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**IMFC Statement by Mukhisa Kituyi
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Failing to address systemic questions reduces trust in the system

Ten years ago, in September 2008, Lehman Brothers declared bankruptcy. No one was quite sure who owed what to whom, who had risked too much and couldn't pay back, or who would go down next; interbank credit markets froze; Wall Street panicked; businesses went under, not just in the United States but across the world; politicians struggled for responses; and the Great Moderation gave way to a crisis and Great Recession.

What is surprising is just how little has changed in its aftermath. The financial system, we are told, is simpler, safer and fairer. But banks have grown even bigger on the back of public money; use of opaque financial instruments are again growing ; shadow banking has grown into a \$160 trillion business, twice the size of the global economy; over-the-counter derivatives have surpassed the \$500 trillion figure; and bonus pools for bankers are swelling once again. On the back of trillions of dollars of publicly generated liquidity through "quantitative easing", asset markets have rebounded, companies are merging on a mega scale and buying back shares has become the measure of managerial acumen. By contrast, the real economy has spluttered along. While some countries have turned to asset markets to boost incomes, others have looked to export markets – but neither option has delivered growth on a sustained basis, and both have driven inequality even higher.

Arguably the greatest damage of all has been dwindling trust in the system. In any system claiming to play by rules, perceptions of rigging are guaranteed eventually to undermine its legitimacy. The sense that those who caused the crisis not only got away with it but profited from it has been a lingering source of discontent since 2008; and that distrust has now infected the political institutions that tie citizens, communities and countries together, at the national, regional and international levels.

The paradox of twenty-first century globalization is that – despite talk about its flexibility, efficiency and competitiveness – advanced and developing economies are becoming increasingly brittle, sluggish and fractured. Inequality continues to rise and indebtedness mounts, but financial chicanery is back in the economic driving seat and political systems are being drained of trust.

Last year's optimism hasn't lasted very long, and risks of financial stress are rising in developing countries

At some point in the past year, the mood music around the global economy changed. The perception of synchronized upswings across many different economies, developed and developing, suggested a positive prognosis for future growth. Upbeat forecasts of economic recovery have led central bankers and macroeconomic policymakers in advanced economies to accept that the time has come to reverse the easy money policies in place for the past decade.

The optimism hasn't lasted very long. Recent growth estimates have been lower than forecast and show some deceleration. Eurozone growth in the first quarter of 2018 is estimated to have decelerated relative to the previous quarter, and is now the slowest rate since the third quarter of 2016; in the United States, the annualized gross domestic product (GDP) growth rate for the first quarter has been revised downward, from 2.3 per cent to 2.0 per cent, significantly lower than the previous three quarters; and growth in the first quarter in Japan turned negative.

Developing economies are holding out better, with first quarter growth for 2018 beating expectations in China and India, but no improvement and even deceleration in Brazil and South Africa. The Russian Federation, like many other oil exporters, has seen the benefits of higher prices. Indeed, commodity exporting regions are generally enjoying the recovery in prices, albeit with some recent signs of a slowdown.

Overall, regional growth forecasts for this year are still on track. However, the number of countries appearing to be in some kind of financial stress has increased and forecasts for the medium term are being revised downwards. Already, as the talk of monetary policy normalization grows louder, a number of developing countries are struggling to cope with capital flow reversals, currency depreciation and associated instability.

Debt-fueled growth and shifting monetary policy leave developing countries vulnerable and global demand weak

The core concern is the continued strong dependence of tepid global growth on debt, in a context of shifting macroeconomic trends. By early 2018, global debt stocks had risen to nearly \$250 trillion –three times global income – from \$142 trillion a decade earlier. UNCTAD's most recent estimate is that the ratio of global debt to GDP is now nearly one third higher than in 2008.

Private debt has exploded, especially in emerging markets and developing countries, whose share of global debt stock increased from 7 per cent in 2007 to 26 per cent in 2017, while the ratio of credit to non-financial corporations to GDP in emerging market economies increased from 56 per cent in 2008 to 105 per cent in 2017.

Vulnerability is reflected in cross-border capital flows, which have not just become more volatile but turned negative for emerging and developing countries as a group since late 2014, with outflows especially large in the second quarter of 2018.

Markets turned unstable as soon as the central banks in advanced economies announced their intention to draw back on the monetary lever. This leaves the global economy on a policy tightrope: reversing the past loose monetary policy, in the absence of countervailing fiscal policy, could abort the halting global recovery; but not doing so simply kicks the policy risks down the road while fuelling further uncertainty and instability.

The implications of monetary policy tightening, whether now or later, could be severe because of the various asset bubbles that have emerged, even as the chances of global contagion from problems in any one region or segment now seem greater than ever. The synchronized

movement of equity markets across the globe is one indicator of this. While property price movements in different countries have been less synchronized, they have also turned buoyant once again after some years of decline or stagnation after the Great Recession.

The cheap liquidity made available in developed country markets led to overheating in asset markets in both advanced and developing economies, as investors engaged in various forms of carry trade. The impact of the liquidity surge on equity markets has been marked, as valuations have touched levels not warranted by potential earnings. This has resulted in a fundamental disconnect between asset prices and real economic forces. With no support from fiscal policy, monetary measures failed to spur robust recovery of the real economy. While asset prices have exploded to unsustainable levels, nominal wages increased by much less, and stagnated in many countries. This has led to further increases in income inequality, which implied that sluggish household demand could only be boosted through renewed debt bubbles.

Meanwhile, debt expansion has not financed increased new investment. In advanced economies, the investment ratio dropped from 23 per cent on average in 2008 to 21 per cent in 2017. Even in emerging markets and developing countries, the ratio of investment to GDP was 32.3 per cent in 2017, only marginally higher than the 30.4 per cent achieved in the crisis year 2008, with some larger economies registering a drop over this period.

“Trade wars” threaten collateral damage in developing countries, and are symptoms of the failure to address broader systemic challenges

The policy dilemma is made more difficult by other “known unknowns”: uncertainties about the movement of oil prices that also reflect geopolitical dynamics, and the possible trajectories and implications of “trade wars” that could result from the current muscle-flexing in the United States and its major trading partners. Trade picked up steam last year following several years of very sluggish growth and will likely continue to do so this year; but bets are off for what might happen beyond that.

In the absence of strong global demand, trade is unlikely to act as an independent engine of global growth. That said, a sharp escalation of tariffs and heightened talk of a trade war will only add to the underlying weakness in the global economy. Because tariffs operate in the first place by redistributing income among several actors, gauging their impact is not as straightforward as some of the more apocalyptic trade pundits are predicting. Still, they will almost certainly not have the desired effect of reducing the current account deficit in the United States; will raise uncertainty if tit-for-tat responses ensue; and will cause significant collateral damage for some developing countries, adding to the pressures already building from financial instability.

This is not, however, the start of the unravelling of the “post-war liberal order,” which has instead been eroded over the past 30 years by the rise of footloose capital, the abandonment of full employment policies, the steady decline of income going to labour, the erosion of social spending and the intertwining of corporate and political power. “Trade wars” are a symptom of an unbalanced hyperglobalized world.

Nor is the rise of emerging economies the source of problems. China's determination to assert its right to development has been greeted with a sense of anxiety, if not hostility, in many Western capitals, despite it adopting policies that have been part of the standard economic playbook used in these same countries as they climbed the development ladder. The difference in discourse between then and now speaks to how far the current multilateral order has moved from its original intent.

The growing backlash against hyperglobalization is not a surprise; that the international trading system is now on the frontline is more so, given that the roots of the heightened insecurity, indebtedness and inequality behind this backlash stem more from the financial system than the trade regime.

There should be little doubting that using tariffs to mitigate the problems of hyperglobalization will not only fail, but also runs the danger of adding to them, through a damaging cycle of retaliatory actions, heightened economic uncertainty, added pressure on wage earners and consumers, and eventually slower growth. Still, it would be foolish to dismiss those voicing concerns about damaging trade shocks as ignorant of the subtleties of Ricardian trade theory or simply the misguided victims of populist politicians. While the gravity of discontent in the North is only now pulling towards trade issues, there are long-standing concerns among developing countries about the workings of the international trading system.

Addressing market power will help address the anxieties of the casualties of globalization

Globalization has been identified with the growing reach of markets, an accelerating pace of technological change and a welcome erosion of political boundaries; the language of "free trade" has been used to promote the idea that even as global economic forces have broken free from local political oversight, a level playing field, governed through a mixture of formal rules, tacit norms and greater competition, will guarantee prosperity for all.

In reality, hyperglobalization has as much to do with profits and mobile capital as with prices and mobile phones, and is governed by large firms that have established increasingly dominant market positions and operate with minimal public scrutiny. Too often money and power have become inseparable and capital – whether tangible or intangible, long-term or short-term, industrial or financial – has extricated itself from regulatory oversight and interference.

The heightened anxiety among the growing number of casualties of hyperglobalization has led to much more questioning of the official story of the shared benefits of trade. Those pitching comparative advantage as a "win-win" boost to economic efficiency and social welfare, without specifying the conditions under which such beneficial outcomes can occur or how any negative effects could be reduced, bear some responsibility in the backlash we face today.

There is no doubt that the new protectionist tide, together with the declining spirit of international cooperation, poses significant challenges for governments around the world. However, doubling down on business as usual is not the right response. Resisting isolationism effectively requires recognizing that many of the rules adopted to promote "free trade" have

failed to move the system in a more inclusive, participatory and development-friendly direction.

This means that it is now essential to introduce a more evidence-based and pragmatic approach to managing trade as well as to designing trade agreements. Recognition of the lessons from successful export economies and the insights of new trade models that acknowledge the impact of trade on inequality need to be combined with an assessment of the causal relationship between rising inequality, corporate rent seeking, falling investment and mounting indebtedness.

A decade after the collapse of Lehman Brothers, the global economy has been unable to establish a robust and stable growth path. Instead, weak demand, rising levels of debt and volatile capital flows have left many economies oscillating between incipient growth recoveries and financial instability. At the same time, austerity measures and unchecked corporate rentierism have pushed inequality higher and torn at the social and political fabric. Tariffs are treacherous instruments for dealing with these problems and if a vicious cycle of retaliation takes hold only make matters worse. But trade wars are a symptom not a cause of economic morbidity. The tragedy of our times is that just as bolder international cooperation is needed to address those causes, more than three decades of unrestrained globalization has drowned out the sense of trust, fairness and justice on which such cooperation depends.