

Trade-Finance Linkages –An Assessment of Selected Issues on G20 Summit Agenda

International Working Group on Trade-Finance Linkages

The Steering Committee of the International Working Group on Trade-Finance Linkages offer the following input for your consideration at the upcoming Group of 20 Summit in Cannes,

The Working Group brings together organizations North and South to promote trade and finance policies on the basis of a paradigm that links such policies in the service of development premised on human rights, gender equality, social justice and ecological goals. It is with this lens that the Group approaches the expected outcomes of the Summit and offers the following analysis structured around three areas:

I. The G20 Development Action Plan

II. Trade, investment and the G20's approach to regulation of commodity derivatives markets

III. Trade and the G20's approach to the international monetary system

I.The G20 Development Action Plan

The Development Action Plan was launched in Seoul with the professed objective of “narrowing the development gap and reducing poverty,” and contributing to strong, sustainable and balanced growth. The G20 set a high bar for such efforts by, among other things, committing to ensure its efforts would “maximize value added and complement development efforts of other key players” and focus on “tangible outcomes of significant impact that remove blockages to improving growth prospects in developing countries.”

We have comments with regard to both the process and the substance of the Development Working Group's activities.

Process Concerns

We urge the G20 to develop open, participatory and consultative processes. At present, it is difficult to see how the G20 is adhering to the Seoul Consensus principle of partnership with low income countries, since to the best of our knowledge, low-income countries have been only marginally involved in the design of the Development Action Plan, at best. Without the engagement of developing country governments and citizens, ownership – the basis for sound development – will be impossible. Moreover, without transparency, citizen involvement is uninformed and unproductive.

We urge the G20 to issue recommendations to the appropriate institutions. At present, the G20 frequently mandates development finance and other institutions to take actions which are more appropriately mandated by the institutions' governing bodies, themselves.

We urge the G20 to adhere to principles of transparency. Civil society and outside experts have been unable to obtain information about the membership and agenda or the background documents for meetings

We urge the G20 to commission documents from organizations and institutions. The practice of commissioning papers from individual staff members of intergovernmental organizations acting in their personal capacity bypasses the institutionalized and more inclusive channels for deliberation and accountability available within such institutions. The G-20 financial ministers have sought advice from the Financial Stability Board, the International Organization of Securities Commissions and the Bank for International Settlements. The Development Working Group should consider requesting input papers from the relevant international organizations, such as the UN Development Program and the UN Conference on Trade and Development. If the Development WG intends to live up to the role and principles it set for itself in Seoul last year, it has to begin by showing that it can apply the good practices that have been largely recognized in the development community.

Substantive concerns based on the G20 Ministerial Meeting on Development and its accompanying "Preliminary Report on the G20 Action Plan on Development."

Trade. We urge the G20 to focus on boosting gains for national capital, growth in output, and poverty reduction. The G20 seems to take merely increasing trade volumes as the goal of its activities. But, many low income countries, including Least Developed Countries, saw their trade levels soar during the pre-crisis period and, yet, the increased exports failed to translate in gains for national capital, growth in output and poverty reduction. The *Social Watch* report, which analyzed indices of Basic Capabilities for the last decade, concludes that increases in trade did not lead to faster, but to slower, progress in relation to such indicators. This is no less true of Africa – the regional focus of G20 activities. The African Progress Report recently expressed concern that "While natural-resource extraction has accounted for only about a third of Africa's real GDP growth in the last decade, more than 80 percent of the continent's export earnings come from primary, generally unprocessed commodities." (African Progress Report 2011, p. 11)

Private investment and job creation. *We urge the G20 to focus on investment principles which can boost national, shared benefits from FDI, including links with domestic companies and job creation.* At the 2010 Seoul Summit, the Group of 20 announced its proposal to leverage and maximize the economic value-added of private investment. This was a welcome focus, as an acute problem in low income countries is that they succeeded in attracting more foreign direct investment, only to find that it is confined to natural resource sectors, which have limited linkages with local companies and limited impact on job creation. The G20 had an opportunity to explore the potential of economic policy tools

that national governments could use to improve their performance in drawing national benefits from FDI presence. But they have, instead, chosen to restrict their inquiry to a look at existing responsible investment principles, presumably of a voluntary nature. The functioning of these measures – and not of unconventional economic policy tools— likely will be the focus of the six pilot country studies the G20 has announced it will conduct. By seeking a broader array of input, as suggested above, the Development Working Group can provide the G-20 Leaders more and better policy investment policy options for low-income countries.

Infrastructure. *We urge the G20 to learn the lessons from past experience with Public-Private Partnerships and the low levels of transparency and participation – together with misallocation of risks -- that have led to poor performance and excessive public sector debts.* The G20 recognizes the persistent gap in infrastructure financing suffered by developing country economies. Yet, unless the G20 Finance Ministers identify new and innovative sources of finance, the G20, itself, is not prepared to help finance the gap. Instead, following conclusions of the High Level Panel on Infrastructure, it the Ministers stresses mechanisms to diversify and enhance sources of financing, particularly private sector financing for such projects. The means for attracting finance would be enhancements in Multilateral Development Banks' procedures to facilitate co-financing arrangements, making better use of project preparation funds, and improving the business climate to promote public and private investment in infrastructure. . This approach overlooks the fact that relying on private finance for filling the financing infrastructure gap has been tried before, and it is largely the reason why the gap has deepened over the years. G-20 promotion of PPPs also overlooks the fact that the private sector only can profit from such projects by offloading risks into public sector budgets – frequently in ways that lack transparency. We are unaware of proposals to utilize approaches [safeguards are not referring to the social and environmental safeguards that the Banks are abolishing here, so there could be a better word choice] to safeguard budgets from the misallocations of risk that hampered the performance of public-private partnerships in the past.

Mobilization of domestic resources. *We urge the G20 to help governments obtain the revenue that it should be earning from its corporate citizens.* To date, little has been achieved on transfer mispricing, a key problem that constrains the ability of developing countries to derive revenue from the trade in which they are engaged. Estimates place the revenue losses due to transfer pricing at around USD 100 billion a year. The G20 offers to support the program recently launched by “the competent multilateral organizations” – these remain unnamed—to “assist developing countries in drafting and enforcing their laws, particularly in the area of transfer pricing.” However welcome this support is, it leaves the government with the responsibilities that should be supported by international cooperative agreements such as country –by –country reporting. The Working Group should consider recommending to the G-20 Leaders that they propose a G-20 sponsored meeting to discuss how best to remedy corporate tax avoidance through transfer mispricing, which is fiscally ruinous for developing countries.

II. Trade, investment and the G20's approach to regulation of commodity derivatives markets

The International Working Group is also concerned about the impact of ongoing deliberations on how to coordinate reforms of commodity derivatives markets in the G20.

Many developing countries still export mainly commodities. For all but two Latin American countries, unprocessed commodities represent more than 50 per cent of their export revenues and, in Africa, primary commodities account for near 70 per cent of the average exports in the period 1995-2006.

This commodity dependence contrasts starkly with the experience of countries that have successfully managed to make trade a pillar for development. This experience shows that the best development payoffs do not only come from commodity production, but from diversification into products with high value added, high skill and technology content, and more linked into domestic production and consumption structures.

In this regard, the price swings and distortions resulting from deregulation in commodity markets – through trade and financial liberalization as well as reserve depletion - negatively affect the capacity of developing countries to prosper, due to their exposure to boom and bust cycles that inhibit investment and productive upgrading strategies. Speculators profit while rarely contributing to higher income for producers or improvements in agricultural production or diversification strategies. In sum, excessive speculation that contributes to higher or more volatile prices seldom benefits producers and producing countries. Commodity price distortion in deregulated derivatives markets cannot be corrected and is sometimes further exacerbated in the price transmission to retail consumer products, particularly for food and energy.

In order to enable developing countries to use trade as an instrument for capital accumulation and its equitable distribution, ongoing approaches to re-regulate commodity derivatives markets in both developed and developing countries –but especially in major financial centers-- must:

- 1) Limit the volatility of commodity prices by measures to prevent excessive speculation, i.e. the exceeding of hard position limits aggregated across all trading venues, calculated on a per trading entity basis,
- 2) Be complemented by limits or bans to those non-end user, non-hedgers or non-commercial participants in commodity derivatives markets who engage in excessive speculation, and disciplines against High Frequency Trade practices that induce non-fundamental factor volatility.
- 3) Be supported by appropriate policies and measures to support the upgrading and diversification of productive structures, and
- 4) Be complemented by a discussion on abolishing export subsidies and re-installing controls of regulating stocks of food related commodities.

We call the G20 to focus on the following specific measures:

-- Regulation and transparency of pre- and post-trade data in derivatives trading should be improved. The Joint Operational Data Initiative announced by the G-20 finance ministers and the Agricultural Markets Information System announced by G-20 agricultural ministers will need additional authorities to ensure that corporate owners of stocks supply accurate and complete information whose anonymity as to corporate information source can be guaranteed by JODI and AMIS officials.

--Previously unregulated *Over the Counter* derivative commodity trades (bilateral trades with no exchange to manage risks of counterparty default) should be carried out on public and regulated exchanges. Exchanges should clearly define the different kinds of traders and require them to report accordingly. The September 2009 G-20 Leaders commitment to moving “standardized OTC derivatives to exchanges or electronic trading platforms, as appropriate,” should be toughened, in view of the broad evasion of this commitment by financial firms that claim the OTC derivative products to be “customized” to their clients’ needs.

--Better [quality](#), publicly accessible [price and volume](#) information should be frequently made available by exchanges. Trade data on OTC derivatives, which remain bilateral and are not moved to electronic platforms, should be reported to trade data repositories to which regulatory authorities must have unfettered access. This aggregate but meaningful information should be made publicly available on a fortnightly basis as is done by the [U.S. Commodity Futures Trading Commission](#) (in the US), in order to enable stakeholders and academics [to analyze trade movements](#).

--Pre-trade and post-trade reporting requirements on physical commodity markets should be implemented so as to enable monitoring of arbitrage between physical and financial commodity markets.

--Exchanges should be legally required to establish aggregate speculative position limits (total number and value of contracts for a given commodity) and these limits should be enforced across regulatory jurisdictions with the cooperation of trade data reporting by exchanges and electronic trading platforms, including Foreign Boards of Trade, as a condition of market access to foreign markets. --Price limits or “circuit breakers” might be required in some markets, e.g. swaps execution facilities and on exchanges that have not them yet.

--Those transactions that, due to insufficient standardization, are not eligible for trading on an exchange should be cleared with higher margin requirements than exchange-traded commodity derivatives and subject to real-time reporting. Those transactions that are not cleared should be subject to real-time reporting and to significantly higher collateral and capital reserve requirements.

--End-users should only obtain exemptions from clearing requirements for OTC trades when the exemption is strictly circumscribed to commercial risk in hedged commodities. Financial firms cannot claim exemptions in order to continue unreported and non-collateralized bilateral trades. The possibility of removing this exemption and addressing end-users needs through alternative means – e.g., making available funding for clearing or price insurance, should be considered.

--The participation of publicly insured depository institutions in commodity derivatives trading should be reduced by requiring higher margin and capital reserve requirements or banned altogether.

-- Trade and investment agreements should not place restrictions on governments' ability to employ macroeconomic and regulatory policy tools to manage boom and busts cycles or stop excessive speculation, and relative prices of commodities versus other, especially non-traditional, export sectors.

III. Trade and the G20's approach to the international monetary system

There is an urgent need to provide for an orderly transition towards an international monetary system that supports stability, trade and an adequate mechanism for adjusting global imbalances without recessionary consequences. The G20's approach to the reform of the international monetary system is where the G-20's failure to make progress will probably be most costly to a world economy that, again, veers dangerously close to a new global recession. There is an acute need for alternative mechanisms to provide stimulus on a sustainable basis, since at this time, the US and European show limited capacity to do so.

But while the G20's recent statements recognize the need to boost job creation, they fail to place the international monetary system reform as the key factor required to succeed in this endeavor. This probably accounts for why the French Presidency of the G20, after getting off to a great start by placing the reform of the monetary system top of its agenda, is grinding progress to a halt in this last stretch. It is understandable that the G20 would fail to deliver a full reform – too ambitious in the light of the timeframe required for that to happen -- but the G20 cannot afford to fail to reach consensus on a sensible, incremental plan of action.

The International Working Group has promoted as key pillars of the required reforms a) a reformed version of Special Drawing Rights-- or a new global reserve currency-- playing a central role, b) an alternative and credible mechanism for the multilateral management of exchange rates and c) greater reliance on regional and sub-regional mechanism for monetary cooperation.

We urge the G20 to:

Innovate on approaches to reduce exchange rate volatility: The G20 has chosen to prioritize discussions on surveillance and lending tools within the IMF. We have reasons to doubt that these approaches, that have gone unresolved for more than a decade, have much to contribute to reducing exchange rate volatility, especially within the still seriously undemocratic IMF structure. On another item being prioritized by the G20, the "framework for managing capital flows," we are concerned that potential outcomes of this process might be curbs on the rights of countries to implement capital account restrictions in accordance with the Articles of Agreement (Article VI). Some preliminary IMF reports recommend subjecting exercise of that right to certain pre-conditions that fail to contemplate

the realities that differentiate developing country economies, particularly their relatively greater reliance on trade.

Welcome the diversity of regional monetary approaches: Instead of welcoming the contribution that diverse and more flexible and context-driven regional financing and liquidity arrangements can make to global financial stability, the IMF is exploring ways to centralize the monetary architecture under one-size-fits-all principles.

Utilize the full potential of Special Drawing Rights reforms: Finally, the discussion on Special Drawing Rights seems limited to a broadening of the currency basket not guided by any particular rationale to make the basket more stable and flexible, but by geopolitical realities and the desire by some to see the renminbi becoming a fully convertible currency. Furthermore, the potential of Special Drawing Rights as an autonomous tool to provide stimulus to the global economy at a time when all other possible mechanisms are failing, is apparently excluded from consideration, as are other reforms that would make the SDRs a more suitable cornerstone for the international monetary system.

Conclusion

We stand ready to provide further input and work with the G20 members that are willing to take leadership in moving forward these proposals.