EMPLOYMENT PAPER

2003/48

Macroeconomic stability, growth and employment

Issues and considerations beyond the Washington Consensus

M. Muqtada

Employment Sector

INTERNATIONAL LABOUR OFFICE GENEVA

Employment Sector

This ILO Sector has the responsibility for assisting and advising ILO constituents in analysing national and global employment and labour market developments in order to elaborate and negotiate policies and programmes for employment promotion and human resources development. The Employment Sector encourages them to invest more in training and human resources development for enhanced employability; to implement special employment promotion programmes in situations of high unemployment, particularly in the context of different types of crisis; to promote the creation of quality jobs in enterprises; upgrade the informal sector and promote gender promotion in employment.

EMPLOYMENT PAPER

2003/48

Macroeconomic stability, growth and employment

Issues and considerations beyond the Washington Consensus

M. Muqtada

Employment Sector
International Labour Office Geneva

ISBN 92-2-113644-2
ISSN 1020-5322

First published 2003

Printed by the International Labour Office, Geneva, Switzerland

Acknowledgements

A previous version of the notes contained in the paper was discussed at an informal meeting of the "Employment and Development" group, set up by EMP/STRAT. This version has taken into account many helpful remarks and suggestions from the participants, in particular from Rashid Amjad, Peter Auer and Ajit Ghose; Dharam Ghai and David Kucera, at the International Institute of Labour Studies, provided useful and encouraging comments on an earlier draft. Statistical assistance and useful research suggestions from Sudip Ranjan Basu, and data and web search assistance from Anne Drougard are gratefully acknowledged. Needless to say, the author remains responsible for any errors and critical omissions.

Muhammed Muqtada

Preface

During the past two decades, the design of macroeconomic policy frameworks, across countries, was focussed predominantly on the attainment of *price* and *balance of payments* stability. The so-called "Washington Consensus", which came to be adopted as the blueprint of stabilization and structural adjustment programme (SAPs), was largely concerned with restraining inflation and reducing fiscal and current account deficits.

The paper attempts to provide a critical assessment of the varied experiences of stabilization. It is largely observed that while stabilization has indeed yielded substantial price discipline, inflation in particular, growth has remained inadequate, volatile and far from reaching the sustained levels required to make any perceptible gains in reducing employment and poverty. In fact, the paper, using cross-section and panel data from 20 selected countries, shows that growth and investment are rather "insignificantly" affected by the "stability" factors.

The paper also provides a brief commentary on the PRSPs (Povery Reduction Strategy Papers) that are currently emerging as the new blueprint of lending by the Bretton Woods institutions. The paper contends that the poverty agenda of the PRSPs and the stabilization targets sought by World Bank and IMF would create innate tensions if the macroeconomic framework fails to articulate both. In this context, it is important to understand that policies may overly conflict among those that reduce prices and deficits, and those needed to create a "fiscal space" for critical public expenditures for social goals.

In the above context, the paper forwards three considerations that are significant for future macropolicy planning. First, one needs to go beyond *stabilization of prices*, to seek factors that would increase and *stabilize growth*. Second, given the high levels of un/underemployment and poverty, there is a need to centralize the goal of "full productive employment" in macroeconomic planning. Third, a macroeoconomic environment by itself would not automacally produce growth or employment; various microeconomic, labour and institutional policies are needed to support macropolicies.

In conclusion, the paper identifies a few ingredients towards alternative designs of macroeconomic policies at the country-level, with the emphasis that these must be *embedded* in the economic and social objectives pursued. A return to the goal of full employment and decent work provides an alternative long-term objective, which needs to be cast in a macroeonomic framework of sustained investment, and employment-friendly growth. The developing countries, especially those facing a "stabilization trap" and high un/underemployment, would need not only a prudent use of the monetary and fiscal levers, but also a degree of focussed government intervention to boost investment and productive employment.

Rashid Amjad
Director a.i.
Employment Strategy Department

Contents

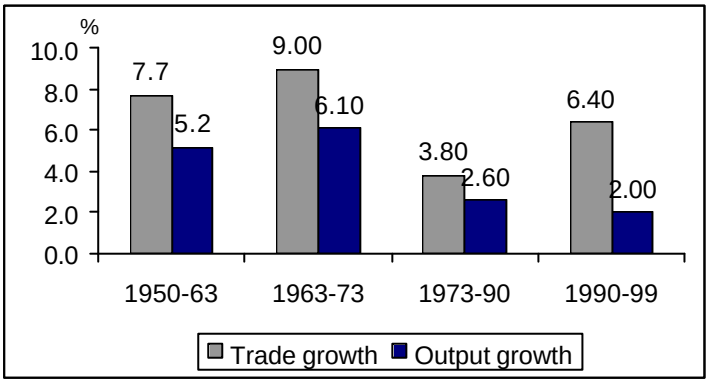
Tables and figures

Appendix: Graphs

I. Introduction

This paper is essentially a cursory exercise in raising a few issues and debates, drawing upon the *lessons and non-lessons* from the *practice* of macroeconomic policy formulation undertaken by most countries of the world since the second oil price shock of 1979. The oil price hike, one may recollect, triggered off serious recessionary tendencies globally. That recession evidently did not take a proportion anywhere comparable to the Great Depression of the 1930s, but certainly initiated a new wave of macroeconomic practice, underpinned by the macroeconomic principles of the so-called *counter-revolution* thinking, across countries. The outcomes of the pursuit of this line of prescriptions, over the past two decades, have been less than encouraging, especially in terms of growth, employment and levels of living (see ILO's *World Employment Report*, 2000-01, for recent trends in global and regional output and employment). Global output growth declined to nearly *one third* of the rates achieved during the 1950s and 1960s (and till 1973, when the first oil price shock came in).

Figure 1. World merchandise trade and output: 1950-99
(Average annual percentage change in volume terms)



Source: WTO, World Trade Statistics, 2001.

This phenomenon (see Figure 1) must strike as worrisome, especially to the bulk of the policy-planners and academic community who trust that employment generation and poverty reduction were closely (though not *automatically*) related to accelerated growth. At the *country level*, Table 1 contrasts the real per capita GDP of the 1980s with that of the 1990s for a random sample of 20 countries.[1] Barring a few exceptions, real per capita income grew very slowly, and in fact, declined in some cases. This then could hardly contribute much to the alleviation of poverty[2] and the unemployment situation. Furthermore, inequality increased. If one were to introduce this, as a simplistic welfare content of growth, social justice becomes far removed. Table 1 also provides some

[1] This is a sample that the author has selected for further empirical work. It contains nine countries where the ILO has recently conducted in-depth *country employment policy reviews* (CEPR), which the author has coordinated.

[2] UNCTAD (*The Least Developed Countries Report 2002: Overview*) states that "the proportion of the total population living on less than $1 a day rose from 51 per cent in the three years before the adoption of a programme (Enhanced Structural Adjustment Facility) to 52 per cent in the first three years after and 53 per cent in the next three years" (p. 24).

estimates to show *"welfare-weighted"* increase in real per capita GDP (see notes to Table 1 on such an index proposed by Sen) was even lower.

Table 1. Per capita growth and welfare

	1980s		1990s	
Countries	Per capita Real GDP	Welfare GDP	Per capita Real GDP	Welfare GDP
Bangladesh	253.16	167.97	314.85	217.40
Barbados	6795.97	3475.46	7232.71	NA
Bolivia	867.93	503.05	897.61	368.92
Brazil	4093.27	1612.75	4299.32	1665.56
Bulgaria	1588.11	1194.02	1485.10	1047.00
Chile	2737.87	1317.46	4383.90	1863.16
Egypt	859.03	558.37	1044.54	726.48
Hungary	4657.75	3305.37	4528.13	3274.52
Indonesia	616.93	405.01	961.49	650.01
Kenya	335.51	148.14	339.53	171.65
Nepal	164.25	114.87	203.60	128.88
Pakistan	384.64	256.15	487.61	335.60
Peru	2378.30	1280.36	2140.66	1185.93
Philippines	1085.38	619.75	1093.11	584.81
Sri Lanka	514.29	320.15	692.99	469.50
Tanzania	183.84	104.51	182.41	93.75
Thailand	1429.74	814.95	2570.14	1486.83
Uganda	236.35	158.36	293.20	183.54
Ukraine	2038.85	1526.49	1220.01	866.21
Zimbabwe	648.94	280.34	680.69	NA

Notes: N.A.: not available.
Sen tried to provide a *welfare* measurement of growth through weighting the latter by the Gini ratio: $Y^* = Y(1- g)$, where Y = per capita real GDP; g = Gini ratio. For the 1980s, the per capita real GDP is for the period: 1980-1990, and for 1990s, the figure is for the period 1990-1999. The Gini ratio figure is related to the average of the available data for 1980s, and 1990s respectively.
Sources: UNCTAD handbook of Statistics CD-ROM 2001; WB, UNDP and ILO for Gini ratio.

The following pages attempt to trace the above outcomes to the macropolicy framework adopted almost across all countries, developed and developing, and to draw attention to the need for a return to the goal of full employment[3] (cf. ILO, *the Global Employment Agenda, 2001*) as the central objective of macroeconomic policy. The exercise, in short, is focussed on the campaign towards "full, productive and freely chosen employment" and draws inspiration from the need

[3] The tripartite conclusions of the ILC Committee on employment, 1996, contained emphatic considerations of policies, for developed and developing countries, towards full employment.

To promote opportunities for women and men to obtain decent and productive work, in conditions of freedom, equity, security and human dignity.

ILO, Decent Work, 1999.

II. Macroeconomic policy and the search for an objective

A macroeconomic policy framework must serve a well-defined objective. A test of its success would thus lie in how far it has contributed to achieving that objective.

The period of the 1980s and 1990s, the hey-days of the World Bank (WB) and IMF's stabilization and structural adjustment programmes, saw a return to "growthmanship" values, and the "trickle down" advocacy of distributive justice. The so-called counter-revolution period (1980s and 1990s) had its own value judgment, deeply embedded in the neo-liberal paradigm. It largely focussed on the individual consumer, the individual firm - all operating under conditions of free competition, and perfect information. Disorders and malaise in the economy were seen as policy distortions, and there was a need to return to *getting the prices right* (WB/IMF model). As contended by Keynes during the Great Depression of the 1930s, as by Keynesians now, such a system fails to predict, or to suggest ways to get out of, prolonged recessions, since aggregate demand equalling aggregate supply could produce an equilibrium, which is less than a full-employment equilibrium (note: *the GNP gap*). The persistently high levels of un/underemployment and poverty, coupled with lack of sustained economic growth, provide a necessary rationale to rethink the objective of macroeconomic policy.

In a free democratic society, stabilizing and empowering *markets* are indeed critical goals. Markets are also a *social entity* that mediates exchange and relations (through the product, services and labour markets). *Prior* to the counter-revolution of the 1980s and 1990s, there was a critical focus on a development agenda, on society, social classes and institutions. Economic considerations and policy-making were *embedded* in the overall goals of the society, and intermediated by various social classes (see, e.g. Kalecki on "intermediate regimes"). In point of fact, the concern over societal order and societal values defined economic, social and political institutions and policies ....

As a rule, the economic system was absorbed in the social system, and whatever principle of behavior predominated in the economy, the presence of the market pattern was found to be compatible with it.

Polanyi (2001 edition, p. 71)

It appears that IMF/WB's campaign, during the past two decades on stabilization and adjustment, contained an overriding focus on one social institution, i.e. the market, with a macropolicy drawn up to "getting the prices right". In the process of moving the economy through the "self-regulating market", governments (esp. in the developing countries) were weakened (reduction in civil services, public expenditure, and importantly, several of their functional roles), while workers felt less certain and less organized, as capital became freer to flow in and out of a country. A growing asymmetry of power allocation between labour and capital, and of power allocation among social institutions implied, *inter alia*, that

workers were moving further away from *decent work*, and capital (esp. big businesses) tended to move away from establishing what Charles Handy termed *decent capitalism*[4].

Provided that the ultimate objectives of growth and development are shared prosperity and social justice, policies and policy reforms need to be seen linked to these objectives. Hence, for policy reformers having undertaken economic reforms, it would be futile, or at best, half-hearted to confine to addressing the "negative effects of liberalization" or "social effects of stabilization". Social "add ons" (e.g. transfers, subsidies) may indeed be necessary to support the weaker and vulnerable groups in societies, but these do not add up to a "corrective" factor, to the process that, in the first place, denies social justice. *An integrated economic and social policy framework is warranted*.

The overarching objective of the ILO being the promotion of social justice, encapsulated in *Decent Work* (ILO, 2001), it is important that we recognize the explanatory and the contextual factors that would best promote the value-basis of the organization. The promotion of socially just societies requires campaign, persuasions, economic policies and political willingness. Thus, while the legal considerations are contained in the ratification and the full implementation of the conventions, it is equally important that side-by side sound and mutually supportive economic and social *policies* are formulated and implemented to serve the same objective in a consistent manner. *The design of a macroeconomic policy framework is a critical core in this*, and is required to "serve" the objective at stake.

III. Washington Consensus on the macropolicy framework

"There are many kinds of macro models of various shapes and sizes" (Bruton, 1997), we are told, and the one which was adopted by the so-called Washington Consensus (WC) focussed predominantly on "getting prices right". The policy prescription on the macro-framework was on the attainment of *price* and *balance of payments* stability. If the prices were stable, and the exchange rate realistic, a country, *cet. par.*, would not face balance of payment difficulties. The intellectual stimulus for this position came from, among others, Anne Krueger (1992), Bela Balassa (1982), Bhagwati and Srinivasan (1979), and others, who claimed that the success of East Asian miracle was largely due to the "macro correctness" and openness of these economies. Alternative views exist on this explanation (Wade, 1990; Amsden 1989).

Since the 1980s, the IMF/WB have predicated their core macropolicy focus on, and conditionalized their lending programme to controlling inflation and reducing fiscal and current account deficits. Voluminous literature, analytical and empirical, has evolved, to establish credibility on why stability matters, and how stability is attained, following the above line of prescriptions[5]. These included among others, the following well-known policy instruments (Bird, 2001):

– fiscal and monetary discipline;
– tax reforms;

[4] The recent scandals in the US corporate world are sending shock waves among investors, and the ordinary citizens whose small but life-times's savings have been lured into a maze of fraudulent accounting practices. "I think we need a philosophy for capitalism. A new philosophy. I call it decent capitalism..." (Charles Handy, Keynote speech, ILO's Second Enterprise Forum, 1999).

- strict control of public expenditure;
- financial liberalization designed to encourage domestic saving;
- the elimination of over-valued exchange rates;
- trade liberalization designed with the objective of raising domestic economic efficiency and exploiting comparative advantage.

A critical precondition for economic growth is an enabling economic and political environment, that encourages both domestic and foreign investors and facilitates longer-term capital accumulation and enterprise development. Macroeconomic stability is a crucially necessary element in establishing such an environment. Since the mid-1980s, the developing countries, one after another, adopted, and experimented with, various measures of stabilization in order to reduce seemingly unsustainable fiscal and current account deficits.

There are those who argue that stabilization policies performed reasonably well, especially when accompanied by structural adjustment programmes (IMF, 2001; WB, 2001), and that growth is negatively affected if prices are unstable (inflation, fiscal deficits, black market premium in the foreign exchange market have been used as indicators; cf. Fischer, 1993).

The need to keep prices stable can hardly be a disputable subject. The worry comes, as expounded by Fischer (1993) from the following logic: "The usual emphasis on the *stability* of the macroeconomic framework (rather than its *conduciveness* to growth) suggests that the main reason macroeconomic factors matter for growth is through *uncertainty*" (italics added). He then identifies two main channels through which uncertainty affects growth; first is policy-induced macroeconomic uncertainty that affects the price mechanism, and second, "temporary uncertainty" about the macroeconomy tends to reduce investment. Fischer (1993) uses a regression analog of growth accounting, and panel data for a large number of countries, to establish how growth is negatively related to inflation and low budget deficits. The first of the two channels is treated at some length, which leaves open the issues of how investment is affected by the price mechanism, or whether investment could be affected by other factors as well.

There are many other studies labouring on the same point (esp. inflation being the main indicator of macroeconomic uncertainty). The results are, however, not quite straightforward, and often mixed. A series of recent studies by the IMF staff states the following:

> *Notwithstanding the theoretical appeal of the arguments that high inflation is damaging to growth, the empirical support for this relationship has been mixed."*
>
> *(Bredenkamp & Schadler, eds. 1999).*

Such studies and results, useful pointers as these are, still keep begging the question. First of all, from the point of view of the individual country, such cross-sectional panel data review is unremarkable. Second, at the country level, what is the cut-off point for inflation, crossing which would initiate unhealthy effects. Surely, here, one is not talking about hyperinflation as we have occasionally seen in some Latin American and Eastern

---

[5] See, among others, Fischer (1993) and several studies by the staff of the IMF, in Bredenkamp and Schadler, eds. (1999).

European countries. One also has to consider, in this regard, the contention that mild inflation, esp. in developing countries, is often conducive to resource mobilization and to utilization of capacity.

The two, presumably inter-related, channels of uncertainty mentioned by Fischer, that affect growth adversely are indeed critical. However, the *causes* of such uncertainty are not fully explained by inflation and other price variables alone.[6] Thus, for instance, investment is certainly likely to be favourably affected if the price environment is conducive. But investment depends on a host of other, possibly no less important, factors. Hence, regressing growth on price variables are likely to show weaker relationship than when directly regressed on investment-GDP ratio. One could then concentrate on what explains investment in an economy.

A series of UNU-WIDER studies (the main findings are summarized in Lance Taylor, 1988) argued that growth often appeared less related to macro reforms than, say, governance and institutions, and that the efficacy of specifically-targeted macro policies (e.g. inflation control) often depended on structural constraints, institutions and group bargains (Banuri, 1990). The ILO has produced its critique of stabilization and structural adjustment via the negative employment/income and institutional effects, both at the global level (ILO, *World Employment Report*, 1996/97), and at the country level (van der Geest and van der Hoeven, eds, 1999).

A cursory review of some *cross-section* and *panel* data, by the present author, on the performance of 20 randomly selected developing countries during the past two decades (1980-1999), tends to stress the following:

First, nearly 20 years of stabilization policy measures, largely through strict conditionalities, have general produced *substantial price discipline*. Tables 2 and 3, and Graphs II (a) to II (e) in Appendix show quite clearly the declining *trends* as well as the reasonably low *levels* of inflation and budget deficits, as currently exist.

Second, the substantial reductions in the inflation rate, in budget and current account deficits are yet to trigger off sustained and adequate growth rates in the individual economies, barring the very few. Not only has growth been inadequate (relative to labour force growth rates and unemployment for example), it has also remained highly volatile (see Graph I in Appendix for growth fluctuations in selected countries). Such volatility in the economic *performance* can possibly occur despite price stability, whether due to financial sector inadequacies, or to shocks from short-term debts or other non-price variables. This, in turn, can further affect investment (Fischer's second channel of uncertainty), and adversely affect aggregate demand, the individual's income and firm's economic viability.[7]

Third, there appears *weak* causal relationship between growth and the price variables (see Table 4 for a cross-country regression). GDP growth rate has a weak relationship with inflation and budget deficit. In fact the latter shows a weak *positive* relationship.

Fourth, the negative relationship between inflation and growth is further corroborated by our panel (pooled) data for the 20 countries, spread over 1980-99, relatively more significant and with a slightly higher R^2 (see eqn (1) in Table 5). Furthermore, growth is negatively (and significantly) related to current account deficit, but *positively* (but insignificantly) related to budget deficit (see eqns. (2) and (3) in Table 5).

---

[6] The IMF staff study, in explaining the determinants of growth (Chapter 5), subsumes variables used by Fischer, and introduces several other price and non-price variables. Nearly 994 observations, and 13 explanatory variables, return a R^2 of 0.22 ! *Investment* does not feature among these. Japan's prolonged low-growth in the recent years, despite near-zero real rates of interest, points to the need for considering various other explanatory factors.

[7] See Ocampo (2002).

Table 2. Growth, inflation and budget deficit

Countries	RGDPGR[1]	Inflation (CPI,%)	BD (%, GDP)
Bangladesh	4.8	6.23	N.A.
Barbados	1.8	1.56	N.A.
Bolivia	4.2	2.16	-2.27
Brazil	3	4.86	N.A.
Bulgaria	-2.7	2.57	1.53
Chile	7.2	3.34	-1.47
Egypt	4.4	3.08	N.A.
Hungary	1.1	10	-3.62
Indonesia	4.8	20.49	-1.1
Kenya	2.2	2.64	N.A.
Nepal	4.8	8.04	-3.93
Pakistan	3.8	4.14	-3.88
Peru	5.1	3.47	-2.09
Philippines	3.2	6.71	-3.73
Sri Lanka	5.2	4.69	-6.85
Tanzania	2	7.89	N.A.
Thailand	4.7	0.31	-10.9
Uganda	7.2	6.36	N.A.
Ukraine	-10.7	22.7	N.A.
Zimbabwe	2.6	58.5	N.A.
France	1.5	0.53	N.A.
Japan	1.3	-0.33	N.A.
UK	2.5	1.56	0.03
US	3.3	2.19	1.34

Notes: N.A.: not available.
RGDPGR: real GDP growth rate, BD (%, GDP): Budget deficit-including grants.
[1] Growth rate related to 1990-1999 period.
Sources: UNCTAD Handbook of Statistics CD-ROM 2001, WDI CD-ROM 2001

Fifth, it may be noted from our panel results that the level of investment (investment-GDP ratio) as a single variable explains growth far better, and more significantly, than all the three "price" variables taken together (eqs. (4) and (5) in Table 5). It may be noted that although the *level* of investment in our snap-shot, cross-section analysis makes for a positive explanation of growth at the individual country-level, investment *trends*, with a few exceptions, are declining (Table 6 later in the text) across almost all countries. Thus, despite broad tendencies towards declining inflation and budget deficits, investment has failed to pick up significantly (see Figure 2 for cross-country illustrations of these relationships).

Table 3. Inflation and budget deficit: trends across countries, 1980-99

	Inflation rate		Budget deficit		GDP growth rate
	1980-82	1997-99	1980-82	1997-99	
Bangladesh	7.96[c]	6.57	1.36	-0.65[h]	4.56
Barbados	12.38	2.67	-3.67	-3.72[h]	1.48
Bolivia	85.39	4.85	0.34[g]	-2.31	1.82
Brazil	118.38[a]	5.00	-2.60	-7.59[i]	2.40
Bulgaria	2.53[b]	360.84	NA	2.13	0.09
Chile	22.54	4.86	2.21	0.30	5.41
Egypt, Arab Rep.	17.74	3.96	-14.39	-1.02[j]	5.20
Hungary	8.15	14.15	-1.90	-4.13	0.77
Indonesia	13.75	28.29	-2.08	-1.49	5.59
Kenya	17.26	6.82	-6.12	-2.74[k]	3.18
Nepal	13.19	7.36	-4.08	-4.14	4.44
Pakistan	8.92	7.25	-5.21	-6.04	5.44
Peru	61.80	6.43	-2.80	-0.52	1.82
Philippines	13.59	7.42	-2.97	-1.84	2.38
Sri Lanka	18.49	7.88	-16.15	-6.46	4.70
Tanzania	29.56	12.26	NA	NA	3.33
Thailand	18.49	7.88	-5.61	-6.89	6.26
Uganda	66.40[a]	7.27[d]	-3.25	NA	5.27
Ukraine	NA	157.67[e]	NA	NA	-6.93
Zimbabwe	8.02	24.00[f]	-8.59	-6.78[j]	4.15

Notes: Inflation rate, CPI (%, annual); years: a) 81-83; b) 86-88; c) 87-89 d) 96-99 e) 95-97; f) 96-98
Budget deficit, including grants (%, GDP); years: g) 86-88; h) 87-89; i) 93-97; j) 95-97; k) 94-96
GDP growth rate quoted from UNCTAD (% per annum) for period 1980-1999; (based on constant 1995 USD GDP).
Sources: WDI 2001, UNCTAD CD-ROM 2001

These illustrations appear to be arguably consistent with the following. Stabilization policies and measures undertaken by the developing countries over the past two decades have indeed yielded substantial price discipline, inflation in particular. Therefore, if growth were found to be negatively related to inflation *during this period*, the likely acceptable explanation is *not* that growth has been damagingly negative due to high inflation, but that declining inflation must have been associated with positive growth! Our illustrations show a weak /negative relationship between the two. A recent IMF study admits that evidence on the relationship can be mixed. Barring a few exceptions, growth in the developing countries was relatively low and/or volatile. This implies that even a *low* positive growth could return a *negative* relationship with inflation rates that were largely declining over the period. Thus, it appears that while inflation rates were falling, growth has remained slow, volatile and far from reaching the sustained levels required to make tangible progress in reducing unemployment and poverty. More significantly, investment trends were largely on the decline (see Table 6). These trends would tend to suggest *tendencies toward a low-level equilibrium trap (a stabilization trap?).*

Table 4. Macro-stability and growth: Cross country regression analysis

Independent variables	Dependant variable: Real GDP growth rate Coefficient
Constant	4.060∗∗ (0.705)
INF avg	-0.002∗ (0.001)
BD avg	0.032 (0.145)
No. of countries	18
R^2	0.140

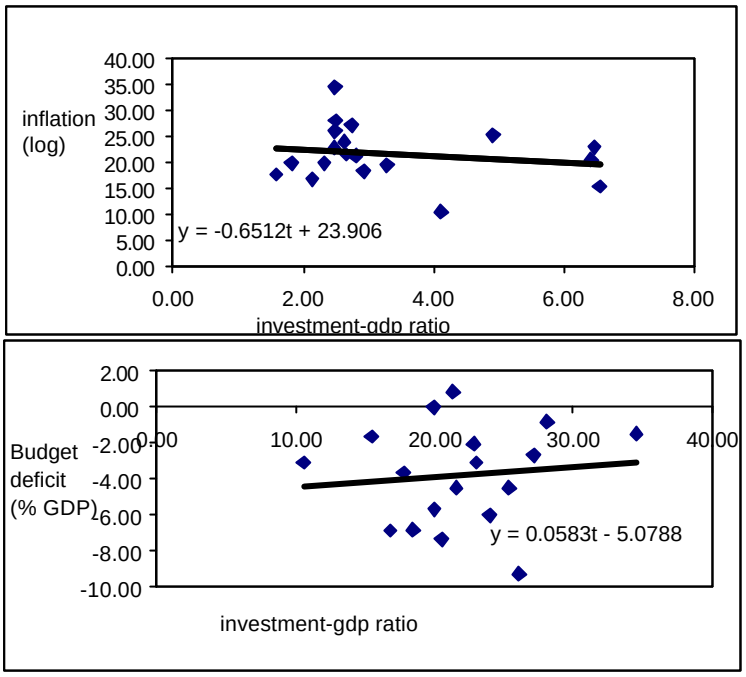
Notes: INF avg: Inflation average, and BD avg: Budget deficit average for the period 1980-1999.
Standard errors in parentheses
∗ significant at 0.15 % level
∗∗significant at 0.01 % level
Sources: WDI CD Rom 2001, World Bank.

Table 5. Growth and stability indices: regression estimates with panel data

Independent variables	Dependant variable: PCGR Estimated coefficient				
	(1)	(2)	(3)	(4)	(5)
Constant	2.254***	2.397***	1.467***	1.871***	-15.026***
IGDR					5.608***
INFL	-0.001*			-.002***	
BGDR		0.038		0.050	
CADR			-0.157***	-0.187***	
Observations	354	296	360	283	303
R^2	0.159	0.071	0.134	0.188	0.367

Notes: GLS estimation is used to obtain estimated coefficients, assuming same slope and intercept for all the cross section units and White heteroskedasticty consistent standard errors. Coefficients are statistically significant at *** 1%, ** 5%, * 10%.
Definition of the variables: PCGR: per capita real GDP growth rate (% annual, based on constant 1995 USD); IGDR: Gross domestic investment (% of GDP, logarithms of); INFL: Inflation, Consumer price index (% annual); BGDR: Budget deficit, overall including grants (% of GDP); CADR: Current account deficit (% of GDP). The sample used 20 countries, and covered the period 1980-1999.
Sources: WDI CD-ROM 2001, the World Bank, IFS-IMF CD-ROM 2001.

Figure 2. Investment, inflation and budget de ficit: Cross-country scatter



Notes: Logarithms of inflation used to take care of large volatility in their values. Investment figure includes both private and public investment, and budget deficit figures include grants. Trend line is estimated by the equation Y= a + bt.
Sources: World Development Indicators 2001, and World Bank dataset

Our empirical evidence would further contend that growth is far better explained by investment levels than by the price variables; and that investment is weakly affected by these price variables, implying that investment depends on a host of other variables beyond macrostability.

Several national and international assessments are now available on the varied experience of stabilization, and its economic and social impacts. In most of these accounts, the essential issue appears to be *not with why stabilize, but with how to manage stabilization.* It is amply clear that stabilization is a continuous process, and that *there is no one-size-fits-all policy package* to provide any quick fixes to macroeconomic imbalance of individual countries. Stabilization measures, as with any macroeconomic policy decision, also carry risks and costs. Hence, a prudent management of stabilization would require a thorough consensus on when and how benefits would outweigh economic and social costs, and how the latter can be mitigated to contain a decline in income and employment entitlement of the poor, and any possible outbreak of social unrest.

Stability is not an end in itself. Rather it creates the enabling environment for growth. Thus, for example, macroeconomic stability, the guiding principle of Chile's economic polices, ushered in the longest growth cycle in the country's history, and reduced poverty and unemployment substantially. *A stable fiscal and current account balance was matched by policies to encourage savings and investment, boost productivity and exports, attract external capital but discourage short-term capital inflows.*

It is not that decision makers are unaware that stability is only a precondition, albeit a significant one, of growth, and that growth can be hindered by a number of structural constraints and infrastructural handicaps. The essential caution in respect of stabilization is rather on the establishment of the appropriate degree of the measures, the time adjustments needed and the sequencing of policies. It is equally important that policies do not overly

conflict, e.g. among those that reduce fiscal deficit and the ones needed to create a fiscal space for critical public expenditures. A further caution is that stability, quickly attained through rapid compression of development expenditures and imports, cannot be sustained, unless there is a resumption of investment and growth. As the lessons of experience tell us, *macroeconomic stability is needed for growth to take place, but then growth is also needed to sustain stability, especially in economies with vast poverty and underemployment.*

Furthermore, markets even if "forced" into a state of stability are inherently vulnerable. Not simply to domestic policy distortions, but also to external factors, viz. terms of trade shocks, short-term capital flows, etc. This is when the "visible" hand of the government may be necessary, and other growth-related policies come into play. The East Asian success is better understood when both the roles of the market and the public interventions are factored in toward explaining how higher investments and growth were achieved (Amsden, 1989).

IV. Post-Washington Consensus: The PRSP model?

Disenchantment with the "Washington Consensus" (WC) surfaced and gathered momentum during the 1990s, and major protests across countries were staged against the WB and IMF. The disenchantment was not only with respect to the WC prescription failing countries return to a sustained growth path, but also with alleged *widening of income inequality*, both within countries and between countries (Cornia, 1999). The WC was quickly relegated, and Stiglitz (1998) and others called for the need to develop a post-Washington Consensus (Bird, 2001). While there has been a general acceptance to move beyond WC, the ideas of post-WC are yet to be articulated. The basic shifts in consideration of the WB/IMF may be summed up as follows: The *post-Washington Consensus* is relatively more accommodating on the key role of the governments, especially in adopting *counter-cyclical* policies, if and when warranted, and the issues of governance, wider participation, and social equity. These must be discussed and "owned" by the country concerned, and hence IMF/WB lending will be taken in greater confidence and legitimacy (I. Islam, 2001; Bird, 2001). With respect to external shocks, and externally driven financial crisis, macropolicy must be designed to contain "speculation" and possibly regulate short-term speculative capital flows. All this is hardly surprising, in that these are simply an acceptance of what went wrong in the understanding of the build-up to the Asian financial crisis, and how IMF prescriptions, with the bias of a pro-cyclical stance to rectitude, became suspect (South Korea and Malaysia, for example, took a more pragmatic stand, introducing controls on short-term loans).

With alleged lack of sustained growth and poverty alleviation, with respect to WC, the IMF/WB sought rectitude in *poverty* as the new over-arching theme. The Poverty Reduction Strategy Papers (PRSPs) came quickly into currency.[8] In point of fact, the Bretton Woods institutions defined the new locus of their concessional lending strategy as critically dependent on country-owned, participation-based PRSPs, and initiated the process, especially for those countries that qualified for debt relief considerations under the Heavily Indebted Poor Countries (HIPC) initiative. The PRSPs would then define the poverty-focussed development agenda of the individual country, and would be drawn up through active participation of the national stakeholders.[9]

---

[8] The UNDP has already embarked on a regional programme entitled *The macroeconomics of poverty reduction.*

[9] In other low and middle income countries, such as Egypt, the WB is undertaking "Social and structural policy" reviews, dominantly focused on poverty alleviation.

The WB/IMF now appears to be in a curious situation. Previously, under the WC macro model, the policy prescriptions were clear and simple, (focussed on controlling inflation, and fiscal and external deficits) and their impact relatively easier to monitor (although increasingly other areas of adjustments and micro-stability were added to the dimensions of conditionality; Cf. Bird 2001). Although in the recent period, various modifications were attempted on "one size fits all", the inherent macro-advocacy was the same. With the emergence of PRSPs, and the transfer of their "ownership" to the individual countries, the WB/IMF do not seem to have a unique macro model yet! While inner tensions prevail within the WB, between the "finance" and the "development" agents ("civil society" agents, as Kanbur termed them; Kanbur, 2001), the WC's macro stance has certainly become diluted.

> *"Black and white" has been replaced by "grey". "Definites" have been replaced by "maybes".*
>
> *Bird (2001)*

The preparation of PRSPs are in progress at the individual country levels, and it will require some time before experiences on individual country macro-planning designs and outcomes are synthesized.[10] The WB has recently put together a *Sourcebook for Poverty Reduction Strategies*, containing a host of themes and chapters, to serve as "guidelines" for designing various economics and social policies, including macropolicy framework at the country level.

The macro chapter, *Macroeconomic Policy and Poverty Reduction*, provides broad guidelines as follows:

- it contends that "economic growth is the single most important factor influencing poverty, and macroeconomic stability is essential for high and sustainable rates of growth";
- it concedes that "macroeconomic stability by itself, however, does not ensure high rates of economic growth"; other key *structural* measures are necessary !
- "... growth alone is not sufficient for poverty reduction. Growth associated with progressive distributional change will have a greater impact on poverty than growth which leaves distribution unchanged";
- "to safeguard macroeconomic stability, the government budget, including the country's poverty reduction strategies, must be financed in a sustainable, non-inflationary manner";
- it acknowledges that "except in cases where macroeconomic imbalances are severe, there will usually be some scope for flexibility in setting short-term macroeconomic target".

In some sense, there are some fundamental concessions being forwarded, compared to the WC stance: that macro stability *per se* will not deliver "magic" solutions; that *equity-sensitive* measures are needed alongside *growth* measures for maximum poverty impact; that short-term macro targets can be flexibly designed, provided macroeconomic elements are in balance !

That macroeconomic stability is a strong precondition for growth is not at dispute, but one has to carefully weigh *the means and the ends* of the economic levers used. A critical contention of the "stabilization" protagonists (WB/IMF) over the 1980s and 1990s

[10] See ILO (2002a).

has been that price stability through stringent monetary policies, and reduction of fiscal and current account deficits, would bring efficiency, and create the climate of sustained investment growth. In most countries, growth has been inadequate, and poverty and unemployment remain persistently high. While this so-called Washington Consensus is now widely derogated, it should be clearly understood why so. Severe inflation is still bad; severe deficits must still be avoided. Policy planners did not have a hold (conditionality; less government, etc.) on how severe was severe. Consequently, while some price stability was attained, they faced a rather *constricted fiscal and import space* (in the absence of any *rapid* increases in tax revenues or export earnings) to manoeuvre on development expenditures or targeted poverty programmes. In their evolving PRSP guidelines, WB/IMF do now concede that:

> *There is no unique set of thresholds for each macroeconomic variable between stability and instability.*
>
> *World Bank, Sourcebook 2001, op.cit.*

The above position accommodates a part of the concerns expressed by the WC critics, but still remains unhelpful in understanding how the *same* "stabilization" concerns would interact in a wider development and political economy context, which the WB's *Sourcebook* is trying to espouse. The fetishism about *price stability* and *fiscal austerity* still remains strong. These elements do restrict the planning "space" for a policy-planner facing an era of declining concessional foreign loans and of competitive FDIs.

Thus, a post-Washington consensus has not yet crystallized. A focus, *let alone the macropolicy focus*, is yet to emerge. What has evolved so far is that a national "ownership" of a country development agenda is being underscored, thus *conceding that one size does not fit all*. So far as the PRSP process (en route to a post-Washington consensus !) is concerned, several worries still remain. The preliminary experience with the preparation of PRSPs and interim-PRSPs suggest: first while there still remains (and quite rightly) a strict insistence by WB/IMF on "getting prices right" for macroeconomic stability, there is very little discourse on how the economic levers (fiscal, monetary and exchange rate policies) are to be designed to bring about such stability. A significant concern is on how the *macro-strategy* will blend with the *development agenda* which a country is being asked to design.[11] Otherwise, the poverty strategy in the PRSP will not constitute a *strategy*, but a series of programmes, project and social sector "add ons". [12] Second, in the absence of the scope for formulating *alternative* macro models to address poverty reduction, the developing countries may very well confront a double jeopardy; they may *de facto* face a "stabilization" conditionality and a "poverty" conditionality, in the event a country achieves neither the macro targets nor the poverty targets. That would hardly enhance the credibility of the new PRSP process, as expressed in the emerging concerns.

> *The perception of a large section of people is that the PRSP is the traditional IMF and World Bank recipe for reforms which must be accepted in order to access their resources. The PRSP is seen as the sugar coating for the reforms process and may face the same fate as the earlier generation of unowned reforms*
>
> *CPD Programme on*
> *Independent review of Bangladesh's development, March 2002*

[11] Such a concern is being expressed at the country level PRSP preparation. See, for example, CPD (2002).
[12] Ocampo (2002), op.cit.

The focus needs re-orientation. The formulation of the macroeconomic policy framework must lie at the heart of the PRSP strategy; these two must not be seen as exercises independent of each other. A critical link will be on how the alternative macropolicy measures are drawn up to define the allocative and redistributive framework that would enhance employment and reduce poverty. In order to accommodate the goal of poverty reduction and full-employment, one would need to rethink a degree of flexibilization in the stabilization standards and design alternative macroeconomic measures (esp. in respect of fiscal, monetary and exchange rate policies) in the wider context of *financing a development strategy that fosters investment, growth, employment and reduces poverty.*

V. Three issues and considerations

Stable markets; stable growth?

Our previous discussion seems to point out that most countries through a fairly strict stabilization programme produced, by and large, a price discipline, and even where (as in some cases) they have not *fully* complied with the "right" prices, the prices were possibly not "too wrong", especially in the context of an ambivalence regarding what precisely are the right prices. In some other extreme cases, such as observed during the Asian crisis, the Argentinean crisis, several domestic policy-induced and external shocks have rocked the price structure.

There was an implicit belief in the adoption of stabilization programme, that it would (together with a range of structural adjustment programmes) help *stabilize markets*, which in turn would support the resumption of efficient and *stable growth.* The two decades of the stabilization practice has shown that attempts to get prices right may not automatically stabilize markets (note the "boom-bust" frequency in the financial markets in several countries), nor stabilize growth (unless stabilized growth implied low growth equilibrium). Furthermore, constricted monetary and fiscal policy, focused largely on inflation control, in many instances dampened aggregate demand, and often affected vital public expenditures on infrastructure development, maintenance and social provisions, etc. If the PRSPs were to tread the same macroeconomic route to "getting prices right", questions will certainly re-emerge, regarding what is the real objective of macropolicy, and *what* precisely are we trying to stabilize: prices, markets, or growth? Experience has shown that stability in one of these need not ensure the stability of the other in any automatic sense. Furthermore, as Ocampo (2002) emphasizes, "the consistency that ought to characterize macroeconomic policies should be based on a broad definition of stability that recognizes that there is no single correlation between its alternative definitions and that *significant trade-offs my be involved*" (italics added)[13]

Slow and inadequate growth that has largely characterized the post-reforms period (except during the first part of 1990s, possibly coinciding with growth regeneration in the United States and some European Union countries) by itself has produced skepticism and protests. This has been fuelled by the boom-bust financial markets, and subsequent growth volatility, with enormous consequences in terms of lost income/employment of the individual citizen, and of reduced assets by the individual enterprises. Stabilization of

[13] Ocampo (2002), op.cit.

prices as the overarching objective of current macroeconomic policy-making has become thoroughly suspect. What then is (are) the alternative(s)?

In free market economies, macro regimes, according to Tobin (1996) can be broadly classified into two: (i) one in which "demand creates its own supply" (demand-managed approach to full-employment equilibrium); and (ii) the other, where "supply creates its own demand" (supply-constraints to full employment equilibrium). In the post-War period, the macroeconomic objective was dominated by full employment and growth considerations (with sustainable external balances). Policies pursued thereafter witnessed growth dividends, and full employment (or near full employment) in much of the industrialized world, and tangible growth in may other parts of the world (notably East Asia). This high growth period between 1950 and 1973, often dubbed as the "golden era", came to a halt during the 1980s after the two oil price shocks of 1973 and 1979. Keynesian demand-management approach to macroeconomic policies came to be relegated, and often put into disrepute, when inflation targeting became the dominant macropolicy concern. (One may note that in the Keynesian framework, inflation control depended relatively more on microeconomic and labour market policies).[14] Tobin, himself taking a neo-Keynesian stance, argued (ostensibly in the context of industrialized countries, esp. the United States) that over time economies keep moving from one regime to the other. During the past two decades, in the developing countries as well as the developed, there was a major, pervasive policy shift towards the second regime, inspired by alleged "government failures" of the previous decades, and which entailed a series of "contractionary" policies and market liberalization measures.

Today, given alleged "new market failures", there is a call in the more recent literature, for a *return to Keynesian demand management*, the paradigm that characterized the growth/ development strategies of the 1950s till 1970s: the role of the government in particular.[15]

> *"... government intervention is at least sometimes (many would argue frequently) desirable to stabilize the level of economic activity."*
>
> *B. Greenwald & J. Stiglitz, 1993*

Would this again be a simple moving from one economic regime to the other, as Tobin argued. Even in demand-management regimes, the Keynesians are divided (see literature on old and new Keynesians, cf. Greenwald and Stiglitz, 1993). There are obviously the middle-ground practitioners who view that during the 1950s-1970s, the framework of a demand-managed economy was held hostage (abused) by governments, while the more recent "price stabilization" macropolicy was held hostage to speculation, crony capitalism and "short-termish dashes". Given now the benefit of hindsight, and half a century of varied experiences, many practitioners have sought to search for a "third way" macroeconomic framework. Gordon Brown, the United Kingdom Chancellor of the Exchequer, in a recent keynote address to the Royal Economic Society (Brown, 2001), has taken such a position, where he advocates the need for a *long-term growth strategy*, although strongly cautioning that "stability" is a precondition for growth in Europe and the United Kingdom. (The European Union and the United Kingdom situations have some contextual differences, esp. where the European Union has to deal with one currency, and a Central Bank, but twelve different fiscal regimes and labour markets, cf. Allsopp, 2002). Indeed Brown (2001) calls for a "modern Keynesian" approach (his third way !) to sustain

[14] Brown (2001).
[15] See Malinvaud et al (1997).

and enhance employment through stability and growth, and focuses on the continuous blend of both *macroeconomic* and *microeconomic* measures, as well as R&D, to simultaneously increase productivity and sustain stability, without one or the other being solely charged with inflation targeting or employment generation.[16]

The developing countries may as well require a "third-way" blend of *macroeconomic* and *microeconomic* measures (labour policies in particular) to reach long-term growth and employment targets. An essential precondition, as earlier contended, is the enhancement in the levels of *investment*. The East Asian economies achieved more than 30 per cent investment-GDP ratios. This was as much facilitated by macrostability as by public interventions in incentive structures, and physical and social infrastructures. High savings-investment rates, among other factors, together with a relatively egalitarian growth, helped these economies to achieve full employment and structural transformation, viz. *a movement of labour to higher productivity sectors.* Such achievements would be less forthcoming when stabilization per se tends to return a low growth, and even a declining effective demand, and when *rates* of investment show declining trends (Table 6).

Table 6. Savings and investment, 1980-99
(annual growth rate)

	Savings		Investment	
Bangladesh	4.69	***	-0.19	
Barbados	-1.35	***	-4.59	***
Bolivia	-3.30	***	-0.19	
Brazil	-0.73	**	-0.11	
Bulgaria	-7.65	***	-7.57	***
Chile	3.79	***	3.20	***
Egypt, Arab Rep.	-1.12	***	-3.83	***
Hungary	-1.55	**	-1.64	***
Indonesia	0.12		0.90	***
Kenya	-3.15	**	-2.76	***
Nepal	1.88	***	1.55	***
Pakistan	3.39	***	-1.20	***
Peru	-2.86	***	-1.51	*
Philippines	-2.40	***	-0.26	
Sri Lanka	2.26	***	-4.54	***
Tanzania	…		…	
Thailand	2.64	***	2.48	***
Uganda	4.89		7.06	***
Ukraine	-5.41	***	NA	
Zimbabwe	0.44		1.51	*

Notes: *** level of significance at 0.01% level; ** level of significance at 0.05% level; * level of significance at 0.10% level. NA: not available; …: dropped from analysis due to insufficient number years of data
Sources: WDI 2001 and World Bank dataset

[16] Brown (2001), *op.cit.*

In the case of developing countries, which are far-distanced from a full-employment economy, the "stability" and "growth" perspectives would need to be addressed somewhat differently (than, e.g. from the European Union's "Stability and Growth Pact", SGP). In the developing countries, *every policy-planner* would almost unanimously agree on the need for macro stability! Moreover, there are strong analytical considerations behind the need for prudent fiscal, monetary and exchange rate policies. It is important to understand why and to what extent: (i) economic reforms, esp. stabilization policies, could *not* attain the goals (of price stability, deficit reduction, etc.) which these policies were set to attain; (ii) why these policies, in trying to establish price efficiency, failed to resume sustained *investment* and *growth*, and in many country cases ended in a so-called *stabilization trap* !

The need for stability in markets, as stated earlier, is hardly in dispute. The end and vital consideration, however, is on how to foster stable growth in the long-run.

Centrality of employment; productive employment

The practice and experience of macroeconomic policy planning during the past half century, both by the developed and developing countries, have produced a reasonable knowledge base from which the individual countries could now draw pragmatic lessons, on which policies are likely to work better in the given *economic* and *social* circumstances of the country. It is also well-known that during the immediate post-War decades, several (of the developed) countries moved along a demand-managed policy towards a full-employment state; thereafter, *sustaining* or *stabilizing employment* at near full employment levels needed modification in the economic levers that were first used to obtain such employment levels. *The Economic Survey of Europe 1949*, prepared under Gunner Myrdal contained a separate theme on the "Level of effective demand", a theme which has now been relegated to priorities of inflation targeting. A "third way" macroeconomic framework, for example, as contained in Brown (2001), is essentially an effort towards fine-tuning the balance of demand and supply-side considerations for near full-employment economies. The social institutions in the individual country would possibly determine the kind of "third way" forward, relevant to that particular country.

The developing countries, which are confronted with vast surplus labour and low productivity, are also deeply caught in distributive tensions and economic and social insecurity. No wonder, now, the multilateral organizations and the donor community have decided unanimously to focus on poverty targeting for which a renewed, re-focussed development strategy was indispensable.[17] *A return to the goal of full, productive and freely chosen employment is emerging as an imperative.*[18]

It may be noted that *neither UNDP's macro studies, nor WB/IMF's PRSPs, being designed to reduce poverty, make any exclusive reference to employment.* Presumably employment generation is seen as an outcome of broad-based growth; otherwise, poverty reduction would have to come through "trickle down" (poverty-elasticity), transfers and subsidies, and other redistributive measures (to reduce inequality). Dudley Seers, the architect of ILO's Colombia employment report, provides a more positive spin on the need for placing employment as a central objective of development. He came to this conclusion when he worked out that, given the growth-employment relationship at that time, Colombia would have required to grow at 14 per cent for fifteen years at stretch to absorb the 5 million unemployed. Thus he maintained

[17] Cf. Meier & Stiglitz (2001); Ocampo (2002).
[18] See ILO's Convention 122.

> *What a development plan needs to concentrate on is first an employment target and then – to achieve the target – not so much the pace as the process of growth.*
>
> *Seers (1971)*

Given the state of world's poverty and unemployment, and low growth in individual countries (and at the global level), many in the recent years as well have emphasized the significance of employment as a central goal. Godfrey (1991), in his analysis of Asian economies, emphasized *"labour shortage"* as the aim of economic planning. In fact, Bruton (1997) defines "sustained labour demand" as a primary macro objective. The macro question he asks is:

> *To what extent and in what way can considerations of aggregate demand and to a lesser extent, aggregate supply contribute to the development process?,*

and further that:

> *... strong demand presence, a demand pressure that presses firmly against supply of all resources, especially labour, is a major advantage in achieving the development objective.*

Such an employment-focussed development objective has been echoed earlier by many notable economists. Chakravarty (1987), for example, argued that "employment-oriented planning" was "of great analytical and practical significance for many developing countries". He maintained, without completely refuting the basic logic of standard growth theories, that

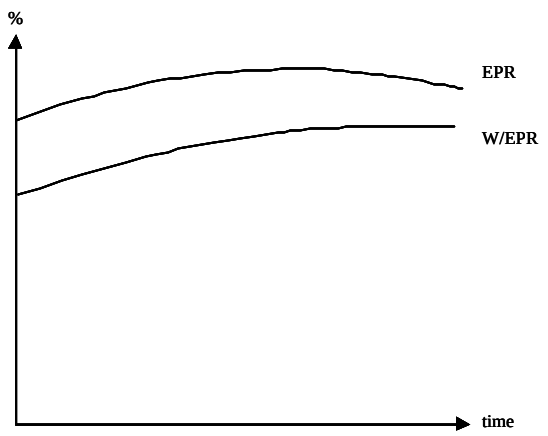
> *... getting fixated on the most rapid accumulation of physical capital may not provide the most appropriate strategy during the transition from a labour-surplus stage to a situation where easily available labour has been fully deployed in productive pursuits.*
>
> *Chakravarty (1987)*

In this context, ILO's convention 122 on the goal of full employment provides a significant *economic* and *social* foundation. According to this convention, employment is both an *economic* as well as a *social* objective (note: the links of employment to equity, poverty alleviation, and a basic income protection). *Ipso facto*, a full employment strategy à la C.122 goes a long way in defining some of the basic parameters of *decent work*: full employment of the labour force; remunerative work; productive employment (and not simply subsidized, targeted employment); freely chosen (implicitly guaranteeing a degree of freedom).

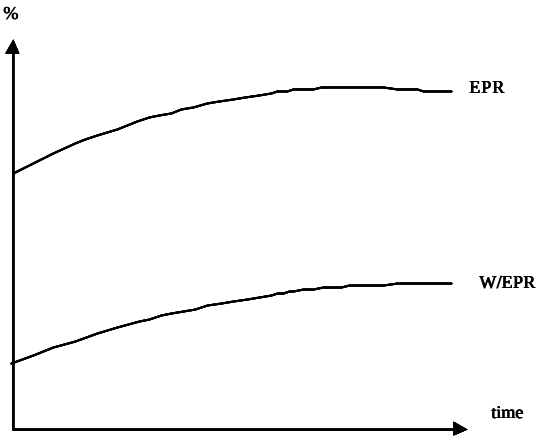
The above possibly presupposes employment generation as essentially *formal sector (FS) job growth, which is more likely to* provide *the necessary nexus for initiating formal employment relationships and institutions, in protecting basic rights of workers and employers*. In the advanced economics, the bulk of the employment-population ratio is characterized as such (e.g. 80-90 per cent of total employment in United Kingdom, United States, France and Japan, etc. are wage employment). In contrast, the formal sector job growth in the developing countries is dismally low (largely between 10 and 30 per cent !), with near stagnancy in manufacturing employment and fast proliferation in informal sector jobs (see Figure 3). In the developing countries, the informal sector has grown beyond proportions, precisely because of the lack of demand for labour in the formal sector; and it is in the informal sector that one naturally tends to observe maximum *decent work* deficits.

Figure 3. Employment-population ratio (EPR) and wage employment (%, EPR)

A typical industrialized country



A typical developing country



In the developing countries, the lack of, or slow growth in FS job is possibly one of the greatest failures of development in the past half century. This calls for a serious rethinking on the new development agenda that needs to underpin structural changes, increase in labour demand and shifts in labour demand to higher productivity sectors through the future industrialization and trade, and other sectoral policies. The paradigms during the 1950s and 1960s on structural transformation and the so-called Lewisian turning points in development through, *inter alia*, labour market tightening, are meaningfully re-emerging.[19] The notion of sustained FS job growth (as part of an employment strategy) can, in the ultimate analysis, be a significant cornerstone in the promotion of *decent work*. It has institutional implications (employment relationships and basic rights at work place), as well as social (Sen's recognition aspect of employment). Moreover, the social protection system and other ALMPs can effectively set a floor to underconsumption in the economy, when rising unemployment may lead to falling effective demand. The ILO's tripartite constituents maintain " that more and better jobs was a foundation for long-lasting stable social and political stability".

Macroeconomic environment; environment for macropolicy

That there is the need for a stable macroeconomic environment for stable growth and employment generation has never been in dispute. During the past two decades, in particular, and under the conditional lending programmes of the WB/IMF, policy makers have assiduously tried to reach "given" macroeconomic targets, using economic levers that were more in tune with "short-termish dashes" than with longer term objectives.[20] The sanctity of such an environment came under increasing scrutiny when first, such environment failed to show any growth dynamics; and second, the policies (such as public expenditure cuts, import controls, etc.) by which such an environment was brought about were themselves found to be adversely affecting aggregate demand, and consequently individual incomes and employment.

[19] Meier and Stiglitz (2001) for a historical account of these development debates. Also see Bruton (1997).
[20] Brown (2001).

Several analysts and empirical researchers have thus often questioned the "sufficiency conditions" of the following, even if found "necessary":

– *"getting prices right will enable stabilization.* Several studies have shown how inflation control has as much to do with orthodox anti-inflationary macro-instruments as structural and institutional policies;[21]

– *stability will usher in growth.* Although Fischer (1993) emphasizes a strong negative relationship between inflation and growth, there are other studies which show that the evidence is mixed (see section IV), and that growth often correlated better with governance (Bhaduri and Marglin). In fact, there has been very little focus on how far an economy could afford an inflationary pressure in the process of growth and employment generation. The WB's *Sourcebook* cites low-inflation economies as those having less than 20 per cent inflation rate.

– *growth will lead to employment generation*. Here, the *pattern*, hence the design, of growth needs to be factored in. Employment is neither *automatic*, nor *cost-free*. The growth-productivity-employment relationship needs to be examined, and understood well. The equation on employment growth and productivity growth has to be reviewed in a correct perspective, especially taking into consideration economic and social constraints facing the individual country.[22]

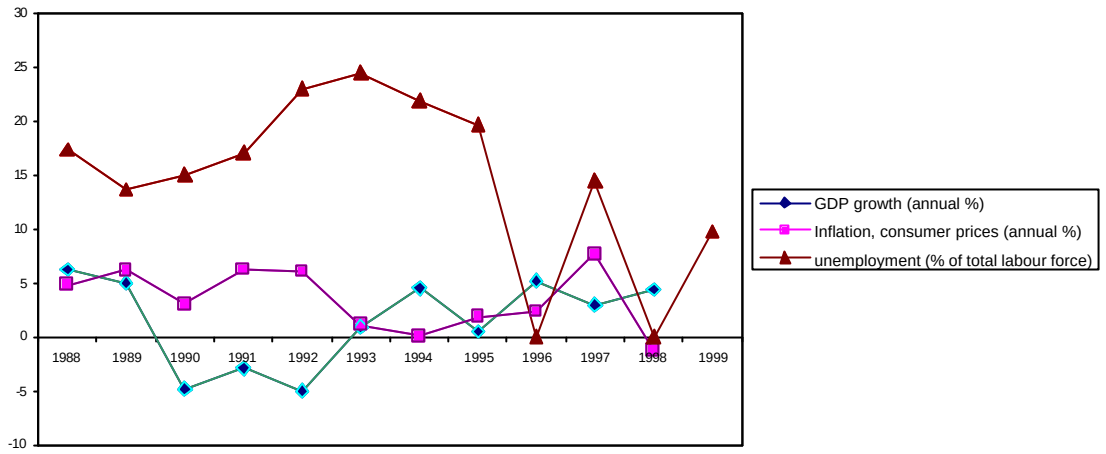
All these imply that the macropolicy framework needs to be *supported* by a number of other policies, micro-economic and institutional. This would further imply that a *country specific* approach was needed to understanding the efficiency of macropolicies. Even *within* a country, given the variety of constraints (formal-informal sector divide in the labour force; social groups, institutions and bargaining regulations), it would be only natural to draw up *alternative macro-scenarios*, taking into account the tolerable *range* (instead of *points*) of fiscal, monetary and exchange rate targets. The *range* and *alternative scenario* concepts would allow an individual country degrees of freedom in planning under various constraints (which may be broadly defined as the *environment* for effective playing out of the macroeconomic policies).

In respect of another crucial dimension of the "environment", it would be significant and expedient to *identify the ingredients of a labour market policy, and the labour market institutions that would help support an employment-friendly macroeconomic policy framework.* This would necessarily require addressing issues of governance, social dialogue, and social compacts to enable a better effectiveness of the impact of macropolicies. In fact, for a country to attain stable growth and steady investment levels, there must be a conducive legal and social infrastructure, with well-defined accountability and responsibilities of employees, workers and the government, that would support policy reforms (see Box on next page on how the tripartite partners in Barbados so ingenuously handled hard macro choices in the early 1990s).

[21] See, for example Banuri (1990), and several WIDER studies on the subject. Some of the results are summarized in Taylor (1988).

[22] While e + p = o (i.e. employment growth *plus* productivity growth is *equal to* output growth), both e and p can be positive if o is sufficiently high (Verdoorn's law !)

Barbados: Protocols and partnerships on critical economic and social policy decisions



Source: World Bank 2000, World Development Indicators

In the wake of massive resentment, both by workers' and employers' groups, and public protests against the proposed structural adjustment programme (SAP) in 1991, a process of mediation and renewed cooperation among the social partners was initiated by civil society representatives, predominantly by the church leadership. The workers felt that the SAP proposal would entail a heavy social price, and an uneven burden on the poorer workers. The process evolved into what is known as the first protocol: *The protocol for the implementation of a prices and incomes policy, 1993-95*. This tripartite agreement was primarily designed to conduct a truly collective effort to get the economy out of the crisis, but through various preemptive measures to minimize layoffs and social hardships. Thus, the parties agreed to avoid the IMF prescription of a devaluation; to focus on competitiveness and productivity; to accept wage freezes until wage increases could be effected through productivity gains; to consider retrenchment as a last resort, that too, after ensuring at least one earner of a family retains his/her job, etc. The agreement fostered a *national resolve to overcome the economic crisis*, and indeed helped the political process to implement difficult economic decisions to achieve stability and resumption of growth.

The success of the first protocol was followed by the second: *The protocol for the implementation of a prices and incomes policy, 1995-97*, which, in the backdrop of a moderate growth success, sought to deepen the role of and *broaden the agenda of social dialogue to effect better articulation of macroeconomic and labour market policies.* The parties moved away from "wage freezes" to "wage restraints", such that Barbados sustained its international competitiveness through higher productivity. Performance-related pay and incentives were introduced. The third protocol: *The protocol for the implementation of a social partnership, 1998-2000*, sought to consolidate the perceived gains from partnerships in economic and social development, especially in an era of globalization; to maintain a peaceful industrial climate; and to reduce income disparities through employment promotion and other measures of social inclusion.

It is interesting to note that the three protocols, covering the period 1993-2000, are associated with (i) an average annual economic growth rate of 4 per cent; (ii) an inflation rate of close to 2 per cent; (iii) a decline in unemployment from nearly 22 per cent in 1994 to 9.8 per cent in 1998.

The Barbados model of "social compacts" has become a major point of reference for the entire Caribbean region.

Source: Muqtada, M.: *A global agenda for employment: Review of national perspectives*, 2001 (mimeo); a modified version is quoted in ILO, *Global Employment Agenda*, 2001.

VI. Consensus on macroeconomic framework: by whom, for whom?

Some of the issues and ideas discussed above tend to appear at once common-sensical, and yet highly debatable. There is a long history to these debates, and at times, these have been confined to academic and ideological warfare. In the real world of policy making, the issue of macro regime is complex, and not simply guided by demand *or* supply constraints. That is because there is no unique "technology" of macroeconomic designs, especially when country-specific structures and institutions play such an enormous role in their implementation and effectiveness. Economic populism, whether as lobby for free market or strong governments, can be misleading. During the past two decades, as part of the structural adjustment programmes, every developing country has been strictly advised by WB/IMF to cut fiscal deficits and to reduce the size of the government and public expenditure. This obviously conflates the need for fiscal balance with what the roles and functions of a government should be in a particular economic and social setting.[23] The designing and formulation of macroeconomic policies cannot be disembedded from the overall economic, social and political context of a country's development process. And as we all know, there are several stakeholders in this process, representing the population and interest groups. It is the consensus and commitment of these stakeholders that are vital in the design and implementation of a macroeconomic reform package.

From the analysis and diagnosis of policy issues in the previous sections, the following seem to emerge, as possible *considerations* in the design of a macroeconomic policy framework.

1. ***A macroeconomic policy framework must support, and be designed according to, the economic and social objective pursued.*** The neo-liberal macroeconomic objective of "getting prices right" over the past two decades perhaps arguably attained some degree of price discipline, but certainly failed to show what this stabilization meant for growth and employment.[24] The latter, in many instances, contracted. A return to the goal of full employment and decent work provides an alternative long-term objective.[25] Such an objective needs to be cast in a long-term framework of sustained investment and growth.

2. ***The goal of full employment and decent work raises considerations of economic and social values, simultaneously.*** Such an objective is broad-based, and is in conformity with the emerging global order towards *integrated* economic and social progress, underpinned by global campaigns against poverty (and other millennial goals) and breach of human rights. If the social malaise and negative social indicators are seen linked to, and emanating from the economic order (the production-distribution system), it is not enough to confine simply to mitigating these negative social effects. It is necessary to address the *disease* (lack of remunerative employment, social protection, etc.) alongside the provision for treatment of the *symptoms* (targeted poverty programmes; food stamps, etc.). It is

[23] For instance, the Scandinavian economies where public expenditure are relatively very high (40-50 per cent of GDP!) would have to re-set their social and institutional settings if they were to follow the WB/IMF prescription.

[24] "… the fact of the matter is that unemployment is not a phantasm, modern societies need ways of dealing with it, and the self-regulating market economy has not done so." See Stiglitz's foreword to Polanyi (2001 edition).

[25] See ILO's Convention 122 on the goal of full employment; and ILO (1999) on an exposition of "decent work".

worth noting that varying the fiscal and budgetary instruments could be guided as much by social considerations as economic.

3. ***Growth is needed (not only for employment but also) for sustaining macroeconomic stability, inasmuch as stability is needed for growth.*** Given that there has been a significant contraction in global output, and low and inadequate economic growth in most of the individual countries, with consequences of pervasive poverty and unemployment, there exist emphatic considerations to seek measures, at the national and international levels, towards *national and global output expansion*. As noted earlier, it is extremely difficult for countries to sustain stability, brought about largely through contractionary monetary and fiscal policies, if growth and employment generation do not resume quickly. This is particularly worrisome for countries facing mass unemployment and poverty. The global output contraction over the past two decades may not have been as "deep" as during the Great Depression of the 1930s, but its prolonged tenure certainly calls for a re-think on accommodating under-consumption and demand management approaches to restoring full employment. An employment-centered growth strategy would require *a reconsideration of Keynesian demand-management policies, alongside price stability considerations*. Over the past 20 years, there appears to have been a *disconnect* between these approaches.

4. ***The effectiveness of a macropolicy will depend both on markets and prudent public interventions.*** It is evident that different countries are differently placed in the trajectory towards full employment (also following different paths, e.g. United States, Japan, European Union) and hence the economic levers (conforming to resource positions, employment elasticities, institutional structures) will have to be varyingly applied. The market must continue to play a dominant role, for otherwise the economy will not have "a rational system of economic calculations". (Khan and Muqtada, eds., 1997). But the real problem lies elsewhere, viz. whether a non-intervention, "deterministic" macro approach will automatically deliver a full-employment output level. Removing distortions and supply constraints may ensure an equilibrium (of aggregate supply and aggregative demand), but this could easily coexist with substantial unemployment. This is what Keynes said, in explaining the Great Depression, that economies under stresses of contractionary policies could run into a state of *underconsumption*, and that demand management policies would be needed to boost consumption, employment, income and output. It appears that this would entail *a degree of government intervention*, the degree of such interventions depending on whether the *GNP gap* (difference between actual and potential GNP), and whether the incidences of poverty and unemployment are big or small. Moreover, *"Keynesian macroeconomics has one immense advantage over its old and new classical rivals: it can explain, and they cannot, the main repeatedly observed characteristics of business fluctuations"* (Tobin, 1996).

5. ***The formulation of a macroeconomic policy framework will necessarily have to be pragmatic and country-specific.*** "One size fits all" cannot be a sensible approach. It is imperative that macro policy design at the individual country level takes into account whether, and to what extent, the economy is *supply-constrained* and/or *demand-constrained*. It is equally important to understand whether *pro-cyclical* and/or *anti-cyclical* economic levers would best ease these constraints, for that particular economy at that particular point in time. Policy priorities would be better identified in such a *pragmatic* approach, one that could act between

"balancing prices" and balancing growth and employment. This would in all likelihood tantamount to each individual country drawing up its *own unique "third" way macro framework, focussed on growth and employment*.

6. ***A macroeconomic policy framework must set macro-targets that are feasible, and are flexible within bounds of alternative growth and employment scenarios*.** Accommodating a "range" in price stability (i.e. a modified definition of "distortion") is a positive stance that is emerging in the PRSP guidelines of the WB and IMF. Previously, lending conditionalities based on achieving precise "point" macro-targets, in rather "short-termish dashes", left very little room for manoeuvre, and little scope for damage control. The point to note here is that there are several variations on any macroeconomic theme (being increasingly recognized by WB/IMF). A useful guide is on identifying the *toleration limits* (of inflation and fiscal deficits), and drawing up *alternative* scenarios of getting/keeping the labour force fully employed.

7. ***In macro-planning, the links between long-term macro objectives (viz. employment and growth) and short-term macro instruments need to be understood, and factored in***. Macroeconomic policies can have immediate repercussions (e.g. budget and import compressions; devaluations, etc.), but such "short-termish dashes" must be weighed against the long term policy perspectives on growth and employment (Brown, 2001). The nuances of macroeconomic policy making would thus lie in balancing market's allocative efficiency (without making a fetish of it) and the incentives to growth and employment. Thus, for instance, a moderate degree of inflation (hitherto unacceptable to WB/IMF) could be tolerated if the exchange rate could be used flexibly, or if concessional loans were available, or if expenditure switching were acceptable. Similarly, public investments in many developing countries have been shown to encourage private investment (infrastructures, etc.), but if, in the process, public sector borrowing is extensive, it will also tend to "crowd out" private investment.

8. ***For the developing countries, in particular, macro policies and instruments need to be critically related to "financing development".*** For the developing countries, especially those facing a "stabilization trap", surplus labour and poverty, a room for manoeuvre perhaps will have to come through a prudent use of the monetary and fiscal levers, and a degree of focussed government intervention to boost investment and employment generation. In fact, a *fiscal master plan* could be devised, linked to the broader objective of financing development. Such a fiscal objective, instead of concentrating on easy (but often disastrous) modes of cutting down public expenditures, ought to focus on (i) *rationalizing* public expenditure (infrastructure, skills, housing), (ii)support to private sector investment; (iii) targeting poverty reduction and social goals; (iv) aggressive resource mobilization. A mildly expansionary fiscal policy may entail a degree of inflation, but so long as it is monitored closely as simply a "recovery" inflation, it can in fact be conducive to reducing unemployment and idle capacity. For the LDCs, there may be a need for external support to "creating" a fiscal space, e.g. through concessional loans, FDIs, debt reduction programmes, etc.

9. ***An appropriate environment for macroeconomic policy is as critical as the establishment of the macropolicy environment itself***. [26] Such an environment requires more than what is called for in WB's structural adjustment programmes (SAPs) in order to support the effective implementation of stabilization policies. The broader environment is related to issues of governance (Banuri, 1990), and institutions, and regulations, especially when macro choices require decisions on trade-offs. Whether it is a question of devaluation, wage-moderation or social protection, there has to be consensus on shared responsibilities, and transparency. Democratic institutions, such as tripartism, when appropriately developed (as in many European Union, Scandinavian countries, Australia, etc.) reflect, even in conflict, trends in economic and social progress. In developing countries, with the formal sector accounting for, in most cases, less than 20 per cent of the employed labour force, such a democratic representation and environment is weak.

VII. A final remark: a coordinated global employment strategy

As we noted at the outset, global growth and productive employment sharply contracted during the past two decades, esp. when compared to the golden era of 1950-1973. Many individual countries registered such a scenario, including the European Union, Japan and in the recent period, the United States. Fetishism, almost all around the globe, with "getting prices right" and restructuring have in fact shrunk markets. More than twenty years of inadequate and fluctuating growth, combined with growing inequality, translated into pervasive poverty, insecurity and social exclusion.

> *Essentially it means that for the first time in two generations, failures on the demand side of the economy – insufficient private spending to make use of the available productive capacity – have become the clear and present limitation on prosperity for a large part of the world.*
>
> *Krugman (1999)*

An appropriate stimulus needs to be sought, both *globally* as well as at the *country level*, in order to increase productive employment. It must be an imperative now to look beyond price stability, and to call for global alliances on a coordinated strategy for stable growth and employment. Some of the recent signals for a *global stimulus*, with calls for a greater flow of concessional aid to the developing countries, debt reductions and re-scheduling, and market access for exports from the developing world are encouraging. These would constitute a significant *support* to the stimulus required, indeed a support to the individual country's right to development. The real stimulus, however, would have to come first *from within*, viz. national efforts and commitment to growth, full employment and decent work.[27] International support, governance and monitoring can then be devised to *complement* and *coordinate* such national efforts.

---

[26] Greenwald and Stiglitz, 1993.

[27] For the developing country, it may be pointed out that a commitment to full employment, and achieving it, requires a full utilization of its labour resources given the current rate of capital formation, and need not be guided by any pre-determined per capita income levels. Japan, South Korea and Taiwan-China achieved near full-employment back in the late 1960s and early 1970s; subsequently, these countries undertook policies to move towards a higher productivity frontier. Cf. Oshima (1987).

For the developing countries, especially those confronted with large labour surplus, the designing and implementation of macropolicies within a full-employment and decent work framework, is more than an economic proposition. It is possibly the most significant way to give effect to the country's commitments to uphold the economic and human rights of the individual.[28] Such a policy stance and commitment at the national level could provide building blocks to the international campaign on, and support to, reaching the millennial goals, given close linkages between employment, poverty and other social goals. A country's right to development, and an individual's right to decent work would, then, underpin and reinforce the rationale for coordinated global employment strategy.

[28] This is especially in the manner "full employment" goal is defined by ILO's Convention 122.

Bibliography

Allsopp, C.: *The future of macroeconomic policy in the European Union*, Discussion Paper No. 7, Bank of England, 2002.

Ames, B.; W. Brown, S. Devarajan and A. Izquierdo: "Macroeconomic policy and poverty reduction" in *Sourcebook for Poverty Reduction Strategies*, World Bank, Washington DC, 2001.

Amsden, A.: *Asia's next giant: South Korea and late industrialization*, Oxford University Press, 1989.

Balassa, B.: *Development strategies in semi-industrializing economies*, John Hopkins University Press, Baltimore, 1982.

Banuri, T.J.: *Economic liberalization: No panacea*, Clarendon Press, Oxford, 1990.

Bhagwati, J. and T.N. Srinivasan: "Trade policy and development", in R. Dornbusch and J.A. Frankel (eds.), *Economic adjustment and reform in low-income countries*, IMF, Washinton, 1999.

Bird, G.: "What happened to the Washington Consensus", *World Economics*, Vol.2, No. 4, 2001.

Bredenkamp, H. and S. Schadler (eds.), *Economic adjustment and reforms in low-income countries*, IMF, Washington DC, 1999.

Brown, G.: "The conditions for high and stable growth and employment", *The Economic Journal*, 111, May, 2001.

Bruton, H.J.: *On the search for well-being*, University of Michigan Press, Ann Arbor, 2001 (paperback).

Centre for Policy Dialogue: *State of Bangladesh Economy on the eve of the Development Forum 2002*, Dhaka, Bangladesh, 2002.

Chakravarty, S.: *Logic of employment-oriented planning in developing countries*, G.L. Mehta Lecture, Madras, 1987.

Cornia, G.A,: "Liberalization, globalization and income distribution", Working Paper No. 157, UNU/WIDER, 1999.

European Commission, "The EU Economy 2001 Review", *European Economy*, No. 73, 2001.

Fischer, S.: "The role of macroeconomic factors in growth", *Journal of Monetary Economics*, No. 32, 1993.

Geest, W. van der and Rolph van der Hoeven (eds.): *Adjustment, Employment and Missing Institutions in Africa*, in association with James Currey, ILO, Geneva, 1999.

Goldsborough, D. et al: *Reinvigorating growth in developing countries: Lessons form adjustment policies in eight economies*, IMF, Washington DC, 1996.

Greenwald, B. and J. Stiglitz, "New and Old Keynesians", in *Journal of economic perspectives*, Vol. 7, No. 1, 1993.

ILO, *Reducing the decent work deficit*, Report of the Director-General, International Labour Conference, 89th Session, ILO, Geneva, June 2001.

ILO, *Decent Work*, Report of the Director-General, International Labour Conference, 87th Session, ILO, Geneva, June 1999.

ILO, *Global Employment Agenda*, Geneva, 2002.

ILO, *National policies in a global context*, World Employment report, ILO, Geneva, 1996-97.

ILO, *Employability in the global economy: How training matters*, World Employment Report, ILO, Geneva, 1998-99.

Islam, I.: "The East Asian crisis and the Bretton Woods institutions: the demise of the "Washington Consensus?" (mimeo), Griffith University, Brisbane, 2001.

Jha, Raghbendra, *Macroeconomics of fiscal policy in developing countries*, Discussion Paper 2001/71, UNU/WIDER, Helsinki, 2001.

Kanbur, R. "Economic policy, distribution and poverty: the nature of disagreements", *World Development*, 29(6), 2001.

Khan, A.R. and M. Muqtada (eds.): *Employment expansion and macroeconomic stability under increasing globalization*, McMillan Press Ltd, London and St. Martin's Press, New York, 1997.

Krueger, A.O.: *Policy lessons from development experience since the second World War*, paper presented at the first ADB Conference on Development Economics, Manila, 1992.

Krugman, P.: *The return of depression economics*, W.W. Norton and Company, NY, 1999.

Lewis, A.: "Summary: The causes of unemployment in Less Developed Countries and some research topics", *International Labour Review*, Vol. 101, No. 5, 1970.

Little, I.M.D et al: *Boom, Crisis and Adjustment: The macroeconomic experience of developing countries*, World Bank and Oxford University Press, 1993.

Lora, E. and M. Olivera: *Macro policy and employment problems en Latin America*, Working Paper 372, Inter-American Development Bank, Cartagena, 1998.

Malinvaud, E. et al, *Development strategy and management of the market economy*, Vol. 1, Oxford University Press, 1997.

Meier, G.M. and J.E. Stiglitz: *Frontiers of development economics: The future in perspective*, World bank and Oxford University Press, 2001.

Ocampo, J.A.: "Rethinking the development agenda", *Cambridge Journal of Economics*, vol. 26, 2002.

Oshima, H.T.: *Economic growth in Monsoon Asia*, University of Tokyo Press, 1987.

Polanyi, K.: *The great transformation*, Farrar and Rinehart, New York, 1944.

Seers, D.: "The Colombian Employment Programme", in W. Galenson, selected *Essays on Employment*, ILO, Geneva, 1971.

Sen, A.K., "Development: Which way now?", *Economic Journal*, #93, December 1983.

Stiglitz, J.: *More instruments and broader goals: moving towards the post-Washington Consensus*, WIDER Annual Lecture, 1998.

Taylor, L.: *Varieties of stabilization experiences: Towards sensible macroeconomics in the Third World*, Clarendon Press, Oxford, 1988.

Tobin, J.: *Full employment and growth: Further Keynesian essays on policy*, Edward Elgar, 1996.

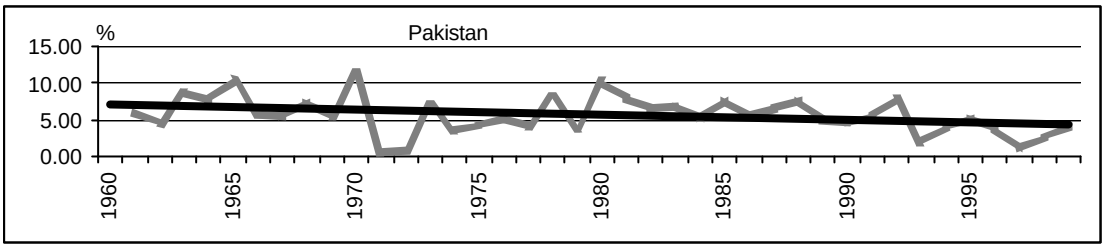
Tobin, J.: *Policies for prosperity. Essays in a Keynesian Mode*, Wheatsheaf Books, 1987.

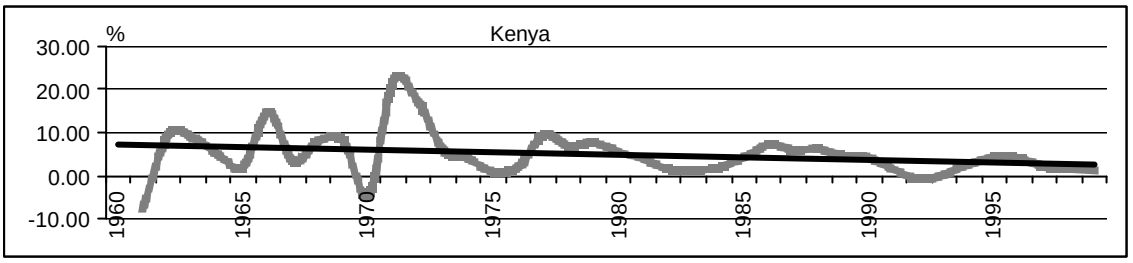
UNCTAD: *The Least Developed Countries report 2002*, United Nations, New York and Geneva, 2002.

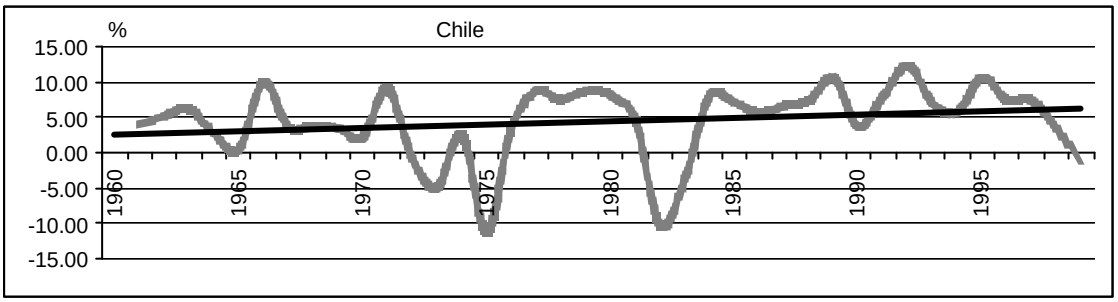
Wade, R.: *Governing the market: Economic theory and the role of the government in East Asian industrialization*, Princeton University Press, 1990.

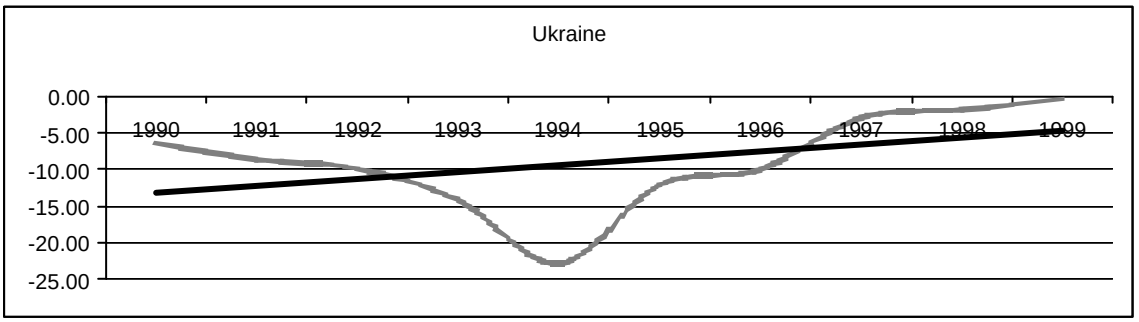
Appendix: Graphs

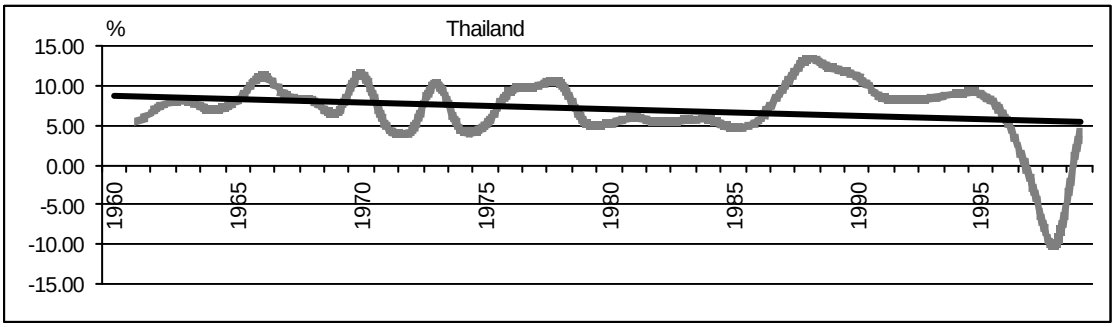
Graph I. Growth Fluctuations: GDP growth rate (%, annual)







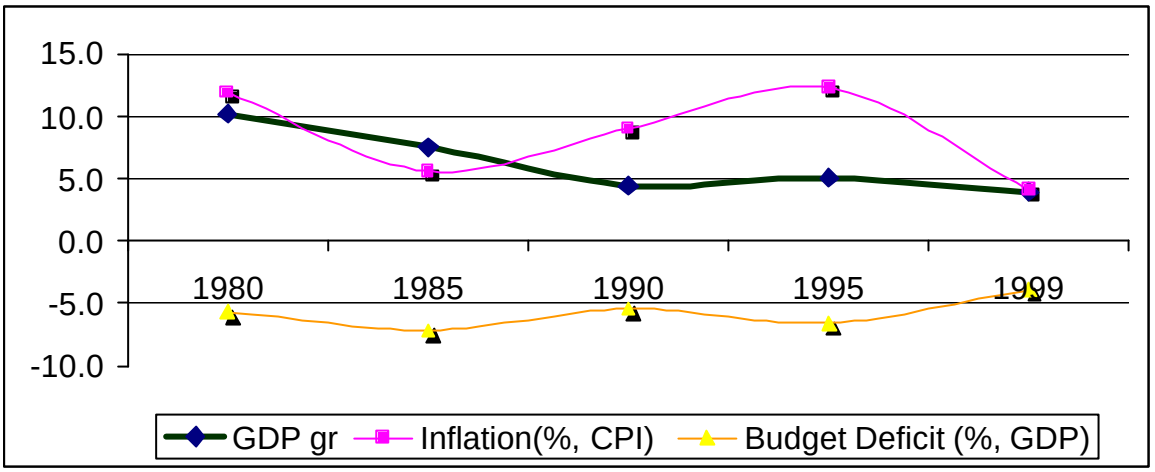




Source: WDI CD-ROM 2001, World Bank

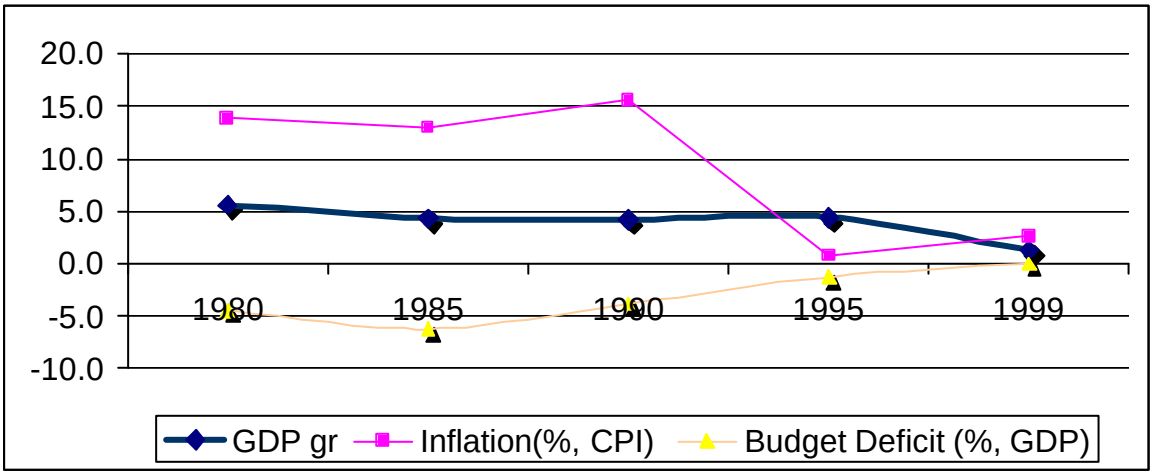
Graph II. Growth Rate and Stability

(a) Pakistan



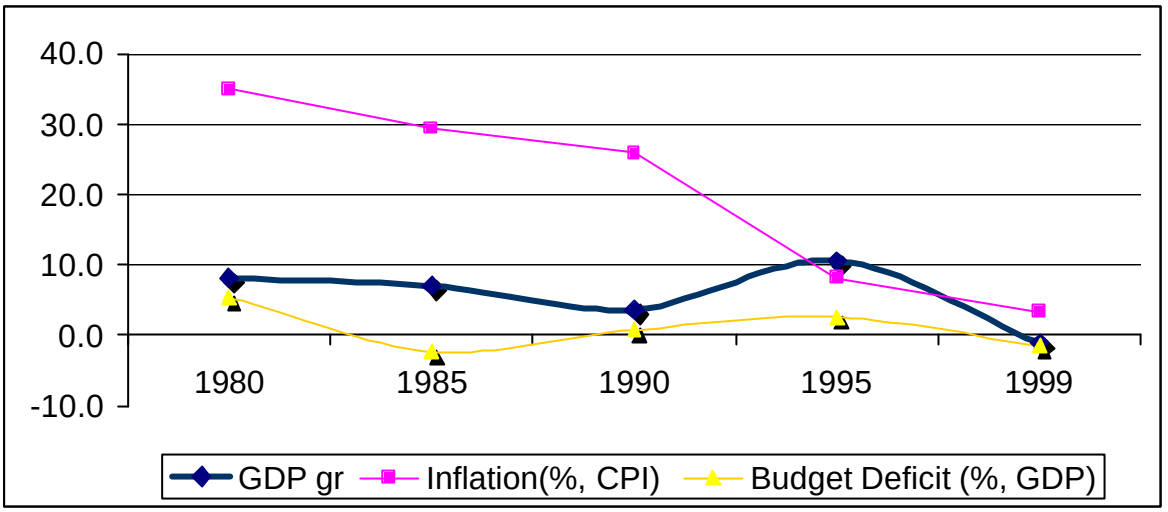
Source: WDI CD-ROM 2001, World Bank

(b) Kenya



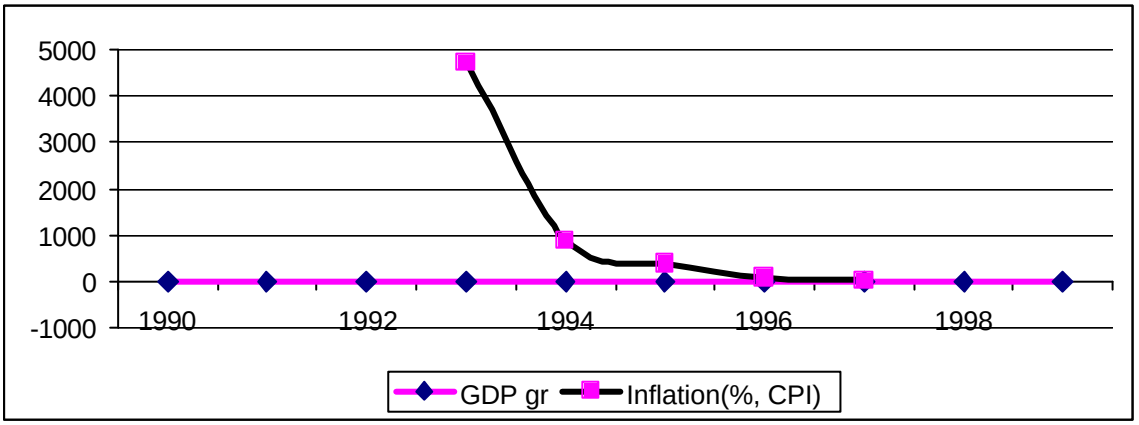
Source: WDI CD-ROM 2001, World Bank

(c) Chile



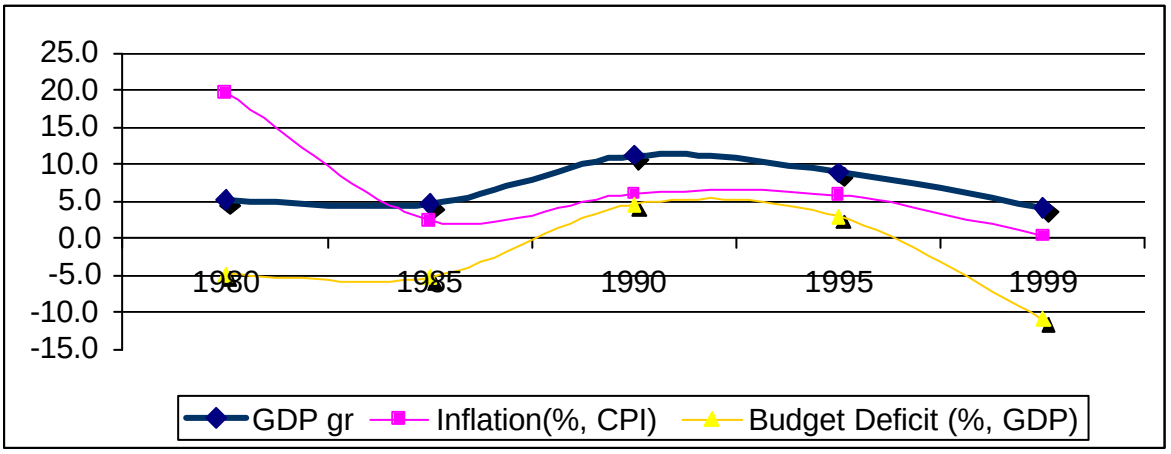
Source: WDI CD-ROM 2001, World Bank

(d) Ukraine



Source: WDI CD-ROM 2001, World Bank

(e) Thailand



Source: WDI CD-ROM 2001, World Bank