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Statement by Supachai Panitchpakdi, Secretary-General,
United Nations Conference on Trade and Development

On behalf of United Nations Conference on Trade and Development

**Statement by Mr. Supachai Panitchpakdi
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To the International Monetary and Financial Committee

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At the start of 2013, the pace of global economic growth remains disappointing. Since the financial crisis in September 2008, the world economy has not been able to recover strong and sustained growth. In 2012, global growth was only 2.3 per cent, slightly lower than the baseline scenario (2.5 per cent) that we presented to this Committee last year. We do not expect any improvement in 2013, the main reason being that growth in the developed economies is likely to slow down from 1.2 per cent in 2012 to 0.8 per cent in 2013, while growth in developing economies is expected to improve only marginally this year, to around 5 per cent. Transition economies are likely to maintain their growth close to the current rate of 3.5 per cent.

From a medium-term perspective, the fallout from the crisis has meant that global per capita growth has stagnated over the last five years. At a mere 1.7 per cent on average, global GDP growth barely exceeded the global rate of population growth. Most worryingly, there are still no signs that recovery is imminent. Instead, there is a risk that this mediocre pace of growth may yet turn into a global recession, particularly if the developed economies remain unable to revive growth and continue to adversely impact on economic dynamism in other regions.

In the developing world, fluctuations in economic growth are heavily influenced by the growth dynamism – or current lack of it – of the North. Many developing countries continue to rely on export specialization models oriented to developed-country markets, and have to cope with unfettered capital flows generating boom and bust cycles and other exogenous shocks. In the current environment, developing countries therefore

need to increase their resilience to external shocks that are propagated from the advanced economies via trade links or capital flows. There is also a need for the advanced economies to renew their commitment to the coordinated and expansionary policies that served them so well during the first phase of the crisis, and to move towards a more sustainable and inclusive economic growth path.

The ripple effects from continued poor economic performance in the North are threatening to undermine much-needed progress towards the Millennium Development Goals (MDGs), just as we approach 2015 and discussions on the “post-2015 development agenda” are under way. There is still time to change the policy direction, and it is essential that we seize this opportunity, rather than allowing the anaemic growth to continue, or to get worse.

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The slow growth in the advanced economies is partly the expected consequence of a deep financial crisis that stopped the provision of credit to the private sector and strongly affected employment and domestic demand. However, these effects have been exacerbated by inappropriate macroeconomic policies, in particular the early withdrawal of fiscal stimuli and the shift to fiscal austerity in 2010, which endangered the still fragile recovery and pushed several advanced economies into a double-dip recession. UNCTAD has always argued for a countercyclical rather than a procyclical policy approach. In its *Trade and Development Report 2011*, UNCTAD showed the disappointing growth performance of countries that had adopted fiscal austerity programmes too soon in previous downturns. In addition, since they had hampered growth – and, consequently, public revenues – these programmes did not achieve their target of fiscal consolidation either. Continued public stimulus and a developmental role for the State, rather than Washington Consensus structural reforms, were needed more than ever in the absence of any support from the private sector.

IMF's Independent Evaluation Office had come to similar conclusions in its 2003 investigations of IMF-supported programmes in 70 countries, noting a tendency to be over-optimistic about the pace of revival of private investment, and the adoption of "fiscal targets based on over-optimistic assumptions about the pace of economic recovery leading inevitably to under performances". In country after country where fiscal tightening was expected to both reduce the budget deficit and boost investment and economic growth, the opposite happened. The lesson has been harsher this time, because of the integrated nature of the world economy and the rapidity with which a crisis in one country is transmitted to others through global trade and financial flows. The most recent research conducted at IMF (see Blanchard and Leigh, IMF Working Paper, 2013) again finds evidence of systematic underestimation of the fiscal multiplier and the negative effects of government spending cuts and tax hikes in times of recession.

In 2013 therefore, at this Spring meeting of the IMF and the World Bank, and with two years still to go before the target date for achievement of the MDGs in 2015, it is essential that we reject the notion that austerity has any automatic connection with fiscal consolidation or growth. Holding on to this ill-fated notion has already had too high an economic and social cost. In the advanced economies it has exacerbated high levels of unemployment and augmented the potential for de-industrialization, which threatens to set back an entire generation; and in the developing countries it is threatening the growth and poverty reduction gains that have been achieved so far.

Secondly, at a more conceptual level, we have learned that "austerity" is not a synonym for "fiscal responsibility". Fiscal administration must be transparent, fair and responsible, which – in present times more than ever – must mean allocating resources where they have maximum impact in terms of employment, investment, income distribution and growth. In this context, cutting essential social spending, as has been part of some austerity packages, may actually be detrimental to the alleged goal of "fiscal responsibility". It is therefore not surprising that many countries adopting these policies have had to repeatedly readjust their fiscal goals and ask their creditors for waivers and longer adjustment periods.

To sum up, fiscal tightening may be an appropriate policy in times of upturn, but in a downturn it will exacerbate the economic slowdown. It is also unlikely to achieve fiscal consolidation. Indeed, fiscal consolidation should be understood not as a precondition for growth, but rather as a consequence of it.

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Having shunned fiscal stimulus measures due to austerity policies, several developed countries have turned towards monetary expansion and structural reforms to stimulate their economies. However, despite expansionary monetary policies in the United States and Europe, banking credit to the private sector has stagnated, or even decreased. This situation persists even after five years of record low interest rates and massive injections of liquidity into the system. The counterparts to credit creation have not responded as expected, either because banks cannot or will not lend, or because consumers and investors cannot or will not borrow. It has already been observed that, during economic depressions, expansionary monetary policies are like “pushing on a string”.

In the industrialized nations, the private sector is engaged in a massive shift away from net borrowing to net savings. This shift constitutes a shock in demand, which has been partially but not sufficiently compensated for by a steep rise in government deficit. In this environment of balance sheet recession and scarce demand, governments must go further in their role as borrower and spender of last resort to offset the private-sector de-leveraging – instead of clamping down and moving in the opposite direction.

In addition, a broader policy mix is needed. Structural reforms, under consideration by several advanced economies, can serve to improve domestic productivity and enhance economic efficiency. However, they should not be seen as a substitute for supportive macroeconomic policies. In most cases, the proposed structural reforms only focus on the supply side, while the problem that must be solved in order to

exit the crisis is the lack of aggregate demand. In some cases, structural reforms may even depress demand further, if they target more “flexible” labour markets, frequently a euphemism for lower wages. The pursuit of export-led growth cannot be the way out either, if many large trading partners are all following the same strategy at the same time – each one counting on the others to expand their demand. Structural reforms deliver better results when they are applied in the context of expansionary policies, and they should deal with the causes of the crisis, which were not excessive government spending or high wages, but rather financial deregulation and high income inequality, as argued in the *Trade and Development Report 2012*.

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One area where appropriate structural reform is needed relates to policies that help boost the incomes and consumption levels of the middle class and poor households, in both advanced and developing economies. Redistributive policies that are aimed at low-income groups can help boost consumption and aggregate demand, and could also help to tackle one of the underlying causes of the imbalances that led to the crisis in the first place. It is not by coincidence that the economic volatility of the last few decades came hand in hand with trends of rising inequality in the distribution of income. Wage restraint and the excessive “flexibilization” of labour markets since the 1980s have led to a trend where, after a long period of relatively stable distribution of income between profits and wages, the share of wages in total income has fallen markedly in most developed and many developing countries. In its *Trade and Development Report 2012*, UNCTAD notes that the Gini coefficient measuring income inequality across all income groups deteriorated in 15 out of 22 developed countries between 1980 and 2000. Even though some countries reversed this trend to some extent after 2000, inequality is generally even more pronounced in developing countries.

The consolidation of income and wealth in the hands of the few has very negative implications for aggregate demand. A reorientation of wage and labour market policies is essential for economic revival. In this context, the role of tax policy is crucial. Many

countries are now beginning to address the issue of “tax havens” as well as the discriminatory tax policies that favour corporate interests at the expense of wider national and international interests.

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One way that developing countries have found to increase their resilience to external economic shocks and to continue their growth has been to reduce their export orientation towards developed economies and to rely to a larger extent on domestic, regional and South–South trade. Indeed, the share of developing regions in global trade has expanded from 29 per cent in 1995 to 42 per cent in 2011. In particular, the share of South–South trade in global trade has doubled from 12 to 24 per cent in that period.

These trends reflect not only subdued demand and slow growth in the North, but also the effect of increasing domestic and regional demand in developing countries. This was due in part to the scaling up of public infrastructure investment in conjunction with post-crisis stimulus packages, but also, as mentioned earlier, to the increasing emergence of a consumer middle class. This is causing a shift in spending power from consumers in advanced economies towards consumers in developing ones, which implies a decline in the per capita income of the median consumer and consequent changes in preferences and spending patterns. The greater importance of emerging market economies will create large new markets, and provide new opportunities for employment, production and exports. A crucial question for the resilience of developing countries’ production and employment patterns will be the extent to which domestic enterprises can capture the newly arising business opportunities. Global value chains are an important part of this question, and empirical evidence suggests that supporting exporters’ domestic embeddedness, rather than simply favouring their inclusion into global supply chains, will be crucial for product upgrading and the attainment of profitability and value-added. Developing countries will therefore need to apply active policies related to promoting industrialization, investment, incomes and welfare, in order to continue to make progress.

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Looking beyond the need to restore growth, the financial crisis has also served as a reminder of the need to reform global economic governance. UNCTAD has long argued that the global economic governance system would gain in coherence if multilateral trade rules were complemented by an effective system of macroeconomic policy coordination and oversight. This gap in the global governance architecture has become even more apparent as it becomes clearer and clearer that uncoordinated national policy measures are not sufficient to address an economic imbalance that is global. Expansionary monetary policies can have spillover effects that go far beyond national or regional boundaries, be it through their direct effects on capital flows and exchange rates, or through indirect effects on trade and other prices. In today's increasingly interrelated and interdependent world, we need a global financial and macroeconomic architecture capable of meeting the needs of the 21st century.

The international monetary and financial system (IMFS) must be reoriented in order to properly fulfil its original mission as stated in the Bretton Woods agreements, which was to smoothly manage international payments, avoid large and persistent current account imbalances, and minimize the costs of adjustment in terms of economic activity and welfare. To date, the current system has been unable to restrain destabilizing capital movements and organize an exchange rate system that reasonably reflects economic fundamentals. These shortcomings have become more evident and damaging with the deepening of financial globalization and the increasing volume of cross-border capital flows.

The IMFS has been unable to deal with global imbalances since it can only induce policy changes in countries with financial needs, which is not the case for any of the major actors: big surplus economies do not need financing, and the biggest deficit country issues the international currency. This introduces a recessionary bias to IMFS, because it tends to implement measures that reduce demand in the deficit countries, but is unable to expand demand in surplus countries.

The IMFS has also failed to avert the disorderly expansion of short-term capital movements, which are a major factor in economic instability. Countries wishing to avoid the procyclical impact of capital flows can implement capital controls, which have been relatively successful in curbing undesired capital movements. However, a multilateral arrangement (such as the “Tobin tax”) would probably be more effective. Moreover, the global financial crisis has shown that unregulated capital flows generate a risk not only in the recipient country, but also in the source economy, since their banks’ solvency may be undermined by their exposure to asset bubbles in foreign countries. Financial supervision should therefore be applied at both ends of capital movements.

Ideally, a global problem should have a global solution. However, achieving a meaningful reform of global economic governance may take time. Hence, in parallel with the efforts at the global level, developing and transition economies should apply regional and national policies in order to reduce their vulnerability to international financial shocks and put their national and regional financial institutions at the service of the real economy.

Growth performance of world regions over the last two decades (Percentages)

	The decade of the 1990s			The period of fast growth 2004-07			The crisis and post-crisis 2008-12		
	annual average growth	contribution to global growth	share over total growth	annual average growth	contribution to global growth	share over total growth	annual average growth	contribution to global growth	share over total growth
World	2.7	2.7	100.0	3.9	3.9	100.0	1.7	1.7	100.0
Developed economies	2.5	1.9	75.8	2.7	2.0	52.8	0.3	0.2	11.4
Economies in transition	-5.9	-0.2	-9.2	7.7	0.2	4.5	1.8	0.0	2.9
Developing economies	4.9	0.9	33.5	7.4	1.6	42.7	5.3	1.4	85.7
Africa	2.5	0.1	2.0	5.9	0.1	3.3	3.6	0.1	5.3
East and South Asia	7.0	0.5	20.3	8.7	1.0	26.8	6.7	1.0	61.0
Western Asia	4.1	0.1	3.8	6.9	0.2	4.6	4.1	0.1	7.4
Latin America and the Caribbean	3.1	0.2	7.3	5.3	0.3	8.0	3.1	0.2	11.8
Oceania	2.5	0.0	0.0	3.1	0.0	0.0	3.4	0.0	0.1

Source: UNCTAD secretariat calculations. Based on United Nations Statistics Division, Department of Economic and Social Affairs (2013), *World Economic Situation and Prospects*, National Accounts Main Aggregates database.