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**Global economic crisis:
implications for trade and development**

Report by the UNCTAD secretariat*

Executive summary

The ongoing global financial and economic crisis has the potential to usher in a period of a global recession that may seriously undermine all countries' process of economic growth and transformation, and also jeopardize efforts to widen economic and social opportunities and improve the livelihoods of ordinary people everywhere. In particular, the crisis may put a brake on and also reverse efforts in developing countries and by the international community to assure development gains from trade, promoting achievement of internationally agreed development goals including the Millennium Development Goals (MDGs) by 2015. The crisis has triggered a slowdown in global economic growth that is manifesting itself in a demand-driven fall in international trade exacerbated by the deficit of credit and trade finance; falling commodity prices; declining remittances; contracting foreign direct investment (FDI); and the potential of declining official development assistance (ODA). These effects have been superimposed onto the ongoing global food crisis, volatile energy prices, and climate-change challenges. The aggregate impact is such that most developing countries are being heavily hurt through declining exports, rising unemployment, and thus falling family incomes, bringing millions of people back into poverty or aggravating the conditions of those in extreme poverty. This has given rise to the most significant challenge facing the global community today – how to focus on buttressing development and poverty-reduction efforts globally and in developing countries, and on setting in place the conditions that will avert future crises and facilitate a sustainable process of economic transformation for all countries. This report by UNCTAD is an effort to contribute to consideration of this major challenge, with a view to identifying policies and strategies that can serve as the bulwark on which to restore confidence, build recovery, and above all, promote inclusive development, where gains are shared widely among all countries and all peoples.

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Main conclusions

The world economy is currently facing a severe global crisis that spilled from financial sector to the real economy in the last quarter of 2008, leading to steep falls in industrial production and a rapid decrease in international trade, and to a slowdown in foreign direct investments and potentially in development assistance. The crisis has brought about a slump in economic growth in most countries, and has been accompanied globally by increases in unemployment. The current global crisis – preceded by the food crisis, volatile energy prices and climate change challenge – is a major blow to attaining the MDGs for developing countries. Addressing the dampening impact of the crisis on international trade and investment to restore growth, and reviewing development policies and partnerships to create sustainable practices and greater resilience to future shocks, must be key priorities in the multilateral agenda.

Most developing countries are now closely linked with the global economy by trade and foreign direct investment flows, and their economies are more sensitive to falling international demand (and conversely to expanding demand). The degree of exposure and integration of developing countries' economies to external markets has greatly increased in recent years. Developing countries' exports on average accounted for more than half of their gross domestic product (GDP) in 2007, up from about a quarter of GDP in 1995.

The ongoing reduction of trade and investment flows is starting to restrain the development prospects of developing countries. They are currently seriously hurt through falling commodity prices, demand-driven drops in exports exacerbated by the deficit of credit and trade finance, capital outflows, declining remittances, and contracting investment. The prospects are more dire for export-oriented developing countries, especially those with a small domestic economy, where the reduction in international demand is more likely to raise unemployment. In some developing countries, workers are shifting out of dynamic export-oriented sectors into lower-productivity activities. Potentially, all these effects could bring millions of people back into poverty.

The decrease in merchandise trade appears to be affecting all developing regions and most types of goods. Moreover, South–South trade, which has been the most dynamic component of world trade for over a decade, is declining too, especially intra-Asian trade. The quick contraction of developing countries' manufacturing trade is largely due to today's highly globalized production and marketing schemes. Among the most affected sectors are automotive products, office and telecommunications equipment, and electronics, as well as textiles and clothing.

Many commodity exporters, particularly those in West Asia, Africa, and countries with economies in transition that benefited from the commodity price boom with considerable terms-of-trade gains, are now facing the downside of their commodity dependence, manifested in a substantial shrinking of export revenues. More than 90 developing countries earn at least 50 per cent of their exports from commodities (47 of them being non-fuel commodity exporters).

UNCTAD currently estimates world merchandise trade to fall between 6 and 8 per cent in 2009. Exports from developing countries and countries with economies in transition could potentially decline in the range of 7 to 9 per cent in volume, in 2009. Developed countries' exports are projected to decline by up to 8 per cent this year. The trade contraction in value would be much greater.

The crisis is also spreading to trade in services and to service sectors in general. Maritime transport is particularly affected, as are tourism and construction services. There is also a growing reduction in the employment levels of migrant workers from developing countries. This is expected to lead to a further fall in remittance inflows to developing countries, which began to slow down in 2008. Conversely, trade in ICT-enabled services appears to be less influenced by the economic downturn, as companies see the offshoring of services as one method of enhancing their competitiveness.

The crisis has translated into a sharp decline in FDI inflows, both for developed and developing countries. UNCTAD estimates that global FDI inflows declined by 15 per cent in 2008. An outright decline in FDI inflows to developing countries is very likely in 2009. FDI flows to financial services, automotive industries, building materials, intermediate goods and some consumption goods are among

the most significantly affected, but so is FDI into activities ranging from the primary sector to non-financial services. FDI outflows from the South are also set to slow down, but to a lesser degree than those from the North. Thus the share of developing countries in global FDI outflows continues to rise, highlighting an increasing presence of transnational corporations (TNCs) from the South.

Multilateral policy responses are required to achieve a sustained global economic recovery. These need to address developing countries' concerns and enable them to continue to grow through trade, investment, remittances, aid, and technological innovation. Strategic intervention by governments is also required to provide new directions in order to achieve the United Nations MDGs.

At the international level, restoring trade finance and mitigating the risk of increased protectionism are immediate challenges. Concluding the World Trade Organization (WTO) Doha Round on balanced and pro-development terms will help, as well as harvesting some of the key development deliverables such as duty-free and quota-free treatment for least developed countries (LDCs). Maintaining and increasing ODA, including through aid for trade, will be important too, especially to build and strengthen productive capacities of developing countries, and related trade-efficiency and facilitation infrastructure.

At the interregional and regional levels, expanding and diversifying South-South cooperation is a viable solution to support and to increase developing countries' trade and investment performance. The crisis offers opportunities for strengthening South-South trade and investment linkages, including through reshaping the existing production supply chains (and creating more regional demand). Available policy instruments such as the Global System of Trade Preferences among Developing Countries (GSTP) and more comprehensive and effective regional trade and investment agreements should be consolidated and enhanced.

At the national level, the crisis has made it timely to review development strategies so as to make them more sustainable against future external shocks, focused on delivering broad-based and inclusive development, and responsive to the imperatives of preserving the environment, while also providing new economic opportunities. Developing countries need to continue to address income inequality and to invest more in education, training, trade-adjustment assistance, health care, community development and tax policy. The role of the state in promoting development has increased in light of the crisis, and there is a need to reflect on how this role can be effectively articulated.

A major challenge for developing countries is to continue to attract foreign investment during the crisis to stimulate economic activities, especially for such investment that serves long-term development goals and enhances competitiveness. Public investment programmes can help. Public-private partnerships are also important. Bilateral and regional investment agreements can encourage FDI. However, national efforts to maintain and attract foreign investment must not result in "race to the bottom" policies.

The United Nations – and in particular UNCTAD – has a special role to play in monitoring the impact of the crisis on trade and development, suggesting coping policies and measures, and building a new consensus on sound and suitable strategies at the national, regional and global level. Given the global span of the crisis, inter-agency collaboration will be crucial.

Introduction and overview

1. The world economy is currently facing a severe global crisis that has spilled from the financial sector to the real economy, including international trade in manufactures, commodities and services. The onset of the present crisis can be traced back to July 2007 with the liquidity crisis due to the loss of confidence in the mortgage credit markets in the United States. At first, there was uncertainty about the possible spillovers to the rest of the economy, and there was also discussion about the risks of contagion and decoupling, that is to say, the capacity of other countries – especially developing countries – to isolate themselves from the problems originating in the United States (which is the largest market for many countries). The hope was that the crisis would be restricted to financial markets, with few repercussions on the real economy and the rest of the world. This hope was shattered in September 2008 as the crisis entered an acute phase, with strong downward fluctuations in the stock markets, substantially reduced rates of economic growth, volatile exchange rates, and squeezes in demand and consumption, leading to falls in industrial production and decreasing flows of international trade and FDI, and causing impacts on related areas such as transfer of technology. The crisis has also been accompanied by increases in unemployment, with concomitant declining incomes and demand. Unemployment could rise by 50 million during 2009, taking the global unemployment rate to above 7 per cent.¹

2. By virtue of globalization, the moment the financial crisis hit the real economy and became a global economic crisis, it was rapidly transmitted to many developing countries through a contraction in trade finance and a slowdown in demand affecting bilateral trade flows. These transmission channels were particularly visible in sectors composed of global production and supply chains. As most developing countries are heavily dependent on developed country markets, the slump in demand from latter due to the crisis has had an adverse impact on the former.

3. Most developing countries are now closely linked to the global economy by trade and FDI flows. As a consequence of the crisis, the significant reduction of these flows is starting to restrain their development perspectives. Developing countries are currently seriously hurt through falling commodity prices, demand-driven drops in exports exacerbated by the deficit of credit and trade finance, capital outflows, declining remittances, and contracting investment. The prospects are more dire for export-oriented developing countries, especially those with a small domestic economy, where the reduction in international demand is more likely to curtail their exports and raise unemployment. As observed in some developing countries, workers are increasingly shifting out of dynamic export-oriented sectors into lower-productivity activities (and moving out of urban areas back into rural areas).

4. These impacts are being combined with the effects of the ongoing food crisis, volatile energy prices, and the climate change challenge (see box 1). Many developing countries are also dependent on ODA, which may shrink during the crisis. Potentially, the aggregate of all these effects could bring millions of people

¹ The financial and economic crisis: a Decent Work response, ILO discussion paper, March 2009.

back into poverty,² and worsen the conditions of those presently living in extreme poverty. This threatens to stall and reverse many years of efforts to achieve internationally agreed development goals, including the MDGs.

Box 1. Multiple crises affecting development

The first decade of the new millennium is thus ending with a situation of multiple crises affecting development. In early 2008, before the financial crisis, the global economy confronted a sharp surge in food prices, leaving many developing countries with citizens facing the threat of hunger. The food crisis arose from a number of factors, and it has led to a number of commendable efforts, including by the United Nations Secretary-General, to resolve the food security problem. In the medium to long term, UNCTAD has called it a “wake-up call” for the international community to address some of the more deep-seated, longer-term causes (see “Addressing the global food crisis: key trade, investment and commodity policies in ensuring sustainable food security and alleviating poverty”, UNCTAD/OSG/2008/1). Investing in agriculture, including with increased ODA, will have to be a priority in attaining food security. Reducing distortions in agricultural trade is another priority.

Furthermore, towards the middle of 2008, energy prices shot up dramatically and raised concerns about energy security for development. Since then, energy prices have declined equally dramatically. The volatility in energy prices has implications on both net energy exporters and importers, on sources of energy supply and interface with climate change, and on energy efficiency measures. The high level of volatility in energy prices has led to much introspection over the impact on economic growth and sustainable development in developing countries. UNCTAD’s report entitled “Energy-related issues from the trade and development perspective” (TD/B/C.I/2) addresses these issues.

The global financial and economic crisis envelops and compounds the impacts of the food and fuel crises. It has raised systemic issues regarding the international financial system and its governance. UNCTAD’s recent report entitled “The global economic crisis: systemic failures and multilateral remedies” (UNCTAD/GDS/2009/1) addresses some of the key areas where systemic failures occur in the international financial system – which UNCTAD has been pointing out over several years in its annual Trade and Development Report – and proposes a number of remedies.

The global financial and economic crisis also has impacts on international trade, commodities and investment, which are addressed in this report.

Furthermore, there is an ongoing need to address climate change by reducing greenhouse gases. This requires an increasing use of more climate-friendly development strategies.

Notwithstanding the dire conditions and the necessity of navigating through the troubled waters of the global economy, it is timely to review development strategies that will make economies more resilient, by addressing the deep-seated causes of the crises, and by fostering a process of economic growth and development that is sustainable, spreads the benefits widely and especially to the poor, and caters for the needs of future generations.

5. The global crisis and its lessons will be subject to extensive in-depth analyses as it progresses. There are many challenges to be addressed, but there are also policy areas which countries can develop – nationally and globally – to sustain trade and development. One challenge is to analyse specific development implications of the crisis, and suggest policy proposals to cope with its detrimental impacts in the short term and rethink development policy for the medium-to-long term. Significantly, signs are emerging of fundamental shifts in the way market economies operate and in the role of governments in economic activities. The crisis affecting development may require rethinking of the whole

² The World Bank estimates that a 1 per cent drop in growth in developing countries could trap another 20 million people into poverty.

economic and social paradigm that has prevailed over the last decades and has nurtured the process of liberalization and globalization. It may involve the articulation of ideas on trade and trade-related policies and sectors that have shown some resilience to the crises and can serve as a bulwark on which to restore confidence, build recovery and foster inclusive development. For the moment, however, it is still too early to assess the real depth of the crisis and its likely duration, and also the effectiveness of the mitigating measures being undertaken by various governments.

6. Countries are responding to the global crisis. At the national level, some countries, both developed and developing, have undertaken national stimulus packages to mitigate the detrimental impact, especially by providing credit, supporting affected domestic industries, and promoting jobs. At the level of the G20, leaders of the G20 countries met in London in April 2009 and pledged to undertake and promote measures to restore credit, growth and jobs in the world economy. At the global level, the United Nations General Assembly has agreed to convene “a United Nations conference at the highest level on the world financial and economic crisis and its impact on development” from 1 to 3 June 2009. This provides an opportunity for the United Nations as a whole to reflect on the causes of the crisis, assess the impacts on all countries, and suggest adequate responses to avoid a recurrence of the crisis and to restore global economic stability. The preparatory process and the conference will draw upon the report of the Commission of Experts of the President of the General Assembly on Reforms of the International Monetary and Financial System. These, and other initiatives, are indicative of the commitment of countries and the international community to comprehensively addressing the crisis and preventing it from ushering in a sustained period of global recession.

7. The purpose of this report is to provide an early assessment of the economic crisis and its effects on world trade in goods and services, commodities and investment, particularly from a development perspective. Chapter I discusses the decline in goods traded as a consequence of the crisis. Chapter II examines the boom-to-bust trends in commodity prices and the impact on the development prospects of commodity-dependent developing countries. Chapter III assesses the impact on trade in services and services sectors. Chapter IV discusses the impact on FDI, including FDI inflows into, and outflows from, developing countries. Chapter V suggests some policy responses, especially at the multilateral level, to cope with the impact of the crisis, including eschewing protectionist tendencies and restoring favourable conditions for trade expansion and sustainable development.

I. Effects on merchandise trade flows

8. Towards the end of 2008 (around October) the global recession started to manifest itself in international trade. The fall in global demand and the slowing-down in economic growth translated into a substantial reduction in international trade that has affected the cross-border trade of virtually all countries and economic sectors. This trend is particularly worrying from a development perspective. In most developing countries, international trade (exports and imports) serves an engine of growth and helps in a substantial way to fight poverty and raise living standards. Trade integration (by maintaining and increasing share of trade to generate development finance and drive industrialization) has been one of the main pillars of the development strategies

for many developing countries, concomitant with deepening processes of liberalization and globalization. But as UNCTAD analyses have described and proposed, such trade integration has to be calibrated, sequenced, and paced to fit in with the trade and economic conditions of countries. It is not only quantitative, but also qualitative, in the sense of spreading the benefits widely and improving personal, national and global welfare.³

1.1 Dependence on exports: developing countries are relatively more exposed to international markets

9. The extent to which developing countries' trade performance is affected by the current economic crisis depends on their dependence on international markets, their export compositions, and exchange rate fluctuations. In general, the more an economy has relied on exports to drive its economic development, the more problems it is likely to face in the current economic crisis. (The reverse is also true, as was seen up until the time of the crisis, i.e. the greater the integration into and dependence on international trade, the greater the opportunities to benefit when global trade prospers.) Countries exporting commodities may encounter further difficulties, as commodities prices have been falling. Finally, countries with currencies appreciating or pegged vis-à-vis the United States dollar may find their exports relatively disadvantaged compared to countries where currencies depreciated.

10. The degree of dependence of developing countries on international trade, and thus their exposure to external markets, as measured by the exports-to-GDP ratio, has greatly increased in recent years (see table 1). Developing countries' exports-to-GDP ratio, on average, accounted for more than half of their GDP in 2007, up from about a quarter of GDP in 1995. Some regional illustrations clearly show the extent of increased trade exposure. For example, the exports-to-GDP ratio for African countries was more than two times higher in 2007 than in 1995. Asia – especially South-East Asian region – has long been more integrated than most other developing regions, with exports contributing more than 60 per cent of GDP. Countries with economies in transition have rapidly become exposed to the world economy, with exports now contributing more than 85 per cent of GDP in 2007, as compared to 34 per cent in 1995.

11. LDCs' exports accounted for 45 per cent of their aggregate GDP in 2007 (this was only about 17 per cent in 1995), with shares especially high in the case of oil-exporting LDCs. Significantly, too, the contribution of exports to GDP in landlocked developing countries rose from 23 per cent to 58 per cent. In contrast, in developed countries, exports contribute to about one third of GDP today, as compared to about one fifth in 1995. While the degree of dependence on international trade in developed countries, overall, is much less than that of developing countries, it is nonetheless important for developed countries too, as a source of finance and growth stimulus. This means that all countries are much more heavily dependent on international trade today than in the past decades, to foster economic growth and attain national and internationally agreed development goals, including the MDGs. Developing countries and countries with economies in transition have a relatively greater exposure nowadays, and therefore a greater vulnerability, to international markets than do developed

³ For discussion, see, for example: Globalization for development: the international trade perspective (UNCTAD/DITC/2007/1).

countries. Keeping international trade flowing must therefore be a global priority, owing to the extensive dependence of all countries – especially developing countries – on international trade to build up national wealth and promote development.

12. In this context, it is worth noting that for developing countries, the most important markets are still those of developed countries, especially the United States, the European Union (EU) and Japan. For example, in 2007, about 21 per cent of developing countries' exports went to the United States, with 18 per cent and 8 per cent going to the EU and Japan respectively.⁴

13. South–South trade has been increasing in importance and has constituted one of the more dynamic components of international trade in recent years, but it has also been affected by the crisis. In 2007, South–South merchandise trade, in terms of exports, had increased more than threefold since 1995, and amounted to more than 46 per cent of developing countries' total trade.⁵ Such trade helped developing countries to diversify production and create new trade and investment flows.

Table 1. Exports-to-GDP ratio in 1995 and 2007 (in per cent)

	Exports-to-GDP in 1995	Exports-to-GDP in 2007
Developing economies	26.09	51.77
Africa	21.87	49.71
Eastern Africa	17.63	26.28
Central Africa	36.91	132.77
Northern Africa	17.05	41.98
Southern Africa	22.42	42.25
Western Africa	31.99	61.26
Asia	33.88	60.83
Eastern Asia	34.92	58.85
Southern Asia	11.54	23.28
South-Eastern Asia	62.17	100.03
Western Asia	26.46	80.15
Latin America and Caribbean	13.02	29.41
Caribbean	17.29	24.20
South America	10.75	25.98
Central America	17.73	37.72
Economies in transition	33.94	85.42
Least developed countries	17.08	45.23
Landlocked developing countries	23.28	58.71
Developed economies	21.87	28.40
Australia	16.08	27.93
Canada	32.46	48.06
European Union	29.84	54.47
Japan	9.96	13.45
United States of America	7.28	10.04

Source: UNCTAD calculations.

⁴ UNCTAD secretariat calculations, based on UNCTAD Handbook of Statistics database.

⁵ UNCTAD data, based on UNCTAD South–South Trade Information System.

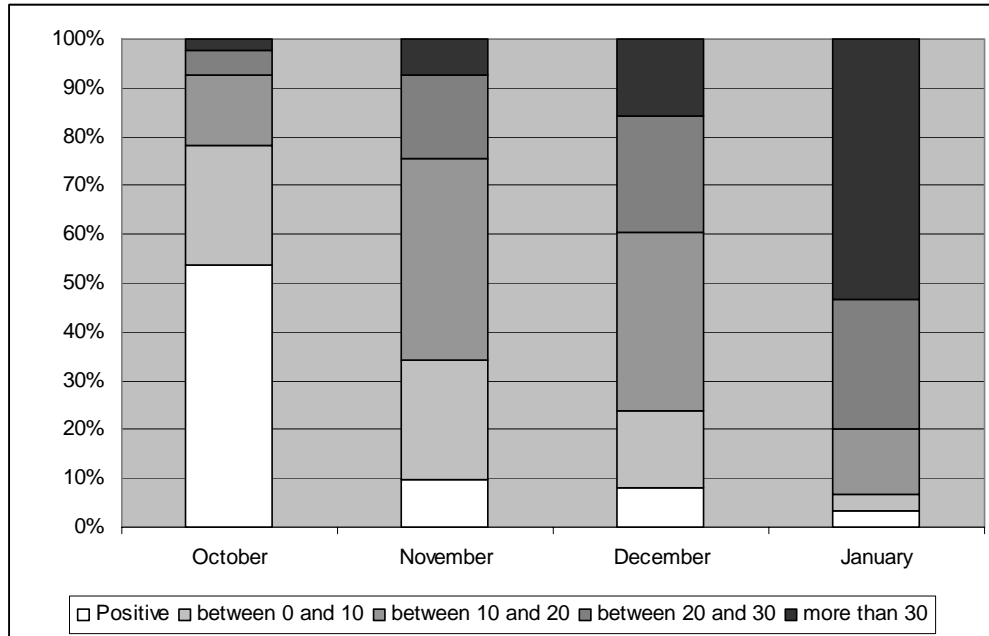
1.2 Impact on overall trade in goods: dynamism rapidly changes to a steep decline

14. In the last three months of 2008, an increasing number of countries started to report absolute declines in trade. Merchandise trade flows have been rapidly contracting since then, affecting an increasing number of countries and sectors. Figure 1 illustrates the fall of world trade towards the end of 2008 and in January 2009. In October 2008, of 41 countries reporting monthly data (the EU countries counted as one), about 18 countries reported a decrease in exports compared with the same month in 2007. The limited downturn in October became more widespread in November, and deteriorated further in December and in January 2009. In January, all but two countries reported decreases in exports, and about half of the countries with data available reported substantial export declines of over 30 per cent.

15. These numbers indicate the gravity and the global scale of the economic crisis, with virtually no country being unaffected. In January 2009 a substantial number of countries, including Chile, Hungary, the Philippines, the Russian Federation, Singapore and Sweden, recorded export declines of more than 40 per cent relative to January 2008. Data for February 2009 were still not available for most countries, but preliminary data suggest similar – if not sharper – declines compared to those of January. For example, preliminary data for China show that on a year-to-year basis, exports fell by 26 per cent (up from 17.5 per cent in January).⁶

⁶ The International Herald Tribune reported on 10 April 2009 some preliminary signs of recovery noted by Chinese manufacturers. Interestingly, these limited signs of international demand recovery were from other developing countries.

Figure 1. A deteriorating scenario
Distribution of 41 countries by rate of decline in exports
 (percentage change in exports relative to the same month of the previous year:
 October, November, December 2008; and January 2009)

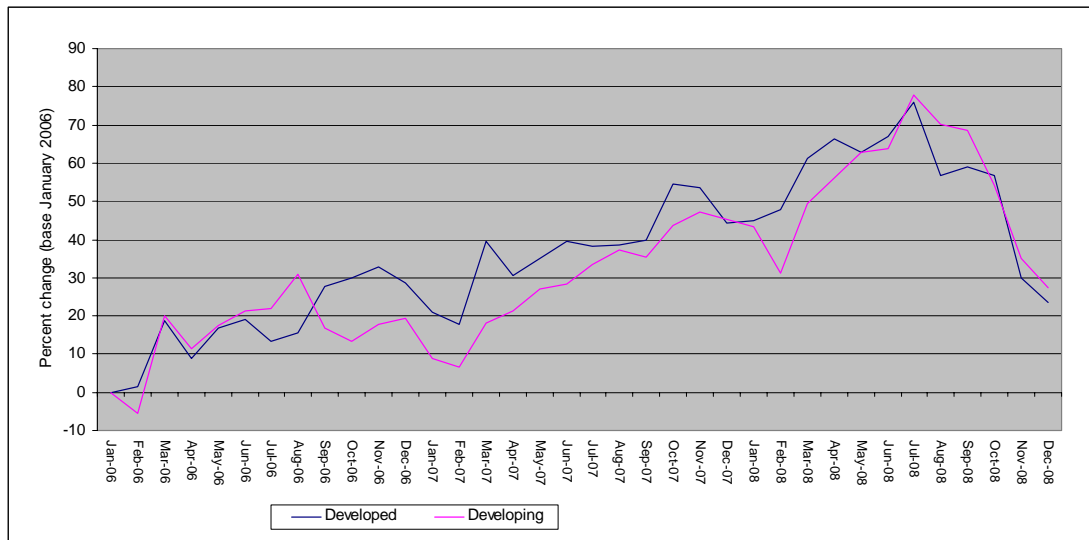


Source: UNCTAD calculations from national statistical sources.

16. To put the current downward trend into perspective, figure 2 shows a standardized series of exports for a sample of 41 developing and developed countries, as well as countries with economies in transition, for which recent monthly data are available.⁷ It shows the rapid growth of exports between January 2006 and July 2008. The peak was followed by a sharp decline beginning in the last quarter of 2008, taking exports down to levels not seen since early 2007. While these changes primarily reflect the movement in commodity prices – oil, in particular – the decrease is widespread, affecting both developing and developed countries.

⁷ Algeria; Argentina; Australia; Belarus; Brazil; Canada; Chile; China; China, Hong Kong; China, Taiwan Province of; Colombia; Costa Rica; Ecuador; Egypt; El Salvador; the European Union; Guatemala; Iceland; India; Indonesia; Israel; Japan; Malaysia; Mexico; Morocco; New Zealand; Norway; Paraguay; Peru; the Philippines; the Republic of Korea; the Russian Federation; Singapore; South Africa; Switzerland; Thailand; Tunisia; Turkey; Ukraine; the United States; and Viet Nam.

Figure 2. Exports trends 2006–2008
(Percentage change relative to January 2006 – based on United States dollar values)

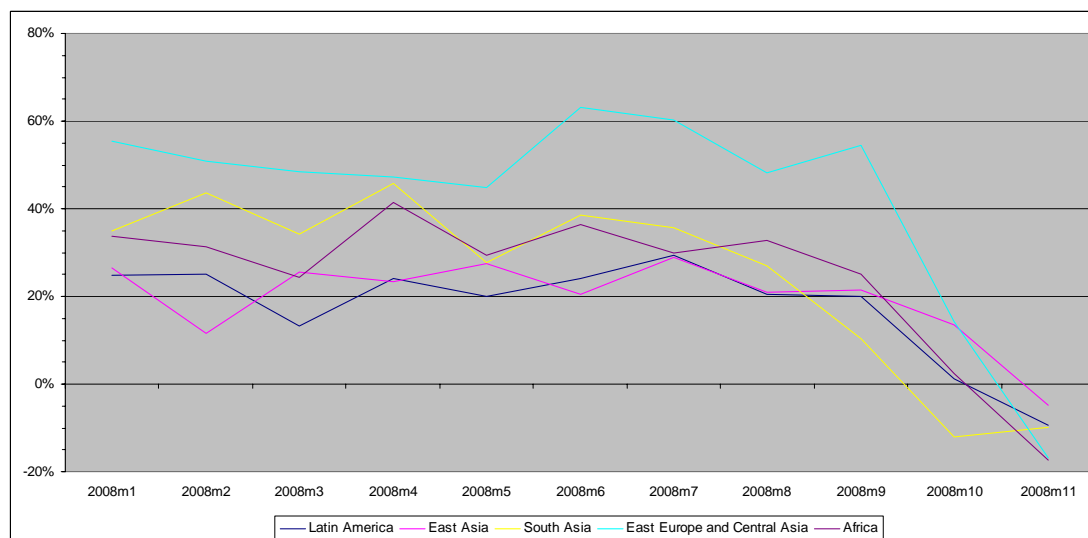


Source: UNCTAD calculations based on data from Datastream, Global Trade Atlas, and national statistical sources.

17. These declines are quite high, however the numbers should be interpreted carefully. International trade is generally expressed in United States dollars, and thus is heavily influenced by exchange rate fluctuations. Moreover, commodity prices were very high in the first half of 2008, inflating the overall value of international trade. The sharp drop in commodity prices towards the end of 2008 (the UNCTAD commodity price index fell by about 20 per cent between January 2008 and January 2009) similarly deflated the value of trade. Consequently, for many countries, the decline in international trade has been considerably smaller in volume terms, as well as in local currency terms. For example, Mexican pesos depreciated about 20 per cent vis-à-vis the United States dollar in 2008, while Mexican exports in dollar terms fell about 30 per cent. That results in a smaller decline in peso terms. Other countries, such as Brazil, Chile, and the Republic of Korea, have seen their currency depreciate by about the same extent as the fall in exports.

18. The decrease in trade has affected all developing regions. Moreover, South–South trade, which has been the most dynamic component of world trade for over a decade, also appears to have declined, especially intra-Asian trade. Figure 3 reports percentage changes in exports for developing country regions to the world in 2008 (in value terms).

Figure 3. Changes in exports – by developing country regions, in 2008
 (United States dollar monthly percentage changes, with respect to the same month in 2007)

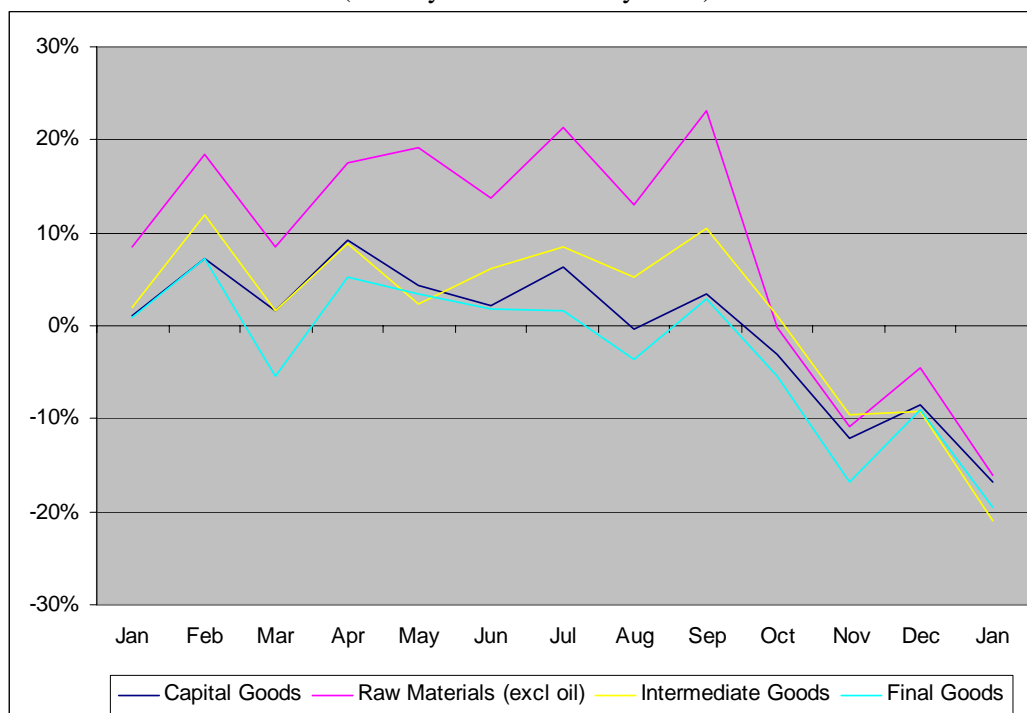


Source: UNCTAD calculations based on data from Datastream, Global Trade Atlas, and national statistical sources.

1.3 Goods sectors affected

19. The decline in international trade appears to be affecting all types of goods. Although disaggregated sectoral data are not yet available for most countries, import data illustrate that declines in trade flows have not been restricted to particular categories of products. Figure 4 reports similar changes in United States imports for capital goods, raw materials (excluding oil), intermediate products and final products.

Figure 4. Year-to-year change in United States imports, by product category
(January 2008 to January 2009)



Source: UNCTAD calculations based on USITC data.

20. United States import data suggest that the economic crisis is having repercussions not only on consumer demand, but also on intermediate and investment goods such as machinery. The decline has been the most pronounced in the case of raw materials, whose prices generally are highly volatile.

21. In general, trade in manufacturing (including non-agricultural commodities) has contracted at a much sharper rate than trade in agricultural products. This is due to the relatively more stable agricultural prices and to a more inelastic demand for agricultural products. Comparable data from November 2008 indicate an overall decline of manufacturing imports for the United States, the EU, China, Japan and Canada of, on average, approximately 15.7 per cent – three times that of agricultural products. Within manufacturing, the most affected sectors appear to be automotive products (with a 28.4 per cent decline in imports compared to November 2007), and office and telecommunications equipment (with a 19.8 per cent decline). Imports of textiles and clothing decreased by about 16.3 per cent and 8.4 per cent, respectively.

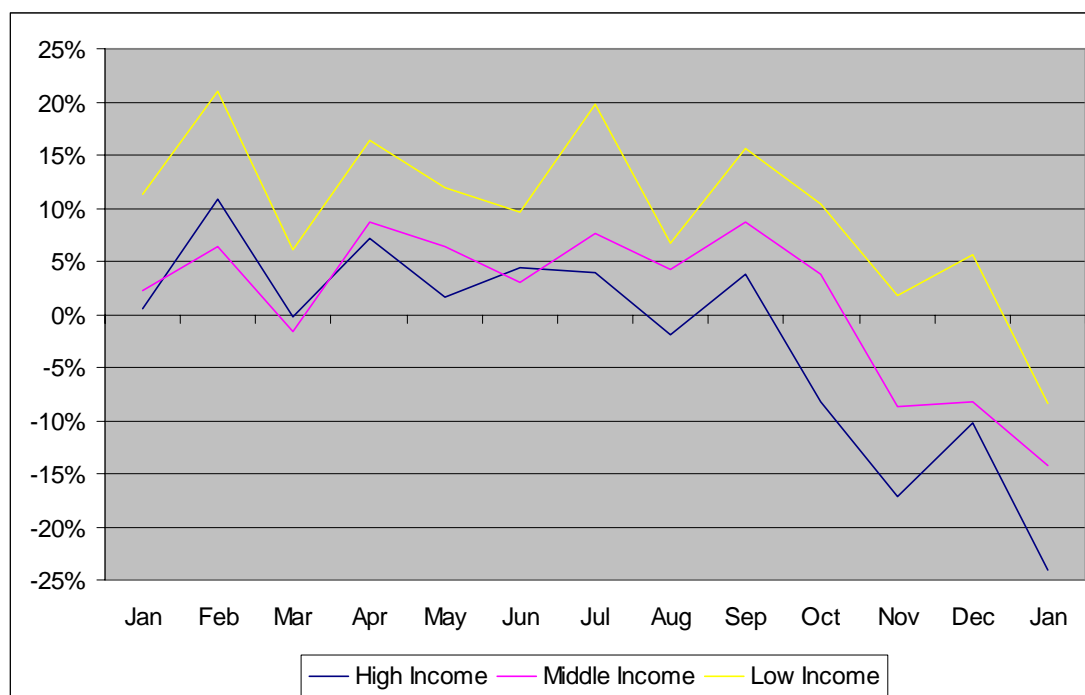
22. The sharp contraction of manufacturing imports is related to the current production and marketing schemes (chains) for manufactured goods. A growing number of exporters from developing countries are part of such schemes. Furthermore, a large share of today's international trade takes place within the bounds of the same firm. For example, over 46 per cent of United States imports are estimated to be intra-firm trade. In addition, for an average country, almost a quarter of its exports to the United States are also intra-firm.⁸ Intra-firm trade and the outsourcing of production processes are correlated with the magnitude and rapidity of contagion from developed to developing countries.

⁸ Intra-Firm Trade and Product Contractibility. NBER research paper. February 2008.

1.4 Bilateral and regional trade flows

23. Another issue to consider when analysing the impact of the economic crisis is how it has affected different trade flows. Although monthly data are still fragmentary, one way to explore this issue is to analyse the patterns of imports from some of the major countries into the United States (fig. 5).

Figure 5. Year-to-year percentage change in United States imports (excluding oil), by origin (January 2008 to January 2009)



Source: UNCTAD calculations based on USITC data.

24. On average, United States imports have been substantially affected by the current crisis, with overall declines of almost 20 per cent in the last two months of 2008. However, the extent of the contraction is quite different across countries. While United States imports from high- and middle-income countries substantially decreased in November and December 2008, imports from low-income countries actually kept increasing up until December 2008. Only in January 2009 did imports from low-income countries decline compared to the same month of 2008, although still at a much lower rate than those from middle- and high-income countries. Data from the European Union show a similar trend: while non-oil imports from high- and middle-income countries declined by about 10 per cent in the last months of 2008, imports from low-income countries increased by about 12 per cent on a year-to-year basis. Although preliminary, these data indicate that non-oil exports from low-income countries may be less affected by the fall in demand in high-income markets. This trend can partly be explained by export composition: low-income countries' exports consist largely of agricultural and raw materials, for which prices decreased relatively less.

25. Trade within regional trade agreements (RTAs) appears to have declined at a similar pace to trade outside RTAs. Intra-EU trade has been declining at rates

slightly higher than those of extra-EU trade (about 24 per cent versus 20 per cent in November 2008). Similarly, for the United States, imports from North American Free Trade Agreement (NAFTA) countries have been declining at a slightly faster pace than those from other countries. Regarding RTAs among developing countries, preliminary data from Brazil indicate that trade within the South American Common Market (MERCOSUR) has followed a similar pattern of decline.⁹ This gives a further indication of the widespread effect of the economic crisis on trade flows. It also provides preliminary evidence that RTAs are not immune from the effects of the global crisis, and intra-RTA trade could face even larger falls than extra-RTA trade. The potential of RTAs of developing countries to act as a buffer against inclement international trading conditions needs to be strengthened.¹⁰

1.5 Projections for 2009: trade will fall substantially

26. UNCTAD currently estimates world merchandise trade to fall between 6 and 8 per cent in 2009. Exports from developing countries and countries with economies in transition could potentially decline, in 2009, in the range of 7 to 9 per cent in volume. Developed countries' exports are projected to decline by up to 8 per cent this year. The trade contraction in value would be much greater.

27. The situation for LDCs also looks grim, in terms of an overall projected decline of exports this year (in 2009) of between 9 and 16 per cent. Landlocked developing countries could experience a potential export fall in the range of 9 to 13.5 per cent.

28. At the regional level, UNCTAD estimates that there could be a drop in exports in the Asia and Pacific region of between 7 and 11 per cent. Exports from Africa could shrink by between 11 and 16 per cent, while exports from sub-Saharan African countries (excluding South Africa) could decline up to 15 per cent. In the case of Latin America and the Caribbean, exports could drop by between 8 and 10 per cent.

29. To give some country examples, exports from Brazil could fall by more than 4 per cent in 2009. Exports from China and India could drop by 13.5–16 per cent and 8–10 per cent respectively. South Africa could face an approximately 5.5–7 per cent decline in exports.

30. UNCTAD estimates that major energy suppliers, such as the Russian Federation and Saudi Arabia, could experience a decline in their overall exports of 8.5–11.5 per cent and 5–6 per cent respectively in 2009.

1.6 Trade finance is drying up and needs to be replenished

31. The global economic crisis and the liquidity crunch imply dire consequences for the availability of trade finance – an important component of international

⁹ Data from the national source (Ministério do Desenvolvimento, Indústria e Comércio Exterior).

¹⁰ UNCTAD's Trade and Development Report 2007 can be of assistance in this regard, as it discusses some ideas on strengthening regional cooperation for development. See also the Report of the Multi-year Expert Meeting on International Cooperation: South–South Cooperation and Regional Integration on its first session (TD/B/C.II/MEM.2/3).

trade. Around 90 per cent of international trade transactions involve credit. Obtaining such finance has become scarce and costly, the bond market and syndicated loans are effectively non-existent, while customers are seeking longer repayment periods. Interest rates on export credits are climbing far above bank refinancing rates; with deals currently offered at 300–600 basis points over inter-bank refinancing rates, three times or more the going rate a year ago. Survey-based data point to a trade finance gap in developing countries of between \$100 billion and \$300 billion on an annual basis.¹¹

32. Therefore, it is increasingly more difficult and costly for developing country exporters to borrow from international financial markets or to apply for export credits and/or export insurance. Banks around the world are reducing or cancelling lending to developing countries, and cutting finance lines to importers and exporters. This is not only impacting the production capacity of developing countries, but also seriously jeopardizing their trade. According to the International Monetary Fund (IMF), trade financing of low-income countries dropped by 18 per cent in the fourth quarter of 2008.¹² Supply chain operations are also being disrupted by lack of financing for developing country suppliers, particularly in Asia.¹³ The G20 commitment to make available \$250 billion in the next two years (2009–2010) to support trade finance is a much-needed initiative that should be rapidly put in place.

II. Effects on commodity prices

33. The historically long commodity price boom between 2002 and 2008, which was a boon to commodity-dependent developing countries, was abruptly aborted in the second half of 2008. The outbreak of the global economic crisis and the impressive bust in commodity prices have basically wiped out the major part of the terms-of-trade gains achieved by commodity exporters over those years. At the same time, this has brought some relief to net commodity importers of food and fuel.

34. The price boom represented the commodity markets' response to the sustained high growth of the world economy, which started in 2002 and lasted until the middle of 2008 (see fig. 6). The majority of the growth was fuelled by dynamically growing developing countries with lower levels of efficiency in energy and in their use of other commodities. Such growth generated a sustained increase in demand for commodities, which has not been matched by a corresponding expansion in supply capacities. The latter had been constrained by underinvestment in capital base and human resources, including by ODA's neglect of agriculture during the previous two decades, which consequently did not allow reasonable proportions to be maintained between the levels of production and spare capacities, and between production/proved reserves ratios. In parallel, the hectic expansion of financial intermediation related to commodity markets, and especially to organized commodity exchanges, also contributed to higher levels of price volatility than had previously been the case. As a result,

¹¹ WTO. Report to the TPRB from the Director-General on the financial and economic crisis and trade-related developments (JOB(09)/30, 26 March 2009).

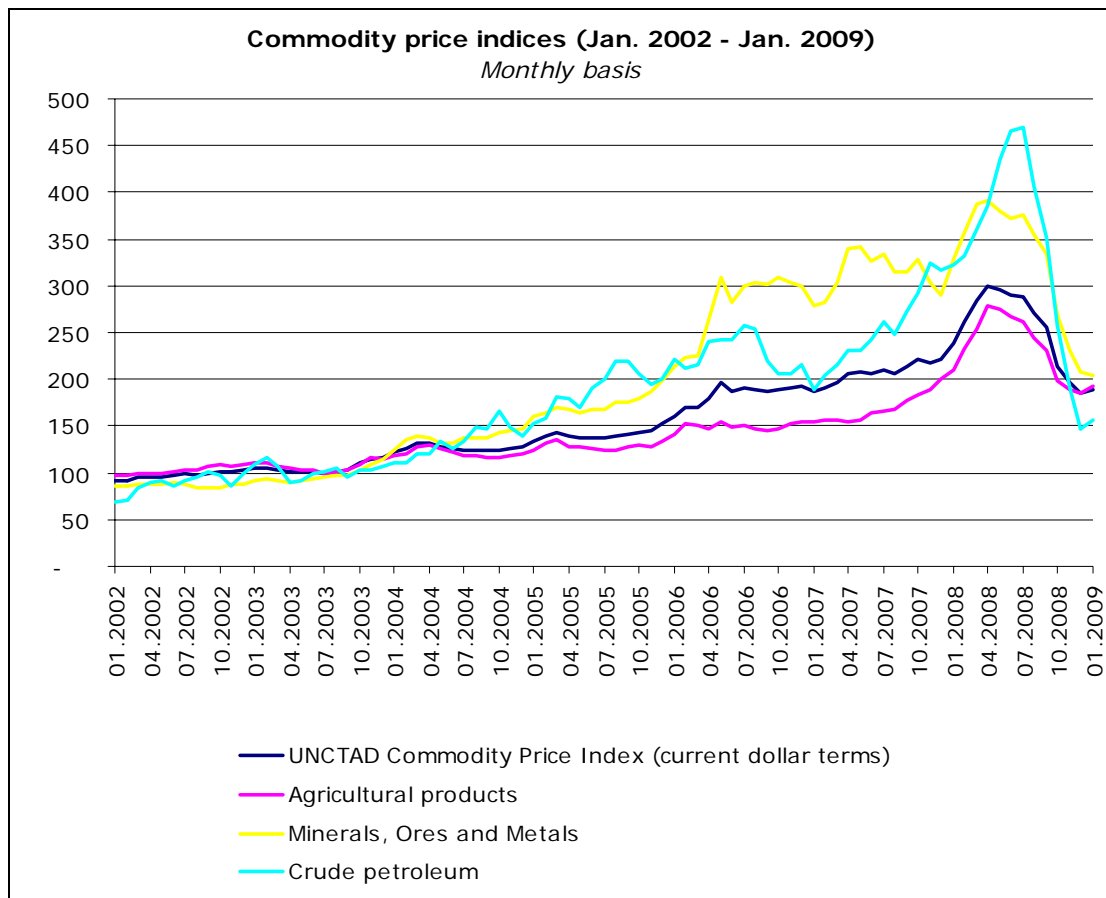
¹² The Implications of the Global Financial Crisis for Low-Income Countries. International Monetary Fund. March 2009.

¹³ The challenges of trade financing. Marc Auboin. Counsellor in the Economic Research and Statistics Division, WTO. 28 January 2009.

commodity prices increased spectacularly, reaching their peak levels by mid-2008. This did much to improve the balance of payments situation of commodity-dependent developing countries, but at the same time resulted in the emergence of the global food crisis.

35. The rise and fall of commodity prices were of an exceptional magnitude (apart from tropical beverages such as coffee, for which the decline was on a smaller scale). As shown in figure 6, the long and steep commodity price boom peaked in the middle of 2008. Prices then fell until the end of the year, and since then have levelled off (see also table 2).

Figure 6.



Source: UNCTAD Commodity Price Statistics

Table 2. The precipitous fall in commodity prices

Commodity group	Peak in 2008*	Jan 2009*	% change
All commodities (excluding crude petroleum)	299.5	189.4	-37
Food	280.6	196.5	-30
Tropical beverages	193.5	165.5	-15
Vegetable oilseeds and oils	370.5	191.7	-48
Agricultural raw materials	228.6	145.6	-36
Minerals, ores and metals	391.6	203.5	-48
Crude petroleum	469.5	155.6	-67

Source: UNCTAD secretariat calculations, based on *UNCTAD Handbook of Statistics* and *UNCTAD Commodity Price Statistics online*.

* Price indexes of all and main commodity groups (in terms of current dollars).

36. The contraction of orders for internationally traded commodities from the demand side and the deterioration of suppliers' financial positions (both inflicted by the banks' credit squeeze), strongly contributed to the dramatic falls in commodity prices and to the downturn in commodity production and demand. However, commodity prices are in many cases still above the pre-boom levels. Uncertainties about the length of the economic crisis and commodity price volatilities provide few incentives for new investments, even in cases where the necessary finance is available.

37. Many commodity exporters, particularly those in West Asia and Africa, and countries with economies in transition that benefited from the commodity price boom with considerable terms-of-trade gains, are now facing the downside of their commodity dependence, manifested in a substantial shrinking of export revenues. More than 90 developing countries earn at least 50 per cent of their exports from commodities (47 of them being non-fuel commodity exporters). For many other developing countries, commodities represent between 20 and 50 per cent of export earnings.¹⁴ Lower commodity prices are being translated into lower incomes for producers and lower fiscal revenue for governments, and also a worsening balance of payments situation, undermining the contribution made by commodities to the development process.

38. As UNCTAD has noted in its past reports, trade in commodities is of vital importance both to exporting and to importing countries. A large number of developing countries, in particular the poorest, depend on primary commodity exports. Those exports, so critical to the employment and income levels of poor farmers and fisherfolk, are a major source of government revenues, accounting for a large proportion of their resources to be used for financing development. On the other hand, importing countries need predictable and affordable access to supplies of raw materials in order to maintain and fuel industrial growth and satisfy the

¹⁴ World Commodity Trends and Prospects. Note by the Secretary-General, United Nations, A/63/267. August 2008, p.11.

consumption demands of their populations. Other concerns, particularly food security and energy security, are also important both to importing and exporting countries. Thus, the boom-to-bust cycle in commodity prices, interfaced with the global crisis, underlines the shared interest of all countries in ensuring that commodity production and trade constitutes a positive force for promoting growth and development, and alleviating poverty.

III. Effects on services trade and services sectors

39. Services constitute the new frontier for the development of international trade, and could provide the basis for reviving economic growth and development. Therefore, there is a need to put in place policies and strategies to enhance the contribution of services and services trade to development, particularly as the global financial and economic crisis is also cascading through the services sector in both developed and developing countries.

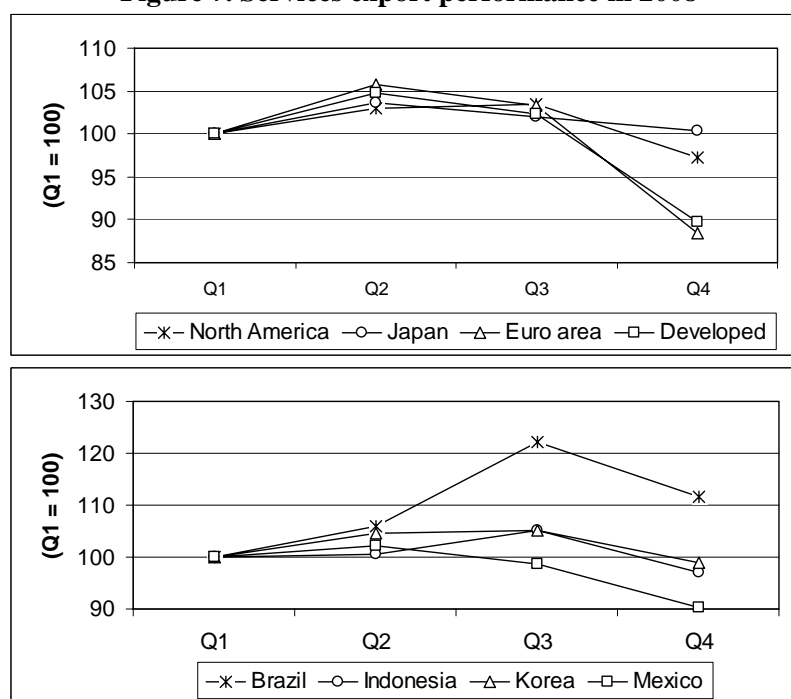
3.1 Trade in services

40. The global crisis has affected not only manufacturing trade, but also trade in services. Coming into the economic crisis, global year-on-year services exports were up sharply, rising by 11 per cent in 2008 to \$3.7 trillion, with an 8.5 per cent and 15 per cent rise achieved by developed and developing countries respectively. However, notwithstanding an overall increase in services exports relative to 2007, intra-year balance of payments data for 2008 clearly indicate that a turning point for services exports growth occurred in the third quarter of 2008, with a precipitous decline in the fourth quarter of 2008.¹⁵

41. As shown in figure 7, overall developed-country services exports dropped by 12 per cent moving from the third quarter to the fourth quarter of 2008. The euro zone marked the largest decline, by over 14 per cent. Not shown in the figure are data for developing countries, where fourth-quarter declines were also significant in several countries for which data is available. For example, in Brazil, Indonesia, Mexico and the Republic of Korea, fourth-quarter services exports fell by between 6 and 9 per cent.¹⁶ As balance of payments data for 2009 become available, the full impact of the economic crisis on services exports of both developed and developing countries will be clearer.

¹⁵ Calculations based on quarterly balance of payment data from SourceOECD.org

¹⁶ Calculations based on quarterly balance of payment data from SourceOECD.org

Figure 7. Services export performance in 2008

Source: Balance of payments data, Organization for Economic Cooperation and Development (OECD).

42. Although detailed services trade data by mode are not yet available for 2008, remittances from international migrants provide a picture, in relative terms, of the effect of the crisis and of rising global unemployment on services workers. According to the International Labour Organization (ILO), the crisis could increase world unemployment by an estimated 20 million persons, raising the number of unemployed people to over 210 million in late 2009.¹⁷ Moreover, to the extent that international migrants lose their jobs, a significant drop in remittances to developing countries is anticipated, particularly in sectors most affected by the crisis such as construction and tourism, which employ a large share of migrant workers. However, World Bank estimates suggest remittances would fall by less than 10 per cent in 2009, to levels between \$280 and \$290 billion, and that remittance flows can be expected to rise again when the global economy recovers, with current projections pointing to a return to a level of \$300 billion in 2010.¹⁸

3.2 Maritime transport is in a sharp decline

43. Transport markets normally react immediately to a downturn in demand. The price of chartering different specialized ships is an excellent indicator of the demand–supply balance for different goods, and the deployment of ships is an indicator of trade flows on specific routes. Maritime transport is of particular importance for some developing countries. Most ships are currently being built in developing countries (China, Republic of Korea), most seafarers are from developing countries (India, Indonesia, the Philippines etc.), ship-scraping takes place mostly in South Asia (Bangladesh, India, Pakistan), and many important

¹⁷ Global Employment Trends Report 2009, International Labour Organization.

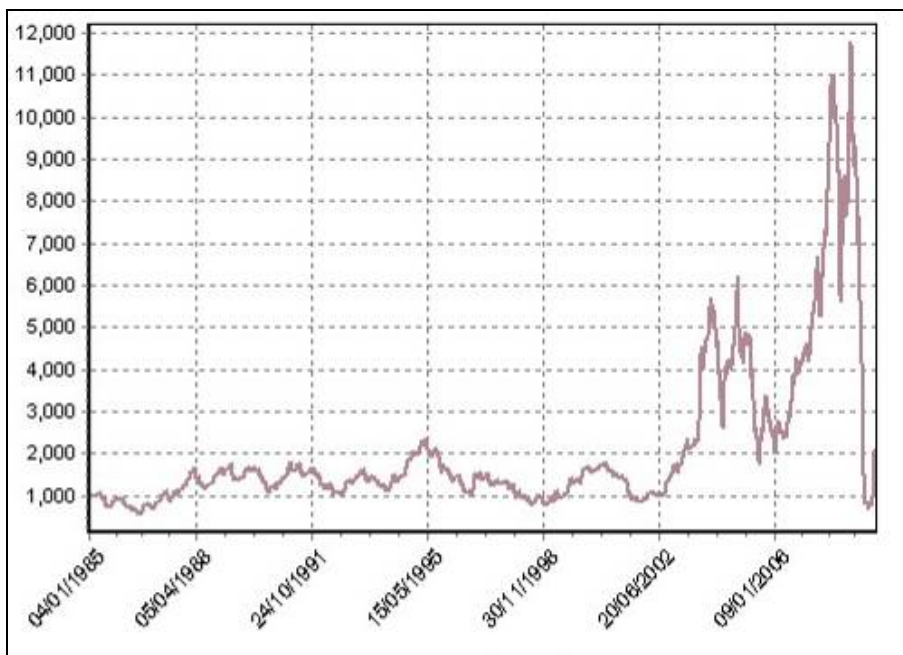
¹⁸ Migration and Development Brief, 9, 2009, World Bank.

shipping companies are headquartered in developing countries (mostly in Asia, with one container shipping company in Chile).

44. The downturn in international trade is confirmed by a number of leading indicators. The Baltic Dry Index (BDI) – a benchmark for global freight costs along key routes – fell substantially during the last months of 2008. The BDI is a composition of four indices covering different vessel sizes of dry bulk ships, i.e. ships that specialize in carrying raw materials such as iron ore, grains and coal. The demand for dry bulk carriers is a very good indicator for industrial production and economic growth, as the traded commodities are used as raw materials and energy supply in industrial production.¹⁹

45. During 2008, the BDI reached historic highs, followed by an extreme – and also historic – slump towards the end of the year (see fig. 8). The BDI's recent surge – a doubling within a few weeks – may reflect a regaining of confidence and demand for raw materials.

Figure 8. Baltic Dry Index, 4 January 1985 to 25 February 2009



Source: The Baltic Exchange. <http://www.balticexchange.com>

46. Other data, such as the routing and deployment of container ships, provide some further insights into the impacts of the global economic crisis on different regions. Although the global container ship fleet continues to grow in line with new deliveries, ships are increasingly being withdrawn from service, and others

¹⁹ Similar to the BDI for dry bulk vessels, there exist indices that capture the cost of chartering container ships, e.g. the Hamburg Index (HIX), which quotes container ship time-charter rates based on data from some 30 Hamburg-based brokers, published by the German Shipbroker Association.¹⁹ According to the HIX, for different container ship types, the charter rate declined by between 24 and 75 per cent during the 12 months to February 2009 (Dynamar: DYNALINERS ANNEX 08A/2009, 25 February 2009).

are being redeployed on different routes. A comparison of fleet deployment in February 2009 with mid-2008, for selected countries from different regions, shows how container carrying capacity is being withdrawn: Chile -22%, Barbados -33%, Angola -13%, United Republic of Tanzania -8%, India -2%, China -5%, and Fiji -3%.²⁰

47. Data on port traffic provide additional information on the downturn in containerized trade. Year-on-year data for January 2009 and 2008 port traffic show that Singapore, the world's largest container port, is down by 19 per cent; Hong Kong (China) is down by 23 per cent, Long Beach is down by 14 per cent, and Le Havre is down by 25 per cent.²¹

48. While those who provide shipping and related services suffer from low freight costs, importers and exporters ("shippers") benefit from the reduction in transaction costs. Until mid-2008, high freight costs, a shortage of shipping supply and congestions in ports were increasingly considered as obstacles and bottlenecks to further growth of trade. Today, transport costs have been significantly reduced. In February 2009, for example, it cost around \$2 to move one ton of dry bulk cargo a distance of 1000 miles in a small "Handy Max" vessel – down from \$16 eight months earlier. Thus, low transport costs may to some extent mitigate the various difficulties faced by importers and exporters. However, high volatility of costs increases risks to traders and suppliers of transport services.

3.3 Evidence from other services sectors

49. Maritime transport and other infrastructure services are closely linked to and are central inputs for other economic activities, including as support services to industry and agriculture. Therefore, as manufacturing activity has declined in the current crisis, so too has activity in related services sectors, such as financial, transportation, telecommunications and energy services. Output and trade are decreasing for many other services sectors too, including tourism, construction, distribution, and information and communications technology (ICT) services.

50. Figures recently released by the World Tourism Organization²² show that international tourist arrivals flattened or exhibited negative growth in each of the last six months of 2008. The 5 per cent growth rate recorded between January and June gave way to a 1 per cent decline in the second half of the year. The World Tourism Organization now projects world tourism to decline by up to 2 per cent in 2009, with markets in the Americas and Europe showing the highest downturns.

51. Construction services have also been affected by the crisis. New home construction starts in developed-country markets declined sharply in 2008. For example, in the United States and the United Kingdom, new housing starts fell by 33 and 37 per cent respectively in 2008.²³ Overall, European construction output

²⁰ UNCTAD connectivity data base, derived from Containerization International Online.

²¹ Containerization International Online. 20 February 2009.

²² World Tourism Organization. International Tourism Challenged by Deteriorating World Economy. Press release. 27 January 2009.

²³ Based on data from the United States Census Bureau and the United Kingdom Department for Communities and Local Government.

is expected to fall by 5 per cent in 2009, following a 3 per cent drop in 2008.²⁴ Rising inventories of new and existing homes, and increasing vacancy rates in commercial property markets, have resulted in a significantly contracted market for construction services in many developed-country markets. Moreover, globally, the construction market is projected to shrink to \$5.6 trillion in 2009, and global construction spending will not hit its 2007 peak of \$5.8 trillion until 2011.²⁵ Every region except Asia will see declines in construction spending. Asian growth will be 2.6 per cent, well below the double-digit increases seen in recent years, as spending in China and India slows significantly. Markets in the Gulf Cooperation Council countries in 2008 experienced some of the largest declines, with growth in the value of new construction contracts falling by some 60 per cent over the past year.²⁶

52. Other services sectors are also expected to show reduced activity as the crisis plays out. In the retail sector, for example, the United States Department of Commerce recently reported that retail sales were down 0.1 per cent – a sharp turnaround from a 4.1 per cent gain in 2007, and the first annual decline in retail sales figures on government records since 1992. Moreover, United States e-commerce sales dropped in the fourth quarter of 2008 by 5.7 per cent, which was the first quarter of negative growth since 2001.²⁷ Retail sales in the EU fell by 1.4 per cent in 2008, following a revised 0.1 per cent increase in 2007.²⁸

53. In ICT services, a recent global survey by Forrester Research found that 43 per cent of developed-country firms are reducing their ICT spending and some 30 per cent are scrutinizing ICT projects for better returns.²⁹ The market segment most significantly affected by reduced spending is outsourcing in the banking and financial services sector, which has contracted due to delays in management initiatives arising over spending constraints in the banking sector. For the ICT services sector overall, the slowdown in the United States economy has seen 70 per cent of firms negotiating lower rates with suppliers and nearly 60 per cent cutting back on contractors. At the same time, however, over 40 per cent of firms surveyed plan to increase their use of offshore vendors, indicating a potential opportunity for developing-country ICT service providers. Thus, compared with trade in manufactures and services in general, trade in ICT-enabled services may be considerably less affected by the economic downturn, as companies see offshoring of services as one method of enhancing their competitiveness.

²⁴ European construction set for sharp fall in 2009. Construction Europe. 12 December 2008.

²⁵ World Construction Market Hit with Steepest Drop in 20 Years. 2 April 2009. IHS Global Insight. Lexington MA, United States.

²⁶ The GCC Economies and the Crash: Short-term Weaknesses, Long-term Strengths. Middle East Institute, Singapore. April 2009.

²⁷ Quarterly retail e-commerce sales, fourth quarter 2008. United States Census Bureau News. 17 February 2009.

²⁸ Eurozone retail sales fall faster than expected. EUbusiness.com. 3 December 2008.

²⁹ Impact of Economic Downturn on Tech Spending. Forrester Research. 9 September 2008.

IV. Effects on foreign direct investment

54. There is ample evidence that the global crisis is having a negative impact on international investment.³⁰ Tighter credit conditions and lower corporate profits have weakened companies' capability to finance their overseas projects; while the global economic recession and a heightened appreciation of risks have eroded business confidence. Many large TNCs have revised their global expansion plans downward, and divestments have taken place. The trend is widespread, hitting all sectors and all three major types of foreign investment (i.e. market-, efficiency- and resource-seeking foreign investment). FDI flows to financial services, automotive industries, building materials, intermediate goods, and some consumption goods have been the most significantly affected, but the consequences of the crisis have been quickly expanding to FDI in other activities, ranging from the primary sector to non-financial services.

55. The situation is rapidly deteriorating. UNCTAD estimates³¹ that global FDI inflows declined by 15 per cent in 2008, to about \$1.6 trillion (fig. 9). This sharp decrease marks the end of a growth cycle which lasted four years. Further decline is anticipated for 2009, especially as regards flows into developing countries. This has raised major concerns about how long the downturn will last and how deep it will go. In this regard, for the period 2010–2012, three scenarios can be envisaged (see fig. 9), the probability of which depends on a wide range of factors, including in particular the evolution of the financial crisis itself, the severity and duration of the global recession, and the efficiency and effectiveness of policy responses:

- **V scenario (optimistic): Quick upturn in FDI flows, beginning end 2009.** Underlying assumptions are: (i) end of the recession as early as the second half of 2009; (ii) quick return of investors' confidence, due, among others reasons, to efficient government policies; (iii) no protectionist setback; (iv) fresh wave of cross-border mergers and acquisitions due to industry restructurings and availability of cash in some companies and financial institutions. Based on a combination of very optimistic assumptions, this scenario seems rather unlikely as seen from today.
- **U scenario (base-case). FDI flows begin to pick up only in 2011.** Major underlying assumptions are: (i) global recession is worse than in the V scenario, lasting at least until the first semester of 2010; (ii) the global value of cross-border mergers and acquisitions remains limited, due to the low price of stocks; (iii) the trend towards the internationalization of companies is still at work in the medium term. This might be the most probable scenario (UNCTAD 2009, forthcoming).
- **L scenario (pessimistic). FDI flows do not pick up before 2012.** Underlying assumptions are: (i) a longer and worse-than-expected economic depression results, among other things, in protectionist tensions affecting the overall trend in globalization; (ii) due to the accumulation of negative factors, companies remain extremely cautious about investments, especially those aimed at financing their international development.

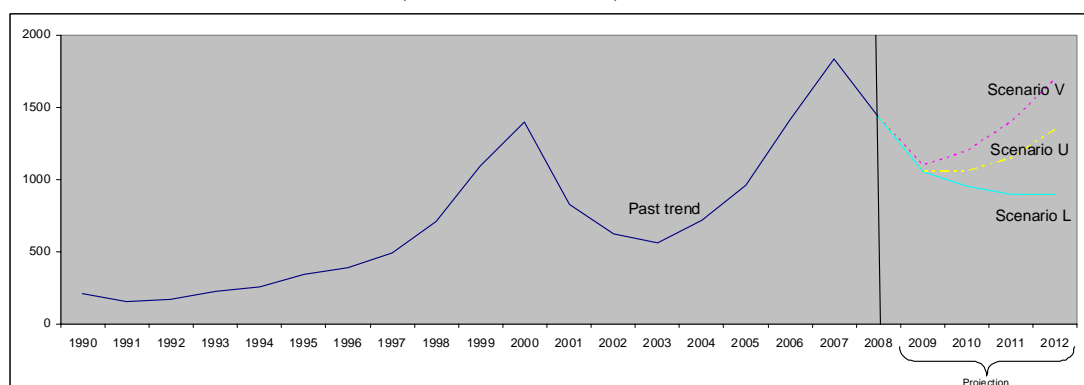
³⁰ See: Assessing the impact of the current financial and economic crisis on global FDI flows. Note prepared by the UNCTAD secretariat. April 2009.

³¹ *Idem*.

56. The negative impact of the current financial crisis and the economic aftermath from it on FDI are likely to become stronger, and a further decline in global FDI flows is expected at least in the short-to-medium term.

57. There are however a few positive forces still at work that can provide some relief to global investment flows. These include, for example, investment opportunities triggered by cheap asset prices and industry restructuring, large amounts of financial resources available in some dynamically growing countries such as sovereign wealth funds, and quick expansion of new activities such as fuel switching, renewable energy, material/resource/energy efficiency and some other environment-related industries. In particular, the financial crisis and the tough economic period ahead may create good opportunities for companies to buy assets at bargain prices, which can help to promote cross-border mergers and acquisitions. Also, the various economic stimulus programmes recently launched in many countries may have a positive impact on FDI inflows. The commitment of G20 leaders to take steps to facilitate trade and investment may also help to improve business confidence among companies.

**Figure 9. Global FDI inflows, 1990-2008,
and three scenarios for the period 2009-2012**
(billions of dollars)



Source: UNCTAD, based on FDI/TNC database (www.unctad.org/fdi statistics) and UNCTAD own estimates.
Note: the shapes of V, U and L scenarios are for illustrative purposes only and not based on any statistical methods.

4.1 FDI inflows

58. The global economic crisis has translated into a sharp decline in FDI inflows both for developed and developing countries. FDI into developed countries in 2008 decreased by an estimated 25 per cent compared to 2007, mainly as a result of the protracted and deepening problems affecting financial institutions and the liquidity crisis in financial markets. As cross-border mergers and acquisitions account for the bulk of FDI in most developed countries, these countries are particularly vulnerable to the credit crunch.

59. In developing countries and countries with economies in transition, preliminary estimates suggest that FDI inflows were more resilient in 2008. For these countries, growth of FDI inflows, while much lower than in 2007, might still have remained positive, except for flows to West Asia. However, the estimated 7 per cent growth rate for 2008 as a whole does not reflect the current critical situation in some developing economies, as the global crisis started to

affect FDI inflows to them only in the last quarter of the year.³² An outright decline in FDI inflows to the developing world at large is very likely in 2009.

60. Concerning the prospects for FDI inflows, almost all developing countries and countries with economies in transition have been affected by the global financial and economic crisis, but to different degrees. The setback is associated with a rising wave of restructuring and divestment and the cancellation of a large number of greenfield projects, as well as a decline in cross-border mergers and acquisitions. Compared to cross-border mergers and acquisitions, international greenfield investments were less impacted in 2008. But they are increasingly being affected in 2009, as a large number of projects are currently being cancelled or postponed.

61. Countries with healthy macroeconomic fundamentals and robust financial systems are likely to recover sooner. Despite clear signals of economic slowdown, a number of large dynamically growing economies may remain attractive to market-seeking FDI, thanks to their market sizes and growth potentials. Certain categories of developing countries however may be particularly vulnerable:

- (a) Developing countries and countries with economies in transition that have open but fragile financial systems risk entering into a “downward spiral” of financial market de-leveraging, currency fluctuations, falling international reserves, rising current account deficits, and a weakening fiscal position. Appeals for assistance have been made by some EU and non-EU countries in Eastern Europe, such as Belarus, Hungary and Ukraine, and also by a number of Asian countries, including Pakistan, the Republic of Korea and Turkey. If such countries do not succeed in regaining financial and macroeconomic stability, FDI inflows may be in sharp decline due to a high perceived level of risk.
- (b) In developing countries reliant on external demand, exports are plunging, leading to a significant slowdown in economic growth. These countries may face an apparent setback in efficiency- and market-seeking FDI inflows, due to collapsed growth prospects in both local and international markets.
- (c) FDI inflows may lose momentum in developing countries with a high degree of dependency on natural resources. During the past few years, FDI growth in some low-income countries in Africa and Latin America has been driven by resources-seeking investment. The recent and sharp decline in mineral and energy prices is affecting not only the export earnings and growth potential of producing countries, but also their prospects of attracting FDI.
- (d) LDCs are especially vulnerable to external shocks from the global financial crisis. They face unprecedented challenges from the possible dry-up of financial flows from both official and private sources. In particular, they risk being further marginalized in the global FDI scene due to the reduced availability of FDI flows at both global and regional levels and to stiffer competition among countries for attracting such flows. Among the LDCs, those countries with a high degree of dependency on mineral exports are likely to be the most negatively affected, as increasing numbers of mines are being closed or suspended by foreign investors. In the Democratic Republic of the Congo, for example, there has been a spate of mine closures forced by

³² Global FDI in decline due to the financial crisis, and a further drop expected. *UNCTAD Investment Brief*. Number 1. 2009.

the global economic downturn, and fly-by-night investors have undermined the mining industry's sustainability and the welfare of its workers.³³

4.2 FDI outflows

62. FDI outflows from the South are also set to slow down, but to a lesser degree than those from the North. Therefore, the share of developing countries in global FDI outflows continues to rise, highlighting an increasingly significant presence of TNCs from the South. Like their counterparts in developed countries, many of them see their capability and propensity to invest abroad inevitably weakened due to the global financial crisis. For example, Hutchison Whampoa (Hong Kong, China) – the largest TNC from the region and from the developing world as a whole, and a leading conglomerate in the global infrastructure industries – has announced that it would suspend all new investments in its global operations. However, in a few dynamically growing countries, the driving forces of capital outflows, such as a large amount of foreign currency reserves, enhanced firm competitiveness and supportive government policies, are still at work. In addition, companies and sovereign wealth funds from these economies are, in general, less affected by the financial turmoil than are enterprises in developed countries; they may continue to be active in overseas investment as part of their long-term strategies and become more important actors in the global FDI arena. For them, the global financial crisis and tough economic period ahead may create good opportunities to buy bargain assets, which can help promote cross-border mergers and acquisitions.³⁴ However, they have also become more cautious in view of the considerable financial losses that some recent overseas investments have caused.

V. Policy responses – keeping international trade and investment flowing and reviewing development strategies

63. The global financial and economic crisis has stimulated consideration and implementation of mitigating policies and measures by countries and the international community. Some of these measures are valid in terms of safeguarding domestic industries and jobs. They can, however, have the unintended impact of constraining trade growth and thus undermining the economic growth prospects of other countries, in view of the deeper interdependence between countries. There is a need to carefully monitor and review such policies with a view to ensuring that such measures also help to build up growth prospects in the world economy. Given the intricacies of the crisis and linkages with the food and fuel crises, as well as the climate change challenge, this is an opportune time, a wake-up call, to review development strategies and the contribution that international trade can make. Some ideas are provided below

³³ See: Barney Jopson. Congo miners suffer as boom turns to bitter bust. *Financial Times*. 10 March 2009.

³⁴ In February 2009, for example, Rio Tinto proposed selling minority stakes in some of its best assets to Chinalco to raise \$12 billion. It was also raising \$7 billion through an issue of bonds to the Chinese group that can be converted into equity, further increasing its stake in Rio Tinto to as much as 18 per cent after its purchase of a 9 per cent stake in the company in February 2008.

with a view to stimulating wider debate and the evolution of a consensus on shock-resilient, welfare-improving and environment-friendly trade and development paths.

5.1 *Protectionism is still a threat*

64. In a situation of global recession, there is a risk of more protectionist trade policies being implemented simultaneously by many governments.³⁵ It is now widely recognized that increased and excessive trade protection in one country is likely to lead to retaliation by other countries in the presence of a global negative shock (the beggar-thy-neighbour policies). The overall result can only be a worsening of the situation for each single country. Protectionist impulses are likely to be lower in the present economic crisis than in past crises. Business interests are often transnational, and multinational firms have little incentive to lobby for protection. In addition, there are also more elaborate and detailed multilateral trade rules under the WTO, including a more effective dispute settlement system. Globalization has also enhanced the integration of countries, and their dependence on each other. All of these realities should act against protectionism. The G20 pledge “to promote global trade and investment and reject protectionism, to underpin prosperity” should be effectively implemented in the period ahead in order to head off protectionist tendencies.

65. Over recent months, many national governments have resorted to various policy measures to safeguard domestic industries and employment affected by the global crisis. Various WTO members have implemented a number of WTO-consistent protective measures over the past few months (as reported by national sources). By using their existing national policy space, countries can respond to the current crisis by increasing protection to reduce imports, without necessarily violating WTO rules, in a number of ways: increasing tariffs within the bindings, using measures of contingent protection such as safeguards and anti-dumping, providing allowed subsidies, managing currency exchange rates and applying other, more subtle, non-tariff measures such as restrictive safety, health and technical regulations and standards. Measures consistent with trade rules should not be normally called “protectionist”. However, the main danger is in their excessive and/or abusive use by trading partners.

66. With regard to investment, there are few signs of deliberate government actions to impede the cross-border flow of investment in reaction to the crisis. However, there is a risk that the massive increase in state intervention and the greater role of governments as economic agents could have a downside in terms of indirectly impacting investment policies, especially in terms of active policies favouring investment domestically and discouraging investing abroad.

67. The economic stimulus programmes of developed countries are much larger than those of developing countries and might eventually substantially alter conditions for competition and future investment decisions by TNCs. Furthermore, numerous governments in developed countries have partially or fully nationalized domestic companies or are envisaging such a step. This primarily affects the financial sector, but it also concerns other economic activities. For instance, the French Government established a Strategic Investment Fund in December 2008, which since then has acquired shares in several

³⁵ For a critical review and discussion, see Baldwin and Evenett (2008).

distressed companies. In February 2009, it augmented its capital participation in VALEO, a French producer of car parts.³⁶ A combination of political considerations and economic needs may induce governments to concentrate the business operations of these new state enterprises on the domestic market and to reduce taxpayers' exposure by scaling down investment abroad. One case in point is the Royal Bank of Scotland, which is now in the majority ownership of the Government of the United Kingdom. It has been reported that despite operating profitably, there are plans to sell all or parts of the bank's Asian affiliates.³⁷ Reducing foreign investment, including divestment abroad, may be an economic necessity and may be unavoidable even in the absence of state intervention. Much depends on whether the trend towards more state ownership and control remains a temporary "fire fighting" measure during the crisis, or whether it results in more permanent structural changes with long-term implications.

68. To some extent, the financial crisis and the corresponding government responses have also had an impact on outward investment from developing countries, in particular the dynamically trading and investing countries. Nationalization policies and increasing state interference reduce investment opportunities for private investors – domestic and foreign – and may create an investment disincentive. While many private investors may currently not have much interest in acquiring enterprises that were or are to be bailed out, state ownership or control may become a more serious investment obstacle in the future if it is maintained after the actual crisis is over.

5.1.1 Tariffs

69. The process of liberalization over the last two decades – unilaterally, regionally and multilaterally – has reduced applied tariffs well below bound rates in many developing countries, thus creating a significant margin for increasing tariffs within WTO bound levels. The International Food Policy Research Institute estimates (in table 3) suggest that if all countries were to raise tariffs to the maximum they are allowed, the average global rate of duty would double. As shown in table 4, the actual binding coverage remains lower for developing countries and especially LDCs. On average, 20 per cent of tariff lines for non-agricultural products are not bound in the case of developing countries. The figure jumps to more than 50 per cent for LDCs. It is still around 4 per cent for developed countries. This means that on those lines, countries are free to apply, at least on a most favoured nation (MFN) basis, the higher level of tariff rates within bound levels, without violating their WTO obligations.

³⁶ See *Neue Zürcher Zeitung*. 26 February 2009, p. 23.

³⁷ See: *Le Monde*. 24 February 2009.

**Table 3. Tariffs faced by high-, middle- and low-income nations:
status quo vs. bound rates**

	Protection faced by exporters from:		
	High-income	Middle-income	Low-income
Status quo	4.6%	4.6%	4.0%
Tariffs raised to bound rates	9.0%	8.9%	11.7%

Source: Bouet and Laborde (2008).

**Table 4. Binding coverage, MFN bound and applied rates
(simple average HS-6 Digit level, percentage ad valorem)**

		Binding coverage	MFN bound	MFN applied
Developing	<i>Total</i>	81.5	40.4	10.5
LDCs		54.9	59.9	13.4
Transition		100.0	7.1	7.4
Developed		96.6	11.6	5.5
Developing	<i>Non-Agri</i>	78.8	30.4	9.6
LDCs		48.0	44.4	13.1
Transition		100.0	6.3	6.6
Developed		96.1	6.3	3.0
Developing	<i>Agri</i>	100.0	58.7	16.8
LDCs		100.0	74.8	15.6
Transition		100.0	12.5	12.6
Developed		100.0	43.9	22.2

Source: World Tariff Profiles (2008) and UNCTAD secretariat computations.

70. WTO reports several instances where some countries have recently raised import tariffs within their bound limits.³⁸ On the other hand, several governments have been also decreasing tariffs, so there is no clear trend so far indicating that overall import tariffs are becoming more restrictive.

5.1.2 Non-tariff measures

71. In times of economic crisis, countries may be more inclined to resort to non-traditional forms of trade-restrictive measures, especially those where multilateral rules and disciplines are lacking or are not fully developed. For example, some policy responses to the recent global food crisis have taken the form of export restrictions and price regulations. Moreover, the increasing environmental and labour-standards awareness is likely to lead many developed countries to consider new kinds of standards and requirements that their trading partners would need to meet, further complicating the competitiveness of countries.

³⁸ WTO. Report to the TPRB from the Director-General on the financial and economic crisis and trade-related developments (JOB(09)/30, 26 March 2009).

72. Although there has been no evidence of a widespread or systematic increase in the number or the restrictive application of non-tariff measures so far, the fragmentary data are providing preliminary indications of a recurrence of the use of non-tariff measures. For example, a number of countries have recently imposed more strict import licensing requirements for some sensitive goods such as steel products. Moreover, it appears that the use of safeguards and anti-dumping measures is on the rise, both in developed and developing countries. According to a WTO report, the number of anti-dumping investigations increased by 27 per cent in 2008 compared to 2007.³⁹ Anti-dumping measures could be among the most disruptive instruments, with potentially serious negative effects on trade, and hence the rise in the use of such measures is a concern. For countries that impose such trade remedies, it would be important to consider their impact on downstream users of the affected imports, especially small and medium-sized enterprises, as well as the wider economic effects.

5.1.3 Subsidies

73. Some governments, mostly in developed countries, have announced plans to expand the use of subsidies, often as a part of national economic stimulus packages. Subsidies can be highly distortive to trade. As is the case for tariffs, they artificially improve the competitiveness of those producers receiving the subsidy not only domestically but also in international markets. By supporting companies that would otherwise have been unable to compete, the subsidies may put otherwise healthy companies in an uncompetitive position, forcing even more subsidies. Subsidies are actionable under WTO rules and can be countervailed. Therefore they may, in turn, generate a chain of countervailing measures and increased protection.

74. Most subsidies granted to domestic producers in the last few months have been directed to the car industry. This has been the case of the United States, Canada, Sweden, Germany, France, Australia, Argentina, the Republic of Korea, China, the Russian Federation and Italy. The most significant of these have been the United States' approved federal loans of \$17.4 billion for General Motors and Chrysler, and France's auto package of €7.8 billion to PSA Peugeot Citroën and Renault. The various forms of loans, credit, and tax exemptions or reductions proposed for the car industry are likely to constitute subsidies in the sense of the WTO Agreement on Subsidies and Countervailing Measures. Therefore, these measures could potentially risk WTO complaints and counteractions by trading partners.

75. Among other measures, the "Buy American" clause in the \$787 billion United States stimulus package (the American Recovery and Reinvestment Act 2009) that requires the use of local over foreign products in public projects has preoccupied many trading partners. However, it will be administered "in a manner consistent with the United States' obligations under international agreements", such as the WTO Agreement on Government Procurement.

³⁹ WTO, *Ibid.*

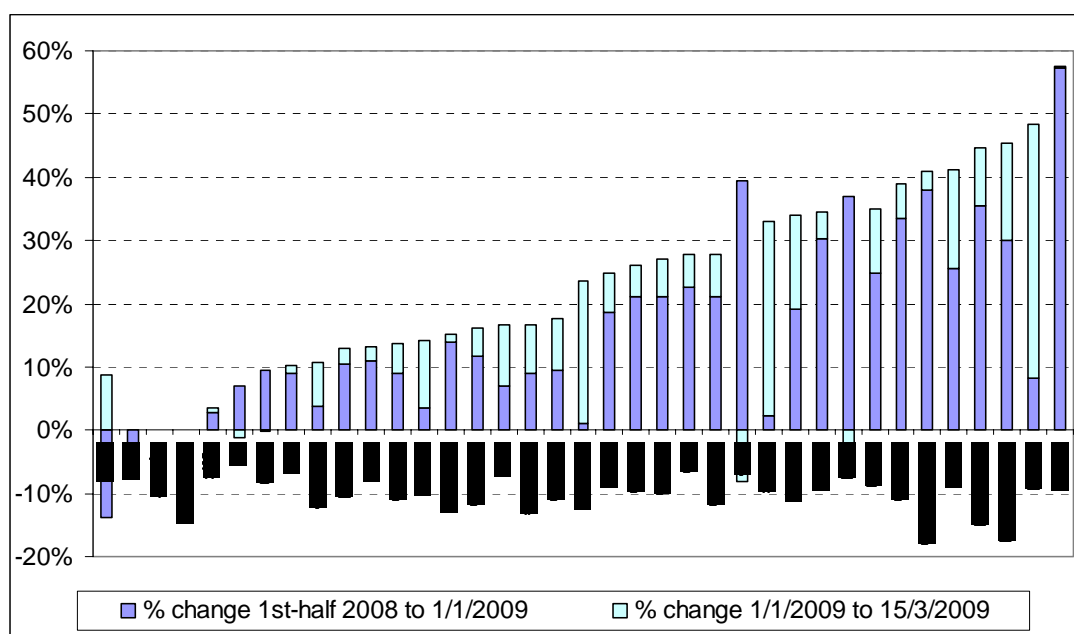
5.1.4 Currency devaluations

76. The last quarter of 2008 and the first months of 2009 show that more and more currencies have devalued vis-à-vis the United States dollar and the euro. Movement in the currency markets, whether managed (competitive devaluations) or forced by market conditions (depreciations), can have a strong impact on export competitiveness.

77. The incentives (and possible benefits) to devalue are particularly high in times of economic crisis. When exports are dwindling and domestic demand is weak, currency devaluation may help in fostering economic growth. This practice may be particularly appealing to some export-oriented countries as they try to boost their economies. In practice, the effects of currency devaluation are similar to those of export subsidies and import duties: they increase the competitiveness of exports and shield domestic producers from external competitors. On the other hand, depreciation is generally destabilizing and inflationary, and it also raises foreign currency debt. Moreover, it has important repercussions for countries, as their creditworthiness may be jeopardized. Devaluation can significantly lower investor confidence in the country's economy and can hurt the ability to attract foreign investment. Finally, any positive effects from currency devaluation cease if trading partners (or export competitors) respond with a similar devaluation.

78. Although most currencies have fallen against the United States dollar and the euro in the past year, the extent of depreciation has been quite different across countries. Figure 10 below reports the extent of devaluation between January 2008 and March 2009. The extreme case is East Asia, where the three key currencies have all been headed in different directions: the yen (Japan) appreciated by 6 per cent, the yuan (China) appreciated by 2 per cent, and the won (Republic of Korea) depreciated by more than 40 per cent. Other East Asian currencies depreciated between 10 and 30 per cent.

Figure 10. Currency devaluations vis-à-vis the United States dollar
(percentage change January 2008–March 2009)



Source: UNCTAD calculations.

79. It may still be too early to assess the impact of currency devaluations on trade, as the effects of the movements in the currency markets have so far not been reflected in the trade data. Exports originating in countries where currencies have devalued have so far not performed any better than those originating in countries where currencies were stable. Moreover, the turmoil in the currency markets has still not subsided. Indeed, a number of countries, including most Eastern European and some East Asian countries, have seen their currencies depreciate further in February and March 2009.

5.2 *Mitigating strategies from the trade and development perspective*

80. Addressing the global economic crisis and its impact on international trade and investment must obviously become a key element on the multilateral agenda. Individual country strategies are also important to address the crisis and put in place development strategies that can mitigate its negative effects on economic growth and development. Indeed, strategic intervention by Governments is required to provide a new direction towards focusing on development gains in order to achieve the MDGs.

81. At the national level, developed countries, and some of the larger developing countries such as Brazil, China, India and South Africa, are turning to boosting domestic demand to restore and sustain economic growth. But this alone is clearly not sufficient. Purchasing power in these larger developing countries – despite its rapid increase in recent years – remains limited. Most LDCs, as well as small and vulnerable economies – which are mostly dependent on a single commodity or on just a few commodities, and are non-diversified exporters – are destined to search for external sources for economic stimulus, as their domestic markets – which are also affected by associated difficulties arising from geographical and climatic conditions and infrastructure deficiencies – are too small to domestically uphold sustained growth paths. These countries are also highly dependent on international trade for their GDP growth. National efforts alone, therefore, will not be able to contain the global crisis – global actions are required to deal with the crisis, and with other multi-faceted aspects such as food and fuel security, and climate change.

82. Concerted efforts are required at the multilateral level to avoid beggar-thy-neighbour policies and to act collectively and coherently in removing distortions to trade and investment. A key global priority must be to resist and arrest tendencies towards protectionism and economic nationalism. In this regard, confidence in the multilateral trading system must be strengthened, with strong support by all countries to conclude the Doha Round on balanced and pro-development terms on an urgent basis. Another global priority is that mitigating measures at the global level must also seek to address developing countries' concerns and enable them to continue to grow through trade, investment, remittances, aid and technological innovation.

83. More fundamentally, a review of development policy and partnership for development is required, and this needs to be articulated at the global level to set a framework within which such new approaches could be modulated to fit country- and region-specific conditions. The latter was aptly described by President Kufuor of Ghana, when at the high-level event of UNCTAD XII in April 2008, he called for a change in development partnership between Africa and its development

partners, and specified that such “a new deal on aid, trade, investment and technology relations between Africa and its development partners must be buttressed on a principle of development solidarity.”⁴⁰ While President Kufuor was referring to African countries, such a new partnership paradigm for development is applicable to all developing countries, in the context of the global efforts to address the global economic crisis.

5.2.1 *Resisting and arresting protectionism*

84. A number of important policy measures were agreed at the G20 summit in London⁴¹ to head off a wave of protectionist measures in the immediate future and to raise confidence in the trading system. In particular, G20 countries committed until the end of 2010 “to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing WTO-inconsistent measures to stimulate exports.” They also pledged to rectify promptly any such measures. In addition, the G20 will minimize any negative impact on trade and investment of domestic policy actions, including fiscal policy and action in support of the financial sector, and will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries. It was also agreed that any such measures would be promptly notified to the WTO, which, together with other international bodies, within their respective mandates, would monitor and report publicly on those undertakings on a quarterly basis.

85. The above undertakings appear to represent an unprecedented “standstill” pact, not only on the usual import measures, but also on export restrictions which may not be regulated by the multilateral trade rules and disciplines. Moreover, services-related and investment barriers, as well as “financial protectionism”, are also covered by this standstill commitment. The implementation of this important commitment is warranted by the grave economic conditions globally; however it may be affected by a number of uncertainties. Firstly, it is not clear how such “standstill” provisions relate to the existing multilateral rules, and to the rights and obligations of WTO members. Normally, a WTO-consistent trade measure taken by a member should not be qualified as “protectionist” and should be deemed to be taken in the legitimate exercise of a country’s WTO rights. Secondly, some WTO-consistent measures comprise important policy space instruments for all countries, especially for developing countries, such as tariffs. Thirdly, the concepts of “investment” or “financial” protectionism are not yet sufficiently defined.

86. Furthermore, it will be important to agree to start implementation of the “duty-free, quota-free” treatment for the exports of LDCs in 2009. This will be a practical confidence-building measure showing that the poorest countries are indeed supported, and that for them all tariff protection in their main markets would be abolished.

87. Equally important would be an assurance by developed countries to keep their GSP schemes free of new restrictions and conditions. Such preferential schemes can become an important stimulus to encourage trade growth in

⁴⁰ <http://www.un.org/webcast/unctad/xii/index.asp?go=500>

⁴¹ The official communiqué of G20 Summit, London, 2 April 2009. Section on “resisting protectionism and promoting global trade and investment”.

developing countries benefiting from these schemes during the crisis and in the post-crisis period.

88. In addition, competition law enforcement has become more important in these times of crisis than before. Some governments are emphasizing that stimulus packages should be consistent with competition rules. It is therefore necessary that countries enhance their competition law enforcement and create effective structures to oversee markets. As weaker market players exit during the crisis, there is a greater risk of illegal cartels, as firms seek any means to avoid failure. Therefore, governments need to remain vigilant against such behaviours. Permitting firms to coordinate price, output, capacity or exit decisions is no more justified during a crisis than during times of growth. Mergers between insolvent and solvent financial institutions that harm competition in the long run may form a necessary part of restoring financial market trust, confidence and stability. But permitting anticompetitive mergers among industrial firms during a crisis is not justifiable if neither firm is clearly failing. Efforts to establish a competitive structure post-crisis should be made, both in financial sectors and in industrial sectors, perhaps during the de-nationalization phase. Greater competition, lower barriers to entry, and adequate infrastructure would help to develop greater productive capacity and greater resilience in the long run.

5.2.2 *Support for trade finance*

89. Failing to support trade finance during the crisis entails significant costs to the global economy and has drastic implications for exporters and importers around the world, especially in developing countries. Stepped-up efforts at the national, regional and international levels⁴² are required to pump up the funds for trade finance, improve lending terms (i.e. reducing the costs of credit and granting longer repayment periods). In this context, the undertaking by the G20 countries to ensure the availability of at least \$250 billion over the next two years to support trade finance is important. Yet, there is no guarantee that these funds will be sufficient or additional to previous pledges, while most governments in developing countries are lacking the financial clout to inject liquidity for trade finance.

90. For developing countries, regional and interregional cooperation and South–South cooperation in trade finance could help address the challenge. For instance, cross-border coordination among banks and credit agencies, including multilateral and development finance institutions and central banks, is required to create a tangible impact capable of mitigating the effects of the credit squeeze and – therefore – enabling trade. Potential immediate actions may include the following: (i) providing solutions to deal with the problem of slackening trade finance through South–South trade financing institutions, such as reinforcing the contribution of the Global Network of Export-Import Banks and Development Finance Institutions (G-NEXID); (ii) establishing a clearing system through

⁴² The Republic of Korea, South Africa, India, Indonesia, and Brazil are examples of countries in which central banks have used foreign exchange reserves in order to engage in pledges or repurchase agreements with the private sector. Multilateral development banks IDB, EBRD, and ADB – and IFC – have recently enhanced their trade facilitation programmes: IFC (from \$1.5 billion to \$3 billion), the Inter-American Development Bank (from \$0.5 billion to \$1 billion), the EBRD (from \$1 billion to \$2 billion), and the Asian Development Bank (from \$0.4 billion to \$1 billion). This has brought the total capacity to \$7 billion on a rollover basis, financing potentially some \$30 billion or so of trade involving small countries and small amounts (\$250,000 on average by transaction). (Auboin 2009).

regional payment and credit agreements to minimize the use of valuable foreign exchange for the purpose of settling regional trade balances; (iii) central banks to pool resources to provide regionally coordinated exchange-rate and balance-of-payments support; (iv) capitalization of regional development banks; (v) enacting macroeconomic cooperation in developing countries.⁴³

5.2.3 *Commodities*

91. The global economic and financial crisis has had a dramatic knockdown effect on commodity-dependent countries that have had to face the double challenge of falling exports both in value and volume terms.

92. During the boom period, many major commodity exporters – and especially exporters of crude oil – created institutions known as sovereign wealth funds, to manage the surplus export revenues. The bulk of their resources were investments in financial instruments in developed countries and on global financial markets. As a result of the economic crisis, they have lost a considerable part of their value. Nevertheless, since the onset of the crisis, sovereign wealth funds have also started to play the role of a cushion against losses that key national operators were assuming due to the adverse external economic conditions. These would be important instruments in the period ahead, providing much-needed financing to bolster development.

93. Commodity exporters that have a lower level of financial assets and lack such national institutional backup have found themselves in a much more difficult situation, and may need international support measures to sustain them through the current economic difficulties. The international support measures may include the BOP support finance from IMF and structural adjustment loans from the World Bank Group. Also, expansion of trade finance programmes by IFIs may help small-scale commodity producers to maintain their exports. Maintaining credit and insurance lines by export credit agencies, inter alia, could support banks to provide structured trade finance to commodity producers.

94. National policy measures might include, for example, maintaining and even expanding the volume of commodity stocks, or diminishing the capacity utilization in the case of extractive industries, in order to equilibrate the international supply with demand. Commodity policies (global and sectoral) that articulate the role and contribution of the commodity sector to trade and development should be elaborated to enhance commodity production and value addition, diversification and financing. The earlier UNCTAD concept of creating and managing international buffer stocks of commodities might also come back in one form or another to the global commodity agenda.

5.2.4 *Inward and outward investment*

95. A major challenge for developing countries is to continue to attract foreign investment during the crisis to stimulate economic activity, especially for investments that serve long-term development goals and enhance competitiveness (e.g. investments in infrastructure, agriculture, sustainable energy, material/resource/energy efficiency and technology). As foreign investment

⁴³ Suggestions by experts during the UNCTAD Multi-year Expert Meeting on International Cooperation: South–South Cooperation and Regional Integration in February 2009. (See the report of the meeting: TD/B/C.II/MEM.2/3).

diminishes in this period of crisis, competition between countries is likely to increase. Public investment programmes adopted by several developing countries can have a positive effect on inward foreign investment, provided that these programmes are open to participation by foreign investors, while promoting national goals. For example, in November 2008, the Chinese Government announced a 4 trillion yuan (about \$580 billion) public investment plan to boost economic growth. Though on a smaller scale, the following countries have similar packages: the Republic of Korea (35 trillion won or \$32 billion), India (200 billion rupees or \$4 billion), Thailand (300 billion baht, or \$8.6 billion), Malaysia (7 billion ringgits or \$2 billion), Philippines (300 billion pesos or \$6.3 billion), and Viet Nam (up to \$6 billion).

96. However, large economic stimulus packages are not an option for many developing countries, in particular LDCs and small vulnerable states. These countries have few options but to seek assistance from the international community to stimulate economic activities. One option is for national economic rescue packages in developed countries to endeavour also to maximize global effects, in particular by supporting investment in poorer countries. Bilateral and regional investment agreements, including those that aim for broader economic partnership between the parties, can help encourage foreign investment within a wider framework of promoting development. Public-private partnerships to establish economically viable industries in sectors with growth potential and market demand can be developed through close cooperation and collaboration.

97. Finding ways of retaining existing investment is especially important, since TNCs in financial difficulty may consider closing foreign affiliates or transferring them to “cheaper” locations. This is already happening in some developed countries. To avoid such divestment, developing countries need to consider how to accommodate the cost-saving strategies of TNCs. For instance, a number of developing countries have included tax relief in their economic stimulus packages.⁴⁴ However, it is important that national efforts to maintain and attract foreign investment must not result in “race to the bottom” policies, under which countries lower social and environmental standards, or offer unsustainable financial or fiscal advantages. International coordination, in particular in a regional context, could help to prevent such an outcome.

98. Economic stimulus programmes in potential host countries may offer, in some cases, an additional incentive for investors from developing countries. Likewise, providing state guarantees to financial institutions could have a crowding-in effect on foreign investment, as these institutions might be considered as “safe bets” by foreign investors. In a few cases, state support has directly benefited TNCs from developing countries. At the same time, divestment strategies of home country governments could offer real opportunities for companies from developing countries to purchase foreign subsidiaries.

⁴⁴ For instance, the corporate tax rate was lowered in the Republic of Korea (from 13–25 per cent to 10–20 per cent) and in the Philippines (from 35 to 30 per cent). Special measures are also provided for SMEs in such countries as Singapore and Viet Nam.

5.2.5 *South–South cooperation*

99. Expanding and diversifying South–South cooperation and regional integration remains a viable long-term solution to supporting developing countries' trade and investment, and helping developing countries to climb out of the crisis. Today's crisis and subsequent economic shocks in many developing countries partly derive from the fact that their production and exports, whether in primary, intermediate or final goods or services, depend, to a large extent, on the economic prosperity and sustainable demand of the markets in developed economies. The crisis offers opportunities for strengthening South–South trade linkages, including through reshaping the existing production supply chains (and creating more regional demand); policy instruments such as GSTP; and more comprehensive and effective regional trade and investment agreements. South–South trade and investment had expanded rapidly in the last decade, and continues to comprise a positive force in trade and investment flows, notwithstanding the fact that such flows have also declined during the crisis. For developing countries, further integration into the international trading system should focus both on North–South and South–South dimensions.

5.2.6 *Developing resilience in trade performance*

100. Improving productivity and competitiveness remains a traditional priority in improving trade performance, and becomes particularly relevant during periods of economic crisis. Important aspects in this regard include diversification into new and dynamic products and services, and markets; focus on physical and social infrastructure development, including investing more on human resources and skill development; and trade facilitation measures. Building and enhancing productive capacity, including through technological innovation, is a key priority in most developing countries, and in particular in LDCs. Such capacity needs to be built especially in agriculture and in particular in food production, and in industrial products, including those with a higher technology content. The development of services capacities to better engage in services trade will also improve the resilience of economies to external shocks.

101. The mobilization of private and public sector funds, including through joint venture initiatives, for investment in production, trade-facilitating infrastructure, the development-oriented reform of trade policies and regulations, and export promotion, are among the key steps required for these purposes.

102. At a time when massive counter-cyclical measures are being applied by developed countries to reverse their economic recessions, the speedy disbursement and application of ODA and aid for trade funds for the benefit of developing countries – especially LDCs – will be crucial. In a climate of acute economic instability and insecurity, the availability of ODA and aid for trade can enhance business confidence and stimulate investment both by domestic and foreign enterprises in developing countries, equipping them to develop and quickly exploit new commercial opportunities. ODA into the development of agriculture is especially important in building domestic capacity to meet local needs for food and in helping to avert future food crises.

5.2.7 *Longer-term opportunities – reviewing development strategies*

103. The global crisis is the right time to review development strategies and make them more sustainable against future external shocks, and also to focus on delivering development more broadly and inclusively. It is therefore important to revisit export-oriented strategies, but without a complete pendulum swing into inward-looking development strategies. In certain cases, there could be a refocusing on building more domestic-demand-creating and demand-driven strategies. In other cases, measures for more effective and qualitative participation in international trade need to be strengthened. In any event, the ultimate goal of enhancing human development has to take primacy in development strategies. Thus, developing countries need, for example, to continue to address problems of income inequality, investing more in education, training, trade-adjustment assistance, health care, community development, and tax and competition policies.

104. Within this framework, the role of governments in support of economic growth and development needs to be redefined. The laissez-faire prescriptions applied in the past to the role of governments – i.e. less activist and more enabling – are now being replaced by active interventions by governments in economic activities, especially through mitigating measures such as the national economic stimulus packages. There is a need for a review and a rebalancing of the roles of the State and the market within development and poverty-reduction strategies.

105. Another opportunity is to treat environmental issues (including measures to address climate change and biodiversity loss) as part of the solution to the crisis, by fostering a more sustainable development policy. It is important for developing countries to focus on areas and sectors that, in the next few years, may become future growth poles of sustainable development. Several new and dynamic sectors could be mentioned in this regard, such as off-grid renewable energy systems in rural areas to boost agricultural development, different forms of sustainable agriculture (including organic agriculture) and the resource-efficient construction/building/refurbishment sectors, including water heaters, cooking equipment, domestic appliances, heating, ventilation, air conditioning, lighting and electronic appliances.

106. It is important for the international community to adopt and implement environmentally friendly policies as part of sound and sustainable development strategies. The initiative by the United Nations to launch a Global Green New Deal, led by the United Nations Environment Programme,⁴⁵ is noteworthy for its aim to ensure that measures to protect the environment and address climate change also create new economic opportunities, including for trade and investment, and concomitantly, measures to cope with the global crisis and resuscitate economic growth should help preserve the environment and mitigate climate change, including through investments in clean industries and technologies.

⁴⁵ <http://www.unep.org/greeneconomy>

5.2.8 UNCTAD's contribution

107. The forthcoming United Nations conference at the highest level on the world financial and economic crisis and its impact on development should provide an opportunity to launch deliberations on a new consensus on development policies and strategies that are more resilient to economic shocks, improve people's economic and social opportunities, spread the benefits of globalization more equally, and follow a less carbon-intensive consumption and production paths.

108. Within the United Nations system, UNCTAD – as the United Nations' focal point for the integrated treatment of trade and development issues – can provide substantive contributions to address immediate responses and help design new trade and development strategies for the medium to long term. In particular, drawing upon its mandate from the Accra Accord of UNCTAD XII (including paragraphs 90, 147, 148), UNCTAD can assist in monitoring and diagnosing the evolving crisis and its impact on trade and development, propose coping measures, and build a new consensus on sound and modern trade, investment and development strategies to be pursued at national, regional and global levels. In particular, recent intergovernmental expert meetings held at UNCTAD have discussed the impact of the global crisis on different sectors and have suggested that UNCTAD continuously monitor such impact. For example, during the expert meeting on South–South cooperation and regional integration, experts suggested that UNCTAD, in cooperation with other agencies, should assist developing countries in elaborating country- and region-specific diagnostic kits to cope with the crisis including longer-term measures for ensuring growth and development.⁴⁶

109. In this regard, UNCTAD could develop a template and possible methodology for developing countries to conduct impact analyses and draw up mitigating and resilience strategies. For example, at the request of the Government of India, UNCTAD is conducting a study on mitigating strategies for India (see box 2). Monitoring and reporting on trade protectionism, and ways of addressing it, is another area in which UNCTAD can be involved, in cooperation with WTO. UNCTAD's ongoing work with other agencies and partners on identifying and addressing non-tariff barriers becomes especially relevant in this regard.

⁴⁶ See: Report of the Multi-year Expert Meeting on International Cooperation: South–South Cooperation and Regional Integration on its first session (TD/B/C.II/MEM.2/3).

**Box 2. Study by UNCTAD India project:
“Impact of global slowdown on India’s exports and employment”**

UNCTAD’s India project, in a forthcoming study, has estimated the impact of global slowdown on India’s exports and employment for the period 2008–2009 up to December 2010. The study estimates the income and price elasticities of India’s total exports and of exports of 10 major sectors to forecast India’s export growth over this period. In addition, time-series analysis has been undertaken using monthly data to forecast export growth. The study shows that India’s export growth declined from 29 per cent in 2007–08 to 5.5 per cent in 2008–2009. This is expected to fall to -2.2 per cent in 2009–2010. A revival of export growth is predicted in 2010 (up to December 2010), with exports reaching double-digit growth in major sectors. As a result of the decline in exports up to March 2010, using export–employment multipliers, the study has estimated sector-wise job losses. Results show that the textiles and clothing sector would account for almost 50 per cent of all job losses, followed by minerals and mineral ores, gems and jewellery, and marine products. High income elasticity and low price sensitivity of some of the employment-intensive export sectors have made these sectors more susceptible to adverse employment effects. The study suggests strategies to build up India’s resilience to external shocks to trade. Detailed analysis has been undertaken to identify “new products” and “new markets” to further diversify India’s exports and to strengthen South–South trade. The need for the Government to implement measures aimed at assisting exporters to retain their market presence during the crisis period has been emphasized. On the other hand, the study cautions that measures that could lead to a decline in imports may adversely affect domestic production and export prospects.

110. UNCTAD is already actively participating and providing substantive analytical inputs on the development impact of the crisis to United Nations-wide activities and reports, including to the World Economic Situation and Prospects report, the Financing for Development and Doha Conference follow-ups, the Special High-level Meeting of the Economic and Social Council with the Bretton Woods Institutions, and WTO and UNCTAD (April 2009) and the proposed United Nations conference on the global crisis (June 2009). UNCTAD’s multi-year expert meetings on such issues as services, development and trade; transport and trade facilitation; South–South cooperation and regional integration; and enterprise development policies and capacity-building in science, technology and innovation provide important forums that can undertake expert review of the impact of the crisis in these specific areas on an annual basis and can suggest related policy recommendations.
