TWN
Third World Network
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Briefing Paper 24

December 2004

Some Observations of the Question of Coherence and Development

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In a closely integrated world economy, no country should be expected to be able to put its house in order independently of what is happening elsewhere. This is true for all countries, including the most advanced, but above all for developing countries. The issue of coherence should accordingly be formulated not just in terms of the impact of rich countries' policies on the poor, but also of the repercussions of multilateral rules and practices for development.

Thus we have three sets of overlapping influences on development:

● **Multilateral rules and practices** (including those of the World Trade Organization, the Bretton Woods Institutions, and the United Nations). Clearly a few major industrial countries exert an undue influence on the shaping of the global institutional framework.

● **Policies in the major industrial countries.** In principle, these should be subject to the same set of multilateral rules and surveillance as the policies of other countries. But in practice, constraints imposed on the policies of industrial countries are significantly less than those on developing countries, and industrial countries enjoy considerable grater policy autonomy and greater scope for unilateral action than developing countries.

● **Policies in developing countries.** Many of these countries perhaps have more policy space than they effectively use to promote development and to determine the pattern of integration into the world economy, but policy autonomy in developing countries is highly circumscribed, not only by multilateral rules and practices (including WTO rules and IMF/WB conditionality), but also because of sheer unilateral pressure of some industrial countries as well as financial markets.

A comprehensive study of coherence should focus on all three areas. One should start with a conceptual framework rather than with a piecemeal approach to the impact of this or that policy or practice on development. To be sure, advocacy is also as important as research. But if one believes that efforts to influence national and global policies and practices of industrial countries are not likely to bear fruit (that is, if the global environment cannot be made more development friendly), then one should enquire into how to survive in such an environment, seeking to reduce external vulnerability and increase self-reliance. Such a mood increasingly dominates the thinking of policy makers in developing countries, notably those in some Latin American countries, who realize that an externally-oriented pattern of development, and particularly catching up with the rich, is becoming more and more difficult.

What I would call "systemic coherence" could thus focus on whether or not multilateral rules and practices, policies in industrial countries and developing countries in the areas of trade, investment, fi-

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nance, debt, labour and so forth reinforce each other in support of economic growth and development. What is at stake here is not just whether policies and practices in each of these areas are individually supportive of development, but also whether they reinforce or work against each other. A partial approach to any one of these areas of influence, including the impact of rich countries' policies on development, would mean ignoring such linkages. In the case of trade this was explicitly recognized in the WTO's Marrakech Declaration, which states: "Ministers recognize, however, that difficulties the origins of which lie outside the trade field cannot be redressed through measures taken in the trade field alone. This underscores the importance of efforts to improve other elements of global economic policymaking to complement the effective implementation of the results achieved in the Uruguay Round."[1]

"Systemic coherence" was the fundamental question that preoccupied the architects of the post-World War II international economic system in the Bretton Woods and Havana Conferences. Their goal was to establish a global system that would prevent the problems encountered in the interwar period, including financial crises, deflationary macroeconomic pressures and collapse of primary commodity prices, leading to ad hoc restrictions over trade and capital flows, beggar-my-neighbour exchange rate policies. Their proposed solution was to be based on four pillars, explicitly stated among the objectives of the International Monetary Fund and in the charter of the proposed International Trade Organization:

- Full employment policies as a basis for trade expansion and liberalization and greater integration - thus putting jobs and growth in front of trade.

- Exchange rate and commodity price stability to ensure a predictable and stable trading environment and steady expansion of trade. Exchange rate stability was to be attained in conditions of strictly limited private international capital flows, which had proved excessively damaging in the interwar period. Commodity stability was to be secured by establishing an International Commodity Stabilization Fund to create buffer stocks.

- Provision of international liquidity for countries facing short-term payments imbalances in order to avoid deflationary macroeconomic policies and destabilizing currency adjustments.

- Provision of long-term finance for war-torn European countries to address their problems of structural trade imbalances and resource gaps.

The initiative was only partially successful in putting in place the institutional arrangements needed, and these arrangements functioned effectively for less than three decades, the so-called "golden age".

The International Trade Organization was intended to provide a rules-based framework for a multilateral trading system as well as to coordinate national policies to insure adequate levels of global demand and employment, but it was not created. The WTO that was finally established in the 1990s, is based in principle on a single-tier system of rights and obligations for industrial countries and developing countries alike, and has placed trade liberalization in front of expansion of economic growth and full employment, thereby rekindling mercantilist agendas.

The proposed International Commodity Stabilization Fund never came into existence either. In the absence of global arrangements, industrial countries, notably the United States and the European Union, resorted to unilateral, protectionist schemes in order to provide stability to primary commodity prices and earnings for their producers. A Compensatory Financing Facility was established in 1963 at the IMF to deal with the consequences of commodity price fluctuations for developing countries, but this scheme eventually became ineffective.

Controls over international private capital flows were gradually lifted starting in the 1960s because they became ineffective as a result inconsistent policies in the major industrial countries. The system of fixed but multilaterally negotiated adjustable exchange rates broke down in the early 1970s for the same reason. The United States, as the main reserve currency country capable of borrowing in its own currency, chose a benign neglect of the exchange rate of its currency. Europeans never opted for free floating against each other and chose to stabilize intra-European currencies within narrow bands, supported by effective institutional arrangements. These protected particularly smaller European countries which lost autonomy against Germany and gained autonomy vis-à-vis international financial markets and the International Monetary Fund (none of which resorted to IMF borrowing since the

[1] World Trade Organization (1994), "On the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Economic Policymaking." Declaration of the World Trade Organization, 15 April 1994, Marrakech, paragraph 4.

1970s). Again, developing countries were left alone to find unilateral solutions to the problem of managing their currencies.

Contrary to its original mandate, the International Monetary Fund has become an institution promoting deflationary adjustment to external shocks in developing countries, rather than providing international liquidity to prevent the need for such an adjustment. Recently, with increased capital account liberalization and recurrent financial crises in emerging markets, it has shown greater proclivity for financial bailout operations than for providing current account financing to countries facing temporary export shortfalls or rapid increases in import costs.

The specific problems of developing countries regarding long-term financing were not discussed in the Bretton Woods Conference but were added only as an afterthought, with the emergence of the World Bank for multilateral development financing. However, the World Bank's resources and lending lagged considerably behind the growing needs of developing countries and, starting in the 1970s, increased emphasis has been placed on private capital flows for financing development.

Thus, in direct contrast to those arrangements originally thought to be necessary to promote coherence and global welfare, current arrangements favour private capital flows over official flows, exchange rate flexibility over stability, deflationary adjustment over financing, and the interest of creditors over debtors. The Bretton Woods/Havana arrangements were founded on the belief that adverse influences emanating from trade, finance and debt should be countered through measures that preserved growth and development. But under present arrangements and policies, developing countries almost invariably find themselves obliged to adjust to international imbalances through domestic retrenchment. It is thus not surprising that once again the question has been raised whether developing countries' participation in the system is compatible with their development objectives.

Research Priorities

The current research on coherence concentrates on individual areas of policy and neglects, in large part, the question of consistency across the different realms of policy. More importantly, in so doing it focuses primarily on trade, and emphasizes the adverse impact of trade restrictions and lack of liberalization in industrial countries on development, including protectionism in agriculture, textiles, and clothing; agricultural subsidies; restrictions over transfer of technology (TRIPs); or labour mobility. In this sense, it is quite consistent with the current ideological rhetoric on the virtues of liberalization, adopted by the very same governments practicing such restrictions. Certainly, such a line can generate a broad alliance and can be potentially effective. However, the flip side of the coin is often neglected: that is, the adverse impact of excessive and premature liberalization forced onto many developing countries by the Bretton Woods Institutions or industrial countries in the context of WTO negotiations. For instance, there is very little in the literature on the impact of import liberalization on jobs, wages and wage differentials, on government revenues and social spending, or on prices and incomes received by agricultural producers.

This point is also relevant for attempts to compartmentalise the economic and social aspects of development challenges, which criticise the Washington Consensus only for leaving out the latter from its agenda. Here the question that needs to be asked is whether social objectives could simply be added to the agenda of liberalization and privatization to form a coherent program.

To illustrate the inconsistencies that may result from partial and piecemeal approaches to coherence, one can look at the agricultural trade policies in the North. As noted above, various stabilization/intervention/subsidy schemes were introduced in the first place in response to the failure to deal with the global commodity problem in the post-war period. Now the agenda is to dismantle these while leaving the commodity problem outside the international agenda. Clearly, this does not make sense and it is not politically sensible to expect the governments in industrial countries to leave their commodity producers to the vagaries of markets in the same way that producers in Africa and elsewhere have been left. Thus, any realistic agenda for agricultural trade liberalization should bring the commodity issue back to the global agenda. Perhaps, this explains the recent French interest in global commodity issues.

In addressing the possible benefits for developing countries of liberalization in trade-related matters by the North, it is also important to take into account reciprocity and single undertaking that govern the negotiations in the WTO. These mean that any trade concession given by the industrial countries to developing countries are likely to be matched by concessions in the same or other areas of negotiation. For instance, in negotiations on trade in services, this could mean having a package combining Mode 4 of movements of natural persons with trade in financial services. Thus, the benefits of the package as a whole, rather than that of increased mobility of labour, would need to be assessed.

Despite recurrent financial crises in developing countries with devastating consequences for poverty and development, the impact of global financial arrangements and financial and macroeconomic policies in industrial countries on development has not received as much attention as trade-related issues. This is quite surprising, given that for most developing countries the financial shocks resulting from volatile capital flows and sudden changes in the terms and conditions of external financing have become a much more important source of disruption to development than trade shocks. The cost of financial instability and crises to developing countries may be at least as high as the potential benefits of liberalization in trade-related areas.

The greater vulnerability of developing countries to external financial shocks arises from a number of structural factors including their external indebtedness, the denomination of their external debt in foreign currencies, a higher degree of dollarization, small size of their financial markets, and underdeveloped institutions and practices regarding financial regulation and control. These factors magnify the adverse impact of destabilizing financial impulses from the major industrial countries including changes in their monetary conditions, macroeconomic policies, interest rates, and exchange rates. Just as the sharp rise in United States interest rates and the appreciation of the dollar was a major factor in the debt crisis of the 1980s, likewise the swings in exchange rates and monetary conditions in the major industrial countries were major influences on both the surge in capital inflows and the subsequent outflows associated with the Latin American and East Asian crises. The instability of G3 exchange rates poses serious difficulties for developing countries, which typically link their exchange rates to major reserve currencies. It is indeed open to question whether emerging markets can attain exchange rate stability when the currencies of the major industrial countries are subject to large gyrations. Indeed, many observers (including Volcker and Soros) have suggested that the global economy will not achieve greater systemic stability without some reform of the G3 exchange rate regime, and that emerging markets remain vulnerable to currency and financial crises as long as major reserve currencies remain highly unstable.

The International Monetary Fund conducts bilateral surveillance of individual countries' policies through annual Article IV consultations and multilateral surveillance through periodic reviews of global economic conditions in the context of the World Economic Outlook. So far IMF surveillance has not succeeded in ensuring stable and properly aligned exchange rates among the three major currencies, or to protect weaker and smaller economies against adverse impulses originating from monetary and financial policies in the major industrial countries. This failure is due to the unbalanced nature of these procedures, which give too little recognition to the disproportionately large global impact of monetary policies in major industrial countries.

Given the degree of global interdependence, a stable system of exchange rates and payments positions calls for a minimum degree of coherence among the macroeconomic policies of major industrial countries- subject to the proviso that this quest should not lead to a deflationary bias in policies, since, as stated by IMF Article IV, the ultimate objective of policy is to foster "orderly economic growth with reasonable price stability". The existing modalities of IMF surveillance do not include ways of attaining such coherence or dealing with unidirectional impulses resulting from changes in the monetary and exchange-rate policies of the United States and other major OECD countries. Without incentives and enforcement procedures linked to the process of peer review under IMF surveillance, other countries in the world economy lack mechanisms under the existing system of global economic governance for redress or dispute settlement regarding these impulses. In this respect governance in macroeconomic and financial policies lags behind that for international trade, where such mechanisms are part of the WTO regime, even though macroeconomic and financial policies have much greater impact on the economic performance of developing countries by influencing private capital flows, exchange rates and the terms and conditions of their external debt.

(This paper is based on remarks prepared for the seminar on "The Coherence and Impact of Rich Countries' Policies on Developing Countries" OECD Development Centre, Paris, 23-24 June 2003. It is published in Impact of Rich Countries Policies on Poor Countries, ed. by Robert Picciotto and Rachel Weaving, Transaction Publishers, 2004.)

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