Elements of a pro-employment macroeconomic Framework: an exploratory note

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Contents

- Preamble
- Mainstream macroeconomic framework (MMF), developing and emerging economies in the pre-crisis period: key features
- MMF, developing and emerging economies in the post-crisis period
- MMF: strengths and weaknesses
- From MMF to 'pro-employment macroeconomic framework': some suggestions

Preamble

- ILO global and country-level research show (1) proliferation of low productivity jobs (2) declining wage shares (3) increasing incidence of low pay (4) rising inequality in many cases even during global boom of the 2000s (ILO, Global Wage Report , forthcoming, Dec 2010)
- 'Progress in full and productive employment…lacking even before crisis' (Global Monitoring Report, 2010)
- 'Serious shortfalls' for human development MDGs at global level even if pre-crisis growth path maintained and despite significant progress in the past (GMR 2010)
- Requires renewed commitment MDGs in general and to 'full employment and decent work for all' in particular (MDG 1b)
- Esp. in wake of Great Recession of 2008-2009 and impending era of fiscal consolidation

Preamble

- 50% of the world's population lack access to any form of social protection, while 80% lack adequate protection
- Endorsement by UN system of 'social protection floor initiative' (SPF-I) in April 2009 has fiscal implications
- Role of SPF-I in increasing effectiveness of automatic stabilizers needs to be recognized
- At the conclusion of the 99th International Labour Conference (June 2010), tripartite partners ask ILO to work on 'pro-employment macroeconomic framework'
- Also asks ILO to engage in collaboration with development partners
- Oslo Conference (Sep 2010) an important step in that direction
- Current presentation is part of the 'post-Oslo' spirit

Preamble

- Draws on ILO office-wide reports/research plus some country-level work that are in progress
- Relies on IMF country reports and research undertaken by BWIs
- Seeks to understand strengths and weaknesses of 'mainstream macroeconomic framework' (MMF) as operationalized in developing and emerging economies
- Aim is to build on strengths of MMF while dealing with weaknesses

MMF and developing countries in the pre-crisis period: key features

- Tracks multiple aggregates, but two nominal targets stand out: (1) low, single digit inflation and (2) prudential limits on debt-to-GDP ratios supported by low fiscal deficits
- Recall 1990 statement by John Williamson…
- **'A …budget deficit in excess of 1-2% of GDP is evidence of…policy failure'**

MMF: key features

- Design of monetary, fiscal and exchange rate policies influenced by key nominal targets
- Stability and predictability based on nominal targets boosts market confidence, improves quality of investment climate and supports economic growth
- Growth in turn leads to durable employment creation

MMF: key features

- Example of MMF in operation in 29 countries in SSA (1995-2000)
- 2007 Report by Independent Evaluation Office of the IMF observes:

  'inflation control and domestic debt management have been key drivers of …monetary and fiscal targets…Cross-country analysis shows that on average SSA PRGFs have targeted inflation rates below 5 percent'

MMF, developing and emerging economies in the post-crisis period

- During crisis, emphasis was on counter-cyclical measures to cope with external demand shock faced by developing countries and emerging economies
- Now, in six countries that we reviewed, emphasis on monetary policy tightening to meet inflation targets (5% to 7%)
- Fiscal consolidation to meet proposed targets on debt-to-GDP ratios (50% or less)
- The six countries are: Bulgaria, El Salvador, Jordan, Indonesia, Mongolia, South Africa
- Consistent with advice in Global Monitoring Report 2010
- Developing and emerging economies should focus on containing inflation and …
- 'Should adopt credible fiscal adjustment plans to boost confidence in macroeconomic policies'

MMF and post crisis period

- Why?
- Several countries face 'high or rising rates of inflation'
- Deterioration in median fiscal deficit-to-GDP ratio of developing countries (from 1.5% in 2008 to 4.5% in 2009)
- Many countries not on a 'sustainable fiscal path'
- Preferable to return to pre-crisis debt-to-GDP ratios in medium term
- Scale of fiscal adjustment should be around 2.7% of GDP assuming a 40% debt-to-GDP ratio as target (IMF, 2010)

MMF: strengths and weaknesses

- This approach associated with significant improvement in macroeconomic balances and growth revival in mid-1990s to 2000s, especially in SSA
- But….gains asymmetric
- Instability kills growth
- Restoration of stability not sufficient for rapid, self-sustaining growth and broad-based employment creation
- MMF has not adequately addressed the challenge of pro-cyclical policies that are inimical to job creation
- Example: If Tanzania could reduce its procyclical policies moderately, net employment creation would be 10% of work-force (ILO, World of Work Report 2010)
- Fiscal prudence can be overwhelmed by private sector-led accumulation of external liabilities
- Examples: Bulgaria today, Indonesia in 1997

MMF: strengths and weaknesses

- Assessment by WB economists (Montiel and Serven, 2006)

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

Monetary policy and inflation targeting:

- Emphasis on low, single digit inflation not compatible with key findings on inflation-growth trade-off
- Also not compatible with historical experience of developing and emerging economies
- Adjustment costs high when monetary policy seeks to contain inflationary pressures due to supply-side shocks

MMF: evaluation

Fiscal policy and debt sustainability:

- Quantitative limits on debt-to-GDP ratios not rooted in robust evidence (IMF, 2002)
- Risk of a ‘residual approach’ to fiscal policy design that is disconnected from international development goals

MMF:evaluation

<u>Exchange rate regimes, capital account and export competitiveness:</u>

- MMF can lead to sustained spells of real exchange rate appreciation
- Inimical to export competitiveness, structural transformation and job creation (Rodrik 2008; Eichengreen, 2008)

Pro-employment macroeconomic framework: key features

- Distinguish between general principles and specific targets
- Full commitment to general principles of price stability and fiscal sustainability
- But…reservations on specific targets
- Macroeconomic policy-makers need to play a dual role
- (1) Guardians of stability
- (2) Active agents of development
- (1) not synonymous with (2)
- Align macropolicy instruments with international development goals and structural transformation

Pro-employment macroeconomic framework: some suggestions

<u>Monetary policy and inflation targeting:</u>

- Resurrect original spirit of IMF article IV consultations that emphasize 'reasonable price stability' with growth
- Build on the idea of macroeconomic policymakers as active agents of development
- One of the top ten binding constraint on private sector growth is lack of access to finance (WB Enterprise surveys)
- Hence…
- Central bank and financial authorities should promote financial inclusion by
- (1) enhancing access to finance for private sector, esp.SMEs
- (2) supporting growth of efficient MFIs to respond to financial needs of poor and vulnerable who seek durable self-employment

Pro-employment macroeconomic framework

Fiscal policy and debt sustainability:

- Identify sustainable resources from domestic and external sources to meet international development goals
- These goals pertain to (1) public investment in health, education and infrastructure to meet MDGs and (2) social protection floor initiative (SPF-I)
- Raise public investment in infrastructure to about 7% of GDP from current rates of 2-3% in many countries (Growth Commission, 2008)
- Invest in SPF-I because it can boost role of automatic stabilizers in developing and emerging economies
- Case studies of 12 countries show that resource requirements of employment dimension of SPF-I usually modest (approx. 1% of GDP) (ILO, 2008)
- This goal can be met with enhanced mobilization and utilization of domestic resources

Exchange rate regimes, capital account and export competitiveness:

- Foster competitive and stable real exchange rate to avoid sustained spells of appreciation and volatility
- Prudent capital account management in cases where short term capital flows are a destabilizing force