Assessing existing responses to the crisis at international, regional and national levels – limitations, perspectives, best practices[1]

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A. Has the world economy turned the corner? Has the recession bottomed out?

Many observers are looking at "green shoots", an FT headline last week May said that the recession "bottomed out". George Soros has said that "the freefall has stopped". This might be true, but these green shoots only suggest a slowing down of the rate of deterioration in GDP, not a real recovery yet. There is no room for comfort for several reasons:

- First, 2009 is not only a year of deep recession but it is the year in which the crisis hits labour markets and people hard. The IMF Growth forecasts for 2009 have been revised downwards four times since October 2008. The latest estimate released last month (April) forecasts a contraction of -1.3% globally, -3.6% in Developed countries. Not surprisingly, and despite the unprecedented amount of fiscal stimulus, large scale job losses continue to be reported in many countries. Of course, the news on the labour market would still be much worse without the boost to aggregate demand through fiscal expansion. But the fact is that unemployment and poverty continue on a steep rise. Last January the ILO forecasted that in the worst case scenario unemployment could rise by 40 million in 2009 alone. Unfortunately, our tracking of labour markets suggests that the world has been advancing towards this worst case scenario. And of course, the rise in unemployment feeds the vicious circle of lower consumer spending, and lower demand.

- Second, other post-war recessions in developed countries were the result of either Central Banks killing a boom that threatened to become inflationary, or an oil price shock. But the financial system was in good shape. Not this time.[2] After the financial collapse and despite actions to bail out the banks, the financial sector is still pretty sick in several developed countries. The credit crunch is still with us and still feeding the vicious circle of recession. This is a major obstacle for a sustainable recovery. The other major obstacle is the fact that there is a major balance sheet disorder in the company and household sectors of the US and other major countries. This suggests that a long process of deleveraging needs to take place before a return to normal levels of investment and consumer expenditure.[3]

- Third, the synchronized nature of the global downturn makes it impossible, as in previous recessions, for any country to export its way out of the crisis.

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[1] Slightly revised version of comments at UNCTAD Symposium on the Economic Crisis, Geneva, 18 May, 2009.
[2] Willem Buiter "Green Shoots : grounds for cautious pessimism", FT.com/maverecon, April 28, 2009.
[3] Martin Wolf "Why the 'Green Shoots' of recovery could yet wither", FT, 22 April, 2009.

World trade is shrinking at the fastest rate since the great depression. De-globalization is occurring.

- Fourth, unfortunately the impact of the crisis in developing countries is only starting and it can be argued that it will get worse, with a lag. The main reason is that all engines of growth and all sources of financing for developing countries are affected by the crisis and have only recently begun to bite: trade, tourism, FDI flows, remittance flows, the prices of primary commodities and ODA. Of course the speed and nature of the impact of the crisis in developing countries vary significantly across countries depending on economic structure, transmission mechanisms, policy responses and constraints and other specificities. Some countries are more vulnerable than others. But given its synchronized nature, the crisis will reverse many of the gains of many countries in terms of growth, poverty reduction and job creation and will have strong negative developmental implications that may outlast the crisis.

- Fifth, from the studies of Reinhart and Rogoff[4] we have learned that recessions that follow a financial crisis tend to be longer and deeper that those that don't. In previous crisis the recovery of output has taken an average of 2 years, but the full recovery of the job and labour market to pre-crisis levels has taken between 4 to 5 years. So a strategy for the upturn will require measures to accelerate the labour market recovery.

For these and other reasons this global recession can be expected to be long and deep, and the recovery, when it comes, can be expected to be slow. The IMF forecasts positive global growth of 1.9% in 2010 (4% in emerging and developing countries, and 0 % in developed countries). But these forecasts, as recent ones, are surrounded by considerable uncertainty.

B. Brief assessment of the policy responses so far

Policy responses have covered four major areas so far: (1) boosting aggregate demand by a combination of fiscal stimulus and efforts to repair the financial system in developed countries; (2) a complex variety of responses in developing countries; (3) a global response centred around the G20 process; and (4) national labour market and social policy responses to try to mitigate the impacts of the crisis.

Developed countries.

In line with Keynesian theories and thanks to them, governments and central banks have injected massive amounts of cash into the world economy. The situation would be much worse had this not been done. Most developed countries have put in place a two-target approach to promote recovery and employment: targeting aggregate demand through fiscal stimulus and low interest rates and targeting the financial sector to restore credit flows to levels compatible with full employment.

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[4] Carmen M. Reinhart and Kenneth S. Rogoff (2008) „The Aftermath of Financial Crisis", Paper presented at the American Economic Association Meeting, San Francisco, Jan 3, 2009, available at http://www.economics.harvard.edu/files/faculty/51_Aftermath.pdf

What assessment can be made to date of fiscal stimulus packages in developed countries?

There have been four evaluations of the impact of fiscal stimulus packages by the IMF, the OECD, Brookings Institution and the ILO. These evaluations look at size, composition and speed of fiscal stimulus. Some of the main conclusions are the following:

- In terms of size, the IMF set a benchmark of 2% of GDP as a necessary minimum. However, the Brookings study and the ILO study conclude that the collective size of the packages of around 1.4% of GDP is inadequate and falls far short of what is needed. The IMF and OECD conclude that although size appears large, the impact is not enough to offset the output gap.

- In terms of composition, the OECD concludes that the spending multipliers are bigger than the tax cut multipliers, and that the fiscal stimulus obtained from the automatic stabilizers in Europe is much larger than the fiscal expansion associated with the crisis-specific stimulus. The ILO study also finds out that the biggest employment impact is obtained from labour-intensive public investment programmes. It argues that the best designed fiscal stimulus packages are those that focus on targeted job generation and social protection, and that the way to give fiscal stimulus the biggest punch is by putting employment and social protection at their core. Unfortunately, so far, direct spending on employment is a minimal share of fiscal stimulus packages.

- Studies also emphasize that quick implementation is crucial to attenuate jobs gaps. Certain infrastructure investment projects need more time to be set up, while transfers can work immediately.

- International coordination of fiscal stimulus is important partly because with open and interlinked economies much of the fiscal stimulus leaks to the rest of the world. This provides a rationale for coordinated stimulus as the most effective way of boosting global aggregate demand. In this sense, the G20 missed an important opportunity. But coordination is difficult as fiscal policy is so uniquely related to local political and economic history and realities.

- A general conclusion is that fiscal policy responses, while helpful, will not be able to fully mitigate the fall in output, let alone employment and labour market outcomes. This is partly because the reduction in private investment and consumer demand is huge. So sustainable recovery can only be obtained when consumer demand and private investment recover in a sustainable way.

What about the second target-the financial sector? Restoring health to the financial sector has taken longer than expected. Despite actions to bail out the banks, the financial sector is still pretty sick in many countries: asset and housing prices continue to fall, there is still uncertainty and lack of transparency about the amount of toxic assets, large write-offs are still expected that will damage many Banks' balance sheets. There are still many zombie banks. And most important, credit flows have not been restored to levels compatible with full employment, and the limited bank lending that takes place is often at high interest rates. So, the credit crunch is still with us and it is urgent to step up efforts in this regard.

In addition, in the US and other major developed economies the company and household sectors are highly indebted and have lost wealth massively. Until house prices stabilize, it is hard to see consumption reviving. And even if credit becomes available at very low interest rates, highly leveraged companies and households will continue to pay back debt rather than accessing new credit until the process of deleveraging runs its course. The experience of Japan in the 90s shows that this can take a long time, and that it is only until the financial sector is restored to health and the process of deleveraging has run it course that private sector investment and consumption can pick up again.[5]

It is also important to note that restoring health to the financial system to sustain a private-sector-led recovery is urgent because the room for discretionary fiscal stimulus has been nearly exhausted in some of the major developed countries, which means that a public-sector-led recovery is not sustainable much beyond 2010 for major economies, and in particular the US.

Developing countries' responses and challenges

In contrast to many developed countries, no developing country suffered from destruction of their financial system prior to the recession. Their contractions are the result of the external shock and transmission mechanisms. Accordingly, their mitigation capacities in terms of policy responses depend mainly on three factors:

- Their dependence on external demand, mostly exports
- Their dependence on external financing (FDI, remittances, ODA)
- Their space for fiscal expansion/discretionary demand management and the ability of the authorities to use it flexibly.

Countries whose development models have been heavily driven by exports and FDI are finding that their strength when world growth was strong has turned into a weakness during recession.

Developing countries should also be able to engage in counter-cyclical policies. And indeed some of them have put in place vigorous crisis response policies including fiscal stimulus packages. But a number of problems should be pointed out:

- First, since all engines of growth and all sources of financing for developing countries are affected by the crisis, it is hard for fiscal stimulus to compensate for these lost sources of growth.

- Second, in developing countries there is a strong argument to focus stimulus on policies that benefit the poor and improve income distribution. Poor people are typically more constrained by lack of income and credit and are more likely to quickly consume or invest the extra cash provided by employment

[5] Richard Koo (2008), *The Holy Grail of Macroeconomics. Lessons from Japan's Great Recession*, John Wiley & Sons.

> guarantee programmes, conditional cash transfer programmes and social protection schemes. Therefore, effective countercyclical fiscal stimulus packages in developing countries should be designed to be strongly pro-poor. Indeed, in developing countries the crisis is an opportunity to create pro-poor stabilizers similar to the automatic social safety nets that rich countries already have in place.[6] The ILO has been arguing for the establishment of a basic social floor in developing countries, and the crisis is an opportunity to do this with a sense of urgency.

Countries with sufficient fiscal space have put in place policy responses and stimulus packages including investment in infrastructure, skills training, enterprise support, unemployment benefits, and cash transfer programmes including employment guarantee schemes.

But the policy response challenges are very serious for countries with heavy dependence on external demand and external financing and little fiscal space as well as limited institutional and administrative capacities to put sophisticated active labour market, skills training and other programmes in place. These problems are exacerbated in countries characterized by low fiscal revenues, widespread poverty, high inequality and informality. And many developing economies lack basic social protection. For instance, only 53 out of 144 developing countries have a cash transfer programme. For these countries international support is essential.

A key question for these countries is: Has the G20 and multilateral system response been sufficient, particularly for the more structurally constrained countries?

The G-20 response

The leaders of the G20 made significant progress in consolidating a coordinated international response. The centrepiece of the short term G20 response is the close to 1 trillion of additional resources: the IMF was given US 500 bn of extra resources; a new SDR allocation of 250 bn was agreed; 100 bn of additional lending was committed for Multilateral Development Banks; and 100 bn to support trade finance. This is a very welcome effort. However, this ambitious financial package is surrounded by important implementation challenges:

- First, some of these amounts are aspirations, and the money is not yet committed by all the major players. (100 bn was committed by Japan, another 100 bn by the EU, and 40 bn by China; the remaining 260bn still needs to be found).
- Second, the policy model that the IMF requests as conditionality to access resources continues to be a problem. The Fund is offering a new crisis insurance credit line (The Flexible Credit Line-FCL) with none of the policy strings usually attached. But this is insurance for the future. For countries knocking at its door the Fund still has a bias towards spending cuts and unnecessarily restrictive financial targets.

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[6] Martin Ravallion, “Bailing Out the World’s Poorest”, World Bank, Policy Research Working Paper 4763, October, 2008.

- Third, approaching the Fund is still surrounded by political and economic stigma. Most countries are reluctant to approach the Fund until they are in very serious trouble. Part of the mistrust of the Fund has to do with the negative signals it sends, part with the policy package demanded, and part with the fact that emerging and developing countries do not participate meaningfully in its governance structure.

On trade matters, the G20 pledge to complete the Doha Round by the end of 2009 and resist new protectionist measures is commendable but the key question here is whether there will be the political commitment to make this pledge credible.

The G20 also recognized the role of the UN Multilateral System. The call on the UN to establish a mechanism to monitor the impact of crisis on the poorest and most vulnerable is to be welcomed, as well as the call on the ILO to assess the actions taken and those required for the future, working with other international organizations.

The G20 welcomed the reports of the London Jobs Conference and the Rome Social Summit, and principles therein, but it remains to be seen how strong is the commitment to put employment, social protection and labour market issues at the centre of policy responses.

For the ILO this is essential. Not enough is being done in this respect. And this is important not only to promote recovery but to lay the foundations for a more inclusive and sustainable pattern of growth and globalization in the future.

Achieving this policy re-balancing is one of the main objectives behind the idea of developing a **Global Jobs Pact,** [7] that will be discussed by the ILO International Labour Conference next June.

A Global Jobs Pact

In the short term, a GJP could aim at stimulating the real economy through financial rescue measures and well designed fiscal stimulus, mitigating the employment and social impacts of the crisis through social and labour market policies, protecting workers through social protection and labour standards, activating the recovery of employment as quickly as possible, and promoting a low carbon, energy efficient growth path.

As explained, the world economy seems to be at the early stages of a long and painful process of deleveraging and restructuring. The proposed GJP can help in easing the pain, bringing fairness to the ongoing adjustments, and maintaining cohesion and social stability in a situation otherwise fraught with dangers and potential for conflict.

In the longer term a GJP could aim at laying the foundations for a more fair and sustainable growth and globalization process by rebalancing policy priorities and

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[7] See ILO Report of the Director-General to the International Labour Conference, Tackling the Global Jobs Crisis, Recovery through Decent Work Policies, 2009, available at www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/documents/meetingdocument/wcms_106162.pdf

agendas, achieving appropriate balances between the role of the state and markets; smart regulations for financial, product and labour markets; and reform of the institutions for the governance of globalization.

As regards social and labour market policies it tries to achieve this through a number of measures, such as the following:

1. Strengthening income maintenance measures for the unemployed such as boosting unemployment benefits (duration, coverage), incentives to employers for work sharing and temporary worker retention, and complementary cash transfer programmes.
2. Expanding social protection measures and protecting pensions from the devastating decline of financial markets.
3. Targeted support to vulnerable groups and sectors, such as introducing temporary youth employment programmes.
4. Strengthening active labour market policies to support employment and earnings such as introducing temporary payroll tax holidays or wage subsidies and expanding training programmes to the unemployed.
5. Investment in the development of workers' skills to prepare for recovery during periods of slack labour demand.
6. Strengthening employment services to facilitate adjustment of firms and individuals to changing labour market conditions. Employment services are more important than ever in times of crisis as workforce mobility increases.
7. Support to enterprises, particularly SMEs, to access credit andovercome cash-flow problems.
8. Public investment in infrastructure, through emergency public works with labour intensive techniques, including measures that contribute to adapting to and mitigating the effects of climate change. Incentives and investments in energy-efficient technologies and "green jobs" can be an important contribution to job creation and recovery.
9. Socially responsible restructuring of enterprises and sectors.
10. Social dialogue at enterprise, sectoral and national levels for all of these policies.

The present crisis is an opportunity to promote innovative patterns of growth. The type of growth dynamic experienced by many African and other developing countries in the past has been concentrated on a few export-led enclaves in mining or a few commodities. Agricultural development and local industrialization has often been neglected. Investing in education, social services, science and knowledge has also been neglected. The crisis is an opportunity to re-think and re-balance development agendas, not just to return to the policies of the past.

Finally, it must be emphasized that the role of the private sector in confronting the crisis is crucial. While business cannot eradicate poverty, poverty will never be eradicated without business, nor sufficient jobs created in a sustainable way. Confidence needs to be restored and new forms of partnership promoted. Business engagement around social and development issues and good corporate citizenship are now more important than ever.