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II. President’s summary *(continued)*

Development strategies in a globalized world: financial policies and productive investment related to trade and development

1. The substantive discussion on agenda item 7 was based on the *Trade and Development Report, 2008* (especially chaps. 4–7), but was also shaped by the current dramatic developments in the financial markets, especially in the United States of America. The decision by the United States Government to bail out large financial firms in order to calm financial markets was interpreted as an indication that the State had an important role to play, not only in stabilizing, but also in supervising and regulating the financial sector.

2. The discussion highlighted the fact that, since 2000, developing countries as a group had been net exporters of capital. The increase in capital exports, which was the counterpart to a substantial improvement of current account balances, was attributed to two principle reasons: (a) an increase of commodity prices, which was benefiting commodity-exporting economies; and (b) a reorientation of macroeconomic policies in many emerging economies to maintain competitive exchange rates and avoid real currency overvaluation. It was suggested that the reorientation of macroeconomic policies was not so much the result of a grand design, but largely the result of financial crises that had struck many developing countries during the previous decade.

3. The discussion also stressed that countries with net capital exports were also those that had higher rates of investment and growth. That fact was understood to challenge orthodox economic theories, which maintained that capital should flow from rich to poor countries, where marginal returns were higher, and that poor countries depended on foreign capital to finance higher investments.

4. It was also noted that, contrary to orthodox economic theory, an increase in investment did not require a prior increase in savings, especially by households; higher investment could be financed from accrued profits as well as credit created in the banking system, subsequently leading to an increase in aggregate savings.

5. It was highlighted that, in most developing countries, stock markets accounted for a very small portion of investment financing, as opportunities to issue were limited, especially for small and new firms. The weakness of the banking sector in many developing countries was a major concern for several delegations.

6. It was also pointed out that financial sector reforms had rarely delivered on their promises, and had not contributed to lasting improvements in investment financing. Lending rates remained high and bank credit was extended primarily to the public sector and for private consumption. Delegations noted that credit flowing to the productive sector was often heavily concentrated on a few large firms, and that financing of agricultural investment was particularly weak. Many delegations saw a role for Governments and central banks in directing credit to private sector investment, through instruments such as development banks, public ownership of commercial banks and public credit guarantees.

7. The fact that in many developing countries the largest part of the economy lacked access to banking services was considered another major problem. It was suggested that microfinance institutions played an important role in some countries, but were no substitute for a functioning commercial banking sector, as they typically provided credit in relatively small volumes, at relatively high interest rates and for relatively short durations. It was also considered important to link informal financing schemes with formal ones.

8. Although a considerable number of developing countries had seen an improvement of their external position, delegations stressed that most countries continued to depend on external resources, including foreign direct investment but especially official development assistance. While the substantial increase in ODA since 2002 was generally welcomed, it was pointed out that most donors were not on track to meet their ODA pledges. Furthermore, a large part of the increase in ODA was due to debt relief, which was recognized as not having been fully additional as stipulated in the Monterrey Consensus. It was also observed that many developing countries could require further debt relief.

9. Delegations also took note of two shifts in aid. Measured as a share of total ODA, development-oriented aid had decreased relative to emergency-related aid, and the share of economic aid had decreased relative to social aid. While ODA for social sectors was considered important for progress towards the Millennium Development Goals, it was stressed that additional ODA should flow into projects related to economic infrastructure and production. That was considered indispensable for higher and more sustained rates of growth in gross domestic product, which was a precondition for more and more productive employment, and for a sustainable reduction of poverty.

10. In addition to social and human development objectives, many developing countries viewed structural economic change and employment creation as key objectives. Delegations proposed that the effectiveness of aid be measured by the contribution of aid to those objectives and suggested that the measures of aid effectiveness be expanded accordingly.

11. It was highlighted that meeting the Millennium Development Goals still required raising the annual flows of ODA to poor nations by at least $50–60 billion above their current levels. Additional resources were needed to finance necessary investment in infrastructure and production. It was suggested that national and international support for facilitating workers' remittances could also foster investment finance.

12. It was also suggested that the current financial crisis must lead to a paradigm shift in economic theory and policy. The crisis had highlighted the inherent risks associated with liberated and unregulated financial markets, and pointed to the need for a strengthened role for the State in supervising and regulating financial activities. Governments should be more active, intervening before bailouts of financial firms became necessary. However, if such bailouts became inevitable to avoid greater damage to the economy as a whole, they should not be free of charge: the financial institutions saved from bankruptcy would have to be regulated more closely to prevent the recurrence of financial crises.

13. It was observed that the inflation risk resulting from commodity price increases might have been overestimated, whereas the risk stemming from tight monetary policies might have been underestimated, especially since many commodity prices had begun to decline. In that context, the discussion emphasized that – while tighter monetary policies could be effective in reducing inflationary pressures stemming from excess demand – they were not the optimal measure to curb inflation pressures originating on the supply side.

14. In order to prevent destabilizing financial speculation, prolonged exchange rate misalignments and unsustainable global economic imbalance, several delegations saw a need for international action to strengthen supervision and regulation of financial markets. A framework for timely and orderly exchange-rate adjustments and an effective mechanism for international coordination of macroeconomic policies were considered desirable. Avoiding a recession would require surplus economies to increase domestic demand to compensate for declining

demand by the United States. Furthermore, it was considered necessary to prevent a competitive devaluation of exchange rates in response to a falling dollar.

15. Several delegations commended the UNCTAD secretariat for the high quality and relevance of its *Trade and Development Report, 2008*. The report was recognized as making important contributions to the forthcoming review conference on financing for development, as well as the ongoing debate on aid effectiveness. Accordingly, the delegations encouraged the secretariat to make further contributions to both processes. It was recognized that the *Trade and Development Report* had long highlighted – and indeed predicted – the dangers associated with deregulated financial markets. Delegations welcomed UNCTAD’s rigorous and far-sighted analysis on monetary and financial issues, and asked the secretariat to strengthen its work in that area, which had a direct and important bearing on international trade and development.