Abstract

Since the 1990s, trade and FDI have been key drivers of global economic integration, growth and prosperity. Yet, recently a number of trends are developing that point to what may be a new era for the world’s economy. International flows of trade and investment are slowing down while international production is shifting from tangible cross-border production networks to intangible value chains. This new era of globalization and industrialization challenges the traditional developmental paradigm based on promoting industrialization through foreign investment and export-led manufacturing and requires a rethinking of strategies to achieve the Sustainable Development Goals (SDGs). It also presents developing countries with unprecedented opportunities to grow and develop their economy.

Against this background, to meet the SDGs developing countries need to formulate strategies that allow them to cope with the challenges while seizing the opportunities of the new globalization era. Existing research and policy discussions point to the importance of coherent and fit-for-purpose policy, regulatory and institutional frameworks in harnessing and strengthening the trade and investment nexus for development and structural transformation.
1. **Introduction**

Since the 1990s, trade and FDI have been key drivers of global economic integration, growth and prosperity. The globalization of production organized around global value chains (GVCs) deepened the interdependence of trade and investment, reinforcing their complementary relationship. It is estimated that more than 80 per cent of global trade is linked to the complex global production networks of multinational enterprises (MNEs). The spread of GVCs accelerated the catch-up of developing countries’ GDP and income levels, and led to greater convergence between economies. Yet, recent years have seen a slowdown in both international trade and investment flows with worrying repercussions for the global economy. This is all the more worrying for developing countries for whom trade and investment flows and the benefits they encompass can be crucial in the pursuit of their development goals.

A new era of globalization and industrialization is emerging that require a reconsideration of development strategies. Trade integration is uneven, with some notable reverses; global capital flows remain buoyant but FDI has slowed in several regions; technological advances and connectivity outpace regulatory responses; and the global flow of migrants is the highest ever, but their distribution is unbalanced. This changing pattern of globalization takes place in a context where the achievement of the SDGs will need a significant increase in finance for sustainable development across the developed and developing world. In developing countries alone, total investment needs for the SDGs are estimated to be in the range of $3.3 to 4.5 trillion per year, for basic infrastructure, climate change mitigation and adaptation, health and education. In the changing global trade and investment landscape, developing countries need to formulate strategies that deal with the new challenges and seize the new opportunities arising.

2. **Key trends defining the new era of globalization**

The new era of globalization is characterized by following intertwined emerging trends:

- **FDI and trade flows are uneven.** In several regions, foreign investment has lost growth momentum over the last decade with knock-on effects for trade and GVCs. In 2017, global investment flows declined significantly with levels still well below the 2007 peak. Although there was growth in international trade, the rate of growth remained modest. In addition, the growth of GVCs appeared to have flattened out; in the past decade, the share of foreign value added in trade, a key measure of the health of GVCs, has stalled and started to flatline after growing more or less continuously since the 1990s. These trends are reflected in a slower expansion of international
production with key indicators (sales, assets and employment in foreign affiliates) growing at much slower pace than before 2010. In particular, sales of foreign affiliates continue to grow but assets and employees are increasing at a slower rate.

Figure 1
Share of foreign value added in total global trade, 1990 to 2017
(Percentage)

Source: UNCTAD; based on data from the UNCTAD-EORA GVC database.

- The modalities and the geography of international production are changing. *International production is characterized by both tangible cross-border production networks and the emergence of intangible value chains.* Services are important not just as globally traded products but also as key enablers of global production. Among developed countries over 70 per cent of cross border trade is in the service sector. This change has been accompanied by the increased importance of intangible assets in the wealth of corporations and by a declining importance of manufacturing. The current level of greenfield projects in manufacturing is reported to be consistently lower than in the preceding five-year period across all developing regions. This evolution has been underpinned by the rapid development of digital trade, and technologies that are disrupting modes of operations and transforming GVCs. At the same time, developing and transition countries are becoming key drivers for
international trade and FDI: South-South trade now accounts for a quarter of the
global total while developing investors represent almost a third of global outflows.

- **Mounting challenges to multilateralism and the multilateral institutions.** The
current climate of political and economic uncertainty is characterized by rising trade
and investment protectionism, skepticism of the political benefits of a multilateral
rules-based system and a popular backlash against globalization and MNEs.

These new trends have serious repercussions for developing countries as they are calling into
question the traditional development strategies of promoting industrialization and
manufacturing through foreign investment, accessing GVCs and moving into high-value activities.
The implications of friction in the global trading system and FDI are particularly pronounced
considering the importance of manufacturing and industrialization for creating decent
employment opportunities. This is especially so in developing countries with youthful
populations and deep seated structural social inequalities. This makes it more difficult for
developing countries to grow through exports and manufacturing FDI. But it is equally difficult to
capture value from new intangible modes of international production, hampering their efforts to
upgrade to higher value-added activities or broaden the tax base. Furthermore, the development
and increased importance of blockchain technology, Fintech, cloud computing, artificial
intelligence, the internet of things and 3D printing is disrupting traditional cross-border flows of
trade and investment, making it challenging to raise taxes, particularly for developing countries.

Yet this rapidly evolving trade and investment climate also presents significant and
unprecedented opportunities for developing countries. The transition to a digital economy can
provide a boost to competitiveness across all sectors, new opportunities for entrepreneurial
activity, and new avenues to access overseas markets and to participate in global e-value chains.
For example, e-commerce is recognized as an important tool to boost the participation of SMEs
in the global economy, providing a potential avenue for economic diversification and industrial
upgrading in developing countries. Similarly, increasing services trade flows (supported by
growing offshoring and tradability of services tasks) may well drive sectoral development just as
export-led manufacturing growth has helped South-East Asian economies (the so-called “Asian
Tigers”) use global trade to develop domestic industries. Efficient services can be catalysts for the
expansion of regional and global value chains.
3. **Policy Implications**

Against this backdrop, the following key policy implications should be considered to harness and strengthen the trade, investment and development nexus — especially from the perspective of developing countries:

- Policies at the national and international levels should address trade and investment issues as interrelated and interdependent, and in doing so account for the complementarities between the two and examine the impact they can have on each other.
- Developing countries should assess how the changing modes of international production, which are gradually transitioning towards intangible networks and inhibiting the traditional model of using manufacturing-oriented investments to boost exports, will affect their SDG strategies, and what steps they can take to adapt in a proactive manner.
- Policymakers need to consider how to facilitate access to safe, secure and cost-effective technological solutions, for example those related to e-commerce, for small and medium businesses, to ensure their integration in GVCs and to help them climb the ladder of value addition in a way that promotes structural transformation.
- It is also becoming increasingly important for developing countries to adopt strategies to increase participation in, and capture value from, the increasingly mobile global digital economy and the trade and investment flows that form part of it.
- With regard to taxation of the digital economy, there is considerable scope for international cooperation to promote fair, effective and coherent mechanisms at the international level, especially considering the potential this has for financing the SDGs in developing countries.
- The increasingly mobile nature of trade and investment flows have also made it imperative for developing countries to overcome the structural and institutional barriers that can impede their integration in GVCs. This includes efforts in the fields of infrastructure, business facilitation and regional connectivity.
- As South-South trade and investment flows are growing, developing countries need to adjust their policies to their new roles as investors and exporters.
- Considering the uncertainties in the global economic environment due to rising protectionism and a backlash against globalization, there is increased need and space for international cooperation to ensure that trade and investment flows, especially to developing countries are shielded from instability, considering how important they can be in the context of the SDGs.
Questions for discussion: Following are some of the key questions that can be part of the debate on the trade, investment and development nexus in light of the issues mentioned above:

- What strategies should developing countries design and adopt to cope with the new era of globalization and industrialization?
- How can such coping strategies translate into tangible and practical policies at the national and international levels?
- In the current changing environment of investment flows, what are the implications for the traditional structural transformation pathway of developing countries through industrialization and manufacturing?
- What are the implications of the movement of international production modes towards intangible and asset light structures for employment creation and other development impacts in developing countries?
- What steps can developing countries take to capture value from new modes of international production which focus on digital and intangible exchanges?
- What can international organizations do to assist developing countries in dealing with the issues arising from trade tensions and new trade barriers, and strengthen cooperation in trade and investment to meet the SDGs?
- What role can international organizations play in ensuring there is an equilibrium in how international trade, investment and other policies (such as taxation) interact in a manner that balances the interests of governments, businesses and citizens?