GROWTH AND DEVELOPMENT IN THE 1990s: LESSONS FROM AN ENIGMATIC DECADE

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A. Managing growth: Accumulation and structural change in an interdependent world

1. Whatever else might divide development economists, they are in broad agreement that rapid and sustained economic growth is a \textit{sine qua non} for tackling abject levels of poverty. Still, as one leading development textbook from the early 1980s noted, anyone who claims to have found the key to the secret of economic growth "is likely to be a fool or a charlatan or both" (Herrick and Kindleberger, 1983: xvi). And despite a subsequent flurry of new and sophisticated growth models and accompanying empirics, a former head of the Council of Economic Advisors to the US President has suggested that “basic theory, shrewd observation and commonsense” (Mankiw, 1995: 308-9), are still probably the most reliable guides for promoting economic growth.

2. One sensible pointer from surveying the experience of today’s advanced economies, including the newest arrivals from East Asia, is that a broad and robust industrial base is a likely component of success.\(^1\) Scale economies, gains from specialization and learning, and conducive demand conditions are some of the basic theoretical reasons why the creation of leading industrial sectors, along with related technological capabilities, holds out the potential for strong income and productivity growth.

3. But shrewd observation of that experience also reveals a good deal of diversity in the timing, pace and content of industrial development, reflecting differences in resource endowments, size and geographical location. Moreover, the institutional arrangements supporting successful industrialization do not conform to a uniform pattern, and eclecticism and flexibility have been the hallmarks of the policy environment, allowing measures to be tailored to local economic circumstances and preferences regarding the trade-offs between rapid growth and social stability.

4. Trying to replicate someone else’s blueprint or following best practice cases are unlikely to provide the right guide for policy makers looking to accelerate growth. That said, in the interplay of linkages making up a virtuous growth regime, capital accumulation seems to provide one important link from launching an industrial take-off to sustaining catch-up growth. Investment simultaneously generates income and expands productive capacity. It also carries strong complementarities with other elements in the growth process, such as technological progress, skills acquisition and institutional deepening. Moreover, due to the sensitivity of the investment decision to the level and stability of economic activity, it plays an important bridging role between cyclical and longer-term features of economic development.\(^2\)

5. A given pace of accumulation can of course generate different growth rates, depending on its nature and composition, as well as the efficiency with which production capacity is utilized. This is one of the main reasons why econometric studies have failed to establish a one-to-one relation between the rate of investment and economic growth.\(^3\)

6. An emphasis on investment shifts the focus of development strategy to the entrepreneurial class and its interaction with the state, including whether and how public investment crowds-in private

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\(^1\) The related question of whether the exploitation of natural resources helps or hinders growth continues to divide economists; see Sachs and Warner, 1995; UNCTAD, 1996, 139-142; and Mayer, 1997.

\(^2\) The role of capital formation as a guide to policy was, of course, stressed by the first generation of development economists from Rodenstein-Rodan and Rostow, to Hirschman and Tinbergen. It was downplayed when the emphasis shifted to price distortions under the influence of the Washington Consensus, and “total factor productivity” became the focus of growth empirics. But there has been something of a return to the former approach more recently in discussions of the “investment climate” and “growth diagnostics”. For a further discussion, see UNCTAD 2003:61-63, and Reati, 2001, for a useful critique of the total factor productivity concept.

\(^3\) Still, it is the case that among the many variables fed into growth equations, investment still emerges as one of the few with a robust and independent impact on economic growth, particularly for rapidly growing middle-income economies, see Levine and Renelt 1992; Ros, 2000; Bosworth and Collins, 2004.
investment. But in any discussion of the forces governing the process of capital accumulation, the manner in which the richest stratum of society acquires and uses its income appears to be of particular significance. A good deal of evidence suggests that, after the initial stages of industrialization, when agricultural incomes provide the main source of investment, capital accumulation is financed primarily by profits in the form of corporate retentions, rather than household savings, often augmented by access to long-term bank lending. This profit-investment nexus provides an important platform for policy design in search of faster growth.4

7. Exporting is a second component in the industrialization and growth strategies of most countries, although that role can be envisaged in a number of ways. On some counts it is about greater competition improving efficiency. On others it is more about the advantages of market size, whether through specialization gains from a more intricate division of labour, technological upgrading or a minimum scale of production. In these latter respects, exporting manufactures brings dynamic advantages. But for many developing countries, exporting is a simple matter of expediency, whereby in the absence of a domestic capital goods sector, financing imports linked to faster growth faces an unavoidable payments constraint.

8. But successful exporting is itself contingent on a favourable investment dynamic. As incomes increase, rising labour costs and the entry of lower-cost producers can rapidly erode the competitiveness of labour-intensive manufactures, and new investments are needed to maintain productivity growth and to upgrade to higher-value-added activities. This export-investment nexus provides a second platform for thinking about growth policies.5

9. While the importance of shifting the structure of output, trade and employment towards the industrial sector is broadly recognized, there is a longstanding disagreement over whether the mutually reinforcing links between trade, investment and economic growth can be brought about (spontaneously) by rapid liberalization of market forces or whether active state intervention is needed to tackle interrelated institutional and structural obstacles that could hold back the process. This disagreement has weighed heavily on recent debates over the opportunities and challenges of globalization. Certainly, the strength of cross-border linkages among production, consumption and financial activities is now such that economic developments in any one country are influenced by economic decision taken outside its boundaries. However, the idea that markets and technologies have, consequently, broken free from nationally grounded resource endowments, institutional arrangements and policy choices seems far fetched and the related suggestion that a reluctance to face global competition lies behind stagnation in some developing regions a poor guide to the main development trends of the past decade or so.

B. A stylized picture of growth and poverty in the 1990s

10. After two decades of strong and consistently positive growth in the developing world, the 1980s began with a series of "slowdowns and meltdowns" (Ben-David and Pappell, 1995). Average annual developing country growth dropped sharply, barely exceeding population growth; in 5 out of the 10 years, per capita incomes contracted. On a broad ($2 a day) measure of poverty, absolute numbers rose sharply during the 1980s, although on a narrower ($1 a day) measure an initial drop in the first half of the decade was followed by a slight reversal towards the end.

11. Aggregate figures can be misleading. Not every region lost its way in the 1980s. The crisis was confined to Latin America, Africa and the Middle East; and there were also countries in each that

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bucked the wider trend. By contrast, East and South Asia enjoyed robust growth, in some countries faster than the 1970s. Poverty trends diverged in parallel. On the narrower measure, as East Asia experienced a sharp drop in poverty rates, there was a persistent rise in the numbers elsewhere.

12. While the debt crisis in the developing world was triggered by a reorientation of policies in the industrial countries (UNCTAD, 1986), it did reveal the extent to which rapid growth had come to depend on steadily rising capital inflows. For many, the crisis was final proof that inward-oriented growth strategies and interventionist policies could not extract developing countries from the mire of poverty and underdevelopment. Close integration with the world economy through rapid liberalization of trade, finance and investment was seen as the way to remove structural and institutional impediments to growth, reduce the debt overhang and end periodic balance-of-payments crises.

13. Even where the costs of adjusting to this new development path were underestimated in the 1980s, the rewards were still expected to materialize in the 1990s through stronger growth performances consistent with market fundamentals. Indeed, because greater openness, a less intrusive state and an expanded role for the private sector were expected to deliver the biggest growth dividend to poorer countries, income convergence was the dominant trend anticipated for the decade.

14. The 1990s certainly witnessed a significant increase in the global integration of goods, services and investment flows. Trade, which began to grow faster than output from the mid-1980s, expanded much faster in the 1990s, with developing countries in the vanguard (UNCTAD 2003: 41-44). As a result there was a rapid, and ubiquitous, rise in the share of exports and imports in GDP in developing countries, as well as a rapid increase in the share of these countries in international trade in goods – from about 23 to about 30 per cent of the total. Figures for FDI were even more dramatic. Average annual inflows into developing countries were almost five times greater in the 1990s than in the 1980s, rising from a quarter to close to one third of global flows and registering a four-fold increase as a share of income.

15. However, the growth response in many developing countries was anaemic; average annual per capita growth rose marginally above that of the 1980s, but remained well below that of the 1970s. Moreover, this recovery was often accompanied by a significant worsening of external deficits (UNCTAD, 1999: 75-94). Growth was also volatile, with boom-bust cycles occurring across most regions. Of the one in four developing countries that did manage to improve on their growth performance of the 1970s, most were from East Asia, and if these are excluded, more people were added to the poverty count in the 1990s than in the 1980s. The problem was particularly acute in sub-Saharan Africa, where per capita incomes by the end of the 1990s were 10 per cent below the level reached in 1980 and an additional 115 million people were living in extreme poverty – over 50 million in the 1990s, accounting for nearly two-thirds of the population (UNCTAD, 2002a, table 20).

16. Consequently, and despite a further slowdown in the advanced countries during the 1990s, income gaps grew wider and convergence failed to materialize (UNCTAD, 1997: 69-101). Still, a more optimistic scenario could point to the very strong growth in China and India, which together accounted for the drop in extreme poverty in the developing world in the 1990s. In both, strong investment and export drives reflected an expanded role for market-based incentives. However, in both cases improving economic trends had begun in the early 1980s and both avoided the shocks of more conventional adjustment programmes. Rather strong but unorthodox policy intervention was an

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6 The idea of convergence had fallen out of favour along with the first generation of neo-classical growth models that predicted it; for a longer discussion see Kozul-Wright and Rowthorn, 2002.

7 On the measurement of poverty in these countries and how they affect global figures, see Berry and Serieux, 2004, and Sutcliffe, 2004.
integral part of their successful brand of “heterodox gradualism” tailored to local conditions (Birdsall, et al, 2005: 145)

C. The variety of development experiences in the 1990s

17. A recent assessment by the World Bank (2005: 30) of its own policy line during the 1990s has acknowledged that there was a persistent tendency to overestimate growth prospects in regions implementing adjustment programmes and to underestimate growth performance in those that were not. That report also recognizes that, for growth to accelerate, formulaic approaches to policy making need to give way to more targeted country-level diagnostics of the constraints on growth, paying careful attention to capital accumulation, structural and technological change, and inequality.

18. But what were the consequences of neglecting these aspects of the development policy challenge in the 1990s? In the first place, regions that underwent adjustment in the 1980s found it particularly difficult to reverse the resulting sharp drop in the share of investment, which in some countries had dipped to below the levels needed to replace depreciated capital. Indeed, where adjustment programmes persisted, the investment cycle often remained volatile, even after the immediate disturbances of the debt crisis subsided. This is a pattern reproduced in much of Latin America and sub-Saharan Africa. By contrast, the countries in East and South Asia that bucked this trend in the 1980s were able to maintain a fast and reasonably stable pace of capital accumulation for most of the 1990s (UNCTAD, 2003: 65-73).

19. In countries where industrial output expanded in the 1980s, this continued in the 1990s. By contrast, where industrial stagnation was the norm, as in Latin America and Africa, most countries found it difficult to reverse the trend in the 1990s. Indeed, “deindustrialization” was visible in some cases (UNCTAD, 2003: 92-99). Moreover, in economies with declining shares of investment and manufacturing value added, a stagnant or falling share of manufactures in total exports was often the norm, even as the overall composition of developing country exports was shifting rapidly towards manufactures, including more skill- and technology-intensive goods. Again regional divergences are striking; during the 1990s, just eight East Asian countries accounted for 70 per cent of developing countries’ trade in manufactures. Outside this group, export strategies relied on low (and in some cases falling) wages or currency depreciation rather than strong productivity growth, and while this stimulated recoveries in some countries, few were able to reach a threshold level of exports consistent with a vibrant industrialization path (UNCTAD, 2003:99-102).

20. Labour market performances, key to tackling poverty, also diverged. Stagnant or falling real wages often coincided with rising unemployment and widening income gaps between skilled and unskilled labour (ILO, 2004: 40-45; Akyuz et al, 2005). In many cases, adjustment policies and the downsizing of the public sector have led to a hollowing out of the middle class. The counterpart of these trends has been an expanding informal economy, which by the end of the 1990s accounted for anywhere between one third and three fifths of the labour force in Africa and Latin America (Schneider, 2002).

21. Taking stock of these trends in the 1990s, the degree of exposure to global market forces is not what seems to distinguish "winners" and "losers". Rather, the main difference, particularly between the East Asian NIEs and most other developing countries, was that liberalization followed the successful implementation of industrial and trade policies; protection and support were removed in large part because they were no longer needed. In the latter, on the contrary, liberalization has largely been triggered by the failure to establish efficient, competitive industries in labour- and/or skill-intensive sectors. Accordingly, the impact of increased competition brought about by opening up on growth, income distribution and poverty has been crucially different.
22. The idiosyncracies of history and geography have played a role in this uneven performance, but a comparative analysis of trends in capital formation, export performance and industrialization does provide a more precise picture of where developing economies stood in relation to each other at the end of the 1990s:

(a) Mature industrializers: This group includes the first-tier NIEs, notably the Republic of Korea and Taiwan Province of China, which achieved industrial maturity through rapid and sustained accumulation of capital, and growth in industrial employment, productivity and output, as well as manufactured exports. In the 1990s these economies enjoyed a share of industrial output in GDP above the levels of advanced countries, exports had shifted to more capital and technology-intensive goods, and industrial growth was starting to slow down as resources shifted towards the service sector;

(b) Rapid industrializers: A number of countries saw a rising share of manufactures in total output, employment and exports, based on strong investment in resource-based and labour-intensive activities, and were beginning to upgrade to middle-range technology products. This group included the second-tier Asian NIEs, but also isolated success stories from other regions, as well as the waking giants of China and India;

(c) Enclave industrializers: Some countries moved away from dependence on commodity exports by linking to international production chains, often by attracting large amounts of FDI and with heavy reliance on imported inputs and machinery. Export growth was often very fast, as in the Philippines, Mexico, and to some extent Morocco. However, overall performance in terms of investment, value added and productivity growth was often quite weak;

(d) Premature deindustrializers: This group included most countries in Latin America, which had achieved a certain degree of industrialization but were unable to sustain a dynamic process of structural change through rapid accumulation and growth. In a context of rapid liberalization, declining shares of manufacturing employment and output and a downgrading to less technology-intensive activities were common trends;

(c) Commodity-dependent exporters: Many poorer economies, particularly in sub-Saharan Africa, remained heavily dependent on one or two commodity exports. In the face of relatively stagnant markets, volatile prices and declining terms of trade, investment dropped further, diversification stalled and productivity remained stagnant. In some cases enclaves of faster export growth emerged in the extractive sectors, usually tied to FDI, but with weak linkages to the rest of the economy. However, some wealthier developing countries, notably Chile, did achieve a faster pace of investment and growth based on their natural resource endowments.

D. The international environment: Trade liberalization, FDI and integration

23. The reorientation of development policy in the early 1980s assumed that inward-oriented development could be quickly switched to a more dynamic outward orientation. Competitive markets would ensure the best allocation of resources according to comparative advantage, securing the export revenues to import capital and intermediate goods to ensure faster growth. Financial liberalization would attract foreign capital seeking high returns in capital-scarce countries, allowing them to invest more than they saved. A bigger flow of FDI would transfer technology and organizational skills and crowd-in domestic investment.

24. But while the global macro environment facing developing countries may have improved in the 1990s (World Bank, 2005: 59-71), it would seem that for many the trade and FDI engines were working much harder without reviving growth.
25. One possible explanation is that biases in the patterns of liberalization prejudiced growth prospects by discriminating against sectors where developing countries could build comparative advantage, even as they unleashed asymmetric market forces on the weaker participants in the trading system (UNCTAD, 1999; ILO, 2004). However, the fact that many countries were trading more but earning less during the 1990s suggests some deep-seated structural problems with the emerging pattern of integration.

26. The experience of many commodity producers is familiar; persistently tight external constraints owing to weak and volatile prices, high levels of indebtedness and stagnant or falling ODA all contributed to a weak investment dynamic and stalled diversification, perpetuating a poverty trap (UNCTAD, 2003, 2004). It is clear that most adjustment programmes did little to alter this pattern of insertion into the global economy during the 1990s, and in some cases, by triggering a process of "deindustrialisation", have almost certainly been regressive.

27. However, primary products were a declining component of developing country trade in the 1990s, continuing a trend begun in the 1980s, and the concomitant rising share of manufactures has included medium- and high-skill and technology-intensive products. Moreover, a significant proportion of the increased FDI into developing countries was designed to relocate manufacturing production to low-cost countries for export back to the home countries of the TNCs or third markets.

28. The favoured sectors, such as clothing and electronics, included some of the most dynamic parts of the trading system. High income elasticities, product innovation and changing consumption patterns all contributed to that dynamism. But even when the final product was classified as high-tech, many developing countries were only involved in low-skill assembly activities using imported capital and intermediate goods and where their contribution to value added was determined by the cost of the least scarce and weakest factor, namely unskilled labour.

29. Such participation in the labour-intensive segment of international production networks can help countries to increase employment and per capita income even when value added generated is low. However, backward and forward linkages to the rest of the economy tend to be weak, and because the final markets for these goods are dominated by oligopolistic firms usually competing on the basis of quality, design, marketing, branding and product differentiation, significant barriers to entry into the high-skill and technology parts of the production chain not only skew the distribution of gains from trade, they can make upgrading particularly difficult. Consequently many middle-income developing countries persisted in labour-intensive manufactures because their producers were finding it difficult to upgrade and diversify. Under these conditions, a simultaneous export drive by developing countries runs the danger of overproduction of standardized mass products with adverse terms of trade effects and attendant pressure to keep wages low. Trends in the 1990s showed that these dangers were real (UNCTAD, 2002: 113-140).

30. The experiences of the 1990s – and from economic history more generally – show that trade liberalization and global economic integration are greatly facilitated by expansion of economic activity and employment and by improvements in living standards. Similarly, sustainable, long-term capital flows, particularly greenfield FDI, are primarily attracted to countries that have already achieved rapid economic growth and steady improvements in human and physical infrastructure. Thus, for those with a robust investment dynamic in both physical and human capital, trade and FDI can reinforce an established virtuous growth circle. Where this is not the case, those same forces are just as likely to lead to marginalization and/or enclave type development.
E. The international environment: Financial liberalization and capital flows

31. Financial markets underwent a dramatic transformation in the early 1980s, thanks to a combination of deregulation, internationalization and innovation, encompassing rich and poor countries alike. While the impulse came from the advanced countries, economic logic promised much for the world’s poorest countries. Deregulated and open financial markets would not only increase the availability of investment finance both domestic and foreign, it would also help create a more stable and disciplined investment climate, and free deficit countries from the unpredictable politics of ODA flows.  

32. The 1990s witnessed a rapid expansion of private capital inflows into developing countries, registering a sevenfold increase over the average for the 1980s. Portfolio flows and foreign direct investment (FDI) posted the strongest growth, accounting for more than two thirds of total private inflows. However, much of the upsurge represented a return to trend after the blighted years of the 1980s. It was also increasingly concentrated in a small group of 20 or so emerging markets which received over 90 per cent of total inflows of capital in the 1990s, compared to some 50 per cent before the outbreak of the debt crisis. More importantly still, those flows proved increasingly difficult to manage in a way consistent with faster and more inclusive economic growth.

33. For countries seeking re-entry into international financial markets after the debt crisis, higher real interest rates and a stable exchange rate were prerequisites. However, while financial stringency proved attractive to foreign investors, a tight monetary and fiscal stance did little to stimulate domestic investment or to improve export prospects. Indeed, increased debt-servicing obligations resulting from higher interest rates, along with weakening export prospects, ran the risk of reproducing an unsustainable debt burden. In many cases, a combination of capital outflows, profit remittances and the accumulation of exchange reserves greatly reduced net inflows, and of these a growing proportion was absorbed by activities which added little to productive capacity. Particularly in the form of short-term loans and portfolio equity, these inflows could be highly unstable and an unreliable source of development finance.

34. As financial markets became increasingly disconnected from the longer-term demands of industrialization, unregulated financial flows triggered boom-bust cycles, which became a recurrent feature of the developing world during the 1990s. The precise circumstances in which the vulnerability to the reversal of capital inflows arose and the subsequent impact on growth varied from region to region. An early warning was given by the Mexican peso crisis of 1994. However, their full force was revealed by the financial crises in East Asia (UNCTAD, 2000), a region with a long-standing record of strong growth and fiscal discipline. As in other episodes of financial crisis and currency turmoil, the crisis in East Asia was preceded by financial liberalization and deregulation which, in some cases, constituted a major break with past practice (UNCTAD, 1998:53-77). Moreover, the extremes of collapse were amplified by unnecessarily tight monetary policies which deepened the debt deflation process, served to depress output and employment and caused serious dislocations in the corporate and financial sectors (Stiglitz, 2002).

35. Although the call for financial liberalization was heeded across the developing world in the 1990s, the majority of countries, and particularly those in Africa, attracted little private flows, and certainly not enough to offset declining aid (UNCTAD, 2000). Privatization and deregulation did attract some

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8 According to the so-called Lawson Doctrine, rising current-account deficits and external indebtedness generated by the private (as opposed to the public) sector are immune to the dangers that proved so destructive in the early 1980s. A passing knowledge of historical trends might have made for a more cautionary stance; see O’Rourke and Williams on, 1999.

9 The annual capital inflow in the 1990s was around 5 per cent of GNP, which was roughly the level prevailing in 1975–1982. If China is excluded, the ratio is actually lower than in the earlier period by one percentage point.
FDI, albeit mainly to extractive sectors or the acquisition of public utilities. But such flows did little to ease payment difficulties, and attempts to meet foreign-exchange deficits of TNC-related activities by encouraging new inflows of the same kind could also be self-defeating (Kregel, 2004, UNCTAD 2005).

F. Some issues at stake

36. Given their structural weaknesses, small domestic markets and dependence on imports for capacity utilization and accumulation, the extent to which poor countries can generate the required resources to stimulate growth and tackle poverty still depends very much on how far they can translate their unexploited natural resources and surplus labour into export earnings, imports and investment. In a world of increased economic and political interdependence, doing so involves ever more complex policy challenges. Responsibility for meeting those challenges rests with developing country Governments, but their efforts can be seriously hindered by imbalances, inconsistencies and biases in the workings of the international trade and financial system.

37. The experience of the 1990s suggests that the policy direction launched in many parts of the developing world after the debt crisis, while uprooting previous regimes, failed to establish a flourishing alternative. Slippages in policy implementation may be partly to blame. But the real problems are ones of design. In particular, inconsistencies among macroeconomic, trade, industrial and financial policies did little to encourage investors and firms to create, expand and improve productive capacity, while at the same time unleashing the forces of global competition.

38. While recently a greater emphasis has been given to poverty alleviation, in part responding to the disappointing outcomes of the past decade, much current policy advice continues to contain all the main elements of the first generation of reforms, designed to "get prices right". And while greater sensitivity to institutional factors is emerging, it is essential that the new emphasis on poverty alleviation be founded on a careful and frank independent assessment of the effects of macroeconomic and structural adjustment policies on growth, distribution and poverty.

39. Success in the 1990s built steadily on improving performance begun in the 1980s. A key feature in all cases appears to have been room to use an array of policy options to manage integration into the global economy and ensure that more of the value added linked to trade stayed at home, and to experiment with a range of more strategic measures to encourage strong capital formation, expand domestic markets and support technological upgrading.

40. Taking stock of the past two decades of economic reform does not mean downplaying the threats from financial imbalances or inflationary pressures, but it should mean recognizing that there are many ways of achieving macroeconomic stability, integration and faster growth (World Bank, 2005) and, in so doing, taking a more constructive view of the role of the state in relation to capital accumulation, industrial development and income inequality. Above all, the "one-size-fits-all" approach needs to give way to a full discussion of the requisite space needed by all developing countries to craft their own policies in light of specific circumstances.

41. Good governance is not synonymous with limited policy intervention or simply getting out of the way of the private sector. Rather, it is much more about strengthening a range of pro-growth institutions that can provide predictable incentives for economic activity, particularly for long-term productive investments, improving dialogue across the various stakeholders involved in making those investments, and disciplining interest groups (from both the public and the private sectors) that work against wider development interests. Today’s successful economies were able to develop such institutions consistent with national political and social cultures and with the bureaucratic and entrepreneurial capacities of local elites.
42. But the record of uneven development, persistent levels of indebtedness and financial crises in the 1990s also suggests that current global arrangements are not delivering the financial resources and monetary stability needed to sustain expansion of employment and output in developing countries. One major concern relates to the destabilizing and deflationary feedbacks among trade, debt and finance.

43. Almost all major crises in emerging markets have been connected with shifts in exchange rates and monetary policy in advanced countries. And while the damage from disorderly exchange rate behaviour has been limited for those economies, this has not been the case for debtor developing countries, which depend more heavily on trade and whose borrowing profile exposes them to greater currency risk. The failure to establish a stable system of exchange rates since the breakdown of Bretton Woods remains a pressing concern for the international community.

44. Any such reform would need to give priority to ensuring coherence in the macroeconomic policies of the major players, in both the developed and the developing worlds. In view of the existing asymmetries in existing surveillance practices, one way forward might be to link this to a mechanism analogous to that used for settling disputes in international trade, where disagreements over the impact of macroeconomic and financial policies could be taken up and their resolution sought. But it is just as essential that developing countries maintain an appropriate degree of policy autonomy in managing capital flows and choosing whatever capital account regime they deem appropriate. Indeed, in light of experience, a basic objective for countries at all levels of development should be to roll back the control that financial capital has established over trade, industry and employment.

45. Existing arrangements do not allow developing countries to overcome their longer-term payments constraint. Recent promises by the G8 countries to double aid are a step in the right direction for the poorest countries, as are the (still tentative) moves towards full debt relief. However, experience continues to show that financial markets often fail to meet this challenge in emerging markets, as they tend to be pro-cyclical and subject to speculative and herd mentalities. Given the increased instability of the external trading and financial environment in developing countries, effective reforms could seek to improve counter-cyclical and emergency financing for trade and other current transactions.

46. In trade, the challenge remains to make the multilateral system more development-friendly. The outcome will be judged by the extent to which developing countries achieve improved market access without undue restrictions on their policy options to foster growth. One of the lessons already learnt from the Uruguay Round is that openness can carry significant costs as well as benefits, particularly for the poorest countries. Some combination of financial support and differential treatment is essential to ensure openness is consistent with poverty alleviation.

47. Larger developing countries may be better placed to manage these pressures. Indeed, as their home markets expand, fuller use of domestic sources of growth may coincide with a less pronounced outward orientation. However, many smaller countries will remain heavily dependent on exports. A possible convergence of interests lies with expanded South-South trade and investment. Efforts to design appropriate arrangements are currently under way and will require the full support of the international community. However, this should not be seen as a substitute for improved access to Northern markets, where some of the starkest inconsistencies in the trading system continue to hamper development prospects.
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