ASIA-PACIFIC TRADE AND INVESTMENT REPORT 2016

Recent Trends and Developments

UNITED NATIONS
ESCAP
Economic and Social Commission for Asia and the Pacific

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FOREWORD

The 2030 Agenda for Sustainable Development recognizes international trade as a generator of inclusive economic growth. It adds value to economies, provides foreign exchange earnings to help finance development and enables job creation, all of which contribute to poverty reduction. Taking advantage of its dynamism, diversity and labor markets has enabled Asia and the Pacific to be competitive in international markets. This is evidenced by the rise in the region's share of global trade and participation in associated value chains.

Like elsewhere, however, the Asia and Pacific region has faced protracted global headwinds since 2007, which has impacted the trade sector and its prospects. This latest *Asia-Pacific Trade and Investment Report 2016* highlights that the region's trade flows are wavering amid continued sluggish global economic and trade growth, downward movement of world commodity prices and an uncertain policy environment. These outcomes come at a time when the need for trade growth to support the 2030 Agenda for Sustainable Development is critical.

Even though regional trade did gain some momentum during 2010-2014, the nominal value of Asia and Pacific exports and imports in 2015 experienced a major slump of 9.7 per cent and 15 per cent, respectively. Sluggish growth in trade is expected to continue through to the end of 2016. Forecasts, presented in this Report, do offer hope for a rebound in trade, more so in value, but growth in exports and imports in volume terms will be around 2.2 per cent and 3.8 per cent, respectively.

To its credit, most of Asia's exporting economies have decoupled from the economic cycles in traditional exports markets, like the United States and the European Union, by not only diversifying their export markets but also through boosting domestic consumption and the services sector. Notwithstanding, the region has the potential to lead by example and revitalize its trade momentum, which will be critical to ensuring our future is sustainable and that our societies are more equal.

Concurrent to trade, foreign direct investment (FDI) flows to developing countries have also slowed. FDI flows and regional integration policies have been adversely affected by populist sentiments which have been growing globally. In Asia and the Pacific, growing discontentment with liberalization has to a certain extent been influenced by the inequitable distribution of the benefits of liberalization and rising inequalities. In this context, it is of little surprise that a number of new restrictive trade measures, particularly in G20 countries, were implemented in 2016.

This year's edition of the *Asia-Pacific Trade and Investment Report* (APTIR) does, however, reveal positive news. With a share of 40%, the Asia-Pacific region is still the largest goods exporting region globally. The region's share in commercial services trade continues to strengthen and restrictiveness of services trade has not increased in the region's economies. Furthermore, the region's active actions towards international investment liberalization helped greenfield FDI inflows grow much faster than the global average. Significant progress was also witnessed in the region's efforts to decrease trade costs, illustrated by *the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific*. A significant number of economies in our region have also already ratified the WTO Trade Facilitation Agreement, with the 12 remaining Asia-Pacific economies on track to ratify the Agreement soon.

In addition to these developments, Asia and the Pacific also witnessed the first signs of some consolidation among the preferential trade activities in the region. Nevertheless, after the results of the recent United States election, it appears that at least one of the mega-regional agreements signed in 2016, has an uncertain future. This is disappointing, and represents a considerable loss in terms of time and costs for the countries that were involved in negotiating this agreement. Moving forward, these developments may, however, allow the region's economies to focus more on South-South integration and enable them to promote trade and investment linkages suited to their development aspirations.

I recommend the *Asia-Pacific Trade and Investment Report 2016: Recent Trends and Developments* to all Governments, development partners and other stakeholders. Together with 5 subregional and almost 30 country trade briefs, this Report offers comprehensive evidence that will help in the introduction of well-informed trade and investment trends and policies across the region. Given that the short-term prospects for international trade are not promising, the changing patterns and prospects outlined in this Report highlight that achieving the 2030 Agenda will require the continued and dedicated efforts of our region's economies to create a strong, vibrant and enabling environment for international trade and investment.

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EXECUTIVE SUMMARY

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

Merchandise trade in trouble

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

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