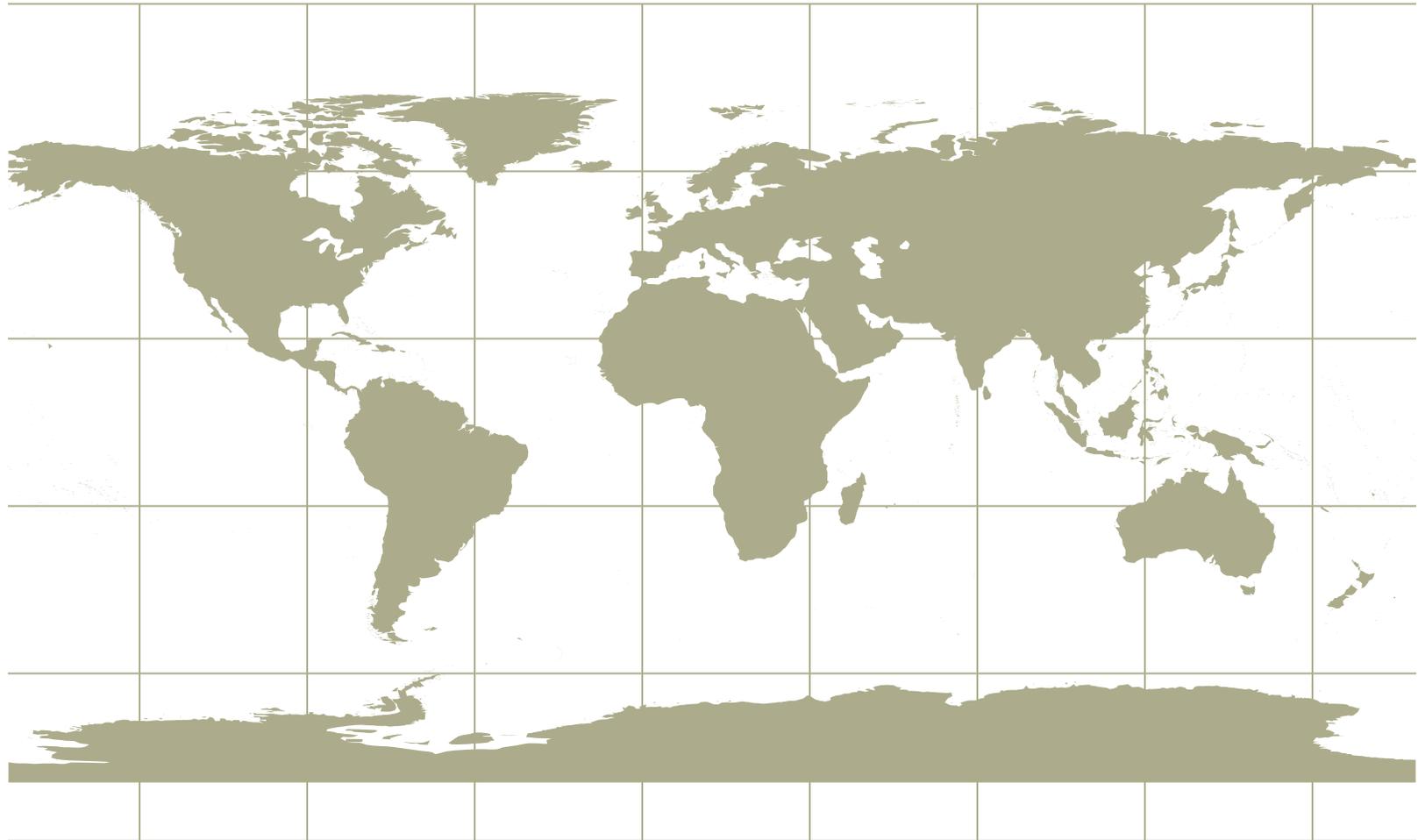


World Economic Situation and Prospects 2015



United Nations
New York, 2015

Chapter II

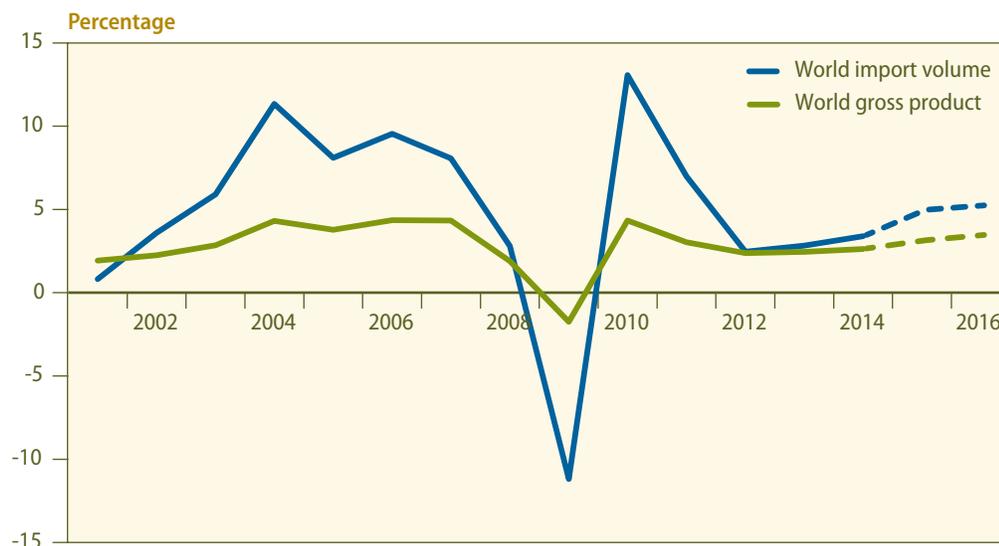
International trade

Trade flows

World trade flows, measured in terms of import volumes, continued to grow at a slow pace in 2014, expanding at about 3.3 per cent, slightly faster than in 2013 but still well below the long-term trend of the decades before the global financial crisis. In the two decades prior to the crisis, for instance, the annual growth of world trade, measured by imports in volume, was on average twice the growth of world gross product (WGP), although trade flows were characterized by much higher volatility than WGP (figure II.1). The eruption of the global financial crisis in 2008 and the subsequent Great Recession in 2009 led to a collapse in world trade flows, with the volume of world imports plummeting over 11 per cent in 2009, 5 times the percentage decline in WGP. Except for a strong rebound in 2010, world trade has been expanding at a sluggish pace during the recovery, at only about the same rate as WGP. In the forecast period, trade growth is expected to expand moderately, at a pace of 4.7 per cent in 2015 and 5.0 per cent in 2016. While this will be an improvement, the ratio of the growth of world trade to that of WGP will still be only 1.5, not a full recovery to the pre-crisis trend.

World trade continued to grow at a slow pace in 2014, but is expected to rise over the forecast period

Figure II.1
Growth of world trade and world gross product, 2001–2016^a



Source: UN/DESA.
a Growth rate for 2014 is partially estimated; rates for 2015 and 2016 are forecast.

At issue is whether the slowdown in trade growth relative to WGP in the years since the global financial crisis reflects a fundamental change in the structure of the global economy, or a transient and cyclical change in the relationship between trade and gross domestic product (GDP). The answer is probably that both cyclical and structural changes are at play.

The slow recovery in developed countries and decelerations in developing countries are blunting trade growth

Among the cyclical changes, the anaemic recovery in major developed countries, particularly the protracted recession in the euro area, has led to feeble import demand. As indicated in the next section, for example, European countries' imports from outside Europe are currently more than 7 per cent below the levels of 2008, and their imports from other European countries are also 8 per cent lower than the levels of 2008. Moreover, weak economic recovery in developed countries has had adverse effects on trade flows in developing countries, as developing countries contribute to more than 30 per cent of the exports to developed countries. In the medium term, stagnant wage growth in many developed countries, coupled with ageing populations, could increase downward pressure on import growth. Furthermore, as trade between developing countries represents a quarter of world trade, slowing growth in developing countries has also weighed on world trade growth.

An increase in post-crisis trade protection is restricting trade growth

After the eruption of the global financial crisis, a large number of countries adopted temporary protectionist measures on international trade and investment, restricting trade flows. For example, the Group of Twenty (G20) countries have adopted 1,244 trade-restrictive measures since October 2008, but only 282 of these had been removed by mid-October 2014.¹ Furthermore, between mid-May and mid-October 2014, G20 members put in place 93 new trade-restrictive measures. The continued accumulation of these restrictive measures remains of concern. This highlights the importance of renewed global efforts to reduce trade restrictions by refraining from the imposition of new measures and eliminating existing ones.

Some factors previously boosting trade growth may have waned

However, some changes in the relationship between trade growth and WGP growth may be structural. World trade can grow faster than WGP for a sustained period only if the prices of international goods and services continue to decline relative to the prices of domestic goods and services. These relative price declines can occur through such factors as new trade agreements to reduce tariffs and other trade barriers, or technological innovations to lower the costs of international transportation. The strong trade growth relative to WGP (a ratio of 2:1) in the 1990s and 2000s was indeed supported by these factors. For example, the achievements of the Uruguay Round of multilateral trade negotiations in the General Agreement on Tariffs and Trade (GATT); the economic integration of the economies in transition, China and other developing economies into the global economy, which removed and reduced barriers to international trade and investment, as exemplified in the process of China's accession to the World Trade Organization (WTO); the increased trade and monetary integration in the European Union (EU), especially the adoption of the euro for a growing number of countries in the region; the reduction of transportation costs by the revolution in information and communication technology and other technologies; and the formation and increasing expansion of global value chains, which distributed various stages of production to different countries, have all significantly promoted international trade. This led to a much faster growth of trade flows in many countries relative to the growth of their GDP and, at the global level, to the growth of world trade at twice the rate of WGP.

¹ World Trade Organization, "Report on G-20 Trade Measures (mid-May 2014 to mid-October 2014)", 5 November 2014.

Some of these key factors driving the growth of world trade before the global financial crisis may have run their course. The WTO Doha Round of multilateral trade negotiations, for example, has made little progress in the past fourteen years, failing to provide new impetus to trade growth. Some may argue that the Doha Round has been at an impasse since 2001, but world trade still registered high growth in the years before the financial crisis of 2008. This is because world trade in the run-up to the crisis continued to benefit from the lagged effects of the trade liberalization of the earlier years. For example, although China's accession to the WTO occurred in 2001, China had a grace period of five years to gradually remove or lower a large number of trade barriers. By now, the lagged benefits from the earlier trade agreements before the Doha Round may have tapered off. The proliferation of various regional trade agreements (RTAs) may generate some new trade flows in some regions, but the overall effects of RTAs on world trade in the long run are not certain and cannot replace the role of the multilateral trading system (see the section on trade policy).

The integration process of the economies in transition and China into the global economy, after accelerating in the 1990s and 2000s, may also have reached a steady state. For instance, after two decades of rapid growth in its exports, at an annual rate of above 20 per cent, China's share in total world trade has increased from a small fraction to about 12 per cent, in line with its share of GDP in WGP. With its wages increasing markedly, its process of transferring labour from the agricultural sector to the manufacturing sector diminishing, and its restructuring towards the services sector, as well as the rising environmental costs associated with industrialization, China's growth in exports is not expected to return to a double-digit pace. On the positive side, the rise of the African economies can provide a renewed impetus to world trade in the next decades, but it will take some time to see the results on a large scale, as the region's share in world trade is still small, at about 3 per cent.

In short, growth of world trade is projected to pick up some momentum from the subdued pace of the past few years in the aftermath of the financial crisis, but the dynamism of the two decades before the crisis may not return soon.

Regional trends

Developed countries are expected to see some improvements in trade flows, with export growth rising from 3.5 per cent in 2014 to 4.4 per cent in 2015. Import growth will also progress at a similar rate through 2016. Trade growth in the United States of America has been relatively weak, although export and import growth has still been above GDP growth. Trade grew by 2.7 per cent in 2014, and a substantial strengthening of trade is expected over the forecast period, with exports growing by 5.3 per cent in 2015 with some slowdown in 2016 to 4.8 per cent as dollar strength cuts into trading partners' purchases. This will be driven by increased foreign demand for capital goods and industrial supplies. In addition, there have been two other developments affecting trade in the United States—significant increases in domestic oil production and a relatively rapid appreciation of the dollar vis-à-vis other currencies. The degree to which the rising dollar will have an impact on export growth remains to be seen; it will depend on the level at which exchange rates stabilize as well as the situation among the trading partners. Import volume growth is expected to rise in a similar pattern as export growth.

Despite the fragile situation in Western Europe, exports and imports are estimated to have grown by 3.2 per cent in 2014, relatively high compared to GDP growth. The currency dynamics have played a role, as the appreciation of the euro in 2013 dampened exports;

Developed countries see some improvement in trade...

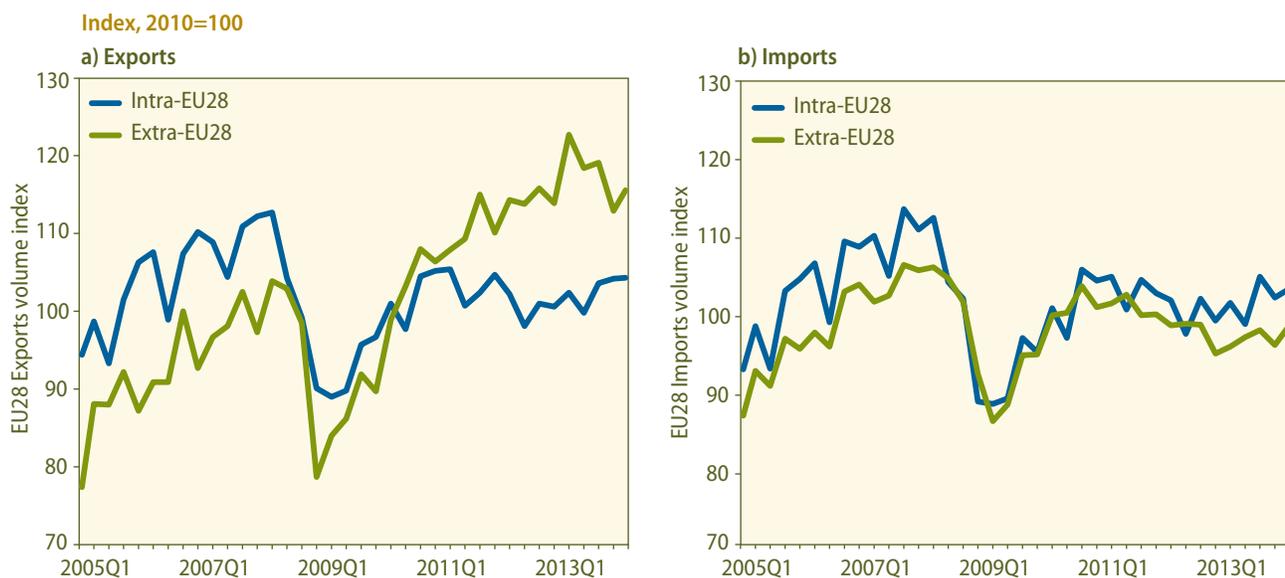
however, its depreciation in the latter half of 2014, and continuing on into the forecast period, is expected to provide a support to exports. Over the forecast period, both export and import growth are expected to improve for the new EU members along with growth prospects for the rest of the EU, with export growth expected to rise from 4.8 per cent in 2014 to 5.1 per cent in 2015 and 5.4 per cent in 2016. Imports are expected to grow similarly, by 5.2 and 5.8 per cent in 2015 and 2016, respectively. As highlighted in chapter I, the geopolitical tension around Ukraine has also impacted trade in a number of countries in the region and could further dampen trade prospects if there is a significant flare-up or further tightening of sanctions. The EU as a whole is expected to see export growth rise from 3.3 per cent in 2014 to 4.4 per cent in 2015 and 4.7 per cent in 2016, with a similar upward trend expected for imports.

...although, intra-EU trade remains sluggish

An interesting feature of the EU region (EU-28) has been the changes in trends with regards to intra- versus extra-EU trade. For most of the past decade, including the crisis period, intra- and extra-EU exports have followed a very similar pattern (figure II.2). However, since mid-2011, intra-EU exports have remained roughly flat, whereas extra-EU exports have risen by more than 7 per cent. More recently, beginning between the fourth quarter of 2012 and the first quarter of 2013, extra-EU imports were flat on average and intra-EU imports increased, albeit from a low level. Overall, the low growth in the euro area has continued to put a damper on intraregional trade, although this may pick up in the forecast period as some modest improvements in euro area growth are expected.

In developed Asia and Oceania, exports have increased relatively rapidly, up from 2.8 per cent in 2013 to 5.0 per cent in 2014. Japanese export growth was roughly the same between 2013 and 2014, despite the substantial depreciation of the yen vis-à-vis the United States dollar. This has resulted in a continuing trade deficit, as imports have remained relatively strong over the same period, although with considerable volatility due to changes in sales taxes. Australian export growth remains relatively strong, although lower than in pre-

Figure II.2
European Union trade volume: intra- and extra-EU trade, 2005 Q1–2014 Q2



vious years as minerals prices have fallen and exports to China have tempered. These trends are expected to continue into 2015, further dampening Australian exports. The region as a whole is expected to see some weakness in 2015, with export growth falling to 2.8 per cent, with some improvement in 2016 to 4.1 per cent. Import growth is expected to decelerate from its 2014 high of 4.4 per cent to 3.7 per cent in 2015 and 1.8 per cent in 2016.

Export trends for the Commonwealth of Independent States (CIS) have been heavily affected by the flattening or contraction in oil output in the CIS energy exporters and the ongoing conflict in Ukraine. A plateau in oil production has curbed export growth of the Russian Federation, while exports plummeted sharply in Ukraine. The overall weakness of the economy of the Russian Federation has slowed export growth in other CIS countries. Exports from the region in 2014 are estimated to be at about the same level as 2013 and are expected to rise somewhat over the forecast period, by 0.6 per cent in 2015 and 1.7 per cent in 2016. The depreciation of the Russian currency and the ban by the Russian Federation on food imports from the Organization for Economic Cooperation and Development (OECD) countries have led to a contraction in imports; devaluations in Kazakhstan and Ukraine and lower remittances in smaller CIS economies have also reduced import growth in the region. Imports in the CIS are estimated to fall by 3.4 per cent in 2014 and improve slowly over the forecast period, rising by only 0.2 and 1.1 per cent in 2015 and 2016, respectively. Despite the slow growth in the EU, South-Eastern Europe is expected to see continued export expansion, albeit with some volatility. Exports are estimated to grow by 6.5 per cent in 2014, rising to 7.4 per cent in 2015 and then receding slightly to 5.3 per cent in 2016. Import growth is expected to strengthen in the forecast period, rising from 6.0 per cent in 2014 to 6.8 per cent in 2015 and 7.0 per cent in 2016.

Growth of exports from developing countries is expected to increase from 3.9 per cent in 2014 to 4.6 per cent in 2015 and 5.5 per cent in 2016, while growth of imports will expand similarly from 3.8 per cent in 2014 to 5.3 and 6.0 per cent in 2015 and 2016, respectively. Africa's exports continued to be relatively weak in 2014, growing only by 2.0 per cent. This weakness was driven by a variety of factors, including slow growth in North Africa and persistent fragility in Central Africa. Tourism and commodity exports have also been slowed by a number of factors, including the Ebola outbreak, terrorist attacks and domestic and political turmoil. This is expected to reverse somewhat in the forecast period with export growth rising to 4.6 per cent in 2015 and 5.0 per cent in 2016, driven by a reversal in North Africa to positive export growth, continued robust growth in East and Southern Africa and improvements in West Africa. Import growth is expected to continue strengthening after rising to 5.4 per cent in 2014, up to 7.0 per cent by 2016.

East Asia experienced relatively moderate export growth in 2014, albeit with significant divergence among countries. Amid strong demand for electrical and electronic goods, manufactures exporters, such as Malaysia, the Philippines and Viet Nam, continued to perform significantly better than commodity exporters like Indonesia. Exports increased moderately in China, the Republic of Korea, Singapore and Taiwan Province of China, but were virtually flat in Thailand and contracted slightly in Indonesia. In Indonesia, the decline can be attributed not only to weak international commodity prices, but also to new regulations banning unprocessed mineral shipments. In Thailand, the stagnation mainly reflects the impact of the political turmoil in the first half of 2014 and a shift in global demand away from hard discs. Overall, the region is estimated to have seen 4.0 per cent growth in exports in 2014. This will improve in the forecast period to 4.8 per cent in 2015 and 5.4 per cent in 2016 as global demand picks up. This pace is, however, still well below pre-crisis trends.

CIS trade is weighed down by conditions in the Russian Federation

Developing countries will see an improvement in trade growth over the forecast period

South Asia shows relatively strong export growth

Import growth has been slightly weaker, at only 3.5 per cent in 2014, although a gradual recovery to 4.9 per cent in 2015 and 5.5 per cent in 2016 is expected.

Most South Asian economies, including Bangladesh, India, the Islamic Republic of Iran and Sri Lanka, recorded relatively strong export growth in 2014. Garment shipments—the main export good in Bangladesh, Pakistan and Sri Lanka—continued to expand at a solid pace amid robust demand from developed economies. Several countries also benefited from the marked depreciation of their currencies in 2013 and from strong growth in tourism revenues. The region as a whole is estimated to have seen export growth of 8.6 per cent in 2014. The prospects for exports remain favourable, with average growth projected at 8.5 per cent in 2015 and 9.1 per cent in 2016. On the import side, South Asia's economies generally benefited from the significant decline in global commodity prices, notably fuel prices, in the past year. Moreover, some country-specific measures, such as an import duty on gold and silver in India, helped curb total import spending. Import growth is estimated at about 4.0 per cent in 2014, but is expected to strengthen over the forecast period to 6.1 per cent in 2015 and 7.6 per cent in 2016.

In Western Asia, the major oil exporters have seen a slight decrease in oil demand, which, combined with the fall in oil prices, has lowered export figures for oil exporters such as the Cooperation Council for the Arab States of the Gulf (GCC) countries. These trends are expected to continue into the forecast period, with potentially still sharper falls in the value of oil exports from the GCC countries over the next few years, depending on whether oil price trends continue. Conversely, Turkey has benefited from the depreciation of its currency, which has increased the competitiveness of its exports. The depreciation has caused Turkish imports to fall. Exports from Western Asia are estimated to have rebounded slightly from low growth in 2013 to growth of 3.0 per cent in 2014, but this remains below pre-crisis trends. Export growth is expected to grow at the same pace in 2015 and then increase to 5.3 per cent in 2016. Despite the falling oil prices, import volumes have remained strong in the region, growing by 4.9 per cent in 2014, and are expected to rise by 6.6 per cent in 2015 and 7.4 per cent in 2016, driven by large-scale infrastructure projects.

The trade picture for Latin America is mixed, with some improvement expected

Expectations regarding trade for Latin America and the Caribbean are mixed. Exports of Mexico and Central America are estimated to have increased by 4.7 per cent in 2014, and are expected to maintain a similar pace of 4.1 per cent in 2015 and 4.7 per cent in 2016. Import growth has remained relatively strong after a dip in 2013 and is expected to stay above 5.0 per cent between 2014 and 2016, driven in part by strong domestic demand and investment. By contrast, slow growth in Europe and the growth moderation in China continue to weigh on exports of South America. Some improvement in exports from South America is expected over the forecast period, with 2.8 per cent growth expected in 2015 and 3.5 per cent in 2016. After slowing down in 2014, owing to subdued investment and household consumption, imports to South America are expected to rise gradually over the forecast period to 3.2 per cent in 2015 and 4.8 per cent in 2016.

Trade decomposition

Many of the shifts in trade patterns that were observed over the past few decades continued in 2014, with developing countries exporting an increasing share of world trade by value, particularly manufactured goods. The destination of exports points to a more pronounced shift, as developing countries export a higher share to other developing countries than in the past, with a comparable fall in developed-country exports to developing countries

(figure II.3). By contrast, the shift in exports to developed countries has been considerably lower, and developed countries still export most of their goods to other developed countries. Much of the rise in developing countries' share of world exports is due to East Asia's rapidly increasing share of global manufacturing exports, which has risen from one fifth in 1995 to over one third in 2013 (figure II.4). The expansion of China's world trade profile has been a significant driving force in this rise, with a more than fivefold increase in the country's share of global manufacturing exports, to about 17.3 per cent in 2013. A significant portion of the shift in manufactured goods trade shares has come at the expense of the United States,

Figure II.3

Regional shares of exports to developing and developed countries and economies in transition, 1995–2013

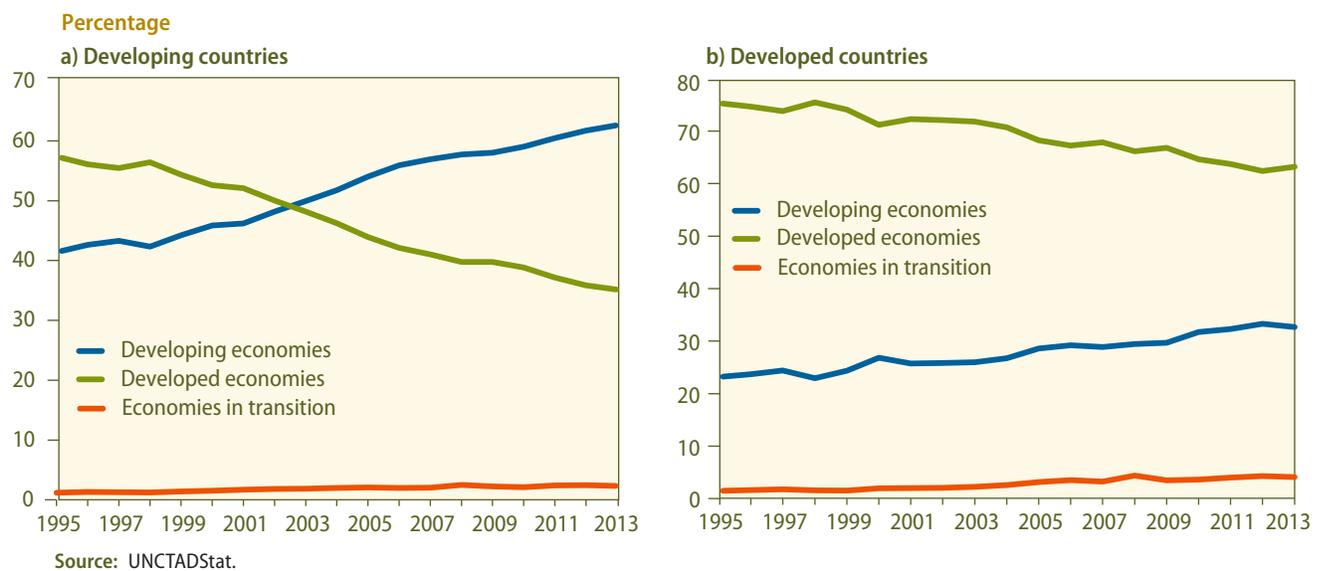
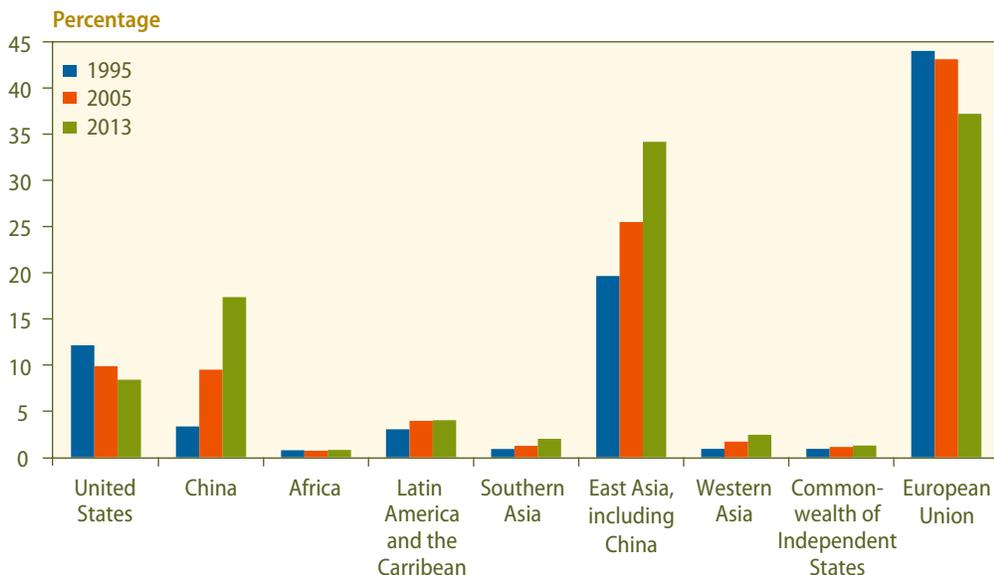


Figure II.4

Regional share in global manufacturing exports



whose share fell by almost 4 percentage points. The EU is still the leading global manufacturing exporter, but its share also decreased, from 44.0 per cent in 1995 to 37.2 in 2013. If current trends persist, East Asia will take over as the largest exporter of manufactures by value in the forecast period.

Developing countries, particularly in East Asia, export an increasing share of the world's manufactured goods

Within the manufacturing sector there have been some significant changes, particularly as global value chains have expanded across the globe. Along with its overall increase in manufacturing exports, East Asia has seen its share of electronics exports rise from less than 20 per cent in 1995 to about 50 per cent in 2013. Mirroring this upward trend in East Asia, major developed-country electronics exporters, such as Japan, the United States and some European countries, have seen their shares diminish. There have been two parallel developments in this process. Some East Asian economies such as the Republic of Korea and Taiwan Province of China have seen their exports of intermediate goods to other countries (mainly in the region) rise, along with increases in the intermediate goods embedded in their own exports. China, on the other hand, continues to rely to a much greater degree on imported inputs for its exports with limited input into other country's production processes. Meanwhile, the Philippines has seen its exports increasingly contribute to value chains in other countries, while absorbing a decreasing fraction of inputs from other countries in their own exports.

The EU share in primary product exports has declined significantly

Trends for exports of primary products are somewhat different, influenced to some degree by changes in commodity prices over the past years. Overall, there has been a significant decline in the EU share in primary product exports, from 32 per cent in 1995 to about 22 per cent in 2013. This decline has been seen across almost all types of commodities, with only a few exceptions, such as tobacco, some types of crude materials, and animal oils and fats. In particular, there have been noticeable declines in the EU export shares in products such as meat, sugar, dairy products, beverages and crude fertilizers. However, the region continues to provide a significant portion of the world's exports in many of those areas. At the same time, some regions have increased their market shares of primary commodities, with the biggest increase coming from Western Asia—although this was only by a little more than 8 per cent over the same period, particularly in fuels. For fuels in particular, the CIS has seen an increase from 1995 to 2013 by 4.5 percentage points to almost 15 per cent of world fuel exports. The United States has seen a relatively large increase in its share of fuel exports as well, by 55 per cent between 1995 and 2013. This increase still only puts United States' fuel exports slightly above 4 per cent of the world total, but this is high enough to rank in the top five world fuel exporters.

Trade in services

World services exports continue to grow, mainly in developing countries

World services exports have continued to increase in recent years, providing some support to the sluggish performance of global trade. According to the most recent data, global exports of services increased by 5.5 per cent in 2013 and 7.0 per cent in the first quarter of 2014, at current prices. As a result, services exports reached \$4.7 trillion in nominal value in 2013, about 20 per cent of total exports. The upward trend in services exports has been driven by developing countries, particularly in Asia and Latin America, as well as economies in transition (figure II.5). In addition, least developed countries (LDCs) have exhibited a remarkably fast expansion, although starting from a low initial level. As a result, between 2000 and 2013, the share of developing countries in world services exports rose from 23 per cent to 30 per cent, particularly in construction and computer and information services (figure II.6).

Trade in services is highly correlated with foreign direct investment (FDI). Over 70 per cent of world FDI outflows between 2010 and 2012 were related to services activities. Developing countries' share in global FDI outflows into services is still low at 17.0 per cent, but this represents a remarkable increase from the early 1990s when it was only 0.6 per cent. Services trade also requires cross-border movement of people supplying services in export markets, particularly the provision of professional and business services, and thus has a strong linkage to the growth in global remittance flows.

Figure II.5
Evolution of services exports by region, 2005–2013

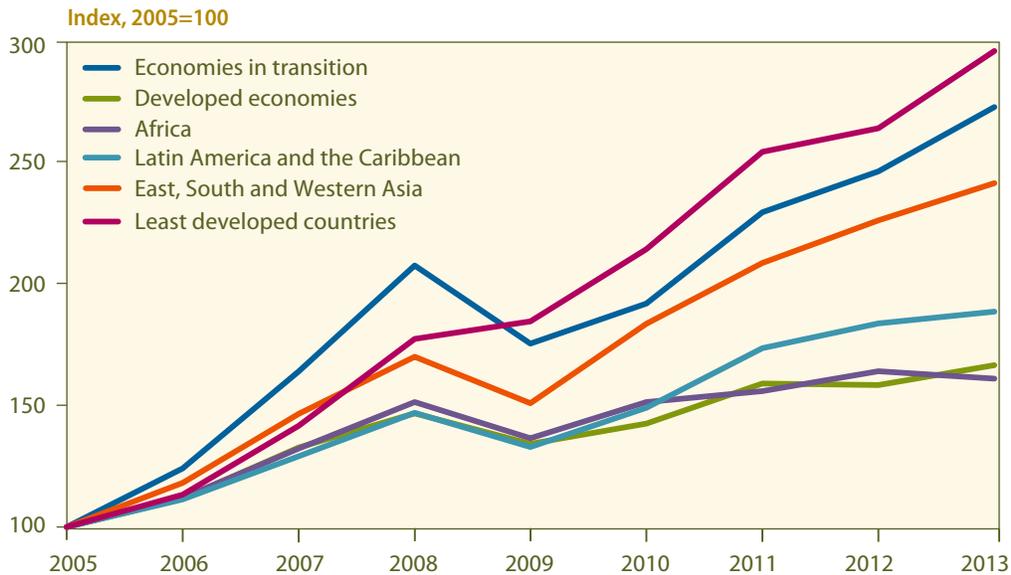


Figure II.6
Developing economies: share in world services exports by sector, 2000 and 2013



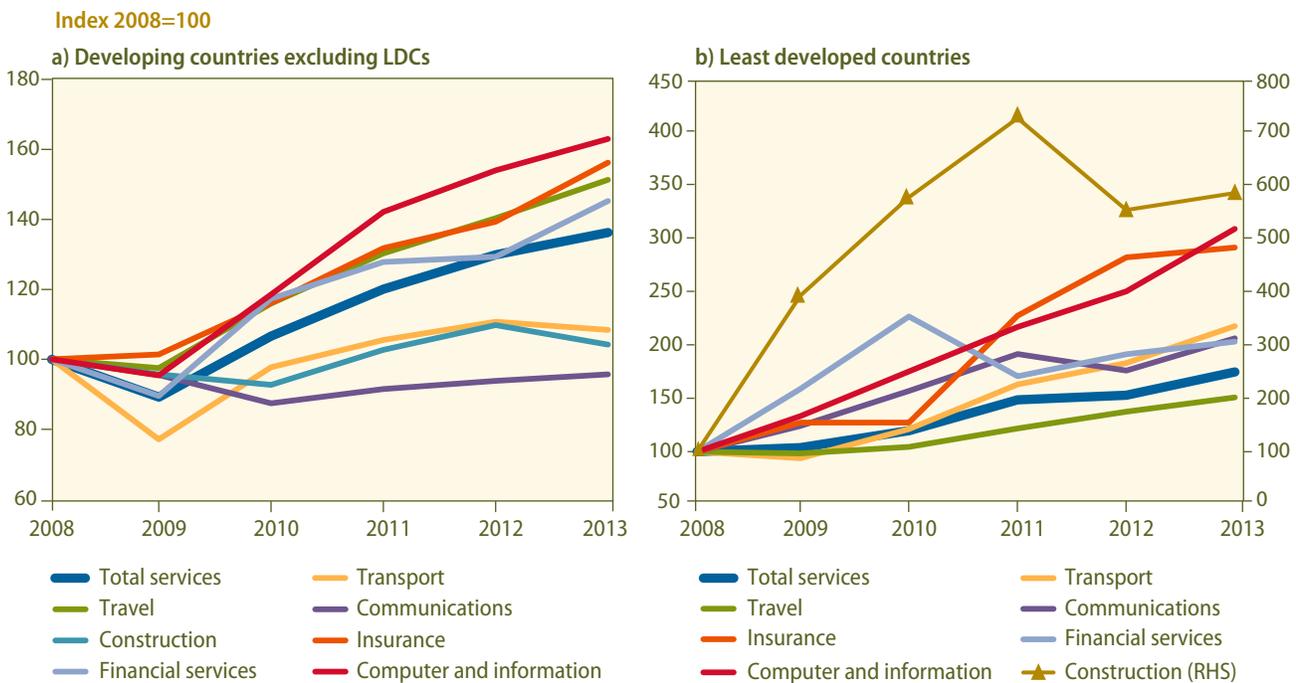
Between 2008 and 2013, the most dynamic services trade sectors in developing countries were computer and information services (figure II.7), posting an annual average growth in exports of these services by 13.0 per cent. Other fast-growing services trade sectors for developing countries were insurance services, followed by travel services and financial services. Communication services, however, have not yet recovered their pre-crisis level. Meanwhile, LDCs posted the highest increase in computer and information services, insurance services and, in particular, construction. However, these sectors together represented just 7.0 per cent of total services exports for LDCs in 2013.

Primary commodity markets

Prices of major commodity groups declined in 2014, with the exception of tropical beverages

Non-oil commodity markets strengthened during the first quarter of 2014, led by strong food and tropical beverages prices, but eased thereafter. As a result, the United Nations Conference on Trade and Development (UNCTAD) Non-oil Nominal Commodity Price Index² increased from 245 points in January to 252 points in March 2014, and decreased afterwards by 6 per cent to reach 236 points in September (figure II.8). The average value of the index over the period of January–September was down about 6 per cent compared to its equivalent value in 2013, but it remained high relative to its long-term trend. Compared to 2013, price trends of major commodity groups registered a decline, with the exception of tropical beverages.

Figure II.7
Exports of services by sub-category, 2008–2013



Source: UNCTADStat.

² The UNCTAD Non-oil Nominal Commodity Price Index covers these subgroups of commodities: food, tropical beverages, vegetable oilseeds and oils, agricultural raw materials, and minerals, ores and metals.

Box II.1

Trends in international tourism

Demand for international tourism remains robust

Despite a global economy in low gear, international tourist arrivals (overnight visitors) increased by 5 per cent worldwide in 2013, reaching a record of 1.1 billion. This upward trend continued in the first half of 2014, when international arrivals grew close to 5 per cent compared to the same period in 2013, with the Americas recording the highest growth (6 per cent), followed by Asia and the Pacific and Europe (5 per cent). Thus, global results are in line with the World Tourism Organization (UNWTO) forecast of 4.0 to 4.5 per cent for 2014 and above the long-term forecast of 3.8 per cent for the period 2010 to 2020.

The positive conditions of the tourism sector are also reflected in the confidence index as measured through the UNWTO Panel of Experts. Since 2013, the confidence index has increased to a level only reached in 2007, previous to the financial crisis. However, the most recent four-month survey shows a slight decline in confidence, largely due to the current geopolitical and health risks across the world, including the Ukraine crisis, the conflicts in the Syria Arab Republic and Iraq, and the Ebola outbreak in West African countries.^a

Export earnings from international tourism reach \$1.4 trillion

Total export earnings generated by international tourism reached \$1,409 billion in 2013. Receipts earned by destinations from international visitors—as recorded in the Balance of Payments Travel credit—grew by 5 per cent in real terms to reach \$1,195 billion, while an additional \$214 billion was earned by international passenger transport (rendered to non-residents).

International tourism (travel and passenger transport) accounts for 30 per cent of the world's exports of services and 6 per cent of total exports, a contribution that is similar for developed and emerging economies. For the group of developed economies, tourism generated \$924 billion in exports in 2013 (figure II.1.1); as an export category it ranked fourth after chemicals (including pharmaceuticals), fuels and automotive products, but ahead of food. For emerging economies, tourism generated \$485 billion in exports in 2013, and it ranked fourth after fuels, food, and clothing and textiles. However, tourism is the first export earner in many emerging economies, including several least developed countries such as

Figure II.1.1

Exports earnings from international tourism and other export categories, 1995–2013



Box II.1 (continued)

Burkina Faso, Gambia, Haiti, Madagascar, Nepal, Rwanda and the United Republic of Tanzania. Furthermore, although fuel is the largest export category worldwide, earnings are heavily concentrated in a few large oil, gas and coal exporters. By contrast, many countries benefit from tourism, which also tends to generate more employment. Additionally, it is interesting to note that during the 2009 economic downturn, international tourism was more resilient than other trade categories, decreasing only by 5 per cent, compared to overall exports declining by 11 per cent.

Tourism in small island developing States

Tourism is a major export and source of foreign revenue, particularly for islands. Small island developing States (SIDS) are a group of 57 countries and territories which share common geographic and economic challenges. In 2013, SIDS welcomed 41 million international tourist arrivals (61 tourists per every 100 residents), plus at least 18 million cruise arrivals (not all countries report). Revenues from international tourism in destinations reached \$54 billion, plus an estimated \$8 billion in passenger transport, bringing the overall contribution to exports to \$62 billion, which represents 9 per cent of SIDS total goods and services exports. Furthermore, tourism accounts for more than half of exports in 12 out of 43 SIDS with data available, and it is the top export category for 23 out of 30 SIDS that provide a breakdown by export category.^b Islands where tourism is a major export earner include Aruba, Bahamas, Barbados, Bermuda, Cabo Verde, Dominican Republic, Fiji, French Polynesia, Haiti, Jamaica, Kiribati, Maldives, Mauritius, Sao Tome and Principe, Seychelles and Tonga.

The United Nations declared 2014 as the International Year of Small Island Developing States, with Samoa hosting the Third United Nations Conference on SIDS in September 2014.^c The Samoa Accelerated Modalities of Action Pathway presented a basis for action in various priority areas for the sustainable development of SIDS through durable partnerships and capacity-building. The document recognized the role of tourism in sustainable development and as a significant driver of economic growth and decent job creation.

Travel facilitation and connectivity

Air connectivity and travel facilitation are key factors in the successful development of sustainable tourism. Implementing adequate policies aimed at openness and easy access can boost tourism growth as well as promote trade and investment, infrastructure development, ease of doing business and social, educational and cultural exchanges. In fact, the G20 Leaders' Summit in 2012 recognized the role of travel and tourism as a vehicle for development and economic growth, and committed to work towards developing travel facilitation initiatives in support of job creation and poverty reduction.

For instance, many destinations can gain by revising and improving visa procedures. Visas can provide essential functions with regard to security, immigration control, limitation of duration of stay and activities, and the application of measures of reciprocity. However, too restrictive a policy can act as a constraint. The challenge is finding a beneficial balance. In recent years, UNWTO has been working closely with partners and stakeholders to move this agenda forward.^d A great deal of progress has been made towards visa facilitation, especially the multilateral agreements that mutually exempt all or certain categories of travellers from the visa requirement. Between 2010 and 2012, over 40 countries made significant changes to their visa policies, facilitating travel from "visa required" to "visa on arrival", "eVisa" or "no visa", according to UNWTO research.

^a See *UNWTO Tourism Highlights 2014 edition*, available from <http://mkt.unwto.org/highlights> and UNWTO World Tourism Barometer, available from <http://mkt.unwto.org/barometer>.

^b *Tourism in Small Island Developing States (SIDS), Building a more sustainable future for the people of Islands*, available from www.wtoelibrary.org/content/gx426g.

^c For Conference resources and documents, see www.sids2014.org.

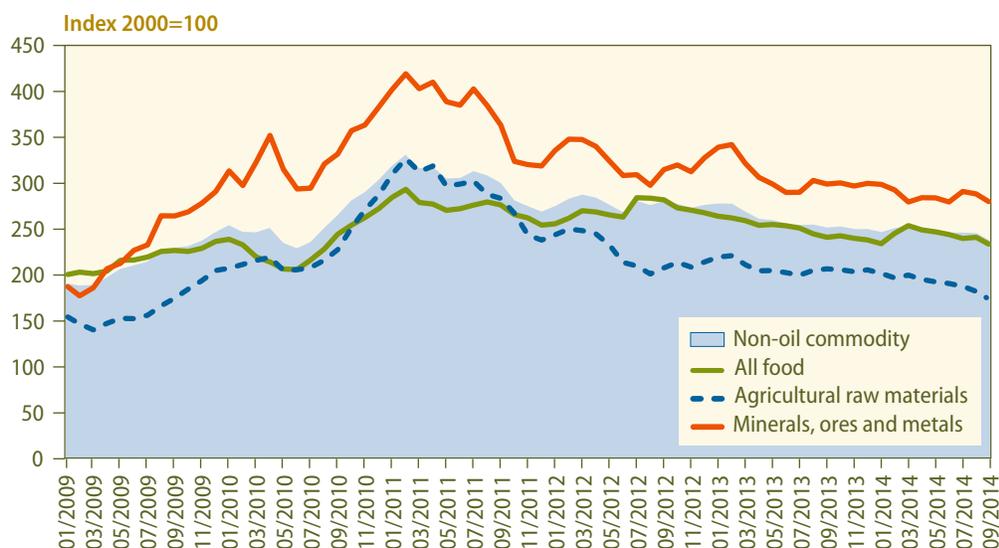
^d See "Facilitation of tourist travel", available from <http://rcm.unwto.org/content/facilitation-tourist-travel>.

Source: UNWTO.

Food and agricultural commodities

Since early 2014, prices of food and agricultural commodities have been trending in different directions (figure II.9). Prices of food, grains in particular, rose in early 2014, owing to dry and freezing weather in the main agrifood producing countries, such as the United States, and conflict between Ukraine and the Russian Federation. Thereafter, thanks to improved weather conditions that boosted global output, prices of grains tumbled. For example, the price of yellow maize n° 3 grade increased by 10 per cent between January and April 2014 to \$231 per ton. Then it dropped by nearly 22 per cent to \$180 per ton in September 2014, the lowest level since August 2010. The benchmark Thai rice price remained relatively

Figure II.8
Price indices of selected groups of commodities, January 2009–September 2014



Source: UNCTAD secretariat, based on data from UNCTADStat.

low compared to the past few years, albeit with some fluctuations, owing to comfortable stocks carrying over from the previous seasons and the releases from Thai government stockpiles. The price averaged \$428 per ton over the period of January–September 2014, 21 per cent lower than the price for the equivalent period in 2013. In contrast, sugar prices increased by 15 per cent from January to March 2014 to 18 cents per pound, following adverse weather in Brazil, a big sugar producer, and concerns over the El Niño phenomenon. Afterwards, sugar prices decreased owing to large inventories and, in September, averaged 16 cents per pound. Beef prices strengthened over the first nine months of 2014, amid a tight supply induced by drought and high feed costs in the United States that weighed on global red meat production.

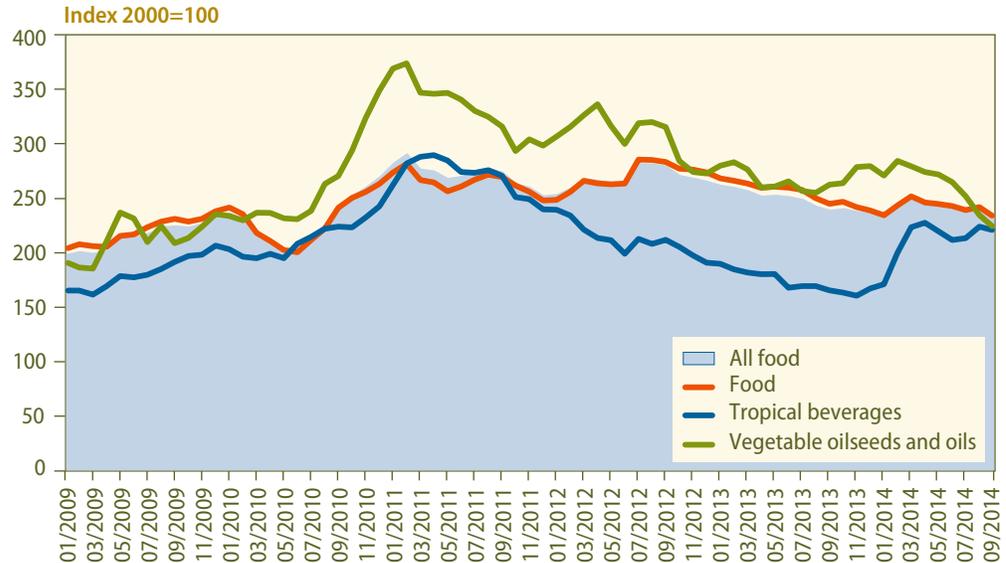
In vegetable oilseed and oil markets, prices generally eased, but with some short-term fluctuations. The UNCTAD Vegetable Oilseeds and Oils Price Index declined by 17 per cent beginning in January to average 224 points in September 2014. This downward trend was driven by drops in prices for soybeans, soybean oil and palm oil, which decreased by 24, 10 and 18 per cent, respectively, owing mainly to good crop conditions. By the next crop season, comfortable world inventories and a good outlook for vegetable oilseed and oil production should keep downward pressure on prices.

The prices for tropical beverages increased in 2014 after a steady decline beginning in 2011. The UNCTAD Tropical Beverages Price Index rose by 29 per cent between January and September 2014 to 221 points, led mainly by strong coffee and cocoa prices. Over this period, the coffee composite indicator index increased by nearly 46 per cent. Cocoa prices gained 14 per cent over the same period owing to strong demand from the chocolate manufacturing industry. These international price increments are often not passed onto small farmers who dominate the production of coffee, cocoa and other agricultural commodities in a number of producing countries (box II.2).

In raw agricultural commodity markets, prices generally trended down over the first nine months of 2014, amid subdued economic activity of major industrial economies. In September, the UNCTAD Agricultural Raw Materials Price Index was 14 per cent lower

Strong cocoa and coffee prices drove increases of tropical beverage prices

Figure II.9
**Price indices of selected food and agricultural commodity groups,
 January 2009–September 2014**



Source: UNCTAD secretariat, based on data from UNCTADStat.

than its value in January. The price of natural rubber (n° 3 RSS) fell by 29 per cent over the period, owing to oversupply and rising stocks. For cotton, the relatively high prices during the first half of 2014 were followed by a significant price drop in the third quarter. In September 2014, the Cotton Outlook Index A fell to 73 cents per pound, the lowest level since December 2009. Record-high global cotton stocks, a good crop outlook in the United States—the world’s biggest cotton exporter—and a lower expected import quota by China in 2015 weighed heavily on cotton prices. In the outlook period, international prices for most agricultural commodities should moderate further, particularly if current crop conditions continue. However, weather concerns, such as the effects of the El Niño phenomenon, are likely to be the major upside risk factor.

Minerals, ores and metals

Downward pressures on prices of minerals, metals and ores continue

The prices of minerals, ores and metals have trended downward from their peak in 2011, with some short-term price fluctuations. During the first nine months of 2014, the UNCTAD Minerals, Ores and Metals Price Index averaged 285 points, compared with 309 points during the same period in 2013. However, this general trend disguises the divergent performance of individual minerals, ores and metals. For instance, while the iron ore market was bearish, nickel and zinc markets were characterized by a strong price recovery from 2013 (figure II.10).

The market for nickel was characterized by oversupply and sliding prices in 2013. However, the market dynamics have changed notably, following the enforcement of an export ban of unprocessed ores in January 2014 by Indonesia, the world’s leading nickel mining country. Concerns over a supply shortage coupled with speculative buying by

Box II.2

Small farmers and commodity prices: cocoa and coffee producer prices

Small farmers are important actors in agricultural global value chains as they produce a large share of traded agricultural commodities. In particular, they dominate the production of tropical beverages as they account for more than 80 per cent of cocoa and about 70 per cent of coffee traded on global markets. Small farmers are price-takers and are atomized, and their incomes—which tend to fluctuate significantly—are largely determined by domestic and external factors beyond their control. These include domestic trade policy, price volatility on international markets and many others. Furthermore, many small farmers do not receive an adequate return on their activities. According to data from the period 2006 to 2011 from the International Cocoa Organization (ICCO), the average share of cocoa producer prices in international prices varied from 50 per cent in Côte d'Ivoire to 72 per cent in Cameroon and to 89 per cent in Ecuador. For coffee, producers in Viet Nam obtained 82 per cent of the international price, while an Ethiopian coffee producer received only 61 per cent. High taxation of the domestic cocoa sector in Côte d'Ivoire, currently at about 22 per cent of exports, has contributed to reducing the price share accruing to farmers. In contrast, relatively higher cocoa producer prices are noted for Cameroon, where domestic taxes have been eliminated and export levies reduced to as low as five cents per kilogram. In Ethiopia, the relatively low price received by coffee producers is associated with factors including relatively high marketing and transaction costs, collusion of buyers, and high concentration of exporters.

Small farmers in low-income developing countries are also affected by increasing market concentration in the agricultural food industry at the global level. For some products, a small number of multinational companies control a large share of the global market. For example, the three largest cocoa multinational companies buy about 50 to 60 per cent of world cocoa production, and this oligopolistic power could erode the limited negotiation room left for small farmers, weakening even further their ability to derive fair benefits from international trade.

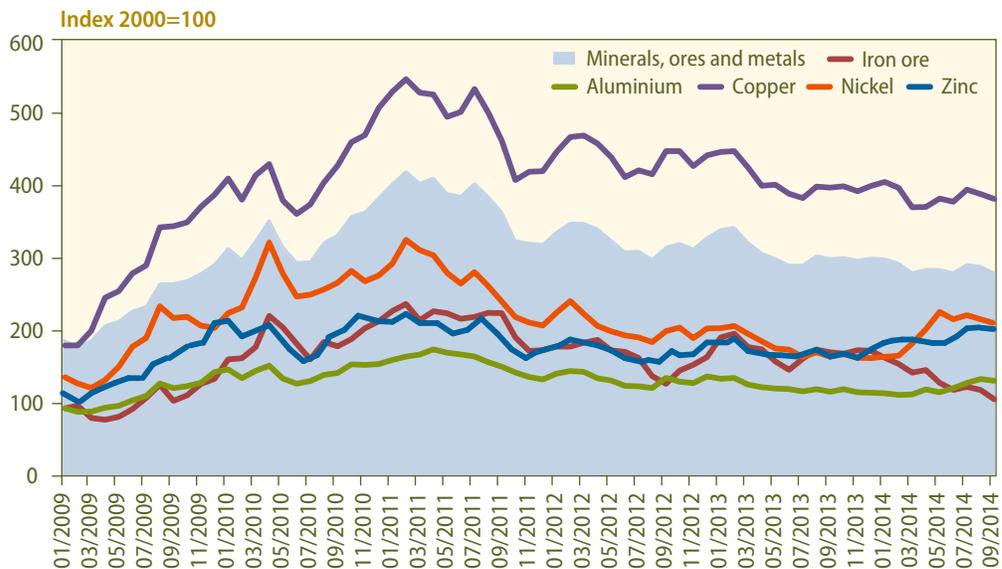
Several policies and actions can help small farmers to address some of these challenges. For example, strengthening farmers' associations would increase their bargaining power by allowing them to deliver in bulk, facilitating quality control, and helping to meet traceability requirements. Negotiating contract farming on behalf of small farmers, whereby transnational corporations source their inputs directly from small farmers, could help to overcome the problems related to having many intermediaries, which leads to higher producer prices. This is the essence of the newly established Public-Private Partnership between Unilever and the International Fund for Agricultural Development. Small farmers can also take advantage of the expanding niche markets in organic products and thus benefit from price premiums these markets offer. For instance, there is high demand for organic cocoa beans driven by food safety and environmental concerns, but supply represents only 0.5 per cent of total cocoa production. This segment offers sizable opportunities.

In addition, there is a need to introduce and enforce competition laws in producer and consumer countries in order to reduce imbalances in bargaining power between sellers and buyers. Enforcement is particularly important at the international level to prevent excessive market power that might result from mergers or acquisitions. Moreover, for countries such as Côte d'Ivoire, lowering domestic taxes could help to increase the share of the international price paid to small farmers. Furthermore, as the case of the Cocoa Board (Cocobod) in Ghana has shown, Governments could provide well-tailored extension services and sponsor institutions that offer subsidized training and credit to small farmers in order to increase their efficiency and competitiveness. The experience of Equity Bank Kenya, with its provision of credit and advisory services to millions of small farmers, also illustrates that even the private sector can make a profit while helping small farmers to transform their activities into sustainable small businesses. Finally, small farmers in low-income developing countries would benefit from domestic policies aimed at increasing local value retention along commodities value chains. For example, thanks to national policy reforms and private sector investments, cocoa has increasingly been processed in countries such as Brazil, Côte d'Ivoire, Ghana and Indonesia.^a These experiences offer small farmers the opportunity to be an integral part of domestic value chains.

^a According to ICCO, origin grindings for cocoa accounted for about 44 per cent in world total grindings in the 2012/2013 crop season, an increase from about 32 per cent in 2000/2001.

Source: UNCTAD.

Figure II.10
Price indices of selected minerals, ores and metals, January 2009–September 2014



Source: UNCTAD secretariat, based on data from UNCTADStat.

financial investors have led to the surge of nickel prices. In May 2014, the London Metal Exchange (LME) nickel price rose to a 27-month high of \$19,434 a ton, an increase of 38 per cent compared to the price in January 2014. Although prices trended downward in the following months, the average price of nickel during the first three quarters of 2014 was 12 per cent above the price in the same period of 2013. The zinc market rallied in the first nine months of 2014, and the average price rose by 12 per cent compared to the January–September average in 2013. In August 2014, the LME zinc price surged to a three-year high of \$2,329 per ton. Stronger demand, driven partly by the growth of automobile production combined with expected tighter supply and decreasing stocks, underpinned the price recovery.

The performance of the copper market was lacklustre in the first three quarters of 2014. Prices averaged \$6,940 per ton, down from \$7,383 in the same period of 2013, translating into a 6.4 per cent decline. In March 2014, the LME copper price fell to \$6,666, the lowest level since July 2010. Rising mine production and concerns over demand prospects from China contributed significantly to the price decline. Furthermore, China's first corporate bond default in March 2014, and a probe into possible base metals financing fraud, increased market uncertainties about China's future copper demand. The prices of iron ore registered a sharp decline of 36 per cent in the first nine months of 2014. The price plunge was mainly due to oversupply by the world's major mining groups and weakening growth in steel production in China, where the subdued property market has suppressed the demand for steel.

In 2015, barring unexpected supply disruptions, the price trends of base metals and ores will be largely determined by the demand from major consuming countries, especially China. The country's economic restructuring from investment towards consumption is likely to support the prices of metals, which are widely used in consumer goods such as zinc, tin and lead, and put pressure on the prices of copper and iron ore.

Oil market prices

In 2014, the Brent oil price declined considerably during the second half of the year, bringing the annual average price down to \$102 per barrel (pb), slightly lower than the previous forecast.³ Lower prices mainly reflected the gap between oil demand growth and oil supply growth (figure II.11), which is expected to continue in 2015. As a result, the average Brent oil price in 2015 is expected to decline to \$92 pb, significantly lower than in recent years. In 2016, as the global economy is expected to improve, oil demand growth will increase and drive prices up to an average of \$96 pb.

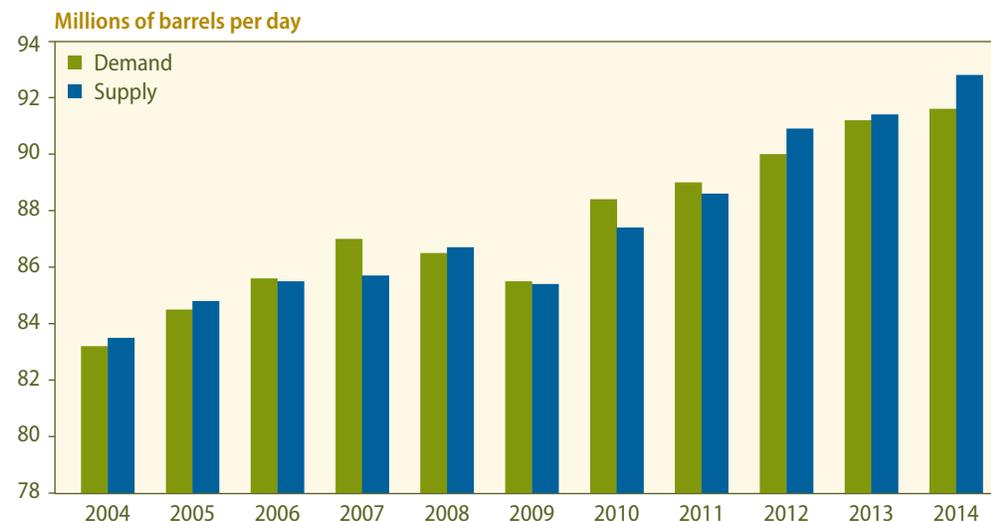
Oil demand growth has been slowing throughout 2014, on the back of sluggish economic activity in several key economies, including Japan and Western Europe. In addition, weaker-than-expected GDP growth in China has also weighed on oil demand. As a result, growth in oil demand was at its lowest level in two and a half years during the second quarter of 2014. According to the International Energy Agency, global oil demand is expected to have grown by 0.6 million barrels per day (bpd) in 2014⁴, bringing total demand up to 92.4 million bpd, lower than originally anticipated. In 2015–2016, although the United States is expected to partially offset weaker demand from other developed economies, global demand growth for crude oil should continue at a moderate pace, in line with the overall demand for commodities. Oil demand growth in 2015 is not expected to exceed 1.1 million bpd, which will bring total demand up to 93.5 million bpd.

Conversely, oil supply has seen strong growth, both from Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC members, reaching 92.8 million bpd in the second quarter of 2014, 1.2 million bpd higher than demand during the same quarter. Oil output from OPEC members has been relatively steady, despite conflicts in Iraq, which produces more than 3 million bpd and became a major pillar of global supply. Against the

Oil demand growth slowed down throughout 2014 and will continue at a moderate pace in 2015

Despite the military conflict in Iraq, there is strong growth in global oil supply

Figure II.11
World oil demand and supply, 2004–2014



Source: International Energy Agency.
Note: Data for 2014 are as of the second quarter.

³ See United Nations, “World economic situation and prospects as of mid-2014” (E/2014/70).

⁴ Based on September’s Oil Market Report.

backdrop of political and military tensions in Iraq, investors had originally worried about supply disruptions and oil prices shot up to a high of \$115 pb in June (figure II.12). However, only a small portion of Iraq's oil output had been threatened, as conflicts were taking place in northern parts of the country. Concerns about disruptions were short-lived and in July 2014 prices started to resume their downward trend, reinforced by the expectations that global oil supply would remain stable throughout the year and the forecast period. Another positive sign has been the recovery in Libya's oil output, which offset losses from other OPEC members. As a whole, OPEC crude oil production (excluding natural gas) is estimated to have exceeded 30 million bpd in 2014. At the same time, supply from developed economies, in particular from the United States, has also been growing strongly and is estimated to have expanded by 1.5 million bpd in 2014, reaching 19.5 million bpd.

Throughout the forecast period, oil supply is expected to remain stable from both OPEC and non-OPEC sources. For OPEC members, several positive prospects are expected to reinforce supply stability. Oil production and exports from the Islamic Republic of Iran could edge up in 2015, beyond the current one million bpd, if an agreement over nuclear negotiations is reached between the Islamic Republic of Iran and members of the Security Council. At the same time, risks of supply disruption have edged down in Iraq.

Despite the fact that demand growth is expected to remain slow, OPEC members are not expected to trim oil production to support Brent prices throughout the forecast period. In August 2014, Saudi Arabia cut its oil output by 330,000 bpd in response to lower demand from its customers. However, as recently announced by Saudi Arabia, further cuts from OPEC members are not expected during the forecast period. Oil supply from developed economies is also expected to remain strong, in particular from Canada and the United States, and is set to expand by 0.9 million bpd in 2015.

Against this backdrop, oil prices are estimated to have declined to an average of \$102 pb in 2014. Supply concerns eased, demand remained tepid, and, in July, hedge funds considerably reduced their net long exposure to Intercontinental Exchange Brent to the lowest since January 2013. As a result, the Brent crude oil price decreased by almost 5 per cent in August compared to July. In September and October, oil prices deepened their slide (figure II.12), settling below \$90 pb, especially after weak industrial and retail data in China was released and output growth for major EU economies was revised downward. The appreciation of the United States dollar has also reinforced the downward trend of the Brent oil price. The stronger dollar weighs on oil markets as it makes commodities denominated in United States dollars more expensive for countries holding other currencies.

In 2015, the average crude oil price is expected to decline by about 10 per cent to \$92 pb from \$102 pb in 2014. This forecast is based on the assumption that OPEC countries will not cut production to support oil prices and that global oil demand growth will continue to be weak. In 2016, the Brent oil price is expected to recover moderately to \$96 pb, provided that global demand growth accelerates gradually while oil output remains stable.

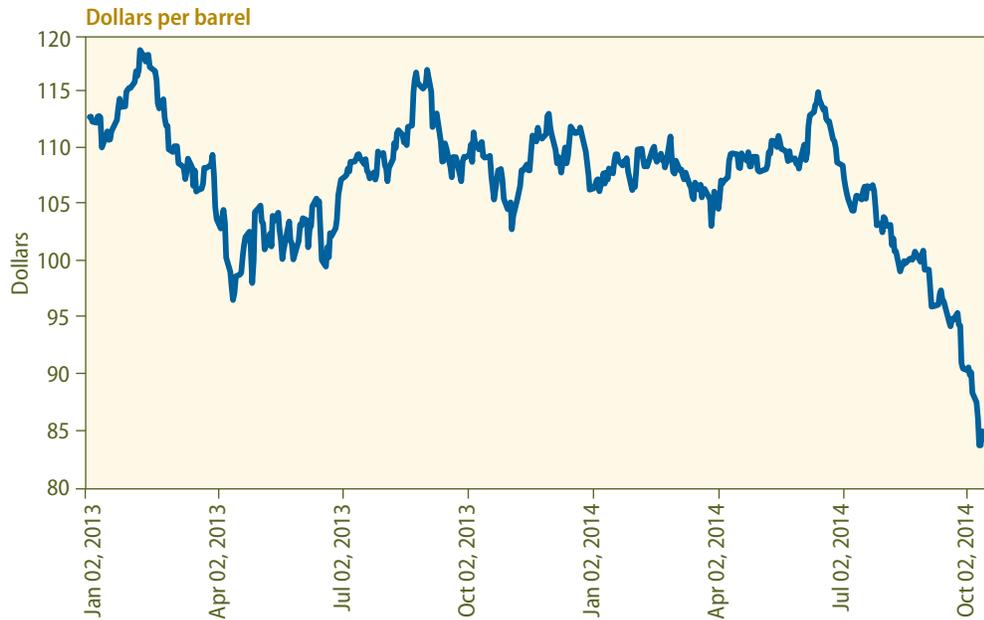
Nevertheless, there are important risks to this forecast. On the downside, growth in oil demand could be weaker, particularly from China, Japan and Western Europe, which would drive prices lower than forecast. On the upside, if OPEC members decide to cut oil production, oil prices could rebound faster than anticipated. At the same time, if the conflict in Iraq escalates, supply disruptions could be a major concern, which would lift the Brent price above the projected price. In addition, current reciprocal sanctions between the Russian Federation and leading OECD countries are raising more concerns about possible consequences for the Russian Federation's oil production and exports.

Global supply will remain robust

Oil prices are expected to decline faster than originally anticipated

Weaker growth in oil demand could drive prices even lower than forecast

Figure II.12
Europe Brent spot price FOB, January 2013–October 2014



Source: United States Energy Information Administration.

Trade policy developments

Multilateral trade negotiations

The Doha Round was launched in 2001 and the original intention was to conclude the round by 2004.⁵ However, recurrent setbacks and the prevalence of alternative negotiating forums, such as regional and plurilateral processes, was increasingly perceived as affecting the credibility of the Multilateral Trade System (MTS) and significantly raised the stakes of the Ninth WTO Ministerial Conference (MC9) in December 2013. Of concern in the run-up to MC9 therefore was the need to find concrete deliverables, focusing on a limited number of issues to enable a subsequent conclusion of the entire Doha Round.

The MC9 resulted in adoption the Bali Ministerial Declaration and a set of decisions known as the Bali Package. The package includes: (i) the Trade Facilitation Agreement (TFA); (ii) the five decisions on agriculture regarding (a) the definition of general services, (b) public stockholding for food security purposes, (c) tariff-rate quota administration, (d) export competition, and (e) cotton; and (iii) four decisions on development-related issues, namely (a) preferential rules of origin (RoO), (b) operationalization of the LDC services waiver, (c) duty-free and quota-free (DFQF) market access for LDCs, and (d) a monitoring mechanism on special and differential treatment (SDT). These texts were negotiated as a package, thus the balance of ambitions and interests within and across the issues was a key stumbling block. The package was generally considered as a major achievement. However,

The Doha Round has made little progress in the last decade

The Doha Round faces new uncertainties as the WTO failed to adopt a legal protocol to implement the TFA

⁵ United Nations, “Report of the Secretary-General on international trade and development” (A/69/179); UNCTAD, “Towards an enabling multilateral trading system for inclusive and sustainable development” (TD/B/C.I/MEM.5/5).

the recent failure at the WTO General Council in July 2014 to adopt a legal protocol necessary to implement the TFA— due to differences among WTO members regarding the linkage between the TFA and post-Bali negotiations on public stockholding for food security purposes—generated significant uncertainty over the prospects for the Bali Package implementation and the entire Doha Round.

Trade facilitation

Onerous and complex customs and transport procedures constitute a substantial part of trade transaction costs, and reducing them through trade facilitation measures is important in boosting trade worldwide. As a result, trade facilitation is expected to generate important welfare gains, particularly for developing countries. Furthermore, many of the specific trade facilitation measures covered by the TFA have proven to have a high return on investment, as they help to reduce costs and increase revenue collection. The reforms also usually have a direct effect on development by improving inter-agency collaboration, investing in human and institutional capacity-building, enhancing good governance and helping the informal sector to participate in the formal economy and international trade. The TFA was the first binding multilateral agreement negotiated since the Uruguay Round and addresses some 37 substantive import, export and transit procedures. It seeks to clarify and improve existing GATT disciplines on customs procedures relating to Article V (freedom of transit), Article VIII (fees and formalities) and Article X (publication and administration of trade regulations).

There is a persistent difference in members' perceptions regarding the linkage between the TFA and other areas of negotiations

While recognizing the economic case of trade facilitation, developing countries, particularly LDCs lacking institutional capacities, were concerned over adjustment costs they would have to bear, as implementation of some measures (e.g., single window procedures) were found to be relatively complex or costly, while other measures were feared to be difficult to eliminate (e.g., mandatory use of customs brokers). It is in recognition of such concerns that the TFA incorporated an unprecedented form of special and differential treatment for developing countries, which formally establishes a linkage between their implementation capacity, provision of capacity-building support and the timing and level of commitments. Accordingly, implementation of various commitments was modulated into three categories of modalities: (i) immediate implementation upon entry into force of the TFA (for a least developed country member within one year after entry into force); (ii) implementation subject to predetermined transition periods; and (iii) implementation subject to the provision of capacity-building support and capacity acquisition. Following MC9, each developing country was to designate for itself those commitments they would be implementing under each category. Since timely and effective provision of capacity-building support was a major cause for concern for many countries, recent efforts have led to the creation of a WTO facility on trade facilitation as a potential source of funding as a last resort while concern continues to exist over the appropriate level of funding. Other international organizations, including UNCTAD, have created additional technical support facilities and reaffirmed their support to assist in implementing the TFA.

Following MC9, WTO members had until 31 July 2014 to adopt a protocol to amend the WTO agreement to incorporate the TFA in its legal architecture on a definitive basis. The proposed protocol would then be open for acceptance until 31 July 2015. It was not adopted, however, owing to persistent difference in members' perceptions regarding the TFA linkage with other areas of negotiations.

Agriculture

Against the backdrop of rising and volatile food prices, many food-insecure countries had introduced public stockholding programmes, such as the procurement of wheat and rice at subsidized, administered (i.e., higher-than-market) prices from low-income farmers as implemented in India. The original proposal on food security was aimed at exempting such price support from the scope of the Aggregate Measure of Support, so that such support is exempt from any quantitative limits. In the absence of agreement on a permanent solution, an interim solution was found at MC9 in the form of a “peace clause”, i.e., an exemption from legal challenge under dispute settlement procedures. The interim nature of the peace clause was the key stumbling block in the negotiations. It was agreed at Bali that WTO members were to engage in negotiations to find a permanent solution for adoption by 2017. This work remains at a preliminary stage with a few new proposals submitted by different groupings (e.g., the United States, G-33) with the proponents of reform reemphasizing their original proposals to introduce formal changes in relevant WTO provisions, while the food-insecure countries are underlining the need to evaluate countries’ experiences on food security issues and policies.

Development issues

While delivering on LDC issues constituted the central elements of development issues, the Bali outcomes in these areas are relatively modest. DFQF market access is an agreed international development target already contained in Millennium Development Goal 8, as further reaffirmed in the United Nations Istanbul Programme of Action for LDCs, which set the target of doubling the share of LDC exports by 2020. The Bali outcome urged, but did not require, expeditious improvement of DFQF coverage by 2015 for those countries that had not provided DFQF treatment for 97 per cent of tariff lines. The outcome on preferential RoO takes the form of non-binding guidelines for making RoO simpler and more transparent. Besides, the importance of continued technical assistance to address the development aspects of cotton was reaffirmed, and a Monitoring Mechanism on SDT to monitor the implementation of existing SDT provisions was established.

Concerning the operationalization of the LDC services waiver, the Bali Package provided a road map for the implementation of preferential market access for LDC services and services suppliers to be covered by the waiver. The waiver is aimed at allowing non-LDCs to deviate from General Agreement on Trade in Services (GATS) Most Favoured Nation (MFN) obligations to provide services preferences in relation to market access restrictions (but not national treatment, the inclusion of which is subject to approval). Although the waiver was adopted in 2011, no WTO member has introduced services preferences for LDCs. The proposed road map rests largely on the formulation by LDCs of a collective request identifying the sectors and modes of their export interest. On that basis, the Council for Trade in Services was expected to convene a high-level meeting within six months, so that developed and developing countries in a position to do so could pledge to implement the provision of services preferences for LDCs. This implied that the onus was on LDCs to identify existing market access barriers affecting their exports and request their elimination on a preferential basis to facilitate their exports. In July 2014, the LDC group submitted such a collective request. The convening of the high-level meeting has now been placed on the agenda of the Council for Trade in Services.

**Issues related to LDCs
make modest progress**

The way forward

The global trade system is at risk of further fragmentation

The inability of WTO members to implement the TFA has created new uncertainties over the prospects for the post-Bali work on the Doha Round. At Bali, it was already recognized that the package, although important, was not a substitute for the overall Doha Round. As a way forward, WTO members were to prepare a clearly defined work programme on the remaining issues of the Doha Round by the end of 2014. These programme guidelines were to prioritize those issues where legally binding outcomes were not achieved at MC9 as well as all other Doha issues central to concluding the Round, while also fully exploring different negotiating approaches, presumably including plurilateral or sectoral approaches. Discussions to date have pointed to some key principles: (i) the need for a balanced approach to agriculture, non-agricultural market access (NAMA) and services; (ii) the centrality of the development dimension; and, (iii) the need to focus on “doables”. Views differ on whether to use the draft modality texts on agriculture and NAMA of 2008 as the basis of future work.

In this process of defining a balanced package for the post-Bali work, it is important that it reflects new trade and policy developments affecting various negotiating areas. For instance, the environment surrounding agricultural negotiations has evolved significantly since 2008. Higher commodity prices have sharpened food security and rural livelihood concerns, and prompted many net-food importing countries to seek to secure domestic food supply through several policy interventions, including production support, public stockholding, international purchases and border protection against import surges. High prices, and national policy reforms, have led to a substantial reduction in the use of trade-distorting support and export subsidies in major subsidizing countries. This in some cases entailed so-called box shifting—the conversion of trade-distorting support, such as price support (amber box), into non- or minimally trade-distorting support, such as direct payment to farmers (green box). However, the resulting concentration of agricultural subsidies in the green box category has raised concern over potentially trade-distorting effects of such support.

The relative incidence of non-tariff measures (NTMs), such as sanitary and phytosanitary (SPS) measures and technical standards, in affecting developing countries’ exports has increased over the years. In agriculture, the average restrictiveness of NTMs is about 20 per cent, more than twice the average tariff of 7 per cent. The costs of compliance are disproportionately high for low-income countries as many lack the capacities required to comply. On the other hand, while average industrial tariffs declined in the 2000s, tariff protection remains important in manufacturing sectors, as many countries seek to support manufacturing capacities and job creation, particularly in labour-intensive consumer industries.

Plurilateral trade agreements

The post-Bali programme is likely to be influenced by parallel plurilateral and regional processes

The composition of the post-Bali work programme is likely to be influenced by parallel plurilateral and regional processes. In July 2014, 14 countries representing 86 per cent of global trade in environmental goods launched plurilateral negotiations for an environmental goods agreement. The agreement is argued to promote green growth and sustainable development while providing impetus for the Round’s conclusion. The negotiations are open to all WTO members and the results would be extended on an MFN basis. These would be built on efforts to reduce import tariffs to below 5 per cent by 2015 on a list of 54 environmental goods as identified by the Asia-Pacific Economic Cooperation countries in 2012. Environmental goods include wind turbines, air quality monitors and solar panels.

The negotiations would first aim at eliminating tariffs, and subsequently address NTMs affecting the products and environmental services.

Another important plurilateral initiative is the negotiations for a trade in services agreement (TISA) involving 23 WTO members, representing 70 per cent of global services trade. The negotiations aim for a comprehensive and ambitious services liberalization by capturing autonomous and preferential liberalization, and seeking to adopt horizontal application of national treatment to all sectors and modes of supply. The TISA is expected to build upon the GATS approach to promote subsequent multilateralization and participation of new members. Automatic multilateralization of the results based on the MFN principle will be temporarily pushed back as long as there is no critical mass of countries joining TISA, implying that the future TISA would be a preferential agreement to be covered under GATS Article V. Plurilateral discussions also continue, while currently pending, on expanding the product and country coverage of the existing WTO Agreement on Information Technology. The revised Agreement on Government Procurement, concluded in 2012, became effective in April 2014. Whether plurilateral approaches—together with their systemic implications—are useful in bringing forward the Doha Round negotiations warrants careful reflection.

Evolving regional trade agreements

The most significant challenge to the multilateral trade system is the increased prevalence of RTAs. As of June 2014, some 585 notifications were made to the WTO, of which 379 were in force. Each developed country had preferential access to an average of 23 countries in 2012, and about 60 per cent of their trade is covered by some RTAs.⁶ Twenty-first century RTAs qualitatively differ from previous RTAs in their scope, composition and depth. They are oriented towards a deeper and more comprehensive integration with a strong regulatory focus on providing a viable platform for regional value chains by ensuring a duty-free and non-tariff-barrier free trading environment. This integration of RTAs with regulatory systems will render them more compatible and transparent. In addition to full market opening, they now encompass a range of behind-the-border regulatory measures including investment, competition policy, capital movement, intellectual property rights and government procurement.

The emergence of “mega-RTAs” represents a major shift in trade relationships, over which many developing countries have no control. The Trans-Pacific Partnership Agreement (TPP), Trans-Atlantic Trade and Investment Partnership Agreement (TTIP) and Regional Comprehensive Economic Partnership Agreement (RCEP), would all create giant economic zones covering substantial proportions of world trade in goods and services (Table II.1). These mega-RTAs are qualitatively different from previous RTAs in their size, depth and systemic consequences and generally draw on a template developed by major players. By inducing deeper liberalization and high-standard, cutting-edge regulatory harmonization that covers an increasing share of world trade, they could affect incentives for multilateralism, and could further erode the primacy of the MTS, which is built upon the non-discrimination principle. This would have significant implications for countries’ incentives to negotiate MFN liberalization at the global level, while some issues with systemic implications, most notably domestic agricultural support, would continue to be most efficiently

RTAs cannot replace the role of the multilateral trade system

⁶ UNCTAD, *Key Statistics and Trends in Trade Policy* (UNCTAD/DITC/TAB/2013/2).

Table II.1
Comparison of “mega-RTAs”

Regional trade agreement	Members	Percentage share in world exports	Intra-group exports as a percentage of global exports	Intra-group imports as a percentage of global imports	Combined GDP as a percentage of world GDP	Bilateral agreements among parties
Pacific Alliance	4	2.7	3.9	4.5	2.8	6
RCEP	16	27.3	42	47.4	29.5	23
TISA	23	70.3	na	na	67.3	
TPP	12	26	46.3	38.3	38.9	25
Tripartite FTA	26	1.7	11.9	12.9	1.6	4
TTIP	2	43.9	17.3	14.3	45.4	0

Source: UNCTADStat and WTO.

Note: EU is counted as one entity. Trade and GDP figures are for 2012.

Mega-RTAs would shift their focus towards regulatory harmonization to reduce divergence in national standards

negotiated at the multilateral level. By developing cutting-edge disciplines, it is often argued that mega-RTAs would set a new template for future trade and investment cooperation.

For instance, emerging mega-RTAs would shift their focus towards regulatory harmonization to reduce divergence in national standards affecting trade. Regulatory harmonization and mutual recognition could remove barriers arising from diverse technical standards, and license and qualification requirements on services and services suppliers. Such regulatory cooperation would be more feasible under RTAs. Some new proposed disciplines under mega-RTAs (e.g., TTIP) include regulatory coherence, whereby each member is required to have an institutional mechanism at the central government level to facilitate central coordination and review of newly covered regulatory measures. This may include conducting impact assessments of a proposed regulatory measure in the light of its objective and efficiency. This could constrain the ability of regulatory authorities. For a third country adopting lower standards, this could represent upward harmonization of regional standards and might have adverse effects on exporting in regional markets in developing countries.

Recent mega-RTA negotiations (e.g., TPP) have also sought to address the potentially anti-competitive effect of state-owned enterprises (SOEs) that tend to receive some preferential treatment including preferential finance.⁷ Some regional disciplines have sought to establish competitive neutrality between SOEs and private companies by eliminating such structural advantages. At the same time, some developing countries have stressed the importance of SOEs in delivering public policy goals. Concern over possible limitation of regulatory autonomy also arose in relation to the Investor-State dispute settlement (ISDS) mechanism increasingly incorporated in RTAs. The ISDS is seen to confer greater rights to foreign investors and lead to “regulatory chill” as regulators might refrain from taking certain regulatory actions (e.g., environmental regulations) for fear of legal challenge under ISDS. Non-trade concerns and geopolitics (linked with the compatibility issues with other RTAs) sometimes play important roles, either as stimulants or obstacles to RTAs. Concerns about infringement of sovereignty and giving unfair privileges to transnational corporations, for instance, have led to objections to RTA clauses allowing ISDS before arbitral tribunals; this would, for example, prevent German ratification of the EU-Canada RTA or acceptance of ISDS in the TTIP.⁸

⁷ See, for instance, <http://www.ustr.gov/tpp>.

⁸ Stefan Wagstyl, “Germany expresses concerns about US and Canada trade deals”, *Financial Times*, 25 September 2014.

From a development perspective, mega-RTAs—and the twenty-first century RTAs more generally—might represent a risk for weaker and more vulnerable developing countries as they can simply be left out. When these countries do take part, locking in existing preferential market access conditions under unilateral preferential arrangements is often a key motivation (e.g., in the context of economic partnership agreements between the African, Caribbean and Pacific Group of States and the EU). Larger and more competitive developing countries face challenges in effectively securing improved market access, as RTAs often preserve high tariffs on import-sensitive products that attracted high protection on a MFN basis, including dairy, sugar and apparel. In contrast, ensuring an adequate content, pace and sequence of their own liberalization is a key concern of developing countries, as the effect of reciprocal tariff elimination would be greater for them, given economic asymmetries. Furthermore, with their stronger behind-the-border disciplines that are “WTO+” or “WTO-X”, RTAs may constrain countries’ policy space to implement proactive trade and industrial policies for development purposes. It is therefore important that market-opening objectives are critically balanced with the flexibility to design and implement measures to build essential productive capacities and move up the value ladder⁹.

The level of services commitments is illustrative of the significance of RTAs in inducing effective liberalization, particularly in developing countries. Trade in services has become a major feature of RTAs, particularly North-South RTAs. Research based on a WTO dataset on services commitments suggest that for developed countries, RTA commitments represent only limited improvements from their GATS commitments because these countries generally register a higher level of GATS commitments than developing countries.¹⁰ In contrast, for developing countries, the level of RTA commitments is markedly higher than GATS commitments in all sectors, due in part to the fact that developing countries’ initial GATS commitments are relatively low. This may also be explained by the asymmetric bargaining structure of North-South RTAs.

Consolidation and expansion of South-South regional integration initiatives are increasingly pursued to create a platform to support developing countries’ integration into regional value chains, and to foster economies of scale, diversification and technology upgrading. In Africa, efforts are directed at boosting intra-African trade by fast-tracking the establishment of a continental pan-African free trade agreement by 2017, building upon the existing tripartite free trade agreement initiative among the East African Community, the Common Market for Eastern and Southern Africa and the Southern African Development Community. In Asia, the Association of Southeast Asian Nations (ASEAN) is headed towards the formation of the ASEAN Free Trade Area in 2015 to support the creation of the ASEAN Economic Community in 2020. In Latin America, new initiatives have emerged such as the Pacific Alliance, alongside the traditional arrangements of the Andean Community and the Common Market of the South (MERCOSUR). A dialogue between MERCOSUR and the Pacific Alliance has been initiated. Many South-South RTAs have also acted as platforms for the development of productive capacity, regional transport and infrastructure networks, and connectivity. Such cooperative initiatives, along with liberalization, have proved to be essential components of “developmental regionalism”.

Vulnerable countries face the risk of being excluded from large RTAs

South-South regional integration initiatives continue on the rise

⁹ UNCTAD, *Trade and Development Report 2014: Global Governance and Policy Space for Development* (United Nations publication, Sales No. E.14.II.D.4).

¹⁰ UNCTAD, “Services, development and trade: the regulatory and institutional dimension” (TD/B/C.I/MEM.4/5; “Impact of access to financial services, including by highlighting remittances on development: economic empowerment of women and youth” (TD/B/C.I/EM.6/2).

Further coherence is needed between the MTS and the RTAs

The quantitative expansion, proliferation and qualitative deepening of RTAs highlight the need for coherence between the MTS and RTAs. It is important to secure convergence between the multilateral and regional processes to ensure an optimal mixture of both arrangements, as well as coherence among regional processes, so that they can, in their totality, create an enabling environment for sustainable development. There is also the need for strong multilateral oversight and effective disciplines, including setting minimum standards for regional regulatory provisions. Developmental coherence is required so that SDT and policy space available under the MTS is not overridden by RTAs. RTAs could also promote broader cooperation.

As of 2013, almost half of world trade took place between countries that had signed RTAs, with almost one third regulated under deep trade agreements. While most developing countries' trade still occurs outside the coverage of RTA rules, there are notable exceptions among some countries of South-East Asia, Southern Africa and Latin America. However, the percentage of global trade taking place under RTAs has not kept pace with the increase in numbers of RTAs, partly because the bulk of world trade still remains between countries or regions that have not yet concluded any RTAs with one another (i.e., China, Japan, the EU and the United States).

Future direction at the multilateral level

Non-negotiating functions of the WTO are fundamental to the transparency, predictability and stability of international trade

While much attention is given to the prolonged Doha Round negotiations, the WTO non-negotiating functions are fundamental to the transparency, predictability and stability of international trade. Existing WTO rules and disciplines serve as the guardian against protectionism and discrimination. In the aftermath of the global economic crisis, the surge in protectionism was much feared but was relatively well contained, thanks essentially to countries' adherence to WTO norms and self-restraints. Such legal foundation of the MTS needs upholding; restrictive measures may disrupt trade. A recent WTO report finds that G20 members put 93 new trade-restrictive measures in place between mid-May and mid-October of 2014, over half of which are trade remedy actions.¹¹ While trade affected by these measures remains marginal, nonetheless it remains of concern that 962 of a total of 1,244 trade-restrictive measures taken since the global crisis remain in place. These measures are estimated to cover \$757 billion or 4.1 per cent of world imports, about 5.3 per cent of the value of G20 imports.

It is also generally believed that the WTO dispute settlement mechanism (DSM) continues to function well as countries continue to use the system. A total of twelve panels were established in 2013, a ten-year high. This not only indicates unaffected legitimacy enjoyed by the DSM, but also rising tensions in trade relations. Recent disputes have increasingly addressed measures reflecting global concerns at the interface of trade and neighbouring public policy areas. These concerns include: health-related packaging regulations on tobacco; measures promoting renewable energy (wind and solar power technology), including through domestic content requirements; sustainable exploitation of natural resources (raw materials and rare earths); and animal welfare (seals, dolphins). Traditional disputes continue to be raised, including those on anti-dumping and subsidies.

The centrality of the MTS is also evidenced by the fact that the MTS continues to be headed towards universality as it attracts new members. Thirty-two countries have acceded

11 World Trade Organization, "Report on G-20 Trade Measures", op. cit.

since 1995, bringing WTO membership to 160, with Yemen being the most recent member. Seychelles' accession is expected by end-2014. These countries have embarked on substantial policy reforms to make their trade regime WTO-compatible. Negotiating balanced terms of accession consistent with their development needs has been a major challenge.

The MTS could be seen as having the characteristic of a public good; however, its relevance and credibility are facing challenges, owing to difficulties encountered in delivering negotiated outcomes in the Doha Round. Strengthening the MTS architecture to better respond to changing economic realities and global challenges would also help address these difficulties. Various twenty-first century trade issues have also been proposed by different analysts as the future agenda for the MTS.¹² For instance, the increased prevalence of trade within global value chains (GVCs) is said to have called for shifting focus of trade liberalization approaches in favour of deeper liberalization, addressing the “trade-investment-services-know-how nexus” by adopting a whole supply chain perspective, and addressing (on a cluster-by-cluster basis) tariff and non-tariff regulatory barriers that increase trade costs throughout GVCs. This argument needs to be weighed against the fact that tariff protection remains prevalent, even in countries integrated in GVCs, and that tariff and industrial policy intervention continue to be used in developing countries to build productive capacity, trigger structural transformation and promote upgrading within GVCs.¹³

Another stream of ideas is to update the “WTO rule book” to better reflect the increased interaction of trade with broader public policies, as such interactions have emerged as new sources of trade disputes. WTO members' prioritizing of trade facilitation and the food security agenda in the Bali package already reflects the changing policy focus to promote trade in GVCs and address interaction between trade and food security. Other suggested agenda items include the relationship between trade and climate change and green growth (e.g., border tax adjustment, local content subsidies, trade-related investment measures and government procurement for renewable energy). Similar to food prices, high energy prices have heightened the concern over access to energy and raw materials (e.g., renewable and fossil fuel subsidies, and export restrictions).

The manner in which the Doha Round has evolved over the past thirteen years indicates the importance of strengthening the negotiating function of the WTO in the future. In retrospect, a large negotiating agenda going beyond the two built-in agendas of agriculture and services may be seen as having contributed to slow progress throughout negotiations. The appropriate level of contributions to be made by developed and developing countries, in terms of issues such as liberalization commitments, became a persistent stumbling block, leading some commentators to question the validity of the current design of SDT. Some institutional factors were also found not to be amenable to efficient negotiations, such as consensus-based decision-making, large and diverse membership, the single undertaking principle, a lack of leadership and weakened business interest. Careful reflection is warranted on how best to strengthen the negotiating function in the presence of parallel plurilateral and regional negotiating processes.

Global value chains are promoting different approaches towards trade liberalization

The negotiating function of the WTO should be strengthened

¹² See World Trade Organization, “The future of trade: the challenges of convergence”, Report of the Panel on Defining the Future of Trade convened by WTO Director-General Pascal Lamy, 24 April 2013, Geneva.

¹³ UNCTAD, *Trade and Development Report 2014*, op. cit.

Policymakers face the challenge of an uncertain global trade system

Trends and implications at the national trade policy level

National trade policymaking should be undertaken within the framework of applicable international rules. However, this is becoming increasingly difficult since both the MTS and RTAs are moving towards ever-greater uncertainty and fragmentation. Heightened attention needs to be paid to: national trade policymaking that is consistent with broader national development objectives and strengthened productive capacities; ensuring coherence of RTAs with the multilateral trading system; and the collection, analysis and dissemination of data on trade and its socioeconomic and developmental impact.

All of this would suggest that developing-country policymakers, whether or not their countries are party to major RTAs, should strive to maximize their information and analysis of these factors in order to determine appropriate responses at the national, regional and multilateral levels. For instance, in determining the potential trade creation or diversion effects of RTAs, consideration must be given to the volumes and structures of trade between individual parties and non-parties to RTAs, similarity of products traded, and prevailing trade regimes (including preferences granted). Policymakers must also pay special attention to the collection and analysis of data about non-tariff measures (such as technical barriers to trade), SPS measures, quantity and price controls, and contingency protection or restrictive RoO, given the prevalence and impact of such measures in international trade and their implications for economic development and public health, food security and environmental objectives.

At the same time, to strengthen the ability to cope with whatever international frameworks (or lack thereof) eventually emerge, further efforts should also be undertaken by developing countries and economies in transition to develop their productive capacity and promote structural economic transformation (including diversification) and trade competitiveness. This would facilitate conformity with any higher and/or harmonized standards agreed upon under RTAs. Trade and other economic or social objectives, such as health, food security or sustainability, should be organically linked within the internationally agreed development goals under the post-2015 development agenda. In this regard, special priority should be provided to trade in agriculture, which may generate significant impetus for economic growth, enhanced food security, poverty reduction and sustainable development.

Last but not least, the concurrence of two multilateral negotiation processes—the post-2015 development agenda and the WTO Doha Round—could still present a unique opportunity to strengthen global policy coherence, thereby linking international trade to inclusive and sustainable growth.