

## Some Observations on the Question of Coherence and Development

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1. 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, even 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 repercussions of multilateral rule and practices for development.
  
2. Thus we have three sets of overlapping influences on development:
  - Multilateral rules and practices (including those of WTO, BWIs and UN): clearly a few major industrial countries exert an undue influence on the shaping of the global institutional framework.
  
  - Policies in the major industrial countries (ICs): these should be, in principles, subject to the same set of multilateral rules and surveillance as policies of other countries: however, in practice, constraints imposed on the policies of ICs are significantly looser than those on developing countries (DCs), and ICs enjoy considerable greater policy autonomy and greater scope for unilateral action than DCs.
  
  - Policies in developing countries: there is perhaps more policy space than is effectively used in many DCs to promote development and to determine the pattern of integration into the world economy, which explains in part the diversity of development experience; but, generally policy autonomy in DCs is

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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 ICs as well as financial markets.

3. The objective of 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. Advocacy is also as important as research. If, on the other hand, one believes that efforts to influence national and global policies and practices of ICs 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 is increasingly dominating the thinking policy makers in DCs, notably in some Latin American countries, realizing that an externally-oriented pattern of development, and particularly catching up with the rich, is becoming more and more difficult.
4. What I would call “systemic coherence” could thus focus on whether or not multilateral rules and practices, policies in ICs and DCs in the areas of trade, investment, finance, debt, labour etc. reinforce each other in support of economic growth and development. Here. It is important to note that what is at stake is not just that policies and practices in each of these 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. This was explicitly recognized, in the case of trade, in paragraph 4 of the Marrakech Declaration “On The Contribution Of The World Trade Organization To Achieving Greater Coherence In Global Economic Policymaking” 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.”

5. “Systemic coherence” was the fundamental question that preoccupied the architects of the post-war international economic system in the Bretton Woods and Havana Conferences. The objective pursued by the architects of the post-war international economic system was to establish a global system that would prevent the problems encountered in the interwar period, including financial crises, deflationary macroeconomic pressures, collapse of primary commodity prices, leading to ad hoc restrictions over trade and capital flows, beggar-my-neighbour exchange rate policies. The solution proposed in the Bretton Woods and Havana Conferences was to be based on four pillars, explicitly stated among the objectives of the IMF and in the charter of ITO:

- Full employment policies as a basis for trade expansion and liberalization and greater integration; i.e. 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.

6. 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 (ITO) 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 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 ICs and DCs 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. In the absence of global arrangements, industrial countries, notably the United States and the EU 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 DCs, 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 ICs. 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-B-vis international financial markets and IMF (none of which resorted to IMF borrowing since the 1970s). Again, DCs were left alone to find unilateral solutions to the problem of managing their currencies.

- Contrary to its original mandate, the Fund has become an institution promoting deflationary adjustment to external shocks in DCs, rather than providing international liquidity to prevent such an adjustment. Recently, with increased capital account liberalization and recurrent financial crises in emerging markets, it has stood readier for financial bail out 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 BW Conference but was added only as an afterthought, with the emergence of the World Bank for multilateral development financing. However, not only the resources and lending of the WB lagged considerably behind the growing needs of DCs, starting in the 1970s increased emphasis has been placed on private capital flows for financing development.

7. 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. While the post-war 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, 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 the participation of DCs in the system is compatible with their

development objectives.

8. 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 doing so it focuses primarily on trade, and emphasizes the adverse impact of trade restrictions and lack of liberalization in ICs 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 BWIs or ICs in the context of WTO negotiations. There is very little, for instance, in the literature on the impact of import liberalization on jobs, wages and wage differentials, on government revenues and social spending, and on prices and incomes received by agricultural producers.
9. This point is also relevant for attempts to compartmentalise development challenges between economic and social, criticising the Washington Consensus only for leaving out the latter from its agenda. The question that needs to ask is whether social objectives could simply be added to the agenda of liberalization and privatization to form a coherent programme.
9. 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, in ICs 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 we are asking to dismantle these while leaving the commodity problem outside the international agenda. instability. Clearly, this does not make sense and it is not politically sensible to expect the governments in ICs 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.

10. In addressing the possible benefits of liberalization in trade-related matters by the North for DCs, 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 ICs to DCs 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 e.g. 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.
11. 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 ICs on development has not received as much attention as trade-related issues. This is quite surprising in view of the fact that for most developing countries 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 DCs may at least be as high as the potential benefits of liberalization in trade-related areas.
12. 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 increase 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. 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 both the surge in capital inflows and the subsequent outflows associated with the East Asian crisis were strongly influenced by swings in exchange rates and monetary conditions in the major industrial countries; and shifts in monetary conditions in the United States have played a large role in the fluctuations in private external financing for Latin American countries. Instability of G3 exchange rates pose 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.

13. The IMF 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 the IMF surveillance has not been successful 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. In the absence of incentives and enforcement procedures linked to the process of peer review under IMF surveillance, countries elsewhere 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 such 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.