

PREPARATIONS FOR THE 1999 MINISTERIAL CONFERENCE

Proposal for the Establishment of a Working Group for the Study of the Impact of the Current Global
Financial and Monetary System on Trade and Development

Communication from the Dominican Republic, Indonesia, Malaysia and Thailand

The following communication, dated 1 October 1999, has been received from the Permanent Mission of Malaysia.

Background

1. Recent developments in the global financial markets have had major negative effects on the world economy, on national economies and on international trade. Indeed, the financial turmoil has caused the biggest harm ever done to the world economy since the Great Depression and, according to many analysts, it does constitute a permanent threat.
2. The lack of global regulation and inadequate regulation of the major international financial players (especially hedge funds and other highly leveraged institutions) and of new financial instruments (including derivatives), has allowed the proliferation of new sophisticated financial products and tools. This has subsequently led to a concentration of the financial resources and economic power in the invisible hands of a few, and has led to the rampant speculation and manipulation of foreign currencies, affecting mainly, if not solely, developing economies.
3. The current trend of deregulation in international finance, advances in technology, and the development of new financial instruments and institutions has resulted in huge volumes of short-term funds crossing borders, estimated at around US\$ 1.5 to 2 trillion daily. The massive inflows and outflows of funds have resulted in volatility and large swings in currency values, money supply, stock market and commodity prices. Currencies no longer necessarily reflect their fundamental values, as their levels can violently fluctuate as a result of herd instinct. In this context, developing countries and emerging markets have been especially vulnerable, while industrialized countries have benefited.
4. The most recent bout of financial volatility and crisis has had disastrous effects on many East Asian countries and Latin American countries as well as Russia. In East Asia, following the collapse of the national currencies and stock markets, and the very heavy increase in debt servicing burdens (as a result of currency devaluation), the growth rates for many countries fell from positive 7-9 per cent average of recent years to minus 7 to 15 per cent in 1998. Development efforts and sacrifices of many, as well as their achievements have been set back many years, if not decades.
5. It is obvious that unless adequate remedies are taken, there will be more bouts of financial volatility, and more countries will be subjected to perpetual financial and monetary instability. In this context, even the stronger economies are not guaranteed from such negative impacts.

6. Since price, the necessary component of any type of trade transaction of goods and services, can be easily affected by 'external' financial and monetary disruptions, via exchange rates and currencies convertibility, exchange rates and customs duties are closely interrelated. Hence, an abusive use of exchange rates, through monetary convertibility and speculative trading on foreign currencies can inflict, as it has been the case, an irremediable damage to the world trading system.

7. The downside effects on international trade, and its consequential effects on economic growth are manifold:

- (a) the growth rate of the volume of world merchandise exports slowed significantly to only 3.8 per cent in 1998 from 10 per cent in 1997, due mainly to the economic contraction in much of Asia, according to the WTO's latest report;
- (b) many other developing countries are also suffering from sharp declines in commodity prices, which to a significant extent is the result of reduced demand from the countries, which have been directly affected by the financial and monetary instability.

8. It is thus clear that financial volatility and monetary uncertainty are now the biggest threat to the expansion of trade and to the benefits that countries can derive from trade, as well as to output growth and employment, especially in developing countries. This is because the speculative trade on foreign currencies and the inflows and outflows of funds has a larger impact on developing countries as their economies are smaller. For example, the flow of a very small percentage of the funds of a financial institution into or out of a developing country can have a large effect on the national currency or the domestic stock market or debt situation of that country, whilst the same volume of funds may have an insignificant impact on a developed economy.

Proposal

9. For the foregoing reasons, it is proposed that a working group be established in the WTO to study the relationship between the workings of the current global financial and monetary system and their effects on international trade and the multilateral trading system, including on the development dimension.

10. The working group should focus, inter alia, on the reforms that may be necessary to (i) safeguard the multilateral trading system from new external financial and monetary disruptions, (ii) provide certainty and predictability to the continuous expansion of trade, and (iii) to ensure that Members genuinely benefit from further liberalization efforts.
