Trade and Finance Linkages

Statement for World Conference on Financial and Economic Crisis and Development

Summary recommendations

In line with the general consensus on the need to revamp and strengthen regulatory tools for finance, the trade and investment negotiations at all levels that affect the utilization of such tools, especially negotiations on financial services in the WTO, should be put on hold indefinitely.

Banking supervision rules and practices should be rebuilt in order to empower national supervisors to evaluate and regulate the capital requirements of banks in ways that are counter-cyclical and subordinated to the desired profile of production sought by a country.

Stronger and progressive taxation rules, including a global taxation regime, should be pursued as a necessary complement to ensure developing countries' access to their fair share of the revenue generated by cross-border trade flows.

The roles of the IMF and the World Bank should be redefined away from trade and investment policies. Trade and investment agreements should urgently establish effective mechanisms to redress the asymmetric impact that development finance institutions and agencies have had on the negotiating space of recipient countries.

The financial and macroeconomic reforms undertaken as a response to the crisis should include measures to a) diversify trade profiles (of both products and markets, domestic and external), b) Manage foreign investment so as to avoid overreliance on export-driven investment on single products or commodities, at the expense of investment in other sectors, c) Rebalance profit- and loss-sharing in the modalities for financing trade-related infrastructure and d) Ensure debt levels do not compromise the establishment of an export-investment nexus while ensuring assessments of debt sustainability remain realistic in the light of expected trade revenue.

In order to address the negative impacts of exchange rate volatility on developing countries' trade, there is an urgent need to:

Establish alternative credible mechanisms for the multilateral management of exchange rates.

Strengthen regional and sub-regional schemes for monetary cooperation that hold the key to lower dependence on the currencies of a few dominant countries. Ultimately, a more balanced and development-oriented system for multilateral management of exchange rates will be one that builds on, and seeks to gradually coordinate, a system that effectively addresses the need for South-South regional currencies and currency units.
Set in place a regular and predictable mechanism to ensure that developing countries can opt-out of their trade obligations to the extent required to compensate for the impacts that poor coordination by reserve currency issuers has on their economies.

In addition, since the global governance system lacks the capacity to manage exchange rates of trend-makers, it is all the more necessary that trend-takers (mostly poor and undiversified economies) should have the necessary space to manage their exchange rates.

In order to support developing country efforts to upgrade their trade to products with higher value added, it is crucial to reduce commodity price volatility that impedes investment and leads to import bill spikes. Regulation of commodity investment vehicles and contracts, especially of over-the-counter (private) ones, will reduce volatility and enable developing countries to manage price risks in key exports and imports, once all contracts and vehicles are transparent and regulated.

Full statement

Trade is the main channel by which the financial crisis is making its impacts felt on the real economies of developing countries. During the period 2003-2008, a boom in trade and exports has shown that no country can succeed in using trade to develop or reduce poverty without supportive internal and external financial structures. Now therapid spread of the financial and economic crisis shows that the fate of developing countries in the trade system lies more on meaningful reforms to the international financial architecture in which context such trade is conducted than on the achievement of enhanced market access. Therefore the trade dimensions and impacts of financial reforms should be factored into any proposed reforms of the global financial system.

In this regard, we welcome the opportunity provided by the mandate of the World Conference on Financial and Economic Crisis and Development to examine and overcome the deepening world financial and economic crisis and its impacts on development as well as to address its present and future impacts on, inter alia, employment, trade and investment.

1. The ability of many crisis affected countries to introduce the capital management techniques and regulations required to alleviate the crisis have been greatly compromised by bilateral trade and investment agreements as well as the WTO-GATS rules on liberalization of trade in financial services. The implementation of industrial as well as pro-employment fiscal, monetary and banking policies, such as exchange rate-targeting, are also compromised by the disciplines on capital management and the respective dispute settlement clauses contained in such agreements. Even as the economic crisis unfolds and the recession deepens, we continue to hear calls for a rapid conclusion of the WTO Doha Round of trade negotiations, which includes ongoing negotiations on the liberalization and deregulation of trade in financial services. These calls ignore the fact that it is because of the limited liberalization of their financial services sectors that some developing country economies were protected from the worst impacts of the crisis.

In line with the general consensus on the need to revamp and strengthen regulatory tools for finance, the trade and investment negotiations at all levels that affect the utilization of such tools, especially negotiations on financial services in the WTO, should be put on hold indefinitely.

2. The rules for banking supervision, embodied in Basel II have significant adverse consequences on trade flows, inter alia, through their impact on increased procyclicality[1] of trade finance and credit for productive activities.

Banking supervision rules and practices should be rebuilt in order to empower national supervisors to evaluate and regulate the capital requirements of banks in ways that are counter-cyclical and subordinated to the desired profile of production sought by a country.

3. The liberalization of trade in both services and goods has facilitated the growth of intra-company trade worldwide limiting governments' capacity for revenue-raising and leading to a substantial shift to regressive taxation of consumption and labor.

Stronger and progressive taxation rules, including a global taxation regime, should be pursued as a necessary complement to ensure developing countries' access to their fair share of the revenue generated by cross-border trade flows.

4. The development of trade rules and agreements is in theory informed by the parties' careful evaluation of the value and impact of market access concessions being exchanged. However, over the time since their founding, the World Bank and International Monetary Fund have increasingly promoted unilateral liberalization of the trade and investment policies of developing countries. The World Bank has no jurisdiction over developed countries; while in general the IMF has failed to influence the policies of these countries. By promoting unilateral liberalization in developing countries, these institutions have induced countries to forego the benefits that negotiated, multilateral liberalization would have provided. The crisis is easily becoming an excuse for them to dramatically increase lending to developing countries, threatening to further expand their leverage over them.

The influence of the Bretton Woods Institutions is exercised through policy conditions attached to lending but through other less conspicuous mechanisms such as annual ratings of countries through instruments such as joint IMF-World Bank Financial Sector Assessment Program. Likewise, the World Bank does a "Country Policy and Institutional Assessment" (CPIA) for each recipient government to rate its performance on an annual basis in order to help establish its level of access to resources. The World Bank allocates seven times more financial assistance to countries with the highest CPIA scores as those with the lowest scores.

The roles of the IMF and the World Bank should be redefined away from trade and investment policies. Trade and investment agreements should urgently establish effective mechanisms to redress the asymmetric impact that development finance institutions and agencies have had on the negotiating space of recipient countries.

5. In most developing countries, the financial crisis was preceded by a five-year boom in trade. This boom coincided, not by chance, with a surge in commodity prices, a trend that hid the meager progress -or even retrogression - that these countries had registered in

their export profiles. A dramatic reduction in the volume of trade and export prices is now exposing the flaws of a reform model that gave centrality to a paradigm of export-led growth neglecting to ensure that increased exports would translate into increased financial gains and greater financial stability, while reducing indebtedness. While some crisis responses are focused on restarting global trade, it is critical to ensure that trade does not resume along the familiar, unsustainable paradigm that significantly failed to be conducive to human development, gender equality, ecological sustainability and the maximization of employment gains in the past.

The financial and macroeconomic reforms undertaken as a response to the crisis should include measures to:

- Diversification of trade profiles (both products and markets, domestic and external),
- Manage foreign investment so as to avoid overreliance on export-driven investment on single products or commodities, at the expense of investment in other sectors,
- Rebalance profit- and loss-sharing in the modalities for financing trade-related infrastructure
- Ensure debt levels do not compromise the establishment of an export-investment nexus while ensuring assessments of debt sustainability remain realistic in the light of expected trade revenue.

6. Increased levels of exchange rate volatility have a strong impact on trade performance through channels such as the levels of domestic investment, the variations of relative prices of export products (which, in turn, affect competitiveness of the economies), the price of access to finance for production and the evaluation of the value of market access concessions. By affecting the prices of essential imports such as food and energy, they also carry consequences for food security and the balance of trade. Without an international financial and monetary system that can counter these trends, international trade will continue to place developing countries at a disadvantage in the global economy. This is likely, in particular, as long as the domestic currency of one country continues to be used widely as main international trading and reserve currency.

In order to address the negative impacts of exchange rate volatility on developing countries' trade, there is an urgent need to:

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Set in place a regular and predictable mechanism to ensure that developing countries can opt-out of their trade obligations to the extent required to compensate for the impacts that poor coordination by reserve currency issuers has on their economies.

In addition, since the global governance system lacks the capacity to manage exchange rates of trend-makers, it is all the more necessary that trend-takers (mostly poor and undiversified economies) should have the necessary space to manage their exchange rates.

7. Commodity index funds invested more than $300 billion at the peak of the commodity price bubble in July 2007. These investments greatly amplified the inherent commodity price volatility that is due to fundamental factors, such as crop failures. This extreme volatility resulted in huge increases in developing country import bills in food and energy, followed by a collapse in aggregate commodity prices between July and November 2007. Extreme price volatility has devastating consequences for food and energy security, which are particularly severe for developing countries. This price collapse severely damaged commodity exports from developing countries for firms that lacked the capacity and capital to lock in the earlier, high prices through futures contracts on publicly traded on commodity exchanges. Because most investments in "innovative" speculative instruments are traded privately (Over the Counter or OTC), they are neither regulated nor reported to public authorities.

Destabilizing financial instruments, such as commodity index funds and OTC trading, must be strictly regulated. Among the regulations that are urgently needed are speculative position limits (total number and value of contracts for a given commodity) that apply equally to all investors and a presumptive prohibition against OTC trades, unless the trader can demonstrate to regulators the inability of standardized contracts to provide price risk management for a specific commodity.   To preclude traders from seeking competitive advantage by trading through unregulated, deregulated and/or desupervised exchanges, governments should negotiate an agreement a Model Agreement on Commodity Exchange Regulation. These regulations, if enforced, will help stabilize prices, foster investment by enabling investors to estimate better rates of return on their investments and help governments to predict what part of commodities export revenues can be used for economic diversification planning to reduce commodity export dependency. Effective diversification should not only improve developing country economies but also enhance their social equity and political stability.

[1] Pro-cyclical means that it magnifies fluctuations in the level of economic activity. Pro-cyclical policies or rules are those that, as economic activity goes down, would have the effect of making a downturn worse. On the other hand, as economic activity peaks up, would have the effect of further bolstering the upward surge.

Initial Signatories:

Action Aid International
Africa Development Interchange Network (Cameroon)
American Friends Service Committee
Bretton Woods Project
Campaign for the Reform of the World Bank
Center of Concern
Citizens' Network on Essential Services

Comision Nacional de Enlace (Costa Rica)
Development Alternatives with Women for a New Era (DAWN)
Focus on the Global South
Genero y Comercio Latinoamerica
IBON Inc. / Asia Pacific Research Network
Institute for Agriculture and Trade Policy
Institute for Policy Studies
International Gender and Trade Network
ITEM /Social Watch
Jubileo Peru
Kenya Debt Relief Network (KENDREN)
K.U.L.U. Women and Development, Denmark
Latin American Network on Debt, Development and Rights (LATINDADD)
Medical Mission Sisters/ NGO Committee on Financing for Development
New Rules for Global Finance Coalition
Red Mexicana de Accion frente al Libre Comercio
Reality of Aid / Asia Pacific
Rede Brazil
Southern and Eastern Africa Trade Information and Negotiations Initiative (SEATINI)
Third World Network