Executive Summary

International Labour Organization

Beyond Macroeconomic Stability

Structural transformation and inclusive development

Edited by Iyanatul Islam and David Kucera

The context

The Great Recession of 2008-09, while wreaking havoc on the lives of millions, also raised expectations that the preoccupation with a conservative strain of macroeconomics under the rubric of the Washington consensus that dominated the 1980s and 1990s would eventually come to an end. This in turn entailed the expectation of a new beginning: namely, macroeconomic and sectoral policies geared towards supporting the quest for structural transformation and inclusive development. The countercyclical policies that were adopted by systemically important countries across the world to stave off a global depression in 2008-09, the renewed commitment to assist developing countries to attain the Millennium Development Goals (MDGs) by 2015 and the endorsement of the social protection floor initiative by the United Nations system in April 2009 appeared to signal a robust affirmation of the international community's commitment to meet the key aspirations of the global development agenda.

Unfortunately, all indications are that, in the spheres of macroeconomic and labour market policies at least, a "business-as-usual scenario" might prevail. There was a sharp shift from countercyclical policies to fiscal austerity between the last quarter of 2009 and mid-2010 in advanced economies. The move to fiscal consolidation was endorsed in the June 2010 Toronto declaration of the G20 summit. The G20 leaders noted that advanced economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. The G20 declaration was based on the optimistic premise that a global recovery was well underway and that an ambitious agenda of "structural reforms" cutting across both labour and product markets would lift global output significantly, create millions of jobs, sustain poverty reduction and reduce global imbalances significantly. In addition, central banks in systemically important advanced countries embarked on unconventional monetary policies – known as "quantitative easing" – to offset the possible contractionary consequences of fiscal austerity, knowing full well that this is a difficult task when an economy is caught in a "liquidity trap".

In the case of developing countries, the emphasis on fiscal consolidation was less emphatic. Nevertheless, global reports on MDGs prepared by the International Monetary Fund and the World Bank echoed the need to remain vigilant about the sustainability of public finances. There is evidence of significant retrenchment of public expenditure in the developing world.

However, the reassertion of a "business-as-usual scenario" entailing a combination of fiscal consolidation, unconventional monetary policy and structural reforms, especially in the advanced countries, has been confronted by a good deal of empirical scrutiny by its critics. Serious questions have been raised about the empirical credibility of the canonical studies that appeared, for a while at least, to provide academic respectability to the agenda of fiscal austerity. At the same time, even economists sympathetic to the cause of conventional macroeconomics opined that quantitative easing has not been particularly effective in dealing with the liquidity trap.

Perhaps the most compelling case against the status quo ante is that global economic recovery has been much slower than expected; the Euro area and the European Union in general continues to be in the grip of stagnation and high unemployment; the recovery in the United States has been tepid. Considerable political and social unrest have wracked the peripheral economies of the Eurozone that bore the brunt of fiscal austerity. At the same time, the much-touted sovereign default caused by debt sustainability concerns was limited to the particular circumstances of the peripheral economies of the Eurozone and simply did not materialize in the case of countries such as the United States, United Kingdom and Japan, which continue to enjoy historically low interest rates despite high debt-to-GDP ratios.

Cracks are also beginning to emerge in the façade of unity among the G20 that was projected at the Toronto summit. The emerging economies of the G20 group have raised concerns about the deleterious spillover effects on their economies which they claim is being triggered by short-term capital inflows caused by quantitative easing. G20 efforts at a renewed and unified commitment to fiscal targets along the Toronto Summit lines remain uncertain largely because of opposition from the United States, Japan and some emerging economies. The G20 communique from the finance ministers and central bankers, released during 2013 refer only in general terms about the importance of "fiscal sustainability" for advanced economies and there are no references to specific targets.

The three thematic pillars of the volume

In light of these salient and unresolved issues that dominate the global policy agenda, this new edited volume seeks to go beyond the narrow conceptualization of macroeconomic stability in the conventional framework and explores the link between structural transformation and inclusive development. The volume rests on three distinct, but interrelated, thematic pillars. The first consists of three chapters addressing the limits of conventional macroeconomics. Chapter 2 by Iyanatul Islam, Ishraq Ahmed, Raquel Ramos and Rathin

Roy delineates the "one-size-fits-all" nature of the policy advice dispensed by the IMF to developing countries. Chapter 3 by Anis Chowdhury and Iyanatul Islam builds an evidence-based case against fiscal consolidation. Chapter 4 by Sarah Anwar and Iyanatul Islam critically examines whether developing countries should set low, single-digit inflation to promote growth and employment. In light of these chapters, the editors argue that the challenge is to find ways in which conventional macroeconomics can be more closely connected to the agenda of structural transformation and inclusive development. This means going beyond a mere reiteration of the virtues of macroeconomic stability. One needs a "dual mandate" for macroeconomic policy managers in developing countries. This dual mandate emphasizes the role of macroeconomic policy managers along two dimensions: (a) as guardians of stability; (b) as agents of inclusive development.

The second thematic pillar encompasses three chapters that deal with the long-run agenda of structural transformation and the development of capabilities. Chapter 5 by David Kucera and Leanne Roncolato enunciates an empirical approach to track the various sources of structural transformation and applies it to sectoral data for a large number of countries. They conclude that changes in both intrasectoral productivity and the cross-sectoral effects shape the relationship between employment and productivity growth.

Chapter 6 by Irmgard Nübler and Christoph Ernst nurtures the thesis that investment in infrastructure leads to the inculcation of capabilities, broadly defined to include knowledge accumulation, dissemination and application. Such capabilities in turn provide the key to the transformational potential of developing countries. The authors illustrate their thesis by using both project-specific and country-level evidence. Chapter 7 by Christina Behrendt reinterprets social protection from the perspective of inclusive development and structural transformation. The author compiles both cross-country data and country-specific experiences to illustrate that well-designed and sustainably funded social protection measures reduce poverty, enhance capabilities and improve employability.

The final thematic pillar, consisting of two chapters, deals with the highly topical issues of inequality, the relative wage share and their macroeconomic consequences. Current concerns about inequality, both global and country-specific, have emerged in the wake of the Great Recession of 2008-09. Chapter 8 by Massimiliano La Marca and Sangheon Lee examines secular trends in the functional distribution of income, most notably the relative wage share, and explores their possible macroeconomic consequences by developing and applying a two-country macroeconomic model. La Marca and Lee show that it is possible for countries to engage in self-defeating wage moderation policies that reduce global welfare. This suggests the need to develop a coordinated approach to wage policies. Chapter 9 by David Kucera, Rossana Galli and Fares Al-Hussami discusses the contemporary debate on income inequality and seeks to establish whether it, combined with stagnant real incomes, is one of the sources of the crisis. They conclude that stagnant real incomes that force households to incur debts to keep their heads above water, rather than the aspirational spirit of "keeping up with the Joneses”, is the key force behind the private-sector indebtedness that fuelled the financial crisis. The authors note that the weakening of labour market institutions lies behind the dismal record of stagnant real incomes in some of the advanced economies.

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