United Nations E/ESCAP/MCREI(2)/2*

Economic and Social Council

Distr.: General
15 August 2017

Original: English

Economic and Social Commission for Asia and the Pacific
Second Ministerial Conference on Regional Economic Cooperation and Integration in Asia and the Pacific

Bangkok, 21-24 November 2017
Item 3 (a) of the provisional agenda**
Review of the region's progress in the four areas of regional economic cooperation and integration, keeping in view the 2030 Agenda for Sustainable Development: removing obstacles to greater market integration

Removing obstacles to greater market integration in Asia and the Pacific

Note by the secretariat

Summary

This document contains a discussion of trends towards market integration in the Asia-Pacific region, an analysis of driving factors and possible obstacles, and policy recommendations for addressing those obstacles. The need to further liberalize and facilitate intraregional trade for both goods and services, the importance of foreign direct investment and regional investment regimes, and the untapped potential of enabling cross-border mobility of labour are highlighted.

The Second Ministerial Conference on Regional Economic Cooperation and Integration in Asia and the Pacific may wish to consider the recommendations and provide guidance on removing obstacles to greater integration in the region while maximizing the benefits of synergies with the 2030 Agenda for Sustainable Development. The Conference may wish to provide guidance to the secretariat on how best to support those efforts.

I. Introduction

1. Integration is the process of reducing fragmentation in markets for goods, services, capital, labour, knowledge and information in order to lower the costs of business transactions and trade. It facilitates the cross-border mobility of factors of production, such as capital and labour, and freer movements of goods and services. These elements promote efficiency in investment flows, trade and industry, leaving less room for information asymmetries, while promoting innovation and dissemination of technologies. Under market-led mechanisms for price determination, market integration

* Reissued for technical reasons on 28 September 2017.

** E/ESCAP/MCREI(2)/L.1.

leads to price convergence for goods, services and factors of production. Free markets catalyse competition but often result in only limited price and economic convergence. This is because convergence is also, and often to a larger degree, influenced by structural (and geographic) differences, such as transport obstacles, energy deficits or other barriers that increase transaction costs. Broadly, market-led integration should be guided and enhanced by the harmonization, coordination or mutual recognition of policies, rules and regulations.

2. Historically, integration has been more intense among neighbouring countries. Growing capital mobility and trade, advances in technology, and reductions in transport and transaction costs have allowed for the expansion of the geographical scope of integration. In the past few decades, Asian economies have globalized to varying degrees and as a consequence are increasingly connected through trade and investment within the region and with the rest of the world. Development in Asia and the Pacific has been largely based on trade-led growth, which has strongly supported regional economies – both in terms of economic activity and job generation. As the largest trading region in the world, Asia and the Pacific accounted for 40 per cent of global exports and 35 per cent of global imports in 2016, compared to 7.8 and 7.2 per cent in 1970, respectively. The East and North-East Asia subregion has historically propelled the region's trade performance, accounting for more than 60 per cent of total Asia-Pacific trade with the rest of the world. Despite slowing growth in recent years, China has remained the main force behind the dominant position of East and North-East Asia in regional trade.[1]

3. More in-depth regional cooperation has the potential to further increase trade and business linkages, while attracting enhanced cross-country flows of foreign direct investment (FDI). Promising prospects exist for the Belt and Road Initiative, including strengthening regional infrastructure to foster the Regional Comprehensive Economic Partnership, which has the potential to further global and regional value chains which will allow effective deployment and channelling of (surplus) savings in the region to countries with investment opportunities that offer higher returns.

4. While the level of market integration achieved among European Union members today is certainly beyond the scope of regional economic cooperation and integration for the Asia-Pacific region (see box 1), such cooperation and integration can be focused on enabling access to regional value chains so that all countries, especially those with special needs, can benefit from the region's vibrant economy. Market integration needs to be steered to support and nurture sustainable development, which has the potential to promote employment and income generation, among other benefits. Removal of trade prohibitions, increased openness and efficient borders will strengthen formal networks and reduce illegal trade and financial flows.

5. The present document contains a discussion of the trends and driving factors of market integration, an identification of the main obstacles, and policy recommendations for addressing these obstacles. It also includes a discussion of market integration to promote technology transfer and innovation. The present document is based on the analyses and recommendations of the Working Group on the Formation of an Integrated Market in Asia and the Pacific, which met in Bangkok in December 2014 and March 2015. It also contains a discussion of the outcomes of the deliberations of the Economic and Social Commission for Asia and the Pacific (ESCAP) at its seventy-second

[1] In 2016, China accounted for 52 per cent of the exports and 47 per cent of the imports in the subregion.

session, in May 2016, the High-level Dialogue on Regional Economic Cooperation and Integration for Enhancing Sustainable Development in Asia and the Pacific, held in Bangkok in April 2017, and the ministerial panel discussion on regional economic cooperation and integration in support of the 2030 Agenda for Sustainable Development during the seventy-third session of the Commission, in May 2017.

Box 1

In search of the ideal market integration model: the European vs. Association of Southeast Asian Nations approach[a]

Despite all the concerns leading to and in the aftermath of the referendum vote on Brexit, the European Union is still seen as the most successful regional integration initiative in the world, currently encompassing 28 economies.

To a large extent, the success of the European approach to integration can be attributed to strong political will grounded in the shared notion that market integration could help keep the peace between European nations[b] and an understanding that members would need to actively work together to converge their economies for a more homogenous region. The establishment of a well-resourced regional institutional mechanism (the European Commission) to support that work was also essential, although achieving balance between national and regional institutions remains a contentious issue.

Through the development of trade, monetary and economic relationships, the European Union has become one of the most powerful regional blocs in the world. It is now a strong economic power with significant political clout (through its common foreign and security policy) and exclusive competences (particularly on trade matters). It also has its own diplomacy with the status of observer with enhanced status at the United Nations, as well as the ability to fund large development projects within the European Union and to strengthen cooperation between the European Union and other regions.

However, achieving such a level of integration is difficult and requires parallel efforts on both political and economic fronts, as well as a step-by-step approach. The European Coal and Steel Community, an organization of six European countries set up to create a common market for coal and steel, was established in 1951 and was the forerunner of today's European Union. The same six countries signed the Treaty of Rome (1957) establishing the European Economic Community and paving the way for "a united Europe". The Treaty of Rome has been amended on a number of occasions, changing the bloc from a customs union to a common market and finally to an economic and a monetary union with expanded membership. Today, the treaty is known as the Treaty on the Functioning of the European Union.

This market integration went through several phases. Between 1957 and 1990, the main achievement of the European Economic Community was getting member countries to adopt a common policy on trade. After removing tariffs and quotas and establishing common customs tariffs, the members agreed to give the European Commission an exclusive competence to harmonize their tariffs with the rest of the world (1968). European countries also decided to standardize their norms and establish common policies on agriculture (Common Agricultural Policy, introduced in 1962) and transport. In order to implement a common currency, most nations of the European

Economic Community decided to create the European Monetary System in 1979 to prevent fluctuations between European currencies.

Between 1990 and 2002, the member countries tried to deepen economic integration through the Economic and Monetary Union. In 1990, members decided to liberalize capital flows in the European Economic Community and established some convergence criteria on inflation, debt, deficits and interest rates for countries that wanted to adopt the common currency, the euro. In 1997, the Stability and Growth Pact on budgetary discipline was adopted, and in 1998, the conversion rates between European currencies and the euro were set. Finally, a single monetary policy and a non-physical form of the euro were introduced in 1999, before the entry into circulation of the euro on 1 January 2002.

Similar to the European integration, the Association of Southeast Asian Nations (ASEAN) was established in 1967 by five South-East Asian countries motivated by political factors. However, since the initiation of the ASEAN Free Trade Area in 1992, the economic aspects of integration have been the main motivators. By 1999, the bloc included 10 countries, which today comprise 629 million people and a gross domestic product of $2.4 trillion, making it the seventh largest market in the world. In contrast to the European integration, there has been no delegation of authority from national Governments to the ASEAN secretariat, and even in the area of trade, there has been no formation of a customs union or a common trade policy. Nevertheless, ASEAN also followed a community-building approach by opting to build three communities – economic, political-security and sociocultural – to move integration forward. The ASEAN Economic Community was supposed to be fully implemented by 2015 with its 10 members sharing a single market and production base that was highly competitive but had the goals of equitable economic development and of the region being fully integrated into the global economy. Building on the achievements of the ASEAN Economic Community, members envisioned a post-2015 ASEAN (known as the ASEAN Economic Community Blueprint 2025) with deepened economic integration and strengthened political cohesion and social responsibility. Under the Blueprint, the institutions necessary to move integration forward will be strengthened. It remains to be seen if it will bring ASEAN closer to the European model or if the latter will transform into a more ASEAN-like model.

[a] www.ec.europa.eu/; www.touteleurope.eu/; and Bruno Jetin and Mia Mikic, eds., ASEAN Economic Community: A Model for Asia-wide Regional Integration? (Palgrave-Macmillan, New York, 2016). Available from http://www.palgrave.com/gp/book/9781137537102.

[b] The process of European integration early on included a proposal to establish a European defence community (1950) which failed. It was only in 1955 at the Messina Conference that the six European leaders were able to return to the idea of integration and unity by focusing on economic integration, which resulted in the Treaty of Rome, as well as the treaty establishing the European Atomic Energy Community (EURATOM Treaty).

II. Liberalizing and facilitating trade for market integration for goods and services

6. The increasing dynamism of developing countries in the Asia-Pacific region, combined with the integration of the region's economies into global value chains, is the driving force behind the growing importance of the region in international trade. Factors such as relatively low wages and the availability of a large and diverse labour force in the region, ample investment resources and advanced technological capabilities have supported integration of the Asia-Pacific region into global value chains. In addition, lower trade barriers and improved transport and information and communications technology connectivity have reinforced this trend and enabled the creation of the regional value chains and production networks.

7. The participation of the economies in the region in global value chains and regional production networks has boosted intraregional trade, which now represents more than half of the region's total trade. However, the intensity of intraregional trade varies across subregions, with the highest levels in South-East Asia and the Pacific (which includes Australia and New Zealand) (see table 1). The high intraregional trade intensity of South-East Asian economies reflects their participation in regional value chains and the benefits of the Association of Southeast Asian Nations (ASEAN).[2] In contrast, given their geographical characteristics, economies in the Pacific are interconnected through Australia and New Zealand and depend heavily on their preferential access to those markets. East and North-East Asia is the most important subregional trading partner for the other subregions of Asia and the Pacific, mainly because of the prominence of China. South-East Asia is the second most important source of imports for the other subregions, except for North and Central Asia. In South and South-West Asia and North and Central Asia, there is limited intra-subregional trade, mainly owing to limited complementarity of exports and relatively high trade costs.

8. The Asian and Pacific economies have become important exporters of global value chain products, whereas final demand for such products still largely comes from North America and Europe. However, the slow recovery in demand for such products in these developed markets has recently led to unprecedented weak trade growth for the Asian and Pacific economies. To offset this trend, these economies must develop alternative sources of growth

---

[2] As shown in *Asia-Pacific Trade and Investment Report 2015: Supporting Participation in Value Chains* (United Nations publication, Sales No. E.15.II.F.15), pp.114-115, global value chain-related production in Asia relies heavily on intraregional intermediate imports. In 2013, more than 65 per cent of the global value chains' intermediate imports of regional economies came from within the region. This link was particularly strong for the apparel, footwear and electronics sectors and moderate for the automotive and processed agriculture sectors. Member States of ASEAN (Indonesia, Malaysia, Singapore and Thailand) are among those exhibiting the positive association between intraregional trade and global value chain participation. The regional nature of global value chains has also been confirmed in other literature, for example, Richard Baldwin, "Global supply chains: why they emerged, why they matter, and where they are going" in *Global Value Chains in a Changing World*, Deborah. K. Elms and Patrick Low, eds. (Geneva, World Trade Organization, 2013), pp. 13-60 (available from www.wto.org/english/res_e/booksp_e/aid4tradeglobalvalue13_e.pdf) and Koen de Backer and Norihiko Yamano, "International comparative evidence on global value chains", OECD Science, Technology and Industry Working Paper, No. 2012/3 (DSTI/DOC(2012)3) (Paris, 2012), (available from www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/DOC(2012)3&docLanguage=En.).

by, for example, boosting domestic and regional demand. However, this is challenging for economically small countries and countries lacking large budgets to fuel government spending.

9. With regard to trade in commercial services, it should be noted that although the region remains a net importer, its share in global services trade continues to grow, with its share in global imports increasing from 29.5 per cent to just below 33.0 per cent, and global exports increasing from 25.5 to 30.0 per cent from 2005 to 2015. Commercial services trade is largely supported by communications, construction, insurance, financial services, computer and information, royalties and licence fees, and cultural and recreational services. Transportation and travel follow with closely competing shares. While East and North-East Asia and South-East Asia are the major contributors in the region to services trade, the share of South and South-West Asia is growing rapidly. At the country level, China, India, Japan and Singapore account for more than half of the services trade in the region.

10. Regulatory obstacles can strongly affect services trade, which plays a key role in facilitating industrial and agricultural trade and countries' participation in value chains. While economies in the region have increased their participation in global services trade, it seems, based on the incomplete data that is available, that intraregional trade in services still lags intraregional trade in goods.

11. Regional and global trade patterns are strongly influenced by trade costs. Such costs include import tariffs, non-tariff or behind-the-border barriers, regulatory and procedural border burdens, and transport costs. Non-tariff measures are believed to pose a greater impediment to trade and be the cause of higher trade costs than tariffs – the traditional barriers to trade – in many sectors. The agricultural and food sectors are most notably affected by such measures. This is particularly disadvantageous for developing countries, which typically have comparative advantages in those sectors. Even small additional costs arising from import barriers, such as non-tariff measures, can harm the competitiveness of countries and their ability to participate in global value chains.

Table 1
Intraregional trade in Asia and the Pacific

	Intraregional merchandise imports (Percentage)		*Intraregional merchandise exports (Percentage)*	
Subregion	*Of gross domestic product*	*Of total imports*	*Of gross domestic product*	*Of total exports*
East and North-East Asia				
1990	6.7	50.3	6.1	42.3
2000	7.9	53.8	7.3	44.3
2015	9.6	58.4	11.9	55.5
North and Central Asia				
1990	2.3	21.4	3.3	22.1
2000	4.4	30.3	8	21
2015	7.9	48.9	8.9	36.5
Pacific				
1990	5.8	41.7	7.4	54.4
2000	8.7	48.4	10.3	60.6
2015	11.6	62.2	12.5	75.4
South and South-West Asia				
1990	3.6	33.3	2.4	29.5
2000	4.8	31.9	2.9	23.8
2015	9.7	44.3	4.2	29.5
South-East Asia				
1990	28.7	60.8	27.3	65.6
2000	37.1	61.7	41.5	59.6
2015	34.6	72.6	32.9	68.6

Source: *Asia-Pacific Trade and Investment Report 2016: Recent Trends and Developments* (United Nations publication, Sales No. E.16.II.F.23) and International Monetary Fund (IMF), IMF Data: Government Finance Statistics. Available from www.imf.org/external/pubs/ft/gfs/manual/gfs.htm (accessed 10 April 2017).

12. However, measuring the exact magnitude of the impact of non-tariff measures on trade is highly complex, as these measures are heterogeneous and are often presented as a package of measures rather than a single measure, making cost comparison difficult. While it is critical that efforts are made to deal with non-tariff measure-based protectionism, more emphasis must be applied to improving the availability of data on the impact and prevalence of non-tariff measures.

13. Nevertheless, the ESCAP-World Bank Trade Cost Database attempts to capture some of these broader issues, offering aggregate measures of trade costs. It points to a high variation of trade costs among Asia and the Pacific countries and subregions, with tariff-equivalent costs ranging from 51 per cent to as much as 369 per cent (table 2), which makes trade integration opportunities very uneven. As table 2 indicates, East and North-East Asian economies typically have the lowest trade costs in the region, while the Pacific island developing economies have the highest overall costs because of geographical constraints. Similarly, trade costs of North and Central Asian economies are about three times higher than those of a sample of representative East Asian economies, despite significant progress made in reducing trade costs since 1996.

Table 2
Estimates of tariff-equivalent costs of trade in Asia and the Pacific
(Percentage)

Region	*ASEAN-4*	*East Asia-3*	*North and Central Asia-4*	*Pacific Islands*	*SAARC-4*	*AUS_NZL*	*EU-3*
ASEAN-4	**76**						
East Asia-3	75	**51**					
North and Central Asia- 4	354	175	**121**				
Pacific Islands	172	175	369	**132**			
SAARC-4	128	124	285	318	**116**		
AUS_NZL	101	88	336	83	138	**52**	
EU-3	106	85	152	209	115	108	**43**
USA	86	63	177	163	110	100	67

Source: ESCAP-World Bank Trade Cost Database. Available from www.artnet.unESCAP.org/databases.html#first (accessed 12 May 2016).

Abbreviations: ASEAN-4: Indonesia, Malaysia, the Philippines and Thailand; AUS-NLZ: Australia and New Zealand; East Asia-3: China, Japan and the Republic of Korea; EU-3: Germany, France and the United Kingdom of Great Britain and Northern Ireland; Pacific islands: Fiji and Papua New Guinea; North and Central Asia-4: Georgia, Kazakhstan, Kyrgyzstan and the Russian Federation; SAARC-4: Bangladesh, India, Pakistan and Sri Lanka; USA: United States of America.

Note: Trade costs shown are tariff equivalents calculated as trade-weighted average trade costs of countries in each subregion with the three largest developed economies (Germany, Japan and the United States of America).

14. Several steps have been taken and policies have been formulated to reduce trade costs, with the Asian and Pacific economies increasingly using bilateral and plurilateral preferential trade agreements over the past two decades. As of June 2017, the Asian and Pacific economies were involved in 170, or 66 per cent, of the total 274 preferential trade agreements in force globally at that time.

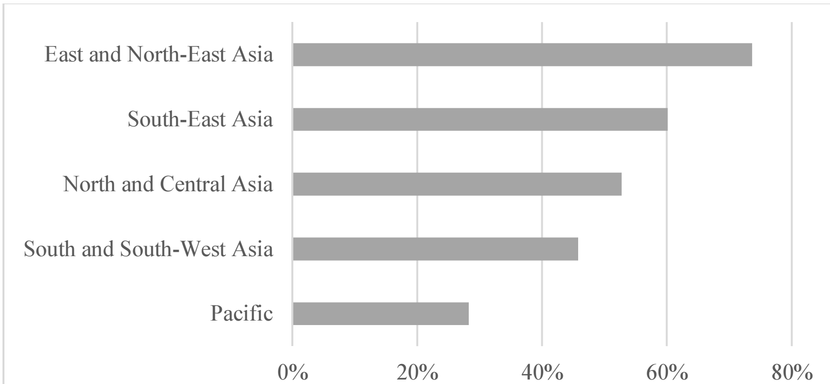
15. Overreliance on preferential trade agreements has led to a multiplicity of overlapping preferential trade agreements, which is often referred to as Asia's noodle bowl. While each individual agreement on its own may be reducing tariffs with the objective of improving market access for its partners, the large number of overlapping and multiple agreements associated with different trade rules may end up increasing transaction costs for businesses, especially for small and medium-sized enterprises. Hence, consolidation of preferential trade agreements to reduce their number and complexity would be beneficial for private sector entities engaging in international commerce.

16. As high trade costs act as an obstacle to trade expansion, Governments in the region are increasingly considering trade facilitation and paperless trade measures to complement and strengthen access to markets opened through preferential trade agreement-driven trade liberalization. Region-wide implementation of cross-border paperless trade measures could bring export gains of as much as $257 billion annually, reduce the time required to export by 44 per cent and cut trade costs by 31 per cent.[3] Similarly, the full implementation of the World Trade Organization (WTO) Agreement on Trade Facilitation, which came into force on 22 February 2017, could reduce trade

[3] *Asia-Pacific Trade and Investment Report 2015: Supporting Participation in Value Chains* (United Nations publication, Sales No. E.15.II.F.15).

costs in the region by up to 17 per cent. Nevertheless, as figure I shows, significant progress in the implementation of the Agreement and of electronic trade document exchange mechanisms has only been made in East and North-East Asia and South-East Asia, with the other subregions considerably lagging.

Figure I
Implementation of trade facilitation and paperless trade measures



Source: ESCAP, *Trade Facilitation and Paperless Trade Implementation 2017: Asia and the Pacific Report* (forthcoming).

17. Recognizing this, ESCAP has supported the development of the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific with the objective of providing the region with a new tool and a digital complement for better implementation of the WTO Agreement on Trade Facilitation and paperless trade provisions already featured in many bilateral trade agreements.[4] Open for signature since October 2016, the Framework Agreement also supports the development of cross-border e-commerce and builds upon existing international standards and bilateral and subregional initiatives.

18. While the region has witnessed a proliferation of preferential trade agreements, Asia-Pacific countries have also been involved in negotiating economic or comprehensive partnership agreements, such as the Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership, which include commitments to liberalize investment, competition policy and/or government procurement. These types of mega-regional agreements have great potential for harmonizing countries' different standards[5] and procedures and for consolidating multiple overlapping rules of origin under existing trade agreements. They also expose the complexities of plurilateralism, which does not necessarily provide the best avenue to meet the development goals that small developing economies would like to achieve through trade.

19. In summary, trade of goods and, to a certain degree, of commercial services has contributed greatly to growth in the Asia-Pacific region through access to global value chains, which has significantly supported intraregional trade. The risk is, however, that the proliferation of trade agreements with

[4] Yaan Duval and Kong Mengjing, "Digital trade facilitation: paperless trade in regional trade agreements", ADBI Working Paper Series, No. 747 (Tokyo, Asian Development Bank Institute, 2017). Available from www.adb.org/publications/digital-trade-facilitation-paperless-trade-regional-trade-agreements.

[5] Industry-led voluntary standards to better align value chains with sustainable development, including through higher levels of competitivity, will also play an important role.

complex trade rules may not be enabling trade and investment flows, as discussed in the next section. Similarly, renewed protectionist measures can prevent the most vulnerable countries in the region from benefiting from the opportunity of boosting their economies on the back of trade. To tackle these risks, efforts may be directed to further facilitating trade by, for example, instituting paperless trade and consolidating existing trade agreements. This will be of particular importance to countries with special needs (see box 2).

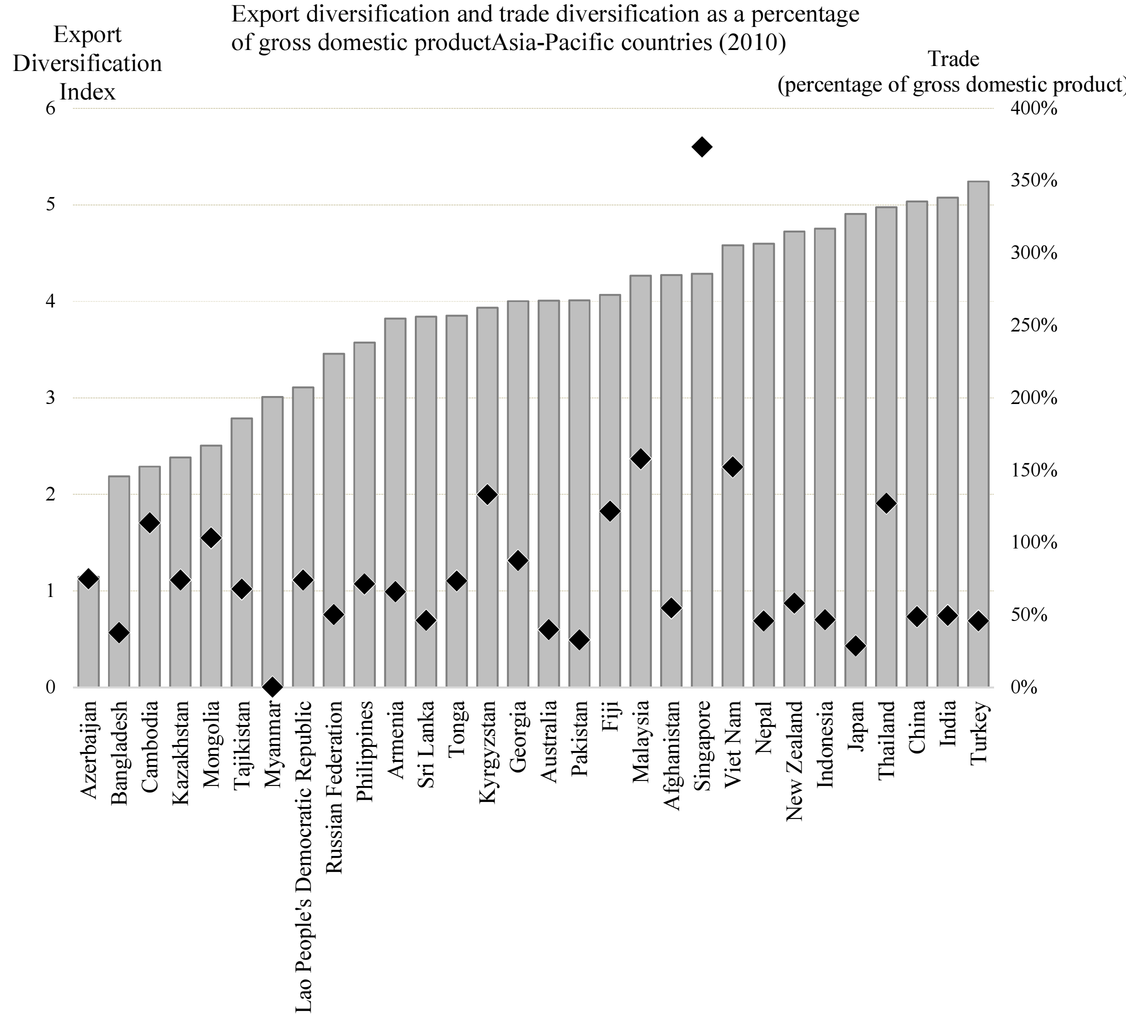
Box 2

Export diversification and market integration[a]

There is strong evidence that trade facilitation and the resulting increased market integration can help countries in diversifying exports,[b] which has been identified as especially important in the early stages of the development process, as shown by the example of the so-called East-Asian Tigers.[c] This makes trade facilitation even more important to some of the least developed and landlocked countries of the region, which have been struggling to diversify their exports.

As shown in the graph below, based on data for half of the Asia-Pacific economies, some of the least diversified economies in the region are Azerbaijan, Bangladesh, Cambodia, Kazakhstan and Mongolia.

Export diversification and trade diversification as a percentage of gross domestic productAsia-Pacific countries (2010)



Source: ESCAP calculations based on IMF, The Diversification Toolkit: Export Diversification and Quality Databases, Spring, 2014 (available from www.imf.org/external/np/res/dfidimf/diversification.htmwww.imf.org/external/np/res/dfidimf/diversification.htm) and IMF, "Sustaining long-run growth and macroeconomic stability in low-income countries: the role of structural transformation and diversification", IMF Policy Paper (March 2014).

Note: The Export Diversification Database provides an estimate of export diversification using product-level data on goods trade from UN Comtrade - International Trade Statistics Database.

In that context, Asia-Pacific countries with special needs should continuously explore new products and markets and formulate policies that assist in expanding their participation and increasing technological content in regional and global value chains. In order to diversify markets and products, Asia-Pacific countries with special needs need to explore intraregional initiatives through regional trade agreements. Regional trade agreements can be an important tool for market diversification as they can be used to promote trade in goods by dismantling tariff and non-tariff barriers, attracting investments, promoting trade in services and reducing trade transaction costs through trade facilitation measures. This would also assist in reducing supply-side constraints, which would ensure the development of regional value chains and promote intraregional investment and technology flows.

Beyond trade policy and market integration, however, countries will also need to holistically work on a number of related areas to enhance their productive capacities, including the development of industrial policies, fiscal policies and infrastructure.

[a] IMF, The Diversification Toolkit: Export Diversification and Quality Databases, Spring, 2014 (available from www.imf.org/external/np/res/dfidimf/diversification.htm); IMF, "Sustaining long-run growth and macroeconomic stability in low-income countries: the role of structural transformation and diversification", IMF Policy Paper (March 2014); and *Asia-Pacific Countries with Special Needs Development Report 2015: Building Productive Capacities to Overcome Structural Challenges* (United Nations publication, Sales No. E.15.II.F.9).

[b] For example, see Ben Shepherd, "Enhancing export diversification through trade facilitation", ARTNeT Policy Brief, No. 19 (Bangkok, ESCAP, 2009) (available from www.unescap.org/sites/default/files/polbrief19.pdf); Allen Dennis and Ben Shepherd, "Trade facilitation and export diversification", *The World Economy*, vol. 34, No. 1 (January 2011), pp. 101-122 (available from www.onlinelibrary.wiley.com/doi/10.1111/twec.2011.34.issue-1/issuetoc); and Cosimo Beverelli, Simon Neumueller and Robert Teh, "Export diversification effects of the WTO Trade Facilitation Agreement", FIW Working Paper, No. 137 (Vienna, FIW, 2015) (available from www.fiw.ac.at/fileadmin/Documents/Publikationen/Working_Paper/N_137_BeverelliNeumuellerTeh.pdf).

[c] IMF, The Diversification Toolkit: Export Diversification and Quality Databases, Spring, 2014 (available from www.imf.org/external/np/res/dfidimf/diversification.htm) and IMF, "Sustaining long-run growth and macroeconomic stability in low-income countries: the role of structural transformation and diversification", IMF Policy Paper (March 2014).

III. Foreign direct investment and regional investment regimes

20. The Asia-Pacific region has become a major destination and source of investment flows, which has served to further boost regional integration. Inflows and outflows of FDI from and to the region have steadily increased, despite some dips emanating from global shocks (figure II). In 2016, the region received 31 per cent, or $541 billion, of the total global FDI inflows and was

responsible for 34 per cent, or $495 billion, of global FDI outflows. Within the region, East and North-East Asia has been the major source of both inward and outward FDI growth.

21. Two patterns can be identified about the composition of FDI in recent years. First, the region experienced a significant increase in greenfield FDI inflows to high value-added industries in the manufacturing and service sectors over the past decade, although the size of these inflows was small. The sectors in which the inflows were directed included alternative/renewable energy, communications, business services, health care and biotechnology, although the size of these FDI inflows remained small. These industries have also received much more stable greenfield FDI inflows when compared with top industries, such as coal/oil/natural gas, real estate, metals and financial services.

22. Second, South-South FDI flows have increased considerably in recent years. They have tended to be directed to the immediate geographic region of the source country.[6] The share of intraregional greenfield FDI inflows of total greenfield FDI inflows to the Asia-Pacific region has continuously increased, accounting for 48 per cent in 2016. China has become the biggest intraregional investor in the region, followed by Japan and the Republic of Korea, each respectively accounting for 24, 18 and 12 per cent of intraregional greenfield FDI investments for the period 2014-2016, while China and ASEAN have become the most attractive destinations for intraregional greenfield FDI (figure III).

23. Despite steady and strong FDI growth in the Asia-Pacific region since 2000, many direct and indirect obstacles still hinder increased intraregional FDI and regional integration. Among these challenges are multiple and overlapping international investment agreements, poor business environments and barriers to trade.

24. Because there is no global governance mechanism, such as a coherent multilateral investment framework, investment promotion and protection have been undertaken primarily through international investment agreements, either in the form of bilateral or subregional investment treaties or as investment chapters in bilateral or regional trade agreements.[7] As in trade, the proliferation of international investment agreements in recent years has resulted in overlapping and duplication among the treaties in a number of areas. Thus, there is a need to consolidate and streamline these agreements to improve transparency and clarity of international investment rules and thereby help to boost regional integration.

25. South-East Asia is the only subregion with a subregional-level investment agreement, the ASEAN Comprehensive Investment Agreement. However, even under the Agreement, individual ASEAN members continue to maintain national investment laws and bilateral investment treaties with each other and with external partners. Consequently, by adding to existing treaty layers, the Agreement could lead to an even more complex network of international obligations.[8]

---

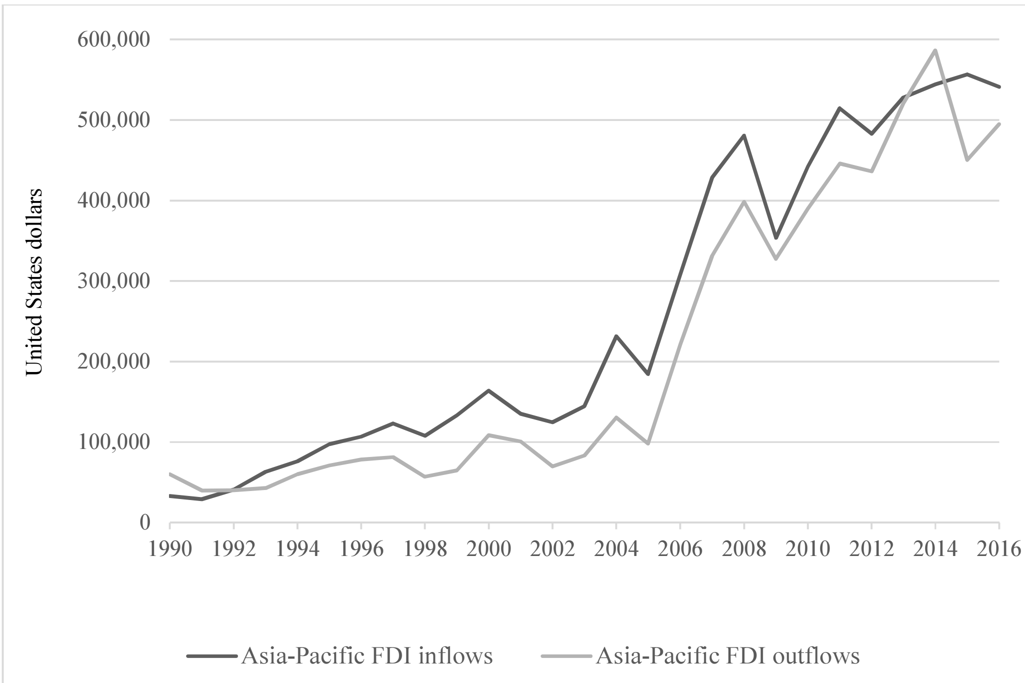
[6] United Nations Conference on Trade and Development, *World Investment Report 2015: Reforming International Investment Governance* (United Nations publication, Sales No. E.15.II.D.5). Available from www.unctad.org/en/PublicationsLibrary/wir2015_en.pdf.

[7] At the global level, 2,324 bilateral investment treaties and 297 treaties with investment provisions were in force as of January 2017. The corresponding figures for Asia and the Pacific are 968 bilateral investment treaties and 148 treaties with investment provisions.

[8] Organization for Economic Cooperation and Development, "Southeast Asia Investment Policy Perspectives", 2014. Available from www.oecd.org/daf/inv/investment-policy/Southeast-Asia-Investment-Policy-Perspectives-2014.pdf.

26. Attempts to establish common investment regimes in other subregions, such as in South Asia through the South Asian Association for Regional Cooperation and in Central Asia through the Eurasian Economic Union, are ongoing but face political obstacles. As FDI involves the presence of foreigners who own local assets and operate in local markets in direct competition with domestic companies, policies to promote and attract FDI are often politically sensitive and face opposition, leading to backtracking or the delay of much-needed economic reforms.[9]

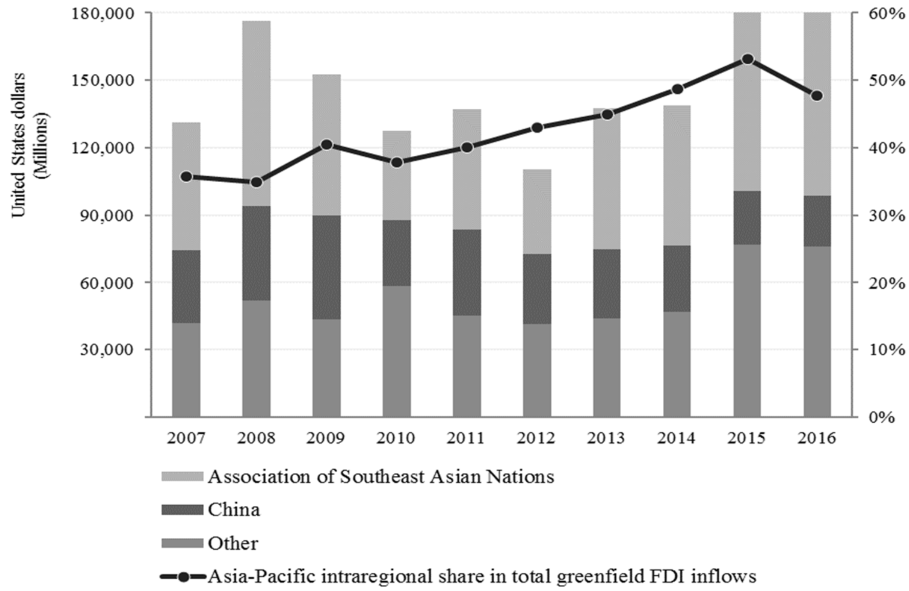
Figure II
Foreign direct investment inflows and outflows to and from the Asia-Pacific region, 1990-2016



Source: ESCAP calculations based on United Nations Conference on Trade and Development, *World Investment Report 2017: Investment and the Digital Economy* (United Nations publications, Sales No. E.17.II.D.3).

[9] Bernard Hoekman and Kamal Saggi "Multilateral disciplines and national investment policies" in *Development, Trade and the WTO: A Handbook*, Bernard Hoekman, Aaditya Mattoo and Philip English, eds. (World Bank, Washington, D.C., 2002). Available from www.documents.worldbank.org/curated/en/805981468763835259/pdf/297990018213149971x.pdf.

Figure III
Intraregional greenfield foreign direct investment inflows in the Asia-Pacific region and their share in total greenfield foreign direct investment inflows, and major destinations, 2007-2016



Source: ESCAP calculations, based on Financial Times Ltd., fDi Markets. Available from www.fdimarkets.com (accessed 15 February 2017).

27. The lack of an effective investment and business climate in many economies of the region has also hindered intraregional FDI.[10] Although improvements have been made in most countries in terms of FDI liberalization, a number of obstacles remain, including excessive red tape; lack of effective investment facilitation and aftercare, in particular at the local government level; lack of required labour skills, infrastructure and technological capabilities for more advanced forms of FDI; and corruption and other obstacles related to ineffective law enforcement.[11],[12] This explains why many investor home countries seek international investment agreements with host countries that emphasize investor protection. Recently, however, calls have grown for more balanced international investment agreements that also recognize host country development needs and the right of Governments to regulate for development purposes.[13] Where such investments impact natural-resource dependent livelihoods and land tenure security, the needs and concerns of local communities, in particular indigenous populations, also require attention.

---

[10] Agnès Bénassy-Quéré, Maylis Coupet and Thierry Mayer, "Institutional determinants of foreign direct investment", *The World Economy*, vol. 30, No. 5 (May 2007), pp. 764-782. Available from www.onlinelibrary.wiley.com/doi/10.1111/j.1467-9701.2007.01022.x/abstract.

[11] Aftercare refers to government support to, for example, retain investment and ensure it has a local economic impact. See United Nations Conference on Trade and Development, "Aftercare: a core function in investment promotion", Investment Advisory Series, series A, No. 1 (Geneva, 2017).

[12] There are numerous studies on the obstacles to FDI. One relevant example is Zdenek Drabek and Warren Payne, "The impact of transparency on foreign direct investment", *Journal of Economic Integration*, vol. 17, No. 4 (December 2002).

[13] ESCAP, Studies in Trade and Investment, No. 68 (ST/ESCAP/2565).

28. Finally, FDI is linked to the establishment and development of global and regional value chains, which have been instrumental in enhancing market integration in the region, particularly in East Asia and South-East Asia.[14] Thus, obstacles to effective cross-border trade, including the lack of effective trade facilitation, are also obstacles to FDI.

IV. Cross-border mobility of labour

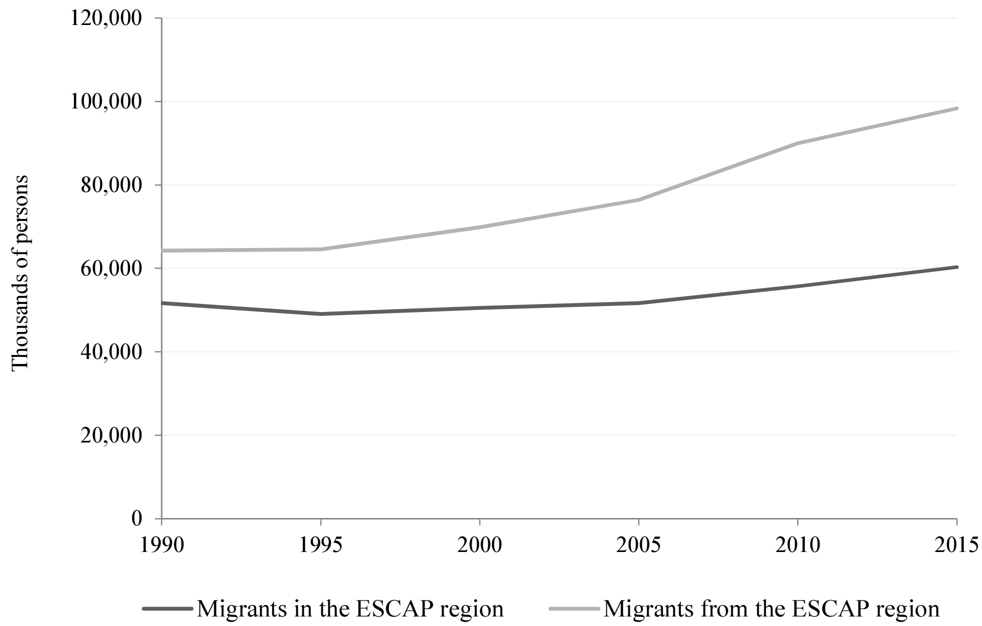
29. Labour market integration remains much lower than levels of integration for intraregional trade and investment. The region has a large population of migrants from labour-surplus countries, most of whom find jobs in construction and domestic work. Of the estimated 231.5 million migrants in the world in 2013, about 59.3 million were in countries in the Asia-Pacific region (25.6 per cent). This represents a notable increase of 7 million (11.8 per cent) from the comparable figure in 1990 (figure IV).

30. Major countries involved in the migration of labour are Australia, Brunei Darussalam, China, India, the Islamic Republic of Iran, Japan, Kazakhstan, Malaysia, Pakistan, the Republic of Korea, the Russian Federation, Singapore and Thailand, some of which have experienced important structural transformations over the previous few decades (figure V). For instance, the foreign worker population in Singapore rose from 21,000 in 1970 (3 per cent of the workforce) to more than one million (35 per cent) in 2010.

31. Remittances have been the main benefit of labour migration, as they provide much-needed resources for origin countries to finance current account deficits, smooth households' consumption, alleviate poverty and catalyse investment in small and medium-sized enterprises. Asia and the Pacific hosts some of the most important remittance corridors in the world, from the Russian Federation to Central Asian countries, from Australia and New Zealand to their Pacific neighbours, and from Thailand to other South-East Asian countries. Similarly, several economies in the region, such as Bangladesh, India, Pakistan and the Philippines, receive large remittances through the migration of members of their labour force, mostly low-skilled workers, to countries in the Middle East, such as Saudi Arabia and the United Arab Emirates.

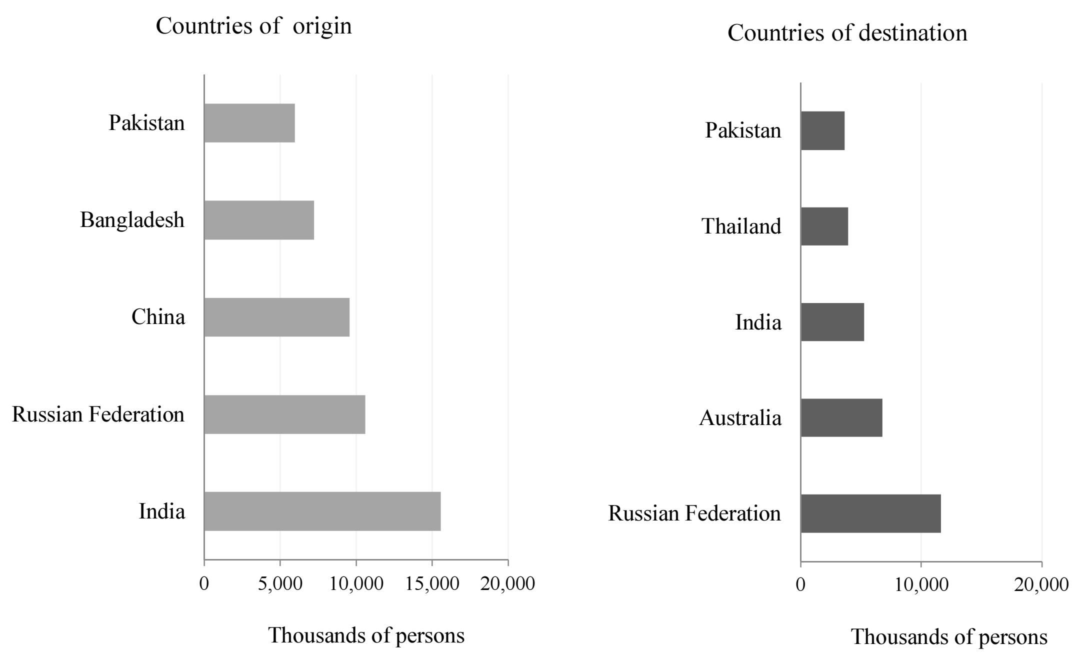
[14] See World Trade Organization and Institute of Developing Economies-Japan External Trade Organization, *Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks* (Geneva, 2011).

Figure IV
Evolution of migration in Asia and the Pacific, 1990-2015



Source: ESCAP, *Asia-Pacific Migration Report 2015: Migrants' Contributions to Development* (ST/ESCAP/2738).

Figure V
Main countries of migration, origin and destination, 2015



Source: ESCAP, *Asia-Pacific Migration Report 2015: Migrants' Contributions to Development* (ST/ESCAP/2738).

32. International migration has the potential to yield a net benefit to migrants and their families, as well as to countries of origin and destination countries. However, harnessing these benefits requires concerted efforts and cooperation initiatives among and between countries in the Asia-Pacific region aimed at addressing political, technical and socially embedded perceptions of migrants.

33. Politically, cross-border mobility of labour touches on a core aspect of state sovereignty, namely the right of states to choose who can enter or reside in their territory. Moreover, migration is often seen as a threat to a country's national security and cultural identity. For these reasons, countries are hesitant to sign international conventions on the protection of migrant workers and are reluctant to enter any agreement that may be interpreted as a commitment to opening their borders.

34. In recent years, there have been some positive policy improvements related to labour market integration. Notably, the Treaty on the Eurasian Economic Union led to the creation of a single labour market through the right to access employment and social protection systems, which rationalized and regularized long-standing labour migration flows between the countries involved.[15] Similarly, the ASEAN Economic Community has liberalized mobility of selected classes of skilled workers through mutual recognition of degrees in specific professions. Most migrants, however, have low skills, so only a small share of the migrants in ASEAN member countries have been affected by this policy. Furthermore, labour migration in ASEAN remains largely irregular, which limits the impact of this policy.

35. A key obstacle to migration is that the mechanisms to promote orderly migration in many countries do not favour easy matching between demand and supply of migrant labour. When vacancies for migrant labour in destination countries cannot be filled because of legal restrictions on migration, the likely outcome is irregular migration. This type of migration can occur without crossing a border illegally. Migrants may hold an irregular status because (a) they entered a country without authorization, (b) they entered legally but are staying or working without authorization, or (c) they entered a country and were authorized to work, but their employment violates regulations, such as those concerning the employer, the duration or type of work, or the hours worked.[16]

36. Irregular migration is problematic on several accounts, as it entails a high risk of exploitation and abuse of migrant workers, who face multiple vulnerabilities in the workplace. Thus, migrants are often not treated in the same way as local workers with regard to remuneration and labour standards.

37. When countries understand and allow labour migration as part of their national policies, migrant workers can be fairly treated and contribute to host country development processes, for instance by spurring technology transfer and innovation. To take advantage of such positive spillover effects, inclusive regulatory frameworks need to be in place. For example, in the Republic of Korea, the Employment Permit System ensures that migrant workers are covered under Korean Labour Law, including those pertaining to working hours and minimum wage. Migrant workers recruited under the Employment

---

[15] The treaty was signed on 29 May 2014 by the leaders of Belarus, Kazakhstan and the Russian Federation. It entered into force on 1 January 2015.

[16] For example, migrants from the Commonwealth of Independent States can enter the Russian Federation freely on a visa-free regime. However, they become irregular once the permitted period of legal stay expires.

Permit System enjoy all basic labour rights, including the right to join trade unions, freedom from forced labour, freedom to bargain collectively and non-discriminatory treatment.

38. In addition to the political challenges, labour market integration involves significant technical adjustments across a wide range of policy areas. For example, differences in educational systems make it difficult to certify that migrant workers have the required qualifications for specific jobs. Similarly, ensuring that migrant workers are able to pay into social protection systems and enjoy the benefits of those systems, particularly with regard to acquired rights, such as pensions, technical cooperation and agreements on such issues are required between countries that may have very different systems.

39. Finally, the public perception of migrants, especially low-skilled migrants, is often negative. This is typically driven by, for example, press coverage that tends to highlight issues of illegality, both about migrants' status and illegal acts carried out by migrants, and by debates that focus on the perceived negative economic effects of migration, such as migrants "taking" jobs from national workers. Even if this is not the case, and low-skilled migrants generally complement national workers and add value to national economies, negative perceptions of migrants tend to prevent Governments of key destination countries from discussing opening labour markets to migrant workers.

V. Market integration, technology transfer and innovation

40. Removing the barriers to market integration discussed above can support technology transfer and, in turn, innovation capability. Science, technology and innovation have been identified as key means of implementation to achieve the Sustainable Development Goals. In this context, the development of innovation capability will be critical if member States are to meet these ambitions.

41. The focus on trade and FDI as the main channels for technology transfer has historically shaped the technology policy discourse and has been an important argument in support of the removal of trade barriers and FDI incentive structures for greater market integration. This discourse assumes that by opening their economies, developing countries provide attractive new markets and a ready supply of labour in exchange for productive technologies that are expected to trigger broader technological upgrading, productivity gains and economic growth.

42. Trade can facilitate direct technology transfers through transactions from one party to another, such as trade in goods embodying technology or the licensing of technologies themselves.[17] There are many modalities through which FDI can generate transfers of technology, including transfers that are directly connected to FDI projects and the establishment of production facilities. Technology transfers may also happen as part of a demonstration effect, whereby domestic firms develop their innovation capability through exposure to products or productive processes of foreign firms (see figure VI). FDI can develop innovation capability through competition from the presence of foreign firms, which may also generate a market restructuring effect. Finally, there may also be labour turnover effects, whereby workers who acquire new skills in foreign firms leave those firms to create their own

[17] Luca Parisotto and Adam Heal, "Impacts of imported technology in Asia-Pacific developing countries: evidence from firm-level data", *Trade Insights*, No. 16 (March 2016).

companies or join existing domestic companies, effectively transferring newly acquired human capital.

43. In addition to trade and FDI, labour mobility also has an impact on the development of innovation capability. Migration affects a country's ability to develop innovation capability in two ways: through the integration of foreign talent migrating into the country and through the loss of skilled workers of domestic origin. This loss of domestic talent, commonly referred to as brain drain, is particularly relevant for developing countries that may struggle to build up human capital in the first place. However, recent research has shown that an outward flow of skilled workers is not necessarily a loss for developing economies.[18] It is possible for developing countries to benefit from high-skilled migration if partnerships between sending and receiving countries encourage a repatriation of skills and knowledge, or brain circulation. Furthermore, the prospect of migration can act as an incentive to acquire skills and build up human capital, which can mean that brain drain could result in a net increase in the domestic level of human capital, or brain gain.[19] Diaspora networks can also play a crucial role in the development of innovation capability, as the large number of start-up companies created by returned Indian migrants demonstrates.

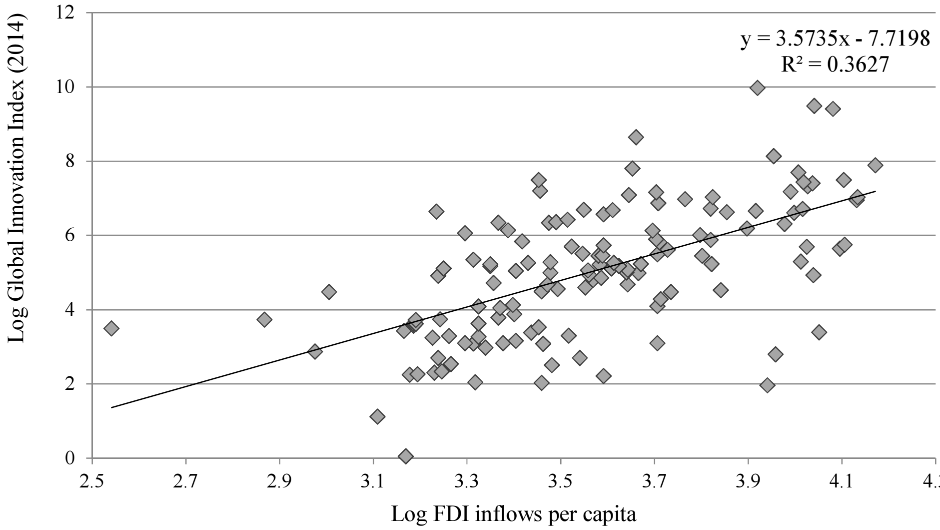
44. Though trade, FDI and labour mobility can support technology transfer and the development of innovation capability, government strategies should also focus on technological learning after initial transfer through policies that support indigenous innovation efforts and an institutional system conducive to innovation.[20]

[18] Uwe Hunger, "The "brain gain" hypothesis: third-world elites in industrialized countries and socioeconomic development in their home country", Center for Comparative Immigration Studies Working Paper, No. 47 (San Diego, California, University of California-San Diego, 2002). Available from www.cctr.ust.hk/materials/library/Brain_Gain_Hypothesis_Third_worlders_in_the_West..pdf.

[19] Michel Beine, Fréderic Docquier and Hillel Rapoport, "Brain drain and human capital formation in developing countries: winners and losers", *The Economic Journal*, vol. 118, No. 528 (April 2008), pp. 631-652.

[20] Xiaolan Fu, Carlo Pietrobelli and Luc Soete, "The role of foreign technology and indigenous innovation in the emerging economies: technological change and catching-up", *World Development*, vol. 39, No. 7 (July 2011), pp. 1204–1212. Available from www.sciencedirect.com/science/journal/0305750X/39/7?sdc=1.

Figure VI
Correlation between the Global Innovation Index ranking and FDI inflows per capita



Source: ESCAP calculations based on Global Innovation Index 2014 (available from www.globalinnovationindex.org/analysis-indicator) and United Nations Conference on Trade and Development, UNCTADSTAT (available from www.unctadstat.unctad.org/EN/) (accessed 9 March 2016).

45. In addition, to increase innovation capability, the next generation framework for technology transfer needs to be based on the principles of openness and collaboration. This is especially true considering the large disparities in innovation capability in Asia and the Pacific and the scale of the common challenges – such as climate change – facing the region. To generate and spread the next wave of breakthrough technologies, the regional innovation system needs to evolve. In many circumstances, this will not necessarily require more technology transfer, but more technology collaboration and sharing.

46. Getting the balance right between openness and competitiveness will be critical. Competition drives innovation and Governments need to carefully assess how a more collaborative approach could dampen the private sector's incentives. One way to increase incentives is through well-functioning intellectual property rights regimes that protect (without stifling) innovation. Another is through flexible technology-pricing regimes, which would adjust to different levels according to the market and level of development. This would allow profit-maximizing companies with an intellectual property monopoly to charge lower prices where consumers are significantly poorer. Although this concept is not new, the way it has been applied to date has provided little incentive to develop new technologies. Rethinking technology transfer as technology collaboration and sharing could be one of the most important components of the 2030 Agenda, and market integration could play a major role in reinforcing these efforts.[21]

[21] Charles Kenny and Owen Barder, "Technology, development, and the post-2015 settlement", CGD Policy Paper, No. 063 (Washington, D.C., Center for Global Development, 2015). Available from www.cgdev.org/sites/default/files/CGD-Policy-Paper-63-Kenny-Barder-Technology-Development-Addis.pdf.

VI. Recommendations

47. **Understanding and curtailing protectionism**. Improved measurements of the level of non-tariff and behind-the-border regulatory measures and assessments of their impacts are necessary to more effectively deal with what is recorded as rising trade costs, especially for smaller and vulnerable countries and traders. Current assessments estimate that the tariff equivalents of these non-tariff measures range between 50 and 350 per cent across the region's economies. To effectively deal with these obstacles to market access, ESCAP can assist countries in prioritizing areas for cooperation to better manage non-tariff measures. For example, mutual recognition agreements and conformity assessment procedures, and harmonization of standards in selected sectors, such as agriculture and processed food, green goods, textiles and certain sectors in services, such as education and health, may serve as effective instruments for broader region-wide cooperation. In this regard, work on improved measurements, impact assessments and ultimately streamlining and potentially harmonizing, where appropriate, non-tariff measures would support trade and investment liberalization for developing countries and countries with special needs.

48. **Streamlining trade agreements**. In contrast to their intention to improve market access, multiple preferential trade agreements, and the complexities arising from compliance with the rules of origin they impose for using tariff preferences, often create impediments for producers and traders. Furthermore, they can divert trade away from the economies not involved in the trade agreements. ESCAP needs to advocate for the adoption of a simpler but more development-friendly framework of rules of origin, which could be exemplified by a re-energized and expanded Asia-Pacific trade agreement.

49. **Promoting trade facilitation and paperless trade**. ESCAP has long been actively involved in the simplification of trade procedures. Following four years of consultations and negotiations, ESCAP member States adopted the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific. The first of its kind, it is complementary to the WTO Agreement on Trade Facilitation and builds on the growing number of bilateral and subregional initiatives in this area. It has been open to all ESCAP member States since the end of 2016 and will enter into force after five member States have ratified it. The implementation of this Agreement has the potential to cut intraregional trade costs and enable countries to reap the benefits associated with cross-border paperless trade, estimated to be as high as $257 billion in increased exports opportunities.

50. **Better utilizing existing regional platforms.** Regional platforms, such as the Commission's Committee on Trade and Investment, can support countries in the region in developing cooperative solutions for trade and investment promotion, as well as in enhancing stakeholder capacities and expertise. These regional platforms should also be better utilized in building the capacity of developing countries in the region to forge alliances and voice joint actions in defence of multilateral options. Examples of possible ways of seeking cooperative solutions include fostering agreement on duty-free and quota-free rules of origin for the least developed countries in the region and lifting the absorptive capacity of least developed countries for trade, technology and investment through regional aid for trade initiatives. This would not only promote regional integration but it would serve to enhance compliance with Sustainable Development Goal 17 – the means of implementation of the 2030 Agenda – which calls for providing technical assistance and for review and monitoring, including data collection and analysis.

51. **Supporting countries' efforts to develop regional investment regimes that would better balance investor rights with host country development needs.** This would enable countries to not only attract more FDI of higher quality that contributes to sustainable development, but it would also help them to gain better market integration, which, in turn, would attract FDI, as open markets and borders are clearly an important determinant of such investments. This would consequently result in a virtuous cycle of FDI and market integration with clear development dividends. However, this requires political will. Common investment regimes should replace and not add to the existing noodle bowls of international investment agreements that mirror the noodle bowl of preferential trade agreements.

52. **Promoting labour market integration processes aiming to enhance coverage across skill-level sectors.** It is also important to target guarantees of equal pay and working conditions between migrant and domestic workers and to ensure migrant workers' access to social protection measures when they are available. To support such processes, it is important to consider ways to align regional qualification frameworks to support job matching and the creation of regional labour markets. The development of common procedures for the payment of social benefits across borders also deserves consideration.

53. The Ministerial Conference may wish to consider the recommendations contained in the present document and provide guidance on removing obstacles to greater integration in the region while maximizing the benefits of synergies with the 2030 Agenda. The Conference may wish to provide guidance to the secretariat on how best to support those efforts.