Chapter 1 Development and Trade-Investment

1-1 Current State of Trade and Investment in Development and their Importance

1-1-1 Importance of Trade and Investment in Development

(1) Trade-Investment and Economic Growth

Trade- and investment-related cooperation is growth-oriented cooperation.

It is considered by many that promoting trade and attracting foreign direct investment will lead to an expansion of domestic employment and will stimulate the private sector, development, and inflows of new technologies, thereby significantly contributing to economic development. **With its ultimate goal of economic growth in developing countries, trade- and investment-related cooperation toward these countries is a typical form of growth-oriented cooperation.**

(2) Globalization of the Economy and the Role of Developing Country Government

Developing country governments face the task of achieving integration into the international liberal trade regime.

Because the private sector is the primary actor in trade and investment, the major role of a developing country government in promoting trade and investment should be creating an environment for promoting and stimulating private economic activities. However, as globalization of the economy progresses rapidly and becomes irreversible, **it has become difficult for many developing countries to achieve their economic growth without being integrated into the globalization. Thus, developing country governments now face the immediate and critical tasks of achieving integration into the international liberal trade regime as represented by the World Trade Organization (WTO) and capturing the full benefits from such integration.**

For such appropriate integration to be made, the governments of developing countries are expected to set and implement comprehensive policies that include the following elements. The governments need to analyze their domestic conditions and the external economic environment surrounding their countries and then set appropriate schedules for economic liberalization with consideration of the appropriate order and pace of trade and investment liberalization. They also need to establish domestic implementation systems for the rules required by the liberal trade regime and to implement national policies that minimize short-term negative impacts on the domestic economy associated with globalization.

1-1-2 Importance of Trade- and Investment-related Cooperation in Development Assistance (Mainstreaming of Trade-related Cooperation)

(1) Poverty Reduction and Growth-oriented Cooperation

Economic growth is a necessary condition for poverty reduction.

As specifically indicated in the United Nations' Millennium Development Goals (MDGs), **there is now a common view in the international community and the donor community that poverty reduction is the most important task in the development agenda of developing countries.** Many believe that development assistance has to focus directly on the alleviation of poverty to produce concrete results from limited aid resources. There is an equally compelling view, however, that poverty reduction and economic growth are inseparable and that the goal of poverty reduction has to be pursued not only by diagnostic methods but by putting a proper priority on growth-oriented cooperation in areas such as trade, investment, and infrastructure provision.

Traditionally, Japan has placed more significance on the latter view, from its experience of official development assistance (ODA) provided to the East Asian countries. In these countries, Japanese assistance has been recognized as pivotal to the region's economic growth, which in turn has led to poverty reduction in the region. Some other donors also seem to be shifting toward the latter, as observed during recent major international conferences such as the International Conference on Financing for Development (Monterrey, March 2001) and the World Summit on Sustainable Development or WSSD (Johannesburg, August 2002). **We now observe a tendency among donors to place more importance on the growth-oriented cooperation in such areas as trade and investment, even in the goal of reducing poverty**.

(2) Revaluation of Investment-related Cooperation in Development

Private investment is necessary for responding to the demand for sufficient development resources

While the international community undertakes efforts to achieve the MDGs as mentioned above, a practical issue has emerged: Domestic resources in developing countries and official resources such as ODA received, alone cannot sufficiently finance the endeavor to achieve such goals. Foreign direct investment has been traditionally recognized as an effective means of transferring production and management skills and technologies from developed to developing countries. In addition, **direct investment and other forms of private sector cooperation are now viewed as impartial agents in meeting the demand for sufficient development resources to achieve MDGs**. ODA could be used to create an appropriate environment in channeling such private resources toward development of developing countries. From this point of view, the investment-related cooperation in ODA is now being revalued and found to be an important tool in development.

(3) Maintaining the Liberal Trade Regime for Sustainable Economic Growth

The WTO provides an essential global public good for maintaining sustainable economic growth.

As exemplified in the cooperation in the area of environment, ODA has a crucial role to play in addressing the global issues beyond the scope of the development of individual developing countries. Although there are mixed views on the current WTO system, it is nonetheless true that **the WTO system provides an essential global public good that enables the international community to maintain its sustainable economic growth at the global level**. Developed country assistance aimed at integrating the developing countries into the WTO system is important to maintaining and improving the liberal trade regime.

1-2 Definition of Trade and Investment

1-2-1 Trade

(1) Trade

A simplistic definition of trade is cross-border commercial transaction. That used to mean mostly trade in goods, but with the growth in the service industries in recent years, trade in services, such as transportation, tourism, telecommunications, and finance, is an increasingly larger and more significant component in trade.[1]

(2) Trade Liberalization and Trade Facilitation

As the opposing concept to protectionism, ***trade liberalization*** has a variety of meanings. In general, it **can be defined as reduction of trade-impeding high tariff rates and elimination of non-tariff barriers purported to restrict trade, conducted for the purpose of promoting international trade**.

Trade facilitation, **however, means promotion of trade in the form of eliminating trade-impeding factors in measures and procedures** other than tariff and non-tariff barriers by such methods as simplifying cumbersome import and export procedures. This is expected to reduce the transaction costs related to trade and improve transparency and predictability. Unlike trade liberalization, trade facilitation does not require adjustments in domestic policies and interests. Therefore, no country objects to the direction toward trade facilitation. But many developing countries remain passive on setting rules for trade facilitation, claiming that they do not have sufficient human and financial resources or infrastructure to accomplish the task. For this reason, there is a demand for identifying the needs and priorities for trade facilitation in the developing countries and to ensure adequate technical assistance and support for capacity

[1] The aggregate level of trade in services in 2000 was US$1,435 billion (measured as exported amount), which is 18.8 percent of total world trade of goods and services (WTO (2001)).

building in this area.[2]

1-2-2 Investment

***Investment* (foreign investment) is defined as international movements of capital** and is usually used to refer to either foreign direct investment (FDI) or foreign portfolio investment (FPI). Conceptually, *direct investment or foreign direct investment can* be defined as long-term, cross-border movements of capital for the financial providers to conduct economic activities in recipient countries (foreign countries), or as equity holding (stock purchase) of foreign corporations, or as lending loans to them for the purpose of participating in corporate management in foreign countries. *Indirect investment* (equity investment, portfolio investment), in contrast, means purchase of debt and equity, not for the purpose of gaining corporate ownership or management control, but simply to receive dividends or benefit from capital gains.[3]

In addition to the transfer of financial resources, direct investment also comes with transfer of technologies and management skills and knowledge (transfer of management resources). And because of this, direct investment is considered to play an important role from the perspective of development.

In the discussion on setting international investment rules for investment liberalization (deregulation) and investment protection, it is often debated whether the rules should be limited to direct investment or should cover indirect investment as well.

In this report, investment refers to direct investment, unless otherwise noted.

1-3 International Trends

Individual donors have started to assist developing countries so that they can enjoy the full benefits of liberalization.

As globalization of the economy progresses, developing countries are increasingly divided between the winners, who can successfully reap the rewards of liberalization, and the losers, who cannot. Consequently, **individual donors have started to cooperate with developing countries to help them build capacity to properly fulfill the obligations and exercise their privileges in the multilateral trade system as represented by the WTO and to set up proper domestic institutions to enjoy the full benefits of economic liberalization**.

Consideration for developing countries is increasingly an important factor at the forum of multilateral trade negotiation also. The Third Ministerial Conference of WTO held in Seattle (November 1999) failed to launch a new round of trade negotiation because of conflicting interests between developed

[2] Paragraph 27 of Ministerial Declaration, WTO Ministerial Meeting in Doha (November 2001).

[3] Despite the clarity at the conceptual level, the statistical definition is ambiguous and varies among countries and institutions. In general, 10 percent or above of share holding or original capital holding is considered direct investment, whereas less than 10 percent is considered indirect investment.

Trends in International Forums:
Failure to launch the new round at the WTO Ministerial Conference in Seattle
→Emphasis on the assistance to the developing countries at the next WTO Ministerial Conference in Doha.
→Donors pledged funding for developing country assistance through DDAGTF.

and developing countries as well as insufficient consideration of civil society groups who oppose trade liberalization. **The following Fourth Ministerial Conference in Doha (November 2001) therefore incorporated more consideration for the positions of developing countries, and as the outcome of negotiation, adopted the Ministerial Declaration, which called for an improvement in market access for developing country products and made reference to the need for technical cooperation in developing countries at various places in the text.** The Doha Development Agenda Global Trust Fund (DDAGTF) was established after the Doha Conference for the purpose of financing technical cooperation to developing country members. Developed country members pledged CHF 30 million (CHF 1.5 million from Japan alone) to the fund at the pledging conference held in Geneva in March 2002. In this way, the need for accommodating the developing countries is now explicitly recognized at the multilateral trade negotiating table. Against such a political backdrop, donors' interest in the area of trade- and investment-related cooperation has grown considerably in recent years.

The focus of donor activities is building capacity to create an enabling environment.

Because the private sector is the primary actor in economic activities such as trade and investment, **many donors focus their activities on the creation of a so-called enabling environment – that is, a business environment supportive of the private sector in conducting its economic activities – rather than directly on trade and investment promotion.** Specific examples of such activities include human resources development within government agencies in charge of multilateral trade negotiation at the WTO and other forums, and formulation and implementation of policies and institutions friendly to the market and, at the same time, consistent with multilateral trade rules.

There is an emerging recognition that **it is critically important that such cooperation builds the capacity of the developing countries to establish their trade-related policies and institutions and to implement them on their own**, rather than developed countries taking the lead in applying their policies and institutions to the developing countries. As indicated by the Organization for Economic Cooperation and Development (OECD) guidelines adopted April 2001, there is a consensus among donors that the following points are important for effective capacity building, which should also be the basis for considering the directions of Japanese bilateral cooperation in the area of trade and investment.[4]

(1) Comprehensive Approach

Stand-alone projects that focus on "at-the-border" issues, such as development of exportable products or improvement in customs administration, once occupied the mainstream of trade- and investment-related cooperation.

[4] OECD (2001)

Points to be considered for effective capacity building:
- Comprehensive approach
- Ensuring ownership which enables stakeholders' involvement
- Emphasis on cooperation process
- Need-based, tailor-made cooperation
- Donor coordination and donors' own capacity building

However, **these projects are not sufficient to promote trade and investment in a true sense. It is now widely recognized that cooperation activities must be designed in a comprehensive manner, paying attention to "behind-the-border" issues as well.** Specifically, donors should be more concerned with helping developing countries build their domestic policies and institutions consistent with international rules as represented by the various agreements under the WTO. Furthermore, donors should also be concerned with the negative impacts that economic liberalization brings to the domestic economy (for example, wider income disparity, environmental problems, deteriorating labor conditions). **For ensuring such a comprehensive approach in trade-related cooperation, it is necessary to mainstream trade into the overall plans such as the national development plans or the Poverty Reduction Strategy Papers (PRSPs) of respective developing countries.** In other words, instead of holding trade and investment promotion itself as an objective, it is important to consider these economic activities as tools for development.

(2) Stakeholders' Participation and Ownership

For such a comprehensive approach to function effectively, **the process must involve various stakeholders, including nongovernmental organizations (NGOs) and civil society, in addition to both the public and the private sectors, and academia.**[5] **And to ensure the participation of these stakeholders, the process absolutely needs be based on ownership by the developing countries themselves.** And as to the government sector, involvement of financial authorities and a wide range of line ministries is considered important in addition to trade-related ministries, which have traditionally been central to cooperation in this area.

(3) Cooperation Process

The main focus in the trade-related cooperation activities is to deepen communication among stakeholders and to formulate consensus on national policies and institutions. Therefore, the "process" of cooperation is a key. As the donors' approach to their development assistance shifts from being input-oriented to being more output-oriented, the process that effectively delivers the outcomes has become more important than ever in recent years.

(4) Need-based Cooperation

Just as the impact of globalization differs among countries, **the need for trade- and investment-related assistance varies with a country's conditions such as its stage of development and its economic structure. Therefore, it is**

[5] The concept of civil society here is rather vague. For example, labor unions, consumer groups, or mass media could be included as its members.

often stressed that the cooperation needs to be tailored to each developing country's needs. Need-based cooperation is particularly crucial for ensuring developing country ownership. It is equally critical for the purpose of maintaining political neutrality and avoiding any perception that developed countries are imposing their views through assistance activities and trying to lead the multilateral trade negotiations toward outcomes that benefit their own interests.

(5) Donor Coordination and Donors' Own Capacity Building

To effectively pursue a comprehensive approach, donors would use their limited aid resources more productively by combining them. It is also recognized as important that donors accumulate their own experiences and improve their functional capability in providing assistance in the area of trade and investment accordingly.

Box 1-1 What is WTO ?

Since the General Agreement on Tariffs and Trade (GATT) was established in 1948 as the basic international rules for international trade, the discussion on international trade rules has been conducted in the context of the GATT system. In response to the desire to strengthen the GATT system, the negotiation during the GATT's Uruguay Round brought about the formulation of new trade rules (that is, WTO agreements) that expand and develop the GATT system as well as the establishment of an international organization that manages the new rules (that is, the World Trade Organization, or WTO). The WTO was established on January 1, 1995.

The WTO agreements refer to the consolidation of the "Marrakesh Agreement Establishing the World Trade Organization (or WTO Agreement)" and the agreements contained in its annexes. Annexes 1, 2, and 3 are inseparable from the WTO establishing agreement. To become a member of the WTO, a country has to accept the establishing agreement and the first three annexes in their entirety. However, each member can choose whether or not it accepts the agreements contained in Annex 4, which are in effect only among those who have accepted them.

The following are the fundamental principles as embodied in the WTO agreements, which together form the rule-based international trade regime.

1) Most Favored Nation (MFN) Treatment

With respect to tariffs and others imposed on exports and imports, the most favored treatment granted to the product from any member country shall be accorded immediately and unconditionally to the like product from any other member countries.

2) National Treatment (NT)

Internal taxes and domestic laws and regulations shall not be applied to the imported products in excess of those applied to like domestic products.

3) Transparency

Any administrative process affecting trade activities shall be published. Members must properly institute laws and regulations and administer them.

List of WTO Agreements (WTO Agreement and its annexes)

Agreement Establishing the World Trade Organization (WTO Agreement)
Annex 1
(1) Annex 1A: Multilateral Agreements on Trade in Goods
(A) General Agreement on Tariffs and Trade 1994 ("GATT 1994")
(B) Agreement on Agriculture
(C) Agreement on the Application of Sanitary and Phytosanitary Measures ("SPS Agreement")
(D) Agreement on Textiles and Clothing ("Textile Agreement")
(E) Agreement on Technical Barriers to Trade ("TBT Agreement")
(F) Agreement on Trade-Related Investment Measures ("TRIMs Agreement")
(G) Agreement on Implementation of Article VI ("Antidumping (AD) Code")
(H) Agreement on Implementation of Article VII ("Customs Valuation Code")
(I) Agreement on Preshipment Inspection
(J) Agreement on Rules of Origin
(K) Agreement on Import Licensing Procedures
(L) Agreement on Subsidies and Countervailing Measures
(M) Agreement on Safeguards
(2) Annex 1B: General Agreement on Trade in Services and Annexes ("GATS")
(3) Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement")
Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU")
Annex 3: Trade Policy Review Mechanism
Annex 4: Plurilateral Trade Agreements
(A) Agreement on Trade in Civil Aircraft
(B) Agreement on Government Procurement
(C) International Dairy Agreement (terminated at the end of 1997)
(D) International Bovine Meat Agreement (terminated at the end of 1997)

Trends in Japanese Assistance:
- Facilitating the creation of an environment for promoting trade and investment
- Capacity building of developing countries for their participation in the WTO system

1-4 Trends in Japanese Assistance

Japanese cooperation in the area of trade and investment has been conducted in the context of facilitating the creation of an appropriate environment for promoting trade and direct investment by private businesses, the primary actors of trade and investment. It has been pointed out in documents such as the New Asian Industries Development (AID) Plan (formulated in the late 1980s), Japan's Official Development Assistance Charter (1992), and Japan's Medium-Term Policy on Official Development Assistance (1999) that Japanese ODA has to be implemented in the way in which it is integrated with trade and direct investment by the private sector, all of which together must contribute to the development of developing countries.[6] In addition

[6] The AID plan was introduced by then-Minister of International Trade and Industry, Mr. Tamura, when he visited Bangkok, Thailand. This package of cooperation covers the areas of aid, direct investment, and imports integrated together. On condition that there are self-help efforts on the side of recipient countries in setting their investment climate, the plan is implemented on the basis of well-arranged and holistic integration of both the private-based cooperation, in the form of direct investment by Japanese businesses in the partner countries and Japanese imports of products from the partner countries, and the government-based multi-dimensional assistance programs in hardware, software, and financial assistance to establish the foundation for such private activities.

to ODA, these documents also mention the need for strengthening coordination with Other Official Flows (OOF), as well as with the private sector activities. In the Medium-Term Policy on ODA, the following specific points are raised.

- **A comprehensive approach is needed** to enhance the development impact. Specifically, the **available resources of pertinent entities** – such as developing countries, donor countries, international organizations, the private sector, and NGOs – must be utilized appropriately.
- **In view of the growing importance of trade and investment and other private sector activities** observed in Asia, Latin America, and elsewhere, **efforts must be undertaken to improve the environment for private sector activities and to promote the inflow of private funds**. In this respect, special attention should be paid to equitable and efficient resource allocation, the amelioration of disparities, and the provision of assistance to sectors not benefiting from private flows.

In addition to the trend toward cooperation based on the “development perspective” as described above, Japan has been pursuing “trade perspective” cooperation in recent years for the purpose of maintaining the multilateral trade system.

Because of the necessity of launching the new round of trade liberalization under an agenda that is well balanced, inclusive, and wide-ranging, **it has become an important task for the international community to foster capacity building in developing countries that strive to achieve proper participation in the WTO system**. Based on such perspectives, the Government of Japan proposed at the Meeting of Ministers Responsible for Trade of the Asia-Pacific Economic Cooperation (APEC) in 2000 to formulate a capacity-building program (“APEC Strategic Plan”) to help the APEC developing country members implement their obligations in participating in the WTO system. The proposal was subsequently adopted at the APEC summit meeting. Following this APEC initiative, the Japan International Cooperation Agency (JICA) has been conducting a Development Study, “WTO Capacity Building Program on the Implementation of WTO Agreements in APEC Countries,” in four ASEAN countries, including Thailand and Indonesia, since 2002.