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Trade, employment and development: Back on track?

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In today's world of increased economic and political interdependence achieving a broad-based, rapid and sustained growth in incomes and employment involves even more complex policy challenges than in the past. This was the case before the recent crisis, but it is even more so as policy makers in both developed and developing countries look for ways to mitigate the damage from that crisis and build a more sustainable recovery.

The International Labour Organisation (ILO) worries that the kind of integrated policy framework and the accompanying degree of policy coherence required to respond effectively to the crisis within and across countries is still not in place. In particular, the kind of mutually supporting links between macroeconomic policies, social protection systems and active labour market measures are still not established to ensure both an inclusive (job-rich) recovery and to realize the Millennium Development Goals (MDGs) within an acceptable time frame.

This worry is very much shared by United Nations Conference on Trade and Development (UNCTAD). Indeed, when the development agenda is expanded beyond the MDGs to include the traditional issues of catch-up productivity growth, economic diversification and technological upgrading, then our worries tend to be amplified.

At the G20 and other meetings, like the recent one in Oslo co-hosted by the ILO and the International Monetary Fund (IMF), there have been signs that the stranglehold on policy design by the financial institutions has begun to loosen. There have been some important steps away from policy orthodoxy, particularly by the IMF, on issues such as inflation targeting, capital controls and countercyclical policy measures.

These are welcome developments but at the end of the day actions speak louder than words. The kind of programmes put together by the Washington institutions since the crisis have continued to carry much of the damaging policy baggage of the recent past, particularly with respect to procyclical adjustments and targets and squeezing public investment programmes, including in Least Developed Countries (LDCs).

Despite the recognition that the growth in global interdependence poses greater problems today, the mechanisms and institutions put in place over the past three decades have not only fallen short on surveillance and the policy coordination challenge but have in many respects contributed to the dissonance and tensions that eventually culminated in the financial crisis that hit in 2008. The failure to make reforms now runs the very serious risk of retuning to "business as usual" and the danger of repeating the boom bust cycles of the recent past.

The kind of institutional changes needed for financial stability - and the "global public good" which the IMF promises to deliver - have made little headway in recent discussions. These include larger, more predictable and less conditioned flows of development finance; adequate international liquidity to support countercyclical macroeconomic policymaking at the domestic level; the management, through some kind of orderly workout mechanism, of sovereign debt crises; a stable exchange rate system; and more representative form of international governance (though small steps have recently been agreed on this).

The problem in achieving progress on these fronts has in one sense not been too little coherence but too much; namely an almost blind faith, particularly at the international level, in freely functioning markets to generate prosperity and stability at the national, regional and global levels.

That is a debate which has not closed though there is a good deal more realism than a few years ago). But what seems not open to question is the fact that by focusing exclusively on a narrow definition of fundamentals (efficient markets, rational expectations, balanced budgets, price stability, and so on) the Washington institutions have consistently missed every single one of the major economic crises that have occurred over the past 25 years, from the savings and loans collapse in the US in the late 1980s, through the Asian financial crisis of 1997, to the subprime meltdown and the collapse of the Icelandic economy in 2008.

These institutions have also missed (or worse neglected) one of the most persistent trends in the global economy over the past three decades, namely the massive increase in income inequality which has occurred, albeit to varying degrees, in almost all countries. This trend is closely linked to the rise of unregulated financial markets and institutions, a trend strongly promoted by these same institutions, and which is the characteristic feature of globalization in our era. This is certainly one of the reasons why rising inequality has been accompanied by such a volatile mixture of shocks, imbalances, asset cycles and generally substandard economic performance.

The key imbalances in this regard are, on the one hand, the falling wage share and the rising level of household indebtedness and, on the other, the rising profit share and the declining (or stagnant) levels of productive investment. Failure to address these imbalances has made for a weak and uneven recovery and a persistent state of labour market distress even when growth has picked up.

These are trends which UNCTAD also identified in its latest Trade and Development Report as lying behind the jobs crisis in many developing countries even prior to the recent crisis.

Unsatisfactory labour market outcomes, in developing countries as much as developed countries, are also due to unfavourable macroeconomic conditions that inhibit investment and productivity growth, along with inadequate wage growth which continues to repress domestic demand. External demand can compensate up to a point but there are dangers with this strategy which can reinforce wage repression and limit capital formation.

The ILO argues that the rebalancing of labour market conditions will require improving wage determination mechanisms; measures to promote productivity growth; and the narrowing of income inequalities. This is very much supported by UNCTAD's analysis. We would also put a very strong emphasis on strategies to enhance domestic demand as an engine of employment creation. The mixture of employment friendly monetary, financial and fiscal policies will have to be tailored to particular local conditions and constraints. Industrial policies will also need to be added to the policy mix; this is already happening in a number of middle-income developing countries

A critical role in moving to a jobs-rich development path must be ceded to a developmental state which aims to create and manage rents in line with the objectives of inclusive growth.

A key question for us is whether we have global arrangements capable of providing the financial and monetary stability to help these states pursue development strategies that sustain the expansion of employment and output and encourage the structural diversification that are necessary for their own long-term success and their effective insertion into the international trading system?

It should be clear to all by now that the question of stability and appropriate alignment of exchange rates (particularly among the G-3 currencies) remains unresolved, and large swings have posed a persistent threat to global financial stability, the international trading system, and to exchange-rate policy and other aspects of external financial management in developing countries. The daily volatility in these rates can often offset annual gains in domestic productivity and drastically alter international competitiveness. This problem has been recognized in recent discussions (though the language of "currency wars" is unhelpful and misleading) but ignored in current global arrangements which are based on a false dichotomy between trade and finance.

Moreover, the international division of labour is still greatly influenced by commercial policies which favour products and markets in which more advanced countries have a dominant position and a competitive edge. High tariffs, tariff escalation, and subsidies in agriculture and fisheries are applied extensively to products that offer the greatest potential for export diversification in developing countries. The panorama of protectionism is no better for industrial products including footwear, clothing and textiles where many developing countries have competitive advantages. The abuse of anti-dumping procedures and product standards against successful developing-country exporters creates further obstacles. Given the adjustment that developed countries will be required to take in the coming years, it is not difficult to imagine a worsening of this situation, unless these countries can make the appropriate expansionary responses which allow their citizens to adjust as living standards rise.

It is also widely believed that the existing arrangements do not allow sufficient policy space to developing countries to overcome their longer-term payments constraint by pursuing targeted trade, industrial and technology policies and thus increasing their export capacity in more dynamic sectors. There are increasing concerns that persistent policy orthodoxy and global arrangements have the result of kicking away the ladder by which today's advanced countries attained their present levels of economic development, denying developing countries many of the policy instruments that were widely and successfully used in the past.

The need for a more effective multilateral trade and financial system cannot be ignored; indeed developing countries continue to have a stake in building such a system. Controlling finance remains the place to begin this task as it was back in the 1945. As Keynes noted at that time: "It is very difficult while you have monetary chaos to have order of any kind in other directions… "

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