II. Trade and development: recent trends and the role of the WTO

The *World Trade Report 2014* looks at how many developing economies are successfully leveraging trade for rapid growth. It focuses on four recent trade trends – the rise of new global players, the spread of production chains, increasing commodity prices, and growing economic interdependence. These trends are transforming the way developing economies benefit from global economic integration. The rules, flexibilities, technical assistance and institutional infrastructure of the WTO have been helpful for developing economies to take advantage of, adapt to and mitigate risks arising from these four trends. The multilateral trading system itself will also need to continue to adapt, so that it can serve to realize the full development potential inherent in the world economy's ongoing transformation.

Contents

A. Introduction

Globalization is transforming development. This section examines how, in its scope and speed, the recent rise of the developing world is unprecedented – eclipsing the rise of the newly industrializing countries after the Second World War, and dwarfing the earlier rise of Europe and North America in the late 19th century. There are many reasons why the developing world has achieved economic lift-off. One of the most important is its integration into the world economy – and the new access to markets, technology and investment that has resulted. This rise of the developing world is one of four recent trends that holds new development opportunities while also bringing new challenges. The same is true for three other trends identified here: the spread of production chains, high commodity prices, and growing economic interdependence.

Contents

Some key facts and findings

- Four new trends have affected the relationship between trade and development since the start of the millennium. As a result, new opportunities and challenges have arisen, particularly for developing countries.
- The four trends are the economic growth of many developing countries (Section B), the growing integration of global production through supply chains (Section C), the higher prices for agricultural goods and natural resources (Section D) and increasing interdependence of the world economy, which causes shocks to reverberate more quickly and globally (Section E). This changing trade and development landscape in turn has implications for the WTO (Section F).
- Since the Industrial Revolution, economic development has widened, deepened and accelerated. In the 19th century, it spread quickly from England to Western Europe and North America. After the Second World War, Japan and newly industrializing economies rapidly caught up, and starting in the 1980s, much of the rest of the developing world began a process of even more rapid industrialization.
- These episodes of development were accompanied by increases in trade, spurred by reductions in trade barriers and costs. During periods of trade repression, such as between the two world wars, economic growth was more subdued.

The rise of the developing world is the most significant economic event of our time. Partly because of the shift to more outward-looking economic policies, partly because of the impact of new transport and communications technologies, and partly because the world economy is more open than ever before, emerging economies have been able to harness globalization to achieve unheard-of rates of economic growth – with 11 economies, representing half the world's population, growing collectively at over 6 per cent a year since 2000.[1] Since 1980, the developing world's share of global trade has grown from a third to almost half. China, to take the most obvious example, is now the world's largest exporter; thirty years ago it ranked 32nd. Most developing countries have seen their economies grow in tandem with their dramatically increasing shares of world trade. China, with its 1.35 billion people, has seen its economy grow at an average of 10 per cent per year for the past three decades. India, with its 1.2 billion people, grew at 7.5 per cent a year between 2000 and 2011, although progress has recently slowed. While these emerging giants have captured the lion's share of attention, this remarkable story of trade-led development includes countries of all sizes and regions – from Indonesia, Ethiopia and Chile, to Cambodia, Ghana and Qatar.

Economic growth is not the only condition for development, but it is a necessary condition – which explains why many of these same countries are also making enormous strides in improved health, educational attainment, living standards and poverty reduction. As the United Nations observed in 2013, "never in history have the living conditions and prospects of so many people changed so dramatically and so fast" (United Nations Development Programme, 2013). At the same time, the recent slowdown of several – though certainly not most – developing countries in the aftermath of the Great Recession of 2008-09 is a reminder that future progress is neither inevitable nor irreversible. Successfully integrating into a turbulent, volatile, ever-changing global economy is a difficult process for developing countries, made even more challenging by the need to share out domestically the benefits and costs of economic growth and adjustment if political support for trade opening is to be sustained. A number of economic and political obstacles – whether self-inflicted or inflicted by others – could still prevent developing countries from continuing along their current growth trajectory.

More than anything, the continued rise of developing countries will depend on maintaining an open global economy. This task too has become more challenging, even as it has become more important. Just as expanding trade is transforming development – opening up new export opportunities, improving access to capital and resources, and stimulating technological diffusion, adaptation and innovation – so too is the rise of the developing world transforming the trading system. Fast-emerging economies such as China are generating enormous new demand for raw materials and manufacturing inputs, pulling other developing economies into their slip-stream, while providing new markets for industrialized countries' machinery, services and technologies. Developing economies may be increasing their share of world trade, but everyone's trade is growing. However, the vertiginous rise of new trade giants requires that all economies, developed and developing alike, adjust and adapt. The result is a more complex, multi-speed, multi-polar world economy.

It is not just trade power that is shifting but trade relations as well. The expansion of global supply chains – where national economies form links in globally integrated production systems – is dramatically deepening economic interdependence. So too is the growth of services trade in recent years. In a world growing more, not less, interconnected, the global rules and policy coordination provided by the multilateral trading system are more necessary than ever.

1. Four recent trade trends

The first of the four trends highlighted in this report is the economic rise of developing and emerging economies, which is explored in depth in Section B. Not coincidentally, the rising living standards in developing regions since 2000 have gone hand-in-hand with rising shares in world trade for these countries. By embracing a policy of trade openness and integration, these countries now have access not just to the capital, technology, and resources needed to fuel rapid industrialization, but to vast and expanding overseas demand for their surging exports.

The old patterns of world trade dominated by the advanced economies in the North are being transformed as emerging economies in the South become new poles of trade expansion. Since 1990, South-South trade – that is, trade among emerging and other developing economies – has grown from 8 per cent of world trade in 1990 to around 25 per cent today, and is projected to reach 30 per cent by 2030. Trade corridors between Asia and North America, and between Asia and Europe, now surpass the old transatlantic trade corridor, while trade corridors between Africa and Asia or Latin America and Africa are growing in importance. Even as the South's share of world trade expands, world trade as a whole continues to grow, meaning that developing countries have ever-richer and more diverse markets for their exports. In short, the rise of new trade powers is a positive sum game.

But despite these gains, developing countries still have a long development path ahead of them, since they fall short of industrial countries on a large number of important economic indicators. Significant proportions of their populations still live below the poverty line. Incomes in emerging economies are still a fraction of those in developed economies. While the export success of today's emerging economies highlights new opportunities and paths for other developing countries, the pace of growth among developing countries remains uneven. Some are experiencing high and sustained growth, others are struggling to move beyond middle-income levels, while still others may be falling behind. This report sheds light on the growing importance of developing countries in the world trading system, and explores how the WTO can play an increasingly central role in advancing their various development objectives.

A second, related, trend, explored in Section C, is the growing integration of global production – especially the rise of supply chains – which is transforming the nature of trade and the way developing countries "connect" to the global economy. A combination of reduced transport and logistics costs, improved information technologies and more open economies have made it easier to "unbundle" production, not only within countries, but across a range of them. Four-fifths of world trade are now channelled through multinationals that locate various stages or tasks of the production process in the most cost-efficient locations around the planet.

Whereas, in the past, value chains were mainly North-South arrangements, South-South value chains are now expanding as well. For developing economies, value chains can lower the bar for entry into the global economy by linking them to established trade networks, thus lowering the costs of economic integration, and allowing them to focus on the products or sectors where they have a comparative advantage, without the need for a comprehensive industrial base. Value chains are also influencing the trade integration strategies of developing economies.

While the average import content of exports is around 25 per cent – and increasing over time – and almost 30 per cent of merchandise trade is now in intermediate goods or components, increasing exports now directly hinges on increasing imports and on removing obstacles to imported inputs. Since value chains involve the integration of production platforms, not just cross-border trade flows, these obstacles can involve everything from tariff barriers and transport bottlenecks to differing standards, investment restrictions and inefficient service suppliers. The emerging world of "unbundled production" offers an important new channel for trade growth and development, while at the same time highlighting differences in countries' capacity to integrate – or in the quality of their integration – as well as the costs of remaining on the margins.

A third major trend, examined in Section D, is the rising price of agricultural goods and natural resources since 2000. With some of the fastest-growing developing economies in the Middle East, Africa and Latin America recently having become commodity-rich exporters, attention has now shifted from how developing economies can diversify out of resources to how they can strengthen their comparative advantage in resources, benefit more (and more widely) from them, and reduce the adverse impact of the boom and bust cycles that typically characterize these markets. This section identifies a number of key issues to be addressed if developing economies with actual or potential comparative advantages in agriculture or natural resources are to exploit higher commodity prices. These include reducing new and less transparent forms of trade protection, guaranteeing adequate rates of return on natural resources and addressing the social and environmental issues critical to inclusive and sustainable growth.

As the world economy has become more interconnected through trade, investment, technology and people flows, it has also become more interdependent. This is the subject of Section E. Just as the economic benefits of widening and deeper integration now spread more quickly across countries and regions, so too do the economic costs, as exemplified by the way in which the shockwaves from the 2008 financial crisis and the subsequent economic downturn reverberated globally. Policy decisions in one country can have simultaneous and often unintended spill-over effects in many distant countries. These spill-overs can become major setbacks for developing economies, especially for the smallest and poorest countries, which lack adequate shock absorbers and are the most vulnerable to economic volatility.

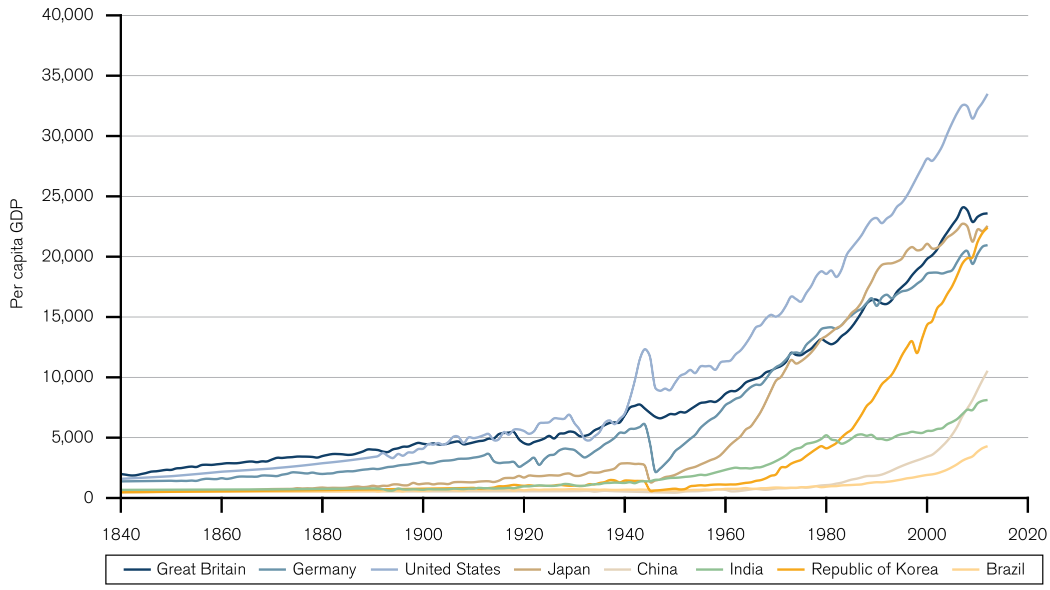
However, there are also major benefits that flow from growing global economic interdependence and diversification. Without strong and robust growth in the developing world after 2008, especially in China and India, the economic fallout from the recent global downturn would have been much worse. Unlike during past crises – such as that of the 1930s – the world economic system proved surprisingly resilient in the face of the Great Recession of 2008-09. Section E explores the lessons we have learned from the recent crisis regarding reducing risks and promoting security in times of global turmoil.

Sections B to E follow similar structures in examining the opportunities and challenges that these four trade trends present to developing countries. They first provide broad, "stylized" facts about these trends and their determinants. Subsequently, the development implications of the trends are analysed, clarifying how participation in supply chains, increasing commodity prices and the global recession have played a significant part in different development patterns across countries in the last 15 years. Finally, the sections identify policies that have proved successful for emerging economies. This highlights the obstacles that need to be removed if other developing countries are to benefit from these trends, and the additional policies that may be needed to maximize benefits and reduce risks.

Building on this analysis, Section F shows how existing WTO rules and practices address development challenges, and how flexibilities currently available to developing and least-developed countries in these trade rules can help facilitate their integration.

Expanding trade may be essential for development but it is hardly sufficient. Countries that have succeeded in transforming trade and economic growth into inclusive, sustainable and broad-based development – whether measured in terms of improving health, rising education, increasing opportunities for women, or decreasing poverty – have also pursued a range of policies that not only share the gains (and costs) of trade openness but ensure that societies are equipped to benefit from global economic integration. While such policies are largely beyond the scope of this study, the report does consider income distribution – not including income per capita – and

Figure A.1: **Per capita GDP for selected economies, 1840-2012**
(1990 International Geary-Khamis dollars)



Source: Maddison Project and IMF.

environmental quality as dimensions of development. This broad perspective is also useful in understanding how the multilateral trading system can contribute to creating a more inclusive and environmentally sustainable development, and thus reinforce popular support for further trade opening and global economic cooperation.

The sheer scope and scale of the latest wave of global economic development may look revolutionary but it is in fact evolutionary, building on trends that began 200 years ago during the Industrial Revolution. The following section looks at these trends from an historical perspective, not only to better understand the relationship between trade and development, but to speculate where the process may be heading in the years ahead.

2. Development and trade: an historical analysis

(a) Global economic development: widening, deepening and accelerating

Two hundred years ago, as a result of the Industrial Revolution, the world entered a period of unprecedented economic growth that continues to this day. Although economic progress was slow and geographically limited at first, it gradually accelerated and radiated outwards, each phase, or wave, of global economic development faster and more extensive than its predecessor (see Figure A.1).[2]

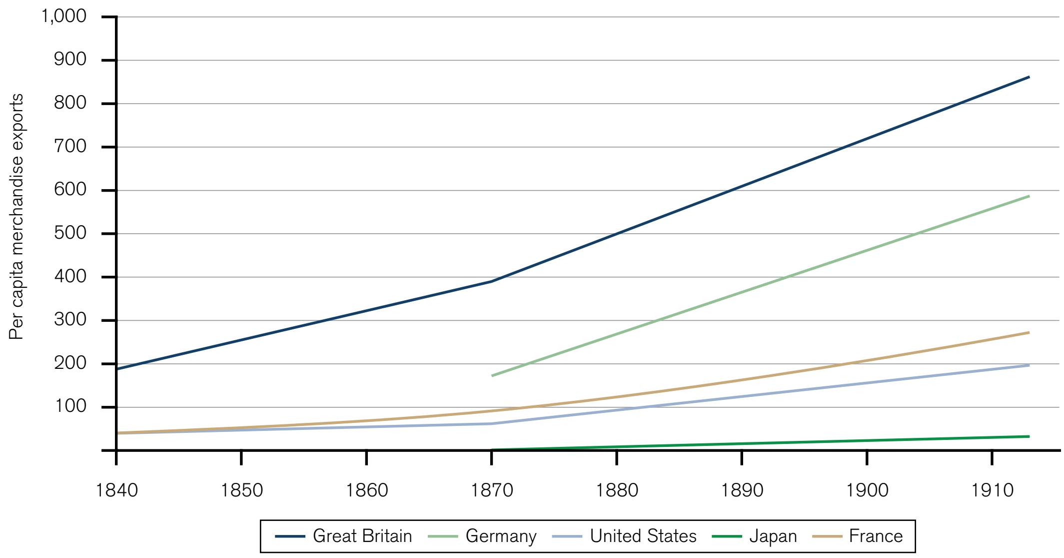
The first wave, which took place in the second half of the 19th century, saw Great Britain, a number of other countries in Western Europe, and North America – the early industrializers – race ahead of the rest of the world, a process which has been called "the great divergence" (Pritchett, 1997). A subsequent wave, which occurred after the Second World War, saw the fast-developing economies of that era – Japan and the newly industrializing economies – rapidly catch up with the developed West, even as the advanced industrial countries redoubled their lead on the poorer and less developed economies that had been left behind.

A final wave, which began in the 1980s, has seen much of the rest of the developing world, including the two giants, China and India, finally begin their own process of rapid industrialization. This "great convergence", which in many ways is only beginning, represents the largest and fastest phase of economic catch-up so far. As Martin Wolf succinctly puts it, "never before have so many people – or so large a portion of the world's people – enjoyed such large rises in their standards of living" (Wolf, 2004).

This accelerating and widening circle of development was only possible because the world economy grew more open and integrated. At each stage, expanding trade was a powerful driver of economic development – opening up new markets, improving access to raw materials, promoting international specialization and stimulating technological diffusion and innovation – which in turn drove further trade expansion.

A central challenge at each historical stage was the development of international rules and structures capable of helping countries to coordinate their increasingly international economic interests, and of managing the powerful forces and stresses unleashed by economic change, such as the rise of new economic powers, the spread of technology and production, and the deepening of global economic integration. Periods of relative economic openness – after

Figure A.2: **Per capita merchandise exports of selected economies, 1840-1913** (1990 US$)



Source: Maddison Project and IMF.

the mid-19th century, after 1945, and after the Cold War – have tended to coincide with global economic development, while periods of trade fragmentation and protectionism – most notably during the inter-war period – have seen economic development stall or go into reverse.

(b) The first wave – early industrializers

The Industrial Revolution, despite its name, had modest beginnings. Although Great Britain was the first industrializer – a lead secured in part because of its access to vast overseas colonial markets and its early embrace of free trade – its economic growth of less than 1 per cent a year in the first half of the 19th century was unremarkable by subsequent standards. Only when other early "developing countries", including Germany, France, the Netherlands, Belgium and later the United States, began to catch up with Great Britain after the mid-19th century, did the world experience the first major period of rapid economic expansion.

From 1870 to 1913, world capita GDP rose 1.3 per cent a year compared with 0.5 per cent between 1820 and 1870, and 0.07 per cent between 1700 and 1820 (Maddison, 2001). Trade, which expanded four times as fast as world output, was a critical driver of economic growth and technological diffusion throughout this period, mainly because of new transport and communications innovations – steamships, railways, telegraph cables – but also because of the spread of open trade and exchange rate policies. This period is sometimes referred to as the "first age of globalization", but in reality only a small cluster of countries in Europe and its former colonies experienced dynamic development, while the vast majority of the world's population, especially in Asia, Latin America and Africa, progressed only slowly, if at all. This growing divergence in living standards and wealth between the fast-industrializing "core" of the world economy and the pre-industrial "periphery" became a defining feature of the global economic landscape over much of the subsequent two centuries.

(i) Death of distance

Breakthroughs in transport and communications technologies in the 19th century were both an effect and a cause of economic development (see Figure A.2). By the late 1830s, steamships were regularly crossing the Atlantic, by the 1850s service to South and West Africa had begun and, with the opening of the Suez Canal in 1869, creating an important short cut to Asia, transoceanic steam shipping took over Far Eastern trade routes as well, sealing their dominance of global trade (Landes, 1969).

Railways were the other major transport breakthrough of the early Industrial Revolution. The world's first freight rail line, the Stockton-Darlington route, opened in 1825, and was soon copied, not just throughout Great Britain, but in the rest of Europe, the Americas, and, by the end of the century, Asia and Latin America as well. A transcontinental line linked the East and West coasts of the United States by 1869, playing a major role not just in the settlement of the West, but in linking the vast American hinterland to global markets (O'Rourke and Findlay, 2007). The Canadian-Pacific railroad was completed by 1885 and the trans-Siberian railway by 1903. The decade prior to the First World War also saw an explosion of railway building in Argentina, India, Australia, China and elsewhere. Railway lines increased from 191,000 kilometres in 1870 to nearly 1 million kilometres in 1913 (Fogel, 1964). Breakthroughs in refrigeration after the 1830s reinforced the impact of steamships and rail, allowing for the transport of chilled meat and butter over great distances (Mokyr, 1990).

Other technologies contributed to lowering communications costs. The arrival of the telegraph in the mid-19th century was as revolutionary as steamships and railroads, effectively ushering in the modern era of instantaneous global communications. The first successful transatlantic telegraph message was sent in August 1858, reducing the communication time between Europe and North America from ten days – the time it took to deliver a message by ship – to a matter of minutes. By the end of the 19th century, British-, French-, German-, and American-owned cables linked Europe and North America in a sophisticated web of telegraphic communications. As transoceanic steamships linked up distant markets, railways connected emerging industrial centres and telegraphs linked financial centres, world trade and investment surged.

(ii) Minimalist international cooperation

Although technology was the major driver of trade and integration in the second half of the 19th century, the spread of liberal economic policies also played a role. First, Great Britain removed many of its tariff barriers and trade restrictions unilaterally (the so-called Navigation and Corn Laws) between 1846 and 1860, providing a powerful push towards more open international trade. Next, in 1860, it negotiated the Cobden Chevalier Treaty with France which, in reducing trade barriers between the world's two biggest economies on a conditional most-favoured nation (MFN) basis, created an incentive for other European countries to conclude similar bilateral trade agreements. Next, in the 1870s, again following Great Britain's lead, the world's major economies shifted to the gold standard and fixed exchange rates, adding perhaps the most important pillar to global economic stability during that period.

Although these institutional arrangements were largely focused on European countries, Europe's place at the centre of the world economy and its extensive imperial and colonial ties meant that large parts of the world economy were automatically (and involuntarily) drawn into the open trading order being constructed after 1860. French, German, Belgian and Dutch colonies essentially adopted the same tariff codes as their home countries while most of Great Britain's dependencies, such as India, applied the same low, non-discriminatory tariff on foreign as well as British imports. Where developing countries attempted to resist opening up to foreign trade and investment, Western powers were prepared to use military muscle to prise open markets, for example during the Anglo-Chinese Opium War between 1839 and 1842, and when US Naval Commodore Perry, by threatening to use force, opened Japan to Western trade in 1853.

This combination of technological change, spreading trade-opening and mass migration fuelled a period of extraordinary economic integration. Indeed, economic historian Kevin O'Rourke argues that "the most impressive episode of international economic integration which the world has seen to date were the years between 1870 and the Great War". Openness – that is, the share of trade in output – rose steadily, from just 1 per cent in 1820 to 7.6 per cent in 1913 – a high point not surpassed until the 1960s (Maddison, 2001).

(iii) Global specialization – if not yet global value chains

While the late 19th century saw nothing as complex and sophisticated as today's global value chains, signs of growing international specialization, the "unbundling" of global production and the spread of foreign investment were already evident. With the arrival of steamships and railways, a vast range of commodities were suddenly accessible to the world's industrial centres, just as new manufactured goods began to flood the rest of the world.

Transoceanic trade in grains, metals, textiles and other bulk commodities – as well as in manufactured goods – became increasingly common in the latter half of the 19th century. Global trade and exchange rate stability encouraged massive outflows of foreign capital during this period – especially from Great Britain, which directed about half its savings abroad, but also from France and Germany. Much of this investment went into railway construction in the United States, Canada, Russia, Latin America and Asia, further strengthening economic integration and accelerating growth. The period 1870 to 1913 also saw large-scale international migration, with an outflow of 17.5 million people from Europe to the Americas and Australasia, further cementing global economic integration. The most striking feature of this emerging global economic system is that it was underpinned by simple – though fragile – rules and agreements, not by a network of international organizations designed to "manage" the world economy.

One of the key factors facilitating Europe's rapid industrialization throughout the 1800s was the vast amount of fertile land in the Americas which could be used to grow the large quantities of food needed to feed a fast-expanding European population, thereby allowing Europe's labour and land to be freed up for further industrialization (Pomeranz, 2000). Despite a fast-growing population and limited arable land, Great Britain saw food prices stop rising in the 1840s and start falling thereafter, helped by the abolition of the Corn Laws, which had imposed high duties on imported corn (O'Rourke and Williamson, 1999; O'Rourke and Findlay, 2007).

Declining food prices benefited industrial workers and urban consumers – helping to fuel further industrialization and urbanization – but disadvantaged landowners and farm labourers. By the 1870s, Great Britain's farm sector employed less than a quarter of its working population. Great Britain also absorbed over a quarter of the world's exports, mainly food and raw materials, and was the main exporter of manufactured goods as well as the largest provider of trade-related services, such as shipping, trade finance and insurance.

Just as farmers in industrialized countries faced increased competition from highly competitive agricultural producers in the New World, developing-country artisanal and craft producers increasingly found themselves out-competed by more capital- and technology-intensive producers in the fast-industrializing North, often protected behind tariff walls, e.g. the 1690-1721 Calico Acts which shielded Great Britain's textile industry from surging Indian imports (Bairoch and Kozul-Wright, 1996). It may be an exaggeration to argue, as does economic historian Paul Bairoch, that massive inflows of European manufactured goods, particularly of textiles and clothing, resulted in the "deindustrialization" of the developing world, but there is no question that the latter half of the 19th century saw the continued consolidation of the North's manufacturing dominance. The destruction of India's textile industry was a striking example but a similar process was taking place in China, Latin America and the Middle East (Bairoch and Kozul-Wright, 1996). According to Bairoch, the developing world saw its share of global manufacturing fall from over a third to less than a tenth between 1860 and 1913 (Bairoch, 1982). Only after the turn of the 20th century did the North's growing manufacturing dominance over the South begin to reverse.

(iv) The industrialized core converging – but the core and the periphery diverging

This "first age of globalization" was less than global in its scope. As the early industrializing countries pulled ahead of the pre-industrial rest (Pomeranz, 2000), a new and uneven global economic landscape began to emerge, defined by a European "core" increasingly focused on manufacturing, and the largely colonial "periphery" supplying raw materials (O'Rourke and Findlay, 2007).

Although commodity specialization brought significant economic benefits – Argentina and Mexico, for example, had among the world's highest growth rates in the second half of the 19th century – for many others, economic progress was modest or non-existent. China, which had the world's largest economy in 1820, saw its per capita GDP actually shrink by over 1 per cent a year between 1870 and 1913. India, other Asian economies and Africa performed marginally better, but still per capita income rose by just a quarter during this period (Maddison, 2001). Meanwhile, the industrialized countries' access to cheaper raw materials and vast markets for their manufactured goods allowed them to advance at a much greater pace, both economically and technologically, than the rest of the world. In 1860, the three leading industrial countries – Great Britain, Germany, and the United States – were producing over a third of total global output; by 1913 their share was a little under two-thirds of a much larger total. In 1820, the richest countries of the world had a GDP per head of about three times the poorest; by 1913, the ratio was ten to one (Maddison, 2001).

(c) The inter-war interregnum – disaster strikes and development stalls

Global integration reversed between 1914 and 1945, the result of a series of related political shocks to the international system – war, depression and economic nationalism. This, in turn, caused economic development largely to stall in many regions and, in Europe, to go backwards. The world economy grew much more slowly than in 1870–1913, world trade grew much less than world income, and the degree of inequality between regions continued to increase (Maddison, 2001). There were exceptions, however. Although the United States and the British "dominions" suffered significant war casualties and the diversion of resources into the war effort, they were spared many of the most destructive aspects of the conflict and benefited from supplying Europe with armaments, munitions and resources. Meanwhile Latin America and Africa were only mildly affected by the disruption of world trade, and in fact benefited from the temporary dislocation of European commodity suppliers.

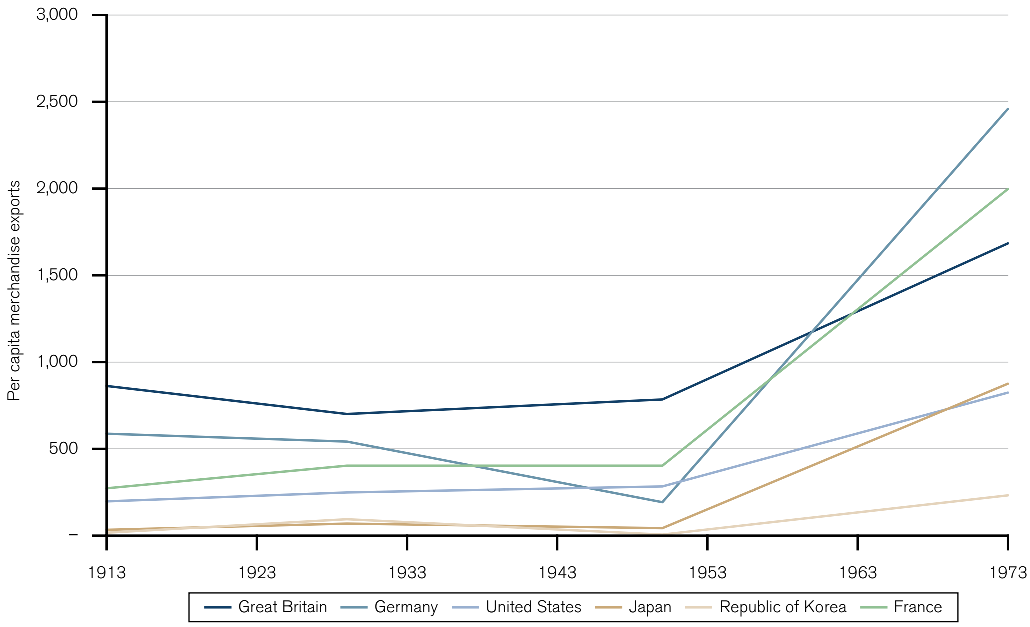
The First World War was an unmitigated disaster. Sixteen million died and another 20 million were wounded. In the war's aftermath, Germany faced huge reparations payments and France lost two-thirds of its foreign investments, while Great Britain suffered major losses to its merchant shipping fleet, liquidated much of its overseas investments, and accumulated massive foreign debts. Frontiers were dramatically redrawn in Europe, as Germany's territory was reduced and the Austrian, Russian and Turkish empires were dismembered, creating new tariff barriers and currency areas, upsetting transport routes and generating massive problems of dislocation and adjustment. The war caused a drop in GDP across most Western European countries, with the biggest falls in Belgium, France and Austria. Western Europe's pre-war levels of GDP were not regained until 1924.

Nonetheless, the world made some tentative progress towards rebuilding the pre-war order with a return to the gold standard in 1925 and the launch of new bilateral trade negotiations in 1927. However, this progress, fragile at best, was soon shattered by the Great Depression of 1929-33. A series of policy mistakes in response to the 1929 Wall Street stock market crash quickly translated into widespread debt default, a massive flight of capital from Europe to the United States, and collapsing global demand. Thanks to the United States' ill-conceived Smoot-Hawley tariff legislation of 1929-30 – which massively increased US tariffs on imported goods – it also led to the collapse of open trading.

A wave of trade protectionism unleashed by the US tariff increase, and exacerbated by falling import prices, saw the volume of world trade fall by more than a quarter over the following years; its 1929 peak was not reached again until 1950 (Eichengreen and Irwin, 2010). The economic downturn was most severe in the United States because of the collapse of its financial system, but the Depression's impact was felt throughout Europe and the Americas. World GDP fell further during the Depression than it had during the First World War. By undermining international cooperation and fuelling the rise of militaristic regimes in Germany, Italy and Japan, the Depression also laid the groundwork for the outbreak of the Second World War.

The Second World War was even more devastating than the First, leaving over 80 million dead, much of Europe and

Figure A.3: **Per capita merchandise exports for selected economies, 1913-73**
(1990 US$)



Source: Maddison Project.

parts of Asia destroyed, and the international economy in ruins. It also led to civil war in China, and the beginnings of the disintegration of the British, Dutch and French empires. However, the experience of other regions was very different. In the United States, for example, output doubled during the war years (at growth rates of 13 per cent a year) as the large slack in the economy after the Depression was mobilized behind the war effort. Latin America's output increased by nearly a quarter, boosted by war-fuelled demands for its commodity exports, and output also grew in Asia and Africa.

(d) The second development wave – a post-war "golden age" of growth

The second wave of economic development ran from the immediate post-Second World War era until the early 1970s – the so-called "golden age" of prosperity – with world GDP growing by 4.9 per cent a year and world trade growing by an even more impressive 7 per cent. The United States grew at over 2.5 per cent a year, consolidating its position as the world's economic and industrial leader but European countries achieved even faster growth rates reflecting the huge scope both for recovery from depression and war and for catch up to the technological advances of the United States (see Figure A.3).

However, the most dramatic economic story during the golden age was the rapid rise of newly industrializing economies in East Asia, which quickly closed the gap with the advanced West. Japan, the "miracle" developing economy of its era, grew at an astounding 10 per cent a year on average between 1950 and 1973 – comparable to the spectacular growth rates recently achieved by China – partly because it was recovering from the war, but mainly because it was catching up with the industrial leaders (Takatoshi, 1996). Its successful export-led ascent provided a model for the subsequent rise of Asia. In some respects the Republic of Korea's economic growth trajectory was even more extraordinary because it lasted longer. Among the world's poorest economies after the Korean War of 1950-53, the Republic of Korea was recording annual growth rates of 10 per cent a year in the early post-war decades, 9 per cent in the 1970s and 1980s, and 6.6 per cent in the 1990s – the fastest sustained growth rate in history – fuelled in no small part by even faster growing trade. The ratio of its merchandise exports to GDP rose from 0.7 per cent in 1950 to 36.3 per cent in 1998 (Wolf, 2004). Other Asian "tigers", such as Chinese Taipei, Hong Kong (China) and Singapore, also advanced at similarly unprecedented rates. This resulted not only in an expansion of the industrial "core", but in a further widening of the gap between the rich world and the pre-industrial poor.

China, which had endured 12 years of war between 1937 and 1949, barely grew at all in the 1950s and 1960s. Although Africa started in 1950 with a per capita GDP slightly higher than Asia's, its per capita income grew the slowest during the golden age, at just 1.8 per cent. Latin America, which had done better than any other region during the inter-war years, also grew more modestly during the golden age, in part because of more restrictive trade regimes.

(i) A new international economic order

The post-war era saw a rapid return to trade growth. This was due in large part to the new international economic order established after the war – anchored in the

International Monetary Fund (IMF), the World Bank, the General Agreement on Tariffs and Trade (GATT) and the Organisation for Economic Co-operation and Development (OECD) – which underpinned the gradual restoration of open trade after its collapse in the inter-war years.

Although the Cold War divide destroyed the wartime dream of building a universal economic system, this divide, and the security concerns it raised, reinforced solidarity and cooperation within the Western alliance, and encouraged countries to hold in check the economic conflicts and beggar-thy-neighbour policies that had proved so disastrous in the 1930s. The United States assumed the leadership role it had largely avoided in the inter-war period, not only by designing the post-war order, but by providing a substantial flow of aid for Europe, encouraging open trade policies and fostering cooperation. Until the 1970s, it also provided the world with a strong anchor for international monetary stability. North-South relations were also gradually transformed, turning from colonial dominance and exclusion to a greater focus on development and financial aid, reinforced by Cold War interests.

In addition to the Cold War divide, however, the gap between the advanced and the developing world continued to widen – leading to what economic historian Lant Pritchett describes as "divergence, big time" (Pritchett, 1997). The biggest beneficiaries of the post-war open trade were the advanced economies, especially Europe and newly industrializing Asia, where trade growth averaged 8.6 and 8 per cent a year respectively. Latin America, with its greater resistance to trade opening and reliance on domestic production rather than imports, benefited less from trade's unprecedented expansion. Africa enjoyed higher export growth than Latin America but significantly lower than the United States, Europe or newly industrializing Asia. Meanwhile, the Soviet bloc and China purposely isolated themselves from the increasingly open and integrated world economy.

(ii) The technological revolution continues

Fast-expanding post-war trade was also a reflection of further technological advances in transport and communications, many of which were fuelled by the war. Innovations in transoceanic shipping included the development of turboelectric transmission mechanisms and the replacement of coal-fired plants with diesel engines. In 1914, coal-burning steamships made up almost the entire world merchant fleet. By the 1920s, this had fallen to only 70 per cent; then to less than 50 per cent in the 1930s; and to only 4 per cent by 1961. The closure of the Suez Canal in 1956-57, and again in 1965, prompted the shipping industry to invest in huge, specialized bulk freighters and oil tankers as well as in the harbour facilities needed to handle them, as a way of reducing the costs of longer shipping routes. The biggest modern super-tankers are more than 30 times the size of their post-war predecessors, and bulk freighters have grown almost as quickly, making it more economical to move commodities and other low-value-to-weight goods over great distances.[3]

The introduction of container ships after the 1960s also drove down ocean bulk shipping costs, although some of the gains in the 1970s and 1980s were offset by rising fuel prices. According to economic historian David Hummels, prices for ocean shipping, which were largely unchanged from 1952 to 1970, increased substantially from 1970 to the mid-1980s, then steadily declined over the next two decades (Hummels, 2007). Railway networks also expanded rapidly, including between the two world wars, especially in developing economies, while diesel and electric locomotives increasingly replaced steam engines. Mass adoption of motor vehicles also began in the inter-war period, and transformed passenger travel and overland haulage. Initially limited to transporting passengers in urban areas, large motorized trucks were soon being used on feeder routes to the main railways lines, and eventually competed with those lines. Air freight represented yet another major transportation breakthrough that began with rising wartime demand, leading to a ten-fold decline in air shipping prices since 1950. As a result, according to Hummels, air shipping has grown from an insignificant share of trade in 1950 to a third of US imports by value and half of US exports outside of North America today (Hummels, 2007).

(iii) The rise of multinational enterprises – laying the groundwork for globalized production

A central feature of the post-war economic landscape was the growing importance of multinational enterprises (MNEs), fuelled by a surge in foreign direct investment. MNEs are not a 20th-century invention. Transnational firms, such as the Dutch East India Company or the British East India Company, played key roles in Europe's colonial dominance of Asia and other regions from the 18th century. Growing transport, trade and investment links in the 19th century only accelerated this trend. However, in the decades after the Second World War, MNE activity expanded most dramatically, thanks to US commercial dominance and the increasing internationalization of trade and especially investment, which grew more rapidly (though also more erratically) than either production or international trade after 1945.

US MNEs heavily dominated foreign investment activity in the two decades after the Second World War but European and Japanese corporations also began to play ever-greater roles. Most of the huge expansion in international investment took place among advanced industrial countries. However, MNE activity in developing countries also expanded throughout this period, with the stock of foreign capital rising from 4 to 22 per cent of developing countries' GDP between 1950 and 1973. As MNEs expanded their global reach and became more interconnected, business activity became increasingly internationalized – laying the groundwork for even greater international specialization and the rise of global value chains.

(iv) The great divergence grows greater

As the United States continued to grow, Europe rapidly recovered, and the Asian tigers raced to catch up, the wealth and income gap between the advancing industrial countries and the developing world grew ever wider. By 1970, the world's richest countries had a per capita GDP 30 times higher than the poorest – compared with only a three-to-one differential a century before. Never before had the world experienced income and wealth differences on this scale (Pomeranz, 2000). The "great divergence" continued.

Some economists, most notably Raul Prebisch, argued that peripheral countries were trapped permanently in a cycle of under-development because of structural imbalances in the world economy, and that radical reforms to the international system and to national industrial policies were needed if the gaps between rich and poor were to be narrowed. Their proposals included shielding infant industries from foreign competition and encouraging inward investment and technology transfers – policies which, it was argued, many advanced economies had also employed to promote their economic and technological development. These ideas helped to shape a generation of developing countries' industrial strategies as well as the design of the GATT's so-called "special and differential" rules – including lower obligations, longer phase-in times and more beneficial market access – for developing countries after the 1960s.

(e) The third development wave – the age of globalization

Since the late 1980s, the world has witnessed a cycle of economic development, the largest so far (see Figure A.4). Its most striking feature is the dramatic growth trajectory of emerging markets, with the vertiginous rise of economic giants such as Brazil, China, India, Indonesia and the Philippines. While, from 1950 to 1973, Japan recorded super-growth of over 10 per cent a year, the rest of Asia only grew at 2.6 per cent. From 1973 to 2000, the rest of Asia grew twice as fast as Japan, and in the 1990s the region grew four times as fast.

Since the 1980s, seven Asian economies (China; Hong Kong, China; Malaysia; Singapore; the Republic of Korea; Chinese Taipei; and Thailand) have grown at an average rate of 8 per cent a year for more than 25 years (Growth Commission, 2008) – a scale and speed of development unmatched in history. Economic growth in the United States has been marginally slower since the early 1970s, at an average rate of 2.4 per cent, than in the post-war period. Europe's and Japan's rapid catch up to US per capita income levels during the golden age (between the Second World War and the early 1970s) had ended for most countries by the 1990s. Between 1973 and 1998, Western Europe's GDP grew by 2.1 per cent a year compared with 4.8 per cent between 1950 and 1972, and has grown even less in the first decade of the 21st century. Once again, expanding trade has both reflected and reinforced this period of global growth.

(i) The post-war order goes global

While the structure of the international system has not changed significantly since the post-war era, its scope and composition have altered dramatically. The successful conclusion of the GATT's Uruguay Round and the creation of the WTO in 1994 were the culmination of a half-century of evolution, deepening existing rules and practices while bringing whole new sectors, such as services and intellectual property, into the rules-based trading system. Membership also expanded dramatically over this period. From just 23 members in 1947, the WTO has 160 members today – three-quarters of which are developing economies, including China and Russia.

(ii) The rise of global value chains

One prominent feature of today's more open and integrated world economy is the rise of value chains. Just as rapidly falling transport costs in the 19th century led to globalization's "first unbundling" – separating factories' locations from those of consumers – the newest wave of integrationist technologies (containerization, air freight, telecommunications, informatics) is leading to globalization's "second unbundling", as Richard Baldwin describes it – the end of the need to perform most manufacturing stages near one another (Baldwin, 2011).

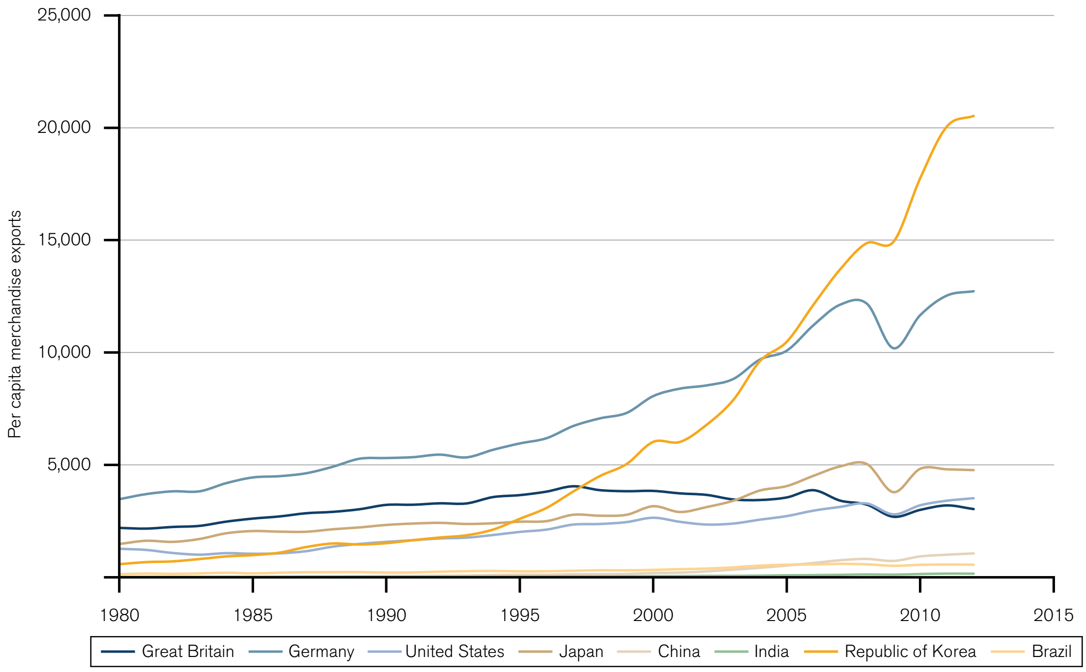
Manufacturing is increasingly managed through complex global supply chains, effectively world factories, which locate various stages of the production process in the world's most cost efficient locations. The proliferation of multinational enterprises, the global reach of which allows them to coordinate production and distribution across many countries, has been indispensable to this process. To enhance efficiency and to optimize profits, MNEs now locate research, development, design, assembly, production of parts, marketing and branding activities in many different countries around the globe. While in 1969 there were just 7,000 MNEs, by 1990 there were 24,000, and today that number has risen to 111,000 – a sixteen-fold increase (United Nations Conference on Trade and Development (UNCTAD), 2013). Cross-border trade between MNEs and their affiliates – or intra-firm trade – now accounts for the largest share of international trade in goods and services.

Global value chains not only have an impact on the strategy of firms, but on that of countries as well. Given that economies participating in value chains can only increase exports in direct proportion to the increase in imports, governments have a key role to play in establishing a policy environment that enhances and facilitates "connectivity", including by unilaterally lowering trade barriers and reducing transaction and logistics costs. The growing importance of global value chains helps explain why China, for example, has emerged as the world's largest manufacturer over the past decade, its factories importing parts and components – mainly from East Asia but also from other economies across the globe – for assembly into final products.

(iii) Resurgence of commodities?

Rising demand for food and raw materials as a result of rapid industrialization and urbanization has fuelled a

Figure A.4: **Per capita merchandise exports for selected economies, 1980-2012** (1990 US$)



Source: WTO Secretariat.

worldwide commodities boom, or super-cycle, that started in the late 1990s and peaked in 2011. Price rises have been widespread across all commodities but most notably in those commodities closely linked to China's rapidly expanding manufacturing and export sector. Some argue that long-standing terms of trade imbalances between manufacturing and commodity exporters are being reversed, and that the recent rise in commodity prices probably represents a deeper structural shift in the global economy that will continue to benefit developing economies. However, others argue that the commodity super-cycle is simply the most recent example of the typical boom and bust pattern that has always governed commodity prices and that signs of slowing demand and values – hastened by a cooling Chinese economy and growing US self-sufficiency in energy – are already evident.

(iv) A great convergence?

The last two centuries have been the most dynamic in world economic history. For many developing economies, recent decades were particularly favourable for growth – to the point that the "great divergence" appears to be giving way to the "great convergence". In the space of a generation, China has become the world's second-largest economy and leading exporter, while India, Brazil, Indonesia and other emerging economies – representing half of the world's population – have also achieved historically high growth rates. As Michael Spence has argued, we are not at the end, nor the beginning, of a process but rather part way through an industrial revolution that is now entering its third century (Spence, 2011). This rapidly spreading advancing and accelerating process of development has been possible because the world economy has become more open and integrated. Economic openness has, in turn, depended on the underlying strength and resilience of the international system – its ability to absorb rising giants, to withstand shocks, and to promote cooperation and coherence.

However, while global economic development and convergence are bringing enormous benefits and opportunities – not least to those in fast-emerging economies – they also carry cost and risks. The *World Trade Report 2014* evaluates these opportunities and risks created by the four main trade factors that are currently driving development – the rise of new economic powers, the spread of global value chains, the growing importance of commodities trade, and the deepening integration and volatility of the world economy.

Endnotes

1 In this report, emerging economies are a subset of developing economies including all non-developed G-20 members. Detailed country group definitions are provided in Appendix Table B.1.

2 This notion of broad phases of economic development draws extensively on the seminal work of economic historian Angus Maddison, (Maddison, 1998).

3 Whereas oil tankers averaged 16,000 deadweight tonnes (dwt) in the early 1950s, they averaged over 100,000 dwts by the 1990s – with modern "super-tankers" exceeding 500,000 dwts and capable of carrying over 3 million barrels of oil (Lundgren, 1996).