

# Chapter V

Trade Regionalism and Development



## A. INTRODUCTION

Regional integration is often examined through a narrow trade lens, whereby reduced barriers to trade are viewed an end in themselves, and attention is focused on the creation and diversion effects of Free Trade Agreements (FTAs). This chapter takes a different approach, in that we see trade as a means to development, not an end. More specifically, we discuss the developmental effects of regional trade and trade agreements in the context of managing sectoral shifts to support a diversified economy and productivity growth.

The chapter starts by examining regionalization and the developmental effects of intraregional trade, measured by a higher degree of diversification and/or a larger share of domestic value added in regional than in total trade. We underline that for regionalism to be development-oriented, it must be part of a broader strategy promoting regional integration and cooperation across a range of non-trade areas. Such a strategy may be called “open developmental regionalism” whereby formal rule-setting is confined to border measures, and informal cooperation on behind-the-border measures and other policy areas works to unleash regionalization dynamics that could support structural transformation. The chapter also discusses the challenges posed to regional arrangements by the emerging digital economy and climate change and whether and how regionalism can revitalise multilateralism, rather than resulting in a fractured international trade system. It insists that a constructive and cooperative approach to multilateralism remains paramount, and open developmental regionalism can be an important tool to make the existing multilateral trading regime more inclusive, especially in new and rapidly evolving areas, such as the digital economy and the response to climate change.

## B. RECENT PATTERNS IN REGIONAL TRADE: DEVELOPMENTAL IMPACTS OF REGIONALIZATION

Trade has the potential to support national development strategies, especially if the related policy prescriptions are not confined to rapid trade liberalization but embrace a more strategic and integrated approach, including other key policy areas, such as macroeconomic and financial management, trade support and industrial policies, to name a few (UNCTAD, 1964). Any attempts to maximize the benefits and minimize the costs of trade integration are not independent of other elements that make up a healthy economy, whether capital formation (both physical and human), quality infrastructure, financial depth or technological innovation. In other words, international trade – including intraregional trade – should not be considered an end in itself but a means to support diversification and industrialization and innovation and productivity improvement more generally. Extensively researched success stories, including reports by UNCTAD, back up this approach.<sup>1</sup>

Several arguments seek to explain why intraregional trade could provide a route to realizing wider development goals (e.g., *TDR*, 2007, chap. 2, chap. 4). A “structuralist” approach posits that the likelihood of trade having a positive impact is greater when it takes place among countries in the same (developing) geographical region because of the advantages of proximity. Moreover, these entities are often closer in terms of their initial development conditions, making for more equally shared gains from trade; when the economic structure of trading partners is similar, gains from trade arise primarily from “economies of scale” and learning effects, rather than from “comparative advantages” reflecting pronounced differences in either technology or relative endowments. More trade can avoid the lock-

<sup>1</sup> The research has been reviewed in previous reports (see *TDR*, 2002, 2003, 2016).

in effects resulting from trade based on comparative advantage – such as a strong reliance on raw materials or an abundance of low-skill labour – and have the potential to promote export diversification and accelerate industrial development. Key to understanding this potential is the fact that foreign competition within a developing region is easier for both policy-makers and domestic firms to manage when it takes place vis-à-vis competitors from neighbouring countries rather than firms from more advanced countries, given the cost and capability gaps with the latter.

From a demand point of view, the gains from trade are more likely to be retained inside a region when they result from intraregional trade than from extra-regional trade, as trade organized around international supply chains is more prone to profit repatriations to headquarters of foreign multinational enterprises (MNEs). Thus, under these circumstances, intraregional trade is expected to result in greater multiplier effects than extra-regional trade.

Another argument derives from the political economy of trade agreements. Trade rules within developing regions are often less stringent than those in bilateral or plurilateral trade agreements characterized by power asymmetry among the participating countries. The risk that power asymmetries could lead to a narrowing of national policy space for developing countries signing trade agreements is probably lower when such agreements take place intraregionally.

Lastly, from a supply chain approach, the integration of countries into regional value chains may strengthen industrial networks by moving inter-industry linkages from a simple hub-and-spokes cluster to a more complex structure as witnessed in some East Asian countries around China. It is often argued that it is easier to join an existing supply chain (especially if it is close geographically) than to build one from scratch domestically as was done, for example, by both the Republic of Korea and Taiwan (Province of China).

Notwithstanding these theoretical considerations, determining whether intraregional trade is more conducive to development than extra-regional trade requires empirical analysis. The rest of this section is devoted to this exercise. We review the composition and evolution of exports of different regional groupings with three types of trading partners since 1995, first with respect to merchandise trade and then services. The idea is that the benefits of trade for economic development cannot be measured simply by the evolution of the total value of exports. Rather, they can be captured by a country's capacity to increase the production (and therefore, the export share) of the products or services more associated with higher productivity, rising incomes and ultimately economic and social development.

In the first set of empirical exercises, we examine the composition of intraregional merchandise exports and compare this to two types of extra-regional flows: first, exports to the (rest of) developing countries and second, exports to the (rest of) developed countries. We consider five country groupings. Four are in various corners of the developing world: Africa, the Association of Southeast Asian Nations (ASEAN),<sup>2</sup> the Commonwealth of Independent States (CIS) and Latin America and the Caribbean. The fifth group is the European Union, which partly plays the role of a benchmark because its members are advanced economies, and it has deep experience of regional integration. The choice of the European Union should not be understood as a call for developing countries to replicate this specific experience, however, as its initial conditions, its motivations, its timing and many other elements created a unique process. Yet focusing on the European Union case yields relevant findings which could be useful when comparing trade flows of other developing regions.

<sup>2</sup> The choice of ASEAN rather than an alternative country grouping in (developing) East and/or South-East Asia reflects its longstanding efforts to achieve regional cooperation. Although its origins reflected political considerations to promote peace in what was then an area with recurrent conflicts, this group moved up a gear in terms of economic cooperation in 1992, with the signature of the ASEAN Free Trade Area (AFTA).

## 1. Trade in goods

Two main sources of merchandise trade data are considered in this analysis: “gross exports” from UNCTADstat<sup>3</sup> and the “domestic value-added content of exports” from OECD Trade in Value Added (TiVA) database.<sup>4</sup> Both sources provide data on aggregated bilateral trade flows, as well as more granular data, thus allowing the decomposition of merchandise exports into three broad categories: primary commodities, excluding energy; energy; and manufactures. Such decomposition sheds light on our main question, with the underlying idea that a larger share of (domestic value added resulting from) exports of manufactures is more conducive to development because of their better paid jobs, their stronger linkages with the rest of the economy, in particular the amount of employment they create, and their higher technological spillover to other parts of the economy, which, in turn, can lay the basis for a strong export-profit-investment nexus (see *TDR*, 1996, chap. 2; *TDR*, 2003, chap. 4; *TDR*, 2005, chap. 2).

It should be noted that each database has pros and cons. Using gross exports allows broader coverage, especially for developing countries. UNCTADstat includes 218 jurisdictions, while TiVA reports indicators for only 66 economies, plus an aggregate for the “Rest of the World”. The use of gross exports as a proxy to measure the country capacity to move up the development ladder can be misleading, however. Researchers have stressed for decades that a particular exported product no longer coincides with an entire domestic production sector. On the contrary, when the product is produced within an integrated international supply chain, the share of the value-added content of exports coming from abroad can be large. Moreover, the classification of the final product as high-skill and/or technology-intensive does not necessarily mean any particular sub-component of the chain (and the exports that result therefrom) is characterized as such.

To circumvent this issue, we may rely on the domestic value-added content in exports as reported in TiVA. Yet turning to TiVA data is not without cost either, as TiVA country coverage is extremely limited, especially in the case of Africa and CIS, and to a lesser extent Latin America and the Caribbean (see the note of Figure 5.1 for more details). For these reasons, our empirical analysis considers gross exports as well as TiVA trade flows. One positive aspect is that these two sources hint at similar conclusions.

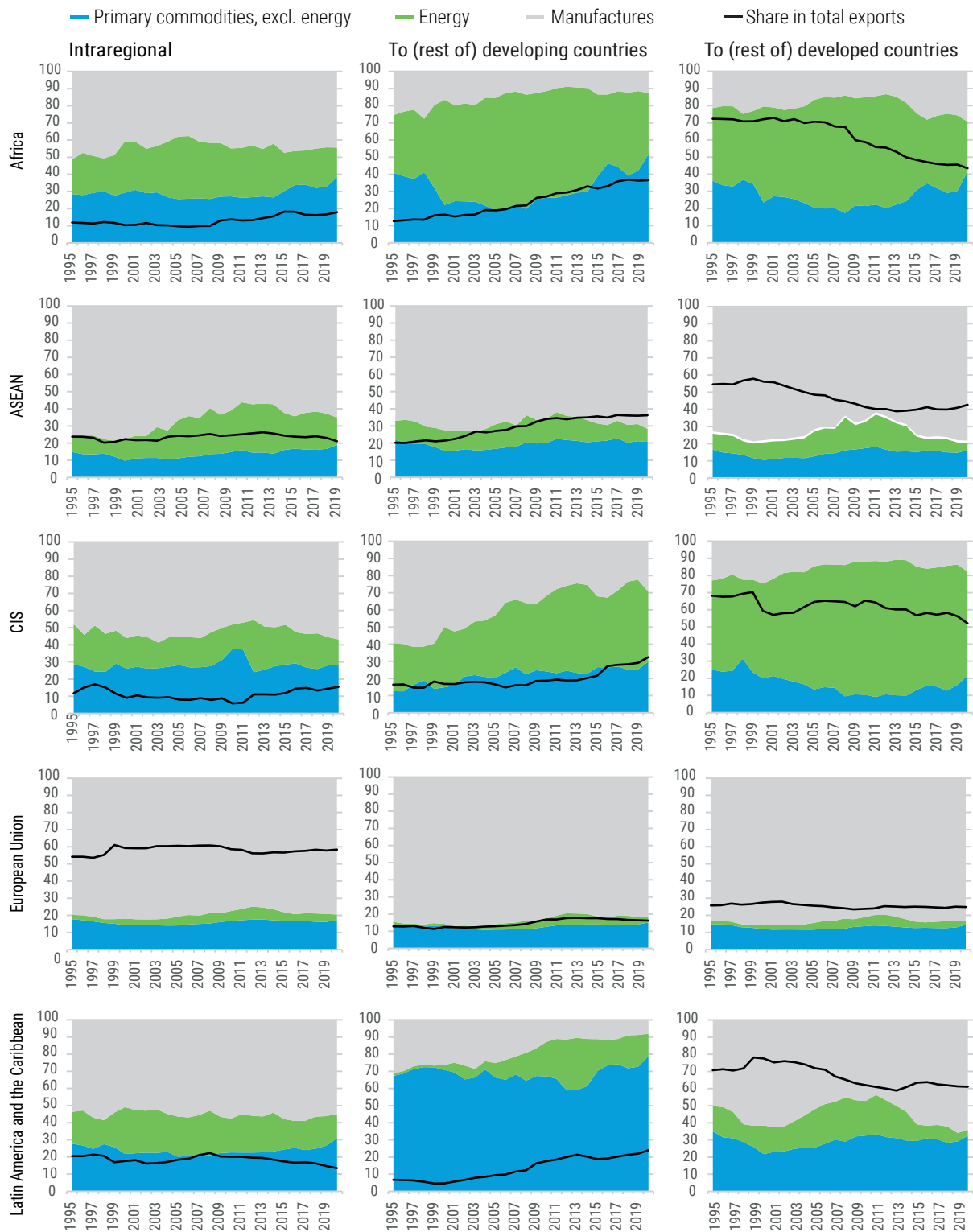
Not surprisingly, the European Union and ASEAN have a much larger share of manufactures in their exports (Figure 5.1), but there are several other takeaways for the European Union exports. First, whether we consider gross exports or domestic value-added content of exports, manufacturing exports still represent the bulk of merchandise trade. This partly reflects the maturity of the economies. Second, because the extraction of primary commodities such as minerals and energy is relatively modest, the share of manufacturing exports appears even greater in the TiVA data (approximately 95 per cent) than in gross exports (approximately 80 per cent). The fact that the bulk of these commodities is initially imported from outside the region, especially to the Netherlands, before being re-exported elsewhere, explains this difference. This feature is a reminder of the potential drawback of the use of gross exports as a proxy for the production capacity of any economy and indicates the value of the TiVA data. A comparison of the two types of data for the European Union (a group with complete and high-quality data) shows that the rise of its exports to the developing world follows the same pattern (black line in Figure 5.1). Similarly, the share of commodity exports in gross exports rose between the late 1990s and the early 2010s, and this trend also appears, albeit more modestly, in the TiVA data. These similar patterns suggest it may be appropriate to consider gross export data if TiVA coverage is more limited, especially if we look at the evolution of the shares, rather than their absolute levels.

<sup>3</sup> See <https://unctadstat.unctad.org>.

<sup>4</sup> See <https://www.oecd.org/sti/ind/measuring-trade-in-value-added.htm>.

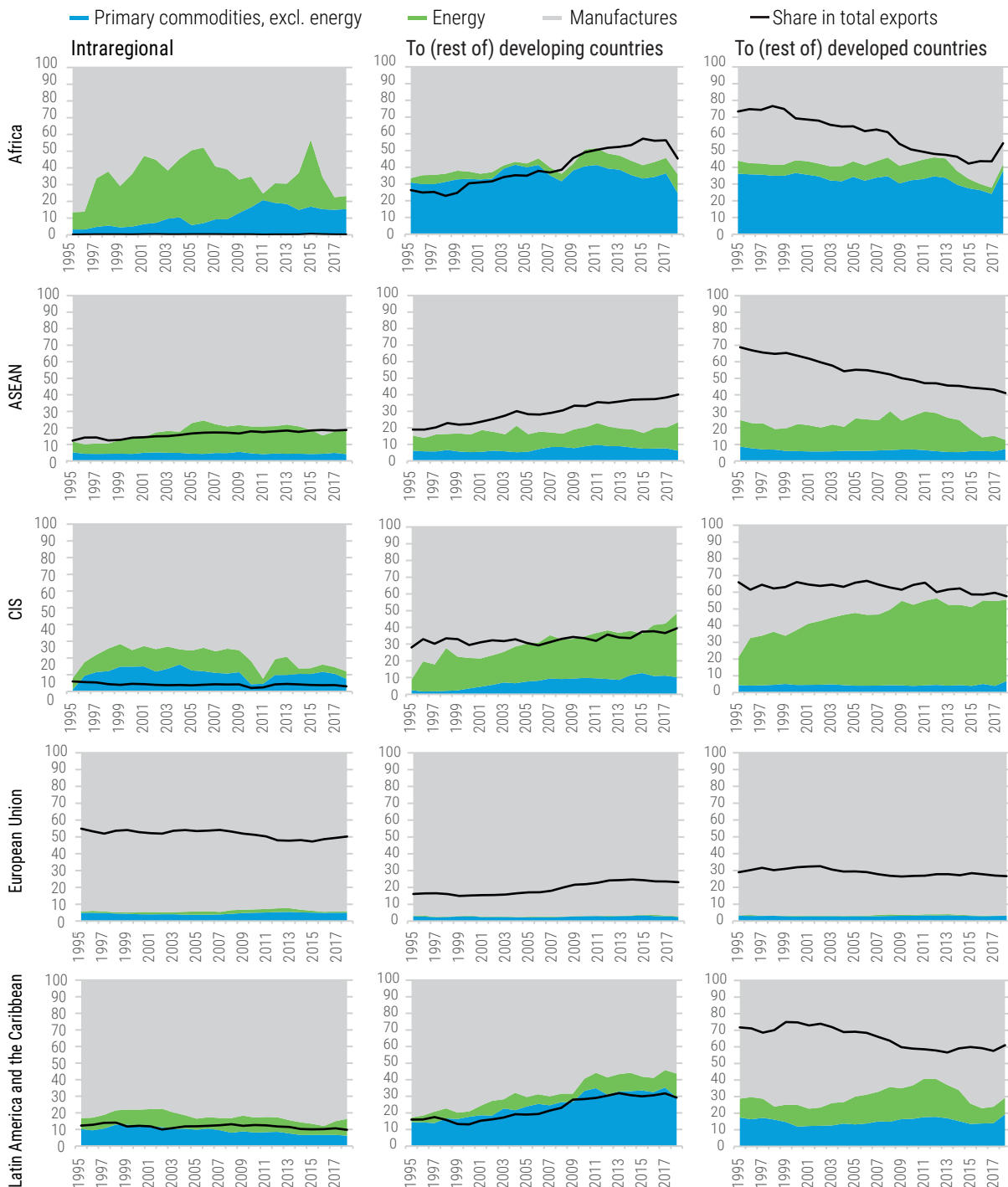
**Figure 5.1** Composition of merchandise exports, selected country groups and components, 1995–2020 (percentage)

**Gross exports**



**Figure 5.1** Composition of merchandise exports, selected country groups and components, 1995–2020 (percentage) (cont.)

**Domestic value-added content of exports**



*Source:* UNCTAD secretariat calculations, based on UNCTADstat and OECD TiVA databases.

*Note:* Country coverage for the “domestic value-added content of exports” (TiVA database) can be limited. Africa refers to only 3 countries (Morocco, South Africa and Tunisia), CIS to 2 countries (Kazakhstan and the Russian Federation), and Latin America and the Caribbean to 6 countries (Argentina, Brazil, Chile, Colombia, Mexico and Peru). The country coverage for ASEAN and the European Union is complete. For “Gross exports,” “Primary commodities, excl. energy” relates to the following codes of the SITC Rev. 3: 0, 1, 2, 4, 667, 68, 961 and 971. “Energy” refers to code 3, while “Manufactures” corresponds to codes 5 to 8 less 667 and 68.

For “Domestic value-added content of exports,” “Primary commodities, excl. energy” relates to the following TiVA codes: D01T03, D07T08 and D09. “Energy” refers to TiVA code D05T06, while “Manufactures” corresponds to TiVA code D10T33.

In ASEAN, the data paint a similar picture, with exports characterized by a large share of manufactures. In fact, when measured using domestic value-added content, manufactures often generate more than 80 per cent of total merchandise exports, and this percentage is similar across partner countries. It reflects the existence of a dense regional production network in manufactures that sources the entire world, particularly in electronics industries, as well as the relatively low endowments of primary commodities, especially in some of the largest economies: Malaysia, the Philippines, Singapore and Thailand. More broadly, the outward-oriented development strategy and the strong reliance on net exports after the 1997-1998 crisis played a significant role in shaping the export structure of this group, notably in the first-tier newly industrializing economy (NIE) of this group (Singapore) and the three second-tier NIEs (Indonesia, Malaysia and Thailand), which together still accounted for approximately three quarters of ASEAN economic output in 2020.

The aggregate picture of ASEAN masks a certain heterogeneity within its members, however. In Brunei Darussalam, for instance, the domestic value added of merchandise exports mainly comes from energy-related products. Meanwhile, for Cambodia and Myanmar, the share of primary commodities (including energy) is significantly larger in intraregional trade than in extra-regional exports, especially those headed to developed countries. This reflects the demand emanating from their neighbouring commodity-dependent countries.

Another salient element is the strong relative decline of developed countries as trading partners over the last three decades. When considering the domestic value-added content of merchandise exports, data show the share of developed countries as a destination of ASEAN total exports gradually decreased from roughly 70 per cent in 1995 to about 40 per cent in 2018. Meanwhile, the share of intraregional trade gained some percentage points. Yet the bulk of the reorientation of ASEAN exports during this period was geared towards developing countries outside this group, especially China.

Turning to other developing regions where trade regionalization (and economic integration) has remained comparatively subdued, we discover more heterogeneity in the export structure to the three types of trading partners. In the case of Africa, the limited coverage in the TiVA data requires us to concentrate on gross exports. The data suggest intraregional trade is more conducive to development, as the share of manufactures is larger (about 40 per cent) for this trade than for exports either to the rest of the developing world (only about 10 per cent) or to developed countries (20 per cent to 25 per cent), even though it remains significantly lower than in the European Union or ASEAN (for a more detailed assessment, see *TDR*, 2019).<sup>5</sup> Unfortunately, intraregional trade has remained low and relatively constant in Africa, except during the last decade when its share increased slightly (see black line in Figure 5.1) to reach almost 20 per cent.

The most dynamic segment of Africa's exports derives from its relationship with other developing countries outside the continent, notably China. However, this extra-regional trade has been dominated by a few primary commodities, sometimes almost reaching nine tenths of total exports to developing countries outside the region. This concentration of Africa's exports in primary and unprocessed goods indicates the continent's limited industrial production and processing capacities. If we replicate a similar decomposition of exports for the numerous economic groups that coexist within Africa, similar pictures emerge in the sense that for all these subgroups, the share of manufactures is greater in intraregional exports than in extra-regional ones. Moreover, in all these cases, export geared towards the rest of the developing world has been the most dynamic segment and has gained significant market shares, to the detriment of the developed country partners. These observations appear, for instance, when looking at the Common Market for Eastern and Southern Africa (COMESA), the Economic Community of Central African States (ECCAS), the Economic Community of West African States (ECOWAS), the Southern African Development Community (SADC), the Economic and Monetary Community of

<sup>5</sup> Similar pictures appear in TiVA data, though the fact that the intraregional figure relies on only three countries – Morocco, South Africa and Tunisia – makes it risky to draw strong conclusions for this continent.



Central Africa (CEMAC), the West African Economic and Monetary Union (WAEMU), the East Africa Community (EAC) and the Southern African Customs Union (SACU).

While TiVA data cover only few African economies, some research indicates the regional value chain integration of African economies is much lower than in Mercosur and ASEAN (de Melo and Twum, 2021). African regional economic communities (RECs) have participated mostly in non-regional value chains, and they pursue forward rather than backward activities (Black et al., 2019). The main reason for this pattern is that most of Africa's exports comprise raw and unprocessed goods, and this also explains the very limited value added created on the continent. Beyond commodity concentration, high transport costs and high non-tariff barriers (Cadot et al., 2015) have contributed to low intraregional trade. Moving ahead, Africa's limited production capabilities and its limited interconnectivity across countries, including poor (road) and missing (rail) infrastructure, represent main challenges for the continent, as Africa's trade infrastructure is mostly geared to serve trade with the rest of the world, not intraregional trade. The development of regional infrastructure and, to a lesser extent, the elimination of non-tariff barriers (NTBs) would be key to stimulating intraregional trade along regional value chains (RVCs).

CIS economies exhibit similar patterns to those in Africa, albeit in a less extreme way. First, CIS intraregional trade appears to be more conducive to development, given its broader share of manufactures (reaching almost 60 per cent in recent years when considering gross exports). This number contrasts with the structure of exports to the rest of the developing countries, where manufactures account for about 25 per cent, or to the developed countries, where they represent less than 20 per cent. Second, intraregional trade has remained relatively low and constant, except for the last decade when its share grew by a few percentage points. Third, the most dynamic segment of CIS exports, in terms of trading partners, has been the rest of the developing world, especially during the last decade. Fourth, since the early 2000s, energy-related products have often represented about half (if not more) of CIS extra-regional export revenues. Notably, the export structure of this group to the rest of the developing world changed dramatically after the collapse of the Soviet Union. While manufactures amounted to 60 per cent of the region's total exports to these trading partners in 1995, it oscillated around 30 per cent after the global financial crisis (GFC).

There is a certain asymmetry, however, within the group. The bulk of Russian Federation exports go outside this group, but for several economies of Central Asia, the Russian Federation remains the largest export destination. For instance, more than 40 per cent of Belarus exports go to the Russian Federation. This highlights the ongoing close economic ties with the Russian Federation. Meanwhile, China has become the largest export recipient of some Central Asian countries, especially those that are geographically close. Outside these two large trading partners, trade in the other countries of this group, either intraregional or extra-regional, is more subdued. This partly reflects the generally remote geographical location of Central Asian economies, their landlocked nature and the development of trade-related infrastructure, all of which imply high transport costs compared to other regions. In this context, exports of goods and services, as share of gross domestic product (GDP), decreased in many Central Asian countries in the decade after the GFC (Karymshakov and Sulaimanova, 2020).

In the years ahead, the disruptions created by the war in Ukraine and the subsequent sanctions applied to the Russian Federation are expected to affect the trade prospects of this group, even though, for the moment, the uncertainty is too high to propose any detailed prospects for the medium term or long term.

In Latin America and the Caribbean, the share of manufactures is much larger in intraregional trade than in extra-regional exports. The two sets of data confirm this finding, even though there is a significant difference between the levels of the share of each of the three main product groups depending on whether we consider gross exports or domestic value-added content of exports. This difference is partly because the Latin American countries considered in TiVA have a larger share of manufacturing exports than many less developed economies of the region.



More precisely, according to TiVA data, manufactures represent more than 80 per cent of the domestic value-added content of intraregional exports. Turning to extra-regional exports to developed countries, still accounting for approximately 60 per cent of the region's total exports, TiVA data show manufactures accounted for about 70 per cent in 2018, the last year of the sample. This is almost the same level as in 1995, at the beginning of the sample. In between, the share of manufactures fluctuated strongly. In the late 1990s, it reached almost 80 per cent, before decreasing gradually in the following decade to reach a trough of about 60 per cent in 2011. As the first commodity supercycle of the twenty-first century faded, along with Mexico's energy exports to the United States, the share of manufactures rebounded almost 20 percentage points between 2012 and 2016. For the Latin American extra-regional exports to developing countries, manufactures lost significant market shares during the observed period. From more than 80 per cent in 1995, it gradually decreased to less than 60 per cent in 2018. This reflects the strong appetite for primary commodities of all kinds in fast-growing economies, especially China.

Overall, the relative decline of manufactures, especially in exports with developing countries outside the region, is not a positive sign, as this trading relationship has grown markedly during the considered period. More generally, a large body of empirical evidence points to the premature deindustrialization of several large economies of Latin America since the beginning of the millennium, as these countries further specialized in commodities and low productivity services (e.g., Rodrik, 2016; Castillo and Neto, 2016).

Promoting regional trade integration could plausibly counteract this tendency. Yet data show that the share of intraregional trade has been either constant (TiVA) or even declined (gross exports). In parallel, the lack of trade interdependence between Brazil and Mexico, the two largest economies of this group, is worth mentioning. In short, while Brazil looks to the East, Mexico looks to the North. More precisely, over recent years, Brazilian exports to China have risen more than 10 times, making China its biggest trading partner by far and leaving its close neighbour, Mexico, far behind. Meanwhile, Mexico's exports to the United States are much more important than those to Brazil – with more than 100 times more exports to the former than the latter. Altogether this highlights some of the persistent limitations to fostering regional trade.

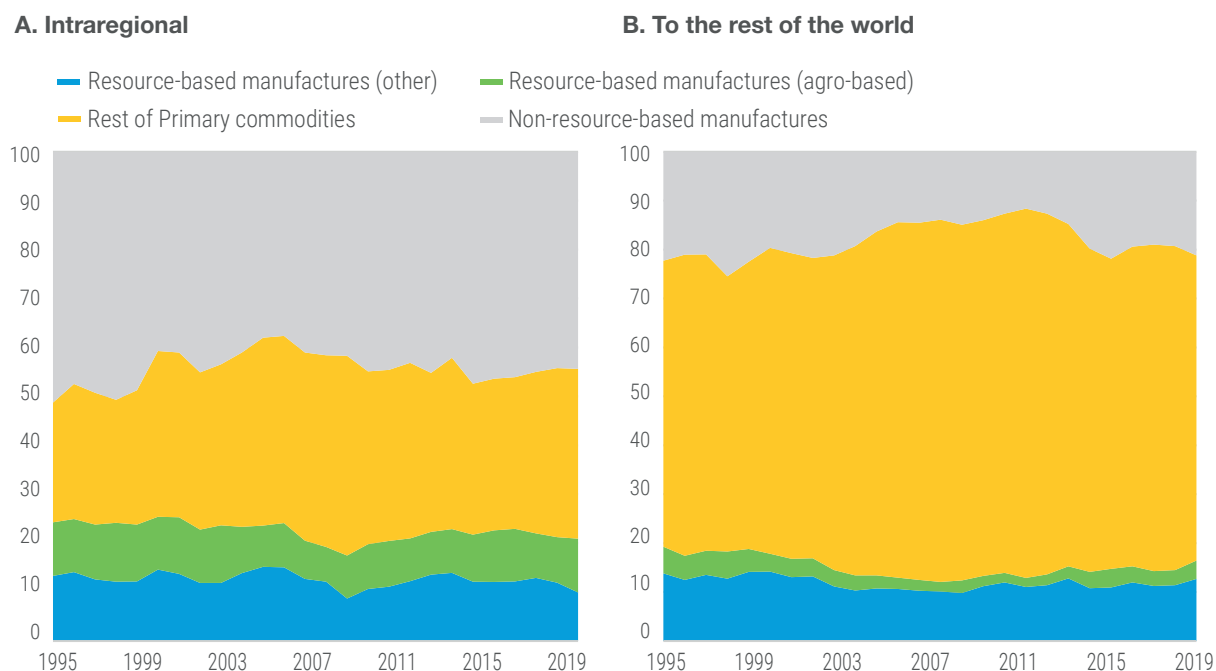
We should note that the broad classifications used in Figure 5.1 have some drawbacks, because the designations “Primary commodities, excl. energy” and “Energy” include products with the potential to lift labour productivity and promote structural change. These include, *inter alia*, some of the processed goods derived from primary commodities or high-value agricultural goods such as horticultural products.<sup>6</sup>

Several scholars have devised development strategies based on (natural) resource-based industrialization (RBI) (e.g., Kjällerström and Dallto, 2007; Morris and Fessehaie, 2014; Neilson et al., 2020; also UNCTAD, 2021a, and references cited therein). Thus, the primacy of manufacture over natural resources suggested in the preceding analysis does not necessarily mean a high and/or increasing share of primary commodities sends a negative signal; in fact, some of these subsectors can play a positive role in the structural transformation towards productive, higher-value and increasingly complex activities. This is especially relevant for Africa at time when the continent aims at investing in modern agriculture under its Agenda 2063.

Figure 5.2 considers two types of resources-based manufactures originally classified under either Primary commodities, excl. energy or Energy in Figure 5.1. These are labelled as “resources-based manufactures,” further split between “agro-based” and “other” in UNCTADstat. Such products are arguably more likely to foster development than other primary commodity products, given their greater potential to improve labour productivity. In this context, Figure 5.2 shows that the share of agro-based manufactured products is larger in intra-African trade than in Africa's exports to the rest of the world. This supports the conclusion derived from Figure 5.1.

<sup>6</sup> Technically speaking, all these products belong to sections 0 to 4 of the Standard International Trade Classification (SITC) rev. 3, the basis for Figure 5.1.

**Figure 5.2** Composition of African merchandise gross exports, selected components, 1995–2020 (percentage)



Source: UNCTAD secretariat calculations, based on UNCTADstat database.

Note: “Resource-based manufactures (agro-based)” relates to the following codes of the SITC Rev. 3 : 016, 017, 023, 024, 035, 037, 046, 047, 048, 056, 058, 059, 061, 062, 073, 098, 111, 112, 122, 232, 247, 248, 251, 264, 265, 269, 421, 422, and 431. “Resource-based manufactures (other)” refers to codes 281 to 289, 322, 325, 334, 335, and 411. “Rest of Primary commodities” corresponds to the sum of “Primary commodities, excl. energy” and “Energy” as defined in figure 5.1 “Gross exports”, to which the two above-defined “Resource-based manufactures” series were subtracted. “Non resource-based manufactures” corresponds to “Manufactures” of figure 5.1 “Gross exports”.

As a whole, the merchandise trade data suggest intraregional trade is associated with greater development potential if we look at its structure, but when we take a look at the size of intraregional trade compared to extra-regional exports, it is clear that intraregional trade is not the silver bullet for development. With this intermediate conclusion in mind, we can move to trade in services.

## 2. Trade in services

Looking at the evolution of the domestic value-added content of gross exports of services sheds additional light on the potential role of intraregional exports. In what follows, we look specifically at “business sector services” (BSR). To put things in perspective, BSR represents the bulk of exports of services, although BSR weight in total exports of goods and services accounts for approximately 38 per cent in Organisation for Economic Co-operation and Development (OECD) economies and 27 per cent in non-OECD economies.

BSR encompasses five sub-aggregates of industries: distributive trade, transport, accommodation and food services (WTH); information and communication (INF); financial and insurance activities (FIN); real estate activities (REA); and other business sector services (OBZ). Of these, WTH includes the less-skilled activities, although one subcomponent of OBZ – “administrative and support services” – encompasses call centres and packaging which do not necessarily require highly-qualified workers.

In the remainder of this section, we perform decompositions similar to those we did for merchandise trade to investigate whether intraregional services trade differs from extra-regional exports, and if so, whether the former is more conducive to development than the latter. More concretely, decomposing the domestic value added of BSR exports between its five main subcomponents reveals the following patterns (Figure 5.3).

For Africa, intraregional coverage is relatively limited because the underlying data only include bilateral exports between Morocco, South Africa and Tunisia. In contrast, the two other panels rely on more country partners. These are therefore less likely to suffer sample bias, even though they still rely only on these three African countries as the source of exports.<sup>7</sup> With this caveat in mind, Africa's BSR exports to the (rest of) developing countries show two things. First, this has been the most dynamic segment for Africa, as its share increased from slightly more than 20 per cent in the late 1990s and early 2000s to more than 40 per cent a decade later. Digging further into BSR subcategories, data show WTH industries have seen their share increasing from roughly 70 per cent to 80 per cent, mostly on the back of a relative decline in INF and FIN. This sends a mixed message in the sense that Africa's exports to developing countries outside the region have grown faster than its exports to other parts of the world, but at the same time, the WTH share of exports to other developing countries has also grown, pointing to a larger share of services industries requiring, on average, lower-skill workers.

Meanwhile, Africa's exports to developed countries contrast markedly with those to other developing countries. Data point to an improvement in the likelihood that exports can promote development in the sense that shares of two high-skill components of BSR, namely INF and OBZ,<sup>8</sup> have grown at the expense of WTH. Yet the declining black line in the same panel reminds us that the performance of Africa's exports to developed countries was weaker than the performance of exports to non-African developing countries between 1995 and 2020. All this points to an ambivalent conclusion on the developmental effects of exports of services for this continent because more dynamism comes with more low-skill activities, while less dynamism in terms of foreign demand comes with a growing share of industries that rely more on high-skill workers.

We can reach similar conclusions for Latin America and the Caribbean. In terms of the export structure, the segment referring to developed economies shows a growing share for OBZ.<sup>9</sup> Yet the performance of the exports to this trading partner group between 1995 and 2020 was muted. In addition, irrespective of the trading partner, the relative size of WTH has remained very high in the region's exports, especially in intraregional trade and in exports to other developing countries. Overall, this empirical evidence does not support the view that intraregional trade in services is more developmental in Latin America and the Caribbean, nor is it possible to infer that extra-regional trade in services is necessarily more conducive to development.

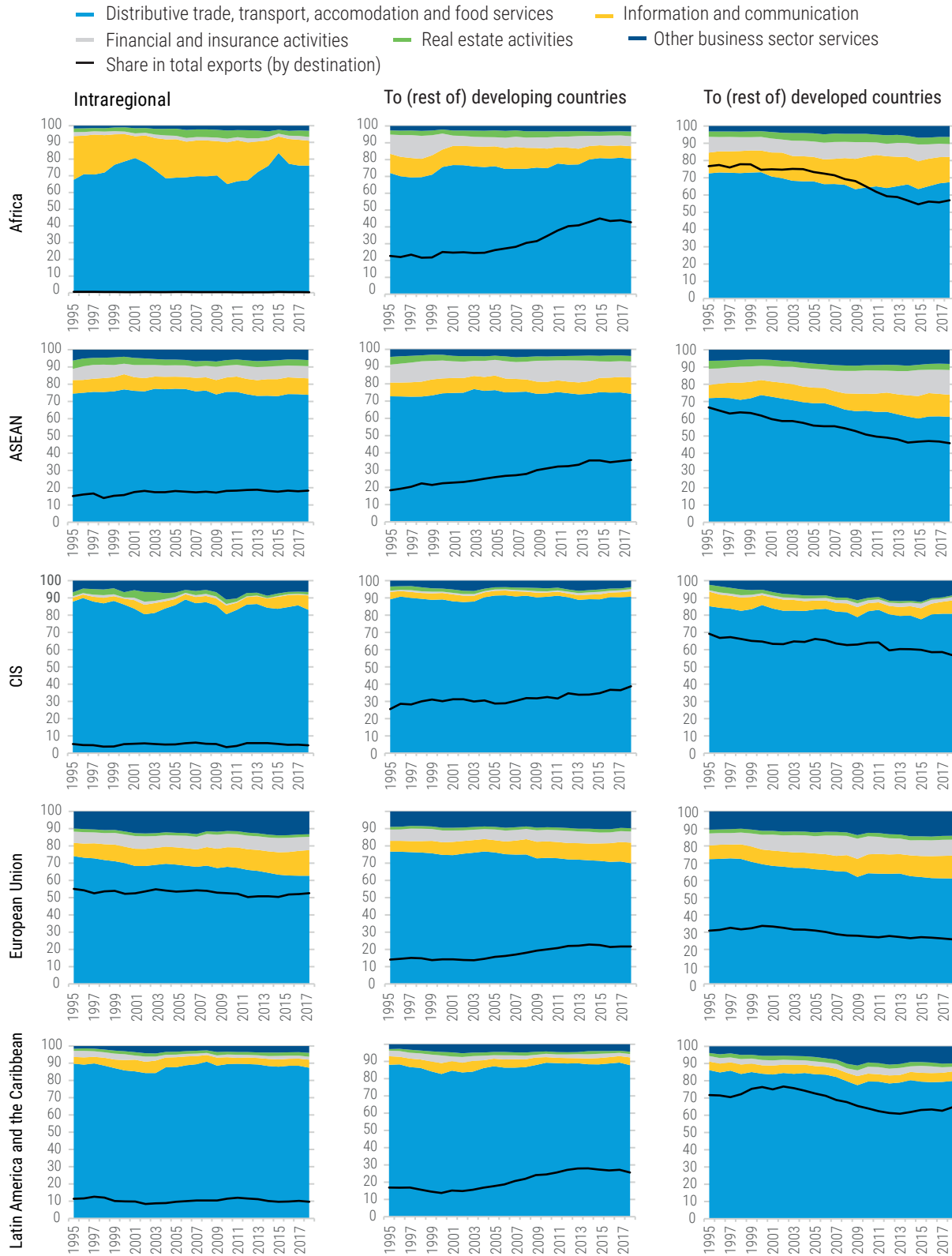
Our analysis of CIS relies on only two countries: Kazakhstan and the Russian Federation. It is therefore patchy, although the limited data hint at conclusions similar to those for Latin America and the Caribbean.

<sup>7</sup> Given the structure of the three underlying African economies, compared to the rest of the continent, data presented for Africa could be seen as a kind of upper bound in the sense that other less-developed African economies are less likely to have greater share of industry aggregates which require higher levels of education (i.e. INF, FIN, REA and OBZ) than the ones necessary, on average, for the services exports of WTH.

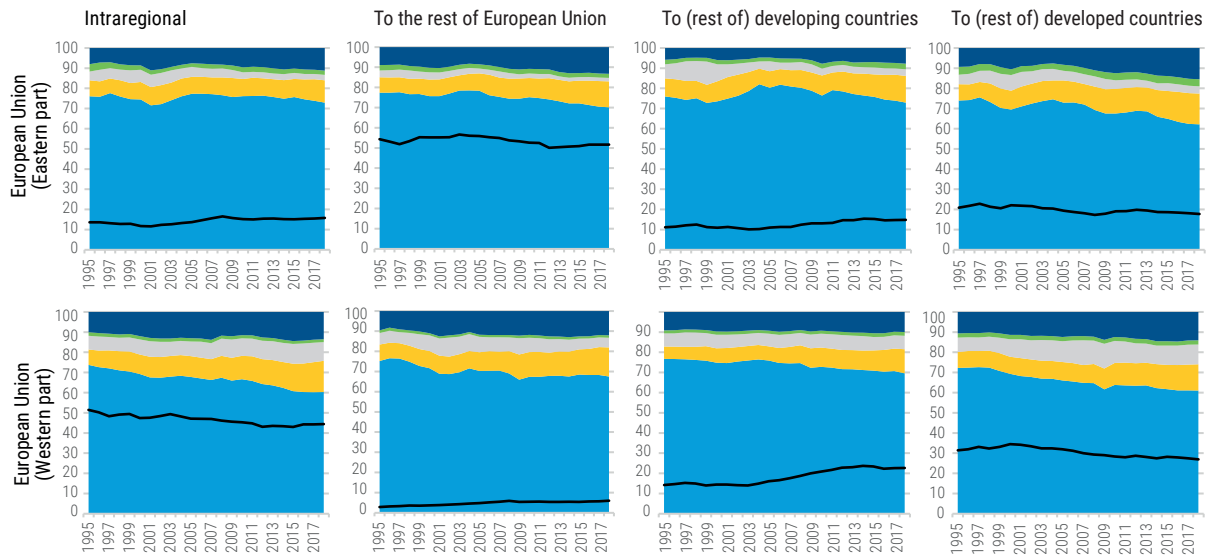
<sup>8</sup> OBZ includes "professional, scientific and technical activities" and "administrative and support services". Further investigations not reported in Figure 5.3 find these two subcomponents contributed roughly the same to the relative increase of the OBZ share during the 1995 to 2018 period.

<sup>9</sup> Unlike for Africa (see previous footnote), in the case of Latin America, "professional, scientific and technical activities" contributed much more to the increase of the OBZ share, even though the share relating to "administrative and support services" also registered positive growth.

**Figure 5.3** Composition of business service exports, selected country groups and industries, 1995–2018 (percentage)



**Figure 5.3** Composition of business service exports, selected country groups and industries, 1995–2018 (percentage) (cont.)



*Source:* UNCTAD secretariat calculations, based on OECD TiVA database.

*Note:* Underlying data correspond to the domestic value-added content of exports. Country coverage can be limited for some groups. Africa refers to only 3 countries (Morocco, South Africa and Tunisia), CIS to 2 countries (Kazakhstan and the Russian Federation), and Latin America and the Caribbean 6 countries (Argentina, Brazil, Chile, Colombia, Mexico and Peru). The country coverage for ASEAN and the European Union is complete. The eastern part of the European Union includes: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The Western part include: Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Spain and Sweden. Industries correspond to TiVA 2021 classification.

The ASEAN data suggest BSR exports of these two countries are likely to be conducive to development because their WTH shares are lower than in other developing regions, irrespective of their trading partners. In that sense, their BSR export structure does not differ much from the European Union in the late 1990s. The four sub-aggregates that require higher skills (INF, FIN, REA and OBZ) make up at least 30 per cent of ASEAN BSR exports, similar to the eastern part of the European Union, even in recent years. Another finding already observed for other developing groups is that ASEAN BSR exports to developed countries are again more conducive to development, though performance over time has been more subdued than ASEAN exports to other developing countries and to a lesser extent to intraregional exports.

The remaining panels of Figure 5.3 look at the European Union and its subdivision into East and West. The motivation for splitting the European Union thusly is to see whether differences arise given the difference in levels of development and the roles these levels play in terms of the organization of European value chains. The overall evolution of the structure in terms of industries confirms BSR exports are more concentrated in high-skill industries, and the shares of these industries have grown over time, especially for OBZ, INF and to a lesser extent FIN. These trends appear across all types of trading partners, albeit more saliently in high-skill industries, in both intraregional trade and exports to other developed countries.

In the East European Union, the structure of BSR exports is similar across the four considered trading partners, though data suggest they are slightly more conducive to development when this subregion exports to developed countries outside the European Union or to a lesser extent to the West European Union. Findings are similar when we look at the West European Union.

The main observations that emerge from our analysis of BSR exports for all regions can be summarized as follows.

- The structure of BSR exports in terms of industries seems more prone to development when regions export to (more) developed regions, yet the demand of these trading partners has been relatively subdued over time, resulting in declining market shares.
- Across developing regions, the structure of BSR exports from ASEAN is more conducive to development than the structure of BSR exports from Africa, Latin America and the Caribbean or CIS. We base this conclusion on the fact that ASEAN reports the larger share of high-skill industries in BSR exports.
- Unlike the merchandise exports described above, the sense that intraregional exports are more conducive to development is not clear in BSR exports. Having said that, while it has not been the most dynamic segment in terms of export destinations, intraregional trade, unlike exports to developed countries, has grown at the same rate as the trade registered by the total BSR exports in each region. This points to a certain resilience for intraregional trade, given the robust demand emanating from large fast-growing developing countries, most notably China. In other words, the relative increase of the share of other developing countries in total BSR exports observed in all developing regions has come at the expense of the exports to developed countries, not intraregional trade.

Findings for trade in services are ambivalent. This might partly be because TiVA export data are less complete, especially for some developing regions. Moreover, the underlying disaggregation in TiVA relies on a much smaller number of industries, thus precluding a deeper understanding of the business services sector. More concretely, unlike for merchandise exports, we cannot strongly affirm that intraregional trade in services is more or less conducive to development.

This leads to two broad take-away messages. First, there is a more similar structure in services exports than in merchandise trade in terms of trading partners. Second, as goods still represent the main component of total exports of goods and services, the findings for merchandise trade seem comparatively more important than those for trade in services. This suggests that, overall, total intraregional exports are more impactful than total extra-regional exports.

## C. DEVELOPMENT-ORIENTED TRADE INTEGRATION AND REGIONAL VALUE CHAINS

The intensification of cross-border production and market linkages in support of structural transformation cannot simply rely on tariff reductions and the elimination of other border measures. Having a trade liberalization agenda does not imply having a structural transformation agenda. This is especially true for mega-regional trade agreements extending the scope and depth of earlier, geographically more limited, bilateral and regional North-South trade agreements whose commitments often go far beyond border measures and tend to reduce policy space (*TDR*, 2006, 2014). Trade integration must be part of a broader development strategy that promotes regional specialization, economies of scale and mutual economic interdependence without preventing linkages among firms and across sectors at the national level to build a strong nexus between profits, investment and exports and allow each economy to upgrade and diversify its productive base (*TDR*, 2016). The establishment of virtuous cycles of rising productivity, increasing economic sophistication and growing intraregional trade can, in turn, underpin greater cooperation around a widening range of non-trade issues that emerge with closer economic interdependence and address emerging imbalances and divergences among participating countries that may, if they persist, undermine the stability of regional arrangements.

Such an approach is best described as developmental regionalism (*TDR*, 2007; UNCTAD, 2013; Davies, 2019) or open developmental regionalism to underline its close relationship with shallow trade agreements that do not unduly reduce the policy space available to developing countries to manage the trade-offs that accompany any move towards closer integration with multiple countries, to implement the collective actions that come with closer cooperation among those countries and to continue to support the broad range of development goals of an inclusive and sustainable development strategy. Developmental regionalism aims first and foremost at boosting productivity growth and creating jobs through economic diversification and technological upgrading. In this respect, closer trade integration among neighbouring countries, the development of regional infrastructure projects, cooperation on industrial policies and shared legal frameworks can unleash virtuous growth cycles and mediate the interface between global economic forces and domestic needs.

Rather than the derivation of formal trade agreements with deep commitments, the strategy involves the informal coordination of policies. Open developmental regionalism requires a stable macroeconomic and financial framework that supports fixed investment and the creation of productive capacity and employment, including by avoiding real exchange-rate instability and overvaluation and by fostering the provision of long-term investment finance (see next chapter). Moreover, policies must be coordinated both across policy areas within an economy and among countries in a region. Institutional structures such as those associated with a developmental state (*TDR*, 2016) are critical, as are joint infrastructure and industrial policies – broadly understood as shaping incentives for structural change and technological upgrading – that complement exchange-rate based international competitiveness with a view to avoiding dependence on cheap labour.

The provision of regionally oriented physical infrastructure, particularly in the form of customs, transport, energy and communication networks, is an indispensable element of developmental regionalism. Energy and water resource management remains a constraint on crop yields, but the process of structural transformation in many developing countries and regional cooperation in this particular area can create supply capacities that expand both trade and growth potential. It has been estimated, for example, that a well-coordinated addition to the irrigated area of Africa's drylands could increase cereal production by 52 per cent (Ward et al., 2016), and an increase in the share of public agricultural expenditure devoted to research and development could greatly increase the use of high-yielding varieties and hence yields (Gollin et al., 2021).

Regarding transport infrastructure, the orientation towards international trade may have led to the overloading (and deterioration) of infrastructure on the main export routes and inadequate funding for the arteries required for enhanced regional trade. Because tackling these challenges will often involve high sunk costs, long gestation periods and free-rider problems, there is a danger that neither market forces nor national government projects will provide effective solutions. Combined or common action by countries at the regional level are more likely to achieve sustainable results.

Similar considerations apply to industrial development and support for RVCs.<sup>10</sup> RVCs are characterized by stronger backward linkages, with many high value-added activities undertaken within a region. They may allow regional producers to export end products to a country within the region and to gain experience and build the local capacities needed to compete globally, thus providing a stepping-stone to global value chains (GVCs). Moreover, by creating income opportunities and domestic demand, such activities can leverage the links between domestic demand and production for the GVCs or RVCs that are critically important for inclusive economic growth.

That said, industrial policies to encourage RVCs face difficult trade-offs. For one, achieving a more efficient regional division of labour will enable economies of scale but also imply that specific countries specialize in specific activities or products and renounce the option of investing in others. In the short

<sup>10</sup> It should be noted that this discussion refers to bottom-up RVCs. These differ from RVCs in the European Union spurred by the integration of poorer South European countries in the 1980s and the low-wage Central European countries in the 1990s, combined with a reduction of trade costs through the creation of the Euro area.



run, this will imply the location of high value-added activities in some parts of the region, while others specialize in more basic activities, inevitably leading to diverging economic performance across the region and complicating the coordination of sectoral support policies. Moreover, entrenched business interests and established practices in a country's financial system will work to reproduce established production and investment structures, while complicating the provision of the investment finance required to create RVCs.

Addressing such trade-offs will require clear communication of the objectives and directions of regional integration agendas, as well as their complementarity and comparative benefits. This may prove difficult in regions without a regional identity. Nevertheless, strong disruptions, such as those wrought by the Covid-19 pandemic or a potential shift of production activities in GVCs, may be propitious moments to undertake such changes.

Similar considerations extend to constraints on diversification associated with a lack of interoperable regional digital payment systems and technological development. Most developing countries access technology from abroad and absorb it within local production systems, supported by national policies and institutions. Yet innovation systems may be devised with an explicit regional dimension involving collaborative research, training schemes and information gathering and may extend to complex institutional issues, such as those relating to the design of intellectual property rights or data management regimes. Regional collaboration will also be required to harmonize the business rules and laws required for RVCs, and resources must be pooled to ensure the effective management RVCs in light of changing needs and conditions.

The global economic restructuring and trend in international supply chains towards regionalization will require an adaptation of policy responses to different value chains and local contexts, not only because of differences in the governance structure of value chains but also because of differences in local and regional productive capacities. Supply-chain regionalization may be led by advanced economies and multinational enterprises involved in near-shoring or friend-shoring their sources to reduce supply-chain disruptions or protect technological advantages. But they may also be backed by a rise of middle-income consumers in a range of developing countries and expanding South-South trade and led by regional efforts to support the structural transformation and economic resilience of regions in the Global South.

Digitalization and intangible assets play a crucial role in international supply chains in high-tech sectors, such as electronics and the machinery and equipment industry, so the digital platforms, mostly from advanced economies, that provide the enabling digital infrastructure are likely to capture increasing shares of value added. The concentration of value added in these advanced economies will be further enhanced by the extent to which higher-technology activities are reshored in them, not only for economic but also for geopolitical reasons. The potential of developing countries to capture value added in such supply chains depends on their digital industrial policy, discussed in the previous section, and their establishment of a digital and data infrastructure and a related local and regional digital and data regulatory framework – this is instrumental in ensuring local and regional firms' confidence in the confidentiality and security of their data. Both elements will be required to improve the bargaining power of local and regional firms in determining the location of supply chain related digital activities.<sup>11</sup>

RVCs may be easier to create when forces within developing regions lead the efforts to do so, the diversification of suppliers increases opportunities for new entrants and there are important regional end markets. This is likely to be the case in relatively simple manufacturing activities, for example, the apparel industry, where labour costs and market access conditions, such as those set in trade agreements, play an important role. But it may also apply to technologically more sophisticated areas, such as the automotive sector. It has been prominent in structural transformations because of its

<sup>11</sup> ASEAN's Framework for Data Protection, Digital Framework Agreement, Data Management Framework and the Model Data Transfer Law (MTT) are examples of attempts to provide regionally consistent rules to make the use of data compatible at the regional level.

multiple linkages: sectors with widespread linkages offer more opportunities to create value added, gain experience and build capacities in design, marketing, branding and distribution at the local and regional levels particularly to the extent to which regional tastes and consumer demands differ from those in advanced country markets. One recent study (Mayer, 2021) showed how access to data on local and regional consumer tastes can create a comparative advantage for developing countries with manufacturing capacities and allow them to re-bundle production stages by replicating value chains but directing them at local and regional markets.

Examples of RVCs in the automotive industry in ASEAN indicate the role of industrial policy in managing foreign direct investment (FDI) inflows and shaping domestic and regional supply chain participation as a stepping stone to industrialization and diversified regional trade (e.g., Natsuda and Thoburn, 2021). Crucial determinants of the overall success and the success in individual regional economies were flexibility (including to changing trade regimes such as brought about by the Uruguay Round agreements) and the timing and sequencing of policymaking, such that trade measures support the structural transformation at different development stages of both the regional economies and the local and regional supply networks in their automotive sectors. Moreover, effective industrial policy<sup>12</sup> is supported by regional monetary arrangements, as well as regional legal frameworks, that, in addition to trade, govern regional investment, capital flows and business practices, with a view to mediating the interface between regional and global developments in these areas.

## D. NEW CHALLENGES TO REGIONAL INTEGRATION: THE DIGITAL ECONOMY AND CLIMATE CHANGE

Deep trade agreements, including emergent mega-regional trade agreements, and recent discussions at the World Trade Organization (WTO) have devoted considerable attention to a wide range of new issues, most prominently the digital economy and climate change.<sup>13</sup> Other issues are gender and human rights, labour standards and the like, especially in mega-regional trade agreements. Our main argument in this section is that these issues do not lend themselves to trade agreements. Instead, they require a large enough policy space that emerging challenges can be addressed in a way that fosters tangible economic, social and environmental benefits. A developmental approach to regionalism would allow multidimensional progress on these issues and move towards a more inclusive multilateralism.

### 1. The digital economy: challenges of data governance

There is wide agreement that data are at the heart of the digital economy and, as such, represent a crucial economic asset. However, although data affect many economic areas – including trade, finance, production, market structure and taxation – data issues are increasingly systemic, impacting health, the environment, national security and human rights, such as privacy. To formulate appropriate policy responses to the evolving digital economy from a developmental perspective, it is important to understand the multi-dimensional nature of data. Gaining such an understanding is hampered by the absence of a generally accepted definition of data or a measure of data flows that would allow

<sup>12</sup> An important ingredient of industrial policy in the region is “product champion policy”. Earlier industrialization experiences in East Asia used “national champion policy”, targeting the development of particular national automobile makers, but the Uruguay Round agreements made these considerably more difficult to apply. Product champion policy aims at steering demand towards vehicle segments with a potential for economies of scale even in relatively small domestic or regional markets.

<sup>13</sup> The discussion in this section focusses on the relationship between these issues and trade regionalism. For a broader discussion of the digital economy, see TDR, 2017, 2018; for discussion of climate change, see TDR, 2019, 2020, 2021.

the economic and social values of data to be traced and thus ensure an inclusive and fair distribution of their related benefits. It is also important to understand that raw data have little economic value. Rather, it is the capacity to access, control, process, analyse and use data that provides economic benefits, and the size of any such benefit is dependent on the context (*TDR*, 2018; UNCTAD, 2021b).

To harness the benefits data can provide to economic development, developing countries need to bridge existing digital and data gaps. Digital industrial policy will be an important instrument to achieve that end. The aim of such policy should be to identify the development objectives of engaging in the digital economy and use these objectives as a basis for building a regulatory framework for the digital economy and data governance, establishing soft and hard digital infrastructure (such as the building of data centres and the capacity to store, process and analyse data) and most importantly targeting measures to increase the data-related value-added content in the production and export of goods and services (*TDR*, 2018). In manufacturing supply chains, this can be done in the pre-production stage through data processing and analysis, in the production stage through robot-based automation and in the post-production stage through e-commerce, while in the services sector, it can be related to the digitized treatment of health-related issues or to the provision of digitized services as an input to manufacturing (e.g., Mayer, 2021).

The objective of regulatory frameworks should be to move developing countries away from the periphery of the digital economy, the financial centres of which are concentrated in the advanced countries of the North. One key objective of global regulatory frameworks in the digital economy should be to address global competition and antitrust issues (*TDR*, 2018; UNCTAD, 2021c). Although social objectives, consumer protection and data confidentiality are clearly important, a perspective that puts digital industrialization at its centre is likely to have more developmental impact. Many developing countries do not yet have national regulatory frameworks that govern who can store, process and use their data.<sup>14</sup> The absence of such national legal frameworks risks providing existing global digital platforms, most of which are headquartered in the United States and China, first-mover advantages and monopoly powers. With no legal frameworks in place, these platforms can use the data of developing countries and appropriate the economic value, leaving little if any benefit to those providing the data or the local economy. Similarly, jobs created in the digital economy in developing countries tend to be low productivity and precarious, with millions of people employed in “microwork”.

There may be a presumption that developing countries can only influence how international digital rules are framed by participating in related debates. However, the developmental outcome of international regulatory frameworks depends on the perspective from which these debates are approached and the inclusiveness of the forum in which they are held.

Approaches to data governance in trade agreements have increasingly supported restrictions on data flows, treating these like any other trade barrier and generally minimizing them. This is the case for the e-commerce chapters of mega-regionals, with related commitments going much further than e-commerce and including issues related to data localization, national security and technological leadership, such as in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Including data issues in mega-regional agreements exposes the digital economy to a race for leadership in technological developments, given the economic and strategic advantages accrued from controlling the data and related digital technologies. This risks consolidating oligopolistic market structures and hampering inclusiveness, thereby amplifying long-standing inequalities between developed and developing countries in the digital economy.

<sup>14</sup> An important exception is China. Other exceptions include Saudi Arabia's National Strategy for Data and AI (see [https://ai.sa/Brochure\\_NSDAI\\_Summit%20version\\_EN.pdf](https://ai.sa/Brochure_NSDAI_Summit%20version_EN.pdf)), India's Data Protection Bill 2021 (see [https://trilegal.com/knowledge\\_repository/the-data-protection-bill-2021/](https://trilegal.com/knowledge_repository/the-data-protection-bill-2021/)) and its Draft National E-Commerce Policy (see [https://dpiit.gov.in/sites/default/files/DraftNational\\_e-commerce\\_Policy\\_23February2019.pdf](https://dpiit.gov.in/sites/default/files/DraftNational_e-commerce_Policy_23February2019.pdf)), as well South Africa's Draft National Policy on Data and Cloud (see [https://www.gov.za/sites/default/files/gcis\\_document/202104/44389gon206.pdf](https://www.gov.za/sites/default/files/gcis_document/202104/44389gon206.pdf)). Other countries (including Indonesia, Malaysia and Sri Lanka) are finalizing their regulations. For broader discussion, see UNCTAD, 2021b, pp. 136–138; Aaronson, 2022.

Endeavours to subject the digital economy to trade norms and commitments is apparent also in recent activities related to the Joint Statement Initiative on e-commerce at the WTO.<sup>15</sup> The legal standing of the Initiative is open to question, however, and some argue its justifications rely on tenuous interpretations of WTO rules (e.g., Kelsey, 2022). Moreover, the initial texts<sup>16</sup> determining the direction and agenda of these rapidly evolving activities may be seen as reflecting the interests of advanced economies and big digital platforms, without accommodating the interests of those at the periphery of the digital economy. In fact, ongoing regulatory activities in the United States and the European Union deviate from the main thrust of these texts and explicitly address market concentration. For example, the European Union Digital Market Act sees competition law as an *ex-ante* instrument that sets out what firms are allowed to do and what not, although it makes important exceptions for small and medium-sized enterprises, probably to protect European firms.<sup>17</sup> In the United States, in October 2020, the majority staff of the Congress House Subcommittee on Antitrust, Commercial and Administrative Law published a set of recommendations to promote competition in technology markets, and in June 2021, the House Judiciary Committee advanced six bills that paralleled many of these recommendations, focusing on the anticompetitive impacts of self-preferencing, mergers and acquisitions, data accumulation and network effects related to digital platforms.<sup>18</sup>

There are general doubts as to the appropriateness of attempts to govern the digital economy and data through trade agreements. For one, a large proportion of data is not linked to any trade flow. This is the case, for example, with the use of foreign online services, such as Internet search engines or social media platforms, where users generate a cross-border flow of data that the service provider can process and monetize without engaging in any trade flow. Trade rules are more generally developed for goods and services that are produced and cease to exist when they are consumed. In contrast, using data does not imply their consumption and cessation of existence. Rather, data are intangible and non-rival. Many people can use the same data simultaneously or over time without their depletion. Data also often involve positive externalities; for example, they can be combined with other data or show network effects of digital platforms (*TDR*, 2018).

Two main sources of distortion in the digital economy are high market concentration and the proliferation of anticompetitive practices. New policies must address the power they give to large digital enterprises to influence the rules of the game to their favour. These distortions are facilitated by the dismantling of large parts of regulations designed to curtail market monopolization and corporate rent seeking and the incomplete updating of existing antitrust and anti-monopoly laws to account for the specific challenges posed by the digital economy. More complete regulation could start with The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the United Nations General Assembly in 1980 (UNCTAD, 2000). It could also take into account the recent efforts of United States and European Union regulators to curb the dominant positions of global digital platforms.

<sup>15</sup> At the 11th WTO Ministerial Conference in December 2017, Ministers declared they would pursue the 1998 Work Programme on Electronic Commerce on the existing mandate, but on the same occasion, a group of 71 WTO members agreed to initiate exploratory work towards future WTO negotiations on trade-related aspects of e-commerce. In January 2019, 76 WTO members confirmed in a joint statement their intention to commence these negotiations, agreeing to “seek to achieve a high standard outcome that builds on existing WTO agreements and frameworks with the participation of as many WTO members as possible” (see [https://www.wto.org/english/tratop\\_e/ecom\\_e/joint\\_statement\\_e.htm](https://www.wto.org/english/tratop_e/ecom_e/joint_statement_e.htm)). See also UNCTAD, 2020.

<sup>16</sup> The European Union stated: “Most proposals broadly align with the topics put forward by the EU” (see [https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/659263/EPRS\\_ATA\(2020\)659263\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/659263/EPRS_ATA(2020)659263_EN.pdf)). Moreover, “The US proposal is not public, but a [now publicly available] leaked communication resembles the digital trade provisions of the US–Mexico–Canada Agreement (USMCA)” (see <https://worldtradelaw.typepad.com/ielpblog/2019/05/us-wto-e-commerce-proposal-reads-like-usmca.html>).

<sup>17</sup> See <https://www.europarl.europa.eu/news/en/press-room/20220315IPR25504/deal-on-digital-markets-act-ensuring-fair-competition-and-more-choice-for-users>.

<sup>18</sup> See [https://judiciary.house.gov/uploadedfiles/competition\\_in\\_digital\\_markets.pdf](https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf); and <https://www.nytimes.com/2021/06/23/technology/big-tech-antitrust-bills.html>.

Regional collaboration frameworks on e-commerce could be a powerful complement to such global efforts (UNCTAD, 2018, 2021b). Digital and data gaps make it difficult to reach consensus on how to harmonize existing rules and standards at the global level, but these gaps tend to be much narrower at regional levels. Regional cooperation on capacity development and the creation of digital infrastructure and data-sharing mechanisms could play a crucial role in investment and competition policies supporting the growth of enterprises in developing countries and maximizing the inclusiveness and developmental impact of the digital economy.

The ASEAN regional cooperation frameworks may be a good example in this context.<sup>19</sup> The ASEAN Economic Community Blueprint 2025 highlights the importance of e-commerce as a channel for cross-border trade and investment. This focus was substantiated in the ASEAN Agreement on E-Commerce, which entered into force in December 2021. In it, ASEAN members recognize the importance of allowing information to cross borders “provided that such information shall be used for business purposes, and subject to respective laws and regulations” (para. 4(a)). They agree to facilitate cross-border e-commerce by working towards eliminating or minimizing barriers to the flow of information across borders, subject to safeguards that ensure security and confidentiality of information and when other legitimate public policy objectives so require. The Framework on Personal Data Protection, a second ASEAN agreement of this nature, “serves to strengthen the protection of personal data in ASEAN and to facilitate cooperation among the Participants, with a view to contribute to the promotion and growth of regional and global trade and the flow of information” (para 1), but this “Framework serves only as a record of the Participants’ intentions and does not constitute or create, and is not intended to constitute or create, obligations under domestic or international law and will not give rise to any legal process and will not be deemed to constitute or create any legally binding or enforceable obligations, express or implied” (para 2).<sup>20</sup> One important characteristic of these agreements is that in line with the ASEAN way, they establish cooperation that is flexible enough to accommodate countries’ different digital development trajectories, but they do not establish digital economy governance in the form of legally enforceable commitments. Such flexibility contrasts with the binding commitments in mega-regional trade agreements, such as CPTPP.

Approaching the digital economy from a development perspective and ensuring inclusiveness of related governance frameworks would probably be best achieved by the United Nations and its 193 Member States (*TDR*, 2018; UNCTAD, 2021b; United Nations, 2019). Contrary to the narrow trade angle, the United Nations can adopt a systemic approach to reflect the specificities of data flows, taking into account relationships with competition, taxation, data access and consumer protection. Deliberations can be based on multistakeholder exchanges that include government representatives from various ministries, as well as experts and representatives of organizations that deal with competition, taxation, technology, consumer protection and other issues related to the digital economy.

## 2. Climate change

Discussions at the WTO, megaregional trade agreements and unilateral trade measures indicate increased attention to issues related to the environment and climate change. Although formal negotiations on a plurilateral Environmental Goods Agreements stalled in 2016 (*TDR*, 2021), some members of the WTO initiated Trade and Environmental Sustainability Structured Discussions (TESSD) and The Informal Dialogue on Plastics Pollution and Environmentally Sustainable Plastics Trade (IDP) in 2020.<sup>21</sup> These member-led plurilateral initiatives have gathered steam, giving rise to two ministerial

<sup>19</sup> For the Digital Transformation Strategy for Africa (2020 to 2030), see <https://au.int/en/documents/20200518/digital-transformation-strategy-africa-2020-2030>.

<sup>20</sup> For the respective documents see <https://aseandse.org/wp-content/uploads/2021/02/AEC-Blueprint-2025-FINAL.pdf>; <https://asean.org/asean-agreement-on-electronic-commerce-officially-enters-into-force/#:~:text=The%20E%2DCommerce%20Agreement%2C%20which,strengthen%20capacity%20to%20implement%20them>; <https://asean.org/wp-content/uploads/2012/05/10-ASEAN-Framework-on-PDP.pdf>.

<sup>21</sup> For a recent discussion of TESSD, see Bellmann, 2022.



statements. One is co-sponsored by 71 members as part of TESSD and includes a commitment to launch dedicated discussions on how “trade-related climate measures and policies can best contribute to climate and environmental goals and commitments while being consistent with WTO rules and principles”. Another on fossil fuel subsidy reform is co-sponsored by 45 WTO members.<sup>22</sup>

Outside the WTO, sustainability chapters in bilateral and plurilateral trade agreements have been the main channel through which climate concerns are reflected in the trading system. These chapters have arguably mainly helped to secure the regulatory advantage of industrialized economies as global standard-setters (Goldberg, 2019). In 2019, discussions began on an Agreement on Climate Change, Trade and Sustainability (ACCTS) between Costa Rica, Fiji, Iceland, New Zealand, Norway and Switzerland, with a focus on liberalizing “environmental goods and services”, eliminating “harmful” fossil fuel subsidies and encouraging eco-labelling.

Around these ongoing discussions, developed countries have tabled unilateral trade-environmental proposals, such as the European Union’s Carbon Border Adjustment Mechanism, are establishing new sectoral deals, such as the European Union-United States Green Steel Deal, and have coordinated their positions, notably through G7 trade ministers’ meetings. Developing countries, by contrast, have not yet formulated a coordinated and coherent approach to the trade and climate nexus.

Although better linkage of climate and trade objectives may seem a positive step forward, the majority of these initiatives lack a strong development dimension. As an example, the OECD has identified a Combined List of Environmental Goods (CLEG) of 268 products at the harmonized system (HS) six-digit level, but around 60 per cent of these products fall under the seven industries identified as high CO<sub>2</sub> emitting industries. Any agreement to liberalize the trade specified in CLEG will mostly benefit the exporters of these products, and these tend to be advanced economies. At the same time, an analysis of the tariff revenues collected (using applied duties) on the imports of items on the CLEG shows that in 2019, developing countries collected \$15 billion (*TDR*, 2021). Reducing tariffs on these goods, many of which are not climate-enhancing, would disproportionately benefit advanced economies and significantly reduce domestic resource mobilization for developing countries precisely when they are facing mounting economic pressures.

When assessing the various producer and consumer fossil fuel subsidies deployed around the world, it is crucial to remember the very different position of developing countries, where around 940 million people continue to lack access to electricity,<sup>23</sup> and the objective must be to increase energy access, not decrease it. For this reason, decreasing fossil fuel subsidies has often led to political unrest, as it essentially becomes a regressive measure impacting the most economically vulnerable. These subsidies need to be rechannelled to renewable energy sources, but transition in developing countries will need to move at a different pace to prevent political and economic instability.

A recent UNCTAD report estimates the European Union proposal of a carbon border adjustment measure (CBAM) will reduce global carbon emissions by not more than 0.1 per cent while decreasing global real income by \$3.4 billion, with developed countries’ incomes rising by \$2.5 billion and developing countries’ incomes falling by \$5.9 billion (*TDR*, 2021). Put simply, the tariffs imposed will have adverse implications for the foreign exchange earnings of developing countries while having little impact on global emissions.

These concerns about a missing developmental dimension in trade commitments combine with mounting evidence that industrialized economies are outsourcing pollution (Copeland et al., 2021, p. 6, 15) at the same time as they avail themselves of industrial policy tools to bolster their dominance within emerging green industries.

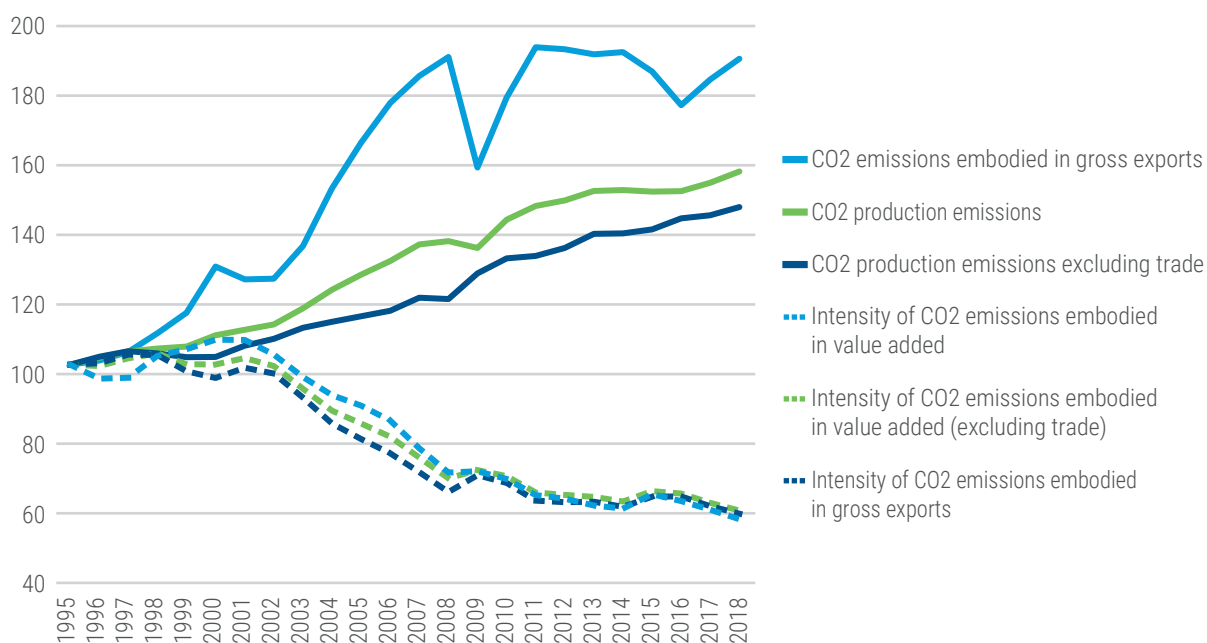
Extra-regional trade plays an important role in these trends. Between 1995 and 2018, CO<sub>2</sub> emissions embedded in global trade increased by 90 per cent, from 4132 tonnes to 7464 tonnes, thereby

<sup>22</sup> See [https://www.wto.org/english/news\\_e/news21\\_e/envir\\_15dec21\\_e.htm](https://www.wto.org/english/news_e/news21_e/envir_15dec21_e.htm).

<sup>23</sup> See <https://ourworldindata.org/energy-access>.

increasing its share in global CO<sub>2</sub> emissions from 23.9 per cent to 29 per cent (Figure 5.4). Over the same period, global emissions grew by 57 per cent, and global emissions excluding trade by 46 per cent. Meanwhile, the emissions intensity of trade declined slightly faster than that of territorial production, partly because of rising trade in services, but the former remained 24 per cent higher in 2018. These figures underline that the existing regulations, including in trade agreements, have not decoupled GDP (especially trade) from fossil fuel extraction and CO<sub>2</sub> emissions, as hopes or claims of “green growth” are increasingly unsubstantiated by empirical investigations (Haberl et al., 2020).

**Figure 5.4** Evolution of global trade-embodied and production emissions of CO<sub>2</sub> and their intensities, 1995–2018 (index numbers, 1995=100)



Source: UNCTAD secretariat calculations, based on OECD TiVA and TiVA-TECO2 databases.

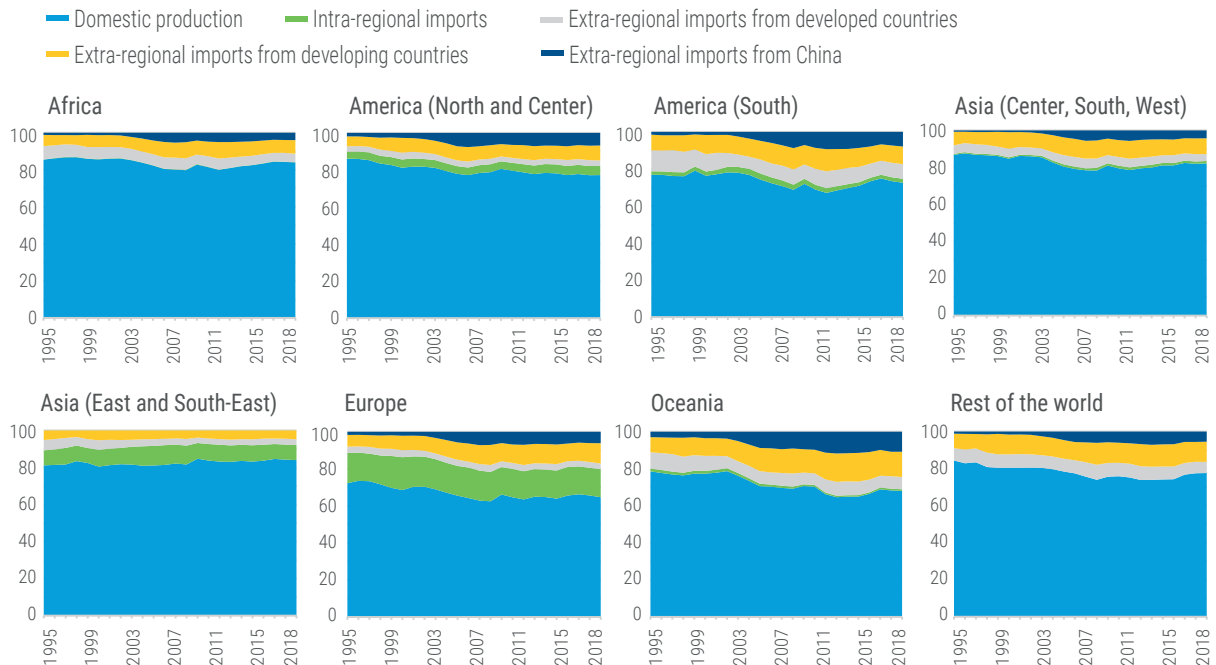
Note: All series are aggregated at the global level and depict their own evolution since 1995. CO<sub>2</sub> production emissions represent the sum of territorial emissions. This sum is composed of CO<sub>2</sub> emissions embodied in gross exports, and of a residual defined as CO<sub>2</sub> emissions excluding trade. Intensities represent the amount of CO<sub>2</sub> emissions (of production, gross exports or production excluding trade) per monetary unit.

Evidence suggests extra-regional imports account for the lion’s share of trade-embodied CO<sub>2</sub> emissions, and most of these originate in developing countries.<sup>24</sup> As Figure 5.5 shows, emissions caused by intra-regional trade have expanded most rapidly in East Asia, whereas in Europe and Oceania, trade-embodied emissions from intra-regional trade declined slightly in absolute terms between 1995 and 2008.

<sup>24</sup> Countries included in TiVA-TECO2 by continent/region: Africa (3): MAR, TUN, ZAF. North America (4): CAN, CRI, MEX, USA. South America (5): ARG, BRA, CHL, COL, PER. Central, Western and South Asia (6): CYP, IND, ISR, KAZ, SAU, TUR. East and South-East Asia (15): BRN, CHN, HKG, IDN, JPN, KHM, KOR, LAO, MMR, MYS, PHL, SGP, THA, TWN, VNM. Europe (32): AUT, BEL, BGR, CHE, CZE, DEU, DNK, ESP, EST, FIN, FRA, GBR, GRC, HRV, HUN, IRL, ISL, ITA, LTU, LUX, LVA, MLT, NLD, NOR, POL, PRT, ROU, RUS, SVK, SVN, SWE. Oceania (2): AUS, NZA. Rest of the world: all remaining countries.



**Figure 5.5** Shares of carbon emissions embodied in final demand by sources, selected country groups, 1995–2018 (percentage)



Source: UNCTAD secretariat calculations, based on OECD TiVA-TECO2 database.

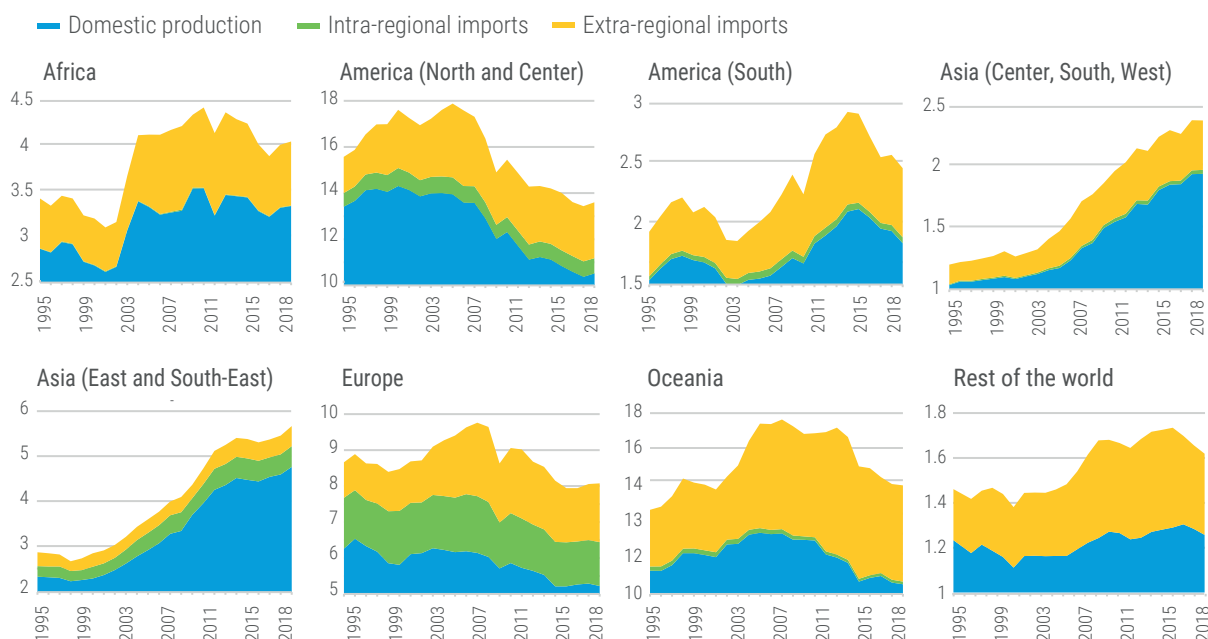
Note: CO<sub>2</sub> emissions embodied in final demand are aggregated for each region and decomposed according to their geographical origin (i. domestic emissions, ii. emissions imported through intra-regional imports or extra-regional imports from either iii. developed countries, iv. developing countries, or v. China). For East and South-East Asia emissions imported from China are included in intra-regional imports. Rest of the world being a single entity in the database, it has no emissions from intra-regional imports.

Given the limited progress in reducing global trade-embodied CO<sub>2</sub> emissions, the per capita emissions of poorer and richer regions still have a ratio 10 to 1, respectively (Figure 5.6). While final demand emissions amounted to 1.6 tonnes of CO<sub>2</sub> emissions per person in smaller developing countries (rest of the world (RoW)) in 2018, with 0.36 tonnes imported, they represented 15.4 tonnes in Oceania, 13.6 tonnes in North America and 8.1 tonnes in Europe, with extra-continental imports amounting to 4.8 tonnes, 2.4 tonnes and 1.6 tonnes in those regions, respectively.

These numbers support recent more detailed empirical findings (Dorninger et al., 2021) showing trade enables a structural and massive South to North material drain representing an “ecologically unequal exchange”. For 2015, Dorninger and colleagues estimated that South to North trade flows embodied a net transfer (i.e. net appropriation by high-income countries) of 10.1 billion tonnes of raw materials, 379 billion hours of human labour, 22.7 EJ of energy and 800 million hectares of land.

Because trade liberalization creates larger markets and opens possibilities for economies of scale, it also strengthens global material extraction, production, consumption and waste. In conventional accounting, this improves consumer welfare, but offsetting trends include growing employment vulnerability and inequality induced by trade, particularly in the Global North (TDR, 2018), and growing material extraction and pollution offshoring affecting populations in the Global South. Multilateral initiatives and regional trade agreements are designed to eliminate tariffs and boost trade flows, and the evidence suggests they also lead to a significant increase in carbon emissions (Tian et al., 2022).

**Figure 5.6** Per capita carbon emissions embodied in final demand by sources, selected country groups, 1995–2018 (tons)



Source: UNCTAD secretariat calculations, based on OECD TiVA-TECO2 database.

Note: Per capita CO<sub>2</sub> emissions are aggregated for each region and decomposed according to their geographical origin (i. domestic emissions, ii. emissions imported through intra-regional imports, or iii. extra-regional imports). Rest of the world being a single entity in the database, it has no emissions from intra-regional imports.

Rather than building a trade and environment agenda on trade liberalization related to commitments in trade agreements, making the most of the coherence between special and differential treatment and the United Nations Framework Convention on Climate Change (UNFCCC) principle of common but differentiated responsibilities may offer a better point of departure for a development-oriented approach to the trade-climate nexus (*TDR*, 2021). A related positive Trade and Environment Agenda would focus on the following: (i) facilitating patent-free green technology transfer; (ii) providing additional finance to promote trade of environmentally sustainable products, such as through the Trade and Environment Fund; (iii) building technical capacities, especially of least developed countries (LDCs) and small island developing states (SIDS), in setting up climate-smart infrastructure and broader adaptive measures; (iv) providing incentives like preferential market access based on progress towards nationally committed goals or incentives for promoting trade of renewables and substitutes; and (v) ensuring adequate policy and fiscal space for developing countries to design their trade policies around environmental goals.

This more multidimensional approach could translate into deeper economic cooperation and planning at the regional level on a series of climate-critical sectors, such as energy, waste, food and infrastructure. By pooling resources, capacities and expertise, regionally devised development plans could build-in resource efficiency from the beginning. As climate impacts rarely stay within borders, such regional developmentalism would become an adaptation measure, strengthening regional resilience to systemic shocks. A central aim should be to tackle ecologically unequal exchange, retaining materials, labour and land to promote developmental ambitions. At the same time, advanced economies will need to regulate for rapid mitigation within their jurisdictions, tackling their dependency on over-consumption.

## E. TOWARDS A COMPLEMENTARY RELATIONSHIP BETWEEN REGIONALISM AND MULTILATERALISM

That international trade can contribute to structural transformation and help establish sustained and inclusive growth is firmly grounded in economic theory (e.g., Colantone et al., 2022; von Arnim, 2017). Successful developers, particularly in East Asia, have used trade to complement the traditional drivers of sustained growth and development. However, the many factors considered critical for the prosperity-enhancing effects of international trade to materialize do not emerge spontaneously and are often absent in today's highly interdependent world. If aggregate demand and global growth are weak, financial instability is endemic and international trade in goods and services is dominated by a relatively small number of large firms, trade runs the risk of creating more losers than winners (Gallagher and Kozul-Wright, 2022).

While the external economic environment has a major effect, the commitments embodied in trade agreements also shape the extent and nature of a country's integration and economic development prospects. It is therefore vital that these commitments respond to development priorities rather than the narrow interests of a few large corporations, whether multinational or domestic (*TDR*, 2014, 2018).

Unfortunately, trade rules have increasingly come to foster incentives skewed to boosting cost competitiveness through labour market flexibility and wage restraint and to crushing or buying out competitors, rather than boosting profitability through investment and increased productivity. The many rules and regulations in the WTO agreements, especially in the many bilateral and regional FTAs between developed and developing countries, constrain the use of industrial policy and are unlikely to support aspirations to enhance the structural transformation and diversification of developing countries. Without special and differential treatment and policy space, it will be difficult for developing countries to transit towards diversified and higher value-added activities in a world facing widening inequality and impending disruptive technological change (*TDR*, 2006, 2014; Davies, 2019).

The increasing attention to geopolitics in the design of trade policy reflects growing tensions at the global level that are challenging the rationale for multilateralism. Greater fragmentation also leads to diverging interests which are hard to reconcile, weakening the appetite for, and effectiveness of, the global coordination needed to respond to current global challenges. As a result, regional identities and historically embedded norms and values may come to play a more relevant role and shape distinct regional policy orders. Managing economic interdependence in such a polycentric world will require achieving a more synergetic relationship between global institutions and regional arrangements.

A constructive and cooperative approach to multilateralism remains paramount. An inclusive multilateral trading system must accommodate the diverging interests of the largest trading nations but must also broaden the space for development policy. This implies seeing the multilateral trading regime as a mechanism by which trade globalization and the nation state are not competitors but are mutually reinforcing.

Multilateralism is beneficial for developing countries because individually they have weak bargaining power vis-à-vis the rich countries. Moreover, multilateralism as a central pillar of global trade governance provides transparency, security and predictability in global trade relations. Trade regionalism can risk marginalizing the rulemaking function of the WTO and the multilateral trading system. But recognizing the virtues of the multilateral system does not mean defending the status quo. If the multilateral system is not made more inclusive, multilateralism may be eclipsed by mega-regional trade agreements driven by the most powerful nations.



This implies that developing countries will need to be engaged in multilateral trade governance while recognizing the possible advantages of open developmental regionalism in areas that do not lend themselves to trade rules and/or where these countries do not yet have the capacity to engage in binding multilateral commitments. In those areas, open developmental regionalism can offer a bulwark against an increasingly challenging world order. When combined with the rolling back of elements of the multilateral trade agenda that have encroached too far into the responsibilities of the state and the adoption of a more integrated approach to the different components of the multilateral architecture (*TDR*, 2016), open developmental regionalism may also help to remedy the insufficient developmental focus of existing multilateral regimes, as demonstrated by the inadequate attention to the “in-built” agenda of the Uruguay Round agreements, especially on agriculture and implementation issues in the operationalization of special and differential treatment, the inability to conclude the Doha Round, the envisaged changes in special and differential treatment and the challenges to consensus decision-making.

For regionalism to support multilateralism, the connections between regional and global governance must be properly managed. FTAs cannot mandate lower standards than WTO rules because doing so would risk WTO members suing parties to the regional agreement for failing to comply with WTO rules. Yet experience tells us it is difficult and takes a long time to amend and add flexibilities to the implementation of WTO commitments. For example, such added flexibilities could have been obtained (i) by creating an expeditious solution to deal with TRIPS restrictions on exporting medicines made under a compulsory licence that was mandated in 2001, but it took 15 years before the amendment to the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement came into force, and the amendment has been widely criticized by several observers as unworkable;<sup>25</sup> (ii) by agreeing to longer transition periods, such as in Trade-Related Investment Measures (TRIMs) agreements proposed by developing countries as an implementation issue, but despite a 2001 mandate (including that they could be an early harvest of the Doha Round), they still have not been agreed upon; or (iii) by allowing countries which graduate from LDC status to continue enjoying LDC status for 12 years after graduation, but this has not yet been agreed to either.

Contrary to the deep FTAs of the 1990s and early 2000s or the recent mega-regionals inspired by the Trans-Pacific Partnership (TPP) which aim at extending the era of hyper-globalization, open developmental regionalism could help developing countries' voices be heard and reinforce South-South cooperation towards achieving a more development-oriented international trade governance. Pursuing regionalism in a form that remains open and developmental may yield fresh insights into the dynamics of trade governance that would support sustainable development in the Global South. An open and pro-active regional trade governance could shield developing economies from adverse global effects and not simply make them wait for such effects to occur and then adopt national policy to contain their economic and social impacts. In terms of rulemaking, open developmental regionalism would limit binding commitments to border measures, while relying on cooperation and creating flexible policies that aim at regional harmonization of behind-the-border trade measures as, for example, in the ASEAN model. Supported by institutional structures such as the developmental state and augmented by cooperation in non-trade areas and regional regulatory frameworks that manage the interface between the global and regional economies, open developmental regionalism may thus also facilitate the management of the diverging interests and sensitivities of developing and developed countries for a more inclusive and developmental international trade governance.

<sup>25</sup> See [https://www.citizen.org/wp-content/uploads/TRIPS-waiver\\_Existing-TRIPS-Flexibilities-Unworkable-for-Scale-Up-of-Covid-19-Medicines-Production-.pdf](https://www.citizen.org/wp-content/uploads/TRIPS-waiver_Existing-TRIPS-Flexibilities-Unworkable-for-Scale-Up-of-Covid-19-Medicines-Production-.pdf).

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