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Secretary-General of UNCTAD  
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Just over two years ago the collapse of the Thai baht and the rapid spread of financial distress across much of developing East Asia looked set to blow the global economy far off course. Today, with the Asian economies recovering strongly, with the irrepressible rise of industrial countries’ stock markets, and with signs of a European growth revival, the worst danger lies in complacency and temporary relief, and in refusing to draw hard lessons from the crisis and to undertake the necessary reforms and changes. Concerns about the fairness and effectiveness of the international financial architecture have been jettisoned, and attention is now turning to a new round of trade negotiations to keep up the momentum of rapid liberalization without enough priority to the need for redressing the imbalances that have contributed so much to the intensification of crises over the last 15 years.

Business as usual is the wrong message for developing countries on the eve of a new century. In recent years these countries have striven hard, and often at considerable cost, to integrate more closely into the world economy. But in the face of deep-seated imbalances in economic power and biases in the international trading and financial systems, their expectations of gains from such integration in terms of faster growth, greater employment opportunities and reduced levels of poverty have been disappointed. As things stand, neither the international economic system nor the policies being recommended to developing countries can deliver a pace of economic growth, estimated by most economists as of the order of 6 per cent per annum, sufficient to begin tackling the problems of underdevelopment.
Most of the institutional and policy charts now guiding developing countries were drawn up in response to the debt crisis of the early 1980s. During those years, many countries faced recurrent balance-of-payments problems, were vulnerable to external shocks and had to endure prolonged periods of macroeconomic distress. The consensus was to place almost all the blame on misguided policies cast in an interventionist mould. The solution was believed to be in rapid and unqualified trade and financial liberalization. With world markets providing the right incentives and private capital flows supplanting ODA, economic stagnation was expected to quickly give way to macroeconomic stability and to rapid sustained economic growth.

Things have not gone as promised. Growth in developing countries has recovered in the 1990s but is well below the average 5.7 per cent achieved in the 1970s. This recovery has been accompanied by a significant worsening of external deficits, on average higher by almost 3 percentage points of GDP. While the situation of falling or stagnant growth with widening deficits is particularly stark in Latin America, a similar pattern is repeated almost everywhere. Only a very small number of countries, notably Chile and China, have been able to buck this trend by combining faster growth with improved trade performance over the past decade. Currently they too are struggling to regain or maintain their growth momentum after the Asian financial crisis.

The reasons why trade deficits have been increasing faster than income in developing countries are undoubtedly complex with many national influences playing their part. However, the evidence provided in this year’s *Trade and Development Report* suggests that a combination of declining terms of trade, slow growth in industrial countries, and “big bang” liberalization of the trade and capital account in developing countries has been a decisive factor.

Still, enthusiasts of this new global trend could point to the surge of private capital to developing countries in the 1990s. The figures can appear seductive: net capital inflows reached over $300 billion in 1997 with an increasing proportion in non-debt creating forms. But even before the recent bouts of financial turmoil in Asia, Eastern Europe and Latin America, there were reasons to be cautious. In the first place, much of the renewed flow has simply marked a
return to trend after the blighted years of the 1980s. Annual capital inflows in the 1990s have averaged around 5 per cent of GNP, much the same level as in the 1970s; if China is excluded, the recent ratio is lower. Moreover, these capital inflows have increasingly been concentrated in a small group of 20 or so emerging markets, which have been receiving over 90 per cent of inflows in the 1990s, compared with some 50 per cent before the debt crisis. This skewed distribution is as much a characteristic of foreign direct investment as other capital flows. China, Brazil and Mexico together account for almost one half of the total FDI inflow.

Just as importantly for those receiving the flows, a growing proportion of net private capital inflows has been absorbed by activities that add little to productive capacity. Out of every dollar brought in by non-residents, only 50 cents is used for financing real resource transfers. Nearly a quarter is taken out by residents, and one fifth is set aside for reserves as a safeguard against speculative attacks on the currency and reversal of capital flows. The increase in developing countries’ reserves from 1990 to 1998 amounted to a staggering 60 per cent of the increase in their import bill during the same period. All this took place despite policy reforms designed to increase access to global capital markets, which should have meant the need for less reserves. Given that reserves cost more than they earn, the price of all this has been a cumulative sum of some $50 billion in the 1990s.

The level and composition of capital flows received by most developing countries are inadequate and inappropriate to their needs. Even under relatively optimistic assumptions regarding growth in industrial countries and terms of trade, the external financing required by developing countries to achieve a target growth of 6 per cent can be estimated to exceed recent capital inflows by more than 40 per cent.
It would seem that after more than a decade of reforms across the developing world, payments disorders remain as acute as ever, external indebtedness is again on the rise and vulnerability to external shocks is perhaps even greater than in the past.

UNCTAD is not alone in worrying about these features of the global economy. There are encouraging signs that a growing and significant number of personalities and international organizations are now beginning to share some of the positions that we have been defending over many years. However, it is necessary to state clearly that we would not subscribe to a new version of a still unbalanced consensus which would take a more cautionary attitude to financial liberalization in developing countries, whilst at the same time pushing forward with rapid trade liberalization. Such an approach would aggravate the already unfair existing conditions. In today’s interdependent world the links between finance and trade cannot be separated so easily. With liberal trading regimes now in place throughout much of the developing world, growth sucks in greater volume of imports than in the past. At the same time attempts to close the payments gap through increased exports to developed countries have to confront sluggish markets, protectionism and adverse movements in the terms of trade. As a result maintaining growth momentum increasingly relies on attracting foreign capital, of any kind. Dependence on hot money has thus become the unstable pillar of economic growth and development in many countries.

What is the alternative? Reform of the global financial architecture remains an urgent priority, with a need for increased official financing, orderly debt workouts and full debt relief for the poorest countries. But it is not simply money that makes today’s world go round and reform of the financial system is not sufficient by itself to allow developing countries to expand and prosper in today’s interdependent world. Most of these countries benefited little from the Uruguay Round and it is now time to take a hard look at the international trading system, in order to establish a sound basis for new multilateral negotiations.
Developed countries’ protectionism against developing countries remains pervasive: tariff levels, tariff escalation and the frequency of tariff peaks are still high in many areas of export interest to developing countries; unjustifiably large subsidies to industrial countries’ agriculture, particularly in the most trade-distorting modality, that is export subsidies, shut out imports from developing countries and lead to unfair competition on third markets; and the threat of market penetration by developing countries’ producers is prompting new forms of protectionism within the framework of the various WTO Agreements. Consequently, the focus of any new trade negotiations must be on market access in areas where developing countries already have or could quickly establish competitive advantage. Balance here does not mean a fifty/fifty outcome because the time has finally come to redress and correct fifty years of neglect and accumulated imbalances against the trade interests of the developing world.

The potential for large overall export gains is underscored by this year’s *Trade and Development Report*. It is estimated 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. Increased agricultural exports could add considerably to this figure. All in all, the increase in annual foreign exchange earnings could be four to five times the annual foreign capital inflows in the 1990s. Moreover, unlike a large part of such flows, the resources would mostly be devoted to productive activities, with beneficial effects on employment.

More flexibility should also be granted to developing countries in the design and implementation of policies. Competitive industries hold the key to future growth not only by boosting exports but also by reducing the dependence of growth on imports. Developed countries continue to promote their industries and their agriculture, while berating similar efforts in developing countries. In some areas of trade policy, where review processes in the WTO are about to get under way, the full impact on developing countries of limiting their policy options needs to be reconsidered, in particular with respect to TRIMs and TRIPs. Special and differential treatment for developing countries of a binding and up-dated kind should be made part of the contractual obligations of the rule-based system.
Finally, developing countries need to improve the management of their exchange rates if they are to benefit from greater integration into the trading system. The advice they have received in recent years has been at best confusing and at worst misleading. Under free capital mobility, no exchange-rate regime can guarantee stable and competitive rates. Countries with free floating regimes are no less vulnerable to financial crises than others though the damage is inflicted differently. Targeting real exchange rates in combination with the control and regulation of destabilizing capital flows is the desirable route for most countries. Evidence is overwhelming that stable and competitive exchange rates lie behind long-term export success and examples abound, most recently from India, China and Malaysia, of the benefits from successful management of capital flows. It is thus essential that the autonomy of developing countries in managing capital flows and in choosing whatever capital account regime they deem appropriate should not be constrained by international agreements on capital account convertibility or trade in financial services.

In conclusion, in the final analysis what counts is not trade and financial liberalization and integration per se but the way this process is conducted - not the quantity, the intensity, the rapidity of liberalization and integration as implied in the “big bang” approach but the quality, the long-term sustainability, the sound sequencing of reforms as embodied in the policies that UNCTAD advocates.