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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT, 2006

OVERVIEW

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UNCTAD/TDR/2006 (Overview)

OVERVIEW

Since 2002, world economic expansion has had a strong positive impact on growth and helped support progress towards the United Nations Millennium Development Goals (MDGs). Most developing countries have benefited from this growth momentum as a result of strong demand for their exports of primary commodities and, to an increasing extent, of manufactures. In addition, a number of other changes in the external environment for development over the past 10 to 15 years have benefited individual developing countries in different ways, depending on their economic structure and state of development. These changes include some improvements in market access, provision of debt relief and commitments by donors to substantial increases in ODA, as well as new opportunities to benefit from FDI and increasing migrants' remittances. In order for all developing countries to reach the MDGs and to reduce the large gap in living standards with the more advanced economies, the global partnership for development, stipulated in Goal 8 of the MDGs, needs to be strengthened further. Much depends on the ability of developing countries to adopt more proactive policies in support of capital formation, structural change and technological upgrading, and on the latitude available to them in light of international rules and disciplines.

Strong growth but increasing imbalances in the world economy

The expansion of world output continued unabated in 2005, and is expected to maintain its pace, with a projected GDP growth of 3.6 per cent in 2006. Output growth in developed countries is likely to continue, at 2.5–3 per cent, despite high prices for oil and industrial raw materials and a tendency towards more restrictive monetary policies. So far, turbulence in the financial markets has not adversely affected global growth to any appreciable extent, but the risks of a slowdown are clearly higher than a year ago. Developing countries, including many of the poorest, have benefited from continuing strong demand and rising prices for primary commodities, but for some of them this has also meant a higher import bill for oil and other raw materials. On the other hand, there are serious imbalances in the world economy, which suggests the need for caution in assessing prospects for the coming years, as their correction could have strong repercussions on developing countries.

The developing countries have contributed to the fast pace of global growth, with strong investment dynamics and an overall growth rate averaging about 6 per cent for the group as a whole. In particular, rapid growth in China and India has contributed to this outcome. It is also noteworthy that many African countries have maintained high growth rates. Growth in that region has accelerated every year since 2003, and projections of around 6 per cent growth for sub-Saharan Africa in 2006 signify an exceptional performance.

Strengthened position of emerging-market economies

Recently, there have been signs of increasing volatility in stock, commodity and currency markets, as well as in short-term capital outflows from some emerging markets – some of the ingredients of financial crises in the past. The dollar is highly vulnerable, and international investors appear to have become nervous in the face of continuing global imbalances and rising interest rates. A number of developing countries have experienced a sharp drop in their stock market prices and some emerging-market currencies have fallen markedly against the dollar, the euro, the yen and those currencies closely attached to them. However, the turbulence is limited to some areas and to a number of countries with fairly high current-account deficits. There is little evidence of a looming major financial crisis, comparable to the Asian or Latin American crises some 10 years ago.

Most emerging-market economies are much less vulnerable than at the time of the big shocks that occurred over the past two decades. In 2005, East and South Asian countries recorded a large surplus on their current accounts and Latin America as a whole was also in surplus. After the Asian and Latin American crises more and more developing countries have sought to follow similar paths of adjustment

that have involved stabilizing their exchange rates at a rather low level, running sizeable current-account surpluses and accumulating large amounts of dollar reserves. While this practice is widely considered as being suboptimal, in many respects it represents the only feasible way in which developing countries can successfully adapt to the systemic deficiencies afflicting today's global economic order characterized by the absence of symmetric obligations of surplus and deficit countries.

It is no surprise that the undervaluation-*cum*-intervention strategy is especially prevalent among developing countries that have recently experienced currency crises following previous liberalization of their financial systems and capital accounts. Having learned that reliance on foreign savings rarely pays off as a sustainable development strategy, a growing number of developing countries have shifted to an alternative strategy that relies on trade surpluses as the engine for investment and growth. This strategy requires them to defend strategically favourable post-crisis competitiveness positions. But it can only function as long as there is at least one country in the global economy that accepts running the corresponding trade deficit.

Redressing the imbalances

At this juncture, it is mainly because of the flexibility and pragmatism of macroeconomic management by the United States that the systemic deficiencies in the global economic order have not yet led to global deflation, but "only" to these imbalances. There is, however, a risk, that the United States may become overburdened in playing the lead role as the global engine for growth for too long. So far, it has been able to neglect its external imbalance as this presented no serious conflict with efforts to sustain full employment and price stability, but there is growing potential for such a conflict. Moreover, there are rising concerns, including among financial market participants, that the imbalance is still growing. It is unlikely that the United States personal savings rate will decline by another 5 percentage points over the next decade, or that the public budget will be allowed to deteriorate by another 6 per cent of GDP. Thus the world economy might soon be without the growth stimuli that have driven it for the past 15 years. There is the prospect of a further dollar depreciation, which would help restore competitiveness and rebalance the external accounts. But the effect of a marked slowdown in United States imports would be spread and amplified across the world economy just as the positive impulses were for all these years. This could quite easily halt the momentum in development progress and poverty reduction achieved in developing countries in recent years, for no fault of theirs.

Notwithstanding the large surpluses of a number of developing countries, the main reason for the United States' perhaps increasingly unmanageable global burden is that some other key industrialized countries, rather than assuming a supportive role, have added to the global burden of the United States. Given the huge external surplus of Japan and Germany, and the significant improvements in their competitive positions in recent years, the required competitiveness gains of the United States should now come mainly at their expense, a process that would be greatly facilitated if the stagnant demand that has prevailed in these economies for all too long were to become more buoyant.

China's role in a benign redressing of global imbalances differs from that of Japan and Germany. Since the beginning of the 1990s, China's domestic demand, along with its imports, has grown very strongly, and the country has played a vital role in spreading and sustaining growth momentum throughout the developing world – a process that must not be derailed. Therefore, renminbi revaluation

should continue gradually, rather than abruptly, taking due account of the regional ramifications. Similar to China, oil-producing countries have only recently begun to play a significant part in the imbalances. Should the high level of oil prices persist, they could contribute to a benign redressing of global imbalances through stronger domestic demand growth and greater social and physical investment with a view to diversifying their economies.

Crucially, what is needed for redressing global imbalances is a responsible multilateral effort, rather than pressure on parts of the developing world. A well-coordinated international macroeconomic approach would considerably improve the chances of the poorer countries to consolidate their recent gains in growth performance. In the absence of such an approach, developing countries should defend their strategically advantageous competitive positions and use the favourable overall environment for investing more and reducing their foreign indebtedness.

Failure of the standard reform agenda

The present phase of relatively fast growth in developing countries, driven by strong global demand originating mainly in the United States and amplified by the rapid expansion of the large Chinese economy, comes after two decades of unsatisfactory growth in most developing countries, especially in Africa and Latin America.

During the 1980s and 1990s, most developing countries undertook far-reaching market-oriented reforms with the expectation that improved factor allocation would be key to their integration into a globalizing world economy. The Bretton Woods institutions played a dominant role in this context, both as lenders, imposing their policy conditionality on borrowing countries, and as "think tanks" with a major impact on the international policy debate. As a result, the principles underlying the reform agenda not only shaped the economic policies of countries that borrowed from the international financial institutions; they also came to be widely accepted as the standard reform package for other countries that were reviewing their development strategies for achieving closer integration into the globalizing world economy.

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