

Pro-Employment Macroeconomic Frameworks: Review of Country Studies

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Reviewing the Terms of Reference for the Studies

- General Objective: ‘Assess the extent to which macroeconomic management has helped attain full and productive employment’ (including structural transformation and poverty reduction)
- Evaluate Four Policy Areas: Monetary Policy, Fiscal Policy, Exchange Rate Policy and Capital Account Management
- 1) The Assigned Goals of Monetary Policy: inflation, growth, employment and poverty
- 2) The Assigned Goals of Fiscal Policy: fiscal sustainability, growth, employment and poverty

Reviewing the Terms of Reference for the Studies

- 3) The Assigned Goals of Exchange Rate Policy: international competitiveness, protection of import-competing sectors, combating inflation
- 4) The Assigned Goals of Capital Account Management: ensuring financial integration as well as enhancing domestic policy space
- I. First Note: Macroeconomic Policies are not adequate in themselves to achieve the combined goals of stability, growth, structural transformation, employment and poverty reduction
- Structural Policies (which can differentially allocate resources across the economy) are also needed

Reviewing the Terms of Reference for the Studies

- Access-Enhancing Policies (such as poverty reduction programmes or labour-market policies) are also needed in order to ensure people's access to economic opportunities
- II. Second Note: The four sets of Macroeconomic Policies have to be consistent with one another: in practice, they cannot operate in isolation
- III. Third Note: The inter-relationships among the four Macroeconomic Policies change in relation to changes in concrete conditions (e.g., economic booms, stagnation, depression; inflation, deflation)
- IV. Fourth Note: Setting invariant rules (e.g., targeting 4% inflation or pegging a currency) can introduce counter-productive rigidities into policymaking

General Comments on the Case Studies

- ❑ The Studies were more incisive in dealing with fiscal and monetary policies than with exchange-rate and capital-account management
- ✓ A common problem: Lack of familiarity with particular forms or tools of exchange-rate or capital-account management (e.g., a managed float, taxes on capital inflows)
- ✓ As countries become more integrated with the global economy, exchange-rate policies and capital-account management become more important
- ❑ Few Studies had a coherent view of the practical inter-relationships among the Four Macroeconomic Policies (e.g., which policies play the leading role, which are more subordinate)

General Comments on the Case Studies

- ❑ Some Studies did not provide a convincing view of the Development Context, particularly the state of employment and incomes (i.e., the 'labour market')
- ✓ Often a lack of information on employment & wages
- ❑ A minority of studies explicitly linked the Four Macroeconomic Policies to the Development Context
- ❑ There was widespread confusion on how Macroeconomic Policies are linked to the Strategic Objectives (changing the Development Context):
 - ✓ Are growth and employment differentiable objectives?
 - ✓ Are employment and poverty reduction differentiable objectives?

General Comments on the Country Studies

- ✓ How can Macroeconomic Policies affect employment as well as growth? Affect It Directly?
- ✓ Overriding Question: What can Macroeconomic Policies Feasibly Achieve on their own???
- ✓ There were some difficulties in understanding how Macroeconomic Policies might influence Structural Transformation (which would achieve the desired combined goals of higher labour productivity, more widespread formal employment and higher real incomes)
- ✓ As a result, there were sometimes understandable digressions into industrial strategies or trade regimes (implicitly recognizing thereby the inherent limitations on Macroeconomic Policies)

1. The Jordanian Country Study

- An impressive study based on a Desk Review
- A fairly comprehensive review of the labour market (many traits are common to the MENA region)
- Fiscal Tightening has led to relative declines in public-sector employment but the private sector has been too weak to create alternative employment (a common problem in the region)
- High levels of 'voluntary unemployment' among Jordanians along with significant inflows of low-wage immigrant labour
- Free Trade Zones (for manufacturing exports to the US) provide low-skilled jobs to immigrant labour and Jordanian women
- But more educated Jordanians often resort to emigration
- Remittance inflows and outflows have a big impact on the success of Macroeconomic Policies

1. The Jordanian Country Study

- While aimed at achieving macroeconomic stability, the conventional economic reforms have not enhanced Employment Creation: Tight fiscal policies have reduced the debt but neglected public investment
- An Exchange-Rate Peg to the US Dollar adopted:
 - As the Dollar has depreciated, Jordan's exports have increased but so have its imports
 - Monetary policies have been rendered ineffective by the currency peg and the large inflows of remittances and ODA
 - Jordan has had to mobilize reserves to maintain the peg and tighten monetary policy in hopes of containing inflation
- Most controls on capital flows were abolished in the late 1990s so large capital flows remain unregulated
- So domestic employment creation remains hostage to the buffeting of powerful external factors

2. The Nigerian Country Study

- This Country Study focuses on monetary policy—with a sustained critique of inflation-targeting
- It posits a contradiction between 1) inflation-targeting and 2) generating employment and real exchange rate stability
- It is noteworthy for its literature review and econometric (VAR) testing of inflation targeting:
 - Findings: High real rates of interest tend to reduce credit, investment and growth—and thus employment
 - The source of inflation is often external shocks, structural deficiencies and inertial price movements—not necessarily monetary excesses
- Nigeria has employed floating exchange-rate regimes—producing exchange-rate volatility (Dutch Disease effects?)
- But oil exports produce large current account surpluses
- Is the Capital Account unregulated as well? Not clear.

2. The Nigerian Country Study

- Nigeria has high open unemployment (particularly youth unemployment) and the decade of 2001-2010 led to virtually no increase in formal employment
- The public sector accounts for over 60% of wage employment but overall wage employment has declined
- Little analysis of underemployment and the informal sector
- Tight monetary policies have constrained the allocation of financial resources to the private sector
- Public expenditures have been substantially reduced in order to reduce large budget deficits but revenue has also been reduced (to 16% of GDP in 2009)—so less fiscal space
- Gross fixed capital investment (which could sustain structural transformation) has also declined, to 10% of GDP
- Conclusion: the need for a multi-target macro framework: targeting employment generation as well as price stability

3. The Sri Lanka Country Study

- This Country Study does a systematic review of the four Macroeconomic Policies
- Sri Lanka is vulnerable due to large fiscal deficits (-8% of GDP in 2010) and current-account deficits (due to rising oil prices and military conflict)
- ✓ Public Revenue has declined from 20% to 15% of GDP (2010) while expenditures have remained at 23%
- ✓ Government has moved recently to boost public investment (which has risen to 6.4% of GDP) in order to promote economic development while maintaining peace
- ✓ Current-Account Vulnerability: Short-term commercial borrowing to finance deficits replaced concessional lending
- Global crisis led to capital outflows; reserves were run down to stem depreciation. This led to the 2009 resort to IMF loans

3. The Sri Lanka Country Study

■ Typical Labour Market Conditions?

- Informal sector employment still over 60% of total
- Service sector is the main driver of growth (60% of GDP) and employment (42% of total employment)
- Job growth (especially in the private sector) was slow in the 2000s and real wages declined overall
- The Employment/Population ratio stalled at 45% and the Labour Force Participation stayed below 50%
- Emigration is the safety valve for jobs: emigrants representing 20% of domestic labour force
- How to Revive & Sustain Growth and Employment?

3. The Sri Lanka Country Study

- Monetary Policy has targeted reserve money (thru interest rates/open-market operations) but inflation has remained high and volatile (22% in 2008)
- The nominal exchange-rate is highly volatile (since it is a small open economy heavily dependent on trade and remittances)
- Though previously closed, the capital account was recently opened, allowing the build-up of commercial borrowing (while FDI and portfolio investment have not increased)
- The Country Study poses a key macroeconomic challenge: open up the capital account while managing the exchange rate and keeping monetary policy independent. But why open up??
- Country Study Recommendation: Combine 'prudent macroeconomic management' with some policy flexibility (6-7% inflation and a budget deficit of -7% of GDP instead of -5%)
- If the country maintained a healthy reserve position, perhaps macroeconomic policies could be geared to growth and employment generation (but under an IMF programme???)

4. The Peru Country Study

- At the macroeconomic level, the Country Study paints Peru as a relative 'success story'
- The country has grown rapidly in the 2000s, inflation has been held in check, and budget deficits and the debt stock have been substantially reduced
- According to the study, conventional macro policies, centred on inflation-targeting, have been successful
- Interest rates & the exchange rate have been liberalized & the capital account has remained open
- Of course, Peru has benefitted from an export boom based on rising prices for its minerals and metals—but, importantly, it has kept inflation on a par with its trading partners

4. The Peru Country Study

- While Peru has grown more rapidly, its economy has not become more diversified and decent employment remains in short supply
- The best review of 'labour-market' conditions:
 - ✓ Informal-sector employment still comprises 69% of the total (2007)
 - ✓ Employment remains concentrated in low value-added sectors (in agriculture, fishing and services; and in small firms)
 - ✓ Growth has been concentrated in a few capital-intensive sectors (copper, gold, zinc)
 - ✓ Though inflation has been reduced, real wages have increased only modestly during the boom

4. The Peru Country Study

- **The Country Study politely asks: Is there room for ‘a slightly less constraining inflation target’?**
- **Lately the target has been 2% though monetary and fiscal policies were eased during the global crisis**
- **Though the exchange rate is supposed to freely float, the IMF has complained that the government has repeatedly ‘managed’ the rate through deploying reserves**
- **A New Problem: the exchange rate has appreciated since 2005, undermining competitiveness. So should the real exchange rate be targeted (instead of the inflation rate)?**
- **Country Study Response: experiment with ‘graduated flexibility’ of the real exchange rate (cf. Ocampo)**
- **Consequences: the need for some ‘temporary, cautious’ management of the capital account? This will imply less autonomy for monetary policy**
- **Would such a new orientation help promote more public investment for economic diversification and employment?**

5. The Turkey Country Study

- The Turkey Country Study is notable for advancing a coherent Strategic Framework for macroeconomic policies:
 - Its Strategic Coherence stems from targeting a Stable and Competitive Real Exchange Rate (SCRER)
- It is also noteworthy for presenting a coherent analysis of the roots of Turkey's macroeconomic problems and employment stagnation:
 - 'Financialisation': 'Employment-Deficient' Growth based on an excessively open capital account and rampant financial speculation that cause the real exchange rate to appreciate—undermining, for instance, the country's labour-intensive export sectors and employment in general

5. The Turkey Country Study

- The global source of problems is identified:
'Neoliberal Globalization' based on free trade, 'liberalized' finance and 'flexible' labour markets
- **Profits increasingly accrue through financial channels: globally, financial profits as a per cent of total profits rose from 25% in 1990 to 40% in 2005**
- **There has been a shift away from productive fixed investments towards securing short-term speculative gains**
- **A long-term secular decline in the share of wages: there is little impetus towards creating 'higher-quality' jobs under such a macro framework**
- **Following its 2000 economic crisis, Turkey followed orthodox adjustment policies based on fiscal austerity (to foster a primary budget surplus) and tight monetary policy (targeting a low inflation rate)**

5. The Turkey Country Study

- **The Results**: Growth was driven largely by an inflow of foreign speculative finance capital
- High real rates of interest were a motive force while 1) appreciation of the Lira (60% against the US Dollar), 2) an import boom and 3) a widening current-account deficit were the consequences
- FDI flowed into privatized assets, real estate and land; and portfolio investment into government debt, the stock market and the banking system
- These trends intensified Turkey's external financial fragility as speculative-fuelled private debt merely supplanted the previous public debt

5. The Turkey Country Study

- Unemployment declined only modestly to about 9% by 2007 from the peak of 10% during the 2001 crisis
- If discouraged workers are included, the rate was 16%
- Between 2002 and 2008 economic growth averaged 6.5%, but employment growth averaged only 0.8% (and half the time the growth was negative)
- A massive out-migration of labour from agriculture, mostly flowing into marginalized, informal-sector, low-paying jobs in services. Traditional manufacturing sectors shed employment
- The switch to inflation targeting in 2006 led to stagnation of real wages (as low real labour costs laid the basis for low inflation)
- The Result: Stagnating Employment & Real Wages; and Short-Circuited Structural Transformation

6. The Argentina Country Study

- **This Country Study's Strategic Framework is also based on SCRER, a Stable and Competitive Real Exchange Rate**
- **It is noteworthy for being able to historically compare and contrast this macroeconomic approach to one that fixes the nominal exchange rate as the anchor of macro policies**
- **The latter approach (the 'Convertibility Plan') was applied by Argentina during 1991-2001, and ended in crisis in 2001-2, while the SCRER was applied, with much greater success, during 2002-2006**
- **The Policy Lessons from the post-2006 period, including during the Global Crisis, remain unclear : in general, the study opts for too much descriptive narrative, and does not maintain enough focus on general policy lessons**

6. The Argentina Country Study

- **The ‘Convertibility Plan’ pegged the nominal exchange rate (to the US Dollar) while opening wide the economy to external capital flows**
- **This led to sustained appreciation of the real exchange rate and the widening of current account deficits (similar to Turkey’s conditions), prompting employment stagnation in the tradable goods sector and declines in real incomes for the employed**
- **The reliance on capital inflows to fuel economic growth and finance current-account deficits also worsened external debt and financial vulnerability**
- **The Argentine economy was increasingly vulnerable to risk contagion and abrupt capital outflows (which were precipitated, in fact, by the 1997-98 Asia Financial Crisis) while its liberalized exchange-rate and capital-account policies were designed to remain powerless in the face of such a financial crisis**

6. The Argentina Country Study

- **The ensuing SCRER Macro Regime (2002-2006):**
 - The economy grew by over 8% per year as aggregate demand increased, investment rose and export performance improved
 - The competitive exchange-rate regime tended to increase the labour intensity of output: full-time employment increased as did real wages
 - Fiscal and current-account surpluses were generated in the wake of debt restructuring and lowered real interest rates, and the IMF debt was quickly paid off
 - **A Major Strategic Lesson:** Implementing a managed floating exchange-rate regime along with intervening in money markets to regulate the interest rate become feasible only as long as the current account is generating surpluses (thus avoiding the famous 'trilemma'; and avoiding the need for capital controls)

Concluding Remarks

- If we add in some of the other Country Studies (not reviewed here), such as on Uganda and Malawi, we appear to have two prospective progressive strategic frameworks for formulating 'pro-employment' macroeconomic policies:
 1. The first framework focuses on maintaining a Stable and Competitive Real Exchange Rate (SCRER) (refer to the Argentina and Turkey studies):
 - ❖ Managing the exchange rate is the leading 'organising' policy, with monetary policy (i.e., regulating the interest rate) playing a subordinate role
 - ❖ The implications for capital-account management remain unclear though some regulation appears necessary
 - ❖ The implications for fiscal policies (particularly public investment) also appear indeterminate (namely, how to deal with inflationary trends precipitated by fiscal expansion)

Concluding Remarks

2. The Second Framework is 'organised' by Public Investment-Focussed Fiscal Policies (PIFFP)
 - ❖ Again, monetary policies are subordinate to fiscal policies though fiscal policies concentrate on expanding aggregate supply as well as stimulating aggregate demand
 - ❖ Managing the real exchange rate will still be critically important in promoting international competitiveness
 - ❖ Managing capital flows will also likely be necessary
 - General Observation: The disappointing employment outcomes highlighted by the Country Studies, even in countries growing rapidly, underline the importance of implementing macroeconomic policies that can support employment-generating structural transformation (change resulting in broad-based, formal-sector employment with both higher labour productivity and real wages)