Speaking points for
Supachai Panitchpakdi
Secretary-General of UNCTAD

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Keeping a development focus: the challenges in ensuring policy coherence for development

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In UNCTAD we have been concerned about several contradictions between international economic governance regimes and policies, and the space for national governments to set their own policy agenda and pursue an autonomous development strategy.

In particular, development encompasses more than a focus on social goals, such as health and education targets. As important as these are, development efforts must also focus on investment and the building of productive capacities for sustainable and inclusive growth.

The international economic environment can provide some useful opportunities for countries if they have the capacities and the policies in place to take advantage of them. UNCTAD refers to this facility as policy space, which it first introduced several years ago and which was then quite controversial. Today, and in the light of the economic crisis, policy space is no longer a controversial concept, as both developed and developing countries alike have strengthened the role of the state in the past two years, and recognized the limitations of market-based pricing mechanisms and allocative efficiency.

1. Coherence between national and international policy regimes: *national policies*

Macro policies

In seeking to mobilize resources for productive investment, countries can look to a number of financial flows, but they must coordinate and be allowed to set appropriate macroeconomic policies to maximize the benefits of these flows.

Looser fiscal and monetary policies may create a budget deficit, but this is not necessarily bad in conditions of growth and employment generation, or to avoid a recession, as happened last year.

Industrial policies

Looking at the experience of East Asia, it is clear that the selective use of industrial policies for nurturing and protecting strategic industries is essential for industrial diversification and building competitiveness. As with the development of advanced economies, industrial policies should be complimented by the selective use of trade policy, such as tariffs and regional trade agreements, until such a time as industries are competitive enough to compete internationally.

Labour market and social policies

Poverty reduction and development is best sustained by employment creation and higher wages. Additionally, redistributive efforts through the tax system or labour market policies will ensure greater income equality, which has a strong link to growth, and is a quick and easy way to reduce poverty.

Concentrating wealth in the hands of the few creates two direct problems for development: firstly, they may not be able or willing to spend or invest extra financial flows; secondly, assuming that entrepreneurship is distributed evenly throughout the population – between men and women – concentrating wealth at one end of the income spectrum, and generally speaking in the hands of men, potentially inhibits dynamic economic talents and innovations from contributing to the development process. Income equality should therefore be a primary target not just of poverty reduction, but also of development – but of which there is no mention in the MDGs for example.

Social protection systems can also help the development process by providing economic and human security, but also by unlocking savings that are used in many countries as a form of self-security – for example in China, savings rates as a proportion of incomes have increased from 16% in 1990 to 30% today.

2. Coherence between national and international policy regimes: *international policies*

Trade/finance

There are some glaring contradictions and myths when it comes to international trade and trade policy. The biggest myth is the myth of free trade: free trade does not exist, nor does anyone want it to, as evidenced, by tariffs, export subsidies, domestic support and a range of non-tariff measures and other restrictions. These contradictions are currently not conducive to development and their perpetuation smacks of hypocrisy.

However, the gains from tariff reductions and other trade measures become less significant when compared to the risks stemming from exchange rate movements and speculative financial flows. Changes in exchange rates between countries can seriously affect the competitiveness of their exports; speculative flows of "hot money" can also affect the exchange rate. The so called 'Carry Trade' – taking advantage of interest rate differentials between countries - has a destabilizing impact on receiving countries, such as Brazil, as it forces an appreciation of their currency and increases inflationary pressures. The country is then forced to keep large reserves in store as insurance against a sudden reversal of these capital inflows, as happened in Asia in 1997/8

UNCTAD has been calling for greater surveillance and management of exchange rates between countries to avoid competitive devaluations and speculative flows. Such an agreement would reflect the kind of non-discriminatory, rules-based system that exists for trade and would provide coherence between the trade and financial systems so that finance no longer undermines trade.

Governance: The BWIs, the G20 and the UN

There are a number of institutions and initiatives that are involved in international economic governance and discussions about reform of the financial sector and the global economy. What is the coherence between them, at the level of mandate, functions and policies?

The IMF needs to be strengthened and reformed in specific areas, notably its surveillance and monetary policy functions. However, reform should include changes to the management of the organization so that it more clearly represents its members, as well as the diversity of opinion among them. In the past, it has focused on one set of countries (e.g. deficit countries) without equal attention given to another set of problematic countries (e.g. surplus countries). Additionally, it should remove itself from development work and focus on its core mandate.

The G20 has taken on the role of international financial sector reform, but since last year has not moved quickly enough to make significant changes. Countries are now in disagreement, or pursuing unilateral actions that leave the door open for regulatory arbitrage. Such an approach to reform and regulation lacks coherence.

Neither the G20 nor the BWIs in their current form can claim the same legitimacy as the UN which represents nearly all countries and a much wider range of opinion and ideas. Reform efforts would be more coherent if they were pursued within the UN multilateral system, which has already proposed many options for financial and economic reform.

Regional initiatives

In addition to the need for coherence between the national and international levels, and between donors and beneficiaries, there is a growing need for coherence at the regional level. In trade, the proliferation of regional trade agreements and export regimes can lead to confusion for businesses. The bilateral negotiation of RTAs between developed and developing countries which may contain so called WTO+ disciplines can also interfere with other commitments or undermine development efforts. Nevertheless, regional alternatives to multilateral initiatives are a rational choice for many developing countries and can bring positive benefits. More monitoring is needed to ensure coherence with the international level however, and that a balance is struck between market access and measures and policies aimed at developing the capacity of countries to take advantage of these new markets.

Aid and debt – social versus productive sector

UNCTAD has been concerned that aid spending has shifted to the social sector at the expense of the productive sector. The share of aid commitments to production sectors (including agriculture) and economic infrastructure fell from 48% in the period 1992-94 to 25% in 2006. This trend needs to be urgently reversed so that countries can build their production capacities and create employment – the best way of tackling poverty.

Highly indebted countries also need to be assisted with their repayments and borrowing requirements, so that aid isn't wasted on servicing debt. In this respect, UNCTAD has proposed a multilateral debt resolution mechanism which would improve the coherence between debtors and creditors and the efficiency of aid spending and debt relief.

During the financial and economic crisis, there was a redistribution of debt from the private to the public sector, from the wealthy to the poor: private deficits became public deficits. In the other direction, public taxes were used to bailout private risk takers. The sovereign debt crisis experienced by several countries therefore partly represents a massive transfer of wealth from the poor to the rich.

This has implications for the political economy of aid in donor countries. Aid budgets are funded by a tax system that increasingly weighs most heavily on low income and middle class tax payers who cannot avoid paying tax. UNCTAD research shows that aid budgets decline anyway after an economic crisis, but there may be more calls to cut budgets if foreign aid and development is not seen as legitimate, that is, if governments think they are seen to be supporting the poor in other countries and not in their own.

And yet governments and the G20 have done little about high income tax avoidance, or about damaging currency speculation, such as the carry trade. It is time to close the tax havens and put a stop to the abuses of the privileges of wealth. Needless to say, this needs to be done in a coherent fashion to avoid arbitrage between tax jurisdictions, and the UN has made proposals on this.