Pro-Employment Macroeconomic Policies

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Brief Background and Context

- **UNDP-Supported Policy-Oriented Research in 21 countries during 2001-2007 focused on 'Pro-Poor Growth'**
  - **Asia: Bangladesh, Cambodia, China, Indonesia, Mongolia, Nepal, Sri Lanka and Vietnam**
  - **Eastern Europe & CIS: Armenia, Kyrgyz Republic, Moldova and Uzbekistan**
  - **Middle East: Sudan, Syria and Yemen**
  - **Sub-Saharan Africa: The Gambia, Ghana, Kenya, Mozambique, South Africa and Zambia**

Brief Background and Context

- Initially, poverty reduction was ‘the entry point’ for discussing macroeconomic and structural policies
- But we realized that the reigning ‘macroeconomic consensus’ did not have a viable growth strategy (it was fixated on stability as a precondition for private sector-led growth)
- Moreover, there were no policy tools identified for translating growth into employment generation (the latter assumed to follow automatically from growth)
- So in later years, we focussed more on policies for <u>Growth, Employment and Poverty Reduction</u>

Connecting Macroeconomic Policies to Employment

1. **A Helpful Tripartite Framework** :

   (S. Osmani 2005: growth, employment intensity & integrability for UNDP-ILO initiative):

A. **Macroeconomic Policies** to stimulate investment, growth and employment (with macro stability as a constraint rather than the objective)

B. **Structural Policies** to influence the pattern of growth (e.g.,the intensity of growth with respect to achieving productive employment)

C. **Equity-Enhancing Policies** to improve the access of poor workers to expanding employment opportunities

Proposed Alternative Macroeconomic Policies

- **Examples of Relevant Publications:**

  1) *IPC Policy Research Brief #4, 2007*:

  'The Macroeconomic Implications of MDG-Based Strategies in Sub-Saharan Africa'

  2) *IPC Policy Research Brief #6, 2008*:

  'Pro-Growth Alternatives for Monetary and Financial Policies in Sub-Saharan Africa'
- **The MDG Agenda called for a dramatic scaling up of public investment in social and economic infrastructure**
- **But there was little attempt to define a public investment-led macroeconomic stance for the MDGs**
- **And employment generation was a completely missing dimension**

Proposed Alternative Macroeconomic Policies

1. **<u>Fiscal Policies</u>: A) More Expansionary B) More focused on public investment (expanding opportunities) and C) More reliant on the mobilization of domestic revenue**

- **A stronger focus on the supply side (e.g., expanding productive capacity, mobilizing domestic resources)**

2. **<u>Exchange-Rate Policies</u>: A) A managed instead of a laissez-faire regime B) Focus on containing external shocks (terms-of-trade or capital outflow shocks) and C) Focus on maintaining a competitive exchange rate**

- **Exchange-rate management takes precedence over monetary policies (such as setting low-inflation targets) , especially in increasingly open economies**

Pro-Employment Monetary Policies

3. <u>Monetary Policies</u>: A) support fiscal expansion and export promotion B) provide adequate liquidity to a growing economy C) foster moderate but positive real rates of interest for private (and public) investment

- Strict inflation targeting (especially a low inflation target, e.g., under 5%) is inconsistent with such an approach
- Moderate inflation (5-10%, if not over 10% per annum for a while) need not be detrimental to growth, nor to export promotion (if the exchange rate is properly managed)
- Managing the <u>Capital Account</u> is a corollary of this approach—particularly for capital-outflow shocks

Managing the Capital Account

- There is a clear need to manage the volume and composition of international private capital flows (see Brazil's recent modest transaction tax)
- Such management is complementary to management of the exchange rate
- Often investment-focused macroeconomic policies have to confront the threat of a decline in 'business confidence', a surge of capital outflows and rapid depreciation of the exchange rate
- It would be difficult to implement independent monetary (and even fiscal policies) without some management of the capital account

The Limits of Macroeconomic Policies

- **Macroeconomic policies (except fiscal policies) are broad, blunt instruments having mostly an economy-wide impact**
- Their impact is often judged by price effects: 1) inflation rates 2) real rates of interest 3) real exchange rates
- And judged by macro ***balances***: A) private investment versus saving (I - S); B) government expenditures versus revenue (G – T); and C) exports versus imports (X – M)
- For employment generation, you also have to examine the **composition** of macroeconomic stimuli as well as their aggregate impact on growth (e.g., the composition of government expenditures)

Pro-Employment Structural Policies

- **Policies that <u>structure</u> the access to economic opportunities and employment**

1. **<u>Fiscal Policies</u>**: Their impact can be differentiated by economic sector or employment category (e.g., the location of public investment in infrastructure)
2. **<u>Financial Policies</u>**: access to financial services can be differentiated (e.g., increasing access in rural areas)
3. **<u>Industrial Policies</u>**: resources can be channeled differentially to various economic sectors or subsectors (e.g., to tradables)
4. **<u>The Trade Regime</u>**: Tariffs can be adjusted, within WTO limits, by sector or subsector
5. **<u>Public-Sector Provision of Services</u>**: Expanding access to critical services (e.g., water or electricity)

The Limits of Structural Policies

- **Structural policies can be calibrated to help foster productive employment (e.g., by supporting employment-intensive sectors or increasing employment intensity within sectors)**
- **Such policies involve a Differential Allocation of Economic Resources**
- **However, liberalisation and privatisation have removed some discretionary powers of the state, leaving resource allocation to market mechanisms**
- **The limits of structural policies: Employment opportunities can be expanded without necessarily providing access to poor workers**

Equity-Enhancing Policies

- There is thus a need for Equity-Enhancing Policies
- They can involve enhancing access of the working population to education, skill development, technology, land and other productive assets and resources
- Households are often poor precisely because their working members lack such access
- Such policies could involve reshaping or refocusing the impact of structural policies, such as providing micro-finance or micro-insurance
- And they could also involve Social Protection: the UN Social Security Floor Initiative, which would provide universal access to social transfers and services (social guarantees against risk)

<u>Example</u>: 'An Employment-Targeted Economic Program for South Africa'

- In addition to greater fiscal and monetary stimulus, this *IPC Country Study #1* advocated increased public spending in three areas:

  1) Public investment in infrastructure, 2) credit subsidies to businesses to promote accelerated employment growth, and 3) income transfers and social support (e.g., a Basic Income Grant)
- The report's assessment: public investment in the country's Expanded Public Works Program alone could not deliver enough employment growth
- There had to be additional incentives to spur private investment in labour-intensive sectors

An Employment-Targeted Economic Program

- A proposed expansion of the Government's system of loan guarantees:

1. Target loans towards 25% of total capital expenditures (to those sectors generating employment)
2. Government underwrites 75% of the loans
3. Assuming a default rate of 15%, the losses would amount to no more than 1-2% of the fiscal budget

- Lesson: Utilize the financial system to provide incentives to private investment as a complement to public investment

Debating Policy Responses to the Global Crisis

- Most of the progressive response to the global crisis could be interpreted as a form of 'Crisis Keynesianism'
- During the height of the crisis, the debate centred on 1) using government expenditures or tax relief as an effective stimulus
- There was much less focus on public investment (China an exception)
- Now the debate has shifted to the timing of an 'Exit Strategy': when to withdraw fiscal and monetary stimuli without precipitating a new downturn
- Conservative economists argue for an Early Exit because they predict demands by investors for higher interest rates on government debt

Has There Been a Sea-change in Macroeconomic Policies?

- There has been no fundamental shift yet in the reigning consensus on macroeconomic policies—at least not to promote growth, employment and development
- See, for example, the February 2010 IMF Staff Note on 'Rethinking Macroeconomic Policy' by the IMF Chief Economist and co-authors:
  - "In many ways, the general policy framework should remain the same: the ultimate goals should be to achieve a <u>stable output gap and stable inflation</u>" (p. 16)
  - The underlying assumption remains the same: macroeconomic policies should focus on short-term stability issues

The Current Debate on Macroeconomic Policies

- The Note does question the general focus on very low inflation targets (i.e., the prevailing 2% target)
- So it recommends raising the general target to 4% (primarily in order to avoid a deflation danger)
- Despite still relatively high food and fuel prices, the IMF favours continued monetary tightening to bring inflation rates down to low single digits
- The IMF Note does acknowledge that:

1. Policymakers should monitor multiple targets—not just the inflation rate
2. And policymakers should also use multiple instruments—not just monetary policy (and not just the policy interest rate)

Further Debating of Macroeconomic Policies

- The IMF Note does now claim that monetary policies alone are not adequate to averting crises
- Financial regulations are also needed (for *preventing* asset bubbles, instead of waiting to clean them up)
- So, there has been some progress on opening up the debate on macroeconomic policies
- The IMF Note also recognizes: “the behaviour of inflation is much more complex than is assumed”
- But it continues to advocate relatively restrictive monetary policies in developing countries, where inflation rates tend to be higher

The Limited Debate on Fiscal Policies

- The IMF states that Fiscal Policies can also be useful during recessions (endorsing the already obvious)
- But mainly as Automatic Stabilizers (e.g., systems of social protection), not as Discretionary Spending
- Maintaining fiscal discipline over the business cycle is still paramount (saving during upswings)
- The IMF has allowed only modest average increases in fiscal deficits during the Great Recession (and for 2010 has favoured fiscal tightening)
- The debate is on the scale and the timing of fiscal tightening, with the IMF cautioning against haste

The Impact on Development

- The IMF has become modestly more flexible—in relation to its previously restrictive benchmarks
- In the process there has been an abandonment, in effect, of the MDG Agenda for the scaling up of ODA financing of development-focussed public investment
- The priority now is to address a key question posed by the ILO-IMF Conference in Norway on Growth, Employment and Social Cohesion: “What policy mix is needed to transition from recovery to strong, sustainable and balanced global growth?”

Transitioning to a Longer-Term Policy Response

- The three-part crisis response is inadequate: 1) easing monetary and fiscal policies, 2) easing pain in the labour market, and 3) subsidizing jobs recovery
- The focus has to be on stimulating public and private investment: expanding aggregate supply, not just cyclically reviving aggregate demand
- Jeffrey Sachs has finally come out with an economic agenda for the MDGs (Financial Times, July 22: 'Sow the Seeds of Long-Term Growth'): "The striking feature in the current debate about austerity and stimulus has been the lack of attention to investment" "A new approach to recovery is needed"

The Longer-Term Policy Response

- Speaking of US recovery, Sachs advocates "investing for the future through serious attention to": 1) sustainable energy, 2) cutting-edge infrastructure, 3) enhanced labour force skills, and 4) promotion of international development through the export of infrastructure (as per China)
- His fifth element is a credible effort to "reduce the federal budget deficit to sustainable levels within *five years*"
- Much of this agenda should apply to developing countries, especially for generating productive employment and their long-term development

Recasting the Agenda for Macroeconomic Policies

- **Macroeconomic policies have to be more proactive, investment-focused and development-oriented**
- **This would involve subordinating monetary policies to fiscal policies, along with managing the exchange-rate and capital flows (the interest rate)**
- **Macroeconomic policies will have to be complemented by structural policies to ensure that economic recovery leads to rapid employment generation along with growth in productivity**
- **Social Protection Measures, such as the Social Floor, would enhance the equity impact of such policies**