

D Re-globalization to reduce poverty and inequality

This chapter discusses how fragmentation could have a negative impact on growth, poverty and inequality, and how re-globalization could help to ensure that the gains from trade are spread more broadly both between and within economies. Opening up trade in agriculture and services and developing new e-commerce rules could boost growth, reduce poverty and make the global economy more inclusive. The WTO can help to facilitate a more inclusive global trading system by updating trade rules at the multilateral level and by working with other international organizations to ensure more people benefit from world trade.

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KEY POINTS



Trade has contributed significantly to poverty reduction and supported a historic convergence of income levels across economies. While trade tends to raise the demand for skilled workers and to increase within-country inequality in the absence of adequate domestic public policies, it offers opportunities to many workers, women and micro, small and medium-sized enterprises (MSMEs), thereby also contributing to greater inclusiveness.



Fragmentation would pose a major threat to the benefits generated by trade for both developed and developing economies. Poorer households are likely to suffer from rising trade costs, as they are more dependent on tradable goods and services.



Embracing globalization under the umbrella of a strengthened multilateral trading system offers a much more promising path toward more inclusiveness for people, businesses and economies.



There is still scope for further industrialization led by global value chains and for further services-led growth facilitated by digital technologies. This can be supported by a reduction of barriers to trade through agreements at the regional and multilateral level.

1. Introduction

Over the past decades, international trade has contributed to overall cross-country income and productivity convergence and has helped lift hundreds of millions of people out of poverty. However, not all economies have reaped the growth dividends of trade equally. Trade has also increasingly been perceived as generating inequality within economies and as leaving some behind. In reality, the impact of trade on distribution, including the labour market and inequality, has been very diverse across economies (Goldberg and Larson, 2023; Pavcnik, 2017).

This chapter discusses how fragmentation can be expected to negatively affect growth, poverty and inequality, and how re-globalization can help to ensure that the gains from trade are spread more broadly both between and within economies.

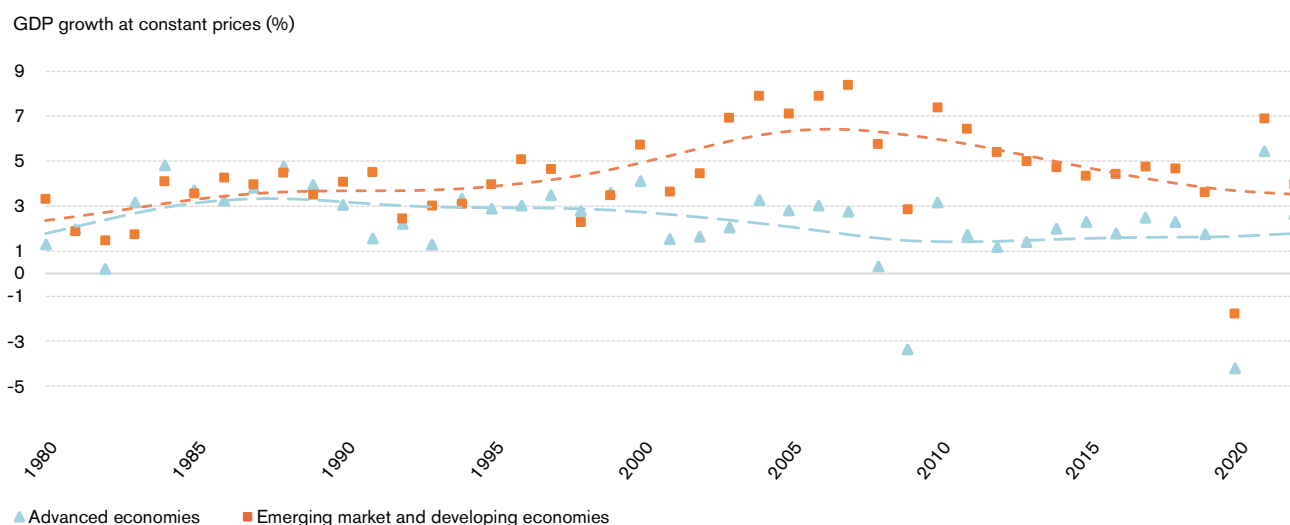
Fragmentation is likely to reduce overall economic activity and harm a majority of economies as knowledge diffusion decreases, even if the possibility exists that a few economies could gain from diverting trade from current trading partners. Developing economies and least developed countries (LDCs), in particular, are likely to suffer from the fragmentation of the current system, which would involve the formation of exclusive trade blocs, and which would result in more difficult access to certain technologies. Empirical work also suggests that fragmentation could increase within-economy inequality and poverty by limiting economic opportunities and financial resources.

This chapter shows that the WTO can help to make the next wave of globalization more inclusive. Binding commitments and the coordination of trade rules at the multilateral level facilitate the inclusion of economies into the global trading system. Trade-opening in services and e-commerce could facilitate the participation not only of more economies but also of more firms and more women in trade. Both services and agriculture trade-opening could boost growth by providing more market access opportunities in areas where developing economies have a comparative advantage. It is already the case that the WTO supports least-developed countries (LDCs) in building the capacity they need to integrate into international trade, via development programmes such as the Aid for Trade initiative and the Enhanced Integrated Framework (EIF), and this work is ongoing. Other international organizations and economies' domestic policies also play an important role in helping make international trade more inclusive.

2. The effects of globalization on poverty and inequality

Trade integration is a powerful tool to improve living standards. Globalization has contributed to unprecedented economic growth and lifted hundreds of millions out of poverty. Despite growing concern over the perceived negative effects of globalization on jobs and wages, trade also benefitted advanced economies, for instance by raising productivity and innovation. However, globalization can, in the absence of adequate complementary policies, exacerbate inequality.

Figure D.1: The pace of economic convergence has slowed down in recent years



Source: Authors' calculations, based on IMF World Economic Outlook data.

Note: The dashed lines represent the respective smoothed trends estimated by applying the Hodrick-Prescott (HP) filter to annual growth rates.

(a) Globalization has led to a convergence of income levels

One of the most striking features of the global economy in recent years has been the increasing importance in the global economy of developing economies (see Figure D.1). Starting in the mid-1980s, faster, trade-enabled growth meant that incomes in many developing economies – and not just China – began to converge with those of high-income economies, marking a break with two hundred years of divergence. Trade, in particular the integration of developing economies into global value chains (GVCs) (see also Chapter B and Figure B.7), contributed to global income and productivity convergence across economies (Goldberg and Larson, 2023).

The strong increase in trade was enabled by decreasing trade costs. Containerization (i.e., the transport of freight by means of large containers) and technological developments lowered transportation and communication costs leading to greater efficiencies. In addition, tariffs and non-tariff measures (NTMs) were reduced through multilateral, plurilateral and regional trade agreements during the last three decades. The volume of world trade increased by 43 times between 1950 and 2021. Average applied tariffs have fallen from 50 per cent in the 1930s to single digits since the 1990s, although other trade restrictions have been increasing in recent years.¹ In 1995, with the creation of the WTO, the strengthening of a rules-based multilateral trade regime further provided the predictable trading environment that fostered trade and growth.

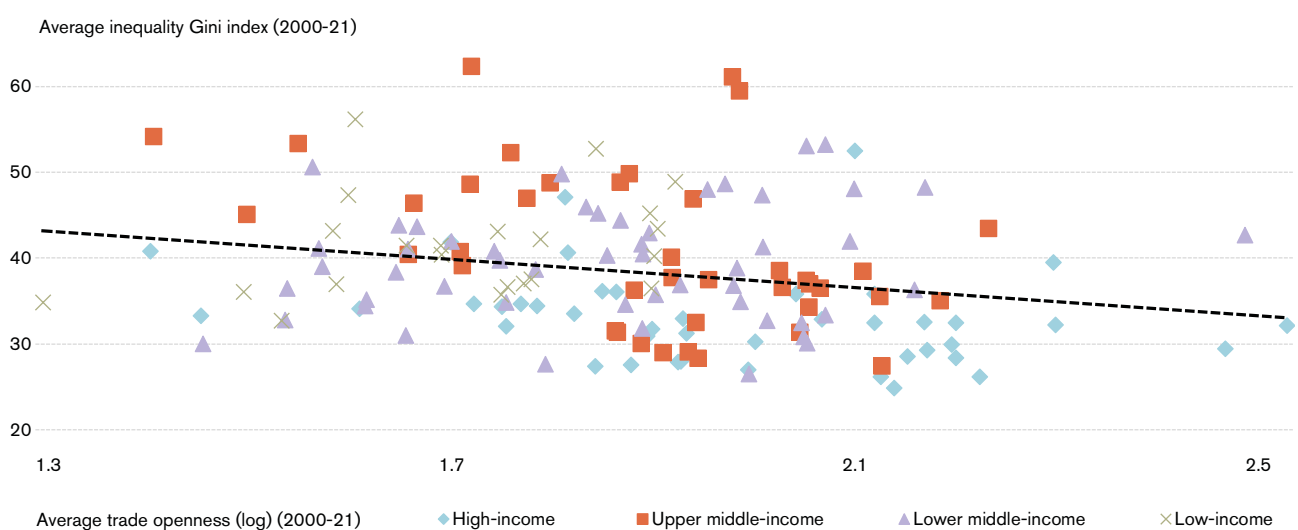
This convergence was accompanied by a decline in global income inequality. The global Gini index (i.e., a measure of inequality, in which higher inequality is indicated by higher values) experienced a fast decline, from 70 to 60 points from the late 1990s to 2018, in large part due to strong income growth in populous poor countries. Global inequality in wealth, however, has increased. Income tax data reveal that since 1995, although the poorest half of the world population experienced about 3 per cent annual income growth, it only captured 2 per cent of the overall wealth growth because it started from very low wealth levels. The middle classes of high-income economies experienced slightly higher income growth and captured 60 per cent of the total wealth growth during the same period. Between 1995 and 2021, 38 per cent of the total wealth growth has gone to the global top 1 per cent (Chancel et al., 2021).

Trade openness can also contribute to economic inclusion (WTO, 2018a). Some of the most open and trade-dependent economies, including Germany, Latvia and the Netherlands, are also some of the most equal in terms of income levels, living standards, and wealth disparities (see Figure D.2). Conversely, some economies have levels of inequality relatively similar to those of less economically integrated economies, highlighting the importance of complementary domestic complementary policies, such as redistribution and labour market policies, in promoting inclusive economic growth (IMF, World Bank and WTO, 2017; WTO, 2017).

(b) Globalization has sharply reduced poverty

From 1981 to 2019, lower- and middle-income economies increased their share in global exports from 19 to 29 per

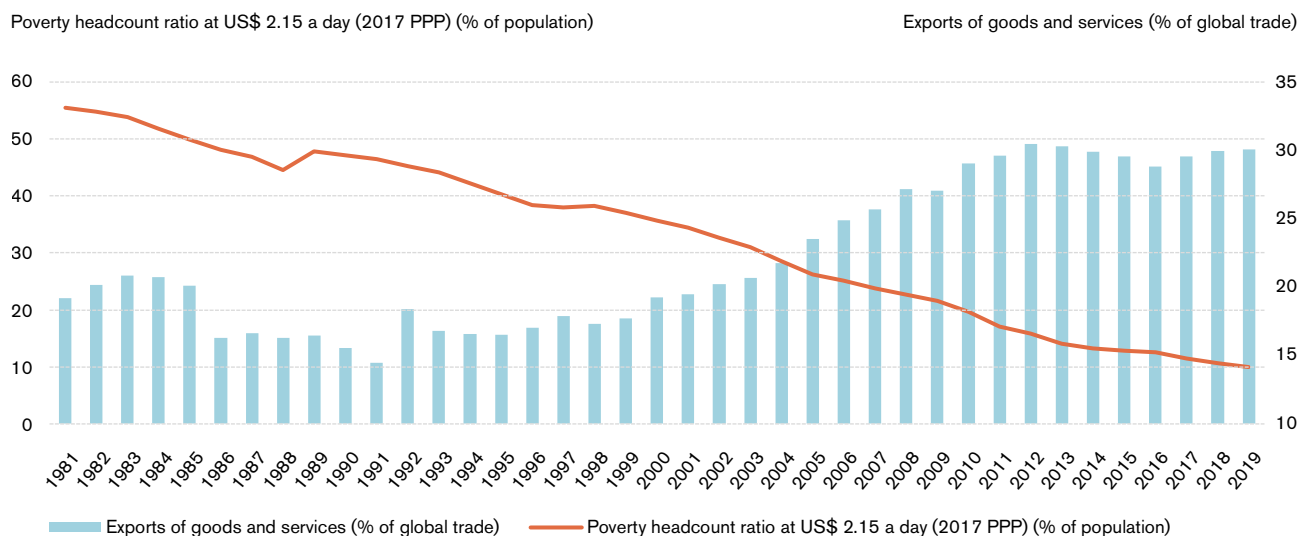
Figure D.2: Trade openness can go hand in hand with economic inclusion



Source: Authors' calculations, based on the World Bank's World Development Indicators.

Note: Trade openness corresponds to the ratio between the sum of exports and imports and gross domestic product (GDP). The Gini coefficient measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality. The average trade openness and Gini coefficients are calculated for the period 2000 to 2021, or a shorter period, based on data availability. The linear trend is represented by the dashed black line, which is statistically different from zero.

Figure D.3: International trade has contributed to reducing extreme poverty



Source: Authors' calculations, based on World Bank's World Development Indicators.

cent, and reduced the share of their population subsisting on less than US\$ 2.15 per day from 55 per cent to 10 per cent (see Figure D.3). Trade contributes to poverty reduction by raising economic growth.² Comprehensive trade opening in developing economies can increase economic growth by an average of 1.0 to 1.5 percentage points (Irwin, 2019). In turn, economic growth, through different mechanisms, has been found to lead to almost one-to-one rise in the real income of the poor (Dollar, Kleineberg and Kraay, 2016). The poor tend to allocate a greater portion of their income towards purchasing tradeable goods, particularly food and beverages, which can be subject to comparatively high tariffs (Cravino and Levchenko, 2017), and thus can gain disproportionately lower prices at the consumer level resulting from the reduction or elimination of trade barriers (Artuc, Porto and Rijkers, 2019; Fajgelbaum and Khandelwal, 2016).

Some economies have, however, not benefited as much as others. While export-led growth has dramatically reduced poverty in East Asia and several Eastern European economies, the number of poor people in sub-Saharan Africa has, for instance, stagnated since the 1990s. Slower progress in economic growth and poverty reduction in Africa in part reflects slower growth in trade.

(c) Large firms derive more benefits from trade than micro, small and medium-sized enterprise

Micro, small and medium-sized enterprises (MSMEs) are vital for job creation, especially in developing economies, as they account for a significant proportion of businesses and employment.³ They can also offer more diversity in the workplace than larger organizations. For instance, businesses owned by women make up a significant

proportion of MSMEs (World Bank and WTO, 2020). However, large firms tend to participate more in international trade compared to small firms. In developed economies, MSMEs account for more than 90 per cent of industrial firms but only 36 per cent of direct exports (WTO, 2022f). MSMEs in developing economies export only 11 per cent of their sales on average, compared to 33 per cent for large firms (WTO, 2022b).

MSMEs often face limitations that prevent them from benefiting more broadly from international trade. MSMEs face higher trade costs than large firms because they are unable to capitalize on economies of scale that reduce fixed costs, meaning that per unit trade and transportation costs are higher (WTO, 2016). Complying with complex trade regulations, customs procedures, and documentation requirements, meeting quality standards, and obtaining trade finance can also be more difficult for small enterprises (ADB, 2021; Cusolito, Safadi and Taglioni, 2016; WTO, 2022b).

Smaller firms also capture fewer of the gains when they are involved in international markets, compared to large firms. MSME exporters from developing economies tend to participate more in upstream, less technology-intensive sectors, which require less processing and therefore generate less value-added to exports (WTO, 2022b). Larger firms capture a greater share of the gains from trade due to their higher productivity (Goldberg and Pavcnik, 2003), while the impact on productivity from exporting and investing in research and development (R&D) is lower for smaller firms (Aw, Roberts and Xu, 2011). There is also evidence of a positive relationship between firm size and markups, meaning that smaller firms are less able to benefit from export-related sales price premiums (Atkin

et al., 2015). Increased competition often dominates the impact of trade on smaller firms, whereas larger firms experience mostly positive impacts, as MSMEs are also more vulnerable to import competition, which can have important implications for within-country inequality (Autor et al., 2020; Melitz and Trefler, 2012).

(d) Globalization has benefited many workers but some have been left behind

Trade can have varied and complex effects on the labour market and within-country inequality outcomes in both developed and developing economies.⁴ These complexities can contribute to within-country inequality outcomes.

(i) The effects of trade on employment are not uniform

The near unanimous view of a variety of studies using different methodologies is that trade has a small but positive effect on aggregate labour market outcomes in advanced economies (Bacchetta and Stolzenburg, 2019; WTO, 2017). This confirms the theoretical view that trade has secondary effects by shifting resources across firms and sectors, which can affect aggregate employment if labour market frictions are sector or firm-specific (Carrère, Grujovic and Robert-Nicoud, 2015; Davis and Harrigan, 2011; Helpman, Itskhoki and Redding, 2010). In low-income economies, informal labour makes up 89 per cent of total employment. The expansion of export opportunities seems to decrease the share of informal employment in the affected sectors and regions, while the expansion of imports tends to have the opposite effect (OECD, 2023b).

The effect of trade on employment is not uniform across sectors. In advanced economies, for example, the expansion of manufactured imports from China seems to have made only a very small contribution to the recent decline in manufacturing employment. While initial studies for the United States (Autor, Dorn and Hanson, 2013) and for Europe (Balsvik, Jensen and Salvanes, 2015; Donoso, Martin and Minondo, 2015; Malgouyres, 2017) find that the increase in Chinese import competition explained a significant share in the decline in the number of manufacturing jobs, subsequent work taking into account other effects of trade, particularly exports and the availability of cheaper inputs from China, finds a very small, or no, impact (Caliendo and Parro, 2023; Feenstra, Ma and Xu, 2017; Wang et al., 2018).

Trade-opening in developing economies does appear to result in shifts in employment across sectors. Examples include reduced agricultural and higher services and manufacturing employment in Viet Nam (Hoang and Nguyen, 2020), an influx of agricultural, unemployed, and non-participating workers into the industrial labour market in China (Ouyang and Yuan, 2019), and reduced employment in manufacturing but increased employment in agriculture and mining in Argentina, Brazil and Mexico (Artuc, Lederman and Rojas, 2015).

(ii) The benefits of trade are not shared equally

Mobility and diversification are key mediating factors for trade's impact on regional inequality. Notwithstanding the previous section, studies have found increased regional inequality in terms of employment, wages and job stability due to import competition (Autor, Dorn and Hanson, 2013; Dauth, Findeisen and Suedekum, 2014; Malgouyres, 2017), although export expansion, cheaper inputs, and value chain linkages can potentially compensate (Kovak, Oldenski and Sly, 2017).⁵ Reaping these gains puts a premium on a fast and smooth regional adjustment to trade. For example, when activities are too concentrated in specific regions, like in Germany, trade can widen regional disparities (Yi, Müller and Stegmaier, 2017). Negative effects of trade can last longer in developing economies, where the mobility of workers between regions is typically much lower than in high-income economies (Artuc, Lederman and Rojas, 2015; Grover, Lall and Maloney, 2022).

Trade can also contribute to inequality through its impact on the skill premium. Empirical research from the 1990s, however, finds that international trade played only a small role in the increase in the skill premium in developed economies by increasing the relative employment of skilled workers; increases in the skill premium were largely driven by technological developments. Contrary to what traditional trade theory would predict, wage inequality and the skill premium increased in many developing economies that had opened up in the 1980s and 1990s.⁶ However, the effects of trade on inequality through these and similar channels have been found to be small (Goldberg and Pavcnik, 2007).

A common issue is that the benefits from trade are not shared equally between producers and consumers and between firms and workers. The cost reductions resulting from tariff reductions are often not entirely passed through to consumers in the form of lower prices. This is because firms with sufficient market power can raise their markups in response to cost reductions and market concentration has been increasing over the last decades (Autor et al., 2020). Moreover, there is evidence that large multinational firms from advanced economies increased their profits at the expense of the margins of domestic firms in developing economies that sell them inputs (Goldberg and Larson, 2023), even if suppliers' markups vary across buyers adopting different sourcing strategies, as has been shown in the Bangladeshi garment sector (Cajal-Grossi, Macchiavello and Noguera, 2022). Labour shares around the world have been falling since the late 1980s (ILO, 2012; Karabarbounis and Neiman, 2013) and globalization contributed to the fall through the offshoring of labour-intensive tasks (Abdih and Danninger, 2017; Elsby, Hobijn and Sahin, 2013).⁷ Moreover, there is evidence that declining labour shares are associated with higher income inequality (ILO and OECD, 2015). As discussed in Section D.3, public policies, including competition and redistribution policies, can help mitigate some of these effects.

(iii) Trade has helped to increase female employment and reduce the gender wage gap

When trade induces an economy to specialize in sectors that employ more women, it helps to reduce the gender gap. For instance, the 2001 United States-Viet Nam bilateral trade agreement mostly benefited female labour-intensive GVC industries such as those producing apparel, clothing and footwear, thus reducing employment gaps between females and males (Hoang and Nguyen, 2020). In addition, the United States-China trade conflict induced expansion in export opportunities in Viet Nam's manufacturing sector. This appears to have led to a reduction in the gender-wage gap (Rotunno et al., 2023). Services employment is, on average, less male-biased than manufacturing or agriculture (Ngai and Petrongolo, 2017), and India's opening of its services sector in the 1990s contributed to a decrease in its gender education gap by increasing the proportion of women receiving education, which outpaced the corresponding increase among men (Nano et al., 2021).

Trade can also contribute to improving gender equality because exporting firms tend to pay better wages. In developing economies, women make up 33 per cent of the workforce of export firms and 28 per cent of importing firms, compared with just 24 per cent of non-exporting firms. The share of female employment tends also to be higher in businesses that are part of GVCs (World Bank and WTO, 2020). However, improving labour conditions and workers' rights in sectors where women continue to face low pay, non-standard working conditions and workplace discrimination is essential to advance gender equality and enhance women's economic empowerment.

3. The effects of fragmentation on poverty and inequality

Fragmentation⁸ has broad and far-reaching consequences for the global economy, with potential winners and losers. While fragmentation can increase growth and reduce income inequality in certain economies, it can also ultimately lead to reduced incomes for both the poor and the rich globally, resulting in increased poverty and exacerbated inequality between economies.

Fragmentation in trade and supply chains can also lead to disruptions in the labour market that may disproportionately affect the employment opportunity, job security and income level of less mobile workers in finding new jobs or in adapting to new job requirements, in response to changes in the economy. Ultimately, the complex impact of fragmentation on poverty and inequality depends on a broad range of factors, including the geopolitical context, the type of fragmentation, and the initial development level of the economies concerned, their market size, and their openness to trade, including the level of their reliance on foreign investment and labour.

(a) Fragmentation hinders global economic convergence

Fragmentation can lead to diminished production efficiency, decreased investor confidence, hindered innovation and higher prices. When economies reduce their economic integration, they can miss out on opportunities to access new markets, technologies, and resources, thereby reducing welfare. In the long-term, the reduction in global knowledge and innovation further dampens the prospects of economic growth. An increasing number of studies confirms the adverse effects of various fragmentation scenarios on economic growth and trade, which affect economies in varying ways.⁹

The larger the trade barriers adopted to loosen existing trade relations, the greater the negative impact on global welfare. For instance, a coordinated global withdrawal of tariff commitments from bilateral and regional trade agreements – i.e., reverting to most-favoured-nation (MFN) tariff rates, coupled with an increase in the cost of traded services could lead to annual worldwide real income losses of 0.3 per cent relative to the baseline after three years.¹⁰ A worldwide increase in tariffs up to legally allowed bound rates, coupled with an increase in costs of traded services, would lead to greater annual global real income losses of up to 0.8 per cent relative to the baseline after three years (Kutlina-Dimitrova and Lakatos, 2017).

Similarly, an overall increase in tariffs of 33 per cent along with the gradual elimination of foreign direct investment and foreign aid flows to developing economies and the gradual phase-out of migration between developing and developed economies could decrease global economic growth by nearly one percentage point annually (Hillebrand, 2009). The costs of a full-scale trade conflict would be even more significant, leading to estimated losses of over 5 per cent of GDP, with even more important significant losses for developing economies (Bekkers and Teh, 2019; Ossa, 2014).

Fragmentation hinders global economic convergence. Thanks to their relative larger domestic market, large economies might be able to absorb part of the rising costs associated with fragmentation by reallocating resources and supplies from foreign markets to domestic ones. However, smaller economies, in particular those relying heavily on trade and foreign investment, may have fewer resources and less capacity to adapt to changes in global trade and investment patterns. For instance, a full shutdown of GVCs, with no international trade in intermediate goods, could reduce welfare in all economies ranging from -3 to -68 per cent, with small, highly integrated economies experiencing the largest welfare losses (Eppinger et al., 2021).¹¹

The process of untangling existing trade relationships becomes even both more complex and more expensive when economies are deeply interdependent. The prospective cost of a global tariff conflict more than

doubled between 2000 and 2014. The rising cost is driven by two factors: the rise of global markups associated with the imposition of more-targeted (i.e., more distortionary) tariffs, and the increasing dependence of emerging economies on intermediate input trade since 2000. While a global tariff conflict could shrink the average economy's real GDP by 2.8 per cent, small downstream economies whose output depends on imported inputs would suffer the largest losses (Lashkaripour, 2021).¹²

Even bilateral trade tensions can reduce economic growth in highly integrated economies. For instance, the trade tensions between China and the United States have been found to have caused a welfare loss of 0.3 per cent of GDP in China and 0.1 per cent of GDP in the United States (Chang, Yao and Zheng, 2021; Fajgelbaum and Khandelwal, 2022).¹³ Similarly, the economic sanctions imposed on the Russian Federation in response to the war in Ukraine are projected to impact most economies negatively, with the Russian Federation experiencing the largest drop in real GDP (Mahlstein et al., 2022).

Geopolitical tensions usually involve only a few economies initiating the decoupling of trade relationships, while other economies may remain neutral or align with some of the decoupling economies. As trade barriers rise between decoupled economies, firms in decoupling economies will look for suppliers and customers in other economies. In that context, decoupling strategies can lead to trade diversion and trade creation that can benefit some neutral or aligning economies (Devarajan et al., 2021; Fajgelbaum, 2023). For instance, the trade tensions between China and the United States have accelerated the transition of manufacturing exports from China to other emerging economies, in particular Viet Nam, which experienced a 40 per cent surge in its exports of tariff-affected products to the United States between 2017 and 2020 (Rotunno et al., 2023). The effects on GDP growth prospects will ultimately depend, in part, on their relative comparative advantages, export capacity and geographic proximity to the decoupling economies.

Most developing economies are, however, vulnerable to decoupling strategies. Although decoupling might prompt some developing economies to expand their domestic production, the slowdown in international trade that would result from slower productivity growth could cause GDP growth and average income growth to falter. According to simulation analysis, deglobalization would imply marginal gains for few economies compared to losses for many economies. In all but one of the economies studied, the decrease in imports of manufactured goods and capital tends to reduce equality, to reduce average incomes or to increase poverty, and in most cases all three. The negative impact is larger for developing economies (e.g. -37 per cent GDP per capita for China, -23 per cent for Guatemala compared to -13 per cent for the United States and -0.8 per cent for the European Union), thus suggesting a push toward divergence rather than convergence (Hillebrand, 2009).

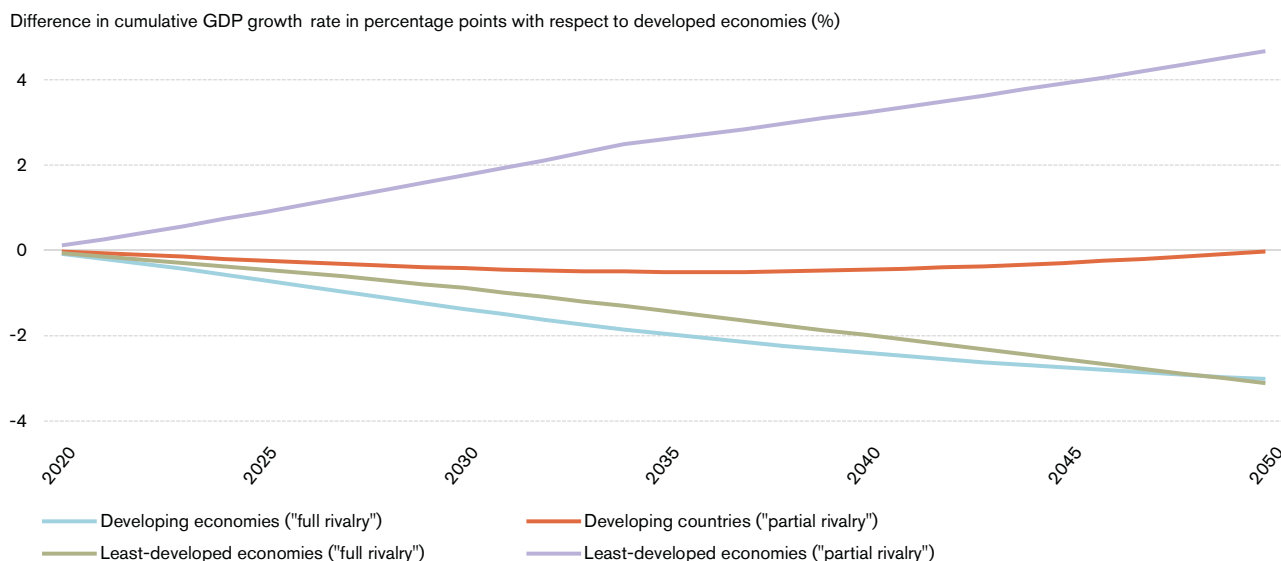
As suggested above, the impact of fragmentation on an economy's GDP trajectory and economic convergence is likely to vary depending on the type of fragmentation. The WTO Global Trade Model (WTO GTM) was used to simulate and analyse how geopolitically-driven fragmentation could impact the global economy and trade patterns by 2050 (Métivier et al., 2023).¹⁴ The "full rivalry" scenario assumes that all economies align themselves either to an Eastern or to a Western self-contained trading bloc by imposing higher trade barriers on the other bloc. Conversely, the "partial rivalry" scenario assumes that some developing economies and all LDCs remain neutral and do not impose higher trade costs on either bloc. It is important to emphasize that these simulation scenarios are not forecasts or predictions about the future but representations of what could happen under a set of specific assumptions.

In the "full rivalry" scenario, where global trade drops by 13 per cent and the spread of knowledge is limited, developing economies and LDCs are expected to be hit the hardest, experiencing an average cumulative loss of about 6.5 per cent of GDP by 2050 relative to 2019, while developed economies would lose about 3 per cent of GDP between 2020 and 2050. As a result, large-scale geopolitical fragmentation would likely lead to persistent global economic divergence (see Figure D.4).

If certain economies do not align and adopt a neutral stance towards geopolitically-driven fragmentation (i.e., a "partial rivalry" scenario), the impact on GDP would vary across income groups, with an average loss of 2.8 per cent in 2050 relative to 2019. The GDP of developing and developed economies would decrease by 3.1 and 3.5 per cent, respectively, while LDCs would experience an average GDP increase of 1.9 per cent. Although LDCs might benefit from not aligning, their GDP growth would fall short of achieving significant global economic convergence due to limited knowledge diffusion and productivity growth in the long term.

Fragmentation is also associated with significant uncertainty, which is often ignored in the modelling studies discussed above. The mere prospect of loosening existing trade relations can increase uncertainty and negatively impact investment and consumer decisions, resulting in lower economic growth, even before the decoupling strategy is implemented. For instance, even before changing its trading relationship with the European Union, the GDP of the United Kingdom was estimated to be around 2 to 3 per cent smaller at the end of 2019 than it would have been if voters had opted to remain in the European Union (Dhingra and Sampson, 2022).¹⁵ More recent estimates reflecting the adoption of the EU-UK Trade and Cooperation Agreement in replacement of the United Kingdom's full access to the European Union's single market suggests that the United Kingdom's GDP may have decreased by between 1.5 per cent and as much as 5 per cent by 2022 (Springford, 2023)

Figure D.4: Fragmentation may slow down or prevent economic convergence



Source: Métivier et al. (2023).

Note: The figure displays GDP growth rate difference in percentage point between developed economies and developing economies and between developed economies and LDCs under both a "full rivalry" and a "partial rivalry" scenario.

(b) Fragmentation increases the risks of poverty and inequality, jeopardizing inclusiveness

Fragmentation can impact poverty and inequality through different channels, including changes in international trade, investment patterns and migration flows. Lower or negative economic growth, limited access to global markets, and disruptions of global supply chains associated with fragmentation may erode the gains in living standards achieved so far. Workers, especially in export-dependent sectors, are particularly exposed to fragmentation through greater labour market disruptions. Consumers, in particular in low-income households, are also vulnerable to higher prices and reduced product variety caused by fragmentation. The exact extent of these impacts may vary depending on specific circumstances in each economy and the type of fragmentation considered.

Full-scale deglobalization with increased tariffs and phased-out international investment and migration could increase not only poverty, but also inequality in most economies (Hillebrand, 2009). Although the manufacturing sector in many economies might marginally increase in terms of domestic value-added, productivity growth would slow down due to decreased competition and capital flows. This would lead to a deceleration in overall GDP and wage growth, with high-skilled jobs experiencing a greater reduction in productivity due to slower technological advance. The low-productivity environment would also result in a reduction in returns to capital. In some economies, these three factors could contribute to a more equitable income distribution, but at the cost of lower incomes for both the poor and the rich. In most other economies, more workers would be pushed

toward relatively more unskilled, low-wage and informal jobs, resulting in increased poverty and inequality.

Although labour market disruptions in many economies have become perpetual and substantial, fragmentation could intensify this phenomenon by increasing the risk of economic instability and unemployment. For instance, although the trade tensions between China and the United States had some positive effects on employment for certain US domestic industries, these have been outweighed by greater job losses caused by more expensive inputs and retaliatory tariffs, with employment reduction particularly concentrated in the US communities most exposed to retaliatory tariffs (Caliendo and Parro, 2023; Flaaen and Pierce, 2019; Waugh, 2019).¹⁶ Similarly, regions in China that faced higher exposure to the US tariffs tended to show a greater reduction in night light intensity, indicating a decline in localized economic activity, which encompasses income as well as employment (Chor and Li, 2021). As discussed above, some non-aligning economies may still benefit in the short term from new job opportunities in some sectors supported by trade diversion and creation stemming from certain fragmentation strategies.

Some decoupling strategies, such as reshoring, could also disrupt labour markets in some sectors through greater automation. While technological advancement in robotics and artificial intelligence can facilitate the reshoring of some activities (typically in high-income economies), it can also reduce the number of reshored jobs by making some imported inputs and tasks (typically done in developing economies) redundant and making automation cost effective (Faber, 2020). Such automation processes can also cause employment to

decline in the economies from which production is reshored. In addition, greater automation is likely to increase the demand for high-skilled workers in the reshoring economy, thereby potentially increasing the skill premium and exacerbating inequalities in the absence of complementary policies.

Decoupling strategies may raise prices, hitting the poor hardest because the increase in trade barriers associated with fragmentation is likely to make imports of goods and services more expensive, and poor households spend relatively more on these tradable goods and services. For instance, the trade tensions between China and the United States led to an increase in the price of intermediates and final goods with additional tariff costs passed through directly into domestic prices of imported goods (Fajgelbaum et al., 2019). Despite transfers and labour tax reductions, low-income and low-wealth households bore the brunt of the hike in tradable consumption prices (Carroll and Hur, 2022). Reducing trade integration can also reduce product variety, potentially lowering living standards by reducing the number of products that may better fit consumers' needs, preferences, and budget (Amiti, Redding and Weinstein, 2019).

Similarly, the decision of the United Kingdom to leave the European Union caused a depreciation of the pound sterling, which increased the price of imports, thereby contributing to a reduction in real income. The United Kingdom's exit from the single market and customs union resulted in a 6 per cent increase in food prices, which increased the cost of living of the poorest household by more than 50 per cent compared to the richest households (Bakker et al., 2022).

Higher trade costs associated with fragmentation are likely to make it even more difficult for MSMEs to participate in trade. The impact of fragmentation on MSMEs can, in theory, be positive or negative depending on the specific policies implemented and the context in which they are implemented. On the positive side, fragmentation can create a market for local MSMEs by reducing competition from larger foreign multinational corporations and providing them with opportunities to access new customers and expand their domestic market share.¹⁷ On the negative side, fragmentation can increase the trade costs they face when importing and exporting, making it more expensive for small businesses to trade globally and remain competitive in global markets.¹⁸ In both situations, fragmentation would raise prices for consumers.

For instance, leaving the European Union caused a variety of challenges for MSME traders both in the United Kingdom and in the European Union due to transition challenges, increased uncertainty about procedures and difficulties in accessing funding. Although the COVID-19 pandemic and its related supply chain impacts meant that businesses were not always sure where their difficulties were coming from, those integrated in UK-EU supply chains reported particular difficulties, especially small businesses involved in more complex trade transactions (Brown, Liñares-Zegarra and Wilson, 2019; Calabrese, Degl'innocenti and Zhou, 2018).

Fragmentation-related trade costs are also likely to impose a greater burden on women. Many women already face higher export costs than men in many economies because they work in sectors subject to relatively higher trade barriers. Export costs faced by women, may therefore further increase in response to fragmentation strategies.¹⁹ Although some women in specific sectors may benefit from some fragmentation strategies,²⁰ limited access to global trade and business can further hinder women's economic advancement (World Bank and WTO, 2020). Moreover, women typically have lower earnings and may have less job security than men, making them more vulnerable to disruptions related to fragmentation. Loss of access to services, including healthcare and childcare, due to lower economic growth caused by fragmentation may also have a disproportionate impact on women.

Finally, fragmentation can further present significant challenges to poverty and inequality reduction by limiting the policy space and financial resources for governments to implement complementary policies aimed at addressing inequalities, such as labour market policies and redistribution policies (WTO, 2017).

4. How re-globalization can be made more inclusive

The idea of re-globalization is to re-invest in the multilateral trading system to make globalization not only more sustainable and more resilient, as discussed elsewhere in this report, but also more inclusive at all levels: in terms of people, business and economies. This section discusses how reinvesting in multilateral cooperation could ensure that the economies that have not yet succeeded in integrating into the world trading system and in deriving the dividends of trade can participate more actively. It also discusses how stronger multilateral cooperation could help ensure that more firms and more workers, including women and workers from low-income households, can participate in and benefit from trade.

While the discussion focuses on international trade cooperation, it also considers other measures required to make globalization more inclusive, including international cooperation in areas such as taxation and competition, support programmes (e.g., official development aid) to enable developing economies and LDCs to finance and implement some of the trade opening measures, and a range of domestic policies to support the adjustment associated with trade-opening.

(a) A revival of multilateral cooperation could help reduce inequalities

(i) A predictable trading environment is key to expand the participation of new trading partners

WTO commitments reduce trade policy uncertainty, thus fostering trade, diversification and development. Evidence suggests that the share of global trade facing higher tariffs



OPINION PIECE

Re-globalization or fragmentation: choices and challenges

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Globalization is still the keystone of international trade following the COVID-19 pandemic, although there seems to be a growing trend toward trade protectionism around the world. Two prevalent features of trade globalization are the coupling of global trade integration with production disintegration (Feenstra, 1998), that is the rising integration of world markets brought about the expansion of global value chains. There is no doubt that protectionism is increasing the cost of trade, but these two features have not collapsed despite crises.

Nevertheless, the recent increase in trade protectionism is presenting trade globalization with serious challenges. There is a growing tendency for world trade to become more localized and organized around regional trade groups, supported by related regional production supply chains: research has long established the dominant presence of Factory Europe, Factory North America and Factory Asia for supply chain trade (Baldwin and Lopez-Gonzalez, 2013) and protectionism could reinforce this dominance.

It is important to stress that, compared to the multilateral trade system overseen by the WTO, regional trade blocs are an inferior choice. The reasons for this are at least three-fold: regional trade blocs weaken the resilience of supply chains; they may enlarge the income gap between the rich and the poor; and they may not be beneficial for global environmental sustainability.

Before the pandemic, policymakers may only have needed to consider how much their own economies would gain from trade and who would gain and lose from various trade policies. In contrast, today policymakers, and international trade cooperation more broadly, need to consider a multitude of factors, including how to balance state security, domestic supply chain resilience, the income gap between the rich and the poor, inclusiveness, and environmental sustainability.

The potential effects of bloc-based regionalization or fragmentation on supply chain resilience are due to the fact that fragmentation could result in fewer economies engaging in production supply chains due to increased

artificial trade costs, such as tariffs and/or non-tariff barriers. Accordingly, the remaining economies that continue to engage in supply chains would reallocate their trade shares. As a result, some economies could lose out from this reallocation, and the resilience of the global supply chain could be weakened. Hence, bloc-based fragmentation could generate a threat to global supply chain resilience.

Trade openness is also important for poverty reduction although it does not imply poverty reduction by default. Understanding this point is crucial for developing economies, since, despite the view that opening up trade naturally reduces poverty, the opposite can also occur: trade can enlarge income inequality within economies if the gains from trade flow to the rich and hence widen the income gap between rich and poor. Recently, China has been an example of an economy that managed to reduce poverty through trade. China successfully reduced the population living in poverty from 55.75 million in 2015 to zero in 2021, an amazing achievement.

For developing economies, bloc-based regionalization could worsen the income gap between the rich and the poor and between urban and rural areas, although more empirical evidence on this is needed. The economic rationale is as follows. As fewer economies engage in regional supply chains, the cost for economies not engaged in supply chains of importing intermediate inputs increases, compared to the cost of those inputs for economies engaged in global supply chains. If an economy's export volume cannot increase simultaneously, the value-added from engaging in regional supply chains will decrease. With diminishing gains from trade, the poor would have a smaller share of the cake, and hence the income gap would widen.

It is also important to have a correct understanding of the nexus between trade and the environment. The consensus of the 2021 United Nations Climate Change Conference (COP26) was that every economy must share the responsibility of protecting the Earth and reduce carbon emissions. But there is debate on how the world's economies should share the emission costs



and, in particular, whether exporting producers or importing consumers should bear the costs. Exporting economies may argue that importing economies should pay the bills for carbon emissions, since importing economies consume the carbon-emitting products. However, importing economies may take the opposite view and argue that exporting economies earn income and even create domestic employment opportunities by producing carbon-emitting products. On this basis, a fair solution seems to be to split the bills between exporting producers and importing consumers.

Finally, a key question that needs to be addressed is the following: if bloc-based fragmentation is a second-best solution for international trade cooperation, how can we revive globalization? Re-globalization, i.e., expanding the

multilateral trading system toward new topics and new actors, seems an appropriate solution. Of course, as part of this process, it will be necessary to resolve some challenges in the WTO system, such as those currently facing the WTO Dispute Settlement Body, to ensure that multilateral cooperation continues to function and develop.

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due to import shocks in the period 1996-2011 would rise from just over 1 per cent under current WTO commitments to over 10 per cent under a counterfactual situation without commitments (Jakubik and Piermartini, 2023).

A stable and predictable trading environment boosts growth and development through several channels. First, reducing trade policy uncertainty boosts trade and GVCs efficiency. Reduction in trade uncertainty has been found to explain 22 per cent of the growth in Chinese exports to the United States following China's entry into the WTO in 2001 (Handley and Limão, 2017). Reducing trade policy uncertainty leads to higher imports and higher firm profits (Handley, Kamal and Monarch, 2020). Second, a stable and predictable trading environment encourages new firms to export and results in more competition and lower prices, thus increasing welfare (Crowley, Meng and Song, 2018; Feng, Li and Swenson, 2017). Finally, a predictable trade policy can boost innovation and growth. For instance, eliminating trade policy uncertainty for Chinese firms wishing to access the US market, through the Permanent Normal Trade Relations status (i.e., a US legal designation for free trade with another economy), has been associated with increased patenting activity (Coelli, 2018).

Making progress on WTO accessions can help new economies to participate in the global trading system. There is significant evidence that joining the WTO increases trade and growth. The effect is stronger for those economies that take up more commitments or that have gone through a rigorous

negotiating process (Brotto, Jakubik and Piermartini, 2021; Larch and Yotov, 2023; Tang and Wei, 2009). This widens the potential supplier base for economies across the world and makes the trading system more resilient and inclusive.

(ii) Greater international trade cooperation can support global economic convergence

There remains considerable potential for increasing the participation of developing economies in the international trade system to accelerate global economic convergence. First, there is room to make further progress on GVC-led industrialization. Trade cooperation can facilitate the participation of more economies in GVCs by reducing tariffs and non-tariff-measures (NTMs)²¹ (WTO, 2014). Addressing NTMs, which explain around 14 per cent of differences of trade costs across countries,²² would support sustainable and more resilient GVC growth (Cali et al., 2023; Ghose and Montfaucon, 2023). Second, further structural shifts in high-income economies from manufacturing to services may, in the future, boost manufacturing imports from lower-income economies with a relevant comparative advantage to high-income economies. Third, as services become ever more tradeable on a cross-border basis, services can be another way for developing economies to integrate into the global trading system (Nano and Stolzenburg, 2021).

WTO simulations show that with a "revival of multilateralism" scenario involving a reversal of the tariff increases between China and the United States, further reductions in tariffs

for all regions and reductions in NTMs for both goods and services, as well as a reduction of uncertainty, all economies would be better off over time than in fragmentation scenarios (see Section D.2 and Figure D.5). The benefits would be even larger in a scenario of an additional decrease in policy uncertainty and further reductions in tariffs and NTMs (Métivier et al., 2023). The increase in trade would increase GDP per capita across the world, especially benefiting developing economies and LDCs thanks to technological spillovers.

(iii) Full implementation of the WTO Trade Facilitation Agreement can boost trade and growth

Exporting requires firms to comply with costly regulations and customs procedures. One additional day in transit is equivalent to an *ad valorem* tariff of between 0.2 per cent and 2 per cent (Hummels and Schaur, 2013). These costs disproportionately affect firms that lack resources to handle these costs or that operate in a very time-sensitive environment – either because they produce goods that are perishable, fashion-dependent or quickly outdated (such as food and beverages, electronics or garments) or because they produce goods that are supply-chain-intensive (such as the automotive sector).

The WTO Trade Facilitation Agreement (TFA), in force since 2017, aims to simplify a number of processes and procedures to improve the efficiency of customs and border management practices and regulations. WTO estimations show that the TFA has led to a US\$ 231 billion increase in trade, with an average 5 per cent increase in global agricultural trade, a 1.5 per cent increase in manufacturing trade, and a roughly 1

per cent increase in total trade. Trade gains have particularly accrued to LDCs, the exports of which increased by 2.4 per cent overall, with a 17 per cent increase in the agriculture sector. Furthermore, real income increased by 0.12 per cent worldwide and 0.24 per cent for LDCs (Beverelli et al., 2023).

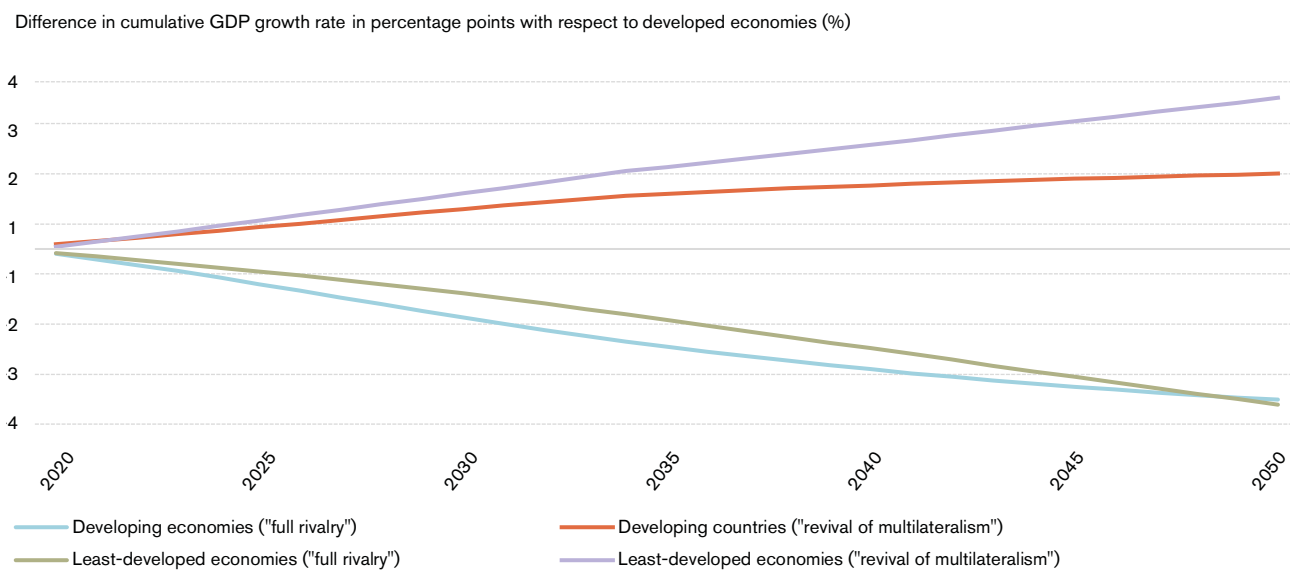
Implementation of TFA commitments stands currently at an estimated 76.8 per cent according to the TFA Facility, with implementation incomplete in developing economies and LDCs. Achieving full implementation can unlock further gains for these economies and support the inclusiveness and resilience of the multilateral trading system. Digitalizing customs and transit processes with interconnected and interoperable systems, establishing transit corridors, and setting up regional port hubs could significantly reduce trade costs, transit times, and support inclusive development.

(iv) More open and predictable services markets foster services-led development

As noted in Chapter B, the importance of services in the global economy has been increasing fast, and trade in services has been expanding at a faster pace than trade in goods. Demographic trends, technological innovation and higher income levels point toward more services trade in the future. In a scenario in which future technological changes are accompanied by a reduction in services trade barriers, the share of services in global trade could increase by 50 per cent by 2040, and the share of developing economies in global services trade could increase by about 15 per cent (WTO, 2019b).

Evidence increasingly suggests that services-led growth provides a new path to development (Baldwin and Forslid, 2020; Nayyar, Hallward-Driemeier and Davies, 2021).

Figure D.5: Greater international trade cooperation supports economic convergence



Source: Métivier et al. (2023).

Note: The figure displays the GDP growth rate difference in percentage point between developed economies and developing economies and between developed economies and LDCs under both a "full rivalry" and a "revival of multilateralism" scenario.

Economic convergence depends on the smooth functioning of the GVC, which is underpinned by services sectors such as transport, telecommunications, finance, and water and electricity distribution, generally known as infrastructure or producer services. Trade in services in these sectors increases their efficiency and is key for competitiveness. The productivity of an economy's labour force hinges crucially on the quality of an economy's educational and health systems. It is therefore essential that developing economies do not miss out on the opportunities that services trade can offer to support economic convergence.

Existing empirical evidence shows that increased openness in sectors such as financial services, telecommunications, electricity distribution, transport and healthcare has led to a variety of positive outcomes, including faster GDP growth rates (Myovella, Karacuka and Haucap, 2020; Pazarbasioglu et al., 2020). By opening up trade, economies can exploit their comparative advantage in different services, for example by exporting services such as bookkeeping, information technology (IT), banking or accounting services and (through mode 1 of supply of services according to the GATS), or increasing their competitiveness by importing infrastructure services such as engineering services (through mode 4 of GATS supply of services) or financial services (through mode 3 of GATS supply of services), as well as by exporting tourist services (through mode 2 of GATS supply of services).

Yet, many services sectors remain subject to significant trade restrictions, especially in lower-income economies (see Box D.1). Total trade costs in services are significantly higher than those in goods, and are particularly high for low-income economies (WTO, 2021c). Trade in services has traditionally faced higher costs compared to trade in goods, largely due to the "proximity burden" of services trade (i.e., the necessity for suppliers and consumers of services to be in close physical contact), and of more complex policy regimes than those applied to the goods trade. These regulations are often required to pursue public policy objectives. For instance, education and training requirements are imposed on service providers, such as doctors, engineers or financial advisers, to ensure their competences.

Expanding multilateral commitments and deepening international cooperation in services would allow economies to reap benefits beyond unilateral opening up of service markets.

First, guarantees afforded by trade agreements against policy reversals provide an important incentive for service providers to supply their products internationally. Even when trade agreements simply bind existing levels of services openness, the reduction in uncertainty has a positive and significant effect on bilateral trade volumes (Lamprecht and Miroudot, 2018).

Second, international cooperation on regulation helps to avoid unnecessary heterogeneity in domestic regulations,

which are a source of unintended trade costs for services suppliers. One estimate suggests that greater harmonization or recognition of foreign regulations could increase services trade through commercial presence by between 13 and 30 per cent (Kyvik-Nordås and Kox, 2009).

Third, international collaboration can contribute to mobilizing the assistance necessary for developing economies to build and improve their regulatory governance structures, thereby facilitating new services market opening. It also promotes information exchanges and the sharing of best practices that might inform all economies' services policy-making towards the least trade-restrictive outcomes.

Making progress in market access has proved difficult. Yet, recently in December 2021, 69 WTO members accounting for over 90 per cent of global services trade reached an agreement on services domestic regulation. The agreement seeks to facilitate services trade by increasing the transparency and predictability of authorization procedures for service providers seeking to do business in foreign markets. According to research by the WTO and the OECD, this outcome could save businesses, especially small businesses, US\$ 150 billion a year globally (WTO and OECD, 2021). Accompanying market-opening negotiations with greater international cooperation focused on domestic regulatory measures may be one way to harness the potential of services trade, and through this to facilitate participation in GVCs (WTO, 2019b).

(v) E-commerce rules for more inclusive globalization

The most dynamic component of services trade is digitally delivered services. As shown in Chapter B, global exports of digitally delivered services have recorded an almost fourfold increase in value since 2005, rising 8.1 per cent on average per year in the period 2005-22, outpacing goods (5.6 per cent) and other services exports (4.2 per cent), reaching US\$ 3.82 trillion in 2022, and representing a 54 per cent share in global services exports, and 12 per cent of total goods and services exports.

Digital trade can boost growth by increasing exports, diversifying economies, and improving competitiveness.²³ In particular, digital trade can provide new opportunities for growth to economies that have had fewer opportunities to participate in globalization, thus fostering economic convergence.

First, digital trade can boost exports from these economies and allow them to make better use of economies of scale, fostering growth. Digitally delivered products (such as e-books, music, and software) are less sensitive to transportation costs than those that are physically delivered. When shopping online, consumers can track their orders online, use feedback from other customers about product quality, and compare prices across markets, which can help to compensate for the lack of information or mis-trust that typically affect small firms more severely. Therefore, poor quality of transport infrastructure, inefficiency of border

crossing procedures and small business sizes are less of a disadvantage in digital trade compared to offline trade.

Second, digital trade can foster economic diversification by making tradable cross-border services that were not tradable before. Digital technologies enable the delivery of services, such as accounting, education, telemedicine and information technology (IT) services, in new ways and remove the need for face-to-face interaction. Diversification is particularly important for the sustainable growth of economies that rely heavily on exports of natural resources or commodities for their GDP, making them vulnerable to price volatility, or that depend heavily on tourism, which is a sector particularly vulnerable to shocks such as natural disasters or civil unrest.

Third, importing digital services such as financial services can increase developing-economy firms' competitiveness in international markets by providing access to new sources of funding and improving financial transactions.

While digital trade can be a new source of integration in the global economies for lower-income economies, the digital regulatory environment has been tightening in many economies. Of the 85 economies covered in the OECD Digital Services Trade Restrictiveness Index,²⁴ which measures barriers that inhibit or prohibit the ability of firms to supply services using electronic networks, 37 have higher 2022 index values indicating a more closed regulatory regime compared to 2014 (the earliest year with available data), 27 have similar values, and 21 have lower values. An additional issue is that some economies lack any form of regulation.

Restrictions and regulatory gaps can both represent an obstacle to trade, innovation and growth in the digital economy, whereas international cooperation for a fair, transparent and predictable regulatory environment can be a powerful tool to harness the digital economy (see Box D.2). Updating international rules for the protection of consumers and businesses engaged in online transactions (covering issues such as privacy, data protection, intellectual property rights, consumer protection, and electronic payment systems) can provide businesses and consumers with greater confidence in the security and reliability of online transactions. This would increase demand and boost investment in the development of new technologies and services, which could help to drive economic growth and create jobs. International cooperation could also go beyond these issues and cover issues such as the digital divide and concentration of market power in a few powerful companies.

(vi) Investment facilitation can contribute to making GVCs more inclusive

Trade and investment are closely interrelated and mutually reinforcing, particularly in the context of GVCs. A network of investment relationships often underpins GVCs as lead firms may choose to cement their GVC relationships through foreign direct investment (FDI).

FDI can contribute to global economic convergence. There is evidence that FDI can foster transfer of production

technology, technical skills, innovative capacity, "soft" technology, such as market awareness, customer service expertise, and organizational and management skills, as well as access to international marketing networks (Moran, Görg and Seric, 2016). There is also evidence that inward FDI has productivity-enhancing effects on domestic firms, including MSMEs, and the economy at large (Javorcik, 2004), and that GVCs with substantial relationship-specific investments tend to be more resilient to shocks than those based on arm's-length transactions (Cattaneo and Shepherd, 2014).

However, FDI does not flow evenly to all economies. In 2021, Africa only accounted for 5.2 per cent of world FDI inflows and Latin America for 8.5 per cent (UNCTAD, 2023).²⁵ As for LDCs, they only represented 1.6 per cent of global FDI inflows.

The policy and institutional frameworks play a key role in helping to reduce risks to private investors and to promote FDI associated with cross-border production networks (OECD, 2015) and there is evidence that a more restrictive regulatory regime governing FDI is associated with a lower degree of GVC integration (Shepherd and Prakash, 2021). Setting up a more transparent, efficient, investment-friendly business climate – by making it easier for domestic and foreign investors to invest, to conduct their day-to-day business and to expand their existing investments – is therefore critical.

In that context, in July 2023 a group of WTO members concluded the negotiations of the Investment Facilitation for Development Agreement (IFD Agreement).²⁶ The aim of this agreement is to increase the transparency of investment measures; speed-up and streamline investment-related administrative procedures; enhance international cooperation, share information and the exchange of best practices; as well as promote sustainable investment. The IFD Agreement includes a dedicated section on "Special and Differential Treatment" (S&DT), modelled on the one contained in the TFA. Participants have highlighted the importance of investment facilitation needs assessments. As the basis for conducting the IFD needs assessments, the WTO Secretariat, in cooperation with seven partner international organizations,²⁷ developed an Investment Facilitation Self-Assessment Guide, drawing on the extensive experience of the TFA Self-Assessment Guide. The expected global welfare gains from an Agreement on Investment Facilitation for Development have been estimated between 0.56 per cent and 1.74 per cent depending on the extent to which depth of the potential agreement facilitates investment (Balistreri and Olekseyuk, 2021).²⁸ The IFD initiative counts over 110 participating WTO members, (over two-thirds of the WTO membership), including more than 70 developing economies, among which are 20 LDCs. Participation by the full membership in these negotiations would provide a way for a more inclusive re-globalization.

(vii) International organizations have an important role to play

Trade costs are higher for low- and middle-income economies. The WTO estimates, for example, that trade costs in African economies are 1.5 times higher than in

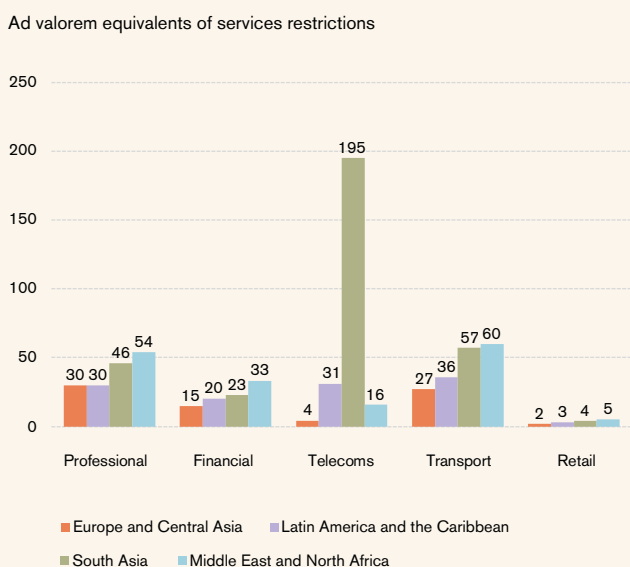
Box D.1: Services trade-opening and manufacturing GVC participation in the Middle East and North Africa region

To participate in global value chains (GVC), firms require a competitive services sector to efficiently coordinate fragmented tasks worldwide. In the Middle East and North Africa (MENA), service liberalization and GVC participation are closely linked (Karam and Zaki, 2020). Compared to other emerging economies, MENA has highly regulated services sectors, with particularly high trade restrictions, except for telecommunications (see Figure D.6.1). Greater integration in GVCs is associated with lower use of services that tend to face relatively higher trade restrictions (see Figure D.6.2). Open sectors have twice the number of GVC-engaged firms compared to closed sectors, indicating negative impacts on manufacturing competitiveness and GVC integration due to protective services policies. The share of GVC-engaged firms in MENA is almost twice as high for more open than for rather closed sectors, implying that protective services policies are likely to affect the competitiveness of the manufacturing sector and reduce integration into GVCs. Most MENA economies struggle with limited competitiveness and inability to upgrade along GVCs due to factors such as competitiveness loss from protected services and lack of competitive industrial policies.

Morocco stands out as an exception in the region due to its least restrictive services sectors, as indicated by its low ad valorem equivalents (AVE) of services trade restrictions (Jafari and Tarr, 2017). Their success in automotive GVCs highlights the benefits of liberalized services trade, as they transformed their participation from labour-intensive, low value-added assembly activities to advanced manufacturing of key parts and components and engineering services (Vidican-Auktor, 2022). It is currently Africa's top automotive manufacturer and the top destination for FDI in the automotive market alongside South Africa (Agarwal et al., 2022; Vidican-Auktor and Hahn, 2017). Notably, they have also launched a prototype of a hydrogen vehicle.

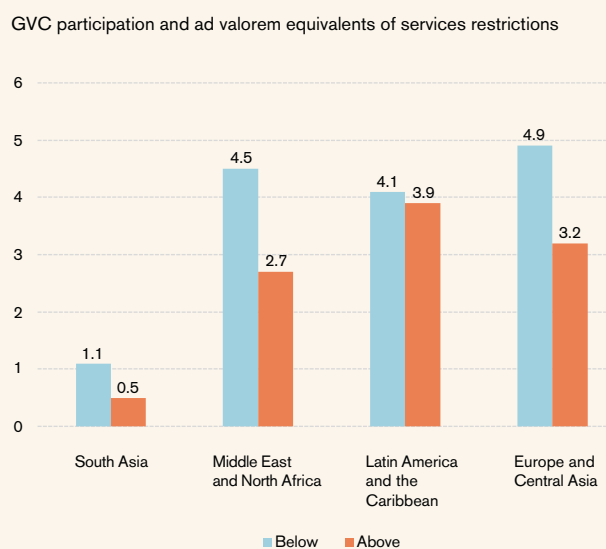
Morocco's success is attributed to their coherent policies, including joining the WTO, signing multiple FTAs, decreasing import tariffs in the automotive sector, and launching Industrial Development Plans. These plans promote R&D, technological upgrading, digitalization, and developing competitive services markets, while incentives are offered to SMEs to foster their engagement with international investors and participation in automotive GVCs.

Figure D.6.1: Ad valorem equivalents of services restrictions (by sector)



Source: Authors' own elaboration using Jafari and Tarr (2017).

Figure D.6.2: GVC participation and ad valorem equivalents of services restrictions (by region)



Source: Authors' own elaboration using the World Bank Enterprise Survey.

Note: The figure compares the share of manufacturing firms participating in GVCs and that rely on protected services (above the median ad valorem equivalent) to the share of those using more open services sectors (below the median ad valorem equivalent).

Box prepared by Professor Chahir Zaki (Cairo University and WTO Chair) and Nora Aboushady (Cairo University).

Box D.2: Ongoing activities at the WTO related to e-commerce regulation

Trade-related issues relating to global electronic commerce are examined under the WTO Work Programme on Electronic Commerce. Since 1998, WTO members have agreed to a temporary moratorium on customs duties on electronic transmissions. In June 2022, they extended the moratorium until the 13th WTO Ministerial Conference (MC13), and agreed to intensify discussions on the scope, definition and impact of the moratorium, on which members continue to have different views.

In addition, a group of 71 WTO members agreed in 2017 to initiate exploratory work towards future WTO negotiations on trade-related aspects of e-commerce in what is known as the Joint Statement Initiative (JSI) on E-commerce. The number of WTO members involved in the negotiations has since risen to 89 (as of July 2023), accounting for over 90 per cent of global trade. These negotiations span a broad range of critical topics such as online consumer protection, electronic signatures and authentication, electronic contracts, transparency, paperless trading, open internet access, and data flows and data localization.

The co-conveners of the JSI on E-commerce announced the launch of the E-commerce Capacity Building Framework in June 2022 to strengthen digital inclusion and to help developing economies and LDCs harness the opportunities of digital trade, including the negotiations, through technical assistance, training and capacity-building.

high-income economies. Trade policy is an important component of total trade costs (approximately accounting for between 14 per cent and 22 per cent of the variation of total trade costs according to the WTO Trade Cost Index). But for many economies that have only marginally benefited from globalization, it is important to complement trade policy reforms with other policies to reduce overall trade costs.

Breaking down overall trade costs, the WTO estimates that transport and communication infrastructure are two major factors affecting trade costs. As discussed earlier, it is important to open up these services sectors to international cooperation to improve their efficiency, and to boost the competitiveness of firms using these services to enable them to start exporting. However, reducing trade costs also requires infrastructural development. This typically requires large investments that many developing economies cannot afford. By opening up access to foreign suppliers in infrastructure sectors and government procurement, international trade can go a long way in attracting needed investments, along with multilateral actions to mobilize resources to improve infrastructure.

International cooperation and partnerships are also vital to promote inclusive and sustainable digital trade growth because low-income economies present significant gaps in terms of digital infrastructure, digital skills and legal and regulatory frameworks. As of 2022, only 56 per cent of the population in lower-middle-income economies and a mere 26 per cent in low-income economies had internet access, in stark contrast to the 92 per cent internet penetration rate observed in high-income economies. Although many low-income economies have adopted digital transformation strategies, their regulatory frameworks remain often underdeveloped. Only about one half of the sub-Saharan economies have comprehensive legislation in place to protect personal data (AUC and OECD, 2021), while about 75 per cent of these economies have adopted laws addressing cybercrime (ITU, 2021).

Improving digital connectivity reduces cross-border trade costs both in goods and services, especially for business and professional services. Importantly, the trade-cost-reducing effect of improved connectivity is magnified by an open regulatory environment. Estimates obtained using the WTO Trade Cost Index show that if all economies improved their mobile broadband connectivity to at least the level of the economy at the 75th percentile of the global distribution, meaning levels similar to Austria, Indonesia, South Africa or Uruguay, the reduction in average trade costs would range between 4 per cent for high-income economies and 11 per cent for low-income economies. Moreover, if all economies also improved their regulatory environment to at least the 75th percentile of the global distribution, the impact of increased digital connectivity would be much more pronounced – ranging between 6 and 22 per cent (see Figure D.7).²⁹ Projections based on the WTO Global Trade Model suggest that digitalization has the potential to increase African exports of services by approximately US\$ 74 billion from 2023 to 2040 (over 7 per cent a year).

Several initiatives are already in place to address the domestic constraints of less developed economies that prevent them from benefitting from digital transformations. These initiatives address all three dimensions of the lower-income economies' digital gap (i.e., infrastructure, skills and regulatory gap) (see Box D.3).

Addressing the digital divide between technologically advanced developed economies and developing economies is a key objective of the UN Sustainable Development Goals (SDGs). SDG 9.C calls for significant increases in access to information and communication technology, and universal, affordable internet access in least developed economies by 2020. Recognizing the importance of digital inclusion, the WTO Aid for Trade initiative, which helps developing economies, and particularly LDCs, to trade, promotes digital connectivity and inclusiveness. International organizations have

also launched programmes to support developing economies in strengthening regulations and skills to leverage digital technologies, such as the World Bank’s Digital Development Partnership, launched in 2016, which supports developing economies in strengthening regulations and skills to leverage digital technologies. In collaboration with UNCTAD’s “eTrade for all” initiative, the World Bank has also implemented an “eTrade for Development” programme to assist developing economies in expanding digital entrepreneurship, improving regulatory environments for digital markets, and facilitating the adoption of customs procedures and logistics to reduce e-commerce costs.

International organizations play a pivotal role in supporting the collection and dissemination of reliable information and communications technology (ICT) statistics, which are crucial for developing and implementing effective policies. The International Telecommunication Union (ITU), in collaboration with UNCTAD, has launched an ICT statistics programme that provides technical support for data collection and training for national statistical offices. Similarly, the “Partnership on Measuring ICT for Development”,³⁰ a multi-stakeholder initiative, is working to improve the quality and availability of ICT data, particularly in developing economies. The WTO has worked with the OECD, the IMF and UNCTAD on a new handbook on measuring digital trade. The G20 has also recognized the importance of reliable data for policymaking and has initiated work on measuring digital trade, with discussions taking place within the G20 Trade and Investment Working Group (TIWG) and the G20 Digital Economy Task Force.

(viii) Complementing multilateralism with deeper regional integration

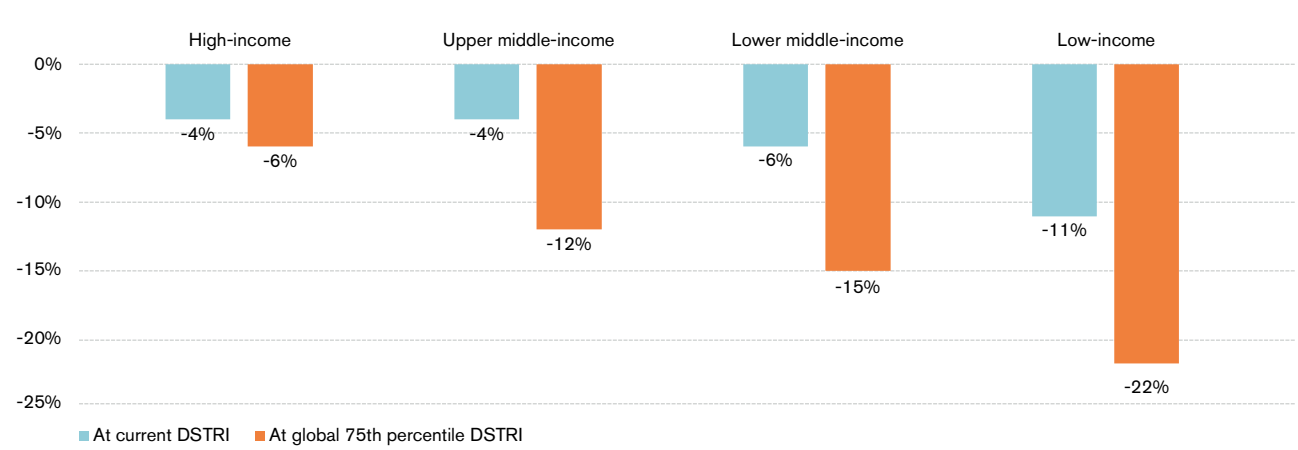
Regional integration can be an effective strategy for economies to integrate into global markets. It can be

beneficial to boost competitiveness in international markets by creating larger and more efficient markets, attracting foreign investment, promoting specialization, and providing a platform for cooperation. Regional integration can complement and reinforce the global trading system by providing a platform for experimentation and learning, and by promoting the adoption of international standards and best practices.³¹

Intraregional trade costs in some regions are stubbornly high and impede economic growth in all aspects. The WTO estimates that Africa’s exports outside of Africa face the equivalent of a 210 per cent tariff, while intra-African exports face the equivalent of a 460 per cent tariff.³² In North Africa and sub-Saharan Africa, for example, average import tariffs within the region amount to 5 per cent and 7 per cent, respectively, while for the Southern Common Market (MERCOSUR), ASEAN, the United States, Mexico, and Canada agreement or the European Union, import tariffs within the regions are below or close to 1 per cent (ElGanainy et al., 2023).

Increasing regional trade integration could promote both the overall economic performance and an integration into the global market beyond commodities trade. For example, the full implementation of the African Continental Free Trade Area (AfCFTA) could lead to an additional 29 per cent increase in total exports by 2035. Intra-African exports could surge by 81 per cent, while exports to the rest of the world would also rise by 19 per cent. The manufacturing sector would particularly benefit from a reduction in tariff and non-tariff barriers, with a projected 62 per cent increase in exports (World Bank, 2020). As trade in manufactured goods allows for greater diversification than commodities trade, this would help African economies to further integrate into GVCs. Export diversification could also be greater in similarly endowed economies engaging in trade (Regolo, 2013).

Figure D.7: Improving digital infrastructure and regulation reduces trade costs



Source: WTO Secretariat estimates based on the WTO Trade Cost Index methodology.

Note: The figures show the estimated average reduction in trade costs across income groups in a scenario where all economies improve their mobile broadband access at least to the level of the economy at the 75th percentile of the global distribution in 2020. The two columns show the estimates depending on the level of the Digital Services Trade Restrictiveness Index (DSTRI).

Box D.3: International cooperation on skills, infrastructure, and regulatory gap is diverse

A number of international organizations, including the Internet Society (ISOC), the International Trade Centre (ITC), the International Telecommunications Union (ITU), the United Nations Commission on International Trade Law (UNCITRAL), the United Nations Conference on Trade and Development (UNCTAD), the Universal Postal Union (UPU) and the World Bank, have launched programmes to strengthen digital trade skills. Regional organizations and development banks, such as the African Union and the Association of Southeast Asian Nations (ASEAN), have also set up programmes to enhance digital skills.

Several international organizations are also promoting the adoption of digital technologies to enhance customs procedures and cross-border e-commerce logistics. Programmes such as UNCTAD's Automated System for Customs Data (ASYCUDA), the World Bank's Trade Facilitation Support Program, and the ITC's trade facilitation programme support economies in overcoming customs barriers by streamlining and, in some cases, harmonizing trade-related procedures and information flows. More recently, the WTO and the World Bank launched a project on digital trade needs assessments in Africa.

Some international organizations assist in developing regulatory infrastructure for safe digital trade, such as UNCTAD's E-Commerce and Law Reform Programme, ITU's legal and regulatory frameworks, and UNCITRAL's Model Laws. The United Nations (UN), the Organisation for Economic Co-operation and Development (OECD) and the World Customs Organization (WCO) also provide guidelines and recommendations on various regulatory areas, including consumer protection, data privacy, and cybersecurity. The need for international cooperation in enhancing cybersecurity has spurred numerous initiatives, including the work of the UN Governmental Groups of Experts on Developments in the Field of Information and Telecommunications in the Context of International Security.

International regulatory cooperation for intellectual property protection in the digital environment has gained ground. The World Intellectual Property Organization (WIPO)'s Joint Recommendations provide standards for trademarks and industrial property rights on the internet. WIPO's "Internet Treaties" update copyright protection to digital contexts. WIPO also assists economies in utilizing digital technologies for intellectual property and global innovation.

Regional trade integration not only attracts more FDI from economies within the region but also from extra-regional countries (Levy-Yeyati, Stein and Daude, 2003; te Velde and Bezemer, 2006). By promoting regulatory convergence, regional trade integration also increases the likelihood of export and market entry for extra-regional firms that have had prior export experience with one of the integrated economies (Lee, Mulabdic and Ruta, 2023). Overall, this suggests the possibility of integrating into the global market in the long run by first integrating on a regional level.

(b) More international cooperation could help share the benefits of trade more broadly within economies

Greater international trade cooperation can ensure more inclusive re-globalization for people and businesses, and assist in reducing poverty by supporting trade, including e-commerce, and enabling MSMEs, women and low-income households to leverage new opportunities.

(i) Digital trade can make trade more inclusive

International trade cooperation holds the potential to stimulate growth in digital trade and to make trade more inclusive, not only for economies, but for MSMEs and for women. Even if they raise a number of challenges for MSMEs, online markets present several advantages for smaller firms compared to offline markets.

First, online trade significantly reduces trade costs, for example those associated with acquiring information. This can disproportionately benefit MSMEs, as such trade costs are typically fixed costs, and are therefore particularly burdensome for MSMEs (Fontagné, Orefice and Piermartini, 2020).

Second, online markets are less capital-intensive. When companies sell online, they do not need to invest in opening a shop abroad to encourage customers to get to know and buy their product. This lesser need for capital favours MSMEs, especially in developing economies, where financial markets may be less efficient.

Third, product lines in which MSMEs are predominantly present, such as gifts and craftwork, attract a greater share of total demand in online than in offline trade (WTO, 2018b).

Fourth, with the development of online platforms and payment systems, even smaller firms can participate in international trade directly, without having to go through large wholesalers and retailers as intermediaries to export.

There is some empirical evidence to suggest that women benefit more from digital trade than men. A survey by the ITC shows that the share of firms owned by women doubles when moving from traditional offline trade to cross-border e-commerce. In Africa, three out of four firms trading exclusively through e-commerce are identified as being

owned by women (ITC, 2017). Women are also relatively more present in online marketplaces. In Upwork, an online marketplace for freelancers to provide services, 44 per cent of the workers are women, compared to an average of 25 per cent of the non-agricultural economy globally (World Bank, 2016). Airbnb estimates that more than 1 million women host on Airbnb, making up 55 per cent of the global Airbnb host community (Zervas, Proserpio and Byers, 2017).

E-commerce platforms, online work platforms and online payments are especially empowering to women's participation in trade, as they help to address time, financial and mobility constraints. E-commerce enables women to run businesses while also managing household obligations, and to reach a much vaster market than they could offline. In addition, digital solutions reduce searching costs between buyers and sellers and remove the need for face-to-face interactions, thus allowing more women to overcome traditionally male-dominant trade networks. Technology-enabled crowdfunding platforms can also help women to access trade finance (World Bank and WTO, 2020).

Connectivity plays a key role in ensuring equal access to information, education, and job opportunities for young people around the world. The rise of online platforms has created opportunities for young people to work from anywhere, and to use their digital skills to work. Depending on the quality of infrastructure, this can be particularly beneficial for young people from geographically remote areas, especially when transportation costs are high. By means of social media, young people can also build networks and collaborate with others around the world, while young entrepreneurs can reach a global audience and sell their products or services online. In terms of education, online education platforms are making it possible to learn new skills and gain knowledge from anywhere in the world, and materials can be obtained in more languages than previously via online means.

New opportunities, however, come with new challenges. As discussed in Section D.3(a), access to digital infrastructure varies widely between economies, as do skills and technical know-how. Although the digital divide is diminishing in certain regards, with nearly two-thirds of the world's population using the internet in 2022, information and data literacy vary across economies, underscoring the need for more digital skill upgrading (ITU, 2022).

Digital access also continues to show a clear gender divide. Although regions with high internet use, such as the Americas and Europe, show almost equal digital access for men and women, there continues to be a difference of roughly 10 per cent between male and female internet use for low-income and lower-middle-income economies.

(ii) Trade in services can be more inclusive

The pattern of growth across sectors matters for poverty reduction. The World Bank (2014), for example, found that growth in manufacturing sectors had no significant effect on poverty reduction, but that a 1 per cent increase in

GDP growth originating from the services sector leads to a reduction in poverty of about 0.96 per cent, compared to a reduction of 0.67 per cent when it is originating from agriculture. Overall, this highlights the potential for alleviating poverty of opening up services, as there is evidence of productivity-enhancing effects arising from services trade (Fu, Wang and Yang, 2023; Nayyar, Hallward-Driemeier and Davies, 2021). An example of this is in India, where a growth trend in services during the 1994-2005 period is associated with a decrease in the trend of the head count poverty rate of around 1.5 points (Ghani and Kharas, 2010).

More open and predictable services markets are not only key to foster service-led development, they are also key to improve the participation of women and MSMEs in the economy. MSMEs and businesses owned by women are already principally active in the services sector, and this is where additional opportunities exist, in particular for those with digital access (OECD, 2021; World Bank and WTO, 2020; WTO, 2016).

Much female employment has shifted into services in the last few decades (World Bank and WTO, 2020), but the trade costs in services are almost double those in goods. As a large share of these costs results from policy barriers, further opening up services markets to trade would offer potentially larger gains both for the economy as a whole and for women in particular (WTO, 2019).

Meanwhile, in terms of MSMEs, more open and predictable markets would not only make it easier for MSMEs already present in the services sector to expand internationally, but they could also help to reduce transport and logistics costs and foster MSME participation in international trade in goods. For example, implementation of the agreement on services domestic regulation, which was concluded in December 2021, and which aims to increase the transparency, predictability, and efficiency of authorization procedures for service providers aspiring to do business in foreign markets, could make it easier for MSMEs in the services sector to expand internationally, on the grounds that access to information and burdensome procedures weigh particularly heavily on MSMEs. Expanding the geographical scope of parties to these initiatives could significantly benefit MSMEs.

(iii) Making trade in goods more inclusive is essential

International cooperation on trade in goods – in the form of full implementation of the WTO TFA or of multilaterally negotiated reductions of tariffs and NTMs – could increase the participation in trade of less advanced economies (see the previous section).

Some of these cooperative measures can also help with the inclusion of firms or workers. NTMs, for example, are particularly burdensome on MSMEs, as are the necessary information requirements to access foreign markets. There is also evidence that MSMEs benefit more than larger firms from improved access to information through the TFA (Fontagné, Orefice and Piermartini, 2020).

Progress in the WTO agriculture negotiations would contribute to a more open, fair, predictable and resilient trading system, while contributing to better food security, economic development, the fight against poverty and environmental sustainability. The current negotiations aim to reach agreement on new provisions covering public stockholding for food security purposes, the reduction of trade-distorting domestic support, including on cotton, market access improvement, a new special safeguard mechanism for developing countries to respond to market upheavals and enhanced transparency, in particular in relation to export restrictions on food products and export competition, following the adoption of the December 2015 Nairobi decision on this topic.

Agricultural trade policies are pivotal in shaping the impact of globalization on poverty. Increases in jobs and wages in sectors enabling economies to export agricultural products competitively can particularly benefit low-income households by improving their employment prospects and income levels. In addition, more open agricultural trade can positively impact the poorest households by affecting the prices and availability of the goods and services they consume. Changes in trade policies can thus affect the affordability of essential food items for low-income households, and can lead to an improvement in food security for the poor (Huang et al., 2007; Karim and Kirschke, 2003; Pyakuryal, Roy and Thapa, 2010). Interestingly, simulations for developing economies in Africa, Asia and Latin America show that agricultural trade reforms lead to more poverty reduction than the opening of non-agricultural sectors (Hertel and Keeney, 2009).

Despite this, agricultural trade opening may not benefit everyone. When China acceded to the WTO in 2001, for example, WTO accession had a positive net impact on the average Chinese farm household, but certain types of agricultural products experienced price declines and increasing imports that affected domestic producers (Huang et al., 2007). Similarly, evidence from Mexico shows that agricultural liberalization in the wake of the 1994 North American Free Trade Agreement (NAFTA) led to an increase in the real price of main agricultural export products and a subsequent increase in employment in agricultural export industries, but the real price of main agricultural import products decreased, and was accompanied by a decrease in employment in the import competing sectors (Prina, 2015).

The reduction of trade-distorting domestic support, which is concentrated in a few economies and generally provided to large producers, is also expected to open new market opportunities for low-income producers, particularly those in developing economies who have not benefitted from such support. Reducing such measures would also free up financial resources for targeted social welfare programmes for low-income producers, and in the process contribute to poverty reduction.

The opening of agricultural markets can be beneficial to women. In certain economies, a shift towards non-

traditional and higher value-added agricultural products, like horticulture, has led to benefits for women and a reduction in gender inequalities in rural areas. However, overall, women tend to benefit more from large-scale, export-oriented production and agro-industrial processing rather than smallholder contract farming (Maertens and Swinnen, 2012), as otherwise agricultural trade opening can have ambiguous effects on gender inequality. Restrictions on access to land, which are often faced by small-scale female farmers, may limit their ability to take advantage of the opportunities presented by agricultural trade opening (García, Nyberg and Saadat, 2006; Hill and Vigneri, 2014). Moreover, women face disadvantages due to limited access to credit and marketing knowledge, which are essential for the technological upgrading required to compete successfully with increasing import competition from international markets (IANGWE, 2011).

The WTO Agreement on Fisheries Subsidies could play a crucial role in poverty reduction by preserving fish stocks, which in turn benefits fishing communities, particularly in poorer regions and countries where these communities constitute a substantial portion of the population. Da-Rocha et al. (2017), for example, provides evidence that a reduction in fisheries subsidies positively affects fish stocks, leading to improved productivity and decreased inequality between industrial and small-scale fishers.

There is evidence that existing tariff structures are biased against women and rural and low-income households. For example, tariffs faced by Indian exporters in destination markets are higher for goods produced by individuals in lower-income groups (Mendoza, Nayyar and Piernartini, 2018). Also, evidence from 54 low- and middle-income countries shows that, on average, tariffs repress the real incomes of female-headed households by 0.6 percentage points relative to that of male-headed ones. Female-headed households bear the brunt of tariffs because they derive a smaller share of their income from and spend a larger share of their budget on agricultural products, which are usually subject to high tariffs in developing countries (Artaç et al., 2021). Along the same lines, sectors that are female-intensive – such as the production of food, beverages, and textiles and apparel – face higher tariffs on inputs, on average. Because of the high tariffs in the sectors in which many women work, female producers pay more for their inputs and face higher restrictions for their exports than men. This hurts women both as consumers and as producers. Moreover, these sectors are also disproportionately burdened by non-tariff measures (World Bank and WTO, 2020).

While the evidence clearly suggests why the reduction of trade costs for the goods that low-income rural workers and women produce requires international cooperation, research is needed to assess the general equilibrium effects of altering this unbalanced access to international markets and whether this would help to reduce income inequality. This is because reducing tariffs could help low-income households as both exporters and consumers of inputs and final products (to the extent they consume some of these

products), but it could harm them as producers where they compete with imports.

(iv) Horizontal initiatives can support inclusivity in trade

Discussions about how to specifically facilitate trade for MSMEs or businesses owned by women are covered by various committees and initiatives within the WTO. For example, there were some references within the WTO Anti-Dumping Agreement and the Agreement on Subsidies and Countervailing Measures (SCM Agreement), the plurilateral Agreement on Government Procurement and the 1998 Work Programme on Electronic Commerce and the work programme on small economies. Other relevant activities include the WTO-led Aid for Trade initiative, which has gradually and increasingly integrated a gender dimension in the objectives of the sponsored projects (World Bank and WTO, 2020).

In addition to these, the Informal Working Group on Micro, Small and Medium-sized Enterprises and the Informal Working Group on Trade and Gender, both of which were established on the sidelines of the 11th WTO Ministerial Conference (MC11) in Buenos Aires in 2017, have brought together like-minded WTO members to explore good practices to facilitate trade for MSMEs and for firms owned by women, as well as to develop recommendations for policy actions. Examples include the 2020 MSME Package of Recommendations and Declarations, revised in 2021 (WTO, 2021d), which supports implementation of the Trade Facilitation Agreement (Annex 3), and the December 2019 Integrated Database Decision on automated information provision to the WTO Integrated Database to increase access to information (Annex 5).

These initiatives also provide an environment for new issues to be discussed by WTO members before raising them formally in WTO committees. For example, the WTO Informal Working Group on MSMEs continues to discuss challenges for MSME access to digital trade, including MSME cyber readiness, standardizing trade digitalization, and single windows (or access points) to access trade information. Recommendations like these will be critical for increasing the inclusiveness of the international trade environment and should be included in discussions at the WTO.

Regional trade agreements (RTAs) are sometimes considered to be a laboratory in which new types of provisions are designed to address different challenges. A growing number of RTAs acknowledge the need to alleviate poverty or set poverty eradication as an RTA objective.³³ Several agreements also identify poverty alleviation as a cooperation area.³⁴ Only a small number of RTAs make a direct reference to addressing inequality,³⁵ in particular regional inequality.³⁶ In parallel, more than 250 RTAs include provisions that explicitly relate to some of the dimensions of inclusiveness, including gender equality, human rights and labour rights (Monteiro, 2021b).

Provisions in RTAs are known to be heterogenous, and inclusiveness-related provisions are no exception. While

many provisions on inclusiveness promote cooperation activities, some other provisions establish specific level playing field disciplines or exemptions. Relatively common provisions related to social inclusiveness require parties to the RTAs to effectively enforce, and in some cases, adopt and improve labour standards (Raess and Sari, 2020). Some relatively recent detailed provisions on inclusiveness specifically target groups of persons that are often vulnerable or marginalized, such as indigenous peoples, persons with disabilities and women. Others specifically target firms, for example to promote corporate social responsibility (Monteiro, 2021a), improve MSME access to trade-related information or exempt MSMEs and/or programmes supporting MSMEs from specific trade obligations set out in the RTA (Monteiro, 2016).

Both the WTO Informal Working Group on MSMEs and the Informal Working Group on Trade and Gender have looked carefully at references to these topics in RTAs. More than half of RTAs notified to the WTO up to 2021 have MSME-related provisions, ranging from language on cooperation to full chapters dedicated to MSMEs, which aim to develop businesses and ensure their access to regulatory information,³⁷ with similar growth seen in gender-related provisions.

(v) International organizations can further promote inclusivity in trade

While all WTO members are committed to uphold a concise yet critical set of universally acknowledged “core” labour standards, as per the acknowledgment explicitly made in the Singapore Ministerial Declaration of the WTO in 1996 (WTO, 1996), the International Labour Organization (ILO) was recognized as the competent body to negotiate and enforce labour standards. The ILO’s conventions and recommendations set labour standards that have global recognition and encompass a wide array of labour rights, including freedom of association, the right to organize and engage in collective bargaining, the abolition of forced labour, the elimination of child labour, the prohibition of any kind of discrimination, the promotion of a safe and healthy work environment, and advocating for equal remuneration (ILO, 2021). The conventions provide a framework to protect workers’ rights and promote decent work across the globe.

The onus for establishing guidelines for labour rights and responsible business conduct for multinational corporations primarily rests with the ILO and the OECD. The ILO’s Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy emphasizes the importance of multinational enterprises operating responsibly and positively and contributing to the economies and societies in which they operate, and highlights the importance of freedom of association, the right to organize and bargain collectively, and the creation of a safe and healthy working environment (ILO, 2022). The OECD Guidelines for Multinational Enterprises provide a framework for responsible business conduct, emphasizing due diligence. They advocate for proactive identification, prevention, and mitigation of potential adverse impacts across operations

and supply chains, thereby promoting transparency and alignment with international standards for sustainable, inclusive growth (OECD, 2018). Recent evidence finds that responsible sourcing standards imposed by multinational enterprises on their suppliers in Costa Rica raised the gains of the roughly one third of low-wage workers employed at exposed suppliers ex ante, but harmed the majority of low-wage workers due to adverse indirect effects on their wages and domestic prices (Alfaro-Ureña et al., 2022). This points to the need for more empirical evidence on the effects of such guidelines.

The OECD has undertaken initiatives to address the novel challenges posed by highly productive and innovative firms, which often rely intensively on intangible assets. These so-called “superstar” firms have exploited deficiencies in international tax regulations to transfer profits to low-tax regions, thereby engendering issues of tax equity and economic disparity and may exploit relative dominance in markets where they operate, characterized by “winner takes all” features, in which a small number of companies gain ever larger market shares, with consequent advantages to their profitability (Dorn, 2021). To address this, as of June 2023, around 143 economies working together within the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) are collaborating on the implementation of 15 measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment (OECD, 2023a). The OECD has also spearheaded extensive research on competition within the digital economy. Key insights include the importance of initiatives promoting data portability and interoperability to promote transparency; line-of-business restrictions that limit the kind of activities a firm can engage in, encompassing non-discrimination obligations, to curb anti-competitive practices on digital platforms; and demand-side remedies, such as amplifying consumer information, comparison tools, and data portability promotion, to address challenges within digital markets.

While the OECD’s initiatives provide a comprehensive blueprint to counter the unique challenges posed by “superstar” firms, it is important to continue refining these strategies and to reinforce international cooperation to ensure tax equity and robust competition and to mitigate the global ramifications of “superstar” firms’ dominance.

Finally, at the other end of the spectrum, international organizations have initiated programmes to support MSMEs’ digital trade participation. For instance, the ITC’s E-solutions programme³⁸ facilitates online trading for MSMEs by creating a shared structure for technology and services, thereby reducing export costs, managing foreign payments, and promoting foreign market awareness. The programme also helps to establish international legal and logistical structures to minimize e-commerce barriers.

The WTO, in collaboration with the World Economic Forum (WEF) and the Electronic World Trade Platform, launched the “Enabling E-commerce” initiative in 2017 to bridge the

gap between global e-commerce policy and practice. The Universal Postal Union (UPU) has also implemented the Easy Export Programme,³⁹ leveraging national postal infrastructure to develop a simplified and harmonized export service for MSMEs. To address the information access issue often faced by MSMEs, several international organizations, including the WTO, UNCTAD and the World Bank, have also launched initiatives to improve access to trade-related information. Several international organizations also have programmes aiming to increase the productive capacity and infrastructure of MSMEs.

(vi) Domestic policies are essential to promote inclusivity in trade

Domestic policies are needed to boost productivity and strengthen the growth potential to ensure that the poor, women and MSMEs can seize the opportunities offered by digital trade or the opening of services or agricultural markets. They are also needed to deal with adjustment frictions and to compensate for losses, to ensure that the gains from trade are shared evenly within economies.

Low-income households, women and MSMEs in certain economies face high “behind-the-border” constraints to their participation in trade, such as limited access to finance, education and technology. For women to capture the full potential benefit from trade, the constraints that hold women back need to be lifted and appropriate policies to deal with adjustment costs to be put in place (World Bank and WTO, 2020). Lack of competition in the distribution sector and high domestic transport costs can significantly limit the extent to which the benefits from trade reach low-income households. Often poorer populations live in rural areas, far from ports, so transport costs and market obstacles can have a significant impact on them: if inland transport costs are high, only a part of the beneficial price changes that trade brings can pass to those populations. If domestic industries are imperfectly competitive, changes in tariffs may be absorbed by profit margins or mark-ups (Goldberg and Larson, 2023).

Available evidence on the effectiveness of adjustment policies suggests that there is no one-size-fits-all recipe to reduce trade-related adjustment costs (Bacchetta, Milet and Monteiro, 2019; Pavcnik, 2017; WTO, 2017). When such programmes are well-designed, they can contribute to a more efficient and socially sustainable trade adjustment process, and help overcome resistance to trade-opening. For example, evidence from Denmark’s flexicurity model⁴⁰ suggests that well-designed programmes can in fact facilitate the adjustment and reduce workers’ concerns about trade and technological change.

General adjustment policies, which aim at addressing adjustment problems independently of their cause, appear to be more adequate than specific trade adjustment policies for facilitating workers’ adjustment to trade in the presence of GVCs (WTO, 2017). In the presence of GVCs, general adjustment policies have the advantage that they can also support workers in those firms that are indirectly affected by trade, but who do not qualify for specific adjustment

assistance due to size thresholds or the difficulty to establish a clear chain of causality between the trade shock and the negative effect on the firm.

More generally, non-specific adjustment policies also support workers adversely affected by technological change and other shocks which induce adjustment processes that are similar to and difficult to disentangle from those induced by trade.

Furthermore, increasing the demand for skills can incentivize skill upgrading and can thereby improve the incomes and prospects of workers. However, a swift response involving the supply of skills is key to these gains and to the distributional impact of trade. Recent research finds that frictions and obstacles that prevent an efficient adjustment of the economy following a trade shock, including skill mismatches, policy distortions limiting firms' hiring abilities, and geographical mobility frictions that prevent workers or capital from moving across regions, tend to be significantly larger than suggested by earlier studies, and are particularly high in developing economies. The negative impact of these frictions is disproportionately borne by workers at the bottom or middle of the wage distribution. As a result, short-term and medium-term adjustment costs from trade, in the form of unemployment and lower wages, can arise and exacerbate the distributional effects of trade.

Trade-opening should be accompanied by effective policies to facilitate adjustment, including policies to increase skills. Passive labour market policies (such as income support and social insurance programmes) and active labour market policies (such as search assistance and training) should focus on the most affected regions, given that the effects of trade vary considerably by region, and that inter-regional labour mobility in many developing economies is relatively limited. Such labour market policies should take into account the fact that a substantial share of the labour force in developing economies is employed informally – informal employment represents 89 per cent of total employment in low-income economies and 81.6 per cent in lower-middle-income economies, compared to 49.7 per cent in upper-middle-income economies and 15.9 per cent in high-income economies (OECD, 2023) – and that informal employment is an important margin of adjustment to trade shocks. To address the fact that formal firms may hire informal workers after trade-opening, effective labour inspection and enforcement of current regulations is necessary.

Finally, it is important to recognize that businesses, consumers, informal worker associations and non-governmental organizations also need to be involved in policy formulation, as well as in the design and oversight of enforcement mechanisms to help ensure that trade and GVC participation create better jobs.

Domestic policies that go beyond labour market policies are also needed. Sound macroeconomic policies and measures that support competitiveness and productivity growth are key to ensure that displaced workers find new opportunities.

Education systems need to prepare workers for the changing demands of the modern labour market, and policies in areas such as housing, credit, and infrastructure need to facilitate mobility. Measures aimed at reviving communities hard-hit by trade shocks could also be considered. Dealing with social dislocation early and comprehensively is critical since the impact may otherwise become entrenched in the community, leading to outcomes that are harsher and longer-lasting.

5. Conclusions

Trade has been an important driver of global economic convergence and poverty reduction. Nevertheless, regions such as sub-Saharan Africa have experienced slower progress, in part due to limited trade growth, in contrast to the successful export-led growth achieved in East Asia and Eastern Europe. Trade has also affected within-country distributional outcomes, but the impact of trade on the labour market and inequality has been very diverse across economies, pointing more to the lack of adequate domestic policies accompanying the process of globalization rather than to the process itself. Inequality between regions in particular, has increased in a number of advanced economies as job losses caused by import competition, and to an even larger extent technological changes, have typically been concentrated in certain sectors and regions and have too often become prolonged. In some advanced economies, job losses and increased inequality have fuelled a growing anti-globalization rhetoric and the increasing use of unilateral measures to support domestic industries and bring back manufacturing jobs.

This chapter suggests that fragmentation risks reducing global welfare and promoting economic divergence, and that it is unlikely to reduce significantly poverty and inequality and to support manufacturing employment. Even if the possibility exists that a few economies could gain from trade by diverting trade from current trading partners, most economies will lose. Studies indicate that, rather than GDP convergence witnessed over past decades, developing economies would suffer from increased economic divergence with the developed world, facing higher absolute GDP losses, and a widening of the GDP gap. But LDCs are likely to suffer the most. At the same time, vulnerable workers in export-dependent sectors would be affected by labour market disruptions, and low-income households, who allocate a larger portion of their income to tradable goods and services, would face the burden of higher prices resulting from trade barriers. Moreover, fragmentation would most likely not bring manufacturing jobs back to advanced economies, given the reinforced trend towards automation. Also, in the new digital era, the development of domestic industries is accompanied by higher demand for workers with skills that differ considerably from those needed by industries that were negatively affected by import competition in the last two decades. Automation and digitalization of production processes will continue because

they increase productivity, allow firms to remain competitive in international markets, improve product quality and provide greater flexibility in responding to changes in the market.

The chapter argues that re-globalization, anchored in WTO-based trade cooperation, would be a more effective pathway towards inclusive growth. Embracing a strengthened multilateral trading system would support inclusiveness by facilitating GVC-led industrialization and services-led growth. Growth in services trade, particularly digitally delivered services, needs agreements on services domestic regulation, e-commerce, and investment facilitation, all of which have seen major advances at the WTO. WTO members can help facilitate a more inclusive global trading system by negotiating new accessions, extending their commitments, updating trade rules at the multilateral level, and working with other international organizations to ensure more people benefit from world trade. Digitalization of trade could provide new opportunities for those economies that have so far been left behind by allowing them to overcome

some of the most important barriers to trade that they face, such as transportation costs and institutional disadvantages. It would also provide new opportunities for small firms, people living in remote areas, and women. Digital trade allows people globally to directly access international markets and supply their services even if there is no longer an industry domestically. Promoting more international cooperation, however, would need to be accompanied by domestic policies as they play an important role in helping make globalization more inclusive.

Endnotes

- As shown by bi-annual WTO Trade Monitoring Reports, an increase in the implementation of export restrictions has been detected in recent years, initially in the context of the COVID-19 pandemic and subsequently in response to the war in Ukraine and the resulting food security crisis.
- See Bacchetta et al. (2021) for a review of the extensive literature on the relationship between trade and economic growth.
- MSMEs have a broad range of definitions that can include level of employment, industry, revenue or assets.
- Note that most of the evidence on the effect of trade on labour market outcomes concerns trade in goods.
- For example, Feenstra, Ma and Xu (2017) find that US labour markets exposed to import competition have followed similar trends as unexposed markets, due to export opportunities or access to cheaper inputs.
- A number of mechanisms can explain how trade could contribute to increases in the skill premium (ILO and WTO, 2017).
- Two studies show that participating in GVCs reduces the labour share for emerging countries more than for advanced countries (Dao, Das and Koczan, 2020; Dreger, Fourné and Holtemöller, 2023). They argue that technological spillovers and the accompanying increase in capital intensity are the main factors driving this result.
- See Chapter A for a definition of fragmentation and re-globalization.
- A number of studies have examined the adverse effects of various fragmentation scenarios on economic growth and trade, which affect economies in varying ways (Bolhuis, Chen and Kett, 2023; Freund et al., 2018; Goes and Bekkers, 2022; IMF, 2022; Ossa, 2014; Ulate, Vasquez and Zarate, 2023).
- The scenario assumes that all WTO members were to withdraw tariff commitments from all existing bilateral/regional trade agreements as well as from unilateral preferential schemes, coupled with a 3 per cent increase in the cost of traded services. In the absence of tariff commitments under regional trade agreements and unilateral preferences such as the Generalized System of Preferences, WTO members would effectively revert to MFN tariffs which would imply a 40 per cent increase in average global duties from 2.7 per cent to 3.8 per cent.
- Shutting down GVCs could have worse welfare effects than shutting down only final goods trade for all individual countries. Similarly, shutting down one type of trade creates larger welfare losses than shutting down both types and moving to autarky. This may reflect the degree to which trade in intermediate goods and trade in final goods can substitute or complement each other. There is a greater welfare cost associated with shutting down GVCs in a world with final goods trade, indicating that input trade might be more valuable if final goods trade is allowed, and vice versa, implying complementarities across the two types of trade (Eppinger et al., 2021).
- Similarly, the welfare loss caused by temporary trade barriers on imported inputs has been found to be twice as great in a world with deeper global supply chains (Erbahar and Zi, 2017).
- Although the trade tensions between China and the United States had some positive effects for certain US domestic industries, they have been outweighed by the negative effects of more expensive inputs and retaliatory tariffs (Flaen and Pierce, 2019). This has contributed to an overall loss of GDP, with US consumer losses being greater than US producer gains and tariff revenue (Fajgelbaum et al., 2019). The negative impact on GDP also reflects a slowdown in US export growth, not only to China but also to other markets, due to retaliatory measures adopted by other economies (Handley, Kamal and Monarch, 2020).
- See Aguiar et al. (2019) for a technical description of the WTO GTM, a recursive dynamic computable general equilibrium model.
- Several studies have modelled the possible macroeconomic impacts of the departure of the United Kingdom from

the European Union under various scenarios. Scenarios assuming minimal limitations on the United Kingdom's access to the European Union's single market have the lowest negative impact on the United Kingdom's GDP. Conversely, scenarios that introduce obstacles to access to the single market are most detrimental. Under a worst-case scenario with no new trade agreement replacing its access to the single market, the estimated long-term negative impact on the United Kingdom's GDP ranges from -2.6 to -8.7 per cent. In contrast, the impact of the worst-case scenario on the GDP of the European Union (EU-27) is estimated to be between 2.7 to 7.6 per cent smaller. Individual member states of the European Union would, however, have been impacted differently, with Ireland, Luxembourg and Malta being most affected due to their closer economic ties with the United Kingdom (Mathieu, 2020).

16. Similarly, recent analysis suggests that antidumping duties foster employment growth in protected industries by decreasing imports and increasing prices, but hamper employment growth in downstream industries by raising production costs (Bown et al., 2023).
17. The relationship between import competition and SMEs is complex, and depends on various factors such as industry, market conditions, and the competitive landscape. Some studies find that the impact of import competition on firm exit is relatively larger for SMEs than large companies (Colantone, Coucke and Sleuwaegen, 2015).
18. MSMEs typically face higher trade costs than large firms because they are unable to capitalize on economies of scale that reduce fixed costs, meaning that per unit trade and transportation costs are higher (WTO, 2016). MSMEs also have more limited resources and face difficulties accessing information, skills, and trade finance (ITC, 2020).
19. The WTO's Trade Cost Index shows that export costs for products of industries which employ relatively more women are higher than those for products of industries which employ predominantly men.
20. For instance, the growth in exports from Viet Nam in sectors that were affected by US tariffs on Chinese products not only created job opportunities but also resulted in wage gains, especially for women (Rotunno et al., 2023).
21. For instance, in some economies, such as Senegal, a crucial constraint on exports is the challenges in complying with the quality standards required in the importing markets, including sanitary and phytosanitary standards (Mbaye et al., 2022).
22. WTO calculations based on the WTO Trade Cost database information available at <http://tradecosts.wto.org/>.
23. There is a rich literature on the positive impact of digital technologies and e-commerce on economic growth, including for developing economies (Humphrey et al., 2003; Myovella, Karacuka and Haucap, 2020; Odedra-Straub, 2003; Vinaja, 2003; Zatonatska, 2018), GVC participation (Dethine, Enjolras and Monticcolo, 2020), innovation, competitiveness and productivity of firms (Lee and Falahat, 2019) and employment (Avom, Dadegnon and Igue, 2021).
24. See <https://goingdigital.oecd.org/en/indicator/73>.
25. See also <https://unctad.org/data-visualization/global-foreign-direct-investment-flows-over-last-30-years>.
26. See https://www.wto.org/english/tratop_e/invfac_public_e/factsheet_ifd.pdf
27. The seven international organizations are the International Trade Centre (ITC), the Organisation for Economic Co-operation and Development (OECD), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Economic Commission for Africa (UNECA), the World Bank Group (WBG), the Inter-American Development Bank (IDB) and the World Economic Forum (WEF).
28. Deep trade agreements are those that refer to policy areas beyond trade, such as investment, environment, labour or micro, small and medium-sized enterprises (WTO, 2011).
29. The WTO study analyses trade cost determinants using data for 2014-18. Digital connectivity is measured as the number of active mobile broadband subscriptions per capita (published by the International Telecommunications Union), taking the minimum between the importer and the exporter. The openness of digital trade regulation is measured as the component "infrastructure and connectivity" of the Digital Services Trade Restrictiveness Index (published by the OECD). Partial equilibrium trade costs are estimated using data for 61 economies sourced from the 2021 OECD TIVA database, following the methodology proposed by Egger et al. (2021).
30. See <https://www.itu.int/en/ITU-D/Statistics/Pages/intlcoop/partnership/default.aspx>.
31. For a review of the evidence on the complementarity between RTA and multilateralism, see (WTO, 2011).
32. WTO calculations using WTO methodology as described in <http://tradecosts.wto.org> on GTAP data.
33. See, for instance, the Costa Rica-Peru RTA and the European Union-Economic Community of West African States (ECOWAS) RTA.
34. See, for instance, the European Union-Viet Nam RTA.
35. See, for instance, the European Union-Central America RTA and the Australia-Peru RTA.
36. See, for instance, the Brazil-Peru RTA.
37. See WTO official document number INF/MSME/6/Rev.3, available at <https://docs.wto.org/dol2festaff/Pages/SS/directdoc.aspx?filename=q:/INF/MSME/W6R3.pdf&Open=True>.
38. See <https://intracen.org/our-work/projects/e-solutions>.
39. See <https://www.upu.int/en/Postal-Solutions/Capacity-Building/Easy-Export>.
40. See <https://www.star.dk/en/about-the-danish-agency-for-labour-market-and-recruitment/flexicurity/>.