

ECOSOC High-Level Policy Dialogue
Current Developments in the World Economy
2 July 2010

Opening

The High-Level Policy Dialogue was moderated by Mr. Sha Zukang, Under-Secretary-General for Economic and Social Affairs

In his opening remarks, Mr. Sha stated that the purpose of the meeting was to share perspectives on what steps the international community should take to climb out of the most severe recession since World War II. He stated that the world economy contracted by 2 per cent in 2009 but is expected to grow 3 per cent during 2010 and 3.1 per cent in 2011. The pace of recovery has been uneven and has not created sufficient jobs. Asia is doing well but other parts of the world are still lagging behind. Fiscal stimulus measures have been the driving force behind the economic recovery. However, the inherent fragility caused by these measures could become a source of renewed financial instability.

Mr. Sha summarized four main points detailed in the *World Economic Situation and Prospects 2010* report. First, the highest priority should be given to dealing with the jobs crisis. Second, greater efforts are needed to reverse setbacks in progress towards the achievement of the MDGs, where the estimated shortfall against Gleneagles commitments will be \$20 billion in 2010. Third, the global crisis has highlighted the need for improved emergency financing through liquidity buffers in the form of regional and international reserves. Fourth, there must be strengthened international policy coordination.

Mr. Sha noted there are no simple recipes for development success, and we need to avoid the “one-size-fits-all” approach. Developing countries must own their development strategies.

In concluding, as Secretary-General of the Rio+20 Summit, Mr. Sha urged all the stakeholders to accelerate the implementation of sustainable development goals and to help build the momentum towards success in Rio in 2012.

Mr. Supachai Panitchpakdi, Secretary-General, UNCTAD

Mr. Supachai began by stating that the economic recovery has been deeply fragile and highly uneven, driven by artificial demand created by the huge fiscal stimulus in response to the economic crisis. In order to craft policies to overcome persisting weaknesses, the right understanding of the background of the crisis is necessary, and he pointed out six trends:

- First, consumer demand remains constrained. Households and other economic actors are still managing excessive debts without outside facilitation, such as employment creation, which hampers their ability to pick increase spending.

- Second, there is little real financial recovery. There is some recovery, but the linkages between the financial sector and the productive sector has not been re-established. Lending practices are not the same due to risk-aversion.
- Third, stimulus spending has been incurred in the hopes of a Keynesian ‘multiplier’ effect; however, the net creation of employment has not been positive since most of the spending has occurred in areas of non-productive activity, such as public health and welfare, which do not lead to job growth. If another round of stimulus spending is to occur, it should be aimed at productive investment.
- Fourth, the large stimulus has led to expansion of public debt. While an impact on the debt market and public finances were foreseen, it was not at the depth that is currently being observed. A fiscal crisis in Europe is contagious and this could lead to another round of financial instability and crisis around the world.
- Fifth, an exit strategy from the current situation is needed. Thus far, trade has been leading the way in the renewal of growth. However, growth should not be propelled by trade growth only; it must also be balanced by domestic demand. It will also be necessary to caution against a rise in trade restrictions.
- Sixth, more and better coordination is needed as the G-20 tries to devise an exit strategy. The coordination of exit strategy is known to be more complicated. Currently, the “Sinatra syndrome”, where each country does it “My Way”, is visible in their approach, as some countries insist on deficit reduction and others on additional stimulus measures. To address this lack of harmony, commitments to the spirit of trade negotiations must materialize. One hopeful development in the G-20 meeting in Toronto was the promise to look at the analysis of the effect of trade liberalization on development, which would give a reason for the incorporation of development issues at the next summit and as a permanent part of the G-20 agenda.

Mr. Supachai pointed out that all of the above could lead to structural shortcomings that will affect the rest of the world. Economic growth in developing countries is uneven, and in particular for the least developed countries (LDCs), it does not measure up to past achievements of growth, making MDG achievement extremely difficult. The ILO has recently concluded that a structural result of the crisis has been that most of the new jobs in the developing countries have been in the informal sector and there are 200 million more working poor.

To better the current situation and get back on track to MDG attainment, four things must be done:

- First, more resources must be mobilized for developing countries and supplementary sources of financing must be found. Remittances are one such option due to their significant role and consistency throughout the crisis. Domestic resources are another such option. South-South cooperation has also been a positive and growing trend.

- Second, inequalities must be addressed in order to achieve inclusive growth. Investments in small-scale producers, education that leads to employment, and in agriculture, especially in extension services, are needed.
- Third, the roles of State and market must be further defined, and state institutions must be strengthened along with market liberalization. In certain areas, such as agricultural investment, carbon-neutral policies and establishing a green economy, Government should lead the way.
- Fourth, international cooperation should be enhanced in order to increase the level of financial assistance and rebalance investment towards social and economic goals. There also needs to be better aid coherence.

On the final point, Mr. Supachai noted that from the recipient countries' perspective, there is a need for a central body to monitor, assess and audit development effectiveness of aid and make aid counter-cyclical. He closed his statement by proposing a forum or commission to this end.

Mr. Reza Moghadam, Director, Strategy, Policy and Review Department, International Monetary Fund

Mr. Moghadam stated that he agreed with Mr. Sha's characterization of the current state of the recovery as uneven and fragile. He added that the world economy was on a precipice but that it was pulled back through multilateral action, such as a coordinated stimulus, coordinated action by central banks, coordinated financial sector actions and a commitment to a free-trade regime. There has been no major increase in protectionism, not in financing for developing countries through the IMF, World Bank and other multilateral banks. There was multilateral action on many fronts.

Mr. Moghadam noted that the persistence in fragility is due to concerns about the financial sector and fiscal sustainability, as well as uneven demand across the globe. To address this, continued multi-lateral actions are needed. There are visible positive trends in this direction, as shown by the recent G20 commitment to put frameworks in place for multilateral action.

The good news for developing countries is that while the crisis was severe, there has been no major increase in indebtedness and fragility on a scale with what has taken place in the past. However, continued and increased investment is needed to maintain economic growth. Traditionally, this has been done through concessional lending but there is also a need for non-concessional financing. An increase in the capacity to manage debt is also needed in developing countries.

Mr. Moghadam concluded by saying that the IMF is focusing on the current framework for building capital to manage debt and investment in developing countries. He also stated that good global governance is needed for multilateralism to work in a more effective way.

Otaviano Canuto, Vice President, Poverty Reduction and Economic Management Network, World Bank

Mr. Canuto pointed to a convergence of views on a series of points about the crisis with the two previous speakers. He agreed that multilateral action was at the core of success in dealing with the crises. He also concurred that the recovery has been fragile and uneven, for the reasons mentioned by Mr. Supachai, and noted that the appropriate path for a stronger recovery is still being researched. He also emphasized the considerable impact of the financial crisis on the poor: 64 million additional people in developing countries are living on less than \$1.25 a day than if there had been no crisis. He also expressed the concern that their coping strategies will likely have long-term consequences.

Mr. Canuto then offered four additional points. He stressed that, first, we must remain focused on the path to MDG achievement without deviation. Second, a mutual accountability compact towards MDGs must be reaffirmed. This will mean that developed countries keep their commitments to enhanced trade openness, aid and debt relief, and, in turn, developing countries focus on good governance and all the elements in the compact since Monterrey. International institutions must become more representative of how the world is now and fairer and more responsive to the range of stakeholders. He observed that international institutions are making common effort to meet this compact. Third, to validate the previous points, he made a strong case for the upcoming replenishment of the International Development Agency (IDA) with appropriate funding for low-income developing countries. Fourth, instruments and mechanisms must be developed to evaluate impacts of actions. He stressed the need to examine what works and what does not work under different circumstances in developing countries. In this respect, he agreed with Mr. Sha that there is no one-size-fits-all and called for urgent action in this regard. Mr. Canuto concluded by informing that the World Bank is making a huge effort in collecting information and learning from practitioners.

Clemens Boonekamp, Director, World Trade Organization

Mr. Boonekamp concurred with the previous speakers and began by focusing on a simple message of the WTO Director General: growth is needed with jobs, without further stress on the fiscal situation, and trade allows to do both.

Mr. Boonekamp emphasized that economic growth has been occurring through trade. Trade volume is expected to improve by 9.5 per cent in 2010 and may even exceed 10 per cent.

He also underscored the importance of multilateralism, stating that it has proven its value and that the multilateral trading system, with its discipline and rules, has shown itself to be of real merit. There has been remarkably little protectionism in response to the crisis. While there has been some increase in resort to protectionism, such as import tariffs and import bans, this is expected to affect only 0.4 per cent of world trade. This is so-called contingency protectionism and legal within the framework of WTO. He considered that WTO is showing its value in holding protectionism at bay.

Mr. Boonekamp noted that while trade is leading the way at the moment, trade alone will not be enough. He stressed that coherent economic policies and strategies are an absolute must. The Doha Development Agenda must be completed, which will allow \$300-700 billion worth of stimulus to the world economy. While the process is moving very slowly and has been frustrating, he assessed that it is almost 80 % towards the end. The negotiations have come to a political impasse. Countries now need to start exchanging concessions and be realistic about what can be done. Trade can help lead the way towards more solid economic recovery, but a conclusion of the Doha Round is necessary for sustainable results. Such conclusion is possible with sufficient political will. Mr. Boonekamp shared the view that the round could be completed shortly into 2011.

Comments and Questions

Ms. Patricia Francis, Executive Director, International Trade Centre, voiced her support for increased international cooperation through such initiatives as Aid-for-Trade and emphasized that the focus should be on efforts that would produce the greatest multiplier effect. She stated that the share of trade in economic recovery could be significant, especially in North and West Africa.

Ms. Francis also emphasized that 70 per cent of the world's poor are women and any solution that is sought must not only be inclusive but also proactive in addressing the challenges faced by women. In particular, the informal sector is dominated by women as some statistics show. She therefore supported a coordinated multilateral action that will improve the business environment to address access to finance by business, especially by women-owned enterprises.

Ms. Francis concurred that a good understanding of markets and the international trade in goods and services is needed to address economic issues constructively. She expressed her support for balancing economic and social goals and emphasized the need for sustainable jobs to reduce poverty. She noted that this can only happen when countries take real ownership of their development objectives and have coherent balance between development and trade objectives, supported by financial resources.

Russia agreed that consumer demand is stagnant and called for the UN's engagement with international financial and trade institutions. Concern was expressed about 'bad' assets, currently estimated at \$2.3 trillion, and about a decrease in real estate prices and its negative impact on balance sheets. It called for a reassessment of the model of growth of the leading economies and for a nexus between the G-8, G-20 and other fora in order for relevant proposals to emerge and be evaluated.

Peru complimented the speakers on the enriching debate, but noted the lack of results in the Doha Development Round and its effect on international trade. Pointing to the current existence of 461 bilateral and/or multilateral free-trade agreements (FTAs), the delegate queried whether these agreements would fit in the structure of the Doha Round. The need for a better structured multilateral system and speedy results was also emphasized, but it was noted that negotiations have been occurring for 9 years without conclusion and that the number of FTAs may increase

even more. Peru asked how the FTAs can be made compatible with the international trade system or whether the trend of increasing FTAs will become an obstacle to the Doha Round.

Indonesia noted that global economic growth of about 3 per cent is expected in 2010 but also stressed that challenges in fiscal consolidation and the sovereign debt crisis could be potentially contagious. The economic recovery has been elusive, and fiscal space has been limited. The need for new sources of growth, stimulating trade and investment, to complement demand was also highlighted as was the desire to see economic growth and employment creation as outcomes of the Doha Round. Indonesia recommended structural reform to reduce fiscal deficits and a balanced approach between short-term recovery and long-term economic sustainability and called for country specific approaches. The representative noted that global problems require global solution addressed in inclusive manner and pointed to the need for effective coordination to develop a mechanism to address such challenges – one that would become part of the international agenda.

St. Lucia asked for clarification of Dr. Supachai's comments. The delegate enquired whether domestic sources of financing and remittances can indeed be relied upon, as those sending funds from abroad have also been affected by unemployment. With regard to domestic services and savings mobilization, it was pointed out that the private sector in many developing countries is limited, and therefore domestic savings and investment often remain an elusive goal. St. Lucia also requested clarification of Mr. Moghadam's remarks, expressing skepticism about IMF's assessment that vulnerability will not increase for indebted countries. St. Lucia also inquired of the WTO whether the agro-industry and agro-processing are included when the agricultural sector is discussed or if it is just the export of raw materials.

Brazil noted that the financial crisis is still evolving and that developing countries are suffering disproportionate effects, even though they were not responsible for the crisis. The crisis has pushed over 100 million more people into hunger and the total number of people suffering from hunger in the world is now close to 1 billion. An additional 60 million people are now poor. These effects are especially visible in developing countries, which lack the fiscal space and social safety nets to address such challenges. Economic gains have been reversed and require a renewed commitment to overcome implementation gaps. Efforts must be delivered and scaled up, and an emphasis must be put on MDG 8. Brazil also expressed its concern about the \$20 billion shortfall from the OECD-DAC countries with respect to their Gleneagles commitments and reaffirmed its commitment to a beneficial outcome of the Doha Round by calling for the elimination or substantial reduction of export subsidies, as this would have the greatest contribution in addressing funding shortfalls. Brazil also called for a comprehensive and durable solution to the debt crises through coordinated and coherent policies.

The **European Union (EU)** noted that, in general, the prospects for growth for Europe and the rest of the world were good despite the recent turbulence. The major down-side risk is the sovereign debt and financial sector vulnerability, but the sovereign debt distress is not derailing economic recovery. In Toronto, the G20 showed that it is the premier forum for international economic cooperation. A coordinated fiscal exit strategy requires credible fiscal policies with country-specific adjustment paths. It expects that consolidation will begin in 2011 or earlier and in combination with structural measures for long-term economic growth. Consolidations will

need to be properly sequenced, with strengthened budgetary framework. The EU noted such fiscal consolidation will support economic growth. The EU acknowledged that open trade is good for growth over the medium term, but trade policy cannot be the main instrument in tackling social policy issues. Social policies are needed to address short-term risks and must be complemented by educational policies in a mutually-supportive policy framework.

Nicaragua noted that the great recession will only be over when employment has been regained and people who had fallen into poverty have climbed out. With respect to the MDGs, the exhortation to increase domestic resources and ODA increase will not be the solution, especially in LDCs and HIPC countries. Nicaragua considers that \$250 billion in special drawing rights (SDR) that was approved in 2009 would increase liquidity. It implied that the situation is not only one of political impasse and lack of political will but rather a structural crisis, with such characteristics as too rapid globalization, too dominant markets, too weak states, too profitable speculation, too short-term investment and too concentrated political power. It noted that globalization without global institution is leading the world into chaos. Nicaragua pointed out that multilateral cooperation goes beyond G-8 and G-20, as these groups lack the authority to decide for the rest. Noting that multilateralism is instead found at the General Assembly and ECOSOC, Nicaragua called for greater authority for these bodies.

Kenya noted that the secondary effects of the financial crisis – a decrease in tourism and demand for goods and services – are having a heavy impact on developing countries, in particular sub-Saharan countries. Remittances are insufficient and will not grow significantly to contribute to further economic development and domestic resource mobilization is also untenable. Kenya expressed its desire for more support from developed countries, as well as clear measures and a direction to sustain the momentum of recovery.

Pakistan agreed with comments by the panelists on multilateralism, which must be transparent, inclusive, and UN-centric and also concurred with calls to improve the development cooperation network and aid effectiveness. People-centered approaches were called for, as well as full ownership of national development plans, adequate and predictable aid flows, full and effective accountability on the part of both developing and developed countries, and a comprehensive understanding of country vulnerabilities. Pakistan concluded that there is no one-size-fits-all approach.

Responses from panelists

Mr. Supachai, in response to the question from Peru, said that efforts are being made in the Doha round to come to terms with regional trade agreements (RTAs), but that the committees that were set up to review them are often not very effective because the parties to the RTAs are not required to disclose full information and often choose not to. He stated that he does not see the significant increase in such agreements as regrettable, as they contribute to South-South cooperation and integration. The inclusion of countries from different development areas, however, will decrease the effectiveness of such agreements.

In response to the question from St. Lucia concerning remittances, Mr. Supachai noted that currently, remittances are double the size of ODA and are also predictable and non-cyclical. He remarked that their amount has not dropped much during the recession; therefore, remittances can support ODA efforts although they cannot compensate for them.

Regarding domestic resource mobilization, Mr. Supachai clarified that he was referring to saving for investment from corporate and private sector retained earnings. He noted that domestic demand can be enhanced by investment and not only by consumption.

Mr. Boonekamp noted that currently there is agreement in the Doha Development Round in the area of regional trade agreements. Because such agreements are often perceived as posing a threat to the multilateral trading system and are thus contrary to the principle of non-discrimination, they must be net trade-creating in order to support international trade. He noted there is no consensus on how to monitor RTAs to ensure they are consistent with WTO rules. He emphasized that while trade is currently leading the way for the recovery, it is not a magic bullet but must be a part of a coherent economic package and called for a strategy to complete the Doha Round.

In response to the remark from St. Lucia concerning debt vulnerability in developing countries, **Mr. Moghadam** acknowledged the presence of large debt but also noted that the low-income countries fared better during this crisis than other countries, although themselves negatively affected. Most developing countries had also created fiscal space for themselves through, for example, debt reduction through HIPC, and were able to use this fiscal space to respond to the economic problems of the past two years.

Augmenting Ms. Francis' comments on gender, **Mr. Canuto** noted that a gender dimension is mainstreamed into all World Bank activities. He added that the lack of infrastructure in low-income countries is not gender-neutral, as it disproportionately affects women in a very negative way.

In response to the question from St. Lucia on remittances, Mr. Canuto pointed out that the flip-side of remittances is migration, which has increasingly become a south-south issue. Therefore, there is an increased interest from both home and destination countries on policies affecting migration, which has become one of the big issues of mankind.

In addition, in response to the comment from St. Lucia on debt vulnerability, Mr. Canuto pointed out that the ability of developing countries to escape even more negative consequences of the financial and economic crisis has been due to the soundness and quality of previously implemented macroeconomic policies and macroeconomic management.