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**49th meeting**

**Summary record of the joint meeting of the Second Committee and the Economic and Social Council on "Inequality, growth and the global economic outlook"**
Held at Headquarters, New York, on Tuesday, 22 October 2013, at 3 p.m.

*Co-Chair*: Mr. Hoxha (Vice-President, Economic and Social Council) ....... (Albania)
*Co-Chair*: Ms. Rebedea (Vice-Chair, Second Committee) ................. (Romania)

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*The meeting was called to order at 3.10 p.m.*

**Introductory remarks**

1. **Mr. Hoxha** (Co-Chair) said that, exactly five years earlier, the global financial system had been on the brink of collapse, and the world economy had gone into free fall. The crisis had spread rapidly, resulting in serious setbacks for the achievement of the Millennium Development Goals (MDGs). Getting the global economy back on the path of recovery and preventing even greater hardship had required coordinated, decisive actions by policymakers around the world. The recovery had been slow and fragile, and the effects of the crisis were still being felt worldwide. Growth had remained sluggish in the developed economies in the past few years, and had also slowed sharply across developing countries, further hampering progress towards poverty reduction and development goals. Unemployment and underemployment levels were still extraordinarily high, and the decline in official development assistance (ODA) posed a serious threat for many of the world's poorest countries.

2. Fortunately, the risk of a renewed global recession had receded, and there might be improvement in the world economy in 2014 and 2015. However, it was likely that global growth would remain relatively weak in most regions. The possibility of many more years of subdued growth in developed and developing countries was one of the biggest risks facing the world.

3. There was a need to strengthen short-term drivers of growth and create conditions for more robust, sustainable and equitable growth in the medium and long term. Bold policy reforms were required to address impediments to sustained growth. Income inequality had increased rapidly over the past decades in many parts of the world. Widening wealth and opportunity gaps had slowed poverty reduction and progress in child and maternal health, nutrition and education. Understanding the causes of rising inequalities and designing policies to reduce those gaps were among the greatest development challenges of the day.

4. **Ms. Akhtar** (Department of Economic and Social Affairs) said that the primary economic risk had to do with possible spillovers related to the exit from unconventional monetary policies.

5. Economies were growing at levels below pre-crisis trends and below potential. The collective monetary stimulus policies of advanced economies, such as asset purchase programmes and near-zero interest rate policies, had spurred the world economies, as had moderation in fiscal adjustment. The slowdown in emerging market economies and some developing countries was of concern, as those economies had been the locomotive of global growth during the downturn.

6. International Monetary Fund (IMF) estimates for 2013, scaled down a few times during the year, forecast global growth in the area of 3.1 per cent, with expectations of 3.6 per cent in 2014. Developing countries, including emerging economies, would register a slowdown of 4.5 per cent in 2013, according to Project LINK estimates. China would adopt an adjusted growth path, with growth slowing from an average of 9.6 per cent from 2008 to 2011 to an average of 7.6 per cent from 2012 to 2014.

7. New policies must not derail the fragile recovery, stimulating instead more robust, inclusive and sustainable economic growth. Emerging markets must build defensive mechanisms to counter the threat of spillover while addressing long-term challenges. Greater attention to infrastructure constraints and human resource development would improve productivity and competitiveness, while attracting foreign direct investment (FDI).

8. Structural reforms were needed to transform a cyclical recovery in advanced economies and stimulate domestic demand in emerging markets. As the exit from the easy monetary policy stance developed, careful fiscal management and normalized private sector credit growth supported by structural reforms would be critical to sustainable growth.

9. The crisis had left deep scars, including output and financial losses and major job dislocation. Almost 600 million new jobs were needed. Social distress must be eased. While discussions of the MDGs referred to the need to lift some 1.2 billion people out of extreme poverty, evidence had not yet emerged regarding how that number might be affected by the crisis. In addition, inequality had consequences that would linger and threaten sustained growth and development.

10. In some economies, growth was associated with reduced inequality, while in others growth had had the opposite effect on income distribution. China and Brazil had registered high growth rates from 1995

through 2005, but had very different outcomes with regard to inequality. The Gini coefficient had increased in China from 0.35 to 0.42, while during the same period it had declined from 0.6 to 0.57 in Brazil.

11. During the past two decades, inequality had been on the rise. According to an estimate by the United Nations Children's Fund, the richest and poorest population quintiles earned 83 per cent and 1 per cent of global income, respectively. Some countries with historically high inequality, including some in South America and sub-Saharan Africa, had reduced inequalities in the past ten years, suggesting that domestic policies and institutions could play an important role.

12. Greater inequality was associated with less sustained growth, and a decrease in inequality increased the expected length of a growth spell by 50 per cent. In developing countries, concentration of assets had been found to inhibit productive investment and restrict growth potential. Growing levels of inequality in access, opportunities and income led to inadequate education, health care and social protection, causing volatility, crises and diminished productivity. Rising inequalities had been associated with excessively debt-financed consumption and investment patterns that had contributed to financial and economic crises.

13. The standard Kuznets curve analysis, which assumed that rising inequality was the necessary price for development at lower levels of per capita income, did not hold true in recent empirical studies. While a degree of inequality might incentivize investment and growth, high inequalities that continued for prolonged periods made sustained growth difficult. Nor did inequalities systematically decline and remain low in developed countries.

14. If appropriate employment, corporate governance, competition, and wage and income distribution policies were in place, structural changes could reduce inequality. The impacts of globalization and technological change on domestic income distribution depended on macroeconomic, financial and labour market policies.

**Presentation on "Inequality and growth"**

15. **Professor Pauly** (University of Toronto), accompanying his statement with a digital slide presentation, said that there had been a dramatic increase in income and wealth inequality in many countries. Economists were attempting to determine whether a certain amount of inequality was the by-product of economic progress, or whether it would have long-term implications. In considering the distribution of economic benefits across economic agents, it was important to distinguish between pre-tax and post-tax incomes and between pre-transfer and post-transfer incomes, and also to determine whether certain economic actors benefited as the result of artificial compensation or whether inequality was simply the outcome of the economic process.

16. In the past 30 years, there had been a very significant increase in the income share earned by the top 1 per cent in such countries as the United States and the United Kingdom, while in France, Germany, Japan and Sweden, that had been less noticeable. Diversity across countries was the result of different policies on access to profits. In some countries, taxes and transfers attempted to eliminate excess returns to certain economic participants. Even in industrial countries, the Gini coefficient varied widely depending on structures, economic characteristics and public policy. While the Gini coefficient had been rising in many countries, it was doing so at different rates. Not only had disposable income in the top decile increased dramatically, but there had been a widening of the gap across income classes, with higher income classes benefiting. Some countries had corrected the market or disposable income outcomes quite actively, while others had not.

17. A certain amount of inequality was probably essential to the effective functioning of a market economy, in order to provide market signals and incentives for investment, growth and entrepreneurial activity. A tolerable level should be distinguished from harmful, excessive inequality that could be damaging to long-term growth. Market outcomes could be controlled, and distribution, tax and transfer policies applied. In some countries, excessive, persistent structural inequalities interacted with market forces, significantly affecting the human capital base. Technical progress had raised returns to capital and skilled labour. The challenge was to enhance the skill set of the labour force so that it could participate in international competition. Over the past 30 years, unskilled labour had been hurt more than any other sector.

18. Economic policy decisions had become increasingly politicized and influenced by interest groups. Certain groups had grown in importance and influence owing to redistribution of income to higher income brackets. Inequalities had a significant impact on intergenerational mobility. Higher levels of inequality lowered intergenerational mobility, with subsequent generations finding it increasingly difficult to move up the economic ladder.

19. As income accrued more unequally, access to knowledge, education and skills development became more limited. At the same time, clusters of highly skilled workers formed in industrial and developing countries. Silicon Valley was an example. Knowledge, success and access to the benefits of one's work were thus clustered as well. Growth theorists saw agglomeration as a way to increase technical innovation and information flows, but there was also a certain negative impact on economic growth. Labour market segmentation and higher rewards for skills accompanied inequality. If such market outcomes were not corrected, a large part of the market was prevented from participating in market success. Outsourcing of jobs affected low-skilled workers more than anyone else.

20. Recent literature indicated that social power and higher income were associated with a reduction in empathy and increased social distance, with people ceasing to care.

21. Empirical work on growth effects was inherently complicated. Time series studies, which looked at the development of countries across time, required data sets encompassing many years. Cross-country evidence did not require long data sets, but there must be controls for idiosyncratic, country-specific factors.

22. There was strong evidence that less inequality was associated with more durable, sustainable growth. Determining factors included economic openness, political and institutional stability, well-developed institutions, and, most important, relatively fair income distribution. Inequality increased the frequency and amplitude of business cycles. While there might be a short-term trade-off between equity and efficiency, that disappeared in the long run.

23. In the past five years, many policies that had attempted to stimulate economic activity had been unsuccessful owing to their differential impacts on various parts of society. Work was under way to determine whether there was an optimal level of inequality.

24. Profits had been generated through regulatory failures over the last 30 years that were very hard to correct. Combined with generous tax policies, income inequality became wealth inequality. In some industrial countries, the ratio of private wealth to national income had more than doubled over the past three or four decades.

25. Societies with greater intergenerational mobility were more equal. The United States had once been a country of unlimited opportunities, but there were other countries where it was currently far easier for people with low incomes to rise into higher income brackets in the next generation. The new persistence in inequality was very worrisome. In the short run, policy could correct it through taxes and transfers. In the long run, there was no easy resolution. Solutions must increase education, skills and innovative capacities and pay close attention to the regulatory framework in order to capture certain profits.

*Interactive discussion*

26. **Mr. Escalona Ojeda** (Bolivarian Republic of Venezuela) said that, as a result of radical changes and crises, a gap between classes had appeared in the post-war era. The social democratic compact had been replaced by globalization, and the space for negotiation between classes had disappeared. During the era of the welfare state, investments had been linked to income growth but the link between investment and job and income growth had disappeared. Investment and speculation contributed very little to the real economy, a factor that had been decisive in the crisis.

27. **Professor Pauly** (University of Toronto) said that in some parts of the world there had been a deviation in the last 30 years from the social compact that had previously governed economic interactions. Deregulation, technical progress and globalization were among the causes. By and large, the phenomenon was limited to the English-speaking world. Those countries that had not adopted the model provided greater freedom for economic progress to their citizens over generations.

28. In addition, regulatory policies in some countries, particularly deregulation of financial markets, had allowed the creation and collection of profits in ways that had shifted economic activity to redistribution and

accumulation of wealth, as opposed to production. A great misallocation of resources in those economies had led the best and the brightest to work in financial service industries that did not create products, but simply reallocated wealth. In the long run, growth prospects in those countries had suffered greatly.

**Presentation on "Project LINK: Global economic outlook"**

29. **Mr. Hong** (Department of Economic and Social Affairs), accompanying his statement with a digital slide presentation, said that Project LINK was an international consortium for economic study and policy analysis consisting of 80 experts from some 60 countries and several international agencies. The Department of Economic and Social Affairs had been relying on Project LINK for decades. Its forecasts, based on inputs from a range of experts, did not constitute an official United Nations outlook.

30. Some developing countries and economies in transition had experienced a significant slowdown over the past two years, In 2013, the world economy had disappointed yet again, missing even the modest projections made by various forecasters. Gross world product was estimated to grow by 2.1 per cent in 2013, down from 2012, and below the Project LINK forecast made in October 2012.

31. On a more positive note, the eurozone had finally emerged from a protracted recession, and a few large emerging economies, including China, were poised to grow stronger. The forecasts for global growth over the next two years were 2.9 and 3.3 per cent, subject to some downside risks.

32. Despite different growth rates, developed and developing countries and economies in transition had moved up and down in synchronization. The growth rate for developing countries was about 2 per cent lower than before the global financial crisis. The growth differential between the developed and developing countries was expected to narrow slightly in the next two years. Developing countries, which had contributed to a large share of global growth in the aftermath of the global financial crisis, were expected to have a smaller share of growth over the next two years, as developed economies gained strength.

33. Estimates indicated that the United States economy would grow by only 1.5 per cent in 2013, the lowest growth since recovery from the recession. A large part of the downturn in the United States had been self-inflicted, caused by fiscal tightening and uncertainties created by political gridlock on budget issues and the recent partial shutdown of the Government. The housing sector and labour markets continued to improve in the United States, and the gross domestic product (GDP) would pick up in 2014 and 2015.

34. Europe had finally emerged from a prolonged recession. However, growth remained weak there owing to fiscal austerity programmes, low demand, and tight bank lending conditions in some countries. Cyprus, Greece and Portugal were expected to remain in recession in 2014.

35. Economic growth in Japan had been boosted by expansionary policies, including fiscal stimulus and quantitative easing. The Government was expected to introduce another package of structural reforms, but the effects were not certain. The increase in the consumption tax rate for the next two years would curb growth.

36. Growth prospects for Africa remained relatively robust. After an estimated growth rate of 4.0 per cent in 2013, GDP growth was expected to accelerate to 4.9 per cent in 2014. Growth prospects depended on improvements in the global economy, particularly commodity prices, and increasing trade and investment ties with emerging economies, such as China, India and Brazil. Growth prospects would also depend on a continued increase in domestic demand.

37. In East Asia, after a measurable slowdown in 2011 and 2012, economic growth had stabilized in the second half of 2013. A moderate increase in regional growth was expected in the next two years. China would grow at a rate of about 7.5 per cent in the next few years, which was significantly lower than its 10 per cent average growth over the past three decades. The shift downward reflected the need for China to develop along a more balanced and sustainable growth path.

38. Many economies in South Asia were facing domestic and external challenges, including energy and transport constraints, macroeconomic imbalances, lack of economic policy reforms and unstable security conditions. Growth in India was expected to recover gradually in 2014 and 2015.

39. While the members of the Gulf Cooperation Council were experiencing a stable recovery, a number of other economies in the region, including Iraq, Jordan, Lebanon, the Syrian Arab Republic and Yemen, were hampered by political instability, social unrest, insecurity and geopolitical tensions. The economy of Turkey was under financial pressure triggered by the reversal in international capital flows.

40. Economic growth in Latin America and the Caribbean, which had decelerated in 2013, was expected to pick up somewhat. Brazil was growing below potential, impeded by weak external demand, volatile capital inflows and tightening monetary conditions. Some improvement was expected in the next two years. Improved manufacturing exports and domestic demand, as well as structural reforms, were expected in Mexico.

41. Most economies of the Commonwealth of Independent States had slowed in 2013, owing to weak exports, external financing constraints and bottlenecks on the supply side. Growth in the Russian Federation had decelerated notably, owing to weak industrial output and investment. Slow improvement was expected over the next two years, but structural challenges would remain.

42. Growth in South-Eastern Europe had rebounded in the second half of 2013, but in the near term growth would remain insufficient to address the need for reindustrialization in the region and reduce excessive unemployment.

43. Unemployment rates remained elevated in a number of European economies. The worst rates were in Spain and Greece, where unemployment stood at 27 per cent, with youth unemployment rates more than double that figure. In the United States, the unemployment rate had continued to improve, but a large portion of the improvement was owing to a decline in labour force participation. Across developing countries, the employment situation was mixed. In East Asia, unemployment rates were generally low, but unemployment was high in North Africa and Western Asia, particularly among youth.

44. Inflation was mild worldwide, reflecting output gaps, high unemployment and financial deleveraging. In general, inflation was not an issue in developed economies. In developing countries and economies in transition, high inflation was found in only about a dozen countries.

45. International trade had shifted into low gear over the past two years. Weak import demand from major developed countries and lack of progress in multilateral trade negotiations over the past decade were among the reasons.

46. The price of most primary commodities had gone down moderately over the past three years. Global demand had been weak, but various factors on the supply side were also among the causes. For example, oil prices had risen and fallen in 2013 along with the tensions over the Syrian Arab Republic.

47. An announcement by the United States Federal Reserve on the possibility of tapering quantitative easing had caused turbulence in global financial markets in the summer of 2013, triggering a reversal in capital inflows to emerging economies. It was estimated that capital inflows would register a decline of 12 per cent from the previous year, the first decline since 2009.

48. Emerging economies had also seen a large sell-off in equity markets, as well as a sharp depreciation of currencies in many cases.

49. The unwinding of unconventional monetary policies by the central banks of major developed economies in the next few years would be a shock to some emerging economies.

50. Systemic risks in the eurozone had abated as a result of various policy measures adopted in the past year, but many banks in the area were still fragile. In countries with debt distress, the real economy remained extremely weak.

51. While the United States had recently averted a default, the problems had simply been postponed for three months. Uncertainties and risks related to the budget and the debt ceiling would continue to loom over the next few years.

52. Quantitative easing was believed to have played a critical role in stabilizing financial markets, providing liquidity for the commercial banks and lowering long-term interest rates. However, by moving huge quantities of financial assets from markets to the central banks, it had possibly created large market distortions, repressing risk premiums for financial assets and causing some misallocation in investor portfolios. Quantitative easing measures had also allowed commercial banks to delay the necessary clean-up of their balance sheets. They had led to

increased volatility in capital inflows, commodity prices and exchange rates in many emerging economies. However, policymakers in developed countries had argued that quantitative easing measures had had positive spillover effects for emerging economies by supporting external demand for their exports and providing extra capital flows to finance domestic investment.

53. When the central banks of major developed economies started to unwind the quantitative easing, there would inevitably be some asset repricing and portfolio rebalancing. It was hoped that banks, investors and the economy would by then be in a more robust position. However, the strong reaction of the market to the announcement of a possible tapering of the quantitative easing made that less likely.

54. There would probably be similar reactions in the future, because quantitative easing measures had moved a large proportion of long-term bonds out of the markets, reducing market liquidity.

55. Premature unwinding of quantitative easing could also lead to a sell-off in global equity markets, a sharp reversal of capital inflows to emerging economies and a spike in risk premiums for external financing in emerging countries. Such shocks to financial markets could move quickly to the real economy in developed and emerging economies and derail world economic growth. If, on the other hand, the central banks kept quantitative easing measures in effect for too long, they would heighten the risk of asset bubbles and inflation, making the future exit even more difficult to manage.

56. Some emerging economies had seen their GDP growth decelerate over the past two years. While those economies were expected to strengthen, they risked a hard landing, as a result of vulnerability to external shocks and the challenges of overcoming domestic structural bottlenecks. Current account deficits were rising in some emerging economies. During the recent crisis, most emerging economies had adopted floating exchange rate regimes, obviating the need to defend their currencies at a pre-set level and avoiding rapid exhaustion of foreign reserves. Financial regulation and macroeconomic management had been improved in those economies, which were generally in a stronger position to respond to external shocks than they had been at the start of the Asian financial crisis of the late 1990s.

57. Over the coming two years, macroeconomic policies in most developed countries would continue to involve a combination of less restrictive fiscal tightening and less accommodative monetary easing. Japan would be the exception, continuing to adopt expansionary fiscal and monetary policies. Central banks in major developed countries would likely maintain low interest rates through mid-2015, with a gradual increase thereafter. The Federal Reserve was expected to taper quantitative easing in 2014. For many central banks, managing a smooth tapering would be a key challenge.

58. Economic challenges facing developing countries and economies in transition had caused some to institute institutional reforms. In response to a slowdown in GDP growth, China had undertaken measures to cut paperwork, reduce administrative intervention in business operations and liberalize interest rates.

59. International policy coordination should be enhanced, with major central banks improving communication regarding timing and targets of policy actions to mitigate shocks and spillover effects from the quantitative easing exit. Such dialogue had often been held in the context of the Group of 20 (G-20). It should also occur in more broadly representative forums, such as the Economic and Social Council and the Second Committee.

60. Current account imbalances across major economies were at a low level. Efforts should continue to prevent imbalances from widening. But G-20 policy coordination should focus on stronger, sustainable growth and jobs, not just on global imbalances. International policy cooperation should also ensure that sufficient resources were made available to developing countries. International donors should redouble efforts to deliver on their existing commitments in order to enable the least developed countries to accelerate progress towards achievement of their development goals.

*Interactive discussion*

61. **Mr. Mahmood** (International Labour Organization (ILO)), accompanying his statement with a digital slide presentation, said that signs of recovery were visible only as weak growth, with very little employment recovery. Many macroeconomic adjustments to fiscal imbalances were placing a heavy

burden on labour markets and preventing improvements in employment. Both IMF and the Department of Economic and Social Affairs had downgraded growth projections, based not on the advanced economies but on developing economies, with huge implications for ILO unemployment estimates

62. Global unemployment was approximately 202 million, but based on the updated estimates, that number would increase by half a million. The recent crisis had resulted in a loss of 32.2 million jobs, half of them in advanced economies and half in the developing economies.

63. In the advanced economies, as well as in Eastern Europe and East Asia, employment growth was flat. In Latin America, South-East Asia and South Africa, the trend was downward. One or two quarters of improvement in some of the advanced economies provided no grounds for complacency. Getting employment back on track would require increasing global growth to 5.2 per cent and increasing global investment by 2 per cent. However, there were many negative feedback loops in the global economy.

64. Households were recovering from asset and wage income loss and were therefore not spending. Despite unconventional monetary policies, such as the reduction of interest rates to nearly zero and quantitative easing on both sides of the Atlantic, firms were not investing sufficiently. Banks were not lending enough because their portfolios were still infected. There was a huge differential between private market lending rates, as illustrated by the spread between lending rates in Germany and in Spain. The transfer of debt to the public sector meant that the cost of borrowing had increased. Fiscal rebalancing, based less on revenue measures than on expenditure reductions, had been implemented to bring down that cost.

65. The negative feedback loops were unfavourable to the labour market: if the private sector was not spending, the only way to renewed growth was through competitiveness and export growth. The fixed exchange rate in the eurozone and the fact that there could be no international devaluation led to wage reductions or freezes in many advanced economies.

66. Fiscal balancing was taking place through a reduction in the public sector wage bill. That was what was causing the 32.2 million jobs gap. The drop in aggregate demand that had resulted from private sector deleveraging and rebalancing in the public sector and improved growth through exports or competitiveness was based not on improving the common good but on beggar-thy-neighbour policies. More balanced drivers of growth and recovery were needed. Until export demand was balanced by domestic demand, growth would remain weak and the jobs gap would increase.

67. **Mr. Turner** (Organisation for Economic Co-operation and Development (OECD)) said that OECD was working to identify structural policies that would simultaneously promote growth and reduce inequality. Those that promoted skills and education attainment would be among the most important. A recent OECD publication, Going for Growth, highlighted opportunities for improvements in structural policies, including educational attainment.

68. There was overwhelming relief that the United States Government had not hit the debt ceiling and that the risk of a default had been avoided. However, no permanent solution had been reached. That was not merely a domestic matter. The world looked to the United States economy as an engine of growth. There would be major negative repercussions for the rest of the world economy if the debt ceiling problem returned in 2014. OECD members would go into recession, and fragile economies, especially in Europe, would be badly hit.

69. While all projections indicated that monetary policy in Japan would put an end to deflation, the lack of detail on how fiscal policy would stabilize and reduce government debt was disappointing. Further structural reform was needed.

70. The fact that excess capacity was not increasing in Europe was grounds for some optimism, as was the fact that interest rate differentials had started to decrease in countries on the periphery. However, projections indicated that there would be little decline in the output gap and thus very little reduction in the high unemployment levels. Interest rate differentials were still exceedingly high.

71. During the review of banks planned for 2014, it was important to determine whether the banks were adequately capitalized and to decide ahead of time what to do if they were not. Further steps should be taken to establish a creditable banking union with a backstop that had general funding. More structural reform was needed, especially in the core countries that had been running current account surpluses.

72. It was not clear whether the downturn in growth in Brazil, the Russian Federation, India, China and South Africa (BRICS) was cyclical or a potential trend. There was enormous scope in those countries for structural policies to promote growth, regardless of the causes of the lower growth observed thus far, as well as for reforming education, product market regulation and public sector efficiency.

73. **Mr. Escalona Ojeda** (Bolivarian Republic of Venezuela) said that it was important to coordinate economic and financial policies. The Economic and Social Council and the Second Committee had a crucial role to play in that regard.

74. It seemed that the banks were at the heart of the problem. Traditionally, they had served as investment intermediaries ensuring that savings were profitably invested. Recently, however, banks had been accumulating money in order to speculate, breaking the link between investment and growth.

75. To gain access to credit, developing countries must meet conditions that violated their sovereignty and implement procyclical policies that did not lead to growth, jobs and production. Credit must be facilitated for developing countries, whose growth and contribution to growth were currently limited. Recessionist policies were in place.

76. It was not clear whether North-South cooperation was in fact cooperation or a business arrangement. That was related to the problem of diminishing ODA and fulfilment of international commitments.

77. Increasing unemployment and inequality were outcomes of a particular consumption model more closely tied to the whims of the rich than to the needs of the poor. The production of items that were not a priority was linked to environmental deterioration. Unsustainable consumption led to growth that did not benefit humanity as a whole.

78. **Ms. Kage** (Germany) asked whether the Project LINK report contained information on the situation in developing countries.

79. **Mr. Hong** (Department of Economic and Social Affairs) said that the report contained data for 162 countries, including 130 developing countries. Unfortunately, reliable data were lacking for some countries.

80. Commercial banks had indeed served in the past as intermediaries between household savings and investment, taking an interest rate of some 2 to 3 per cent as income. With deregulation, they had grown greedier over the past 20 or 30 years, inventing numerous financial instruments and becoming involved in trading for their own profit. That was the problem in many developed countries, and it was the source of the subprime loan problem. The instruments that the banks had designed were packages, and no one knew their risks. Banks had lent to households that could not afford housing, persuading them to buy on the expectation of a price increase of 10 per cent within the year that would enable them to sell at a profit. Such a game could not go on forever. While the regulatory authorities understood the issue, the response had been slow and weak, owing to the influence of interest groups. There was still much to be done to reform the financial and bank sectors.

81. The financial crisis had increased inequality by causing many people to lose their jobs. In addition, macroeconomic policies in developed countries had increased income inequality. Quantitative easing, for example, injected liquidity into financial markets to boost equity prices, benefiting only the 40 to 50 per cent of the population who owned stock.

82. Because most households had not seen their income increase, demand was limited, slowing recovery. In addition, the wealthy generally consumed little, aggravating the lack of demand and resulting in a vicious circle. GDP could not recover quickly, which led to further unemployment.

83. **Mr. Mahmood** (International Labour Organization (ILO)) said that the deficiency in aggregate demand was a result of devaluation of assets, mainly houses, owned by households, as well as of employment and wage loss. Measures in advanced economies that were lowering household income were also a contributing factor, and those measures had been copied in developing economies.

84. While productivity and competitiveness were important in the long run, aggregate demand must be supported in the short run in order to emerge from the crisis. A more balanced growth path based on consumption and domestic and external demand was needed. The labour market required support, as a growth strategy. With a quarter of the adult population

and half of the youth population out of work, social protection measures were important.

85. **Professor Pauly** (University of Toronto) said that incentives and regulatory environments in many industrial countries favoured wealth redistribution over wealth creation, directing resources to activities that did not generate output. Policy decisions designed to free up economic activity had led to serious misallocations of resources. Underlying legitimate short-term concerns about lack of demand, jobs and real investment was a long-term structural problem. The regulatory and policy environment must favour real wealth creation over financial wealth creation.

*The meeting rose at 5.45 p.m.*