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IMFC Statement by Mukhisa Kituyi
Secretary-General

UNCTAD

Statement by Dr. Mukhisa Kituyi, Secretary-General, UNCTAD to the International Monetary and Financial Committee

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The world economy will, this year, experience a deep recession amid a still unchecked pandemic. The cost in terms of lives and livelihoods has already been enormous and, while the lifting of lockdown has triggered a bounce back, its pace and extent is difficult to gauge given the high levels of economic and epidemiological uncertainty. UNCTAD believes that now is the time to hammer out a plan for global recovery, one that can actually return even the most vulnerable countries to a stronger position than before the crisis. But this was also the promise a decade ago after the global financial crisis. To recover better this time will require enacting overdue reforms to the multilateral architecture that could help tackle the deepening fractures and growing tensions that threaten the health and stability of the global economy.

A shock to an already shaky economic foundation

While policy-makers around the world have reacted quickly and decisively during the early stages of the current crisis, questions still arise as to whether the support offered has been channelled effectively or the requisite policy coordination will be in place to ensure resilience at the global level once the pandemic is under control. This only adds to the uncertain trajectory of recovery. The growing disconnect between squeezed household budgets and booming stock markets, and between rising bankruptcy rates among small and medium enterprises and larger corporations flush with liquid assets are clear signs of imbalance.

As the first emergency measures are wound down, policy discussions are reminiscent of 2010. Back then the withdrawal of fiscal stimulus adversely impacted growth while quantitative easing and low interest rates propelled asset prices ever higher, reinforcing a culture of quick financial returns, with private equity, share buy-backs and mergers and acquisitions the instruments of choice. In one startling example, between 2010–2019, S&P 500 companies channelled almost a trillion dollar a year into share buy backs and dividend payments. Policymakers will need to keep such operations in check to avoid undermining the recovery from the COVID-19 shock.

Another reason to cast doubt on prospects of a strong recovery is the asymmetry between developing and developed economies in their attempts to cope with the shock and manage financial constraints. While many developed economies have, for the moment, eschewed plans for fiscal consolidation in order to ramp up real government spending and provide large amounts of government-backed credit, most developing economies have not been given this latitude, their fiscal and monetary space still constrained by the rules and practices of the pre-COVID-19 world.

A severe contraction and a disappointing rebound

In the wake of the pandemic, the global economy will contract by an estimated 4.3 per cent this year, leaving global output by year's end over $6 trillion short (in current US dollars) of what economists had expected it to be before the Covid-19 pathogen began to spread. And as domestic activity contracts, so does the international economy; trade will shrink by anywhere between 10 and 20 per cent this year, foreign direct investment flows by up to 40 per cent and remittances will drop by over $100 billion.

The biggest output contractions will occur in the developed world, with some countries likely to register a double-digit decline. But the greatest economic and social damage will be in the developing world where levels of informality are high, there is continued reliance on a few commodities or tourism as a source of foreign exchange and debt is a particularly heavy burden on government finances. Latin America is likely to be very hard hit with a drop in output this year of 7.6 per cent with particularly large declines, possibly double digit, in some of the largest economies, notably Argentina and Mexico. The contrast with East Asia, where growth will remain in positive territory, albeit much lower than in 2019 – China, for example, is expected to grow at 1.3 per cent – is stark.

The sharp contraction of output in the second and (in some cases) third quarters was the product of several factors: full or partial lockdowns, significant disruptions of trade and global value chains, collapse and weak rebound of person-to-person services, including tourism, and investment-dampening uncertainty. The massive relief packages adopted mainly by advanced economies – estimated to date at a staggering $13 trillion for G20 countries – have helped mitigate the decline and will probably lead to a recovery in the second half of the year. With 4 out of every 10 dollars in these packages supporting aggregate demand directly (through spending on goods and services) and indirectly (through transfers to households), and the rest being credit and other financial operations, the life support extended to the global economy could have been stronger. Still, it has so far been stronger than during the last crisis and, also thanks to the resilience of East Asian economies, the global downturn may be less severe than initially expected.

Even with the bounce in the second half of this year, however, job losses and rising debt distress will continue to stalk recovery. Indeed, with current relief packages due to wind down or end altogether by the end of this year the big question is what to expect in 2021. A full V-shaped recovery with annual growth next year above 5 per cent and the world economy returning to its 2019 level by end of 2021 is looking increasingly unlikely. However, even this outcome would leave a $12 trillion income shortfall in its wake and an engorged debt burden, in the public sector due to the relief packages, and in the corporate sector on the back of the debt addiction that accompanied the post-GFC QE programmes.

Our own expectation is for global growth next year around 4 per cent, and positive in all regions. This assumes policy continuity in the leading economies, in the sense of a renewal of current relief packages. However, concerns remain with pre-existing conditions that could hold back growth. In particular, high

corporate debt levels in advanced economies could expose wider fragilities in financial markets, while sovereign debt distress in many developing economies, large and small, could precipitate a further round of capital flight and financial meltdown if relief is not forthcoming.

But the potentially most troubling threat to recovery comes from repeating the defining policy mistake of a decade ago, returning prematurely to fiscal austerity. If governments opt for fiscal tightening in an attempt to bring down public debt and businesses adopt an aggressive cost-cutting strategy in an attempt to boost exports, the recovery will likely fizzle out next year, with a double-dip recession a real possibility in many countries by 2022.

A lost decade

A combination of fiscal austerity and more labour market deregulation will not only weaken aggregate demand, it will also adversely impact private investment and productive capacity, exacerbating a productivity slowdown that was already visible before the pandemic struck.

While some economies might recover by boosting exports, this is certainly not an option for most countries. First, an acceleration of global trade to the degree required to compensate for the overall sluggishness is unlikely in a context where value chains have been weakened during the pandemic. Second, even for those economies who previously enjoyed a payments surplus and might be looking to export their way out of the crisis, it will be necessary that the counterpart deficit countries boost their domestic demand significantly and overcome their financial constraints to be able to increase their external borrowing. Such a configuration of outcomes is unlikely under current circumstances.

In a deeper setback for the world, these adverse economic conditions will derail any attempt to advance an energy transformation that could mitigate climate change and will preclude meeting the SDGs by 2030.

UNCTAD has estimated that, if adopted, a return to policies-as-usual will translate into average global growth rates of 2 per cent annually to 2030, significantly below the average rate of growth of 3.1 per cent experienced after the GFC, and even further below the average rate of 3.8 per cent between the ‘dot-com’ crisis and the GFC. In this scenario, by end of 2021 global unemployment will climb from a pre-pandemic rate of 5 per cent to above 8 per cent (an increase of about 150 million workers seeking for jobs), and will remain above 6 per cent until at least 2030. What is more, despite fiscal austerity, public debt ratios will continue to rise because of the slow growth of GDP and government revenues. UNCTAD estimates that in this scenario, despite an average annual growth of government spending as low as 1.2 per cent (compared with 2.9 per cent in the post-GFC period), the ratio of gross public debt to GDP for the world as whole will actually increase from 89 per cent in 2021 to 92 per cent in 2030.

In sum, without a change of direction in policy, the next ten years will be a lost decade for growth, development, employment, the environment and economic and social justice.

Another growth strategy is possible, but requires a change of direction in policy

At this time, a 'lost decade' can still be avoided. The 'growth revival' scenario proposed in our Trade and Development Report 2020 indicates a possible way out, based on the following policy mix: (i) a durable fiscal expansion (ii) direct employment creation together with proactive measures to promote employment-intensive private investment, combined with stronger social protection, including for people outside the labour force, and a strong expansion of the care economy with better treatment for its workers; (iii) public investment in infrastructure to support structural transformation, with incentives for private fixed capital formation and curbs on speculative investment; (iv) a serious commitment to climate stabilization both in the form of regulation (e.g. emission limits for private vehicles) and of investment to develop supply of renewables and increase energy efficiency (the combination of which has net positive employment effects).

UNCTAD projects that this strategy will have significantly positive effects on economic activity (due to fiscal multipliers currently in the range of 1.4 to 2.0) and government revenues. Yet, realistically, to bring down deficit and debt ratios, progressive tax reforms will also have to be implemented. This will mean partially shifting the burden from indirect taxes (which are regressive and discourage spending) to direct taxes, from low-income to high-income earners (who are less likely to reduce their spending following a tax increase) and on corporate earnings and rents (with relative exemptions depending on employment creation).

Policy also needs to contain and dial back rising global macro-financial imbalances, which have been left unchecked because of the dominance of 'inflation targeting' rules while neglecting asset-price rises. Thus, UNCTAD proposes re-regulation of financial and capital markets with the aim of curbing purely speculative investment and financial sector leverage. This is consistent with the call for more domestic demand stimulus in countries with an external surplus (instead of injections to global demand by advanced deficit economies based on borrowing and asset appreciations). If domestic demand in surplus economies grows faster, deficit economies can concentrate on the structural transformations necessary to increase productivity and become more competitive in the high end of the value-added spectrum. There are, as UNCTAD indicates, many combinations of domestic demand support, trade measures and industrialization strategies that ensure faster growth in both deficit and surplus countries, but reducing global imbalances requires that domestic demand grows faster in the latter. This is reflected in the "growth revival" scenario described in the TDR 2020.

In this scenario gross world product grows at an average annual rate of 3.8 per cent, with government spending (current and investment) growing at an average annual rate of 3.1 per cent and private investment growing at 6.1 per cent. Unemployment rates are significantly reduced, reaching pre-pandemic levels by 2024-25 and approaching full employment levels by 2030. The demand stimulus is engineered in order not to place undue pressure on productive capacity (thus containing inflation

surges), and for public debt ratios to gradually decline. The level of new investment occurring in this scenario is sufficient to deliver a strong boost to the energy transition, such that carbon emissions will approach the Kyoto target of a maximum of 1.5 degrees Celsius above pre-industrial average. In this scenario the gap in per capita income between developing and developed countries is reduced by 10 percent by 2030 (excluding China, whose per capita income is growing faster than in advanced economies already). These outcomes, while positive, fall short of the SDGs but they point to the kind of plausible growth path that is needed for tangible progress, and in the opposite direction to the one the global economy would take if guided by the policy approach of the last decade.

A "better recovery" also requires changes in the multilateral architecture

The post-war multilateral order has struggled to adapt to changes. Reforms, while regularly promised, have been resisted by the strongest players. Still, the legacy of Bretton Woods has left in place mechanisms that can still be employed to help resolve the current crisis. But there remain significant gaps in the system that will hold back a better recovery if not urgently addressed. Much like in 1945 doing so will require a marriage of creative thinking and bold leadership that address immediate challenges of relief and recovery while setting a course for longer-term resilience and stability.

UNCTAD's own proposals for collective actions at the multilateral level include the following:

1. In the short-run and to alleviate immediate balance of payment pressures, expansive use should be made of Special Drawing Rights (SDRs), through a relocation of unused SDRs in developed economies to developing countries, as well as through a sizeable fresh allocation that ensures that at least US$ 1 trillion in SDR reach the developing world soon. This represents a meagre 7.5% of the relief packages adopted by the major economies earlier in the year.

2. Extended debt moratoria that last well beyond 2020, include all vulnerable developing countries independently of their income status and extend their scope to bring on board private as well as multilateral creditors. Given the wide reach of private credit rating agencies and their decisive role in either facilitating or hampering progress on debt moratoria and relief, we suggest that the time has come to proactively engage with the establishment of a publicly controlled credit rating agency. Beyond debt moratoria, debt cancellations will have to be considered systematically over the next year.

3. A Marshall Plan for global health recovery could provide a more dedicated framework for building future resilience. If the donor community met the 0.7 per cent of GNI Official Development Assistance (ODA) target for the next two years that would generate something in the order of $380bn above current commitments. An additional $220bn mobilized by the network of multilateral and regional financing institutions could complete a $600bn support package over the next 18 to 20 months. The money should be dispersed largely as grants but

with some room for zero interest loans, the precise mixture determined as the emergency response evolves.

4. The lending capacity of multilateral development banks should be boosted. This new lending could, for example, come from existing shareholders redirecting environmentally damaging subsidies, for example for fossil fuels and industrial agriculture, to the capital base of these institutions, or from more innovative sources, such as a financial transaction tax, and augmented by borrowing on international capital markets, with a measured relaxing of their fidelity to financial sobriety. In return, these institutions should reassess their policy conditionalities in line with a more sustainable and inclusive development agenda.

5. Properly regulated international financial markets. Volatile international capital flows generate cycles that increase the financial fragility of receiving countries, especially in the developing world. Insulating measures, including capital controls, will need to be country specific, determined by the nature and degree of a country's financial openness and by the institutional set-up of its financial system.

6. Comprehensive international tax reforms to avoid a race to the bottom in tax matters are urgently needed to increase cross-border tax transparency and developing countries' voice in this regard. This extends, in particular, to the improved international governance of extractive industries and of international rules for the taxation of digital services and sectors.

7. Finally, a global sovereign debt authority, independent of either (institutional or private) creditor or debtor interests, should be established to address debt cancellations and reprofiling in a systematic fashion and to correct the manifold flaws in the current handling of sovereign debt restructuring. These have come under a glaring spotlight during the current crisis, including the crippling fragmentation and complexity of existing procedures, the potentially extraordinary powers of hold-out creditors to sabotage restructurings, and the resultant inefficacy of crisis resolutions. UNCTAD is currently working on the details of such an authority.

For all its destruction of human and economic life, the novel coronavirus has created an opportunity for lasting change, in part because it has laid bare the shortcomings of the world that existed well before this pathogen made its way around the world. The financial crisis a decade ago did the same, but the world did not rise to the challenge, and we were still living with the vestiges of that failure when the virus leapt from animal to human in late 2019. Now the problems are, if anything, larger. But the intellectual environment around them is much more vibrant, and the political will to attack them shows some promising signs of life. There is reason for hope but not for complacency.