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ENHANCING INTRAREGIONAL TRADE AND INVESTMENT

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Note by the secretariat

SUMMARY

Trade and investment flows in the region, which have been negatively affected by the global economic crisis, must be restored as soon as possible in order to prevent long-term fallout on economic growth and employment. In this regard, the secretariat makes a case for regional cooperation, with a focus on promoting intraregional trade. To expand such trade, enhanced levels of regional integration are required. A comprehensive and meaningful regional trade agreement is the fundamental building block of the integration process, and also contributes to the strength of the multilateral trading system.

The focus of the present document, therefore, is on the role of regional trade agreements in managing regional integration, and the need to strengthen and consolidate existing regional trade agreements in particular. In this regard, the secretariat: (a) discusses the emerging potential of the Asia-Pacific Trade Agreement as a framework for consolidation; (b) reviews complementary modalities for regional integration, including the mechanisms for regional policy coherence and coordination; (c) reviews the role of ESCAP in developing the Asia-Pacific Trade and Investment Agreements Database and providing the Asia-Pacific Trade Agreement with secretariat services; and (d) outlines recommendations for consideration by the Committee.

The Committee may wish to deliberate on the issues and recommendations discussed in the present document and in particular on the role of ESCAP in addressing these issues.

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Introduction

1. The present document is based on chapter 3 of the *Asia-Pacific Trade and Investment Report 2009*.¹ In it, the secretariat: (a) examines the role regional trade agreements (RTAs) play in managing regional integration; (b) reviews the role of ESCAP in promoting regional integration; and (c) makes recommendations for consideration by the Committee.

I. PROMOTING SOUTH-SOUTH TRADE AND INVESTMENT IN THE REGION

2. Given that the global economic crisis has revealed the dependence of Asia-Pacific economies on exports to developed countries, a case can be made for increasing intraregional trade, in particular trade among the region's developing countries. Research has indicated that such trade can: (a) have a positive impact on development; (b) expand productive capacity; (c) upgrade industry; and (d) help fully utilize resources. However, exports to the North tend to be more sophisticated than exports under South-South trade and therefore more associated with learning opportunities. Thus, South-South trade should not replace, but rather complement, North-South trade as a means of diversifying export products and markets.

3. The intraregional trade flows of Asia-Pacific economies have been increasing steadily, but are still below their potential. With regard to developing members of ESCAP for which there are consistent data, intraregional trade figures range from 32.7 per cent in 1998 to 38.9 per cent in 2008. Since the mid-1990s, 85 per cent of total South-South trade has originated in Asia, and almost all was directed to countries in the Asian region. Intraregional investment flows are more modest and figures are hard to come by. However, several countries in the region, such as China, India, Malaysia, the Republic of Korea, Singapore and Thailand, have successfully

¹ ESCAP, *Asia-Pacific Trade and Investment Report 2009* (United Nations publication, Sales No. E.09.II.F.19). Printed copies of the *Report* will be distributed at the Committee session. The *Report* will be available online at www.unescap.org/tid/aptir.asp as of 10 October 2009.

connected foreign direct investment with the development of regional and global supply chains.

4. Opportunities to enhance intraregional trade and investment are still significant. However, among developing countries, barriers to trade and investment—both tariff and non-tariff, and behind-the-border measures—are relatively high. Trade and investment liberalization is therefore necessary, but not sufficient. Other actions, including regional cooperation in macroeconomic policy coordination and supply-side capacity-building, are also required. In sum, deeper levels of regional integration must be pursued in order to promote intraregional trade and investment and ensure their contribution to development. In this context, a more comprehensive and deeper RTA could be considered a useful building block of such a process and a major modality for enhancing intraregional trade and investment.

II. REGIONAL TRADE AGREEMENTS IN ASIA AND THE PACIFIC

5. According to the ESCAP Asia-Pacific Trade and Investment Agreements Database (APTIAD), by the end of July 2009 there were 104 RTAs involving an ESCAP member State in force. Of these, 75 are bilateral, and 26 of those involve a partner from outside the Asia-Pacific region. These RTAs vary widely in terms of scope, coverage, membership and other characteristics. In addition, Asia-Pacific countries are party to over a thousand bilateral investment treaties and have been the most active in concluding such treaties in the last few years. At the same time, investment provisions are emerging as a feature of RTAs.

6. While the potential of RTAs to create trade and investment is widely recognized, in practice trade creation has been modest, and the impact of RTAs on poverty reduction and development as a whole is even more elusive. This can be partly explained by the relatively low utilization rates of many RTAs; some are not fully implemented. In many cases, the commitments under RTAs are too shallow to be of interest to business. Cumbersome rules of origin also play a role. On the positive side, the trade diversion effects of RTAs in the region have also been limited. However, RTAs are by definition discriminatory and as such undermine the principles of the multilateral trading system. Their proliferation has led to a confusing network of overlapping and sometimes conflicting commitments among countries, which are often signatories to multiple agreements with overlapping membership (the so-called “noodle bowl” effect). If such agreements are to lead to trade creation, have a significant impact on development and evolve as building blocks of regional integration and the multilateral trading system, they need to be strengthened, expanded and consolidated. The success of such a process is, however, largely a function of national policy and political commitment.

7. ESCAP research on trade flows in Asia and the Pacific has revealed relatively strong increases at the subregional level and for the region as a whole under various liberalization scenarios. As expected, the formation of a free trade agreement with full tariff elimination and covering all ESCAP member countries increases trade flows much more than a liberalization scenario with limited tariff cuts, or a limited number of participating countries. For example, when tariffs are eliminated completely under an ESCAP-wide free trade agreement, intraregional exports increase by 17.7 per cent, which is almost five times the increase in intraregional exports that would result from a weak liberalization, that is, by cutting tariffs only by 25 per cent. If such an ESCAP-wide and complete agreement were to be concluded,

and the associated increase in intraregional trade were to materialize, the number of people currently living on less than \$1 a day would be reduced by 42.9 million.²

III. MAKING SENSE OF THE “NOODLE BOWL”

8. In order to evolve RTAs into building blocks of regional integration and of the multilateral trading system, it is important that they be: (a) strengthened in terms of coverage and commitments; (b) expanded in terms of membership, in order to limit potential trade diversion; and (c) harmonized and consolidated.

9. Strengthening RTAs requires: (a) a deepening of commitments (that is, wider margins of preferences); (b) an expansion of coverage, that is, an increase in the number of products on which commitments are made; and (c) an expansion of the scope, to include issues such as trade in services, trade facilitation, non-tariff measures and possibly investment, competition and other trade-related areas. Research has indicated that the reduction of non-tariff barriers in particular would yield significant benefits. Ultimately, such a process could lead to customs unions and, in the long run, perhaps economic communities or unions. So far in the region, only the Association of Southeast Asian Nations (ASEAN) is committed to the establishment of an Economic Community by 2015. The only customs union fully within the region is that of Central Asia, under the Eurasian Economic Community.³ On the positive side, it appears that the scope of RTAs in the region is indeed widening, though the enforcement of many of those agreements remains an issue. As of the end of July 2009, 47 RTAs in the region had investment provisions, 32 RTAs had provisions on trade in services, and 33 agreements had provisions on trade facilitation, but these provisions vary widely because agreements do not follow a common negotiating framework.

10. It is important that RTAs make a direct contribution to development. While special and differential treatment, technical assistance, and revenue compensation schemes help in making such agreements development-friendly, it is ultimately the coverage and depth of the liberalizing commitments which are linked to development and poverty reduction. In particular, RTAs should lead to inclusive and sustainable trade that covers sectors such as agriculture, services (including issues related to mode 4 of the General Agreement on Trade in Services (GATS)), and intellectual property rights, which have potentially significant impacts on poverty. The inclusion of labour (“inclusive”) and environmental (“sustainable”) provisions could also be considered, but the formulation of such clauses should be clear and development-oriented and their implementation should be closely monitored to prevent them from being used as hidden protectionist measures.

11. It is also important that the memberships of RTAs be expanded, in order to enhance benefits. This is made more complex by the fact that such agreements tend to be concentrated in subregions. The solution is to allow accession for any developing country willing to accept the existing modalities of liberalization within the RTA.

12. The consolidation of RTAs under the same rules is probably the most difficult challenge, as such a process is complex and politically sensitive. However, it would make perfect economic sense, as the European experience has shown. Consolidation has both geographical and functional dimensions. Geographical consolidation would enable RTAs to absorb the bilateral trade agreements established between its individual members, or merge with other small and similar RTAs.

² For further details and results, see ESCAP, *Asia-Pacific Trade and Investment Report 2009* (United Nations publication, Sales No. E.09.II.F.19), chapter 3.

³ There is a customs union between Turkey and the European Union.

However, for such a process to be successful, functional consolidation is also necessary, that is, common frameworks on rules of origin and other commitments need to be agreed on before geographical consolidation is possible. The ASEAN Plus Three⁴ configuration has emerged as one potential force for regional integration; the Asia-Pacific Trade Agreement (APTA) has emerged as another.

IV. THE ASIA-PACIFIC TRADE AGREEMENT

13. Since the accession of China to APTA, this Agreement has made significant progress in terms of deepening commitments and widening its scope. Though still a positive list-based Agreement, the number of tariff lines under concession rose to almost 5,000 upon the conclusion of the third round of negotiations. The current fourth round of negotiations is expected to expand the coverage of preferences to at least 50 per cent of the number of tariff lines of each member, and to at least 20-25 per cent of the value of bilateral trade. It also aims to provide a tariff concession of at least 50 per cent (on average). At the same time, progress has been made in negotiating framework agreements on trade in services, trade facilitation, non-tariff barriers and investment, and these agreements were expected to be adopted by the Ministerial Council of APTA at its third session, to be held in Seoul on 22 October 2009.⁵

14. As its membership cuts across subregions of ESCAP and includes some of the largest and most dynamic economies, namely, China, India and the Republic of Korea, APTA has emerged as a potential driver of regional integration. No other RTA binds these countries together. While China, India and the Republic of Korea have concluded bilateral trade agreements with ASEAN, the “hub-and-spoke” character of those agreements does not cover bilateral trade relations among these three countries themselves. Furthermore, APTA has relatively simple and flexible rules of origin, which could be used as a template for common rules of origin for the region. APTA is fully operational and implemented. However, for APTA to truly serve as the driver of regional integration, its scope and depth of commitments need to be expanded on the basis of a negative-list approach and its membership needs to be broadened. Ongoing efforts towards these ends are being made, both by the participating States and by the ESCAP secretariat, which serves as the secretariat for APTA (see section VI below).

V. MOVING BEYOND REGIONAL TRADE AGREEMENTS

15. Ultimately, regional cooperation must be broader and more intensive if it is to enhance regional and intraregional trade and investment. RTAs can go a long way towards fostering this kind of cooperation. RTAs are, however, limited in their ability to ensure broad-based regional coherence or consistency across a wide spectrum of

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