

DRAFT NOT FOR QUOTATION

Trade issues crucial for effectively dealing with the global financial crisis in developing countries

By Aldo Caliari, Center of Concern

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In late 2008, as the financial crisis reached undoubtedly global and historical proportions, the leaders of several countries started talking about the need for a “Bretton Woods II”, in reference to the foundational character of the reform that the crisis should trigger.

In November of last year, the Group of 20 (G20) –a grouping that involves several emerging market countries and was created after the East Asian financial crisis as an informal forum to broaden the discussion on international economic affairs – was vested with a new mandate. This group usually meets at Finance Ministers level but Heads of State of the countries in this group were summoned to the US by President Bush for an unprecedented G20 Summit on Financial Markets and the World Economy that agreed on “Principles” and an “Action Plan for Reform.” The Summit was followed by a second one, held in London on April 2 of this year and it is announced that a third one will be hosted by the US government, later in September. An effort to convene a Summit on world financial and monetary reform is also underway at the United Nations, to be held on June 24-26. Its preparations were fed by a Commission of Experts on Financial and Monetary Reforms appointed by the President of the General Assembly. Chaired by Nobel Prize-winner economist Joseph Stiglitz, the Commission features former and current well-known economic policy-makers, besides expert from academia.

With so much attention focused on the response to the global financial crisis, it would be easy to assume trade issues will take a backseat to financial ones. But, for developing countries, this approach would be a tragedy. As the financial crisis continues to unfold, it is becoming clear that the main channels by which the financial crisis is making its impacts felt on developing countries are trade and trade-related ones. This is not surprising based on the sheer fact that developing countries exports-to-GDP ratio increased from being about a quarter of their GDP in 1995, to being more than half of their GDP in 2007.¹

Yet, the crisis was preceded by a period (2003-2008) of boom in trade and exports. During this boom it also became apparent that no country can succeed in using trade to develop or reduce poverty without supportive internal and external financial structures.

Both aspects highlight the results of years of reform in developing countries that placed export-led growth as the central paradigm, without an equal emphasis on the mechanisms by which such exports would yield increased and stable financial gains to them. It means that both, in good and bad times, 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. The trade dimensions and impacts of financial reforms should, thus, be factored into any proposed reforms of the global financial and monetary system.

Yet, these are issues typically ignored in trade negotiations, which tend to focus exclusively on pursuing the exchange of market access concessions. On the other hand, the trade dimensions and impacts of financial reforms are neither appreciated nor factored in attempts at financial reforms, domestic and global.

In what follows, this paper discusses the many trade-related channels by which the financial crisis is affecting developing countries. The next section discusses the role of commodity prices. Section II addresses infrastructure financing and debt sustainability in the light of trade trends. The withdrawal of foreign investment and the relationship this bears to trade issues is addressed in Section III, while the exchange rate problems that feed and are fed by trade trends are addressed in Section IV. Sections V and VI touch upon, respectively, the scarcity of trade finance and the issues raised by the liberalization of financial services. Section VII, finally, engages in the

regulation of financial instruments. Section VIII closes with some conclusions on trade as a development finance and a financial stability tool.

I. The role of commodity prices

A first impact to underscore is the one that developing countries will sustain as a result of the fall in commodity prices. To put these impacts in perspective it is necessary to highlight that between 2002 and 2007 the prices of all commodities, in dollar terms, increased 113 per cent.² This average masks large differences between the minerals group (around 260 percent) and food and tropical beverages (60 percent). Nonetheless, the increases were all significant across the board, especially after decades of declining prices. The fact that some factors behind the increase (e.g., growing demand from high-growth economies such as India and China) were removed from the epicenter of the financial crisis led some to hope that the fall in prices would not be that significant. However, as growth projections for China and India were revised downwards such hopes faded. Indeed, while South-South trade has been increasing, developing countries still experience high concentration in their export markets, making them largely susceptible to a recession affecting markets of the North- a dynamic China and India themselves are also exposed to.

With a scenario of lower demand everywhere, commodity prices went down at, in some cases, shocking speed (e.g., oil which went to a 50 % of price in two months). There is a bright side to the slump in commodity prices. Developing countries that until mid-2008 were trying to cope with rising bills for their food and fuel imports are now experiencing some relief.³

But the prevailing side of the picture is the significant negative effects that lower prices will have on export revenues. The fact that the exceptional growth period experienced by developing country economies in the last five years coincides with the surge of commodity prices is more than a mere coincidence. For all but two Latin American countries, commodities represent more than 50 % of their exports. More than three quarters of the growth in export revenue in 2007 were due purely to price increases of those commodities.⁴ A similar trend is notable in Africa which is, in fact, more dependent on commodities than Latin America. Primary commodities, including fuels, account for near 70 percent of the average exports in the period 1995-2006.⁵

What these numbers are saying is that what has been characterized as a boom actually hides meager progress –or even retrogression -- in the export profiles of developing countries. Very few countries had been able to use the increased revenue from the boom in commodities to get higher up in the ladder of diversification and value-added. In some cases the hindrance was that the rents of the boom were not captured at the country level, while in other cases captured rents were not devoted to invest in infrastructure and productive capacity but in either immediate consumption or long postponed social needs. A few countries were merely able to take advantage of the access to the natural resources to expand into natural resource-based manufactures. As a result, trade profiles have not changed much, leaving no room for cushioning the impacts of the decrease in prices. The effectively utilization of increased commodity revenue would have required a capacity that, after years of downsizing and withdrawal from economic planning, states were barely starting to re-build.

To the extent that some countries were able to develop some manufacturing capacity, this may also fall prey to the scenario of lower demand in client countries, forcing adjustment that, given the small margins available to adjust in price (or, in some cases, even wage cuts), will have to be done via downsizing. The scarcity in trade credit is a compounding factor, as integration in global production chains is the common expression of the export-led model in manufactures by developing countries.

The effective utilization of increased commodity revenue would have required a capacity that has been wiped out after years of downsizing and withdrawal from economic planning. For instance, studies on Africa underscore the tendency of diversification trends to stop after the introduction of a stabilization approach to macroeconomic policies and trade openness that characterized the economic paradigm prevailing in the continent after the early 1980s.⁶

Not having made use of the surpluses of good times to diversify, developing countries will be faced with the challenge of diversifying in bad times, and with less income. The incipient capacity for planning that, in a learning-by-doing fashion, they were starting to develop, is at least as important an asset as any potential new access to markets, and should be carefully nurtured.

II. The role of trade in infrastructure financing and the sustainability of debt

The impact of lower export revenues will be also felt in a number of indirect ways. It is very common that, in times of boom, both countries and their lenders tend to be overoptimistic about future trends. The risks of infrastructure projects going wrong are generously evaluated against the backdrop of the growing income prospects. Costs and terms of borrowing that are very high compared with the historical, but not with the most recent, reality tend to be considered viable. This boom has been no exception.

One particular trend in public funding for infrastructure projects has been the increased role of private sector participation, through contracts that provide public funding guarantees, often encouraged by multilateral financial institutions. For example, it is common practice in several public-private partnership contracts to attach provisions that guarantee a certain level of demand and, therefore, revenue to the provider. If the economic activity then does not sustain such demand, the government becomes liable for the difference. The exchange rate risk is sometimes built into demand guarantees. That is, in spite of devaluations that may be necessary for monetary and economic policy reasons, devaluations whose impacts domestic investors and citizens bear in terms of decreased import purchasing capacity would not affect the private investor.⁷

So, whereas ideally private sector participation should mean less of the risks of a downturn will be borne by the countries, and more by the private sector, the reality of public-private partnerships has been generally the opposite. Compounding the generous concessions built into private sector contracts, guarantees do not represent an immediate expense, so they escape the degree of scrutiny that actual budget expenditures would receive.⁸ This opacity also fosters what the IMF has called “a guarantee culture” on the part of the private sector, so guarantees, instead of a subsidiary mechanism, are provided for risks that the private sector would be best positioned to manage on its own. Since the guarantees are more likely to be called at a time of generalized economic distress (e.g., a financial crisis) their fiscal consequences are aggravated by their pro-cyclicality and potentially multiplying effects.⁹

As put by the World Bank, the financial crisis will cause some existing projects to experience financial distress, and will cause significant dislocations in countries’ agendas to address infrastructure deficits.¹⁰ The links to trade are even clearer for many of the projects which were ostensible undertaken to improve trade competitiveness, considered a complement to increased liberalization of trade. It is rare to find clauses safeguarding the country’s cost and benefit position in the contract in case the expected returns from exports do not materialize. Neither are there provisions to ensure the country would capture a greater share of the revenue in case the projects yield higher-than-expected returns. Renegotiations tend to be the only way, but they are cumbersome and face internal and external obstacles.

Responses to the crisis have also emphasized financing for infrastructure, ostensibly to pick up the financing that the private sector is withdrawing from. The World Bank is among those entities increasing its provision of funding for infrastructure. Over three years IFC is expected to invest a minimum of US\$300 million and mobilize between US\$1.5 billion and US\$10 billion from other sources. But the provision of more lending may be a factor that either improves or worsens the situation. The final effect will depend on what is the appropriate sharing of risks and returns between private and public actors and particularly between IFC and its borrowers, and whether a realistic and sound methodology is used for the evaluation of trade-related returns.

Alongside the deterioration of trade and fiscal balances, debt levels are set to grow. For low income countries, and in spite of the debt relief committed in the Heavily Indebted Poor Countries Initiative and its most recent

expansion, the Multilateral Debt Relief Initiative—launched by the Group of 8 meeting in Gleneagles 3 years ago - debt situations is rapidly deteriorating. Trade is a key factor in that equation. The least risky group is, according to the most recent reports, the 18 low income countries that received all debt relief commitments already. Out of the countries in this group, less than half of them have a low risk of falling back into debt distress.¹¹ Moreover, those with low and moderate risks are highly vulnerable to export shocks.¹² One third of the countries that were not eligible for HIPC/MDRI are also either in or at risk of debt distress.

But it is important to keep in mind that the assessment of risks and “sustainability” is according to the rather tolerant parameters of the Debt Sustainability Framework adopted in 2005. Such reform resulted in a ramping up of the thresholds at which borrowers are considered to be in trouble. Some substantial criticisms had been made of the methodology for measuring debt sustainability in the past, which relied on overoptimistic projections of export and GDP growth.¹³ In spite of its attempt to address the problem with stress-testing methodologies, the boom of the last years continued to boost the optimism of projections. The IMF/ Bank staff assert, referring to the situation of countries not in the HIPC/MDRI program, that the situation is not worse because these countries were having an export growth rate of 11 percent average in a 10-year average. Export projections based on such trends will be rendered useless by the impact of the crisis and so will the projections of debt ratios for many countries. The very notion of “low” or “moderate” risk will certainly come under challenge.

The increasing debt problems are not confined to the LICs group. Commodity prices have had a major impact in worsening export outlooks of several middle-income countries, such as Argentina, Mexico, Brazil, South Africa and Kazakhstan. As the current accounts of some countries show signs of worsening, making more borrowing necessary, rating agencies such as Fitch proceeded to downgrade them.¹⁴ The downgrades will only feed, in a vicious circle, into increasing the costs for these countries to repay their existing obligations or refinance them.

Reciprocally, the need to direct more income to paying debt service can only contribute to accentuate the problems both low and middle income countries have in making investment necessary to expand their production capacity or place them in tighter competition with pressing immediate social needs.

III. Trade and the withdrawal of foreign investment

There was another factor boosting the “boom” in developing countries right before the crisis hit, and it was record increases in foreign direct investment. Most of the investment was tied, in more or less direct ways, to the high rates of export growth.

For Latin America and the Caribbean, ECLAC reports that unprecedented volumes of FDI were largely attributable to the persistent worldwide demand for the natural resources in abundant supply in the region. With the change in price trends for commodities, this has begun to change, and ECLAC forecasts FDI flows to the region to fall between 35%-45% during 2009.¹⁵ The most recent report by ECLAC observes that even as plans for FDI in the natural resources sector take more time to backtrack, firms in the sector are already revising their plans.¹⁶ These trends are replicated in FDI in natural resource-based sectors that were also a significant factor in FDI growing inflows into Africa and Central Asia. In 2006-2007, 82 percent of foreign investment in Africa landed in 10 countries, most of them oil- or mineral-producers.¹⁷ That year also marked a second year in growth of FDI inflows to the LDCs in Africa, growth clearly linked to the rise in prices of commodities and is, therefore, also set to go down as prices fall.¹⁸

Though it is true that the natural resource-seeking investment was a high share,¹⁹ if the analysis of investments whose reversal is affected by trade were to stop at this type of investment only, it would incur in an understatement. Efficiency-seeking investment has been even faster to retreat. Referring to the efficiency-seeking investment in Mexico and the Caribbean, ECLAC says “The recession in the United States slowed activity among the export platforms located in the sub-region, which had been set up mainly to serve the United States market, and this stemmed the flow of export-oriented FDI.”²⁰ Also tied to trade was a good part of market-seeking investment—investment that goes to a country trying to profit from the rise of purchasing capacity developed in

some countries.²¹ It was the boom of natural resource exports that was backing the increased income and purchasing capacity in several countries. Consequently, such investment already started to suffer as a result of decelerated growth in the countries that had been riding the export boom.²² Commodity trends are associated even to some FDI flows in manufacturing, as reported by UNCTAD in regards to resource-based manufacturing products in Latin America.²³

Foreign investment frameworks have been reformed all over the developing world in the name of facilitating and attracting such flows which, the rationale goes, would bolster growth and development. But what the figures are saying is that foreign investment was rather attracted by high levels of growth than the cause of them. Even from a purely neutral balance of payments perspective, attracting more foreign investment cannot be considered to have always a positive effect because foreign investment that comes in good times leaves quickly in bad times, generating a rather procyclical effect for the balance of payments.

In this scenario, the attraction of foreign investment to export-oriented sectors should be geared to ensure that part of the revenues from increased prices will contribute to a domestic capital base in good times, helping also nurture the basis for greater stability in bad times.

IV. Trade-related exchange rate movements

The financial crisis has also underscored the difficulties faced by developing countries trying to benefit from trade in the absence of a system to provide some measure of stability to exchange rates. The projection of competitive advantages and domestic investment oriented to exports, especially in a long term, are hampered. Costs of finance are rendered more volatile, too.

In already two studies,²⁴ the IMF has argued that fluctuations of exchange rates do not have such a strong impact in trade performance and has advocated in favor of market-based hedging instruments as the way forward for developing countries that are affected. Critics contend that this is only available to large companies, with the means and sophistication to pursue such hedging. But difficulties being faced by companies in emerging markets should call into question whether even for large companies in developing countries this practice is a reliable safeguard or the most efficient use for the resources of both the private sector and the government. In countries such as Brazil, Mexico and South Korea, companies have reportedly lost huge amounts by taking the wrong side on derivatives to hedge against dollar movements.²⁵ In Brazil, the government had to intervene to protect the companies affected by lending to them at below-market interest rates, in another sign of the costs that the problem may have for developing countries public treasuries.²⁶

In addition to the effects that the financial crisis will have on the export chances of developing countries, it is important to mention that the swings in the prices of the currencies of many developing countries are closely related to their trade profile. The currencies of commodity-dependent economies are especially affected, as their currencies tend to lose value in the face of declining commodity price trends that make their growth and export prospects more dubious and may prompt investors to withdraw capital. Some experts use the term “commodity currencies” to refer to the strong correlation between the prices of commodity exports and the currencies in countries such as Chile (copper) or Australia and New Zealand (agricultural products).²⁷ Even if the direction of causality might remain open to question, the phenomenon means, by definition, that the export profile of the country has a strong impact on how its currency will fare. Though the research cited here focuses on commodity-producing countries, there are indicia that it could more broadly relate to undiversified export structures.²⁸

Whereas usually a currency depreciation gives a boost to exports that can boost income and help offset other negative effects, that relieving effect cannot be expected under current conditions. It will make little difference given the downward trends in demand by international markets.

V. The scarcity of trade finance

One very obvious way the credit crunch will project onto trade by developing economies is the impact it has on trade-finance, that is, the different mechanisms by which typically a bank or financial institution, for a fee, guarantees payment of shipments by an importer or exporter. The deterioration of availability and terms of trade credit was already being felt earlier in 2008, but the situation significantly worsened since September, with the collapse and defensive stances taken by major international banks. According to a statement made by Brazil last October in the WTO: "Exporters from developing countries who seek trade finance find themselves in the odd situation of being among the most creditworthy economic agents, but unable to access credit in a scenario with heightened overall risk perceptions that lead to more stringent requirements by the banks, or simply because funds are not available any longer."²⁹

In a recent paper, World Bank staff points out that trade credit was traditionally thought to be only relevant from a microeconomic point of view, but he argues this should no longer be the case.³⁰ The author explores the role of trade credit as a mechanism for the amplification of shocks at the macro level and finds strong evidence for the hypothesis that an increase in the use of trade-credit along the input-output chain linking two industries results in an increase in their correlation.³¹ This is certainly not good news to the many countries that have moved, in the last two decades, to find their niche as providers in a number of global production chains. The problems for both providers who need cash but also buyers, who face the threat that their cash-strapped providers may disappear because of the inability of holding up without such credit, are becoming more evident.

In addition, the scarcity of trade credit is bringing to the spotlight a sector little heard of, but that is vital to the continued operations of supply chains: trade insurance. While large companies tend to take the risk that trade credits will not be honored, small providers could be so largely affected by the failure of a big buyer that they usually take insurance. Since last year, because of the drying up of credit, trade insurers have seen a rise in their losses. Atradius, the UK's biggest credit insurer, saw its losses increase to account for more than 70 per cent of revenues, up from a norm of 50-60 per cent.³² In what some reports say is a panic reaction, they quickly blacklisted as non-insurable many companies, some of them large buyers such as General Motors, Woolworths and Ford. Moreover, trade credit insurers are likely to base their assessment of the creditworthiness of a foreign company partly on the economic stability of its home country. A commentator speaks of the formation of a vicious circle: "insurers are cutting trade credit insurance because they believe that the scarcity of bank loans has increased the chances of businesses failing. Companies who use the cover are then more exposed to collapse themselves, because some lenders will not advance new funds unless credit insurance is in place."³³

The urgency of the situation prompted the WTO Director General to take the unusual step of hosting a meeting of main trade-finance providers, which was held November 12 in Geneva. According to an estimate presented at the meeting, the liquidity gap in trade finance amounts to US\$ 25 billion and analysts at that meeting predicted that the situation will get still worse.³⁴ In a more recent report the WTO shared estimates of unmet demand for trade financing that range between US\$ 100 to US\$ 300 billion on an annual and roll-over basis.³⁵ The concerted government efforts in a number of industrialized countries to recapitalize their banking systems may, for this purpose, not be of much help. A reporter said that, as the government takes a stake in banks, their priorities may be to get taxpayers' money back and, politically, stimulate lending to domestic business rather than devote taxpayers' equity to far-off trade finance.³⁶

In some countries like Brazil and India, where governments have rapidly made available credit support for exporters. But it is unlikely that countries with lower levels of reserves will be able to have that support forthcoming.³⁷

At the London Summit the G20 Leaders committed to "ensure availability" of \$ 250 billion for trade finance. Like other figures in the Summit declaration, close scrutiny revealed there is much bang but little buck to this one. The ambiguous reference is rather an estimate of all that would be spent -by countries and private sector -- in trade finance in the next two years, than a new and additional pledge attributable to this meeting.

This observation applies to a new trade finance facility launched by the World Bank the day before the Summit and presented with much fanfare as a "\$ 50 billion trade finance facility." The fine print of that announcement revealed that pledges amount to scarcely \$5 billion, with \$ 50 billion being the amount of total trade that is expected to be financed by it.³⁸ One of the annexes to the Summit Declaration puts actual voluntary bilateral contributions made at the Summit at \$ 3-4 billion, to be contributed to that same World Bank pool.³⁹

Not only are the pledges woefully insufficient, but they seem to have taken removed from attention the structural issues that affect developing countries' access to trade finance. Much more relief could be offered by serious follow up to another commitment at the Summit to ask regulators to "make use of available flexibility in capital requirements for trade finance."⁴⁰ The negative impact that Basel II may have on trade flows, *inter alia*, through increased procyclicality of trade finance, has triggered complaints from developing countries.⁴¹ Balance-sheet exposure to least-developing countries costs banks apparently three times as much as exposure to developed countries, creating a large asymmetry in access to this type of lending.⁴² Unfortunately, making use of "available flexibility" offers very little space for hope, and the work program that is dealing with reforms to banking supervision are taking place in a separate fashion from the issues of trade financing faced by developing countries.

VI. Trade in financial services

The impact of the crisis will also be determined by the degree of openness to trade in services, particularly financial services, of developing countries. The flexibility of many of these countries to introduce the capital management techniques required by the crisis has been compromised already by trade and investment agreements.

In a speech last year, the WTO Director General Mr. Lamy's stated belief that financial services trade openings can also be useful, by "bringing fresh capital inflows." However, the experiences with foreign banks operating in developing countries has oftentimes not meant they bring "fresh capital." Quite to the contrary, in many cases their business model relies on using existing capital that, given a larger pool of resources and access to intra-company credit or international capital markets, can be better leveraged.

The IMF reports that it is the developing countries that more opened themselves to foreign banks –economies in Eastern Europe-- that are faring worst comparing to the ones that had a relatively more closed financial sector, such as those in Asia.⁴³ Indeed, as the crisis erupted, it became clear that, far from representing relief, foreign banks operating in developing countries brought added woes. The crisis started with a number of banks based in developed countries that had either invested in subprime market securities or provided backup credit lines for special purpose vehicles and had to recapitalize them.⁴⁴ For supervisory purposes, the originating banks were not even subject to the jurisdiction of developing countries that are now bearing the impacts. Yet, it is the host countries that are now suffering lack of access to credit.

At the same time, the remedial measures taken in developed countries to deal with distressed banks represent an additional burden for developing countries, as they can hardly match such back-up government support. Cornford is of the view that "Both actions already taken in support of financial firms at risk due to the credit crisis in industrial countries and new prudential regulations may have implications for negotiations and other activities on financial services in the WTO."⁴⁵

The measures being taken to review the supervision of global banks may actually hurt more than they help access to credit by developing country producers. For instance, the current chair of the British Financial Services Authority, Lord Turner, is arguing for changes that will require global financial institutions to keep significant capital in each country in which they do business and make sure each unit has its own source of liquidity in a crisis. In turn this will cut profits, increase costs and represent less opportunities to realize economies of scales by such banks, with consequences for "the ability of global banks to play their role in lubricating the flows of capital and trade."⁴⁶ On the other hand, some would question the alleged efficiency of global banks, or the lack of margins to adjust without increasing prices. Noting that the financial industry represents between 30% and 40% of the

aggregate profits of the quoted corporate sector in the US, UK and globally—compared with 10 % forty years ago—one analyst states “It seems strange that an industry whose role is that of intermediation rather than the production of consumption goods and services should command such a high share of capital, profits and brains.”⁴⁷

It is also worth noting that the liberalization of financial services does not only bring dangers to the banking sector. In a powerful piece, Vander Stichele argues that the government obligation not to stop a foreign service provider from entering the country and offering financial services that have been committed may mean in practice that it could be difficult for the authorities to prohibit derivative trading, a measure many governments are finding necessary to implement.⁴⁸

As Joy Kategekwa says, referring to similar rules in the Economic Partnership Agreements, “The role of regulation has never been more vindicated than at this time of financial turmoil,”⁴⁹ so extreme caution in adopting any new rules, and even a roll-back of existing ones, is in order.

VII. Trade and the regulation of financial instruments

In a cyclical way, this paper closes the account of trade-related channels by which the financial crisis affects developing countries going back to the first one, commodities, but from a different angle.

As stated by economist Jan Kregel, “If there had ever been a doubt about the impact international finance on trade, the current conditions in financial and commodity markets should remove it.”⁵⁰

In the last few years commodities have become an asset class to be included in asset allocation models of portfolio investment, so their prices no longer determined by the demand for final use relative to available supply, but rather by the demand to hold them and those willing to supply them without actually producing them. There was, as a result, a sharp increase in non-commercial demand for commodities at a time when other fundamental factors caused prices to tighten.⁵¹

By mid-2008 there were 60 commodities-linked US funds and notes tracked by Financial Research Corporation (only nine with records stretching back more than two years). In Europe, over 100 exchange traded commodities are on offer, mostly from London-based ETF Securities. Goldman Sachs estimates pointed to pension funds and mutual funds having invested a total of approximately US\$85 billion in commodity index funds, and to investments in its own index, the Goldman Sachs Commodity Index (GSCI), having tripled over the past few years. Between end of 2005 and early 2008, index-linked commodity investment had doubled to \$260 billion, according to Citigroup.⁵²

Just as these investments amplified prices movements on the rise, they amplified their movement down in the collapse. Extreme volatility 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.

Thus, it is crucial to the trade interests of developing countries that the volatility of these prices receives adequate treatment through a thorough regulation of “innovative” speculative instruments that are traded privately (Over the Counter or OTC). These are currently neither regulated nor reported to public authorities. Among the regulations urgently needed are, as suggested by expert Mr. Steve Suppan, 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.⁵³

VIII. Trade as a tool for development finance and financial stability

As the financial crisis unfolds, it is increasingly clear that developing countries stand to suffer the most, and that the impacts will be most strongly felt through trade and trade-related channels. Years of trade reforms in these countries have emphasized an export-led, pro-liberalization model, and sidelined the reality that no country can succeed in using trade to develop and reduce poverty without supportive internal and external financial structures.

This is the time to pursue a rebalancing act. Trade can be a development finance tool and one that helps countries weather, rather than place them at the mercy, of financial cycles. In this regard, the crisis could be seen as an opportunity to address longstanding issues that have prevented developing countries from a more beneficial trade engagement in the global economy, including during much more benign times. An agenda for response to the global financial crisis that fails to place those reforms at the center is more than merely a missed opportunity to fix these longstanding problems. It could have tragic consequences for the future of those economies.

Thus the urgency of a shift in approach. But for a shift in approach to happen, the trade concerns of developing countries should be at the center of the reform of the international finance and monetary systems.

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- ³⁰ Raddatz, Claudio 2008. Credit Chains and Sectoral Comovements: Does the Use of Trade Credit Amplify Sectoral Shocks? Policy Research Working Paper 4525. The World Bank. Development Research Group.
- ³¹ *Ib.*
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- ³⁸ World Bank 2009. New Trade Finance Program to Provide up to \$50 Billion Boost to Trade in Developing Countries. Press Release No:2009/291/IFC-EXC. April 2, 2009.
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- ⁴⁰ G20 Leaders’ Statement, April 20, 2009. Available at <http://www.londonsummit.gov.uk/en/summit-aims/summit-communicue/>
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- ⁵¹ Ib.
- ⁵² For more details and statistics see Caliarì, Aldo “International Policy Aspects of Food Price Inflation: Some Remarks”, Remarks originally delivered at an interfaith briefing and discussion about food and fuel held Wednesday, June 4, 2008 in Washington, DC.
- ⁵³ The author is grateful to Steve Suppan, at Institute for Agriculture and Trade Policy, for comments that, though made for a different piece, fed into this section of the paper.