

	2014
	<p>Employment Policy Department, ILO</p> <p>Workshop on:</p> <p><b>The Role of Central Banks in Meeting Development and Employment Challenges</b></p>

## Proceedings of the workshop

17-18 July 2014, Room VII, Geneva



## **Background:**

The global financial crisis has left lingering effects on the world of work. Since the onset of the crisis 28 million jobs are estimated to have been lost. Some 197 million people were left jobless in 2012. In addition, 39 million people were estimated to have withdrawn from labour markets due to gloomy prospect of finding a job. Besides, the quality of jobs has deteriorated. The impact of the jobs crisis has spread beyond the epicentres of the financial crisis to the developing world, where creation of productive employment is crucial for improving the welfare of the population.

The protracted jobs crisis has brought to the fore employment creation as a priority policy agenda. In recent years, various G8 and G20 Leaders' Summits stressed the importance of addressing the global jobs deficit. For instance, the G20 Task Force on Employment have embarked on a G20 employment agenda and also the European Commission called for coordinated growth and job creation efforts in order to tackle the protracted jobs crisis which has particularly affected youth.

Challenges of job creation today, however, are compounded especially because governments in the world are faced with narrowing fiscal space and still gloomy economic outlook. Indeed, although influential drivers of macroeconomic policies and development agendas in the past two decades prior to the global financial crisis have been in demise, many countries are yet to implement an alternative policy framework that accelerates job creation in a sustainable manner. Hence, the 99th session of the International Labour Conference (June, 2010) and the 101st session of the International Labour Conference (June, 2012) urged the ILO to promote pro-employment macroeconomic policies

Against this backdrop, the ILO-Korea partnership project 2013-2014 intends to generate evidence on the pivotal roles that central banks can play in pursuing the twin goals of macroeconomic stability and employment creation. It has thus carried out studies on the role of central banks in meeting development and employment challenges. This research examines mechanisms that allow central banks to influence employment creation and aims at informing national and global debates on the nexus between macroeconomic stability and employment growth.

## **Objectives:**

This seminar aims to deepen the understandings on crucial roles that Central Banks can play in meeting development and employment challenges of today. The insights gained from this meeting will be reflected in ILO's future technical assistance to developing countries in the field of national employment policy.

## **Target participants:**

20-25 in-house and external experts in employment, macroeconomics or development

## Agenda

17 July 2014	
09:30	<p><b>Opening Session</b></p> <p>Welcome and introductory remarks by <b>Sandra Polaski</b> (Deputy Director-General for Policy, ILO) and <b>Azita Berar Awad</b> (Director, Employment Policy Department, ILO)</p> <p>Remarks by <b>H.E. Mr Youngjip Ahn</b>, Ambassador and Deputy Permanent Representative, Permanent Mission of the Republic of Korea</p> <p>Chair: <b>Iyanatul Islam</b> (Chief, Employment and Labour Market Policies Branch, ILO)</p>
10:15	Coffee break
10:30	<p><b>Session 1. Central Banks: Beyond Inflation Targeting - Evidence and Policy Implications</b></p> <p>“Monetary Transmission in Low-Income Countries”  <b>Professor Peter Montiel</b>, Fairleigh S. Dickenson Jr. '41 Professor of Economics at Williams College, Williamstown, USA</p> <p>Chair: <b>James Howard</b> (CABINET, ILO)  Discussant: <b>Dr Ole Rummel</b>, Adviser, Centre for Central Banking Studies, Bank of England, London, United Kingdom</p> <p>Open discussion</p>
11:30	<p><b>Session 2. Central Banks in Developing Countries</b></p> <p>“The Role of Central Banks in Meeting Development and Employment Objectives”  <b>Professor Gerald Epstein</b>, Professor and Co-Director of Political Economy Research Institute (PERI) University of Massachusetts, Amherst, USA</p> <p>Chair: <b>Isabel Ortiz</b> (Director, Social Protection Department, ILO)  Discussant: <b>Mr Simon Zadek</b>, Co-Director of the UNEP Inquiry on Options for a Sustainable Finance System, United Nations Environment Programme (UNEP), Geneva, Switzerland</p> <p>Open discussion</p>
12:30	<b>Lunch</b>
14:00	<p><b>Session 3. The Role of Central Banks: The Case of Pakistan</b></p> <p>“The Role of Central Banks in Supporting Economic Growth and Creation of Productive Employment: The Case of Pakistan”  <b>Dr Asad Sayeed</b>, Director, Collective for Social Science Research, Karachi, Pakistan</p> <p>Chair: <b>Moazam Mahmood</b> (Research Department, ILO)  Discussant: <b>Dr Rossana Galli</b>, Lecturer, Institute of Political Science, University of Zurich, Switzerland</p> <p>Video conference with <b>Dr Mushtaq Khan</b>, Chief Economic Advisor, State Bank of Pakistan, Karachi, Pakistan (TBC)</p>

	Open Discussion
15:00	<p><b>Session 4. Central Banks in an Historical Perspective: The Case of Korea</b></p> <p>“Korea’s Economic Development and the Bank of Korea”  <b>Mr Young-Chan Kim</b>, Expert Consultant, Office of International Affairs, The Bank of Korea, Seoul, Republic of Korea</p> <p>Chair: <b>Dr Eddy Lee</b>, Expert on International Economics and Asian Economies  Discussant: <b>Uma Rani Amara</b> (Research Department, ILO)</p> <p>Open discussion</p>
16:00	Coffee break
16:15	<p><b>Session 5. The Role of Central Banks: The Case of Cambodia</b></p> <p>“Roles of the Central Bank in Supporting Economic Diversification and Creation of Productive Employment: the case of Cambodia”  <b>Dr Vouthy Khou</b>, Director, Economic Research and International Cooperation Department, National Bank of Cambodia, Phnom Penh, Cambodia</p> <p>Chair: <b>Dr Asad Sayeed</b>, Director, Collective for Social Science Research, Karachi, Pakistan  Discussant: <b>Dr Alexander Barkawi</b>, Director, Council on Economic Policies, Zurich, Switzerland</p> <p>Open discussion</p>
17:30	Cocktail Reception (Espace Gobelins)

**18 July 2014**

09:30	<p><b>Session 6. The Role of Central Banks: The Case of Ecuador</b></p> <p>“Financial Inclusion Policy in Ecuador: Roles of the Central Bank towards Economic and Job Creation”  <b>Ms Daniela Arias</b> (Expert Consultant) and presented by <b>Juan Chacaltana</b>, Employment and Labour Market Specialist(DWT/CO-Peru)</p> <p>Chair: <b>Yadong Wang</b> (Employment Policy Department, ILO)  Discussant: <b>Mario Berrios</b> (Enterprises Department, ILO) and <b>Yousra Hamed</b> (SFU-Enterprises Department, ILO)</p> <p>Open discussion</p>
10:30	Coffee break
10:45	<p><b>Session 7. Dual Mandates and Advanced Economies</b></p> <p>“Between Doctrine and Pragmatism: The ECB and the Crisis”  <b>Professor Francesco Saraceno</b>, Senior Economist, OFCE Research Centre in Economics of Sciences-Po, Paris, France</p> <p>Chair: <b>Ekkehard Ernst</b> (Research Department, ILO)  Discussant: <b>Matthieu Charpe</b> (Research Department, ILO)</p>

11:45	<p>Open discussion</p> <p><b>Session 8. The Role of Central Banks: The Case of Mozambique</b></p> <p>“Meeting the Development and Employment Challenges in Mozambique: Role of the Central Bank”</p> <p><b>Kazutoshi Chatani</b> (Employment Policy Department, ILO) and <b>Oluwaseun Pedro</b> (Employment Policy Department, ILO)</p> <p>Chair: <b>Massimiliano La Marca</b> (Social Protection Department, ILO)</p> <p>Discussant: <b>Mr Jamal Omar</b>, Assistant Director, Research Department, Central Bank of Mozambique, Maputo, Mozambique</p> <p>Open discussion</p>
13:00	<p><b>Closing Remarks</b></p> <p><b>Iyanatul Islam</b> and <b>Nomaan Majid</b> (Employment Policy Department, ILO)</p>

## Opening remarks

By H.E. Mr Youngjip Ahn

Ambassador and Deputy Permanent Representative, Permanent Mission of the Republic of Korea

H.E. Mr Youngjip Ahn inaugurates the workshop by thanking Ms. Sandra Polaski for the invitation as well as the ILO for the on-going research supporting macroeconomic policies to achieve economic growth and employment creation.

The Ambassador explains that the Korean government has supported ILO research on macroeconomic policies since 2010. This seminar is part of the partnership between the Korean government and the ILO for the period 2012-2014 aimed to examine the mechanisms that would allow the Central Banks to pursue the dual goals of price stability and employment creation. The project also includes five central bank country cases studies in developing countries.

Next, the Ambassador explains the relevance of the seminar in the global macroeconomic context where economic recovery is slow and employment creation remains stagnant. He briefly overviews the main labour market indicators at the global level and highlights the challenges that job seekers face in a world with severe job creation deficits. He points out that much have to be learnt about employment in a globalized economy. He concludes by saying that the seminar aims at generating better policy-making responses to current challenges, in particular by answering to two questions: 1) What should be the Central Banks' mandate in the current economic context? Should they focus on inflation targeting and macroeconomic stabilization or should they help their countries develop and support productive growth and employment creation; and 2) how can Central Banks create and promote decent jobs that can also help to achieve social and economic development? How can Central Banks strike a balance between the stability role and the development role?

By Sandra Polaski

Deputy Director-General for Policy, ILO

Ms. Sandra Polaski welcomes the participants and makes the following observations:

- The ILO has long recognized that labour market outcomes are profoundly shaped by demand- and supply-side forces and by both macro- and micro-economic policies.
- This conviction has also been affirmed by our governance structures, especially since the 2007 financial crisis. Most recently, in June, the International Labour Conference, our highest governance body, discussed how ILO employment policy should be guided for the next four years and re-affirmed the need for the ILO to deepen its understanding of macroeconomic, sectoral and labour market policies and the way they shape employment outcomes.
- This has important implications also for the nature of our engagement with member states. It means reaching out to, and fostering linkages with, core macroeconomic policy institutions in addition to our regular interactions with Ministries of Labour and employer and worker organizations.

- It is in this context that the current workshop has been conceived. Central banks in both developing and advanced countries represent key macroeconomic policy actors. Their analytical frameworks and their actions shape the overall policy environment and we need to understand those frameworks and policy actions.
- In the wake of the global financial and economic crisis of 2007-2009, renewed debate is taking place on the appropriate role of central banks, especially in the advanced countries.
- How does one conduct monetary policy when interest rates hit a ‘zero lower bound’? Has the policy regime of inflation targeting run its course? Should the mandates of central banks be broader, focusing both on price stability and employment?
- In particular, the idea of a broader mandate for central banks is highly relevant for developing countries. As a core institution, it is reasonable that a central bank should centrally connected with core development concerns pertaining to growth and employment.
- A narrow remit focusing solely or largely on price stability is not sufficient. We recognize the necessity of reasonable price stability - inflation hurts the poor and hurts development. However price stability alone is far from enough to engender growth, development and employment creation.
- Indeed, even in advanced countries, the issue of a ‘dual mandate’ for central banks – one that focuses on both price stability and employment - is very much part of contemporary discussion.
- In my own country, the United States Federal Reserve System has renewed its commitment to the dual mandate in a context of sluggish growth and slack labour market conditions. Recent research by the Boston Fed shows that **central banks with a dual mandate in advanced countries have a better record on employment and as good a record on price stability than single mandate central banks.**<sup>1</sup>
- The focus on a broader approach to macroeconomic policy that goes beyond concerns about stability is also reflected in the deliberations of the G20.
- As the premier body dedicated to international economic policy coordination, it has brought together finance ministries, central bankers and employment ministries to engage in a dialogue in a common global forum. It has encouraged G-20 member states to focus on the employment effects of macro-policy settings. In an innovation this year, countries will present growth strategies and national employment plans in integrated policy documents which will form the background to the Leaders’ Summit in Brisbane, Australia in November 2014. We in the ILO are actively engaged in this process.
- Our engagement with central banks is growing in significance:
  - For example, the Social Finance Unit in the Enterprise Department is working with central banks in Indonesia and Morocco in the implementation of their financial inclusion policies.

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<sup>1</sup> <http://www.bostonfed.org/news/speeches/rosengren/2013/041213/index.htm?wt.src=rss>

- Our Bangkok Office has worked with the Bank of Thailand on the employment dimensions of monetary policy.
- Our San Jose Office in Costa Rica is currently assisting the Ministry of Labour in its policy dialogue with the Central Bank. The expectation is that, as a result of this dialogue, the central bank will review its mandate that currently focuses largely, if not solely, on low and stable inflation.
- This workshop is part of our growing quest to deepen our linkages with central banks as well as with academics and practitioners who are experts in the field of macroeconomic policies and have a particular interest in the centrality of such policies from a development and employment perspective.
- We hope to learn from the collective reflections of distinguished participants in this workshop and use this knowledge to support our mandate and mission as the key international organization dedicated to improving conditions in the world of work. Such conditions will only improve if there are ample and productive employment opportunities for all.

By Azita Berar Awad  
 Director, Employment Policy Department, ILO

Ms. Azita Berar Awad welcomes participants to the workshop and highlights the importance of the event as part of a series of activities aimed at deepening policy oriented research on macroeconomic frameworks development and employment outcomes. The results of this research build capacity and policy tools that strengthen the integration of pro-employment macroeconomic frameworks with employment policies.

Ms. Berar Awad underlines two points that provide the background of the event: (i) As part of the mandate of the ILO, the department has undertaken a series of analyses on macroeconomic policy frameworks and dialogues at the country level in particular in developing countries in all regions to better understand the linkages between macroeconomic frameworks and employment outcomes, especially during the crisis. (ii) In the context of the numerous country requests received every biennium for technical support on employment policies and strategies, the ILO is increasingly broadening its diagnostic framework to include the dimensions of pro-employment macroeconomic policy, sectoral policy, labour market policy and institutions, skills development etc. The findings of this research feed into broad-based social dialogue that include, beyond the traditional tripartite constituents (Ministry of Labour and Employers' and Workers' organizations), Central Banks, Ministry of Finance, Ministry of Education and Sectoral ministries.

Ms. Berar Awad concludes by thanking the Ambassador of Korea and the Government of Korea for their continuous support and partnership with the ILO over the years which made possible the organization of this important event.



## Session 1. Central Banks: Beyond Inflation Targeting - Evidence and Policy Implications

**Presenter:** Professor Peter Montiel, Fairleigh S. Dickenson Jr., Professor of Economics at Williams College, Williamstown, USA

**Discussant:** Dr Ole Rummel, Adviser, Centre for Central Banking Studies, Bank of England, London, United Kingdom

**Moderator:** James Howard, (CABINET, ILO)

### **Presenter:**

Professor Montiel focuses on three major points in his presentation on “Monetary Transmission in Low-Income Countries”. First, he discusses the theoretical difference between monetary transmission mechanisms in low-income countries compared to high-income countries. The second point he makes relates to the difficulties in finding systematic empirical evidence in support of a strong and reliable transmission mechanism in the low-income countries. Thirdly, he discusses the challenges in identifying suitable policy implications for weak and less reliable monetary policy transmission. Professor Montiel argues that in low-income countries the financial architecture and the policy environment differ in ways that are likely to influence the effectiveness of monetary transmission. Given these reasons, the credit and lending channel is the most likely mechanism through which monetary policy is transmitted to aggregate demand in low income countries. However, the credit and lending channel could also be less effective as a result of severe credit-market frictions in the forms of both asymmetric information and moral hazard leading to high costs of contract enforcement and oligopolistic behaviour in the banking sector. In the end, the presenter states that the policy implications need to be worked out as this is ongoing research; however, referring to Brainard (1967), he quotes “if you have a policy instrument that is *noisy*, it is better not to apply it forcefully”. Therefore, if monetary policy transmission mechanism is weak and less reliable it is better to adopt weak inflation targeting.

### **Discussant:**

The discussant Dr. Ole Rummel reiterates that the stabilisation channels in developing countries remain acute and identifying the means of enhancing the effectiveness of monetary policy in such cases is an important challenge for policy makers and researchers alike. In addition, he mentions that although the central bank’s hands for direct actions in meeting employment and development challenges are tied, there remains a range of indirect actions or tools that come with the “independent” role of the central bank, such tools include: moral suasion and providing support/advice for other government institutions.

### **Open discussion:**

During the open discussion, a participant notes that since the 2008 financial crisis, there has been a difference in the frictionless textbook model on monetary transmission mechanism and the reality in advanced economies is that the interest rate has gone down and bank lending has remained low. Another participant asks whether there is an attempt at the inclusion of the informal financial sector in the analysis carried out by the presenter. Others questions and comments include the issue of an alternative way of monetary policy, or the type of policies lessons that can be drawn from the impulse response of emerging economies and low-income economies.

Professor Montiel replies to these remarks by stating that the lesson from the financial crisis is that frictionless model does not capture reality. Secondly, explaining that research has always focused on perfect segmentation between the formal and the informal sector, which is problematic. A better understanding of monetary policy in developing countries would need to take into account the informal financial sector. Next, he suggests that an alternative policy would be looking more closely at the IMF:

“Two Target Two Instruments” approach on monetary and exchange rate policies. He addresses the last comment by stating that the deficiencies in policies are the sources of friction in low-income countries and his area of research is focused on the impact of monetary policy on aggregate demand. Dr Rummel adds that understanding the labour market still poses as a huge challenge for central banks; the Bank of England for example still does not have a full grasp of how the labour market works in England.

## Session 2. Central Banks in Developing Countries

**Presenter:** Professor Gerald Epstein, Professor and Co-Director of Political Economy Research Institute (PERI), University of Massachusetts

**Discussant:** Mr Simon Zadek, Co-Director of the UNEP Inquiry on Options for a Sustainable Finance System

**Chair:** Isabel Ortiz, Director ILO Social Protection Department

### **Presenter:**

Professor Epstein starts his presentation “The Role of Central Banks (CBs) in Meeting Development and Employment Objectives” by stating that developing countries have to adopt a macroeconomic framework that helps to promote decent employment. However, he doubts that the CB policies in place are appropriate for the achievement of this goal. There is a widespread belief that CBs should primarily focus to achieve a single digit inflation target (IT). While Prof. Epstein underlines that low inflation is important, he also argues that it should not be the only focus of CBs since it pushes aside other problems such as unemployment and poverty. Among others, Prof. Epstein criticizes the following aspects about the current CB policies: First, price stability does not per se imply macroeconomic stability nor does it automatically lead to economic growth and employment creation. Second, there is no empirical evidence that 5 percent or less is an appropriate inflation target for developing countries. Third, some of the implicit assumptions<sup>2</sup> of central banking are not met in a developing country context requiring a different approach taken by CBs. Fourth, the source of inflation matters. In developing countries, inflation is often caused by supply shocks with limited options by the CBs to react. Next, the presenter talks about a global study undertaken in various countries looking at alternatives to IT that are more suitable for development and employment generation. Some aspects are: investment promotion and stable exchange rates. Then, Prof. Epstein presents examples of countries that either have already broadened their CBs’ targets and instruments (Argentina and Bangladesh) or that are planning to do so (Madagascar and South Africa). Lastly, the presenter comments on potential objections to arguments for more CB orientation to development and employment generation. Among others, he brings forward the following arguments: First, in reply to the objection that CBs should only focus on prices and let other institutions deal with other policy areas, Prof. Epstein comments that without coordination, de-centralized activities can lead to instability. Second, concerning the fear that a greater focus on development and employment compromises CBs’ independence, the presenter points out that there is no such thing as real independence and that CBs are necessarily part of the political process. Lastly, with regards to the fear of overloading CBs with more tasks, Prof. Epstein replies that CBs cannot do everything, but that they can and must play a greater supporting role.

### **Discussant:**

Mr. Zadek comments on Prof. Epstein’s presentation from an environmental perspective. He agrees that CB policies need to be adjusted to the means of the real economy such as employment or environmental issues. In this regard, he states that it is not necessary to invent a new set of roles for CBs, but to apply the ones that were already used in the past. Additionally, he poses a couple of questions and makes a few comments: First, he asks whether climate change represents a threat to the current financial system and whether all credit is good credit. Second, he mentions the time horizons CBs operate which tend to be

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<sup>2</sup> These assumptions include the following: 1) Inflation rates above low single digits are harmful to economic growth; 2) financial markets allocate savings efficiently so there is no need for CBs to direct credit; 3) international capital flows are allocated efficiently, therefore there is no need for capital management techniques; and 4) the economy automatically reaches full employment and the medium to long run, therefore there is no need for CBs to target employment.

short and therefore the necessity of thinking more about long run consequences, especially with respect to environmental issues and climate change.

Concerning the role of CBs with respect to climate change, Prof. Epstein replies that climate change is already implicitly having an impact on monetary policy by influencing commodity prices to which CBs react. He also stresses that CBs should react to climate change more explicitly.

**Open discussion:**

The audience asks the reasons why CBs decided to focus on IT in the first place. According to Prof. Epstein, this was a reaction to the high inflation in the 70s and 80s as well part of the neoliberal policies promoted by the Washington Consensus. One participant asks the role that CBs can play with respect to regulating the financial infrastructure and the payment system in developing countries. Prof. Epstein replies that CBs play an important role in this regard and that they start to get more involved in these areas, e.g. by lending to micro enterprises or banks that are oriented towards these kinds of activities. Another person poses the question on the conditions under which directed credit can work and its feasibility in a developing country context. Prof. Epstein replies that more research is needed on this issue.

### Session 3. The role of Central Banks: The Case of Pakistan

**Presenter:** Dr Asad Sayeed, Director, Collective for Social Science Research, Karachi, Pakistan

**Discussant:** Dr Rossana Galli, Lecturer, Institute of Political Science, University of Zurich, Switzerland

Video conference with Dr Mushtaq Khan, Chief Economic Advisor, State Bank of Pakistan, Karachi, Pakistan

**Moderator:** Moazam Mahmood (Research Department, ILO)

#### **Presenter:**

In his presentation on “The role of Central Banks in Supporting Economic Growth and Creation of Productive Employment”, Dr Asad Sayeed first outlines Pakistan’s macroeconomic performance over the last decade with a stagflation in the last five years, i.e. low/moderate growth together with moderate inflation. Employment challenges remain a major concern with very low labour force participation for women despite a significant progress over the last decade. In particular, there has been an increase in unpaid family labour in rural areas.

The presenter then provides an overview of the historical evolution and role of the State Bank of Pakistan (SBP) which takes its origins in the SBP Act 1956 and whose mandate includes not only monetary stability but also “fuller utilisation of the country’s productive resources”.

Dr Asad Sayeed extensively elaborates on the institutional developments of the SBP since 1990s and the changing roles that the SBP played during four major economic events (1991: significant liberalization of the economy and autonomy of SBP where the role of SBP changed significantly. 1998: the nuclear tests and foreign exchange crisis. 2002-2005: high liquidity phase. 2007-2008: crisis year).

The presenter then turns to the development agenda and the priority areas of the SBP over the years, with an emphasis on agriculture, exports, industry, microfinance etc. Finally, Dr Asad Sayeed sketches the contradictions in macroeconomic policy management tools including monetary and fiscal policies before summarizing the main findings of his paper including the following four core issues: (i) the financial deepening and the broadening of the financial sector starting from few commercial banks to a spectrum of institutions which has not resulted in either increasing the savings rate or greater formalization of the economy; (ii) the regulatory structure and intermediation iii) the issue of the Government “Single dominant borrower” which is the most important reason for the lack of effective intermediation (iv) the question of regional financing and uneven development across provinces of Pakistan.

#### **Discussants:**

Dr Rossana Galli raises the importance of considering the issue of inequality amongst the Central Banks’ objectives in view of broadening their mandates. Higher income inequality negatively affects economic growth through various channels, especially through two transmission channels: (i) social instability does not create the conditions for investment (ii) the importance of creating economic demand through the formation of a solid middle class - which is missing in many developing countries - in the view of a developing a solid purchasing power that is conducive to sustainable economic growth (domestic led growth vs. export led growth).

As inequality affects economic growth and vice versa, the same holds true for monetary policy and inequality. There are various transmission channels through which monetary policy affects the real economy (cf. Prof. Montiel’s presentation) as well as inequality. Developing countries face a limited access to formal financial sector. In addition, exchange rate channel is important since the poor are more affected by price commodity changes particularly in food prices.

Finally, Dr Rossana Galli raises the question of the type of instruments that Central Banks could use to positively affect inequality outcomes, for example through credit allocations to SMEs or microcredit. In the context of developing countries, she stresses the value of providing credit to youth for

entrepreneurship and offering microcredit to those below and close to the poverty line with the idea of creating a middle class.

Dr Mushtaq Khan intervenes by video conference and makes the following observations: (i) On the liquidity boom over the period 2002-2005, the speaker stresses the importance of understanding the government's borrowing behaviour. One of the reasons behind the boom was the absence of tools to absorb liquidity by the State Bank. The banks had too much money, the government was not borrowing, and as a consequence monetary policy collapsed. (ii) On the lack of a proactive exchange rate over the period 2007-2008, it is important to understand - from the policy point of view- that the price of oil was very high and had a direct impact on retail fuel prices which are critical in setting the expectations of small businesses and households. (iii) Dr Khan points out that during a period of two years, between 2009 and 2013, interest rates were cut by 5 percent, government borrowing went up and yet private sector borrowing was down. Further, he adds that in the past years, interest rates increased a bit, yet private sector has picked up, showcasing that the traditional relationship between private sector borrowing and interest rate breaks down when fundamental problems of the economy exist. (iv) Referring to Dr Sayeed's point on the priority lending schemes that are in place, Dr Khan indicates that these are in most of the cases legacy schemes but their functioning is questionable. For example, he cites the export refinance scheme (PFS) initially designed to target small exporters, but which in the end benefitted huge exporters. He stresses the difficulty of removing schemes that already exist (v) Finally, Dr. Khan asks the following open questions: Should policy makers and central banks have a role in creating a better balance in the banking system? How do you incentivize private banks? Should we have a proactive central bank? How does it go along with the prevailing international view and that of IFIs (international financial institutions)? Dr Mushtaq Khan also highlights two reasons why the banks are reluctant to lend to the private sector. First, the ease to lend to the government compared to the private sector and second, lending to the agriculture sector or small and medium enterprises requires specialised skills, which so many of the big banks have not invested in.

#### **Open discussion:**

The open discussion covers various aspects of the regulatory and supervision role of the SBP. Professor Epstein suggests that given the excess liquidity in the banking sector, a suitable instrument to mop out the excess could be a continuous rise in the reserve requirement. Another participant states the difficulties in sterilisation programs in developing countries. However, he sheds light on the evidence of important interventions through coordination between monetary policy aiming at sterilization and smoothing government's expenditures.

Dr Asad Sayeed replies to the comments by the discussants, by highlighting the major constraints faced in Pakistan such as the energy crisis, high political risk, poor law and order, fragile financial sector and real economy. All these factors weigh in, leaving space for speculation. He argues that this is where the regulatory structure of the SBP is meant to fill in the gaps. In addition, he states that Pakistan's Government has started initiating and allocating loans to empower the youth.

## Session 4. Central Banks in an Historical Perspective: The Case of Korea

**Presenter:** Mr Young-Chan Kim, Expert Consultant, Office of International Affairs, The Bank of Korea, Seoul, Republic of Korea

**Discussant:** Uma Rani Amara, Research Department, ILO

**Moderator:** Dr Eddy Lee, Expert on International Economics and Asian Economies

### **Presenter:**

Mr Kim begins his presentation entitled “Korea’s Economic Development and the Bank of Korea” with a brief overview of the Korean development process showing how the Korean economy transformed from a poor developing country into an advanced economy, passing through different economic and policy stages. Then he compares the two crises that severely affected Korea’s growth (1997 and 2008), the challenges of low employment rate for women and youth, high household debt and population aging that the country faces today.

Mr Kim then explains the roles of the Korea’s Central Bank (BOK) and how the BOK changed from monetary targeting to inflation targeting in 1998. The BOK changed its mandate after 2011 and added macro-prudential objectives to it as well as instruments to achieve them. The new focus of the BOK is to attain financial stability. Finally, Mr Kim describes the transmission of monetary policy in Korea, in particular the credit channel.

### **Discussant:**

Uma Rani Amara brings to the discussion two other country examples of development: Brazil and India, where both countries have relied heavily on development banks in their industrialization efforts. She highlights the role of industrialization policies such as tax exemptions and special credit provisions aimed to priority sectors as good policy practices. In the Indian case, the 2008 crisis has turned the central bank to enhance its stabilization role (with the argument that fiscal expansion is high and inflationary) which could have consequences for development objectives. Finally, Uma Rani Amara raises two issues:

a) Could there be some sort of norm, for example 10 % of bank credit aimed at priority sectors? She mentions that firms which receive these credits are unfortunately quite often the rich private corporates and these credits are re-invested in the financial market. She further adds the issue of regulating to ensure that credit aimed at priority sectors are used for appropriate investment, as well as the respective roles of the Government and the Central Bank in this matter.

b) Could it be possible to de-link the short-term money market focus from the long-term role of bank credit and economic growth and move to an approach of bank credit and sectorial distribution? Regarding Korea, Uma Rani Amara highlights that employment has not yet picked up since the last crisis and this remains a big concern.

### **Open discussion:**

The questions raised from the floor include: What are the lending facilities of the BOK to Small and Medium Enterprises (SMEs)? What is the SMEs scheme? When the private sector knows that the CB is backing lines of credit, the default probability is higher. What is the position of non-performing loans in Korea today? What was the original motivation behind the credit program to SMEs? Is there evidence about what happened with these credits to SMEs?

The presenter provides further information and indicates that the government has the objective of raising employment rate to 70%. For the loans, the commercial banks lend first and the BOK supports after. The default risk is on the commercial bank, the BOK requests collateral but the BOK is the one providing the credit at a low interest rate. Credit to SMEs started in 1994 and the credit increased after the 1997 crisis to support employment in the SMEs and reap growth potentials. There is recent

economic evidence on the success of the SME credit programme in a research paper published by the BOK.



## Session 5: The Role of Central Banks: The Case of Cambodia

- Presenter:** Dr Vouthy Khou, Director, Economic Research and International Cooperation Department, National Bank of Cambodia, Phnom Penh, Cambodia
- Discussant:** Dr Alexander Barkawi, Director, Council on Economic Policies, Zurich, Switzerland
- Moderator:** Dr Asad Sayeed, Director, Collective for Social Science Research, Karachi, Pakistan

### Presenter:

In his presentation Dr Khou explores the role of the National Bank of Cambodia (NBC) to support development, diversification, growth and employment in the context of a dollarized economy. In introducing Cambodia's development and employment challenges, Dr Khou points out that although there is rapid development in Cambodia, the economy still depends mainly on the exports of garment and agricultural products, tourism and construction. Outlining employment challenges, he highlights the high concentration of labour force in the agriculture sector in the rural areas, while in the urban areas there is a rise in employment in both the industry and services sector. Based on the low unemployment rate of less than 1%, Dr Khou suggests a redefinition of the employment rate in Cambodia, as he states that the current employment rate captures anyone working for more than 1 hour in the previous week. In meeting the challenges of economic diversification, he points to the government's national development and economic diversification policy, which includes the improvement of affordable credit. Finally, Dr Khou gives examples of problems with high dollarization and the limitations of instruments available to deal with them in Cambodia. In a highly dollarized economy, monetary policy is less effective in maintaining price stability and promoting economic growth. In such cases the monetary transmission mechanism remains weak, the use of money supply and interest rate is ineffective and the banks' ability as a lender of last resort is restricted. Leaving the reserve requirements, purchase of US dollars and lending to banks as the only instruments available.

### Discussant:

The discussant makes three main points in reaction to Dr Khou's presentation. First, he stresses that there should be a clear distinction between economic growth, diversification and job creation since jobless growth and real estate bubbles can show up as economic growth but may have little to do with economic diversification. Second, he questions the setting of inflation target and the manner in which the NBC comes to a 5% inflation target. Third, he points out from the paper written by the presenter that there are clear direct interventions the NBC is already putting in place to promote economic diversification, such as: the temporal credit ceiling on the real estate sector and lower reserve requirements that favour the agriculture sector. Finally, he asks what would change in targets and policies of the NBC, if its objective was pro-employment, inclusive and green growth.

### Open discussion:

A variety of questions are raised by the audience including the availability and the role of development banks in Cambodia. Another participant questions if the main risk of high dollarization is coming from a stable exchange rate or something else.

Dr Khou's replies to the comments made by the discussant by stating the objective of the NBC is to maintain price stability and by doing so the NBC supports economic stability, growth and job creation. Furthermore, he explains that development banks exist in Cambodia; however, the fundamental role of development bank has been neglected. The rural development banks act as intermediaries in redistributing funds. Concerning the last comment made with regards to the risk of high dollarization, Dr Khou states that the exchange rate is stable in Cambodia and the risk is not from the exchange rate; however, high dollarization in Cambodia is closely linked to the rapid rising levels of inequality.

## Session 6. The Role of Central Banks: The Case of Ecuador

**Presenter:** Ms Daniela Arias (Expert Consultant) and presented by Juan Chacaltana, Employment and Labour Market Specialist (DWT/CO-Peru)

**Discussants:** Mario Berrios (Enterprises Department, ILO) and Yousra Hamed (SFU-Enterprises Department, ILO)

**Moderator:** Yadong Wang (Employment Policy Department, ILO)

### **Presenter:**

Mr Chacaltana begins his presentation entitled “Financial Inclusion Policy in Ecuador: Roles of the Central Bank towards Economic and Job Creation” with some stylized facts about the Ecuadorean economy. Ecuador is a dollarized economy, meaning that monetary policy is effectively absent. Employment levels recently rose (almost 9% points in the last 7 years). In addition, Ecuador has strongly reduced poverty levels (12% points in 8 years) and a high percentage of the population entered the middle class. After a brief description of the literature review, the speaker presents the current mandate of the Ecuadorean central bank (ECB) and its new role towards financial inclusion. Three main innovations to foster financial inclusion are described in the presentation: The National System of Payments, the use of electronic money and the CONAFIPS.

Under the new objective of financial inclusion, the ECB has created the National System of Payments, a technological and administrative platform that is used by the ECB to manage all financial and monetary operations, such as distribution of the budgetary funds allocated to each public institution; payment and processing of pay checks; and wire transfers between institutions. Also, the use of electronic money has been implemented. Under this new policy, Ecuadorians can exchange dollars for electronic money on their mobile phones at 1:1 conversion rates as well as doing money transfers, collecting the human development bond (a big conditional cash transfer program from the government) and paying utilities. The CONAFIPS are independently administered and funded public institution in charge of supporting the popular and solidarity based financial sector through policies that promote financial inclusion. It is a second tier bank that gives preferential interest rates to the sector. They specifically lend to people giving priority to people living in poverty areas. 82.6% of their credit portfolio was allocated in specific zones where the poverty rate was greater than 65%.

Next, Mr Chacaltana makes a brief summary of the progress of these three components. Finally, he raises some issues such as the sustainability of a dollarized economy. Also, he points out the fact that the ECB cannot directly lend to users and institutions which delays the financial inclusion policy implementation.

### **Discussants:**

Mr Berrios, questions whether the ECB is a central bank or a development bank. This question is also raised by Professor Epstein who indicates that in practice the ECB is working as a development bank, indirectly channelling credit to the most needed. The discussant also points out that credit supply in a dollarized economy depends on the central bank reserves, and that this is a fact of the Ecuadorean economy. Oil is Ecuador’s main export and its main source of foreign currency inflows. This makes Ecuador very vulnerable to oil shocks. In case this happens, foreign currency reserves could be affected and thus, the credit supply. This is why the discussant points out that capital account management is very important and should be followed closely by the government. Finally, he suggests that it would be desirable not only to widen the objectives of the central bank but also to have better policy coordination between the central banks with the government and other institutions to achieve better outcomes. In the Ecuadorean case, the executive branch has taken de facto control of the central bank. This aspect of ‘policy management’ is important to consider.

Ms Hamed, a second discussant, highlights the role of financial inclusion and financial deepening in the job creation process. Access to finance gives the small firms the opportunity to invest, grow and hire new employees, things they would not be able to do without access to credit. In order to achieve the goal of financial inclusion, she adds financial literacy as a complementary tool. She mentions two cases in which central banks worked together with the ILO to spread education on financial literacy. The first one is the case of Indonesia, where there has been an impact evaluation of the effects of financial literacy training on financial inclusion. Also, the ILO is helping the bank of Indonesia to create their Nation Financial Education Curriculum. With the Moroccan Central Bank, the ILO helped create the National Foundation for Financial Education to coordinate the education strategy within the country among relevant institutions. It is chaired by the central bank and it has representatives of line ministries, commercial banks and microfinance institutions. The ILO is also helping them to create their own financial education curriculum.

**Open discussion:**

The open discussion includes the following questions: the degree to which Ecuador implements capital account management to prevent foreign shocks; the difference between the CONAFIPS and the reserve mechanism; whether the ECB encounters any corruption issues and the effectiveness of CONAFIPS.

The presenter indicates that the reserve mechanism is essentially the money that is made available to development bank of which CONAFIPS is one. It lends to the poorest (also in rural areas) and it is independent from the ECB (although it receives money from it). There has been no investigation on corruption. The big issue in a macroeconomic perspective is its sustainability. The Ecuadorean government has realized that the international context is changing and that is why they want to modify the financial law to further control the financial sector.

## Session 7. Dual Mandates and Advanced Economies

**Presenter:** Professor Francesco Saraceno, Senior Economist, OFCE Research Centre in Economics of Science-Po

**Discussant:** Matthieu Charpe, Research Department, ILO

**Chair:** Ekkehard Ernst, Research Department, ILO

### **Presenter:**

Professor Saraceno starts his presentation “Between Doctrine and Pragmatism: The ECB and the Crisis” by explaining the ECB mandate as embedded in the Statute. He mentions that the monetary policy of the ECB is limited to one primary objective, namely price stability, which can be defined freely by the ECB (currently close to 2% over the medium term). The roots of the ECB Statute can be traced back to the 1990s and the belief that strong and efficient markets are much more suitable to boost growth than fiscal and monetary policy. Second, the presenter talks about the ECB actions during the crisis and argues that the EU is heading towards an inconsistent setup. He says that the US is characterized by extreme market flexibility and a limited social security system. As a consequence, the market takes a great deal of macroeconomic shocks and monetary policy in the US is quite proactive in order to smooth shocks. In contrast, the EU has a strong welfare state to absorb shocks. Therefore, monetary policy takes a lesser role in smoothing shocks and as a consequence, it is less proactive. However, in the last years the social security safety net was drastically reduced in many EU countries. Today, the system is characterized by a strong inconsistency: On the one side, there is less protection through a weakening of the welfare state and on the other side, macroeconomic policy is quite constricted. Furthermore, austerity measures limited the implementation of fiscal policies. Luckily, Mario Draghi took some brave and innovative decisions and stretched the mandate of the ECB to respond to the crisis. One example is of its role as “lender of last resort”. Lastly, Prof. Saraceno underlines the need to institutionalize this broader role recently taken by the ECB in the EMU governance structure.

### **Discussant:**

Matthieu Charpe first gives a brief summary of the presenter’s research paper. In the paper, the poor growth performance by EU countries relative to the US is explained by the Berlin Washington consensus and the inconsistent setup of the European Union as a currency area. Next, Matthieu Charpe gives some alternative explanations for the slower growth performance of the EU. Among others, he points out an overall slowdown of growth on both sides of the Atlantic instead of an actual divergence of growth between the two world regions. Additionally, he argues that the debt financed consumption boost in the US and the absence of debt resolution mechanisms at EU level might be an explanatory factor. Then, the discussant responds to the critique of the DSGE model as set forward in the paper. He explains that this kind of model is based on the assumption that the tradeoff between present and future consumption is determined by the interest rate. Therefore, when consumption is low, as it is the case today, the CB can rebalance it by lowering the interest rate. As a consequence, this kind of model has difficulties in explaining prolonged periods of low aggregate demand. Some alternative models might be more suitable like a Post-Keynesian Agent Based Model or an amended version of the New-Keynesian Model. Matthieu Charpe finishes his discussion by naming some reasons to be optimistic about the EU. First, some countries decided to abolish large corporate tax privileges. Second, as a reaction to the democratic deficit in the EU, the president of the commission is now elected by the EU parliament.

### **Open discussion:**

One participant asks about the interaction between a country’s monetary policy and its industrial policy. The presenter replies that the EU is unfortunately the only major world region without an industrial policy and thus stresses the need of having one. CBs can create a stable macroeconomic environment and

certainty about the business cycle to support such industrial policies. Another participant makes three comments: First, he reminds that the ECB Statute is based on the one from the Bundesbank. Second, he argues that the EU institutions were inconsistent right from the beginning. Third, concerning the role of the ECB as “lender of last resort” he states that it has not yet been tested whether it would actually do whatever it takes to save the Euro.

## Session 8. The Role of Central Banks: The Case of Mozambique

**Presenter:** Kazutoshi Chatani, Oluwaseun Pedro, ILO

**Discussant:** Mr. Jamal Omar, Assistant Director, Research Department, Central Bank of Mozambique, Maputo, Mozambique

**Moderator:** Massimiliano La Marca, ILO

### **Presenters:**

In the presentation entitled “Meeting the development and employment challenges in Mozambique: The role of the Central Bank”, Kazutoshi Chatani first introduces Mozambique’s context, a country that has grown rapidly in the last two decades but still facing many challenges in terms of poverty, the labour market and a relatively narrowly-based economy. In this context, the Central Bank (CB) could play a role in accelerating diversification conducive to employment generation. The speaker then introduces the findings of a content analysis of the main objectives of 51 selected Central Banks in developing countries, showing that priority is given to price stability compared to issues such as economic growth and employment creation.

Next, Oluwaseun Pedro explains the monetary transmission mechanisms in Mozambique compared to Sub-Saharan Africa, emphasizing the CB three most important channels revolving around (i) credit/bank lending, (ii) interest rate (iii) exchange rate. The transmission mechanism is weak in Mozambique. With three banks controlling 85 percent of the assets and high commercial interest rates, it is difficult for commercial banks to lend to the private sector as well as for the poor to have access to lending. The speaker sketches some of the policy implications that the country would need to address to meet its development and employment challenges, such as the need to develop a more competitive and inclusive financial system.

### **Discussant:**

Jamal Omar provides some comments to the paper, with specific emphasis on (i) the need for stronger evidence supporting the view that the current CB policy framework is insufficient to deliver macroeconomic stability (ii) the role of other public institutions in addressing challenges such as access to credit, financial inclusion and price volatility (iii) the instruments and means through which the employment objective can be achieved if it should become a focus issue for the CB.

### **Open discussion:**

The comments raised from the audience are related to the role of the CB in bringing down interest rates and the reasons behind the high transaction and lending costs, in particular for small and medium enterprises (SMEs) that face higher interest rates.

Jamal Omar refers to the lack of competition in the market as the main reason for the spread. Banks often complain of limited accounting systems and lack of information on their clients and organizational deficiencies. In addition, the judicial framework for dispute resolution is weak.

In the open discussion, several questions and observations are made by the participants including (i) the case of Mozambique provides an interesting illustration of the growth of a natural resources exports model in the recent years; (ii) the ways through which the Central Bank should convince the society that their mandate benefits them; (iii) the emphasis laid on microfinance institutions and small scale financing vs. large infrastructure projects and public goods projects; (iv) the way the CB’s performance would change if it adopts a dual mandate; (v) the exchange rate policy implemented in Mozambique and the issue of the Dutch disease; (vi) the link between financial deepening, economic growth and employment creation and (vii) the channels through which savings are moved into productive investment.

## Closing remarks

By Mr Nomaan Majid

Senior Development Economist, ILO

The speaker takes an overall perspective on the workshop. He notes that the two opening perspectives offered by Professors Montiel and Epstein were extremely useful in situating the importance of central question being asked, namely: ***What is the role that central banks can play in the development process?***

He notes that Professor Montiel's presentation starts from an abstract pure world, and cautiously builds that world up, introducing noise and friction, in order to ask the central question. Clearly in order to ask it, he has to make the world different from the ideal original, a world that is noisy, sticky and with frictions. In this noisier world Professor Montiel argues that monetary policy transmission which is otherwise clear, gets weakened. It is in this "friction-driven weakening", that economic characteristics of the developing world perhaps lie. The places where we find explanations for the weakness of the transmission mechanism in Professor Montiel's framework are to a great extent also institutional.

Professor Epstein's presentation in contrast, suggests that we need to recognise upfront, the specificity of the world in which we are asking this question, and thus the role of the Central Bank must be understood within the explicit context of a macroeconomic policy framework that is warranted in a typical developing economy.

If Professor Montiel's elegant characterisation is cautious and accretional, it is so because it gives primacy to the "role of the central bank" part of our question. Professor Epstein's recognisably focuses on the "development process" "part of the question within which he argues this role of the Central Bank must be understood.

In many ways this difference goes to the heart of the issue. However, whether the role of central banks is to be found in institutional and other fragilities due to frictions, in an otherwise ideal world; or in a macroeconomic framework appropriate for an economy with a dualistic economic structure, it is clear that there is room, at least, to discuss the matter in both approaches.

The discussion on the second day by Professor Saraceno provides a fascinating and yet a very practical window on how critical this issue of central bank mandates can become even in an advanced economy context. The lesson for developing economies here is to discover as to why this is the case. The dual mandate topic becomes a burning issue in the advanced world, precisely when there is a crisis of employment. And an employment crisis is something poor developing economies are familiar with, on a permanent basis.

The presentation on Korea gives a perspective on what a central bank in an ex-developing economy did once upon a time. It holds many lessons for present day developing economies. And perhaps it is time for developing economies not just to admire the export led growth of Asian miracle economies but learn from the roles that core institutions played in that growth process.

The case studies offer their own concrete narratives of how the central banks in present day developing economies are grappling with their developmental responsibilities in the specific economic conditions under which they operate.

The speaker offers thanks to his colleagues for organizing the workshop, and expresses gratitude to presenters, discussants, chairs and participants for contributing to a valuable and thought provoking day and a half.

By Mr Iyanatul Islam

Chief, Employment and Labour Market Policies Branch, ILO

Yan Islam thanks all speakers, discussants and chairs for their contributions to the workshop. He emphasizes that this workshop is a continuation of work on ‘pro-employment macroeconomic policies’ that has been under way since 2010. He points out that undue emphasis has been given to inflation targeting regimes to attain the goal of price stability. Such a goal is, of course, a fundamental element of a central bank’s mandate, but it can be achieved through a variety of institutional arrangements, of which an inflation targeting regime is one possible exemplar. Furthermore, in low and middle income countries, central banks have a crucial developmental role to play. This was highlighted by a former Indian Prime Minister who reportedly offered the following counsel to the governor of the Reserve Bank of India:

‘With your mind ...fully taken up by issues like interest rates and...monetary policy transmission, it is easy to forget that monetary policy is also about reducing hunger and malnutrition, putting children in school, creating jobs, building roads and bridges and increasing the productivity of our farms and firms.’



## List of participants

<b>Speakers</b>		
Sandra Polaski	Deputy Director-General for Policy, ILO	<a href="mailto:polaski@ilo.org">polaski@ilo.org</a>
Azita Berar Awad	Director, Employment Policy Department, ILO	<a href="mailto:berar@ilo.org">berar@ilo.org</a>
Iyanatul Islam	Chief, Employment and Labour Market Policies Branch, ILO	<a href="mailto:islami@ilo.org">islami@ilo.org</a>
Youngjip Ahn	Ambassador and Deputy Permanent Representative, Permanent Mission of the Republic of Korea	<a href="mailto:mission.korea-rep@ties.itu.int">mission.korea-rep@ties.itu.int</a>
Peter Montiel	Professor of Economics at Williams College, Williamstown, USA	<a href="mailto:Peter.J.Montiel@williams.edu">Peter.J.Montiel@williams.edu</a>
Gerald Epstein	Professor and Co-Director of Political Economy Research Institute (PERI) University of Massachusetts, Amherst, USA	<a href="mailto:gepstein@econs.umass.edu">gepstein@econs.umass.edu</a>
Asad Sayeed	Director, Collective for Social Science Research, Karachi, Pakistan	<a href="mailto:asadsayeed@gmail.com">asadsayeed@gmail.com</a>
Young-Chan Kim	Expert Consultant, Office of International Affairs, The Bank of Korea, Seoul, Republic of Korea	<a href="mailto:yckim@bok.or.kr">yckim@bok.or.kr</a>
Vouthy Khou	Director, Economic Research and International Cooperation Department, National Bank of Cambodia, Phnom Penh, Cambodia	<a href="mailto:vouthy.khou@yahoo.com">vouthy.khou@yahoo.com</a>
Juan Chacaltana on behalf of Daniela Arias	Employment and Labour Market Specialist, DWT/CO-Peru, ILO	<a href="mailto:jchacaltana@gmail.com">jchacaltana@gmail.com</a> <a href="mailto:ariasd56@newschool.edu">ariasd56@newschool.edu</a>
Francesco Saraceno	Senior Economist, OFCE Research Centre in Economics of Sciences-Po, Paris, France	<a href="mailto:saraceno@gmail.com">saraceno@gmail.com</a>
Kazutoshi Chatani	Employment Policy Department, ILO	<a href="mailto:chatani@ilo.org">chatani@ilo.org</a>
Pedro Oluwaseun Olufemi	Employment Policy Department, ILO	<a href="mailto:pedro@iloguest.org">pedro@iloguest.org</a>
Nomaan Majid	Employment Policy Department, ILO	<a href="mailto:majid@ilo.org">majid@ilo.org</a>
<b>Discussants</b>		
Ole Rummel	Adviser, Centre for Central Banking Studies, Bank of England, London, United Kingdom	<a href="mailto:Ole.Rummel@bankofengland.co.uk">Ole.Rummel@bankofengland.co.uk</a>
Simon Zadek	Co-Director of the UNEP Inquiry on Options for a Sustainable Finance System, United Nations Environment Programme (UNEP), Geneva, Switzerland	<a href="mailto:sizadek@gmail.com">sizadek@gmail.com</a>
Rossana Galli	Lecturer, Institute of Political Science, University of Zurich, Switzerland	<a href="mailto:gallir@hispeed.ch">gallir@hispeed.ch</a>
Mushtaq Khan	Chief Economic Advisor, State Bank of Pakistan, Karachi, Pakistan	<a href="mailto:khan.mush@gmail.com">khan.mush@gmail.com</a>
Uma Rani Amara	Research Department, ILO	<a href="mailto:amara@ilo.org">amara@ilo.org</a>
Alexander Barkawi	Director, Council on Economic	<a href="mailto:ab@cepweb.org">ab@cepweb.org</a>

	Policies, Zurich, Switzerland	
Mario Berrios	Enterprises Department, ILO	<a href="mailto:berrios@ilo.org">berrios@ilo.org</a>
Yousra Hamed	SFU-Enterprises Department, ILO	<a href="mailto:hamed@ilo.org">hamed@ilo.org</a>
Matthieu Charpe	Research Department, ILO	<a href="mailto:charpe@ilo.org">charpe@ilo.org</a>
Jamal Omar	Assistant Director, Research Department, Central Bank of Mozambique, Maputo, Mozambique	<a href="mailto:jamal.omar@bancomoc.mz">jamal.omar@bancomoc.mz</a>
<b>Moderators</b>		
James Howard	CABINET, ILO	<a href="mailto:howardj@ilo.org">howardj@ilo.org</a>
Isabel Ortiz	Social Protection Department, ILO	<a href="mailto:ortizi@ilo.org">ortizi@ilo.org</a>
Moazam Mahmood	Research Department, ILO	<a href="mailto:mahmood@ilo.org">mahmood@ilo.org</a>
Eddy Lee	Expert on International Economics and Asian Economies	<a href="mailto:lee_eddy@gw.ilo.org">lee_eddy@gw.ilo.org</a>
Asad Sayeed	Director, Collective for Social Science Research, Karachi, Pakistan	<a href="mailto:asadsayeed@gmail.com">asadsayeed@gmail.com</a>
Yadong Wang	Employment Policy Department, ILO	<a href="mailto:wangy@ilo.org">wangy@ilo.org</a>
Ekkehard Ernst	Research Department, ILO	<a href="mailto:ernste@ilo.org">ernste@ilo.org</a>
Massimiliano La Marca	Social Protection Department, ILO	<a href="mailto:lamarca@ilo.org">lamarca@ilo.org</a>
<b>Assistant and note takers</b>		
Jane Bang	Employment Policy Department, ILO	<a href="mailto:bang@ilo.org">bang@ilo.org</a>
Mareike Laura Theisling	Employment Policy Department, ILO	<a href="mailto:theisling@iloguest.org">theisling@iloguest.org</a>
Miranda Kwong	Employment Policy Department, ILO	<a href="mailto:kwong@ilo.org">kwong@ilo.org</a>
Pedro Oluwaseun Olufemi	Employment Policy Department, ILO	<a href="mailto:pedro@iloguest.org">pedro@iloguest.org</a>
Agustin Velasquez	Employment Policy Department, ILO	<a href="mailto:velasqueza@iloguest.org">velasqueza@iloguest.org</a>