

Statement by**Mr. Mukhisa Kituyi
Secretary-General of UNCTAD****to the International Monetary and Financial Committee
and the Development Committee****Washington, D.C. - October 12, 2013**

There has been much talk recently about economic “recovery” taking hold in developed countries and with it a return to “normality” for the world economy. In reality, that recovery is uneven and timid. Global output growth will barely exceed 2 per cent in 2013, measured at constant 2005 dollars, little changed from last year’s weak performance. With a growth rate of around 4.5 per cent, developing countries will continue to make the largest contribution, accounting for two thirds of global growth; transition economies will grow at around 2.5 per cent, while developed economies will grow slightly above 1 per cent. The growth in international trade has also slowed sharply since 2010, to less than 2 per cent in volume this year, compared to an average of 7-8 per cent in the pre-crisis years.

This failure to gain traction leaves the recovery vulnerable to unexpected shocks and changes in investor sentiment. Moreover, many of the structural imbalances that lay behind the crisis have yet to be addressed. This means that a return to pre-crisis growth is not only unlikely to happen, but is also undesirable given that it was built on unsustainable global demand and financing patterns.

Employment conditions are symptomatic of the current precarious situation in developed economies. The total number of employed in those countries has declined from 510 million in 2007 to 500 million in 2012, creating a jobs gap or deficit that is larger and longer-lasting than in any previous crisis affecting these countries over the past three decades. This led to historically high unemployment rates, especially in the European Union (close to 12 per cent) and the United States (around 7.5 per cent). Unemployment performance has fared better in developing countries: among the G-20 emerging economies, only Mexico and South Africa had higher rates of unemployment at the end of 2012 than before the crisis: all the other countries managed to reduce that rate. However, in many developing countries the quality of employment has not improved, with underemployment and informal sector jobs persistent structural challenges.

As the developed economies continue to experience slow or stagnant growth, the resilience of developing economies is beginning to weaken. Following the crisis, the initial difference in the economic fortune of developed and developing countries led some to speculate about a “de-coupling” of the growth performance of the latter from the former. Developing countries were able to mitigate the impact of the crisis by means of expansionary macroeconomic policies and by relying on closer trade and investment ties with each other. The differential in growth rates between developed and developing countries increased sharply, reaching 6.2 percentage points in 2009, although it declined to around 3.5 percentage points in 2012-2013. In fact, as the external economic environment shows few signs of improvement and with the effects of expansionary policies now fading, the developing and transition economies are also struggling to maintain their growth momentum.

If the period of slow growth in developed countries does continue, it seems highly unlikely that developing countries will be able to rely on exports to those countries to return to pre-crisis growth rates. Developing countries have seen their share in global exports rise steadily over the past two decades linked, in particular, to the expansion of south-south trade. Much of this is, however, concentrated in Asia and is closely tied to the spread of international production networks. These networks continue to rely on

developed countries as their ultimate markets. This suggests that south-south trade has not yet become an autonomous engine of growth for developing countries. Some care is therefore needed to avoid fuelling unrealistic expectations of GDP and trade expansion in those countries based on simple extrapolations of recent trends: while more active policies will be needed to secure lasting development gains from choosing a different growth path.

One shared challenge facing both developing and developed countries will be to ensure that wages keep pace with increases in productivity. Globally, the share of labour-income as a per cent of GDP has fallen dramatically in recent decades. However, wage income constitutes a large proportion of total income (about two-thirds in developed countries) and is still the most important source of demand for goods and services in many countries. Further reductions in the share of labour income will have dampening effects on household consumption with resort to higher levels of household debt unlikely to compensate this time around. The damage to sustained growth from this pattern of global underconsumption could worsen if the trend of too many goods chasing too few consumers triggers second-round effects through dampening investment, raising the threat of stagnationary pressures across the global economy.

This negative outcome is not inevitable. Coordinated macroeconomic policies in which surplus countries apply a stronger stimulus and no country adopts contractionary policies would deliver better results in terms of growth, income distribution, employment and global imbalances than current policies that place all the burden of adjustment on deficit countries. According to quantitative exercises on alternative policy scenarios conducted with the United Nations Global Policy Model, even if developed countries were to persevere with their current policy stance, developing countries could still improve their economic performance by pursuing a coordinated economic stimulus. From this perspective, encouraging regional cooperation and closer South-South ties would need to be an important component of their development strategies.

Prior to the Great Recession, buoyant consumer demand in some developed countries enabled the rapid growth of manufactured exports from industrializing developing and transition economies which, in turn, provided opportunities for primary commodity exports from other countries. This virtuous expansionary circle boosted global growth and seemed to vindicate developing and transition economies in adopting an export-oriented growth model. However, the model rested on a rising tide of household and corporate debt, and its viability is under question in the current context of balance sheet adjustments and slow growth in developed economies. Exports growth from developing countries also declined significantly from more than 11 per cent a year between 2002 and 2007 to less than 4 per cent since January 2011.

As discussed in UNCTAD's Trade and Development Report 2013, to address the prospect of a prolonged period of considerably slower export growth, policymakers in developing countries need to give greater weight to domestic demand as an engine of growth. Such a move towards a more balanced growth path could compensate for the adverse impact of slower growing exports to developed countries. Moreover, this more balanced growth strategy could be pursued by all developing and transition economies simultaneously without beggar-thy-neighbour effects. In fact, if many countries expand simultaneously their domestic demand, their economies could become markets for each other, fostering regional and South-South trade.

Putting in place the measures that are required to achieve this change in growth trajectory will need a policy rethink in several areas. It will require a move away from seeing labour as only a cost of production that needs to be kept low in order to compete on global markets and towards seeing it as a key source of consumer demand. Also, in order to avoid an import surge and subsequent payments crisis, it will be essential to strengthen domestic investment and innovation to ensure a convergence in domestic production and consumption patterns. This, in turn, means re-directing the financial sector, to ensure that enterprises can access the credit they need, at the right price, to transform their productive processes into

ones that can meet the needs of local and regional consumers. Public investment will also be needed, to develop infrastructure, transport and education among other things. Industrial policies can help strengthen the competitiveness of domestic producers in domestic and regional markets, and to help gear production structures to the changing composition of demand as per capita incomes rise.

In their pursuit of more balanced growth strategies, countries will need to fully utilize the policy space still available following the Uruguay Round trade agreements and various regional and bilateral trade and investment agreements. Such agreements should also preserve adequate policy space for developing countries, including by allowing a greater degree of support to certain industries that are at an early stage of development.

In light of the obstacles faced by advanced economies to effectively reregulate their financial markets and institutions and given the absence of any significant efforts at the multilateral level to bring about greater market stability, developing countries need to find ways to protect their financial systems against the vagaries of international finance and to make them more supportive of productive investment.

The recent ebb and flow of capital to emerging markets since the financial crisis has served as a reminder that these movements have much more to do with financial conditions in the centre than with a specific host country's conditions or needs. Macro-prudential measures are increasingly seen as necessary to reduce the threat to growth and development from future rounds of financial instability. Given the scope of the potential damage, the use of controls on both inward and outward capital flows should not be excluded from the list of tools available to developing countries facing significant financial volatility.

The announcement by the US Federal Reserve in May 2013 of its intention to slow down the pace of quantitative easing has caused turmoil in the currency markets of many emerging economies, accelerating an economic slowdown that had already been set in motion in the larger economies of the South. In the era of finance-led globalization, characterized by increased inter-dependence and instability, these events have demonstrated yet again that developing countries are still very vulnerable to economic and policy shifts in the advanced economies, and a further reminder that de-coupling in the South is a misleading description of recent trends.

Together with the policy changes described earlier for rebalancing away from excessive dependence on external markets for goods and finance, south-south cooperation can be a further critical element of a new development strategy. Appropriate regional arrangements can provide support to industrialization and economic diversification, as well as new external markets to complement domestic demand. In the current economic context in which southern countries can no longer rely on the northern markets for sustainable growth and development such arrangements would appear to have taken on even greater significance.

In this respect, south-south cooperation can support regional trade and productive integration. It can help overcome the obstacles that have hindered regional integration to date, by setting up new financing mechanisms for trade and infrastructure development, and supporting a more ambitious agenda that focuses on productive capacity building and structural transformation at the regional level. South-south cooperation can further support a new development strategy by filling the gaps in the current international financial architecture in critical areas for developing countries, such as macroeconomic volatility and external shocks.

Recent initiatives in the area of south-south cooperation have been very encouraging. In particular, it is worth highlighting the on-going discussions for the creation of a BRICS development bank to support infrastructure and development projects both in BRICS and other developing countries. Other important south-south initiatives worth mentioning include a BRICS agreement to set up an international reserve pool to work as an additional line of defence against external financial shocks, and initiatives to create

local currency swap arrangements to address volatility and shocks in currency markets and support trade among participating countries.

Alongside the challenges facing developing countries in this uncertain and still evolving global economic environment, debt sustainability remains an important issue. As the discussion of tapering and exit from the unconventional expansionary monetary policy in developed countries is picking up, rates on long-term bonds have begun to rise. This is particularly true for developing countries that have expended a significant degree of their fiscal buffers in recent years to respond and mitigate negative shocks stemming from the global financial and economic crisis, which came on the back of the food and fuel crises in 2007-2008. At the outset of the crisis, many developing countries had a strong or balanced fiscal position but now, for many, their fiscal policy space has greatly diminished.

Since the outbreak of the global crisis the growth of the total external debt stock of developing countries has grown at a faster pace. In 2011 it reached \$4.8 trillion, marking a 10.7 per cent increase over the previous year; 2012 marks the third consecutive year that the growth of external debt of developing countries has exceeded 10 per cent following nearly a decade of average growth around 7 per cent. Along with rising debt stocks developing countries also experienced a slowing of output and export growth which has contributed to a worsening of key debt ratios over the past year: and although the external debt situation of developing countries as a group remains manageable aggregate statistics mask some important differences between regions and country groupings.

For many LDC economies in Sub-Saharan Africa, a combination of strong growth, prudent macroeconomic management, and debt relief has produced a sharp decline in debt burdens. However, the public debt ratios have been rising in many post-HIPC/MDRI countries in recent years. A number of countries that have completed the HIPC Initiative continue to be classified at a high risk of debt distress. This is a worrisome trend particularly as it is accompanied by a decrease of ODA flows over the last two years, at a time when low income countries need highly concessional financing to maintain debt sustainability.

Debt sustainability depends upon a multitude of factors that include not only future growth, but also borrowing conditions, terms of trade, foreign exchange risk, interest rate risk, among other considerations. As such debt sustainability is part of a much wider policy discussion. However, a preemptive strategy supported by appropriate policies and standards can usefully focus on the prevention of future debt crises. In this respect, the implementation of the UNCTAD Principles on Responsible Sovereign Lending and Borrowing provides a step in the right direction.

Further to the efforts at the country level the international community must remain vigilant in providing assistance and debt relief to countries in need, especially as the post-2015 agenda takes shape. With the conclusion of the HIPC Initiative drawing near, lessons must be drawn from both the successes and shortcomings of the Initiative. As it is not realistic to assume that additional challenges will not arise in the future, the international community should make its best effort to learn from this experience to better prepare for debt crisis response in the future. In addition, the international community should more actively explore a rules-based approach to sovereign debt workouts to increase predictability and the timely restructuring of debt when required, with fair burden sharing, including the provision of minimum outlays in the budget for social protection. In this context, UNCTAD has set up a working group with the participation of all stakeholders to develop a debt workout mechanism.

Imbalances and instability in the global economy continue to threaten growth and stability at the national level, particularly, but not only, in developing countries. Addressing these problems remains to a large extent the responsibility of systemically important advanced economies.

However, and even though the increased weight, in recent years, of developing countries in global output, trade, FDI and capital flows has been concentrated in a small number of them, this shift opens up new possibilities. For one, it gives greater weight to their voice and increases their bargaining power as a group for reshaping the rules and institutions that constrain the policy space available to countries that are latecomers to development. But perhaps as importantly, the international community should now realize that, with the structural shifts in the world economy, global economic partnerships should move away from unidirectional and asymmetrical relationships and embrace, instead, the logic and the spirit of truly international collective action.