

# Chapter II



International Markets:  
Trade, Capital Flows,  
Commodities



## From a fractured international architecture to a sustainable new global order

The current wrong-footed international financial architecture and global trading system undermines the pursuit of the harmonious and stable order required to meet the goals of the 2030 Agenda for Sustainable Development or the Paris Agreement targets. More concretely, UNCTAD analysis finds that after the COVID-19 shock:

- International trade and its related power asymmetries have contributed to further worsening global labour income share. In addition, unilateral shifts in industrial policies in developed economies are generating tensions among trading partners, hampering prospects for structural transformation in developing countries.
- Elevated commodity prices persist globally, harming the most vulnerable and creating food insecurity for 350 million people worldwide.
- Global financial conditions are markedly deteriorating, placing almost one third of frontier market economies on the precipice of debt distress. This follows the deepening of their financial integration into international capital markets over the last decade.

In envisioning a hopeful future, a new paradigm is needed, one that goes beyond the traditional boundaries of globalization and trade liberalization. This new global order would require a comprehensive approach and a concerted effort to transform aspirations into a resilient, multifaceted system capable of meeting the intricate demands of an interconnected world. The imperative is clear: escalate the search for effective governance measures to rectify the imbalances and vulnerabilities inherent in the current global economic and financial architecture.

### In light of these dynamics, UNCTAD proposes

- Building a new consensus for international trade that can better accommodate policy priorities such as building resilient supply chains, achieving a just energy transition, delivering decent jobs, tackling corruption and corporate tax avoidance, and developing a secure digital infrastructure.
- Revisiting existing international trade agreements to create policy space for countries to redesign their production, consumption and trading profiles to face contemporary global challenges.
- Strengthening South–South trade cooperation, for instance by revitalizing the Global System of Trade Preferences (GSTP).
- Establishing effective mechanisms for debt restructuring and relief based on the participation of all developing countries with agreed procedures, incentives and deterrents.

## A. INTRODUCTION

Two key sets of factors have shaped the recent evolution in international markets. On the one hand, the year 2022 marked the culmination of the pandemic recovery. In this sense – and considering the risks to global growth discussed in chapter I – the world economy now begins a post-COVID-19 pandemic period conditioned by a few decisive elements whose overall impact is difficult to predict. These include a tighter monetary stance by central banks in advanced countries; a more geostrategic policy approach to international economic relations; the growing influence of industrial policy on trade strategies of major economies; and multiple geoeconomic uncertainties.

On the other hand, the post-pandemic cycle reveals trends that build upon pre-existing structural weaknesses in the global economy, which pre-date the COVID-19 shock. These are particularly onerous for developing countries and relate to:

- The growing concentration of export markets and related asymmetry of income distribution;
- A slowdown in investment and an unsustainable burden of debt;
- A widening technological divide;
- The mounting costs of the climate crisis and related challenges around the energy transition.

The intertwining of conjunctural and structural concerns poses governance challenges for today's highly interdependent global economy. In addition to the gaps in the international financial architecture analysed in Part II of this Report, there are serious concerns about the rule-based multilateral trading system given the diminishing prospects of achieving the kind of harmonious and stable order required to meet the goals of the 2030 Agenda and the targets set by the Paris Agreement.

If, and how, policymakers will meet these governance challenges over the coming months will determine whether the world avoids a global recession in 2024; whether developing countries avoid a “lost decade”, and whether the currently fractured multilateral system ends the decade in more robust health.

Finding the right response will require policymakers to adopt a long-term perspective and a holistic approach. Many longstanding concerns of developing countries regarding the international trading system, including distorted agricultural markets, food insecurity, premature de-industrialization and restrictive business practices, have never been adequately addressed, often leading to winner-takes-most outcomes rather than the win-win results envisaged in canonical trade models.

This chapter addresses these dilemmas, surveying recent developments in international trade (section B), commodity markets (section C) and international capital markets (section D), with the aim of identifying priority areas that require multilateral attention.

## B. TRADE

After experiencing a rollercoaster ride in 2020–2022, global trade in goods and services is forecast to grow about 1 per cent in 2023, significantly below world economic output growth (chapter I). It is also lower than the average growth registered during the last decade, itself the slowest average growth period for global trade since the end of the Second World War. In the medium term, trade is heading back to its subdued pre-crisis trend; in the near term, it will stand even below this figure. This is because the growth of merchandise trade has hovered around negative territory in 2023, despite global trade in services showing resilience.

*“Global trade is forecast to grow about 1 per cent in 2023, significantly below world economic output growth, with merchandise trade hovering in negative territory.”*

Behind these observations lie deeper shifts in the structure of global trade and a transformation of the political readings of the role of international trade today. Many of these changes concern the governance system that emerged with the conclusion of the Uruguay Round in 1994 and the creation of the World Trade Organization (WTO).

If the 1980s and the 1990s are commonly described as the period of trade liberalization, the past three decades were marked not so much by reducing trade tariffs and barriers to investment but by changes to domestic regulatory standards and norms within national jurisdictions. The global regulatory architecture that emerged as a result of these reforms has benefited the interests of big business, such as international banks and other multinational enterprises (MNEs), above all else (Rodrik, 2023). As many developing countries were on the receiving end of these reforms, their policy space has been progressively diminished by the recent crises.

The asymmetry of gains from the international trading system, apparent in both the advanced and developing countries, has been building into a backlash against the rules of global governance and, increasingly, the very idea of free trade. This backlash is prompting policymakers to reassess their strategic prioritization of the role of trade. In the unfolding policy debate on the regulatory architecture of global trade, the potential costs of deeper trade relations are no longer seen as marginal. Similarly, the notion that the benefits from deregulation reforms

– to developed and developing countries alike – would flow automatically has never been challenged so strongly and so widely. Instead, managing trade increasingly turns on harnessing strategic interests with the support of State actors, much more willing to intervene in the workings of markets, both domestic and international (Sullivan, 2023; Hudson, 2022).

*“The asymmetry of gains from the international trading system, apparent in both advanced and developing countries, has been building into a backlash against the rules of global governance and the very idea of free trade.”*

discussions around trade policy. The turning tide is also visible in an emergent new paradigm of trade that approaches the challenge of global economic interdependence from a more strategic standpoint that can better accommodate new policy priorities, such as reducing inequality, building resilience, and accelerating the energy transition (Rodrik, 2023).

A new lexicography of trade reflects these ongoing shifts, with a series of buzzwords, such as “fragmentation”, “deglobalization”, “slowbalization”, “reshoring”, “nearshoring”, “friendshoring”, “de-risking”, “decoupling”, “open strategic autonomy” and “new industrial policy” peppering current

The question to what extent the emergent consensus on the need to reform international trade can be translated into a new regime of international trade remains open. What is already apparent is that a significant reshaping of world trade, including the restructuring of global supply chains, is under way. Navigating this

transformation poses major challenges to most developing economies at a time when their prospects for economic growth are deteriorating, the investment climate is worsening, and financial stresses are mounting (see chapter I and section D below).

*“A significant reshaping of world trade is under way. Navigating this transformation poses major challenges to most developing economies.”*

If history is any guide, as national security and geopolitical considerations move to the centre of the policy stage, not only will multilateral options struggle for attention, but many developing countries risk being caught in the crossfire of trade disputes or face growing pressure to take sides in economic conflicts they neither want nor need. Furthermore, the rise of protectionist unilateral trade measures and the more widespread use of industrial policies in large economies can adversely impact developing economies’ exports and hinder their prospects for structural transformation.

Some developing countries may see gains from a restructuring of global supply chains in the near-term. Similarly, a green investment boom in advanced economies might bring opportunities for some fortunately endowed countries, such as exporters of strategic minerals. Yet, sustainable developmental success will require parallel support to promote access to reliable (and cheaper) sources of finance, a rebalancing of trade rules and levelling the playing field.

This, in turn, includes policies that facilitate technology transfer and reduce the market power of large MNEs, as well as enabling developing countries to add more value domestically to their exports, including through greater processing of raw materials. What is more, an analysis of several key indicators relating to income distribution and power asymmetry confirms that development cannot be reduced to increased trade flows, and that achieving the Sustainable Development Goals (SDGs) requires a set of proactive policy strategies and institutions that reflect economic, social and environmental priorities of the developing countries.

## 1. Review of recent cyclical developments in international trade

Recent trends in international trade provide a mix of good and bad news, with the balance tipping to the negative side, especially when looking beyond conjunctural indicators and considering some recent developments relating to trade policy (subsection 2) and the distributional impact of trade (subsection 3).

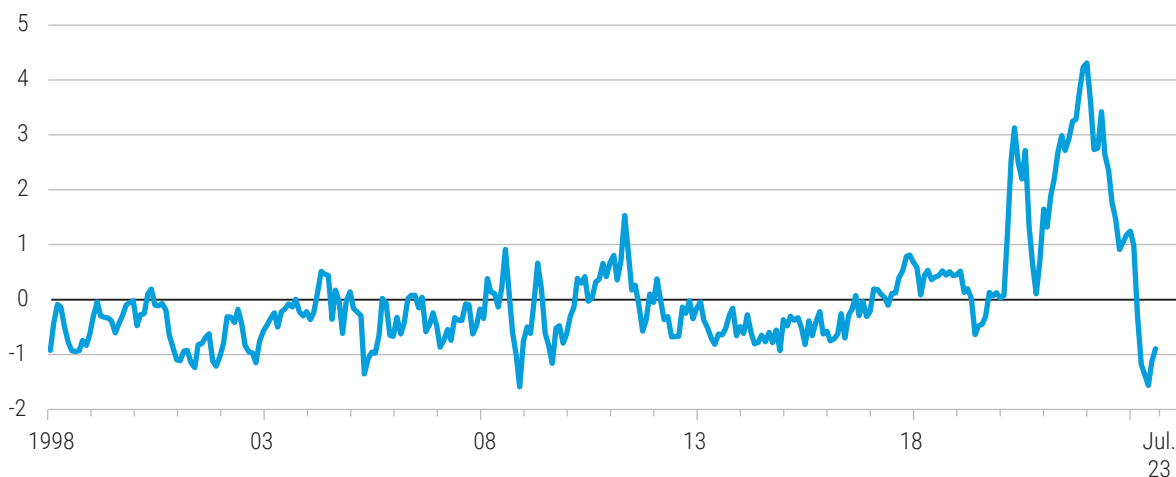
*“The normalization of cyclical trade indicators should not mask the ongoing tectonic shifts that are taking place in international trade policy settings.”*

On the positive front, several indicators suggest a return to some form of normalcy after the collapse and recovery that followed the COVID-19 outbreak, with the major supply-chain disruptions that took place between 2020 and 2022 coming to an end (figure II.1). Altogether, this is expected to ease pressures on prices owing to the end of the lockdowns in China, the normalization of trade composition after the COVID-19 boom in demand for manufactured goods, the stabilization of transport logistics for goods in several developed countries, and adjustments to the effects of the war in Ukraine and the economic sanctions that followed.

The trend towards normalization is also reflected in the sharp drop of international maritime freight rates for container and dry bulk during the second half of 2022, after a surge to historical highs in the aftermath of the COVID-19 outbreak (figure II.2).

### Figure II.1 The sharp swing of supply chain pressures after their COVID-19 highs

Global supply chain pressure index  
(Standard deviations from average value)

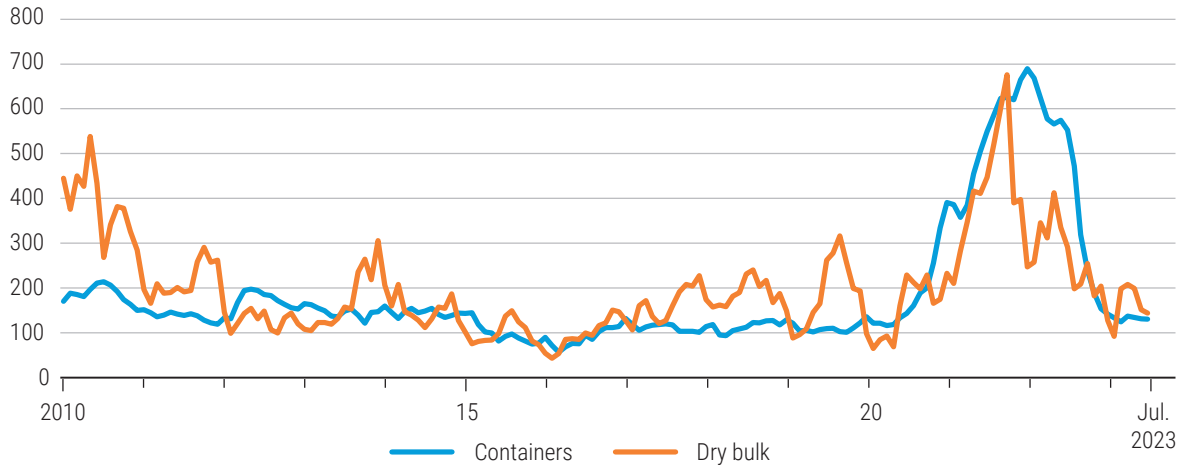


**Source:** Benigno et al. (2023).

**Note:** The Global Supply Chain Pressure Index (GSCPI) integrates transportation cost data and manufacturing indicators to provide a gauge of global supply chain conditions, by considering a number of metrics with the aim of providing a comprehensive summary of potential supply chain disruptions. For global transportation costs, it includes data from the Baltic Dry Index and the Harpex index, as well as airfreight cost indices from the United States Bureau of Labor Statistics. GSCPI also uses several supply chain-related components from Purchasing Managers' Index (PMI) surveys, focusing on manufacturing firms. The index is normalized such that a zero indicates the index is at its average value, with positive values representing how many standard deviations the index is above this average value (and negative values representing the opposite).

**Figure II.2 Maritime freight rates have returned close to their 2010s average**

Monthly rates, dry bulk and containers  
 (Index numbers, average 2015=100)



**Source:** UNCTAD calculations based on Clarksons Research Shipping Intelligence Network database.

**Note:** “Dry bulk” relates to the Baltic Exchange Dry Index and “containers” to the Shanghai Containerized Freight Index (SCFI) Comprehensive index.

Furthermore – and relevant for trade in services as it relates to both international transport and tourism, two of its main components – the recovery in international air traffic has continued after the sector was hit hard by the pandemic. Global air revenue-passenger kilometres (RPKs) – which indicates the number of kilometres travelled by paying passengers – was only 9 per cent below pre-pandemic levels in May 2023. This followed an expansion of almost 50 per cent year on year, owing partly to China reopening its international markets, which resulted in an almost threefold annual increase for Asia–Pacific carriers (figure II.3).

All the above positive trends pushed international trade, when measured in current dollars, to an all-time high of around \$32 trillion in 2022, an increase of 13 per cent compared to 2021 and a rise of 25 per cent from the pre-COVID-19 levels of 2019. However, a pertinent factor behind this result relates to the *sharp price increases in some heavily traded commodities*, especially energy and to a lesser extent agri-food, metals and minerals. When measured in constant prices, international trade, both goods and services, recorded an increase of about 3.5 per cent in 2022.

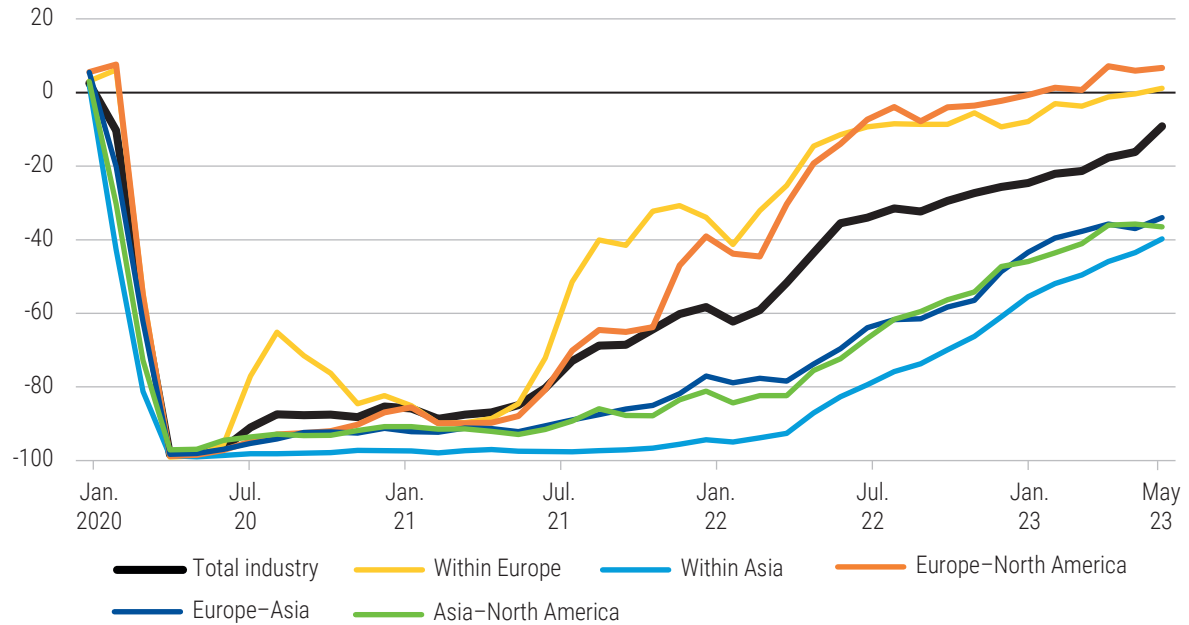
Under a more granular examination, quarterly data shows that merchandise trade peaked during the second or third quarters of 2022 – depending on whether figures are looked at in constant (volumes) or current prices (values) (figure II.4). Over the subsequent quarters, declines set in, albeit more slowly when controlling for the negative price effects (dashed line). This was unexpected to most observers, who had anticipated a significant rebound owing to a normalization of the inventory cycle and a relaxing of the pandemic restrictions in China. Preliminary estimates for the second and third quarters of 2023 confirm the downward trend as the post-lockdown rebound has waned and expectations about international merchandise trade prospects have deteriorated (*Financial Times*, 2023a).

Regarding trade in services, this subaggregate component also receded during the second half of 2022, while estimates for 2023 show resumed growth during the first half of 2023. This highlights the overall resilience of some of the services sectors, even if the overall growth over the last five quarters has been weak.

As a result, the annual growth of international trade in goods and services is expected to decelerate to about 1 per cent in real terms in 2023, less than half the already subdued growth of global economic activity (chapter I). Moreover, multiple downside risks remain, which could further impact the trade outlook. These include, inter alia, ongoing trade tensions between major economies, the weakening of global demand and growing geopolitical uncertainties.

**Figure II.3 International air passengers flying high: But Asia still not at cruising altitude**

International revenue passenger kilometres, year-on-year change compared to 2019  
(Percentage)

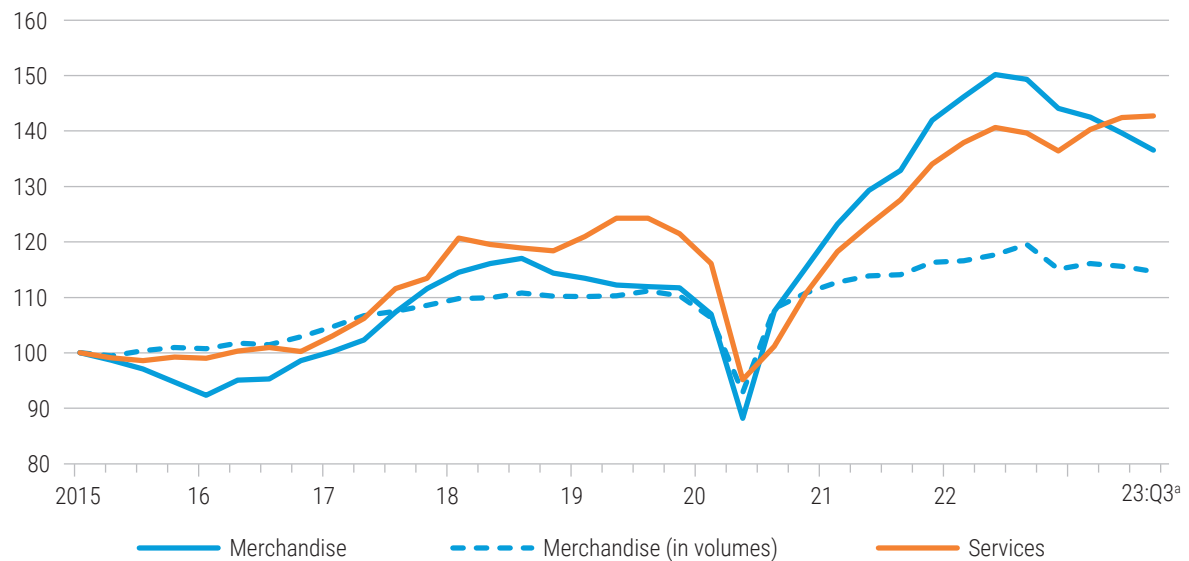


Source: UNCTAD calculations based on IATA (2023) *Monthly Statistics by Route Area* (May).

Note: The figure depicts the top five route areas in 2019, ranked by performed traffic level. RPKs corresponds to the sum of the products obtained by multiplying the number of revenue passengers by the flight stage distance (one RPK means that one passenger is carried on one kilometre).

**Figure II.4 Global trade: Merchandise is declining while services appear more resilient**

Quarterly world trade, merchandise (in values and volumes) and services (in values)  
(Index numbers, first quarter of 2015=100)



Source: UNCTAD calculations based on UNCTADstat database.

Note: All series are seasonally adjusted.

<sup>a</sup> Estimates from UNCTAD nowcasts for the second and third quarters of 2023.



## 2. A new paradigm of international trade?

The subdued trade outlook coincides with a renewed focus on policy matters. For much of the post-World War II era, policy decisions on trade were built on a relatively straightforward set of assumptions. A general commitment to openness tempered by abiding sectoral priorities and security concerns, combined with a recognition that the places where goods were made largely coincided with where jobs were created and profits registered (and reinvested).

While the connections were never perfect, particularly in developing countries, international trade was seen, both academically and politically, as an important lubricant that could help support a virtuous circle connecting jobs, investment, productivity, and incomes. Even where the required international linkages were weak, broken, or missing altogether, the “permissive international trade regime” embedded in the post-war global economic architecture gave governments the policy space and tools to repair or replace them. It also allowed governments to “create social and economic institutions that suited their individual preferences and needs” (Rodrik, 2023). That stopped being the case a while ago.

The evolution of global value chains, the financialization of corporate structures, the adoption of one-size-fits-all policy programmes and the squeezing of national fiscal autonomy have narrowed the room for policymakers aiming to align their efforts at integrating into the global economy with national and local priorities. For many developing countries, this challenge has coincided with uneven growth spurts coexisting with weak job creation (at least in the formal economy), structural regression towards less diversified economies, including through “premature de-industrialization”, increased commodity dependence and widening social divisions.

The limits of the labour-intensive trade-led growth model and the unequal benefits from trade integration became a growing concern before the pandemic (e.g., World Bank, 2020). During the past two years, this concern further transformed into a set of moves that point to a new political economy of trade governance. In the emergent “new consensus”, globalization in general, and trade liberalization specifically, are secondary to the goals of building resilient supply chains, supporting a just energy transition, delivering decent jobs, tackling corruption and corporate tax avoidance, and developing a secure digital infrastructure (Luce, 2023).

In a candid statement, the National Security Adviser to the President of the United States, argued that, not only did meeting these goals move trade policy beyond a simple call to reduce tariffs, it also abandoned the assumption that “trade-enabled growth would be inclusive growth, that the gains of trade would end up getting broadly shared within nations” and rather took the view that a more integrated policy approach was required, built around a dedicated industrial strategy and new international partnerships (Sullivan, 2023).

These are laudable aims, long advocated by UNCTAD and previous editions of this report (e.g., TDR 1997, 2018). But without adequate policy coordination at all levels of policymaking, the move towards a new set of priorities for international trade governance can generate tensions among trading partners. It also can raise serious concerns, particularly for developing countries with no fiscal space, if the approach is adopted unilaterally and without careful consideration of the implications for established multilateral practices and procedures. Some aspects of these tensions, current and potential, are examined below.

### a. The trade dispute between China and the United States

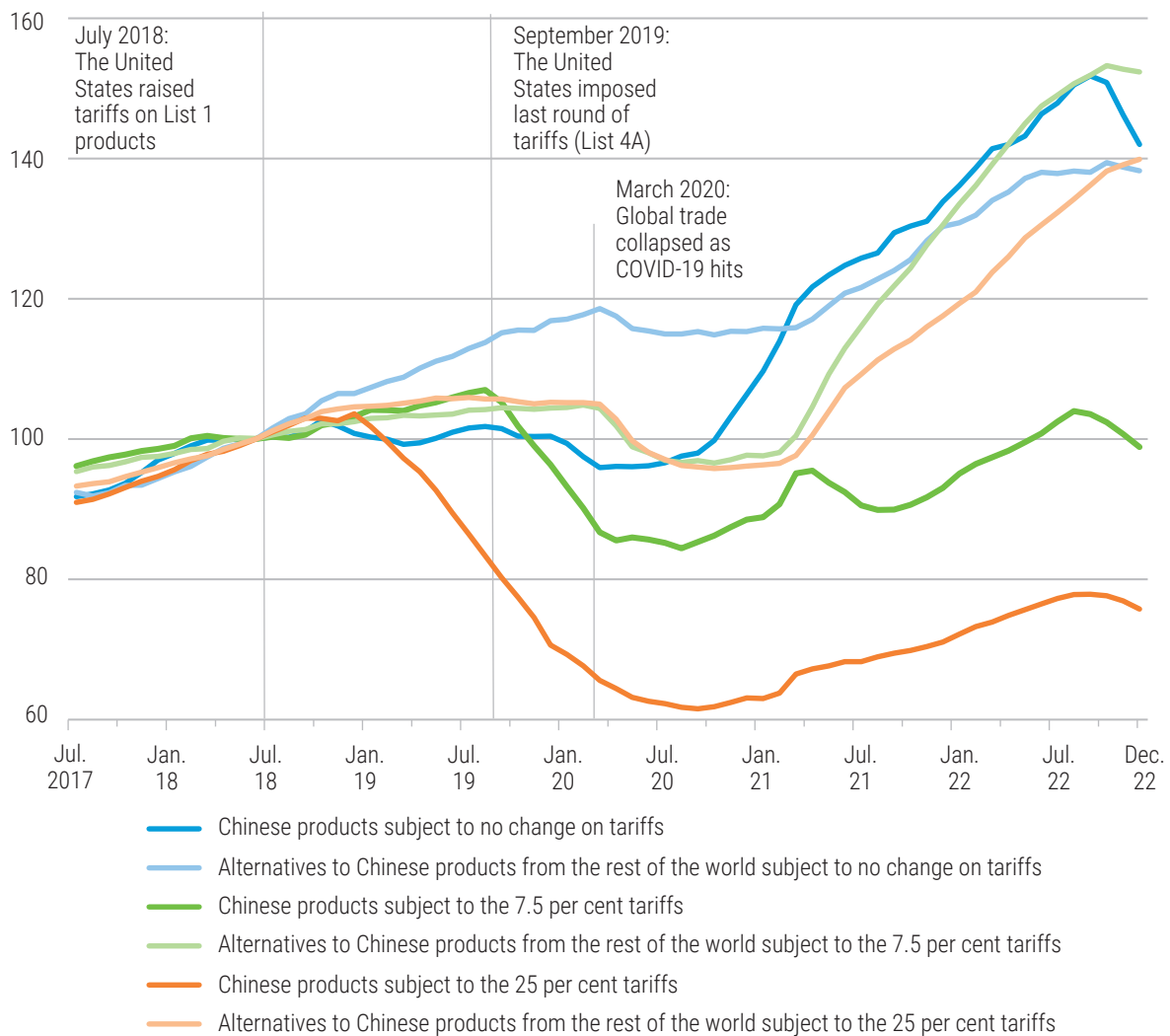
This century has seen the United States displaced by China as the world's leading exporter of manufactured goods (chapter I). While a growing trade deficit with China provoked intermittent responses from legislatures in the United States (Siripurapu and Berman, 2022), a more assertive stance began only in 2017, with progressive increases in tariff on exports from China. This has resulted in significant trade diversion, mostly to the benefit of main economic rivals to China, including Mexico and the European Union (Moody's Analytics, 2020), though some policy details have also created worries, and at times outright disapproval, among these beneficiaries.



A paradox of the current trade dispute between the world's two largest economies is that total imports of goods to the United States from China have returned to their pre-COVID-19 peak. This is due to the sharp increase in products not subject to tariffs (figure II.5). Bilateral imports of both goods and services from China to the United States reached the highest level ever recorded, at \$564 billion in 2022, as services continue to expand. The United States remains by far the main destination for exports of merchandise from China; followed by Japan, Republic of Korea, Viet Nam and India.

**Figure II.5 The paradox of United States-China trade decoupling**  
**The merchandise imports by the United States from China that were subject to increased tariffs have followed a divergent trend. The rest of the bilateral imports continued to rise until mid-2022, resulting in the total bilateral import bill of 2022 nearly matching its record high of 2018**

Goods imports of the United States from China and the rest of world by tariff list  
 (Index numbers, June 2018=100)



**Source:** Bown (2023) based on United States imports data from the United States Census Bureau and the Bureau of Economic Analysis.  
**Notes:** Lighter lines refer to imports from the rest of the world, which have therefore not been subject to increased tariffs by the United States. All series refer to 12-month trailing sums of not seasonally adjusted import data. A “list” refers to the group of products subject to the United States tariffs imposed on imports from China under Section 301 of the Trade Act of 1974. “Chinese products subject to the 25 per cent tariffs” relates to goods appearing in lists 1, 2 or 3. “Chinese products subject to the 7.5 per cent tariffs” relates to goods appearing in list 4A.

At the same time, notwithstanding this recovery, the trade dispute has imposed costs on the trading partners. A large body of research shows that real incomes have been adversely affected in both countries due to the tariffs, with consumers of imported goods shouldering the burden through increased prices (e.g., Amiti et al., 2019; Cavallo et al., 2021; Fajgelbaum and Khandelwal, 2022). Fajgelbaum et al. (2023) find that it also opened new trade opportunities for “bystander” countries rather than just causing shifts among existing trade partners.

While the precise trigger of the process is yet to be ascertained, this may be explained by the fact that countries that became the beneficiaries of the trade war (e.g. Czechia, Malaysia and Mexico, according to Fajgelbaum et al., 2023) might have viewed it as an opportunity to invest in new facilities, trade infrastructure, or trade and investment facilitation, or alternatively, because these countries might have enjoyed better credit reallocation conditions (Hassan et al. 2020). Alternatively, they might have already been well integrated into global trade, allowing them to seize new exporting opportunities across various sectors. Importantly, the significant diversity of the benefiting economies (not the sectors) suggests that country-specific reforms and institutions can be key determinants in driving how countries’ exports respond in this new era of post-pandemic globalization.

## **b. The rise of export controls**

New export controls have been another manifestation of the shifting sentiment around trade policy across the globe. These have mostly covered three types of non-mutually exclusive objectives: (i) securing domestic supply, (ii) restricting geopolitical rivals, and (iii) encouraging investment in locally based processing facilities.

### *(i) Securing domestic supply*

With regards to domestic supply concerns, the current WTO rules allow for temporary export restrictions or prohibitions to prevent or relieve critical shortages of essential products, provided all measures are communicated, have phase-out timelines and are proportionate to the scale of the problem at hand.

A key issue here is to define what can be considered as proportionate. During COVID-19, for instance, over 80 countries resorted to banning exports of medical and personal protective goods in the early phases of the pandemic (UNCTAD, 2021a). Similarly, following the outbreak of the war in Ukraine in early 2022, almost 100 export restrictions on essential agricultural commodities were identified to have been applied by 35 WTO members or observers (WTO, 2023).

Overall, such unilateral measures often do more harm than good, which begs the question of whether the international community should not come up with stricter rules, especially on essential goods such as medicinal products or food, to ensure that similar future practices are better controlled and do not result in a negative spiral that ultimately hampers the resilience of all. Discussions have been continuing for some time, yet no significant agreement has been reached and it is unlikely to emerge before the WTO Thirteenth Ministerial Conference of February 2024, at best.

### *(ii) Constraining geopolitical rivals*

A plethora of additional geopolitical-related export restrictions – such as non-automatic licensing, incomplete rebate of value added tax (VAT) on exports or even outright bans – have also emerged in recent years. Under Article XXI of the General Agreement on Tariffs and Trade (GATT), “national security” has long provided an umbrella for derogation of international trade rules. The war in Ukraine, along with concerns about potential future military conflicts, has only strengthened that position. As a result, the supply of different raw materials critical for the green transition or for food or industrial production has been affected after several exporters implemented such measures (OECD, 2022).

In other cases, these curbs have related to high-technology components, for example the overseas sales of chip-making technology, as well as sales of advanced chips to some countries including, China, by the United

States in October 2022. This was later followed by Japan and the Kingdom of the Netherlands. Other similar interventions relate to the efforts of the United States to exclude Chinese companies from participating in the development of global digital infrastructure for security concerns such as the development of the global submarine cable market (*Financial Times*, 2023b). Elsewhere, Poland, Slovakia, Hungary and Romania have imposed a ban on the import of Ukrainian grain, even as the European Union discontinued its own ban in September 2023 (AP News, 2023).

### *(iii) Encouraging investment in locally based processing facilities*

Export restrictions aimed at boosting value addition domestically and building forward linkages within the country are, from a developmental perspective, becoming an objective for some commodity exporting countries. In this vein, Indonesia has encouraged investment in locally based processing facilities relating to the global energy transition by limiting its nickel exports through successive policies since 2009. This culminated in a complete ban on nickel ore exports in 2014 (UNCTAD, 2017).

The European Union disputed this policy at the WTO, and in November 2022, a Panel recommended that Indonesia brings its measures into conformity with its obligations under the GATT 1994. Indonesia subsequently appealed that decision, and as of now, the case is pending due to the current non-operational status of the Appellate Body.<sup>1</sup> More recently, Zimbabwe, in December 2022, and Namibia, in June 2023, also announced the ban of exports of unprocessed critical minerals including rare earths and lithium to try to build more of the supply chain for processing raw materials domestically (Africanews, 2022; Reuters, 2023).

In this instance, and notwithstanding the specific aspects of each commodity and situation, UNCTAD has long maintained that effectiveness of such types of trade policy depends on the non-substitutability of the commodity in question. If ready substitutes for the product are available in international markets, other exporters are likely to benefit from these export bans.

The trade-off between national policy autonomy and global and regional economic integration is difficult to manoeuvre for most developing countries. Insufficient policy space can prevent governments from addressing local needs, ultimately undermining the effectiveness and trust in global regulations. One metric for assessing the appropriate balance of policies for a country's needs can be the effectiveness of a policy in promoting economic diversification and advancement. This is provided there is no superior alternative option for achieving the same objective for all parties involved.

*“One metric to gauge the adequacy of export restrictions of raw materials to promote domestic processing facilities by developing countries should be how well a policy can promote economic diversification and advancement.”*

### **c. The growing use of subsidies and other trade instruments by developed countries to foster the green transition**

The growing use of subsidies – sometimes discriminatory – has emerged, notably in developed countries that have rediscovered a more active role for industrial policies to promote investment and jobs at home and facilitate the transition to green practices. In the United States, there have been a series of interrelated legislative initiatives – the Inflation Reduction Act (IRA), the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and the Infrastructure Investment and Jobs Act (IIJA) – which promote new spending and tax credits aimed, inter alia, at supporting key sectors of the economy – electric vehicles, green manufacturing, the semiconductor industry, and renewable energy production – as well as addressing regional divergence, labour market inequalities, and national security issues.

In the European Union, under the banner “open strategic autonomy”, the main relevant frameworks are the Green Deal Industrial Plan (GDIP) and its Net-Zero Industry Act (NZIA). GDIP will include multiple funding approaches and places an emphasis on workforce training, aiming to equip European workers with the

<sup>1</sup> For more details, see [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds592\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds592_e.htm).

necessary skills to maximize their employability during the energy transition. NZIA will ease the regulations on state aid regarding allowable domestic subsidies, to cover more types of clean energy projects. Also, the European Union intends to extend its support to domestic manufacturing through the implementation of the European Sovereignty Fund, offering subsidies for select industries. However, unlike the initiatives in the United States, there are no clear budget lines attached to these proposals, with some countries arguing that it is simply a way to allocate unused funds from the Recovery and Resilience Facility of the European Union as well as other existing funding programmes (such as InvestEU, REPowerEU, and Innovation funds).

Though they stand outside the subsidy provision, when it comes to trade, two parts of the overarching GDIP are particularly pertinent: the carbon border adjustment mechanism (CBAM) and the Deforestation Regulation (EUDR). CBAM is scheduled to start in October 2023, while the EUDR entered into force in June 2023.<sup>2</sup>

These initiatives have raised concerns around the world, especially among developing countries (e.g., UNCTAD, 2021b). Several countries, including China, are expected to challenge it at WTO, partly because the introduction of distinct carbon pricing certificates based on a product's country of origin might infringe upon the WTO "most favoured nation" (MFN) principle (Garg, 2022). Moreover, they risk unfairly penalizing the exports of developing countries because these economies have often less capacity to adapt to new specific standards. Furthermore, by imposing equal carbon taxes on developed and developing nations, the proposed CBAM would also violate the Paris Agreement principle of "common but differentiated responsibilities" (CBDR). With respect to EUDR, exporting countries are concerned that the traceability requirement will be impractical and could constitute a *de facto* import ban.

*"The fact that recent initiatives were not discussed multilaterally, even though developing countries will bear a significant part of the consequences, is problematic."*

In other words, it is important for every nation to acknowledge its role in addressing a common global challenge like climate change or deforestation. However, it is unfair to place equal demands on less affluent countries, compared to wealthier ones. Historically, wealthier countries have generated a greater amount of carbon emissions over time – and continue to do so. Many of them have also carried out significant levels of deforestation. This calls for better alignment between the non-discrimination and the CBDR principles,

for which the coherence between special and differential treatment provisions (SDT) and CBDR could offer a starting point for understanding a development-sensitive approach to the trade-climate nexus.

Also, the fact that these recent initiatives were not discussed multilaterally, even though developing countries will bear part, and most likely a significant part (TDR, 2022), of the consequences, is problematic (Rajan, 2023). Weighing the advantages of domestic climate-oriented industrial policies against their adverse impacts on trade relations will likely require an independent assessment, including a revamping of some WTO agreements, notably to ensure that (green) technology is adequately shared with the developing world. This is a pressing concern because as green industrial policy strengthens, trade policies and environmental goals are now interacting much more closely.

### 3. Revisiting the distributional impacts of trade

That increased trade flows have not always been accompanied by considerable progress in terms of development outcomes is a longstanding concern of UNCTAD since its creation in 1964. While the trading system has undergone significant changes in the intervening years – particularly since the implementation of

<sup>2</sup> Under CBAM, importers in the European Union buy carbon certificates corresponding to the carbon price that would have been paid, had the goods been produced under the carbon pricing rules of the European Union. It is a policy tool to reduce the risk of carbon leakage, i.e., preventing the importers of the European Union from diverting purchases to foreign goods that may be cheaper than the equivalent of the European Union but more carbon-emitting. Yet, the measure may be perceived as an additional tariff on a specific import, the rate of which corresponds to the carbon price of the European Union (European Commission, 2021). EUDR requires foreign exporters to the European Union of commodities like soybeans, beef, palm oil, wood, cocoa, coffee, rubber and some of their derived products to prove that products do not originate from recently deforested land or have contributed to forest degradation.

the Uruguay Round agreement – insufficient attention to their distributive impact explains, in part, why many developing countries, and more recently some constituencies in developed economies, have expressed their discontent towards the current rules and practices of the international trading system (Davies et al., 2021; Levell and Dorn, 2022; Rodrik, 2022).

The expansion of trade in the era of hyperglobalization has been closely tied to the spread of global value chains (GVCs) controlled by lead firms, primarily headquartered in advanced economies (TDR, 2018: chap. II). In parallel, more developing countries have participated in the international division of labour by providing specific links in these chains, drawing on their abundance of unskilled labour. The promise was that such fledgling manufacturing activities, through a mixture of upgrading and spillover effects, would quickly establish robust and inclusive growth paths aligned with their comparative advantage.

The success of this model has been neither uniform nor certain (cf. World Bank, 2020). This raises questions about the strong bets made in many developing economies on the spillovers expected from processing trade, because unless developing countries manage to capture part of the surplus created by these GVCs and reinvest it in productive capacities and infrastructure, immediate gains in output and employment are unlikely to translate into a dynamic move up the development ladder. In short, replicating the successes that have been registered in several developing countries, mostly in East and South-East Asia, has proven difficult elsewhere.

*“The rise in big profits for MNEs, together with their growing concentration, is pushing down the global labour income share, exacerbating income inequality.”*

Moreover, along with the rise of export market concentration, large firms have increased their ability to extract rents. Empirical evidence suggests that part of the surge in the profitability of top MNEs – a proxy for the very large firms dominating international trade and finance – together with their growing concentration, has acted as a major force pushing down the global labour income share, thus exacerbating personal income inequality. It has also led to unequal trading relations even as developing countries have deepened their participation in global trade. Chapter III examines the problems of market concentration in the global food trading sector in detail.

Assessing distributional concerns, both within and across countries, usually comes with delays due to difficulties in data availability and measurement. To help address these difficulties, the empirical analysis proposed below builds on TDR (2018: chap. II). More concretely, this subsection provides an update of previous findings in two areas: (a) the concentration of exports among firms within developing countries, and (b) the evolution of labour and capital income shares, especially for the top 2,000 largest firms in the world.

While a fully-fledged analysis is beyond the scope of this chapter, this update gives an indication of the role trade has played vis-à-vis these metrics during the COVID-19 pandemic years, with new data supporting two main findings:

- Export concentrations appear to have strengthened in the majority of the observed developing countries between the pre-pandemic period and the COVID-19 years.
- Factor income distribution has continued to shift further in favour of capital-owners during the COVID-19 pandemic years, with the profits of the largest 2,000 firms worldwide accounting for the bulk of this gain. This mirrored the continued decline of the labour income share globally.

The details of these findings are further discussed in the remaining part of this subsection.

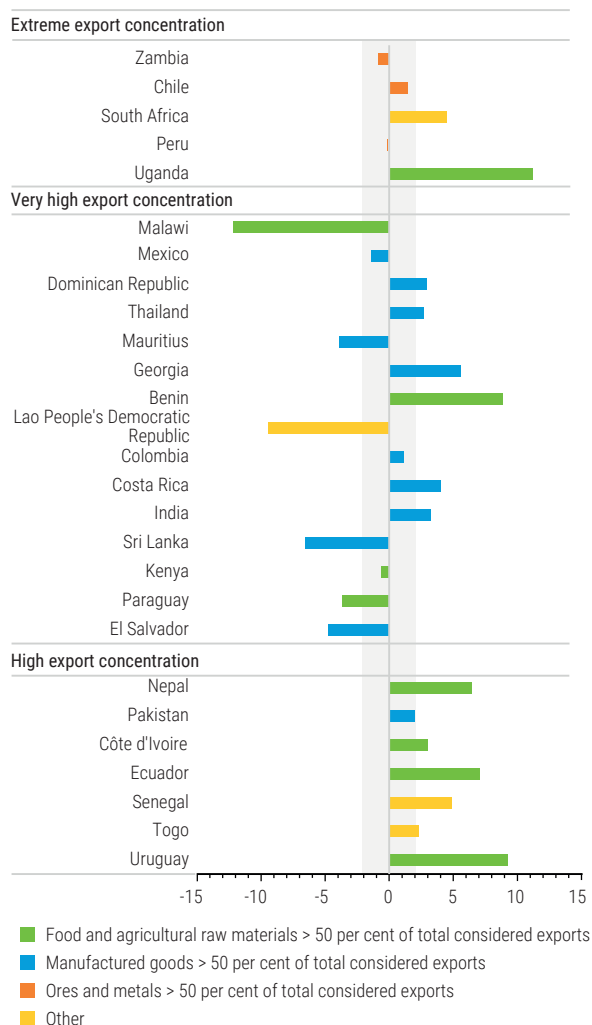
#### a. Concentration in export markets has strengthened in recent years

International trade has long been dominated by large MNEs that trade and invest abroad. This greater market access has often led to unequal gains, and these gains disproportionately benefit a minority of economic entities. This finding is also valid in developing countries.

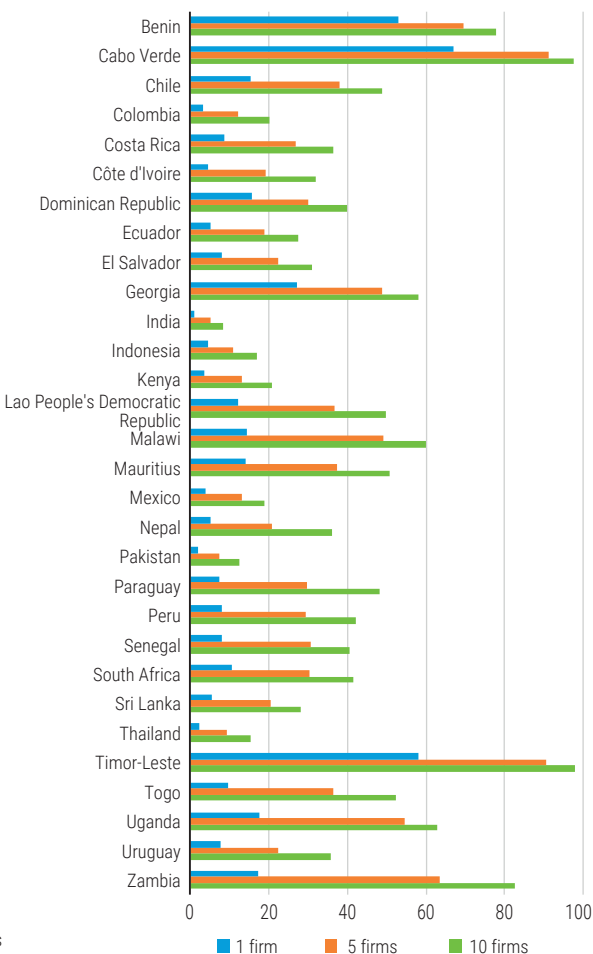
The recent update of the *Exporter Dynamics Database* by Fernandes et al. (forthcoming) – which provides aggregated firm-level data on goods exports (excluding the oil sector, as well as services) for 30 developing countries for the period of 2020–2022 – confirms this stylized fact. Data show that within each country the top 1-per cent largest exporting firms altogether received between 40–90 per cent of the total export revenues of the entire country (figure II.6).

**Figure II.6 During the pandemic, export concentration strengthened further in more than half of surveyed developing countries**

**A. Changes in countries' exports shares of the top 1-per cent exporting firms by types of export specialization: 2015–2019 vs. 2020–2022**  
 (Percentage points)



**B. Shares in a country's exports by its largest exporting firms, 2020–2022**  
 (Percentage)



**Source:** UNCTAD based on the 2023 release of the *Exporter Dynamics Database* described in Fernandes et al., 2016.

**Notes:** The current version of the database includes 30 developing countries with data for 2020–2022, of which only 27 economies also have data for 2015–2019. The database reports aggregated firm-level data on goods exports (excluding the oil sector and services) within the very restricted circle of exporting firms. In panel A, countries are sorted in a descending order of their export concentration. Moreover, “extreme” export concentration designates countries where the top 1-per cent firms accounted for more than 70 per cent of total exports in 2015–2019. Similarly, “very high” and “high” export concentration designate countries where the top 1-per cent firms accounted for between 50 and 70 per cent, and between 36 and 49 per cent, respectively.



What is more telling still, is that this indicator of export concentration has increased in recent years in more than half of the developing countries included in the database. The statement is based on a comparison between the average export shares that accrue to the top 1-per cent exporting firms in each country during the 2015–2019 period versus the one that was registered during the 2020–2022 pandemic years.

These results presented in figure II.6.A show a trend towards further export concentration after COVID-19. More precisely, out of 27 countries for which sufficient data exist, the aggregated share in total exports of the top 1-per cent largest exporters had increased by at least 2 percentage points in 14 cases. The average increase for this group of 14 countries was almost 6 percentage points.

Notably, as figure II.6.A shows, it is mostly countries specialized in food and agricultural raw materials or manufactured goods (5 jurisdictions each) that accounted for the bulk of these increases. Figure II.6.A also points to the fact that in the 7 countries with the lowest export concentration in the 2015–2019 period (ranging between 36–50 per cent), the share of exports accruing to their top 1-per cent firms increased in all these jurisdictions by an average of 5 percentage points within this relatively short time span.

By contrast, export concentration had significantly diminished (i.e., a decline of at least 2 percentage points) in only 6 countries out of 27. For those economies, the average decline was less than 3 percentage points. Meanwhile, export concentration had remained rather constant (i.e., an absolute change of less than 2 percentage points) in the 7 remaining countries. Out of these 7 cases, 3 jurisdictions are considered as ores and metals exporters. Their exports were already extremely concentrated on the eve of the COVID-19 shock, in the sense that each country's top 1-per cent exporting firms accounted in aggregate for more than 70 per cent of the total country exports in 2015–2019.

Focusing further on the top firms, this time in absolute numbers, not in relative terms, figure II.6.B shows that foreign trade is often dominated by just a handful of firms. For instance, when the sample is restricted to the largest exporting firm(s) – unlike above, the number of entities, not the top percentage(s) of firms – within each country, data show that for the period 2020–2022, the share of total exports can sometimes exceed 50 per cent for one single firm. Moreover, except for a few outliers in the database, there is only a handful of countries where the share of the 10 largest firms represents less than 20 per cent of the total exports. In general, the value is much higher. For instance, the median is about 40 per cent, and it is common to see figures above 50 per cent. One outlier is India, which records the smallest figure in the database. Its 10 largest firms account for 8 per cent of its total exports, although the total number of exporting firms exceeded 123,000 in 2021.

To sum up, recently released data confirm that the levels of export concentrations among large MNEs are elevated across the board and that this tendency has strengthened during the pandemic years. These findings raise concerns about market control and the distribution of the gains from trade. This topic is addressed below by looking at the evolution of the factor income and the role played by MNEs worldwide in contributing to income inequality.

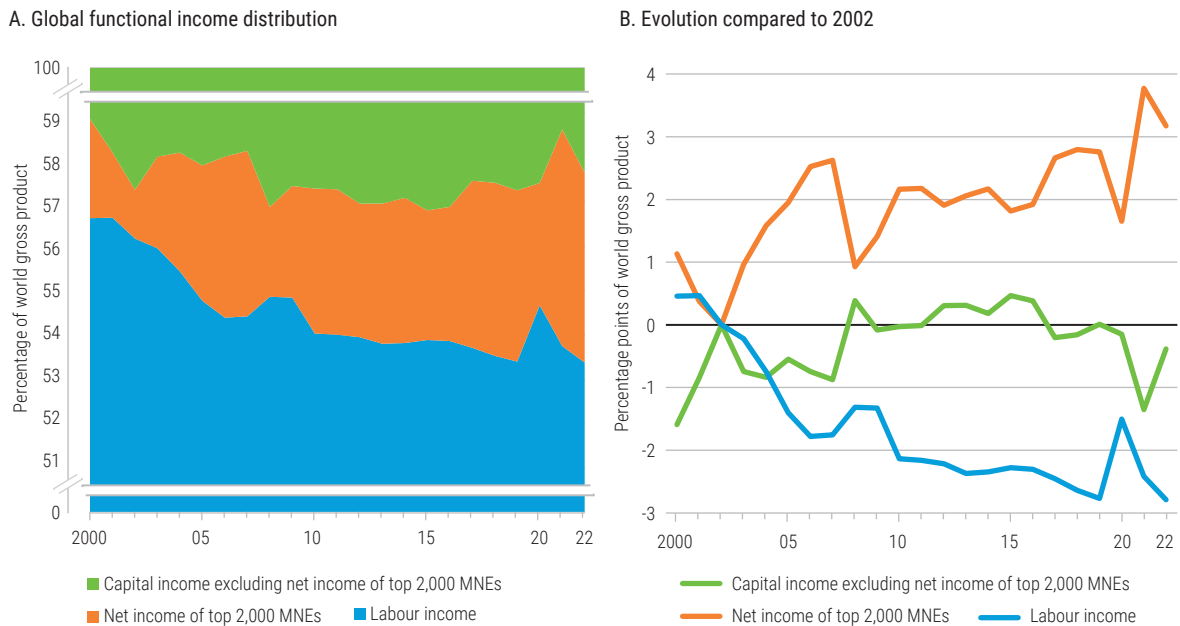
### b. Asymmetry of world income distribution deepens

Another metric to examine when analysing how the activities of large firms affect income distribution globally is the evolution of labour and capital incomes shares, and especially the role played by the largest 2,000 MNEs worldwide.

Figure II.7 updates previous analyses on functional incomes at the level of the world economy until 2022, splitting the capital incomes share into two components. One relating to the net income (i.e., profits) of the 2,000 largest firms globally, and a residual that can be interpreted as the remaining capital income outside the profits of these large enterprises worldwide.<sup>3</sup>

<sup>3</sup> For more details about the methodology and a further discussion on the relevance of the use of this metrics for international trade, both in goods and services, see TDR, 2018:56–57.

**Figure II.7 Increasing asymmetries of trade benefits: After the COVID-19 shock, profits of top 2,000 multinational enterprises further increased while the global labour income share continued to shrink**



**Source:** UNCTAD calculations based on the Refinitiv Eikon database and the United Nations Global Policy Model.  
**Notes:** The selection of the top 2,000 firms is based on their market capitalization. Thus, it excludes non-listed firms. In panel A, the net income of the top 2,000 MNEs (derived from the financial statement of listed firms) and the capital income excluding net income of top 2,000 MNEs add up to the world capital income (derived from national accounts data) even though methodologies differ in several regards across both sets of accounts.

While the share of capital income other than profits accruing to the top 2,000 MNEs has remained relatively flat over the last two decades, the profits of top MNEs have registered a gradual increase over this period, only interrupted temporarily at times of major turmoil such as the global financial crisis (GFC) in 2008 and the COVID-19 shock in 2020. Mirroring this evolution, global labour income share has registered a decline of 3 percentage points from almost 57 per cent in 2000 to slightly more than 53 per cent in 2022. The declining labour share and the rising profits of MNEs point to the key role of large corporations dominating international activities – partly though by no means exclusively through their organization of production and trade – in driving up global functional income inequality.<sup>4</sup>

*“While the costs and risks of asymmetric structure of global trade are more readily acknowledged, the search for governance solutions to address these issues has barely begun.”*

More broadly, the trends of growing income inequality and continuing concentration of market power press the need to find more equitable policy solutions. Here, while the costs and risks of asymmetric structure of global trade are now more readily acknowledged, the search for governance solutions to address these issues has barely begun. In the meantime, increasingly complex crises and compounding risks further magnify the structural asymmetries of the global economy.

<sup>4</sup> The critical role of control of intellectual property in the inequality story has been examined elsewhere, see TDR 2017 and Baker 2018.

## 4. Conclusion

A healthy trading system is crucial for meeting the 2030 Agenda. Unfortunately, it remains unclear whether there is the political will among key trade partners to guide it through its current difficulties. For the future outcome to be positive, policymakers will need a bold pro-developmental and cooperative approach to address the fault lines in the international trading system, both old and new. The ideal response is neither to double down on free trade nor to return to the situations in place prior to the COVID-19 shock.

Building such an adequate answer requires revisiting existing agreements at the bilateral, regional and multilateral levels to create policy space for all countries to redesign their production, consumption and trading profiles to face contemporary global challenges.

Ten specific multilateral trade agreements have, for example, been identified by the Group of 90 (G90) developing countries at the WTO (G90, 2023), which include the Agreement on Subsidies and Countervailing Measures (ASCM), Agreement on Trade-Related Investment Measures (TRIMS), and Trade-Related Aspects of Intellectual Property Rights (TRIPS). The G90 proposal seeks to strengthen existing flexibilities for developing members to make them more precise, effective and operational so that they may more effectively address development aims of members. Failure to address these concerns may result in growing asymmetries, which will make it even more difficult for the world to deliver on its 2030 Agenda.

Ideally, such reforms should build upon some of the core General and Special Principles (GSP) that Member States agreed upon at the creation of UNCTAD in 1964. These remain relevant to the governance of international trade relations and trade policies in support of development, namely “policy space”, “special and differential treatment” and “voice and solidarity” (Davies et al., 2021).

Given the new industrial policy initiatives being adopted in advanced countries (as discussed in subsection B.2.C above), which may shorten their existing supply chains, developing countries will need to look for new outlets to diversify their export markets. In this context, regional trade as well as South–South trade can provide a significant opportunity. Since 1995, South–South merchandise trade has grown faster than global trade and faster than North–South trade. In 2022, South–South trade accounted for around 54 per cent of South’s total trade. South–South trade has also grown steadily in food, fuel, ores and metals, and fertilizers, with many developing countries, including Brazil, China, India, Indonesia and Thailand playing major roles.

While South–South trade should not be seen as an alternative to North–South trade, it can provide an opportunity for developing countries to diversify their production and export basket. In the same vein, regional integration programmes – such as the African Continental Free Trade Area (AfCFTA) – to the extent they support diversification and the benefits are broadly shared, can also mitigate the negative effects of the current situation, including with respect to climate change and food insecurity.

To further boost South–South trade, the Global System of Trade Preferences (GSTP) initiative of UNCTAD can play a critical role by providing an opportunity to negotiate inter alia tariff reductions among developing countries in products based on mutual preferences (box II.1). GSTP can also support a just green transition in the developing countries by focussing on green products and facilitating green technology transfers. Doing so will, however, need a more integrated policy nexus of financial-investment-industrial-technology-trade cooperation among developing countries (TDR, 2022; UNCTAD, 2023a).

*“There is a need to revisit existing agreements at the bilateral, regional and multilateral levels to create policy space for all countries to redesign their production, consumption and trading profiles to face contemporary global challenges.”*

*“Since 1995, South–South merchandise trade has grown faster than global trade and faster than North–South trade. In 2022, South–South trade accounted for around 54 per cent of the South’s total trade.”*

### **Box II.1 South–South trade cooperation: recent developments around the BRICS and the Global System of Trade Preferences initiative**

Emerging economies' rapidly increasing economic prominence in international trade has become more pronounced in recent years. The expansion of the five-member group of the BRICS (Brazil, the Russian Federation, India, China, and South Africa) with six more members (Argentina, Egypt, Ethiopia, the Islamic Republic of Iran, Saudi Arabia and the United Arab Emirates), as announced in August 2023, suggests a potential new economic block that accounts for 30 per cent of current global GDP, with a growing population that already stands as 46 per cent the world population.

The XV BRICS Ministerial Declaration confirms the members' commitment to “the open, fair, predictable, inclusive, equitable non-discriminatory and rules-based multilateral trading system with WTO”. While there appears to be advancements in finance and investment cooperation, trade among BRICS has yet to fully exploit the South–South trade potential: current trade flows mainly take place between China and the other members, with relatively little bilateral trade among Brazil, India and South Africa for instance.

GSTP is another older initiative aiming at strengthening South–South trade cooperation. GSTP is an agile partnership framework that allows its members to take a variety of cooperative actions in the area of tariffs, para-tariffs, non-tariff measures, direct trade measures and sectoral arrangements.

The conceptual basis of GSTP was provided in 1976 by the Group of 77 (G77). GSTP was accepted in the multilateral trading system, under paragraph 2(c) of the Decision of 28 November 1979: “Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries”, generally referred to as the “Enabling Clause” of the GATT. During the subsequent three decades, GSTP has had its ups and downs.

A new impetus occurred in December 2010 in Brazil with the conclusion of the third round of negotiations. This culminated in the adoption of the São Paulo Round Protocol by eight participants (counting Mercosur as one): Cuba, Egypt, India, Indonesia, Malaysia, Morocco, the Republic of Korea and Mercosur (i.e., Argentina, Brazil, Paraguay and Uruguay).

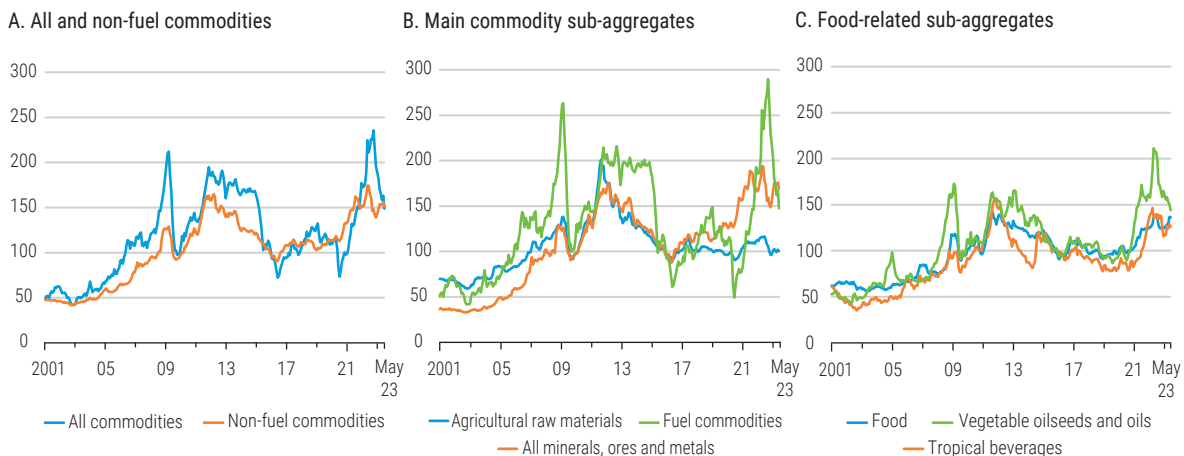
Though the São Paulo Round Protocol has still to enter into force, the ratification by Brazil at the end of 2022 created a significant step forward in this direction, which could help the 11 current signatories reap up to \$14 billion of shared welfare gains (UNCTAD, 2019). Furthermore, such a framework can be an effective tool for accelerating the Goals by fostering knowledge sharing on best practices in trade, investment, capacity-building and technology transfer, including in new areas for cooperation such as energy transition and food security.

## C. COMMODITY MARKETS

The notable recent upward trajectory in commodity prices – brought on by the pandemic and, in some cases, exacerbated by the outbreak of the war in Ukraine – has given way to a moderation in these prices starting in mid-2022 and continuing into 2023. Yet, many commodity prices have not returned to their pre-pandemic levels. Still, the aggregate commodity price index registered a drop of more than 30 per cent in May 2023 compared to a year earlier (figure II.8). The reduction in aggregate prices has been primarily driven by fuel commodities, which experienced a significant drop of over 40 per cent during this period. However, some product groupings in the UNCTAD price index registered more muted reductions during this period to remain at historically high levels. Notably the prices of minerals, ores and metals declined only 4 per cent, while food dropped by just 2 per cent.

**Figure II.8 Commodity prices have moderated since 2022, but many products remain at historical levels**

Commodity price indices, selected commodity groups and products  
(Index numbers, average 2015=100)



**Source:** UNCTAD calculations based on UNCTADstat database.

**Note:** Index numbers are based on prices in current dollars.

A key factor in the moderation observed in commodity prices since the middle of last year has been the deteriorating outlook for global demand, compounded by the sharper than anticipated tightening of monetary policy by central banks across the globe. This current round of global monetary tightening has been both more rapid and synchronized than the previous bout of tightening just prior to the GFC. The application of this more restrictive monetary stance has dampened expectations for global economic growth. Meanwhile, the heightening of financial market stress – with the failure of several banks in the United States and the exposed fragility of large banking institutions elsewhere during the first half of 2023 – has added further gloom to the global economic outlook, resulting in a softening in the global demand for raw materials. Similarly, the more restrictive monetary conditions and accompanying uptick in international interest rates has also prompted investors to move financial investments away from commodities towards higher interest-bearing assets (chapter III). Lastly, the slower than expected rebound in China following the reopening of its economy and the persistent weaknesses in its real estate sector have also contributed to the slackening in broad commodity price indices after they peaked in the course of 2022.

*“Although commodity prices have moderated since mid-2022, they remain above their pre-pandemic levels.”*

For its part, the surge in the prices of commodities – most notably crude oil, natural gas and grains – following the outbreak of the war in Ukraine eased from the middle of 2022 thanks in large part to a reorientation of trade flows of key commodity exports from the Russian Federation and Ukraine, as well as the brokering of the Black Sea Initiative agreement in July 2022 to enable the shipment of grains and other materials from strategically important Ukrainian ports (UNCTAD, 2022a).

## 1. Oil and natural gas

Fuel commodities is the group that initially showed the sharpest decline after mid-2022, with prices of crude oil and natural gas falling by 33 per cent and 67 per cent, respectively, over the 12 months to May 2023. Though the oil price has since rebounded somewhat to over \$90 per barrel, the initial drastic drop corresponded to the outsized impact of the global factors outlined above in the energy sector, together with a range of factors specific to the energy industry. Moreover, despite the announced rounds of production cuts by OPEC+ countries in April 2023 – representing a reduction of over 1 million barrels per day – a significant increase in oil production from non-OPEC+ countries as well as a substantial release of strategic petroleum reserves by OECD member countries have more than offset the agreed OPEC+ cuts. For its part, Western economic sanctions on Russian crude oil exports have mostly resulted in redirecting these flows to countries such as China and India at a discounted price, meaning that their impact on global oil supplies has been minimal while also having a downward influence on global crude prices.

The precipitous fall in natural gas prices from the unprecedented highs registered last year – in the wake of the restrictions imposed by European importers of Russian natural gas and the intermittent shutting down of gas pipelines to Europe by the Russian authorities – is principally due to the reshuffling of export and import markets in this sector. European countries have successfully re-oriented their natural gas imports towards liquefied natural gas (LNG) purchases, particularly from the United States, alleviating, to a significant degree, the upward price pressures in the region's natural gas markets. The longer-term reorientation of European natural gas imports towards LNG is reflected in the much milder downturn in global LNG prices during the last year (15 per cent). This re-orientation by European gas importers is not without its negative consequences: various developing countries, such as Bangladesh and Pakistan, have seen a tightening and redirecting of the global supply of LNG shipments on which their economies depend. Similarly, while the prices of both crude oil and natural gas have fallen significantly from the highs observed in the middle of 2022, they still lie significantly above the average levels registered during the five years prior to the pandemic, posing a significant challenge for developing countries dependent on the import of these products to meet their energy needs.

## 2. Minerals and metals

The expected bump in demand for various commodities due to the relaxing of COVID-19 restrictions and reopening of the economy in China in December 2022 has proven to be far less pronounced than anticipated. This outcome has been particularly relevant for the minerals and metals commodity group for which Chinese demand represents about half of total global demand. Specifically, the reduction in metals prices observed over the 12 months to May 2023 is to a large degree due to the continuing financial challenges faced by the Chinese real estate sector, which accounts for a significant share of global demand for industrial metals. Partially offsetting this comparative shortfall in demand has been strong State spending on infrastructure projects by the Chinese authorities. This has helped to sustain the demand for products such as copper and iron ore whose downward price movement of 12 and 20 per cent, respectively, would have been far more pronounced without the bump to global demand provided by this spending.



### 3. Food

The commodity group where the impact of recent trends in international prices has been most detrimental for developing nations is that of food commodities. As the Global Crisis Response Group of the United Nations noted, international food prices were already approaching historic highs even before the conflict broke out, causing food import bills to rise dramatically, with about two thirds of the increase of costs concentrated in developing countries (United Nations, 2022). The further climb in international food prices in the wake of the outbreak of the war in Ukraine left many developing countries faced with prohibitively high prices for many of their most basic staple food products. Moreover, the impact of the disruption in the supply and transport of grains, notably wheat, maize, and sunflower products, from Ukraine and the Russian Federation, proved particularly acute for African and Middle Eastern countries that rely on the flow of grains from these countries to meet their basic food needs (UNCTAD, 2022b).

The international prices of many of these food products have moderated over the 12 months to May 2023 – with prices of wheat, maize and sunflower oil dropping by 25, 21 and 51 per cent respectively – partly thanks to the Black Sea Initiative and to increased supplies from South America and other major producing countries. Still, international food prices remain at historically high levels, and the pass-through of lower international prices to domestic prices has proven to be weak. In fact, in several developing countries, the domestic prices of basic foods in June 2023 remained above their levels of the previous year and continue to weigh on food security. Relevant factors which have kept domestic prices at elevated levels include high fertilizer costs, adverse weather, high distribution costs, strong indebtedness as well as domestic currency weaknesses (UNCTAD, 2023b; FAO, 2023). As discussed further in chapter III, the financialization of food markets and the pricing behaviour of large commodity traders have been other contributing factors. As a result, almost 350 million people worldwide – including more than 100 million people in sub-Saharan Africa – are projected to be food insecure in 2023, which is over double the number in 2020 (WFP, 2023).

For its part, higher food prices also impact income distribution within countries. Where the production is more capital-intensive, as happens in larger farms and where land is more concentrated, higher food prices generate rents that favour the richest individuals and large landowners (Mohtadi and Castells-Quintana, 2021). Moreover, where food supply chains are highly concentrated and small farmers have no bargaining power, at the global level food price increases may be fully captured by big corporations controlling food trade, storage, processing and retail (Hansen, 2013; Deconinck, 2021).

Using data covering 126 countries (82 developing and 44 developed) for the period 1990–2020, an empirical analysis shows that rising food prices are associated with increased inequality in developing countries, while the impact in the developed countries was found to be statistically insignificant (UNCTAD, 2023c). This highlights the importance of the role played by government policies to provide safety nets to both producers and the consumers of food. For example, the United States implements the Supplemental Nutrition Assistance Program (SNAP) earlier known as the Food Stamp Program to protect consumers, and the Federal Crop Insurance Program buffers farmers' incomes from losses due to disasters or low prices.

While COVID-19 and the war in Ukraine have accelerated food price volatility, and thus raised global food insecurity, data show that after decades of improvements, the number of people in hunger started to rise around 2014, some years before the emergence of these two events (Saccone, 2021). Along with local conflicts and national economic crises, a main driver for this increase has unequivocally been identified as climate change (FAO et al., 2020; Ray et al., 2019; Mirzabaev et al., 2023). More generally, the rapidly changing climate, political turmoil, and macroeconomic shocks, combined with the speculative behaviour of commodity traders, have introduced further instability and uncertainty in food markets (IPES-Food, 2022; Rabbi et al., 2023), which call for specific policies that address food insecurity. Part of these requires to improve the integration of small farmers into the domestic and international markets, raising their bargaining power, and making the gains from trade reach the poorest farmer. This requires addressing the high concentration of food markets and discouraging speculative behaviour with adequate regulations. Breaking the food monopolies is critical for progressing towards global food security. These issues are dealt with in more detail in chapter III.

## D. GLOBAL FINANCIAL CONDITIONS AND DEVELOPING COUNTRY VULNERABILITIES

On the eve of the COVID-19 shock, many developing countries already faced unsustainable debt burdens (TDR, 2019). Since then, compounding crises – the pandemic, the war in Ukraine, the deepening climate crisis and the cost-of-living crisis – along with the most aggressive monetary tightening in developed countries since the 1970s, have exacerbated this situation (chapter I). While a systemic debt crisis – in which a growing number of developing countries move simultaneously from distress to default – has so far been kept at bay, a development crisis is already unfolding, with external debt service draining resources away from delivering the 2030 Agenda and the goals of the Paris Agreement (UNCTAD, 2023c).

One difference between the current and previous debt crises in the developing world is that emerging market economies (EMEs) – i.e., countries that were brought into international financial markets in earlier periods – are not at the forefront. This time around, it is mostly low- or lower-middle-income developing countries that started to tap international capital markets. This mostly occurred during the capital flow boom after the global financial crisis and before COVID-19. These countries, hereafter referred to as “frontier market economies” (FMEs), have been the hardest hit (see special section in this chapter (p. 66) for the list of countries considered as FMEs in this Report).

The staggered integration of EMEs and FMEs into international capital markets has meant that while both groups are vulnerable to changes in global financial conditions and changes in the risk perceptions of global investors, they have experienced different degrees of external financial vulnerability since COVID-19. However, without a concerted effort from the international community, the slowdown of the global economy in 2023, and the danger that things could worsen in 2024, raises serious concerns across the developing world. As a result, an increasing number of developing countries, financially exhausted from years of treading water, may begin to sink under the growing weight of unpayable debts.

This section provides an overview of the recent evolution of capital flows and debt vulnerabilities in developing countries, with a particular focus on FMEs.

### 1. Capital flows to developing countries: Recent developments

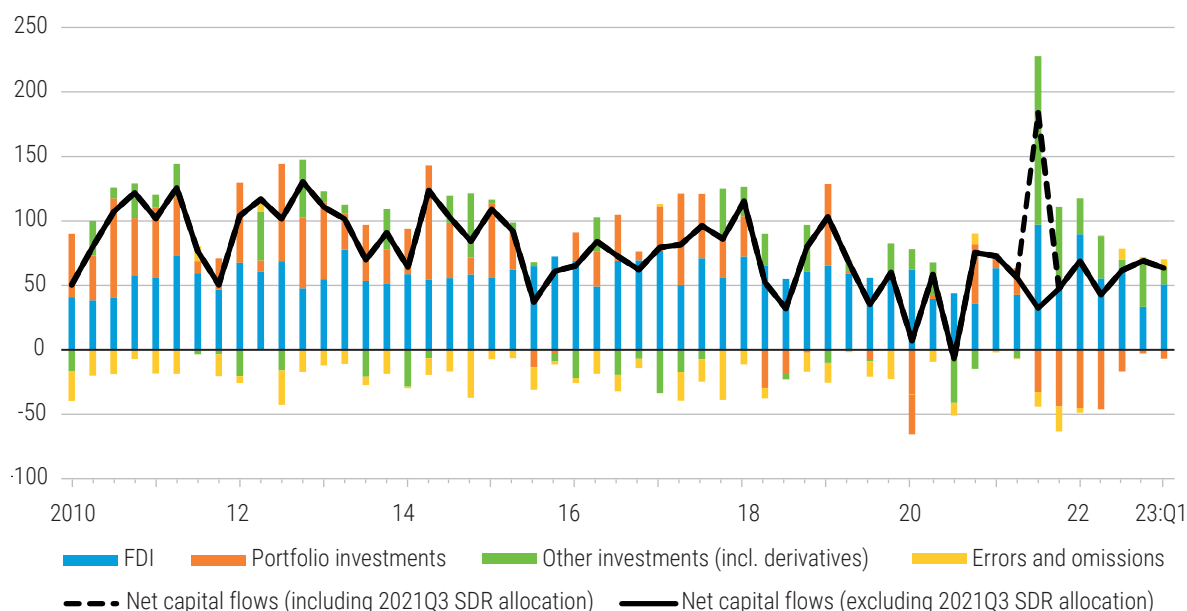
Cross-border financial transactions involving developing countries have experienced significant shocks in recent years. With the onset of the COVID-19 pandemic, net capital inflows to low- and middle-income developing countries (excluding China) came to a sudden halt during the first quarter of 2020. This scenario repeated itself during the third quarter of 2020 when additional pandemic-related measures were put in place as the second wave of COVID-19 hit. These two quarterly figures contrast markedly with the lower bound of about \$50 billion of net quarterly capital inflows that these countries, in aggregate, typically received between 2010 and 2019 (figure II.9).

The second half of 2021 and the first half of 2022 also marked abnormal times for capital flows, albeit in the upper end of the distribution this time around. Net foreign direct investments (FDI) and other investment inflows reached record levels in three quarters, partly due to the cyclical rebound of the global economy and, in the case of other investments, to the new allocation of special drawing rights (SDRs) during the third quarter of 2021. Meanwhile, net portfolio inflows turned strongly negative for four quarters in a row, as the policy stance by the central banks of developed countries was to raise policy rates to contain and attenuate inflationary pressures (TDR, 2022).

Since mid-2022, sharp portfolio outflows have ceased, while net foreign direct investments and other investments, in aggregate, have receded from their previous highs, leaving the sum of the three main components of the financial account slightly above the \$50 billion mark per quarter.

### Figure II.9 Capital flows to developing countries have been very volatile in recent years, with portfolio investments turning highly negative in late-2021 and early-2022

Net capital inflows to low- and middle-income developing countries, excluding China  
(Billions of dollars)



**Source:** UNCTAD calculations based on IMF Balance of Payments Statistics.

**Notes:** The two “net capital flows” series exclude the transactions of the monetary authorities registered under Reserves in the balance of payments statistics. Because SDR allocations (unlike SDR holdings, which are included in Reserves) are registered under “Other investments” in the financial account, the “Net capital flows (excluding 2021Q3 SDR allocation)” series aims at neutralizing the SDR allocation of the third quarter of 2021 worth about \$650 billion, of which it is estimated that about 20 per cent was shared among the countries considered in this figure. All series refer to net non-resident inflows minus net resident outflows. Thus, positive values correspond to net inflows to this group of countries. Each component reflects the aggregation of the net figures of all available low-income and middle-income developing countries in the database. The balance of net derivatives, which is relatively small, was merged with other investments.

However, the aggregates mask significant differences between countries and regions. For example, FDI flows to Latin America and the Caribbean – typically the most stable source of foreign capital for developing countries – experienced a significant increase in 2022 (UNCTAD, 2023c). By contrast, FDI flows to least developed countries (LDCs) fell by 16 per cent to \$22 billion in 2022, with the top five recipients of this group – Ethiopia, Cambodia, Bangladesh, Senegal, and Mozambique, in that order – accounting for about 70 per cent of this figure. Turning to portfolio flows, significant differences exist between its equity and debt subcomponents, including external versus domestic sovereign bonds. During the third quarter of 2021, non-resident outflows totalling \$28.5 billion mostly affected equity flows. Leaving aside the special case of the first quarter of 2020, when COVID-19 hit, the withdrawal of debt investments by non-residents reached a record of almost \$25 billion during the first quarter of 2022. And while equity investment by non-residents started to bounce back earlier, the debt investment counterparts have remained in negative territory up to the fourth quarter of 2022 at least.<sup>5</sup>

For more recent trends relating to EMEs, due to the lag in the publication of balance of payments data for many of these countries, it is necessary to rely on proxy indicators which are only available for a limited number of countries. One source is the weekly release of *JP Morgan EM Flows*, which focuses on a subset of portfolio

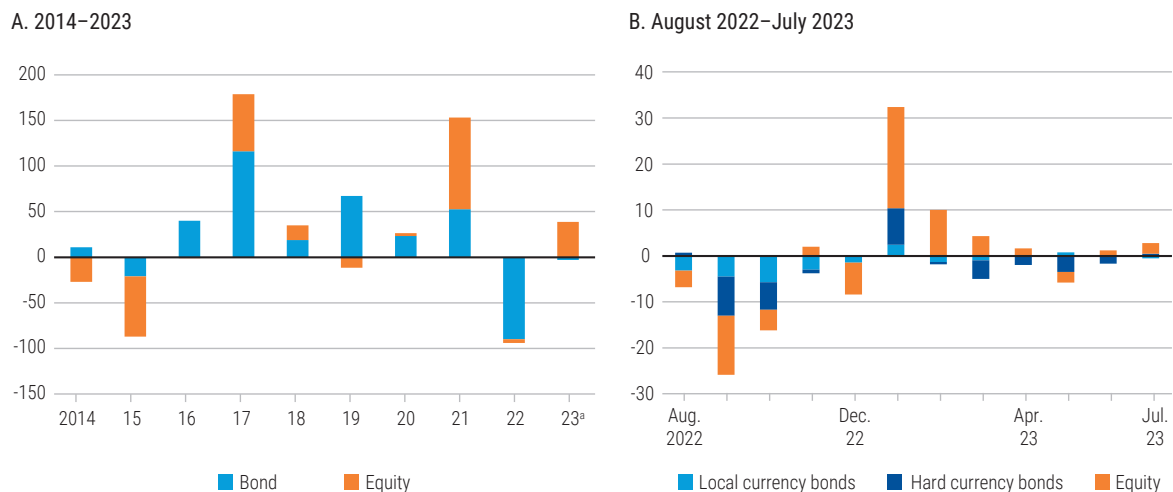
<sup>5</sup> At the time of going to press, data for the first quarter of 2023 remained incomplete to have a final assessment of the aggregate for this group of countries.

investments. According to these data, figure II.10.A shows that during the first seven months of 2023, total investor fund flows were positive, in aggregate, due to a rebound of its equity subcomponent, though this total figure conceals different developments across the types of capital flows and country groups in recent months.

Equity fund flows experienced a robust rebound in the first quarter of 2023, primarily attracted by low valuations in EMEs following the selloffs of 2022 (figure II.10.B). These flows have since declined sharply. Meanwhile, hard currency bond flows increased significantly in January 2023 followed thereafter by five consecutive months of outflows, which were particularly large between March and April 2023. Local currency net bond flows have so far hovered around zero throughout this year, owing to large outflows from the Chinese domestic bond market, which offset inflows into other EME local bonds.

### Figure II.10 Equity fund flows to emerging market economies rebounded in early 2023

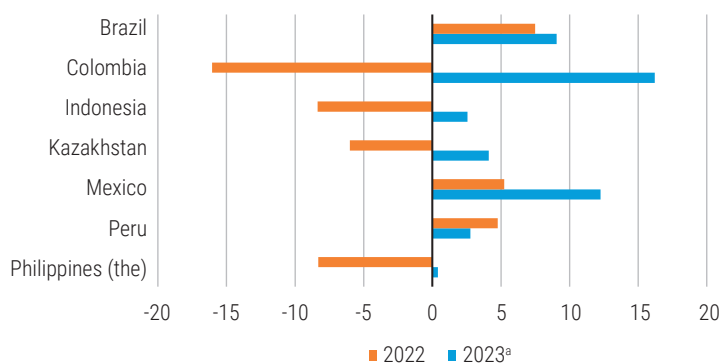
Emerging markets fund flows, bond and equity  
(Billions of dollars)



Source: UNCTAD calculations based on JP Morgan EM Flows Weekly (4 August 2023).  
<sup>a</sup> The figure for 2023 includes data until July.

### Figure II.11 Significant appreciations of several emerging market currencies in the first half of 2023

Change in the value of the domestic currency vis-à-vis the dollar, selected economies  
(Percentage)



Source: UNCTAD calculations based on Refinitiv data.  
Note: Positive value indicates currency appreciation.  
<sup>a</sup> The figure for 2023 includes data until 31 July 2023.

Altogether, these net inflows have triggered appreciations of at least 14 EME currencies, most of them in Asia and Latin America, making local bonds even more profitable for global investors (figure II.11).

Overall, these patterns suggest that spillovers from bank distress in March 2023 have been milder on larger EMEs (IMF, 2023). As many EME central banks sharply hiked their interest rate before the Federal Reserve started tightening its interest rates, many of these economies have become increasingly attractive to hot capital flows seeking higher yields (UNCTAD, 2023c). By contrast, debt problems appear more acute in several FMEs.

## 2. Debt and development distress in developing countries: Insights from the frontier market economies

The recent rise in debt distress and related development setbacks in developing countries can be directly attributed to inherent structural weaknesses in the international financial system. It has proven inadequate in facilitating access to reliable sources of external development finance in the required quantity, cost and maturity, for these countries to meet their development needs.

Other related factors have also played a role as further explained below. These include: (i) the insufficient official development assistance (ODA) (box II.2); (ii) a relative decline of official concessional financing (and the denial of access to some categories of developing countries for such schemes); (iii) decisions of credit rating agencies (CRAs); and (iv) an inadequate global financial safety net (GFSN). Added to this is the significant presence of illicit financial flows (IFFs), which diminish government revenues and drain resources away from development (UNCTAD, 2023e).

On the back of these developments, developing countries have become increasingly reliant on global financial markets to meet their funding requirements. Moreover, for most of the last decade, these private actors have provided access to capital for countries that were previously excluded from financial markets, albeit at an elevated cost even during relatively stable times. However, the strongly cyclical nature of these flows and the compounding crises of recent years have exposed the limitations of the system in dealing, in an equitable and timely manner, with debt distress and its subsequent impact on development.

*“Frontier market economies are currently experiencing severe financial vulnerabilities after deepening their integration into international capital markets over the last decade.”*

A renewed sense of urgency to advance multilateral solutions is required, given the magnitude of the debt challenges faced. In the aftermath of the COVID-19 pandemic, the total world debt of both public and non-financial private sectors peaked at 257 per cent of world gross product in 2020, before receding 10 percentage points by the end of 2021. Within this broader context, developing countries are highly vulnerable, as their debts, private and public, registered significant increases over the last decade. More specifically, private debt in a broad group of emerging markets and developing economies increased from 84 to 130 per cent of GDP between 2010 and 2021.<sup>6</sup> Meanwhile, total public debt in these countries nearly doubled, reaching 64 per cent of GDP by 2022.

The rapid accumulation of non-concessional debt has caused a significant increase in interest payments. Since the ending of easy monetary policy in both developed and developing economies, these payments have reached new highs, with a double burden in countries that have also seen their currencies depreciating against the dollar and euro. The number of countries where interest spending accounted for 10 per cent or more of public revenues increased from 29 countries in 2010 to 50 countries in 2022. Consequently, interest payments in many developing countries outpaced expenditures in critical sectors such as education, health, and public investment over the past decade. Currently, at least 3.3 billion people live in countries that spend more on interest than on either health or education (United Nations, 2023). Most of these countries experienced declines in their Human Development Index in recent years (UNCTAD, 2023d). Carrying these greater debt burdens obstructs the mobilization of resources needed to achieve the goals of the 2030 Agenda.

*“In the past decade, interest payments in many developing countries outpaced expenditures in critical sectors such as education, health, and public investment. Carrying these greater debt burdens obstructs the mobilization of resources needed to achieve the goals of the 2030 Agenda.”*

<sup>6</sup> UNCTAD calculations based on IMF Global Debt database. Note that IMF classifies 97 economies as emerging markets and developing economies. These include those that are neither advanced economies nor low-income countries.

### Box II.2 Recent trends in official development assistance

For several low-income and lower-middle-income countries, diminished access to concessional official development finance has contributed to the increasing reliance on private external finance. This trend is particularly pronounced among recently promoted lower-middle-income countries that transitioned from low-income status shortly after GFC (e.g., Angola, Mongolia, Nigeria, Pakistan, and Viet Nam). These nations lost access to affordable concessional external finance from the Poverty Reduction and Growth Trust (PRGT) and the International Development Association (IDA). Thus, they represent the “missing middle of development finance” (United Nations, 2020).

Recent patterns in official development assistance (ODA) have also played a role. ODA takes the form of grants, loans to sovereign entities, debt relief and contributions to multilateral institutions (calculated on a grant-equivalent basis). In 2022, total net ODA from the Development Assistance Committee (DAC) member countries reached \$211 billion, a rise from \$186 billion in 2021, largely due to spending on refugees, much of it in the donor countries themselves. However, as a percentage of the gross national income (GNI) of DAC members, this equated to only 0.36 per cent, falling short of the target 0.7 per cent of GNI, which is only achieved by five donor countries. Furthermore, in 2021, DAC members disbursed \$129 billion in ODA to developing countries, of which \$84 billion (65 per cent) was directly allocated to these nations and \$45 billion (35 per cent) was allocated to multiple regions (called “unspecified” flows). The difference of \$57 billion in 2021 between the total net ODA aforementioned (\$186 billion) and the amount disbursed to developing countries (\$129 billion) is categorized as “unallocated” flows and relates to expenditures within donor countries, such as administrative costs and in-house refugee expenses.

Amid the context of ODA realigning away from central budget support towards in-donor expenditures and broader multilateral priorities, these “unspecified” and “unallocated” flows constituted, respectively, an average of 24 per cent and 30 per cent of net ODA from DAC members to developing countries between 2014 and 2021. It is anticipated that this proportion increased in 2022 due to the war in Ukraine.

Within developing countries, FMEs require particular attention. Collectively, this subgroup of economies within developing countries registered the fastest growth of external public debt over the last decade. It is therefore not a coincidence that even if FMEs altogether only represented, vis-à-vis the total of developing countries, 8 per cent of their GDP and 6 per cent of their total public debt in recent years, they accounted for 20 per cent of developing countries’ total external public debt (figure II.12). In other words, FMEs, and especially their public sector, are now particularly exposed to the asymmetries and shortcomings of the international financial architecture, particularly with respect to the consequences of debt distress.

Part of this rapid increase of debt has relied on the global investors’ idea that FMEs are the next generation of EMEs, with expectations of rapid and sustained economic growth linked to, and fuelled by, their increased integration into global financial markets. The growing significance of FMEs as an asset class over the past two decades has been influenced by three interconnected trends: the pursuit of higher returns by global investors, a divergence in the returns on bonds of different developing groups, and a compression of credit ratings of EMEs.

To begin with, non-resident portfolio inflows to developing countries were spurred by global push factors after the GFC. This pattern mirrored the historical capital flow cycles that followed the breakdown of the Bretton Woods system (Akyüz, 2017; TDR, 1998). Easy monetary and financial conditions in developed countries



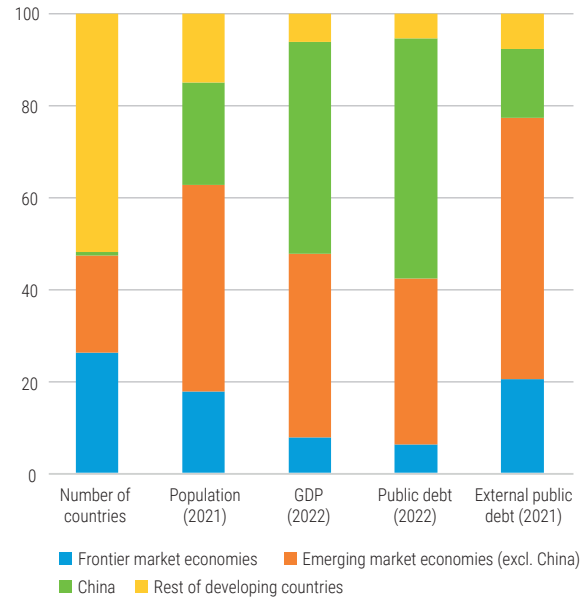
led investors to accept higher risks in their search for bigger returns (da Silva et al., 2021). Demand prompted the growth of alternative asset classes with the desired characteristics, including FME bonds.

While it is common to group flows to developing countries together, such practice masks a divergence in the return on bonds in different developing groups. Following the GFC, long-term returns on non-investment grade bonds from developing countries outpaced those of investment grade bonds consistently – except for a period during the onset of the pandemic shock of 2020 (figure II.13).

Moreover, investors’ demand for non-investment grade instruments was affected by credit compression among EMEs, as most of these countries became investment grade. CRAs played a pivotal role in this dynamic due to their pro-cyclical behaviour. Market reactions are amplified by their ratings during both the boom and contraction phases of capital flow cycles (Griffith-Jones and Kraemer, 2021; Pretorius and Botha, 2017). As EMEs weathered the GFC in terms that beat market expectations, CRAs enhanced their assessments of these countries between 2006 and 2015. By 2015, 21 out of 31 EMEs had achieved investment-grade status, leading to a reduction in the potential supply of non-investment grade bonds among this group (figure II.14.A).

**Figure II.12 Frontier markets contribute less than 10 per cent of developing countries’ total output but carry 20 per cent of the external public debt**

Shares with respect to all developing countries’ aggregates, selected indicators (Percentage)

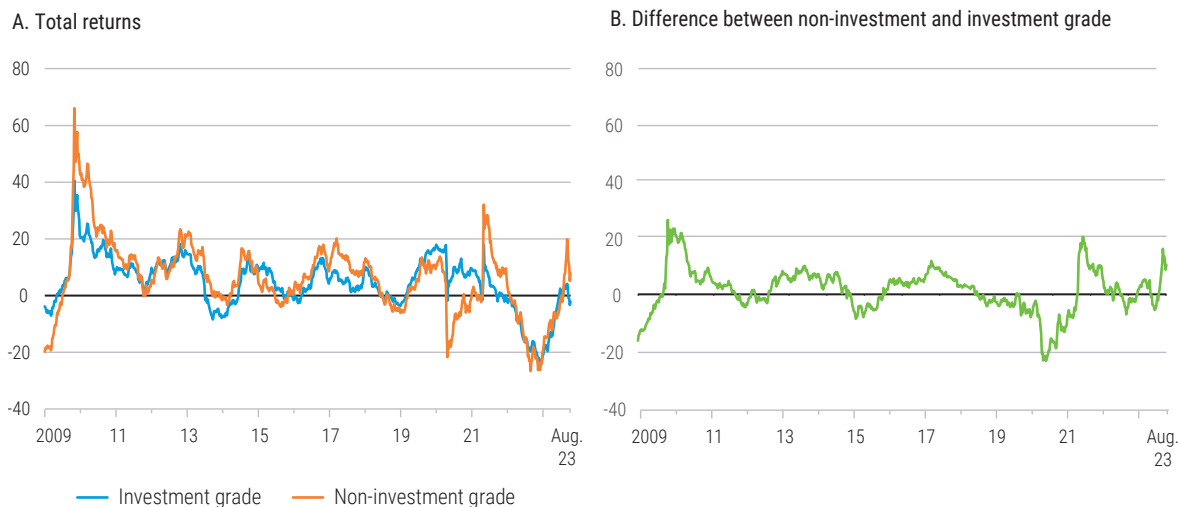


Source: UNCTAD calculations based on Refinitiv data.

Note: For each indicator, the year of reference is provided between parentheses.

**Figure II.13 In the years after the global financial crisis, returns of non-investment grade bonds usually outstripped those of investment-grade bonds**

Year-on-year total returns and their difference on public bond indices, selected grades (Percentage)

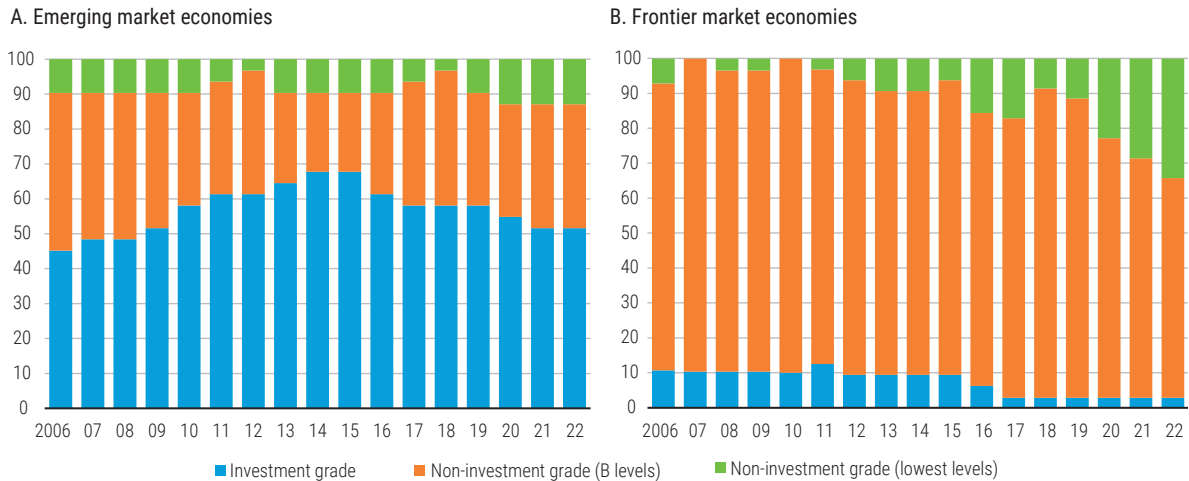


Source: UNCTAD calculations based on JP Morgan Emerging Market Bond Index (EMBI) Global Diversified Total Return Index.

Note: These indicators refer to year-on-year changes of dollar-denominated sovereign and quasi-sovereign indices and are provided on a weekly basis ending on 24 August 2023.

**Figure II.14 Frontiers filling the vacuum in the non-investment grade segment**

Distribution of credit ratings within selected country groups  
 (Percentage and absolute number of countries within bars)



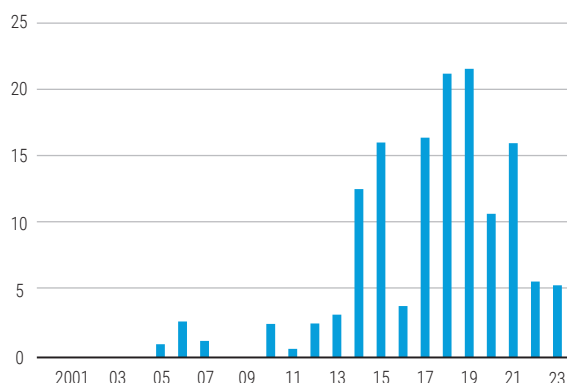
Source: UNCTAD calculations based on Refinitiv and Oxford Economics.

Notes: Average ratings between the three main credit rating agencies (CRAs): Fitch, Moody's and Standard & Poor's. "Non-investment (B levels)" refers to all the grades considered by CRAs as "speculative" and "highly speculative". "Non-investment (lower levels)" corresponds to the remaining grades within the non-investment heading, and thus carry even greater risks.

The decline in the number of EME sovereigns categorized as non-investment grade encouraged investors to seek higher yielding alternatives in the early 2010s. FMEs emerged to fill this void, with most of these countries being rated as non-investment grade (figure II.14.B). FMEs attracted investors in pursuit of higher returns, opening the doors to global financial markets for these countries. While only three FMEs had issued sovereign bonds denominated in hard currency between 2000 and 2009, this count surged to 27 countries in the ensuing decade. Annual bond issuance of FMEs reached a record value of \$22 billion in 2018 and 2019, just before the onset of the COVID-19 pandemic (figure II.15).

**Figure II.15 Frontiers' bond issuance was on the rise during the last decade until the COVID-19 shock**

Gross issuances of hard-currency frontier markets' sovereign bonds  
 (Billions of dollars)



Source: UNCTAD calculations based on Refinitiv.

Notes: This figure only considers bonds issued by governments denominated in dollars, euro and yen with a minimum face value equivalent to \$500 million. It includes rollover of previous bonds.

The surge in bond issuance by FMEs has been at the core of the massive accumulation of external public and publicly guaranteed (PPG) debt by these countries over the past decade. The stock of PPG bonds issued by FMEs rose sevenfold during the last decade, reaching \$154 billion in 2021. As a result, since 2011, the portion of FMEs' PPG debt held by private creditors almost doubled from 19.6 to 35.9 per cent, with bondholders accounting for 8.8 per cent and 23.7 per cent, respectively (figure II.16). In total, FMEs' external PPG debt reached \$651 billion in 2021, marking a threefold increase since 2010. For comparison, during the same period, external PPG debt of EMEs and remaining developing countries doubled (figure II.17).

The accumulation of external PPG debt is exerting significant pressures on the public finances of FMEs, as growing debt service obligations reduce available resources for crucial public expenditures. Debt service on PPG debt relative to government revenues

surged from almost 6 to 16 per cent between 2010 and 2021. In contrast, for EMEs, this figure stood at 3 per cent, while it reached 7 per cent for other developing countries in 2021 (figure II.18.A). As of 2021, a minimum of 26 FMEs allocated 10 per cent or more of their revenues to debt service. Moreover, among the top 25 developing countries with the highest debt service to revenue ratio in 2021, 15 were FMEs (60 per cent of the total). The leading 4 countries on this list were all FMEs (figure II.18.B). As a result, the pressure of debt service on development expenditures has become substantial in FMEs. 26 out of 37 FMEs were spending more on external PPG debt service relative to either education or health by 2021 (UNCTAD, 2023c).

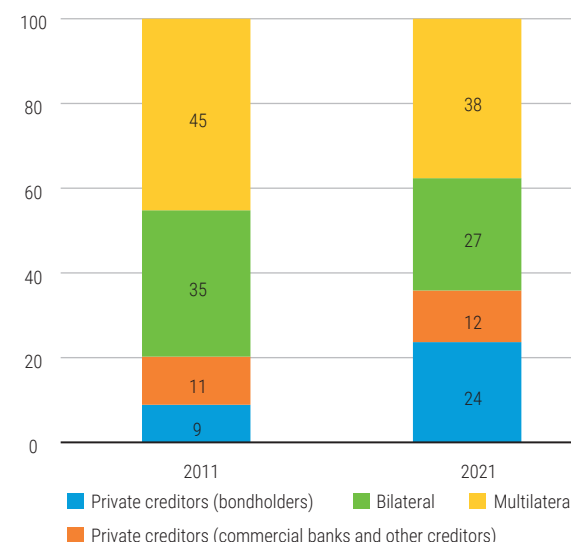
External public debt in FMEs is also contributing to heightened external vulnerabilities. The ratio of external debt service to exports in FMEs rose from about 6 to 16 per cent between 2011 and 2021. In comparison, this metric stood at 15 per cent for EMEs and 10 per cent for other developing countries in 2021 (figure II.19.A).<sup>7</sup> To provide context, these aggregate figures are double or even triple the threshold established by the 1953 London Agreement on restructuring war debts for Germany. This agreement limited the portion of export revenues that could be allocated to external debt servicing to 5 per cent of the total, with the aim of ensuring the post-war recovery of the then Federal Republic of Germany would be sustainable (TDR, 2015). Furthermore, among the 25 countries with the highest proportion of export revenues allocated to total external debt servicing in 2021, over half (13 countries) were FMEs (figure II.19.B).

Cracks in the market façade of FMEs appeared in the aftermath of COVID-19. The buildup of debt vulnerabilities over the previous decade led to an increase in bond spreads of FMEs relative to that of EMEs (figure II.20). This shift indicates that markets are factoring in a heightened risk of default for this specific group of economies. In fact, most of the countries that have lost market access since 2019 fall into the category of FMEs (figure II.21). The number of FMEs trading with spreads surpassing the 1,000-basis points threshold – used to gauge market access – has notably increased from 1 to 13 between January 2019 and August 2023. In addition, it is mostly FMEs that have been downgraded in

<sup>7</sup> The high ratio in EMEs is a result of the higher share of the private non-guaranteed (PNG) debt in the long-term debt compared to FMEs (45.4 per cent and 32 per cent in 2021, respectively).

### Figure II.16 The reliance on private creditors for external financing of frontier market economies has strengthened

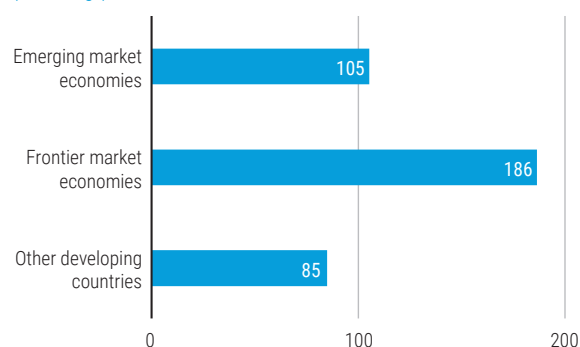
Creditor composition of frontier market economies' external public and publicly guaranteed debt (Percentage)



Source: UNCTAD calculations based on World Bank International Debt Statistics.

### Figure II.17 External public debt of frontier markets has grown faster post-financial crisis

Growth of public and publicly guaranteed external debt, selected groups of developing countries, 2010–2021 (Percentage)



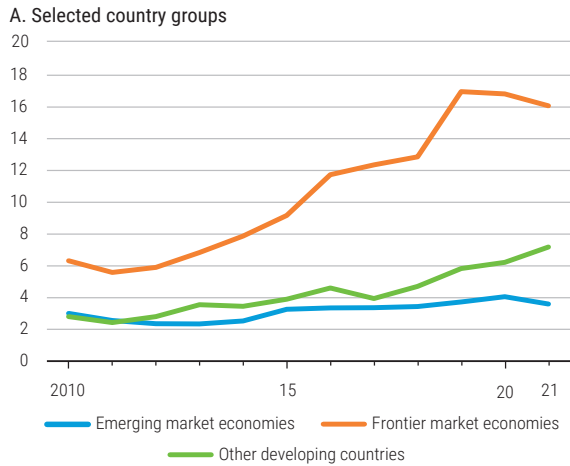
Source: UNCTAD calculations based on IMF World Economic Outlook.

recent years by CRAs to a rating of CCC or lower, indicating substantial credit risks and likelihood of default (figure II.22).

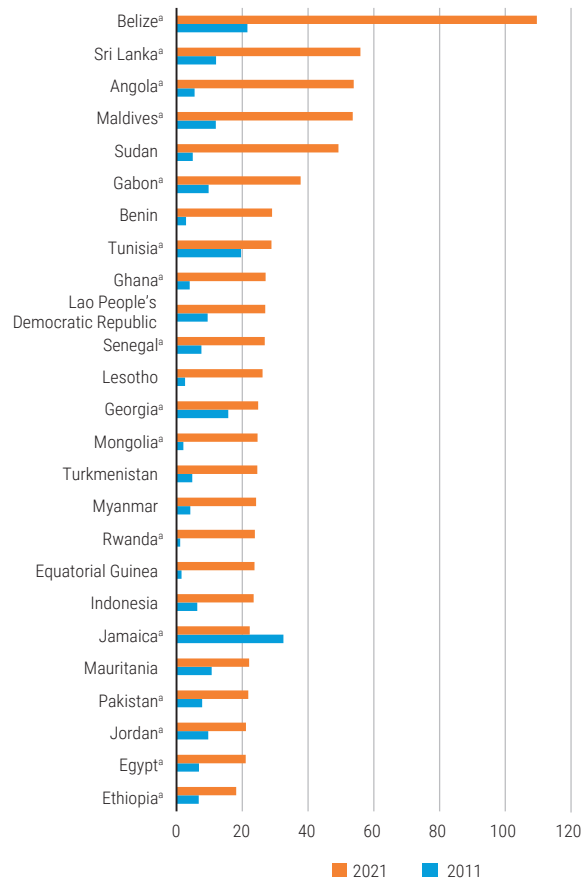
With each subsequent shock since 2020, more FMEs have found themselves in a situation of debt distress, placing them at ground zero in the looming debt crisis (figure II.22). The developing countries that

**Figure II.18 Frontier markets' public finances are under heavy pressure after a decade of debt accumulation**

Public and publicly guaranteed external debt service relative to government revenues  
 (Percentage)



**B. Top 25 within all developing countries in 2021**



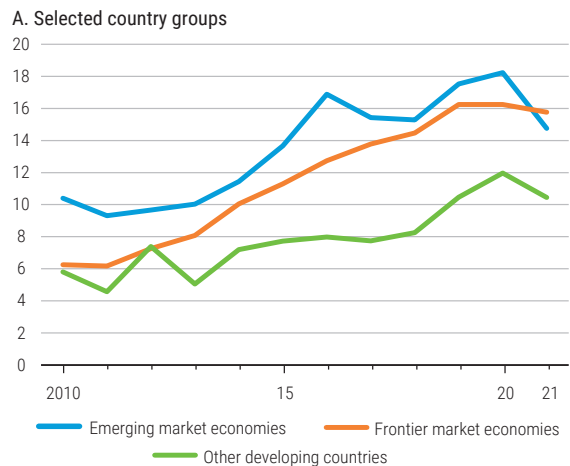
**Source:** UNCTAD calculations based on World Bank International Debt Statistics and IMF World Economic Outlook.

**Note:** Indonesia is the only emerging market economy in this group.

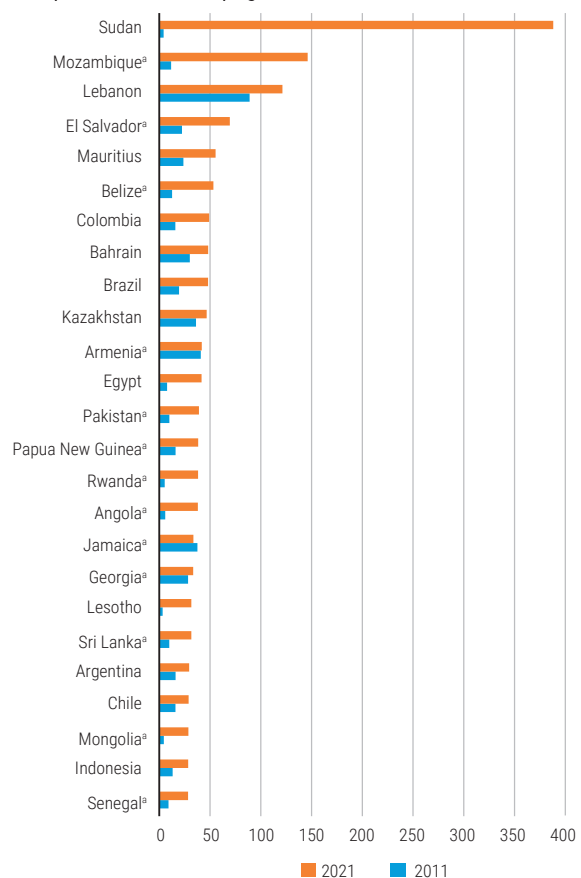
<sup>a</sup> Frontier market economies.

**Figure II.19 Frontier markets' external debt service drains export revenues**

Public and publicly guaranteed external debt service relative to export revenues  
 (Percentage)



**B. Top 25 within all developing countries in 2021**



**Source:** See figure II.18.

**Note:** Argentina, Brazil, Chile, Colombia, Egypt, Indonesia, Kazakhstan and Lebanon belong to the group of emerging market economies (EMEs), while Bahrain, Lesotho, Mauritius and the Sudan do not belong to EMEs or the frontier market economies.

<sup>a</sup> Frontier market economies.

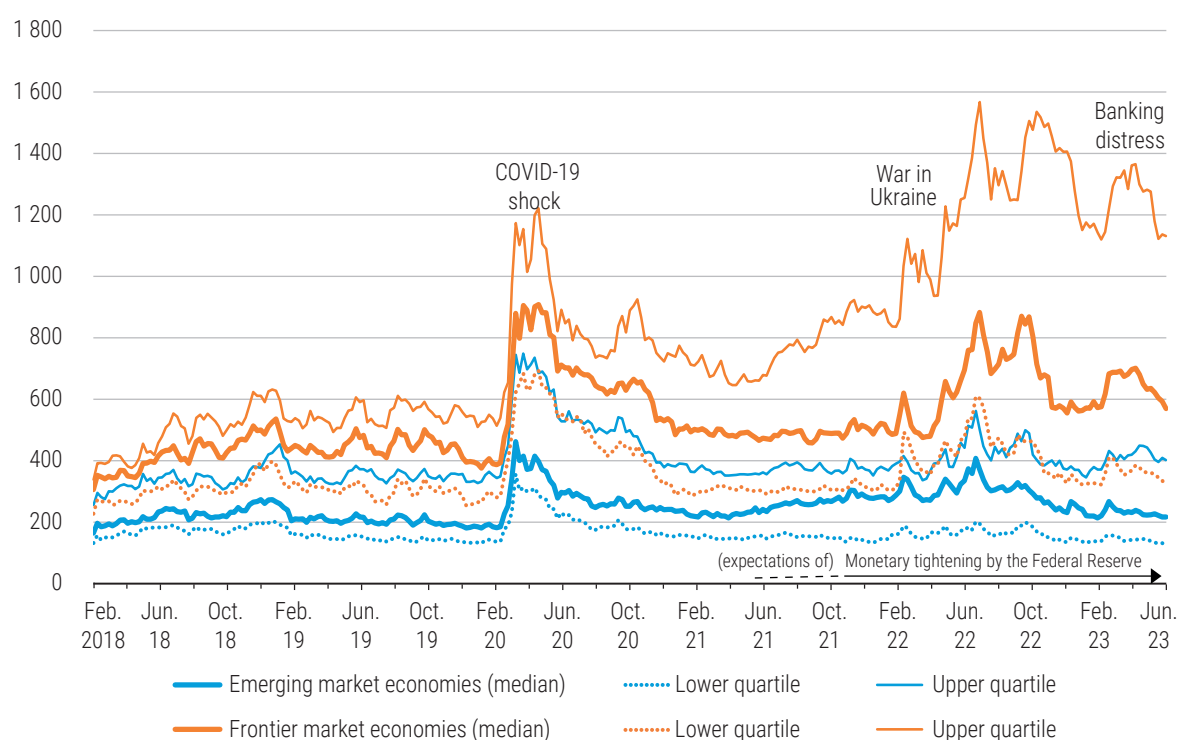
have been classified as in default by S&P Global Ratings as of July 2023 since the pandemic, are all FMEs (Ghana, Sri Lanka, Suriname and Zambia). In addition, Ethiopia applied for debt restructuring under the G20 Common Framework.<sup>8</sup>

The debt challenges faced by developing countries in general, and those of FMEs in particular, are set to increase as a large wave of bond repayments comes due in the coming years (figure II.23). FME bond repayments, including principal and coupon payments, will reach \$13 billion in 2024 and continue to be high at least until the end of the decade. This raises concerns that more FMEs may default if their market access is not restored. Moreover, for EMEs and FMEs that have retained market access, new sovereign bond issuances will be costly given the higher interest rates in developed countries. Higher borrowing costs in a context of lower economic growth – and as discussed in chapter I, both are conditions that look set to last well into next year – will undermine debt sustainability. Without measures to effectively address this dynamic, most countries are expected to prioritize fiscal consolidation to stabilize debt levels (UNCTAD, 2023c). Regrettably, this dynamic will place the attainment of the 2030 Agenda further out of reach.

The trajectory of debt vulnerabilities in FMEs reveals the imbalance between the advantages and disadvantages of dismantling capital controls in developing countries and rapidly integrating into unregulated international private capital markets – a theme discussed in previous reports (TDR, 2015; 2019). While the benefits encompass access to external financing in countries constrained by balance of payments restrictions and limited domestic financial markets, as has been discussed above, the associated costs are exceedingly high.

### Figure II.20 Frontier markets are at the forefront of compounding crises

Spreads with respect to the Treasuries of the United States, selected country groups  
(Basis points)



**Source:** UNCTAD calculations based on JP Morgan Emerging Market Bond Index (EMBI) data.

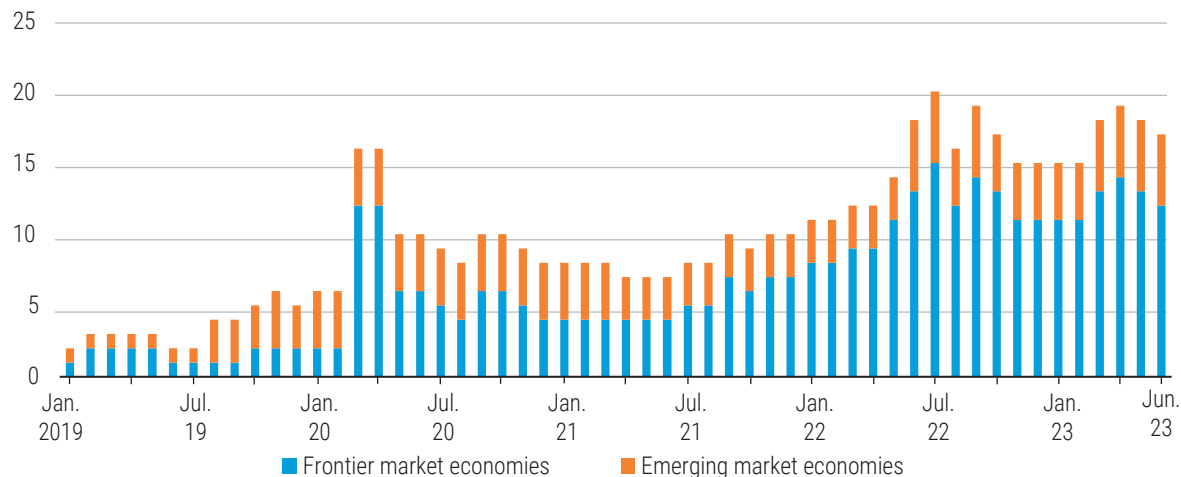
**Note:** Medians and quartiles are based on the availability of country-level data in JP Morgan EMBI–Global Diversified, a widely-followed dollar-denominated sovereign and quasi-sovereign index.

<sup>8</sup> Debt restructurings of Chad and Malawi (not considered as FME) have not been classified as in default by a rating agency.

**Figure II.21 Growing number of frontier markets moving into debt distress**

Emerging and frontier markets with bond spreads above 1,000 basis points over treasuries of the United States

(Number of countries)



Source: See figure II.20.

**Figure II.22 COVID-19 and other financial shocks increased debt vulnerability of frontier markets**

Public debt situation of selected frontier market economies after COVID-19 and other subsequent major financial shocks

Pre-COVID-19	COVID-19 shock (March 2020)	Monetary tightening	
		War in Ukraine (February 2022)	Banking distress (March 2023)
Suriname	Angola	Belize	Belize
Zambia	Belize	El Salvador	Bolivia (Plurinational State of)
Angola	Cameroon	Ethiopia	El Salvador
Belize	Gabon	Ghana	Ethiopia
Bolivia (Plurinational State of)	Ghana	Pakistan	Ghana
Cameroon	Iraq	Sri Lanka	Maldives
Costa Rica	Mongolia	Suriname	Mozambique
El Salvador	Mozambique	Tajikistan	Pakistan
Ethiopia	Nigeria	Tunisia	Sri Lanka
Gabon	Sri Lanka	Zambia	Suriname
Ghana	Suriname	Maldives	Tajikistan
Iraq	Tajikistan	Mozambique	Tunisia
Kenya	Tunisia	Papua New Guinea	Zambia
Maldives	Zambia	Angola	Gabon
Mongolia	Costa Rica	Bolivia (Plurinational State of)	Kenya
Mozambique	El Salvador	Cameroon	Angola
Nigeria	Ethiopia	Costa Rica	Cameroon
Pakistan	Kenya	Gabon	Costa Rica
Papua New Guinea	Pakistan	Iraq	Iraq
Sri Lanka	Bolivia (Plurinational State of)	Kenya	Mongolia
Tajikistan	Maldives	Mongolia	Nigeria
Tunisia	Papua New Guinea	Nigeria	Papua New Guinea

Market access (Green), Almost at distress level (Yellow), Distress level (Red)

Source: UNCTAD calculations and typology based on JP Morgan Emerging Market Bond Index–Global Diversified indices.

Note: This figure only considers frontier market economies whose spreads reached 800 basis points or more since 2020. JP Morgan EMBI-Global Diversified tracks dollar-denominated sovereign and quasi-sovereign bonds. “Distress level” refers to spreads vis-à-vis the treasuries of the United States above 1,000 basis points (bp). “Almost at distress level” relates to spreads between 800-1 000 bp and “Market access” corresponds to spreads below 800 bp.

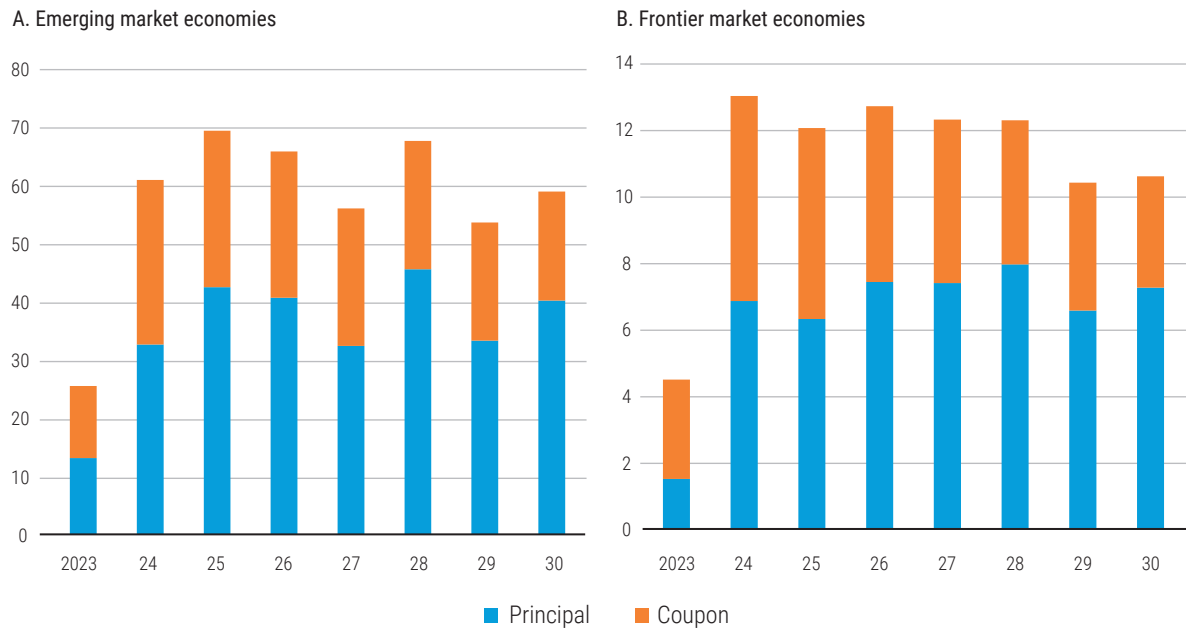


The analysis above has shown that the search for yield by global investors created global push conditions in which FMEs were flooded with capital inflows. However, the worsening of external financial conditions associated with compounding crises and downgrades by CRAs, has produced a rapid exit of those flows. This has triggered a further deterioration of financial conditions, cutting some FMEs off from accessing those markets altogether. Collectively, these factors have combined to place almost a third of FMEs on the precipice of debt distress, with five already falling over the edge. The international response to this problem has been insufficient. Urgent measures are imperative to prevent more FMEs from reaching the brink of financial distress, and worse still, tipping into default. Equally crucial is the reform of the international financial architecture, including the increase of reliable and affordable financial resources to fulfil the 2030 Agenda and the Paris Agreement, with effective and timely mechanisms of debt restructuring and relief. Otherwise, the siren calls of international financial markets will entice more low- and lower-middle-income developing countries on to the rocks of debt distress and default. Detailed discussions on these reforms can be found in chapters IV to VI of this Report.

*“One third of frontier market economies are on the precipice of debt distress, with five already falling over the edge. The international response to this has been insufficient.”*

**Figure II.23 Emerging and frontier markets face a wall of debt repayments from 2024 onwards**

Bond repayment schedule from principals and coupons  
(Billions of dollars)



Source: UNCTAD calculations based on Refinitiv.

Note: This figure only considers bonds issued by governments denominated in dollars, euro and yen with a minimum face value equivalent to \$500 million.

## SPECIAL SECTION

### Definition of the frontier market economies considered in chapter II

There is no formal definition of FMEs, although the term often refers to developing countries with small yet investable markets of recent origin, which are part of the next generation of EMEs (Schipke, 2015). For the sake of the analysis of this chapter, FMEs are identified with the 37 countries in the JP Morgan Next Generation Markets (NEXGEN) index, itself a subset of the larger JP Morgan Emerging Markets Bond index (EMBI). NEXGEN focuses on dollar-denominated government bonds from FMEs. This diverse group includes countries across all World Bank income classification levels, some of which are LDCs and small island developing States (SIDS) (table II.A.1). Of these, 14 FMEs were eligible for the International Monetary Fund (IMF) Poverty Reduction and Growth Trust (PRGT) and the World Bank International Development Association (IDA), with 10 participating in the heavily indebted poor countries (HIPC) initiative.

Table II.A.1 List of frontier market economies

Country	Region	Income group	SIDS	LDC	HIPC	PRGT and IDA eligible
Angola	Sub-Saharan Africa	LMIC				
Armenia	Western Asia	UMIC				
Azerbaijan	Western Asia	UMIC				
Barbados	Latin America and the Caribbean	HIC				
Belize	Latin America and the Caribbean	LMIC				
Bolivia (Plurinational State of)	Latin America and the Caribbean	LMIC				
Cameroon	Sub-Saharan Africa	LMIC				
Costa Rica	Latin America and the Caribbean	UMIC				
Côte d'Ivoire	Sub-Saharan Africa	LMIC				
El Salvador	Latin America and the Caribbean	LMIC				
Ethiopia	Sub-Saharan Africa	LIC				
Gabon	Sub-Saharan Africa	UMIC				
Georgia	Western Asia	UMIC				
Ghana	Sub-Saharan Africa	LMIC				
Guatemala	Latin America and the Caribbean	UMIC				
Honduras	Latin America and the Caribbean	LMIC				
Iraq	Western Asia	UMIC				
Jamaica	Latin America and the Caribbean	UMIC				
Jordan	Western Asia	UMIC				
Kenya	Sub-Saharan Africa	LMIC				
Maldives	Southern Asia	UMIC				
Mongolia	Eastern Asia	LMIC				
Mozambique	Sub-Saharan Africa	LIC				
Namibia	Sub-Saharan Africa	LMIC				
Nigeria	Sub-Saharan Africa	LMIC				
Pakistan	Southern Asia	LMIC				
Papua New Guinea	Oceania	LMIC				
Paraguay	Latin America and the Caribbean	UMIC				
Rwanda	Sub-Saharan Africa	LIC				
Senegal	Sub-Saharan Africa	LMIC				
Sri Lanka	Southern Asia	LMIC				
Suriname	Latin America and the Caribbean	UMIC				
Tajikistan	Central and Southern Asia	LMIC				
Tunisia	Northern Africa	LMIC				
Uzbekistan	Central Asia	LMIC				
Viet Nam	South-Eastern Asia	LMIC				
Zambia	Sub-Saharan Africa	LMIC				

*Source:* UNCTAD typology based on World Bank (July 2022) and UNCTADstat (2023) classifications.

*Note:* IDA: International Development Association; HIPC: heavily indebted poor country; LDC: least developed country; LIC: low-income country; LMIC: lower middle-income country; PRGT: poverty reduction and growth trust; SIDS: small island developing State; UMIC: upper middle-income country.

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