

Industrial Countries Must Work Harder for Development if Globalization is to Deliver on its Promises

Imbalances in the Trading System Stymie Growth Prospects in the Developing Countries*

Closer integration of developing countries into the global trading and financial system is not bringing faster growth but increased external deficits and instability. In its Trade and Development Report 1999 (175 pages), UNCTAD explains what has gone wrong and calls for an overhaul of development policies.

The Report argues that "in the present era, when the world economy is more integrated than at any time in its recent history, developing countries depend even more on external resources to achieve rates of growth sufficient to address the deep-rooted problems of poverty and underdevelopment". Based on empirical analysis, the Report concludes that market access, not "hot money", is the key to growth.

With liberal trading regimes now in place throughout much of the developing world, economic growth sucks in a great volume of imports than in the past. However, attempts to close the payments gap through increased exports to developed countries are running up against sluggish markets, adverse movements in the terms of trade, and protectionism.

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.

Industrialized Countries Protectionism Hinders Global Integration

Developing countries have been striving hard, often at considerable cost, to integrate more closely into the world economy. But protectionism in the developed countries has prevented them from fully exploiting their existing or potential competitive advantage.

The Report estimates, for example, that in low-technology industries alone, developing countries are missing out on an additional US\$ 700 billion in annual export earnings, as a result of trade barriers. This represents at least four times the average annual private foreign capital inflows in the 1990s (including foreign direct investment FDI).

"Governments in the North should (...) work harder to convince a sometimes sceptical public that there are direct benefits, in terms of more jobs and rising incomes, from expanding trade with the "South", states UNCTAD

Secretary General Rubens Ricupero in his Overview. "They must also recognize that a more stable international financial system free from hot money and recurrent crisis in emerging markets is in their longer-term interests".

Developing Countries Must Better Defend Their Interests

With new trade negotiations likely to start next year, UNCTAD contends that market access in the developed countries must form the centerpiece of a "positive trade agenda." This means an assault on tariff peaks and on their frequency and escalation in products of interest to the developing countries (such as footwear, leather and travel goods, textiles and clothing, toys and sports equipment, wood and paper products, rubber, plastics, and agricultural products).

It also involves dismantling subsidies to OECD countries' agriculture, which, at US\$ 350 billion, amount to twice the value of developing country exports. Finally, it requires confronting anti-dumping procedures, the possible abuse of health and safety standards as a means of controlling imports, and signs of backsliding in the developed countries on existing agreements, such as the practice of so-called "voluntary" export restraints.

At the same time, the Report notes that competitive industries in the developing countries are needed, both to reduce their ballooning imports and to boost exports. Here, too, biases in the international trading system are working against developing country interests.

The considerable financial resources employed by the world's richest countries to support their mature producers provides sufficient ground to retain the infant-industry concept as an integral part of trade-policy discussions.

The upcoming reviews of trade-related intellectual property rights (TRIPs) and trade-related investment measures (TRIMs) in the World Trade Organization (WTO) should remove elements detrimental to developing countries. Furthermore, special and differential treatment for developing countries should be made part of the contractual obligations of the rule-based trading system.

To date, reform of the "financial architecture" of the global economic system has been discussed separately from the workings of the trading system. UNCTAD explains why in today's interdependent world reform in both areas needs to move in tandem.

Consistency between current account and capital account policies is a place to start. In view of the increased external financial vulnerability of developing countries, there is now widespread agreement that a country would require a level of reserves beyond six months import cover, so as to meet one year of financial obligations without recourse to new loans.

The Dangers of Excessive Trade and Financial Liberalization

Much of the policy environment in place today in developing countries was fashioned after the debt crisis of the 1980s in response to recurrent payments crises. Rapid liberalization was the recommended tonic, promising an alternative to close and punctuated growth through access to foreign capital, markets and technology. The predicted benefits have been well off the mark. According to the Report, while annual growth in developing countries in the 1990s has accelerated above that of the 1980s, it remains 2 percentage points lower than during the 1970s (see also TAD/INF/2817), while the average trade deficit has been almost 3 per cent higher.

In almost half the developing countries examined in the Report, the trend is one of widening trade deficits, with falling or stagnant growth.

UNCTAD identifies three main reasons why deficits have been increasing faster than income in developing countries:

- Big-bang liberalization has produced an import surge in the developing countries, while exports have not been able to keep pace;
- The slowdown in the industrial economies since the early 1970s has added an additional percentage point to trade deficits in the developing nations;
- Terms-of-trade declines constantly eat into the purchasing power of exports of developing countries.

Against this background, developing countries have been forced to chase external private capital to support trade liberalization efforts. But liberalization of capital flows *has actually made matters worse by leading to exchange rate appreciations and instability, thereby undermining trade performance.*"

The Report's examination of exchange rate movements in 58 developing countries suggests that the misalignment of currency values is an even greater problem today than it was in the 1970s. "Developing countries need to improve the management of their exchange rates if they are to benefit from greater integration into the trading system," the Report says. Capital controls will need to be an integral part of the policy arsenal available to developing countries.

Private Capital Flows have Not had Desired Effect

The privatization of development finance was expected to reduce greatly the external constraints on growth in developing countries. This

* Courtesy: UNCTAD Press Release 1st Sept. '99

has not transpired. Nevertheless, the change in the composition of financial flows has been dramatic: official financing, as a percentage of total capital inflows, has fallen from 50 per cent in the 1980s to 20 per cent in the 1990s. This decline reflects both an absolute drop in official development assistance (ODA) and a significant increase in private flows in the past decade.

These new inflows of private capital are not necessarily being put to productive use, in the interests of the task of development. The Report explains why this is so:

- Much of the new capital is absorbed either by reserve accumulation to safeguard against speculative attacks or by outflows from residents. For every US dollar brought into emerging markets during the 1990s, less than 40 per cent has been available to finance the current account. Given that reserves cost more than they earn, the price of reserve accumulation in the 1990s in developing countries has been as high as US\$ 50 billion.
- The FDI boom in the 1990s has been driven in part by mergers and acquisitions, many of them in services and other non-tradeable sectors, with the potential to create payments problems; the Report warns that attempts to meet foreign exchange deficits arising from FDI (i.e. through increased imports and remittances abroad) by encouraging the same type of inflows could be self-defeating.
- Liquid capital in search of arbitrage profits has introduced a pervasive sense of instability into development finance. Portfolio equity and short-term loans reached US\$ 100 billion in the mid-1990s but fell back after the Asian and Russian crises to just US\$ 15 billion at the end of 1998.

Taking a closer look at the surge in capital inflows to developing countries in the 1990s, UNCTAD says that, in fact, the numbers are a return to trend after the blighted 1980s; averaging 5 per cent of GNP, the present figure is no different from the seven good years (1975-82) that preceded the debt crisis. On the other hand, capital inflows are even more concentrated than in the past; a small group of 20 emerging markets received over 90 per cent of total inflows in the 1990s, compared to 50 per cent before the debt crisis. Concentration is as significant for FDI as for other capital flows.

Although an important part of the capital inflow into developing countries in the present decade has allegedly been "non-debt-creating", external indebtedness is again on the rise. In Latin America, in 1998, the debt-to-export ratio rose above 200 per cent.

The Report stresses that reform of the financial architecture needs to recognize the limits of private capital markets to provide development finance. The international community must "include a greater role for official financing, recognize the rights as well as the obligations of debtors, and provide full debt relief for the poorest developing countries".

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documents and in 1999 revised its guidelines on "procurement under IBRD loan and IDA credit". Under the new provision, the World Bank can reject contract bid or cancel loan if the bidder has engaged in fraud and corruption and the concern companies can be blacklisted. In 1996 the International Monetary Fund (IMF) and after the Uruguay Round of Trade Negotiations, the WTO, have started initiatives to address the issues of corruption in international trade arena. International NGO's like ICC, TI and the World Economic Forum are working to formulate methods to deter corruption in international business transactions. Since 1981 the International Anti-Corruption Conference (IACC) organised by a Hong Kong based NGO, Independent Commission Against Corruption (ICAC) and the 1998 Interpol's "International Conference on Corruption Related Crimes" held at Lyons helped to shape international opinion against corruption. Since the early 1990's the three regional multilateral treaties, i.e. the Organisation of American States (OAS), European Union (EU) and OECD (February 15, 1999) anti-bribery conventions are very much relevant for the prevention of corruption in international trade. But ironically according to the latest report of TI, the major OECD countries are in the top bribe given status. It also mentioned that out of 19 top-bribe giving countries, the top dozens are members of OECD which includes Italy, Japan, France, Spain, the US, Germany, Belgium and the U.K.

The UNGA and ECOSOC adopted resolutions, which suggested certain suggestions as "action against corruption", i.e. first it urges States to develop and implement specific and comprehensive anti-corruption strategies to enhance accountability by adopting and enforcing civil, administrative, fiscal and criminal law measures. Second, it urges States to increase their capacity for the prevention, detection, investigation and prosecution of corrupt practices by adopting, promoting public awareness, by strengthening their criminal justice systems. Third, it also suggests for the establishment of an appropriate,

independent statutory body for the prevention, control and monitoring of corruption. Fourth, it urges the States to increase and improve international co-operation for the prevention and control of corruption, mutual legal assistance, sharing of information and arrangement for extradition of criminals in relation to corruption. Finally, it urges States to take note of the international code of conduct for public-office holders for adoption and implementation in domestic level. Also the international code of conduct for public officials suggests number of provisions specially to ensure a corruption free public office and business environment.

It must be borne in mind that the international initiatives to combat corruption will not be effective so long as the nation states are not adopting and implementing them in their national level. As the international communities know UN and other international organisations are not Super States and hence they cannot impose directives on a State from outside. Legally speaking, the emerging international law against corruption is only non-legally binding directive principles, which lacks a proper enforcement mechanism. But there is no denying the fact that these developments help and encourage to shape global crusade against corruption and in this regard no single state will feel lonely to fight against this nagging menace.

So in a welfare state the corruption bodes ill for the future of any nation where doubts are expressed about the probity, sincerity and integrity of the public officials. Such officials tend to shake the peoples' confidence and bring the entire system into disrepute in the country's welfare set up; in that vein the Indian Prime Minister's call for zero tolerance against corruption and the well response from various quarters, specially from Central Vigilance Commission (CVC) and its efforts to bring together the Indian Commerce and Industry (FICCI, ICC, Assocham) for signing an anti-bribery convention, in the light of the OECD's anti-corruption convention is a modest attempt to dignify India's credibility on the subject.