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Globalization for development: Opportunities and challenges

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Preface: From Midrand to Accra

1. When the Conference was last convened in the African continent, in Midrand, South Africa, in 1996, it was a time of hope and promise for both South Africa and the developing world. Developing countries were hoping to take full advantage of the fast-accelerating globalization of trade and capital flows, and many had already made efforts to integrate into the international trading system, accompanied by an opening up of their financial sector and capital account, a pillar of their economic reform agenda. Rapid liberalization and increasing exposure to international market forces and competition were expected to boost efficiency and competitiveness, which in turn would underpin a more rapid rate of economic growth and a narrowing of the income gap with developed countries.

2. This widespread optimism was further boosted by the recent completion of the Uruguay Round, which covered key sectors of interest to developing countries, and the establishment of the World Trade Organization (WTO), with its binding dispute settlement system to oversee the rules-based trading system.

3. By the end of the 1990s, however, this faith in the openness agenda had begun to fade after the East Asian financial crisis, which demonstrated the dangers of capital-account opening. The initial euphoria about the potential of the trading system also gave way to a more sober assessment, as it became clearer that the actual outcomes fell short of expectations. It also became apparent that the implementation of the Uruguay Round agreements was imposing often significant costs on developing countries, while many of the promised benefits remained elusive, and some would only accrue after long transition periods.

4. More broadly, there was a growing public recognition that increasing economic integration alone was not addressing development concerns. Despite extensive trade liberalization, many least developed countries had not achieved significant poverty reduction, and some had experienced negative growth. The widespread concern that the benefits of globalization were being reaped at the cost of the poor, environmental degradation and workers' rights found expression in broad protest movements in civil society.

5. The reaction to the disappointing developmental results led to a number of important initiatives. The most prominent among them was the Millennium Summit in 2000, where the leaders of all States Members of the United Nations adopted the Millennium Development Goals, to be achieved by 2015. The subsequent International Conference on Financing for Development, held in Monterrey, Mexico, in March 2002, addressed the question of how to mobilize both national and international finance to achieve development and attain the goals.

6. The shift in priorities was also reflected in the multilateral trading system, when WTO members agreed on another round of trade negotiations in 2001 that included an explicit development agenda. Disenchantment with the development record of trade liberalization also led to calls for greater attention to be paid to the supply constraints and productive capacities of developing countries through the "Aid for Trade" initiative.

7. It is interesting to note that this renewed emphasis on development paradoxically emerged not at a time of economic crisis, but at a time when the world economy was delivering growth to a large number of developing countries. Ever

since the end of the mild recession of the early 2000s, which was due to the bursting of the "dot-com" bubble and the terrorist attacks of 11 September 2001, the world economic environment has been extraordinarily propitious. Indeed, developing economies as a group have performed significantly well in the last five years, achieving on average 5–6 per cent growth. More countries than ever before have been able to benefit from the favourable environment. Even the least developed countries and other African countries, which experienced erratic growth patterns in the past, have been growing at an average annual growth rate of more than 5 per cent, representing significant progress over the late 1990s. However, not all countries or all segments of the population are beneficiaries of this growth, which partly explains the paradox of prosperity and protest. Thus, the old question of growth with equity has resurfaced in a new context, adding urgency to the need to find new ways of sharing the gains from globalization in a more democratic way.

8. Another aspect of this growth experience is that it has been associated with a fundamental change in the pattern of the world economy. Whereas in 1996 the bulk of trade and investment flows were between the developed economies, while the countries of the South were mainly providers of raw materials in exchange for manufactured products, today's picture is strikingly different. A number of large developing countries such as China and India have experienced spectacular growth over the past decade, making them engines of growth for the world economy. Their demand for imports has generated export opportunities for developed and developing countries alike. As a result, the share of South–South trade is increasing in the world economy, making inter-South trade a veritable locomotive of growth. Besides merchandise trade, many developing countries are increasingly exporters of manufactures, skill-intensive services and capital.

9. A "second generation" of globalization is thus emerging. A distinctive characteristic of this phase of globalization is economic multipolarity, in which the South plays a significant role. Today, no negotiation of an international economic agreement is conceivable without the presence of China, India, Brazil and South Africa at the table. The new economic weight of some developing countries creates significant opportunities for the rest of the developing world. It also highlights the need for policy diversity rather than uniformity.

10. However, there is no room for complacency. Despite the economic success of the last five years, vigilance is required for a number of reasons. The current broad-based economic expansion is subject to risks, which should be avoided through careful economic management. One of these risks is related to the continuing build-up of global current-account imbalances. If the unwinding of these imbalances is not orderly, much of the current growth momentum may be lost. Another risk relates to the potential impact of higher energy prices. Furthermore, past experience suggests that much of the improvement in commodity prices could be reversed. It is therefore essential that the current windfall gains be used in the service of continued and sustained growth. There are also emerging signs that the rise of the South is prompting protectionist reactions in developed economies. This goes against the liberalization paradigm that fuelled the current wave of globalization and threatens to harm the propitious environment.

11. A second, and even more compelling, reason for caution is that despite the unprecedented expansion of trade, not everyone is benefiting from globalization. As noted above, certain countries, and certain segments of the population within

countries, are being left out of the current growth bonanza and are often adversely affected by its consequences. The performance of non–oil-exporting developing countries, for example, is significantly worse than that of developing countries as a whole. In addition, many countries, especially the least developed countries and lower- and middle-income developing and transition countries, have not been able to translate growth effectively into poverty reduction and broader human development. Progress towards the Millennium Development Goals in sub-Saharan Africa continues to lag far behind, despite accelerated growth.

12. Moreover, not all promises of globalization have been fulfilled. While the implementation of the Uruguay Round agreements has improved developing countries' access to the markets of developed countries, the reduction in tariff barriers has in recent years been accompanied by an increase in the use of non-tariff measures. The launching of the Heavily Indebted Poor Countries Debt Initiative in 1996 has not yet succeeded in solving external debt problems, and commitments to step up official development assistance have yet to be translated into scaled-up flows.

I. New realities and persistent challenges

A. Significant advances

13. Since early 2000, the overall performance of developing countries and their ability to catch up with the richest countries have improved in an impressive way in several crucial areas. The recovery of the world economy since the end of the dotcom bubble has stimulated growth in nearly all regions and countries. Despite enormous and persistent differences in absolute income, developing countries increased their real income (GDP deflated by consumer prices) by 71 per cent in the decade 1996–2006, compared to 30 per cent in the G-7 countries. Real income in Latin America, despite serious setbacks due to financial crises in Brazil, Argentina and some smaller countries, grew by 39 per cent, Africa by 55 per cent and the economies in transition by 57 per cent. In 2006, five years after the beginning of the global recovery, only two of 132 developing countries recorded falling real income, compared to seven countries in the period 2000–2005 and 13 in the half decade before that. At the same time, volatility of growth has come down to levels normally observed only in highly developed economies.

14. In this favourable external economic climate, most developing economies have seen strong growth in employment or succeeded in stabilizing or slightly reducing unemployment rates. However, measured unemployment in developing countries is much less responsive than unemployment in developed economies to high growth rates. The main reason for this slow response in developing regions and emerging markets (sometimes confounded with jobless growth) may be found in the huge reserves of labour that are stimulated to enter more formal markets only during a sustained period of rising demand for labour and rising wages. As some emerging economies, including China, show, the process of integrating a large number of previously underutilized workers into the officially measured labour force may take many years of high growth rates.

15. The dynamic growth in developing countries has been stimulated by extraordinary export growth. Real exports of developing economies nearly tripled between 1996 and 2006, whereas those from the G-7 only rose by some 75 per cent. In this area, Asia clearly dominated the picture, with transition economies and Latin America coming in second, and Africa showing exactly the same increase as the G-7. In terms of imports, the expansion in different regions was much closer. Asia was the strongest importer, with a 170 per cent increase, while the transition economies had a 150 per cent increase. Africa’s outcome was quite balanced, with real imports increasing almost as much as exports. Since 1995, world merchandise trade has been growing at an annual average rate of 7.5 per cent, sustaining the strong growth rates that emerged in the early 1990s, though still not matching the averages of more than 10 per cent witnessed through the 1960s and 1970s. Overall, the share of developing countries in global trade increased from 29 per cent in 1996 to 34 per cent in 2006.

16. A related development has been the sustained rise in South–South exchanges. For example, South–South merchandise trade is estimated to have expanded from $577 billion in 1995 to $1.7 trillion in 2005. This resulted in a concomitant increase in the South–South share of world merchandise exports to 15 per cent in 2005, compared to 11 per cent in 1995. During the last two decades, the shares of a number of emerging economies in international merchandise and services trade have

grown considerably. Seven countries in particular have contributed immensely to this trend: Brazil, India, China, Mexico, the Russian Federation, South Africa and the Republic of Korea. The share of merchandise exports of these countries in global exports increased from 10.6 per cent in 1995 to 17.2 per cent in 2005. This robust trade performance contributed to a high economic growth rate in these emerging economies, with annual real GDP growth of 5.7 per cent.

17. As a consequence of this favourable trade performance, the overall current accounts of developing countries have swung to a surplus for the first time since the end of the Bretton Woods monetary system at the beginning of the 1970s, while those of developed economies are in deficit, mainly due to the huge deficit of the United States. The swing can be observed in the three big regional groups and, even more surprisingly, in most of the bigger regional subgroups. In 2005, sub-Saharan Africa – if South Africa, with a deficit of 6 per cent, is excluded – recorded a current account surplus of more than 6 per cent of GDP on a clearly rising trend. In South America, a deficit of 2.5 per cent in 1995 turned into a surplus of 3 per cent by 2005; excluding Brazil, it amounted to 4.5 per cent of GDP. The only exception is the group of transition economies in Eastern Europe, if the oil producers of the region are not included.

18. There is a close correlation between the improvement of overall economic performance and the reduction of current account deficits and emerging surplus regimes in the globalized economy in the wake of financial crises. This shows that huge price effects on both the export and import sides brought about the turnaround in the balance of payments and at the same time stimulated growth. However, there are two different classes of such stimulants.

19. The first can be observed in many cases of middle-income countries such Argentina or Brazil. Both countries anchored their currencies to the United States dollar at the beginning of the 1990s to bring down inflation. This strategy implied a real appreciation of their currencies and a loss of competitiveness over time because the nominal exchange rate was absolutely stable (Argentina) or depreciated less than needed to compensate for inflation differentials (Brazil). In both cases, the current accounts went into deficit. Only after a painful financial crisis and a sharp currency devaluation did they swing into surplus. In both countries (as in other cases in Europe and elsewhere) devaluation was at first a way out of the crisis, but proved to be beneficial in terms of export performance and import compression in manufacturing for a much longer time. In other words, the overall competitiveness of a number of developing countries increased dramatically, owing to forced currency devaluation after the crisis.

20. However, many other countries have lost part of the gains of competitiveness of that period due to renewed appreciation of their currencies. In particular, this is the case in some countries in Asia such as the Republic of Korea, Thailand and Indonesia, and in the biggest country in Latin America, Brazil, where speculation-driven appreciation of the currency has resulted in a deterioration of post-crisis advantages in competitiveness. In Eastern Europe and in the transition countries in general, the global position in trade has worsened due to rapid wage growth and overvalued currencies, which are reflected in huge current account deficits of the non-oil producers in that region.

21. The second class of stimulants to developing economies' current accounts in the last decade clearly relates to commodity price hikes and the concomitant

improvement in terms of trade of commodity-producing countries. Again, it was due to an external shock that the prices of commodities increased relative to manufactured goods; given the low elasticity of demand for these products, the revenues of the producers reached all-time highs, improving their external balances.

22. Investment in particular has been positively affected by the favourable environment since the turn of the century. Whilst real investment in the G-7 countries has remained rather flat (and investment–GDP ratios have declined), developing economies were able to trigger an investment boom (in absolute terms and relative to aggregate demand) once the financial crises were overcome. In fact, the most dynamic region in terms of investment was Africa, outpacing even Asia with a doubling of fixed investment since 2000. Given the fact that Asia received a much higher share of foreign direct investment, domestic investment growth in Africa is truly remarkable, despite the rather low level of its investment ratio compared to that of Asia.

23. Most countries also managed to trigger stable expansion of domestic demand. Real private consumption increased steadily in the last half of the 1990s and has accelerated remarkably since. As employment did not grow much over this period, the growth in consumption is more associated with growth of real incomes of private households. Since 2003, the growth rate of real private consumption in all regions has been strong, with Asia the most dynamic.

B. Apprehension

24. Global trade and financial integration have reached unprecedented depth, involving a continuously growing number of economies, goods, services and financial instruments. Nearly all countries are facing the challenges of globally open markets and the greater power of global players on these markets. In Asia, new driver nations of this global economy have emerged which are bigger and more dynamic than their predecessors in the 1970s and 1980s. This has spread uncertainty and apprehension.

25. Paradoxically, globalization fears are common in rich and poor countries alike, though for very different reasons. Exports from dynamic Asian economies such as China and India penetrating the world market for certain consumer goods are taken as proof of the dangers that the new global drivers portend, even if the successful firms exporting from these emerging economies are owned by internationally-versatile companies from developed countries. This apprehension is intensified by the increasing offshoring of information technology-driven services to some developing countries and the export of high-technology plants to low-wage locations. The 1.5 billion workers in the emerging economies with small endowments of capital are viewed by some economists and influential politicians in the developed countries as an addition to the existing work force in their economies. This is often simplistically interpreted to imply that the global supply of labour has increased by 50 per cent, which in turn means that, in the last decade, the global capital–labour ratio has halved, thereby creating a new abundance of labour (in particular low-skilled labour), pushing down wages, raising profits and creating upward pressure on interest rates because of the relative scarcity of capital. Hence, a dramatic shift of market power and income to the owners of capital occurs. As a result, the notion of "competitiveness of nations" has acquired a new connotation and greater influence in developed countries, and has even made its mark in

international negotiations, including those in the World Trade Organization (WTO). It has created a fundamentally wary attitude towards countries with low wages, and has led to demands for higher social and environmental standards for developing countries.

26. For developing countries, the apprehension arises from the slow realization of the gains from trade and liberalization, and the uncertainties and lack of national autonomy associated with fast-moving global markets that are very much driven and steered by the major economies. Lack of diversification of export structures, reliance on foreign direct investment, technological dependence and the slow pace of the process of catching up and reducing absolute poverty are taken as grounds to question the mutual benefits promised by the open market reform agenda. In addition, the integration of the developing countries into the global division of labour during the last decade has not been as smooth as many expected. Financial crises have undermined many promising development programmes and led to traumatic experiences and dependence on international capital markets and major donors. In part due to these concerns, in recent years the imperative of regaining control and widening the scope of national policies has preoccupied the developing countries' international development agenda.

27. On closer examination, the reality of the impact of globalization lies somewhere between the divergent fears and points of view presented above. The fears of developed economies about low-wage labour in the emerging South are clearly overstated. Internationally, the mobility of labour is extremely low and the mobility of fixed capital, which should not be confused with short-term financial flows, is rather limited. Consequently, the equalization of factor prices and of labour in particular does not happen overnight. Indeed, from the perspective of many populous developing countries, this is still seen as a frustratingly slow process. The structural change induced by this rather smooth integration has neither impeded growth in the developed world nor forced the kind of shocks that accompanied the rise in unemployment in the industrialized world in the 1970s and 1980s. By contrast, as labour productivity in emerging economies has improved and their domestic income and consumption expanded, demand for products from the rest of the world has increased.

28. Furthermore, the positive effects stemming from the Asian growth dynamics and spilling over into other regions of the world economy need to be given due consideration. The boom in commodity demand and the rise in commodity prices have offered long-missed opportunities for many commodity producers in the developing world, and have led to significant and prolonged improvement in the terms of trade of these countries. Even Africa as a whole looks back to a half decade of growth rates beyond 5 per cent annually, notwithstanding the adverse external environment for some non-commodity-producing countries. Most importantly, despite externalities such as climate change, it is neither coincidental nor necessarily a transient phenomenon that the performance of the world economy since 2000 has been stronger than at any time in the 30 preceding years. All around the world, growth rates have accelerated and proved to be rather stable over a relatively extended period.

C. Persistent challenges

29. Despite the impressive performance of developing countries as a whole in recent years, many countries, in particular the least developed and other low-income economies, have not been lifted by the recovery, and continue to rely on exports of low value added primary commodities. These countries have suffered from worsening terms of trade, highly volatile world prices and a decline in their share in world trade. The export share of the 50 least developed countries (LDCs), the majority of which are in sub-Saharan Africa and commodity-dependent, fell from 2.5 per cent in 1960 to about 0.5 per cent in 1995, and have since hovered around this level, though the improvement in commodity prices helped raise their share to 0.8 per cent in 2006.

30. There is strong evidence that high rates of economic growth have not been translating effectively into poverty reduction in many cases. This is partly related to the fact that agricultural productivity is very low and, with rising populations, average farm sizes are getting smaller, thereby creating a situation where it is difficult to make a reasonable living from the land. More and more people are seeking work outside agriculture. But most LDC economies are simply not able to generate productive employment opportunities for these people. In four fifths of them, non-agricultural labour productivity in the new millennium was lower than it had been 20 years earlier, and agricultural labour productivity actually declined in one third of them.

31. There is also increasing differentiation amongst developing countries within each region of the world, including the LDCs. This trend has been particularly apparent since 1980, but it has intensified recently. Estimates suggest that, in 1980, 64 per cent of international income inequality amongst developing countries (excluding China) could be explained by differences between regions, and 36 per cent by differences within regions. But by 2001 those proportions had almost totally reversed, so that 62 per cent of international income inequality amongst developing countries (excluding China) was explained by differences within regions and 38 per cent by differences between regions.

32. These estimates reflect the fact that some countries within each region are doing well whilst others have very sluggish growth. In Latin America, for example, recent estimates of changes in the incidence of poverty between 1999 and 2005 show that poverty was clearly falling in six countries (Chile, Colombia, Ecuador, Honduras, Mexico and the Bolivarian Republic of Venezuela), whilst it was clearly increasing in five others (Argentina, Bolivia, El Salvador, Panama and Uruguay). In four other countries for which data are available, there was little change.

33. The challenge for policymakers is how to promote inclusive development and preserve the main features of the current favourable scenario beyond a cyclical backlash. This requires a new approach to global economic governance as well as a new focus for national policies. The prevailing consensus, putting liberalized markets and flexible prices at centre stage, has proved to be insufficient in the light of the complex challenges that the new generation of globalization poses. A concrete vision of the global partnership for development has to emerge based on the new realities, which call for a more equitable and effective balance between open global markets, the sovereignty of the nation-State, and the rule of law and related international regulations.

34. More broadly, it should be acknowledged that conventional economic wisdom may not have all the answers to the challenges that many poor people face in a globalizing world. Experience shows that policy advice for integration has resulted in some communities being exposed to hitherto unknown risks, making them vulnerable to even the slightest external shocks. Ten years ago, many Asian countries learnt to their cost the dangers of excessive reliance on debt finance, both foreign and domestic. In Thailand, the response to the crisis relied to a large extent on the "Sufficiency Economy" philosophy that the King of Thailand developed over many years. Sufficiency Economy is not a policy prescription, but a philosophy that incorporates universal values of relevance to day-to-day economic and human relations. It emphasizes responsible consumption: living within one's means; moderation; sustainable use of resources, especially in agricultural production; nurturing the development of small and medium-sized enterprises; and building capacity through development from within. It is worth exploring whether these principles could be applied in other developing countries to help them build up resilience to the shocks of globalization and formulate people-centred development.

D. The capital flows paradox

35. For a number of years now, global capital flows have reversed as current accounts swung around and developing countries became net exporters of capital and developed countries net importers. For the first time in decades, developing countries as a group have attained a rare moment of independence from international capital markets. Capital surplus could be used to lower interest rates through national monetary policy measures and has further stimulated domestic investment. It has also opened up new opportunities for current and future "emerging" economies for proactive policy management of inward and outward financial flows (official and private), domestic resources and appropriate fiscal and monetary policies.

36. Most orthodox development theory would consider such net export of capital from poorer countries as a constraint on domestic investment. Yet the realities of rising domestic investment in capital-exporting developing countries cannot be denied. Exports of capital from poor developing countries – supposedly endowed with little capital – to the rich North – supposedly endowed with plenty of capital – have not constrained these countries' ability to invest larger sums in fixed capital at home than any time in the last 30 years, a fact that poses a new challenge for orthodox development theory. It implies a need for a rethinking of the most crucial assumptions about how developing countries can best manage the functional relation between savings, investment, capital flows (including both foreign direct investment (FDI) and official development assistance) and the alternate policies, and paths that such policy diversity offers for catching up.

37. The belief, held in many development circles over many years, that poorer countries have a chronic "savings gap", due to the inability of their private households to save, and can rely only on permanent net inflows of capital to catch up, needs to be re-examined in the light of the recent performance of a large number of emerging economies in all regions. The apparent paradox behind this performance and the wider policy space it implies has been driven mainly by several powerful developing economies with market access (in Asia, Latin America and Eastern Europe), and appears both sustainable and relevant to other emerging

economies. However, its wider significance for very poor and other lower- and middle-income countries remains to be seen.

38. Nevertheless, the implications of these new developments for development policy and the future of the open global market are remarkable and point to a new meaning of interdependence during this latest phase of globalization. If developing countries are able to create (and export) capital, this should allay growing apprehensions in developed countries about the impact on their economies of offshoring and capital scarcity in developing countries. It is these latter factors that are often considered to be exerting downward pressure on wages in developed economies. In fact, with reverse capital flows, this may not be the case.

39. Developing countries such as China and India are on a similar path to that pursued by countries such as Japan and the Republic of Korea when they were developing 30 years ago: catching up by applying high technology in a low-wage environment, thereby lowering unit labour costs. The leapfrogging of stages of the usual domestic technological evolution and the improvement of overall competitiveness by realizing temporary monopoly rents are made possible through this combination of high productivity with low wages. This model has come into full swing since the crisis-driven devaluation corrected the exchange rate misalignments of the 1990s. This policy mix has proved its feasibility and relevance to the realities that labour-and-capital-surplus emerging economies need to tackle on the long march to development without actually aggravating global imbalances or welfare in the North.

40. For example, in a globalized world in which the horizons of Governments and companies are fast expanding, it is increasingly recognized that countries may use both inward and outward FDI to upgrade the competitiveness of their indigenous resources and capabilities. In both cases, foreign assets (resources, capabilities, access to markets, patents, trademarks, entrepreneurial skills and institutions) are acquired. This facilitates structural change, thereby promoting dynamic comparative advantage and enhancing a country’s development potential. Increasingly, developing countries engage in a combination of inward and outward FDI. Of course, some developing countries might be in a more favourable position to exploit or gain new assets via outward FDI, while others might better advance their competitive/comparative advantage by encouraging inward FDI, so the balance varies considerably between countries. For example, over the course of the last two decades, China has moved from heavy reliance on inward FDI to a relatively greater utilization of outward FDI.

41. It is also noted, however, that the share of FDI in this process in China in particular is higher than it was in Japan and the Republic of Korea in the past. However, the fact that increasing numbers of developing countries, despite higher inflows of FDI, are net exporters of capital raises the question as to whether it is the scale of foreign capital import as such that is critical or, more significantly, the import of know-how that comes with capital. Whether the owner of the plant in a developing country is a domestic or a foreign investor is a question of secondary importance in capital-surplus countries. In other words, if integrated within a comprehensive set of development policies, the impact of today’s offshoring need not be different from the impact of former catching-up processes, namely those driven by imitation and the import of technology. The economic consequences are more or less the same for developing and developed economies. Clearly, the

development effects of FDI for the host economy depend on a range of factors, including the amount of technological spillovers from affiliates to domestic enterprises, the creation of forward and backward linkages within the economy, and the impact on domestic investment.

42. There can be no doubt that the pace of development in the big emerging economies can contribute to an acceleration of structural change in many countries, developing and developed alike. For developed economies, the Japanese challenge of the 1960s or the challenge by the "small tigers" of the 1980s is replaced by the Chinese or Indian challenge today, though on a scale not witnessed in previous epochs. As in earlier times, certain sectors or groups of low-skilled workers are endangered by low-wage competitors abroad employing sophisticated machinery. In many countries, it is feared that the pace of structural change could overstretch the ability of employers and employees to adjust. Unemployment and low growth would follow.

43. However, there is no evidence that this process has endangered the social safety net or the growth performance of developed countries in general in the last 10 years. The opposite seems to be closer to truth. The fact that those developed countries with large deficits in their current accounts, such as the United States or the United Kingdom, do much better in terms of growth and job creation than the big surplus countries, such as Japan and Germany, clearly points to other factors explaining the latter group's dismal performance.

E. From "getting prices right" to "getting development right"

44. During the 1980s and 1990s, most developing countries undertook far-reaching market-oriented reforms. The international financial institutions played a dominant role in this context, both as lenders, imposing their policy conditionality on borrowing countries, and as setters of the international development agenda. The market-oriented reform agenda was based on the expectation that capital accumulation, technological progress and structural change would result from more efficient resource allocation following improvements in the incentive structure and reduced State intervention. "Getting the prices right" was the catchword for this agenda.

45. However, from the very beginning, the orthodox reform agenda, which came to be known as the "Washington Consensus", stood in stark contrast to the successful catching-up of a number of East Asian economies that had based their development strategies on capital accumulation, supported by pragmatic and proactive industrial policies combined with more measured and often strategic integration into international markets and proactive macroeconomic policies.

46. This strategy seemed to falter when, in the second half of the 1990s, some of these countries experienced a dramatic, albeit short-lived, downturn in their economic growth performance. But, as shown by UNCTAD at the time, the financial crisis resulted to a large degree from premature capital-account liberalization, which made their economies vulnerable to the vagaries of international capital markets. Other countries in the region, which had maintained prudent integration and proactive policy strategies, experienced buoyant economic performance. With the global recovery under way after 2000, even the crisis-stricken economies returned to a steep growth path.

47. Against the backdrop of recurrent crises of the global economic system, the formulation of the Millennium Development Goals in 2000 reflected a certain dissatisfaction among global policymakers with progress in development and in the fight against poverty under the conditions that had prevailed over the previous two decades. In 2002, the Monterrey Consensus recognized, among other things, the challenge facing developing countries in creating the necessary internal conditions for adequate levels of productive investment and ensuring complementary public investment in the development of local capacities – aspects that had been largely neglected in earlier reform programmes. At the same time, policymakers in many developing countries began to reconsider their development strategies, guided by the successful industrialization strategies of a range of East Asian economies, as well as the earlier experience of the now-developed countries. All of this testified to the growing uncertainly about the commitment to the orthodox reform agenda and reflected a common finding: proactive macro, trade and industrial policies are needed for successful integration and for sustained improvements in the standards of living and incomes of all population groups.

48. Historical evidence shows that countries raise the living standards of their populations by raising labour productivity. This is associated with a substantial change in the sectoral pattern of production and employment, from agricultural to industrial products, and a shift from labour-intensive activities to a growing range of capital- and technology-intensive activities. Transformation of the production structure requires entrepreneurs who are capable and willing to invest in activities that are new to the domestic economy. Schumpeter long ago pointed to the importance of innovative investment for economic development, and it has recently been argued that innovation and the consequent rise in productivity account for much of the extraordinary growth in various parts of the world since the industrial revolution.

49. Investment plays a key role because it simultaneously generates income, expands productive capacity and carries strong complementarities with other factors in the growth process, such as technological progress, skills acquisition and institutional deepening. However, the occurrence of innovative investment is not automatic; it can encounter structural and institutional impediments. Moreover, the macroeconomic environment can be inappropriate for encouraging and supporting investors seeking to create or expand productive capacity and increase productivity.

50. Thus, the key to the development process is creating the necessary conditions for innovative investment. The most important condition is that firms have access to reliable, adequate and cost-effective sources for financing their investments. This is least costly when profits are the main source of investment financing. Indeed, if an investment-profit nexus can be ignited, profits from innovative investments simultaneously increase the incentive for firms to invest and their capacity to finance new investments.

51. On the other hand, when enterprises are heavily dependent on borrowing to meet their needs for fixed investment and working capital, as is the case for new enterprises, the stance of domestic monetary policy is of crucial importance, because high levels of nominal and real interest rates tend to increase production and opportunity costs. An overly restrictive monetary policy may bias investment decisions in favour of financial assets or in favour of fixed investment in production activities with known costs and demand schedules. Hence, a wide range of

conditions must come together for firms that are competitive domestically to become successful exporters in the global markets.

52. The linkages between investment, productivity growth, successful integration into the international trading and financial systems and economic development have been seen in recent years through the lens of international competitiveness. A wide range of criteria and measures of competitiveness of countries have been elaborated, some of which have been extensively publicized as global rankings of nations. Indeed, the concept of competitiveness can contribute to a better understanding of the distribution of wealth in a globalized economy if it relates to both national income and international trade performance, particularly the performance of industrial sectors that are important in terms of employment or productivity growth. In this context, competitiveness is achieved as part of a Schumpeterian logic of capitalist development being a sequence of innovative investments associated with dynamic imperfect competition and productivity gains. Such an understanding assigns a major role to economic policy in facilitating productivity-increasing investment and providing the institutional arrangements for a high degree of competitiveness.

53. New technology in the form of added capital per worker (or embodied technological change) is said to be at the heart of the development process through which nations become rich. And embodied technological change is driven by investment based on either innovation of domestic entrepreneurs or putting imported capital equipment to efficient use. Thus, the concept of competitiveness in the context of economic development needs to take account of the interdependence of investment, trade, finance and technology. The key question is how different price, wage, exchange rate and trade arrangements influence innovative investment, and whether productivity gains of individual firms translate into benefits for the overall economy. These benefits can be reflected in rising living standards while maintaining external balances, or into unchanged living standards and rising market shares while maintaining external surpluses.

54. Competitiveness in international markets is determined by both real and monetary factors. It may increase as a result of the relatively strong productivity performance of companies or of the national economy as a whole that is not reflected in higher wage rates. But greater competitiveness can also result from a depreciation of a country’s real effective exchange rate following either a depreciation of its nominal effective exchange rate or a smaller rise in wages compared to productivity growth (i.e. falling unit labour cost growth) than in other countries.

55. It should be noted, however, that the policy concept of competitiveness as outlined above is mainly relevant for middle-income countries, where economic success depends on investment that leads to sustained improvements in productivity. It is less relevant today for many of the poorest countries, where capital accumulation can help raise per capita income and living standards simply by allowing a fuller use of underutilized labour and natural resources without altering the efficiency with which resources are utilized.

II. Coherence in global policymaking: Multilateralism at a crossroads

A. Systemic imbalances in global finance and a new mercantilism

56. Companies gaining market shares at the expense of other companies are an essential ingredient of the market system, but the idea of nations gaining at the expense of other nations is much more problematic. All countries can simultaneously raise productivity and wages and the level of trade to improve their overall economic welfare, but they cannot all together increase their market share or their current account surpluses.

57. It is thus worrisome that many important players in the global economy are engaging in a race to the bottom in an attempt to gain market shares. Until now, the international community has not been able to agree on rules that could prevent "economic battles of nations", despite the fact that they are counterproductive in the long term.

58. This has brought into focus a phenomenon that could be termed the "new mercantilism". It is not only wages and social contributions that are under downward pressure to improve the "international competitiveness" of a country. Many Governments in Europe, for example, have been reducing corporate taxation and have granted generous subsidies to companies in an attempt to attract them. In the same way as a regional entity such as the European Union or a global sectoral institution such as WTO has tried to prevent this kind of unbridled competition that is attractive for the single player but cannot be successful for the area as a whole, the world has to find ways to limit such unproductive competition of nations.

59. The extraordinary deficit in the current account of the United States (more than $850 billion in 2006) and the surplus of several developed countries and China testify to the unsettled state of the global integration process. This situation is leading to increasing political pressure within the United States Congress to act unilaterally to protect the country from becoming swamped by imported goods. Paradoxically, despite much tension and negotiations, no decisive action plan has been launched to reduce the imbalances in the medium or long term. Diverse attempts to alter the course of currency markets ended in some changes in the real exchange rates of the countries involved, but most of these changes did not lead to the expected outcome.

60. Most of the financial crises in the post-Bretton Woods era of floating exchange rates have been characterized by nominal interest rate differentials and the resulting portfolio investment. As a rule, the quantity of inflows is big enough to increase the short-term attractiveness of the high-inflation country's currency, resulting in appreciation, which further raises the return on investment.

61. In what is a clear systemic failure, a revaluation of the currency of the higher-inflation country fundamentally undermines the normal functioning of the "exchange rate mechanism" in the short term. The high-inflation country's higher prices on the world market are not offset by a nominal depreciation, and the appreciation adds to the loss of competitiveness of that country and worsens the current account situation rapidly.

62. If exchange rates do not follow the purchasing power rule in the short term and destabilize the external accounts, the introduction of this rule as a political target is

the only way out. The presence of carry trade brings into question the widespread acceptance of floating as the only feasible solution to the problem of the external balance. Thus, the pressure on China to float its currency may actually end up with unexpected results. As China's interest rates are still rather low the renmimbi could be carried to high-interest-rate locations, and it would then depreciate and further increase China's competitiveness.. Such an outcome would accentuate global imbalances.

B. The case for a multilateral effort in global finance

63. For small open economies, and developing countries in particular, a stable and prospering external sector is of enormous importance. That is why the exchange rate is the single most influential price in these economies, as it dominates overall competitiveness and has a strong impact on the national price level. To avoid the fight for market shares through manipulation of the exchange rate, wage rates, taxes or subsidies, and to prevent the financial markets from driving the competitive positions of nations in the wrong direction, a new "code of conduct" is needed regarding the overall competitiveness of nations.

64. Such a code of conduct, reflecting a new spirit of multilateralism in global economic governance, would have to balance the advantages of one country against the disadvantages of other directly or indirectly affected countries. For example, changes in the nominal exchange rate deviating from the fundamentals (inflation differentials) affect international trade in exactly the same way as changes in tariffs and export bounties do. Consequently, such real exchange rate changes have to be subject to multilateral oversight and negotiations. The reasons for the deviation from the fundamentals and the necessary dimension of the deviation have to be identified by an international institution and have to be enforced by a multilateral decision-making body. Only if such rules apply can all trading parties avoid unjustified overall losses or gains of competitiveness and developing countries systematically avoid the trap of overvaluation that has been one of the most important impediments to prosperity in the past.

65. The exchange rate of any country is, by definition, a multilateral phenomenon, and any rate change in open economies produces externalities and multilateral repercussions. That is why the idea of a cooperative global monetary system is as compelling as the idea of a multilateral trading system. In the same way as intended by multilateral trade rules, a well-designed global financial system has to create equal conditions for all parties involved and help to avoid unfair competition. Avoiding competitive depreciations and other monetary distortions that have negative effects on the functioning of the international trading system is more important in today's highly interdependent world than at any other time in history.

66. With respect to their external financing needs, developing countries can be divided into two groups: low-income countries (and some lower-middle-income countries) with limited or no financial market access, and middle-income countries with market access (often referred to as emerging market countries). These two groups of countries face different challenges. Most of the external finance that flows to the first group consists of concessional loans, grants and official development assistance (ODA). The main challenge for these countries is to mobilize adequate financing to sustain development and poverty-reduction programmes. The second group of countries, however, can issue sovereign bonds in the international markets,

and many can increasingly resort to their own developing domestic financial markets. In this case, the main challenge is to either reduce the high volatility that characterizes private capital flows to these countries or implement policies aimed at reducing the costs of this high volatility. For both groups to obtain the financing, they need to sustain growth or prevent erosion of recent achievements. Multilateral cooperation is more necessary than ever, be it for moral, political or financial coherence imperatives.

C. Sustainable financing for sustained development

67. The second half of the 1990s was characterized by declining ODA, but this situation was reversed in 2002, and by 2005 ODA from donors from the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) had risen to $82 billion (0.33 per cent of gross national income (GNI) of developed countries). Despite this recent trend, which was spurred by debt relief and other exceptional flows, the current and projected levels of ODA still fall short of the G-8 pledge to double aid to Africa by 2010, and donor countries as a group are still committing less than the agreed target of 0.7 per cent of GNI to aid. Notwithstanding the inconclusive evidence and arguments presented by aid sceptics as to the necessity and impact of ODA, for many least developed and low-income countries, ODA remains the only source of financing for a range of developmental and poverty-reduction policies and programmes.

68. Aid allocation, however, continues to be characterized by selectivity and instability. The top 20 aid recipients received more than half of net bilateral ODA, and less than 50 per cent of aid recipients received 90 per cent of all aid, with many poor low-income countries receiving very little assistance. A large part of the recent increase in aid was due to debt relief under the Heavily Indebted Poor Country (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI). Debt forgiveness represented 5 per cent of overall ODA flows in 1990, whereas in 2006 they stood at 30 per cent. A key component of the HIPC initiative upon establishment in 1996 was the notion of additionality. However, ODA less debt forgiveness declined from the start of the initiative to its lowest level in 1997, and only since 2003 has nominal ODA less debt forgiveness risen above the 1995 value to levels comparable to those in the early 1990s.

69. The fact that several developing countries have become lenders in the international capital markets reflects deeper inconsistencies in the current structure of the international financial architecture. Many middle-income and developing countries maintain undervalued exchange rates and accumulate international reserves because they want to be able to face potential crises without requiring support from or having to comply with policy conditionality by the international financial institutions. Hence, the mandates and the functionality of these institutions are subject to sustained scrutiny, as they risk marginalization, since major developing countries are making do without them, either by self-insuring or by proposing alternative institutions.

70. Reforming existing institutions in line with new realities and building consensus on crisis prevention mechanisms (such as debt sustainability analysis) and crisis resolution mechanisms (such as debt restructuring) could help in improving the efficiency and universal credibility of the international financial

system. Donors can play a major role in helping developing countries improve their debt management capabilities and also their capacity to record and disseminate information on the structure of total public debt.

71. Over the last few years, the IMF has developed the debt sustainability framework (DSF) for middle-income market-access countries and the IMF and World Bank have jointly developed a DSF for low-income countries. While the main objective of the DSF for market-access countries is to examine vulnerabilities and devise policies aimed at reducing the probability of a debt crisis, the DSF for low-income countries is also aimed at guiding IDA grant-allocation decisions. Although the increasing importance of domestic borrowing is often recognized, most debt sustainability analyses concentrate on external debt. An aggregate debt ratio where "riskier" types of debt have a higher weight than safer types would be superior to the current practice. Better information on debt structure and more research on vulnerabilities arising from different types of debt could help in designing such an indicator. This would in turn improve debt management and reduce the probability of debt crises through better tracking of debt risks.

72. The most important issue with the DSF for low-income countries has to do with its use of debt thresholds aimed at measuring a country's risk of debt distress and determining eligibility for IDA grants. According to the Framework, debt sustainability is driven by a combination of the country's debt ratios and the quality of its policies (as measured by the Country Policy and Institutional Assessment index, CPIA). Several concerns remain with respect to the use of the CPIA index. The thresholds are calculated by using an econometric exercise that may lead to sub-optimal outcomes, as the borrowing capacity of those at the top of each CPIA category may be underestimated and those at the bottom may be overestimated. The concept of good governance and institutions is inherently subjective and, since the World Bank is also making recommendations on issues of governance, the index may reflect how well countries are implementing that advice. Another concern pertains to the accuracy of the measure and the consistency with which it is measured across countries, and it may not offer the proper incentives and rewards for low performers and fragile states.

73. Furthermore, the DSF is based on the primacy of debt servicing and does not explicitly include an evaluation of needs in respect of reaching the MDGs. As stated in the United Nations Secretary-General's follow-up Report to the Millennium Summit: "… we should redefine debt sustainability as the level of debt that allows a country to achieve the MDGs and reach 2015 without an increase in debt ratios." Other considerations have also been cited, for example by the United Nations Commission on Human Rights, which is drafting guidelines for external debt relief to ensure that the need to service foreign debt does not undermine obligations for realization of fundamental economic, social and cultural rights. Meanwhile, the growing legal and political interest in concepts such as odious debt and responsible lending adds yet another dimension to the concept of debt sustainability and its applicability as currently defined.

74. Another important trend in development finance relates to the increasing importance of corporate versus sovereign borrowing. In 1996, only 20 per cent of long-term external debt was owed by private borrowers. In 2006 that share had doubled to 41 per cent. The increase in corporate borrowing has been especially important in Eastern Europe and Central Asia. In 2006, firms from this region

contracted new debt for $135 billion and they accounted for 40 per cent of total corporate debt of developing countries, up from an average of 19 per cent over the period 1996-2003. East Europe and Central Asia is the region with the highest external debt ratio and accounts for over a third of the global debt stock of developing and transition economies. Of long-term debt ($743 billion), 89 per cent was owed to private creditors and 63 per cent was held by private borrowers.

75. The accumulation of foreign exchange reserves (reaching $522 billion in 2006) has put the countries in the region in a relatively safe position in case of future financial or debt stress. Nevertheless, by relying more on the international markets, corporate borrowers may have increased their exposure to interest rate and currency risk, and this exposure raises several policy challenges. The most important among these is to assess the public sector's contingent liabilities arising from private sector borrowing. Governments need to pay particular attention to the rapid increase in foreign currency borrowing by domestic banks. Although there are no indications that the banking sector as a whole has over-borrowed in recent years, some banks in Eastern European and Central Asian countries have borrowed heavily in international capital markets and on-lent those funds in the domestic market. This could lead to currency mismatches either in the banks or in the ultimate borrowers' balance sheets and thus increase financial fragility.

76. The international community will come together in Doha in 2008 to review the implementation of the range of commitments made in the areas of finance, trade and investment in the Monterrey Consensus. This should result in greater attention to the important interplay between external debt and other, new elements of strengthened financial policy space for developing countries. A major objective of an international financial architecture better adapted to the realities of the new century should be the development of safer debt instruments (such as GDP-indexed and commodity-indexed bonds). Multilateral institutions could play a role through policy advice and by promoting the coordinated issuance of such instruments by a number of countries to provide benchmarking. Multilateral development banks could issue loans with repayment schedules linked to GDP growth as a way of promoting the idea of indexing debt payments to economic performance. The structure of the new financial architecture should focus on crisis prevention but should not rule out that even an improved system would not be crisis-free and hence should also include mechanisms for crisis resolution along the lines of the now defunct proposal for a sovereign default restructuring mechanism.

D. Redressing asymmetries in the multilateral trading system

1. Doha at the crossroads

77. At a multilateral level, the Doha Round of WTO trade negotiations launched in November 2001 was intended to offer an opportunity to mainstream development into the multilateral trading system and to correct existing imbalances in the trading regime. A development-oriented outcome is imperative for realizing Millennium Development Goal 8 of "an open, equitable, rule-based, predictable and non-discriminatory" multilateral trading system. Today, however, the system stands at a crossroads.

78. Following the Sixth WTO Ministerial Conference in December 2005 in Hong Kong, China, the Doha Round has entered its most crucial phase. There is an urgent

need to find solutions on key issues, namely agricultural market access, domestic support in agriculture, industrial tariffs and services. Ambitious structural adjustment in agricultural policy is important to enable a balanced and development-focused outcome. It remains imperative that substantial development content with additional commercial opportunities for developing countries be included on a contractual basis in the final outcome of the Doha Round. Five key elements of a development package must be delivered to ensure the credibility of the system:

(a) Firstly, the Doha Round must result in significantly enhanced and additional real market access and entry for developing countries' exports of manufactured goods, commodities and services in their major markets so as to enable them to grow and prosper. This implies tariff elimination, removal of tariff escalation and peaks, and providing access in services sectors engaged in by developing countries, especially in modes 4 and 1, and addressing non tariff barriers. The provision of duty-free and quota-free treatment to all LDCs for all their products on a lasting basis, as agreed at the Sixth WTO Ministerial Conference, and which remains to be implemented fully, is symbolic of this emphasis;

(b) Secondly, the Doha Round should bring about improvements in multilateral rules that address and remove existing asymmetries and enhance the fairness and equity of the multilateral trading system. Substantially reducing and removing trade-distorting agricultural subsidies is indispensable for levelling the playing field for fair competition in agricultural trade. An appropriate pacing and sequencing of market opening, as well as institutional and regulatory reform, are also important, particularly on services, accompanied by flanking policies and support for building domestic supply capacity;

(c) Thirdly, the development dimension signifies an adequate and sufficient degree of policy autonomy for economic governance that would allow countries to effectively manage and regulate their domestic economic policies in the light of national development and public policy objectives, within the multilateral framework of rights and obligations under WTO. This translates into such measures as more operational special and differential treatment and less than full reciprocity; preserving tariff revenue; promoting domestic nascent industries and pre-empting de-industrialization; preserving long-standing trade preferences; safeguarding food security, livelihood security and rural development; providing for use of policies and measures to foster commodity sector production, diversification and competitiveness; universal access to essential and infrastructure services; access to essential drugs; implementation-related issues; and concerns of small and vulnerable economies;

(d) Fourthly, development solidarity is required from the international community for developing countries for undertaking adjustment and meeting implementation costs, building trade-related infrastructure, and supplying capacity-building for taking advantage of trade opportunities. In this context, Aid for Trade is an essential complement to trade liberalization in the trading system. If it provides for additional aid, it can play an important role – along with improved market access, balanced rules and sound domestic policies – in helping developing countries realize sustained gains from trade;

(e) Fifthly, it is important to ensure coherence and a positive interface between regional trade agreements (RTAs) and the multilateral trading system. In respect of the never-ending tide of regionalism, robust progress in and a successful conclusion to the Doha Round is the best guarantee against the continuing erosion of the multilateral system. Specifically, the WTO rules on RTAs, under negotiation in the Doha negotiations, need clarification and improvement so as to improve compliance and better take into account developmental aspects of RTAs.

79. The universality of WTO membership is essential for the legitimacy and governance of the trading system. Accession of 29 developing countries and countries with economies in transition is thus a systemic priority. However, experience has shown that relatively deep liberalization and stringent reform commitments, including WTO-plus commitments, have been requested from acceding developing countries. It is crucial to ensure fair and equitable terms of accession commensurate with the acceding country's trade, financial and development needs, and provision of increased support in all stages of the accession negotiations.

80. A notable trend in the international trading system is that, with the decline in tariffs as a result of eight multilateral trade negotiations, the relative importance of non-tariff barriers has risen, both as instruments of protection and for regulating trade. The nature of the non-tariff barriers most applied has also changed: measures intended to protect local consumers have increased, while measures meant to protect local producers have declined. In many developed countries, regulatory policy now focuses on protection of the environment, public health and safety, and often includes higher standards for the domestic market than existing international standards. While these regulations do not contravene WTO rules directly, they open avenues for protectionist abuse and also entail greater compliance costs than would otherwise be the case.

2. Proliferation of regional integration agreements

81. Another notable feature of the international trading system is the worldwide proliferation of regional integration initiatives, in particular RTAs. The number of operational RTAs, whether South–South, North–North or North–South, is expected to grow to 400 by 2010. Currently, trade between RTA partners accounts for nearly 45 per cent of global merchandise trade. Given the growing number, membership and trade coverage of RTAs, their impact on the international trading system will be significant. Careful attention needs to be paid to the scope of such agreements and their development impact on developing countries, especially the tendency towards deeper liberalization, a WTO-plus agenda, and an inward-looking approach that hampers trade with third parties and undermines the multilateral trading system.

82. When properly managed, regional cooperation can offer another avenue to protect the weakest participants against unfettered market forces and unpredictable shocks. Regional liberalization cannot be expected to deliver substantial development gains by itself, but it can support innovative approaches by extending cooperation to common or well-coordinated policies in the monetary and financial area, industrial development, infrastructure and employment. Effective cooperation on these fronts could not only enhance developing countries' output growth and trading capacities, but also strengthen their influence on global economic governance.

83. The close association between regionalization and industrialization in Western Europe and East Asia has often been cited as part of a virtuous development path. In this respect, the European Union is an excellent example of regional cooperation for other regions. It holds certain lessons in terms of institution building and the development of common policy approaches that can usefully inform formal cooperation among developing countries. On the other hand, the regional integration experience in East Asia, which has taken place without formally agreed policy cooperation, provides a lesson of growth and structural change at the regional level, which can be helpful in identifying the real driving forces behind economic dynamics.

III. Key trade and development issues in the current global economic environment

84. The unprecedented pace, scope and scale of globalization described above have not only given rise to new realities but also sharpened or given urgency and renewed focus to some key trade and development issues. Facilitating the quantitative and qualitative integration of developing countries, and countries with economies in transition, into the international trading system requires that these key trade and development issues be identified and that, in the years ahead, their implications for development be assessed, and relevant policies and measures at both national and international levels be elaborated. This chapter will identify a number of such issues, including the new South and South–South trade, energy security, labour mobility, services, commodities, environment and climate change, and technology and innovation.

A. The emergence of the "new South"

85. North–South trade remains important, with the North providing the main markets and sources of imports, investment and technology for developing countries. Conversely, the South is now becoming a major source and destination market for the North, a fact that reflects growing interdependence. Furthermore, what is significant is that South–South trade, in terms of both quantity and quality, has emerged from the periphery of world trade towards becoming a more central and dynamic aspect. Integral to this transformational change has been the rise of the new South – a new breed of dynamically growing trading and investing countries with wide-ranging portfolios and global enterprises. Globalization now has a Southern face too. There has been a marked diversification of export-import baskets and improvement in terms of trade, including through increased complementarities and trade. South–South merchandise trade increased threefold from $577 billion in 1995 to $1.7 trillion in 2005; this raised the South–South share of world merchandise exports to 15 per cent in 2005, accounting for 46 per cent of those countries' merchandise trade. The manufacturing sector represented a large part of South–South trade, accounting for 42 per cent in 2005, but commodities are becoming dominant and services trade has begun to thrive.

86. Intraregional trade is the mainstay of South–South trade, but interregional trade has burgeoned, particularly since 2000. Intra-Asian South–South trade accounts for 80 per cent of the Asian region's South–South trade, but there has been a surge in Asia's trade with Africa and Latin America, driven largely by its demand for energy, food and industrial raw materials, and its exports of manufactures to other developing regions. While China is a main driver of South–South trade expansion (China–Africa merchandise trade totalled $55.5 billion in 2006), India, Brazil, South Africa and South-East Asian countries are also potential regional and interregional drivers.

87. The implications of this phenomenon for the drivers themselves, other developing countries and the rest of the world are manifold and evolving. The new South's ascent, capacity and persistent challenges require a realistic assessment and systematic monitoring, so that growth continues and in turn contributes to replication of further successes in those countries and the rest of the South. This can be better ensured with the emulation of the new South's best trade practices, including in supporting productive capacity, value addition, infrastructure-building

and linkages, and transfer of appropriate technologies. Institutional adaptation and innovation at national, regional and global levels are required in order to more effectively tap and realize the development potential of the South.

88. South–South trade is beginning to acquire a critical mass of its own. It will need continuous nurturing through appropriate trade and investment liberalization and facilitation and infrastructure agreements, financing arrangements, macroeconomic and regulatory policy coordination, and consultative mechanisms. Furthermore, the North can play a supportive role, including by providing preferential market access and South–South cumulation in rules of origin to build South–South production and trade chains. Already Northern enterprises have contributed to regional and interregional value and supply chains, and this should no doubt receive a further boost. Aid for Trade packages can be targeted to support South–South trade for a multiplier effect. Enhancement of the South's individual and collective purchasing power, productive capacity and demand growth is bound to be beneficial for all countries.

89. The promotion of South–South trade remains a desirable objective because of the market and investment opportunities that it offers to low-income developing countries. Systematic monitoring, research and analysis regarding South–South trade flows are essential in order to identify lessons and best practices that can contribute to replication of positive development experiences and sustain further development of such trade. One way in which UNCTAD could assist South–South interaction is through its research and analysis and by developing and strengthening a South–South trade information system. The continued servicing of the GSTP Agreement and its third round of negotiations by UNCTAD and the implementation of results remain central to UNCTAD's work on South–South trade. Furthermore, UNCTAD's support to institutional development for the South-South trade in commodities, services and manufactures and broader economic cooperation needs to be enhanced to meet the emerging need for institutional reforms.

90. A major feature of the new South is the emergence of developing countries as significant sources of investment. In absolute terms, outward FDI flows from developing countries increased – from an annual average of $65 billion in the 1990s to $120 billion in 2005. A small number of home countries are responsible for a large share of these FDI outflows, but companies from more and more countries see the need to explore investment opportunities abroad to defend or build a competitive position. The value of the stock of FDI from developing and transition economies was estimated at $1.4 trillion in 2005, or 13 per cent of the world total. As recently as 1990, only six developing and transition economies reported outward FDI stocks of more than $5 billion; by 2005, that threshold had been exceeded by 25 developing and transition economies.

91. This has given rise to the emergence of developing country TNCs. Southern TNCs invest proportionally more in developing countries than do their developed-country counterparts. FDI can assist host developing countries in a number of ways, including adding to financial resources and productive capacity, supporting export activity, creating employment and transferring technology. This assists the continuing burgeoning of developing economies and South-South cooperation. FDI by developing-country TNCs can result in proportionally greater gains where their competitive strengths, motives and strategies differ from developed-country TNCs. For example, they are more likely to establish greenfield operations, they more

commonly use standardized, non-proprietary technology, and the technological gap between local firms and their affiliates is narrower than the gap with affiliates established by developed-country TNCs. All this augurs well for South-South development cooperation, with the aim of maximizing gains and avoiding pitfalls.

B. Energy security

92. Energy is one of the most important drivers of economic development, especially in the context of increasing globalization, trade growth and the digital revolution. However, access to energy varies dramatically between countries and regions. For example, two billion people in developing countries lack access to electricity and need to be taken out of this energy poverty. Energy demand and uses by developing countries are growing exponentially owing to population growth and economic requirements for building infrastructure, including transport, productive capacity in agriculture and manufacturing, and trade competitiveness. By 2030, developing countries will account for almost half of total energy demand. The International Energy Agency estimates that satisfying global demand requires a cumulative investment in energy-supply infrastructure of more than $20 trillion over the period 2005–2030, with at least half this amount being directed to developing countries.

93. Owing to rapid increases in world consumption and geopolitical upheavals, the past few years have witnessed wide fluctuations in oil prices, which reached a record high in the summer of 2006 at $70 a barrel. One obvious effect of this is higher oil import bills. It has also had a greater impact on oil-importing middle-income developing countries, where industrialization has led to greater dependence on oil imports.

94. For oil-exporting countries, the main challenge is to invest the surpluses prudently in order to ensure income for future generations and to ensure that the revenue flow does not cause real exchange rate appreciation, weaken competitiveness or lead to overdependence on a single sector. Local participation in both upstream and downstream activities needs to be increased. The impact on oil-importing countries tends to be a greater absorption of export revenues through rising import bills, higher transportation costs and inflation rates, and reduced GDP growth, trade competitiveness and resources for anti-poverty programmes. Oil-importing developing countries, especially LDCs, need to adopt measures that mitigate the effects of oil price peaks through appropriate arrangements and need to be supported by developing partners through appropriate stabilization/compensatory finance funding mechanisms.

95. Diversifying into renewable energy sources is an imperative at national, regional and global levels for economic and environmental sustainability. Awareness of this has pushed energy security and rebalancing of energy mixes high up the trade and development policy agenda of all countries and of the corporate sector. At the global level, the imperatives for creative solutions through R&D and coalitions of energy users and producers for efficient use of energy and renewable energy sources cannot be overemphasized. Increasing adoption of energy efficiency standards will affect production and processing methods in traded goods and services, thus impacting on the trade competitiveness and productive capacities of developing countries. Sustainable energy mixes best suited to each country's situation and strategic and development-conducive energy portfolios are needed.

96. Among the products emerging from the search for a new economic model based on low-carbon emissions are biofuels. The biofuels sector has experienced considerable development over the past decade. To ensure that biofuels production and use yield positive environmental and development results, Governments have to develop appropriate strategies on issues such as whether biofuel production is intended for transportation or for broader energy replacement, land requirements and which conversion technology is desirable. The economic and environmental impacts, the compatibility of biofuels with existing fuel delivery/use infrastructures and competing uses for biomass also have to be assessed. Country-based assessments (such as those undertaken by UNCTAD in Guatemala and the jatropha plantation development in Ghana) will help countries to better engage with biofuels and assist them in setting up the required domestic frameworks. For biofuels to make a major contribution to development, it is important that the comparative advantage of the South in this area be recognized and given scope, and that the South be involved in standard-setting.

C. Mobility and development: Labour integration

97. There are unprecedented and increasing opportunities for labour integration and mobility in the context of trade- and investment-led globalization. This is due to several factors, including growing complementarities between developed and developing countries with respect to demographics and labour force (e.g. an ageing population in developed countries versus a young one in developing countries, skill shortages in developed countries and surpluses in developing countries at all skill levels in key sectors); innovations in transport, telecommunications and ICT which allow easy access to cost-quality competitive labour anywhere in the world (e.g. the outsourcing of business services); the growth of new labour-intensive sectors such as nursing- home and health-care services; and productivity and wage differentials between developed and developing countries.

98. With these push and pull factors and the obvious benefits and costs of migration for sending and receiving countries, the challenge is to ensure that there is “gain” rather than “drain” from migration for all as a result of liberalizing the movement of people. The socio-economic benefits to the sending countries include the inflow of remittances and foreign exchange; and the return of skilled workers, which may increase local human capital stock, as well as transfer of skills and links to foreign networks (brain gain and circulation). Remittances have received much attention from sending countries as they are seen as a stable source of development finance.

99. There is a need for more conscious raising of awareness in both developed and developing countries of the actual costs and benefits of labour integration, together with a sustained dialogue between labour and global enterprises. This would include an economy-wide analysis of labour requirements sectorally, both domestic and foreign, and in the short to medium term in order to determine the best policy mix with respect to migration. International cooperation for a better managed migration policy would certainly be useful, including devising rules and regulations on employment and labour, visas, human resource development, structural adjustment policies and social safety nets. Policies could be geared towards better managing movements through regulated entry of temporary workers rather than outright prohibition leading to illegal migration and attendant problems. A meaningful

outcome to the Doha negotiations on Mode 4 would provide an important avenue for facilitating legal temporary movement of persons to supply services.

100. One way of assuaging public opinion in receiving countries and ensuring mutual benefits for both sending and receiving countries is to ensure temporariness of stay. This can include actions such as taxing employers, or requiring them to post bonds for every migrant recruited, or targeted incentives for migrants to return to their home country at the end of the contract, including through refunding their social security and pension contributions. Sending countries need to make maximum use of benefits from remittances and returning migrants; assist in the reintegration of returning migrant workers and stimulate investments; put in place the appropriate infrastructure and incentives; and invest in building the human capital base to mitigate possible negative effects of the movement of highly skilled workers.

101. UNCTAD, together with other international organizations in the Global Migration Group (GMG), will play its part by clarifying issues that lie at the interface of trade, migration and globalization for development in order to better equip policymakers everywhere and to shape public opinion in favour of a greater understanding of the true balance of benefits accruing from labour market integration. UNCTAD believes in the premise that it is a win-win situation for countries that are the origin of labour movements and those that are the destination of such movements, and for the global economy as a whole, if integration is managed by all concerned in an enlightened and cooperative spirit, with pragmatism, realism and a global strategic vision, and without political or cultural prejudice.

D. Services: The new trade and development frontier

102. Services contribute to economic growth and development through the creation of a competitive economy, providing new jobs, enhancing universal access to essential services and stimulating trade. Services sectors provide the backbone of an integrated and effective economy nationally, regionally and globally. An improved services economy improves performance in merchandise trade as the increased sophistication and availability of producer services enhance international competitiveness in exports of primary and manufactured goods. The informal services sector is also an important aspect of the services economy in developing countries. With globalization, the potential for developing countries to expand and diversify their economies through increased services development and trade has increased immensely. Today, services account for over 70 per cent of employment in developed countries and about 35 per cent in developing countries. World services trade has nearly tripled to reach $2.4 trillion, while the FDI inward stock has quadrupled to nearly $10 trillion in the wake of globalized production of goods and services It is widely acknowledged that increased services trade can generate development gains that cannot be achieved through a narrow focus on exports of primary commodities and manufactures alone.

103. Developing countries' performance in services trade in recent years has been exceptional. Since 1990, services exports from developing countries have grown at an average annual rate of 8 per cent compared with 6 per cent for developed countries. Accordingly, their share of world services exports has climbed to 24 per cent. However, at present the services trade of developing countries is dominated by only a few of those countries. Asian countries account for 75 per cent of all

developing countries' services trade. Africa and Latin America and the Caribbean accounted for 10 per cent and 15 per cent respectively. The top 15 developing country services exporters account for 80 per cent of all developing country services exports. An increasing number of countries are successful in exporting services such as tourism, transport, construction, audiovisual, computer and information services, and business and professional services, particularly through Modes 1 and Mode 4. South–South trade in services is also expanding, and within this trade regional trade agreements play an important role.

104. However, the potential of services sector development and services trade is yet to be fully realized by many developing countries, especially in sub-Saharan Africa and LDCs. LDCs continue to be marginalized from international flows of services, with their share in world services exports being about 0.8 per cent. Also, most services in the informal sector are not tradable, a fact that reduces the ability to benefit from trade-led globalization. Positively integrating those countries into the services economy and trade and ensuring that they derive development gains remain a major development challenge. The Doha Round of negotiations on services offers an important avenue for liberalizing services trade in a development-friendly manner and from the perspective of developing countries, specifically through "meaningful" commitments in sectors and modes of export interest to them.

105. At the same time, for services liberalization to generate pro-development outcomes, the proper pacing and sequencing of reform and liberalization are crucial. Establishing regulatory and institutional frameworks that work well and are sound is a precondition for opening up services markets particularly essential services where universal access is vital. In developing countries, regulatory systems are still at an emerging stage, and this poses challenges for policymakers. Hence, there is a need for policy space for countries to go through the trial and error process, which allows them to identify the best policy in the light of their particular economic, social and developmental needs.

E. Commodities: Sustaining the new growth trend

106. A majority of developing countries are dependent on the commodity sector as the largest source of revenue and employment for the population and the principal source of external finance (foreign exchange) for development. Some 94 developing countries still derive more than 50 per cent of their export earnings from primary commodities. In addition, the commodity sector is beset by problems related to the workings of the international trading system. Persistent supply/demand imbalances in world commodity markets have been due, in varying degrees across commodities, partly to trade-distorting domestic support and export subsidies in certain industrialized countries. This not only displaces developing country exporters on world markets but also reduces world prices (e.g. cotton). Another factor has been pressures on low-income commodity-producing countries to increase export volumes, even in the face of declining world prices, so as to expand or maintain the level of foreign exchange earnings and thereby sustain debt servicing and import capacity.

107. Since 2002 there has been a "commodity boom", with international commodity prices showing a strong upward trend after their sharp fall from 1995–1997 to 2002. The rise in prices has been driven by the boom in metal and mineral prices, which have increased by 191 per cent, and crude oil prices, which have risen by 140 per

cent. Increases for agricultural raw materials and tropical beverages taken as groups averaged 58 per cent and 45 per cent, respectively. Common factors responsible for the price increases include the strong growth in the import demand of developing countries owing to the rapid pace of industrialization, especially in China but also in India and other emerging developing countries; the increased production of biofuels; and emerging supply constraints in some commodity markets. Notwithstanding the recent upward trends, the increases in commodity prices have not been large enough in some cases to offset the severe declines in prices suffered in the past. Expressed in current United States dollars, non-fuel commodity prices are still lower than they were in the early 1980s. In real terms, by the end of 2005 commodity prices were still about 30 per cent lower than the average for the period 1975–1985. Furthermore, low-income commodity-dependent developing countries continue to face difficulties in retaining international market shares.

108. Nevertheless, with prospects of better prices and stable demand growth for a considerable period of time, perhaps as much as 10 years, commodity-dependent developing countries may be able to generate sufficient finance to invest in their development and poverty reduction programmes. Their success in basing development on commodity production and trade will depend on both the international environment and their ability to undertake, alone or jointly, the necessary institutional changes.

109. Harnessing the present boom in commodity prices for development is an urgent matter for developing countries and the international community. It requires substantial investment in infrastructure and supply-side capacity-building. The AidforTrade initiative could play a critical role in supporting improvements in the competitiveness of traditional commodity sectors, vertical and horizontal diversification in commodity-dependent countries and the mitigation of the short-term impact of commodity "shocks" at the national level, including through the financing of safety net programmes for small and resource-poor producers seriously affected by commodity market instability.

110. It is also vital that issues relating to commodities be urgently and adequately addressed at the multilateral level. The Conference on the Global Initiative on Commodities, the first UNCTAD XII preparatory event, held in Brasilia from 7 to 11 May 2007, responded to this urgency by relaunching the commodities agenda from a poverty reduction and development perspective. The Global Commodity Initiative and its outcome represents the basis for an action agenda for a global commodity partnership strategy.

F. Environment, climate change and development: The challenges ahead

111. Any attempt to promote sustained development and reduce poverty must take the natural environment into consideration, as it is the poor who are most dependent on the natural environment to meet their daily food, health, livelihood and shelter needs. Therefore, the environment qualifies as an important global public good, and the interface between the environment, on the one hand, and trade and development, on the other hand, is a central component of the globalization process. There is in particular a general recognition that increased trade flows that result from globalization have to be accompanied by environmental sustainability and poverty reduction in order to truly achieve sustainable development. Environmental impact

is perceived as an increasingly important factor of production that directly bears on production costs, competitiveness and opportunities in international trade.

112. The trade, environment and sustainable development nexus in the context of globalization renders policy coherence and an enabling environment essential for developing countries to effectively and proactively respond to the challenges and opportunities of climate change and biodiversity, environmental requirements and market access, increasing material efficiency and lowering the pollution intensity of production for export, profiting from export opportunities in environmentally preferable products, and avoiding the tacit import of old/second-hand/prohibited goods into developing countries.

113. Climate change is a crucial factor of globalization that currently poses one of the greatest risks to environmental, social and economic development in both the developed and developing countries; it is having profound and irreversible direct and indirect effects that threaten to reverse decades of development efforts. Increasing emissions of greenhouse gases such as carbon dioxide and methane are causing changes in the global climate systems, with adverse impacts on developing countries and related significant economic costs if no remedial actions are taken. The impacts of climate change are inequitable. Poor countries are hit the hardest and earliest, and yet they account for only a relatively small share of total greenhouse gas emissions. Sectors that are crucial for the livelihood of the poor in developing countries such as agriculture, fisheries, industry, energy and transport are very sensitive to climate change. The introduction of climate response measures through the emerging carbon market and the Kyoto Protocol has trade and development implications, as it affects economic sectors such as transportation, energy use, electricity generation, agriculture and forestry.

114. One persistent environment-related problem, which has direct implications for trade and development, concerns the new environmental, health and food-safety requirements (EHFSRs) on the access of developing country products to key export markets. New EHFSRs are becoming more stringent, frequent, complex and interrelated. This poses serious challenges, but also provides opportunities for export competitiveness as well as sustainable production and consumption methods at national level. There is also a trend towards privatization of many EHFSRs and thus a related tacit alliance between mandatory and voluntary private-sector-set requirements. Governments establish product characteristics and product-related processes and production methods (PPMs), and the private sector follows up by imposing specific non-product-related PPMs to meet the product characteristics. Private standards are widely believed to be outside WTO disciplines, and thus pose challenges in terms of justifiability, transparency, discrimination and equivalence.

115. The new private-sector-architectured supply-chain requirements tend to marginalize smaller countries and producers. This contradicts pro-poor development strategies and disconnects those most in need of trading opportunities, in particular small farmers. On the positive side, growing consumer demand for environmentally preferable products presents new opportunities for those producers and countries that can produce in more energy-efficient and environmentally friendly ways – and can effectively communicate this fact to consumers. An example is the rapid expansion of organic agriculture markets, with global growth rates of over 12 per cent in the last few decades, compared with overall agriculture market growth. Generally, there is heightened interest in environmentally preferable products,

services and production methods since these are the strategic markets of the future. Equally important has been biotrade, providing impetus to this emerging market. Developing countries need to identify and exploit the market niches and opportunities open to them.

G. Technology and innovation for trade and competitiveness

116. New technologies are a key enabler of globalization. Two features in particular have emerged as burning issues for development. One is that ICTs play a critical role in the fragmentation of the global value-added chain and in shifting parts of production to different geographical locations. This feature has now been extended to the service industry and the delocalization to lower-cost markets. By using ICTs, firms are able to exchange knowledge and information online from anywhere in the world, communicate just-in-time with clients and suppliers, and deliver services efficiently and promptly. Developing countries are increasing their participation in global ICT goods trade. The other feature is that rapidly growing containerization of international seaborne trade has led to technological advances in cargo-handling equipment, the extensive application of IT-based management systems, and transport organization processes in seaports and inland freight terminals. A number of developing countries have anticipated trends in transport services and technologies and speedily adapted to changing requirements. However, problems remain to be solved in the many low-income and vulnerable countries, especially LDCs and LLDCs, where basic transport infrastructure is in urgent need of improvement and where more advanced logistics services and networks can be put in place only with international support.

IV. Strengthening productive capacities, trade and investment: The enabling environment

117. Productive capacities, trade and investment are interlinked and mutually reinforcing elements of the national and international economic structure. There is a great deal of cumulative causation between them. Reflecting this, an enabling environment needs to operate simultaneously at the global level through policies that promote an open and equitable environment, and at the national level through policies that foster growth, investment and entrepreneurship, as well as technology, innovation and employment. The enabling environment should also provide opportunities for inclusive development, extending the benefits of growth and income earning to vulnerable population groups, the poor and women.

118. The following sections describe key issues in the enabling environment, beginning at the global and macroeconomic level, and then moving to the national and more microeconomic level.

A. The global framework and the enabling environment

119. Policies fostering global economic governance through the development of a stable international financial system conducive to growth and development and an equitable international trading system, as examined in chapter II, are recognized as critical in creating an enabling environment for strengthening productive capacities in developing countries and transition economies. In addition, a number of new policy issues at the international level are increasingly attracting attention. These include policies fostering South–South cooperation, international investment agreements and issues related to intellectual property rights, as well as initiatives such as Aid for Trade.

1. The promise of South–South cooperation

120. There is an important window of opportunity for developing countries and the international community, as well as UNCTAD, to support the emergence of the new South in the wider effort to assist developing countries in maximizing development benefits from globalization. Support for effective and coherent policies, coordinated at subregional, regional and interregional levels, ensures that the dynamism of South–South trade and investment is sustained and contributes to positive economic and social development.

121. The emergence of the new South and the South–South trade and investment dynamism demand institutional and regulatory changes, adaptation and innovation in respect of both South–South and North–South development dialogue and cooperation. South–South liberalization needs to be consolidated and pursued further, including through rationalization of South–South RTAs. In that respect, the successful conclusion of the third (São Paulo) round of GSTP negotiations is a singular challenge facing the South in terms of strengthening a global instrument for South–South trade preferences. A successful conclusion with significant market access enhancement will set the stage for increased inter- and intraregional trade among developing countries. Investment in R&D and technological cooperation at the regional level are also needed in order to build the scientific and technological basis for future economic relations. The introduction and the implementation of

trade and development finance schemes to meet burgeoning South–South needs are necessary.

2. FDI and international investment agreements.

122. Today, developing countries are facing unprecedented challenges in terms of content and capacity resulting from the growing diversity and complexity of the IIA universe and the growing risk of overlapping treaty obligations. There are currently over 2,500 bilateral investment treaties (BITs), 2,700 double taxation treaties (DTTs) and 240 bilateral and regional free trade agreements with investment provisions. These include a growing number of South–South agreements, a fact that reflects the emerging status of some developing countries as sources of outward investment. In addition, there are the multilateral instruments dealing with specific aspects of investments (e.g. GATS, TRIMs, ICSID) and regional integration organizations that also include rules on investment (e.g. ASEAN, COMESA, MERCOSUR, OECD).

123. As a result, issues related to policy coherence are moving more and more to the forefront of policy consideration, for example in terms of aligning a country's IIA network with its domestic laws and economic development policies and between the different IIAs. The risk of incoherence is great for developing countries that lack expertise and bargaining power in investment rule-making. Another challenge is how to balance the rights and interests of foreign investors, on the one hand, and host countries, on the other hand, as reflected in the increasing number of treaty-based investor–State disputes submitted to international arbitration. Related to this is the question of whether reference should be made to corporate responsibilities in this regard. These are key issues in any IIA negotiation, and are at the heart of the debate about the future development of international investment rules. Finally, finding new methods to further strengthen the development dimension of IIAs remains a crucial issue.

124. These issues will need to be addressed when discussing the future prospects for working towards ensuring that international investment relations between countries are governed in a more uniform, predictable and transparent way.

3. Intellectual property rights

125. Intellectual property policies attempt to strike a balance between proprietary and public domain interests. The current landscape for developing countries is particularly complex as they seek to determine the optimal balance in the light of their development objectives, while at the same time many countries are negotiating and seeking to comply with international agreements that contain provisions on intellectual property that often restrict national policy space. There is a need for both developed and developing countries to understand better the implications of this landscape, and to be able to strategically deploy the flexibilities that they have under international agreements, such as the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), in the light of their development objectives.

126. Developing countries that are rich in traditional knowledge, innovations and practices (TK) should be able to benefit from this resource, notably by addressing concerns that TK is being inappropriately exploited and patented by third parties

without the consent of its original holders and without the fair sharing of resulting benefits.

127. International cooperation for the management of knowledge as a global public good needs to address a number of challenges. First, the international community needs to give thought to the design of an "optimal" intellectual property system which supports research and the creation of knowledge, as well as its use and dissemination. Second, such a system should take into consideration the special needs of poor countries, for which the cost of access to the patent system may be too high. Finally, financial or technical cooperation needs to be reinforced in order to address the gap in science and technology education and research in developing countries. The question of technology transfer and sharing of knowledge is of prime importance for economic development.

4. Aid for Trade and development

128. Building productive capacity touches on almost all areas of development policy and hence requires a multifaceted approach to development assistance. Aid for Trade is an important way to jump-start the development process by creating a virtuous circle between trade and domestic productive capacity-building, and consequently economic growth, employment and poverty reduction in developing countries. This calls for ODA to be used more effectively to support proactive measures in areas such as physical infrastructure, national financial systems, domestic entrepreneurship and trade logistics. This is particularly important for LDCs, a number of which have not yet tapped the benefits of existing preferential market access provisions, and cannot benefit from an extension of such privileges without support measures for building productive capacities. However, while the concept of Aid for Trade has been accepted, its operationalization is still in the making. It is urgent that the mechanism be supported with substantial resources that should be additional to development aid, predictable and non-debt-creating.

B. National policies to promote an enabling environment

129. Policies to strengthen domestic productive capacities and mobilize resources need to be sufficiently flexible to address the varying economic, social and other development challenges. The multiplicity of these challenges inevitably calls for an appropriate "policy mix" or "diversity of policies" tailored to each country-specific situation, rather than a one-size-fits-all approach. This "policy space" should give countries the freedom to design policies which are consonant with their national development priorities. There are, however, some common themes that all countries will need to address:

(a) Pro-growth macroeconomic policies that set off a virtuous circle of investment, growth, development and poverty reduction. In this respect, trade and industrial policies should be complementary in order to achieve international competitiveness in increasingly sophisticated products. Trade integration should not be seen as an end in itself, but rather as a means for technological upgrading and increasing domestic value-added based on a close net of domestic forward and backward linkages;

(b) Structural change and diversification. Most developing country Governments have long acknowledged the need for structural change and diversification of their economies;

(c) The effective and enabling State. The experiences of the newly industrialized countries and other successful developing economies suggest that an effective and enabling State is a sine qua non for formulating and implementing national development strategies. This entails a strong and politically stable developmental State with a skilled and educated civil service capable of identifying and implementing a national development strategy that incorporates the requisite trade and investment policies, fosters technological development and builds the necessary infrastructure.

130. The sections that follow focus on policies supportive of investment and the business environment, as well as infrastructure development, technology and innovation.

1. Pragmatism in trade and industrial policy

131. Much controversy persists about the economic rationale for proactive trade and industrial policies, as well as their viability. Some of this is related to a questioning of the efficacy of such policies, which in the past were often identified with failed inward-looking, import-substituting strategies with open-ended government interventions and a strong bias towards protectionism. The controversy has also related to the possible adverse effects of such policies on efficient resource allocation. However, the historical experience of economic catch-up in mature and late industrializing countries shows that exclusive concentration on allocative efficiency implies that too little attention is paid to stimulating the dynamic forces of markets that underlie structural change and economic growth. As a recent study by the World Bank argues, “growth entails more than the efficient use of resources”. This is particularly true for developing countries, where economic growth entails dynamic investment and rapid changes in the structure and technology content of production.

132. Indeed, proactive trade and industrial policies should not be understood as inward-looking, protectionist defence mechanisms to support industries where production and employment are threatened by lack of demand or foreign competitors that have successfully upgraded their products or their production processes. Rather, the role of national support policies is to strengthen the lead role of innovative private enterprises and related capital formation. These policies should help resolve information and coordination problems in the process of capital formation and productivity enhancement. They should also ensure that cumulative production experience is translated into productivity gains. This industrial policy support should be complemented by a trade policy designed to achieve an open environment and international competitiveness in increasingly more sophisticated products.

133. Another lesson from recent evaluations of reform programmes of the last 10 to 15 years is that support for foreign and in particular domestic investment should be combined with an appropriate legal and regulatory framework to secure gains for development. In this context, there is a need for a pragmatic and strategic perspective in order to integrate FDI into a broader development strategy geared to structural and technological change.

2. The role of institutions in good governance

134. There is an increasing consensus that governance and institutional arrangements are critical determinants of economic development. But there is much less agreement as to what exactly the role of institutions should be in the pursuit of development objectives, and what types of institutional arrangements are the most appropriate for achieving those objectives.

135. Conventional economic wisdom suggests that the main role of institutions is to reduce transaction costs so as to create new markets and make existing ones function more efficiently. Economic policies should be supported by universally applicable types of institutions, particularly for granting and protecting property rights, in line with "global best practices", derived from the current institutional set-up in developed countries. Proponents of this approach point to empirical evidence from cross-country analyses, which typically find a positive correlation between the quality of institutions and economic growth.

3. Foreign direct investment and TNCs

136. The relatively high growth in inward FDI flows to developing and transition economies reflects the fact that these countries have continued to open up to FDI and to provide increasingly attractive environments for such investments. At the same time, countries are becoming more aware of the need to adjust their policy frameworks to ensure greater development gains from inward FDI. With a more knowledge-based global economy, some countries are furthermore seeking to integrate their FDI policies within a broader development strategy, linking them to such important areas as trade, education, science and technology, and enterprise development.

137. Increasingly, some developing countries are using both inward and outward FDI to upgrade the competitiveness of their indigenous resources and capabilities to facilitate structural changes in their economies, thereby promoting dynamic comparative advantage. For instance, outward FDI by a developing country's TNC can secure foreign knowledge and competitive advantages, which can then be absorbed by the parent company and the home country through various mechanisms. A good investment strategy is one that recognizes the risks and limitations associated with FDI (inward and outward) and the fact that FDI is not a substitute for domestic investment, but a complement to domestic efforts to meet development objectives.

138. The new focus of attention in the FDI arena is to design strategies to ensure that FDI serves development aims. This will not occur automatically, and an integrated cohesive approach is needed. Key policies include the following: (1) building a dynamic domestic enterprise sector; (2) addressing a number of policy and institutional areas, starting for instance with the development of an institutional framework that promotes investments and innovation; (3) improving the quality, reliability and cost-competitiveness of backbone infrastructure services; (4) enhancing the technology, human resource capacities and knowledge base of the economy; (5) supporting the internationalization of domestic enterprises, as internationally competitive firms tend to be in a better position to attract FDI and contribute to development objectives; (6) maintaining competitive markets; (7) improving the transparency and predictability of laws and regulations and consistency in their enforcement, while promoting higher standards of public

service and efficiency in policy implementation; and (8) creating synergies and effective coordination between institutions that are responsible for policy formulation and implementation, in particular in the areas of trade, enterprise and investment promotion.

139. The emphasis on policy coherence may be one of the most striking lessons learned from those developing countries that are now emerging as more important nodes in the networks of TNCs. In most of those countries, the starting point has been a long-term vision of how to move the economy towards higher-value-added and knowledge-based activities. For example, the recent success of some Asian economies in attracting FDI in R&D is no coincidence: it is the outcome of coherent and targeted government policies – evolving over time – aimed at strengthening the overall framework for innovation and knowledge inflows. In some form (and to varying degrees), those countries have actively sought to attract technology, know-how, people and capital from abroad. They have invested strategically in human resources, typically with a strong focus on science and engineering; invested in infrastructure development for R&D (such as science parks, public R&D laboratories, and incubators); used performance requirements and incentives as part of the overall strategy to attract FDI in targeted activities; and strategically implemented IPR protection policies.

140. Finally, the G8 Heiligendamm Summit gave a strong impetus to the development of an enabling environment for investment in developing countries, with a call for UNCTAD and the OECD to develop best practices for building an institutional environment conducive to increased investment and sustainable development, including through Investment Policy Reviews, and through engaging industrialized countries, emerging economies and developing countries in a dialogue aimed at building international consensus and disseminating best practices in this respect. In the coming years, UNCTAD will respond to this call and will assist interested member countries in sharpening the development dimension of their investment policy frameworks and building the institutional capacities needed to enhance the development benefits deriving from domestic and foreign investment.

4. Boosting domestic enterprise

141. To benefit from an increasingly globalized and interdependent world economy, developing countries need strong and competitive firms that are able to internationalize (e.g. take advantage of export opportunities, participate in global value chains and develop business linkages). A new focus by both Governments and the international development community on policies that help the growth of the private sector, particularly SMEs, in developing countries is necessary. In addition to the international policies mentioned above, national policy measures required include:

(a) Promoting skills development and innovation. Strengthening the supply capacity of local enterprises requires both good infrastructure facilities (such as technology parks) and the development of a range of skills, including technical skills in production processes and management know-how. Entrepreneurship development requires specialized training to shape personal behaviours and attitudes in order to develop the new business leaders of tomorrow;

(b) Improving access to finance, and the range and price of financial services available at all levels (e.g. banking and credit services for SMEs and the poor);

(c) Strengthening the accounting and insurance professions. Professional services in the areas of accounting and insurance are a crucial part of the infrastructure that facilitates investment and supports enterprise development. Insurance services facilitate investment, improve business continuity following disasters, and are an essential element of trade. Internationally recognized good practices in both financial and non-financial corporate accounting and reporting play a key role in enterprise development, allowing an enterprise to efficiently mobilize, allocate and account for both domestic and international investment capital. Developing countries need assistance in developing high-quality accounting and insurance services through the strengthening of professional and regulatory institutions;

(d) Developing business linkages and industrial clusters. Key strategies in enterprise development are the promotion of global business linkages and the development of industrial clusters. Building business linkages between domestic SMEs and TNCs is an effective way to access new markets, and upgrade technology and management skills. Cluster initiatives that promote cooperation among a network of firms operating in the same or complementary industries lead to the development of a local pool of skilled labour and allow policymakers to focus on the full range of issues affecting a specific sector.

5. Competitive practices

142. Competition policy plays an important role in promoting competitiveness, building entrepreneurship, facilitating market access and entry, enhancing the equity of the international trading system and ensuring that trade liberalization generates development gains. Accordingly, an effective enabling environment must include both national competition policies and international cooperation to deal with cross-border anti-competitive practices. Unfortunately, developing countries continue to face enforcement difficulties in addressing anti-competitive practices with international elements. Thus, helping developing countries to strengthen their enforcement capacity is a priority.

143. In recent years, in response to anti-competitive mergers and hard-core cartels, some developing countries have examined the anti-competitive effects of these on their markets and sought to impose sanctions on the companies concerned without being able to enforce any prohibition order. Enhanced international cooperation on competition law and policy is required in order to address anti-competitive practices that lead to losses by developing countries.

6. Transport infrastructure and trade facilitation

144. Trade-based globalization processes have been made possible largely through advances in the areas of transport and communications. International supply chains nowadays fully incorporate the distribution and inventory legs of global production and distribution processes. In such a context, all physical, technological and formal obstacles to cost-effective trade transactions should be addressed in a comprehensive manner, whereby investments in “hardware” solutions such as transport and storage infrastructure and equipment must be supported by corresponding streamlined managerial and administrative systems. Trade facilitation is crucial for ensuring that international trade requirements for efficiency are met by trade-monitoring administrations, such as customs. In order not to hinder

international competitiveness, both trading communities and public administrations in developing countries need to be institutionally and technologically aligned with their counterparts in neighbouring and overseas trading partner countries.

145. Trade-supporting infrastructure and services are increasingly provided by the private sector. The management of seaports, airports, roads and railways is often outsourced to national or international private companies. As the public sector withdraws from operations, there is a growing need for strengthened capacity to monitor and regulate the industry. Overcoming non-physical barriers to enhance the efficient use of existing physical transport infrastructure is a major objective to be pursued, particularly when investment resources are scarce. While trade and transport facilitation on its own may not be a sufficient condition for achieving structural change, it is however a necessary condition without which employment shifts to new industries and export-led economic growth will not materialize.

146. In order to ensure that development objectives are being met, Governments must give high priority to transport issues, must review and revise if necessary the legal and regulatory framework to allow greater participation of the private sector, introduce reform measures to make providers of transport services more responsive to user demands, streamline administrative procedures, introduce a system of transport performance indicators, promote the use of information technology and strengthen training programmes in this sector. In an ideal situation, these measures would form part of a coherent package to be applied at the national or even subregional level in order to take full advantage of the role that the transport sector can play in regional integration. At the international level it is important that policies and regulatory regimes be harmonized and Governments be assisted in devising the necessary policy measures required in order to ensure that transport supply capacities are created or strengthened and that traders are placed in a position to effectively take advantage of transport opportunities offered in liberalized and globalized transport markets.

7. Technology, innovation and knowledge, and the enabling environment

147. Without technological progress, capital accumulation faces diminishing returns. Improvements in production technology continually offset the diminishing returns to capital accumulation and generate improvements in labour productivity, both directly because of the improvements in technology and indirectly because of the additional capital accumulation that these improvements make possible.

148. It is now well established that the capacity to assimilate, diffuse and generate knowledge is crucial for sustainable growth and development, since knowledge forms the basis of technological upgrading and innovations. While knowledge is recognized as a public good at the national level, it has also become a global public good owing to its cross-border diffusion and access to it. Furthermore, knowledge is crucial for the provision of other public goods, such as prevention of the emergence and spread of infectious diseases and tackling climate change.

149. The challenge is therefore to harness knowledge for development, with an enabling environment being provided for the production of ideas and innovations, as well as for their dissemination and use by different actors, directly or indirectly involved in the production process. This involves a combination of domestic efforts to develop institutions, infrastructure and a policy and regulatory framework, as well as efforts at the level of international cooperation, in order to facilitate the

generation and use of innovative systems for knowledge-sharing and learning – that is, to transform knowledge into a global public good.

8. ICT policies

150. Countries that have benefited most from the development of ICTs are those that have created a sound ICT-enabling environment, including a trade and investment environment that is conducive in terms of telecommunications and the development of the ICT industry. Favourable national ICT policies include pro-poor ICT strategies, a legal and regulatory framework, the development of e-government services, policies for capacity-building and human resources development, and the promotion of accessible, high-quality and affordable technology and relevant content.

151. Countries that have already put in place national ICT policies now need to review their implementation and impact at the country level and carry out an analysis of the successes and failures in the implementation of their ICT plans, including the institutional framework, in order to make subsequent adjustments and revise their ICT development plans. Reviewing ICT plans on a regular basis and in coordination with the different stakeholders involved is crucial. It is therefore recommended that developing countries define, as part of their ICT plans, mechanisms for ongoing policy review, assessment and monitoring. Core ICT indicators as defined by the international community can help in this process.

V. Strengthening UNCTAD's role, impact and effectiveness

152. UNCTAD is an integral part of the multilateral development system. As the focal point of the United Nations on trade and development and the interrelated issues of finance, investment, technology and sustainable development, its distinctiveness lies in its treatment of development against the multifaceted challenges arising from the fast-changing world economy and international trade. Over more than four decades in the service of development, UNCTAD has consistently addressed the concerns and endeavoured to advance the interests of all developing countries in the international economic and trading systems. In the context of deepening interdependence between developed and developing countries, as well as among the latter, this unique orientation of the organization will continue.

153. Enhancing UNCTAD's institutional effectiveness is a continuous process. The key aim is to keep the organization fit so that it can make the maximum contribution to the multilateral development system by promoting the economic advancement of developing countries. Since UNCTAD XI, the institutional aspects of UNCTAD's work – involving the three pillars of research and analysis, intergovernmental work and technical cooperation – have been taken up within the context of two distinct but complementary processes.

154. At the mid-term review conducted by the Trade and Development Board in 2006, member States made recommendations on all three pillars. In addition, a panel of eminent persons was established in 2005 to advise on enhancing the development role and impact of UNCTAD. At its forty-first executive session, in April 2007, the Board endorsed a number of the panel's recommendations, and implementation of these has begun. The Board also decided to pursue its consultations on those recommendations on which conceptual convergence emerged.

155. At the same session, the Board decided that one of the sub-themes of UNCTAD XII would be "Strengthening UNCTAD: enhancing its development role, impact and institutional effectiveness". The inclusion of this sub-theme in the agenda of the Conference is a clear indication of member States' desire to further strengthen the organization's contribution to development.

A. Improving the working methods of UNCTAD

1. Research and analysis

156. UNCTAD is primarily a knowledge organization, with research and analysis at its core. Further strengthening UNCTAD's research and analysis will involve a multi-point strategy aimed at sharpening its policy-orientation, with greater attention to the implications of a resurgent South for development, international economic cooperation and systemic issues. Greater emphasis will be paid to the country dimension, the capacity to respond quickly to emerging and new issues, and improved outreach. To that end, mobilizing adequate resources for research and analysis will be an important consideration.

157. A primary goal of research in an intergovernmental organization is to provide policymakers with sound and realistic policy choices. To that end, UNCTAD's research will continue to be policy-oriented, focusing more sharply on providing genuinely development-oriented policy options at the national, regional and international levels, as well as on systemic issues affecting development. Besides

the continued treatment of medium- and long-term issues, it should be possible during each four-year conference cycle to identify a body of innovative and practical policy recommendations on new and emerging issues arising from UNCTAD’s research effort.

158. There is now clear convergence on a view long held by UNCTAD that development is not a linear process amenable to a standardized set of policy prescriptions. The fact at one size does not fit all warrants greater attention in UNCTAD’s research to the specific situation in different countries, with a view to enhancing the development impact of UNCTAD’s work. To further account for country experiences, research and analysis will place greater emphasis on country case studies and country-specific policy reviews. In the case of the latter, UNCTAD has considerable experience in investment policy reviews, and this approach should be extended to other areas, such as trade and commodities.

159. Another way in which UNCTAD can increase its impact is to develop a capacity to respond rapidly to emerging issues in order to make its analysis and policy recommendations available to member States and other stakeholders “in real time”. This should help member States to deal more effectively with challenges such as global economic imbalances, financial crises, the trade and developmental aspects of post-conflict reconstruction and recovery, and the economic implications of phenomena such as pandemics or climate change.

160. To strengthen the impact of its research, UNCTAD needs to greatly improve its outreach, which will require better targeting of the audience for its work, better management of its relationships with the media and smarter use of information and communication technology to disseminate its messages. It will be important to reach out to policymakers and policy advocates in all regions and at all levels, as well as to academic and research institutions and civil society entities. To that end, a proactive effort will have to be made to identify a broad network of recipients. UNCTAD should also strengthen ties with the development research community in developing countries.

161. The further strengthening of UNCTAD’s research and analysis will warrant the provision of more resources for this purpose. This can be achieved through a combination of the following: (a) deepening the research commitment within each relevant programme element; (b) intensifying interdivisional collaboration on cross-cutting issues such as the least developed countries and South–South cooperation; (c) making greater use of interdivisional task forces, which should allow resources to be devoted temporarily to specific time-bound research projects without altering their long-term allocation; (d) engaging in intensified research collaboration with other parts of the United Nations system, as well as with a network of research entities throughout the world; (e) using increased extrabudgetary resources for research and analysis, especially with regard to new and emerging issues, with the possibility of using part of these resources to establish a system of resident scholars to work on new and emerging issues on fixed-term contracts. The long-term goal of these steps is to strengthen UNCTAD’s position as a pre-eminent centre of research and a leading source of policy support for decision makers at the national and international levels.

2. Intergovernmental machinery

162. The intergovernmental machinery of UNCTAD must be more action-oriented in its monitoring of systemic changes in the areas of trade, finance, investment, technology and sustainable development, and in its practical contributions to development policy options at the national, regional and global levels. One of the principal objectives of its work should be to effectively equip developing countries with realistic and smart policy choices to enable them to maximize the opportunities presented by globalization and economic integration and to deal with the risks arising therefrom. This is particularly important for countries that have not been able to participate meaningfully in the globalization process but have been exposed to its risks. A related task should be to make constructive suggestions on how to achieve the orderly evolution of the international economic and trading systems in a development-supportive manner.

163. The added value of having an issue discussed in an intergovernmental forum is the prospect of reaching intergovernmental consensus that leads to intergovernmental action. At the mid-term review in 2006, member States recommended that UNCTAD should ensure that intergovernmental meetings resulted in development-oriented outcomes, including policy options (TD/B(S-XXIII)/5, para. 13 (b)). This important recommendation should now be fully implemented, bearing in mind the broader systemic shifts affecting development.

164. The intergovernmental pillar of UNCTAD must also be more closely linked with the research and analysis pillar. Greater attention should be given to utilizing the secretariat's analysis more fully in the process of formulating policy-oriented outcomes. At the same time, the intergovernmental machinery should identify areas where new or further research and analysis is required. It should discuss emerging challenges and opportunities based on a real-time analysis by the secretariat with a view to producing rapid policy responses. This will require a more innovative and targeted use of the intergovernmental machinery, especially the executive sessions of the Board.

165. The Trade and Development Board should have a broader agenda and should play a more prominent role in the work of the General Assembly and the Economic and Social Council. The Board should support the work of the Assembly more actively in the main areas of UNCTAD's mandate, including trade, finance and investment, as well as in the areas of systemic issues and countries with special development needs. In particular, it should specifically seek to contribute agreed inputs to the General Assembly's deliberations and resolution on trade and development, including by submitting agreed elements of the resolution for consideration by the General Assembly.

166. For the Board to play a more prominent role in the work of the General Assembly, its calendar of meetings should be harmonized with that of the Assembly. To that end, expert meetings could take place from November to March and sessions of the commissions in May–June, so that the results of their work could feed into the deliberations of the Board in September or October and then into the work of the General Assembly in October or November. This would also allow more time to prepare for expert meetings.

167. The Board should also play a full role in UNCTAD's contribution to the implementation of and follow-up to the Millennium Development Goals and the outcomes of major United Nations and other international conferences and summits. In addition to carrying out its annual review, it should seek to take advantage of UNCTAD's research and analysis to contribute to the General Assembly's ongoing work in such areas as the Millennium Development Goals, sustainable development and financing for development. It should also contribute in such areas as South–South cooperation, climate change and poverty eradication.

168. The mandates of the three existing commissions (on trade, investment and enterprise) need to be reviewed; proposals for the creation of a new commission have already been tabled. In taking their decision on this issue, member States may wish to consider the possibility of establishing commissions for a four-year period consistent with the UNCTAD conference cycle, while keeping in mind the need to retain a standing focus on the core areas of its work.

169. A number of expert meetings have proved successful because of the inherent interest of the topics and the quality of the discussions. To enable such meetings to systematically achieve their full potential in terms of contributing to policy formulation, it will be important to focus more sharply on actionable outcomes, make better use of analytical inputs so that topics are dealt with in greater depth, and promote closer interaction among participants. A key constraint on the effective functioning of expert meetings is the ongoing problem of funding the participation of experts from developing countries. So far no sustainable funding method has been found, nor has consensus been reached on the use of regular budget resources for this purpose. Contributions to the trust fund set up to finance expert participation have been inadequate to cover needs. A permanent solution to this problem must be found, since maintaining the status quo without one is no longer a viable option if the expert meetings are to function effectively.

3. Technical cooperation

170. The most important issue to come up recently in relation to technical cooperation is the "One United Nations" concept, which was launched in 2004 by the United Nations Development Group and the United Nations System Chief Executives Board for Coordination to achieve more cohesiveness and efficiency in United Nations development assistance operations at the country level. In 2005 and 2006, the Economic and Social Council, the General Assembly (in its follow-up to the Millennium Summit) and the High-level Panel on System-wide Coherence of the Secretary-General of the United Nations made similar calls for greater country-level coherence. In December 2006, eight countries volunteered to be One United Nations pilot countries, and in April 2007 the Secretary-General of the United Nations submitted his response to the report of the High-level Panel on United Nations System-wide Coherence to the General Assembly (A/61/836).

171. UNCTAD currently faces a number of difficulties at the country level. It is a "non-resident agency", meaning it does not have a country presence; trade-related assistance is marginal in the design of United Nations plans at the country level; the extrabudgetary resources currently provided to UNCTAD are fragmented, unpredictable and earmarked; and its interregional and regional operations do not facilitate participation in the United Nations Development Assistance Framework (UNDAF), which is country-based. It will therefore be essential to ensure that the

One United Nations process is implemented in such a way that it becomes easier, not harder still, for UNCTAD to raise the profile of trade and development at the country level.

172. To achieve this, UNCTAD will have to work closely with other organizations that have complementary objectives. At the most recent meeting of the Chief Executives Board for Coordination, UNCTAD proposed the creation of a "trade and productive sectors" cluster, the purpose of which would be to allow organizations working on trade and development and related issues to join forces and, within the One United Nations process, to increase their impact at the country level. The organizations involved so far are the United Nations Industrial Development Organization (UNIDO), the Food and Agriculture Organization of the United Nations (FAO), the International Trade Centre (ITC) and WTO, but it will be important to engage the regional commissions of the United Nations as well. The goal is to raise the profile of trade and productive sectors in various countries, to propose a package of technical cooperation programmes that could be supplied by the cluster, and to ensure greater overall coherence in country development plans.

173. A second major focus for UNCTAD technical cooperation activities will be the "Aid for Trade" initiative. The aid-for-trade agenda includes technical assistance to build capacity to formulate locally-owned trade policies, participate in trade negotiations, implement trade agreements, build supply-side capacities (including trade-related infrastructure) and provide compensatory assistance to offset adjustment costs. UNCTAD can provide technical cooperation at each stage of the trading process, from investment, enterprise development and financing, through customs operation and transport, to market access and market entry. Moreover, the WTO task force on aid for trade has recommended that donors should consider channelling aid-for-trade funds multilaterally where appropriate. UNCTAD, working in cooperation with other organizations, notably the members of the trade and productive sectors cluster, should play a leading role in this respect.

174. Underlying these objectives is the assumption that UNCTAD's technical cooperation efforts must be much better organized and integrated. Greater used should be made of "packages" of programmes, which should be sharply focused on a limited number of thematic areas. This will not only help resolve the problem of fragmentation of such efforts, but also improve UNCTAD's ability to better integrate its technical cooperation activities at the country level.

175. UNCTAD also has to greatly improve its technical cooperation outreach. It must ensure that its technical cooperation capacity is brought to the attention of potential recipients much more effectively; it must ensure that its funding needs are brought to the attention of potential donors in a much more coherent way; and it must continuously monitor and evaluate the effectiveness of its technical cooperation activities in order to better disseminate their added value and relevance. For their part, developing countries should make their needs known to the secretariat, and donors are urged to substantially increase their contributions to UNCTAD technical assistance funds in the context of their commitment to substantially increase official development assistance.

B. Enhancing UNCTAD's role in emerging issues

176. UNCTAD will be strengthened and its impact enhanced if it is entrusted with ambitious goals. No matter how efficient UNCTAD's working methods may be, if

the tasks it is asked to do are not significant, its impact will not be significant either. Such tasks may relate to traditional areas of its work that are still important in relation to development, or to new and emerging issues upon which UNCTAD's expertise can be brought to bear. Some examples of such issues are given below.

1. Special development needs of groups of countries

177. The lack of progress made by the least developed countries towards achieving the Millennium Development Goals has emerged as a serious concern at the mid-point of the time frame for their implementation. UNCTAD will contribute to the efforts by the United Nations system to diagnose the causes of this lack of progress and will make practical policy recommendations to put the LDCs back on track. Poor middle-income countries and some economies in transition are also beset by poverty, unemployment and income inequality, and are in urgent need of more targeted international support, including through international poverty-reduction efforts. The Trade and Development Board could take up these issues on the basis of analysis provided by the UNCTAD secretariat, with a view to making recommendations.

2. New-generation South–South cooperation

178. UNCTAD has always championed South–South cooperation. In the current phase of globalization, the relevance and development potential of South–South cooperation has increased substantially. UNCTAD will strengthen its support for such cooperation by: deepening its research and analysis of South–South trade and investment, with the focus on new opportunities and emerging challenges; supporting South–South regional and interregional trade integration, including networking of South–South regional trade agreements and the interface with North–South agreements; providing practical, pro-development solutions to expand South–South trade in goods, services and commodities; upgrading its data and analytical tools on South–South cooperation, such as the new South–South Trade Information System; focusing its technical cooperation programmes more on South–South issues; and supporting the Agreement on the Global System of Trade Preferences among Developing Countries.

3. A changing commodities economy

179. Since 2002, there has been a "commodity boom", with international commodity prices showing a strong upward trend. Commodity-dependent developing countries may be able to use this window of opportunity to grow at a pace that will reduce poverty. Their success will depend on both the international environment – including the provision of finance for investment in infrastructure and supply-side capacity-building – and their ability to undertake necessary institutional development. UNCTAD will provide analytical and capacity-building support, particularly by strengthening its work on improving the access of small and poor producers to markets; strengthening regional cooperation on commodity market development; promoting the sustainable-development aspects of commodity production and trade; and enhancing the management of mineral resource wealth. UNCTAD's ongoing work on improving the competitiveness of commodity sectors and vertical and horizontal diversification will be informed by the need to respond to the changes taking place. In this context, the aid-for-trade initiative will be particularly important. UNCTAD will also give priority to issues that require action

at the multilateral level, including the development of new mechanisms to mitigate the short-term impact of commodity market fluctuations and the financing of safety-net programmes. It will mobilize international cooperation in support of commodity sector development.

4. Trade and development implications of climate change

180. The impact of climate change, which will have particularly adverse consequences for developing countries, and the significant economic costs of inaction in this area have recently been receiving increased attention from the international community. Measures taken in response to climate change in the areas of transportation, energy use, electricity generation, agriculture and forestry have significant trade and development implications. There is a growing willingness to adopt more stringent climate-change policies at both the national and international levels. UNCTAD is particularly well placed to address the following issues in this respect: the effect of climate-change policies on trade competitiveness, particularly with regard to the fossil-fuel energy content of tradable goods; trade and investment opportunities arising as a result of the adoption of measures to combat climate change; investment promotion and development gains in developing countries under the clean development mechanism of the Kyoto Protocol; and the compatibility of climate policy and trade rules.

5. Migration

181. Labour migration is expected to continue to rise for economic, political, security and sociocultural reasons, but opportunities for labour market integration remain limited due to political and security pressures, as well as its perceived negative effects on wages and employment. Migration brings benefits and costs to both countries of origin and countries of destination: the challenge is to ensure win-win outcomes for all. UNCTAD can help promote inclusive globalization in respect of migration by assisting countries to incorporate policies on labour market integration into their national and international development strategies; it can clarify issues at the interface of trade, migration and globalization; and it can enhance understanding and consensus among policymakers on the balance of benefits accruing from labour market integration.

6. Energy security

182. There are still 1.6 billion people in the world without electricity: to achieve the Millennium Development Goals, this number would need to be reduced to less than 1 billion by 2015. However, this will not be possible without dramatic new investment in energy infrastructure and resources, including alternative energy sources and efficient energy use. Countries need to optimize their energy mix and expand the use of renewable energy sources such as biofuel that contribute less to climate change while having a positive effect on rural incomes and agricultural diversification. Oil-exporting developing countries face the challenge of investing the surplus in such a way that it provides income for future generations without weakening the competitiveness of other exports. UNCTAD can help energy-exporting countries to devise strategies on the development of the energy sector as an engine for growth and development; assist energy-importing countries in attaining energy security through producer-consumer partnerships; enhance

procurement, finance and risk management; and promote regional energy cooperation.

7. Trade and development dimensions of post-conflict recovery

183. Restarting and transforming the economic machinery is a pressing concern for countries emerging from conflict and trying to put their societies on the road to recovery and growth. In a globalizing world economy, such efforts need to take full account of trade, investment and interrelated issues. UNCTAD's expertise and experience could make a significant contribution to the efforts by countries in the recovery process to formulate effective development strategies that would help them not only to devise ways of integrating into the global and regional economies on beneficial terms, but also to cope with external economic challenges. UNCTAD research and policy support could be complemented by technical cooperation for institutional, legal, regulatory and human capacity-building, to be delivered in cooperation with other United Nations agencies in order to provide the necessary, but so far underrepresented, economic aspect of post-conflict and crisis recovery.

8. Science, technology and innovation

184. As the global marketplace becomes increasingly liberalized and competitive, countries need to constantly upgrade their technological capabilities. Governments need to regularly assess the conditions governing the transfer of technology and the requirements for upgrading technological capacity. They also need to identify weaknesses in their science and technology policy, including in their innovation policies, and ensure they have the appropriate institutions to support their science and technology strategy. Information and communication technologies are unique in the way they can allow newcomers to leapfrog to state-of-the-art technologies without having to struggle with obsolete technologies.

185. UNCTAD should undertake policy-oriented research into knowledge as a global public good and into issues related to the transfer of technology, including appropriate mechanisms for its global dissemination. It should enhance its research and analysis on the role and impact of information and communication technologies in the field of development, with a focus on the information economy (including issues of Internet governance), intellectual property rights and the financing of technologies. It should also analyse trends in emerging technologies, in particular with regard to promoting the transfer of environmentally sound technologies to developing countries.

186. In full synergy with its research and analysis work, UNCTAD should provide technical assistance to countries through its science, technology and innovation policy reviews. It should also provide assistance with policymaking in the field of information and communication technology (ICT), including ICT measurement and legal and regulatory frameworks. In order to enhance the development of knowledge and skills for the purposes of trade, science and technology, UNCTAD should continue to encourage links between researchers and policymakers and the use of research-based policymaking for sustainable development and poverty reduction.

9. Emerging barriers to developing countries' trade and investment

187. It is a matter of concern that the opportunities for access by developing countries to developed countries' markets are subjected to an increasing variety of

non-tariff barriers. The Secretary-General's High-level Panel on Non-Tariff Barriers is a timely step in dealing with this issue in a system-wide manner. At the same time, the establishment of an inter-agency mechanism on this topic to assist the Panel is a testimony to UNCTAD's eagerness and ability to work with agencies of the United Nations system on common issues. Work on this issue will continue and will be strengthened. Another emerging type of barrier relates to developing countries' investment efforts in developed countries, which at times come up against obstacles on the grounds of national security, economic patriotism, social clauses and other forms of restriction. These and other emerging barriers need to be dealt with systematically, with a view to establishing fair terms of engagement.

10. Aid for trade and development

188. Aid for Trade is an essential complement to international trade liberalization, whether multilateral, bilateral or unilateral, to realize the potential development gains and to mitigate the costs of adjustment and implementation. Aid-for-Trade funds should be channelled multilaterally to help developing countries build their productive capacities and their ability to compete effectively in international markets. As indicated in chapter IV, progress on Aid for Trade must not be linked with progress in the Round. These important markers for Aid for Trade have been highlighted in the report of the WTO Task Force on Aid for Trade and should be taken on board in transforming commitments into action. For their part, prospective beneficiaries of Aid for Trade must ensure better mainstreaming of trade into national development policies and plans. Prioritization of trade in development is critical to evolving stakeholder Governments' commitment to trade and to implementing trade-enhancing programmes.

189. Over a period of many years, UNCTAD has gained significant experience in trade- and development-related technical assistance, and its programmes can make an important contribution. For example, UNCTAD has established expertise in training officials from developing countries in trade policy issues and assisting them to participate effectively in trade negotiations; promoting the diversification of commodity-dependent economies; assessing the impact of trade in services, non-tariff barriers and the interface between trade and environmental measures; strengthening developing countries' capacities to meet environmental and health-related product standards and to make use of preferential schemes and regional integration, including among developing countries; and drafting competition laws and policies.

190. UNCTAD can further assist developing countries in building productive capacities and international competitiveness through such measures as investment policy reviews and investment promotion; science, technology and innovation strategies; entrepreneurship and enterprise development; trade logistics; customs systems and trade facilitation; and the use of information and communications technologies for development. Together with other crucially needed measures, such as building and upgrading infrastructure and adjustment assistance, these actions will significantly strengthen the ability of developing countries to make use of existing and new market access opportunities and thereby multiply the gains from trade.

C. Enhancing UNCTAD's role in the context of United Nations reform

191. Efforts are being made to strengthen UNCTAD's role within the context of United Nations reform, a process that is still under way and whose outcome cannot be predicted with certainty. However, it is safe to say that development will remain a core preoccupation of the United Nations and that UNCTAD will have a distinct role in carrying forward the development mission of the United Nations.

192. The basic mandate of UNCTAD is set out in General Assembly resolution 1995 (XIX) of 1964, which established UNCTAD as an organ of the General Assembly. Since then, UNCTAD has been designated as the focal point within the United Nations for the integrated treatment of trade and development and interrelated issues in the areas of finance, technology, investment and sustainable development.

193. In the coming years, developing countries and countries with economies in transition will continue to face major challenges in the area of trade and development, including those arising from emerging and new issues. They will continue to need policy advice, and they will continue to need capacity-building assistance. As the United Nations focal point in this area, and as an organ of the General Assembly, UNCTAD must play a lead role in tackling these challenges. At the same time, the General Assembly will need to make sure that UNCTAD is shielded from wasteful "mandate creep".

194. The actions outlined in this report are designed to help enable UNCTAD to fulfil its role in promoting international cooperation in the field of trade and development and in helping countries address the challenges and opportunities of globalization. They will establish UNCTAD as a leading centre of research and analysis, providing its stakeholders with innovative and practical policy recommendations based on broad cooperation with other organizations and think tanks. They will enable the UNCTAD intergovernmental machinery to generate action-oriented outcomes in all areas of UNCTAD's mandate in order to guide Governments in their development efforts and in promoting orderly and development-oriented systemic evolution, and they will allow it to support the General Assembly directly in its deliberations on trade and development. They will place UNCTAD at the heart of a cluster of global and regional organizations offering a package of capacity-building technical assistance activities on trade and development and interrelated areas that can be delivered through the One United Nations process in accordance with each country's needs.