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Global output is set to grow in 2016 at a rate close to 2.4 per cent, which is around the average for the past 6 years. This confirms a significant slowdown compared to the pre-crisis expansion of about 4 per cent a year. Developed economies will grow, as a group, at about 1.7 per cent, compared to about 1.9 per cent in 2015. Developing countries will continue growing close to 4 per cent, as in 2015. This performance, however, is entirely due to East, South-East and South Asian countries. Growth in Latin America, Africa and West Asia will be adversely affected by term-of-trade losses and capital flow reversals, and by related fiscal and balance of payments constraints. The vulnerability facing emerging economies marks the third phase of the international crisis.

The widespread and prolonged slowdown in economic activity raises unanswered questions about its causes. It may result from the dynamics of the crisis itself, and/or a number of policy mistakes, but it can also reflect more fundamental problems that maintain the world economy on a low growth path, and could even plunge it into a "secular stagnation". Whatever the cause, a world economy that cannot stimulate faster grow without triggering heightened instability, but cannot regain stability without repressing growth, is experiencing a "new abnormal".

The protracted slowdown is partly due to temporary factors…

Clearly, the disappointing performances of recent years can be partly explained by the longer time an economy needs to absorb the consequences of a major financial crisis. Such a crisis weakens the balance sheets of financial and non-financial agents, and tends to trigger deflationary pressures. As long as banks' assets are burdened with non-performing loans, they restrain new credit to the private sector, especially as they must comply with pro-cyclical BIS rules. Concomitantly, firms and households seek to reduce their debts rather than expanding their expenditure in investment or consumption, especially if firms do not anticipate rising demand and households face stagnant income and high unemployment rates. This deleveraging process has advanced at different speeds in developed countries, but still weighs on aggregate demand in many of them.

In this context, the policy mix applied in most developed countries, which combined fiscal austerity with monetary expansion, was inappropriate. The abundant liquidity resulting from expansionary monetary policies had little impact on credit and aggregate demand, while fiscal austerity – prematurely applied when private demand had not yet recovered – dragged economic activity down. In the case of the European Union such austerity measures even pushed it into a new recession between late 2011 and early 2013.

An overabundance of liquidity has had limited effects in expanding the demand for goods and services in developed economies, instead driving the recovery of financial assets and real estate. It also spurred capital flows to emerging economies. At first, these inflows reinforced the counter-cyclical policies adopted in many of these countries after the crisis. But they also generated macroeconomic vulnerabilities in several countries (such as rising indebtedness in the private sector, currency appreciation, trade deficits and financial bubbles), which became apparent when capital flows diminished or reversed. With the fall in their export prices and

capital ouflows in 2014-2015, several developing countries had to adjust their expenditure in the face of fiscal and external restraints.

… but the structural causes of the slowdown remain to be addressed

Financial deleveraging and policy mistakes have certainly weighed on economic recovery, mainly by depressing consumption and investment. After several years of low investment and high unemployment, some economies will endure persistent shortfalls of fixed capital and insufficient labour skills. However, this alone can hardly explain the difficulties in reinstating a stronger growth process eight years after the crisis erupted.

Attention has increasingly focused on a variety of structural factors that could be hindering growth, offering related "structural reforms" to deal with them. In its analysis of the global crisis presented in its Trade and Development Reports, UNCTAD has identified several such adverse long-term trends, including the process of financial de-regulation, growing inequality and the rolling back of the economic responsibilities of the state. All these trends continue to negatively impact on aggregate demand, which remains the main obstacle to growth in developed countries.

The call for structural reforms as a way to overcome the crisis is therefore absolutely justified, provided that it meets two conditions: such reforms should address these structural causes of the crisis, and their implementation should not jeopardize the macroeconomic conditions of recovery by further weakening aggregate demand. These seem obvious, but they have not been the norm.

From this point of view, some of the structural reforms that are frequently proposed do not meet the required conditions and may well backfire. Most of the proposed reforms target lower costs and increased efficiency through deregulating product and services markets and reforming labor markets. However, if the search for more "labour flexibility" means reducing labour protection, it may further lower the bargaining power of wage-earners and deepen income inequality. In addition, cost-reducing measures would not be helpful for increasing investment in economies where firms' profits are high but demand is low (as is the case in many developed countries). Similarly, if the deregulation agenda means reducing government's economic involvement and policy space, it would not only deprive the economy of much needed public investment, but also of the public sector guidance in the search of a more inclusive and sustainable growth. Furthermore, stronger regulations are needed in the financial sector, including off-shore finance, which appears today not only as a symbol of unfairness, but also as the main mechanism to bias incentives, distort competition and erode government revenues.

International trade will only recover with aggregate demand

The growth in the volume of global merchandise trade slowed to just 2 per cent in 2015, a weaker pace than the growth of world gross product, estimated at 2.4 per cent. The ratio of these two numbers (the elasticity of trade to economic growth) was smaller than one, something that has only happened in years of very weak or negative world economic growth. Since 2010, that elasticity remained around 1, which contrasts with the pre-crisis period, when the volume of international trade grew twice as fast as that of global output (Table 1).

Table 1
GDP and merchandise trade, 2004-2015
(Annual percentage changes in volume)

	GDP		Imports		Exports	
	2004-08	2011-15	I 2005 - II 2008	IV 2010 - III 2015	I 2005 - II 2008	IV 2010 - III 2015
Total	3.6	2.4	7.0	2.4	7.2	2.3
Developed economies	2.3	1.4	4.6	1.3	6.0	1.4
Transition economies	7.6	1.8	25.4	-3.9	8.4	1.0
Developing economies	7.1	4.7	10.7	4.4	9.4	3.5
of which						
Africa	5.8	3.2	14.5	5.3	4.3	-1.1
Latin America and the Caribbean	5.1	2.4	11.3	3.2	3.0	3.3
Asia	8.0	5.6	10.2	4.6	11.5	3.9

Source: UNCTADStat

It is normal that, as domestic demand slows down, the demand for imported goods and services decelerate too. However, the loss of dynamism in international trade has been much stronger than that of global product. International trade has not only been affected by slower economic growth, but also because that growth has become less intensive in imports, and therefore offers less opportunities to exports. This reflects, among other factors, the lower investment rates, as fixed investment is intensive in imported goods, and weaker trade of pieces and parts in international production networks; the latter is partly due to weaker demand in the final markets (mostly developed countries) impacting on related inputs trade and partly to import substitution of those inputs in the countries where they are assembled, starting with China.

By some accounts, increased trade protection explains the weakness of global trade and the main factor holding back the full recovery of economic growth. Mega trade deals have been centre-stage in public debates over the last couple of years, offered as a solution. They are variously promoted as either the only reliable source of foreign exchange, or of aggregate demand that cannot be unleashed without trade liberalization reforms, or as a mean to control costs through competitive pressures. They are also seen as ways to boost productivity by attracting FDI or eliminating low-productivity ventures. Thus several nations are set to ratify or extend free trade agreements (FTAs). And those which are not actively pursuing one or various FTAs, are visibly worried about the potentially detrimental implications of being left out from deals signed by neighbouring nations.

While positive synergies between trade, growth and economic development exist and should be promoted, the direction of causality does not run in a simple direction from trade to economic growth. Hence, further lowering of any remaining trade barrier will not spur trade and, as a result, economic growth, unless domestic demand in the main economies is recovering. Furthermore, many measures incroporated in these trade agreements refer to liberalization and de-regulation measures (including in the financial sector) that go against the structural reforms, which UNCTAD deems are needed to deal with the causes of the crisis, as

mentioned above. In particular, they tend to restrict the remaining space for active development policies.

The causality at a global level runs from aggregate demand to trade. An increase of net exports of a single country is exactly equal to a fall of net exports somewhere else: it cannot be a general recipe for all countries. On the contrary, if many countries seek to expand net exports through competitive devaluations or reducing costs, the strategy would be at best ineffective, or even counterproductive if this implies a fall in labour income and the aggregate demand. In such 'race to the bottom', there can be no winner.

As long as global demand remains weak, the best way to spur both economic activity and trade should focus on spurring domestic demand simultaneously in the main economies. A first line of action requires reversing the long-term decline of wage shares that has become the norm in many countries. This is particularly important in (but not restricted to) countries with a trade surplus, as faster increases of labour income in such economies would stimulate their GDP and their demand for imports without causing external deficits, and contribute to net exports and economic growth in deficit countries. Some countries have started implementing measures in such a direction and these should be encouraged, extended and deepened.

A complementary line of action would be enhancing fiscal expansionary measures, particularly in areas that have to do with investment in social and physical infrastructure. Economies should adopt expansionary policies or at a minimum neutral fiscal stances since the sustained austerity applied over the last four to five years in most countries has caused a serious drag in growth potential. Changes in the structure of fiscal revenues (increasing its progressivity) and expenditure (focusing more on social transfers and infrastructure investment with high multiplier effects) would also stimulate growth, even without altering total values.

The combination of labour income policies with expansionary fiscal stances would play a significant role in the expansion of global trade and would also contribute effectively to sustained technical progress and productivity growth. Given that 'cost-cutting' to increase competitiveness has adverse effects on aggregate demand, the growth of productivity has to come from innovation responding to economies of scale and specialization, which is what trade can help deliver along a robust pattern of global growth of demand.

Concerns about developing country debt sustainability on the rise

With the financing requirements for the implementation of Agenda 2030 estimated to range anywhere between $1.6 to $3 trillion per year, debt sustainability in many developing countries remains a matter of concern. In 2015, 22 developing and emerging economies were in debt distress, with a growing number of other developing economies considered at risk or even high risk of external public or private-sector debt crises.

For developing countries as a whole, total external debt stocks rose from $3.7 trillion in 2008 to $6.4 trillion in 2014. So far, owing to continued solid growth performances in most developing countries, debt-to GDP ratios have registered only a moderate upward trend overall. Nevertheless, some of the economies that benefited from the debt relief initiatives of the 1990s and 2000s, such as Ghana and Mozambique, have now reached debt-to-GDP ratios similar to those they struggled with prior to these initiatives being launched. Many emerging and developing countries, as discussed earlier, are now being affected by the slowdown of already sluggish global growth in trade and real investment. The current downturn of the latest commodity super-cycle, has meant that highly commodity-dependent developing economies have been hit particularly hard.

The growing vulnerability of developing economies' debt sustainability has, however, deeper roots in their accelerated integration into the international financial system over the past two decades that, in the case of lower-income economies, happened often without sufficient financial deepening at home. This integration has profoundly changed the financial landscape of developing country debt strategies and composition.

The most obvious change has been the very marked shift from official to private creditors of their long-term external debt, with the share of official creditors having fallen from 53 per cent in 1990 to 43 per cent in 2000 and just 20 per cent in 2014. At the same time, the share of bond-financed long-term external debt rose from 8 per cent in 1990 to 32 per cent in 2014, a trend that increasingly extends also to low-income countries whose issuance of international bonds increased sharply after 2012. Easy access to international financial markets, awash with cheap credit, has also seen the external cooperate debt of mostly emerging economies grow, in particular since the global financial crisis. Another change has been the rapid growth of domestic bond markets in low-income developing economies, with strong participation by large foreign (and often institutional) bondholders. A final feature of this landscape, that is only gradually gaining attention, is the growing fragility of expanding microfinance systems and the concomitant rise of micro-debt crises, in particular in some South East Asian and Latin American economies.

Many observers as well as developing country governments initially emphasised the potential of some of these trends, arguing that the improved access to international capital markets reflected their increased economic potential and facilitated the financing of ambitious transformational agendas. Looming debt crises, growing instability in financial markets and the renewed slowdown in global economic activity are, however, shifting sentiments.

UNCTAD has long warned of the formidable challenges associated with such a hurried integration of developing economies into an under-regulated international financial system, in particular in the context of global economic dynamics that remain unhealthily dependent on both private and public debt, and very high market risks attached to commercial borrowing, including refinancing risks, currency risks and generally much higher macroeconomic instability.

When very large capital flows enter relatively small economies in short period of times, even fairly developed states often lack the capacity to ensure that these inflows can be channelled into long-term productive investment. Instead, these flows often generate domestic credit booms, steep asset price increases and currency appreciations, followed by growing trade deficits. When investor confidence eventually ebbs away, capital flow reversals and worsening financing conditions quickly undermine debt sustainability, initially often in the private sector. As we have seen over and again, once a crisis becomes systemic, private sector liabilities turned toxic are highly likely to end up on the public balance sheets. It is doubtful that recourse to domestic debt financing provides adequate protection against these dangers, even though it does mitigate the currency risk associated with external debt financing. But where large chunks of domestic debt are held by foreign participants – often large institutional investors – the risks associated with potentially highly volatile investor perceptions remain very high.

Towards a multilateral framework to deal with sovereign debt problems

One important implication of these continued challenges to debt sustainability in developing economies is that UNCTAD's longstanding call for a co-ordinated multilateral approach to sovereign debt restructuring processes remains more relevant and valid than ever. As argued in detail in our Trade and Development Report 2015, a sovereign debt restructuring mechanism aims not only at facilitating an equitable restructuring of unsustainable debt burdens, but it also helps to prevent financial meltdowns in countries facing difficulties in

servicing their external obligations. UN Resolution A/RES/69/319 on Basic Principles of Sovereign Debt Restructuring Processes, adopted in September 2015, marks a substantial step forward in this regard. It adopts a gradual approach that promotes a set of international legal principles to influence legal and policy practice, nationally and internationally, to promote sovereign debt sustainability. UNCTAD very much welcomes this progress.

A final consideration is that the mentioned dangers to debt sustainability in developing economies should also provide grounds for further reflection on how best to address the wider challenges for financing development, acknowledged in both the Addis Ababa Action Agenda as well as Agenda 2030. Both these agendas promote a shift in emphasis from global development finance based on a predominantly public and ODA-centred model to a new global framework that gives greater importance to private and domestic sources of finance. There is some concern that this approach will not only shift the burden of financing the new development goals to developing countries but will seriously erode the contribution of international public finance to development cooperation.

But even as countries utilize potentially increased capacity to use domestic financing, caution must be exercised to ensure that debt sustainability is maintained. Similarly, while innovative sources of financing development, such as public-private partnerships, blended finance, climate finance, and the like are important, it is also important to remember that developing countries' public balance sheets are already heavily burdened with implicit and explicit contingent liabilities – that is hidden debts that will only emerge when things turn difficult. Financing development requires a multiplicity of sources and mechanisms, and among these, official development assistance (especially that involving actual flow of funds to developing countries) remains essential, as it provides long-term resources and hard currency which can be used in development projects with high long-term public returns but that may not be attractive for private agents seeking short-term profits.