How global food and energy, and financial and economic crises changed approaches to eradicate poverty and generate employment

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Background

1. The global food and energy, and financial and economic crises exposed the inadequacies of the policy advice and analyses of international organizations; but enhanced the credibility of the UN's analyses and policy recommendations, which forewarned about the crisis and pre-mature fiscal consolidation, while others ignored the risks.

2. There is now more or less a consensus that the neo-liberal policy paradigm, popularly referred to as "Washington consensus", that dominated since the 1980s, failed to deliver the promised inclusive development. Its cornerstones have been "stabilize, liberalize, privatize and globalize". These were packaged as "good" policies supposed to lead to accelerate growth and poverty reduction. Instead, the world witnessed more frequent financial crises with increasing depth and duration, and rising inequalities. Recent research within the International Monetary Fund (IMF) has concluded that the neo-liberal policies were over-sold and contributed to financial crises and rising inequality.[1]

3. The former World Bank President, Wolfensohn acknowledged in 2000, "… if we take a closer look, we see something else – something alarming. In developing countries, excluding China, at least 100 million more people are living in poverty today than a decade ago. And the gap between rich and poor yawns wider."[2]

4. Reflecting on the outcomes of the so-called "good" policies, World Bank's Growth Commission concluded in 2005: "Macroeconomic policies improved in a majority of developing countries in the 1990s, but the expected growth benefits failed to materialize… In addition, a series of financial crises severely depressed growth and worsened poverty [. . .] [B]oth slow growth and multiple crises were symptoms of deficiencies in the design and execution of the pro-growth reform strategies that were adopted in the 1990s with macroeconomic stability as their centerpiece."[3]

5. However, the United Nations has been always sceptical about the so-called consensus "good" policy package, while acknowledged the need for adjustment following the debt crisis resulting from oil price shocks of the 1970s and rising interest rates in the 1980s. In other words, there was never a consensus.

6. With UNICEF's *Adjustment with a Human Face* and UNDP's *Human Development Report*, the UN challenged the moral foundation of the neo-liberal policy paradigm. It argued forcefully that to

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[1] See, for example, Ostry, Jonathan, Prakash Loungani, and Davide Furceri (2016). "Neoliberalism: Oversold?" *Finance & Development*, June; also Furceri, Davide and Prakash Loungani (2013), "Who Let Gini Out?" *Finance & Development*, December.

[2] Foreword to Thomas, Vinod, Mansoor Dailami, Ashok Dhareshwar, Daniel Kaufmann, Nalin Kishor, Ramon Lopez and Yan Wang (2000), *The Quality of Growth*, OUP for the World Bank; p. xlii

[3] World Bank (2005), *Economic Growth in the 1990s: Learning from a Decade of Reform*, The World Bank, Washington, DC; p. 95

"balance budgets by unbalancing the lives of the people" is short-sighted and wrong and boldly declared, "People cannot be reduced to a single dimension as economic creatures".

7. The UN reiterated its founding principle of larger freedom (Charter Article 55) and pointed out that the purpose of development is to offer people more options, one of them being access to income - not as an end in itself but as a means of augmenting human wellbeing. Other options include long life, knowledge, political freedom, personal security, community participation and guaranteed human rights.

8. Analysis of inequality and unemployment as well as environmental concerns featured prominently in UN flagship publications, such as Report on World Social Situation (RWSS) and World Economic and Social Survey (WESS).

9. For example, the 1992 issue of the WESS drew attention to over-dominance of the market-oriented approach pushed by the IMF and World Bank with their structural adjustment policies to the neglect of the appropriate role of the State. It noted, "The pendulum may have swayed too far in the direction of market orientation, leading to a neglect of the role and responsibility of the State in development Both historical and contemporary experience suggest that the State has indispensable functions in defining legal frameworks, providing infrastructure, establishing monetary and financial stability, ensuring education and health, maintaining an acceptable distribution of income and social justice, safeguarding the environment, and providing a vision of the future role of the country in the world economy" (p. 3).

10. It was in this context that the UN convened the 1995 Social Summit and refocused its Fourth Development Decade (1991-2000) to launch its First Poverty Eradication Decade (1997-2006).

Global food and energy, and financial and economic crises: The UN at the lead of policy response

11. The global food and energy, and financial and economic crises offered the UN a unique opportunity to lead an effective international response. Thus, at the UN-CEB's first regular session 2009, Executive Heads adopted a Communiqué endorsing 9 Joint Crisis Initiatives to assist countries and the global community to confront the crisis, accelerate recovery, and build a fair and inclusive system of globalization based on sustainable economic, social and environmental development for all. They are:
    a. Social protection floor
    b. Humanitarian, security and social stability
    c. Technology and innovation
    d. Monitoring and analysis
    e. Additional financing for the most vulnerable
    f. Food security
    g. Trade
    h. Green Economy Initiative (GEI)
    i. Global jobs pact

12. The focus of this short paper is mainly the policy initiative (d) Monitoring and analysis which includes macroeconomic policies. However, it will also reflect on policy initiative (a) social protection.

UN's macroeconomic policy advice

13. The crisis underscored the importance of alternative macroeconomic policy advice that can prevent economic meltdowns and contagion in the first place. The idea of providing Member States with a 'second opinion' on macro-economic policies was first raised and unanimously approved at the High Level Committee on Programmes (HLCP) meeting on the financial and economic crisis in March 2010 where the IMF, in particular, welcomed the UN's macroeconomic advice initiative.[4]

14. This was due to the fact that both the IMF and OECD largely ignored the underlying risks to the global economy. The UN was one of the few organizations to identify risks to the global economy before the 2008-2009 global financial crisis. Even after US sub-prime housing debt problems became apparent and Lehman Brothers had collapsed, both the IMF and OECD remained optimistic, predicting a soft-landing in the US at worst, which they suggested would be off-set by robust growth in Europe. Both supported the turn to 'fiscal consolidation' as soon as ostensible 'green shoots of recovery' were spotted in 2009.

15. On the other hand, the UN's World Economic Situation and Prospects (WESP) not only identified the US sub-prime housing market and global imbalances as potential sources of trouble, but also argued forcefully against pre-mature withdrawal of stimulus package pointing to the risk of a double-dip recession. In early 2009, the UN proposed a Global Green New Deal (GGND) comprising of public work programmes and social protection, including in developing countries.

16. The UN Secretary-General's report, "Keeping the Promise", for the 2010 MDGs Summit. Paragraph 50 of the Report states, "Macroeconomic policies should not focus narrowly on debt stabilization and curbing inflation, but should ultimately be supportive of growth of real output and employment. It is often necessary, therefore, to relax unnecessarily stringent fiscal and monetary restrictions and to use countercyclical fiscal and monetary policies to boost employment and incomes and to minimize the impact of external and other shocks on poverty. This requires countries to strengthen mobilization of domestic resources and adopt mechanisms that promote countercyclical policy responses. Enhanced international cooperation to strengthen tax revenue collection and increase sovereign debt sustainability can greatly buttress the fiscal capacities of all Governments."

17. The world leaders at the 2012 the UN Conference on Sustainable Development (Rio+20) called for "adopting forward-looking macroeconomic policies that promote sustainable development and lead to sustained, inclusive and equitable economic growth…" (paragraph 150).

Rethinking Macroeconomic policies

18. In the wake of the 2008-2009 global financial crisis (GFC), the International Monetary Fund (IMF), under the leadership of its Chief Economist, Oliver Blanchard, gathered Nobel Laurette economists, Joseph Stiglitz and Michael Spence, and eminent economist, David Romer to take stock of the situation. They argued for re-thinking of macroeconomic policies of the past 30 years.[5]

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[4] Report of the High-Level Committee on Programmes (HLCP) at its Nineteenth Session (ILO Headquarters, Geneva, Switzerland, 3-4 March 2010), please see paragraph 5

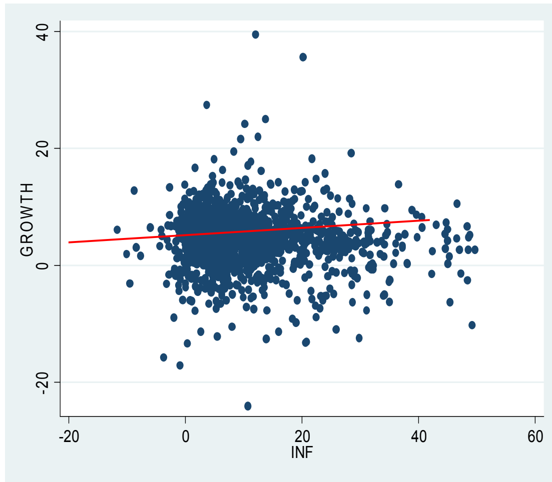
[5] See, for example, Oliver Blanchard, Giovanni Dell'Ariccia and Paolo Mauro (2010), "Rethinking Macroeconomic Policy", IMF Staff Position Note, February 12, SPN/10/03; and Growth Commission (2010), Post-Crisis Growth

19. The crisis has exposed the myths that (a) inflation above a single digit (usually above 5%) hurts growth and (b) government debt (above 40%) hurts growth. As can be seen, these relationships are influenced by extreme values or outliers. Moderate levels of inflation (say, around 10-12%) and public debt (say around 50%) do not necessarily cause macroeconomic instability or hurt growth. Additionally, these do not imply any optimal level or knife-edge situation. The destabilizing or harmful inflation and debt levels can vary depending on country specific circumstances.

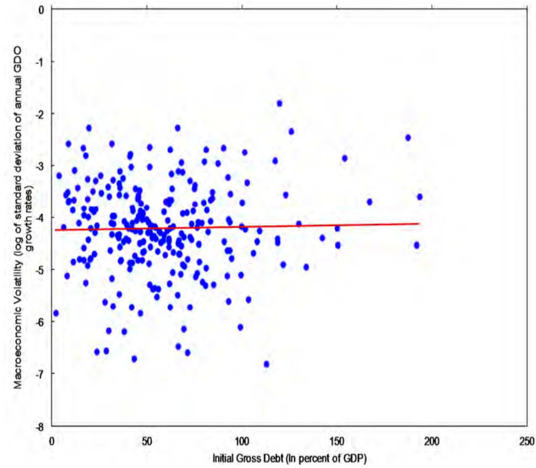
Figure 1: Inflation-growth

Figure 2: Govt. debt-macroeconomic instability

(40 developing countries;1960-2010)

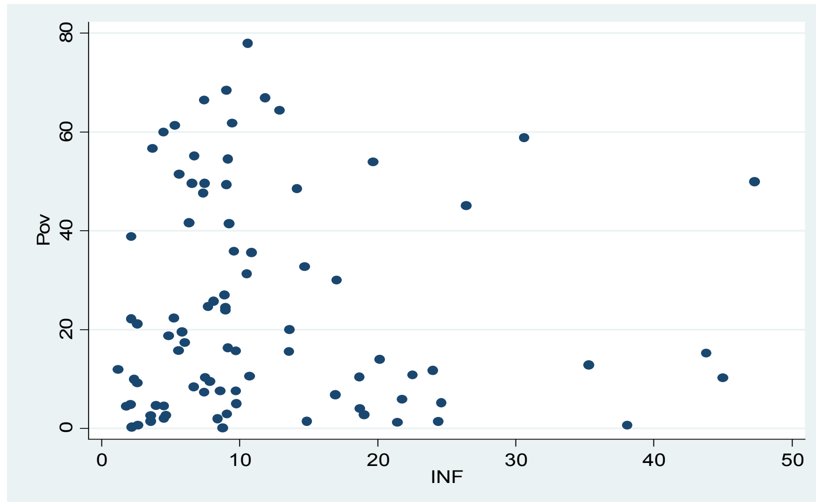


Source: World Bank, *World Development Indicators*



Source: IMF, *Fiscal Monitor*, May 2010

Figure 3: Inflation-poverty (40 developing countries,1960-2010)



Source: World Bank, *World Development Indicators*

in Developing Countries: A Special Report of the Commission on Growth and Development on the Implications of the 2008 Financial Crisis, Washington, DC: The World Bank.

20. In its 2012 World Economic Outlook (October, p. 109), the IMF acknowledged that debt thresholds are not robust, "(T)here is no simple relationship between debt and growth. In fact, our …analysis emphasizes that there are many factors that matter for a country's growth and debt performance. Moreover, there is no single threshold for debt ratios that can delineate the 'bad' from the 'good'."

21. In its October 2014 World Economic Outlook, the IMF observed that "debt-financed projects could have large output effects without increasing the debt-to-GDP ratio, if clearly identified infrastructure needs are met through efficient investment". The IMF's October 2015 World Economic Outlook asserted that debt-financed public investment in infrastructure, education, health and social protection would boost aggregate demand and productivity.

22. IMF's Independent Evaluation Office acknowledged the inconclusive nature of inflation-growth relationship and did not find any convincing evidence to support inflation above 5% hurts growth.[6] Blanchard questioned the wisdom of rigidly targeting a low inflation rate and did not think it was outlandish to raise the target.

Macroeconomic policies to eradicate poverty and generate employment

23. Macroeconomic policies must be consistently counter-cyclical. That is, tighten them during the expansionary phase if the pace is too fast to outstrip supply capacity of the economy that may spill-over into inflation and external imbalance. Conversely, loosen them during economic downturns to add to demand and productive capacity, through public investment in infrastructure, health, education and training, etc.

24. Built-in strong automatic stabilizers, such as progressive taxation and social protection measures, financial inclusion and macro-prudential regulations provide supporting roles. Wages or income policies and active labour market policies also play supporting roles.

Fiscal policy

25. The joint Development Committee of the World Bank and IMF has laid down some guidelines for designing fiscal policy to achieve stabilization and developmental goals. It notes that fiscal deficit is not a useful indicator of "longer term effects on government assets or on economic growth."[7]

26. Therefore, the joint Development Committee advises to shift the focus from fiscal deficit to the transmission channels through which fiscal policy influences long-term growth. That is, "attention be focused on the likely growth effects of the level, composition and efficiency of public spending and taxation." The Development Committee warns: "Fiscal policy that neglects these effects runs the risk of achieving stability while potentially undermining long-term growth and poverty reduction."

27. As part of the crisis response, there has been a growing recognition of the need to ease budget constraints and allow for an increasing degree of deficit spending, especially to

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[7] IMF-World Bank Development Committee (2006), 'Fiscal Policy for Growth and Development: An Interim Report', April 6 (p. i)

support social investments.[8] By doing so, more resources can be allocated to address the impacts of the crisis and support poverty-reducing and employment-generating economic growth.

Monetary policy

28. The preamble of the IMF's Article of Agreement IV states that "each member shall ... endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances" (Article IV.1.i).

29. The key here is "reasonable" price stability and due regard for country specific circumstances. Therefore, monetary authorities should not excessively focus on a pre-determined inflation target without any regard for growth or causes of inflation. This means due attention to the supply side factors. For example, if inflation is caused primarily by rising food prices due to crop failure, monetary tightening may be counterproductive as far as underlying causes of inflation are concerned. Instead, the appropriate policy would be to expand credit to agriculture to accelerate its revival.

30. Monetary authorities should try to keep real interest low or moderate to support investment in light of the fact that World Bank's Enterprise Surveys show access to finance is among the top-5 business impediments. Access to finance is critical for SMEs as well as for agriculture, which depend solely on the banking sector for external financing.

31. Monetary authorities should also ensure that credit does not fuel speculative activities, especially in the capital market and does not create property bubbles. There is a considerable body of work showing that financial sector deregulation that saw huge wave of bank mergers motivated by the short-term criteria of volatile stock markets led to exclusion of SMEs and small borrowers from formal credit markets.[9]

Supportive policies

Exchange rate and capital flows management policies

32. Many observers have attributed the 1997-98 Asian financial and currency crises to their pegged exchange rates, and suggested a more flexible exchange rate regime. But a greater flexible exchange rate is not always an optimum policy for the developing world. No single arrangement is necessarily right for all countries all the time. Given the role of exports and foreign direct investment (FDI) and the need to stabilize the economy a developing country should follow an exchange rate stability approach.

33. Some macro-prudential control on capital flows would allow monetary authorities to conduct independent monetary and exchange rate policies in support of both internal and external balances. Some prudential regulation of the financial sector would allow monetary authorities to influence credit allocation to the socially desirable sectors, including promoting financial inclusion. This would also allow the fiscal authority to borrow when needed without being hostage to the financial speculators.

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[8] IMF (2009), "Creating policy space—Responsive design and streamlined conditionality in recent low-income country programs", recent low-income country programs", https://www.imf.org/external/np/pp/eng/2009/091009A.pdf

[9] See, for instance A. K. Bagchi and Gary Dymski. eds. (2007), *Capture and Exclude: Developing Economies and the Poor in Global Finance*, New Delhi: Tulika

34. Capital flows management is a sovereign right of a country under the IMF's Article of Agreement (Article VI). Both the IMF and World Bank have now recognized capital flow management as an essential macroeconomic policy tool.[10] The IMF has suggested a range of tools for managing capital flows.[11]

Financial inclusion

35. Central banks should also promote financial inclusion through changes to the regulatory framework. A growing body of research shows that financial inclusion can have significant beneficial effects for individuals and the economy as a whole. For example, the lack of access to finance can lead to poverty traps and inequality whereas providing individuals with access to savings instruments increases savings, productive investment, consumption and female empowerment.[12]

Social protection and wages policies

36. Social protection can play a supporting role, both directly and indirectly. First, social protection is a built-in automatic stabilizer. Measures, such as unemployment benefits, rise at a time of falling economic activity to support demand and decline during recovery. Progressive taxation does the same – it dampens demand when income rises; it also collects enough revenues during good times to pay for social protection during bad times.

37. Second, social protection measures, such as publicly funded childcare, education, healthcare, housing and basic services, act as social wage, which society pays through the taxation system in order to support social objectives. Ideally social wage is determined at tripartite consultations, involving the labour, business and government, where the labour offers to soften wage demand and the business offers to fund social wage by paying taxes. Thus, a strong social wage component can prevent wage-price spirals facilitating monetary policy's task of controlling inflation without inflicting recession or causing unemployment. It can also support economic restructuring while preventing unnecessary waste or community resistance.

38. Australia between 1983 and 1990 offers a good example of such a consensual macroeconomic policy framework that helped simultaneously reduce inflation and unemployment. Uzbekistan used expanded social protection measures to soften the impact of its transition in the 1990s and to reignite growth. Uzbekistan was the first country to come out of its post-independence economic contraction.

39. A joint ILO-EU- International Institute for Labour Studies has evaluated the fiscal stimulus packages globally following the first G20 London Summit. It found that most stimulus packages contained social protection measures and labour market programmes. It also found that countries that showed relatively better GDP and employment recovery also had

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[10] IMF (2012). 'The Liberalization and Management of Capital Flows: An Institutional View', November 14. World Bank (2010). *Global Economic Prospects Crisis, Finance, and Growth*. Washington DC

[11] Ostry, J. D., A. R. Ghosh, K. Habermeier, M. Chamon, M. S. Qureshi, L. Laeven, and A. Kokenyne (2011). 'Managing Capital Inflows: What Tools to Use?'. IMF Staff Discussion Note 11/06. See ESCAP/MPDD Policy Brief # for a discussion of pros and cons of various techniques.

[12] For global evidence and general discussion on financial inclusion, see Allen, F., Demirgüç-Kunt, A., Klapper, L. and Martinez Peria, M.S. (2012), "The Foundations of Financial Inclusion: Understanding Ownership and Use of Formal Accounts", *Policy Research Working Paper* No. 6290, World Bank, Washington DC.

implemented bigger stimulus packages as a percent of GDP. The overall fiscal stimulus of the G-20 countries saved between 7 and 11 million jobs, representing 29-43% of the G20s total unemployment in the first half of 2009.[13]

Concluding remarks

40. Macroeconomic policies should revert back to the recommendations of the UN first pioneering Expert Group Report – *National and International Measures for Full Employment* (1949) – that governments should
    a. "adopt and announce a full employment target" in conformity with the UN Charter and the Universal Declaration of Human Rights (para 141.i);
    b. "announce the nature of the policies…in order to maintain the stability of the price level and to combat inflationary tendencies in a manner consistent with the maintenance of …full-employment target" (para 141.iv).

41. One can see the fundamental difference with the current policy orientation (since the 1980s) which puts inflation target at the centre. The Report also emphasized country specific circumstances instead of a "one-size-fits-all" approach in determining national policy measures. In highlighting the importance of pre-announcement of targets and policy measures, it was well ahead of the curve dealing with the destabilizing (policy ineffectiveness) impact of "time-inconsistency" and lack of "policy credibility".

42. Macroeconomic policies, with built-in strong automatic stabilizers, must be consistently counter-cyclical and growth promoting. Social protection along with wage and labour market policies, and macro-prudential regulations along with financial inclusion policies provide supporting roles.

43. Restoring the historical role of macroeconomic policies with a strong social protection system at their core requires revisiting the orthodox macroeconomic policy framework and the reform paradigm that emphasize balancing fiscal budget, low inflation, deregulation, privatization and liberalization.

44. However, this does not mean any complacency on the part of policymakers. Macroeconomic policies must ensure long-term sustainability by linking additional fiscal spending and expanded credit to productive or developmental purposes. By contributing to inclusive growth directly and indirectly an expanded universal social protection system is unlikely to jeopardise long-term fiscal sustainability.

[13] "A review of global fiscal stimulus", EC-IILS Joint Discount Paper Series No. 5; http://www.ilo.org/wcmsp5/groups/public/---dgreports/---inst/documents/publication/wcms_194175.pdf