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### Trade and Development Board

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## High-level dialogue: Is the world integrating or disintegrating?

Note by the UNCTAD secretariat

### *Executive summary*

Globalization through trade, finance, investment and technology has strengthened the integration of the global economy and brought about new opportunities, as well as new challenges. In the area of international trade, the underpinning policy framework of trade agreements and negotiations is changing rapidly.

In the wake of recent developments and two landmarks of regional integration – namely the fiftieth anniversary of the Association of Southeast Asian Nations (ASEAN) and the sixtieth anniversary of the European Union – the high-level dialogue of the Trade and Development Board provides an opportunity to assess the contribution of regional integration to economic growth and building productive capacities and fostering stronger and more integrated economies across the globe.

This note sets out the possibility of a new normal in global trade relations, provides an overview of regional trade agreements (RTAs) in developing countries and addresses the role of regionalism in economic development. The note concludes with some policy recommendations for consideration by member States.



## Background

1. Until recently, the negotiation of interregional agreements and RTAs was a predominant feature of international cooperation. Such agreements kept expanding in size and complexity, moving from the domain of bilateral agreements to ever more ambitious multilateral agreements, and most countries were parties to at least one such agreement. Since 1995, more than 400 RTAs covering trade in goods and/or services have been notified to the World Trade Organization.

2. In the last decade, a new approach to RTAs involving a multiplicity of countries was developed in many regions including, among others, the negotiations for the Trans-Pacific Partnership, the Transatlantic Trade and Investment Partnership between the United States of America and the European Union, the Regional Comprehensive Economic Partnership between member States of ASEAN, the Pacific Alliance among four States in Latin America and an African continental free trade area.

3. The largest of these RTAs were dubbed mega-regionals, and are multiparty trade agreements that can be defined by both their size and ambition. However, recent events have seemed to call into question the era of regionalism on such a scale, namely the decision of the United Kingdom of Great Britain and Northern Ireland to withdraw from the European Union and the withdrawal of the United States from the Trans-Pacific Partnership.

4. There has been a marked slowdown in the fragmentation of production processes or, rather, a shortening of global value chains. Between chains, final demand has shifted to products that have lower import intensity. At the national level, for example in China, final demand has shifted away from durables and investment goods, towards services and products with lower import intensities and an increasing share of domestic value added.<sup>1</sup>

5. The high-level dialogue will allow for a candid look at the current status of some RTAs, such as ASEAN, the Eurasian Economic Union, the European Union and the Southern Common Market, with respect to sustainable development strategies. It may also consider how recent developments could influence the way RTAs evolve in the future, including promoting the achievement of sustainable development and strengthening regional economic integration.

6. The high-level dialogue will also facilitate exchanges of experiences in the field of regional economic integration through the presentation of best practices available under RTAs represented by various geographical regions. The aim is to arrive at practical policy recommendations with regard to how RTAs can promote inclusive and sustainable development and meet emerging challenges, while supporting economic structural transformation.

### I. Towards a new paradigm of trade relations

7. Throughout the 1980s and 1990s, many developing countries embraced open markets and reduced the role of government in economic policies. This led to an economically interdependent and more globalized world, and paved the way for an increase in the number and ambitions of new regional groupings in the 1990s. Some of these regional agreements were inspired by the successful economic integration process in Europe, and many led to the formation of similar customs unions and/or free trade areas, such as ASEAN, the Southern Common Market and the North American Free Trade Agreement, that facilitated trade between members through the removal of tariffs and non-tariff barriers.

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<sup>1</sup> M Timmer, B Los, R Stehrer and G De Vries, 2016, Production fragmentation and the global trade slowdown, *Vox*, 21 November, available at <http://voxeu.org/article/production-fragmentation-and-global-trade-slowdown> (accessed 30 June 2017).

8. However, as integration and globalization continued apace, there were many people that felt excluded or disenfranchised by the rapidly changing world, although such grievances may not have been a direct result of trade integration. By tapping into this public discontent, political campaigns focusing on slowing or reversing integration have gained much traction. Such sentiments and political outcomes will have significant effects on the nature of any further global economic and political integration. Based on these recent trends, it appears that a new phase of globalization and, consequently, a new approach to RTAs and negotiations, may have begun.

9. The withdrawal of the United Kingdom from the European Union may represent one of the largest upheavals in the political and economic sphere of the United Kingdom following the end of the Second World War. The Government of the United Kingdom intends to leave the single market and negotiate a new partnership with the European Union and, as a priority, will pursue a free trade agreement with the European Union. As a member State of the European Union, the United Kingdom is a party to 36 trade agreements with third countries, and the future of these trade agreements needs to be assessed, along with the establishment of a stable trade relationship with the European Union. Much depends on the final outcome of the negotiations for withdrawing from the European Union and, whichever scenario prevails, there will be a rather long period of uncertainty during and after the negotiations, for both the United Kingdom and its existing and prospective trading partners.

10. To date, the priorities of the current United States administration on trade policy have revolved around two main aspects, namely a reduction of the national trade deficit, which has recently reached over \$500 billion, and a preference for bilateral trade negotiations. To this end, the United States has withdrawn from the Trans-Pacific Partnership, is conducting reviews to assess the major causes of the trade deficit and is preparing to renegotiate the North American Free Trade Agreement. Canada and Mexico have also expressed a willingness to renegotiate and modernize the Agreement.

11. With the change in tack of the world's largest economy and the uncertainty surrounding the negotiations for the withdrawal of the United Kingdom from the European Union, geopolitics, as much as pure trade-related issues, may determine the future of many RTAs.

## **II. Regional trade agreements in developing countries**

12. Despite some setbacks, in the foreseeable future, regional integration will continue to play a significant role in determining the economic futures of billions of people. Globalization has had a huge effect on the developing world, and the widespread withdrawal of support for globalization has to date been limited. Deepening intraregional trade and investment encourages the further development of region-wide value chains and enables the productivity gains that come with greater specialization and scale. In addition, it creates the potential for high numbers of micro, small and medium-sized enterprises to gain a foothold on such value chains. Despite recent changes, the potential of global value chains remains high for many developing countries. However, much depends on the extent to which regions that have lagged behind Europe, East Asia and North America manage to increase their participation in the international fragmentation of production.

13. With the withdrawal of the United States from the Trans-Pacific Partnership, the global spotlight has turned to the ASEAN-led Regional Comprehensive Economic Partnership. The evolution of the Partnership will determine to a great extent the role of trade in development in the wider Asia-Pacific region. Agreements are in place for an early establishment of the Partnership and to conclude negotiations by the end of 2017. Once completed, the Partnership will become the world's largest free trade area, covering a population of 3.5 billion, with a combined gross domestic product of \$23 trillion, or one third of the world's total. As the six non-ASEAN member States have all signed free trade agreements with the regional bloc, the Partnership fully complies with the ASEAN vision of promoting regional integration and contributes to its aim of building an ASEAN economic community.

14. There is strong commitment to enhanced regionalism across Asia. The One Belt, One Road initiative is likely to transform trade across Asia in the coming decade. This \$900 billion project will involve the development of six major economic corridors,<sup>2</sup> featuring energy and industrial clusters, and composed of railways, roads, waterways, airways, pipelines and information highways.

15. In Latin America, the emergence of the Pacific Alliance, an integration scheme between Chile, Colombia, Mexico and Peru, has revived a push for regional integration aimed at liberalizing the movement of people, goods, services and capital among participating States. It may serve as a platform to further strengthen trade relations with countries in the Asia-Pacific region. The current trade architecture in Latin America is characterized by multiple overlapping free trade agreements, where subsets of countries are parties to several agreements among themselves. The resulting agreements raise transaction costs and discourage production chains at the regional level. Further convergence between the Pacific Alliance and the Southern Common Market would create scope to advance integration in Latin America.

16. External processes can also help boost intraregional integration. European Union exports to the Southern Common Market are increasing, and rose from €21 billion in 2005 to €46 billion in 2015. In the same period, Southern Common Market exports to the European Union rose from €32 billion to €42 billion. Given this increased economic activity, reviving long-stalled negotiations between the two blocs could help strengthen trade and investment flows within the Southern Common Market.

17. African countries have continued their regional integration efforts and the consolidation of regional groups, for example with the signing in 2015 of a tripartite free trade agreement by the Common Market for Eastern and Southern Africa, the East African Community and the Southern African Development Community. This will enhance market integration, infrastructure development and industrialization within Eastern and Southern Africa and provide spillover benefits to other regions on the continent. This trade bloc constitutes at least half of the States, population and gross domestic product of the continent and, once fully implemented, is expected to significantly increase intraregional trade.<sup>3</sup>

18. Further, African Union Heads of State and Government have committed to establishing, by the end of 2017, an African continental free trade area, in order to establish the free movement of business persons and investments and a single continental market for goods and services, as well as to expand intra-African trade and increase the continent's appeal as a global trade partner. Once implemented, the continental free trade area will be the world's largest free trade area by number of countries, with all 54 States on the continent involved.

19. There is much scope for gains in trade integration in Africa. In the 2000s, the share of intraregional exports and imports relative to total world trade of the region was around 11–13 per cent in developing Africa, and rose to around 15 per cent in 2015. In the same period, the share was 19–20 per cent in developing America and 48–51 per cent in developing Asia.<sup>4</sup>

### III. The role of regionalism in economic development

20. The Nairobi Maafikiano, the outcome of the fourteenth session of the United Nations Conference on Trade and Development, agreed on by member States in July 2016, highlights the importance of regional integration in promoting inclusive growth and sustainable development through, inter alia, strengthening regional economic cooperation

<sup>2</sup> New Eurasian land bridge, China–Mongolia–Russian Federation, China–Central Asia–Western Asia, China–mainland Southeast Asia, China–Pakistan and Bangladesh–China–India–Myanmar.

<sup>3</sup> African Development Bank, Organization for Economic Cooperation and Development and United Nations Development Programme, 2017, *African Economic Outlook 2017* (Paris).

<sup>4</sup> UNCTAD, 2013, *Economic Development in Africa Report 2013: Intra-African Trade – Unlocking Private Sector Dynamism* (United Nations publication, Sales No. E.13.II.D.2, New York and Geneva).

among developing and developed countries. Regional integration can be an important catalyst to reducing trade barriers, implementing policy reforms, decreasing trade costs and increasing developing country participation in regional and global value chains.

21. Such discussion is particularly timely as negotiations on sustainable development issues are proceeding slowly at the multilateral level, while RTAs advance at a faster pace in addressing sustainable development concerns. A growing number of bilateral, regional and interregional trade agreements incorporate provisions that address social and developmental concerns. For instance, many contemporary RTAs recognize the importance of gender mainstreaming for achieving inclusive economic growth, as well as the key role that gender equality policies can play in fostering socioeconomic development. Similar expansion with regard to labour policy considerations can also be seen in RTAs. Another example of how RTAs are becoming instruments of sustainable development strategies is found in the area of environmental protection. Since 2010, there has been an upward trend in the inclusion of more substantive environmental provisions in RTAs, such as those that refer to environmental cooperation, public participation, dispute settlement, the coverage of specific environmental issues and implementation mechanisms.

22. Finally, while the presence of externalities can and does serve as an added justification for deviating from policy neutrality, adopting a more strategic approach is not about favouring blanket protection and picking winners. Rather, it is about combining various elements of trade policy, depending on a country's resource base, macroeconomic policies and level of development. It is a process of discovery, whereby Governments and businesses assess the benefits and challenges of new activities and technologies, learn to address externalities such as climate change and promote diversification and value addition. While countries remain responsible for their own development strategies, appropriate trading rules, including those applied under RTAs, can support such strategies by providing a framework for long-term sustainable development objectives.

#### **IV. Policy recommendations**

23. Member States can enhance the facilitating role that cooperation within and among RTAs can have in areas where policy coordination and coherence is most needed to increase synergies between trade and the Sustainable Development Goals. Such areas include reducing trade policy uncertainty; avoiding the extremes of trade protectionism at regional and multilateral levels; promoting the structural transformation of low-income and/or commodity-dependent developing countries; devising regulatory measures and standards, for example in the areas of health, the environment and competition policy, that enhance and do not undermine the trade flows of developing countries; and formulating policy measures to achieve inclusive trade, for example for small and medium-sized enterprises, women and youth.

24. In order to maximize the benefits of existing RTAs, partners' RTAs should address factors such as promoting complementarities, widening production and export structures, enhancing the diversification of products and addressing high competition from imports – in particular of manufactured products – from other developing countries.

25. Regions characterized by multiple overlapping free trade agreements or RTAs should prioritize further convergence, to lower transaction costs and regulatory burdens and to encourage the growth of production chains at regional levels.

26. Agreements between regional blocs can bring about trade and welfare gains for the parties concerned. Given the increased economic activity between the European Union and the Southern Common Market, for example, there is an opportunity for the revival of negotiations between the two blocs, which would further strengthen trade and investment flows.

27. The One Belt, One Road initiative is characterized by huge infrastructure investments to establish physical trade routes, to promote trade across Asia and beyond. Consideration should be given to establishing accompanying trade agreements for partners, which promote both economic growth and sustainable development.

28. Policymakers faced with domestic anti-globalization sentiment should carefully identify both causes and remedies for proper resolution. Trade has been blamed for changing labour market conditions and driving income inequality, while the driving force may be, more frequently, technological changes. The contribution of trade to job creation and in promoting the achievement of the Sustainable Development Goals should be emphasized.

29. In the light of the decision of the United Kingdom to withdraw from the European Union, non-member States of the European Union, in particular developing countries, may consider the opportunity to launch preparations for possible trade negotiations with the United Kingdom for more suitably tailored agreements between partners, which further address trade and the Sustainable Development Goals.

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