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UNITED
NATIONS

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United Nations Conference on Trade and Development

Distr.
LIMITED

TD/B/48/L.2/Add.6
11 October 2001

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Forty-eighth session
Geneva, 1-12 October 2001

DRAFT REPORT OF THE TRADE AND DEVELOPMENT BOARD ON ITS FORTY-EIGHTH SESSION

Held at the Palais des Nations
from 1 to 12 October 2001

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FINANCIAL STABILITY: REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE AND THE ROLE OF REGIONAL COOPERATION

UNCTAD events in support of financing for development
Informal meetings of the Trade and Development Board
(2-3 October 2001)

Summary prepared by the UNCTAD secretariat

1. These events were in two parts: firstly, a full-day debate on item 2 of the Board's agenda: "Interdependence: Financial stability: Reform of the international financial architecture and the role of regional cooperation", involving experts,[1] delegates attending the session of the Trade and Development Board and representatives of international organizations; and, secondly, a video conference involving, in Geneva, participants in the session of the Board and, in New York, the Bureau of the Preparatory Committee for the High-level International Event on Financing for Development, together with the Chairman of the Group of 77 and the Financing for Development Coordinating Secretariat. The present summary is likewise in two parts, one covering the full-day debate and the other the video conference.

Informal debate with experts

The terrorist attacks and economic prospects

2. Regarding the situation of the global economy after the terrorist attacks in the United States, the panellists agreed that these attacks had aggravated recessionary tendencies in the United States economy. This was likely to have an adverse impact on the economic situation in developing countries as a result both of falling demand for their exports and declining private capital flows to such countries. The panellists hoped that the coordinated monetary stimulus by the major developed countries, as well as the supportive fiscal measures, would lessen the negative impact of the attacks and strengthen economic recovery. Heightened concern about the situation of the global economy had given welcome new impetus to closer international macroeconomic coordination, a process which, it was hoped, would be continued.

The prospects for international financial reform

3. On prospects for fundamental reform of the international financial architecture, the panellists said that enthusiasm had given way to the perception that it was virtually impossible to reach consensus on such reform, and that second-best solutions in the form of

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[1] Mr. Philip Bowring, *International Herald Tribune;* Prof. Paulo Nogueira Batista Jr., Getulio Vargas Foundation, Saõ Paulo, former Undersecretary for Economic Affairs, Ministry of Planning, Brazil; Dr. Eisuke Sakakibara, Global Security Research Centre, Keio University, Tokyo, former Vice Minister of Finance for International Affairs, Japan; Dr. Yu Yongding, Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences, Beijing, China.

'do-it-yourself' approaches to crisis prevention and management at both the regional and national levels currently appeared to be the only politically feasible alternative. One panellist expressed the view that the terrorist attacks might actually set back the process of reform by diverting attention to other matters of more immediate concern. Fundamental reform was likely to be possible only in the aftermath of a crisis with serious economic repercussions in major industrial countries.

An international lender of last resort and crisis management

4. There were major unresolved issues concerning policies on crisis management and the private external debt of developing countries. The panellists had little hope regarding an agreement concerning the creation of an international lender of last resort (LOLR). Moral hazard was often given as one reason for inaction. However, while moral hazard existed also at the national level, there was general agreement on the need for last resort financing in order to avert systemic crises. Another reason stemmed from the widespread opposition to involving the private sector in the burden sharing of crisis management, without which an international LOLR was unlikely to be politically acceptable. However, developed countries appeared to be moving towards greater acceptance of standstills and debt moratoria as a way of increasing private-sector involvement, and recent remarks of the United States Secretary of the Treasury favouring the extension of domestic insolvency procedures to cross-border debt were cited in this regard.

5. One panellist argued that the emerging market economies had increasingly shown their willingness to solve the LOLR problem through their own independent actions, as reflected in massive accumulation of foreign exchange reserves. Whilst this was a costly option, it was preferable to undergoing crises.

Exchange-rate regimes

6. A major unresolved issue of the reform of the international financial architecture was the establishment of a stable global exchange-rate system. Concerning national exchange-rate regimes, a move towards the "corner" solutions of fixed pegs or free floating which had been recommended in some circles was not observable in reality. Managed floating (or 'implicit moving target zones') was the preferred and (in the panellists' view) the best solution. But to be successful, such a regime required competent management that would pragmatically balance tactical and strategic considerations, as well reasonably high foreign exchange reserves and willingness to use capital controls. Attention was drawn under the heading of exchange-rate regimes to Argentina's current economic problems, which were a drastic illustration of the cost that could result from the loss of monetary independence following the adoption of a currency board. Other developing countries had recently adopted, or were considering the adoption of, dollarization, but this was desirable only for countries with strong trade links to the United States.

7. With regard to the Group-of-Three currencies, no major regime change could be expected as long as none of the three currencies was directly affected by a financial crisis.

The Group-of-Three central banks would continue to resort to ad hoc intervention, while gearing monetary policy towards domestic objectives. The panellists had no doubt that better and increased coordination of intervention in the markets of Group-of-Three currencies was required to ensure greater international financial stability.

8. The advent of the euro was welcomed, and the panellists tended to accept the view that the euro was currently undervalued. There was support from the panellists for greater use of the euro in countries' exchange reserves and for intervention in currency markets. But there was skepticism as to the likelihood that the euro would rival the dollar as a reserve currency in the medium term.

Private financial flows to developing countries

9. The panellists suggested that less reliance on private capital flows should be a common goal for all developing countries, because of (i) the volatility of such flows, (ii) the likelihood that financial flows to developing countries would decline in reaction to the less optimistic outlook for the global economy and to the falling profitability of FDI in major recipient countries, and (iii) the lack of meaningful international financial reforms. However, greater self-reliance should not mean a retreat to autarky.

10. One panellist drew attention to the role of excessive external lending and investment inflows in the Asian crisis. These had not only strained still weak national supervisory regimes but had also contributed to the build-up of excess productive capacity in several sectors, which was now holding back economic recovery.

Regulation and supervision

11. Steps taken recently to strengthen national regulation and supervision regimes were generally welcomed. However, one panellist drew special attention to the fact that insufficient attention had been given to the weak credit controls of financial firms in industrial countries, which had made a major contribution to the depth of the Asian financial crisis. Such weaknesses should be the subject of more rigorous financial supervision in countries that were the source of international financial flows.

Regional financial cooperation

12. In the absence of tangible progress in the reform of the international financial architecture, the panellists felt that regional financial cooperation and arrangements could be a second-best solution. However, it was not realistic to expect rapid progress in this area. One panellist considered that the success of European monetary integration had been favoured by the close trade ties among the countries involved and had been based on a unique and historically motivated political commitment by EU member States, which so far was still lacking in Asia, for example, and which in general was difficult to replicate elsewhere. Another panellist noted that the yen continued to be mainly a local currency, implying that

there was no currency in the region that could play a role comparable to that of the deutsch mark in the transition to European Monetary Union.

13. Regional financial cooperation in Asia had so far proven to be difficult, even though the existence of extensive mutual trade and technology flows was a useful basis and some initial steps had been taken (such as the Chiang Mai initiative). Moreover further impetus behind such steps had been provided by disappointment with the IMF. Three countries in particular, Japan, China and the Republic of Korea, needed to make particular efforts, if these initiatives were to progress further. One panellist argued that China had so far kept a low profile for both economic and political reasons but was prepared to engage more fully in regional cooperation. Another panellist noted the reluctance of Japan to take the political lead in regional cooperation in Asia, although it was now prepared to provide financial resources. However, comparing the Asian with the European situation, he saw hopeful parallels between the potential roles of China and India on the one hand and the role played by France and Germany in Europe on the other. Another panellist noted that regional integration in Latin America, notably MERCOSUR, had gone through some difficult times, not least because of the very strong differences between the financial systems and exchange-rate regimes of Argentina and Brazil.

Economic situation of specific countries and regions

14. Regarding the economic situation in Asia one panellist expressed the view that pessimism was exaggerated despite the region's dependence on exports of electronic goods, a still incomplete process of banking and corporate restructuring, and a decline in the stock markets steeper than in most developed countries. He drew attention to a number of counterbalancing factors. Exclusive attention to gross export values of major Asian countries was misleading because of the large import content of their exports. This meant that the vulnerability of economic activity to trade shocks was smaller than often assumed. Secondly, the high current-account surpluses of many countries in the region offered them ample room for the stimulation of domestic demand. Thirdly, reducing interest rates had allowed them to maintain stable real exchange rates. Fourthly, import demand in Japan was picking up and China's imports continued to grow. Fifthly, intra-regional capital flows remained fairly high.

15. Another panellist explained that the economic situation in China was different from that of many other developing countries. Notwithstanding the financial turbulence in 1997–1998, China had continued to strengthen its external position as measured in terms of export growth, openness, FDI inflows, and the accumulation of foreign exchange reserves. China was now in a position to consider the option of shifting its exchange-rate regime to pegging to a basket of currencies and of revaluing rather than devaluing its currency. Accession to the WTO would entail problems for some sectors, but membership was indicative of China's acceptance of globalization and the opportunities it offered.

Surveillance

16. The need for more effective and less biased IMF Article IV surveillance was stressed. However, replying to this point, the representative of the IMF stated that Article IV surveillance was not biased and affected all member countries equally.

Financing for development

17. Regarding the forthcoming international conference on Financing for Development, the panellists felt that the recent crises reinforced the need to rethink development strategies in the direction of less reliance on external financing. The agenda for the conference should reflect, *inter alia,* the different routes that could be taken towards greater national financial self-reliance.

Video conference on financing for development

18. Opening the meeting, the President of the Board (United Republic of Tanzania) presented a brief summary of the formal and informal discussions of the Trade and Development Board on agenda item 2 dealing with “Financial Stability: Reform of the international financial architecture and the role of regional cooperation”. His intervention highlighted some of the differences between views expressed in the statements of developed and developing country delegates, particularly over the weight to be given to domestic and systemic issues in the context of financial reform.

19. The Secretary-General of UNCTAD acknowledged that the New York and Geneva diplomatic corps were still not sufficiently familiar with each other’s work and expressed his hope that further exchanges of this kind would remedy this problem. He pointed out that UNCTAD’s distinctive contribution within the UN system lay in providing an integrated treatment of trade, finance, investment and technology from a development perspective. In addition, UNCTAD would be involved in discussions on the areas of trade and finance where the secretariat had a significant amount of accumulated expertise. Devising appropriate policies would not, however, follow from looking at these subjects separately but rather from examining their mutual relations. This raised the wider issue of coherence among the various issues on the agenda of financing for development, which he believed would be the key to the success of the Monterrey conference.

20. The Co-Chair of the Bureau (Sweden) acknowledged the gaps in working relations between Geneva and New York, and expressed interest in hearing about the state of play on trade issues in the run-up to Doha. There was considerable interest in New York in the idea of coherence and in possible ways to achieve it. The Vice-Chair of the Bureau (Egypt) raised the issue of institutional coherence across the broad family of multilateral institutions dealing with economic issues. One representative saw a real opportunity following the tragic events in New York and Washington for a decisive outcome at the Monterrey Conference aimed at achieving greater coherence across the multilateral economic system. Another representative

emphasized the link between trade and finance as being of special importance for many developing countries, noting that it was a subject on which UNCTAD could make an important contribution.

21. In response, the Secretary-General of UNCTAD expressed some scepticism about the prospects for achieving concrete results at the conference on specific aspects of issues such as trade, ODA, and FDI, since these were all being discussed in other multilateral fora or were covered under actions at regional, bilateral and national levels; any decision would have to be coordinated with those discussions. This fact increased the importance of bringing coherence to the top of the agenda of the Financing for Development conference. For this reason it was important not to see the Conference as a one-off event, but rather as the launching of an orderly process of ongoing discussion on the basis of a balanced agenda. The model to follow in this regard remained the post-Second-World-War system in which the specialized institutions were intended to operate within an integrated system under a central coordinating body such as ECOSOC, which was to be the vehicle for institutional and programmatic coherence. In any event it would be essential to bring the concept of interdependence back to the core of the discussion of globalization. The alternative was to have profit maximization at the core of that process, which would be an unsatisfactory outcome. Concerning the links between trade and finance, the Secretary-General noted that UNCTAD was currently examining those links in a special study.

22. The President of the Board gave a brief summary of the issues on the trade agenda currently under discussion in the preparations for the Doha ministerial, including mandated issues (agriculture and services), implementation issues, new issues or issues brought up at Singapore (such as competition policy, investment and government procurement), and organizational issues related to the work programme of the WTO. One participant believed that there was a good deal of consensus on trade matters related to the Financing for Development process, in particular on the value of open trade policies in stimulating growth and alleviating poverty. In this context he believed a good start had been made in building a consensus for the forthcoming ministerial in Doha. However, another participant suggested that the discussion was in a much more precarious state, perhaps even more so than before the meeting in Seattle, with very large differences among parties on some of the most important areas of negotiation, including agriculture and anti-dumping, implementation issues, the new issues, and TRIPs.

23. The New York group returned to the issue of coherence in the context primarily of WTO issues. One representative raised two sets of issues where developing countries were looking for more coherence; firstly, debt relief and market access, and secondly, international standards and capacity building. Another representative recognized that coherence between national and international policy issues was central to success at Monterrey, and that approaching the subject from the perspective of interdependence would be important.

24. In response, the Secretary-General of UNCTAD stressed that it was necessary to keep a firm practical grasp on the concept of coherence. To illustrate the lack of coordination and coherence in the treatment of trade and finance respectively, he noted that the unilateral trade liberalization required as part of the conditions placed on lending from multilateral financial

institutions in the context of structural adjustment programmes was not recognized as constituting concessions during negotiations on trade liberalization in the context of multilateral trade negotiations at the WTO.

25. One representative expressed his concern that some issues had not yet been given proper attention, particularly debt and debt relief. He also stressed the need for coherence, not only between the secretariats in Geneva and New York, but also among developing countries, particularly those of the Group of 77, for the purpose of forging strong developing-country positions at the Financing for Development conference. In closing remarks, the Co-Chair of the Bureau insisted that the process of preparing for the conference was still ongoing, and that debt would be a central issue. Any initiatives to strengthen country groupings would be welcomed.