# THE EVOLUTION OF DEVELOPMENTAL POLICY PERSPECTIVE WITHIN THE UNITED NATIONS IN THE 2000s

ADNAN KOÇAK
108674002

İSTANBUL BİLGİ ÜNİVERSİTESİ
SOSYAL BİLİMLER ENSTİTÜSÜ
ULUSLARARASI EKONOMİ POLİTİK YÜKSEK LİSANS
PROGRAMI

Prof. Dr. E. AHMET TONAK

2011

The Evolution of Developmental Policy Perspective Within The United Nations In The 2000s

Kalkınma Politikaları Perspektifinin 2000'lerde Birleşmiş Milletler İçerisindeki Gelişimi

Adnan Koçak

108674002

| | |
|---|---|
| Prof. Dr. E. Ahmet Tonak | : …………………… |
| Prof. Dr. Oktar Türel | : …………………… |
| Doç. Dr. Cem Başlevent | : …………………… |

| | |
|---|---|
| Tezin Onaylandığı Tarih | : 14/01/2011 |
| Toplam Sayfa Sayısı | : 79 |



| Anahtar Kelimeler | Key Words |
|---|---|
| 1) Kalkınma | 1) Development |
| 2) Birleşmiş Milletler | 2) United Nations |
| 3) Küreselleşme | 3) Globalization |
| 4) Uluslararası Ticaret | 4) International Trade |
| 5) İktisadi Büyüme | 5) Economic Growth |

The Evolution of Developmental Policy Perspective Within The United Nations In The 2000s

Kalkınma Politikaları Perspektifinin 2000'lerde Birleşmiş Milletler İçerisindeki Gelişimi


Adnan Koçak

108674002


| | |
|---|---|
| Prof. Dr. E. Ahmet Tonak | : .................... |
| Prof. Dr. Oktar Türel | : .................... |
| Doç. Dr. Cem Başlevent | : .................... |
| Tezin Onaylandığı Tarih | : .................... |
| Toplam Sayfa Sayısı | : 79 |

| Anahtar Kelimeler | Key Words |
|---|---|
| 1) Kalkınma | 1) Development |
| 2) Birleşmiş Milletler | 2) United Nations |
| 3) Küreselleşme | 3) Globalization |
| 4) Uluslararası Ticaret | 4) International Trade |
| 5) İktisadi Büyüme | 5) Economic Growth |

## STATEMENT OF AUTHORSHIP

This thesis contains no material which has been accepted for any award or any other degree or diploma in any university or other institution. It is affirmed by the candidate that, to the best of his (or her) knowledge, the thesis contains no material previously published or written by another person, except where due reference is made in the text of the thesis.

Adnan Koçak

## ABSTRACT

This study aims to examine the evolution of the policy perspectives within the United Nations, with respect to its affiliated entities. The study, which comprises the 2000s, is conducted around five themes. Those themes are; (I) international trading patterns and policies, (II) growth and structural change, (III) commodity prices and terms of trade, (IV) foreign direct investments and (V) macroeconomic coordination tools and policies in the global economy. The policy perspectives, shaped around those themes, have been also examined with respect to the economic conditions they emerged and the economic approaches that influenced their evolution.

# ÖZET

Bu çalışma, bağlı kuruluşları özelinde Birleşmiş Milletler'in kalkınma politikaları perspektifinin değişiminin incelenmesini amaç edinmiştir. 2000'li yılları kapsayan bu inceleme, beş ana tema çerçevesinde yapılmıştır. Bu temalar; (I) uluslararası ticaret örüntüsü ve ticaret politikaları, (II) büyüme ve yapısal gelişme, (III) meta fiyatları ve ticaret hadleri, (IV) doğrudan yabancı yatırımlar ve (V) uluslararası ekonomide makroekonomik eşgüdüm araç ve politikaları olarak belirlenmiştir. Bu temalar kapsamında oluşturulan politika perspektiflerinin, ne tür iktisadi şartlar altında belirdiği ve nasıl bir iktisadi yaklaşımın ürünü olarak değiştiğinin irdelenmesi de çalışmanın kapsamındadır.

## TABLE OF CONTENTS

## LIST OF TABLES

## LIST OF FIGURES

# INTRODUCTION

The study is about the evolution of the developmental agenda adopted by UN entities, like UNCTAD (United Nations Conference on Trade and Development), UNDP (United Nations Development Programme), FAO (Food and Agriculture Organization of the United Nations) and UNIDO (United Nations Industrial Development Organization) in the 2000s. The purpose of the study is to seek how those institutions' philosophy of development evolved around certain themes. Policy prescriptions focusing on those themes are important in the sense that they can help explaining and identifying the perspectives of economic development. (1) Trade patterns and trade policies; (2) Growth, inclusive of industrial and rural development; (3) commodity prices, terms of trade and commodity exchanges; (4) foreign direct investment (FDI) and (5) macroeconomic coordination tools and policies in the global economy are the economic themes chosen in this study, with respect to the relevant UN entities' focuses and policies for them. The basis of the evolution of development perspective will be examined around those areas of concern.

The choice of the relevant UN entities is due to their specialization on certain key areas like growth, agriculture, investment and international trade. When focus of interest is on agriculture and issues related to food, it is quite relevant to take FAO's policy projections and works into consideration, whereas UNCTAD is taken as the major source of competent and influential policy-maker on trade. Also, more than one UN entities' approaches will be evaluated under themes, where the interest areas overlap.

The time period of the analysis is chosen as the last decade, initiating from the year 2000. This kind of a time constraint enables to specify certain themes more comprehensively. Since, this decade has been witnessing intensive debates about the growth prospects, trade relations and the international financial capital movements; thus triggering proposals about the new global economic architecture and economic coordination at the global level. So, the 2000s has been chosen with the motive to cover the themes mentioned in this paper accurately within the developmental framework of UN entities. So, beginning with the international trading patterns, the study will continue in a thematic order, elaborating one economic theme, concerning economic development in each chapter so as to explain the vision of development embraced by the UN entities and its evolution. The survey will end with the issue of international economic coordination and concluding comments.

# Chapter 1

# International Trading Patterns and Trade Policies

## 1.1 General

Trade is one of the most debated areas in international economic relations and as well as in the agenda of development. With the inclusion of globalization into this picture, the issue has become more inter-nationalized and multi-dimensional; since the volume of trade and its influence on domestic economic activities increased significantly, also accompanying the impact of the latest technological progress. So, global decision makers and policy-making institutions, which deal with developmental policies, have to seriously consider trade and trade-related issues in their policy prescriptions.

Trade policies have globally evolved into a new area of debate after the emergence of so-called Washington Consensus which puts trade liberalization, at any price, on the policy agenda. The rigidity of those policy prescriptions has stimulated powerful criticisms not only from heterodox scholars but also from well-known mainstream economists like Stiglitz. Nowadays, the developmentalist view on trade accepts trade as a means, but not an end in itself.[1] Therefore, as far as development policies are concerned, trade policies shall aim to contribute to national development, especially in developing countries. Such a goal requires

[1] Rodrik, D. (2001, March). "Trading in Illusions". *Foreign Policy, Vol. 123*, pp. 56-66.

keeping pace with the changing international trading patterns of trade successfully and conducting trade policies within this framework, seeking to exploit the benefits of trade for development. Thus, the first years of the new decade will be examined initially, which is significant for the developments in international structuring of trade and its patterns.

## 1.2 International Trading Patterns

### 1.2.1 Geopolitics of Trade in the Early 2000s

The early years in the decade witnessed important developments shaping the world trade. Firstly, there was a recovery in the world trade that had been contracting after the Asian financial crisis. Fluctuations in world trade volumes have highlighted the cyclical movements in trade and its impact on economic growth. Secondly, accession of China into the World Trade Organization in 2001 was the sign of the entry of a very influential player in world trade.

With respect to early UNCTAD papers in this decade, the ongoing concern about trade was the continuing effects of the Asian crisis, which had taken place in the final years of the previous decade.[2] The beginning of the new decade was shaped under the effects of this economic crisis. Since the crisis adversely affected economic growth performance, considerations over global growth prospects has been influential on the international trade relations, as well in UNCTAD policy

[2] East Asian financial crisis have affected the developing economies initiating from the years of 1997-8.

papers. UNCTAD mentions the economic growth performance of developed countries and their demand for imports, and identifies them as the major reason of the fluctuations in the world trade. In this context, the relationship between economic growth and trade was manifested in the relative recovery of world trade in the beginning of the 2000s (UNCTAD, 2001: chap. II).

The negative effects of East Asian crisis on trade did not last long, and trade volumes were quickly recovered, with an important contribution coming from the developing countries. Although, developing countries were the outperformers in the expansion of trade volume, developed countries also accelerated their imports. In the import performance of developed countries, the role of the United States "as the buyer of the last resort" from the rest of the world was one important factor. Other contributors to the growth of the imports of developed countries were the EU-region and Japan; although the latter has been lagging behind the Western countries. The developing countries as a group increased their level of imports by about 11 per cent in 2000 (the growth rate, of which was 6 per cent in 1999 and negative in 1998).[3] So, the growth in the volume of imports could be observed in all developing regions including Latin American and Asian countries. In 2001, as well, China recorded powerful growth in import volumes, by increasing its import volume by 26 per cent compared to the previous year. The growth in global export volume was pioneered by Middle East countries and Russian Federation, mainly due to the increasing demand for oil and metals. So, there is some kind of cyclicality in the late 1990s and in the new century, which

[3] UNCTAD (United Nations Conference on Trade and Development). (2001). *Trade and Development Report 2001*. New York and Geneva: United Nations. p. 31

has been characterized by a downturn with the Asian financial crisis, followed by regaining a momentum with the 2000s; that lasted throughout the decade until the end of 2007.

Under those circumstances the policy implications for trade in the beginning of the century needed to be put into a new context, which was tried by the Doha Development Agenda of 2001.

### 1.2.2 Doha Development Round

Doha Development Round is series of trade negotiations which was kicked off in late 2001, under the monitoring of the World Trade Organization. The main purpose was to reduce trade barriers in order to promote total trade on a global scale. Though, before the round, the motivation of developing countries was to obtain more favorable conditions of access to developed country markets, by reducing the tariffs that developed countries prefer to apply to some certain product groups. In accordance, Finger and Noges (2001) state, in particular the main agenda for developing countries in the beginning of the round was to revise the current international trading patterns and global trade policies, which was argued to work in favor of developed countries even in traditional primary commodities or agricultural raw materials markets like sugar, cocoa, rice and tobacco, where developed countries do not apply visible barriers to trade (UNCTAD, 2002: 34). The main issue in the meetings was agriculture, in the form of phasing out all forms of export subsidies, since elimination of export subsidies was expected to improve exporting facilities of many developing countries. This proposition was supported by a study which predicts that, if the protection in labor-intensive activities in developed countries would be removed; developing country export earnings would increase by $700 billion in the year 1999.[4]

The initial atmosphere that led developing countries to expect better prospects for their development has begun to disappear in later years, when the parties could not agree upon a common framework in the negotiations. Afterwards, scholars like Rodrik claimed that the trade rounds actually had never been aiming to promote development.[5] So it can be claimed that Doha Round was not very meaningful in this context. The Round and Doha Development Agenda deserves attention in the sense that, it serves like a benchmark to the evolution of world trade since it took place in the very beginning of our period of study and characterizes the contents of development philosophy with regard to trade: The exports of the developing countries have still been concentrated on the exploitation of natural resources or unskilled labor, and products, which intensively use these factors generally lack dynamism in world markets (UNCTAD, 2002: 53).

### 1.2.3 Developing Countries and Trade

As developing countries increased their effectiveness and role in global trade, some major shifts occurred in the international patterns. As seen in the Figure- 1,

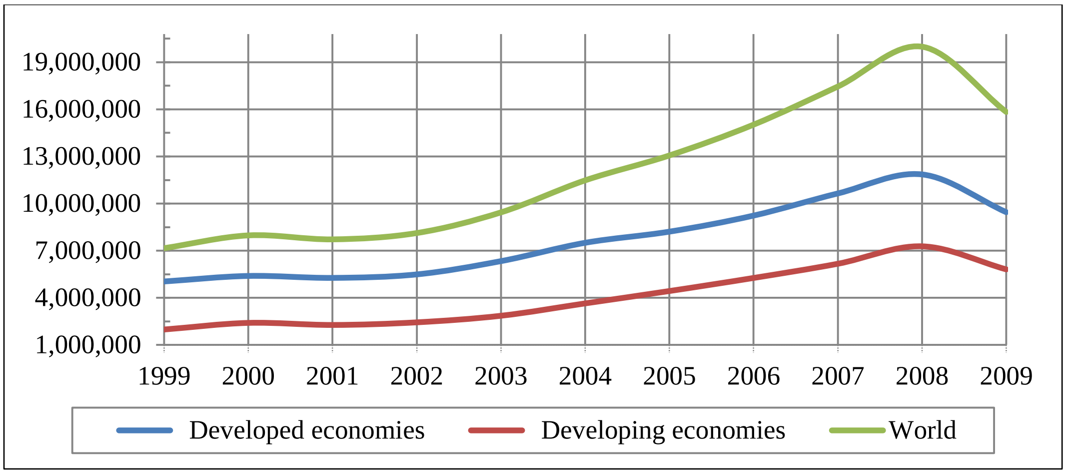
---

[4] UNCTAD (United Nations Conference on Trade and Development). (2002). *Trade and Development Report 2002*. New York and Geneva: United Nations. p. 46
[5] http://www.guardian.co.uk/commentisfree/2008/aug/08/wto.internationalaidanddevelopment

developing countries is in a process of raising their exports, through the 2000s. The leaders of this change are China and India which are most popular world trade actors in 2000s.

Figure- 1

*Exports of merchandise and services (million USD, 1999-2009)*




Source: UNCTAD Stat, http://unctadstat.unctad.org/TableViewer/tableView.aspx

As the participation of developing countries increased in world trade, the international trading patterns have become subject to structural shifts. In this context, one important issue is the emergence of so-called “new regionalism”. Before interpreting the shifts in those patterns, the difference between regionalism and regionalization must be underlined. Within the definition of regionalism, what is mentioned is a policy-induced integration. On the other hand, regionalization is a market-driven integration supported by regional growth dynamics and the emergence of international production networks.[6] In this point, the term used in

[6] UNCTAD (United Nations Conference on Trade and Development). (2007). *Trade and Development Report 2007*. New York and Geneva: United Nations. p. 53

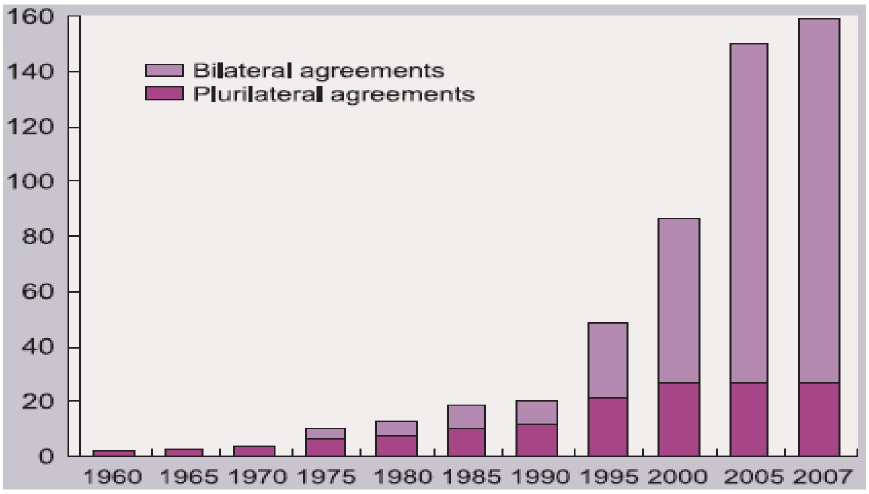
UNCTAD studies to refer to the evolving patterns in trade is “regionalization”. In the 2000s, according to UNCTAD, a new regionalism is on the agenda, which refers to trade agreements that are mostly bilateral and concluded between countries in different regions. This term is somewhat ambiguous and misleading. The new regionalism is characterized with the following features: Reducing of trade barriers, conditional on partners agreeing to liberalize such additional areas like FDI regime, government procurements and trade in services.

Moreover, Figure- 2 below shows the share of bilateral agreements in the total number of trade agreements and its increasing pace, constantly. Especially the increasing trend with the 2000s deserves attention: Trade agreements are mostly in the form of bilateral agreements instead of multilateral agreements. The main reason behind the shift towards bilateral trade agreements is the preference of major developed countries. Developed countries are mostly willing to develop bilateral agreements, since they are closer to obtain more benefits and concessions, which they have lesser chances to obtain in regional agreements, including a group of countries (UNCTAD, 2007). Lately, the United States appears as the most prominent developed country, engaging more and more this kind of bilateral agreements with developing countries.

At this point, North, i.e. the group of developed countries and South, i.e. the group of developing countries, trade patterns and agreements deserve attention, in the context of policy space and development concerns of developing countries. From an optimistic point of view, North - South bilateral trade agreements can sustain the required market access for developing countries in order to promote their exports.

Figure- 2

*Number of Plurilateral and Bilateral Trade Agreements (cumulative, 1960-2007)*

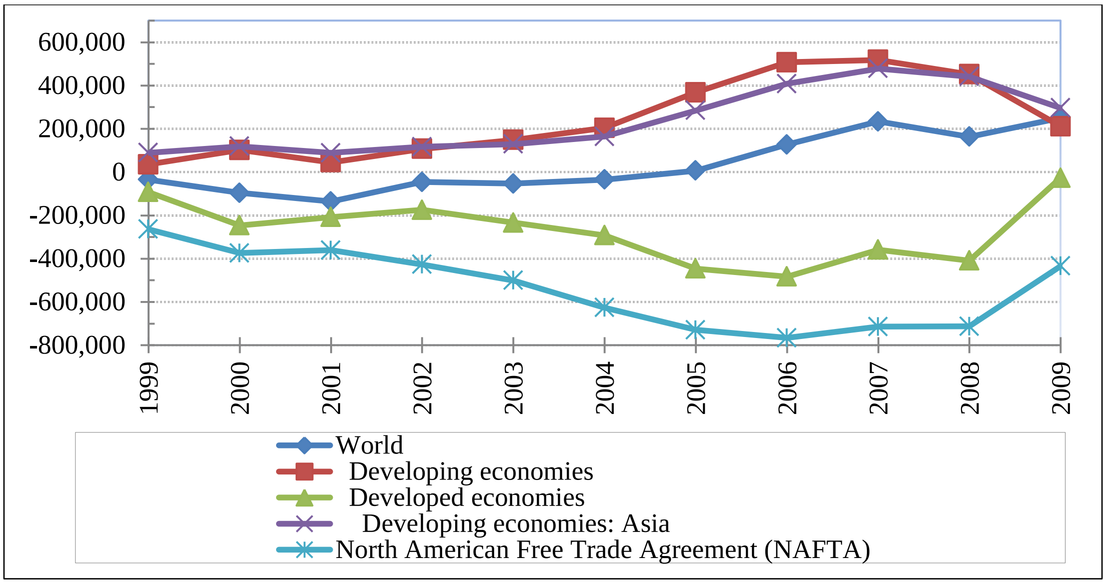



Source: UNCTAD (United Nations Conference on Trade and Development). (2007). *Trade and Development Report 2007*. New York and Geneva: United Nations. p. 55

On the other hand, with bilateral preferential trade agreements, developed countries can obtain concessions, which they cannot obtain via multilateral trade agreements with a set of developing countries, as noted earlier. These concessions can be in the form of far-reaching liberalization of investments and access to government procurements, new rules on competition policy and stricter rules on property rights (UNCTAD, 2007: 57). So, an emerging concept called South – South trade is becoming more appreciated among the developing countries.

Figure- 3

*Total trade balance in merchandise and services (million USD, 1999-2009)*




Source: UNCTAD Stat, http://unctadstat.unctad.org/TableViewer/tableView.aspx

Even developing countries gain greater revenue, by increasing their trade surpluses that is seen on Figure- 3, they are still dependent on the oil imports, since they have been passing through an earlier stage of industrialization compared to developed countries. Within this context, South – South trade relations comes to the fore as a shift in international trading patterns. Oil price surge, which challenges developing countries, actually is a result of change in developing countries' production, rather than a supply side shock. The rise is tied to the gradual increase in demand for oil especially in China and India. The output growth in developing countries is altering the composition of world trade (UNCTAD, 2005: VI). So, the promotion of South-South trade suggests itself as a desirable objective for the following reasons: (1) sluggish growth in developed countries and their confirmed trade barriers, against the products of export interest to developing countries imply that developing countries should give more emphasis to each other's markets to enjoy export benefits in order to sustain economic growth; (2) rapidly growing Asian economies reduces the need for developing countries to seek developed country markets in order to benefit from the economies of scale; (3) continued dependence on developed country markets can result in pressures on developing countries with binding commitments to rapid trade and financial liberalization (UNCTAD, 2005: VII).

### 1.3 Trade Policies

As international trading patterns are subject to multidimensional change, the goals of trade policies at national levels also shifted around the 2000s. Whilst the shifts in global trade take place, at the same time, developing countries face the challenge to ensure at most wealth and satisfaction of human wants from the benefits of trade.[7] The recommended policy option for developing countries, in order to adjust themselves to the challenges of the new century, is to shift out of primary product export-focused trade composition. Transformation from heavy dependency on primary product exporting to the manufactured production and export of industrial products has been defined as a more effective way to participate in the international division of labor (UNCTAD, 2002). Though some exceptions exist among developing countries, still many of them are concentrating on natural resource-based exports. This kind of pattern gives birth to the heavy dependency on export income from developed countries. Thus, developing

[7] UNCTAD (United Nations Conference on Trade and Development). (2002). *Trade and Development Report 2002*. New York and Geneva: United Nations. p. IV

countries obtain decreasing contribution of export earnings from many developed countries and thus face the risk of losing momentum in their economic growth process. Such a situation was observed in the year 2002, when export prices fell approximately 3 per cent.[8] Such great dependency of the developing countries on developed economies and in particular, the US export markets is a risk that causes unsustainable trading income. This must be the first and foremost task for developing countries to assume. China, India and Korea are given as role models by UNCTAD, since those Asian countries have been able to sustain a more diversified export structure with regard to other developing countries, thus did not suffer the fluctuations of global trade in the 2000s, as much as the others had to face (UNCTAD, 2003: 42). But still this dependency increases the chance for the value of exports to fall rapidly than import prices, and thus eradicating the current account surpluses obtained by developing countries with high primary commodity prices. The vulnerability of the developing countries, generated from such trading pattern has again become evident in the 2000s.

Within this framework, the policy prescriptions proposed to developing countries are shaped on the following strategies. What is seen as a necessary evolution is the transition to labor-intensive manufacturing exports, which is the standard advice to developing countries.[9] One of the most important reasons of this advice has its roots in the economic structures of developing countries, e.g. the demographical composition of their population and labor force. Developing countries generally have the population as the plentiful resource compared to their

[8] UNCTAD (United Nations Conference on Trade and Development). (2002). *Trade and Development Report 2002*. New York and Geneva: United Nations. p. 16
[9] ibid. p. 113

natural resources. Secondly, labor-intensive manufacturing is seemed to be the best preliminary phase for upgrading into technology-intensive and capital-intensive production. Primary commodity production is far away from providing a basis for such an upgrading, compared to labor-intensive manufacturing. Thirdly, the demand for labor-intensive products is more stable than the demand for primary products (UNCTAD, 2003: 113). Overall, the evolution of trade patterns is regarded as necessary for developing countries in the context of manufacturing and labor transformation. The major reason can be put forward with an emphasis on the so called export-dynamism.

So, sustainable increase in trading income for development is seen as a possible way out by UNCTAD and the primary tool suggested for this purpose, is the labor productivity growth for developing country exportables. UNCTAD (TDR, 2003: chap. V) states its position on the production structure of an economy, as it is important for developing countries since the level of productivity, productivity growth rates and potential for technological progress vary across agriculture, industry and services.[10] The motive for transforming the production structure of an economy is to upgrade domestically competitive producers to successful exporters. In order to sustain this capability of domestic exporters, the measures proposed are as follows: (1) the provision of adequate infrastructure, mainly in the areas of transportation and communication. Possible disadvantages originating from such handicaps are needed to be offset by lowering wages or reducing costs of production, thus creating problems for exporters; (2) developing country

[10] UNCTAD (United Nations Conference on Trade and Development). (2004). *Trade and Development Report, 2003*. New York and Geneva: United Nations. p. 102

exporters need imported raw materials and intermediate production inputs, therefore seek working capital and credit to run their operations. Availability of trade finance is important in this sense, whether it can be accessed through commercial institutions or government-supported loans; (3) in order to keep domestic firms competent, the average nominal labor cost growth must not exceed those of the international competitors; (4) productivity improvements at domestic-level also require a stable environment for nominal exchange rates in the first place.[11]

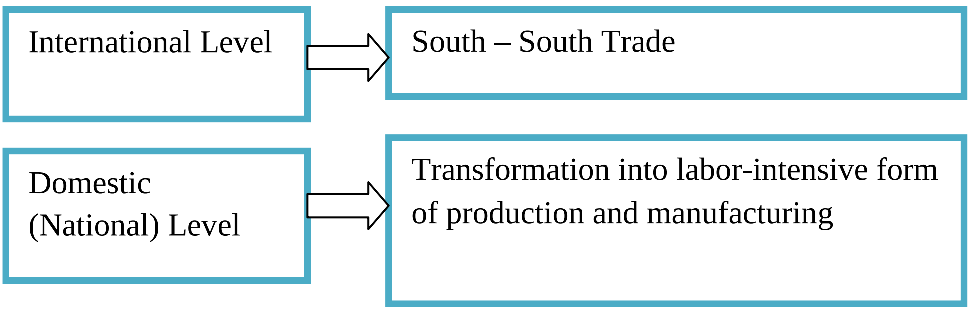
Within the financial context of international trading, developing countries are advised also to successfully manage the exchange rate in order to promote export revenue. One of the most common and effective way to obtain benefits from international trade is the management of exchange rates, according to various UNCTAD papers. The reason is best explained by a quotation from Agosin and Tussie (1993:22) “The historical record … shows that … [a]ll countries that have succeeded in generating a sustained growth of their exports, have also been able to maintain exchange rates that are attractive to exporters over long periods of time.” Scholars like Rodrik also support this exchange rate oriented, export-led position by indicating that “credible, sustained real exchange rate depreciation may constitute the most effective industrial policy there is.”[12] There is the emphasis on the importance of being able to manage their exchange rates competitively. Theoretically, floating exchange rate regime and free capital mobility is claimed to be the proper tool for stabilizing exchange rates. This argument is based on the

[11] UNCTAD (United Nations Conference on Trade and Development). (2004). *Trade and Development Report, 2004.* New York and Geneva: United Nations. p. 103
[12] ibid. p. 104

movements of nominal interest rates which are expected to remove temporary disequilibria (Friedman, 1953). Concerning the management of exchange rates, one important feature is the character of this intervention; either sharp or not. Although, the general approach is likely to accept the merits of real exchange rate depreciation for helping international cost competitiveness and improving trade balance, the sharp interventions are not welcomed by many. According to UNCTAD, sharp interventions result in additional disturbances which may have adverse effects.[13] Also, at the domestic level UNCTAD advocates the policy of augmenting the existing stock of physical and human capital.[14]

Figure- 4

*Suggested Policy Actions to be taken by Developing Countries in the 2000s*




## 1.4 Conclusion

The early 2000s were subject to significant alterations in international trading patterns and trade policies. When the cyclical developments in world trade related to economic crisis combined with the developments like the accession of China to

[13] UNCTAD (United Nations Conference on Trade and Development). (2004). *Trade and Development Report, 2004*. New York and Geneva: United Nations. p. 105
[14] ibid. p. 105

WTO, increasing emphasis on regional trade relations and the changing structure of importers (like the U.S' role as the main importing party for developing countries), the trade policies of developing countries had to evolve into a different nature in order to be conducive to their development. But, although the decade seems to be challenging for developing countries, it is obvious that developing countries are ascendant in world trade, much important than before they were used to be. The advice for sustaining development consists of two-dimensional approaches, shown on Figure- 4. At the global level, in order to get rid of the dependency on developed countries, the developing countries shall aim to develop stronger trade relations, via South-South trade. But this must be supported with the transformation of domestic level, which must be in the form of converting from the primary exports-based structures to more labor and capital intensive manufactured good exportation. Of course, managing exchange rates is an important issue; in order not to lose the competiveness in the global market.

To sum up, even though developing countries have greater say on global trade, they have still to improve their domestic production structures and become more competitive in manufactured and skill-intensive productions. This transformation will provide them a stronger basis in the global arena, and they will be able to gain much policy space to conduct the trade relations that they find as the most appropriate setting for their sustainable growth process.

# Chapter 2

# Growth and Structural Change

## 2.1 General

Economic growth has been accounted for one of the most important pillars in the process of development. It is one (and for some scholars the most important one) of the criteria for measuring the economic development among nations. Although, the UN entities recognize the multi-dimensional nature of development; they accepted economic growth is essential as helping to eradicate poverty and hunger.[15] In a recent study[16], the UNDP has identified five requirements for sustainable growth as follows: (1) Achieving macroeconomic stability; (2) creating a better business environment; (3) establishing good governance and strong institutions; (4) instituting social reforms to improve equity; (5) managing the environment. In numerical terms, for least developed and developing countries, the 7 per cent average annual growth rate is needed to attain the MDGs.[17]

Thus, the characteristics of world output growth and their reflections on development agenda have been attracting the attention of the UN entities. So, firstly the evolution of economic activity worldwide, both in developed and

[15] http://www.un.org/millenniumgoals/pdf/MDG%20Report%202010%20En%20r15%20-low%20res%2020100615%20-.pdf#page=8
[16] http://www.senate.gov.ph/publications/Five%20Pillars%20of%20Growth.pdf
[17] UNCTAD (United Nations Conference on Trade and Development). (2005). *Trade and Development Report 2005.* New York and Geneva: United Nations. p. 5

developing countries and the characteristic features of this growth will be reviewed below. Later, industrialization and rural development policies will be examined in some detail, as they are two major determinants of economic activity within an economy.

## 2.2 Economic Growth Prospects

When the worldwide economic performance is at stake, the most significant one among developed countries, i.e. the United States comes to the fore. Economic growth has been pioneered by the domestic demand within U.S. for most of the new decade. The private domestic investment and personal consumption increase in high levels has driven this growth.[18] The depreciation of U.S. dollar against the currencies of its major trading partners, which has began in 2001 and continued throughout the decade, increased U.S. exports; however its imports have grown even faster.[19] Thus, trade contribution to GDP growth has been negative for the U.S. The current-account deficits have reached 6% of its GDP as of 2004, raising questions about the sustainability of this deficit. Thus, the importance of personal consumption expenditures and fixed investments in order to promote economic activity are becoming more important in case of the U.S. and other developed countries. Increases in labor income and corporate profits in the first of years of the decade seem contributing to the private domestic consumption; on the other hand, slower productivity gains and higher energy costs were likely to offset their

---

[18] UNCTAD (United Nations Conference on Trade and Development). (2005). *Trade and Development Report 2005.* New York and Geneva: United Nations. p. 2

[19] Extensively reviewed in the Chapter-1, within the "*Developing Countries"* and *"Trade Policies"* sub-sections.

effects. Table- 1 below shows the output performance of certain country groups for two decades.

Table- 1

*World Output Growth (percentage, 1991-2010)*

| *Period\Country* | **World** | **Developed Countries** | *of which United States* | **Developing Countries** | *of which China* |
|---|---|---|---|---|---|
| **1991-2001 *(avg.)*** | 3.1 | 2.6 | 3.5 | 4.8 | 10.3 |
| **2002** | 1.9 | 1.3 | 1.6 | 3.9 | 9.1 |
| **2003** | 2.7 | 1.9 | 2.5 | 5.4 | 10.0 |
| **2004** | 4.1 | 3.1 | 3.6 | 7.3 | 10.1 |
| **2005** | 3.5 | 2.5 | 3.1 | 6.7 | 10.4 |
| **2006** | 3.9 | 2.8 | 2.7 | 7.4 | 11.6 |
| **2007** | 3.9 | 2.5 | 2.1 | 7.8 | 13.0 |
| **2008** | 1.7 | 0.3 | 0.4 | 5.4 | 9.6 |
| **2009** | -1.9 | -3.4 | -2.4 | 2.4 | 8.7 |
| **2010**[20] | 3.5 | 2.2 | 2.9 | 6.9 | 10.0 |

Source: UNCTAD (TDR, 2008: 2 and 2010: 2)

The fiscal policy of governments is also another important determinant for the level of economic activity. The less expansionary fiscal policies in order to control the public debt (like reforming of social security system) have also created obstacles for the rising levels of economic activity (UNCTAD, 2005: 2). The new decade has also been an era, when the interest rates have been at historically low levels, which has been contributing to increase the consumption of durable goods and sustaining fixed investment. Like the U.S., almost all developed countries have shown a negative contribution from net exports to their GDP growth. Some

[20] Forecast figures for 2010.

of them, especially which have rich natural resource endowments, e.g. Russia and Australia have recorded positive trends in terms of trade; thanks to favorable commodity prices of their exports. The Euro-zone, which consists of many developed countries, also lost momentum related to negative export performance after the appreciation of Euro in the period of 2003 to mid-2008. In the new decade, EU zone has been facing deflationary wage policies and EU has been losing market shares to developing countries. This have hit the sustainable growth in the zone and created question marks about the consequences of deflationary policies.

Developing countries are keener on sustainable economic growth, since they have not yet attained the level of industrialization that developed countries have reached at present. But, developing countries could not be evaluated as a single group due to their different economic structures, production patterns and labor and capital endowments. Like the developed countries, developing countries which export the primary commodities as their major item of trading, like many African countries, recorded positive balances, contributing to their output growth. West Asian developing countries that receive massive oil revenues have also recorded fairly satisfactory growth rates.

## 2.3 Industrial Development

Together with the MDGs, UNDP has also formulated policy measures which have the potential to effectively contribute growth (UNIDO, 2004). Industrial development has been expected to play a key role in removing the barriers before economic growth, as it is seen as a key contributor to technology diffusion and economy wide productivity improvements.

The process of globalization has contributed to the shift in the industrial production to developing countries from developed countries. This shift is mainly caused by specialization in production by transnational corporations, developments in international supply chains and the liberalization of trade flows.[21] But some emerging markets have not been able to realize the potential of developmental impact that industrial development could have on low and middle-income countries. In this extent, the specialization issue is underlined by UNIDO, implying that evolving patterns in specialization matters for developing countries and aims to strengthen the role of manufacturing as a dynamic force of economic transformation (UNDIO, 2009).

### 2.3.1 Industrialization, structural change and growth

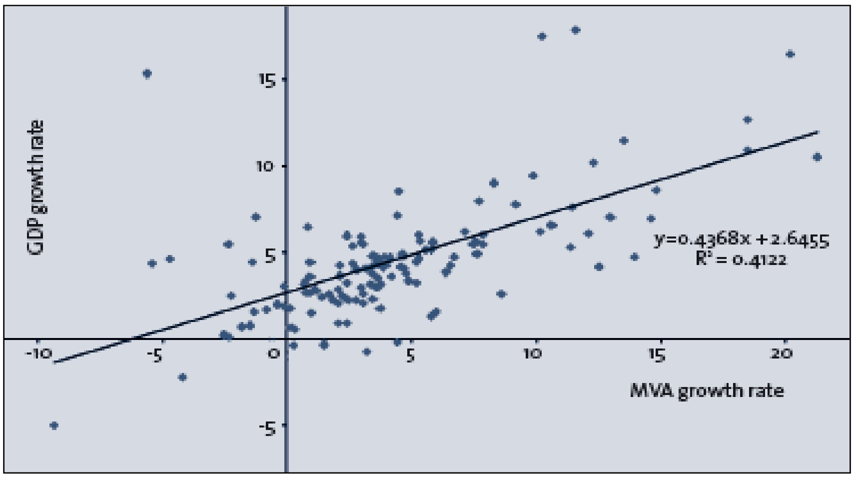
"…*Industrialization* has been fundamental for economic *development*..." is a quotation from UNIDO, in its studies for industrial development, ignoring the chance of development without sufficient industrializing. The premises of the expansion in manufacturing are in the form of benefiting from the economies of scale which decreases the unit costs of production. This will help to overcome the difficulties, like shortages of land and resources that may constrain the growth of

[21] http://www.unido.org/fileadmin/user_media/Publications/IDR_2009_print.PDF

agriculture and extractive industries.[22] The association between growth in manufacturing value added and growth in GDP supports this relationship; and any country rarely has been able to develop without industrializing. As seen below, on Figure- 5, the regression line suggests that faster growth in manufacturing is correlated with faster GDP growth.

Figure- 5

*Relationship of MVA growth rate and GDP growth rate (percentage, 2000-2005)*




Source: UNIDO (2009)

The globalization of markets helped low-income countries to find adequate demand for the increased level of manufactures that they have produced. Therefore, such a market size constraint no more exists. But, as globalization process has lately evolved into a new phase, re-studying the process of industrialization around two themes is needed.

[22] UNIDO (United Nations Industrial Development Organization). (2009). *Industrial Development Report 2009.* Vienna: United Nations. p. xiii

Firstly, there is a significant rise of manufacturing output that is internationally traded, aided by the reduction of trade barriers and decreasing transportation costs. Therefore, trade has become decisive on manufacturing, implying that industrialization can no longer be regarded as a solely internal process. The growth of trade in manufacturing was the basic reason for the shift of production locations from developed countries to developing countries. But this shift has not taken place in all developing countries, instead, highly concentrated on some of them, e.g. China.

Secondly, another global economic factor that affected the industrialization process was the fluctuations in commodity prices. For low income countries the boom in those prices may seem beneficial, but also heavy dependency of developing countries on commodities, like oil, may result in de-industrialization in case of a hike in those prices (UNIDO, 2009: 41). Thus, the trade issue is deeply embedded into industrialization and economic growth prospects; overlapping in many meetings carried out by UN entities under the name of "making trade work for poor and developing countries".[23]

In detail, the changing conjuncture in global trading, forces the developing countries into a position that the level of sophistication of a country's export structure is vital and determining for growth. A study by Rodrik (2006) demonstrates that, the shift in the manufacturing base in developing countries, from low-technology to high-technology activities will result in knowledge-based

[23] UNIDO (United Nations Industrial Development Organization). (2004). *The Role of Industrial Development in the Achievement of the Millennium Development Goals.* Vienna: United Nations. p. 12

spillovers to the rest of the economy thus raising income levels. Sophisticated exports also imply that highly competitive and global firms are present in an economy. Because, if a less developed country firm’s exports can compete, in a market in which developed country competitors are also present, productivity in that firm shall be equal or exceeding the levels of productivity in developed country firms (UNIDO, 2009: 13).

The importance of developing countries in global manufacturing trade has become apparent with regard to the very rapid surge of South-South trade. As mentioned in Chapter-1 of this study, the share of South-South trade in the world economy has increased. Export dynamism is the factor that is increasing the role of developing countries in this context, which is decomposed to three factors; growth in global demand, geographic shift in production and change in export propensity. Developing countries have been successful in order to sophisticate their export structure compared to other country groups, thus they are increasing their share in global market for manufactured goods since 2000 due to South-South trade.[24]

Within this framework, the policy prescriptions advised by UNIDO for developing countries to promote industrialization can be summarized under the following themes: First of all, infrastructure investment is indispensible for low-income countries to close the gap between developed and developing countries. This can be realized through increasing the share of the infrastructure investment in the state budget, besides encouraging the private investment. Moreover, the

[24] UNIDO (United Nations Industrial Development Organization). (2009). *Industrial Development Report 2009*. Vienna: United Nations. p. 52

influence of trade on manufacturing and industrialization must be recognized. The trade logistics must be exploited in order to obtain global competitiveness. China's economic zones in western coast are a good example for this, making the way for Export Processing Zones (EPZ). Combined with the infrastructure deficiencies with poor public institutions, elsewhere in the country, importance of such zones grows larger. Afterwards, individual decisions of firms to agglomerate in these special economic zones, would be a market-driven process and shall not be adversely affected by the public policies, but instead must be supported. Special Economic Zones (SEZ) combine trade and spatial policies, in a way it helps industrial development, especially in developing countries. This is mainly due to its help to create a favorable focus environment for government investments and institutional reforms in order to sustain threshold physical and social infrastructure. According to UNIDO, the clustering of productive firms will result in productivity increase, giving the example of city of Qiaotou in China. But such a concentration among developing countries creates risks for countries that are less developed and try to promote their process of industrial transformation via manufacturing.

After the framework put for the goods to be produced, there is also emphasis about the production place. Overall, the key structural changes taking place in industrial production, locations and markets are shaping the opportunities and challenges faced by developing countries as they seek to industrialize.[25]

[25] UNIDO (United Nations Industrial Development Organization). (2009). *Industrial Development Report 2009.*Vienna: United Nations. p. 55

### 2.4 Rural Development

According to FAO, an area fulfills the requirements in order to be identified as "rural" if it is an open area, with low density of population and the residents of the rural area uses the resource, which is the natural endowment in that "rural" area, for primary production processes (FAO & UNESCO, 2003). Besides industrialization, one other major determinant of economic growth is the rural development. The importance of rural development is likely to fade in some developed countries and replaced by the importance attributed to industrialization, since the greater part of the population is living in urban areas, now. But this is not the case for developing and least developed countries yet. The reasoning again is related to the demographic structure of the developing countries: It is estimated that for the next two decades, the majority of the population living in developing countries will continue to be rural. This is even more valid in the case for the least developed countries where the people living in rural areas will still represent over 55 per cent of the total population in 2030.[26] In other words, during this period, the development challenge will continue to be related to rural trends and conditions. Thus, special emphasis must be given in rural areas in order to be able to reach the development goals set by UN agencies in the beginning of the millennium.

Rural areas have been generally neglected in development (FAO & UNESCO, 2003). This backwardness in rural and agricultural development is increasing the

[26] FAO & UNESCO (2003). *Education for Rural Development: Towards new policy responses*. Rome and Paris: United Nations. p.39

importance for agricultural development to fill the gap between developed and developing countries. Thus, GDP growth in agriculture is encouraged by UN, since growth in agricultural areas are more effective in benefiting the poor compared to growth generated outside the agriculture (UN, 2008: 1). The lack of financial institutions and outreach to loans by households and small businesses in rural areas is an important handicap for rural development. For instance, in Pakistan and Cameroon, less than 5 per cent of the amount borrowed by poor rural households was obtained from formal lenders, including banks and microfinance institutions. In general, access to credit has a positive impact on household income, technology adoption and food consumption. These in turn have important long-term effects on household productivity and on poverty rates.[27] Thus, rural finance must become more accessible with the support from public policy in developing countries.

Moreover, as land is considered to be the major resource base in rural development, its distribution is very important. But in developing countries, particularly in Latin America, the distribution is highly unequal. The so-called "Green Revolution"[28] helped increasing the agricultural production in the recent decades, but yield growth has recently slowed down. So, investments aiming to increase the yields and output level, requires the inclusion of government initiative. Overall, the policies that are offered by UN entities introduce the government into the picture. As seen on Figure- 6, which has been prepared from

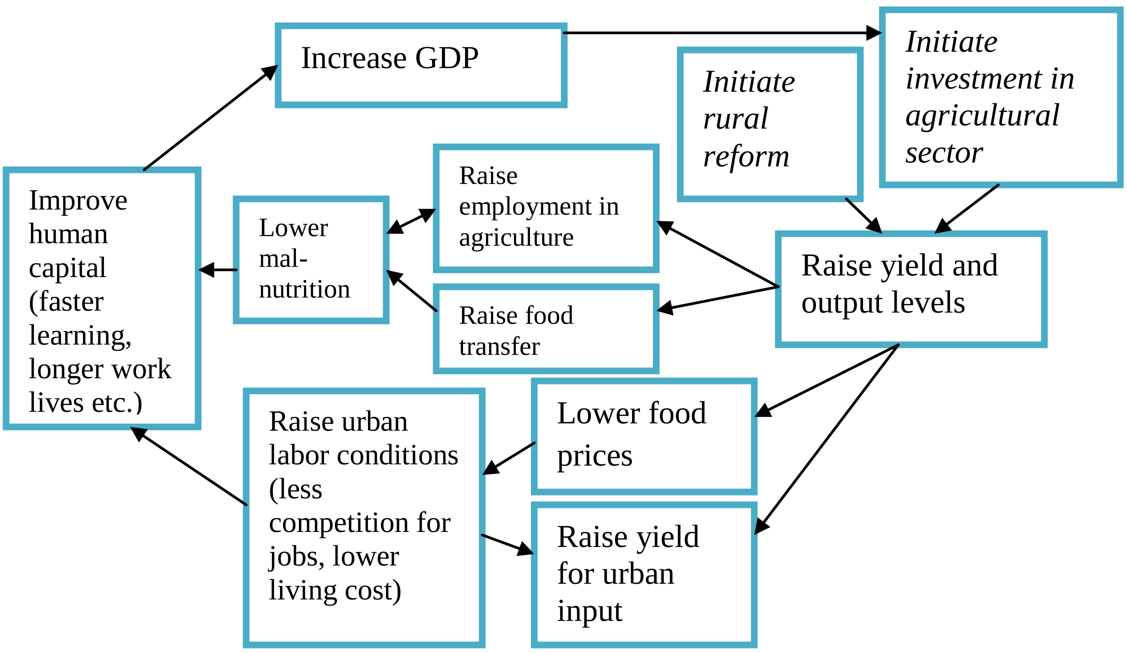
[27] UN (United Nations). (2008). *Trends in Sustainable Development 2008-2009*. New York: United Nations. p. 15

[28] Green Revolution is the name of the initiatives of research and development in order to increase the agriculture production in numerous developing countries.

the studies of the UN Department of Economic and Social Affairs and World Bank, increase in economic activity and GDP can be obtained with the rural reform and investment initiatives in agriculture sector. Such initiatives will result in raising yields and output levels; decreasing food prices and rising urban input, at the same time. In agriculture, such improvements will increase rural employment. Thus the positive impacts can be analyzed at both rural and urban level, improving the economic activity and GDP growth. Overall, rural development strategies aiming to increase productivity in agriculture generally can be composed of the following: a macroeconomic framework provided by the growth, employment and redistribution strategy (UNIDO, 2004).

Figure- 6

*Rural and agriculture-led development strategy*




Source: Cypher and Dietz (2009)

In the case of rural development, the reality that rural population has been generally the poorest section of the society requires the social and poverty-focused dimension to be a priority as well as economic dimension.

**2.5 Conclusion**

The positive correlations between manufacturing and GDP growth have been accepted by many developmentalists, that's why the task of industrial development is highly dependent on the manufacturing patterns. Within this pattern, the inclusion of trading into the picture is required since 2000s, especially for developing countries. Thus, the task of industrialization is not a internal process anymore. Especially for developing countries, the significance rural development is essential for the sustainable development, which is highly dependent on the state initiatives. That developmental approach has been realized under the Sustainable Agriculture and Rural Development (SARD) Initiative by FAO.[29]

[29] http://www.fao.org/sard/en/init/2224/index.html

# Chapter 3

## Commodity Prices, Terms of Trade and Problems in Commodity Exchanges

### 3.1 General

Throughout the 2000s, world has witnessed significant changes in international markets for primary commodities.[30] From a developmental perspective, commodity price hikes may seem to be beneficial to developing countries, since the exports of developing countries were usually in the form of primary commodities.[31] Instability in commodity prices is linked to terms of trade and the earnings from exports. As much as the developing countries obtain more external resources from their exports, they will have the chance of financing new investments in infrastructure and developmental purposes, thus advance in structural change, output and employment growth. Of course, trade is not a one-sided transaction, developing countries may also be in the position of importing party in the commodity trading; and may suffer from declining terms of trade, and vice versa. As developing countries have more vulnerable social structures and lesser capacities to maneuver under these conditions, the economic and social costs to be paid by them can be higher, compared to developed countries (UNCTAD, 2008: 19). Evolution in commodity prices and reasons for changing relative price patterns in commodity markets and its impacts in developmental

[30] UNCTAD (United Nations Conference on Trade and Development). (2008). *Trade and Development Report, 2008*. New York and Geneva: United Nations. p. 19
[31] ibid.

agenda through terms of trade in the previous decade will be evaluated in this chapter.

### 3.2 Commodity Prices

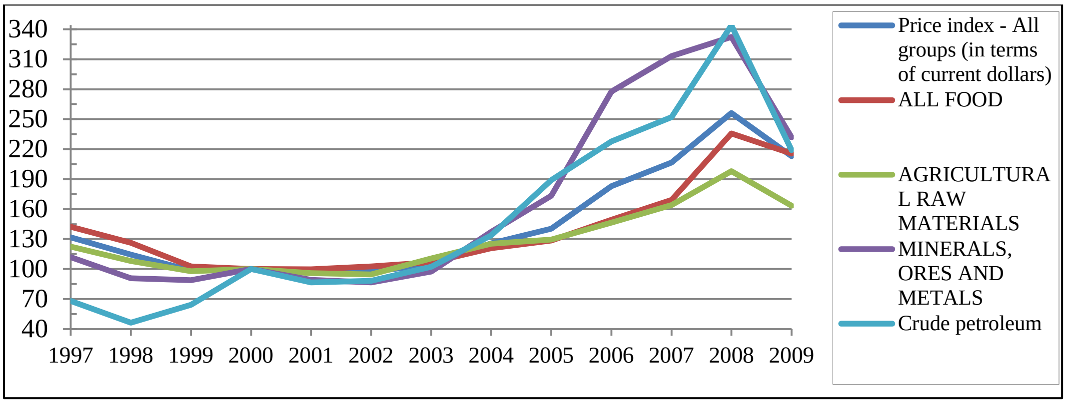
Wide fluctuations in commodity prices of agricultural products like food, tropical beverages, vegetable oil seeds and agricultural raw materials, have been the case throughout the 2000s.

The four years before the millennium, annual price changes of non-oil commodities had been consecutively negative in general;[32] however non-oil commodity groups had divergent price trends. In contrast, oil prices have surged in the breakout of the new century, creating problems for developing countries. The decrease in non-oil commodity prices combined with the rise in oil prices, negatively affected balance-of-payments of developing countries which are generally dependent on the production and exports of few commodities (UNCTAD, 2001). This long period of decline in many commodity prices in terms of U.S. dollar has ended in 2002.

[32] UNCTAD (United Nations Conference on Trade and Development). (2001). *Trade and Development Report, 2001*. New York and Geneva: United Nations. p. 33

Figure- 7

*Free market commodity price indices (Base year: 2000, 1997-2009)*




Source: UNCTAD Stat,

http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=106

According to UNCTAD; the continuous increase in commodity prices beginning from 2002, is the main concern, and it has been primarily associated with the patterns of economic growth in developing countries (UNCTAD, 2008: 19). The major reason behind the change was the increasing demand, which was pioneered by China and India. Two countries, populations of which had largely been rural a few decades ago, have recently entered into a process of rapid industrialization and infrastructure development with the process of urbanization (UNCTAD 2005; chap. II). While, such developments affects the demand for primary commodities, supply side constraints appeared as well; because, in the previous decades the investment initiatives for new capacity build-up especially in sectors like oil and raw materials had been limited in countries that had expected the low price levels in the 1990s would have continued in the new decade (UNCTAD, 2008: 20).

### 3.2.1 Agricultural Commodities and Biofuels

Although, for many commodities price movement trends were upward since early 2000s, as observed in Figure- 7, the prices of different commodities like mining products and agricultural products showed varying patterns.

The sudden boom in food prices after mid-2006, particularly in vegetable oilseeds, is tied to changing economic structures of developing countries: The developing countries, especially Asian ones like China and India, have attained higher levels of growth and more disposable income, so their standard of living and dietary habits improved, leading to higher levels of demand. Especially from 2003 onwards, the impact of Chinese development that required greater amount of commodity inputs to meet its industrialization and development needs on the increasing prices have been extensively studied.[33] This impact is visible in all almost commodity groups, including agricultural raw materials, metals, minerals, vegetable oilseeds and oils.

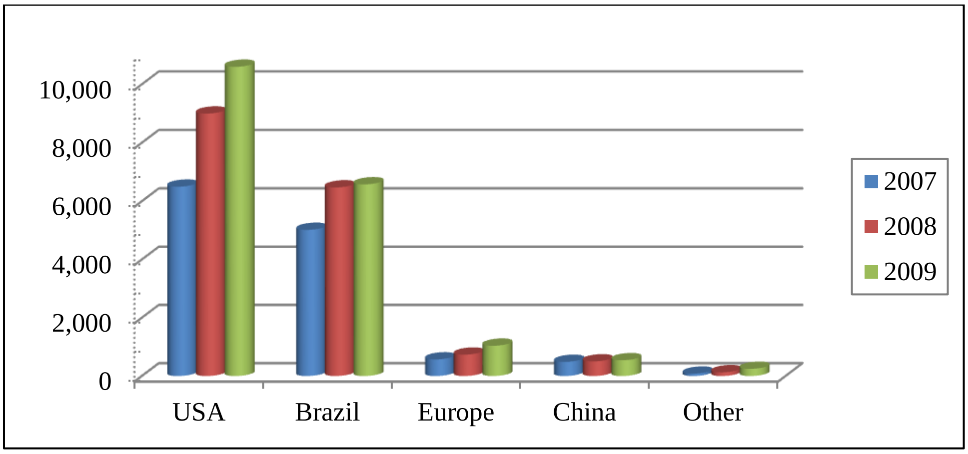
Besides those shifts, the oil prices' surge also contributed to the rapid change in agricultural product prices, since biofuel production emerged as an alternative source to oil, which claimed the scarce arable land for growing crops (UNCTAD, 2008). Biofuel is a product which interlinks two different commodity groups, i.e. agricultural raw materials and oil. Especially in Brazil, the transformation of crop fields to biofuel production has to do with the rising food prices, due to its

[33] UNCTAD (United Nations Conference on Trade and Development). (2004). *Trade and Development Report, 2004*. New York and Geneva: United Nations. p. 51

negative effect on the supply side of agricultural products.[34] Within the 2000s the ethanol fuel production has almost quadrupled, to a great extent related to the performance of the United States and Brazil. This trend in period 2007-2009 can be seen clearly on the Figure- 8, below. The policy choice of European Union and United States to encourage the substitution of fuels with biofuels is an important contributor to this trend.

Figure- 8

*Global Ethanol Fuel Production (million gallons, 2007-2009)*




Source: www.afdc.energy.gov/afdc/data/

At this point, financialization in the world economy is also enters into the picture, as far as the behavior of financial investors in commodity markets is concerned. With increasing effects of financialization, the rise in many commodity prices has created a danger for food security and agricultural development in developing countries. UNCTAD papers do not welcome financial investors due to the characteristics of their investment motives; since those investors treat

[34] http://www.ers.usda.gov/AmberWaves/November07/Features/Biofuels.htm

commodities as an asset class. Like the bubbles generated in real estate market, in the period 2002-2007 has seen bubbles in commodity markets as well, with the manipulations of the financial investors. It is indicated that behavior of financial investors on commodity markets is largely guided by considerations that are unrelated to commodity market fundamentals.[35] The increasing financializaiton can be seen on Figure- 9 that shows the futures and option contracts outstanding on commodity exchanges, for two decades. The increasing pace starting from the mid-2000s is clearly observed. Commodity futures markets play a role in price discovery and in the transfer of price risk, from market participants (like producers and consumers) to other market agents, who carry speculative motives. So, it is natural for those agents to behave commodities as an investment alternative to assets such as equities, bonds and real estate.

Figure- 9

*Futures and options contracts outstanding on commodity exchanges (millions of contracts, 1993-2009)*


Source: BIS (2009, June)

[35] UNCTAD (United Nations Conference on Trade and Development). (2009). *Trade and Development Report 2009*. New York and Geneva: United Nations. p. 54

Under the light of those developments, UNCTAD offers the following policy prescriptions: (1) There must be a more rigid regulation in the commodity futures exchanges. The functioning of commodity futures exchanges has to be structured in a way that reliable price signals of primary commodities can be provided to producers and consumers. In commodity futures trading, international cooperation is required among regulatory agencies; (2) besides the regulatory measures to be taken, there are responsibilities left to the international community; that is, to deal with the physical stock of food stuffs, which must be rebuilt in order to be capable of responding sharp price movements.[36]

The surge in agricultural product prices has created problems not only in economic terms, but also in food security especially in developing countries. Food and Agriculture Organization (FAO), which has been aiming to sustain the food safety for the low income masses, underlines this cruciality. FAO points out its policy prescriptions in order to overcome any problem in food safety. FAO underlines the importance of the following; (1) Creating safety nets for consumers are very important which take vulnerable population groups to their targets. These include targeted food distribution programs, targeted cash transfer schemes, feeding programs and employment schemes; (2) the government authorities are invited to take actions for managing markets and stocks to increase food supplies. Lately, government intervention’s costs and risks made them to take smaller actions and leave the market to its own devices. An important market management policy is buying and/or selling of publicly held stocks to also

[36] UNCTAD (United Nations Conference on Trade and Development). (2009). *Trade and Development Report 2009*. New York and Geneva: United Nations. p. 77

stabilize domestic market prices; (3) cutting tariffs to increase food imports is suggested as a policy prescription, since import tariffs raise the price of imported foods and protect the domestic production from international competition; (4) restricting exports to increase domestic food supplies; (5) in short-run high food prices can be seen as an opportunity for the supply side agents. But, to realize these supply responses, it will require overcoming more supply-side constraints; (6) food price increases should be managed by realizing that increasing prices do not always reflect a stimulus for agricultural growth. [37]

### 3.2.2 Oil and Petroleum Commodities

Besides agricultural products and biofuels, one other major commodity group is crude oil and petroleum products.

The consequences of a rise in oil prices may be defined as first and second-round effects. Firstly, the rise in general price level is expected after a hike in oil prices, since the price elasticity of demand is rather lower at most stages of the product chain. Moreover, the second-round effects can be examined if the workers start to bargain for higher wages after the increase in price level which caused by loss in real income.[38] In case of successful bargaining of workers for higher wages to compensate the real income loss, the result will be the upward pressure on the price level, since firms would seek to pass the rising labor costs onto consumer

[37] FAO (Food and Agriculture Organization). (2009). *The State of Agricultural Commodity Markets 2009*. p. 41
[38] UNCTAD (United Nations Conference on Trade and Development). (2005). *Trade and Development Report, 2005*. New York and Geneva: United Nations. p. 20

prices (UNCTAD, 2005). In this context, the 2000s have witnessed massive price hikes and fluctuations for oil and petroleum commodities. In June 2008, the oil prices reached its historical peak; $140 per barrel.[39] In this rapid increase, the demand from non-OECD countries is the most important factor, again led by the Asian developing countries and in particular, China. Chinese and Asian demand for oil increased 4.2% and 3.9% respectively, in the year 2007. On the one hand, demand for oil has been surging; on the other hand, the supply of oil has not been increasing, due to lack of new oil finds. The demand increases in major consumers in 2007 has been witnessed as mentioned above, whereas the oil production increase remained at the rate of 0.2 per cent in the same year. This is a good point to underline the changing patterns of supply and demand (UNCTAD, 2008). The supply levels have also been subject to fluctuations due to the production cutting decisions of institutions like Organization of Petroleum Exporting Countries (OPEC), in certain times of the decade. Although, such policy interventions may be temporary, they may have consequences on the supply and therefore on the price level of oil and related commodities. In 2006, the decision to decrease the levels of oil production was the product of such a policy measure; because next year the members of OPEC decided to increase the production from 35.5 million barrels per day to 37.3 millions. The result was demand exceeding supply in 2007, whereas the next year oil market returned to surplus position. As UNCTAD states, the measures taken by oil producing countries is no more sufficient to calm the market. Therefore the oil market is too

[39] http://www.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D

sensitive to any supply-side problem, reflecting it to oil prices.[40] As of today, in the short run the elasticity of supply and demand is expected to be low; then oil prices are likely to be kept high.

At this point, what UNCTAD offers to the developing countries as a policy recommendation, is to adjust their oil consumption to lower levels, through energy-saving and more efficient uses of energy in the long-term. The choice towards new energy resources may seem to be costly especially for developing countries, but when oil prices are high; such a policy shift would be beneficial for them. The effect of oil-product prices is important on the prices of other commodities, especially on agricultural commodities. This dependency generally take two forms: Firstly, the upsurge in the oil prices causes the prices of substitutes for oil by-products to increase. The biofuel production is the best example in this regard, whose production has risen directly related to the oil price increase.[41] Secondly, the indirect effects of oil prices are shown on the higher freight and transportation rates for many commodity groups. According to Rubin and Tal, the price increase in oil will lead to a stronger tendency to seek supplies from domestic markets.[42] Oil prices are capable of effecting monetary policy beyond its effects on other commodity prices. The rise in oil prices does have an inflationary impact.

---

[40] UNCTAD (United Nations Conference on Trade and Development). (2008). *Trade and Development Report, 2008*. New York and Geneva: United Nations. p. 26
[41] ibid. p. 27
[42] ibid.

Within this framework, the exchange rates are also important to the extent of benefits gained from the price hikes. The depreciation of U.S. dollar is relevant in this context, as commodity prices are usually denominated in dollars. Typically, commodity prices move in the opposite direction to the dollar exchange rate. A depreciation of dollar means that commodity prices rose much less or fell in terms of other major currencies (UNCTAD, 2004). In case of Brazil, the producers benefited little from the dollar price increase of biofuels, since the Brazilian domestic currency strongly appreciated against the dollar.[43] In addition to this, the weak dollar with the low global interest rates has motivated international investors to demand commodities, since other financial assets might not seem as attractive as commodities.[44] This kind of investment raises the volatility in commodity markets.

### 3.3 Terms of Trade

In order to observe the domestic-level effects of the trade relations that countries engage; the concept of "barter terms of trade" (or, colloquially, terms of trade, in short) is used, which is the ratio of the price index of a country's exports, to the price index of its imports. The prices and market movements of commodity products is determined by the composition of a country's imports and exports, in the short run; and by the capability of adapting its trading composition to changing international supply and demand conditions. Prebisch-Singer thesis

[43] UNCTAD (United Nations Conference on Trade and Development). (2008). *Trade and Development Report, 2008*. New York and Geneva: United Nations. p. 22
[44] UNCTAD (United Nations Conference on Trade and Development). (2004). *Trade and Development Report, 2004*. New York and Geneva: United Nations. p. 50

foresees a decrease in the terms of trade of internationally traded primary commodities *vis-à-vis* the manufactures over the long run. Since, many developing countries had been dependent on the exports of primary commodities, their terms of trade is related with the terms of trade of primary commodities against manufactures.[45] The secular decline in terms of trade of primary commodities, *vis-à-vis* manufactures is attributed to the following: (1) developing countries were dependent on the imports of manufactures from the industrialized countries that apply protectionism for their domestic production; (2) income elasticity of demand for primary commodities like food is lower than from manufactures and that technical progress in manufacturing tend to reduce the amount of inputs used per output (UNCTAD, 2005: 87). Thus the terms of trade of developing countries vis-à-vis developed countries was expected to decrease in the long run, in the earlier analysis of terms of trade.

With latest developments especially in developing countries, terms of trade issue is now revisited, with the hope of upturn in the terms of trade for primary products and in general, for the benefit of developing countries. The sharp price changes in the globally traded goods redistributes gross national incomes across countries. At a given level of export earnings or import expenditure, terms of trade gains indicate a relative increase in real income, since the same amount of export enables a greater volume of importing; and terms of trade losses indicate a relative loss of real income, since the same amount of exports can buy a smaller volume of imports (UNCTAD, 2008: 27). This redistribution has got to do with the latest

[45] UNCTAD (United Nations Conference on Trade and Development). (2003). *Economic Development in Africa: Trade Performance and Commodity Dependence*. New York and Geneva: United Nations.

evolution in the terms of trade. Developing countries, which generally exported primary commodities and imported manufactured and industrial products all along the century, suffered deterioration in terms of trade in the past century, but now the wind has significantly changed with the surging commodity prices in new decade.[46]

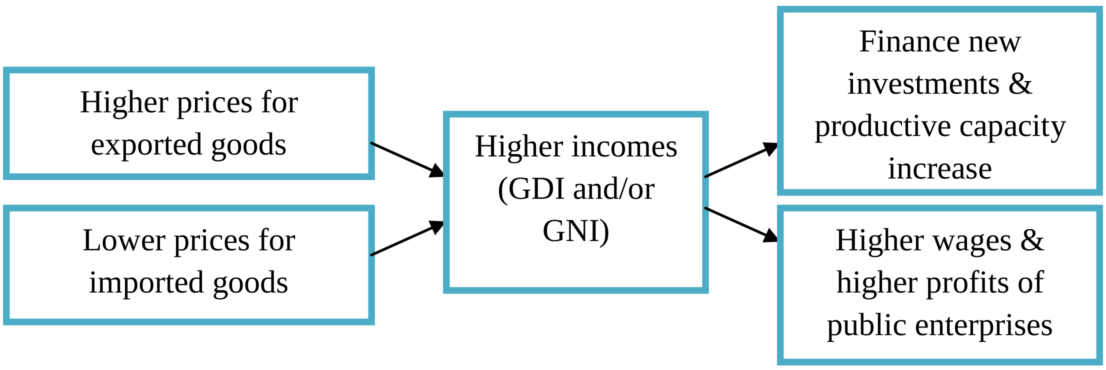
The stereotyping of developing countries as the exporters of primary commodities and importers of manufactures; and the developed countries as the exporters of manufactures and importers of primary commodities is no more valid. Within the developing countries, a diversification concerning terms of trade also occured, where the fuel and mining exporters gained; on the other hand, the exporters of labor intensive manufactures have lost. For instance, Africa's terms of trade has improved by 30 percent and Latin America by 8 percent in the period 1999-2004. In contrast, East Asian countries' terms of trade has deteriorated by 11 percent; since they started to consume and import more primary commodities whose prices have gone up. The main reason behind the surge in prices of primary commodities compared to manufactures can be explained with two structural changes in international markets. On the demand side, the emergence of some developing countries as the importers of the primary commodities; and on the supply side, manufactured goods were exported to the global market in greater quantities by the developing countries that have lower labor costs.

[46] UNCTAD (United Nations Conference on Trade and Development). (2008). *Trade and Development Report, 2008*. New York and Geneva: United Nations. p. 28

In this context, the policy advice to developing countries was mainly, to transform into manufacturing from primary product exporting. But the old pattern of trade in developing countries is subject to change, both in direction of trade and in product composition. Although, many developing countries still engage in primary commodity exportation, as mentioned above, they also engage in manufacturing exports to developed countries. UNCTAD (2005: 88) underlines this situation, noting that "…developing countries can no more be classified as exporters of primary commodities and importers of manufactures…" Therefore, the debate on the terms of trade is now focused around the movements of prices of manufactured goods exported by developing countries and those exported by developed countries with the changes in trade patterns (UNCTAD, 2002: 117). In other words also the debate is centered on the terms of trade of manufactures vis-à-vis other manufactures, as well as it is has been around the terms of trade of primary commodities and manufactures.

Figure- 10

*The Developmental Settings of Terms of Trade*




Source: UNCTAD (United Nations Conference on Trade and Development). (2005). *Trade and Development Report 2005*. New York and Geneva: United Nations. p. 108

The consequences of the surge in global commodity prices and its prospects, also led to policy shifts at domestic level. As developmental agenda includes the distribution of export income, the privatization and tax incentives for foreign investors are also questioned in developing countries, with the hike of commodity prices. Privatization and tax initiatives have led to considerable reduction of government revenues from mining sector in developing countries.[47] Some countries are at the start of revising, and some have already begun to revise their fiscal and ownership regulations relating the oil and mining sectors, that have high rents.

## 3.4 Conclusion

The commodity price hike since early 2000s, caused by strong demand and the slow supply response combined together, resulted in the low inventory levels for many commodities. This situation created a hope for the developing countries, which have the chance to have terms of trade changing in their favor and therefore improved financing capabilities for their investments. But, it came out that developing countries are no more only exporters of primary commodities, and importers of manufactures; but also exporters of manufactures that will reflect a negative trend in terms of trade of these manufactures.

On the other hand, changing market fundamentals in commodity markets created a base for speculation and thus attracted financial investors that are investing in

[47] UNCTAD (United Nations Conference on Trade and Development). (2005). *Trade and Development Report 2005*. New York and Geneva: United Nations. p. 109

futures market for commodities. According to UNCTAD, increasing existence of financial investors in commodity markets in the form of commodity futures and options have an effect on the price movements that goes beyond the market fundamentals (UNCTAD, 2008: 22).

The main challenge for countries that are benefiting from the positive trend in their terms of trade is the use of this additional revenues and increases in gross national incomes. But, even if this may seem promising, it requires a developmental perspective on the higher income obtained from the export earnings (through rising export prices or falling prices for imported inputs). As well, the income gains may also be translated into higher wages or profits of public enterprises. Those gains can have positive developmental effects, by strengthening the ability of those countries to finance new investments in infrastructure and productive capacity, via the improvement in: (1) employment; (2) productivity; (3) output growth.

# Chapter 4

# Foreign Direct Investment

## 4.1 General

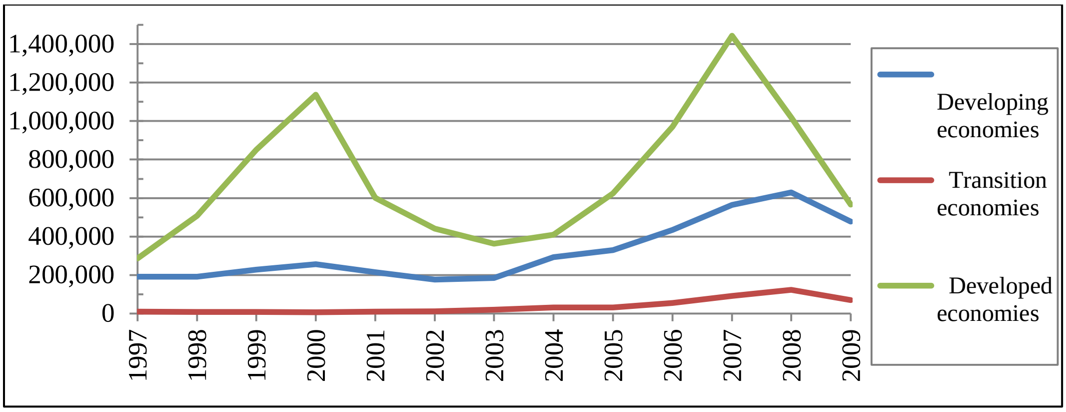
Foreign direct investment (FDI) in the global economy (particularly in developing countries) is an important item in the agenda of UNCTAD, which is to be monitored and to be followed-up on a timely basis with its publications. The past two decades have witnessed a massive increase in FDI levels by TNCs to developing and transition economies, which justifies the emphasis given to FDI in UNCTAD studies. This process can be evaluated as a result of globalization process, that developing country firms have come to realize the importance of accessing international markets and becoming part of global production systems (UNCTAD, 2006). Although, developed countries are still the dominant part of the global FDI flows, the rising share of developing and transition economies, is expected to affect the development prospects of those countries. Since, as it is accepted, the proponents of globalization come up with the argument that FDI flows are in favor of developing and transition economies, this chapter will seek to walk through the evolution of FDI in the new decade, and its implications for domestic policy-makers.

## 4.2 Global Evolution in FDI

When the evolution of FDI in 2000s is studied, it comes out that FDI have been growing fast in the period 2003 to 2007, but this trend turned down with the year 2008. The global FDI flows that have been gone down to almost $500 billion during 2003-2004 period, then reached $2 trillion in 2007 and faced a rapid decline in the final years of the decade, down to $1.2 trillion. Developing and transition economies received more FDI in the year of crisis; 2008, with their shares in global FDI inflows growing to 37% and 7%, respectively, from 27% and 5% in the previous year (UNCTAD, 2009b: 4).The crisis moments are times when transnational corporations can go to investment cuts, therefore the decline in total FDI in 2008-2009, shows the adverse effects of this phenomenon. Figure- 11 below shows the fluctuations in global FDI, which is claimed to be intimately related with recent medium-term cycles (Boratav, 2010: 93). According to Boratav, the association of capital flows and growth rates has been in an inverse direction during the cycle 1989-97. Whenever the growth rate of capital flows is decreased, the developing countries are able to record higher growth rates. Thus, decreasing economic growth rates usually accompanied with astronomic hikes in capital flows. After the crisis of 2001 was over, the period 2002-2007 witnessed a major increase (varying from 20 to 46 per cent per annum growth rates) in capital flows.

Figure- 11

*Foreign Direct Investments-inflows (USD million, 1997-2009)*




Source: UNCTAD Stat, http://unctadstat.unctad.org/TableViewer/tableView.aspx

This decline was due to the following causes according to World Investment Report (UNCTAD, 2009: chap. I); (1) Financial downturn has negatively affected the investment propensity of TNCs both at domestic and global levels. Since the conditions for obtaining loans, have been more stringent, a reduction in the financial resources led transnational corporations to abandon a portion of their investment projects; (2) Also the depressed markets has reduced firms' propensity to invest in further expansion of production capacity, at both domestic and international levels; (3) The gloomy economic environment may also create a tendency for risk aversion in firms that face uncertainties.

As mentioned in UNCTAD studies the operations of TNCs are among the important factors shaping the FDI in the globalized world economy. One aspect that developing countries have to deal with is also the trade balance due to the decline in exports of the largest TNCs from developing countries. Their sales began to fall markedly since that period, and their profits for the whole year fell by 28.9 per cent.[48] The developed economies have the largest share of FDI inflows in world total. Transition economies and developing economies have a modest portion within those inflows.

Various roles are attributed to FDI across different regions. For instance, in Asia, FDI has contributed to the industrial upgrading that spreads to many industries, whereas especially in transition economies of South and Eastern Europe, the foreign banks have been enhancing their existence and creating some concerns at domestic level. On the other hand, in developed countries, the excessive outward FDI has created problems of unemployment at domestic level. The cyclical movements are important in this diversity among the FDI and capital flows in different regions. The center (in the framework of this paper can be identified as, developed countries) and periphery (developing countries) distinction is used in order to analyze the cyclical developments in the last decades. According to some scholars (e.g. Boratav, 2010: 85), initial resource inflows shall be directed to the periphery in order to enable developed countries to transfer it back. The formation and enhancing of economic surplus will be supported by the developed countries, in the shape of direct investments or credit inflows to the developing countries; raising serious questions about the quality of FDI, beyond its quantity.

Besides the quantity of the FDI, its quality and composition are also vital for home and host countries, when development prospects are concerned. Impact of outgoing FDI on the home economy is related to the improvement of

[48] UNCTAD (United Nations Conference on Trade and Development). (2009). *World Investment Report 2009*. New York and Geneva: United Nations. p. 26

competitiveness of outward investing firms, and whether this investment is leading to improvement the competitiveness for industries generally and the whole economy (UNCTAD, 2006). Such an improvement in the home economy depends on the effects of outward FDI and economic variables, like availability of financial resources for investment, exports and employment. In the case of developed countries, the outward FDI has been able to provide such improvement. For developing countries, the outward FDI may have implications that go beyond the economic terms, and have political, social and environmental consequences. So, policy-makers have to be careful about the potential costs and benefits of allowed outward FDI for the home economy.[49] Impacts of FDI in host economies on economic welfare, growth and development are observed in many ways, mentioned in several "World Investment Reports" by UNCTAD (WIR, 1993 and WIR, 1999). The gains to the host country are in the form of interactions of FDI flow with the local economy, by building production facilities and creating employment that will require training. Also TNCs are parts of the value chains that will establish backward linkages with suppliers and forward linkages with distributors and sales organizations. This will stimulate production in supplier and distribution firms in the host country and create a channel for the transfer of technology. Moreover, by the impacts of competition, there might be spillover effects, on the local firms to spur their performances. Overall the potential increases in employment and income, due to entry of FDI, will create multiplier effects in hosting economy, as a whole.

---

[49] UNCTAD (United Nations Conference on Trade and Development). (2006). *World Investment Report 2006.* New York and Geneva: United Nations. chap. VI

The expectations of national policy-makers for such a change can be supported by the empirical observations as well. In the year 2000 the changes in national policy concerning regulation have been 98 per cent in favor of further promotion and liberalization of and only 2 per cent have been in favor of restrictions. But when we come to 2009, the proportions have been changed to 70 per cent to 30 per cent, respectively, but still highly in favor of liberalization and promotion (UNCTAD, 2010b).

Table- 2

*National Regulatory Changes (2000-2008)*

| **Year** | **Number of countries that introduced changes** | **Number of regulatory changes** | |
|---|---|---|---|
| | | *More Favourable* | *Less Favourable* |
| **2000** | 70 | 147 | 3 |
| **2001** | 71 | 193 | 14 |
| **2002** | 72 | 234 | 12 |
| **2003** | 82 | 218 | 24 |
| **2004** | 103 | 234 | 36 |
| **2005** | 92 | 162 | 41 |
| **2006** | 91 | 142 | 35 |
| **2007** | 58 | 74 | 24 |
| **2008** | 55 | 85 | 25 |

Source: UNCTAD database on national laws and regulations.

Under those circumstances, UNCTAD points out the new developments in FDI policies. In the last two decades national regulations related to FDI, indicate that 110 new FDI-related measures were introduced and 85 of those measures were favorable to FDI.[50] So, there is a policy trend towards easing obstacles before FDI. Measures taken by host countries in this regard include raising FDI ceilings or the level of the general review threshold. In other cases, the acquisition of residential real estate by foreign investors was eased.[51]

Besides those developments, there are some new steps taken in order to regulate FDI. But UNCTAD makes a distinction at this point, which tries to question the character of those regulations, if they are in favor of domestic over foreign investors, or introduce obstacles to outward investment in order to keep capital at home. Such an aim may not be achieved by applying restrictions on FDI from abroad, but by unevenly favoring domestic products and/or domestic content. So, in the future there are signs of a new shift towards economic nationalism in order to protect the so-called national champions from takeovers abroad.[52] UNCTAD argues that a new probable conjuncture in this way may not provide the desired benefit for developing countries from FDI, as UN entities expect.

### 4.3 Conclusion

One of the results of the evolving circumstances within the new decade is the dichotomy observed in investment policy trends. One party is favoring further liberalization and the promotion of FDI, in a conjuncture of high competition among host countries for FDI. In contrast, proponents of regulation are in favor of

[50] UNCTAD (United Nations Conference on Trade and Development). (2009). *World Investment Report 2009*. New York and Geneva: United Nations. p. 30
[51] ibid. chap. II
[52] ibid. p. 31

investment protectionism, although this approach has not been fully effective yet. But, developments that have taken place in 2003, has been providing arguments for the people who have suspicions about the merits of FDI, when the FDI was down 21 per cent globally and thus had an adverse effect on developing countries (UNCTAD, 2003b). The reliability of FDI in long-term projections, overriding challenge for developing countries to support national policies and attract FDI at the same time is problematic. Those latest developments bring the world economy and domestic authorities to a crossroads where the rebalancing rights and obligations of investors and the state can be revisited (UNCTAD, 2010b). The near future is likely to face new debates; since a recovery of FDI flows is expected in the short term, but still it will take some time to reach its peak in the 2000s, according to studies carried by UNCTAD. But the policymakers in developing countries will face a challenge, within the conjuncture of the rough competition for foreign investment that developing countries require for financing their capital accumulation.

# Chapter 5

## Macroeconomic Coordination Tools and Policies in the Global Economy

### 5.1 General

Macroeconomic policies do not necessarily have to include the international coordination dimension, if the economy of a country is closed to external influences and any financial interactions. In case of a development strategy within a closed economy, providing macroeconomic coordination would not be an important; or even a relevant task. But since the issue of macroeconomic coordination is examined in a specific time period, starting from the 2000s, we must not underestimate the intensified effects of globalization that have been decisive on national policy settings. As many academics argue, increasing integration in the world economy, holds out the promise of mutual gains to countries from the coordination of their macroeconomic policy decisions (Fischer, 1987). Hence, the effects of globalization on the tools of macroeconomic policy management will be noted first, and later the new policy prescriptions under these circumstances will be examined.

Therefore, this chapter is shaped around two interrelated dimensions of macroeconomic policy.[53] The first is the effects of globalization and its reflections on macroeconomic policy-building. The second is the coordination possibilities

[53] From the speech given by Dr. Compton Bourne, President of the Caribbean Development Bank, in the "Seminar on Monetary Cooperation in Caribbean".

and structures formed afterwards the effects of globalization process. The policy range will include monetary and fiscal policies. The subject is elaborated with respect to the broader scope of the thesis, which is the formulation and implementation of developmental policies. Thus, it is important to recognize the linkage between development and macroeconomic policy prescriptions.

## 5.2 The Effects of Globalization in Macroeconomic Policy Coordination

In order to see the change in the macroeconomic policy settings in the 2000s, the major characteristics of the previous era must be understood. Free movement of the financial capital was advocated in the wake of the crises of balance of payments since the oil shocks of the 1970s, in order to finance the deficits. Throughout the 1980s, the majority of developing countries started to welcome more foreign capital in order to accelerate growth.[54] But beginning with the late 1990s, the financial capital inflows into the developing countries have mostly been in the form of portfolio investments. The amendment that IMF had made in the late 1990s, which contributed to the opening of the capital accounts of the member states, increased the pressure on developing countries for the full liberalization of international capital flows throughout the 2000s. Williamson and Mahar (1998) also note the rapidity of liberalization in developing countries which had been implemented even faster than in developed countries. Since 2003, we observe a drastic increase in gross private capital inflows (UNCTAD, 2006: 129).

---

[54] UNCTAD (United Nations Conference on Trade and Development). (2004). *Trade and Development Report 2004*. New York and Geneva: United Nations. p. 93

In the global market economy, as of the latest form it took in the late 2000s, the effect of globalization and the enforcement of international financial institutions' policies make it almost impossible to shape a fully independent macroeconomic policy mechanism. From this point, we can see that increasing pace of rapid globalization process in the last decade imposed constraints to the framework of national macroeconomic policy settings. Besides other effects of globalization, financialization of the global capital with the accompanying trend of liberalizing capital movements is probably the most important contributor to this change. Before such an intensive integration took place, macroeconomic policies could be exercised with a greater degree of independence since the spillover effects from other economies to developing countries could be limited. Although, countries still practice their own economic policies in a certain degree of independence, it is obvious that this room of maneuver had been greater before the last decade. This global integration primarily affected the monetary and exchange rate management, having certain consequences on other macroeconomic policies, ultimately on development policies.[55] The policy framework in the beginning of the 2000s was closer to orthodoxy in comparison to the earlier decades, putting the price stability at the center of its interest.[56] But, as the catch-up trend of developing countries and economic growth declined within the decade, the macroeconomic policies and tools had to be redefined.

The new character of financial integration demands developing countries, to come up with a new understanding in macroeconomic policy-making, since

---

[55] UNCTAD (United Nations Conference on Trade and Development). (2006). *Trade and Development Report 2006*. New York and Geneva: United Nations. p. 128

[56] ibid. p. XV

international capital flows are more volatile and effective in developing country economies. The tools, which countries use in order to administer their macroeconomic environment, like exchange rates, investment and saving policies, etc. are subject to the consequences of this change.

### 5.3 Monetary and Fiscal Policy Tools

Macroeconomic policy tools have been used primarily to stabilize the price level, which is seen as a prerequisite for sustainable growth performance. This kind of approach had dominated the assignment of macroeconomic policies for a period, under the heading of sound macroeconomic policies. Within this framework, monetary policy was given the role of a preventer against any combination of inflationary policies, and the role of fiscal policy was confined to helping monetary policy by keeping budget deficits low with minimum government intervention (UNCTAD, 2006: 142). But, this legacy of previous decades has been subject to change. In the new scheme, monetary policy is not and cannot be the only tool to sustain price stability, unlike orthodox approach once believed, but non-monetary tools like fiscal and incomes policies must also be in use (Flessbeck et al., 2005). Within this framework, monetary and fiscal policy shall be implemented with coherence, constituting the center of focus in macroeconomic policy settings and coordination of those interrelated measures.

#### 5.3.1 Monetary Policy

Basically, the management of money and interest rates constitutes the scope of monetary policy, according to Mishkin.[57] Within this task of monetary policy settings, the focus is on the possible effects of capital inflows on credit market and interest rates according to UNCTAD: At the macroeconomic level, the expected task from developing country governments is to produce policies in line with promoting development. For this aim, the role of capital accumulation was underlined for growth and structural change since it was presumed to create income, employment, productive capacity and technological progress. Therefore, the investment incentives seem vital for a dynamic growth process. This understanding emphasizes two prerequisites which are; (1) price stability, (2) availability of domestic and foreign savings. The static view has been identified as deficient and discursively increased the expectations of developing countries from capital account liberalization in the past decades.[58]

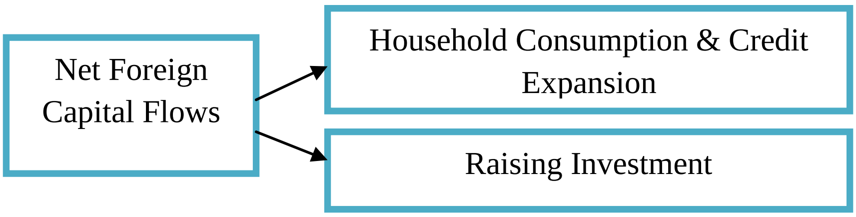
The latest wave of liberalization of capital inflows has brought new consequences forward, parallel to its significance in domestic markets. It is obviously an opportunity that capital inflows can ease the balance of payments constraints that countries may struggle to control, via increase in net capital inflows concomitant with waves of liberalization.[59] But, the recent studies have shown that the significant part of capital inflows in developing countries have been used in domestic financial system for credit expansion, instead of raising investment and

[57] Mishkin, F. (2004). *The Economics of Money, Banking, and Financial Markets*. 7th ed. Boston: Addison-Wesley.
[58] UNCTAD (United Nations Conference on Trade and Development). (2006). *Trade and Development Report 2006*. New York and Geneva: United Nations. p. 134
[59] ibid.

productive capacity.[60] So, although the expected outcome from net capital inflows is the increase in investment and productive capacity; the result would be in the form of rising consumption or unproductive activities. So, the proper use of capital inflows is an issue of debate. To examine the controversial consequences of capital inflows and its effect on the credit base, an experience can be mentioned here. In 1990s, such as a case was seen in Latin America, where the increase in bank lending caused by the foreign capital inflow, was accompanied by rising private consumption. Thus, abundant foreign capital was not associated with higher investment and growth prospects according to many writers like Aizenmann (2005).

Figure- 12

*Possible Usage of Foreign Savings*




There is another view which avoids the foreign capital inflow-based approach. The alternative view is that investment does not depend on the ex-ante availability of domestic or foreign savings, but depends on the effectiveness of the financial intermediation that manages credit sources to be channeled into productive uses. Thus, this approach emphasizes the importance of domestic economic institutions, and ultimately the central banks, to provide finance to firms to be used for

[60] UNCTAD (United Nations Conference on Trade and Development). (2006). *Trade and Development Report 2006*. New York and Geneva: United Nations. p. 134

investment purposes (UNCTAD, 1991: 93). The burden of providing finance for investment extends the area of responsibility for monetary policy. Beyond the usual responsibilities of price and exchange rate stability, the performance of the real sector, using monetary aggregates and interest rates, is also included into the picture.[61]

The interest rate and exchange rate management come forward as the major tools of monetary policy management at this point. Within this framework, exchange rate problem is proposed to be handled with a system of managed flexible exchange rates.[62] In the high-inflation countries, which have to offer high interest rate for attracting short term capital inflows, the domestic currency is under pressure to appreciate. So, within a multilaterally agreed framework managed flexible exchange rates become a solution (UNCTAD, 2009: 127). In an internationally agreed exchange rate system based on the stable and sustainable real exchange rates of all countries can help countries to protect themselves from the speculative capital flows and avoid the distortion of exchange rate parities. According to UNCTAD, stable real exchange rates can help to achieve the following; (1) curbing the speculation that is fuelled from inflation and interest rate differentials. High inflation and higher interest rates would be compensated by the devaluation of nominal exchange rates; (2) currency crises would be prevented, since the speculation due to high inflation in some countries would

[61] UNCTAD (United Nations Conference on Trade and Development). (2006). *Trade and Development Report 2006*.New York and Geneva: United Nations. p. 135

[62] UNCTAD (United Nations Conference on Trade and Development). (2009). *Trade and Development Report 2009*. New York and Geneva: United Nations. p. 127

disappear; (3) global imbalances will also be prevented; competitiveness in global trade relations would be maintained.

As explained above, a stable real exchange rate system is beneficial and coherent; and thus requires the international coordination, besides multilateral institution-building. This coordination can be assured at the regional level in the first place, which will help to ensure reserve pooling for the countries of a region in case of a foreign debt crisis. Such regional cooperation will be helpful to avert financial and currency crises and decrease the dependency on funding from international financial institutions (UNCTAD, 2009: 129).

At this point, the pro-cyclical bias is also taken into consideration. The monetary policy alone, cannot help achieving the multidimensional conflicting objectives, especially when the cyclical developments are considered. Therefore, in the times of crises the central banks should not quickly accept the general policy to apply tightening monetary policy and raising interest rates in order to attract foreign capital inflows (UNCTAD, 2006: 135). So, the contribution of capital inflows are subject to serious debate and the acceptance of the idea that such inflows do always ease the balance of payments through creating productive capacity is questioned.

In the new fiscal and monetary context, the governments are not rigorously criticized by financing their fiscal deficit through using monetary policy tools. Those kinds of criticism were old habits, not acceptable in the new global macroeconomic order with new decade. Lately, the idea is derived from the view that monetary policy instruments may be employed for different purposes at different points in time (UNCTAD, 2006). Especially in the times of crises, counter-cyclical monetary policy in developing countries should be used in order to overcome tightening monetary policy and raising interest rates in order to attract foreign capital.[63]

### 5.3.2 Fiscal Policy

In the context of fiscal policy, the focus will be on the significance of the investment and saving nexus, since this relationship is decisive for the policy setting (Palley, 1996: 1). The approach towards saving and investment nexus, which demands a greater sophistication in the assignment of macroeconomic policies, can be put in a place between heterodox and orthodox approach. The approach that advocates saving causes investment is identified with classical economics, whereas the one that investment causes saving is identified with Keynesian economics. To a certain extent, the investment and saving nexus is examined in monetary policy; but the scope of fiscal policy goes beyond monetary policy, so fiscal policy choices can also result in certain changes in government spending and taxation.

The general view that, saving causes investment leads to the advocacy of fiscal austerity, since the government deficits are assumed to negatively affect national saving and capital formation (Palley, 1996: 1). The implications of this view and

[63] UNCTAD (United Nations Conference on Trade and Development). (2006). *Trade and Development Report 2006*. New York and Geneva: United Nations. p. 136

its policy prescriptions follow in the form of justified fiscal austerity, and in its latest form, the fiscal rules enforced on governments. Again the view that saving causes investment shapes other outcomes about macroeconomic policies. If government deficits are to be closed, then policy makers shall not reduce the disposable income and household savings through raising taxes, but rather by cutting government spending.[64] Thus, the upper level income taxes shall be cut first since the propensity to save is positively related to income.

One other major implication of such a view is on the social security and public pension funds' issue. If the desired policy prescription is to increase the private saving, then such government operations about social security shall be diverted to privatized pension systems.[65]

Within this context, there are supporters of external saving who emphasize the dependency on the inflow of foreign savings. This view overestimates the opportunities of foreign saving and capital flows in raising the capability of investment and catching up of developing economies with the developed ones. On the other side, there is a more institution-focused approach, which supports the ability of right macroeconomic policies and institutions, in creating savings for the process of dynamic development. This divergence of opinion is an important point of departure about the investment and saving relationship.

[64] Palley, I. T. (1996). "The Saving and Investment Nexus: Why it Matters and How it Works". *CEPA Working Paper Series-II. Working Paper No 1*. New York: Center for Economic Policy Analysis. p. 2
[65] ibid.

In detail, orthodox approach is not likely to accept the assumption that investment does not depend on savings that exist at the outset, since this kind of assumption requires the monetary policy actions that might break orthodox rules due to public financing of firms. But the use of this finance is important, since if it is channeled to pioneering firms and companies, this can increase real investment and creates output growth. The danger of inflation and difficulties in controlling price stability makes the second approach questioned by the supporters of foreign capital. But, if savings are accepted as the result of growth and not its precondition, liberalizing barriers to the inflow of foreign capital is not always a necessary way for successful catching-up of developing countries, unlike orthodox approach that sees it as necessary.

Before and in the beginning of the 2000s, much of the macroeconomic policy had been based on the claim that saving causes investment.[66] But today, many empirical evidence showed that investment spending increases both personal and government saving.[67]

### 5.4 Conclusion

While concluding this chapter, reference must be made firstly on the impact of globalization and its effects in shaping the form of financialization, which became decisive on the tools of macroeconomic policy management and on the context of coordination. This phenomenon was seen as a vital opportunity in the previous

[66] Palley, I. T. (1996). "The Saving and Investment Nexus: Why it Matters and How it Works". *CEPA Working Paper Series-II. Working Paper No 1*. New York: Center for Economic Policy Analysis. p. 13
[67] ibid. p.14

decades and partly in the early 2000s, with the coordination possibilities of macroeconomic policies. Although, there are empirical studies, such like Obstfeld and Rogoff (2000), that fundamentally reject the idea of economic and financial coordination bringing significant gains; the mainstream approach is supportive of welfare gains that can be achieved with proper economic coordination (Sutherland, 2004). But, the way to use the macroeconomic policy tools and coordinate them internationally is still a controversial issue; even its merits are accepted. The main point of departure is the attitude towards the most distinct feature of the era, which are the capital flows, whether it initiates investment or not. In the beginning of the new decade, so-called sound macroeconomic approach has been on the agenda as a legacy of previous decades and this approach was characterized by the views of orthodox school, placing price stability to its primary focus. The alternative view to monetarist or orthodox tradition opposes the acceptance that higher investment depends on the existing level of savings, either domestic or foreign. This kind of a more heterodox approach envisages a greater space for monetary policy, enabling it to take investment expenditure out of savers' scope of decision. Investment finance can support firms that are used to generate investment, higher income, and ultimately higher savings from that higher income. The successes of many industrializing economies, especially in Asia, which have attained much of their economic goals via heterodox policy tools like direct intervention and incomes policy, have provided ground for this judgment. But, since all those cannot be handled solely with monetary policy, fiscal policy and various forms of incomes policy may also be included into this scheme (UNCTAD, 2006: 135). But even in this more heterodox approach, the non-inflationary environment is still widely accepted as the precondition for sustained dynamic economic growth in developing countries.[68] Thus, the monetary policies have to take the price stabilization into the center of their concern.

So now there is likely to come out a new way of setting in macroeconomic policies, which is not shaped purely with the waves of liberalization in the early 1990s, leading to the so-called Washington Consensus. In this scheme, macroeconomic policy coordination comes to the fore as a kind of economic policy concept, in order to sustain economic development and minimizing the external negative effects originating from regional or global level (Hein and Truger, 2004).

As the result, the anti-inflationary and price stability-focused policy approach at macroeconomic level, which has become more attractive since the beginning of the decade, is now partially replaced by a more flexible approach. So, the coordination which has been aiming price stability through the actions of the major central banks and governments, started to gather a greater chance for producing domestic policy prescriptions, adding incomes and wage policies to monetary and fiscal macroeconomic management tools. But so far, the tools of coordination in macroeconomic policy that has been mentioned above are not used comprehensively. At the moments of crisis, taking place at the recent times, macroeconomic policy coordination has been practiced on an *ad-hoc* basis (UNCTAD, 2009: 130).

---

[68] UNCTAD (United Nations Conference on Trade and Development). (2006). *Trade and Development Report 2006*. New York and Geneva: United Nations. p. 142

# CONCLUSIONS

The development policies of countries, usually put the emphasis on economic issues, but due to their multidimensional character, they also include various other factors, besides the economic ones. United Nations, as an institution which is aware of this multidimensionality, contains several entities that undertake studies about developmental perspectives.

Development policies may not have been derived solely from a given philosophical motive or from the ideas of an economic school of thought. But if the logic and objectives of those policies are analyzed within a historical context, some of them agree with a certain philosophy/school of economic thought. Since our study is concerned with the first decade of the 21$^{st}$ century, it is apparent that a very important source of ideas at that time has been the orthodox approach that is reflected in the so-called Washington Consensus. It is a reality that, this approach has been gradually strengthening its influence over economic policy-making since the 1990s, in line with the process of globalization. In order to measure the proximity between the developmental policy prescriptions offered by the UN institutions and the Washington Consensus; first of all, the evolution, trends and factors of the themes that determine these policies must be evaluated. From this point of view, the policy prescriptions which are contrary to the ongoing orthodox approach, and advocate an effective presence of the state in the economy, can be placed under the heterodox approach. More broadly, the criteria to be applied in order to determine whether the policies are closer to and applicable by heterodoxy, or not, are defined as follows; (1) an attitude towards capitalist economy and the free market system, which is shaped in the understanding of not identifying capitalist economy and the free market system, with the most appropriate model of organizing the society; (2) the shortcomings of the market system is open to criticism (unlike the neoclassical economists); (3) the government intervention can be called to overcome the shortcomings of the free market system; (4) emphasizing social, political, structural, institutional, historical and cultural factors together with economic factors (Cypher and Dietz, 2009: chap. 6). In order to make a comparison among the policies proposed towards development, main criteria listed above shall be kept under consideration. Besides those, some operational additions or departures from those criteria are undertaken, in order to make a comparison among policies proposed on the basis of developmental approaches.

The findings of this study are related to the evolution of economic outlook and policies in the 2000s. The evolution, taking place at the global level, has led the way for rethinking the policy prescriptions at the domestic level. Reviewing this change shows clearly that different constituents of development policy have been overlapping onto each other and are subject to mutual interaction. For instance, the initial change in the commodity prices have led the way to swings in the terms of trade and trade-related policies, later affecting the fiscal and monetary policies at the domestic level. Such policy evolutions and changes shall be further examined in order to understand whether they are contrary to orthodoxy and more close to heterodoxy, or not. Influences of the heterodox approach can be found on the certain policy prescriptions of the UN entities. To seek and examine some of those influences in the context of the development perspectives, can be useful:

Trade-related policies have expanded their area of influence, and thus becoming more important component of development for governments. The debate on trade-related policies of global decision-makers has evolved into a new phase after the so-called Washington Consensus, which promotes the idea that trade liberalization is desirable at any price. The orthodox approach has been quite distinctive on this issue, vehemently pressing for the removal of barriers before free trade. But, when the change in the terms of trade, caused by the commodity price movements and its effects on the development are reviewed, the orthodox recommendation to specialize on the certain goods that the country has comparative and/or absolute advantage, has been criticized by the UN institutions.. As in the case of China, the role of the state has been decisive on resource allocation, production locations and goods to be traded. This planning role assumed by the state has its impacts on economic growth, industrialization and rural development. The role of the state for sustaining structural change is accepted in the policy prescriptions of the UN bodies. Such an understanding sees the existence of an institutional framework as essential, besides infrastructure investment by the government for industrial and rural development. Nowadays, the debate on trade policies is about whether seeing trade as a means, or an end in itself. Therefore, the diverging position on this issue is related with the decision-making institutions' positioning towards the space for policy prescriptions produced by, and autonomies to implement, national institutional innovations in developing countries. The rigidness of those policy prescriptions has awakened powerful criticisms not only from heterodox scholars but also from mainstream economics. Another issue that has been debated in the developmental agenda throughout 2000s was the capital flows and FDI, in particular. The position of the UN institutions over this issue is not the same, as of the proponents of globalization that is embodied in the belief that capital flows and FDI encourages local firms to become more competitive via integration to global economy and creates resources for investment finance. Capital flights and fluctuations in capital movements observed in crisis times throughout this decade, together with the investments that are not production-oriented; but instead taking the form of short run portfolio investments, have brought forward the necessity to make structural arrangements in this context. The UN approach is quite skeptical about the availability of the FDI potential that can be attracted to developing countries in order to sustain the mentioned long-run development strategy. Besides, UNCTAD studies indicate that FDI flows are not unidirectional, benefiting each developing country all the time. It is clearly stated that FDI is a way to increase developing countries' access to technology and organizational skills, but it necessarily should not have to be identified as the most desirable or effective channel for the promotion of technology and skills. The policies towards FDI have been reconsidered after the rapid success of East Asian economies and their collapse with the 1997 crisis. In this context, lessons derived from the FDI in East Asia have strengthened the skeptical views about the "miracles" of FDI. UNCTAD is also skeptical, of opening up at any cost, liberalization and privatization in order to attract FDI. Instead, what UNCTAD proposes as a development strategy involving FDI includes the features that had been identified as suggestive of the heterodox approach, noted above. The intervention by the government is required in order to create a pro-investment macroeconomic environment. The involvement of state action would be in the form of a mixture of fiscal policies, subsidized credits, restricted entries, forced mergers and direct public investments. Those policies are useful to stimulate profits and direct it to productive channels. Building upon this statement, we can see that UNCTAD officials are aware of the benefits of rents, which can help the primary sector's productive efforts, if those rents could properly be managed. Rents could have favorable effects; and in this context the existence of government intervention must not be rejected in principle simply on the grounds of patronage relations and inefficiency. Again, in order to benefit from FDI initiatives, the economy under consideration must have achieved a certain level of capability according to UNCTAD. The success in the long run development strategy of a developing country is related to the export innovation and promotion.

My overall conclusion is that, the UN institutions are somewhat realistic in their development perspective and suggest "to grab at most benefits from the process of globalization" as an implicit view in many of their policies. Therefore, we cannot identify their policy stance as centrally-produced blueprints through a deductive approach. In this context, the various policy prescriptions by the UN institutions may fall apart from the orthodox approach, but this does not mean that the UN entirely commits itself to a deductive heterodox policy. In reaching to this outcome, I have assessed the characteristics of the evolution throughout the 2000s. As mentioned above, after times of crisis and failures of the preceding policy paradigm; it is easier and more operational to go to policy shifts, especially when the deficits of the implemented policies come out. Hence, in many UN policy prescriptions, the criticisms that have arisen as a response to globalization process and ongoing orthodox approach, can be seen. Especially, the role of the state and the idea of bringing the state back in, has showed its impacts on developmental perspective after the serious economic crises. The example of

China, as the most distinctive developing country in the scope of economic development, can be a benchmark with its successful policy exercises, and as well as for the structural instabilities they face. As mentioned in the themes studied, China's success in sustaining trading income is something quite obvious. The policy perspectives generated by UN, is coherent with the path China followed to succeed this; in the extent of including state initiative in necessary points like establishing special economic zones, encouraging transforming from labor-intensive production patterns to manufactures, sound management of exchange rate, liberalization of trade barriers, etc. This kind of approach is supportive for my thesis that UN seeks no engagement to a single policy perspective or economic approach, but rather picking up useful aspects from different approaches. The approach of UN that appreciates the benefits obtained through the free market opportunities is open to debate, in the long run. Since, it is widely forecasted that the trade pattern that China have built up with developed economies, and in particular with the United States, is not a sustainable one. This unsustainable pattern, in the extent of using cheap labor force, will provide more export income for a certain period. But when the Chinese households will reach a higher level of disposable income and start to bargain for higher wages, meanwhile increasing their consumption levels, the ongoing economic structure will not be able to survive. In this point, again the technological transformation and investment for efficiency in production factors seems the most appropriate way, with the involvement of state with a gradual development approach. So, this time will there be a new China, i.e. Africa, providing cheap labor force for attracting the international manufacturing, TNCs and financial capital? And will China (and other fast growing developing countries of today) be in the role of developed countries that are investing in the cheap production bases, as of today? Therefore, as derived from the example of China, the general UN's pragmatic approach can face some problems in the near future. The perspective, which uses state involvement in certain areas required, in a limited manner and exerts policies of liberalization in order to reap benefits from trade, can be accepted as appropriate and efficient in the short term. This approach can be legitimized with today's intensive and harsh competition in global economy, but the 2000s have shown that especially within the context of inclusion of the state in developmental perspective, the future policies can be subject to greater changes. In the near future, it will not be wrong to expect that developmental perspectives of UN institutions will be shaped under the urgent matters and necessities of the latest developments in the world economy.

## REFERENCES


Agosin, M. and Tussie, D. (1993). *Trade and growth: New dilemmas in trade policy*. New York: St. Martin's Press.

Aizenmann, J., and Lee, J. (2005). "International Reserves: Precautionary versus Mercantalist Views, Theory and Evidence." *IMF Working Paper No. 05/198*. Washington: International Monetary Fund.

BIS (Bank for International Settlements). (2009, June). *BIS Quarterly Review 2009: International banking and financial market developments*. Basel: BIS.

Boratav, K. (2010). *Emperyalizm, Sosyalizm ve Türkiye*. İstanbul: Yordam.

Cypher, M. J., and Dietz, L. J. (2009). *The Process of Economic Development*. New York: Routledge.

FAO (Food and Agriculture Organization of the United Nations) & UNESCO (United Nations Educational, Scientific and Cultural Organization). (2003). *Education for Rural Development: towards new policy responses.* Rome and Paris: United Nations.

FAO (Food and Agriculture Organization of the United Nations). (2008). *The State of Food and Agriculture 2008.* Rome: United Nations.

---. (2009a). *The State of Food and Agriculture 2009.* Rome: United Nations.

---. (2009b). *The State of Agricultural Commodity Markets 2009*. Rome: United Nations.

Finger, J. M., and Noges, J. (2001). “The unbalanced Uruguay Round outcome: the new areas in future WTO negotiations”. P*olicy Research Working Paper Series No. 2732,* Washington: World Bank.

Fischer, S. (1987, May). “International Macroeconomic Policy Coordination.” *NBER Working Paper No. 2244,* Massachusetts: National Bureau of Economic Research.

Flessbeck, H., Dullien S. and Geiger, M. (2005). “China’s Spectacular Growth Since the mid-1990s: Macroeconomic Conditions and Economic Policy Challenges*”. China in Globalizing World*. New York and Geneva: United Nations Conference on Trade and Development. pp. 1-44.

Friedman, M. (1953). “The case for flexible exchange rates*”. Essays in Positive Economics.* Chicago: University of Chicago Press.

Hein, E. and Truger, A. (2004, August). “Macroeconomic co-ordination as an economic policy concept – opportuntites and obstacles in the EMU”. *WSI Discussion Paper No .125,* Düsseldorf: WSI der Hans-Böckler-Stiftung.

Kaplinksy, R. (2006, June). “Revisiting the Revisited Terms of Trade: Will China make a difference?” *World Development*, *Vol. 34, No. 6*, pp. 981-995.

Mishkin, F. (2004). *The Economics of Money, Banking and Financial Markets*. 7th ed. Boston: Addison-Wesley.

Obstfeld, M. and Rogoff K. (2000, August). “Do we really need a new international monetary compact?”. *NBER Working Paper No. 7864*. Massachusetts: National Bureau of Economic Research.

Olivier N. J., Zyl, C., and Williams, C. (2010). “Rural Development within the Context of Development, Sustainability and Rural Issues – Some Constitutional, Policy and Implementation Perspectives”. *Potchefstroom Electronic Law Journal, Vol. 13(1),* pp. 101-169.

Palley, I. T. (1996). “The Saving and Investment Nexus: Why it Matters and How it Works”. *CEPA Working Paper Series-II. No 1*, New York: Center for Economic Policy Analysis.

Rodrik, D. (2006, January). “What's so special about China's exports?” *NBER Working Paper No. 11947,* Massachusetts: National Bureau of Economic Research.

---. (2001, March). “Trading in Illusions”. *Foreign Policy*, *Vol. 123*, pp. 56-66.

Rubin, J., and Tal, B. (2008). “Will soaring transport costs reverse globalization?” *CIBC World Markets StategEcon*, 27 May 2008.

Seminar on Monetary Cooperation in the Caribbean. *Some Issues in Macroeconomic Policy Coordination.* Jamaica, 18 May 2006.

Sutherland, A. (2004, February). “International Monetary Coordination and Financial Market Integration”. *CEPR Discussion Papers No. 4251*, London: Center for Economic Policy Research.

UN (United Nations). (2008). *Trends in Sustainable Development 2008-2009*. New York: United Nations.

UNCTAD (United Nations Conference on Trade and Development). (2001). *Trade and Development Report 2001*. New York and Geneva: United Nations.

---. (2002). *Trade and Development Report 2002*. New York and Geneva: United Nations.

---. (2004). *Trade and Development Report 2004*. New York and Geneva: United Nations.

---. (2005). *Trade and Development Report 2005*. New York and Geneva: United Nations.

---. (2008). *Trade and Development Report 2008*. New York and Geneva: United Nations.

---. (2009a). *Trade and Development Report 2009*. New York and Geneva: United Nations.

---. (2010a). *Trade and Development Report 2010*. New York and Geneva: United Nations.

---. (1991). *Trade and Development Report 1991*. Geneva: United Nations.

---. (2003a). *Economic Development in Africa: Trade Performance and Commodity Dependence*. New York and Geneva: United Nations.

---. (2010b). *World Investment Report 2010.* New York and Geneva: United Nations.

---. (2009b). *World Investment Report 2010.* New York and Geneva: United Nations.

---. (2006). *World Investment Report 2006.* New York and Geneva: United Nations.

---. (2003b). *World Investment Report 2003.* New York and Geneva: United Nations.

---. (1993). *World Investment Report 1993.* New York: United Nations.

---. (1999). *World Investment Report 1999.* New York and Geneva: United Nations.

UNIDO (United Nations Industrial Development Organization). (2009). *Industrial Development Report 2009.* Vienna: United Nations.

---. (2004). *The Role of Industrial Development in the Achievement of the Millennium Development Goals.* Vienna: United Nations.

Williamson, J., and Mahar, M. (1998). “A Survey of Financial Liberalisation”. *Essays in International Finance No. 211*. Princeton: Princeton University.