



# **International Monetary and Financial Committee**

Twenty-Fifth Meeting  
April 21, 2012

**Statement by Supachai Panitchpakdi**  
Secretary-General  
United Nations Conference on Trade and Development

**Statement by Mr. Supachai Panitchpakdi  
Secretary-General of UNCTAD**

**To the International Monetary and Financial Committee  
and the Development Committee**

**Washington, DC, April 2012**

Chairperson,  
Distinguished Ministers,  
Excellencies,  
Ladies and Gentlemen:

The pace of global recovery slowed in 2011 and the world economy is in danger of slipping into a major downturn in 2012. Global output growth is expected to decelerate further, after growing by only 2.8 per cent in 2011. Growth will remain very low in developed countries and Europe is heading for a new recession. But growth will also decelerate in developing and transition economies. It is obvious that global governance has failed to address the multiple and interconnected problems stalking the global economy since 2008.

The most pressing challenge is the jobs crisis in many developed economies. The employment situation is dramatic in some European countries that are now facing problems to access the international capital markets. As workers remain out of a job for longer periods, medium-term growth prospects also suffer because of the detrimental effect on workers' income expectations and on their skills and experience. Extremely low interest rates and abundant liquidity provided by Central Banks has not been sufficient to stimulate investment under conditions of depressed aggregate demand. If, as many governments plan, more fiscal tightening is added to this scenario in the course of 2012 or 2013, a quick recovery is unlikely.

Even though economic ties among developing countries have strengthened, developing countries remain highly vulnerable to changes in economic conditions in the developed economies. A significant worsening of the situation in Europe or in the United States would seriously affect developing countries and economies in transition through trade and financial channels. The impact would vary, given that their economic and financial linkages to major developed economies differ. Asian developing countries, particularly those in East Asia, would suffer mainly through a drop in exports to developed economies. Countries in Africa, Latin America and Western Asia, along with the major economies in transition, would be affected by declining primary commodity prices. In addition, a full-fledged recession in the developed world would send shock waves through the financial markets by bursting some of the newly inflated bubbles on stock, commodity and currency exchanges.

A robust, balanced, and sustained global recovery requires much improved global governance and in particular more pervasive and coordinated policies from the largest economies. Given the exhaustion of monetary policy instruments, fiscal stimuli with an orientation towards public investment and jobs creation are indispensable. At the international level, these policies have to be complemented by accelerated reforms of the financial regulatory system and of the international monetary system.

The persistent external imbalances in the global economy that have developed over the past decade remain an important point of concern. After narrowing during the “Great Recession” they increased again in 2010 and 2011. However, there has been some improvement. China and Japan, which experienced a real appreciation of their currencies between 2007 and 2011, saw their current account surpluses, which had peaked at 10 and 5 per cent of GDP in 2007, coming down to 3 and 2 per cent of GDP in 2011. The US dollar started depreciating in real terms in 2006, and the current account deficit of the United States halved from approximately 6 per cent of GDP in 2006 to 3 per cent of GDP in 2011. Over the same period, the German real exchange remained stable and so did Germany's current account surplus. In fact, Germany is now the only big economy with a

large and persistent current account surplus. On the other hand, some emerging countries had to face a strong “appreciation wind” that deteriorated past export performances and turned the current account back into deficit. Brazil, for instance, had to struggle with large speculative capital inflows, a rapid real appreciation of the currency and a current account swing from a small surplus in 2007 to a deficit of 2.1 per cent of GDP in 2011.

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Many governments responded to the crisis that erupted after the collapse of Lehman Brothers with large stabilization packages aimed at restoring aggregate demand. This was the right response. However, concerns about rising public debt are now leading to a premature reversal of these expansionary fiscal policies. Pressures for a reversal of the fiscal stimulus are of particular concern because the private sector has not yet completed its deleveraging process and, in such a debt-deflation process, expansionary monetary policy cannot have a major stimulating effect.

The trend towards deregulation of the financial system over the past three decades has led to more risk-taking, more financial crises, and larger injections of public money in the financial sector. The recent sharp increase in public sector deficits and public indebtedness is the result of a grave crisis in the financial system following a wave of financial liberalization. It is thus paradoxical, to say the least, that the same financial agents that caused the crisis have now become the judges of the suitability of public policies adopted to contain its damage. Financial markets are often characterized by herd behaviour because acting against the majority, even if justified by accurate information about fundamentals, may result in large losses. As a consequence, prices in financial and “financialized” markets tend to overshoot or even to move in the wrong direction. When herding dominates the scene, no single participant questions whether the underlying information is correct or can be rationally related to events and developments in the real economy. This phenomenon has been observed in securities markets and markets for financial derivatives, but also in currency and commodity futures markets.

In currency markets, for instance, financial speculation is a major factor in leading exchange rates against the fundamentals. This happens frequently because private short-term capital flows are destabilizing. These flows of the “carry trade” type are attracted by positive interest rate differentials but the sheer size of such flows tend to appreciate the exchange rates of countries with relatively high inflation and high nominal interest rates, thus moving exchange rates against the fundamentals, as macroeconomic conditions would have required a depreciation.

Individual countries have tried to limit overvaluation by intervening in the currency markets and by taxing hot money inflows. This pragmatic approach is justified under the current conditions, but it does not address the root cause of the problem. At UNCTAD, we have been working towards the design of a global exchange rate system that can help in preventing trade distortions and serve as a source of stability in international financial relations. Without going into details, we are proposing a system of rules-based managed floating. In principle, such a regime may be regarded as a dynamic version of the Bretton Woods system. Like the Bretton Woods system, it would aim at avoiding fundamental balance-of-payments disequilibria; but unlike that system, it would rely on continuous adjustments of the nominal exchange rate to prevent misalignments of the real exchange rate, instead of inflation coordination and ex post adjustment of the exchange rate if the inflation coordination did not work out.

Commodity prices have displayed considerable volatility over the past decade. The commodity price boom between 2002 and 2008 was the most pronounced in several decades – in magnitude, duration and breadth. The subsequent price decline following the eruption of the current global crisis in mid-2008 was notable both for its sharpness and for the number of commodities affected. Since mid-2009, and especially since the summer of 2010, global commodity prices have been rising again, though there was some flattening out in the first half of 2011.

Some observers consider broad-based changes in fundamental supply and demand relationships as the sole drivers of recent commodity price development. However,

analyses based on cross-market correlations increasingly support the view that these fluctuations have been influenced by the growing participation of financial investors in commodity trading for purely financial motives – a phenomenon often referred to as the “financialization of commodity trading”. A recent UNCTAD study shows that the rise of high frequency trading marks a new step in the financialization of commodity markets. The very existence of cross-market correlations between commodities and shares even at 1-second intervals proves the presence of trading strategies operated by robots on multiple assets. This research adds to the growing empirical evidence supporting the idea that the financialization of commodity markets has a serious impact on the price determination.

Financialization may lead more frequently to situations in which commodity prices continue to increase even when the real economy is slowing and global industrial capacity remains underused. The recent rise in oil prices demonstrates that point. High commodity prices, detached from the real economy, may contribute to the global slowdown to the extent that they induce premature tightening of monetary policy. In this way, financialization has the capacity to inflict damage on the real economy by sending the wrong signals for macroeconomic management.

In December 2011, the United Nations General Assembly adopted by consensus a resolution entitled “Addressing Excessive Price Volatility in Food and Related Financial and Commodity Markets” (A/RES/66/188). This resolution, based on an initiative by the President of the Dominican Republic, led to a High-Level Thematic Debate. UNCTAD contributed directly to this Debate and welcomes the rich exchange of ideas about different ways to reduce excessive price volatility in food and related financial and commodity markets. The resolution should contribute to building a global consensus that recognizes the impact of speculative activity in commodity markets and its negative impact on economic and social stability. Such a consensus is necessary to put in place policies aimed at restricting the influence of financial markets on such crucial factors as commodity prices and currency rates. These policies include ensuring greater transparency in the operations of derivatives markets and the creation of appropriate

monitoring and regulatory mechanisms to limit in a sustainable manner the impact of financial speculation on commodity prices.

It is obvious that we need to strengthen and tighten domestic and international financial regulation. The crisis provided a window of opportunity for doing so, it is my impression that this opportunity is not being fully used and that despite our shared understanding of the way in which financial market failings led to the crisis, the reform agenda has become a victim to mainstream tendencies to view financial markets as efficient as well as to the lobbying power of the financial industry.

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Beyond the urgent need to reduce the destabilizing impact of financial markets, job creation should be our first priority. In order to restore pre-crisis employment and absorb the new entrants to the labour market, the global economy needs to create 64 million jobs. In 2011, the average unemployment rate of the developed countries was above 8.6 per cent, almost three percentage points higher than its pre-crisis level. In developing countries, employment has recovered more rapidly, but unemployment rates remain high, often above 10 per cent in urban areas, and a large share of workers continues to be underemployed or in informal employment.

It is often thought that rising and persistent unemployment is caused by institutional arrangements that limit the flexibility of the labour market and prevent wages from falling sufficiently to absorb the excess supply of labour. However, if this were true, we should not have observed high unemployment rates in countries, like the United States, where the labour market is considered to be very flexible and where wages, in particular the real wages of middle income workers, have been lagging productivity for many years, indeed, have not been participating in productivity growth for several decades.

There can be no doubt, therefore, that high unemployment in the current context is caused by lack of aggregated demand, and cutting wages only exacerbates the problem.

Aggregate demand depends crucially on the distribution of the gains from productivity growth. Many of the policies adopted over the past 25 years have sought to keep wages low, and have served to translate productivity gains into higher capital income. However, keeping wages down in order to generate higher profits is self-defeating. Without the rising purchasing power of wage earners, domestic demand cannot grow sufficiently to enable owners of capital to employ their capacity fully. The only way to avoid this dilemma consists of exporting to satisfy foreign demand. However, such a strategy cannot work if applied by many countries at the same time. One country can be successful with such an approach, but only at the expense of growth and employment generation in other countries.

In developing economies that are still highly dependent on the production and export of primary commodities, the link between growth and employment creation is less direct. Increases in commodity prices can lead to income growth without an increase in real output, and thus do not necessarily result in higher employment. Transforming income gains resulting from commodity price increases into a sustained process of growth and employment creation requires that higher prices are treated like productivity growth and passed on through rising wages and greater domestic demand. The role of the State is essential for capturing a significant part of that income for society at large and for generating the conditions for higher domestic demand and rising employment in the rest of the economy. Therefore, in developing countries, as in developed countries, the ability to achieve sustained growth of income and employment on the basis of productivity growth or terms-of-trade gains depends critically on how the resulting gains are distributed within the economy.

A successful strategy for development, growth and employment depends crucially on investment in fixed capital. In a market economy, such investment is dependent on the growth of aggregate demand, on the one hand, and access to finance on the other hand. The dominating reform agenda of the 1980s and 1990s has failed to show that capital accumulation, productivity growth and job creation automatically result if markets are freed and the borders are opened for goods and for capital. By contrast, public policies



aimed at supporting demand, investment and employment growth are as necessary as policies to protect the domestic economy against the vagaries of the financial markets.

The task of monetary, financial and fiscal policies to support the creation of employment can be facilitated by the additional use of income policies that build on certain rules for determining the distribution of incomes in a growing economy. Well-designed income policies based on real wage growth in line with productivity growth can contribute to employment creation by enabling a steady expansion of domestic demand.

Moreover, many developing countries have a history of high inflation. This has proven to be extremely costly, because central banks often adopted contractionary policies to reduce inflation to its target level, which implies sacrificing real investment and employment for the sake of nominal stabilization. In some developing countries, a rule for growth of nominal labour income along the path of average productivity growth plus the inflation target can help to stabilize the economy on both, the real and nominal side.

However, such an anchoring of nominal wages to the productivity growth trend (plus the inflation target) implies that the share of labour in total income remains unchanged. To redress inequities and accumulated inequalities, the government still has room to change a given distribution of income between capital and labour by introducing additional measures or new systems of taxation to correct the market outcome. Both the rule to stabilize the market income shares and the attempt of the government to change secondary distribution should be part of a social compact. Similarly, in countries where a large part of the working population is self-employed in low-productivity activities, wages policies need to be complemented by other redistributive measures.