Chapter 4

The International System

4.1 There is rightly an increasing emphasis on the importance of good governance in developing countries and a growing consensus on its components. However, there is a need for equal emphasis on what might be called 'global governance' or 'international governance'.

4.2 The establishment of the United Nations after the Second World War was a major landmark in world history; so was the establishment of the Bretton Woods institutions, and the various technical cooperation and assistance agencies within the aegis of the United Nations and other bodies. However imperfect these bodies may have been, they represented an unprecedented degree of international cooperation; and we believe there remains much in the international system that the world cannot afford to lose.

4.3 But we also recognise that an international system out of step with current realities and needs ill-serves the world; and an efficient international system is a public good that enhances the welfare of all. Yet individual countries pursuing their own national interests will not necessarily succeed in achieving the best international system. We believe that the new conjuncture in world political and economic relations reveals a critical need and presents an opportunity to improve the present international system.

Global Security

4.4 The development issue cannot be separated from the issue of global security and ways of promoting it. Peace is an essential pre-condition to prosperity; and prosperity tends to promote peace and stability.

For forty years the United Nations' achievements fell far short of the huge expectations originally envisaged for it. In particular, its role in the promotion of collective security was undermined by the East-West conflict. Nevertheless, the charter of the United Nations endured, and provided guidance for the international community in the search for global peace and security. The United Nations, as an institution, contributed to the political process of decolonisation; provided a means of conflict resolution and pioneered techniques of containment such as the use of peace-keeping forces; effected a conceptual and moral revolution in the defence of human rights; contributed to the development and extension of international law; developed mechanisms for the mobilisation of emergency relief for people in distress and of assistance for refugees; and provided a means of mobilising world concern and action on a range of global problems such as the environment and drug trafficking.

4.5 While this is an impressive record, peace remained fragile for much of that period. Conflicts and threats to national security were an ever menacing reality in many countries, particularly in the developing world.

4.6 Many reasons have been offered for this failure: institutional weaknesses and lack of leadership and political will are some. A basic problem, however, is that while the causes and effects of most major challenges are international, the authority for dealing with them remains vested with nation states. And major countries have been unwilling to see a dilution in their dominance of the international system. This puts the United Nations in an ambiguous role. Its effectiveness has been shown to be limited to cases of agreement among its major members—very rare until recently, now fortunately more numerous. The many countries not in the category of 'major members' have often felt sidelined and powerless.

4.7 The nature of conflict in the world has also been changing in such a way that the distinction between domestic and international conflicts is being increasingly blurred. Civil wars, terrorist campaigns and attacks on civil authorities by powerful groups receiving support from external sources have become frequent sources of instability. Religious passions know no boundaries. They often fall outside the primary scope of action envisaged by the founders of the United Nations.

4.8 The ending of the Cold War provides new opportunities as well as new challenges to the United Nations. By easing tensions it could lead to greater emphasis on multilateral bodies for problem-solving of all kinds, including security. The growth of multi-polarity could also support movement towards a more democratic decision-making process

which takes greater account of the 'public good' nature of an efficient international system.

4.9 Thus, at present, the international community has an opportunity to define better the role of the United Nations and make it a more effective instrument for problem-solving. The Security Council's role could be enhanced by making more use of it for consensus building, behind the scenes negotiations and opening up of and posing alternatives to parties in conflict. It could also serve a useful function by taking on new roles such as determining damage and compensation due as a result of conflicts. But this requires a greater recognition on the part of the world community that in an increasingly interdependent world, global—and regional—institutions have a greater role to play, at the expense of national freedom of action; and that strengthening the United Nations is in the best interests of all.

4.10 The United Nations could also enhance its security-promoting role through projecting in the international community a more comprehensive concept of security that takes into account economic and social development, environmental change, human rights and migration. It could undertake more forward-looking analyses in this respect and provide early warnings of impending threats to global security. It could also contribute to world security through greater capacity and involvement in the monitoring and verification of disarmament agreements and compliance with internationally agreed bans on the production of, and trade in, armaments.

Economic Issues

4.11 As in the political field, the world community has achieved much in the economic sphere in terms of putting in place global institutions for co-operation. The establishment of the IMF and the World Bank—and the GATT in place of the stillborn International Trade Organisation (ITO)—provided in the post war decades a remarkable degree of monetary stability and a framework for economic co-operation and trade liberalisation. These were to underpin a remarkable period of growth in output and trade.

4.12 The Bank and the Fund responded to changing needs through a number of developments: the establishment of IDA, the increased importance given to non-project lending, the creation of Special Drawing Rights, the establishment of the Compensatory Financing Facility, the two Oil Facilities, the Trust Fund and, later, the Structural Adjustment Facility and its enhanced version. The role of these two institutions in attempting to contain the debt crisis in the 1980s also reflects a similar responsiveness to a changing situation.

4.13 In international trade, although the institutional arrangements fell short of original expectations, the GATT was instrumental in achieving a more liberal approach to market access. It has not, however, been able to prevent spreading threats to multilateralism and growing pressures of protectionism which could undermine world trade expansion.

4.14 These efforts at monetary, financial and trade cooperation were supplemented by technical cooperation and programmes of technical assistance to developing countries. The development of new varieties of seeds which made possible the 'Green Revolution', the elimination of diseases such as smallpox, the establishment and growth of a multilateral food aid programme, the provision of technical assistance through the various UN and other international bodies were all examples of multilateralism. Many developing countries themselves played a significant part in this process.

4.15 These were substantial achievements. The global institutions underlying them need to be preserved, and indeed strengthened. We are concerned, however, that in recent years the spirit of cooperation and the commitment to multilateralism and the development objective—which underlay the post-War vision—have increasingly come under threat, and that at a time when global economic and political changes require increased, not diminishing, cooperation. While the institutions themselves have undergone much change, and have acquired much valuable experience, there is a widening gap between them and the management needs called for by the present global situation and problems. Global change has also given rise to a need for co-operation in areas in which the world had hitherto not developed adequate mechanisms. For example, the environment has become a major international issue affecting all countries. Increasingly, drug trafficking is having major health and social impacts in many countries, and in some it is threatening to undermine basic legal and political institutions (see Annex 3 on pp.157-160). We believe that the international system should be strengthened to meet these new needs. We review some possible measures below.

Money, Finance and Macro-economic Policy Co-ordination

4.16 In recent years, the increased interdependence of the world economy has been accompanied by a growing role for markets in the determination of major currency exchange rates and interest rates. Under the impact of technological change and the dismantling of controls on capital flows, financial transactions have increased immensely in importance. There has also been a growing interrelationship between monetary, financial and trade issues. Under these conditions, consistency and appropriate policy mixes between monetary, fiscal and other

instruments in major industrial countries have assumed a new importance, not only for the stability and growth of their own economies but for the world economy.

4.17 These countries responded by establishing groups such as the G5 and the G7, which have as their objective increased consultations and better coordination (see Box 4.1 on pp.40-41). We recognise that these groups—and the OECD—have acquired a salience in this regard and play a useful role. Through intensified consultations, the G7 has in recent years achieved a degree of monetary cooperation and exchange rate intervention; underpinned governments' resolve to implement micro-economic reforms and adjustment; and helped develop common stances to issues such as developing country debt, the environment, and changes in Eastern Europe.

4.18 It remains the case, however, that these powerful groups are prone to reflect the domestic concerns of their members even though the participation of the IMF Managing Director in the G7 meetings is meant to bring a wider perspective to its discussions. The absence of well established mechanisms to ensure follow-up action to commitments, and a monitoring of the policy actions within agreed time-frames and well specified targets also limits the value of these consultations. The present procedures largely rely on the application of peer pressure for follow-up action. Even in the proclaimed key areas of foreign exchange rate stability and interest rate policy, success in harmonisation has been clearly limited.

4.19 The developing countries have also responded to the evolving situation by establishing their own country groupings— such as the G24 and G15—though they have yet to acquire a comparable degree of organisation in cooperation and coordinating their affairs (see Box 4.2 on pp.42-43). There is no Third World Secretariat corresponding to that of the OECD although a modest South Centre has been established to serve the G15. The UNCTAD, which has been traditionally under Third World leadership, has to some extent fulfilled the role of a 'think-tank' for the developing countries. However, in recent years, its influence has declined. In this context, it is noteworthy that the Commonwealth straddles the North and the South and has been able to maintain the dialogue between its members from both groups of countries. It may be able to serve as a catalyst for change in the international system.

4.20 Notwithstanding the cooperation that has been achieved through intensified consultations in the industrial country forums, the international implications of national economic policies continue to receive inadequate attention. G7 countries have yet to give due consideration to the effects of their policies on the developing world. And the global

economic environment continues to be characterised by the risk of significant malfunction due to lack of sufficient coordination.

4.21 We believe that the IMF has a central role to play in this regard, through enhanced multilateral surveillance. It should, in particular, assume its intended role in ensuring that global adjustment is symmetrical, with surplus as well as deficit countries undertaking adjustment; and in promoting contra-cyclical policies in order to bring about more stable world economic conditions. This is in line with the mandate given to the IMF at Bretton Woods.

4.22 While improved multilateral surveillance and better coordination by the G7 should reduce the risks of a significant malfunctioning in the global economy, such risks cannot be eliminated altogether. It is clear that national circumstances and priorities will ultimately have a significant weight in the formulation of policy. Fiscal and monetary policies in the developed countries, through resulting high interest rates or unduly onerous claims on world savings, can have severely adverse external effects. In addition, shocks arise from other circumstances such as the impact of war on oil supplies, crop failures and natural disasters. What is necessary is to ensure an international system that provides adequate safety nets and compensatory assistance to countries to mitigate the effects of shocks.

4.23 International economic events tend to have a disproportionate effect on developing countries, arising from such circumstances as poorly diversified production and export structures, debt overhang, limited access to commercial finance and poor cushioning capacity to withstand shocks due to the low level of incomes. The objectives of the international system and national policies should be twofold: to reduce the propensity to shocks on the one hand, and to mitigate the vulnerability to shocks on the other. There is a need to provide safety-net arrangements for weaker countries so that the position of the world's absolute poor is not made worse by external cyclical downturns and shocks. Other than the Compensatory and Contingency Financing Facility (CCFF) of the IMF and the Stabex scheme of the European Community (limited to ACP and least developed countries), there are at present no significant standing mechanisms in place that provide support to developing countries in periods of downturn in world economic activity. But even the CCFF and Stabex have limited capacity to provide support. The CCFF has, over the years, lost its automaticity and become more conditional. We believe that it needs to be strengthened to meet the needs of member countries more adequately. There should be larger access under it; it should provide assistance on terms of less stringent conditionality, longer maturity and lower cost. It must emerge as an effective instrument for contra-cyclical financing with low conditionality.

Box 4.1

Economic Cooperation Among Major Industrial Countries

G5 and G7 Cooperation

The collapse of the Bretton Woods System and the Smithsonian Agreement, as well as the oil price shocks, posed new problems in the 1970s. Industrial countries were confronted with the phenomenon of stagflation: the coexistence of inflation and unemployment at higher levels than in previous years after the Second World War. The efforts of the Committee on the Reform of the International Monetary System and Related Issues (the Committee of Twenty) to build an alternative rule-based system did not bear fruit. However, as macro-economic problems became more acute, the major countries began to search for ways of consulting in limited fora. These issues occupied the attention of the Bonn Western Economic Summit (1978).

Since then, the institutional framework for cooperation among the major economies is based on the Annual Economic Summits and bi-annual meetings of Finance Ministers and Governors prior to the meetings of the Interim and Development Committees. Additional ad hoc meetings are held when the situation warrants it. The Tokyo Economic Summit (1986) requested the Group of Five Finance Ministers (Britain, France, Germany, Japan and the United States) to include Canada and Italy (making it into a group of seven) in their meetings on global economic and financial issues.

The emergence of significant imbalances among major industrial countries and growing concerns about the misalignment of exchange rates in the mid-1980s led to increased willingness on the part of these governments to coordinate their economic policies. However, translating this into substantive action at the national level has proved difficult and the commitment to macro-economic coordination has receded. Action remains spasmodic rather than continuous, with little or no monitoring of follow-up action to commitments. Economic cooperation has also relied too heavily on currency intervention.

Important developments include the following:

Plaza Agreement (September 1985): The G5 launched a coordinated programme to manage a soft drive down in the value of the US dollar so as to enable exchange rates to better reflect economic fundamentals.

Tokyo Summit (May 1986): It was decided that Finance Ministers of the G7 would work together more closely and meet more frequently between the annual economic summits. Ministers, in conjunction with the Managing Director of the IMF, would review their governments' national economic objectives and forecasts at least once a year, taking into account indicators such as GNP growth, inflation, interest rates, unemployment, fiscal deficit ratios, current account and trade balances, monetary growth, reserves and exchange rates.

Louvre Accord (February 1987): Finance Ministers of the G5 and Canada declared that the US dollar, which had fallen about 40 per cent from its 1985 peak, had declined enough. They agreed on steps to stabilise the dollar within a range, which they did not announce. Countries with external surpluses agreed to stimulate domestic investment and consumption so as to increase their absorption levels. The United States agreed to fiscal contraction to reduce its external deficit. Japan launched a major plan to recycle part of its surplus to developing countries during the following three years.

Toronto Summit (July 1988): The G7 reached a consensus on rescheduling the official debt of the poorest countries, particularly in sub-Saharan Africa. They also emphasized the undesirability of excessive fluctuation of exchange rates.

Houston Summit (July 1990): The G7 stressed the need to contain inflation and make further progress in adjusting their countries' external imbalances. Additionally, action was recommended to conclude successfully the Uruguay Round of trade negotiations by inter alia major agricultural policy reform. Commitments were made for global action to protect the environment. Longer repayment periods were urged for official debt of lower middle-income countries undertaking strong policy reforms. The G7 also called for increased aid for developing countries undertaking political and economic reforms.

BIS and OECD

Important operational cooperation among the central banks of the industrial countries and support for the stability of the international monetary system is achieved through the Bank for International Settlements (BIS), set up in 1930. Governors of Central Banks meet regularly at the BIS to coordinate international monetary policy and to ensure orderly conditions on international financial markets.

A broad-based form of cooperation among industrial countries takes place through the Organisation for Economic Cooperation and Development (OECD). The OECD Council meets annually at ministerial level, immediately prior to the G7 Summit, and examines economic policy requirements for individual members in the context of the interests of the OECD as a whole. The OECD also provides useful links between the major economies and trading blocs as well as among virtually all individual industrial countries. It has recently embarked on a dialogue with 'dynamic' Asian economies. There is also important functional cooperation on matters of interest to individual members and to the OECD as a group, which helps to identify areas for joint action and to formulate common positions on contentious issues. In addition, coordination of industrial country export credit subsidies is effected under the OECD aegis.

4.24 Petroleum is a significant component of the total imports of many developing countries, and fluctuations in petroleum prices tend to have a large impact on their balance of payments. The sharp rise in these prices at the start of the recent Gulf crisis illustrates the problem. The CCFF is temporarily (November 1990 to December 1991) covering petroleum. We propose that this coverage be made permanent.

4.25 There is a widespread concern among developing countries that because of financial constraints and an unstated preference for a short-leash approach on the part of creditor countries, the assistance available from multilateral financial institutions in support of stabilisation and

Box 4.2

Developing Country Fora

Like industrial countries, developing countries have also established their own fora. However, the progress made in cooperation and the degree of organisation in the coordination of their affairs has been limited. They also do not have a Secretariat analogous to that of the OECD.

The Group of Seventy-seven (G77)

The Group of 77 was set up in 1963 and given concrete organisational form at the end of the first United Nations Conference on Trade and Development (UNCTAD I) in 1964 when 77 developing countries decided to act together to promote their economic interests. Since then the Group has played a vital role in developing and coordinating the positions of developing countries on international economic issues; in presenting a united front at multilateral negotiations with the developed countries, particularly in the UN fora; and in promoting cooperation among themselves. Membership of the group has now grown to over 125.

The Group of Twenty-four (G24)

The Group of Twenty-four, formally known as the Intergovernmental Group of Twenty-four on International Monetary Affairs, was established following a decision by the Group of 77 in 1972. Its main objective is to review the international monetary and financial situation and assess developments in international relations in these areas, particularly as they affect the interests of developing countries. Members of the Group are drawn equally from Africa,

adjustment is cast in too short a time-frame, forcing them to rely more on demand management measures than on structural adjustment (see Box 4.3 on pp.44-45). The weaknesses of such an approach are being increasingly acknowledged. Forced adjustment necessitated by short-term balance of payments arithmetic and the resulting import compression renders it impossible to make the investment required for recovery and diversification of the economy; and it inflicts an unnecessary loss of output and pain on developing countries. The contraction in developing country markets also means significant losses to industrial country exports and employment. We consider that much of this could be avoided by enabling the international system to support

Asia and Latin America. The Group usually meets twice a year, at ministerial level, in advance of the meetings of the Interim and Development Committees of the IMF and the World Bank.

The Group of Fifteen (G15)

The establishment of a Summit-Level Group of Developing countries, also known as the Group of Fifteen, was announced at the Non-Aligned Summit in Belgrade in September 1989. It was envisaged that the Group would serve as a forum for regular consultations among developing countries and for formulating and monitoring the implementation of programmes of cooperation among them. Its major tasks would be to review the world economic situation and the state of international economic relations affecting developing countries, especially in critical areas such as development, debt, finance, money, trade, science and technology, and the environment; to suggest strategies which developing countries could use to cope with emerging challenges; and to propose initiatives that might be taken in South-South and South-North fora. The results of consultations within the Group would be made available to other developing countries at suitable fora such as the Non-Aligned Movement and the Group of 77. At its first Summit meeting in June 1990 in Kuala Lumpur, the Group agreed on a specific programme of action consisting of 12 projects to advance cooperation among themselves, and set out its views on several issues of current concern to developing countries.

In November 1990, a Technical Support Facility was established to assist the Group. The Group will hold annual Summits, the next being scheduled for Caracas, Venezuela, in June 1991.

Box 4.3

Structural Adjustment in Developing Countries: Main Features

Over 50 developing countries are currently undertaking structural adjustment programmes. These programmes are a response to protracted crises which have affected many developing countries, and are adopted at the instance of the Bank and the IMF. They entail two types of policy response. The stabilisation component of adjustment is designed to bring domestic absorption (consumption and investment) into line with available resources. If, as is often the case, the impetus for adjustment stems from an 'external shock', this involves reductions in domestic expenditure to levels which are commensurate with the lower level of external resources available. The structural reforms in adjustment programmes entail changes in relative prices and institutions designed to make economies more market oriented, and thereby generate sustainable long-term growth. They also aim to mobilise more domestic savings and promote investment.

Structural adjustment programmes typically include the following features:

Stabilisation Measures

- Monetary policies
  - positive real interest rates
  - increases in reserve ratios
  - more vigorous open market operations
  - credit controls (these are not favoured by the IMF)
- Re-alignment of the exchange rate to a near market-determined rate (depreciation)
- Reduction of budgetary deficits
  - increased revenue mobilisation efforts
  - reductions in expenditure, including cuts in subsidies
  - reviews of public investment priorities and identification of a core programme of investment
- Deregulation of administered prices

- Real wage restraint
  - removal of formal indexation arrangements

Structural reforms

- Promotion of private sector (domestic and foreign)
  - definitive political commitment
  - rapid improvement in infrastructure
  - improvement in regulatory regimes
  - facilitation of investment approval procedures
- Commercialisation of public enterprises
  - improvement in operational efficiency
  - privatisation programmes
- Financial sector reforms
  - movement to market-determined interest rates
  - capital market development, including promotion of stock exchanges
- Liberalisation of trade regime
  - removal of import and exchange controls and progress towards lower and less dispersed bands of tariffs
- Price flexibility
- Tax reforms
  - reduction of distortionary effects on resource allocation
  - increased elasticity of tax system
- Administrative reforms
  - reduction in size of public service
  - increased pay and pay differentials to attract and retain trained/technical staff
  - 'Safety net'
  - well-targeted programmes of transfers to vulnerable groups
  - training, credit and employment programmes for vulnerable groups.

adjustment in developing countries in a longer time-frame and in a more growth-oriented framework. But that would call for a change in the attitudes of creditor countries; they should be more willing to vest the multilateral institutions with greater financial resources, and increase aid flows.

4.26 Present arrangements regarding the creation and growth of global liquidity are also a matter of concern. Industrial countries have taken the view that the growth of international capital markets, and their ability to provide finance to creditworthy countries, obviates the need for any formal arrangement for liquidity creation; and that the creation of unconditional liquidity, such as through Special Drawing Rights, could be inflationary and undermine the discipline required for adjustment. Such a view, however, ignores on the one hand the uncertainties surrounding the operations of the current multiple currency reserve system and the fact that the growth of liquidity depends in part upon reserve currency countries' willingness to run balance of payments deficits; and on the other hand the fact that commercial banks have become increasingly risk-averse regarding sovereign lending. As a result, even some creditworthy developing countries are having difficulty in obtaining access to sufficient liquidity. This strengthens the case for providing international liquidity from official sources. A related issue in this context is the extent to which the use of national currencies as reserve assets may have weakened policy discipline and coordination in the major industrial countries.

4.27 We believe that there is a case for examining these issues more fully; and for strengthening the role of Special Drawing Rights, both as a reserve asset and in providing liquidity during difficult times for the world economy. There have recently been rapid shifts in the surpluses of traditional surplus countries as a result of political events such as the Gulf war and German unification, which also call for new instruments of global management and sources of liquidity.

4.28 The increased weight of funds from capital markets in global financial flows also raises several systemic questions. Exchange and interest rates are now influenced as much by transactions on the capital account as on the trade account; and, often, restrictive trade practices are encouraged by such market-determined capital movements. The IMF, as it operates at present, is ill-equipped to deal with this situation. We believe that greater coordination of policy, including a more integrated approach to trade and monetary questions, is needed.

4.29 There was also a sharp increase in foreign direct investment in the 1980s. Much of it was driven by technological change and globalisation of production and markets, and it was concentrated in the triad of the United States, European Community and Japan. It meant that, in

effect, technological progress is causing economic performance among nations and regions to diverge further. While it is helping significantly to increase productivity and open up new opportunities for trade, it is also affecting the balance of competition. New disciplines and rules on capital flows and technology transfers are under consideration in the GATT and elsewhere. We believe that the international system should be strengthened to deal with these new challenges. (We discuss issues related to the international trading system in paras.4.32-4.35.)

4.30 The recent experience of developing countries raises serious doubts about their ability to attract the kind of capital flows required for financing their development. The balance of payments positions of traditional surplus countries are undergoing a major change, and many new claimants on global savings are fast emerging. Under these conditions, the ability of the international system to meet the needs of development finance on a stable and long-term basis is coming into question. We believe that steps are needed to improve the international system in this regard. One way by which this could be achieved is to enhance the capacity of the multilateral financial institutions—the World Bank and the regional development banks —in the provision of development finance through larger capital increases and replenishment of concessional resources; another is to expand bilateral official development assistance. These two approaches are, of course, by no means exclusive and in practice both should be pursued. We believe that both the industrial and the developing countries could also do much more to promote private capital flows to developing countries. (We discuss some possible measures in Chapter 6.)

4.31 Over recent years, there has been a growing overlap in the activities of the IMF and the World Bank, with the Fund increasingly tying its credits to structural adjustment reforms and the Bank paying more attention to balance of payments financing needs. To some extent this is inevitable. But it has brought fears of cross-conditionality; and because of the differences in the two institutions' mandates, operational time-frames and areas of competence, negotiation and implemention of programmes have become more complex. The Bank and the Fund have sought to strengthen their collaboration and settle their differences by the establishment of conflict resolution mechanisms. We believe, however, that there is need for further clarity in this area; and that the distinct character and independence of the two institutions should be maintained. A re-invigoration of the Fund's role in multilateral surveillance—particularly of major currency countries—would also help to delineate their respective roles more clearly.

Trade

4.32 The international trade, financial and technological links that now draw countries more closely together have dramatically changed the policy context for governments, multilateral agencies and transnational corporations. For many reasons, the member countries have constrained the extent to which the GATT can respond to the increasingly rapid process of change in the international economy. GATT's credibility has also been undermined since the early 1970s as its inability to deal with what came to be known as the new protectionism became increasingly apparent. The Tokyo Round Codes have helped in addressing a number of problems arising from change. But they apply only among signatory countries and membership varies from code to code. The fragmentation thus introduced has moved the GATT system away from its fundamental principle of multilateralism. Moreover, as structured, the system could not also address the strains in international trading conditions which arose during the 1980s from the significant expansion in foreign investment flows and from the rapid pace of technological change.

4.33 Given all the changes, what was required was a significant strengthening of the GATT to enable it to deal with what was, in effect, an erosion of its authority, to tackle the new protectionism, and to address the issues relating to foreign investment, technology, intellectual property rights, and services. As a result, several systemic issues, including the functioning of the GATT system, were included in the Uruguay Round of multilateral trade negotiations. We welcome the progress made so far in this area. Instituting a Trade Policy Review Mechanism, agreeing on biennial ministerial meetings and improving the dispute settlement procedures are very worthwhile developments. But achieving a fundamental improvement "in the overall effectiveness and decision-making of the GATT system", as envisaged in the Punta del Este Declaration launching the Round, will require much further progress. Completion of substantive agreements on services and trade-related aspects of intellectual property rights would also raise complex questions, institutional and other.

4.34 In order to administer the Uruguay Round agreements effectively and strengthen the institutional framework for the international trading system, some governments have proposed the establishment of a World Trade Organisation. Most developing countries, however, would prefer consideration to be given to the establishment of a development-oriented international trade organisation to deal both with trade liberalisation and with other issues having a bearing on trade and development, such as restrictive business practices, transfer of technology, trade financing, and the inter-relationships between the international monetary, financial and trading systems.

4.35 We believe that further strengthening of the institutional framework of the multilateral trading system is essential for several reasons, not least to administer the Uruguay Round agreements effectively, particularly the new issues (see paras. 7.45-46). A stronger institutional base would also help a trade organisation to increase its contribution towards achieving greater coherence in global economic policy-making through strengthening its relationship with the international organisations responsible for monetary and financial matters. There is a need to address these important institutional issues also.

Small Developing Countries

4.36 A particular concern of the Commonwealth is the vulnerability of small states. The growing interdependence of the world economy, the continuing absence of an established collective security system at the United Nations, and the escalation of regional, ethnic, religious and other conflicts which the world has witnessed in recent years, have continued to expose these states to great risks. We consider that the international system has not yet adequately responded to their needs.

4.37 Small states are particularly vulnerable to security threats. In recent years these threats have included open aggression, as well as destabilisation caused by terrorism and attacks supported by outside groups. The international community has an obligation to develop mechanisms to respond speedily to the requests of small states under threat. We believe that there is a special role for the UN Secretary-General in this regard. As a Commonwealth Consultative Group recommended some years ago, in cases of incipient and low-level security threats the Secretary-General should respond positively by sending missions to the concerned states at their request.[1] The Secretary-General should also regularly monitor developments in relation to the security of small states and forewarn of any possible dangers.

4.38 We consider that the establishment of new norms of conduct and a new order which provides security to smaller nations and supports their sovereignty is vital if security and defence concerns are not to pre-empt concerns about development.

4.39 The international system should also take into account the particular economic vulnerabilities of small states. These arise from the larger role of trade in their economies, and the dependence on a small number of activities in economic production. Their primary

[1] See Report of a Commonwealth Consultative Group, 'Vulnerability: Small States in Global Society', Commonwealth Secretariat, 1985.

products export sector is sometimes dominated by one or two powerful transnational corporations. In many instances, migrants' earnings and other invisible flows form a large part of the national economy. The small size of domestic markets deprives them of the advantages of economies of scale, and their frequently narrow resource base makes diversification difficult. Natural disasters are harder to cope with in small states. Such states also have a smaller reservoir of administrative and technically trained personnel compared with larger countries, making management of the economy that much more difficult.

4.40 We believe that the multilateral financial institutions should pay special attention to these particular vulnerabilities. They should do so in the provision of assistance under facilities such as the IMF's Compensatory and Contingency Financing Facility; in the design of adjustment programmes; by adopting more flexible criteria in graduating the small states from concessional funding facilities (such as the IMF's Enhanced Structural Adjustment Facility, or IDA); and by improving access to their resources. Special efforts should also be made to strengthen the disaster preparedness of the small states, and put in place mechanisms for the provision of international help in a predictable and speedy manner. Small states should consider pooling their administrative, research, and negotiating resources through regional arrangements to overcome the shortages in these resources.

Sovereignty

4.41 The increased political, economic and technological interdependence which we have stressed earlier in this Report, carries with it a necessary surrender of national freedom of action.

4.42 In many countries, particularly in the developed world, there is now a widespread appreciation of the need to co-ordinate economic policy; there is also a wide recognition that integration within regional groups brings benefits which outweigh the resultant constraints to independent action, even though within some of them it has produced very real political and economic tensions. In other countries there has been a sense that the weaker members of a group have been obliged to give up a greater degree of freedom of action than their stronger partners. There is, in particular, a feeling in many developing countries that the international financial institutions have intruded into domestic policy-making; and that in practice these institutions no longer exercise effective surveillance over the policies of industrial countries which impinge on the developing world. Whether right or wrong, such feelings tend to undermine the credibility of these institutions; and adversely affect the follow-up action agreed in global forums. Yet it remains the case that in an increasingly interdependent world many

economic and other benefits can only be obtained and harmful effects avoided through closer integration and the surrender of some freedom of action. Better structured international institutions and mechanisms can help individual countries to come to terms more willingly with the need for closer integration.

4.43 In this context we believe that the world community should explore the scope for strengthening the role of the United Nations, which remains a pivotal global institution. It is also important to restore to the IMF, in matters that affect the world economy as a whole, some of the influence it has lost to groups like the G5, G7 and G10; and to preserve the relative position of developing countries in the decision-making bodies of the IMF and the World Bank (see Annex 4 on pp. 161-166).

4.44 Where possible, emphasis on consensus-building would also enhance the sense of wider participation in global management. A particular case in point is the design and monitoring of Bank and Fund adjustment programmes, whose implementation has tended to suffer from perceptions of real or imagined unfairness. We believe that the full confidence of the political authorities implementing the programmes is critical to success; and it could be greatly enhanced by exploring ways of reaching decisions more by genuine consensus. We see merit in the suggestion that associating independent experts in technical analyses and monitoring of implementation could assist the process of consensus-building. In this context, we see a role for an independent Institute, or possibly the strengthening of an existing institution, whose focus would be on providing policy-oriented technical support, and on bridging the gap in negotiations and implementation between the adjusting countries and the Bretton Woods institutions.

Solutions for New Issues

4.45 There is an increasingly urgent need to find international solutions for new issues, ranging from drugs, through the environment, to democracy; and for others, like trade, where there seems to be a consensus that more international authority is necessary to enforce and supervise agreements. The international community therefore has to find an enduring and well specified mechanism to raise new issues, and then to negotiate new international agreements.

4.46 One area to explore is the possibility of a greater role for regional organisations, not merely to realise the advantages in trade or payments that have been traditionally perceived as their main raison d'etre, but to provide a way of adequately representing the smaller and weaker countries within the international system, and mediating between them and the larger and stronger countries. Such organisations could also

have a role in the environmental regulation needed among neighbouring countries. This could prove one way of effectively promoting regional organisations which could later take a more active role at a global level.

4.47 The principal need is to find an enduring framework within which countries can identify new needs for international cooperation or regulation, whether because of the emergence of new or newly-realised subjects, as in the case of the environment, or dissatisfaction with the present forums, as in some of the monetary, finance and trade areas. The moves in this direction that have occurred, by using adaptations of present organisations, like the Global Environment Facility or the new Trade Policy Review Mechanism of the GATT, show that countries at all levels of development do agree on some of the new problems, and also on the need for intervention. The present international system, which dates largely from the then revolutionary innovations and surrenders of sovereignty of the 1940s, needs to be reinvigorated in order to enable it to respond to new issues.