

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD



TRADE AND DEVELOPMENT

REPORT 2018

POWER, PLATFORMS AND
THE FREE TRADE DELUSION



UNITED NATIONS

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THE FREE TRADE DELUSION

Report by the secretariat of the
United Nations Conference on Trade and Development



UNITED NATIONS
New York and Geneva, 2018

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This publication has been edited externally.

UNCTAD/TDR/2018

UNITED NATIONS PUBLICATION

Sales No. E.18.II.D.7

ISBN 978-92-1-112931-1

eISBN 978-92-1-047322-4

ISSN 0255-4607

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Foreword

The world economy is again under stress. The immediate pressures are building around escalating tariffs and volatile financial flows but behind these threats to global stability is a wider failure, since 2008, to address the inequities and imbalances of our hyperglobalized world.

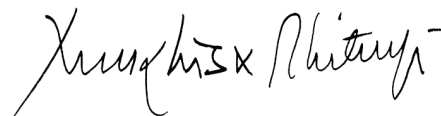
The growing mountain of debt, more than three times the size of global output, is symbolic of that failure. While the public sector in advanced economies has been obliged to borrow more since the crisis, it is the rapid growth of private indebtedness, particularly in the corporate sector, which needs to be monitored closely; this has, in the past, been a harbinger of crisis.

The growing indebtedness observed globally is closely linked to rising inequality. The two have been connected by the growing weight and influence of financial markets, a defining feature of hyperglobalization. Banks becoming too big to fail came to epitomize the reckless neglect of regulators prior to the crisis. But the ability of financial institutions to rig markets has survived the early rush of reform in the aftermath of the crisis and efforts are underway to push back even on the limited regulations that have been put in place.

Asymmetric power is not unique to financial markets; the global trade landscape is also dominated by big players. The ability of lead firms in global production networks to capture more of the value added has led to unequal trading relations even as developing countries have deepened their participation in global trade.

The digital world has bucked the gloomier post-crisis trend and is opening up new growth opportunities for developing countries. But the worrying spirit of monopoly risks distorting outcomes. Getting to grips with the policy and regulatory challenges this poses must be an integral part of rebalancing the global economy.

All these old and new pressures are weighing down on multilateralism. In our interdependent world, inward looking solutions do not offer a way forward; the challenge is to find ways to make multilateralism work for all and for the health of the planet. There is much to be done.



Mukhisa Kituyi
Secretary-General of UNCTAD

Contents

<i>Foreword</i>	<i>iii</i>
<i>Explanatory notes</i>	<i>x</i>
<i>Abbreviations</i>	<i>xi</i>
OVERVIEW	<i>I–XIV</i>

Chapter I

CURRENT TRENDS AND CHALLENGES IN THE GLOBAL ECONOMY	<i>1</i>
A. Making sense of global economic trends	<i>1</i>
1. The Panglossian disconnect.....	<i>1</i>
2. Asset market surges.....	<i>2</i>
3. Asset markets and income inequality.....	<i>3</i>
4. Volatile capital flows	<i>5</i>
5. The global explosion of debt.....	<i>5</i>
B. Emerging policy challenges	<i>7</i>
1. The oil price hike.....	<i>8</i>
2. United States protectionism and potential trade wars	<i>8</i>
C. Global trade patterns	<i>9</i>
1. Signals from global trade.....	<i>9</i>
2. Commercial services trade.....	<i>10</i>
3. Commodity price trends	<i>11</i>
D. The drivers of growth	<i>13</i>
E. Regional growth trends	<i>15</i>
1. Developed countries	<i>15</i>
2. Transition economies.....	<i>17</i>
3. Latin America	<i>18</i>
4. West Asia	<i>19</i>
5. Developing Africa.....	<i>20</i>
6. Developing Asia	<i>21</i>
7. Growth in an environment of instability.....	<i>22</i>
Notes	<i>24</i>
References	<i>25</i>
Appendix I.A: A “trade war” scenario	<i>27</i>

Chapter II

THE SHIFTING CONTOURS OF TRADE UNDER HYPERGLOBALIZATION	<i>35</i>
A. Introduction	<i>35</i>
B. Trade dynamics after the Second World War	<i>36</i>
1. The rise and fall of the Golden Age: 1950–1986.....	<i>36</i>
2. Hyperglobalization: 1986–present.....	<i>40</i>
C. Trade-charged structural change: Diverging paths among developing regions	<i>45</i>

D. Trade and inequality under hyperglobalization	50
1. GVCs, jobs offshoring, processing trade and income polarization in manufacturing.....	51
2. Concentration in export markets, intangible barriers to competition and corporate rents: A look at the top 2,000 TNCs.....	53
E. Unequalizing trade: Macroeconomic risks and development policy challenges	59
Notes	61
References	64

Chapter III

ECONOMIC DEVELOPMENT IN A DIGITAL WORLD: PROSPECTS, PITFALLS AND POLICY OPTIONS	69
A. Introduction	69
B. Digital technologies in value chains: Potential opportunities for income generation and upgrading	70
1. The distribution of value added and upgrading in traditional value chains.....	70
2. Digitalization: Potential impacts on the manufacturing process	72
C. Adapting economic policies to a digital world	80
1. Facilitating integration into a digital economy and ensuring an equitable sharing of its benefits.....	81
2. Trade and investment rules in the digital era.....	90
3. South–South and triangular cooperation for a digital world	92
D. The way forward for developing countries	94
Notes	97
References	99

Chapter IV

BRIDGING GAPS OR WIDENING DIVIDES: INFRASTRUCTURE DEVELOPMENT AND STRUCTURAL TRANSFORMATION	103
A. Introduction	103
B. Infrastructure matters: Conceptual issues and historical lessons	106
1. Types of infrastructure.....	107
2. Infrastructure and the virtuous circle of growth.....	109
3. Historical experiences.....	112
C. Infrastructure in developing countries	115
1. Needs and gaps.....	115
2. The financing gap narrative	118
D. A framework for considering the role of infrastructure in development	122
1. Some basic considerations.....	122
2. The role of planning in infrastructure development.....	123
3. Experiences with national development plans: Country evidence.....	125
E. Conclusion	126
Notes	127
References	128

List of figures

Figure

1.1	G20 real GDP growth rates, first quarter 2009–first quarter 2018	1
1.2	Stock market, selected developed economies, January 1990–March 2018.....	3
1.3	Stock market, selected developed and emerging Asian economies, January 1990–March 2018...	3
1.4	Change in stock market indices, selected economies, 2009–2018.....	3
1.5	United States residential property prices, first quarter 2005–fourth quarter 2017	4
1.6	Euro area residential property prices, first quarter 2005–fourth quarter 2017	4
1.7	Residential property prices, selected European economies, first quarter 2005–fourth quarter 2017.....	4
1.8	Stock market appreciation and nominal wages increase, selected economies, 2009–2015	4
1.9	Net private capital flow by region, first quarter 2007–fourth quarter 2017.....	5
1.10	World trade volume trends, January 2008–April 2018.....	10
1.11	Monthly commodity price indices by commodity group, January 2002–May 2018	12
1.12	United States private-sector nominal average hourly earnings, 2007–2018	16
1A.1	Labour income share and consumption in countries involved in the trade war, 2003–2023	29
1A.2	External income and transfers, and the current account in countries involved in the trade war, 2015–2023	31
1A.3	Growth of GDP and investment, 2015–2023	33
1A.4	World gross product and trade volume growth rates, 1990–2023.....	34
2.1	World trade, global output and related elasticities, selected country groups and periods, 1870–2016.....	37
2.2	Share in global merchandise exports, 1948–2017.....	37
2.3	Developing economies' share of trade by weight, 1970–2016.....	37
2.B1.1	Income of the United States on direct investment abroad, selected countries, first quarter 2000 to first quarter 2018.....	39
2.4	Total gross exports, selected country groups and China, 1948–2016	41
2.B2.1	Trade and investment bilateral connections based on international agreements, 1960–2015.....	42
2.B2.2	WTO-plus and WTO-extra policy areas included in trade agreements.....	43
2.5	Global network of merchandise trade, selected years, 1986–2016	44
2.6	Share of BRICS versus RIBS in world economy, 1990–2016.....	45
2.7	World trade in value added by sectors, selected country groups, 1995–2011.....	46
2.8	Export structure by technological levels, selected developing regions, 1990–2016.....	48
2.9	Export structure by technological levels and selected partners, selected developing regions, 1990–2016	49
2.10	Average shares of top 1 per cent, 5 per cent and 25 per cent exporters in country total export, 1997–2014.....	53
2.11	Export market entrant survival rate in 2010.....	54
2.12	Payments and receipts related to the use of foreign IPR, selected country groups, 1995–2015.....	55
2.13	Top 2,000 TNCs revenues and world trade, 1995–2015	56

Figure

2.14	Top 2,000 TNCs profit and the global labour income share, 1995–2015.....	57
2.B3.1	Shares in top 2,000 TNCs profits, selected countries and country groups, 1995–2015.....	58
3.1	Stylized manufacturing value chain smile curve.....	72
3.2	Selected ICT services as a share of total intermediate consumption in manufacturing, selected economies, 2000–2014.....	74
3.3	Domestic value added shares in manufactured products finalized in an economy, selected economies, 2000 and 2014.....	77
3.4	Types of digital platforms.....	78
3.5	Geographic location of big tech companies, selected companies.....	79
3.6	Share of “big tech companies” in top 100 non-financial corporations.....	80
3.7	Shares of top 1 per cent companies from technology, software and IT-services sector, 1996–2015.....	80
3.8	Active mobile-broadband subscriptions, 2007–2017.....	82
3.9	Mobile-broadband prices, 2013 and 2016.....	82
3.10	Individuals using the Internet, 2005–2017.....	82
4.1	Multilateral development banks: Finance for infrastructure as proportion of total banks’ finance.....	105
4.2	Number of electrical outages in a typical month.....	111
4.3	Current infrastructure investment, selected subregions and economies.....	116
4.4	Paved road density.....	117
4.5	Logistics performance index, 2016.....	117
4.6	Energy access, 2016.....	117
4.7	Telephone access and use, 2016.....	118
4.8	Safely managed water supply access, 2015.....	118
4.9	Sanitation facilities access, 2015.....	118
4.10	Trends in public investment, 1980–2015.....	120
4.11	Infrastructure planning: Country evidence.....	125

List of tables and boxes

Table

1.1	Completed and pending mergers and acquisitions deals worldwide, 2016–2018	6
1.2	World primary commodity prices, 2008–2018.....	11
1.3	Drivers of demand in different countries, 2017–2018.....	14
1.4	World output growth, 1991–2018.....	17
1A.1	Outcomes for countries/other groups	32
1A.2	World variables.....	34
2.1	Value added shares in gross exports of developing economies, level and changes, 1995–2014.....	47
2.2	Shares in exported value added in manufacturing GVCs, 2000–2014.....	51
2.3	Top 2,000 TNCs – key indicators, 1996–2015.....	56
3.1	Digital technologies.....	71
4.1	The role of infrastructure in industrialization of the Republic of Korea.....	114
4.2	Infrastructure investment needs at the global level, annual 2015/16–2030	115

Box

1.1	Global scenarios: From toiling to troubling	23
2.1	Measurement challenges in mapping international “trade”.....	38
2.2	Using laws not wisely but too well: The international legal framework in the era of GVCs.....	42
2.3	“There’s no place like home”: The geographical location of headquarters of the top TNCs.....	58
3.1	The Data Revolution Policy of Rwanda.....	90
4.1	What do empirical studies tell us?.....	104
4.2	Balanced versus unbalanced growth	110

Explanatory notes

Classification by country or commodity group

The classification of countries in this *Report* has been adopted solely for the purposes of statistical or analytical convenience and does not necessarily imply any judgement concerning the stage of development of a particular country or area.

There is no established convention for the designation of “developing”, “transition” and “developed” countries or areas in the United Nations system. This *Report* follows the classification as defined in the *UNCTAD Handbook of Statistics 2017* (United Nations publication, Sales No. E.17.II.D.7) for these three major country groupings (see http://unctad.org/en/PublicationsLibrary/tdstat42_en.pdf).

For statistical purposes, regional groupings and classifications by commodity group used in this *Report* follow generally those employed in the *UNCTAD Handbook of Statistics 2017* unless otherwise stated. The data for China do not include those for Hong Kong Special Administrative Region (Hong Kong SAR), Macao Special Administrative Region (Macao SAR) and Taiwan Province of China.

The terms “country” / “economy” refer, as appropriate, also to territories or areas.

References to “Latin America” in the text or tables include the Caribbean countries unless otherwise indicated.

References to “sub-Saharan Africa” in the text or tables include South Africa unless otherwise indicated.

Other notes

References in the text to *TDR* are to the *Trade and Development Report* (of a particular year). For example, *TDR 2017* refers to *Trade and Development Report 2017* (United Nations publication, Sales No. E.17.II.D.5).

References in the text to the United States are to the United States of America and those to the United Kingdom are to the United Kingdom of Great Britain and Northern Ireland.

The term “dollar” (\$) refers to United States dollars, unless otherwise stated.

The term “billion” signifies 1,000 million.

The term “tons” refers to metric tons.

Annual rates of growth and change refer to compound rates.

Exports are valued FOB and imports CIF, unless otherwise specified.

Use of a dash (–) between dates representing years, e.g. 2015–2017, signifies the full period involved, including the initial and final years.

An oblique stroke (/) between two years, e.g. 2016/17, signifies a fiscal or crop year.

A dot (.) in a table indicates that the item is not applicable.

Two dots (..) in a table indicate that the data are not available, or are not separately reported.

A dash (–) or a zero (0) in a table indicates that the amount is nil or negligible.

Decimals and percentages do not necessarily add up to totals because of rounding.

Abbreviations

AI	artificial intelligence
BIT	bilateral investment treaty
CAD	computer-aided design
CIS	Commonwealth of Independent States
EPZ	export processing zone
EU-19	European Union (19 members of the eurozone)
EU-27	European Union 2007–2013 (27 countries)
FDI	foreign direct investment
FTA	free trade agreement
G20	Group of Twenty
GDP	gross domestic product
GFC	global financial crisis
GVC	global value chain
ICT	information and communication technology
IMF	International Monetary Fund
IoT	Internet of Things
IPR	intellectual property rights
LAC	Latin America and the Caribbean
LDCs	least developed countries
M&A	mergers and acquisitions
NAFTA	North American Free Trade Agreement
NCE	New Climate Economy
NIE	newly industrializing economy
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
R&D	research and development
SaaS	software as a service
TDR	Trade and Development Report
TiVA	OECD-WTO Trade in Value-Added initiative
TNC	transnational corporation
UNCTAD	United Nations Conference on Trade and Development
WIOD	World Input–Output Database
WTO	World Trade Organization

OVERVIEW

Technological changes are having a profound impact on the way we go about our daily lives. Digital innovations have already changed the way we earn, learn, shop and play. Collectively, as a fourth industrial revolution, they are changing the geography of production and the contours of work. But in the end, social and political actions – in the form of rules, norms and policies – will determine how the future unfolds.

In this respect, the digital revolution has the misfortune of unfolding in a neo-liberal era. Over the last four decades, a mixture of financial chicanery, unrestrained corporate power and economic austerity has shredded the social contract that emerged after the Second World War and replaced it with a different set of rules, norms and policies, at the national, regional and international levels. This has enabled capital – whether tangible or intangible, long-term or short-term, industrial or financial – to escape from regulatory oversight, expand into new areas of profit-making and restrict the influence of policymakers over how business is done.

This agenda has co-opted a vision of an interconnected digital world, free from artificial boundaries to the flow of information, lending a sense of technological euphoria to a belief in its own inevitability and immutability. Big business has responded by turning the mining and processing of data into a rent-seeking cornucopia.

Recent events – beginning with the financial crisis, through the sluggish recovery that has followed, to the fake news and data privacy scandals now grabbing headlines – have forced policymakers to face the inequities and imbalances produced by this agenda. Governments have begun to acknowledge the need to fill regulatory deficits that harm the public, to provide stronger safety nets for those adversely affected by technological progress and to invest in the skills needed for a twenty-first century workforce. But so far, actions have spoken more softly than words.

Despite the talk, this is neither a brave nor a new world. The globalization era before 1914 was also one of dramatic technological changes as telegraph cables, railroads and steamships speeded up and shrank the world; it was also a world of unchecked monopoly power, financial speculation, booms and busts, and rising inequality. Mark Twain castigated a “Gilded Age” of obscene private wealth, endemic political corruption and widespread social squalor; and, not unlike today’s digital overlords, the railroad entrepreneurs of yesteryear were master manipulators of financial innovations, pricing techniques and political connections that boosted their profits even as they harmed business rivals and the public alike.

*And much like today, the new communication technologies of the nineteenth century helped capital to reconfigure the global economy. Many commentators wistfully describe this as a “free trade” era, evoking David Ricardo’s idea of comparative advantage to suggest that even technological laggards were better off specializing in what they did best and opening up to international trade. Here was a comforting win–win narrative for a winner-takes-most world, and an article of faith for the globalist cause, which led John Maynard Keynes, in his *General Theory*, to draw parallels with the Holy Inquisition.*

In reality, international trade in the late nineteenth century was managed through an unholy mixture of colonial controls in the periphery and rising tariffs in the emerging core, often, as in the case of the United States, pushed to very high levels. But like today, talk of free trade provided

a useful cover for the unhindered movement of capital and an accompanying set of rules – the gold standard, repressive labour laws, balanced budgets – that disciplined government spending and kept the costs of doing business in check.

As the growing imbalances and tensions of contemporary globalization play out in an increasingly financialized and digitalized world, the multilateral trading system is being stretched to its limit. Uncomfortable parallels with the 1930s have been quickly drawn. But if there is one lesson to take from the interwar years, it is that talking up free trade against a backdrop of austerity and widespread political mistrust will not hold the centre as things fall apart. And simply pledging to leave no one behind while appealing to the goodwill of corporations or the better angels of the super-rich are, at best, hopeful pleas for a more civic world and, at worst, wilful attempts to deflect from serious discussion of the real factors driving growing inequality, indebtedness and insecurity.

The response cannot be to retreat into some mythical vision of national exceptionalism, or to sit back and hope that a wave of digital exuberance will wash these problems away. There is, rather, an urgent need to rethink the multilateral system, if the digital age is to deliver on its promise.

In the absence of a progressive narrative and bold leadership, it is no surprise that the interregnum, as Antonio Gramsci would have predicted, is exhibiting disturbing signs of political morbidity. Finding the right narrative will be no easy task. For the moment, we might do best to recall the words of Mary Shelley – whose monstrous creation, Frankenstein, celebrating 200 years this year, has lost none of its power to evoke our fear of and fascination with technological progress – “the beginning is always today”.

Pricking thumbs: Where is the global economy heading?

Ten years ago, in September 2008, Lehman Brothers declared bankruptcy. Suddenly, no one was quite sure who owed what to whom, who had risked too much and couldn't pay back, or who would go down next; interbank credit markets froze; Wall Street panicked; businesses went under, not just in the United States but across the world; politicians struggled for responses; and economic pundits were left wondering whether the Great Moderation was turning in to another Great Depression.

What is surprising, with hindsight, is the complacency in the run-up to the crisis. What is more surprising still is just how little has changed in its aftermath. The financial system, we are told, is simpler, safer and fairer. But banks have grown even bigger on the back of public money; opaque financial instruments are again *de rigueur*; shadow banking has grown into a \$160 trillion business, twice the size of the global economy; over-the-counter derivatives have surpassed the \$500 trillion figure; and (little surprise) bonus pools for bankers are overflowing once again.

On the back of trillions of dollars of publicly generated liquidity (“quantitative easing”), asset markets have rebounded, companies are merging on a mega scale and buying back shares has become the measure of managerial acumen. By contrast, the real economy has spluttered along through ephemeral bouts of optimism and intermittent talk of downside risk. While some countries have turned to asset markets to boost incomes, others have looked to export markets – but neither option has delivered growth on a sustained basis, and both have driven inequality even higher.

Arguably the greatest damage of all has been dwindling trust in the system. Here economists have no excuses, at least if they have bothered to read Adam Smith. In any system claiming to play by rules, perceptions of rigging are guaranteed eventually to undermine its legitimacy. The sense that those who caused the crisis not only got away with it but profited from it has been a lingering source of discontent since 2008; and that distrust has now infected the political institutions that tie citizens, communities and countries together, at the national, regional and international levels.

The paradox of twenty-first century globalization is that – despite an endless stream of talk about its flexibility, efficiency and competitiveness – advanced and developing economies are becoming increasingly brittle,

sluggish and fractured. As inequality continues to rise and indebtedness mounts, with financial chicanery back in the economic driving seat and political systems drained of trust, what could possibly go wrong?

At some point in the past year, the mood music around the global economy changed. The perception of synchronized upswings across many different economies, developed and developing, suggested a positive prognosis for future growth. Upbeat forecasts of economic recovery have led central bankers and macroeconomic policymakers in advanced economies to accept that the time has come to reverse the easy money policies in place for the past decade.

The optimism hasn't lasted very long. Recent growth estimates have been lower than forecast and show some deceleration. Eurozone growth in the first quarter of 2018 is estimated to have decelerated relative to the previous quarter, and is now the slowest rate since the third quarter of 2016; in the United States, the annualized gross domestic product (GDP) growth rate for the first quarter has been revised downward, from 2.3 per cent to 2.0 per cent, significantly lower than the previous three quarters; and growth in the first quarter in Japan turned negative.

Developing economies are holding out better, with first quarter growth for 2018 beating expectations in China and India, but no improvement and even deceleration in Brazil and South Africa. The Russian Federation, like many other oil exporters, has seen the benefits of higher prices. Indeed, commodity exporting regions are generally enjoying the recovery in prices, albeit with some recent signs of a slowdown.

Overall, regional growth forecasts for this year are still on track. However, the number of countries appearing to be in some kind of financial stress has increased and forecasts for the medium term are being revised downwards. Already, as the talk of monetary policy normalization grows louder, a number of developing countries are struggling to cope with capital flow reversals, currency depreciation and associated instability.

The core concern is the continued strong dependence of tepid global growth on debt, in a context of shifting macroeconomic trends. By early 2018, global debt stocks had risen to nearly \$250 trillion—three times global income— from \$142 trillion a decade earlier. UNCTAD's most recent estimate is that the ratio of global debt to GDP is now nearly one third higher than in 2008.

Private debt has exploded, especially in emerging markets and developing countries, whose share of global debt stock increased from 7 per cent in 2007 to 26 per cent in 2017, while the ratio of credit to non-financial corporations to GDP in emerging market economies increased from 56 per cent in 2008 to 105 per cent in 2017.

Vulnerability is reflected in cross-border capital flows, which have not just become more volatile but turned negative for emerging and developing countries as a group since late 2014, with outflows especially large in the second quarter of 2018.

Clearly, markets turned unstable as soon as the central banks in advanced economies announced their intention to draw back on the monetary lever. This leaves the global economy on a policy tightrope: reversing the past loose monetary policy (in the absence of countervailing fiscal policy) could abort the halting global recovery; but not doing so simply kicks the policy risks down the road while fuelling further uncertainty and instability.

What is more, the implications of monetary policy tightening, whether now or later, could be severe because of the various asset bubbles that have emerged, even as the chances of global contagion from problems in any one region or segment now seem greater than ever. The synchronized movement of equity markets across the globe is one indicator of this. While property price movements in different countries have been less synchronized, they have also turned buoyant once again after some years of decline or stagnation after the Great Recession.

The cheap liquidity made available in developed country markets led to overheating in asset markets in both advanced and developing economies, as investors engaged in various forms of carry trade. The impact of

the liquidity surge on equity markets has been marked, as valuations have touched levels not warranted by potential earnings. This has resulted in a fundamental disconnect between asset prices and real economic forces. With no support from fiscal policy, monetary measures failed to spur robust recovery of the real economy. While asset prices have exploded to unsustainable levels, nominal wages increased by much less, and stagnated in many countries. This has led to further increases in income inequality, which implied that sluggish household demand could only be boosted through renewed debt bubbles.

Meanwhile, debt expansion has not financed increased new investment. In advanced economies, the investment ratio dropped from 23 per cent on average in 2008 to 21 per cent in 2017. Even in emerging markets and developing countries, the ratio of investment to GDP was 32.3 per cent in 2017, only marginally higher than the 30.4 per cent achieved in the crisis year 2008, with some larger economies registering a drop over this period.

The policy dilemma is made more difficult by other “known unknowns”: uncertainties about the movement of oil prices that also reflect geopolitical dynamics, and the possible trajectories and implications of trade wars that could result from the current muscle-flexing in the United States and its major trading partners. Trade picked up steam last year following several years of very sluggish growth and will likely continue to do so this year; but bets are off for what might happen beyond that.

In the absence of strong global demand, trade is unlikely to act as an independent engine of global growth. That said, a sharp escalation of tariffs and heightened talk of a trade war will only add to the underlying weakness in the global economy. Because tariffs operate in the first place by redistributing income among several actors, gauging their impact is not as straightforward as some of the more apocalyptic trade pundits are predicting. Still, they will almost certainly not have the desired effect of reducing the current account deficit in the United States; will raise uncertainty if tit-for-tat responses ensue; and will cause significant collateral damage for some developing countries, adding to the pressures already building from financial instability.

This is not, however, the start of the unravelling of the “post-war liberal order”. That order has been eroded over the past 30 years by the rise of footloose capital, the abandonment of full employment policies, the steady decline of income going to labour, the erosion of social spending and the intertwining of corporate and political power. Trade wars are a symptom of an unbalanced hyperglobalized world.

Nor is the rise of emerging economies the source of problems. China’s determination to assert its right to development has been greeted with a sense of anxiety, if not hostility, in many Western capitals, despite it adopting policies that have been part of the standard economic playbook used in these same countries as they climbed the development ladder. Indeed, China’s success is exactly what those who gathered in Havana back in 1947 to design an International Trade Organization wanted and sought to encourage. The difference in discourse between then and now speaks to how far the current multilateral order has moved from its original intent.

The wretched spirit of monopoly

As discussed in last year’s *Trade and Development Report*, increased market concentration and rising markups have become commonplace across many sectors and economies, with rent-seeking behaviour dominating at the top of the corporate food chain. These trends have inevitably extended across borders.

International trade has always been dominated by big firms. However, in the decades following the end of the Second World War, markets remained contested, as new entrants emerged and as countervailing bargaining power in the workplace, along with effective State regulations, constrained the power and reach of large corporations. Many of those constraints have been eroded in the era of hyperglobalization, even as more markets were opened up for business.

The resulting expansion of trade has been closely tied to the spread of global value chains (GVCs) governed by lead firms, principally headquartered in advanced economies. These have allowed more developing countries to participate in the international division of labour by providing specific links in these chains, drawing on their abundance of unskilled labour. The promise was that such fledgling manufacturing activities, through a mixture of upgrading and spillover effects, would quickly establish robust and inclusive growth paths aligned to their comparative advantage. Things have not turned out quite so simply.

The World Input–Output Database makes it possible to assess changes in the cross-country distribution of value added in manufactured output. The domestic share in this can be disaggregated into the shares received by management, marketing, research and development, and fabrication (or actual production), taking the capital share as a residual. From 2000 to 2014, both the domestic share of total value added and the domestic share of labour income in total value added declined in most countries, with the significant exception of China. The evidence for the domestic part of the capital share is more mixed; it increased sizeably in the United States and to a lesser extent in Mexico, while it declined in Brazil and China. However, the capital share is affected by transfer pricing and related practices, which cause returns on capital to show up in low-tax jurisdictions rather than the country where such returns originate.

The domestic share of fabrication declined in all countries other than Canada and China (in which country the share increased to 30 per cent in 2014). The picture for management and marketing activities is mixed, but the domestic share of research and development activities in total value added increased in most developed economies, particularly in Japan. There was also an increase in this share (from relatively low levels) in a range of developing economies, notably Brazil, China, Indonesia, Mexico, the Republic of Korea and Taiwan Province of China. Nevertheless, developed economies still recorded the highest levels of domestic shares of research and development activities in total value added.

One important factor behind these distributional trends has been the increased bargaining power of corporations, in part due to extremely concentrated export markets. Recent evidence from firm-level data on non-oil merchandise exports shows that, within the restricted circle of exporting firms, the top 1 per cent accounted for 57 per cent of country exports on average in 2014. The distribution of exports is thus highly skewed in favour of the largest firms. The concentration is even more extreme at the top of the distribution and increased further under hyperglobalization. After the global financial crisis, the 5 largest exporting firms, on average, accounted for 30 per cent of a country's total exports, and the 10 largest exporting firms for 42 per cent. This sheer size reinforced the gradual dilution of social and political accountability of large corporations to national constituencies and labour around the world.

In developing countries, the adverse impact of international trade on inequality has also resulted from the proliferation of special processing trade regimes and export-processing zones, which subsidize the organization of low-cost and low-productivity assembly work by the lead firms in control of GVCs, with limited benefits for the broader economy. The mixed outcomes of policies to promote processing trade often reflect the strategies of transnational corporations to capture value in GVCs that are designed on their own terms, with high value-added inputs and protected intellectual property content sold at high prices to processing exporters, and the actual production in developing countries accounting for only a tiny fraction of the value of exported final goods.

This raises questions about the strong bets made in many developing economies on the spillovers expected from processing trade, because unless developing countries manage to capture part of the surplus created by these GVCs and reinvest it in productive capacities and infrastructure, immediate gains in output and employment are unlikely to translate into a dynamic move up the development ladder.

China's particular success in using GVCs has crucially relied on its capacity to claim and use policy space to actively leverage trade through targeted industrial and other policies aiming at raising domestic value added in manufacturing exports. It has also relied on the ability of the Chinese authorities to develop independent financing mechanisms and acquire control over foreign assets, which are now being perceived by developed

countries as a threat to their own business interests. Replicating these measures, however, is proving difficult elsewhere.

Along with the rise of export market concentration, large firms have increased their ability to extract rents from newer and more intangible barriers to competition, reflected in heightened protection for intellectual property rights and abilities to exploit national rules and regulations for profit shifting and tax avoidance purposes. The consequent increase in returns from monopolies generated by IPRs, as well as reduction in relative tax costs of larger companies, creates an uneven playing field. The empirical exercises carried out for this *Report* suggest that the surge in the profitability of top transnational corporations – a proxy for the very large firms dominating international trade and finance – together with their growing concentration, has acted as a major force pushing down the global labour income share, thus exacerbating personal income inequality.

The increase in profits of large “superstar” firms has been a major driver of global functional inequality, widening the gap between a small number of big winners and a large collection of smaller companies and workers that are being squeezed.

Given this winner-takes-most world, a key question is whether the spread of digital technologies risks further concentrating the benefits among a small number of first movers, both across and within countries, or whether it will operate to disrupt the status quo and promote greater inclusion.

All companies, if they are to enjoy efficiency gains and take innovative steps, should be able to collect and analyse the full range of data on the markets and cost conditions under which they operate. Lack of such information and the skills to manage it have long been seen as a constraint on the growth of most firms in developing countries, as well as on smaller firms in advanced economies.

The good news for developing countries is that data intelligence, created by the use of algorithms on big data, can help firms (both in the digital sector and beyond) to develop unique products and services, extend and coordinate complex supply chains, and underpin the world of algorithmic decision-making. Engaging in digital trade could be a promising first step, by encouraging the provision of hard and soft digital infrastructure, which is a basic requirement for people and enterprises to engage successfully in the digital economy. Anecdotal success stories point to firms from the South exploiting digital technologies to move in to pre- and post-production tasks in the value chain where value added is greatest. Significantly, China’s ambitious new industrial strategy aims to make this an economy-wide goal by 2025.

The bad news comes from trends pointing in a different direction. The widening gaps across firms have been particularly marked in the digital world. Of the top 25 big tech firms (in terms of market capitalization) 14 are based in the United States, 3 in the European Union, 3 in China, 4 in other Asian countries and 1 in Africa. The top three big tech firms in the United States have an average market capitalization of more than \$400 billion, compared with an average of \$200 billion in the top big tech firms in China, \$123 billion in Asia, \$69 billion in Europe and \$66 billion in Africa. What has been significant is the pace at which the benefits of market dominance have accrued in this sector: Amazon’s profits-to-sales ratio increased from 10 per cent in 2005 to 23 per cent in 2015, while that for Alibaba increased from 10 per cent in 2011 to 32 per cent in 2015.

The size of these gaps and the speed with which they have opened up are, in large part, due to the extraction, processing and sale of data. Data, like ideas and knowledge more generally, and unlike most physical goods and services, if easily available, can be used simultaneously by multiple users. The challenge for business is twofold: to convert a seemingly abundant resource into a scarce asset and to realize the scale economies associated with network effects; if firms can achieve both, the returns appear to be limitless.

One way in which digitization is profoundly impacting distribution is through the emergence of platform monopolies. Using a combination of strengthened property rights, first-mover advantages, market power and other uncompetitive practices, these platforms control and use digitized data to organize and mediate

transactions between the various actors, and have the capability of expanding the size of such ecosystems in a circular, feedback-driven process.

The trend towards greater concentration, in both the digital and analogue worlds of business, poses several macroeconomic risks and development challenges, which are starkly evident today. One concern is the negative impact that trade under hyperglobalization can have on aggregate demand, as it helps capital to progressively acquire a larger share of world income at the expense of labour. Many economists have noted that rising inequality, together with the higher propensity to save of the rich, creates a bias towards underconsumption or, alternatively, has encouraged debt-led consumption enabled by financial deregulation. Both of these processes tend to end badly.

Since the financial crisis, financial markets and major transnational financial institutions have, with some justification, become the principal villains in this story – but it is now evident that non-financial corporations cannot remain immune from criticism. Facing weaker prospective sales in a context of weak aggregate demand that has been compounded by the post-crisis turn to austerity, large corporations have cut back on investment, further depressing aggregate demand and contributing to slower trade in recent years. This breakdown of the profit investment nexus is one of the factors behind the reported slowdown in productivity growth, particularly in advanced economies.

In such an environment, incentives are strong for firms to seek to boost profitability through rent-seeking strategies, such as intensifying international competition between workers and between Governments to reduce labour and tax costs, crushing or buying up competitors to build up market dominance and increase markups, etc. The unfortunate truth is that the attempts of big firms to enhance their own market position through such strategies only make the broader economic system more fragile and vulnerable, since together they lead to more inequality, underconsumption, debt and, consequently, macroeconomic vulnerability.

One form of rent extraction attracting increasing attention is aggressive tax optimization by locating a firm's tax base in low-tax jurisdictions. The fact that United States companies generate more investment income from Luxembourg and Bermuda than from China and Germany is a reflection of corporate fiscal strategy, not economic fundamentals. The digital economy may exacerbate tax-base erosion because a multinational enterprise whose main assets are intellectual property or data can easily offshore such assets. While the Organization for Economic Cooperation and Development's Base Erosion and Profit Shifting initiative has taken some useful steps towards safeguarding fiscal revenues, taxing where activities are undertaken rather than where firms declare themselves as being headquartered redistributes rents and may be better suited to enlarging the tax bases of developing countries.

Bits and bots: Policy challenges in the digital era

Regulating digital super platforms and developing national marketing platforms is essential for developing countries to gain from e-commerce. Without this, linking into existing super platforms will only provide the companies that run them with more data, strengthening them further and facilitating their greater access to domestic markets.

Since Alexander Hamilton first set out his economic strategy for the fledgling United States, it has been understood that catching up requires active industrial policies to mobilize domestic resources and channel them in a productive direction. This is no less true when those resources are data in the form of binary digits. Indeed, given the economic power imbalances inherent in the data revolution, it will be even more crucial for countries to devise policies to ensure equitable distribution of gains arising from data which are generated within national boundaries.

To develop domestic digital capacities and digital infrastructure, some developing country Governments (such as those of Indonesia, the Philippines and Viet Nam) are using localization measures, just as many

developed countries have done in both the earlier and current phases of digitalization. But most developing countries do not have such policies, implying that data are owned by those who gather and store it, mainly digital super platforms, which then have full exclusive and unlimited rights on it. National data policies should be designed to address four core issues: who can own data, how it can be collected, who can use it, and under what terms. It should also address the issue of data sovereignty, which relates to which data can leave the country and are thereby not governed under domestic law.

For developing countries, moving towards and benefiting from a digital future is obviously contingent upon the appropriate physical and digital infrastructure as well as digital capabilities. The challenges faced by these countries in ensuring such digital infrastructure are evident from the well-known and still-large gaps with developed countries: the active broadband subscription in the developed world (at 97 per cent) is more than double that in the developing world (48 per cent); in Africa, only 22 per cent of individuals use the Internet, as compared with 80 per cent in Europe. Even an economy such as India, with a more sophisticated digital sector, is lagging well behind in terms of Internet bandwidth, connection speed and network readiness.

To develop digital capabilities, efforts are needed at various levels: introducing digital education in schools and universities; upgrading the digital skills of the existing workforce; running special basic and advanced skill development programmes for the youth and older persons, including digital skills training programmes in existing professional development programmes; and providing financial support to develop digital entrepreneurship.

While skills development and infrastructure provision will be necessary, they are not sufficient to ensure developmental benefits; a more comprehensive strategy and a much fuller range of policy measures are needed. Industrial policies for digitalization should seek to exploit the strong synergies between supply-side and demand-side pressures in establishing a “digital virtuous circle” of emerging digital sectors and firms, rising investment and innovation, accelerating productivity growth and rising incomes and expanding markets. This may require moving towards a more mission-oriented industrial policy in a digital world to counter existing market asymmetries. For example, Governments could invest directly in infant digital platforms or acquire large equity stakes in them through sovereign digital wealth funds, in order to spread the fruits of high productivity growth from technological change more widely.

Mission-oriented industrial policy is also required because of the changed structure of finance for investment in the digital economy. Unlike tangible assets, intangible assets – such as data, software, market analysis, organizational design, patents, copyrights and the like – tend to be unique or most valuable within narrowly defined specific contexts, making them difficult to value as collateral. As a result, supporting investment in intangibles may well require an increased role for development banks as sources of finance, or of specialized financing vehicles, as well as policy measures designed to strengthen the profit–investment nexus, such as changing financial reporting requirements or imposing restrictions on share buybacks and dividend payments when investment is low, or preferential fiscal treatment of reinvested profits.

At the same time, the digital economy creates significant new regulatory policy challenges because the network effects and economies of scale associated with digitalization can cause rising inequality and generate barriers to market entry. The overwhelming control over digital platforms by a few firms points to the need for active consideration of policies to prevent anticompetitive behaviour by such firms, as well as potential misuse of data that are collected in the process.

One way of addressing rent-seeking strategies in a digital world would be to break up the large firms responsible for market concentration. An alternative would be to accept the tendency towards market concentration but regulate that tendency with a view to limiting a firm’s ability to exploit its dominance. Given that a country’s data may have public utility features, one option could be to regulate large firms as public utilities with direct public provision of the digitized services. This means that the digital economy would be considered similarly to traditional essential network industries, such as water and energy.

To keep up in the ongoing technological revolution, developing countries are in urgent need of international technology transfers from the developed countries and other developing countries that have been able to develop advanced digital technologies. International technology transfers have become much more complicated in the digital economy because technology and data analytics are being equated with trade secrets, and because some binding rules apply to source-code sharing. South–South digital cooperation can play an important role in helping developing countries grasp the rising opportunities in the digital world by providing mutual support for their digital infrastructure and capabilities.

Still, developing countries will need to preserve, and possibly expand, their available policy space to implement an industrialization strategy that should now include digital policies around data localization, management of data flows, technology transfers and custom duties on electronic transmissions. Some of the rules in existing trade agreements, as well as those under negotiation, restrict the flexibilities of the signatory Governments to adopt localization measures. Negotiations for the Trade in Services Agreement include a proposal that, for transferring data outside the national boundaries, the operator simply needs to establish a need to transfer data offshore “in connection with the conduct of its business”. The Trans-Pacific Partnership document includes binding rules on Governments’ ability to restrict the use or location of computing facilities inside national boundaries and prohibits Governments from designing policies requiring source-code sharing, except for national security reasons. Some of the proposals on e-commerce in the World Trade Organization include binding rules on cross-border data transfers and localization restrictions.

The international community is just beginning a dialogue on the required rules and regulations to manage all this, and agreement still needs to be reached on which issues relating to the digital economy are in the realm of the World Trade Organization and which fall under other international organizations. A premature commitment to rules with long-term impacts in this fast-moving area, where influential actors are driven by narrow business interests, should be avoided.

BRICS and mortar

There is no doubting that, as trade has accelerated under hyperglobalization, developing countries have captured a growing share of that trade, including by trading more with each other. However, turning these trends into a transformative development process has proved elusive across many parts of the South.

The significant metamorphosis of trade started in the mid-1980s and was particularly strong in East and South-East Asia, based on mutually reinforcing regional dynamics and State-targeted industrial policies that helped build strong links between profit, investment and exports. A rapid pace of domestic investment helped to tap both learning and scale economies, sustaining rapid productivity growth, driving the shift from resource-based to labour-intensive and subsequently to technology-intensive production and exports, and opening up Northern markets to those exports. In the absence of such linkages in other developing regions, the export of manufactures has been a poorer predictor of productivity growth during this period.

Over time, a gradual shift within Asia has seen China overtake Japan as the largest exporter from the region in 2004, and then become the world’s largest exporter in 2007. This story has, somewhat casually, been rolled, under the BRICS (Brazil, Russian Federation, India, China and South Africa) acronym, into a wide narrative about the rise of large emerging economies. However, while their combined political weight has important geostrategic consequences, they are too varied a set of economic experiences to make for a collective economic force. Even within this group, China’s experience is extraordinary. The share of BRICS in global output increased from 5.4 per cent in 1990 to 22.2 per cent in 2016. But excluding China, the share of “RIBS” in global output went up from 3.7 per cent to around 7.4 per cent – an increase, but not a spectacular one. This is mirrored in global export shares, where China significantly outpaces the others in the group. Indeed, in most of the rest of the developing world, outside East and South-East Asia, export shares remained roughly constant and in some cases even declined, other than during the rising phase of the commodity price supercycle, when major commodity exporters registered a temporary increase of their market shares.

The growth acceleration and structural transformation in East Asia have spilled over to the rest of the developing world, mainly in the form of boosted demand for raw materials. Nevertheless, again with the exception of some successful cases in Asia, there has been very little evidence of broad-based trade-induced structural change.

This is, in part, a reflection of asymmetric power relations between lead firms and suppliers in manufacturing value chains, and weak bargaining positions for developing countries. The experiences of Mexico and Central American countries as assembly manufacturers, for example, have been linked to the creation of enclave economies, with few domestic linkages and limited, if any, upgrading. The same can be said about the electronics and automotive industries in Eastern and Central Europe.

Trade in Value-Added (TiVA) data show that China has been more of an outlier, one of very few countries that managed to increase their shares of manufacturing domestic value added in gross exports (with a 12 percentage point increase between 1995 and 2014). Of 27 other developing countries recorded in TiVA, only 6 experienced increases, albeit of much smaller magnitudes. Instead, for many developing countries, trade under hyperglobalization strengthened the economic weight of extractive industries; 18 of the 27 developing countries experienced increases in shares of extractive industries in export value added. This may partly reflect price effects during the commodity boom, but the persistence of such effects over many years has strengthened incentives for investment in extractive industries, private and public, resulting in higher volumes, which in the long run is likely to have further entrenched dependence on extractive industries, with adverse implications for structural change.

Disaggregating developing countries' exports by the technological intensity of products points to significant differences in both structure and dynamics. On the one hand, the first-tier newly industrialized economies and China depict clear trends towards technological upgrading. By contrast, Africa and West Asia show limited progress as their exports remain extremely concentrated in commodities, with hardly any increase in shares of technology-intensive manufactures, regardless of their labour skill levels. Latin America and the rest of South, South-East and East Asia fell between these two extremes. In Latin America, the 1990s were a period of some structural change with technological upgrading, but this pattern was partly reversed during the commodity supercycle. As the commodity price boom receded, Latin America's trade structure returned to its position of the late 1990s, suggesting that technological upgrading has been limited at best. In the rest of South, South-East and East Asia, tendencies towards relative technological upgrading appeared in export data only in the 2000s, with a shift towards high-skill labour and technology-intensive goods. However, there is still some way to go to reach even the current structure of China, let alone the first-tier newly industrialized economies.

Overall, bilateral trade data suggest that intraregional trade seems to have the greatest potential in terms of providing support to move up the ladder, confirming the validity of previous UNCTAD calls for strengthening regional trade. By contrast, the expansion of East and South-East Asia has not triggered significant positive structural changes in the export structures of other developing regions; rather, it has intensified their role as providers of commodities. And with the slowdown of world trade since the global financial crisis, underlying structural weaknesses have been revealed in many countries. One of those weaknesses is the lack of a solid infrastructure base.

Whether measured as road density per square kilometre, access to energy, telephone connectivity (essential in the new digital era), piped water or basic sanitation facilities, infrastructure bottlenecks are obstacles to sustained growth in many developing regions, especially in South Asia and sub-Saharan Africa. This is, in part, a consequence of the neo-liberal turn in development policy that diluted the original goal of multilateral finance to fund infrastructure projects: for example, the ratio of infrastructure lending to total loans made by the World Bank in the 2000s was down 60 per cent from the figures for the 1960s. Combined with a wider policy assault on public investment, many developing countries have been left denuded of the infrastructure needed to compete effectively in more open markets.

However, infrastructure has made a comeback in recent years. The United Nations' ambitious 2030 Agenda for Sustainable Development requires big infrastructure projects if it is to stand any chance of success, with estimates of annual global investment needs in the range of several trillion dollars. China's Belt and Road Initiative, an estimated trillion-dollar infrastructure package, promises to extend its own investment–export model to a global stage.

But while headline-grabbing figures on the size of the financing gap have no doubt helped to raise awareness of the infrastructure challenge, there is a danger of missing the critical role it plays in structural transformation, and the importance of complementary policies and institutions in fostering that role. Moreover, if history is any guide, the later countries begin their development push, the bigger the resource mobilization challenge and the more necessary that infrastructure investments are properly planned and sequenced.

Regardless of a country's level of development, infrastructure represents a long-term investment in an uncertain future, and – given the significant scale economies, large sunk costs, strong complementarities and long gestation periods that tend to be involved – infrastructure planning is, as the American banker Felix Rohatyn has dubbed it, a “bold endeavour”. At the same time, these same features make for both “natural monopolies” and significant coordination challenges that can generate big returns for private investors, but often require public sector involvement if they are to be delivered on the requisite scale and to full effect. An unfortunate consequence has been to turn the infrastructure challenge into a political football between the “market failure” and “government failure” camps.

What is needed instead is a paradigm shift that places infrastructure investment squarely in the context of structural transformation and provides an alternate perspective on how to plan, execute and coordinate those investments, particularly for developing countries that are building their industrial capacities. Doing so means revisiting, and refreshing, an older debate on development planning. In particular, Albert Hirschman's seminal study *The Strategy of Economic Development*, published 60 years ago, can provide a framework to link what was then commonly called “social overhead capital” (public infrastructure) and directly productive activities (private investment).

Hirschman associated planning with a model of “unbalanced growth”, in which productive resources are best selectively targeted at sectors with the potential to build backward and forward linkages, thereby revealing gaps and generating price disruptions which stimulate further rounds of private investment, promoting organizational and other capabilities needed to keep the growth process going and sending the right signals to policymakers on where they should focus their infrastructure investments.

This approach, by tying financial viability to a wider set of developmental criteria, provides an alternative to the current fashion for reducing infrastructure planning to a portfolio choice, with a focus on the bankability of individual projects and risk-adjusted returns in line with the calculations of private investors.

Despite the current enthusiasm among policy makers for scaling up private sector involvement in infrastructure projects, financial markets in the era of hyperglobalization have avoided such projects in favour of more short-term lending and speculative positions in existing assets. Even when private sector participation in infrastructure has taken place, it has often pursued short-term financial gains over public service delivery, cherry picking projects accordingly and leading to substandard and fragmented infrastructure systems ill-suited to the promotion of accelerated growth and structural transformation.

The way forward requires instead a visionary but pragmatic experimentalism. Transformative development needs a more strategic approach, in which infrastructure development is planned to promote linkages that support industrial development and diversification. Such planning should pay due consideration to how infrastructure investments are structured, the key feedback loops between infrastructure and productivity growth, and the trade-offs involved in the choice of infrastructure. It matters which infrastructure investments are prioritized and how those priorities are reached. Some types of infrastructure (such as roads and telecommunications) have a greater impact on productivity than others (for example, air transport or sewage).

Planning forces policymakers to think about patient capital, since infrastructure investment typically begins to have an impact on private sector productivity only after some time and a threshold level of infrastructure investment has been reached. This also means that Governments need to be willing to take some risk; successful infrastructure programmes of the past have been as much the product of political ambition as of careful public accounting and cold statistical calculations. Finally, network effects of modern infrastructure as well as the complementarities between different types of infrastructure are important – energy promotion in rural areas will not necessarily lead to higher rates of returns among firms when roads or telecommunications are not concomitantly provided. These effects need to be factored into overall planning and coordination efforts.

As such, planning should be seen less as a top-down instruction manual and more as a coordinating umbrella embracing a wide range of differing interests and strategic choices, focusing on what sectors to prioritize and technologies to adopt, the macro coordination of investment decisions, the amount of resources required and how to mobilize them. From this perspective, the comeback of national development plans in many developing countries since the beginning of the new millennium is encouraging, even though an initial assessment of these initiatives suggests a continuing disconnect between infrastructure plans and a country's development strategy. More work is needed to connect a country's different stakeholders and the policy areas with which infrastructure overlaps, with attention to consistency, the development of capacities for planning, project preparation and execution, and a clear system of penalties to ensure that plans are followed through, as well as accountability to minimize unnecessary costs and ensure legitimacy. Ultimately, this requires bold political leadership.

Free trade troubadours

The growing backlash against hyperglobalization is not a surprise; that the international trading system is now on the frontline is more so, given that the roots of the heightened insecurity, indebtedness and inequality behind this backlash stem more from the financial system than the trade regime.

There should be little doubt that using tariffs to mitigate the problems of hyperglobalization will not only fail, but also runs the danger of adding to them, through a damaging cycle of retaliatory actions, heightened economic uncertainty, added pressure on wage earners and consumers, and eventually slower growth. Still, it would be foolish to dismiss those voicing concerns about damaging trade shocks as ignorant of the subtleties of Ricardian trade theory or simply the misguided victims of populist politicians. Indeed, while the gravity of discontent in the North is only now pulling towards trade issues, there are long-standing concerns among developing countries about the workings of the international trading system.

The dominant narrative of the current era has identified globalization with the growing reach of markets, an accelerating pace of technological change and the (welcome) erosion of political boundaries; the language of “free trade” has been used incessantly to promote the idea that even as global economic forces have broken free from local political oversight, a level playing field, governed through a mixture of formal rules, tacit norms and greater competition, will guarantee prosperity for all.

In reality, hyperglobalization has as much to do with profits and mobile capital as with prices and mobile phones, and is governed by large firms that have established increasingly dominant market positions and operate under “free trade” agreements that have been subject to intense corporate lobbying and all too frequently enacted with minimal public scrutiny. As described in previous *Reports*, this is a world where money and power have become inseparable and where capital – whether tangible or intangible, long-term or short-term, industrial or financial – has extricated itself from regulatory oversight and interference.

As a result, it is hardly surprising that the heightened anxiety among the growing number of casualties of hyperglobalization has led to much more questioning of the official story of the shared benefits of trade. Mainstream economists bear their part of the responsibility for the current state of affairs. Ignoring their

own theoretical subtleties and the nuances of economic history, they remain biased in favour of *unqualified free trade* when it comes to communicating with policymakers and broader audiences. The mainstream narrative pitches “comparative advantage” as a “win–win” boost to economic efficiency and social welfare, without specifying the conditions under which such beneficial outcomes can occur or how any negative effects could be reduced.

There is no doubt that the new protectionist tide, together with the declining spirit of international cooperation, poses significant challenges for governments around the world. However, doubling down on business as usual is not the right response. Resisting isolationism effectively requires recognizing that many of the rules adopted to promote “free trade” have failed to move the system in a more inclusive, participatory and development-friendly direction.

This means that it is now essential to introduce a more evidence-based and pragmatic approach to managing trade as well as to designing trade agreements. The narrative around trade should abandon unrealistic assumptions – such as full employment, perfect competition, savings-determined investment or constant income distribution – that have underpinned the dominant policy discourse on trade policy. Instead, recognition of the lessons from successful export economies and the insights of new trade models that acknowledge the impact of trade on inequality need to be combined with an assessment of the causal relationship between rising inequality, corporate rent seeking, falling investment and mounting indebtedness.

UNCTAD has argued consistently in the past few years that a new international compact is required – a Global New Deal – that would aim for international economic integration in more democratic, equitable and sustainable forms. Specifically, with reference to strategies for international trade and the architecture that sustains it, there is a strong case, on its seventieth anniversary, for revisiting the Havana Charter for an International Trade Organization, which emerged – albeit ephemerally – from the original New Deal and can still provide important pointers for our contemporary concerns.

First of all, the Havana Charter looked to situate trade agreements in an expansionary macroeconomic setting, noting that “the avoidance of unemployment or underemployment, through the achievement and maintenance in each country of useful employment opportunities for those able and willing to work and of a large and steadily growing volume of production and effective demand for goods and services, is not of domestic concern alone, but is also a necessary condition for the achievement of the general purpose... including the expansion of international trade, and thus for the well-being of all other countries”. This focus on full employment has been abandoned in the period of hyperglobalization, both at the national level and in the “trade” and “economic cooperation” agreements that have dominated the landscape. It should be revived if the widespread backlash against trade is not to gather more strength.

Secondly, the Havana Charter recognized the links between labour market conditions, inequality and trade, calling for improvements in wages and working conditions in line with productivity changes. It also aimed to prevent “business practices affecting international trade which restrain competition, limit access to markets or foster monopolistic control”, and dedicated an entire chapter to dealing with the problem of restrictive business practices. Revisiting these goals in light of twenty-first century challenges, including those of the digital economy, should be a priority.

Thirdly, the Havana Charter insisted that there were multiple development paths to marry local goals with integration into the global economy, and that countries should have sufficient policy space to pursue pragmatic experimentation to ensure a harmonious marriage. This need for policy space also brings to the forefront the matter of negotiating “trade” agreements that have in recent decades privileged the requirements of capital and limited the possibilities for development in line with social priorities.

A decade after the collapse of Lehman Brothers, the global economy has been unable to establish a robust and stable growth path. Instead, weak demand, rising levels of debt and volatile capital flows have left many economies oscillating between incipient growth recoveries and financial instability. At the same time,

austerity measures and unchecked corporate rentierism have pushed inequality higher and torn at the social and political fabric. As the drafters of the Havana Charter knew from experience, tariffs are treacherous instruments for dealing with these problems and if a vicious cycle of retaliation takes hold only make matters worse. But trade wars are a symptom not a cause of economic morbidity. The tragedy of our times is that just as bolder international cooperation is needed to address those causes, more than three decades of relentless banging of the free trade drum has drowned out the sense of trust, fairness and justice on which such cooperation depends. ■