INTERNATIONAL LABOUR OFFICE

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Committee on Employment and Social Policy **ESP**

FOR DEBATE AND GUIDANCE

FIRST ITEM ON THE AGENDA

Recovery patterns, growth and employment potential, with specific reference to Global Jobs Pact integrated approach countries

Overview

Issues covered

This paper reviews global recovery patterns in the aftermath of the worldwide recession of 2008–09, focusing on output and employment, and key macroeconomic policy issues to improve the post-crisis growth potential. It examines these issues for six of the countries (Bulgaria, El Salvador, Indonesia, Jordan, Mongolia and South Africa) that have requested ILO support for an integrated application of the Global Jobs Pact.

Policy implications

The paper has implications for the debate on fiscal policies in relation to sustainability and growth potential (see paragraphs 26–32 and part II).

Financial implications

None.

Action/Decision required

None.

References to other Governing Body documents and ILO instruments

None.

Executive summary

This paper takes stock of what the Office has learned about output and employment recovery patterns in the aftermath of the global recession of 2008–09. The aim is to improve our understanding of the growth and employment potential in the post-crisis era and policies to develop this potential. The issues dealt with are central to the core questions explored in the Global Jobs Pact, the recurrent discussion on employment and the G20 assessments: how to promote recovery which leads to strong, sustainable and balanced growth; how to reduce the gap between global domestic product (GDP) recovery and jobs recovery; and how to promote a pro-employment macroeconomic framework.

The first part of the paper reviews global recovery patterns in output and employment and key macroeconomic policy issues to improve the post-crisis growth potential. It shows that many countries are experiencing a weak jobs recovery, despite a revival in GDP growth rates starting in the second quarter of 2009. Out of 76 countries, only 21 had a drop in unemployment in this recovery period, while 55 countries had an increase in unemployment.

Country-level evidence shows that the crisis was largely transmitted through exports, despite the fact that the global recession of 2008–09 began as a financial crisis with its epicentre in the United States. The evidence also shows that a higher proportion of emerging economies are exporting their way out of the crisis, but a higher incidence of high-income economies are relying on domestic consumption to support the recovery process. The latest quarterly data show that, with the exception of East Asia, investment rates are declining in various regions of the world.

The fiscal stimulus packages enacted in 2009 saved some 21 million jobs in the G20 countries and an additional 5 million jobs in selected non-G20 countries. Countries with large fiscal stimulus packages substantially expanded monetary liquidity/credit, and well-targeted labour market policies seem to have reversed the downturn more quickly.

This raises the question of whether fiscal stimulus packages and relevant labour market policies should be replaced by fiscal consolidation exercises in 2010 and beyond. This paper argues that, with the exception of countries with very high debt-to-GDP ratios, premature withdrawal of stimulus packages is risky.

The concerted fiscal stimulus packages for 2009 could not fully offset the global GDP gap of US$3.7 trillion and the corresponding gap of 37 million jobs that emerged in 2009. Furthermore, an examination of private sector and public sector balances across different parts of the world shows that a process of deleveraging by households and enterprises is under way. Prematurely withdrawing the fiscal stimulus packages and pertinent labour market policies will merely worsen this deleveraging process and might even lead to a "double dip" recession.

The second part reviews the experiences of six of the countries that have requested ILO support for an integrated application of the Global Jobs Pact (Bulgaria, El Salvador, Indonesia, Jordan, Mongolia, South Africa). In line with global trends, GDP recovery is also under way in these six countries, although it is slow in some and swift in others.

An examination of pre- and post-crisis growth patterns suggests that the countries under review continue to face significant labour market and employment challenges entailing high unemployment and underemployment, underutilization of the skills and talents of young people and persistent gender disparities along multiple dimensions.

Although these countries enacted countercyclical policies to cope with the crisis, this has now given way to monetary policy tightening to meet inflation targets (usually 6 per cent or less) and prudential limits on debt-to-GDP ratios (usually 50 per cent or less). In some countries, current institutional arrangements preclude the use of exchange rate flexibility. The mainstream macroeconomic framework that was so dominant in the pre-crisis period is used to guide the attainment of key targets pertaining to inflation, debts and deficits.

The paper explores the extent to which key elements of the mainstream macroeconomic framework can be modified in the Global Jobs Pact countries in order to consolidate job-rich recovery in the medium term. This represents the transition to a pro-employment macroeconomic framework. Such an exploratory exercise is consistent with the rethinking of post-crisis macroeconomics that is under way, most notably among leading International Monetary Fund (IMF) economists.

In the area of monetary policy and inflation targeting, central banks and financial authorities should aim for "reasonable price stability" with growth as noted in the preamble to the article IV agreements of the IMF, rather than a "one size fits all" target of low, single-digit inflation. Within this framework, central banks and financial authorities should promote financial inclusion by: (1) enhancing access to finance for the private sector; and (2) supporting the growth of microfinance institutions to respond to the credit needs of poor and vulnerable households. These proposals are important, given that lack of access to finance is among the top ten binding constraints on business operations in the countries under review and given that these countries generally lack microfinance institutions of international standing.

In the area of fiscal policy and debt sustainability, the aim is to identify sustainable resources from both external and domestic sources to meet core development goals. These goals pertain to: (1) public investment in health, education and infrastructure to meet the Millennium Development Goals (MDGs); and (2) social protection for all. There is a need for substantially increased budgetary allocations to support the Social Protection Floor Initiative. There is also a need to raise public investment in infrastructure to about 7 per cent of GDP from current rates of 2 to 3 per cent.

In the area of exchange rate regimes and capital account management, it is desirable to develop institutional arrangements that can engender real exchange-rate stability. In addition, a prudent approach to capital account management would be useful in cases where unrestrained short capital flows become a destabilizing force.

Finally, a pro-employment macroeconomic framework should be part of a holistic development strategy that supports economic diversification, including the creation of "green jobs", through industry and trade policies, and that strengthens labour market institutions to promote wage-led growth.

Introduction

1. The crisis and its recovery phase have had very diverse impacts in output and employment in countries around the world. This is partly determined by different economic structures, transmission mechanisms and institutional contexts, as well as policy responses. Since the beginning of the crisis, the ILO has tracked country-specific impacts of the global recession of 2008–09 and more recent recovery paths. A better understanding of the interaction between patterns of recovery in output and employment is essential to draw lessons about which policies and institutions can mitigate impacts and accelerate recovery of labour markets.

2. This paper takes stock of what the Office has learned about output and employment recovery patterns. The aim is to improve our understanding of the growth and employment potential in the post-crisis period and the policies to develop this potential. The issues dealt with are central to some of the fundamental questions of the Global Jobs Pact, the recurrent discussion on employment and G20 concerns: how to promote recovery which leads to strong, sustainable and balanced growth; how to reduce the gap between GDP recovery and jobs recovery; and how to promote a pro-employment macroeconomic framework.

3. The first part of the paper reviews global recovery patterns in output and employment and key macroeconomic policy issues to improve the post-crisis growth potential. The second part examines these issues for six of the countries that have requested ILO support for an integrated application of the Global Jobs Pact.

I. Global recovery patterns, growth and employment potential

4. There are five sets of indicators that allow analysis of global impact and recovery: (1) the relationship between GDP growth, employment and unemployment; (2) the evolution of key components of aggregate demand: exports, consumption and investment; (3) the impact of the policy stimulus on employment; (4) the projected potential for future growth of GDP and employment; and (5) the pattern of public and private balances which helps to clarify the policy choices regarding fiscal sustainability. The following sections take each one of these issues in turn.

The relationship between GDP growth, employment and unemployment: From crisis to recovery

5. Figure 1 shows the change in quarterly GDP and employment levels compared to a year earlier for five quarters from Q4 of 2008 to Q4 of 2009. [1] The figure shows that all parts of the globe were affected by the crisis in terms of a sharp drop in GDP in Q1 and Q2 of 2009. But the crisis clearly affected the high-income economies the most, with GDP dropping by $0.6 trillion in Q4 of 2008 (compared to a year earlier to allow for seasonality), and over $1 trillion in each of Q1 and Q2 of 2009. The next highest drop in GDP was in Latin America: $80 billion in each of Q1 and Q2 of 2009.

6. Recovery in GDP has come in all regions in Q3 and Q4 of 2009, except South Asia where it began a quarter earlier, and South Africa where it began a quarter later.

[1] Coverage was very weak for Africa with only South Africa yielding quarterly data and for East Asia and South Asia with for instance, China and India missing quarterly national employment data.

7. In terms of loss of employment, the high-income economies have suffered most. The cumulative loss of employment was 32 million between Q4 of 2008 and Q4 of 2009. Recovery in employment in these economies has come only in Q1 of 2010, with a two-quarter lag after GDP recovery, and it has been weaker. While GDP went into positive territory in Q1 of 2010, employment remained well below it for this quarter. In keeping with this finding, the Organisation for Economic Co-operation and Development (OECD) [2] expected only a modest decline in unemployment in 2010, while the European Commission [3] expected only stabilization of unemployment at around 10 per cent over 2010.

8. Towards the east of Europe, quarterly data was available only for Croatia, Republic of Moldova, Russian Federation and Turkey, where figure 1 shows that GDP and employment rebounded simultaneously, but from lower impact levels.

9. Seven Latin American economies for which quarterly data are available follow a similar pattern of a rebound in GDP and employment. Mexico accounts for much of the surge in the regional aggregate for employment in Q4 of 2009, after which it had a second dip in Q1 2010. Reports from the Economic Commission for Latin America and the Caribbean (ECLAC) and the ILO concur on this employment recovery in the second half of 2009. [4]

[2] *OECD Economic Outlook 2010*, No. 87, OECD, Paris, 2010.

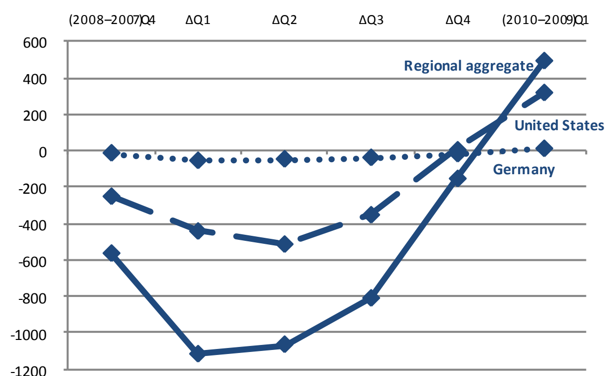
[3] European Commission: *European Economic Forecast – Spring 2010. European Economy 2/10*, Directorate-General for Economic and Financial Affairs, Luxembourg, 2010, p. 21.

[4] ECLAC–ILO: *The employment situation in Latin America and the Caribbean*, Bulletin No. 3, Santiago, Chile, June 2010.

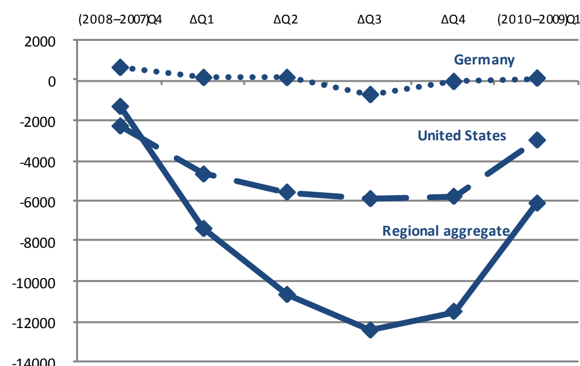
Figure 1. Absolute change in quarterly GDP and total employment levels compared to a year earlier (Q4 2008 to Q1 2010)

Developed economies and European Union

Absolute change in gross domestic product, constant prices (constant 2005 Q1 US$ billions)

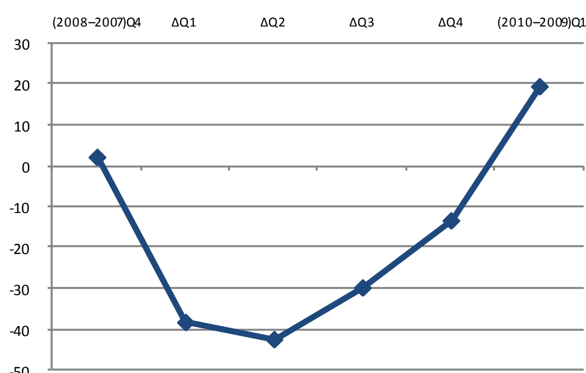


Absolute change in total employment (000s)

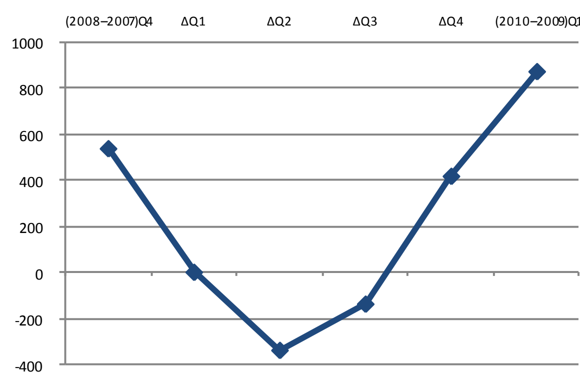


Croatia, Republic of Moldova, Russian Federation and Turkey

Absolute change in gross domestic product, constant prices (constant 2005 Q1 US$ billions)

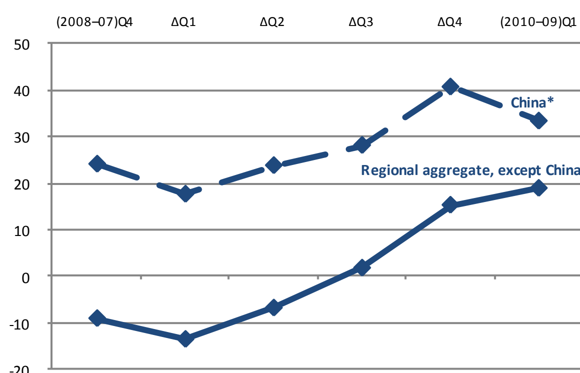


Absolute change in total employment (000s)

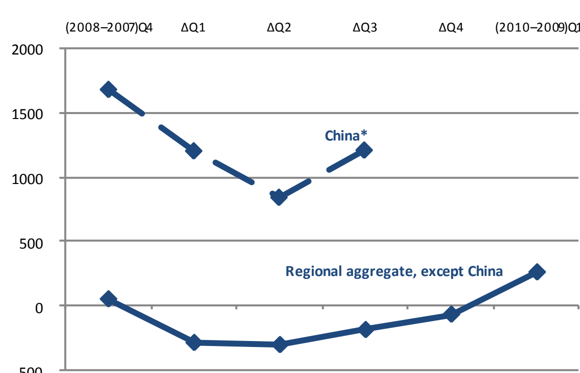


China,* Hong Kong (China), Republic of Korea and Taiwan (China)

Absolute change in gross domestic product, constant prices (constant 2005 Q1 US$ billions)



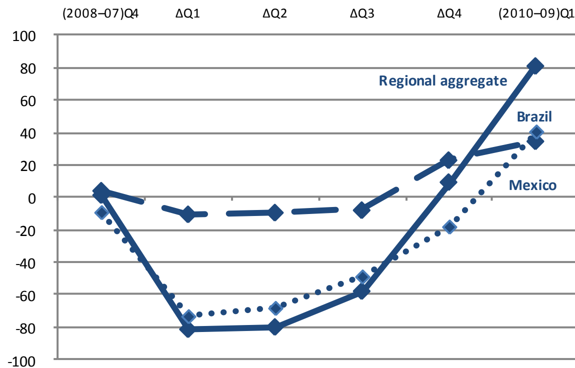
Absolute change in total employment (000s)



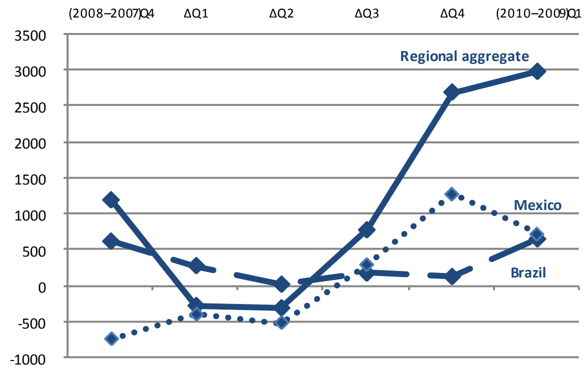
* For China, the employment data refer to selected urban areas. For further information or technical questions, please contact the ILO Department of Statistics.

Latin America*

Absolute change in gross domestic product, constant prices (constant 2005 Q1 US$ billions)



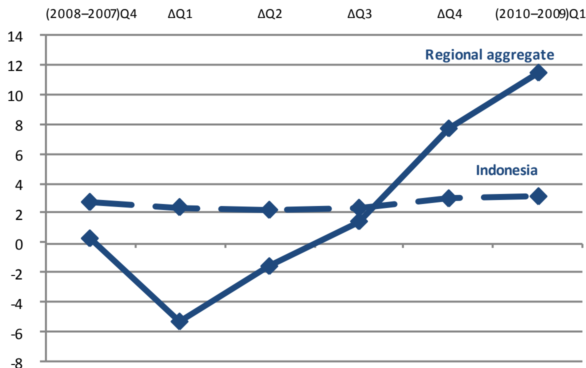
Absolute change in total employment (000s)



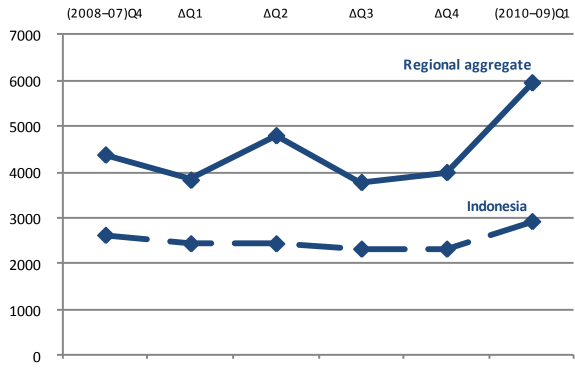
* Argentina, Brazil (for employment: selected urban areas), Chile, Colombia, Mexico, Peru (for employment: selected urban areas), Bolivarian Republic of Venezuela.

South-East Asia*

Absolute change in gross domestic product, constant prices (constant 2005 Q1 US$ billions)



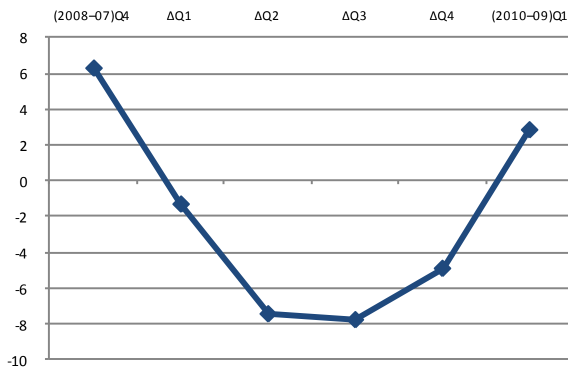
Absolute change in total employment (000s)



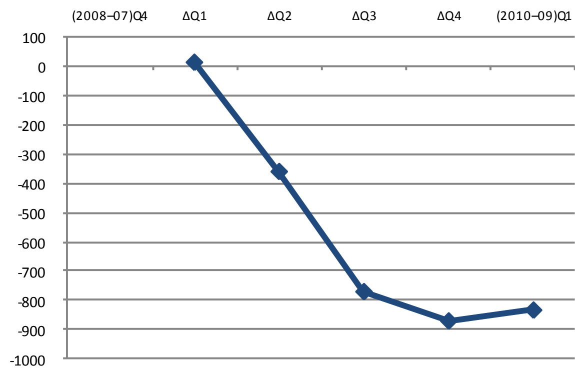
*Indonesia (for employment: Q2 is the same as Q1, and Q4 is the same as Q3, because the Labour Force Survey is run biannually), Malaysia, Philippines, Singapore, Thailand.

South Africa

Absolute change in gross domestic product, constant prices (constant 2005 Q1 US$ billions)



Absolute change in total employment (000s)



Note: The estimated output and employment loss can only be calculated by considering the simple average over the quarters.
Sources: IMF: *World Economic Outlook: Rebalancing Growth,* Apr. 2010; ILO estimates, Eurostat and National Statistical Offices.

10. In South-East and East Asia, while GDP becomes negative for the first two quarters of 2009, employment remains positive for South-East Asia and becomes mildly negative for East Asia. The employment recovery is flatter. The Asian Development Bank (ADB) also notes that unemployment stabilized over 2009, with some drops expected for 2010. [5]

11. The only quarterly data available for Africa was for South Africa. As figure 1 shows, the impact of the crisis has been high for both employment and GDP. Also, employment has not followed the rebound in GDP in Q4 2009 and Q1 of 2010. The *African Economic Outlook* expects post-crisis GDP growth to be lower than pre-crisis growth. [6]

12. The impact of the crisis and the pattern of recovery can also be examined in terms of GDP growth rates and unemployment rates. The impact can be estimated as the difference between Q3 2009 and a year earlier (given the depth of the crisis in mid-2009). The recovery can be estimated as the difference between the latest quarter for which data was available (which is usually Q1 2010) and a year earlier.

13. This detailed country data is analysed through figures 2(a) and 2(b). Figure 2(a) plots declines in GDP growth (between Q3 of 2009 and a year earlier) on the vertical axis in three grades: positive to -2 per cent, -2 per cent to -5 per cent, and more than -5 per cent. The impact of the crisis on unemployment rates is plotted on the horizontal axis in three grades: under 2 per cent, 2 per cent to 5 per cent, and above 5 per cent.

14. Figure 2(b) shows recovery by plotting improvement in GDP growth on the vertical axis and improvement in the unemployment rate on the horizontal axis.

15. Figure 2(a) shows that countries generally had a higher impact on GDP growth rates than on their unemployment rates, since most countries fell below the “diagonal” in the boxes (with the diagonal showing proportionality). Notable exceptions include Spain and New Zealand, both of which had a sharper increase in unemployment for any given decline in GDP growth.

16. Figure 2(b) shows that the pattern of recovery is disproportionate, with more countries having a jobless recovery or a weak jobs recovery, despite the revival in GDP growth rates. Out of 76 countries, only 21 countries had a drop in unemployment in this recovery period, while 55 countries had an increase in unemployment.

[5] ADB: *Asian Development Outlook 2010* (Manila, 2010).

[6] OECD–African Development Bank: *African Economic Outlook 2010* (Paris, OECD, 2010). See www.africaneconomicoutlook.org.

Figure 2(a). Impact: Country classification with respect to the percentage point change in total unemployment rate and GDP growth rate, for the crisis impact period (Q3 2008–Q3 2009)

		Total unemployment rate (percentage)		
	Variation (in percentage points) 2008 Q3 to 2009 Q3	< 2	2 and 5	> 5
GDP growth rate (percentage), quarterly percentage change from one year earlier	> -2	Australia, Republic of Korea, Luxembourg, Singapore, Taiwan (China)	New Zealand	
	-2 and -5	Belgium, Colombia, France, Hong Kong (China), Indonesia, Israel, Italy, Japan, Malta, Norway, Philippines, Poland, Switzerland	Canada, Denmark, Greece, Portugal, Turkey, United States	Spain
	< -5	Argentina, Austria, Brazil, Bulgaria, Croatia, Cyprus, Germany, Netherlands, Peru, Russian Federation, South Africa, Thailand, Bolivarian Republic of Venezuela	Chile, Czech Republic, Finland, Hungary, Iceland, Mexico, Republic of Moldova, Slovakia, Slovenia, Sweden, United Kingdom	Estonia, Ireland, Latvia, Lithuania

Sources: IMF: *World Economic Outlook: Rebalancing Growth*, Apr. 2010; ILO estimates, Eurostat and National Statistical Offices.

Figure 2(b). Recovery: Country classification with respect to the percentage point change in unemployment rate and GDP growth rate, for the crisis impact period, latest quarter available and 2009 Q3*

		Total unemployment rate (percentage)		
	*Variation (in percentage points) latest quarter available and 2009 Q3**	> -2**	-2 and -5	< -5
GDP growth rate (percentage), quarterly percentage change from one year earlier	< 2	Argentina, Cyprus, Greece, Iceland, Indonesia, Norway, Bolivarian Republic of Venezuela		
	2 and 5	Australia, Austria, Belgium, Colombia, Israel, Italy, Republic of Korea, Malta, New Zealand, Philippines, Poland, Portugal, Spain, Switzerland		
	> 5	Brazil, Bulgaria, Canada, Chile, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hong Kong (China), Hungary, Ireland, Japan, Republic of Moldova, Latvia, Lithuania, Luxembourg, Malaysia, Mexico, Netherlands, Peru, Russian Federation, Singapore, Slovakia, Slovenia, South Africa, Sweden, Taiwan (China), Thailand, Turkey, United Kingdom, United States		

Notes: * If the series are not seasonally adjusted, then the difference is between the latest quarter available and the quarter of the previous year. ** Only 21 countries (28 per cent of the whole sample) had a drop in unemployment rate between 0.1 and 1.4 percentage points.

Sources: IMF: *World Economic Outlook: Rebalancing Growth*, Apr. 2010; ILO estimates, Eurostat and National Statistical Offices.

Economic transmission mechanisms of the crisis impact and recovery

17. The impact of the crisis and the recovery is captured through three main transmission mechanisms: exports, consumption and investment. [7] Country-level evidence shows that the global recession of 2008–09 was largely transmitted through exports, despite the fact that it started as a financial crisis in 2007 in the United States. The evidence also shows that a higher proportion of emerging economies are exporting their way out of the crisis, but a higher incidence of high-income economies are relying on domestic consumption to support the recovery process. The latest quarterly data show that, with the exception of East Asia, investment rates are declining in various regions of the world.

18. Figure 3(a) shows the impact of the crisis by plotting change in export shares on the vertical axis and change in consumption shares on the horizontal axis. Figure 3(b) replicates this exercise to trace recovery patterns.

19. Figure 3(a) shows that the majority of countries experienced a sharper decline in export shares than consumption shares during the crisis period.

20. Figure 3(b) shows more emerging economies exporting their way out of the crisis, while more high-income economies have attempted to use consumption to support aggregate demand. This is consistent with the observations of the European Central Bank's mid-2010 report. [8]

21. Table 1 shows that investment growth rates were hit hardest by the crisis in high-income economies, Eastern Europe and Latin America, and had not yet recovered in these regions by Q4 2009. There is however, a strong investment recovery in India. In 2010, Egypt and South Africa seem to have suffered a steep decline in investment rates.

[7] The ILO had foreshadowed the current debate on global imbalances by pointing out at the Asian Employment Forum in Beijing in August 2007 that emerging Asia, the exemplar being China, was overly reliant on exports to high-income economies, the exemplar being the United States. See ILO: *Setting policy directions for job creation and poverty reduction*, Background paper for the Asian Employment Forum: Growth, Employment and Decent Work, Beijing, People's Republic of China, 13–15 August 2007.

[8] Cited in *Financial Times*, 3 Sep. 2010.

Table 1. Average growth rate of gross fixed capital formation, by region and selected countries, for impact and recovery period

Averages of regions and select countries	Percentage change	
	Impact	Recovery
	Q2 2009–Q2 2008	Latest quarter † (year-on-year)
Developed countries and European Union *	-15.7	-0.1
CSEE and Commonwealth of Independent States **	-0.2	-0.1
Latin America ***	-5.8	-3.3
Hong Kong (China) and Republic of Korea	2.4	5.8
India	1.3	25.5
South-East Asia and the Pacific ****	11.1	12.9
Egypt	5.9	-29.1
South Africa	9.3	-2.6

Notes: † Growth rate is calculated in constant 2005 US$. The impact period is represented by growth rate from Q2 of 2008 to Q2 of 2009, and the recovery period by Q4 of 2008 to Q4 of 2009. At the regional level the rate is the rate of growth at the aggregate of all countries with data available in the region. * Developed countries and European Union: excluding Cyprus, Malta and Slovakia. ** Central and South-Eastern Europe (non-EU) and Commonwealth of Independent States: Armenia, Croatia, Republic of Moldova, Russian Federation and Turkey. *** Latin America: Argentina, Plurinational State of Bolivia, Brazil, Chile, Colombia, Mexico and Peru. **** South-East Asia and the Pacific: Indonesia, Malaysia, Philippines and Thailand.

Source: IMF International Financial Statistics.

Figure 3(a). Impact: Country classification with respect to the percentage point change in consumption and exports, for the crisis impact period (Q2 2008–Q2 2009)

		Household consumption (percentage)		
	Variation (in percentage points) Q2 2008–Q2 2009	**<2**	**2 to 5**	**>5**
Exports	**>-2**	Argentina, Colombia, Iceland, Ireland, New Zealand, Poland	*Brazil, United Kingdom*	*Armenia*
	-2 to -5	Australia, Estonia, France, Greece, Republic of Korea, Latvia, United States	*Turkey*	*Mexico, Russian Federation*
	<-5	Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Hong Kong (China), Hungary, India, Indonesia, Israel, Italy, Netherlands, Philippines, Portugal, South Africa, Switzerland, Thailand	*Austria, Canada, Chile, Egypt, Finland, Germany, Japan, Lithuania, Luxembourg, Sweden, Peru*	*Malaysia, Norway*

Export fall

Consumption cushion

Source: IMF International Financial Statistics.

Figure 3(b). Recovery: Country classification with respect to the percentage point change in consumption and exports, for the latest quarter to quarter period available
(Q1 2009–Q1 2010, or Q4 2008–Q4 2009 were not available)

		Household consumption (percentage)		
	Variation (in percentage points) Q2 2008–Q2 2009	**<0**	**0 to 2**	**>2**
Exports	**<0**	Argentina, Canada, Chile, Colombia, Croatia, Estonia, Republic of Korea, Portugal, South Africa	*Australia, Austria, Brazil, Denmark, Italy, Netherlands, New Zealand, Sweden, Switzerland, Turkey, United Kingdom*	*Egypt, Finland, Norway*
	0 to 2	Bulgaria, Hungary, India, Indonesia, Malaysia, Mexico, Peru, Poland	Armenia, France, Russian Federation, United States	Greece
	>2	Belgium, Hong Kong (China), Lithuania, Luxembourg, Japan, Philippines, Thailand	Czech Republic, Ireland	Iceland, Israel, Latvia

Export-led recovery
Consumption-led recovery

Source: IMF International Financial Statistics.

The impact of the policy stimulus on employment

22. In April 2010, the ILO estimated that in G20 countries discretionary stimulus plus automatic stabilizers had resulted in generating or saving some 21 million jobs, [9] and also that some 5 million jobs have been created or saved over 2009–10 in selected non-G20 countries for which data were available. [10] There were significant job losses in the first two quarters of 2009 until the stimulus kicked in and restrained the job losses in the third and fourth quarters of 2009. Boosting aggregate demand through stimulus thus complemented labour market policies and was a central element in bringing the global recession to an end. Countries with large fiscal stimulus packages substantially expanded monetary liquidity/credit, and well-targeted labour market policies seem to have reversed the downturn more quickly.

[9] ILO: *Accelerating a job-rich recovery in G20 countries: Building on experience*, An ILO report, with substantive contributions from OECD, to the Meeting of G20 Labour and Employment Ministers, 20–21 April, 2010, Washington, DC.

[10] ILO: “Estimates of the impact of the stimulus on employment”, Background paper for the present study, forthcoming.

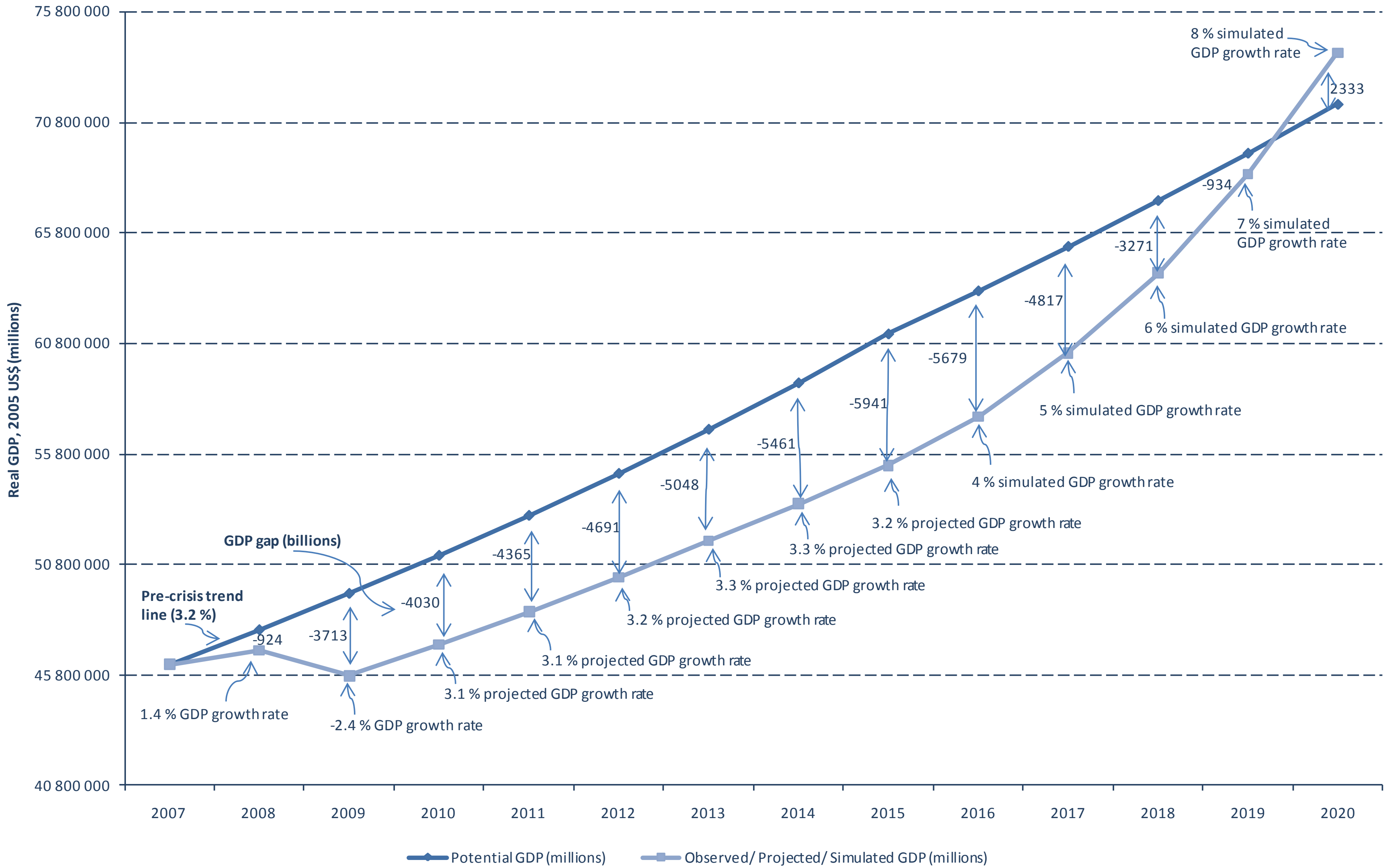
Growth and employment potential in the post-crisis period

23. The GDP gap created by the crisis in 2009 was approximately $3.7 trillion (figure 4), while the employment gap in 2009 was approximately 37 million jobs (figure 5). These two figures show that these GDP and employment gaps will not be removed unless post-crisis GDP and employment grows at historically unprecedented rates. Thus, global GDP growth will have to be 6 per cent in order to close the global output gap by 2019, while employment growth will have to be 2.3 per cent for the employment gap to be removed.

24. These findings are consistent with the work of Carmen Reinhart who showed in her study of 15 crises that in ten of these crises unemployment never fell back to its pre-crisis level within 20 years. [11]

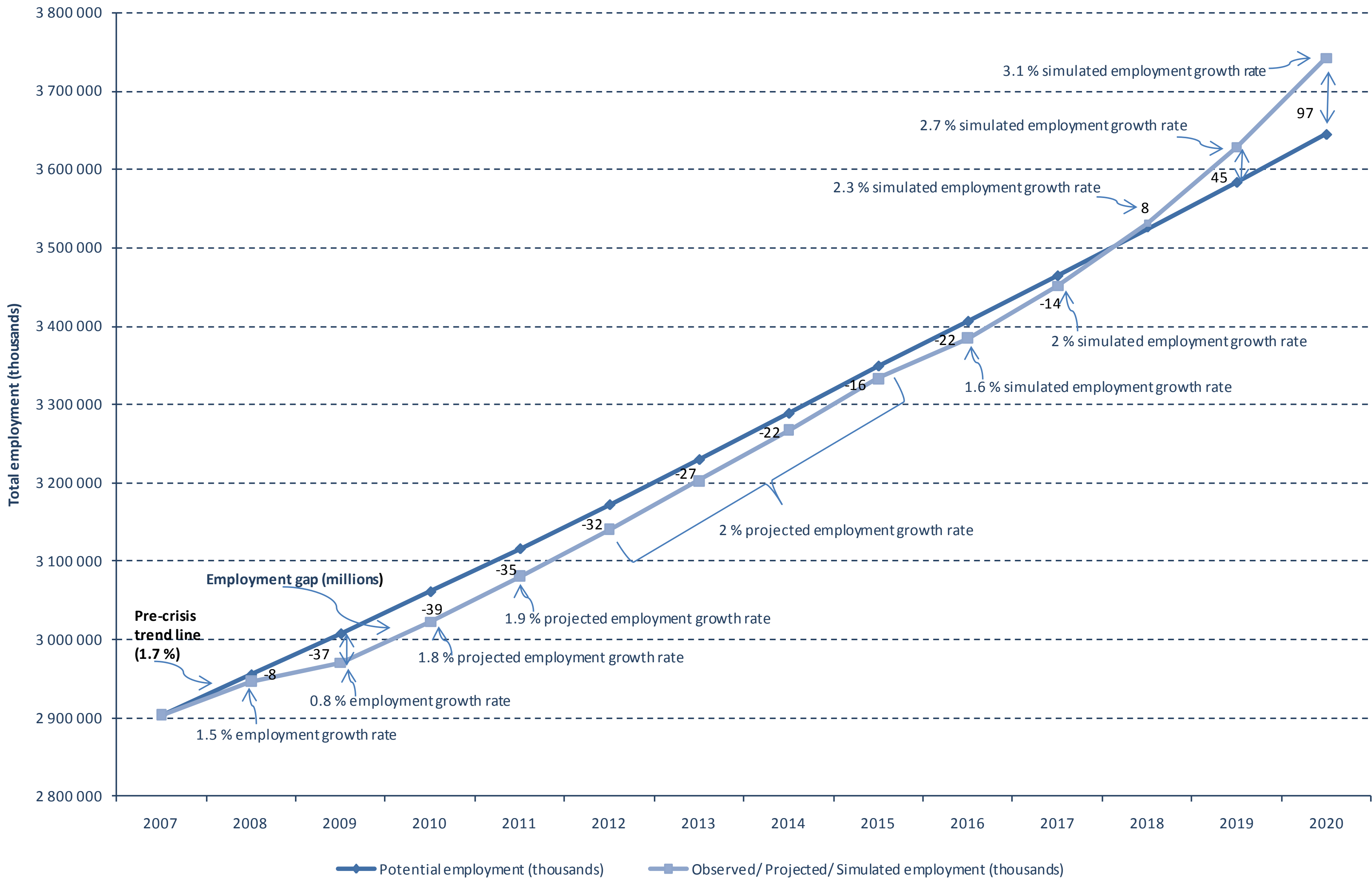
[11] C. Reinhart and V. Reinhart: *After the Fall*, paper prepared for the Federal Reserve Bank of Kansas City Economic Policy Symposium, Macroeconomic Policy: Post-Crisis and Risks Ahead, Jackson Hole, Wyoming, 26–28 August 2010.

Figure 4. Global real gross domestic product based on 164 countries, 2005 (US$ millions)



Sources: ILO estimates; IMF: *World Economic Outlook: Rebalancing Growth*, Apr. 2010.

Figure 5. Global employment based on 164 countries (thousands)



Sources: ILO estimates; IMF: *World Economic Outlook: Rebalancing Growth*, Apr. 2010.

Fiscal sustainability and growth potential

25. It is in this context of the expected pattern of recovery and post-crisis growth that the policy debate needs to be set. Premature unwinding of fiscal and monetary stimulus has been of concern to the ILO. This concern is shared by the IMF and the G20. The overview to the background document for the Joint ILO–IMF Oslo Conference in September 2010 states that: "As a general strategy, most high-income economies should not tighten their fiscal policies before 2011, because tightening sooner could undermine the recovery," but also: "Clearly … the fiscal situation varies across countries, requiring adaptation of this general strategy to the available fiscal space."

26. Fiscal sustainability is an important objective. The question is: what is the path to get there and how fast? Some want to frontload the fiscal adjustment; others think fiscal consolidation should be postponed until the recovery of the private sector is clearly consolidated. A number of key issues should be taken into account in this respect.

27. First, fiscal sustainability should be discussed in a context of promoting strong, sustainable and balanced growth. In fact, the main factor behind fiscal deficits in developed countries is not the discretionary stimulus per se, not even the bailout packages for the financial sectors, but the fact that the collapse of output in 2008–09 led to a sharp decline in tax revenues, which in turn pushed up public debt-to-GDP ratios. In the G20 high-income economies, the increase in the debt-to-GDP ratio between 2008 and 2015 is expected to be nearly 40 percentage points of GDP. As shown in figure 6, half of that increase is attributable to revenue losses. In comparison, the fiscal stimulus makes a much more modest contribution, and so does the support that governments provided to their financial sectors.

28. This suggests strongly that, with the exception of countries with very high debt-to-GDP ratios, premature withdrawal of stimulus that affects growth negatively can be self-defeating. Instead, growth and aggregate demand policies matter. If a country can sustain growth based on investment, higher employment, better wages and incomes, then it can improve its fiscal position. Conversely, if it consolidates too fast or too soon, it can negatively affect growth and therefore fiscal revenues and it can end up with less growth and an even worse fiscal deficit.

29. Second, some argue that financial markets will not find fiscal consolidation credible if it is done gradually or slowly. Two issues can be raised here: (1) there is hardly any evidence that financial markets are seeking a rapid fiscal consolidation exercise, as they are aware that such an exercise can actually retard the recovery process and thus worsen public debt-to-GDP ratios; and (2) there is an important connection in this regard between credibility and social dialogue. A hypothesis with important support is that the better the quality of social dialogue in a country the more credible the economic strategies of that country. A good and solid understanding between the government, employers and workers around economic objectives increases the credibility of the economic strategy. If a country has a credible strategy based on solid social dialogue, the argument to have rapid fiscal consolidation is reduced. So social dialogue is important to the development of fiscal sustainability strategies.

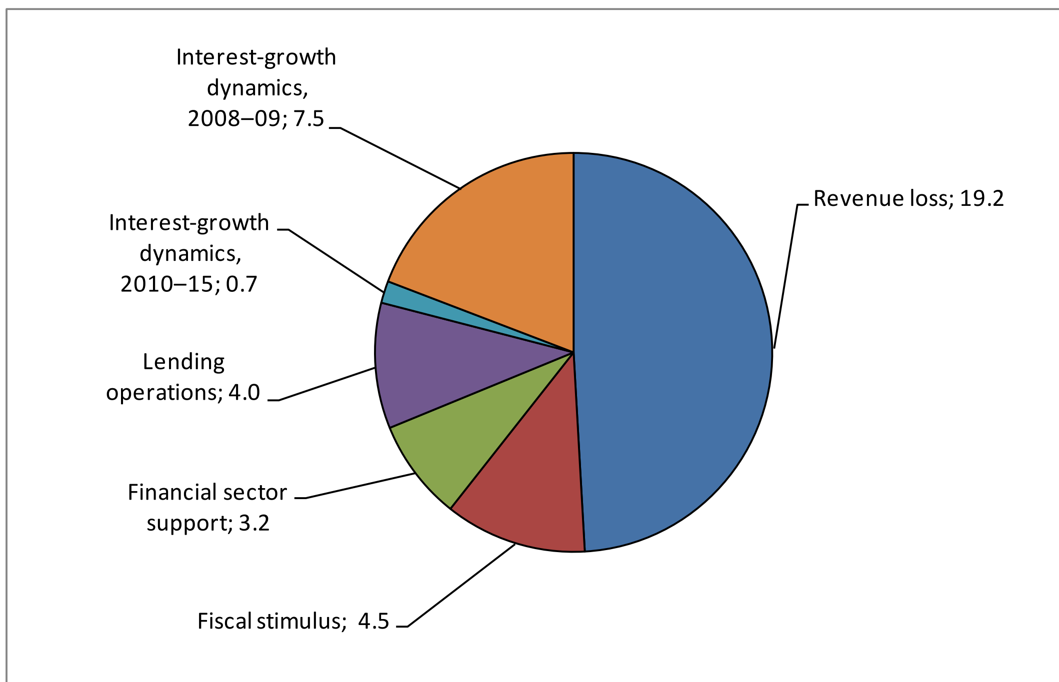
30. Third, the need to stimulate aggregate demand and the risk of premature withdrawal of stimulus has been widely discussed, and they are very important. But equally important and much less discussed has been the supply side: a period of below-trend investment, alongside the depreciation of human capital that comes with high unemployment/ underemployment, affects the level and growth of potential output. There is a vicious circle

here: the unemployment rate stays high because it has been high. In other words, long-term unemployment, youth unemployment and the increase in precarious work leave permanent scars not only for the people in those conditions and for their families, but cause systemic damage for economies as a whole. Damage to the supply side can be caused or aggravated by bad policies such as restricting credit, not investing enough in training and re-training or in incentives for re-hiring. Therefore, an appropriate recovery policy should pay attention to both the demand side and the supply side. [12]

31. Fourth, it is important to consider public and private balances together. Table 2(a) shows the pre-crisis pattern of public and private balances. The table shows that public balances were largely positive, with very high private expenditures, resulting in current account outflows from the high-income economies, Latin America and South Asia, towards East Asia and the Gulf region.

32. Table 2(b) then shows the impact of the crisis on these public and private balances. The high-income economies particularly, but all other regions as well, have run up large public deficits which have been financed by larger private savings. Table 2(c) gives the same snapshot for 2009. This shows that the private sector, households and enterprises are still deleveraging and saving rather than spending. Therefore, if the public deficit is lowered, there is no evidence as yet that it will be compensated by increased private expenditures to maintain a level of aggregate demand commensurate with a recovery in GDP and employment.

Figure 6. High-income economies: Sources of increase in public debt, 2008



The majority of the projected 39 percentage points of GDP increase in public debt is due to cyclical weakness in economies.

Source: IMF, *Navigating the Fiscal Challenges Ahead, Fiscal Monitor Series*, prepared by the Staff of the Fiscal Affairs Department, 14 May 2010.

[12] This point has also been made by Reinhart and Reinhart, op. cit.

Table 2(a). Variations in budget balance, private net savings and the current account balance between 2007 and 2004 (in percentage points) [13]

Region	Budget balance	Private net savings	Current account balance
Central and South-Eastern Europe (non-EU) and Commonwealth of Independent States	2.32	-5.19	-2.87
Developed economies and the European Union	2.25	-2.55	-0.31
East Asia	2.03	2.36	4.39
Latin America and the Caribbean	0.34	-1.02	-0.69
Middle East	-0.28	6.17	5.89
North Africa	1.40	1.74	3.13
South-East Asia and the Pacific	0.68	1.77	2.45
South Asia	0.79	-2.02	-1.23
Sub-Saharan Africa	2.81	-3.81	-1.00
World	2.20	-1.76	0.44

Table 2(b). Variations in budget balance, private net savings and the current account balance between 2010 and 2007 (in percentage points) [13]

Region	Budget balance	Private net savings	Current account balance
Central and South-Eastern Europe (non-EU) and Commonwealth of Independent States	-6.85	7.95	1.11
Developed economies and the European Union	-6.64	7.14	0.5
East Asia	-3.68	-0.7	-4.38
Latin America and the Caribbean	-1.55	-0.08	-1.63
Middle East	-3.78	-7.54	-11.32
North Africa	-7.08	-3.1	-10.19
South-East Asia and the Pacific	-2.25	-0.38	-2.63
South Asia	-2.57	2.25	-0.31
Sub-Saharan Africa	-6.5	5.53	-0.97
World	-5.51	5.32	-0.19

[13] Private net savings are derived from the budget balance and current account balance observations. World estimates are based on the sum of the countries listed below: *Central and South-Eastern Europe (non-EU)* and Commonwealth of Independent States: Azerbaijan, Kazakhstan, Russian Federation, Turkey, Ukraine; *Developed Economies and the European Union*: Australia, Austria, Belgium, Bulgaria, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Spain, Sweden, Switzerland, United Kingdom, United States; *East Asia*: China, Hong Kong (China), Republic of Korea, Taiwan (China); *Latin America and the Caribbean:* Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Bolivarian Republic of Venezuela; *Middle East*: Islamic Republic of Iran, Saudi Arabia; *North Africa:* Algeria, Egypt; *South-East Asia and the Pacific*: Indonesia, Malaysia, Philippines, Singapore, Thailand, Viet Nam; *South Asia*: India, Pakistan, Sri Lanka; *Sub-Saharan Africa*: Nigeria, South Africa.

Table 2(c). Budget balance, the private net savings and the current account balance in 2009 (percentage of GDP) [13]

Region	Budget balance	Private net savings	Current account balance
Central and South-Eastern Europe (non-EU) and Commonwealth of Independent States	-5.90	7.70	1.90
Developed economies and the European Union	-8.00	6.40	-0.60
East Asia	-1.90	8.20	6.30
Latin America and the Caribbean	-3.10	2.80	-0.30
Middle East	-2.04	5.25	3.22
North Africa	-7.20	5.30	-1.90
South-East Asia and the Pacific	-3.48	9.51	6.02
South Asia	-6.46	4.08	-2.38
Sub-Saharan Africa	-5.25	5.06	-0.20
World	-6.64	6.96	0.33

Source: OECD, *Economic Outlook Database Inventory*, EO87, June 2010; Economist Intelligence Unit.

II. Recovery patterns in integrated Global Jobs Pact countries [14]

33. The Conclusions concerning the recurrent discussion on employment adopted at the 99th Session (2010) of the International Labour Conference state that: "Governments of member States should assess as appropriate the following: … design and implementation of a pro-employment macroeconomic policy framework that promotes growth, investment, sustainable enterprise, decent work, employability, skills development and a fair distribution of income, 'to place full and productive employment and decent work at the centre of economic and social policies' " (paragraph 25(iii)). The conclusions ask the Office to improve and coordinate "its technical and analytical capacity to examine macroeconomic policies from the perspective of employment outcomes" (paragraph 27(i)). This section looks at the challenges of jobs recovery, with an emphasis on the macroeconomic framework, in selected countries that have requested the integrated application of the Global Jobs Pact: Bulgaria, El Salvador, Indonesia, Mongolia, Jordan and South Africa.

The pre-crisis period: Robust growth amidst labour market and employment challenges

34. All countries, and to a lesser extent El Salvador, participated in the global boom of the pre-crisis period (table 3). Yet two features stand out. First, in many cases the patterns of growth were such that the rates of growth achieved were unsustainable: they were driven either by commodity price booms or by a surge in external resources. Second, despite rapid growth, the labour market and employment outcomes have been modest. Even where there were substantial declines in unemployment (as in Bulgaria), the achievements were rapidly

[14] "Integrated Global Jobs Pact countries" refers to those countries that have requested an integrated application of the Global Jobs Pact based on the full Global Jobs Pact country scan methodology. So far nine countries have requested this with a positive response from the ILO. Six of these are the focus of this section.

reversed in the wake of the global recession. Elsewhere, as in El Salvador, Indonesia and Mongolia, indicators on the quality of employment convey a less promising achievement than that inferred from unemployment rates. For Jordan and South Africa, labour market outcomes were characterized by relatively low employment-to-population ratios and significant labour market segmentation. Labour markets in the countries considered have very high youth unemployment rates and display persistent gender disparities along multiple dimensions.

Table 3. Growth performance, patterns of growth and labour market performance in the Global Jobs Pact countries during the global boom (2002–07)

Country	Growth performance in the pre-crisis period	Pattern of growth	Labour market performance in the 2000s
Bulgaria	Economy declined at a rate of -2.5 per cent in 1992–2001, but a sharp turnaround in the 2000s, with growth peaking at 6.3 per cent in 2006.	Growth fuelled by short-term capital flows that at one point reached 34 per cent of GDP. Asset price bubble in real estate and financial services and a boom in nominal wage growth that exceeded productivity growth, leading to a sharp increase in unit labour costs.	– Unemployment rate declined from 10.1 per cent to 6.9 per cent (2002–07) as did share of vulnerable employment: 10.2 per cent to 8.7 per cent (2005–07). – Youth unemployment rate declined from 35.6 per cent to 15.1 per cent (2002–07). – Modest improvement in employment-to-population ratio: 43.8 per cent to 46.3 per cent (2005–07). – Share of working poor (US$1 a day) negligible (2003). – Women had higher unemployment, lower employment-to-population ratio and higher share of vulnerable employment.
El Salvador	Grew at a moderate pace of 4.4 per cent in 1992–2001, but below this rate during the global boom of 2000s.	Low-investment, high-consumption economy, heavily reliant on remittances (17.1 per cent of GDP) and closely linked to the US economy.	– Unemployment rate at 6.6 per cent (2006). – Some decline in share of vulnerable employment from 38.8 per cent to 35.5 per cent (2005–06). – Youth unemployment rate increased from 11.5 per cent to 12.4 per cent (2002–07). – Employment-to-population ratio constant at 55 per cent (2005–07). – Share of working poor (US$1 a day) at 15.6 per cent (2005), no higher than it was in 1995. – Women had higher unemployment, lower employment-to-population ratio and higher share of vulnerable employment.
Indonesia	One of the world's 13 fastest growing economies before the 1997 Asian financial crisis, when the economy contracted by 13 per cent. Return of growth in the 5–6 per cent range during the 2000s.	Heavily reliant on commodity exports (accounting for more than 60 per cent of total exports). Domestic consumption and investment accounted for more than 70 per cent of growth between 2002 and 2008.	– Unemployment rate declined: 11.2 per cent to 9.1 per cent (2005–07), but share of vulnerable employment roughly constant at 63 per cent (2005–07). – Youth unemployment rate declined from 25.5 per cent to 23.8 per cent (2003–07). – Employment-to-population ratio roughly constant at 60 per cent (2002–07). – Share of working poor (US$1 a day) declined from 37.2 per cent to 27.8 per cent (2002–05). – Women had higher unemployment, lower employment-to-population ratio and higher share of vulnerable employment.

Country	Growth performance in the pre-crisis period	Pattern of growth	Labour market performance in the 2000s
Jordan	Grew at 5 per cent in 1992–2001. Growth rate accelerated to a peak of 8.9 per cent in 2007.	Economy heavily reliant on remittances (17.6 per cent of GDP) and closely linked to business cycles of the Gulf States. Late 2000s witnessed an oil-price boom fuelling large FDI inflows to Jordan, 78 per cent of which came from the Gulf States. Robust domestic consumption and asset price bubble in non-tradable sector.	– Unemployment rate at 12.7 per cent (2008). – Employment-to-population ratio constant at 39 per cent. – Share of working poor (US$1 a day) negligible (2006). – Significant labour market segmentation between foreign workers and Jordanian nationals. Sixty-three per cent of jobs created in 2002–05 were filled by migrant workers. – Women had higher unemployment, lower employment-to-population ratio and higher share of vulnerable employment.
Mongolia	Grew at a rather slow pace of 1.1 per cent in 1992–2001 period, but from 2002 onwards grew very rapidly, with growth rate reaching 10.2 per cent in 2007.	Boom in 2000s driven by the mining sector, which at one point accounted for 28 per cent of GDP, while contraction of manufacturing sector continued unabated.	– Unemployment rate 3.3 per cent (2005). – Youth unemployment rate at 20 per cent (2003). – Employment-to-population ratio constant at 52 per cent (2005–07). – Share of vulnerable employment at 59 per cent (2002–03). – Increase in working poor from 21.9 per cent to 30.5 per cent (2002–05). – Women had higher unemployment, lower employment-to-population ratio and higher share of vulnerable employment.
South Africa	Grew at a modest pace of 2.2 per cent in the 1992–2001 period, but during the global boom of the 2000s growth peaked at 5.5 per cent in 2007.	Largest and most important economy in sub-Saharan Africa. Despite efforts to diversify industrial base, economy is heavily reliant on the service sector and commodity exports. Recipient of large-scale capital inflows during global boom.	– Unemployment rate declined from 26.7 per cent to 23 per cent (2005–07). – Employment-to-population ratio increased from 38.7 per cent to 41.1 per cent (2005–07). – Youth unemployment declined from 56 per cent.5 to 46.9 per cent (2002–07). – Share of working poor (US$1 a day) at 44 per cent (2000). – Significant labour market segmentation along ethnic and racial lines. – Women had higher unemployment, lower employment-to-population ratio and higher share of vulnerable employment.

Sources: Country briefs prepared by ILO staff; IMF: *World Economic Outlook: Rebalancing Growth*, Apr. 2010; ILO: *Key Indicators of the Labour Market (KILM)*, 6th edition (Geneva, 2010); UN: Millennium Development Goals database, update 23 July 2010.

From crisis to recovery: The return of growth amidst labour market and employment challenges

35. All the Global Jobs Pact economies were adversely affected by the global recession, some much more than others. As shown in table 4, four of the them went into recession in 2009, with Bulgaria suffering the steepest decline in output (-5.0 per cent) followed by El Salvador (-3.5 per cent), South Africa (-1.8 per cent) and Mongolia (-1.6 per cent). While Jordan suffered a significant growth deceleration (growth fell from a peak of 8.9 per cent in 2007 to 2.8 per cent), Indonesia proved quite resilient, with growth in 2009 dipping a little below the trend growth rate of 5–6 per cent in the 2000s. Projections suggest a swift GDP recovery in Indonesia and Mongolia in 2010 and beyond, but much slower recovery

in Bulgaria, El Salvador, Jordan and South Africa. Even by 2015, these economies are expected to barely return to their trend growth.

Table 4. Global Jobs Pact countries: Impact on GDP, labour market adjustment during the crisis and prospects for GDP recovery

Country	Impact on GDP	Projected GDP recovery	Labour market adjustments (2008 to Q1 2010)
Bulgaria	Steep recession. GDP fell by 5 per cent in 2009, while GDP growth was more than 6 per cent in 2007.	**Slow** Return to trend growth rate not expected before 2015.	– Unemployment rate increases from 5.6 per cent in 2008 to 10.2 per cent in Q1 of 2010. – Youth unemployment rate increases from 12.7 per cent in 2008 to 23.8 per cent in Q1 of 2010. – Employment-to-population ratio falls from 50.8 per cent to 46.1 per cent. Freeze in public sector wages.
El Salvador	Steep recession. GDP fell by 3.5 per cent.	**Slow** Return to trend growth rate not expected before 2015.	– Unemployment rate increased from 5.9 per cent in 2008 to an estimated 9 per cent in 2010.
Indonesia	Moderate growth deceleration, but no outright recession. Growth rate of GDP fell to 4.5 per cent in 2009 from 6 to 6.3 per cent in 2007.	**Swift** Return to trend growth rate by 2010.	– Unemployment rate declined from 8.4 per cent in 2008 to 7.4 per cent in Q1 of 2010, but ... – Informal employment in 2009 higher than in 1996. – Real wages among production workers in 2009, 10 per cent lower than in 2005.
Jordan	Significant growth deceleration, but no outright recession. Growth rate fell to 2.8 per cent in 2009 from 8.9 per cent in 2007.	**Slow** Return to trend growth rate not expected before 2015.	– Aggregate unemployment rate increased from 12 per cent in Q3 of 2008 to 14 per cent in Q3 of 2009, but ... – A decline to 12.4 per cent in Q1 of 2010. – Youth unemployment rate rises from 24.9 per cent in Q2 of 2009 to 27.7 per cent in Q1 of 2010.
Mongolia	Moderate recession, with GDP declining by 1.6 per cent in 2009. GDP growth was 10.2 per cent in 2007.	**Swift** 7 per cent growth rate expected in 2010 and 2011.	– Patchy data show that aggregate unemployment reached 12.8 per cent in 2009, with evidence of a sharp decline in real wages in the informal economy.
South Africa	Significant recession, with GDP declining by 1.8 per cent in 2009. GDP growth was 5.5 per cent in 2007.	**Slow** Even by 2015 trend growth will be below pre-crisis peak of 5.5 per cent growth.	– Modest increase in unemployment rate from 22.9 per cent in 2008 to 25.2 per cent in Q1 of 2010. – Brunt of the adjustment occurred through a sharp rise in discouragement.

Sources: Country briefs prepared by the ILO; IMF: *World Economic Outlook: Rebalancing Growth*, Apr. 2010; ILO, Department of Statistics, July 2010.

36. The impact of the global recession on the labour market in the Global Jobs Pact countries has varied. Once again, Indonesia proved most resilient with aggregate unemployment rate declining between 2008 and 2009. South Africa also experienced a modest increase in unemployment, but much of the labour market adjustment took place through a sharp increase in the incidence of discouraged workers. The other economies – most notably Bulgaria and Mongolia – experienced a notable increase in unemployment from their already high levels.

37. Even in the countries undergoing a swift recovery (Indonesia and Mongolia), the nature and scale of the labour market and employment challenges – proliferation of low-productivity jobs, sluggish real wage growth – is undiminished. Furthermore, the trend growth rate of around 6 per cent in Indonesia and 5 per cent in South Africa will not be enough to meet the self-proclaimed target of halving the aggregate unemployment rate in these two countries.

38. Some of the Global Jobs Pact countries engaged in significant countercyclical policies, entailing expansionary monetary policy and implementation of fiscal stimulus packages. Most notable are the cases of South Africa, which had a fiscal stimulus package worth 4.03 per cent of GDP, and Indonesia which had a fiscal stimulus package worth 1.4 per cent of GDP. [15] South Africa devoted 55.7 per cent of its fiscal stimulus package to social protection measures, but Indonesia committed only 8.8 per cent. Both countries also placed a good deal of emphasis on public investment in infrastructure as part of their countercyclical interventions. [16]

39. The other countries were constrained by their fiscal circumstances in implementing any significant expansionary fiscal policy. In the case of Mongolia, its fiscal and external positions deteriorated so much that it agreed to a cut in public expenditure equivalent to 5 per cent of GDP under an IMF lending arrangement in April 2009. In the case of Bulgaria, there is little room to move, given its lack of fiscal and policy space, while El Salvador developed an anti-crisis plan equivalent to 17 per cent of public expenditure. [17] Jordan focused on easing credit constraints and tax cuts to all sectors.

40. Extensive evaluations of crisis mitigation policies in 54 countries, with particular emphasis on employment and social protection policies, have been made by the ILO and included in documents submitted to the G20. [18]

Prospects for job-rich economic recovery in the medium term: The role of a pro-employment macroeconomic framework

41. Measured by growth rates, Global Jobs Pact economies have entered a recovery phase, although at different speeds. However, the labour market situation in all economies combines elements of pre-existing decent work deficits with deterioration, quite severe in some cases, brought about by the crisis. The crisis has reminded policy-makers of the close links between macroeconomic frameworks and employment and social outcomes.

[15] Y. Zhang et al.: *Social protection in fiscal stimulus packages: Some evidence* (New York, UNDP/ODS Working Paper, 3 Mar. 2010).

[16] ibid.

[17] El Salvador was, however, successful in mobilizing substantial external resources from the Bretton Woods institutions.

[18] ILO: *Protecting people, promoting jobs: From crisis response to recovery and sustainable growth*, Communication to G20 Leaders by the ILO Director-General, Pittsburgh Summit, 24–25 September 2009. ILO: *Employment and social protection policies from crisis to recovery and beyond: A review of experience*, An ILO report to the G20 Labour and Employment Ministers Meeting, Washington, DC, 20–21 April, 2010. ILO: *Accelerating job-rich recovery in G20 countries: Building on experience*, op. cit.

42. Thus, an important issue for all countries is how to develop a medium-term macroeconomic policy approach that can promote and consolidate job-rich economic recovery. To tackle this issue, the next section briefly reviews the main elements of the macroeconomic rethinking under way. Following this, current macroeconomic policy developments in the selected Global Jobs Pact countries are reviewed. This sets the context for suggesting the elements of a framework that has the potential to support job-rich economic recovery in the medium term more effectively. These are issues that should be subject to more detailed research and social dialogue in the countries concerned.

Main elements in the ongoing rethinking of macroeconomic policies

43. The conventional pre-crisis macroeconomic policy paradigm emphasized the importance of macroeconomic stability, and the practice was based on measuring and targeting three basic indicators: inflation, fiscal deficits and debt-to-GDP ratios. Financial and economic programming fixes targets for these three fundamental variables, and monetary, fiscal and exchange-rate policies are oriented towards reaching these targets. In this framework, growth and employment considerations are not totally absent, but are often subordinated to macroeconomic stability objectives under the view that macroeconomic stability is an essential precondition for growth and investment. The logic is that the price mechanism works best when prices are stable, and when the price mechanism is working well, resources will be efficiently allocated and fully employed. Improving the supply side of the economy in this way should be the main focus of macroeconomic policy.

44. Experience has shown that "sound and stable macroeconomic policy and good management of the economy" is indeed a key element of the enabling environment for sustainable enterprises and for growth of output and employment, and that "monetary, fiscal and exchange rate policies should guarantee stable and predictable economic conditions". [19] Creating conditions for the price mechanism to work well is important. However, the crisis has generated a revisiting of these general propositions at two levels. At one level economists, led by Oliver Blanchard and his colleagues at the IMF, have been revisiting the appropriate levels of the targets for inflation, fiscal deficit and debt-to-GDP ratios, to accommodate more room for growth, employment and social protection policies. At another level, recession and deflation have revived interest in countercyclical policies.

[19] ILO: *Conclusions concerning the promotion of sustainable enterprises*, International Labour Conference, 96th Session, Geneva, 2007, para. 11(6).

45. More specifically, the following issues are being subject to revision and debate:

- The available evidence shows that focusing on "one-size-fits-all" thresholds pertaining to inflation, debts and deficits has not yielded the growth dividends that were expected. [20] A debate led by Olivier Blanchard and colleagues at the IMF has opened on the appropriate levels of the targets for these variables in general and in different country contexts. [21] Blanchard et al. have suggested the need for higher inflation targets. [22]

- One-size-fits-all targets were discarded with the pragmatic imperative during the crisis of putting in place countercyclical fiscal and monetary policies in very diverse contexts. Post-crisis, the question is whether there is a need for countries to go back to a common set of targets, whether these targets should be the same for developing and developed countries, and the different speeds of convergence.

- The emphasis on using monetary policy to attain predetermined inflation targets is an appropriate approach when inflation is driven by excess demand, but much less so when temporary inflation surges occur due to supply-side shocks – which happened during the late 2000s as a result of the sharp increase in fuel and energy prices. [23]

- Inflation targeting creates incentives for policy-makers to restrain imported inflation by using the exchange rate as a nominal anchor. This, combined with unrestrained capital inflows, imparts a bias in favour of real exchange rate appreciation which damages export competitiveness.

- Instead of targeting only financial variables and considering real variables such as growth and employment as residuals, an appropriate macroeconomic framework should also explicitly target output, employment and levels of social investment, and explicitly consider the trade-offs with the financial thresholds. In other words, a pro-employment macroeconomic framework should introduce multiple targets. [24]

[20] P. Montiel and L. Serven: "Macroeconomic Stability in Developing Countries: How Much Is Enough?" in *World Bank Research Observer*, Vol. 21, Issue 2, (Oxford University Press, 2006), pp. 151–178; International Institute for Labour Studies: *The World of Work 2010: From one crisis to the next?* (Geneva, ILO, 2010), Chapter 3.

[21] Setting inflation targets significantly below 11 per cent might even retard growth, presumably because of restraints on the growth of aggregate demand. See S. Khan and A.S. Senhadji: "Threshold Effects in the Relation between Inflation and Growth" in *IMF Staff Papers*, Vol. 48, No. 1 (IMF, 2001), pp. 1–21. The growth-retarding effects of public debt-to-GDP ratio occurs at 85–90 per cent according to one study (Reinhart and Rogoff, 2009), but the validity of even that threshold has been questioned by more recent research (Bivens and Turner, 2010). See C.M. Reinhart and K. Rogoff: *This Time is Different: Eight Centuries of Financial Folly*, (Princeton University Press, 2009); J. Bivens and A. Turner: *Putting Public Debt in Context: Historical and International Comparisons*, Economic Policy Institute Briefing Paper No. 272 (Washington, DC, 2010).

[22] O. Blanchard, G. Dell'Ariccia and P. Mauro: *Rethinking Macroeconomic Policy*, IMF Staff Position Note (SPN/10/03), IMF Research Department, 2010.

[23] Cost-push factors can often significantly influence spikes in the inflation rate, even in the case of Bulgaria and Mongolia where excess domestic demand played a role.

[24] M. Muqtada: *The crisis of orthodox macroeconomic policy: The case for a renewed commitment to full employment*, Employment Working Paper No. 53 (Geneva, ILO Employment Sector, 2010).

- Aggregate demand management can be influenced by expansionary or countercyclical fiscal and monetary policies, but also by incomes and wages policies, and policies that affect the level of private and public investment, as well as exports. All of these are key drivers of aggregate demand. An employment-friendly macroeconomic framework for strong, sustainable and balanced growth should also incorporate these kinds of issues. [25]

Macroeconomic policy developments in selected Global Jobs Pact countries: A brief overview

46. Against the background of this rethinking, this section offers a brief overview of the current macroeconomic frameworks in the Global Jobs Pact countries, with an emphasis on the fiscal, monetary and exchange rate regimes. There is ongoing work in the context of the Global Jobs Pact country scans, and the inventory of crisis and recovery policy responses, to assess the employment and social policy dimensions, which are not the main focus of this paper.

47. Table 5 provides a summary. There was a short-lived phase of expansionary fiscal and monetary policies in the wake of the global recession of 2008–09 in some of the Global Jobs Pact countries, but in 2010 and beyond, all countries seem to be set for a tightening phase. In some cases (as in Bulgaria, El Salvador, Jordan and Mongolia), a programme of substantial fiscal consolidation is under way. This post-crisis tightening phase is driven by the need to meet inflation targets (usually less than 6 per cent) and respond to debt sustainability concerns magnified by the impact of the recession on public finances. Debt sustainability in turn is derived from thresholds pertaining to public debt-to-GDP ratios (usually set at 50 to 60 per cent, with the notable exception of Indonesia which is aiming to maintain a public debt-to-GDP ratio of less than 30 per cent).

48. In some countries the macroeconomic targets have been subject to national debate and concerns have been expressed regarding the degree to which they might unduly restrict the policy and fiscal space to promote recovery. For example, in South Africa, the ILO's social partners are engaged in a debate on the efficacy of the inflation-targeting regime. [26] In El Salvador there has been a lively discourse on the benefits and costs of official dollarization. [27]

49. In the area of exchange rate regimes, which are an important element of the enabling environment for sustainable enterprises through their impacts on export competitiveness, some countries – most notably Bulgaria, El Salvador and Jordan – have institutional arrangements (currency board, official dollarization, a fixed peg to the US dollar) that do not allow exchange rate flexibility. Even those countries that operate a flexible exchange rate regime (such as Indonesia, Mongolia and South Africa) have sought to use the exchange rate to restrain imported inflation and thus stabilize inflation expectations. An open approach to capital account management is the norm in all the Global Jobs Pact countries, although the South African Government has actively discouraged domestic firms from engaging in liability dollarization. Current estimates of real exchange appreciation for

[25] ILO–IMF: *The challenges of growth, employment and social cohesion*, discussion document, Joint ILO–IMF conference in cooperation with the Office of the Prime Minister of Norway (2010).

[26] IMF: *South Africa: Staff Report for the 2009 Article IV Consultation,* IMF Country Report No. 09/273, Sep. 2009, para. 21.

[27] O. Monzón de León: "Debate sobre la dolarización en El Salvador" in *Noticias y Crónicas*, 29 Apr. 2010. Available at http://lavanguardiaelsalvador.wordpress.com/2010/04/29/debate-sobre-la-dolarizacion-en-el-salvador/.

the countries under review range from 6 to 26 per cent. Such real exchange rate appreciation undermines international competitiveness, growth and employment prospects, and is the object of national policy debates in some countries.

Table 5. Current macroeconomic framework in selected Global Jobs Pact countries

Country	Monetary policy and inflation targeting	Fiscal policy and debt sustainability	Exchange rate regimes and capital account management
Bulgaria	– Currency board operating since 1997 with the presumption that it would contain inflation. But during the high-growth era of the 2000s, inflation reached double digit figures in mid-2008 reflecting a combination of supply-side shocks and rapid domestic demand growth. – Economy badly hit by the crisis and inflation rate dropped to 1 per cent by 2009.	– Fiscal surplus averaged 2.8 per cent of GDP in the 2004–08 period and public debt-to-GDP ratio reached 16 per cent by the end of 2009. – Yet high external indebtedness by the private sector reached in excess of 100 per cent of GDP. – A major fiscal consolidation programme is now under way. Target is cash deficit of 0.7 per cent of GDP which has not been reached.	– Fixed exchange rate regime as a by-product of the currency board arrangement and as preparation for Euro area membership. – During the high-growth era of the 2000s, short-term capital flows amounted to 34 per cent of GDP. Current account widened to more than 20 per cent of GDP, but reversal since then. – Measures of real exchange rate demonstrate sharp appreciation ranging between 16–26 per cent in the boom period.
El Salvador	– Official dollarization since 2001. Precludes use of discretionary monetary policy. – Domestic inflation rate linked to US inflation rate, although there was a spike in the inflation rate in late 2000s due to supply-side shocks.	– Aim is to reduce fiscal deficit as proportion of GDP to 1.5 by 2015 from 5.3 per cent in 2009. – Debt-to-GDP ratio expected to stabilize below 50 per cent. – Tighter fiscal envelope to be combined with redirection of public expenditure to social programmes and infrastructure.	– Official dollarization. Precludes exchange rate flexibility. – Highly integrated with the US economy and sensitive to its business cycle. – Real exchange rate appreciation when the US dollar rose in value against other major currencies in 2008–09.
Indonesia	– Committed to an inflation target of 4–6 per cent. – Monetary policy tightening to cope with inflationary spike due to fuel and energy price boom in late 2000s. – An expansionary phase to cope with crisis and a tightening phase now under way to meet inflation target.	– Expansionary fiscal policy to cope with crisis, but since then, cautious fiscal policy with a deficit-to-GDP ratio of 2 per cent. – Low debt-to-GDP ratio (below 30 per cent). Authorities committed to bring it down even lower in the medium term.	– Operates flexible exchange rate regime, but seeks to use exchange rate as nominal anchor. – Bias towards real exchange rate appreciation. No major restrictions on capital account.
Jordan	– Inflation surged to double-digit figures (14 per cent) due to food and energy price shock of the 2000s, but in post-crisis period came down to near zero. – Monetary easing in 2009–10 to cope with crisis. – IMF staff assessment is now that monetary policy should be proactive and contain inflationary pressures. – Current inflation around 5 per cent.	– Legislated ceiling of 60 per cent public debt-to-GDP ratio. – Substantial fiscal consolidation planned. Aim is to bring down fiscal deficit, currently at 6 per cent of GDP, to 3 per cent of GDP over medium term. – Expectation that the 3 per cent target will stabilize debt-to-GDP ratio at 53 per cent	– Current account developments seem to be driven mainly by swings in commodity prices, widening sharply to 9.5 per cent of GDP, but declining to 6 per cent since then. – Local currency fixed to US dollar and regarded in IMF staff assessments as playing an “indispensable role in anchoring inflation expectations”. – No major restrictions on capital account.

Country	Monetary policy and inflation targeting	Fiscal policy and debt sustainability	Exchange rate regimes and capital account management
Mongolia	– Expansionary monetary policy in the pre-crisis phase. – Poised for a tightening phase during the course of 2010 to cope with inflationary pressures, although such pressures are partly driven by cost-push factors. – Eventual move to explicit inflation targeting.	– Aiming for fiscal adjustment to the order of 5 per cent of GDP in 2011 after an expansionary phase in the pre-crisis period. – Making the transition to means-tested social transfers. – Poised to adopt a fiscal sustainability framework with legislated limits on debts and deficits.	– Flexible exchange rate regime, but evidence of significant real exchange rate appreciation (26 per cent). – No major restrictions on capital account.
South Africa	– Committed to an inflation target of 3–6 per cent. – Monetary policy tightening to cope with inflationary spike due to fuel and energy price boom in late 2000s. – An expansionary phase to cope with crisis and a tightening phase now under way to meet inflation target.	– The authorities intend to run a cautious fiscal policy consistent with the commitment to take pre-emptive action well before the debt-to-GDP ratio reaches 50 per cent. – Accepts IMF staff assessment that South Africa faces medium-term fiscal risks and needs to moderate spending growth.	– Flexible exchange rate regime, but evidence of real exchange rate appreciation (6–16 per cent). – No major restrictions on capital account, but safeguards against liability dollarization.

Sources: Country briefs prepared by ILO; IMF latest (2009–10) article IV consultations, available at http://www.imf.org/external/country/index.htm.

Towards a pro-employment macroeconomic framework: Some recommendations

50. A key point in the present debates is whether incremental changes, rather than a radical overhaul to the standard macroeconomic framework, are sufficient and adequate to align current policies with existing labour market and employment challenges. Even incremental changes will take time to evolve and will require that countries have the political will to engage in policy experimentation. This section summarizes the elements of a macroeconomic framework that has potential to support job-rich economic recovery in the medium term more effectively in the countries under review. These are issues that should be subject to more detailed research and social dialogue in the countries concerned.

51. In the area of monetary policy and inflation targeting, policy-makers in the Global Jobs Pact countries might wish to adopt a more flexible approach and focus on broader goals and objectives. As the Director-General of the ILO observes: "Job creation must be a targeted goal for governments alongside low inflation, sound fiscal policies and other macroeconomic objectives." [28] It is worth resurrecting the original intent and spirit of the IMF's article IV consultations, which called on member States to attain "reasonable price stability" within a framework of growth-promoting policies. The precise interpretation of what is reasonable price stability should be tailored to country-specific circumstances in order to avoid a "one-size-fits-all" target.

52. Attempts to curb cost-push inflation through restrictive monetary policies should also be avoided, because they are usually ineffective in taming inflation and, by raising the cost of borrowing, undermine investment and growth prospects.

[28] J. Somavia: "G20 and the real economy: What's at stake", Statements 2010, ILO, 25 June 2010. Available at http://www.ilo.org/public/english/bureau/dgo/speeches/somavia/2010/opedg20.pdf.

53. Central banks should seek to promote financial inclusion and serve the needs of the real economy without forsaking their obligation of prudence and their role in safeguarding price stability. Enhancing financial inclusion implies: (1) increasing access to finance for the private sector, especially small and medium-sized enterprises; (2) encouraging the development of efficient microfinance institutions (MFIs) that can respond to the financing needs of poor and vulnerable households who seek durable self-employment.

54. With the exception of South Africa, lack of access to finance is cited by enterprises in all the countries under review as the most important constraint on business operations and their employment-creating potential. [29]

55. Of the countries reviewed, only Jordan has one world-class MFI based on the Forbes list of the world's top 50 MFIs. [30]

56. In the area of fiscal policy and debt sustainability, there should be regular and rigorous assessments of "resource gaps" between what is needed and what is provided. Two key international development goals might be used as a guide to determine spending needs at the national level. These are: (1) public investment in health, education and infrastructure to attain the MDGs within an accelerated framework; (2) the Social Protection Floor Initiative which includes conditional cash transfers (CCTs) and employment guarantee schemes (EGS). Of course, social protection measures should not be limited to CCTs and EGS. A comprehensive and properly functioning social protection system is best seen as an approach that draws on a combination of "active" and "passive measures" to sustain both domestic living standards and economic security by acting as automatic stabilizers to temper the consequences of business cycles.

57. The available evidence shows that there has been a decline in public investment in developing and emerging economies since the mid-1980s (and in some cases earlier), despite the fact that such investment makes a significant contribution to growth and employment. [31] In South Africa, for example, public investment in infrastructure on a per capita basis fell by 72 per cent between 1976 and 2002. [32] In light of these considerations, the Commission on Growth and Development suggests public investment rate of around 7 per cent of GDP in infrastructure is needed as an important element of a national development strategy. [33] Yet the data suggest that barely 2 to 3 per cent of GDP is invested

[29] This is based on the World Bank "Enterprise Surveys" which now cover more than 100,000 enterprises in 118 countries. An average of 25 per cent of enterprises surveyed in the Global Jobs Pact countries cite lack of access as the most important constraint on business operations. The results can be generated by using a "do your own analysis" instrument available at www.enterprisesurveys.org.

[30] This list is available at www.forbes.com/2007/12/20/microfinance-philanthropy-credit-biz-cz_ms_1220microfinance_table.html. The MFI in Jordan is ranked at No. 45.

[31] S. Arslanalp et al.: *Public Capital and Growth*, IMF Working Paper No. 175, (IMF Fiscal Affairs Department, 2010).

[32] P. Perkins et al.: "An Analysis of Economic Infrastructure Investment in South Africa" in *South African Journal of Economics*, Vol. 73, Issue 2, (Economic Society of South Africa, 2005), pp. 211–228.

[33] Commission on Growth and Development: *The Growth Report: Strategies for sustained growth and inclusive development* (Washington, DC, World Bank, 2008), pp. 33–35. Available at www.growthcommission.org.

in infrastructure in many developing countries and emerging economies, including the Global Jobs Pact countries. [34]

58. The available evidence assembled by the ILO suggests that barely 25 per cent of the population in developing and emerging economies have access to social protection. Some of the countries examined here, such as Indonesia, allocate resources to social protection that are well below regional norms.

59. Current and proposed initiatives in some Global Jobs Pact countries to promote employment opportunities for the poor and vulnerable seem inadequate to meet the aspirations of the Social Protection Floor Initiative. For example, in South Africa the expanded public works programme is currently designed to meet the needs of about 9 per cent of the poor and vulnerable segments of the population. [35]

60. The role of fiscal policy is to bridge the resource gaps by seeking to mobilize domestic and external resources within a framework of fiscal sustainability to support the international development goals. Improving budgetary execution and raising the tax-to-GDP ratio in countries with a low tax burden – such as Indonesia and El Salvador – are core planks of a resource mobilization strategy. This can be complemented by other initiatives, such as public–private partnerships.

61. Domestic resource mobilization needs to be supported by enhanced development assistance from donors. Hence, maintaining aid commitments, and exploring feasible options for identifying alternative sources of reliable and low-cost development finance to supplement traditional sources, are important elements of a pro-employment macroeconomic framework.

62. In the sphere of exchange rate regimes and capital account management, the aim should be the adoption of institutional arrangements that sustain real exchange stability, given the evidence that the real exchange rate exerts a powerful influence on structural transformation. [36]

63. Unrestrained capital flows can be destabilizing, especially in cases of developing economies. Under certain circumstances they lead to real exchange rate volatility that is destructive of strong, sustainable and balanced growth. Hence, a more prudent approach to

[34] Commission on Growth and Development, op. cit.

[35] The current expanded public works programme will cover 1 million poor people over four years, but there are 11.6 million marginalized people (unemployed, underemployed and discouraged workers). South African Presidency: *Second Economy Strategy: Addressing Inequality and Economic Marginalisation. A Strategic Framework*, Jan. 2009, p. 2.

[36] See G. Epstein and E. Yelden: *Inflation Targeting, Employment Creation and Economic Development*, G-24 Policy Brief No. 14, 2009; J.A. Frankel: "What's In and Out in Global Money" in *Finance and Development*, Sept. 2010; R. Frenkel and M. Rapetti: *A Concise History of Exchange Rate Regimes in Latin America*, (Washington, DC, Center for Economic and Poverty Research, 2010); UNCTAD: *Global monetary chaos: Systemic failures need bold multilateral responses*, Policy Briefs No. 12, Mar. 2010. D. Rodrik, *The Real Exchange Rate and Economic Growth*, Brooking Papers on Economic Activity, (Cambridge, Harvard University, 2008), provides cross-country evidence on the impact of the real exchange rate on growth.

capital account management might be justified, as this opens up policy space for initiatives that create employment. [37]

64. Macroeconomic policy needs to be part of a holistic development strategy that seeks to promote economic diversification through the use of appropriate industry and trade policies. This means striking the right balance between promoting efficient domestic industries and responding to the pressures of international competition. [38] Such industry and trade policies, which includes the creation of "green jobs" to cope with climate change, [39] is necessary to sustain productivity-driven increases in real wages that are at the core of improving the living standards of workers and their families. This will require an emphasis on skills, training labour mobility and employability to support a process of structural transformation.

65. All the countries under review recognize the challenge of using appropriate industry and trade policies to promote economic diversification. In the case of Jordan, for example, the stated ambition of the country is to expand the manufacturing and export base beyond the apparel industry that has failed to attract Jordanian workers. In the case of Indonesia, moving away from its heavy reliance on commodity exports is a major policy issue. In Mongolia, the primary challenge is the gradual transformation of the economy, currently heavily dependent on the mining sector, to a human-resource-based economy. In El Salvador, diversifying into a broader network of trading partners and breaking out of the low wage–low productivity equilibrium is the key national aspiration. In the case of South Africa, the National Framework Agreement of 19 February 2009 clearly suggests the emergence of a "developmental" approach to economic management that is now reflected in a comprehensive industrial policy unveiled in February 2010. In Bulgaria, the pre-crisis model of short capital flows that drove growth through an asset price bubble in the non-tradable sector is no longer seen as a viable strategy. In light of considerably constrained fiscal and policy space, supporting both domestic and external demand will require a wage–productivity compact that could boost purchasing power without compromising on competitiveness.

66. In general, policy-makers in the Global Jobs Pact countries might wish to consider the "construction of a framework of labour market institutions which help produce wage outcomes that, from a macroeconomic perspective, are conducive to maintaining aggregate demand and sustainable growth …". [40] This issue has gained a great deal of salience because declining wage share and rising wage inequality in the pre-crisis period in many developed and developing countries have contributed to global imbalances that were at the core of the global financial crisis of 2007–08.

[37] J.D. Ostry et al.: *Capital Inflows: The Role of Controls*, IMF Staff Position Note (SPN/10/04), 19 Feb. 2010.

[38] A carefully articulated case for industry and trade policies can be found in D. Rodrik: *Normalizing Industry Policy*, Working Paper No. 3, (Washington, DC, Commission on Growth and Development, 2008). Rodrik reviews the cases of El Salvador, South Africa and Uruguay.

[39] See ILO: *Green jobs: Towards decent work in a sustainable*, *low-carbon world* (Geneva, 2008). This report – which is the first comprehensive study released by the ILO on the subject – shows that green jobs are being generated in many sectors and economies around the world as a consequence of measures to tackle climate change and to reduce emissions of greenhouse gases. The report highlights the fact that, unless current policy frameworks change, only a fraction of the potential benefits for jobs and development can be harnessed.

[40] ILO–IMF: *The challenges of growth, employment and social cohesion*, op. cit., p. 75.

67. The construction of labour market institutions that strikes the right balance between protecting workers' rights and promoting growth will need to ensure that "real wages in aggregate … grow more or less in line with productivity". [41] This will mean strengthening mechanisms for wage determination through reinvigorated minimum wages policies, social dialogue and collective bargaining at the enterprise and industry level, and tripartite consultations and negotiations on economic and social policies. Strengthening of the wage determination process along such lines is likely to confer multiple benefits: (a) preservation of international competitiveness; (b) sustaining aggregate demand by acting as a bulwark against declining wage share; and (c) sustaining reasonable price stability. It is worth emphasizing that cross-country evidence compiled by the ILO shows that increases in union density (from 15 per cent to over 50 per cent) can bring about a significant reduction in the incidence of low pay (from 24.6 per cent to 12.3 per cent). [42] Hence, appropriately designed labour market institutions that strengthen the process of collective bargaining can play a critical role in a pro-employment macroeconomic framework.

Geneva, 27 October 2010

Submitted for debate and guidance

[41] ILO–IMF: op.cit.

[42] See S. Lee, *In-work poverty: Low pay and poverty: What can be done?*, paper presented at the Joint ILO–UNDP Technical Meeting on Employment, the Crisis and MDG acceleration, Geneva, 30 September–1 October 2010. The presentation draws on findings that will be reported in the Global Wages Report 2010/11.