



United Nations
Conference
on Trade and
Development

Distr.
LIMITED

TD/B/47/L.7
19 October 2000

Original : ENGLISH

TRADE AND DEVELOPMENT BOARD
Forty-seventh session
Geneva, 9 October 2000
Item 3 of the agenda

**INTERDEPENDENCE AND GLOBAL ECONOMIC ISSUES
FROM A TRADE AND DEVELOPMENT PERSPECTIVE:
CRISIS AND RECOVERY IN EMERGING MARKETS**

Chairman's summary

1. The recovery of the world economy from the shock waves of the Asian crisis was broadly welcomed. While it was recognized that technological progress and the globalization of trade, finance and productive activity offered new opportunities for wealth creation under appropriate macroeconomic policies and with good governance, weaknesses in national policies and institutions could be punished much more quickly and severely by international markets than in the past. That such punishment by international investors could occur even when there was no solid basis for a negative risk assessment was a concern widely expressed. There was also considerable concern about the disparities in economic performance across and within regions and about the persistence of macroeconomic imbalances.

2. It became clear in the course of the discussions that difficult policy choices were not restricted to developing countries. Growth disparities within the industrialized world had resulted in trade imbalances, while technological and financial innovations had led to greater fragility of financial and trade flows. There was broad agreement that the recent rise in oil prices from their depressed levels of the past decade had added another element of fragility and heightened uncertainty. It was felt by many that the risk of renewed global economic turbulence was still quite high, with developing countries the most vulnerable. But there was also widespread confidence that prudent macroeconomic adjustments in the developed countries could prevent temporary shocks spiraling into inflation or deflation, and that these countries were better placed than in the past to use policies to correct the existing global imbalances without jeopardizing the growth prospects of the developing countries.

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3. There was broad agreement that oil-importing developing countries were in a particularly difficult situation, as many of them were caught between a rising import bill and declining prices for their own export commodities, and that such countries required compensatory financing through the multilateral financial institutions.

4. Given the underlying weaknesses, there was little room for complacency. Rather, the present conditions offered an opportunity to reshape international economic relations in the interest of all countries and to reinforce the fight against poverty. Expanding trade opportunities and improving market access would help developing countries to become less dependent on capital inflows and hence less vulnerable to external shocks originating from international capital markets and policy shifts in the developed countries.

5. The East Asian financial crisis had shown that even for the most successful developing countries there were substantial downside risks in the process of globalization. It was broadly acknowledged that there had been a number of shortcomings in the diagnosis of this crisis, and that initial policy responses might not have been optimal. But the difficulty of prescribing the right medicine given the specific characteristics of each crisis was also recognized. While some speakers believed that the tightening of monetary and financial policies had contributed to the recovery, most pointed to the severe social effects of these policies in terms of rising poverty and unemployment. The recovery in the East Asian economies was still quite fragile, and countries had to continue with their structural reforms, in particular those aimed at strengthening the financial and corporate sector.

6. Views as to how best to respond to financial panics differed. Arguments were put forward in favour of both orthodox and heterodox policies. However, there was some degree of consensus that, in the absence of social safety nets, falls in output and employment, resulting from sharp rises in interest rates could do serious social and economic damage, and that temporary and selective capital controls and standstills might be part of an alternative policy package that would also have to include bailing-in of the private sector and timely provision of adequate liquidity. There was also broad satisfaction that during the crisis and recovery of East Asia, the international trading system had proven its effectiveness, as markets remained open despite sharp swings in trade flows and balance of payments positions.

7. While increased private capital flows to developing countries were generally welcome and might serve as a vehicle to accelerate development, international capital markets did not always allocate funds efficiently at the global level. The downside risks of globalization were considered particularly acute in international financial markets where imperfections due to herd behaviour and irrational expectations were endemic. There was certainly a major role for national policies in crisis prevention and solution. Good corporate governance, an appropriate maturity structure of external debt and an effective regulatory system for the domestic financial sector were stressed. On some accounts, the real key to a successful policy response was whether it contributed to strengthening market confidence. However, it was also recognized that international investors primarily cared about maximizing the return on their investments and much less about the quality of corporate governance and financial regulations. Attention was drawn to the fact that, while much of the financial burden of the Asian crisis was born by the public sector, the crisis had originated in the private sector. Consequently, more attention should be given to prudential regulation and supervision of private

8. The discussion also addressed the systemic factors behind the recent financial crises, which could only be effectively addressed at the international level. Greater stability of the international financial system required appropriate regulation of financial flows. There was consensus that improved prudential regulations were required over highly leveraged institutions, particularly in the derivative and hedge fund markets, and more effective and independent supervision was desirable. Consensus was more difficult to reach on the appropriateness of capital controls, the introduction of debt-workout procedures, and the establishment of a lender of last resort. While, on the one hand, it was suggested that the reform of the international financial architecture should aim at a solidly institutionalized setting, it was also suggested that such arrangements could turn out to be too rigid in the medium term, so that a case-by-case approach might be preferable.

9. There was broad agreement that governance in the international monetary and financial system should be made more transparent and participatory, and some speakers pointed to the progress that had already been made in this respect in the international financial institutions. Greater regional monetary cooperation was considered to be useful for the prevention and management of currency crises, albeit through complementing existing multilateral arrangements; efforts towards strengthening regional monetary cooperation, which had already made some progress in Asia, should not divert attention away from the need to strengthen the financial architecture at the global level.

10. Emphasis was placed also on the need for strengthened policy coordination among the major developed countries to avoid large fluctuations of the exchange rates among the three major currencies. While it was observed that central bankers and other policy makers of the G-7 countries were in frequent contact and that policy coordination did not require formal mechanisms, such as exchange-rate target zones as proposed by others, there were also suggestions that, in order to be effective, more institutionalized forms of such coordination were necessary. The Enhanced HIPC Initiative was generally welcomed, but it was also made clear that the debt problem remained an obstacle to faster development, especially in least developed countries. Moreover, it was observed that while for a large number of developing countries official flows remained essential for higher investment and growth, these flows had been on a downward trend for much of the past decade, barely compensating for adverse shifts in the terms of trade. An acceleration of debt relief procedures and their extension to a greater number of poor countries, as well as renewed efforts on the part of donor countries to raise their ODA to previously agreed targets, were considered by many speakers to be necessary preconditions for a reduction of poverty and a narrowing of the income gap between North and South.