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Sustainable Development Goals and the Challenges Ahead

by

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Contemporary macroeconomic dynamics and developing countries' financial dilemma

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Contemporary macroeconomic dynamics and developing countries' financial dilemma

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. Risks and benefits for new entrants into global capital markets: proceed with caution

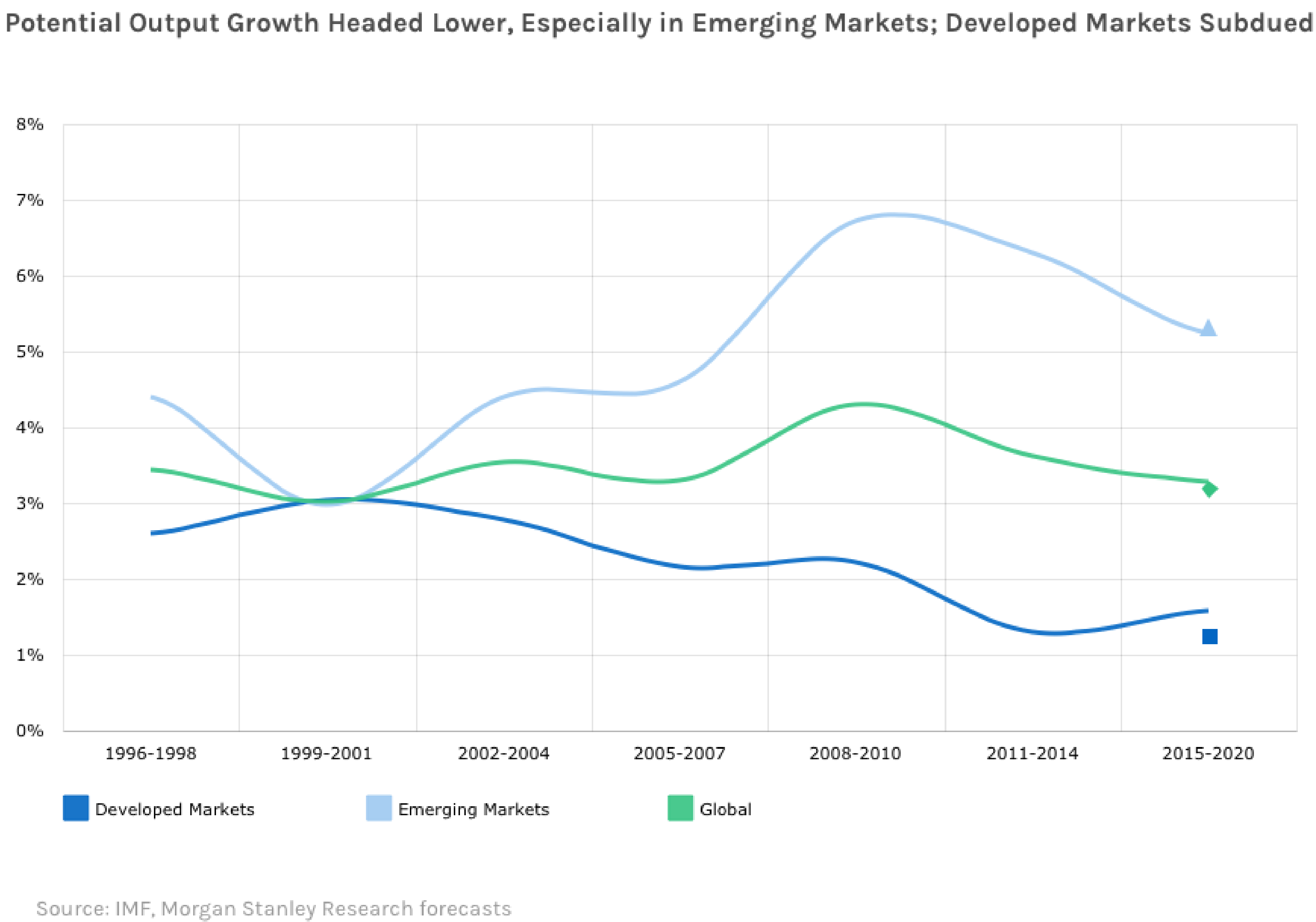
Developing countries' financial dilemma

- 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 increasingly move, just as capital does. Consequently, remittances are now more dominant in both inward and outward cross-border flows across the globe.

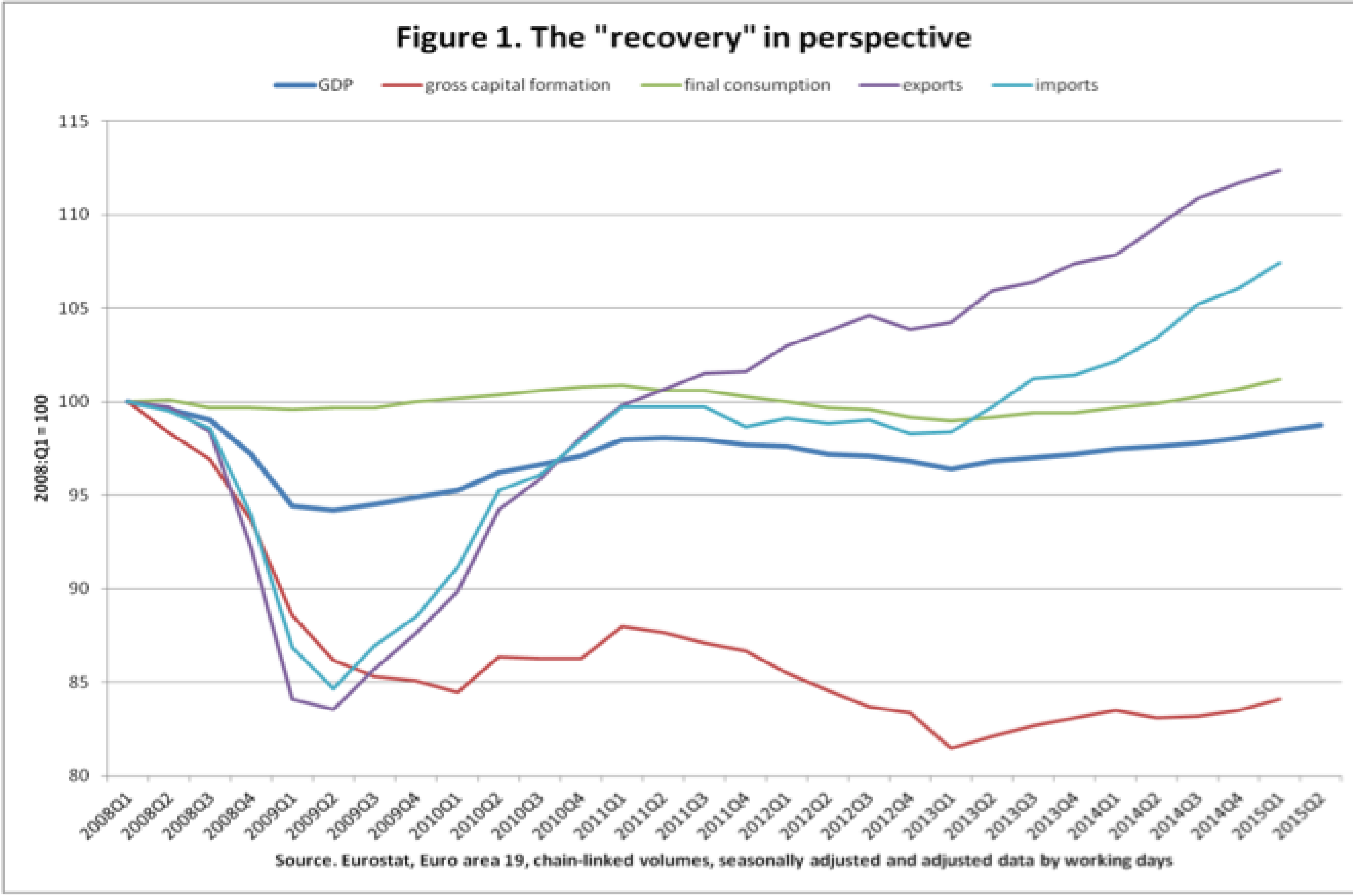
Developing countries' financial dilemma

- These trends are undercutting the capacity of governments to assure prosperity for their residents; but while public repayment crises among emerging countries are inevitable, 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 to avoid financial blackmail when crises come.
- A multilateral sovereign debt resolution mechanism will provide one such back-stop, leaving some policy space open until a new global economic regime emerges.

1. Global macro environment: medium-term prospects



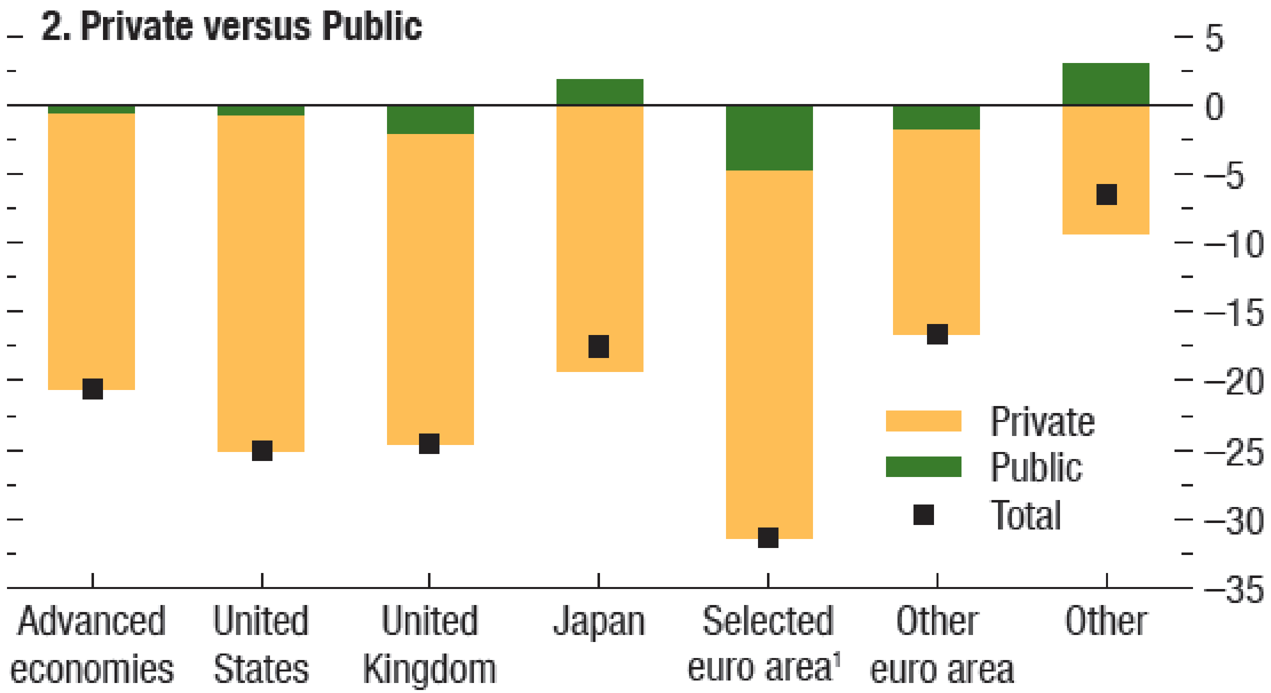
Taken from "Global Macro: Pros and Cons of Getting Stuck in the Middle," Morgan Stanley Research, September 11, 2015; section entitled "Emerging-Market Drag."



From: **Euroland Has No Plan B: It Needs An Urgent Recovery Plan**
by Jörg Bibow on 7 September 2015, *Social Europe.*

Figure 4.4. Decomposition of the Investment Slump, 2008–14

(Average percent deviation from spring 2007 forecasts)



Sources: Consensus Economics; Haver Analytics; IMF, Fiscal Monitor database; national authorities; and IMF staff estimates.
Note: The figure presents data for 28 advanced economies: Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Singapore, Slovak Republic, Slovenia, Spain, Sweden, United Kingdom, United States.
[1]Euro area economies (Greece, Ireland, Italy, Portugal, Spain) with high borrowing spreads during the 2010–11 sovereign debt crisis.

Recent findings about fiscal policy

Three conclusions come from recent studies:

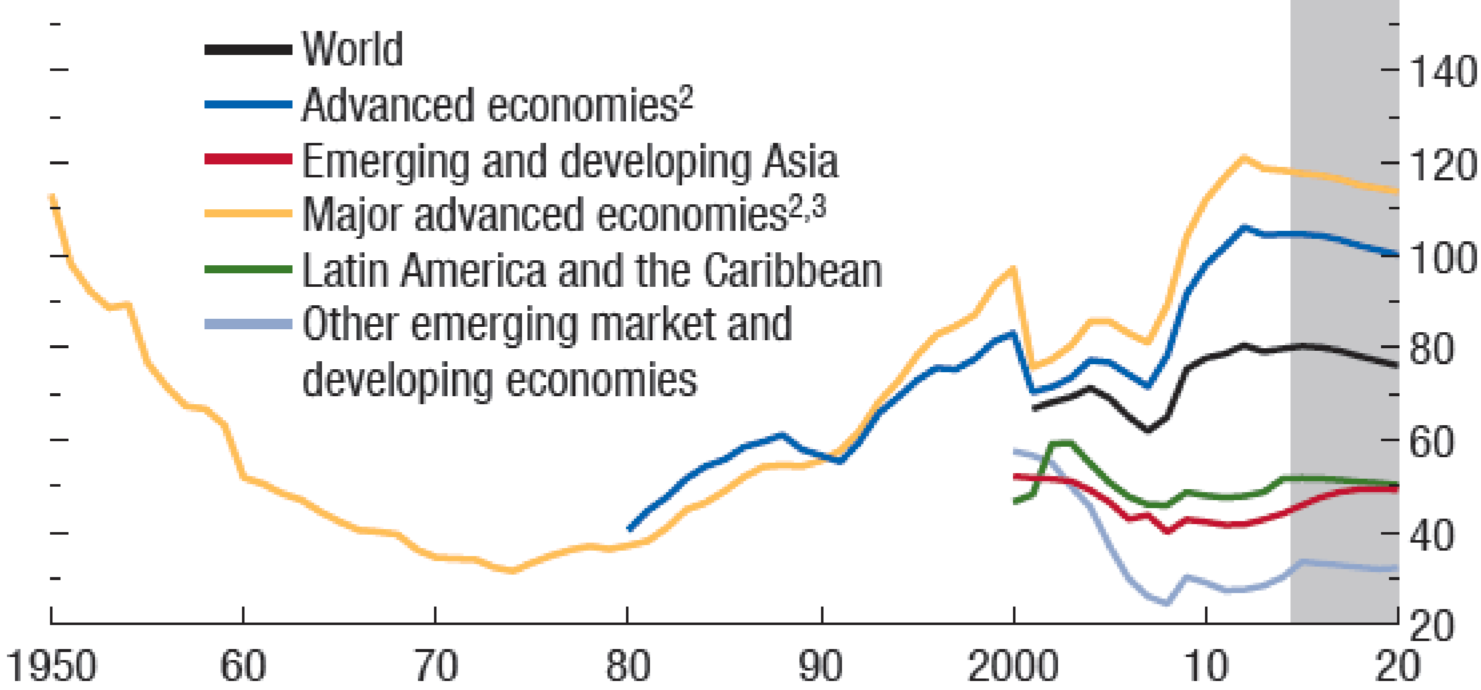
1. Austerity fiscal policy is not expansionary except in very special circumstances not generally found.
2. Expansionary fiscal policy is feasible even in the open economies of the present day – but it must be coordinated among nations with the largest income flows.
3. Monetary policy cannot do it all.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

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

Some stylized facts

- 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.
- Once debt crises emerge, their governments have less policy space to develop responses to crises.

3. Gross Public Debt



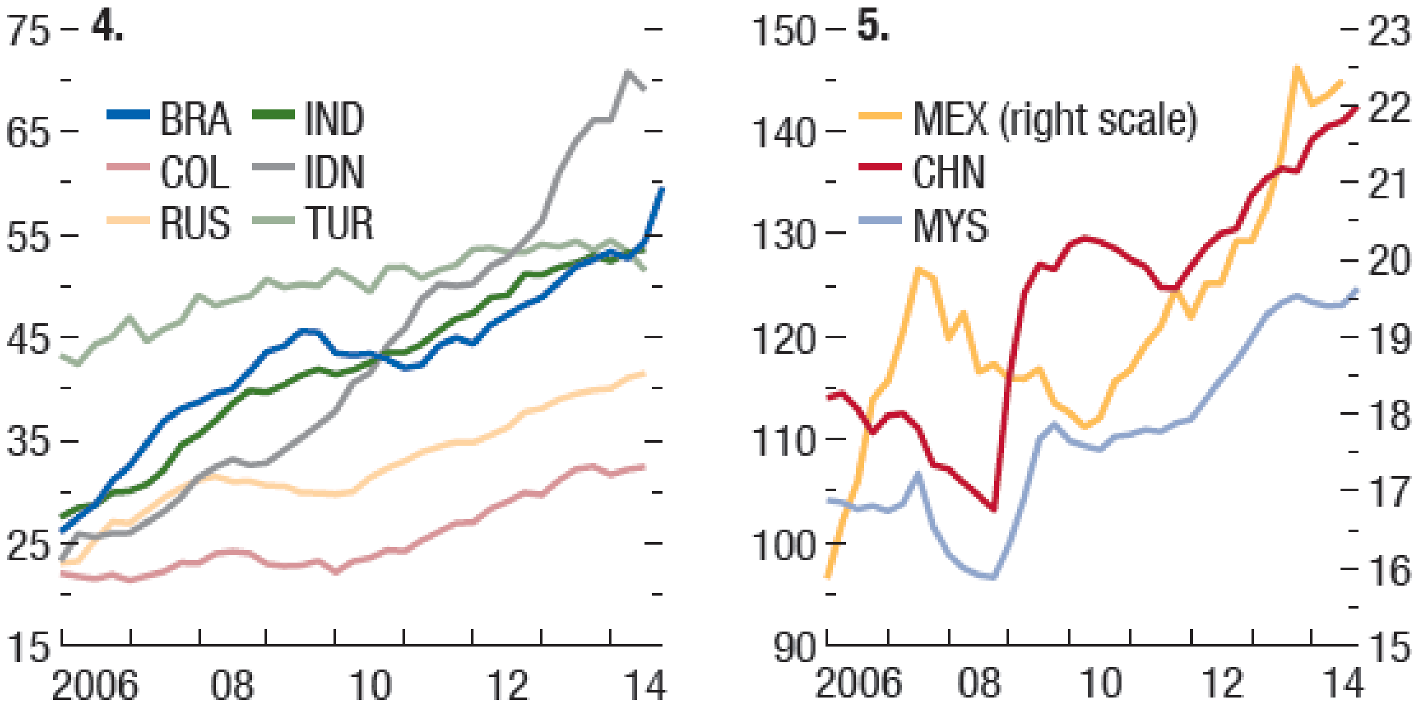
Source: IMF staff estimates.

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

[2]Data up to 2000 exclude the United States.

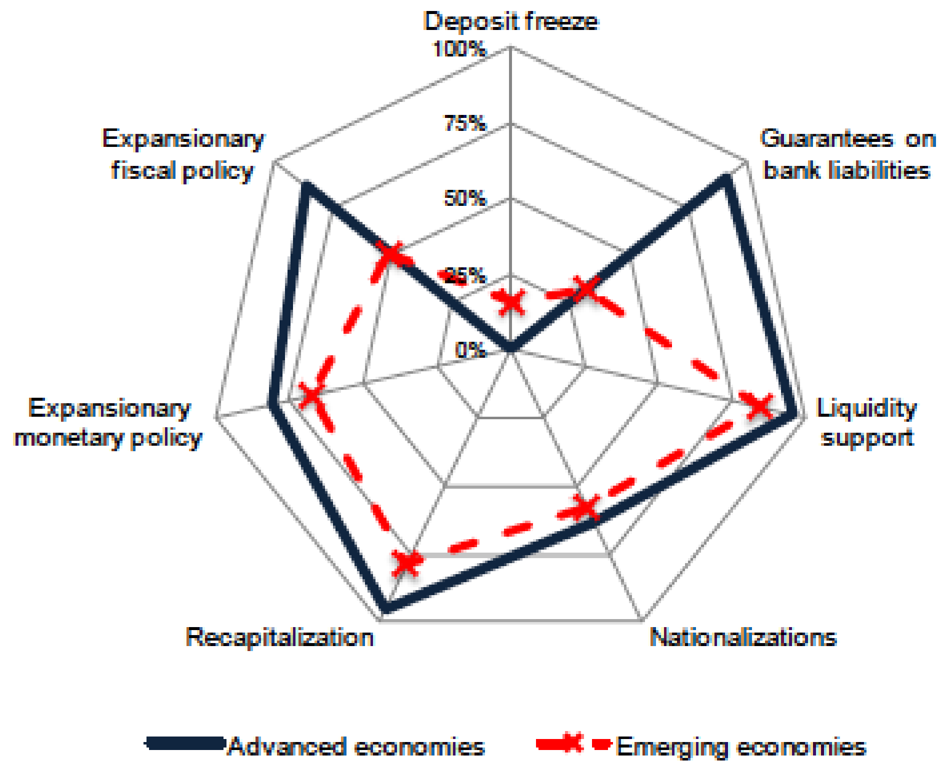
[3]Canada, France, Germany, Italy, Japan, United Kingdom, United States.

Credit-to-GDP Ratio[2]
(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.
[1]Deflated by two-year-ahead WEO inflation projections.
[2]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



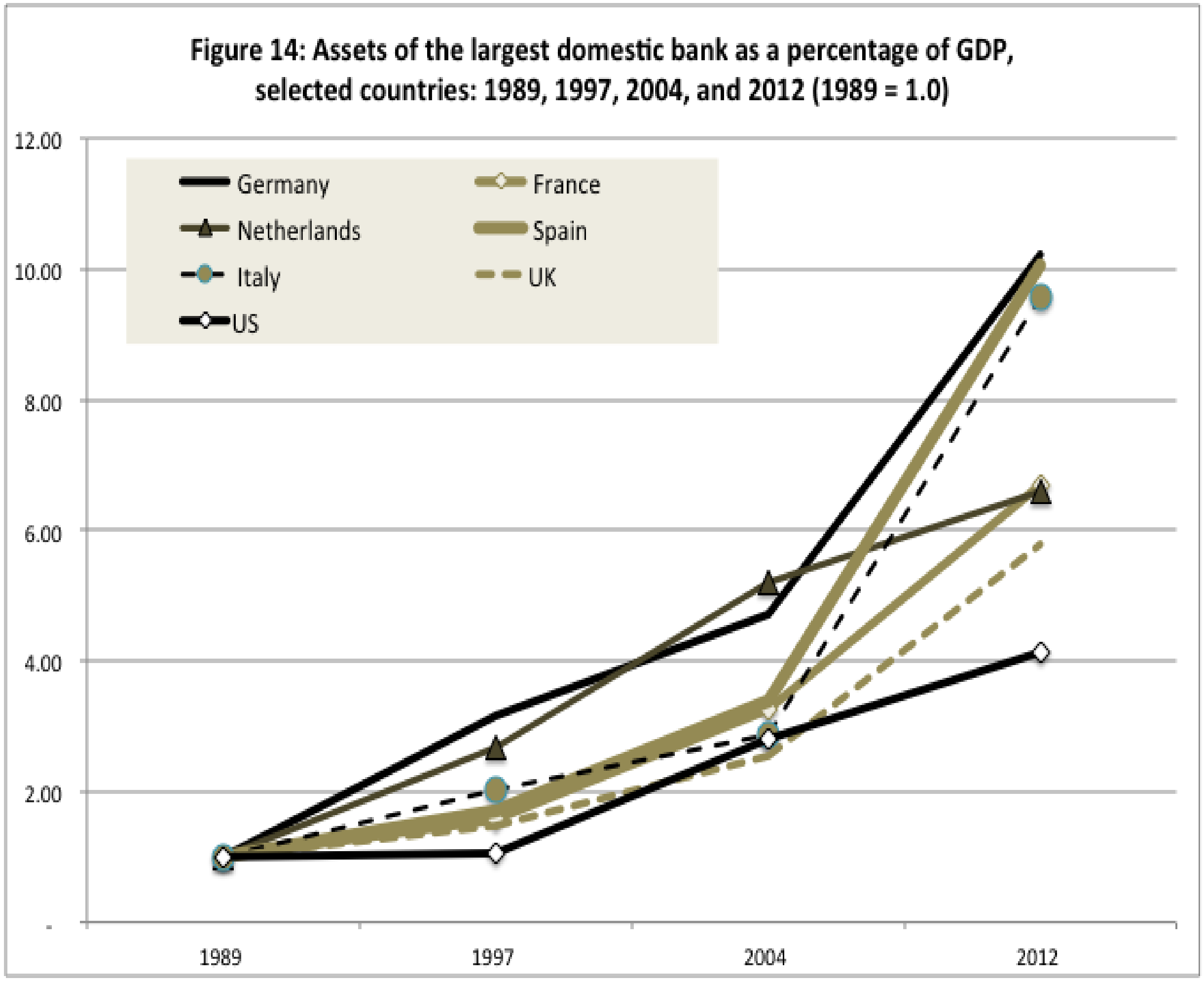
Source: Authors' calculations.

There is less policy space for developing countries, which lack lender-of-last-resort capabiility 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 innovation, cross-border bank claims and remittances

Some stylized facts

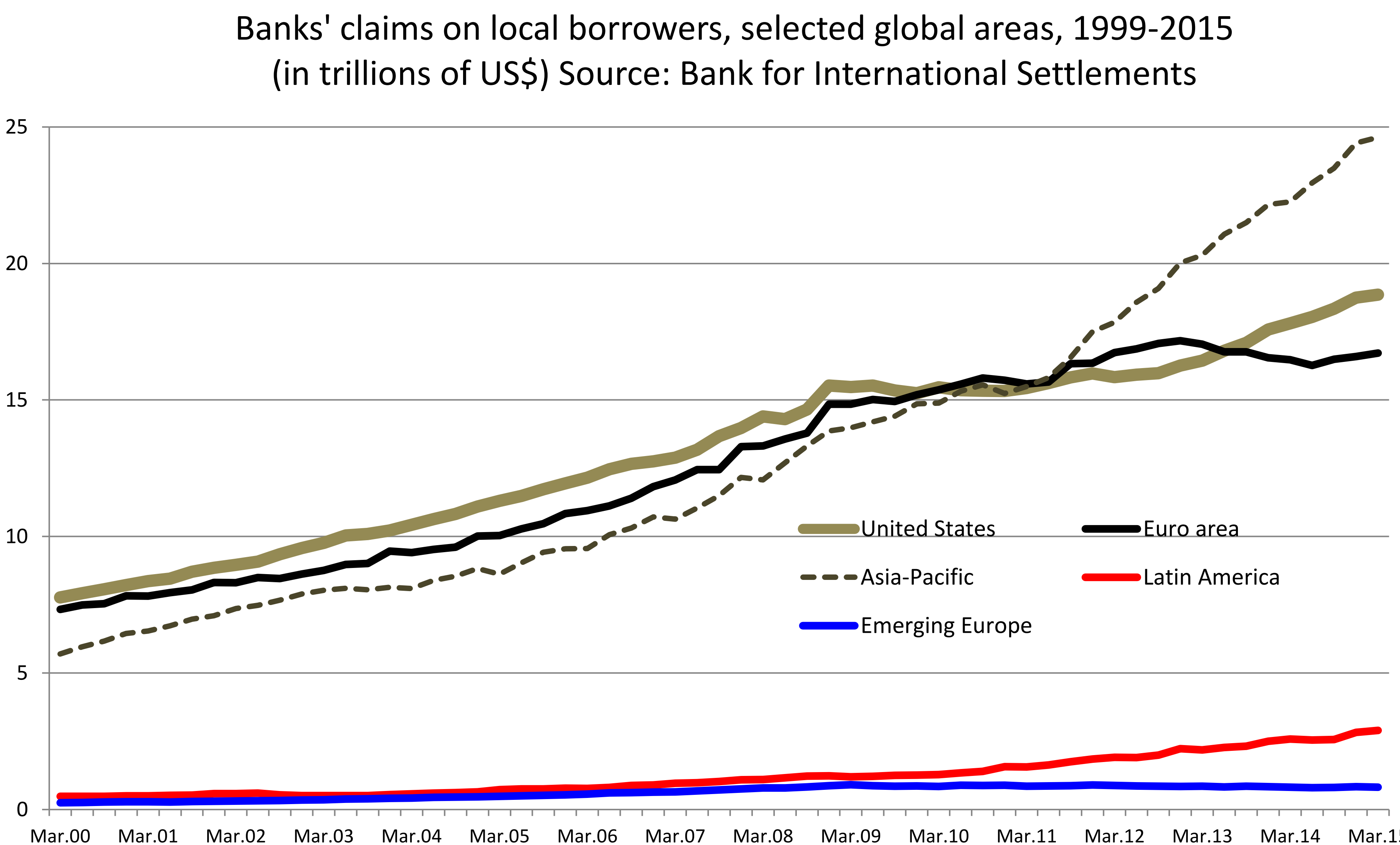
- Continual innovation in finance is drivey by large global banks from nations with reserve-currency status. Due to these innovations, securitization ("originate to distribute" model) is replacing lending ("buy to hold" model), privileges financial firms in these same nations.
- These nations' too-big-to-fail 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 the slowdown in economic growth and in investment demand, and with banks' post-crisis need to recapitalize, lending has slowed.

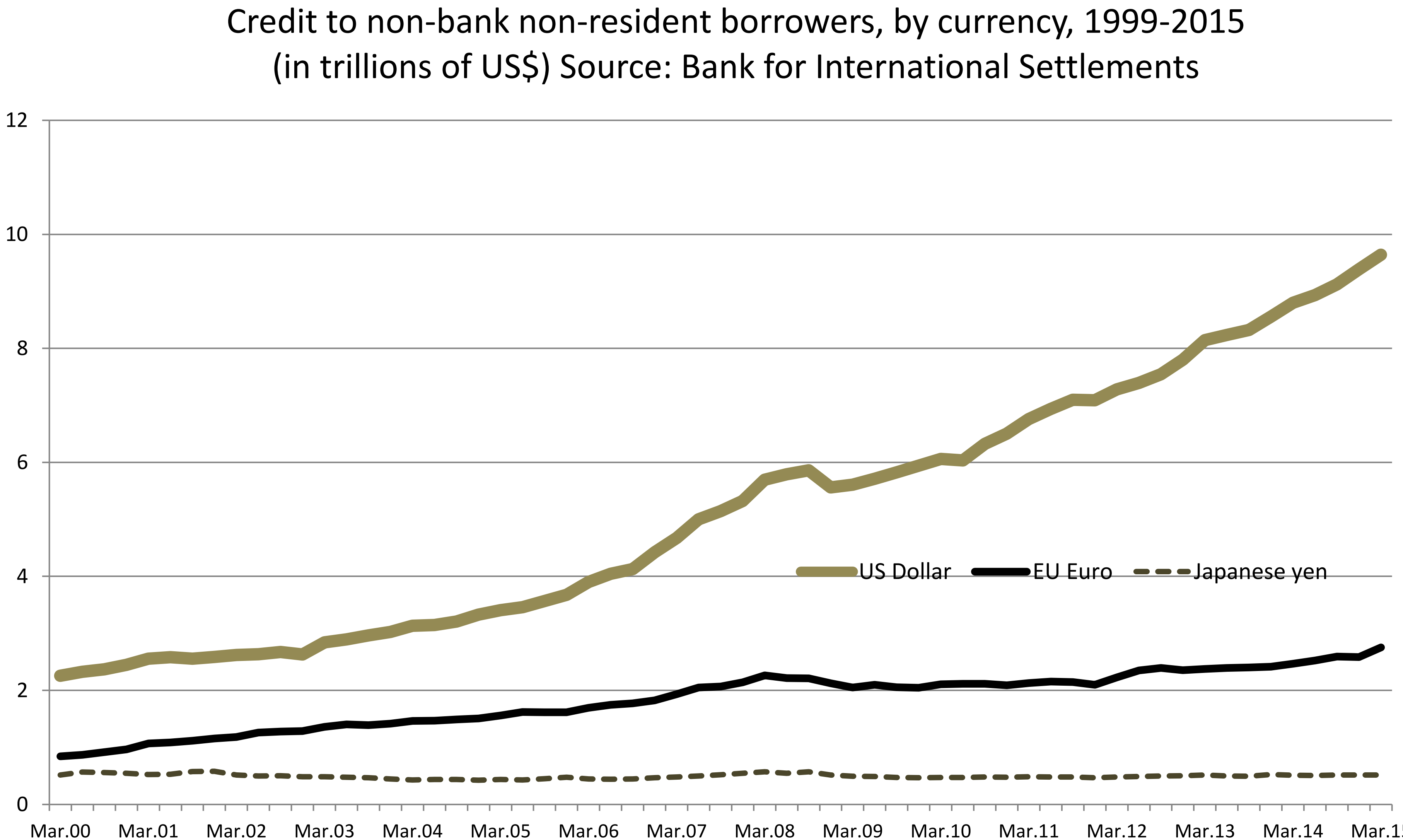


Accompanying this hyper-expansion of finance relative to income flows is the upward shift in the income of the upper 10% (Piketty) and the parallel growth of megabanks at the “micro” scale.

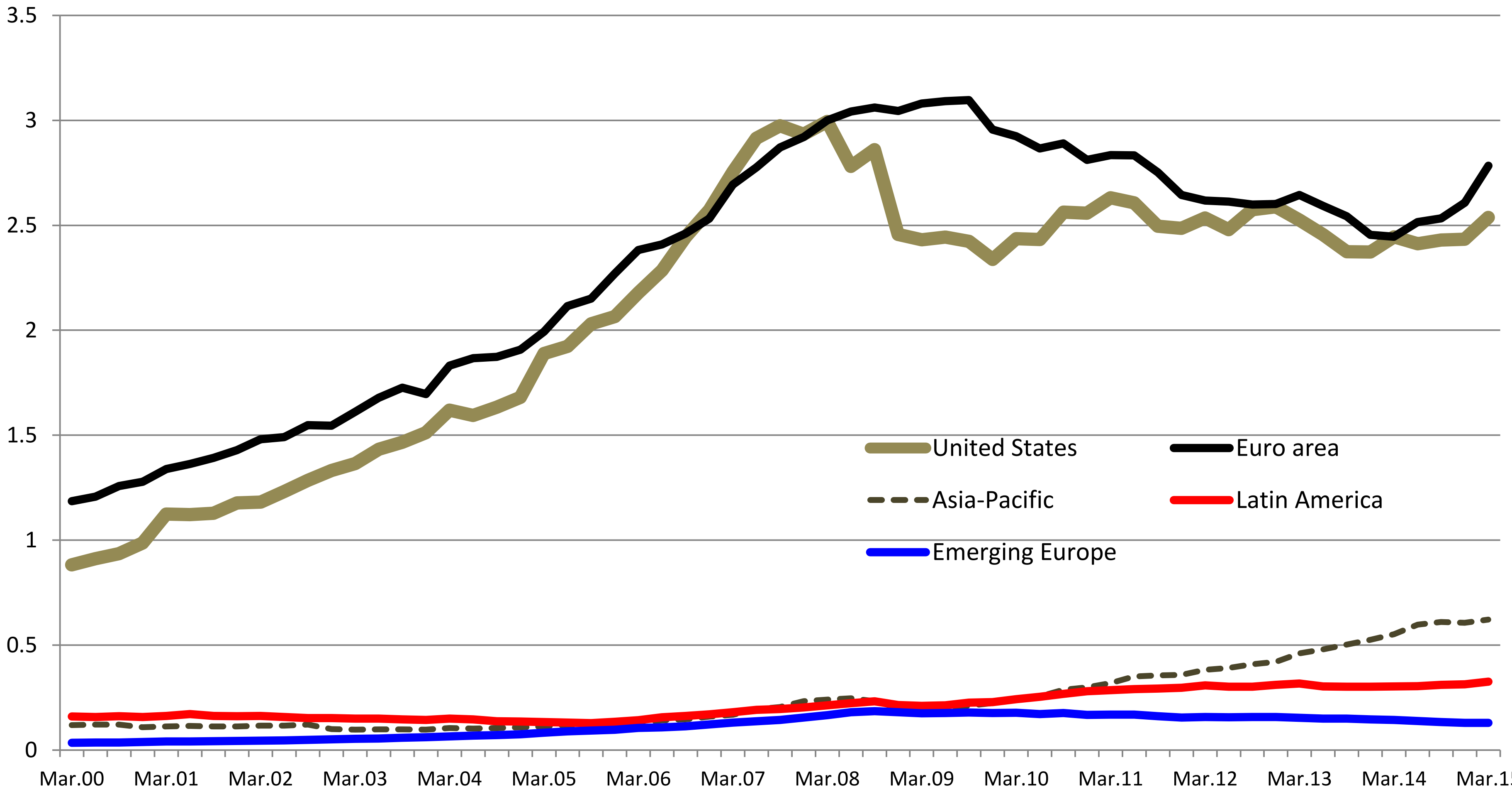
Some stylized facts

- 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.
- With the exception of China, most developing-country flows are small relative to those in upper-income nations.
- 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.

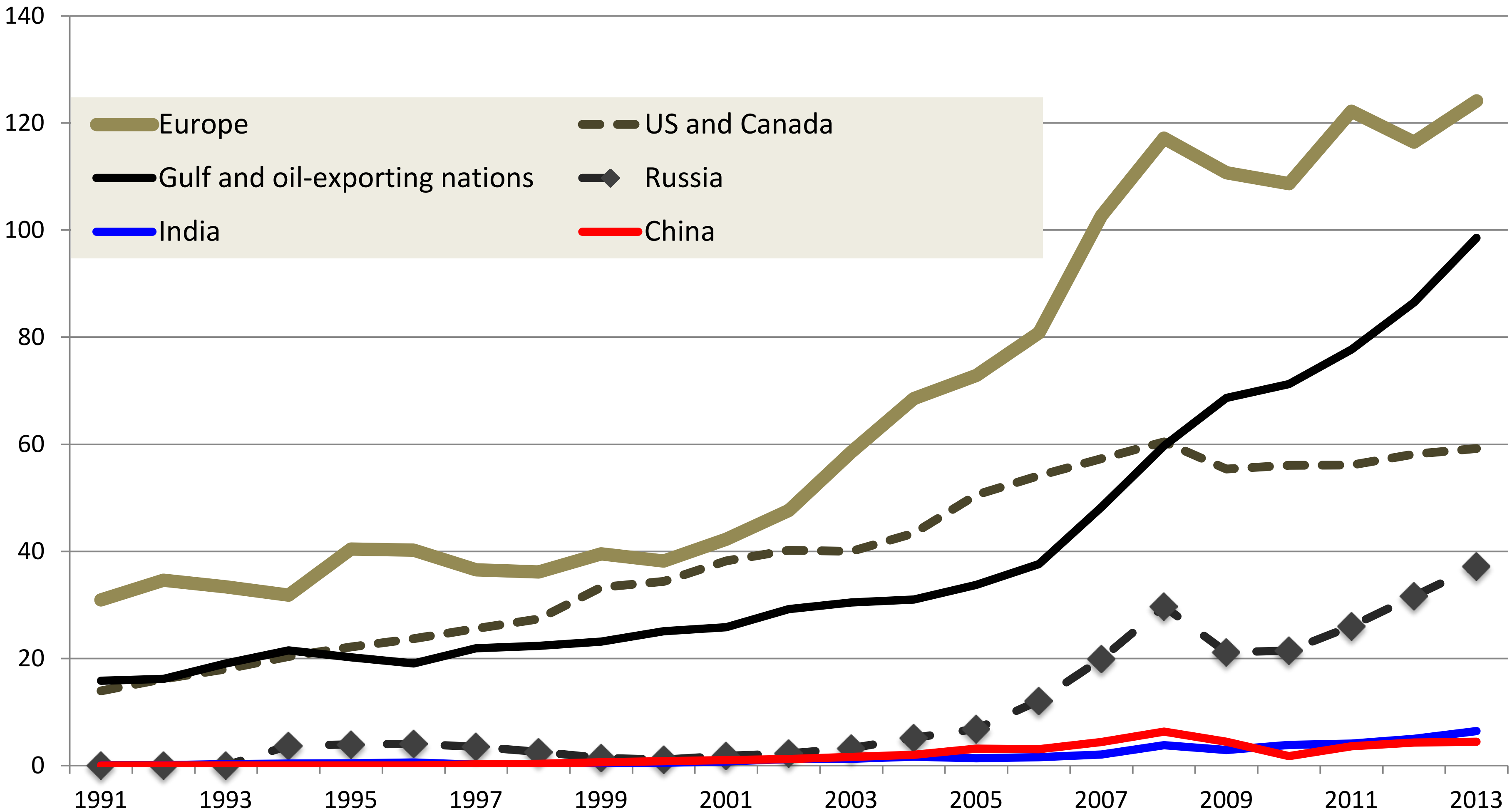

Banks' claims on local borrowers, selected global areas, 1999-2015
(in trillions of US$) Source: Bank for International Settlements
25
20
15
10
5
0
Mar.00
Mar.01
Mar.02
Mar.03
Mar.04
Mar.05
Mar.06
Mar.07
Mar.08
Mar.09
Mar.10
Mar.11
Mar.12
Mar.13
Mar.14
Mar.15
United States
Euro area
Asia-Pacific
Latin America
Emerging Europe


Credit to non-bank non-resident borrowers, by currency, 1999-2015
(in trillions of US$) Source: Bank for International Settlements
12
10
8
6
4
2
0
US Dollar
EU Euro
Japanese yen
Mar.00
Mar.01
Mar.02
Mar.03
Mar.04
Mar.05
Mar.06
Mar.07
Mar.08
Mar.09
Mar.10
Mar.11
Mar.12
Mar.13
Mar.14
Mar.15

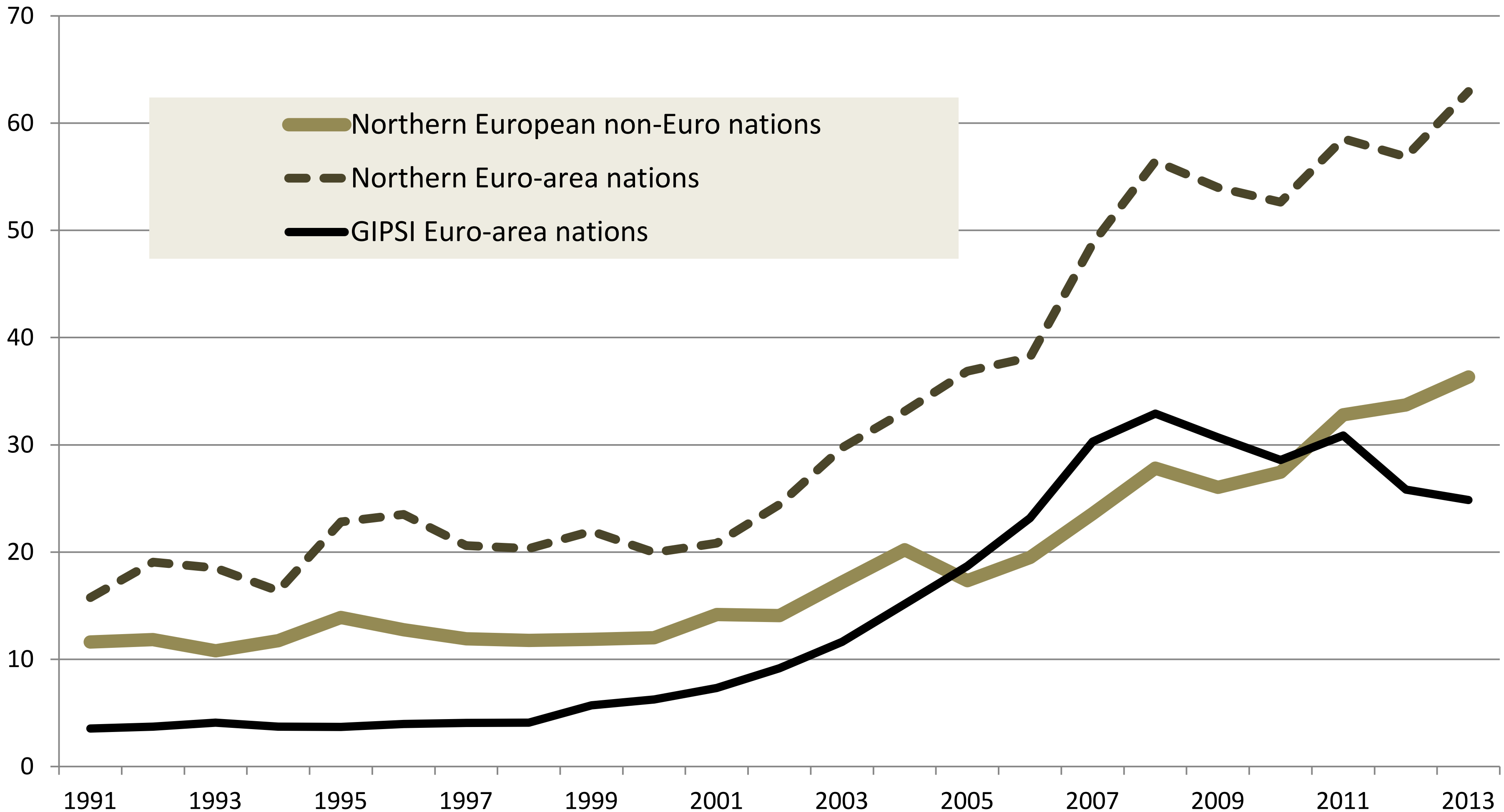
Banks' cross-border claims, selected global areas, 1999-2015
(in trillions of US$) Source: Bank for International Settlements

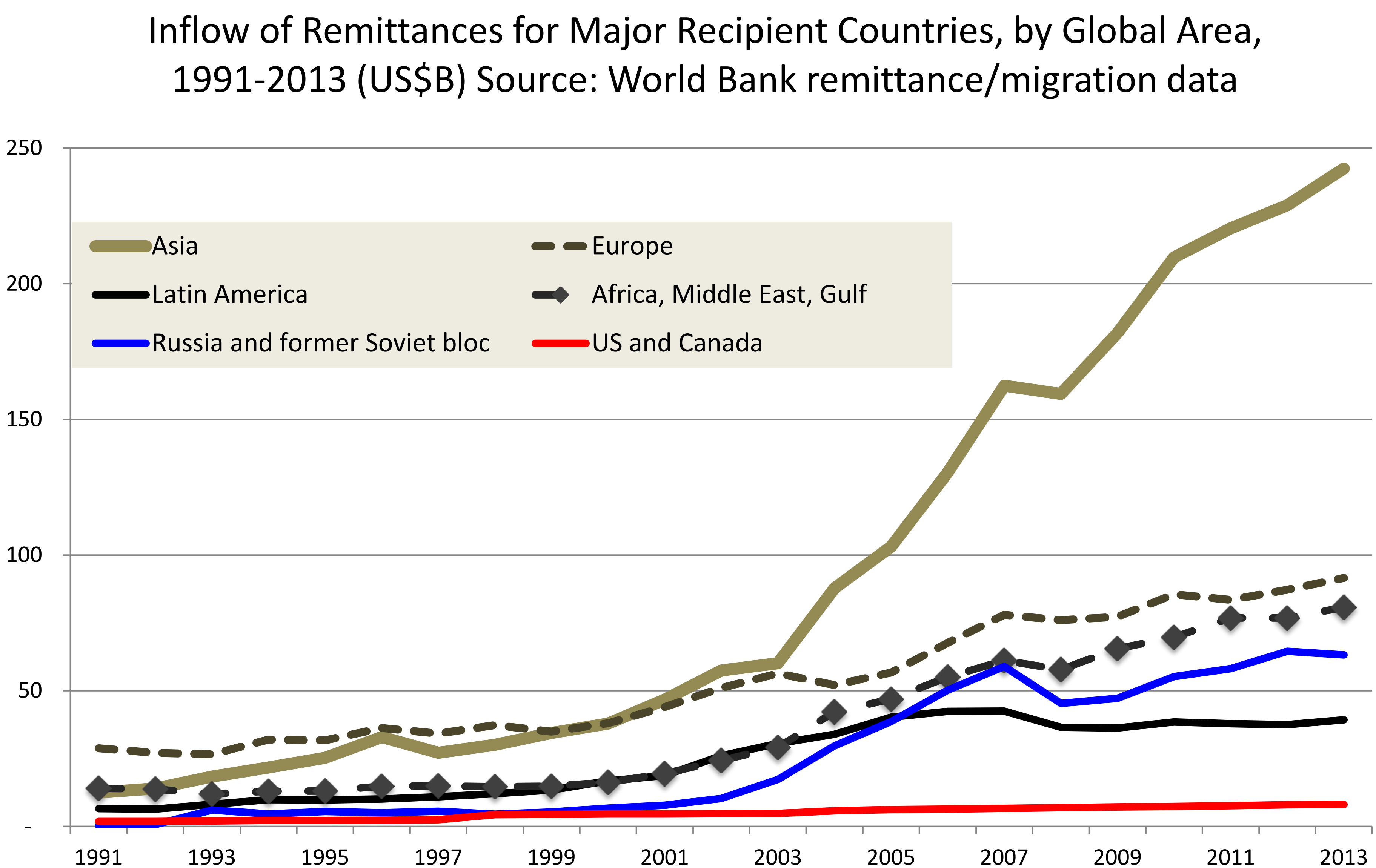


Outflow of Remittances by Country or Global Area, 1991-2013 (US$B)
Source: World Bank remittance/migration data

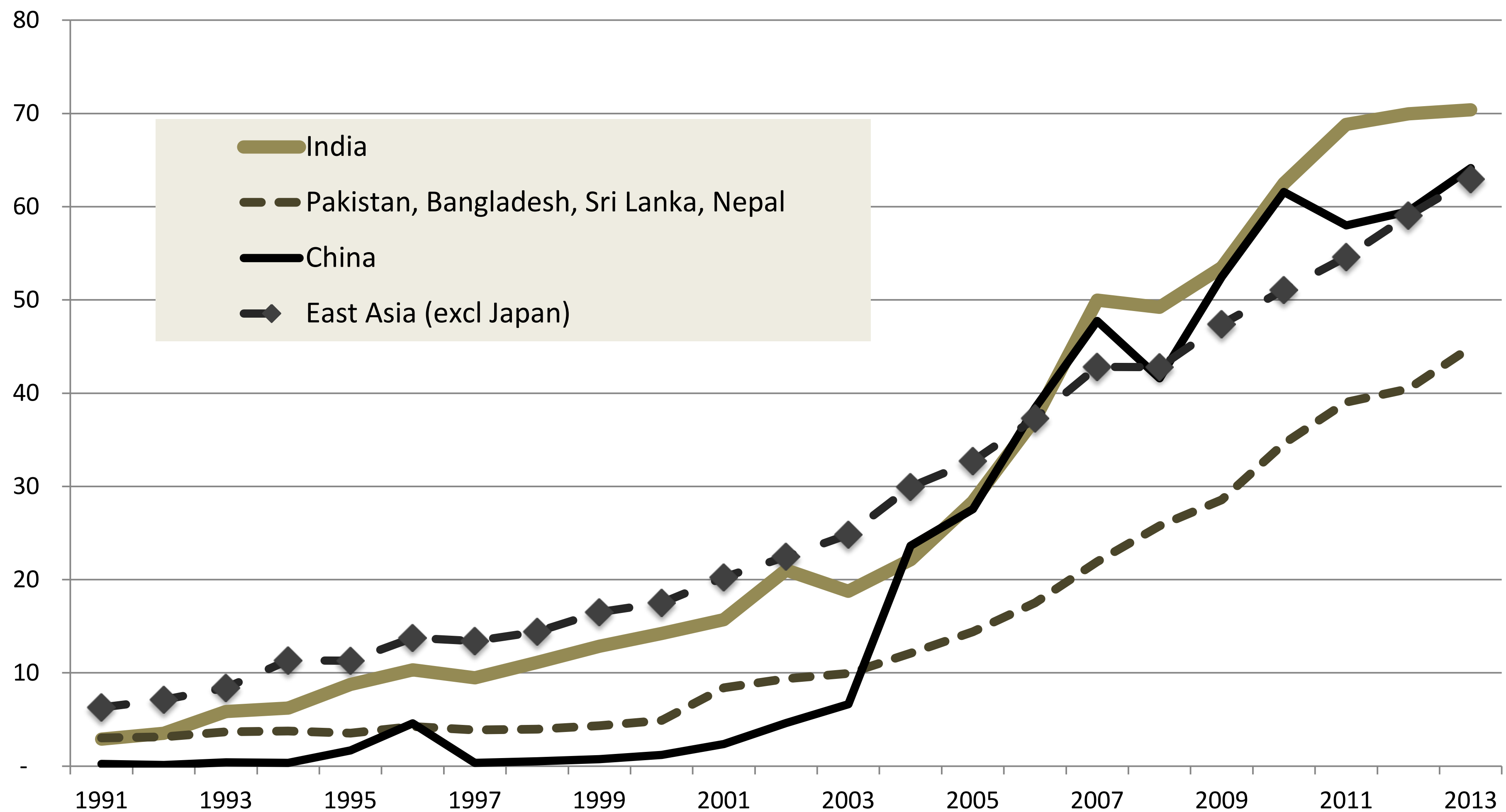


Outflow of Remittances for countries in 3 European areas, 1991-2013 (US$B) Source: World Bank remittance/migration data

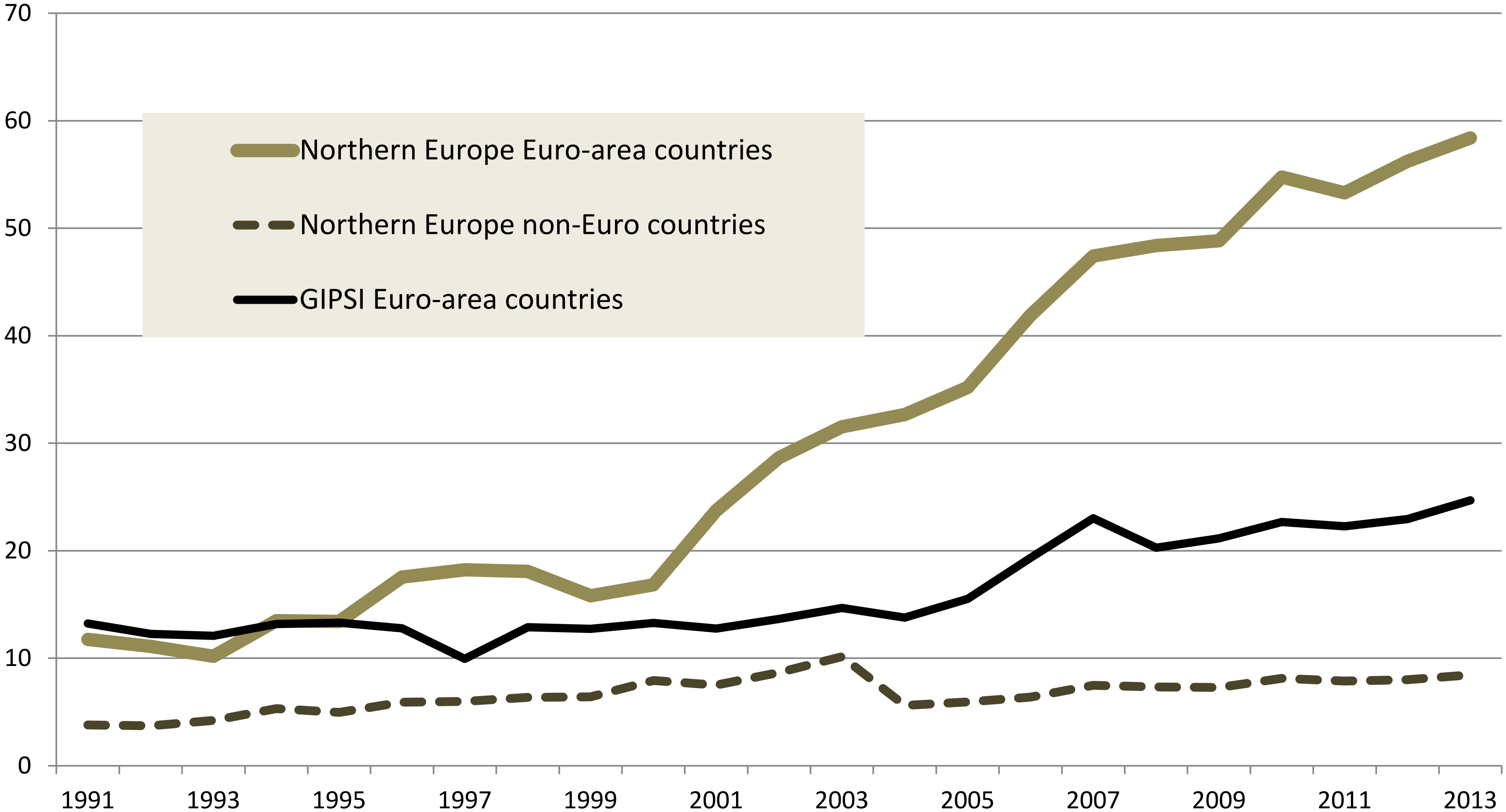



Inflow of Remittances for Major Recipient Countries, by Global Area, 1991-2013 (US$B) Source: World Bank remittance/migration data
Asia
Europe
Latin America
Africa, Middle East, Gulf
Russia and former Soviet bloc
US and Canada
250
200
150
100
50
-
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013

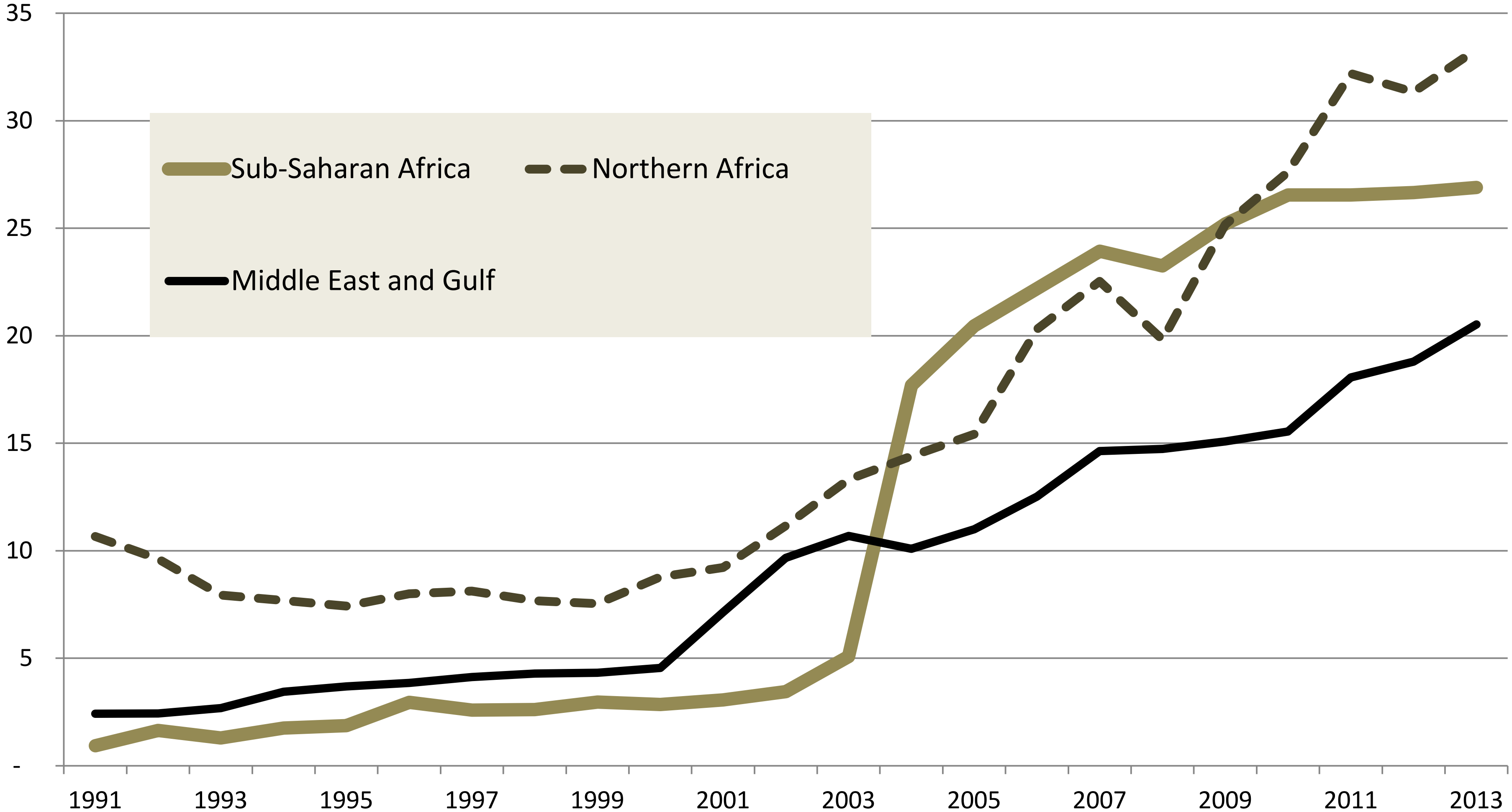
Inflow of Remittances for Recipient Country Groupings within Asia, 1991-2013 (US$B) Source: World Bank remittance/migration data



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



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. Further, these countries' banks have lent more to developing nations than they might otherwise have.
- 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, financial markets searching for zero-sum speculative gain
- Financial boom-bust in developies economies

2. QE ends, interest rates raised in US, UK, Europe:

- Financial bust in developing economies

5. Risks and benefits for new national entrants into global capital markets: proceed with caution

Conclusion: Proceed with caution

- The US, Europe and Japan can undertake coordinated expansionary spending to generate green growth, rebuild infrastructure, address global warming. Until they do, developing economies' slowdown and austerity fiscal policies undercut growth in developing economies.
- Public deficits are likely, as are rising levels of private debt; and when trouble comes, private debt becomes public debt. So more developing-government engagement with global debt markets can be anticipated in the medium run.
- Higher levels of public debt for embattled sovereign states triggers two further forces undercutting development.

Conclusion: Proceed with caution

- First, the households bearing the cost of reduced services and higher taxes are likely to deepen their involvement in the ever-more complex global network of guest workers and immigrants who use cross-border income flows for family survival.
- Second, engagement with the new legal structure of lending – and the conflict-of-laws problems associated with securitization – is inevitable. At present, multiple contracts on one debt-instrument cash-flow are resolved principally in favor of the laws of the ultimate creditor's home country.
- Facilitating the use of novel lending instruments (securitization), as with Europe's possible Capital Markets Union, does not create new lenders or new lending; it redistributes risks and rewards within the financial complex.

Conclusion: Proceed with caution

- The disempowering of governments that are not able to meet social-contractual promises due to the fact that flexibility only works one way (downward adjustment of wages, working rules, pensions, and so on) disables developing economies' capacity to build economic futures with workers and residents within domestic borders.
- A backstop for developing nations managing sovereign debt under adverse conditions is sorely needed – to maintain both human welfare and sovereignty itself.
- A multilaterial sovereign-debt resolution mechanism would be one such backstop for developing countries contending with the harsh winds of global austerity.