Development in the globalized context and the role of international institutions

Markus Henn
Project Officer Financial Markets
World Economy, Ecology & Development – WEED
contact: markus.henn@weed-online.org

17 October 2010, Weil der Stadt
World Trade Index (1929=100)

Source: CPB
Trade and development

Development often is correlated with trade (but: U.S. versus Germany)

Economic Reasoning: Comparative (Cost) Advantage (David Ricardo)

Development through trade liberalization?

- Development took place with different levels of openness
- Dangers: monocultures; export dependency; home market losses
- Successful: mixed approach, limited/lopsided openness
Success stories with trade

- state planning and regulation plays an important role (e.g. Japan)
- access to knowledge (e.g. South-Korea, China)
- protection of infant industries and certain sectors (e.g. South-Korea)
- education and social security (e.g. China versus India)
- no membership in trade institutions necessary (e.g. China, Vietnam)
Global GDP and global financial assets

Source: McKinsey, World Bank
Financial market capitalism

• Liberalization of markets, investors, products
• Short-term speculation and excessive risk taking
• Growth and dominance of financial sector
• Privatization
• Competition between states; tax havens
• Wealth inequality
• Global imbalances
• Instabilities and financial crises increase

But: non-financial industry remains very important
Financial market deficiencies

- Financial markets are no well-functioning markets
- Price mechanism upside down: price increase strengthens demand
- Technical trading, herd behaviour
- Bull and bear markets
- Instability, bubbles, and crises
Financial market price discovery

- fundamental value
- effective price discovery
- ineffective price discovery
Financial Crises (selection)

1980ies  Latin american and african debt crisis
1987    Stock exchange crash, U.S. savings&loans crisis
1992/93  European currency system
1994/95  Mexico
1997/98  Asia
1999    Brazil
2000    Argentina, New economy
2001    Russia, Turkey
2007-   global

1945-1971:  38 crises
1973-1997:  139 crisis
Financialised food markets: the 2007/08 price spike

FAO food price index

Commodity index funds:
- 2003: US$ 13 billions
- 2008: US$ 260 billions

Haiti, April 2008: hunger revolt

Source: FAO 2010
Global interest rate parity, arbitrage and carry trade

U.S.: interest rate 1%

Brazil: interest rate 10%

October 2009: Brazil sets capital inflow controls and taxes

Recent IMF Working Paper: „Capital controls on certain types of inflows might usefully complement prudential regulations to limit financial fragility and can be part of the toolkit...“
U.S. trade balance deficit – mainly financed by China

Source: U.S. Census Bureau
The financial crisis and developing countries

2007
USA: Suprime crisis
- Toxic papers

2008
Advanced Economies: financial crisis
- Less demand (trade, tourism)
- Less investment
- Less remittances

2009
Also developing countries: economic crisis

2010
Recovering, but...
Growth of GDP

- Projection, Source: IMF, WEO Data, April 2010
Foreign Direct Investments in Developing Countries

![Graph showing foreign direct investments from 2001 to 2011.](image)

*Projection, Source: IMF, WEO Data, April 2010*
Remittances from migrants to developing countries

* Estimated, Source: World Bank
Poverty (income less than 2 USD a day)

*Estimated, Source: ILO 2010

World Bank/UN: 55-103 million poor (less than 1.25 USD a day) additionally through crisis
IMF and World Bank gave loans of over 425 billion USD to emerging and developing countries (as of begin 2010)

*Projection, Source: IMF, WEO Data, April 2010
Foreign banks: questionable advantages

Recent IMF Working Papers:

- “Foreign-bank lending funded by domestic deposits and denominated in local currency is likely to be more resistant to external financial shocks and indeed, in Latin America, acted as a firewall against the transmission of global financial shocks.“

- “Foreign banks are not necessarily more efficient than their domestic counterparts” (on Central America)
72 tax havens (fulfill at least one condition)

1. Delaware (U.S.)
2. Luxembourg
3. Switzerland
4. Cayman Islands
5. City of London

Seychelles offshore structures can provide you with many investment opportunities and tax advantages. Here are some of the reasons why Seychelles are:

- Political and economic stability
- Tax efficiency
- Limited liability
- Minimum compliance requirements
- Privacy
- Asset protection
- Minimum administrative requirements
- Flexible company legislation
- Many opportunities for international business
- Investment opportunities

Other attractive features include modern and developed trust legislation, efficient aircraft and shipping registries, provisions for the formation and domiciliation of mutual funds and captive insurance companies, and Free Trade Zone for manufacturing and service companies, benefiting from zero taxation, application procedures and availability of work and resident permits.
Tax havens: what's the problem?

- **Revenue losses**: states cannot tax beneficiaries, tax competition

- **Illicit flows** (source: Raymond Baker / Tax Justice Network):
  - 1-1.6 trillion US$ per year
  - growth since 1990s approximately 9% annually
  - 350-500 billion US$ per year from developing countries

- **Wrong incentives**: investments lead by tax advantages

- **Inequality**: big companies and rich individuals favoured

- **Lack of control / secrecy**: risk-taking
Structural reforms for sustainable globalization

- Sustainable (finance) business: less risky, less speculative
- Take into account development interest
- Careful and limited liberalization
- Close down tax havens
- Tackle volatility in markets
- Tackle global imbalances
- Redistribute globally and nationally
Do international institutions matter, and why?

Why international institutions:
- Interest: national? global?
- Responsibility: countries? global/common?

What problems with international institutions?
- National interest, and the prisoner's dilemma
- One global solution (e.g. for development) or local/regional ones?

What type of institutions:
- Type of integration (negative / positive)
- Degree of integration (decision power, enforcement)
International trade and financial institutions

- World Trade Organization
- World Bank
- International Monetary Fund
- G8/G20
- United Nations (UNCTAD, UNDP)
- other

1944: Bretton Woods (WTO: ITO/GATT)
World Trade Organisation (WTO)

Founded 1995, before: only General Agreement on Tariffs and Trade (GATT) from 1947

Set of Treaties (apart from GATT):  
• General Agreement on Trade in Services (GATS)  
• Agreement on Agriculture (AoA)  
• Trade-Related Aspects of Intellectual Property Rights (TRIPS)  
• others (SPS, TBT, DSU)

One country, one vote

Main goal: trade promotion through liberalization; WTO: „need for positive efforts designed to ensure that developing countries ... secure a share in the growth in international trade“
The WTO and developing countries

Interest politics by advanced economies, upholding own trade barriers

Doha negotiation round: „development round“; since 2001

So far, not accomplished: conflict between developing and advanced countries, e.g. on agricultural subsidies

Source: Via Campesina

WEED, International Institutions and development, 16 Oct 2010
World Bank Headquarters Washington D.C.
World Bank

- International Bank for Reconstruction and Development
- International Development Association (from 1960 on)

**186 members**

**Main shareholders:** USA (app. 15%), Japan, Germany, France, UK

**President (U.S.):** Robert Zoellick

**Main goals:** lending (2008: 38.2 billion $), subsidies, analysis, and advise;

*World Bank:* „We provide low-interest loans, interest-free credits and grants to developing countries for a wide array of purposes that include investments in education, health, public administration, infrastructure, financial and private sector development, agriculture and environmental and natural resource management.“

WEED, International Institutions and development, 16 Oct 2010
World Bank: lending policy

1950ies/60ies: little, Europe

1970ies: growth, develop. countries

1980ies/90ies: neoliberal approach and conditionality („Washington Consensus“); inappropriate and unsustainable lending (technocratic approach, megaprojects, hard currency loans)

Today: revised strategy on paper: e.g. role of the state, dams, lending standards; new roles (e.g. climate change adaption)

Sources: World Bank, 2030 Water Resources Group
World Bank: lending standards since 2006

1. Social and Environmental Assessment and Management
2. Labor and Working Conditions
3. Pollution Prevention and Abatement
4. Community Health, Safety and Security
5. Land Acquisition and Involuntary Resettlement
7. Indigenous Peoples
8. Cultural Heritage

However, practice still dubious: conditionality, education, gender, sustainability, power
World Bank loan: Medupi Coal Power Station

3 to 4 billion USD for South Africa by World Bank in April 2010

Against: e.g. environmentalists, in WB: US, UK, NL, Italy, Norway

For: South African government, other

Source: Eskom
International Monetary Fund (IMF)

**History:**
- 50ies/60ies: financial and currency stability
- 70ies: collapse of fixed exchange rate system
- 80ies/90ies: neoliberal lending facility
- 1996: highly Indebted Pour Countries Initiative
- Decade till 2008: vanishing importance
- Post-crisis revival

**Today**
- 187 member countries
- Total quotas: 328 billion USD
- Pledged or committed: 600 billion USD

**European President** (Dominique Strauß-Kahn)
Article I of the Articles of Agreement sets out the IMF’s main goals:

• promoting international monetary cooperation;
• facilitating the expansion and balanced growth of international trade;
• promoting exchange stability;
• assisting in the establishment of a multilateral system of payments;
• making resources available to members experiencing balance of payments difficulties
## IMF Financial Activities

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010 (7 Oct)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GRA Credit (SDR billions)</strong></td>
<td>17.5</td>
<td>37.2</td>
<td>52.5</td>
</tr>
<tr>
<td><strong>PRG Trust Credit (SDR billions)</strong></td>
<td>4</td>
<td>5.1</td>
<td>19.8</td>
</tr>
<tr>
<td><strong>Highly Indebted Poor Countries</strong></td>
<td>35</td>
<td>35</td>
<td>36</td>
</tr>
<tr>
<td><strong>Multilateral Debt Relief Countries</strong></td>
<td>25</td>
<td>27</td>
<td>29</td>
</tr>
<tr>
<td><strong>HIPC Umbrella (SDR millions)</strong></td>
<td>399.0</td>
<td>418.0</td>
<td>670.0</td>
</tr>
<tr>
<td><strong>Usable resources (SDR billions)</strong></td>
<td>152.4</td>
<td>290.2</td>
<td>303.8</td>
</tr>
</tbody>
</table>
IMF: Lending policy

• Conditionality: fiscal austerity, liberalization, privatization; focus on inflation, currency, investor protection,
• Example: the „IMF crisis“ in Asia 1997/98
• New policy since the current crisis?
  - formally yes (inflation, deficits, capital controls),
  - but reality?
  - wishable or not?

Source: Univ. Wisconsin
<table>
<thead>
<tr>
<th>Country</th>
<th>Voting Power (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>16.74</td>
</tr>
<tr>
<td>Japan</td>
<td>6.01</td>
</tr>
<tr>
<td>Germany</td>
<td>5.87</td>
</tr>
<tr>
<td>France</td>
<td>4.85</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>4.85</td>
</tr>
<tr>
<td>China</td>
<td>3.66</td>
</tr>
<tr>
<td>Italy</td>
<td>3.19</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>3.16</td>
</tr>
<tr>
<td>Canada</td>
<td>2.88</td>
</tr>
<tr>
<td>Russia</td>
<td>2.69</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.34</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.08</td>
</tr>
</tbody>
</table>

Source: [www.imf.org](http://www.imf.org), October 2010
**IMF: Power and Interest**

**Martin Wolf (chief economist, Financial Times, 2004):**
„The ... charge against the IMF is that it is a tool of the G7, particularly of the US and, more particularly still, of Wall Street. The answer to this charge is obvious: guilty. The institution responds to the realities of power and the self-defined interest of its dominant players.“

**Quota reform 2010:** developing and emerging countries shall get more influence, but details are heavily debated
No formal mandate, but politically very influential

G7/G8 critizised for not taking into account developing countries' interest

New setting with G20: split of developing countries: China, India, Brazil, South Africa – and the rest
Summary

- International institutions can support development

- International are driven by certain ideological forces; they should, however, reflect the best economic reasoning

- International institutions are prone to be vehicles of national interest

- International institutions have to reflect the interest of developing countries and give them influence
Thank you for your attention!

www.weed-online.org