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Circumventing macroeconomic conservatism: A policy framework for growth, employment and poverty reduction[1]

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Macroeconomic policy, as currently understood and practised in many developing countries, is mired in a "stabilization trap". It seems to be preoccupied with stability at the expense of growth and with fiscal and inflation targets at the expense of employment.[2] As Vines notes, "theoretical developments and the ideological climate in industrial countries influence policy advice given to developing countries" (2001, p. 137). The notion that there is a universally agreed set of ideas in policy-making was advanced by Williamson (1994, 1999) and termed the "Washington Consensus", according to which fiscal prudence was ranked first among ten core propositions,[3] but where no reference was made to full employment as a leading objective. Other noted economists dispensed rather similar advice to developing country policy-makers, preaching the virtues of low inflation targets, fiscal discipline, and tight money (Dornbusch, 1993; Fischer, 1993; Harberger, 1984).

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[1] This is an abridged and revised version of a paper produced for the Employment Strategy Department of the ILO, Geneva.

[2] The conservative nature of macroeconomics as applied to developing countries is explored in McKinley (2001). See also Reich who argues that the current global economic climate is such that central bankers in the world's most powerful economies should eschew their preoccupation with low inflation and tight budgets and pursue expansionary fiscal and monetary policy to enhance employment (Reich, 2002, pp. 116-118).

[3] Other policy proposals in the Washington Consensus include reorientation of public expenditure towards basic health, infrastructure and education, tax reform, financial liberalization, unified and competitive exchange rates, openness to foreign investment, privatization, deregulation and secure property rights (or the rule of law). A comprehensive evaluation of the Washington Consensus is beyond the scope of this article given that it focuses on macroeconomic conservatism. For a critique of the Washington Consensus, see Beeson and Islam (2004).

The influence of global investors on policy-makers reinforces the bias in favour of fiscal and financial variables, at least in the context of developing economies (ADB, 1999). Orthodox macroeconomics also highlights the virtue of labour market flexibility rather than the importance of labour market institutions in dealing with the issue of the welfare of workers (Standing, 1999; van der Hoeven, 2000).[4]

This article argues that the empirical foundation of macroeconomic conservatism is fragile and that the intellectual momentum exists to develop a viable alternative to current orthodoxy. This would entail a renewed commitment to employment creation as a core goal of macroeconomic policy and creating "fiscal space" to sustain investments in infrastructure and human development. It would also entail an emphasis on comprehensive social protection to deal with economic insecurity engendered by macroeconomic volatility. There is a case for an inclusive approach to policy-making and for investing efforts in producing an enabling global environment to support pro-poor and employment-friendly national policy initiatives. In short, the article suggests a policy framework consistent with the substance and spirit of the ILO's Decent Work Agenda that emphasizes employment creation, comprehensive social protection and the strengthening of labour market institutions through social dialogue and protection of labour rights (ILO, 2001).

Macroeconomic policy, growth and poverty: Revisiting cross-country statistical analyses

Statistical analyses, entailing both descriptive methods and econometric techniques applied to large-scale cross-country data, have typically been employed by practitioners to argue the case for macroeconomic conservatism. Fischer (1993) was one of the first to induct macroeconomic policy variables in cross-country growth regressions and he concluded that low inflation and fiscal prudence contributed to faster growth. Others, such as Ian Little et al., seem more circumspect, noting that "… a country's macroeconomic policies can only explain a part, often a small part, of its economic performance" (1993, pp. 401-402). Such circumspection is supported by studies that find that moderate rates of inflation are not harmful to growth (Bruno and Easterly, 1995). Based on these and subsequent contributions to the literature that extended the cross-country approach to a study of the statistical determinants of global

[4] As Nobel Laureate Joseph Stiglitz (2002a, p. 13) put it: "[T]he mantra of … labour market flexibility [is] a thinly disguised attempt to roll back … gains that workers had achieved over years and years of bargaining and political activity."

poverty,[5] one can arrive at surprisingly eclectic conclusions that are contrary to the tenets of macroeconomic orthodoxy. Such eclectic conclusions are upheld by some new estimates presented here. They are generated from long-run data (1960 to 2000) across a large range of countries (93 for the 1960-79 period; 137 for the 1980-2000 period; and 126 for the 1970-2000 period) provided in the World Bank's *World Development Indicators 2002*.[6]

To start with, consider figures 1 and 2 that show that high inflation rates and large fiscal deficits do not represent the norm for either developed or developing economies, when seen from the perspective of long-run data. Admittedly, as figures 3 and 4 show, inflation in excess of 15 per cent or fiscal deficits in excess of 10 per cent of GDP are, for some periods at least (1980-2000), associated with negative growth. However, when these findings are seen in conjunction with those shown in figures 1 and 2, it seems that these outcomes represent macroeconomic extremes. For example, only a small number of countries are characterized by budget deficits in excess of 10 per cent of GDP (figure 2). The bulk of countries have budget deficits that range between 0 and 5 per cent of GDP.

This is an important point, because macroeconomic conservatism is essentially a parable on the misfortunes that await countries – thankfully not the majority – when they allow inflation to become excessive and the fiscal position to become untenable. Hence, current macroeconomic orthodoxy is an approach that relies on extreme examples to build its case. This conclusion is also strongly supported by a re-examination of the cross-country work in Easterly (2003), who shows that the robustness of the findings that standard policy variables (such as fiscal and trade policy) strongly influence growth, is driven largely by extreme observations. Easterly also makes the important point that, though macroeconomic profligacy can "kill" growth, it does not follow that merely following prudent macroeconomic policy will create it. The latter depends, he contends, on firmly established institutions.

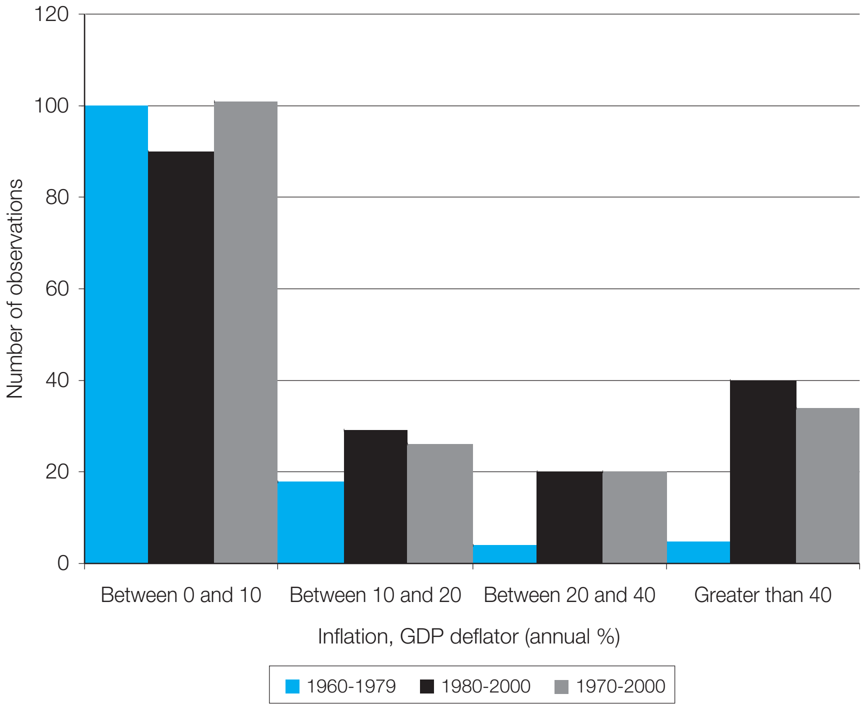
Another important implication of this discussion is that substantive disagreements and debates are likely to be about "intermediate cases". Is a 5 per cent budget deficit necessarily worse than a 3 per cent budget deficit? Is a 3 per cent inflation rate necessarily superior to a 6 per cent inflation rate? This is where dogmatic prescriptions are unlikely to be helpful.

Consider now table 1. Here, countries are grouped into good performers (represented by per capita growth in excess of 3 per cent per annum), intermediate performers (between 1 and 3 per cent per capita growth), and bad performers (less than 1 per cent per capita growth). The

[5] Examples include Ghura et al. (2002), Cashin et al. (2001), Mallick and Chowdhury (2002). Even Dollar and Kraay (2000), who are widely regarded to be supporters of the Washington Consensus, do not find a statistically significant relationship between inflation, fiscal prudence and poverty.

[6] Muqtada (2003) has conducted a similar exercise.

Figure 1. Distribution of countries by inflation rates, 1960-2000



Note on sample sizes: 93 countries for the 1960-79 period; 137 countries for the 1980-2000 period; and 126 countries for the 1970-2000 period.

Source: Derived from the World Bank (2002), available online at www.worldbank.org

inflation rate for the intermediate performers is a little above that for the good performers, but there is no meaningful difference in the fiscal position of the two groups. As expected, the bad performers are characterized by relatively high rates of inflation, but even here, the recorded fiscal deficit is not significantly worse than for other groups.

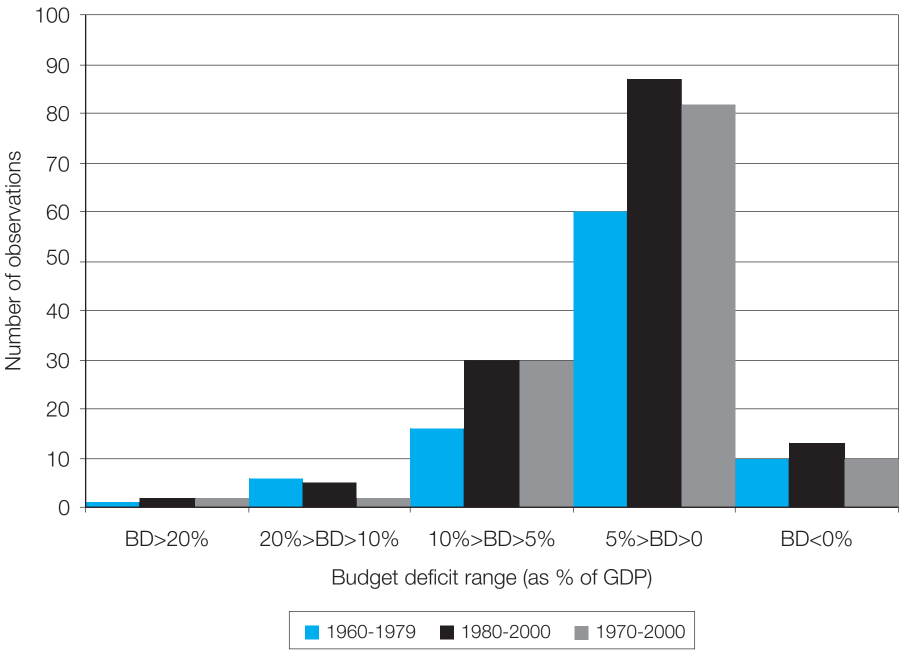
Table 1. Inflation, budget deficit and growth, 1960-2000

Performers	Inflation		Budget deficit		Median growth rate	
	1960-79	1980-2000	1960-79	1980-2000	1960-79	1980-2000
Good	6.13	5.8	–3.67	–2.65	4.61	3.87
Intermediate	7.35	7.96	–2.71	–2.56	2.83	1.56
Bad	7.38	21.49	–2.08	–3.81	1.05	–0.6

Note on sample sizes: 173 countries for 1960-79 period; 175 countries for 1980-2000 period. Countries classified into performance categories based on growth rates (good = above 3 per cent; intermediate = between 1 and 3 per cent; bad = under 1 per cent).

Source: as in figure 1.

Figure 2. Distribution of countries by budget deficit, 1960-2000



Source and note: as in figure 1.

The findings in table 1 can be supplemented by an attempt to find statistically significant negative relationships between inflation and growth, as well as between fiscal deficits and growth. This can be inferred from the cross-country regression reported below. There is a statistically significant relationship between inflation and growth, but not between fiscal deficits and growth.[7] The estimated size of the coefficient for the inflation variable is quite small.

$$\mathrm{PCGR} = \underset{(-1.32)}{-0.077} \; \underset{(-3.30)}{-0.007}\,\mathrm{INIY60} \; \underset{(-4.28)}{-0.005}\,\mathrm{INF} + \underset{(1.43)}{0.047}\,\mathrm{BD} + \underset{(6.11)}{0.14}\,\mathrm{INV}$$

Note that:

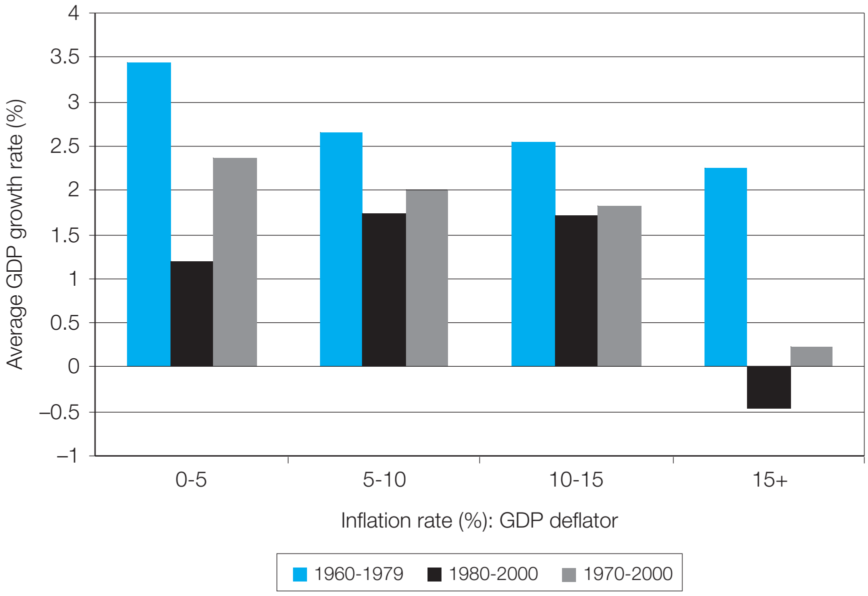
Adjusted R-square = 0.336

T-ratios (in parentheses)

Number of observations = 141

[7] Note that in the reported regression equation, inflation denoted by INF and the budget deficit denoted by BD could be correlated, giving rise to multicollinearity problems. In that case, the statistical insignificance of the coefficient of BD needs to be treated with caution. However, the results reported in this study are consistent with the findings of other cross-country studies.

Figure 3. Inflation and per capita growth rate, 1960-2000



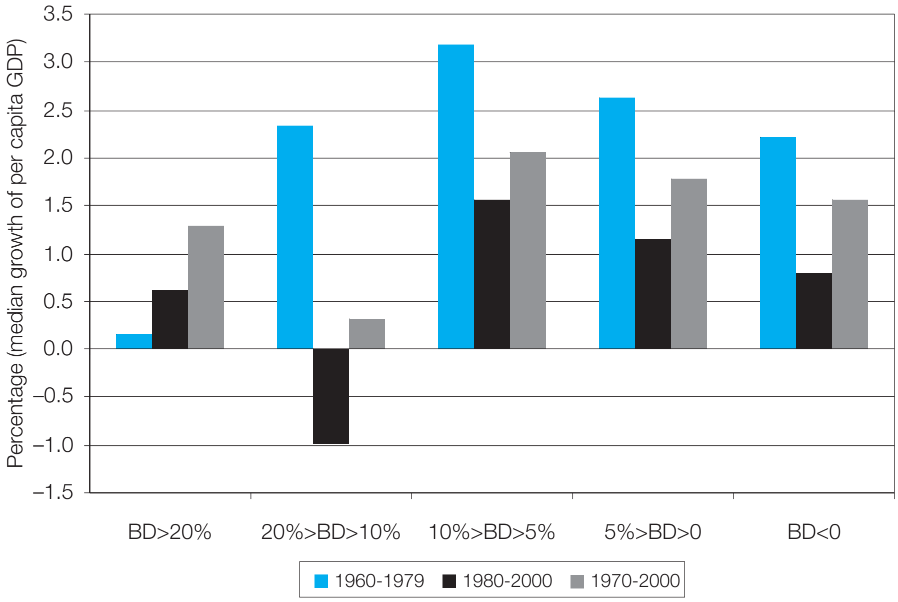
Source and note: as in figure 1.

Time period = 1960-2000
PCGR = per capita growth rate
INIY60 = real income in 1960
INF = GDP deflator
BD = Budget deficit (including grants) as % of GDP
INV = gross investment as % of GDP.

The cross-country regression also highlights the important point that investment matters for growth and can easily offset the negative impact of inflation on growth (given that the size of the estimated coefficient is significantly larger than the one for inflation).[8] An important study by Ian Little et al. (1993) maintains that macroeconomic policy influences growth through the investment channel, and this may well be a more direct way of exploring the macroeconomic policy-growth linkage than either the government's fiscal position or a given inflation rate. Volatility in GDP impairs the investment climate by creating uncertainty and leads to volatility in investment. Furthermore, countries with

[8] In a classic contribution to cross-country growth regressions, Levine and Renelt (1992) highlighted the role of investment in explaining cross-country growth.

Figure 4. Budget deficits and median growth of per capita GDP, 1960-2000



Source and note: as in figure 1.

mediocre growth suffer from both low investment ratios and low productivity of investment, particularly because of poor project selection in the public sector and the uncertainty created by a volatile macroeconomic environment.

These propositions are illustrated in table 2. Once again, countries are grouped into good performers (growth in excess of 3 per cent per annum), intermediate performers (growth between 1 and 3 per cent) and bad performers (growth of less than 1 per cent). For the 1960-2000 period, the bad performers had low investment ratios, high volatility of investment (as measured by the coefficient of variation) and negative productivity of investment (defined here as investment ratio adjusted by the growth rate), compared with the good performers.

Table 3 documents the statistical associations between poverty (based on international poverty lines), per capita income, inflation, budget deficits and inequality. No statistically significant link exists between poverty and inflation; nor does such a link exist between poverty and a government's fiscal position. The key determinants of poverty are the level of per capita income, the rate of growth of per capita income and inequality – findings that are well-known in the literature and highlight the importance of equitable growth, rather than fiscal and nominal variables, in poverty reduction.

Table 2. Investment and growth, cross-country patterns, 1960-2000

Performers	Median growth	Investment ratio	Investment productivity	Coefficient of variation of investment
Good	4.0	24.84	0.15	0.18
Intermediate	2.1	20.52	0.1	0.21
Bad	–0.18	19.86	–0.01	0.27

Note on sample sizes: 173 countries for 1960-79 period; 175 countries for 1980-2000 period. Countries classified into performance categories based on per capita growth rates (good = above 3 per cent; intermediate = between 1 and 3 per cent; bad = under 1 per cent).

Source: as in figure 1.

Table 3. Poverty and macroeconomic policy variables, some cross-country regressions (1980s and 1990s)

Dependent variables	Poverty ($1 a day)				Poverty ($2 a day)			
	I	II	III	IV	I	II	III	IV
Per capita Income†				–0.01* (2.42)*				–0.01* (–5.98)*
Per capita growth†	–3.98* (–3.32*)				–3.43* (–2.10)*			
Inequality (Gini coefficient)†				0.630* (–4.71)*				0.17 (0.57)
Inflation (GDP deflator)†		–0.02 (–0.99)				–0.33 (–1.27)		
Budget deficit/surplus (including grants) (% of GDP)†			–0.85 (–1.12)				–1.45 (–1.39)	
Adjusted R-square	0.14*	0.01	0.05	0.29*	0.05*	0.01	0.02	0.39*
Number of observations	60*	60	60	55*	60*	60	49	55*

Sources and notes: Estimates based on OLS method and applied to long-run data compiled from World Bank (2002), UNDP 2002 (for global poverty) and inequality database maintained by World Institute of Development Economics Research (WIDER), Helsinki, Finland. * = statistically significant results. † = estimated coefficient with t-ratios in parentheses.

Towards pro-growth, pro-poor, employment-friendly macroeconomic policy

On the basis of the evidence presented here, it seems that the empirical case for macroeconomic orthodoxy which enunciates the growth-promoting and poverty-reducing virtues of fiscal prudence and low inflation is overstated. This prompts the search for credible alternatives to macroeconomic conservatism. This section of the article highlights some proposals that are highly pertinent to a putative framework for engendering pro-growth, pro-poor, employment-friendly macroeconomic policy.

Employment creation as a core macroeconomic policy goal

Current orthodoxy emphasizes inflation targeting, together with fiscal prudence, in determining the overall policy framework. The notion that very low inflation is an appropriate macroeconomic goal is not supported by the empirical literature. On the issue of fiscal prudence, the discussion on the pertinent empirical evidence has suggested the lack of a reliable statistical link between the government's fiscal position and either growth or poverty. In any case, long-run data show that the majority of developing countries do not, or cannot afford to, run fiscal deficits in excess of 5 per cent of GDP. Hence, concerns about lack of fiscal prudence in the developing world may be exaggerated. The Nobel Laureate Joseph Stiglitz has drawn attention to the context-specific nature of budget deficits. As he puts it:

> [T]here is no simple optimum level of the budget deficit. The optimum deficit – or the range of sustainable deficits – depends on circumstances, including the cyclical state of the economy, prospects for future growth, the uses of government spending, the depth of financial markets, and the levels of national savings and national investment (Stiglitz, 1998, p. 5).

Given the relatively fragile nature of cross-country findings, it is best to be circumspect about making mechanical and formulaic statements that countries should aim for predetermined inflation and fiscal targets or about being overly concerned if these limits are crossed in some countries. This paves the way for arguing the necessity of integrating employment concerns in macroeconomic management, thus restoring some balance in the way policy-makers set goals and priorities. It would entail setting a durable job creation target consistent at least with absorbing new entrants to the workforce (given assumptions about the structural parameters of an economy). This key target would then set the context for working out the corresponding growth rate, requisite policy initiatives and budgetary framework.

In advocating the case for employment-oriented macroeconomic policy, one should be aware that, in a market economy, it is not easy to announce a target for job growth in advance. Employment, after all, is a derived demand flowing from the direct demand for goods and services. A complex range of factors that influence private and public investment, net exports and consumption in turn influence the growth of aggregate demand. A clear knowledge of these variables is thus a prerequisite for making predictions on job growth.

The methodological complexities of pursuing employment-oriented macroeconomic policy should not drive one to nihilism. Policy-makers should be inspired by the encouraging fact that a stable, long-run employment–GDP relationship – the so-called "Okun's Law" – has been found in industrial countries (Kelly, 2000, p. 23). This relationship has been useful in identifying growth thresholds at which employment creation becomes significant. One study, based on examination of data for G-7 countries for the 1960-1994 period, concludes that the employment–GDP relationship appears to have become stronger over time (Padalino and Vivarelli, 1997, p. 211). There is no reason to suppose that Okun's Law would not operate in the market economies of developing countries. This yields the promising implication that policy-makers can exploit the parsimonious information embedded in Okun's Law and make it the linchpin of their macroeconomic strategy. The alternative is the fatalistic view that governments cannot influence labour market outcomes without falling into an inefficient command economy framework.

The use of employment creation targets as the locus of macroeconomic management in turn provides scope for exploring ways in which the growth process can be made employment-intensive, thus reducing the burden on the growth rate alone to engender the required number of jobs to meet policy goals. Well-known initiatives include the encouragement of small and medium-sized enterprises (SMEs) to act as key vehicles for job-creation by ensuring the reduction of entry barriers to new and existing businesses, making the regulatory environment simple and predictable, and ensuring that the education and training system supports the human resource needs of SMEs.

ILO studies have argued that governments ought consistently to incorporate the use of "labour-based" rather than "equipment-based" production methods in their public investment policy (ILO, 2000a). The public sector is a major player in infrastructure investment. One ILO study in the context of a specific country (Indonesia) has shown that labour-based production methods in infrastructure investment can generate as many as 1.2 million durable jobs over four years without compromising the quality standards associated with equipment-intensive production techniques (ILO, 1999). Comparative studies have shown that labour-based infrastructure programmes are between 10 and 30 per cent less costly in financial terms. They also reduce foreign exchange requirements by 50 to 60 per cent and create employment five times higher than the same investment in equipment-intensive programmes (ILO, 2000a).

Create "fiscal space" to sustain investments in human development and basic infrastructure

A major challenge facing many developing countries is to find ways in which fiscal policy can be made less pro-cyclical, in order to cushion the impact of adverse shocks. There are legitimate concerns that the tax and economic structures of many developing countries result in pro-cyclical government revenues, which fall sharply in recessions and rise during boom periods.[9]

Given such constraints, how can one design counter-cyclical fiscal policy so as to create the necessary "fiscal space" to sustain investments in human capital development and basic infrastructure? It should be possible to create a fiscal stabilization fund that would be used to smooth public spending across economic cycles. Such a fund would be financed from excess revenues collected by the central government during periods of growth, commodity price booms, privatizations and concessions by the international community (e.g. debt restructuring and debt relief).[10]

Setting up a stabilization fund is merely the start of a fair, efficient, transparent and accountable fiscal policy in developing countries. What principles should be promulgated to ensure that public spending programmes are generally pro-growth and pro-poor and that such designated programmes are protected during macroeconomic crises?

There is general agreement that "targeted human development programmes" (THDPs) and public investments in basic infrastructure are both pro-poor and pro-growth in orientation. Public expenditure on basic health and education may be complemented by institutional arrangements in which programme benefits are used by the prospective beneficiaries for their designated purposes. For example, in order to be eligible for programme benefits (in both cash and kind), poor families could be required to send their children to school, undertake mandatory pre- and post-natal care, and attend nutritional courses.

In addition to fiscal commitments to basic education and health, there is general agreement that public expenditure on basic infrastructure enhances growth and creates an enabling environment for poverty reduction by reinforcing the complementarity between public and private investments.[11] The challenge, however, is to ensure that pro-growth and pro-poor public expenditure programmes are protected and sustained during economic downturns. Studies have shown that when such

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[9] Thus, if taxes are largely expenditure-based (as they often are) and if a developing economy relies heavily on primary commodities, then revenues would be pro-cyclical. It has been estimated that, in Latin America, a 1 per cent fall in growth leads to a decline in revenues of 5.8 per cent, while the corresponding number in industrialized countries is 1.8 per cent. See Lustig (2000), p. 9.

[10] Examples include the Chilean Copper Compensation Fund, and the Peruvian legislation that in December 1999 incorporated the launching of a stabilization fund as part of its Fiscal Prudence and Transparency Law.

[11] Easterly (2001), among others, notes that an index of infrastructure development (telephone lines per 1,000 persons) is a statistically significant explanatory variable in cross-country growth regressions. A bivariate regression using long-run, cross-country data yields the following statistically significant relationship (at 1 per cent level of significance) between (log of) poverty ($1-a-day: pov1) and the aforementioned (log of) index of infrastructure development (Tel): Pov1 = 0.605 –.072 Tel, R-Square: 0.412.

programmes are scaled down in response to a crisis, they lose their potential to reach the poor (Ravallion, 2002).

A variety of budgetary protocols could be developed to reinforce the capacity of governments to protect pro-growth and pro-poor public spending. One possibility is earmarking revenues (say, from a previously created fiscal stabilization fund) for specific programmes based on agreed criteria, such as the effectiveness of programmes in reaching the poor and in sustaining a pro-growth environment. The adoption of this procedure would mean that spending in the earmarked areas was quarantined from fiscal adjustments. Of course, the earmarking exercise would have to be limited in scope and carried out in a transparent and accountable manner.

Another budgetary protocol worth examining is for the government and the legislature to negotiate, during the budget approval process, a ranking of programmes using agreed priority criteria (as noted above). Thus, when "… expenditure cuts are needed, the order in which cuts take place is determined automatically depending on the priority assigned to each program" (Lustig, 2000, p. 15).

Admittedly, budgetary protocols are not perfect and there is always the risk that they can be significantly compromised through protracted political horse-trading. Nevertheless, they stand a better chance of leading to a fair, efficient, transparent and accountable fiscal policy for sustaining pro-growth, pro-poor public spending programmes across economic cycles, in contrast to the (sadly) quite common situation, where formal arrangements are not in place. The process of fiscal adjustments then becomes mired in political controversy and conflict.

Finally, in designing pro-poor fiscal policy, a major constraint plaguing the adequate funding of human development expenditures in developing countries is the rather low revenues (as a proportion of GDP) generated through the taxation system. An appropriate reform of the taxation system that improves revenue collection is thus an essential ingredient of pro-poor, pro-growth public expenditure programmes.

Comprehensive social protection to deal with economic insecurity

The 1997 financial crisis in east Asia is perhaps the most recent and starkest reminder that economic insecurity and vulnerability are endemic even in developing economies hailed in the past as success stories. The usual statistics that focus on current poverty underestimates the incidence of vulnerability, that is, the risk of falling into a transient episode of poverty or deeper poverty (Islam, 2002).

A major form of vulnerability is exposure to labour market risks, entailing such phenomena as fluctuating real wages, unemployment, underemployment and curtailed job opportunities in the formal sector following macroeconomic crises or even structural reform (such as job-shedding arising from privatization and trade liberalization).[12] Such labour market risks should not be dismissed as the normal dynamics of a market economy or be perceived as best handled through informal systems of social protection (entailing a combination of individual resilience and community-based support). A growing body of professional opinion considers that formal mechanisms are necessary to help individuals, households and communities cope with change, especially if such change is unanticipated (Morduch, 1999).

There is also the view that the relentless pace of globalization has enhanced, rather than moderated, the vulnerability of national economies to externally driven crises and that globalization can reinforce underlying inequalities in a society. These risks potentially entail a major backlash against globalization. Hence, social protection may be seen as an attempt by the State to mitigate the risks associated with an increasingly integrated world economy. This in turn serves to mobilize a political commitment to harness the potential benefits of globalization (Bergsten, 2000; Rodrik, 1999).

Apart from acting as a shock absorber, a well-designed and comprehensive social protection system can sustain effective demand by reducing the incidence of under-consumption in a market economy (as measured by the incidence of long-term poverty after adjusting for interventions through social protection initiatives). Indeed, recent evidence from the industrialized countries shows that in the absence of a tax-financed social protection system, poverty would have been between 47 per cent (the United States) and 91 per cent (Finland) higher than what is typically observed (ILO, 2000b, pp. 40-41).

While the case for social protection is now well accepted, various complex policy problems arise in the design of social protection measures. These problems will be illustrated in relation to two well-known mechanisms for dealing with vulnerability. The first pertains to unemployment benefit schemes aimed at formal-sector workers; the second concerns public works employing workers in the informal sector and in the rural economy.[13] In combining the two elements of social protection, the discussion recognizes that the primary challenge in most developing economies is to incorporate the "excluded majority" in any

[12] Other labour market risks include unanticipated "incapacity" due to illness and work-related injury, but these issues are not discussed here. For an overview, see ILO (2000b), chapters 4 and 5.

[13] There are, of course, other direct and indirect mechanisms for dealing with vulnerability, such as training of retrenched workers, social funds to support community-driven projects, micro-finance entailing savings, insurance and credit. In order to focus the discussion, only unemployment benefit and public works will be considered here.

state-led scheme that aims to empower individuals to deal with vulnerability; see Beattie (2000), van Ginneken (1999), ESCAP (2000), ILO (2000b) and World Bank (2000).

Unemployment benefit schemes

Unemployment benefit schemes have been perhaps the most durable feature of social protection policies in industrialized countries. A well-known justification for their introduction and persistence is that the private sector is unlikely to insure individuals against the systemic risk of recession in market economies.

However, developing countries have generally been reluctant to adopt unemployment benefit schemes. One review, for example, found that only four countries in Asia have either unemployment insurance or unemployment assistance (Vroman, 1999). Various objections to unemployment benefit schemes may be made. It can be argued that they are fiscally unaffordable for developing economies. They do not conform to the poverty alleviation objective, because unemployment is a “luxury” that the poor can ill afford. Unemployment benefits have disincentive effects because they tend to increase the duration of voluntary unemployment and could become entrenched as “entitlements” that are difficult to remove for political reasons.

Despite the reservations about unemployment benefits, in the wake of the Asian crisis there has been a resurgence of interest in exploring their applicability to developing economies. An ILO study has argued the case for introducing unemployment insurance schemes in east Asian economies (Lee, 1998, chapter 4). Estimates suggest that “[A]n average required contribution rate of between 0.3 to 0.4 per cent of payroll between 1991 to 2000 would have been sufficient to provide all insured job losers over this period, including during the current crisis, with 12 months of benefits” (Lee, 1998, p. 83).[14] A study of Indonesia finds that a “[A] 4 per cent contribution of salary could allow for unemployment benefits of 70 per cent of salary for 25 weeks” (ILO, 2004, p. 52). Another independent study claims that “[M]ost of the Asian economies … should be able to operate (an unemployment insurance programme) with OECD generosity utilizing an average payroll tax rate of 1.0 per cent” (Vroman, 1999, p. 37).

Those who advocate the introduction of unemployment insurance also question whether such a scheme entails large disincentive effects. At least some studies claim that these are moderate and that they apply to the extreme case of unconditional payment of a uniform rate to all

[14] The calculations assume that the coverage of the scheme would be the same as existing social security provisions and would provide 12 months benefit at a replacement rate of 50 per cent of previous earnings.

beneficiaries for the entire duration of unemployment (Atkinson and Micklewright, 1991).

Some argue that an economy without unemployment insurance can be trapped into a "low-level equilibrium" of low-productivity jobs. Workers readily accept low-paid jobs in order to avoid the risk of unemployment. Firms respond by supplying such low-productivity jobs and charging an insurance premium in the form of lower wages. In such circumstances, a moderate level of unemployment insurance can encourage workers to take on more risks and increase both aggregate welfare and output (Acemoglu and Shimmer, 2000; see also Marimon and Zilibotti (1999)).

It is also worth emphasizing that, over the years, all sensible unemployment benefit schemes operating in the industrialized countries have incorporated features reducing the alleged disincentive effects. These include well-specified eligibility criteria, limited duration of benefits, demonstrated evidence that beneficiaries are actively engaged in job search and compulsory acceptance of job offers. Some practitioners have also suggested ways in which, in an east Asian context, the problems associated with unemployment benefits schemes can be reduced.[15]

Whatever the future shape of an unemployment insurance scheme in developing countries, it will leave out a large fraction of the informal-sector workforce, of the self-employed and of workers in rural areas. Discussion of alternative forms of employment protection is therefore necessary and perhaps the best-known example is public works – also known as workfare.

Public works

Public works have been – and remain – quite common in many developing countries. However, as with other social protection measures, they can be beset by various problems. One recurring problem is that the institutional mechanisms for protecting the poor from adverse shocks are not usually in place. As the Asian financial crisis demonstrated, policy-makers frequently have to improvise programmes as an emergency response to a crisis, and rely on projects and programmes designed for beneficiaries and objectives other than those of crisis mitigation. This suggests that insufficient time and thought are given to questions of design and implementation. Workfare programmes should be carefully crafted and institutionalized as built-in social protection measures, prior to the onset of a crisis.

[15] See Edwards and Manning (1999), who argue the case for an "unemployment savings account" that will be self-financing and with benefits tightly linked to contributions. The authors concede that, at the very least, the system will require employers and employees to be identified with a unique number, and the information system as a whole to be efficient and up to date. Not surprisingly, the authors are concerned that the administrative capacity to meet these institutional prerequisites may be lacking.

Guidelines now exist on good design features that can make a public works programme operate effectively in a developing country context; see Ravallion (1998), Subbarao et al. (1997) and World Bank (2000). These features include the need to set wages at a level no higher than the market-determined rate for unskilled manual work. Another possibility is to set wages at a small multiple (say, 10 per cent) of the prevailing poverty line. One advantage of such a deliberate policy of low wages is that it causes the programme to become "self-targeting", i.e. it is likely to attract only those who need and so must accept work at such a wage rate. This obviates the need for elaborate eligibility criteria to screen out the non-poor from the poor. The projects should try to target poor areas and should strive to create assets of value to poor communities. Where the non-poor are likely to be significant beneficiaries of such created assets, co-financing should be compulsory and the funds thus generated should be ploughed back into the budgets of public works projects.

As in the case of unemployment insurance, there is the question of the fiscal affordability of such a social protection initiative. The available evidence suggests that "[C]osts of safety nets need not be large even if they reach a large number of beneficiaries" (Lustig, 2000, p. 17). Typically, the cost of operating workfare programmes is well below 1 per cent of GDP, while social safety net expenditures represent a modest proportion of the budget.[16]

Finally, it is worth pointing out that, even with well-designed unemployment insurance and a public works programme, there are still challenges to the creation of a fiscally feasible and comprehensive social protection system in developing countries. Quite apart from the major task of reforming existing social institutions to improve compliance and to extend social security coverage to the formal economy and self-reliant workers, "worldwide experience indicates that enrolment of the informal economy workers in compulsory social security financing is very difficult" (ILO, 2004, p. 53). Options to deal with these constraints include "the formation of social protection cooperatives or other decentralized organizations [that] could provide the economies of scale necessary for affordable coverage" (ILO, 2004, p. 53). But these options remain in the realm of ideas and are not widely accepted practical agendas. Nevertheless, they suggest that, in principle at least, it is possible to design a comprehensive social protection system in developing countries. The political will and commitment are necessary for an enterprise that could take a decade to build.

[16] The Mexican *Progresa* costs about 0.2 per cent of GDP and 2 million households are beneficiaries. The *Trajabar* programme in Argentina reaches 350,000 persons and costs a quarter of 1 per cent of GDP. In Indonesia, safety net operations cost about 2 per cent of the central government's budget (Lustig, 2000). During the financial crisis, it probably prevented several million from sliding into transient poverty (Dhanani and Islam, 2002).

Empower labour market institutions

There is a widespread view that unemployment and underemployment are caused largely by labour market rigidities (strong unions, minimum wage legislation and assertive social regulation of working conditions). However, studies of successful small European economies show that macroeconomic conservatism succeeded in maintaining employment growth and price stability because they were underpinned by a socially negotiated wages policy in a context of well-developed labour market institutions. Unrestrained labour market flexibility was not the solution (Auer (2001), drawing on Schettkat (2001)).

Of course, developing countries cannot expect to emulate the labour market institutions of advanced European economies, but seeking to entrench labour market flexibility in the process of development is also highly problematic. Uncritical endorsement of labour market flexibility impedes the development of labour market institutions even in a minimal sense (freedom of association and trade union rights) and leads to chaotic industrial relations that may be prejudicial to both growth and macroeconomic stability.

Fortunately, the ideological divide on labour market flexibility that once existed in the international community is beginning to blur.[17] There is growing recognition that freedom of association and trade union rights are critical to the development of credible and durable industrial relations systems, that are then conducive to both growth and macroeconomic stability. At the same time, econometric studies using cross-country data show that the adoption of core labour standards is not inimical to growth (Rama, 2001) and, in some cases, may even have a positive impact on certain growth-promoting variables, such as foreign direct investment (Kucera, 2002). Other studies have carefully reviewed the evidence by focusing on a sample of OECD economies and concluded that labour market flexibility does not necessarily enhance employment growth (Baker et al., 2002).

Encourage an inclusive approach to policy-making

The notion of an inclusive approach to policy-making is closely related to the ILO's notion of social dialogue, which may be defined as all types of negotiation, consultation or simply exchanges of information between representatives of governments, employers and workers on issues of common interest regarding economic and social policy. It is

[17] Freeman (1993) raised the issue of an ideological divide between the ILO and the World Bank on labour markets, with the former advocating strengthening labour market institutions and the latter calling for labour market flexibility. Since then the Bank has offered a more circumspect view (see, for example, World Bank (1995)). For an excellent example of recent collaboration between the World Bank and the ILO on studies of labour markets, see Betcherman and Islam (2001).

now widely accepted that such participatory processes, which can occur at enterprise, industry or national levels, have proved their value as a key instrument for constructing economic and social policy. The ILO's approach is unique for its linking of public deliberation to the principle of tripartism (involving governments, employers, and unions), rather than all pertinent stakeholders (such as non-workplace-based civil society organizations). The rest of the discussion will rely on this more focused definition of social dialogue, but it will emphasize the usefulness of broadening the range of the participation in social dialogue.

Why is it necessary to discuss pertinent policy issues democratically? One argument is primarily to build trust between parties with different interests but common economic aims in the presence of asymmetric information (Campbell, 1999, pp. 3-8). Thus, employers have an interest in maximizing the returns to shareholders, while workers are primarily concerned with wages and working conditions. Yet the act of production requires cooperation despite the disparate interests of the key actors. When employers and workers do not trust each other, several consequences may endanger such cooperation: withholding of information by either party that supports appropriate decision-making at the workplace, resort to exit strategies by workers, e.g. leaving the job, low morale and poor commitment to work, even resort to violence. Hence, workers need to be given a "voice", a mechanism whereby information can be shared and trust built up.

Information-sharing and trust-enhancing processes are particularly useful when drastic adjustments – such as lay-offs, wage cuts, shorter working time – have to be made in the presence of macroeconomic shocks. Commitment to equitable sharing of the inevitable costs of adjustments is likely to be more durable if decisions are reached collectively through discussion and negotiation between employers and workers (with the government acting as a third party).

Social dialogue engenders wider benefits beyond the potentially valuable impact of easing the process of labour market adjustments triggered by macroeconomic fluctuations. Thus it can be a useful tool to nurture democratic values. It can also respond to important aspects of poverty, such as voicelessness and powerlessness, which have been highlighted in recent studies (Narayan et al., 1999).

So what are the key constraints and challenges inhibiting the development of an inclusive approach to policy-making in developing countries? What can be done to respond to them?

The problem is partly ideological. There is the well-known view that key policy decisions can be made effectively and quickly only by specialists and technical experts insulated from free-flowing public discourse. From that standpoint, social dialogue is likely to be perceived as the start of a process eventually leading to the subjugation of the formal policy-making machinery to narrow group interests.

But the notion that economic policy-making ought to be the preserve of benevolent technocrats is slowly changing. For example, recent poverty reduction strategy papers (PRSPs), with their emphasis on participation and consultation, are a useful development (Ames, Bhatt and Plant, 2002).[18] Admittedly, public consultations on a national policy document run certain risks. They can become either mud-slinging matches between the uninformed and the prejudiced, or mere rituals engaged in by bureaucrats to respond to the democratic aspirations of civil society. There are no easy solutions to these problems, but at least the public consultations underpinning PRSPs are a promising start.

The effectiveness of the ILO's tripartite principle as applied to social dialogue may be diluted by the weaknesses of the social partners. The key actors are usually the ministries of labour, the trade unions and the employers' associations. Ministries of labour are usually subordinate to the key strategic ministries and agencies, notably the finance ministry and central bank. These are the primary national stakeholders in negotiations with donor agencies to fashion macroeconomic packages to deal with crises. The effectiveness of such a package requires a social consensus on sharing the short-run costs of adjustments. Such consensus ought to be crafted through social dialogue, but one can hardly expect ministries of labour to play a leadership role, since they are not usually major players in the development of a macroeconomic package.

There is a case, it seems, for broadening the concept of social partners, even if it means straying beyond the strict interpretation of the ILO's tripartite principles. Certainly, a government's representation in social dialogue should not focus simply on the labour ministry, but should incorporate the strategic ministries and agencies closely connected to the development of macroeconomic policy. This would increase the chances of labour market issues receiving attention in the design of a macroeconomic policy package.[19]

Another way of broadening the notion of partnership in social dialogue would be to include "public intellectuals", namely, university academics and researchers from think-tanks, who can influence informed opinion on current social and economic issues. Their role has been enhanced by the transition to democracy achieved in many developing countries. This has opened up enormous opportunities for influencing

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[18] Low-income countries, especially those belonging to the group of heavily indebted poor countries (HIPCs), are now expected to produce PRSPs to gain access to development assistance.

[19] It appears that some of the more successful examples of social dialogue in the crisis-affected east Asian economies, such as Malaysia and Republic of Korea, bear the *imprimatur* not just of the strategic ministries, but also of the presidential or prime ministerial office; see Campbell (1999).

public debates through the (largely) free media. Their spirit and intellectual energy could be harnessed more effectively than has perhaps so far been done, to support the role of the traditional social partners.

One should also highlight the challenges facing employers' organizations, and business in general, in supporting the social dialogue process. Business associations prefer the time-honoured technique of investing resources in lobbying ministries and political parties in order to influence national policies. If the returns to lobbying are higher than the returns to investment in social dialogue, the predictable results will be reduced support for the latter and more effort in the former. The issue of lobbying by business groups is complex but if, over time, business groups find that there are alternative, and credible, channels to represent their causes to society at large and to the government, then they are more likely to support social dialogue. This shifts the onus back to the government to exercise leadership, establishing public discourse as a core element of transparent and accountable policy-making.

Perhaps one of the greatest challenges facing the growth of social dialogue in developing countries is the lack of a viable trade union movement, in terms of both representation and capacity. This is compounded by the fact that the self-employed and the informal sector represent a very significant proportion of the workforce. How does one develop credible "voice" representation for this excluded group? This is where one may need to work creatively with non-workplace civil society organizations with a credible record of representing the poor. Linking the trade union movement to emerging pro-poor associations could be a promising way of achieving a broad-based coalition to represent the poor.

One final issue is that public deliberations are not costless. Indeed, the logistics of hosting social dialogue on a regular basis use up scarce fiscal resources. One could quite plausibly argue that cash-strapped governments are unlikely to attach priority to investing budgetary resources in hosting public deliberations. This is a valid concern, but it can be addressed. Co-financing by the non-governmental dialogue partners (especially business associations) is always possible and desirable. Donor assistance could also be tapped to create a trust fund dedicated to funding initiatives in national dialogue.[20]

Temper the influence of global investors

In its annual meeting in Hong Kong in September 1997, the International Monetary Fund (IMF) issued a statement endorsing an even-

[20] Dan Morrow of the World Bank evokes the example of Bolivia, which has such a dedicated trust fund managed by the UNDP. These observations were made by Morrow in the UN *Poverty Retreat*, Tarrytown, New York, 20 July 2000.

tual move to capital account convertibility among IMF members. This was a fundamental departure from the Article of Agreement of 1994 that included only current account liberalization as an obligation and a goal, and did not embrace capital account convertibility as an obligation and an eventual goal. At the time, the 1997 financial crisis was just beginning and so failed to dampen the enthusiasm of the advocates of deep economic integration, who held that both trade and capital account liberalization would create and sustain national prosperity across the world. Since then, there has been a strategic retreat from such a position. There is growing realization that short-term capital mobility imposes certain costs on developing countries that can no longer be ignored.

Short-term capital mobility creates an environment in which the interests of global investors wield inordinate influence over national macroeconomic agendas by creating a bias in favour of low inflation and fiscal conservatism irrespective of country-specific circumstances. While some studies have claimed positive economic benefits for an open capital account in terms of faster growth and lower inflation (e.g. Quinn, 1997), the professional literature has generally been far more circumspect (e.g. Rodrik, 1998). Indeed, a recent study by Easterly and others claims that "… countries with more open capital accounts are more likely to go into recessions" (Easterly et al., 1999, p. 43). Recessions of this nature can in turn lead to sharp, albeit transient, increased poverty, collapse of real wages and growing unemployment/underemployment. One should also take account of the high fiscal costs entailed in taking over bad loans and the recapitalization of insolvent banks that typically emerge following a macroeconomic crisis induced by capital outflows.[21] To make matters worse, the burden of bearing such costs is unevenly shared: typically, these are borne by ordinary citizens and taxpayers, while the direct benefits of "cleaning up" the banking system are reaped by relatively well-off domestic and international investors.

It is thus not surprising that controls on short-term capital inflows as ways of reducing the risk of the recurrence of financial crises in developing countries and of restraining the influence of global investors on a national macroeconomic agenda have emerged as an important issue in current global policy debates. Such controls would entail a combination of taxes and quantitative restraints of a prudential nature and would assist in lengthening the average maturity of external debt.[22] Advocates of capital

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[21] In the Mexican crisis of 1994-95, the cost of cleaning up the banking system was estimated at around 19 per cent of GDP (*Financial Times*, 16 Sep. 1999).

[22] Perhaps the most widely cited case of imaginatively designed capital controls is that of Chile. Policy-makers combined market-based instruments with non-renumerative reserve requirements on short-term flows. There is also a resurgence of interest in the Tobin tax. This proposal, originally advocated by James Tobin in 1972, entails the imposition of a uniform, but moderate, tax on spot transactions in foreign exchanges; see Ul Haq, Kaul and Grunberg (1996).

controls could point to the fact that China weathered the Asian financial crisis so well largely because it had such controls in place. They could also point to the experience of Malaysia, which instituted capital controls in September 1998 – an initiative that won the guarded approval of the IMF.[23]

Of course, capital controls can generate allocative inefficiencies. They should not be seen as a substitute for sound economic policies. Gradually, as financial systems approach international standards, a country can ease capital controls to reap the rewards of globalization. Moreover, it can take a long time to build up domestic financial institutions and prudential regulation in developing economies to the required international norms (Cole and Slade, 1999). The alternative approach (hasty and premature capital account liberalization) that characterized pre-crisis Asia produces undue risks and uncertain gains.

Create an enabling global environment

Recent macroeconomic crises have been contagious, that is, they have affected a range of countries, although they were not closely related and had distinct economic, institutional and social characteristics. While institutional weaknesses and policy errors in certain countries have played a role, macroeconomic contagion cannot be explained as simply the product of fiscal, monetary and structural weaknesses. There is growing recognition that, since macroeconomic crises and their consequences spill across national borders, combined international and regional cooperation is needed to complement national initiatives.

The need for international cooperation to deal with macroeconomic contagion has led to rethinking on how to deal with the unsustainable sovereign debt that often results from such contagion. The traditional approach is IMF-led large-scale international bail-outs of crisis-affected economies. This approach is seen as wasteful and ineffective and the bail-outs are suspected of helping out international creditors. This has bred proposals for designing effective sovereign debt restructuring schemes. The aim is to reduce the unsustainable external debt problems that periodically afflict developing countries, but at the same time to enable those countries to reap the benefits of external finance. This would entail balancing the interests of creditors (usually from the rich nations of the world) and of debtors (usually from the developing countries) by ensuring that the former are held at least partially responsible for poor lending decisions. One proposal from the IMF contemplates a "… sovereign debt restructuring mechanism that

[23] See Kaplan and Rodrik (2001) for a positive evaluation of the Malaysian experience. Critics typically argue that capital controls cannot be held responsible for Malaysia's economic recovery because other crisis-affected economies recovered without resorting to capital controls.

would empower a debtor and a super-majority of creditors to take the key decisions in a restructuring in a timely and efficient way" (Krueger, 2002a, p. 7).[24] It remains to be seen whether these proposals will be adopted and will work effectively. Critics contend that the Bretton Woods institutions still do not show any credible sign of disengaging from the traditional approach of large-scale international bail-outs (Goldstein, 2002).

Closely related to the issue of debt restructuring is debt relief.[25] Until the mid-1990s, any serious attempt to deal with the growing debt problems of very poor countries through large-scale debt relief was not central to the Bretton Woods institutions' policy agenda. Largely because of civic activism coordinated globally by the Jubilee 2000 movement launched in 1996, debt relief has now become a core part of global policy debates. The Bretton Woods institutions operate an HIPC (heavily indebted poor countries) initiative that processes debt-relief programmes on a case-by-case basis. Critics contend that the HIPC process is agonizingly slow.

With progress on debt relief proceeding at an unsatisfactory pace for the poorest countries of the world, the prospects for extending the idea to cover middle-income developing countries seem even less likely at this stage. Instead, such countries have been the targets of large-scale international bail-outs that, as noted above, critics have found ineffective and wasteful.

The emerging theory of "odious debt", proposed by Kremer and Jayachandran (2002), suggests a way in which debt forgiveness could be extended to cover countries other than the HIPCs. This is the idea that many developing countries are carrying "odious debt" incurred by autocratic rulers who used the funds involved for personal gain and to maintain their anti-democratic authority. Kremer and Jayachandran propose new institutional arrangements that would simultaneously discourage the creation of odious debt by creditors in rich countries and their payment by successor governments in developing countries. These arrangements might include: (a) the creation of an independent institution vetted by the world's leading powers and international organizations, that would declare a regime odious and announce that legitimate successor (e.g. democratically elected) governments would be justified in repudiating such debt; (b) changing laws in creditor nations so that seizure of a country's assets would not be permitted in the event of non-repayment of odious debt; and (c) making foreign aid to successor governments contingent on non-repayment of odious debt.

The net effect of these proposed arrangements, the authors argue, would be to minimize the build-up of odious debt across a wide range of

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[24] A more detailed explanation is provided in Krueger (2002b).

[25] This discussion draws on UNDP (2002), pp. 102-104.

developing countries, to increase legitimate governments' ability to borrow in international markets, and to attract foreign investment, enabling them to finance much-needed development activities in a non-inflationary way. Though these ideas are innovative, there are doubts whether the international community will seriously consider them. Financial interests in the creditor nations are a powerful lobby. Such a lobby might regard the notion of "odious debt" as an attempt to curtail their capacity to exploit their comparative advantage to trade in financial services with the rest of the world. The Bretton Woods institutions, too, might be reluctant to endorse the policy implications of the theory of odious debt. International bail-outs are a well-established mechanism for such institutions to exercise their power and influence in the policy-making processes of a wide range of developing countries. Finally, one must not overlook the challenges involved in determining odious debt. Some cases might be quite clear, for example the former apartheid-based government in South Africa, and the governments of Somoza in Nicaragua, Marcos in the Philippines, Duvalier in Haiti, Mobutu Seko in former Zaire, and Abacha in Nigeria; other cases are likely to be more contentious, for example, the Suharto regime in Indonesia.[26]

Despite such caveats, debt relief, whether justified from the perspective of the odious debt theory or on compassionate grounds, will clearly remain a core element in global policy debates on the need to deal with macroeconomic contagion and its consequences.

There are also much more contentious proposals to craft a new era of development cooperation going well beyond issues of sovereign debt restructuring. One could argue that the legitimacy of current institutions of global economic governance is impaired, as they do not provide sufficient scope for the airing of developing countries' concerns. The nationally owned and driven development strategies currently proposed in the poverty reduction strategy papers (PRSPs) represent one attempt to deal with such grievances. However, as a preliminary evaluation has shown, it has not been easy for the PRSPs to disengage from the constraints of economic orthodoxy; see, for example, Ames et al. (2002) and ILO (2002).

A growing number of influential voices are now arguing that, to remain at the forefront of development policy and practice, the institutions of global economic governance, notably the Bretton Woods institutions, must confront their impaired legitimacy. These organizations have indeed made commendable attempts recently to improve the transparency and accountability of their operations and decisions, but critics contend that a great deal more needs to be done; see, for exam-

[26] Winters (2001) has argued that the current democratically elected Indonesian Government is carrying "criminal debt" from the previous authoritarian regime and deserves to be considered for large-scale debt relief.

ple, UNDP (2002), Stiglitz (2002b), Kapur (2002) and Pincus and Winters (2002). The thesis of impaired legitimacy is rooted in the current structure of the Bretton Woods institutions, in which the current voting formula disproportionately favours rich countries. This creates powerful incentives for the G-7 nations, the United States in particular, to pursue their commercial and national interests often at the expense of those of developing countries. This pursuit of self-interest is usually couched in the language of the Washington Consensus, suggesting that there is a universally agreed set of ideas on what constitutes a national macroeconomic agenda and, more generally, a national development agenda. One solution, some argue, lies in changing the Bretton Woods voting formula so that the developing countries have much greater voice and influence. Another is to disband the durable, but entirely undemocratic, practice whereby the head of the World Bank is chosen by the United States and the head of the IMF is chosen by the nations of north-western Europe.

Others have argued that that there should be clear separation between the policy analyses, research and operational activities of the Bretton Woods institutions, by ensuring that the former are carried out by independent agencies. Currently, the research departments are located within these institutions, creating the risk that some politically sensitive policy-oriented research could be used to justify the operational imperatives of the World Bank and IMF; see Deaton (2002), Kanbur (2002) and Wade (2002). Critics maintain that it is through the lending operations and "country assistance strategies" that the largest shareholders of the two institutions seek to exercise their strategic influence.

While it is easy to dismiss these as too contentious and, hence, unlikely ever to be seriously considered by the international community, there is a clear need to move away from an artificial consensus on global policy issues. This is necessary in order to nourish the spirit of eclecticism and intellectual diversity anchored in the idea of country-specific approaches to macroeconomic policy as part of a holistic approach to development.

Finally, given the regionally specific nature of recent macroeconomic crises, a movement has emerged seeking to develop regional and financial cooperation, to supplement multilateral efforts to devise an effective approach to reducing the probability (and consequences) of macroeconomic contagion.[27] This idea was first mooted with the onset of the 1997 financial crisis in east Asia, in the form of a proposed Asian Monetary Fund (AMF) to supplement the financing facilities available through the IMF. The idea was rejected by the IMF, the European Union

[27] The discussion draws on Rana (2002). See also Bowles (2002) and Webber (2001), who interpret the resurgence in Asia/Pacific regional cooperation as an attempt to temper the influence of the United States on the region and the world in general.

and the United States on the ground that it would duplicate the activities of the IMF and that such a regional body would lack the political will to ask member countries to undertake unpopular adjustment measures to cope with macroeconomic crises. Recent developments suggest that the idea of a regional financial architecture to supplement conventional multilateral arrangements is emerging with renewed vigour.

A good example is the so-called Chiang Mai Initiative (CMI). Stemming from a meeting of finance ministers from the "ASEAN+3" group, held in May 2001 in Chiang Mai, Thailand,[28] the CMI called for: (a) an expanded ASEAN Swap Arrangement, that entails all ASEAN countries and a network of bilateral swap and repurchase agreement facilities among the members of the ASEAN+3 group; (b) regular information-sharing among the members of the group; (c) a regional financing arrangement to supplement international facilities; and (d) an early warning system to reduce the probability of financial crises and thus promote financial stability in the country. A recent evaluation of the CMI by the Asian Development Bank suggests that notable progress has been achieved (Rana, 2002, p. 8).

In conclusion

One final observation seems appropriate at this juncture. Crafting a new era of development cooperation that will facilitate pro-poor, employment-friendly macroeconomic agendas at national level will require an environment in which developing countries can harness an increased inflow of external resources to meet national development goals through both aid and access to the markets of the rich nations. Access to such markets depends not just on both rich and poor countries dismantling trade barriers, but also on the ability of the developed world to create the necessary demand for developing country exports.[29] This in turn entails fostering and sustaining buoyant domestic markets in the industrialized countries – a task that surely belongs to the domain of macroeconomic policy.

Trade flows would have to be complemented by appropriate aid flows. Current calculations suggest that annual flows of development assistance will have to double from the current annual flows of US$56 billion if the world community wishes to make a credible commitment to financing the United Nations' Millennium Development Goals.[30] At

[28] This group consists of ASEAN plus the People's Republic of China, Japan and Korea.

[29] Unilateral trade policy reforms that are typically advocated for developing countries are often inspired by the view that trade liberalization is the primary driver of growth. The evidence is highly contested. See Rodrik (2001) for a critique and Warner (2003) for a "pro-trade" view.

[30] UNDP (2002), p. 31. In the UN Millenium Summit held in September 2000, more than 180 countries embraced the goal of attaining target reductions in both income and non-income dimensions of poverty.

the same time, renewed efforts will have to be made to ensure that the available quantum of aid is allocated to the priority areas directly influencing growth, employment creation and poverty.

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