UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD)

CONFÉRENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DÉVELOPPEMENT (CNUCED)

ECOSOC 2010

High-Level Policy Dialogue
with the international financial and trade
institutions on current developments in
the world economy

New York, 2 July 2010

Statement by

Dr. Supachai Panitchpakdi,
Secretary-General of UNCTAD

Excellencies,
Distinguished delegates,
Ladies and gentlemen,

The past decade was an optimistic period for developing countries and for their development partners. Economic growth rates achieved record heights – exceeding 5% even in poverty-strapped sub-Saharan Africa – and after a decade of stagnation, aid flows began to rise. The MDG initiative to tackle poverty and related development challenges through a set of internationally agreed development targets certainly galvanized donor country support. Since the recent financial crisis, however, economic growth has shrunk. The impact has been severe, not just on poor developing countries in great need of aid, but also in donor countries that are coming under increasing fiscal pressure to cut their aid budgets. Prospects for achieving the MDGs by the 2015 target date look dimmer than ever.

We must remain focused on poverty and redress inequalities

Prospects are especially bleak for MDG 1, halving the number of people living in extreme poverty. Even before the crisis hit, the rapid economic growth of the past 10 years had failed to staunch rising inequality, which is frequently associated with poverty. In fact, the evidence indicates that economic growth may even worsen the situation of vulnerable people and communities where income distribution is unequal. The policy implication is clear: making economic growth more inclusive – clearly a prerequisite to achieving all the goals – requires placing public investment in productive sectors, employment and income distribution on an equal footing with price stability in the design of more inclusive development strategies. Indeed, there is increasing evidence that greater inclusion is also good for economic growth.

The past 10 years have seen a massive transfer of wealth, whether through taxation, the socialization of risk, low or stagnant wage growth among workers, or cheap imports from developing countries to industrialized nations. Inclusive economic growth calls for rebalancing this wealth transfer. In addition to reforms of taxation and financial regulation, we need international support for other policies that can address some of the problems many countries now face, such as low employment generation and low wages.

Employment generation is the main mechanism by which poverty is reduced, societies become more equal and economic growth can be sustained; it is, in the long run, crucial to attaining all the MDGs. Increasing the share of productivity gains that have accrued to workers will be one way to more fairly distribute the benefits of globalization and boost consumption through higher wages. But we also need to look at more radical measures for redressing the wealth transfer from vulnerable and low-paid workers in the real and informal economy to high-wage earners in the casino activities of the financial economy. Among other things, this may be achieved through debt rescheduling – a subject I will return to later.

Current trends in the global economy

With developing countries leading the recovery, the policy-sponsored upturn in developed countries remains fragile and uneven. In a repeat of global pre-crisis patterns, the United States has been experiencing a stronger recovery in domestic demand than the leading developed surplus countries. But in moving forward, the United States is likely to face strong headwinds as its fiscal stimulus peters out in the course of 2010, with fiscal austerity measures spreading at the state and local government levels as balanced-budget rules bite. Although originating in the United States, the global crisis has now become Europe-centred, and the continent is acting as a drag on the global recovery. With the prospect of a premature removal of stimulus in Europe, the risks of a European or even global double-dip recession are perceived as rising. The unfolding of events in the world's foremost trading region poses a formidable global threat. In the eagerness to embark on consolidation, people forget that a double-dip recession resulting from the retreat from expansionary policies would pose the greatest threat by far to public finances.

At the peak of the global crisis, G20 members managed to see eye-to-eye on the need for coordinated measures as the sheer severity of events necessitated only the most extraordinary coordinated action on stimulus measures from these countries. Apparently that moment has passed. Shared views and diagnoses of challenges seem harder to reach as important conflicts in policy visions have re-emerged. The Euro area believes that rather than harming growth, fiscal austerity would support it, by boosting confidence. In the United States, by contrast, the prevailing fear is that continued domestic demand stagnation in Europe may threaten the recovery.

The European view rests on an extreme set of assumptions. The supporting evidence for their position consists of small-country experiences featuring currency depreciation and sharply falling interest rates. A fallacy of composition is involved in applying the experiences of individual small countries to the case of continent-wide austerity. In the current situation, the "short-run" effects of fiscal austerity, including job losses, are unlikely to be offset by sharply falling interest rates and improved confidence about long-run prospects. And Euro depreciation essentially means exporting deflation from an economy nearly as large as the US to the rest of the world. Instead, failure to coordinate policies effectively at the global level raises the prospect of re-emerging global imbalances, especially among developed countries. Should such prospects materialize, they would indirectly weaken the chances of success for the MDGs.

The need for increased wages and a focus on employment

During the past 40 years of rapid globalization, the belief that low wages are a key factor of international competitiveness has dominated economic policymaking. Exports and export-led growth have been a defining feature of the globalized era, fuelling the perception that wage growth must be stripped to the bone in order to preserve hard-won competitive advantages against low-wage economies. It is against this background that the MDGs were introduced in the first place, several of them dealing with the social consequences of low wages, unemployment and poverty.

Yet low-wage economies, such as China, are not only characterized by cheap labour; they are also hi-tech economies, resulting from high rates of foreign investment and technology transfer. Productivity gains have accrued not only from cheaper labour, but also from investment in capital, which has helped improve the lives of millions of Chinese and generated a large trade surplus. Indeed, China's productivity gains have benefited rich developed countries as well.

However, a growth strategy based on exports is evidently not sustainable for all countries, for a number of reasons. Foremost among these is the logical corollary that not everyone can be a net exporter: some countries will have to be net importers of goods and services. It is these countries that have propped up global demand in the past decade, together with the demand for raw materials that have provided the inputs to exported manufactures.

The economic crisis has had what may turn out to be a transformative impact on demand. The traditional consumers of last resort in North America and Europe are facing constraints on their consumption; developing countries will instead have to look to the own domestic markets, regional markets and increased South-South connections to pick up the slack in demand. This not only helps countries diversify the markets for their products, thereby offering some degree of protection against external shocks, but also has other benefits nationally and internationally.

At the national level, policies intended to allow wage growth and encourage consumption can help maintain demand and employment – the key factor for achieving the sustainable poverty reduction envisaged by MDG 1. Internationally, the increase in these countries' demand for imports – and here I am referring specifically to China and other Asian nations – can also help rebalance the huge asymmetries in foreign reserves. The current withdrawal of around US$7 trillion from the world economy, which is being held as a form of self-insurance in foreign exchange reserves, represents a giant loss of demand for the world economy, and developing countries in particular, at a time when it is most needed. Rebalancing reserve holdings, along with wage growth, are two areas that could have an immediate but sustainable impact on demand and ultimately on poverty reduction.

The correct response to current global economic conditions, therefore, is not to freeze or reduce wages, or to increase taxation, which would punish the most vulnerable, but to invest in growth, most probably through deficit spending and investment in productive capacities. This is the most efficient way to tackle poverty and to reverse the impact of the crisis on the poorest, which has severely affected the trajectory of efforts to meet the MDGs.

Not the right time for fiscal austerity

The bond markets have indeed got governments scared, but large deficits during a contractionary or sluggish growth phase are the sign of attempts to resuscitate demand. Conventional wisdom suggests we should be wary of large deficits. But we are living in unconventional times, and our priorities are to protect the most vulnerable, and not just the profit margins of wealthy corporations. Deficits only become truly dangerous when there is a double-dip recession as a result of fiscal rectitude. This is exactly what happened to the United States in 1937, when Treasury Secretary Henry Morgenthau thought it timely to reduce government spending. The result was a calamitous descent back into recession – a descent arrested only by the outbreak of the Second World War.

Clearly, then, this is not the time to be cutting deficits. In the current situation, any withdrawal of policy stimulus remains a highly delicate matter: In many countries, private demand has so far only partially recovered from its trough and, remaining fragile, is nowhere near its pre-crisis levels. This is especially true for Europe, the world's foremost trading region. Premature national or regional exits from domestic demand-supporting measures could render countries or regions over-reliant on exports for their growth. The stimulus burden to be carried by the remaining countries at the regional or global level would then rise accordingly. Re-emerging global imbalances and protectionism could be the consequence.

The global economic crisis and immediate policy responses saw a shrinking of imbalances. But if the global economic forces that gave rise to imbalances prior to the crisis reassert themselves, rising imbalances will also re-emerge in due course. Strong domestic demand growth in developing countries, led by China, together with strengthening currencies, contributes to global rebalancing. But forces working toward global imbalances emanating from developing countries may see some revival owing to developing countries' need to self-insure. Imbalances among advanced economies risk becoming even greater, due to relative domestic demand growth developments that are amplified rather than offset by the weakness of the Euro.

Developing countries need help with their debt positions

For developing countries, sovereign debt can become an unsustainable burden. In some countries, debt servicing alone absorbs 40% of their aid receipts – money that would be far more wisely spent on investment in productive capacity and job creation. UNCTAD has been calling for the creation of a multilateral debt work-out mechanism to ease the burden on poor countries and to bring some coherence to development assistance in general. Debt rescheduling and the better management of debt, including postponing debt repayments and declaring moratoriums on debt, could help countries that need to temporarily increase government revenue to support their economies.

* * *

As I said at the outset, the global economic crisis has meant a setback to achieving the MDGs by 2015. But getting the goals back on track does not end in 2015. With the right policies, it might even be possible to go further and faster <u>after</u> 2015. In UNCTAD, we believe that the MDGs should be better aligned with development strategies. In the first place, this means making countries the masters of their own destinies. They need to increase their “fiscal space” through domestic resource mobilization in order to make growth more inclusive. In the second place, this calls for strong States with a developmental vision. This is not to imply that there is no role for the market, nor that State control solves all problems. But experience has shown that the most successful policies are those that strike the right and pragmatic balance between the State and the market. Such policies are aimed at economic diversification, infrastructure development, skill formation, social safety nets and private-sector development.

Thank you.

* * *