

TST Issues Brief: Macroeconomic policy questions (including international trade, international financial system and external debt sustainability)¹

Introduction

Macroeconomic policies, including those related to international trade, finance and debt management, are critical to support a global enabling environment for growth and sustainable development. The goal to develop a global partnership for development (MDG8) was intended to help countries achieve the MDGs. The challenge post-2015 is to improve further the enabling environment by incorporating sustainable development considerations that were not prominent in the MDGs. These include, for instance, equality, human rights and environmental protection. This brief is about how better coordinated macroeconomic and structural policies in both developed and developing countries can contribute to achieving sustainable development objectives.

The history of global financial and economic crises shows how macroeconomic and financial policies in some countries have the potential to set back growth and sustainable development efforts around the world. For example, the 2008 crisis exposed the inability of existing regulatory mechanisms to prevent excessive risk-taking and fraud in the financial sector. The crisis highlighted the need for macroeconomic policies to focus more on employment creation and to see risk in a wider perspective including social inclusiveness, the respect for human rights and environmental sustainability.

I. Stock-taking

a. Macroeconomic policy trends before the global financial crisis

During the period between the Millennium Declaration and 2007, **world GDP expanded** at an annual average rate of 3.3%.² This growth was driven by growing investment in emerging countries, international trade, and consumption in developed countries supported by relatively stable inflation, low interest rates and broadening access to credit. The burden of many highly indebted poor countries has been alleviated through debt restructuring. Unemployment and extreme poverty decreased significantly in many countries, directly accelerating progress towards the achievement of MDGs.

These positive outcomes, however, have occurred in a context of insufficient inclusiveness, growing global imbalances and financial risks, as well as **environmentally and socially unsustainable production and consumption patterns**.³ Despite improved environmental standards and technological progress, expanding economic activity has resulted in growing environmental degradation and accelerated impacts of climate change, with fossil-fuel CO₂ emissions rising on average by 3 per cent per year.⁴

Several processes have undermined the **inclusiveness** of economic growth. Globalization has benefitted mobile factors of production, such as capital and skilled labour. While global integration has generated considerable employment in developing countries, intense international competition and production offshoring have contributed to a growing disconnect between labour productivity and wages in many countries, especially in developed ones. Income inequality has continued to rise in most regions, compounded by weakening redistribution mechanisms. In developed countries, tax revenues as a share of GDP started declining, partly due to lower taxation rates, especially for capital income.⁵ Globally, growing tax avoidance by wealthy individuals and transnational corporations serviced through tax havens and offshore financial centres has further undermined public finances.

¹ This Issues Brief was co-authored by UN-DESA and UNDP, with contributions from ILO, OHCHR, UN-ESCAP, UNFPA, UN-Habitat, UNIDO, UN-Women, WFP and WTO.

² United Nations, 2013, *World Economic Situation and Prospects 2013*, New York.

³ United Nations, 2013a, *World Economic and Social Situation 2013*, New York.

⁴ International Energy Agency. See www.iea.org/co2highlights/co2highlights.xls.

⁵ Facundo Alvaredo, Anthony B. Atkinson, Thomas Piketty, Emmanuel Saez (2013) « The Top 1 Percent in International and Historical Perspective », NBER Working Paper No. 19075.

Before the crisis, growing **global imbalances**, accompanied by accommodative monetary policy in developed countries and reserves accumulation by many surplus developing countries, exerted downward pressure on interest rates globally. Private debt soared and financial market risks rose seemingly unnoticed, as weakly regulated credit intermediaries backed by too-big-to-fail banks built up leverage in the shadow-banking sector. Opaque and complex financial products that were designated as safe by credit rating agencies and sold to investors around the world resulted in large systemic risks, culminating in the financial and economic crisis in 2008.⁶

b. The international response to the global financial and economic crisis

The **international policy reaction to the crisis** has focused on restoring financial and economic stability. Government support measures to the financial sector were announced in over 40 countries.⁷ G20 countries briefly coordinated their fiscal and monetary policies, delivering unprecedented monetary easing and fiscal stimulus. However, many countries soon turned to fiscal austerity measures with the declared objective of reducing budget deficits and public debts. They opted for expansionary monetary policies expecting to reignite economic growth. However, numerous studies have called into question the economic benefits of austerity measures.⁸ Since the crisis, the prices of financial assets have recovered in developed countries, but consumer demand and productive investment have remained muted. Further, unemployment has remained elevated and average economic growth has been cut in half compared to the pre-crisis period.

Many developing countries have weathered the crisis better. However, the crisis resulted in declining external demand and development aid.⁹ Slower economic activity coupled with unconventional monetary easing in developed countries has further impacted developing countries by nurturing sizeable and volatile short-term capital flows and speculative activity in foreign exchange and commodity markets which can exacerbate the volatility of food prices and consequently impact on hunger and nutrition.¹⁰

The current approach to international financial reform has focused on ensuring the safety and soundness of the financial system, focused primarily on the banking sector. In accordance with the Basel III standards,¹¹ most G20 countries foresee raising capital requirements for banks. However, several studies find that these changes are likely to be too small to increase the resilience of the banking system sufficiently.¹² Meanwhile, facilitating access to finance, one of the primary functions of an effective financial system, has not been fully incorporated into the policy agenda. Given the risk weightings within the capital adequacy rules, Basel III could further limit access to finance for smaller entities and long term financing. Basel III is being supplemented by other measures, such as those promoted by the Financial Stability Board (FSB), to enhance financial stability.¹³ However, ineffective coordination of macroeconomic policies and inadequate financial reform continue to undermine robust and stable economic growth.

⁶ United Nations, 2013a.

⁷ International Monetary Fund, *Global Financial Stability Report*, Washington, D.C., October 2012.

⁸ On the economic impacts of austerity see e.g. Olivier Blanchard and Daniel Leigh, "Growth Forecast Errors and Fiscal Multipliers," IMF Working Papers, WP/13/1 (January 2013); ILO, World of Work Report 2012 "Better Jobs for a Better Economy". On the human rights impacts of austerity see e.g. Report of the United Nations High Commissioner for Human Rights: Austerity measures and economic and social rights, E/2013/82 (7 May 2013); Report of the Independent Expert on the question of human rights and extreme poverty, A/HRC/17/34 (17 March 2011).

⁹ ODA commitments and disbursements fell in 2011 and 2012 and they are expected to stagnate in the medium term.

¹⁰ Food and Agriculture Organization, 2009, *The State of Food Insecurity in the World*, Rome, 2009.

¹¹ Promulgated by the Basel Committee on Banking Supervision.

¹² United Nations, 2012, *World Economic Situation and Prospects 2012*, New York

¹³ http://www.financialstabilityboard.org/list/fsb_pa/index.htm.

c. International trade¹⁴

Open trade is a means to create employment and contribute to MDG achievement through greater economic activity and revenues. Developing countries can derive significant benefit from an open, fair, rule-based, predictable, and non-discriminatory trading and financial system (MDG8).¹⁵

Trade liberalization can contribute to increased growth through enhancing access to technology, intermediate and capital goods and increased competition, which in turn could reduce poverty through employment creation. The synergy between trade liberalization and economic growth can be strengthened if other complementary policies are in place, e.g. investment in public goods, such as education, transport and information and communication technology (ICT) infrastructure, which could enhance the ability of individuals and firms to take advantage of trade opportunities and to diversify towards higher value-added exports over time.

The **distribution of the gains (and losses) from trade** remains a concern. Trade expansion can accelerate structural change in economies, creating near-term winners and losers. Globalization has been one contributor to rising income inequality.¹⁶ This highlights the importance of complementary measures to mitigate the negative impacts and equitably distribute the benefits of a more competitive trading system.

Special and differential treatment and aid for trade are critical to the promotion of a fair trading system. Additional measures such as improving rural infrastructure to help integrate rural households into world markets, increasing rural education to enhance labor mobility and expanding access to credit, can further enhance the potential gains from trade.

The effect of trade on the **environment and emissions of greenhouse gases (GHGs)** is ambiguous. Trade liberalization can lead to more efficient production, but can also lead to shifting production to countries with lower environmental and labour standards. Furthermore, trade induces freight transportation pollution. A recent study shows that two-thirds of trade-related emissions come from production activities, and the remainder comes from international transport. However, this mix varies widely across products and across countries.¹⁷ It is important to facilitate greater emission efficiencies in production—including through the transfer of clean technologies, transportation and adoption of sound environmental policies.

d. External debt sustainability

External debt can help States weather economic shocks and fund social and economic objectives at times when domestic resources are limited. However, servicing grossly unsustainable debt can threaten the ability of States to realize these same objectives. The inability of States with heavy debt burdens to access affordable credit during the current crisis has revealed problems with the existing debt framework.

The fact that risks posed by unsustainable debts persist in developing countries, despite the near completion of the Highly Indebted Poor Country (HIPC) Initiative, further illustrates the problem with the existing framework. Out of 39 eligible countries, 35 have reached the completion point in HIPC and are receiving irrevocable debt relief. One of the remaining four countries is receiving interim relief and the other three are making progress towards reaching the decision point. However, the HIPC eligibility criteria are sometimes seen as restrictive. In some cases, the criteria impose conditionalities, such as ceilings on commercial and

¹⁴ Issues related to the functioning and challenges facing the multilateral trading system are numerous and require detailed discussion. Due to space constraints, this issues brief will not address them in full. The issues brief on means of implementation and global partnership for development can touch upon the prospects for multilateral trade cooperation, including issues such as delivering on a development-oriented Doha Round or addressing non-traditional market access.

¹⁵ United Nations, 2012, *Realizing the Future We Want for All*, Report to the Secretary-General by the UN System Task Team on the Post 2015 Development Agenda, June 2012, (New York), See also Principle 12 of the Rio Declaration 1992; para. 2.9 of Chapter 2 of Agenda 21; para. 47 of the Plan of Implementation of the 2002 World Summit on Sustainable Development; and the Preamble to the Marrakesh Agreement Establishing the World Trade Organization.

¹⁶ See for instance Goldberg and Pavcnik 2007, Topalova 2007.

¹⁷ Anca D. Cristea, David Hummels, Laura Puzello, Misak G. Avetisyan, 2011, "Trade and the Greenhouse Gas Emissions from International Freight Transport", NBER Working Paper No. 17117

private borrowing, which are contested by recipient countries.¹⁸ Recently, several sovereign debt restructurings have taken place in developing countries, especially in the Caribbean, but in most cases, these have either been insufficient or not timely. Several other countries mostly in sub-Saharan Africa are also in high risk or in debt distress.¹⁹

II. Overview of proposals

The UN System Task Team (UNTT) has pointed out that working towards achieving sustainable development would require a **broad approach to macroeconomic policies**. This approach should combine macroeconomic and financial stability with broader structural policies that would enable the generation of productive and decent employment, the reduction of poverty and inequalities, low-carbon and resource efficient growth, and welfare protection.²⁰

In order to achieve development goals, donors have been urged to reaffirm their **ODA goals** of disbursing the equivalent of 0.7 per cent of their GNI, out of which 0.15 to 0.20 per cent of their GNI should target LDCs, with a clear timetable.²¹ These efforts should be matched by fiscal policies in developing countries that speed up domestic resource mobilization through, for example, the strengthening of the tax base.

An **OECD action plan**, welcomed by the G20 in St. Petersburg in September 2013, aims at containing growing tax avoidance by designing new rules to limit double non-taxation of income.²² The proposal emphasizes the importance of addressing the issue of income generated by the digital economy, which can easily be shifted to low-tax jurisdictions. Greater transparency and improved data will be needed to determine the location where financial assets are created and investments take place as well as where multinational corporations report profits for tax purposes. Developing countries are also often less equipped to deal with transfer mispricing by multinational enterprises. For this reason, the UN Committee of Experts on International Cooperation in Tax Matters has developed a Practical Manual on Transfer Pricing for Developing Countries.

Private sources are critical in providing long-term financing.²³ The UNTT flagged the importance of a renewed global partnership, which should *inter alia* promote **longer-term investment**, including foreign direct investment, in critical sectors such as transportation, agriculture, energy, infrastructure, and ICT. The new partnership should also identify effective mechanisms to mobilize additional resources for **financing sustainable development**.²⁴ The intergovernmental expert committee on a sustainable development financing strategy is currently working to develop options in this regard.

Existing proposals to **strengthen and reform the international financial system** have two interrelated and mutually reinforcing aims: to reduce its fragility and instability, and to facilitate a reallocation of global investments toward sustainable development. In this spirit, the Report of the High-level Panel of Eminent Persons to the Secretary-General calls for reforms to ensure stability of the global financial system and encourage stable, long-term private foreign investment.²⁵

To increase **international financial stability**, there are policy proposals to address global imbalances and the volatility of cross-border capital flows. The Commission of Experts of the President of the United Nations General Assembly recommended that the international reserve system make greater use of International Monetary Fund (IMF) Special Drawing Rights (SDRs) as a way to reduce systemic risks associated with global

¹⁸ See for instance the Report of the Independent Expert on foreign debt and human rights, Cephas Lumina, *An assessment of the human rights impact of international debt relief initiatives*, A/HRC/23/27 (11 June 2013).

¹⁹ United Nations, 2013b, *The Global Partnership for Development: The Challenge We Face, MDG Gap Task Force Report 2013*, New York.

²⁰ United Nations, 2012, *Realizing the Future We Want for All*, Report to the Secretary-General by the UN System Task Team on the Post 2015 Development Agenda, June 2012, (New York), p.29.

²¹ United Nations, 2013c, *A Renewed Global Partnership for Development*, Report to the Secretary-General by the UN System Task Team on the Post 2015 Development Agenda, March, New York, p.10.

²² OECD, 2013, *Action Plan on Base Erosion and Profit Shifting*, Paris.

²³ United Nations, 2013d, *A New Global Partnership: Eradicate Poverty and Transform Economies Through Sustainable Development*, The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda, p.26.

²⁴ United Nations, 2013c, pp.10-12.

²⁵ United Nations, 2013d.

imbalances, and as a low-cost alternative to accumulation of international reserves.²⁶ To better manage large and volatile cross-border capital flows, the G20 endorsed the use of capital flow management measures alongside macroeconomic policies.²⁷ A reliable global financial safety net could also reduce incentives for countries to hold reserves. In addition to increased flexibility in the IMF's lending facilities, there are proposals to improve cooperation between national central banks, regional mechanisms and the IMF.

Proposals to strengthen financial regulation include suggestions by the Financial Stability Board (FSB) to tighten oversight and **regulation of large and systemically important financial institutions**, beyond the general standards of Basel III²⁸ Further reforms of derivative markets, uniform global accounting standards, and reform of compensation practices in the financial sector are also needed. Despite historically low debt levels in developing countries, the lack of a rules-based approach to sovereign debt workouts remains a concern, eliciting calls for an international bankruptcy procedure. There is also a call for greater transparency, accountability and participation in international financial institutions like the World Bank and the IMF.

Additional investments are needed to address social needs, infrastructure gaps, and green technologies.

Proposals to facilitate such investments include a report by international organizations at the request of the G20,²⁹ which recommended tapping the potential of institutional investors, capital markets and development banks. However, without a reduction in risk and changes to incentives, the private sector is unlikely to contribute to its full potential in financing sustainable development investments. A background study to inform the Intergovernmental Committee of Experts on Sustainable Development Financing, prepared by a United Nations Inter-agency Working Group, calls for donors to meet ODA commitments, but also for multi-faceted policy reforms aimed at reducing impediments to private investment in sustainable development, including: (i) reducing risks by improving the enabling environment; (ii) public leveraging of private resource flows; and (iii) better aligning private incentives with public goals.

The UN has called for a speedy conclusion of a **development-oriented Doha Round of multilateral trade negotiations** in order to increase market access for developing countries and increase workers' mobility. In order to allow developing countries to be able to reap the full benefits of open global markets, support to enhancing country supply side capacity, including through the Aid for Trade platform, must be strengthened.³⁰

International debt sustainability initiatives should go beyond the HIPC initiative and the Multilateral Debt Relief Initiative (MDRI). Some developed and developing countries remain critically indebted or are at significant risk of debt distress.³¹ In 2012, the United Nations Conference on Trade and Development (UNCTAD) formulated the Principles on Responsible Sovereign Lending and Borrowing.³² These Principles specify the responsibility of both sovereign borrowers and lenders and advocate a code of good conduct and institutional setup for concluding debt transactions. The IMF is considering strengthening its debt sustainability and market access assessments of countries to prevent the use of resources to bail out private creditors and decrease the costs of debt restructuring. It is also calling for clearer rules for public sector involvement as creditors, especially for non-Paris Club creditors.³³ The UN has also proposed setting up an international working group to examine options for enhancing the international architecture for debt restructuring.³⁴

²⁶ http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf.

²⁷ www.g20.utoronto.ca/2011/2011-finance-capital-flows-111015-en.pdf.

²⁸ FSB, 2013, Implementing the FSB Key Attributes of Effective Resolution Regimes – how far have we come?

²⁹ www.g20.org/load/781255094.

³⁰ United Nations, 2013b, p.13.

³¹ Ibid, p.12.

³² See http://www.unctad.info/upload/Debt%20Portal/Principles%20drafts/SLB_Principles_English_Doha_22-04-2012.pdf.

³³ International Monetary Fund, "Sovereign Debt Restructuring—Recent Developments and Implications for The Fund's Legal And Policy Framework," 26 April, 2013, (Washington).

³⁴ United Nations, 2013b.

III. Way forward

- a. Forward looking macroeconomic policies focused on sustainable growth, decent work and reduction of inequality³⁵

In order to **support economic stability**, comprehensive financial regulation should not only ensure the safety and soundness of the financial system, but also equitable access to finance and sufficient long-term financing for sustainable development. Financial regulatory reforms should eradicate the occurrence of moral hazard arising from the existence of “too-big-to-fail” entities. Compensation incentives that enticed individuals to take excessive risk should be altered and executive compensation should be tied to long-term returns. Overall, ‘light touch’ financial regulation should be replaced by an approach that assesses the potential damage financial ‘innovation’ can inflict on the real economy and that clearly distinguishes business mishaps from systemic fraud. The UN Guiding Principles on Business and Human Rights offer concrete guidance for establishing a fair, rules-based system of accountability for businesses, including those in the financial sector.³⁶

There is a need to shift away from macroeconomic policies focused predominantly on curbing inflation to the neglect of stimulating employment growth. Instead, forward-looking macroeconomic policies³⁷ should promote long-term public and private investment in **support of broad-based, sustainable growth and decent employment**. This may, at times, require the use of countercyclical policies to smooth economic cycles and minimize the human impact of economic shocks.

Forward-looking macroeconomic policies can further **improve inclusiveness** by ensuring the provision of public goods even in times of crisis. For example, maintaining a social protection floor and investment in human capital through good quality universal health and education services can reduce poverty and inequality while promoting long-term economic and social stability.

The mobilization of domestic resources should be strengthened through progressive taxation, including capital income. International cooperation must be enhanced to eradicate financial secrecy and double non-taxation, and curb individual and corporate tax avoidance and evasion, and fight corruption and the illicit flow of funds.

Forward-looking macroeconomic policies and the reform of the international trade and financial system should also **promote environmentally sustainable development patterns**. This transition would be facilitated by the adoption of a new system of national accounting capturing not only economic, but also environmental stocks and flows. Public investment as well as incentives for private investment in ‘green’ technologies should be strengthened. ‘Green’ investments should be increased to secure clean water, air and energy as well as to reverse the trend of increasing CO₂ emissions and enable the needed 80% reduction in global CO₂ emissions by 2050. Environmental externalities should be priced into goods prices through carbon taxes or other schemes.

- b. International trade

Policies are needed to **alleviate pressures on workers in sectors that could lose as trade expands**, especially in vulnerable groups of countries, such as the least developed countries. Impact assessments are necessary to ensure that environmental, human rights and social impacts, including on food security, are accounted for and mitigated.³⁸ Ensuring the compatibility of these policies with a transition to more open trade is desirable. Trade protectionism could deprive the world of an engine of economic growth and the gains associated with improved efficiency. Social protection systems can help in the adjustment process.

³⁵ As defined by Rio+20, para 150, and MDG Summit outcome document, para 23b.

³⁶ United Nations, Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, 21 March 2011, A/HRC/17/31.

³⁷ See A/64/665, para.50 for a more extensive definition.

³⁸ See e.g. The Guiding Principles on Human Rights Impact Assessments of Trade and Investment Agreements, A/HRC/19/59/Add.5 (19 December 2011).

Trade can be harnessed to reduce inequality with continued efforts to promote skill upgrading to help workers adjust to changes in global markets and to benefit from new opportunities. At the same time, strengthening the ability of producers to compete through productive sector development policies and trade facilitation initiatives should also help support job creation.

Trade in ‘environmental goods and services’³⁹ that promote sustainability and productive transformation and innovation should also be supported. Producers’ access to skills and technologies to be able to adapt to global market demands for environmentally sustainable products will become increasingly important.⁴⁰ Appropriate policies are needed to **internalize negative environmental externalities related to transportation systems and production techniques** used.

c. External debt sustainability

The international financial community should assure timely debt relief for countries struggling with unsustainable debt. To prevent more countries falling into debt distress, the international community should also **devise principles to reduce excessive debt** and encourage countries to lend and borrow responsibly. The UN Guiding Principles on Foreign Debt and Human Rights offer guidance in this regard. To promote further progress, the United Nations should convoke an international working group to examine options for enhancing the international architecture for debt restructuring.⁴¹ One of the aims of this working group would be to consider designing a more formal and comprehensive sovereign debt workout mechanism which would bring more transparency to the process.

In conclusion, a macroeconomic strategy that uses all available policy instruments to balance the objectives of inclusive economic growth with socially acceptable distributional outcomes and environmental sustainability is essential to a strategy for sustainable development.

³⁹ At the Doha Ministerial Conference in 2001, WTO Members decided to launch negotiations that, for the first time, would include trade and environment as part of the negotiating agenda (para 31 of the Declaration), including the relationship between WTO rules and specific trade obligations in MEAs; observer status for MEA secretariats; and the liberalization of trade in environmental goods and services.

⁴⁰ WTO, *World Trade Report 2013: Factors shaping the Future of World Trade*, Geneva, 2013.

⁴¹ United Nations, 2013b.