Forward Looking Macroeconomic Policies for Inclusive and Sustainable Development in Asia- Pacific Region: A Commentary

Based on the remarks made by Governor Dr. Yuba Raj Khatiwada as a Panelist in the UNESCAP Ministerial Meeting, Bangkok, April 30, 2013

1. *Expecting Unconventional Role of Macroeconomic Policies*

Macroeconomic policies are historically designed and implemented more for stability and less for growth - qualified as inclusive or broad based. As such, they are rarely applied for inclusive or any kind of qualitative growth or distributive justice. The recent UNESCAP report on forward looking macroeconomic policies for inclusive and sustainable development is a pioneering work in this direction. Structural constraints to sustained high and inclusive growth in the Asia- Pacific region are properly analyzed in that report. This is a noble beginning for unconventional macroeconomic policies; but for making such policies work for inclusive and sustainable development, further work is required on the institutions, actors, agencies, and instruments of the macroeconomic policies. My view point here is to share my thoughts on the forward looking macroeconomic policies and how or whether these policies can be reoriented for addressing structural impediments for inclusive and equitable growth which also delivers sustainable development.

Over time, macroeconomic policies have evolved as faceless policy measures; or, we have made them blunt in the pretext of their overly focused role on stabilization. As such, they can have multiple objectives –often complementing than competing - and can be given a human face. We can cite several areas of macroeconomic policies with human face; they are linked with inequality, poverty, gender, and inclusion. They can also be linked with environment. We can reorient our macroeconomic policies to achieve poverty reduction, gender equality, reduction of inequality, and preventing environment degradation. Thus assigning single objective, single target, and single instrument for macroeconomic policies in general, and for monetary policy in particular, must first be corrected as a move toward economically, socially and environmentally responsible macroeconomic policies.

2. *Key Pillars of Forward Looking Macroeconomic Policies*

In the context of global economic development challenges, I would like to focus on the four pillars of unconventional forward looking macroeconomic policies:

(a) Fostering inclusive growth, decent jobs and economic transformation

(b) Promoting inclusion and equality

(c) Ensuring economic stability and

(d) Serving social and environmental goals

Regarding the first pillar, a debate is necessary to define inclusive growth and to ensure that inclusion leads towards equity before orienting macroeconomic policies to this direction. Also we need to understand as to what we mean by equitable or job intensive or socially and environmentally sustainable growth. Also a fresh debate is required for growth driven by consumption or investment or innovation and technology. A revisit is required in either of domestic or external drivers of growth implying growth driven by foreign or domestic consumption. This has a bearing on the strategic orientation of macroeconomic policies. As inclusive growth has to be job centric, we have to assess how macroeconomic policies can facilitate this, and whether we can dictate the choice of technique for production. Also, incentives for job centric growth are usually not sufficient. Notwithstanding all this, it can be argued that macroeconomic policies can enhance access to productive resources and thus promote inclusive growth. Financial policies like micro finance and safety nets or fiscal incentives for production oriented activities of the communities or cooperatives help inclusive growth as well.

Economic transformation calls for the paradigm shift in production and choice of technology for the same. Inclusion does not necessarily transform the economy, and market based transformation may be exclusionary. Trade off might take place between market-led economic transformation that besets on efficiency and inclusive growth that may need state intervention. This requires that we need to optimize between efficiency and inclusion. So there is a need for (i) reorientation of macroeconomic policies which often undermine inclusion and (ii) recognition of the role of third player (cooperative and other grass root organizations) in inclusive economic development and linking them to macroeconomic policy environment.

Regarding the second pillar, we see that two actors of development are not enough. Community organizations must bridge the gap. Government may enforce inclusion but market runs in efficiency criteria. Thus, as mentioned before, trade-off between inclusion and efficiency implies that optimization would be necessary, if we do not want to achieve one at the total cost of the other. Social business is a concept which the community organizations carry forward both efficiency and inclusion. Then macroeconomic policies, which so far overly focus on efficiency and often at the cost of inclusion, have to evolve new instruments which help such organizations and support the optimization. Besides, development cannot be sustained in a situation of growing inequality while market forces mostly widen inequality and states either do not have market friendly instruments or do not want to use direct instruments to reduce inequality. Forward looking macroeconomic policies must consider equality along with facilitating economic growth. As income and asset redistribution with macroeconomic policies is not an easy job, policies that supports built-in- distribution of income and assets have to be innovated.

On pillar three, conventional wisdom says that macroeconomic policies are meant for stability. And, there is no debate on the stabilizing role of those policies. The issue here is of stability plus. We observe that macroeconomic policies have overly focused on stability in the past, often at the cost of growth and inclusion or equity. Also aggregative monetary measures like quantitative easing and tightening, not considering the quality aspect of the monetary or credit aggregates, have been in practice. Fiscal policy is often seen from budget numbers and underlying deficit without considering the qualitative aspect of the same. A comfortable debt position must allow for more fiscal space to public spending for infrastructure, social sector, and social protection. However, role of public sector has often been undermined and privatization has often resulted in poorer access to public goods and services, not necessarily improving efficiency. Tax policy reforms have often been regressive. An example is VAT or single rate income and corporate tax. Subsidy is often seen as wastage from budgetary or fiscal and not from social angle. As such, inclusion means strong fiscal instruments like resource allocation to the social sector, transfers and subsidies for those who are left behind by the market forces.

Regarding pillar four, there is growing consensus that macroeconomic policies can help achieve social and environmental goals. Historically, macroeconomic policies are often designed without human face. They are overly focused on stabilization impeding social development goals and suppressing economic development. Macroeconomic policies which put poverty, gender equality and empowerment of women, financing agriculture and rural development, and making micro interventions like micro finance, income generation activities, enterprises for self employment, etc at the forefront of their orientation help achieve social objectives. Macroeconomic policies or macro prudential policies which encourage corporate social responsibility also help achieve social goals of development. Macro prudential measures for Green Banking, environment friendly credit flows, financing agriculture, forestry and green enterprises, environment-based tax instruments and differentiated tax measures, and charging fees for polluters can be instrumental to meet the social and environmental goals of macro policies.

The above points may be something new from traditional policy perspectives, but when we face unprecedented challenges of inclusion, equality, sustainability, and justice, we need to reorient our policies and evolve unconventional policy instruments to address the challenges. As we have already had analytical works on macro policies and poverty, macro policies and inequality, macro policies and gender, and macro policies and environment, we can readily work towards giving a human face to our macroeconomic policy measures.

3. Key Challenges for Unconventional Macroeconomic Policies

There are however many challenges for implementing the four pillars of non conventional macroeconomic policy measures. Some of them can be cited as follows:

(1) Do market based macroeconomic policy instruments serve the goals of inclusion and sustainability?

(2) Will market be responsible towards social goals without being offered meaningful incentives and motivations for profit?

(3) Can state or government deliver the expected outputs with existing institutions, mechanism and capacity?

(4) Will cooperatives, communities and other grass root organizations evolve as credible and capable institutions to deliver the expected macroeconomic output?

(5) Will macroeconomic policies be able to be linked with the community and cooperatives sectors which at the grass root level are supporting inclusive growth?

(6) Will global and even national policy environment and institutions allow for non conventional tools and approaches of macroeconomic policies?

We term the current 6 per cent economic growth of Asian Region below the potential! But the question is how to justify the potential. Can we judge it from the lens of advanced economies which achieved high growth at the expense of: (i) underdevelopment in other parts of the world, (ii) consumption of non renewable natural resources, (iii) capital and human resources flows from underdeveloped world, and (iv) future generation's well-being? Are we expecting the West to continue unsustainable consumption for our aspired growth? If not, are we encouraging our region to initiate unsustainable consumption for promoting growth? For sure, without addressing inequality, domestic consumption led growth would be economically, socially and politically questionable.

When infrastructure is the bottleneck for faster growth, huge investment for the same will often overheat the economy as the time lag between investment and output may be long; and given high commodity price environment, it may build inflationary pressure. High commodity prices are already pushing inflationary condition in the region. More importantly, in the absence of adequacy of foreign exchange reserves, the external sector pressure will destabilize the exchange rate. The underdeveloped financial market and already highly leveraged credit situation tell that there is no unlimited space for monetary easing.

We need to understand that the past export led high growth of the Asian Region was a bubble in itself driven by over spending of the West - both at the government and household levels. The welfare and warfare spending led consumption of the governments of some advanced countries and cheap bank credit driven consumption of the households made many Asian economies to grow faster. This did not need to change the structure of production till the crisis. Now it is time to change the course as the transition will take some time before growth could pick up to new height.

It is not only the Asian countries but also the International Financial Institutions (IFIs) working in infrastructure projects in the region did not see the need for rapid expansion of such facility to carry on sustained high growth. Too much focus on outward oriented policies was bound to create a setback at some time. So if we are looking for a sustained very high economic growth, we need to restructure the economy, identify the long run drivers of growth and reorient macroeconomic policies for sustained and inclusive production, distribution and consumption.

4. *Addressing Inclusive Development Challenges*

Two actors of development - the state and the market- are not enough

Governments have sometimes failed to promote and sustain development, and so have the markets. Exclusion is pervasive in the areas where state is absent and private sector (the market force) does not want to be – obviously for profit reason. In either case, community organizations have sustained and filled in the gap; thus, they must be considered as the third actor of development. People who have no access to resources, opportunities and power are mostly deprived of development benefits and the challenge is how to bring these people in the development process. The third actor which mobilizes the people through community approach is necessary. The non-government organizations, community organizations, and cooperative organizations are the ones which have to be mobilized for empowering this section of people and enhancing their access to resources, opportunities and development benefits.

There is an understanding that poverty is a multidimensional issue. So the strategy to secure a world free of absolute poverty must also address the historical and institutional roots of poverty which demands fundamental reforms in the economic and political institutions. Efforts towards social and economic transformation will help to change these institutions. Well defined and enabling roles of the state, the market, and the community organizations including cooperatives and non government organization having transparent and defined development agenda will help the transformation and promote institutions which deliver inclusive development.

Deep-rooted geographical, institutional and political reasons make some countries poorer than others. The best way of eradicating poverty and moving towards prosperity is to expedite the process of institutional reform that will ensure sustained (including equitable) economic development. Most of economic, social and political reforms necessary for institutional change have to be domestically driven and macroeconomic policies have to be designed accordingly. International community should facilitate and incentivize such reform initiatives. While the global community should support credible domestic macroeconomic policy measures, it should keep in mind that a prescription around given framework does not fit all and must be tailored to domestic condition. New international financial architecture and policy framework would be necessary to deliver the new things.

Economic transformation is a key to inclusive development

Sustained development will require a different pattern of growth that transforms the economy and the society to ensure human security. Economic transformation implies diversifying the sources of economic growth, improving technology and human capital, and channeling financial resources more effectively toward productive investment. While the acquisition and application of technology is a key factor in achieving economic transformation, economic activities are, in turn, inherent sources of technological progress. Hence, economic growth, economic transformation and technological change are interwoven activities that reinforce each other.

Economic transformation, if market based, may exclude a large section of the society from the growth process. A trade-off might exist between market-led economic transformation that survives on efficiency and inclusive growth that may need state interventions. The fundamental issue then is how to use macroeconomic policies to strike a balance between efficiency and inclusion.

Inclusive growth requires that all participate in the process of production and benefit from the outputs

Decent job is a critical component of inclusive growth as it paves the way for broader social and economic advancement, strengthening individuals, their families and communities. But there are constraints towards creating almost close to full employment jobs. First, production generated through market driven choice of technology does not ensure enough jobs, the case of jobless growth. Second, the kind of jobs created through the market forces of production do not necessarily match with the existing surplus labour force in the country. Third, even if people are interested to work in the areas of labour market opportunity, they have skill mismatch and require extensive training to transform the skills.

Government is not the major provider of jobs, nor can it ensure unlimited unemployment benefit. Still for public works, it can be as labour intensive as possible, despite technological and efficiency constraints in choosing such labour intensive technology. In a country like ours where foreign aid accounts for a large chunk of development financing, inclusive growth cannot be achieved if the donor funded programs do not create jobs or include people in the development process. Care must be given to ensure that donor support is seriously working towards inclusive growth and particularly towards creation of more jobs. Drivers of growth must also create jobs, like agriculture, small and medium enterprises, and construction.

There should be proper understanding of the role of cooperatives and community organizations. Cooperative is the best model to inclusive growth where the poor and disempowered people participate to and also benefit from the growth process. They work for inclusive and high economic growth as (i) they are the platform for enfranchising the less privileged, (ii) they mobilize local resources for production and better distribution, and (iii) they create decent self employment. As we have just celebrated the International Year of the Cooperatives, we need to give continuity to cooperative activities for engaging all its members in production, processing, and distribution of goods and up-scale them to promote inclusive and equitable growth.

Inclusion does not ensure equity, nor does it necessarily transform the economy

Myth about inclusion must be clear; for, neither does it necessarily transform the economy, nor does it ensure equity. Inclusion is tokenism which only pacifies the grievances against exclusion and deprivation. The global agenda for development must focus on equity rather than limiting to inclusion which is difficult to achieve without meaningfully engaging everyone in the process and in the benefit of economic growth. In that case, domestic policy makers and global institutions supporting (or influencing!) macroeconomic policy of host countries require to reorient their policy strategies and interventions.

Inclusion and efficiency may not go together

Government may enforce inclusion but market runs in efficiency. Where market is predominant player of development, ensuring inclusion could mean a trade off to efficiency. So, optimization between inclusion and efficiency would be important. Macroeconomic policies must work towards this and ensure that development actors take care of both inclusion and efficiency matters.

Current development cannot be sustained amid growing inequality within and among countries

Development cannot be sustained in a situation of growing inequality as the latter dampens domestic demand, social raptures cohesion, and triggers conflict ultimately eroding development environment. However, reducing inequality is not an easy job. Conventional macroeconomic policies which promote market forces mostly widen inequality, and states either do not have the proper instruments or do not want to use them for reducing inequality. Global institutions which work for macroeconomic policies in general and trade, aid and investment policies in particular, must have the zeal, instruments and clout to create a more inclusive global development. Forward looking macroeconomic policies must include the actors and the instruments to address the inter-country and intra-country inequality in income and development outcomes.

Sustained development must encompass grass root organizations as the vehicle to transmit macroeconomic policy impulses at the household level

Policy makers and development partners serious about inclusive and sustainable development must understand the role of cooperatives and community organizations. Non government organizations are also important for policy advocacy, social mobilization, and empowerment. But unless there is production relation of such activities, we do not gain much for inclusive economic growth. Cooperative which heavily engages in production and fair distribution is thus best model to inclusive growth where the poor and disempowered people participate to and also benefit from the growth process. But, mostly they are semi formal institutions and outside the ambit of formal financial system governance. Such organizations must come within the domain of formal regulatory framework and be guided by macro policy stances. As the world has just celebrated the International Year of the Cooperatives, such activity needs continuity for engaging all its members in production, processing, and distribution of goods and services which, of course, will promotes inclusive and equitable growth. Forward looking fiscal, monetary, and trade policies will have to facilitate such a process.

5. Concluding Remarks

Conventional role of the fiscal and monetary authorities is to facilitate the market for efficient allocation of resources for economic growth without much bothering on who would benefit from the growth and how much. Issues of inequality or exclusion did not appear as the concern of these policies and they were made blunt with respect to distribution and social justice. Current global and national concern is on the quality of growth and its distribution, as it affects the sustainability of economic development. After the repeated crises in the economies of the world, there has been a reversal in some of the conventional policy stances like in the role of the market and the state. Neither the current crises nor their solutions taken by several countries are conventional. As such, no any conventional macroeconomic theory and policy has been able to address such issues.

What we can infer from the current state of economic policies is that new macroeconomic theory is evolving with the unconventional policy practices of the world economies and we are learning from the present and not from the past practices. If we global and national public policy makers do not recognize the changing paradigm of development and continue to adhere to the same old policies and practices, we run the risk of our extinction or redundancy. If international and national financial institutions have learned lessons from the weaknesses of macroeconomic policies of the past, it is time to correct them and act for inclusive and sustainable development with human face.