UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT, 1981-2011

Three decades of thinking development

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TRADE AND DEVELOPMENT REPORT, 1981–2011:
Three Decades of Thinking Development

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- An UNCTAD in-depth study, which reviews and references the key issues that have been addressed by the TDR since its inception. This study, included in the first part of this publication under the title "*Three Decades of Thinking Development*", was prepared by Detlef Kotte, former Head of the Macroeconomic and Development Policies Branch in the UNCTAD Division on Globalization and Development Strategies. The study also benefited from comments by Yilmaz Akyüz, Andrew Cornford, Heiner Flassbeck and Jörg Mayer.

- A panel discussion "*Thinking Development: Three Decades of the Trade and Development Report*" which took place in Geneva on 20 February 2012 as a pre-Conference event for UNCTAD XIII. An earlier version of the above mentioned study served as background document for this discussion. The contributions of experts participating in this panel, as well as a summary of the discussions, are presented in the second part of this publication. The full webcast of this panel discussion can be viewed at: http://www.unmultimedia.org/tv/webcast/2012/02/am-session-unctad-panel-discussion-on-thinking-development.html.

- The digitization of the whole series of the *Trade and Development Report*, with the support of the Digitization and Microform Unit of the Library of the United Nations Office at Geneva. The complete series of the TDR in electronic version is now available at the UNCTAD website: www.unctad.org.

- The launch of a new UNCTAD blog, *"Thinking Development: commentary on ideas, events and policies in the global economy*", in the context of the UNCTAD Virtual Institute and Global Network of Think Tanks.

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Foreword by the Secretary-General of UNCTAD

UNCTAD was created in 1964 to address imbalances and asymmetries in the global economy – particularly in the trading system – that were constraining the efforts of developing countries to establish strong and balanced growth and development paths. In doing so, we were forced to confront the monopoly of economic thinking that dominated many discussions at the international level and that ignored or marginalized the specific needs and concerns of developing countries.

As a result, rigorous and independent research was at the heart of the UNCTAD work programme from its inception. Without it, our efforts to build a consensus in support of a more balanced global economy and devise complementary technical assistance programmes would have lacked the necessary foundation and direction. Those efforts translated into a series of major initiatives at the international level during the 1960s and 1970s, from the aid target of 0.7 per cent of GDP to the call for debt relief and the establishment of the General System of Trade Preferences (GSTP) among developing countries, to name but three that have continued to this day.

Undertaking independent research became more difficult after the debt crisis that hit many developing countries in the early 1980s. In its aftermath, the diagnosis of what had gone wrong, along with the policy prescriptions to put things right, were increasingly squeezed into a "one-size-fits-all" framework of rolling back the State and unleashing market forces as the only acceptable route to sustained economic growth. In particular, removing restrictions on international capital flows was presented as a "win-win" option for countries at all levels of development.

In resisting this trend, UNCTAD economists continued to highlight the downside risks of an unbalanced international economic environment for development. Indeed they were among the few who warned that a growing role of unregulated private financial flows would more likely than not add to the problems facing policymakers in many developing countries. The *Trade and Development Report* (TDR), launched as the debt crisis was about to break, became UNCTAD's principal vehicle for offering an assessment of the evolving global situation and advancing alternative policy proposals. It is a testament to the quality of the research presented in the *TDR* that practically no other international agency warned countries such as Mexico or Thailand about the potential dangers of rapidly opening up their capital account, the possibility of middle-income countries becoming trapped in the low-value-added stages of international production networks, or the threat to economic and social stability from growing levels of inequality.

As Deputy Prime Minister of Thailand at the time of the crisis that engulfed us in July 1997, I had inside knowledge of my country's policy-making and felt uncomfortable with the explanations by various centres of international policy-making regarding both our region's success and the causes of the crisis. I experienced great difficulty in having to accept the policy conditionalities associated with adjustment loans that eventually turned out to deepen, rather than alleviate, the crisis.

UNCTAD's independent thinking and exploration of ideas for development policy-making, as presented in the *TDR*, was a welcome source of alternative thinking in this context. And, as I found out as Chairman of UNCTAD X held in Bangkok in 2000, appreciation of its work extended well beyond my region. Policymakers

in many developing countries greatly valued the Report's insistence on building development strategies grounded in local realities rather than abstract models.

An abiding theme across 30 years of the *TDR* has been its advocating of the need to strike the appropriate balance between multilateral rules and actions and national policy autonomy for addressing specific local needs and challenges. It has argued that many of the changes to multilateral governance since the collapse of the Bretton Woods systems, in trade as well as finance, have failed to create the right balance. In the run-up to the eleventh UNCTAD conference in Sao Paulo our economists coined the term "policy space" to enliven the discussion on this issue. It was addressed in detail in *TDR 2006*, the year after I became Secretary-General of UNCTAD. I was glad to see that the Report reflected not only lessons confirmed by my own experience as Director General of the World Trade Organization, but also those from my earlier incarnation as a policymaker from a developing country.

Subsequent *TDR*s maintained this perspective when examining the build-up to, and macroeconomic impacts of, the current world economic and financial crisis. They emphasized how weak international monetary and financial governance had turned the turmoil that originated in the United States into a global, systemic crisis. The Reports we have produced since 2009 have argued that the dynamics of the crisis reflect failures in national and international financial regulation, persistent global imbalances, the absence of an international monetary system and deep inconsistencies among global trade, financial and monetary policies.

In my Report to the forthcoming UNCTAD XIII, I have drawn on the *TDR*s prepared during my time as Secretary-General of UNCTAD, as well as on earlier reports, to describe what I call "finance-driven globalization", as the dominant form of international economic relations during the past three decades and to identify a range of imbalances which are in urgent need of correction if sustainable and inclusive outcomes are to become the norm rather than the exception The alternative lies in what I have called "development-led globalization".

In our increasingly interdependent world, it is only through cooperation and a revival of multilateralism that the international community can effectively rebalance the world economy, turn recent growth spurts into sustainable development paths, and ensure that all sections of society, particularly the poorest and most vulnerable, are able to reap the benefits. The United Nations must play a central role in guiding this process. The *TDR*'s focus on strengthening global interdependence whilst maintaining appropriate national policy-making capacity will, I believe, provide critical input into efforts aimed at addressing these challenges.

Supachai Panitchpakdi
Secretary-General of UNCTAD

Part One

TRADE AND DEVELOPMENT REPORT, 1981–2011: THREE DECADES OF THINKING DEVELOPMENT

1. INTRODUCTION

This review traces the key issues relating to the global economy and development strategies that have been addressed in UNCTAD's *Trade and Development Reports (TDRs)* over the past three decades. It also intends to show how ideas, opinions and proposals expressed in the TDR, and the analytical approaches used, differed from those of proponents of "the mainstream" and how they evolved in response to new challenges arising from developments in the world economy.

Over its 48 years of existence, UNCTAD evolved from a negotiating forum (in the first 20 years of its existence) to a "development think tank", and the TDR has been its main outlet. Presenting the results of the Secretariat's policy analysis as mandated by the diverse Conferences, the TDR has served both as a document for debate in intergovernmental bodies, primarily in UNCTAD's Trade and Development Board, and as a publication directed at a much broader audience.

The launch of the TDR series responded to the interest of the Group of 77 in independent research on trade and development issues and in alternative views and policy options to those of the Bretton Woods institutions. Such "independent policy research and analysis" from a development perspective by a United Nations body was considered essential in the absence of an institution at the global level that reflected specific developing-country concerns and it provided intellectual inputs to a multilateral North-South dialogue. The originality of the Report lies in its discussion of national policies and strategies in the context of the performance of the global economy and its institutions, with the aim of providing substance to the notion of a "global partnership for development".

In launching the TDR series in 1981, UNCTAD took a novel approach to the discussion of development challenges and development policies by giving up the dichotomy between short-term economic issues and long-term development issues that had shaped "development economics" during the post-war era. This implied not only linking demand management with policies in support of structural change and gradual integration into the world economy, but also linking success of development efforts at the national level with structural and cyclical developments in the world economy. In particular, the TDR emphasized the importance of the external environment for development in developing countries – thereby, in a way, anticipating the notion of globalization.

A recurrent aspect of the TDR has been its, frequently implicit, discussion of the role of the State in economic activity, in general, and in economic development, in particular. The TDR has distinguished itself from reports of other organizations in taking a prudent attitude towards the merits of the free market. However, it has never served as an agent in favour of an "anti-market" ideology. Rather, it has aimed at promoting well-targeted pragmatism in policy-making. The

concern of the TDR has not been "State vs. market", but effective policy vs. "market fundamentalism". Accordingly, it has tried to help developing countries to create what is sometimes called a "developmental state". In this regard the TDR has remained consistent over the 30 years of its existence.

It has also remained consistent in basing its analysis on the concept of global interdependence – even at times when there was considerable pressure to restrict the policy debate to national issues in developing countries – and on Keynesian macroeconomics, even when such a concept had fallen out of grace. The TDR's approach could be considered "structuralist", because it has always seen many of the economic problems in developing countries as deriving from the way in which they have interacted with developed countries, and because its analysis and policy recommendations have been based on the recognition of factors that limit the capacity and willingness of private enterprises in developing countries to undertake long-term investments and to modernize their productive capacity, which hampers structural transformation.

An excursion into the past 30 issues of the TDR reveals that analyses in the Report frequently anticipated emerging economic problems at an early stage, and that in many instances policies came to be practiced that were in line with the TDR's recommendations made several years earlier. Such analyses and recommendations often received little support from member States at the time they were formulated and little acknowledgment at later stages. The point is not that the TDR "predicted" future events – which it also did in several instances – but that it looked at the functioning of the world economy and the development process from a different angle than other international organizations and a large segment of the economic profession. This different angle often proved to be the more appropriate one.

As the difficulty in concluding the Doha Round of multilateral trade negotiations – the so-called "Development Round" – shows, the promotion of a development-friendly integration of developing countries into the world economy remains a major challenge. The world economy has undergone major changes since the inception of the TDR series in the early 1980s, partly as a result of institutional developments, notably the creation of the World Trade Organization (WTO) and increased membership of developing countries in this organization, and partly as a result of structural changes in many countries. Nonetheless, the raison d'être of the TDR remains valid: it continues to provide critical assessments of current economic developments and policy action, forward-looking analysis and evidence-based policy recommendations.

This review first revisits the concept of interdependence, which has shaped the TDRs' policy analyses and recommendations for three decades.[1] Section 3 then tries to explain the approach of the TDR to macroeconomic and financial policies in both developed and developing countries. Section 4 reviews the TDR's contribution to the debate about the shortcomings and the reforms of global governance in trade, finance and macroeconomics. Section 5 summarizes the TDRs' assessments of the failures and successes of development policy, as well as their recommendations for development strategies, taking into account the lessons from past experiences. The short concluding section discusses briefly some of the issues that remain topical and others that may become relevant for analysis in future TDRs.

2. INTERDEPENDENCE

The present situation appears to require a new development paradigm, and this paradigm will need to take explicit account of the fact that issues concerning the management of the world economy, on the one hand, and long-term development objectives on the other, are intermingled.

Trade and Development Report, 1981: 2.

The distinct perspective of the TDR on development issues has been, from the very outset, that of interdependence in two areas: interdependence of economic conditions and policies among countries, and interdependence among different areas of economic activity and spheres of economic policy. The Report to the First United Nations Conference on Trade and Development in 1964 had already formulated a strategy designed to promote economic development in the poorer countries through strong capital formation and expansion of exports, both traditional and non-traditional. Central to that agenda was the idea that developing countries could base economic development on their own efforts only if they had sufficient scope to accelerate capital formation and diversify their economic structure. This agenda also emphasized the *interdependence between trade and finance, given that, particularly in the early stages of industrialization, imports would almost certainly grow faster than exports, and financing the gap would be key to accelerating growth* (04:VII).

At the time, the World Bank, the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT), in line with their respective mandates, took only partial approaches to international economic cooperation and development. The World Bank dealt with structural and long-term development issues, the IMF focused on monetary, balance-of-payments and short-term stabilization issues, and GATT was exclusively concerned with trade. This pattern was modified over time: through the conditionalities and cross-conditionalities attached to its lending, the IMF also entered the development arena and, together with the World Bank, increasingly shaped the trade policies of its developing-country clients, while the WTO also entered the field of finance through its work on financial services.

These international economic governance arrangements, the subject of profound TDR criticism in recent years, were already considered inappropriate in the early 1980s, since they *separate from one another the ever more closely connected problems of development, employment, debt, trade and payments balances.* The TDR suggested an *alternative approach on the basis of the interdependence of the problems in these fields and of the mutual dependence of employment and development* (84:11). UNCTAD's approach to economic development, and especially that of the TDR – its flagship report – has thus been based on a "holistic" view that addresses explicitly the linkages between these different areas of policy and their interaction in determining development outcomes.

2.1 Defining interdependence

In 1986, the TDR summarized its view of *interdependence of countries and markets,* which would remain largely relevant over the subsequent 25 years, and which shaped both its analyses and policy recommendations, as follows:

> *In most countries, a substantial share of home output is being absorbed by foreign demand, and a substantial share of home demand is being satisfied by imports... Most countries are also more tightly linked through monetary and financial relations. As the main money and capital markets have become more closely integrated, capital has become highly mobile across frontiers and this has made it more difficult for countries with open capital markets to both control their exchange rates and pursue autonomous monetary policies.*
>
> *External indebtedness provides another important form of linkage. For one thing, the debt servicing capacity of developing countries is affected by their exports and imports. For another, those developing countries that have borrowed heavily from capital markets have become directly exposed to swings in world interest rates.*
>
> *Differences in the way prices of different types of internationally traded goods are formed are also important. Since prices of most primary products fluctuate in response to market conditions more widely than those of manufactures, the real incomes of primary producers are particularly vulnerable to changes in the pressure of world demand.*
>
> *In any country, a gap [between the propensity to save and the willingness to invest] must be filled either domestically, via public sector borrowing and spending, or internationally, via external deficits and debt accumulation by other countries... For a large economy, choosing between the trade-surplus and domestic options has major international repercussions* (86: VI, VII).

Global interdependence thus has two aspects. First, it results from the trade and financial relations of countries and the impact of the performance of the developed countries on the potential for growth and development in the developing countries. Second, it results from the impact of macroeconomic, trade and financial policies in the major economies on economic performance and policy requirements in other countries. *Interdependence among countries implies that the economy of each is both sufficiently open for it to come under considerable influence from abroad, and sufficiently large for its own policies to make a significant impact on others* (90:134).

The interdependence of different spheres of economic activity and policy results from the effects of trade flows and trade policies on financial stability and external indebtedness, on the one hand, and on the impacts of the availability of external finance and exchange-rate developments on trade flows, trade policies and the pace and pattern of structural change, on the other. Consequently, the TDR emphasized the crucial importance of the interaction between the economic performance of different countries and regions, which determine the external environment for national development processes. In addition to the behaviour of markets, this external environment is shaped to a large extent by different areas of public policy. The concept of interdependence is therefore closely related to that of coherence between macroeconomic, financial, trade and development policies and related institution building. In this sense, the TDR, by analysing the implications of economic performance and policy decisions in the major developed countries for the economically much weaker developing countries – and later also the transition economies – to some extent anticipated later policy debates in the context of "globalization", a term that became popular in the 1990s.

> *An appropriate management of interdependence implies that no country with a sufficiently open economy (even if it is too small to have*

> *itself an impact on others) should be expected to be able to put its house in order regardless of what other countries are doing. ... Nor should any country set its policies without paying attention to their possible international consequences. A considerable amount of flexibility and discretion may be introduced, based on extensive consultations among the parties concerned. However, it should also be recognized that it necessarily implies a certain degree of constraint on national policy making* (90: 134, 135).

2.2 Applying the concept of interdependence

In the early years of the TDR, the main issue with regard to interdependence was the unfavourable external environment for development, which saw a continuing deterioration in the terms of trade and a major recession in the industrialized countries. The interdependence between developing-country export earnings, which should become more complex after a majority of developing countries shift to outward-oriented development strategies, and macroeconomic developments in the developed world was emphasized in the first issue of the Report: *The level of economic activity in the developed market-economy countries remains the single most important factor in determining the export earnings of developing countries* (81: 3).

The entire first decade of the TDR series was marked by the sovereign debt crisis that affected many developing countries, and frustrations relating to their adjustment efforts. In 1981 the TDR observed: *There exists a paradoxical asymmetry in international relations which, on the one hand, requires countries to honour their debt obligations and, on the other, permits creditor nations to hinder their doing so by restricting imports* (81: 3). The result was *a process that enforces the containment of external imbalances through sharply reduced economic growth* (82:1).

These unfavourable developments were seen as being not only due to the national policies of the developed economies, but also to the institutional framework and practical operations of the international trade and payments systems which govern the interactions among countries. In 1984, the TDR thus concluded: *The debt question can only be satisfactorily resolved in the context of reform of the system of trade and payments* (84: 12).

But the perspective of interdependence also led the TDR to caution about possible repercussions of the deflationary adjustment in debtor countries for the creditor countries and the world economy as a whole. It suggested that helping debtor countries to restore growth and imports would make a large contribution to correcting imbalances. A reduction of commercial bank debt, combined with official debt relief and new financial flows, would result in substantial annual increases in net import demand from debtor countries (88: ch. IV).

The same spirit has been behind the TDRs' policy recommendations for a greater role for official financing when payments difficulties arise (e.g. 94:170; 95: ch. II; 98: ch. IV), for orderly debt workout mechanisms that ensure burden-sharing between debtors and creditors (e.g. 86: ch. VI; 98: 71; 01: ch. III), and for official debt relief for the poorest countries (e.g. 88: ch.IV; 93: Part III). These recommendations are grounded in an application of the concept of interdependence that is consistent with an emphasis on the role of aggregate demand for growth and macroeconomic stability in the Keynesian tradition. An easing of the debt burden and the provision of adequate external support from official sources to economies in financial difficulties were seen not only as prerequisites for crisis solution in the interests of both debtors and creditors, but, more generally, as important elements of countercyclical policies at the global level.

For example, when the TDR 2003 identified *a widening deflationary gap created by deficient global demand*, it recommended the adoption of *Keynesian policies to expand liquidity and effective demand,*

both at the national and global level, including policies to address the liquidity needs and the debt burden of developing countries facing stringent external financial conditions. For all countries, the prospects for prosperity hinge on international cooperation as well as on the intensity of their own efforts (03: IV). And when the TDR discussed the global policy response to the financial crisis that started in 2008, it suggested including in the fiscal stimulus programmes of the more advanced economies a concerted increase in bilateral aid flows to low-income countries with balance-of-payments problems and limited fiscal space: *In addition, a temporary moratorium on official debt repayments would allow low-income countries to counter, to some extent, the impact of lower export earnings on their import capacity and government budgets*. Such measures, the Report underlined, *would not only constitute an important element in efforts to attenuate the impact of the global crisis on growth, poverty alleviation and investment in the debtor countries, but it would also contribute to stabilizing global demand* (09: VII).

The debt and development crisis of the early 1980s clearly revealed the extent of global interdependence. The perspective of the TDR was therefore very much focused on macroeconomic, financial and trade policies in the developed countries, which shaped the external conditions for growth and development in developing countries. By contrast, the design of national development strategies initially received less attention. Although the TDR recognized that in some countries that were experiencing crises *the initial conditions making for vulnerability were the product of policy errors,* it also understood that the structural features of developing countries were such that external shocks *may interact with the initial conditions in such a way as to unleash explosive forces* (89: V).

Another important aspect of interdependence repeatedly mentioned in the TDR has been that stable growth of global demand is essential for stemming protectionism (87: II; 96: 92; 02: 137; 09: 36), and that distribution of global demand also matters in this regard, as evidenced by the growing imbalances in the world economy since the beginning of the new millennium (00: 27; 04: ch. I). This raises the important issue of coherence between the design of the international trading system and governance of the international monetary and financial system (see section 4.5 below).

2.3 Evolution of issues related to interdependence

Over time, certain facets of interdependence became increasingly important and others changed. When export-oriented development strategies and trade liberalization had become the credo of the international financial organizations, the WTO and most developing-country governments in the 1980s and 1990s, interdependence between economic development in the South and macroeconomic and trade policies in the North assumed ever greater importance, as expressed in TDR 1999: *Liberalization as a successful growth strategy in an interdependent global economy relies crucially on exports, which in turn are highly dependent on growth in industrial countries and greater access of developing countries to their markets* (99: IX).

In 2002, the TDR found that greater competition among developing countries in world markets for labour-intensive products implied a fallacy of composition, similar to that observed in primary commodity markets. This was evidenced by a tendency for the prices of manufactured exports from developing countries to fall vis-à-vis those of the industrialized countries since the late 1990s (02: ch. IV). Similarly, increased competition among developing countries to attract foreign direct investment in the labour-intensive segments of international production networks led them to offer ever greater fiscal incentives and other concessions to transnational corporations (TNCs) (05: IX; 02: ch. IV). As a result, interdependence between countries is no longer just

a North-South matter. It has become increasingly relevant also for South-South economic relations.

TDR 2005 examined the implications of the new economic dynamism of a number of emerging market economies, especially China, for other developing countries (05: chs. II-IV). It found that the growth dynamics in China had positive effects on many developed and developing countries that benefit from rising exports to China and other emerging-market economies. However, these developments did not fundamentally change the interdependence of markets and policies. First, much of the South-South trade involving China was linked closely to China's exports to developed countries (05: VI). Second, variations in the growth performance of fast-growing, large developing countries were seen to have a strong influence on the volume and terms of trade of other developing countries. Third, China's increasing participation in international trade posed new challenges for many countries, since it could contribute to a fall in the export prices of the types of manufactures that it produced and exported along with other developing countries (05: ch. II). Fourth, even if continuing growth in China and other large emerging market economies was likely to sustain the demand for primary commodities, the basic problem of instability in those prices remained unresolved (05: IX).

Regarding the interdependence of markets, an important new feature is the substantially closer interaction between the markets for different commodities, particularly energy commodities (08: ch. II), as well as between financial markets and the markets for primary commodities, which has been studied in great detail in the most recent issues of the TDR, especially in 2011. The increasing influence of financial market actors has accentuated the fluctuations in commodity prices and the level of uncertainty for both producers and consumers, besides adding to the balance-of-payments and fiscal problems of several poor developing countries (11: ch. V; also 09: ch. II). However, another aspect of interdependence related to commodity prices has remained as relevant today, as it was when observed in TDR 1990, namely that *any tendency for commodity prices to rise would be read in industrial countries as a resurgence of inflation and would trigger a response by the monetary authorities (even in circumstances in which interest rates were already high)* (90: IV; also 08: 38; 10: 21; 11: IV). With the rapidly rising consumption of certain primary commodities, this aspect of interdependence has also become an important issue in fast-growing emerging economies.

Clearly, the interdependence between the functioning of financial markets, on the one hand, and macroeconomic developments and the performance of goods markets, on the other, has also become more complex since the time the first TDRs were launched. A particular concern of the TDR has therefore been the instability and unpredictability of private capital flows to developing countries (88: ch. II; 90: Part Two, ch. I; 98: ch. III; 99: ch. III; 03: ch. II). Recurrent financial crises have often been triggered by events outside the countries affected by such crises. This led the TDR 1999 to warn against an international system in which developing countries become overly dependent on capital inflows: *The international community must face up to the need for exports rather than unstable capital flows to underpin a return to rapid and sustained growth in the third world* (99: IX).

It is also widely accepted that imbalances between the major economies in the world contributed to the eruption of the financial and economic crisis of 2008–2009 – an issue repeatedly raised in every issue of the TDR since 2000. Looking back in history, TDR 2000 said in this regard: *The experience of the 1960s and 1980s shows that large imbalances in external payments and capital flows between the United States and other major industrial countries can pose serious threats to global growth and stability, since the willingness of investors in surplus countries to hold dollar-denominated assets can come to an abrupt end* (00: IV).

As early as 1982, the TDR pointed to a problem for developing countries that would take on increasing importance in the subsequent decades: the loss of policy space. It interpreted the development crisis of the 1980s not simply as *a set of poor growth figures for one or two years,* but as the result of the *progressive alteration of the international environment in ways that narrow the range of feasible policies open to developing countries to promote their own development, and that reduce the effectiveness of those that are available* (82: 5; also 90: XII). But with the increasing degree of integration into global production and financial markets, external influences over national policy targets became even stronger and policy autonomy was further reduced – an issue that was discussed in depth in TDR 2006 (06: chs. II, IV, V; see also section 5.3.3 below).

3. MACROECONOMICS AND FINANCE

This section explains the TDRs' specific views on macroeconomics, and examines how these have evolved over 30 years. It starts with a discussion of some theoretical aspects of the macroeconomic analyses and policy recommendations (section 3.1). Section 3.2 then reviews the TDR's critique of the reorientation of macroeconomic policies, from demand management, with a focus on growth and employment creation, to a neoliberal and monetarist orientation, with the main focus on inflation control. This is followed by a summary of the TDR's analyses, comments and recommendations in the areas of monetary, financial and fiscal policies, with emphasis on those in developed countries (sections 3.3 to 3.5), but also with regard to their implications for developing countries (section 3.6). Section 3.7 then reviews the analyses and reflections presented in the TDRs on topics related to the conduct of macroeconomic policies, namely imbalances and macroeconomic policy coordination, competitiveness and employment creation.

3.1 Theoretical underpinnings

The policy analysis and recommendations of the TDRs have been shaped by theoretical propositions in the tradition of Keynes, Kalecki/Kaldor and Schumpeter. The underlying theories of saving, investment and the rate of interest, as well as the theories of inflation and employment have distinguished UNCTAD's policy analyses from those of other institutions – and from the majority of economists.

3.1.1 The savings-investment relationship

The TDR's view on the macroeconomic savings-investment identity determined, to very large extent, its analyses and policy recommendation. As discussed in 2008, the neoclassical growth model is *based on the assumption that investment is financed from a savings pool created mainly by household savings. Accordingly, entrepreneurial investment will be maximized by policies aimed at increasing household savings rates* (08: VII). The TDR has questioned this model, positing that the resumption of growth is a necessary condition for increasing domestic savings, rather than its effect, and that an increase in real investment is possible without a prior cut in consumption, *since the investment itself will create the required savings by generating additional income*. Thus it is not savings, but financing of investment that is needed to raise output and incomes and to accelerate structural change. This leads to the conclusion that *it is more pertinent to focus on the factors constraining investment and pushing up interest rates, in particular the organization of the*

financial system and its impact on the cost and supply of finance (91: V).

Addressing this question in connection with the adjustment efforts of developing countries that were hit by the debt crisis in the 1980s, TDR 1986 stated: *It is unrealistic to suppose that it would be possible to push up savings and thereby increase significantly output, investment and exports. Rather, one must look to an improvement in the external environment to trigger a rise in output, investment, income – and hence savings* (86: XII; also 99: 75–76).

In the TDR's view, the financing of investment depends primarily on savings from corporate profits – i.e. the establishment of what the TDR has called since 1997 "*profit-investment nexus"* (97: VII and ch. VI; also 94: 72; 96: ch. I and II; 08: ch. IV) – and on the ability of the banking system to create credit. In the real world, distinct from the assumption of the standard growth model, *profit expectations (rather than the level of savings) determine the level of investment in real productive capital. For example, a fall in the savings ratio does not lead to a fall in investment; on the contrary, since it implies an increase in consumer demand, it will increase profits and stimulate investment* (08: VII).

Strong enterprise profits simultaneously increase the incentive for firms to invest and their capacity to finance new investments from retained earnings (08: VII), and to *the extent that investment can be financed by the banking system, which has the power to create credit depending on the amount of liquidity provided by the central bank, the prior existence of savings balances in the financial system is not a prerequisite for investment* (08: VIII). It follows from this that the level of interest rates is not determined by the scarcity of savings. Rather, it is determined by the central bank through its "policy rate" (i.e. the rate it charges for the provision of liquidity to the banking system) and its supply of such liquidity, as well as competition among banks.

The same applies at the international level, where the standard growth model assumes that in poorer countries insufficient domestic savings have to be complemented by "foreign savings" (i.e. capital imports) to enable an increase in investment (the "savings gap theory"). However, the causality works in the opposite direction: changes in the current account lead to changes in the level of investment and savings (08: VII). Several issues of the TDR pointed to empirical evidence refuting the predictions based on the savings gap model, such as episodes when developing countries, especially in Latin America, had attracted waves of capital inflows in the 1990s but failed to achieve growth in productive investment (08: VII). Similarly, after 2000, an increasing number of developing countries had become net exporters of capital, but at the same time tended to grow faster and to have a higher investment ratio than countries that were net capital importers (08: ch. III). For many observers this was a "puzzle", but in the same vein as in 1991 (91: V) the TDR countered that *net capital exports from fast growing developing countries are no longer puzzling if one recognizes the limitations of the underlying theories: the savings gap model and the neoclassical growth model* (08:VII).

The upshot of these considerations is that attracting capital inflows to replace domestic savings is often unnecessary from a macroeconomic perspective, while the negative side effects of such policies can even harm domestic investment in productive capacity (see section 5 below). Of course, this does not make external financing obsolete; indeed, it is essential for the short-term financing of merchandise trade transactions and for the long-term financing of foreign exchange expenditures on imported capital goods in cases where current export earnings are insufficient to cover these. It is in the latter context (i.e. the foreign-exchange gap faced by most developing countries) that the TDR often called for higher capital flows to developing countries, for two reasons: first, to avoid the need for cutting down on imports during periods of slow export growth or in response to negative external shocks, and, second, to enable higher imports of capital and intermediate goods by the poorest and structurally weak economies.

3.1.2 Wages, employment and inflation

High rates of unemployment are often attributed to labour market rigidities that prevent wages from falling to an equilibrium level at which all excess labour would be absorbed. TDR 1995 pointed out that this is essentially a microeconomic rationale. While an individual enterprise may respond to falling wages by expanding its workforce and output to capture a larger share of the market for its products, boosting employment in the economy as a whole will require

an increase in the level of aggregate demand. But the latter cannot be expected to materialize from labour market deregulation or from wage reduction, which is more likely to reduce demand (95: Part 3, ch. I).

Chapter III of TDR 2010 again discussed this issue at considerable length, rejecting the idea that labour and capital are substituted at a given level of output according to their relative prices. It stressed that at the macroeconomic level, the dual character of labour compensation matters. Since it accounts for the largest proportion of production costs, any changes to it relative to productivity are therefore one of the key determinants of inflation. But labour compensation determines, to a very large extent, the level of demand of private households, which is the main component of aggregate demand.

The TDR therefore underlined the need to analyse employment in connection with output growth and the macroeconomic conditions that influence investment in fixed capital: *Once it is recognized that it is not primarily the relative cost of labour but the pace of output growth that is the key determinant of the level of employment, it follows that investment in real productive capacity and demand expansion that motivates such investment are the main drivers of both income growth and employment creation* (10: 83–84).

Regarding the theoretical basis for monetary policy, especially with regard to its main objective of ensuring price stability, the TDR was frequently – at times strongly – critical of the monetarist approach, which suggests that "too much money chasing too few goods" inevitably creates inflation. It considered this theory – based on a mere identity rather than on a proven functional relationship – as too simplistic a basis for policy decisions. First, even within the framework of that theory, if money supply rises faster than money demand, the velocity of money can adjust. Second, as expressed in TDR 2009: "*too much money" needs a channel through which to inject the virus of inflation into an economy. There are only two channels for this to happen: if demand growth exceeds potential supply growth ('demand-pull inflation'), or if increases in the costs of production, particularly labour costs, exceed productivity growth (domestic 'cost-push' or 'wage-push' inflation)* (09: VII, VIII; also 95: Part III, ch. IV; 00: 1).

Moreover, the response must differ depending on whether the cause of inflation is excessively rising costs or excess demand. In particular, upward pressure on costs and prices resulting from higher import prices needs to be looked at in a different way than price increases caused by domestic factors, because domestic macroeconomic policy can do little, if anything, to treat the source of the problem.

3.1.3 Implications for policy recommendations

In the neoclassical framework, which has governed economic thinking over the past few decades, there is little room for a proactive economic policy, and where it offers economic policy options, they often point in the opposite direction to those suggested by the Keynes-Schumpeter model. This also explains the critical stance the TDR took from the outset on the economic policies that were promoted under structural adjustment programmes, IMF conditionality and the so-called Washington Consensus. But it also led to alternative assessments of the policy orientation of the developed countries, in particular with regard to their monetary and fiscal policies, and the organization of the financial sector.

Based on its theoretical foundation, the TDR has been insisting:

- On an understanding of economic development as a process of structural change driven primarily by fixed capital formation, the pace of which is strongly influenced by monetary, fiscal and financial policies that encourage private investment (and reinvestment of increasing profits);
- On proactive management of the financial sector aimed at ensuring that it serves enterprise in the real sector rather than serving itself;
- That adjustment through deflationary policies is mostly counterproductive; and
- That employment creation results from investment in productive capacity and not from low wages.

3.2 Macroeconomic paradigm shift in the late 1970s and early 1980s

The TDR series was initiated at a time of economic upheaval. In the late 1970s and early 1980s the shift in the macroeconomic policy orientation of the major industrialized countries had led to a sharp rise in international interest rates. At the same time, slow growth in most of these countries had caused trade volumes and primary commodity prices to fall. This shift would mark the course of the world economy and the context for development over the next three decades. Inflation had reached intolerable levels in many countries in the second half of the 1970s, and coincided with slow growth in the early 1980s. In this environment, the TDR expressed concern that the pressure on governments of the major industrialized countries to pursue full employment objectives had drastically weakened (84: 8). The key problem of the new policy orientation was not that macroeconomic policy was giving emphasis to containing inflation, but that this was to the virtual exclusion of other policy objectives, a policy stance that would continue over the subsequent decades.

In addition, *shifts in economic policy since the late 1960s, such as the floating of exchange rates and the adoption of variants of monetarism, combined with progressive financial deregulation and certain other aspects of reliance on free markets, had increased the potential for instability and crisis in the world economy and the vulnerability of employment, trade and development* (84: 8; 88: XII). The new macroeconomic orientation, supported by a majority of economists and international organizations, was thus part of a much more general redefinition of the role of the State in the economy, which favoured significantly reducing the extent of State intervention and public sector involvement in the economy (86: IV).

While agreeing on the need to lower inflation, the TDR became an increasingly lonely voice in the 1980s and 1990s in warning of the risks this shift in the policy regime entailed for the world economy, and especially for developing countries and employment. The TDR maintained its policy recommendations to focus on managing aggregate demand as the main determinant of macroeconomic outcomes. Thus, it rejected the idea that had gained considerable support at the time (and with some variations has remained popular even today), that the slowdown in growth in the developed countries had been caused by a decline in labour productivity as a result of *changing attitudes to work, the proliferation of government regulations, existing tax structures, accelerated inflation, shifts in relative prices, changes in the quality of the labour force, lack of adequate innovation and inadequate research and development* (82: 2). The reorientation of policy was accompanied by a shift in the economic paradigm: from support for capital accumulation as the engine of growth, the emphasis was now on the efficiency of factor allocation. This was reflected, *inter alia,* in the preference for liberalized – as opposed to regulated – markets, for laissez-faire over interventionism, and in a shift from demand management to “supply-side policies”.

3.3 Monetary policy

The shift in the orientation towards finding a balance between containing inflation and promoting growth as the main objective of monetary policy was neither temporary nor limited to the industrialized countries. It soon came to be reflected also in the policy orientation of the international financial institutions, and spread, largely as a result of propagation by the latter, to a majority of developing countries.

While the new policy orientation was successful in bringing down inflation in the industrialized countries, it was accompanied by the steepest and longest recession in the post-war period until then, and a jump in unemployment in OECD countries (86: V). The adverse impact on growth, investment and employment was because the monetary policy implied the use of demand contraction to deal with cost-push inflation, as the TDR had pointed out in 1982 (82: 3). A major problem was that inflation was perceived as a problem of monetary policy rather than one of wage determination and unit labour costs and a resulting wage-price spiral, which could have been better tackled by other means, such as an incomes policy (see also section 3.8).

When inflation had been considerably reduced and recovery set in during the 1980s, the TDR frequently criticized central banks for not bringing down interest rates to the ranges of the 1960s and 1970s (90: IV; 92: IV; 94: IV, 95: VII). The average long-term rate of interest was found to have remained *5-6 times higher than in the previous two cyclical expansions* (90: IV).

In 1996, the TDR pointed out, as it would repeatedly do in later issues, that the rate of unemployment compatible with price stability may be much lower than was generally assumed by monetary authorities, as evidenced by the experience of the United States in the mid-1990s (96: III). The argument then advanced by the TDR was the same as in recent years: inflation can be contained without an excessively restrictive monetary policy stance, and at much lower costs in terms of foregone output, when unit labour costs are kept under control (95: VII; 96: IV; 05: 24; 10: ch. V).

By the mid-1990s the TDR deplored what would remain a central macroeconomic issue until today, namely that

> *The generally restrictive monetary policies implemented in the last two decades have shunted economies into low-growth paths in which low demand growth and low potential output have fed back into one another (95: VII; also 94: V). Upturns have tended to be quickly smothered whereas downturns have been left to work themselves out; the real economy has been disturbed by waves of private debt and credit creation and contraction, in the course of which speculation has naturally thrived; and there have been large imbalances in current account positions and consequent strains in foreign exchange markets and the trading system. These phenomena have been responsible for mounting unemployment and trade imbalances* (94: V).

As the same thinking governed monetary policy in most industrialized countries, the TDR warned of the detrimental effects on the world economy as a whole: *global demand deficiency is a recipe for waste, unemployment, depressed commodity prices, and conflicts among nations* (94: VI).

Since the mid-1990s, the TDR has emphasized the risk of deflation when monetary policy continues to focus on combating inflation, even in situations where inflationary pressures have dissipated and unemployment is rising, and, in particular, when parallel attempts are made to improve fiscal balances (96: IV; 03: IV). It has consistently urged governments to embark on macroeconomic policies designed for *raising the tempo of investment and growth*, the prime need being to *provide business with lower capital costs, on the one hand, and improved prospects for sales, on the other* (95: VIII).

Using the same line of reasoning, the TDRs since 2009 have responded to widespread concerns that the large injections of central bank money in many countries will sooner or later lead to inflation if governments and central banks do not react early to contain that risk: *In the present situation, with capacity utilization at historic lows and unemployment rising at a dramatic rate, economies will take years to restore a level of capacity utilization where supply cannot keep up with demand, or a level of employment that could trigger demand for higher wages. This will allow central banks to gradually withdraw excess liquidity by selling revalued assets and absorbing excess money supply* (09: VII, VIII).

3.4 Financial policy

The TDR recognized that relatively high interest rates and slower growth over three decades were not only due to the generally more restrictive monetary policy stance; another factor was financial deregulation, which also made both interest rates and exchange rates more unstable, causing *greater reluctance among producers to make long-term commitments, and thus to slow the pace of investment in equipment and structures* (88: XII).

Part Two of TDR 1990 entitled, The Internationalization of Finance, was probably a landmark in determining UNCTAD's view of financial liberalization and its implications for trade, investment and growth. The Report denounced *the ascendancy of finance over industry* as the main source *of instability and unpredictability in the world economy* (90: I). This was at a time when policymakers, a large body of public opinion and most of academia subscribed to the merits of financial deregulation and liberalization and the dismantling of government intervention in the allocation of finance and the functioning of financial markets ("financial repression").

It took the global financial crisis of 2008–2009 for a larger number of observers and policymakers to realize that financial policies in the industrialized countries had been misguided for many years. As expressed in TDR 2009, the crisis is a reflection of the predominance that purely financial activities have gained over real productive activities: *Large parts of the financial markets have come to be entirely detached from real sector activities.* In the view of the TDR, this is the outcome of *blind faith in the "efficiency" of deregulated financial markets*, which *led authorities to allow the emergence of a shadow financial system and several global "casinos" with little or no supervision and inadequate capital requirements* (09: III, IX).

From the perspective of the TDR, the current crisis has shown, once again, the *lack of economic logic* of the financial markets:

> *As participants in financial markets often seek speculative gains by moving before others do, these markets are always "ready for take-off", and eventually interpret any "news" from this perspective. Indeed, they often tend to misread a situation as being driven by economic fundamentals when these are just mirages, such as perceived signs of economic recovery in certain economies or fears of forthcoming inflation. As long as prices are strongly influenced by speculative flows – with correlated positions [in different markets] moving in and out of risk – markets cannot function efficiently* (09: III, IV).

This was not the first time that UNCTAD, through the TDR, raised its voice louder than other institutions on the problems resulting from deregulated financial markets. Earlier issues had already emphasized that the recurring financial and currency crises since the end of the Bretton Woods system were a reflection of fundamental flaws in the system itself, rather than occasional accidents in a system that, in principle, functioned well. The judgement of the TDR on the functioning of financial markets and their management became increasingly harsh over the years, not only because each crisis saw a repeat of the same patterns, but also because the strength of speculative influences and the impacts of the crises on the real sector continued to grow each time, while policymakers failed to draw lessons from the previous experiences.

In 1990, already, the TDR stated: *Financial markets have for some time had an independent capacity to destabilize developing countries: there are now increasing indications of the vulnerability of* <u>*all*</u> *countries to financial crisis* (90: I). *Financial markets need to be managed if they are to serve the needs of enterprise* (90: XII).

It is notable, that this was written 18 years before financial instability culminated dramatically in the crisis that erupted in 2008. Repeated warnings would follow against the risks emanating from an insufficiently regulated financial industry for the real economy. Even prior to this crisis, a number of TDRs had called for stronger prudential regulation and a strengthened framework for governance of international banking[2] (91: V; 92: V; 95: IV; 01: I). These were based on the insight that *modern financial markets are organized less to create wealth and employment than to extract rent by buying and selling second-hand assets, and the 'discipline' these markets exert on policymakers reinforces the advantages of existing wealth holders* (98: II).

The issue of systemic risk and derivatives, which has become so prominent in the context of the 2008–2009 financial crisis, was addressed in the TDR as early as 1995, following large trading losses and bankruptcies of several banks (95: Part 2, ch. III). The chapter pointed to the potential of the growing use of derivatives *for causing a crisis that would lead to breakdown in the financial system and its three key functions of credit allocation, payments and the pricing of financial assets*. It concluded that a lesson to be learned from various instances of collapse or extreme strain in derivatives markets was the need for strong legal and institutional frameworks. But even with improved prudential standards, the Report maintained, systemic risk *will continue to be present during periods when high volatility in asset markets endangers participants or is accompanied by major insolvencies* (95: IV).

In 2000, the TDR highlighted the unhealthy macroeconomic and financial developments that had caused the dotcom bubble, and which would later prove to be a major cause of the financial and economic crisis in 2008–2009 namely the build-up of financial bubbles, where *self-fulfilling expectations rather than solid earnings prospects are moving the market.* The TDR then commented: *The mania for cross-border mergers and acquisitions has contributed to a large worldwide financial bubble in technology stocks, whose prices have been rising much faster than productivity… A combination of dwindling private savings, rising private debt, mounting current-account deficits and the bubble in technology stocks, has been sustained by the continuing attractiveness of dollar-denominated assets to non-residents. But this situation cannot continue indefinitely* (00: I, III).

After the experience with recurrent financial and currency crises, culminating in the 2008–2009 crisis and the huge bailouts that became necessary, the TDR noted that it would not be sufficient to tighten prudential regulation over financial institutions and to weed out financial instruments with no social returns: *In the interests of greater stability and reliability of the financial system, the balance between private activity and State involvement in the financial sector may need to be revised fundamentally*. *The heavy involvement of governments and central banks justifies a redefinition of the role of central banks and public financial institutions in supporting real economic activity* (09: VIII).

A continuing problem, which was also cited in much earlier TDRs, is the surrender of governments and central banks to the growing power of financial markets, and the *"confidence game"* the former were playing by taking macroeconomic policy measures *"that may not make sense in and of themselves but that policymakers believe will appeal to the prejudices of investors"* (06: 138, quoting Krugman, 1998). Already in 1988 the TDR had hinted at the problem that macroeconomic policy decisions were often taken with a view to how financial markets would react rather than what the authorities believed to be appropriate (88: IV). After the financial crises in some Latin American countries in the first half of the 1990s, the TDR stated: *The right remedies are unlikely to be found by orienting policy towards regaining the confidence of portfolio managers; their mood swings are, in any case, extremely difficult to keep pace with. A further round of rethinking economic policies may be required* (95: III, IV). This contention is equally valid today, particularly in the current phase of macroeconomic disorientation in many OECD countries.

3.5 Fiscal policy

Apart from taking a critical position with regard to the shift in orientation of monetary policy and the laissez-faire attitude of governments to financial markets, the TDR also frequently criticized the increasing focus on balancing the budget as an objective in itself (85: 52; 88: IV; 95: ch. IV; 96: ch. I; 97: 10; 06: ch. IV; 10: VII). Such a focus implied that fiscal policy ceased to be a tool of demand management, whereas the TDR advocated that a proactive fiscal policy would respond to the needs of the macroeconomic situation. It emphasized that when there was a risk of deflation, the effectiveness of monetary policy would be severely constrained so that fiscal expansion – or at least avoiding fiscal retrenchment – would be particularly important. In 1992, the TDR made it very clear that in some situations *the private sector is unable to take the lead in reigniting growth. This is precisely the context in which it is most apt to adopt Keynesian policies of raising government spending.* (92: IV; also 03: IV; 09: VIII: 35). But mostly, as the TDR observed a year later, *the leading industrialized countries are seeking solutions in the motto of that decade: "Leave it to the markets!"* (93: III).

The TDR's support of a proactive fiscal policy, was vindicated in 2004, when it was able to point to *the processes that have led to the recovery of the world economy and the regional growth patterns in the developing world: The economies that provided growth stimuli to the rest of the world were those where monetary and fiscal policy supported domestic demand growth. This is true for both developed and developing countries* (04: V; also 09: II).

During the 2008 and 2009 financial and economic crisis the TDR's approach to macroeconomic management all of a sudden appeared to become "mainstream", as all major economies implemented strong monetary and fiscal measures in response to the crisis. To some extent, the IMF supported this reorientation also for developing countries, at least at the level of rhetoric. It is important to emphasize that the TDR recommended using monetary and fiscal policy for demand management, and not to bail out financial markets and institutions. With regard to the former, the reorientation of macroeconomic policies turned out to be no more than what the Report later called *a short "Keynesian moment"* (11: V).

In 2010, the TDR again cautioned against an error in fiscal management, as fiscal consolidation was being sought by means of a shift towards fiscal retrenchment. This, it believed, could not only *compromise further recovery since, in most developed countries, especially in Western Europe, private demand, so far, has only partially recovered from its trough* (10: II); but fiscal austerity was also likely to fail to achieve its objective of reducing the budget deficit (11: ch. III). In the same sense as in 1992, when it stated that *by promoting growth, higher expenditures would probably reduce rather than increase deficits* (92: IV), TDR 2011 pointed out that in periods when the private sector lacks dynamism, fiscal retrenchment will lead to lower fiscal revenues and therefore fail to reduce the fiscal deficit and lower the debt (11: VII). Moreover, TDR 2009 refuted the idea that growing budget deficits as a consequence of fiscal stimulus packages require a rise in tax rates as soon as the crisis is over, because *in a growing economy government revenue will normally rise sufficiently at constant tax rates to reduce the deficit* (09: VII). On the other hand, the TDR has always expressed serious doubts about the ability of tax cuts to trigger a revival of investment activity, as much in its first issue as in its most recent one (81: 3 and 4; 11: ch. III).

In this context, TDR 2011, ch. III also elaborated on an often neglected aspect which has a bearing on both the effectiveness of fiscal policy in stimulating aggregate demand and its repercussions on the budget balance: the way in which the public sector spends and taxes is not neutral; changes in different types of revenue or expenditure generate different macroeconomic outcomes (11: VII).

However, the importance accorded by the TDR to proactive fiscal policy as a key tool of demand management does not imply that it has ignored the fundamental need for fiscal discipline: *The size of the domestic public debt does matter, since it may compromise budget flexibility in the future. This is why, in order to be truly countercyclical, an expansionary fiscal policy in a recession needs to be combined with fiscal consolidation when recovery sets in and output growth accelerates* (09: VII).

3.6 Effects of macroeconomic policies in the North on the South

The TDR saw the shift in the macroeconomic policy orientation in the major industrialized countries in the early 1980s as a cause of the depth and length of the crises in developing countries in the 1980s. It led to an abrupt rise in interest rates on the outstanding external debt, reduced bank lending and a contraction of exports to the industrialized countries (81: 3; 82: 3; 84: 12; 90: IV; 99: IV). The debt-distressed countries – mainly in Africa and Latin America – consistently experienced poor growth performances, while others – mainly in East Asia – continued to grow rapidly (albeit also more slowly than in the 1970s) (90: II, III). Weak investment *entailed a slow-down in the pace of the technological up-dating of the productive base* (90: III).

As for the cause of the prolonged weakness of commodity prices throughout the 1980s, which led to significant terms-of-trade losses in commodity-exporting developing countries, the TDR acknowledged the role of oversupplies of many commodities as a result of *the investment boom in raw materials resulting from the previous high level of prices.* But it put greater emphasis on the impact of *attempts by producer countries to increase export earnings in response to their debt problems* (90: IV).

In many countries the foreign exchange losses due to the combined effects of recession and interest rates amounted to 10 per cent of GNP [gross national product], in some cases up to one third, the TDR noted in 1985 (85: 3). In addition, many countries were forced to cut down on new borrowing, so that interest payments represented a multiple of new borrowing, and several countries faced a huge negative net transfer of financial resources (87: VII, also 85: 6).[3]

The external shocks *disturbed not only the external accounts but also fiscal balances: The rise in international interest rates raised interest payments by the public sector and the fall in export earnings reduced government revenues* (89: V).

Altogether, this made the 1980s a “lost decade for development”, which, as TDR 1990 showed, was accompanied by a widening of the income and wealth gap, not only between developed and developing countries, but also among the developing countries. As growth in developing countries’ main export markets remained subdued also in the 1990s, TDR 1999 estimated that the slow growth in the industrialized countries during these two decades had widened the trade deficits of developing countries by as much as 1 per cent of gross domestic product (GDP) (99: ch. IV).

The turnaround in macroeconomic thinking in the major developed countries also had indirect impacts on developing countries. It was reflected in the way the multilateral lending institutions, especially the IMF, responded to the debt and development crisis and their policy prescriptions for borrowing countries (see also sections 4 and 5 below). The TDR deplored the loan provisions of official multilateral lending and the conditions attached to such lending, which became increasingly restrictive and procyclical (82: 2; 93: III; 01: IX). Its concerns about the deflationary bias of their lending conditionalities were echoed much later by increasingly discontented governments of borrowing countries in the course of the 1990s.

Even in periods of severe macroeconomic disorder connected with the payments crises in developing countries since the early 1980s and 1990s, the TDR

did not subscribe to the conventional view on which the conditionalities imposed by the international financial institutions were based. These institutions considered budget deficits, excessive money creation and overvalued exchange rates to be errors of domestic macroeconomic policy. While not dismissing the proposition that such "errors" had played a certain role in some cases, the TDR insisted that external shocks had played a much greater role. It maintained that policies aiming at balance-of-payments and fiscal adjustments, as recommended or imposed by the international financial institutions, had made matters worse. They depressed economic activity and tax revenues, while sharp currency devaluations raised the domestic-currency-denominated cost of debt service and imports. This fuelled inflationary pressures and sharply increased domestic interest rates added to the strong deflationary impact (89: ch. IV).

3.7 Imbalances, macroeconomic policy coordination and mercantilism

Both the level of global demand and its distribution across countries have been a frequent concern of the TDR. In 1994, it argued that *the level of global demand is not an accident of fortune,* and that governments can *regulate the level of demand* and macroeconomic stability in the world economy only when acting collectively (94: VI). Other issues of the Report pointed to the desirability of better international policy coordination, *not on an ad-hoc but on a continuing basis* (85: 12, 13; also 01: 66; 03: 20; 04: 84; 06: 64). The main concern in this context has been to avoid a situation where an overall deflationary stance of macroeconomic policies in developed economies depresses global demand and employment. Also to be avoided are inconsistencies between monetary and fiscal policies, and between the macroeconomic policy orientation of different developed economies, which lead to exchange-rate misalignments, imbalances and instability. The TDR observed that such divergences in macroeconomic policies had become more frequent since the end of the Bretton Woods system (94: VI, 97: III; 00: IV). It regretted the lack of multilateral mechanisms that would ensure symmetrical adjustments in surplus as much as in deficit economies, including the largest national economy (the United States), which could exploit its status as the main reserve-currency country to finance its trade deficit.

In the mid-1980s, the TDR reiterated that the incoherence between the fiscal and monetary policy stance of the United States – which supported high interest rates and tax reductions – together with an inconsistency in the overall macroeconomic stance of the United States (expansionary), on the one hand, and Europe and Japan (deflationary), on the other, was the main reason for the strengthening of the dollar and the growing global imbalances. It believed that these increased the risk of financial instability (85: Part One, ch. I): *It is highly unlikely that the present trends in trade imbalances can continue for long; sooner or later financial markets will become reluctant to accumulate dollar-denominated assets* (85: 11). (Two years later, this episode would end with the stock market crash of 1987.) The TDR pointed to the urgency of better international macroeconomic policy coordination, as *imbalances resulting from disparities in demand creation and interest rate differentials cannot be corrected solely by unilateral policy changes or through the operation of private currency and capital markets* (85: 11).

In the 1990s the TDR again pointed to the need for coordinated measures to correct the current- account imbalances that involved a large deficit in the United States and large surpluses in Europe and Japan: *The experience of the 1980s illustrates the difficulties that can be posed by mounting trade imbalances and misalignments in exchange rates for both the international trading system and international monetary stability* (97: III). The Report suggested that an orderly and non-deflationary correction of these imbalances would require a coordinated policy response, with an emphasis on demand expansion in

the surplus economies rather than monetary tightening in the United States (97: III, IV).

In 2000, the TDR observed that the *new current global macroeconomic imbalances bear some disturbing resemblances to those of the 1970s and 1980s, when the absence of cooperation and coordination among the major economic powers led to systemic breakdown and hard landings. And what we have learnt about the global economy over the past few decades tells us that failure to resolve such imbalances in an orderly manner will be most damaging to growth in the developing countries* (00: I). The hard landing this time around took the form of the global financial crisis eight years later.

In 2004, again, the TDR warned: *Large disparities in the strength of domestic demand persist among the major industrial countries, and increasing trade imbalances between the major economic blocks could increase instability in currency and financial markets* (04: I). However, policymakers failed to acknowledge the need for an internationally balanced macroeconomic management of demand. As a *globally coordinated adjustment, whereby surplus countries would expand domestic demand to compensate for slower growth in the deficit countries, was not forthcoming, a hard-landing scenario was thus predictable* (09: III).

Following the period of successful macroeconomic policy coordination at the peak of the crisis, TDR 2010 identified a new risk in the build-up of imbalances as a result of a premature shift to restrictive fiscal policies in some of major economies. It noted that the restrictive policies *make countries overdependent on exports for their growth and could lead to the re-emergence of current-account imbalances of the kind that contributed to the build-up of the financial and economic crisis in the first place* (10: III).

Regarding the problem of adjustment by countries with large current-account surpluses, the TDR was alarmed at the widespread lack of understanding of international macroeconomic relationships, observing that trade *surpluses are again being valued as a prop to economic activity.* It criticized the mercantilist idea that countries should seek growth by improving their overall competitiveness vis-à-vis others, which was becoming accepted as an axiom: *While one country can improve its international competitiveness (and thus, perhaps, its growth performance), it is not possible for all countries to do so at the same time* (94: V).

On examining the macroeconomic aspects of job creation and unemployment in its 2010 issue, the TDR remarked that the increasing reliance on external demand had induced a tendency to keep labour costs as low as possible*: But if exports do not rise as expected, because other countries pursue the same strategy, or if the production dynamics in export industries do not spill over to other parts of the economy, as in many developing countries – especially in Africa and Latin America – these measures can be counterproductive for sustainable employment creation* (10: IX).

3.8 Incomes policies for employment creation and inflation control

Rising unemployment since the 1980s was attributed by most economists and international organizations to "artificial rigidities in labour markets". This reasoning was in line with the shift in orientation of macroeconomic policies.The TDR has repeatedly argued that this explanation is essentially microeconomic and fails to consider the macroeconomic dynamics of employment and investment. According to the TDR, employment performance is related to the pace of demand growth and capital accumulation: *The curse of unemployment will remain as long as demand is insufficient to induce firms to hire more workers* (93: III; also 95: ch. III; 10: ch. III; and section 3.1 above).

In 1995, the TDR pointed to the fact that *labour markets have, in fact, become considerably more flexible over the past decade without bringing a faster pace of employment creation… and that the worsening performance as regards jobs over the past two decades has gone hand-in-hand with a significant*

slowdown in capital formation (95: VII). It attributed this to restrictive monetary policies and financial deregulation, which pushed up interest rates, rather than to high labour costs or low profitability of the existing capital stock.

The TDR also dismissed other popular explanations of increasing unemployment in the industrialized countries, such as the expansion of North-South trade and technological progress. As early as 1984, the TDR saw high employment in the North and development with job creation in the South as two objectives that were perfectly compatible, provided the orientation of macroeconomics policies in the North would not be deflationary. In a detailed analysis in 1995, the TDR showed that competition from developing countries, combined with the introduction of labour-saving technology, may explain job losses in certain sectors but cannot explain the unemployment problem for these economies as a whole (95: V; 10: ch. III). Later it added that the attempts of many companies in the industrialized countries to improve their international competitiveness by cutting wages would *aggravate the weakness of domestic demand* (04: III) and thus compromise employment.

In 1995, the TDR recommended that the only way to reduce unemployment would be by *raising the tempo of investment and growth through lower capital costs, on the one hand, and improved prospects for sales, on the other* (95: VIII). Following this line of reasoning, TDR 2010 suggested that a strategy for reducing unemployment should start with a stronger focus on private investment, while ensuring that *productivity gains resulting from higher investment are distributed between labour and capital in a way that lifts domestic demand. This strategy was successfully pursued in most developed countries during the so-called "golden age of capitalism" between 1950 and 1973, when unemployment was at historically low levels. Labour markets were then generally much more regulated than today*, but monetary and fiscal policies were geared to *ensuring a high level of employment* (10: IX).

Similarly, TDR 2003 noted that in the process of structural change in East and South-East Asia, including China, *a significant and continuous improvement in productivity across a broad range of industrial sectors was compatible with rapidly rising real wages* (03: VIII, IX). By contrast, countries where wage growth was restrained in an attempt to raise international competitiveness did not achieve *sustained improvements in export and value-added performance to the same extent as countries that succeeded in raising productivity and wages in a virtuous process of capital accumulation and employment growth* (03: XI).

In addition, TDR 2010 recommended several other measures of incomes policy, which, while deviating from the paradigm of labour market flexibility, have a direct impact on employment and poverty reduction and an indirect one through the creation of domestic demand. The Report stated that in formulating more proactive employment-creating policies *it will be necessary to take into account institutional frameworks that differ widely, even among countries at similar levels of per capita income* (10: XI), but it also suggested that governments should consider supporting the building of institutions that facilitate productivity-led growth of labour income, which constitutes the largest driver of domestic demand.

It proposed that elements of such a strategy could be the introduction of a minimum wage and its regular adjustment to productivity growth in the economy, and the (re-)activation of collective bargaining mechanisms together with the creation and empowerment of trade unions (10: XI). In many developing countries it would also be necessary to improve earnings as well as working conditions in the informal sectors of the economy. *One way of doing this is to implement public employment schemes that establish an effective floor to the level of earnings and working conditions by making available jobs that offer such minimum employment terms* (10: XII). Some of these measures, it noted, had helped to improve employment in several developing and emerging market economies after 2002.

The experiences of both the "golden age" and the catching-up process of the East Asian economies had also shown that an incomes policy based on the principle of linking wage growth with productivity growth could also help to keep inflation under control. When wage increases do not exceed productivity gains, unit labour costs remain relatively stable and there is no risk of excessive demand growth from rising consumption expenditures. In such an environment, the scope for expansionary monetary policy that fuels a dynamic investment process and productivity growth is much larger than is usually assumed, as evidenced in more recent episodes of monetary expansion (10: 92; also 00: III).

4. GLOBAL ECONOMIC GOVERNANCE

4.1 Introduction

Although the TDR has the term "trade" in its name, it has probably contributed as much to discussions on development-related international monetary and financial issues as it has to trade issues. This is because the interaction of trade and development cannot be analysed independently of financial and monetary issues. From its perspective of interdependence, the TDR has therefore regularly examined the performance of the international monetary and financial system. This includes an assessment of the functioning of the international financial institutions in terms of their impacts on developments in the world economy, and especially in developing countries. In this context, it also covers issues relating to trade financing and the balance of payments, as well as the debt situation in developing countries.

The TDRs have followed the evolution of the multilateral system and made proposals to make it more development friendly. They have regularly commented on the main features of IMF and World Bank lending policies and the way in which those policies have influenced macroeconomic and structural policies in developing countries. One central issue in this context has been the way in which the Washington-based institutions, through their conditionalities – and cross-conditionalities – have leveraged certain macroeconomic concepts. A particular concern raised by TDRs was their urging of many developing countries to engage in financial and capital-account liberalization as well as unilateral trade liberalization, often with serious repercussions for their development. Another issue raised by the TDRs has been the inadequate quantity and modalities of official lending to developing countries, which frequently forced them to undertake costly deflationary adjustment to external macroeconomic and financial shocks. A third issue has been the way in which the international community has dealt with external debt problems.

Over the years, the TDR became an increasingly "heterodox" voice in the international policy debate as economic "orthodoxy", and its protagonists – the IMF, World Bank, WTO and OECD – progressively shifted to "market fundamentalist" positions. Yet, as time passed, the Washington-based institutions modified their policy approach, albeit reluctantly and only partially, in ways that had earlier and repeatedly been suggested in the TDR. Examples are their eventual recognition of the need for a global – rather than "case-by-case" – approach to solving the debt crisis of the 1980s; a slightly revised attitude to capital controls to counter international financial instability; the attempted institutionalization of sovereign debt workouts; acceptance of the need for official debt relief in the poorest countries; a slightly revised view of the merits of industrial policy in support of structural change; and attempts to avoid procyclicality and socially detrimental effects of conditionality.

This section first reviews the TDR series in its assessments of the international trading system. It then traces the main lines of TDR analyses of the international monetary and financial system, and finally summarizes the main proposals made in various TDRs, from the point of view of development, with regard to improving the governance of both trade and financial relations in the world economy.

4.2 Governance of international trade and commodity markets

The TDR's main contribution to the debate on governance arrangements for international trade has consisted of an analysis of trade policy issues, including those related to the Uruguay and Doha Rounds of multilateral trade negotiations and the resulting WTO rules in terms of their specific relevance for development. The TDR has never advocated free trade as an objective in its own right, and has frequently expressed reservations about trade liberalization as an objective per se. Taking a pragmatic approach, it has consistently recommended gradual and selective trade integration as a key element of development strategies. It has therefore examined the design of the international trading system and its evolution from the point of view of the opportunities and constraints that system imposes on the development process.

4.2.1 Multilateral trading system

The early 1980s saw a rising tide of protectionism, which the TDR attributed to the changes in the macroeconomic policy priorities of the industrialized countries. The shift of emphasis from growth and high employment to combating inflation slowed the pace of global demand (see also section 3 above). TDR 1984 described the contradictory trends in the international trading system as follows: *On the one hand, trade has been liberalized as a result of a series of rounds of trade negotiations addressed primarily toward the reduction of tariffs and of quantitative restrictions that fall within the ambit of GATT. At the same time there has been a trend toward the increased use of protective trade measures of a discretionary character which has accelerated in recent years* (84: 4; also 85: 8).

The problem of protectionism in the developed countries remained an issue of particular concern for the TDR during the period of the Uruguay Round negotiations (1986–1994). The introduction of a vast array of non-tariff measures by developed countries in sectors where developing countries were particularly successful, including in agricultural products and labour-intensive goods, implied a reduction in the export potential of developing countries. Many of these countries had introduced drastic unilateral trade liberalization packages during the 1980s with the aim of solving their external debt problems and financing necessary imports of capital goods and technology from export earnings (88: Part One, ch.III; 89: Part One, ch. III, 91: Part One, ch. III).

Against this background, the TDR hoped for a successful outcome of the Uruguay Round: *It is important that the long-standing international policy commitment to 'make room' for the exports of manufactures from developing countries should be fully implemented, through a rollback of existing non-tariff barriers and other measures, so as to improve market access. The Uruguay Round offers an opportunity to achieve these objectives* (88: XV; also 92: VI). Moreover, the TDR expected that the conclusion of the Uruguay Round would also contain *specific provisions on differential and more favourable treatment for developing countries* (93: IX). However, this issue has remained unresolved until today.

On the other hand, the TDR frequently expressed doubts about the contention that *any form of protection is inimical to export success* for countries that are still in the process of building and upgrading industries to catch up with the more advanced economies: Many successful exporters among the developing countries *introduced across-the-board import liberalization only after, sometimes well after, the upturn of exports. This suggests that trade reform should follow a sequence in which protection is reduced substantially first on inputs used by export sectors, and on other goods only after export supply capabilities have been built up* (92: VI; also 93: IV). This implies that a development-friendly multilateral trading system should allow for sufficient flexibility

for the pursuit of country-specific industrialization strategies. This issue would receive greater attention in subsequent years with reference to "policy space" (96: ch. III; 99: 132; 04: ch. III).

Soon after the conclusion of the Uruguay Round with the Marrakech Agreement in 1994, the TDR still expected significant improvements in the conditions for export-oriented investment (94: IX). But it also warned that *it would be unrealistic to expect the international trading system to evolve in the right direction unless the twin problems of unemployment and low wages in the developed market economy countries are tackled* (95: IX).

However, a comprehensive assessment by the TDR of the practical outcomes of the new Agreement a few years later indicated disappointing outcomes (99: ch. IV): *The predicted gains to developing countries from the Uruguay Round have proved to be exaggerated* (99: I). *Tariff levels and the frequency of tariff peaks are still high in many areas of export interest to developing countries* and *subsidization of agricultural output in the North not only shuts out imports from developing countries, but also leads to unfair competition in the latter's own markets. The panorama of protectionism is no better for industrial products* (99: IX).

A further assessment in TDR 2002, after the Doha Round of multilateral trade negotiations – also referred to as the "Development Round" – had already begun, confirmed the disappointing trends: *Trade liberalization has been limited and slow in textiles and clothing along with other labour-intensive manufactures, compared to the pace of liberalization in other sectors. High tariffs and tariff escalation have been compounded by other overt forms of protection, as well as by the adverse impact of anti-dumping actions and product standards. The growing number of non-tariff barriers, especially against unsophisticated manufactures, has reinforced the prevailing patterns of market access, which favour high-tech products over low- and middle-range products that tend to gain importance in the early stages of industrialization* (02: VI).

To demonstrate the impacts of improved market access, the TDR had estimated in 1999 *that an extra $700 billion of annual export earnings could be achieved in a relatively short time in a number of low-technology and resource-based industries. Agricultural exports could add considerably to this figure. All-in-all, the increase in annual foreign-exchange earnings could be at least four times the annual private foreign capital inflow in the 1990s* (99: IX).

But it was not only the disappointing results in terms of market access that perpetuated earlier concerns about the appropriateness of the WTO rules from a development perspective. The new multilateral trade rules were also seen as failing to offer sufficient flexibility for the implementation of national development policies similar to those that had proved successful in the Asian newly industrializing economies (NIEs) as well as in many developed countries (02: X). TDR 2002 was therefore critical of the *gap between the rhetoric and the reality of a liberal international economic order. Nowhere is this gap more evident than in the international trading system. Even as Governments extol the virtues of free trade, they are only too willing to intervene to protect their domestic constituencies that feel threatened by the cold winds of international competition. Such remnants of neo-mercantilist thinking have done much to unbalance the bargain struck during the Uruguay Round* (02: I).

Consequently, the Report stressed the continuing challenge to make the multilateral trading system more development-friendly. The outcome of the Doha Round of multilateral trade negotiations *will be judged by the extent to which developing countries achieve greater market access without their policy options being restricted* (02: XI; also 06: XIX). TDR 2006 found market access conditions still biased against developing countries, owing to *the use of non-tariff measures, particularly antidumping measures, which have emerged over the past 25 years as the most widespread impediment to international trade, and to exports from developing countries in particular* (06: VI).

With the stalling of the Doha Round, which was scheduled to be concluded in 2005, the TDR noted that *further discussions and negotiations will need to explore a range of options aimed at creating a new framework or new guidelines for special and differential treatment (SDT). This endeavour would probably need to start from the recognition that SDT for developing countries means redressing structural imbalances rather than giving concessions. Developed countries would need to agree to a new framework or new guidelines for SDT without receiving concessions in return* (06: XIX).

Thus, while the TDR always emphasized the merits of multilateral trade rules and disciplines in global economic governance, it also called for the need to apply those rules flexibly to developing countries. In this context, it drew attention to the fact that *in legal terms, WTO rules are equally binding on all participants, but in economic terms they are biased towards an accommodation of the requirements of the developed countries* (06: XX). TDR 2006 therefore argued that developing countries should be able *to modulate applied industrial tariffs levied on particular product categories in accordance with their path of technological upgrading as a key instrument of sectoral policy* (06: XIII).

4.2.2 Bilateral and regional trade arrangements

In its support for the principle of multilateralism in global economic governance, the TDR has repeatedly drawn attention to the drawbacks of regional and bilateral trade agreements involving developed and developing countries.

In the 1990s the TDR saw two main problems with such agreements: that they could *lead to significant trade losses for non-members* (90: VI), and that they could weaken efforts to improve the multilateral trading system (91: VIII). In a later analysis in 2007, the perspective leaned more towards the implications for developing-country members of such agreements that had multiplied rapidly since the early 1990s. The Report warned that bilateral or regional preferential trade agreements between developed and developing countries often bypass multilateral institutions and arrangements. It noted that this reflected a belief by the participating governments that a number of those agreements *could serve as a better vehicle for advancing their preferred agendas of economic liberalization and internationalization of investment and production* (07: VIII). It accepted that free trade agreements between developed and developing countries had the potential to provide the developing-country partner(s) with better market access to the developed-country partner(s) and may attract more foreign direct investment (FDI). However it also alerted developing countries to some potential disadvantages, as such agreements generally demand far-reaching liberalization of foreign investment and government procurement, the incorporation of labour and environmental standards, and, in many cases, *much broader and deeper liberalization of trade in goods than that agreed under WTO arrangements* (07: IX).

4.2.3 International commodity markets

Low and unstable primary commodity prices and the related terms-of-trade problem were among the central issues in North-South economic relations since the time of the first UNCTAD conference in 1964. The majority of developing countries then depended heavily on primary commodity exports for foreign exchange earnings, and four decades later commodity dependence persists in many countries, especially in Africa. The stabilization of such markets and the reduced economic dependence of many countries, especially African countries, on those markets have traditionally been major objectives espoused by UNCTAD. This is mainly because there is ample evidence that commodity price volatility is *one of the reasons why commodity-dependent economies have lower long-term average growth rates than economies with diversified production structures* (08: IV). Moreover, terms-of-trade losses as a result of weak commodity prices frequently imply real income losses for the poorest countries, which affect their ability to import essential goods with a given export capacity (82:15, 16, 38; 88: 92; 93: 20; 05: ch.III).

Against this background, commodity price developments and the functioning of international commodity markets have been followed very closely in every TDR. The very first TDR advocated a new development paradigm that would include, as one of its key elements, *a substantial improvement in the terms of trade of developing countries through appropriate commodity policies* (81: 5). Over the years the Report regularly pointed to the important role of output growth in developed countries as a key determinant of the evolution of the prices of most primary commodities. In recent years, fast and sustained growth in a number of large emerging economies, particularly China, has contributed to a structural increase in demand for primary commodities, which has changed both short- and long-term demand prospects. However, TDR 2005 found that *the basic problem of instability in these prices and*

their long-term tendency to deteriorate in real terms vis-à-vis the prices of manufactures, especially those exported by developed countries, remains unresolved. When oil prices surged after 2002, oil-importing developed countries called for measures to stabilize those prices. On this occasion, the TDR noted again *that in the spirit of a global partnership for development the international community might consider mechanisms at the global or regional level that could serve to reduce the instability of prices of a wider range of commodities, not just oil, to mitigate its impact on the national incomes of exporting countries* (05: VIII, IX; 06: annex 1 to ch. I).

Three years later it became clear that such mechanisms were needed for two purposes: to mitigate the impact of falling and unstable prices on exporters of primary commodities, and to reduce the impact of unstable and rising prices on developing-country importers of such commodities, especially countries that depend on food imports. As stated by the TDR (2008: IV): *The surge in food prices in some countries calls for specific income transfers targeted to the most needy households* (which in poor countries require additional foreign assistance). *It also demonstrates the importance, from both a macroeconomic and social perspective, of new measures aimed at achieving greater commodity price stability and of quick-response instruments to mitigate the impact of sharp commodity price fluctuations*.

An issue of increasing importance for the functioning of primary commodity markets has been the impact of financial speculation. Such speculation was identified as an important factor in commodity price formation already in the 1980s (90: IV), but its impact has become a particularly important challenge for global economic governance in recent years. Since 2008, the TDR has devoted much attention to the "financialization" of primary commodity markets (08: ch. II; 09: ch. II; 11: ch. V). TDR 2011 noted that the growing participation of financial investors in commodity trading for purely financial motives has *caused those markets to follow less the logic of a goods market and more that of financial markets where herd behaviour often dominates* (11: XI). This new aspect of commodity price formation is a result of the fact that *financial investors in commodity futures exchanges have been treating commodities increasingly as an alternative asset class to optimize the risk-return profile of their portfolios. A particular concern with respect to this financialization of commodity trading is the growing influence of so-called index traders, who tend to take only long positions that exert upward pressure on prices. The average size of their positions has become so large that they can significantly influence prices and create speculative bubbles, with extremely detrimental effects on normal trading activities and market efficiency* (09: IV).

In the TDR's view, the problem with financialization is not only that it increases volatility and dangerously disconnects prices from fundamentals; it also creates problems for those who have a real economic interest in commodity futures markets: *Under these conditions, hedging against commodity price risk becomes more complex, more expensive, and perhaps unaffordable for developing-country users. Moreover, the signals emanating from commodity exchanges are getting to be less reliable as a basis for investment decisions and for supply and demand management by producers and consumers* (09: IV).

The TDR recognized that international price stabilization mechanisms agreed multilaterally between producers and consumers, such as the various commodity agreements of the past, were unlikely to become a political option in the near future. *It would therefore be useful to tackle the factors that cause large commodity price fluctuations in the first place and correct any undesired market outcomes. Stricter regulatory measures that help contain speculation on commodity markets could be one important step* (08: V). In addition, TDR 2008 called for an improvement in *international compensatory finance schemes*, with *more rapid disbursements and more financial resources for balance-of-payments or income support.* Such measures *should not only be able to cover shortfalls in export earnings but also higher import costs resulting from sharp increases in prices of essential commodity imports, particularly food and energy* (08: V).

4.3 The international monetary and financial system: a critique

4.3.1 Financial instability and the handling of financial and payments difficulties

In the early 1980s, the TDR observed a fundamental shift in the policy orientation of the Washington-based institutions. In 1984 it noted that, whereas the post-war system had been *designed to protect levels of activity to the greatest extent possible from external constraints and external monetary and financial disturbances*, the arrangements following the break-down of the Bretton Woods System were *geared toward ensuring freedom for international capital markets, which have assumed a dominant role in determining the availability of payments finance and the pattern of exchange rates* (84: 8).

In the mid-1970s, external finance was still playing an important role in cushioning downward pressures on import volumes, and therefore on output and investment. This was partly due to private financial flows and partly to official lending, such as through the so-called Oil Facility established by the IMF in response to the payments difficulties encountered by many oil-importing countries in the mid-1970s (82:43-45). But towards the end of the 1970s the international financial institutions were ill prepared to counterbalance the deflationary impact on developing countries of the events that shocked the world economy in the late 1970s and early 1980s and the procyclical behaviour of private actors (84: 6). The radical shift in the macroeconomic policy orientation of the major industrialized countries was accompanied by pressure on the IMF to limit quota increases and to impose stricter loan conditionalities, as the TDR observed in 1982 (82: 5). Thus, from the late 1970s onwards deficit countries were for the most part required to adjust their external imbalances by means of deflation, as the foreign exchange losses resulting from the combined effects of recession and higher interest rates in the first half of the 1980s were not compensated by increased external financing from official sources (84: Part Two, ch. III; 85: Part Two, ch. III).

On the other hand, the TDR soon realized that the dismantling of obstacles to international capital movements was increasing *the scope for the transmission of instability among different markets and causing the volatility of exchange rates to be more closely connected to movements in the prices of many other assets* (88: XII). According to the TDR, *financial innovation and deregulation of financial markets had the potential for instability* not only in national economies but for the entire international financial system (91: V; also 90: X). All this would become obvious in the subsequent two decades, as evidenced by the frequency of financial and currency crises, including the global financial crisis of 2008-2009 that had its origin in countries which, supposedly, had the most sophisticated financial sectors in the world.

In 1990, a time when policymakers and most of academia still subscribed to the merits of financial deregulation and liberalization, the TDR pointed to the need *for more collective control and guidance over international finance* (90: I). But these warnings *fell on deaf ears*. Indeed, the Report was obliged to comment eight years later, following the episodes of debt deflation in the United States, the European Monetary System (EMS) crisis in 1992–1993, the Mexican crisis of 1994–1995 and the East Asian crisis of 1997–1998: *Each time, the prevailing approaches have been based on the notion of the infallibility of markets and on an explanation of the crisis in terms of misguided domestic policies*. Meanwhile the systemic nature of financial instability continued to be overlooked (98: I).

Subsequent to the Asian financial crisis, the TDR sharpened its criticism of the way in which the international financial institutions were managing financial crises. In 1998 it noted: *Countries that year after year enjoyed growth rates of 8–10 per*

cent per annum, maintained full employment and went a long way towards eradicating poverty are now suffering a severe economic contraction. The international policy response has contributed to the severity of the crisis by failing to appreciate the full gravity of the situation, and by placing too much faith in conventional policy prescriptions. High interest rates forced debtors *to cut down on their activity and liquidate assets, while economies were driven into deep recession* (98: II, III). The financial assistance coordinated by the IMF was criticized for coming too late, *usually only after the collapse of the currency,* and for taking *the form of bailouts designed to meet the demands of creditors and to prevent defaults*. TDR 1998 criticized such operations for not being particularly helpful to the countries themselves, but mainly serving to *protect creditors from bearing the costs of their decisions* (98: VIII). It also questioned the capacity of the IMF to adequately meet the needs of the system in terms of the possible volume of its lending in light of the increasing need to *stabilize currency markets and thus avoid the transformation of currency attacks into solvency crises* (98: VIII).

Criticism of the IMF's diagnoses before and after the Asian financial crisis and that of its policy prescriptions became more widespread. Furthermore, developing and emerging market economies revised their macroeconomic strategies in order to reduce their dependence on international capital markets and on IMF assistance.

4.3.2 Problems of conditionality and policy surveillance

One of the recurrent concerns of the TDR has been the influence of international financial institutions, especially the IMF, on policies of its member States. This concern has two aspects. The first is related to the fact that the IMF can meaningfully influence national policies only when a country asks for its financial support and thus becomes subject to IMF conditionality. The second is related to the nature of that conditionality.

Regarding the first aspect, the TDR has disapproved of the asymmetrical way in which the IMF exerts its surveillance function over its borrowing members, on the one hand, and its non-borrowing members on the other. In 1990, the TDR (Part Two, ch. I) noted that the record of multilateral surveillance was *extremely poor*. Whereas the IMF's position vis-à-vis the developing countries had been considerably strengthened, policies in the major industrialized countries were outside the scope of effective surveillance by the IMF.

Indeed, global surveillance procedures failed to prevent the international financial crises and currency turmoils of the 1990s, as pointed out in 1998 (ch. IV): *In part this failure reflects belated, and only partial, adaptation of existing procedures to the problems posed by large autonomous private capital flows. But perhaps more fundamentally, it is due to the unbalanced nature of these procedures, which give too little recognition to the disproportionately large global impact of monetary policies in a small minority of OECD countries* (98: 93).

Although the inadequacy of IMF surveillance in response to conditions produced by greater global financial integration and recurrent financial crises was widely recognized in the 1990s, including by the Group of Ten and the IMF's Interim Committee, there was little improvement. After the Asian financial crisis, the TDR noted: *Over the past two decades, the unwillingness of the advanced countries to defer to IMF on contentious monetary and financial matters which directly affect their own interests has meant that the Fund's surveillance of the policies of the most important players in the global system has lost any real purpose. Instead, there has been an intensification of surveillance of developing countries, which has now been extended to include financial sector issues, consistent with the diagnosis that the main flaws are to be found in debtor countries. One result has been the expansion of conditionalities attached to IMF lending to countries facing actual or potential crisis. This has given rise to serious concerns about undermining sovereign responsibility, even as the effectiveness of IMF surveillance is increasingly questioned* (01: IX; also 06: XXI).

Regarding the nature of IMF conditionality, the TDR criticized both the structural and macroeconomic conditions, as well as the cross-conditionality attached to IMF and World Bank lending and later also to the provision of official debt relief. Macroeconomic conditionality mostly implied requiring recipient countries to adopt a procyclical policy stance through a tighter monetary policy and fiscal retrenchment. As a complement to macroeconomic tightening, countries were expected to undertake "growth-oriented

structural reforms" which would give broader scope to market mechanisms and private sector initiatives. They were to give greater emphasis to liberalization and deregulation and reduce the role of the State, including cutting the share of public consumption and investment. The TDR argued that such structural reform programmes overemphasized market forces, even in countries where many preconditions for well-functioning markets were not fulfilled. They also implied an intrusion into national policy autonomy in various areas, for example with regard to the privatization of State-owned enterprises, the dismantling of public institutions that supported the agricultural sector, and the liberalization of external trade and finance (93: III; also 94: Part Two, chs. II and III).

In the view of the TDR, these policy prescriptions, rather than helping countries to overcome recession, mostly served to make matters worse, particularly because they caused investment to stall and because they did not sufficiently acknowledge the external causes of payments crises (82: 2; 89: V; 93: 3). Moreover, the TDR observed that, based on the conventional perception that the reasons for macroeconomic and financial disorder and external indebtedness were mainly to be found in flaws in domestic policies, conditionality on borrowing countries intensified over time. It started to extend beyond financial sector issues to include non-economic matters as well, thereby increasingly undermining sovereign responsibility (01: Part Two, ch. III). When criticism of IMF conditionality grew in the aftermath of the Asian financial crisis in the late 1990s, the IMF's International Monetary and Financial Committee discussed the need to streamline and refocus its surveillance in line with the Fund's core competence in macroeconomic policy. However, TDR 2001 found that the way in which financial difficulties in some emerging markets were being dealt with in the first years of the new millennium did not indicate a break with past practice (01: ch. III).

More generally, the 2001 Report voiced the disappointment of an increasing number of observers and officials in developing countries and emerging economies that, *despite the initial emphasis of some policy makers in the leading industrial economies on the need for systemic reform after the Asian crisis, moves in that direction have subsequently stalled. Instead of establishing institutions and mechanisms at the international level to reduce the likelihood of such crises and better manage them when they do occur, there has been a very one-sided emphasis on reforming domestic institutions and policies in developing countries. By contrast, little attention is given to the role played by institutions and policies in creditor countries in triggering international financial crises* (01: VI, VII).

The financial crisis that began in 2008 again led to official pronouncements by the IMF that it would revise the terms of its conditionality. However, TDR 2009 showed that problems concerning conditionality remain as relevant as before. While IMF lending surged after the outbreak of the current crisis, the TDR found *that in almost all its recent lending arrangements, the Fund has continued to impose procyclical macroeconomic tightening, including the requirement for a reduction in public spending and an increase in interest rates* (09: VII).

4.3.3 Exchange-rate disorder

The TDR frequently expressed concern *that volatile exchange rates have significant unfavourable effects on international trade,* as wide fluctuations and long-term movements of exchange rates leading to overvaluation frequently cause protectionist pressures (88: XIII). It blamed this primarily on the disorder in the international exchange-rate system following the breakdown of the Bretton Woods system. TDR 2009 (ch. IV) also pointed to the weakness of an international reserve system that uses a national currency as the main reserve asset. Such a system always depends on monetary policy decisions by the central bank that issues that currency – decisions that are taken according to national policy needs and preferences, without considering the needs of the international payments system and the world economy. Another disadvantage of such a system is that, at times of current-account disequilibria, it imposes the entire adjustment burden on deficit countries. Only deficit countries that issue a reserve currency have no obligation to adjust to growing current-account disequilibria.

The Report attributed the ensuing problems for the world economy to the absence of appropriate multilateral arrangements to ensure greater exchange-rate stability of the major currencies. It also pointed to flaws in the policy advice of the international

financial institutions on exchange-rate arrangements in developing countries (99: X). It suggested that this advice had been *at best confusing and at worst misleading*, because it did not consider the option of direct controls over capital flows. The TDR argued that under free capital mobility, neither freely floating exchange rates, as suggested in some cases, nor a completely fixed exchange rate or even a currency board system, as chosen in other cases, could insulate economies from instability of an external origin. *Freely floating rates, combined with capital mobility, undermine currency stability.* But with a completely fixed exchange rate or a currency board system, *the effects of capital inflows and outflows are transmitted to levels of economic activity and to goods and assets prices, and may include threats to banking stability* (98:X). Thus, *differences among pegged, floating and fixed regimes lie not so much in their capacity to prevent damage to the real economy as in the way damage is inflicted in the first place* (99: X).

In light of these considerations, various TDRs have made proposals for reform of the international exchange-rate system and for exchange-rate arrangements in developing and emerging economies. These are believed to contribute to greater financial stability and a macroeconomic and financial environment that is more conducive to investment in productive capacity and employment generation (see sections 4.4.5 and 5.3.2 below).

4.4 Recommendations for reform of the international monetary and financial system

In light of its assessments of the shortcomings of the global governance arrangements, the TDR has made many recommendations for reform, which have evolved over time. In several cases its recommendations anticipated changes in these arrangements that were later discussed and adopted in other forums.

Of particular importance in this regard were the contributions in TDRs 1990 (Part Two: The Internationalization of Finance), 1998 (Part One, ch. IV: The Management and Prevention of Financial Crises), 2001 (Part Two: Reform of the International Financial Architecture), and 2009 (chapter IV: Reform of the International Monetary and Financial System). But even prior to these Reports, as early as 1984 the TDR had proposed some principles for systemic reform in response to the unfavourable developments in international monetary and financial governance since the end of the Bretton Woods system and the greater instability and unpredictability of the financial system. Those principles could in a very similar form be equally applicable today: *A viable system needs not only to reaffirm the emphasis on employment and growth that underlay the design of the post-war systems* [of trade, money and finance] *but also to complete that commitment by establishing mechanisms to ensure adequate growth opportunities for all members of the system – the establishment of a development consensus* (84:11).

Since 1984, various TDRs have formulated elements of a reform agenda that is equally relevant today (84:11, 12; 86: annex to ch. VI; 90: Part Two, ch. I; 98: Part One, ch. IV). The following have been the main proposals:

- Surveillance and effective international coordination of economic policies in the major countries that have a strong impact on other economies, in order to avoid a deflationary bias in the system and the build-up of large current-account imbalances;
- Regulation and supervision of finance and international capital flows;
- Provision of adequate official financing that helps avoid payments problems and allows economies that encounter such problems to make necessary adjustments without sacrificing growth and progress in development;

- International mechanisms to prevent and manage financial crises, including debt reduction;
- Arrangements for maintaining stable exchange rates among the major international currencies;
- Greater coherence and consistency in the formulation of policies relating to trade and to finance so that they are mutually supportive in their promotion of full employment and development.

These themes are addressed below.

4.4.1 Policy surveillance and coordination

Following the Asian financial crisis, the TDR suggested that in light of the increasing financial instability and the impact of external factors on the payments situation of developing and emerging economies, new guidelines for IMF surveillance should specify circumstances in which the Fund should recommend the imposition or strengthening of capital controls (98: 95). This line of reasoning led TDR 2009 to suggest that IMF support for measures to manage the capital account as part of its surveillance function could ensure that debtor countries or governments are not "penalized" by no lending or excessively high interest rates. IMF endorsement of national policy measures is typically viewed by international investors as a sign of credibility of such policies (09: 120).

However, the main concern continued to be the need for a reduction of asymmetries in surveillance (01: 70). In 1990, the TDR (Part Two, ch. I) observed that there had been a significant increase in interdependence among the major industrialized countries compared with the time when monetary arrangements were put in place in the immediate post-war era. The dependence of economic performance in developing countries on the policy mix and stance of the major OECD countries had also become stronger, and the capacity of financial markets and capital flows to generate global disturbances had grown (90: 136). Therefore the Report believed that the surveillance function of the IMF should be considerably strengthened in order to help attain the objectives of growth and stability, as provided in Article I of its Articles of Agreement. This would require that the burden of adjusting policy in the case of large current-account imbalances *is shared between deficit and surplus countries in such a way as to avoid bias towards deflation and high interest rates. Global targets and indicators should also be used to ensure that the world economy as a whole is neither deflated nor over-heated* (90: XII). The Report stressed that the surveillance function of the IMF had particular importance for the process of policy coordination. It should not be limited to exchange-rate policies but should also include adjustment processes, and, *it should be conducted on a multilateral basis before issues regarding policies and indicators are taken up in bilateral consultations* (90: 136).

TDR 2001 made a more concrete proposal in this regard: *A priority of the reform process must be strengthening surveillance mechanisms to achieve a minimum degree of coherence among the macroeconomic policies of the major industrialized countries. In view of the asymmetries in existing practices, one way forward might be to link surveillance procedures to a mechanism analogous to that used for settling disputes in international trade, where disagreements over the impact of macroeconomic and financial policies could be taken up and their resolution sought* (01: IX).

The need for policy coordination was again stressed in various TDRs in the run-up to the global financial crisis that began in 2008 (01: 66; 03: 20; 06: 64). But it was only after the crisis had erupted that the G-20 sought to ensure a more coordinated policy response. It was recognized that coordination of the fiscal stimulus programmes of different countries would enhance their overall impact on global demand and reduce the risk of protectionist reflex actions against "free-riders" (09: VI). However, as in previous instances, such as with the Plaza and Louvre Accords in 1985 and 1987 among the major industrialized countries, policy coordination occurred only on an ad hoc basis in episodes of acute crisis. This is why the TDR has called for more permanent and more effective arrangements for improved policy coordination, to be led by an international institution that would not only implement ad hoc measures for crisis management but also prevent the build-up of global crises (09: 129-130).

Another important recommendation made by the TDR was that, in order to achieve greater international policy coherence, international policy coordination should also take into account the needs of developing countries. These countries are affected

by the macroeconomic policy stances of the major developed countries, which exert a strong influence not only on the volume and terms of trade, but also on the availability and cost of external finance (90: Part Two, ch. I). Moreover, in situations of weak global demand, a balanced programme of global expansion that includes greater provision of official finance to developing countries – and debt relief, where appropriate – could reduce the need for contraction of imports by those countries, while at the same time contributing to stabilizing global demand (87: IV; 88: V: 03: IV; 09: VII).

4.4.2 Governance of international capital flows

It is one thing to call for stricter financial regulation when there is general agreement that this is needed as a result of the financial crisis; it is another to call for stronger financial regulation when the broad general tendency is directed towards relaxing such regulation. The latter is what the TDR started to do more than 20 years ago. In 1988, it noted that the need to *establish appropriate frameworks and guidelines for markets* and to *contain harmful effects of large unpredictable changes* had increased as a result of *actions taken by major OECD governments as part of a thrust towards greater reliance on free markets* (88: XIII*). Prudential regulations need to be tightened to raise the cost of excessively risky operations in both credit and security markets. They also need to be harmonized, and applied in all major financial centres including those offshore* (90: XII). However, inaction in this regard was a major cause of the financial crisis of 2008, prompting the TDR to repeat these calls, this time in concert with many others (09: ch. III).

Having pointed to the need for regulation and supervision of finance and international capital flows to reduce financial and exchange-rate instability in earlier issues, the TDR addressed the related issues in more detail in the 1990s. In connection with its assessment of the Uruguay Round negotiations on financial services, the Report reviewed the governance of international banking and the work of the Basel Committee on Banking Supervision (92: annex I to Part Two). This work responded to developing countries' increasing demand for information, explanation and guidance on issues relating to global regulatory reform. Its relevance has been confirmed by the introduction of regulations within the Basel 2 framework in more than 100 countries.

TDR 1994 (annex to Part Two, ch. II) reviewed pre-existing international regimes for capital movements and made several new proposals. For example, the discussion of a tax aimed at slowing speculative international capital transactions as a means to reducing the negative impact of speculation on financial and exchange-rate stability goes back to 1988 (88: XIV; 90: XII). The possibility of such a tax, which was initially proposed by Nobel Laureate James Tobin in 1978 (Tobin, 1978), was examined in detail in the annex to TDR 1996. At the time, the TDR expressed some scepticism to the proposal due partly to considerations related to the difficulty in designing a practicable tax of this kind. However, following the eruption of the financial crisis in 2008, the idea of such a tax has gained widespread support in some major European countries, and suggests that this difficulty will simply be overridden by means of some probably arbitrary solution.

Moreover, the TDR soon recognized that the liberalization of international capital movements could lead to undesirable inflows. It therefore called for defence mechanisms aimed at reducing the vulnerability to financial and currency crises triggered by shocks generated outside a country's sphere of influence. In the absence of appropriate arrangements in the international governance system, especially global mechanisms for stabilizing capital flows, it emphasized the need for protective national policies. Accordingly, in the 1990s, before capital inflows into developing countries started to surge, and before the financial crises that would subsequently hit several emerging market economies, it commented on the usefulness of controls over capital movements. Based on historical experience of finance and capital flows to developing countries, it expected that policies based on the Washington Consensus would trigger a rapid increase of such flows, followed by a bust (see also section 5 below).

While the application of such measures and other forms of capital-account management are in the national domain, global governance matters in making them internationally acceptable. This is why TDR 1998 emphasized that, rather than imposing new constraints on capital-account management, international financial governance arrangements should

provide for greater flexibility to allow governments to pursue various options in this regard (98: Part One, ch. IV; see also section 5.3.2).

4.4.3 Official financing

Regarding the role of official financing for developing countries and emerging markets, the TDR has recommended the provision of IMF lending for the purpose of bridging short-term payments difficulties resulting from the impact of unfavourable movements in the global economy. This included strong advocacy for lending in crisis situations to support trade, employment and growth. At the same time, the Report has been critical of bailouts for international creditors and investors. Another area of concern has revolved around the level, stability and conditions of official development assistance (ODA), especially for low-income and least developed countries.

After the collapse of the Bretton Woods system and the subsequent liberalization of international capital markets, followed also by widespread capital-account liberalization in developing countries, it was expected that the external financing requirements of developing countries would be satisfied by private capital inflows. But, as observed in several TDRs during the 1990s, only a minority of developing countries *has had access to these markets, while a majority has continued to depend heavily on official financing, including export credits* (96: IV; also 93: VIII; 99: X; 08: X). Greater provision of official financing was also deemed necessary in view of the increased outward orientation of most developing countries, and because *the private financial system operates in a pro-cyclical fashion, accentuating the deflationary impact on developing countries of events in the world economy* (84: 6).

With regard to the provision of official financing for the prevention and mitigation of payments problems and for alleviating the constraints on development financing, the TDR frequently advocated allocations of additional special drawing rights (SDR) by the IMF in the 1990s (91: VI; 92: IV; 95: 45). Again in 2001 the TDR complained that *IMF quotas have lagged far behind the growth of global output, trade and financial flows* (01:VIII). In April 2009, the G-20, in its Global Plan for Recovery and Reform, finally *decided to significantly increase the IMF's resources, to provide additional lending through multilateral development banks and to support trade finance.* Yet the TDR argued that *the effectiveness of the announced international support could have been greatly increased if it had been linked to a reform of the system of allocation of SDRs,* in a way that it would yield greater benefits for those countries that are most in need of unconditional access to official finance (09: VI, VII).

Official development assistance in real terms had declined steadily throughout the 1990s. TDR 1999 (ch. IV) compared ODA levels with terms-of-trade losses and the effects of trade and financial liberalization and slower growth in the industrialized countries. It concluded that net capital inflows received by most developing countries fell far short of what would be needed to achieve an annual GDP growth rate of at least 6 per cent. This was considered to be a rate that would allow developing countries to overcome their social and technological handicaps and narrow the income gap with developed countries: *Even under relatively optimistic assumptions regarding growth in industrial countries and the terms of trade, the external financing needs of developing countries can be estimated to exceed recent net capital inflows by more than 40 per cent* (99: VII). Following the formulation of the Millennium Development Goals (MDGs) in 2000 and the Monterrey Consensus in 2002, ODA disbursements increased substantially, but the 2008 Report observed that many donors often were not on track to meet their ODA pledges. It still saw a considerable gap between actual ODA flows and the aid estimated to be necessary for implementing measures to attain the MDGs: *for a realistic chance of meeting the MDGs, ODA would need to be increased by $50-$60 billion a year above current levels* (08: XI).

Moreover, TDR 2008 highlighted an aspect that is rarely taken into account when the potential impact of aid on development is considered, namely the need to link ODA to investment in growth-enhancing productive capacities. Aid effectiveness had come to be increasingly viewed in terms of its direct contribution to achieving the MDGs; as noted by the TDR, *a larger proportion of ODA is being spent for health, education and other social purposes*. However, while recognizing that *this kind of ODA is essential and justified in its own right,* the Report emphasized that unless ODA helps boost investment and growth, *it is unlikely to be effective in reducing poverty in the*

long term, beyond the MDG target year of 2015 (08: XI). The Report proposed one possible way to increase ODA effectiveness: *to leverage ODA through the creation or strengthening of institutions that would channel ODA into public and private investment projects financed jointly with domestic financial institutions. This could facilitate access of potential domestic investors to long-term financing and reduce the credit risk of domestic banks – and thus the interest they charge. At the same time it could help to build a better functioning system of domestic financial intermediation* (08: XI).

4.4.4 Management of financial and debt crises

(a) Dealing with sovereign debt

The debt problems of many developing countries in the early 1980s were treated by the international community for a long time as individual problems of each debtor country. Accordingly, the remedies prescribed focused on debt rescheduling and domestic adjustment, irrespective of the costs in terms of forgone output, and thus, debt servicing capacity itself. TDR 1985, by contrast, outlined the elements of an international strategy to solve external debt problems based on the recognition of an *intimate connection between the debt problem and the evolution of the external environment* (85: 3).

While the international financial institutions continued to deal with the debt problems on a "case-by-case" basis, the TDR insisted on a global solution. This was not only because the crisis was largely due to the malfunctioning of the global economy (see section 3 above), but also because a *process of action and reaction by individual creditors and debtors is likely to be disorderly. A measure of debt or debt-service forgiveness must therefore be part of the normal 'menu' of financial techniques* (87: VIII). The TDR always maintained that the external debt problems of developing countries had to be solved with the support of the governments of the creditor countries and the international financial agencies, but without placing an undue burden on the populations of the indebted countries or obstructing development. This should help debtor countries to avoid the need for import compression, improve their export capacity through accelerated domestic capital formation and strengthen their public finances. To this end, the TDR proposed the establishment of an *international debt facility* (88: VIII; also 90: VIII), and indicated various kinds of incentives the governments of creditor countries could provide to commercial creditors to achieve an orderly, concerted debt reduction (93: Part Three).

Based on a simulation model, TDR 1988 showed that full repayment of the debts owed by developing countries to private lenders in the mid-1980s was economically not possible, and that therefore debt relief was necessary. The Report emphasized *the mutual interest of creditors and debtors in removing the debt overhang* and estimated that a *30 per cent cut in commercial bank debt, together with new lending by multilateral agencies and vigorous efforts by debtors to invest and export,* was *the minimum needed to remove the foreign-exchange constraint and break out of the vicious circle*. It added that such a reduction of bank debt would amount *to about one-half of the discount at which their debt is currently traded on secondary markets* (88: VII, VIII; also 89: V).

It took several years before the international debt strategy was finally revised along the lines advocated by the TDR. The Brady Initiative finally offered a means of settling creditors' claims on indebted countries in an orderly way, putting an end to the most severe payments constraints. The subsequent introduction of new policy guidelines by the IMF and the World Bank led the TDR to state: *It is now accepted that reduction of debt and debt service must play a much greater role and that creditor governments must be involved in the process*. Even though the TDR recognized this as a significant step forward, it also identified its weaknesses and called for more action, because *the extent to which countries can engage in debt equity swaps and privatization without jeopardizing their public finances* was limited (89: X, XI). Moreover, the Report objected to the fact that the agreements under the Brady Initiative *were negotiated without authoritative estimates of the debt and debt service reduction required*. The *failure to assign to any international financial agency the role of "honest broker" has left the level of debt reduction to be shaped by the balance of negotiating strength rather than by objective needs* (90: VIII).

Against this background, TDR 1990 feared that *the task of breaking the vicious circle of poor growth, over-indebtedness and economic disorder* would

continue *for a decade ahead* (90: I). Indeed, most developing countries would not return to growth rates commensurate with their stage of development before the turn of the millennium, when the global economy embarked on a long period of expansion.

In the TDR's analysis, increasing capital inflows in the 1990s were partly due to the Brady deals. This was because, first, they implied that a significant share of the debt that was owed to commercial banks was substituted by debt owed to governments, and secondly, because the initiative was viewed by actors on international capital markets as a sign of reduced risk of new capital flows to the debtor countries. Together with considerably higher interest rates in many of these countries and sharp interest rate cuts in the United States to contain the fallout from the Savings and Loan crisis, this attracted arbitrage – or "carry trade" – speculation with attendant bandwagon effects. The TDR warned of the unsustainability of such inflows in the mid-1990s, especially for Latin American, but also for some Asian economies (92: 51–52; 93: XI; 94: II, also 98: ch. III).

Following the experience of further financial and currency crises in Latin America, the Russian Federation and East Asia, TDR 1999 suggested that reform of the global financial architecture should aim at *a roll-back of the control that financial capital has established over trade, industry and employment* (99: X) in countries at all stages of economic development. It also called for the reform to include a greater role for official financing and recognition of the rights as well as the obligations of debtors.

The year before, the TDR had elaborated recommendations for the prevention and better management of financial crises. It suggested that the most effective way to prevent widespread defaults and bankruptcies as a result of an attack against a currency would be to apply, at the international level, the same insolvency principles and procedures as those provided in the bankruptcy legislation of many countries. *The procedures allow for a standstill on debt servicing in order to provide the debtor with a breathing space from its creditors. The debtor thus has an opportunity to formulate a debt reorganization plan, and equal treatment for creditors is also guaranteed. During the reorganization the debtor is provided with access to the working capital needed for its operations* (98: VIII, IX). This proposal for a statutory approach to deal with external debt problems preceded by several years a very similar proposal by the IMF (in 2002) under the heading, "Sovereign Debt Restructuring Mechanism" in an attempt to compel all commercial creditors to agree on debt restructurings.

Indeed, as early as 1986, the TDR had suggested such a mechanism as part of a solution to the sovereign debt crisis of the 1980s (86: annex to ch. VI). The Report argued that *the lack of a well-articulated, impartial framework for resolving international debt problems creates considerable danger that international debtors will suffer the worst of both possible worlds: they may experience the financial and economic stigma of being judged de facto bankrupt, with all the consequences that entails regarding creditworthiness and future access to financing. At the same time, they are largely without the benefits of receiving the financial relief and financial reorganization that would accompany a de jure bankruptcy handled in a manner similar to chapter 11 of the United States bankruptcy code* (86: 141).

In order *to safeguard debtor countries from the over-reaction of financial markets,* the TDR further proposed the introduction of rules that would allow a debtor country to decide a standstill on its debt repayments when facing *an attack on its currency once its reserves or currency fall below a certain threshold.* This decision should *then be submitted for approval to an independent panel of experts within a specified period* (98: IX). In addition, it proposed that the IMF provide *"lending into arrears", which would require much smaller sums than bailout operations. Such a procedure*, it argued, would not only be *similar to GATT safeguard provisions allowing countries to take emergency actions* in trade matters (01: ch. VI), but it would also be *in entire harmony with the spirit of bankruptcy laws, the binding force of which is recognized by all civilized nations*[4] (98: IX).

However, proposals of this kind *met with strong opposition from some of the major economic powers and market participants, who favoured voluntary arrangements between debtors and creditors*, and *governments in some debtor countries have also been reluctant to back this proposal for fear of impairing their access to international capital markets*. The TDR nevertheless insisted that *without statutory protection for debtors, the balance of power will continue to weigh heavily in favour of creditors* (01: VIII). In the same vein, some years later, it emphasized that *the international community should not abandon*

the idea of creating a mechanism aimed at speedy resolutions of debt crises and fair burden-sharing among creditors and debtors (08: XIII).

(b) Official debt relief

With regard to the difficulties of least developed and low-income developing countries in servicing their debts owed to official creditors, the TDR regularly reviewed the terms of debt reorganization by the Paris Club, the institution that handles the rescheduling of official debt owed mainly to OECD countries.[5] As the debt problems of many poor countries persisted, despite frequent adjustments of these terms in the course of the 1980s and 1990s, the TDR over many years advocated greater flexibility in the provision of debt relief provided to individual countries to restore sustainability of their remaining debt. In addition, it called for a widening of the eligibility criteria and a greater degree of concessionality on the remaining debt (88: IX, X and ch. III; 89: VII, X; 91: IV; 93: Part Three; 95: II).

However, it was only in 1996 that the G-8 finally recognized the need for a bolder approach to deal with the debt problems of the low-income countries. This led to the Heavily Indebted Poor Countries (HIPC) Initiative of the IMF and the World Bank, which began implementation in 1996. Although the TDR welcomed this Initiative as a major step forward, the analyses of its results in the subsequent Reports were rather sobering (96: ch. II; 97: II, 50; 06: 53, 54). In the years following the launch of the HIPC Initiative, the TDR became increasingly critical of the slowness of its implementation, the limitations of its coverage and the conditionalities attached to the provision of debt relief (06: ch. II). Moreover, the TDR pointed out that the Initiative ignored the problems of many countries in servicing their increasing debts owed to the multilateral financial institutions (96: ch. II; also 93: X; 95: II). It saw debt relief not only as a solution to a financial problem, but also as an instrument for launching a process of sustained development. It therefore advocated the inclusion in the HIPC of all poor countries, no matter what their level of indebtedness, as well as the provision of debt relief to developing countries that are not eligible under the HIPC initiative but which have an unsustainable level of debt (08: XI: also 99:X).

It took until 2005 before the G-8, in an attempt to give *an additional push to resolve the debt problem of the poorest countries*, announced the Multilateral Debt Relief Initiative (MDRI), whereby multilateral financial institutions undertook to cancel the entire debt of countries that had fulfilled the requirements for full bilateral debt relief under the HIPC Initiative (06: ch. III).

However, in the TDR's assessment, *the sustainability of the external debt situation remains highly vulnerable to shocks, and the fallout of the global economic crisis since 2008 is again impairing their ability to service their external debt without compromising their imports.* TDR 2009 therefore recommended that *a concerted multilateral effort to increase bilateral aid flows* and *a temporary moratorium on official debt repayments* be *integrated into fiscal stimulus packages* undertaken in donor countries (09: VII).

4.4.5 Reform of the exchange-rate system

In light of the shortcomings of prevailing exchange-rate arrangements, there was repeated discussion of the need to fill the institutional gap left by the breakdown of the Bretton Woods system. Various TDRs offered proposals aimed at achieving greater exchange-rate stability and avoiding misalignments that lead to current-account imbalances. In 1984, the TDR recalled that under the Bretton Woods system the *monetary arrangements embodied in the IMF were founded on the principle that exchange rates should not be influenced by speculative pressures. Par values were not to be defended at the cost of unreasonably high unemployment but could be adjusted to correct a fundamental disequilibrium. More important was the determination of the members of the IMF to eschew recourse to exchange rates as an active instrument for obtaining full employment. In brief, the monetary arrangements sought to ensure that exchange rates reflected countries' underlying competitiveness in trade as well as to prevent these rates from being disrupted by private capital movements or "beggar-thy-neighbour" policies* (84: 3). But TDR 1990 also underlined the need to avoid the mistakes of the Bretton Woods regime by providing sufficient flexibility to allow exchange rates to adjust to changes in differentials in inflation and productivity growth (90: 133).

That TDR also suggested that governments should *commit themselves to defend a publicly announced*

pattern of exchange rates, which should be internationally agreed and compatible with high levels of activity and employment (90:XII). Regarding exchange rates among the major reserve currencies, it specifically recommended an arrangement similar to that practiced at the time in the European Monetary System, with adjustable pegs, predefined obligations and intervention rules. Such a system, the Report added, should be complemented by strengthened multilateral surveillance and coordination of the policies of the major industrialized countries (90: Part Two, ch. I). Noting that there was no serious discussion on how the IMF might help rebuild a stable exchange-rate system among the G-3 currencies, TDR 2001 reiterated these recommendations by endorsing the idea of formally established target zones (01: 66).

Regarding exchange-rate arrangements in developing and emerging economies, TDR 1998 (ch. IV) emphasized that currency stability should not be sacrificed in the interest of free capital mobility. It repeated its earlier recommendations for managed exchange-rate regimes and the role of capital-account management techniques in support of exchange-rate stability. It noted that, if applied unilaterally, *managed exchange-rate regimes are vulnerable to large accumulations of short-term external debt and to other potentially volatile capital inflows. Such regimes are likely to be sustainable only if accompanied by active management of external liabilities, which may often entail recourse to capital controls* (98: X, XI). And even then, the capacity of small and open economies to stabilize their exchange rates are quite limited, especially when, in crisis situations, there is a threat for the currency to depreciate more than desirable for a stable current account (04: ch. IV).

From the perspective of TDR 2001, the 1990s had produced ample evidence that even with the best management of their exchange rates, *developing countries cannot unilaterally ensure appropriate alignment and stability of their exchange rates as long as major reserve currencies are subject to frequent gyrations and misalignments and international capital flows* [are prone] *to large swings beyond the control of recipient countries* (01: VII, VIII).

In 2004, the TDR recalled that one condition for successful integration of developing countries into the world economy is that those countries should be *able to manage their exchange rates in a way that allows them not only to sustain competitive rates over the longer term, but also to retain enough policy space to be able to make orderly adjustments when faced with exogenous shocks* (04: VII). On the other hand, *attempts by many countries to keep their currencies at an undervalued rate may end up in competitive devaluations, which can be disastrous for the world economy, as the experience of the 1930s has shown* (04: IX). Since exchange-rate movements can affect international trade in a similar way as trade policies, the TDR called for a framework of multilateral oversight and disciplines similar to those governing trade in agreements of the WTO as the most appropriate solution to this problem (04: 132; 07: V; 08: VI).

Based on this line of reasoning, it proposed the creation of a multilaterally agreed framework for exchange-rate management that would focus on stability of the real exchange rate at a level that is consistent with a sustainable current-account position. The pattern of nominal exchange rates would, in principle, be determined according to purchasing power parities. Subsequently, nominal exchange rates would be systematically adjusted according to differentials in unit labour costs or central bank interest rates (11: ch. VI). The TDR based this concept on the precedents of the Bretton Woods system and the European Monetary System, where *the implicit rule was that the exchange rate of a national currency with the international currency was determined by the purchasing power of that currency expressed in all other currencies*. It acknowledged that *this rule may be difficult to introduce at the time the system starts, because of the problem of determining the initial purchasing power parities of each currency, but it would be straightforward and simple once the system is on track.* It also recognized that *some additional criteria may need to be applied that reflect structural features related to the level of development of different countries* (09: XII).

Such a multilateral system, the TDR argued, would

- Curb speculation and destabilizing capital flows at their source, because the main trigger for currency speculation is the inflation and interest rate differential. Higher inflation and higher interest rates would be compensated by a devaluation of nominal exchange rates, thereby reducing the scope for gains from carry trade.
- Help prevent fundamental and long-lasting trade imbalances and subsequent debt traps for

developing countries, as real exchange rates would be more stable.

- Imply symmetric intervention by countries facing strong depreciation pressure and those facing the corresponding appreciation pressure. Countries would automatically receive financial assistance through swap agreements or through symmetric intervention.
- Reduce the need to hold international reserves to defend exchange rates, and this could be combined with a stronger role for special drawing rights (SDR) if allocations were made according to a country's need for international liquidity to stabilize its real exchange rate at a multilaterally agreed level.

Such a system would be able to achieve sufficient stability of the real exchange rate to enhance international trade and facilitate decision-making on fixed investment in the tradable sector; and it would be sufficiently flexible to accommodate differences in the evolution of interest rates across countries.

4.5 Coherence in global governance

The counterpart to the concept of interdependence as an analytical approach is the notion of coherence. It relates to:

- Coherence in the design of national policies across countries, which requires coordination of national macroeconomic policies and international policy surveillance (section 4.4.1 above);
- Consistency between national policies and international arrangements, especially with regard to trade relations (sections 4.2.1 and 4.2.2); and
- Coherence in the assignments and performances of international institutions, especially with regard to trade, on the one hand, and monetary and financial relations on the other.

With regard to the notion of a "global partnership for development" and coherence in development policy, TDR 2004 noted that *a feasible development agenda requires a more complex analytical and policy framework than that offered by the 'openness model'. A fundamental question is how to reinforce coherence between national development strategies and global processes and disciplines, as well as policy coherence among and within the various sectors of the global economy that impact on development prospects of developing countries* (04: VI and ch. IV).

In this context, the TDR has frequently raised the issue of the loss of policy space for governments of developing countries in pursuing their national development strategies. To the extent that such loss results from international commitments made in the area of trade, TDR 2006 pointed to an asymmetry in their effect on countries at different stages of development as *multilateral rules and commitments governing international economic relations are, in legal terms, equally binding on all participants, but in economic terms they are biased towards an accommodation of the requirements of the developed countries*. Therefore *an appropriate balance between national policy space and international disciplines and commitments requires strengthening the development dimension in the multilateral trading system* (06: XX).

Regarding coherence in the operation of international institutions, the TDR reckoned, as early as 1988, that *if market forces are to operate effectively in international trade, a greater degree of international monetary and financial cooperation will be required* because of the impact on trade relations of *speculative behaviour on foreign exchange and other financial markets* (88: I, XIV). Especially wide fluctuations of exchange rates that have characterized the world economy since the mid-1970s *lent support to the notion that exchange rate instability has a ratchet effect on protectionism* (88: XIV). Six years later, the Marrakech Declaration[6] indeed emphasized the need for greater global coherence of policies in

the fields of trade, money and finance. However, subsequently no major reforms were undertaken in this regard. This caused TDR 2004 to reiterate that *existing modalities in the multilateral trading system do not address the problems of trade performance that originate in the monetary and financial system. There are no mechanisms under the existing system of global economic governance for dispute settlement or redress regarding these impulses*.

As a possible solution, the TDR proposed for the trading regime, *a review of the balance-of-payments provisions of the GATT* (04: IX). But it also pointed to another asymmetry in global economic governance, namely that, *contrary to the existing institutional structure in international trade, current international monetary and financial arrangements are not organized around a multilateral rules-based system that applies a specific set of core principles to all participants. This asymmetry has particularly strong adverse impacts on developing countries, because self-centred national monetary and financial policies can have much more damaging effects than those caused by trade and trade-related policies* (06: XX).

Thus, in qualitative terms, and from the perspective of development, the scope of multilateral disciplines in the current pattern of global economic governance appears to be too narrow in the area of international monetary and financial relations, but may well be too broad in the area of international trade. This is so because the rapid pace of globalization in monetary and financial relationships has not been accompanied by an equally rapid change in multilateral monetary and financial rules and disciplines (06: XX). The introduction of multilaterally agreed rules for exchange-rate management, as proposed in recent TDRs would thus help to strengthen coherence between the international trading system and the international monetary system.

Given the problems created by unstable commodity prices for capital formation and diversification in commodity-dependent economies, the TDR also suggested that *the global economic system would gain greater coherence if new efforts were made at the multilateral level to control price fluctuations on international commodity markets* (08: IV, V).

Another aspect of coherence in global governance is the influence of countries at different stages of development. The governance arrangements in the international financial institutions still reflect, for most part, the constellation in the world economy of the early 1950s. This is why, since the beginning of the new millennium, the TDR has strongly supported the claims of developing countries for *much greater collective influence in the multilateral financial institutions and on their decision-making practices.* However, as consensus has often been lacking among these countries on several issues of the reform agenda, it also stressed that *effective reform of the international monetary and financial system will ultimately depend on the willingness of developing countries to organize their efforts around common objectives* (01: X).

5. DEVELOPMENT STRATEGIES: ASSESSMENTS AND RECOMMENDATIONS

5.1 Introduction

Although the international environment for development has been the main recurring theme of the TDR, since 1992 the Report has also paid greater attention to issues relating to national development strategies.[7] This has been in line with the growing interest in identifying the reasons for the widening discrepancies in the development experiences of different countries and regions. In analysing both success stories and failures, the TDR has pursued the objective of identifying ingredients for development strategies that have the potential to advance economic and social development in countries with widely varying characteristics.

Much of the discussion of the TDR was defined by its critical assessment of structural adjustment programmes (SAPs) and policy reforms based on the Washington Consensus and by a comparison of the development experiences of East Asia and other regions. More recently, the experience of China and the consequences of the Chinese development strategy for the options of other developing countries have received greater attention. This section first reviews the TDRs' analyses of the development strategies pursued by different countries and the lessons that can be drawn from various experiences. This is followed by a review of the TDRs' main recommendations for policies promoting industrialization, structural change and strategic integration into the world economy.

5.2 Lessons from three decades of development experience

5.2.1 Shortcomings of structural adjustment and the Washington Consensus

The 1980s and 1990s were shaped by a radical shift in development thinking and practice in the wake of the debt and development crisis of the 1980s. As the TDR put it, from the perspective of 1999, *for many, the crisis was final proof that inward-oriented growth strategies and interventionist policies could not extract developing countries from the mire of poverty and underdevelopment. Thus, in the second half of the decade, a powerful consensus was forged around "getting prices right"* (99: V).

The new policy approach looked to liberate enterprise from state intervention [in addition to correcting price distortions], *deferring to the invisible touch of global market forces* (03: I), thereby preparing the ground for a recovery led by private investment.

Trade liberalization was expected to improve resource allocation based on comparative advantage and boost export revenues. Financial liberalization was undertaken in order to attract foreign capital seeking high returns in capital-scarce countries. Moreover, it was hoped that *a bigger flow of foreign direct investment would further accelerate growth not only by supplementing domestic resources for capital accumulation, but also through transfer of technology and organizational skills* (99: V; also 93: IV). The swing to the free market philosophy took place *at an amazing speed* in Latin American countries that were especially hard hit by the debt crisis of the early 1980s, but it was also rapid in Africa (93: Part Two, chs. II and III).

The Bretton Woods institutions played a dominant role in the dissemination of this policy approach, both as lenders, imposing their policy conditionality on borrowing countries, and as "think tanks" with a major impact on the international policy debate. The Washington Consensus approach also shaped the economic thinking of elites in many developing countries, notably in Latin America. As a result, the principles underlying the reform agenda shaped development strategies in the 1980s, 1990s and into the new millennium in large parts of the world (06: ch. II).

From the beginning, the TDR adopted a critical attitude towards these reforms, grounded in the recognition that *practically no country that has modernized in recent decades has pursued purely market-oriented financial policies* (91: VI). The TDR was especially concerned with the drop in the share of investment in the first half of the 1980s – seen by the World Bank as an "investment pause" – and its slow and incomplete recovery thereafter (89: Part One, ch. IV; 93: Part Two, chs. II and III; 03: VI). It compared the new strategies with those chosen by several countries in East and South-East Asia that had been much less affected by the debt crisis of the early 1980s and did not embark on the new development paradigm with the same enthusiasm as others.

The recovery in Latin America in the early 1990s at a time of global recession was seen by many observers as an indication of the success of the reforms. However, TDR 1993 again warned against interpreting this as *proof that "root-and-branch market-orientation" provides a sure recipe for recovery and sustained growth regardless of the external trading and financial environment* (93: III). The Report observed that the recovery was *generally driven by consumption rather than investment*, and relied on large inflows of private foreign capital (93: V). It related the latter partly to the success of the Brady Plan (see also section 4.4.4 above), which had *opened the floodgates to foreign capital*, the return of flight capital, and increasing FDI in connection with privatization, which was a major element of SAPs.

The problem, according to TDR 1993, was that these capital inflows did not translate into sufficient new private investment for strengthening and upgrading production and export potential. It attributed this to an unfavourable *configuration of interest rates and exchange rates* and reduced public investment. It even went further by warning that *if the configuration is not improved in time there may be payments crisis later* (93: V), which indeed turned out to be the case a little more than a year later. Most observers and market participants were taken by surprise when new financial turbulence engulfed Latin America following a "shift of sentiment" in international financial markets after the collapse of the Mexican peso in December 1994. Since 1991, the TDR had frequently warned that the surge of capital flows to Latin America might be unsustainable and that the speculative character of much of those inflows made the region susceptible to a sudden reversal (91: Part One, ch. III; 92: annex II to Part Two; 93: Part Two, ch. III; 95: Part Two, ch. II). These predictions not only turned out to be correct, but the analysis of how fragility is created and how a crisis builds up also proved insightful by subsequent events: *An influx of capital in response to interest rate differentials shifts the mood of markets and encourages a further influx, which then acquires further momentum by putting upward pressure on the exchange rate, thus enlarging opportunities for profitable arbitrage* (93: V; also 94: II, 95: III).

While most observers believed the 1994-1995 crisis in Latin America (and several that were to follow in emerging markets) was due to "slippages in implementation of an outward-oriented strategy", the TDR asserted the crisis was due to *the economic strategy itself*, notwithstanding the fact that it *had received the blessing of the international community: 'big bang' liberalization of trade and of the capital account led to a sharp increase in their import propensity, but exports failed to keep pace, with the notable exception of China* (99: V–VII).

In 1999, the TDR observed that *after more than a decade of liberal reforms in developing countries, their payments disorders remain as acute as ever and their economies depend even more on external financial resources*. It found that growth rates were even lower than before the radical policy change, while many countries' external deficits had worsened. Moreover, *where trade balances have improved, there has generally been a slowdown in economic growth* (99: VI). In 2003, the TDR noted that in Latin America this trend had been accompanied by a premature trend towards "deindustrialization", as indicated by a declining share of manufacturing value added in total output (03: VII).

The Report's criticism of SAPs in Africa, where investment and growth performance were also disappointing, was as harsh as that of the Latin American programmes, although with some nuances (98: Part Two). Since most African countries did not attract private capital flows, they were less affected by financial instability than Latin America. But, since the agricultural sector still plays a much greater role in African economies, the TDR signalled that any harm done to the functioning of this sector could have more far-reaching consequences than elsewhere, as was sadly confirmed with the food crisis in and after 2008. TDR 1993 also highlighted a deterioration in the external environment for African development, with falling commodity prices and insufficient official lending and ODA to compensate for the loss of foreign exchange earnings*: losses on the terms of trade have been a multiple of the aid increment* (93: VI).

The Report never left any doubts about its critical view of the standard policies undertaken under SAPs and, later, the Poverty Reduction Strategy Papers. The supply-side and "leave it to the markets" credo of these policies, in the TDR's opinion, overemphasized efficiency increases by altering resource "allocation" at the expense of "accumulation". The latter would have required a different macroeconomic policy stance altogether and greater intervention in favour of real productive investment, especially in potentially dynamic sectors (93: 110; 03: ch. IV).

The TDR even showed that the policy prescriptions of the new agenda undermined growth by rendering the macroeconomic and financial environment hostile to corporate investment. The liberalization of capital flows, a key element of the outward-oriented strategy, *led to currency appreciations and instability, thereby undermining trade performance*, while *a growing proportion of net private capital inflows is absorbed by activities which add little to productive capacity* (99: VII). [Moreover,] *the policy choices and institutional reforms designed to remove state-induced distortions have weakened long-term growth prospects. The policy reforms have been unsuccessful because the "creative" element of Schumpeter's process of "creative destruction" has failed to bring about real transformation of the productive structure through higher investment and technological change* (03: XI).

In 2003, the TDR conceded that Washington-Consensus-type policies were successful inasmuch as they brought inflation under control and led to greater monetary and fiscal discipline (03: ch. VI). However, it found that *the experience does not support the underlying logic of the new policy approach, namely that an import-substitution growth strategy could effectively be replaced by a market-driven, outward-oriented strategy simply by eliminating inflation, downsizing the public sector, and opening markets to foreign trade and capital* (03: XI). It maintained that the reform agenda had overlooked the importance of aggregate demand, real interest rates and real exchange rates.

TDR 2010 recalled that in the 1980s and 1990s, development strategies in most countries had relied heavily on exports to drive expansion of their formal modern sectors. These strategies were unsuccessful in many countries because the supply capacities and competitiveness of domestic producers on global markets were inadequate owing to insufficient capital accumulation. In other countries these strategies created pressure to keep wages low, so that the domestic labour force did not share in the productivity gains. To a large extent, these gains were passed on to lower prices in order to increase the competitiveness of the labour-intensive tradable goods sectors. However, as a consequence, domestic demand stagnated, employment problems persisted, or even worsened, and inequality increased (97: ch. III; 10: ch. IV).

The legacy of insufficient capital accumulation due to inconsistencies of macroeconomic, trade, FDI and financial policies continued to weigh on many countries even into the new millennium, although their performance in terms of exports, growth and employment creation improved after 2002. But rather than interpreting this improvement as a late harvest

of the market-oriented policy reforms, the TDR suggested it was due to faster growth in the developed countries, especially rapidly rising net imports by the United States, and higher primary commodity prices.

Moreover, TDR 2010 considered *more accommodative monetary policies and an exchange-rate policy that aimed at preserving international competitiveness,* which it had been advocating for many years, as important factors for faster growth. It also pointed out that several countries took specific measures that represented a diversion from the paradigm of labour market flexibility, such as *sizeable rises in the minimum wage, the reactivation of collective bargaining bodies and the launching of public works programmes.* Such measures were found to have contributed to a significant fall in informal employment and unemployment, and poverty until 2008 (10: VII).

5.2.2 The East Asian development experience

In the 1980s and much of the 1990s East Asia stood out as the bright spot in the development landscape. But while many observers sought to interpret this success as the result of liberalization and market forces, the TDR focused on the policy strategy behind that success.

A study by the World Bank (1993) presented a distorted picture of the experiences of the newly industrializing economies (NIEs) of East Asia, explaining their success on the basis of traditional economics and market forces while overlooking the high degree of selective intervention by their governments, especially in the larger economies. Several issues of the TDR, on the other hand, identified various institutional and policy arrangements that had made the difference. They showed that the "East Asian miracle" was not due to market forces alone, but also to extremely effective government intervention (94: Part Two, ch. I; 96: Part Two, chs. I and II; 97: Part Two, ch. VI). The State had played a very active role in directing the process of structural change and industrial upgrading: *Government intervention in Japan, Republic of Korea and Taiwan province of China was designed to counteract a number of factors that typically limit the capacity and willingness of individual firms in developing countries to undertake long-term investments and modernize their methods of production and organization. It was directed at accelerating the pace of both growth and structural transformation, by changing the composition of industry through rapid capital accumulation, and by increasing the dynamism and efficiency of the industrialization process as a whole. It sought to make profitable sectors and activities which would not have been attractive to investors in a regime of laissez-faire, but which could be expected in due course to be able to withstand international competition. And it sought to stimulate the "animal spirits" of investors, strengthen their confidence, lengthen their time horizons, coordinate their expansion plans, and enlarge their command over resources* (94: VI, VII).

TDR 2003 summarized the reasons for the greater success of the strategies pursued in East Asia compared with the policies pursued in Africa and Latin America as follows: Opening-up to international trade took place in a more stable macroeconomic environment with a rising share of investment in GDP. *The regional peak of 30 per cent of GDP was surpassed in a number of countries, in some cases by a considerable margin. Investment in machinery and equipment along with expanding construction in physical infrastructure were important features of East Asian investment. This improvement in overall investment was in most cases associated with a stable or rising share of public investment with strong crowding-in effects* (03: VI). Whereas some interpretations of the East Asian experience highlighted the benefits of rapid liberalization of foreign trade and finance and deregulation of domestic markets, while reducing the role of the State, the TDR found: *No doubt, competition in foreign markets has exerted an important discipline over enterprises, thereby promoting efficiency. However, the principal rationale for the strategy of export-oriented industrialization that these countries pursued has been different. Initially they had no significant capital goods sector and produced mainly consumer goods. Exports, together with some limitation of imports of consumer goods, allowed domestic industry to expand without a corresponding growth in domestic consumption, and provided the foreign exchange needed for capital goods imports and access to advanced foreign technology. While success in raising investment depended crucially on export growth, export expansion in turn required new investment. Thus, rapid growth required mutually reinforcing dynamic interactions among savings, investment and exports* (96: VII).

In earlier issues, the TDR had already underlined the important role of strong government support to

private business and exports: *Some of the most outstanding performers industrialized using a panoply of controls and subsidized credit in favour of activities picked by the Government as having a potential for rapid productivity gains, including heavy industries* (93: IV). Furthermore, through a selective approach to attracting FDI in support of infant industries and establishing close links with foreign firms, host countries gained access to the requisite technologies. Due to these policies, TDR 1996 commented, *successful export orientation was accompanied by structural changes, from resource-based to labour-intensive, and subsequently to technology-intensive, production and exports, especially to the fastest growing northern markets* (96: VII).

But the TDR also recognized problems that emerged in East and South-East Asia in the 1990s. It observed that these countries were running higher deficits in the 1990s than in the 1980s without achieving faster growth, and that they were not undertaking financial and capital-account liberalization in the same deliberate manner as trade liberalization before. As a result, they had become more vulnerable to external financial shocks. As early as 1994, the Report warned that East Asia was becoming a destination of *hot money* and that *a bandwagon in financial or currency markets might prompt a reversal of such capital flows* (94: II). Indeed, large inflows of speculative capital and overvaluation of the real exchange rates, with attendant effects on current-account balances, triggered what came to be known as the Asian financial crisis in 1997–1998. The crisis led to a dramatic fall in GDP growth rates in a number of countries, but it also prompted a rethinking of the policies that had led to the crisis and the policies that would be necessary to reduce their vulnerability to future external shocks (06: V).

5.3 TDR recommendations for development strategies

Many of the TDRs' recommendations have derived from lessons drawn from the successful experiences of several Asian countries that managed to catch up with the developed countries – and from experiences in these latter countries themselves. But at the same time, the TDRs have cautioned against simply replicating their development strategies. While certain principles underlying those strategies might be universally valid, in practice, each country would have to tailor its development strategy to its own specific historical, cultural and institutional background. For many countries, raising income levels and creating productive employment for a growing population would require them to reduce their reliance on primary commodities, while for others it would necessitate increasing the domestic value-added components in their manufacturing sectors. Thus, benefiting from the opportunities of participating in the international trading system requires different strategies at different stages of development (02: ch. III). The TDR also noted the diversity of experiences among the Asian countries themselves, in particular between the so-called first- and the second-tier NIEs, which demonstrates that there is no single, universally applicable model, but a range of options available to other developing countries (96: VI).

Moreover, the design of development strategies has to take account of the changing international context for development. On the one hand, developing countries have fewer policy options for outward-oriented strategies; on the other hand, new market opportunities have arisen.

Nevertheless, referring to historical experience, the TDR emphasized two elements that are common to practically all successful development strategies. First, *establishing a broad and robust domestic industrial base holds the key to successful development because of its potential for strong productivity and income growth* (03: VII). Key factors in this context are the establishment of a nexus between profits and investment, and exports and investment, along with government intervention in businesses

in selected sectors in support of structural change. Second, an active management of integration into the global economy is indispensable for modern industrialization and development. This should be guided by a sense of pragmatism rather than ideology: liberalization of trade and international capital flows should not be considered as objectives in their own right, but as instruments for development that are part of a broader development and growth strategy. The two elements need to be linked through measures that channel capital inflows and profits from exports to domestic capital accumulation (96: VI; 06: VI).

5.3.1 Domestic policies in support of industrialization and structural change

(a) Industrialization and the profit-investment nexus

Regarding the creation of a domestic industrial base, the TDR underlined the importance of *a strong and sustained investment drive by national elites, often from very low levels,* which *has been a defining feature of successful development episodes* (03: VI). In order to reach what the TDR suggested as a target threshold of investment – 20 per cent of GDP in poorer countries, rising to 25 per cent as countries climb the income ladder – it maintained that continuing efforts would be needed *to ensure a pro-investment policy regime through an appropriate mix of macroeconomic and market pressures and incentives* (02: XI). Several TDRs, in particular the 1997 issue (Part Two, chs. V and VI), have elaborated on the important role of profits for growth dynamics: *What distinguishes late industrializers from other developing countries is the high animal spirits of their business class, reflected in exceptionally high rates of saving and investments from profits*. The establishment of a profit-investment nexus was therefore considered key to successful structural transformation and output growth. However, TDR 1997 argued that such a nexus would not normally emerge spontaneously, even if basic conditions such as political stability were secured and property rights guaranteed: *Policies must be actively pursued that are designed to provide incentives to private firms to retain profits and invest them in the enhancement of productivity, capacity and employment. Fiscal instruments, both taxes and subsidies, can be important tools in this respect. But there is also an array of trade, financial and competition policies that can help raise profitability and investment in key industries above what might be attained under free market conditions. Closing unproductive channels of wealth accumulation and discouraging luxury consumption are essential ingredients of such a strategy* (97: VII).

In addition to favourable monetary and financial conditions, and pressures and incentives from market forces, the right interventions and well-targeted incentives by governments play a crucial role in influencing the pace and direction of diversification and industrial upgrading. Domestic and external environments conducive to increasing export earnings are important; but what matters even more in the industrialization process is the stimulation of a *dynamic interaction between exports and investment* (96: VI).

An export-investment nexus results when profits earned from exports lead to higher investment through (a) reinvestment of such profits, (b) stimulation of additional investment in the profitable export sectors, (c) stimulation of investment in other domestic industries through linkages with the exports sector, and (d) investment of fiscal revenues from export activities in education, health and infrastructure (02: XI; 05: IX). These, in turn, will enable higher and, over time, more sophisticated production for both export and domestic markets.

In this context, the distribution of commodity rents received increasing attention with the rise of primary commodity prices between 2003 and 2008. For many developing countries this rise led to considerably higher export earnings. However, the TDR found evidence that in many cases, especially in the oil and gas and mining sectors in Africa and Latin America, these higher earnings in the commodity sector did not translate into commensurate increases in domestic income and government revenues. According to the TDR, this was because of a *large share of the gains from the higher prices that have gone into profit remittances* and because of a policy, since the early 1990s, of attracting FDI through the provision of fiscal incentives (08: V; 05: IX). To the extent that commodity rents go into profit remittances *they are lost for capital accumulation in the country where they originate, unless they are reinvested by the foreign companies. But the latter may often not be in the interest of the exporting country either because,*

rather than contributing to diversification and industrial upgrading, such reinvestment in the same activities tends to perpetuate commodity dependence (08: V).

Since it is not only the level of investment but also its structure that matters for the upgrading of economic activity, one of the distinctive features of the TDR has been its long-standing advocacy of proactive industrial policies adapted to different stages of development and to new opportunities for economic progress (92: VI; 03: XII). In this regard, the TDRs' view contrasted, at times sharply, with the view of other international organizations, especially the IMF and World Bank, regarding industrial policy. These other institutions asserted that, all government intervention that aims at directing the development of private economic activities leads to distortions and should be avoided because it prevents market forces from behaving in the way that abstract models suggest. But the divergent experiences of developing countries studied in the TDR had made it clear that *exclusive concentration on allocative efficiency implies a lack of sufficient attention to stimulating the dynamic forces of markets which underlie structural change and economic growth,* and that *industrial policies were an important supportive factor for East Asia's economic catch-up as well as for industrialization in today's mature economies* (06: X). Accordingly, the TDR advocated an industrial policy aimed at *strengthening the creative forces of markets and related capital formation* by helping private firms to *solve information and coordination problems arising in the process of capital formation* and by *translating cumulative production experience into productivity gains* (06: X, XI).

Several issues of the TDR discussed industrial policy in some detail. For example, TDR 1992 highlighted the importance of industrial policy to support the learning process of companies, especially where new products and markets are involved (92: VI). TDR 2009 summarized the discussions in earlier reports of elements of policy aimed at promoting innovative investment and achieving international competitiveness in increasingly sophisticated products: *A successful industrial policy may comprise, among other elements, public sector engagement in R&D, simplifying access to patents, fiscal and financial support for new production activities, information dissemination, and FDI policies that favour integration into international production chains. Government procurement can also have an important impact* (09: XV). New forms of industrial policy may include supporting private businesses in their efforts to engage in international trade by helping to identify the most promising ways and the most dynamic product groups, especially in connection with international production-sharing arrangements of transnational corporations (TNCs).

TDR 2002 examined the possibilities that had opened up for industrial latecomers through participation in labour-intensive segments of international production networks. Such networks had been established either within large TNCs, or through international subcontracting of groups of smaller enterprises. The TDR suggested that these had widened the possible range of sectors where industrialization could begin. Although participation in these segments may generate a relatively small increase in value added, it could *yield considerable benefits for countries in the early stages of industrialization.* It would generate employment for low-skilled surplus labour and allow the acquisition of *basic techniques and organizational skills, which are prerequisites for more broad-based growth* (02: VII).

Foreign direct investment can play a potentially important role in industrial strategy. In this regard, the TDR always emphasized that the actual benefits of FDI depend on how well the profit interests of TNCs are reconciled with public interest in developing countries. To be beneficial for the public, FDI needs to contribute to creating employment, raising domestic value added and export earnings, and broadly supporting domestic industrialization through the transfer of technology and organizational skills.

In the 1980s and 1990s many developing countries attracted FDI through fiscal incentives, and often through extensive privatization initiatives (93: ch. III). But in African and Latin American countries, the increase in FDI flows did not accelerate growth to the extent expected (99: ch. V). TDR 2003 pointed out that the strong growth of FDI flows to developing countries in the 1990s largely reflected mergers and acquisitions (rather than greenfield investments). *Much of this merger activity was in service sectors, and has the potential to add to payments difficulties* (99: VII). Another important share of FDI went into the mining sector, and thus *tended to shift the production structure away from sectors with the greatest potential for productivity growth* (03: IX).

Due to the mixed experience with FDI as a vehicle for development, the TDR favoured a selective approach to such investment, following the example of several successful NIEs (96: VII; 02: XI; 03: XII; 06:XI). It emphasized the need for *a well-devised approach to FDI* as part of *targeted trade and industrial policies* (02: XI; also 06: XI), and cautioned against placing too much emphasis on FDI in development strategies. Increased competition among developing countries to attract FDI in the labour-intensive segments of international production networks often leads them to offer ever greater fiscal incentives and other concessions to TNCs, resulting in a "race to the bottom". To avoid this, TDR 2005 suggested that potential host countries of FDI *cooperate in the formulation of some generally agreed principles relating to the fiscal treatment of foreign investors*. The Report saw the upward trend in world market prices of fuels and mining products as an *opportunity to review the existing fiscal and ownership regimes,* where there was evidence that incentives provided in the past may have been excessively generous or where they were no longer necessary for motivating FDI (05: IX).

The TDR clearly adopted a position favouring proactive State involvement in shaping the development process over a laissez-faire approach on the grounds that markets alone, especially in developing countries, are unable to produce outcomes that reflect the social and economic interests of development and structural change. It is, however, also important to note that the TDR, while insisting that markets alone could not be relied upon to promote faster growth and prosperity in developing countries, did not propagate a *false ideology of State infallibility*; rather, it acknowledged that in developing countries *instances of misdirected interventionism* had not been infrequent, and that intervention did not always lead to desirable outcomes (91: VI; 98: XV). But in such cases the challenge for governments, supported, where necessary, by international organizations, should be to improve intervention mechanisms rather than abandon them altogether, and adjust intervention in line with the maturing of markets.

(b) The role of monetary conditions and domestic finance

The TDR frequently stressed the need for particular attention to the conditions for the financing of investment in productive capacity, and for continuous upgrading in line with technological possibilities and market demand. The importance of strengthening domestic finance as a central element of any development strategy has been emphasized in various TDRs since the early 1990s. The Report considered it more important for developing countries to improve their own financial systems than to rely on external financing for investment, and to design appropriate monetary and financial policies in the context of integration into the international financial system. *Finance must serve industry and commerce – not vice versa. It must therefore not be allowed to become too costly or uncertain for business*. Reliable domestic sources of affordable long-term finance were seen as a precondition for promoting dynamic entrepreneurship and for enabling business firms to operate with longer time horizons that enable "learning by doing" (91: VI).

According to the TDR, domestic conditions for the financing of investment in productive capacity depend on three elements: first, a monetary policy that keeps the cost of finance low; second, strengthening the domestic banking system and the role of governments in the allocation of credit; and third, regulation of the domestic financial sector.

Regarding monetary conditions, the TDR observed that in the cases of successful industrialization in East Asia, policy interest rates in the 1980s and 1990s generally had been slightly higher than the rate of inflation but lower than real GDP growth rates. By contrast, they were higher than GDP growth rates in most African and Latin American countries, where investment ratios and growth rates remained low. As observed in TDR 2008: *When interest rates are too high, they have a negative impact on the most important sources of financing for investment: company profits and bank credit* (08: VIII).

Maintaining low and stable interest rates is facilitated when a high degree of flexibility of monetary policy is retained by appropriate exchange-rate arrangements and capital-account management, and by using additional instruments, such as fiscal and income policies, to ensure domestic stability.

TDR 2008 also noted that self-financing from retained earnings is the most important and most reliable source for financing private investment (08: VII; also 95: III), thereby reiterating the importance of establishing a profit-investment nexus, which had been discussed earlier in TDR 1994 (Part Two, ch. I).

It is very important that a substantial part of firms' earnings be reinvested in productive capacity, rather than being used, for example, for luxury consumption or speculative activities (08: VII). Therefore, measures that increase the liquidity of firms and encourage the retention of profits may help to spur investment (08: VIII). Such measures had played an important role in East Asia, as discussed in TDR 1997 (ch. IV).

In addition to financing from retained profits, bank financing is particularly important, since the banking system is the link between liquidity-creating monetary institutions and the real sector: *To the extent that investment can be financed by the banking system, which has the power to create credit, depending on the amount of liquidity provided by the central bank, the prior existence of savings balances in the financial system is not a prerequisite for investment* (08: VIII; see also section 3.2 above). However, in 1991 the TDR had remarked that in most developing countries private financial institutions cannot be relied upon for the financing of investment in productive capacities. They are mostly *weak or even absent, while business firms tend to be under-capitalized* (91: VI).

Comparing the "Anglo-Saxon" and the German/Japanese model of financing, the 1991 Report concluded, that *most developing countries have more to gain by improving the banking system and by upgrading the quality of government intervention* in the allocation of finance than by creating equity markets (91: VII). In many countries, although it was hoped that opening up to foreign banks would lead to improvements in the banking sector, domestic financial systems mostly remained weak throughout the two subsequent decades. TDR 2008 observed that in most developing countries *new, innovative and small enterprises, in particular, often encounter severe financing constraints even when they are able to pay high real lending rates. Therefore, when developing countries with weak financial systems undertake domestic governance reforms, as frequently advocated, priority may need to be given to dealing with those institutional shortcomings that represent major obstacles to the provision of long-term credit for investment at reasonable interest rates* (08: IX).

Moreover, the 2008 report noted that *from the perspective of financing for development, it is not only the microeconomic profitability of an investment project that matters, but also the external benefits the project generates for the economy as a whole* (08: IX, X). It recalled an observation already made in 1991, that in most countries which had undergone a successful process of industrialization *governments have improvised techniques consciously to direct credit* to sectors and activities that are strategically important for the economy as a whole (91: VI). Moreover, *public sector banks, particularly development banks, could play an important role in ensuring access of firms to reliable sources for financing productive investment* (08: IX).

Recurrent financial crises in emerging economies have confirmed what had already been noted in the early 1990s, namely that managing financial markets in order to ensure that they serve the needs of the real economy is even more important in developing countries than in the industrialized countries (90: XII). Therefore, the Report stressed that the expansion of domestic finance in developing countries should be accompanied by strong prudential regulations and effective bank supervision (91: Part One, ch. III).

5.3.2 Strategic integration

TDR 1997 acknowledged that the quality and quantity of investment could be improved through closer linkages with the world economy through trade and capital flows, including FDI. But it also underlined that *these external linkages must be complementary to, and not a substitute for, the domestic forces of growth through capital accumulation and technological capacity building. This can be achieved only through a carefully managed and phased integration into the world economy, tailoring the process to the level of economic development in a country and capacity of existing institutions and industries. Such a strategy contrasts sharply with the "big bang" liberalization adopted by some countries in recent years* (97: VII).

(a) Export-led growth and its limits

Policy reforms in the 1980s aimed at replacing import-substitution strategies by export-led growth. Yet the early TDRs, apart from drawing attention to the potential for increased trade among developing countries (83: Part Two), noted that the economic performance of developing countries could be improved by measures promoting the supply of domestic manufactures as substitutes for imports

(81: 5; 85: 14). Such measures would temporarily support and protect nascent industries from the overwhelming competition of more efficient producers in the developed world. Subsequently, as the idea generally gained ground that growth in developing countries could be advanced by relying more than in the past on exports, the TDR paid increasing attention to how national industrialization efforts could benefit from the opportunities offered by the world market. Later, the limits to export-led growth became more obvious, and the TDR suggested that developing countries may be well advised to rely to a greater extent on domestic markets.

These propositions are not contradictory. First, while the earlier import-substitution strategy focused on foreign exchange constraints and policies influencing the supply side, recent recommendations relate to policies that support domestic demand, especially in the context of wage policy. Second, several TDRs in the late 1990s made it very clear that *it is wrong to see export expansion and import substitution as mutually exclusive strategies* (98: 219). In the successful industrialization of East Asia *both were integral parts of a single strategy which aimed to accelerate investment and productivity growth in the long run and enhance the pace of innovation* (96: 130).

This reasoning was elaborated further in TDR 1999: *The success of fast-growing developing economies shows that an export push often followed the build-up of domestic production capacity for the replacement of imports. In view of the evidence that the import content of growth in developing countries is now an even greater constraint on sustained economic growth than in the past, a rethinking of this issue is an urgent necessity in many developing countries. All trade and industrial policies must be designed and implemented so as to reflect differences in levels of economic development, resource endowments and macroeconomic circumstances. In both export orientation and import substitution there are easy and difficult stages, and Governments must be ready to make timely shifts in the incentive structure as their economies graduate through different stages of industrial and economic development* (99: 131–133).

In the view of the TDR, industrial policy should be *complemented by a trade policy designed to achieve international competitiveness in increasingly more sophisticated products* (06: X, XI). The TDR has always fully acknowledged the potential benefits of trade for growth, but it has also called into question *across-the-board opening up to international markets*, which it considers unnecessary to reap such benefits. In its concept of *strategic trade integration,* it believes some temporary protection of selected nascent industries can be a key element of policies aimed at structural change (06: XI; also 02: VI). *Which production should receive industrial and trade policy support and for how long will depend on many factors, which are likely to change in the course of economic development* (06: XI).

However, the potential for enhancing structural change and growth in developing countries through international trade depends not only on domestic policies but also on the international context. The latter is determined by the level and pattern of external demand, as well as by competition from producers in other countries and the industrialization strategies pursued in those countries.

TDR 1996 considered that *in the presence of slower expansion of global demand, the simultaneous attempt by a large number of developing countries to push up exports that they are able to produce – i.e. mainly low-skilled, labour-intensive manufactures – could flood the market and significantly reduce world prices* (96: IX; also 86: 128). In 2002, the TDR analysed this problem in greater detail. It found that *excessive competition among developing countries in world markets for labour-intensive products and for FDI* had led to a tendency for *the prices of manufactured exports from developing countries to weaken vis-à-vis those of the industrial countries in recent years. Competitive pressures are further compounded by the way labour markets in developing countries accommodate the additional supply of labour-intensive goods through flexible wages, allowing firms to compete on the basis of price without undermining profitability. Competition among firms, including international firms, in developing countries becomes competition among labour located in different countries* (02: VIII, IX).

This reasoning was pursued further in subsequent Reports: *In any case, a strategy of export-led growth based on wage compression, which makes countries overly dependent on foreign demand growth, may not be sustainable for a large number of countries and over a long period of time. This is because not all countries can successfully pursue this strategy simultaneously, and because there are limits to how*

far the share of labour in total income can be reduced (10: IX).

Moreover, the TDR warned that between 2000 and 2008 export-oriented strategies had benefited from relatively fast growth in the industrialized countries, which in some of them (especially the United States) was connected with a growing trade deficit, as well as the emergence of China as a large importer from world markets. But owing to adjustments in the level and structure of demand that are likely to occur in these two large economies in connection with the rebalancing of the global economy, the outlook tends *to darken even for those developing and emerging-market economies that in the past successfully based their growth on an expansion of exports rather than domestic demand* (10: IX).

Against this background, the most recent issues of the TDR, pointing to limits on the potential of primarily export-oriented development strategies, have recommended *a rethinking of the paradigm of export-led development based on keeping labour costs low. Past experience and theoretical considerations suggest that a sustainable growth strategy requires a greater reliance on domestic demand than has been the case in many countries over the past 30 years* (10: I). Strengthening domestic forces of growth would require greater emphasis on raising domestic mass incomes through wage adaptation in line with productivity gains, rather than using productivity gains for lowering export prices to increase market shares on export markets. In this context, TDR 2010 emphasized that wages must not only be considered from the point of view of costs at the firm level but also from a macroeconomic perspective: they are the most important source for consumer demand and, ideally, should grow in line with productivity to create dynamic domestic demand (see section 3.8 above). In many developing countries, *productivity-enhancing and income-protection measures in agriculture* [are] *equally important*. TDR 2010 remarked that such measures have been used *in practically all developed countries for decades to enable agricultural producers and workers to participate in economy-wide productivity and income growth. This will require a revitalization of agricultural support institutions and measures to reduce the impact on farmers' incomes of highly subsidized agricultural products imported from developed countries* (10: XII). Such measures, it noted, can also help strengthen the capacity of small-scale entrepreneurs or the self-employed to invest in productivity-enhancing equipment.

(b) Integration into the global financial system

The TDR always recognized the importance of stable capital flows to developing countries as an instrument that could be useful for accelerating development and structural change. It enables countries to import more capital goods, and thus to boost domestic investment in real productive capacity. But it also expressed concerns about an excessive reliance on private capital flows because the behaviour of financial markets is strongly influenced by policies in the industrialized countries and by unpredictable changes in "market sentiment". Financial liberalization can bring benefits *provided that considerable industrial advance has already been achieved, and strong institutions and markets and competitive industries are in place*. It should be *undertaken gradually and without preventing the Government from pursuing an active industrial policy* (91: VII).

A rapid opening up of the capital account and overdependence on private capital inflows not only increases the vulnerability of the domestic economy to external shocks transmitted via the capital account; it also implies a number of important constraints on the autonomy of developing countries in the conduct of macroeconomic policy (see section 5.3.3).

With the accumulation of experience which demonstrated that higher inflows of private capital were not necessarily followed by higher rates of investment and faster growth, the TDR became ever more sceptical about external financing. In 2008 it argued that, *financing of domestic investment does not always require a current-account deficit – that is, a net capital inflow – provided that domestic monetary policy and the local financial system offer a favourable environment for long-term financing of private firms* (08: I; also 04: IX; 06: XVI).

In the wake of the Asian financial crisis in the late 1990s governments of many emerging-market economies were no longer convinced that *domestic monetary policies have to be geared to generating confidence in international financial markets* (06: V). This implied a change in policy objectives, with an emphasis on avoiding trade deficits and dependence on international capital markets and on IMF assistance when payments problems arose. Governments

also aimed at preventing an overvaluation of their exchange rates resulting from capital inflows and, through currency market intervention, they accumulated large amounts of foreign exchange reserves. Trade surpluses and private capital inflows that exceeded their external financing needs were used to repay outstanding debt or to accumulate foreign exchange reserves, which amounts to increasing official capital outflows. This change in strategy was very much in line with the scepticism expressed by the TDR in previous years regarding the potential benefits of opening up to private international capital markets and the unreliability of private capital flows as a source of development finance.

Reserve accumulation not only provided a cushion against the vagaries of international financial markets; it also avoided currency overvaluation and resulting current-account deficits, excessive credit expansion for consumption and speculation. TDR 1998 considered the "problems of cost and feasibility" of accumulating reserves for this purpose. It pointed to the possible costs for the economy as a whole, resulting from the fact that the rate of interest on foreign loans usually exceeds the return on foreign reserves. It also alluded to fiscal costs resulting from the sterilization of the monetary impact of reserve accumulation since the real interest on government debt typically also exceeds the return on reserves (98: 86).

However, later TDRs also recognized that these costs may need to be seen in comparison with the possibly much larger macroeconomic costs that could have resulted from the exchange-rate appreciation that would have occurred in the absence of currency market intervention (09: 123). According to the TDR, this strategy, which implied a more expansionary monetary policy, contributed to better growth performance in many emerging economies, especially in Asia and Latin America. It served not only to prevent a loss of competitiveness of domestic producers in the markets for internationally traded goods, but also to make the domestic financial sector more resilient to external financial disturbances, as evidenced before and during the global financial crisis that erupted in 2008 (08: VI; 09: II).

Since the early 1990s the TDR has also advocated active capital-account management in order to reduce the risk of speculative bubbles in domestic markets and to provide governments with greater flexibility for domestic macroeconomic policies (92: VII; 95: III; 98: X). Although in recent years capital controls generally have come to be viewed more positively, in the early 1990s the TDR went against the received wisdom in reviewing measures to discourage capital flows that were not related to real investment or to trade transactions but were motivated by short-term gains (94: II; 93: ch. III; 95: ch. II).

In 2009, the TDR supported its earlier recommendations for proactive capital-account management. It showed how emerging market economies had succeeded in limiting undesirable capital inflows through a variety of instruments, ranging from outright bans or minimum-stay requirements, to the imposition of non-interest-bearing reserve requirements or taxes on foreign loans that are designed to offset interest rate differentials (93: VIII; also 98: VIII; 09: X).

In the second half of the 1990s discussions concentrated on the pros and cons of fixed or floating exchange-rate regimes for developing countries, and the macroeconomic policies that were consistent with one or other of these "corner solutions" (01: VII, VIII). Following the experience of the Asian financial crisis, the TDR perceived *a growing consensus that developing countries should target real exchange rates in combination with the control and regulation of destabilizing capital flows. This offers a viable alternative to free floating or to ceding completely monetary authority to a foreign central bank. Successful examples of control over inflows and outflows abound, from Chile to China, India and Malaysia, and provide a rich arsenal of tools for better management of the capital account and exchange rates* (99: X).

The 2008 Report showed that overvaluation of exchange rates had been the most frequent and the most "reliable" predictor of financial crises in developing countries over the past 15 years: *Current-account reversals in developing countries with a high share of manufactures in their total trade are primarily driven by large real-exchange-rate changes, whereas for commodity-dependent economies, terms-of-trade shocks are the major factor. An increase in the current-account deficit as a result of an appreciation of the real exchange rate and a concomitant loss of competitiveness of domestic producers may be temporarily financed by a net capital inflow, but it will sooner or later require some form of adjustment, normally a real depreciation. Indeed, overvaluation has been*

the most frequent and the most "reliable" predictor of financial crises in developing countries (08: VI).

5.3.3 The problem of policy space

It is often argued that some of the key elements of the East Asian development strategy cannot be replicated because national policy autonomy has diminished as a consequence of the conclusion of the Uruguay Round. Agreements made under that Round closed or narrowed some of the earlier policy options available to countries, such as the scope for lengthy periods of protection or resort to extensive trade-related subsidies (96: ch. III; also 02: ch. II). But TDR 1996 also indicated that, despite the narrowing of policy space as a result of WTO rules, in many areas, *such as investment and savings, research and development, and regional policies, there remains ample room for active policy measures* (96: X). After several more years under the new trade regime that had emerged from the Uruguay Round, TDR 2003 found that governments still had a considerable range of options for proactive policies for nurturing competitive enterprises and promoting technological upgrading, *particularly on such matters as industrial support, technological progress and public infrastructure* (03: XII).

TDR 2006 examined this issue of policy autonomy in more depth, confirming that governments can support the creation of *new productive capacity and new areas of comparative advantage by the provision of public funds in support of R&D and innovation activities*. However, it cautioned that *the eventual outcome of the Doha Round may well further reduce flexibility in policy-making by developing countries, particularly in the area of industrial tariffs* (06: XIV).

TDR 2006 pointed out that a reduction of policy autonomy was not only the result of commitments undertaken by countries in multilateral trade and investment agreements; policy-making was also constrained by the loan conditionalities of international financial institutions. Those loan conditionalities had proliferated since the early 1980s, and increasingly *extended into structural and even non-economic areas without taking sufficient account of country-specific factors* (06: IX).

Moreover, apart from these "*de jure*" constraints on policy autonomy, *there are a number of important constraints that result "de facto" from policy decisions relating to the form and degree of a country's integration into the international economy*. TDR 2006 considered these constraints on macroeconomic policies potentially even more serious than those on trade policies. A number of important limits on policy space resulted from too much reliance on private capital inflows to finance trade deficits following the opening up of the capital account. With the progressive liberalization of international capital markets and developing countries' increasing financial openness, those countries experienced more frequent impacts from external shocks via their capital account than via the trade account of their balance of payments. At the same time, their reliance on private capital inflows restricted their autonomy in the conduct of macroeconomic policy. *Most notable among these is the loss of the ability to use the exchange rate as an effective instrument for external adjustment, or the interest rate as an instrument for influencing domestic demand and credit conditions, because of a reliance on private capital inflows to finance trade deficits following the opening up of the capital account* (06: IX, see also 90: XII).

Given the reduced ability to employ traditional instruments of economic policy, TDR 2006 saw the need for policy innovation (i.e. the use of policy instruments that were less subject to restrictions on policy space). With respect to macroeconomic management, it discussed, in particular, the merits of "heterodox", non-monetary, instruments, such as an *incomes policy or direct intervention in the goods and labour markets* as measures for maintaining price stability: *Without a sufficient number of policy instruments that can be used effectively to dampen inflationary risks, the attempt to boost development through expansionary macroeconomic policies is likely to fail, as inflation will rapidly flare up. Conversely, countries that successfully use heterodox instruments to achieve price stability have more room to employ macroeconomic policy to spur an investment-led development process* (06: XVI; also 7: XVII).

6. OUTLOOK

Many of the issues which the TDR has dealt with in the past remain unresolved. This is as true for reforms of the international financial and trading systems as it is for national efforts in developing countries to accelerate structural change, and boost employment and incomes for their populations. Integration into the global economy remains a key challenge for most of them. In most cases this will not be possible without external support and development-friendly reforms of the international economic system. In all these areas, there is ample scope for the TDR to build on its previous work and to further contribute to new thinking.

Compared to the time when the first TDR was launched, probably the most important new challenge at the global level is that of dealing with the problems associated with climate change, which will determine the framework for economic policy-making at the national and international levels in the coming decades. The international community will have to find appropriate measures of financial and technical support to developing countries to meet the challenges of climate change adaptation and mitigation.

With regard to the imperative of climate change mitigation, a central question is how it can be reconciled with growth and economic development. TDR 2009 provided an initial input to this debate (09: ch. V). There is general agreement that one way or another economic policy in all countries will have to influence the incentives for consumers and producers to switch to more climate-friendly patterns of consumption and production. But the challenge from a development perspective is how to make the necessary adaptation compatible with faster growth and employment creation to absorb surplus labour in developing countries. Rather than looking at the "costs" of climate change mitigation to developing countries, TDR 2009 therefore focused on possible new opportunities and the potential for income gains in those countries arising from this global process. It dismissed the inevitability of a *trade-off between growth and development and climate change mitigation... Experiences from both developed and developing countries show that many synergies are possible between GHG* [greenhouse gas] *emission reductions and development objectives* (09: XIV).

This, the Report suggested, could be the starting point for forward-looking industrial policies. In the future the most dynamic product groups in international trade may well be those that respond to the global imperative of climate change mitigation (09: XIV, XV), and many countries *already have "natural comparative advantages", particularly in the production of low-carbon energy, which so far have been of minor economic importance.* Others may *create dynamic comparative advantages* in this area with the help of an appropriate industrial policy. Such a policy would need to provide the right incentives for domestic producers to explore how they might participate in the production of goods embodying climate-friendly technologies or themselves develop such products adapted to specific local needs and possibilities.

In this context, TDR 2009 emphasized that the *policy space for support measures in this area is less narrowly circumscribed by multilateral agreements than in other areas* (09: XV). Moreover, since climate change mitigation is in the interests of all countries, the willingness of the international community to support industrial development in this direction may be greater than in other areas. Negotiations of relevant international agreements on climate change, trade, FDI and intellectual property rights should

therefore aim at allowing developing countries sufficient policy space in this context. Given the global public good character of climate change mitigation, the TDR called upon the more advanced economies to consider *interpreting the flexibilities of the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement) in a way that would allow compulsory licensing for the production of equipment and goods that embed climate-friendly technologies, and for related processes, similar to the exemptions accorded for medicines in support of public health* (09: XVI).

Against this background, and the difficulties in the negotiations under the aegis of the United Nations conferences on climate change to forge agreement between developed, emerging and developing countries on a global climate policy, further work in this area will gain increasing relevance. And it should be of particular interest to developing countries.

A second area of growing importance for policy-oriented research and analysis is that of enhancing economic cooperation among developing countries. This would be particularly relevant, given the growing opportunities for mutually beneficial trade and financial relations among developing and emerging economies, on the one hand, and dissatisfaction with progress in global institutional reforms on the other.

Since 1983, when the TDR devoted Part II to economic cooperation among developing countries, the Report has paid relatively little attention to this subject. At the time, the TDR concluded that the potential for developing countries to benefit from strengthened South-South trade relations had been tapped only to a limited extent. It also noted that over and above direct benefits that could arise from such trade, there was also considerable scope for technological and technical cooperation. This potential is likely to have grown considerably over the past three decades. TDR 1983 also pointed to some possible indirect benefits that could accrue from economic cooperation among developing countries with similar structures and economic interests in terms of strengthening their bargaining power vis-à-vis other governments and transnational corporations – an aspect that the TDR raised in the context of FDI policies.

Having discussed the importance of regional dynamics in the East Asian growth process in 1996 (Part Two, ch. I), TDR 2007 (chs. IV and V) reviewed various aspects of regional cooperation among developing countries in greater detail. It may be worth building on some of these aspects in the future. The Report pointed out that for many developing countries at an early stage of industrial development a regional orientation involving countries at a similar level of development may be a more viable option than immediate integration into the world market to obtain access to a larger market as a means of achieving scale economies and diversifying production. It also noted that effective regional integration has sometimes occurred among countries without their first concluding formal preferential trade arrangements. It further underlined that regional integration means more than regional trade liberalization; there appears to be considerable scope for common public policies at the regional level in support of structural transformation, industrialization and faster growth. The need and scope for such policies deserve further attention. In the wake of the Asian financial crisis, TDR 1998 already recommended collaboration and consultation at the regional level as a means of preventing currency disorder and contagion effects (98:106). And TDR 2007 devoted an entire chapter to various types and options for regional financial and monetary cooperation. These could be explored further, taking into account changing conditions in the international financial system and the particularities of different regions.

A third important area of further research and analysis, building on earlier work in previous TDRs, concerns the issue of inequality. It is widely recognized that globalization has not narrowed the income gap between the poorer and the richer countries. On the contrary, that gap appears to have widened across countries, except for a few fast growing economies, and inequality has also increased within countries.

TDR 1997 undertook an analysis of the interactions between globalization, income distribution and growth. It showed that since the early 1980s the world economy has been characterized by rising inequality and slow growth. Income gaps between North and South have continued to widen: *In 1965, the average per capita income of the G7 countries was 20 times that of the world's poorest seven countries. By 1995 it was 39 times as much*. The Report also found that income inequality had increased within countries: *The income share of the richest 20 per cent has risen almost everywhere since the early 1980s, in many cases reversing a postwar trend. In more than*

half of the developing countries the richest 20 per cent today receive over 50 per cent of the national income. Those at the bottom have failed to see real gains in living standards, and in some cases have had to endure real losses (97: IV).

At the time, the TDR noted that these international and national divisions might reflect merely temporary adjustments to a rapidly changing world economy, and be a prelude to rapid growth and the trickling down of income gains to all other socio-economic groups. As globalization has advanced further and several financial crises have occurred in the meantime, with worsening income distribution being both a cause and effect, further work in this area, examining more recent trends, their causes and their effects, could be highly relevant.

An important set of questions in this context is related to the extent to which capital income has gained in comparison with labour income, and how incomes from financial activity have evolved in comparison with profits from real productive activity and wages. For the poorer countries, growth of agricultural incomes remains a particular concern.

Another important question concerns the effects of increasing inequalities and their impacts on the level and structure of demand, output and accumulation of household debt. In 1997, the TDR noted that some of the factors that contribute to greater inequality in a globalizing world also deter investment and slow down growth. It saw the combination of increased profits, stagnating investment, rising unemployment and reduced pay as a major cause of concern.

A fourth theme that is likely to remain highly relevant is related to the relative roles of domestic and external demand, as well as domestic and external financing of investment, in the growth process in developing and emerging economies. Recent TDRs have indicated that a stronger reliance on domestic demand and domestic financing for development is probably an important element of more stable growth in developing countries in today's global economy. Economic conditions are characterized by global financial instability, limits to export-led growth and deflationary tendencies following the recent financial crises. A further study of policy options to sustain an expansion of mass incomes while maintaining price stability and high rates of investment is therefore of considerable relevance for future TDRs. This also applies to the question of how to shape national financial systems and fiscal policies in developing countries to support investment and growth.

In the context of national policies, an area of work which is likely to become topical relates to demographic changes. These may pose greater challenges in the future, not only for employment creation in countries with fast population growth, but also for the design of an international framework for migration. Another issue related to demographic change, especially urbanization, is the design of appropriate social security systems.

Notes

1. This review contains numerous quotations from, and references to, the different issues of the TDR. Quotations from the original text of various TDR issues are in italics. References in brackets indicate first the year and then the page or chapter number. For example "88:III" indicates TDR 1988, page III (roman numbers refer to the Overview of that issue), "03: 215" indicates TDR 2003, page 215 of the main text), and "96: ch.III" is a reference to the entire chapter III of TDR 1996.
2. "Recognition of this need has been reflected in the efforts of the Basle Committee on Banking Supervision to strengthen and harmonize prudential supervision" (92: V).
3. An original contribution of the TDR in connection with its study of debt crises in the 1980s was its observation of the relationship between debt, the cost of and access to trade finance, and the growing resort of developing countries to countertrade (i.e. exchange goods and/or services without the use of an internationally accepted currency) (86: ch. IV.B).
4. Quoting the New York Court of Appeals, which had once ruled in favour of a debtor government that had imposed a unilateral standstill.
5. Guidelines for negotiations of official and officially guaranteed debt of developing countries were effectively set at UNCTAD in 1980 through the adoption of Trade and Development Board Resolution 222(XXI) which was seen by Michel Camdessus, the then chairman of the Paris Club, "as establishing the international legitimacy of the Paris Club within the international financial architecture" (Cosio-Pascal, 2008).
6. Point 3 of the Marrakech Declaration of 15 April 1994 states: "Ministers confirm their resolution to strive for greater global coherence of policies in the fields of trade, money and finance, including cooperation between the WTO, the IMF and the World Bank for that purpose" (WTO, 2012).
7. TDR 1992 was the first to devote two chapters to domestic policies and issues concerning national development strategies (Part Three, ch. I on "Reforming Trade Policies", and ch. II on "Reforming Public Enterprises").

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Part Two

PANEL DISCUSSION ON

"THINKING DEVELOPMENT: THREE DECADES OF THE *TRADE AND DEVELOPMENT REPORT*"

To commemorate the three decades of the Trade and Development Report, UNCTAD organized in Geneva on 20 February 2012 an expert panel discussion "Thinking development: Three decades of the Trade and Development Report", *conceived as a pre-Conference event for UNCTAD XIII. This panel discussion gathered a number of experts in the field of macroeconomics and development strategies to discuss the contribution of the Report to the debate on trade and development.*

The panel discussion focused on key issues in the global economy and the design of development strategies that have been addressed in the TDR *over the past three decades. It highlighted how ideas, opinions and proposals expressed in the* TDR, *and the analytical approaches used, differed from those of the "mainstream" and how they evolved in response to new challenges arising from globalization.*

This one-day event was conducted in four sessions on:

- *The origins and evolving ideas of the* TDR
- *The macroeconomic reasoning of the* TDR
- *The* TDR *approach to development strategies*
- *The evolving issues in international economic governance*

Part Two of this publication presents the contributions of the experts to this panel discussion. The views expressed and the designation and terminology used in these papers are those of the authors and do not necessarily reflect the views of the UNCTAD secretariat.

The last section of Part Two presents a brief summary of the discussions.

OPENING STATEMENT

by

Anthony Mothae Maruping,

Ambassador, Permanent Mission of the Kingdom of Lesotho and President of the Trade and Development Board (UNCTAD)

Excellencies, distinguished Panellists and Moderators, Ladies and Gentlemen;

May I commence by warmly welcoming you all and by thanking you coming to grace this celebration of the 30th Anniversary of UNCTAD's *Trade and Development Report*. It is a day to celebrate this achievement.

The first *Trade and Development Report* (*TDR*) was published in 1981. The last edition of the *Report*, *TDR 2011,* constituted a landmark of the three decades of UNCTAD' s *premiere* flagship publication.

Since its inception, UNCTAD evolved from a negotiating forum to a "development think tank", and the *TDR* has been the main outlet for disseminating UNCTAD' s generated ideas. In presenting the results of the policy-oriented analysis as mandated by the diverse Conferences, *TDR* has served as a document laying ground for informed debate in intergovernmental bodies, primarily in UNCTAD' s Trade and Development Board. It is also a publication accessible to a broader audience as well as to expert opinion.

This remarkable attainment is worthy of celebration. A befitting celebration with a "banquet of food for thought" is what today's event is all about.

UNCTAD has organized this expert panel discussion *Thinking development: Three decades of the Trade and Development Report,* so as to also serve as a pre-Conference event for UNCTAD XIII Conference whose preparatory process is now in full throttle. This panel discussion has gathered a number of well-known experts in the field of macroeconomics and socio-economic development strategies to discuss the contribution of the *Report* to the constructive global debate on development.

The panel discussion will focus on key issues in the global economy and the design of socio-economic development strategies that have been addressed in the *TDR* over the past three decades. It aims to highlight how ideas, opinions and proposals expressed in the *TDR*, and the analytical approaches used, differed from those of the "mainstream" and how they evolved in response to new challenges arising from globalization. Traditionally, it has endeavoured to probe, analyse and interpret all relevant facets. It always tried to look at issues from various angles for the sake of thoroughness.

This one-day, yet action pact, event will be conducted in four panels on:

- the origins and evolving ideas of the *TDR*;
- the macroeconomic reasoning of the *TDR*;
- the *TDR* approach to development strategies; and
- the evolving issues in international economic governance.

This exercise of retracing the steps of *TDR* is being done at the juncture of particular interest given the transformation of the global economy since its inception. The socio-economic landscape and dynamics changed drastically over the period. It has been a long and exciting journey for *TDR*. Economies in

transition came into being. Economies of the Russian Federation, China, Brazil and India grew phenomenally and shifted the global economic centre of gravity. Observations, analyses, interpretations and prescriptions have come and gone from the days of Structural Adjustment Programmes, Heavily Indebted Poor Countries initiatives and successors, to the Tequila Crisis and later the Asian Financial Crisis; then Food and Energy Crises, financialization of the commodity markets and accompanying price volatility, and most recently the global financial and economic crisis that caused a drop in global trade and deep recession with high unemployment resulting and has come to be known as the Great Recession. This deep recession is manifesting itself as being non-responsive to orthodox prescriptions. Under what commonly has come to be known as the Washington Consensus the pendulum swung too far to the extreme and hurriedly towards liberalization of the markets. New nebulous financial instruments had emerged in the markets and financial supervision and regulation had taken the back seat. It has been an interesting thirty years period.

TDR has been the kind of Report that many always looked forward to its release. It has been value adding. Given the interconnectedness of issues, namely financial, economic and social, UNCTAD' s work in the process of fulfilling its role or mandate of research and analysis and consensus building should be permitted to be as broad as necessary to cover even the borderline, fringes and transcending issues. Comprehensive and coherent analysis and interpretation form a complete and clearer picture that lays strong basis for logical and thus credible policy and strategies formulation.

Complementarity, coordination and cooperation among the relevant international organizations bring about the realization of the benefits of synergies and symbiosis.

The line-up of panellists and moderators is an outstanding one. They are composed of highly respectable experts in the subject matter. They are people of high calibre with long and pertinent experience. We are bound to gain from their contribution to the discussion today. Without further ado, let us commence the panel discussion sessions.

Thank you for your kind attention.

ORIGINS AND EVOLVING IDEAS OF THE *TDR*

Introductory remarks

by

Richard Kozul-Wright

Head, Unit on Economic Cooperation and Integration Among Developing Countries, UNCTAD

Let me thank the organizers of this meeting for inviting me to the task of moderating this opening panel.

I will begin by putting this session's discussion of the origins and evolving ideas of the *Trade and Development Report* (TDR) into a general context, which I hope will provide the setting for the contributions of Rubens Ricupero and Yilmaz Akyüz. When you look back at 1980, which was when the idea of the *TDR* arose, you realize that it was a pretty tumultuous and uncertain economic and political time, and one with some interesting parallels to the current era: advanced economies were struggling to come to terms with economic shocks that had created stagflationary pressures; many may have forgotten, but it was the largest bailout in the history of the United States when in 1980 the Chrysler corporation was bailed out by the Carter administration in the United States; the price of gold hit historic highs in 1980; developing countries had been enjoying about a decade of extensive growth, which was much faster than that in the advanced countries. At the same time, global imbalances were taxing the international community over that period; the Brandt Commission launched its report in 1980 arguing that the international governance system needed a much greater representation for developing countries, a theme that continues to resonate; and of course the Cold War was still on and indeed heating up, as the Soviet Union had invaded Afghanistan the year before, and there were surrogate wars going on in Central America and in Southern Africa.

Against this backdrop of a fairly tumultuous economic and political time, a number of people in UNCTAD, particularly Gamani Corea, the then Secretary-General, and Gerry Arsenis, the Head of the Money and Finance Division at the time, felt that UNCTAD needed to have a regular voice to present its more integrated perspective on the trade and development challenge, which would go beyond the ad hoc sessional documents that it had already been producing on a regular basis. This feeling was present all the more because, at that time, the Bretton Woods Institutions themselves were moving away from their more traditional concerns towards a focus on the challenges facing developing countries. For example, the World Development Report had been launched by the World Bank in 1978.

The first TDR was published in 1981 and by the time Yilmaz Akyüz joined UNCTAD in 1984, the situation and probable further evolution of the global economy had become a little bit clearer. It was quite clear that the developed economies had turned to a much more austere approach to macroeconomic policymaking. This had a major impact on developing countries which were in the throes of a very serious debt crisis which had began in 1982. Therefore, it is not surprising that the first few *TDRs* would focus on the issues of debt and finance. In doing so, UNCTAD could draw on a long and established tradition of working on these issues that goes back to the first conference in 1964. Indeed, it is sometimes forgotten that the links between trade and finance were hard wired into

UNCTAD's original mandate and had been a major focus of research and analysis since then. In some sense, by focusing on debt and finance, UNCTAD and the *TDR* felt the pulse of globalization. Many of the people working on globalization at the time already realized that finance, rather than trade, was driving globalization. Indeed, the issues of financialization that Ambassador Maruping mentioned earlier were already taking shape and became the focus of the *TDR*. The *TDR* also underlined that globalization was not a naturally given process; rather, it was a policy driven process, with the policies of advanced countries very much setting the stage for the direction of the global economy. The interests of the advanced countries were very much shaping the global economy and did so to the detriment of many developing countries' growth performance; as a matter of fact, this period would later become known as "the lost decade of development". UNCTAD, and the *TDR* in particular, was swimming against the tide of some kind of simplistic market optimism, which was the overriding attitude of the international community, particularly the part based in Washington and Paris.

At the end of the decade, the crucial role of international finance became much more apparent and the shift towards a new development policy paradigm, often referred to as the "Washington Consensus", was further reinforced. I would argue that this process forced the *TDR* to maintain its emphasis on global issues, but also to look more carefully at the differences across developing countries which were becoming apparent. As a result, the *TDR* started to look more closely at differences across the developing world, including in terms of national development strategies and the way in which economic policymaking, now characterized by market fundamentalism, was affecting policymaking in the developing world.

I joined the *TDR* team in 1994 and Rubens Ricupero became Secretary-General of UNCTAD in 1995. These years saw the beginning of very profound research and analysis which have established the *TDR* as a serious and critical voice in development economics. I am sure that my colleagues will go through the kind of work that was done in that period but I feel that it is a remarkable body of work which looks at the links between trade and employment and analyses the East Asian development experience from a perspective that sharply differs from the interpretations of the World Bank that had come to dominate that debate.

The *TDR* perspective, which emphasized the importance of industrialization in the development process and underlined the critical role of the developmental state to any sort of effective development strategy, was then used to revisit the African development challenge. This new line of research in UNCTAD questioned the foundations on which the structural adjustment type approach to development strategy had been based and that had damaged the continent over the previous decade and a half. Remarkable at the time, this line of research also emphasized the intimate link between finance and a pattern of worsening income inequality and growing instability; it did so particularly in the 1997 *TDR*, which anticipates current debates by at least a decade. This research also undertook seminal work on the links between income distribution and economic growth. Moreover, it seriously examined the role of global value chains in the developing process before other people started to look at the way in which value chains were affecting trade and development prospects. Indeed, it is quite a remarkable body of work which added very careful analysis of issues related to strategic policymaking to the earlier work on global governance and the global economic environment. Of course, there is always a danger for someone like myself to look at this through rose tinted glasses, but I do believe that it is a remarkable body of work and I hope that the two panellists of this session discuss it further.

When I look back on that period I remember not only the work but also an unbelievable lively, challenging and exciting professional experience, which I believe existed nowhere else in the UN system at that time. I had myself worked on a couple of other UN flagship publications in New York and in Geneva and none of them had the kind of intellectual vigor and commitment of the *TDR* team. This atmosphere was ultimately due to the people that formed that team, some of whom are on this podium, others are in the audience. But it is the people who are not here that I think deserve a special mention. Shahen Abrahamian, an important person in the process of creating the *TDR*, was certainly one of the reasons why I wanted to join the team; Shahen Abrahamian sadly died in 1995 at a tragically early age but had played an instrumental role in building the Report's tradition. So did Roger Lawrence who was head of the Division in UNCTAD when I joined the *TDR* team, as well as many others. I think that all of these people were committed to a certain approach to the development challenge, as well as to a certain approach to research

which made this to be a particularly attractive and vibrant environment. It also was and continues to be, a resource-constrained environment. Yilmaz Akyüz used to say that we did not need big resources but big ideas. Nevertheless, facing serious resource constraints has always been a feature of research in the UN system. John Toye, in his book on the Intellectual History of UNCTAD, estimates that the *TDR* costs one-fifth of what it costs to produce the World Development Report. So all those who worry about value for money and results-based management may want to take a careful look at a comparison of what the *TDR* has achieved within its resource constraints compared with the reports of other organizations.

A further element that contributes to the environment in which an institution's flagship report is produced regards the difficult process of finding a balance between institutional coherence and analytical creativity and, indeed, the whole issue of establishing a line of research in the UN which combines a sense of institutional responsibility with pushing the boundaries. Again, John Toye talks about this very difficult issue in his book. Having assumed recently the role of clearance in UNCTAD, I begin to appreciate some of the problems that we used to complain about when we were on the delivery side of the *TDR*. Rubens Ricupero used the phrase "let a thousand flowers bloom" to describe the kind of environment that he wanted to see flourish in UNCTAD for research. My own suspicion is that a "thousand flowers bloom with Chinese characteristics" is a little different from a "thousand flowers bloom with Brazilian characteristics". But maybe you Rubens would like to talk on this issue a little bit. So, without further ado – and if I may thank these two gentlemen for my experience in UNCTAD with the *TDR* which I consider to be one of the best experiences I have had as a professional economist – let me hand the floor over to Rubens Ricupero.

Statement
by
Rubens Ricupero
Former Secretary-General of UNCTAD

Ninety four times did Pope John Paul II ask for forgiveness for the sins and crimes committed by Christians over two thousand years of History. Would it be too much to expect that some multilateral economic organizations admit their share of responsibility for the current financial crisis and ask forgiveness for the terrible advice they gave countries in recent years?

When Queen Elizabeth II visited the London School of Economics in November 2008 she candidly asked the question that was in everyone's mind: "Why did nobody see it coming?" After a few months of embarrassment, a group of eminent British economists sent a letter apologizing to the Queen. They wrote: "Your Majesty, the failure to foresee the timing, the extent and severity of the crisis and to head it off (…) was principally the failure of the collective imagination of many bright people (…) to understand the risks to the system as a whole".

The letter went on to recognize that the wizards, some of them Nobel Prize winners, who believed that their plans to protect the financial system were infallible, were guilty of "wishful thinking combined with hubris". The times before the crisis were characterized by a "psychology of denial".

I could not find a more precise description of the prevalent reception of issue after issue of the *TDR* by the mainstream economists in some multilateral institutions and in the press: a collective attitude of denial. It was not so much active hostility or political censorship although we also had a taste of both from time to time. It was a studied posturing of deliberate silence, of avoiding to acknowledge the very existence, not to say the possible interest, of a differing view.

The 1996 *TDR* was the first published under my official responsibility and I am proud that, in defiance of conventional rules, it was dedicated to the memory of Shahen Abrahamian, who had passed away a few months before and had been one of the major intellectual forces behind the Report.

One year before, Abrahamian should have felt vindicated during the discussion of the Mexican *tequila* crisis. If someone wants to get a taste of that not so nostalgic past, there is a vivid account in the internet by our dear friend Chakravarthi Raghavan under the heading of the Third World Network.

He tells as Carlos Fortin, Officer-in-Charge of UNCTAD at the time, remarked that in 1994, when the *TDR* had warned against the dangers surrounding global finance, the Wall Street Journal had derided the organization's economists as contemporary Rip Van Winkles coming from the backwoods of a far-way past. One year later, the same paper would run a story on the first page acknowledging that those same economists had been warning for years about the likelihood of the kind of crisis that overtook Mexico.

Over the three decades of its existence, the *TDR* covered a multitude of subjects and became a true encyclopedia of development thought. I will not attempt a comprehensive examination of its most interesting conclusions in areas that are closer to my experience such as the imbalances and shortcomings of the multilateral trading system, the rate of value added to manufacture exports as the definitive

criterion of development, or the real nature of the successful development policies implemented by China and other Asian countries in contrast to the neoliberal travesty of such policies concocted by some organizations.

Nor will I concentrate on the domain that proved to be the most accurate anticipation of things to come: the systematic analysis of the dangers of too much and too early financial liberalization and deregulation; the enlightened proposition of a complete set of policy advice to deal in an effective and humane way with excessive indebtedness; and the promotion of sound policies to prevent and avoid financial and monetary crises.

What I rather want to highlight in the *TDR*'s arsenal of ideas is the overall perspective of development in its totality and complexity, of a whole greater than the sum of its parts, of its indivisible nature. The 1996 *TDR* was precisely devoted to the interaction of all factors indispensable to development: finance, exchange rates, investment, trade and technology.

This amounted to a lucid effort of never losing sight of the forest when looking at the individual trees. It unfolded into two basic approaches that came to singularize the *TDR*'s distinctiveness. The first was and is the insistence on the central importance of the external economic environment as a propitious or adverse condition for development that may at times prove determinant. In some ways the idea is an offshoot of Raul Prebisch's old theory of "center and periphery", "his wonderful terminology", as Professor Jagdish Bhagwati put it.

The second and complementary approach is that the quality of national policies does matter when trying to take advantage of favourable external circumstances or to make up for unfavourable contexts. Due to the very different particularities and stages of growth of developing countries, they should be allowed a reasonable degree of policy space to adopt measures and orientations most appropriate to their needs. For so doing a capable State machinery is indispensable to set the policy framework most conducive to development.

How amazing is it that a theoretical construction of such balance, clarity and comprehensiveness should be so often misunderstood and misconstrued! After all, the *TDR* and UNCTAD never attempted to impose conditionalities nor dictate prescriptions to countries, never pretended to define a consensus supposedly of universal value to all nations.

The opposite was true as people frequently complained that the Reports were not prescriptive enough, that they left too much freedom of choice in sorting out the existing alternatives, of inviting countries to face their own responsibilities.

If development had to be approached from a perspective of totality, a logical corollary that ensued was that interdependence should provide the cornerstone for the creation of a favourable external environment. Interdependence and its necessary consequence, multilateral cooperation, were then seen as the only paths that could ensure a healthy and balanced world economy.

Dealing with the world economy in its totality as a complex and interrelated system led the *TDR* to analyse development as an indivisible whole. On its part, this approach forced to the surface the need for coherence between the monetary and financial system, on the one side, and the commercial system, on the other. As we all know, this is a crucial question that lies at the very heart of the major macroeconomic imbalances between chronically surplus and deficit economies.

The destructive crisis that we are currently experiencing is a direct result of such staggering imbalances. Or better said, the crisis was the product of the ideological belief that the markets would self-correct the imbalances that they had created and the fatal alibi that ideology provided for the failure of multilateral cooperation in dealing with them.

Among all the *TDR*'s achievements, the one that stands out as a lesson of immediate and urgent usefulness is its contribution to the recent science of "crisiology", the branch of economics dealing with crisis.

Nowadays, this has been a flourishing academic field and entire sections of bookshops had to be devoted to the prolific production in the field. As a footnote to the tendency, allow me just to mention that even the very best in that crop are not immune from some odd conclusions. The interesting and exhaustive study by Rogoff and Reinhart, for instance, has a table where, on the basis of several historic criteria,

it lists the countries that are about to graduate from the likelihood of default. Well, among the happy few, you will be pleasantly surprised to find Greece, of all places, and Portugal, which shows how perceptions can radically change in a matter of months or weeks!

I have not reread every line the *TDR* wrote on crises but I do hope that it has never ventured into such perilous exercises! Books and reports on financial crises have become so frequent now that they no longer attract much attention. In the early 1990s, however, after the fall of the Berlin Wall, the end of communism and the end of History, of *la pensée unique,* and triumphant globalization as an ideology, to foresee financial crises was seen as preposterous and deserving a full dressing from the Wall Street Journal.

When I arrived in Geneva on September, 1995, making fun of UNCTAD was a fashionable sport. A few days after I took office, the Observer column in the Financial Times welcomed me with a note translating our acronym as meaning Under No Condition Take Any Decision! Who at the time would dream that 15 years later the newborn institution across the corner announced as the end of UNCTAD would find itself in a not so dissimilar predicament!

Before the end of 1994, when the financial meltdown in Mexico reminded us that mortality was an inevitable destiny not only of civilizations but of globalization as well, there was a widespread belief that the Great Normalization had banned the possibility of real crisis, not the kind associated to the normal business cycle. That is the explanation to the indignant reaction to the first *TDR*'s prophecies about the dangers of too much short time capital inflows into developing economies.

Even after the *tequila* crisis vindicated the accuracy of the reasoning, the episode continued to be looked upon as no more than an additional consequence of the lack of discipline and the careless laxity of Southerner peoples, of those that would later be branded as belonging to "the Club Méditerranée" variety. A few weeks before the Thailand currency collapse announced the start of the 1997 Asian crisis, a front page title in the Financial Times summed up the IMF Spring Report of that year: "*The future of the world economy is rosy*, says the IMF".

That was in February or March. Months later, when the crisis was about to reach Singapore, during the IMF and World Bank Fall joint meeting that took place in Hong Kong (China), it is astonishing to remember that the IMF was still trying to sell an amendment to The Articles of Agreement establishing the mandatory character of the full opening of the capital account of the balance of payments and the absolute interdiction of any capital control!

The 1998–1999 Russian and Brazilian crises were not sufficient either to dispel the notion that financial and monetary crises could only happen in the distant and barbaric periphery of the system, in the same way as challenges to democracy and capitalism were relegated to faraway and irrelevant countries such as Afghanistan in Fukuyama's famous essay on *The End of History.* You all know how that particular story ended and how the crisis finally struck at the very heart of the system. I am not going to retell a story that has already been told many times. My aim was just to call back to our minds what was the intellectual and psychological atmosphere that prevailed during most of the years of my personal experience with the *TDR* elaboration.

In preparing these comments, I read here and there some of the *TDR*'s texts about financial crises. I was impressed by their freshness, their analytical depth and their permanent validity. If they had read them, the Greeks would have understood the poignant dark humor of Professor Bhagwati's comment that, once you get caught by the trap of financial globalization, to get free from it is like to send a letter resigning from the Mafia…The *Onorata Società* does not take lightly this kind of thing as we *meridionali* well know…

If you sensed in my words a touch of irony and sarcasm you are probably right. I hope that I have not been guilty of the ugly sin of *schadenfreude,* what others would call the joy of the prophet or Cassandra's revenge. Many times has the *TDR* been accused of being Cassandra's voice. Of course people missed the main point: Cassandra, indeed, was right and had the Trojans listened to her, the Greeks would have been forced to withdraw and mankind would be deprived of a beautiful poem. Perhaps even the subsequent fate of the Greeks would spare them the current plight, who knows?

This long *recherche du temps perdu* leaves us with a bitter taste. If the *TDR* was so generally accurate, why is it that so few paid any attention to what it had to say? Should we be forced to admit that Chesterton

was right, after all, when he wrote that *History teaches us that History teaches us nothing*? Should we attribute this lack of prevision to a "failure of the collective imagination of many bright people (…) to the combination of wishful thinking with hubris (…) to a psychology of denial"?

There is a little bit of truthfulness in each of these factors but I suspect that they do not capture the full truth. At least for the individuals in positions of power in politics and in finance – and they are often interchangeable – there is something more. It is a suspicious coincidence between their intellectual conclusions and their financial and career interests. In other words, there is an element of ideology, in Karl Mannheim's definition as a set of beliefs and values, supposedly scientific and objective but conveniently serving and concealing class and sectors interests.

From this category of people, who are again in power, or better, who have never lost their dominant positions in running the banks and the governments, the only kind of repentance we can expect is the one attributed to a famous American pop star pianist of the 1960s. After a particularly atrocious performance that brought him piles of money, asked how he felt about a crushing critical piece in the New York Times, he replied: "I cried out all the way to the bank"! If they feel any sort of conscience pain they will at best say: "Since the financial crisis started, each year we have been crying out all the way to cash our millionaire bonuses and stock options"!

I do not believe that in the *TDR* unit or in UNCTAD people were intrinsically morally superior to those lords of finance or that they were intellectually brighter. What they had was something quite different: an international public service ethics, a commitment to critical and independent thought, a desire to imitate the lessons left from giants such as Gunnar Myrdal and Raul Prebisch.

Like Don Raúl, they felt great respect for the theories from the North as those theories had much merit. But likewise him, they would examine them with critical spirit to see to what point they fitted structurally distinct conditions in the South. They were moved by a constant search for intellectual emancipation and they felt a passion for independence, integrity, the refusal to serve as tools of special economic interests or even the so-called "sacred egoism" of national interests. And happily enough, most of the time they found in the United Nations the institutional framework that offered them the minimum conditions to work without having to sell their souls.

I was fortunate that at the end of my public career I could benefit from the wisdom, the experience and the moral example of men such as Carlos Fortin, Roger Lawrence, Yilmaz Akyüz, Professor John Toye, briefly, and their collaborators, Richard Kozul-Wright, Andrew Cornford, Charles Gore, Detlef Kotte, Taffere Tesfachew, later Heiner Flassbeck, Alfredo Calcagno and many outstanding people working in other sectors of UNCTAD. I would like to make a special mention of the outstanding contribution made by Professor Jan A. Kregel over many years in relation to financial, monetary and other relevant issues covered by the *TDR*. I was delighted and encouraged to see that the Secretary-General, Dr. Supachai, has assured them of his unfailing support, guidance and trust, that the *TDR* has been able to keep its brightest promises, that the preparations for UNCTAD XIII have renewed and reinforced the best of UNCTAD's traditions.

I never had the knowledge or the talent to be really of any help to them. I am afraid that, on account of my diplomatic professional deformation, I may even at times been a nuisance to them in my tendency to tone down incisive moods of expression or too bold predictions of things to come. Thus it is appropriate that I too should ask forgiveness for my faults and shortcomings.

As I cannot share the glory of the *TDR* team, and of their colleagues in similar difficult pursuits, I can at least praise them for their accomplishments and thank them for the invaluable contribution they gave me and UNCTAD. And I conclude by saying from the bottom of my heart: "Long live the *Trade and Development Report*! Long live the United Nations Conference on Trade and Development! Long live the women and men in international organizations and elsewhere who struggle for more justice, equity and equality in the world economy!" Thank you!

Statement

by

Yılmaz Akyüz

Special Economic Advisor, South Centre;
Former Director, Division on Globalization and Development Strategies, UNCTAD

I will give my personal reflections on research done in the *TDR* in the 1980s and 1990s, but I have closely followed what happened since that time. I joined UNCTAD in 1984 working in MFD (Money, Finance and Development Division, as it was called at the time), when the brilliant economist Shahen Abrahamian was coordinating the *TDR* with the director of the Division, Roger Lawrence. Roger was an excellent economist, with a very good understanding of international monetary and financial issues from the point of view of developing countries. I had also the privilege of working with Sidney Dell, who I think was one of the most prominent economists of the United Nations system. When Shahen died unexpectedly in 1995, I took over effectively the coordination of the research of the *TDR* until my retirement in 2003.

The intellectual backdrop of *TDR* research and its analytical basis goes back to Raúl Prebisch, the founding father of UNCTAD and its first Secretary-General, from 1964 to 1969. Prebisch had a deep influence on the thinking of the research team particularly in industrialization, trade and development issues (as part of larger post-war development thinking, underlying UNCTAD's concerns of the 60s and 70s). The team was also influenced by the Heterodox Keynesian tradition, not only in macroeconomics but also in finance (Minsky was mentioned in *TDR*s in the 1980s), accumulation, distribution and growth (Kalecki and Kaldor tradition). However, the *TDR* team never denied the importance of having a sound command of mainstream economics, its analyses and policy prescriptions, and there was never a wholesale rejection of such analyses or policy advice.

A second person who had a major influence for research in the *TDR* was Gunnar Myrdal, a brilliant Swedish economist, Nobel Prize winner in 1974 and Executive Secretary of the United Nations Economic Commission for Europe (UNECE) in the period 1947–1957. Myrdal wrote a piece on research in UNECE "The Research Work of the Secretariat of the Economic Commission for Europe" in *30 Economic Essays in Honour of Eric Lindahl*, Stockholm, 1956, which discussed some principles for both the Secretariat and the Governments that should govern research in international organizations:

1. Independence: The Secretariat should be a free and independent scientific agent, guided by established standards of profession, with the right to decide on its own initiative to undertake studies as well as responding to governments' requests. "Independent research" is reiterated by UNCTAD intergovernmental machinery on several occasions. Some major governments often wanted to keep secretariat out of certain key issues intrinsically linked to development, but the UNCTAD secretariat has guarded until today its independence jealously.

2. Competence: Earning and preserving independence presumes high competence. Indeed this was the single most important norm in selection of research staff, despite bureaucratic hurdles in the UN and resource constraints – the *TDR* has often been produced by a few people, a trickle of what goes in the reports of Bretton Woods Institutions (BWIs).

3. Relevance and usefulness: Academic, pure scientific, research should be left to universities and the

research in international organizations should have practical purpose, basically to improve policy making at the national and international level. This is needed for intergovernmental support.

The *TDR* was, has been and is always highly policy oriented, at national and international level, even though it was not giving blueprints for policy making. It was used by the developing countries mostly in international policy issues, to support their positions; although *TDR*'s position was not always the same as that of developing countries in international negotiations. But developing countries rarely used the *TDR* in their national policy issues. And advanced economies hardly used it any way. In retrospect, costly policy mistakes could have been avoided if governments had engaged in a constructive dialogue over policy options.

4. Scientific modesty: The Secretariat should welcome criticism, even the harshest one, on every point, but expect and receive respect for its scientific work. Major Group B countries rarely took the trouble to make a critical assessment of *TDR* research, but chose to ignore them.

5. Integrity: Do not steer clear of problems where political interest are powerful or avoid analytical inferences because they are politically awkward. *TDR* research rarely eschewed controversial issues because of political indications.

6. Caution: Need to express findings with a certain reserve and to avoid formulations which might appear provocative. But if taken too far this could lead to work without perspective or significance. "Statesmanship in Research" calls for formulating findings with special care, but not engaging in intellectual compromise. On very few occasions researchers tempted to use strong language or top management appeared to be engaging in intellectual compromise, but in general Statesmanship in Research was secured. Staff was never obliged to advocate positions against its research findings and beliefs.

7. Government tolerance for scientific research: "Independence is possible only if governments accept that in scientific inquiry there can be no monopoly of truth and be prepared to see results contradicting their positions." Myrdal points out that post-war governments were generally willing to pay this price and the cold war helped enhance political tolerance. After the 1980s, notably after the collapse of the Berlin Wall, dominant powers have become increasingly intolerant to diversity of views regarding national and international economic issues and indeed wanted the Washington Consensus to become a global consensus. And I think this is still the case.

Looking at the content of *TDR* research in the 1980s and 1990s, as well as today, it has addressed a wide range of inseparable issues in development (industrialization, trade, debt, finance, macroeconomics, international production and transnational corporations); it made critical assessments of mainstream analysis and policy advice; it offered alternatives; it issued warnings of potential difficulties that could result from misguided policies. But ironically, the most important contributions of the *TDR*, in my view, were in *debt and finance*, where the *TDR* was and still is well ahead of the curve. The Division responsible was originally called Money, Finance and Development Division, later became Global Interdependence Division, then the Resources for Development Programme and now Globalization and Development Strategies Division. They have always dealt with international monetary and financial issues, among others, gave intellectual and substantive support to the Group of 24, participated in International Monetary and Financial Committee (formerly Interim Committee) and Development Committee of BWIs, carried over UNCTAD's (UN's) past successes in the introduction of Special Drawing Rights, debt relief and Compensatory Financial Facility.

The *TDR* started grappling with the Latin American debt problem soon after its inception in 1981, when Mexico defaulted in August 1982. This was a recurrent theme of the *TDR* during the 80s. The *TDR* differed from the mainstream not only in the analysis of the reasons for the crisis but more importantly in the analysis of debt sustainability in Latin America. It argued (1986/1987) that the Baker Plan of 1985 (concerted lending plus austerity) could not resolve it. In 1988, the *TDR* made a proposal based on simulations that at least 30 per cent of debt write-off was needed for Latin America to get back to growth. Major creditor governments did not pay attention to this proposal, but the Financial Times picked it up in its front page. A year later, the Baker Plan was replaced by the Brady Initiative which provided relief by over 30 per cent. But this came after many years of muddling through and with a high cost for the region in terms of development.

Staff working on debt issues at UNCTAD saw official debt of poor countries even less payable. In fact, guidelines for negotiations of bilateral debt of developing countries (DCs) had been set at UNCTAD in 1980 with Trade and Development Board Resolution 222. These were seen by Mr. Camdessus, the chairman of the Paris Club at the time, "as establishing the international legitimacy of the Paris Club within the international financial architecture." However, the Paris Club left out multilateral debt. The secretariat thinking was that policies in poor countries were often imposed by BWIs as part of the conditions attached to lending, but when they failed and debt became unpayable, the burden fell entirely on developing countries. Thus, starting in the early 1990s, *TDR* argued for multilateral debt relief (the most specific chapter in this matter appeared in *TDR* 1993). This was seen almost as heresy by major shareholders of BWIs. But then HIPC came in 1996. Even though it was imperfect and the *TDR* kept on criticising HIPC for being a creditor-driven process, the inadequacy of the relief and the conditionality pushing the kind of policies that had failed and made debt unpayable in the first place.

Right from the 1980s the *TDR* argued for replacing creditor-led, ad hoc and arbitrary debt workout mechanisms, both for official and commercial debt, with statutory mechanisms. The *TDR* was not the first to think or ask for it, but UNCTAD was the first international organization putting it in clear terms in *TDR* 1986:

> The lack of a well-articulated, impartial framework for resolving international debt problems creates a considerable danger … that international debtors will suffer the worst of both possible worlds: they may experience the financial and economic stigma of being judged *de facto* bankrupt, … At the same time, they are largely without the benefits of receiving the financial relief and financial reorganization that would accompany a *de jure* bankruptcy handled in a manner similar to chapter 11 of the United States Bankruptcy Code.

This was reiterated in *TDR* 1998 and 2001 after recurrent crises in developing countries.

Towards the end of the 1990s and the early 2000s, with growing unease of some OECD governments about the size of increased bailouts and the moral hazard problem, IMFC requested the IMF secretariat to prepare a proposal for a statutory Sovereign Debt Restructuring Mechanism (SDRM) in 2002. The IMF secretariat prepared a series of documents discussing various aspects of the problem, which originally contained several elements of *TDR* proposals. But none of the substantive IMF documents made any reference to them. SDRM was first diluted and then abandoned because of opposition from financial markets and the United States. Ironically none of the debtor developing countries that could benefit from a statutory framework supported it or asked for a revision, for fear that their access to market would be impaired. Now it is being rediscovered again in Europe, traumatized by the debt crisis in the periphery.

In the early 1990s, the *TDR* turned to capital flows and financial instability. In 1991, it argued that success of the Brady Plan plus Washington Consensus policies (and NAFTA for Mexico) could attract large amounts of capital to Latin America, and that could lead to balance of payments and financial fragility, and eventually to crises. Starting in 1991, there was a section in the *TDR* warning Mexico to impose controls over capital inflows, something that was discovered by the IMF twenty years later after the subprime crisis. An interesting summary of these warnings was prepared by UNCTAD's press officer at the time in *TDR* 1995 (pages 76–77). After Mexico in 1995, the *TDR* gave a warning that for Argentina the key question was not "if" but "when". This was followed by an analysis in *TDR* 1996 that some East Asian countries were heavily dependent on capital flows and highly vulnerable to financial crisis. These were not simple conjectures but conclusions from rigorous analyses in the tradition of Keynes and Minsky that mainstream discovered only after the subprime crisis, 15 years later.

While the *TDR* was doing all that work on debt and finance, the mainstream was actually occupied in fiction, renewing its faith in markets:

- When the crisis in Mexico happened in 1982, we were told that it was due to fiscal deficits. Capital flows and deficits associated with private savings gap would not lead to instability (Lawson Doctrine).
- Mexico in 1994/1995 was in fiscal balance; the crisis was said to be due to excessive private consumption. It would not have happen if capital flows had financed investment.

- Pre-1997 Asia had an investment boom financed largely by external capital, but the financial crisis was said to have resulted from corruption and inefficiencies associated with government interventions.

Other examples of early warning and unorthodox analyses from the *TDR* include:

- That unleashing of global market forces (globalization) would lead to rising instability and inequality. Tendencies towards increased inequality were detected in Asia already in 1997, the region that was benefiting most from globalization.
- That excessive and indiscriminate reliance on Foreign Direct Investment (FDI) would not bring catch-up industrialization (now a concern that some FDI-dependent South East Asian countries may be falling into a middle-income trap).
- That more exports do not necessarily mean more income and value-added (high import content of exports in high-tech parts in production networks and double-counting that other organizations working on trade are now discovering).
- That the Washington Consensus policies were deindustrializing Latin America (now widely recognized, at least in some countries in the region).
- From the beginning of the Uruguay Round negotiations, UNCTAD researchers in trade warned constantly that for the trading system to become viable, the development dimension of WTO had to be recognized. At the time, the approach of major countries to negotiations was still like a business negotiation. Since Doha, this has been recognized, even though in rhetorics

In concluding, I am not suggesting that the *TDR* was infallible; far from it. I can give you a number of examples when the *TDR* went off track (pessimism on Brazilian crisis, missing positive balance of payments and FDI implications of China's accession to WTO, etc.). The point is that we were engaged, like other institutions, in scientific research, asking similar questions and trying to come up with some answers that were different to what others were saying – in many areas, not necessarily in all areas. But these were ignored. And when dominant powers have little tolerance for diversity, trying to suppress or ignore dissident views even when they are proven right, you end up with big and costly mistakes and progress tends to be slow and erratic. I believe this is why yesterday's unbending advocates of liberalization and Washington Consensus both in the financial press and the academic community are now talking about "capitalism in crisis".

THE *TDR* APPROACH TO DEVELOPMENT STRATEGIES

Introductory remarks

by

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At UNCTAD, we believe that our research and analysis is the backbone of our work on trade and development and on the various related issues that the organization addresses. The aim is to provide ahead-of-the-curve and innovative analysis and policy advice. And, as Yilmaz Akyüz was saying, passion for independence is always there, with a critical mind and a focus on development – an approach which is our pride. If there is any report coming out of UNCTAD that symbolizes and embodies the spirit of this objective, it is the *TDR*. In UNCTAD, we talk about a number of flagship publications, but I think that deep down we all know that there is only one flagship publication, and that is the *TDR*.

In my personal opinion, the *TDR* has been at its best when examining issues at the international level, and analysing the impact of the international economic environment on developing countries. It is in this area that the Report can be said to be "ahead of the curve". It is very interesting to read *TDR* 1997 or 1998 and some chapters from *TDR* 2002 after the recent crisis; these reports could have been reissued just changing the year, and most likely nobody would have noticed.

As noted in the background document, it is since 1992 that the *TDR* began to examine national development policies and strategies by reviewing largely the East Asian experience (or what the World Bank termed, the East Asian "miracle"). In the 1990s and early 2000s, various *TDR* issues highlighted lessons from East Asian experiences and their implications for other developing countries. However, from these analyses, in my view it is clear that most of the lessons are more relevant for emerging economies and economies with fairly well developed institutions and markets than for the poorer developing countries. Of course, UNCTAD has always been fully cognizant of the fact that policy lessons from the East and South- East Asian experiences cannot be drawn in a mechanical way or applied to other countries automatically. At any given moment in time each country faces a unique situation, which depends on a host of factors, including its size, starting position, cultural mix, level of development and past history, as well as the external environment which can sometimes be a constraining factor. Accordingly, and as noted in the background document, the *TDR* has always been mindful of the fact that the search for lessons from a successful country (or group of countries) should not be guided by a desire to exactly replicate that country's experience elsewhere. Indeed, such efforts can sometimes be counterproductive. The real question is whether other countries can construct their own policy regimes and supporting institutions based on development principles that have been a helpful guide to policymakers and other actors involved in successful development experiences. In this respect, UNCTAD found the development experiences of countries in the East Asian and South-East Asian subregions to be instructive and useful for many other developing countries in Asia, Africa and Latin America where the basic institutional infrastructure to manage complex economic policies are arguably lacking.

In contrast to the mainstream perspective presented by the World Bank, what was striking for UNCTAD was how the concept of "market failure" was understood in the South-East Asian context. It was not defined in relation to the efficient allocation of resources, as the existing conventional wisdom dictated, but rather in relation to the ability of the market mechanism to achieve specific development goals set by the government. Furthermore, unlike in many other developing countries, government intervention in many South-East Asian countries was influenced by the logic of pragmatism and by a clear development vision. This of course does not mean that governments in this region got policies right all the time, nor that the policy decisions made always achieved the desired objectives; far from it – in some cases it was a question of trial and error and learning from mistakes and trying again with different policies. Nevertheless, there were consistent efforts to design policies that would promote the interests of the nation as a whole and in a manner consistent with the broader national interest. Whether these policy lessons are relevant for countries with weak business sectors, less developed markets and institutions and limited resources is hard to say.

Nevertheless, I am very pleased that, in his response to questions, Mr. Ricupero mentioned the commodities issue and how it has been resurfacing since 2002. We talk about amazing and sustained growth in Africa and in the least developed countries between 2000 and 2008 – just before the recent crisis erupted. That growth was driven by a commodity price boom, which, on the one hand is good news, since it enabled some poor economies to generate surplus revenues for investment. But, on the other hand, what this has also done is to reinforce dependence on commodities. In fact, we have noticed a process of deindustrialization in some LDCs during this period. Perhaps a challenge for the *TDR* in the future is to address the prospects for sustained growth in these types of countries, and to examine the role of commodities in the development process of the poorest economies in the developing world.

Statement

by

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The publication of UNCTAD's *Trade and Development Report* coincides quite closely with my own career as a teacher and researcher in economics, which began in the mid-1980s. Most of that period has been spent in a university in India, where over these decades I have been a constant, regular and appreciative user of these Reports. The information and analysis in these Reports has generally been directly relevant to my own areas of research. The Reports over the years provide a concise and interesting history of global trends that are relevant for developing countries. In addition, because they have highlighted particular issues in ways that provide new insights or open up questions that deserve further investigation, they often point to fruitful directions for further research. And because they are so policy-oriented, they have often fed directly into policy discussions and debates that I have been involved in, not just in India but in several other developing countries.

The Reports have also been extremely useful for teaching graduate students in courses relating to international trade and finance, open economy macroeconomics and development. Students, and particularly those engaged in research on development or international economics, have responded to these Reports enthusiastically. There are several reasons for this positive response. First, the *TDRs* typically include insightful analyses of macroeconomic trends and processes that are based on sound theoretical principles and rigorous and careful empirical work. Second, the analysis is not just empirically grounded but nuanced and sensible, avoiding dogmatic positions and knee-jerk responses in favour of a more pragmatic approach. This has often meant combining results and insights that originally come from rather different perspectives, but usually within a coherent logical framework. Third, the focus of *TDR* analyses has been not only on identifying constraints and warning about potential dangers of particular policies and processes, but also discovering possibilities and noting feasible policy options even given various constraints. Fourth, the *TDRs* have often been ahead of the curve – not only in noting the implications of strategies such as financial deregulation and capital account liberalization, but also in capturing trends well before they have become more widely evident, such as in the behaviour of commodity prices or export prices of developing countries. This prescience is not only remarkable in itself, but also ensures that the *TDRs* remain relevant well after they are first produced, such that earlier editions of the Report continue to have a freshness and contemporary application that are sometimes startling.

All these positive features were revealed to me as even more remarkable, when I realized that the *TDRs* have been produced all along with a tiny fraction of the human and financial resources that are regularly expended in producing the flagship reports of the multilateral lending institutions. Just a handful of core staff and a few consultants are usually involved, yet the Reports have shown impressive breadth of knowledge, depth of analysis and consistent quality.

Over the decades the *TDR* has evolved an approach to development strategies that is clear, systematic and distinctive from what could be described as the more mainstream or "Washington Consensus"

approach. Broadly speaking, this approach could be described as one that views development most fundamentally as economic diversification, a process involving the shift of both income and employment away from lower value added to higher value added activities. Such a process is not seen as automatic, but rather one that requires proactive state policies and intervention in different ways. Greater economic openness and reliance on market-determined prices and incentives are viewed as unlikely to produce desired outcomes in this regard, because the resulting patterns of specialization and growth are more likely to be based on static comparative advantage, which would deprive economies of the potential dynamic comparative advantages coming from scale economies of different kinds.

Therefore, instead of seeing diversification to higher value added activities simply as a by-product of trade and investment openness, the *TDRs* have generally viewed this as something that requires state intervention. In general the Reports have advocated policies and forms of intervention that are flexible and imaginative, that respond and adjust to changing global circumstances, as well as policies that can be tailored to specific domestic requirements of particular countries. One important insight that UNCTAD highlighted quite early on (and was only recognized by other institutions like the World Bank very much later) is that the often cited dichotomy between export-led growth and import-substituting growth is a false one, because the successful exporters that also managed to diversify their economies were precisely the countries that had also benefited from selective and strategic policies to protect certain kinds of activities. The *TDR*'s approach to trade protection has generally been non-canonical, accepting the need for certain kinds of protection in particular situations but not advocating one uniform pattern for all countries.

More recently, the *TDRs* have made important contributions in highlighting the difficulties and pitfalls in strategic attempts at diversification into higher value added exporting activities for developing countries that are forced to get into areas where there are low or no barriers to entry. Some important work on the fallacy of composition and deteriorating terms of trade even for manufactured goods exporters showed how even so-called "sunrise" industries that have relatively low barriers to entry can easily get overcrowded in global markets, leading to declining relative prices and reduced unit values of such exports.

Another area in which the *TDRs* have been strong is in establishing the link between macroeconomic policies and overall development strategies. For several decades now, *TDRs* have been identifying the problems of stabilization and adjustment policies that are procyclical in nature, and emphasizing that attempts to enforce further austerity in the midst of a slump (especially one that is characterized by asset deflation) may not only worsen the slump but have adverse medium-term and long-term implications for growth and structural transformation. This analysis has often come in the form of warnings that have then been only too severely realized through the bitter experience of developing countries in post-crisis scenarios. Unfortunately, much of the same analysis has had to be repeated in the most recent *TDRs*, with a different set of countries but with the same pessimistic predictions likely to be realized. It does seem somewhat surprising that despite the rather impressive track record the *TDR* has shown thus far in terms of assessing the likely dynamic outcomes of particular macroeconomic policy choices, its voice is still less widely recognized and heard in the international policy debate.

The *TDRs* have also been good at exploring the ways in which public and private debt problems can be resolved. The need for orderly debt workouts has been a recurrent theme, and several of the proposals and suggestions for such mechanisms that have been elaborated in older *TDRs* could still be very usefully dusted off and resurrected to good effect in the current international financial system. The critical role played by finance in development has also been frequently recognized, and the need for proactive strategies in this regard – through development banking and other measures that ensure both greater diversification and better inclusion – have been constantly highlighted concerns.

The ways in which the *TDRs* have dealt with the external context for developing countries has also been extremely important. In the past decade in particular, there have been several significant contributions, for example in isolating the effect of liberalized capital flows and the globalization of finance in determining exchange rate movements, thereby changing domestic incentives between tradable and non-tradable activities and therefore affecting macroeconomic processes. The financialization of commodity markets, and the consequent impact of price volatility in global food and fuel markets, has

also been an area in which major insights have been thrown up by both analytical and empirical work described in the *TDRs*. Very recently, *TDRs* have taken up the important issue of control over natural resources, the significance of patterns of control over such resources and how countries can avoid the "resource curse" through specific policies that affect both production and distribution.

There are many other areas in which *TDRs* have contributed, which may be only natural in a period spanning three decades. What is remarkable about these documents, however, is how eminently sensible they have been. So it is surprising remarkable that the empirically substantiated analysis and reasoned arguments in the *TDRs* are somehow still seen as opposed to the dominant "mainstream" view. One can only hope that eventually, the very logical, nuanced and yet pragmatic economic perspective embodied in the *TDRs* does eventually become the mainstream way of thinking, for the economics discipline and for those concerned with development.

Statement

by

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(Financial) globalization and work

As various issues of the *TDR* have documented, the end of the eighties and the beginning of the nineties can be seen as a turning point for financial globalization. The fall of the Berlin Wall brought scholars as Francis Fukuyama to declare the end of history: democratic free market thinking has gained the ideological battle forever.[1] John Williamson published in 1989 for the first time his ideas of a 'Washington Consensus'[2] – a list of policy recommendations for developing countries mainly based on experiences with Structural Adjustment Programmes in Latin America at the end of the eighties. The term globalization gets familiar in the public press.[3] Banks in the United States of America gained more freedom as the Clinton Administration repealed the Glass-Steagall Act in 1999. Internationally, the IMF and World Bank, supported by the United States of America and European governments flexed their muscles for liberalization of the capital market. The percentage IMF Member States, both developed and developing, that removed restrictions on capital flows increased strongly between 1990 and 2004.[4] The United States of America did not only push for the inclusion of clauses on 'decent work' in trade agreements with many countries, but also for capital market liberalization. In the beginning of the 21st century free capital should become the engine for substantial growth and progress of nations: financialization became 'the only game in town'.[5]

What was the result? In any case it was not higher economic growth as promised.[6] On the contrary: growth took place mostly in countries which participated in globalization but on their own terms, with continuing restrictions on capital flows and with political decisions which were often not those of the Washington Consensus. An example is the steady growth in India, China and Brazil. Financialization has almost thrown the rest of the world in a deep financial, economic and social hole. Despite courageous promises by national and international policy makers after the crisis in 2008, the beacons have not yet changed. In 2012, a second crisis or recession cannot be excluded.

The continuing globalization and especially the financial globalization has a major influence on work, work conditions and work security of workers all over the world. Globalization makes the power lines and tensions that dominate the national and international labour markets clear and sharpens the contrast between workers which profit from globalization and those who have difficulties to make ends meet.

The nature of work changes: more flexible work in developed countries and continuing, sometimes even increasing, informal work in many developing and emerging countries. There is more work in some of the fast growing countries, but its remuneration and the security it offers are very unequally distributed. Averages of well-being in countries hide often more than they reveal: most poor people do not live anymore in poor countries.

Trends at international labour markets

Since the beginning of financial globalization, at least eight important international labour market trends are noticeable:[7]

1. *Lower employment to population ratios*. The Asian and sub-Saharan African regions had the highest employment to population ratio but since 1990 this is declining. The only regions where the ratio increased – because of increased female employment to population ratio – from an extreme low to a somewhat higher level are the Middle East and North Africa regions.

2. *A shift from employment in industry to employment in services*. Globally the share of employment in services increased from 33.5 to 43.5 per cent. And in the developed regions even from 61 to 71 per cent. There is however an important distinction between services in developing and developed countries. In the first group of countries activities in the informal sector, with low value added, are often an important component of the service sector.

3. *More precarious work*. This a noticeable trend both in developed and developing countries. In developed countries, it takes the form of temporary contracts, often for less than 40 hours a week. For example in Europe, 70 per cent of the working population between 25 and 49 years cannot find a permanent job; they work involuntarily in temporary or part-time jobs.[8] In developing countries, precarious work takes the form of a relative big informal sector, which, against earlier expectations, is not getting smaller soon.

4. *Continuing or increasing youth unemployment*. In many regions in the world, youth unemployment is high, on average two and a half times as high as for other age groups. The highest rate of youth unemployment is in the Middle East and North Africa, where 25 per cent or more of all youth do not have a job. In countries with lower youth unemployment, it is nevertheless often difficult for youth to find a decent job. In the European Union, the first job is often a part-time job or a job without any form of social security.

5. *A decreasing labour share in the national income*. According to the ILO, this is the case for 75 per cent of all countries, including major emerging countries. Thus the number of people which live in countries with a declining labour share is well over 80 per cent.

6. *Increasing wage differentiation*. Not only did the labour share decrease, but also the differences between wage earners have vastly increased. The ratio of incomes between the 10 per cent highest and lowest wage earners has increased in 70 per cent of all countries. Some countries in Latin America form an exception, but inequalities in these countries were the highest of the world and are still very high.

7. *Enterprises become transnational and production processes change*. At the moment, there are about 82,000 transnational enterprises with 810,000 partners over the whole world. Exports of these enterprises have grown from a quarter to one third of all world's exports. Also employment in these enterprises has grown fast to about 100 million workers. Trade now mainly takes place between subsidiaries of these enterprises which form parts of global production chains with special production techniques.

8. *Migration*. Globalization also has affected migration but to a lesser extent. Global figures about migration do not show a rising trend (migrants form about 2.7 per cent of the world population) but there are nevertheless regional shifts. In Europe, the share of migrants increased from 3 per cent in 1960 to 8.8 per cent in 2005, in the United States of America from 6.75 per cent to 13.8 per cent and in Oceania, from 13.5 per cent to 16.4 per cent. The biggest increase was in the Gulf States from 4.9 per cent to 37.1 per cent. In regions with a rapid increase in migration, one observes increasing social tension, but 'remittances' are often an important source of income for sending countries.

The trends presented above have contributed to the fact that the global labour market is today rather different than 30 years ago. An important element is growing inequality. Also the definition of work is changing. The continuing poverty, including for families where all family members work, has led to the concept of 'working poor': work that does not generate sufficient income to live from and to place one's family above the poverty line. UNDP and ILO use statistics to measure the quality of work.[9] The World Bank distinguishes between: "good jobs" and "bad jobs",[10] largely based on income criteria. The ILO goes further and uses decent work, where work is approached from four

vantage points: employment, labour rights, social security and social dialogue. When the concept was introduced, it was the intention to construct a decent work index, but as different members of the ILO could not agree on the precise elements of an index and the measurement and weighting factors of these, the index was never introduced.[11] Progress in decent work is now analysed through yearly thematic reports at the international labour conference.

The crisis of 2008

The crisis of 2008 had major consequences for labour markets all over the world. In developing countries employment in the export sectors decreased, with negative consequences for other sectors in the economy. Studies of earlier 'business cycles' and earlier financial crises have demonstrated that employment recovered more slowly and to a lesser degree than other economic variables ('jobless recovery'). [12] This was also the case with the crisis of 2008. However, this crisis was different because the boom before the crisis already produced less decent jobs than normally would have been expected. On top of that the very fragile recovery phase is characterized by a slow growth in decent jobs.[13] This was and is of great consequence for millions of families all over the world.[14]

In comparison with the 1930s it could however have even been worse. Right after the outbreak of the crisis, many governments took robust measures to avoid a repeat of the experiences of the 1930s. Countries that had fiscal space decreased taxes to stimulate demand. This amounted to 1.7 per cent of world GDP. A joint monetary policy resulted in historically low interest rates and banks were massively supported by their governments. The bill for the United States of America and Europe was $11.5 trillion, about a sixth of world GDP. These measures supported the economy and according to the ILO helped to save about 20 million jobs. Some countries also used their stimulus measures to expand their system of social security (Brazil, India), to increase or extend unemployment benefits (Japan, United States of America) and to implement working time reductions (France, Germany, the Netherlands).[15]

The crisis of 2008 and its consequences could have therefore been a signal to arrest the globalization trends indicated above and to arrive at a more stable and fair economic development, for the crisis in 2008 was to a very large extent the consequence of financial globalization and the ensuing increase in inequality, which, for example, left many American families indebted. As the governments of developed and of developing countries forcefully stimulated the economy and supported their banks to avoid a massive depression, one could have expected also stronger measures to combat the deeper causes of the crisis, particularly financial globalization and growing income inequality. In the first phase of the crisis this hope was frequently expressed[16] but soon it turned out that the political constellation was not (yet) mature enough to intervene more vigorously. It is therefore the poorer groups that are often hit double or triple (see table 1.1). First, because they did not profit from the boom leading up to the crisis; second, because they were hit by the crisis; and third, because they suffer from lower public spending, especially in social areas, as a consequence of fiscal tightening to lower public budget deficits which were largely caused by support to the banking system and stimulus measures.[17]

Table 1.1

EFFECTS ON VARIOUS SOCIO-ECONOMIC GROUPS IN DIFFERENT COUNTRIES

	Pre-crisis	*Crisis*	*Post-crisis stimu-lus*	*Post-crisis fiscal austerity*	*Back on track*
Developed countries					
Capital owners	++	–	++	+	?
Skilled workers	++	–	+	–	?
Unskilled workers	–	–	+	–	?
Excluded	–	0	0	–	?
Emerging developing countries					
Capital owners	++	+	++	+	?
Skilled workers	++	–	+	+	?
Unskilled workers	+	–	+	–	?
Peasants	–	–	+	–	?
Poor developing countries					
Capital owners	+	0	+	+	?
Skilled workers	+	–	+	–	?
Unskilled workers	–	–	+	–	?
Peasants	–	0	+	–	?

Globalization and financialization

It is clear that many feel the threat of globalization for decent work. In recent surveys, people in developing and in developed countries clearly indicated what concerns them most: work and work for their children. Why have politicians or the political system often not taken these concerns seriously? Why is the concern that so many people have for a decent job neglected in politicians mind? Why could governments (rightfully) act as bankers of last resort, which engaged trillions of dollars, but could governments not act as employer of last resort? Why such an asymmetric approach to capital and labour?

One reason is ideological: the thinking of a broad group of politicians, both in developing and in developed countries is still based on neo-classical thinking that was the basis for the earlier mentioned Washington Consensus: trust financial and economic markets and make labour market more flexible.

A second reason is that political parties are afraid to put employment at the centre. They are afraid to fall back to class antagonism or afraid to be regarded as old fashioned.

A third reason is that continuing liberalization is a politically easy solution. It requires less: less public sector which acts in a reactive way, spends money to keep up the financial system and translates social policies into safety nets. Attention to work and to decent work requires, however, more involvement from governments in these times of globalization and greater policy coherence among almost all aspects of socio-economic policy: macroeconomic policy, sectoral and structural policies, education policies and social security policies. This requires attention to work and especially decent work to be not only of concern to the ministry of labour – in many countries, especially in developing countries, not always an influential ministry – but also to the highest political level. International financial agencies should not only be accountable on how they contribute to growth and stability but also on how many decent jobs have been created[18] as the *Trade and Development Report* of 2010 clearly demonstrated.

It is imperative to have an integrated and global vision on labour markets. It does not make sense to speak of a national labour market. But this requires another way of thinking. Blueprints are not available, but if rethinking does not start now it could be too late. The world is changing very rapidly in the context of globalization.

A different globalization

Contrary to what many think or argue, globalization is not an accomplished fact.

The negative outcomes from the current globalization process (including greater inequality and greater insecurity) can well cause counterforces and ultimately lead to a rejection of all forms of globalization as happened in the 1930s. The World Commission on the Social Dimension of Globalization did look at various alternatives and came to the following conclusions:

> Ours is a critical but positive message for changing the current path of globalization. We believe the benefits of globalization can be extended to more people and better shared between and within countries, with many more voices having an influence on its course. The resources and the means are at hand. Our proposals are ambitious but feasible. We are certain that a better world is possible. We seek a process of globalization with a strong social dimension based on universally shared values, and respect for human rights and individual dignity; one that is fair, inclusive, democratically governed and provides opportunities and tangible benefits for all countries and people.[19]

A point which the Commission underscores is that changes are by no means without friction: the integration of markets has losers and winners. The often-used expression of a "win-win" situation is certainly not applicable, leads to troubled political thinking and circumvents necessary and difficult political decisions.

A different globalization needs therefore to be crafted upon national and international solidarity, not only from a moral principle but also from long-term thinking: a growing polarization between winners and losers will lead to increasing dissatisfaction, especially when the losers belong to the younger generations, which then can lead to national and international chaos. A different globalization needs therefore to be based upon a number of principles in which people and work, with a number of economic,

ecological and democratic boundary conditions, are central.[20]

Work in 2012

The conclusion is that work has to become central in national and international politics. It concerns in effect decent work, including labour rights, social security and social dialogue. In economic crises, an emergency break is sometimes used to reduce labour rights and as such to create more employment. However, research on fundamental labour rights – elimination of child labour, freedom of association, social dialogue, equal treatment and remuneration for women and abolishment of forced labour – has shown that a positive correlation exists between economic development and fundamental labour rights.[21]

But progress in labour rights in developed countries that are now integrated in the world market does not come automatically. It was the outcome of action by concerned citizens, trade unions and an engaged middle class. This will not be different in the future. International cooperation should therefore not only focus on integrating poor countries in the world economy and strengthening the position of the poor in those countries but also in strengthening groups which stand for an improvement in labour rights. International cooperation has to be placed in the context of increased solidarity as the past 30 issues of the *Trade and Development Reports* have so amply demonstrated.

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Statement

by

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30 years of the UNCTAD *Trade and Development Report* – A South African perspective

Introduction

Before I discuss the influence of the *TDR* on the new Democratic South Africa, please allow me some personal reflections. What has been the impact of the *TDR* on me personally as a student of development studies, a policy maker and a trade negotiator? During the 1980s, the first decade of the *TDR*, I was an activist in the mass democratic movement working to get beyond the Apartheid regime. It was only with the release of Nelson Mandela in February 1990, that many of us could focus on reconstruction and development. I was fortunate to have gained a scholarship to do a two year M. Phil in Development Studies at IDS Sussex and participate in the many debates and discussions on Development. Williamson had written his famous paper in 1989 describing the Washington Consensus and its success.[1] In essence this paradigm called for fiscal discipline, de-regulation of financial markets, trade liberalization, devaluation of exchange rates and privatization. The Reagan and Thatcher regimes in the United States and the United Kingdom in the 1980s had advanced and strengthened these views as the prevailing dogma.

This neoliberal paradigm was encroaching upon all the academic institutions in Britain. However, IDS was able to resist the power of this new fashion. It had within its portals none other than Hans Singer, who had worked with Keynes and then Raul Prebisch on the famous (or infamous) theory of Import Substitution and the theory of declining terms of trade of commodities (the main product of most developing countries). In addition, there were a group of development economists – Raphie Kaplinsky, John Humphrey and Hubert Schmitz – that were working on how developing countries could beneficiate their commodities (to get out of the terms of trade decline syndrome) and industrialize thus creating a more sustainable basis for their development process. There were also a number of development economists, such as Robert Wade, that had published several books on the development experiences of East Asia – first tier and second tier Newly Industrializing Countries (NICs) – and demonstrated how these countries had used a mix of Import Substitution Industrialization (ISI) and export oriented strategies to industrialize and grow. Robert Wade, Gordon White, Robin Murray and others showed how almost all successful industrializers including, the United Kingdom, the United States, Germany and Japan had relied not only on market forces but on a strong state to advance their development – contributing to the theory of the Developmental State. David Evans, Chris Stevens and Adrian Wood taught that there was no automatic relationship between trade liberalization and economic growth, contrary to the views and policy advice of the Washington Consensus and Structural Adjustment Programmes of the World Bank and IMF that were being implemented in several countries in Africa and Latin America. In the two years that I spent at Sussex the *TDR* was prescribed reading for all our coursework. Indeed, several of our lecturers

were also contributors to the Reports. I thus became deeply immersed in the development approaches and policy recommendations of UNCTAD and the *TDR*.

There were a significant number of South Africans that studied at Sussex who went on to become policy makers in several new government departments. However, many South Africans were also trained in other institutions in Britain and in the United States, including short training programmes in the World Bank and IMF, where the Washington Consensus had become the dominant paradigm. In the World Bank and IMF indeed the view of the so-called market of the Washington Consensus was supreme. In his book[2], entitled: *The Roaring Nineties*, Joseph Stiglitz argues that the United States continued to advance this free-market "Washington Consensus" internationally, calling for free trade, de-regulated financial markets and the privatization of state enterprises. The new South African Government could not escape the power and influence of the Washington Consensus as it was advocated by the Washington institutions, academia and lobbyists from the private sector.

The first decade of the new Government was thus one of contending views and perspectives. Nevertheless, the challenges arising from its Apartheid legacy and the high expectations of its people for delivery, coupled with a vibrant civil society and a strong trade union movement meant that the new South Africa could not be shackled by any ideological orthodoxies; be it from the left or right – a state led or statist ("dirigist") view of development or a market fundamentalist and Washington Consensus view of development. It was in this context that South Africa readily agreed to host UNCTAD IX, held in Midrand, in April/May 1996. What are the principles, concepts and approaches of the *TDR* approach to development? How did the new democratic South Africa relate to these concepts? I have identified 10 development concepts drawn from various issues of the *TDR* over the past 3 decades that I will briefly discuss below. In each case, I will draw out the learning and lessons drawn by South African policy makers and civil society activists.

1. The Developmental State

Within a year of his release from Robben Island, Mandela had to confront the debate about the role of the state in the development of South Africa. The Freedom Charter, a visionary document developed in the mass movements of the 1950s and adopted by the Congress of the People in 1955 had stated: *"The mineral wealth beneath the soil, the banks and the monopoly industry shall be transferred to the ownership of the people as a whole"*. The ANC policy of nationalization was thus under severe scrutiny by the private sector and they confronted Mandela with this at his first meeting of the World Economic Forum, in Davos, Switzerland. Whilst the Washington Consensus and the Bretton Woods Institutions were arguing for the rolling back of the state, UNCTAD's research revealed the important role of the state in the successes of the NICs in East Asia. Thus the ANC and then the first Mandela Government took a pragmatic approach in this debate favouring neither a statist/dirigiste approach nor market fundamentalism. UNCTADs approach of a Developmental State became a vision and objective that South Africa's policy makers began to pursue to advance the Reconstruction and Development Programme (RDP) of the first democratic Government.

2. A holistic and integrated approach to development thinking

UNCTAD is unique in the UN system. It integrates various areas of economic and social policies at the national level and encourages a more holistic approach to development thinking. This is precisely what the first democratic Government had attempted in 1994 with the RDP. Although the first Mandela Government attempted to integrate our macroeconomic and fiscal policies with trade and industrial policies, and social policies, the inertia of the state bureaucracy and the culture of working in bureaucratic silos proved to be too challenging and the Ministry of the RDP was disbanded. The current Government has created a new Ministry and Department of Economic Development to make a renewed attempt to build and coordinate development strategies across several line ministries and departments of Government. In addition, there are two new Ministries in the Presidency that play a coordinating role: the National Planning Commission and the Department of Performance Monitoring and Evaluation. The *TDR* approach of integrating the analysis of different areas of development policy and strategy will continue to guide South Africa in its own efforts in this regard.

3. Partnership for Development

The new South Africa recognized from its inception the links between nation building and reconstruction and development and thus it developed a permanent process of engagement and consultation between the new democratic state and the various stakeholders from civil society, including business organizations, trade unions and community organizations. All these stakeholders are well represented in the National Development and Labour Council (NEDLAC). Thus at Midrand, South Africa advocated and supported the need for UNCTAD to invite and engage with NGOs at its formal meetings and deliberations. In addition, the concept of an active engagement with the private sector in the implementation of development programmes became part of the new democratic Governments work style. Leveraging the resources of the state to encourage and foster new private sector investment in infrastructure and development projects was crucial in the success of cross border projects such as the Maputo Corridor. South Africa thus played an important role in contributing to the UNCTAD theme of Partnership for Development at UNCTAD IX.

4. Industrial policy

ANC and COSATU policy makers had begun to think about how to restructure the economy, build its competitiveness and create decent jobs before the onset of South Africa's new Democracy in 1994. Much of the analytical concepts and lessons from other experiences were drawn from the work done by UNCTAD. However, the implementation of industrial strategy in a policy environment that was skeptical of state led or guided approaches to development proved to be challenging for the new Government. There was also a need to roll back some programmes that buttressed the privileges of the Apartheid regime and its patrons in big business. South Africa has adopted a pragmatic approach based on the lessons from the experience of comparator countries and its own experience (a "process of self-discovery") and is implementing an active industrial policy set out in its Industrial Policy Action Plans and New Growth Path.

5. Strategic integration

The new democratic South Africa recognized that the deepening trade and financial flows made possible by the reduced cost of transport and new technologies in telecommunications and the internet would pose many new challenges but also contained new opportunities for development. There was also an awareness that trade and financial liberalization were not the harbingers of growth and jobs but would need to be carefully managed to make the necessary reforms in the economy. The new South Africa would need to build its productive capacity and encourage and nurture the dynamic Schumpeterian innovation required to re-build South Africa's competitiveness. Thus South Africa's new trade policy was to draw on the concept of "strategic trade integration" in the global economy. This required a pragmatic approach to trade liberalization, carefully opening sectors to international competition, sequencing and timing this with complementary policies of industrial development and capacity building progammes.

6. Policy space

The new democratic South Africa came into being on the eve of the conclusion of the Uruguay Round (UR) and adoption of the Marrakesh Agreement. A former World Bank chief economist, Michael Finger argued that the UR outcome was unbalanced and the results were biased against developing countries.[3] UNCTAD research had corroborated this outcome and warned that the "policy space" for development in various areas such as innovation and support for industrial policies was increasingly circumscribed by several UR agreements such as TRIPS, Subsidies and Countervailing Agreement, and the TRIMS agreement. Other writers such as Ha-Joon Chang argued that the ladder was being kicked away for newcomers and late industrializers in the developing world by these new disciplines of the UR round.[4] The so-called Implementation issues, arising from the imbalanced agreements of the UR were to become the core concerns of developing countries as they launched the Doha Round of the negotiations. South Africa supported these efforts. Later, in the course of the Doha Round, South Africa was to lead the effort in

several areas to secure policy space for development in areas such as paragraph 6 flexibilities for cheaper medicines for the poor, strengthening of Special and Differential Treatment for developing countries, and flexibilities for developing countries in the NAMA negotiations to preserve their policy space for industrial development.

7. Interdependence: North-South and South-South and regional integration

As it re-integrated with the world economy after 1994, South Africa began to build partnerships with the North and strengthen its South-South relations. In line with the "Partnership for Development" theme of UNTAD IX, the new South Africa understood the need to deepen its relations with the North to secure markets for its value-added exports and tap into the financial flows, investment and technology required for its growth. However, it also recognized that it had to simultaneously diversify and deepen its relations with the dynamic developing countries of the South in search of complementarities and more mutually beneficial trade and investment flows. In addition, it had to deepen its integration with its African neighbours seeking more balanced and sustainable trade and investment relations accompanied by greater economic cooperation in infrastructure and productive development. In short, the new democratic South Africa sought a path of "Development Integration" rather than the more narrow efficiency seeking trade integration approach (associated with the economist Jacob Viner). UNCTAD had already been working on both South-South trade and development integration approaches to regional integration for some time and South Africa was a keen student of its policy advice and lessons drawn from experiences of other developing countries.

8. Growth enhancing ODA and Aid for Trade. South Africa Spatial Development Initiatives – North-South corridor

South Africa was very aware that it could only succeed in its own development if it also contributed to growth and development amongst its neighbours and the African continent as a whole. This is why it played a crucial role in the conceptualization and advancement of the New Partnership for African Development (NEPAD). Thus, South Africa was to contribute to building more mutually beneficial trade and investment relations with its neighbours. The Maputo development corridor was as a flagship project. This experience was to be drawn on to support similar cross border infrastructure projects in other parts of the continent – such as the North-South corridor. Thus, ODA in South Africa's view had to go beyond the traditional social welfare programmes of Northern donors and it had to provide the leverage required to contribute to infrastructure development and stimulate the development of the productive sectors thus contributing to a more sustainable growth path. It was with this perspective that South Africa supported the Aid for Trade initiative in the WTO as Chair of the Committee of Trade and Development Special Session (CTDSS) in 2004–2006.

9. Coherence in policy making: national and global

UNCTAD is a unique UN body that integrates the macroeconomic, productive and social sectors in its analyses and policy dialogue and advice. It has been arguing for the need for greater coherence in policy making both at a national level (discussed above) and also at international levels. At the global level, the Bretton Woods Institutions and the UN institutions showed little enthusiasm for their own coordination. During the peak of the Structural Adjustment Programmes propagated and implemented in many developing countries by the Bretton Woods Institutions in the 1980s and 1990s, many policy errors were made as a result of this lack of coordination, with dire consequences for many developing countries. In many countries, too rapid liberalization unsupported by complementary policy to build supporting institutions, appropriate regulatory framework, infrastructure and supply side support led to the destruction of existing industries and employment, reduced growth and increased levels of poverty and inequality. Thus at the 2005 WTO Hong Kong Ministerial Conference, South Africa as the chair of the WTO CTDSS played a leading role in obtaining the agreement of the WTO that there should be greater policy coherence by donors, multilateral agencies and international financial institutions with WTO agreements in the conditionalities that they often impose on developing country members.

Developing Countries have also been arguing that there needs to be greater reform of the Bretton Woods Institutions and the WTO. In a book launched by the Secretary-General of UNCTAD, Dr. Supachai, titled: *Reforming the WTO, Developing Countries in the WTO*, I have argued that there needs to be greater coherence between the Bretton Woods Institutions and the UN, based on the objective of Sustainable Development, long championed by UNCTAD and other UN bodies.

10. Climate change: embrace link to opportunity and challenge

UNCTAD has advocated that developing countries embrace the challenges of climate change mitigation and adaptation. This is a bold and principled stance that stands in stark contrast to the approaches of denialism and narrow mercantilism and nationalism adopted by some major developed countries. At a recent UNCTAD panel, Prof. Sachs stated that the three big challenges of the global economy today are: (i) poverty reduction; (ii) inequality and the need for more inclusive growth; and (iii) sustainable development. To these challenges we have to add our responses to climate change, or rather mainstreaming our responses to climate change into our economic, social and environmental policies. Each of us has to do this at the national level and we have to act together globally in a coordinated manner for these actions to be effective.

South Africa has declared climate change to be a national priority. South Africa is a relatively significant contributor to global climate change with significant GHG emission levels from its energy intensive fossil-fuel powered economy. However, South Africa is also extremely vulnerable and exposed to the impacts of climate change due to its socio-economic and environmental context. A major effort is thus being made to transition the South African economy away from coal based energy. The Government has decided to include "Green and Energy Efficient Industries" as an additional focus of its industrial strategy, highlighting renewable energy and energy efficiency.

However, South Africa faces many challenges in implementing this climate strategy, including finance and technology and capacity building for its small and medium enterprises. The Unilateral Border Adjustment Taxes contemplated by a number of developed countries (including the recent EU Airlines tax and proposed Maritime tax) will have a devastating impact on the South African economy and compound its challenges as it transitions to a low carbon economy. New rules on these issues, first in the UNFCC and then in WTO, will need to be discussed and debated. Developing countries such as South Africa will look to UNCTAD to provide a forum for such objective research, discussion, and debate.

Conclusion

In sum, my personal experience, and that of South Africa, with UNCTAD and its *TDR* was and remains one that is rich and fruitful. Thus on this occasion – the celebration of three decades of the *TDR* – South Africans would like me to say: Long live the *TDR*! Long Live UNCTAD!

Notes

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THE MACROECONOMIC REASONING IN THE *TDR*

Introductory remarks

by

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TDR and the Originality of UNCTAD

UNCTAD's work was initially based on a centre-periphery view of the world in which there were rich, technologically advanced industrial countries and poor technologically backward developing countries, and the basic pattern of international trade was the exchange of the manufactures produced in the former for the commodities produced in the latter. Steady economic growth was assumed to be inevitable in the advanced industrial countries and the problem of development in the peripheral countries was seen as a question of how to integrate them into the growth dynamic of the centre in a way in which there were mutual benefits for both the centre and the periphery. It was argued that this would not happen automatically because of the balance of payments constraints facing developing countries given the structure of international trade. In this situation, the free play of market forces could not guarantee fast enough growth rates in developing countries to address the pressing social problems of poverty, malnutrition and accelerating jobless urbanization. There was therefore a need for development planning to help developing countries to accelerate the process of development and such disciplined effort should be supported by international cooperation.

The content of development policies and international cooperation was derived from the analysis of the constraints from the centre-periphery pattern of global interdependence. These were synthesized in Raul Prebisch's Report of the Secretary-General to UNCTAD I, "Towards a New Trade Policy for Development". At the national level, the policy focus should be promoting industrialization, and in particular turning away from "inward-looking industrialization", by getting rid of excessive protectionism and by promoting exports of manufactures, which in a rational policy would be combined judiciously with import substitution. At the international level, this policy should be supported by measures to ensure higher prices for commodities for producing countries, to reduce commodity price instability, to provide compensatory financing, to provide trade preferences for selected manufactures exports and to use aid to build up trade capacities. Most fundamentally, the application of the principle of reciprocity in trade liberalization *before peripheral countries industrialized* should be rejected because it would lead to unequal outcomes and would not maximize international trade. Special measures were also recognized as being necessary for the "least developed" amongst the developing countries.

This initial UNCTAD synthesis is rightly recognized as brilliant. It provided the intellectual foundation for the so-called golden years of the organization, from 1964, through the period when attempts were made to promote a New International Economic Order, to the end of the 1970s. As such, these ideas have often been associated with UNCTAD's originality.

However, intellectual histories make clear that these ideas were actually hatched in Latin America, and particularly in ECLAC, and projected to a global scale through the vision of Raul Prebisch. I would like to argue here, therefore, that one should not look for the originality of UNCTAD in this first synthesis. Rather it lies in the analytical and policy work of UNCTAD which began in the 1980s, particularly, though not exclusively, through the vehicle of the *Trade and Development Report* (*TDR*).

The first Trade and Development Report was published in 1981 and it states quite clearly that "The present situation appears to require a new development paradigm". This was, of course, a moment in which development thinking and practice was turning decisively away from planning. But more fundamentally, the initial *TDR*s identified real structural changes in the global economy which, quite apart from the swinging of the ideological pendulum, were rendering the old paradigm obsolete.

One element of this changed situation was the deep economic recession in advanced economies. A second was the breakdown of the international development consensus between developed and developing countries which UNCTAD had been promoting. This was based on the idea that accelerated economic development in developing countries would increase their purchasing power, and if their import capacity increased this would promote economic growth in developed countries and contribute to full employment. Once controlling inflation replaced full employment as the central axis of economic policy in developed countries, this rationale for an international development consensus was sidelined. But third, and perhaps most important, was that a new form of global interdependence was emerging which was rendering obsolete the centre-periphery pattern which had underpinned UNCTAD's work in the 1960s and 1970s.

The *TDR*'s of the early 1980s grapple to formulate a new language to grasp this new reality. They speak of "the internationalization of output and trade"; the emergence of a new international division of labour, with the industrialization occurring in the periphery in a very uneven way; an increase in the effective control of resources by transnational corporations and their dominant market power influencing the distribution of the benefits of trade; "the growing privatization of the international monetary system", as private capital flows became more and more important; a growing tendency in which "national money and capital markets have increasingly become integrated into a world money and capital market"; and the emergence of new international regimes governing economic and financial relations. What was being addressed was, of course, the multiple-stranded phenomenon which later came to be labelled "globalization".

I would argue that since the early 1980s, the *TDR* has sought to construct a new synthesis to grasp the new realities following the breakdown of the centre-periphery model on which UNCTAD was founded. Moreover, it is in this, and related work such as the Least Developed Countries Report, that the originality of UNCTAD lies.

In seeking to reconstruct a new synthesis, there was continuity with the past in the sense that, as in the Prebisch paradigm, the focus was on the interaction between global interdependence and national processes. Moreover, as in the past, analytical work sought to blend macroeconomic and financial analysis with developmental and trade analysis. The basic object of study remained the analysis of the ways in which macroeconomic balances, particularly the investment-savings nexus and the balance of payments constraint, interacted with structural change, the working of capital and labour markets, and the dynamics of distribution, in the context of global interdependence, to generate virtuous circles of sustained growth, vicious cycles of economic stagnation and periodic economic crises and growth collapse. However, there were important new contributions.

Three contributions stand out. Firstly, there was enhanced understanding of successful development experiences, following an intense effort to decode the role of government in East Asian development and to work out how that could be applied in Africa (see, in particular, *TDR* 1994, 1996, 1998). Secondly, there was deep understanding of the nature of financial crises and debt dynamics. This strand of work began with warnings in the late 1980s, continued with prescient analyses and policy proposals in the 1990s, particularly in the light of the East Asian financial crisis, and continued through the 2000s, with increased understanding of the financialization of international commodity markets and the effects of the nature of the international monetary system on development prospects. Thirdly, there was an

important intervention on the relationship between globalization, growth and distribution (*TDR* 1997), which remains, 15 years on, one of the most insightful and fresh studies on the subject.

In general, UNCTAD's work in the *Trade and Development Report* has been of the utmost significance. As I have argued elsewhere (Gore, 2000), whereas UNDP provided a moral critique of the Washington Consensus policies, focusing on their objectives, UNCTAD provided an economic critique based on a more realistic understanding of how capitalist economies grow and develop than that provided by market fundamentalism. These analyses were founded on a deep understanding of, and belief in, the dynamic benefits of capitalism, married with recognition of its proneness to instability, its radical inequalities and the ever-present processes of creative destruction through which success always carried the seeds of future failure.

The analytical insights of the *TDR* were critically important in the 1990s when the Washington Consensus was at its peak. But they have remained important up until today because, although pronounced dead on many occasions, the Consensus still enjoys a lively afterlife. But was a new synthesis, comparable to the Prebisch's centre-periphery model, actually formulated?

Overall, I think it was not. One close shot was the *TDR* 1999 which argued that trade liberalization was associated with faster import growth than export growth and this was leading to increased reliance on external finance and increased vulnerability to financial crises. In the early 2000s, some effort was also made to refine the picture with a deeper understanding of different forms of industrialization in developing countries and integration into global value-chains. But in general I think that too much attention was paid to how new forms of global interdependence were associated with instability and financial crises, and too little attention was paid to how new forms of global interdependence were associated with rising inequality.

In some sense, the frequent recurrence of actual and ever-larger financial crises crowded out the slow and sustained study of the silent and slower crisis of persistent and rising inequality at a global scale. This tendency was further reinforced by a continuing fracture between the macroeconomic and financial analysis and expertise on the one hand, and the developmental and trade analysis and expertise on the other hand, with the former always perceived as superior. Marrying these two strands in the work of the *TDR* has always been difficult.

The failure to do more work on inequality and follow up on the *TDR* 1997 was, I believe, a major strategic error. A new international development consensus centred on MDGs and a so-called people-centred approach to development actually did emerge in 2000 after the Millennium Declaration. With a focus on global inequality, UNCTAD could have warned against much of the romantic violence which has come with this approach. But without sustained work of this type, UNCTAD has not had a significant voice in these debates.

So where should we go from here? Fortunately there will be renewed attention to inequality in the *TDR* 2012. Moreover, it is possible for UNCTAD now to engage pro-actively with the post-2015 development policy framework. But the deeper challenge now is that, as *TDR* 1981 put it, "The present situation appears to require a new development paradigm". Put simply, as many recognize, the global financial crisis marks the end of an era. But the problem is, as it was for those writing the *TDRs* of the early 1980s, to discern what the emerging tendencies are.

There are many possibilities. But I have argued elsewhere (Gore, 2010) that we have come to the end of the period where globalization can serve as a useful organizing principle for development thinking and practice, and we must now focus on global sustainable development. This implies a major shift in vision from viewing the economy as an isolated system to viewing the economic system as a subsystem of the ecological system, drawing material resources from the ecological systems and in turn affecting those systems through waste and pollution, including carbon emissions. This paradigm shift offers new ways of looking at international trade, development and global inequality in a world where my carbon footprint affects everyone everywhere, and so does yours, and where the richest 15 per cent of the world population are responsible for 75 per cent of total carbon emissions. This is now the most existentially important new form of global interdependence.

This shift in vision is going to be vital for thinking about, and negotiating consensus on, a sustainable

future of prosperity for all. But realizing this shift in vision requires a new mix of skills amongst professionals and deeper inter-disciplinarity, merging the macroeconomic, the developmental and the ecological. Do we have the imagination? Will we be able to change again? Once again we face a test of the originality of UNCTAD.

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Statement

by

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Reflections on some of the macroeconomic issues raised by UNCTAD's *Trade and Development Report* over three decades

Introduction

First of all, I congratulate the *Trade and Development Report* on its 30th birthday; oh that we were all so young! I have only been a regular recipient of the *Report* for the last eight years or so, and have never read it from cover to cover. But I always look for interesting charts and tables, and I read the *Overview* containing the main arguments. It has always had a Keynesian, non-orthodox (although not too non-orthodox) flavour about it, which distinguishes it from publications emanating from other international institutions concerned with economic development such as the World Bank, International Monetary Fund and the World Trade Organization. In particular, it has always advocated and promoted policies of international Keynesianism, stressing the importance for all countries in the world of maintaining global aggregate demand so that trade can be kept on an even keel and not suffer extreme ups and downs as it did in the 1930s and 1980s, and again today (UNCTAD, 1987, 1996, 2002, 2009, 2011). It has always been cautious about symmetrical trade liberalization, which can cause balance of payments problems for weak countries if imports grow faster than exports (UNCTAD, 1992, 1993), and cautious over the liberalization of international capital flows which can lead to severe short-term macroeconomic instability, especially in the presence of large global payments imbalances (UNCTAD, 1999, 2006, 2007, 2009). It has also pointed to the damage done to countries by the uncontrolled movement of primary commodity prices and the long-term deterioration of terms of trade of many primary commodities (UNCTAD, 2008, 2011). Interestingly, these are all issues that preoccupied Keynes in the 1930s and at Bretton Woods in the 1940s, and were central to the criticisms of orthodox trade theory made by UNCTAD's first Secretary-General, Raul Prebisch, in the 1950s and 1960s. I will take up some of these issues in what I have to say below.

Firstly, I discuss the role of exports in economic growth, and why the structure of trade matters for economic performance (UNCTAD, 1996, 2003, 2006, 2010). Secondly, I refer to Prebisch's concern over the balance of payments consequences of the freeing of trade. Thirdly, I refer to my own research (with others) of the effects of trade liberalization on export growth, import growth, the balance of payments and the trade-off between growth and the balance of payments. Finally, I end with discussion of Keynes's solutions to global imbalances and the

instability of primary product prices which plague the world economy today more seriously than they did when Keynes was writing his plans for a new international economic order to be implemented after the Second World War.

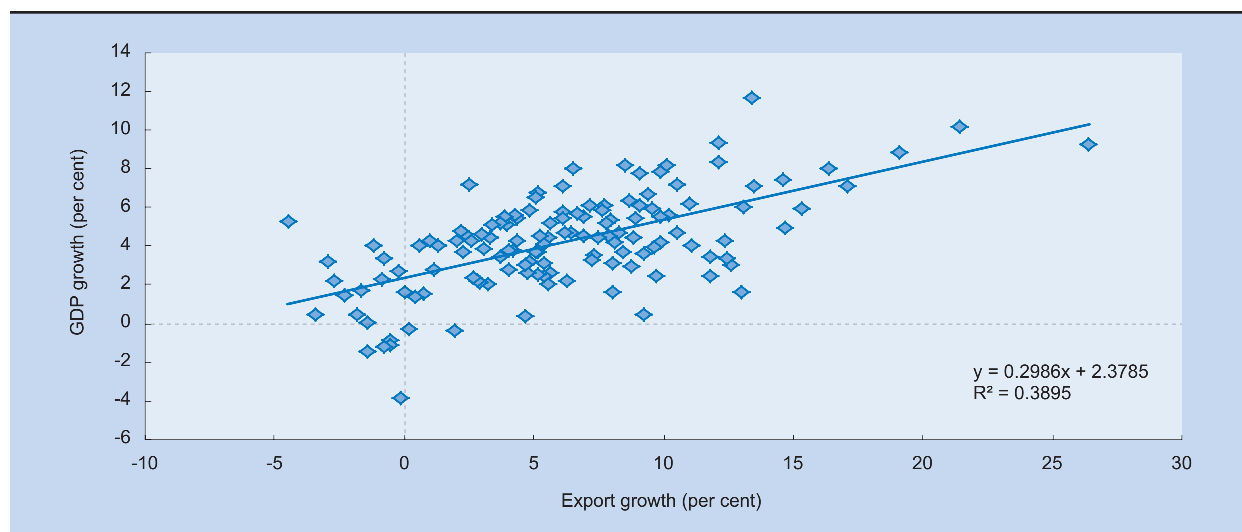
Exports and growth

It was the great 19th century economist, Alfred Marshall, who wrote 'the causes which determine the economic progress of nations belong to the study of international trade' (Marshall, 1890). He was right. There is a stronger correlation between GDP growth and export growth than between GDP growth and almost any other single variable. Figure 1 gives the correlation across 133 countries over the period 1995–2006.

In discussing the relation between exports and growth, however, it is useful to distinguish at least three different models with different emphases. First, there is the orthodox supply-side model (see Feder, 1983) which assumes that the export sector, because of its exposure to foreign competition, has a higher level of productivity than the non-export sector and confers externalities on the non-export sector. Thus the share of exports in GDP, and the growth of exports, both matter for overall growth performance. I have no quibble with this, but the orthodoxy neglects the demand side, which may be even more important. Exports are not only a direct source of demand, but also an indirect source because they pay for the import content of other components of demand, allowing these other components to grow faster than otherwise would be the case. This is the open economy analogue of the Hicks super-multiplier (see McCombie, 1985).[1] Thirdly, export growth can set up a virtuous circle of growth whereby export growth leads to fast GDP growth; fast GDP growth leads to greater competitiveness through static and dynamic returns to scale, and improved competitiveness leads to faster export growth (see Dixon and Thirlwall, 1975, UNCTAD, 1996). In such a cumulative model, it is differences in the income elasticities of demand for exports (and imports, if balance of payments equilibrium on current account is a requirement – see below) between countries which is the essence of divergence between industrial and agricultural economies, or between 'centre' and 'periphery' to use the terminology coined by Prebisch (1950, 1959). It makes a difference to countries whether they produce and export cabbages or computers. Structure, and the supply and demand characteristics of goods, matter for economic performance. As early as the mid-19th century, in the debates over free trade, John Stuart Mill (1848) recognized that the growth effects of

Figure 1

ASSOCIATION BETWEEN GDP GROWTH AND EXPORT GROWTH



trade depend on what a country specializes in – whether natural resource activities or manufacturing activity; and most recently Stiglitz (2006) has written:

> A country whose static comparative advantage lies in, say, agriculture, risks stagnation; [without protection]its comparative advantage will remain in agriculture, with limited growth prospects. Broad based industrial protection can lead to an increase in the size of the industrial sector which is, almost everywhere, the source of innovation; many of these advances spill over into the rest of the economy, as do the benefits from the development of institutions, like financial markets, that accompany the growth of the industrial sector.

'What you export matters' has been formally modelled by Hausmann, Hwang and Rodrik (2007) who show a strong relation across countries between the structure of exports, export growth and GDP growth (where structure is measured by a country's share of 'high income' goods associated with rich countries).

One country's exports, however, are another country's imports. Imports can also be growth-promoting in a number of ways. Imports of capital goods, particularly into developing countries without their own capital goods sector, are important for investment and structural change. Capital imports embody knowledge and technical progress which can be mimicked. Imports of consumption goods increase choice and consumer welfare. The real problem arises, however, when the growth of imports exceeds the growth of exports which causes balance of payments deficits. If deficits cannot be financed, and real exchange rate changes are not an efficient balance of payments adjustment mechanism, economic growth may have to be sacrificed, and the static and dynamic welfare gains from trade may be offset by real income losses from unemployment.

This was one of the major grounds on which Prebisch (1950, 1959) questioned the mutual profitability of free trade between 'centre' and 'periphery' with the latter exporting primary commodities with a low income elasticity of demand and importing manufactured goods with a higher income elasticity of demand. The orthodoxy still ignores the monetary or balance of payments effects of trade in the discussion of the welfare benefits of trade. This neglect has a long ancestry which stretches from the price-specie flow mechanism of David Hume (1752) (the old gold standard adjustment mechanism) to the modern view that current account deficits do not matter because they simply represent consumption smoothing (Obstfeld and Rogoff, 1997). Free trade orthodoxy assumes balanced trade and the full employment of resources which in the real world may not apply to many developing countries. This leads me to the discussion of trade liberalization and the impact that liberalization has had on export growth, import growth and the balance of payments, and whether trade liberalization has improved the trade-off between growth and the balance of payments.

Impact of trade liberalization in developing countries

The first point to make is that export growth and trade liberalization are not the same. As Stiglitz (2006) remarks:

> Advocates of liberalisation - - - - cite statistical studies claiming that trade liberalisation enhances growth. But a careful look at the evidence shows something quite different - - - it is exports –not the removal of trade barriers- that is the driving force of growth. Studies that focus directly on the removal of trade barriers show little relationship between liberalisation and growth. The advocates of quick liberalisation tired an intellectual sleight of hand, hoping that the broad brush discussion of the benefits of globalisation would suffice to make their case.

Advocates of liberalization always stress the beneficial impact of trade liberalization on exports, but rarely focus on the other side of the coin which is the surge of imports that may result, and the negative effects that trade liberalization can have on the balance of payments.[2] It is this neglect, combined with my interest in balance of payments constrained growth models (see McCombie and Thirlwall, 1994, 2002, and Thirlwall, 2011), that led me in the early 2000s to embark on a major research programme (with collaborators) on the impact of trade liberalization on trade performance in developing countries in general, and Latin American economies in particular.

The first study to emerge from the research programme was Santos-Paulino and Thirlwall (2004) which takes a panel of 22 developing countries from the four 'regions' of Africa, Latin America, East Asia and South Asia that undertook significant trade

liberalization during the period 1972–1997. Trade restrictions are measured by export and import duties, and liberalization is captured by a dummy variable in the year in which significant liberalization took place (and continued). What we found (taking an average of results from different statistical methods of estimation using panel and time series/cross section data) was that export growth accelerated by about 2 percentage points; import growth jumped by 6 percentage points, and the trade balance/GDP ratio deteriorated by 2 percentage points.[3]

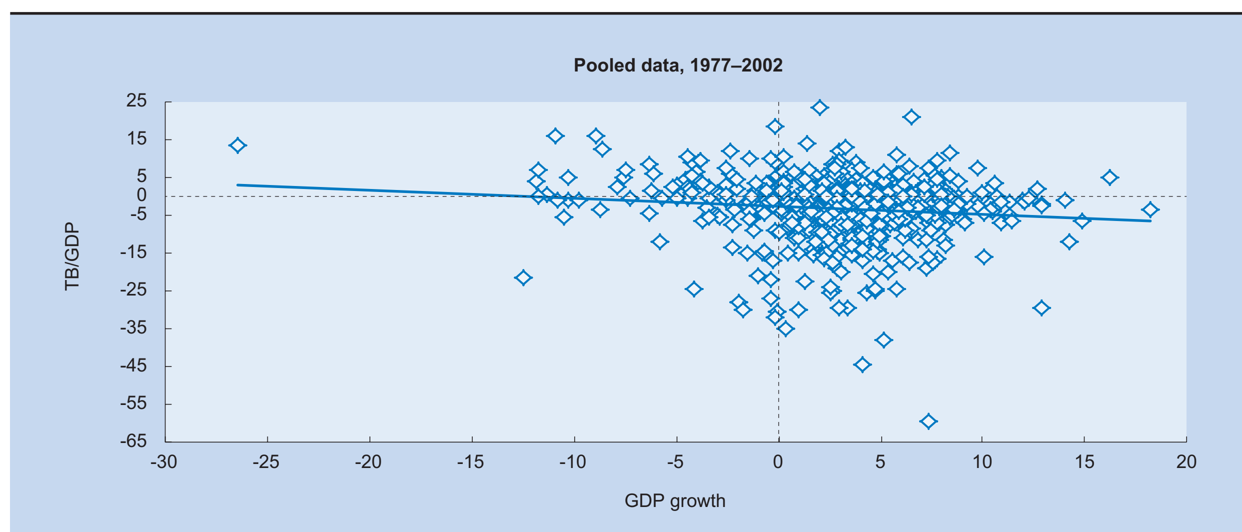
A second study (Pacheco-Lopez and Thirlwall, 2006) estimates the direct effect of trade liberalization on the income elasticity of demand for imports for 17 Latin American countries over the period 1977–2002 using a slope dummy variable to capture the income elasticity pre- and post-liberalization. The estimated elasticity for the pre-liberalization period is 2.08, and 2.63 for the post-liberalization period. This result is confirmed using the technique of rolling regressions taking 13 overlapping periods starting from 1977–1990 and ending in 1989–2002. The estimated income elasticity starts at 2.04 and ends at 2.82 giving an annual trend rate of increase of approximately 0.04 percentage points. This increase in the income elasticity of imports more or less offsets the increase in export growth post-liberalization, leaving the GDP growth rate consistent with balance of payments equilibrium broadly unchanged. This was also the conclusion of Parikh (2002) taking 64 countries:

> The exports of most of the liberalising countries have not grown fast enough after trade liberalisation to compensate for the rapid growth of imports during the years immediately following trade liberalisation. The evidence suggests that trade liberalisation in developing countries has tended to lead to a deterioration in the trade account.

The ultimate test of successful trade liberalization, at least at the macro level, is whether it lifts a country on to a higher growth path consistent with external balance; in other words, if it improves the trade-off between growth and the balance of payments. In a third study (Pacheco-Lopez and Thirlwall, 2007) this issue is examined for the same 17 Latin American countries as discussed above taking the trade balance/GDP ratio as the dependent variable and income growth (y) as the independent variable. The technique is first to estimate the trade-off curve for the whole time period and then to include a shift dummy into the regression equation for the year in which each country undertook trade liberalization in a significant way to see whether the shift dummy is positive or negative. Using pooled data (giving 425 observations) shown in figure 2, and fitting a linear regression gives the simple trade-off curve as (t statistics in brackets):

Figure 2

THE RELATION BETWEEN GDP GROWTH AND THE TRADE BALANCE TO GDP RATIO



$$TB/GDP = -3.203 - 0.315\,(y) \quad (1)$$
$$\quad\quad (6.3) \quad (3.3)$$

Adding the shift dummy variable (lib) gives:

$$TB/GDP = -1.387 - 0.258\,(y) - 3.610\,(lib) \quad (2)$$
$$\quad\quad (2.1) \quad (2.7) \quad (4.2)$$

The shift dummy turns out to be *negative.* Trade liberalization has apparently worsened the trade-off by 3.61 percentage points. When the model is extended to allow for real exchange rate changes and the growth of world income the coefficient on the lib dummy falls to -2.0, but is still significantly negative. All this has implications for the sequencing of liberalization (UNCTAD, 1992, 1993).

Global imbalances

The consequences of trade, and trade liberalization, for the balance of payments of countries, have implications for global imbalances and the optimal functioning of the world economy. Global imbalances are bad for the health of the world economy. They give rise to huge, volatile and speculative capital flows, they contribute to currency instability and the need for countries to hold large foreign exchange reserves to intervene in currency markets when necessary, and they lead to an arbitrary reallocation of resources between surplus and deficit countries, often from poor to rich countries (UNCTAD, 1985, 2000). Today, for example, there is something perverse about poor Chinese transferring resources to Americans twenty times richer than themselves.

Global imbalances can cause severe difficulties for individual countries, particularly those in deficit, and they exert deflationary bias on the whole world economy. Of course, the world as a whole cannot be balance of payments constrained, but it only requires one country or a small group of countries not to be constrained for all the rest to be so. There is a limit to which deficit countries are willing to finance deficits. And that limit may constrain growth considerably below the rate that would achieve the full employment of resources. That is the surest sign of balance of payments constrained growth: deficits on current account and unemployed domestic resources. Commentators make the obvious point that not all countries can have export-led growth – some countries have to import – but export-led growth from deficit countries is not a zero-sum game if surplus countries allow their surpluses to diminish. The world as a whole would be better off.

The world economy need not be in this situation of serious global imbalances if it instituted institutional mechanisms to penalize surplus countries that are reluctant, or unable for some reason, to spend more or reduce their surpluses in some other way[4] (I am dubious about the role of currency appreciation). The IMF could declare, for example, if the decision-making bodies agreed, that it will not tolerate members' surpluses exceeding a certain percentage of GDP – say 2 per cent, which is a sustainable deficit for most countries. In the old days of the Bretton Woods system, this magnitude of deficit would have put countries on the margin of fundamental balance of payments disequilibrium. Countries with surpluses above 2 per cent of GDP could be fined at progressively higher rates. The proceeds from fines could be given as aid to the poorest countries in deficit. Indeed, Keynes had a similar plan in mind at the Bretton Woods conference in 1944 in his proposals for an International Clearing Union[5] which would have been like a world central bank, issuing its own international money (bancor) which countries would have used for payments to each other. Each country would have had a quota with the Union (as countries do now with the IMF which determines borrowing limits). Keynes's proposal was that if a country had a credit (or debit) balance in excess of one-quarter of its quota, it would pay a charge of one per cent of the excess balance, and another one per cent if its credit (or debit) exceeded one-half of its quota. If credit balances exceeded 50 per cent of quota on the average for at least one year, the country would have to discuss with the Governing Board appropriate measures to restore equilibrium. Keynes writes : 'these charges - - - - would be valuable and important inducements towards keeping a level balance, and a significant indication that the system looks on excessive credit balances with as critical an eye as on excessive debit balances, each one, indeed, the inevitable concomitant of the other'. As is well known, however, Keynes's proposal for an International Clearing Union was rejected by the Americans at Bretton Woods. Keynes used to joke that his proposal for a bank had become a fund (the IMF), and his proposal for a fund had been named a bank (the World Bank)!

Keynes's other proposal for a 'scarce currency' clause, which would have given the right to deficit countries to discriminate against the import of goods from surplus countries (expected to be the United States of America), was accepted, but the clause was never implemented because the United States of America soon became a debtor country.

The idea of a scarce currency clause could, however, be resurrected to be used against persistent surplus countries in the way originally envisaged. Both ideas of trade discrimination (notwithstanding the rules of the WTO, which has never shown interest in the balance of payments consequences of free trade), and the penalization of surplus countries, are ripe for consideration for a more stable international economic order, and to reduce deflationary bias in the world economy arising from balance of payments constraints on demand and growth in perpetual deficit countries.

The instability of primary product prices

Another destabilizing feature of the world economy that preoccupied Keynes both before and during the Second World War was instability of primary product prices. In a Memorandum in 1942 on the 'International Regulation of Primary Products', he remarked : "one of the greatest evils in international trade before the war was the wide and rapid fluctuations in the world price of primary commodities - - - - it must be the primary purpose of control to prevent these wide fluctuations" (Moggridge, 1980).

The developing countries in particular, and the world economy in general, suffer several problems from the uncontrolled movement of primary product prices. Firstly, it leads to a great deal of instability in the foreign exchange earnings and balance of payments position of developing countries which makes investment planning and economic management much more difficult than would otherwise be the case. Secondly, price volatility of primary products leads to volatility in the terms of trade, which may not reflect movements in the equilibrium terms of trade between primary products and industrial goods. In these circumstances, world economic growth becomes supply constrained if the prices of primary products are 'too high', or demand constrained if they are 'too low'. Thirdly, because of asymmetries in the economic system, volatility imparts inflationary bias combined with tendencies towards depression in the world economy at large. When the prices of primary products fall, the demand for industrial goods falls but their prices are sticky downwards. When the prices of primary products rise, prices of industrial goods are quick to follow suit and governments depress demand to control inflation. The result is stagflation (UNCTAD, 1990, 2008, 2010, 2011). As Keynes put it in his Memorandum:

> At present, a falling off in effective demand in the industrial consuming countries cause a price collapse which means a corresponding break in the levels of incomes and effective demand in the raw material producing countries, with a further adverse reaction, by repercussion, on effective demand in the industrial centres; and so, in the familiar way, the slump goes from bad to worse. And when the recovery comes, the rebound of excessive demands through the stimulus of inflated price promotes, in the same evil manner, the excesses of the boom (Moggridge, 1980: 121).

There is explicit recognition here of the mutual interdependence of primary producing developing countries and richer developed countries, which has been a central theme running through UNCTAD's *Trade and Development Reports*, and was dramatically highlighted by the Brandt Commission Report published in 1980.

The instability of primary product prices that Keynes observed has not gone away (UNCTAD, 2005). A major study by Cashin and McDermot (2002) at the IMF looks at trends and cycles in both the nominal and real prices of 17 non-food primary commodities over the period 1862–1999 and conclude:

> Although there is a downward trend in real commodity prices [the terms of trade] - - - it is small compared with the variability of prices. In contrast, rapid, unexpected and often large movements in commodity prices are an important feature of their behaviour. Such movements can have serious consequences for the terms of trade, real incomes, and fiscal positions of commodity dependent countries, and have profound implications for the achievement of macroeconomic stabilisation.

They find 13 occasions since 1913 when the annual price change was more than 20 per cent. They also find average price slumps last longer than price

booms (4.2 years compared to 3.6 years). Kanbur and Vines (1986) demonstrate large macro gains from the stabilization of primary product prices.

Keynes's solution to primary product price instability was his proposal for what he called 'commod control', an international body representing leading producers and consumers that would stand ready to buy 'commods' (Keynes's name for typical commodities), and store them at a price (say) 10 per cent below the fixed basic price and sell them at 10 per cent above. Commodities should be stored as widely as possible across producing and consuming countries. The latter idea has some contemporary relevance as a means of responding quickly to conditions of famine. The finance for the holding and storage of 'commods' in Keynes's scheme would have been provided through his proposal for an International Clearing Union acting like a world central bank with the power to create money for international collectively agreed purposes. Keynes was convinced that such a 'commod control' scheme would make a major contribution to curing the international trade cycle and would operate much more immediately and effectively than public works. But Keynes's proposal never even got to Bretton Woods because of opposition in the United Kingdom from both the Bank of England and the Ministry of Agriculture (see, Thirlwall, 1987).

Today, the finance for storage and holdings of stocks could be provided by the issue of Special Drawing Rights (SDRs) by the IMF. The world has created a new international money, but fails to use it for socially useful purposes. Seventy years have passed since Keynes's war-time proposal, but primary product price fluctuations still plague the world economy. The world still lacks the requisite international mechanisms to rectify what is a major source of instability for the world economy.

Conclusions

What I have tried to do in this brief paper is to take up some of the macroeconomic themes that UNCTAD's *Trade and Development Report* has focused on over the last thirty years, and to give my own perspective on their importance. I believe that some of the issues have not been given as much attention as they deserve, particularly the balance of payments consequences of the freeing of trade. But I endorse the emphasis on the importance of trade for growth, the highlighting of the importance of the role of structure in the determination of macroeconomic performance, the importance of avoiding deflationary bias in the world economy and maintaining global demand, and the serious problems posed by commodity price fluctuations. What the world now needs are appropriate institutional structures and rules of the game to achieve the outcomes that the *Trade and Development Report* has championed over the years.

Notes

1. I am hoping that the *Trade and Development Report* never uses the term 'net exports' and asserts that if 'net exports' are zero (trade is balanced) that exports make no contribution to growth. They do, by paying for consumption good imports, investment good imports, and imports that go into exports.
2. One notable exception is the work of Parikh in the UNCTAD *Trade and Development Report, 1999*.
3. Parikh's study for UNCTAD (1999) of 16 countries over the period 1970–1995 found a deterioration in the trade balance of 2.7 per cent of GDP.
4. UNCTAD (1990) addresses the issue of sharing adjustment between surplus and deficit countries.
5. Command Paper 6437, April 1943. Reprinted in Thirlwall (1987).

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Statement

by

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Keynes, Schumpeter and the Macroeconomics of the *TDR*

The section on macroeconomics and finance in the excellent paper prepared for this panel by the UNCTAD secretariat opens with a clear statement of the intellectual roots of the analytical approach of the *Trade and Development Report*. It links it essentially to the contribution of the two economics giants of the 20th Century, John Maynard Keynes and Joseph Alois Schumpeter (with a reference also to the work of Michal Kalecki and Nicholas Kaldor). This intellectual lineage is important to understand the macroeconomic reasoning of the *TDR* and its relationship with the so-called "mainstream" macroeconomic analysis as exemplified by the World Bank, the International Monetary Fund, the GATT/WTO and the OECD, to which UNCTAD and the *TDR* have often been perceived as an alternative.

The *TDR* has in effect consistently proposed alternative views to those of the mainstream on the analysis of the global economy, on developed countries' macroeconomic management policies and on national development policies for developing countries. This has at times been characterized as involving an anti-market stance. The truth is, of course, quite different. As the Secretariat paper succinctly puts it, the *TDR* "aimed at promoting well-targeted pragmatism in policy making. The concern of the *TDR* was not 'state vs. market', but effective policy vs. 'market fundamentalism'".

And this is entirely in line with the views of Keynes and Schumpeter. As is well-known, both were sharp critics of orthodox market economics, albeit for different reasons. Keynes' critique centred on the challenge to the assumption that free markets would by themselves achieve full employment equilibrium, on the need for state intervention to expand effective demand and on the crucial role of investment in determining the level of spending in the economy; Schumpeter's critique focused on the neglect of innovation and entrepreneurship in orthodox theorizing and the need to introduce a dynamic approach. Schumpeter, furthermore, was convinced that capitalism had a tendency to disintegration, and that there was a corresponding tendency for socialism to prevail.

The emphasis on the critical elements in Keynes' and Schumpeter's analyses of capitalism has tended to obscure the fact that neither was against the market or private enterprise. Keynes in particular was a fairly strong advocate of free markets. In the *General Theory* he wrote:

> If we believe the volume of output to be given, *i.e.* to be determined by forces outside the classical scheme of thought, then there is no objection to be raised against the classical analysis of the manner in which private self-interest will determine what in particular is produced, in what proportions the factors of production will be combined to produce it, and how the value of the final product will be distributed between them."[1]

He was also totally opposed to socialism and the command economy and particularly critical – indeed,

scornful – of Marxian socialism. "Marxian socialism", he wrote in 1924, "must always remain a portent to the historians of opinion – how a doctrine so illogical and so dull can have exercised so powerful and enduring influence over the minds of men and, through them, the course of history."[2]

As an aside, it is interesting to note that another distinguished Cambridge economist and Keynes associate, Joan Robinson, thought this dismissive attitude was a disservice to Keynes himself. "Kalecki" – she wrote – "had one great advantage over Keynes – he never learnt orthodox economics … The only economics he had studied was Marx's. Keynes could never make head or tails of Marx … But starting from Marx would have saved him a lot of trouble".[3]

Schumpeter's position on free market capitalism was more ambivalent. While in his early writings – notably his 1911 *Theory of Economic Development*[4] – he took the view that small firm competition was best for innovation, in his main work of 1942 *Capitalism, Socialism and Democracy* he argues that monopoly, particularly of the enlightened sort exemplified by the Aluminum Company of America, is the most innovative system:

> … because perfect competition is impossible under modern industrial conditions—or because it always has been impossible—the large-scale establishment or unit of control must be accepted as a necessary evil inseparable from … economic progress … What we have got to accept is that it has come to be the most powerful engine of that progress and in particular of the long-run expansion of total output … In this respect, perfect competition is not only impossible but inferior, and has no title to being set up as a model of ideal efficiency.[5]

And, as already indicated, in the last analysis he thought capitalism could not survive and that socialism was its heir apparent. This statement, however, has two major caveats. Firstly, it does not entail a preference for socialism: "prognosis does not imply anything about the desirability of the course of events that one predicts. If a doctor predicts that his patient will die presently, this does not mean that he desires it. One may hate socialism or at least look upon it with cool criticism, and yet foresee its advent."[6]

Secondly, and more importantly, Schumpeter believes that capitalism will break down not under the weight of economic failure but because of its spectacular success, at the heart of which is the figure of the innovative entrepreneur and the quintessentially capitalist process of creative destruction that innovation entails. His view is that this very success is undermining the social institutions that protect it, and a main criticism of orthodox market economists is their inability or unwillingness to recognize this process and to address the need for action to rescue capitalism from the threat of its own success.[7]

There is therefore some significant common ground in the fundamental approaches of Keynes and Schumpeter to the analysis of capitalism, and yet the two – despite furthermore being exact contemporaries and knowing each other for over two decades – had little time for each other. Harvard Professor Arthur Smithies refers to "Keynes' indifference to Schumpeter and Schumpeter's hostility to Keynes", both of which he attributes to the fact that "Keynes was a lineal descendant of the English Utilitarians while Schumpeter had no Utilitarian blood in his veins".[8]

There is, of course, a more specific theoretical reason for this distancing, and one that poses a difficult challenge to any effort at building a macroeconomic analytical framework that aims at incorporating both contributions. In one crucial respect, the basic parameters of Keynes' and Schumpeter's models are different. Keynes' model assumes constant production functions; technological change is exogenous and the issue is how to maintain full employment in the short run ("in the long run we're all dead"). By contrast, for Schumpeter "the outstanding feature of capitalism" is that production functions "are being incessantly revolutionized. The capitalist process is essentially a process of change of the type that is being assumed away [in the *General Theory*]".[9] In his review of the *General Theory* Schumpeter writes: "Since Mr. Keynes eliminates the most powerful propeller of investment, the financing of changes in production functions, the investment process in his theoretical world has hardly anything to do with the investment process in the actual world …"[10]

The *TDR* approach addresses this predicament by placing emphasis on capital accumulation, redefining the savings-investment relationship and introducing the notion of the profit-investment nexus. In a Keynesian departure from neoclassical growth models according to which investment is financed by

household savings, the *TDR* model posits, to quote the Secretariat's paper, that "growth is a condition for increasing domestic savings rather than its effect and that an increase in real investment is possible without a prior cut in consumption, since the investment itself will create the required savings by generating additional income. What is needed to raise output and incomes and to accelerate structural change are not savings but financing of investment. This leads to the conclusion that it is more pertinent to focus on the factors constraining investment and pushing up interest rates." Attracting foreign investment is still necessary, but not to replace domestic savings, rather to finance trade and the foreign exchange cost of investment when export earnings are insufficient.

Schumpeter on the other hand is very much present in the notion of the investment-profit nexus and particularly in its policy implications. The nexus is defined as "the dynamic interactions between profits and investment which arise because profits are simultaneously an incentive for investment, a source of investment and an outcome of investment."[11] As applied to the East Asian industrialization process, this analysis leads to three basic propositions:

> First, high rates of investment played a major role in the exceptionally rapid growth of successful East Asian economies and this investment was, after an initial period, supported by high rates of domestic savings. Second, profits increasingly became the main source of savings and capital accumulation. Third, government policy accelerated the process of capital accumulation by creating rents and pushing profits over and above those that could be attained under free market policies.[12]

It was the accelerated pace of capital accumulation that made it possible to improve rapidly the methods of production and quality of output, to diversify the range of goods and services produced and to compete successfully in world markets for manufactured goods.[13] The policy lesson, in the words of the Secretariat paper, is that "strong enterprise profits simultaneously increase the incentive for firms to invest and their capacity to finance new investments from retained earnings, and to the extent that investment can be financed by the banking system, which has the power to create credit depending on the amount of liquidity provided by the central bank, the prior existence of savings balances in the financial system is not a prerequisite for investment."

There is a second major area in the *TDR* analysis where the influence of Keynes and Schumpeter is apparent. It is the introduction of a political economy approach whereby economic processes and outcomes are not simply the play of abstract variables but reflect the social and political interaction and indeed struggles of different groups with different, and often opposed, interests and with varying power and influence.

Here the main inspiration is Schumpeter. Keynes was, of course, fully aware of the political economy of economic processes, but as somebody possessing himself an extraordinarily intelligent mind he was sometimes reluctant to admit that other intelligent individuals could fail to respond to a logical and structured argument solely because it did not serve their interests. In the introduction to his *Essays in Persuasion*, published in November 1931 as the global capitalist economy was plunging into the Great Depression, Keynes explained that his central thesis was "the profound conviction that the Economic Problem, as one may call it for short, the problem of want and poverty and the economic struggle between classes and nations, is nothing but a frightful muddle, a transitory and *unnecessary* muddle. For the Western World already has the resources and the technique, if we could create the organization to use them, capable of reducing the Economic Problem, which now absorbs our moral and material energies, to a position of secondary importance."

Schumpeter takes an entirely different view: economic processes and policies do not essentially have to do with persuasion and rational discourse, but with interests and power:

> There is no scientific sense whatever in creating for one's self some metaphysical entity to be called "The Common Good" and a not less metaphysical "State", that, sailing high in the clouds and exempt from and above human struggles and group interests, worships at the shrine of that Common Good. But the economists of all times have done precisely this. While perfectly aware, of course, of the fact that the business process must be understood from the businessman's interest, most of them have been blind to the no less obvious fact that the political process and hence political measures that affect economic life must be understood from the politician's interest ... And political science itself was in general as little concerned about the facts of its subject

> matter and as prone to philosophize on this very same common good and popular will. It was, therefore, a major scientific merit of Marx that he hauled down the state from the clouds and into the sphere of realistic analysis.[14]

And it is this notion that economic processes and policies always have winners and losers that is at the heart of the political economy approach of the *TDR*. A good example of this kind of analysis was the 1997 *TDR* whose Part II was on Globalization, Distribution and Growth. It is appropriate to conclude these remarks by quoting at some length its main conclusions, since today, fifteen years later, they retain full validity as the kinds of issues that the debate on globalization and development should be addressing seriously:

> - Taken as a whole, the world economy is growing too slowly to generate sufficient employment with adequate pay or to alleviate poverty;
> - This has accentuated longstanding tendencies for divergence between developed and developing countries. Moreover, greater gaps between them have been accompanied by widening gaps within the South as a handful of newly industrialized economies have pushed ahead of other developing countries;
> - Finance has been gaining an upper hand over industry and rentiers over investors. Trading in existing assets is often a much more lucrative business than creating wealth through new investment;
> - Capital has gained in comparison with labour, and profit shares have risen in developed and developing countries alike;
> - Growing wage inequality between skilled and unskilled labour is becoming a global problem;
> - The hollowing out of the middle class has become a prominent feature of income distribution in many countries; and
> - There is almost everywhere increased job and income insecurity.[15]

Notes

1 John Maynard Keynes, *The General Theory of Employment, Interest and Money*, New Delhi, Atlantic, 2008: 347 (first published in 1936).

2 John Maynard Keynes, *The End of Laissez Faire. The Economic Consequences of the Peace*, Prometheus Books, 2004: 33(first published in 1926 and 1919, respectively).

3 Joan Robinson, *Collected Economic Papers*, Vol. III, Cambridge, MA, MIT Press, 1980: 95–96.

4 Joseph A. Schumpeter, The Theory of Economic Development. *An inquiry into profits, capital, credit, interest, and the business cycle*, Cambridge, Mass., Harvard University Press, 1934.

5 Joseph A. Schumpeter, *Capitalism, Socialism and Democracy,* Taylor and Francis e-library, 2003: 106.

6 Schumpeter, *Capitalism, Socialism and Democracy*, op.cit.: 61.

7 In an address to the American Economic Association in 1949 Schumpeter lists the developments that, in his view, reflect the process of disintegration of capitalism and the rise of socialist tendencies, and then adds this gently ironic comment: "I believe that there is a mountain in Switzerland on which congresses of economists have been held which have expressed disapproval of all or most of these things. But these anathemata have not even provoked attack." The reference is, of course, to the meetings of the Mont Pelerin Society organized in 1947 by Friedrich Hayek and attended by, among others, Karl Popper, Ludwig von Mises and Milton Friedman. Joseph A. Schumpeter ("The March into Socialism", *American Economic Review*, 40(2), Papers and Proceedings of the Sixty Second Annual Meeting of the American Economic Association, May, 1950: 449).

8 Arthur Smithies, "Schumpeter and Keynes", *The Review of Economics and Statistics*, May 1951, 33(2):164.

9 Joseph A. Schumpeter, Review of Keynes General Theory. *Journal of American Statistic Association*, December 1936: 794.

10 Ibid.

11 Yilmaz Akyuz and Charles Gore, The Investment-Profits Nexus in East Asian Industrialization, *World Development, 1996,* 24(3): 461.

12 Ibid.

13 Ibid: 468

14 Joseph A. Schumpeter, "The Communist Manifesto," *Journal of Political Economy*, June I949: 199.

15 UNCTAD, *Trade and Development Report 1997*: 63

Statement

by

Heiner Flassbeck

Director, Division on Globalization and Development Strategies, UNCTAD

What I am going to discuss, in line with what Carlos said, is the theoretical background of the *TDR* in the last ten years. For the 20 preceding years Yilmaz is much more competent to speak, so let me stay with the more recent past. I'll try to put the *TDR* in perspective to some big ideas in economics, on which we are all building our analysis. Unfortunately, I must say, although I am German, I never found a way into Marx's theories, though I tried several times but always stopped reading after ten pages or so. But indeed, I will try to answer this session's question, concerning the essence of the macroeconomic reasoning in the *TDR*.

Before that, I want to comment on one point that was discussed extensively this morning, namely why the *TDR* has so often not received the attention and recognition it deserves? My answer would be that insufficient recognition being received by your work can be a positive indicator about the significance of what you are saying. There is one form of obliviousness that is not a good indicator, namely, if you are totally boring or you are totally besides the point, if you are not questioning and challenging anything. Well then, if you are not paid attention to, then it is ok and you need not complain about it. But that is truly not the case of the *TDR*.

The *TDR* has always been provocative, always willing to challenge mainstream ideas and in this case insufficient recognition from the other side of the debate may signal that you are doing exactly the right thing. This is because your challenge has hit the core of the matter and endangers the credibility of the other side of the debate. If your whole theoretical edifice is being critically assessed by a certain person or publication, and not only by way of theorizing but most critically, through empirical evidence, then it is usually the best strategy to simply dismiss what this person or this publication says as being irrelevant. Engaging with such criticism may undermine your methodology and put at risk the credibility of your work in the broader public eye. Being sidelined for this reason, and I will give some examples later on, is in fact the best indicator of successful critical and forward-looking research.

So what is the essence of macroeconomic reasoning in the *TDR*? To put it in a nutshell: markets do not get the macroeconomic prices right. Do not misunderstand: Carlos Fortin said correctly that we are in favour of the market economy in principle. But although we are in favour of a market economy we have to take note of the fact that there are many markets in this world that do not get the prices right, indeed, that never get the prices right. And if you have major markets, and it is indeed the macroeconomic markets that I am talking about, that never get the prices right then you have a major problem in the global economy.

If, for example, currency speculation drives the currency valuation systematically away from equilibrium, even in the wrong direction given the values of the fundamentals, the huge destabilizing effects marginalize many other questions including those about the right structure of trade or the role of tariffs and protection in general.

Then the priority question for the global economy is how do we get the prices for international trade right? How do we get currencies that are following

the fundamentals? Take the wonderful case of Brazil: The country has experienced an enormous real appreciation in the last 5 years. The real exchange rate of the Brazilian Real appreciated, mainly due to carry trade speculation between Japan and Brazil, by around 60 per cent. India is another example. We have many examples in the recent past where countries are flooded by short-term capital and the prices go exactly in the wrong direction.

Now, if you show that simple fact, as we did in the G-20 deliberations (UNCTAD has observer status since 2010 due to the advocacy of some developing country G-20 members) to those delegations who are strongly advising to leave the currency valuation exclusively to the market because only the market can get the price right, what do you expect? What would be the reaction of the United States delegate in the G-20 to the presentation of this fact? His whole argument, in particular his complaint about China that has to liberate its capital account and has to leave its currency to the market so that the market can find the fundamental valuation, is based on the belief that the markets are always right. If you show that the market price is most of the time going in the wrong direction, if you demonstrate that the markets never find the fundamentals, what would he say? The answer is: Nothing. Silence. He just ignores you. And the reaction of IMF, World Bank, OECD, Bank for International Settlements and most of those sitting around in these meetings, is similar.

Silence is the only way out for them, because they have no argument at all! And if they talk about commodity prices as if commodity prices are always reflecting just supply and demand and you show that is not true because commodity prices are highly correlated with other financial market prices, what are they going to say? Again, no reaction at all is the most probable outcome because they have no argument at all and because you have challenged the keystone of their argument.

The same is true for the other macroeconomic prices. As I said, exchange rates are never right if you leave them to the market. Commodity prices are rarely right if you leave them to the market. But we have another important price that is hardly ever determined by the market – that is the interest rate. Interest rates are determined by central banks. To be sure, monetarism got it wrong, no central bank in the world steers money supply and the point of intersection of that supply with money demand determines interest rates. Central banks directly fix interest rates and provide as much money as necessary to keep the rate at the targeted level.

That is why, in the past ten years, we have criticized the traditional assignment of policies, which was driven by monetarism, where central banks try to bring down inflation even at the price of extremely high interest rates. We have argued consistently and constantly in the *TDR* that it is better to look out for other instruments to stabilize prices and use monetary policies to stimulate investment, real investment obviously, not gambling in international casinos.

That instrument is wages. But if you demonstrate empirically that inflation is mainly determined by the price of labour, by wages, salaries and productivity, namely unit labour costs, then you are again in danger of being ignored, because the most important of all dogmas is the one about the "flexible labour market". Every well-trained traditional economist strongly believes that the flexible labour market is, as Rolph Van der Hoeven has shown in the morning, the only way to overcome unemployment.

But if it is not true, and indeed, in *TDR 2010* we have argued that it is not true, then you are the odd guy out and you will be met with stony silence. But there are very good arguments to make the case that flexible wages do not clear the labour market because, as Joseph Schumpeter and Alfred Marshall knew very well, for the labour market as a whole supply and demand are not independent. However, to argue with normal supply and demand curves only makes sense if both are independent. For such a big factor as labour as a whole this is not true. So forget about neoclassical economics as far as the wage level and the labour market as a whole is concerned.

This simple analysis provides us with good arguments to hold that in the four extremely important macromarkets the normal market mechanism does not work – the currency market, commodity markets, the money market and the labour market. The "Washington Consensus" was about getting the prices right. But how can we get the prices right in the economy as a whole if in all these important markets the prices are hardly ever right and never clear the market?

In light of this, the essence of the macroeconomic reasoning of the *TDR* is that you need a state, a

government to do most of the work. You need a government with a clear idea about the functioning of the economy, about the development potential of the economy and about the external constraints the economy faces and, in light of these ideas, a government that is able to design an economic policy strategy. That, in essence, is the main policy thrust of the *TDR* in the last ten years.

Charles Gore asked: why it is important? Well, because all the other things are nitty-gritty compared to that big idea. There is not much that can move the world in the right direction if the four big prices that I mentioned are most of the time wrong. Governments have to intervene in the commodity market to get it right in light of an idea about the degree of financialization and based on its correlation with other financial market prices. To get the currency market right you need an idea about the fundamental and fair valuation of currencies and governments have to design a scheme, which allows currencies to follow the fundamentals. And to get the interest rate right, you have to follow an idea about the interest rates that is conducive to development and will help your investment in fixed capital to flourish and to help you catch up.

The fourth and maybe the most important idea you need is about the functioning of the labour market and about the conditions people need to invest so much of their lives in a system that is characterized by a growing division of labour. I think, we will be able to argue the case for a fair share of labour in *TDR 2012* because the division of labour has to bear fruit for all and not only for few. Many examples show already that this is not possible without intervention of governments and they also show that this is not only necessary for social reasons but mainly for economic reasons because without that no country is able to generate the domestic demand to generate a sustainable growth path and to respect all the other targets that we have as human beings.

Let me put the core of the message in a bit more abstract terms: A neoclassical economist would argue that a functioning market economy is about flexible prices and rather fixed quantities. We are arguing just the other way round: a functioning market economy, a developmental economy, an economy with the potential to develop works well with rather fixed macroeconomic prices and flexible quantities. If these prices are fixed at a pro-growth level and quantities are flexible growing income will be the result. That is exactly what you expect from a functioning economy for development.

Now, please allow me to give you a last example of why it is so difficult to overcome ignorance. Berthold Brecht in his play about the life of Galileo Galilei describes what happens if you are questioning, based on empirical evidence, the whole edifice of a science. At a certain point of the debate some mainstream scientists visit Galileo and ask him to enter into a formal dispute about his thesis. Galileo responds that he is not asking for a formal dispute but only a check of the facts. There is my telescope, he says; just look through it and you see what I am saying. But the philosophers and the mathematicians, who came to discuss with him, refuse to look through the telescope. Instead, they argue that it is useless for them to look through it as they know for a priori reasons that Galileo must be wrong. That is exactly the point of ignorance the *TDR* often touches; the better the argument and the stronger the evidence the more likely the analysis is to be ignored.

EVOLVING ISSUES IN INTERNATIONAL ECONOMIC GOVERNANCE

Introductory remarks

by

Andrew Cornford

Observatoire de la Finance, Geneva

Before turning the floor over to the speakers I should like to make some brief introductory remarks about the subject of international economic governance.

In principle, international economic governance includes: (1) the private law of international transactions; (2) national government law of international transactions; and (3) the law of international economic institutions. The first of these headings is largely beyond the scope of today's session, covering as it does contract law, insurance law, corporate law, maritime law and options for dispute resolution involving these subjects. It is with second two headings – national government regulation of international transactions and the law of international economic institutions, and the many interactions and the interdependence of the two headings – which I expect the speakers and subsequent debate to concentrate on today.

These two headings inevitably overlap substantially with other subjects covered by today's meeting – macroeconomics, exchange rates, international trade policy, the procedures and conditionality of lending by international financial institutions, external debt, development policies and strategies, and so on. Indeed, when I joined UNCTAD in 1977, I think that the consensus would have been that the coverage of international governance was largely co-extensive with these subjects.

More recently, owing to the enhanced importance of private as opposed to public actors and institutions in the functioning of the international economy since the 1970s and the more recent shift in relative global economic power and weight away from the United States and Western Europe towards Asia, the focus of discussion of international governance has broadened.

The changed configuration of economic power and weight has intensified debate over the representativeness of the multilateral institutions responsible for international economic governance. The enhanced importance of private actors and institutions has led to greatly increased attention in international governance to the operations and functioning of these actors and institutions. A notable early manifestation of this increased attention was the development of key international financial standards after the Asian financial crisis of 1997–1998. More recently, since the outbreak of the current financial crisis, the international economy is having to absorb what sometimes seems a tsunami of new rules and standards concerning financial markets and institutions and related parts of macroeconomics.

The design of a new architecture capable of reducing the likelihood of future global financial instability and of contributing more effectively to real economic activity and development – an architecture which has numerous connections to the model of international economic relations enticingly outlined in the Secretary-General's report to the forthcoming UNCTAD conference – the design of such an architecture poses difficult problems, concerning which

I think international consensus is still lacking, as to the appropriate balance between the scope of national policy and regulation, on the one hand, and international rules and standards, on the other. This balance is one of the subjects which I hope the speakers and other interveners will broach this afternoon.

Thank you for your attention. Now for our speakers.

Statement
by
Jomo Kwame Sundaram
Assistant Secretary-General for Economic Development,
United Nations Department of Economic and Social Affairs

Reflections on UNCTAD annual review with an attitude

First, let me thank the organizers for this kind invitation. It is a great honour for me to be here to pay tribute to the *Trade and Development Report* which is a bit of a misnomer. It should be, in my view, the *Macro-financial, Trade and Development Report*, because in the hands of the leadership of the *Trade and Development Report*, this is what it has become. It has been extremely important for a variety of reasons. So, I would like to pay tribute to the men and women who are here and also to those who are no longer with us and some who are not here, but are still with us. It is very important for us to recognize that a sustained collective effort over three decades is a great achievement indeed.

It is also important for us to recognize the importance of leadership. I particularly want to take this opportunity to pay tribute to Yilmaz Akyüz because he demonstrated for me something which I did not quite appreciate until I saw him in action. When I first met him, he was a P-5 but simply by hard work, commitment, vision, initiative and working effectively with others, he exercised leadership in very important ways. Even though he was not Director for very long, he was effectively the leader of *TDR* for an extended period of time.

My engagement with the *TDR* has been mainly in the last half decade or so after I joined the UN seven years ago. I have also had the pleasure of working with the *TDR* team, in particular with Heiner Flassbeck and some of his colleagues, on some challenges, in particular, challenges posed by the current crisis which has also elevated the role and status of the *TDR*. In a very profound sense, it has been the *TDR*, together with colleagues working in New York, and the Bank of International Settlements under the leadership of William White, who consistently warned of the very dangerous features developing on the macro-financial front which culminated in the present crisis, and it is unfortunate for the world that we were ignored. I do not take pleasure in being right but ignored. The world has paid a very high price for ignoring this important work. But it is precisely because we did this work that there has been a belated recognition by the international community of the need for a second opinion.

American pundit James Carville once quipped that after he dies, he would like to return as the bond market because that is where real power truly lies today. We are living in a world where all too many leaders, including those in the G-20 group of major economies, are constantly looking over their shoulders at what financial markets will say about their policy changes. The resulting failure of leadership and weakness of international coordination at a time like this, when we are facing the prospect of protracted economic slowdown and its devastating consequences for billions of people, is a terrible indictment of the system.

We all know that the Bretton Woods conference in 1944 changed the world. Not all the problems of the financial system were satisfactorily resolved, but since the end of the Bretton Woods system in 1971, there has been ad-hocism instead, with no systemic reform to speak of. What we have had is an accretion

of ad hoc reforms, and quite correctly, the Committee overseeing the IMF was called the Interim Committee for decades. In many ways, it was a reflection of the fact that all new arrangements were essentially ad hoc and occasional pretensions of being systemic were misleading; hence, Robert Triffin's 'non-system' characterization.

Very importantly, the Bretton Woods system was not just simply about the international monetary and financial system narrowly conceived. It was about creating the conditions for sustained growth, of output and job creation, post-war reconstruction and post-colonial development – as the official name of the World Bank implied. The stakes were high and the reforms were seen as absolutely necessary to avoid the kinds of social and political developments which led to the outbreak of the Second World War. The Bretton Woods conference was held just a few months following the Philadelphia Declaration which was a very important landmark for the ILO affirming the commitment to full employment. This needs to be re-emphasized because there is no other way to alleviate poverty in a sustained fashion if we do not create decent and productive jobs for the world's population. A lot of recent so-called 'silver bullets' from Washington have been essentially gimmicky with none able to alleviate poverty in a sustained fashion.

Empirical evidence, shown by Richard Kozul-Wright, who has been associated with the *TDR* for a very long time, demonstrates that financial globalization has been growing faster than trade integration, which is what we normally associate with globalization. As a consequence of this, we have seen significant transfers of financial resources, not from the North to the South, as promised by advocates of financial liberalization or globalization who promised massive transfers of financial resources from the capital rich economies to the capital poor economies. But what has actually happened has been the converse. The capital flows have been from the poor to the rich. The recent book of Leonce Ndikumana and James Boyce shows the flows of resources from Africa to the rich world. Half of these resources have gone to the United States of America for reasons we all know. One might think that this flow of resources across borders may have resulted in an elevated rate of investment, but this simply did not happen. The costs of funds have not been significantly reduced by financial globalization either. Also, very importantly, we have not seen a diminution of volatility and instability in the last few decades, especially affecting not only the so-called emerging market economies, but also some OECD economies.

Although the IMF was right in emphasizing the need for coordinated fiscal stimulus efforts to avert a global meltdown, its emphasis since early 2010 on fiscal consolidation has distracted attention away from the urgent need of sustaining recovery. The IMF's responses in other areas, especially before 2009, exacerbated the situation in different ways, by limiting policy space. The premature and unnecessary emphasis on fiscal consolidation quickly brought an end to the nascent fiscal stimuli and the welcome green shoots of recovery. A whole range of reforms are needed now, but there has to be better prioritization.

In the mid-1940s, the basic vote for all 44 members of the IMF accounted for 11.4 per cent of the total vote. By 2008, the basic vote had shrunk from 11.4 to 2.2 per cent shared among its 184 members. As the value of a basic vote diminished by over 95 per cent, smaller and poorer economies have effectively lost voice in the governance of the institution. Effective governance rights on the basis of 'one dollar one vote' are simply not consistent with the original intent to set up the IMF as an international financial cooperative. This basic founding principle has been undermined by the erosion of the weight of the basic vote over the decades. If the original weight of the basic vote had been retained, basic votes would account for almost half the votes today with the more than fourfold increase in membership from 44 to 185.

As many of you know, the 63rd President of the General Assembly set up a Commission chaired by Joseph Stiglitz. Rubens Ricupero, former Secretary-General of UNCTAD, was one of the members with Jan Kregel, a former member of the *TDR* team, serving as Chief Rapporteur. Unfortunately, many of its important and constructive proposals have been sidelined since, even at the United Nations in New York. The proposals were nuanced in addressing different types of derivatives, clearing house mechanisms, market mechanisms, global economic governance and regulations – all relevant to improving and enhancing international economic performance.

In the longer term, the long deferred problem of global imbalances needs to be addressed, but doing so should not stand in the way of urgent recovery efforts.

The reserve currency system needs to be addressed in this connection. Article 6, Section 3 of the Fund's Articles of Agreement is very unequivocal in ensuring all member countries the sovereign right to capital controls, but instead, we have seen Fund staff preaching the contrary for decades now. Although there are over 100 countries which have some type of capital control, many of them are in denial that they have capital controls for fear of adverse market perceptions in the current ideological climate. This basically deters national authorities from exercising rights which they have and which the IMF should enable them to exercise.

Another challenge highlighted by the current fiscal and related debt problems is the need for greater international tax cooperation. Some governments jealously guard their tax prerogatives in myopic ways, not appreciating the benefits for all from greater cooperation. Thankfully, there is now growing recognition of the need to enhance international cooperation because it is precisely in a much more globalized world that one can find a lot more tax evasion by taking advantage of the global interstices of the jigsaw of national arrangements. This has been exposed time and again, even before the crisis. In the current Greek crisis, for example, it has been estimated that the top 15,000 tax payers in Greece have avoided paying an average of 4 million Euros each, totaling over 60 billion Euros. Some claim that this has got to do with the terms and conditions on which the military decided to go back to the barracks in the 1970s. It is the developing countries which have the weakest government capacities, precisely because tax capacities are weak and consequently, other government capacities and capabilities need to be better developed.

There are many challenges we face in the international economic system. There should be a much stronger reform process taking place in response to this economic crisis. The G-7 and G-20 have failed. The G-7 has failed for reasons which we all know, which is why the G-20 was elevated to its current status. While there were promising beginnings with the G-20, particularly in the first half of 2009, with the April London Summit, there has been very little progress since then, whether in terms of international cooperation needed for strong and sustained recovery, or for bringing about the necessary reforms of the international financial system, important not only for achieving strong and sustained growth, but also for reducing the anarchy which exists in the financial world today.

The London summit in April 2009 was probably the high point for the G-20, with tangible progress modest since then. In 2010, there were some initiatives by the Koreans which were good and friendly to development, but these have not been sustained. In 2011, a number of new issues were opened up by the French Presidency, which was very promising, but there is less to show for it, now in retrospect. Here, I need to compliment the role of UNCTAD, particularly the Division on Globalization and Development Strategies (DGDS), for doing most of the heavy lifting on several fronts. The question of commodity price increases was distinguished from the problem of commodity price volatility, and the relative roles of 'economic fundamentals' versus financialization were also unpacked in informed and important ways – as reflected in some UNCTAD documents and other writings by Jayati Ghosh and others. Unfortunately, there was strong resistance by some powerful G-20 members, so the final report was not as good.

Some G-20 successes have been double-edged. The main requirement for the banking system has been to raise capital requirements. Little has been done to address problems raised by the emergence of the shadow banking system although the Financial Stability Board may come up with some relevant proposals before too long.

From the macro-financial point of view, there is no way we are going to have strong sustained, balance and inclusive growth if we do not ensure that systemically, we have adequate counter-cyclical policies, institutions, instruments and mechanisms. This is of fundamental importance, and now is precisely the time when we need to push hard on these issues, building coalitions of support for such initiatives and reforms. There are a number of worthwhile French initiatives last year which may no longer be taken up in the G-20, but that does not preclude the UN system responding to those deemed worthwhile. Yet, there are a number of initiatives which the G-20 has developed that are well worth supporting, which underscores the utility and efficacy of a smaller forum, especially for discussion of complex new issues. One such matter being addressed by the current Mexican Presidency of the G-20 is the issue of financial inclusion.

On the other hand, some issues are being taken up in ways almost antagonistic to UN processes. For example, as negotiations proceed for the Rio+20 summit on sustainable development, to be held right after the G-20 summit in June 2012, the OECD is promoting

a discussion on green growth in the G-20 which does not recognize the principles of sustainable development, thus unnecessarily antagonizing some G-20 members. Needless to say, these G-20 developing countries are resisting this type of discussion.

But relying on the G-20 to provide leadership out of the financial messes the world is in is problematic for a variety of institutional and other reasons. Some point to the absence of a permanent secretariat; but the existence of a secretariat is not going to make things better because, for all intents and purposes, right now, the IMF and the OECD serve many functions of a de facto secretariat. Being what it is, the kind of agenda the OECD brings to the table is considered hugely problematic by most G-20 emerging market economies not in the OECD. Developing countries have long been urging governance reforms for the Bretton Woods institutions. Governance reform has long lagged behind the changing shares of the world economy, especially following the rapid growth of some Asian economies and other emerging market economies which should have led to corresponding quota reforms by now.

The French-commissioned Bill Gates report on innovative development financing came up with useful ideas which could have opened up useful discussions, but the report has not received the attention and follow-up actions it deserves, suggesting that the ad hoc and arbitrary nature of G-20 work is problematic and less promising than expected. Initiatives arising from ad hoc arrangements may actually undermine existing institutional arrangements such as those of the IMF. Arturo O'Connell and I found ourselves trying to strengthen the IMF. A legitimate multilateral institution like the IMF has certain responsibilities which it should be able to undertake and fulfill instead of relying on ad hoc mechanisms proposed by others. Most importantly, of course, such ad hoc arrangements undermine the commitment to inclusive multilateralism, which the UN system represents, including the Bretton Woods institutions.

There have been many issues discussed in the context of the United Nations. One idea, which has been discussed many times, is the creation of a Global Economic Council, endorsed by Chancellor Angela Merkel and Prime Minister Manmohan Singh, which has gained some traction. I cannot imagine that any other forum can bring about this Global Economic Council besides the United Nations. It is important to keep this flame alive, considering the need for a much more legitimate body in terms of international economic governance than the G-20. But for obvious reasons, such an initiative is unlikely to be initiated by most G-20 Member States.

The debate on global economic governance seems unlikely to make ECOSOC more important. The proposal for an Economic Security Council is not going anywhere. The L-27 proposal by Kemal Dervis and others is unlikely to be implemented although it is quite promising. Choosing one instead of ECOSOC's two per UN constituency and meeting at the Leaders' level, the L-27's constituency-based system should ensure much more legitimacy than the G-20 arrangements while retaining most current G-20 members. Alternatively, the General Committee of the General Assembly, which meets once a year just before the General Debate opens in September every year is another avenue which could be explored. But we have not seen any serious discussion thus far, although such an initiative does not require charter change and could enable the UN to address concerns which need international attention at the highest level of the heads of Government.

One new proposal under discussion is alleviating the Commission for Sustainable Development into a Council for Sustainable Development. There seems to be growing support for this proposal which may well result in a summit outcome document in Rio in June to this effect. For this reason, it is important to consider how a Sustainable Development Council can strengthen the UN, especially ECOSOC, to ensure we go forward, not backward.

The other urgent issue, of course, is the need for international leadership, and the proposal which has come out from the UN system is for a new deal for our times. There are two elements which distinguish this proposal from the Roosevelt initiative of the mid-1930s. First, this must necessarily involve international cooperation. Some recent issues of the *World Economic Situation and Prospects* have contained some policy modeling work by Alex Izurieta highlighting the clear advantages for all of international cooperation and coordination, compared to non-cooperation. In the scenarios of international cooperation, everybody would be better off in a situation in which both developed and developing countries would benefit.

Clearly, a whole range of reform efforts are badly needed. Unfortunately, current reform efforts are unfinished and inadequate. Another element, which is very much of an UNCTAD issue, is the urgent need for a sovereign debt sustainability framework. There was a proposal some years ago from Anne Krueger, while she was at the IMF, for a sovereign debt restructuring mechanism (SDRM). UNCTAD has the mandate to make progress on this front.

At the risk of stating the obvious, critics of the existing international financial system are not suggesting that we do not need an international financial system, but rather one that better serves desirable investments and growth of the economy. In this regard, there currently is renewed attention to the need for new sources of infrastructure financing. There are a number of proposals (e.g. for a South Bank) which need to be revisited in this regard, and many lessons to be learned, for example, from the European Investment Bank and the former Andean Development Corporation (CAF), now called the Development Bank of Latin America. All these offer very important lessons. There is a proposal for an Asian Investment Bank and there are various other proposals which should be explored and developed, and certainly deserve the attention of UNCTAD.

In recent years, I have tried to work closely with the people responsible for the *TDR* to try to develop a ‘second opinion’ macroeconomic advisory capacity through the UN system. Unfortunately, the impact has been relatively modest because financial resources have been difficult to get. The existence of an alternative is especially important because one of the problems we face today is related to the theme of this session on international economic governance, namely the failure of leadership.

Although modest so far, the emergence of a UN system macroeconomic advisory capacity, offering an alternative perspective to that coming from Washington, is vital. Already, to be fair to the IMF, there has been a great deal of rethinking on some issues in recent years, and this has opened up some important policy space, but such pressure from analytical competition has to be greatly enhanced to become significant. We at the UN can claim some credit for this, precisely because we have offered such an alternative, and the *TDR* pioneered this in the UN three decades ago.

There are many issues which the *TDR* has been raising over the last three decades which still need to be addressed. I want to thank *TDR* and those responsible for putting these issues on the international agenda.

Statement

by

Arturo O'Connell

*Advisor to the Presidency of the Central Bank of Argentina**

Evolving issues in the institutional government of the international economy

The limelight on the institutional government of the international economy since the present-day crisis started – proximate date around 2007 but with roots into several decades past – has been dominated by the activity of the G-20. No doubt, widening the G7/G8 forum to include a few other advanced ones outside those chosen in the 1970s, plus a whole set of developing countries, looks like being a step in the right direction. But the limitations are too many. On the one hand, a "*forum*" even if complemented by dozens of working groups does not satisfactorily discharge the responsibilities of a true government.[1] "Peer-pressure" is no substitute for rules arrived to through some democratic process consecrated in an international organization. And the lack of a secretariat leads to the twin sins of a continuous stream of working group meetings – an exhausting experience for a small group of officials running around the world with the risk also of their principals losing control of developments coming up to ministerial or heads of State level without due political input – and the emergence of some very specific institution, e.g., the IMF as the de facto secretariat, not always representing a new vision of the tasks ahead, a circumstance that compounds the loosely controlled outcome of the working groups. [2]

There are a few other deficits in the G-20 experience. Although some efforts have been made towards introducing subjects other than those of finance and some areas of macroeconomics, the government of the international economy has to address issues as those of employment or food/hunger, all of them highly interconnected and important that have gone unheeded.

But most importantly, there is a serious democratic deficit with several dimensions. The first and obvious one, is that more than 150 countries are left aside with very few attempts to include them through at least roundabout ways. Paradoxically, it has become a feature of G-20 meetings, that businessmen, not necessarily very representative of those worst hit by the crisis neither of those from which much should be learned about new ways of governing the international economy, hold a meeting supposedly to advise the heads of Government and State.

At the same time, as with other international *fora*, influential politicians – parliamentarians or ex-heads of Government – have been left aside, as the whole exercise is monopolized by sections of the bureaucracies of their own countries, mainly central bankers and ministers of finance – an almost overlapping

* This presentation is offered on a strictly personal capacity and should not be construed as representing the opinions of either the Presidency of the Board of Governors of the Central Bank of the Republic of Argentina.

group of people only exceptionally not sharing the same views of the world. The exercise ends up in summit meetings that, as always, are not meant to debate anything that has not been agreed at lower levels dominated by such an "epistemic community".

That combination of deficits looks like having made of the G-20 less a representative instance of a wider section of the world's countries but rather a co-optation exercise by some of the more powerful countries to make the rest toe the line that – now that the best managed developing countries need not resort to IMF support – used to be the role of conditionality imposed under the Fund's programmes.

Paradoxically, the above limitations of the G-20 process coexist with two clear facts. The first one is that both figures and perceptions point to the developing countries having become the "locomotive" of the world economy; in fact in the period 2007–2011 three-quarters of world economic growth originated in this group of countries. And the second one, that some major, and not that major, developing countries have generated current account surpluses that do not seem to come to an end and have accumulated sizable foreign exchange reserves and "sovereign wealth funds" while the advanced countries deficits that have become habitual do not find easy sources of finance, leaving aside the "exorbitant privilege" of the international currency issuer. One is witnessing these days that developing countries with a GDP per head of only one-fifth of that of the Eurozone are being asked directly, or indirectly through the IMF, to come to the support of the Eurozone as it is undergoing a serious crisis.

Consequently, developing countries' capacity to sustain high activity levels spilling over into demand for goods, services and investment from – among others – advanced countries plus their, in principle, ability to help some advanced countries bridge their financial needs, should result in their playing a totally different role than a subordinate one.

That capacity to play a different role has mostly been built with the use of economic instruments quite different to the present-day dominating ideas in most advanced countries propagated through the IFIs and the WTO as well as through "peer-pressure" at the G-20. Briefly, it consists of a different combination of government and markets in handling their economic problems. While some of the European countries are dismantling welfare state institutions built over a century of struggle for more equitable and compassionate societies, some of the developing countries, granted from abysmally lower levels, have been able to reduce inequality in their societies. Still, and in spite of the lessons of the crisis, advanced countries and the international organizations dominated by them today are insistent in developing countries abandoning what are considered old ideas. If there was a time when today's advanced countries were fully protectionist, now that is unacceptable for their less developed brethren. Similarly, their financial systems – including the management of international flows – should not be structured in ways similar to those enacted not many decades ago by those now playing in the upper leagues.

There is no dearth of interesting and attractive proposals put forward to overcome the G-20 limitations and, more in general, the various deficits in the institutions governing the international economy. Legitimacy of representation still lies in the United Nations system. Therefore, besides merits on its own rights, special attention should be granted to the report issued by the Commission set up by the President of the UN's General Assembly, better known as the Stiglitz Commission.[3] It is suggested that a Global Economic Coordination Council should be set up plus a whole set of changes in the policies and government of IFIs and various suggestions to organize a different international monetary system as well as reforms to be introduced in international finance. UNCTAD via several of its *Trade and Development Reports* has for many years been suggesting reforms in many fields as well. Unfortunately, and as it has been the case in previous occasions, once panic was left behind – although it raises its head here and there – little progress along the necessary radical reform of the government of the international economy has been made.

The crux of the problem confronting the government of the international economy is that two combined issues have to be tackled. First and foremost is to leave behind outmoded ways of thought, the ones that have led to the present day crisis, started and reinforced by the deregulated, financially dominated advanced economies. In this sense, developing countries have to reaffirm their views and experiences that different but diverse ways of conducting economic affairs – not necessarily a single way but not that followed in the last quarter of a century in the advanced

world – are needed, surely with a higher degree of public intervention and a privileged attention to the welfare of the majority of their populations.

The second issue would be to reclaim their due quota of power, of voting power. But more importantly, developing countries have to win the battle of ideas to achieve a consensus building power, under which the above ideas could flourish and become “natural”; they would differ from those propagated against scientific advance and the dramatic experience by the “Washington Consensus” in extreme forms that have gone beyond those exposed by Mr. Williamson in his well-known book. In comparison, the matter of creation of new institutions and/or of better coordination between the existing ones is truly a secondary one.

For that purpose we must revisit the stock of teachings that the *TDRs* have been disseminating for now 30 years, precisely when the name of the day was the opposite; in those years it was assumed that development would take place by itself by just letting “the markets” – increasingly big finance, to go back to the expressions of an era that confronted similar challenges – work. Those teachings have to be forcefully reinstated not just to enjoy the hubris of a “I told you so” exercise but to guide public opinion, leaders in all walks of life and the public at large that there is a different, and if you want, more “scientific”, way to promote the wealth of nations.

Notes

1 In the words of Tommaso Padoa-Schioppa “The fact of the matter is that the thirty years of growing laissez-faire and globalization were also years of declining international cooperation. This was epitomized by the shift from international institutions to ‘forums’, from the strong, treaty-based, binding form invented in the mid-1940s to the soft, voluntary, and narcissistic form of periodic meetings of self-appointed groups, without the support of staff commitment to the ‘interest of the world’, and without any power to take binding decisions”. See his “Markets and Government Before, During and After the 2007–20XX Crisis”; Per Jacobsson Lecture; Per Jacobsson Foundation, June 2010. In our opinion, however, international institutions run the risk of becoming too single-minded while in fact diversity in norms is decisive for an extremely varied world. For instance, Art. 4, sec. 3, b) of the IMF’s Articles of Agreement prescribe that: “These principles (on member countries’ exchange arrangements) shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members”, a prescription not applied very frequently.

2 In the case of the IMF one should clearly distinguish between political decisions taken as part of the “United States Treasury-Wall-Street-Complex” (Jagdish Bhagwati expression paraphrasing President Eisenhower’s farewell speech warning the American public against the “Military-Industrial Complex”; see Mr. Bhagwati’s “The Capital Myth; The Difference between Trade in Widgets and Dollars”, Foreign Affairs, vol.77, No.3, May-June 1998) and the work of its staff, particularly of its Research Department out of which, for instance, in 2003–2005, came a few key papers on the lack of effect of capital inflows on growth; in fact, one of them showed a negative effect on growth. On the other side, the “political” use of the IMF could be seen in how their report on the Argentine financial system under the FSAP scheme, right before the dramatic crisis at the end of 2001, was pointing to only some minor problems in the financial system that would collapse only a few weeks afterwards.

3 See “Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System”, 21 September 2009.

THE WAY FORWARD

Closing remarks

by

Alfredo Calcagno

Head, Macroeconomic and Development Policies Branch, UNCTAD

We have listened to very interesting presentations today, and to a very stimulating debate. I think the reason why this discussion has been so stimulating is not only because of its reference to the history of development thought, but also because of its relevance for understanding the economic problems and development challenges in today's world. Through three decades of providing an annual document, the *TDR* team has also come up with an alternative approach to analysing development.

If the *TDR* has become a useful instrument for understanding the development process and elaborating development strategies, it is because it has provided a pertinent critique of the approaches and policy advice of other international institutions. In accordance with UNCTAD's mandate, the *TDR* has viewed trade and development issues from the perspective of developing and least developed countries. It has enriched the debate on development by showing the feasibility of alternative policies to those proposed by the Washington-based institutions and the neoliberal thinking and tried to break the uniformity of the "pensée unique", which has been so pervasive among academia, the mass media and policymakers since the early 1980s, when the *TDR* was launched.

The *TDR* has made a valuable contribution to an understanding of complex economic and social theory and reality, not only because it has been one of the few dissonant voices for many years, but also because its analyses and policy recommendations have often proved to be more accurate and valid than those of the mainstream. In my view, this is due to the fact that the *TDR* has always followed a critical and pragmatic approach rather than one that tends to justify the status quo. Rejecting dogmatism and complacency is the only way for a social discipline to resemble a science. A critical view comes more naturally to researchers that espouse developing countries' point of view, since those countries suffer the most from the status quo.

For the team that will continue to produce the *TDR*, this critical approach is probably the most important inheritance from our predecessors.

I think it was Franz Marc, the expressionist painter, who said "tradition is not wearing your grandfather's hat; it is buying a new one, just like he did". This applies to the present *TDR* team, in the sense that we must continuously be open to new topics of importance to development strategies; we must maintain a fresh outlook and an open mind, taking nothing for granted. In the last section of the background document, Detlef Kotte outlined some important emerging issues that could be addressed in future *TDRs*. This does not mean that many "old" topics have lost their importance; on the contrary, several challenges that the world economy faces today are a continuation of traditional issues already studied in UNCTAD and in previous *TDRs*, such as financial crises, and problems relating to terms of trade, income distribution or the functioning of the international financial system. In addition, any new topics that may be taken up in the future should be studied with the same analytical and critical approach. In other words, *what* we study is one thing – though we may have to expand the scope

of our analysis; another is *how* we study it. And there are no reasons for abandoning the methodological instruments and the overall analytical orientations that have characterized the *TDR*.

Economics is not an experimental science, but we can learn from experience. A critical analysis of past and present developments has been the basis for much of the *TDR*'s most valuable contributions. Its study of different situations and experiences supported its disapproval of "one size fits all" approaches, and enabled it to provide an understanding of why some policies were successful while others failed. Some of the experiences of developing countries affected by financial crises and debt may provide very useful lessons for what is happening in Europe today. The *TDRs*' policy recommendations which have advocated enlarging and using policy space and regulating financial markets do not stem from ideological preconceptions, but from an analysis of a wide spectrum of cases.

This does not mean that the *TDR* does not subscribe to any theory; as several panellists and moderators have clearly shown, the choice of theoretical framework is guided by a consideration of what is the most useful for explaining reality. Indeed, all economists, including those who produce policy-oriented reports like the *TDR*, suscribe to some kind of theory and ideology. Here, I do not mean ideology as "fausse conscience" or lack of intellectual honesty, as is frequently understood ("ideology is my opponent's ideas", said Raymond Aron); I mean ideology as part of the methodological framework that is indispensable in all economic analysis, as stated by Maurice Dobb. Not admitting the existence of any ideological and theoretical framework would be to behave like Jourdain in Molière's "Bourgeois Gentilhomme", who spoke in prose without noticing it. Or as Keynes wrote in the General Theory, "Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist".

Economists should acknowledge their affiliation to some theoretical orientations, and recognize that there may be viewpoints other than their own. And, though it may be more difficult, they should admit their mistakes resulting from an erroneous theoretical approach. As noted by Schumpeter, economists and policymakers may be familiar with some facts that contradict their theoretical beliefs, without following the logical consequences of such a contradiction. This is why many of them still support concepts such as the efficiency of financial markets, the neutrality of money or the prevalence of self-correcting markets. The reason why it is sometimes difficult to recognize the flaws of some economic dogmas is that by doing so it can affect powerful vested interests. For example, the present financial crisis has made it abundantly clear that money is not neutral. But for that matter, neither are central banks, since they have been observed to favour some agents to the detriment of others. Consequently, the main justification for the independence of central banks disappears, and this is considered complete heresy. It is more comfortable to maintain that, at least "in the long run", money is neutral.

The *TDR* has a theoretical foundation, and the discussions today mentioned the names of Prebisch, Keynes, Kalecki, Schumpeter and Minsky, thereby showing its affiliation to a structuralist and Keynesian theoretical tradition. This is a tradition that is worth continuing. It would be ironical to have resisted market fundamentalism in the 1980s and 1990s, only to surrender to it after the 2008 crisis. This latest crisis has revealed the flaws of unbridled free markets which should be evident to anyone who does not wear ideological blinkers.

SUMMARY OF THE DEBATE

The debate concentrated on three issues: the way in which the *Trade and Development Report* has been used, the reasons why the Report often has not received appropriate recognition, and ideas for major possible themes for the Report to address in the future.

Regarding use of the Report, one speaker from civil society mentioned that staff at his institution had used the *TDR* as a reference for their own analyses and for understanding global economic developments. It had also been used for disseminating to policymakers and to the general public UNCTAD's contribution to independent thinking and its exploration of ideas for developmental policy-making, as it often presented alternative views to those advocated by other international organizations. The Report's analysis and associated policy conclusions regarding the East Asian development experience and the East Asian crisis had been particularly useful, as was its evaluation of their implications for the reform of the international monetary and financial architecture. The Report's cautioning against big-bang trade liberalization, and its arguing that this would risk causing deindustrialization, especially in African countries, was considered equally valuable advice. He also said that the concerns expressed in the Reports about possible adverse impacts of too rapid trade liberalization had been among the reasons why, in the current Doha Round of multilateral trade negotiations, it was recognized that least developed countries should not move too swiftly towards full trade liberalization. The same speaker observed that the analyses in recent issues of the Report regarding the macroeconomic impacts of the current economic and financial crisis, which were in line with its traditional analyses and policy orientations, had also been very useful. Speakers from academia added that they had used the Reports as teaching material in conjunction with reports from other international organizations. They particularly valued the Reports' serious theoretical and empirical analyses and their related nuanced policy conclusions. Speakers also pointed to the Report's utility for developing-country policymakers, as underlined by Mr. Ismail's presentation.

A range of speakers commented that the *TDR* had not always received the recognition it deserved, but differed in their assessment of the reasons for this. Some mentioned that the Report ran up against vested interests because of its support of developing-country interests, which did not always coincide with the interests of financial markets and the policies adopted by developed countries. Others said that the Report's theoretical tradition was, in addition to mainstream economic theory, based on the thinking of economists such as Gunnar Myrdal, John Maynard Keynes, Hyman Minsky, Raul Prebisch and Joseph Schumpeter, which for many years had been considered "outmoded". The alternative voice provided by the Report had often met with a collective attitude of denial that the very existence of any alternative to mainstream economic views could be relevant to today's problems. It was only with the current crisis that the usefulness of a plurality of views was acknowledged and that more mainstream economic analysis had "rediscovered" the pertinence of the thinking of the above-mentioned economists. In a sense, this rediscovery had brought mainstream thinking closer to the approaches and policies that the *TDR* had consistently upheld. It was also suggested that on some occasions the Report's policy recommendations may not have been mentioned deliberately. For example, in December 2001 the then chief economist of the International Monetary Fund proposed a "new" approach to sovereign debt restructuring along the lines of that used to address domestic bankruptcy – a position that had been advocated explicitly by the *TDR* much earlier. Recourse to the principles of orderly debt workouts along the lines of Chapter 11 of the United States Bankruptcy Code had first been proposed by UNCTAD in *TDR*

1986 (annex to chapter VI) in the context of the debt crisis of the 1980s, and further elaborated in *TDR 1998* (chapter IV) and the *TDR 2001* (chapter III), published in April of that year.

With regard to possible future topics that might be addressed by the *TDR*, there was some discussion as to whether and how new issues should be treated. There was also a discussion as to what extent new issues should draw on specific areas and policy messages that Raul Prebisch, UNCTAD's first Secretary-General, had examined in the 1950s and 1960s. One speaker mentioned that the key issues for the twenty-first century included human rights, the environment, inclusive development and the promotion of gender equality, and suggested that the Report should play an important role in mainstreaming these issues into general economic life. Some also believed that of similar importance was growth and development in commodity-based economies. Key challenges were how to avoid repeating these countries' disappointing performances during past commodity price booms, and how to maximize the benefits of buoyant commodity exports for economic growth and structural change. In this regard, it was noted that the Report could take its cue from Prebisch's work and also explore whether the East Asian model could be replicated in economies with different initial conditions.

Other speakers argued that it would not be useful to cling too closely to Prebisch's work. While extremely useful at the time, his casting of global interdependence in terms of centre versus periphery and commodities versus manufactures no longer reflected the way in which the global economy was functioning. The situation had changed and so had the analytical approaches to examine it. Developing countries had assumed an increasingly important role in world economic relations and had become major exporters of manufactures. Indeed, this had led Hans Singer, whose name had been closely associated with that of Prebisch, to reformulate the so-called Prebisch-Singer hypothesis already in the early 1990s. A challenge for the Report was therefore to propose a new development paradigm more suited to the new context.

A third group of speakers shared elements of both these alternatives, emphasizing that the Report should continue to take a critical approach towards economic theory and facts, as well as support policies that benefit all, but especially citizens in developing countries. They believed that the *TDR* should continue to examine emerging issues of importance to developing countries, but also maintain its focus on where it could make valuable contributions. Many of the issues that had been UNCTAD's main concern during the 1960s and 1970s, as well as during the early years of the Report – namely trade, finance and macroeconomics – were still relevant and should not be abandoned. Rather than treating new topical subjects, the Report needed to maintain its tradition of trying to anticipate issues within its core competence of global interdependence and its impact on national policy-making. It was in these areas that it could adopt new approaches in order to provide new solutions aimed at ensuring that domestic policies and international action were mutually supportive in achieving sustainable development. This was also considered necessary for practical reasons, as the small number of staff preparing the Report could not acquire and maintain expertise in an ever-expanding range of topics.

This publication was prepared by the UNCTAD secretariat to commemorate the first three decades of the *Trade and Development Report* (*TDR*) – UNCTAD's main flagship publication – whose first edition was published in 1981.

Part One of this publication traces the key issues relating to the global economy and development strategies discussed in various *TDRs* over the past three decades. It also shows how the ideas, analytical perspectives and policy proposals expressed in the *TDR* have differed from "mainstream" thinking, and how they have evolved in response to new challenges arising from global economic developments.

The salient features reviewed in this publication are:

- The concept of interdependence, which has shaped the *TDR*s' policy analyses and recommendations over three decades;
- The approach of the *TDR* to macroeconomic and financial policies in both developed and developing countries;
- The *TDR*s' contribution to the debate about the shortcomings and the need for reform of global governance in trade, finance and macroeconomics;
- The *TDR*s' assessments of the failures and successes of development policy, as well as their recommendations for development strategies, taking into account lessons from past experiences; and
- Issues that remain topical and others that may become relevant for analysis in future *TDR*s.

Part Two of the publication comprises the contributions of the experts who participated in a panel discussion on *"Thinking Development: Three Decades of the Trade and Development Report"*, a pre-Conference event for UNCTAD XIII, which took place in Geneva on 20 February 2012.

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