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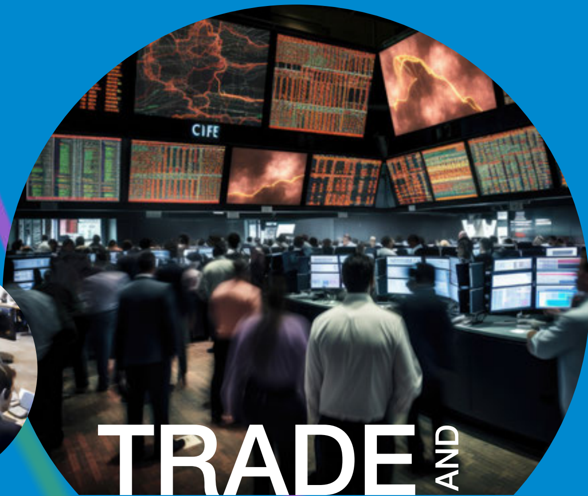

TRADE AND DEVELOPMENT REPORT 2023

Growth, Debt, and Climate: Realigning the Global Financial Architecture

OVERVIEW

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Growth, Debt and Climate: Realigning the Global Financial Architecture

United Nations
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Abbreviations

BRICS	Brazil, the Russian Federation, India, China and South Africa
FME	frontier market economy
GDP	gross domestic product
GVC	global value chain
IFA	international financial architecture
IFF	illicit financial flows
IMF	International Monetary Fund
WTO	World Trade Organization

TRADE AND DEVELOPMENT REPORT 2023

Policy priorities

The *Trade and Development Report 2023: Growth, Debt and Climate – Realigning the Global Financial Architecture* identifies five core policy priorities:

- Reducing inequality.
- Balancing the priorities of monetary stability with long-term financial sustainability.
- Regulating commodity trading generally, and food trading in particular.
- Addressing the crushing burden of debt servicing and the threat of spreading debt crises.
- Providing reliable access to finance and technology transfer to enable the energy transition.

Specific policy recommendations for a development-centred global debt architecture

1. Increase concessional finance through capitalization of multilateral and regional banks, and issuance of special drawing rights.
2. Enhance transparency in financing terms and conditions, using the digitalization of loan contracts to improve accuracy.
3. Revise the UNCTAD Principles for Responsible Sovereign Lending and Borrowing to motivate and underpin the importance of guiding principles throughout the stages of sovereign debt acquisition.
4. Improve debt sustainability analysis and tracking to reflect the achievement of the Sustainable Development Goals and empower country negotiators with improved data on their potential for growth and fiscal consolidation.
5. Enable countries to utilize innovative financial instruments such as sustainable development bonds and resilience bonds. Develop rules for automatic restructurings and guarantees.
6. Enhance resilience during external crises, for example by implementing standstill rules on debtors' obligations in crises, and create a space to enable the avoidance of debt distress.
7. Encourage borrowers to share information and experiences, drawing inspiration from private creditor coordination.
8. Initiate work on a more robust debt workout mechanism and a global debt authority.

OVERVIEW

Global economy: Stalling into 2024

The year 2023 is likely to be seen as an inflection point in a fragile and uneven global recovery, post-pandemic. The entire world economy, except for North Africa and Central and East Asia, has slowed since 2022. With projected growth in 2023 of 2.4 per cent, the world enters 2024 at "stall speed", matching the definition of a global recession. Divergence of low growth trends between key regions, as well as within the BRICS countries (Brazil, the Russian Federation, India, China and South Africa) and the Group of Seven indicates that there is no clear driving force to propel the world economy onto a robust recovery track. Without adequate coordinated policy responses or mechanisms, today's diverse and compounding shocks risk being transformed into tomorrow's systemic crises. In the face of new challenges to the international political economy, this scenario is a threat to the multilateral system and to global economic stability. Policymakers need to engage on multiple fronts to chart a stronger, more resilient trajectory for the future.

The year also saw a mix of economic outcomes. On the one hand, inflation, while still above pre-pandemic levels, is coming under control in many parts of the world. The banking crises of the second quarter of 2023 did not lead to financial contagion and commodity prices are down from their 2022 peaks. A small improvement in global growth is expected in 2024, but it is contingent on recovery in the euro area and on other leading economies avoiding adverse shocks. On the other hand, three sets of structural problems threaten global long-term stability and economic resilience:

(a) Diverging recovery paths in the context of slower growth across major regions;

(b) Deepening asymmetries in income and wealth;

(c) Growing pressures of indebtedness and thinning policy autonomy in developing economies.

These three factors add to an increasingly complex interplay between economic, climate and geopolitical risks. Against this background, prospects for developing countries are especially concerning. Development requires a favourable external environment based on robust global demand, stable exchange rates and affordable financing. The ability of developing countries to accelerate growth, strengthen productive capacities, decarbonize and meet their financial obligations is fundamentally dependent on steady, strong global demand. Today, however, international policy coordination is driven by central banks that focus primarily on short-term monetary stability over long-term financial sustainability. This trend, together with inadequate regulation in commodity markets and continuous neglect for rising inequality, is fracturing the world economy and splintering off developing countries, undermining their ability to thrive.

"A strategy of sustainable and balanced growth becomes less feasible if high levels of debt and inadequate financial regulation threaten financial stability and food security, while, in parallel, income is increasingly retained by global corporations rather than workers."

Against this background, 2024 is unlikely to show substantial improvement. A strategy of sustainable and balanced growth becomes less feasible if high levels of debt and inadequate financial regulation threaten financial stability and food security, while, in parallel, income is increasingly retained by global corporations rather than workers. In the face of a crisis, previous coordination efforts have tended to ignore sectors or countries that are not considered systemically relevant, thus compounding the very crisis they sought to resolve. This mistake should be avoided at all costs.

The *Trade and Development Report 2023* presents an alternative response. It outlines an approach based on balancing the pace of disinflation and the impact of high real interest rates not only against inflation indicators, but also in relation to economic activity, employment, income inequality and fiscal stability. Yet in the current framework of international financial architecture, policy space is easily curtailed by movements in the asset markets. This has heavy impacts on social policies, investment and employment generation. In an interconnected world in which developing countries are potential engines of economic growth, policymakers in advanced economies should consider the damage that high interest rates can cause to long-term investment, both in terms of structural change and climate adaptation as well as debt sustainability.

To address these problems, this Report identifies five core policy priorities:

1. **Reducing inequality.** This should be made a policy priority in developed and developing countries. This requires concerted increases of real wages and concrete commitments towards comprehensive social protection. Monetary policy is not to be used as the sole tool to alleviate inflationary pressures. With supply-side problems still unaddressed, a policy mix is needed to attain financial sustainability, help lower inequalities and deliver inclusive growth.

2. **Balancing the priorities of monetary stability with long-term financial sustainability.** In light of growing interdependencies in the global economy, central banks should assume a wider stabilizing function within this landscape.

3. **Regulating commodity trading generally, and food trading in particular.** This needs to be done internationally, using a systemic approach developed within the framework of the global financial architecture.

4. **Addressing the crushing burden of debt servicing and the threat of spreading debt crises.** To do this, the rules and practices of the global financial architecture need to be reformed. The mechanisms, principles and institutions of global finance should ensure reliable access to international liquidity and a stable financial environment that promotes investment-led growth. Given the failures of the current architecture to enable the resilience and recovery of developing countries from debt stress, it is crucial to establish a mechanism to resolve sovereign debt workouts. This should be based on the participation of all developing countries and include agreed procedures, incentives and deterrents.

5. **Providing reliable access to finance and technology transfer to enable the energy transition.** This would require not only fiscal and monetary agreements among the Group of 20, but also agreements within the World Trade Organization (WTO) to implement technology transfer, and within the International Monetary Fund (IMF) and World Bank to ensure dependable financing. Without eliminating the incentives and regulatory conduits that make cross-border speculative investment so profitable, private capital is unlikely to be channelled to measures to help adapt to climate change.

Global growth landscape: Divergence under clouds of uncertainty

In 2023, the global outlook was shaped by four main factors. First, international prices of oil, gas and food returned to late 2021 levels, eliminating a powerful driver of inflation. However, retail prices in many countries remained higher than pre-pandemic averages, putting pressure on household budgets. With supply-side drivers of inflation largely addressed, Governments should in principle be able to tackle profiteering more effectively. Yet, the policy actions currently observed mostly involve central banks continuing to signal the likelihood of high interest rates.

Second, the United States of America, accounting for a quarter of the world economy, displayed resilience during two years of rising consumer price inflation (April 2020–June 2022). This was despite a year and a half of blanket disinflation policies (11 interest rate hikes in 18 months) and sporadic financial market disruptions. Key parts of the economy, buoyed by employment and nominal wage growth, have sustained consumption and spending. At the same time, although unemployment reached historic lows, the employment rate remains at recession levels, standing at 58 per cent of the population, and for many, wages remain very low.

Third, in China, lifting of the remaining COVID-19-related restrictions helped sustain the recovery that began in 2022 and which revamped industrial production. The country's economic growth relies less on exports than in the past and the Government continues to enjoy considerable fiscal space. However, persistent weaknesses in the real estate sector pose challenges, including potential financial stress, reduced job creation, constrained consumer spending and delayed investments. Escalating geopolitical tensions are disrupting the dominant position of China in key global value chains, clouding prospects in some of its frontier technology sectors, at least in the short-term. Authorities have responded to slower than expected growth with a mix of monetary expansion, supply-side incentives and regulatory tightening. The overall impact of the chosen policy responses and their spillover effects, particularly on neighbouring economies, remains uncertain.

Fourth, concerns over growth prospects in China should not divert attention away from the deteriorating economic health of the European economy. With a share of the global economy similar to that of China (approximately

18 per cent in purchasing power parity, higher at current exchange rates), the global consequences of the slowdown in Europe are at least twice as weighty as those of the slowdown in China.

"With a share of the global economy similar to that of China, the consequences of the slowdown in Europe are at least twice as weighty as those of the slowdown in China."

At the current juncture, larger emerging economies are unlikely to provide a robust offset to slower growth in advanced economies. With tighter monetary policy, low investment and limited government spending, the world economy is experiencing a lacklustre recovery reminiscent of the aftermath of the 2007–2009 financial crisis. Of particular concern, given the ambitious development and climate targets set by the international community with a 2030 delivery date, growth in almost all regions in 2023 and 2024 is also set to fall below the average for the five-year period before the pandemic. Latin America stands out as an exceptional example of the trend, facing an even more challenging situation due to its particularly weak growth prior to the pandemic.

Trends in international markets

During 2023, developments in the international trade and finance system were influenced by uncertainties. 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 together with multiple geoeconomic risks. In addition, several structural weaknesses that pre-date the COVID-19 shock have become particularly significant for developing countries. These relate to the growing concentration of export markets and related asymmetry of income distribution, a slowdown in investment and an unsustainable burden of debt, the widening technological divide and the mounting costs of the climate crisis and related challenges around the energy transition.

The intertwining of immediate and long-term concerns poses significant governance challenges for today's interdependent global economy. Increasingly, the principles of the rules-based multilateral trading system are being contested. This trend is unlikely to fade, given the diminishing prospects of achieving the kind of harmonious and stable order required to meet the goals of the 2030 Agenda for Sustainable Development and the targets of the Paris Agreement. Whether, and how, policymakers will meet these governance challenges over the coming months will determine whether the world avoids recession in 2024. Resolving these governance issues also depends on developing countries sidestepping a "lost decade" and the multilateral system avoiding further fracture and ending the current decade in more robust health.

Reshaping global trade

After a rollercoaster ride in 2020–2022, global trade in goods and services points to a subdued expansion of 1 per cent in 2023, significantly below world economic output growth. This is also lower than the average growth registered during the last decade, itself the slowest average growth period for global trade since 1945. In the medium-term, trade is heading back to its subdued pre-crisis trend; in the near-term, despite the resilience of global trade in services, it will remain sluggish, as the growth of merchandise trade hovered in negative territory throughout 2023.

"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."

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, increasingly, the very idea of free trade. This backlash is prompting policymakers to reassess their strategic prioritization of the role of trade. A new trade lexicography reflects these shifts, with terms such as "fragmentation", "deglobalization", "slowbalization", "reshoring", "nearshoring", "friendshoring", "de-risking", "decoupling", "open strategic autonomy" and "new industrial policy" peppering current discussions around trade policy.

New export controls have also reflected the shifting sentiment around trade policy across the globe. These have covered three types of non-mutually exclusive objectives: (a) securing domestic supply, (b) restricting geopolitical rivals, and (c) encouraging investment in locally based processing facilities. The shift is also apparent in current discussions around the need for a new paradigm of trade that can support the challenge of global economic integration and interdependence. A new three-fold strategy can be built around the need to prioritize reducing inequality, building resilience and accelerating the energy transition.

Regardless of whether the calls to reform international trade can be translated into a new regime of international economic governance, a significant reshaping of world trade is underway which includes a restructuring of global supply chains. 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. Two risks can be already identified. First, 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. Second, in large economies, the rise of protectionist unilateral trade measures and a wider use of industrial policies can adversely impact developing economies' exports and hinder their prospects for structural transformation.

At the same time, some developing countries may see gains from a restructuring of global supply chains in the near-term. A green investment boom in advanced economies might bring opportunities for some fortunately endowed countries, such as exporters of strategic minerals. However, 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.

Trade disputes and asymmetries

The twenty-first century has witnessed China displacing the United States as the world's leading exporter of manufactured goods. While a growing trade deficit with China provoked intermittent responses from legislatures in the United States, a more assertive stance only began in 2017, seen in progressive tariff increases on exports from China. These tariff increases resulted in significant trade diversion, mostly benefiting the main economic rivals to China, including Mexico and the European Union.

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. Bilateral imports of goods and services from China to the United States reached the highest level ever recorded – $564 billion in 2022 – as services continued to expand. The United States remains the main destination for exports of merchandise from China. This is followed by Japan, the Republic of Korea, Viet Nam and India. At the same time, notwithstanding this recovery, the trade dispute has imposed costs on trading partners.

With regards to domestic supply concerns, current WTO rules allow for temporary export restrictions or prohibitions to prevent or relieve critical shortages of essential products. This is 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 defining what is considered as "proportionate". In the early phases of the COVID-19 pandemic, over 80 countries resorted to banning exports of medical and personal protective goods. 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 and observers.

Ultimately, 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 medical products and food, to ensure that similar future practices are better controlled and do not result in a negative spiral that 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 13th Ministerial Conference of February 2024.

The expansion of trade in the era of hyperglobalization has been closely tied to the spread of global value chains (GVCs) controlled by large firms that are primarily headquartered in advanced economies. In parallel, a growing number of developing countries have participated in the international division of labour by providing specific links in these chains, drawing on their abundance of unskilled labour. This mode of international integration was based on the promise 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. This raises questions about the strong bets made in many developing economies on the spillovers expected from processing trade. 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 registered in several developing countries, mostly in East and South-East Asia, has proven difficult elsewhere.

Along with the rise of export market concentration, large firms have increased their ability to extract rents. Empirical evidence indicates that the rise in profits of large multinational entreprises, together with their growing concentration, is a driving force pushing down the global labour income share and exacerbating income inequality. This has also led to unequal trading relations, even as developing countries have deepened their participation in global trade. New data points to two main trends:

"The rise in profits of large multinational entreprises, together with their growing concentration, is a driving force exacerbating income inequality."

- 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.

A healthy trading system is crucial for meeting the 2030 Agenda. It remains unclear whether key trade partners have the political will to guide the system through its current difficulties. In 2023, the Group of 90 countries at WTO identified 10 specific multilateral trade agreements that would require revisions to allow more policy space for countries to be able to redesign their production, consumption and trading profiles to face contemporary global challenges. The Group of 90 proposal seeks to strengthen existing flexibilities for developing members, to make them more precise, effective and operational and to more effectively address members' development aims. Failure to address these concerns in a pro-development and cooperative approach may further exacerbate today's asymmetries. This will make it even more difficult for the world to deliver on the 2030 Agenda.

Trends in commodity markets

The aggregate Commodity Price Index registered a drop of more than 30 per cent in May 2023 compared to the previous year. The reduction in aggregate prices has primarily been driven by fuel commodities, which experienced a significant drop of over 40 per cent during this period. However, some product groupings in the UNCTAD Commodity Price Index registered more muted reductions during this period, to remain at historically high levels. The prices of minerals, ores and metals declined only 4 per cent, while food dropped by just 2 per cent.

Four factors explain the moderation of commodity prices. First, price surges in crude oil, natural gas and grains following the outbreak of the war in Ukraine eased from the middle of 2022. This was due to a reorientation of trade flows of key commodity exports from the Russian Federation and Ukraine, and the brokering of the Black Sea Initiative in July 2022 to enable the shipment of grains and other materials from strategically important Ukrainian ports. The second factor is the deteriorating outlook for global demand, compounded by monetary tightening across the globe. Third, restrictive monetary conditions and an accompanying uptick in international interest rates prompted investors to move financial investments away from commodities towards higher interest-bearing assets. Fourth, the slower than expected rebound in China following the reopening of its economy and the persistent weaknesses in its real estate sector also contributed to the loosening of broad commodity price indices after the peaks reached in 2022.

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 noted by the United Nations Global Crisis Response Group, international food prices were already approaching historic highs even before the outbreak of the war in Ukraine, causing food import bills to rise dramatically. About two thirds of the increase of costs were concentrated in developing countries. The further climb in international food prices after February 2022 left many developing countries facing 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.

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 transmission of lower international prices to domestic prices has been weak. In several developing countries, the domestic prices of basic foods in June 2023 remained above their levels of the previous year and continue to impact food security. Relevant factors keeping domestic prices at elevated levels include high fertilizer costs, adverse weather, high distribution costs, strong indebtedness as well as domestic currency weaknesses. The financialization of food systems and the pricing behaviour of large commodity traders have also played a role in price and market volatility. As a result, almost 350 million people worldwide – including more than 100 million people in sub-Saharan Africa – are estimated to be food insecure in 2023, which is over double the number in 2020.

Global financial conditions and developing country vulnerabilities

On the eve of the COVID-19 shock, many developing countries already faced unsustainable debt burdens. Since then, compounding crises, along with the most aggressive monetary tightening in developed countries since the 1970s, have exacerbated this situation. 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. External debt servicing is draining resources away from delivering on the 2030 Agenda and on the goals of the Paris Agreement.

One difference between the current and previous debt crises in the developing world is that emerging market economies, i.e. countries that were brought into international financial markets in earlier periods, are not at the forefront. This time around, it is generally 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, referred to as "frontier market economies" (FMEs), have been the hardest hit. 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. The current structural paradigms are proving 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 factors contributing to the unfolding crisis of debt service include: insufficient official development assistance, a relative decline of official concessional financing (and the denial of access to some categories of developing countries for such schemes), decisions of credit rating agencies and an inadequate global financial safety net. Added to this is the significant presence of illicit financial flows (IFFs), which diminishes the scope for mobilizing domestic resources.

"Total public debt in emerging markets and developing countries has nearly doubled, reaching 64 per cent of GDP by 2022."

Given the magnitude of the debt challenges faced, a renewed sense of urgency to advance multilateral solutions is required. 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. Their debts, both 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 gross domestic product (GDP) between 2010 and 2021. 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 seen their currencies depreciate 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 in 2010 to 50 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. Most of these countries experienced declines in their Human Development Index in recent years. 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."

Within developing countries, frontier market economies 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 collectively, FMEs only represented 8 per cent of their GDP and 6 per cent of their total public debt in recent years, vis-à-vis the total of developing countries, they accounted for 20 per cent of developing countries' total external public debt. 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.

"Currently, at least 3.3 billion people live in countries that spend more on interest than on either health or education."

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 next few years. 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 emerging market economies and frontier market economies 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 will undermine debt sustainability. Without measures to effectively address this dynamic, most countries are expected to prioritize fiscal consolidation to stabilize debt levels. Regrettably, this dynamic will place attaining the 2030 Agenda even further out of reach.

Food commodities, corporate profiteering and crises: Revisiting the international regulatory agenda

The last few years of commodity price volatility have coincided with a period of record profits for global energy and food traders. In food trading, the four companies that conservatively account for about 70 per cent of the global food market share registered a dramatic rise in profits during 2021–2022. The asymmetry between growing risks to food security of millions around the world and profiteering by a few corporations, became particularly stark during 2022–2023. In the highly concentrated commodity trading industry, the superprofits enjoyed by agripolies trickle down very slowly, if at all, to local farming communities.

Increasingly, warnings about this asymmetry come from market analysts, civil society, regulators and international organizations concerned with the lack of regulatory oversight of commodity trading. Yet opacity, cross-sector interconnections and intragroup corporate activity pose major hurdles in any effort to scope the problem, identify risks and workable solutions. This can explain why, despite growing public attention on the issue of market concentration and profiteering, current policy debate on possible multilateral solutions to the food systems crisis has not addressed this question in depth.

The current predicament has illuminated two key aspects of the status quo. First, there is ample evidence that banks, asset managers, hedge funds and other financial institutions continue to profit from the most recent bout of commodity market volatility. Second, by actively managing risk, commodity trading firms have assumed many financing, insurance and investment functions typically associated with the activity of banks. In this context, large international trading firms, or ABCD-type companies,[1] have come to occupy a privileged position in terms of setting prices, accessing financing and participating directly in the financial markets. This enables speculative trades in organized market platforms as well as in over-the-counter operations, over which most governments in advanced countries have no authority or control.

[1] Large firms of a size and stature akin to the four big commodity traders, Archer Daniels Midland, Bunge, Cargill and Louis Dreyfus Company, known as “ABCD” because of the coincidence of their initials.

This Report presents results from UNCTAD research that studies patterns of profiteering in the global food trading sector. Analysis reveals that unregulated financial activities play a major role in the profit structure of global food traders. Relatedly, corporate profits from financial operations appear to be strongly linked with periods of excessive speculation in commodities markets and the growth of shadow banking.

Three specific findings follow from this analysis. First, food trading companies have come to rely on the use of financial instruments and engineering not simply to hedge their commercial positions, but to strategically ride the wave of market volatility. Second, market and price volatility appear to have a much more pronounced role in the sector's financial operations, in contrast to their core commercial activities. Third, financial instruments and techniques designed for hedging a range of commercial risks are being used by the sector for speculative purposes. This is enabled by the current regulatory architecture of commodity trading as a whole, which remains diluted and fragmented.

A key consequence of this regulatory fragmentation is the dichotomy between the regulatory treatment of commodity traders as manufacturing corporations on the one hand, and their increasingly more profitable (yet unregulated) activities in financial markets, on the other. The concept behind this distinction between commercial and financial market participants is that an industrial business should only look for security in prices, not betting for the sake of it. However, large grain processors with access to a wealth of information regarding food markets have a clear interest in using their hedging activities as a profit centre. In the process, they tend to change their business model and start operating like a financial actor, benefiting from exemptions designed for purely commercial hedgers.

"Large grain processors with access to a wealth of information regarding food markets have a clear interest in using their hedging activities as a profit centre."

In the case of major food giants, using hedging for purely speculative purposes appears to take place at the level of subsidiaries, and is often not reported at a consolidated level. Specifically, by using a series of subsidiaries located in appropriate jurisdictions, food monopolies have found a way to combine several advantages:

- A superior knowledge of the agricultural commodities markets (real-time supply and demand and prospective knowledge of how the markets will evolve);
- An ability to store agricultural commodities to harness price surges when they occur: ABCD invested heavily in infrastructure for storage and built significant grain reserves; but with no obligation to disclose their grain stocks;
- The secrecy of their operations and benefiting from derogations to the rules applicable to pure financial actors; ABCD have legally structured their operations using hundreds of subsidiaries incorporated to take advantage of the various menus of regulations (or lack thereof) offered by different jurisdictions, including secrecy jurisdictions, around the world.

Empirical analysis by UNCTAD indicates abnormal use of intragroup transfers within private corporate groups. Intragroup transfers are financial transactions between legally independent entities within a corporate group. The analysis led to three key findings:

- First, the cases showing growth in asset dominance are observed primarily at the subsidiary level within the group, indicating increased use of intragroup transfers.
- Second, this suggests that the amount of excess profits being made could be underestimated when only looking at public profit and loss reporting.
- Third, profiteering is not limited to a specific sector but is specific to individual firms. There are concerns that excess profits may be linked to market concentration, benefiting only a few global players in the commodity trading community. This reinforces the need to consider group membership and the evolving behaviour of major international players in the sector.

"Profiteering reinforces the need to consider corporate group membership and the behaviour of major players in the food trading sector."

These three issues crystallized in the commodities sector at the peak of the energy crisis in 2020–2021, when market volatility threatened the financial stability of clearing houses and required the support of public liquidity injections.

The growth of unregulated financial activities within today's food trading industry suggests that financial stability risks may evolve under the radar of regulators, while corporate influence over strategically significant markets continues to grow. This compounds the challenge of detecting and curbing excessive market speculation in commodity and food trading; it can add to risks of the shadow banking system and thus endanger financial stability. It also conceals IFF risks and exposures in the poorly regulated yet highly interconnected and systemically important food trading industry.

"The historical approach, which distinguishes between commercial and financial operators in agricultural commodity derivatives, is ill-suited to the current economic and legal structures of global trade in certain agricultural products and their associated derivatives."

Together, these developments warrant a revision to the existing regulatory architecture of commodity trading. The historical approach, which distinguishes between commercial and financial operators in agricultural commodity derivatives, is ill-suited to the current economic and legal structures of global trade in certain agricultural products and their associated derivatives. Possible solutions centre on three interrelated levels of policy reform that capture the connection between market practices and financial activities:

(a) Market-level reform: close loopholes, facilitate transparency;

(b) Systemic-level reform: recognize aspects of food traders' activities as financial institutions and extend relevant regulations;

(c) Global governance-level reform: extend monitoring and regulations to the level of corporate subsidiaries in the sector to address the problem of the origin of profits, enhance transparency and curb the risks of illicit financial flows.

Crucially, all three levels of necessary action require much more cooperation on data quality, disclosure and corporate transparency in the sector. At the same time, while data transparency is necessary, it is insufficient for market participants to discover prices. What is required is a process in which all market participants contribute daily price information, and which is accessible to all participants and regulators on a daily basis.

The role of monopolies on strategically important markets in times of crises and the complexity of global corporate and financial structures that enable speculation and profiteering not only require close attention, but also smart policies. Regulation of these interconnected problems needs to be targeted to the specific issues at hand, at a multilateral level. Crucially, reforms need to be conceived in an integrated way, targeting key priorities across the system. More specifically:

(a) The problem of excessive financial speculation in commodities markets needs to be addressed along with the problem of unregulated activities in the underregulated sector;

(b) The issue of corporate control over key markets cannot be resolved by antitrust measures alone but requires a coherent framework of national competition and industrial policies;

(c) International cooperation and commitment are critical in the effort to enhance data quality and transparency in commodity trading and curb the risks of financial instability and illicit finance.

Reforming the international financial architecture: The view from UNCTAD

The international financial architecture (IFA) is a framework of institutions, policies, rules and practices that govern the global financial system. Aimed at supporting international cooperation, IFA focuses on ensuring monetary and financial stability, international trade and investment and supporting the mobilization of financing required for sustainable development in the age of climate crises.

Recurring financial and debt crises, as well as the shortfall in required development and climate finance, highlight that the scope of today's financial, macroeconomic and development challenges stretch far beyond the IFA framework, the institutional core of which was created in the mid-twentieth century. And while many of today's problems are of a systemic nature, two aspects have been apparent from an early stage.

First, the framework of the IFA and its institutions are not set up to deliver the kind of financial support needed by developing countries to realize their growth and development ambitions in a rapidly changing global economy confronted with climate crises. Second, given that they often have sizable and lasting current account deficits, developing countries operate under conditions of asymmetrical access and restricted policy autonomy. This contributes to the accumulation of unsustainable external debt burdens.

The search for a desired change of direction requires these systemic challenges to be addressed comprehensively. However, both the required global agreement and the political will to take reforms forward have been lacking. Instead, a wide range of more piecemeal and ad hoc reforms have been pursued. A series of recent reform proposals (new institutions, new alliances between existing institutions, new policy instruments, and new systemic thinking), often initiated by developing countries, may be advanced into the basis for an alternative international financial architecture.

These proposed revisions are often contested, partly because they may appear incoherent both between themselves and with the current IFA. Yet, they are widening the scope for institutional experimentation and may eventually give rise to more participatory and sustainable global monetary and financial governance. UNCTAD promotes a systemic approach to finance, trade and development, and an insistence on structural transformation has put the institution ahead of the curve. Nevertheless, it is increasingly clear that a truly systemic approach goes beyond the interdependence of trade and finance. It must also incorporate the challenges that arise from environmental shocks and sustainability, most urgently linked to climate and biodiversity challenges, as well as geopolitical risks.

Chapters IV through VI of this Report analyse two sets of such challenges. The first involves promoting economic and financial stability in a world that is becoming increasingly financially fragile and vulnerable to cross-border spillovers. Timely and adequate liquidity support and an adequate financial safety net, combined with mechanisms to reduce trade imbalances and ensure capital for investment-led growth, have long been central to how UNCTAD would view an inclusive and sustainable international financial architecture.

The second set of challenges includes the need to secure vast financial resources to support economic, social, and human development; to make progress towards the Sustainable Development Goals; and to develop frameworks for the necessary cooperation to address complex problems in the global commons (e.g. global pandemics, climate change, forced displacement, tax avoidance, and cyberrelated risks).

Chapters IV to through VI of the *Trade and Development Report 2023* build on UNCTAD approaches to reforming the international financial architecture and advances proposals for a resilient, climate-oriented ecosystem of debt and financial governance.

Redesigning the global debt ecosystem to work for developing countries

A succession of recent crises and external shocks – often non-economic – has added to the burden of debt service across many developing countries. In parallel, the period of low growth globally and the effects of monetary tightening in core markets endanger pathways for export-driven recovery in developing countries. In these conditions, the historical narrative around the origins of and solutions to the sovereign debt problem is losing credibility.

Resolving sovereign debt burdens is made more complex due to deficiencies in IFA, which repeatedly falls short in providing timely and adequate support to countries in distress. The Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative of the Group of 20, introduced during the COVID-19 pandemic, has proven sluggish and insufficient for effective debt restructuring. The hierarchical nature of the international financial system, marked by resource asymmetries, exacerbates these challenges and prompts many countries to accumulate more debt. These compounding problems demand a re-evaluation of how nations navigate the intricate landscape of sovereign debt across four key areas of global debt governance: transparency, sustainability tracking, debt resolution and restructuring.

The current debt landscape is both highly diverse and complex. Developing countries' sovereign debts surged to $11.4 trillion by the end of 2022, reflecting a 15.7 per cent increase since the onset of the COVID-19 pandemic. Recently, creditor composition has shifted too, with a significant rise in the share of private creditors. Private creditors' holdings almost doubled to 13 per cent in 2021 (up from 7 per cent in 2010), with bondholders' share reaching 4 per cent (from a share of 0 per cent in 2010).

The past three years have laid bare that an unforeseen shock can put many countries in a precarious position. The continual servicing of barely affordable debt places countries under a considerable burden and drains resources from development. On average, at the end of 2022, the debt service burden as a share of export revenues was 15.7 per cent for middle-income and low-income countries as a group, while it was 22.6 per cent for low-income countries as a group.

"The continual servicing of barely affordable debt places countries under a considerable burden and drains resources from development."

The historical mechanisms to resolve the problem of sovereign debt restructuring are ill-suited to respond to these changes. In approaching this problem, the international community has tended to engage in a practice of "muddling through", combining exchange offers with political pressure and an expansion of financial support instruments, particularly a proliferation of new funding instruments at IMF.

Undergirding these efforts was the idea that austerity would re-establish creditor confidence, stabilize the fiscal position and trigger future growth in borrowing countries. On the downside, debt workouts continued to cause considerable damage to the economic and social stability of populations in borrowing countries, particularly among less affluent and more vulnerable groups. Human rights challenges to austerity succeeded in only a small number of cases. Some of the more successful cases of debt restructuring, such as in Barbados and Greece, featured the retroactive insertion of collective action clauses into domestic debt. Innovations in bond design, such as bonds linked to GDP, issued for example by Argentina and Greece, were meant to allow smoother recoveries. However, in the case of Argentina, this resulted in litigation over the method of calculating GDP.

The COVID-19 pandemic and concurrent ecological and geopolitical crises have underscored that a lack of government investment in health care might do more harm than good. At present, climate change and the need for a transition to clean energy follow a similar pattern, requiring upfront investment to mitigate longer-term consequences. Furthermore, inflationary pressures associated with value chain distortions and energy issues in the wake of the war in Ukraine have created adverse conditions for borrowing countries, putting many at risk of downgrading.

IMF has signed credit agreements with approximately 100 Governments since 2020; 13 countries have since defaulted: Argentina, Belarus, Belize, Chad, Ecuador, Ghana, Lebanon, Malawi, the Russian Federation, Sri Lanka, Suriname, Ukraine and Zambia. In addition, exposure of borrowers to new non-Paris Club creditors, such as China, has reached a crucial point, calling into question an institutional structure centred on the Paris Club and creating additional challenges for debt transparency. In this context, the sovereign debt debate has shifted towards global public policy instruments and away from overconfidence in markets or advanced countries.

To change this dysfunctional debt architecture, a new, development-centred ecosystem is needed. This requires a comprehensive re-evaluation of factors that contribute to unsustainable sovereign debt, such as climate change, demographics, health, global economic shifts, rising interest rates, geopolitical realignments, political instability and the implications of sovereign debt on industrial policies in debtor States. New creative thinking needs to be developed along the entire sovereign debt life cycle.

For debt workouts to be transformed in such a way that they contribute to sovereign resilience, multiple innovations both of a private (contractual) and a public (statutory) nature are required. These need to be coordinated rather than played out against each other. Improved sovereign debt restructuring requires substantive and institutional changes to the existing framework, potentially built around six key elements.

First, an automatic standstill for countries declaring distress is needed, to concentrate the minds of creditors on the workout process. This would prevent holdouts and encourage debtor countries to enter the distress stage before it is too late. Early declaration of distress and early resolution would prevent countries being locked out of markets for a prolonged period. To ensure creditor equity, a standstill might be a useful device to ensure inclusion of private creditors, as would principles on comparability of treatment and rules to prevent creditors from realizing collateral.

Second, a mechanism is needed to determine the perimeter of legitimate debt. This relates to rules regarding unconstitutional debt resulting from corruption, opacity and secrecy, flawed authorization and reckless creditor practices.

Third, at the country level, improved debt sustainability analysis needs to be available. Yet, it should not only reflect the need to achieve the Sustainable Development Goals and climate transition, including related investments and necessary industrial policies. Ideally, it should also empower country negotiators with improved data on their potential for growth and fiscal consolidation. This requires developing countries to have their own models, but it also requires greater transparency of the IMF debt sustainability analysis models and assumptions (and ideally, a willingness from IMF to modify them where necessary).

Fourth, country specifics need to be reflected in institutional flexibility and innovative approaches in macrofinancial policies. Discretion should be exercised over the use of various types of capital controls as part of the ordinary toolkit of developing countries. Improved innovative financial instruments are needed, such as debt-for-climate swaps or debt-for-nature swaps, that provide mechanisms to enhance fiscal space – albeit at the margins.

Fifth, the system needs an institutional framework that fosters resilience. Given the significant current ecological, social and geopolitical challenges, institutions charged with regulating sovereign debt need to bridge differences between constituencies and stakeholders. This speaks in favour of large, universal organizations, including the United Nations. Other actors, such as the Group of 20, might play a crucial role, particularly in ensuring the support of a wide range of capital-exporting States.

Sixth, a borrower's club needs to become part of global debt governance. Through a borrower's club, debtor countries could discuss technical issues and innovation, bond issuance experiences or novel debt instruments for sustainable development – and learn from each other's experiences. Debtor countries with recent experience could advise those facing debt distress on reducing their restructuring costs or building political relations between the debtor countries. This support could lead to a more stable and resilient global financial system, benefiting both borrowers and creditors.

Specific policy recommendations for a development-centred global debt architecture are to:

- Increase concessional finance through capitalization of multilateral and regional banks, and issuance of special drawing rights.
- Enhance transparency in financing terms and conditions, using the digitalization of loan contracts to improve accuracy.
- Revise the UNCTAD *Principles for Responsible Sovereign Lending and Borrowing* to motivate and underpin the importance of guiding principles throughout the stages of sovereign debt acquisition.
- Improve debt sustainability analysis and tracking to reflect the achievement of the Sustainable Development Goals and empower country negotiators with improved data on their potential for growth and fiscal consolidation.
- Enable countries to utilize innovative financial instruments such as sustainable development bonds and resilience bonds. Develop rules for automatic restructurings and guarantees.
- Enhance resilience during external crises, for example by implementing standstill rules on debtors' obligations in crises, and create a space to enable the avoidance of debt distress.
- Encourage borrowers to share information and experiences, drawing inspiration from private creditor coordination.
- Initiate work on a more robust debt workout mechanism and a global debt authority.

Financial reforms for climate-aligned development

The vulnerabilities in the current economic situation add tension to the intensifying debate on how to scale up finance and better guide it towards climate-aligned development. It is essential to reconcile ecological and developmental priorities and reflect this in the scale of finance available to developing countries and the terms on which it is offered.

The international financial system continues to deliver only a fraction of the financing needed – despite the relatively auspicious environment of a decade of record low interest rates and a slew of pledges from Governments, financial institutions and corporations. Now that lending conditions have changed, it is even more essential to address two major challenges that are the root cause of this. First, there is a need to reassess the role and optimal forms of participation of the public and the private sectors in financing economic transformation, which is marked by uncertainty, risk and redistribution. This is not a new story, but it is an urgent one. Second, continued patterns of public and private financing often lead to climate goals being undermined, directly and indirectly, and this is exacerbated by a lack of finance to cover the economic and social costs of transition. One example where finance flows are inconsistent with climate pledges includes the trillions of dollars still supporting fossil fuels.

"There is a need to reassess the role and optimal forms of participation of the public and the private sectors in financing economic transformation, which is marked by uncertainty, risk and redistribution."

The starting point of any reform should be the view that climate finance needs to be in addition and complementary to development finance. Current negotiations with respect to the climate agenda represent an important opportunity to align the two. The guiding principles to achieve this can draw on the lessons from the original New Deal of the 1930s and offer a means to tackle economic insecurity, long-standing infrastructure gaps and climate and finance inequalities.

From this view, one of the most obvious and elemental reforms would be to ensure that public funds pledged for development and climate action are indeed paid, as promised. In 2022, official development assistance was the equivalent of just 0.36 per cent of Development Assistance Committee donors' combined gross national income, much less than the 0.7 per cent pledged by these donors decades ago. Just 5 out of 32 of these donor countries meet their pledged target, meaning that tens of billions of dollars could be generated if the remaining members honoured their pledges.

In addition to the magnitude of finance available, what is also lacking is ease of access to finance for those who need it. One of the most effective ways to enable this would be to strengthen support to public development banks – of which there are more than 450, varying in size and scope, and with national, regional, or multilateral remits and ownership.

Public development banks have the mandate to follow social or economic imperatives beyond short-term profit maximization, meaning they are potentially able to lend for development and climate purposes that offer a social or ecological benefit and not necessarily a financial one. This objective, aligned with their capacity to create and leverage credit over and above the funds they receive, and the fact they can often access concessional finance for on-lending with other banks, including commercial ones, and private investors, means they can be an effective means of scaling up. Equally importantly, these banks also have the technical, managerial and operational skills necessary to utilize the finance effectively once it is raised. In addition to increasing banks' base capital, it is crucial to expand the lending headroom of development banks, widening out their lending activities to the poorest parts of the world, and enabling them to provide not only concessional loans and grants, but also loans in local currencies in collaboration with national development banks.

Central banks can also have a key role in shaping the national and international agenda for climate and development finance. Some central banks in both developed and developing countries are already implementing such policies, yet more could be done to enable these core institutions to play the market shaping roles of the not-so-distant past. Several central banks already have monetary policies and regulatory frameworks that aim to help realign finance with decarbonization targets. Several are incorporating climate risks and climate stress tests into their operations. More could be done to require these banks to report on financing related to Sustainable Development Goals, in addition to climate goals.

Some banks, including central banks and development banks, have set goals for divesting from coal, oil and gas. However, many more are continuing to lend to this sector and herein lies a major challenge for most countries and governments. The trillions of dollars' worth of lending for exploration and operation in this high-carbon sector, in addition to further trillions of dollars of subsidies to fossil fuel producers and consumers, is at odds with the ambition to reduce CO_2 emissions.

At the same time, for many developing countries, fossil fuels continue to be the most likely source of realizing basic electrification and development needs, in the short-term at least. Furthermore, fossil fuel subsidies are a blunt tool used to support low-income households. Principles of “common but differentiated responsibility and respective capabilities”, “special and differential treatment” and “polluter pays” are well established in international law and provide a basis for articulating the respective obligations between richer and poorer countries. Much would need to change for this to be reflected in practice.

How can the record be changed? The COVID-19 pandemic has shown that when the will is there, Governments and their institutions can use their powers to mobilize vast amounts of capital for the welfare of their citizens, to restrict harmful activities and repurpose industries to achieve national goals.

This is not to say that all choices made during the time of the pandemic were perfect; but rather, it shows how it is possible to achieve rapid and profound change. One of the most effective ways to do this today needs to be addressing the continued dependence on fossil fuels head-on; to wind down the most problematic and polluting activities and shift to cleaner and renewable activities, while at the same time ensuring that development benefits are created and development needs are met. It means finding alternative long-term support for low-income countries and poor households and financing alternative paths for development. This is no simple matter, and would require a fundamental realignment of the financial system to orient finance towards supporting social and development needs, while respecting environmental limits.

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