



# World Economic Situation and Prospects

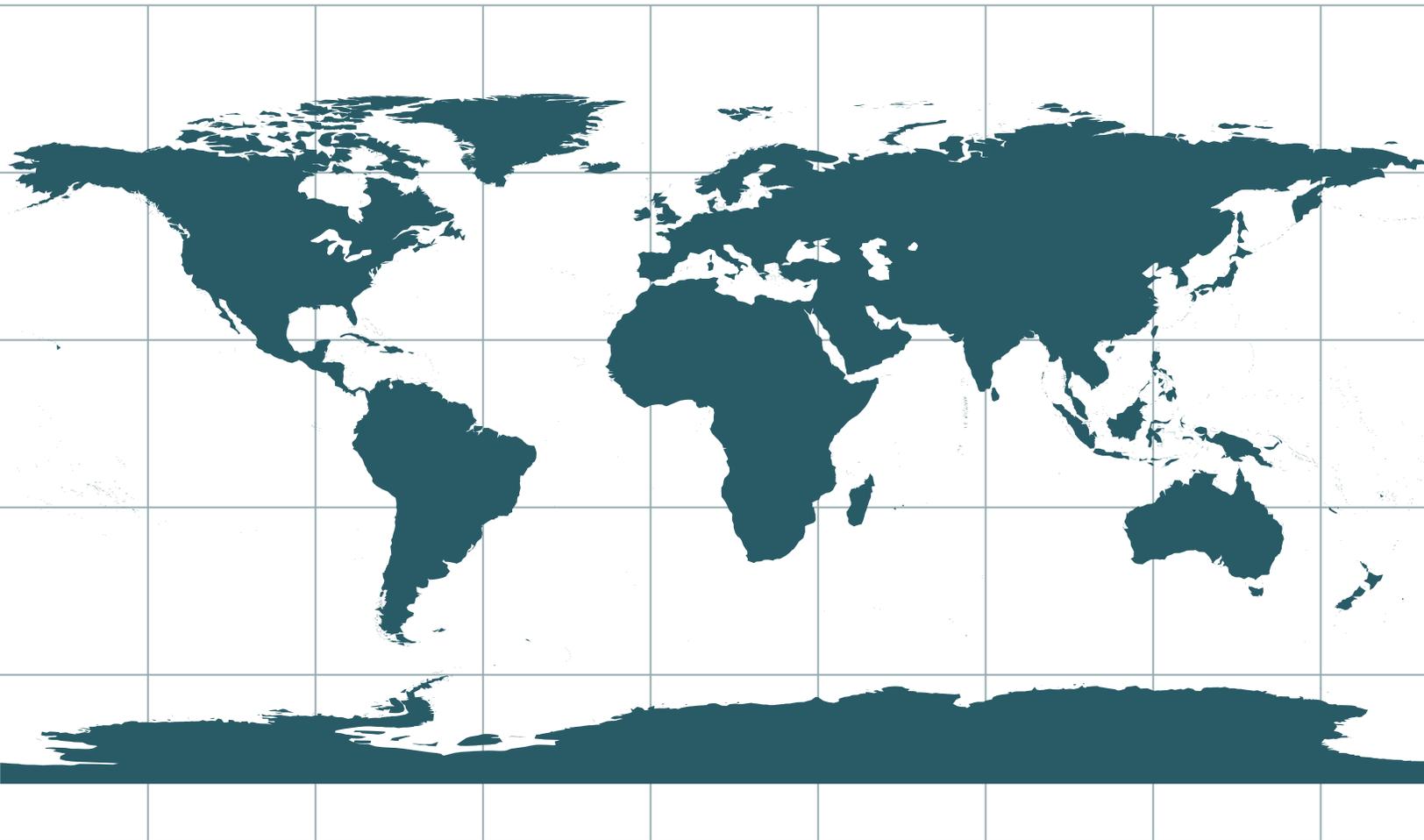


2016



United Nations

# World Economic Situation and Prospects 2016



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## Chapter II

# International trade

### Trade flows

The subdued performance of world trade flows persisted into 2015, with the volume of world trade projected to increase by only 2.7 per cent for the year, the lowest rate since the global financial crisis and approximately the same rate as the estimated world gross product growth for 2015 (figure II.1). For the second consecutive year, developed economies played the leading role in driving global trade. Among all regions, the developed economies in Europe contributed most significantly to global import growth in 2015, accounting for 70.3 per cent of the growth (figure II.2). On the other hand, the contribution from developing East Asia dropped sharply. The region is projected to be responsible for just 8.4 per cent of global import growth in 2015, after accounting for 27 per cent on average in the previous decade. In the outlook, global trade growth is expected to pick up to a moderate pace of 4.0 per cent in 2016 and 4.7 per cent in 2017, outpacing real world gross product growth, but still considerably below the rates witnessed during the pre-crisis period.

The subdued performance of world trade reflects a combination of cyclical and structural factors. On the cyclical side, weak aggregate demand—initially emanating from the slow recovery in the euro area and more recently the slowdown of large emerging economies—has restricted global trade. In the first half of 2015, the volume of imports into the Russian Federation dropped by more than 25 per cent, while in Brazil and India imports declined by 8-9 per cent, and China's import demand also slowed sharply.

China's slowdown in import demand in particular has significant spillovers to the rest of the world. As of 2014, China accounts for more than 12 per cent of global mer-

**World trade growth remained weak in 2015, but is expected to rise moderately in the forecast period**

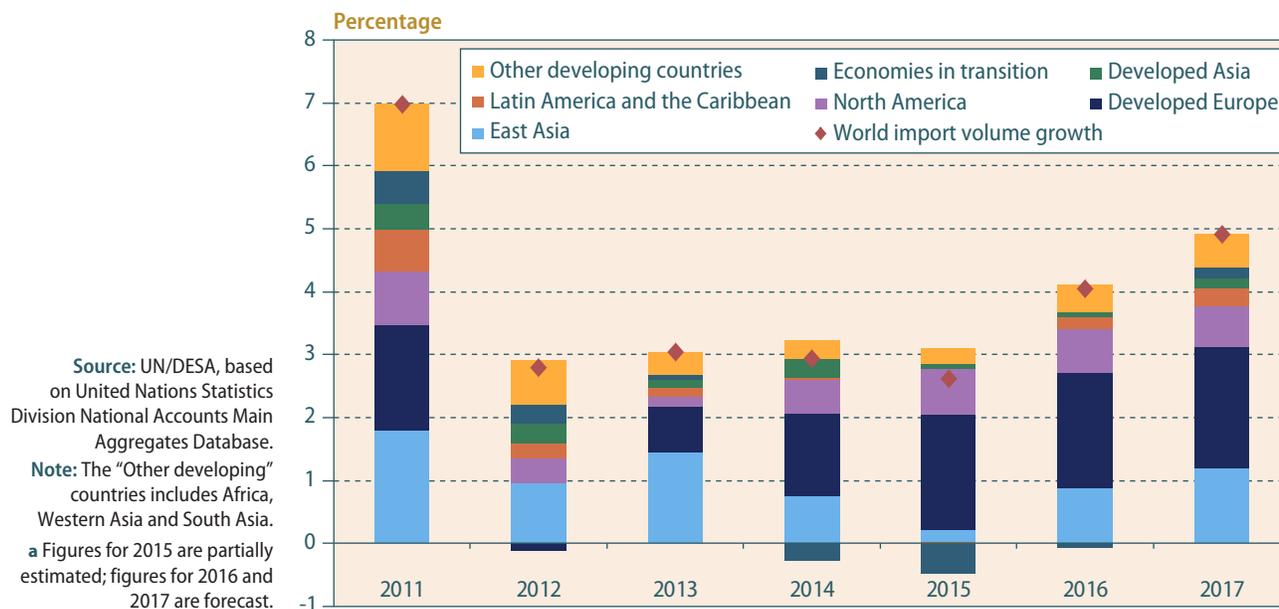
**Subdued global trade reflects both cyclical and structural factors**

Figure II.1  
Growth of world trade and world gross product, 2007-2017<sup>a</sup>



Source: UN/DESA, based on United Nations Statistics Division National Accounts Main Aggregates Database. <sup>a</sup> Growth rate for 2015 is partially estimated; growth rates for 2016 and 2017 are forecast.

Figure II.2  
Regional contribution to global import growth, 2011–2017<sup>a</sup>

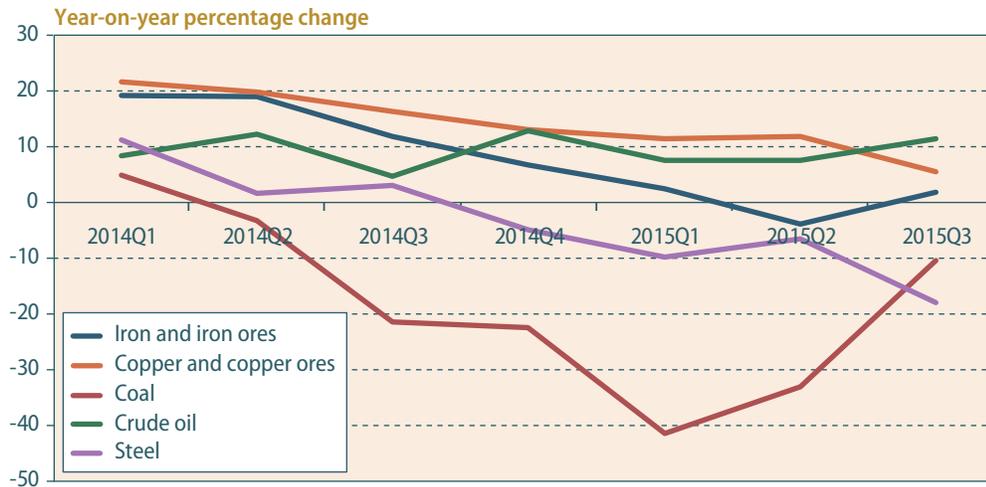


chandise exports and about 10 per cent of total merchandise imports. In addition, China is the top shipment destination for about 29 economies, which include many countries of the Asia Pacific region and commodity-exporting economies. Slowing demand from China has had an important impact on the global demand for certain commodities, contributing to the downward trend in commodity prices. In the first three quarters of 2015, China's imports of coal and steel (in volume terms) recorded a dramatic year-over-year decline, which reflects the slowdown in fixed investment (figure II.3). Imports of copper ores continued to rise, but the growth rate dropped by 10 percentage points compared to the first three quarters of 2014. By contrast, growth of crude oil imports have remained steady, which could reflect a strategy of increasing inventories while the price is low (see section on oil market prices). Overall, it is estimated that China accounted for about 20 per cent of the slowdown in import growth of developing economies and economies in transition between 2014 and 2015.

The slowdown in world trade also reflects a structural shift in the relationship between trade and gross domestic product (GDP) growth since the mid-2000s (Hoekman, 2015). The composition of global demand may be one factor explaining the shift. At the global level, the share of capital goods in total imports gradually dropped from 35.0 per cent in 2000 to 30.1 per cent in 2014, whereas consumer goods maintained their share of about 30 per cent throughout the same period.<sup>1</sup> Consumption tends to have a lower import content relative to investment, and the extended period of weak global investment (as discussed in chapter 1) has partly changed the import intensity of GDP growth. Given the continued uncertainty of the global economy, investment growth is expected to remain weak, and a significant rebound in the share of capital goods in world trade is unlikely in the near term. The lack of trade finance has also been attributed as a factor for the slowdown in world trade since the financial crisis. However,

<sup>1</sup> World Integrated Trade Solution, available from <http://wits.worldbank.org/>.

Figure II.3  
China's imports of selected commodities, 2014 Q1–2015 Q3



Source: UN/DESA calculation, based on data from China Customs Statistics.

this is not supported by cross-country data from bank surveys (International Chamber of Commerce, 2015).

The slower expansion of global value chains (GVCs) in recent years also partly explains the reduced trade intensity of global growth. Rapid expansion of the GVCs played a key role in accelerating global trade growth in the 1990s and early 2000s. This acceleration was also driven by a period of rapid integration of China and countries in Central and Eastern Europe into global markets. There is, however, a natural limit to the international fragmentation of production, and these factors have made a more limited contribution to world trade growth since the mid-2000s. In particular, China has been increasingly relying on domestic inputs for intermediate goods. Its share of intermediate goods in total imports dropped from almost 33 per cent in 2001 (when China joined the World Trade Organization (WTO)) to about 18 per cent in 2013, partly explaining the diminished importance of GVCs in trade flows. Further integration of other large emerging economies such as Brazil, India and South Africa into global markets, and a more prominent role for Africa, have the potential to accelerate global trade growth in the medium term. This will, however, require policy initiatives to reduce trade costs and barriers, and deepen regional integration; it remains to be seen to what extent these potential actors can provide a new impetus to global trade.

The WTO Doha Round of multilateral trade negotiations has made little progress in providing an additional push to global trade in the last fifteen years. There has been a rise in regional trade agreements (RTAs) around the world, which have the potential to generate significant new trade flows. But RTAs can also have trade-diversion effects, with trade growing within a RTA, thereby adversely affecting trade flows with and among non-RTA members. The recent conclusion of the Trans-Pacific Partnership (TPP) Agreement, which involved twelve countries and over 40 per cent of the world gross product, could expand trade opportunities for certain countries. Nonetheless, the proliferation of the RTAs cannot replace the role of the multilateral trading system (see section on trade policy), and can only partially offset the negative effects of restrictive trade measures, which continue to rise but at a slower pace than in previous years. Between October 2014 and May 2015, the Group of Twenty (G20), for example, adopted 119 new trade-restrictive measures (World Trade Organization, 2015a).

**The slower expansion of global value chains has weighed on global trade**

**Multilateral trade negotiations have made little progress in boosting trade**

**Major swings in exchange rates and the continued decline in commodity prices are shaping global trade**

In recent years, large swings in exchange rates and the steep decline in commodity prices have had adverse effects on world trade. Currencies of many emerging markets and some developed economies have depreciated significantly against the dollar. While the associated competitiveness gains have supported exports in some countries—in Western Europe and South Asia, for instance—the sharp rise in import prices has cut back import demand significantly in many developing economies and economies in transition. A growing disconnect between exchange-rate swings and export performance has been argued in some empirical studies, owing to the greater relevance of GVCs in international trade (Ahmed, Appendino and Ruta, 2015). Backward and forward production linkages may make exchange-rate depreciations less effective in boosting exports. However, conventional trade that does not involve the GVCs still contributes a considerable amount of global trade, with the foreign content of exports averaging only about 25 per cent across economies (Leigh and others, 2015). While exports may have become less responsive to exchange-rate fluctuations in economies that are deeply integrated in GVCs, recent evidence also suggests that exchange-rate swings continue to have significant implications for the volume of exports (International Monetary Fund, 2015a, chap. 3).

The decline in commodity prices has also affected the volume, value and composition of trade flows (see section on the decomposition analysis). The collapse in the oil price in particular has led to a significant worsening of commodity terms of trade and of public finances for fuel-exporting economies, whereas other economies have largely seen an improvement in commodity terms of trade (box II.1). The oil price drop has signifi-

Box II.1

**The current commodity price slump, terms-of-trade effects and government finances in commodity-dependent developing countries**

Given the decline in commodity prices since 2011, commodity-dependent developing countries (CDDCs)—defined by UNCTAD as developing countries deriving at least 60 per cent of their export revenues from commodity exports<sup>a</sup>—have experienced a deterioration of public finances. For example, public revenues of African CDDCs dropped from an average of 26.1 per cent of GDP between 2004 and 2007, to 21.2 per cent of GDP between 2011 and 2014. This partly explains the deterioration of these countries' average primary budget balances from a surplus of 3.6 per cent of GDP to a deficit of 1.8 per cent of GDP between the two periods. Many CDDCs have increased or are contemplating an increase in borrowing in order to shore up their finances.

Falling commodity-related revenues, depreciation in exchange rates and adverse terms of trade effects explain the deterioration in fiscal balance. Figure II.1.1 shows the declines in the commodity export and import price indices for 81 commodity-dependent countries between April 2011 and August 2015. Countries close to the 45-degree line have experienced similar declines in their export and import price indices, with minimal impact on their terms of trade. The further away a country is from the 45-degree line, the more asymmetric the impact has been. Economies above the 45-degree line have experienced an improvement in the commodity terms of trade, and those below the line experienced deterioration. As expected, most fuel exporters have seen a negative net price effect, with the commodity terms-of-trade worsening on average by 16.2 per cent (for more details on methodology of the estimates of the terms-of-trade effects, see the appendix to this chapter).

The commodity price slump has had the most adverse effect in countries where a high threshold oil price defined the overall fiscal envelope. In Algeria and Saudi Arabia, for example, fiscal breakeven oil prices were \$129.80 per barrel (pb) and \$111.30 pb, respectively, in 2014 (International Monetary Fund, 2015b). These were already too high, and the margin between actual and breakeven prices widened further in 2015. Oil prices averaged \$62 pb in December 2014 and \$47 pb in August 2015. As a result, many of the oil-exporting economies (Algeria, Angola, Iraq, Nigeria, Saudi Arabia and Venezuela (Bolivarian

*(continued)*

Republic of) have been forced to cut spending and government investment. Saudi Arabia, which had built large foreign-currency reserves during the commodity boom, has drawn down its reserves to cover last year's shortfall in oil revenue.<sup>b</sup> Other oil exporters are also experiencing downward pressure on their international reserves.

The commodity price collapse has also had similar fiscal effects on non-oil commodity exporters. In July 2015, Chile, the world's biggest copper producer, halved the growth rate of its projected fiscal revenue from the original estimate of 5.0 per cent to 2.4 per cent. The revision reflects the continued deterioration in copper price from \$3.12 to \$2.75 per pound.<sup>c</sup> In Zambia, where copper exports represent more than two thirds of total export earnings and account for 25-30 per cent of government revenue, the decline in copper prices will also contribute to the widening of the budget deficit. The International Monetary Fund (2015c) has revised the country's 2015 projected budget deficit from 4.6 per cent to 7.8 per cent of GDP.

The decline in commodity prices has been associated with significant currency depreciations in a number of CDDCs. In 2015, currencies in many CDDCs, including the Zambian kwacha, the Angolan kwanza, and the Nigerian naira, recorded some of their strongest depreciations against the United States dollar in several years. This has pushed up the prices of non-commodity imports, further amplifying the sharp deterioration in their terms of trade. Given the limited capacity to substitute imports with domestic goods, this suggests that many CDDCs will experience a deterioration of both their current-account and government budget balances in the short to medium term. Countries where budget deficits are being financed through external borrowing are exposed to currency risks, which may, in turn, adversely affect their debt sustainability. In the short term, the prospect of a twin deficit is likely to negatively affect these countries' standing in terms of sovereign risk and credit worthiness.

The current pressure on CDDCs' government budgets calls for strong policy actions to improve the governance of the commodity sector. The need to adopt countercyclical fiscal rules that require CDDCs to save during price booms and draw on the savings when prices collapse cannot be overemphasized. The current experience also highlights the importance of economic and fiscal diversification to reduce countries' exposure to the vagaries of commodity market cycles. Furthermore, current CDDCs difficulties suggest that, to the extent possible, the international community should adopt appropriate measures to reduce excessive price volatility in commodity markets. The Agricultural Market Information System (AMIS)—an initiative of the Group of Twenty established in the aftermath of the 2007-2008 food crisis—presents a good example of an international measure.

Box II.1 (continued)

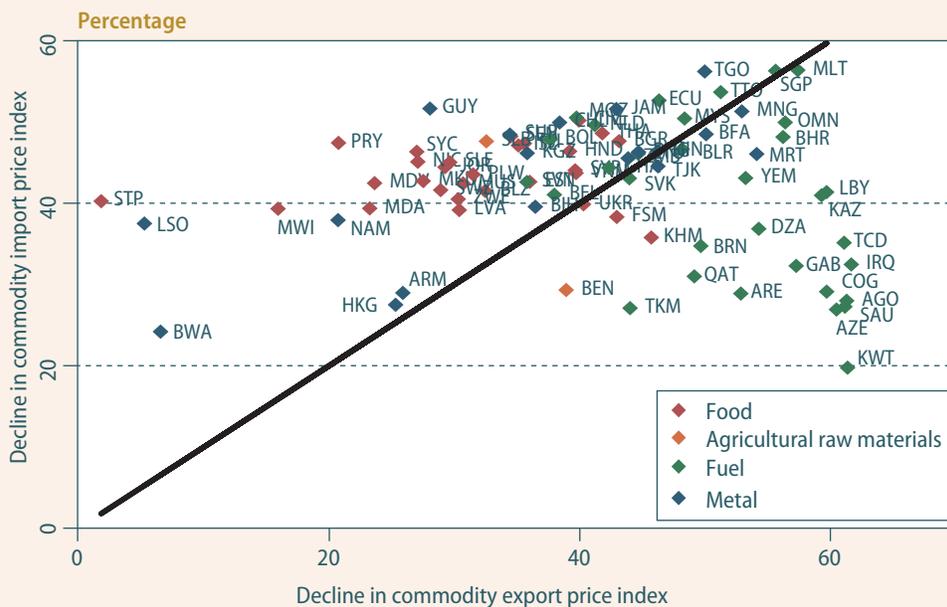
Source: UNCTAD, Special Unit on Commodities and UN/DESA.

<sup>a</sup> In 2014, out of 146 developing countries for which data was available, 94, or about two thirds, were CDDCs.

<sup>b</sup> From April to September 2015, the country's central bank withdrew about \$70 billion from global asset managers (*Financial Times*, 28 September 2015).

<sup>c</sup> The data is from Chile's Minister of Finance (Quiroga, 2015).

Figure II.1.1  
Commodity export and import price decline, April 2011–August 2015



Source: UNCTAD, Special Unit on Commodities and UN/DESA.

Note: See table J in the Statistical Annex to this publication for definitions of country codes.

cantly limited fuel-exporting countries' demand for goods and services from the rest of the world, with knock-on effects in non-fuel-exporting countries. UN/DESA estimates suggest that only 39 out of a sample of 178 economies have experienced a deterioration in their commodity terms of trade since 2011. Collectively, these 39 economies accounted for approximately 16 per cent of the global merchandise imports in 2014. As the positive terms-of-trade shock in other countries is absorbed, this may support somewhat stronger world trade growth next year.

Overall, global trade continues to be subdued and is expected to pick up only moderately during the forecast period. This underscores the need for renewed efforts for strengthening the multilateral trading system, as well as for reducing trade-restrictive measures, to fully exploit the potential gains from global trade and facilitate the realization of the Sustainable Development Goals (SDGs).

### Regional trends

**Western Europe is expected to drive the recovery of global trade**

Western European economies will continue to be the main drivers of global trade growth in the outlook period, averaging more than 5 per cent growth per annum in imports during 2016-2017. The region's exports will continue to be supported by a high level of intraregional trade and competitiveness gains, via depreciation of the euro relative to the United States dollar. The United States of America will also see an improvement in export growth in 2016 and 2017, provided the dollar does not experience a further sharp appreciation in the near term. Import growth is projected to remain higher than export growth, reflecting the positive terms-of-trade effect of the strong United States dollar and some revival of private fixed investment.

The economies in transition experienced a sharp drop in the volume of trade in 2015. The Commonwealth of Independent States (CIS) is projected to register a fall of 3.1 per cent in export volumes and 15.6 per cent in import volumes, following sharp currency depreciations and weaker domestic demand. Exports from Ukraine saw the steepest decline amidst ongoing conflicts in the East of the country. The trade prospects of CIS economies remain affected by the economic difficulties faced by the Russian Federation and Ukraine and the geopolitical tensions in the region. Going into 2016-2017, exports from the CIS are projected to grow by only 0.7 per cent, whereas imports are forecast to expand by about 1.4 per cent per annum.

Exports from Africa expanded by an estimated 4.5 per cent in 2015, while imports grew by about 3.5 per cent. The slowdown in China—Africa's biggest trading partner—weighed on the trade performance of the continent. However, exports to India and trade within Africa have been robust, providing some support to total export volumes. Low commodity prices have nevertheless driven a decline in the region's export values of about 21.3 per cent in 2015. In the outlook, annual growth of export and import volumes is expected to average about 4.6 per cent.

**Trade growth in East and South Asia is expected to recover in the near term**

Trade growth in East Asia was unusually tepid in 2015. East Asian currencies displayed resilience in the beginning of 2015, but downward pressures increased and several currencies depreciated to multi-year lows against the dollar by the end of the third quarter, partly reflecting interventions in the currency markets. Both export and import growth in the region is expected to rebound—to 3.4 and 3.9 per cent, respectively—reflecting stronger demand from developed economies and expanding investment growth in several major economies. South Asia's merchandise exports have also been weak in 2015, partly

reflecting some country-specific factors. Similar to East Asia, merchandise export growth from South Asia is also expected to recover to 5.4 per cent, on average, during 2016-2017, due to a pickup in external demand and currency depreciations. In value terms, Western Asia's exports faced a sharp decline of 20 per cent in 2015. This sudden drop was driven by the collapse in the oil price, although export volumes grew by 7.9 per cent. As oil prices are expected to remain low, oil-exporting economies will continue to suffer declining exports in value terms in 2016 before seeing a return to growth in 2017. Real import growth into the region is projected to remain stable at about 3.8 per cent per annum during 2016-2017, supported by the growing non-oil sector.

In Latin American and Caribbean economies, export volume growth is projected to improve by 2.8 per cent in 2015, whereas import volumes will contract by 0.3 per cent. In value terms, exports are expected to experience a sharp decline on account of the lower commodity prices. However, trade performance has been divergent within the region. Trade flows from Mexico and Central America continue to improve, partly explained by the recovery of the economy of the United States, while commodity-exporting economies in South America have been significantly affected by the slowdown in China's demand for metals and by the lower mineral and metal prices. Overall, regional annual average export and import growth are projected to improve to 4.2 per cent in 2016-2017.

**Trade performance in Latin America remains divergent across subregions**

## Decomposition analysis<sup>2</sup>

The total value of world merchandise trade started to contract rapidly in late 2014. In addition to the weak growth in the volume of trade, as discussed in the previous sections, a key factor explaining this contraction was the sharp decline of dollar-denominated prices for traded merchandise. Aggregate world trade prices declined by more than 14 per cent over this period, including the sharp plunge in the price of oil, more moderate but widely spread declines in non-oil commodities prices (see section on primary commodity markets), and a decline in export prices for manufactured goods<sup>3</sup> (figure II.4). Most major exporters of manufactured goods saw the price of their exports decline in United States dollar terms because of the strong appreciation of the dollar, although when measured in national currencies, those prices were stable or increasing mildly (figure II.5).<sup>4</sup>

**World trade prices declined across the board in 2015**

The decline of trade prices has temporarily suspended the shift in trade patterns that were observed in recent decades.<sup>5</sup> As developing countries were the major commodity exporters, reduced commodity prices have slowed down the expansion of developing countries' nominal market share in world trade (figure II.6). On the other hand, developing countries' share in developed countries' imports of manufactured goods increased from 31.7 per cent to 32.3 per cent between 2013 and 2014. For developing countries' import of

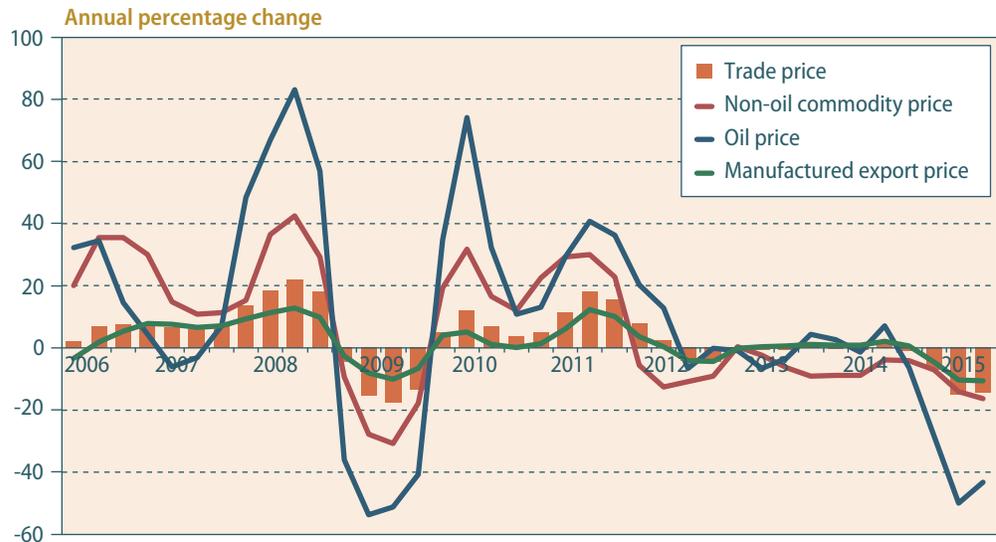
<sup>2</sup> This section only discusses international trade in merchandise.

<sup>3</sup> The decline in export prices for manufactured goods was noticeably lower than the plunge in oil and non-oil commodities. Nevertheless, statistical analysis shows that its contribution to the change in the total trade price was similar, reflecting the magnitude of manufacturing trade relative to commodities.

<sup>4</sup> According to the Bank of International Settlements, the United States dollar effectively appreciated by 12 per cent against a basket of 60 currencies during the first half of 2015.

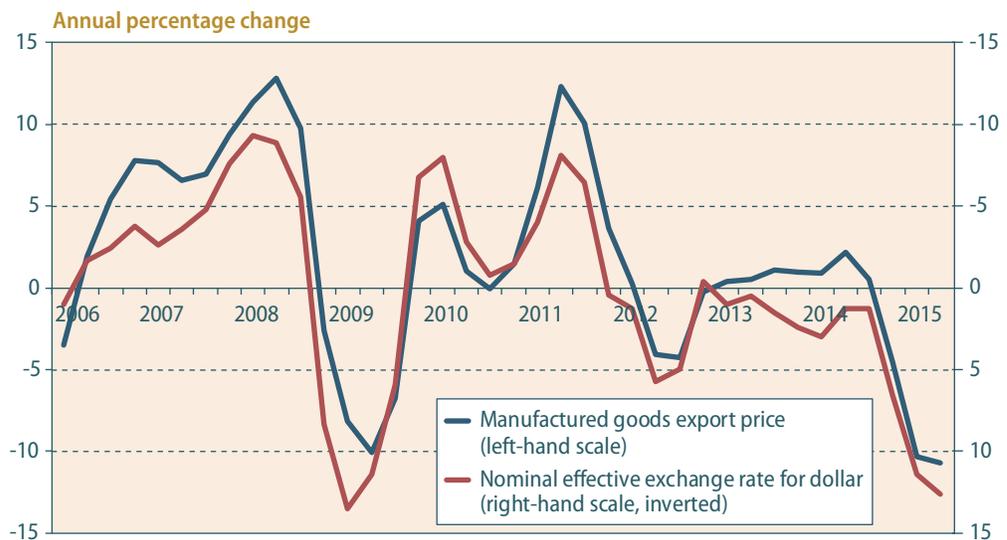
<sup>5</sup> See United Nations (2015b, chap. 2), section on trade decomposition.

Figure II.4  
World trade prices, 2006 Q1–2015 Q2



Source: UN/DESA, based on data from WTO and UNCTAD.

Figure II.5  
Manufactured goods export price and dollar exchange rate, 2006 Q1–2015 Q1



Source: UN/DESA, based on data from WTO and UNCTAD.

manufactured goods, this share increased from 60.3 per cent to 60.9 per cent, which was much slower than the average speed for the past two decades.

### Trade in services

**World services trade continues to expand robustly, especially in developing countries**

Trade in services is providing the much-needed support to the feeble performance of global trade. More dynamic than merchandise trade, global services exports grew at an average annual rate of 3.6 per cent—faster than merchandise exports, which grew at an average rate of 3 per cent annually during 2008-2014. Services exports were also more resilient through

Figure II.6  
Regional shares of exports to developing and developed countries, 1995–2014

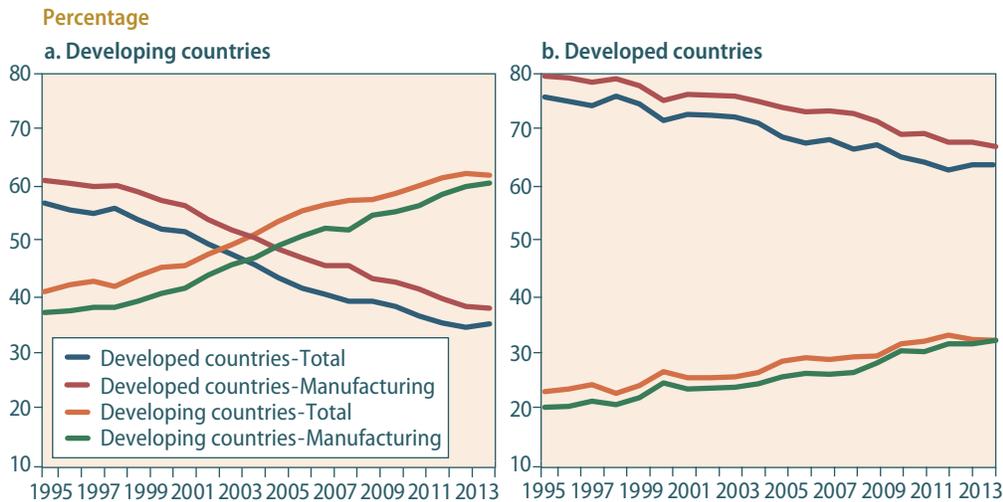
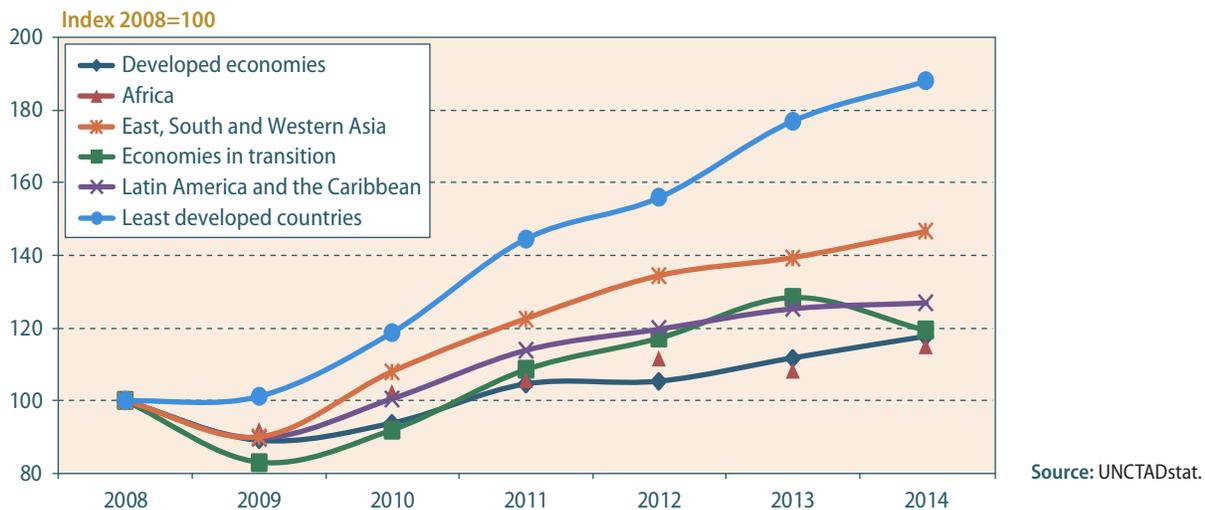


Figure II.7  
Services exports by level of development and region, 2008–2014



the global financial crisis, highlighting the importance of services as an option for export diversification. In fact, the fragmentation of production through GVCs—which has been rising during the past decade—requires efficient professional, business and infrastructure services such as energy, transport, information and communications technology and financial services. It also requires value-added services, including research and development, product design and marketing.

Most of the growth in services exports has been driven by developing countries—in Asia and Latin America and the Caribbean, for example—while least developed countries (LDCs) have also continued to register impressive growth (figure II.7). This dynamism is mostly due to travel (box II.2), financial services, telecommunications, computer and

## Box II.2

**Trends in international tourism****Tourism and the Sustainable Development Goals**

Over the past decades, tourism has grown into a major economic sector and an important source of foreign-currency revenue for many countries around the world. Tourism is also increasingly recognized as a powerful tool for addressing global challenges including job creation, poverty eradication and sustainable development. The United Nations World Tourism Organization (UNWTO), together with United Nations sister agencies, is committed to the advancement of the 2030 Agenda for Sustainable Development, in which sustainable tourism is firmly positioned. In particular, UNWTO promotes tourism as a direct and indirect contributor to each of the 17 Sustainable Development Goals (SDGs) recently adopted by the United Nations General Assembly. In particular, tourism is featured in three goals (8, 12 and 14), focusing on sustainable and inclusive economic growth, job creation, and sustainable consumption and production. The Sustainable Tourism Programme (STP) of the 10-Year Framework of Programmes on Sustainable Consumption and Production Patterns (10YFP) aims at accelerating the shift towards sustainable consumption and production in both developed and developing countries.<sup>a</sup> Led by UNWTO, the vision of 10YFP STP is for a tourism sector that has globally adopted sustainable consumption and production practices, enabling enhanced environmental and social outcomes and improved economic performance.

**Tourism as a source of job creation**

Tourism is a relatively labour-intensive sector and it has become a major source for job creation at all skill levels. In particular, tourism accounts for one in eleven jobs worldwide, including direct, indirect and induced jobs. Tourism has a significant multiplier effect, creating employment in related sectors such as agriculture, construction, maintenance, retail, handicrafts or financial services. In addition, in times of economic difficulties, employment in tourism tends to be less affected and to recover more quickly than other economic sectors (United Nations World Tourism Organization and International Labour Organization, 2011). The key challenge is to establish sustainable policies that enhance both the quantity and quality of employment in the tourism sector.

In September 2015, the G20 Ministers of Tourism (T20) met in Turkey to discuss how tourism can create more and better jobs as a means to reduce inequalities at national and international levels. Recalling that tourism is one of the most dynamic and resilient economic sectors, the T20 committed in their Declaration<sup>b</sup> to maximize the potential of tourism to generate jobs, particularly for women and youth, as well as to enhance the role of small and medium-sized enterprises in the tourism value chain. Importantly, tourism has a higher share of women employees and entrepreneurs than the economy as a whole and creates significant employment opportunities for young people, thus firmly contributing to reducing youth unemployment. For instance, research by UNWTO and UN Women (2011) shows that the percentage of women entrepreneurs in hotels and restaurants is significantly higher than in other activities in several developing countries.

**International tourism maintains sustained growth**

Tourism continues to grow robustly despite the weak economic conditions at the global level. In 2014, international tourist arrivals (overnight visitors) increased by 4 per cent, reaching a total of 1,133 million worldwide, up from 1,087 million in 2013. The positive trend continued in the first half of 2015, with international arrivals growing by 4 per cent compared to the same period last year. However, tourism flows have been shifted somewhat by currency fluctuations and lower oil prices in 2015. Many destinations are benefitting from more favourable exchange rates, while the stronger United States dollar is fuelling outbound demand from the United States. The decline in oil prices has lowered transport costs, but at the same time it has weakened outbound demand from oil-exporting economies such as Brazil, Nigeria, the Russian Federation and Saudi Arabia. According to projections by UNWTO, international tourist arriv-

(continued)

als are expected to increase by 3 to 4 per cent worldwide in 2015, in line with the long-term forecast of 3.8 per cent a year for the period between 2010 and 2020 (United Nations World Tourism Organization, 2015a and 2015b).

### International tourism is the fourth largest export category

Receipts earned by destinations from international visitors grew by 4 per cent in real terms, to \$1,248 billion, while an additional \$222 billion were generated by international passenger transport (rendered to non-residents). Hence, international tourism generated total export earnings of \$1.5 trillion in 2014. Tourism is a major international trade category at the sectoral level, ranking fourth after fuels, chemicals and food. In fact, international tourism (travel and passenger transport) accounts for 6 per cent of total exports of goods and services, and for 30 per cent of services exports alone. As a result, earnings from tourism contribute substantially to the improvement of the balance of payments of many emerging and advanced economies, offsetting a deficit in their trade balance or adding to an already positive balance.

International tourism can generate a tourism trade surplus (when receipts exceed expenditure) or a deficit (vice versa) in the national account of a country. The United States of America has the world's largest travel surplus of \$66 billion, resulting from tourism receipts of \$177 billion and expenditure of \$111 billion. Among emerging economies, Thailand and Turkey boast the largest travel surpluses, while Malaysia, Croatia, Mexico, South Africa, Morocco, Dominican Republic, Viet Nam, India, Egypt, Hungary and Jordan all recorded a surplus between \$3 billion and \$10 billion (figure II.2.1). For many small developing countries, including most small island States, tourism is a major source of foreign-currency income as well. On the opposite side of the spectrum, some key source markets record a deficit in their tourism trade balance. China has the largest deficit of \$108 billion. China earned a substantial \$57 billion in 2014, but, as the world's top tourism outbound market, it spent \$165 billion.

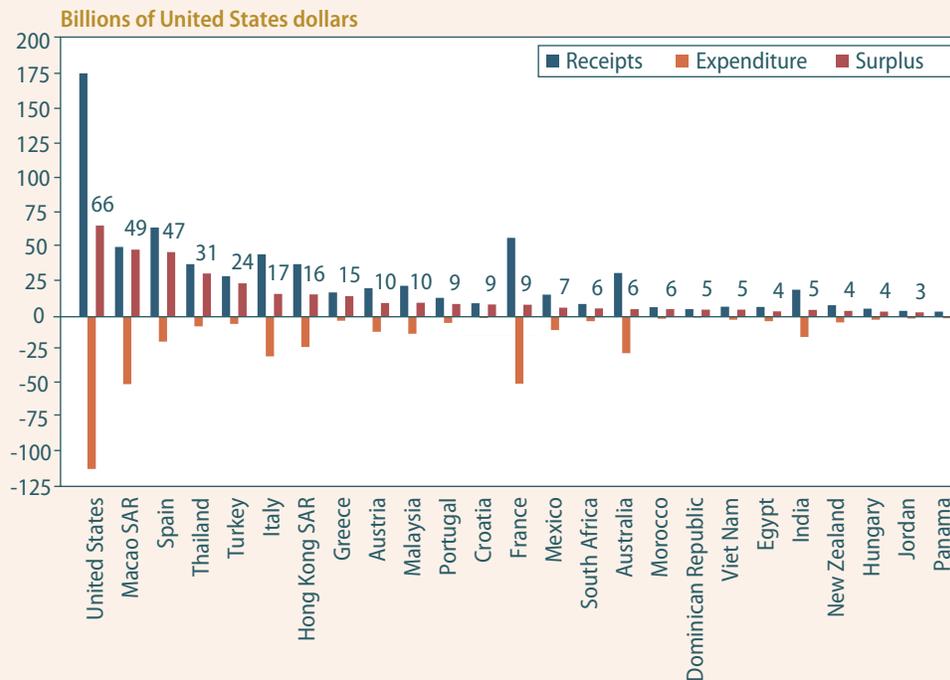
Box II.2 (continued)

Source: United Nations World Tourism Organization (UNWTO).

<sup>a</sup> More information on 10YFP is available from <http://sdt.unwto.org/sustainable-tourism-10yfp>.

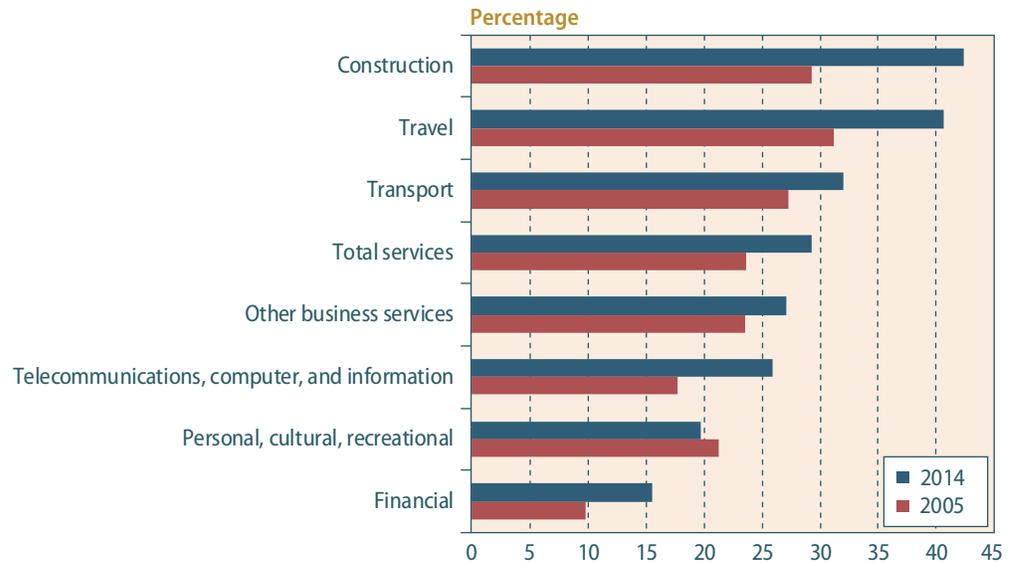
<sup>b</sup> G20 Tourism Ministers Declaration, available from <https://g20.org/wp-content/uploads/2015/09/T.20Declaration.pdf>.

Figure II.2.1  
Countries with largest surplus on the travel balance, 2014



Source: UNWTO.

Figure II.8  
Developing economies' share in world services exports by sector, 2005 and 2014



Source: UNCTADstat.

information services, and other business services. Developing countries have increased their participation in global services exports from 24 per cent in 2005 to 29 per cent in 2014. This increased participation was more pronounced in construction, travel, and telecommunications, computer and information services (figure II.8).

The actual magnitude and importance of services trade is not fully captured by most statistics, as they rely mainly on cross-border services trade data. Services trade increasingly occurs through foreign direct investment and the movement of natural persons. Services sales by affiliates could be estimated to be in the order of \$18 trillion in 2014, nearly four times greater than global cross-border services exports (United Nations, General Assembly, 2015b). Trade through the movement of natural persons has also risen significantly, given the growth in global remittance flows (see chap. III).

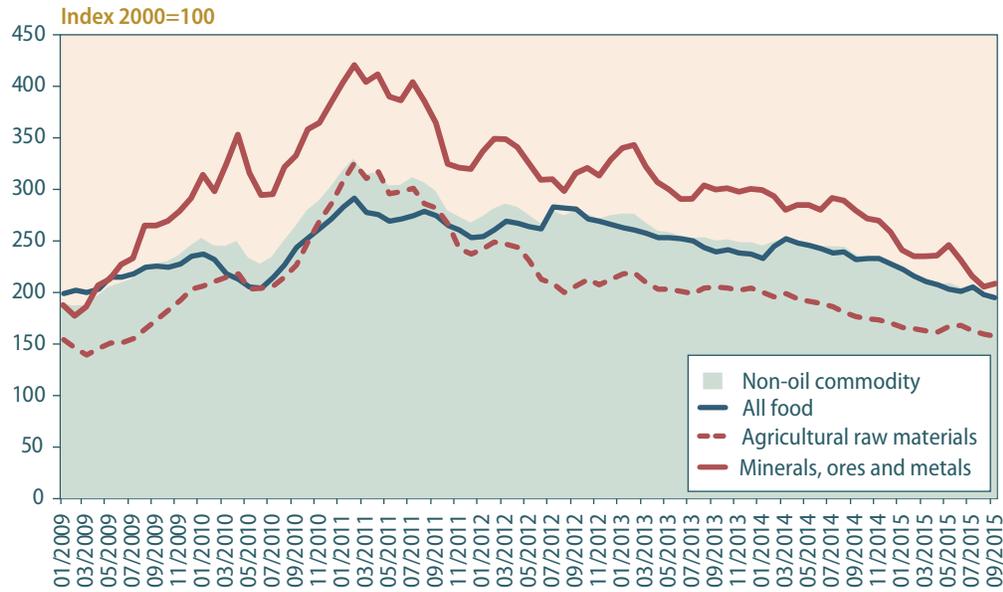
## Primary commodity markets

**Most commodities continue with a downward trend in prices**

In 2015, commodity prices continued their slump that began in 2011. The United Nations Conference on Trade and Development (UNCTAD) Non-oil Nominal Commodity Price Index averaged 193 points in September 2015, nearly 41 per cent lower than its peak of 329.5 points in February 2011 (figure II.9).<sup>6</sup> Almost all commodity prices have fallen across the board since the beginning of the year, and this trend is expected to continue into 2016 if current conditions persist. Out of 24 commodities which are major components of the index considered, only three products, namely cocoa, cotton and tea, recorded price increases between September and January 2015 (figure II.10). The global commodities rout

<sup>6</sup> The United Nations Conference on Trade and Development (UNCTAD) Non-oil Nominal Commodity Price Index covers these subgroups of commodities: All food (Food, Tropical beverages, Vegetable oilseeds and oils), Agricultural raw materials; and Minerals, ores and metals.

Figure II.9  
**UNCTAD non-oil commodity price index, January 2009–September 2015**



Source: UNCTADstat.

Figure II.10  
**Average monthly price change for selected commodities, January 2015–September 2015**



Source: UNCTADstat.

is negatively impacting the macroeconomic performance of commodity-dependent developing countries and economies in transition, as evidenced by their deteriorating terms of trade, international reserves and public finances (box II.1).

**Ample supply and slowing demand are contributing to the decline in commodity prices**

The continuing bearish mood in global commodity markets is driven by a number of factors including ample supplies; slowing demand in China and other emerging economies, especially for minerals and metals;<sup>7</sup> faltering economic recovery in advanced economies such as Japan; and a strong dollar. In addition, the ongoing commodity slump is associated with increasing outflows of commodity-based financial investments, which has in turn further exacerbated the slump in prices.<sup>8</sup> Ample supplies and a sluggish world economy are likely to continue through 2016, maintaining the downward pressure on most commodities prices. However, some potential risk factors, including the unfolding El Niño phenomenon for agricultural commodities prices and significant cutbacks in production by miners, as well as delays in new projects for minerals and metals, may partly offset the downward pressures on commodity prices.

### Food and agricultural commodities

**Market fundamentals maintain low prices for most agricultural commodities...**

In agricultural food markets, prices generally trended downward during the first nine months of 2015, thanks to good harvests (figure II.11). For instance, the average price of wheat (*Hard Red Winter No.2*) and maize (*Yellow Maize No. 3*) dropped respectively by 23 and 17 per cent in the period from January to September 2015 compared with the same period last year. These drops are mainly driven by ample supplies, thanks to record production, which should exceed 700 and 1000 million tons in 2014/15 for wheat and maize, respectively. With respect to rice, prices continue to soften as a result of good production and the release from Thai government stockpiles. The average price of Thai rice dropped below \$400 per ton in April 2015 for the first time since 2008, reaching \$356 in September 2015. Looking ahead, grain markets should remain calm, at least throughout 2016, underscored by high levels of stocks, unless the developing El Niño phenomenon severely impacts major producing regions.

**...but the El Niño phenomenon remains a major risk factor**

In sugar markets, prices continued to collapse owing to good harvests that prolonged the glut and, recently, by the weakening of the Brazilian real which boosted exports from Brazil. In September 2015, the FOB price of sugar at Caribbean ports averaged \$11.86 per pound, almost a third of its record price of 30 cents reached in January 2011. In 2016, the effects of the developing El Niño on sugarcane production is likely to put an upward pressure on sugar prices.

For vegetable oilseed and oils, good supply conditions for products such as soybeans, soybean oil and palm oil in major exporting countries including the United States, Brazil, Indonesia and Malaysia exerted downward pressure on prices. The situation was exacerbated by the slump in crude oil prices that reduced interest in biofuel production, for which

<sup>7</sup> For example, China's merchandise imports decreased by 2.2 per cent in the second quarter of 2015 year on year. This was partly driven by drops in quantities of metals such iron and steel (-10.0 per cent) and copper (-6.0 per cent). See World Trade Organization (2015b).

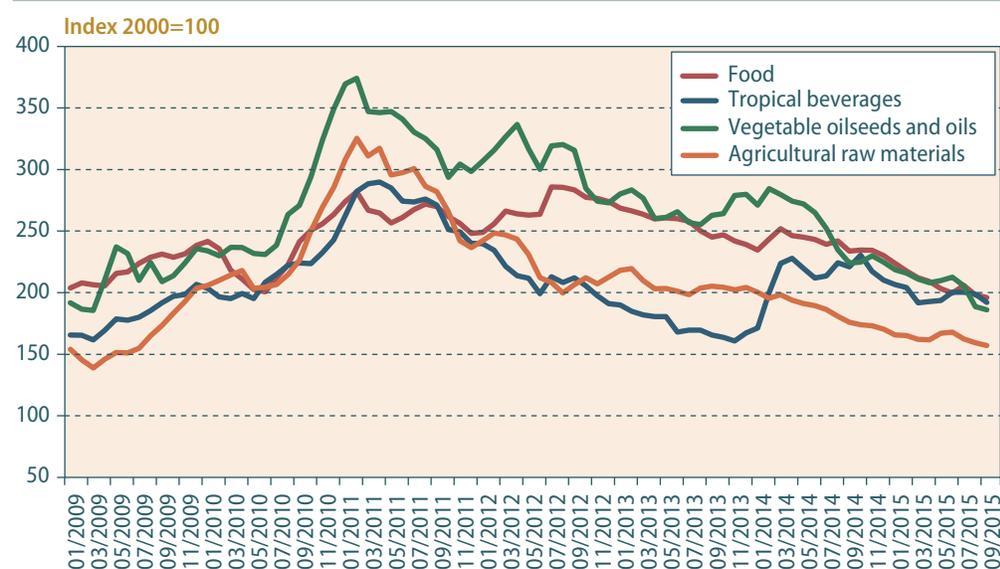
<sup>8</sup> According to data from Hedge Fund Research Ltd, cited by Bloomberg, the amount of money under management by hedge funds specializing in commodities stood at \$24 billion in 2014, 15 per cent below the peak of 2012. See Blas (2015).

vegetable oils are inputs. In September 2015, the UNCTAD Vegetable Oilseeds and Oils Price Index halved from its peak in 2011.

The prices of tropical beverages followed divergent paths. Coffee prices remained relatively high in 2014, driven primarily by drought in Brazil, but subsequently weakened as a result of improved weather conditions; strong exports, boosted by the weakening of major producing countries' currencies, such as the Brazilian real and Colombian peso; and only moderate growth in global demand. In September 2015, the Composite Indicator Price of the International Coffee Organization (ICO) averaged \$1.13 per pound, 35 per cent down compared to a peak of \$1.73 in October 2014. The price of cocoa beans trended up from \$1.32 per pound in January to \$1.49 in September 2015. The increase was driven mainly by supply disruptions in Ghana following disappointing harvests caused by problems in the application of pesticides and fungicides. In tea markets, the Mombasa tea price averaged \$3.71 per kilogram in September 2015 compared to the relatively low prices of less than \$2.65 per kilogram in 2014. The price surge was largely driven by reduced output in Kenya, the world's biggest exporter of the black variety of tea, following dry weather.

Raw material prices have generally been declining from their peaks in 2011 owing to a fragile recovery in the global economy in a context of abundant supplies. In September 2015, the price of natural rubber (RSS 3) averaged \$1.31 per kilogram, well below the peak of \$6.26 in February 2011. In the case of cotton, the A Index, a proxy for world cotton markets, moved up from an average of 67 cents per pound in January to nearly 73 cents in May 2015 and retreated afterwards, reaching 69 cents in September 2015. Relative to their levels in 2011, cotton prices have declined significantly, owing to good harvests which helped to build stocks and, more recently, to the release of stockpiles from China.<sup>9</sup>

Figure II.11  
Price indices of selected food and agricultural commodity groups,  
January 2009–September 2015



Source: UNCTADstat.

<sup>9</sup> Cotton stocks are estimated at nearly 22 million tons for the 2014–2015 season, with China accounting for half of this quantity.



rebounded briefly between April and June 2015 before receding afterwards. In September 2015, the iron ore price at the Chinese port of Tianjin averaged \$57 per ton, almost a third of its peak in February 2011. Low iron ore prices are underscored by a global glut exacerbated by low-cost mining from big producers such as Rio Tinto, BHP Billiton and Vale SA, combined with weak growth in steel production, especially in China.

The London Metal Exchange (LME) price of copper increased from \$5,701 to \$6,296 per ton between February and May 2015. Thereafter the price dropped as a result of weak demand, notably from construction activity and infrastructure investments in China. In September 2015, the LME copper price averaged \$5,203 per ton. Moreover, demand for substitutes such as aluminium, which averaged \$1,588 per ton in September 2015 from a peak of \$2,662 in April 2011, exerted downward pressure on copper prices. In nickel markets, prices were relatively strong in the first part of 2014, driven by the enforcement of an export ban on unprocessed ores by Indonesia, the world's leading nickel producer. However, from July 2014, nickel prices have been generally falling, as China has been able to partly replace imports from Indonesia with those from the Philippines. In September 2015, the LME nickel price averaged \$9,895 per ton, a significant drop from a peak of \$19,434 in May 2014. The capacity of exporting countries such as the Philippines to supply international markets will play a key role in determining the price fluctuations for nickel in 2016.

In precious metals markets, the gold price over the first nine months of 2015 was much lower than its levels in 2011 and 2012. In September 2015, it averaged \$1,125 per troy ounce compared with prices of over \$1,500 between May 2011 and March 2013. The key driving factors of the bearish trend include sizeable outflows from gold exchange-traded funds due to the strengthening dollar and improved economic prospects in the United States. Looking ahead, by mid-2016, gold prices will be sensitive to market fundamentals, to the possibility of a rise in the policy rate in the United States, to geopolitical tensions and to uncertainty over the global economic recovery. Overall, metals, ores and mineral prices are likely to remain low throughout 2016 if current global economic conditions continue. However, significant production cutbacks by big miners remain an important upward risk factor in these markets.

## Oil market prices

The global oil market remains oversupplied, as changes on demand and supply dynamics have not derailed the overall unbalanced market. Consequently, prices have been low in 2015 and will continue so during the forecast period, as there is no indication that production will stop outpacing demand in the near future. Thus, considering that the gap between oil demand growth and oil supply growth will continue in 2016, the average Brent oil price is expected to remain subdued next year, before recovering to a higher equilibrium price in 2017 (figure II.13).

Oil demand spikes were observed at the beginning of 2015, following an extremely cold winter in the Northern Hemisphere. In addition, demand from China remained unexpectedly strong during the first half of 2015, indicating that the country has been building stocks. Nevertheless, for the year as a whole, demand growth has been moderate. After growing by 1.1 million barrels per day (bpd) in 2014 to 92.4 million bpd, global demand is expected to grow by 1.3 million bpd in 2015, mainly driven by non-Organization for Economic Cooperation and Development (OECD) economies, China in particular. In 2016, demand growth is expected to remain subdued, in line with overall global economic con-

**Slowing construction and infrastructure in China weighed on prices for copper**

**Prices for metals, ores and minerals are likely to remain relatively low**

**Oil prices are expected to remain low in 2015 and 2016**

**Growth of oil supply outpaced that of oil demand in 2015**

Figure II.13  
**Monthly Brent crude oil price average, January 1984–September 2015**



Source: UN/DESA, based on data from the World Bank.

ditions, especially in emerging economies. In particular, weaker GDP growth projections for the Chinese economy are expected to weigh on oil demand. Even if the United States partially offsets the weaker demand from other regions, global demand growth for crude oil should remain moderate and is not expected to exceed 1.2 million bpd.

On the supply side, oil production remained much stronger than originally anticipated. In 2014, global supply grew by 2.4 million bpd to 93.4, with the bulk of the increase originating from non-Organization of the Petroleum Exporting Countries (OPEC) oil producers, the United States in particular. In 2015, despite an over-supplied market and lower oil prices, non-OPEC supply continued to increase, albeit at a slower pace than in the previous year. So far, United States oil production has been extremely resilient, but growing financial pressure on shale operators and a sharp fall in the number of active rigs will have their toll on production. At the same time, OPEC producers, Saudi Arabia in particular, have continued to increase production, letting oil prices fall. Thus, in 2015, global supply is expected to grow by 2.2 million bpd to 95.6 million bpd.

In 2016, total global supply will remain similar to the 2015 level, as different forces are expected to offset each other. On the one hand, North American production is expected to decline, particularly in the United States where oil production is projected to fall by about 400,000 bpd. On the other hand, Iran's production will contribute to global supply—especially in the second half of 2016, given the delay in lifting the sanctions—as a deal was reached with the P5+1 nations. At the same time, despite internal pressures from several members, OPEC as a group is not expected to cut production, keeping downward pressure on prices. Inventories have also been growing fast and reaching unprecedented levels. In OECD countries, inventories reached almost 2.7 billion barrels at the end of 2014 and are expected to increase further in both 2015 and 2016, remaining at record highs.

In 2015, the Brent oil price started the year on an upward trend following a demand revival, mainly due to the cold winter in the Northern Hemisphere. However, the oil price

rebound was short-lived, as concerns over global demand growth started to emerge soon afterwards, owing to the anticipated slowdown in China and other emerging economies, which have been the main oil demand drivers in the past decade. As a result, by the end of the second quarter and throughout the third quarter of 2015, the Brent oil price dropped significantly again, reaching as low as \$41.76 per barrel (pb) on 26 August. Thus, the average Brent oil price for 2015 is expected to be \$53 pb. In 2016, considering that the gap between oil demand growth and oil supply growth will continue, the average price is expected to be \$51 pb, before recovering to a higher equilibrium price of \$62 pb in 2017.

These price assumptions face a number of downside risks. A sharper economic slowdown in the global economy, especially in emerging economies and China, would weaken demand and put further downward pressure on oil prices. Another downside risk is related to Iran's production. The market price has already adjusted to some extent to the fact that Iran's production will enter the global market. However, the pace and volume at which this will happen is unclear, which could lead to further downward price adjustments.

There are also upside risks to these assumptions. Non-OPEC production may decline more than anticipated, as the low oil price squeezes new entrants out of the market. OPEC may decide to cut production in order to sustain prices, as fiscal pressures are mounting in several OPEC economies. Furthermore, if internal conflicts escalate or political instability surges—in Africa or Western Asia, for instance—oil production could be disrupted and oil prices pushed higher. It is nevertheless assumed that the overall supply would grow more slowly and prices would be expected to rise relative to current assumptions.

## Trade policy developments

### Multilateral trade negotiations

Global trade is an important determinant of strong growth and development. It provides the means to access larger external markets, as well as skills, technology and capital, which in turn allow for specialization, a better use of productive resources and economies of scale to catalyse a desired structural transformation. At the global level, there remains considerable untapped potential to exploit the benefits of international trade. A set of coherent and integrated policies is required to tap the potential. At the heart of such a policy mix are trade policy and a multilateral trading system that promotes trade performance without discrimination.

A universal, rules-based, non-discriminatory and equitable multilateral trading system is a central element for harvesting the development potential of trade, also recognized in goal 17 of the SDGs. Existing WTO norms and disciplines constitute the cornerstone of a rules-based multilateral trading system, serving as a guarantee against discrimination. In fact, the WTO dispute settlement mechanism is widely regarded as a success and has handled disputes covering over \$1 trillion (United Nations, General Assembly, 2015b). This is important, as the effectiveness of the rules-based trading system hinges upon the actual enforcement of its rules. The universality of the multilateral system, also envisaged in the SDGs, is pursued through accession processes. Since 1995, 34 protocols were signed, bringing membership to 161 countries. Kazakhstan joined the WTO as its 162<sup>nd</sup> member in November 2015, and the accessions of Afghanistan and Liberia are in sight. Those countries undertook important policy reforms to make their trade regime WTO-compatible,

**Strengthening the multilateral trading system will allow countries to better exploit the benefits from trade...**

facing the challenge of negotiating balanced terms of accession consistent with their development needs.

**...but the Doha Round has made little progress in the last fifteen years**

Importantly, to harvest the benefits of the multilateral trading system, it is necessary to find a way forward when negotiations hit an impasse. The Doha Round was launched in 2001 and negotiations were to give priority attention to developing countries' implementation difficulties with a view to redressing existing imbalances and enhancing openness. However, progress remains limited, affecting the credibility of the system. Meanwhile, plurilateral and regional agreements outside the WTO have increased, affecting its centrality.

In this regard, different views on how to face evolving economic realities continue to pose a stumbling block to progress in multilateral negotiations. For instance, developed countries maintain that higher commodity prices and policy reforms in previous years had led to a substantial reduction in their use of trade-distorting agricultural support, while there was an increased use of such measures by developing countries, including for food security purposes. Meanwhile, many developing countries have stressed that persistent development challenges, such as pervasive poverty, food insecurity and a nascent industrial base, call for flexibilities and special and differential treatment.

**Interlinkages across issues have become a stumbling block for the Doha Round**

Another main bottleneck that shapes the contours of the post-Bali work programme is the interlinkage across different topics of the negotiations. For many developing members, this calls for "sequencing"—that is, an early harvest in terms of concrete results in reducing domestic support as a pre-requisite for providing concessions in other areas of the negotiations. For several developed countries, "parallelism" is essential to advancing negotiations, meaning that concrete results in domestic support are subject to parallel advancements in the market access package comprising agriculture, non-agricultural market access (NAMA) and services.

Several recent developments suggest no major breakthrough is expected from the Tenth WTO Ministerial Conference (MC10) in Nairobi in December 2015. A group of 50 developing and developed members submitted a communication stating their strong support to the multilateral trading system and determination to continue intensive efforts to develop a comprehensive package of credible outcomes that allows the conclusion of the Doha Round. In particular, these countries have called on all of the largest of the WTO members to work together and show the leadership necessary to make MC10 a success. The group underscores that a success would highlight the unique capacity of the WTO to deliver meaningful improvements in global trade rules and bring development benefits that cannot be matched through trade negotiations conducted outside the WTO.

The WTO Director-General confirmed that a work programme would not be delivered as it had been mandated, but that members had identified a road to success in Nairobi. Although several views will be difficult to reconcile, important commonalities can yield results in Nairobi. These would include development issues, particularly on LDCs, export competition on agriculture, and improved transparency in several areas. Regardless of the outcome of MC10, it will remain an imperative to pursue and promote the development dimension of the multilateral trading system, whether under the current framework or under a reformulated architecture. In any case, it is necessary to ensure that there is coherence between the multilateral trading system and the SDGs.

### *Agriculture and non-agriculture market access*

In agriculture, the market pillar is still looking for a common strategy to reduce tariffs and increase market access. In these discussions, the Group of 33—a group of developing countries concerned about food security issues—stressed the continued need for special products and special safeguard mechanisms to afford these countries with some flexibility to address, inter alia, the challenges related to higher and more volatile food prices affecting the food supply and the livelihood of subsistence and small-scale farmers. Also, the ongoing negotiations on domestic support aim to reduce trade-distorting agricultural subsidies in line with target 2.b of the SDGs. Countries that have traditionally used trade-distorting support have reduced it, while increasing non-trade distorting green box support, thus meeting technical commitments without reducing actual spending (box II.3). This has promoted the discussion on how limits for support should be applied and if the de minimis support for developing countries should be granted with special and differential treatment. In addition, the search for a permanent solution to the issue of public stockholding for food security in developing countries continues. Possible options include raising the limit of support for developing countries or redefining the method for calculating the subsidy.

**Reductions in tariffs and increased market access remain central in agricultural negotiations**

#### Box II.3

#### **Agriculture negotiations, food security and sustainable development**

The demand on world food is rising and projected to increase by 20 per cent by 2030. At the same time, hunger remains a challenge for almost 795 million people worldwide in 2014-2016—most of them from developing regions, representing 13 per cent of those regions' populations (Food and Agriculture Organization of the United Nations, 2015). The challenge of eliminating hunger and ensuring food security (i.e., the physical, social and economic access of all people, at all times, to sufficient, safe and nutritious food which meets dietary needs and food preferences for an active and healthy life) is duly recognized in the 2030 Agenda for Sustainable Development (target 2.1). The Agenda also aims to ensure sustainable food production (2.4) and double agricultural productivity, including through access to productive resources and inputs, knowledge, financial services, markets and opportunities for value addition (2.3) by 2030.

Many countries pursue policies and strategies for ensuring food security, which include subsidies for the production of staple food. Nevertheless, beyond environmental and geographical challenges, these strategies may not be economically viable or optimal as they may affect diversification and structural transformation. As such, several countries rely on foreign markets to meet their food demands, linking food security strategies to international trade. According to the food dependency index of the United Nations Conference on Trade and Development (UNCTAD), many countries in East Africa, Latin America and South Asia tend to be net food exporters while the remaining African and Asian countries are net food importers (figure II.3.1). Furthermore, many African and Asian economies have increased their dependence on imported food since 2008 (United Nations Conference on Trade and Development, 2015a).

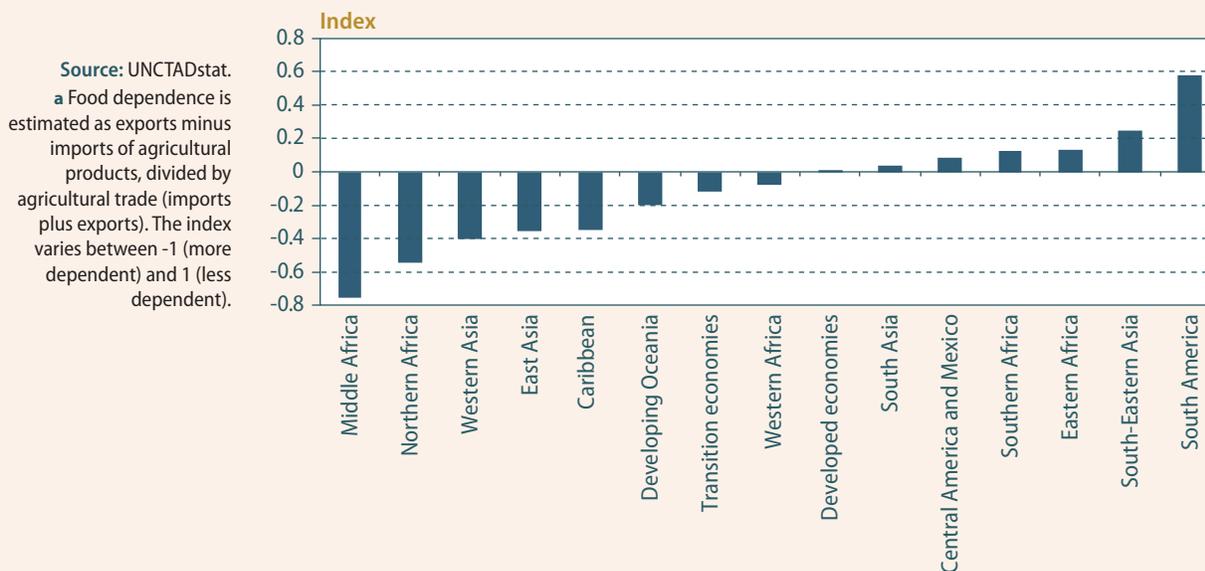
Consequently, fair and predictable international agricultural markets are necessary for contributing to food availability and affordability for many food-importing economies. The multilateral trading system needs to ensure access to staple food while encouraging more investment in food production and promoting sustainable agriculture. In multilateral trade negotiations, the market access pillar seeks to ensure the availability of food through tariff reduction, while the domestic support pillar aims to ensure stable prices and access to food by eliminating distortions in agricultural markets. Arguably, reducing subsidies will increase food prices and hence a balance must be reached by limiting trade-distorting support.

In the market access pillar, discussions revolve around tariff cuts and how these can be applied. An UNCTAD analysis (Vanzetti, 2015b) compared the impact on the African, Caribbean and Pacific Group of States (ACP) of different formulas regarding tariff cuts. It found that the different scenarios produce

*(continued)*

Box II.3 (continued)

Figure II.3.1

Food dependency index by region and development level, 2014<sup>a</sup>

modest and somewhat similar results in tariff reduction. For ACP imports, the impact of the formulas on applied tariffs is small, since there is an important difference between bound and applied rates. On exports, there is also a limited reduction in tariffs. This is due both to increased trade with other developing countries that are not making considerable tariff cuts and to little improvement in market access in the European Union, where preferential treatment is already applied. In addition, the ACP would not benefit from market access improvements because of preference erosion. ACP countries presented a proposal insisting on the need for flexibilities for developing countries in agriculture, even in the event of changes in the tariff reduction approach. These include special products, for which developing countries are to be given extra flexibility in market access for food and livelihood security and rural development. They also comprise a special safeguard mechanism to allow developing countries to raise tariffs temporarily to deal with import surges or price falls. Other big coalitions of developing countries in the World Trade Organization (WTO), including the Group of Thirty Three, have also insisted on flexibilities (United Nations Conference on Trade and Development, 2015b). Discussions are still ongoing on the options for cutting tariffs and related issues. In agriculture, tariffs are more important than domestic support or export subsidies.

Target 2.b of the Sustainable Development Goals provides a context for domestic support negotiations. It confirms that correcting and preventing trade distortions in agricultural markets, including through the elimination of all forms of export subsidies and all export measures with equivalent effect, in accordance with the Doha mandate, contributes to the objective of ending hunger, achieving food security and promoting sustainable agriculture. Disciplining the “Overall Trade-Distorting Domestic Support”, a category of support comprising all subcategories of trade-distorting support, was foreseen in the 2008 modalities. This envisaged limiting the possibility of eluding reduction commitments by changing the nature of support measures or targeted products. Still, some economies shifted trade-distorting support to “green box” support, meeting reduction commitments without reducing actual spending levels. This led to recent discussions focusing on whether numerical limits should apply to all countries and on whether the de minimis support for developing countries of 5.0 per cent of domestic production should be changed or granted with special and differential treatment. A permanent solution on public stockholding, still to be found, should contribute to food security.

Source: UNCTAD, Division on International Trade in Goods and Services, and Commodities.

The outcome of these negotiations is linked to results in other negotiating areas, placing agricultural issues as key points influencing the overall outcome of the Tenth Ministerial Conference of the WTO and perhaps of the Doha Round. The success of multilateralism therefore remains critical for eliminating hunger and promoting food security as underscored in the 2030 Agenda for Sustainable Development.

Increased industrial trade opportunities for developing countries, under the auspices of NAMA, are in line with targets 17.11 and 8.2 of the SDGs, contributing to diversification, technological upgrading and innovation. The key issue in negotiations has been how to ensure real market access while fulfilling the “less than full reciprocity” principle for developing countries. The issue of non-tariff barriers is not yet addressed but its use is on the rise. Possible outcomes in this area may be influenced by ongoing plurilateral negotiations, namely the Information Technology Agreement and the Environmental Goods Agreement. Increased market access in these areas would be relevant in terms of meeting certain targets and goals of the SDGs.

### *Services*

With the focus on agricultural negotiations, there has been limited engagement on services negotiations. Members agree that the focus should be on areas of market access and domestic regulation, and that a strong development dimension with flexibilities for developing countries should be part of the negotiations. Still, some members consider that the negotiations on the General Agreement on Trade in Services (GATS) rules on government procurement, subsidies and emergency safeguard measures have not advanced enough to become part of the work programme. Furthermore, discussions since the Bali Ministerial Conference have not narrowed the divergent positions on the level of ambition for the services negotiations, including whether certain sectors or modes should be given a greater focus, and whether to move forward with the services component of the post-Bali work programme or to wait until it is clearer what the work programme will contain for agriculture and industrial goods.

Furthermore, several major players are engaged in the plurilateral negotiations for the Trade in Services Agreement (TISA) outside the Doha Round, which has diverted attention from multilateral negotiations on services in the WTO. These negotiations involve 25 WTO members representing at least 70 per cent of global services trade, and negotiations are aiming for comprehensive and ambitious services liberalization with substantial sectoral coverage that attracts broad participation and that could be multilateralized. It is notable that some major developing countries are not part of this process, and the TISA compatibility with the WTO and GATS is questionable. In the absence of a critical mass, the future agreement would take the form of a preferential services agreement in the sense of GATS Article V. The negotiations are based on the GATS positive list approach while national treatment commitments would be applied horizontally. The negotiations also address regulatory disciplines such as licensing, financial services, telecommunications, e-commerce, and movement of professionals. The existence of multiple services RTAs among TISA participants implies that the effect of TISA on intragroup services trade may be limited. TISA participants' overall export interests may primarily rest with non-TISA participants.

One important development objective in multilateral services negotiations, in line with target 17.11, is achieving preferential market access for LDCs. In this regard, a services waiver allows non-LDCs to deviate from market access and national treatment obligations relating to the most favoured nation (MFN) principle under the GATS. Although the waiver aimed at allowing non-LDCs to deviate from market access and national treatment obligations relating to MFNs under the GATS was adopted in 2011, WTO members had not introduced preferential access in services for LDCs. The Bali decision provided a road map for the operationalization of LDC services waivers, resting largely on the formulation by LDCs of a collective request identifying the sectors and modes of their export interest.

**Several countries are engaged in plurilateral negotiations on services outside the Doha Round**

UNCTAD assisted LDCs in their collective request and in evaluating preferential treatment intentions and notifications. The LDCs collective request, submitted in July 2014, addressed horizontal and sectoral market access and national treatment restrictions in many sectors, including travel, tourism, banking, transport, logistics, education, information and communications technology, business process outsourcing and creative industry. The barriers affecting mode 4 (the movement of natural persons) were given particular attention, such as those relating to the recognition of educational and professional qualifications, and to costly application fees and burdensome documentation for visas, licences and work permits.

In the context of this waiver, 17 notifications expressing preferential treatment for LDCs services and services suppliers had been received by 2 November 2015, which was fewer than expected. Of these, several notifications address only parts of the collective request that had been presented by LDCs, and at least one notification is perceived as backtracking with regard to intentions that had been previously expressed. In general, the notifications addressed modes 1, 2 and 3 of trade in services. Some notifications include good examples of preferential treatment, including extending periods of entry and stay and waiving economic needs tests, visa fees and work permits. Some notifications also detail measures to enhance LDCs supply capacity, including by facilitating temporary movement for study and capacity-building and assistance in relation to the construction of infrastructures for tourism, education, medical, cultural and sporting services. Nonetheless, a commercially meaningful outcome will require more waivers for LDCs. Furthermore, the notifications did not adequately address trade through mode 4, which is important for many LDCs.

### *Trade facilitation*

#### **The Agreement on Trade Facilitation is still in the process of ratification**

Implementation of trade facilitation measures is expected to reduce overall trade costs and contribute to developing countries' exports in line with target 17.11 of the SDGs. It is also projected to promote economic diversification, technological upgrading and innovation in line with target 8.2 of the SDGs. The Agreement on Trade Facilitation, an outcome of the Ninth Ministerial Conference (MC9) of the WTO in 2013 in Bali, was the first binding multilateral agreement since the Uruguay Round. When two thirds of the WTO members ratify, it will enter into force. As of August 2015, twelve countries had completed ratification, and 73 countries, including four LDCs, notified the WTO of their "Category A" commitments (the self-designated provisions for immediate implementation). Depending on the progress in the ratification process, the Agreement could be a concrete outcome at MC10. Several developing countries, however, remain concerned regarding the cost and complexity of implementing some of the measures. Special and differential treatment in this agreement links the level and timing of commitments to implementation capacity, the provision of capacity-building, and acquisition of capacity. In this context, the WTO launched a Trade Facilitation Agreement Facility in 2015 in order to help developing countries build implementation capacity.

### *Development issues*

The duty-free and quota-free (DFQF) market access for LDCs, addressed by target 17.12 of the SDGs, is supported by a WTO ministerial decision. Almost all developed countries have implemented it and several developing countries have also extended it. Simpler and more transparent rules of origin are important for LDCs to use DFQF preferences. The new European Union (EU) Generalized System of Preferences, where third-party certi-

fication by public authorities will change to self-certification by registered exporters, is a relevant example of how to simplify and facilitate the rules of origin administration. In addition, provisions related to special and differential treatment should be precise, effective and operational to ensure that they are meaningful for LDCs.

## Regional trade agreements

The developments in the multilateral trading system, or the lack thereof, have been impacted by the increased prevalence of RTAs. As of April 2015, the WTO received notification of 612 RTAs, of which 406 were in force, including South-South, twenty-first century and mega-RTAs. The twenty-first century RTAs aim for full market opening and “behind-the-border” measures, pursuing regulatory coherence, overcoming non-tariff barriers and creating a platform for GVCs. These measures focus on services, investment, competition, capital movement, intellectual property and government procurement. Regulatory coherence is sought through harmonization, mutual recognition or mechanisms such as prior comments on regulatory initiatives. Mega-RTAs are the likely game changers. For instance, the Transatlantic Trade and Investment Partnership between the United States and the EU would cover half of global output and a third of global trade. The Regional Comprehensive Economic Partnership would create a free trade area between the Association of Southeast Asian Nations and its six external partners, covering half of the world’s population.

The Trans-Pacific Partnership (TPP) Agreement among Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Viet Nam was concluded in October 2015. It is the first case of a completed new-generation mega-RTA, which has a significant bearing on the future evolution of the international trading system and could give further impetus to negotiations of other mega-RTAs. The TPP creates a market of 800 million people with a GDP of \$28 trillion, over 40 per cent of the world gross product. Comprehensive in scope, the TPP covers goods, services, investment, e-commerce, intellectual property, government procurement, competition, labour protection, environment, regulatory harmonization, small and medium-sized enterprises (SMEs) and state-owned enterprises (SOEs). Driven also by geopolitical considerations, it is principally aimed at facilitating trade and investment among TPP parties, including through regulatory harmonization. The agreement sets a high-standard “template” for trade agreements in the twenty-first century and may attract new members, such as Indonesia, the Republic of Korea and Thailand.

The TPP is projected to yield annual global income gains of \$223 billion by 2025 pushing up world gross product by 1.0 per cent, and generating an estimated \$305 billion in additional world exports per year (United Nations Conference on Trade and Development, forthcoming). The bulk of the gains are estimated to arise from regulatory harmonization and mutual recognition, which will reduce trade costs. TPP members are the major beneficiaries of trade creation and diversion, but with asymmetries. For instance, exports from New Zealand and Viet Nam to the United States are estimated to increase by 13 per cent. Their high initial tariffs imply an important increase in market access, especially in meat for New Zealand and clothing for Viet Nam.

Non-TPP members, on the other hand, can be impacted by trade and investment diversion that is induced by preferential liberalization, and by adjustment costs derived from regulatory harmonization. The trade effects can be significant for some undiversified economies dependent on a few products and markets for exports, particularly certain

**RTAs cannot replace the role of the multilateral trading system**

**The Trans-Pacific Partnership is the first mega-RTA completed**

**Most of the gains from the Trans-Pacific Partnership are related to the reduction of trade costs...**

**...but other countries can also be affected by trade and investment diversion**

LDCs. Some TPP members, such as Canada, Mexico, Peru and Singapore that already benefit from pre-existing RTAs may also experience some trade diversion, as their relative preference margins diminish in favour of other TPP partners. These trade effects could be amplified if these immediate trade shocks lead to durable changes in investment, competition, technology and employment levels.

A computable general equilibrium analysis conducted by UNCTAD confirms that trade liberalization is generally beneficial in terms of income gains.<sup>11</sup> Still, these income effects are very modest globally, especially when compared with underlying growth. This is because tariff cuts are not very deep, due to already liberalized markets and to the abundance of persistent exemptions. Because of trade-diversion-related losses for non-members, the global gains in mega-RTAs are much lower than those of a potential Doha Round (Vanzetti, 2015a). Positive outcomes from the Doha Round, particularly on MFN tariff reduction and the effective implementation of DFQF market access for LDCs, could also serve for attenuating the possible adverse effect of mega-RTAs on non-members. Multilateral negotiations could also lead to generalized preference erosion with an impact for preference-dependent countries.

Efforts are warranted at the national and international levels to enhance productive capacities and export competitiveness, particularly in countries facing the adverse effects of trade diversion and preference erosion. Such efforts include assistance in meeting regulatory standards, as well as promoting diversification for greater resilience, and supporting adjustment processes through the implementation of social safety nets and active labour market policies such as labour reskilling. The RTAs have other potential development benefits: Many South-South trade agreements intensify and deepen regional integration, and contribute to productive capacity and regional infrastructure networks. Substantial income gains are expected from the volume of trade covered in new RTAs, and even larger gains from the strong regulatory focus aiming to reduce regulatory barriers. Non-trade measures, comprising sanitary and phytosanitary and technical barriers, affect over 50 per cent of exports from developing countries, 90 per cent of trade in natural resources, and 80 per cent of trade in manufacturing. They represent about 14 per cent of tariff equivalents on average, and even higher on agriculture.

These transformational shifts have implications for developing countries. Regulatory harmonization can raise costs of adjustment. Such costs should be minimized through the use of less stringent standards, mutual recognition and international standards. Stronger regulatory disciplines limit regulatory autonomy and thus may limit the scope of proactive development plans and industrial policies. Discipline on government procurement, SOEs and export taxes could limit support to domestic industries and to SMEs. For example, some RTAs aim for competitive neutrality but developing countries stress the importance of SOEs in delivering public policy goals. Also, investor-State disputes may lead to regulatory freezes, created by fear of legal challenge and compensation claims from investors. There

**The increasing prevalence of RTAs affects the credibility of the multilateral trading system**

<sup>11</sup> This analysis uses a multi-regional Computable General Equilibrium (CGE) model GTAP, capturing linkages between countries and inter-sectoral effects. Five scenarios are modelled: baseline from 2011 to 2025, Doha Round of multilateral negotiations, RCEP, TPP and TTIP. For more information, see Vanzetti (2015a).

## Box II.4

**Sanitary and phytosanitary measures and trade distortions**

Valued at about \$1.5 trillion annually, the international trade in agricultural products offers great opportunities to farmers from developing countries. Yet it is a challenging task for them to access the international agricultural market. Recent years have brought a significant shift in the trade policy of many countries, which is increasingly focused on “behind-the-border” measures. Consequently, for exporting farmers, market access is now more about fulfilling quality and safety criteria rather than dealing with quotas and border protection. Indeed, the commerce of agricultural products is heavily and increasingly determined by compliance issues, involving a wide array of regulatory measures. Many of these measures fall in the category of sanitary and phytosanitary (SPS) measures and include diverse conditions such as import licenses, inspection requirements, testing and certification requirements, labelling and packaging requirements, and quarantines. Many of these measures, although necessary to address quality, safety and environmental concerns as well as the needs of agrifood businesses to streamline food production chains, do ultimately add to production and transaction costs.

One of the most relevant aspects of SPS measures is their potential distorting effect on international trade. For exporters, the main concern is how well they can compete for market shares in highly regulated markets where costs of compliance are not trivial. Importantly, the cost of compliance with regulatory measures is often asymmetric across exporters, as the cost depends on infrastructure, technical know-how and the availability of production facilities. These aspects are usually available to larger firms based in developed and emerging markets and to firms integrated in global value chains, but they are generally less available—often not available at all—to smaller firms in many developing countries. Any proliferation and increased stringency of SPS measures therefore can induce shifts to exporters with stronger capacities for SPS compliance.

A recent UNCTAD study by Murina and Nicita (2014) examines the European Union (EU) framework of SPS measures and investigates the extent to which these measures affect export to the EU from low-income countries.<sup>a</sup> The study argues that the comprehensiveness of the EU regulatory framework, as well as its higher stringency vis-à-vis frameworks implemented by trading partners, act as an important market-access barrier for low-income countries. In quantitative terms, the study finds that the distorting effects of the EU SPS measures vary across product groups and result in a total loss of about \$3 billion, or about 15 per cent of exports, from low-income countries (figure II.4.1).

The UNCTAD study also finds that low-income countries which have deep preferential trade agreements with the EU (i.e., an agreement that goes beyond simple preferential access to cover beyond-the-border issues) can more effectively comply with SPS measures. This finding is important, as it suggests that some of the costs associated with SPS compliance can be reduced through well-targeted technical assistance programmes incorporated in trade agreements. Technical assistance programmes can help in meeting some of the fixed costs of compliance, such as those related to lack of infrastructure, quality control mechanisms and certification agencies, making low-income countries more competitive. Indeed, the disproportionate effect of the EU regulations on the exports of agricultural products from developing countries is recognized even within the EU regulatory framework.<sup>b</sup>

Going forward, developing countries will confront the challenges of adapting to the high levels of regulatory standards that regional trade agreements such as the Trans-Pacific Partnership Agreement are expected to enforce. Whether in terms of mutual recognition or harmonization, regulatory measures are likely to take a central role in many trade agreements in the future. In this regard, low-income countries would need to make sure that the sharing of costs related to compliance with the regulatory framework is addressed within the agreement, and possibly facilitated by targeted technical assistance. In addition, multilateral cooperation through an improved trade facilitation agenda, paired with existing initiatives such as Aid for Trade and the Enhanced Integrated Framework, should surely help developing countries cope with the challenges of meeting SPS and other regulatory standards.

*(continued)*

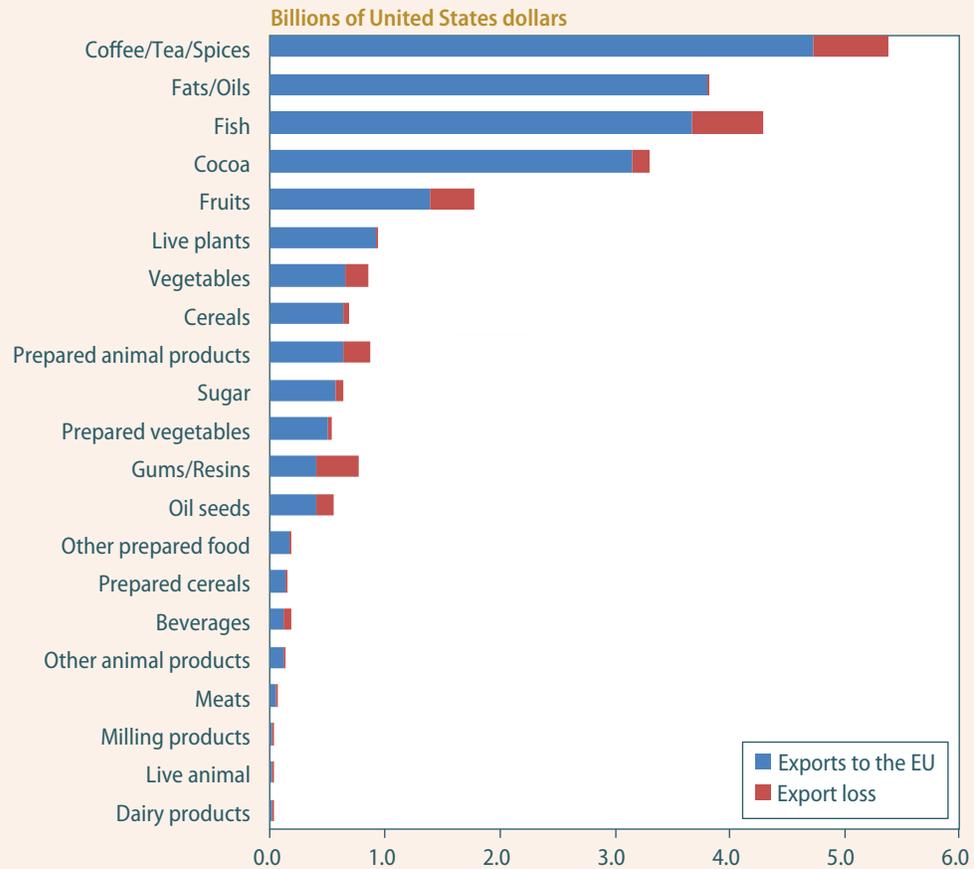
**Source:** UNCTAD, Division on International Trade in Goods and Services, and Commodities.

<sup>a</sup> Using the UNCTAD TRAINS database on non-tariff measures, this paper utilizes a gravity model of bilateral trade to investigate the effect of the EU sanitary and phytosanitary measures for 125 exporting countries and covering about 700 different products in 21 agricultural sectors.

<sup>b</sup> For example, EU Regulation No. 882/2004 acknowledges the special needs of developing countries, in particular of the least developed countries, for technical assistance to comply with EU regulations.

Box II.4 (continued)

Figure II.4.1  
Exports and export loss to the European Union



Source: UNCTAD, based on Murina and Nicita (2014).

are also systemic implications for the multilateral trading system. For instance, mega-RTAs can affect incentives for multilateralism and the regulatory templates of RTAs might be used as a basis for future multilateral negotiations. Most significantly, proliferation of RTAs may lead to a two-tiered trading system which would differentiate countries and affect the relevance and centrality of the multilateral trading system.

### Future direction

**Further coherence is needed between the multilateral trading system and the RTAs**

The multilateral trading system is a global public good with a universal, rules-based, non-discriminatory and equitable nature that can maximize the development potential of international trade. This is especially important as the potential of trade is not automatically translated into development benefits. The fact that the 20 largest exporters in 2014 (mainly developed and Asian economies) represented 71 per cent of world trade reminds us that inequality between and within countries—a concern explicitly stated in SDGs—remains a persistent development challenge requiring policy attention.

Furthermore, the importance of multilateralism is matched by its challenges. Limited progress in the Doha Round, together with an increasing prevalence of new-generation RTAs, affects the credibility and centrality of the multilateral system. Mega-RTAs in particular can diminish incentives for multilateral negotiations with potential implications for outsiders, especially for developing countries. This highlights the importance of enhancing coherence between RTAs and the multilateral trading system so they can support and sustain an enabling development environment. It also underscores the need to review the institutional adaptations that the multilateral trading system requires for enhancing its relevance and effectiveness as it faces the reality of multiple parallel processes.

Global trade and its governance should be consistent with sustainable development goals, and the multilateral trading system has to be revitalized, with improved credibility and relevance. This will require a fair, equitable and open trading environment and coherence among multilateralism, RTAs and policy space, including through special and differential treatment, so that trade can contribute to broad-based sustainable development and reduce inequalities among and within economies. Furthermore, the potential of large benefits from productivity gains underlines the importance of developing a best-fit policy mix that includes trade policy, regulatory and institutional frameworks, and a new generation of industrial policies focused on enhancing competitiveness and value addition through technology, innovation and structural change.



## Appendix

### Measuring the commodity terms-of-trade effect of the commodity price drop

In an attempt to measure the net commodity terms-of-trade<sup>1</sup> effect of the global commodity price changes at the country level, monthly commodity export and import price indices for a total of 178 economies have been created. For each economy, the indices are constructed by weighing the monthly spot price of a commodity by its share in the economy's commodity export or import basket.<sup>2</sup> A total of 41 international commodity prices have been considered, with the indices covering, on average, 90 per cent of commodity export values and 86 per cent of commodity import values in 2014. The construction of these monthly indices allows examination of the country-specific impact of the commodity price shocks on the commodity terms of trade. Focus is primarily on commodity-dependent countries, defined here as countries for which the sum of commodity exports and imports accounts for over 30 per cent of GDP. These countries are classified into four groups, based on their main export commodity: fuel, food, metals and agricultural raw materials.

Figure II.1.1 in box II.1 shows the declines in the commodity export and import price indices for 81 commodity-dependent countries over the period April 2011-August 2015. In a second step, indices are scaled by the respective share of commodity exports and imports in GDP in order to take into account differences in the importance of commodity trade across countries. This provides a first indication of how the commodity terms of trade shock affects gross domestic income and domestic demand.<sup>3</sup> Figure II.A.1 depicts the adjusted declines in the export and import price indices. The adjustment tends to reinforce the negative price effects for fuel exporters as indicated by the significant distance from the 45-degree line. Many fuel exporters have not only seen sharp price declines on the export side and very limited price declines on the import side, but the share of fuel exports in GDP is also large. As a result, the negative impact of the commodity terms-of-trade shock on these countries is expected to be large.

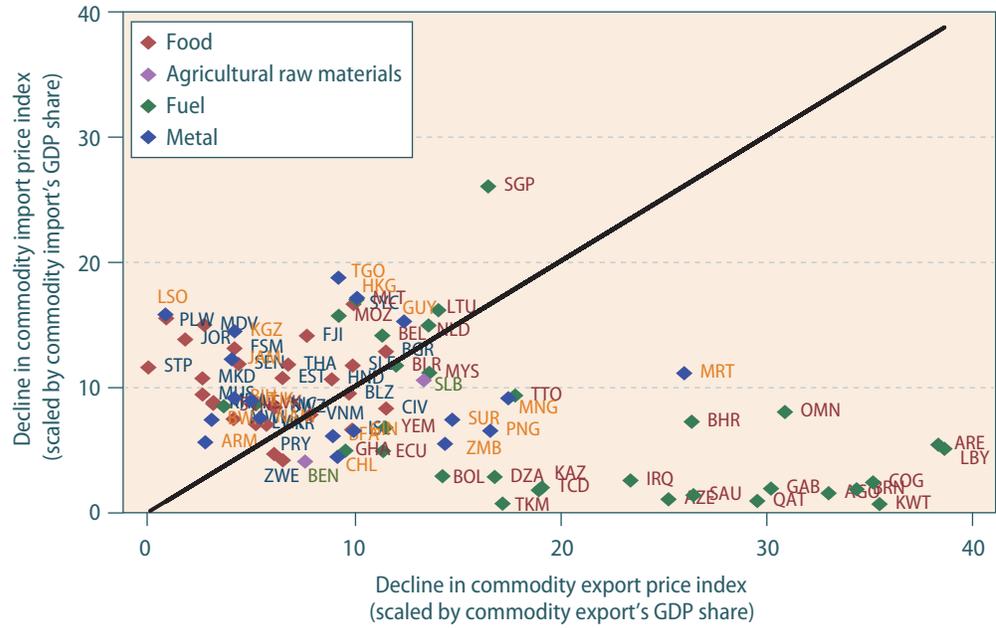
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<sup>1</sup> Commodity terms-of-trade is defined here as the price of a country's commodity exports in terms of its commodity imports.

<sup>2</sup> Commodity price data were retrieved from UNCTADstat, IMF Primary Commodity Price data and the World Bank Commodity Price Data (The Pink Sheet). Commodity trade data were retrieved from UNCTADstat.

<sup>3</sup> A comprehensive assessment of the country-level impact of the commodity price shocks would require a more complex and dynamic framework that takes into account the changes in inflation, exchange rates, fiscal balances and other macroeconomic variables.

Figure II.A.1  
**Commodity export and import price decline, scaled by GDP share of commodity export and import, April 2011–August 2015**



Source: UN/DESA.  
 Note: See table J in the Statistical Annex to this publication for definitions of country codes.