

Policy Statement:

STATE OF WORLD ECONOMY STILL REASON FOR CONCERN, WARNS RUBENS RICUPERO

UNCTAD Secretary-General Rubens Ricupero submitted the following statement to the Ministerial Meeting of the Group of 24 at the IMF and World Bank Meetings in Prague on 23-25 September 2000:

"The world economy made a welcome turnaround in 1999, confounding fears that it would drop into recession. Robust growth was accompanied by an improvement in world trade and the return of some degree of normalcy to currency and financial markets, after the chaotic conditions of the previous two years. A combination of one-off and unexpected events certainly helped: expenditures undertaken to avoid any potential disruption from the Y2K computer bug provided a massive shot in the arm for the world economy; the reversal of policies of austerity in East Asia in the second half of 1998 helped spur growth in that region; and the United States economy continued to surge ahead, belying forecasts and growing well above what was customarily believed to be its longer-term potential.

All in all, the immediate prospects for the world economy have improved, with growth this year expected to exceed 3 per cent. Attention is now turning to how best to consolidate global growth and ensure a much wider disbursement of the benefits of globalization.

For developing countries this will require renewed private capital flows, together with continued domestic reforms and the spread of new technologies. However, the wreckage from the Asian crisis will not be cleared away by simple incantations to the new economy. Making good on the promises of globalization will call for considerable policy effort. Not only are the root causes that led to the fear of recession during 1998-1999 still present, but further fault lines have emerged, along which any unexpected movements could have damaging consequences for both industrial and developing countries. ...

In this respect, the continued rise of oil prices is cause for concern. The onus is on policy makers to avoid this triggering an inflationary or deflationary spiral. Appropriate policy responses in industrial countries should include, where necessary, fiscal measures. These countries are indeed better placed than in the 1970s and 1980s to make the adjustments needed. For oil importing developing countries, facing the burden of a rising import bill, compensatory financing from multilateral institutions on soft terms should be considered. We are happy to hear that the World Bank is prepared to make available structural loans and other forms of emergency funding to oil-importing poor countries. ...

The disparities in growth rates within the industrial world and a strong dollar have resulted in growing trade imbalances as the United States has become "buyer of last resort" to the world economy. The countries with trade surpluses are more than willing to hold the proceeds in dollar assets in the United States. At the same time, the combination of technological and financial innovations has aggravated the underlying fragility of current financial and trade flows. European and Japanese TNCs have joined in the process of buying into the technological gains already made by United States firms. Headline-grabbing mergers and acquisitions in the high-tech sector have spilled over into a financial bubble in technology stocks, where self-fulfilling expectations rather than solid earning prospects have been moving the market.

The task of correcting these global economic imbalances has fallen in a one-sided manner on monetary policy. This will not carry the day. Hikes in United States interest rates have been adding to the attractiveness of assets there, and have thus failed to check spending in the United States economy. ... if policy makers in Europe and Japan feel obliged to follow suit, the existing pattern of exchange rates and trade balances will remain essentially unchanged. All this bears some disturbing resemblances to the



macroeconomic imbalances of the 1970s and 1980s, when the absence of cooperation and coordination among the major economic powers led to systemic breakdown and hard landings. But unlike then, private debt dominates today's capital flows with the attendant dangers of volatile market sentiment. ... What we have learned about the global economy over the past few decades tells us that failure to resolve imbalances in an orderly manner will be most damaging to growth in the developing countries.

The vulnerability of developing countries to any policy shifts in the major industrial countries will, of course, depend on their current state of health... However, with persistent biases and asymmetries in the trading system and structural uncertainty and volatility continuing to characterise the financial system, growth in many countries remains beholden to unstable capital flows. But any large reflux of capital anticipates growing risks as well as improving opportunities for these economies.

The problems facing much of Africa are of a different order. The basic policy challenge for much of the continent remains how to overcome savings and foreign-exchange constraints and to raise investment to the level required for growth of at least 6 per cent per annum. The current level of private capital inflows is too small to fill the resource gap but still big enough to make many African economies vulnerable to the arbitrage arithmetic of short-term capital flows. This also means a steadily growing dependence on official flows. But in recent years these have barely compensated for resource losses due to unfavourable trading conditions. The only way to end Africa's aid dependence is to launch a massive aid programme and to sustain rapid growth for a sufficiently long period so as to allow domestic savings and external private flows to gradually replace official flows.

The HIPC initiative can also play an important role in this respect. However, a much bolder approach is required if the initiative is to retain its credibility and succeed in removing the debt overhang of the world's poorest countries. One approach would be recourse to an independent panel of experts which would assess debt sustainability, eligibility for debt reduction, conditionality and financing. ... Until the panel has decided on its recommendations, HIPCs' debt-service payments should be suspended with no additional interest obligations being incurred in consequence.

The pace of recovery of East Asia over the past year has been encouraging. However, the fact that neither the depth of crisis nor the speed of recovery was anticipated even by those responsible for policy should caution against excessive exuberance. ... Recovery has been accompanied by only limited corporate restructuring, and the health of the financial system continues to rely on public intervention in the credit mechanism... Exports are unlikely to continue at their recent pace, and public deficits and debt have been on the rise in most countries seriously hit by the crisis. ... Finally, the recovery has so far been supported by highly favourable conditions in the world economy which are susceptible to change. A sharp slowdown in the United States and a deterioration in global financial conditions could be particularly damaging.

A fundamental lesson of the financial crisis is surely that excessive reliance on foreign resources and markets leaves growth prospects vulnerable to external shocks. In an increasingly interdependent global financial and trading system, it is clear that trust in market forces and monetary policy alone will not be sufficient. Increased international cooperation and dialogue are needed if the full potential of new technologies to bridge the growing gap between the rich and poor is to be realized. This calls for bold leadership, of the kind which heralded in the postwar Golden Age."