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**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

Rapporteur: Mr. Federico Perazza (Uruguay)

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|----------------------------|-----------------------------|
| Speakers: | India |
| Officer-in-Charge of GDS | Norway |
| Japan | Nepal |
| Cuba | United States of America |
| Iran (Islamic Republic of) | Mexico |
| Belgium | International Monetary Fund |
| China | |

Note for delegations

This draft report is a provisional text circulated for clearance by delegations.

Requests for amendments to statements by individual delegations should be communicated by **Wednesday, 17 October 2001** at the latest, to:
UNCTAD Editorial Section, Room E.8102, Fax No. 907 0056, Tel. No. 907 5654/1066.

Chapter I

INTERDEPENDENCE AND GLOBAL ECONOMIC ISSUES FROM A TRADE AND DEVELOPMENT PERSPECTIVE: FINANCIAL STABILITY: REFORM OF THE INTERNATIONAL ARCHITECTURE AND THE ROLE OF REGIONAL COOPERATION

(Agenda item 2)

1. For its consideration of this item, the Board had before it the following documentation:

Trade and Development Report, 2001, and Overview (UNCTAD/TDR/2001).

2. The **Officer-in-Charge of the Division for Globalization and Development Strategies** introduced the item.

3. The representative of **Japan** said that while the shock emanating from the recent terrorist attacks would possibly have negative impacts on the global economy, coordinated policies could limit the magnitude of the economic downturn. The Japanese Government would participate in this process to avoid economic turmoil inside and outside Japan.

4. An upturn in the Japanese economy was not yet imminent. Exports and production as well as capital investment were declining, and conditions in the labour market were deteriorating badly. The Government was strongly committed to revitalizing the economy by taking prompt action on fiscal and structural reform and on rooting out bad bank loans. It would continue to contribute to the promotion of trade and development in developing countries by strengthening and enhancing the effectiveness of its ODA despite the reduction by 9 per cent in 2002.

5. Japan was fully committed to the launching of a new round of trade negotiations at the fourth WTO Ministerial Conference in Doha. It was collaborating with developing countries to ensure that the new round would adequately address their priorities. It would also intensify its efforts through bilateral and multilateral technical cooperation and capacity building to assist the developing countries in the process of integration into the global trading system. To supplement its multilateral trade relations, the Japanese Government had also initiated negotiations on a Japan-Singapore Economic Partnership Agreement.

6. Efforts to strengthen the international financial system must be continued. Since the Cologne Summit, various steps had been taken, such as the reinforcement of IMF surveillance, the promotion and implementation of key international codes and standards, increased involvement of the private sector in crisis prevention and resolution, reforms of IMF lending, and the enhancement of IMF transparency and accountability

7. With regard to the *Trade and Development Report, 2001*, he agreed that no single foreign-exchange regime was right for all countries all the time and that a managed rate could be appropriate. In the context of Asian monetary cooperation, the Chiang Mai Initiative had

been launched in May 2000 by the “ASEAN plus 3” group, consisting of the ASEAN members, China, Japan and the Republic of Korea. The objective was to promote and strengthen monetary and financial cooperation in East Asia, supplementing existing mechanisms such as the IMF. At a meeting in May 2001, the “ASEAN plus 3” group had reaffirmed that they would continue efforts to develop the scale of and participation in bilateral swap arrangements.

8. The representative of **Cuba**, speaking on behalf of the **Group of 77 and China**, said that recent hopes for a rapid economic recovery in the United States economy had now waned. Developing countries, and in particular the poorest segments of their populations, would be the most severely affected by any economic setbacks. Developing countries were likely to experience a slow-down in export growth and a decline in commodity prices, less private lending and lower inflows of FDI, while their borrowing costs on international capital markets were likely to rise. He welcomed the action of the major central banks to ease monetary policy after the terrorist attacks in New York, but advocated additional action on the fiscal side and a further strengthening of international policy coordination, which should also include developing countries.

9. Other fundamental issues relating to global interdependence needed continued attention. For example, developing countries needed to be given more influence in the area of international trade. The upcoming WTO Ministerial Conference should address concerns about the implementation of existing trade agreements, for example in the areas of agriculture and textiles and clothing. To overcome the current asymmetries in the world trading system, it was essential that the WTO give greater attention to the developmental dimension of trading rules, allow for special and differential treatment for the developing countries, and improve market access in areas of export interest to developing countries.

10. Regarding international financial relations, he regretted the absence of rules that would help prevent financial crises and improve their management. Creditor interests were still given priority, and the involvement of the private sector in crisis management continued to be insufficient. As a result, the Governments of countries affected by financial crises were often forced to assume responsibility for private debt, with substantial costs in terms of national income. Many developing countries had strengthened their domestic financial and banking systems, but the international financial system needed to be reformed as well. The fact that in most cases financial crises in emerging-market economies had been triggered by supply-side-driven fluctuations in international capital flows pointed to a systemic problem in the functioning of the international financial system. Stringent codes and standards for the domestic financial sector, macroeconomic policy reform and greater transparency were important but would not eliminate the risk of further financial crises. Moreover, they represented an often excessive administrative burden on developing countries. Including them in the conditionality of the international financial institutions should be avoided. The structure and governance of the international monetary and financial system needed to become more open, transparent and democratic. Greater exchange-rate stability among the major currencies was desirable to achieve a more stable trading environment and to reduce currency risk in developing-country debt servicing.

11. Given that private financial flows were inherently volatile and that only a few developing countries had access to international capital markets, ODA needed to rise to internationally agreed levels and become more effective through a decoupling from donor demands. The HIPC initiative was proceeding too slowly and was too limited in scope. A bolder approach based on an independent assessment of the degree of individual countries' over-indebtedness was necessary. Finally, in accordance with the Brussels Programme of Action, least developed countries required enhanced inflows of FDI and other external financing.

12. The representative of the **Islamic Republic of Iran**, speaking on behalf of the **Asian Group and China**, said that the political and economic uncertainty following the horrific events in the United States had increased the downside risks facing the world economy and the need to strengthen macroeconomic policy coordination among the major industrialized countries. The impact of macroeconomic policy decisions on all countries not directly involved in this coordination, especially the developing countries, had to be taken into account.

13. There was an urgent need to raise official flows to developing countries to the target levels already agreed by the international community, given the expected decline in the developing countries' export earnings and their limited access to private financial markets shown by the *Trade and Development Report, 2001*. ODA had to be made more effective by decoupling it from conditions imposed by donors and by increasing the share of official financing in the form of grants for poverty alleviation programmes, especially for the least developed countries.

14. Current practices for dealing with the developing countries' external debt should be reviewed to incorporate the principles of the domestic regimes in most industrial countries, where debtors' rights and their protection were recognized. Furthermore, debt relief should not be at the expense of new official financing. While the prevention and better management of financial crises in developing countries required a strategy for involving the private sector, the increased instability of the economic environment of these countries and their increased external financing needs required the improvement of counter-cyclical and emergency financing for trade and other current transactions. An increase in the IMF lending quotas should therefore be part of the reform of the Bretton Woods institutions. This would help to relieve developing countries from the burden of committing scarce resources to the accumulation of unproductive foreign-exchange reserves.

15. The exchange rate system should be on the agenda of any discussion of financing for development. There was also a need for strengthening surveillance of the macroeconomic policies of industrialized countries and for creating a mechanism for ensuring the consistency of those policies with stable external financial conditions for developing countries. Special measures were necessary to help the least developed countries that were becoming more reliant on trade as an engine for growth and for which the lifting of trade and capital controls could be particularly damaging. Developed countries should allocate at least 0.15–0.20 per cent of their GDP to ODA for the LDCs, in accordance with international agreements. As long as no real progress was achieved with regard to effective global arrangements to ensure

greater financial stability, developing countries should retain policy autonomy with respect to exchange-rate regimes and capital-account liberalization.

16. The representative of **Belgium**, speaking on behalf of the **European Union**, said that the situation referred to in the *Trade and Development Report, 2001* had changed considerably since the report had been published. The recent terrorist attacks in the United States had worsened the immediate growth prospects for the world economy. However, the European Union believed that, if the international community undertook the necessary measures, the situation would improve in the short term, and the EU was determined to participate in that effort. The European Central Bank had already introduced a number of measures to reassure the financial markets, and the EU welcomed OPEC's initiative to stabilize oil prices.

17. Although the African continent once more had not benefited from the improved economic situation observed in other parts of the world, the commentary on global trends in the *Trade and Development Report, 2001* was too bleak. The EU remained very much concerned by the development situation in Africa and would continue its support for the enhanced HIPC initiative. The international financial community needed greater cooperation among its actors, particularly among the different international financial institutions. Committed efforts to stabilize the international financial system were required, and recent initiatives in this direction from the IMF, the World Bank and other institutions were most welcome. The issue of controlling exchange rates and capital flows needed to be handled carefully, as there was no single recipe for responding to financial crises. Domestic reforms aimed at increased transparency and disclosure, strengthening of regulatory standards, and more effective burden-sharing arrangements could contribute to greater financial stability. Other instruments were also available to prevent the build-up of external financial vulnerability without impeding trade or medium- and long-term investment flows. Moreover, regulation of financial flows should not be used to sustain inappropriate policies; domestic preventive action was the best way to avoid financial crises. The role of the IMF should not be that of an international lender of last resort, and a temporary allocation of SDRs in the current crisis situation was not appropriate. The IMF should instead act as a catalyst for financing from other sources, applying adequate conditionality.

18. The introduction of the euro would have an important impact on the EU's trading partners and the international financial system by helping to reduce the threat that currency instability posed to development and trade. It would also increasingly contribute to world economic growth as the EU became a large integrated market.

19. The representative of **China** noted that the world economy had witnessed a marked slow-down since the beginning of the year. The economic recession in the United States, Japan and the European Union was spreading to other regions through trade and financial links. Many of the newly industrialized economies were stagnant. Developing economies relying heavily on exports, particularly technology products, had been hit even harder than during the Asian financial crisis. Sluggish commodity markets and fluctuations in the price of oil had eroded the benefits of debt relief and of limited preferential trade measures in favour of developing countries.

20. The current international financial situation had three characteristics. Firstly, due to the predominance of the dollar in international finance, actions taken by the United States had a major bearing on the functioning of the international financial system. Secondly, the unsynchronized economic cycles in the areas of the three major currencies – the dollar, the yen and the euro – made macroeconomic policy coordination difficult and resulted in unstable exchange rates, which in turn had adverse effects on trade and economic development and on overall financial stability. Thirdly, some developing countries were experiencing huge capital outflows to developed countries at a time when they badly needed resources for development.

21. The orderly functioning of the international financial system depended on strengthened coordination of macroeconomic policies. Countries with the greatest influence on financial markets should shoulder their responsibilities by enhancing the supervision of international capital flows in order to reduce the adverse impact of their instability on the financial markets of developing countries.

22. The Asian financial crisis had highlighted the need for an equitable and predictable multilateral trading system and for a sound and effective international financial system. The current system was beset by serious shortcomings, and its reform had lagged far behind the progress of globalization. The IMF and the World Bank had a major role to play in promoting reform of the international financial system and in safeguarding international financial stability. In the context of reform, careful attention should be paid to the interests of the developing countries and their ability to assume obligations which resulted from reform. Important aspects of reform included international financial codes and standards and a stable exchange-rate system. Developing countries should be involved in the formulation of the codes and standards.

23. Freedom of choice regarding exchange-rate regimes was essential to the functioning of the international financial system. In today's world, there was no single exchange-rate regime suitable for all economies at all times. Accordingly, in reforming the international financial system, consideration must be given to the national conditions of countries, especially of developing countries, and to their right of choice in this area. Regional economic cooperation could contribute to the enhancement of the collective capacity of countries involved and to the stability of international financial markets.

24. China had always actively participated in meetings, negotiations and other activities within the framework of UNCTAD, IMF and the World Bank, and had provided inputs in the reform of these institutions. During the Asian financial crisis, China had assisted countries affected by the crisis, and by defending the value of its own currency, China had prevented the crisis from spreading further. Such participation in international cooperation for financial stability was an essential and continuing feature of Chinese policy.

25. The representative of **India** feared that the synchronized economic slowdown in all major developed countries, combined with the effects of the recent events in the United States, made it unlikely that developing countries would maintain growth at the level achieved in 2000. Consequently, cooperation among, and responsible action by, all major

actors in the world economy was absolutely necessary. While appropriate domestic policies were important, a successful development strategy required a favourable external environment. The decline in the flows of FDI and their unequal distribution was worrying. In the current international environment, FDI was driven mainly by technological progress, managerial factors and industrial clustering. This implied that liberalization had to be backed up by investment promotion policies to develop locational advantages. The declining levels of aid and the stagnation of other official financial flows to developing countries had to be addressed in global economic fora. The increased frequency of international financial and currency crises had focused the attention of the international community on reform of international financial institutions to face challenges of crisis prevention and resolution, since existing institutions seemed inadequate to deal with financial globalization. But so far the reform process had incorrectly concentrated on national action and on disciplining debtors. Insufficient attention had been given to the involvement of the private sector, while the disbursement of official funds for crisis management had curtailed the availability of such funds for other purposes. Capital-account liberalization and convertibility was a long-term goal and should be seen within a broader set of objectives. While welcome in principle, the sheer number of international codes and standards proposed in areas of direct operational concern to the IMF risked becoming excessively demanding in terms of manpower and financial resources and overly intrusive in national policy making. They should not become part of IMF conditionality. The international exchange-rate system should be a major item on the agenda of the Financing for Development conference. Regional monetary arrangements also deserved attention, but replicating the European experience would be difficult for developing countries.

26. The representative of **Norway** said that, although the analyses in the *Trade and Development Report, 2001* were interesting and thought provoking, he disagreed with some of its assumptions and conclusions. The global economic outlook was far more uncertain than a year earlier, despite interest-rate cuts, tax reductions and concerted monetary measures introduced in the wake of the recent terrorist attacks.

27. The Norwegian Government's new action plan for poverty reduction in developing countries emphasized the need for better policy coherence in industrialized countries. Developed and developing countries should also look at various aspects of their policies to ensure that they were mutually consistent and supportive of the Millennium development targets. Norway was embarking on such a process.

28. In the current situation, Asian and Latin American countries, which were highly dependent on exports to the United States, faced new difficulties, but lower United States interest rates and a falling US dollar would reduce debt-service payments. In some least developed countries, civil and political unrest would continue to affect their growth opportunities. Even in a favourable global economic environment, growth could not take off in the absence of certain fundamental domestic conditions. Lower commodity prices and declines in investment flows would clearly have a negative impact on the LDCs. Norway reaffirmed its pledge, made at the Third United Nations Conference on the Least Developed

Countries in Brussels, to phase out duties and quotas on exports of everything but arms by mid-2002.

29. The launching of a new round of trade negotiations could play an important role in boosting the international economy. A precondition for a successful WTO Ministerial Meeting in Doha was that implementation issues be dealt with in a satisfactory manner. In his country's view, a more open world trading system and increased foreign direct investment in developing countries were generally more important for poverty reduction than ODA.

30. The Norwegian Government did not subscribe to the strong criticisms of the present international financial architecture in the *Trade and Development Report, 2001*. First, the policy response to the East Asian crisis had prevented it from becoming global, and economic recovery had begun quite swiftly. Second, the *Report* was wrong in asserting that the entire reform agenda was directed exclusively at developing countries. Third, the *Report* had not convincingly made the case for creating new international institutions. Fourth, regarding the debt issue, it should be noted that much had happened since the first generation of HIPC beneficiaries, and debt relief alone could not provide sustained economic growth in the long run, unless accompanied by domestic reforms. Fifth, Norway did not accept the view that the IMF concentrated its surveillance on developing countries, since Norway and other OECD countries were subject to this process on a regular basis.

31. The representative of **Indonesia** said that the outlook for the world economy was bleak, especially for developing countries, because of a loss of confidence in capital markets and depressed growth in developed countries. The developing countries faced a saving-investment gap, an import-export gap, reduced competitiveness, and distorted international prices. Indonesia was nonetheless committed to continuing implementing its stabilization programme, and it was actively involved in developing closer financial ties with its neighbours in the region, including through the Chiang May Initiative. However, conditions in the world economy could hamper regional cooperation, and there was a risk that the economic gap between the developed and the developing world would widen further. The WTO and the Bretton Woods institutions had shown little enthusiasm for accommodating the need for a balanced and stable international trade and financial system, probably because some countries considered that globalization and liberalization of trade were the only avenue to growth and prosperity. There had been excessive emphasis on domestic reforms instead of on a restructuring of the financial architecture and on finance for development. Global problems required global actions, and there was a need for effective global governance in many economic, social, political and humanitarian areas, including trade and finance. UNCTAD's analysis should put more focus on policy actions, and specifically on the implications and costs of a failure to reform the financial architecture and the multilateral trading system, the policy prerequisites for just global governance, and cooperation mechanisms to create an enabling international environment for the development of developing countries.

32. The representative of **Nepal** drew attention to the downward risks increasingly facing the world economy and called for bolder policies and strengthened international cooperation

to prevent further deterioration. He noted that the recent, strengthened macroeconomic policy coordination was encouraging.

33. The conference on Financing for Development should address the need for increasing ODA for poverty alleviation and longer-term infrastructure development, as well as the issue of debt relief (including total cancellation for least developed countries). The small share of least developed countries in total FDI flows highlighted the need for alternative forms of resource flows, and their declining share of international trade was another issue that must be addressed urgently.

34. Policy reforms in developing countries to achieve macroeconomic stability and sustainable growth were often painful, increasing poverty and hardship, and without a favourable economic climate and financial assistance they would become even more difficult. UNCTAD's assistance in strengthening institutions and manpower development in developing countries had a critical role to play in that connection.

35. Globalization without the guidance of the human intellect could create pockets of exclusion and marginalization. The search for greater protection of intellectual property rights must be reconciled with the requirements of social justice and universal human rights. The world coalition being assembled against terrorism must produce a new global culture that rejected intolerance based on differences in colour, ethnicity, ideology or faith.

36. The representative of the **United States of America** said that sustainable economic growth in both industrialized and developing countries benefited from market-based policies that effectively harnessed global capital flows. While these flows were not without risk, countries could minimize disturbances from short-term market volatility by avoiding inconsistency between monetary and exchange-rate policies, embracing responsible fiscal practices, managing the maturity profile of their debt, monitoring currency and liquidity risk in the banking sector, and ensuring the existence of an effective system of corporate governance and a solid legal framework for economic activity.

37. Sound policies at the country level needed to be matched by efforts at the international level. Significant reforms at the IMF in 2000 to improve its lending facilities had been followed in 2001 with efforts to focus and prioritize conditions on its lending and to sharpen its crisis-prevention capabilities. Contagion needed to be better understood so that mechanisms which avoided excessively frequent intervention and the problem of moral hazard could be introduced to contain it. Those who enjoyed the rewards of high-risk investments should also accept the costs when these investments went wrong. Reforms were also under way at the World Bank and the multilateral development banks. President Bush had proposed that the share of funding provided by those institutions as grants rather than as loans be increased to 50 per cent in the case of the poorest and least creditworthy countries.

38. The *Trade and Development Report, 2001* had expressed a number of views on the international financial system, but in his country's view the time was not ripe for conclusions on this topic. He was also surprised, at a time of global economic slowdown, to see UNCTAD advocating measures that would be likely to further restrict flows of capital to

developing countries. The United States encouraged the United Nations, WTO, IMF, the World Bank and other institutions to enhance their cooperation through existing channels, while focusing on their individual mandates in such a way as to make best use of their expertise and to avoid overlap in their work.

39. The representative of **Mexico** said that UNCTAD had a number of comparative advantages in the context of reform of international financial institutions and the achievement of financial and monetary stability. The concept of sustainable development must be fully integrated into the agenda of these international institutions.

40. Multilateral cooperation could make a major contribution to development in the long run, particularly in areas such as the introduction of clear and transparent regulations and policies. Through capacity building, UNCTAD could help countries to free themselves from the vicious circle of poverty. Since financial resources to promote investment in developing countries were ever more scarce, measures in this area should be an integral part of the agenda of the conference on Financing for Development, which would provide an opportunity to explore new ways to approach this important issue

41. The representative of the **International Monetary Fund**, referring to the *Trade and Development Report, 2001*, said that regular surveillance of the larger developed as well as of developing countries was of key importance in enabling the Fund to respond adequately to international economic or financial crises. Fund surveillance had been strengthened to include financial-sector developments in both developed and developing countries, since standards needed to be improved in all member countries, given the spill-over effects of poor regulatory standards and the incidence of financial crises in developed as well as developing countries. Regarding international capital flows, the Fund's Executive Board had not discussed in any comprehensive way giving the Fund jurisdiction over capital controls. Fund advice emphasized appropriately sequenced capital-account liberalization, with the pace depending on a country's specific circumstances. The Fund considered problems in the domestic financial sector as the root cause of recent financial crises and had refocused its surveillance accordingly.

42. The active use of capital controls had negative effects on both macroeconomic stabilization and microeconomic efficiency. Moreover, a discussion of countries' experiences with capital controls needed to be linked to that of prudential policies in both debtor and creditor countries. The claim that exchange-rate misalignments and gyrations among the G-3 currencies had played an important role in most major emerging-market crises downgraded the importance in most recent crises of the interaction of domestic financial-sector problems with unsustainable external exposures and exchange-rate regimes.

43. The involvement of the private sector in crisis management was a complex issue on which progress so far had been slow. Strict limits on access to Fund resources involving the introduction of thresholds above which concerted private sector involvement would be automatically required was a subject on which there was no agreement among the Executive Directors. The positive and negative features of standstill proposals had to be weighed against each other, and the case for legally sanctioned standstills was not proven. Countries whose

entry into crisis was regarded as posing a systemic risk could now access Fund resources beyond normal limits, but the provision of such exceptional access was accompanied by the expectation of greater private sector involvement than under normal access. Thus the dichotomy set up by the *Trade and Development Report, 2001* between exceptional access and private-sector involvement was misleading. And in other cases the Fund had never encouraged countries to default.