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AUSTERITY DID NOT LEAD TO GROWTH; SUPPORTIVE GOVERNMENT POLICIES ARE STILL NEEDED, UNCTAD REPORT SAYS

Results back earlier warnings: developing countries are vulnerable as fiscal cuts and labour-market reforms in developed nations hinder recovery from recession

Geneva, 12 September 2012 – As predicted by UNCTAD economists, fiscal austerity and wage compression are further weakening growth in developed countries without achieving the expected results of reduced fiscal deficits, job creation, and renewed confidence of financial markets, **the Trade and Development Report 2012**[1] says.

The publication, subtitled "**Policies for inclusive and balanced growth**", was published today. It focuses especially on income inequality, and says that reducing widening gaps in wealth and income will not only have social benefits, but will also lead to higher economic growth. (See press release UNCTAD/PRESS/PR/2012/31.)

The **Trade and Development Report 2012** notes that many developing countries are supporting domestic demand and growth with countercyclical economic policies. But it contends that they cannot avoid a slowdown and are vulnerable to a continuing deterioration in advanced economies.

Warnings have been issued by UNCTAD over the past two years that a number of developed countries are shifting too soon from economic stimulus measures to government budget cuts. The result, according to the report, is that without sufficient State spending to inject some life into domestic markets, the already weak demand for goods and services has stagnated or weakened still further. Rather than raising business and financial-market confidence, the approach has left many firms pessimistic about the future and unwilling to invest in new production or hire new workers.

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[1] The Report (Sales No. E.12.II.D.6, ISBN-13: 978-92-1-112846-8) may be obtained from United Publications Sales and Marketing Office at the address mentioned below or from United Nations sales agents throughout the world. Price: US$ 55 (50% discount for residents of developing countries, and 75% discount for residents of least developed countries). Customers may send orders or inquiries to: United Publications Sales and Marketing Office, 300 E 42nd Street, 9th Floor, IN-919J New York, NY 10017, United States. tel.: +1 212 963 8302, fax: +1 212 963 3489, e-mail: publications@un.org, https://unp.un.org.

General trends

In its review of trends in the global economy, the report warns that growth is slowing in all regions of the world, hamstrung in part by austerity measures that are hampering demand in the major developed-country markets, thus cutting the export prospects of developing countries. A number of developing countries are carrying out continued countercyclical policies that support domestic demand, the report says, but these will not be sufficient if growth doesn't pick up in the large advanced economies.

Global growth fell from 4.1 per cent in 2010 to 2.7 per cent in 2011, the report figures show. A further decline is expected by UNCTAD – to below 2.5 per cent – in 2012.

The report predicts a tumble in developed countries to a mere 1 per cent growth this year – a combination of a renewed recession in the European Union and growth of around 2 per cent in the United States of America and Japan.

Economic expansion in developing and transition economies is expected to be stronger over 2012 – 5 per cent and 4 per cent, respectively – but also down from previous years. The developing world, driven by progress in several large economies, is less dependent than it used to be on the mature developed economies, and has a more resilient domestic demand. The report notes that between 2006 and 2012, some 74 per cent of global output growth was generated in developing countries, as compared with only 22 per cent in developed countries. In the 1980s and 1990s, by contrast, developed countries accounted for 75 per cent of global growth, a proportion that fell to slightly over 50 per cent between 2000 and 2006.

However, developing countries are still vulnerable to weakened demand for their exports from the developed economies, the report says, and that is likely to be the case as austerity programmes continue, and especially as they bite more deeply in Europe. The trend is already reflected in stagnating export volumes to developed-country markets and in a declining trend in commodity prices since the second quarter of 2011. Moreover, financial instability in developed countries is affecting financial flows to emerging market economies and adding to the inherent volatility of commodity prices, the report contends.

Warnings about austerity programmes were given by UNCTAD as early as 2010, contending that the problems were being misdiagnosed – that the challenge to recovery was not mounting government debt, but lack of domestic demand. The **Trade and Development Report 2010** cautioned that "(T)here is a high risk that the withdrawal of fiscal stimulus before the return of strong domestic consumption and investment will jeopardize economic recovery".

This year's report says that those fears have been borne out, and that the main problem hindering recovery from the global downturn is recessionary pressures in developed countries. These include balance-sheet adjustments in the private sector, high unemployment, which depresses household revenues and hinders household consumption, and governments scrambling prematurely to reduce their debts. Such policies not only misdiagnose the causes of the crisis – high fiscal deficits were a result and not the cause of the crisis – but also underestimate the negative macroeconomic impacts of policies that restrain demand in the midst of a recession. Indeed, with faltering growth, fiscal revenues and fiscal consolidation have been below expectations in several countries, failing to restore investor confidence. Climbing government debt must be addressed, but in the long run this will be achieved through restoring growth and fiscal revenues, the report says. Moreover, as they further weaken growth dynamics, wage compression policies in developed countries tend to increase unemployment instead of stimulating investment and job creation. Lowering labour costs in many countries with strong trade ties at the same time would not significantly improve competitiveness in any of them, and would be counterproductive, as it would constrain domestic demand everywhere, the **Trade and Development Report 2012** contends.

In this situation, structural reforms cannot be a substitute for supportive macroeconomic policies, the report stresses. However, they can contribute to a recovery when they create or reinforce social safety nets, and expand the supportive economic role of the State, as is happening in several developing countries. Reforms should also address the root causes of the crisis by reforming the national and international financial systems, and reversing the trend towards increasing income inequality that most countries have suffered since the 1980s, the report says. It notes, however, that reforms currently proposed in several developed countries (including labour flexibility policies) tend to further depress real wages, limit domestic demand, and widen income gaps.

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