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By early 2019 the growth pick-up which began in late 2017 was petering out, repeating a pattern that has become familiar during the past decade of tepid recovery from the global financial crisis. Now, however, the world economy carries a much heavier burden of corporate and public debt than when the crisis hit. The long-term decline of the wage share has also continued, weakening global aggregate demand. This describes a far more fragile conjuncture than that predicted a year ago by most observers, and should provide the opportunity to revisit the policy paradigm that has guided the global economy throughout the post-crisis period.

Poor GDP performance is not due to trade frictions

Among the major economies, only the United States experienced an acceleration in its growth rate between 2017 and 2018, from 2.2 per cent to 2.9 per cent. Mostly resulting from the combination of tax rebates to the corporate sector and stock market appreciations, this started to fade away towards the end of 2018. In annualized terms, U.S. growth in the fourth quarter was 2.2 per cent, exhibiting not only the same growth rate, but also an almost exact composition of demand as in 2017: moderate growth of consumption, weak investment and exports, and negative growth of public spending. China experienced its slowest growth in 2018 in 28 years, albeit still significant at 6.6 per cent. In response, policy-makers are allowing for more stimuli through local governments and continue to push for a shift towards more reliance on domestic consumption, but uncertainties remain.

Many observers argue that trade frictions between these two economies, triggered by tariff measures adopted by the United States in January 2018, have been the main factor keeping growth down, however, this is not definitively verified in the data. To date, overall trade flows have been only marginally affected and carry a limited impact on GDP performance, especially when policy makers indicate their readiness to enact palliative measures. According to CPB data, imports from both the US and emerging Asia have experienced a decline in November and December, but only partially reversing the previously upward trend. Indeed by January 2019, according to the latest data available, import volume growth in both cases reverted back towards trend. In terms of GDP growth impact, the variations of export and import components with respect to GDP in 2018 were almost identical to those of 2017 for the United States, and only marginally weaker for China, likely due to differences resulting from policy efforts towards domestic activity and away from exports as sources of demand.

Meanwhile, several advanced economies including Canada, Germany, Italy and Japan, each lost around one full percentage point of growth in 2018 relative to 2017. In these cases, except Japan, growth was particularly weak in the fourth quarter of 2018, with Italy experiencing a technical recession in the second half of 2018, while growth in Germany stalled. Growth in other relatively large advanced economies, like France and the United Kingdom decelerated by about half of a percentage point.

Among the larger emerging economies only India and Saudi Arabia accelerated over this same period, but economies like Argentina, Mexico, Turkey and South Africa slowed, most significantly in Argentina and Turkey, with the former falling into deep recession. Finally, Brazil maintained in 2018 its growth rate of 2017, albeit a barely acceptable 1.1 per cent

growth, particularly considering that during the previous two years the economy contracted by nearly seven per cent.

In all these cases, it is difficult to attribute the growth disappointment to trade policy tensions. The trends of growth of import volume in Japan, Europe, Latin America, Africa and the Middle East, which were positive over the previous years, were broadly maintained up to the third quarter of 2018. In the case of Japan, and partially Latin America, there was a decline afterwards. Given the quarterly patterns of GDP growth in these countries, the trade reversals seem an effect, rather than a cause, of the income slowdown. Indeed, GDP and their changing composition exert a major influence on the trade slowdown, as UNCTAD has argued in previous Trade and Development Reports.

Stock market swings, not fundamentals

It is however plausible that trade policy frictions in an already fragile world economy can shake confidence and ultimately weaken economic performance. But even if such effects could be verified, the implication is that economic growth has been relying excessively on market expectations rather than robust demand drivers. The data suggests this has been the case. Throughout 2017, across all major economies there have been sharply rising stock market trends, which either stabilized at high levels or continued to rise through roughly the first half of 2018, except in China which experienced a decline throughout the full year 2018. The buoyancy of stock markets across most economies has built a momentum of positive expectations, which was expressed in the enthusiastic GDP growth forecasts issued a year ago by most institutions.

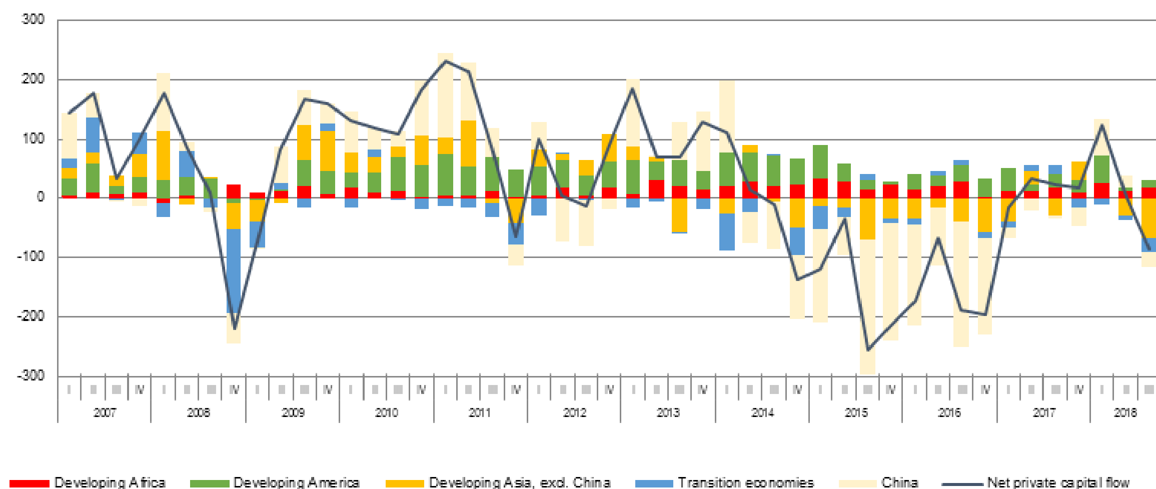
As argued in the Trade and Development Report 2018, behind such dramatic and synchronized stock market appreciations lies an excessive reliance on monetary easing as the main post-crisis macroeconomic policy tool. The analysis of the Flow-of-Funds accounts of the United States, which was a major player in the post-crisis liquidity expansion, is instructive in this respect. First, the behaviour of the household sector has continued to be driven by the same pressures that were characteristic prior to the global crisis: financial borrowing has been almost entirely used for housing, through investments in real estate, while earned savings were mostly allocated for the purchase of financial assets, particularly stock and shares. The only difference post crisis is that borrowing has been significantly reduced and most financial acquisitions have resulted from increased savings. As discussed below, the increase of aggregate household savings in the United States indicates a sharp increase of inequality, as the rich tend to put aside a significant portion of their income for financial investment instead of expenditure. But the lesson to be drawn from the financial structure of the household sector of the United States in the post-crisis period is that its behaviour has been a relevant factor contributing to a striking rise of the stock market.

Second, a similar lesson can be drawn from the financial structure of the corporate sector in the United States, apparent in the Flow-of-Funds accounts. Net financial borrowing of the corporate sector has been almost entirely devoted to acquisition of financial assets, not physical investment. The liquidity expansions of the post-crisis period have not led to more productive activity. Productive investment has been limited and mostly financed by earned profits, with a small contribution from net equity issues. In turn, such a relatively small portion of net equity issues is the result of the fact that in the post-crisis period the corporate sector has used its own and borrowed funds for ‘shares-buy-back’ operations and ‘mergers-and-acquisitions,’ including financial investments abroad. These activities were, in effect, the only observable

result of the quantitative easing experience, replicated in other advanced economies that continued the monetary expansions through 2018. The only perceptible difference in the United States is that during the first half of last year the pace of borrowing slowed down as the tax rebates to the corporate sector was the major source of funds, due to the increase in retained earnings. By the second half of 2018 financial borrowing resumed partially, though not at the same pace of 2017. Essentially, the pace of borrowing has been the main driver of stock market appreciations.

Expectations created in equity markets spilled-over into investors' confidence as well as into resumptions of capital flows from the issuing advanced countries to emerging economies. By contrast, towards the second half of the year, following indications by central banks of unwinding the monetary stimuli – and in the case of the United States, actual rises of interest rates – the expectations of investors on a continuing stream of cheap funds collapsed, stock market volatility rose sharply, and most emerging economies experienced capital flow reversals that hit their domestic markets (figure 1).

Figure 1: Net private capital flow by region, 2007–2018 (Billions of current dollars)



The capital outflows experienced by emerging economies triggered the now familiar pro-cyclical fatal combination of shocks, to exchange rates combined with falls in their relative terms of trade. The former, dramatic depreciations in the major economies in the second and third quarters of 2018, have been apparent in the daily press. The latter, adversity in terms of trade, has been reflected in a relative decline in commodity prices, except oil which, with fluctuations, continued to appreciate throughout the summer.

In sum, the confidence in a growth momentum presumed to be sustained by good fundamentals, as expressed by many analysts and policy makers about a year ago, was erroneous. The growth performance of most economies was to a very considerable extent based on stock market euphoria inflated by continuing quantitative-easing experiments. It reflected a sentiment, not a robust economic reality.

Policy déjà vu: freer trade and more liquidity for stock markets

By early autumn 2018, following a series of interest rate hikes by the Federal Reserve and forward guidance announcing a monetary policy unwinding by other main central banks, stock markets of all major economies started to show sharp declines. The so-called 'bear market'

turn lasted through the end of the year. Other factors, such as the uneasiness about a potential slowdown of growth in China, together with the mentioned trade policy frictions between the United States and a number of its trade partners played a contributing role in the sharp turn of stock market sentiment.

The reaction of policy makers through the last quarter of 2018, and more prominently from the beginning of this year, was to join calls for reinstating the monetary stances that had fed the stock market euphoria, and to avert further protectionist moves, if necessary through free trade negotiations running against or alongside the multilateral trade system. As noted above, such policy calls should be carefully examined because neither was the stock market a fundamental driver of real economic activity, nor were trade policy frictions a fundamental cause of growth slowdown.

The need to question such policy reactions, promoted by many international organizations, is even more urgent in view of the potential impact that such policies could have on rising global financial fragility. The sharp rise of indebtedness that the global monetary expansion has created is tantamount to a debt 'time-bomb'. What is more, a continuing neglect of policies to address the rising inequalities of income and wealth that were magnified by financialization makes wage earners and the poor very vulnerable targets of a potential financial crisis.

A dangerous mix: over-indebtedness and inequality

The world economy has been threatened for too long by an unprecedented volume of accumulated debt. How much longer the world economy can keep going under such a debt burden is difficult to predict. But a financial crisis, especially if the policies now in place contribute to deepen this same pattern, seems inevitable.

According to most recent BIS data, the combined debt of the non-financial corporate sector and governments of advanced economies has reached about 260 per cent of GDP by the third quarter of 2018. This represents an increment of about 13 percentage points in GDP terms with respect to the figure of 2008 Q3, before the crisis hit. Comparing the average of the post crisis with that of the period between the shallow recession of the US in 2001 Q3 and the global crisis, the increment of public and corporate sector debt of advanced economies was 14 percentage points of GDP. Within this aggregate, the most striking rise was that of government debt, which was before the global crisis at a relatively stable level of 70 per cent of GDP, and after the crisis jumped to about 100 per cent of GDP, where it has remained, broadly. It is important to recall that this rise of government debt was the result of a private sector financial crisis, in the first place. Further, it is concerning that the level remained so high afterwards – showing a partial rise above 100 per cent in the last 3-4 years – despite the fact that policy-makers have stressed that fiscal austerity was the only acceptable way to effectively reduce debt burdens. UNCTAD research, on the other hand, has questioned such a view, insisting that fiscal austerity in a context of depressed aggregate demand would hit economic growth and erode public sector finances.

Regarding the debt of the corporate sector of advanced economies, the level has remained relatively stable in the post crisis, around 160 per cent of GDP, but its composition has changed. While bank credit has slowly declined, it was non-bank credit to the non-financial corporate sector which has been rising in the post-crisis, from about 70 per cent of GDP to about 85 per cent of GDP. In other words, monetary easing has triggered a rise in securitization and it was

this mechanism, not direct credit from the banking system, which has contributed to an increasing vulnerability of the non-financial corporate sector of advanced economies.

The patterns of debt accumulation in developing countries has been no less alarming. According to the BIS, debt of the public and non-financial corporate sectors combined has risen from 110 per cent of GDP in 2008 to about 180 per cent of GDP by the third quarter of 2018. The most significant of the increases has been in the corporate sector, with debt rising from a relatively stable level of about 80 per cent of GDP before the crisis, to 140 per cent of GDP in 2018. Meanwhile, debt of the public sector for the set of countries recorded by the BIS rose from about 40 per cent of GDP to a still manageable 50 per cent of GDP in 2018.

The extraordinary rise of private sector debt responds mainly to two distinctive factors. China proactively pursued a set of stimuli in the immediate post-crisis period, followed by a policy towards shifting emphasis to domestic growth drivers, both of which involved a rise of private and state-owned enterprise indebtedness. Though the levels of indebtedness in China calls for caution, these do not follow the same dynamics of external sector indebtedness and securitization that affect most other large and medium-size emerging economies. Rather, indebtedness in these other emerging economies has followed from spill overs of monetary easing in the advanced economies and as such carries unpredictable risks, combining capital outflows with exchange rate depreciations.

In sum, the levels of debt in the world economy are higher now, in nominal terms and relative to GDP, than the levels that triggered a financial crisis a decade ago. The fact that most commercial banks have been more closely regulated, at least to an extent, and periodically subject to 'stress tests' is of lesser relevance than the fact that such levels of debt have become more interconnected, between sectors, especially to the non-banking and securitization sectors, and between countries. The potential for a cascade of financial crisis is considerable.

The risks of financial crises are compounded by the fact that neither the public sectors nor the household sectors in most economies are in robust financial shape. As a result of fiscal austerity, public sectors have become comparatively smaller with respect to GDP in many developed economies and in some of the major emerging economies as well. The capacity of these relatively slimmer public sectors to absorb losses of income and employment in a crisis is weaker now than during the last global crisis. And the financial balance sheets of public sectors have become also more vulnerable, because austerity has not significantly reduced debt burdens relative to GDP.

Income distribution has also worsened, especially in many of the developed economies. From the early 1990s, the share of labour income in GDP of advanced economies has been on a declining trend, from about 58 per cent to about 55 per cent when the crisis hit, reaching 53.5 per cent according to partial figures in 2018. Emerging economies have also seen a declining trend, which was particularly sharp before the crisis, from about 53 per cent in the early 1990s to 48.5 per cent in the crisis. In some countries, though, there have been successful policy efforts to turn around this trend and as a consequence the labour income share in emerging economies has risen partially to about 50.5 per cent in 2018. However, in some of these countries that had shown improvements, like Argentina, Brazil and a few other minor countries in Latin America and Asia, the trend has again turned in the last two years.

In conclusion, the state of the world economy is deeply concerning. Economic growth is fragile; policy makers are calling for the same sort of policies and stimuli that were ineffective

in reigniting aggregate demand after the crisis but also contributed to exacerbating vulnerabilities by weakening public sectors, worsening income distribution and increasing the already heavy burden of debt. A different vision is called for, one that radically shifts the focus away from financialization and towards an inclusive, public-sector driven agenda.

Reclaiming multilateralism for a global green new deal

The political effort required to face up to the looming threat of economic, social and environmental breakdown will require new global norms and rules to restore a place for diverse development models geared toward stability, development, and decarbonization with the widest possible set of policy options, to rebuild trust in the workings of the multilateral system, to broaden its participation and beneficiaries at the local as well as the global level. Doing so will need to confront and contest the furies of hyperglobalisation; neo-liberal thinking, financialized economies and heightened monopoly power. But it will also require a different mix of growth and distributional outcomes that can deliver rising living standards for the majority of our citizens without further damaging an already fragile ecosystem.

Countries cannot be expected to undertake any such policy programs in isolation. At the global level, a New Multilateralism is urgently needed to pursue these in a way that maximizes the effectiveness of national development strategies without creating negative global spillovers to partner nations. This alternative is what we call a Global Green New Deal, suggesting a rough model in the original New Deal from the 1930s but cognizant of new, and daunting, challenges.

There is always the danger, as Gabriel Garcia Marquez warned, of a “perverse lucidity of nostalgia” in examining past experiences. In truth, we cannot return to the era of Bretton Woods; but we can still learn from its sense of ambition, underlying values and guiding principles in devising a new deal for shared prosperity, social justice and environmental rehabilitation.

A New Multilateralism will require the following design principles:

1. Global rules should be calibrated toward the overarching goals of social and economic stability, shared prosperity, and environmental sustainability and be protected against capture by the most powerful players.
2. States share common but differentiated responsibilities in a multilateral system built to advance global public goods and protect the global commons.
3. The right of states to policy space to pursue national development strategies should be enshrined in global rules.
4. Global regulations should be designed both to strengthen a dynamic international division of labour and to prevent destructive unilateral economic actions that prevent other nations from realizing common goals.
5. Global public institutions must be accountable to their full membership, open to a diversity of viewpoints, cognizant of new voices, and have balanced dispute resolution systems.