United Nations Conference on Trade and Development

FINANCING FOR DEVELOPMENT

Contribution by UNCTAD to the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus

November 2008

UNITED NATIONS
New York and Geneva, 2008

UNCTAD/GDS/2008/1

Foreword

Once again, the ongoing global financial crisis has highlighted the inherent defects of the global financial system and the high degree of interdependence between trade, finance and macroeconomic development policies. UNCTAD and a few others have for some time been warning of imbalances, speculation in the exchange rate, the housing bubble and other problems, out of concern that they could help trigger a global economic meltdown. These developments have been prompted by some of the systemic shortcomings that were already identified in the Monterrey Consensus in 2002 but were not, unfortunately, subsequently addressed with sufficiently vigorous multilateral action. One meaningful contribution that the Doha review process can make now is to relaunch a reform agenda for the international financial system that also takes into account the concerns and interests of the developing countries.

The developments that led to the global financial crisis have been exacerbated by unprecedented deregulation and liberalization – an approach frequently recommended by mainstream economists as the recipe for success in developing countries. Yet over-reliance on market discipline, combined with bankers' ingenuity in designing new financial products, has diverted attention from the clarity, transparency and quality of loans. Today, there is much talk of new rules and regulations, codes of conduct and Bretton Woods II – the kinds of policies that UNCTAD has been recommending for several years. Now, developed and developing countries alike are rushing to adopt policies deemed too heterodox in the previous global climate.

The current crisis will have major implications for the work of the United Nations, especially in the context of financing for development. At Doha, the financing for development process can only be reviewed against the backdrop of the current world economic turmoil. First, it is essential to ensure that bailouts, unwinding and recapitalization of financial institutions do not come at the expense of international and global efforts,

such as official development assistance in support of the Millennium Development Goals and climate change adjustment funds. Second, we must learn from the experience of this and previous crises, in order to pave the way for a multilateral approach to the reform of the international financial governance system. As UNCTAD has argued in many of its analytical reports, this will require revisiting the role of the State; it will also require prudential regulations and regulatory oversight. A new balance must be struck between freedom of capital markets and a reasonable degree of financial stability. Third, the so-called "capital flow paradox" should give rise to new reflections on how to recreate national and global financial systems in such a way that more and cheaper finance can be channelled into productive investment in developing countries, rather than relying on excessive expenditure and speculation on developed country financial markets. A better balance is needed here as well.

The Doha conference comes at a point in time when multilateral action to alleviate the impact of recent events on the developing world is urgently required. Moreover, the architecture of the global financial system must be redesigned even beyond this present context, and this must be a global undertaking and a United Nations initiative.

Supachai Panitchpakdi

Secretary-General of UNCTAD

Preface

The present publication is part of UNCTAD's contribution to the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, to be held 29 November–2 December 2008 in Doha, Qatar. It has evolved through a series of engagements on the part of the UNCTAD membership and secretariat.

The Trade and Development Board of UNCTAD – as part of its consideration of the interrelated issues of interdependence and systemic coherence addressed in September 2008 at its fifty-fifth session – reviewed the pressing issues emanating from the international economic agenda. (This was the first Board session following UNCTAD XII, which was held in Accra, Ghana, in April 2008.) In this connection, the Board considered it pertinent to provide support in the areas of UNCTAD's core competence to the preparatory process of the upcoming conference in Doha. At the same time, the Board's attention was fixed on the global financial crisis, which was emerging in full force through a variety of channels across continents.

The Board thus decided to hold an executive session to articulate its institutional contribution to the agenda to be addressed by Governments in Doha – particularly in the interrelated areas of trade, investment, finance and development – in the context of the raging global financial crisis. The agenda for the executive session was elaborated through an UNCTAD presidential consultation on 16 October 2008.

Against this backdrop, the first part of the publication captures the outcome of the deliberations which transpired during the forty-fifth executive session of the Trade and Development Board, held on 13 November 2008. Neither the reported highlights of the discussions nor the major conclusions are a negotiated text, but are instead a summary by the President. The report of the debate reflects the concerns of member States about the implementation of the Monterrey Consensus, especially the

anxiety from the severe setback the global financial crisis was going to have on the development process. The member States were unanimous in their view that the present financial crisis exposed a systemic fault of global economic governance, one that would need a systemic response to address this systemic crisis in the international monetary and financial system. The members also felt that the approach should go beyond "firefighting" activities, to cover consistent and coherent institutional measures (e.g. strengthening international mechanisms for financial oversights, and ensuring liquidity and solvency). In this context, it was considered that the upcoming conference provided a potential opportunity to review not only the core elements of the Monterrey Consensus, but also other global economic issues which had direct bearing on financing for development. The interventions at the Board's executive session frequently referred to the upcoming meeting of G-20 countries held on 15 and 16 November in Washington, D.C., and expressed the hope that the conclave would objectively address the problems, taking into account the needs of developed and developing countries alike.

The second part of the publication contains an issues note, which was prepared to inform the debate of the Trade and Development Board executive session. The note reviews, from UNCTAD's development perspective, the six core aspects of the Monterrey Consensus. These range from mobilization of domestic resources for development, to flows of official development assistance, to coherence of the international monetary and financial systems. It may be pointed out that all these issues fell squarely within the domain of the work programme specified under the Accra Accord. The issues note essentially highlights the new features that have evolved in the world economy since the adoption of the Monterrey Consensus in 2002. Some of the interesting trends identified in the note include the so-called paradox of capital flows and speculation in the commodity markets in general. The added value from the issues note comes from its analysis of the current global financial crisis, the impact of which is being increasingly felt in the developing world, particularly in its

most vulnerable segments. Thus, six years after its adoption, the Monterrey Consensus needs to be subjected to fundamental scrutiny at Doha in a very different global climate.

UNCTAD, as mandated by the United Nations General Assembly, remains an institutional stakeholder in global efforts to promote international trade and development through research and analysis, technical cooperation and consensus-building. In the face of one of the stiffest challenges to the global economy in a century, one reckons that the Doha conference would find the perspectives expressed in this publication not only engaging but also actionable.

I take this opportunity to thank all those whose ideas and efforts are embodied in this publication.

Debapriya Bhattacharya
President of the Trade and Development Board
Ambassador and Permanent Representative of Bangladesh

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President's Summary

Forty-fifth executive session of the Trade and Development Board

13 November 2008

Highlights

An executive session of the Trade and Development Board was held on 13 November 2008 with the objective of formulating inputs to the preparation of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus in Doha, Qatar, from 29 November to 2 December 2008. It comprised two half-day discussion sessions with delegations from more than 100 countries. The programme of the executive session, the list of speakers and the list of participating countries are annexed.

The discussions at the executive session came at a particularly appropriate time, as developing countries were increasingly feeling the impact of the global financial crisis. It also gave an opportunity to member States to express their views on the objectives and process of a reform of global economic governance just two days before the G-20 summit meeting in Washington, D.C. was scheduled to launch a global effort to reform the international monetary and financial system. Eighteen delegations attending the executive session came from countries participating in the upcoming G-20 meeting.

Speakers generally emphasized that the present financial and economic crisis was a systemic one that called for

comprehensive global solutions to stabilize the system and prevent similar crises in the future. Delegates recognized that, in dealing with the most pressing issues of the crisis in the past weeks, a shift in thinking had taken place – from purely market-driven solutions towards measures involving an active role of the State. Countries affected by the crisis had expanded their policy space for actions that were unthinkable just months ago.

There was a general hope that the Doha conference would deliver more than a simple review of the implementation of the Monterrey Consensus. It should prepare the ground for a comprehensive follow-up to, and a strengthening of, the financing for development process. In doing so, it should help to put in place a new approach to development that would also take account of lessons to be learned from the financial crisis and the need to reform the international economic system in order to overcome the systemic weaknesses. The Board agreed that the current financial crisis showed the need, in an increasingly globalized economy, for stronger global economic governance, building on the principles of multilateralism with a clear set of global financial rules and regulations.

Most delegations expressed serious concerns about the spillover effects from the crisis in the financial sector into the real economy, and from the developed to the developing countries, which could lead to a severe setback in progress towards the Millennium Development Goals (MDGs). All developing countries and economies and transition are likely to feel the impact of the financial crisis and the recession in major developed countries. Least developed countries, landlocked developing countries, small island developing States and other structurally weak, vulnerable and small economies – as well as transit developing countries, middle-income countries and World

Trade Organization-acceding countries – will all face special problems.

It was recognized that the severity and length of the recession would depend to a large extent on the economic and financial policy responses. The need for collective and well-coordinated international action in this regard was recognized. It also became clear that the mobilization of additional financial resources for development – in particular increased official development assistance (ODA) to meet the Millennium Development Goals – was becoming even more urgent with the spreading of the impact of the financial crisis.

There was broad agreement on the need to fundamentally examine the international financial system and to address the issue of systemic coherence in a meaningful manner. This process should be undertaken with the participation of all States. It was suggested that the United Nations had the universality of membership, the political credibility and the substantive competence to play a key role in the process of revising the global economic architecture, as well as the legitimacy and confidence of the global community to make that role viable.

Summary of the deliberations

Delegations commented on the progress achieved under the different chapters of the Monterrey Consensus and on further steps to be taken by the international community with regard to financing for development. The deliberations of the Trade and Development Board took place against the backdrop of the current financial crisis, its impact on developing countries and the systemic issues it raises.

Many delegations considered the progress in the implementation of the Monterrey Consensus to be modest, although significant progress was recognized in the area of debt relief for the poorest countries. ODA flows had increased, but actual disbursements were much lower than the commitments made, and fell short of the requirements for meeting the MDGs by an estimated $150 billion annually. Moreover, it was noted that the ODA for economic infrastructure and the productive sectors had fallen relative to aid in the form of debt relief and for social and humanitarian purposes.

While great hopes had been attached to the Monterrey Consensus as an instrument to strengthen multilateralism for development, the years following the consensus had witnessed little progress in implementing international measures in support of financing for development. The financing for development process had to be strengthened and adapted to the changes that the world economy had undergone since 2002.

All delegations agreed that the crisis, perceived as the most serious one since the 1930s, revealed shortcomings not only in national financial governance but also in the management of the world economy and international financial

markets. Efforts to regulate international finance, as well as macroeconomic coordination around the world, were judged to have been inadequate.

It was highlighted that the financial crisis had different impacts on different groups of countries, depending on their exposure to international financial markets and their economic and export structures. While most countries were likely to suffer from a fall in export volumes and reduced tax revenues, commodity exporters would also be affected by falling commodity prices. Foreign direct investment flows were likely to fall in the wake of a global economic downturn, with negative effects on many developing countries. Emerging market economies would feel the impact through reduced private capital inflows and higher costs of refinancing their external debt, while the poorer countries were particularly vulnerable to possible falls in ODA and migrants' remittances.

Many developing country delegations expressed serious concerns about a possible decline of aid flows precisely when there was a particular need to increase those flows to compensate for negative effects through trade.

Moreover, many delegations were preoccupied that the recession in the developed world economy could trigger new protectionist tendencies. Several delegations also expressed disappointment that the "development round" of World Trade Organization negotiations had not fulfilled its promises. It was considered more important than ever to bring this round to a conclusion that met the needs of developing countries.

Delegations attached certain hopes to the financial and macroeconomic policy responses in countries that were directly affected by the crisis. It was noted that, distinct from other

experiences in the past, Governments had responded with the necessary countercyclical measures by providing financial support to large financial institutions in trouble and by designing programmes to raise demand.

Several delegations suggested that the issue of policy space for developing country Governments had acquired renewed pertinence in the light of the experience of some of the major developed countries, where Governments had created additional policy space in an effort to prevent the entire collapse of their national financial systems. Several delegations called for a revitalization of the role of the State in development. Regulation, rule-setting and oversight by Governments had to be strengthened, especially in financial markets, and Governments also had to step in where this was required by market failures.

Global arrangements that had a bearing on national policy space should be reviewed as the need for sufficient flexibility and policy scope to react to crisis situations had become very clear. It was considered necessary that the future global financial system be designed in a way that left appropriate policy space for any State to be able to prevent crises and to react when emergency situations occurred.

It was suggested that financial stability had become a global public good, and that its proper management required far-reaching reforms of the global economic governance system and the adaptation of institutions and instruments to the needs of the twenty-first century. An effectively operating multilateral monetary and financial system was necessary for countries to benefit from the opportunities offered by the multilateral trading system.

Therefore, great importance was attached to strengthened global cooperation on monetary and financial matters in order to ensure financial stability, advance the effective functioning of financial markets and minimize all possible negative impacts of financial volatility. The fundamental flaws in the international economic system with regard to accountability, transparency and prudence had to be addressed. These were all hallmarks of good governance, which had been observed neither by the international financial institutions nor in the countries where the current crisis originated.

Several speakers pointed to the important potential role of regional cooperation and regional monetary and financial institutions in the management of the global economic system and in mobilizing financial resources for development.

Many delegations welcomed the opportunity of the upcoming G-20 meeting in Washington, D.C., to initiate global considerations on systemic issues. The important role of the United Nations in this process was also underlined. Delegations noted that UNCTAD was well placed to address the persistent challenges of the global economic system with high-quality analyses and policy recommendations. It was recalled that UNCTAD had been one of the few institutions that had warned, in its *Trade and Development Reports* of the past years, of a global economic crisis, and had offered specific recommendations which could have averted – or at least meaningfully mitigated and prepared – for the crisis. Many delegations considered the United Nations to be the right forum to generate political consensus on basic principles of a multilateral financial order that allowed for smoother economic globalization.

The debate reflected broad agreement that the Doha conference must provide new impetus to the implementation of the Monterrey Consensus. It was also felt that it should contribute to ensuring that the current financial turmoil did not compromise the engagement of the international community in the financing of development. Moreover, it should strengthen the gender dimension and respond to new challenges, such as climate change, the food crisis and energy security.

Recommendations put forward by participants

Participants put forward important recommendations on all sub-themes of the Monterrey Consensus, especially with regard to sub-themes 4 and 6, which were perceived to be of particular relevance at the present juncture in the light of the current financial crisis and the looming recession in major developed countries. The sub-themes included:

Sub-theme I – Mobilizing domestic financial resources for development

- Developing countries should give heightened attention to the mobilization of domestic financial resources for development. In this regard, special attention should be given to enhance the role of the banking system in the financing of productive investment.
- Tax collection should be made more effective through greater transparency in rules and regulations. International cooperation in tax matters must be strengthened further.

Sub-theme II – Mobilizing international resources for development: foreign direct investment and other private flows

- All efforts should be made to avoid a fall in private capital flows to developing countries. Particular support should be given to South–South flows of foreign direct investment. The role of Sovereign Wealth Funds from developing countries in meeting the external financing needs of other developing countries should be strengthened.
- Efforts to reform the international financial architecture should aim at containing speculation in international financial and currency markets in order to reduce the instability of private capital flows to developing countries.

Sub-theme III – International trade as an engine for development

- It is of crucial importance for developing countries that the financial crisis and the slowdown in the growth of the world economy do not lead to a new wave of protectionism. Indeed, the deadlock in the Doha Round of international trade negotiations must be broken, and efforts to achieve an ambitious and balanced outcome that fully reflects the interests of developing countries, must be reinforced.
- In order to strengthen the role of trade as an engine of development, many developing countries, especially in Africa, need to address more actively supply-side constraints. These efforts must be supported by further opening of developed country markets for exports of interest to developing countries.
- The commodity problem must receive increased international attention. Reforms of the international financial system

should also aim at reducing speculation in international commodity markets.

- The international community should support the efforts at the national level for the integration of local producers into international supply chains and innovative financing and risk management tools for agricultural commodity producers.

Sub-theme IV – Increasing international financial and technical cooperation for development

Priority should be given to meeting the new challenges faced by the world's poor as a result of the financial crisis and the recession in the developed countries. Therefore, the Doha conference should pay particular attention to the continuation and further increase of ODA flows, especially for countries whose Governments are suffering from a decline in public revenue as a result of the crises.

- The Doha conference should urge the implementation of aid commitments already made by bilateral donors to close the MDG financing gap. In this context, debt relief should not be considered as part of ODA.
- Increased official financing to assist developing countries is also necessary in order to help countries in coping with the ongoing food crisis.
- Aid effectiveness must be raised further. In order to be effective, aid must be provided on a predictable and sustained basis.
- The development of a framework for Aid for Trade is imperative for countries to reap the potential benefits from trade, as is the Enhanced Integrated Framework and the provision of additional resources for trade financing. These

have become even more important in the face of the financial crisis and reduced access of developing countries to private financing.

- The international community should continue efforts to bring forward innovative financing mechanisms. These are becoming all the more important as new challenges arise, in particular meeting the challenge of adaptation to climate change and mitigation of its effects.
- A new facility for the International Monetary Fund should be created to stop the spillover of the crisis to middle-income countries. The capital of Sovereign Wealth Funds and foreign exchange reserves accumulated by a number of surplus economies should be used to mobilize additional financial support for countries in need.

Sub-theme V – External debt

- There is need for bolder initiatives to solve the external debt problems of the developing countries in an effective, equitable and development-oriented manner, particularly in the countries that will be the most affected by reduced foreign exchange incomes and higher costs of their external debt as a result of the financial crisis and the recession.
- It is important to achieve and maintain sustainable debt situations in developing countries. Debt sustainability strategies should be linked to a country's capacity to achieve its national development goals, including the MDGs.

Sub-theme VI – Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development

- In the short term, it is necessary to ensure a global policy response to restore global financial stability and economic growth. Measures to help financial market participants regain confidence and stimulate demand are required in order to combat a credit crunch and mitigate the impact of the financial crisis on output growth and employment. In order for such countercyclical action to be effective, fiscal as well as monetary policy instruments should be used, and these policies should be implemented in an internationally well-coordinated manner.

- In the medium and long term, Governments must play a more active role in the management of the financial system, at both the national and international levels, by strengthening the regulation and supervision of financial intermediaries. Accountability of all actors and full transparency in financial markets have to be ensured.

- The role of credit rating agencies needs to be reassessed and their activities made subject to stronger public scrutiny.

- In order to avoid systemic crises in the future, and to reduce the risk of excessive and destabilizing speculation, early warning systems should be established at the national and international levels.

- The global financial system must be reformed around the core principles of transparency, integrity, responsibility, sound banking practice and international governance. Globally acceptable standards of supervision should be elaborated and applied equally and consistently in all countries.

- The international monetary and financial system must be better equipped with instruments to prevent prolonged exchange-rate misalignments and currency speculation. In order to achieve greater coherence between the international trading system and the international financial system, and to avoid large global current account imbalances, a multilateral exchange rate mechanism and macroeconomic policy must become central elements in a new global economic governance system.

- Monitoring and surveillance of the global financial system through an international body should be strengthened, and it should cover all economies of the world, especially those whose national economic policies and performances have an impact on the rest of the world. In this context, the Bretton Woods institutions may play an important role, but concerted efforts need to be taken to reform the International Monetary Fund.

- The debate on the lessons from the financial crisis and the process of reform of the international economic governance system must take place with universal, democratic and equitable participation of all States. Genuine efforts must be made to include developing countries in the decision-making and norm-setting processes of the key financial, monetary and trading institutions, and to strengthen their role in the management of global public goods.

There was a widespread view among delegations that the Doha conference should be seized to bring developing country concerns to bear on the process of consensus-building on a better international financial architecture. Because of its broad political legitimacy, and adequate representation of different groups of developing countries, the United Nations system was perceived

as having a particular legitimacy to play a key role in international financial reform. UNCTAD was called upon to help contain the negative effects of the financial crisis on developing countries, building on its proven competence in policy analysis and technical cooperation.

Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus

Issues note by the UNCTAD secretariat[1]

Executive summary

The General Assembly invited the Trade and Development Board to contribute, within its mandate, to the implementation and review of progress of the outcomes of the major United Nations conferences and summits. With the present issues note, UNCTAD contributes to the forthcoming Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, to be held in Doha, as well as to the ongoing debate on, inter alia, the implementation of the Millennium Development Goals (MDGs). The issues note reviews, from UNCTAD's development perspective, the six chapters of the Monterey Consensus, ranging from mobilization of domestic resources for development to official flows and coherence of the international monetary, financial and trading systems. The examination of the six chapters is undertaken against the new elements dominating the world economy, in particular the current financial crisis. The paper highlights in particular the new features that have evolved in the world economy since the adoption of the Monterey Consensus in 2002, such as the paradox of the capital flows, the issue of speculation in commodity markets and the shortcomings in the functioning of financial markets in general. The note suggests main issues for consideration by the Board, updated to

[1] Extracted from UNCTAD document TD/B/EX(45)/2.

take full account of the recent developments in the financial and economic environment. Finally, the document addresses in its annex the implications for developing countries of the financial markets crisis, and points to the need for strengthening global coordination on monetary and financial matters.

I. From Monterrey to Doha: the way back to multilateralism?

The forthcoming Doha review conference on commitments made in Monterrey in 2002 to ensure sustained financing for development could not come at a more opportune juncture for developing and developed countries alike. Between 2002 and 2007, notable achievements could be claimed in the core areas covered by the Consensus, through (a) sustained global growth and the wider benefits this has generated in terms of a relatively long period of productive domestic investment and growth in many regions of the world; (b) expanding global trade and enhanced private financial flows; and (c) advancing official financial cooperation in the areas of aid and debt.

Despite stalemates in the current round of international trade negotiations, many countries, including many developing countries, have benefited from the positive development of the global economy and the associated increase in global demand – reflected in a considerable increase in exports – which is due to changes of both export volumes and values. Emerging market economies with strong manufacturing sectors (especially East and South-east Asian economies) have significantly increased their export volumes and export purchasing power, despite declining barter terms of trade. Many commodity-rich economies (especially in Africa and West Asia), by contrast, have recorded relatively strong increases in export values and

associated improvements of their barter terms of trade. However, there are considerable differences among developing countries in terms of their production and trade structures, and their capacities. Many least developed countries (LDCs) and other African countries not only have weak productive and export capacities, they are also heavily dependent on the import of essential commodities. The price increases of imported goods have resulted in further deterioration of their current account balances, with negative effects on economic growth; the price hike of food in particular has squeezed household incomes, worsened poverty and impeded progress toward the achievement of other Millennium Development Goals (MDGs).

Despite the improved economic performance of many developing countries during the past decade or so, development assistance remains important, especially for low-income countries. It is therefore important that the donor community live up to its aid pledges, especially as the global financial crisis and associated economic downturn begins to negatively affect a large number of developing economies. Although many donors have considerably increased their official development assistance (ODA), particularly since 2002, it must be emphasized that a large share of this increase is attributable to debt relief rather than new aid disbursements, and that a drastically declining share of the aid disbursements is actually used for the development of economic infrastructure and production. However, aid to the productive sector is of the utmost importance to enable higher and more sustained economic growth, and more and more productive employment, without which it will be impossible to sustainably reduce poverty.

The scope and depth of commitments made at Monterrey have naturally become linked to the global agenda for achieving

the MDGs by 2015. This implies a set of actions on behalf of developed and developing partners, which has become all the more pressing as some major MDG targets recede on the horizon.

With hindsight, it is clear that Monterrey, coming in the wake of major financial crises in Asia and Latin America, embodied the hopeful outlook of the moment. But the belief that the economic and development policies which had emerged more by chance than by strategic design after those crises could be extrapolated far into the future turned out to be rather naïve. It encouraged complacency among many Governments as to the need for public policy interventions at the national, regional or multilateral levels in global finance. "Development" seemed to be "breaking out" on its own, and even poverty by some measures was falling, as the world economy grew at an unprecedented pace. Not surprisingly, of the six substantive chapters of the Consensus, the one on which perhaps the least progress has been possible since 2002 is that addressing systemic issues and global financial and monetary cooperation, which only a vocal minority of some observers, Governments and international organizations, including UNCTAD (see *Trade and Development Reports*, various issues), have pursued. The current financial crisis has now shifted the tide.

The lack of political design became obvious by the fact that, on a global scale, capital flows reversed. For decades, if not centuries, capital had been flowing from the apparently capital-rich industrialized world to the labour-abundant developing countries of Asia, Africa and Latin America. Then the flows turned around. Building on the commodity price upswing and improved competitiveness in the production of manufactures that resulted from the devaluation shocks of previous financial crises,

many emerging economies of the South became net exporters of capital to a number of de-industrializing countries in the North, which were characterized by relatively high consumption of domestic and foreign products and a rapid increase of indebtedness.

The accumulation of reserves through sustained, dynamic export performance accounted for some of the newly-found financial power originating in developing countries. However, this reversal of capital flow patterns also showed that, for some emerging developing economies pursuing a vigorous macroeconomic and fiscal policy agenda, financing for investment could originate in national banking systems on the basis of controlled monetary policy, without dependency on external sources of finance.

Such developments highlight the interdependence between the trade, finance and monetary systems, and hence the systemic dimensions of their management. The increasing flow of capital from developing to developed economies, rather than the other way round, points to the need for a fresh assessment of development financing and capital accumulation through domestic resource mobilization, proactive macroeconomic management and international trade on the one hand, and external capital flows in the form of foreign direct investment (FDI), debt and ODA on the other.

Moreover, the policy implications of the current financial crisis have to be part of an agenda for Doha if the conference is to claim relevance for economic development. The wave of bailouts and the nationalization of large parts of the financial sector in the United States and Europe, and the dramatic repercussions of the crisis on currencies in developing and transition countries, show that the whole structure of modern

market-based financial capitalism has to be fundamentally questioned. In consequence, the recent events should be at the centre of the discussion in Doha because they have important global implications. This requires better regulation and oversight, not only at the national level, but especially at the international level. The current events clearly call for a new approach to financial regulation everywhere and for much more coordination across countries. Moreover, developing countries should not shy away from using all the possible instruments (including imposing limits on capital flows) in order to protect themselves from such global financial shocks.

Furthermore, other issues, such as excessive speculation in commodity markets – which has caused undue rises of food prices, with severe negative effects on poverty in many poor countries that are net food importers – were not evident or relevant at the time of Monterrey. The sustained upswing and recent boom, possibly to be followed by a bust, has shown the destructive effects of large price swings in food, energy and other commodities, and most observers suspect that speculation in futures markets has played a key role in these large price swings. More needs to be done to define a clear strategy to limit such destabilizing activities. This is at the core of the financing for development process, because large swings in commodity and food prices have enormous implications for trade, the behaviour of countries' current accounts and ODA requirements. The direct interaction between trade and financial flows, and the need for active national and international public policies to manage this interaction, bring to the forefront more than ever the themes of systemic coherence and multilateralism of the Monterrey Consensus.

As the international community comes together in Doha to review the Consensus and progress in achieving its goals, these features of the global financial system cannot be ignored in exploring the new landscape of financing for development. Nor can the enduring issues escape attention at Doha this year, including the global imbalances and the still-pertinent challenges of financing development through aid and debt reduction for the poorer, commodity-dependent economies of the so-called bottom billion.

II. The new global financial challenge for Governments: avoiding meltdown

In 2007, UNCTAD warned that there must be something fundamentally wrong with a financial system that could not survive for three or four years without facing a damaging or at least unsettling financial crisis (TD/B/54/CRP.2). UNCTAD was then a rather lonely voice. What emerged in 2007 as an apparent liquidity problem in an obscure corner of a sophisticated, highly leveraged and apparently risk-free financial market has today acquired a truly global dimension. What first appeared to be a United States housing sector credit instrument weakness is being gradually exposed as more than a liquidity problem affecting United States financial markets – it also raises wider questions of the solvency of banks and financial enterprises internationally (threatening, in some cases, the solvency of national economies). As taxpayers, market actors and policymakers around the world scramble to assess the implications and extent of the economic tsunami whose first waves are reaching their shores, Governments meeting in Doha under the universal framework provided by the United Nations can only enrich their review of Monterrey by taking stock in a candid and bold manner of the implications of this global crisis for multilateral finance for

development and for the poorest countries' growth prospects (see annex).

For the immediate future at least, the imperatives of other so-called "global public goods" – be they in the areas of security, climate change or governance – recede as the implications of global recession begin to be assessed around the world. Indeed, economic and social security in its deepest and widest sense, and the common welfare of humanity, seem to be at stake at a moment of simultaneous economic and political uncertainty unknown in the post-Second World War framework (see World Economic and Social Survey, 2008). The current crisis has challenged not only the fundamentals of many an economy around the world, but has also shaken faith in the policy preferences, regulatory stances and free-market "engineering" that are increasingly being held accountable for creating the state of irrational complacency, if not exuberance, that led to the current debacle.

International financial institutions, including the Financial Stability Forum (FSF), which was set up in 1999 as a response to the Asian financial crisis, has failed to effectively fulfil its mandate. The FSF was established "to promote international financial stability, improve the functioning of financial markets and reduce the tendency for financial shocks to propagate from country to country, thus destabilizing the world economy". To this end, it is encouraged "to assess vulnerabilities affecting the international financial system; to identify and oversee action needed to address these; and to improve coordination and information exchange among the various authorities responsible for financial stability" (www.fsforum.org/about/mandate.htm, 23 October 2008). The FSF also promotes the adoption of international standards. The failure of international financial

institutions to identity and effectively respond to the current financial crisis, until recently, has two important reasons: (a) the international financial institutions have a strong belief in the self-correcting mechanisms of the market, which have made them not only blind to market failures, but also reluctant to encourage a stronger role of the State in regulating financial markets; and (b) the international financial institutions have focused on reforming the financial markets in their debtor countries, the developing countries, but have not been effective in encouraging reform and greater transparency in the financial markets of their creditor countries, the industrialized countries.

Credit rating agencies played a critical role during the Asian financial crisis, and find themselves once again at the centre stage of the current financial crisis. The rating agencies have provided outstanding ratings to deeply flawed financial instruments, and have thereby helped to exacerbate the current situation. It is high time that these agencies be subjected to critical scrutiny and reform, the conclusion of which may well be that these agencies should be abolished altogether or be subjected to stricter oversight.

Doha provides an opportune moment not only to revisit, reaffirm and strengthen existing development partnership commitments, but also to provide an early platform to begin to absorb the common lessons of the crisis. A key lesson is that the regulation and supervision of financial markets must be strengthened, and that the discussions of how to reform and strengthen the multilateral financial and monetary regime must be opened up beyond the international financial institutions and their stakeholders to include the pertinent agencies of the United Nations, as well as many more developing countries. Although the agreed rescue packages for financial institutions are

necessary to prevent the financial crisis from leaving even deeper marks in the real economy, the rescue operations raise fundamental questions. Citizens and policymakers worldwide are questioning what precise combination of deregulation, weakened public oversight or poor governance allowed markets to increasingly dictate public policy, ultimately handing taxpayers a trillion-dollar liability to be recouped somewhere down the road.

Many new questions need to be addressed in the context of Doha:

(a) How was it possible that a shadow financial economy driven by securitization and leveraging extracted double-digit dividends for a couple of years and then generated hundreds of billions of dollars of "toxic waste". Why did Governments allow the mushrooming of a huge casino above the real economies, even though it has been sufficiently clear for a long time that the casino was failing to allocate capital in an efficient way around the globe?

(b) How can poorer, weaker countries that have yet to escape the poverty trap cope with the imminent global economic downturn if the very market model that has created the current crisis, and which has been promoted as the only recipe for meeting the challenges of globalization, seems increasingly irrelevant in important developed countries?

(c) Should they also abandon deregulation, privatization and liberalization in favour of restoring policy space that would allow Governments to actively intervene in financial markets, nationalize private debt and even engage in direct economic crisis management by the

legislative branch, as recently witnessed in the United States and Europe?

(d) In what forums and with what participation is it appropriate to discuss the reform of the multilateral financial and monetary regime (question of process), and what kind of regulation and supervision is needed to create a viable multilateral financial and monetary system (question of substance)?

III. Mobilizing domestic financial resources for trade and development: a new set of priorities

At the core of the Monterrey Consensus is a recognition that, however globalized the world might be, development – as well as the financing of it – starts at home. Be it in terms of domestic investment and financial intermediation, prudent fiscal management and monetary policy, or the shape and effectiveness of governance, the Consensus places the (initial) burden of growth on a host of national policies and institutions that are needed for a virtuous development path to be attained. Finance from external sources may also be necessary at a significant scale for many developing countries, but its appropriate management is also a matter of domestic policies. However, the policy space to do so, and to address other strategic concerns of development, has been shrinking at the same pace that global economic integration has intensified (*Trade and Development Report, 2006*).

In the same vein, the "good governance agenda" of the last decades was an agenda sometimes confused with "less Government". By contrast, today's realities oblige developing and developed States alike to assert themselves, not so much to

ensure the achievement of this simplistic *good* governance agenda, but to shape a new model of *effective* governance that can fulfil public responsibilities towards private citizens and maintain some degree of national sovereignty, while promoting peaceful and cooperative interaction with other, poorer or richer, countries in a multilateral, action-oriented framework. And to that extent, many countries, including many of the poorest, must seek to improve their tax systems to raise tax revenues. However, it is clear that countries with low incomes and large informal economies are not able to raise sufficient tax revenues to cover necessary public investment in the social sectors and economic infrastructure, amongst others.

Efforts to increase financing for productive investment must therefore go beyond the current focus on mobilizing existing resources (especially household savings) and concentrate more strongly on the creation of new resources (such as bank credit). Financing for investment can originate from the banking system on the basis of controlled monetary policy of the central bank setting the interest rate at a level conducive to growth without fuelling inflation. However, the institutional requirements for such a process of credit creation are often not in place in developing countries and monetary expansion may lead to runaway inflation (*Trade and Development Report, 2008*). It is thus necessary to rethink the institutional setup of domestic monetary and whole financial systems which, in some cases, have been damaged by orthodox policy reforms. In this setting, it is worthwhile to evaluate to what extent credit creation through "monetary financing" will enable investment without the prior accumulation of financial savings at a given level of income.

In many developing countries, especially LDCs, stock markets are too limited and unable to provide necessary finance for new companies, especially small and medium-sized companies. In sum, several developing countries lack a well-working system of financial intermediation and may not be able to build such a system in the near future. In the absence of a mature system of private financial intermediation, countries should identify viable instruments to accelerate development and provide affordable risk capital, with the aim of strengthening the productive sector of the economy. Public credit and guarantees, national development banks, taxation and social security system reforms can contribute to development finance and lessen the impact of global turbulence.

The rise in the prices of many primary commodities and the concomitant increase in export earnings of many developing countries temporarily improved the domestic conditions for the financing of development. The key challenge today, on the one hand, is how to translate the still-existing gains from improved terms of trade into lasting progress through accelerated investment in productive capacity. On the other hand, the recent drop of activity in the developed world and the unwinding of speculative positions have already brought down a number of commodity prices, which may quickly revert the gains into losses. In any case, developing countries need to implement policies aimed at retaining a greater share of the commodity rents in the long run and channelling these rents into investment in industrial upgrading and diversification (*Trade and Development Report, 2005* and *2008*; *Least Developed Country Report 2008*; and *World Investment Report 2008*).

Questions include:

(a) If the challenge for economic policy is not how to increase household savings in the first place, but how to finance an increase in investment in fixed capital that will generate rising income and, in the process, lead to higher *ex-post* savings, how should the traditional policy agendas be adjusted?

(b) Do public sector financial institutions need to assume a more important role in the financing of investment in developing countries and in which way?

(c) How should commodity-producing countries deal with revenues from natural resource exploitation and the threat of falling prices?

IV. International resources for development: the outlook for private flows

Different types of private financial flows are affected to different degrees by the current financial crisis. It is apparent that the crisis has already led to a decrease of short-term capital flows to developing countries and a considerable decline in stock markets in developing countries. Insofar as these trends are associated with a decline of carry trades and a deflation of stock market bubbles, they encourage adjustments in line with fundamentals and should thus have a stabilizing effect on economies (UNCTAD Policy Brief No. 4). As with previous crises, however, there is a danger of overshooting corrections because of herding behaviour, and associated with this an excessive decrease of investment.

In comparison, FDI is relatively stable, as it tends to be associated with a longer-term perspective. This does not mean

that FDI will not be affected by current trends, but it is difficult to forecast exactly how. While uncertainties and reduced business confidence arising from the financial crisis may well discourage FDI, there are a number of offsetting factors which could ameliorate this trend:

(a) A number of private equity funds have been established to invest in developing countries and, inasmuch as they rely heavily on debt funding for their activities, are likely to reduce their investment in the short and medium term;

(b) Sovereign wealth funds, whose assets have increased in recent years because of high trade surpluses in a number of countries, are increasingly investing through FDI – including greenfield FDI – and their orientation has shifted proportionally to developing countries. Developing countries may benefit from increased investment by sovereign wealth funds as opportunities dry up in developed countries;

(c) A similar scenario can be constructed for transnational corporations (TNCs) from the South. At present, developing countries still provide profitable investment opportunities, but these may decline if the global economic slowdown further deepens and is protracted;

(d) Developed country TNCs remain the largest investors in developing countries and, like their counterparts from the South, can continue to invest based on retained earnings. A deepening of the crisis, however, may encourage these TNCs to repatriate a larger share of their profits.

Doha provides a useful opportunity to debate these issues and the likely impact of the financial crisis on FDI flows, and thereby reflect on appropriate policies to ensure that FDI

remains a significant mechanism for mobilizing international resources for development.

Questions include:

(a) Considering the increasing diversity of international investors, are some of these investors more viable than others as financiers for development, and under which circumstances?

(b) Which actions can be taken to increase and improve South–South investments, especially in the context of South–South cooperation and regional integration?

(c) Recognizing the challenges associated with FDI in different economic sectors (e.g. mineral extraction, infrastructure services and agriculture), what are appropriate national, regional and international policies to ensure that investment flows fully contribute to the development agenda, according to member States?

(d) Considering the current financial and economic situation, what can be done to ensure that FDI and other capita flows continue to provide necessary resources for development financing?

V. International resources for development: official flows

A considerable number of Governments in developing countries remain cut off from access to capital from domestic or international financial markets. In the current global credit crunch, even some middle-income developing countries might see debt financing dry up. In addition, developing countries often lack the ability to broaden their tax base, while facing high

gross domestic product (GDP) growth volatility and hence fragile revenue bases. Many operate within constrained monetary and fiscal policy space, so concessional loans and grants remain crucial forms of financing for infrastructure and complementary public investment.

Following the Monterrey Consensus of 2002, most bilateral donors set ambitious targets for increasing ODA as their contribution to a global partnership for development intended to meet the MDGs. However, despite a substantial increase in disbursements, most donors are not on track to meet their ODA commitments. Moreover, there is still a considerable gap between actual ODA flows and the aid estimated to be necessary for implementing measures in pursuit of the MDGs. Meeting the MDGs, especially the reduction of extreme poverty by one half by 2015, will require raising the annual flows of ODA to poor nations by at least $50 billion–$60 billion above their current level.

With the focus on MDGs, the proportion of ODA spent for health, education and other social purposes has increased substantially, at the expense of the share of ODA dedicated to improving economic infrastructure and strengthening productive sectors. Although an increase of ODA for social purposes is essential and justified, sustained poverty reduction depends even more on faster income growth and job creation. Unless ODA helps boost growth, it is unlikely to be effective in reducing poverty in the long term beyond the MDG target year of 2015 (*Trade and Development Report, 2008*; *Least Developed Country Report 2008*).

In addition to more and more balanced ODA, there is also a need for more effective aid. Aid effectiveness is threatened by an increasing number of public and private donors, as well as a

lack of coherence and coordination between these donors. To strengthen aid effectiveness, it is important that aid delivery and reporting systems be harmonized, and that the principle of national ownership be not just recognized but realized. In addition, aid effectiveness can also be improved by allocating aid in accordance with needs: (a) more aid to LDCs; (b) more economically-oriented aid to countries that have the weakest economies; (c) more socially-oriented aid to countries that are least on track to reach human and social development objectives; and (d) more governance-related aid to countries that have the weakest institutions. UNCTAD proposes that the effectiveness of aid be measured against declared objectives of aid (*Trade and Development Report, 2008*).

The Monterrey Consensus states that debt relief should be "fully financed through additional resources" (para. 49), but there is no clear evidence that such an outcome has ensued. Debt relief, while an important component in assisting developing countries to advance in their development endeavours, is primarily an accounting exercise that generates only relatively small amounts of cash for increased public spending in the period in which it is provided. But most of the recent increase in ODA is accounted for by debt relief which, rather than being additional as called for, has tended to crowd out non-debt relief aid flows that are more liquid.

As developing countries begin to feel the cold winds blowing through the global economy, they need to have their balance sheets in as strong a position as possible. Given the magnitudes of government financial bailouts and public support offered in recent weeks to failing financial institutions and markets, it can only be surmised how far even a fraction of such resources could go in helping indebted developing countries to

reduce their vulnerability to global financial slowdown and slump. Debt relief initiatives should be extended to middle-income countries with a heavy debt burden, and donors should recognize that past debt relief efforts have bypassed countries with large developmental needs, which have avoided unsustainable debt situations at the cost of lower public spending for infrastructure and social services.

Financial crises in countries with market access are often driven by liquidity problems and not by solvency problems – even though solvency problems are sometimes the outcome of a liquidity problem. International coordination is particularly important because some of the shocks that may lead to a liquidity crisis depend on external factors, and these shocks often originate from policy decisions of the advanced economies. These externalities call for more international coordination in policymaking. Innovative debt instruments such as GDP-indexed bonds and local currency debt instruments could make developing countries more resilient to external shocks. Developing countries may need the help of the international community in order to be able to issue such instruments.

Debt crises are bound to occur, even with less overall debt, with improved debt management and better and safer debt instruments. Ideally, there should be two crisis resolution mechanisms – one for middle-income countries with a large share of commercial debt, and one for low-income countries which have a large share of their debt with official creditors. In addition, it would be useful to create an independent body, mandated by both debtors and creditors, to evaluate the debt situation of countries facing external debt problems and to decide on the level and form of debt relief needed.

Questions include:

(a) Will donor countries continue to honour their aid pledges, despite the current economic crisis and associated strains on public budgets?

(b) How can a renewed interest of bilateral and multilateral donors in the development of productive capacities, and a concomitant increase of development assistance for economic infrastructure and production, be encouraged?

(c) How can the official sector make sure that debt relief is truly additional, as countries that need debt relief are also likely to need more external resources?

(d) Debt sustainability is an issue for both low-income and middle-income countries. Thus, how can debt relief efforts be designed in a non-discriminatory way among different groups of countries?

(e) Can a new debt resolution mechanism be created aimed at guaranteeing speedy solutions to debt crises and ensuring fair burden-sharing among creditors and debtors?

VI. Addressing systemic issues: coherence of the international monetary, financial and trading systems

UNCTAD has pointed time and again to the important shortcomings associated with the lack of coherence between an international trading system that is governed by a set of internationally agreed rules and regulations, and an international monetary and financial system that is not (e.g. *Trade and Development Report, 1990*). Since financial crises produce enormous costs for the real economy and put the trading system under strain – creating the perverse situation in which the

financial system undermines rather than supports the real economy – closer multilateral monetary cooperation is an indispensable need. A functioning multilateral financial and monetary system is necessary for countries to reap the potential gains from a freer multilateral trading system.

Moreover, the recent financial crisis has shown that the international financial system in its present form is unable to function for more than three or four years without an unsettling crisis. Hence, the need for financial sector reforms at both the national and international levels is obvious. Such reforms include the design of more appropriate international rules and regulations, and more effective international financial institutions.

Climate change is another issue of global dimension that requires global action and institution-building. Innovative and additional financing mechanisms will be needed to expand the supply of and access to alternative sources of energy, to support low-carbon policies and programmes in developing countries, and to finance the costs of adaptation. Greater international cooperation to develop and transfer low-cost technologies to developing countries is critical to meeting the challenges of both mitigation and adaptation.

Finally, there are a number of shortcomings that arise due to poor quality of corporate accounting and reporting. The challenges faced by developing countries and countries with economies in transition in mobilizing tax revenues, ensuring proper use of corporate accounts, and introducing modern financial mechanisms, all require high-quality, internationally-comparable standards of corporate reporting. Strengthening the ability of developing countries and countries with economies in transition to implement such international standards of

accounting and reporting will improve the ability of those countries to maintain a stable and transparent financial market, and ensure stronger systems of accountability for the allocation of scarce resources.

Questions include:

(a) How can multilateral rules and institutions be strengthened to help reduce uncertainty and instability in international financial markets, and induce greater compatibility of national macroeconomic policies?

(b) How should an international body be designed that would be able to respond in a timely and appropriate way to the needs of developing countries when a crisis looms?

(c) What are the main strands of a more effective regulation of financial markets to promote sustained and innovative financial development, while preventing financial engineering that rewards excessive risk-taking?

(d) An internationally-coordinated macroeconomic policy response is needed to mitigate the increasing risk that the fight against the global financial crisis will result in a global recession. Who should take the lead?

Annex to the issues note

The financial market crisis: implications for developing countries

Crisis originating in developed markets…

The financial market crisis that erupted in the United States in August 2007 and reached a new culmination point in September and October 2008 is essentially a developed-market financial crisis. On many accounts, it represents the largest financial shock since the Great Depression, and it has the potential to trigger a deep global recession if countercyclical policies are not applied all over the globe in a coordinated manner.

So far, the spillover of the crisis to developing and emerging economies has not affected domestic demand in a number of large developing countries. However, the looming recession in the developed world and the increased level of integration in trade and finance imply that the current crisis will eventually affect all sectors in all countries across the world.

Considerable uncertainty as to the extent and scale of the financial crisis and its attendant effects for the real economy remains. Nevertheless, there is a strong risk that the de-leveraging of securitized financial instruments will increasingly affect asset classes that had so far not been considered as high-risk and expose an increasing number of financial institutions to liquidity problems. Additionally, the threat of a credit crunch is imminent as long as the bail-out packages (such as the one announced by the United States Treasury and a number of European Governments) have not absorbed the majority of the bad loans at a price that helps to restore sound balance sheets.

Moreover, the financial cost of the bail-out packages and the financial scale of the crisis itself crucially depend on the ability of the authorities to revive the real economy by means of expansionary monetary and fiscal policy.

Given the risk of a full-fledged recession or even a depression in the developed world, the recent correction of the strong increase in primary commodity prices, notably oil, during the first few months of 2008 has provided some relief. The attendant decline in headline inflation now makes stagflation a dwindling threat. This decline also substantially reduces what is often portrayed as a "dilemma" for central banks between decreasing interest rates to combat the economic slowdown and keeping interest rates high to combat inflation. This is good news as, in most countries, the increase in headline inflation resulted from a supply shock driven by the food and energy price surge, which should not have been be called "inflation" in the first place.

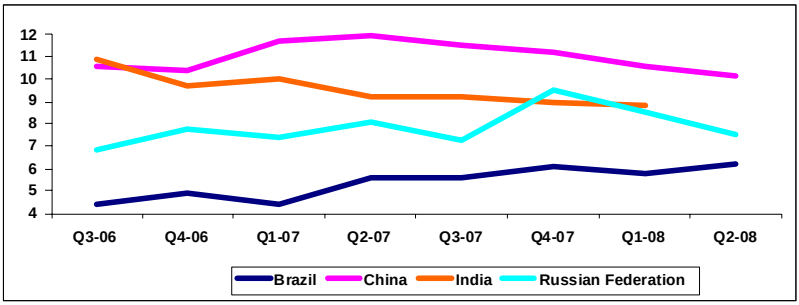
A sharp economic slowdown in developed countries and the resulting lower import demand have adverse effects on the real economy of many developing countries. With the United States dollar at a very low level, import demand in the United States is anaemic and United States exports are booming. Dollar depreciation will pick up if international investors lose confidence in the United States authorities' ability to handle the crisis and to stabilize the real economy. Dollar depreciation, to be sure, intensifies the links with the crisis in the developed world. It has the opposite effect of the famous de-linking or de-coupling that has been mentioned by policymakers in developing countries time and again. Dollar depreciation has to be welcomed in terms of the correction of the global imbalances,

but its negative effects on growth and employment in the rest of the world have to be fought by active countercyclical policies.

Taking all these factors together implies a sizeable risk that the current financial crisis is set to affect developing and emerging economies significantly more than has been the case so far. Available data (the dissemination of most of the relevant data lags reality by three to six months) suggest that developing countries have not experienced a strong adverse effect from the financial market crisis and the related slowdown in United States real economic activity. While growth rates in developing countries have slowed over the past 12 months, they remain strong by historic standards. Hence, in purely quantitative terms, there has been a "decoupling" by developing countries as a group up to now. But while developing countries in West Asia, Africa and the Commonwealth of Independent States (CIS) have felt few if any adverse effects, economic activity has been more adversely affected in East and South Asia, Latin America and the Caribbean, and Central and Eastern Europe (see figure 1 and table 1 below).[2]

[2] The overall relatively favourable picture of output performance in developing countries, nonetheless, masks the fact that a number of individual countries have recently been exposed to adverse external effects. But these adverse effects have been mainly related to strongly increased food and energy import bills. These features are not directly related to the financial crisis, even though part of the food and energy price increases may have been indirectly affected, namely by the switching of portfolio investors from purely financial to commodity-related assets.

Figure 1. Quarterly GDP growth rates, selected countries, annual % change, 2006–2008



Source: Economist Intelligence Unit and IBGE.

Table 1. GDP growth rates, selected country groups, 2006–2009

	2005	2006	2007	2008
CIS	6.8	7.7	8.6	7.6
Africa	5.7	5.6	5.8	6.0
East Asia	7.5	7.9	8.1	7.2
South Asia	7.7	8.2	8.5	7.0
South-East Asia	5.7	6.0	6.4	5.4
West Asia	6.8	5.7	5.1	5.7
Latin America and the Caribbean	4.9	5.6	5.7	4.6
Developing countries	6.6	7.1	7.3	6.4
Developed countries	2.4	2.8	2.5	1.6

Source: TDR 2008, table 1.1.

The financial contagion to developing countries and emerging markets has been contained mainly to the stock market. Equity markets have plunged across the world, but in most countries this decline basically represents a correction of the very steep increase that had occurred during the first half of 2007. Consequently, the recent decline mostly represents a fallback to the pre-euphoria levels of the third quarter of 2006 (see the Emerging Markets Price Index in figure 2 below).

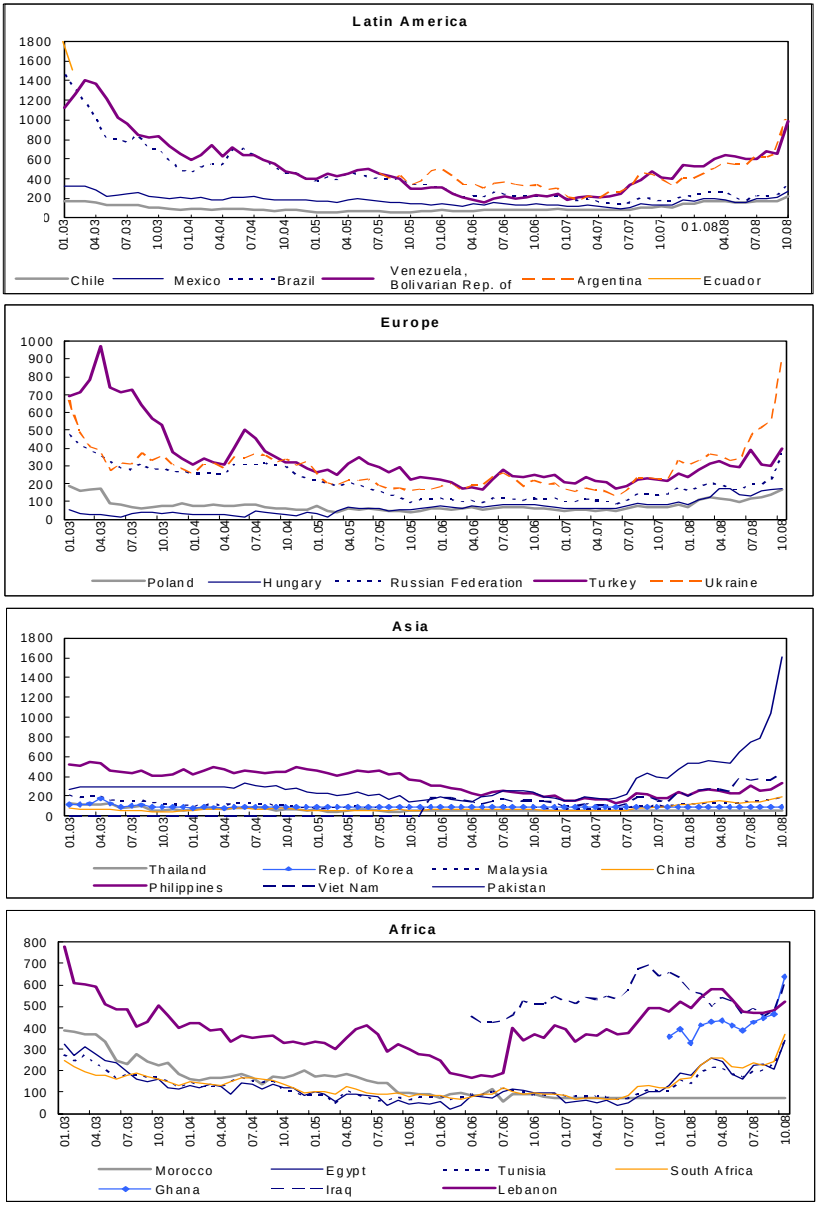
Figure 2. MSCI Emerging Markets Price Index

Figure 3. Emerging Markets Spread

…spreads into the developing world…

External financial conditions for emerging market economies have tightened. The yield spreads between emerging market economy bonds and United States treasury bills climbed to about 689 basis points on 21 October 2008 (see Emerging Markets Spread in figure 3 above). However, October spreads for many developing countries were still lower than during previous financial crises. During the Asian crisis in 1997–1998 and financial turmoil in Argentina and Brazil in 2001–2003, spreads increased by several thousand basis points (see figure 4 below and *Trade and Development Report, 2003*: 27). However, the recent spike in financial market spread could be a sign that investors are changing their risk perception of emerging markets and reduce investment.

Figure 4. Emerging markets quarterly bond spreads, selected regions and countries, January 2003–October 2008, basis points



Source: Thomson Financial, DataStream.

While financial market spreads have remained relatively low on average, which implies a smaller risk of global contagion, the overall low level masks considerable differences across countries (see charts above). Obviously, some of the most recent increases in financial market spreads are related to geopolitical tensions rather than to the current financial crisis (e.g. Pakistan and Ukraine). But there are clearly also differences across emerging markets regarding their exposure to the global financial turmoil. On the other hand, it is difficult to ascertain what effective financial burden an increase in a country's risk rating actually implies, because this burden depends on the extent to which the country really uses international financial markets in the given situation, either to incur new debt or to roll over existing debt that reaches maturity.

… albeit with huge differences…

There are two main reasons for some resilience of developing country activity: (a) domestic demand has assumed a more important role in their growth performance; and (b) the increase in primary commodity prices has strengthened the external account of many developing countries and reduced their dependence on foreign capital.

Domestic consumption and investment have been main driving forces of the recent growth episode in many emerging economies. In Brazil, private consumption and gross fixed investment grew by 6.5 per cent and 13.4 per cent, respectively, in 2007, compared to GDP growth of 5.4 per cent; the respective numbers for China, where net exports also contributed to GDP growth, are 9.6 per cent for consumption, 11.2 per cent for investment and 11.9 per cent for GDP (data from Economist Intelligence Unit). While real income gains and domestic credit

growth have driven domestic consumption in a number of countries, in others, such as the Russian Federation, an expansionary fiscal stance, fuelled by buoyant oil prices, has been a main driver of domestic demand. A closely related reason for the greater resilience is the increased importance of South–South trade. This factor has been of crucial importance for commodity-exporting countries (mainly in Africa, Latin America and West Asia) that experienced a strong improvement in their terms of trade in the wake of strongly rising primary commodity prices. In this environment, variations in developed country business cycles have come to play a less dominant role in driving swings in economic activities in developing countries than hitherto.

The second reason for the greater resilience is the fact that many developing countries have adopted domestic policies that have remarkably reduced their exposure to sudden stops in financial inflows or speculative attacks against their currencies following upheavals in international financial markets. This applies to developing countries with a high share of manufactures in their total trade. These countries improved their external positions in the aftermath of the Asian or Latin American financial crisis and the associated large real exchange-rate depreciations. Governments and central banks subsequently sought to maintain a competitive real exchange rate (the nominal exchange rate adjusted for inflation differentials between countries is the most comprehensive measure of the international competitiveness of economies) through active exchange-rate management. Such exchange-rate management made them less vulnerable to speculative attacks while allowing them to soften any arising adjustment pressure.

Developing countries with a high share of manufactures in their trade play a key role in the transmission of effects from the current financial crisis to the developing world. Their export performance will be affected most by an economic slowdown in developed countries while, in turn, their economic performance has a crucial impact on commodity-exporting countries because their demand affects both the volume of global commodity demand and commodity prices.

The substantial differences across developing countries regarding their exposure to financial market upheaval, international trade linkages and economic structure makes it necessary to distinguish among groups of developing and emerging economies.

Currently, most exposed are **Central and Eastern European countries** that combine high current account deficits with a substantial stock of foreign liabilities by the private sector. An unwinding of "carry trade" (portfolio investors borrowing in low-yielding currencies and buying in high-yielding ones) has led in some of these countries already (e.g. Romania and Hungary) to a sharp depreciation of the real exchange rate. While this implies an improvement of the overall international competitiveness of the respective countries' enterprises, which will eventually benefit their external accounts, it also implies a major adverse balance-sheet effect for households and banks. These countries' exposure to the unwinding of carry trades could eventually lead to severe stress in the domestic banking sector and a decline in household consumption, with strongly adverse consequences for growth.

However, adverse effects from the unwinding of carry trade are not limited to countries with current account deficits. Rather, the ones that are exposed are all those countries that

have adopted relatively high nominal interest rates and whose banks or private households have accumulated massive foreign liabilities. As UNCTAD warned in *Trade and Development Report, 2007* (pp. 17–18), currently most exposed is Iceland, whose currency is suffering record depreciations and which risks suffering a full-blown banking and balance-of-payments crisis. *Trade and Development Report, 2007* also pointed to risks for Brazil, where high nominal interest rates had led to a steady appreciation, and where the unwinding of carry trade position now puts significant strain on the stock market.

The exporters of manufactures in **East and South Asia** are likely to be hardest hit by a slowdown in developed country import demand. It will be important in these countries not to accentuate downward pressures by adopting restrictive monetary and fiscal policies. Some of these countries, particularly in South-East Asia, recently tightened monetary policies in reaction to the sharply increased prices for food and energy products of which they are net importers. However, the balance of risks between inflation and economic slowdown is shifting for these countries towards deflation.

Given that the strong economic performance of China has been a key factor behind the growing importance of developing countries in global economic growth and in global trade flows, the future economic fortune of China is in many respects crucial for how the repercussions of the financial market crisis will affect other developing countries. Although there is a risk that a further sharp correction in equity prices will lead to wealth effects that stifle consumer spending, the slowdown in exports is the bigger threat. Overall, however, domestic demand growth and investment activity are steady and strong.

The impact of the financial crisis on **Africa** and **West Asia** will be determined mostly by the evolution of commodity prices. Continued robust demand for commodity imports by China and India has served as cushions for commodity-exporting countries against an otherwise global economic downturn. But this may not last forever. While commodity prices are expected to remain volatile and above historic levels, a temporary but very sharp decline in commodity prices due to the unravelling of speculative positions cannot be excluded. This would imply a worsening of the terms of trade positions of the net-commodity exporters among these countries, which are nonetheless historically still very favourable. But it would also ease inflationary pressure in net-food and particularly net-oil importing countries with attendant lower exchange-rate and macroeconomic adjustment pressure.

The impact of the financial crisis on **Latin America** will be determined by the interplay of several factors, given these countries' relatively advanced financial integration and the relatively diversified composition of their export baskets. Access to international finance has become more expensive in many of these countries, but remains far cheaper than during the financial turmoil in 2001–2003. The main difference with earlier episodes of financial turmoil, however, is that the region has become much less dependent on foreign financing. But given that much of the improvement in the countries' external position hinges on increased commodity prices, a commodity price plunge could rapidly confront these countries with a less comfortable external position.

If developed country bail-out packages actually lead to a substantial burden in these countries' fiscal budgets, there is a risk that they will reduce ODA, with serious negative effects on

the most aid-dependent economies, the **LDCs**. An assessment of previous financial crises in developed countries shows that, in some countries, financial crisis has led to significantly lower aid disbursements. This, however, was not a uniform reaction across the sample. Many countries have not decreased – and some have even increased – aid in the midst of economic difficulties.

It is important that donors honour their aid pledges, even in the current situation. It would be detrimental for the development of developing countries, and their progression towards internationally agreed development goals, if efforts to stabilize global financial markets were to result in a decrease of development assistance. Developing countries have contributed least to the global financial crisis, and they should not be the first victims of it. In order to effectively reduce poverty and achieve other development objectives, the developing countries, especially the poorest, require considerable investment, not only in the social but also the economic sector.

Like developed economies, developing countries depend on stable and functioning financial markets to finance productive investments. The current crisis should encourage countries to critically examine past financial sector reforms with a view to minimize destabilizing speculation, and create financial markets that are more conducive for the financing of investment

Global coordination is needed more than ever

De-coupling is not automatic. Developing countries should do everything to maintain or encourage, where appropriate, the dynamics of domestic demand in order to compensate, as much as possible, for a shrinking foreign demand. This implies mainly allowing real wages to increase in tandem with productivity growth, while containing nominal

wage growth in line with inflation targets, and avoiding monetary and fiscal tightening.

However, the systemic impact of national policy measures would be greatly enhanced through multilateral coordination. Such coordinated measures would take the form of temporary fiscal support to stimulate economic activity and avoid recession in developed countries, provide sufficient liquidity so that there is no credit crunch, and facilitate an orderly unwinding of global imbalances, combining a rebalancing of domestic demand across countries with supportive movements in real exchange rates.

Coordinated regulatory measures also need to be taken, given that the financial crisis is due not only to financial innovation (securitization and off-balance-sheet financing), but also to loose regulation.

Annex I

Programme

Thursday, 13 November 2008

President: H.E. Ambassador Debapriya Bhattacharya (Bangladesh)

10 a.m. **Plenary meeting** Room XXVI

Opening of the session

Item 1. Adoption of the agenda and organization of work (TD/B/EX(45)/1)

Item 2. Financing for development: Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus (TD/B/EX(45)/2)

- Opening statement by Mr. Supachai Panitchpakdi, Secretary-General of UNCTAD
- Statement by the Honourable Kwaku Agyemang Manu, Deputy-Minister of Trade and Industry, Ghana

Lead speakers

- H.E. Mr. Mothae Anthony Maruping, Ambassador, Permanent Representative of Lesotho
- H.E. Mr. Peter Gooderham, Ambassador, Permanent Representative of the United Kingdom

- H.E. Mr. Vassily Nebenzia, Deputy Permanent Representative, Permanent Mission, Russian Federation

Followed by

- Statements by regional groups and individual member States

3 p.m. **Videoconference link with New York** Room XXVI

- Mr. K. S. Jomo, Assistant Secretary-General, Department of Economic and Social Affairs (DESA)

Followed by

- Mr. Heiner Flassbeck, Director, Division on Globalization and Development Strategies, UNCTAD

Interactive discussion

Item 3. Report of the Board on its forty-fifth executive session

Annex II

List of speakers at the forty-fifth executive session of the Trade and Development Board

Morning session

Opening statements

- Mr. Supachai Panitchpakdi, Secretary-General of UNCTAD
- Honourable Kwaku Agyemang Manu, Deputy-Minister of Trade and Industry, Ghana

Lead speakers

- Mr. Mothae Anthony Maruping, Ambassador, Permanent Representative of Lesotho
- Mr. Peter Gooderham, Ambassador, Permanent Representative of the United Kingdom
- Mr. Vassily Nebenzia, Deputy Permanent Representative, Permanent Mission, Russian Federation

Groups

- G77 and China: Mr. Mothae Anthony Maruping, Ambassador, Permanent Representative of Lesotho
- European Union: Mr. Jean-Batiste Mattéi, Ambassador, Permanent Representative of France
- Asian Group: Mr. I Gusti Agung Wesaka Puja, Ambassador, Chargé d'affaires, Permanent Mission of Indonesia
- GRULAC: Barbados Ms. Corlita Babb-Schaefer, Counsellor, Permanent Mission of Barbados
- African Group: Mr. Bamanga Abbas Malloum, Ambassador, Permanent Representative of Chad

- Group D: Ms. Karabaeva Madina, Attaché, Permanent Mission of Kyrgysztan
- Landlocked developing countries (LLDCs): Mr. Rigoberto Gauto Vielman, Ambassador, Permanent Representative of Paraguay
- Least developed countries (LDCs): Mr. Dinesh Bhattarai, Ambassador, Permanent Representative of Nepal

Individual delegations

- China, Mr. Chen Jianping, Deputy Permanent Representative
- Japan, Mr. Makio Miyagawa, Ambassador, Deputy Permanent Representative
- Azerbaijan, Mr. Elchin Amirbayov, Ambassador, Permanent Representative

Afternoon session

Panellists

- Mr. K. S. Jomo, Assistant Secretary-General, Department of Economic and Social Affairs (by video-conference with New York)
- Mr. Heiner Flassbeck, Director, Division on Globalization and Development Strategies, UNCTAD

Individual delegations

- Pakistan, Ms. Tehmina Janjua, Deputy Permanent Representative
- Venezuela (Bolivarian Rep. of), Mr. German Mundarain Hernandez, Ambassador, Permanent Representative
- Turkey, Mr. Ali Sait Akin, Deputy Permanent Representative
- Iran (Islamic Rep. of), Mr. Alireza Moaiyeri, Ambassador, Permanent Representative

- Thailand, Mr. Vijavat Isarabhadki, Chargé d'Affaires, a.i., Ambassador, Deputy Permanent Representative
- Mexico, Mrs. Mabel Gómez Oliver, Ambassador, Deputy Permanent Representative
- Trinidad and Tobago, Mr Dennis Francis, Ambassador, Permanent Representative
- Norway, Ms. Bente Angeli-Hansen, Ambassador, Permanent Representative
- India, Ms. Nutan Kapoor Mahawar, First Secretary, Permanent Mission
- Yemen, Mr. Ibrahim Al-Adoofi, Ambassador, Permanent Representative
- Morocco, Mr. Anas Alami-Hamedane, First Secretary, Permanent Mission
- Ecuador, Mr. Carlos Santos, Counsellor, Permanent Mission
- Malaysia, Mrs. Anizan Siti Hajar Adnin, Deputy Permanent Representative
- Angola, Mr. Rui Livramento, Economic Advisor, Permanent Mission
- Egypt, Mr. Hisham Badr, Ambassador, Permanent Representative
- El Salvador, Ms. Carmen Elena Castillo-Gallandat, Minister Counsellor
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Civil society organizations

- International Chamber of Commerce, Ms. Jacqueline Côté, Permanent Representative
- Oxfam International, Mr. Ataollah Shafii, Policy Advisor

Annex III

List of countries and territories represented at the executive session

Afghanistan, Albania, Algeria, Angola, Argentina, Australia, Austria, Azerbaijan, Bangladesh, Barbados, Belarus, Belgium, Benin, Bhutan, Brazil, Bulgaria, Cambodia, Cameroon, Canada, Cape Verde, Chad, Chile, China, Colombia, Congo, Costa Rica, Croatia, Cuba, Cyprus, Czech Republic, Djibouti, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Ethiopia, Finland, France, Gabon, Germany, Ghana, Greece, Haiti, Holy See, Honduras, Hungary, India, Indonesia, Iran (Islamic Republic of), Iraq, Israel, Italy, Jamaica, Japan, Kazakhstan, Kuwait, Kyrgyzstan, Lao People's Democratic Republic, Lebanon, Lesotho, Lithuania, Madagascar, Malaysia, Mali, Mauritania, Mauritius, Mexico, Mongolia, Morocco, Mozambique, Nepal, Nicaragua, Niger, Nigeria, Norway, Oman, Pakistan, Palestine, Panama, Paraguay, Peru, Philippines, Portugal, Qatar, Romania, Russian Federation, Rwanda, Serbia, Singapore, Slovakia, South Africa, Swaziland, Sweden, Syrian Arab Republic, Thailand, the former Yugoslav Republic of Macedonia, Trinidad and Tobago, Tunisia, Turkey, Ukraine, United Arab Emirates, United Kingdom of Great Britain and Northern Ireland, Uruguay, Uzbekistan, Venezuela (Bolivarian Republic of), Viet Nam, Yemen, Zambia and Zimbabwe.