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POWER, PLATFORMS AND THE FREE TRADE DELUSION

Chapter II

THE SHIFTING CONTOURS OF TRADE UNDER HYPERGLOBALIZATION

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II

A. Introduction

The backlash against hyperglobalization is gaining momentum with the international trading system on the front line. This is a surprising turn of events. As discussed in previous *Report*s, the roots of the heightened insecurity, indebtedness and inequality that are hallmarks of the current era stem more from the workings of the financial system than the trade regime; and that regime proved robust in the face of the economic fallout from the global financial crisis. Moreover, using tariffs to mitigate the problems of hyperglobalization will not only fail to do so but runs the danger of adding to them, through a vicious circle of retaliatory actions, heightened economic uncertainty and slower growth.

Still, it would be foolish to dismiss the constituency in advanced economies worried about trade shocks as simply ignorant of the subtleties of Ricardian theory or misguided victims of populist politicians. Indeed, in addition to discontent in the North, there are numerous and long-standing concerns that developing countries have been raising about the workings of the international trading system which have also intensified in this century.

In reality, the lived experiences of each and every constituency at the local level reflects the intertwining of trade, financial and technological forces operating through national, regional and global markets and managed by policies, regulations and institutions designed to govern those markets and interactions.

The dominant narrative of the current era equates globalization with the growing reach (and porosity) of markets and an accelerating pace of technological change. It employs the language of "free trade" to promote the idea of a harmonious (win-win) world governed through clear rules and greater competition. But hyperglobalization has as much to do with profits and mobile capital as with prices and mobile phones and it is governed by large firms that have established increasingly dominant market positions. Indeed, while trade and technology, through both destructive as well as creative impulses, have, no doubt, had an impact on the way we go about organizing our lives, in the end it is social and political initiatives in the form of rules, norms and policies that matter most for the outcomes of an interdependent world. And, as described in previous *Report*s, the hyperglobalized world is one 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 restraint and muted the voice and influence of other social stakeholders with an interest in the direction of public policy.

As a result, it is hardly surprising that heightened anxiety among a growing number of casualties of hyperglobalization has led to much more questioning of the official story of the shared benefits of trade. Trade sceptics now have substantial political constituencies across the world, in both developed and developing countries.

Mainstream economists bear part of the responsibility for the current state of affairs. Ignoring their own analytical nuances and the subtleties of economic history, they remain biased in favour of unqualified free trade when it comes to communicating with policymakers and broader audiences (see e.g. Driskill, 2012; Rodrik, 2017, 2018).[1] 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 abrogated.

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, the call to double down on "free trade" provides a cover for a regime of footloose capital, concentrated market power and the capture of public policy by powerful economic interests. Fighting isolationism effectively requires recognizing that many of the rules adopted to promote "free trade" have not promoted a rules-based system that is inclusive, transparent and development friendly. Reviving optimism about trade and multilateralism must go beyond simply promoting trade for trade's sake and pitching multilateralism as the last line of defence against an autarchic Hobbesian dystopia. A more positive narrative and agenda is required.

The 2030 Agenda for Sustainable Development offers such an agenda but it lacks a clear accompanying narrative, simply stating that "[i]nternational trade is an engine for inclusive economic growth" (United Nations, 2015). This is unfortunate, because the case for international trade and its implications for growth, employment and distributive justice and social norms is a subtle one that depends heavily on context (Rodrik, 2011).

In the context of hyperglobalization, this chapter addresses the following questions: To what extent has trade promoted structural change? Which countries and/or social groups have benefited from deeper trade integration? Under what conditions can trade have positive developmental and distributive effects? It provides new evidence that the governance of international trade in the era of hyperglobalization has contributed to increasing domestic inequalities in many countries. This has in part reflected the way in which trade is governed in global value chains (GVCs), which has heightened the bargaining power of footloose capital, including through job offshoring to poorer countries (or simply the threat of that), as well as market concentrating and rent-seeking practices of large firms that effectively weaken competition. This is partly because international trade is increasingly governed by "free trade" agreements that empower global firms. For example, services derived from intangible assets whose geographical location can be determined by firms almost at will – such as financial assets or intellectual property rights (IPR) – can now be "traded" more freely between higher-tax and lower-tax jurisdictions and within transnational corporations (TNCs) themselves. Overall, these processes have tilted the distribution of value added in favour of capital, especially transnational capital, whose owners remain mostly headquartered in developed countries.

The chapter is structured as follows.[2] Section B reviews some stylized facts on the shifting dynamics of world trade since the Second World War, highlighting some key patterns that have shaped this changing landscape. Section C assesses to what extent trade has promoted structural change in developing countries. Section D examines the effects of trade on inequality. Section E discusses the macroeconomic relevance of the trade and development challenges and lays out some policy recommendations.

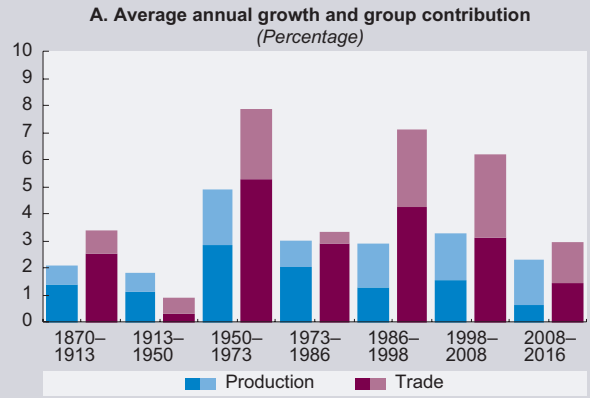
B. Trade dynamics after the Second World War

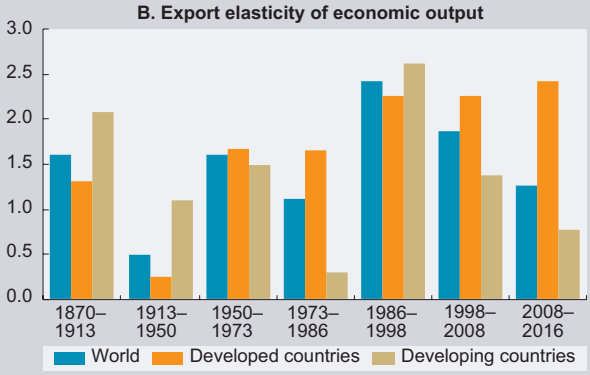
Between the end of the Second World War and the global financial crisis (GFC), the growth of world trade consistently outpaced that of global output albeit with significant differences in the gap across subperiods (figure 2.1). The gap has persisted since 2008, just as both trade and output growth have been low by historical standards. However, there are other significant changes in trade dynamics over the last 70 years, particularly with respect to developing country participation, that it is important to flag.

1. The rise and fall of the Golden Age: 1950–1986

Between 1950 and 1973, world trade grew at an average annual rate of nearly 8 per cent, amid strong declines of trade costs of all kinds resulting from peace dividends, improvements in transport, a fast pace of investment and rapid productivity growth, a measured drop in tariffs, and a stable international monetary system. Rapid recovery in Western Europe,

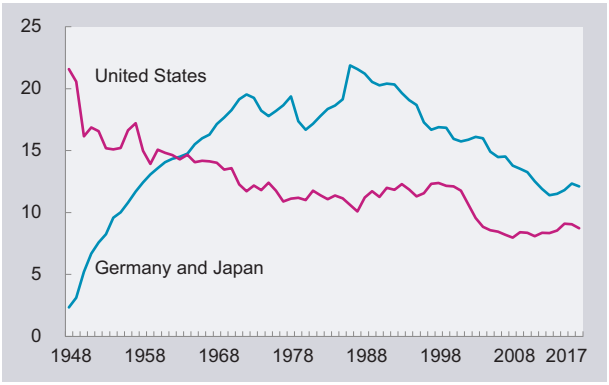
FIGURE 2.1 **World trade, global output and related elasticities, selected country groups and periods, 1870–2016**





Source: UNCTAD secretariat calculations, based on Maddison (2006) tables 1–3 and F-3 for data until 1973 and UNCTADstat afterwards.
Note: The darker areas in panel A represent the contribution of developed countries to the corresponding world aggregates. Data in panel A represent real annual compound growth rates, computed using constant 1990 dollars between 1870 and 1973 and constant 2010 dollars between 1973 and 2016.

FIGURE 2.2 **Share in global merchandise exports, 1948–2017**
(Percentage)



Source: UNCTAD secretariat calculations, based on UNCTADstat.
Note: Germany comprises Federal and Democratic Republics prior to 1990.

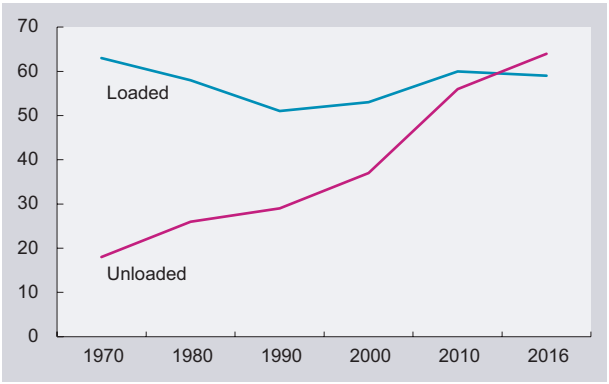
solid growth in the United States and stellar growth in Japan, along with continuing industrialization in the Soviet Union and the emergence of first-tier newly industrializing economies (NIEs) towards the end of this period also contributed to this process. Developed countries accounted for two thirds of the growth of world trade during this period with the big change being the steady decline of the United States as a trading hegemon and its replacement by the Federal Republic of Germany and Japan (figure 2.2).

Most of the increase in trade flows reflected rising intra- and inter-industry trade among developed countries and with a strong regional dimension. Trade rules, consequently, were designed by a small club of relatively wealthy converging economies, to consolidate broad economic gains coming from outside the trading system (Rose, 2004), and with a degree of tolerance of the trade practices of (mainly developing) countries who were not part of the club but with little concern to address their particular challenges.

In the South, growth rates of output and trade during the "Golden Age" were consistently higher than in previous periods but persistently lower than those in advanced economies. Moreover, developing countries' structure of trade remained highly unbalanced, dominated by primary exports to Northern markets, which on average still accounted for two thirds of developing country exports at the end of the Golden Age.

Figure 2.3 shows the sharp asymmetry, in terms of world tonnage, in the participation of developing

FIGURE 2.3 **Developing economies' share of trade by weight, 1970–2016**
(Percentage)



Source: UNCTAD, 2017a: figure 1.4 (b).
Note: Data reflect share of total tonnage in world seaborne trade.

BOX 2.1 Measurement challenges in mapping international "trade"

The statistical recording of "trade" has become increasingly complex, as more production across the world is organized by GVCs and so parts and components of products, as well as the services that are embedded in traded products, cross borders several times.[a] Moreover, a growing share of traded services (particularly services deriving from intangible assets with no determined geographical location, such as financial loans or IPR licensing) represent intra-firm trade, much of which used for tax optimization strategies of firms. Unlike regular trade between distinct firms, such trades often do not generate any production, employment and labour income in the low-tax jurisdictions where they are recorded, even as they siphon capital income and profit out of higher-tax jurisdictions. These distortions are most visible in offshore financial centres, but they also occur in a less perceptible manner in much larger countries.

Such processes create obstacles to a mapping of world trade that accurately reflects production, employment, and capital and labour incomes. At present, the basic principle for the compilation of trade statistics is the crossing of a border, following recommendations made by the United Nations Statistical Commission. Because trade in goods necessarily involves crossing a border at a customs checkpoint, merchandise trade has long been reasonably accurately registered, at least to the extent that states properly performed their core functions. However, as production has fragmented along GVCs, the growing trade in intermediate goods and services embedded in final goods as well as reimports tend to exaggerate the trade performance of countries with large processing trade sectors, such as China. This can distort the mapping of global trade, which is why statistical offices and researchers have created and are using trade in value added databases, such as TiVA or WIOD (which are also used in this *Report*). Even though such value added data rely on input–output tables and reductionist assumptions, such as the reliance on a representative firm for each industry-country (e.g. see discussion in Koopman et al., 2014; Johnson, forthcoming 2018), these efforts represent an improvement over gross trade data.

But trade in services creates additional complications and difficulties for the measurement of cross-border trade. This is essentially because of the non-tangible nature of most services: unlike merchandise trade, these services do not cross borders in physical forms that enable classification according to commodity codes, quantity, origin and destination. They do not have to go through the customs procedures that are crucial for collecting merchandise trade data. So trade in services is not recorded in customs-based data. Effectively it only exists in the balance-of-payments accounts, which consider only whether there was a change in the country of residence of the owner of the goods and services that are exchanged, rather than whether and how they crossed borders.[b]

However, services now account for the bulk of global GDP, and their share in international trade is growing. In the past, some economists may have labelled all services as "non-tradable", but the growing importance of services in recent trade negotiations and in the new generation of trade agreements (box 2.2) show that this approach is obsolete. According to some estimates, the share of services in total trade in value added exceeds 50 per cent in many developed countries and could now have reached 40 per cent at the global level, compared to 30 per cent in 1980 (World Bank et al., 2017). The rising share of traded services in value added terms stands in contrast with the share of traded services in gross terms, which remained unchanged at about 20 per cent of total (goods and services) gross trade since 1980. This difference arises from the embedding of intermediate services into final goods, which tends to inflate the relative magnitude of gross trade in goods.

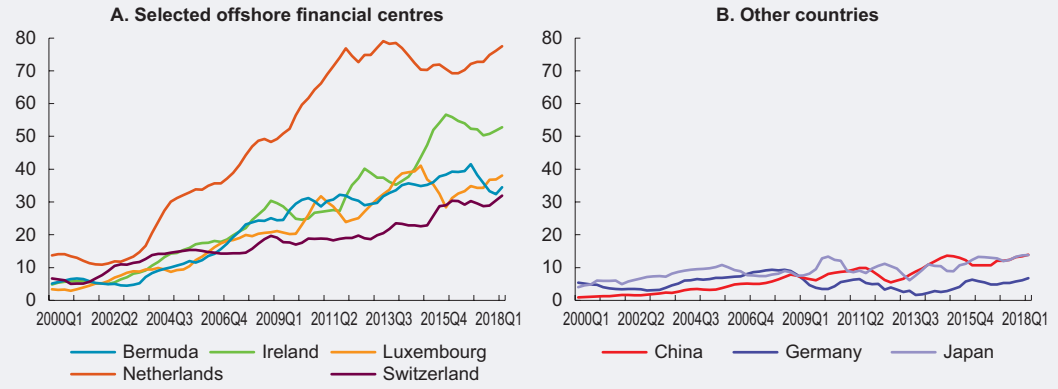
Data on trade in value added may correct to some extent the biases created by production fragmentation along GVCs, but they do not address the fundamental difficulty of assessing the real or fictive nature of reported flows of trade in services. As noted above, unlike physical goods, services are intangible and their official geographical location is determined not by which borders they may have crossed, but by the residence of the owner of exchanged services. The measurement of some services, such as tourism, may not be affected by this problem, but only because it involves the travel of a natural person, who needs to physically pass through a customs checkpoint to cross a border. Many internationally traded services, however, do not involve international travel, and in an increasing share of cases, they do not even involve natural persons but only intangible exchange between companies. Such international transactions often represent fictitious intra-firm accounting techniques aiming at avoiding taxation, which biases the measurement of the "actual" amount of international trade in services. Contrary to a widely shared belief, almost no trade in goods is taking place within multinational firms, whose boundaries are increasingly determined by the use of a common set of intangible inputs, knowledge and the transfer of capabilities rather than by the transfer of goods (Ramondo et al., 2016; Atalay et al., 2014).

The growing significance of intangible assets, such as financial assets, patents, trademarks, rights to design, corporate logos, etc., has important implications for how companies behave as well as how economists and

trade analysts consider international trade. Mainstream trade economists still tend to believe that "[t]he decision about whether and where to build a foreign plant is quite separate from how and where to raise the financing for that plant" (Markusen, 2004: xii), and that the latter can simply be analysed as part of the traditional theory of capital flows. But multinational companies tend to treat issues of "residency" quite differently. For them, the location of intangible assets is one of the most significant instruments for minimizing tax liabilities, and therefore they can and do choose to locate their intangible assets in jurisdictions that minimize their aggregate tax payments. This can create "phantom trade flows" that do not represent genuine movements of services at all. As Lipsey (2009) has noted, economists therefore need to accept that there has been a change in the reality they are attempting to measure, rather than get fooled into believing that the recorded data represent the reality in such circumstances.

The extent to which this is a problem is easily seen from the example of TNCs of the United States, evident in figure 2.B1.1. The large and exploding incomes from investments abroad (much of which is in the form of intangible investment in IPR of various kinds, valued by the firms themselves) in low-tax or no-tax jurisdictions that do not constitute large markets in themselves, shows how important this strategy has become for the overall profitability of these large TNCs. Obviously this affects tax collection by government; but it also distorts our understanding of global trade in services.

FIGURE 2.B1.1 **Income of the United States on direct investment abroad, selected countries, first quarter 2000 to first quarter 2018**
(Billions of dollars)



Source: Setser and Frank, 2018, based on United States Bureau of Economic Analysis.
Note: Data correspond to the four-quarter trailing sum.

One solution for disentangling growing flows of fictitious intra-firm trade in services from genuine trade in services would be for national statistical offices to produce accounts based on ownership rather than residency. Such accounts would net out the effects of phantom intra-firm transactions and provide a more accurate picture of trade in services. So far, the Bureau of Economic Analysis (BEA) of the United States is the only statistical office that regularly publishes an ownership-based current account for that country.[c] There have been several attempts by civil society to push for country-by-country reporting of TNCs accounts, and the United Nations has also called for this in the discussions on financing for development (UNCTAD, 2017b). These proposals are very important not only for more transparency about intra-firm trade flows, and better knowledge about the true nature of trade in services, but also for raising the fiscal resources required by governments to meet the Sustainable Development Goals.

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[a] See e.g. Lipsey, 2009 and Feenstra et al., 2010 for a detailed discussion of the main issues at stake.

[b] The concern of public authorities with the residency of the holders of goods and services has its origin in the gold standard monetary regime, which incentivized countries to track how much gold was in the hands of their nationals as a proxy for the demand for their national currency at a time when monetary authorities were constrained by the need to preserve fixed exchange rates.

[c] Research by Ramondo et al., 2016 and Atalay et al., 2014 cited above are based on these BEA data.

economies in world seaborne trade, the main vector for shipping goods. In 1970, almost two thirds of world tonnage were loaded in (i.e. exported from) developing countries, whereas less than one fifth was unloaded (i.e. imported into) there. This gap contrasts with developing countries' exports and imports measured in nominal terms, which were roughly equivalent. This difference is a reminder of the unfavourable terms of trade and the balance of payment constraints that prevailed during that era due to developing countries' relatively constrained role as providers of primary commodities.

The asymmetric structure of international trade and lagging growth performance of most developing countries fuelled growing concerns among many of their policymakers over biases in the rules of the trading system. It also underpinned the idea of "unequal exchange", which argued that the structure of world trade was responsible for the persistent inequality between developed and developing economies. The worries that developing economies would remain marginalized and unable to take advantage of international trade provided the basis for the creation of UNCTAD in 1964, to renegotiate trade rules so as to loosen the constraints on catch-up growth and to redirect international cooperation in support of diversification away from commodity dependence. However, signs of the success of the export-oriented growth model in the East Asian NIEs started to show in the late 1960s, with a more dramatic acceleration, demonstrated by their sharply rising share in global merchandise exports, from the mid-1970s (*TDR 2016*).

Under pressure from a series of internal and external shocks, the 1973–1986 period was difficult for advanced and developing countries alike, except for oil exporters, who enjoyed significant terms-of-trade gains, as well as for first-tier NIEs, whose market shares in manufacturing exports expanded. In part as a result of the slowdown in advanced country growth, and the (short-lived) recycling of petro-dollars to emerging economies, a discussion of southern markets replacing northern markets for each other exports (so-called South–South trade) briefly emerged (Lewis, 1979) but was abruptly cut short by the debt crisis in the early 1980s and subsequent structural adjustment programmes which further repressed growth, particularly in Africa and Latin America. As a result, the annual growth of trade almost halved in the 1973–1986 period compared to 1950–1973. Meanwhile, the annual growth of global output decreased from about 5 per cent to 3 per cent. During this period, the South contributed a little over one tenth of global trade expansion, but to one third of the growth of world income.

2. Hyperglobalization: 1986–present

Starting from the mid-1980s, a new phase of trade expansion took place. In contrast with the two previous post-war periods included in figure 2.1 – the Golden Age and the subsequent turbulent decade – this new round of globalization was marked by very fast acceleration of trade, especially in some parts of the developing world. Until the GFC, the growth of world trade in real terms rebounded to an annual average of more than 6 per cent, with the contribution of the South peaking at about half of this figure in the 2000s. This new era was also marked by a further increase in the elasticity of world trade to global output, which peaked at 2.4 during the 1986–1998 period and then remained close to 2 during the following decade (figure 2.1.B). Interestingly, the growth of global output remained much lower (about 2 percentage points) than in the Golden Age era, which reflects the shift in the broad macroeconomic policy framework that led to higher unemployment and lower investment in developed economies, and thus lower growth (see e.g. *TDR 1995*: part three).

The metamorphosis of trade started around 1986, though significant measurement challenges remain in properly mapping international "trade" (box 2.1). This period coincides with the beginning of the Uruguay Round and came in the wake of several important political shifts. It occurred when many developing countries were still adjusting to the debt crisis by abandoning import-substitution industrialization (ISI) and turning to more export-oriented strategies based on liberalized imports. It also coincided with the end of the East–West divide and the rise of a "new world order" dominated by liberal ideology. On the supply side, the erosion of organized labour and the flexibilization of labour markets, along with the continued spread of technological progress (containerization, information and communication technology (ICT), etc.), facilitated the fragmentation of production along GVCs and the coordination of complex processes across long distances, with the resulting cross-border movement of inputs instrumental in boosting trade. This was supported by the proliferation of free trade agreements (FTAs) and bilateral investment treaties (BITs) (box 2.2)

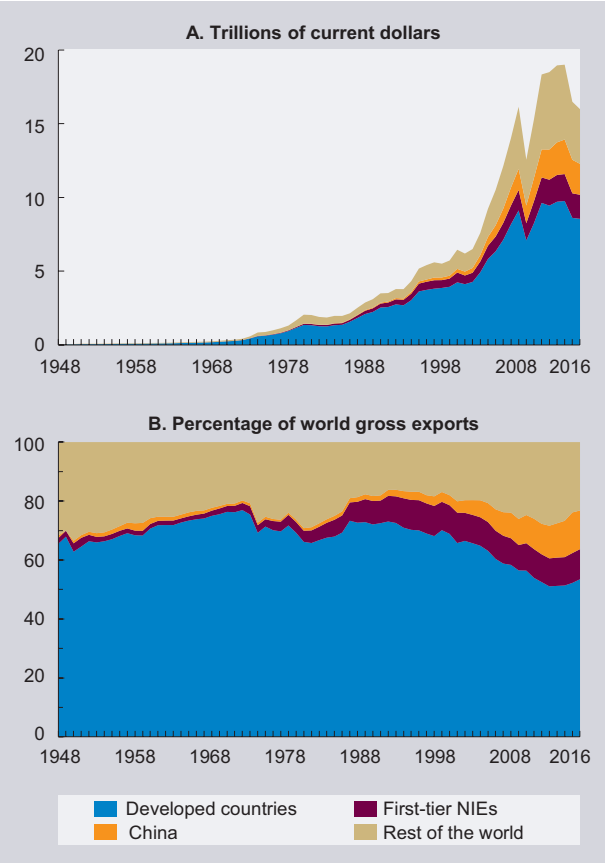
and subsequently by the accession of China to the World Trade Organization (WTO) in 2001, which lowered the cost of labour by enlarging the globally available reserve army of workers. On the demand side, the end of full employment and the growing deregulation of financial markets encouraged a shift from wage-driven to debt-driven aggregate demand in large advanced economies; that, in turn, eased the balance-of-payments constraint, allowing some economies, including in the developing world, to prolong asset booms for longer and, in turn, for other economies to tap into external demand to maintain growth (*TDR 2016*: chap. I.C).

The trade acceleration was particularly strong in East and South-East Asia, based on mutually reinforcing dynamic interactions between profit, investment and exports in state-targeted industrial sectors; within this subgroup, the share of first-tier NIEs in world exports reached about one tenth of world trade in the mid-1990s and stabilized at this level thereafter (figure 2.4). This successful profit–investment–export nexus was accompanied by specific policy measures aiming at promoting structural changes, from resource-based to labour-intensive and subsequently to technology-intensive production and exports, and by increased penetration of northern markets (*TDR 1996*: chap. II; *TDR 2003*: chap. IV). With some lag, China followed broadly the same strategy, although on a scale and speed never achieved before and with a stronger presence of state-owned enterprises (SOEs). Chinese exports increased from less than 2 per cent of world trade in the mid-1980s to more than 13 per cent in 2016. This increase in China (on top of the first-tier NIEs) was associated with a reduction in developed countries' share in world exports, from nearly three quarters of gross merchandise exports in 1986 to just over one half in 2016.[3] This decline was almost entirely due to the relative decline of North–North trade, which decreased from more than 60 per cent of global trade to less than 40 per cent over the same period. Nevertheless, in most of the rest of the developing world, export shares remained roughly constant or sometimes even declined, except during the rising phase of the commodity price supercycle when major commodity exporters registered a temporary increase of their market shares.

This mirrored changes in the destination of exports, which progressively shifted to developing countries. Between the mid-1980s and 2016, the share of world exports to developing and transition economies rose from roughly one quarter to one half. South–South trade accounted for more than 50 per cent of this increase, from a base of only one quarter of exports to the South in 1986. Since these data include trade in intermediate goods, these changes partly reflect the expansion of GVCs, which have had significant impacts on the geography of production of manufactured products. While gross trade data show that developing countries' gross revenues from manufacturing as a share of their total exports increased from about one half in 1995 to two thirds in 2016, this may overestimate the rise of the manufacturing in developing countries' exports, partly because of double-counting problems arising in the context of GVCs (see box 2.1).[4]

Figure 2.5 provides four snapshots of the global network of merchandise trade at 10-year intervals from 1986 onwards. The 1986 figure illustrates the limited trade flows outside the developed economies, at a time when developing countries mostly provided raw material and energy sources to developed economies. In 1996, the increased role played by the most

FIGURE 2.4 Total gross exports, selected country groups and China, 1948–2016

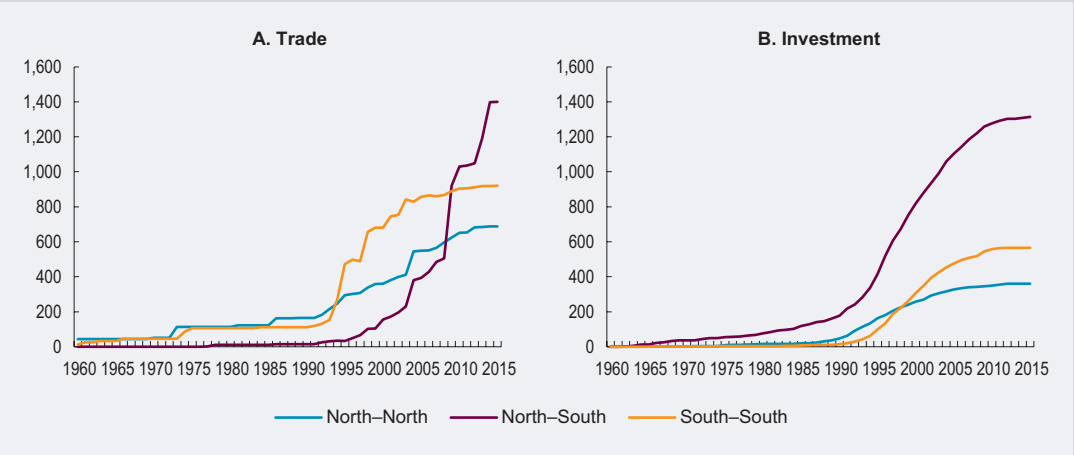


Source: UNCTAD secretariat calculations, based on UNCTADstat.

BOX 2.2 Using laws not wisely but too well: The international legal framework in the era of GVCs

The expansion of GVCs has been closely connected with changes in the legal architecture of the international trading system. The number of trade agreements and other kinds of international economic treaties (such as bilateral agreements on investment protection, avoidance of double taxation, etc.) rose exponentially after 1990. In this process, TNCs headquartered mostly in developed countries found themselves in a privileged position to influence rule-making and to reorganize large swathes of world production, thereby creating possibilities of expanding their cost-minimizing strategies on a global scale.

FIGURE 2.B2.1 **Trade and investment bilateral connections based on international agreements, 1960–2015**
(Number of country pairs)



Source: UNCTAD secretariat calculations, based on de Sousa, 2012, and UNCTAD International Investment Agreements Navigator.
Note: Investment category does not include trade treaties with investment provisions (TIPs).

Between 1990 and 2015, the number of trade agreements increased from 50 to 279, with many of them plurilateral and therefore involving a larger number of country pairs (figure 2.B2.1.A). Bilateral investment treaties (BITs) grew almost tenfold from 238 to 2,239 over the same period (figure 2.B2.1.B). These legal changes were designed to enhance international economic integration, boosting trade and cross-border investment. However, they also greatly eased the possibilities for tangible asset acquisition, intangible asset shifting and financial speculation. As a result, the main actors and beneficiaries of this metamorphosis of "trade" were not necessarily the populations in the concerned countries, but rather the largest corporate players that were involved in lobbying for and shaping the rules of international trade and finance.

Trade agreements prior to 1990 were mostly between neighbouring countries sharing comparable levels of economic development and labour protection, with the objective of promoting regional integration through trade (figure 2.B2.1.A). However, post-1990 agreements were more about increasing economic integration across regions and between developed and developing countries, promoting both more open trade (including processing trade) and liberalized capital flows. At the same time, the "depth" of such agreements kept increasing, bringing under their discipline many policy areas that had thus far been excluded from trade negotiations. Historically, trade agreements focused on issues pertaining mostly to tariffs and quotas. After 1995, so-called "WTO-plus" provisions included in most trade agreements (figure 2.B2.2.A) also covered customs regulations, export taxes, anti-dumping measures, countervailing duty measures, technical barriers to trade, and sanitary and phytosanitary standards. Other agreements further committed signatories to enforce provisions liberalizing financial services or public procurement, with far-reaching implications for public policy, employment and income distribution. As to "WTO-extra" provisions (figure 2.B2.2.B), which are not discussed under the WTO umbrella, they include a wide-ranging and expanding set of policy areas, which often further reduced developing countries' policy space.

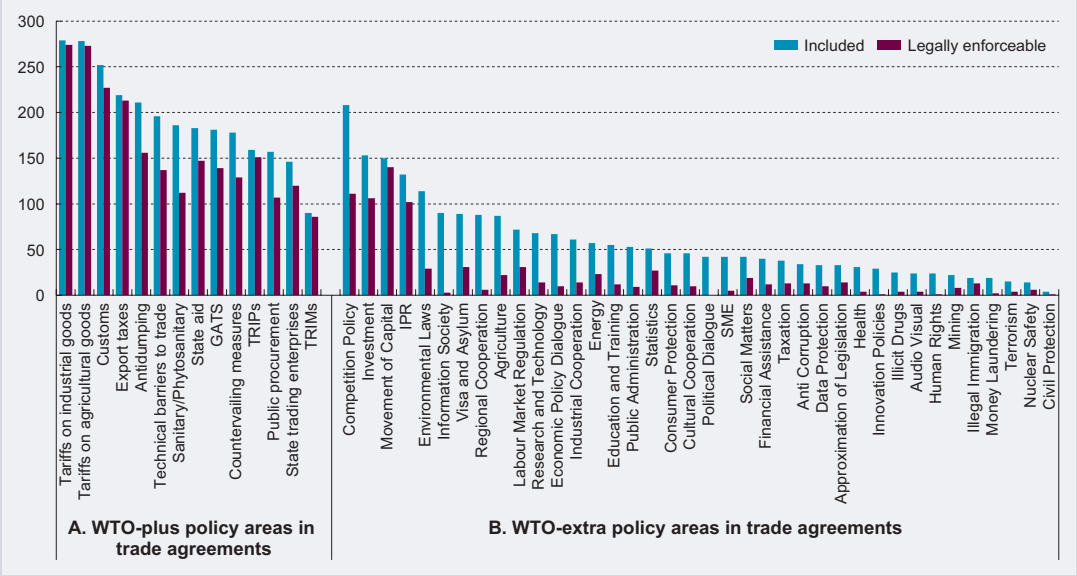
So-called "core" provisions are defined as the set of WTO-plus provisions and four WTO-extra provisions (competition policy, movement of capital, investment and investor rights protection, and IPR protection),

because they are economically more meaningful, at least from the perspective of non-financial and financial TNCs alike. Interestingly, trade agreements between developed and developing countries cover on average almost as many policy areas (20) as those among developed countries (22) and thus have equivalent "depth". This reflects the ability of developed country TNCs to insert provisions dear to their interests in agreements negotiated by their governments. By contrast, South–South trade agreements (13) are considered more "shallow".

Almost 90 per cent of trade agreements include at least one of the core WTO-extra provisions and one third include all of them (Hofmann et al., 2017). By contrast, policy areas of great importance for social actors with much lesser voice in opaque closed-door trade negotiations, such as the protection of labour rights, consumers and the environment or provisions preventing corporate tax avoidance, are barely included or remain legally unenforceable. If negotiators genuinely want "trade" and related agreements to become vehicles for more inclusive and sustainable development, they must begin by correcting this glaring asymmetry (Namur Declaration, 2016; Kohler and Storm, 2016; Piketty, 2016).

It has been noted that the expansion of trade agreements and their increasing depth after 1990 are a testimony to greater leverage of large exporters in trade negotiations, which exceeds the leverage of importers (Rodrik,

FIGURE 2.B2.2 **WTO-plus and WTO-extra policy areas included in trade agreements**
(Number of treaties)

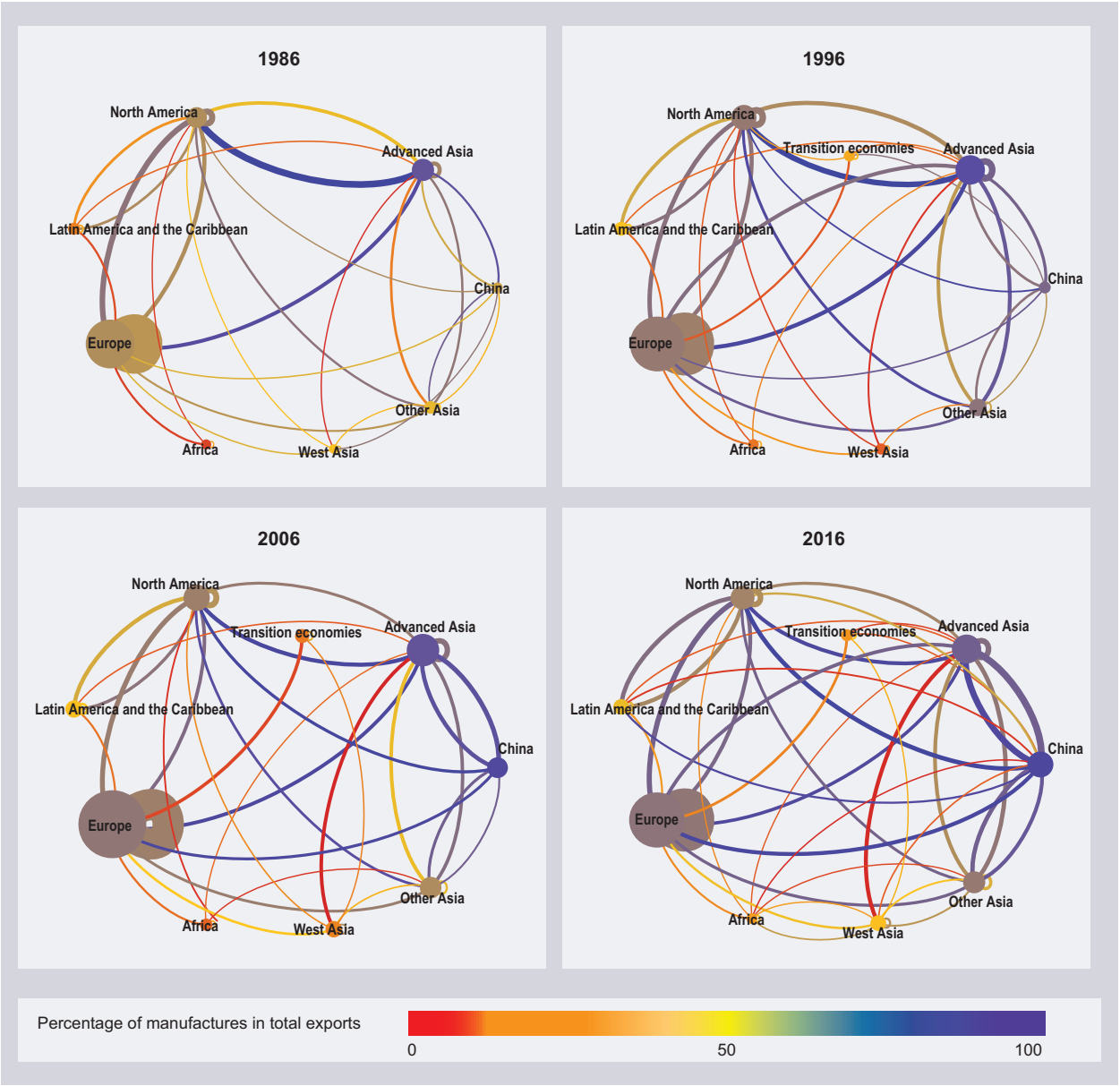


Source: UNCTAD secretariat calculations, based on Hofmann et al., 2017.

2018). Hence, it is likely that such agreements are increasingly becoming a mechanism for promoting rent-seeking by large exporting firms, especially through provisions pertaining to IPR, cross-border capital flows, investor–state dispute settlement procedures and the harmonization of regulatory standards, etc., which have little to do with "trade" in the strict sense.

As the meaning of "trade" is increasingly adrift, what economists commonly label as "trade agreements" should rather be properly designated as "comprehensive economic and trade agreements". Accordingly, their impact on distribution, jobs and welfare should be assessed using more comprehensive models including macrofinancial linkages, rather than narrow trade models, which incorporate many flawed assumptions, such as full employment of production factors of constant distribution, thus ruling out a priori any risks and costs associated with deeper "trade" liberalization (Kohler and Storm, 2016). In addition to ensuring greater voice to civil society and to concerned stakeholders in the process of negotiating these legal agreements, it is important to incorporate into such treaties both greater accountability and flexibility to change clauses in the light of experience.

FIGURE 2.5 **Global network of merchandise trade, selected years, 1986–2016**



Source: UNCTAD secretariat calculations, based on the United Nations Comtrade database.
Note: The node size and edge width depict export flows as a share of world gross product. The node/edge colour reflects the commodity versus manufacture intensity. The direction of edges is clockwise. When the exports of a given node are less than 5 per cent of its total exports, the edges are not reported. "Advanced Asia" refers to Australia, Japan, New Zealand, the Republic of Korea, Singapore, Hong Kong (China) and Taiwan Province of China.

advanced economies in Asia was already evident, as was the shift in this region away from commodity-based exports. Ten years later, the significant change was the increased significance of China, even as intra-European trade strengthened further. Around this time, there had been a gradual shift within Asia, as China overtook Japan as the largest exporter from the region in 2004, and then became the world's largest exporter in 2007.[5] Overall, this strengthened the East Asian hub in the global trade network. Finally, by 2016, China registered an even greater share in world exports, together with other advanced Asian economies.

Beyond the rise of South–South flows depicted by the increased links between developing regions over the decades, what figure 2.5 shows is the restructuring of the Asian pole in global trade, most of all the growth acceleration and structural transformation in China. This then spilled over to the rest of the

developing world, mainly in the form of boosted demand for raw materials. Consequently, apart from some successful cases in Asia, there has been very little evidence of broad-based trade-induced structural change in other parts of the developing world regions. Hyperspecialization has in fact accompanied the acceleration of trade from the 1990s, including with the rise of South–South trade (Hanson, 2012; Escaith and Gaudin, 2014). This, in part, reflects the reversion in many developing countries to primary export dependence against the backdrop of rising commodity prices from the start of the millennium but it is also 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 (Gallagher and Zarsky, 2007; Paus, 2014). The same can be said about the electronics and automotive industries in Eastern and Central Europe (Plank and Staritz, 2013; Pavlínek, 2016; Pavlínek and Ženka, 2016).

C. Trade-charged structural change: Diverging paths among developing regions

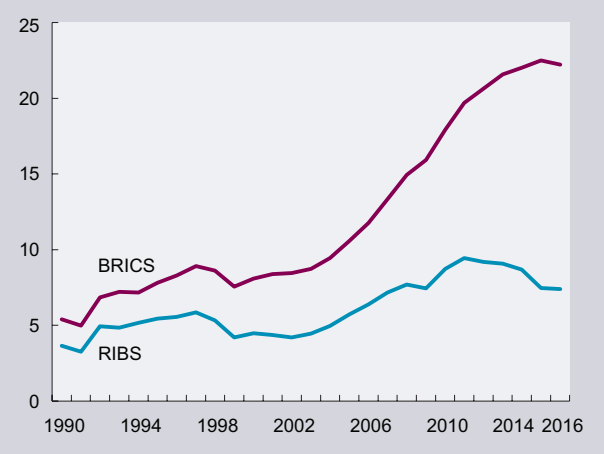
The "rise of the South" in international trade has been a much-cited feature of hyperglobalization, disrupting the dominant pattern of North–North trade in the previous era of managed globalization, and establishing a landscape in which North–South and South–South trade have assumed greater weight. BRICS[6] have become symbolic of this changing landscape but GVCs are seen as its great disruptors.

On closer examination, the gap between BRICS and RIBS[7] is a significant one (figure 2.6) and the rise of the South refers primarily to the singular experience of some Asian countries in trading manufactured products. As discussed in *TDR 2016*, these economies (beginning with the first-tier NIEs followed, albeit more restrained, by a second tier in South-East Asia, and then more dramatically by China) have managed to narrow the income gaps with richer countries based on the establishment of leading industrial sectors, along with related technological and social capabilities that have promoted upgrading, and, through a series of linkages, diversification into new sectors. On this basis, these tiger economies (albeit with variation across them) were able to combine a strong rise in the share of manufacturing output and employment with strong labour productivity growth. In most cases, a rapid pace of investment helped to tap both learning and scale economies, sustaining rapid productivity growth. Yet, a rise in exports – due to a robust investment–export nexus – was also key to this pattern of expansion. 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.

As a result, in 2016, Asia alone accounted for about 88 per cent of developing country gross exports of manufactures to the world, and for 93 per cent of South–South trade in manufactures, while East Asia alone accounted for 72 per cent of both.[8] To a lesser extent, the increase of the South's share in global exports in this century was also the result of increased export revenues of commodity exporters during the 2000s supercycle.

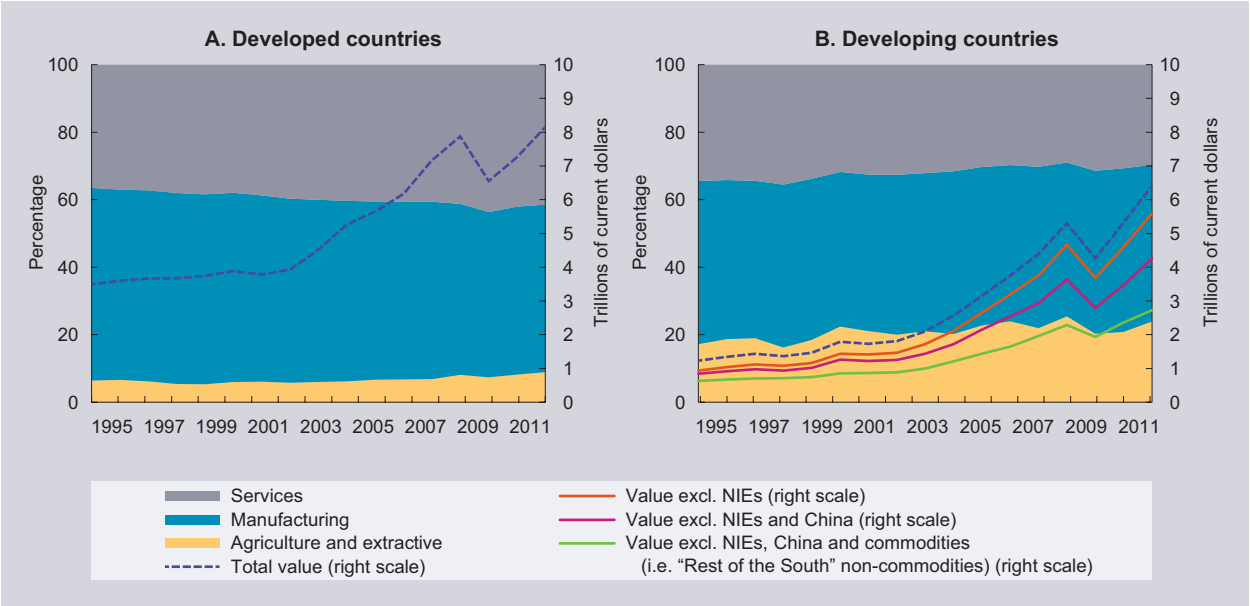
Trade in Value-Added (TiVA) data show the evolution of exports in both developed and developing countries (figure 2.7). In value added terms, developing

FIGURE 2.6 Share of BRICS versus RIBS in world economy, 1990–2016
(Percentage)



Source: UNCTAD secretariat calculations, based on UNCTADstat.
Note: Underlying data corresponds to the sum of GDP in current dollars.

FIGURE 2.7 **World trade in value added by sectors, selected country groups, 1995–2011**



Source: UNCTAD secretariat calculations, based on TiVA database.
Note: "Services" includes electricity, water and gas supply, and construction.

countries' exports in 2011 were still smaller than those from developed countries: $6.4 trillion versus $8.2 trillion. Figure 2.7.B also indicates the rapid development of China and first-tier NIEs in manufactured products, along with the increasing export share of the extractive industries in the rest of the developing world. The increase in exports from the remaining sectors of the rest of developing countries was far less significant: amounting to only $2.7 trillion in 2011, compared to $6.4 trillion worth of exports from China and the first-tier NIEs (all three sectors) along with other developing countries' exports of extractive industries.

Similar conclusions arise by looking at the country level. Table 2.1 shows how China has been more of an outlier, one of very few countries that have managed to increase their shares of manufacturing domestic value added in gross exports (an 11.9 percentage point increase between 1995 and 2014). The trajectory of China has benefited from a well-calibrated industrial policy to help exploit growing demand from developed countries (e.g. Poon, 2014). This experience was not common: out of 27 developing entities recorded in TiVA, only 6 others experienced increases, albeit of much smaller magnitudes: the Philippines, 7.4 percentage points (from a very low starting point); Indonesia, 4.3; Argentina, 2.3; Viet Nam, 2.1; Turkey, 1.8; and Mexico, 0.4.

Instead, for many developing countries, trade under hyperglobalization strengthened the economic weight of extractive industries, whose share in aggregate domestic value added exported by developing countries (not their gross exports as shown in table 2.1) rose from 1995 by almost nine percentage points to reach 21.5 per cent in 2011. Eighteen out of 27 developing and emerging market economies experienced increases in the shares of extractive industries in export value added. Some like the Russian Federation, Brazil, Colombia, Peru and Brunei Darussalam (along with the "rest of the world", which covers many African and smaller developing countries), showed increases of more than 10 percentage points.[9] 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. In the long run, this is likely to further entrench dependence on extractive industries, with adverse implications for structural change.

Table 2.1 shows that production fragmentation along GVCs also resulted in a declining share of domestic value added in gross exports, also known as vertical specialization (Hummels et al., 2001), in both developed and developing countries.[10] This share dropped in developed countries by 7 percentage

TABLE 2.1 Value added shares in gross exports of developing economies, level and changes, 1995–2014

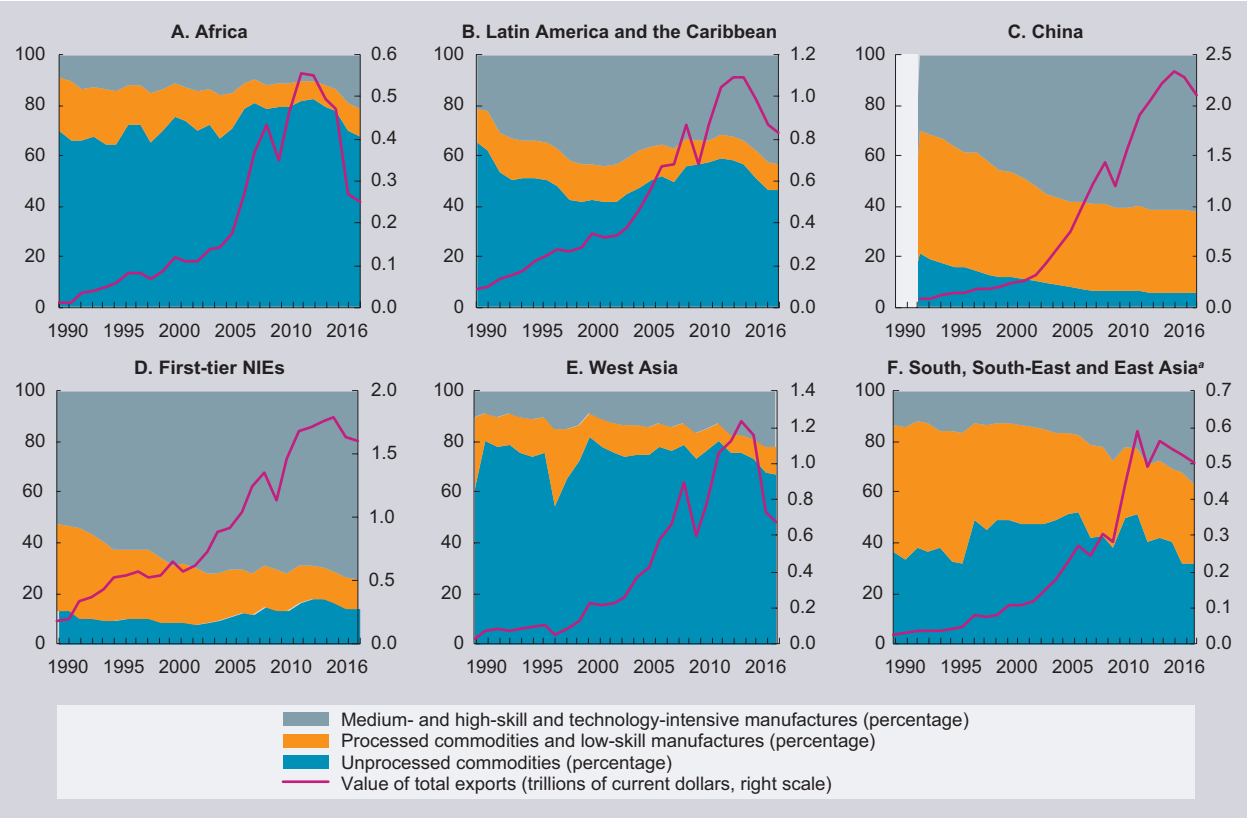
	Level of domestic value added in gross exports in 2014 (Percentage)	*Changes in value added shares in gross exports since 1995 (Percentage points)*			
		FOREIGN	*DOMESTIC*		
			Agriculture and extractives	*Manufacturing*	*Services*[a]
Argentina	87.5	6.8	1.0	2.3	-10.1
Brazil	87.6	4.7	17.6	-16.5	-5.8
Brunei Darussalam[b]	95.7	-3.0	15.5	-2.6	-9.8
Cambodia	61.6	25.6	-32.4	-3.2	10.0
Chile	81.1	4.8	1.5	-2.7	-3.6
China	70.7	-1.7	-2.8	11.9	-7.4
Colombia	91.1	0.5	9.0	-1.2	-8.3
Costa Rica	73.5	4.4	-9.7	-2.3	7.6
India	79.0	11.6	-3.5	-12.9	4.8
Indonesia	88.0	0.1	3.7	4.3	-8.1
Malaysia	60.9	8.7	1.4	-5.8	-4.3
Mexico	66.5	6.1	0.0	0.4	-6.5
Morocco	75.0	6.1	-7.6	-6.5	8.0
Peru	87.4	2.7	22.5	-15.5	-9.7
Philippines (the)	76.3	-6.1	1.4	7.4	-2.7
Republic of Korea	62.2	15.5	-0.6	-6.1	-8.8
Russian Federation (the)	86.3	0.8	8.7	-6.4	-3.1
Saudi Arabia	96.4	-0.6	5.3	-0.3	-4.4
Singapore	59.5	-1.6	-0.1	-4.2	5.9
South Africa	79.3	7.5	8.3	-12.3	-3.5
Thailand	62.7	13.1	1.1	-5.1	-9.1
Tunisia	65.9	9.3	2.7	-1.5	-10.5
Turkey	78.2	12.9	-0.3	1.8	-14.4
Viet Nam	63.7	14.6	-5.8	2.1	-10.9
Hong-Kong, China	79.6	-1.1	-0.3	-14.3	15.7
Taiwan Province of China	56.9	12.5	-0.2	-9.6	-2.7
Rest of the World[b]	89.5	-2.8	12.1	-4.9	-4.5
Developing economies[b]	75.3	4.2	4.3	-3.5	-5.1
Developed economies[b]	75.8	7.2	1.7	-10.1	1.1

Source: UNCTAD secretariat calculations, based on TiVA database.
Note: All other developing countries in the database are listed, including the category "Rest of the world", which covers many medium and small developing countries. TiVA's 37 developed countries are not reported here.
a "Services" also includes electricity, water and gas supply, and construction.
b Data only available until 2011.

points to 75.8 per cent, while that in developing countries fell by 4 percentage points to 75.3 per cent. But this more muted decline in developing countries was due to only two factors: for China, spectacular manufacturing expansion that entailed an increase in domestic value added in gross exports, and the growing weight of extractive industries in the trade balance of other developing countries. Excluding both China and extractive industries, the share of domestic value added in other developing countries' exports declined by 11 percentage points, an even sharper decline than in developed countries. This highlights some of the challenges that countries face when their firms link to GVCs (section D).

Figure 2.8 disaggregates the total exports of developing countries by the technological intensity of products, using the *TDR 2002* classification of labour skill levels and technology intensity. While some caution is warranted with this approach,[11] it also points to significant differences across countries in both structure and dynamics. On the one hand, the first-tier NIEs and China display clear trends towards technological upgrading, even though questions remain about the extent to which this has benefited workers employed at the assembly stage in manufacturing GVCs (see section D.1). By contrast, Africa and West Asia showed limited progress as their exports remain extremely concentrated in commodities, with hardly

FIGURE 2.8 **Export structure by technological levels, selected developing regions, 1990–2016**
(Percentage and trillions of dollars)



Source: UNCTAD secretariat calculations, based on Comtrade database.
Note: The product classification comes from UNCTAD *TDR 2002*.
a South, South-East and East Asia does not comprise China and NIEs (both tiers).

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 (SSEE) Asia fell between these two extremes. In Latin America, the 1990s were a period of some structural change with technological upgrading, but this pattern 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. Although exports in current dollars more than doubled over this period, the data suggest that overall, technological upgrading did not really take place.

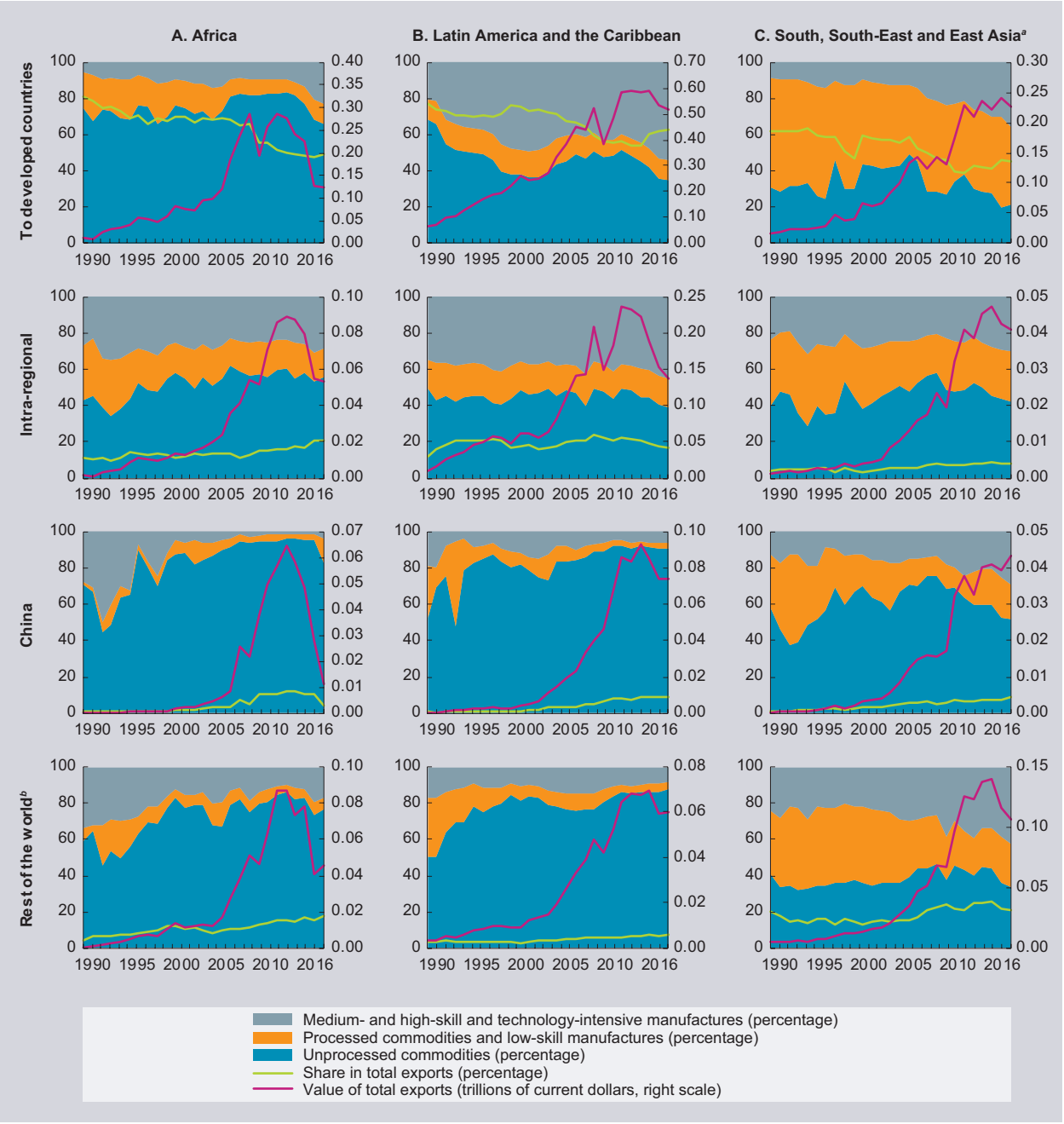
In the rest of SSEE Asia, tendencies towards relative technological upgrading appeared in export data only in the 2000s, with a shift towards high-skill labour and technology-intensive goods. However, there is still a long way to go to reach even the current structure of China and the first-tier NIEs. Indeed, the share of commodities and labour-intensive and resource-intensive manufactures, though declining, remained relatively high, at almost 30 per cent each.

Analysing exports by destinations sheds additional light on the underlying drivers. Figure 2.9.A–C show how export structures have changed in the developing regions of Africa, Latin America and SSEE Asia (except China and the NIEs), for the following destinations: (i) developed countries, (ii) intraregional, (iii) China, and (iv) developing countries other then China and the two tiers of Asian NIEs.

Figure 2.9.A illustrates that Africa's exports were highly concentrated in commodities. This was most evident for exports to China, and for exports to developed countries, and to a slightly lesser extent for other non-African trade partners. By contrast, intraregional trade was more in line with technological upgrading, with slightly larger shares of technology-intensive manufactures.

In Latin America, the export structure depended even more on its trade partners. In exports to developed economies, there was an increase in the share of technology- and medium-skill-intensive manufactures.

FIGURE 2.9 **Export structure by technological levels and selected partners, selected developing regions, 1990–2016**
(Percentage and trillions of dollars)



Source: UNCTAD secretariat calculations, based on Comtrade database.
a South, South-East and East Asia does not comprise China and NIEs (both tiers).
b Rest of the world excludes NIEs (both tiers).

However, this destination became relatively less important for Latin American exports. Meanwhile, intraregional trade consisted of more diversified goods, with technology-intensive manufactures accounting for about one half. Exports to China and other developing countries and transition economies remained highly concentrated in commodities, and this pattern strengthened from the mid-2000s, to the extent that in 2016, 90 per cent of Latin America's exports to China consisted of commodities.

In SSEE Asian economies excluding China and the NIEs, overall exports experienced a process of upgrading. Exports to all destinations showed

a relative decrease of commodities as well as of labour- and resource-intensive manufactures over the last decade. This pattern was less pronounced for the exports to China due to an increased share of labour- and resource-intensive manufactures, which suggest that the flying geese development paradigm (*TDR 1997*) remains at an early stage. Exports to all remaining developing countries and transition economies had the greatest share of technology-intensive goods, with high-skill labour-intensive manufactures representing the largest share.

This suggests that the rapid development of China (and more generally 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. This need not be a negative outcome, if the revenues from such exports are used to finance domestic economic diversification and technological upgrading. But such a push typically requires systematic industrial policies in a context of rising domestic demand. In practice, such examples are not that common. By contrast, 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 (UNCTAD, 2013).

D. Trade and inequality under hyperglobalization

Trade under hyperglobalization, and the associated expansion of GVCs, is often pitched as widening the opportunities for inclusive growth and shared prosperity. The underlying assumption is that because GVCs allow developing countries to focus on individual links in the chain, their firms can integrate with the world economy "on a shoestring" without facing the large risks (and costs) incurred by investing in all the tasks required for producing the finished product or services (e.g. World Bank et al., 2017). According to this view, developing countries can thereby more easily reap the benefits of their major comparative advantage: abundant cheap labour. Following this logic, such integration in the global economy should lead to a reduction of inequality in the South as demand for unskilled labour increases.

Reality is, unfortunately, less obliging. Indeed, it is now increasingly acknowledged that trade patterns under hyperglobalization contributed to polarizing domestic income and wealth distribution not only in the North (e.g. Harrison et al., 2011; Temin, 2017), but also in the South (e.g. Goldberg and Pavcnik, 2007; Pavcnik, 2017), thus exacerbating domestic economic inequalities. Recently-released data that enable the disaggregation of the value added along GVCs support this view. They suggest that these outcomes are partly the result of the proliferation of GVCs and partly due to the behaviour of lead firms, mostly large TNCs that are today the most significant players in international trade.

This section examines this question. Section D.1 reports new evidence that GVCs and the spread of low-productivity assembly lines in export processing zones (EPZs) across the South have not just contributed to suppressing the wages of manufacturing workers in the North, but have also exacerbated the income gap between manufacturing workers and owners of capital in developing countries. Section D.2 analyses the rise of export market concentration under hyperglobalization, and the associated increase in the ability of large firms to extract rents. Much as was argued in *TDR 2017*, the evidence is that increased rents have largely resulted from newer and more intangible barriers to competition, reflected in heightened protection for IPR and abilities to exploit national rules and regulations for profit-shifting and tax-avoidance purposes. The consequent increase in returns from monopolies generated by IPR as well as a reduction in the 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 TNCs – 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.

Overall, these negative effects of international trade on inequality echo the concerns expressed by Raul Prebisch on the prevalence of oligopolistic enterprises in exports of manufactures and how export market structures can affect income distribution. However, as Milberg and Winkler (2013: 280–281) note, today this is less about the nature of the product exported and more about the governance of GVC where, "[m]any

lead firms in global production networks maintain markups by operating in factor or input markets that are increasingly oligopolistic. Buying practices of lead firms can lead to shaving markups and cost cutting by suppliers that leave them unable to innovate and resistant to improvements in wages or labour standards". These processes also have wider macroeconomic repercussions, discussed in section E.

1. GVCs, jobs offshoring, processing trade and income polarization in manufacturing

Recently developed decomposition techniques shed new light on trends in income distribution following the global fragmentation of production. The World Input–Output Database (WIOD)[12] provides data suggesting that the reshaping of global manufacturing production and trade increased inequality in both developed and developing countries. Changes in factor income shares in global manufacturing GVCs between 1995 and 2008 mostly benefited the owners of capital, in the North as well as in the South. Globally, their share in income along all manufacturing GVCs increased by 6.5 percentage points to reach 47.4 per cent in 2008. High-skilled workers also benefited, although to a more limited extent. The share of low-skilled workers, who represent the demographic majority in the South, declined sharply by 6.3 per cent (Timmer et al., 2014). This challenges a key prediction of the Heckscher-Ohlin model that underpins the narrative of GVCs as vehicles for reducing inequality (e.g. Lopez Gonzalez et al., 2015).[13]

Examining how value added is distributed across capital and labour – split in two business functions (i.e. headquarter and fabrication)[14] performed along the "smile curve" – confirms this analysis (de Vries et al., 2018). At the global level, the share of capital income in manufacturing GVCs increased by 3 percentage points between 2000 and 2014 (table 2.2).

TABLE 2.2 Shares in exported value added in manufacturing GVCs, 2000–2014

Global level

	2000	*2014*	*Difference*
Capital	44.8	47.8	3.0
Labour	55.2	52.2	-3.0
Headquarter functions	31.7	30.4	-1.3
Fabrication	23.5	21.8	-1.7

Country groups

	High income			**China**			**Other countries**		
	2000	*2014*	*Difference*	*2000*	*2014*	*Difference*	*2000*	*2014*	*Difference*
Capital	40.3	42.3	2.0	57.0	49.6	-7.5	59.2	59.4	0.2
Labour	59.7	57.7	-2.0	43.0	50.4	7.5	40.8	40.6	-0.2
Headquarter functions	35.2	37.0	1.7	13.6	19.7	6.0	22.5	23.7	1.1
Fabrication	24.5	20.8	-3.7	29.3	30.8	1.4	18.3	16.9	-1.3

Selected countries

	Brazil			**Indonesia**			**India**		
	2000	*2014*	*Difference*	*2000*	*2014*	*Difference*	*2000*	*2014*	*Difference*
Capital	49.1	43.2	-5.9	59.9	59.0	-0.9	56.6	60.6	4.0
Labour	50.9	56.8	5.9	40.1	41.0	0.9	43.4	39.4	-4.0
Headquarter functions	22.3	30.3	8.0	25.6	27.6	2.0	29.7	28.9	-0.8
Fabrication	28.6	26.5	-2.1	14.5	13.3	-1.1	13.7	10.5	-3.2
	Mexico			**Russian Federation**			**Turkey**		
	2000	*2014*	*Difference*	*2000*	*2014*	*Difference*	*2000*	*2014*	*Difference*
Capital	68.3	76.7	8.4	51.3	47.4	-3.9	59.3	62.5	3.2
Labour	31.7	23.3	-8.4	48.7	52.6	3.9	40.7	37.5	-3.2
Headquarter functions	13.0	10.5	-2.4	22.4	30.5	8.1	17.0	15.3	-1.7
Fabrication	18.8	12.8	-6.0	26.3	22.1	-4.2	23.7	22.2	-1.5

Source: UNCTAD secretariat calculations, based on WIOD (2016).
Note: WIOD (2016 release) includes 43 countries plus one category for the "rest of the world", which is only included in the global aggregate figures. "High income" covers 34 countries, including the high-income developing economies of the Republic of Korea and Taiwan Province of China. "Other countries" includes two developed countries (Bulgaria and Romania) and six developing countries and transition economies (Brazil, India, Indonesia, Mexico, the Russian Federation and Turkey). All manufacturing sectors are included.

Meanwhile, the income share accruing to workers at the fabrication stage, who are good proxies for low- and medium-skilled labour, declined by 3.7 percentage points in high-income countries and 1.3 percentage points in most of G20 emerging economies but China (together with Bulgaria and Romania) which are regrouped under "other countries". Additional findings provided by Chen et al. (2017) and WIPO (2017) indicate that rising capital income was driven by growing returns to intangible assets, whose share in value added of global manufacturing trade is estimated to have risen from 27.8 per cent to 31.9 per cent between 2000 and 2007, representing almost twice the share of income accruing to tangible capital.

The only place where the share of labour income in fabrication increased is China, the "world factory", though only by 1.4 percentage points. By contrast, the income share of more skilled Chinese workers employed in pre- and post-fabrication stages, labelled under "headquarter functions", increased by 6.0 percentage points. Together with evidence of rising personal inequality in China (e.g. Galbraith, 2012), these findings support the hypothesis that the relative increase in the income share of less-skilled workers was driven by growing employment in manufacturing assembly lines (the quantity effect) rather than by an increase in the relative wage income of those workers compared to high-skilled workers and capitalists (the price effect).

In other developing countries, negative relative price effects combined with negligible or negative quantity effects depressed the income shares of low- and medium-skilled workers employed at the fabrication stage. Consequently, the share in value added accruing to fabrication declined in developing countries between 2000 and 2014, by 2.1 percentage points in Brazil, 1.1 in Indonesia, 3.2 in India, 6.0 in Mexico, 4.2 in the Russian Federation and 1.5 in Turkey (table 2.2). Though the labour income share in export manufacturing increased in Brazil, Indonesia and the Russian Federation, it benefited only a minority of more skilled workers performing headquarter functions. In India, Mexico and Turkey, the share of capital increased unambiguously to the detriment of all workers, by 4.0, 8.4 and 3.2 percentage points, respectively.

This increasing inequality reflected various forces. One important factor has been the increased bargaining power of corporations, in part due to growing market concentration under hyperglobalization, and the gradual dilution of their social and political accountability to national constituencies and labour in both developed and developing countries (Quentin and Campling, 2018; Bivens et al., 2018). The ability of TNCs to offshore plants and related low- and medium-skilled jobs (or simply to threaten to do so) and to shift their intangible assets almost at will decisively weakened the bargaining power of organized labour and public authorities. This further biased the distribution of productivity gains in favour of private capital owners. This polarizing dynamic unfolded most visibly in manufacturing GVCs, but it also affected jobs and working conditions in many service activities segmented into internationally traded tasks.[15] Another factor was the greater weight of finance in TNCs operations, which went hand in hand with greater emphasis on corporate strategies for maximizing shareholder value, repaying loans or embarking on share buy-back programmes (*TDR 2017*).

In developing countries, the negative impact of international trade on inequality was partly the result of the proliferation of special processing trade regimes and EPZs.[16] Many countries created regimes favouring exporters, with the objective of attracting or preserving investment, production and jobs on their shores.[17] The associated risk, however, is that such regimes merely subsidize labour-intensive assembly work or, more precisely, subsidize the organization of low-cost and low-productivity assembly work by large exporters or foreign TNCs in control of GVCs. Evidence accumulating in recent years, particularly from experiences in China, points to the limited benefits of such policies for the broader economy and their negative effects on income distribution. Interestingly, the export processing firms in China that expanded after 2001 were mostly foreign-owned,[18] and typically characterized by lower productivity, lower profitability, lower wages, lower capital and skills intensity and lower research and development expenditure, compared to non-processing exporters and non-exporters (Lu et al., 2010; Lu, 2010; Dai et al., 2016).[19] This meant that, while China could count on foreign TNCs to integrate its economy into GVCs, it could not rely on them to significantly upgrade the skills and the pay of its workforce or bolster its productive capacities.

The mixed outcomes of policies to promote processing trade often reflect the strategies of TNCs 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, with the actual production (fabrication) in developing countries accounting for only a tiny fraction of the value of exported final goods (e.g. Dedrick et al., 2010; Ali-Yrkkö et al., 2011; WIPO, 2017). This is consistent with evidence of the lower productivity of processing exporters in China as well as the decline in value added accruing to low- and medium-skilled workers at the fabrication stage in manufacturing GVCs, as shown in table 2.2.[20]

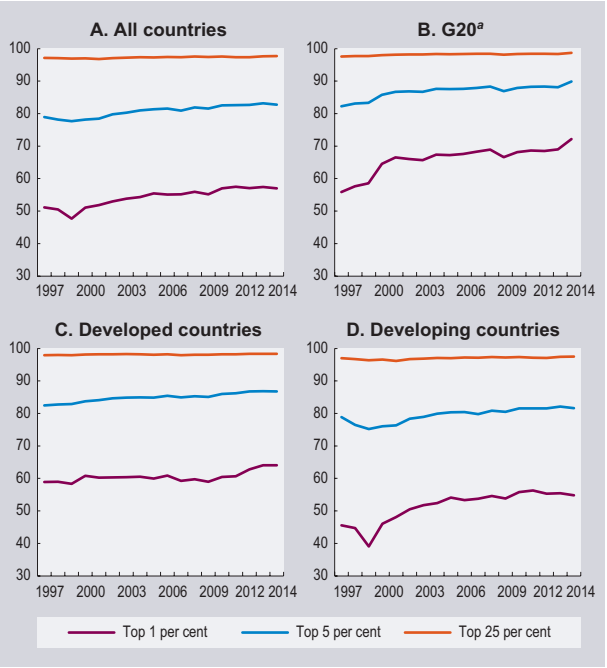
The ongoing success of China at bolstering its productive capacities – thus slowly breaking out of the trap of processing trade and moving up the value ladder – has crucially relied on its capacity to claim and use policy space to actively leverage trade through targeted industrial and other policies aiming at raising domestic value added in manufacturing exports (Poon, 2014, 2018). It has also relied on the ability of the Chinese authorities to develop independent financing mechanisms and acquire control over foreign assets, which are being perceived by developed countries as a threat to their own business interests (e.g. USTR, 2018).

The many specificities of China (institutional setting, size, diaspora, etc.) suggest that there is limited scope for imitating its development strategy by other differently placed developing countries. This raises questions about the benefits for workers in other Southern economies that have made strong bets on the spillovers expected from processing trade, such as Malaysia and Viet Nam in South-East Asia, but also Mexico and Kenya in other developing regions, where processing trade can represent up to more than 80 per cent of gross exports. Unless these 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 (Meagher et al., 2016).

2. Concentration in export markets, intangible barriers to competition and corporate rents: A look at the top 2,000 TNCs

To an even larger extent than domestic markets, global exports today are dominated by very large companies, most of them TNCs.[21] Large firms have become the most relevant actors in international trade, although their dominance is hard to quantify precisely, because of data limitations and obstacles to combining country-level trade data with transnational firm-level data (see box 2.1).

FIGURE 2.10 Average shares of top 1 per cent, 5 per cent and 25 per cent exporters in country total export, 1997–2014



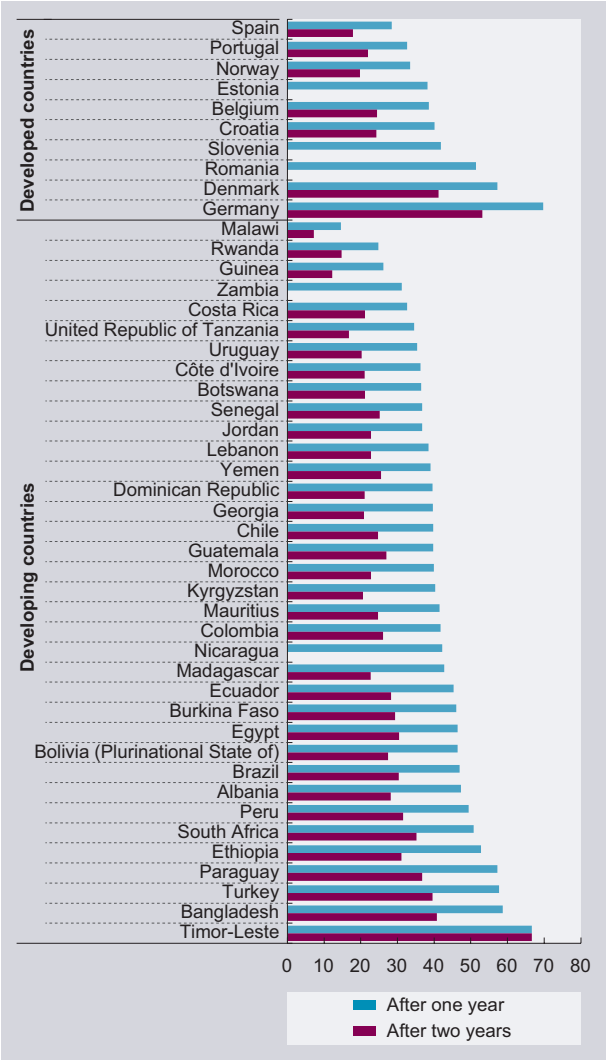
Source: UNCTAD secretariat calculations, based on the Exporter Dynamics Database described in Fernandes et al., 2016.

a The Exporter Dynamics Database contains only Brazil, Germany, Mexico, Turkey and South Africa of the G20 countries.

Nevertheless, recent evidence from aggregated firm-level data on goods exports (excluding the oil sector, as well as services) shows that, within the very restricted circle of exporting firms, the top 1 per cent accounted for 57 per cent of country exports on average in 2014 (figure 2.10.A). Moreover, while the share of the top 5 per cent exceeded 80 per cent of country export revenues on average, the top 25 per cent accounted for virtually all country exports. The distribution of exports is thus highly skewed in favour of the largest firms, especially in G20 emerging economies and in developed countries. It is evident to a lesser extent in developing economies, though even in this group such concentration has been rising rapidly (figure 2.10.B, C and D).

The concentration is even more extreme at the top of the distribution. Freund and Pierola (2015) found that the 5 largest exporting firms account, on

FIGURE 2.11 Export market entrant survival rate in 2010
(Percentage)



Source: Exporter Dynamics Database described in Fernandes et al., 2016.
Note: Data after two years are missing for Estonia, Nicaragua, Slovenia, Romania and Zambia.

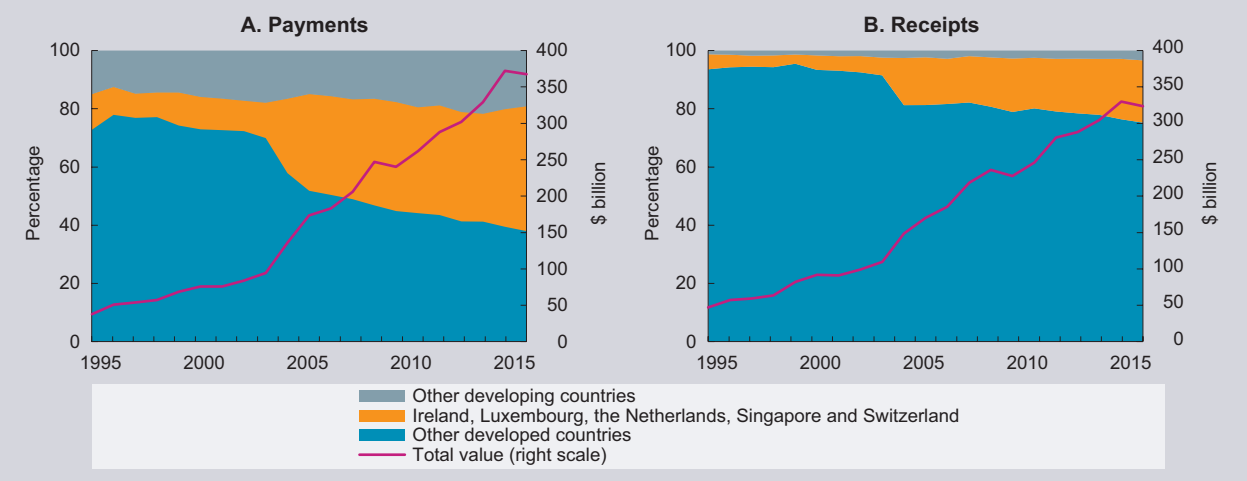
average, for 30 per cent of a country's total exports. In 2012, the 10 largest exporting firms in each country accounted, on average, for 42 per cent of a country's total exports.[22] In the few G20 economies represented in the sample, the 10 largest firms (out of tens or hundreds of thousands of exporting firms)[23] provided 28 per cent of total exports (excluding oil) in Brazil, 23 per cent in Germany, 23 per cent in Mexico, 15 per cent in Turkey and 34 per cent in South Africa.

Not surprisingly, new entrants and relatively smaller exporters tend to have low survival rates: on average, 73 per cent of firms stopped exporting only two years after having started, with exporting firms in developing countries faring slightly worse than those in developed countries (figure 2.11).[24] If all firms (large and small) were competing on a level playing field, the low survival rate among new exporting firms could be interpreted as a sign of strong competition, likely to be associated with low firm profitability and high consumer surplus. But the significantly higher profitability of the largest firms that dominate export markets casts doubt on such an interpretation. This is more likely to be a fallout of the "winner takes most" syndrome that partly results from the market structures and institutional and regulatory conditions that have nurtured new monopolistic practices and enabled TNCs to capture a growing share of the economic surplus (*TDR 2017*: chap. VI).[25] This obviously tends to further polarize income distribution.

The dominance of a small number of TNCs over trade was acknowledged long ago (e.g. Kindleberger, 1969, 1970), but took on a new significance as the legal framework and meaning of "trade" deepened after the 1990s (box 2.2). While mainstream trade theory did seek to integrate the presence of TNCs (e.g. Markusen, 1984; Markusen and Venables, 1998), their dominance in international trade was only incorporated into the set of core trade modelling assumptions much later, and that too under the neutral label of "heterogeneous" firms (Melitz, 2003). Similarly, the existence of monopolistic rents in international trade have been taken note of in mainstream theory, but the additional step of acknowledging the wider implications was rarely taken. As discussed in section E, these implications include both the polarizing effects of trade on income distribution resulting from concentration and monopolistic behaviour of large firms, as well as plausible negative macrofinancial externalities that harm the potential for inclusive development. This is because corporate rents (and thus higher profits) also arise out of strategies aimed at instrumentalizing other actors, by lobbying policymakers, buying out competitors, sharing markets, collusion, blocking new entrants, etc.[26]

Paradoxically, even as tangible barriers to trade imposed by governments, such as tariffs and quotas, have been declining over the last 30 years or so, intangible barriers to competition rooted in "free trade" treaties and erected by large firms themselves have surged, as they exploit the increased legal protection of intellectual property and the broadening scope for intangible intra-firm trade. According to some estimates, intangible assets may represent up to two thirds of the value of large firms (Menell and

FIGURE 2.12 Payments and receipts related to the use of foreign IPR, selected country groups, 1995–2015



Source: UNCTAD secretariat calculations, based on World Bank, World Development Indicators.

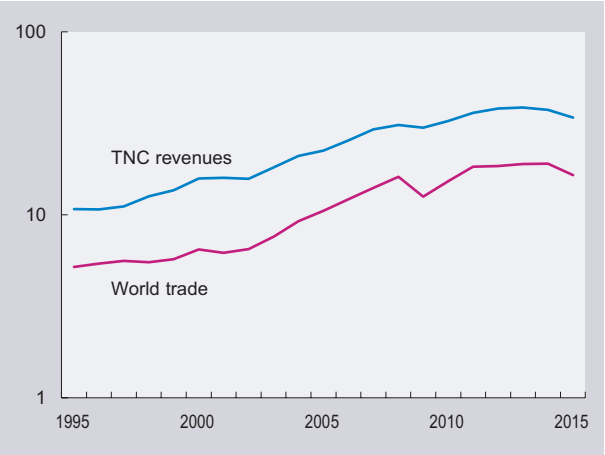
Scotchmer, 2007). This is obviously so for firms that are often positively coined as "knowledge-intensive", such as the digital firms considered in chapter III. Yet, knowledge can be valuable in diverse settings and for a variety of reasons: for its scarcity (e.g. a patent protecting a technological innovation) or precisely because it is widely shared and engrained in the minds of consumers (e.g. brand recognition). As the World Trade Organization (WTO, 2012) notes, "many products that used to be traded as low-technology goods or commodities now contain a higher proportion of invention and design in their value", that is, protected intellectual property content. In short, knowledge-intensive intangible assets are valuable because they ensure a certain degree of market power, not because they represent an inherent and benevolent force for innovation and technological progress.

Returns to knowledge-intensive intangible assets proxied by charges for the use of foreign IPR rose almost unabated throughout the GFC and its aftermath, even as returns to tangible assets declined. At the global level, charges (i.e. payments) for the use of foreign IPR rose from less than $50 billion in 1995 to $367 billion in 2015 (figure 2.12.A).[27] To the extent that charges for the use of foreign IPR reflect transactions taking place between unaffiliated firms, they genuinely indicate their market or "arm's length" value and the cost charged to final consumers. Yet, a growing share of these charges represent payments and receipts between affiliates of the same group, often merely intended to shift profit to low-tax jurisdictions.[28] Recent leaks from fiscal authorities, banks, audit and consulting or legal firms' records, revealing corporate tax-avoidance scandals involving large TNCs, have made clear why major offshore financial centres (such as Ireland, Luxembourg, the Netherlands, Singapore or Switzerland) that account for a tiny fraction of global production, have become major players in terms of the use of foreign IPR (figure 2.12.A).

IPR charges are merely one of the many forms of more widespread profit shifting within companies or groups, that weigh negatively on public finances and collective wage bargaining in many countries.[29] Indeed, the largest recipient country (the United States) is simultaneously the victim of the most massive IPR-related corporate tax avoidance by TNCs "trading" intangibles.[30] Far from promoting innovation or competition, such schemes illustrate how corporate cost-saving strategies (especially in relation to wages and taxes) rely on international arbitrage and free-riding; and while they may be successful for creating monopolistic rents and crushing competition effectively they do so at the cost of public welfare (*TDR 2017*: chap. VI; Diez et al., 2018).

The rise of intangible barriers that further distort competition, increase corporate leverage and foster monopolistic rents has been partly supported by changes to domestic laws in many countries. But international treaties may have been even more significant, such as double non-taxation agreements and new generation trade agreements that include provisions strengthening the protection of IPR,

FIGURE 2.13 Top 2,000 TNCs revenues and world trade, 1995–2015
(Trillions of current dollars)



Source: UNCTAD secretariat calculations, based on UNCTADstat and UNCTAD database of consolidated financial statements, based on Thomson Reuters Worldscope.
Note: The logarithmic scale on the vertical axis is used to show the similar trajectories of the two variables.

foreign investment, etc. Moreover, unlike domestic rule-making in a democracy, international treaty negotiations tend to be much more secretive, providing more room for detrimental lobbying by large rent-seeking firms (Rodrik, 2018).

This is probably why very large firms, which account for the bulk of international trade, have experienced rising rents under hyperglobalization, leading to rising profits. This is confirmed by empirical analysis of the largest 2,000 TNCs.[31] While these firms represent a limited subset of the top 1 per cent of exporters discussed above, they cover listed firms involved in the oil and services trade, including financial services.[32] However, it is not possible from this database to distinguish firms' cross-border activities from their domestic activities, so the results described here relate to the aggregate size and activities of these top 2,000 firms.

In this context, it is no surprise that total revenues from top TNCs have been greater than world trade throughout the period 1995 to 2015 (figure 2.13). Yet, to the extent that the revenues of top TNCs have moved very much in tandem with global trade because they are responsible for the bulk of it, some selected indicators can reveal both the extent of concentration and the rents (here proxied by profits) captured by TNCs, including through cross-border trade.

The annual profits[33] of these top 2,000 companies rose from $0.7 trillion in the late 1990s to $2.6 trillion in recent years (table 2.3).[34] While profits grew on average by 8.5 per cent per year, the average annual growth rate of revenue was only 6.8 per cent. This disparity led the profit to revenue ratio to increase from 5.7 per cent in the late 1990s to 7.0 per cent in recent years, a 23 per cent increase. The five-year averages shown in table 2.3 smooth out profit volatility, but between 1996 and 2015 this ratio rose even more dramatically, by 58 per cent.

TABLE 2.3 Top 2,000 TNCs – key indicators, 1996–2015
(Trillions of dollars)

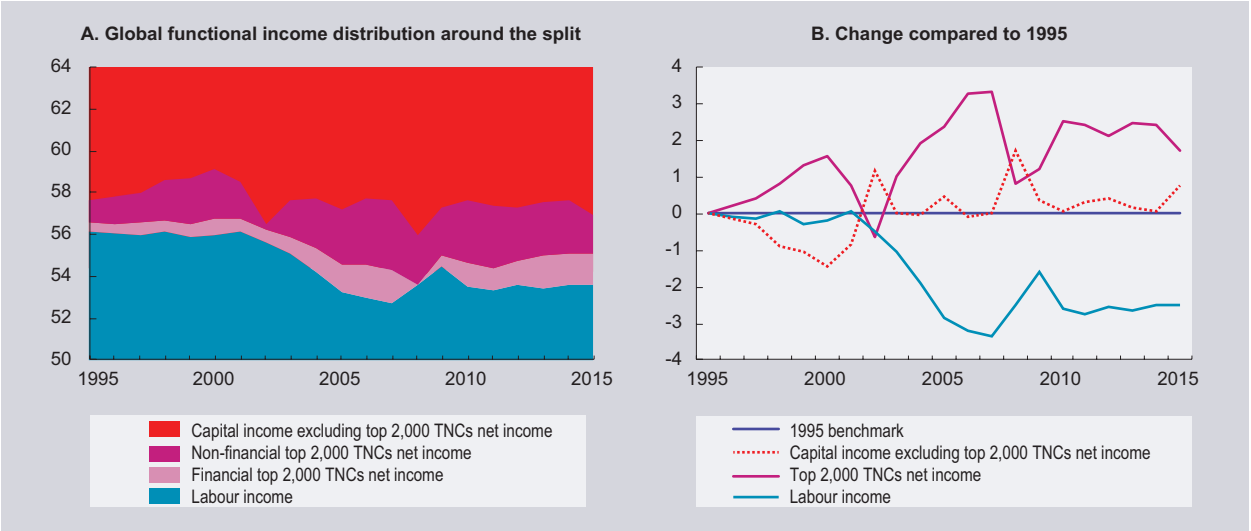
	1996–2000	*2001–2005*	*2006–2010*	*2011–2015*
Net sales or revenues	12.8	18.7	29.7	36.8
Net income or profits	0.7	1.0	2.0	2.6
Ratio of profit to revenue	**5.7%**	**5.4%**	**6.8%**	**7.0%**

Source: UNCTAD database of consolidated financial statements, based on Thomson Reuters Worldscope.
Note: Data relate to annual averages.

There were many sources of this rising profitability. Besides the growing market power noted above, deepening financialization certainly played a central role (see *TDR 2017*: chap. V). TNCs strengthened their ability to operate on a global scale through debt-financed mergers and acquisitions that expanded their control over potential competitors.[35] The greater weight of finance in their operations went hand in hand with greater emphasis on corporate strategies for maximizing shareholder value, including through share buy-back programmes.[36] Furthermore, as documented by Baud and Durand (2012) for the retail sector, a growing number of non-financial TNCs have relied on financial operations to generate profits,[37] and even in the supposedly most innovative and booming sectors, such as digital technologies, tech giants are exploiting financial activities to boost their profit (e.g. Platt et al., 2017).

This increase in profits of large firms has been a major driver of global functional inequality, associated with declines in the global labour income share during the last two decades. Market concentration increases as industries become progressively dominated by

FIGURE 2.14 Top 2,000 TNCs profit and the global labour income share, 1995–2015
(Percentage of world gross product)



Source: UNCTAD database of consolidated financial statements, based on Thomson Reuters Worldscope and UNCTAD internal World Economic Database.

Note: In panel A, all three areas coloured red or pink add up to the share of capital income. Pink areas represent the net income or profit of top 2,000 TNCs (both financial and non-financial, measured in corporate accounts) as a share of global GDP (measured in national accounts). As an approximation, they were subtracted from the share of capital income (measured in national accounts only) even though methodologies differ in several regards across both sets of accounts.

"superstar" firms with high profits and low shares of labour in firm value added, and as the importance of superstar firms increases, the aggregate labour share tends to fall (Autor et al., 2017a). For example, in the United States and several other developed countries, industry sales became increasingly concentrated in a small number of firms; more intense industry concentration was associated with larger declines in industry labour income shares; and so the fall in the labour share was mostly driven by such declines in large firms (Autor et al., 2017b).

Obviously, a decline in the labour share necessarily involves a rise in the capital income share. But since measured value added accruing to capital is not net of depreciation, a rise in the capital income share can be caused by two different processes: by a rise in the cost of capital, which may be compatible with declining and even zero profit; or by a rise in corporate profit. Barkai (2016) found that the cost of capital in the United States declined even more rapidly than labour income between 1984 and 2014, as the share of corporate profits in value added increased by 12 points.

Kohler and Cripps (2018) showed that globally, the rising share of capital income since 1995 was driven by the accelerated expansion of the profits of top TNCs. While the share of capital income other than profits accruing to the top TNCs increased slightly under hyperglobalization (red area in figure 2.14.A), the rapid growth of the profits of top TNCs (pink areas) was the major force pushing down the global labour income share (blue area). This dropped from 56.1 per cent in 1995 to 52.8 per cent in 2007, before rising slightly in the aftermath of the GFC to reach 53.6 per cent in 2015. As a result, the rise in the profits of top TNCs accounted for more than two thirds of the decline in the global labour income share between 1995 and 2015. Therefore, although the rising share of the profits of top TNCs has come at the expense of smaller enterprises, it has also been strongly correlated with the declining labour income share since the beginning of the new millennium (figure 2.14.B). This points to the key role of the largest 2,000 TNCs dominating international "trade" and finance in driving up global functional income inequality.

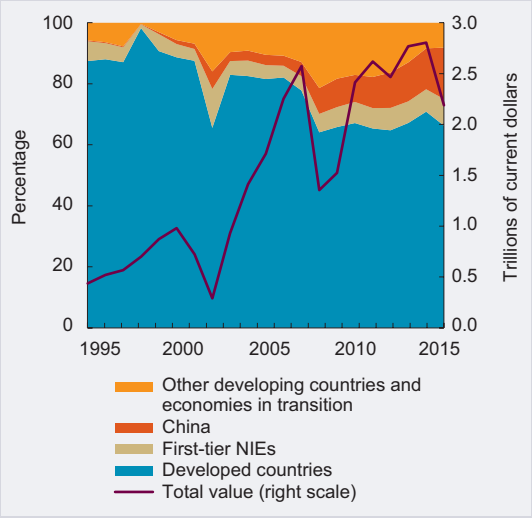
In sum, the evidence in this section describes a widening gap between a small number of big winners in GVCs and a large collection of participants, both smaller companies and workers, who are being squeezed. Rising export market concentration and intangible barriers to competition, both of which have increased the rents of top TNCs (the largest players in international trade and finance) have exacerbated

BOX 2.3 "There's no place like home": The geographical location of headquarters of the top TNCs

This chapter shows how the "rise of the South" other than China has been moderate at best. As noted in section B, the share of the South in global trade in 2011 was nearly 48 per cent in gross value terms and 44 per cent in value added terms; but excluding extractive industries, first-generation NIEs and China, the share was less than 23 per cent. This means that the claims of a "Great Convergence" (Baldwin, 2016) are still far-fetched. However, the picture of international inequality is even more dire in terms of the locations of the headquarters of TNCs.

Obviously, the geographical networks of TNCs activities and ownership structures are much more complex than can be deduced from a simple mapping of TNC headquarters. Nevertheless, the geographical location of the headquarters remains a key criterion for establishing from where effective control over a corporate entity is exerted. Unsurprisingly, the vast majority of top TNCs remain headquartered in developed countries. Accordingly, the distribution of the returns to transnational capital is much more skewed in favour of investors resident in developed countries than the distribution of (exported) value added more generally (Quentin and Campling, 2018). In short, if trade is nurturing growing concentration and corporate rents, these disproportionately benefit Northern investors. Through its impact on corporate rents, "trade" thus adds to international and functional inequality.

FIGURE 2.B3.1 Shares in top 2,000 TNCs profits, selected countries and country groups, 1995–2015



Source: UNCTAD database of consolidated financial statements, based on Thomson Reuters Worldscope.
Note: See note to table 2.3.

Reflecting the rise of China in global trade and finance, the number of Chinese top TNCs increased rapidly over the past two decades from zero to about 200. Although they are taking a growing share the profits of top TNCs (17 per cent in 2015), their expansion does not seem to threaten top TNCs headquartered in the United States (Starrs, 2014), which still account for 37 per cent of the profits of top TNCs, almost as much as in 1995 (figure 2.B3.1). Interestingly however, the share of Chinese financial TNCs in top TNCs profit expanded rapidly to more than 10 per cent to total top TNCs profits, exceeding those of United States financial top TNCs in 2015. Much like the top United States TNCs, those headquartered in NIEs seem to hold their ground as their big neighbour is rising. In relative terms, the expansion of Chinese top TNCs thus seems to have come about at the expense of other developed countries' TNCs, which could explain some of the ramped-up rhetoric in the incipient trade wars.

TNCs headquartered in other developing countries accounted for less than 10 per cent of top TNCs profits in 2015, much the same share as it was before the decade-long commodity boom. (Even within this, it should be borne in mind that an unknown fraction of the small profit share accruing to top Southern TNCs actually accrued to Northern investors owning shares in these companies.) Thus, the stake of the "Rest of the South" in the control over top TNCs, including global production decisions and transnational capital income, remains negligible. Their marginality is all the more striking given the important and growing demography of the "Rest of the South" (68.2 per cent of world population in 2015).

other impacts of trade on inequality. Furthermore, as large TNCs have increased their weight in rule-making at all levels, they have become ever less accountable from a social perspective (see e.g. Carroll, 2012; Carroll and Sapinski, 2016; Zingales, 2017) as well as with respect to environmental concerns.[38] This is one of the main reasons why trade liberalization under hyperglobalization did not deliver the promised shared prosperity in the North or the South. Rather, it promoted debt-fuelled market concentration dominated by a relatively small number of top TNCs, deepened the financialization of the global economy and vastly increased the influence of transnational capital over national and international policy decisions that affect global production, employment and income distribution. Much as in

Prebisch's time, albeit for different types of activities, the dynamics (and the rules) of international trade still reflect the imbalances between, on the one hand, powerful exporting firms with monopolistic control whose rents are concentrated in the developed countries (see box 2.3) and, on the other hand, "peripheral" firms (and their employees), in both developed and developing countries, involved in providing goods and services with low barriers to entry. This kind of polarization compounds the more classical Prebisch-type outcome described in section C, which was related to the ways in which trade still contributes to the persistence of specialization in primary products in many developing regions.

E. Unequalizing trade: Macroeconomic risks and development policy challenges

The belief that international trade can be an "engine for development" and help establish an inclusive growth path, as recently affirmed in the 2030 Agenda for Sustainable Development, is neither new nor unreasonable. Yet, these objectives should not lead to simplistic advocacy of untrammelled free trade. When UNCTAD was convened for the first time in 1964, policymakers from the South were concerned that their countries were increasingly being marginalized by an international trading system that added to polarizing pressures in the global economy (UNCTAD, 1964). This was not seen as the ineluctable consequence of market or technological forces but the outcome of institutions, policies and rules, at the national and global levels, that always and everywhere animate and channel these forces in both creative and destructive directions, and could be changed if the balance was seen as unfair and undesirable. More than half a century later, and despite myriad changes in the volume, direction and governance of cross-border trade, such concerns have surfaced once again, in advanced economies as well as in developing economies.

It is evident that increased trade under hyperglobalization has created opportunities for structural change, but only in very limited parts of the Global South. Besides the first-tier NIEs and more recently China, only a few countries have managed to leverage trade as a means for mobilizing and reallocating productive factors away from primary commodities towards higher value added manufacturing and service activities, and even then in a sporadic manner. As global trade has decelerated since the GFC, underlying structural weaknesses have been revealed in many countries. In many cases, the growth spurts that occurred were on the back of unsustainable booms in extractive industries, which in turn further entrenched patterns of hyperspecialization, when what was needed was to move towards more diversified structures. In developing countries that did increase manufactured exports via the offshoring of production, the underlying shift in corporate strategy to minimize costs and maximize the capture of rents has, in combination with the indiscriminate application of neoliberal policies, exacerbated the unequalizing impact of trade.

These outcomes pose several macroeconomic risks and development challenges, which are starkly evident today. The main concern is probably the negative impact that trade under hyperglobalization has had on aggregate demand (*TDR 2016*). As capital progressively acquired a larger share of world income at the expense of labour, within-country wage, income and wealth inequality rose in most countries in a self-reinforcing manner. 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. Before the GFC, this pattern, as discussed in previous *Report*s, was reflected in, and compounded by, global imbalances that were prolonged by premature external opening.

Global 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 and 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. The expansion of ICT

and digital companies (discussed in chapter III) has not changed this trend; if anything it has, by introducing newer kinds of market control and rent-seeking behaviour, made the situation worse.

In such an environment, incentives are strong for seeking to boost profitability through means other than raising productivity, 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 individual TNCs to enhance their own market position through such strategies only makes the broader economic system more fragile and vulnerable, since together they lead to more inequality, underconsumption, debt and, consequently, macroeconomic vulnerability.

In an interdependent world characterized by financial instability and low growth, trade risks becoming a zero-sum game. Unilateral actions by governments to reinvigorate their own economy by trade protectionism, currency depreciation or wage restraint risk increasing tensions between countries and ending in a self-defeating spiral. But simple-minded calls for more trade liberalization are no substitute for development strategies either (e.g. *TDR 2016*). It is true that trade has been successfully leveraged for promoting structural change by some countries, most recently China. But without policy interventions to generate structural change, channel profits into productive investment and bring better quality employment, trade can nurture more economic, social and environmental damage, at odds with the Sustainable Development Goals.

While "best practice" is a poor guide for development policy (World Bank, 2017), the experiences of successful industrializers should be used as a source of policy experimentation for other developing countries to develop their own strategy based on their national specificities. In such context, governments should realize that relying on so-called "second-best" approaches is often preferable for their economies and populations (Chang, 2003).

The various pieces of evidence examined in this chapter call for a more evidence-based and pragmatic approach to managing trade as well as to designing trade agreements. Crucially, it is important to address trade with a narrative that departs from unrealistic assumptions, such as full employment, perfect competition, savings-determined investment or constant income distribution, which underpin mainstream computable general equilibrium trade models and the associated policy discourse on trade policy. Instead, the insights of new trade theory 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.

As the benefits of hyperglobalization are increasingly concentrated, the mood of populations in many countries is changing and new narratives are needed. As UNCTAD has argued consistently in the past few years (*TDRs 2011, 2014, 2017*), a new international compact is required – a Global New Deal – that would aim for international economic integration in more democratic, equitable and sustainable forms.

There are several elements of such a Global New Deal that have already been elaborated in previous *Report*s. Specifically, with reference to strategies for international trade and the architecture that sustains it, there is a strong case for revisiting the Havana Charter 1948,[39] which emerged, albeit ephemerally, from the original New Deal and still provides important insights for our contemporary concerns. First of all, the Charter (chap. II, art. 2.1) looked to nestle trade in the appropriate 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 employment has largely been lost in the period of hyperglobalization, and also finds little reflection in the "trade" and "economic cooperation" agreements that have dominated the landscape. Yet it must be revived if the widespread backlash against trade is not to gather more strength.

Second, the 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 sought to prevent "business practices affecting international trade which restrain competition, limit

access to markets or foster monopolistic control" (chap. V, art. 46.1) and dedicated an entire chapter to dealing with the problem of restrictive business practices. Revisiting these goals in light of twenty-first-century challenges should be a priority.

Third, the Charter insisted that there were multiple development paths to marry local goals with integration into the global economy and that countries must 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. ■

Notes

1 In this context, Rodrik, 2018: 74, commented on the unanimous consensus among 38 polled economists that North American Free Trade Agreement (NAFTA) had on average made citizens of the United States better off as follows:

> The economists must have been aware that trade agreements, like free trade itself, create winners and losers. But how did they weight the gains and losses to reach a judgement that US citizens would be better off "on average"? Did it not matter who gained and lost, whether they were rich or poor to begin with, or whether the gains and losses would be diffuse or concentrated? What if the likely redistribution was large compared to the efficiency gains? What did they assume about the likely compensation for the losers, or did it not matter at all? And would their evaluation be any different if they knew that recent research suggests NAFTA produced minute net efficiency gains for the United States economy while severely depressing wages of those groups and communities most directly affected by Mexican competition?

2 For presenting compelling stylized facts doing justice to the complexity of the task at hand, this chapter exploits several databases. All of them suffer from limitations. Yet they shed light on distinct aspects of this global puzzle. In addition to gross merchandise trade from United Nations Comtrade (https://comtrade.un.org/), which proposes the broadest coverage in terms of time scale and number of countries, but excludes services and suffers from double counting, sections B and C also use data from the joint OECD–WTO Trade in Value-Added (TiVA) initiative (http://www.oecd.org/sti/ind/measuring-trade-in-value-added.htm). TiVA addresses double counting issues and includes trade in services, though without fixing deeper-running methodological issues (box 2.1). Unlike section B, which uses value added data from TiVA to map production and trade, section D.1 relies on value added data from the World Input–Output Database (WIOD) (http://www.wiod.org) to map trade and income distribution in manufacturing GVCs (de Vries, 2018; de Vries et al., 2018). More precisely, it examines whether trade is associated with a deepening "smile curve" and polarizing distributional effects across production factors and business functions, thus hurting lower-skilled workers. Then, section D.2 uses firm-level data from the Exporter Dynamic Database (Fernandes et al., 2016) (https://datacatalog.worldbank.org/dataset/exporter-dynamics-database) on exports from 70 countries, mostly developing countries, to assess the trend of market concentration in goods exports. The analysis of market concentration is complemented by UNCTAD data on the consolidated financial statements of the top 2,000 largest TNCs, based on Thomson Reuters Worldscope, which provide a more global perspective and further account for the growing role of services, especially financial services, in global production and trade. Data on charges for IPR is also exploited to highlight growing returns to intangible assets and the pervasive challenge of profit shifting, which biases the level playing field, bolstering rents and market concentration. As nation-based mappings of trade in times of rising cross-border ownership and (intra-firm) trade in intangible services are subject to growing distortions (box 2.1), box 2.3 again exploits Thomson Reuters EIKON data (https://customers.thomsonreuters.com/eikon/) to pin down the headquarter location of top TNCs as an imperfect proxy for the nationality of owners of transnational capital, and stresses how elusive the "rise of the South" remains in terms of its control over transnational capital. Finally, data from the Global Policy Model's World Database (https://www.un.org/development/desa/dpad/publication/united-nations-global-policy-model/) is crossed with the profits of top TNCs to illustrate the role of top TNCs in driving down the global labour income share, in accordance with the most recent academic research findings conducted at the country-level (Barkai, 2016; Autor et al., 2017a, 2017b).

3 The decline was similar even in terms of value-added trade.

4 TiVA data show that the share of manufactures exports in total trade has remained roughly constant at about 50 per cent between 1995 and 2011 (the latest year, for which TiVA provides data).

5 Considering the EU-27 as one single entity and its trade with the rest of the world (extra-European Union trade in goods), the export revenues in dollars from China overtook the ones from the EU-27 in 2014.

6 Brazil, the Russian Federation, India, China and South Africa.

7 The Russian Federation, India, Brazil and South Africa.

8 Or put it differently, East Asia's exports of manufactures to the world accounted for about 63 per cent of total developing-country exports of manufactures to the world, while East Asia's exports of manufactures to the developing and transition economies accounted for 67 per cent of total developing-country exports of manufactures to developing countries and transition economies.

9 These findings do not appear directly in table 2.1 but in its underlying data since in table 2.1 "agriculture" was merged with extractive industries into the same column, for presentation purposes.

10 This is confirmed by the analysis in chap. III.

11 Earlier UNCTAD research had already stressed that this type of analysis can be problematic as what could appear as a success (i.e. exporting a larger share of more sophisticated products) may not represent a truly positive structural change. This is because for many goods intensive in technology and high and medium skills it might well be that the exporting country is only engaged in assembly activities intensive in low-skilled labour within a GVC. Thus, the apparent technological "leapfrogging" that gross trade data can suggest might represent a statistical mirage (*TDR 2002*: 77–81). For this reason, this approach should be interpreted as a rather optimistic picture that might require further investigation. On the flip side, absent any progress (or even worse, a deterioration) using this biased approach suggests, at best, a non-upgrading situation or a plausible degradation (downgrading).

12 The 2016 version of the WIOD database covers 43 countries for 2014 and a model for the rest of the world for the period 2000–2014. Data for 56 sectors are classified according to the International Standard Industrial Classification revision 4.

13 The positive narrative on trade and GVCs does not only rely on the rather old-fashioned Heckscher-Ohlin model. It is also inspired by more recent developments of mainstream trade theory. Several shortcomings of (new) trade theory models are discussed in section D.2.

14 In this chapter, headquarter functions comprises the following professions defined by de Vries et al., 2018: (1) Management: general managers, financial managers, human resources and other support functions; (2) Research and development: engineers and related professionals, computing professionals; (3) Marketing: sales persons, client information clerks, customer services representatives. See chapter III and de Vries et al., 2018, for more details. This framework offers a preliminary attempt to track the distributional impact of GVCs.

15 Moreover, irrespective of GVCs, the polarizing impact of trade has long been particularly acute for extractive industries and commodity exports, because of their higher capital-intensity, which constrains the benefits in terms of employment and income for indigenous people, who still are on numerous occasions dispossessed of their land and livelihood. Gender segmentation also plays an important role in the polarizing role of trade, see *TDR 2017*, chap. IV.

16 Processing trade regimes dispense firms located in EPZs from any import or export duty, submitting them to much lighter regulations and sometimes even granting them tax rebates and other advantages; for a detailed discussion of EPZs and their record with respect to economic and social upgrading, see Milberg and Winkler, 2013: chap. 7.

17 As of 2006, the International Labour Organization (ILO) counted over 130 countries with laws providing for EPZs, compared to only 46 in 1986. During the same period, the number of EPZs worldwide increased from 176 to 3,500, harbouring at least 66 million jobs (ILO, 2014). In the United States, over 300 "foreign trade zones" account for 13 per cent of manufacturing output (Grant, 2018) and in the European Union inward processing regimes account for 10 per cent of total European Union exports (Cernat and Pajot, 2012). In China, processing trade still accounts for nearly half of its exports, exceeding gross exports of most countries, except Germany and the United States (Lu, 2010; Dai et al., 2016; Kee and Tang, 2016).

18 Part of those foreign firm may actually be owned by mainland Chinese investors, as part of inward-flowing foreign direct investment (FDI) is simply round tripping through Hong Kong (China).

19 Such observations challenge the popular claim that exporting firms (irrespective of the nationality of their owners and despite evidence of pervasive processing trade in many developing countries) are more competitive than non-exporting firms, because exporting firms are necessarily more productive (e.g. Melitz, 2003).

20 In addition to earning wages that are in relative decline, low-skilled assembly employees are regularly submitted to exploitative and sometimes even hazardous working conditions, in China (e.g. China Labor Watch, 2012; Merchant, 2017) and elsewhere (e.g. Richardson et al., 2017).

21 Most firms are not involved in exports. For instance, in the United States only 1 per cent of firms are involved in exports (Lederer, 2017). This share may be somewhat higher in small export-oriented economies, but given high export market concentration, the

number of exporting firms only represents a small fraction of the total number of domestic firms.

22 Additional data related to the Exporter Dynamics Database provided by Fernandes et al., 2016.

23 In Germany, for instances, more than 110,000 firms are involved in exports.

24 Similar findings appear across all sectors and are not driven by extraordinary levels of concentration or new export firm mortality in a particular industry.

25 At a minimum, available evidence challenges the claim that international trade in the era of GVCs offers growing opportunities for individual entrepreneurs, small and medium enterprises and the poor in developing countries.

26 The characteristics of corporate rent-seeking schemes can be sector-specific. See Havice and Campling, 2017, and references therein.

27 Developing countries remain net payers for the use of foreign IPR, and they have so far failed to increase their share of receipts, which is close to zero (figure 2.12.B).

28 Five high-income offshore financial centres accounted for 42 per cent of global payments in 2015. Also, note that reported payments are higher than reported receipts. Moreover, the number of reporting countries peaked around the GFC, with a maximum of 154 and 143 countries reporting foreign IPR-related payments and receipts, respectively, in 2008/2009. In 2015, these numbers had declined to 148 and 129, respectively. About one third of the low-tax jurisdictions classified as "non-cooperative" by the OECD in 2009 never reported these charges. Despite a decline in the number of reporting countries, IPR charges increased after the GFC.

29 The IPR regime in tandem with the "broken" international tax regime (IMF, 2013) provide a legal cover for large TNCs to transfer their IPR to affiliates in jurisdictions with low tax rates or offering special tax deals. For instance, a TNC headquartered in the United States can license its IPR to an affiliate in Ireland, thus maintaining its IPR under the stronger protection of the jurisdiction of the United States. The Irish affiliate will pay undervalued charges for this licence, but in exchange it will cash in much larger profits generated by those IPR and pay close to no taxes in Ireland. For a more detailed discussion of IPR-based profit shifting schemes and possible solutions, see Blair-Stanek, 2015. For a typology of the different forms of intellectual property trade and value capture, see Fu, 2018: table 1.

30 According to a widely cited reference focusing on the United States (Grubert, 2003), IPR profit shifting schemes may be the most effective ones, slightly ahead of creative loans. Congressional Research of the United States finds that IPR profit shifting schemes alone may deprive the authorities of the United States from between $57 billion and up to $90 billion every year (Keightley, 2013), i.e. between 25 and 40 per cent of corporate tax revenue collected by the authorities. Other developed countries are also affected by such schemes and developing countries may be those most affected in relative terms by profit shifting more generally (Crivelli et al., 2015). Such (tax) cost-saving schemes only available to larger firms have been acknowledged to bias competition and threaten the survival of competing small and medium enterprises unable or unwilling to engage into systematic tax avoidance.

31 Data were derived from Thomson Reuters Worldscope Database, from which UNCTAD has constructed a database of consolidated financial statements of publicly listed companies in 56 developed and developing countries, but headquartered in a total of 121 countries. After ranking them by asset value and selecting the 2,000 largest, it appears that the top 2,000 TNCs were headquartered in a total of only 63 countries. The choice regarding the number of TNCs comes from the Forbes Global 2,000 list, which designates, since 2003, the largest 2,000 TNCs. Rather than looking at a smaller set of TNCs, like the largest 100 TNCs as used for instance in the *World Investment Report*s by UNCTAD, it was decided to consider a larger number of TNCs to make sure that it has a broader coverage in terms of sectors and ultimately that these 2,000 firms span almost all the traded activities worldwide.

32 For this reason, some of these top TNCs are not part of the underlying firms that are considered in Exporter Dynamic Database discussed above.

33 Profit or net income represents income after all operating and non-operating income and expense, reserves, income taxes, minority interest and extraordinary items, converted to United States dollars using the fiscal year end exchange rate.

34 Far from being evenly distributed, rising returns to transnational capital mainly accrue to developed countries, where the large majority of top TNCs remain headquartered and, to a lesser though growing extent, to first-tier NIEs and China. For further discussion on this aspect, see box 2.3.

35 According to the Institute for Mergers, Acquisitions & Alliances (https://imaa-institute.org/mergers-and-acquisitions-statistics), the last two decades were characterized by a very high level of merger activity, which exceeded $2 trillion in value per year.

36 Recent evidence suggests that this process has further intensified in the very recent past. See Pearlstein, 2018.

37 For instance, in the retail sector, supermarkets can resort to tricks, such as charging slotting fees.

38 As an example of the environmental unaccountability of large players in international trade, the 2015 Paris Agreement does not set any emissions reduction targets for maritime transport and civil aviation, which represent key enablers for merchandise and services (notably tourism) trade, even

though they together account for 10 per cent of global emissions and their emissions are projected to grow by 250 per cent by 2050. Such an outcome was supported by developed countries governments (European Union Trade Policy Committee, 2015) stating that "the EU's overall objective is to have COP decisions without any explicit mention of trade or IPR issues and to minimize discussion on trade-related issues. Any attempt to create any kind of provision/agenda item/work programme/mechanism on trade/IPR at the UNFCCC discussions cannot be accepted".

39 Available at: https://www.wto.org/english/docs_e/legal_e/havana_e.pdf.

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