



The Commonwealth

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A Rising Commonwealth Tide: Emerging Dynamics of Intra- Commonwealth Trade and Investment

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Abstract

This study highlights the emerging dynamics and further potential of intra-Commonwealth trade and investment. The Commonwealth provides tremendous trade and investment opportunities. Its members' combined global exports of goods and services are valued (in 2013) at US\$3.4 trillion, which is about 15 per cent of the world's total exports. The intra-Commonwealth trade in goods and services is currently estimated at \$687 billion and is projected to surpass \$1 trillion by 2020. FDI flows between Commonwealth members reached \$80 billion before being hit by the global financial crisis of 2008 and intra-Commonwealth flow of remittances is estimated at \$45 billion.

The results from econometric analysis show that controlling for various factors, Commonwealth members, on average, tend to trade more between them and generate more FDI flows, and compared to other partners trade costs are 19% lower when both trading partners are from the Commonwealth. Simulation exercise also shows that strengthening trade logistics can tremendously expand trade flows in these economies. Since the currently substantial level of trade and investment has been achieved in the absence of any formal trade policy mechanisms, coordinated actions amongst members can enhance it greatly.

JEL Classification: F10; F14, F21, F24, D23

Key words: International Trade, FDI, Commonwealth, Remittance and Trade Costs

This paper was written by Dr Mohammad A Razzaque, Salamat Ali, Dr Jodie Keane and Laura Gosset from the Trade Division of the Commonwealth Secretariat. The figures and tables presented in this paper are from the authors' own calculations based on data from the United Nations Conference on Trade and Development (UNCTAD) and the World Bank. The views expressed in this paper are those of the authors and do not necessarily reflect the views of the Commonwealth Secretariat or its member countries.

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1. Introduction

As a voluntary association of 53 nations, the Commonwealth comprises a diverse membership of rich and poor, large and small, as well as landlocked and waterlocked countries. The members share an inherited connection through a common language, similar institutions and familiar legal systems.

The Commonwealth is not a formal trading bloc and as such does not administer association-wide policy measures to promote trade between members. Rather, with the proliferation of preferential or regional trading agreements – to date, more than 600 such schemes have been notified to the World Trade Organization (WTO) – individual Commonwealth nations are members of at least one preferential trading agreement (PTA). Concurrently, Commonwealth countries have also looked for trading opportunities with the dominant and emerging global and regional trading powers.

Yet there is huge potential for trade and investment opportunities and significant gains to be made from closer cooperation and increased integration into the Commonwealth. This is reflected in Commonwealth Heads of Governments' Kotte Statement on International Trade and Investment, issued during their Colombo Summit in 2013, where they mentioned, '[W]e recognize the potential for growth in intra-Commonwealth trade and investment as well as the importance of promoting practical measures to overcome constraints to such growth.'

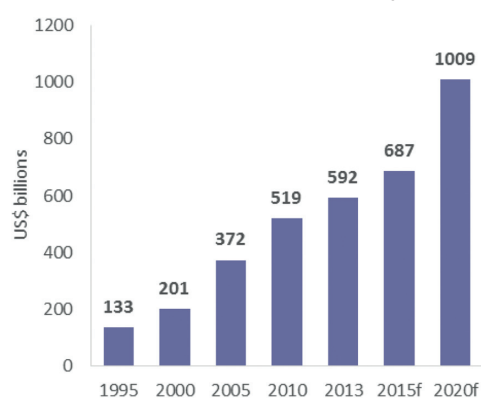
This paper presents some findings from ongoing work being undertaken by the Commonwealth Secretariat in order to better understand the nature and potential of intra-Commonwealth trade. It also provides some broad measures for more effectively harnessing intra-Commonwealth trade and investment flows.

2. Total volume of trade between Commonwealth members

During 2003–2013, trade in goods and services between Commonwealth countries expanded from US\$266 billion to \$592 billion, thus registering an average annual growth of about 10 per cent. We estimate the intra-Commonwealth trade in goods and services in 2015 to be \$687 billion and it is projected to surpass \$1 trillion by 2020 (Figure 1)¹.

In 2013, Commonwealth members' combined total exports of goods and services to all countries stood at \$3.4 trillion. This is estimated to be 14.8 per cent of world exports, down from 16.8 per cent in 2000. On the other hand, during the same time the share of intra-Commonwealth in total trade of Commonwealth countries has risen from 15.2 per cent to 17.6 per cent (Figure 2).

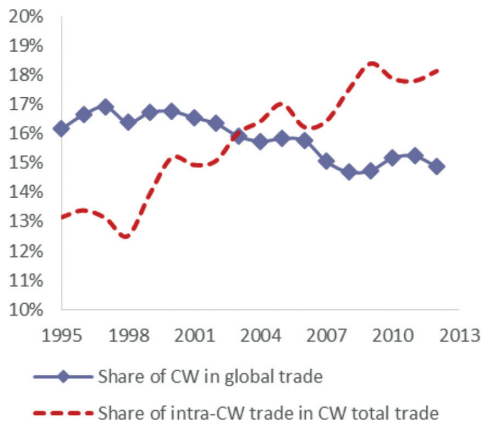
Figure 1. Intra-Commonwealth trade in goods and services will surpass \$1 trillion by 2020



In terms of merchandise exports, intra-Commonwealth trade in 2015 is estimated at \$525

¹ In 2013, total world trade in goods and services amounted to \$23.3 trillion, with \$18.6 trillion as trade in merchandise goods and US\$4.7 trillion as trade in services.

Figure 2. The relative significance of intra-Commonwealth trade in Commonwealth countries' total trade is rising



billion (out of \$3.0 trillion for all Commonwealth countries global exports). More than half of intra-Commonwealth goods exports are driven by three Asian countries: Singapore, India and Malaysia. In addition to the United Kingdom, Australia and Canada, the two largest sub-Saharan economies, Nigeria and South Africa, have also become important drivers of goods trade (Figure 3). Asian and African countries account for almost three-quarters of intra-Commonwealth trade in goods (Figure 4).

Turning to trade in services, Commonwealth services exports to the world are estimated to be \$1.3 trillion in 2015 as against the total world services trade of \$4.7 trillion. Intra-Commonwealth services trade stood at \$113 billion in 2009, the last year for which bilateral services data are available. This trade is projected to reach \$162 billion in 2015.

Accounting for almost one-third of the trade, the United Kingdom is the dominant intra-Commonwealth services trader, followed by Singapore, India, Australia, Canada and Malaysia. South Africa and Nigeria have also become

Figure 3. Top 10 countries, % share of intra-Commonwealth goods trade (2013)

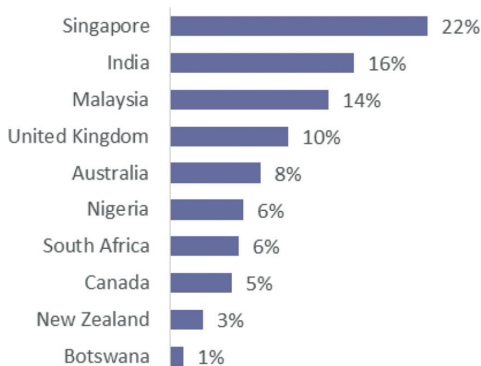
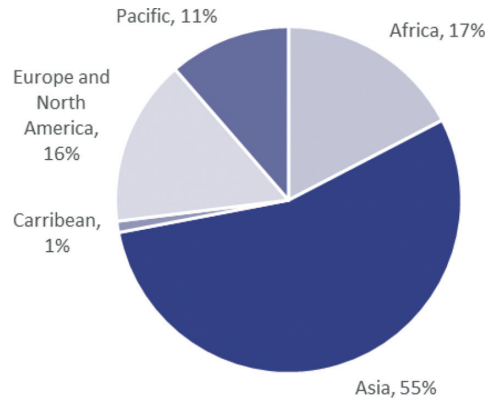


Figure 4. Intra-Commonwealth goods trade by region (2013)



prominent services traders, on an intra-Commonwealth and intra-regional basis (Figure 5).

Many small states and several landlocked African Commonwealth countries in particular suffer from certain inherent characteristics (including unfavourable geographical location of being far away from global growth and commercial centres inflicting high trade costs) seriously inhibiting their trading capacity. Nevertheless, small states tend to be more dependent on trading with the Commonwealth (Figure 6). For as many as 40 members, at least 20 per cent of their merchandise export earnings is sourced from within the Commonwealth; for 10 countries, it is more than 50 per cent.

The above is particularly impressive when considered against the fact that most Commonwealth members are active in their own formal regional trading arrangements, involving non-Commonwealth countries. Many developing members have also expanded their trade with non-Commonwealth members, with the African Growth and Opportunity Act (AGOA) and EU-EBA (Everything but Arms) being prominent examples. Furthermore,

Figure 5. Top 10 countries, % share of intra-Commonwealth services trade (2009)

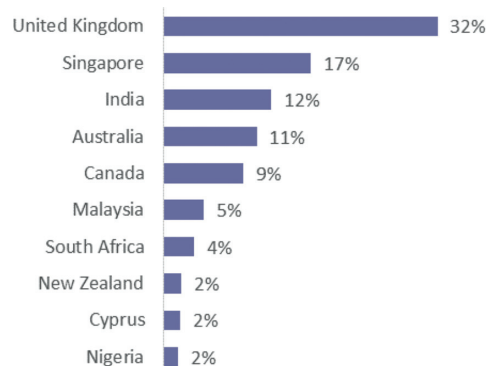


Figure 6. Smaller countries tend to rely more on intra-Commonwealth trade

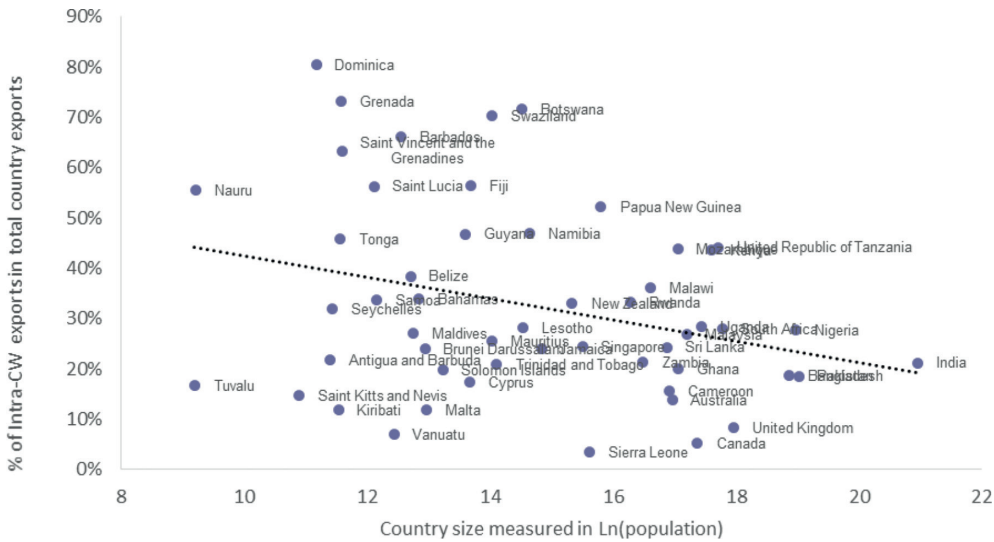


Figure 7. Commonwealth members' trade with China has risen rapidly



all Commonwealth countries actively seek for greater trading opportunities with the emerging countries. China is a glaring example. In

2000, China accounted for 5 per cent or more of six Commonwealth members' total trade; this has now risen to 39 countries (Figure 7).

3. Intra-Commonwealth investment and remittance flows

Using United Nations Conference on Trade and Development (UNCTAD) global data on

foreign direct investment (FDI), a strong upwards trend is found in investment flows

Figure 8. Intra-Commonwealth FDI flows are on the rise

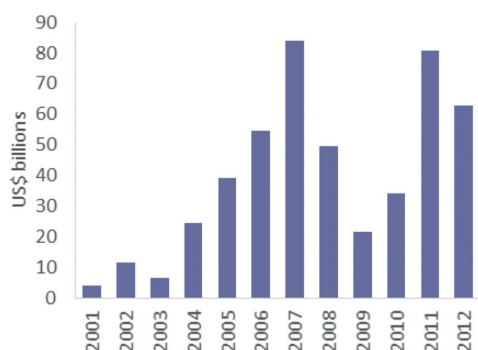
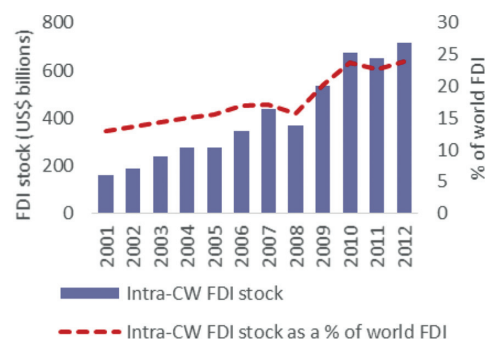


Figure 9. Intra-Commonwealth FDI stock is already substantial



between Commonwealth members. Intra-Commonwealth FDI flows increased from \$10 billion in 2002 to \$65 billion in 2012. Such flows actually reached \$80 billion in 2007 before the global financial crisis, and have not yet reached this pre-crisis peak (Figure 8).

According to our estimates, intra-Commonwealth FDI flows (\$65 billion in 2012) accounted for more than a quarter of total global investment inflows in Commonwealth countries (\$250 billion). Because these FDI figures are annual flows that represent only equity capital, reinvested earnings, and intra-company loans, the data on FDI stock can provide further insights. We estimate that in 2012 the combined FDI stock of seven major members (the United Kingdom, Canada, Australia,

South Africa, Malaysia, Singapore and India) in 38 Commonwealth countries, for which information is available, stood at \$716 billion². The relative significance of intra-Commonwealth stock on average has risen from 13 per cent in 2001 to 24 per cent in 2012 (Figure 9).

The United Kingdom and Canada hold close to \$180 billion each in other Commonwealth countries followed by Australia and Singapore (\$120 billion each) followed by South Africa, Malaysia and India, each having stock of between \$40 billion and \$50 billion. The combined FDI stock held by Commonwealth countries in the United Kingdom is higher than that held by the United Kingdom in other Commonwealth countries (Table 1). It is also worth mentioning that emerging Commonwealth developing

Table 1. Intra-Commonwealth FDI stock in the United Kingdom and held by the United Kingdom (2012)

FDI stock in the UK held by Commonwealth members	FDI (US\$ bn)	Recipient of the UK's FDI	FDI (US\$ bn)
Canada	87.2	Australia	67.2
Australia	58.5	Canada	52.5
Singapore	35.7	South Africa	21.2
South Africa	18.0	Singapore	14.5
Malaysia	4.5	India	9.5
India	2.1	Malaysia	3.3
		Nigeria	3.1
		Cyprus	2.7
		Malta	2.7
		Kenya	0.8
Total	206.0		177.5

2 FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus the net indebtedness of affiliates to the parent enterprise. It is reported on book value basis.

Table 2. Top recipients of intra-Commonwealth remittances (2014)

Country	Amount from Commonwealth (US\$ millions)	Amount from world (US\$ millions)	Main source country (%) of intra Commonwealth	
India	16,329	70,389	Pakistan	29%
Nigeria	7,837	20,921	United Kingdom	48%
Bangladesh	5,629	14,969	India	74%
Pakistan	4,354	17,060	India	47%
Sri Lanka	2,047	7,036	United Kingdom	25%
Malaysia	1,431	1,565	Singapore	71%
Australia	1,124	2,292	United Kingdom	47%
United Kingdom	956	1,839	Australia	48%
Kenya	873	1,481	United Kingdom	57%
South Africa	729	1,039	United Kingdom	38%

countries such as South Africa and India are found to be maintaining significant FDI stock in several other developing and developed countries.

Our econometric work using a large firm-level global database seems to suggest that firms in Commonwealth countries with a share of foreign ownership (10 per cent or more), are three times more likely to export to other Commonwealth markets than elsewhere. This signifies the importance of FDI in promoting intra-Commonwealth trade.

The Commonwealth represents strong diasporic connections and these can result in deep, as well as unique, trade and investment linkages between member countries. For example, it is estimated that half of all Commonwealth migration is intra-Commonwealth in nature. Immigrants not only demand goods and services from their home countries, they also introduce new products and services to their host countries. Diaspora-related trade in services includes flows associated with

sectors such as telecommunications, tourism, transportation and media. The circulation of new ideas and knowledge may positively affect business development in unconventional ways.

We have analysed bilateral remittances data to find that in 2014 remittance flows between Commonwealth members amounted to \$45 billion compared with \$147 billion received by all Commonwealth members from all other sources. Of intra-Commonwealth remittance flows, \$42 billion went to developing countries, including \$11 billion to Commonwealth sub-Saharan Africa, \$833 million to the Caribbean and \$357 million to Pacific Island countries. The top remittance sending countries in the Commonwealth are the United Kingdom, India, Canada, Pakistan, Australia, Singapore, New Zealand and Singapore. The major recipients of intra-Commonwealth remittances are India (\$16.3 billion), Nigeria (\$7.8 billion), Bangladesh (\$5.6 billion), Pakistan (\$4.3 billion) and Sri Lanka (\$2.0 billion) (Table 2).

4. Is there a 'Commonwealth effect' influencing trade and investment flows?

Trade policy relations, including on goods, services and investment, within the Commonwealth are determined by individual members' multi-lateral, regional and bilateral commitments,

which in most cases include non-Commonwealth countries. Along with these, as various nations and country groups emerge as important economic and trading powers in the

global economy, individual Commonwealth members have attempted to develop new trade linkages with them. This has resulted in increases in trade with the USA, Japan, the EU as a group and, most recently, China.

Commonwealth members are also widely dispersed geographically with average geographical distances between members from the five major markets in the Commonwealth (the United Kingdom, India, Canada, South Africa and Australia) being very high. In simple economic geography terms, many members of the Commonwealth cannot be viewed as 'natural' trading partners.

In spite of this, anecdotal evidence from various business leaders dealing with trade and investment issues across the globe suggests that doing business within Commonwealth countries is more convenient. Sharing a common language and culture and being familiar with institutions and similar legal systems are considered reasons for this.

Economists often use the gravity model to explain international trade flows. This applied

trade workhorse owes its origin to Newton's law of universal gravitation relating the force of attraction between two objects as a function of combined mass and the distance between them. It suggests that larger and richer countries would trade more than the smaller and poorer countries, all other factors being equal. In addition, geographical proximity promotes bilateral trade flows as it reduces transport and information costs. Additional factors, such as having common borders, a common language or common colonial linkages or being part of a regional trade agreement or common currency union, are also typically considered in such analytical exercises.

Our results from applying cutting-edge econometric techniques to comprehensive bilateral trade and investment flow data on the global economy (both within and outside the Commonwealth) suggest that when bilateral partners are both Commonwealth members, they, on average, trade more and generate more FDI inflows than other trade partners (Table 3).

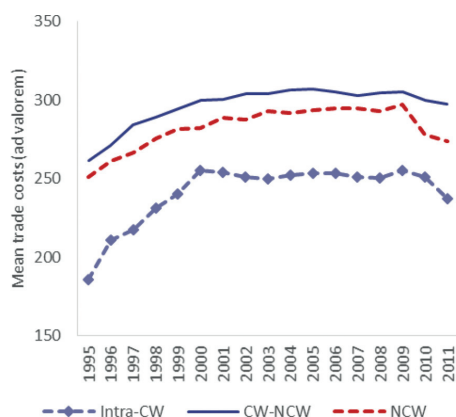
Table 3. The Commonwealth effect in trade in goods, services and FDI flows

	Goods		Services		FDI
	1	2	3	4	5
Commonwealth membership (Yes=1; 0 otherwise)	0.093**	.173**	0.42***	0.28***	0.104**
Whether members of the same trading blocs (Yes=1; 0 otherwise)	0.45***		0.26***		-0.022
Countries share a border (Yes=1; 0 otherwise)	0.44***		0.24***		0.374***
Countries share an official language (Yes=1; 0 otherwise)	-0.021		0.13***		0.499***
ln(Distance between countries (km))	-0.79***		-0.59***		-0.978***
Member of the Common colony post 1945(Yes=1; 0 otherwise)	0.10***		0.15***		0.729***
Countries share common legal systems(Yes=1; 0 otherwise)	0.24***		0.17***		0.426***
Bilateral Trade Costs		-1.12***		-0.98***	
Sample Size	82,428	82,428	57,339	82,428	43,204
Sample Period	2000–10		2000–10		2001–12
R-Squared	0.87		0.89		0.61

Notes: The dependent variables in the model are bilateral flows in goods, services and FDI. All bilateral pairs of countries have been considered including both Commonwealth and non-Commonwealth members. ***, **, and *, denote the statistical significance of the estimated coefficients respectively at 1%, 5% and 10% levels. These estimations include fixed effects for countries and time. Not all variables used in the regression are reported here. The Pseudo Poisson Maximum Likelihood (PPML) method with fixed effects were employed for goods and services equations. Because of the negative values associated with FDI flows for certain country pairs, the FDI equation could not be estimated using PPML. It was estimated using the two-way fixed effect panel data model.

Source: Secretariat's Working

Figure 10. Trade costs, Commonwealth partners vs. others



Indeed, when both countries are Commonwealth members, bilateral trade in goods and services are, respectively, 10 per cent and 42 per cent higher and bilateral investment is 10 per cent higher.

Does the ‘Commonwealth effect’, along with such favourable factors as common language and similar institutions and legal systems, translate into lower trading costs between two Commonwealth countries? We have examined this issue using a joint United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP)–World Bank global database on bilateral trade costs between up to 178 countries over 1995–2010. The analysis reveals that trade costs are indeed lower between Commonwealth member countries than other pairs (Figure 10)³. Our econometric estimates seem to suggest that, compared with other pairs (e.g. between Commonwealth and non-Commonwealth members), bilateral trade costs for Commonwealth partners are 19 per cent lower and are statistically significant.

5. Options for more effectively harnessing intra-Commonwealth trade flows

Given the above encouraging trends and prospects, we consider some measures here to more effectively harness intra-Commonwealth trade flows. This is not meant to be exhaustive, and the way forward here is within the ambit of a non-trade bloc association.

5.1 Trade facilitation

The importance of trade facilitation as a vehicle for promoting trade cannot be overemphasised. The issue has been catapulted into prominence through a multilateral deal that the members of the WTO agreed after an almost decade-long negotiation. In the WTO’s parlance, trade facilitation is somewhat narrowly defined to measures towards simplification of procedures involving customs and border-handling of

goods. Trade facilitation is unlikely to be implemented in a way that supports only the promotion of intra-Commonwealth trade. Nevertheless, it may be of interest to know the potential implications of improved trade facilitation for Commonwealth countries.

Empirical assessments with the help of a widely used global computable general equilibrium (CGE) model, known as the Global Trade Analysis Project (GTAP) model, were undertaken to assess three scenarios: **scenario I**: individual Commonwealth countries achieve the same level of trade facilitation efficiency as achieved by Singapore and the United Kingdom, as measured by the World Bank’s Logistics Performance Index (LPI); **scenario II**: individual Commonwealth members achieve at least the same level of efficiency as

³ In this figure trade costs appear to be rising from 1995 to 2000. There could be three potential reasons for this rise: first, as the explanatory note to the dataset contains, these costs are measured in relative terms as a ratio of cost of trading with another trading partner (bilaterally) to the costs of trading in the domestic market (intra-national costs). If the domestic trade costs fall, the ratio might go up. Secondly, the transport costs have actually increased in this period, probably due to higher fuel prices (ESPAS, 2013; P-42). The third potential contributory factor is an increase in air transport of goods especially for high value items as a result of the surge in intermediates trade.

South Africa; and **scenario III**: Commonwealth countries do not make any improvement in trade facilitation but abolish all tariffs on their intra-Commonwealth trade.

When the individual Commonwealth countries achieve the Singapore or United Kingdom level of trade facilitation efficiency, the combined GDP gains in the Commonwealth turn out to be \$502 billion. Achieving at least South Africa's level would result in output gains of \$177 billion. On the other hand, in the absence of any improved trade facilitation measures, if all Commonwealth members opted to abolish all tariffs applied on intra-Commonwealth trade, gross domestic product (GDP) gains would be limited to just \$80 billion. Achieving the more realistic target, as in Scenario 2, would result in additional intra-Commonwealth exports of \$120 billion, and employment generation of \$24 million in Commonwealth countries.

5.2 Global value chains

Our analysis suggests that Commonwealth participation in global value chains (GVCs) as currently defined is modestly associated with levels of international market access (IMA). This suggests that improvements in IMA, including through investments and improvements in trade facilitation measures, could spur greater Commonwealth participation in GVCs⁴. There is as yet untapped potential regarding the expansion of production networks within the Commonwealth in view of members' varying levels of economic development and specialisation within different sectors. New drivers of GVCs may emanate from some of the emerging economies, including from within the Commonwealth. This process can be further facilitated by the presence of large diasporic communities.

5.3 Mobilising remittances to leverage investment

As remittance flows have become substantial and more stable than many other types of

capital flows, mobilising diaspora savings can lead to new business and investment opportunities. There are already innovative examples regarding the money transfer business in Kenya, through M-Pesa, a mobile money transfer system that was first launched in 2007 by the Kenyan mobile network operator Safaricom, partly owned by Vodafone Group plc. This suggests the potential for scaling up other innovative service initiatives.

5.4 Strengthening existing regional integration

There also exists significant potential for increasing the volume of intra-Commonwealth trade as the existing regional integration arrangements are not very effective and there are major infrastructure barriers. Strengthening the existing and most promising regional trading arrangements particularly in Asia and Africa can generate a huge trade response. Facilitating investment flows to certain sectors, textiles and clothing in South Asia and agro-processing and leather in Africa, and supporting regional harmonisation and improvement of standards can boost trade between Commonwealth members.

5.5 Building supply-side capacity in developing countries

Improving supply-side capacities, especially those related to infrastructure, trade facilitation and to meeting technical standards is important for many Commonwealth developing countries. This can be pursued more effectively through targeted support measure as available, for example through the Aid for Trade initiative. The implementation of the trade facilitation deal under the auspices of the WTO also opens up the opportunity for addressing these constraints.

4 As defined by the OECD (2014) and its index constructed of backward (DVA) and forward (FVA) linkages.

