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Current Global Crises: a Wake-up Call to Shift Gears – UN

Overhaul needed of machinery for international finance, aid and trade

United Nations, New York, 29 June: The 2008-2009 global economic crisis exposed systemic failures in the workings of today's financial markets and major deficiencies at the core of economic policy-making, says the *World Economic and Social Survey 2010* (WESS), launched today by the United Nations.

Solutions will not be easy, and will require major overhaul of present mechanisms that govern development assistance, trade and international finance, according to the 2010 Survey, entitled "Retooling Global Development".

The Survey says that the United States' financial implosion, which that has affected livelihoods in every region of the world, underscored the interconnectedness of the global economy. This complex interdependence was induced by decades of globalization.

It will be necessary to change the pattern of economic interdependence, states the Survey, because restarting the pattern of growth that led to the present crisis will only lay the seeds for future, possibly more harmful, crises. The crisis suggests that globalization as we know it is not sustainable and needs to change direction.

The global financial crisis has also exposed serious weaknesses in global economic governance. Fortunately, a remarkable spirit of multilateralism has prevailed so far in the responses to this upheaval. Still, this cannot hide the shortcomings in institutions and rules that were shaped, for the most part, more than 60 years ago. Since then, world conditions have become much more complex, and there are daunting challenges ahead.

Times are changing

Some major changes in the global economy are likely to be dominant in the foreseeable future. The rapid growth in developing Asia has shifted the balance of global economic power, elevating the living standards of the recently advanced countries, while leaving others, especially in Africa, to fall farther behind.

While the global number of poor living on less than \$1.25 a day decreased from 1.8 billion in 1990 to 1.4 billion in 2005, nearly the entire reduction was concentrated in China. In sub-Saharan Africa and South Asia, the number of poor actually increased. With few exceptions, income inequalities within countries have also escalated since the early 1980s. Redressing this global economic divergence, to prevent it from becoming a source of tension and insecurity, will be a major challenge in the decades ahead, warns the Survey.

Demographic changes in the coming decades will strongly increase global interdependence. Each year, the world population increases by more than 70 million. By 2050, the global economy would need to provide a decent living to more than 9 billion people, 85 per cent of whom will be living in developing countries.

By 2050, 1 out of 4 people in developed countries, and 1 out of 7 in present-day developing nations, will be over 65 years of age, putting pressure on pension and health systems. Further, the presence of declining and ageing populations in developed regions may result in migration flows much larger than today.

By 2050, 70 per cent of the world's population is projected to live in urban areas and mega-cities where further growth will create its own problems. The *Survey* points out that persistent widespread poverty and inequality among urban-dwellers may become sources of social and political instability.

The growing world population has been supported in part by the degradation of our natural environment. About one half of the forests are gone, groundwater sources are rapidly being depleted, biodiversity has undergone enormous reductions and, through burning fossil fuels, about 30 billion tons of carbon dioxide are currently being emitted each year. Thus, greater prosperity for humanity has resulted in huge environmental costs with global consequences.

The global crisis has crystallized how interconnected financial markets are and that problems in one part of the system can quickly cause shock waves elsewhere. Additionally, climate change and increasing migratory flows are both challenges with global ramifications. Yet, the policies, rules and institutions established to govern these processes are mostly on the national level, and global mechanisms in place are strongly compartmentalized.

Without reform, the *Survey* warns, tensions will grow between decision-making processes at the national level and those at the global level. The question is how to reform global governance institutions to more coherently address these challenges while allowing all nations to determine their own destinies.

Retooling global development

In the light of these major challenges, *WESS* says the crisis provides an opportunity to re-examine and reform the system of global governance so that economic interdependence can be harnessed to overcome poverty instead of being the source of instability and the driver of increasing economic and political inequities.

Because of their complexity, solutions will not be easy. They will require new thinking and a new balance between national and global decision-making processes. According to *WESS 2010*, this will require major overhaul of present mechanisms that govern development assistance, trade and international finance.

International aid and trade processes must be reformed to ensure that Governments have the needed policy space to experiment with solutions appropriate to the local situation. International regulation of capital flows to ensure stable, long-term financing for developing countries is needed. National Governments must also be supported in their efforts to raise greater revenue for domestic needs. This will require expanded information exchange on bank accounts and mutual assistance in the collection of tax debts.

Based on an assessment of recent successful development experiences, such as those in parts of Asia, the *WESS 2010* concludes that equity in income, assets and access to education and health is necessary for sustainable and accelerated growth. Providing equal opportunities for all and taking difficult decisions about reorienting their economies to simultaneously make economic growth more inclusive and environmentally sustainable while allocating sufficient resources for education, health and social protection will require strengthened Government capacities to formulate and implement national development strategies.

Aid: Put developing countries in the driver's seat

The present aid architecture is highly fragmented and often considered ineffective. For instance, in a single year, Tanzania manages over 700 aid-financed projects and receives more than 500 donor missions. Over the past decade, the average size of aid projects declined by two-thirds, while the number of projects increased six fold globally. Fragmentation is not helping effectiveness. Yet, many poor countries remain in great need of development assistance to have a better chance of overcoming poverty and poor health. Moreover, climate change is especially affecting the poorest of nations and will require at least a hundred billion dollars every year in new investments in the coming decades. More resources will be wasted if additional assistance does not accompany reduced fragmentation and increase effectiveness.

The Survey proposes that developing countries be put in the driver's seat in identifying financing gaps through well-designed national development strategies. Donors would no longer line up numerous individual projects, with specific conditions and administrative requirements, but instead would jointly support a broad set of development policies for which recipient Governments would be held accountable.

The impasse over the 2001 Doha Round, which aimed at more development-oriented trading rules, reflects the difficulty of striking a proper balance between a level playing field, i.e. a common set of rules, and the capacities among countries to competitively engage in trade. The equal treatment of all states effectively skews international trading against small economies. To make the multilateral trading system more conducive to sustainable development, it needs to both expand and restrict the scope of WTO rules. On the one hand, trade rules should be more flexible to allow weaker economies time and space to build up their industries to compete in international markets. On the other hand, WTO's rule-setting should be subordinate to principles set elsewhere. For

instance, environmental agreements, such as those related to climate change, should guide trade rules for environment-sustaining products and will require adjustments in intellectual property protections under WTO. Similarly, WTO rules will require revision in line with efforts that are being undertaken to strengthen financial regulation, including in stemming volatile capital flows. At present, under the WTO's General Agreement on Trade in Services, for instance, participating governments would not be allowed to impose restrictions on the kind of financial assets offered by foreign banks in their domestic financial markets.

The deregulation of global finance played a large role in the current crisis. Developing countries expected that less regulated finance would increase external funding, but instead it made growth more unstable, hampering domestic investment and economic development. The *WESS* argues that greater financial regulation by national authorities will only be effective if internationally coordinated.

Need to coordinate financial regulation

Furthermore, it suggests a new international agency to coordinate financial regulation along with deep reform of the global reserve system. *WESS* proposes a system that is less dependent on the United States dollar and which pools reserve holdings regionally and internationally to provide cheaper insurance to countries coping with economic shocks and payment problems. The new system would also be able to issue new international liquidity, including for financing development and fighting climate change.

Accordingly, *WESS* proposes fundamental revisions of the existing institutions for global economic governance. But for an effective more sustainable rebalancing of the global economy much closer coordination is needed across the trading system, the new regime for international financial regulation, the global reserve system and the mechanisms for mobilizing and channelling development finance and climate funding. At present, the Group of 20 (G20) is taking on some areas of coordination, but as an informal platform responding to the crisis it has mostly focused on financial reforms. *WESS* notes that sustainable rebalancing of the world economy will take years, if not decades, and can only be successful if there is greater policy coherence. To this end, *WESS* proposes that the international community consider institutionalizing a global economic coordination mechanism within the more representative multilateral system.

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