RE-THINKING MACROECONOMIC POLICY FROM THE PERSPECTIVE OF EMPLOYMENT AND INCLUSIVE DEVELOPMENT
NOTES FOR SESSION 1

Prepared by

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OUTLINE

- Three thematic pillars
- Employment and inclusive development: overview
- Context: rethinking macro vs business as usual
- The conventional framework and its critique:
- Monetary Policy
- Fiscal Policy
- Exchange rate and capital account management
- Future directions:

1. Monetary Policy
2. Fiscal Policy
3. Exchange rate and capital account management

THREE THEMATIC PILLARS

These notes rest on three thematic pillars:

(1) rethinking macroeconomic policy from the perspective of employment and inclusive development (session 1)

(2) aligning macroeconomic policy to support sectoral strategies for employment promotion (sessions 1 and 2)

(3) macroeconomic policy,inequality and labour market institutions (session 2)

EMPLOYMENT AND INCLUSIVE DEVELOPMENT:OVERVIEW

Employment plays a key role in inclusive development which entails:

(1) Sustained increase in per capita GDP

(2) Sustained reduction income and non-income dimensions of poverty

(3) Significant progress towards full and productive employment at living wages and acceptable working conditions

(4) Stable level of low inequality or significant and sustained decline in high level of inequality

CONTEXT: RETHINKING MACRO VS BUSINESS AS USUAL

- Rethinking macro in wake of global financial crisis (Blanchard *et al*, 2010, 2012)
- Implementation of counter-cyclical policies in many countries in 2008-2009 (ILO/WB, 2012)
- New IMF template on labour market analysis (Sep 24, 2012)
- ILO/IMF collaboration since 2010
- ILO's International Labour Conference resolution 2010, re-affirmed in 2012
- UN group on post-2015 Development Agenda
- WDR 2013 on jobs and development
- IFC report on jobs and the role of the private sector (2013)
- McKinsey report on jobs and Africa (2012)
- BUT…

CONTEXT: RETHINKING MACRO VS BUSINESS AS USUAL

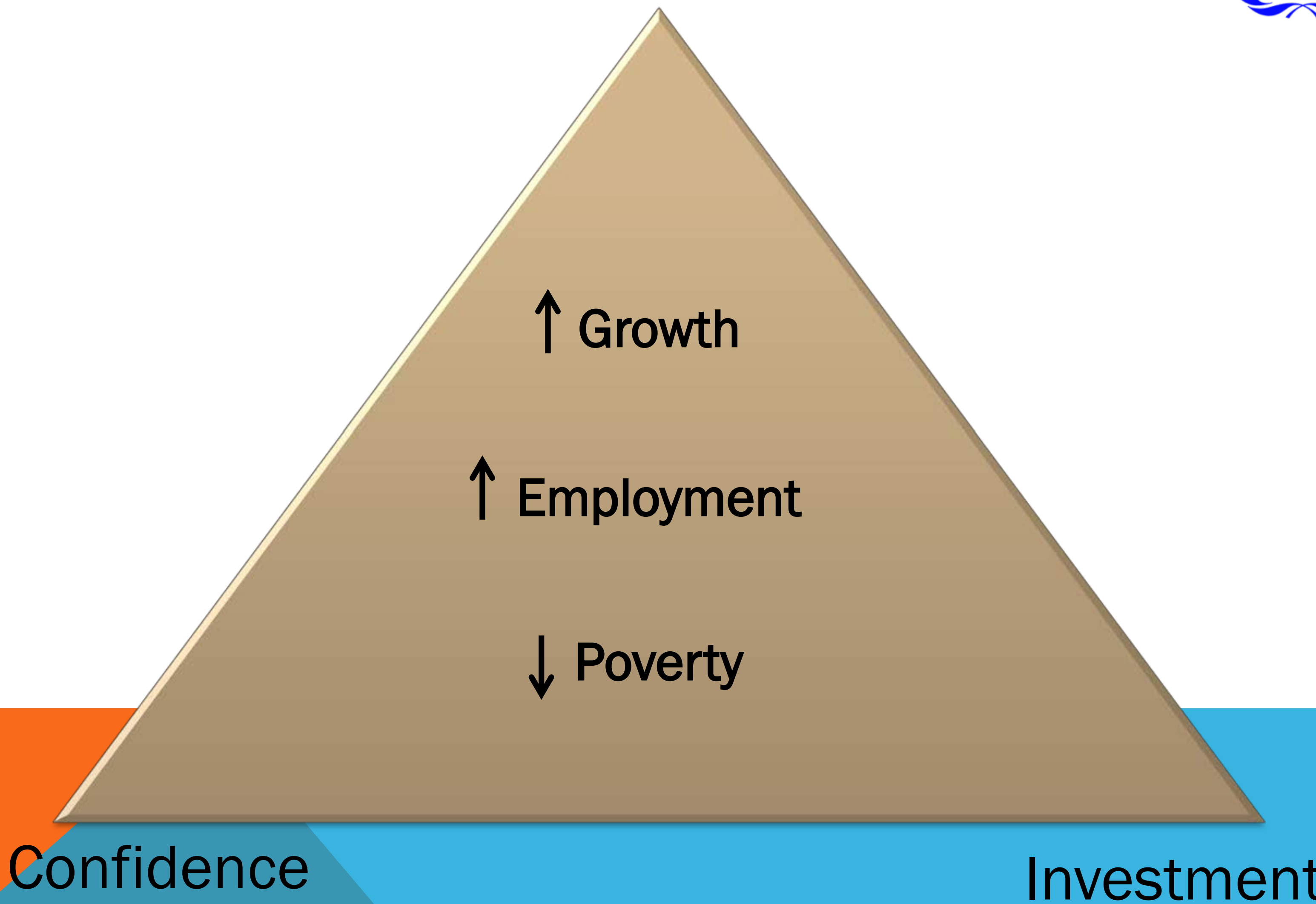
- Revisionist moments do not necessarily last
- Who remembers the revisionism of mid-2000s?
- Barcelona Forum 2004, Montiel and Serven 2006, Zagha *et al* 2006, WB 2005, IMF 2005, Development Cttee 2006
- Business as usual today through fiscal austerity agenda in Eurozone and EU
- Revisionist moments need resolute movements for change

THE STANDARD FRAMEWORK

Macroeconomic stability part of the ‘fundamentals’ that support growth and jobs (WDR, 2013:3)

See diagram>>>

Macroeconomic Stability



CONVENTIONAL FRAMEWORK

- Stability conceived as key targets on:
- Inflation
- Debts and deficits
- External balance
- Policies framed around those targets

MONETARY POLICY IN THE CONVENTIONAL FRAMEWORK

- Low, single digit inflation targets across all countries
- Actual announced targets for 18 developing and emerging economies: 3.5 %
- Reduced inflation risks lead to low real borrowing rates
- Boosts private investment
- Approach 'pro-poor' because inflation hurts poor

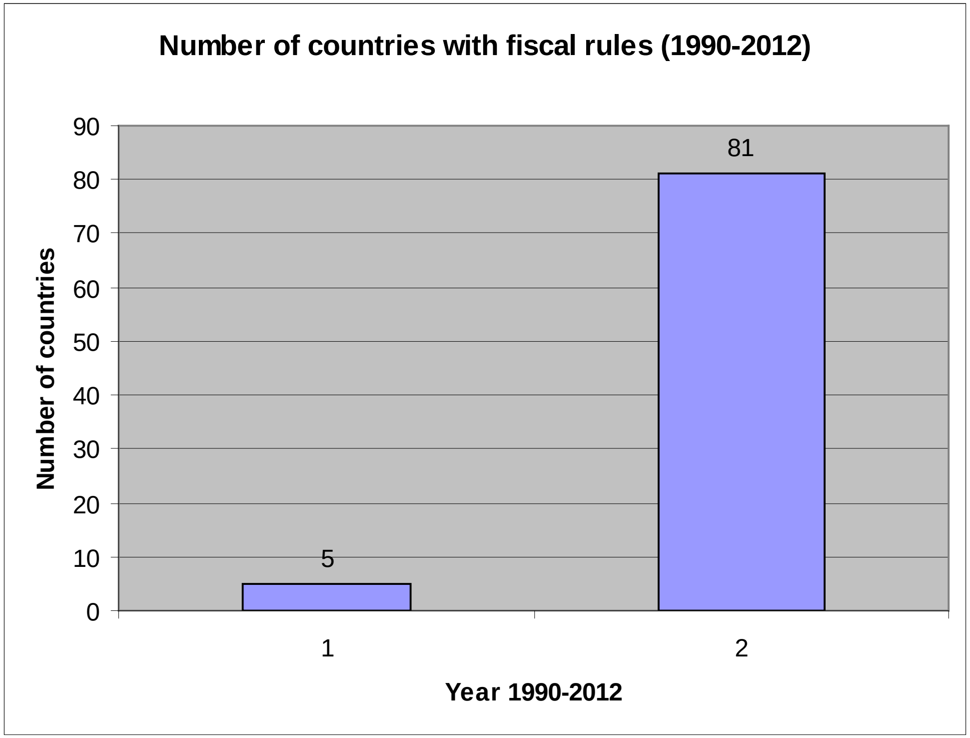
FISCAL POLICY IN THE CONVENTIONAL FRAMEWORK

- Observe debt limits
- <40% of GDP in LICs and MICs (IMF, 2002; IMF Fiscal Monitor 2010)
- Observe deficit limits
- 1%-2% of GDP: one suggestion (Williamson, 2002)
- <5% of GDP in practice

FISCAL POLICY IN CONVENTIONAL FRAMEWORK

- Front-loaded fiscal consolidation (FLFC) when debt/deficit limits breached significantly
- FLFC have little or no contractionary impact
- Might even be ‘expansionary’ (Alesina *et al*, 2010)
- ‘Credible’ fiscal policy boosts private investment
- ‘Credible’ fiscal policy needs rules on budgetary aggregates
- Growing popularity of fiscal rules
- See diagram>>>

FISCAL RULES ARE NOW POPULAR



EXCHANGE RATE REGIMES IN THE CONVENTIONAL FRAMEWORK

- Consensus of the 1990s: Need ‘corner solutions’
- Either hard pegs or independent floating
- Also focus on forex adequacy
- Forex reserves should be equal to at least 3 mths import coverage

CAPITAL ACCOUNT MANAGEMENT IN CONVENTIONAL FRAMEWORK

- 'IFIs and G7 governments generally treat capital mobility as something to be encouraged' (Barcelona Forum, 2004)
- In 1997, IMF suggested open capital account as eventual policy goal for LICs and MICs (Bhagwati, 1998)
- But…momentum stalled after 1997 Asian financial crisis

CRITIQUE OF CONVENTIONAL FRAMEWORK

'Over the 1990s macroeconomic policies improved in many developing countries, but the growth dividend from this fell short of expectations and a policy agenda focused on stability turned out to be associated with a multiplicity of financial crises'

'A single-minded pursuit of macroeconomic stability may have come at the expense of growth-enhancing policies…'

(Montiel and Serven, 2006: 152; 170)

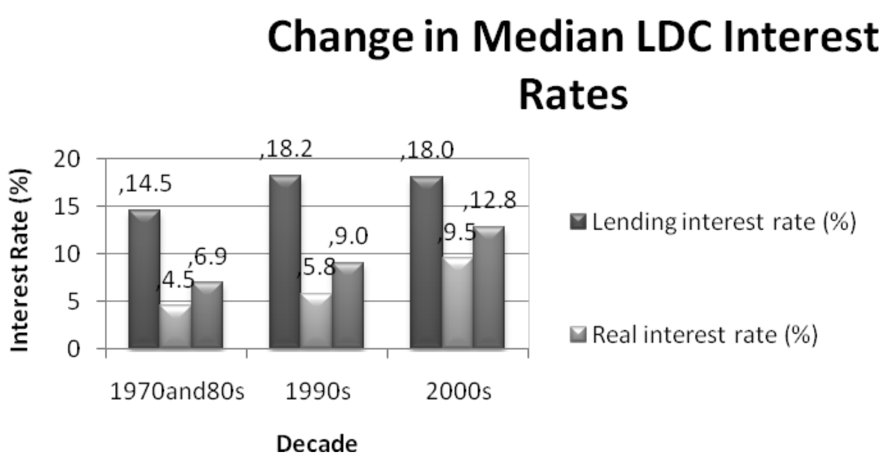
CRITIQUE OF CONVENTIONAL FRAMEWORK: MONETARY POLICY

- ‘Inflation targeting - narrowly defined - has seen its best days’ (Frenkel, 2010)
- Does not take account of ‘threshold effects’ in growth-inflation relationship
- 11-17% from comparative studies
- 6-11% from country-specific studies
- Announced inflation targets disconnected from long-run (50 yrs) inflation rates for LICs and MICs

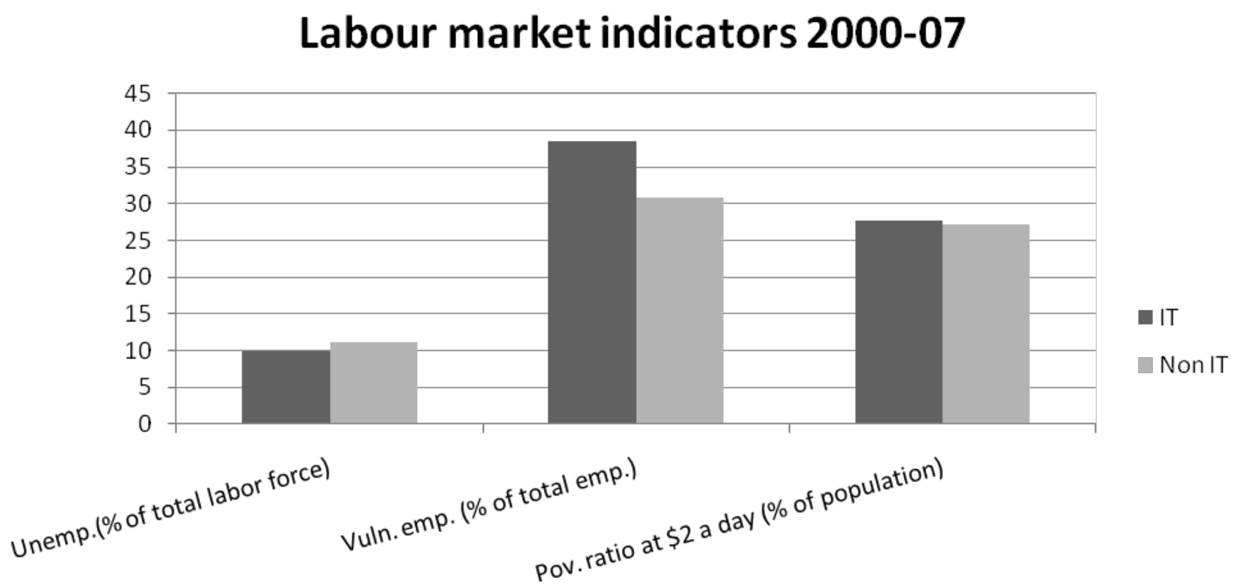
CRITIQUE OF CONVENTIONAL FRAMEWORK: MONETARY POLICY

- Not well equipped to handle supply-side inflation, esp. food price inflation
- Global food price index of WB reached highest level in July 2012
- Global food price movements and domestic inflation rates closely correlated
- Does not monitor asset price bubbles
- Reduced inflation risk not captured in lower real borrowing costs
- IT countries do not do better than non-IT countries
- >>>graphs>>>

LENDING RATES DO NOT SEEM TO DECLINE



IT COUNTRIES NOT BETTER THAN NON-IT COUNTRIES (24 COUNTRIES)



CRITIQUE OF CONVENTIONAL FRAMEWORK: FISCAL POLICY

- New evidence questions reliability of fiscal thresholds
- Overwhelming evidence that FLFC contractionary
- Fiscal rules cannot guard against contingent liabilities
- Fiscal adjustments can end up compressing public investment across both developed and developing countries (Serven, 2007)

CRITIQUE OF CONVENTIONAL FRAMEWORK: EXCHANGE RATE REGIMES

- ‘There is a spectrum of possible exchange rate arrangements…No single arrangement is necessarily right for all countries all the time’ (Asia-Europe Finance Ministers Meeting, 2001)
- Hard pegs impose severe constraints on policy space
- Hard pegs associated with financial crisis and deep recession (e.g. Argentina in 1999-2001)
- Persistence of ‘intermediate regimes’

CRITIQUE OF CONVENTIONAL FRAMEWORK: CAPITAL ACCOUNT MANAGEMENT

- ‘LICs are largely cut off from private financial flows’
- ‘Private capital flows to MICs are highly volatile…even in countri s with sound policies’ (Barcelona Forum, 2004)
- Private capital flows impose severe constraints on policy space
- Creates ‘liability dollarization’
- Induces ‘fear of floating’
- Can trigger balance sheet recession (e.g. 1997 Asian Financial Crisis)

FUTURE DIRECTIONS

- Move away from ‘single mandat
- Adopt ‘dual mandate’
- Macropolicy managers should be
- (1) Guardians of stability
- (2) Active agents of development

FUTURE DIRECTIONS

Interventions through

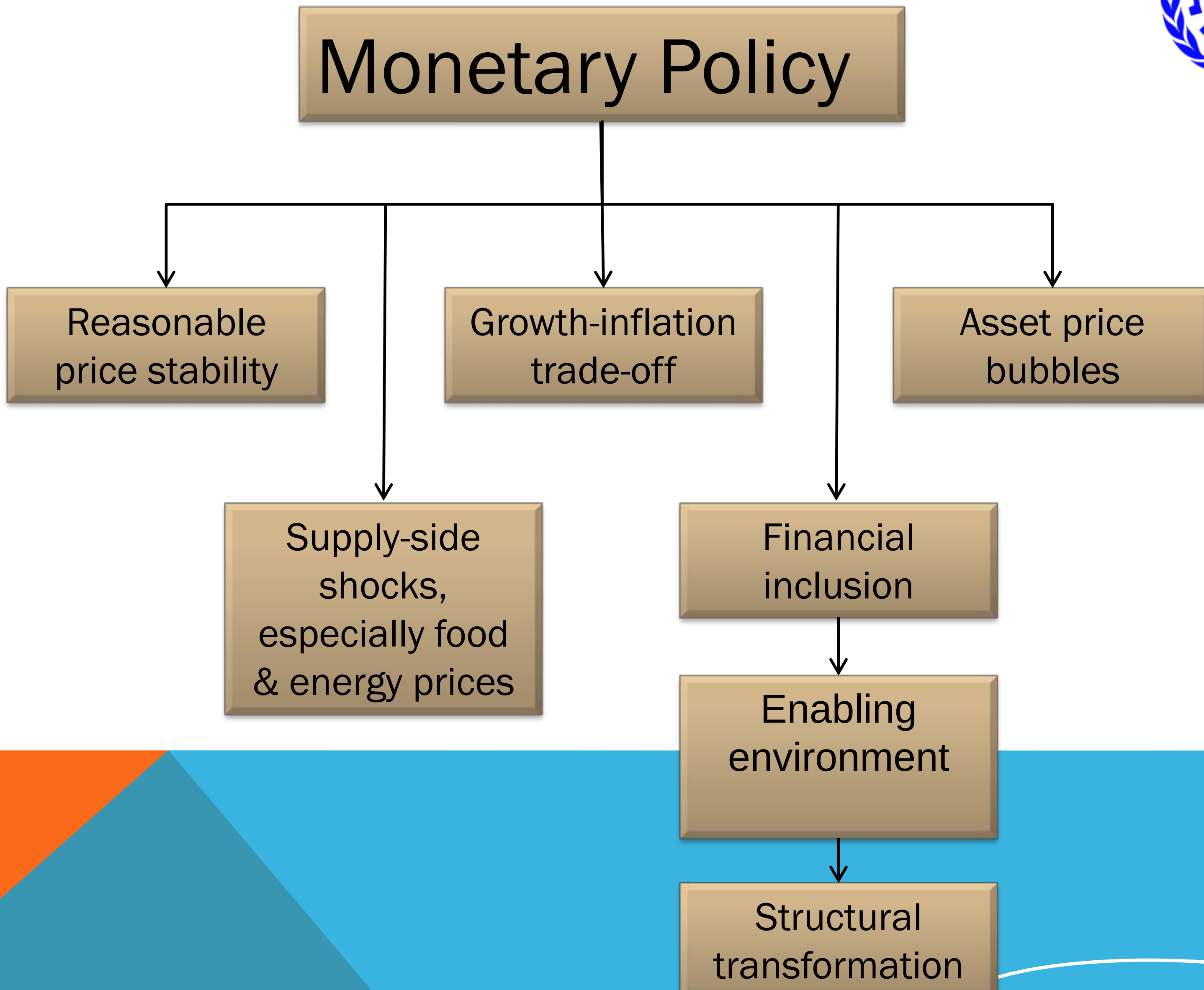
(1) counter-cyclical policies

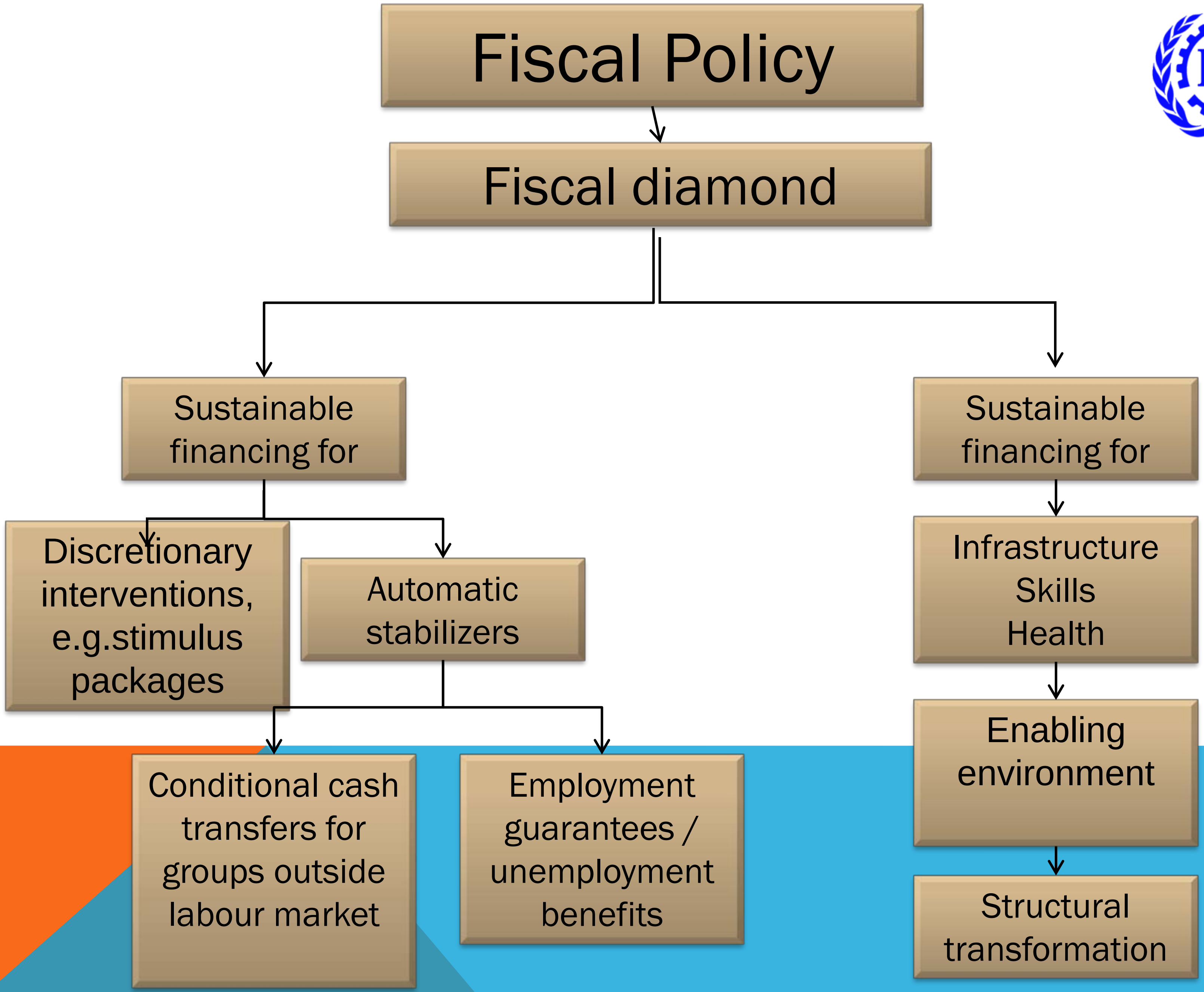
(2) long-term sustainable financing of core development goals

(3) financial inclusion

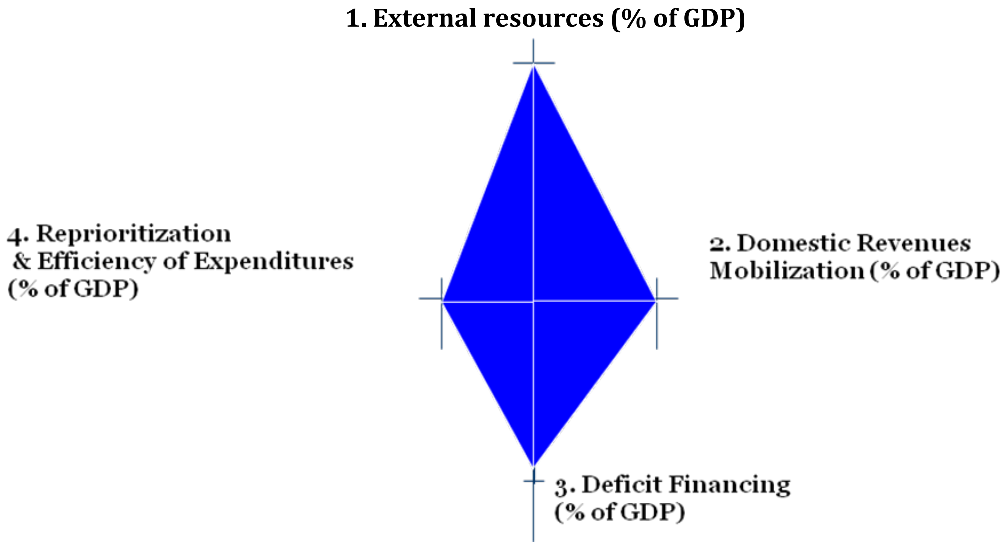
(4) prudent ex rate regime and capital account management

Leads to ‘enabling environment’ to promote inclusive growth and structural transformation>>>diagrams>>>


Monetary Policy
Reasonable price stability
Growth-inflation trade-off
Asset price bubbles
Supply-side shocks, especially food & energy prices
Financial inclusion
Enabling environment
Structural transformation


Fiscal Policy
Fiscal diamond
Sustainable financing for
Discretionary interventions, e.g.stimulus packages
Automatic stabilizers
Conditional cash transfers for groups outside labour market
Employment guarantees / unemployment benefits
Sustainable financing for
Infrastructure
Skills
Health
Enabling environment
Structural transformation

FISCAL DIAMOND AS BASIS FOR RESOURCE MOBILIZATION



FUTURE DIRECTIONS: EXCHANGE RATE AND CAPITAL ACCOUNT MANAGEMENT

- Move away from 'corner solutions', esp. hard pegs
- Use principle of sustaining stable and competitive real exchange rate regimes
- Evidence that impact on growth and structural transformation positive
- Corroborated by ILO-supported country-level studies (eg Argentina, El Salvador, Malawi) and in-house reviews of literature
- Pay attention to adequacy of foreign exchange reserves
- But …avoid excessive forex accumulation
- Prudent capital account management to avoid 'liability dollarization' and preserve policy space
- International rules for capital controls (Williamson et al 2012)

NOTES FOR SESSION 1/FINAL SLIDE

Thank you!

Please contact islami@ilo.org for further details on this presentation