MACROECONOMIC POLICY, GROWTH AND EMPLOYMENT: A DEVELOPMENT PERSPECTIVE

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OUTLINE

- 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 for macroeconomic frameworks for developing countries

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

CONTEXT: RETHINKING MACRO VS BUSINESS AS USUAL

- Rethinking macro in wake of global financial crisis (Blanchard *et al* , 2010, 2013, 2014)
- Implementation of counter-cyclical policies in many countries in 2008-2009 (ILO/WB, 2012)
- New IMF template on labour market analysis (2012)
- ILO/IMF collaboration since 2010
- ILO's International Labour Conference resolution 2010, re-affirmed in 2012 and 2014
- UN group on post-2015 Development Agenda
- ILO report (2014a) on 'developing with jobs'
- WDR 2013 on jobs and development
- IFC report on jobs and the role of the private sector (2013)
- IMF report on jobs and growth (2013)
- McKinsey report on jobs and Africa (2012)
- Challenge of ultra-low inflation in advanced economies
- BUT…

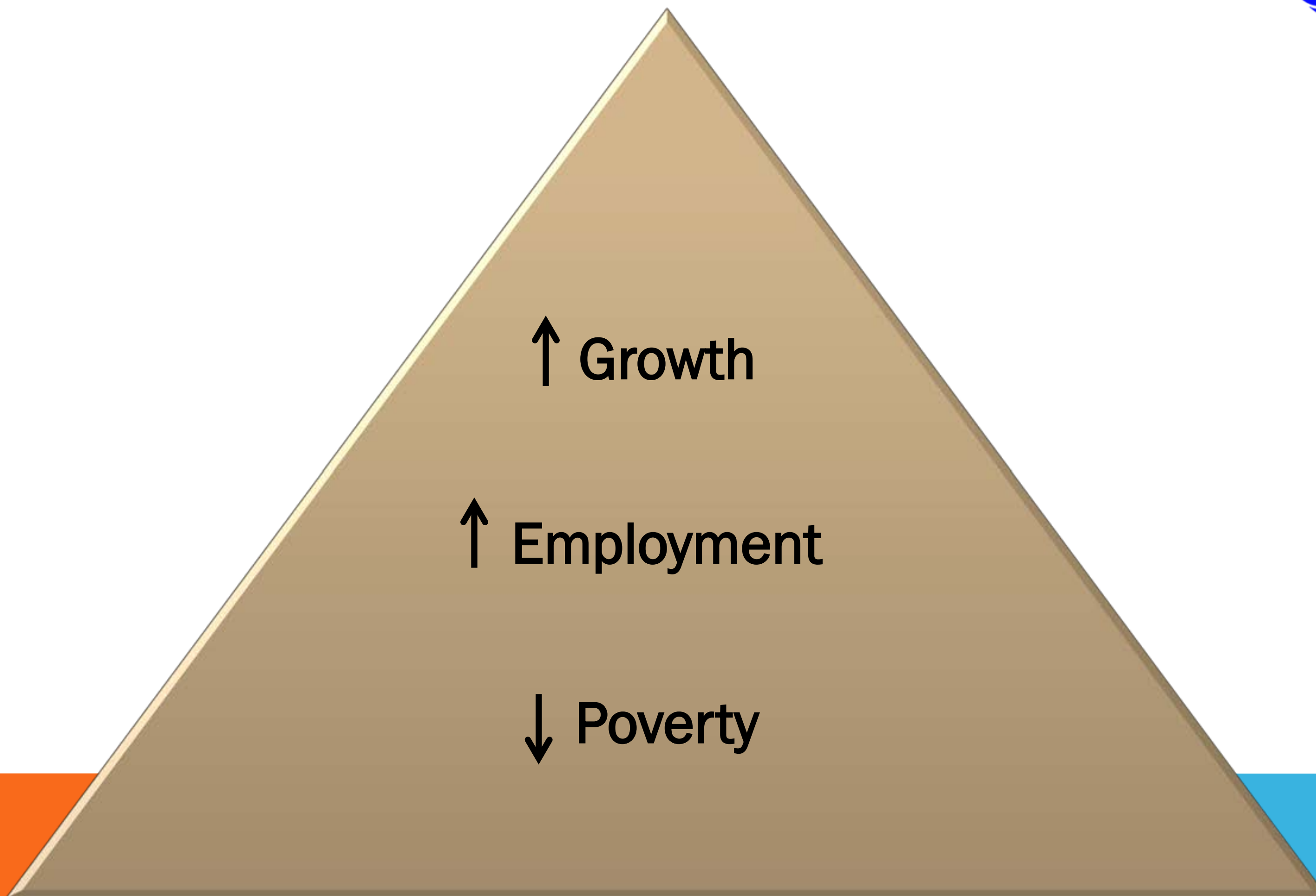
CONTEXT: RETHINKING MACRO VS BUSINESS AS USUAL

- 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

Macroeconomic stability part of the ‘fundamentals’ that support growth and jobs (WDR, 2013:3). Also, IMF (2013), IFC (2013), OECD (2014)

See diagram>>>

Macroeconomic Stability



Confidence

Investment

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
- Monetary policy in only 5 countries out of 51 LICs and MICs have employment as explicit objective (ILO, 2014)
- 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

INFLATION TARGETING REGIMES RELATIVE TO OTHER POLICY REGIMES, IMF, 2014 (%)

Exchange rate anchor	Monetary aggregate target	Inflation targeting	Other
47.6	13.1	17.8	22.5

TRENDS IN MONETARY POLICY REGIMES

- Inflation targeting (IT) regimes have declined over time.
- In 2008, 22.9 % of IMF member states could be classified as IT regimes
- In 2014, this proportion came down to 17.8%
- A 2015 survey (www.centralbanking.com) shows that 54% of respondents felt need to move away from IT regimes.
- Previous surveys suggested that 65% of respondents supported IT regimes

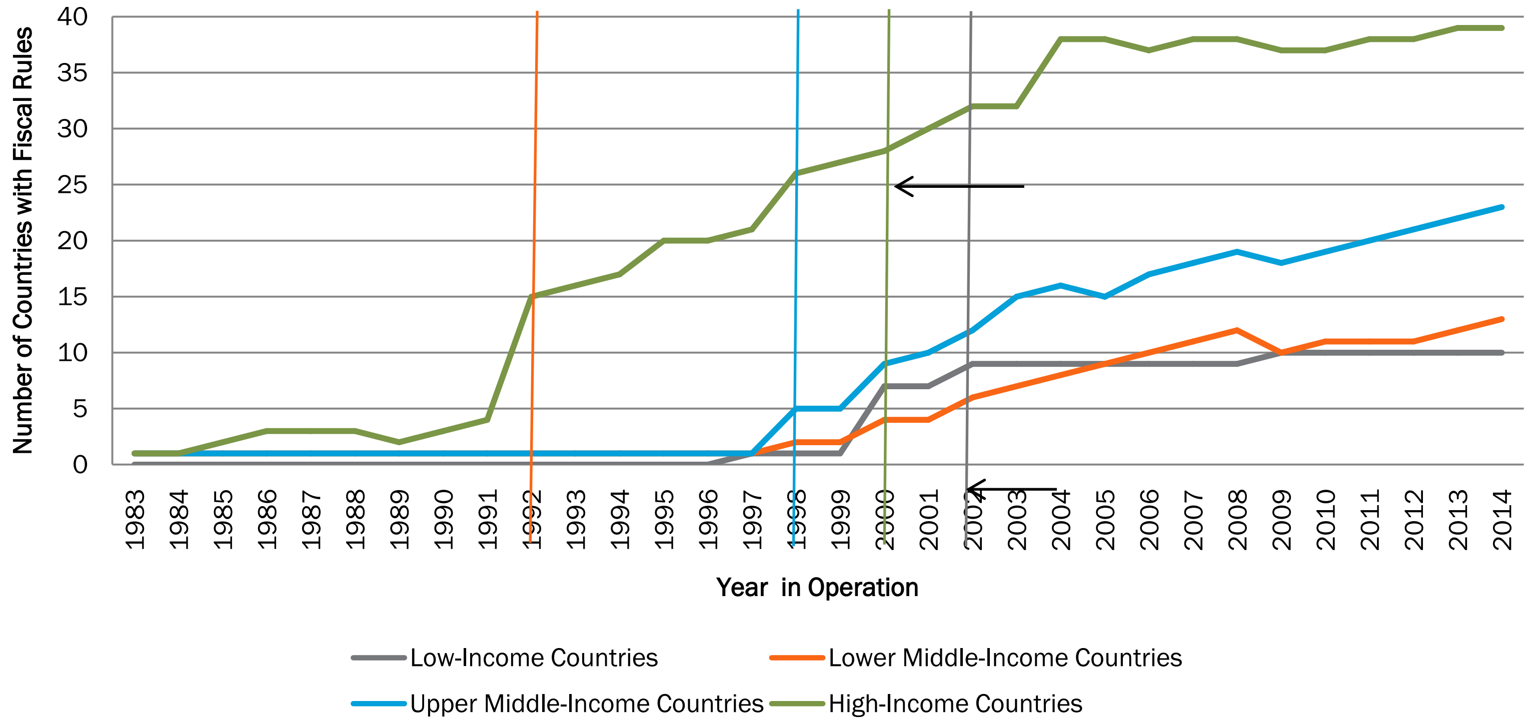
FISCAL POLICY IN THE CONVENTIONAL FRAMEWORK

- 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
- One advantage of independent floating is that it provides monetary policy autonomy
- 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

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

(Montiel and Serven, 2006: 152; 170)

CRITIQUE

- But… a 2009 paper (Sirimaneetham and Temple) claims that there is a statistically significant relationship between growth and a new index of macrostability (called ‘RMACRO’)
- Period of measurement is 1970-1999
- However, anomalous country-specific cases
- Examples: Uganda and Togo
- New index shows Togo among world’s best five in terms of macrostability (Table 4, p.458-9)
- Uganda among worst five (Table4, pp.458-9)
- Yet, Uganda does far better than Togo in terms of growth and social indicators (UNDP 2013)

CRITIQUE OF CONVENTIONAL FRAMEWORK: MONETARY POLICY

- ‘Inflation targeting - narrowly defined - has seen its best days’ (Frenkel, 2012)
- 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 (40- 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
- Transmission mechanism of monetary policy weak in LICs (Montiel, 2015)
- 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 consistently better than non-IT countries

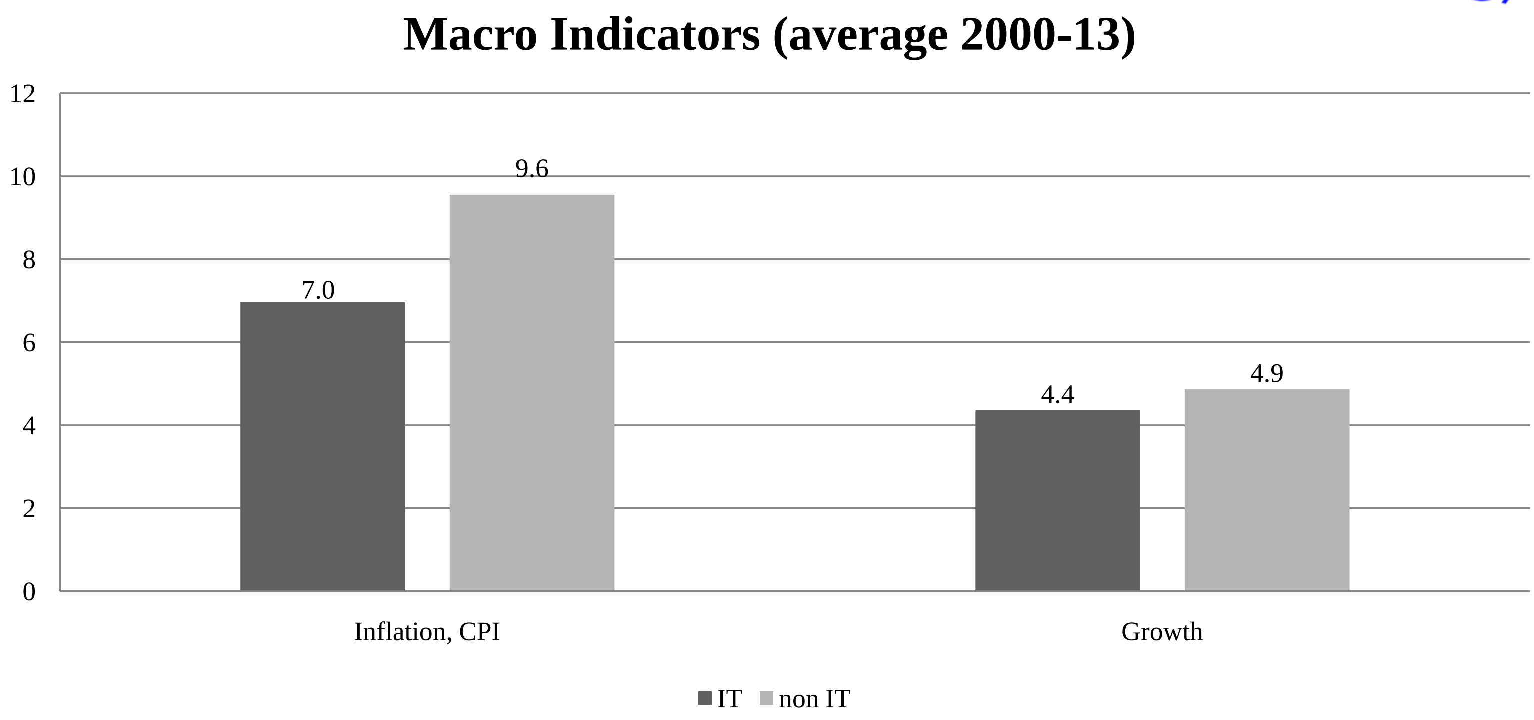
INFLATION AND GROWTH PERFORMANCE: 30+ ADVANCED COUNTRIES BY POLICY REGIME(COBHAM, 2015)

	Inflation (%) 1999-2007	Growth (%) 1999-2007
Constrained multiple Objectives	2.2	4.3
Single Objective of price stability	1.9	3.1

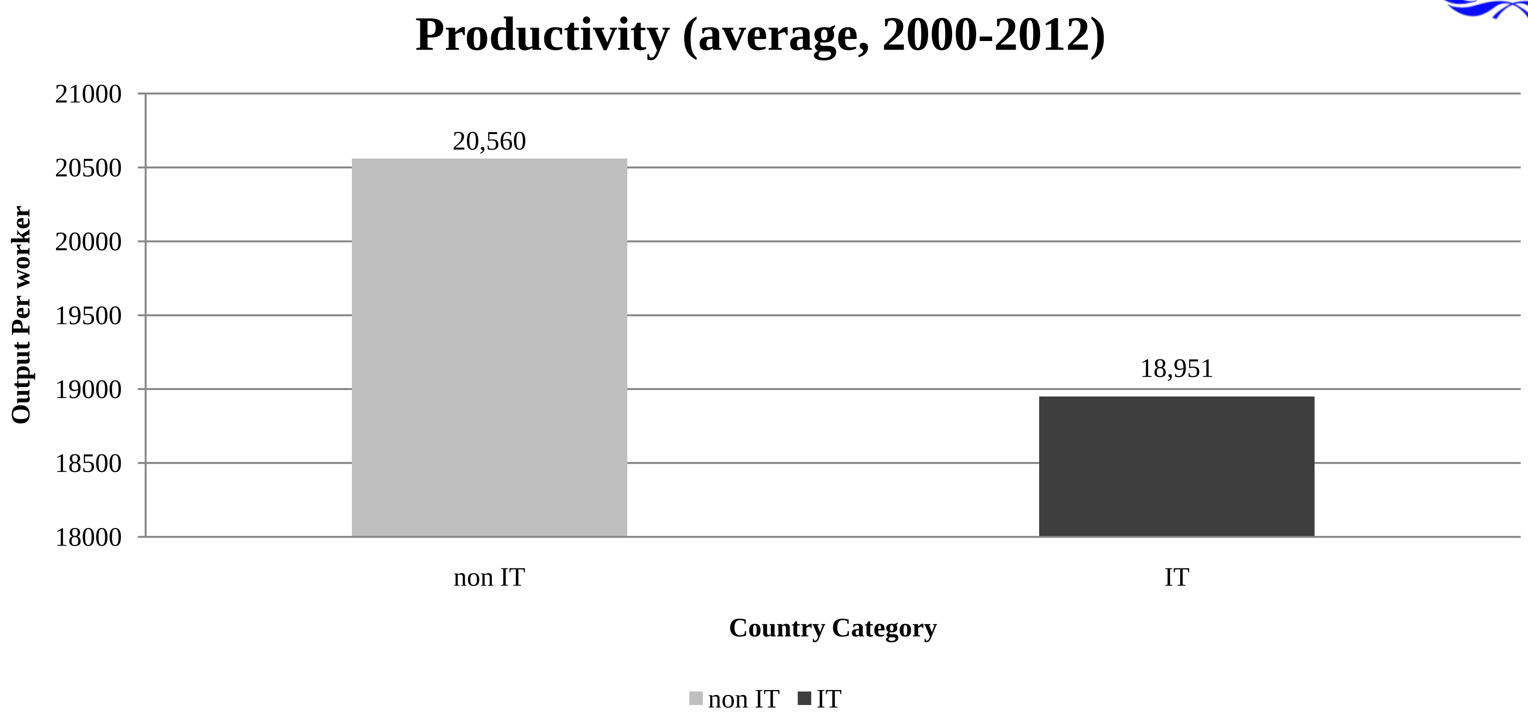
SOME EVIDENCE (SAN FRANCISCO FED, 2015)

- Inflation performance better for developing countries that adopted IT regimes
- Growth performance not better for adopters

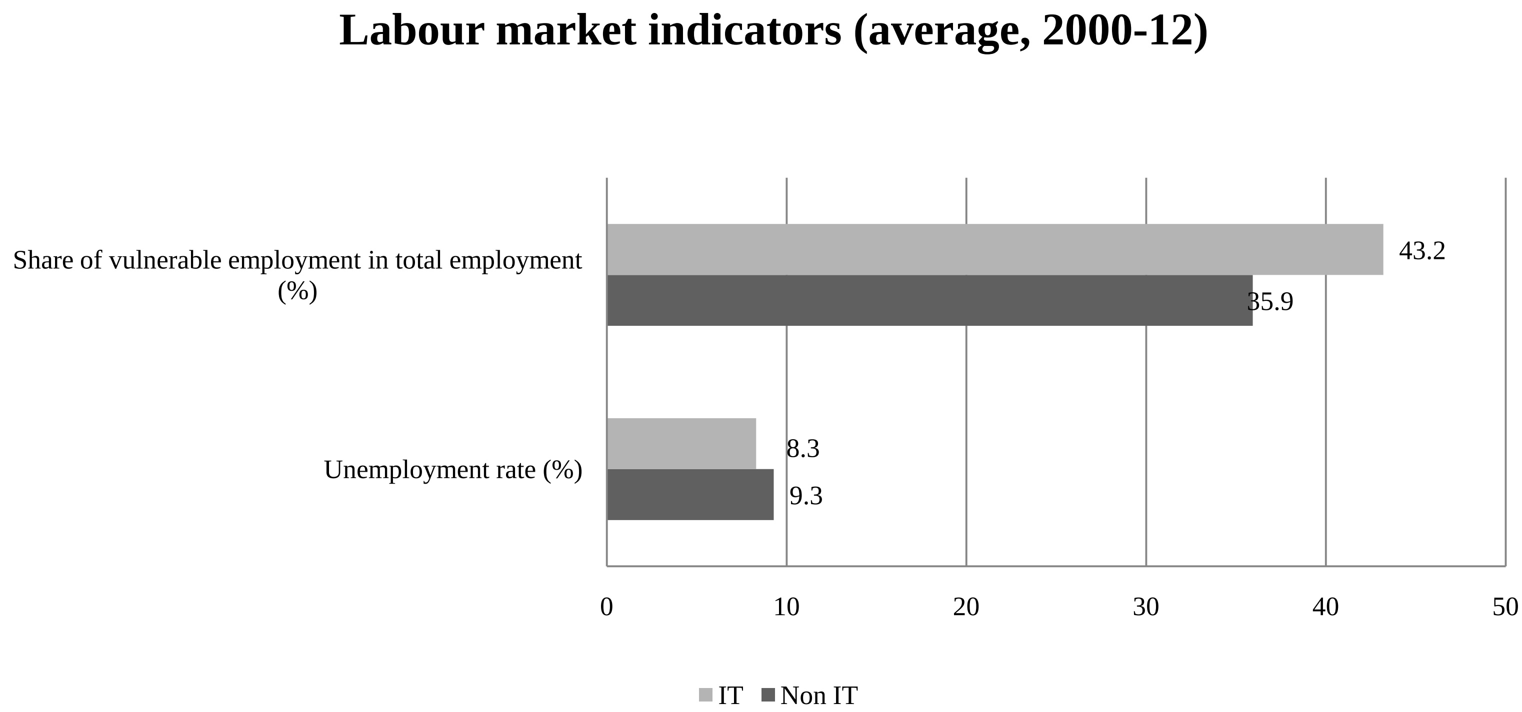
IT COUNTRIES VS NON IT DEVELOPING COUNTRIES (24 CASES) (ANWAR AND ISLAM, 2011;2014)



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



IT VS NON-IT COUNTRIES (24 DEVELOPING 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 (eg. Eurozone countries, Grauwe, 2011)
- Fiscal adjustments can end up compressing public investment (Easterly et al, 2007; Serven, 2007)
- In EA 18, public investment significantly lower now than in 2008
- No consistent record of better performance for countries with fiscal rules

FISCAL RULES, GROWTH AND LABOUR MARKET INDICATORS (RAY, VELASQUEZ AND ISLAM, 2015)

All developing countries (1997-2013)	With fiscal rules	Without fiscal rules
Working poor (%)	42.25	43.43
Vulnerable Emp(%)	58.44	57.10
Employment rate (%)	60.34	59.59
Unemployment rate (%)	8.31	8.30
Per capita GDP growth (%)	2.41	2.48

FISCAL RULES AND CROSS-COUNTRY GROWTH REGRESSIONS (RAY, VELASQUEZ AND ISLAM, 2015)

- Fiscal rules as explanatory variable in cross-country growth regressions do not seem to work well
- Fiscal rules -vely related to per capita GDP growth, contrary to expectations
- No statistically significant link between fiscal rules and domestic investment
- But…statistically significant link with FDI

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’

% OF IMF MEMBER STATES BY EXCHANGE RATE REGIMES, 2014

Hard pegs	Soft pegs	Floating with some intervention	Free floating	Other managed arrangement
13.1	43.5	18.8	15.2	9.4

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 countries 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)

CAPITAL MOBILITY: FURTHER OBSERVATIONS

- Recent work (2013) under taken by Helene Rey and others suggest that, in face of ‘global financial cycle ‘, even free floating exchange rates cannot insulate monetary policy
- Hence, some intervention needed to regain monetary policy autonomy
- Need combination of macro-prudential tools and capital controls to temper global financial cycle

FUTURE DIRECTIONS

- Move away from ‘single mandate’
- 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

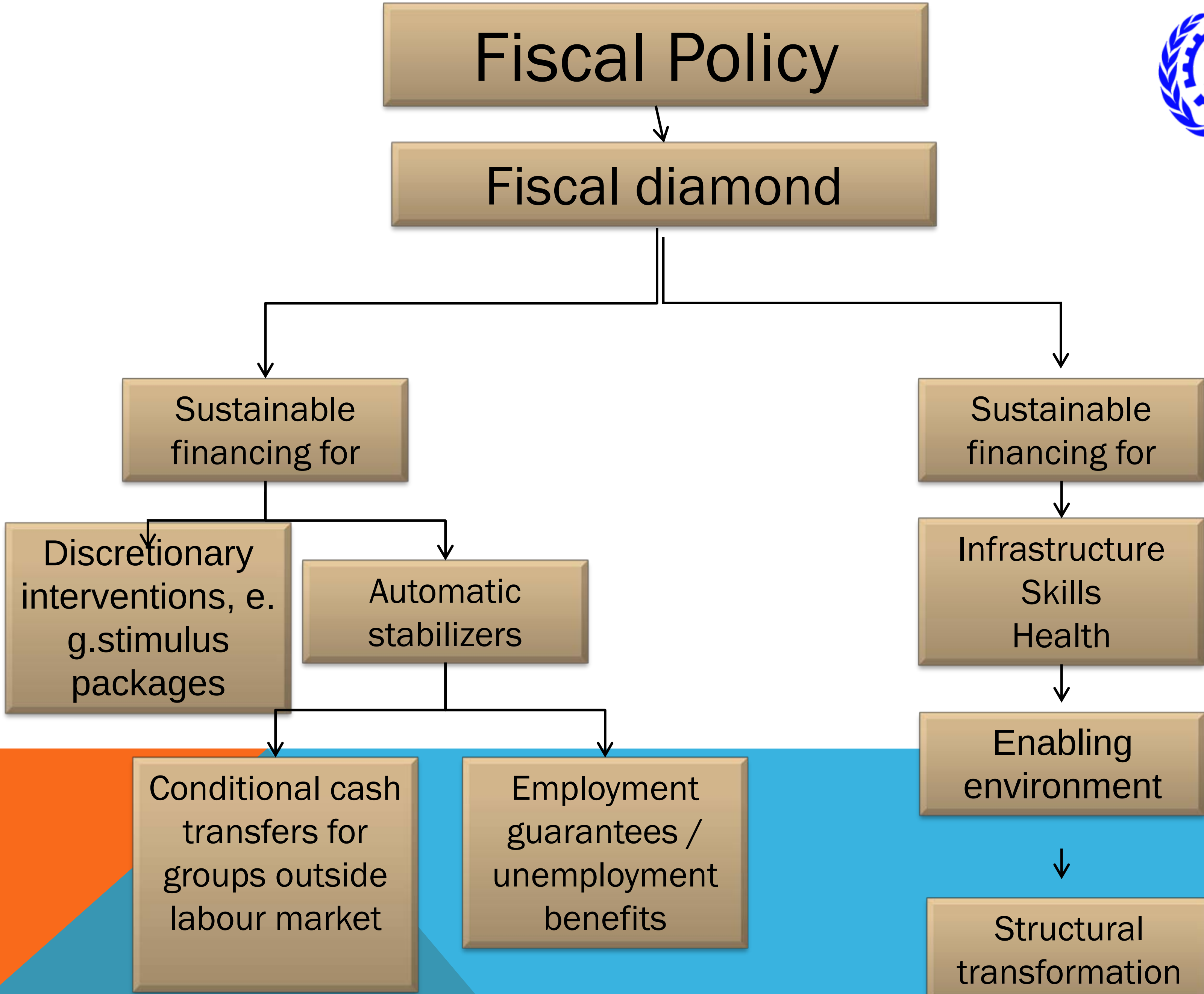
(3) financial inclusion

(4) prudent ex rate regime and capital account management

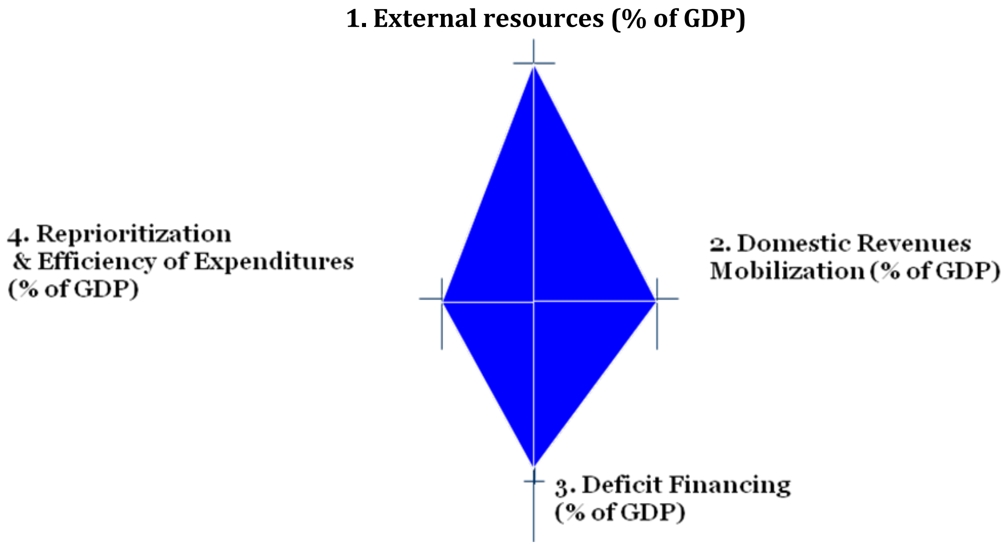
Leads to ‘enabling environment’ to promote inclusive growth and structural transformation>>>Graphs>>>

Monetary & Financial Policies

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


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)

Thank you!

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for further details on this presentation