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On Behalf of the UN Conference on Trade and Development

Statement by Supachai Panitchpakdi, Secretary-General of UNCTAD, at the Spring Meetings of the IMF and the World Bank

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The recovery of the world economy that started in 2002 continues unabated. With 3.5 per cent growth, the world economy will expand at a similar pace in 2006 as in 2005. Contrary to expectations, neither the high prices for oil and industrial raw materials nor the first steps of major central banks to normalize liquidity supply and address turbulences on financial markets, have yet had a negative impact on the recovery. The upswing of the world economy has brought about a major improvement in the living standards and the employment situation of hundreds of millions of people in developing and developed countries alike. The recovery has also contributed to fighting poverty and to progress in achieving some of the most important MDG's. This should give rise to particular caution with regard to the global imbalances that continue to be the main burden of the world economy, and whose dissolution may have significantly negative repercussions.

In many respects, developing countries have been setting the pace for this success story with strong investment dynamics and an overall growth rate close to 6 per cent. As in previous years, rapid growth in China and India is contributing most to this outcome. In part this is due to their weight and their impact on regional averages; but they are also the engine for trade in manufactures within Asia, and their resilient growth dynamics sustain international demand for a wide range of primary commodities. Inflation has remained subdued despite some countries reducing or even suppressing subsidies on energy prices. In this environment of moderate inflation macroeconomic policies remained globally accommodating, and domestic demand is increasingly contributing to GDP growth. As a result, economic growth in East and South Asia, which attained 7 per cent in 2005, is expected to continue at similar rates in 2006.

Other parts of the developing world will also continue to grow relatively fast. For 2006, a growth rate of 4 per cent in Latina America, 5 per cent in Africa and 6 per cent in the CIS should be possible; in West Asia, growth will probably decelerate moderately because the volume of oil production can not keep growing at the same rate as in previous years. With monetary policy freed from the chains of unsustainable exchange rate regimes, most of Latin America has succeeded in transmitting the external stimulus into the domestic economy without reviving inflationary tendencies. The real growth rate in that region is likely to exceed 4 per cent for the third consecutive year and unemployment rates have fallen substantively, from 11 per cent in 2002 to 9.3 per cent in 2005.

Another remarkable feature of the global recovery has been the ability of many African countries to maintain high growth rates since 2003. Higher company and government revenues following the hike in the prices of many commodities seem to spill over into the domestic economy and stimulate spending. Like in Latin America, a rekindling of inflation has been avoided.

Developed countries will maintain an economic expansion of some 2.5 per cent. A moderate slowdown in the United States is likely to be compensated by a moderate improvement in the

European Union. In the United States, a more neutral monetary policy, a likely slowdown in the growth of house prices and high energy prices will moderate private consumption and investment. US exports have recovered since 2003, but the overall effect of foreign trade will still be negative with imports outpacing exports. The opposite is true for Europe. Despite a modest recovery of domestic demand export growth remains the driving force of the biggest economies, and overall growth is likely to remain weak. In Japan the long deflationary phase appears to have come to an end, as GDP growth will be stable at 2.8 per cent and domestic demand is recovering following a large increase in exports in the last four years. However, the foreseeable end of a very expansionary monetary policy and some measures aimed at fiscal consolidation might moderate the rapid growth witnessed in the last quarter of 2005.

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Obviously, the favourable evolution of their terms of trade has had a significant impact on the economic performance of many developing countries in recent years. Rapid growth of continent-sized economies like China and India, coupled with the continued demand from the United States after the recovery in 2002, has pushed up the prices of many primary commodities. According to most forecasts this is to continue in 2006, in both nominal and real terms.

Since 2003, the terms of trade of developing countries have experienced sizeable changes, with substantial gains in countries specialized in extractive industries and drastic losses in those depending on exports of manufactures and imports of raw materials, especially oil. Changes were less dramatic in countries that are mainly exporters of manufactures, but that also have some relevant primary exports, such as Brazil, Malaysia, Mexico, South Africa and Viet Nam. The terms of trade have varied the most among agriculture exporters, reflecting large differences in the movements of prices for specific products and also differences in the share of oil in their imports. For instance, in 2005 the terms of trade of coffee-exporters improved while those of exporters of cotton and vegetable oils deteriorated sharply.

The recent largely favourable evolution of the terms at which countries trade with one another in developing countries has had an impact not only on the balance of payments, but also on the income of the different economic agents and their domestic expenditure. In countries with substantial gains from the terms of trade, such as the exporters of hydrocarbons, ores and minerals, the resulting real income gains financed higher domestic expenditure, stimulated growth and helped to reduce net foreign indebtedness. Moreover, and sometimes even more important, the improvements in fiscal and external balances made it possible to pursue much more expansionary economic policies. This has additionally boosted growth in several countries of Africa, West Asia, CIS and Latin America.

The deteriorating terms of trade of several countries that have become major exporters of manufactures, but are dependent on imports of fuels and other raw materials, did not retard growth in these countries noticeably. As the fall in the price of manufactures mainly reflected improvements in labour productivity, the quick response of export volumes compensated for the loss of income per unit of output. This was the case, in particular, in the most successful South and East Asian countries. It was the countries that rely on a handful of non-oil and non-mining commodity exports, and that also depend on imported fuels that were the most vulnerable. Many of these countries are located in the Sub-Saharan region.

Despite the relatively favourable evolution of the terms of trade of many developing countries, complacency must be avoided. First, prices of non-oil commodities in real terms remain clearly below the level of 30 years ago. Second, commodity prices are dependent on factors beyond the control of the producer countries, such as strong demand from the big catching-up regions and brisk global economic growth in general. Third, several among the poorest countries are not benefiting from buoyant demand for their export commodities. This is either because their trade structure is heavily biased towards those commodities least in demand or because parts of the gains from higher export prices are absorbed by profit remittances to developed countries. One of the most important challenges for national policy makers and for the international community is to ensure a fair distribution of the rent arising from primary production and its proper use in financing development.

From a global perspective, it is important to note that the commodity price hike did not result in a slowdown of the world economy. One of the reasons for this benign outcome is the fact that the implied change in relative prices did not drive up the overall price levels in consuming countries. For this reason, it did not provoke restrictive action by central banks, as had been the case in previous price-hikes. Moreover, most of the commodity producers shared the extra income obtained by increasing export revenues with the rest of the world more quickly and more smoothly than in previous oil price explosions, for example through higher imports of manufactures, workers remittances, or capital exports.

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However, the international situation may deteriorate abruptly if existing global trade imbalances are not properly managed. If no pre-emptive action is taken, the widening of deficits and surpluses may culminate in a disorderly adjustment of the world's leading currencies, which would have a strong negative effect on global growth and poverty reduction. The lack of a multilateral approach to ensure a smooth adjustment is an ongoing matter of concern.

In addressing this problem, it should be borne in mind that current account balances have a dual nature: By definition, they are the difference between current receipts and expenditures for internationally traded goods and services. At the same time, from a national perspective, the current account balance always exactly equals the gap between national saving and domestic investment. Although these tautological relationships do not provide, by themselves, any explanation or imply certain causality, they are taken as starting points of divergent tracks of analysis, which lead to different policy recommendations.

The view putting national saving centre stage concludes that the decision to save a high ratio of disposable income leads to a capital account surplus, because not all these savings can be used productively inside the national boundaries. The opposite outcome, a current account deficit, is the result of the domestic propensity to invest being in excess of the domestic propensity to save. Hence, that view asserts that trade balances are basically the result of national saving decisions, given a set of investment opportunities.

The alternative explanation of imbalances insists on the relevance of swings in trade flows induced by big changes in relative prices between tradable and non-tradable goods and services, and in the international competitiveness of countries, as induced by real exchange rate changes. In this view, the decision of private households - for example - to save less does not necessarily affect the trade balance if the additional demand can be satisfied by

competitive domestic production. A decline in the private household savings rate can be compensated by other sources of national savings, such as business profits, government saving or lower government dis-saving due to higher tax receipts. In this view, the relationship between national saving and the trade balance is more complex, as it involves all the relevant agents in one country and all the agents in all the other countries.

The policy-prescriptions arising from each view are fundamentally different. The savings perspective stresses the superior profitability of domestic investment in countries running a current-account deficit and the poor investment opportunities in the rest of the world. Foreign savings benefiting from the implied arbitrage process are most welcome. Globally the capital inflows will balance over time the profit discrepancies and the transitional current account balances are just the vehicle to achieve this. Thus, there is no urgency to adjust the imbalances: They are self-correcting as the new investment in the deficit country bolsters competitiveness. The process can only be slightly reinforced by encouraging more household and government saving in the deficit countries, and vice versa in surplus countries.

By contrast, if current-account deficits do not mainly reflect the strength of domestic investment but the lack of competitiveness in the deficit country or a long lasting growth gap, the imbalance asks for a quick and a global response. As many experiences have shown in the past, deficits resulting from a loss of overall competitiveness are often financed at favourable terms for quite some time even in countries that do not issue the world's leading currency. Nevertheless, neither the deficit country itself nor the rest of world are willing to accept the by-products of the deficit forever, and growing protectionism in the deficit country as well as growing nervousness of investors in the surplus countries are unavoidable. Hence, in the words of Alan Greenspan (quoting Herbert Stein): "What cannot go on forever, will not go on forever".

At the present growth rates of exports and imports in the United States the current account deficit will reach ten per cent of GDP in 2009 and the net asset position of the United States will reach 100 per cent of GDP in 2012. Even at the present level of current account deficit (6.5 per cent of GDP) and the current rate of nominal GDP growth, the net foreign asset position of the US will jump from a negative position of 22 per cent of GDP in 2004 to one equivalent to 50 per cent of GDP in 2010.

The later a market-driven or a government-driven correction takes place, the more disruptive it will be to financial markets and even to the US economy. Pre-emptive action is needed. It would necessarily entail some adjustment in the US economy, including an exchange rate devaluation and lower domestic expenditure. The restrictive impact on the global economy can only be mitigated if it is accompanied by expansionary policies both in large surplus economies and in those countries that are growing far below their potential. This applies mostly for the countries of the European Union having adopted the euro.

The correction of the global imbalances must not be deflationary if the efforts towards the MDGs are not to be jeopardized. Therefore, it would be mistaken to rely only on downward adjustment of demand and growth in the main deficit countries, especially the United States, or on exchange rate adjustments in the Asian surplus countries. The developed surplus economies will have to assume a greater role than in recent years as engines of world-wide growth by expanding their domestic demand. Therefore the most promising approach to achieve an orderly adjustment would be through global macroeconomic policy coordination, involving also the major developing economies.

Strengthened macroeconomic policy coordination is also necessary to improve the coherence between the international trading and financial systems. There is a striking asymmetry in existing multilateral arrangements between trade on the one hand, and monetary and financial relations on the other. While international trade is now organized in a rules-based system with certain core principles applying to all participants, this is not the case in international monetary and financial relations. This asymmetry is all the more important, as the adverse international spill-over generated by self-centred national monetary and financial policies can be much more damaging than those created by trade policies, particularly for developing countries.

A global monetary authority like the IMF could play an important role in strengthening the international institutional framework in the monetary and financial area. It would have to focus on international monetary and financial stability. In principle, surveillance could play an important role in promoting a more stable and more reliable system of exchange rates to ensure a predictable trading environment. But in order to fulfil that role, surveillance would need to become more effective, and more symmetrical between program and non-program countries. Its main objective should be the prevention not only of crises in emerging markets, but also of persistent trade imbalances and exchange rate misalignments in major industrial countries. Any reform of the Fund designed to increase its authority and legitimacy would also need to address the distribution of voting rights and other measures that would strengthen the voice and participation of the developing countries in its decision-making processes.

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The many initiatives taken recently to cancel debt of the poorest developing countries and to increase the level of ODA are to be welcomed. Beyond debt relief, which is a recognition that the old debt cannot ever be repaid, a large majority of poor countries will continue to rely on external resources to complement their small domestic resources for the financing of their development goals, including the MDGs. In all these initiatives it will be essential to firmly establish the principle of additionality.

In the context of the Aid for Trade initiative, it is encouraging to see that the Hong Kong Ministerial recognized the need for additional resources to build the supply capacities of developing countries and meet their adjustment costs. Many developing countries will need assistance to cover costs arising, for example, from preference erosion, terms-of-trade losses (in the case of net food-importing countries), or loss of fiscal revenues from tariffs. It is also needed to compensate for compliance costs related to implementing new WTO agreements, and the building of necessary trade-related infrastructure and supply-side capacity in order to benefit from the post-Doha multilateral trading system. Aid for Trade must address all these needs and it will only be meaningful and effective if it is additional to other ODA commitments, predictable and non-debt creating. Firm commitments to provide the required resources for the implementation of the Aid-for-Trade initiative, with a substantial proportion delivered through multilateral mechanisms, offer the best guarantees of predictability, additionality and functionality.

As full debt cancellation will turn the page of the debt crisis of the heavily indebted poor countries, attention need now to be given to providing the means for these countries to grow and develop, while maintaining debt sustainability. Debt sustainability for the poorest

countries is best secured if financial resources come in the form of grants and if donors consequently agree to substantially increase grant-based ODA.

Receiving external financial resources at appropriate terms can help sustain the servicing of external debt. In the final analysis, however, the long-term sustainability of external debt depends on a confluence of many factors at the international and national levels, notably on economic growth and export prospects of debtor countries and on the creation of an enabling environment conducive to development. It should be noted that enhanced market access for goods and services of export interest to developing countries contributes significantly to their debt sustainability.