Statement by
Mukhisa Kituyi
Secretary-General
UNCTAD
Statement by

Mukhisa Kituyi
Secretary-General of UNCTAD

to the International Monetary and Financial Committee
and the Development Committee

Washington, D.C., October 11, 2014

The world economy continues to grow at significantly lower rates than before the crisis. In several regions, that subdued growth does not generate sufficient good-quality employment to reduce open unemployment and underemployment. This unsatisfactory outcome is to a large extent the result of an inconsistent policy mix, in particular in several developed economies. In this more challenging global economic environment, developed countries need to improve the policy mix with a view to increasing aggregate demand, and developing countries need to look for new growth drivers, expanding and better harnessing the policy space available to them. New UNCTAD analysis shows that a scenario of more consistent internationally coordinated policies for balanced growth could raise global output by 1-2 percentage points annually going forward. Increasing sovereign debt stocks, particularly in developing countries, and the ongoing litigation against Argentina also point to the pressing need for international agreement on a multilateral debt workout mechanism.

Continued weakness of the global economy

Six years after the eruption of the global financial crisis, the world economy has been unable to recover a strong and sustainable growth path. A modest improvement is expected in the growth rate of global output in 2014, to slightly above 2.5 per cent, compared to 2.3 per cent in 2012 and 2013,1 thanks to a moderate acceleration in developed economies, from 1.3 per cent in 2013 to 1.7 per cent in 2014. Developing countries as a group are set to repeat their economic performance of 2012-2013 (at around 4.5 per cent), while transition economies (particularly those in Europe) continue to slow down for the third year in a row, to below 1 per cent, on average.

International trade remains lacklustre, with the volume of merchandise trade increasing at a rate slightly above 2 per cent in 2012 and 2013, and an expected growth of between 2.5 and 3 per cent for 2014. This lack of dynamism contrasts sharply with its rapid expansion in the two decades before the crisis, when global trade of goods and services expanded more than twice as fast as GDP.

While several forces have undoubtedly been at work, there is no evidence that the slowdown in international trade is because of higher trade barriers or supply-side difficulties; rather, lacklustre trade growth has overwhelmingly been the result of weak global demand. It is therefore highly unlikely that international trade alone will be able to drive global growth forward.

1 Output is measured in 2005 US$ at market prices.
Policy mix challenges in developed countries

The present recovery in the developed economies is the slowest on record since the Second World War. It took three years for the United States to recover its pre-crisis level of GDP, four years for Japan, and only in 2014 is the European Union expected to do so. Regarding per capita GDP, the United States and Japan returned to their 2007 levels only in 2013, while in the European Union, per capita GDP in 2014 remains almost 2 per cent below its 2007 value. Recovery in employment has also been slow, taking four years for developed countries to reach the same absolute level as 2008.

The weak recovery is due, in part, to the nature and magnitude of the crisis. After a financial crisis it is normal for aggregate demand to remain subdued for a protracted period of time, as both debtors and creditors seek simultaneously to consolidate their balance sheets and recapitalize. In this case, however, policy missteps have compounded the weakness of the recovery.

After a short period of simultaneous supportive fiscal and monetary policies, which helped avoid a full-scale financial implosion and led to an economic rebound in 2010, most developed economies shifted to fiscal austerity. As UNCTAD warned in the 2010 Trade and Development Report, such a move was premature, because private sector demand had not yet been re-established on a solid basis. Indeed, it was very unlikely to do so in a timely manner, given the on-going deleveraging and the high levels of open unemployment. The resulting emphasis on rapid "fiscal consolidation" has prompted an undue reliance on monetary policy to fashion the recovery. Not only has this implied very low interest rates, but also massive money creation through Central Banks’ "unconventional monetary policies".

Considerable emphasis has, in addition, been given to boosting competitiveness, particularly through containing wage costs, as a means to encourage net exports and restore growth. This raises two problems. First, this strategy cannot be pursued across the board, because, unlike productivity, competitiveness by nature is a relative variable. In that sense, it can only increase in some countries if it decreases in others. Therefore, if several trade partners cut their wage costs at the same time, none of them will actually improve their competitiveness. The second problem is that cutting wages depresses domestic demand, with the risk of a race to the bottom further constraining prospects of a sustained economic recovery.

It is clear that this combination of policy choices has been inadequate. The cost of fiscal restriction in terms of output growth was greatly underestimated. With high levels of unemployment and idle capacity, fiscal multipliers are also high, making the drag on GDP from cutting public investment and social expenditure sizable, as shown in the UNCTAD Trade and Development Report 2011. With output growth constrained, fiscal revenues have also been below expectations, while the promised recovery of investor confidence in the real economy has not materialized. At the same time, monetary expansion by the Central Banks has not translated into an expansion of credit that finances increased private expenditure, because the deleveraging process is far from completed. The massive monetary injection was used more for speculative than for productive purposes, reinflating the price of financial assets but also leading in many cases to capital outflows to developing and emerging economies. For sure, albeit indirectly, the
associated wealth effect has helped private demand to recover in some countries, but on a rather fragile basis. Nonetheless, the action by Central Banks was very effective in reducing the risk of sovereign default, as it was clear when the European Central Bank announced in 2012, with its unlimited Outright Monetary Transactions, that it would act, if necessary, as a lender of last resort.

It seems therefore that using monetary policy to reduce the risks on the financial sphere, and using fiscal and income policies to support economic activity would be a better policy combination for strengthening the recovery, given that the main constraint on economic growth is the lack of aggregate demand. The effects of such a policy reorientation would be maximized if the respective policies were adopted in a coordinated fashion, especially among developed countries, as further discussed below.

In search of new growth drivers in developing countries

Developing countries have managed to recover from the Great Recession faster than developed countries, as they tackled the consequences of the global financial crisis by supporting domestic demand with countercyclical policies. The task was further eased in those countries that benefited from rising commodity prices. However, there are limits to what can be achieved by developing countries through either countercyclical policies or gains from the terms of trade; new sources of dynamism will need to be found if countries are to recover their pre-crisis growth rates. In addition to measures that could help bolster the growth of domestic markets, including redistributive measures, many countries need to raise their levels of domestic investment, including in the public sector, and conduct industrial policies aimed at an expansion of their productive capacity and competitiveness so as to respond to rising demand without excessive pressure on domestic prices or their trade balance.

Developing countries will also have to face the challenge of persistent instability of the international financial system. Tackling this should involve the adoption of more prudent macroeconomic and regulatory policies at the national level, but also better surveillance and stronger regulation at the regional and global levels.

Developing and transition economies are affected by a global financial cycle that is mainly driven by developed countries’ economic conditions and monetary policy decisions. The resulting capital movements do not necessarily coincide with the needs of receiving countries. Instead, they tend to increase their financial fragility, which can eventually lead to a financial crisis. In order to create and maintain domestic macroeconomic and financial conditions that support growth, governments should have at their disposal suitable policy instruments for managing international capital flows. These should be considered normal instruments in policymakers’ toolkit, rather than exceptional and temporary devices to be employed only in critical times. Multilateral rules in the IMF’s Articles of Agreement and in the General Agreement on Trade in Services of the World Trade Organization do allow governments to manage their capital accounts, including a resort to capital controls. However, some bilateral and plurilateral trade and investment agreements that have been signed, or are being negotiated, introduce more stringent commitments with respect to financial liberalization than those contained in multilateral agreements. Therefore, governments that aim to maintain
macroeconomic and financial stability should carefully consider the risks in taking on such commitments.

More generally, developing and transition economies need to preserve and enlarge their policy space to pursue the most appropriate mix of economic and social policies to achieve equitable and sustainable development. Indeed, building more competitive firms, moving resources into higher value added sectors and strengthening national technological capabilities must rely on both market forces and government actions; effective industrial policies and dedicated efforts to support and coordinate private- and public-sector activities are also crucial.

**The need for consistent policies and better international policy coordination**

Restoring higher growth rates and setting them on a sustainable basis will require improving the consistency of economic policies, in several respects. First, and as noted earlier, policy tools and policy goals should be appropriately matched: fiscal and incomes policy should aim at revamping demand, while Central Banks should use their toolkit to support investment in the real sector and maintain low risk premia, without necessarily creating huge amounts of money (the existence of a lender of last resort willing to play its role is more important in that respect). A second aspect of policy consistency refers to using all possible policy instruments for supporting the recovery of demand given that this is the primary constraint on growth; mixing fiscal and wage restraint with monetary expansion is not the right combination. A third aspect refers to consistency of policies among countries: some may want to reinvigorate domestic demand, while others may focus on (net) export demand for recovering growth. But only, if most countries – led by large surplus economies – adopt simultaneously pro-growth policy stances, will the positive spillovers among them strengthen growth everywhere and make it more sustainable.

UNCTAD has conducted a scenario modelling exercise which indicates that the benefits from such a policy reorientation could be large. In the coordinated growth scenario, global GDP growth would accelerate by more than one per cent over the years 2015-2019 (from 3.4 per cent in the baseline to 4.7 per cent), and by almost two per cent for the period 2020-2024 (as GDP growth rate would reach 5.5 per cent instead of 3.6 per cent in the baseline). This scenario assumes a policy package which comprises incomes policies to support growth of demand on a sustainable basis; growth-enhancing fiscal policies; industrial policies to promote private investment and structural transformation; regulation of systemically important financial institutions and capital controls to stabilize global financial markets; and development-oriented trade agreements. Its results are compared with those of the “baseline” scenario, which broadly continues with business-as-usual policies. Importantly, the faster growth rates for all regions in the expansionary policy scenario are the result not only of policy stimuli in each country individually, but also of the synergy emerging from the co-ordination of pro-growth policy stances among all regions.

International policy coordination and cooperation would also be helpful to address other global economic problems, such as the public revenues losses due to tax competition among countries, or resulting from tax avoidance and evasion through transfer pricing by large international firms, illicit international financial flows and low-tax (or no-tax) jurisdictions. Reducing tax leakages would provide developing countries with larger public revenues (and “fiscal space”) to finance
development programmes but would also support expansionary macroeconomic programmes in the advanced economies.

**The need for a genuine multilateral debt workout mechanism**

Within the global context of vibrant capital flows, the total external debt stocks of developing countries and transition economies have continued to increase. These stocks reached $6 trillion in 2013, rising 8.7 per cent over 2012 levels (UNCTAD secretariat calculations based on the World Bank 2014 *International Debt Statistics*). Total debt to GDP increased to 22.7 per cent in 2013, from 20.9 in 2011 and 21.7 per cent in 2012. Debt service to exports rose from 7.9 to 8.3 per cent and total debt to exports increased from 72.8 per cent to 75.9 per cent from 2012 to 2013.

The increase in sovereign debt stocks is partly driven by the recent bond issues by some countries in sub-Saharan Africa, which reached historical highs of $5 billion in 2013. This level is equivalent to 20 per cent of aid and 12 per cent of FDI for the region. A number of LDCs (Rwanda, Tanzania and Zambia) have augmented traditional concessional loans by borrowing on international financial markets on commercial terms, because they can issue bonds at a lower interest rate compared to domestic markets. It is interesting to note that the yields on four out of eight rated sub-Saharan African Eurobond issuers were lower than 5 per cent in 2013. Greater access to the international financial market could help LDCs financing part of their long-term infrastructure needs for economic growth. However, the LDCs and other developing countries should pursue active debt management to avoid over-indebtedness and mitigate the risks associated with these new financial instruments, including rollover risk, currency risk, and greater macroeconomic volatility from large capital inflows. The recent return of both Ghana and Zambia to the IMF, in the face of sharp declines in their currency, is a reminder that it is crucial for countries to manage such capital inflows and volatility.

It is also important to take note of the important structural changes in public debt that have occurred in most developing and transition economies over the past decade. Locally and internationally issued securities have continued to account for the bulk of it while bank loans have remained a small proportion of the total. This has been associated both with a concomitant increase in foreign participation in domestic markets for government debt, and a rapid increase in corporate issues abroad. At the end of 2013, for a number of developing countries, foreign investors held more than one third of government bonds in local debt markets. Almost all these foreign holdings are denominated in local currencies. An important implication of increased foreign access to domestic debt markets is a sizeable shift in the holder profile of government debt towards non-residents, particularly in securities. It is estimated that foreigners now hold $1 trillion government debt of developing and transition economies, excluding foreign official loans.

The global financial cycle involves large amounts of capital flows that frequently have disruptive macroeconomic effects in receiving countries. This may lead to balance of payment and financial crises when capital inflows stop or reverse. These are generally fiscal crises as well, as governments take on a large part of the cost of the crisis.
The larger share of securities in the public debt in most developing and transition economies compared to that of bank loans and bilateral debt has opened a number of new opportunities for developing countries, but it also leaves them vulnerable in times of debt distress as the international mechanism for restructuring bonds remains slow, inefficient, and uncertain leading to the possibility of costly defaults.

Recent debt crises have again demonstrated that disorderly debt restructurings can lead in many cases, through procrastination and the costly bailout of creditors, to socializing private debt, damaging economic adjustments and to considerable human suffering. Furthermore, the protracted (and ongoing) litigations by a few bondholders against Argentina has shown that the current judicial framework, in which public law issues are treated by commercial courts, not only discourages new debt restructuring, but can even jeopardize successful past restructuring. This experience has led to intensified international debate on the need for a sovereign debt restructuring mechanism to improve efficiency, fairness and co-ordination in restructuring episodes.

The litigation against Argentina further highlights the problem of the existing legal forum fragmentation. Different courts have very different interpretations of the same contractual clause and hence impose a wide array of rulings. The end result is further incoherence and unpredictability in debt restructuring. Moreover, the recent ruling against Argentina affects third-party holders of restructured bonds as it prevents them from receiving payments Argentina keeps making; it also obliges third-party financial institutions to provide information about assets of sovereign borrowers, which will have a significant impact on the international financial system. This example shows that politics and interests groups can have an impact on the outcome of debt restructurings, compromising consistency and fairness. The ruling has made future debt restructuring much more difficult as debtors are left with only moral suasion and diplomatic channels to encourage creditor coordination.

With a view to increase the efficiency, stability and predictability of the international financial system, recent General Assembly resolutions on debt have called for consideration of enhanced approaches to sovereign debt restructuring and recognized the design of a multilateral debt workout mechanism as a necessary tool for debt crisis resolution.

Finally, data shows that debt relief provided under the HIPC Initiative and MDRI has achieved a redirection of resources towards poverty reducing expenditures. While the international community should be satisfied that the increase in poverty reducing revenue has been achieved, we must also be aware that most HIPCs remain off track for achieving many of the Millennium Development Goals targets. Debt relief alone is not a panacea to the development challenges confronting HIPCs; it is a necessary but insufficient solution and we must find ways to provide additional assistance both in terms of development financing and capacity building to those countries. This could be an issue picked up in the United Nations Conference on Financing Development to be held next year.