



United Nations Conference on Trade and Development

Distr.: General
3 November 2011

Original: English

Thirteenth session

Doha, Qatar
21–26 April 2012

Preface to the report of the Secretary-General of UNCTAD to UNCTAD XIII*

Development-led globalization: Towards sustainable and inclusive development paths

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* For the full report, see UNCTAD(XIII)/1 at http://www-dev.unctad.org/en/docs/tdxiii_report_en.pdf.

The world turned upside down

1. In my report to UNCTAD XII (TD/413), I warned that, despite an unprecedented global boom over the previous five years, significant risks and vulnerabilities threatened growth prospects and could undermine moves towards a more equitable and effective global partnership for development. In particular, I argued that “putting liberalized markets and flexible prices at centre stage has proved to be insufficient in the light of the complex challenges that the new generation of globalization poses”.

2. At that time, I was swimming against the tide of conventional thinking. Even though there were clouds on the economic horizon, notably the housing market in the United States and (closely related) concerns about global imbalances, the consensus forecast was for fair economic weather sustained by strong market fundamentals. Indeed, at the time that I was writing, the International Monetary Fund (IMF) was raising its global growth projections.

3. With the benefit of hindsight, my report underestimated the seriousness of the global imbalances. Sharply rising food prices were an early indication that the world economy was out of kilter. The danger signs became apparent during the UNCTAD conference in Accra, when prices for cereals, soybeans and rice were all at historic highs. In the following months, further rises led to political unrest in several countries. There were also concerns about the price of oil, which had risen above \$100 per barrel, raising inflationary worries along with the possibility of geopolitical tensions.

4. Financial turbulence hit in August 2007, and the collapse of Northern Rock in February 2008 and Bear Stearns in March 2008 revealed serious stresses in the financial markets. Concerns over subprime lending in the United States housing markets intensified in the middle of 2008. But it was the bankruptcy of Lehman Brothers in September that triggered a crisis that few had anticipated or even imagined possible, exposing the full extent of global financial fragility. Credit markets froze and equity prices collapsed. Leading financial institutions failed, while many others turned to their governments for support. The speed of contagion was breathtaking, and the sense of panic in the financial markets and among policymakers was palpable.

5. The first lesson to draw from the crisis is that leaving markets to regulate themselves is both ineffectual and costly. Bailing out financial institutions has already run into trillions of dollars, and despite unprecedented fiscal and monetary responses, the global economy experienced its first contraction since the Great Depression. An estimated 10 per cent of global output was lost between 2008 and 2010, and tens of millions of jobs were destroyed; according to estimates by the International Labour Organization, 200 million people are currently unemployed worldwide. The impact was felt even in those communities that had seen few benefits during the boom years: due to the crisis, the number of people living in extreme poverty jumped by between 50 and 100 million.

6. A second lesson is that when a large number of economies collapse so dramatically, there must have been underlying weaknesses and fragilities missed or ignored by policymakers prior to the crisis. No one doubts the creative impulse of market forces, but the private pursuit of short-term gain can sometimes result in insufficient productive investment and concentrate the rewards with the favoured few. The risks are particularly pronounced when financial markets detach themselves from the real economy, tying wealth creation to the rapid accumulation of debt and rising asset prices rather than to steady productivity improvements and increasing incomes, and channelling innovation to financial engineering rather than to technological progress. Such a growth strategy is likely to be neither stable nor fair.

7. A third lesson is that when things do fall apart, the state remains the only institution capable of mobilizing the resources needed to confront large and systemic threats. The idea that the nation state had somehow outlived its usefulness in a borderless world was never very serious. Since the state is pivotal to establishing an inclusive social contract and strengthening participatory politics, it is both imprudent and unrealistic to reduce or bypass its role in managing economic development and change. The more worrying trend in recent years has been the growing influence of financial markets in bending public policy and resources to their own needs and interests – leading a former IMF chief economist to warn of a “quiet coup” – including in the post-crisis period.

8. Even as a tentative recovery has set in, the imbalances that arose during the previous boom, particularly in advanced countries, have proved very difficult to overcome. The private debt overhang remains a drag in many countries, while the combined effect of financial bailouts and recession has led to rising public deficits, triggering sovereign debt crises in some countries and stalling the recovery in others. Everywhere, employment creation has lagged behind, raising the threat of jobless growth and the spectre of protectionist responses. This provides a fourth lesson from the crisis, namely that in an interdependent world, countries cannot be expected to tackle destabilizing threats and imbalances on their own. And yet, to date, effective rebalancing strategies have not materialized at the multilateral level. The initial reaction to the food and financial crises was swift, with significant resources committed on both fronts, along with improved policy coordination; and protectionist responses have so far been kept in check. But the reforms required to prevent a repetition of the crisis have proved elusive. In the resulting interregnum, the burden of adjustment has been shifted onto overstretched public and household finances, with growing threats to the social peace and stability.

9. Neither IMF nor the World Bank, having abandoned their original *raison d’être* to the siren calls of unregulated financial markets, have been able to forge a vision of a post-crisis world economy consistent with changed economic and political realities. This failure points to a wider hiatus in global governance. The Doha Development Round is fast approaching its tenth anniversary, and its completion – as initially conceived – is still to happen. Progress on reducing greenhouse gas emissions has stalled following the failure to reach a comprehensive deal in Copenhagen. Finally, even before the latest crisis, keeping the Millennium Development Goals on track was a struggle: their achievement by 2015 is now only a distant possibility. It is telling that even a small proportion of the resources used to save financial institutions deemed “too big to fail” could never be found in better economic times for social and economic development, infrastructure-building and social welfare, or to address environmental challenges.

A. Goodbye finance-driven globalization

10. It has become commonplace to view these developments as part of the inevitable stresses and strains of moving to a borderless world economy, and the price to be paid for the greater efficiency and dynamism of global market forces. Doing so requires a good deal of faith in the textbook logic of how markets work. In fact, the past 30 years have seen a persistent slowdown in global growth, weaker investment performance in many countries, and a sharp rise in income inequality almost everywhere. Moreover, describing the global economy as a natural system with a logic of its own ignores the policy choices underpinning it.

11. The extensive deregulation of the financial sector in the advanced countries, the dismantling of controls on cross-border financial activities, and the ensuing surge in capital flows marked a radical break with the post-war international policy framework. The rapid ascent of financial interests has eroded the checks and balances that had previously helped

channel market forces into the kind of creative and productive activities needed for long-term growth, and has instead encouraged short-term, and at times destructive, behaviour by banks, businesses, and households. Ideological support came from the efficient market hypothesis, which made the case for a hands-off policy approach applicable to all economic circumstances and challenges.

12. The crisis has put to rest the idea that there is a “one-size-fits-all” policy agenda. It has also been a considerable shock to the confidence of the developed world, and to the belief that economic disasters only occur in developing countries because of weak institutions, corruption and mismanagement. The former head of IMF, Dominique Strauss-Kahn, was right to conclude that events since 2008 have “devastated the intellectual foundations of the global economic order of the last twenty-five years” and have shattered confidence in simple policy fixes to complex development challenges.

13. Since the early 1990s, against the grain of conventional economic wisdom, UNCTAD has been arguing that the risks from the premature liberalization of trade and capital flows are significant, that the benefits are not simply there for the taking, and that a more pragmatic approach to development strategy is essential. In 1993 UNCTAD warned of an emerging financial crisis in Mexico, in 1995 we flagged the systemic risk from growing derivatives markets, and in 1997 we were not only alert to the dangers of rapid financial liberalization in East Asia but also suggested that a combination of repeated shocks and growing inequalities could produce a backlash against globalization. We have consistently argued that, in the face of large and unruly capital movements, neither fixed nor flexible exchange rates can provide the macroeconomic stability needed to secure strong growth, and that capital controls should be a permanent part of the policy toolkit. We have warned that an undue emphasis on inflation targeting would likely fuel damaging boom-and-bust cycles, particularly in developing countries, arguing instead for greater fiscal space and a more balanced approach to demand management. Throughout the past decades, we have been warning that the build-up of private and public sector debt was feeding unsustainable imbalances at the household, national and global level, and that “bailouts” were neither an effective nor a desirable solution. In 2008, we argued that the financialization of markets of strategic interest to developing countries had reached dangerous levels, and that it had become a more significant influence on trade and development than real economic fundamentals.

14. With all this in mind, I have chosen the term finance-driven globalization (FDG) to characterize the dominant pattern of international economic relations during the past three decades. This is intended to convey the idea that financial deregulation, concerted moves to open up the capital account, and rapidly rising international capital flows have been the main forces shaping global economic integration since the breakdown of the Bretton Woods system. Financial markets and institutions have become the masters rather than the servants of the real economy, distorting trade and investment, heightening levels of inequality, and posing a systemic threat to economic stability.

15. The latest crisis has served as a further reminder that FDG is a political project and is, therefore, the subject of legitimate discussion and debate. To date, the response has largely been one of muddling through, with ad hoc measures to mitigate the damage from economic shocks, informal partnerships to tackle global imbalances, and impromptu alliances to push for greater market transparency. There has been progress: the G20 has added a new and more focused layer of coordination in international economic matters, and has helped to nudge the multilateral financial institutions towards (marginally) more representative governance structures and (slightly) less dogmatic advice. However, divisions have emerged among the advanced economies on how to reform the international financial system, with alarming signs of a reversion to “business as usual”. Indeed, their financial sectors have already returned to many of the old practices, even as public finances

deteriorate and the recovery stalls. Austerity measures are back on the agenda, and resistance to financial regulation has begun in earnest.

B. The future is not what it used to be

16. Money and finance have dominated policy discussions and grabbed the headlines. However, there are other important trends shaping development prospects. Soon after UNCTAD XII in Accra, the United Nations concluded that the planet was now truly urban, with over half the world's population living in cities. This figure is expected to rise to over 60 per cent by 2030. Urbanization has long been seen as a progressive trend, closely linked to a series of cumulative processes raising economic and social well-being. However the links are not automatic, and considerable challenges lie ahead. Rapid urbanization, premature deindustrialization and a degraded public sector have led to speculations about a "hollowing out" of the middle-class, and, more dramatically, a "planet of slums". Where these trends have collided with the ambitions of a youthful population, economic frustrations have spilled over into political unrest, as witnessed recently in North Africa.

17. It would be equally amiss to ignore environmental challenges, and, in particular, what the United Nations Human Settlements Programme (UN-HABITAT) has dubbed the "deadly collision" between urbanization and climate change. It is widely acknowledged that global warming is the unwelcome (and unpriced) result of successful development of today's advanced economies. But solving it will require a global policy response that brings about a new economic trajectory without compromising existing development goals. That will entail low-carbon, high-growth paths based around new technologies that can deliver an adequate supply of energy and rising incomes to a growing global population, with greatly reduced greenhouse gas emissions. A large investment push, with adequate financing and technology transfer from richer countries, is essential to this rebalancing challenge, and serves as a reminder of the interrelated nature of the challenges facing the international community. To date, the requisite economic incentives, degree of political will and appropriate partnerships have been noticeable by their absence.

18. The rise of new growth poles in the South also heralds a significant shift in the global economic and political landscape. China has already become the world's second-largest economy and its largest exporter. India has now posted two decades of strong growth and is steadily climbing the export ladder. Growth in other large developing countries, such as Brazil and Indonesia, picked up in the second half of the last decade. Since the Accra conference, the share of developing countries in world income has risen by more than 3 percentage points, to 30 per cent. Trade and investment patterns have shifted accordingly, and new political alliances and groupings have emerged, suggesting that a new world order is already taking shape.

19. The resilience to, and rebound from, the crisis in parts of the developing world certainly marks an important break with the past and has raised hopes of a prolonged period of convergence ahead. UNCTAD has always looked to an emerging South as being key to a more balanced global economy. However, a degree of caution is warranted. To date, this shift has been uneven, with large differences between developing regions and among individual countries; many of the least developed countries (LDCs) have seen the income gap between them and other countries widen further during the past two decades, suggesting that polarization pressures continue to shape global economic relations. Moreover, many emerging markets remain dependent on the leading economies and vulnerable to changes in policy and in economic conditions there. The impact of the Northern debt crisis on developing countries will need to be monitored carefully. The emerging South is still work in progress, and new forms of cooperation and partnership will be needed to consolidate recent gains and to meet the challenges ahead.

C. Hello development-led globalization

20. Against a backdrop of economic imbalances and political tensions in interwar Europe, John Maynard Keynes called for “new policies and new instruments to adapt and control the working of economic forces, so that they do not intolerably interfere with contemporary ideas as to what is fit and proper in the interests of social stability and social justice”. A new deal did eventually emerge, but only after a push for “business as usual” had left a trail of currency disorders, wasted resources and shattered communities. Today’s global economic landscape bears some unnerving similarities to the interwar years; as then, neither muddling through nor a return to business as usual will get things back on track. The challenge is to rebalance economies in a way that is timely, sustainable and just.

21. This time around, rebalancing will need a global new deal that can “lifts all boats”, in developed and developing countries alike. It is a basic truth that people everywhere want much the same thing: a decent job, a secure home, a safe environment, a better future for their children and a government that listens and responds to their concerns. UNCTAD has consistently suggested a battery of policy measures and institutional reforms at the national and the international level to support rising living standards in developing countries, build their resilience to external shocks, and help them pursue a balanced integration with the global economy. The challenge, as I outlined in my report to UNCTAD XII, was less about “getting prices right” and more about “getting development right”, through a pragmatic, proactive and socially inclusive approach to macroeconomic, trade and industrial policies.

22. Finding the appropriate mixture of reflation, redistribution and regulatory measures to achieve these goals is now the urgent task of policymakers, at the international as much as the national level. I have chosen the term development-led globalization (DLG) to describe the principles, priorities and policies that need to be pursued to turn tentative recovery into an inclusive and sustainable future.

23. Reforming the financial system is the place to begin. Even before the crisis, it was clear that stable and inclusive development was incompatible with speculative market behaviour, boom-and-bust cycles, and the austerity programmes to which they invariably lead. It is telling that the emerging success stories from the South have, in large part, pursued policies that have avoided these dangers. Finance needs to get back to the business of providing security for people’s savings and mobilizing resources for productive investment. Reforms are also needed to replace unruly and procyclical capital flows with predictable and long-term development finance, to regain stability in currency markets and to support expansionary macroeconomic adjustments. Surveillance and regulation will need to be strengthened at all levels, and new institutional arrangements may need to be considered. Regional financial cooperation, despite the current difficulties in the eurozone, will, in particular, have a much larger role to play in a more balanced international architecture.

24. Stable monetary and financial arrangements are a precondition for making trade and investment work for inclusive growth and development. But rebalancing requires that financial and other resources be channelled towards the right kind of productive activities. Industrial development remains a priority for many developing countries because of the opportunities it provides to raise productivity and incomes, and to get the most from international trade. But a wider sectoral approach, including a focus on the primary sector in many LDCs, is needed in order to ensure that measures to diversify economic activity are consistent with job creation, the security of food and energy supplies, and effective responses to the climate challenge.

25. Talk of “picking winners” has been given an unexpected boost by the exigencies of the financial crisis, but the real challenge is to make sure that industrial policy, broadly conceived, is properly aligned with other measures needed to build inclusive development

paths. Since diversified economies are the building blocks of a dynamic trading system, it is essential that trade policies and rules – at all levels – support this agenda. Cutting through the Gordian knot of existing regional trade and investment agreements and building more productive forms of integration among neighbouring countries offers a way forward for developing countries. There is also a case for new global rules in areas of particular interest to developing countries, including for commodity markets and the effective transfer of technologies.

26. An inclusive development agenda cannot depend on economic policies alone. Under FDG, the stresses and burdens of unregulated markets have, all too often, been shifted to individuals and households and, in countries where social welfare systems exist, to government budgets. In many cases, unprecedented increases in income inequality have gone hand in hand with underfunded public services and rising levels of household indebtedness. The resulting cost to economic security and social cohesion has been enormous. Even when growth has accelerated, as it did in many developing countries between 2002 and 2008, too many people were left behind. A balanced economy depends on a strong social compact which, in turn, requires a range of universal and targeted social policies, tailored to specific circumstances, to ensure that the benefits of growth are widely enjoyed and its risks are shared fairly.

27. The crisis has confirmed UNCTAD's long-standing insistence on the importance of policy space. Its role in building new and more inclusive development paths cannot be understated. This is needed to allow governments – particularly but not only in developing countries – to correct market failures, promote collaboration among enterprises in areas of long-term investment, manage integration with the global economy, and ensure that the rewards from doing so are evenly shared. In order to do so, states must forge a coherent and inclusive developmental vision and build a strong compact with different interest groups to better manage the conflicts and trade-offs that change inevitably brings. Effectiveness also hinges on a more integrated approach to policymaking which not only links macroeconomic, sectoral, trade and financial policies in support of growth and development, but also brings together economic, environmental and social policies, leading to sustainable and inclusive outcomes. Accordingly, in the full version of my report to UNCTAD XIII (with the symbol UNCTAD(XIII)/1), I stress the critical role of the developmental state in building balanced growth paths in an economy where the mobilization and allocation of resources relies on market forces.

28. This should not be taken to imply that states never fail. Indeed, accountability, transparency and the rule of law are just as important for making states sufficiently representative as they are for making markets sufficiently stable. However, when we compare success stories from North America to Scandinavia to East Asia, we find that market economies can operate within a wide spectrum of social and political arrangements, and that, beyond a few core principles, there is no single model of state–market relations for others to emulate. Each country must be able to experiment and discover what configuration of institutions and governance works best in its circumstances and in line with the expectations of its population.

29. Responsibility for the choice of policies to secure a prosperous, fair and stable future remains to a large extent with national governments, institutions and constituencies. However, in our interdependent world, a more secure and inclusive global economy requires strong international leadership and carries collective responsibilities. There are hard questions to answer about whether current arrangements can help to build socially inclusive alternatives to FDG, and what governance structures might support DLG. UNCTAD XIII in Doha provides an opportunity for the international community to discuss these challenges in a frank, open and constructive manner.