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## **Sustainable Development Goals and the Challenges Ahead**

by

**Mr. Gary A. Dymski**

Professor of Applied Economics  
Leeds University Business School  
University of Leeds

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD

# Overcoming developing countries' financial dilemma: toward a sustainable future

Gary A. Dymski

Professor of Applied Economics

Leeds University Business School

University of Leeds

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# Overcoming developing countries' financial dilemma: toward a sustainable future

1. Global macro environment: medium-term prospects
2. Debt crises without policy space: developing countries' structural fix
3. Financial innovation, cross-border bank claims and remittances
4. Quantitative easing and developing countries
5. Conclusion: Surpassing old problems, finding new uses for global capital markets

# Developing countries' financial dilemma

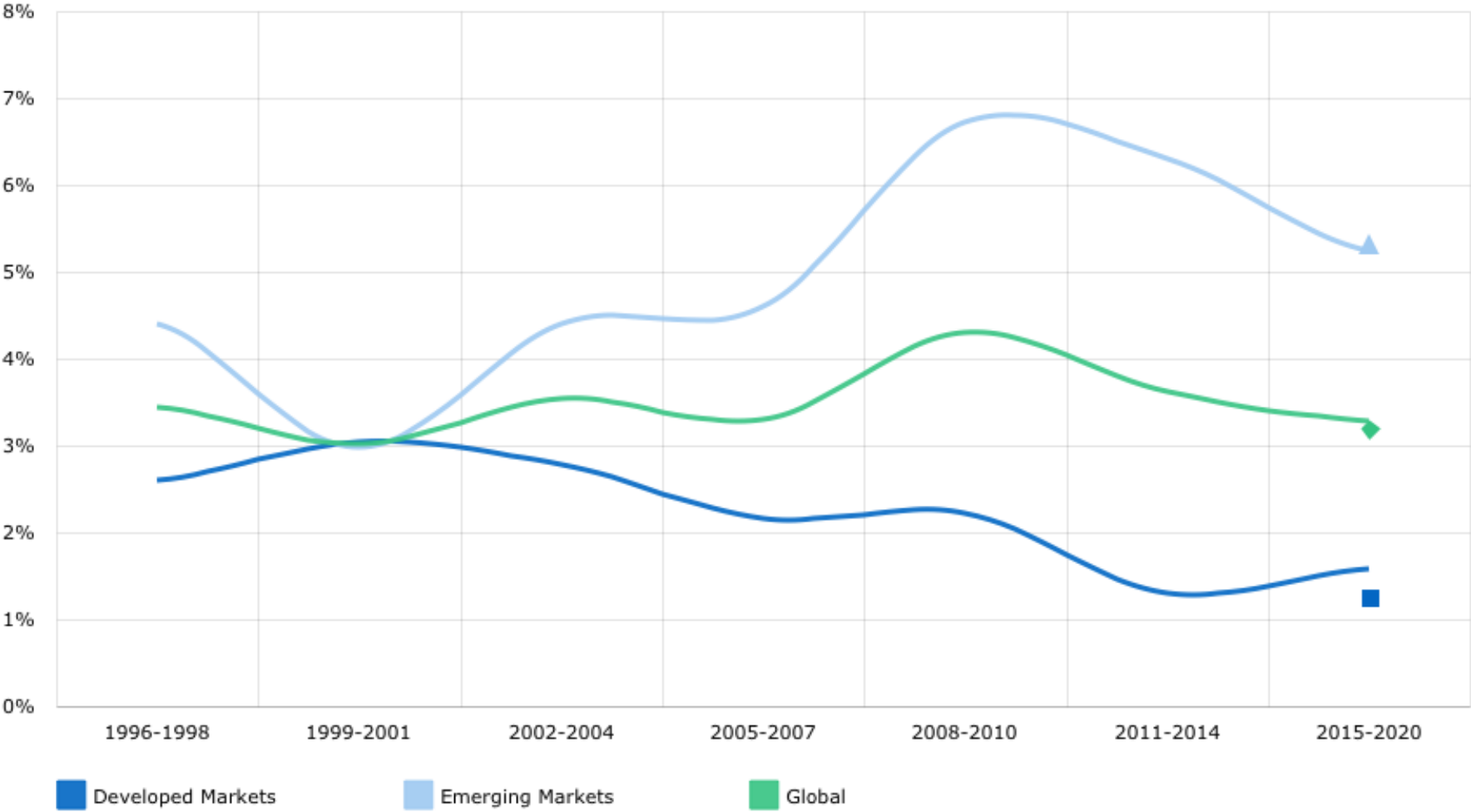
- Austerity fiscal policy, now embedded among high-income economies, deepens financialization among developing economies. Governments are forced to borrow to compensate for budget holes or to support investment; households too must adjust as they can.
- But with weak growth, debts go bad, and private debt turns public responsibility. Financial crises are inevitable.
- Credit flows from higher-income countries to developing countries have slowed. Humans themselves are increasingly on the move, just as capital is. Consequently, remittances are now more dominant in both inward and outward cross-border flows across the globe.

# Overcoming the dilemma, renewing sovereignty

- These trends are undercutting the capacity of governments to assure prosperity for their residents; and there is no alternative to borrowing as budgetary need grows and revenues slow. The UK's circle of budget cuts and deficits shows this clearly.
- Governments need a backstop so as to maintain sovereignty after crises come.
- A multilateral sovereign debt resolution mechanism will provide one such back-stop. But another set of multilateral mechanisms should be planned simultaneously, to create the bases for financing sustainable development efforts all around the world.

1. Global macro environment:  
medium-term prospects

# Potential Output Growth Headed Lower, Especially in Emerging Markets; Developed Markets Subdued



Source: IMF, Morgan Stanley Research forecasts

Taken from “Global Macro: Pros and Cons of Getting Stuck in the Middle,” Morgan Stanley Research, September 11, 2015; section entitled “Emerging-Market Drag.”

# Recent findings about macroeconomic policy

Three conclusions come from recent studies:

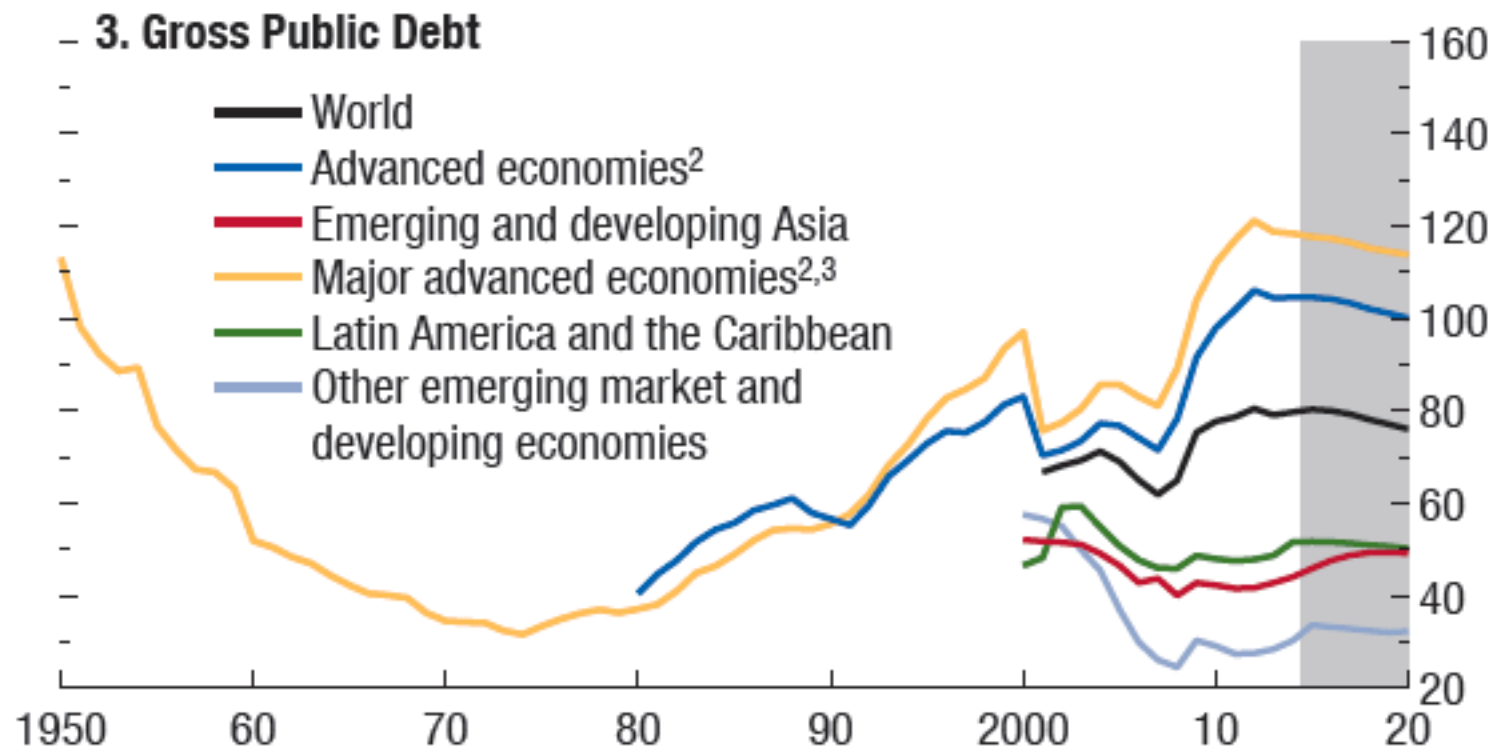
1. Austerity fiscal policy is not expansionary except in very special circumstances not generally found.
2. Expansionary fiscal policy is feasible even in the open economies of the present day – but it must be coordinated among nations with the largest income flows.
3. Monetary policy cannot do it all. Overuse of monetary policy without fiscal policy stimulus leads to global economic distortions.



2. Debt crises without policy  
space: developing countries'  
structural fix

# Developing nations' structural fix

- Government and private debt levels are often higher for higher-income than for developing countries.
- But debt crises are far more common in developing countries than in higher-income countries.
- The reason is that private-sector agents in developing countries are more financially fragile and have less support from welfare-state provisions. And private debt, which has been expanding fast in many developing countries, turns into public debt when crisis comes.
- The debt crises that emerge squeeze these sovereigns' policy space for responding either to human needs or financial demands.



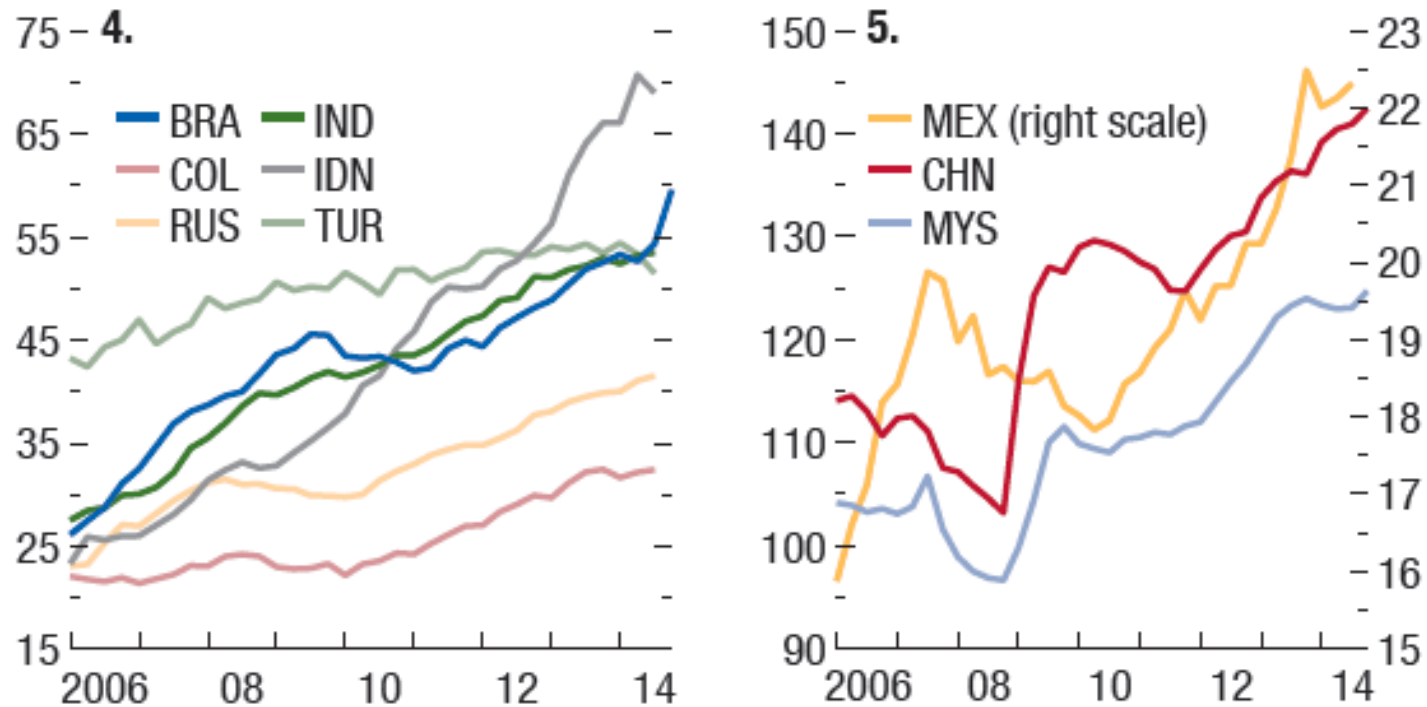
Source: IMF staff estimates.

<sup>1</sup>Euro area countries (Greece, Ireland, Italy, Portugal, Spain) with high borrowing spreads during the 2010–11 sovereign debt crisis.

<sup>2</sup>Data up to 2000 exclude the United States.

<sup>3</sup>Canada, France, Germany, Italy, Japan, United Kingdom, United States.

## Credit-to-GDP Ratio<sup>2</sup> (Percent)



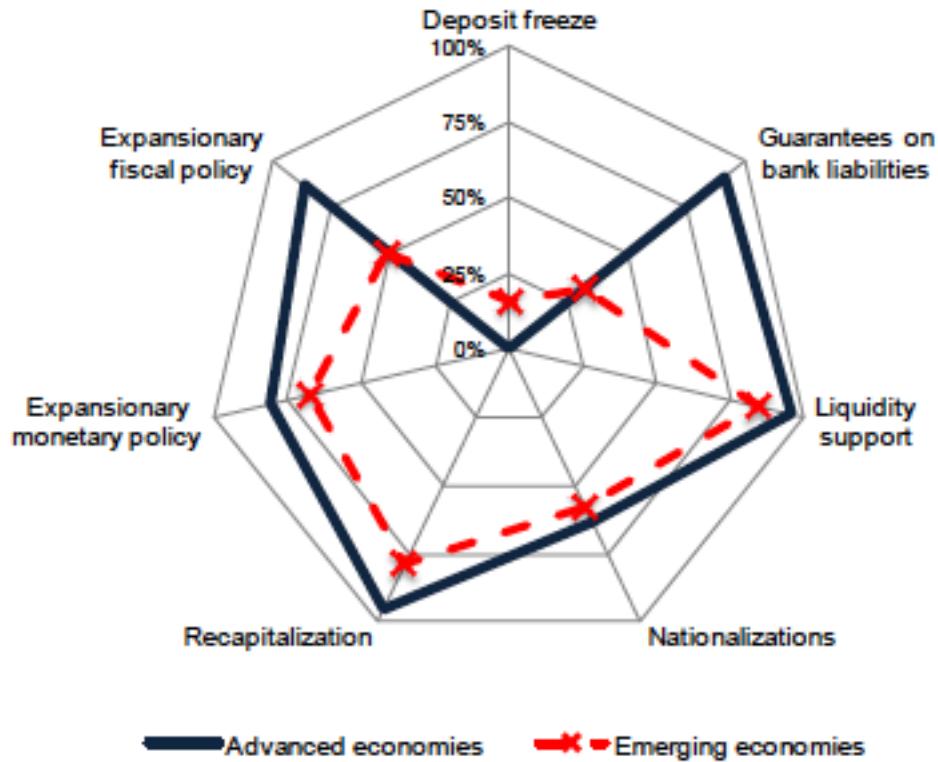
Sources: Haver Analytics; IMF, International Financial Statistics (IFS) database; and IMF staff calculations.

Note: Data labels in the figure use International Organization for Standardization (ISO) country codes.

<sup>1</sup>Deflated by two-year-ahead WEO inflation projections.

<sup>2</sup>Credit is other depository corporations' claims on the private sector (from IFS), except in the case of Brazil, for which private sector credit is from the Monetary Policy and Financial System Credit Operations published by Banco Central do Brasil.

Figure 6. Differences in the Mix of Crisis Policies



Source: Authors' calculations.

There is less policy space for developing countries, which lack lender-of-last-resort capability and must carefully consider exchange-rate vulnerabilities. The lenders they must bargain with are often – not always - backed by too-big-to-fail guarantees back-stopped by lender-of-last-resort central banks.

### 3. Financial competition, cross-border bank claims and remittances

# Financial competition and lending slowdown

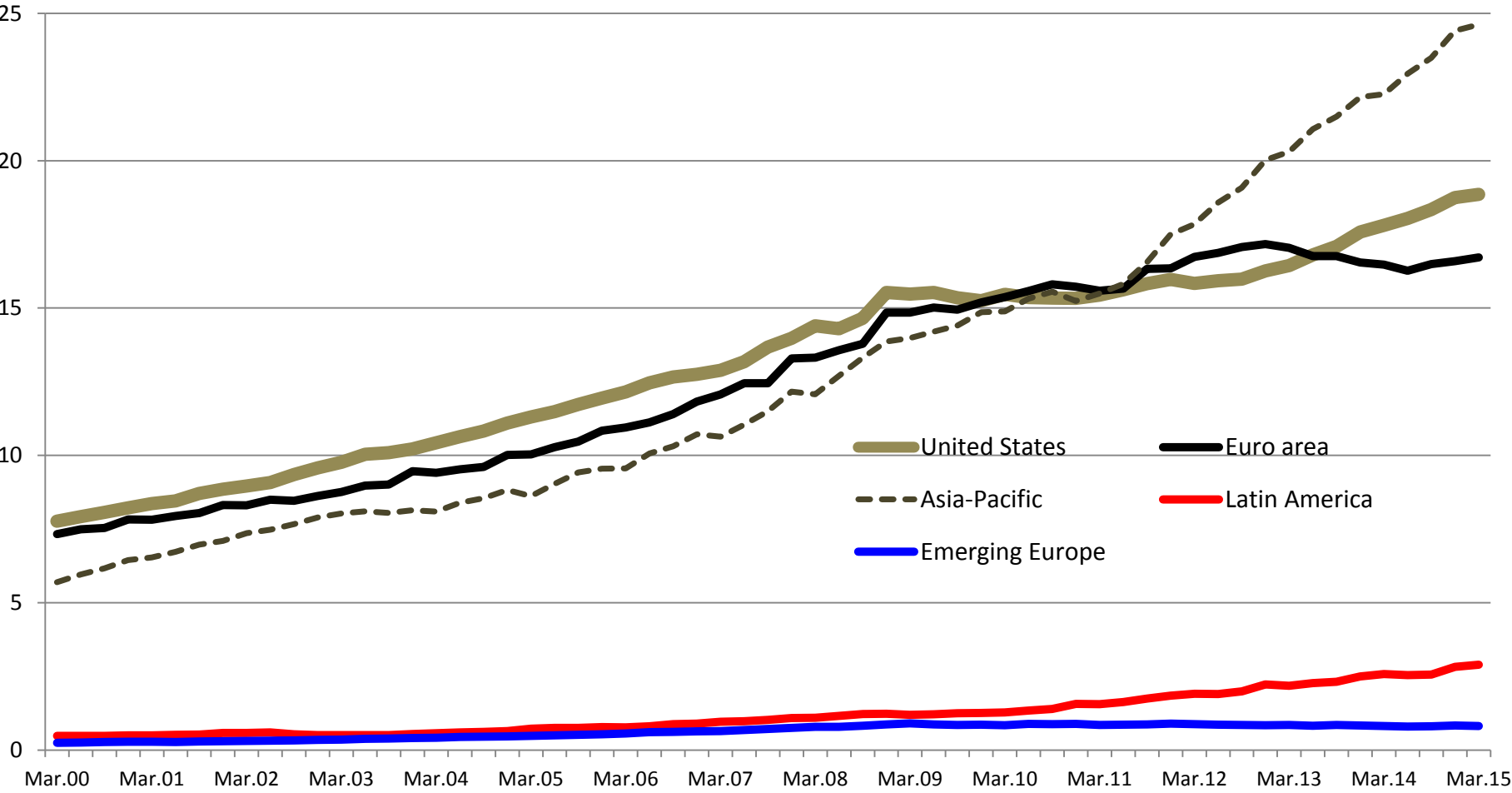
- Continual innovation in finance is driven by large global banks from nations with reserve-currency status. Due to these innovations, securitization (“originate to distribute” model) is replacing lending (“buy to hold” model); this privileges financial firms in these same nations.
- These nations’ too-big-to-fail banks are engaged in a furious strategic repositioning – but they are not shrinking. To the contrary, they are seeking to redefine their market niches vis-à-vis their competition.
- But with economic slowdown, global policy stalemate, uncertainty and the need to recapitalize have led to a slowdown in bank lending.

# Cross-border claims and flows

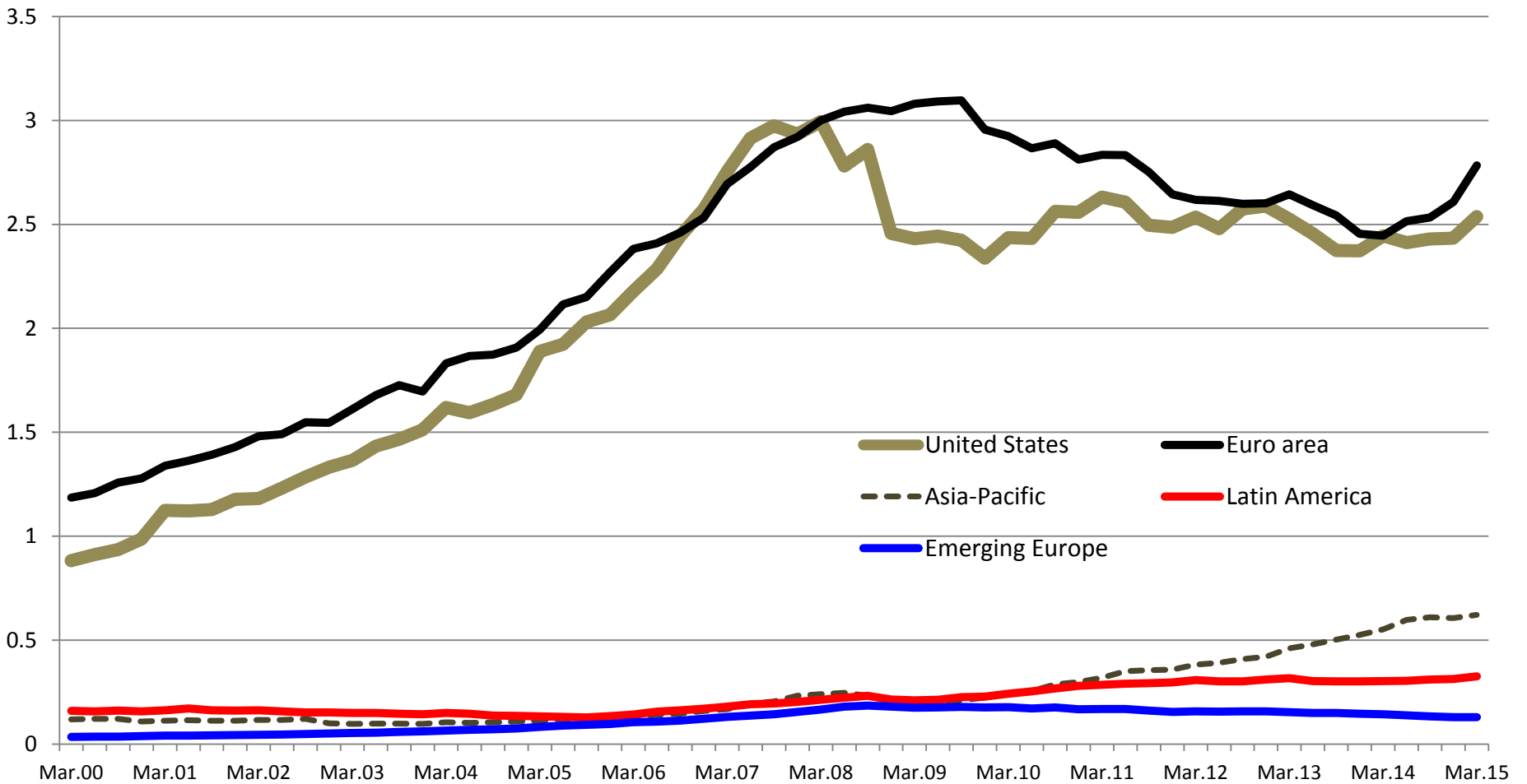
- The growth of large banks' domestic claims and cross-border claims has slowed down since 2008 in upper-income economies, but grown in developing countries.
- The global relationship *tout entier* between workers, firms, and countries has become more fluid as people – workers – have become more mobile, just as capital has, leading to more complex patterns of cross-border cash flows.
- The magnitudes of remittance inflows nearly matches bank lending flows in many developing countries; but remittance flows flow robustly in both directions, not one.



Banks' claims on local borrowers, selected global areas, 1999-2015  
(in trillions of US\$) Source: Bank for International Settlements

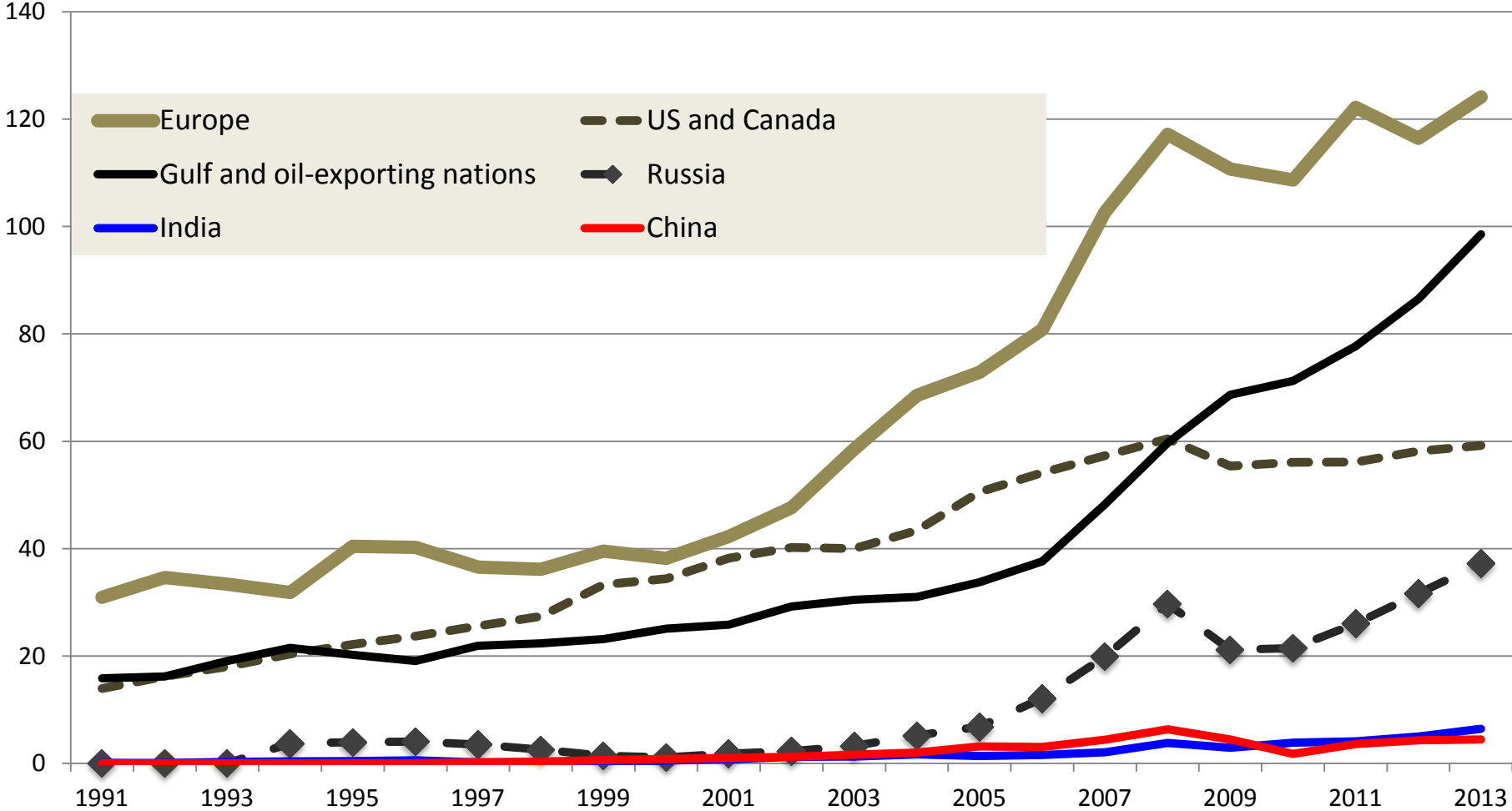


Banks' cross-border claims, selected global areas, 1999-2015  
(in trillions of US\$) Source: Bank for International Settlements

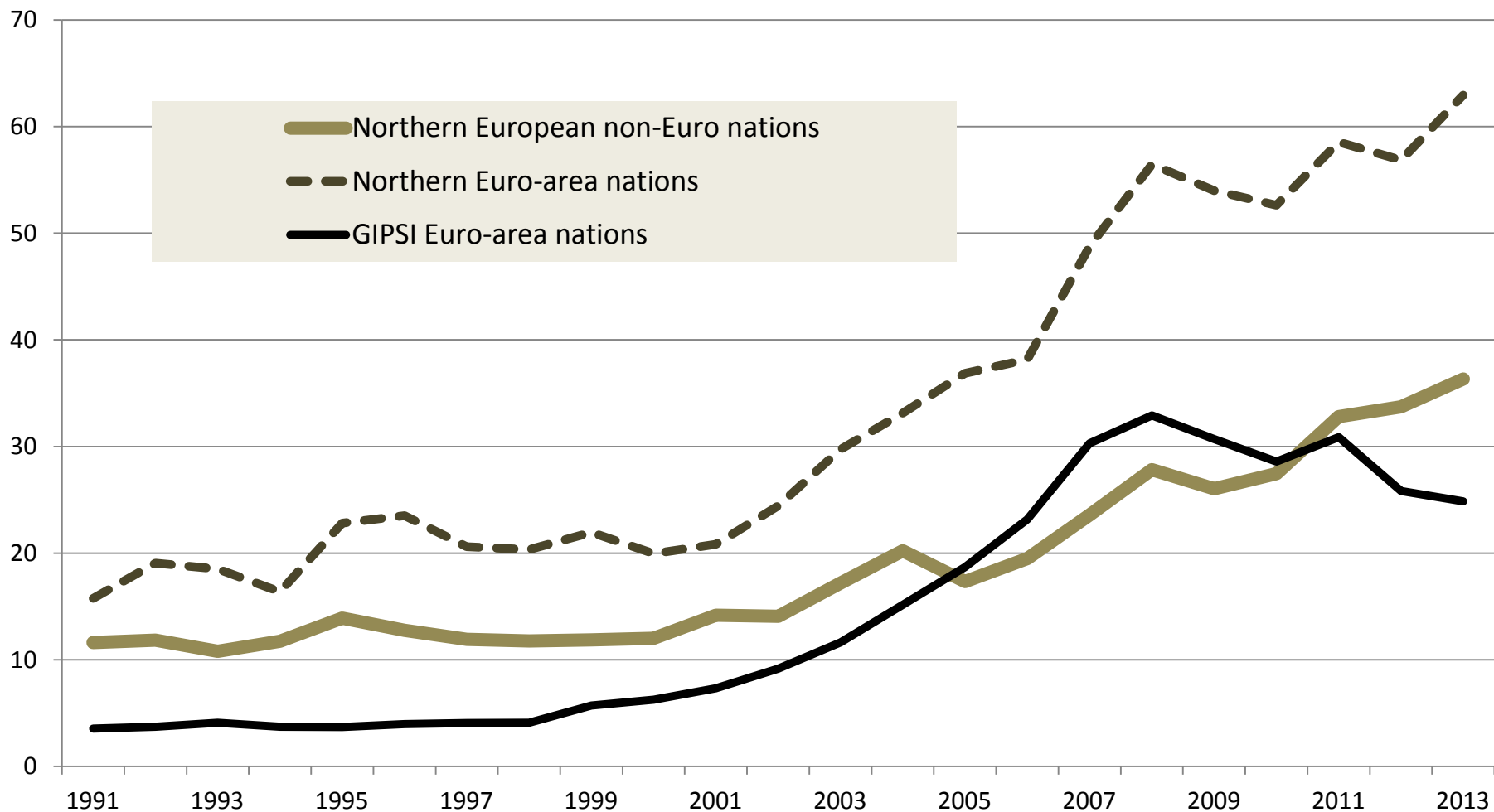


# Outflow of Remittances by Country or Global Area, 1991-2013 (US\$B)

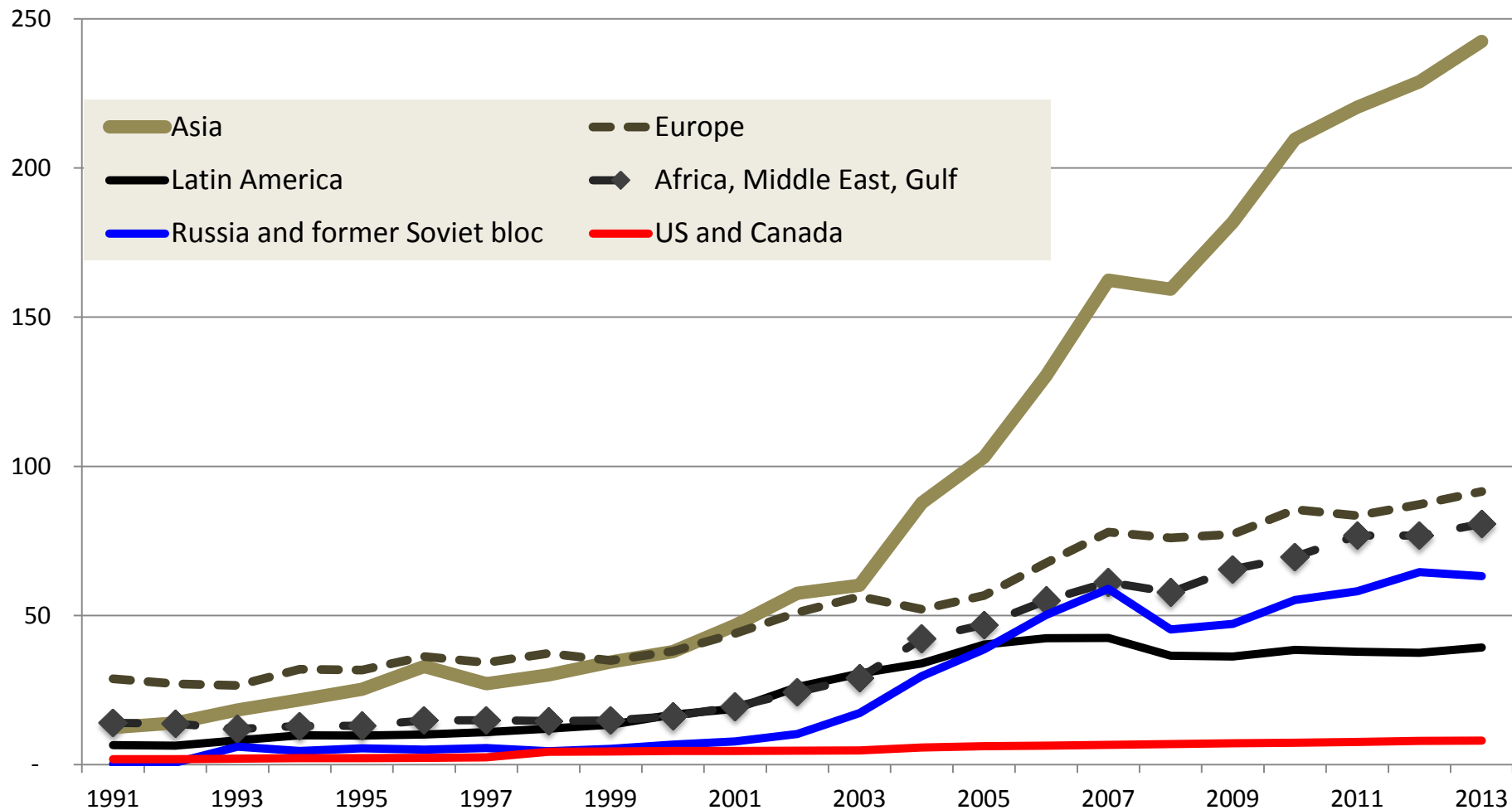
Source: World Bank remittance/migration data



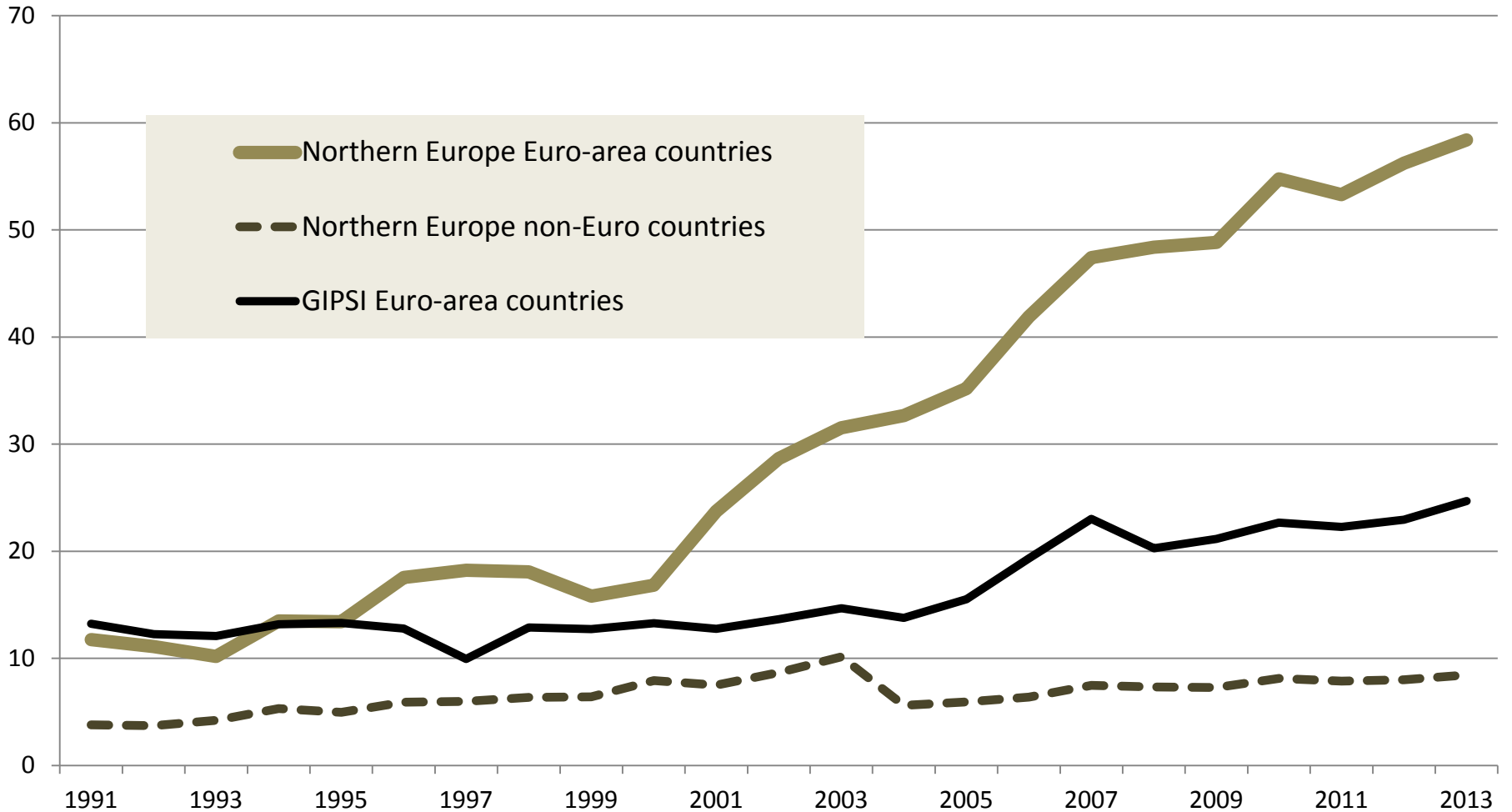
Outflow of Remittances for countries in 3 European areas, 1991-2013  
(US\$B) Source: World Bank remittance/migration data



Inflow of Remittances for Major Recipient Countries, by Global Area, 1991-2013 (US\$B) Source: World Bank remittance/migration data



Inflow of Remittances for Recipient Country Groupings within Europe, 1991-2013 (US\$B) Source: World Bank remittance/migration data



## 4. Quantitative easing and developing countries

# Conclusions of recent research

- Research is split on the effects of quantitative easing. In one view, it has helped developing countries by generating more economic output in high-income countries pursuing QE. It is also argued that these countries' banks have lent more to developing nations than they might have done otherwise.
- A contrary view: QE has primarily supported global-North bank balance sheets and asset values. Further, it has artificially increased exchange rates in countries with high interest rates, and fed debt levels there as well.
- High exchange rates have stymied industrial recovery, and the wide and variable interest spreads have encouraged speculation in global-South currencies and assets.



# Austerity fiscal policy and quantitative easing

If fiscal austerity continues among higher-income countries, both quantitative-easing scenarios will spell further stagnation and/or crisis in the global South.

1. QE continues, US/UK/EU interest rates stay low:
  - Bubble-led growth, zero-sum speculation in financial markets
  - Financial boom-bust in developing economies
2. QE ends, interest rates raised in US, UK, Europe:
  - Financial bust in developing economies

But, low interest rates provide an opportunity for innovative financing.

5. Surpassing old problems,  
finding new uses for global  
capital markets: “Proceed  
with caution” and “Finance  
sustainable futures”

## Conclusion: “Proceed with caution”

- High-income nations can and must undertake coordinated efforts to generate green growth, rebuild infrastructure, and address global warming – throughout the world.
- Until then, slow growth and austerity fiscal policies undercut growth in developing economies. Public deficits and increasing private debt will lead to further problems of sovereign indebtedness.
- The legal structure of securitization-based lending makes – and the conflict-of-laws problems associated with securitization – makes conflicts over repayment inevitable. At present, conflicts of laws are resolved principally in favor of creditor home countries.

## Conclusion: “Finance sustainable futures”

- Sovereigns that cannot meet human needs and pay off debt simultaneously must not be forced to resolve this dilemma by making choices that undercut their capacity to build economic futures within their domestic borders.
- A backstop for these nations is sorely needed – specifically, a multilateral sovereign-debt resolution mechanism to assist countries to restore their national integrity and policy space.
- But let us add, to this multilateral conversation about debt resolution, a multilateral planning process for mechanisms that will enable all countries, global North and South, to have access to the means needed to put in place infrastructure and policy innovations responding to their global-warming challenges.

## Conclusion: “Finance sustainable futures”

- The need for a novel financing approach has been recognized with Europe’s Capital Markets Union plan. But the CMU plan does not create new lending in itself; it redistributes risks and rewards within the existing framework. So we must go further.
- The challenge of taking on global warming should be approached as a world-wide “race to the moon” moment. If we do not establish new research and investment initiatives that address manifestations and causes of global warming in every country, we do not deserve our great-grandchildren.
- New multilateral mechanisms that move finance where it is needed to preserve sustainable futures around the world should be included in any discussion of sovereign debt restructuring. Let stronger nations save their children’s futures.