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Chapter I

CURRENT TRENDS AND CHALLENGES IN THE WORLD ECONOMY



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A. Recent trends in the world economy

1. Global growth

The global economy is still struggling to return to a strong and sustained growth path. World output, which grew at a rate of 2.2 per cent in 2012, is forecast to grow at a similar rate in 2013. Developed countries will continue to lag behind the world average, with a likely 1 per cent increase in gross domestic product (GDP), due to a slight deceleration in the United States and a continuing recession in the euro area. Developing and transition economies should grow by about 4.7 per cent and 2.7 per cent respectively (table 1.1). Even though these growth rates are significantly higher than those of developed countries, they remain well below their pre-crisis levels. Furthermore, they confirm the pace of deceleration that started in 2012.

Economic activity in many developed countries and a number of emerging market economies is still suffering from the impacts of the financial and economic crisis that started in 2008 and the persistence of domestic and international imbalances that led to it. However, continuing weak growth in several countries may also be partly due to their current macroeconomic policy stance.

Among *developed economies*, growth in the European Union (EU) is expected to shrink for the second consecutive year, with a particularly severe economic contraction in the euro area. Private demand remains subdued, especially in the euro-zone periphery countries (Greece, Ireland, Italy, Portugal and Spain), due to high unemployment, wage compression, low consumer confidence and the still incomplete process of balance sheet consolidation. Given the ongoing process of deleveraging, expansionary monetary policies have failed to increase the supply of credit for productive activities. In this context, continued fiscal tightening makes a return to a higher growth trajectory highly unlikely, as it adds a deflationary impulse to already weak private demand. While foreign trade (mainly through the reduction of imports) contributed to growth in the euro area, this was more than offset by the negative effect of contracting domestic demand, which even the surplus countries have been reluctant to stimulate. This perpetuates disequilibrium within the euro zone and reduces the scope for an export-led recovery of other countries in the zone. Hence, despite the fact that the tensions in the financial markets of the euro area have receded following intervention by the European Central Bank (ECB), prospects for a resumption of growth

Table 1.1

WORLD OUTPUT GROWTH, 2005–2013									
<i>(Annual percentage change)</i>									
<i>Region/country</i>	2005	2006	2007	2008	2009	2010	2011	2012	2013 ^a
World	3.5	4.1	4.0	1.5	-2.2	4.1	2.8	2.2	2.1
Developed countries	2.4	2.8	2.6	0.0	-3.8	2.6	1.5	1.2	1.0
<i>of which:</i>									
Japan	1.3	1.7	2.2	-1.0	-5.5	4.7	-0.6	1.9	1.9
United States	3.1	2.7	1.9	-0.3	-3.1	2.4	1.8	2.2	1.7
European Union (EU-27)	2.1	3.3	3.2	0.3	-4.3	2.1	1.6	-0.3	-0.2
<i>of which:</i>									
Euro area	1.7	3.3	3.0	0.4	-4.4	2.0	1.5	-0.6	-0.7
France	1.8	2.5	2.3	-0.1	-3.1	1.7	2.0	0.0	-0.2
Germany	0.7	3.7	3.3	1.1	-5.1	4.2	3.0	0.7	0.3
Italy	0.9	2.2	1.7	-1.2	-5.5	1.7	0.4	-2.4	-1.8
United Kingdom	2.8	2.6	3.6	-1.0	-4.0	1.8	0.9	0.2	1.1
South-East Europe and CIS	6.5	8.3	8.6	5.2	-6.6	4.5	4.5	3.0	2.7
South-East Europe ^b	4.7	4.8	5.5	3.7	-4.3	0.0	1.1	-1.4	0.3
CIS	6.7	8.7	8.9	5.3	-6.8	4.9	4.8	3.4	2.9
<i>of which:</i>									
Russian Federation	6.4	8.2	8.5	5.2	-7.8	4.5	4.3	3.4	2.5
Developing countries	6.8	7.6	7.9	5.3	2.4	7.9	5.9	4.6	4.7
Africa	5.8	5.9	6.2	5.2	2.8	4.9	1.0	5.4	4.0
North Africa, excl. Sudan	5.1	5.4	4.7	4.6	3.2	4.1	-6.1	7.8	3.6
Sub-Saharan Africa, excl. South Africa	6.7	6.5	7.7	6.6	4.9	6.4	4.8	5.3	5.4
South Africa	5.3	5.6	5.5	3.6	-1.5	3.1	3.5	2.5	1.7
Latin America and the Caribbean	4.5	5.6	5.6	4.0	-1.9	5.9	4.3	3.0	3.1
Caribbean	7.4	9.4	5.8	3.1	-0.1	2.6	2.4	2.5	2.7
Central America, excl. Mexico	4.8	6.4	7.0	4.1	-0.2	4.1	5.2	5.0	4.1
Mexico	3.2	5.2	3.3	1.2	-6.0	5.5	4.0	3.9	2.8
South America	5.0	5.5	6.6	5.5	-0.2	6.4	4.6	2.5	3.2
<i>of which:</i>									
Brazil	3.2	4.0	6.1	5.2	-0.3	7.5	2.7	0.9	2.5
Asia	7.8	8.6	9.0	5.8	3.9	8.9	7.1	5.0	5.2
East Asia	8.6	9.9	11.0	6.9	5.9	9.5	7.7	6.0	6.1
<i>of which:</i>									
China	11.3	12.7	14.2	9.6	9.2	10.4	9.3	7.8	7.6
South Asia	8.0	8.3	8.9	5.2	4.7	9.4	6.6	3.0	4.3
<i>of which:</i>									
India	9.0	9.4	10.1	6.2	5.0	11.2	7.7	3.8	5.2
South-East Asia	5.8	6.1	6.6	4.3	1.2	8.0	4.5	5.4	4.7
West Asia	6.8	7.0	4.6	3.8	-1.7	7.0	7.1	3.2	3.5
Oceania	3.4	2.9	3.5	2.7	2.3	3.6	4.3	4.1	2.7

Source: UNCTAD secretariat calculations, based on United Nations, Department of Economic and Social Affairs (UN-DESA), *National Accounts Main Aggregates* database, and *World Economic Situation and Prospects (WESP): Update as of mid-2013*; ECLAC, 2013; ESCAP, 2013; OECD, 2013; IMF, *World Economic Outlook*, April 2013; Economist Intelligence Unit, *EIU CountryData* database; JP Morgan, *Global Data Watch*; and national sources.

Note: Calculations for country aggregates are based on GDP at constant 2005 dollars. CIS includes Georgia.

^a Forecasts.

^b Albania, Bosnia and Herzegovina, Croatia, Montenegro, Serbia and the former Yugoslav Republic of Macedonia.

of consumption and investment in these countries remain grim.

Japan is bucking the current austerity trend of other developed economies by providing a strong fiscal stimulus in conjunction with monetary policy expansion with the aim of reviving economic growth and curbing deflationary trends. An increase of government spending on infrastructure and social services, including health care and education, has been announced, to be accompanied by efforts to boost demand and structural policies oriented towards innovation and investment. To complement these efforts, in April 2013 the Bank of Japan announced that it will increase its purchase of government bonds and other assets by 50 trillion yen per year (equivalent to 10 per cent of Japan's GDP) in order to achieve an inflation target of 2 per cent. Overall, these measures could help maintain Japan's GDP growth at close to 2 per cent in 2013.

The United States is expected to grow at 1.7 per cent, compared with 2.2 per cent in 2012, due to a new configuration of factors. Partly owing to significant progress made in the consolidation of its banking sector, private domestic demand has begun to recover. The pace of job creation in the private sector has enabled a gradual fall in the unemployment rate. On the other hand, cuts in federal government spending, enacted in March 2013, and budget constraints faced by several State and municipal governments are a strong drag on economic growth. Since the net outcome of these opposing tendencies is unclear, there is also considerable uncertainty about whether the expansionary monetary policy stance will be maintained.

By contrast, *developing countries* continue to be the main drivers of growth, contributing to about two thirds of global growth in 2013. In many of them, growth has been driven more by domestic demand than by exports, as external demand, particularly from developed economies, has remained weak. Developing countries are expected to grow at the rate of 4.5–5 per cent in 2013, similar to 2012. This would result from two distinctive patterns. On the one hand, growth in some large developing economies, such as Argentina, Brazil, India and Turkey, which was subdued in 2012, is forecast to accelerate. On the other hand, several other developing economies seem unlikely to be able to maintain their previous year's growth rates. Their expected growth deceleration

partly reflects the accumulated effect of continuing sluggishness in developed economies and lower prices for primary commodity exports, but also the decreasing policy stimuli which were relatively weak anyhow. The combination of these factors may also affect China's growth rate, which is expected to slow down moderately from 7.8 per cent in 2012 to about 7.6 in 2013. Even though this would be only a mild deceleration, it is likely to disappoint many of China's trading partners.

Among the developing regions, *East, South and South-East Asia* are expected to experience the highest growth rates in 2013, of 6.1 per cent, 4.3 per cent and 4.7 per cent, respectively. In most of these countries, growth is being driven essentially by domestic demand. In China, the contribution of net exports to GDP growth was negligible, while fixed investment and private consumption, as a result of faster wage growth, continued to drive output expansion. Encouraged by various incomes policy measures, domestic private demand is also supporting output growth in a number of other countries in the region, such as India, Indonesia, the Philippines and Thailand (ESCAP, 2013). In addition, along with GDP growth, credit to the private sector has tended to rise, further supporting demand.

Economic growth in *West Asia* slowed down dramatically, from 7.1 per cent in 2011 to 3.2 per cent in 2012, a level that is expected to be maintained in 2013. Weaker external demand, especially from Europe, affected the entire region, but most prominently Turkey, which saw its growth rate fall sharply from around 9 per cent in 2010 and 2011 to 2.2 per cent in 2012, but it is expected to accelerate towards 3.3 per cent in 2013. The Gulf Cooperation Council (GCC) countries maintained large public spending programmes to bolster domestic demand and growth, despite scaling back their oil production during the last quarter of 2012 to support oil prices. Finally, the civil war in the Syrian Arab Republic not only greatly affected that country but continued to heighten perceptions of risk with regard to neighbouring countries, which resulted in subdued investment, tourism and trade in Jordan and Lebanon.

Growth in *Africa* is expected to slow down in 2013, owing to weaker performance in North Africa, where political instability in some countries has been mirrored in recent years by strong fluctuations in growth. In sub-Saharan Africa (excluding

South Africa), GDP growth is expected to remain stable in 2013, at above 5 per cent. The main growth drivers include high earnings from exports of primary commodities and energy as well as tourism, and relatively strong growth of public and private investment in some countries. Angola, Côte d'Ivoire, the Democratic Republic of the Congo, Ethiopia, Gambia, Ghana, Liberia, Rwanda, Sierra Leone and the United Republic of Tanzania are likely to see rapid growth bolstered by strong investments, especially in infrastructure, telecommunications, energy and the extractive industries. On the other hand, growth in several middle-income countries of Africa is forecast to decelerate further in 2013, in particular in countries that have close trade ties with Europe, including South Africa. Moreover, several least developed countries (LDCs) of West Africa which depend on exports of single commodities remain vulnerable to drastic swings in demand for those commodities.

Growth is set to remain relatively stable in *Latin America and the Caribbean*, at around 3 per cent, on average, as a slowdown in some countries, including Mexico, is likely to be offset by faster growth in Argentina and Brazil. In 2012 and the first months of 2013, regional growth has been driven mostly by domestic demand based on moderate but consistent increases in public and private consumption and investment (ECLAC, 2013). Governments generally turned to more supportive fiscal and monetary policies in a context of low fiscal deficits and low inflation for the region as a whole. Growth of exports and imports fell sharply in 2012, which resulted in a slight increase in the region's current account deficit. Domestic demand will continue to support growth in 2013 based on rising real wages and employment, as well as an expansion of bank credit. In addition, a recovery of agriculture and investment should contribute to better economic performances in Argentina and Brazil after weak growth in 2012. On the other hand, owing to sluggish international demand and lower export prices of oil and mining products (although they remain at historically high levels) a slowdown is expected in the Bolivarian Republic of Venezuela, Chile, Ecuador, Mexico and Peru.

There has been a downward trend in the economic performance of the *transition economies* since 2012. The impact of the continuing crisis in much of Western Europe caused the economies of South-Eastern Europe to fall into recession in 2012, and they

will barely remain afloat in 2013. The members of the Commonwealth of Independent State (CIS) maintained a growth rate of over 3 per cent in 2012 based on sustained domestic demand, but this is expected to slow down slightly in 2013. The region's economic prospects remain closely linked to the performance of the economy of the Russian Federation and to commodity price developments, particularly in oil and natural gas.

The continuing expansion of developing economies as a group (in particular the largest economy among them, China) has led to their gaining increasing weight in the world economy, which suggests the possible emergence of a new pattern of global growth. While developed countries remain the main export markets for developing countries as a group, the share of the latter's contribution to growth in the world economy has risen from 28 per cent in the 1990s to about 40 per cent in the period 2003–2007, and close to 75 per cent since 2008. However, more recently, growth in these economies has decelerated. They may continue to grow at a relatively fast pace if they are able to strengthen domestic demand and if they can rely more on each other for the expansion of aggregate demand through greater South-South trade. However, even if they achieve more rapid growth by adopting such a strategy, and increase their imports from developed countries, this will not be sufficient to lift developed countries out of their growth slump.

2. International trade

(a) Goods

International trade in goods has not returned to the rapid growth rate of the years preceding the crisis. On the contrary, it decelerated further in 2012, and while the outlook for world trade remains uncertain, the first signs in 2013 do not point to an expansion. After a sharp fall in 2008–2009 and a quick recovery in 2010, the volume of trade in goods grew by only 5.3 per cent in 2011 and by 1.7 per cent in 2012. This slower rate of expansion occurred in developed, developing and transition economies alike (table 1.2).

Sluggish economic activity in developed countries, particularly in Europe, accounted for most of this very significant slowdown. In 2012, EU imports

Table 1.2

Region/country	Volume of exports				Volume of imports			
	2009	2010	2011	2012	2009	2010	2011	2012
World	-13.3	13.9	5.2	1.8	-13.6	13.8	5.3	1.6
Developed countries	-15.5	13.0	4.9	0.4	-14.6	10.8	3.4	-0.5
of which:								
Japan	-24.8	27.5	-0.6	-1.0	-12.2	10.1	4.2	3.7
United States	-14.0	15.4	7.2	4.1	-16.4	14.8	3.8	2.8
European Union	-14.9	11.6	5.5	-0.2	-14.5	9.6	2.8	-2.8
Transition economies	-14.4	11.3	4.2	1.0	-28.2	15.9	15.7	3.9
of which:								
CIS	-13.9	11.4	4.2	1.3	-29.1	19.7	17.4	5.0
Developing countries	-9.7	16.0	6.0	3.6	-10.2	18.8	7.4	4.5
Africa	-9.5	8.8	-8.3	5.7	-6.2	8.4	2.8	8.0
Sub-Saharan Africa	-7.8	9.6	-0.7	0.1	-9.0	9.7	7.9	4.2
Latin America and the Caribbean	-7.4	8.3	4.6	2.2	-17.9	22.5	10.8	2.5
East Asia	-10.9	24.1	10.4	5.2	-5.3	22.7	7.4	4.3
of which:								
China	-14.1	29.1	13.0	7.2	-1.1	25.4	10.3	5.9
South Asia	-6.1	10.0	8.8	-10.2	-5.5	14.0	6.0	2.0
of which:								
India	-6.8	14.0	14.2	-2.5	-0.9	13.8	9.1	5.8
South-East Asia	-10.0	18.6	4.4	2.2	-15.8	22.0	6.7	6.0
West Asia	-4.8	5.7	6.5	6.9	-14.2	8.4	8.1	5.8

Source: UNCTAD secretariat calculations, based on UNCTADstat.

of goods shrank by 2.8 per cent in volume and by 5 per cent in value. Extremely weak intra-EU trade was responsible for almost 90 per cent of the decline in Europe's exports in 2012. However, trade performance was also weak in other developed countries. In Japan, exports have not yet recovered from their sharp fall caused by the earthquake of 2011,¹ while the volume of its imports has continued to grow at a moderate pace. Among the other major developed countries, only the United States maintained a positive growth rate of both exports and imports, although that of its exports appears to be decelerating further in 2013. This signals a mounting headwind for the world's largest economy, where exports initially appeared to spur a recovery.

Trade growth also decelerated considerably in developing and transition economies in 2012, though the figures remained positive for most countries. In the transition economies, the rate of growth of the volume of exports was 1 per cent in 2012, down from 4.2 per cent in 2011, and that of imports was

3.9 per cent in 2012, down from 15.7 per cent in 2011. Likewise, in developing countries the rate of growth of exports fell from 6 per cent in 2011 to 3.6 per cent in 2011, and that of imports from 7.4 per cent in 2011 to 4.5 per cent in 2012.

At the subregional level, two notable exceptions stand out from this general pattern of developing-country trade. The first is the recovery of trade in some North African economies from low levels in 2011, which contributed to higher trade growth in Africa as a whole. The second is the absolute decline in the volume of exports from South Asia, explained mainly by a reduction of oil exports from the Islamic Republic of Iran,² though India's export volumes also fell, by 2.5 per cent. This was largely due to the economic slowdown in Europe, which accounts for almost one fifth of India's total exports, as well as weak exports to China.

An examination of longer time periods puts into perspective the structural changes associated with the

slowdown of trade. By the end of 2012, the volume of global trade was only 7.5 per cent above its 2007 level. The average annual growth rate during the period 2008–2012 was about 1.4 per cent – well below the 7.4 per cent registered during the period 2003–2007.

With regard to China, the powerhouse of global trade in recent years, the slowdown is even more striking. The world's largest exporter experienced a sharp deceleration of its exports as a consequence of the 2008–2009 economic crisis, largely due to its reliance on demand from developed countries. The rate of growth of China's exports (by volume) decelerated to 13 per cent in 2011 and to 7.2 per cent in 2012, in sharp contrast to their massive growth rate of 27 per cent during the period 2002–2007 following China's accession to the World Trade Organization (WTO). This was the first time since the East Asian crisis in the late 1990s that China's export growth was slower than that of its GDP. Concomitantly, in 2012, the growth of China's imports decelerated to 5.9 per cent by volume and to 4.3 per cent by value, from 19 per cent and 26 per cent, respectively, between 2002 and 2007. As a result, only regions exporting a large proportion of primary commodities (i.e. Africa, West Asia and, to a lesser extent, Latin America) saw a significant increase in their exports to China in 2012, both by volume and value.

Several exporters of manufactures in Asia registered a sizeable slowdown of growth in their external trade. For example, between 2002 and 2007, the volume of exports of the Republic of Korea, Thailand and Malaysia increased by an annual average of 14 per cent, 10 per cent and 9 per cent, respectively; in 2012, those rates fell to 1.5 per cent in the Republic of Korea, 2.5 per cent in Thailand and 0.5 per cent in Malaysia. This was the result not only of lower import demand from Europe, but also of slower growth in some developing regions, in particular East Asia.

The crisis of 2008–2009 altered trade patterns in both developed and developing countries. On the one hand, imports and exports (by volume) of developed regions have remained below their pre-crisis levels, with the exception of the United States where exports have exceeded their previous peak of August 2008. On the other hand, exports from the group of emerging market economies were 22 per cent above their pre-crisis peaks, while the corresponding figure for their imports was 26 per cent higher. However, the pace of growth of trade of these economies has

slowed down significantly: during the pre-crisis years, between 2002 and 2007, their export volume grew at an average annual rate of 11.3 per cent, but fell to only 3.5 per cent between January 2011 and April 2013. Growth in the volume of their imports also slowed down, from 12.4 per cent to 5.5 per cent over the same period (chart 1.1).

Available data for the first half of 2013 tend to confirm that the recent slowdown persists. Data from the CPB Netherlands Bureau for Economic Policy Analysis (CPB) show that the volume of international trade grew by a year-on-year average of less than 2 per cent in the first five months of 2013. Among the developed countries exports and imports virtually stagnated in the United States and fell in the EU and Japan. Exports from emerging economies decelerated during the same period, with the exception of those from the emerging Asian economies, which increased by 6.2 per cent in the first months of 2013.³

Overall, this general downward trend in international trade highlights the vulnerabilities developing countries continue to face at a time of lacklustre growth in developed countries. It is also indicative of a probably less favourable external trade environment over the next few years, which points to the need for a gradual shift from the reliance on external sources of growth towards a greater emphasis on domestic sources.

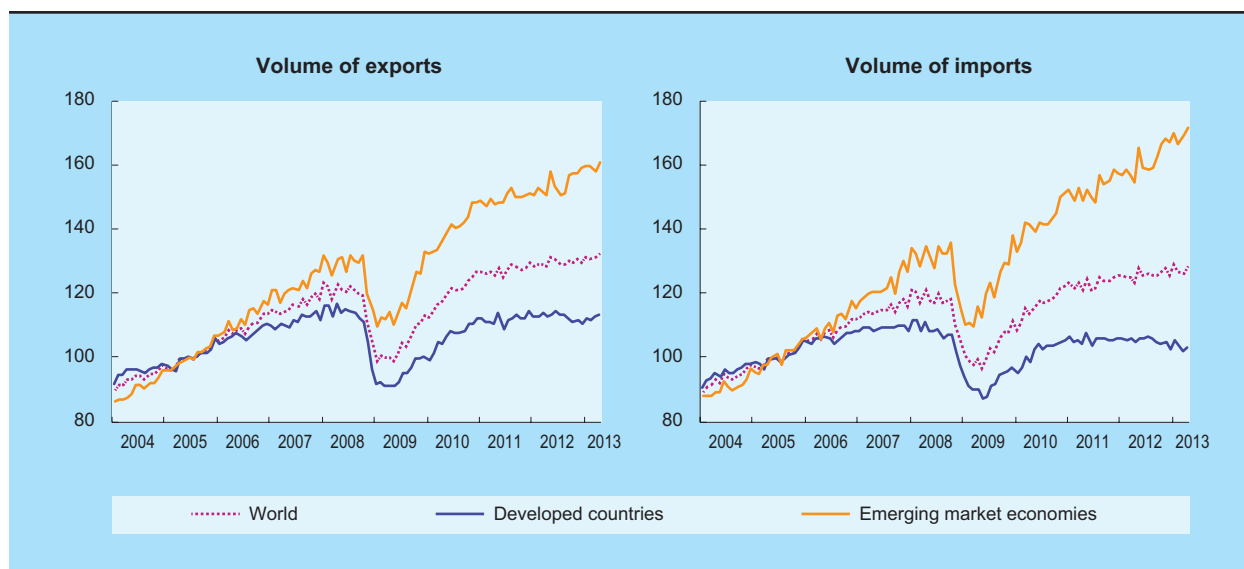
(b) Services

Similar to merchandise trade, world trade in commercial services grew by 1–2 per cent in 2012, according to preliminary estimates by UNCTAD/WTO. Within this broad category, international tourism grew by 4 per cent in 2012, both in terms of receipts in real terms (i.e. adjusting for exchange rate fluctuations and inflation) and the number of arrivals. Tourism roughly accounts for 30 per cent of world exports of services and for 6 per cent of overall exports of goods and services. It also ranks fifth as a worldwide export category after fuels, chemicals, food and automotive products, and even first in many developing countries. The Americas recorded the largest increase in receipts from tourism (7 per cent), followed by Asia and the Pacific (6 per cent), Africa (5 per cent) and Europe (2 per cent). By contrast, receipts in West Asia were again down by 2 per cent (World Tourism Organization, 2013). Tourist receipts

Chart 1.1

WORLD TRADE BY VOLUME, JANUARY 2004–APRIL 2013

(Index numbers, 2005 = 100)



Source: UNCTAD secretariat calculations, based on CPB Netherlands Bureau of Economic Policy Analysis, *World Trade* database.

Note: Emerging market economies excludes Central and Eastern Europe.

of the top 10 destinations, which include 7 developed economies together with China, Hong Kong (China) and Macao (China), remained virtually unchanged in 2012, whereas several emerging market destinations, including India, South Africa, Thailand, Ukraine and Viet Nam registered double-digit growth figures.

The growth of international transport services – the second largest category of commercial services – while positive, was hindered by a number of downside factors, including the continued recession in the euro area, fragile recovery in the United States, and the relative deceleration and rebalancing of growth of the Chinese economy. Preliminary data indicate that world seaborne trade – a measure of demand for shipping, port and logistics services – climbed by 4.3 per cent in 2012.

In particular, dry bulk trade expanded by 6.7 per cent in 2012, in line with the long-term trend, driven mainly by two main commodities – iron ore and coal. Trade in iron ore rose by 5.4 per cent, though this was considered the slowest increase in more than a decade. A strong increase in China's demand was met by exports from Australia and, to a lesser extent, by long-haul shipments from Brazil. Meanwhile,

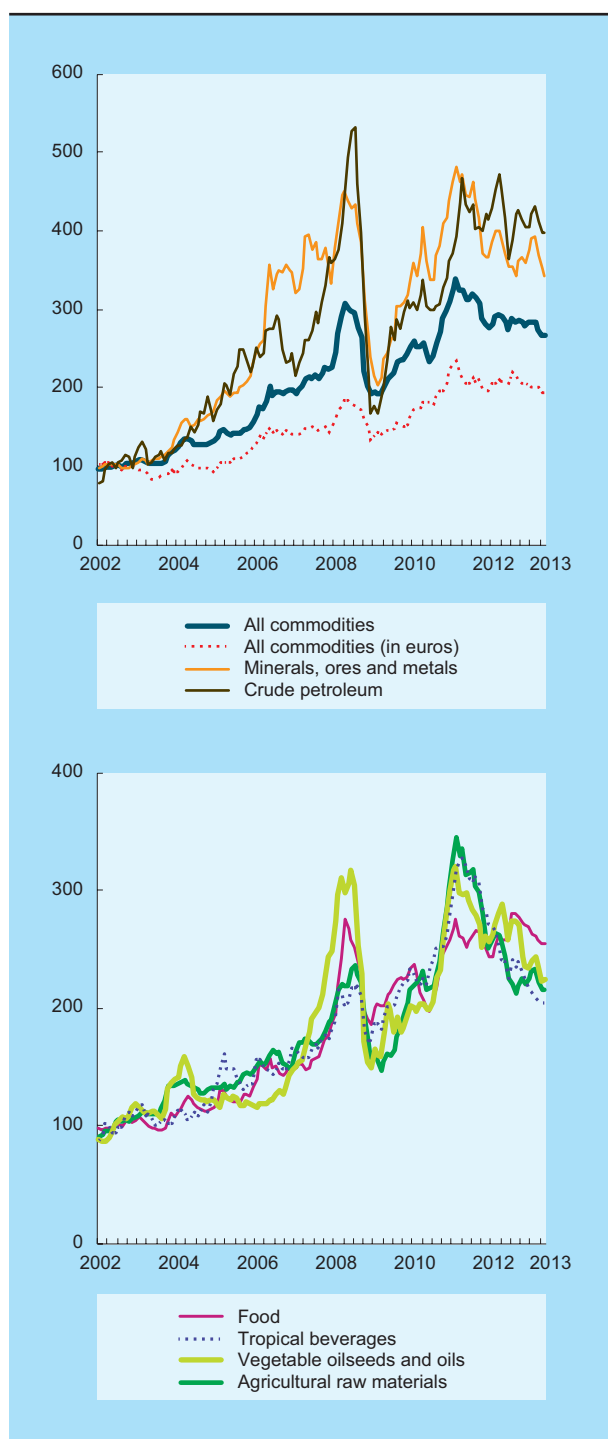
imports from India, previously China's third largest supplier, dropped by over 50 per cent as a result of rising export taxes on iron ore as well as mining and export bans. Coal shipments increased significantly (12.3 per cent) driven by strong demand for steam coal (14.2 per cent) stemming from the recovery in European imports and rapidly growing imports by China. In the United States, greater use of domestically produced shale gas resulted in an increase in its coal exports, which in turn lowered international coal prices and drove up global demand for coal.

Developments in tanker trade, which accounts for one third of global seaborne trade, mirrored the behaviour of global oil demand. In 2012, demand for crude oil increased marginally by 1.5 per cent in volume. Meanwhile, the growth of containerized trade decelerated to 3.2 per cent, from 7.1 per cent in 2011. The volumes of such trade continued to be affected by weak performance on the main-lane East-West routes linking Asia to Europe and North America. Growth was mainly driven by an increase in that trade on secondary routes, in particular, South-South, North-South and intraregional routes. Containerized trade accounts for about 16 per cent of global merchandise trade by volume and over 50 per

Chart 1.2

MONTHLY COMMODITY PRICE INDICES BY COMMODITY GROUP, JAN. 2002–MAY 2013

(Index numbers, 2002 = 100)



Source: UNCTAD secretariat calculations, based on UNCTAD, *Commodity Price Statistics Online* database.

Note: Crude petroleum price is the average of Dubai/Brent/West Texas Intermediate, equally weighted. Index numbers are based on prices in current dollars, unless otherwise specified.

cent by value, but it remains under severe pressure. The industry continues to face the problem of how to absorb excess shipping supply capacity, as well as how to employ the rapidly growing capacity of very large ships when most of the growth is being generated by regional trade which requires medium-sized or smaller container ships (UNCTAD, 2013).

3. Recent trends in commodity prices

During 2012 and the first five months of 2013, the prices of most commodity groups continued to retreat from their peaks reached in early 2011 (chart 1.2). Major exceptions were the prices of food and oil, which have been fluctuating within a band over the past two years. The main reasons for the decline in many commodity prices over this period were weak demand growth and an uncertain outlook for global economic activity, together with improved supply prospects. However, most commodity prices still remain at substantially higher levels than the average prices recorded during the commodity price boom of 2003–2008 (table 1.3).

Prices of food and vegetable oilseeds and oils surged in mid-2012 as a result of reduced supplies caused by weather-related events, most notably the worst drought in the United States in half a century. Food crops were also adversely affected by unfavourable climatic conditions in the Black Sea area and in Australia. While the increase in the prices of food commodities such as corn, wheat and soybeans was alarming, a food crisis was avoided mainly because rice, which is critical for food security, was not affected, and countries refrained from imposing trade restrictions. Food prices fell in the second part of the year owing to better supply prospects. After the tight markets and high prices of 2012/2013, forecasts for 2013/14 point to a better world cereal supply and demand balance (FAO, 2013). With good prospects for production and replenishment of stocks, prices should ease. This is not the case, however, for soybeans, which, in mid-2013, recorded a rise in prices resulting from tight supplies and low inventories, particularly in the United States.

The price of oil has been high and relatively stable over the past year. Between July 2012 and June 2013 the average price for Brent/Dubai/West

Table 1.3

WORLD PRIMARY COMMODITY PRICES, 2007–2013								2011–2013 versus 2003–2008 ^b
Commodity groups	2007	2008	2009	2010	2011	2012	2013 ^a	
All commodities^c	13.0	24.0	-16.9	20.4	17.9	-8.4	-3.3	68.6
All commodities (in SDRs)^c	8.6	19.5	-14.5	21.7	14.1	-5.5	-2.2	63.9
All food	13.3	39.2	-8.5	7.4	17.8	-1.4	-4.3	77.0
Food and tropical beverages	8.6	40.4	-5.4	5.6	16.5	-0.4	-3.3	78.1
<i>Tropical beverages</i>	10.4	20.2	1.9	17.5	26.8	-21.5	-13.5	77.9
Coffee	12.5	15.4	-6.9	27.3	42.9	-25.7	-16.2	96.9
Cocoa	22.6	32.2	11.9	8.5	-4.9	-19.7	-5.8	42.9
Tea	-12.3	27.2	16.5	-1.0	11.4	0.8	-14.2	52.8
<i>Food</i>	8.5	42.5	-6.0	4.4	15.4	2.0	-2.4	78.2
Sugar	-31.7	26.9	41.8	17.3	22.2	-17.1	-15.5	121.5
Beef	1.9	2.6	-1.2	27.5	20.0	2.6	1.4	63.4
Maize	38.2	34.0	-24.4	13.2	50.1	2.6	-0.5	112.5
Wheat	34.3	27.5	-31.4	3.3	35.1	-0.1	0.8	53.9
Rice	9.5	110.7	-15.8	-11.5	5.9	5.1	-2.9	64.0
Bananas	-0.9	24.6	0.7	3.7	10.8	0.9	-6.2	58.2
Vegetable oilseeds and oils	52.9	31.9	-28.4	22.7	27.2	-7.6	-11.4	69.5
Soybeans	43.0	36.1	-16.6	3.1	20.2	9.4	-6.4	67.4
Agricultural raw materials	12.0	20.5	-17.5	38.3	28.1	-23.0	-5.3	70.3
Hides and skins	4.5	-11.3	-30.0	60.5	14.0	1.4	3.4	22.8
Cotton	10.2	12.8	-12.2	65.3	47.5	-41.8	2.2	87.2
Tobacco	11.6	8.3	18.0	1.8	3.8	-3.9	2.0	45.9
Rubber	9.5	16.9	-27.0	90.3	32.0	-30.5	-8.4	119.4
Tropical logs	19.5	39.3	-20.6	1.8	13.8	-7.4	1.0	28.6
Minerals, ores and metals	12.8	6.2	-30.3	41.3	14.7	-14.1	-0.8	54.9
Aluminium	2.7	-2.5	-35.3	30.5	10.4	-15.8	-4.0	1.1
Phosphate rock	60.5	387.2	-64.8	1.1	50.3	0.5	-8.2	88.6
Iron ore	77.4	26.8	-48.7	82.4	15.0	-23.4	10.1	26.6
Tin	65.6	27.3	-26.7	50.4	28.0	-19.2	8.7	125.2
Copper	5.9	-2.3	-26.3	47.0	17.1	-9.9	-3.9	70.2
Nickel	53.5	-43.3	-30.6	48.9	5.0	-23.4	-5.9	-2.8
Lead	100.2	-19.0	-17.7	25.0	11.8	-14.2	6.3	60.1
Zinc	-1.0	-42.2	-11.7	30.5	1.5	-11.2	0.4	5.6
Gold	15.3	25.1	11.6	26.1	27.8	6.4	-6.6	184.6
Crude petroleum^d	10.7	36.4	-36.3	28.0	31.4	1.0	-2.2	77.3
Memo item:								
Manufactures^e	7.5	4.9	-5.6	1.9	10.3	-2.2

Source: UNCTAD secretariat calculations, based on UNCTAD, *Commodity Price Statistics Online*; and United Nations Statistics Division (UNSD), *Monthly Bulletin of Statistics*, various issues.

Note: In current dollars unless otherwise specified.

a Percentage change between the average for the period January to May 2013 and the average for 2012.

b Percentage change between the 2003–2008 average and the 2011–2013 average.

c Excluding crude petroleum. SDRs = special drawing rights.

d Average of Brent, Dubai and West Texas Intermediate, equally weighted.

e Unit value of exports of manufactured goods of developed countries.

Texas Intermediate (WTI) was \$105.5 per barrel, with prices fluctuating between \$99 and \$111 per barrel. Upward pressure on oil prices has been related to a decline in production by members of the Organization of the Petroleum Exporting Countries (OPEC) in the last quarter of 2012, and to geopolitical tensions in West Asia which affected oil supplies. By contrast, downside pressures on oil prices in 2013 have been mostly linked to increased production, mainly in North America, as well as sluggish global demand growth, particularly in members of the Organisation for Economic Co-operation and Development (OECD). Indeed, it is expected that all of the growth in demand for oil in 2013 will come from non-OECD countries, while demand may actually fall in OECD countries. Overall, it appears that new supplies will provide a buffer against supply shocks stemming from geopolitical tensions. However, some observers see a tighter market when the different oil grades are considered: there could be an abundant supply of light and sweet crude oil, but not of medium and sour crude. Prices of oil and metals also increased in early 2013 based on expectations of improved global economic conditions. However, subsequently, metal prices declined once more due to slow growth of demand and increasing supplies, as well as rising inventories.

Commodity prices also continue to be influenced by the activities of financial investors. The

rebound in oil and metal prices observed in the second half of 2012 may have been partly related to the third round of quantitative easing in the United States, with some of the increased liquidity probably being used to invest in commodity futures markets. By mid-2013, indications that this monetary stimulus could be scaled back, together with a credit squeeze in China, fuelled a wave of sell-offs in commodity derivatives. Thus, in the same way as financial investors contributed to amplifying the increases in commodity prices by buying commodity derivatives over the past decade, the commodity sell-offs by financial investors may well have had some influence on the decline in commodity prices in 2013. For example, data from Barclays (2013) show that commodity assets under management fell by \$27 billion in April 2013. Moreover, according to media reports, banks are expected to downsize or withdraw from their commodity investment business due to increased regulatory and capital costs.

The commodity price corrections in 2012 and 2013 might point to a reversal of the rising trend in prices witnessed during the first decade of the millennium. On the other hand, they could merely be a pause in that trend. Section B of chapter II provides a more detailed assessment of the likely evolution of commodity prices over a longer term.

B. The structural nature of the latest crisis

The recurrence of economic crises is one of the best established facts in economic history. However, not all crises are similar, nor do they require similar policy responses. An accurate assessment of a crisis must determine whether it is the result of temporary problems, which may be resolved mainly by self-correcting mechanisms, or more systemic problems. In the first case, the *status quo ante* can be expected to be restored after a certain period of time. In the case of a structural (or systemic) crisis, however, changes to the prevailing economic and social framework become necessary.

The analysis in the previous section has revealed that neither the developed economies, nor the developing and transition economies have been able to return to the rapid growth pace they experienced before the onset of the latest crisis. Many praised the “green shoots” of re nascent growth in 2010, but, soon after, the prospect of a rapid return to a “normal” state faded. The notion of what is “normal” itself is changing, and several observers are speaking of a “new normal” with regard to economic performances that can be expected in different countries and regions. This refers, in general, to lower growth rates, but also,

and more fundamentally, to the changing conditions and driving forces behind that growth. Since, as this *Report* argues, the factors that underpinned the pre-crisis economic expansion were unsustainable, endogenous adjustment mechanisms or automatic stabilizers are not likely to restore them. Moreover, relying on such a strategy will not succeed in returning economies to their previous growth pattern, nor is it desirable.

There is increasing recognition of the structural nature of the present crisis, as evidenced by the widespread calls for structural reforms. However, identifying the kinds of reforms needed depends critically on a correct diagnosis of the nature of the structural problems. Many proponents of structural reforms believe their main goals should be to improve competitiveness and restore the strength and confidence of financial markets. These goals are supposed to be achieved by short-term measures such as the compression of labour costs and fiscal austerity. However, so far, this approach has delivered disappointing results. Other proposals include radical measures, such as more flexible labour markets, lower social security coverage and a smaller economic role for the State. However, none of these proposed reforms are likely to solve the structural problems, and may even aggravate them, because they appear to be based on a flawed diagnosis.

1. An impossible return to the pre-crisis growth pattern

(a) Persistent employment problems

Five years after the onset of the global crisis, employment conditions remain precarious in most developed countries. Unemployment rates grew persistently in the EU, from 7.2 per cent in 2007 to 11 per cent in May 2013. In the United States, the open unemployment rate declined from its peak of 10 per cent in late 2009/early 2010 to 7.6 per cent in mid-2013, which is still historically high compared with less than 5 per cent in 2007. However, open unemployment rates, only partially depict the employment situation; if these rates are considered along with discouraged workers, those marginally attached to the labour force and those employed part time for economic reasons, the total rate of labour

underutilization was 14.3 per cent in June 2013.⁴ In Japan, employment indicators have improved significantly: unemployment is down to 4.1 per cent in May 2013, after exceeding 5.5 per cent in mid-2009, and is thus heading towards its pre-crisis low of 3.5 per cent.⁵

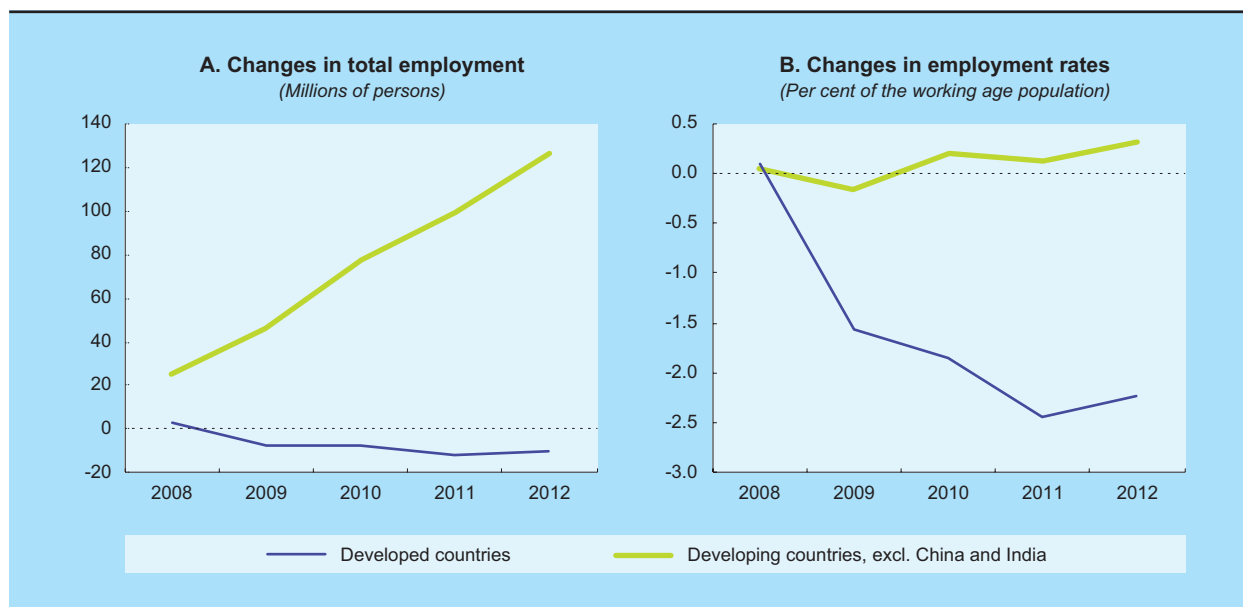
In the developed countries as a whole, the total number of employed declined from 510 million in 2007 to 500 million in 2012; the employment rate (defined as a percentage of the working age population) in these countries fell from 68.8 per cent to 66.6 per cent.⁶ Had that rate not fallen, total employment would have reached 517 million persons in 2012, which means that the employment deficit caused by the crisis (i.e. fewer employed people than expected based on pre-crisis trends) amounted to 17 million persons. This jobs gap or deficit resulting from the crisis has been larger and longer lasting than in any previous crisis affecting developed countries over the past three decades (chart 1.3).

Open unemployment in developing countries has been quite different since the onset of the crisis compared with the pre-crisis period. Among the largest developing and transition economies (those that are members of the G-20), only Mexico and South Africa had higher unemployment rates at the end of 2012 than before the crisis; all the other countries managed to reduce that rate. Between 2007 and 2012, 130 million jobs were created in the developing countries (excluding China and India), sufficient to prevent an increase in their jobs deficit (chart 1.3). Most developing countries, however, continue to face huge long-standing employment problems, including low participation rates in formal activities, particularly among women, high youth unemployment and a large proportion of low-quality jobs.

The discrepancies between developed and developing countries with regard to employment generation reflect their different growth performances. In developed countries, the strategy of creating jobs by reducing (or allowing a reduction of) real wages has not delivered the expected results in the presence of slow, or in some cases negative, output growth. Such wage policies have an adverse impact on aggregate demand, which makes private firms less willing to invest and to hire new workers. Reducing the price of labour does not lead to the expected outcome of equilibrating demand and supply on the labour market, because lowering the price of labour (the real wage) not only reduces the costs of producing

Chart 1.3

CHANGES IN TOTAL EMPLOYMENT AND EMPLOYMENT RATES IN DEVELOPED AND DEVELOPING COUNTRIES, 2008–2012



Source: UNCTAD secretariat calculations, based on ILO, *Key Indicators of the Labour Market (KILM)* database; and UN-DESA, *World Population Prospects: The 2012 Revision* database.

Note: China and India are excluded because small variations in their estimates would significantly alter global outcomes.

goods and services, but also the demand for those goods and services. Attempts to overcome employment problems by lowering wages and introducing greater flexibility to the labour market are bound to fail because they ignore this macroeconomic interdependence of demand and supply that causes the labour market to function differently from a typical goods market. To the extent that lower unit labour costs in one country give producers in that country a competitive advantage on international markets, any increase in employment as a result of higher exports will be at the expense of production and employment in the importing countries.

(b) Adjustments that do not adjust

In the current policy debate, there is broad agreement about the goals but not about how best to achieve them, and sometimes the means appear to be confused with ends. Restoring growth and employment levels, reducing public debt ratios, repairing banking systems and re-establishing credit flows are generally shared objectives. However,

disagreement on priorities, on the appropriate policy tools, as well as on the timing and sequencing, leads to quite different, and sometimes opposite, policy recommendations. For instance, the dominant view in most developed countries and in several international organizations, at least since 2010, has been that fiscal consolidation is a prerequisite for sustained growth because it will bolster the confidence of financial markets and prevent sovereign defaults. Indeed, this was adopted as a major commitment at the G-20 summit in Toronto in June 2010. Those opposed to this shift towards fiscal austerity see fiscal consolidation as a long-term goal which would be achieved through sustained growth, and not as a precondition for growth. In this view, premature fiscal tightening will not only be very costly in economic and social terms; it will also be counterproductive, because, with slower growth, fiscal revenues will be lower, and the public-debt-to-GDP ratio is unlikely to decline, or may even rise further (see, for instance, *TDR 2011*, chap. III; Krugman, 2012; Calcagno, 2012).

The impact of a change in public revenue and in spending on GDP (i.e. the value of fiscal multipliers)

has been studied extensively. Many of these studies, including by the International Monetary Fund (IMF, 2010), suggest that fiscal multipliers are relatively low. For example, the ECB estimates short-term fiscal multipliers to be generally lower than 1, which means that the negative impact on GDP growth of a reduction of government spending or an increase of taxes over the first two years is smaller than the amount of that fiscal change. On the other hand, the long-term multiplier of a spending cut would be positive, meaning that the level of the GDP that would be obtained after a transitory period of more than 10 years following a fiscal tightening would be higher than the level expected without it. This would result from the reduction of labour taxes that would be made possible by an improved budget position resulting from fiscal austerity; gains would be larger if, in addition, fiscal consolidation also led to lower sovereign risk premiums (ECB, 2012).⁷ However, a recent study by the IMF (2012) found that fiscal multipliers in times of economic depression were much higher than the values it had estimated in previous reports. The reason is that in an economy with a huge amount of idle resources, an increase in public spending does not involve any “crowding out” of private expenditure. This means that expansionary fiscal policies are an important instrument to spur growth and actually reduce the public-debt-to-GDP ratio. However, the IMF recommendation does not go so far as to recommend such policies; it merely recommends undertaking fiscal adjustment over a longer time span. It suggests that policymakers should determine the pace of fiscal adjustment taking into account not only the values of short-term fiscal multipliers and debt-to-GDP ratios, but also the strength of private demand and the credibility of fiscal consolidation plans (Blanchard and Leigh, 2013).

A set of estimates of fiscal multipliers are presented in table 1.4 based on the United Nations Global Policy Model. Even if only the effects of an increase in fiscal expenditure during the first year are considered, the results strongly support the hypothesis of high multipliers, which significantly exceed 1 in all the cases, and are frequently greater than 1.5. On the other hand, multipliers associated with changes in taxation are much lower, in all cases below 0.5 in absolute values.⁸ This means that the composition of a fiscal package may be at least as important as its size. In particular, it would be possible to design fiscal packages comprising both higher taxes and expenditure, which would therefore have a neutral

Table 1.4

SHORT-TERM FISCAL MULTIPLIERS

	Government spending on goods and services	Government taxes net of transfers and subsidies
Argentina	1.66	-0.36
Brazil	1.84	-0.37
Canada	1.51	-0.27
China	1.76	-0.42
CIS	1.54	-0.33
France	1.48	-0.27
Germany	1.38	-0.29
India	1.65	-0.41
Indonesia	1.64	-0.41
Italy	1.48	-0.31
Japan	1.35	-0.29
Mexico	1.59	-0.36
South Africa	1.68	-0.31
Turkey	1.71	-0.39
United Kingdom	1.32	-0.26
United States	1.58	-0.36

Source: UNCTAD secretariat estimates, based on United Nations Global Policy Model (see the annex to this chapter).

Note: Multiplier values represent first-year impact on GDP of one-unit *ex-ante* increases in government spending or government revenues (i.e. taxes net of transfers and subsidies).

ex-ante effect on the fiscal balance, but still a positive impact on growth. This in turn would enlarge the tax base and would eventually deliver a positive *ex-post* effect on the fiscal balance and the public-debt-to-GDP ratio. But given the high values of government spending multipliers, it is likely that a debt-financed increase in fiscal expenditure would generate enough growth and supplementary fiscal revenues to reduce that ratio.⁹ As shown in the annex to this chapter, this effect would be even stronger if several countries pursued expansionary policies simultaneously.

Despite growing evidence that fiscal austerity hampers GDP growth, many governments are unwilling to change this strategy as they believe they do not have enough policy space for reversing their fiscal policy stance;¹⁰ instead, they are relying on monetary policy for supporting growth and employment. However, there is little scope for monetary

policy to further reduce interest rates in developed economies, as these are already extremely low. In addition, so far, unconventional monetary policies (i.e. quantitative monetary expansion) have failed to revive credit to the private sector. Banks and other financial institutions that have access to liquidity will not automatically increase their supply of credit commensurately, as they may still have to consolidate their balance sheets. Moreover, even if they did expand their credit supply, many private firms would be unlikely to borrow more as long as they have to consolidate their own balance sheets without any prospect of expanding production when they face stagnant, or even falling, demand. This is why using monetary policy for pulling an economy out of a depression triggered by a financial crisis may be like “pushing into a string”.

On the other hand, central bank interventions (or announcements of their intentions) have proved remarkably effective in lowering risk premiums on sovereign debt. Thus, monetary and fiscal policies may be used for different purposes for tackling the crisis. Fiscal policy, given its strong potential impact on aggregate demand, could be used to support growth and employment instead of trying to restore the confidence of financial markets through fiscal austerity. Meanwhile, central banks could enlarge their role as lenders of last resort (LLR) to generate that confidence and maintain interest rates at low levels. Moreover, these central bank actions to support credit and growth are more likely to succeed if they are accompanied by an expansionary fiscal policy.

2. *Roots of the crisis: the build-up of structural problems*

Since the late 1970s and early 1980s policies based on supply-side economics, neoliberalism and finance-led globalization have involved a redefinition of the role of the State in the economy and its regulatory tasks; an extraordinary expansion of the role of finance at the national and international levels; an opening up of economies, including a reduction of trade tariffs; and a general increase in inequality of income distribution. The resulting new roles of the public, private and external sectors, the expansion of finance and the increasing income concentration altered the structure and dynamics of global demand in a way that heightened vulnerabilities, eventually

leading to the crisis. In other words, the present crisis was not the unfortunate result of some misguided financial decisions; rather, it was the culmination of a number of structural problems that have been building up over the past three decades, which created the conditions for greater economic instability.

(a) *Income inequality*

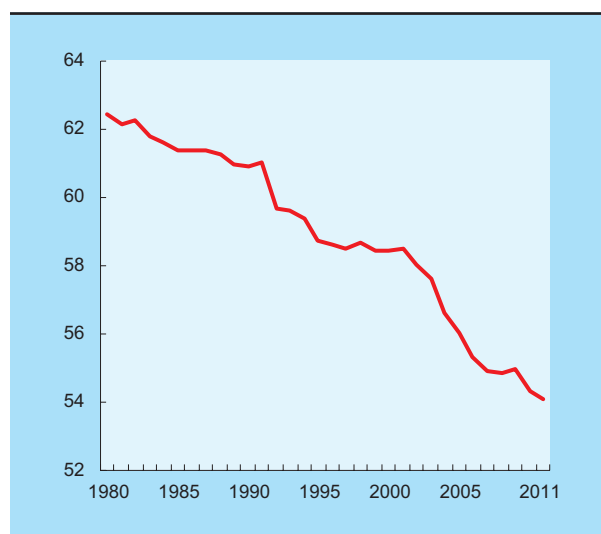
In order to achieve sustained global growth and development, there has to be consistent growth of household income, the largest component of which is labour income obtained from the production of goods and services.¹¹ However, over the past three decades, labour income in the world economy has been growing at a slower pace than the growth of world output (chart 1.4), with some diverging trends over the past decade.¹²

The observed declining trends in the share of labour income – or wage share – have often been justified as being necessary in order to reduce costs and induce investment. However, wage income

Chart 1.4

SHARE OF WORLD LABOUR INCOME IN WORLD GROSS OUTPUT, 1980–2011

(Weighted averages, per cent)



Source: UNCTAD secretariat calculations, using UN Global Policy Model, based on UN-DESA, *National Accounts Main Aggregates* database; and ILO, *Global Wage* database.

Note: Mixed income, typically from self-employment, is included in the labour share.

constitutes a large proportion of total income (about two thirds in developed countries), and is therefore the most important source of demand for goods and services. Thus, sizeable reductions of such income relative to productivity gains will have tangible negative effects on the rate of household consumption. And, to the extent that productive investment is driven by expectations of expanding demand, second-round effects of lower consumption on investment would seem unavoidable.

The decline in the share of labour income has led to a rising trend of profit mark-ups in the world as a whole. The tendency of companies to seek profit gains from exploiting wage differentials, rather than through innovation and investment, has produced limited dynamic benefits for the rest of society. In other words, the presumed transmission of higher profits to higher gross fixed capital formation has not materialized.¹³

In addition to these negative effects on long-term growth, greater income inequality also contributed to the financial crisis. The links between expanding finance and rising inequality operated in two ways. The larger size and role played by the financial sector led to a greater concentration of income in the hands of *rentiers* (both equity holders and interest earners) and a few high-wage earners, especially in the financial sector. Concomitantly, greater inequality led to rising demand for credit, both from households whose current income was insufficient to cover their consumption and housing needs and from firms that distributed a disproportionate share of their profits to their shareholders (*TDR 2012*, chap. II). This led to a financial bubble that eventually burst, leaving many households, firms and banks in financial distress.

(b) *Smaller role for the State*

Another long-running trend since the early 1980s has been the diminishing economic role of the State in many countries by way of privatization, deregulation and lower public expenditure (on the latter, see section C of this chapter and table 1.7). This served to increase economic fragility in different ways.

When the public sector's share of GDP shrinks, economic vulnerability increases because of that sector's diminished capacity to compensate for the usual fluctuations in the business cycle and to cope

with significant crises.¹⁴ But even more relevant than governments' ability to intervene, is their willingness to conduct countercyclical policies at a time when the desirability for balanced fiscal budgets has become dogma (Galbraith, 2008).

Calls for balancing budgets frequently overlook the fact that one economic sector's deficit is necessarily another sector's surplus. Therefore, a reduction (or increase) in the public sector deficit shows up as either a reduction (or increase) in the private sector surplus, or a reduction (or increase) in the surplus of the rest of the world, or a combination of these two. For the world as a whole, where the external sector is, by definition, in balance, public and private sectors mirror each other. This can be illustrated by the evolution of public and private sector balances at the global level between 1971 and 2011 (chart 1.5). As this chart shows aggregate values, it mainly reflects what happened in the largest countries. It appears that between the mid-1970s and 1990, there was a persistent and rather stable public deficit (and private surplus) at around 3.5 per cent of global output. This in itself did not pose a problem: it is normal for the private sector to run surpluses, since its assumed objective is wealth accumulation. And that level of public deficit would not lead to any explosive accumulation of public debt stocks; on the contrary, it would be consistent with a stable debt-output ratio if, at the same time, nominal output were to grow sufficiently.¹⁵

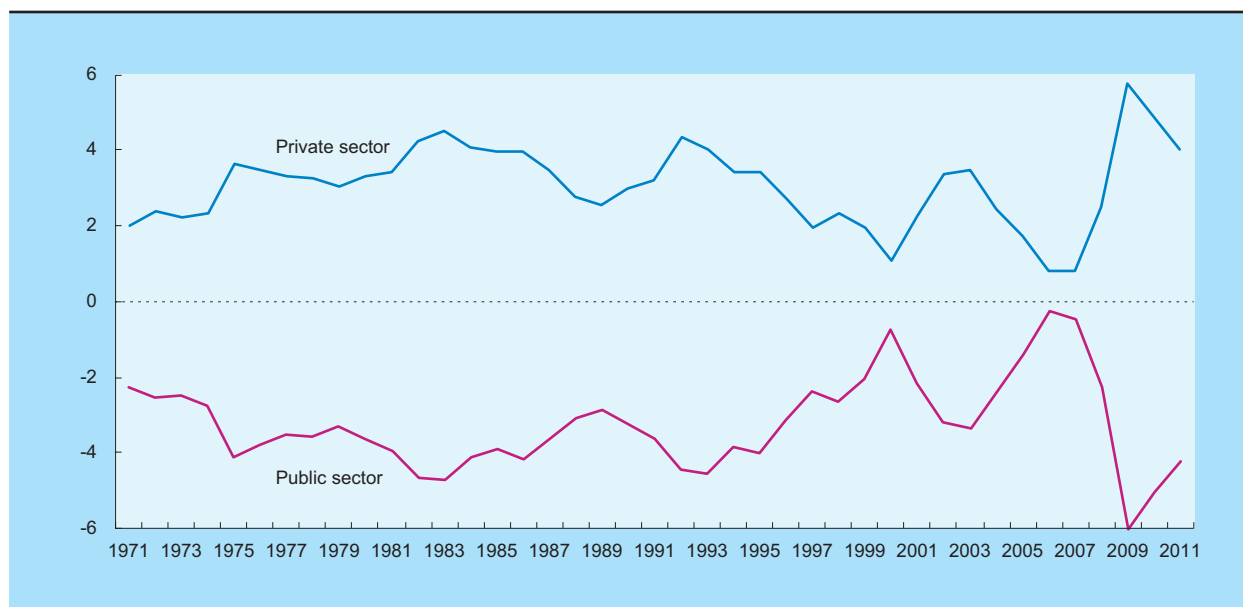
This contrasts with the considerable instability observed since the beginning of the 1990s. It is noteworthy that periods of shrinking public deficits actually preceded major crises in 2001 and 2008. It was possible to cut public deficits because the private sector was reducing its savings and many private agents became highly indebted in the wake of unsustainable financial bubbles. Pressures to reduce fiscal deficits can be destabilizing to the extent that those deficits are mirrored by shrinking private sector surpluses. Indeed, they are partly responsible for the greater frequency of financial crises.

Another factor contributing to those crises since the 1980s has been widespread financial liberalization, which is another major aspect of the reduced economic role of the State. Financial deregulation, coupled with the extraordinary expansion of financial assets, allowed macroeconomic policies limited room for manoeuvre, and their effects came to be increasingly swayed by reactions on financial markets.

Chart 1.5

FINANCIAL POSITIONS OF PUBLIC AND PRIVATE SECTORS IN THE WORLD ECONOMY, 1971–2011

(Per cent of world domestic product)



Source: UNCTAD secretariat calculations, using UN Global Policy Model, based on UN-DESA, *National Accounts Main Aggregates* database; IMF, *Government Financial Statistics*; Eurostat; and national sources.

Note: Figures above zero denote a surplus and below zero a deficit. Surpluses indicate additions to the net stock of financial wealth, and deficits indicate additions to the stock of debt. Except for small errors of measurement and aggregation of large numbers, the surpluses and deficits mirror each other.

Moreover, as the access of governments to central bank financing was limited, the financial sector gained greater influence over policymakers.

This interaction between developments in the financial sector, together with the weakening of government and central bank influence on the economy, generates a particular problem when a recession does not result from cycles in the real sector of the economy, but instead from overindebtedness of the private sector as a whole. Koo (2013a) describes this type of recession as follows: “When a debt-financed asset price bubble bursts, the private sector is left with a huge debt overhang, and to climb out of this state of negative equity it must pay down debt or increase savings, even if interest rates are zero. When the private sector as a whole is minimizing debt, the economy continuously loses aggregate demand equivalent to

the saved but unborrowed amount. This situation has come to be known as a balance sheet recession.” In such a situation, the choice is between a prolonged recession and a public-deficit-financed recovery. As the private sector takes a long time to reduce its debt, additional borrowing by the public sector would be the only recourse. As noted by Koo (2013b), “the only way to keep both the GDP and money supply from shrinking is for the government – the last borrower standing – to step in and borrow the unborrowed savings and spend them in the private sector.”¹⁶

At the same time, however, governments are reluctant to increase their debt for fear of negative reactions from the financial markets and from public opinion, much of which has been given to understand that financial markets “know better” than governments (Koo, 2013a).

(c) *The prominent role of a poorly regulated financial sector*

The value of global financial assets grew from \$14 trillion in 1980 to \$56 trillion in 1990 and \$206 trillion in 2007; and in current GDP terms it tripled, from 120 per cent of GDP in 1980 to 365 per cent in 2007 (Lund et al., 2013: 14). This expansion was accompanied (and encouraged) by extensive deregulation of national financial markets and the progressive liberalization of international capital movements. As a result, cross-border capital flows jumped from \$500 billion in 1980 to a peak of \$12 trillion in 2007. This would explain why an increasing proportion of financial assets are owned by non-residents. Between 1980 and 1995, the stock of foreign-owned financial assets represented around 25 per cent of global financial assets. This share increased to 28 per cent in 2000, 38 per cent in 2005 and almost 50 per cent in 2007–2010, when foreign-owned assets exceeded \$100 trillion, or 150 per cent of world output.

This more prominent role of financial markets carries the risk of greater economic instability, because these markets are intrinsically prone to boom-and-bust processes, especially if they are loosely regulated. A typical process begins with rising prices of financial and non-financial assets, which boost wealth temporarily and serve as collateral for new credits or equity withdrawals. This in turn finances private spending and also new asset acquisitions, which push up asset prices further. This process can continue for a relatively long time, which sustains economic growth and thus helps enhance investor confidence. However, eventually the asset price bubble that had sustained a credit-boom expansion will burst, leading to a drastic and long-lasting contraction of economic activity.

This portrays many historical episodes of “manias, panics and crashes” (Kindleberger, 1978), including the bubble that triggered the present crisis. It is indeed surprising that, as the bubble grew, some worrying signals were dismissed by policymakers as well as rating agencies and financial agents because, although household debt was rising, the value of household assets was also rising (Bernanke, 2005).¹⁷ Due to an exclusive focus on monetary stability the early signals of financial instability went unheeded.

According to some observers, monetary policy that focuses exclusively on low inflation rates

contributes to the credit cycle (Godley, 1999; Shin, 2010). Usually, low or falling interest rates reflect low current or expected inflation. This may allow the burden of the debt service to fall or remain low despite a rising stock of debt. But as soon as perceptions of risk change, interest rate premiums rise. The burden of servicing debts that were contracted at flexible interest rates or the costs of revolving debt that is reaching maturity rise, sometimes drastically. In addition, a drastic reversal of credit demand and, by implication, of spending, may trigger an economic downturn that would make debt repayments more difficult.

The extraordinary expansion of the financial sector over the years has also been accompanied by changes in its patterns of operation, which contributed to an increase in financial fragility. These included a high level of financial leveraging, an increasing reliance on short-term borrowing for bank funding, the extension of a poorly capitalized and unregulated shadow financial system, perverse incentives that encouraged excessive risk-taking by financial traders, a reliance on flawed pricing models and the “lend and distribute” behaviour that weakened the role of banks in discriminating between good and bad borrowers. The procyclical bias of bank credit was exacerbated by value-at-risk models and the Basel rules on bank capital, which allowed banks to expand credit during booms, when risks seemed low and the price of collaterals rose, and obliged them to cut lending during downturns. The vulnerability of the financial system also increased as a result of its growing concentration and loss of diversity. Much of its operations today are handled by “too-big-to-fail” institutions which tend to take on far greater risks than would be taken by smaller institutions. As the same type of business strategies tended to be replicated across the financial sector, the system became more vulnerable to macro-economic shocks (such as the collapse of real estate markets) that affected all the agents at the same time (see *TDR 2011*, chap. IV).

The search for rapid gains led to large flows of credit – including loans that were insufficiently collateralized – that were used for consumption, rather than for financing productive investment and innovative enterprise. This kind of credit-fuelled spending by the private sector had the potential to offset the subdued demand that was caused by lagging wages and worsening income distribution. However, debt-driven consumption is not a viable option in the long run.

It is possible that some of the characteristics of the credit boom in developed countries are being replicated in developing countries, with some variations. Asset appreciations and private spending that exceeds income are often supported by capital inflows, usually channelled through domestic financial institutions. In such cases, currency mismatches between debt and revenue tend to generate or reinforce the credit boom-and-bust cycle.

Through these different channels, the growing size and role of the financial sector, together with its present structure and modes of functioning, have become a major source of economic instability and misallocation of resources in many countries. It has also facilitated the rise of international imbalances, another key structural problem that is examined in the next subsection.

(d) International imbalances with asymmetric adjustments and a recessionary bias

Increasing current account imbalances and the expansion of international finance are closely intertwined. In the immediate post-war era, there are unlikely to have been any countries that had large external deficits for extended periods of time. But such deficits have become more and more common in the era of financialization that started in the 1980s and deepened from the 1990s onwards.

Large surplus and deficit imbalances in the world economy from the mid-1970s to the early 1980s were mostly due to oil shocks (chart 1.6). These shocks contributed to the expansion of international financial markets through the recycling of petrodollars. However, the imbalances were considered temporary, as it was assumed that oil-deficit countries would devise strategies to reduce their oil-import bills. By contrast, in the middle of the 1980s the United States had an external deficit of about 3 per cent of GDP which was unrelated to oil. This was matched by surpluses in Japan and a few Western European countries, which took concerted corrective action in 1985. The smooth correction of external imbalances that followed could be considered the last time there was proactive international coordination in the management of trade and exchange rates. But it may also serve as a lesson about the limits of a framework for policy coordination that focuses

exclusively on exchange rates while disregarding the growing instability of the global financial system as a whole in view of subsequent developments.

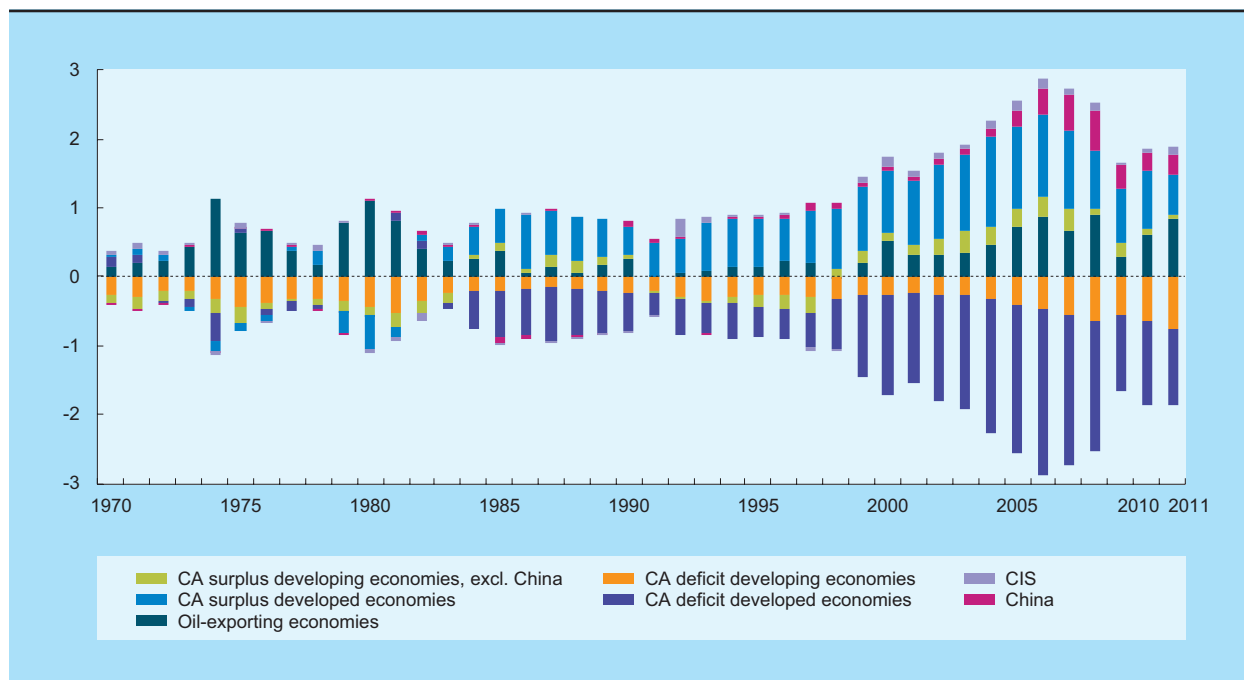
By the end of the 1990s, a tendency towards rising global imbalances re-emerged, owing largely to current account deficits in a few developed countries where credit-driven expansion became prevalent, as described in the previous subsection. This tendency was reinforced by the adoption of export-led strategies by developed-country exporters of manufactures, such as Japan and a few North European countries, followed by Germany. During the 1990s, and more clearly after the Asian financial crisis, a number of developing countries that emerged as suppliers of low-cost manufactures generated growing external surpluses. Others that also sustained surpluses included net exporters of energy and raw materials, especially during the 2000s when commodity prices turned favourable. These factors together caused global current account imbalances to peak in 2006 at nearly 3 per cent of world income. The reversal that followed from 2007 onwards coincided with the first signs of financial turmoil in the major deficit country, the United States, and culminated with the financial and economic crisis in 2008–2009. This highlighted the limitations of the asset-appreciation, credit-driven model discussed above. Global imbalances have remained at about 2 per cent since 2009 – a level that is still historically high. Furthermore, global imbalances have been on the rise since 2009.

Export-led growth strategies, to the extent that they have frequently led to trade surpluses, are only sustainable if other countries maintain trade deficits over a long period. In short, the success of such strategies in some countries relies on external deficits in other countries, and the willingness and capacity of the deficit countries to pile up external debt. But since the crisis, developed countries with deficits seem to be less willing and able to play the role of global consumer of last resort due to their ever-increasing indebtedness. Despite this, policymakers in some countries are trying to respond to weaker domestic demand by gaining export market shares through improved international competitiveness. This is particularly the case with those crisis-hit countries that were running large current account deficits before the crisis and have undertaken recessionary adjustments programmes. The most common measure adopted, at least in the short run, has been internal devaluation, particularly through wage compression. However,

Chart 1.6

CONTRIBUTIONS TO GLOBAL IMBALANCES OF SELECTED GROUPS OF COUNTRIES, 1970–2011

(Current account balance as a percentage of world gross product)



Source: UNCTAD secretariat calculations, based on UN-DESA, *National Accounts Main Aggregates* database; IMF, *World Economic Outlook (WEO)* database.

Note: Deficit and surplus classification was based on the average current account (CA) position between 2004 and 2007. CIS includes Georgia.

this simultaneous action by several trade partners contributes to a global compression of income and reinforces a race to the bottom. This not only has negative effects on global aggregate demand, since a country's lower wage bill constitutes a demand constraint that affects other countries as well, but it also undermines their efforts to gain competitiveness (Capaldo and Izurieta, 2013).

A global mechanism to help rebalance external demand will not be effective if it places the entire or most of the burden of adjustment on deficit countries. Such an asymmetric adjustment is deflationary, since debtor countries are forced to cut spending while there is no obligation on the part of creditor countries to increase spending, which leads to a shortfall of demand at the global level. It would be preferable, from an economic and social point of view, if surplus countries assumed a greater role in the rebalancing process by expanding their domestic demand. Ideally, an asymmetric *expansionary* approach would be the

most effective way to restart global output growth on a sustainable basis. In such an approach, the adjustment burden would be taken on primarily by the surplus countries by way of stronger wage increases and fiscal expansion.

In order to explore the global consequences of these alternative approaches, the annex to this chapter presents three simulations showing the outcomes of alternative policy strategies. They are quantitative exercises based on the United Nations Global Policy Model. These exercises show the performance of the world economy divided into 25 countries or groups of countries at the horizon 2030 based on two alternative scenarios in addition to the baseline scenario. The baseline scenario is an economic projection assuming that there will be neither policy changes nor shocks ahead. Both alternative scenarios involve the following policy changes aimed at stimulating the economy: expansionary fiscal policies, with higher public consumption and investment spending;

progressive income redistribution through a wage policy, taxation and public transfers; and a supportive monetary policy in terms of low interest rates and greater access to credit, while avoiding the creation of financial bubbles. Surplus countries are assumed to apply a stronger stimulus than deficit countries, but no country is supposed to adopt a contractionary policy stance. The difference between these two alternative scenarios is that in scenario A, *all countries* implement policy changes that are more or less ambitious depending on their starting position, whereas in scenario B, *only developing and transition economies* adopt such policy changes. In addition, the policy stimulus in scenario B is smaller due to balance-of-payments constraints resulting from non-action on the part of developed countries.

Scenario A, which includes a generalized stimulus, achieves not only a substantial reduction of global imbalances, but also the best results in terms of economic growth, employment creation and fiscal balances in all the countries. This is in line with the view that the best approach to resolving the present economic problems, including on the fiscal side, is if all countries simultaneously adopt expansionary policies, taking into account their respective capacities, rather than adopting generalized austerity.

Scenario B, in which only developing and transition economies apply more expansionary policies, yields inferior economic results, though still clearly better results than those of the baseline. This is especially true for developing and transition economies. Expansionary policies pursued by them may compensate for protracted slow growth of exports to the developed countries. Also developed countries obtain some benefits in this scenario compared with the baseline scenario, even if these are minor. But these

mostly stem from the fact that, instead of coordinating efforts towards a genuine global rebalancing and acceleration of growth, the developed countries will press ahead with individual policies towards achieving external competitiveness by squeezing labour income. Their gains therefore result from enlarging their share in global demand. What is more, such gains will not be evenly distributed between wage-earners and profit-earners in these countries. Finally, such practices will not help to rebalance the world economy.

These exercises are not forecasts, since their hypothesis of extensive policy changes are highly unlikely to occur. Rather, they are quantitative exercises that are intended to evaluate the consistency and economic feasibility of coordinated policies aimed at spurring growth and employment by addressing the structural causes of the crisis, such as income inequality, the diminishing role of the State and financial systems that do not support the real economy, and at correcting the present asymmetric and deflationary approach to global imbalances.

The simulations also show that a general shift towards expansionary policies is economically feasible, and would deliver better results in all respects than the baseline scenario. This supports the view that all countries should engage in a coordinated effort aimed at a sustained expansion of global demand. This exercise also shows that even if developed countries persevere with their current policies, there is, nevertheless, scope for developing and transition economies to improve their economic performances by providing a coordinated economic stimulus. Hence, encouraging regional cooperation and South-South trade would need to be an important component of their development strategies.

C. Developing and transition economies are continuing to grow, but remain vulnerable

The shape of the world economy has changed significantly over the past three decades. The share of developing countries in global GDP has increased, and several developing countries and regions have assumed a greater role as additional drivers of global economic growth. Other elements of this rise of the South include the growing importance of developing countries in international trade and capital flows. This section starts with an account of developing countries' growth record over the past three decades, and goes on to discuss some issues related to their increased trade and financial integration. It argues that, while greater integration supported their rapid growth when the general external economic environment was favourable, with that environment now turning less favourable, it has also increased their vulnerability.

1. Growth performance since the early 1990s

The 1990s and the beginning of the new millennium saw a series of payments and financial crises in developing countries, including in Mexico in 1994, in some parts of Asia in 1997–1998 – with spillovers to Brazil and the Russian Federation in 2008 – in Turkey in 2000–2001 and in Argentina in 2001–2002. In spite of these crises, developing countries registered an average annual GDP growth of 4.7 per cent during the period 1991–2002, exceeding that of developed countries by over two percentage points (table 1.5). Meanwhile, average annual GDP growth of the transition economies declined by 2.6 per cent, largely as a result of their economic collapse in the early 1990s. Developing countries' growth performance

during the period 1991–2002 was superior to that of developed countries for a number of reasons. One was their rebound from economic downturns related to debt crises that many of them had experienced in the 1980s along with sharp declines in commodity prices. Another was the mixed performance of developed countries, with a protracted period of slow growth in Japan, uneven growth in Europe, and a sharp growth deceleration in the United States, which was associated with the bursting of the dot-com bubble in 2001.

During the period 2003–2007, output growth in developing and transition economies accelerated, even as developed countries continued to experience relatively slow growth, on average. The average annual GDP growth of both developing and transition economies exceeded that of developed countries by 4.5–5 percentage points (table 1.5). The onset of the global economic and financial crisis initially reinforced this trend, as the downturn in 2008–2009 was less dramatic and the subsequent recovery more rapid in developing than in developed countries. This growth differential in favour of developing countries was unprecedented (Akyüz, 2012), even though it subsequently shrank over the period 2010–2012.

Growth acceleration during 2003–2007 compared with the period 1991–2002 has diverged considerably across developing countries. It was particularly pronounced in some of the large developing and transition economies, such as Argentina, India, the Russian Federation, South Africa and Turkey, but much less so in Brazil, China and Mexico. The Republic of Korea even recorded lower average annual growth rates. The sharp increase in those rates in Argentina, the Russian Federation and Turkey was partly due to these countries' swift recovery from severe crises at the beginning of the

Table 1.5

COMPARATIVE OUTPUT GROWTH PERFORMANCE, SELECTED COUNTRIES AND COUNTRY GROUPS, 1991–2013

(Per cent)

	1991–2002		2003–2007		2008–2012		2010 2011 2012 2013			
	Output growth (annual average)	Contribution to global growth	Output growth (annual average)	Contribution to global growth	Output growth (annual average)	Contribution to global growth	Output growth			
World	2.9	2.9	3.7	3.7	1.7	1.7	4.1	2.8	2.2	2.1
Developed economies	2.6	2.0	2.6	2.0	0.3	0.2	2.6	1.5	1.2	1.0
Transition economies	-2.6	-0.1	7.6	0.2	1.8	0.0	4.5	4.5	3.0	2.7
Developing economies	4.7	0.8	7.0	1.5	5.3	1.4	7.9	5.9	4.6	4.7
Africa	2.9	0.1	5.8	0.1	3.6	0.1	4.9	1.0	5.4	4.0
East, South-East and South Asia	6.5	0.5	8.3	0.9	6.8	1.0	9.3	7.0	5.3	5.5
West Asia	3.7	0.1	6.9	0.2	4.0	0.1	7.0	7.1	3.2	3.5
Latin America and the Caribbean	2.9	0.2	4.8	0.3	3.0	0.2	5.9	4.3	3.0	3.1
Oceania	2.2	0.0	3.1	0.0	3.4	0.0	3.6	4.3	4.1	2.7
Memo items:										
Argentina	2.6	0.0	8.9	0.0	5.8	0.0	9.2	8.9	1.9	4.8
Brazil	2.6	0.1	4.0	0.1	3.3	0.1	7.5	2.7	0.9	2.5
China	10.1	0.2	11.6	0.5	9.4	0.6	10.4	9.3	7.8	7.6
India	5.9	0.1	8.6	0.1	7.2	0.1	11.2	7.7	3.8	5.2
Indonesia	3.6	0.0	5.5	0.0	5.9	0.0	6.2	6.5	6.2	5.7
Mexico	3.1	0.1	3.6	0.1	1.6	0.0	5.5	4.0	3.9	2.8
Republic of Korea	6.1	0.1	4.4	0.1	3.1	0.1	6.3	3.7	2.0	1.6
Russian Federation	-2.7	-0.1	7.4	0.1	1.5	0.0	4.5	4.3	3.4	2.5
Saudi Arabia	2.0	0.0	4.7	0.0	4.4	0.0	5.1	7.1	5.9	4.0
South Africa	2.3	0.0	4.9	0.0	2.1	0.0	3.1	3.5	2.5	1.7
Turkey	3.3	0.0	7.3	0.1	3.5	0.0	9.2	8.8	2.2	3.3

Source: UNCTAD secretariat calculations, based on table 1.1.

Note: Data for 2013 are forecasts.

millennium, which had caused large output losses. In 2011–2012 growth performance gradually worsened in all developing regions, as well as in most countries individually (table 1.5), especially in Brazil, India and Turkey. Nevertheless, even in these latter countries, per capita income continues to exceed pre-crisis levels by a significant margin. This indicates that the adoption of countercyclical macroeconomic policies enabled many developing countries to mitigate the impact of the Great Recession on their economies for a certain period of time. However, the more recent worsening of their growth performance suggests that the growth stimulus effects of their expansionary policies may be petering out.

Despite the healthy growth in developing and transition economies, developed countries remained the main drivers of global growth until the onset of the current crisis. During the period 1990–2005, these latter countries accounted for about three quarters of global GDP (table 1.6), and the share of their contribution to global economic growth exceeded 50 per cent. By contrast, during the period 2008–2012, as a group they contributed very little to global growth (table 1.5). Since 2010, global growth has been driven mainly by developing countries, which have accounted for about two thirds of such growth, while the contribution of transition economies has been negligible.

Table 1.6

SHARES IN GLOBAL GDP, SELECTED COUNTRIES AND COUNTRY GROUPS, 1970–2012

	Market prices ^a										Purchasing power parity ^b						
	1970	1980	1990	1995	2000	2005	2007	2010	2012	1990	1995	2000	2005	2007	2010	2012	
Developed economies	69.5	69.9	78.8	78.3	77.0	73.8	69.6	63.7	60.4	63.4	62.3	60.9	56.7	54.2	50.0	48.1	
Transition economies	13.7	8.5	3.9	1.9	1.2	2.4	3.3	3.3	3.9	7.9	4.3	3.9	4.5	4.7	4.6	4.6	
Developing economies	16.8	21.6	17.3	19.8	21.7	23.8	27.1	33.0	35.8	28.7	33.4	35.2	38.8	41.1	45.4	47.3	
Africa	2.7	3.6	2.2	1.8	1.9	2.2	2.4	2.7	2.9	3.5	3.3	3.4	3.7	3.8	4.0	4.0	
East, South-East and South Asia	7.5	8.3	8.1	10.1	11.0	12.8	14.8	18.9	21.3	13.6	17.8	19.7	23.2	25.3	29.0	30.7	
West Asia	1.3	3.2	2.0	1.8	2.2	2.8	3.1	3.3	3.6	2.9	3.0	3.2	3.4	3.5	3.7	3.9	
Latin America and the Caribbean	5.3	6.4	4.9	6.1	6.6	5.9	6.7	8.0	8.0	8.6	9.2	8.9	8.4	8.5	8.6	8.7	
Oceania	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Memo items:																	
Argentina	1.0	0.6	0.6	0.9	0.9	0.4	0.5	0.6	0.7	0.7	0.8	0.8	0.7	0.8	0.9	0.9	
Brazil	1.1	1.6	1.7	2.6	2.0	1.9	2.4	3.4	3.2	3.0	3.2	2.9	2.8	2.8	2.9	2.8	
China	2.8	2.6	1.8	2.5	3.7	5.0	6.2	9.4	11.3	3.5	5.6	7.1	9.4	11.0	13.6	14.9	
India	1.9	1.6	1.5	1.2	1.4	1.8	2.2	2.6	2.6	2.9	3.3	3.7	4.3	4.6	5.4	5.6	
Indonesia	0.3	0.7	0.6	0.7	0.5	0.6	0.8	1.1	1.2	1.1	1.4	1.2	1.2	1.3	1.4	1.5	
Mexico	1.3	1.9	1.3	1.0	2.0	1.8	1.8	1.6	1.6	2.4	2.3	2.5	2.3	2.2	2.1	2.1	
Republic of Korea	0.3	0.5	1.2	1.8	1.6	1.8	1.9	1.6	1.6	1.3	1.7	1.8	1.9	1.9	2.0	1.9	
Russian Federation	n.a.	n.a.	n.a.	1.3	0.8	1.7	2.3	2.3	2.8	5.3	2.9	2.6	3.0	3.2	3.0	3.0	
Saudi Arabia	0.2	1.4	0.5	0.5	0.6	0.7	0.7	0.7	0.9	0.8	0.9	0.9	0.9	0.9	1.0	1.1	
South Africa	0.5	0.7	0.5	0.5	0.4	0.5	0.5	0.6	0.5	0.8	0.7	0.7	0.7	0.7	0.7	0.7	
Turkey	0.7	0.8	0.9	0.8	0.8	1.1	1.2	1.1	1.1	1.1	1.2	1.2	1.3	1.3	1.3	1.4	

Source: UNCTAD secretariat calculations, based on IMF, *World Economic Outlook*, April 2013; Economist Intelligence Unit, *EIU CountryData* database; table 1.1; and *UNCTADstat*.

a Calculated using dollars at current prices and current exchange rates.

b Estimated on the basis of current GDP using 2005 PPP values.

The share of developed countries in the global economy was about 70 per cent in 1970 and reached almost 80 per cent during the 1990s, following a decline in the share of the transition economies during that decade (table 1.6). Since the beginning of the millennium, and especially as a result of the Great Recession, the share of developed countries in the global economy fell sharply to about 60 per cent in 2012. The share of developing countries increased by 7 percentage points between 1970 and 2005, and rapidly rose by another 12 percentage points during the subsequent seven years to reach over 35 per cent of global GDP in 2012.

Measured in terms of purchasing power parity (PPP), the share of developing countries in global output reached 47.3 per cent in 2012, and thus almost

matched that of developed countries (table 1.6). This does not mean that developing countries have become as important as developed countries as drivers of global growth, because a country's contribution to global supply and demand, as well as the expansionary or deflationary impulses it transmits to the other countries, is determined by the market values of its goods and services, rather than by PPP equivalents. However, it is well known that economic development is associated with an increase in a country's price levels, as also reflected in an appreciation of its real exchange rate and an ensuing gradual closing of the gap in its PPP relative to developed countries.¹⁸ This means that the increase in the weight of developing countries in the global economy to almost 50 per cent, as measured in PPP terms, could be taken to indicate the future evolution of their weight measured

Table 1.7

GDP BY TYPE OF EXPENDITURE, SELECTED COUNTRIES AND COUNTRY GROUPS, 1981–2011

	Percentage of GDP				Average annual growth				Percentage of GDP				Average annual growth			
	1981–1990	1991–2002	2003–2007	2008–2011	1981–1990	1991–2002	2003–2007	2008–2011	1981–1990	1991–2002	2003–2007	2008–2011	1981–1990	1991–2002	2003–2007	2008–2011
Developed economies																
GDP	100.0	100.0	100.0	100.0	3.2	2.6	2.6	-0.1	100.0	100.0	100.0	100.0	3.1	3.8	5.9	3.8
HH	60.7	61.1	62.1	62.7	3.2	2.8	2.5	0.3	58.7	59.5	58.8	58.8	3.1	3.8	5.5	3.6
Gov	20.7	19.0	18.3	19.0	2.6	1.7	1.6	1.5	16.3	14.3	13.3	13.7	3.1	2.6	4.8	5.0
Inv	18.9	20.0	20.7	18.5	4.2	3.2	4.1	-4.0	23.0	23.4	23.6	25.3	0.7	3.4	9.1	3.9
Exp	13.3	19.3	24.3	26.5	4.9	6.5	6.5	0.8	23.4	32.1	41.5	42.8	3.1	7.2	10.3	3.6
Imp	13.2	19.2	25.5	26.8	5.7	6.9	6.6	0.1	20.5	28.9	37.4	41.1	2.8	6.9	12.0	4.1
Developing economies, excl.China																
Developing economies																
GDP	100.0	100.0	100.0	100.0	3.6	4.7	7.0	5.3	100.0	100.0	100.0	100.0	1.7	2.9	4.9	2.8
HH	58.3	57.3	54.6	52.9	3.7	4.4	5.9	4.5	59.9	62.5	63.2	64.7	1.6	3.0	5.2	3.3
Gov	16.1	14.4	13.5	13.6	3.7	3.6	5.9	5.7	17.5	15.5	14.5	14.5	1.8	1.9	3.4	3.7
Inv	24.3	25.7	27.5	30.8	1.6	4.8	10.4	7.4	21.2	21.3	20.9	22.5	-2.1	3.9	7.7	2.3
Exp	22.2	30.3	40.4	42.0	3.5	8.2	12.0	5.9	11.9	18.8	24.5	23.9	4.7	7.6	7.8	1.7
Imp	19.6	27.2	35.9	39.6	3.2	7.7	13.1	7.0	10.3	18.1	23.2	26.7	0.1	8.4	11.2	4.4
Latin America and the Caribbean																
GDP	100.0	100.0	100.0	100.0	3.6	4.7	7.0	5.3	100.0	100.0	100.0	100.0	1.7	2.9	4.9	2.8
HH	58.3	57.3	54.6	52.9	3.7	4.4	5.9	4.5	59.9	62.5	63.2	64.7	1.6	3.0	5.2	3.3
Gov	16.1	14.4	13.5	13.6	3.7	3.6	5.9	5.7	17.5	15.5	14.5	14.5	1.8	1.9	3.4	3.7
Inv	24.3	25.7	27.5	30.8	1.6	4.8	10.4	7.4	21.2	21.3	20.9	22.5	-2.1	3.9	7.7	2.3
Exp	22.2	30.3	40.4	42.0	3.5	8.2	12.0	5.9	11.9	18.8	24.5	23.9	4.7	7.6	7.8	1.7
Imp	19.6	27.2	35.9	39.6	3.2	7.7	13.1	7.0	10.3	18.1	23.2	26.7	0.1	8.4	11.2	4.4
Transition economies																
GDP	...	100.0	100.0	100.0	...	-3.0	7.6	1.2	100.0	100.0	100.0	100.0	1.9	2.9	5.8	3.5
HH	...	47.0	53.2	60.8	...	-1.3	10.7	3.3	61.7	62.4	62.1	62.8	1.9	3.2	5.1	4.3
Gov	...	20.2	16.7	15.2	...	-1.8	2.7	0.8	16.0	15.6	14.7	16.0	2.7	1.6	6.5	5.9
Inv	...	27.1	23.1	24.0	...	-12.2	14.9	-2.1	21.4	18.0	19.6	22.3	-4.5	3.2	9.3	4.5
Exp	...	30.8	38.6	37.0	...	1.1	8.4	0.8	29.3	33.7	36.6	35.7	1.8	4.1	8.6	0.5
Imp	...	23.3	31.2	35.5	...	-2.7	15.5	0.9	27.3	27.1	31.9	36.3	-2.4	4.7	10.6	4.1
Africa																
GDP	...	100.0	100.0	100.0	...	-3.0	7.6	1.2	100.0	100.0	100.0	100.0	1.9	2.9	5.8	3.5
HH	...	47.0	53.2	60.8	...	-1.3	10.7	3.3	61.7	62.4	62.1	62.8	1.9	3.2	5.1	4.3
Gov	...	20.2	16.7	15.2	...	-1.8	2.7	0.8	16.0	15.6	14.7	16.0	2.7	1.6	6.5	5.9
Inv	...	27.1	23.1	24.0	...	-12.2	14.9	-2.1	21.4	18.0	19.6	22.3	-4.5	3.2	9.3	4.5
Exp	...	30.8	38.6	37.0	...	1.1	8.4	0.8	29.3	33.7	36.6	35.7	1.8	4.1	8.6	0.5
Imp	...	23.3	31.2	35.5	...	-2.7	15.5	0.9	27.3	27.1	31.9	36.3	-2.4	4.7	10.6	4.1
United States																
GDP	100.0	100.0	100.0	100.0	3.6	3.5	2.8	0.0	100.0	100.0	100.0	100.0	1.4	3.7	6.9	3.7
HH	66.8	67.7	70.0	70.9	3.8	3.8	3.0	0.3	49.8	51.1	52.7	53.1	3.6	3.5	7.9	2.5
Gov	20.4	17.1	15.8	16.5	3.4	1.2	1.4	1.5	17.1	15.1	15.0	16.0	4.6	2.1	7.0	4.7
Inv	15.4	17.7	19.4	15.7	4.1	6.6	3.7	-5.1	16.5	16.8	20.8	24.2	-0.2	3.9	15.1	4.1
Exp	6.5	10.0	11.1	13.1	6.0	6.0	7.2	2.6	42.5	40.5	45.6	44.7	-3.4	5.3	9.5	2.2
Imp	7.9	12.2	16.3	16.2	7.9	8.9	6.4	-0.5	26.3	23.8	34.1	39.3	1.3	4.1	16.9	2.1
West Asia																
GDP	100.0	100.0	100.0	100.0	3.6	3.5	2.8	0.0	100.0	100.0	100.0	100.0	1.4	3.7	6.9	3.7
HH	66.8	67.7	70.0	70.9	3.8	3.8	3.0	0.3	49.8	51.1	52.7	53.1	3.6	3.5	7.9	2.5
Gov	20.4	17.1	15.8	16.5	3.4	1.2	1.4	1.5	17.1	15.1	15.0	16.0	4.6	2.1	7.0	4.7
Inv	15.4	17.7	19.4	15.7	4.1	6.6	3.7	-5.1	16.5	16.8	20.8	24.2	-0.2	3.9	15.1	4.1
Exp	6.5	10.0	11.1	13.1	6.0	6.0	7.2	2.6	42.5	40.5	45.6	44.7	-3.4	5.3	9.5	2.2
Imp	7.9	12.2	16.3	16.2	7.9	8.9	6.4	-0.5	26.3	23.8	34.1	39.3	1.3	4.1	16.9	2.1
Europe																
GDP	100.0	100.0	100.0	100.0	2.5	2.3	2.6	-0.3	100.0	100.0	100.0	100.0	4.7	5.1	8.1	6.4
HH	57.7	57.8	57.6	57.5	2.5	2.3	2.2	0.0	65.5	61.2	58.3	57.3	4.1	4.7	7.2	5.6
Gov	22.4	21.2	20.4	21.1	1.9	1.6	1.9	1.3	13.6	12.2	10.9	11.3	3.0	4.7	5.9	9.0
Inv	18.9	19.7	20.8	19.6	3.4	2.8	4.7	-4.2	30.3	26.8	32.1	35.8	2.7	4.1	14.2	7.4
Exp	19.4	28.8	37.9	41.0	4.5	6.8	6.5	0.8	11.3	15.9	21.1	23.0	6.0	7.0	13.6	8.6
Imp	18.5	27.4	36.7	39.2	5.0	6.6	6.8	0.1	15.9	16.0	22.5	27.1	0.9	6.0	17.1	9.0
Japan																
GDP	100.0	100.0	100.0	100.0	4.6	0.9	1.8	-0.8	100.0	100.0	100.0	100.0	5.1	4.6	6.2	4.5
HH	58.1	57.8	57.6	58.6	4.0	1.3	1.1	0.4	56.5	56.0	56.8	55.9	4.7	5.0	5.4	4.3
Gov	15.4	16.4	18.3	19.0	3.6	3.0	1.0	1.7	11.7	10.0	10.2	10.9	3.7	4.2	5.8	6.4
Inv	27.0	26.6	22.5	19.8	6.1	-1.1	1.2	-4.7	31.4	31.0	24.0	25.0	4.8	0.5	6.9	5.4
Exp	8.1	9.8	14.5	15.7	4.9	3.9	9.6	-1.5	39.2	62.4	82.1	83.7	7.4	8.9	11.3	3.6
Imp	7.6	10.2	12.8	13.0	5.9	4.0	4.8	-0.7	37.5	57.9	73.1	75.3	6.6	7.7	11.7	3.5
South-East Asia																
GDP	100.0	100.0	100.0	100.0	10.3	10.1	11.6	9.6	100.0	100.0	100.0	100.0	8.7	5.4	4.9	3.3
HH	53.5	45.2	38.9	35.9	11.8	8.7	8.0	8.8	57.6	59.1	55.4	53.1	8.0	5.3	3.2	2.3
Gov	14.5	14.7	14.0	13.2	11.8	10.0	9.8	7.9	16.9	14.5	12.8	12.7	6.2	3.6	3.2	3.3
Inv	38.0	38.3	41.7	46.4	7.9	10.6	13.4	13.4	26.8	30.5	26.5	23.1	10.4	3.7	3.8	0.4
Exp	9.7	20.3	36.0	39.9	13.6	18.3	20.0	13.7	31.5	45.5	65.5	74.0	12.7	9.2	11.8	5.3
Imp	9.4	17.5	30.4	35.3	14.3	17.1	18.6	18.0	32.4	49.3	61.0	63.8	12.0	7.8	9.6	3.7
China																
GDP	100.0	100.0	100.0	100.0	10.3	10.1	11.6	9.6	100.0	100.0	100.0	100.0	8.7	5.4	4.9	3.3
HH	53.5	45.2	38.9	35.9	11.8	8.7	8.0	8.8	57.6	59.1	55.4	53.1	8.0	5.3	3.2	2.3
Gov	14.5	14.7	14.0	13.2	11.8	10.0	9.8	7.9	16.9	14.5	12.8	12.7	6.2	3.6	3.2	3.3
Inv	38.0	38.3	41.7	46.4	7.9	10.6	13.4	13.4	26.8	30.5	26.5	23.1	10.4	3.7	3.8	0.4
Exp	9.7	20.3	36.0	39.9	13.6	18.3	20.0	13.7	31.5	45.5	65.5	74.0	12.7	9.2	11.8	5.3
Imp	9.4	17.5	30.4	35.3	14.3	17.1	18.6	18.0	32.4	49.3	61.0	63.8	12.0	7.8	9.6	3.7
East Asia, excl.China																
GDP	100.0	100.0	100.0	100.0	10.3	10.1	11.6	9.6	100.0	100.0	100.0	100.0	8.7	5.4	4.9	3.3
HH	53.5	45.2	38.9	35.9	11.8	8.7	8.0	8.8	57.6	59.1	55.4	53.1	8.0	5.3	3.2	2.3
Gov	14.5	14.7	14.0	13.2	11.8	10.0	9.8	7.9	16.9	14.5	12.8	12.7	6.2	3.6	3.2	3.3
Inv	38.0	38.3	41.7	46.4	7.9	10.6	13.4	13.4	26.8	30.5	26.5	23.1	10.4	3.7	3.8	0.4
Exp	9.7	20.3	36.0	39.9	13.6	18.3	20.0	13.7	31.5	45.5	65.5	74.0	12.7	9.2	11.8	5.3
Imp	9.4	17.5	30.4	35.3	14.3	17.1	18.6	18.0	32.4	49.3	61.0	63.8	12.0	7.8	9.6	3.7

Source: UNCTAD secretariat calculations, based on UNCTADstat.

Note: Averages and growth rates based on constant 2005 prices and 2005 exchange rates. HH=household consumption expenditure; Gov=government consumption expenditure; Inv=gross capital formation; Exp=exports, Imp=imports. Numbers do not necessarily add up to 100 due to rounding.

in market values, provided that these countries continue their catch-up process.

These changes in the shares of different countries and country groups in global output and in their contributions to global growth have been accompanied by changes in the composition of aggregate demand in many of them. A comparison of the evolution of private consumption, public expenditure (more precisely, government consumption, since it excludes public investment), investment, exports and imports shows that between the 1980s and 2003–2007 government consumption as a share of GDP fell in the vast majority of regions (table 1.7). Government consumption in constant prices recovered in Africa, Latin America and West Asia during the period of the commodity price boom between 2003 and 2007, when many governments in these regions used windfall gains to boost social spending. Major exceptions to the general decline in the share of current government spending in aggregate demand were Japan, where spending increased with a view to compensating for the sharp decline in the share of private demand, and China, where it remained fairly stable, while the share of domestic consumption fell.

This comparison also shows a slight reversal of the widespread tendency of a declining share of government consumption in GDP during the period 2008–2011. This reversal resulted from a rapid expansion of countercyclical fiscal spending in all country groups (Griffith-Jones and Ocampo, 2009),¹⁹ except in transition economies and China. This exception is partly due to the fact that most of the countercyclical fiscal stimulus in that country consisted of higher public investment rather than current expenditure. The share of investment (public and private) rose by 8 percentage points, averaging 46 per cent of GDP in the period 2008–2011. This was accompanied by a significant fall in the share of household consumption in GDP from an average of over 50 per cent in the 1980s to an average of about 36 per cent in the period 2008–2011.

The evolution of the composition of aggregate supply and demand over the three decades from 1981 to 2011 shows a very rapid growth of exports and imports, both in developed and developing countries (table 1.7). Their share in GDP, at constant prices, virtually doubled: from around 13 per cent to 27 per cent in developed countries, and from 20 per cent to close to 40 per cent in developing countries. At

current prices, this growth was somewhat slower in the latter group of countries (and has even slightly reversed since 2008) owing to a real appreciation of most developing-country currencies during the period, which resulted in their GDP at current prices growing faster than at constant prices. The increase was most notable in East and South-East Asia, where the share of exports in GDP rose by more than 30 percentage points between 1981–1990 and 2008–2011. Net exports in China (exports minus imports) amounted to 6 per cent of its GDP between 2003 and 2007.

To sum up, the larger role of international trade in the composition of aggregate demand in developing countries' growth was accompanied by a smaller role of government consumption in most of these economies. East Asia, especially China, also saw a significant decline in the share of household consumption in GDP. Until the early 2000s, increased participation in international trade had beneficial effects in a number of countries, especially in developing Asia, although much less so in Latin America and Africa. With the generally favourable external economic environment from 2003 until the onset of the latest crisis, their greater outward orientation contributed to an increase in the growth performance of all these developing regions. However, an export-oriented growth strategy also implies greater vulnerability to a deterioration of the external environment, as witnessed since 2008.

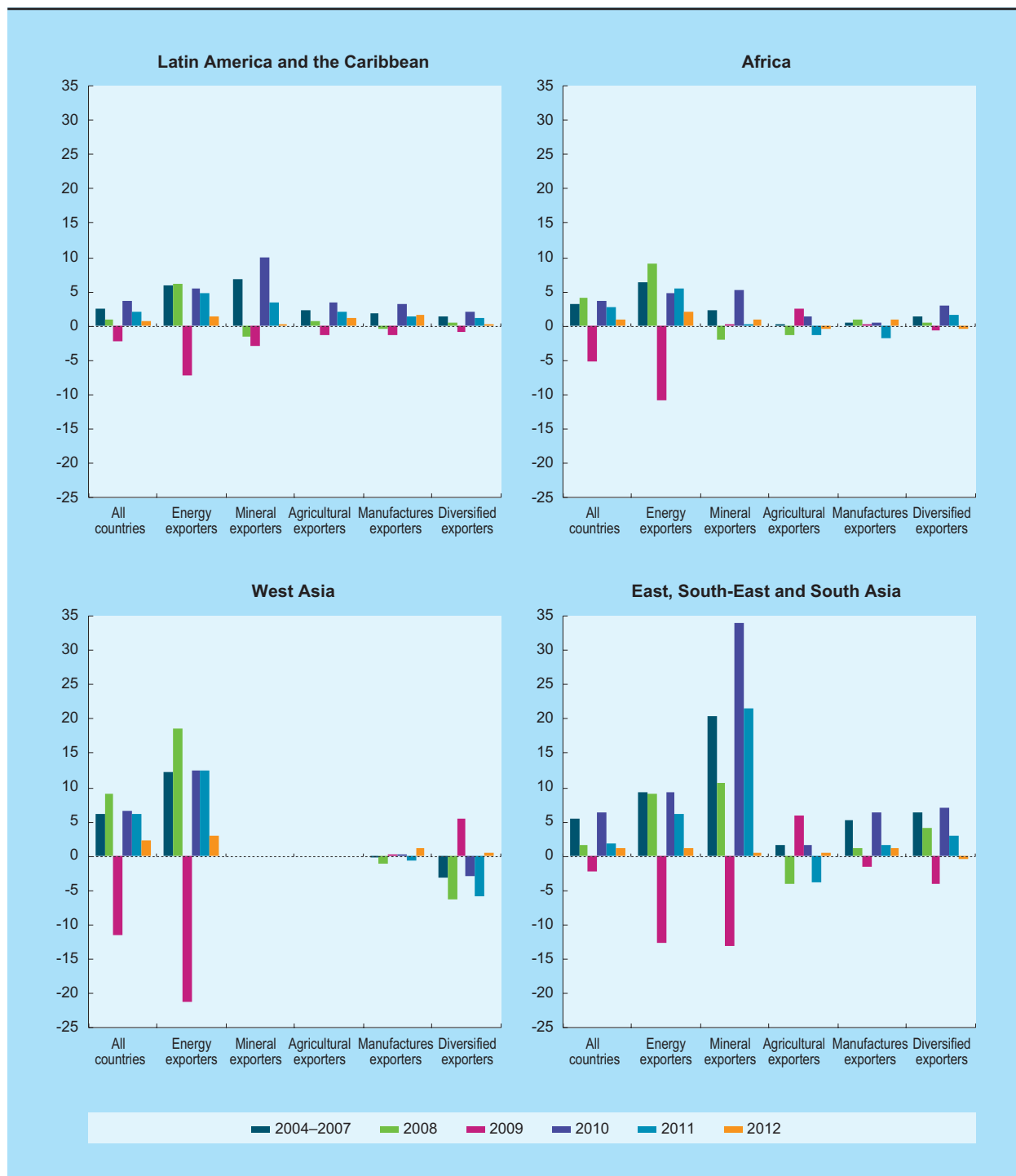
2. *Vulnerability to trade shocks*

The impact of an export-oriented strategy on a country's economic growth depends on the evolution of global demand for that country's exports and/or on price developments of those goods that constitute a large proportion of the country's export basket. Changing international prices have long been recognized as a major external source of a country's vulnerability. They have a particularly strong effect on countries that export mainly primary commodities, since prices of commodities have generally been more volatile than those of manufactures and services. In addition, the global financial crisis poses the risk of a severe slowdown of demand for manufactures exported by developing countries, and a further decline in the prices of such manufactures,

Chart 1.7

TRADE SHOCKS, BY DEVELOPING REGION AND EXPORT SPECIALIZATION, 2004–2012

(Change relative to GDP in previous year, per cent)



Source: UNCTAD secretariat calculations, based on *UN Comtrade*; *UNCTADstat*; United States Bureau of Labor Statistics (BLS); and CPB Netherlands Bureau for Economic Policy Analysis.

Note: A trade shock is calculated as the gains and losses in national income (measured as a percentage of GDP) resulting from changes in export volumes and terms of trade. Within each region, countries are classified by export specialization where energy, minerals or agricultural products account for at least 40 per cent, or manufactures for at least 50 per cent, of a country's exports; all other countries are classified as diversified exporters.

Table 1.8

WORLD EXPORTS BY ORIGIN AND DESTINATION, SELECTED COUNTRY GROUPS, 1995–2012
(Per cent of world exports)

	Origin \ Destination	Developing economies	Transition economies	Developed economies	Total
1995	Developing economies	11.9	0.3	16.1	28.3
	Transition economies	0.3	0.6	1.1	2.1
	Developed economies	16.6	1.1	52.1	69.7
	Total	28.8	2.0	69.2	100.0
2000	Developing economies	13.1	0.2	18.8	32.1
	Transition economies	0.4	0.5	1.4	2.4
	Developed economies	15.0	0.8	49.8	65.5
	Total	28.5	1.5	70.1	100.0
2005	Developing economies	16.7	0.5	19.1	36.3
	Transition economies	0.6	0.7	2.1	3.5
	Developed economies	13.6	1.4	45.3	60.3
	Total	31.0	2.5	66.5	100.0
2008	Developing economies	19.8	0.8	18.3	38.9
	Transition economies	0.9	0.9	2.8	4.6
	Developed economies	13.6	1.9	40.9	56.5
	Total	34.3	3.7	62.0	100.0
2010	Developing economies	23.2	0.7	18.4	42.3
	Transition economies	0.9	0.7	2.1	3.7
	Developed economies	15.3	1.5	37.2	54.0
	Total	39.4	2.9	57.7	100.0
2012	Developing economies	25.3	0.8	18.5	44.7
	Transition economies	0.9	0.8	2.4	4.1
	Developed economies	15.0	1.7	34.6	51.2
	Total	41.2	3.3	55.5	100.0

Source: UNCTAD secretariat calculations, based on *UNCTADstat*.

Note: Numbers do not necessarily add up to 100 due to rounding.

especially low-skill-intensive products (see also chapter II of this *Report*).

To examine countries' vulnerability to international price and demand shocks, individual countries within each geographical region were classified according to their export specialization (chart 1.7). An analysis of this classification shows that both exporters of primary commodities and exporters of manufactures suffered severe trade shocks during the period 2008–2009. But it also shows that the beneficial impact of the subsequent rebound was both larger and more rapid for countries with a high share of primary commodities in their exports than for countries exporting mainly manufactures.

Some observers have interpreted developing countries' relatively rapid economic growth in recent years as a manifestation of their "decoupling" from

the economic performance of developed countries. This has led them to conclude that the widely expected protracted weakness of demand growth in developed countries may not cause a sizeable decline in developing countries' opportunities to export manufactures. Rather, developing countries could move to a new type of export-led growth, with South-South trade becoming the main driving force (Canuto, Haddad and Hanson, 2010). South-South trade has indeed gained in importance, with its share in total developing-country exports increasing from less than 30 per cent during the second half of the 1990s to almost 45 per cent in 2012. About half of this increase has occurred since 2008 (table 1.8).

However, as already mentioned, the rapid growth in developing countries in 2010 was mainly due to their adoption of countercyclical macroeconomic policies and their recovery from the slowdown

Table 1.9

SOUTH-SOUTH EXPORTS, BY REGION AND PRODUCT CATEGORY, 1995–2012

(Per cent of total South-South trade)

	Share in total South-South exports of the respective product category						Average annual percentage growth		
	1995	2000	2005	2007	2010	2012	1996–2002	2003–2007	2008–2012
Asia									
Asian exports to other developing countries									
Total merchandise	7.8	8.1	7.9	9.0	10.2	10.1	5.8	29.1	14.4
Manufactures	9.0	9.4	9.2	11.1	13.3	13.5	5.5	28.6	14.8
Primary commodities	5.2	5.4	5.4	5.6	5.4	5.5	7.2	30.7	12.6
Intraregional exports									
Total merchandise	76.5	76.7	77.1	75.3	73.7	74.4	5.4	23.5	12.1
Manufactures	80.8	81.7	82.3	80.5	78.9	78.8	5.4	21.3	10.6
Primary commodities	66.2	66.2	66.4	65.4	63.7	66.2	5.4	29.3	13.5
Intra- East and South-East Asian exports									
Total merchandise	58.7	55.9	53.3	49.4	46.5	45.8	4.5	20.6	11.2
Manufactures	68.8	70.0	68.0	64.2	60.9	60.3	5.4	20.0	9.9
Primary commodities	35.4	27.2	25.2	23.1	22.5	23.0	1.4	24.3	14.0
China's exports to other Asian developing countries									
Total merchandise	10.6	10.9	15.9	17.4	17.0	18.2	9.1	30.1	13.1
Manufactures	12.6	13.8	21.5	24.8	25.0	27.8	9.9	31.3	13.1
Primary commodities	5.9	4.9	5.0	4.4	4.0	4.5	5.0	20.8	13.8
Other Asian developing countries' exports to China									
Total merchandise	13.2	14.6	18.9	17.5	17.9	17.5	8.3	24.9	13.3
Manufactures	15.1	17.0	22.8	21.2	21.4	19.6	9.0	23.1	10.1
Primary commodities	9.2	10.0	11.6	11.1	12.5	12.9	5.6	32.3	17.9
Latin America and the Caribbean									
Intraregional exports									
Total merchandise	7.7	7.7	6.3	6.2	5.2	5.0	2.8	25.2	6.8
Manufactures	6.1	5.9	5.3	5.4	4.8	4.9	1.9	26.8	7.7
Primary commodities	11.6	11.7	8.7	7.9	6.1	5.6	4.0	23.2	5.7
Latin American and Caribbean exports to other developing countries									
Total merchandise	3.2	2.3	3.5	3.8	4.8	5.1	2.7	30.6	19.6
Manufactures	1.4	0.9	1.4	1.3	1.0	1.1	0.1	24.3	5.8
Primary commodities	7.3	5.3	8.0	8.7	11.7	11.7	3.9	32.7	22.4
Latin American and Caribbean exports to China									
Total merchandise	0.4	0.5	1.2	1.4	2.2	2.3	11.7	38.0	25.4
Manufactures	0.1	0.1	0.3	0.3	0.3	0.4	20.7	20.7	13.3
Primary commodities	1.3	1.2	3.0	3.6	5.6	5.5	9.8	42.7	26.8
Africa									
Intraregional exports									
Total merchandise	2.3	1.8	1.7	1.7	1.8	1.6	2.1	18.9	10.2
Manufactures	1.7	1.2	1.0	1.1	1.2	1.0	1.0	13.1	8.7
Primary commodities	3.7	3.0	2.9	2.7	2.6	2.5	3.0	22.7	10.7
African exports to other developing countries									
Total merchandise	2.4	3.2	3.4	3.9	4.3	3.8	7.9	32.3	12.6
Manufactures	0.9	0.8	0.8	0.6	0.8	0.8	1.8	18.0	12.3
Primary commodities	5.7	8.0	8.5	9.6	10.3	8.5	9.9	35.3	12.3
African exports to China									
Total merchandise	0.2	0.6	1.1	1.4	1.7	1.1	23.2	51.0	8.4
Manufactures	0.1	0.0	0.1	0.1	0.1	0.1	3.8	23.3	21.6
Primary commodities	0.5	1.6	3.3	3.9	4.6	2.6	27.4	53.3	7.8

Source: UNCTAD secretariat calculations, based on UNCTADstat.

Note: Shares of developing Oceania's exports are negligible and therefore not reported.

(or recession) of 2009, though their growth has been losing steam since then. Moreover, a disaggregation of developing countries' total exports by major product categories indicates little change in the two main characteristics of South-South trade, namely its narrow concentration in Asia, related to these countries' strong involvement in international production networks, with developed countries as final destination markets, and the major role of primary commodities in the expansion of South-South trade over the past two decades (see also *TDR 2005*, chap. IV). Three quarters of South-South trade takes place within Asia, and Asian exports to other developing countries account for another 10 per cent of such trade (table 1.9). China alone accounts for about 40 per cent of South-South trade, almost half of intra-Asian total merchandise trade and 60 per cent of intra-Asian trade in manufactures, as well as for about one third of all developing-country imports from Africa and Latin America. This implies that China has probably been the single most important country in stimulating South-South trade through its imports from other developing countries over the past two decades.

Moreover, the share of manufactured exports between countries in East and South-East Asia in total South-South trade in manufactures has declined significantly since 2000, and even more so since 2005 (table 1.9). This decline is mirrored by a decline in China's imports of manufactures from other developing Asian countries as a share of total South-South trade in manufactures. A contributory factor could be the decline in exports from Asian supply chains to their developed-country end markets.²⁰ But it could also be due to the rising share of primary exports from Latin America and Africa in South-South trade. However, on a cautionary note, it should be borne in mind that the large amount of trade between geographically close countries involved in international production chains results in considerable double-counting of South-South trade in manufactures, since the exports of countries participating in those chains generally have a high import content, and those chains play an important role in South-South trade.

The significant role of primary commodities in the dynamics of South-South exports reflects, *inter alia*, the rapid increase in the absolute value of South-South trade in mineral fuels and metals, which has grown much more rapidly than that of any other product category, especially since 2008 (chart 1.8).

On the other hand, while developing-country exports to developed countries have grown less rapidly, overall, low-, medium- and high-skill and technologically-intensive manufactures were the most dynamic product groups in South-North trade over the period 1995–2012, second only to mineral fuels.

Taken together, there is little evidence to support the view that South-South trade has become an autonomous engine of growth for developing countries. Rather, the close links between the dynamics of South-South trade, on the one hand, and trade in primary commodities and trade within international production networks whose final destination is developed-country markets, on the other, indicates that engaging in South-South trade has probably done little to reduce developing countries' vulnerability to external trade shocks. However, if developing countries could shift to a growth strategy that gives a greater role to domestic demand growth, a greater share of their manufactured imports would be destined for final use in their domestic markets rather than being re-exported to developed countries. Such a shift could well increase the contribution of South-South trade to output growth in developing countries.

This strengthens the argument for a renewed role for domestic demand as the motor for a sustained and balanced growth of the world economy. Another set of adverse conditions related to the relatively more subdued growth performance of developing countries arises from the heightened instability of capital flows. Indeed, emerging economies saw a sudden reversal of the large capital inflows they had received until early 2013, following the first signs of a probable withdrawal of quantitative easing by the Federal Reserve of the United States in June 2013, which exacerbated uncertainty in the financial markets, with possible repercussions for the macroeconomic policies of many developing countries.

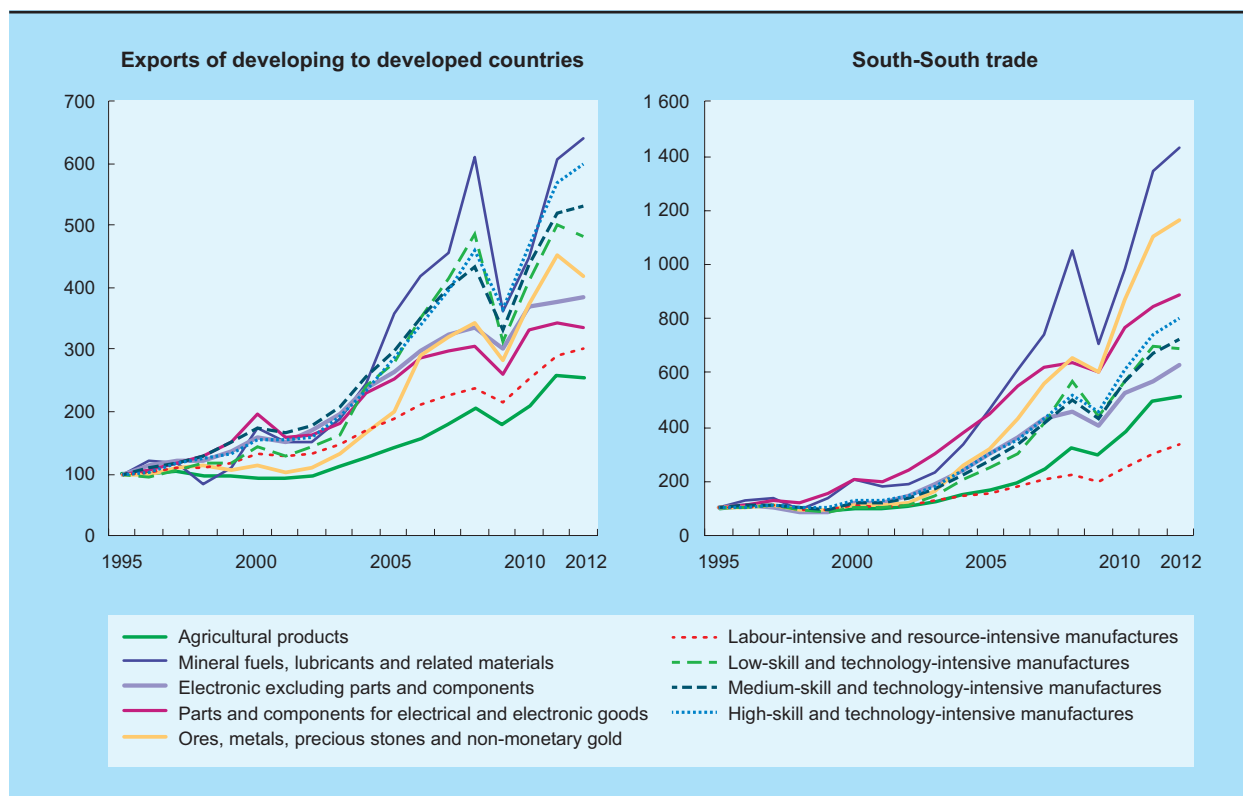
3. Vulnerability to financial instability

The strong rise in cross-border capital movements since the mid-1970s has been accompanied by an increase in the share of developing countries as recipients of international capital flows. However, capital flows to developing countries have rarely exhibited a continuous and smooth tendency; rather,

Chart 1.8

EVOLUTION OF DEVELOPING-COUNTRY EXPORTS BY BROAD PRODUCT CATEGORY, 1995–2012

(Index numbers, 1995 = 100)



Source: UNCTAD secretariat calculations, based on *UNCTADstat*, Merchandise trade matrix.

they have frequently been punctuated by sudden reversals. The associated boom-bust cycles in domestic credit and asset prices have recurrently triggered severe crises in these countries. The sheer magnitude of capital outflows from developed to developing countries, driven by even minor adjustments in financial portfolios, tend to destabilize the economies of the latter countries, as discussed in chapter III of this *Report*.

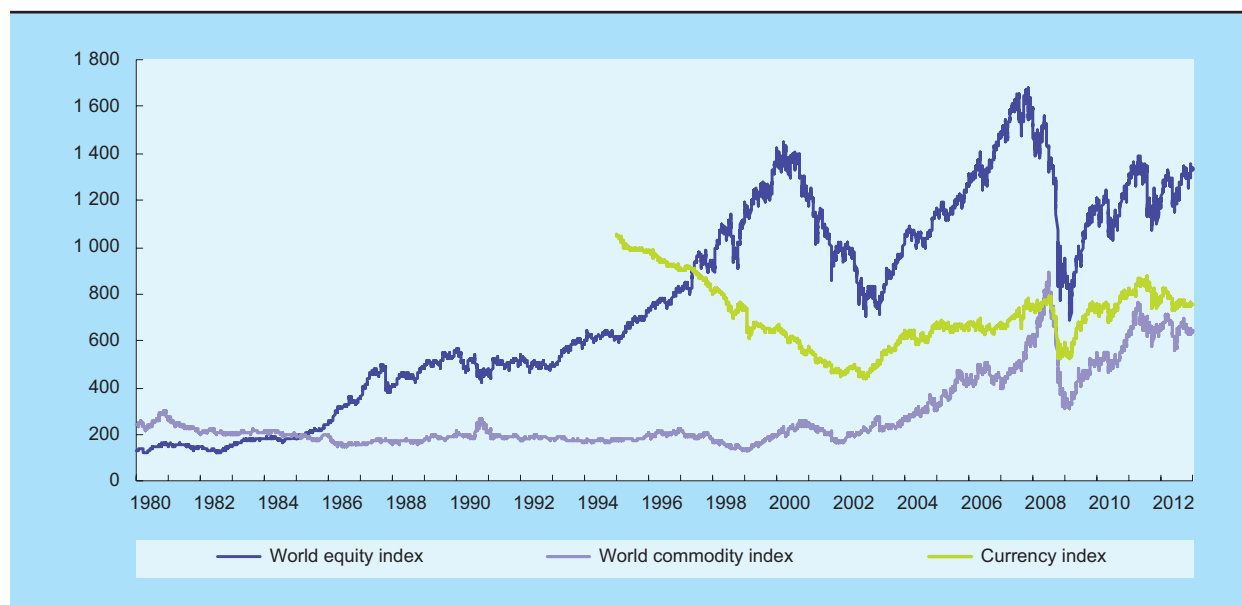
Another important factor contributing to developing countries' financial vulnerability relates to the price formation mechanisms in markets, including exchange rates and commodity markets, which can have a strong impact on developing countries. The rapidly growing presence of financial traders on commodity markets has overridden market mechanisms, resulting in a looser link between the ultimate supply or demand of the commodity and the treatment of commodity futures as a financial asset. As traders

tend to make position changes based on information related to other asset markets, irrespective of prevailing conditions in specific commodity markets, they have tended to generate a positive correlation between the prices of different asset classes (equity shares, currencies usually used as targets in carry-trade operations and commodity prices) (*TDR 2009*, chap. II). Chart 1.9 shows how the prices of different kinds of assets, which were uncorrelated until the early 2000, have become highly correlated since 2002, and especially since 2008. The more synchronized price movements across those assets indicate a weaker operation of fundamentals in price formation in each of their markets. For instance, currency appreciation or depreciation generally did not reflect current account conditions in several developing economies: the Brazilian real appreciated, both in nominal and real terms, between 2006 and 2008, and again between 2009 and mid-2011, despite a persistent deterioration in its current account balance;

Chart 1.9

PRICE TRENDS IN GLOBAL ASSET MARKETS, 1980–2012

(Price index)



Source: UNCTAD secretariat calculations, based on Bloomberg.

Note: World equity index refers to the MSCI world index. World commodity index refers to the S&P GSCI index. Currency index refers to an equally weighted index, which includes the Australian dollar, the Brazilian real and the South African rand spot rates (average 1995 = 1,000).

similarly, between 2003 and mid-2008, Turkey's real effective exchange rate (REER)²¹ appreciated by almost 50 per cent, in parallel with a gradual increase of its current account deficit.

This development has been exacerbated by the proliferation of information systems and models which are driven by the same data and trading principles (such as so-called "momentum trading", "risk-on/risk-off" behavioural responses or, generally, "algorithmic trading"). Trading based on these models is often done very rapidly (often referred to as high-frequency trading) and tends to result in herd behaviour, whereby market participants mimic each others' trading behaviour, follow the price trend for some time and try to disinvest just before the other market participants sell their assets (UNCTAD, 2011; Bicchetti and Maystre, 2012; and UNCTAD, 2012).

Taken together, the above evidence indicates that key prices for the economies of developing countries may move in ways unrelated to market fundamentals, and in tandem with those of other asset classes such as equities. The consequent high degree of cross-market correlation and herd behaviour risks making global financial markets "thinner", in the sense that virtually all market participants take bets on the same side of the market, which makes it more difficult to find a matching counterpart. The corollary to this is that relatively minor events can trigger a drastic change of direction in financial or financialized markets. In addition, such price changes may be more sensitive to changes in the monetary policies of developed countries, or in the general risk perception prevailing in those countries, than on supply and demand conditions in specific commodity markets and developing countries. ■

Notes

- 1 Despite the reconstruction and rehabilitation of machine production facilities in the areas of north-eastern Japan that were hit by the earthquake and tsunami and the robust growth of Japan's exports towards many developing countries in Africa, Latin America and West Asia, its overall exports fell in 2012 for the second year in a row.
- 2 The decline in exports from the Islamic Republic of Iran was primarily due to a tightening of trade sanctions by the United States and the EU. As a result, its exports of crude oil and lease condensate shrank by about 40 per cent, to approximately 1.5 million barrels per day (bbl/d) in 2012, compared with 2.5 million bbl/d in 2011.
- 3 At first sight, this evolution of exports of the group of emerging Asian economies slightly contrasts with the patterns of other developing regions. However, this relatively high figure of 6.2 per cent needs to be viewed with some caution. First, it results partly from relatively low levels in early 2012, which to some extent could reflect distortions associated with the Chinese New Year. Second, CPB robust trade data for January to April 2013 contrast with more negative signals emanating from China's customs figures for May and June 2013. According to the latter source, the value of China's exports shrank by 3.1 per cent in June year on year, down from a meagre 1 per cent in May. Meanwhile, imports fell by 0.7 per cent in June, year on year, having slipped by 0.3 per cent in May. Third, the year-on-year rise of 17.4 per cent of the value of exports for the January–April 2013 period presumably partly reflect overinvoicing practices by exporters speculating on the appreciation of the renminbi (*Financial Times*, “China to crack down on faked export deals”, 6 May 2013). These practices would also affect CPB's data on trade volumes. For at least these reasons, it remains difficult to fully grasp the magnitude of the slowdown in this region. In addition, in all likelihood, the squeeze in the Chinese money market and an unexpected rise in inventories, which are extremely dependent on changes in the growth of the economy, also played a role in these recent low trade figures. Nevertheless, recent anecdotal evidence of a marked deterioration in industrial activity, such as a fall in output and in new orders, suggest that China's slowdown could continue in the coming months (*Financial Times*, “Anaemic manufacturing data raise China growth fears”, 1 July 2013).
- 4 See United States Department of Labor, Bureau of Labor Statistics, at: <http://www.bls.gov/news.release/empsit.t15.htm>.
- 5 See Statistics Bureau of Japan, at: <http://www.stat.go.jp/english/data/roudou/Ingindex.htm>.
- 6 This decline in absolute terms was quite general: the EU lost 5 million jobs between the last quarter of 2007 and that of 2012; the United States lost 3.5 million jobs between December 2007 and December 2012; and in Japan employment fell by 1.5 million between December 2007 and May 2013, though this may be partly due to demographic trends, as the working age population diminished by 5.2 million persons between 1998 and 2012. See European Commission Eurostat, at: http://epp.eurostat.ec.europa.eu/portal/page/portal/employment_unemployment_ifs/data/database; United States Department of Labor, Bureau of Labor Statistics, at: <http://www.bls.gov/news.release/empsit.t15.htm>; and Statistics Bureau of Japan, at: <http://www.stat.go.jp/english/data/roudou/Ingindex.htm>.
- 7 Multipliers differ, depending on which expenditure is reduced or which tax is raised, and the most costly are cuts in investment spending. Multipliers are much lower (generally below 0.6) if fiscal consolidation policies are credible (i.e. if markets are convinced that announced consolidation measures will be fully implemented and enduring). Based on these considerations, the ECB states that “While there may be a temporary deterioration in growth resulting from fiscal consolidation, well-designed fiscal adjustment leads to a permanent improvement in the structural balance and thus has a favourable impact on the path of the debt-to-GDP ratio. Consequently, postponing the necessary budgetary adjustment is not a credible alternative to a timely correction of fiscal imbalances” (ECB, 2012: 81).

- 8 Additional modelling exercises also show that the fiscal multipliers can have a greater impact on GDP depending mostly on: (i) the composition of the initial policy shock, and (ii) whether the expansionary shock is accompanied by income redistribution policies. Essentially, if progressive income distribution effects are included in the design of fiscal measures, the positive response to larger government spending is higher. Meanwhile, the negative effect on GDP of increased taxation, net of transfers and subsidies, is smaller if it consists of higher direct taxation, and larger if it consists of lower social transfers.
- 9 Arithmetically, the overall effect on the public-debt-to-GDP ratio of a debt-financed increase in public spending depends on the values of the fiscal multiplier, the public revenues as a percentage of GDP and the initial debt stock as a percentage of GDP. For instance, assuming a multiplier of 1.3, an initial debt-to-GDP ratio of 60 per cent and public revenues-to-GDP ratio of 35 per cent, an increase of 5 per cent of GDP in public spending would reduce the debt-to-GDP ratio to 59 per cent. The empirical debate, however, is basically economic, and revolves around the “crowding-out” debate. As stated in *TDR 2011*: “for those who believe in crowding out effects, increases in government spending reduce private expenditure. In this case, either supplementary spending is financed with borrowing and leads to a higher interest rate, which lowers investment and consumption, or the government opts to raise taxes to bridge the fiscal gap, which reduces private disposable income and demand. Hence, public stimulus will be irrelevant at best, and may even be counterproductive if it raises concerns among private investors. Theoretical models supporting this view have been criticized for their unrealistic assumptions – such as perfect foresight, infinite planning horizons, perfect capital markets, and an absence of distribution effects through taxation – which make them unsuitable for policy decisions in the real world. In particular, their starting point usually assumes full employment, when the discussion is precisely how to recover from an economic slump. Even in more normal times, however, the empirical evidence for crowding out is weak at best.”
- 10 “Fiscal space” may have different meanings. The most comprehensive and useful from an economics point of view is the capability of generating a fiscal stimulus that would improve economic and fiscal conditions in the medium to long term. Hence, even if a country has high fiscal deficits and a high public-debt-to-GDP ratio, a government has fiscal space, from a dynamic perspective, if it can access low-cost financing and profit from the very high fiscal multipliers that exist during economic recessions. A static view of fiscal space only compares the current level of public debt or deficit with a given target (which may be self-imposed or agreed with the IMF or the European Commission).
- 11 This primary income is supplemented by income redistribution (or secondary income) implemented by the State through direct taxation and personal transfers.
- 12 The falling trends in the share of labour income are evident in both absolute and relative terms. In absolute terms, the growth of real wages of the population in the lower segments of income distribution has remained subdued, or even negative, in several developed countries over the past few decades (see, for example, *TDR 2010*). In developing countries, there was significant wage growth between 2000 and 2007, but this has slowed down, and in many cases halted, since the start of the recent financial crisis (Ashenfelter, 2012). In relative terms, available empirical analyses of the functional distribution of income, which cover various countries, also point to growing inequality in the distribution of value added. Labour income as a share of total income has been falling in almost all developed countries (Storm and Naastepad, 2012; *TDR 2012*). In developing countries, even though empirical evidence is scarcer and more heterogeneous, these shares have also declined, on average, although a reversal has taken place in the 2000s in a number of Latin American and South-East Asian countries (Stockhammer, 2012; *TDR 2012*).
- 13 Looking at the world economy as a whole, Onaran and Galanis (2012) show that a simultaneous and continuing decline in the wage share leads to a slowdown of global growth. Furthermore, in a more detailed investigation of 16 individual country members of the G-20, the authors find that 9 of these countries show a positive correlation between wage growth and GDP growth. Of the remaining 7 economies which show negative correlations between wage growth and GDP growth when considered individually, 4 of them effectively register lower growth when facing a simultaneous reduction in the wage share. Moreover, they find that when the wage shares of all economies fall simultaneously, these four economies contract as well. Galbraith (2012) reaches a similar conclusion based on a large empirical investigation across many countries and over time. In this case, however, a negative impact on growth from more unequal distribution is shown to be strongly influenced by the nature of the changes in income distribution, as well as by the socio-economic context and the level of development. For example, the effect of changes in income distribution on consumption in the United States over the past three decades is shaped by developments in the financial sector. On the one hand, the growth of the financial sector is a key determinant of the rapid deterioration of income distribution. (The vast data sample confirms that countries and cities that

- predominantly host financial activities also display a high degree of inequality of income distribution.) On the other hand, the impact on household spending is mediated by the ability of the financial sector to extend credit to enable consumption, which can last until a crisis emerges. In developing countries, Galbraith (2012) confirms a pattern of inequality over the long run similar to what Kuznets posited, namely that rising inequality in early stages of development is followed by improvements in income distribution as development progresses. However, at some stages and in specific ways, developments in the financial sector also exert an influence on how rising inequality is transmitted to spending. Evidence from China, for example, shows that a greater share of the rising national income is contributing to financial speculation and real estate bubbles, and thus household consumption is not rising as fast as national income.
- 14 According to Minsky (1982), one of the reasons why recovery from the Great Depression of the 1930s was so difficult was the small amount of public expenditure around 1930, which was only 10 per cent of GDP in the United States.
- 15 For instance, a deficit of 3.6 per cent of GDP is consistent with a debt ratio that is stabilized at 60 per cent of GDP, with an annual real GDP growth of 3 per cent and an increase in the GDP deflator of 3 per cent.
- 16 These considerations mainly concern the degree of effectiveness of the multiplier, depending on the level, or lack, of aggregate demand and to what extent private agents are preoccupied with their own balance sheets. Another consideration in assessing the government's effectiveness in sustaining demand and employment relates to the degree of confidence of private agents in government actions (Berglund and Vernengo, 2004). With a similar consideration in mind, based on an empirical study of 140 countries over the period 1972–2005, Carrère and de Melo (2012), suggest that fiscal stimulus is effective provided the rest of the economy is stable and the fiscal deficit is contained. In sum, the effectiveness of public spending to generate demand and employment depends not only on economic processes, but also on political ones (Kalecki, 1943).
- 17 As stated by Bernanke, “Some observers have expressed concern about rising levels of household debt, and we at the Federal Reserve follow these developments closely. However, concerns about debt growth should be allayed by the fact that household assets (particularly housing wealth) have risen even more quickly than household liabilities.” Similar remarks were made by his predecessor as Chairman of the Federal Reserve Board, Alan Greenspan, in his testimony before the Committee on Banking, Housing, and Urban Affairs of the United States Senate in February 2005 (available at: <http://www.federalreserve.gov/boarddocs/hh/2005/february/testimony.htm>).
- 18 This is explained by the so-called Balassa-Samuelson effect (i.e. price levels in wealthier countries are systematically higher than in poorer ones).
- 19 The United Nations (2010: table I.4) recorded the fiscal measures made public by many governments at the time of the crisis. Of the 55 countries covered, the 10 countries that applied the strongest stimulus measures, all but one were developing and transition economies. In eight of these countries, the measures amounted to more than 10 per cent of GDP spread over two to three years. However, following the implementation of such high levels of stimulus since 2012, there may have been a turnaround in the pace of government spending. Ortiz and Cummins (2013), on reviewing government projections up to 2016, as recorded by the IMF, note that there has been a shift towards fiscal austerity by 119 countries in 2013, and this is likely to increase to 132 countries by 2015.
- 20 *TDR 2002* (Part 2, chap. III) provides an early discussion of the role of international production networks in the export dynamism and industrialization of developing countries.
- 21 The REER corresponds to the nominal exchange rate of a currency vis-à-vis the currencies of all trading partners, adjusted for the inflation differentials.

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Annex to chapter I

ALTERNATIVE SCENARIOS FOR THE WORLD ECONOMY

This annex presents a quantification of global economic scenarios through 2030. It is intended to illustrate alternative scenarios for a balanced and sustained pro-growth global outcome based on the United Nations Global Policy Model.¹

Three simulations are presented: a *baseline* and two *alternative scenarios*. The baseline is a projection assuming that there will be neither policy changes nor shocks ahead.² In the two *alternative scenarios*, a reorientation of macroeconomic policy towards the adoption of measures that provide stronger support for an expansion of aggregate domestic demand is assumed. These *alternative scenarios* assume a continuing path of economic convergence between countries, and incorporate the current macroeconomic constraints and potential of each economy or group of economies. In other words, they take into account their particular structural conditions, as well as the interactions between countries through trade and finance. The main distinction between the two alternative scenarios is that in one scenario all

countries would be involved in a demand-driven policy effort (scenario A), while in the other scenario, only developing and emerging market economies would embark on this alternative macroeconomic policy stance (scenario B).

The alternative scenarios are grounded in macroeconomic reasoning, not political feasibility. Therefore, they do not discuss the policy coordination processes that would be needed at the regional or global levels, nor do they attach any probability to the occurrence of such processes. However, even though the political processes are not discussed, these simulations serve to illustrate the advantages that would result from a coordinated effort aimed at a sustained expansion of global demand. Left to the operation of markets alone, there would be no self-adjusting mechanisms for the world as a whole to ensure coherence between the policies of individual countries and avoid negative trade-offs and welfare losses. The quantifications shown here may provide policymakers with a concrete template to debate policy choices.

The policy assumptions in the alternative scenarios

The nature of the assumed policy changes is the same in both scenarios A and B, but in scenario A *all* countries, developed, developing and transition economies alike, are assumed to pursue more expansionary macroeconomic policies to the extent needed to ensure a growth-enhancing environment for each country. The main areas of assumed policy changes are listed below:

- A stronger role of the public sector, both in terms of spending and decisions on taxation. The proactive fiscal stance would aim at contributing to a stable growth of demand and at strengthening productive capacity through physical and social infrastructure, the provision of incentives to private investment and appropriate industrial and structural policies.
- Measures aimed at a more equal distribution of income through setting a minimum wage, direct taxation and welfare-enhancing programmes. These measures, which will effectively lead to wage increases closer to average productivity gains, will play a dual role: they will help sustain the expansion of aggregate demand, and, by virtue of such expansion, they will trigger improvements in productivity through demand-driven technical progress mechanisms.
- Supportive monetary and credit policies and improved financial regulations. Interest rates and credit availability are assumed to support private and public sector activity, and at the same time avoid excessive asset appreciations or financial fragility of private and public institutions.
- Tax and spending policies are assumed to be made consistent with an improvement in the financial positions of the public sectors in countries where they have been strained in the recent past. In such cases, government spending will increase at a slower rate than GDP growth, but will nevertheless provide a sizeable economic stimulus through spending fiscal multipliers that are significantly greater than 1 (as explained in section B of this chapter). Likewise, it will be assumed that fiscal positions will improve with the help of higher taxes imposed on sectors that are not employment-intensive.
- On the external front, it would involve reforms of the international monetary and financial systems. In these scenarios it is assumed that progressive adjustments of nominal and real exchange rates will be conducive to reducing global imbalances and fostering economic development. To narrow both trade and financial imbalances without deflationary adjustments in deficit countries, it is assumed that surplus countries will make a greater contribution than deficit countries through measures aimed at bolstering domestic demand. To enable industrialization and export diversification in developing countries, it is also assumed that there will be non-discriminatory market access for these countries and mechanisms to promote South-South cooperation, including in the area of environment-friendly technologies, as discussed below. Better regulation of commodity markets is assumed to reduce the adverse influence of their “financialization” on primary and energy prices.
- It is further assumed that measures, including incentives to private investment, government spending and taxation, will address environmental challenges by helping to mitigate carbon emissions and environmental degradation.³ Investments in technological innovations for the

more efficient production and use of energy and primary inputs are assumed to take priority. In addition, industrial policies in energy and primary commodity exporters will aim at greater economic diversification. New technologies will become more advanced and made available at the same pace as that of other technological developments in recent history.

In scenario B, it is assumed that the developed countries will maintain their currently dominant policy stances, and will therefore remain on a sub-par growth trajectory driven by fiscal austerity and pressures to compress labour income. The latter may contribute to competitiveness gains in external markets, but also to reduced or slow growth of consumption. By contrast, developing and transition economies are assumed to press ahead with the set of policies described above, but since they would be facing a more adverse external environment, they would face harsher constraints.

In addition, it is assumed that the major developed countries will continue with their recent choices

of monetary policy and financial regulation, which showed little concern for potential spillover effects on developing countries. Developing countries are assumed to implement some level of capital controls, but, in the absence of international cooperation, these measures will be only partially effective. Likewise, reducing external imbalances and promoting economic development will become more challenging if, as assumed, developed countries do not depart from their current policy stances. For example, facing harsher wage competition from the latter group, developing countries may not be able to improve on functional distribution of income to the extent they could in scenario A. Similarly, the greater market access assumed in scenario A to enhance export diversification of developing countries will be applied only by and among developing countries. Overall, these conditions will shake the confidence and expectations that generally influence portfolio and fixed capital investment, as well as financial costs. But even considering these limitations, there remains considerable scope for coordination among developing and emerging economies with regard to the aforementioned policy alternatives.

Outcomes of the scenarios

An illustrative set of outcomes resulting from the combination of assumptions in the two alternative scenarios is presented below for the major regions and for the world as a whole.⁴ Chart 1.A.1 shows that GDP growth is significantly higher in scenario A than in both scenario B and the baseline scenario for all regions. It needs to be borne in mind that the current global conditions are particularly adverse, as both developed and developing countries still face huge challenges and bottlenecks resulting from the financial crisis.

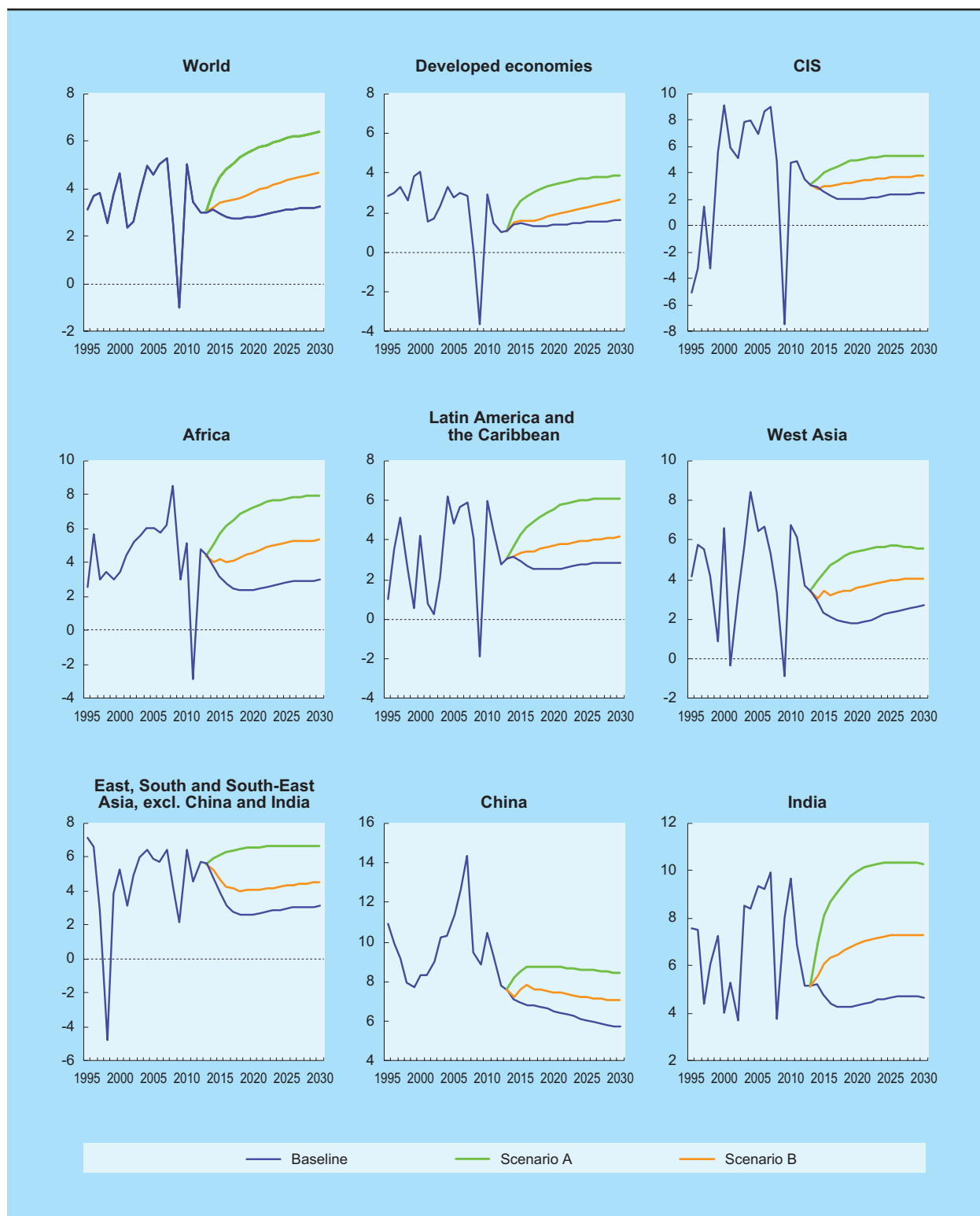
The growth trajectory outcomes from the policy assumptions in scenario A are consistent with the

obtained patterns of improved functional distribution of income, shown in chart 1.A.2. The recent past was marked by an unequivocal deterioration of income distribution between labour and profits in practically all regions, with partial exceptions in Latin America and some Asian countries. A catch-up of functional distribution is economically desirable and feasible, but might proceed at a relatively moderate pace. Such an improvement is a major factor for the growth of internal demand in each country as well as for the growth of global trade activity. In turn, economies of scale resulting from larger domestic and foreign markets induce technical progress. But these processes would take time and need to be jointly managed, since

Chart 1.A.1

**GDP GROWTH: HISTORICAL AND ESTIMATED UNDER THE TWO SCENARIOS,
BY REGION/GROUP, CHINA AND INDIA, 1995–2030**

(Per cent)



Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model.

Note: Growth refers to GDP at constant 2005 PPP dollars. CIS includes Georgia.

Chart 1.A.2

LABOUR-INCOME SHARE: HISTORICAL AND ESTIMATED UNDER THE TWO SCENARIOS, BY REGION/GROUP, CHINA AND INDIA, 1995–2030

(Per cent of GDP)



Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model.

Note: CIS includes Georgia.

very rapid changes in income distribution and the consequent expansion of GDP growth may generate unsustainable trade deficits.

Employment growth is captured in table 1.A.1, together with the growth of private consumption and investment. Faster growth of investment, and hence employment, is expected as a result of the growth- and development-enhancing assumptions of the simulations, except in China and India, where investment rates are already very high and a rebalancing towards greater domestic consumption is due. Employment creation is both an effect of the growth patterns as well as a factor for faster growth of consumption.

A critical element in the simulations is the calibration of the fiscal stance. As shown in table 1.A.2, robust growth of government spending can be made consistent with improvements in the fiscal and current account balances. Subject to the limitations outlined above, GDP growth helps strengthen the financial positions of all domestic sectors – private and public.

The global configuration of imbalances presented in chart A of chart 1.A.3 shows a marked reduction of external imbalances in the scenario in which all countries provide a policy stimulus (i.e. scenario A). This results mainly from the greater emphasis of surplus countries on domestic demand, enhanced market access for developing countries, and a reform of international finance which reduces the need for countries to accumulate large external reserves.

Several lessons can be drawn from the outcome of scenario B, in which developed countries do not adopt more supportive policies. First, it shows that it is worthwhile for developing and transition economies to embark on coordinated policies that stimulate domestic demand, even if developed countries do not pursue similar policies.

Second, it can be observed that developed countries manage to achieve a faster growth rate, even if more moderately, than in the baseline scenario. This is despite the fact that growth of public spending is negligible and functional income distribution continues to deteriorate. The outcome does not contradict the propositions made in this Report; rather, it corroborates the proposition that such a strategy could yield some partial gains for some, though not

all, countries at the same time. There will be two distinctive approaches, depending on the prevailing institutional structures. Some developed countries will continue to adopt an export-led strategy by stressing wage compression measures. In deficit developed countries, some degree of growth could be supported by renewed debt accumulation by the domestic sectors. These two sets of countries will influence the configuration of global imbalances shown in chart B of chart 1.A.3. Greater external imbalances will also affect developing countries, though these will not be as large as in the baseline scenario because developing countries are assumed to agree on regional mechanisms of trade cooperation (see table 1.A.2).

Third, as stressed above, more binding constraints arise for developing and emerging economies in the implementation and outcomes of the policies they aim to undertake. The new configuration of external imbalances suggests that there will be a build-up of global instability similar to the one experienced in the run-up to the financial crisis. Moreover, developed countries are assumed to rely more heavily on monetary expansion mechanisms without a complementary fiscal expansionary stance and without sufficiently robust growth of domestic employment (see tables 1.A.1 and 1.A.2). The risks of financial spillovers on exchange rates and commodity markets will have some effect on the macro-financial decisions of developing countries. In sum, the external environment that developing countries will face will be more adverse in scenario B than in the alternative scenario A, but will be better than in the baseline scenario owing to enhanced regional and South-South cooperation.

In conclusion, a demand-driven coordinated policy effort (such as in scenarios A and B) would lead to significantly better global economic outcomes than those resulting from the baseline scenario in which current policies are maintained. Additionally, a greater degree of international coordination would deliver higher growth rates for GDP and employment in all countries and would reduce global imbalances (scenario A). But even if developed countries were to persevere with their current policy stance, developing countries could still improve their economic performance by providing a coordinated economic stimulus. Hence, encouraging regional cooperation and South-South trade would need to be an important component of their development strategies. ■

Table 1.A.1

		PRIVATE CONSUMPTION, PRIVATE INVESTMENT AND EMPLOYMENT GAINS UNDER THE TWO SCENARIOS, BY REGION/GROUP, CHINA AND INDIA, 2007–2030											
		Average annual growth of private consumption (Per cent)				Average annual growth of private investment (Per cent)				Employment gains (Millions of jobs created relative to the baseline scenario)			
		2007– 2012	2013– 2018	2019– 2024	2025– 2030	2007– 2012	2013– 2018	2019– 2024	2025– 2030	2013– 2018	2019– 2024	2025– 2030	
World	Baseline	2.9	3.1	2.9	3.0	3.7	2.6	3.1	3.8	.	.	.	
	Scenario A	.	4.7	5.8	6.2	.	3.5	5.8	6.4	36.6	85.9	101.8	
	Scenario B	.	3.6	4.1	4.4	.	2.7	4.0	4.9	17.6	42.2	52.5	
Developed economies	Baseline	1.0	1.7	1.6	1.6	-2.2	1.9	2.4	2.8	.	.	.	
	Scenario A	.	2.7	3.3	3.6	.	3.2	4.9	4.9	7.2	18.5	19.8	
	Scenario B	.	1.7	2.0	2.3	.	2.1	3.3	4.2	0.5	2.5	3.9	
CIS	Baseline	4.4	1.8	2.3	2.7	7.4	1.5	1.0	2.6	.	.	.	
	Scenario A	.	3.8	5.1	5.3	.	2.9	5.5	5.7	0.7	2.2	2.8	
	Scenario B	.	2.5	3.5	3.8	.	2.0	3.1	4.0	0.3	1.0	1.4	
Africa	Baseline	5.2	3.5	3.0	3.0	7.0	4.4	2.9	3.3	.	.	.	
	Scenario A	.	6.2	7.1	7.6	.	6.4	7.9	8.0	4.5	14.7	22.5	
	Scenario B	.	4.5	4.8	5.2	.	5.1	5.5	5.9	2.5	8.5	13.2	
Latin America and the Caribbean	Baseline	4.0	3.0	2.7	2.7	5.0	1.7	2.2	3.2	.	.	.	
	Scenario A	.	4.1	5.4	5.9	.	2.1	5.5	6.2	3.4	6.5	6.9	
	Scenario B	.	3.3	3.7	3.9	.	1.5	3.3	4.2	1.9	3.6	3.4	
West Asia	Baseline	4.3	3.2	2.6	2.6	6.6	3.0	0.7	2.0	.	.	.	
	Scenario A	.	5.6	6.1	5.9	.	3.9	5.9	6.3	1.5	4.8	6.3	
	Scenario B	.	4.4	4.3	4.2	.	3.1	3.2	4.2	0.8	2.6	3.5	
East, South and South-East Asia, excl. China and India	Baseline	5.1	3.9	3.0	2.9	6.5	5.4	1.6	2.4	.	.	.	
	Scenario A	.	5.3	6.2	6.5	.	4.8	6.8	6.9	6.2	15.4	19.3	
	Scenario B	.	4.3	4.1	4.2	.	5.2	3.5	4.1	3.8	9.7	12.0	
China	Baseline	8.8	8.9	7.1	6.1	11.8	3.4	5.1	5.3	.	.	.	
	Scenario A	.	12.3	11.1	9.5	.	3.5	5.7	6.5	8.0	12.1	9.1	
	Scenario B	.	10.8	9.3	7.8	.	3.1	4.9	5.5	4.7	7.3	6.3	
India	Baseline	7.8	5.2	4.8	4.7	8.4	2.2	2.2	3.7	.	.	.	
	Scenario A	.	8.1	9.9	10.3	.	4.7	8.9	10.0	5.0	11.8	15.2	
	Scenario B	.	6.5	7.2	7.3	.	2.9	5.1	6.5	3.0	7.2	8.8	

Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model.

Note: CIS includes Georgia.

Table 1.A.2

**PUBLIC SPENDING, NET PUBLIC LENDING AND CURRENT ACCOUNT BALANCE
UNDER THE TWO SCENARIOS, BY REGION/GROUP,
CHINA AND INDIA, 2007–2030**

		Average annual growth of public spending (Per cent)				Average annual net public lending (Per cent of GDP)				Current account balance (Per cent of GDP)			
		2007– 2012	2013– 2018	2019– 2024	2025– 2030	2007– 2012	2013– 2018	2019– 2024	2025– 2030	2007– 2012	2013– 2018	2019– 2024	2025– 2030
World	Baseline	3.6	2.1	2.3	2.8	-3.7	-3.6	-3.2	-3.0	-	-	-	-
	Scenario A	.	4.0	5.7	6.2	.	-2.7	-1.7	-1.7	-	-	-	-
	Scenario B	.	3.1	3.7	4.3	.	-3.5	-2.7	-2.4	-	-	-	-
Developed economies	Baseline	1.6	0.5	0.7	0.8	-5.6	-4.9	-3.7	-3.0	-0.5	-0.4	-1.3	-2.4
	Scenario A	.	1.2	3.0	3.5	.	-3.7	-2.5	-2.5	.	-0.4	-0.5	-0.8
	Scenario B	.	0.6	0.9	1.3	.	-4.8	-3.2	-1.9	.	-0.3	-0.5	-0.9
CIS	Baseline	3.1	2.0	1.6	1.7	1.2	0.6	0.4	0.9	2.5	0.2	0.7	1.4
	Scenario A	.	3.0	4.9	5.4	.	1.1	0.9	0.2	.	0.7	0.6	0.5
	Scenario B	.	2.5	3.5	3.8	.	0.7	0.2	-0.1	.	0.3	0.3	0.5
Africa	Baseline	7.2	1.6	1.2	2.2	-2.7	-4.3	-2.5	-1.1	-1.6	-4.3	-6.4	-5.8
	Scenario A	.	2.9	6.8	7.6	.	-2.8	-1.0	-1.1	.	-2.3	-1.5	-0.2
	Scenario B	.	2.2	4.2	5.0	.	-3.7	-2.4	-2.0	.	-3.6	-4.6	-4.0
Latin America and the Caribbean	Baseline	5.8	2.2	1.8	2.3	-2.4	-3.6	-3.2	-2.6	-2.7	-3.5	-3.8	-3.4
	Scenario A	.	4.1	5.5	6.0	.	-3.0	-2.4	-2.5	.	-2.5	-0.7	0.1
	Scenario B	.	3.1	3.7	4.0	.	-3.5	-3.4	-3.4	.	-3.1	-2.6	-2.0
West Asia	Baseline	5.0	3.0	1.8	2.8	4.7	0.5	-0.7	-0.1	7.9	2.4	0.8	2.0
	Scenario A	.	3.8	5.5	5.9	.	0.9	-0.7	-0.7	.	4.3	1.5	0.8
	Scenario B	.	3.3	3.9	4.5	.	0.5	-1.0	-1.0	.	3.3	0.8	0.8
East, South and South-East Asia, excl. China and India	Baseline	5.5	3.3	2.4	2.8	-2.8	-2.9	-3.2	-3.0	-1.6	-4.2	-4.5	-3.3
	Scenario A	.	8.5	7.1	6.8	.	-2.8	-2.8	-2.9	.	-2.2	-0.5	0.0
	Scenario B	.	6.2	4.8	4.7	.	-3.0	-3.6	-3.8	.	-3.7	-3.6	-2.9
China	Baseline	9.0	7.1	7.3	6.6	-1.0	-0.2	-1.3	-2.5	4.8	6.8	8.4	8.3
	Scenario A	.	12.2	9.9	8.7	.	-0.1	-0.0	-0.0	.	3.3	1.6	1.5
	Scenario B	.	10.4	8.8	7.8	.	-0.3	-1.0	-1.5	.	4.6	3.9	3.6
India	Baseline	9.7	4.9	4.7	4.9	-8.3	-9.6	-10.0	-10.1	-6.0	-4.8	-2.7	-1.9
	Scenario A	.	9.4	10.2	10.3	.	-6.2	-3.1	-3.0	.	-4.5	-1.8	-1.1
	Scenario B	.	7.4	7.6	7.7	.	-7.9	-6.7	-6.9	.	-4.7	-2.7	-2.2

Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model.

Note: CIS includes Georgia.

Chart 1.A.3

GLOBAL IMBALANCES UNDER TWO SCENARIOS, 1980–2030

(Per cent of world output)



Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model.

Note: The shaded area shows the simulation period. Deficit and surplus classification was based on the average current account (CA) position between 2004 and 2007. CIS includes Georgia.

Notes

- 1 The UN Global Policy Model can be accessed at: http://www.un.org/en/development/desa/policy/publications/ungpm/gpm_concepts_2010.pdf. The version used in this Report – number 5b – incorporates employment and functional distribution of income and their feedbacks into the macro and global economy. The full technical description of the model, version 3, can be downloaded from: http://www.un.org/en/development/desa/policy/publications/ungpm/gpm_technicaldescription_main_2010.pdf.
- 2 These assumptions of no policy changes and the absence of shocks from now to 2030 are clearly unrealistic, but are convenient in order to net out the impact of the policy changes analysed in the other two scenarios.
- 3 The GPM has the ability to quantify both the intensity of use of raw materials in the production of domestic output and differentiated patterns in the use of fossil-fuel and non-fossil-fuel technologies.
- 4 The assumptions discussed above imply considering trade-offs and interactions within and between economies. Depending on how these trade-offs are managed, different outcomes may result. For example, higher growth targets could be achieved in some developing countries if other countries agree to wider trade preferences. Similarly, some countries could grow faster or slower depending on the levels of external deficits and surpluses that countries are prepared to tolerate.