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Addressing systemic issues: Strengthening the coherence and consistency of multilateral financial, investment, trade and development policy

Note by the UNCTAD secretariat

Summary

This note provides an overview of interrelated systemic issues in the global economy and their impact on promoting developmental goals at the national and international levels. Decades of global deregulation of financial, labour, product and service markets have led to increasing global financial instability and international competition patterns that have substantively strengthened corporate market and political powers vis-à-vis national Governments and deepened global income inequalities. As a result, large global imbalances have built up in the global economy that are inimical to developmental interests, through worsening balance-of-payment constraints, increasing external debt burdens and reduced national policy space. This has become starkly obvious in the context of the coronavirus disease (COVID-19) pandemic.

The note suggests core elements of an effective multilateral response to alleviate the economic impact of the pandemic and promote a more development-friendly system of global economic governance in the longer term.

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Introduction

1. The third session of the Intergovernmental Group of Experts on Financing for Development agreed that discussions at the fourth session should consider the following topic: Addressing systemic issues – strengthening the coherence and consistency of multilateral financial, investment, trade and development policy. The agreed guiding questions were as follows:[1]

(a) Through which institutional reforms, and improvements in policy coordination and coherence, can regulatory gaps and misaligned incentives in the financial system be addressed so as to increase financial stability for long-term development and global economic prosperity?

(b) How can the role of the United Nations in scaling up effective development finance, and in strengthening the international financial safety net, be rendered more effective?

(c) Which policy tools and mechanisms, at the national, regional and multilateral levels, can best help to reduce excessive volatility in commodity prices and advance a development-friendly trade and investment regime that facilitates domestic financial resource mobilization in developing countries?

(d) How can the voice and participation of developing countries in international economic decision-making and norm-setting be broadened and strengthened?

2. This topic corresponds to action area F of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development and section II.F.1–5 of the reports of the Inter-agency Task Force on Financing for Development. The Addis Ababa Action Agenda noted that the Monterrey Consensus of the International Conference on Financing for Development, adopted in 2002, emphasized "the importance of continuing to improve global economic governance and to strengthen the United Nations leadership role in promoting development [and the] importance of the coherence and consistency of the international financial and monetary and trading systems in support of development".[2] The Addis Ababa Action Agenda took into account regulatory improvements made following the global financial crisis in 2008/09 and stated that continued risks to financial stability suggested a need to pursue further reforms of the international financial and monetary system, and States committed to strengthening international coordination and policy coherence to enhance global financial and macroeconomic stability. In addition, States remained committed to maintaining a strong and quota-based International Monetary Fund, with adequate resources to fulfil its systemic responsibilities, and urged the International Monetary Fund to continue its efforts to provide more comprehensive and flexible financial responses to the needs of developing countries. States also committed to assessing and if necessary reducing the systemic risks associated with shadow banking, and reducing mechanistic reliance on credit-rating agency assessments. Finally, States recommitted to broadening and strengthening the voice and participation of developing countries in international economic decision-making and norm-setting and global economic governance.[3]

3. Action area F built on the Monterrey Consensus, which focused on systemic issues of international financial and trade architectures with the aim of promoting a development-friendly international trading system, ensuring affordable access to technology for structural transformation and reducing financial and debt vulnerabilities in developing countries. Underlying this was the broad recognition that core drivers of development and determinants of national policy space were increasingly global or systemic in nature and that, in a more financialized global economy, this was particularly the case for issues related to the financing of development. States noted that "since Monterrey we have

[1] TD/B/EFD/3/3.
[2] A/RES/69/313, paragraph 103.
[3] Ibid, paragraphs 106, 107, 109 and 110.

become increasingly aware of the need to take account of economic, social and environmental challenges [and] to enhance policy coherence across all three dimensions of sustainable development" and resolved "to strengthen the coherence and consistency of multilateral financial, investment, trade and development policy and environment institutions and platforms, and increase cooperation between major international institutions, while respecting mandates and governance structures".[4]

I. When the winner takes most: Systemic issues in the pre-pandemic global economy

4. Recent decades have seen the erosion of two main principles that guided the Bretton Woods system of global economic governance, namely, that the system should enhance domestic policy space to support national growth and development strategies and that it should avoid deflationary biases in the global economy by placing the burden of adjustments to international macroeconomic and financial imbalances on both surplus and deficit countries in even ways. Trade liberalization was paired with capital controls and fixed or pegged exchange rate regimes in order to ensure that the benefits from trade would accrue to domestic resource mobilization. Behind these guiding principles of the Bretton Woods system was the idea that global aggregate demand needed to be managed if the global public good of economic, financial and, ultimately therefore, social and political stability was to be achieved and if economic growth and development were to proceed along balanced, inclusive and sustainable paths.

5. The rise of hyperglobalization since the 1990s, that is, the combined deregulation of financial, labour, product and service markets at the global level, alongside already advanced trade liberalization, has tended to reinforce the-winner-takes-most features of the global economy rather than support national growth and development strategies. Under this new policy paradigm, global aggregate demand management was largely abandoned, since private sector spending was to be the main spontaneous engine of global growth and private credit creation, the main fuel of economic expansion and income generation. Given the increased interconnectedness of production, trade, investment and finance, a number of equally intertwined systemic issues have emerged. Increasing financial instability has resulted in a steep rise in the number of financial crises, in both developed and developing countries, since the mid-1970s.[5] Global debt stocks rose from $16 trillion in 1980, or 140 per cent of global gross domestic product (GDP), to $228 trillion, or 267 per cent of global GDP, by end-2018, while the pace of private fixed capital formation, in particular in leading developed economies, has been on a long-term downward trend in the past four decades.[6] At the same time, finance-led hyperglobalization has seen a substantive shift of bargaining power away from still largely nationally regulated labour to increasingly footloose capital, fuelling increases in corporate market and political power and increasing income and wealth inequalities in many parts of the world.

6. In a context of sluggish global growth, such dynamics favour deflationary adjustments to macroeconomic shocks, in particular in developing countries, such as austerity programmes; beggar-thy-neighbour policies to increase international competitiveness through low-cost strategies; and attracting foreign direct investment through a race to the bottom on taxation and subsidy schemes. Depressed domestic demand and rising external debt burdens reduce national policy space to finance developmental, social and environmental policies. At the same time, an increasingly fragmented multilateral system has been unable or unwilling to scale up international finance towards both greening the global economy and facilitating catching-up sustainable development.

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[4] Ibid, paragraphs 103 and 113.

[5] In 1970–2011, there were over 140 banking crises, 218 currency crises and 66 sovereign crises, the majority of which occurred after 1980 (L Laeven and F Valencia, 2012, Systemic banking crises database: An update, working paper No. 12/163, International Monetary Fund).

[6] UNCTAD, 2020a, *Trade and Development Report 2020: From Global Pandemic to Prosperity for All – Avoiding Another Lost Decade* (United Nations publication, Geneva), chapter I.

A. Financialization and the rise of the financial periphery

7. Well before this sea change in international policy paradigms, Raúl Prebisch and others identified structural centre-periphery relationships in the global economy that systemically reproduced the economic dependencies of the developing periphery in advanced centres.[7] The original analysis highlighted systemic divergences between the growth prospects of commodity-dependent developing economies and those of advanced economies with a large manufacturing base. Financialization, that is, "the increasing importance of financial markets, financial motives, financial institutions and financial elites in the operations of the economy and its governing institutions, both at the national and international levels",[8] has added a new dimension to this analysis by driving the inclusion of a growing number of developing countries into a financial periphery.

8. Waves of bank consolidations created too-big-to-fail mega banks in financial centres, as well as a network of non-bank financial intermediaries, such as broker-dealers, money market mutual funds, hedge funds and insurance corporations, known as shadow banking.[9] This system thrived on the introduction of financial innovations, such as securitization, credit derivatives and special purpose vehicles. Although financial innovation worked to diversify individual creditor risks, private risk management failed to pick up mounting systemic financial risk, culminating in the global financial crisis. Subsequent regulatory reforms have largely remained ineffective in slowing down financialization trends and, in particular, reining in the shadow-banking sector. This sector controlled about $98 trillion worth of assets in 2008 and this figure had risen to over $180 trillion worth of assets in 2019, with the industry now managing a higher share of global financial assets than both commercial banks and public financial institutions together.[10]

9. From the perspective of developing countries, a core characteristic of financialization has been the growing exposure of their external financing to the logic of private financial risk management and to the vagaries of global financial investor sentiment. As the integration of developing countries, in particular of frontier markets (defined as "those that resemble emerging markets with regard to international market access"),[11] into international financial markets accelerated over the past three decades, this provided new opportunities to refinance external liabilities and borrow anew, at lower interest rates and with longer maturities than their domestic financial markets could generally offer and at a time when their access to public development finance became more limited.[12] Yet it has also meant that the external financing profiles of developing countries are now highly dependent on monetary and fiscal policy decisions in advanced economies and on their

[7] See JA Ocampo, 1995, Terms of trade and centre-periphery relations, in: JL Dietz, ed., *Latin America's Economic Development: Confronting Crisis*, second edition (Lynne Rienner Publishers, Boulder, United States of America); R Prebisch, 1950, *The Economic Development of Latin America and Its Principal Problems* (United Nations publication, New York); and HW Singer, 1950, The distribution of gains between investing and borrowing countries, *The American Economic Review*, 40(2):473–485.

[8] G Epstein, 2001, Financialization, rentier interests, and central bank policy, prepared for the conference on financialization of the world economy of the Department of Economics and Political Economy Research Institute, University of Massachusetts, Amherst, United States, 7 and 8 December.

[9] See G Dymski, 2018, Developing economies, international financial integration and sustainable development, prepared for the second session of the Intergovernmental Group of Experts on Financing for Development, 7–9 November; and UNCTAD, 2019a, *Trade and Development Report 2019: Financing A Global Green New Deal* (United Nations publication, Geneva), chapter II.

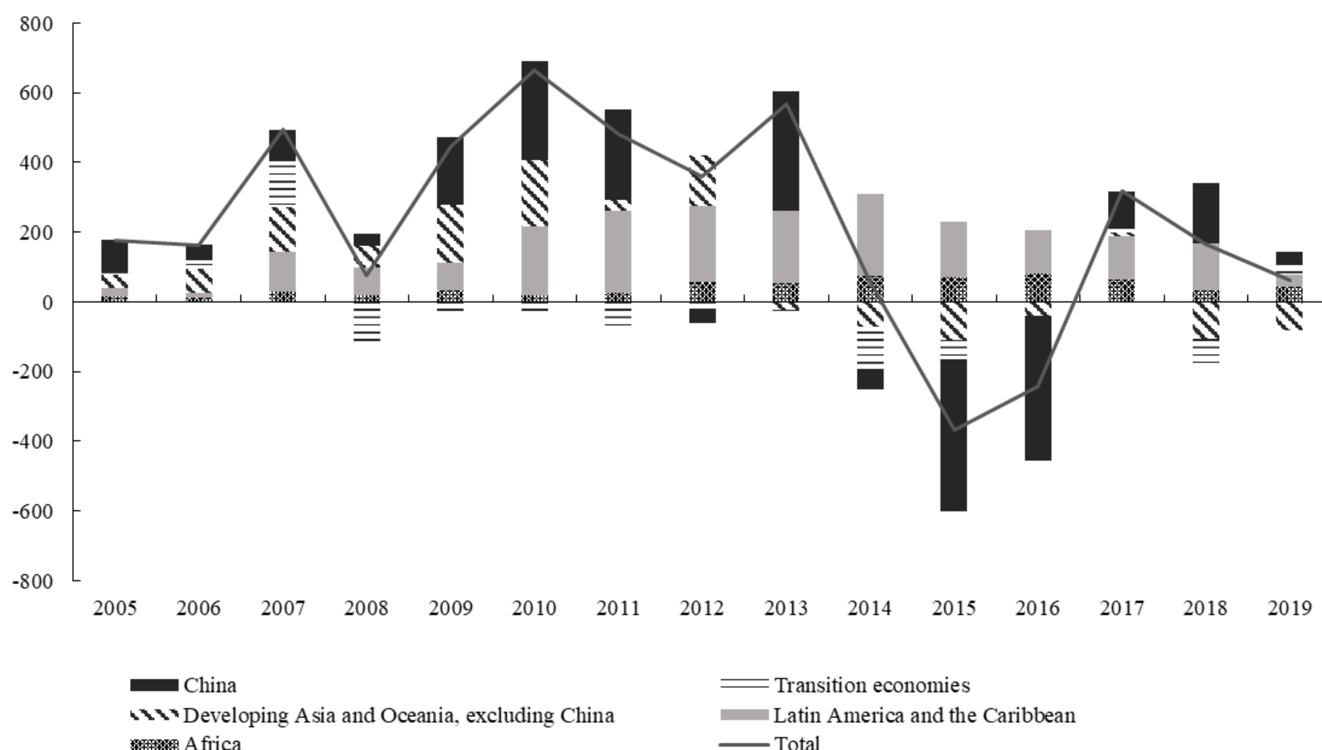
[10] High-frequency trading, for example, corresponds to over 80 per cent of the volume traded on the Nasdaq Stock Market and amplified the selling of stocks due to the pandemic (Financial Stability Board, 2020, Global Monitoring Report on Non-Bank Financial Intermediation 2019 (Basel, Switzerland)). See https://www.nasdaq.com/articles/what-you-should-know-about-high-frequency-traders-amidst-covid-19-2020-04-08.

[11] International Monetary Fund, 2020, The evolution of public debt vulnerabilities in lower-income economies, policy paper No. 20/003. The number of frontier economies included in the JP Morgan next generation markets index rose from 17 in 2011 to 36 in 2019.

[12] TD/B/EFD/3/2. See https://developmentfinance.un.org/official-development-assistance.

ability to provide a functional outlet for centre-based financiers in search of high-yield assets abroad. This is evident in the high level of volatility of net private capital flows to developing countries, which continued unabated following the global financial crisis, involving both greater magnitudes and more pronounced reversals (figure 1).[13]

Figure 1
Net private capital flows by developing country group
(Billions of dollars)



Source: UNCTAD calculations, based on International Monetary Fund balance of payments statistics.

10. Importantly, developing countries have, on average, been affected by private capital flow reversals despite strong economic fundamentals, such as relatively low public debt, small budget deficits, low inflation rates and high levels of reserve holdings. One estimate suggests that, following the global financial crisis, global financial conditions are now five times more important as a determinant of private capital flows to developing countries than with regard to developed economies.[14] A central factor in this synchronized behaviour of capital flow movements across developing economies has been the reliance of investor strategies on mechanistic assessments by a few private credit rating agencies and on passively managed global investment funds led by a small number of asset managers. At present, these allocate around 70 per cent of private investor capital to developing countries on the basis of highly correlated benchmark indices.[15]

11. While portfolio flows and other investments have been the most volatile components of net private capital flows to developing countries,[16] foreign direct investment flows to

[13] See, for example, B Eichengreen and P Gupta, 2016, Managing sudden stops, policy research working paper No. 7639, World Bank; and B Eichengreen, P Gupta and O Masetti, 2017, Are capital flows fickle? Increasingly? And does the answer still depend on type? policy research working paper No. 7972, World Bank.

[14] LS Goldberg and S Krogstrup, 2018, International capital flow pressures, working paper No. 24286, National Bureau of Economic Research.

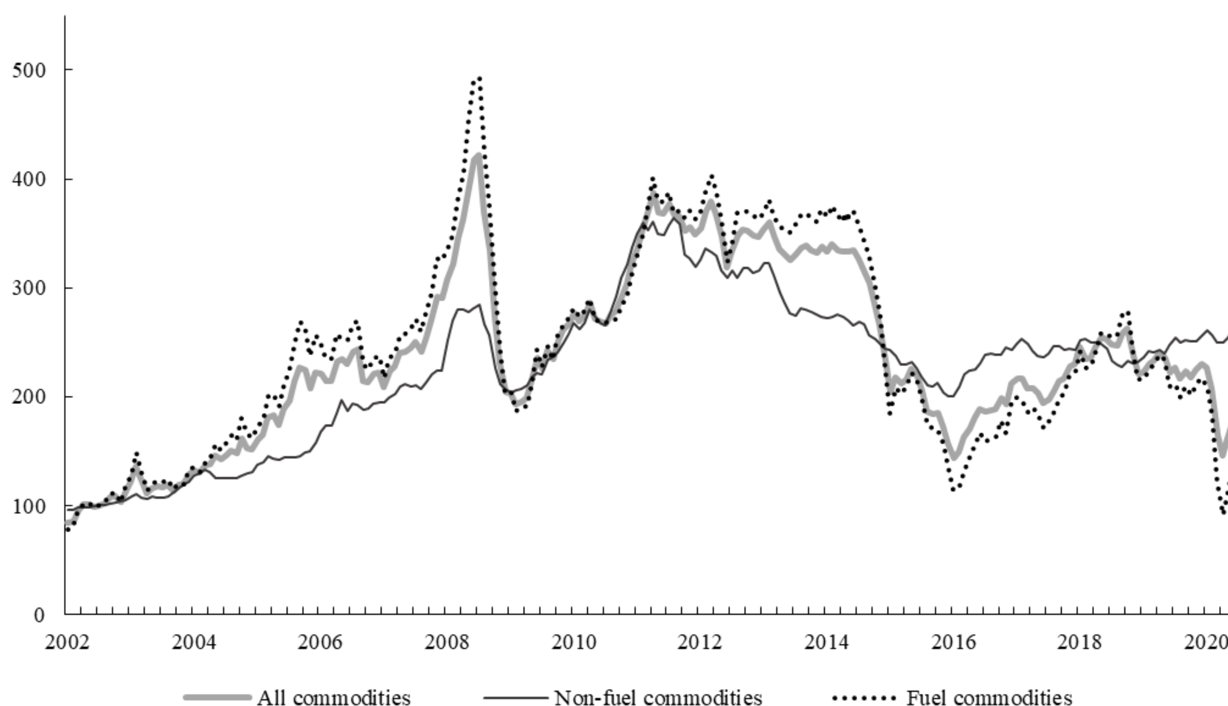
[15] C Raddatz, SL Schmukler and S Williams, 2017, International asset allocations and capital flows: The benchmark effect, *Journal of International Economics*, 108(C):413–430.

[16] See A/73/180.

developing countries had been relatively stable, averaging $674 billion since 2010, despite global foreign direct investment having exhibited a broadly downward trend since the global financial crisis, declining continuously from $2 trillion in 2015 to $1.5 trillion in 2018 and 2019, prior to the current pandemic-related steep downturn.[17] However, by some estimates, over a third of such foreign direct investment flowed through corporate shell companies, designed to maximize tax avoidance and corporate financial profits, rather than being invested in productive activities in host countries.[18]

12. Beyond its impact on the volatility of net private capital flows to developing countries, financialization has also been an important factor in the increased volatility of export earnings, and commodity price volatility is a good example in this regard. Commodity price formation has many supply and demand determinants and a long history of speculative investment, yet the financialization of commodity markets, reflected in the growing role of derivative markets such as over-the-counter markets, leaves some 95 developing countries that earn half or more of their foreign exchange revenue from commodities highly exposed to excessive price volatility (figure 2). The broadly downward trend that set in with the commodity price slump in 2014 has been aggravated by the pandemic, with the aggregate price index registering a 21.5 per cent drop in the first six months of 2020 compared with the same period in 2019.[19]

Figure 2
Monthly price indices by commodity group, January 2002–June 2020
(2002 = 100)



Source: UNCTAD calculations, based on UNCTADstat.

[17] UNCTAD, 2020b, *World Investment Report: International Production Beyond the Pandemic* (United Nations publication, Geneva).

[18] J Damgaard, T Elkjaer and N Johannesen, 2019, The rise of phantom investments, *Finance and Development*, 56(3):11–13.

[19] UNCTAD, 2020a, chapter I.

B. Global inequities: Worsening income distribution and increasing market power

13. Hyperglobalization increases the interconnectedness of production, trade, investment and financial arrangements. This process has spurred global competition for investment, jobs and customers, with capital becoming increasingly global and labour still largely nationally regulated. As increased international competition has encouraged producers to cut costs, including labour costs, with workers in different locations competing against each other, large corporations have tended to maximize profits by relocating investments around the world. This dynamic tends to increase the returns to capital and the wages of highly skilled workers, affecting the distribution of income in many parts of the world.[20] The share of wages in total income has therefore been on a declining path for more than three decades, falling from about 57 per cent of gross world product in 1990 to about 52 per cent in 2017. This trajectory has been steady in developed economies, where the wage share fell continuously from 58.5 per cent in 1990 to 54.5 per cent in 2017. In developing and transition economies, following a decline from 54 per cent in 1990 to 48.5 per cent in 2007, there has been some improvement, with the wage share rising again to nearly 51 per cent by 2017, owing mostly to increases in larger developing economies, notably China.[21] Other measures of inequality paint a similar picture and, while there is ongoing debate about which measures best capture the trends, the main drift towards the deterioration and polarization of income distribution seems evident.[22]

14. An important systemic driver of increasing income inequality has been growing market concentration, in both financial and non-financial sectors, and the concomitant rise of rent-seeking behaviours by increasingly influential large corporations. Rent-seeking behaviour describes the ability to capture income through the ownership and control of existing assets or through a dominant market position, rather than from innovative activity or the productive deployment of resources to create output and employment. Alongside too-big-to-fail financial institutions, non-financial corporations have also become adept at using rent-seeking strategies to bolster their profits.[23] Such strategies include tax avoidance, with recent estimates of revenue losses from tax-motived illicit financial outflows by transnational corporations in developing countries ranging from $50 billion to $200 billion per year, depending on the methodology used and countries covered.[24] In addition, intellectual property has become an important source of corporate rent extraction, particularly from developing countries, contributing to barriers to technology transfer and to the concentration of high valued-added activities and associated income streams in developed countries. Recent research suggests, for example, that United States firms participating in global value chains capture disproportionate shares of global profits through their control of intellectual property rights that serve as key strategic assets to boost market power rather than innovation.[25] The concentration of gains from digital trade in a few large transnational corporations and strong market concentration in non-oil merchandise export markets, in which the top 1 per cent of firms controlled, on average, as much as 57 per cent of country exports in 2014, substantially add to this picture.[26] Still other rents may be described as political rents, derived from the ability to influence particular aspects of

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[20] International Labour Organization, 2015, *Labour Markets, Institutions and Inequality: Building Just Societies in the Twenty-First Century* (Geneva).

[21] UNCTAD, 2016, *Trade and Development Report, 2016: Structural Transformation for Inclusive and Sustained Growth* (United Nations publication, New York and Geneva), chapter I; UNCTAD, 2020a, chapter III.

[22] See, for example, United Nations Economist Network, 2020, *Report of the United Nations Economist Network for the United Nations Seventy-Fifth Anniversary: Shaping the Trends of Our Time* (United Nations publication), chapter 6.

[23] UNCTAD, 2017, *Trade and Development Report 2017: Beyond Austerity – Towards a Global New Deal* (United Nations publication, New York and Geneva), chapter V.

[24] UNCTAD, 2018, *Trade and Development Report 2018: Power, Platforms and the Free Trade Delusion* (United Nations publication, New York and Geneva), chapter II.

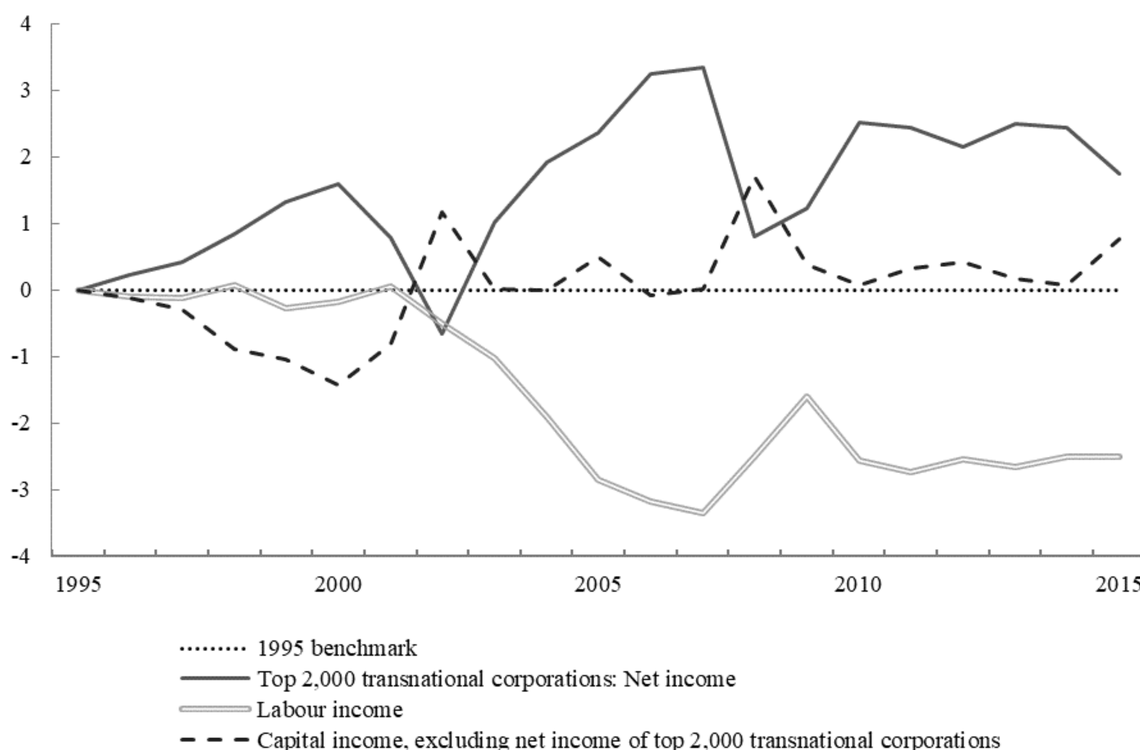
[25] HM Schwartz, 2019, American hegemony: Intellectual property rights, dollar centrality and infrastructural power, *Review of International Political Economy*, 26(3):490–519.

[26] UNCTAD, 2018, chapter II.

government policies through corporate lobbying, for example to benefit from large-scale privatization schemes of public services or from public subsidies without clear economic or efficiency justifications.

15. Figure 3 illustrates the impact on income distribution of such winner-takes-most competition, in which market concentration and rent extraction tend to feed off one another. Using the UNCTAD database of consolidated financial statements of publicly listed companies in 56 developed and developing countries, the profit income of the top 2,000 transnational corporations is compared with that of up to 30,000 companies in the database and these two patterns with the observed decline in the global wage share. The losses from 1995 onwards in terms of the global wage share can be almost entirely explained by the gains in terms of the profit incomes of the top 2,000 transnational corporations.

Figure 3
Top 2,000 non-financial transnational corporations: Changes in profit and global labour income share
(Percentage of gross world product)



Source: UNCTAD database of consolidated financial statements, based on Thomson Reuters Worldscope and UNCTAD world economic database.

16. From the perspective of developing countries, growing market concentration and the rise of corporate rent-seeking have, moreover, limited their prospects for structural transformation in a context in which global value chains dominate international production and trade patterns. In addition, the proliferation of bilateral and regional investment treaties and trade agreements has narrowed the national trade and industrial, but also social and environmental, policy spaces of developing countries, as standards and regulations have been harmonized outside multilateral negotiations. Even where global value chains have allowed developing countries to participate in the international division of labour by providing specific links in such chains, this has largely drawn on their abundance of cheap labour and natural resources, locking them into low value-added activities. Opportunities to dynamically and strategically develop comparative advantages have thus passed many

developing countries by, including many middle-income countries that have remained in a middle-income trap.[27]

C. Unsustainable global imbalances: Careering towards a wall of debt

17. These systemic trends towards financial instability, increasing income inequalities and winner-takes-most global competition patterns have resulted in the build-up of external imbalances that undermine developmental prospects. A development-friendly international monetary and financial system would ensure that high-productivity surplus economies systematically recycled their surpluses to lower-productivity economies by adopting expansionary policies at home to stimulate domestic demand for imports from the latter, by investing in these economies rather than in international financial markets and by lending to them on reasonable or even concessional terms.

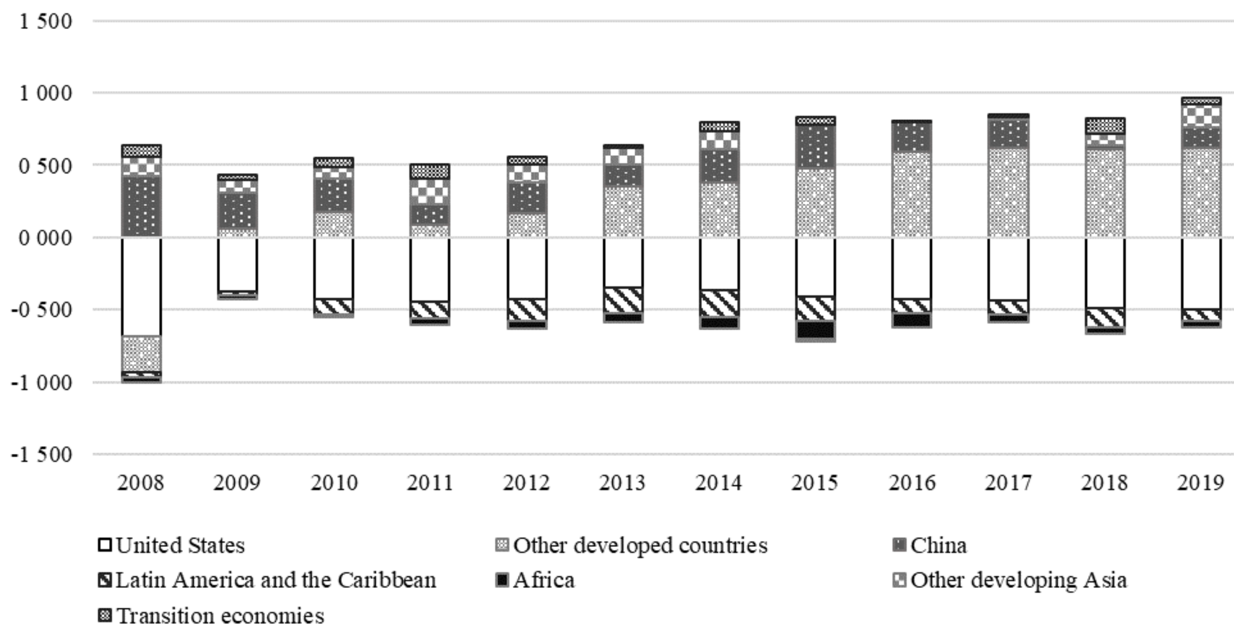
18. However, contributions over the past decade by countries and regions to current account surpluses and deficits reveal another winner-takes-most trend (figure 4). In a context of flat trade growth following the global financial crisis,[28] a few high-productivity economies, such as Germany, Japan, the Netherlands and the Republic of Korea, have expanded their relative shares in global current account surpluses. For the most part, these expansions do not have substantive indirect growth effects in developing economies, for example through the latter's participation in global value chains, since the foreign value-added content of their exports is considerably lower than, for example, that of China, whose relative share in global current account surpluses has shrunk.[29] Deficits, which provide a net stimulus to global aggregate demand, are carried by developing countries themselves, in particular in Africa and Latin America and the Caribbean, alongside the United States. However, demand stimulus for developing countries arising from the United States trade deficit is limited, since this mostly benefits advanced economies, such as Canada, Japan, Germany and the European Union, together with a few larger developing economies, such as China and Mexico.

[27] See, for example, A Andreoni and F Tregenna, 2020, Escaping the middle-income technology trap: A comparative analysis of industrial policies in China, Brazil and South Africa, *Structural Change and Economic Dynamics*, 54(C):324–340.

[28] UNCTAD, 2019a, p. 14.

[29] UNCTAD, 2017.

Figure 4
Participation in global current account balances by region
(Trillions of dollars)



Source: UNCTAD calculations, based on International Monetary Fund balance of payments statistics.

19. An important corollary to these shifts in current account balances is that with international credit still largely denominated in United States dollars, the international credit system requires an accommodating United States trade deficit that ensures that net inflows of United States dollars reach debtor countries in order that they can service their dollar obligations. However, since trade surpluses have been accumulated mostly by high-productivity countries that do not have or have little external debt with the United States, the supply of dollars through the United States trade deficit mostly does not serve the purpose of allowing indebted poorer economies to settle their dollar-denominated debt. The failure of international trade policy to provide accommodating trade deficits eventually leads to debt crises in developing countries when slow global growth and recessions in lead economies mean that debt obligations can no longer be settled through trade or refinanced. This has become evident in the context of the COVID-19 crisis, which has seen the international monetary and financial system struggle with providing much needed liquidity in hard currency, in particular in United States dollars, to developing countries.

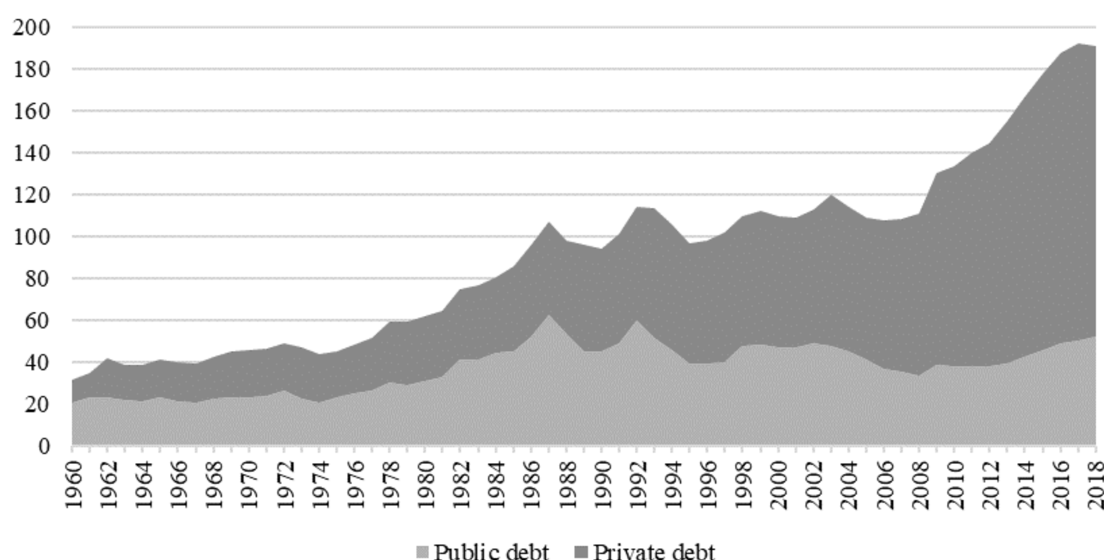
20. Moreover, increasing external liabilities in developing countries are more expensive to service than is the case in developed countries, whereas their external assets (mainly reflecting the build-up of international reserves in the form of dollar-denominated securities to safeguard against sudden capital flow reversals and exchange rate fluctuations) are low-yielding, further underlining their financial periphery status. In 1995–2018, developing countries earned, on average, about 2 percentage points less on their gross external assets and paid about 2 percentage points more on their gross external liabilities compared with developed countries, implying a total return differential of about -4 percentage points between developing and developed countries. In 16 developing countries, the resultant resource transfer to developed countries amounted to around $440 billion per year, or 2.2 per cent of their combined GDP in 2000–2018.[30]

21. In conjunction with increasing financial vulnerabilities due to their exposure to higher-risk, shorter-maturity borrowing in international financial markets, high capital flow volatility, downward pressures on commodity prices and concomitant exchange rate

[30] UNCTAD, 2019b, Managing capital inflows to reduce resource transfer from developing to developed countries, policy brief No. 76.

volatility, it is not surprising that the debt burdens of developing countries have risen substantively over the past decade. At end-2018, total developing country debt stocks were 191 per cent of their combined GDP, the highest level on record (figure 5). This reflects not only a steep acceleration of debt accumulation but also stymied GDP growth, in a context of sluggish global aggregate demand growth and waning opportunities to promote domestic structural transformation.

Figure 5
Developing countries: Total debt
(Percentage of gross domestic product)



Source: UNCTAD calculations, based on the International Monetary Fund global debt database.

22. The increase in total developing country indebtedness relative to GDP has been led by the private sector, in particular in high-income developing countries and frontier markets. Public sector indebtedness was on the increase following the global financial crisis, yet has been kept in check by Governments wishing to satisfy international credit rating agencies, international creditors and major foreign investors, or being left with no choice but to engage in austerity programmes in response to exogenous shocks and deteriorating external imbalances. However, the marked upsurge in private sector indebtedness, near doubling from 77.6 to 139.1 per cent in 2008–2018, also carries major risks for public finances. First, private debt contracted in foreign currency ultimately represents a claim on a country’s international reserves, in particular if private entities have failed to hedge their foreign currency liabilities against foreign currency assets. Second, if private debt is denominated in the domestic currency but held by foreigners, sudden reversals in investor sentiments can undermine debt sustainability. Third, high levels of domestic private debt issued in the domestic currency and held by residents represent a contingent liability on public sector finances, if exogenous shocks lead to widespread bankruptcies or the creditworthiness of borrowers deteriorates systematically.

23. Policymakers in many developing countries have sought to reduce the share of external liabilities in their total debt by opening bond and equity markets to foreigners and by borrowing in domestic currencies, yet the external indebtedness of developing countries has more than doubled, from $4.5 trillion in 2009 to $10 trillion in 2019, rising on average from 25.2 per cent of their combined GDP to 29 per cent in 2019 and, if China is excluded due to its large economy and modest external debt burdens, rising to 38.3 per cent. These average figures mask much higher external debt-to-GDP ratios in many developing countries, in particular in Latin America and the Caribbean and in some economies in Africa. At the same time, marked shifts in the ownership of public external debt from official to private creditors, as well as from commercial bank lending to bond finance, have contributed to a steady absorption of the resources of developing countries into the

servicing of such external debt obligations. In 2019, developing countries spent, on average, 14.6 per cent of their export revenues to service external debt obligations, up from 7.8 per cent in 2011 and, in a growing number of developing countries, more than a quarter of their government revenues goes towards servicing external public debt obligations, including oil exporters affected by the recent collapse in oil prices and middle-income countries and small island developing States with high debt burdens.[31] As a result, developing countries face a hurdle of debt service repayments throughout the 2020s, with repayments in 2020 and 2021 on their public external debt alone amounting to $2 trillion to $2.3 trillion for high-income countries and an estimated $700 billion to $1.1 trillion for low-income countries and middle-income countries.[32]

24. As noted, the renewed build-up of debt stocks is not limited to developing countries. In developed countries, fast-rising non-financial corporate debt of deteriorating quality remains the main cause of concern. Such debt reached $75 trillion at end-2019, double the level in 2008, and represents a massive contingent liability for global financial stability, in particular in a context of increasing corporate defaults due to the pandemic.[33] In 2019, only 30 per cent of the outstanding global stock of non-financial corporate bonds were rated A or above.[34] Moreover, significant global imbalances and the concomitant accumulation of external debt burdens undermine coordinated progress in addressing environmental degradation and promoting green transformations. Fossil fuel-abundant developing countries, faced with unsustainable external debt burdens and pressures on domestic spending, will continue to tap these resources if development priorities depend on their extraction.

D. The role of United States dollar hegemony

25. As noted, the patterns of current account imbalances in the global economy are problematic not only because they force deflationary adjustments, but also because they expose the impact of United States dollar hegemony on the ability of debtor countries to honour repayments.

26. Reliance on the dollar to govern the international monetary and financial system was a point of contention at the Bretton Woods conference in 1944, reflecting concerns that relying on a lead reserve currency for the management of the system ran the risk of having the provision of international liquidity and the management of global external imbalances bound to the internal constraints and interests of the issuer of the international reserve assets. In theory, the issuer of the international reserve currency is granted the exorbitant privilege of soft balance-of-payment constraints (since it can refinance deficits through the issuance of government bonds to the rest of the world that is either in need of international currency to pay for international transactions and/or willing to build up dollar reserves for insurance against exogenous shocks) in exchange for accommodating the financial needs of a growing global economy. In practice, the quid pro quo in this equation has been discarded, at the latest since the end-1970s, after subsequent Governments in the United States abandoned wider obligations as issuers of the international reserve currency in favour of a "controlled disintegration" of global economic governance, while retaining their exorbitant privilege.[35]

[31] See A/75/281; Inter-agency Task Force on Financing for Development, 2020, *Financing for Sustainable Development Report 2020* (United Nations publication, New York), chapter III.E; UNCTAD, 2019a, chapter IV.

[32] UNCTAD, 2020c, Trade and Development Report update: From the great lockdown to the great meltdown – developing country debt in the time of COVID-19, available at https://unctad.org/webflyer/great-lockdown-great-meltdown.

[33] UNCTAD, 2020a, chapter IV.

[34] S Çelik, G Demirtaş and M Isaksson, 2019, Corporate bond markets in a time of unconventional monetary policy, Capital Market Series, Organization for Economic Cooperation and Development.

[35] Y Varoufakis, 2011, *The Global Minotaur: America, the True Origins of the Financial Crisis and the Future of the World Economy* (Zed Books, London).

27. The turn towards embedding United States dollar hegemony with the promotion of hyperglobalization has not been unproblematic for the lead economy. A continued reliance on soft constraints on growing trade deficits has made domestic household and corporate sectors vulnerable to confidence shocks in their ability to service their debt (as witnessed during the global financial crisis with regard to household debt and at present a concern for non-financial corporate debt), with important spillover effects on global financial stability.[36] In addition, a reliance on high levels of imports of components of final products and services, or outsourcing, tends to undermine high-quality job creation and favour labour market segregation, thereby increasing income inequalities.

28. From the point of view of developing countries, continued United States dollar hegemony under the conditions of a highly volatile international financial environment is problematic primarily because it worsens already severe balance-of-payment constraints. Although expert opinion is divided about the future of United States dollar hegemony more generally,[37] available evidence suggests that this hegemony remains entrenched in developing countries. Following the global financial crisis, the share of dollars in the foreign currency reserves of developing countries rose from a fairly steady 60 per cent in the 2000s to over 65 per cent. In addition, in 2007–2019, the share of dollar-denominated securities in all issued international securities by developing countries increased from 66.9 to 80 per cent and the dollar also dominated the expansion of shadow-banking in larger developing economies.[38]

29. Reliance on a lead currency to govern the international monetary and financial system can also facilitate the use of financial sanctions with the explicit objective of achieving regime change in certain countries. The use of unilateral and coercive measures is considered to constitute a flagrant violation of the principles of international law under the Charter of the United Nations[39] and there is widespread agreement that such measures rarely achieve their stated aims.[40] However, at present, financial sanctions rely directly on United States dollar hegemony and on enforcement through the dominant international payment system, making it difficult or impossible for target officials, administrations or institutions to engage in dollar-based transactions.[41] Contrary to trade sanctions, market forces also tend to strengthen financial sanctions, through their impact on third parties and given the concerns of intermediary banks about the reputational and financial costs of being prosecuted for violating such sanctions.

II. The pandemic: Squeezed fiscal policy space and wanting international policy coordination

30. These systemic issues have been thrown into stark relief by the impact of the COVID-19 pandemic on the global economy. According to UNCTAD estimates, world output is expected to fall by 4.2 per cent in 2020, followed by an expansion of 4.1 per cent

[36] UNCTAD, 2020a, chapter II.

[37] See B Eichengreen, 2019, Two views of the international monetary system, available at https://www.intereconomics.eu/contents/year/2019/number/4/article/two-views-of-the-international-monetary-system.html.

[38] UNCTAD, 2019a, chapter IV, and calculations based on Bank for International Settlements international securities statistics.

[39] See, for example, A/RES/74/200.

[40] See, for example, M Neuenkirch and F Neumeier, 2016, The impact of United States sanctions on poverty, *Journal of Development Economics*, 121(C):110–119.

[41] BE Carter and R Farha, 2013, Overview and operation of United States financial sanctions, *Georgetown Journal of International Law*, 44:903–913. The vast majority of cross-border dollar transactions (95 per cent according to the Federal Reserve Bank of New York) are settled through the Clearing House Interbank Payments System, through which transactions are monitored by financial institutions and held, rejected or blocked and reported to the United States Office of Foreign Assets Control.

in 2021 if appropriate policies are adopted. Yet world income would still be 5.7 per cent below its pre-pandemic trend in 2021.[42]

31. Extensive government intervention, in particular in advanced economies, may have, to date, helped to avert the worst in these economies. Such intervention has included immediate monetary and fiscal interventions, followed by an extension of longer-term lending facilities to non-financial corporations and support to smaller businesses, the unemployed and furloughed workers. Central bank balance sheets have acquired much greater positions in both public sector and non-financial private sector assets than was the case following the global financial crisis. Developing countries, however, cannot easily flatten the contagion curve by closing down large parts of their primarily informal economies, without risking more people dying from hunger than from illness. Their health and social protection systems tend to be weaker, requiring stronger additional efforts to combat the pandemic relative to existing resources. At the same time, their central banks cannot act as lenders of last resort to their Governments and expand their balance sheets at a scale comparable to that in advanced economies, without risking massive devaluations of domestic currencies against hard currencies and consequent wide-ranging macroeconomic destabilization. Given already low or falling international reserve cushions in many developing countries, they are thus heavily reliant on international liquidity support in hard currency.

32. Balance-of payment constraints on domestic fiscal space have been reinforced during the course of the pandemic through four main channels.

33. First, non-resident capital flight from developing countries in response to the pandemic has been unprecedented compared with earlier crisis episodes, reaching a cumulative $104.8 billion in the first three months of the pandemic, compared with $33 billion in the same period following the global financial crisis.[43]

34. Second, international merchandise trade is reported to have contracted by 17.7 per cent in May 2019–May 2020, undermining access by developing countries to foreign currency earnings.[44] Financial price speculation alongside reductions in global aggregate demand particularly affect commodity-dependent developing countries, namely with regard to oil, but closely followed by minerals such as copper. The virtual collapse of the international tourist industry (trade services) is also a significant factor, as this industry has long been a lifeline in many low-income countries and middle-income countries, including small island developing States.

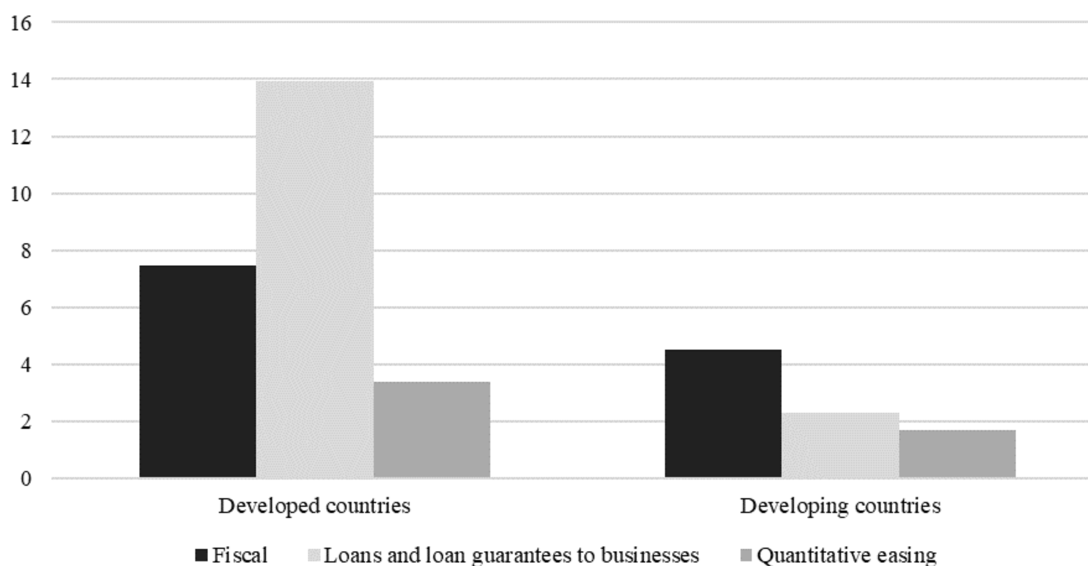
35. Third, remittances, a crucial source of foreign currency inflows in many low-income countries and middle-income countries, are projected to decrease by around 20 per cent in 2020, from a record level of $554 billion in 2019.[45]

36. Fourth, foreign direct investment in developing countries, a usually more stable modality of external financing, is expected to contract by up to 40 per cent in 2020 compared with 2019.[46] This situation is all the more critical in developing countries that already had substantive external debt burdens prior to the pandemic.

37. Overall, the combination of pressures on domestic public budgets arising from immediate health-related expenditure requirements and growing balance-of-payment constraints has resulted in a significant expenditure gap between developed and developing countries in dealing with the fallout of the pandemic (figure 6).

[42] UNCTAD, 2020a, chapter I.
[43] Ibid, figure 1.5.
[44] Netherlands Bureau for Economic Policy Analysis, 2020, World trade monitor, June, available at https://www.cpb.nl/en/cpb-world-trade-monitor-june-2020.
[45] World Bank, 2020, COVID-19 crisis through a migration lens, Migration and Development Brief No. 32.
[46] UNCTAD, 2020b.

Figure 6
Magnitude of pandemic-related policy stimulus packages, 25 May 2020
(Percentage of gross domestic product)



Source: UNCTAD calculations, based on national sources as reported by the Institute of International Finance, the International Monetary Fund and the Organization for Economic Cooperation and Development (see UNCTAD, 2020d, South–South cooperation at the time of COVID-19: Building solidarity among developing countries, available at https://unctad.org/meeting/panel-discussion-south-south-cooperation-times-covid-19).

Note: Under "fiscal", short-term deferral measures, that is, tax payments deferred from one quarter or month to the next, are not included; and quantitative easing refers to estimates of additional asset purchases by central banks in response to the pandemic.

38. The response by the international community to ensure adequate liquidity provision to developing countries has been muted. The International Monetary Fund and the World Bank substantively and rapidly increased their emergency lending facilities and simplified access to these, yet such lending still constitutes new borrowing at a cost and remains attached to controversial policy conditionalities that have often proved counterproductive in the past. Proposals to leverage the International Monetary Fund special drawing rights for the provision of unconditional liquidity relief, in particular to developing countries, "have fallen on deaf ears" and currency swap arrangements between central banks to facilitate access to hard currencies have remained limited to a few larger developing countries.[47] Debt relief has largely focused on debt moratoriums offered by the Group of 20 Debt Service Suspension Initiative for the poorest countries, adopted on 15 April 2020 and subsequently extended to June 2021.[48] Under this initiative, 73 primarily low-income countries are eligible for a suspension of debt repayments to bilateral creditors provided they have active borrowing status with the International Monetary Fund, including requests for future financing, and provide a full disclosure of their public debt obligations. At present, the initiative covers an estimated $5 billion to $6 billion in debt repayment suspensions for the 46 developing countries that have signed up to the initiative to date. Total external long-term public debt stocks of countries eligible for the initiative were at $457.3 billion at end-2018, of which $174.3 billion was owed to bilateral creditors.[49]

[47] See, for example, UNCTAD, 2020a, chapter IV.
[48] See communiqué of 15 April 2020, available at https://g20.org/en/g20/Pages/documents.aspx.
[49] UNCTAD, 2020c.

39. The COVID-19 crisis also threatens to further derail the timely implementation of the 2030 Agenda for Sustainable Development. Five years into the implementation period and prior to the onset of the crisis, UNCTAD estimated that investment in 10 key areas remained inadequate. For example, while the number of announced projects for all developing countries increased from 478 in 2010–2014 to 676 in 2015–2019, this still represented a fall in the value of investment from $618 billion to $417 billion, or a decrease of 32 per cent. Moreover, only an estimated one third of these projects have begun to attract any actual spending since 2015, which amounted to $148 billion in 2019.[50]

III. Addressing systemic issues: Reviving multilateralism in times of crisis

40. Systemic issues require systemic responses. Building resilience to systemic issues (such as global financial instability, growing income inequalities and increasing market power and consequently large imbalances in the global economy and debt-driven growth) is a first step, but one that relegates multilateral coordination to the role of damage limitation. A revived multilateralism should therefore also strengthen its ability to reform the current system of global economic governance with a view to achieving the 2030 Agenda for Sustainable Development and, as stated in the Addis Ababa Action Agenda, taking account of economic, social and environmental challenges and enhancing policy coherence across all three dimensions of sustainable development.

41. Boosting global aggregate demand will be crucial for a sustained post-pandemic recovery that does not simply return to business as usual but addresses inclusiveness and sustainability challenges. In a world of mobile finance, many Governments may be reluctant to adopt bold expansionary policies on their own out of concern that this might cause capital flight and currency depreciations or that much of the benefit of increasing domestic demand might leak to other countries. A priority area for a revived multilateralism is therefore the enhanced multilateral coordination of national policy efforts, to ensure that all countries can benefit from a simultaneous boost to their domestic and external markets. To enhance the legitimacy of a coordinated macroeconomic stimulus package, plurilateral initiatives, such as by the Group of 20, could be linked to deliberations at the Economic and Social Council.[51]

42. More effective multilateral policy coordination will also be crucial to boost international development finance and strengthen support to developing countries in mobilizing domestic resources for this purpose. First and priority steps in this direction should include the following:

(a) Strengthening the role of special drawing rights in the international reserve system to facilitate the provision of unconditional liquidity support in hard currency to developing countries. One way to regain traction in expanding special drawing rights is by linking these to the Sustainable Development Goals and/or to specific objectives, such as reversing environmental damage and degradation;

(b) Developing a global Marshall Plan for health recovery and future resilience to health-related shocks in developing countries. This could be financed through a combination of enhanced official development assistance in the next two years and a support package by recapitalized regional and multilateral development banks;[52]

(c) Strengthening multilateral coordination to address unsustainable external debt burdens in developing countries, which is of particular urgency in the current context in order to avoid turning a liquidity crisis into serial sovereign defaults. A range of both short-term and longer-term policy proposals in this regard has been endorsed by the United Nations initiative on financing for development in the era of COVID-19 and beyond,

[50] UNCTAD, 2020b.

[51] See, for example, A/CONF.214/CRP.1 (report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, 2009).

[52] UNCTAD, 2020a, box 5.2.

co-convened by Canada, Jamaica and the United Nations, highlighting the central role of the United Nations in this area.[53] Strengthened multilateral coordination will be crucial in order to normalize automatic debt moratoriums in response to disaster situations that are comprehensive across all creditor types (commercial, bilateral and multilateral) and to provide a balanced, comprehensive and transparent multilateral framework for debt relief and sovereign debt restructuring procedures. As UNCTAD has noted,[54] the fragmented and ad hoc nature of the current international debt architecture routinely results in debt crisis resolutions that tend to undermine rather than promote future growth prospects and improved debt sustainability in developing countries;

(d) Creating a public credit rating agency that can provide an independent and public perspective on the creditworthiness of sovereigns as well as of regional and multilateral development banks. The problematic role of having a few credit rating agencies as de facto arbiters of responsible financial behaviour has become particularly evident during the pandemic, limiting the effectiveness of the Debt Service Suspension Initiative, while the largest credit rating agencies are also among the companies that profited during the first three months of the pandemic;

(e) Facilitating the flexible and unconditional use of capital controls by Governments to mitigate capital flow volatility and support the effectiveness of macroeconomic policies aimed at securing economic growth and development;

(f) Strengthening support for national and regional development banks, including by facilitating their recapitalization;

(g) Mitigating commodity price volatility through international regulations that aim to: increase transparency in physical markets, to allow commodity producers and consumers to identify whether specific price signals relate to changes in fundamentals or to financial market events; limit financial speculation in commodity futures and over-the-counter markets, for example through restrictive limits on speculative position holdings; and support the re-establishment of international commodity agreements, in particular in food commodity markets most vulnerable to environmental shocks and the price instability of which has widespread economic and social effects on the most vulnerable populations.

43. A comprehensive multilateral approach to addressing systemic imbalances in the global economy will, however, have to go beyond initial improvements to the international financial architecture, vital as these are. It will also have to rein in the inequities that have arisen from increased market concentration and corporate rent-seeking, through coordinated antitrust and antimonopoly regulation. A relevant starting point could be the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the General Assembly in 1980. In addition, further progress on reforming the international taxation system will be required to combat illicit financial flows from developing countries; strengthen genuinely multilateral cooperation with regard to the reform of international corporate taxation to limit profit-shifting strategies; and address important issues arising from the taxation of digital super platforms. Finally, rebalancing the multilateral trading regime to ensure that it has a stronger developmental role will be essential, to increase the policy space of developing countries to promote structural transformation. This should include a revival of the developmental mandate of the Doha round of negotiations under the World Trade Organization, but also requires the reconsideration of bilaterally and regionally negotiated restrictions, for example on the use of intellectual property rights and technology transfers, when these are more constraining than multilateral agreements.

44. Developing countries bear the brunt of current systemic asymmetries in the global economy through reduced national policy space and high levels of vulnerability to financial instability and exogenous macroeconomic shocks. It is therefore indispensable to the success of strengthened multilateral policy coordination and cooperation to increase the

[53] See https://www.un.org/en/coronavirus/financing-development/.

[54] See, for example, UNCTAD, 2015, *Trade and Development Report, 2015: Making the International Financial Architecture Work For Development* (United Nations publication, New York and Geneva), chapter V; and UNCTAD, 2019a, chapter IV.

voice and formal representation of developing countries in bodies central to global financial and economic governance and to further strengthen the role of the United Nations as the most inclusive forum to promote multilateral cooperation in addressing systemic issues and the effective advancement of the 2030 Agenda for Sustainable Development. A number of possibilities in this regard are mentioned in this note, and additional avenues should also be considered based on existing strengths in the United Nations system and in close cooperation with the International Monetary Fund and the World Bank, in particular.