributions were made available to the drafters of the Report, and these are accessible on the APTIR webpage www.unescap.org/tid/ti_report2013/home.asp.

Furthermore, in the preparation process of a report such as this, a deeper understanding and clarification of methodology and data is gained. This proves to be useful in the ESCAP secretariat’s work on building capacity for further analytical work in the region.

The fact that other policies need to accompany policies of international openness (such as trade liberalization) to guarantee that the benefits are shared by all suggests that one should not rely only on this (trade) policy to reduce poverty.

One important factor impacting inclusiveness and not addressed in this report is access to assets, especially land.

More generally, the reasons for departure between model-based outcomes and reality relate to various complications arising from inefficient factor markets and thus inadequacy of assuming that necessary adjustments will happen quickly and without additional investment, local or foreign, or new labour skills (see more in Intal, 2008). As discussed later, this partially could be fixed by pairing trade liberalization with a number of complementary policies (other than distributive measures) which are often ignored in the simplistic prescriptions on trade liberalization.

It is not only in developing countries that workers and poor carry the cost of trade liberalization. Autor and all (2013) examined the impact of exposure to rising trade competition on the employment and earning trajectory of United States workers between 1992 and 2007. They found that workers bear substantial costs as a result of the “shock” of rising import competition.

A need for local and national coordination is clear. International cooperation is necessary to enable smoother and beneficial participation of least developed and developing countries in trade and global value chains. Often policies of trading and investment partners (related to for example their overseas development assistance (ODA), Aid for Trade, or GSP schemes), or rules set at regional (trading blocs) or international level such as WTO, WIPO and OECD may (adversely) affect the effectiveness of national efforts to implement pro-poor and pro-development trade and investment.

It is beyond the scope of this Report to go into discussion of desirable features of national trade policies, but it is still important to just mention that stability, transparency and predictability are of crucial importance.

These are results of trade having positive impacts on and allowing use of competition, economies of scale, learning by doing etc.

Examples of trade policy related distortions include market barriers in general, tariffs, non-tariff barriers (NTBs), and trade-related regulations. These are not justified by public policy concerns or evenly distributed across economic sectors, differences in market entry barriers and incentives to rent-seeking behaviour, trade-distorting effects of policies that discriminate goods, services and factors by geographical origins of trade (such as preferential trade agreements and GSP schemes). The problem is that many distortions also arise from infrastructural management, regulation and complimentary policy areas such as macroeconomic, financial and labour markets, governance and human capital creation (Giordano and Li, 2012).

However, the orthodox presumption is that the total loss will fall short of overall gains (except in the case of Bhagwati’s (1958) “immiserizing growth”), thus creating sufficient resources for making sure that no one is worse off. While this theoretical prescription works in a long-run, in reality there are many challenges to making it operational. Consequently, some people end up being hurt by policy changes. But, “rejecting any reform that adversely affected any poor person would be a recipe for long-run stagnation, which would ultimately increase, not reduce, poverty” (Winters, 2000, p. 2).

Intal (2008) uses the case of the Philippines to identify these important complementary policies: quality of the investment response, the workings of the labour market and industrial relations, the overall macroeconomic environment, and the quality of government institutions and related policies, among others.

The preference erosion also arises from a host of preferential trade agreements between developed and developing countries, further increasing competitiveness challenges of the least developed countries’ exports.

While a number of developed countries DFQF schemes cover 97% of the items (as mandated by the Hong Kong Declaration), the United States never implemented a similar scheme covering all least developed countries.

Even the partial preferential trade agreements focused only trade in goods can positively influence trade and investment flows and thereby help with inclusive development. See, for example, the positive spillover effects of the India-Sri Lanka Free Trade Agreement on growth of FDI and employment in chapter 10.

Although this estimate should be taken with caution given the difficulties in quantifying linkages between trade facilitation and poverty, a forthcoming ESCAP-ARTNet study
Asia-Pacific Trade and Investment Report 2013

on China concludes that a 1% increase in port efficiency may be associated with a 1% decrease in poverty index (Wu, 2013).

Based on UNCTAD (2010). Bhutan’s dairy farmers use mobile phones to access market information, avoid intermediaries, collective pricing etc. Grameen Phone of Bangladesh has facilitated mobile phone services including internet based facilities to the rural people through more than 350,000 village ladies.

Thailand’s Mukdahan province is located at the border of Thailand and the Lao People’s Democratic Republic in the East West Economic Corridor and is close to Savannakhet of the Lao People’s Democratic Republic.
INTRODUCTION

This chapter contains a cross-country analysis examining how poverty and inclusive growth are affected by international openness. In it, the interaction between international openness and underlying conditions, such as capital and labour mobility, ease of firm entry and exit, good governance and the rule of law, access to education and health facilities is also considered. Existing literature together with the analysis in this Report, points to the need to explore four dimensions of potential linkage between openness and inclusiveness, namely (i) aggregate employment and its distribution; (ii) aggregate productivity; (iii) poverty and income inequality; and (iv) equal opportunity between genders. Analysis is done using aggregate data from the Asia-Pacific region from 1988 to 2010.

Results clearly show that an expansion of trade and investment does not necessarily produce inclusive development. The results show that a range of complementary policies are required to increase the inclusiveness of economic development in the presence of international openness. Along with trade and investment policies, it appears that it is important to choose a balanced mix of complementary policies to use hand-in-hand with the managed opening of national economies. Some suggested complementary policies are: increasing labour market flexibility; raising aggregate investment; boosting information and communication technology expenditure; and improving equal access to education.
A. INTERNATIONAL OPENNESS AND EMPLOYMENT

1. Evidence from the literature

The broad-based labour market participation required by inclusive growth demands further productive employment growth; this is to make room for groups currently outside or on the fringes of the labour market. Current literature indicates that the contribution of international trade to aggregate employment is muted and changes over time. The contribution also depends on the direction of trade flows and is strongly connected to country characteristics, such as the labour market regime. The following important linkages are relevant for further examination in the Asia-Pacific context.

1. For the economy as a whole, positive employment effects of international openness only arise in the longer term, if at all. Empirical evidence shows that trade only plays a minor role in determining aggregate employment. However, from industry-level analysis it appears that trade liberalization reduces unemployment, albeit only with a lag. There are short-term increases in the unemployment rate following trade liberalization, but these are generally outweighed by employment gains over the longer term.

2. Aggregate employment effects depend on the net trade position of each sector. Industries that face import competition tend to shed workers, increasing the risk of unemployment in these industries. For example, increased import competition propelled Mexican employers to downsize their workforce, while those sectors subject to stronger import liberalization in Chile witnessed higher and eventually more persistent unemployment. On the contrary, industries that are net exporters seem to add workers overall, rather than shed them. The skill mismatch between labour supply and demand may cause increasing unemployment, even in export sectors. There is some evidence of rising unemployment among medium-skilled workers. However, when data incorporating occupational characteristics is used, exports may also reduce employment opportunities for medium-skilled workers.

3. Informal employment seems to mirror the effect on aggregate employment: rising in the short term but falling over longer periods of international openness. In the context of inclusive growth, it is important to consider informal employment as it tends to generate unequal income distributions, as well as dragging on potential economic growth. Effects of trade policy changes differ in the short and the long run. Liberalized economies tend to be associated with less informal employment in the long run, but the short-run adjustment to increased openness tends to stimulate temporary informal employment. In the long run, increased openness and diversification seem desirable: they tend to decrease informal employment and thus include a growing share of the population in the benefits from the resulting growth.

4. In order to reap the benefits of international openness, labour market regimes seem to play a crucial role. The lack of worker reallocation seems to be a major obstacle to broad employment growth following increased international openness. Overall, weak labour reallocation, from contracting to thriving sectors, is prevalent throughout the developing world.

2. Evidence on employment opportunities in the Asia-Pacific region

The inclusivity indicators representing the potential for employment opportunities are: (i) the employment-population ratio, and (ii) the share of informal (i.e. contract-less) employment in total employment. This Report’s analysis holds that decent employment is the central means to enhance the inclusiveness of growth. Rather than spreading the benefits of growth through public redistribution schemes, individuals should participate in the economy through productive employment. The employment-population ratio and the share of informal employment capture this dimension, which is an aggregate measure of the availability of employment opportunities.

The literature review made two discoveries: net trade flow (net exports/net imports) appears to matter for employment outcomes; and labour market regimes seem to also play a crucial role. The model used in this Report will explain the trade flow direction and composition, which could have important implications on complementary policies. The important aspects of trade composition emphasized in this model include types of export markets (measured
by export shares to high- and middle-income markets) and characteristics of export industries (traditional sectors, and the intensity of imported intermediates). Results, generally, reflect that international openness by itself has little impact on employment opportunities. However, some interactions between openness and complementary policies are of significance. To illustrate these interactions and their impacts on the employment opportunities, figures 9.1 and 9.2 depict the effect of a given international openness variable on the employment-participation rate or the informal employment share.

Our results imply that the employment participation rate is significantly related to the interactions between the share of intermediate goods in total imports and labour market flexibility with the outward-over-inward FDI ratio. Figure 9.1 displays how a change in each of these variables would benefit the hypothetical average Asia-Pacific country from a sample.

According to our counterfactuals, changes in the share of intermediate goods imports only have a muted effect on employment participation. The average Asia-Pacific economy in the data set had a 32% share of intermediate goods in its total imports. For the bottom quarter, this value was 22% while it was 38% at the top quarter of observations in our sample. According to our estimates, if the average Asia-Pacific country were to change its share of intermediate goods

**Box 9.1**

How to interpret figures in this chapter

The figures are constructed to help explain results of econometric analysis. The analysis sought to assess the benefit of altering one complementary policy (at a time) that was found to be statistically related to international openness. The starting point is the average Asia-Pacific economy in our sample. The sample average of the inclusivity indicator of interest is represented by a grey column. To illustrate the costs and benefits of changing a complementary policy, we generate two counterfactuals. The first counterfactual assumes that the average Asia-Pacific economy dropped its complementary policy value from the mean to the bottom quarter. The estimated result of such a drop is illustrated by a red square. The second counterfactual goes into the opposite direction. Instead of falling into the bottom quarter (25th percentile) we now assume that the average Asia-Pacific country moves up into the top quarter (75th percentile) found in our sample. The estimated result of this counterfactual is represented by a green dot.

**FIGURE 9.1**

Intermediate imports and composition of FDI affect the employment participation rate

![Chart showing the effect of intermediate imports, FDI outward/inward ratio, and labor market flexibility on employment participation rate. The chart displays average Asia-Pacific economy, change to 25th percentile, and change to 75th percentile for each variable.]
in total imports from 32 to 22%, the employment participation rate would increase slightly from 58.42 (figure 9.1, grey column) to 58.55% (figure 9.1, red square). However, if the average Asia-Pacific country were to move from the mean intermediate goods share into the top quarter (38%), then the hypothetical employment participation rate would fall to 58.35% (figure 9.1, green dot).

Interpreting the impact of additional labour market flexibility is similar. As figure 9.1 illustrates, a move from the mean into the first quarter of the most flexible labour markets in our sample would raise the employment participation rate, albeit a tiny amount. Similarly, if the average Asia-Pacific country were to fall from the mean to the bottom quarter of labour market flexibility, the consequences for employment participation would be negative, though minimal.

In our sample, countries that have relatively more outward foreign direct investment (FDI) also feature higher employment participation rates. The mean outward/inward FDI ratio in our data is 0.3, implying $3 of outward FDI stock for every $10 of inward FDI stock. If this average value were to increase to $4 outward FDI per $10 inward, the employment participation rate would increase to 58.62%. Were it to drop to only $2, the employment participation rate would drop to 58.23%. Countries with a relatively higher outward FDI stock thus seem to enjoy higher employment participation rates. However, causation may run both ways and there may also be an uncontrolled third factor, e.g. education attainment or development status, at play.

Regarding the informal employment share, increasing the share of traditional goods in total exports could potentially decrease the size of informal employment. As figure 9.2 shows, moving from the average share of traditional goods in total exports (0.8% in our sample) to that of the top quarter (0.9%) would decrease the informal employment share from 37.4 to 37%. The considerable sensitivity of the informal employment share to this export class is also illustrated by a move in the other direction. If an average Asia-Pacific country was to move from the mean to the bottom quarter (0.3% of total exports), the hypothetical informal employment share would rise to 39.57%.

Economic and trade diversification and international openness lead to increased formal employment.

**FIGURE 9.2**

The composition of exports, FDI and the exposure to international trade affect the informal employment share.
A further implication of the hypothetical deviation from the average country in figure 9.2 is the importance of trade in reducing the informal employment share. If international openness measures, as the sum of the GDP share of exports and imports, increase from the sample mean of 50% to a hypothetical 60%, the informal employment share would fall by close to a percentage point. Therefore, according to these estimates opening to trade may reduce informal employment. However, increases in total trade would need to be of a considerable magnitude.

The interpretation of the columns representing share of intermediate goods in total imports and outward-over-inward FDI ratio are as above.

These estimates and the graphical representation imply a variety of indicators for inclusive trade. It suggests that complementary policies can contribute to a formal employment increase in a gradually opening economy. The estimates hint at promotion of intermediate imports and exports in traditional goods sectors as a means to boost employment outcomes. Furthermore, an increase in labour market flexibility may lay the ground for positive employment effects of increased international openness.

**B. INTERNATIONAL OPENNESS AND PRODUCTIVITY**

1. **Evidence from the literature**

Regarding inclusive trade, the question is whether international openness increases overall productivity. Literature has shown that access to world markets increases aggregate productivity. The increase can be attributed to the reallocation of market share towards productive exporting companies, thus raising average output per worker. There are two ways that trade can benefit aggregate productivity, even after initial liberalization has been implemented: firms may learn by exporting, as well as by learning to export. The former implies that firms have additional productivity gains from ongoing exports, on top of the initial boost. The latter gives a certain nuance to the notion that exporters were productive in the first place. This could be due to systematic preparation for exporting, well before the first international shipment is realized. Below are key findings from relevant literature.

1. **Companies exposed to trade tend to be more productive, on average.** “Exporters are better” is the brief conclusion of Wagner (2007), who studied the 1996-2005 literature (see also Melitz, 2003). On average, exporting firms tend to be more productive than their domestic-oriented counterparts. It is commonly observed that exporters are more productive even before they start to export. That is, more productive firms seem to “self-select” into export activity. Besides providing more room for productive enterprises to flourish, international openness may also be productivity-enhancing for non-exporters.

2. **The higher productivity of exporters may be due to deliberate preparation.** It may well be that the decision to enter a foreign market triggers a learning process that is completed once the first product leaves the domestic shore. Such preparation activities, which are a positive impact of trade, may be rooted in the common observation that exporters tend to be more productive a priori.

3. **In developing countries, companies tend to learn by exporting.** Once companies have tapped foreign markets, this may continue to benefit plant productivity growth for a variety of reasons. For instance, rising production may continuously generate economies of scale and generate savings. Furthermore, observing and reacting to foreign competitors, as well as customers, may spur innovation in processes and products. In line with this insight, learning by exporting is often seen in developing and transition economies.

4. **Exporting companies tend to invest in productivity-enhancements.** Firms exposed to international trade are more likely to upgrade their production technology, than those who are not. The complementarity activities of research and development in exporting are also important. An exporter that engages in research and development, or provides training for workers, will experience significantly higher productivity gains in the subsequent periods than an exporting company that does not invest in either of those activities.
5. **Liberalizing intermediate inputs is a boon to plant productivity.** Increased import access to intermediates may ease some of the technological constraints present in a closed economy.\(^{115}\) Several studies indicate that increasing productivity after trade liberalization may be due to better sourcing of intermediate products from abroad. Liberalizing intermediate goods trade is more effective in raising productivity than tariff liberalization on final products.

6. **Foreign direct investment increases productivity.** Establishments that are owned by foreign multinationals show higher average productivity than their fully domestic-owned competitors. The establishment of China’s special economic zones (SEZs) throughout the 1980s and 1990s saw average labour productivity rise in these zones, thanks to FDI invested in their SEZs. However, the rise in productivity was only partially reflected in higher wages, with corporate profits capturing most of the productivity increases.

On a positive note, the local labour force (e.g. in Indonesia) gains from productivity increases in foreign-owned companies. This is in the form of higher wages and, eventually, increased employment.\(^ {116}\) Besides direct productivity gains to the plant receiving FDI, there is some evidence of productivity gains for companies along its value chain.\(^ {117}\) FDI also leads to lower prices, higher output and overall higher profits, both up- and down-stream of the foreign-owned plant. Therefore, further suppliers, final goods producers and ultimately consumers, as well as those with direct involvement in foreign ownership, benefit from having foreign investors.

**2. Evidence on productivity impacts in the Asia-Pacific region**

There is evidence that the inclusivity indicator used to evaluate the contribution of international openness to productivity is the real value of output per worker. Goldberg and others (2010a and 2010b) note that there must be caution in interpreting this rough measure, as the source of fluctuations in this variable remains unclear. As the value of output is constructed from revenue data, it is not clear whether revenues change due to increased production efficiency, variations in price premiums, product quality or the product range. However, in the discussion of inclusive growth, neither of these possible sources for productivity increases stands out as an ideal indicator of inclusiveness.

In this section, the additional policy variables capture the role of intermediate imports, the preparation and skill-enhancement activities of (future) exporting companies, as well as the importance of the export destination.\(^ {118}\) The role of intermediate imports is included by controlling for its share in total imports.\(^ {119}\) The inclusion of trade with specific export destination relates to the point mentioned in the literature review, that productivity enhancements are particularly pronounced in trade with a higher income partner.\(^ {120}\) Finally, preparation and productivity-enhancing activities are controlled for using three variables: first, investment as a share of GDP; second, in order to capture companies’ investments into their labour force a measure of ICT expenditure is included;\(^ {121}\) and third, the measure to assess employer’s investment into their labour forces is the prevalence of vocational training.\(^ {122}\) Results show that increased trade openness, as well as the impact of FDI, is beneficial for domestic productivity. However, the combination between international openness and complementary policies appear to have mixed results. Graphical representation attempts to clarify the overall effect of international openness in combination with various complementary policies. Here, significant interactions concern intermediate imports, vocational training, and investment and ICT expenditure. As before, the importance of these policies is considered by calculating the effect of a hypothetical move away from the sample mean.

Figure 9.3 illustrates the economic importance of the various statistically significant complementary policies and the international openness measures.\(^ {123}\) As expected the most effective means to increase productivity is to increase investment as a share of GDP. Moving from an average share of 25% to the top quarter’s share of 31% may be associated with a boost of output per worker from $5,450 to $6,090.

With ICT expenditure and intermediate imports, results presented in figure 9.3 suggest that a
movement of the average Asia-Pacific country into the first quarter of these complementary policies is not conducive to the inclusiveness of growth. However, this negative effect is reversed if international openness increases simultaneously. For instance, if one were to boost ICT expenditure in the presence of increasing outward FDI, productivity losses turn into net productivity gains. The same is true for intermediate imports, which accompanied by an increasing net trade surplus are associated with higher domestic productivity.

According to these estimates, increasing the share of the people in vocational training may not produce immediate positive productivity results. From our sample, a possible move from the average 2% of the population that is in vocational training to the top quarter’s value of 4% decreases aggregate productivity considerably.

Regarding the tested dimensions of international openness, an increase in the FDI stock appears beneficial for aggregate productivity. Countries that showed a higher sum of outward and inward FDI stock compared to domestic GDP also showed higher aggregate productivity. This is especially true when the outward FDI stock increases more rapidly as a share of GDP than the inward FDI stock. As already pointed out above for employment participation, causation may run both ways in the sense that it may only be the more productive countries that are able to generate outward FDI in the first place. The observed association could thus again be driven by an unobserved third factor such as the development stage of the economy.

These beneficial effects of FDI openness contrast with the seemingly negative relationship between productivity and international trade integration. In our sample, countries with a higher share of total trade over GDP showed less output per worker. The effect found for the composition of trade as measured by the exports/imports ratio helps illuminate this counter-intuitive association. If exports increase faster than imports, namely the exports/imports ratio increases, the potential negative effect is smaller and eventually becomes positive.¹²⁴ For

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124 Countries with higher share of FDI to GDP tend to show higher aggregate productivity.
countries that export more than they import, increases in total trade are associated with increased aggregate productivity. Thus our evidence suggests that the composition of trade matters for aggregate productivity.

A few potential complementary policies emerge from this section. First, promoting aggregate investment is a growing boon to domestic productivity, once countries increase their de facto openness to FDI. However, estimated results imply that an increased relative importance of outward FDI may dampen, although not counteract, this positive effect. Second, increased ICT expenditure may also boost productivity, especially in countries that see relatively high volumes of outward FDI. Increasing access to ICT may allow for the reintegration of employees, whose traditional industries have shifted away from domestic production. Lastly, promotion of intermediate goods imports may increase productivity in net exporting countries. However, results are ambiguous with respect to this policy; increased intermediate imports seem to have a negative association with productivity, in the presence of increasing de facto trade openness.

C. INTERNATIONAL OPENNESS, WAGES AND INEQUALITY

1. Evidence from literature review

The notion of inclusive growth is strongly associated with a fair distribution of growth’s benefits among the population. Current research implies that there is an association between international openness and the domestic distribution of income. In political discourse, increased globalization is often portrayed as a main culprit behind increasing national income inequality. However, other macroeconomic trends, such as skill-biased technological change, are more significant in increasing inequalities around the globe. The literature review provides the following findings.

1. Economic growth is the main driver of poverty alleviation. Consistent with the concept of inclusive growth, economic growth is key to eradicating poverty. On average, economic growth benefits the poor. From this perspective, it is encouraging that a strong and positive association between output and trade volume growth is found. Those developing countries embracing integration into the world economy have experienced faster growth and poverty reduction than those that have not. However, besides the growth-enhancing aspect, it is not clear whether trade-induced growth is more beneficial to the poor than economic growth stemming from other sources.

2. Gains from trade are not as strong in rural areas. A variety of studies from developing countries have found that urban areas tend to benefit more from trade liberalization, both in terms of income and consumption. For example, there was less progress in poverty reduction in Indian rural areas that saw their production sectors become increasingly exposed to trade. However, geographical labour mobility played an important role in avoiding negative labour market impacts from trade liberalization. Chen and Ravallion (2004) argue that the dominance of agricultural production in rural areas puts them in a harder position. With the price of their produce decreased, rural families are dependent on agricultural production, have low mobility, and possess little possibility to trade outside their home province. These families are the most vulnerable to reductions in living standards.

There are also irregular gains in the tariff-pass-through that occurs between trade among rural and urban areas. This is more pronounced in urban areas than in the countryside, implying that prices adjust less in rural areas. Therefore, the benefits of trade on consumption are somewhat asymmetrical in nature. Regardless of this pass-through aspect, the poorer segments of Indian society benefit most from reduced prices, as their consumption basket includes more tradable goods, both in urban and rural areas. Further, from the consumption perspective, Nicita (2009) finds that it is mainly rich and urban households who benefit from Mexico-United States trade liberalization. He discovers while aggregate consumption prices for Mexican agricultural and manufacturing products have fallen, wages and the wage gap between skilled and unskilled labour have risen slightly. While the average Mexican household gains through increased affordability of their consumption basket, households that depend on agricultural production saw a loss in their purchasing power.
3. On the aggregate, trade and income inequality may be positively related. Various cross-country studies, using data from the 1960s until the end of the century, found a positive association between trade volumes and income inequality.125

4. Exporters tend to pay better and increase the skill premium in developing countries. Exporting firms seem to pay higher wages than their domestic-centered counterparts, according to a variety of studies from developing and emerging countries. Furthermore, opening up to international markets increases the demand for the more relatively skilled parts of the labour force. Numerous studies have found that, following liberalization and with increasing trade flows, the wages of more skilled workers grow faster. A possible explanation for this increase is that sectors using unskilled labour tend to be the most protected, thus have the most to lose from tariff liberalizations. However, a rising skill premium is no longer automatically associated with increasing internationalization. Similarly, liberalization of intermediate goods imports reduced the wage gap between skilled and unskilled workers working at the same Indonesian plant.126

5. Basic education matters. Education levels could play a role in low-income countries when looking at country characteristics associated with skill premium development. Based on 61 countries, a study by Gourdon, Maystre and de Melo (2008) found that trade liberalization is associated with increased income inequality in low-income countries whose workforces are scarcely educated or whose exports consisted mainly of natural resources. In low-income countries where the majority of the labour force has at least primary education, income inequality reduced following liberalization.

6. Foreign-owned firms in developing countries tend to pay more. When simple wage averages between domestic and foreign-owned enterprises in developing countries are compared, wage differences of up to 50% are observed. Even though the dominant portion of this inequality can be attributable to differences in the job characteristics between the two groups, foreign-owned firms still pay a wage premium of up to 10% over domestic-owned enterprises.

7. Technological change, rather than international openness, seems to be the main force behind income inequality. Arguably, income inequality has risen worldwide in the past few decades. While international integration has also taken off in this period, it may not be the main driver behind the former phenomenon. In both developing and developed countries, international integration had largely no negative effects on the income distribution (IMF, 2007). Rather than being harmful, there is a more equal distribution of income in developing countries which have embraced international trade.

While acknowledging the dominant role of technological progress in income inequality, studies from emerging economies also provide evidence of international trade’s role.

To capture the relationship between international openness and the domestic income distribution, three inclusivity indicators have been collected. The analysis begins with the evolution of real average hourly wages. Poverty prevalence, as share of the population living on less than $2 (PPP) per day, is then measured. The Gini index (a popular measure of income inequality) is also used to gauge the relationship between international openness and income distribution.127

2. Evidence from the Asia-Pacific region on the impact of openness on real wages and inequality

The literature review on the international openness and poverty/income inequality nexus produced a variety of additional controls. Numerous studies have stressed that skill-biased technological change may be at the heart of the changes observed in income inequality. According to the skill-biased technological change hypothesis, increasing computerization of economies is disproportionally beneficial to skilled workers. To control for skill-biased technological change, this study uses trade data on ICT. To proxy for the computerization of the work place, the average import value of office machinery per employee is calculated.128

Due to lack of data, the model is limited to one further control variable. The additional variable included in this model is real GDP per capita, as differentiation between general economic growth-induced poverty reductions and the specific merits of trade- or FDI-induced growth is sought.
The main interaction, with respect to real wages, occurs between the outward/inward FDI stock ratio and real GDP per capita. According to these estimates, adding outward FDI dampens the real wage of domestic workers, albeit at an increasingly slow pace. This relationship is also shown in figure 9.4, illustrating that a higher real GDP per capita is not necessarily reflected in higher wages. However, a higher share of inward FDI in a country’s total FDI stock, measured as a reduction in the FDI outward/inward ratio, contributes positively to real wages in the host country. According to figure 9.4, moving from the mean value of the outward-over-inward FDI ratio of 0.3 to a lower 0.2 increases the real wage from $1.05 to $1.10.

Regarding the poverty rate, an increase in ICT expenditure per worker seems to be a principal complementary policy (figure 9.5). According to these estimates, moving from the average sample expenditure of $3.73 to $10 would lower the poverty rate from 34% to below 20%. As shown above, the reduced sample size may lie behind the strength of this association, as the estimated coefficients may be unreliable. Apart from the strong ICT result, all other policies and international openness variables seem beneficial for poverty reduction, although to a lesser extent.

Thus implications for complementary policy are few. Again, the limited size of the sample, together with observation gaps for individual countries, decreased the reliability of these results. Based on a combination of the estimation tables and the graphical representation (of statistically significant interaction terms), increased ICT expenditure may contribute to the inclusiveness of growth. Besides its association with lower poverty rates, estimation results imply a diminishing negative effect on the Gini coefficient, as in figure 9.6. This eventually turns positive with higher degrees of outward FDI.

Increasing ICT expenditure per worker is most effective tool in fighting poverty.

Lastly, figure 9.5 depicts the statistically significant interaction between ICT expenditure and share of FDI over GDP, with respect to the Gini coefficient. It appears that the size of total FDI stock relative to GDP is not an economically important determinant for the value of Gini coefficient. This is different for the volume of ICT expenditure per worker. In this instance, higher expenditure is associated with greater income equality. Again, sensitivity of the Gini coefficient against the value of ICT expenditure may be a product of the sample size. However, the benefits of increased information technology (IT) in the workplace may accrue to only a small subset of the working population.
The stage of development and ICT expenditure affect the poverty rate.

**FIGURE 9.5**
The stage of development and ICT expenditure affect the poverty rate.

**FIGURE 9.6**
ICT expenditure affects income distribution.
D. INTERNATIONAL OPENNESS AND GENDER EQUALITY IN EMPLOYMENT OPPORTUNITIES

1. Evidence from the literature

Similar to the case of income inequality previously discussed, identifying the possible effects of international openness on the equal treatment of male and female workers proves challenging. In the relatively small literature on this topic, the conclusions drawn on female labour-force participation and the size of the gender wage gap are not clear cut.

1. Export orientation is associated with higher female labour force participation. For instance, a positive correlation between export orientation and the intensity of female labour-force participation is found in Turkey and a variety of Asian countries. Job losses associated with increases in imports seem to affect male workers predominantly as they form a large share of the current work force. The North American Free Trade Area’s (NAFTA) introduction in Mexico led to the substitution of female blue-collar labour for male. Some apparently positive effects on female employment may be due to traditional trading sectors utilizing a substantial amount of female labour. These traditional sectors include textiles, leather goods or footwear. However, findings indicate that increased competition from abroad can put downward pressure on female labour force participation in OECD countries. In some East Asian countries, a defeminization of the labour force is reorienting their exports towards other industries.

2. The link between international openness and the gender wage gap remains unclear. Analysing the evolution of the gender wage gap in 80 countries among many occupations during 20 years, Oostendorp (2009) finds a mixture of developments in low-and high-skilled employment associated with increasing international openness. In developing countries, the gender wage gap in low-skilled jobs seems to have narrowed while in high-skilled jobs it has become wider. However, individual country studies do not necessarily support this pattern. The literature is far from conclusive on what the role of trade is; whether it is still persisting, or even widening, gender wage gap.

2. Assessing equal gender opportunities in the Asia-Pacific region

The prime inclusivity indicator chosen for equal opportunity is female labour force participation. The initial estimation was done using participation of females in labour force. The second model uses the ratio of female to male labour force participation. As female labour force participation was relatively lower at the outset, positive changes in this ratio imply that female employment is catching up; in other words, employment opportunities are spreading more equally between the sexes.

The literature review offers little guidance as to the choice of further controls for equal opportunity. Besides an observed equalization of labour force participation rates across the sexes in exporting countries, a measurable finding in the aggregate was the importance of the export composition. Apparently, traditional export sectors, such as textiles and leather products are associated with higher female labour input. In contrast, an economy geared towards industrial and capital intensive production seemed to display the opposite relationship. Reflecting on these insights, two controls are added to the baseline specification: first, the share of traditional export sectors, namely textiles and leather products, in total exports; second, the value added of industrial production in total GDP.

Besides trade, the education of women is likely to play an important role in female employment. To address this issue, the complementary policy variables include the ratio of female over male enrollment rates in primary education. This ratio captures the strength of female educational attainment in relation to the male labour force.

Results show only muted effects of international openness on equal opportunity, in accordance with the findings of the literature review. Figures 9.7 and 9.8 reveal that absolute female labour force participation, as well as relative female-to-male employment participation, is not strongly influenced by international openness variables alone, nor when joined with complementary policy variables.

While the economic effect is minimal, figure 9.7 suggests that a reduction in the share of
Female employment participation is little affected by complementary policies. If the average Asia-Pacific country could increase primary enrollment from 89 to 99%, the enrollment rate found in the top quarter of countries in the region, our estimates imply an increase in the female employment participation rate from 48.38 to 48.73%. There can be similar gains by reducing the share of traditional exports from an average of 0.8% to the bottom quarter’s value of 0.3%. As evident from figure 9.7, changes in the degree of international openness (as measured by the share of trade in GDP or the outward-over-inward FDI stock ratio), while showing a statistically significant association, is of no essential economic importance in female labour force participation rates.

Export sophistication, as well as an increase in the female primary enrollment rate, may lift female employment participation. The same pattern also applies in relation to ‘catch up’ in female labour force participation rates. In this sample, the female labour force participation rate is as roughly 70% of the male rate. As with the previous findings on how to increase female labour force participation per se, relative participation rates may be increased via less traditional goods exports (by promoting export sophistication) and increased female primary enrollment. Again, the degree of international openness is largely irrelevant to the inclusivity indicator. Openness is measured by total trade value as a share of GDP or the outward-over-inward FDI ratio.

Two implications for the policy toolkit emerge with respect to the use of complementary policies. First, the positive employment effect found in traditional goods exports in the first empirical section does not carry over to female employment participation. On the contrary, female labour force participation apparently decreases in relation to the size of the traditional goods sector, as measured by its export share. Second, the equality of primary school enrollment across the sexes helps increase the benefits from rising international openness. In turn, this contributes to the equal economic opportunity of women, although only to a small extent.

**FIGURE 9.7**

Female employment participation is little affected by complementary policies.
CONCLUSION

In this chapter, the association between international openness and the dimensions of inclusive economic growth was investigated while considering the following four dimensions: (i) employment opportunities; (ii) productivity; (iii) real wages and income inequality; and (iv) equal employment opportunity between genders. Econometric analysis suggests that while international openness matters for inclusive growth, its impact could be enhanced by use of various complementary policies.

The picture was nuanced in relation to the promotion of intermediate goods imports, and in relation to exports from traditional sectors such as leather and textiles. While intermediate goods imports promoted employment and productivity in net exporting countries, their effect on less integrated or net importing countries was found to be negative. Regarding traditional goods exports, the positive effect found for aggregate employment did not seem to carry over into increased female employment participation.

However, analysis also drew less ambiguous policy conclusions. International openness may benefit inclusiveness, especially if countries target exports to high-income countries and have more flexible labour markets. Furthermore, the gains from expenditure on information and communications technology seemed to be an increasing function of international openness. The promotion of aggregate investment may also provide a boost to domestic productivity. More importantly, basic and equal access to education was found to be especially beneficial in the presence of international integration.

Nevertheless, the literature and this analysis points to the necessary use of complementary policies to make growth more socially beneficial. Much of this Report has focused on identifying these complementary policies and measures, as well as describing how these can enhance the positive impacts of trade and investment. Additionally, there are broader complementary policies that have to be put in place for trade and investment to produce helpful results. These policies include: institutions and regulation; macroeconomic and exchange rate policies; competition policy; industrial policies; infrastructure and human capital investment strategy; and social and environmental protection.

A reliance on complementary policies to address the downsides from liberalization, or conversely to enhance its upsides, appear to let trade and investment policy itself “off the hook”. Where
complementary policies work, because they are often little visible, trade and investment policy may wrongly take the credit for poverty alleviation and inclusive outcomes. Where liberalization increases unemployment, the blame may be heaped on the lack of "appropriate" complementary policies rather than being placed on the liberalization itself. But this is a mischaracterization. For, while complementary policies will remain essential, as this Report has shown, truly inclusive trade policy would attempt, as far as possible, to preempt the need for these policies. This could be achieved, for instance, by built-in mechanisms and policies to soften any adverse impacts. For example, instead of having trade liberalization generate unemployment (with some or no income assistance from the Government), inclusive trade liberalization could estimate its sectoral employment impact and be adjusted accordingly. It could also calculate the social cost of offering trade adjustment programmes, such as reskilling and relocation, leading to a better understanding of the net social benefits of the proposed policy change.134 Such an approach would be truly coherent policymaking: it would take into account the economy-wide effects of individual policy changes, as well as the interdependency of various policies.

REFERENCES


ONLINE DATABASES


ONLINE DATABASES


### Data description

The data set used in the empirical section of this paper is an unbalanced panel of ESCAP Member States. For a list of all included countries, see Fritz (2013). The data stretches from 1988 to 2011.

**Employment-population ratio.** The data for “Employment to population ratio, age 15-64” was taken from the World Bank World Development Indicators Database. Also used for female citizens only as well as the ratio of female over male labour force participation rates.

**Foreign direct investment.** Data for stocks of inward and outward FDI taken from UNCTADStat.

**GDP.** The data for “GDP in current USD” has been taken from the World Bank World Development Indicators Database. It was used for the normalization of various variables used in the estimation.

**Gini coefficient.** The used data is the result of merged individual series from the World Bank World Development Indicators Database and the UNU-WIDER World Income Inequality Database. Where multiple observations were available for a given country-year pair, the Gini coefficient based on the most similar calculation method was chosen.

**ICT expenditure.** The variable has been constructed as imports of ICT products per worker. Import data has been taken from United Nations Comtrade for the SITC rev. 3 code 75 (“Office machines and automatic data-processing machines”). Converted into real terms using the United States consumer price index (CPI) for the relevant period. Employment data has been constructed from the World Bank World Development Indicators Database statistics on population and the employment-participation ratio.

**Informal employment.** The data for the “Wage and salaried workers, total percentage of total employed” has been taken from the World Bank World Development Indicators Database. This variable covers all employment with a formal contract. The measure of informality used in the estimation is the difference between the World Bank’s measure and 100. Again, the variable has been transformed into a share through a division by 100.

**Investment.** The data for “Total investment as percentage of GDP” have been taken from the IMF World Economic Outlook Database. The data have been transformed into a share through a division by 100.

**Poverty.** The used variables are “Poverty headcount ratio at $2 a day (PPP) (percentage of population)” and “Poverty headcount ratio at national poverty line (percentage of population)” taken from the World Bank World Development Indicators Database. As the original data unit is percentage points, the data were transformed into shares through a division by 100.

**Productivity.** Data has been constructed as GDP per worker using data available from the World Bank World Development Indicators Database. GDP has been converted into real terms using the United States consumer price index for the relevant period. Base year is 2005.
School enrollment. The data for the “ratio of female to male primary/secondary school enrollment” as well as the numbers of students in primary or vocational training have been extracted from the World Bank World Development Indicators Database.

Tax revenue. Taxes on income, profits, and capital gains as levied on the actual or presumptive net income of individuals, on the profits of corporations and enterprises, and on capital gains. Data taken from the World Bank World Development Indicators Database.

Trade flow data. All trade data was extracted from the United Nations Comtrade using the classification SITC Rev.3. Data were used on the aggregate or decomposed into subcategories for intermediate goods, raw materials etc. using WTO definitions for the latter. In case a product appeared in more than one subcategory, the trade value has been divided by the total number of assigned subcategories and was attributed to each subcategory in equal amount. The traditional goods referred to in the estimations include all textiles and clothes exports (SITC code 65) as well as exports of leather and footwear products (SITC code 61).

Value added. Data for “value added by industry as percentage of GDP” has been extracted from the World Bank World Development Indicators Database. As the original data unit is percentage points, the data were transformed into shares through a division by 100.

Vocational training. Secondary vocational pupils are the number of secondary students enrolled in technical and vocational education programmes, including teacher training. Data taken from the World Bank World Development Indicators Database.

Wages. Data for average hourly wages has been extracted from the Occupational Wages around the World Database [ID: hw3wuus]. Converted into real values using the United States consumer price index in the relevant period, basis year 2005.

ENDNOTES

The analysis is based on an unbalanced panel data set with observations ranging from 1988 to 2011. Data description, methodology and empirical specification are briefly explained in the Annex. Readers are advised to consult a background paper prepared by Johannes Fritz (2013) for further technical details and a thorough literature review.

A myriad of literature reviews exist for each of the considered linkages between international openness and inclusiveness; employment, the productivity effects, poverty prevalence and inequality, and trade and gender participation. The most important are listed here: (a) for trade and employment see e.g. Bacchetta, Ernst and Bustamente, 2009; Brooks and Go, 2012; Hoekman and Winters, 2005; Jansen, Peters and Salazar-Xirinachs, 2011; Newfarmer and Sztajerowska, 2012; Munro, 2011; (b) for productivity see e.g. Greenaway and Kneller, 2007; López, 2005; Wagner, 2007; (c) for poverty prevalence see e.g. Berg and Krueger, 2003; Goldberg and Pavcnik, 2004; Harrison, 2007; Winters, McCulloch and McKay, 2004; (d) for income inequality see e.g. Dollar, 2005; Goldberg and Pavcnik, 2005; Harrison, McLaren and McMillan, 2011; Milanovic, 2005; Pavcnik, 2011, and equal opportunity see e.g. Berik, 2011. Brooks and Go (2012) provide an extensive literature on the employment aspect of trade, in the context of inclusive growth in Asia. Following from these researchers, this chapter briefly recaps their work, as well as more recent findings, from the perspective of inclusive trade and investment before turning to analytical assessment under each inclusivity variable. As the analytical part of this chapter is concerned with the Asia-Pacific region, the evidence presented below is focused on the experience of developing and transition economies. References to findings in industrialized countries are given where they provide additional insight for policymakers in the Asia-Pacific region.

The following Asia-Pacific countries are included in the dataset: Afghanistan; Armenia; Australia; Azerbaijan; Bangladesh; Bhutan; Brunei Darussalam; Cambodia; China; Fiji; Georgia; India; Indonesia; Iran (Islamic Republic of); Japan; Kazakhstan; Kiribati; Kyrgyzstan; Malaysia; Maldives; Mongolia; Nepal; New Zealand; Pakistan; Papua New Guinea; Philippines; Republic of Korea; Russian Federation; Samoa; Singapore; Solomon Islands; Sri Lanka; Tajikistan; Thailand; Tonga; Turkey; Turkmenistan; Tuvalu; Vanuatu; and Viet Nam.

To measure labour market flexibility, a proxy for the WEF’s Labor Market Flexibility Index is created. The labor market flexibility index is a measure of these components: 1) Cooperation in labour-employer relations [1 = generally confrontational; 7 = generally cooperative]; 2) Flexibility of wage determination [1 = by a centralized bargaining process; 7 = by each individual company]; 3) Hiring and firing practices [1 = heavily impeded by regulations; 7 =
extremely flexible]; 4) Redundancy costs in weeks of salary [lowest value is 0 (no cost), highest 82 weeks], and 5) Effect of taxation on incentives to work [1 = significantly reduce the incentive to work; 7 = do not reduce incentive to work at all]. A country is considered more flexible the higher it scores on average in these five components. Enhancing either of these five components increases labour market flexibility in the given metric.

110 As discussed earlier one important aspect of employability opportunities includes a concept of underemployment. Unfortunately, lack of data for sample countries does not allow direct assessment here; however, see OECD (2014, forthcoming), chapter 1 for further insights.

111 As touched on in the literature review, informal employment is particularly relevant in this context. This is due to contract-less work relationships being able to dampen individual skill development, as precautionary provisions. Note that given its construction, informal employment is a subset of total employment. Therefore, analysing total and informal employment jointly allows inference to whether trade-induced employment changes materialize in formal or informal employment relationships.

112 The estimation in this section includes: four international openness indicators, four complementary policy variables, as well as interaction terms between each complementary policy variable and the international openness indicators. See Fritz (2013) for a full description. The international openness indicators are the sum of inward and outward FDI stocks as a share of GDP, the sum of exports and imports as a share of GDP and the ratios of exports/imports and outward/inward FDI. The complementary measure variables used in this model are the share of intermediate imports in total imports, the share of traditional goods exports in total exports, the share of goods going to OECD members, and the share of goods going to middle-income countries. For this estimation, traditional goods are labour intensive products such as textiles and clothing as well as footwear and leather products. Due to data availability, the complementary policy (labour market flexibility) is represented by a proxy (relative tax revenue from labour and profits).

113 These figures have been calculated using the entire estimation results,thus taking all coefficients at face value. The counterfactual estimates have been calculated by altering the particular variable from its mean value. For the complementary measure variables, alternative scenarios correspond to the 25th and 75th percentile values found in the sample. For the international openness variables, the alternative scenarios correspond to the increases in the text. In the figures above, counterfactuals have only been constructed for the interactions that were found to be statistically significant. See Fritz (2013) for more detailed results.

114 See also most recent work by OECD on refining a measurement of productivity for more information on the linkage with trade (OECD, 2014, forthcoming, chapter 3).

115 Johnson and Noguera (2012) said intermediates accounted for more than 60% of world trade in the early 2000s. Several studies indicate that liberalizing intermediate goods trade, rather than final goods trade, is more effective in raising productivity. For example, using Indonesian plant-level data shows that a 1% tariff reduction transmits into firm productivity with a multiplier of 1.2, if the tariff decrease targets an imported input. This multiplier is more than twice the size of the productivity increase achieved by slashing tariffs on final output. Note that import tariff liberalization on final products is still beneficial but reducing those on intermediates may be more effective in boosting productivity. In addition, there is some evidence of desirable consequences on the product range. For example, some evidence from India shows a strong association between a broader spectrum of domestically produced products and increased access to imported intermediate products. Besides increasing productivity, tariff reduction in a firm’s intermediate goods imports may lead to a higher propensity of export for that firm. A study of Argentinian firms finds that lower import tariffs are associated with a higher propensity to export and for those firms already exporting, an increase in the share of sales has been realized through exports.

116 Using plant level data on foreign- and domestically-owned establishments, Arnold and Javorcik (2009) find that productivity in the former plants increased from the first year and also grew in the subsequent period. Encouragingly, productivity gains were shared with the plant work force in the form of higher wages and, eventually, increased employment. Interestingly, the foreign-owned plants were more involved in international trade, both for their output and input. The latter aspect is consistent with the finding that the inclusion of imported inputs into the production process may be a key driver in trade-related productivity gains.


118 This model’s estimation includes the same international openness indicators as that of the one in section A.2. The complementary policy variables used here are the share of intermediate imports in total imports, the share of exports going to OECD members, the share of exports going to middle-income countries, the share of employees undergoing vocational training, the share of investment in GDP, and a proxy for the real expenditure on ICT products per employee.

119 As the sale of final products using such intermediates may be delayed, the share of intermediate imports is included both for the present as well for the previous year.

120 As productivity is simply a ratio of the price of output over labour input, productivity gains reaped in trade with higher income partners need not necessarily reflect more efficient production, but rather a higher price premium. To control for this channel, the share of exports going to OECD countries is included as a control variable.

121 As data for ICT expenditure is not readily available, this study uses trade data on ICT products. To proxy for the computerization of the work place, the average real import value of office machinery per employee is computed and included in the estimation.

122 This prevalence is captured by the share of total employees currently enrolled in vocational training for each country, and the working assumption is that a higher level of
vocational training is associated with higher labour force productivity.

The considered data points for the complementary policy variables reflect the sample mean, the 25th percentile and the 75th percentile. For the stated variables, these values are: intermediate import share [0.22; 0.32; 0.38]; vocational training share [0.006; 0.02; 0.04]; investment share [0.2; 0.25; 0.31]; ICT expenditure $/worker [0.26; 3.74; 10].

For the considered data points for complementary policy variables reflect the sample mean, the 25th percentile and the 75th percentile. For the stated variables, these values are: traditional export share [0.003; 0.008; 0.009]; female primary enrollment [0.86; 0.89; 0.99]. For the international openness variables, the hypothetical values are: FDI O/I ratio [0.3; 0.4; 0.5]; trade/GDP [0.4; 0.5; 0.6].

Unfortunately, data availability for these variables is severely limited. At best, the data sets used in the estimations of this section are one third of the size of the ones used so far. For this reason, results in this section have to be interpreted cautiously. As we will see in the graphical representation, the predictions are very sensitive to deviations from the mean and quickly move out of sample.

The estimation underlying this model includes the same international openness indicators as that of section A.2. The complementary policy variable used is a proxy for the real expenditure on ICT products per employee. To control for the stage of development, real GDP per capita is included as a further control variable.

The considered data points for the complementary policy variables reflect the sample mean – the 25th percentile and the 75th percentile. For the stated variables, these values are: intermediate RGDP/capita in S [790; 4178; 5634]; ICT expenditure $/worker [0.26; 3.74; 10]. For the international openness variables, the hypothetical values are: FDI O/I ratio [0.3; 0.4; 0.5]; FDI/GDP [0.3; 0.4; 0.5].

Estimation in this section includes the same international openness indicators as those of section A.2. The complementary policy variable used are the share of traditional goods exports in total exports, the share of industry in total value added, and the ratio of past female to male primary school enrollment rates.
INTRODUCTION

To enrich this report, a number of country and sectoral studies have been conducted. The studies, which are presented below, along with some examples taken from the existing literature, illustrate challenges at the country or sectoral level that are not covered in the econometric work, but are important in providing a comprehensive understanding of who benefits from trade, investment, trade facilitation and other related policies in Asia and the Pacific and why.

The cases are organized by the specific aspect of international openness that they reflect, that is: trade integration; trade facilitation; foreign direct investment (FDI) and investment promotion; and development of responsible business practices. Each case is also paired with the indicators of inclusivity which were examined earlier (table 10.1). The concluding section offers a brief synthesis of the main lessons learnt from the presented cases and presents policy recommendations.
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## TABLE 10.1
Quick guide to cases of inclusive trade and investment in the Asia-Pacific region

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A. TRADE INTEGRATION AND PROMOTION

In this Report, it has been established that trade liberalization policies alone, despite increasing efficiency, do not necessarily produce benefits for all. To improve the chances of trade delivering inclusive growth, Governments need to craft a comprehensive strategy – combining trade policies with appropriate complementary measures. Policies should aim at helping all levels of society gain from increased trade. The benefits obtained through exports should be utilized for economic restructuring to further improve the economy’s resilience and efficiency (Lim, 2009). This does not imply that further trade liberalization has to be postponed until such additional measures are established. Instead, the pace of trade liberalization needs to be more carefully managed while complementary policies are more urgently pursued. This can generate a virtuous circle in which improved productivity and competitiveness would also foster new investment. With more investment and trade comes faster economic growth, which can lead to higher fiscal revenue for Governments. These in turn can be allocated to further enhancements in the complementary policies. The case studies provide illustrations of how these synergies could be exploited to enhance prosperity for all. They also demonstrate how easier access to regional and global markets can provide direct benefits to producers and consumers.

1. Trade integration reduced poverty but now the Lao people must battle inequality

The trade liberalization and growing international integration of the Lao People’s Democratic Republic has delivered economic growth, growing household incomes and poverty reduction. The benefits have been felt in both rural and urban areas. Trade has led to falling poverty by lowering the cost of living and raising real income. As a result of trade, consumers can access a wider choice of goods, and at lower prices. With better, cheaper inputs and better access to credit, farm productivity and returns to household enterprises have grown, raising household incomes. That, in combination with economic growth, increased the Government’s revenues and facilitated investment spending on infrastructure and social services. As a result, poverty has been declining rapidly, though with growing inequality. However, environmental impacts and the forced relocation caused by some large, land-exploitation projects have raised concerns over villagers’ livelihoods and food security.

Since the Lao People’s Democratic Republic joined ASEAN in 1997, a growing number of bilateral trade agreements for preferential market access have been signed to ease trade with trading partners. As the country was preparing for WTO accession (completed in February 2013) and the creation of the ASEAN Economic Community (AEC) in 2015, trade barriers were gradually dropped, including tariffs for many goods originated in ASEAN. Over this same period, trade as a percentage of GDP grew as the Lao People’s Democratic Republic gradually became more integrated with the world; poverty continued to decline steadily from 46% in 1993 to 27.6% by 2008. If this poverty reduction trend continues, the national poverty rate will have dropped to 19% by 2015 (see figure 10.1).

Poverty declined across all regions, but at a faster rate in urban areas. Poverty in the capital, Vientiane, fell at a faster rate than in the northern, central and southern regions of the country. While rates of absolute poverty fell over the 15-year period – 1992/93-2007/08 – inequality increased nationwide, with the exception of the southern region. The share of total household income spent on food also declined; while the share in 1992/3 was 64.3% it had fallen to 46.1% by 2007/8. On the other hand, spending on non-food items, essential for everyday living, increased.

The decline in the share of income spent on food was largely caused by a reduction in self-produced food. This was attributed to growing household cash income – as farm households transitioned from self-sufficient farming towards commercial farming. This was aided by more villages becoming connected with the market economy via greater access to roads, electricity and telecommunications. More affordable personal transportation units (motorcycles) and telecommunication units have become available and thus entering commercial agriculture is more feasible for villagers.

The population also benefited from growing ownership of durable goods as household income rose and the prices of durable goods fell in real
Source: Southichack and Phonvisay (2013).

terms (figure 10.2). For example, the price of motorcycles dropped substantially after Chinese and Korean motorcycles entered the market at a price around half that charged by their Thai competitors.

The rates of ownership of durable goods (motorbikes, mobile phones, televisions, refrigerators and electric rice cookers) rose faster than in urban areas. This seems to suggest that real purchasing power of rural households was growing faster than that of the average urbanite. Price and household consumption expenditure analyses for 47 consumer goods and services all indicate that between 1997/98 and 2007/08 real consumption in rural areas grew at a higher rate than in urban area – though the sample size was small.

The Lao People’s Democratic Republic also benefited from improvements in its terms of trade. Global prices for its rice, meat, vegetables, coffee and traditional skirts improved while prices for imports of essential everyday goods fell. This particularly helped farmers and other producers. To some extent these benefits for households were offset by worsening terms of trade for other items such as gasoline, electricity, water, school fees, school uniforms and other clothing items.

Source: Southichack and Phonvisay (2013).
International trade has helped job creation in non-agricultural sectors to a limited extent. However, as economic growth has been largely driven by the capital-intensive resource sector, job creation outside the agricultural sector remains rudimentary. A recent labour survey revealed that the Lao labour force has a low level of educational attainment, with 48.7% having only primary school education. Only 7.2% of the labour force has technical school education and only 5.4% has at least college education. Thus, low educational attainment remains one of the most important barriers to many types of investments and, thus, to job creation outside of agriculture.

In addition, data suggest that agricultural productivity has increased, as trade allowed for greater availability of improved inputs and cheaper technology in agricultural production. This evidence is confirmed by the finding from the price-household expenditure ratio analysis which suggests that farmers’ real income has grown. More jobs in the non-agricultural sector have been created as it continued to expand, although the number was still very small compared to farm jobs. While most newly created non-agricultural jobs are located in urban areas, the possibility of internal migration allows the rural population to also benefit.

Government revenues and expenditures have grown over time in both real, total, and per capita amounts, especially since the mid-2000s. Since 2005, real per capita revenues from domestic sources have increased, as a result of the growing economy and international trade. This allowed the Government to expand infrastructural development and increase its spending on social services. However, a considerable proportion of government revenues (28.6%) and expenditures (19.2%) have been financed by import taxes (tariffs and excise tax on imported goods). A drastic drop in import taxes revenue could jeopardize efforts of poverty reduction, at least in the short run. However, rural and poor households would be made worse off from a reduction in import taxes only if it led to a cut in government spending on social services such as retirement benefits, primary education and healthcare.

Rural households could also be worse off, if trade liberalization led to a substantial increase in land-extensive or resource-based investments, which could result in land encroachment or destruction of natural forest and environmental degradation.

Rapid growth in investment, associated with FDI and stimulated by trade liberalization and international integration, has created a growing demand and competition for resources. Without the Government’s proper attention, villagers’ rights to livelihoods and security could be violated and, as a result, push the affected villagers towards greater hardship and deeper into poverty.

Policy actions are needed to enhance complementary policies and ensure that the benefits from trade continue to be widely shared. But as poverty is a complex, multidimensional problem, involving multiple factors that go far beyond the scope of responsibilities entrusted with the Ministry of Industry and Commerce, policy responses which go beyond the traditional realm of trade policy will also be needed. While the Ministry is capable of implementing certain policies that can contribute to poverty reduction, inter-ministry cooperation is necessary in order to adequately tackle poverty problems. Thus, while a focus is on trade related issues, policy recommendations made by the study go beyond those relevant for the Ministry’s direct responsibilities.

The following actions are recommended:

- Reduce trade costs associated with administrative barriers and technical barriers;
- Promote market competition;
- Prioritize infrastructure development;
- Strengthen and expand agricultural extension services;
- Improve general education quality and expand enrolment in technical (vocation) training schools;
- Enhance government regulation of activities based on exploitation of land and those with potential environmental impacts.

LESSONS

Overall, the trade liberalization and growing international integration of the Lao People’s Democratic Republic have been successful in achieving economic growth, lifting household incomes and reducing poverty. This has benefited both rural and urban areas and facilitated the introduction of farmers into commercial agriculture. Yet, low educational
attainment remains one of the most important barriers to many types of investments and, thus, to job creation outside of agriculture. Of importance for continued poverty reduction are: the direction of government revenue spending; increasing educational attainment to facilitate job creation outside of agriculture; and appropriate governance of natural resource exploitation.

2. Spillover effects of free bilateral trade between India and Sri Lanka: the creation of employment opportunities through enhanced investment flows and trade

Exports of Sri Lanka have had duty-free access to the Indian market under the India–Sri Lanka Free Trade Agreement (ISLFTA) since 2003. ISLFTA has adopted a conventional approach to trade liberalization and included trade in goods but not liberalization of investment or services trade. The critics of the agreement claimed that focusing on goods only would limit the agreement’s potential for job creation. Instead they preferred a wider focus including promotion of trade in services and investment flows. Since the agreement has been under implementation for a decade, it is now possible to review its effects on employment and on other important aspects of inclusivity and development.

From the perspective of expanding bilateral trade, the agreement was very successful; in 2000 Sri Lanka’s exports to India were $58 million, less than one tenth of its imports from India totaling $600 million. In 2012 exports grew to $519 million and imports to $3.4 billion, therefore reducing the import-export ratio to 6 to 1. Over the same period, Sri Lanka also diversified its exports to India. While there has been a reduction in exports of major traditional export products, a variety of other products have gained market access and have contributed to a steady increase of exports to India.

At the same time, in parallel with the expansion of trade under the trade agreement, new FDI flows were triggered in activities associated with rubber-based products, ceramics, electrical and electronic items, wood-based products, agricultural commodities and consumer durables. A study by UNCTAD (2003) tied these new investments, totaling $145 million in 37 different projects, to the existence of the bilateral free trade.

By 2012, India emerged as the fourth largest overall investor in Sri Lanka with investments of $160 million. According to the Board of Investment of Sri Lanka, India was the second largest foreign direct investor in Sri Lanka in 2011, with an investment of $147 million (out of a total inbound FDI of $1.057 billion). Notable recent Indian investment commitments are from: Shree Renuka Sugar to set up a sugar refining plant at Hambantota ($220 million); Dabur to set a fruit juice manufacturing plant ($20 million); Altair Project by South City, Kolkata for real estate development in Colombo ($400 million); and Krrish Square Project by Krrish Group for Mixed-development in Colombo ($460 million).

Moreover, the last few years have also witnessed an increasing trend of Sri Lankan investment into India. Significant examples include Brandix (about $1 billion to set up a Brandix India Apparel City spread over 1,000 acre land in Vishakapatnam), MAS holdings, John Keels, Hayleys, Aitken Spence (hotels), Ceylon Biscuits (Munchee brand), Carsons Cumberbatch (Carlsberg) and DRH Logistics International.

Indian investments in Sri Lanka, have mostly been in the labour intensive sectors of vegetable oil and fat, metals, ferrous metals, oilseeds, wood products and machinery equipment. These investments opened employment opportunities to local, mostly unskilled, people. Moreover, opportunities for increased employment at semi-skilled or skilled levels were also created. De Mel (2009) who studied the impacts of ISLFTA on employment estimated that as of the end of 2007, some 6,747 individuals gained employment as a result of Indian investment in 70 projects. De Mel also pointed out that most of these projects appear to be in areas of the services sector that were not explicitly covered by the free trade agreement, and therefore cannot be attributed to the agreement-led impacts. On the other hand, Kelegama and Karunaratne (2013) observed that within the first two years of the implementation of ISLFTA, several sectors experienced over 100% growth, including industries such as chemical product manufacturing, cement manufacturing.
and pearl harvesting. They stated that some 5,900 jobs were created as a result of Indian investment projects and in few cases these related to inter-company relocation of labour.

Despite the limited scope of the agreement which only liberalized trade in goods, bilateral investment flows also rose. Together with the expansion of trade, this helped to generate more employment and to contribute towards further integration of the two economies. Freer trade has not only directly facilitated the investments in the manufacturing sector, but also had spillover effects on the services sectors like telecommunications which provide greater opportunities for higher-skill employment. This was also recognized recently by the President of the Indo-Lanka Chamber of Commerce and Industry who stated that the FTA had been a win-win for both nations.

LESSONS

Even without explicit liberalization of services trade or for temporary movement of natural persons, FTA-driven investments can have a positive impact on local employment. The India-Sri Lanka FTA is a very good example how an expansion of trade flows may lead to positive spillover effects in inward investment and thereby induce job creation.

3. Promoting inclusive trade where it matters the most – at the community level

There have been several initiatives which aimed at promoting growth and inclusivity through trade, but few of them have seen similar success to the “One Village One Product” (OVOP) movement. Begun in Oita, Japan in the late 1970s, what started as a rural development programme intended to create employment at the village-level by promoting local products has now become a global model for trade promotion. Today, OVOP has been applied in dozens of countries. While each country applies its own adaption of the OVOP model, the main goals are the same – alleviating poverty, developing rural areas and creating employment at the community level through the promotion of locally produced products.

Thailand’s local version of OVOP – the One Tambon, One Village [OTOP] programme – is widely acknowledged as one of the most successful adoptions of the original movement. Since its initiation in 2001, OTOP has grown from a poverty alleviation programme to a more sophisticated SME promotion programme which now covers more than over 22,762 villages nationwide, with 37,840 OTOP producers and over 1.3 million members and employees. OTOP has been particularly successful in generating inclusive employment. Many of the programme beneficiaries have been housewives and older people, who now enjoy access to employment and are able to contribute to overall rising household earnings.

The programme has also contributed to increased productivity and higher quality products through its quality control efforts for exportable products. Locally made products are rated through “Product Champion” contests that have four main criteria. The criteria include: i) export potential through strong brand capacity; ii) stability and production sustainability and stability of quality; iii) levels of consumer satisfaction; and iv) the background of the product, particularly the use of locally available resources, knowledge and culture. The program has also created an OTOP logo to assist with consumer recognition, and a system of stars indicating the ranking in the Product Champion contests. Products granted more stars are able to receive superior financial support including bank loans, marketing loans, the provision of tools and machineries and enjoy enhanced export promotion benefits, including access to local and international exhibitions and fairs.

The results of the OTOP programme thus far have been impressive. According to the Government of Thailand, SMEs supported by OTOP account for 37% of GDP and 30% of total exports of Thailand (GPRD, 2013). OTOP product sales amount to 76 billion baht and are expected to top 100 million baht by 2015 when Thailand enters the ASEAN Economic Community (GPRD, 2013). The OTOP community and Thai SMEs have identified several measures which would improve the programme’s impact, including: enhanced access to financing instruments; improved access to modern technology, information and knowledge about key export markets; and support in meeting international product standards.
OVOP and its sister programmes such as OTOP are proof of how trade and investment can successfully promote inclusivity. Through these programmes, local communities have proven to be more than capable of taking part in international trade if they are given the opportunity to do so on their own terms and with their own products. These programmes also show that it is not necessarily trade and investment itself that creates inclusive development impacts - but rather it is the modalities of that trade and investment that does so. Clearly empowering whole communities to produce and export original products is one way of making trade inclusive.

LESSONS

OTOP has created a strong network of producers and therefore has the potential to assist poor and rural communities in many ways, including by enhancing market access, product recognition and promotion, business skills and access to capital.

B. TRADE FACILITATION MEASURES FOR INCLUSIVE DEVELOPMENT

A number of trade facilitating initiatives in the Asia-Pacific region resulted in gains for the poor. The cases selected show that trade facilitation contributes to inclusive development. The cases also show that interventions in supply chains at their early stages (e.g. production or post-production) deliver the maximum benefits from trade facilitation.

1. India’s e-choupal – generating “win-win” outcomes based on ICT and better logistics

Electronic choupal or e-choupal (Hindi for “meeting place”) is equipped with a computer and internet connectivity. It is run by an operator, who acts as the interface between the computer and the less literate farmers (who are unable to operate computers). The operator is a trained individual, who also works as an ITC salesperson, often a literate farmer from the village. E-choupal is an initiative by ITC India, a large company involved in commodity exports, food processing and retailing etc. It has retail outlets across the country. Their biggest export item is soybeans, sourced from rural India. E-choupal was first established in 2000. Since then ITC has established 4,500 e-choupals in 40,000 villages impacting about 4 million farmers.

North Indian rural markets are characterized by supply chains dominated by a number of intermediaries. Typically, the soybeans of a producer reach the local wholesale market (called Mandi) after passing through two intermediaries. The farm gate price is what the first intermediary quotes. The volume is weighed using traditional weighing machines, often generating inaccurate results disfavouring the farmer. The quality of the product deteriorates over the long-supply chain due to inefficient transportation systems and weak infrastructure.

ITC has established working relationships with meteorological departments and agricultural universities to develop information content for the computer systems used by the e-choupals. It also receives information from input supply companies on the price and availability of fertilizers and seeds. The computer is connected to a central server which contains ITC prices for agricultural products. It contains the “Mandi” prices too. Farmers can compare and negotiate their prices with ITC. The farmer also can get access to weather forecast, information on production practices and soil testing services, and can place order for fertilizers and other inputs. The internet connectivity allows farmers to submit any query to the operator, which the operator searches through ITC’s server or the internet.

The farmers could also sell their produce to ITC through the operator. They bring samples of their produce and the operator quotes a price. They can then compare the prices offered by other intermediaries through the internet. If agreeable, the farmers transport the produce to the ITC collection centre nearby and get paid by the operator within two hours. ITC uses modern equipment and weighing systems to ensure less spillage and correct reading of the volume. Transportation costs are reimbursed by ITC. Farmers reportedly prefer this system compared to traditional Mandi or auction systems.

The e-choupal model is primarily based on two aspects of trade facilitation: improved access to trade-related information and efficient logistics and transportation services. The initiative yields a “win-win” result for both ITC and the farmers. Both reduced their transaction costs. In the traditional system, material handling, labour payment at the Mandi and spillage used
to cost farmers about 3% of the value supplied. It is reported to be nil now. Farmers can have access to up to date weather information, better agricultural practices, price information and supply-demand data for their products. ITC also saves 3% of the value procured from less spillage, using modern equipment, and lower transport cost. A continuous and predictable supply of soybeans helps their business now that there is an influx of farmers into e-choupal. Farmers’ sales of their produce are now more organized, predictable and secured.

LESSONS

The e-choupal case shows how farmers can achieve economic gains from better post-production handling and improved access to information. The ICT-based solutions can also be used to build strong business linkages down the international supply chains. These linkages not only facilitate trade but integrate small producers into supply chains also. The improved services including access to market information and logistical facilities provide better alternatives to the farmers for supplying their products. Since ITC is supplying their products to domestic markets, it is natural that the quality improvements in their products could spill over to the domestic markets that ITC supplies to. In the long run, the knowledge gained could lead to higher long-term productivity.

2. Thayang Cooperative: facilitating linkages between farmers and the organic market with support from e-traceability

It is extremely difficult for individual farmers in developing countries to supply to international markets. It is no different for Thai farmers. They either sell their produce in local markets or supply to traders for sales in big cities as their products do not meet the criteria for export quality. This is also because appropriate production practices are not followed. They are not organized and so it is costly for them to export without any common platform. One company overcame all these issues – Thayang Agriculture Company Ltd.

Thayang is a leading exporter of organic bananas to Japan and also a supplier to the supermarkets of Thailand. It is a farmers’ cooperative, established in 1966, located in Petchburi Province in Thailand. The cooperative currently employs about 2,100 farmers and produces about 1,300 tons of chemical free bananas. Its primary client is a Japanese organization called TOHTO. It supplies to local supermarkets and retailers too. A simplistic value chain of Thayang is presented in figure 10.3.

Thayang farmers operate under a contract farming system. They receive information on production methods, input, credit and extensive support from the cooperative. Prices of bananas

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**FIGURE 10.3**

Value chain for exporting organic banana

(Thayang Agriculture Co., Ltd)

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**Source:** Keretho, 2012.
are fixed and higher than open market prices. In addition to this, Thayang has developed an electronic traceability system which allows Japanese consumers to trace back necessary information on origins and production.

Thayang has been supplying bananas to its counterpart in Japan since 1992. However, it did not have a traceability system and a farmer information management system until very recently. As a result, they did not receive ISO 9000 and ISO 14000 certification. However, now with help of Japanese buyers, it has implemented a barcode traceability system. As presented in figure 10.4, the traceability system at Thayang captures information at four stages: farm level, delivery at packing facility, packing and delivery (Otento (Thailand), n.d.).

The traceability system and good agricultural practice are central to Thayang’s operation. Farmers in the Thayang cooperative follow certain guidelines for producing bananas. They refrain from using chemical fertilizers or pesticides and use the land for banana production only. They maintain a record of their cultivation too. The information items include: the farmer’s name and code; the cultivation area; crop numbers; transplant dates; and the use or not of chemicals. They also record information on production techniques such as manure usage and any pest treatments (Otento (Thailand) Co., Ltd., n.d.). The cooperative plays a “quality control” role by inspecting the farm site, identifying bananas to harvest and transporting them back to cooperative premises. At the receiving facility, the receiving date, farm code, number of products, the workers’ details are recorded. The product specifications are checked against those demanded by the TOHTO or Japanese buyer. This database produces product labels containing data from the database. Then labels are printed and put on the bananas and boxes carrying them. After packing, the boxes are kept in a temperature controlled environment at 12.5 degree celsius. The bananas are then exported to Japan’s Agricultural Cooperative Corporation (WAGO). Delivery data including shipping dates and the number of cartons are then entered in the system. WAGO then let the bananas ripen and supply them to the TOHTO consumer cooperative.

A number of factors have been key to this success story. First, Thayang has been able to organize the farmers and reduce the transaction cost. Second, adoption of an e-traceability system helped retain the Japanese organic market. Third, farmers have been provided with appropriate technology, quality specifications, credit and technical service. Fourth, Thayang has maintained a strong control over the entire supply chain to ensure the quality of the products.

**FIGURE 10.4** Information recorded in Thayang’s Electronic Traceability System

- **FARMING**
  - Land
  - Source of Banana Sprout
  - Planting Date
  - Farming Processes
  - Fertilizer, watering
  - Insect and weed harvesting

- **RECEIVING**
  - Date of receiving
  - Farm details
  - Owner details
  - Number of product
  - Weight
  - Workers

- **PACKING**
  - Date of packing
  - Packing quantity
  - Workers

- **DELIVERY**
  - Shipping date
  - Number of cartons
  - Workers

*Source: Adapted from Otento Thailand Co. Ltd. Presentation.*
LESSONS

Successfully integrating agricultural producers into high-value international supply chains involves significant changes on how they organize and interact among themselves and with other actors in the supply chain. Cooperating with actors up in the value chain led to increased learning opportunities and technology transfer for the farmers. Enhanced and more transparent procedures through implementation of traceability systems have helped targeting health conscious consumers and access high-value export markets.

3. Dongfeng in China: revolutionizing a village through e-commerce

Dongfeng, located in China’s eastern province of Jiangsu, used to be a poor village as recently as ten years ago. Inhabited by about 5,000 people, villagers were dependent on traditional agriculture, mainly rearing pigs or producing vegetables in their farmlands. Now, many of them own online shops that sell furniture. Villagers use an online platform called taobao.com, which is China’s largest consumer to consumer e-commerce website for the domestic market. It offers a secure online payment system for traders.

A local village graduate called Sun Han is the hero of the case. Upon return from a city where Sun was working in a telecom company, he started his own online store selling home accessories in 2006. He started to take interest in small furniture, and employed a few villagers to begin making furniture. He immediately experienced good sales and experienced a ten-fold revenue increase in just a year. He started to educate other villagers on using the internet and e-commerce websites. The villagers started learning skills for making furniture. The furniture was relatively simple with few features. Nevertheless, demand was quite high and many villagers started their own online stores shortly after. An estimated 100 online stores were established by 2008. Slowly logistics service providers opened their offices in the village. Some entrepreneurs could not operate computers and were not able to transact online. They used handwriting recognizing software to type in computers. The farmers turned entrepreneurs started providing support services including furniture design and delivery. Up to the end of 2011, there were 1,200 online stores and more than 600 households were involved in furniture manufacturing. About 85% of the total furniture sales on taobao.com are now done by Dongfeng villagers. Total sales exceeded 300 million Chinese yuan ($49 million) in 2010. Average monthly profits for villagers are several thousand Chinese yuan. The furniture products are now supplied to Beijing, Shanghai, Guangzhou and exported to: Japan; New Zealand; Republic of Korea; Spain; Hong Kong, China; and other economies. Today, driven by the rise of the furniture industry, most of the villagers are engaged in the furniture business through online sales. This situation created opportunities for peripheral industries. As of 2010, there were six metal processing plants, two hardware accessories shops, seven computer stores and fifteen logistics service providers in the village (Jin, 2012).

A number of aspects were critical to the success of Dongfeng village. First, the adoption of e-commerce as a platform to trade by the villagers was crucial. Dongfeng residents were not exposed to the practice of e-commerce before Sun Han started his own business. Good Internet connectivity and a safe e-payment option also helped. The ease of entering online trading enabled villagers to quickly start their stores. Almost anyone could open a store on websites like taobao.com. Second, the market for furniture was correctly identified. This was combined with quick learning of new skills by the workers.

LESSONS

This case is perhaps one of few cases where traditional farmers have undergone a complete transformation and become entrepreneurs driven mainly by the adoption of modern information and communications technology and services. E-commerce enabled a remote village to connect with the national market and to conduct business and trade efficiently. The case highlights the fact that the availability of such technologies and services may not be enough and their benefits need to be demonstrated widely, including to those that may not be initially perceived as likely users; the economic gains of further adoption could be enormous.
4. Export processing zones in Sri Lanka and their impact on poverty reduction

In Sri Lanka, there are 12 economic zones including nine export processing zones (EPZs), two industrial parks and one export processing park. Until 2007, EPZs contributed to 38% of total exports. Since the establishment of the first EPZ, employment in these economic zones has increased significantly. In 2012, these economic zones employed more than 127,000 workers, a significant share of them being female.

A recent ESCAP-ARTNeT study analysed “the effectiveness of EPZs on poverty reduction and an analysis of these zones as a mechanism of trade facilitation” (Karunaratne and Abaysekara, 2013). In essence, this study examined the efficiency of the trade procedures in these zones and their socio-economic impact on their immediate surroundings. It also looked at the impact of the zones on employment generation, education, and working conditions in these areas.

The two largest EPZs which were the subject of the study are located in Katunayake and Biyagama around 50 km from Colombo. Enterprises operating inside EPZs are approved by the Board of Investment of Sri Lanka. The study found at least two aspects of trade facilitation that EPZ enterprises are enjoying access to compared with enterprises outside the zones in relation to importing and exporting. They are: (i) a reduction in necessary documentation and processes, (ii) a reduction of time taken.

The findings showed that customs and other procedures related to trading were simplified for enterprises inside EPZs. For example, enterprises are not required to visit customs offices in Colombo to submit a customs declaration; instead it can be done inside EPZs. Cargo can also be examined inside EPZs rather than in the port. Table 10.2 provides a comparative picture of the processes for the enterprises inside and outside EPZs.

EPZ enterprises require substantially fewer documents. For import declarations for example, only five types of documents are needed as opposed to nine types for non-EPZ enterprises. Time taken to complete export and import procedures for EPZ enterprises are almost half of those of outside EPZs. For example, submission of the customs declaration takes about four hours for enterprises inside EPZs whereas it could take up to ten hours for other enterprises.

The study considered a number of factors to assess the impact on poverty reduction for the workers in the immediate surroundings of EPZs. In doing so, it considered job creation, wages, female workforce participation, working conditions and benefits, and indirect employment as some of the major indicators. The study reported mixed findings. The major positive impact was clearly direct job creation. More than 127,000 jobs in all the zones of Sri Lanka were created. What is noticeable is that most of these jobs went to low-skilled workers due to the nature of the jobs. Many jobs were occupied by workers coming from villages far from EPZs. As can be seen in figure 10.5, share of female workers in Sri Lankan EPZs is mostly higher than that of male workers. More than 60% of workers in Sri Lankan EPZs are female. This is quite a contrast to Sri Lanka’s entire workforce, of which, only 33% are female. However, when it comes to wages, mean averages for low-skilled workers in manufacturing units of EPZs were only 5% higher than the average across Sri Lanka’s entire manufacturing sector. One downside as found in the study is the high turnover rate for EPZ workers compared with non-EPZ workers. As reported by the workers, the reasons included “hectic work-schedules” and insufficient wages. This is quite surprising given the strict labour standards set by the Board of Investment of Sri Lanka, which stipulates working hours, overtime pay, and holidays. On the other hand, workers outside EPZs were receiving better work benefits including healthcare facilities, and on the job training, and were staying with their employers longer. As required by the Sri Lankan law for private sector employees, all workers received Employees’ Provident Fund and Employees’ Trust Fund.

LESSONS

EPZs, by facilitating trade and investment, led to the creation of jobs for low-skilled and female workers inside the zones, and the development of support services in the zone-surrounding areas. However, higher staff turnover rates in EPZs suggest that the overall working
conditions may not be as good inside as outside EPZs. To enhance inclusive outcomes of EPZ, special attention may be needed on enforcing appropriate labour laws in these zones. In the long term, however, facilitating trade and investment across the national territory rather than only in special zones should be pursued.

C. FOREIGN DIRECT INVESTMENT AND PROMOTION POLICIES

The potential benefits of FDI for households in host countries are derived from: the impacts it can have on supply capacity and job creation; the transfer of new technologies and skills; the

<table>
<thead>
<tr>
<th>Processes or activities</th>
<th>Enterprises outside EPZs</th>
<th>Enterprises inside EPZs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Line Ministry approval</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Import License</td>
<td>Required</td>
<td>Not required</td>
</tr>
<tr>
<td>Payment terms</td>
<td>Limited to L/C, D/A, DP, or Advance (T/T, bank draft)</td>
<td>None-payment also by offshore 3rd party</td>
</tr>
<tr>
<td>Advanced payment limits</td>
<td>$10,000</td>
<td>No limit</td>
</tr>
<tr>
<td>No-foreign-exchange-basis imports</td>
<td>Maximum of $1,000 and no commercial quantities</td>
<td>No limit</td>
</tr>
<tr>
<td>Original documents</td>
<td>Received through bank</td>
<td>Received directly from shipper</td>
</tr>
<tr>
<td>Delivery order</td>
<td>Obtained from shipping agent</td>
<td>Obtained from shipping agent</td>
</tr>
<tr>
<td>Import declaration</td>
<td>Customs declaration submitted to Customs (Long Room)</td>
<td>Customs declaration submitted to BOI service center in Colombo or EPZs</td>
</tr>
<tr>
<td>Payment of duties and taxes</td>
<td>Bank of Ceylon near Long Room</td>
<td>Bank of Ceylon counter at BOI location</td>
</tr>
<tr>
<td>Determination of examination level</td>
<td>By Customs</td>
<td>By Customs</td>
</tr>
<tr>
<td>CBCU registration – sea cargo only</td>
<td>Not required</td>
<td>Required</td>
</tr>
<tr>
<td>Payment of SLPA charges</td>
<td>SLPA center at Port</td>
<td>SLPA counter at BOI office or at Port</td>
</tr>
<tr>
<td>Collect gate pass from SLPA</td>
<td>Delivery documents to SLPA</td>
<td>Delivery documents taken to SLPA</td>
</tr>
<tr>
<td>Cargo pickup</td>
<td>From port</td>
<td>From port</td>
</tr>
<tr>
<td>Cargo examination</td>
<td>Examination by Customs</td>
<td>Examination by Customs at Verification Unit, EPZs, or consignee location</td>
</tr>
<tr>
<td>Transport cargo to importer location</td>
<td>Only after examination – if required</td>
<td>Before examination - possible</td>
</tr>
</tbody>
</table>

development of managerial know-how; access to finance; and access to new markets. Promotion and facilitation of FDI thus often forms a core part of the strategy employed by host countries to promote economic development. However, FDI can function as a mixed blessing: it can contribute capital and skills to developing countries but, unless properly regulated, it also carries the risk of transnational corporations (TNCs) abusing their market power.

Despite the growing trend towards more responsible business practices, there are incidences where the operations of companies – local or foreign-owned – have negatively affected the welfare of local communities because of abusive labour practices, indifference towards the environment, or a near-sighted focus on pursuit of profit. Recent tragedies in a number of factories operating in the least developed countries and as part of global supply chains have given rise to new criticism of the operations of TNCs in these countries. The tragedies have cast a shadow on the positive impact FDI can have on host economies. Notwithstanding those instances, under the right conditions and policy environment, FDI has the potential to contribute significantly to inclusive growth.

Studies have found that FDI inflows not only enhance productivity and exports of affiliates of TNCs, but can also positively influence sales and productivity of local suppliers to foreign plants. For instance, a 1% rise in FDI resulted in a 3% growth in productivity of input suppliers in Lithuania (Javorcik, 2004). It is thus also important for Governments to support building the capacity to absorb and adapt technology. For example, Singapore in collaboration with TNCs has set up various centres to adopt and adapt foreign technologies to local requirements. This can be done through pro-competitive regulations, education and promoting innovation.

Empirical evidence of the impact of FDI on host economies reveals that its impact depends on decisions made by the investor as well as the local context (Colen, Maertens and Swinnen, 2008). Investor decisions include the motives for investing, the mode of entry and the choice of investment destination. The local context is determined by government policies, rules and regulations, the level of human capital formation, governance and institutions.

Although FDI is not a panacea for development, it can help support inclusive growth when host governments, home governments, and TNCs...
adopt certain measures. The following examples describe these measures and illustrate how FDI can impact employment, productivity and skills, wages and non-wage working conditions. The last example describes what home governments can do to ensure that companies investing abroad support inclusive development in the host country.

1. Inclusive growth through foreign direct investment in the retail sector

Retail is one of the most controversial sectors in developing countries for FDI as it is typically dominated by small and medium-sized enterprises (SMEs) that provide the bulk of employment. It is argued that FDI would crowd out SMEs and would lead to unemployment. Singh (2011) cites studies which report employment losses in the value chain. For example, as compared with 18 jobs created by a street vendor, 10 by a traditional retailer and 8 by a shop vendor in Viet Nam, a supermarket like Big C needed just 4 persons for the same volume of produce handled (Wiggerthale, 2007). A study also found that the spread of supermarkets led to a 14% reduction in the share of “mom and pop” stores in Thailand within four years of permission for FDI entry (Vander Stichele, van der Wal and Oldenzeil, 2006). It is thus argued that the use of modern technology by supermarkets prevents effective employment creation.

However, the evidence for job reduction as a result of FDI in retail is not conclusive. For instance, Mukherjee and Patel (2005), in a study of developing countries’ experiences with FDI in retail, found that FDI in general led to higher quality of employment and, as long as the economy was growing, no negative effect on employment could be found. Popli and Singh (2012), in evaluating the potential impact of India’s FDI liberalization policy in retail, found that at least 10 million jobs would be created within three years. They also observe that in Indonesia, even several years after the entry of supermarkets, 90% of fresh food and 70% of all food is still controlled by traditional retailers. In China, FDI in retailing rose sharply after China entered WTO but currently local retailers still dominate the Chinese market, competing successfully on the basis of superior knowledge of local culture and consumer demand and essential connections with local Government.

Moreover, FDI in retailing has positive effects on productivity, efficiency and international competitiveness of the retail sector in developing countries and links local farmers, suppliers and manufacturers to global supply chains. Chari and Raghavan (2012) note that the entry by large international retailers into the Indian market may help tackle inflation especially in food prices. Moreover, technical know-how from foreign firms can improve supply chain efficiency in India, in particular for agricultural produce. Better linkages between demand and supply have the potential to improve the price signals that farmers receive and also serve to enhance agricultural and other exports.

A similar trend is noted in Thailand after it liberalized FDI in the wake of the 1997 Asian financial crisis. It was argued that FDI breached the fragile competitive balance that existed in Thailand between traditional retailers and wholesalers, with unfair methods such as predatory pricing, exclusive dealing and resale price maintenance. Shannon (2009) ironically observes that the criticism from local retailers, suppliers and politicians was directed at the big hypermarkets rather than the smaller convenience stores such as 7-Eleven which have a potentially much larger impact on local grocery stores. In the meantime, Schipmann and Qaim (2011) observe many wet-markets in Thailand continue to operate in city centres alongside the foreign mega-stores without much apparent difficulty as they cater to different market segments. The biggest threat today is not posed by hypermarkets but the proliferation of convenience store chains such as 7-Eleven (Natrajan, 2012). While the lack of zoning laws undoubtedly contributed to the elimination of many local mom-and-pop stores, the influx of foreign retailers seems to have contributed to employment among suppliers as most of the sourcing by the big supermarkets is done from local producers. Therefore, it can be observed that FDI in retailing has contributed to employment on a rather large scale, including in the provinces though precise figures are difficult to obtain.

In addition, as observed by Meyer-Ohle (2010) in a study of large shopping malls in Japan and Singapore, Asian malls are very competitive as they play a strong role as leisure destinations. Thus, while there is evidence that foreign retailers have crowded out SMEs, in their absence local
large retailers may have had the same effect. The consolidation and growth of large retailers reflects changes in global business models and consumer behaviour and are therefore part and parcel of the economic development and growth process. As Fels (2010) reports, from 1997 to 2007 more than 100,000 small shops were forced out of business by modern retail outlets. These social costs must be balanced against the benefits flowing from lower costs to consumers.

LESSONS

These cases show that the displacement of local retailers by superstores, foreign or national, does not always occur and that the evidence of job displacement as a result of entry of (foreign) supermarkets is not conclusive. However, the rise of indigenous large retail shopping complexes shows that domestic retailers can be very competitive. In this respect, the issue in assessing the impact of the retail industry on inclusive growth is not so much the influx of FDI but rather the issue of concentration and dominance by a few large firms, national or foreign. Therefore, countries have to watch for anti-competitive behaviour which would squeeze local suppliers, raise prices and reduce quality. The enforcement of proper competition and zoning laws and the aggressive promotion of responsible business practices backed by adequate legislation would be the right responses; however, given the speed of change,

Governments may have difficulty to keep up with implementing appropriate legislation.

2. Malaysian ICT sector: using foreign direct investment to create employment and improve skills

In the 1970s, the state of Penang in Malaysia adopted an export-oriented strategy by plugging into the global economy via the electronics sector. The availability of an English-speaking workforce together with the Government’s tight control over labour organizations attracted foreign investors looking for cheap labour in the early 1970s while the establishment of free trade zones eased the operations of these TNCs and allowed for duty-free import of intermediate and capital goods. Over time, Penang has become one of the most developed industry clusters, and information and communications technology (ICT) the leading manufacturing sector in Malaysia.

FDI in both the ICT and electronics industries has been a key driver of growth and development in Malaysia. Earlier, employment creation was one of the motives for Malaysia to attract FDI; however, the attainment of near full employment in the country since the early 1990s implies that mere employment creation is no longer the aim for the FDI-led development strategy of Malaysia. Rather it is the technology from FDI and the need to create high technology skills through

**BOX 10.1**

Thriving retail sector of Thailand

At roughly 300 stores per million people (similar to Malaysia and Singapore), compared to an average of 50 in Viet Nam or Indonesia, plus online shopping, the Thai multi-brand retail scenario is comparable to that in the United States or Western Europe. All its formats permeate the city: cash and carry (usually wholesale), hypermarkets, supermarkets, smaller “express” shops, the ubiquitous “Sevens” and their main competitor, Family Mart, that dot almost every Bangkok street. Big retail currently handles close to half the total value of a retail trade worth around 480 billion baht. Wet-markets and traditional grocery stores account for the other half, but with a relatively lower rate of growth, this share is projected to fall.

Given the lax legislative environment, the surge in FDI in retail met with resistance when anti-competitive behaviour was noted. It was argued that FDI breached the fragile competitive balance that existed in Thailand between traditional retailers and wholesalers, with unfair methods such as predatory pricing, exclusive dealing and resale price maintenance. However, as of today, a retail act, first drafted in 2007, remains a draft.

However, FDI in retail is no longer a contentious domestic issue. Local capital proved no pushover: in the past decade they have wrested a big share of the pie and the sector is clearly oligopolistic in character. They were strong enough to drive out French giant Carrefour in 2010. In fact, in preparation for the ASEAN Economic Community, the focus is on outward FDI in other ASEAN countries and also India.

*Source:* Natrajan (2012)
technology transfer that is urgently needed, especially as Malaysia aspires to become a high-income economy by 2020. In order to attract FDI from leading information technology (IT) TNCs in the world, the Malaysian Government has offered tax incentives, invested in infrastructure such as fibre optic network and imported skilled foreign knowledge and IT workers.

The role of foreign companies in creating employment opportunities in the Malaysian ICT sector has been significant. Foreign firms have tended to employ more workers than local firms. Over the period 2000-2008 foreign firms operating in the ICT sector employed on average over 900 workers per company whereas the corresponding number for local companies was slightly below 300. This difference may be due to differences in scale, however the fact remains that foreign firms on average employed over a quarter of a million people per year during 2000-2008 compared to slightly above a 100,000 jobs employed by local companies in the ICT sector.

Overall, the Malaysian ICT industry employs more female than male workers. Female workers are often tasked with unskilled jobs and over the period 2000-2008 on average accounted for 60% of the unskilled workforce hired in foreign firms, and 56% of the workforce in local firms. While the share of skilled female workers still remains low, it has been increasing in recent years. In both foreign and local firms, male workers have a higher proportion of the skilled jobs.

All in all, over the period 2000-2007 foreign establishments in the ICT sector have been important in terms of their contribution to value added, employment, and exports of the industry. While both local and foreign firms have increased their share of skilled workers, labour productivity of foreign firms has remained higher than their local counterparts. This might be due to the outsourcing of lower value added production from foreign to local firms. Significantly, foreign firms utilize more Malaysian skilled workers than local firms. This may be attributed to their relatively higher wages and salaries and a tight labour market for local talents. While the ICT sector has increased employment opportunities for women both in foreign and local firms, as noted above, they are employed mainly in unskilled jobs. Women are also paid less than their male counterparts in both skilled and unskilled work.

Over the period 2000-2007 foreign companies in the ICT sector have also increased their share of value added as a percentage of total value added in the sector, whereas the share of local companies has declined. In 2000, foreign firms accounted for 73% of value added in the ICT sector; in 2007 their share had risen to 79%. Local companies have struggled to match the levels of value added of foreign companies. One of the reasons for this is that they lack absorptive capacity to upgrade manufacturing activities from low to high value added activities. Due to lack of proper skills among the local population, local companies have not been able to fully benefit from knowledge or technology spillovers from foreign companies.

The Government of Malaysia has made efforts to improve the level of human capital in the country. For example, the Penang Skills Development Centre (PSDC) was created in 1989 to address the problem of mismatch between the skills industry needed and the skills the local workers had. The Centre offers a great example of how to create linkages between TNCs, SMEs, the Government and the academia. The Centre provides training to SMEs in areas ranging from business skills to learning how to use the latest technology and links them with TNCs through coaching and mentoring programmes. By 2002, the Centre had trained over 75,000 workers. The Government has been active in providing the physical infrastructure to enable the programme and academia has been involved in providing training materials and teacher training. One of the reasons for why the Centre has been so successful is that training has been relevant and tailored to meet the needs of companies and the economy. In addition, SMEs have been partnered with TNCs after careful matching of business philosophies, needs and capabilities (UNCTAD, 2000; Ruffing, 2006). The success of the Centre shows that Malaysia has taken steps in the right direction; however, more similar efforts are required to transform Malaysia into a high value added economy. More attention could also be directed towards the training and skills upgrade of female workers, who seem to be stuck in low-skilled and low-paying positions. In order to ensure an inclusive outcome, the Malaysian Government needs to make sure that both training and job opportunities are provided equally to male and female workers.
LESSONS

The key policy lesson highlighted by the example of Malaysia is the critical need for developing countries to focus on human capital development in order to gain from the presence of TNCs in the country. While a lot of attention is paid in developing countries on creating the appropriate investment conditions to attract FDI, less attention has been paid on enhancing the absorptive capacities of their economies. The education system in the host country must be well equipped to supply the kind of human capital that is needed by TNCs and for industrial upgrading. Equally important is to ensure that all members of society have opportunities to improve their skill level.

3. Foreign direct investment and wages in China – an evolving landscape

The tremendous economic growth experienced by China over the past three decades has been largely driven by FDI. China is the developing world’s largest recipient of FDI, attracting $121 billion in 2012. Over the years, TNCs relocated production and sourced inputs from China, drawn in part by a stable system and plentiful workforce, but especially by low wages. Today, partly as a result of tremendous economic success of China, this picture is changing: wages are climbing, and the desire for a more skilled workforce is increasing. FDI, though still higher than in any other developing country, fell by 2.3% in 2012 compared to the previous year.

What is prompting these shifts? In an effort to lessen turnover and address worker discontent, both TNCs and the Government have been increasing wages. HSBC estimates that Chinese manufacturing wages rose about 20% per year between 2005 and 2011; in 2011 the Chinese Government raised the minimum wage by an average of 20% across 13 provinces. Accenture Consulting examined the wage levels specifically in three of the most important manufacturing industries in China: footwear (Nike, Adidas, Puma), heavy machinery (Caterpillar, John Deere, Terex), and personal computers (Hewlett Packard, Dell, Apple, Lenovo). For all three industries the average hourly wage has risen over the past years. Figure 10.6 shows how the average real wage has developed in Bangladesh, China, India, Indonesia, Thailand and Viet Nam since 2005. Whereas most countries have experienced moderate growth in average real wages, or even a decline as in India, average real wages have surged in China.

Wages in China are rising for three reasons: (1) a shortage of skilled workers in eastern China, where the majority of FDI-driven manufacturing still takes place; (2) increasing experience and educational levels of the workforce; and (3) government legal and regulatory measures to increase wage rates, embodied, for instance, in the Labour Contract Law of 2008. In essence, a combination of rising education and FDI has led to increases in Chinese worker productivity. Together with a public policy of supporting higher incomes, these effects have translated into rising wages. This public policy has meant that the Government has allowed increasing labour organization, collective bargaining, and strikes, even though independent unions are still banned in China (factory unions are either part of the Government-run All-China Federation of Trade Unions or organized by employers).

These trends reflect China’s aim to move up the value-added chain to increasingly skilled and technology-oriented production activities. The middle class is growing, and with it the standard of living of millions of people. FDI flowing to China is increasingly oriented to the domestic market consumption, as opposed to being oriented to exports as before. At the same time, these trends also represent an opportunity for other countries in Asia. South-East Asian countries, which received only 2.7% of global FDI in 2002 following the 1997 Asian financial crisis, currently receive 8.2% of global FDI, almost on par with China’s 9%. Firms are increasingly directing new or redirecting existing FDI from China to countries with relatively more attractive wage rates, such as Cambodia, India, Indonesia, Thailand, or Viet Nam.

The experience of China provides a very useful example for how a country is managing the process of economic evolution, combining FDI attraction, education, and regulation to achieve its domestic social goals.
4. Can foreign direct investment help Thailand to absorb a higher minimum wage?\footnote{151}

After several decades of minimum wages being outpaced by inflation, the Thai Government recently raised the minimum wage to 300 baht (approximately $10) per day. Given that 30-40% of Thai businesses are labour-intensive, some economists expect that higher wages will be a blow to FDI in Thailand over the next few years.

The fear is that Thailand’s international and regional competitiveness will be adversely impacted by increased labour costs. Foreign investors may consider relocating to other countries, such as Indonesia and Viet Nam. This would also induce Thai businesses to employ greater numbers of informal and migrant workers, who are expected to arrive from neighbouring countries in even greater numbers, particularly Cambodia and Myanmar, where the daily minimum wage is $2.03 and 58 cents, respectively.

In contrast, other economists believe that the minimum wage will improve Thailand’s chances of competing with other regional economies in attracting new FDI. The rationale is that a higher minimum wage will require firms to increase productivity to stay competitive, thereby moving Thailand’s economy up the value chain. This would require increasing training and technology adoption, and thus help Thailand escape the notorious middle-income trap. The higher minimum wage may also push Thai workers to raise their own skill levels in preparation for increased labour competition as a result of influx of migrant workers. According to a recent Economic and Social Survey of Asia and Pacific (ESCAP, 2013b), the minimum wage increase in Thailand may boost GDP growth by 0.7% and add 0.6 of a percentage point to employment growth by 2015, so long as it is accompanied by appropriate adjustment policies and measures.

The Government of Thailand expects that increased income for workers will boost domestic consumption, which will provide a strong incentive for foreign investors to increase FDI to tap into growing Thai disposable income. As firms attempt to satisfy this growing consumption demand, this may in turn foster productivity gains and innovation, and in turn lead to further economic growth.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure10.6.png}
\caption{The growth in average real wages in selected countries}
\end{figure}

\textbf{Source}: The Economist Intelligence Unit, Country Data Database.
Finally, when TNCs make decisions between FDI market destinations, they take into account a multitude of factors, including but not limited to labour regulations and labour conditions in addition to labour costs. Implementation of the recent minimum wage hike is a signal to the international community that Thailand is serious about economic modernization and industrial transformation, moving away from unskilled labour industries to more value-added activities. This should attract TNCs that aim to source and produce goods and services further along the economic value chain. The real impact of this minimum wage increase remains to be seen, but these represent some of the mechanisms whereby the increase can help Thailand achieve investment and growth that is sustainable and inclusive.

5. Improving non-wage labour conditions in the garment industry: Bangladesh and Cambodia

Bangladesh and Cambodia provide interesting contrasts in their approaches to the structure and regulation of FDI in the garment industry. In Bangladesh, investment in the garment industry is mostly from domestic sources, with TNCs purchasing the final products. In contrast, investment in the garment industry in Cambodia is mostly from FDI. By comparing these two countries, one can derive insights on the impact of FDI in a domestic economy that could be useful to other countries where the production of garments also play an important economic role.

**Bangladesh**

Bangladesh is the world’s second-leading garment exporter after China, with garments comprising 79% of the economy’s $24.3 billion of exports. Bangladesh has more than 5,000 garment factories, employing almost 4 million workers. The industry has helped raise the living standards of millions of people, driving growth at nearly 6% annually. It has provided steady employment for many rural migrants, particularly women, who earn more than they would have in traditional rural activities. In doing so, the industry has given women an independent source of income, empowering them as economic agents. The growth of the Bangladeshi garment industry has therefore decreased poverty and empowered traditionally disenfranchised populations (Razzae and Eusuf 2007).

Nevertheless, the garment industry has been plagued over the past couple of years by concerns over safety, loss of life and angry protests over rock-bottom wages. In 2013, Rana Plaza, an eight-story commercial building, collapsed in Dhaka, resulting in the death of 1,127 people. This and other disasters have attracted international attention to labour conditions in Bangladesh, bringing pledges from government officials and many global companies to tighten safety standards. The Government of the United States cut the country’s GSP duty-free trade privilege, and the European Union has threatened to do the same if Bangladeshi authorities do not ensure that factories across the country comply with international labour standards. This could exert pressure as 40% of the country’s garment exports go to the United States market and 60% to the European Union market. The European Union has offered assistance to the Bangladeshi authorities to help meet these standards. The Government of the United States also exerted pressure on their apparel importers to actively contribute to improving the work safety and labour climate in Bangladesh.

The host country has a key role to play in helping to make such investment inclusive. The Government of Bangladesh shut down three factories of the Nassa Group (manufacturer for WalMart and Sears) and recommended that the owner of Rana Plaza, along with the owners of the five garment factories housed in the building, be charged with “culpable homicide” for allegedly forcing employees to return to work the previous day. The Government of Bangladesh also announced it would raise the minimum wage for garment workers and issued a new labour law that makes it easier for workers to organize by removing the previous requirement that factory owners approve formation of a union. However, ILO has stated the new law falls short of providing labour freedom of association, as it stipulates that workers can only form a union if 30% of employees approve in advance (Agence France Presse, 2013).

TNCs are playing a key role in making their investment decisions lead to more inclusive development. Nearly 90 firms from Australia, Europe and the United States, including Carrefour, H&M, Gap, Walmart, Target and Tesco, have signed agreements to improve conditions in garment factories in Bangladesh.
The agreements require setting up safety standards and inspections in factories with which these firms do business in Bangladesh. These inspection results would then be used for remedial steps where there are safety issues.

**Cambodia**

Just as in Bangladesh, the garment industry in Cambodia is critical for the country’s growth, employment and foreign exchange earnings. According to IMF (2013), garments accounted for 75% of the country’s total exports of $5.22 billion in 2011. The garments industry generates 9.2% of total gross value added (UNCTAD, 2013a or 2013b) and employs up to half a million workers, with 500 garment and shoe factories.

FDI into Cambodia has increased from an estimated $520 million in 2009 to $1.5 billion in 2012 (IMF, 2013). Investors are attracted by significant investment incentives to investors offered by the Government of Cambodia. UNCTAD (2013a or 2013b) estimates that from 2007 to 2011 about 90% of investment in the garment industry was as a result of FDI.

The real effect on Cambodian workers in the garment industry, however, is mixed. On the one hand, garment industry jobs pay some of the highest salaries across manufacturing sectors in Cambodia, although these salaries remain amongst the lowest in the region overall. Over the period 2001-2011, the annual average salary of garment workers rose by 65%, allowing them to support their families in rural areas. In addition, over 90% of employees are women, thereby providing employment opportunities and revenue to a traditionally disadvantaged segment of the population. The International Finance Corporation estimates that the garment industry in Cambodia helps alleviate poverty in nearly 10% of the population (UNCTAD, 2013a or 2013b).

On the other hand, there has been a recent spate of strikes protesting difficult working conditions. The Cambodian Labour Ministry’s Department of Vocational Training announced that approximately 1,686 workers in garment and shoe factories fainted in 2012 due mainly to overwork, poor health, and exposure to chemical substances. Strikes by the country’s more than 300,000 garment workers nearly quadrupled in 2012 to 134, according to the Garment Manufacturers Association of Cambodia. Most existing factories are running at full capacity, with a shortage of skilled workers, causing employees to press their demands for better wages and working conditions. In addition, the collapse of a concrete roof at a Nike shoe factory in Cambodia in May 2013 has reinforced pressure on suppliers to the world’s big garment brands to raise wages and improve working conditions.

There exists a framework to monitor and report on conditions in the garment industry. The “Better Factories Cambodia (BFC)” programme of ILO is established as a factory auditing body to monitor Cambodia’s improvements in labour rights and conditions in factories. The cost of compliance with the programme has meant that production costs are higher and hence factories need to raise productivity in order to stay competitive in the export market. This requires potentially more training, better technology, and moving up the value chain. At the same time, better working conditions could also enhance efficiency in production. It is still too early to tell whether these effects will continue to play out in this way. But preliminary research by Fukunishi and Yamagata (2013) suggests that the increase of labour costs due to BFC played a role in inducing productivity growth. OECD and others (2013) concludes that “the case of the Cambodian garment industry suggests the possibility that social upgrading catalysed economic upgrading, although this relationship is still unclear.”

**LESSONS**

While both countries had a similar starting point, different government policies, private sector programmes, and consumer awareness have led investment in the garment industry to have very different developmental implications in each country. The lesson learned is that it is very difficult for a country, by itself, to adopt the measures necessary to guide investment towards inclusive outcomes. Rather, there has to be partnership between all actors. International organizations, business groups, civil society and other stakeholders can together create conditions whereby investment translates into sustainable, dynamic and inclusive growth. This example of two countries therefore shows that the host government, home government and
private sector all need to take measures that help investment be more inclusive.

6. When abroad, abide by domestic standards: firms from the United States in overseas markets

The United States has instituted strict requirements on its companies investing in Myanmar to ensure that, as the country re-engages with the international community, FDI promotes instead of hinders its development process. Effective 1 July 2013, United States firms investing more than $500,000 in Myanmar, or any amount in oil and gas, will have to report on how they ensure the rights of workers and provide protection for the environment. Firms also need to report on any payment over $10,000 to agencies or officials, any contact with Myanmar’s military, arrangements with private security companies, and the details of any purchase of land or real property. The business community, represented by the United States Chamber of Commerce, has complained that no other country is instituting similar obligations on its firms and that smaller firms will be especially at a disadvantage to compete since the costs of reporting will be relatively large comparative to their scale of operations. Even for larger firms the Chamber of Commerce views these requirements as putting firms at a competitive disadvantage relative to European and Asian firms, that have been rushing headfirst into this newly opening market.

Though firms from the United States have complained that they are at a competitive disadvantage because of different regulatory standards, these standards are an important step to ensure that investment in a newly opening market serves the interest of all stakeholders. In the short term, there may be additional costs to reporting, or in some cases loss of business to competitors that are willing to engage in unscrupulous activities. However, experience with instituting similar standards in the past has shown that businesses adapt and fold these requirements in their business models. They then find alternative ways to be competitive and in doing so help advance developmental outcomes.

A comparable experience can be seen from the Foreign Corrupt Practices Act of the United States. This act prohibits United States firms to give bribes as part of their business operations. In some cases this puts United States businesses at a disadvantage compared to firms from other countries that receive no sanction if they bribe officials. However, the fact that bribery is off the table for United States firms means this cost of doing business is nullified, and foreign officials and firms know they cannot pressure firms in this way. Dealings are more straightforward, and counterparts often prefer to engage in deals where things are clear and above board, rather than uncertain and surreptitious. After all, there is always a cost due to uncertainty and bribery leads to more uncertainty, not less: the payment that is sufficient today may no longer be sufficient tomorrow. Coupled with transparency provisions and independent reviews of government contracts, these measures can be sufficient to create a business climate that fosters development for all rather than enrichment for some.

Governments and officials seeking to improve the conditions of their citizens rather than simply their own are therefore likely to seek business partners operating under standards such as those imposed upon United States firms. Many see Myanmar as a test case for how a newly opening economy can choose to partner with firms that are abiding by certain corporate social responsibility instruments, so that investment leads to inclusive development, rather than the imbalanced and uneven development that has marked some other economic openings.

D. EXAMPLES OF RESPONSIBLE BUSINESS PRACTICES

As discussed earlier, businesses can contribute to inclusive development through their actions. More and more companies are adopting inclusive business models and implementing responsible business practices that have a tangible impact on economic and social development. Companies adhering to responsible business practices also ensure that they are implementing principles of good governance related to human rights, labour, environment, and anti-corruption in core business activities. As responsible business practices include focus on non-discrimination and community involvement, such practices can increase opportunities for low-income or socially-disadvantaged groups to be involved in
the value chain of companies’ core business as suppliers, distributors, retailers, or customers. The following case studies exemplify how companies in the tourism sector can support the education of local people, provide opportunities for career development and help alleviate poverty. A study also looks at how a new way of organizing business has affected the welfare of cocoa farmers in Vanuatu. The final example describes how ESCAP is working to raise awareness about opportunities to include persons with disabilities in business activities.

1. Soria Moria Boutique Hotel, Cambodia

The Soria Moria Boutique Hotel was founded in 2007 by a Norwegian couple. It is located in Cambodia in the town of Siem Reap. In 2012, the hotel employed 35 full-time employees, as well as 30 drivers and guides, all of them locals. What makes the Soria Moria Boutique Hotel unique is that, in 2011, it became the first majority employee-owned hotel in Cambodia as all hotel employees turned into business partners and owners. By giving the local hotel employees responsibility over the future of the hotel, the business truly empowered parts of the local population.

The hotel is also highly active in skills development of the local population and is exemplary in fostering employee upward mobility. The hotel supports a local non-governmental organization, Sala Bai, which offers free hotel skills training to about 100 young people annually. Participants in the training programme receive assistance in finding training and work placement in local hotels, including Soria Moria. Furthermore, in order to enhance employment possibilities of disadvantaged local youth, the hotel initiated the Employee Elevator programme. As part of the programme the hotel provides paid trainee positions to disadvantaged youth. In addition to the traineeship, the professional development of the participants is supported throughout their careers to ensure their upward mobility.

A good illustration of upward mobility of employees in the Soria Moria Boutique Hotel is the General Manager, Sam Sokha, who started as a dishwasher in the first business the hotel’s owners set up in Cambodia. With the support of the Soria Moria Higher Education Programme, which was established in 2007, she completed a degree in tourism management and a further Master’s Degree in business administration. The Programme funds scholarships for local community members to attend university. Finance for the Programme comes from donations from guests and profits of the hotel. In 2012, the Soria Moria Higher Education Programme supported 12 university students. The fact that employees are the owners of the hotel and that they are offered ample opportunities for upward career mobility has led to increased employee motivation, which has also benefitted the business.

2. Nihiwatu resort, Indonesia

The founders of the luxury resort Nihiwatu, who originate from the United States, founded the Sumba Foundation in 2000 in order to bring social benefits to the local population. Through the Sumba Foundation, the Nihiwatu resort (located on the remote Indonesian island of Sumba) has been able to use income from the resort for the implementation of local poverty alleviation measures. The Sumba Foundation focuses on social development in the areas of health, education and employment creation. By 2010, efforts of the Sumba Foundation had helped to decrease malaria infection rates by 85%. In addition, by building wells for several communities on the island, the Foundation has been instrumental in providing clean water to more than 14,800 people. As part of its efforts to enhance education opportunities, the Foundation has supported 14 local schools and funded scholarships for outstanding students who also have received job offers from the resort.

In order to actively provide employment opportunities for the local population, in 2010 the Sumba Foundation supported five organic farms which sold their products to Nihiwatu. Moreover, the Foundation supported a local bio-diesel project allowing the local members of the project to sell the fuel they generate to the resort. The project also engaged 120 Sumbanese families to produce coconuts to make the fuel. In the same year the resort also directly employed 210 persons, 95% of which were local Sumbanese.

The local engagement of the Nihiwatu resort provides a strong argument that the tourism business and social development projects can be mutually reinforcing. By 2010, holidaying dentists have helped to treat 1,300 villagers, enabling tourists to be part of the resort’s social
development efforts and to enrich their travelling experience. In addition, the resort’s guests support the efforts of the Sumba Foundation by donating money. Many of the resort’s guests return every year for vacation in order to see how their donations have benefited the local population. Therefore, the case of Nihiwatu shows that being socially responsible enriches the products tourist companies offer their customers and make the business sustainable as it creates a bond between the business and customers and improves customer loyalty.

3. **Cooperatives improve export performance and life for cocoa farmers on Malekula, Vanuatu**

The cocoa bean is one of the most important export goods of the Pacific islands. This case study presents the export challenges cocoa farmers face on the Pacific island of Malekula in the South Pacific islands of Vanuatu and describe how these challenges were successfully addressed with the establishment of a farmer’s association. The association allowed the farmers to be more productive and to earn a considerably bigger share of export revenues, along with improving access to education and health services.

The Cocoa Growers Association (CGA) was initiated by a project named POPACA, funded by France and the European Union, that lasted from 2001 to 2006. It established over 25 cooperatives for cocoa bean production on the island of Malekula in the South Pacific islands of Vanuatu. The project built steel drum dryers for the 25 cooperatives to improve the quality of dried cocoa beans. Of the 25 cooperatives initiated by POPACA, community leaders of 19 cooperatives took ownership of the project and the communities still thrive today.

CGA acts as an umbrella organization for the cooperatives and provides many services to the cocoa farmers of Malekula. The CGA provides access to cocoa seedlings, training on management and bookkeeping in the local language, provides advance payment and credit for the cooperatives and provides world market information. CGA, functioning as a non-profit organization, effectively eliminates the middleman in cocoa export by buying the cooperatives’ beans to export for a higher price than middlemen offer. The higher price nearly doubled the income for cocoa producers. Higher income was associated with the ability to pay school fees for children and increased investment in tools, communications and transportation. Over 1,500 people benefit from the improved access to export the high quality cocoa beans.

The main challenges farmers faced in cocoa production as a stable means of income before the project were extremely low prices, low quality dried cocoa beans, lack of buyer options, lack of access to credit and unpredictable buying periods. CGA acted to address these issues and has successfully been able to tackle some of them over the past six years. CGA has a revolving credit fund to provide advances to the cooperatives, and pay farmers “at the gate”, when they need it the most. CGA provides regular trainings on how to improve the quality of beans and enhance the cooperatives’ management operations by saving and investing funds for tool and equipment upgrades. CGA acts as a constant support for the farmers and is a stable local institution for farmers to buy high quality seedlings, learn about world market prices, receive trainings on better farm and business management and receive higher prices for their improved cocoa beans.

Notwithstanding obvious successes, one has to mention remaining weaknesses of CGA that could be addressed in the future. Foremost is the failure to promote gender equity. Though CGA provided access to the market for cocoa growers, this access was limited, at least at the management levels, to males. Additionally, the lack of strategic planning that exists will be a central pain point for CGA until resolved, and opportunities to strengthen this skill set must be provided for other similar associations. Also, the pursuit of organic certification must be considered as future organizations are designed to ensure that the highest level of economic benefit is derived. Finally, production issues (e.g. the age of the cocoa trees, low yield levels, and others) will need to be improved as CGA moves forward and in any future iterations of this type of organization.

**LESSONS**

*CGA has proven to be an effective organizational model delivering inclusive outcomes through*
exports because it addresses a well-established and well-known agricultural activity, and delivers a larger percentage of the final value of the product to its producers by cutting out predatory middlemen, establishing volume, and improving product quality. The CGA approach could be used in various other countries, especially when producers in various sectors struggle to break the cycle of low education/effort, low quality, and a low rate of return.

4. ESCAP-Sasakawa Award for disability-inclusive business practices in the Asia-Pacific region

In 2013, ESCAP, the Nippon Foundation and the Asia-Pacific Development Center on Disability launched the ESCAP-Sasakawa Award for disability-inclusive business in the Asia-Pacific region. This initiative aims to raise awareness of opportunities for inclusion of persons with disabilities in business activities as part of the Asian and Pacific Decade of Persons with Disabilities, 2013-2022. The Award aims to recognize three kinds of enterprises that demonstrate excellence and innovation in the delivery of disability-inclusive business practices: (a) a disability-inclusive multinational enterprise; (b) a disability-inclusive national or subnational enterprise; and (c) a disability-inclusive entrepreneurial business. All winners will receive recognition for their work, while the winner of the entrepreneurial category will additionally receive a cash prize ranging from $50,000 to $100,000 depending on the budget proposal of the suggested disability project the entrepreneurial business put forward.

Disability-inclusive businesses integrate persons with disabilities across most or all of the value chain in their business model. This involves developing and implementing new ways of expanding the impact on people with disabilities. Such an approach potentially involves a wide range of participants, both inside and outside the company including: senior management, supervisors, human resources personnel, product designers, suppliers, contractors, retail staff, building managers, marketers, and advertising agencies.

Disability-inclusive products and services are tailored specifically towards persons with disabilities – whether as customers, clients, employees or business partners. Products include ramps, lifts and other assistive devices. Services include retail site accessibility, specialized audio-visual services and interpersonal customer services. Institutional elements include workplace policies and human resource procedures, such as recruitment, selection and appointment, career guidance and development, and retention/return to work. Disability-inclusive products and services can also be “universally designed” in that they are designed from the perspective of catering to the needs of both persons with and without disabilities, such as drinking water from bottles marked with Braille. All these elements can give employers maximum access to the widest possible talent pool, and therefore make it more likely that investment is at once inclusive and also leads to dynamic and sustainable growth.

E. SECTORAL CASE STUDIES

As there are no one-size-fits-all solutions to enhancing inclusive trade and investment, it is important to acknowledge the differences not only between countries but also between sectors. Although all efforts to support development and improve the welfare of people are encouraged, some measures have proven to be more relevant than others in various sectors. Whereas the strengthening of the legal framework and the implementation of international standards, guidelines and initiatives have shown to be effective in the natural resources sector, investments in productivity are essential in the agriculture and manufacturing sectors. An example from India illustrates how promoting services trade through the removal of trade barriers together with targeted pro-poor policies and investments in education are necessary to ensure inclusive outcomes. The final example highlights the need to improve countries’ absorptive capacity in order to fully benefit from technology transfer and other potential benefits brought by trade and investment.

1. Inclusive development of natural resources sectors

Natural resources sectors such as mining, oil, gas, hydro, and forestry plantations are
attractive investments for resource-seeking multinational and state enterprises. The Asian and Pacific region produces well over a quarter of the world’s crude oil and natural gas, 70% of the world’s coal, sizeable percentages of other metals and minerals, and nearly a third of all energy produced from hydropower. It is also the world export leader of intensive plantation commodities such as timber, rubber and palm oil. Natural resource exploitation is often highly dependent on FDI, and the coal, oil and natural gas sectors are major destinations for FDI in the region, with developing countries such as Myanmar, Viet Nam, Indonesia, Turkmenistan and Uzbekistan being especially dependent on these investments.

Natural resource investments have the potential to bring about significant economic growth and development. However, corruption and poor fiscal management have often led to greater inequality. While natural resource investments generally have large potential to bring in foreign exchange earnings (through FDI and trade) and increase government revenue (through royalties, taxes and/or production sharing agreements), these benefits generally appear more at the macroeconomic level rather than the local level, in particular since employment impacts from such sectors are generally relatively low. As for related risks, natural resource investments have a poor record for human rights abuses and causing social ills through displacement and disruptions to the environment. Issues such as involuntary resettlement and the use of violence against community members to defend corporate assets are among the worst of these, yet health and safety and violations of labour rights remain an issue. The activities of these industries also often put pressure on the environment and on biodiversity, in particular in relation to water and deforestation. Due to the large amounts of capital involved in these investments, governance challenges such as corruption also present a clear challenge.

More responsible business practices are necessary to avoid these problems and bring about poverty reduction and social development at the local level. Businesses and policymakers share the responsibility of ensuring these responsible business practices take place.

On the policy front, the main challenges are to maximize economic benefits at both national and local levels while ensuring that the environment and human rights are well protected. In order to do this, Governments must do a number of things. First, they have to establish strong national legal and regulatory frameworks governing natural resource use. This involves ensuring investment and mining laws are sound, transparent and incentivize the right kind of investments. Second, comprehensive social and environmental regulations as well as their enforcement are determining factors. In essence, government policies are a major factor in encouraging businesses to appropriately and adequately address the environmental and social impacts of their operations.

Countries must also manage incoming resources and their own government revenues strategically. Participatory processes throughout the entire project cycle, as well as other mechanisms to enhance transparency and accountability are essential to ensuring the benefits of natural resource wealth are shared.

Meanwhile, businesses have the essential role of adopting and implementing international standards of responsible business practice to help them avoid negative impacts from their operations. A number of international standards, guidelines and initiatives have emerged to help businesses do so. These include voluntary principles-based initiatives such as the Global Compact and Guiding Principles on Human Rights; standards such as the OECD Guidelines for Multinational Enterprises, ISO 26000, International Financial Corporation (IFC) Performance Standards, and initiatives to increase transparency such as the Global Reporting Initiative (GRI). In addition to these instruments, a number of additional initiatives focus on the natural resources industries specifically, including Publish What You Pay and the Extractive Industry Transparency Initiative, certification systems, such as the Roundtable on Sustainable Palm Oil (RSPO) and Kimberly Process, and industry associations, such as The Global Oil and Gas Industry Association for Environmental and Social Issues (IPIECA) and International Council on Mining and Minerals (ICMM).

While enforcement mechanisms are still weak or non-existent for many of these instruments, what such instruments do achieve is to set clear expectations for business and provide a wealth of
implementation guidance. Such expectations are most effective with the biggest, most globalized and most visible companies, in particular in cases where companies feel pressure and scrutiny from financial stakeholders, host governments or home governments. However, many of the smaller, lesser-known TNCs fall through the cracks, facilitated in part by Asian financial institutions that are less concerned about these issues.

Ensuring inclusive investments in the natural resources sector thus requires policymakers to put in place a regulatory system and competent institutions to ensure that laws and regulations related to such areas as mining, environment and social laws follow international best practice, and their implementation is ensured. It is also important to ensure that revenues from the sector are used wisely and transparently, and that the proceeds not only benefit the country at large but also the communities impacted by the natural resource exploration.

Furthermore, businesses in the sector should be held accountable to international standards of responsible business practices. This includes ensuring that local communities are consulted and involved throughout the entire project cycle, through transparent and fair negotiations, and that grievance mechanisms are put in place to address the concerns of communities and workers. Finally, production linkages to local communities and companies should be facilitated, so that more value added is generated locally.

LESSONS

The revision of laws regarding the exploitation of natural resources may successfully lead to improved environmental requirements, increase local participation by giving local communities some approval authority, improve control and enforcement by Government in issuing licences. Auditing and accountability have also been improved. At the same time, a

BOX 10.2 Regulatory reform in Mongolia

Over the last few years, Mongolia was one of the fastest growing economies in the world, to a large extent because of investments in mining. The largest of these is the Oyo Tolgoi copper-gold mine, with a total projected investment of more than $10 billion. In 2009, the Government of Mongolia, Rio Tinto, and Ivanhoe Mines signed the Oyu Tolgoi Investment Agreement. It also specified that new laws passed subsequent to signing the agreement would not apply to Oyu Tolgoi.

After the signing of the agreement, formal complaints were filed by a civil society organization about the quality of the environmental impact assessment and water study for this project. It questioned the potential impact on quality and availability of water, wildlife and biodiversity in the area, and therefore on the pastures on which the country’s traditional nomadic population depend.

Following this, the issuance and processing of new mining and exploration licences was suspended in 2010, and a working group was established to undertake revisions of the Mining Law. This ongoing revision is expected to introduce stricter environmental requirements (in particular relating to mine closures and rehabilitation), increased local participation by giving local communities some approval authority, improved control and enforcement by the Government in issuing licences, greater requirements for local development and local sourcing although points of contention still revolve around license classifications, and increased role for the Government as well as local community participation more broadly.

The revision procedure bears several things worth noting. The Presidential Office announced that it is relying more on national experts compared to previous revisions and the Government has increased its lawmaking capacity as well as accumulated experience dealing with foreign and domestic investors. In doing so, it has studied the practices of other resource-based economies. The process has been more inclusive and efforts have been made to avoid politicizing the revisions. The first public hearing took place on 18 January 2013. In efforts to address public concerns about mining, the working group has engaged civil society activists, local governments, government agencies and various professional organizations.
At the same time, Mongolia is also seeking to offer greater assurances to foreign investors by making changes to the Investment Law. The revisions will make investments subject to regulation rather than bilateral deals. This is intended to provide greater clarity and stability to investors by making investments subject to, but also protected by, legislation that can only be amended by a two thirds parliamentary majority and whereby future changes will not affect the rules for investments made today.

Other changes include a more restrictive water usage law (2009) which prohibits minerals exploration in water basins and forested areas and cancelled over 200 mining and exploration licences for operations deemed too close to water basins and forests. Some efforts also target corruption through transparency. Since 2007, the Independent Authority Against Corruption has been operational. The Freedom of Information Law (2011) enables the public to seek information from government institutions and authorities about their activities, human resources, budget, finance and procurement of goods and services with state funds. The Conflict of Interest Law (2012) is intended to prevent conflicts of interest arising between the official duties and private interests of those in public service roles, and to regulate and monitor conflicts of interest in order to ensure that public service activities accord with the public interest and that transparency and faith in public services is maintained.

Mongolia is also an active participant of the Extractive Industries Transparency Initiative (EITI). It has filed reports yearly since 2006 and was declared an EITI compliant country in 2010. The process seems to be helping. In the first year, the reconciliation committee found a final discrepancy of $83.08 million (against total corporate claims of payments totally $430.83 million), while for 2011, the final discrepancy was down to $59,000. The accountants and auditors responsible for completing the report had a number of recommendations for improvement.

None of these measures is perfect and criticism/scepticism exists around all of them. Still, they are steps in the right direction.

new investment law should not repel foreign investors and should ensure a stable investment environment. Including civil society turned out to be of crucial importance to ensure that traditional population will still be able to survive when natural resources are exploited under the new laws.

2. Inclusive aspects of trade in the rice sector of Thailand

Rice is a staple food for nearly half of the world’s population, making its production, import and export pivotal components of global consumption and food security (International Rice Research Institute (IRRI, n.d.). For the past three decades, until 2012, Thailand has maintained its global status as the top rice exporting country in the world – known internationally particularly for its aromatic long-grain Thai Jasmine rice. In the past 40 years, Thailand’s shift from subsistence to commercial farming has had significant impacts on Thai rice export and its consumption globally; this shift has led to both challenges and opportunities for Thailand’s rice market in terms of developing an inclusive environment for both producers and traders.
Rice is a pillar of the Thai agricultural economy, with 55% of the country’s arable land occupied in rice production, making it the fifth largest cultivator in the world (IRRI, n.d.). However, after years of being the world’s top exporter of rice, the amount of the crop shipped from Viet Nam and India exceeded that of Thailand in 2012. Many credit the drop to the Government’s rice pledging scheme. The enactment of a government rice pledging scheme increased the price of paddy rice purchased by the Government to a higher rate than the market price. These controversial policies were first initiated in early 2000s; since this time the policies have been somewhat revised and reinstated. The current Government has allocated 405 billion baht, approximately $13 billion, in government funds allocated for the 2013 rice pledging scheme (Finch, 2012).

What the rice pledging scheme allows the Government of Thailand to do is act as a middleman: as a rice buyer. However, rice is a sensitive good, in which quality and grade depend on processing of raw rice (ensuring that rice grain sizes do not get mixed), and ensuring appropriate moisture content and storage. Therefore, the Government of Thailand outsources this task to over 600 mills across the nation (the country maintains more than 30,000 mills nationwide). Locations are set up nationally in which farmers can bring their rice product, and the government purchaser will register farmers and offer the farmer a purchasing price based on the rice quality. Ministry of officials interviewed as part of this study stated that due to the fact that rice farmers maintain little market negotiating power, the scheme is designed to improve farmer livelihoods through allowing farmers to sell their rice product, and the government purchaser will register farmers and offer the farmer a purchasing price based on the rice quality. Ministry officials interviewed as part of this study stated that due to the fact that rice farmers maintain little market negotiating power, the scheme is designed to improve farmer livelihoods through allowing farmers to sell their rice product at a higher price. A ministry official from the Rice Bureau under the Ministry of Commerce stated that: “...after one-year of implementation of the scheme, it has been seen that the farmers have earned more money...improving their living standard and purchasing power”. Conversely, the representative also stated that the policy has not enhanced Thailand’s rice trade as seen by the country losing its number one exporter status last year (figure 10.7).

The rice exports of Thailand have increased significantly over the last two decades. Investment in infrastructure especially roads and distribution networks made exporting easier. Likewise, international product marketing enhanced consumer demand. Additionally, Thailand’s significant investment between the 1960s and 1980s, in agricultural development, improved irrigation systems, research and development, and technology resulted in improved crop yields, allowing for production to steadily increase along with demand. By 2008, Thailand exported approximately 10 million tons of rice, which made up about 33% of the world’s rice trade (IRRI, n.d.). This is a drastic change from production in the past, where Thai farmers grew rice mostly to meet household consumption demands, rather than supplying the global market.

This transition and Thailand’s integration into the global market, has increased producer income over the past few decades as well (figure 10.8). As seen in the example of Thailand, increased production, consumption, improved technology and ease of export are all components which have led to an inclusive market and opportunities for improved livelihoods. However, it should also be noted that significant market exposure, as well as government interventions, can cause price volatility. An example of this can be seen during the 2008 rice crisis, which significantly increased producer profit margins (Morris, 2013). However, despite the positive impacts for producers seen in 2008, there is also the potential for negative effects on farmer income generation if the global price experiences a sharp decline.

Uncertain production and consumption trends are potential risk factors for global prices. While, increased rice consumption both internally and internationally have been seen, according to ADB, it is projected that: “rice consumption is expected to continue rising, though at a lagged pace. However, production is projected to grow at a faster clip than in the previous decade, primarily due to rising yield. The rising surplus will lead to the sustained growth of exports and accumulation of stocks” (ADB, 2012). Both sustained growth in exports and accumulations of stocks contribute to greater food security for rice dependent countries, however this can have a negative effect on rice prices internationally, creating a downward trend in prices due to the increased global supply.

Currently, however, increased producer prices and profit margins have continuously improved since 2000. While increased wages also indicate
improved livelihoods and inclusion, equal access to increased wages/income at the field level are also, more generally, key aspects of an inclusive market. Farmer income received from rice production is based on rice quality. Lack of farmer bargaining power to negotiate with buyers (exporters, merchants, millers, etc.), is particularly due to the high level of organization among distributor/exporters and the quality standards in place. Therefore, from the production side, a farmer’s access to a high wage is based on his/her ability to produce high quality rice and effectively manage production costs, which is an agricultural risk experienced across the rice sector, however this risk is disproportionately detrimental to small and medium holder farmers who lack access to the resources and safety nets which are often more accessible by large scale producers.

Overall, despite some limitations, over the past two decades significant improvements within the rice market, in terms of quality, production, export and price, have been observed. Additionally, small and medium holder farmers have improved their living standards through

**FIGURE 10.7**
Trends in rice exports of Thailand

<table>
<thead>
<tr>
<th>Year</th>
<th>Quantity (tonnes)</th>
<th>Trade Value (Millions of United States dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>1200</td>
<td>1000</td>
</tr>
<tr>
<td>1991</td>
<td>1100</td>
<td>900</td>
</tr>
<tr>
<td>1992</td>
<td>1000</td>
<td>800</td>
</tr>
<tr>
<td>1993</td>
<td>900</td>
<td>700</td>
</tr>
</tbody>
</table>

**Source:** Calculated by authors based on export data from United Nations COMTRADE, from WITS database.

**FIGURE 10.8**
Export quantity of Thai rice

<table>
<thead>
<tr>
<th>Year</th>
<th>Quantity (United States dollar/tonne)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>100</td>
</tr>
<tr>
<td>1991</td>
<td>110</td>
</tr>
<tr>
<td>1992</td>
<td>120</td>
</tr>
<tr>
<td>1993</td>
<td>130</td>
</tr>
</tbody>
</table>

**Source:** Calculated by the authors based on FAOSTAT data.
improved income generation and access to resources/infrastructure. However, challenges still persist, particularly for small holder farmers who produce less and generate lower total income. Therefore, policy recommendations have been made in order to further enhance the rice trade and inclusive aspects of the rice sector of Thailand.

**Policy recommendations:**

1. The current Government policy is not a long-term solution. It is therefore suggested that the problem be tackled at its root cause; meaning in tandem with the Government’s short-term policies, long-term sustainable policy implementation measures should be explored in order to improve farmer livelihoods in a more comprehensive manner. Officials interviewed as part of this study stated that the policies must also focus on building farmers’ capacities to achieve more sustainable outcomes. This can be specifically achieved through conducting trainings on new technologies and market innovations, farming techniques, basic agricultural financial management/business management skills, and environmentally protective practices. This would allow farmers to improve their rice’s quality, quantity, productivity and income. Additionally, the use of newly developed rice breads and mechanisms can economize the cost of production and can make the price more competitive in the market.

2. Government rice stockpiles have surged to record highs of 18.2 million metric tons in 2013, compared to 5.4 million tons between 2008 and 2010, due to export reductions caused by the Government’s rice pledging scheme (Javier, 2013). In order to assist Thailand in regaining its number one exporter status, as well as assist Thai exporters to remain competitive in the market, current policies must be assessed in terms of sustainability and effective use of government funds. Furthermore, policy planning in order to identify a sustainable industry direction should be established. A first step in this direction, as recommended by a policy official at the Royal Thai Consulate General’s Office – Economics Department, New York, can be the incorporation of an agricultural development plan into the national agenda. If undertaken, stakeholders on all levels should be consulted and play a participatory role in the planning process, this includes small and medium holder farmers.

3. Increased government spending on research, in developing new rice breads, improved irrigation systems and technologies can significantly impact productivity, export and improve farmers’ livelihoods. Furthermore, rice policy should focus on quality control and value-added components to increase marketability.

   a. Particular attention should be given to research and development in high-yielding rice varieties and varieties which are more resistant to climate change (i.e. flood and drought tolerant varieties).

   b. Further improved and developed irrigation systems will assist farmers in managing appropriate water levels for rice cultivation and in some cases allow for harvest twice a year.

   c. It is important to patent and trademark Thai Rice breads to protect Thailand’s intellectual property and rights in the market.

3. **Regional production networks, manufacturing and inclusive growth in the Philippines**

Regional economic integration in East and South-East Asia has been characterized as initially a market-driven process of increased trade and FDI inflows, and subsequently a formal process of arrangements to liberalize trade and integrate economic activities through free trade agreements (FTAs) among East and South-East Asian countries (Balboa and Medalla, 2011). This has led to more intensified regional production networks involving many regional countries, including the Philippines. Set against the backdrop of continuing economic integration in the region, it seems that economic growth in the Philippines has not been as inclusive as in the other countries: manifested in the increase in the magnitude of poverty.

The challenge is to increase demand for the labour services of the poor while pursuing integration into production networks. It appears that the manufacturing sector provides employment opportunities for the poor and also offers relatively higher wages compared to agriculture, which is currently the major
employer of the poor. However, expected high-productivity employment opportunities from the manufacturing sector were not fully realized due to some bottlenecks in the sector. This partly explains the persistence of poverty in the Philippines. To promote inclusive growth and reduce poverty, the manufacturing sector has to be made more competitive and, at the same time, productivity in the agriculture sector (the major employer of the poor) has to be increased.

The Philippine manufacturing sector has been stagnant for years due to bottlenecks such as low investment, poor infrastructure and weak logistics. The country’s investment rate (both public and private) has been falling in recent years and has been comparatively lower than those of its neighbours. The low investment rate can be attributed to poor infrastructure, high vulnerability to macroeconomic and political risks, the weak financial system, poor logistics and high energy costs. As a result, industrial upgrading, and thus labour productivity growth, are being hampered. These have negative implications for labour demand thereby decelerating the creation of good-paying jobs in skilled-labour manufacturing industries. At the same time, the quality of human capital in the country can partly explain the low investment rate and low labour absorption in manufacturing subsectors (Intal, Borromeo and Largoza 2010). Some of the low-skilled labour-intensive manufacturing industries such as garments and textiles that can potentially absorb large number of less-educated workers are not big players in the manufacturing sector. As a consequence, the manufacturing sector as a whole was not able to absorb a greater number of less-educated workers, who are generally the poor, and therefore failed to contribute much to poverty reduction.

Meanwhile, regional economic integration has affected the agriculture sector through tariff reductions on certain agricultural and fishery products, as stipulated in a number of FTAs. While these subsectors absorb the majority of the less-educated workers, they tend to offer very low wages. In fact, wages of the less-educated workers in the agriculture sector are among the lowest (around PHP137 in 2009 while PHP147 in 2011, on average). Thus, high absorption of less-educated workers, who are generally the poor, in the agriculture sector provides another explanation of the non-inclusivity of economic growth and thus the persistence of poverty in the country.

According to Intal, Borromeo and Largoza (2010), regional production networks have been central to regional economic integration in East Asia during the past two decades. Consequently, there has been further extension of integration through Regional Comprehensive Economic Partnership negotiations and other agreements. Thus, it is expected that production networks in East and South-East Asia will further deepen and widen in the years to come.

What could be done so that further integration of the Philippines into regional production networks benefits more of the country’s poor? To achieve more inclusive growth and reduced poverty, it is important to attack the problem from both the demand and supply sides. Demand for less-educated workers needs to be increased to absorb the significant number of less-educated poor workers. Regional economic integration that leads to regional production networks resulting in a more dynamic manufacturing sector can be one source of that increased demand. At the same time, investments have to be made to increase the access of the poor to quality education so that they can take advantage of employment opportunities which are not available to most of the poor right now.

The study has shown that the manufacturing sector absorbs “less-educated workers” and pays them higher wages than in other sectors. If the manufacturing sector can grow faster, this can provide employment opportunities for less-educated poor workers. It is imperative to address constraints in the manufacturing sector so that it can absorb a greater number of the poor and lift them out of poverty. Aldaba and Aldaba (2010) highlighted some concrete suggestions on how the manufacturing sector can be revived and become more competitive. Alongside adopting an industrial policy that aims to develop local firms, it is suggested that the Government must also carry out measures that would improve the investment climate in the country and increase the participation of local firms in higher segments of the industry value chain. Some of the recommended policies in the aforementioned paper are as follows: (i) human resource development and training; (ii) industrial and technology upgrading, or development of technological capabilities and
specialized skills of firms; (iii) finance support programmes for SMEs; (iv) improved linkages between local firms (including SMEs) and TNCs through information exchange; (v) promotion of subcontracting and outsourcing activities; (vi) improvement of infrastructure and logistics through policies aimed at lowering power and communication costs, provision of sufficient port systems, travel time reduction, and offering of travel and shipment options; (vii) improvement of overall investment climate by addressing low institutional quality, corruption and inefficient bureaucracy; and, (viii) capacity building and adequate funding for the Competitiveness and Linkages Programme of the Department of Trade and Industry and Board of Investments.

However, the manufacturing sector employs only 8.3% of total workers, of which 23% are less-educated. This translates to around 1 million less-educated workers in the manufacturing sector. Assuming an annual growth rate of 5% or higher, the manufacturing sector can only absorb a small proportion of the less-educated workers. It is thus not likely that the manufacturing sector can quickly absorb all the excess labour in the agriculture sector, where 74% of chronically poor workers are currently employed. If the Government aims to reduce poverty more quickly, it is equally important to also increase productivity in the agriculture sector.

Moreover, it is also important that the quality of labour being supplied by the poor be enhanced so that more employment opportunities would be opened to them. At the same time, improving labour quality would have long-term positive impact on technical, skill-intensive manufacturing firms that participate in regional production networks, such as electronics, machineriies, chemicals, and high-technology agro-industry (World Bank, 2010). In fact, the 2010 Philippines Skills Report noted that manufacturing firms with a higher proportion of skilled workers, or those with at least some high school education, tend to be more competitive. Hence, programmes aimed at improving human capital are very timely and relevant.

4. Services trade growth in India: implications for poverty and inequality

Trade in services has gained more importance in recent years as advances in technology have permitted new means of providing services across borders. While there is little doubt that services trade is an essential ingredient in economic growth and sustainable development, it is widely accepted that it can only make such positive contribution if appropriately liberalized across countries. A well-crafted reform process facilitates services trade and generates higher economic and social welfare, more particularly in developing countries where services is the largest single occupational category.

Global services trade has risen substantially over the last two decades; growth has been higher than that for trade in goods in the past decade. Developing economies and China and India in particular, have witnessed even faster growth rates in services trade. India has seen a gradual structural shift towards the services sector over the past decades, with services comprising a growing share of GDP and employment. Today, the services sector in India represents an essential component of the competitive, knowledge-based economy, accounting for 56.5% of GDP in 2012-13. India’s services export currently constitutes about 35% of the country’s total export. India’s share of world commercial services exports increased from 1.08% in 2000 to 3.23% in 2012 (see table 10.3). Taken together, China and India contribute to over 7% of global commercial services exports and about 10% of world commercial services imports. While commercial services exports grew much faster in India than that of China during 2000 and 2012, China’s prowess in merchandise export generates huge services imports, almost double than that of India. Yet, a large part of services sector, both in India and China, is untapped and rarely exposed to the international market.

The services sector has been the major source of economic growth in recent years in India. India’s emerging services trade sectors are no longer traditional sectors such as transport, travel and tourism. Technology is also redefining the way social services are provided with a potential to enhance the effectiveness and efficiency of public and private social service delivery. Services now provide the bulk of employment for the skilled and unskilled workforce, both in the organized and unorganized sectors. In contrast, financial services as well as information and communication technology services, which currently dominate the services exports basket of India, offer employment only to the skilled
workforce. Therefore, the most challenging task is how to balance this structural shift in order to minimise the short-term maladies of globalization. Removal of barriers to services trade through liberalization and complementary policy reforms, can lead to both sectoral and economy-wide improvements in performance and generate pro-poor growth.

India has also done extremely well in IT and the IT-enabled services sector, including business process outsourcing activities. This sector has revealed a strong comparative advantage and significant foreign demand growth. This explains India’s interests in Modes 1 and 4 of the General Agreement on Trade in Services negotiations. However, the growth of IT and IT-enabled services are concentrated in select urban centres, and are biased to high and medium skill labour. India’s growth (and inward investment) brings new technology in the economy. The adoption of new technology furthers the wage divide, particularly between the skilled and unskilled, in the short run. As a result, while the IT and IT-enabled services sector can assist in poverty reduction, it can also increase inequality within urban areas as well as inequality between urban and rural regions.

Econometric evidence appears to strengthen the existing linkage between trade and poverty. India has been relatively successful in delivering pro-poor growth in the past few decades. Although the impact of services exports on poverty and inequality appears to have been marginal, the empirical estimations do not raise any doubt that poverty reduction has benefited from services exports. Higher income from services exports has been helping India to deliver successful pro-poor growth.

Although poverty has responded effectively to growth and services exports over time, the same does not hold true in the case of inequality; the knowledge and skill-intensive nature of services exports favour the skilled workforce more than the unskilled workforce. Hence, the growth of services exports has alleviated poverty through the expansion of income, although it has not been particularly effective in reducing (urban) income inequality. It must be added that although the econometric results do not conclusively show the role of services exports in rising urban inequality, they do point out that some of infrastructural variables (e.g. personal computers or telephone lines) have selectively benefited the urban workforce. Nonetheless, infrastructure related to services exports (mainly software and business process outsourcing) exports, currency depreciation, and reduced tariffs on trade have been instrumental in enhancing India’s services exports. Therefore, services trade has surely helped in the reduction of poverty in India but at the same time has increased urban inequality as well as inequality between urban and rural areas.

As India continues to expand its services sector, both for domestic consumption and international trade, the challenge facing industry and the Government is rising inequality. Therefore, the key message is that services trade may tend to

### TABLE 10.3

<table>
<thead>
<tr>
<th></th>
<th>Export 2000</th>
<th>Export 2012</th>
<th>CAGR** (%)</th>
<th>Export 2000</th>
<th>Export 2012</th>
<th>CAGR** (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World</strong></td>
<td>1491.00</td>
<td>4349.90</td>
<td>9.33</td>
<td>1463.80</td>
<td>4152.30</td>
<td>9.08</td>
</tr>
<tr>
<td><strong>China</strong></td>
<td>30.15</td>
<td>190.44</td>
<td>16.60</td>
<td>35.86</td>
<td>280.16</td>
<td>18.69</td>
</tr>
<tr>
<td>Share of China in world (%)</td>
<td>2.02</td>
<td>4.38</td>
<td>16.60</td>
<td>2.45</td>
<td>6.75</td>
<td>18.69</td>
</tr>
<tr>
<td><strong>India</strong></td>
<td>16.03</td>
<td>140.71</td>
<td>19.84</td>
<td>18.90</td>
<td>127.48</td>
<td>17.24</td>
</tr>
<tr>
<td>Share of India in world (%)</td>
<td>1.08</td>
<td>3.23</td>
<td>19.84</td>
<td>1.29</td>
<td>3.07</td>
<td>17.24</td>
</tr>
</tbody>
</table>

aggravate inequalities in the absence of policies and programmes for guaranteeing “inclusive” economic growth. By effective pro-poor targeting, the Government can make services exports better for the poor, and reduce the divide between them and the richer segments of society. There are a number of ways this can be done with important policy implications for India. We recommend that the Government of India build capacity to maximize the country’s endowments of skilled IT labour. A greater role for the private sector in ICT training and development would increase the supply of skilled manpower. Evidently, most of the growth in inequality between the highest and lowest earners is due to poor educational performance of the unskilled. The Government has to improve the quality of education, from primary to higher education.

5. Technology transfer and inclusive growth

Foreign companies have an incentive to transfer technology to domestic companies if it allows them to receive higher-quality inputs at a lower price from domestic companies within an environment of proper intellectual property rights protection. In order to avoid being overly dependent only on one supplier, foreign companies may disseminate technology to more than one domestic company. According to Moran (2011), foreign companies have in some cases found it beneficial to assist local companies in meeting the specific quality criteria of the foreign company and to become reliable suppliers. This type of support has extended to component suppliers as well as supporting industries. The assistance from foreign companies has often come in the form of setting up production lines, helping in the formulation of management strategies, assisting in financial planning and quality control as well as facilitating companies’ access to export markets.

The agriculture sector, which in many least developed countries still is the most important economic sector, provides a good example of potential positive effects of FDI on technology transfer. Synergies between FDI in agriculture and inclusive growth arise when foreign investors provide local farmers with what they need the most: financial capital, modern technology, management expertise and business know-how (FAO, 2013). By helping farmers in developing countries in these fields, FDI can contribute to inclusive growth as farmers, and especially small farmers, often belong to socially-disadvantaged groups. In addition, FDI in agriculture of developing countries is particularly important for inclusive growth where local farmers lack access to information, supply chains, domestic and international markets, and state-of-the-art technology as well as managerial skills (Stamm and others, 2006). Box 10.3 provides an example of how a partnership between a TNC and local small farmers in India has promoted technology and skills transfer as well as inclusive growth.

Empirical studies have yet to reach a consensus about the impact of technology transfer on productivity. Studies often use different definitions of productivity or technology and make different assumptions regarding, for example, plant size or factor intensity (Lipsey and Sjoholm, 2004). Therefore, empirical studies of technology transfer and the impact of FDI on host country productivity have often yielded varying results. For example, Javorcik (2004) shows that a positive link exists between foreign company presence and the productivity of workers. In her study on firm-level data from Lithuania, Javorcik (2004) finds that productivity spreads from foreign companies to local companies through backward linkages, especially in cases where there is joint foreign and domestic ownership of the company as these companies are more likely to source domestically. This view is challenged by Kohpaiboon (2009), who has studied vertical and horizontal spillovers in Thailand. Kohpaiboon finds that no spillovers from backward or forward linkages can be found in the Thai manufacturing sector. Instead, he discovers that horizontal technology transfers take place under a liberal trade policy regime. In addition, export-oriented companies tend to be more productive than domestic market-oriented ones. Kohpaiboon concludes that in order for host economies to fully benefit from productivity increases resulting from foreign company presence, they must also pay attention to liberalizing trade policy.

In general, there are several channels through which technology transfer can take place (see table 10.4). Technology can be transferred through demonstration or imitation, labour mobility, exports, competition or backward and forward linkages with local companies (Crespo and Fontoura, 2007; also Blalock and Gertler, 2008). We will look at each of these channels in turn. First, adopting new technology may be expensive for local companies, especially if there is uncertainty about the benefits of the
If a foreign company demonstrates that the technology can be successfully used in the market, the risks of acquiring the technology are reduced for the domestic company. Second, labour mobility contributes to technology transfer when local companies hire workers who have previously worked for foreign companies and who can then apply their knowledge of technologies in their work at the local firm. It is important to note, however, that foreign companies tend to pay higher wages than domestic companies which can discourage labour mobility from foreign firms to domestic firms. Third, entering export markets can be costly for host country firms as it requires the establishment of distribution networks and infrastructures and knowledge of foreign markets. By following the examples of foreign companies, or possibly collaborating with them, domestic companies can reduce the costs of entering those markets. Fourth, increased competition in the domestic market can act as an incentive for domestic companies to use existing resources more efficiently or adopt new technologies. The downside of increased competition is that local companies may lose market share to foreign companies and therefore may not be able to operate on an efficient scale.

Finally, local companies may become suppliers to foreign companies through backward linkages, if the foreign company sources input from the local company. In this case, the foreign company, in order to ensure a certain level of quality, may provide technology support to the local supplier to allow the supplier to reach required quality levels. It is also possible, that local companies create backward linkages with foreign companies and source inputs from them. The possible benefits would arise from gaining access to higher quality or cheaper inputs. However, higher quality inputs may lead to an increase in the price of the end product, which could hurt the sales of the domestic firm. (Crespo and Fontoura, 2007)

Irsova and Havranek (2012), Lipsey and Sjoholm (2004) as well as Crespo and Fontoura (2007) have listed some of the potential factors that determine when and how transfers, especially horizontal transfers, take place. First, the size of the technology gap between domestic and foreign firms determines whether transfers are possible in the first place. If the gap is very large domestic firms might be unable to make use of the new technologies provided by foreign firms; if it is too narrow, foreign firms might not provide anything new to domestic firms. Second, while domestic companies, which have previously had experience with foreign technologies (for example through international trade), are often more receptive to foreign capital, they may also have less to learn from foreign firms as a result. Third, foreign investors with sophisticated technologies may be hesitant about investing in countries with low levels of intellectual property rights protection. Also, if protection levels are very high, domestic firms might have trouble in absorbing the technologies of foreign firms. Fourth, domestic companies often have easier access to technology of only partly foreign-owned

Box 10.3 Nestlé is assisting farmers to develop their skills and upgrade technology

The case of the involvement of Nestlé in Moga in North-East India is an example of good practice in forming partnerships between TNCs and small farmers in developing countries. Skill development and technology upgrading have been at the heart of the partnership. The company established refrigerated milk collection points to enable small farmers to sell their fresh milk close to their farms. These refrigerated milk collection points also enable local farmers to establish contacts with veterinarians, agronomists and trainers. In monthly training sessions, small farmers are trained on how to improve their animals’ health, cultivate environmentally sustainable fodder as well as manage their farms better. As a result of Nestlé’s involvement in Moga, the number of local farmers who supply Nestlé with milk rose from 180 in 1962 to 75,000 in 2006. Nestlé has substantially helped to provide employment opportunities and improve standards of living of the local population. Furthermore, the educational activities of Nestlé in Moga provided the company with a stable, local supply-chain base it so much depends on for its activities.

companies. Therefore, a high prevalence of joint ventures may facilitate technology transfers provided the local partner in a joint venture adds value to the venture. Finally, a highly educated labour force would be in a better position to adopt new technologies than a low-skilled workforce.

The extent to which a host country can benefit from new technologies brought by foreign companies depends on the absorptive capacity of the country. Absorptive capacity refers to the ability to make use of and apply knowledge received from others (Crespo and Fontoura, 2007). Above we touched upon the determinants of technology transfer, which already hint at the ways in which host governments can facilitate technology transfer in the local economy and ensure that the outcome is inclusive.

Labour mobility both between foreign and domestic companies and between different geographic locations can work as a channel to spread new technologies to local companies throughout the host country. Governments can facilitate labour mobility between foreign and local companies by offering opportunities for local workers to upgrade their skills to match with those required by foreign firms. Encouraging local workers who have previously worked for foreign companies to start their own firms can be an effective way to facilitate technology transfer to the domestic economy. The Government can promote this by supporting entrepreneurship and providing SME development assistance. This would also serve to facilitate the formation of backward or forward linkages between foreign and domestic companies. Additionally, making sure that workers are also geographically mobile would help to spread new technologies evenly across the country.

Trade liberalization also plays a crucial role in facilitating technology transfer. Companies that have been exposed to foreign technologies in the past usually tend to be more able to absorb new ones in the future. Integrating into the regional and global economy through trade agreements is important, but linkages can also be forged through business-level efforts. For example, investment promotion agencies or boards of investment can work to create linkages between their foreign counterparts and bring foreign and local companies closer together.

The absorptive capacity of local companies is also largely determined by the research and development capacity of the firm and the level of education among the employees (Lipsey and Sjoholm, 2004 and Suyanto and Bloch, 2009). For example, Xu (2000) finds that in order for technology transfer to result in productivity growth, the host country needs to reach a certain level of human capital development.

### TABLE 10.4

<table>
<thead>
<tr>
<th>Channels</th>
<th>Benefits for local companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demonstration/imitation</td>
<td>Risks of adopting new technology are reduced as foreign company demonstrates how to successfully use the technology</td>
</tr>
<tr>
<td>Labour mobility</td>
<td>Local companies hire workers, who have previously worked for foreign companies, and benefit from their higher level of skills</td>
</tr>
<tr>
<td>Exports</td>
<td>Reduced costs for entering export market by collaborating with foreign companies to establish distribution networks of other export infrastructure</td>
</tr>
<tr>
<td>Competition</td>
<td>Gives an incentive to use existing resources more efficiently</td>
</tr>
<tr>
<td>Backward/forward linkages</td>
<td>Becoming suppliers to foreign companies or gaining access to cheaper or higher quality inputs</td>
</tr>
</tbody>
</table>
As countries develop, it becomes increasingly important to differentiate between increases in productivity and increases in innovation. Productivity captures improvements in efficiency: one can do more with the same amount, or do the same amount with less. Innovation, by contrast, is the quality of inventing new products or production processes. And in today’s world innovation and creating recognizable brands for products provide a competitive edge that is crucial for companies to thrive. Both productivity and innovation may be important for inclusive investment and economic development, but productivity more so in the short term and innovation more so in the medium and longer term. FDI generally leads to increases in productivity, depending on the absorptive capacity of the economy, as described above. While FDI generally would have positive impacts on innovation, some scholars have argued that FDI may actually hinder the development of technological capabilities among local firms and, hence, the long-term growth prospects of local economies (Jin, García and Salomon, 2013). This could take place through several mechanisms: (a) foreign firms might attract and pay for higher-skilled labour, leaving domestic firms short on talent, which is a key ingredient to innovation; (b) FDI can also reduce the expected returns to local entrepreneurship, so that the best would-be entrepreneurs prefer to take employment with foreign firms instead of founding new enterprises; (c) foreign firms could relegate local firms to less innovative, less profitable market niches, parts of the economy where the local firms do not face competition from the better capitalized, managed, and experienced foreign firms. For all these reasons, measures should be adopted to ensure that FDI leads to both increases in productivity and increases in innovation. And in both cases, public policies should work to translate this increase in productivity and innovation to increases in the real wages of workers.

CONCLUSION

The case studies reveal some important lessons and insights. More broadly, the following conclusions and policy recommendations, many of them closely interlinked, can be formulated as derived from the case studies but also incorporating the analysis of previous chapters in this part of the Report.

1. Increased openness under the right conditions can contribute to economic growth, employment generation and poverty reduction. However, additional government policies are required to ensure that the growth is truly inclusive. This includes policies to prevent unsustainable income inequalities and help all groups of society, in particular vulnerable groups, actively participate in, and benefit from, trade and investment processes. Amongst other things, targeted and higher public expenditures are required to develop supply-side capacity in particular in the areas of infrastructure and education, including of women.

2. The contribution of preferential trade liberalization to economic growth is greater if the coverage is broad and commitments sufficiently deep. Inclusive impacts will depend on net trade creation and employment effects. These are rarely fully known prior to implementation. However, a priori impact analysis based on economic data and modeling can help guide policymakers in putting in place supplementary measures, for example, trade adjustment programmes. Other complementary policies that should be considered include: minimum wages, education and life-long learning; social safety nets; unemployment benefits; and improved access to ICT and credit.

3. The development of domestic SMEs is crucial for creating jobs among the poorer segments of society. Governments can help this process by promoting entrepreneurship and reducing risk by facilitating access to finance, skills, business development services, appropriate technologies and market information and helping SMEs to forge effective linkages with larger and foreign enterprises which dominate regional and global value chains and production networks.

4. Duty- and quota-free imports of goods from the least developed countries can help these countries generate income from trade. This income is needed to improve these countries’ overall supply-side capacity and competitiveness. In addition, the Aid-for-Trade initiative should be used to complement locally available resources to strengthen inclusive trade and investment by steering the use of Aid-for-Trade funds towards trade expansion that generates jobs and income for poor people.
5. In that context, improvement of trade facilitation measures is a tested way for building inclusive trade-led growth. In particular, the proper application and utilization of modern ICT and Internet-based solutions such as traceability systems and e-commerce, help build supply-side capacity of many vulnerable groups, in particular farmers. These can be relatively cheap and quick and facilitate vulnerable groups’ access to market information and customers, thereby helping them to meet international quality standards and integrate more effectively into regional and global supply chains. Therefore, Governments should establish the required ICT infrastructure in rural and other relatively remote areas on a priority basis.

6. EPZs can play an important part in generating employment and income, in particular for women, though Governments need to ensure that such zones do not undermine internationally acceptable labour conditions and wages as part of FDI incentive packages. In addition, as employment in such zones is usually low-skilled, EPZs should strive towards attracting higher value-added industries and related services in the longer run. For this purpose, training and education of the labour force, in particular women, should be a priority. Further policies need to be put in place to allow better spillovers from the best practices followed in EPZs to the rest of national economy.

7. FDI has been proved to play an important role in the overall development process including by enhancing economic growth but this contribution is not automatic. By developing the overall investment and business climate, including strengthening the legal framework and infrastructure and aligning the national education system with the skills requirements of foreign investors, Governments can make FDI work for all.

8. FDI can lead to technology transfer leading, in turn, to enhanced productivity, in particular in the agricultural sector under specific conditions and when effective linkages are forged between foreign investors and local suppliers and farms. Among the required conditions are local absorptive capacity, a healthy level of competition, labour mobility, a minimum level of intellectual property rights protection, and the willingness of foreign companies to forge effective linkages with local companies thereby facilitating the access of local companies to technologies and export markets and related services and logistics.

9. The adoption and implementation of proper (i.e. internationally recognized) labour conditions and paying visible attention to wider social concerns and issues are becoming increasingly important determinants of individual companies’ competitiveness and the competitiveness of supply chains. As a result, businesses need to switch from practicing a charity-based perception of corporate social responsibility to the adoption of international principles of responsible business conduct and corporate sustainability.

10. FDI source countries can contribute to inclusive development in host countries by holding their companies investing abroad to stringent moral, inclusive and sustainability standards which make them liable to prosecution and/or risk customer backlash at home if those standards are violated. In this regard, the development of strong consumer groups in home and host countries are very important.

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Some of which are published as TID working papers available from www.unescap.org/tid

Southichack and Phonvisay (2013).


According to Ministry of Commerce of Sri Lanka those declining traditional exports refer to vegetable oil, primary copper, margarine, marbles and pepper, while new exports include insulated wires and cables, poultry feeds, pneumatic tires, ceramics, apparel, furniture, air conditioners and coolers, measuring and checking instruments, glass bottles, processes meat products, medium density fiber boards, rubber gloves, thermal papers, tiles, boilers and machinery parts, iron and steel articles, panel boards and enclosures, sacks and bags, etc. (see http://goo.gl/JQWTK, accessed 7 October 2013).

High Commission of India (2013). India’s important investments to Sri Lanka are in the areas of petroleum retail, hospitals, telecom, vanaspati, copper and other metal industries, real estate, telecommunication, hospitality and tourism, banking and financial services, IT and food processing (tea and fruit juices). Indian business organizations such as Indian Oil Corporation, Tatas, Bharti Airtel, Piramal Glass, LIC, Ashok Leyland, L&T and Taj Hotels are present in Sri Lanka.


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135 Some of which are published as TID working papers available from www.unescap.org/tid


139 According to Ministry of Commerce of Sri Lanka those declining traditional exports refer to vegetable oil, primary copper, margarine, marbles and pepper, while new exports include insulated wires and cables, poultry feeds, pneumatic tires, ceramics, apparel, furniture, air conditioners and coolers, measuring and checking instruments, glass bottles, processes meat products, medium density fiber boards, rubber gloves, thermal papers, tiles, boilers and machinery parts, iron and steel articles, panel boards and enclosures, sacks and bags, etc. (see http://goo.gl/JQWTK, accessed 7 October 2013).

140 High Commission of India (2013). India’s important investments to Sri Lanka are in the areas of petroleum retail, hospitals, telecom, vanaspati, copper and other metal industries, real estate, telecommunication, hospitality and tourism, banking and financial services, IT and food processing (tea and fruit juices). Indian business organizations such as Indian Oil Corporation, Tatas, Bharti Airtel, Piramal Glass, LIC, Ashok Leyland, L&T and Taj Hotels are present in Sri Lanka.

141 Prepared by Teemu Puutto based on GPRD (2013) and Igusa, K. and others (2011).

142 Armenia, Brunei Darussalam, Cambodia, China, Egypt, Ethiopia, Georgia, Lao People’s Democratic Republic, India, Indonesia, Kenya, Nepal, Malawi, Malaysia, Mongolia, Nigeria, Peru, the Philippines, Rwanda, Senegal, Tanzania, Thailand, Uganda and Viet Nam.

143 Based on Bowonder, Gupta and Sing (2005), FAO (2013), Bhatnagar and others (2003) and references therein.


145 The case has been prepared based on Chanadee and others (2011), and various presentations made in workshops, including Keretho (2012) and Pratumsa (2013).

146 The case has been prepared based on various authors, including Chinese Academy of Social Sciences (2010), Chen, Li and Zhao (2009).

147 The case has been prepared based on Karunaratne and Abaysekara (2013) and sources therein.

148 ESCAP (2013a) and Natrajan (2012).

149 Based on Tham and Kam (2013).


152 Examples of FDI incentives include tax holidays of up to nine years, exemption from import duty on machinery and equipment, free repatriation of profits, and special depreciation allowances to encourage reinvestment of earnings.


154 Responsible Travel.com (2012) and World Travel and Tourism Council (2012).

155 Responsible Travel.com (2010).

156 Geurtsen (2013).

157 Based on Overall (2013)

158 Based on Morris (2013)

159 For comprehensive information on inclusive trade in the rice sector of Thailand, see Morris (2013).

160 Based on Reyes and others (2013) and references cited therein.

161 Prepared by Prabir De, Research and Information System for Developing Countries (RIS), New Delhi and Ajitava Raychaudhuri, Jadavpur University, Kolkata, India.

162 Joint ventures have mixed track records. Often, countries starting to open up to FDI are reluctant to grant 100% foreign ownership and insist on joint ventures. In many cases, however, the domestic joint venture partner is not up to the task, leading to frustration and often termination of the venture. As a result, various countries amended their foreign investment laws to allow for an increased number of sectors allowing wholly-foreign-owned enterprises.
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