Statement by

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THE GLOBAL ECONOMIC COLLAPSE’S LONG-TERM IMPACTS ON DEVELOPING COUNTRIES

The most severe global financial crisis since the Great Depression has wreaked havoc on the world economy. Even with an expected recovery in the second half of 2009, the United Nations estimates that world gross product (WGP) will likely fall by 2.6 per cent for the year. Some calm has returned to global financial markets since the second quarter of 2009, with equity prices rebounding and risk premiums narrowing. World international trade has rebounded somewhat. Industrial production in many parts of the world has shown signs of recovery.

Encouraging as these recent trends may be, global economic conditions are still very fragile. The world economy is projected to recover in 2010, but most likely at a pace below 2 per cent. The global recession will translate into a fall in world per-capita income by 3.7 per cent in 2009, with sharp declines not only in developed economies but also in a large number of developing countries: at least 60 developing countries (of 107 countries for which data are available) are expected to suffer declining per-capita income in 2009 and tens of millions more people likely will remain poor or fall into poverty. A substantial slowdown in progress towards the other Millennium Development Goals (MDGs) is expected as well, especially in those countries that were not on track to meet most of the MDGs even prior to the crisis, such as a number of economies in sub-Saharan Africa. Some of the adverse impacts could be long-lasting, damaging the basis of human development, in such areas as maternal and infant mortality, education enrollment and completion rates, women’s employment and access to public services.

The UN system, along with its partners, has been working to help countries weather this storm. But this system needs to be assisted with additional resources for monitoring the condition of the most vulnerable, for protecting them against adverse impacts and for building resilience into the future.

ESTABLISHING AN INTERNATIONAL COUNTER-CYCLICAL FRAMEWORK

Since late 2008, massive public funding of about 30 per cent of WGP has been made available, mostly by developed economies, to recapitalize banks, taking partial or full Government ownership of ailing financial institutions and providing ample guarantees on bank deposits and other financial assets. The governments of many countries have also adopted various fiscal stimulus packages, totalling about $2.8 trillion, or about 4 per cent of WGP, for 2009-2011. While these policy measures are properly associated with a tentative recovery of the global economy, it is not yet clear whether they will lead to the restoration of a robust and sustainable growth of the world economy, especially in developing countries.
As noted in the communiqué of the G20 leaders in Pittsburgh, the premature withdrawal of monetary and fiscal stimuli poses a significant risk. Despite a rebound in production, employment growth continues to be weak, and will likely remain so in 2010. Both the financial sector and the real economy are still fragile, requiring continued strong policy support. There are legitimate concerns about the fast deteriorating fiscal positions in some major economies. However, past crises show that the most successful cases are where fiscal consolidation took place during a sustained recovery of the economy and related boosts in public revenue, while failures occurred where fiscal stimulus measures were too weak or withdrawn too soon, leading to aborted recoveries alongside mounting public indebtedness.

Thus, an ‘exit strategy’ should retain a countercyclical policy framework, with stimulus measures only phased out after unemployment rates have come down to acceptable levels. In order to reduce uncertainties and to anchor market expectations, it will be desirable for policymakers worldwide to agree on a set of credible guidelines for phasing out stimulus measures after the global economy has recovered. It is important to coordinate these guidelines internationally, to avoid inconsistency and negative cross-border policy spillover effects, which could delay, or even derail, the recovery of the world economy. Given the systemic defects of the current global reserve system, a poorly executed exit strategy will exacerbate exchange rate instability.

More international efforts are needed to ensure adequate transfer of resources to developing countries, particularly to the most vulnerable low-income economies. Most developing countries lack the resources to undertake the needed counter-cyclical measures for mitigating the impact of the global financial crisis on their economies. Of the $1.1 trillion international financing packages under the auspices of the G-20, only $750 billion has been delivered and only in terms of contributions to IMF resources. Only $50 billion was earmarked for supporting social protection, boosting trade and safeguarding development in low-income countries, but this promise has only been partially fulfilled. In this regard, given the possible long-lasting impact on low-income countries, it is also critical for the international community to deliver on ODA commitments. To meet the 2005 Gleneagles commitments, ODA flows from OECD/DAC countries should increase by $35 billion to reach at least $155 billion by 2010. Of this increase, $20 billion should go to Africa. The crisis cannot be an excuse not to deliver; rather, it should be a reason to accelerate on commitments, given the increased external financing needs in the poorest countries.

There is a continued need for enhanced international coordination of macroeconomic policies. This is not only needed for putting the global economy on a path to real recovery, but also to steer towards a more balanced and sustainable growth path. The crisis has narrowed global imbalances in a recessionary fashion, with surplus countries losing export revenue and deficit countries seeing sharp drops in imports. However, the structural problems that caused the emergence of the wide global imbalances in the first place have not been removed. Current policy efforts for recovery could well cause a re-emergence of macroeconomic imbalances. In most surplus countries, especially in Asia, the conditions of heavy dependence on exports for growth and relatively weak domestic demand have not fundamentally changed. The continued global imbalances and mounting public indebtedness increases the risk of strong downward pressure on the dollar. Effective policy coordination will be needed to ensure that such a destabilizing scenario does not become a new drag on the global economy. The ‘Framework for Strong, Sustainable and Balanced Growth’ -- agreed to by the G-20 leaders in Pittsburgh -- will only succeed if it addresses these underlying weaknesses in the global system.

GLOBAL GOVERNANCE AND THE BRETON WOODS INSTITUTIONS

Recognizing that the roots of the current crisis lie in failures in global governance, the United Nations Conference on the World Financial and Economic Crisis and its Impact on Development in June 2009 called for (1) “reforming and strengthening the international financial and economic system and architecture, as appropriate, to adapt to current challenges” and (2) “fostering good governance at all
levels, including in the international financial institutions and financial markets.” In this regard, it recognized “the urgent need for further reform of the governance of the Bretton Woods institutions, on the basis of a fair and equitable representation of developing countries, in order to increase the credibility and accountability of these institutions.”

The June 2009 UN Conference also called for “an expeditious completion of the reform process of the World Bank’s governance and of an accelerated road map for further reforms on voice and participation of developing countries, with a view to reaching agreement by April 2010, based on an approach that reflects its development mandate and with the involvement of all shareholders in a transparent, consultative and inclusive process” and “inclusive consultations on further reforms to improve the responsiveness and adaptability of the World Bank.”

While the international emergency measures contributed to the ‘green shoots’ of recovery currently celebrated and appear to have “worked”, the urgency of completing required international governance reforms has been underlined by the enormous costs of these interventions, both in terms of public resources and economic distress borne by billions not party to their design and implementation. Moreover, the outcomes of the September G-20 summit in Pittsburgh highlight the political difficulties that need to be overcome in the following areas:

*Voice and participation.* The proposed increase in the weight of votes of emerging economies is a step in the right direction, and politically expedient with these economies’ increased financing contributions. However, much of the increases in the votes of certain emerging economies have been achieved at the expense of the votes of other developing countries, a retrogression from the agreement in September 2006 which promised these reforms in terms of increasing the overall voice of developing countries. The understanding that providing ample voting weight to potential users of Bretton Woods institutions’ resources would help guarantee the institutions’ effectiveness - a principle enshrined in the original 1944 allocation of voting weights when European countries were the prospective users - should guide vote reallocation and reforms in voting procedures - including in the determination of the number of seats in governing bodies.

*International Financial Regulation.* International coordination of financial regulation is indispensable in achieving the intention of “G20” countries to reshape regulatory systems to identify and take account of macro-prudential risks; expand the perimeter of regulation and oversight to all systemically important financial institutions, instruments and markets; mitigate pro-cyclicality in prudential regulation; strengthen capital, liquidity and risk management; implement new principles on executive remuneration; and improve standards on valuation and provisioning.

In a financially integrated world, regulatory effectiveness depends in large part on significantly enhanced international cooperation among regulators. However, current institutional arrangements to ensure that national decisions regarding regulation appropriately take into account both external and domestic consequences remain ineffective. The effort at the Pittsburgh summit to agree on compensation standards in the financial sector presents an example of the need to rise above the variety of inconsistencies among regulatory systems across countries. Intentions to limit the systemic risk arising from financial institutions’ size and interconnectedness will require international coordination.

Establishing international mechanisms to coordinate regulation, minimize conflicting standards, and enforce agreements, akin to the trade policy issues dealt with at the World Trade Organization, will entail an extended but necessary process in the coming years.

*Rebalancing Global Demand for the Long-term.* In Pittsburgh, G-20 countries called for “a pattern of growth across countries that is more sustainable and balanced, and reduce development imbalances,” a
pattern we have advocated in recent years. While improved surveillance and exchange rate adjustments have important roles to play in this regard, this impact would be limited as long as domestic sources of deficits and surpluses, being sustained by global stresses, are not addressed. Exchange rate adjustments would have more predictable consequences with a reduction in dependence of the global reserve system on the US dollar.

In developed countries, the reduction of fiscal imbalances and decreased reliance on debt-financed consumption as well as reduced asset and income inequalities would be indispensable. For many developing countries, switching from dependence on export demand to domestic demand will require a fundamental reorientation of economic policy. States must recapture policy space, including the capacity to raise taxes and tariffs, to fund higher rates of social and capital investment and develop domestic industries. Their income policies should enable labour productivity increases to translate more rapidly into higher wages.

STRENGTHENING INTERNATIONAL COOPERATION IN TAX MATTERS

Capital mobility, in the absence of tax harmonization among countries, has contributed to regulatory and tax competition, with the result of clearly diminished capacities of tax and financial authorities to secure the information required for supervision and tax collection. The UN Financing for Development Conference in Doha in 2008, the G-20 meeting in London in April 2009 and the UN conference on the financial crisis in June 2009 all highlighted the importance of strengthening international cooperation in tax matters.

This newly strengthened effort can only be effective with the full and equitable participation of all tax jurisdictions, particularly developing countries, which are poorly represented in key tax cooperation fora such as the OECD and the G-20. Faster progress in reducing harmful tax competition and upgrading cooperation in such areas as exchange of information and transfer pricing can be achieved through universal participation of all countries.

GLOBAL RESERVE SYSTEM FOR STABILITY, ACCOUNTABILITY, AND EQUITY

In our Spring 2009 statement, we emphasized the technical advantages of a global reserve currency independent of the currency of any one economy, or region, and note the burgeoning international interest in this issue. We highlighted the advantage of such a system in reducing the inherent instability of the current approach which relies on external deficits by the country providing global reserves. In Pittsburgh last month, G-20 countries called for a new era in managing global imbalances. As we emphasized above, this objective will require adjustments to global arrangements, to allow countries to take the necessary domestic adjustments, within an international countercyclical framework. While the Pittsburgh commitments do not include any enforcement mechanism, important progress in managing imbalances can be made by reducing the reserve currency country’s “privilege” to run external deficits in order to provide international liquidity.

It is timely to emphasize that such a system also creates a more equitable method of sharing the seigniorage derived from providing global liquidity. Greater use of a truly global reserve currency, such as the IMF’s Special Drawing Rights, enables the seigniorage gained to be deployed for development purposes, as asserted in the Monterrey Consensus in 2002.

CLEAN ENERGY INVESTMENT STRATEGY AS A KEY GLOBAL WARMING REponce

So far, the climate challenge has been dealt with mainly as an environmental problem. This needs to change decisively, if the global community is to meet the climate stabilization goals that science is asking
for. Setting targets and timetables are necessary but not sufficient in themselves, as they do not deal with the underlying development problems facing developing countries. Climate change and development have to be addressed together as the highest priorities of the international community.

Especially in recent years, the post-Kyoto record highlights the partial role price-based mechanisms can play in addressing the climate change problem. Volatility in the price of energy have made carbon markets quite unstable in terms of trading volumes and prices and, thus, unsuitable for providing the long-term signals needed to reorient long-term investment spending. Because of market instability, the impact of taxation and (removal of energy) subsidy mechanisms will be subject to the same unpredictability of impact and, moreover, these approaches have to address the issue of compensating for distributional effects. Most important, the scale of the change in economic behavior required to meet the challenge suggests that market-based approaches, more appropriate to marginal changes, will be inadequate, to the global task.

A substantial and additional investment programme to enable developing countries to transition to a low carbon and climate resilient development path is the most effective way to meet the global community’s climate objectives, as suggested in the September 2009 UN World Economic and Social Survey entitled *Promoting Development, Saving the Planet*. Financial investments must be complemented with scaled up efforts to develop the capacity of national and sub-national policy makers and partners to identify ways to advance human development and grow the economy while adapting to the impact of climate change and mitigating emissions. Agreement on the transfer of technology to the developing world is another critical component for enabling a transition to cleaner energy, infrastructure and industry.”

Generating the volume of financing to meet the climate change challenge will require summoning the necessary political commitment at the global level, in which the outcome the Copenhagen summit in December can play a critical role. Governance arrangements for climate change resources need to be fundamentally different from those under which official development assistance is currently provided. The United Nations Framework Convention on Climate Change (UNFCCC) provides the only legitimate and universally accepted framework for aggregating and equitably allocating resources on the basis of existing agreements.