Introductory note

Regional economic integration has the potential to complement national development strategies and to address some of the longstanding structural weakness of many developing and least-developed countries. UNCTAD research shows that integration – when implemented within a broader development strategy that promotes economic and trade diversification, structural changes and technological development – may enhance productive capacities, realise economies of scale, help to promote technology transfer, create new markets and improve competitiveness. Through the development of regional trade integration, firms can boost their competitiveness and diversity export markets. Regional economic integration can, therefore, be a launch pad for the effective participation of developing countries in the global economy.[1]

These days, regionalism has forcefully returned to the forefront of attention. One reason for this has been the slow progress in the Doha Round of multilateral trade negotiations that has led countries to increasingly pursue regional agendas. However, the benefits of regional integration cut deeper than this – as is clear by the evidence linking regional integration with economic growth and poverty reduction. One thinks in particular of the experience of economic and political integration in Europe; and of the differences in economic performances of the Asian region, where regional trade accounts for a very high proportion of total trade and economic growth has been rapid, compared to some countries in Africa, where regional trade accounts for less than 10 per cent and growth has been slow or even stagnant.

Trade is essential for regional integration and cooperation to support the development policy agenda, and it has to extend beyond trade liberalisation. It needs to include policy areas that strengthen the potential for growth and structural change in developing countries. These include macroeconomic and financial management, as well as trade support and industrial policies.

There is a considerable body of economics literature, mostly in the branch of international trade theory, which views regionalisation with alarm and sees it as the result of trade-diverting agreements which threaten to undermine the global trading system. Such agreements may have played some role in boosting regional trade at the expense of multilateral transactions, but it is far from clear that this is inevitably the case; indeed, there are a number of more fundamental forces at play that tend to be ignored by mainstream trade theory. Regional trade in Europe, North America and, increasingly, in East Asia is largely dominated by intra-industry exchanges of intermediate manufactures and capital goods, and these reflect a very high degree of specialisation in the various stages of the manufacturing production process. Intra-industry trade has the propensity to be most intense among industrialised (or industrialising) countries at similar levels of

[1] UNCTAD (2009), *Economic Development in Africa Report*, United Nations, New York and Geneva, UNCTAD (2007), *Trade and Development Report 2007: Regional Cooperation for Development*, United Nations, New York and Geneva.

development and is driven by dynamic economies of scale and specialisation and by the search for long production runs. These processes tend to generate economies of agglomeration and to trigger cumulative patterns that reinforce the degree of concentration over time.

Once such processes are under way there will be pressure from producers within the region to lower or remove the various barriers to intra-regional trade, including bureaucratic red tape, conflicting legal restrictions and administrative procedures and so on, as well as demands for better transport and communications infrastructure. These various demands are likely to be accompanied by the creation of institutions for closer regional cooperation, as has happened, for example, in Western Europe. At first, such cooperation will tend to focus on technical issues (trade barriers, standards and the like) but as regional production systems become ever more integrated, so the regional policy framework is likely to expand.

With these underlying processes in mind, it seems clear that regional economic integration can contribute to generating development prospects in a wide range of areas. It can improve development prospects in terms of physical infrastructure, which is often missing or of poor quality in developing countries. Road, rail or air transport are areas where cooperation on major investment projects can help reduce bottlenecks in public infrastructure. Energy and water supply are other cases in point. The first Union of South American Nations (UNASUR) Summit on Energy held in 2007 was a successful experience promoting energy integration in the region.

In the context of regulatory and institutional cooperation, regionalism can also help address those areas which present today's central development challenges. Cooperation in the regulation of infrastructure services sectors can facilitate the supply of energy or water to the poor and marginalised by creating economies of scale that contribute to extending the coverage of services at lower costs.

Cooperative regional arrangements on monetary and financial aspects, such as the Chiang Mai initiative, provide valuable tools for the stabilisation of intra-regional exchange rates, and thereby reduce their potential to serve as a source of instability or as a transmission mechanism for global shocks. The Bank of the South (Banco del Sur), recently established by seven South American countries to finance projects in agriculture, energy and health care for member nations and to enhance trade, is yet another example. Cooperation in areas related to migration and the movement of people, the protection of the environment or the management of river basins provide further evidence. Other areas in which regional integration may also bring substantial improvements are education, research and development, and transfer of technology.

South–South cooperation has also been deepened on agriculture, rural development and food security, for instance: the Comprehensive Africa Agriculture Development Programme (CAADP);[2] the New Partnership for Africa's Development (NEPAD), the Council of Agriculture of South America (CAS); and the ASEAN Integrated Food Security (AIFS) Framework and the Strategic Plan of Action on ASEAN Food Security (SPA-FS) adopted by the 14th ASEAN Summit in 2009.

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[2] UNCTAD, 'The role of South–South and triangular cooperation for sustainable agriculture development and food security in developing countries', TD/B/C.II/MEM.2/5, 2009.

In UNCTAD we have a particular interest in regional integration on trade, an area which has been highly dynamic over the last decades. Since the 1990s there has been a proliferation of regional and bilateral free trade agreements (FTAs) or preferential trade agreements (PTAs) between developed and developing countries. The number of currently operational regional trade agreeements (RTAs) notified to the World Trade Organization (WTO) has risen from fewer than 100 in 1995 to more than 225 in 2009. Consequently, more than half of world merchandise trade, and a significant portion of trade in services, fall under regional trading regimes.[3] The scope of RTAs has evolved significantly over time. The newer generation of RTAs – characteristic of the so-called 'new regionalism' – has wider coverage, going beyond just tariff measures to include deeper 'behind-the-border' regulatory policy measures, such as services, investment, competition policy, government procurement and labour mobility, as well as such non-trade policy commitments as current and capital account opening. The financial and economic crisis has accentuated the vulnerability of countries that have made broad and deep commitments through RTAs.[4]

There are numerous reasons for developing countries to negotiate RTAs: to secure market access, to obtain preferential concessions or to overcome stalemate in the Doha Work Programme. Nevertheless, RTAs, particularly when undertaken on a North–South basis, also present multiple – sometimes difficult – choices for developing countries. RTAs may require sharp tariff reductions (which can expose domestic manufacturers to overwhelming competition), include the WTO 'plus issues' (for example, competition, investment or government procurement), replace special and differential treatment with full reciprocity or even lead to preference erosion.[5]

Hence, in assessing the possible economic and social benefits and costs of entering into North–South bilateral or regional FTAs, developing countries should not only look at the potential changes in exports and imports arising from new or more secure market opening but also consider the impact of such agreements on their policy options and instruments for longer-term development.

In the years from 1995 to 2007, trade growth in developing countries doubled its ratio to GDP, reaching more than 50 per cent of developing-country domestic output – illustrating the importance of trade as a channel of finance for development. In particular, South–South trade between developing countries increased by more than three times its 1995 level, reaching almost 46 per cent of their total trade in 2007. These trends helped developing countries to diversify production and create new trade and investment flows.

Linking South–South trade to structural transformation will pose different policy challenges for different groups of countries. For African economies, South–South trade offers opportunities for diversification away from commodity dependence, and perhaps

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[3] Roberto Fiorentino's chapter in this Handbook (Volume I, ch. 1) entitled 'The never-ending story of regional trade agreements', examines recent developments in RTA proliferation.

[4] UNCTAD, 'South–South cooperation and regional integration: where we stand and future directions', TD/B/C.II/MEM.2/2, 2008.

[5] See the chapter by Richard G. Lipsey and Murray Smith in this handbook (Volume I, ch. 3), entitled 'Multilateral versus regional trading arrangements: substitutes or complements?', for an examination of the political economy dynamics of RTAs.

more so than their trade with the North, although this is likely to vary across product groups. It also offers some middle-income economies in Asia and Latin America an opportunity to avoid producing only relatively unsophisticated manufactured goods. Moreover, new opportunities might be emerging for those developing countries, which export higher value-added, technology-intensive products.[6]

The recent financial and economic crisis has forced Northern economies to undertake large-scale adjustments (at the household, government and national levels) and to correct the massive financial imbalances that have built up over the last few years. This has slowed down consumption and growth in these economies, and it has also exposed the dangers of relying too heavily on Northern economies as main trading partners. These developments suggest that Southern trade, as both a vent for surplus and a source of diversification and upgrading, might take on an even greater importance over the coming years.

Expanding these opportunities will not come automatically, it will depend on renewed cooperation among countries of the South. In this respect, South–South trade should not be approached as a stand-alone engine of growth, but as part of a broader set of interdependent challenges involving investment, structural changes and technological upgrading.

The area of international investment has also seen important developments at the regional level. In the case of East Asia, a close association between the pattern of industrialisation and its regional location had been linked with the upgrading of economic activity from resource-based and labour-intensive industries to more and more sophisticated manufactures by the lead economies, which in turn has opened up opportunities for the less-developed neighbouring countries to enter the regional division of labour by engaging in less-demanding activities.

To stay ahead, the countries in the first tier of development have been forced to move up the trade hierarchy and export more sophisticated products where they now have a comparative advantage, with foreign direct investment (FDI) providing one possible route for recycling comparative advantage. This idea of a regional division of labour, combining an industrial and locational hierarchy, has been described as the 'flying-geese' development paradigm. Within this paradigm, government policy has been central to the regional impact of FDI, and when drawing wider lessons from this experience, it should not be forgotten that much of the international spillovers within East Asia have been ultimately generated because of the success of the industrial policy of the first-tier newly industrialised economies, rather than through a purely market-generated process.[7]

UNCTAD, which is the focal point within the United Nations Secretariat for matters related to FDI, is collecting – and disseminating – data on investment rule-making at the regional level. The number of BITs – bilateral investment treaties – has risen rapidly across the world. From 388 in 1990, the number at the end of 2008 reached a total of 2,676. Among developing countries, Asia led the conclusion of BITs, with 31 new BITs in

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[6] UNCTAD, 'Making South–South trade an engine for inclusive growth', Policy Brief 8, November 2009.

[7] UNCTAD has provided an extensive discussion of the East Asian model of development in its Trade and Development Reports, in particular those in 1994, 1996 and 2003.

that year alone. However, just how successful BITs are in attracting FDI remains an open question, and further research is needed on this issue, including on whether such treaties involving developing countries carry clear advantages. Besides BITs, international investment rules are progressively being adopted as part of regional, inter-regional and plurilateral trade agreements. These agreements have been multiplying steadily (287 by the end of 2009). Again, a large majority of agreements – about 87 per cent – have been concluded since the 1990s. Until the late 1980s, investment facilitation through these agreements remained confined mainly to intra-regional processes involving countries at similar levels of development, albeit with a few exceptions (such as the agreements between the European Community and developing countries). Since 1990, however, countries and groups located it different regions have concluded trade and investment agreements with one another, involving both developed and developing countries.

The spreading of these types of agreement has been one of the key developments in international economic relations in recent years. These 'other IIAs' are particularly relevant as they manifest a trend towards a more integrated approach when dealing with interrelated issues in international investment rule-making. Their greater variation presents an opportunity for experimenting with different approaches and accounting for the special circumstances of countries in different regions and at different levels of economic development. At the same time, their complexity increases and so does the likelihood of overlaps and inconsistencies between provisions. Over time, the negotiation of these agreements has created a multifaceted and multilayered system of overlapping – and sometimes also contradictory – rules.

All these and many more, are good reasons for the development community to take a careful look at the state and prospects of regional cooperation and economic integration today. In UNCTAD, we attach great importance to the close collaboration with academia, creating useful linkages between policy making and theory. Studies like this International Handbook are, therefore, a major achievement and I would like to thank all the participants for the hard work and congratulate everybody for the impressive contributions they are making to this welcome endeavour.

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