

Chapter II

International trade

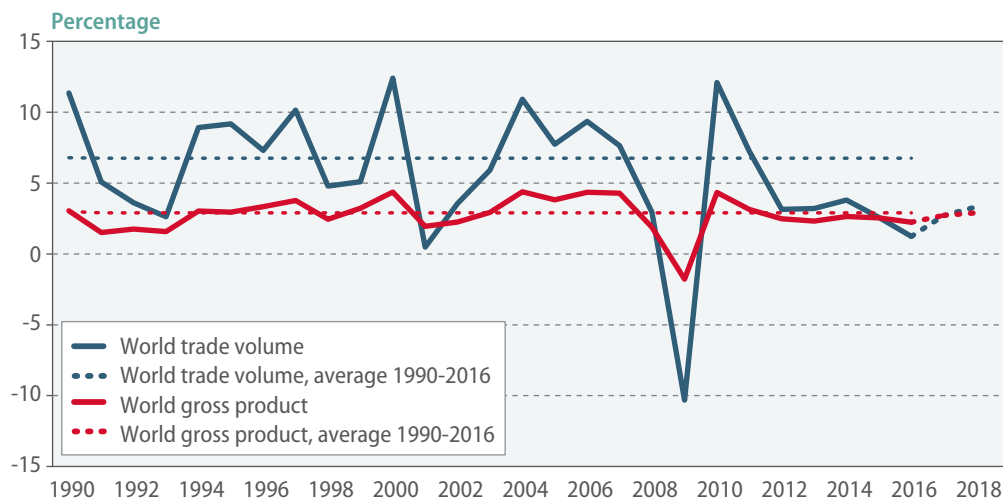
Trade flows

General trend in trade flows

Global trade flows weakened further in 2016. At the slowest pace since the Great Recession of 2009, the volume of world trade is estimated to have grown by a meagre 1.2 per cent. The downward shift in world trade growth in recent years has been significant: in the two decades prior to the global financial crisis, the average growth of the volume of world trade was about 7 per cent, but it slowed down to below 3 per cent between 2012 and 2016 (figure II.1). More worrisome is the substantial decline in the ratio of global trade growth to world gross product (WGP) growth, dropping from an average of 2:1 in 1980–2008 to 1:1 recently, and even lower in 2016.

Figure II.1

Growth of volume of world trade and growth of world gross product, 1990–2018



Source: UN/DESA.

Note: Growth for 2016 is partially estimated; growth for 2017 and 2018 are forecasts.

A number of factors are behind the slowdown of global trade flows in recent years. Some of these are cyclical and others structural (see Constantinescu and others, 2015; European Central Bank, 2016; International Monetary Fund, 2016c). Since the global financial crisis, the subdued gross domestic product (GDP) growth and the change in the composition of aggregate demand in many countries seem to have significantly impacted trade

A demand composition effect contributed to the slowdown in trade

Import demand is more sensitive to fixed investment in many countries

flows. In particular, a substantial weakening in fixed investment growth in both developed countries and emerging economies in the aftermath of the crisis appears to be highly correlated with the slowdown in global trade flows (figure II.2).

On average, capital goods account for about 39 per cent of world merchandise trade. Consequently, in many countries, import demand is more sensitive to fixed investment than other expenditure components of GDP. For instance, for a sample of 18 OECD countries, the average import intensity of investment, exports, private consumption and public consumption are respectively 32, 28, 25 and 10 per cent (figure II.3). According to some studies, the compositional effect explains a significant part of the plummet of imports during the financial crisis and the subsequent decline in the ratio of import growth to GDP growth for major developed countries (Bussière and others, 2013).

Figure II.2

Year-on-year change in global gross fixed capital formation and growth of world trade, 1990–2015

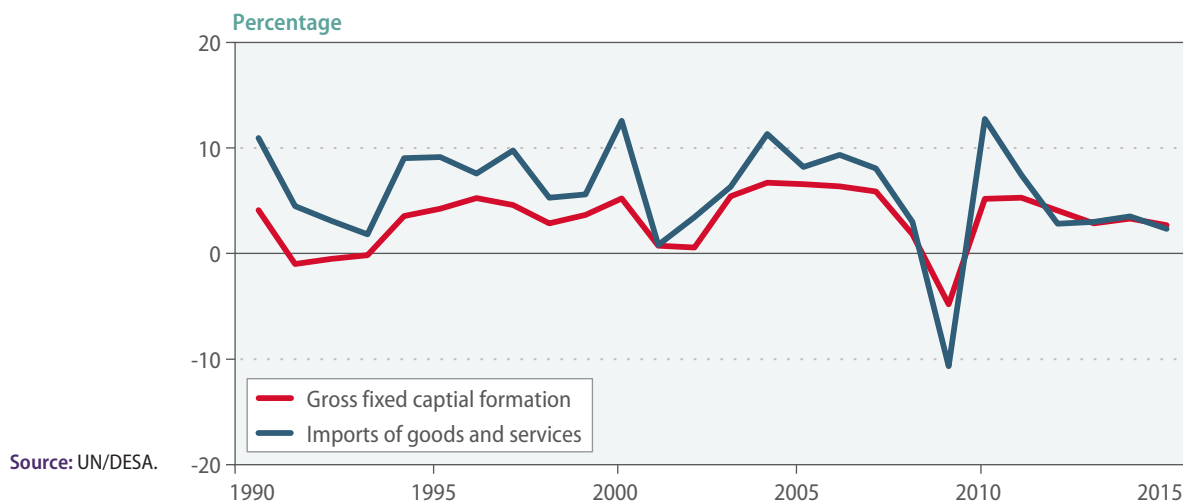
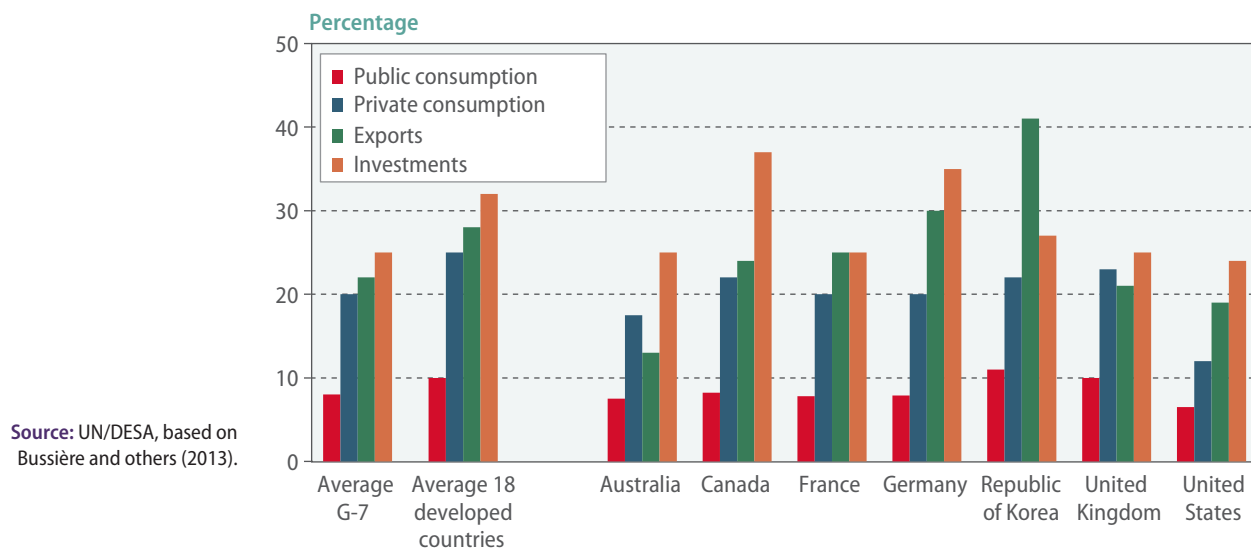


Figure II.3

Import intensity of the expenditure components of GDP



Empirical studies also show that heightened uncertainties in the aftermath of the global financial crisis, in terms of increased volatility in financial markets, including equities, bonds, currencies and commodity prices, may have had a direct adverse impact on international trade flows. For instance, Novy and Taylor (2014) show that in response to uncertainty shocks, firms adjust their orders to foreign intermediaries more strongly than to domestic ones, given differences in their cost structure. As a result, heightened uncertainties lead to a larger contraction of international trade flows than of domestic sectors.

Diminished expansion of international global value chains (GVCs) has also significantly subdued trade flows. GVCs expanded substantially during the 1990s and 2000s, driven by “efficiency-seeking” foreign direct investment to establish International Systems of Integrated Production (ISIP) in sectors such as automobiles, electronics and apparel. This led to a boom in international trade flows in the 1990s and early 2000s, but has noticeably decelerated in the last decade. As a case in point, the share of Chinese imports of parts and components in merchandise exports has decreased from 60 per cent in 2000 to less than 35 per cent in recent years (Constantinescu and others, 2015). This is partly because a number of manufacturing plants have moved their operations into other countries such as Bangladesh and Viet Nam due to increasing labour costs in coastal areas of China.

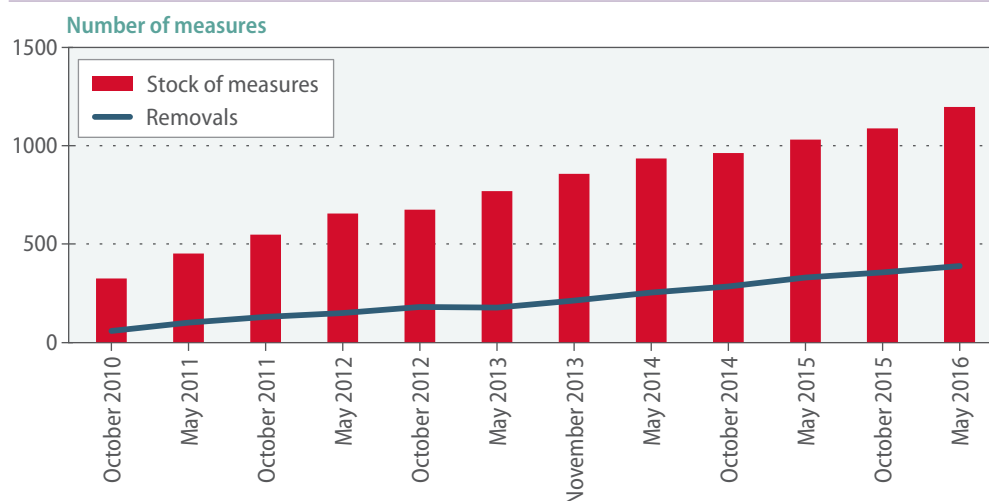
In addition to waning GVC expansion, the pace of dismantling trade barriers between countries has also diminished. The World Trade Organization (WTO) Doha Round of multilateral trade negotiations has not progressed in supporting trade flows in recent years, and the effects of Regional Trade Agreements (RTAs), such as the possible Trans-Pacific Partnership, remain uncertain. Moreover, the rise of trade-restrictive measures observed since the financial crisis is becoming more widespread across both developed and developing countries (WTO, 2016a; European Commission, 2016). These restrictive measures have mainly appeared as non-tariff barriers. Between October 2015 and May 2016, the Group of Twenty (G20) countries implemented 145 new trade-restrictive measures, marking the highest monthly average since 2009. Trade-restrictive measures in place increased from 324 in 2010 to 1,196 in 2016 (figure II.4), and 75 per cent of all trade-restrictive actions executed since the financial crisis are still in place (WTO, 2016a).

Heightened uncertainties also have a negative effect on trade

A slower expansion of global value chains also tapers trade growth

Slower progress in trade liberalisation likewise leads to a more tepid trade expansion

Figure II.4
Trade-restrictive measures, G20, October 2010–May 2016



Source: WTO (2016a).

The rising number of trade restrictions is mostly explained by the rise in anti-dumping actions, safeguard actions and countervailing duty measures

Trade covered by these restrictive measures is about 6 per cent of G20 imports and about 5 per cent of global imports. Anti-dumping actions, safeguarding actions and countervailing duty measures account for most of the rise in trade-restrictive measures, as well as the creeping demand for local content. Meanwhile, bailouts and subsidies continue to represent a large proportion of trade-distortive measures in place. While the empirical evidence on the linkage between the recent upswing in trade-restrictive measures and the observed slowdown in global trade growth remains limited, if protectionist tendencies persist and intensify, this will likely weigh on global trade prospects.

Strong trade growth in the past was also due to exceptional historical events

The recent rise of local content requirements, or the so-called “localisation measures”,¹ can change the balance between trade and foreign direct investment (FDI) strategies of transnational firms. Some firms are implementing more aggressive localisation strategies worldwide, favouring the FDI approach to serving external markets (Evenett and Fritz, 2016; Bathia and others, 2016). Interestingly, in 2015, cross-border mergers and acquisitions in the manufacturing sector peaked at an historical high of \$388 billion (UNCTAD, 2016b).

From a long-run perspective, the strong trade growth relative to world gross product (WGP) growth in the 1990s and 2000s, at a ratio of 2:1, was also driven by historical events which are not repeatable. This includes the integration of the economies in transition, China and other developing economies into the global economy, which significantly reduced barriers to international trade and investment. China’s export growth surged at the annual rate of 20 per cent for about two decades during and after its accession to the WTO. Similar one-off events include increased trade and monetary integration within the European Union, especially the adoption of the euro. In addition, the revolution in information and communication technology (ICT) and other technologies led to lower global transportation costs.

Trade growth is expected to rebound slightly

A slight rebound is expected for global trade growth, at a pace of 2.7 per cent in 2017 and 3.3 per cent in 2018, along with some improvement in WGP growth (see chapter I), but the ratio of global trade growth to WGP growth is not expected to return to its historical highs in the foreseeable future.

Trade in services

Trade in services has been more resilient than trade in goods

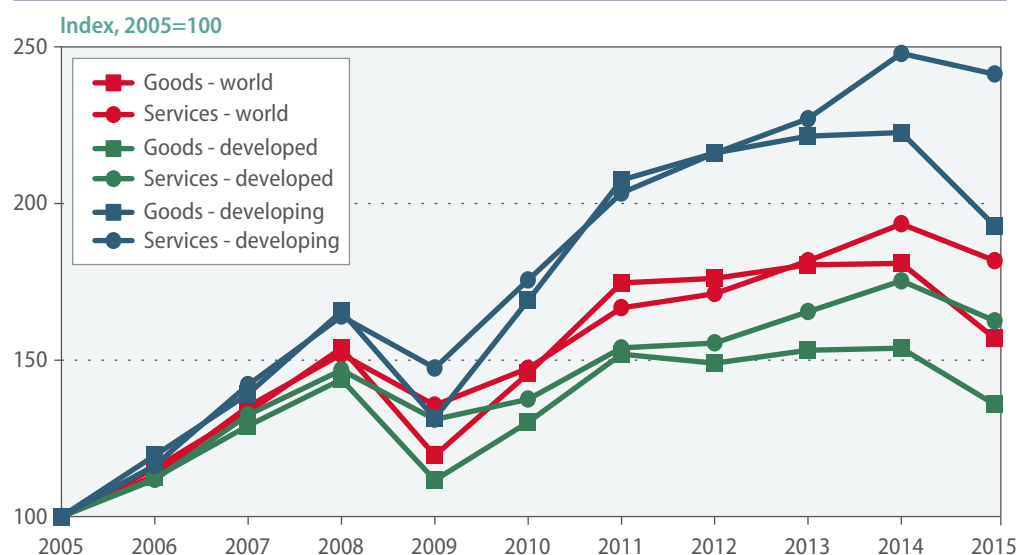
Services remain a key avenue to realising international trade potential. Although the value of global exports in services decreased by about 6 per cent from \$5.1 trillion in 2014 to \$4.8 trillion in 2015, trade in services has been more resilient than trade in goods, as observed after the global financial crisis. This trend holds for both developed and developing economies (figure II.5), highlighting the relevance of services for export diversification. As in goods trade, transition economies took the greatest decline, exceeding 15 per cent. Least developed countries (LDCs) constitute a notable exception, with trade in services growing 1.3 per cent in 2015.

Major economies were the main services exporters

The world’s largest exporters of services in 2015, which are similar to the largest exporters of goods, continued to be major economies, including the United States of America, accounting for 14.9 per cent of global exports in services, followed by the United Kingdom of Great Britain and Northern Ireland at 7.3 per cent, then China at 6 per cent and Germany with 5.3 per cent. Meanwhile, developing and transition economies have increased their share in global trade in services, from 23 per cent in 2005 to 31 per cent in 2015. The share of LDCs in global services trade still lies below 1 per cent and has only expanded from 0.5 per cent in 2005 to 0.8 per cent in 2015.

¹ Localisation measures include not only local content requirements but also tax, tariff or price concessions in local procurement, and tailoring import licensing procedures to promote domestic purchases and reserve lines of production to domestic firms, among others.

Figure II.5
Trade in goods and services, global and by country groups, 2005–2015



Source: UNCTADstat.

Exports of services from developing and transition economies grew more than that of developed economies in almost every sector between 2005 and 2015, including some higher value-added sectors, such as financial services, telecommunication, computer and information services, and other business services. Between 2014 and 2015, trade in telecommunication, computer and information services and intellectual property grew in developing economies, due to growth in Asia and Latin America and the Caribbean, in contrast to a decline in developed economies (figure II.6).

Nonetheless, developing economies still show a pattern of specialization in traditional services such as transport and travel, especially in Africa and LDCs, while developed economies continue to lead in higher value-added services, such as financial and insurance services (figure II.7).

The share of services in international trade is significantly lower than the shares of services in domestic output and employment. The services sector accounts for roughly three-quarters of value-added and employment in developed economies, and close to half in developing countries and economies in transition. However, the share of services in trade is only about one-quarter for developed economies and 15 per cent for developing countries and economies in transition. This is partly due to an underestimation in statistics of trade in services.

In addition, data on cross-border trade in services do not capture the significant value-added of services embedded in goods, particularly in sectors such as energy, chemicals, machinery and transport equipment. In 2011, services accounted for 59 per cent of the gross value-added of exports in developed economies and 43 per cent in developing and transition economies.

This is much higher than the contribution of services to total exports, as measured by traditional cross-border data. Even in a simple jacket, physical components, including labour, fabric, lining, buttons, sleeve heads, shoulder pads, labels and hangtags, account for only 9 per cent of the price; the remaining 91 per cent of the value is for intangible assets, including a wide range of services such as retail, logistics, banking and marketing (see Low, 2013).

Exports of services growth was stronger in developing and transition economies

The share of services in trade remains lower than in domestic output

Data insufficiently reflect the value of services embedded in goods

Figure II.6
Growth rate in trade in services by country groups and sectors, 2005–2015 (CAGR) and 2015

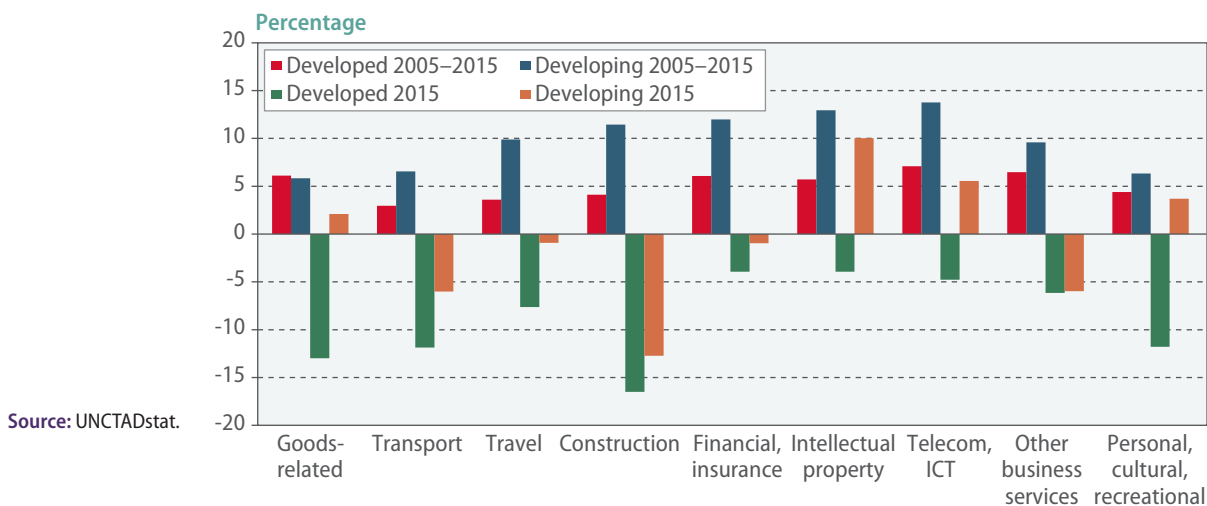
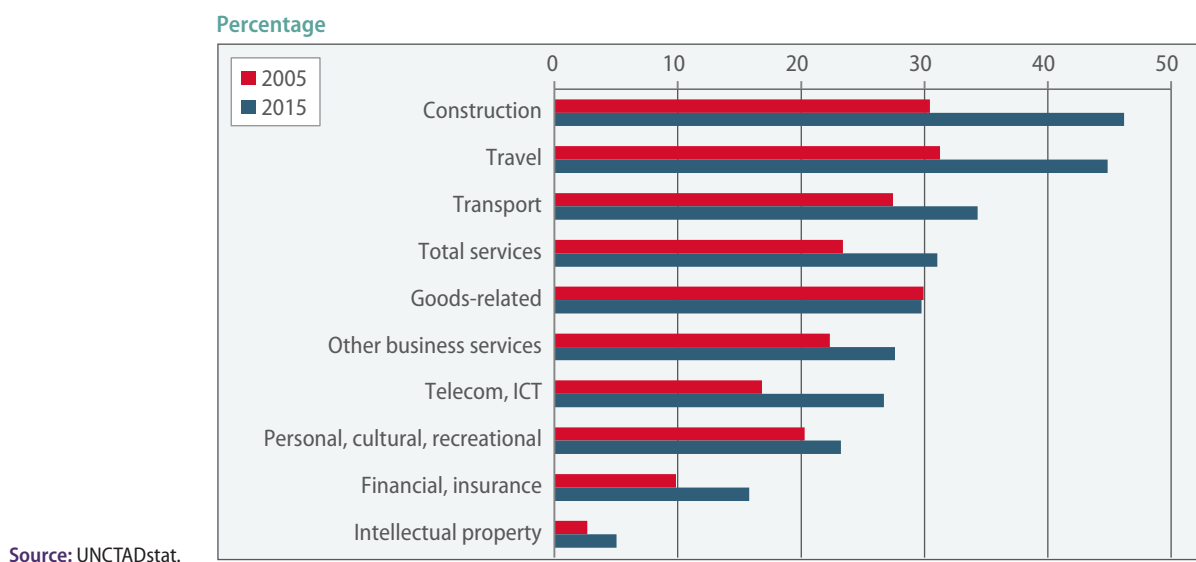


Figure II.7
Developing economies, share in global services exports by sector, 2005 and 2015



Services are a vital enabling factor for trade

This illustrates the vital role of services, including those related to infrastructure, as enablers of trade in all economic sectors and as direct determinants of economic productivity and competitiveness (see UNCTAD, 2012). All economic sectors combine a services element at all stages in GVCs, including pre-production, production, and post-production. Back-office services in the form of financial, communications, business services and utilities account for 33 per cent of all services activities in the whole value chain; production services such as quality control, engineering, security and medical services for 26 per cent; pre-production services for 18 per cent; post-production and sales services for 9 per cent; post-sales services for 8 per cent and establishment services for 6 per cent (see Low, 2015).

Transport, for example, plays a key role in linking consumers and producers, and integrating markets by facilitating exports and imports. Improving transport infrastructure, logistics and cross-border trade facilities is central to reducing delivery times and costs, and therefore for the integration into GVCs. For developing countries which are short on transport infrastructure, especially for landlocked developing countries, this is particularly important. Telecommunications, computer and information services drive economic and social activity and lead to greater productivity and competitiveness. Cross-border trade also gets a boost (box II.1).

Financial services promote domestic and international transactions, mobilise and channel domestic savings and open up credit for small and medium-sized enterprises (SMEs) and households. This fosters supply and export capacity, supporting entrepreneurship and linking SMEs to GVCs. Another benefit of financial inclusion is speedier, safer and less costly remittances.

Transport and ICT are key service sectors

Financial services are driving economic activity

Box II.1

Digital economy and ICT services-enabled trade

Telecommunications and ICT services are crucial in facilitating modern economic and social activities, contributing to productivity and competitiveness. As infrastructure services, they provide inputs to the overall economy, strengthening supply capacity for other sectors. For example, two billion people currently do not have access to a bank account but, of these, 1.6 billion have access to a mobile phone; therefore, telecommunications and ICT services can play a key role in supporting financial inclusion through digital financial services (UNCTAD, 2016c; UNCTAD, 2016d), with reduced costs and increased coverage.

The benefits of telecommunications and ICT services are further enhanced in the context of international trade, where information and connectivity barriers are traditionally higher. ICT-enabled solutions improve connections between providers and customers, enhance knowledge on the traded product and alternatives, provide payment solutions and in some cases facilitate distribution services.

Cross-border trade is enhanced by ICT-induced efficiencies, such as reductions of transport costs and electronic means of delivery. Online activities often have backward and forward linkages involving all modes of services. The e-commerce, and ICT-enabled trade in general, is crucial for SMEs, enabling them to access new domestic and international markets and participate in global value chains (GVCs) (UNCTAD, 2016c; UNCTAD, 2016d).

E-commerce became an issue on the Doha Development Agenda and gained new dynamism at the WTO even without a negotiating mandate (WTO, 2016b). The global value of e-commerce in 2013 was estimated at \$15 trillion in business-to-business (B2B) transactions and at \$1.2 trillion in business-to-consumer (B2C) transactions (UNCTAD, 2015a).

There are several conditions for developing e-commerce, including a comprehensive enabling ecosystem. For example, in China, the e-commerce company Alibaba established a diverse ecosystem to enable trade through a network of services, including an e-payment system which soon expanded to banking, investment, and clearing house for cross-border trade. One of its affiliates, Alipay, has approximately 400 million users of its online payment services.^a Alibaba's platform integrates consumers, manufacturers, customs clearing, transport and several financial services such as credit, foreign exchange and insurance (UNCTAD, 2014a).

Furthermore, SMEs account for a larger share of businesses trading through Alibaba than in traditional markets. Chinese companies trading through Alibaba can reach up to 98 export destinations, almost double that in other markets. A 10 per cent rise in Internet use within a country increases the number of products traded internationally by 1.5 per cent and raises the average trade value per product by 0.6 per cent (World Bank, 2016a).

E-commerce has not gone far enough in narrowing the digital divide. This divide has not decreased in recent years in terms of the number of Internet users, and low and middle-income economies are still lagging behind in fixed broadband subscriptions (figure II.1.1). SDG target 9.c calls for a boosted access to ICT and for universal and affordable access to the Internet in LDCs by 2020, where 85 per cent of

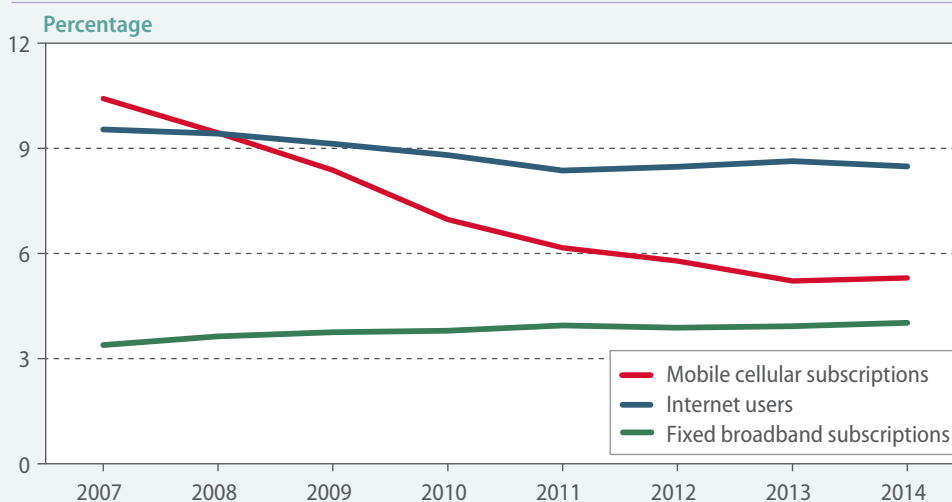
^a <https://intl.alipay.com/in>
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(continued)

Box II.1 (continued)

Figure II.1.1

Digital divide: gap of low and middle-income economies from the world average, 2007–2014 (per 100 users or subscriptions)



Source: UNCTAD calculations based on the World Bank WDI.

Note: Based on World Bank classification; low and middle-income economies are those in which 2015 GNI per capita was \$12,475 or less.

people are offline (WTO, 2016b). In 2016, the e-commerce index of UNCTAD was 71 for developed economies and 24 for Africa (UNCTAD, 2016e), confirming an e-commerce divide wider than the digital divide.

As already mentioned, a customized and coherent regulatory and institutional framework must work in conjunction with e-commerce, especially in the context of exponential technological change, increasing convergence of telecommunication, computer and broadcast technologies, blurring between content and carriage and overlap between telecommunication and financial services in some segments (UNCTAD, 2016c). In this regard, UNCTAD developed Services Policy Reviews (SPRs). The SPR of Rwanda, for example, identified cyber security and data protection regulatory issues that needed to be dealt with by legislative processes.

The global trade dimension of e-commerce requires an examination of undue barriers to trade and regulatory divergence, with a view to enhancing transparency, objectivity and coherence between regulatory and international trade agendas. This should support e-business activities. The sequencing of regulatory reform and liberalization is critical (UNCTAD, 2016f).

The Republic of Korea has set a good example with higher Internet access, where 98.5 per cent of households had Internet access at home in 2014 (ITU, 2016). This is partly explained by public policies prioritizing ICT and earmarking the universal fund from the sector in telecom infrastructure development. Additionally, telecom liberalization has been pursued multilaterally and through RTAs while seeking coherence with national regulations. The country has established coordination mechanisms, including the State Council chaired by the President or by the Prime Minister to settle disputes.

Cross-border commitments in telecommunications and ICT services are still limited in the context of the General Agreement on Trade in Services (GATS). Unbound market access is higher than full market access in developed economies and higher than full and partial market access in developing economies (WTO, 2016c). While RTAs increased binding commitments, controversial regulations, such as commercial presence and localization requirements, still exist.

A Trade in Services Agreement (TISA) may propose that data protection issues be addressed by mutual recognition of consumer protection systems instead of local presence requirements. There are also concerns regarding overly aggressive e-commerce provisions in some trade agreements. In India, a cautious, gradual, and learning-by-doing approach to services liberalization allowed the country to become a successful exporter. Policy space was preserved by first initiating unilateral liberalization and rolling it back at times.

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Crucially, from a development perspective, a 10 per cent rise in remittances may contribute to a 3.5 per cent reduction in the share of people living in poverty (UNCTAD, 2014b; UNCTAD, 2015b). This is recognised by target 10.c of the Sustainable Development Goals (SDGs) on reducing transaction costs on migrant remittances to less than 3 per cent. Financial services such as savings, loans and insurances play a vital development role in remittances by providing options for investing these private funds in productive activities, social services and infrastructure (UNCTAD, 2013a). These options may comprise diaspora funds which could be enhanced through financial education and tax and credit incentives. Remittances also represent a promising source of demand for financial services and may thus contribute to financial inclusion.

In general, efficient business, professional and infrastructure services are a must in supporting GVCs. Research and development, product design and marketing services can also bolster export diversification and increase export and supply capacities.

The 2030 Agenda for Sustainable Development, including the SDGs themselves, needs well-functioning infrastructure and basic services in order to succeed. Infrastructure services are reflected in SDG 5 on gender equality and in SDG 9 on infrastructure, industrialization and innovation. Specific infrastructure services are reflected in other goals and targets: energy in SDG 7; ICT services in SDG 4 on education, as well as SDGs 5 and 9; transport services in SDG 11 on cities and human settlements; and financial services in SDG 1 on ending poverty, SDG 2 on ending hunger, and SDG 5 as well as SDG 8 on economic growth.

Policy, regulatory and institutional frameworks which ensure efficient and competitive markets while supporting available, affordable, convenient, equitable and high-quality services are also necessary to achieve development gains, especially from infrastructure.

These frameworks should address external and coordination issues so that service sectors and the economy at large are aligned and complement each other. However, devising frameworks best fit to national circumstances and priorities is a difficult challenge. They need to function within rapidly evolving national regulatory landscapes to ensure that they better respond to new models in ICT services; to seek a pro-development outcome between financial stability, security and inclusion; and to address climate change and energy efficiency goals through transport and energy regulations. Challenges are especially acute for some developing countries with fiscal and institutional constraints, including issues related to the political commitment, accountability and independence of regulators and regulatory capacity.

Regulatory and institutional frameworks are also increasingly subject to trade liberalization requirements under multilateral, plurilateral and regional trade negotiations which aim to address the potential trade-restrictive effects of domestic regulation. Policy coherence must be established between services regulation and liberalization so that the benefits of opening markets are balanced with the need to implement regulatory measures in support of public policy objectives. In other words, smart regulations should cohere with development needs and minimize inadvertent trade-restrictive effects. Regulatory and institutional frameworks should be built in advance to accommodate the content, pace and sequencing of liberalization and be equipped to adapt to new challenges, including those from liberalized markets (UNCTAD, 2016c). Lessons can be drawn from the UNCTAD Services Policy Reviews.

Another notable sector in trade in services, international tourism, has shown some resilience amid an overall sluggish trend in international trade (box II.2).

The 2030 Agenda reflects the importance of services

Policy frameworks are a condition for realizing gains from services

Regulations are more and more subject to trade liberalization processes

Box II.2

Trends in international tourism**International tourist arrivals up 4 per cent in the first half of 2016**

International tourist arrivals (overnight visitors) increased by 5 per cent in 2015, reaching a record 1,186 million, up from 1,134 million in 2014. Demand for international tourism remained robust, with growth exceeding the long-term average for the sixth year in a row, following the 2009 global economic crisis. China, the United Kingdom and the United States led outbound tourism in their respective regions, fuelled by their strong currencies and economies, driving intraregional demand. This trend continued into the first nine months of 2016, with January-September arrivals increasing by 4 per cent compared to the same period last year, in line with the estimate by the World Tourism Organization (UNWTO) of 3.5 to 4.5 per cent for 2016.

By regions, in the first nine months of 2016, international arrivals increased by 9 per cent in Asia and the Pacific, 4 per cent in the Americas, 2 per cent in Europe and 8 per cent in Africa, with Sub-Saharan destinations rebounding strongly, while North Africa continued to report weak results. Limited data for the Middle East points to an estimated decrease of 6 per cent, though results vary from destination to destination (UNWTO, 2016a; UNWTO, 2016b).

Global factors affecting tourism flows

Three major factors influenced tourism flows in 2015 and the first half of 2016: strong exchange rate fluctuations, the decline in prices of oil and other commodities, and ongoing global concern about safety and security. These factors did not greatly alter overall tourism volumes, but influenced destination choice, and therefore the size and direction of specific tourism flows.

Exchange rate movements shifted the purchasing power of many source markets and the price competitiveness of multiple destinations. The appreciation of the US dollar, in particular, fuelled outbound demand from the United States. Euro area destinations benefitted from more favourable exchange rates, as did a number of emerging economies with weaker currencies. Drops in prices of oil and other commodities contributed to tourism growth globally, aided by lower prices of transport and increased disposable income in importing countries, although it weakened demand from commodity exporting markets.

Finally, security and geopolitical tensions have redirected travel flows and remain a global challenge. Most noticeably, terrorist actions in different locations around the world such as Belgium, Egypt, France, Tunisia and Turkey had negative effects on tourism. On a positive note, many countries around the world reported double-digit growth, including major destinations like Canada, Japan, Spain and Thailand.

Share of international tourism rises to 7 per cent of world exports

International tourism receipts reached US\$1,260 billion in 2015, up 4 per cent in real terms (taking into account exchange rate fluctuations and inflation) from 2014. International passenger transport (rendered to non-residents) generated another US\$211 billion in 2015. Total tourism export earnings reached US\$1.5 trillion, or US\$4 billion a day on average. International tourism represents 7 per cent of the world's exports in goods and services, up from 6 per cent in 2014, as it has grown faster than total world trade (figure II.2.1). International tourism has proven to be more stable and resilient than trade. As an export category, tourism now ranks third after fuels and chemicals, and ahead of food and automotive products (figure II.2.2).

Tourism is an essential component of export diversification and has shown a strong capacity to compensate for weaker export revenues in many commodity and oil exporting countries. For many developing countries, it is an important, if not critical part of the economy, generating a large part of their export revenues and creating much needed employment. Tourism accounts for 10 per cent of world gross product and one in 11 jobs globally.

In order to realize the full potential of revenue generation and job creation through tourism, destinations must continue to create adequate conditions in terms of planning and promotion. Policies should aim to build a healthy business environment, promote travel facilitation and ensure appropriate

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Figure II.2.1

Year-on-year real change in international tourism (BOP Travel & Passenger transport) and merchandise trade, 2006–2015

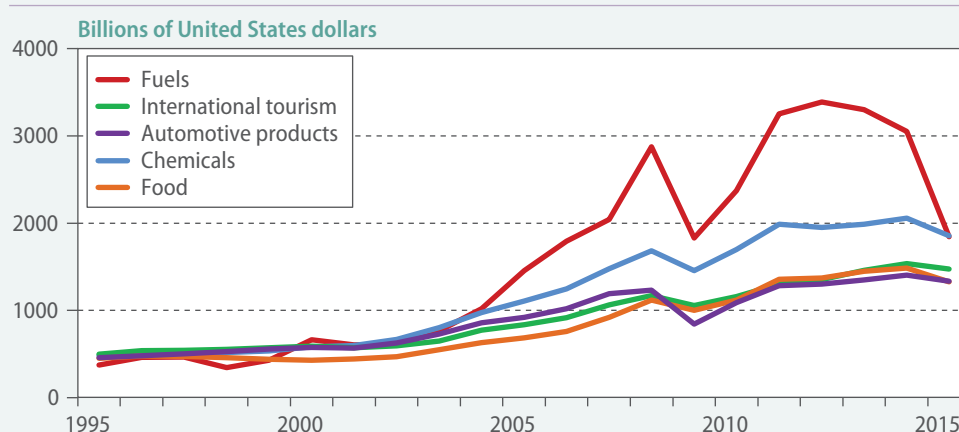


Box II.2 (continued)

Source: United Nations World Tourism Organization (UNWTO) and World Trade Organization (WTO).

Figure II.2.2

International tourism (BOP Travel & Passenger transport) and exports, world total, 1995–2015



Source: United Nations World Tourism Organization (UNWTO) and World Trade Organization (WTO).

infrastructure to accommodate growth, including the development of roads, railways and airports. Air connectivity is particularly important, especially for remote island states which depend on tourism and trade. Policies must also strive for the adoption of sustainable production and consumption patterns, to enhance environmental and social outcomes, as well as improve economic performance.

International Year of Sustainable Tourism for Development (IY2017)

The importance of tourism for economic development around the world is well reflected in the designation of 2017 as the International Year of Sustainable Tourism for Development^a by the United Nations General Assembly at its 70th session. The International Year resolution states that tourism can make a significant contribution to the three dimensions of sustainable development — economic, social and environmental — and can create decent jobs and generate trade through its close links to other sectors. IY2017 aims to support a change in policies, business practices and consumer behaviour towards a more sustainable tourism sector in the context of the SDGs.^b Tourism is featured as targets within three specific SDGs (8, 12 and 14), which focus on sustainable and inclusive economic growth, job creation and sustainable consumption and production. In many developing and least developed countries, tourism is the most viable, effective and sustainable option for development and poverty alleviation.

^a See Roadmap and other information on the International Year of Sustainable Tourism for Development at: <http://www2.unwto.org/tourism4development2017>.
^b More information on the Sustainable Development Goals (SDGs) at: <http://icr.unwto.org/content/tourism-and-sdgs>.

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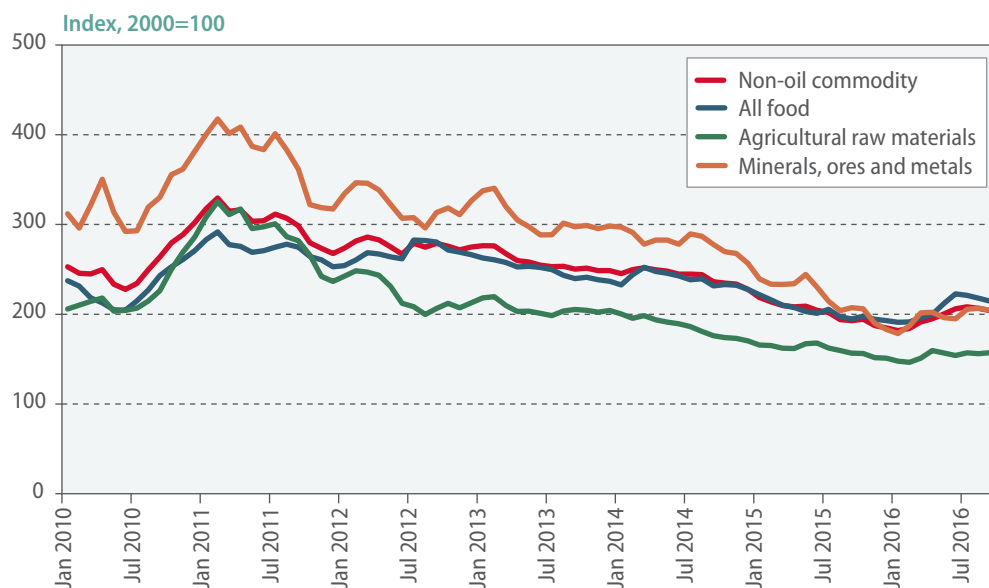
Trends in commodity prices

Commodity prices
rose in 2016

The UNCTAD non-oil nominal commodity price index has been trending upwards since the beginning of 2016 (figure II.8). It stood at 204.0 points in September 2016, compared to 181.8 points in January 2016, which constitutes a 12.2 per cent increase. On a year-on-year basis, commodity prices had increased by 5.8 per cent from September 2015. Overall, commodity prices remain substantially lower than at the peaks of the boom period. In February 2011, the index was at 329.5 points, implying that its value in September 2016 was still 38.2 per cent lower than its peak.

Figure II.8

UNCTAD non-oil Commodity Price Index, January 2010–September 2016



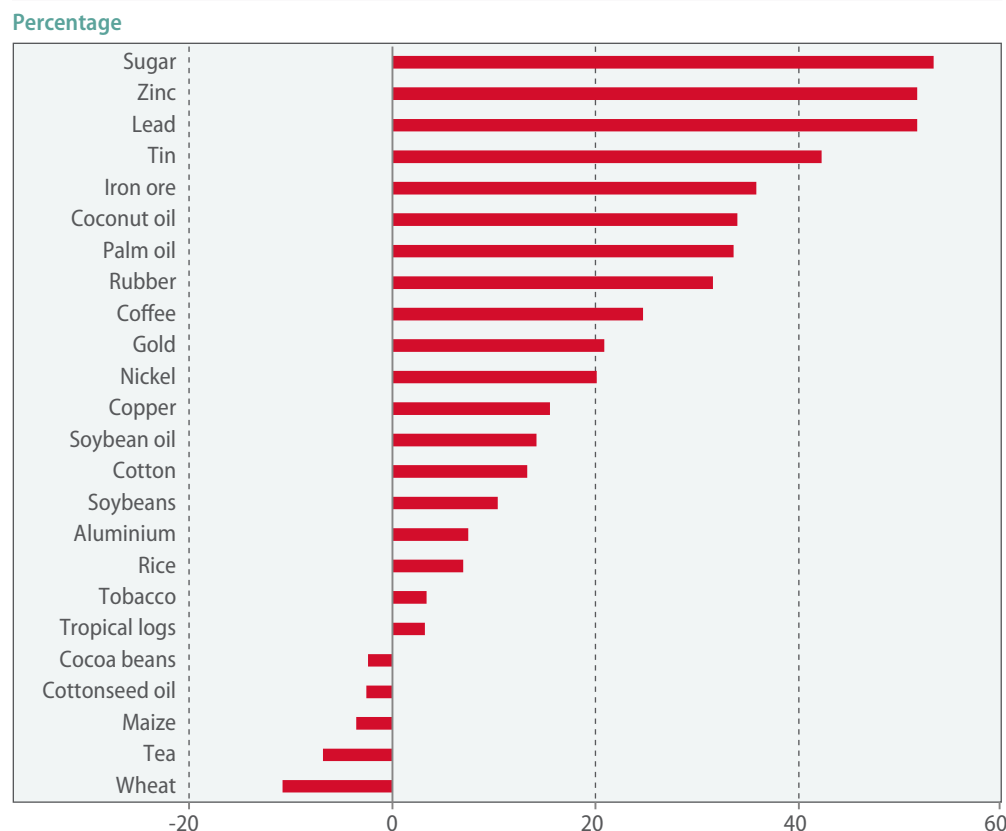
Supply side factors have
underpinned higher
commodity prices

Supply cuts and output uncertainties, especially for metals and agricultural commodities, pushed up commodity prices during 2016. For agricultural commodities, El Niño-related adverse weather conditions caused output shortfalls for commodities such as palm oil, rice and coffee. Mineral, ore and metal supply has been constricted by production suspension, for example, with nickel mines in the Philippines, copper mines in the Democratic Republic of the Congo and Zambia and zinc mines in Australia and Peru. A partial reversal of the United States dollar appreciation and rising oil prices also supported gains in commodities prices during the first two quarters of 2016.

Food prices showed the
steepest increase

Among the subcategories of the UNCTAD non-oil nominal commodity price index, minerals, ores and metals prices showed the steepest increase from January to September 2016, at 14.5 per cent, followed by food at 12.2 per cent. The upward price trend for agricultural raw materials was more subdued at 6.4 per cent. Prices of almost all major commodities increased, albeit from a relatively low base. Notable exceptions were wheat and tea, which experienced significant price drops, as well as cocoa beans, cottonseed oil and maize, for which prices mildly decreased (figure II.9).

Figure II.9
Percentage change of the price index of selected commodities between January and July 2016



Going forward, large swings in commodity prices seem unlikely. Supply conditions could ease for some commodities. For instance, Indonesian ferronickel exports to China are picking up and replacing some of the shortfalls in nickel ore supply from the Philippines. Also, copper from new mines in Peru has started to reach the market, counterweighing supply constrictions elsewhere. For other commodities, output remains uncertain. For example, the supply deficit of sugar is forecast to increase. Overall, commodity prices are likely to increase moderately in 2017.

In the outlook, large price swings are unlikely, given slack supply capacities

Food and agricultural commodities

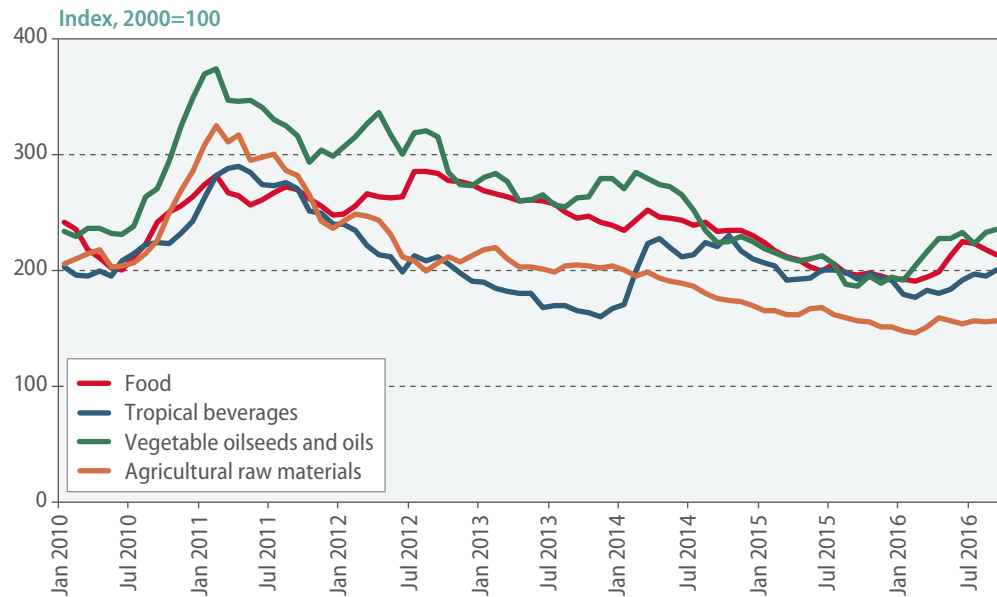
In agricultural food markets, prices generally trended upwards over the first nine months of 2016 (figure II.10). Vegetable oilseeds and oils showed the steepest increase among the three components of the UNCTAD All Food Index, gaining 22.7 per cent, closely followed by food commodities at 10.9 per cent; the price of tropical beverages rose by 11.6 per cent, with the increase owing largely to coffee.

Agricultural commodity prices have trended upwards

Sugar (*Caribbean ports*) registered the biggest price gains — at 53.2 per cent from January to September 2016. In September 2016, the FOB price of sugar at Caribbean ports reached its highest level since July 2012 at US¢ 21.5 per lb. This price spike was mainly

Sugar registered the steepest price increase due to low inventories

Figure II.10
**Price indices of food and agricultural commodity groups,
 January 2010–September 2016**



Source: UNCTADstat.

due to low inventories triggered by a growing production-demand gap, which is expected to further widen after falling output forecasts for Brazil, India and Thailand. Hence, the upward trend in sugar prices is likely to continue in the near future.

Thai rice has seen a major price increase of 26.9 per cent over the first three quarters of 2016 amid production losses due to droughts in India, Thailand and Viet Nam caused by El Niño. In August and September, the rice price plummeted amid projections of gains in world rice production in the 2016/17 season, which could end the price hike in the second half of 2017.

Maize (*Yellow Maize No. 3*) registered a slight price decrease of 3.6 per cent between January and September 2016. With forecasts showing global output to rise in 2016/17, including a record harvest in the United States, price hikes are not likely in 2017.

Two major exceptions to the higher trend of food commodity prices were wheat and tea. The price of wheat (*Hard Red Winter No.2*) reached \$190 per ton in September 2016, its lowest level since June 2010 and second lowest level in a decade. Large harvests in the main producing countries — Canada, the United States and the Russian Federation — are continuing to exert downward pressure on the price of wheat. The price of Kenyan tea declined throughout the first quarter of 2016 based on strong supply and weak demand, reaching a low of US\$ 238 per kg in April 2016, but then made gains, reaching US\$ 298 per kg in September 2016. Prices are expected to remain fairly stable.

The UNCTAD Vegetable Oilseeds and Oils Price Index stood at 236 points in September 2016, up 22.7 per cent since the beginning of 2016 and up 26.4 per cent since September 2015. Almost all individual oilseeds and oils had trended upwards by September 2016. Shortfalls in production of oilseeds such as soybeans in South America and palm oil in South-East Asia due to adverse weather conditions caused by El Niño mainly drove this trend. Tentative forecasts for the 2016/17 growing season show supply will continue to fall short of demand, continuing to push up prices of oilseeds and vegetable oils into 2017.

The first three quarters of 2016 showed mixed results for tropical beverages. While the price of tea dropped considerably, the price of cocoa beans decreased by just 2.4 per cent. It peaked in June 2016 amid a weakening pound sterling and reports of subdued production. Triggered by positive production forecasts for the 2016/17 season, the price of cocoa continued its slide, which looks set to continue. The price of coffee (*ICO composite indicator price*) showed a steep uptick of 24.6 per cent. This was fuelled by droughts in Brazil and a strong Brazilian real. Looking forward, rising world demand combined with uncertainty about key producers' output may continue to exert upward pressure on coffee prices.

With the exception of jute, linseed oil and sisal, prices of all agricultural raw materials increased from January to September 2016. From January to September 2016, the price of rubber (*RSS 3*) rose sharply by 31.6 per cent, driven by an export quota scheme set in force in March 2016 by major producers such as Indonesia, Malaysia and Thailand. However, the September 2016 price was still 74.4 per cent lower than the peak price in February 2011.

Cotton prices (*Cotlook A Index*) also trended upwards, increasing by 13.3 per cent over the first three quarters of 2016. For the 2016/17 season, world production is forecast to increase slightly faster than demand. In addition, the Chinese government started to auction off some of its large cotton stockpiles in May 2016, which could push down global prices by reducing Chinese demand for imported cotton. Overall, a further increase of the cotton price in 2017 does not seem likely.

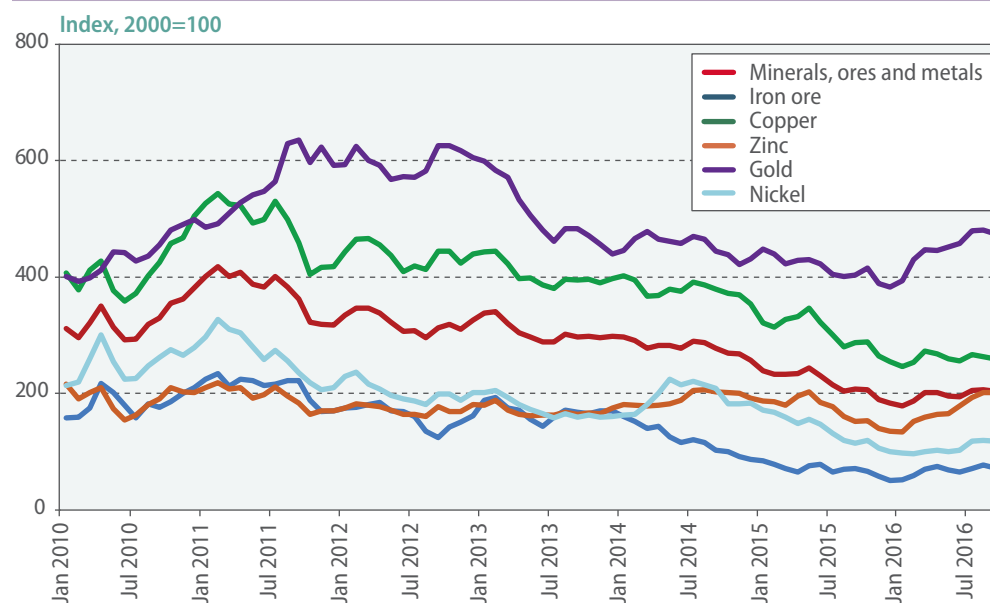
Minerals, metals and ores

In January 2016, the UNCTAD Minerals, Ores and Metals Price Index reached its lowest level since February 2009 at 178 points, which was also the second lowest level in more than a decade. From January 2016 onwards, the index trended upwards, reaching 204.3 points in September (figure II.11). Price increases were mainly driven by supply cuts and uncertainties.

Supply cuts and uncertainties drove up prices of minerals, ores and metals

Figure II.11

Price indices of selected minerals, ores and metals, January 2010–September 2016



Source: UNCTADstat.

The London Metal Exchange (LME) price of nickel increased by 20.1 per cent between January and September 2016, up 2.9 per cent on a year-on-year basis. Mine shut-downs in the Philippines due to environmental concerns were a key driver. The market outlook depends largely on the extent to which the shortfall in Philippine nickel exports, in particular to China, could be replaced by other sources. Early signs indicate that ferromanganese exports from Indonesia are growing, which suggest that nickel supply conditions could ease in 2017.

The iron ore prices at the port of Tianjin climbed 35.8 per cent from a very low basis of \$42 per dry metric ton at the beginning of the year. In September 2016, the price of iron ore averaged \$57 per dry metric ton, which was still down 68.3 per cent from the peak in February 2011. Expectations of substantive low-cost supply reaching the market in the second half of 2016 and early 2017 pose a significant downside risk to the price of iron ore in the near future.

Copper registered the weakest price increase among metals

Copper's price rise was the weakest in 2016, registering an increase of 5.6 per cent between January and September 2016. In September, the LME price of copper stood at \$4,706 per metric ton, less than half of its peak value in February 2011. With estimates showing supply for refined copper growing faster than demand due to expanded operations in existing mines and new mine production (such as in Peru), the outlook for recovery remains subdued.

The LME price of zinc showed a particularly sharp increase of 51.6 per cent during the first three quarters of 2016. The main drivers were supply cuts by major zinc producers. For instance, Glencore closed zinc mines in Australia and Peru, reducing its zinc output by 30.6 per cent in the first half of 2016. Mine closures and supply cuts look set to continue to put upward pressure on the zinc price.

Investment demand drove gold prices higher

The gold price increased by 20.8 per cent from January to September 2016 and by 17.9 per cent on a year-on-year basis. The low-yield environment and macroeconomic uncertainties seem to be the main drivers of increased investment demand for gold (box II.3).

Oil prices

Oil prices have increased but remain affected by excess supply

Global oil prices have generally trended upwards since January 2016 (figure II.12), as developments supported expectations for a narrower gap between oil supply and demand. Nevertheless, the global oil market remained affected by excess supply and elevated inventories in 2016, amid record-high production by several major oil producers, including in the member States of the Cooperation Council for the Arab States of the Gulf (GCC) and the Russian Federation.

Persistent uncertainty over the strength of global growth also weighed on investor sentiments, generating high volatility in the oil market. Against this backdrop, crude oil prices remained subdued in 2016, averaging an estimated \$43 per barrel (2015: \$52 per barrel).

In January, the lifting of sanctions on the Islamic Republic of Iran exacerbated concerns over a widening supply glut in the oil market. Investor sentiments worldwide were also adversely affected by a sharp decline in global equity markets. These developments contributed to the decline of the Brent oil price to a 12-year low of \$26 per barrel on 20 January.

The decline in oil prices reversed as large supply disruptions in Canada, Libya and Nigeria tightened global oversupply conditions. In addition, persistently low oil prices continued to restrain profits and output of the higher cost oil producers. In the United States,

Box II.3

Recent trends and the future of the gold market

Gold is a special commodity. It serves a wide variety of uses including as a store of value, raw material for jewellery and industrial applications and as a conductor in electronic devices.^a Gold is also an important asset class for investors and a component of central banks' reserve holdings. There is a close correlation between gold prices and changes in macroeconomic and geopolitical conditions. In this regard, an analysis of the gold investment market is particularly relevant, given the current environment of heightened uncertainty about the future of the world economy and near-zero and negative rates of return on alternative assets.

Investment was the largest component of gold demand in the first half of 2016 and has been one of the key determinants of gold prices over the past decade. While jewellery has accounted for 56.4 per cent of net cumulative gold demand in 2006–2015, volatility of investment demand, particularly through gold-backed exchange-traded funds (ETFs), was more than twice that of demand for jewellery.

ETFs and physical gold attract different types of investors. For example, in 2013, demand for bars and coins reached its peak of 1,705 tonnes, while ETFs recorded an unprecedented net outflow of 916 tonnes (figure II.3.1). This suggests that to a large extent, investors in ETFs are driven by strategic motives, introducing more volatility in the gold market than physical gold holders who tend to purchase gold with a longer-term perspective. The largest gold ETFs now hold more gold than major central banks. For instance, industry leader SPDR Gold Shares has more than \$40 billion worth of assets under management; they hold more gold than the Bank of Japan, the Reserve Bank of India or the European Central Bank (ECB). This seems to illustrate the commodities financialization hypothesis, which is defined as the expanding role of financial motives, markets, actors and institutions in the development of commodity prices.

After a steady decline from the historic peak of \$1,772 per troy ounce in September 2011 to \$1,068 per troy ounce in December 2015,^b the price of gold increased by 21.9 per cent between January and July 2016.^c Two factors seem to have stimulated demand for investment and thus strengthened the price of gold — uncertainty and low interest rates.

Uncertainty pushes economic agents to buy gold as a safe haven product. For example, the spot price of gold increased by 7.5 per cent within two weeks following the vote by the United Kingdom to leave the European Union ("Brexit") on 23 June 2016. Also, from the day that Lehman Brothers announced that it would file for Chapter 11 bankruptcy protection on 15 September 2008, triggering a global economic crisis, the price of gold increased by 15.1 per cent in two weeks' time.

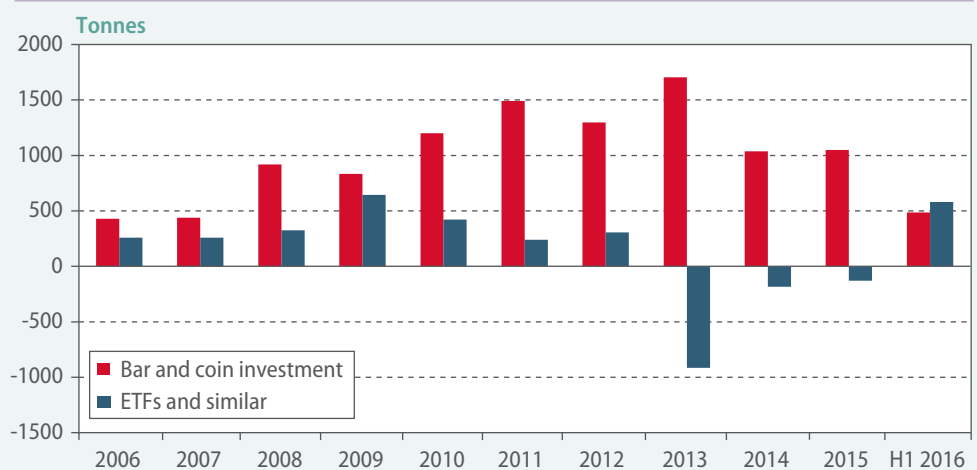
^a See also UNCTAD (2016f).

^b Data from UNCTADStat database.

^c Calculation based on data from the London Bullion Market Association (LBMA).

Figure II.3.1

Gold investment demand, 2006–mid-2016



(continued)

Source: World Gold Council (2016).

Box II.3 (continued)

Low interest rates increase the attractiveness of gold by decreasing the opportunity costs of holding it, suggesting a negative correlation between rates of return on alternative assets and the price of gold. For instance, the coefficient of correlation between monthly gold prices and 10-year United States government bond yields from January 2005 to July 2016 is -0.83.^d In the first quarter of 2016, policy rates have been cut to zero and below zero by the ECB and the Bank of Japan, respectively. This reinforced the low-yield environment in major economies and could be a factor contributing to the current increase in the price of gold.

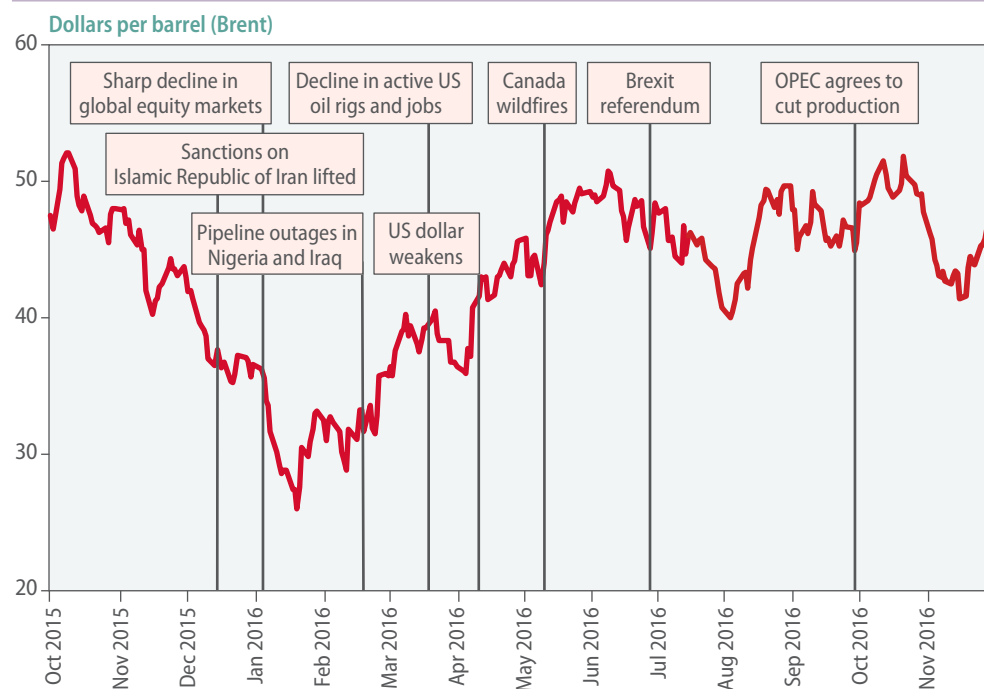
The medium-term outlook for the gold market strongly depends on expectations regarding the development of investment demand. In this context, a rise of the policy rate by the United States Federal Reserve Board is likely to have a moderating effect on gold investments and prices. Also, a further strengthening of the United States dollar against major currencies could weigh on the gold price. On the upside, policy rates in Japan, the euro area and the United Kingdom are expected to remain negative or near zero at least in the near future. The uncertainty created by the Brexit vote will continue to exert influence and drive risk-adverse capital towards gold. Furthermore, central bank demand for gold has been substantial over the past five years, with the Central Bank of the Russian Federation and the People's Bank of China being the largest net buyers in 2016 amid a push towards reserve asset diversification. This trend is expected to continue and support gold prices. Finally, if continued expansionary monetary policies in major economies raise inflation expectations, this would also put upward pressure on the gold price. Overall, the price of gold is expected to keep rising in 2016 and 2017.

^d Calculation based on data from US Federal Reserve Bank of St. Louis and LBMA.

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Figure II.12

Oil price and major events, October 2015–November 2016



Source: U.S. Energy Information Administration, CEIC Data.

crude oil production declined amid a falling number of active oil rigs and further cutbacks in shale investment.

Meanwhile, global oil demand continued to grow in 2016. The pace of growth, however, was slower than in 2015 as the positive boost from low oil prices to consumption growth waned. Oil demand was driven mainly by robust consumption in the large emerging economies, particularly China and India. Amid a continued moderate expansion of economic activity, oil demand in Europe and the United States also improved during the year. Consequently, in May, oil prices surpassed \$50 per barrel for the first time since November 2015.

Oil demand expanded, but at a slower pace

Oil prices edged up towards the end of November, following an agreement by the Organization of the Petroleum Exporting Countries (OPEC) producers to cut oil production for the first time since the global financial crisis. The move by OPEC to bolster oil prices marks a reversal in its strategy of defending market share since the collapse of crude oil prices in 2014. Indeed, total supply from OPEC producers continued to expand at a strong pace in 2016, contributing to persistent global oversupply concerns during the year. Notably, output of the low-cost producers such as Kuwait, Saudi Arabia, and the United Arab Emirates reached record highs in 2016 while the Islamic Republic of Iran's production rose rapidly to pre-sanction levels.

Looking ahead, oil supply growth is expected to slow as OPEC producers move to cut production and non-OPEC supply continues to decline. In addition, the fall in new investments in the oil and gas industry will potentially constrain the pace in global oil output going forward. Of note, the International Energy Agency reported that global energy investment contracted at an annual pace of 8 per cent in 2015, mainly due to lower upstream oil and gas investment.

Oil supply growth will slow due to production cuts and lower investment

Oil demand is expected to continue strengthening in line with the projected improvement in global growth. Growth in oil demand will remain supported mainly by the United States and the large emerging economies, particularly China and India. Nevertheless, China's ongoing economic rebalancing efforts will constrain its oil consumption growth while its accumulation of strategic oil reserves is expected to moderate as storage capacity is filled.

Oil demand will strengthen in line with global economic growth

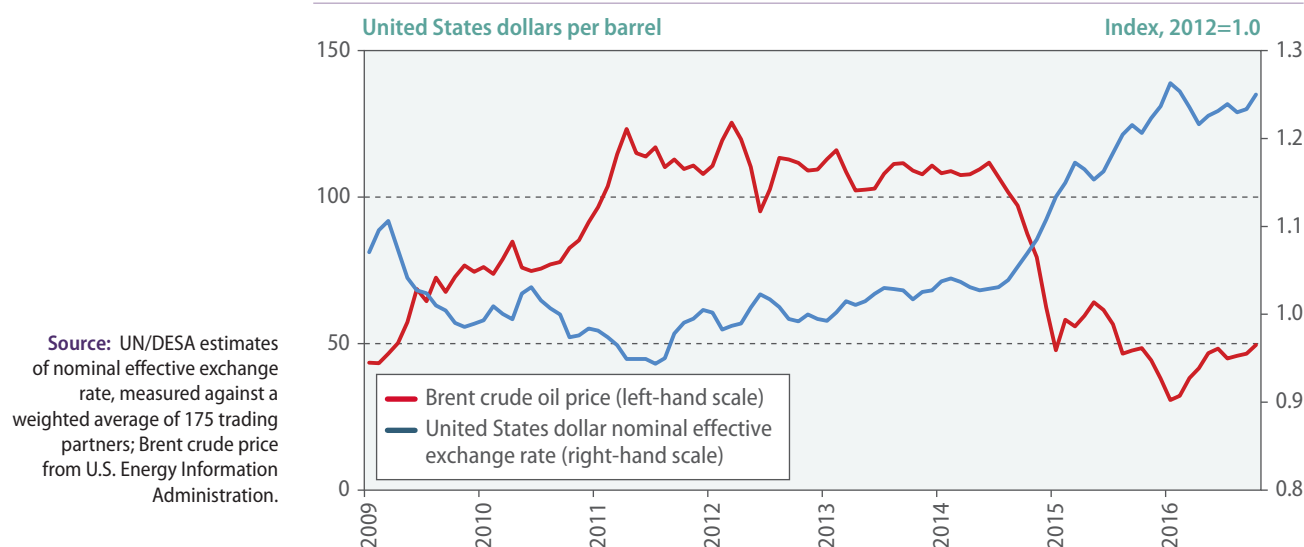
Given these dynamics, crude oil prices are assumed to recover modestly to an average of \$52 per barrel in 2017 and increase further to \$61 per barrel in 2018.

There are several downside risks to this outlook. Global growth which is weaker than expected, especially a potentially sharp slowdown in the emerging economies, could weigh on oil demand and prices.

More resilient supply by high-cost producer countries, such as the United States, would place further downward pressure on oil prices. Global oil prices remain vulnerable to shifts in investor sentiments, amid high economic and policy uncertainty. Heightened investor risk aversion resulting in a strengthening of the United States dollar will lead to a further decline in crude oil prices, given the strong inverse relationship between the two variables (figure II.13).

There are also upside risks to the oil prices. A larger-than-expected production cut by OPEC countries would boost sentiment and support oil prices. An escalation of security threats or internal conflicts such as in the Middle East and Western Africa could result in significant and prolonged supply disruptions, placing upward pressure on oil prices. Nevertheless, given that higher oil prices will incentivize more production, particularly in the shale industry, there will be a ceiling on the magnitude of oil price increases.

Figure II.13

Crude oil prices and the US dollar, January 2000–October 2016

Trade policy developments

Multilateral trade negotiations

The 2030 Agenda for Sustainable Development requires a revitalized global partnership for the implementation of the SDGs, including in the area of trade

International trade and foreign investment have been mutually supportive, contributing to the transformation of many developing economies and, with the support of a coherent and appropriate policy mix, to lifting more than one billion people out of extreme poverty (UNCTAD, 2016g). Global trade is identified by the Addis Ababa Action Agenda as an important engine for inclusive economic growth, sustainable development and poverty reduction, and the multilateral trading system is the primary channel for its promotion (UNCTAD, 2016g). The 2030 Agenda requires a revitalized global partnership for the implementation of the SDGs, including in the area of trade. In this regard, as called for under target 17.10 in SDG 17, a universal, rules-based, open, non-discriminatory and equitable multilateral trading system continues to be the cornerstone of such partnership.

A favourable national and international environment must be promoted through coherent and sustainable policies in support of growth, industrial development, infrastructure, employment and enabling structural change. The fourteenth session of the quadrennial ministerial meeting of UNCTAD, held in July 2016 in Nairobi, was the first United Nations Ministerial Conference after the launch of the 2030 Agenda. It strove for a global consensus on major lines of action which seek to attain the SDGs through trade. This included acknowledging the vital role of reinvigorating the multilateral trading system with a stronger development focus as well as the interdependence of trade, finance, investment, technology and development (UNCTAD, 2016h).

The slowdown in trade makes support for the multilateral trading system even more important

The current slowdown in trade flows and the uneven gains — both among and within countries — call for reinforced support to international trade and to the multilateral trading system. Multilateral rules and disciplines reduce trade barriers and discrimination, supported by the dispute settlement mechanism of the WTO, which is a unique judicial body

ensuring automaticity in panel proceedings and remedial action in case of non-compliance. This effective enforcement system has been increasingly used as countries seek to resolve trade disputes through judicial mechanisms in a context of slow pace of the multilateral hard-rule making. Since 1995 and as of June 2016, it has received 507 requests for consultations, handling disputes covering over \$1 trillion of trade flows. The effectiveness and legitimacy of the system are confirmed by its use by WTO members seeking to resolve disputes in regional trade agreements.

Overall, non-negotiating functions of the multilateral trading system are central to transparency, predictability and stability of international trade. Furthermore, universality has been pursued by accession processes, with WTO membership reaching 164 with the accession packages of Afghanistan and Liberia being adopted at the tenth Ministerial Conference of the WTO in Nairobi (MC10). Since 1995 and as of July 2016, 36 countries acceded to the WTO, including nine LDCs. These factors allow the multilateral trading system to keep its legitimacy as a global public good, fundamental for sustainable development.

The stalled progress in multilateral trade negotiations under the Doha Round is having a greater effect on the centrality of the multilateral trading system. Originally, negotiations were intended to conclude in 2004 but, even with a work programme to conclude the Doha Round approved in the ninth WTO Ministerial Conference (MC9) in December 2013 in Bali, WTO members could not agree on the way forward. While some countries reaffirm the Doha Development Agenda and the Declaration and Decisions from Doha, other members support new approaches to advance negotiations and liberalization.

When the Doha Round was launched in 2001, it aimed to prioritize attention to implementation difficulties of developing countries and special and differential treatment to address imbalances from the outcomes of the Uruguay Round. Meaningful progress in the Doha Round is relevant to revitalize the global partnership for sustainable development. It is directly related to achieving several goals and targets, most notably target 17.10 of SDG 17 to promote a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the WTO, including through the conclusion of negotiations under its Doha Development Agenda.

The Doha Round covers a broad range of the market access and rules agenda, in addition to the two built-in agendas of agriculture and services, under a single undertaking. Considering the lack of agreement on how to move forward, some WTO members argue that the Doha Round should be replaced with a new agenda. Developed countries called for differentiation of developing countries according to their share in global trade, claiming lack of reciprocity in negotiations from emerging economies. Developing countries in general wish to continue negotiations on key issues under the existing structure and special and differential treatment, and argue that the Doha Round can only be terminated by consensus — since it was launched by consensus.

In this context, several countries have pursued their trade interests through plurilateral and regional negotiations. This shift is also motivated by the changing nature of trade, spurred by GVCs as well as the rising significance of trade in services and, in particular, ICT services-enabled trade. With already reduced tariffs, this boosts the relevance of regulatory measures in reducing trade costs and addressing trade barriers through regulatory convergence. These alternative plurilateral and regional approaches can be more effective in this regard and have allowed delving into new issues such as regulatory harmonization, investment, competition, and state-owned enterprises.

Several countries have pursued their trade interests through plurilateral and regional negotiations

Efforts to invigorate the multilateral trading system and its negotiations should consider that the broad agenda under the single undertaking did not facilitate inter-sectoral trade-offs as it was expected when the Doha Round was adopted. If prioritization is necessary, special attention should be given to a core development agenda, including a built-in one of agriculture and services, to align the multilateral trading system with the 2030 Agenda for Sustainable Development, including the SDGs.

In addition, multilateral hard-rule making — focused on commitments — could be complemented with soft-rule making initiatives with the participation of all stakeholders, focusing on consensus building. This would address several members' caution in making legally binding commitments as called for in hard-rule making. Promoting consensus on several trade issues and developing best practices, guidelines and lessons learned could facilitate hard-rule making by enabling better understanding, and building national capacity to formulate the required measures. Such an approach, reflected in the UNCTAD mandate, should complement and support efforts to make hard rules and achieve broader multilateralism (UNCTAD, 2016i).

Plurilateral negotiations

The mix of hard-rule commitments and soft-rule non-binding principles can be achieved by plurilateral negotiations

The mix of hard-rule commitments and soft-rule non-binding principles can be achieved by plurilateral negotiations whose flexibility allows pursuing liberalization at a faster pace. Still, plurilateral initiatives can be seen as diverting the focus away from multilateral negotiations. In any case, plurilateral efforts need to ensure inclusiveness, transparency, and flexibility for developing countries in line with the novel form of flexibility adopted in the Trade Facilitation Agreement. Capacity-building support was also critical to facilitate the engagement of developing countries in these negotiations (UNCTAD, 2016i).

The Information Technology Agreement (ITA) is plurilateral, involving 53 participants, but is applied on a most-favoured nation (MFN) basis, which means that tariff reductions will be extended to all WTO members.

The agreement covers a list of more than 200 information and technology products, valued at \$1.3 trillion and representing 10 per cent of global merchandise trade and 90 per cent of global trade in these products. Products covered by the ITA expansion include new generation multi-component integrated circuits, touch screens, medical and Global Positioning System (GPS) navigation equipment.

About 65 per cent of the tariff lines were to be fully eliminated by July 2016 and most of the remaining tariffs are to be phased out until 2019. Most importantly, the ITA is expected to contribute to further expanding the digital economy (United Nations, 2016c).

The environmental goods agreement involves 17 participants and it covers more than 50 products and almost 80 per cent of global trade of these products (UNCTAD, 2016j). It intends to allow the addition of new products and services linked to environmental goods. This agreement envisages eliminating tariffs in the covered products and to be extended to all WTO members through MFN basis. The environmental goods agreement can be crucial in fostering environmental technologies.

Plurilateral negotiations for a Trade in Services Agreement (TISA) are continuing

Plurilateral negotiations for a TISA are ongoing among 23 participants, mostly high-income and upper-middle-income countries, which account for around 70 per cent of global services trade. The agreement would seek ambitious services liberalization, addressing behind the border measures and holding the potential to strongly impact regulatory frameworks. However, major developing countries are not participating, which impedes a critical

mass that would be necessary for the multilateralization of the agreement. TISA could therefore become a preferential services agreement not extended to all WTO members.

Regional trade agreements

Regional trade agreements (RTAs) have increased their importance in the international trading system because they can more effectively address behind-the-border and overall regulatory measures stemming from the changing nature of trade. The WTO was notified of 635 RTAs as of July 2016, of which 423 were in force.² This trend was accentuated by mega-RTAs that aim to achieve a duty-free and other barriers-free environment and address regulatory diversity through coherence and convergence.

The African Continental Free Trade Area (CFTA) is a large scale RTA in a South-South context that aims to boost intraregional trade, including through deepened regional regulatory cooperation. Negotiations were launched in June 2015 and are expected to be concluded in 2017, covering both goods and services. They are building on progress achieved by Regional Economic Commissions (RECs), including the Tripartite Free Trade Agreement among the Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC) and the Southern African Development Community (SADC). CFTA-related efforts recognise the importance of setting the adequate level of ambition, considering the asymmetric level of integration in different RECs and the multiplicity of sub-regional and inter-sub-regional integration processes (United Nations, 2016c; UNCTAD, 2015c).

The negotiations of the Trans-Pacific Partnership (TPP) were concluded in October 2015, potentially creating a market of 800 million people and \$28 trillion among Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Viet Nam. Within its comprehensive 30 chapters, it covers goods and services trade, investment, e-commerce, intellectual property, government procurement, competition, labour protection, environment, regulatory coherence, SMEs and state-owned enterprises. It sets a high-standard template seeking regulatory harmonization.

The “WTO-plus-plus” nature of mega-RTAs would imply that developing countries exporting to those countries would need to accept the higher regional standards. Not only will countries in the agreement encounter adjustment costs derived from upward harmonization, but other countries will be subject to additional costs of higher regulatory standards spread, for example, by neighbouring countries which are part of some regional integration scheme. The bulk of gains from the TPP, with a market covering 40 per cent of global GDP, is expected from regulatory harmonization and mutual recognition.

Still, although some members of mega-RTAs could have gains, non-members, and even some members that already have preferential access, may lose due to trade diversion. Because of the diversion, the annual gains from a Doha Round outcome would far exceed the global benefits of mega-RTAs, including the TPP, the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Atlantic Trade and Investment Partnership Agreement (TTIP). In spite of its higher potential global benefits, the Doha Round would be adversely affected by mega-RTAs as they reduce incentives for multilateralism and may create a “two-tiered” and fragmented trading system.

Regional trade agreements have become more important in the international trading system

Trade diversion remains a major concern

² WTO website, 2016-10-07.

Trade and least developed countries

The Istanbul Programme of Action defined the target of doubling the share of LDCs' exports in global exports by 2020

Recognising the demanding situation of LDCs, the Fourth United Nations Conference on the Least Developed Countries adopted in 2011 in Istanbul the Programme of Action for the Least Developed Countries for the Decade 2011-2020 to overcome the structural challenges LDCs face in order to eradicate poverty, achieve internationally agreed development goals and enable graduation from the LDC category. Trade's major role in ensuring sustainable economic development was acknowledged. The Conference established the goal of increasing the share of LDCs in global trade through broadening their export base (box II.4). In particular, the Istanbul Programme of Action defined the target of doubling LDCs' global exports by 2020.

In this regard, the Istanbul Programme of Action called for LDCs, with support from their development partners, to address supply-side constraints by enhancing productive capacities and reducing constraints on the private sector, as well as building and diversifying their export base. It also called for favourable market access conditions for all products originating in LDCs, including through the reduction or elimination of arbitrary or unjustified non-tariff barriers and other trade-distorting measures.

Specific mentions were made of a supportive and responsive international trade and finance architecture, and of regional cooperation, including through regional trade integration and other arrangements. These could facilitate LDCs' development and beneficial integration into the world economy by increasing the size of markets, improving their competitiveness and enhancing regional connectivity (United Nations, 2011).

In May 2016, the Istanbul Programme of Action went through a comprehensive high-level midterm review of its implementation, which underlined the importance of trade and investment as major drivers of economic growth, employment generation and structural transformation. Notwithstanding, it was recognised that many LDCs continue to face multiple challenges, including stagnant trade flows, and that swift actions were necessary to realize the Istanbul Programme of Action and the 2030 Agenda promise of leaving no one behind.

It was noted that market access for products of LDCs has seen improvement in some developing countries, but LDCs' exports remain highly concentrated in a few primary products vulnerable to commodity price volatility and to exogenous economic and environmental shocks (United Nations, General Assembly, 2016a).

The share of LDCs' exports in global merchandise decreased from 1.1 per cent in 2010 to 0.9 per cent in 2015, while the share of services exports from LDCs in world services increased from 0.6 per cent in 2010 to 0.8 per cent in 2015. The level of merchandise exports is far behind the objective of doubling shares of global exports by 2020, while services exports are closer to this target.

Emphasis was placed on the key role of a universal, rules-based, open, non-discriminatory and equitable multilateral trading system in promoting export diversification, trade and economic growth. In this regard, importance was given to accelerating accession of engaged LDCs and to reducing trade barriers to LDCs by, for example, meeting the commitments of the Agreement on Sanitary and Phytosanitary Measures and the Agreement on Technical Barriers to Trade.

The agricultural sector in LDCs continues to be affected by trade restrictions and distortions in world agricultural markets and public stockholding in a manner that adversely affects food security. Countries were also urged to make use of WTO ministerial decisions on Duty Free and Quota Free (DFQF) market access for LDCs and on preferential rules of

origin for those countries, as well as aid for trade, also in the context of the extension of the Enhanced Integrated Framework for Trade-related Technical Assistance to LDCs.

LDCs were also encouraged to use existing trade and investment support mechanisms, including programmes from international organizations.

The WTO Ministerial decisions adopted at MC10 are non-binding guidelines to encourage preferential origin-related criteria for LDCs. This included the promotion of the use of a low-threshold level for ad valorem percentage criteria, allowing the use of non-originating materials for 75 per cent of the product's value. It also included the encouragement of the use of simple change in tariff heading or subheading rules and the use of the single-transformation rule for apparels. Also of central importance, it called for more user-friendly document requirements and customs procedures.

The WTO Ministerial decisions adopted at MC10 are non-binding guidelines to encourage preferential origin-related criteria for LDCs

MC10 also extended the validity period of the waiver allowing for preferential treatment for services and services providers of LDCs until 31 December 2030, compensating for the four years that have elapsed without concrete results since the waiver was adopted in 2011. It calls for increased efforts to notify commercially meaningful preferences. LDCs have expressed concern about the commercial value of preferences and non-market access, as the development impact of the waiver depends on the content of the preference and on the capacity of LDCs to take advantage of such preferences.

The way forward

The way forward in realizing the development potential of international trade requires addressing several challenges. The first relates to trade liberalization, as the progress in reducing tariffs, the rise of trade associated with GVCs, the increasing service-orientation of economies and ICT services shift the focus of trade policy to behind-the-border regulatory measures.

The second challenge concerns the new issues being proposed for the negotiating agenda of the WTO, including topics ranging from the environment to public health. The third challenge is the need to mix hard rule making approaches with supportive and complementary soft rule making efforts. Finally, the fourth challenge is the growing prevalence of RTAs, particularly mega-RTAs, which have a significant impact on the multilateral trading system owing to their size, number and novelty (UNCTAD, 2016i).

Overall, the development effects of RTAs need to be continuously monitored and assessed. Action must be taken to support the multilateral trading system, ensuring that regional efforts complement, rather than substitute, an enabling environment for trade and development centred in multilateralism and are aligned with the SDGs.

Box II.4

G20 policies and LDCs' economic integration

Promoting the economic integration of least developed countries (LDCs) into the global economy has been the objective of many multilateral declarations and has been more recently reiterated in the SDGs.

Specifically SDG 17, related to strengthening the means of implementation and revitalizing the global partnership for sustainable development, aims to "increase significantly the exports of developing countries, in particular with a view to doubling the least developed countries' share of global exports by 2020" (Target 17.11) and to "realize timely implementation of duty-free and quota-free market access on a lasting basis for all least developed countries" (Target 17.12).

While LDCs represent around 12 per cent of the world's population, they contribute only about one per cent of global exports. Moreover, LDCs' exports are largely concentrated in commodities. Their export-to-GDP ratio is significantly below the average of developing countries and has been on a clear downward trend since 2011, partially driven by the fall in commodity prices. The G20 generally recognize LDCs' trade constraints and provide LDC exporters with preferential market access and technical cooperation programs to increase competitiveness. The G20 have made progress towards allowing duty-free quota-free market access for LDCs and affirmed their commitment to assist developing countries in complying with standards and regulations.

Many G20 members, including some of the G20 developing countries such as China and India, provide tariff preferences to LDCs on a non-reciprocal basis. Although most of the preferential schemes are generous, in many sectors of importance for LDCs, such as agriculture, textiles and apparel, tariffs remain substantial and tariff peaks (particularly high rates on specific products) are prominent.

While tariffs are just one of the burdens to LDCs' exports, there are also a large and increasing set of regulations and requirements which are generally referred to as non-tariff measures (NTMs). NTMs pose a particular challenge for LDCs in two respects. First, NTMs tend to be more prevalent in products that are typically exported by LDCs, such as agriculture, textiles and apparel. Second, NTMs can have a potentially distortionary effect on trade, as the compliance with NTMs depends on technical know-how, production facilities, and an infrastructural base which many LDCs lack, leading to negative effects on their export competitiveness (Nicita and Seiermann, 2016).

Preferential tariff schemes are important, but will not be sufficient to meet the ambitious SDG target of doubling LDCs' export share by 2020. They need to be complemented by policies which help LDCs comply with NTMs. At the aggregate level, allowing for tariff-free market access for LDCs is likely to boost LDC exports to G20 by almost \$10 billion, equivalent to an increase in LDCs' total exports of almost 5 per cent. Eliminating the distortionary trade effects of NTMs would increase LDC exports to G20 countries by about \$23 billion, equivalent to about a 10 per cent increase. Together, LDCs would increase their exports by about 15 per cent.

The impact differs across product categories, LDCs and G20 countries. The largest effects would be concentrated in the textile and apparel sectors (figure II.4.1), as well as in some of the agricultural categories, in particular vegetable products. Consequently, LDCs which tend to export such products (e.g. Asian LDCs and some of the African agricultural exporters) would benefit more than natural resource exporters.

Heterogeneous results across G20 countries depend largely on the size of their economy but also on the existing tariff concessions, their regulatory framework and import composition. For the EU, which already sets most tariffs at zero for LDCs, a significant 6 per cent increase of LDC exports would be obtained by assisting developing countries in complying with the EU's regulatory framework. The United States must enlarge its preferential tariff schemes, as the effects of tariffs and NTMs are roughly equal. Results dwindle in improving LDCs' access to the Chinese market, because existing LDC exports to China are highly concentrated in natural resources, which face zero or very low tariffs and few NTMs. With regard to other G20 members, LDCs would benefit from both enhancing the preferential schemes and increasing the ability of LDC exporters to comply with NTMs (figure II.4.2).

(continued)

Fundamentally critical is whether the policy options identified in this study are feasible to implement. Enlarging preferential tariff schemes to cover all LDC exports is straightforward, but reducing the distortionary trade effects of NTMs on LDCs requires a more complex approach. Many NTMs serve important and legitimate domestic public policy objectives in G20 countries.

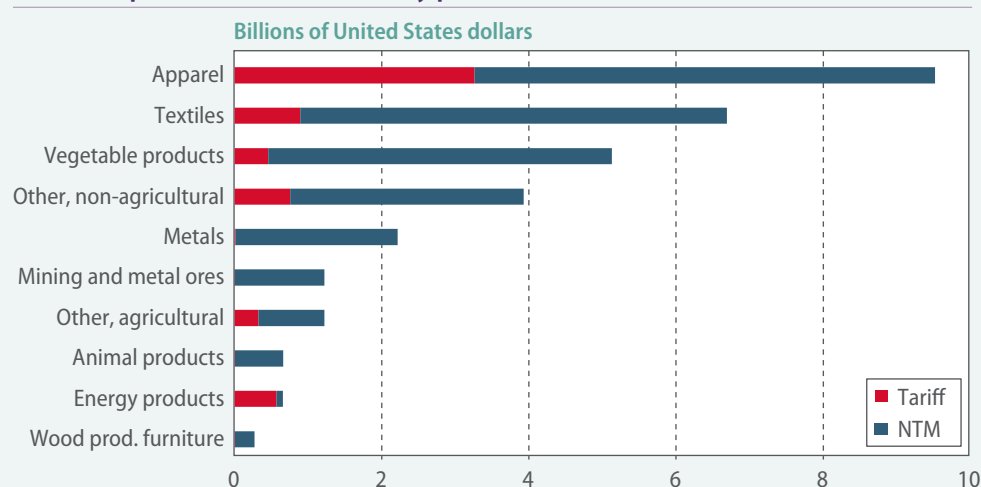
G20 countries should facilitate LDCs' integration into the global economy by helping them comply with NTMs through regulatory frameworks that prevent discrimination, encourage transparency and provide technical assistance to minimize LDCs' cost of compliance.

Box II.4 (continued)

Authors: Alessandro Nicita and Julia Seiermann, drawing on a recent study by Nicita and Seiermann (2016).

Figure II.4.1

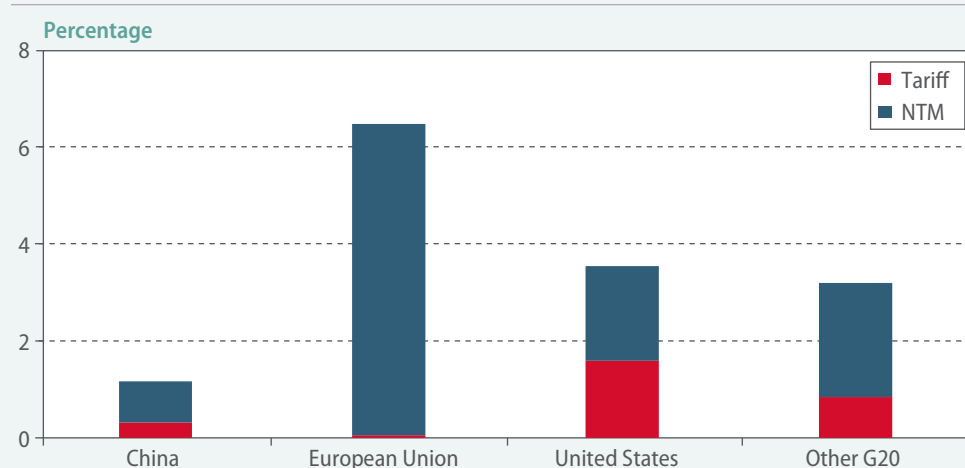
Impact of duty free access and elimination of negative effect of NTMs on LDC exports to G20 countries, by product



Source: Nicita and Seiermann (2016).

Figure II.4.2

Impact of duty free access and elimination of negative effect of NTMs on LDCs total exports, by G20 country



Source: Nicita and Seiermann (2016).