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Macroeconomic policies for productive capacity, employment creation, sustainable development and the achievement of the Millennium Development Goals, in the context of sustained, inclusive and equitable economic growth in pursuit of poverty eradication

Report of the Secretary-General

Summary

The aftermath of the global financial and economic crisis and the resultant jobs crisis have shown that current macroeconomic models are less than adequate in containing global economic and financial risks. They have not led to the creation of new and decent employment opportunities or to substantial declines in unemployment rates, even after the return to positive economic growth during the recovery from the crisis.

In the present report, it is argued that macroeconomic policymaking needs to be reconsidered in the context of the urgent and fundamental need for employment creation and full employment. Instead of narrowly focusing on maintaining the stability of such nominal variables as debt and inflation, countries should consider employment creation and full employment as a priority macroeconomic policy objective. Macroeconomic policies should also be aligned with the need to augment productive capacity and achieve sustainable development. Fiscal policy, in particular, should be supportive of Government investments in those areas. Monetary policy should ensure financial sector stability and support productive sectors, especially agriculture and employment-intensive small and medium-sized enterprises, while exchange rate policy should support tradable sectors. Such policy configuration may

* E/2012/100.

require active capital flows management. At the international level, there is a strong need for enhanced global coordination to create an enabling environment for addressing current macroeconomic challenges, in particular the unprecedented high level of global unemployment.

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I. Introduction

1. Article 55 of the Charter of the United Nations establishes the promotion of full employment as one of the mandates of the United Nations. In their national development strategies and macroeconomic policies, countries need to return to the priority of job creation with a view to full employment. One of the major challenges faced by the global community today is the urgent need for employment creation and decent work.

2. The financial and economic crisis of 2008-2009 highlighted the continued damaging impact on living standards of macroeconomic instability and recession, in particular through sustained high rates of unemployment in developed countries, as well as an increase in vulnerable employment and in the number of working poor in developing countries.[1] Sustained, inclusive and equitable economic growth and full employment with reasonable macroeconomic stability are crucial elements for eradicating poverty, fulfilling the Millennium Development Goals and maximizing long-run gains in real incomes.

3. This understanding is consistent with the Articles of Agreement of the International Monetary Fund (IMF). For example, section 1 of article IV states that each member shall endeavour to direct its economic and financial policies towards the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances.

4. However, macroeconomic policies during the three decades prior to the crisis shifted away from the above-mentioned principle and centred on financial, as opposed to real, variables. In this approach, emphasis was placed on low single-digit inflation (usually 2-3 per cent in developed countries and 4-5 per cent in developing countries) and low budget deficits (around 2 per cent of the gross domestic product (GDP)), preferably surpluses, as prerequisites for growth and employment. The focus on inflation, deficit and debt rendered macroeconomic policies procyclical, and the goals of low inflation and fiscal deficit were achieved by many developing countries, usually at the expense of growth and more effective employment of both labour and capital.

5. This pre-crisis dominant macroeconomic paradigm has now been questioned, and there is recognition that macroeconomic policies need to be examined with respect to their interrelationships with employment creation, the augmentation of productive capacity and the achievement of sustainable development objectives;[2] this recognition reaffirms macroeconomic policy principles in the IMF Articles of Agreement.

6. At the international level, global coordination is needed for the creation of an enabling environment. The present report analyses these issues in the context of the overarching objective of attaining the Millennium Development Goals and

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[1] This is also a feature in developed countries. For example, as many as 6 per cent of employees and 18 per cent of self-employed people were classified as poor in 2007 in Europe, and the figures are rising (see Liz Alderman, "Ranks of working poor grow in Europe", *New York Times*, 1 April 2012, and Neil Fraser, Rodolfo Gutiérrez and Ramón Peña-Casas, eds., *Working Poverty in Europe*, Work and Welfare in Europe Series (Palgrave Macmillan, 2011).

[2] This shift was documented at a major conference organized by IMF in March 2011. See Olivier J. Blanchard and others, eds., *In the Wake of the Crisis: Leading Economists Reassess Economic Policy* (Cambridge, Massachusetts, MIT Press, 2012).

achieving sustained, inclusive and equitable economic growth for poverty eradication.[3]

II. Macroeconomic policy

7. In general, the objective of macroeconomic policies is to maximize long-run societal well-being in an equitable and sustainable manner. In particular, macroeconomic policies affect growth, employment, inflation, interest rates, national debt and the balance of payments.

8. The principal macroeconomic policies used to affect these variables are fiscal, monetary and exchange rate policies. Fiscal policy instruments consist of Government expenditure and taxation, monetary policy instruments include interest rate, reserve requirement and credit, and exchange rate policy is primarily geared towards the balance of payments. There is a high degree of interdependence among fiscal, monetary and exchange rate policies.

9. The short-term objective of macroeconomic policies is usually economic stabilization, such as stimulating an economy in recession or keeping inflation in check during an expansion, and the attainment of a sustainable balance of payments. However, there are also important short- and long-term linkages between macroeconomic policies and employment, productive capacity and sustainable development. For example, Government expenditure and taxation (or subsidy) policies affect both public and private investment, as well as social programmes. Monetary and financial policies also support productive activities, especially agriculture and employment-intensive small and medium-sized enterprises through specialized credit facilities. Exchange rate policies affect the growth of tradable sectors and, hence, structural transformation.

10. However, the conduct of macroeconomic policies becomes severely constrained in a globalized economy that allows free flows of short-term capital. In choosing its monetary and exchange rate policies, a country has to give up one of the two policies to market forces: if a country exercises control over its monetary policy, it cannot retain this control without allowing its exchange rate to float; on the other hand, if it wants to manage the exchange rate for a developmental purpose, then it necessarily cedes control over its monetary policy.[4] Even fiscal policy becomes hostage to financial market whims, as the adoption of a particular policy could trigger abrupt and disruptive withdrawals of short-term capital. Thus, for the effective conduct of macroeconomic policies, countries should exercise their sovereign right under article VI of the IMF Articles of Agreement and actively manage short-term capital flows. Both IMF and the World Bank have recognized the need for capital flows management in the wake of the crisis.[5]

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[3] The present report should be read in conjunction with the report of the Secretary-General on promoting productive capacity, employment and decent work to eradicate poverty in the context of inclusive, sustainable and equitable economic growth at all levels for achieving the Millennium Development Goals (E/2012/63).

[4] This is known as the “open economy trilemma” or “impossible trinity”: capital mobility, independent monetary policy and control over the exchange rate cannot all be achieved simultaneously.

[5] IMF, “Recent experiences in managing capital inflows — cross-cutting themes and possible policy framework” (2011). Available from www.imf.org/external/np/pp/eng/2011/021411a.pdf.

11. As noted previously, the predominant macroeconomic policy model prior to the crisis was one where monetary policy focused strongly, if not exclusively, on inflation. Fiscal policy played a secondary role, with its limited effectiveness attributed to leakages through increased imports or offsetting declines in consumption by private agents who apparently save to pay for future tax burdens caused by fiscal deficits. It was also presumed that fiscal policy, by affecting interest rates, crowded out private investment. However, there is very limited empirical support for these concerns.[6]

12. Financial intermediation and regulation were not seen to be part of the framework, and their macroeconomic implications were largely not taken into account. Domestic financial sector deregulation was also the norm for developed and developing economies, accompanied by the progressive dismantling of controls over cross-border capital flows and the adoption of flexible exchange rates. This integrated domestic financial systems with international financial markets and institutions, intensifying financial globalization and severely constraining macroeconomic policy space.

13. Since the debt crisis of the early 1980s, the predominant macroeconomic model advocated to developing countries as a "one size fits all" approach by which to build a healthy economy and investment climate was the Washington Consensus, a combination of tight macroeconomic policies, privatization, rapid liberalization and deregulation. The size and role of Government were minimized, in particular through reduced public investment and social programmes, in favour of privatization and fiscal discipline. Export promotion was also pushed and, with the exception of cash crops for export, the agricultural sector was neglected. The emphasis on reduced Government may have significantly weakened the institutional capacity to deal with crisis situations.

14. Overall, however, this approach did not result in sustained high economic growth.[7] Rather, the spread of economic liberalization and fiscal consolidation yielded a significant shrinkage of public investment and policy space in developing countries. Financial globalization lessened the ability to control rapid private capital flow reversals, when substantial amounts of capital can be withdrawn from a country in short periods, or to counter the resulting financial turmoil and economic contraction and implement countercyclical financial and macroeconomic policies.

15. Contrary to the claims by its proponents, deregulated financial globalization produced perverse outcomes, such as capital flowing from developing to developed countries and the rise of borrowing costs.[8] The procyclical nature of private capital flows also increased the risk of financial and balance of payments crises experienced by many emerging market economies during the 1990s and 2000s.[7]

16. Many developing countries following the dominant policy framework also saw their fiscal space shrink. The decline in revenues due to the reduction of some direct

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[6] Richard Hemming, Michael Kell and Selma Mahfouz, "The effectiveness of fiscal policy in stimulating economic activity — a review of the literature", Working Paper, WP/02/208 (IMF, 2002). Available from www.imf.org/external/pubs/ft/wp/2002/wp02208.pdf.

[7] *Report on the World Social Situation 2010: Rethinking Poverty* (United Nations publication, Sales No. E.09.IV.10).

[8] Maurice Obstfeld, "International finance and growth in developing countries: what have we learned?", NBER Working Paper, No. 14691 (Cambridge, Massachusetts, National Bureau of Economic Research, 2009). Available from www.nber.org/papers/w14691.

taxes was not compensated by the introduction of a value added tax (VAT). VAT has been found to be regressive, disproportionately affecting the poor, and to encourage the informal and black economy.[9]

17. Many poor countries also saw their external debt rise as they failed to take advantage of liberalized trade owing to a lack of productive capacity. Their manufacturing and food production suffered as a result of the availability of cheaper imports.

18. The economic and financial crisis showed that the policies in place through deregulated financial globalization and the dominant macroeconomic frameworks were not sufficient to prevent worldwide price volatility in commodities and asset price bubbles or to contain the negative effects of the crisis.

19. The crisis not only brought a shift in the macroeconomic policy framework but also returned fiscal policy to centre stage, as the ability of central banks to effectively use monetary policy to lower interest rates became limited because interest rates were already substantially low. The crisis also revealed the importance of fiscal space, that is, having sufficient room in the Government's budget to allow it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position. Some Governments' fiscal space became limited, however, as they had to inject considerable financial support for the financial sector and roll out fiscal stimulus packages. Others were limited in their use of fiscal policy because of high levels of debt or large unfunded liabilities.

20. In addition to exposing the limitations of the dominant macroeconomic framework, the crisis offers a number of key lessons: (a) the importance of consistent countercyclical policies; (b) the necessity of having the fiscal space to run larger fiscal deficits when needed; (c) the need to increase and improve automatic fiscal stabilizers, such as transfers, which are triggered by a macroeconomic variable crossing a threshold level, because of the time required for political decision-making and the implementation of discretionary fiscal measures; (d) the importance of social dialogue for identifying developmental and macroeconomic priorities and for ensuring broad-based, inclusive growth and development; and (e) the importance of policy coordination and consistency among countries to combat financial crises and economic downturns.

III. Employment creation and decent work

Global unemployment

21. According to the International Labour Organization (ILO), the world entered 2012 facing a serious jobs challenge and widespread decent work deficits. There was a backlog of global unemployment of 200 million, an increase of 27 million since the start of the crisis. In addition, more than 400 million new jobs would be needed over the following decade to avoid a further increase in unemployment.

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[9] See Michael Keen, "What do (and don't) we know about the value added tax?: a review of Richard M. Bird and Pierre-Pascal Gendron's *The VAT in Developing and Transitional Countries*", *Journal of Economic Literature*, vol. 47, No. 1 (2009), pp. 159-170. See also Marta Ruiz, Rachel Sharpe and María José Romero, "Approaches and impacts: IFI tax policy in developing countries" (European Network on Debt and Development and ActionAid, 2011), available from http://eurodad.org/?p=4564.

Hence, the world must rise to the urgent challenge of creating 600 million productive jobs over the following decade, which would still leave 900 million workers and their families, largely in developing countries, living below the US$ 2-a-day poverty line.[10]

22. In general, the global economy's ability to generate employment in keeping with the growth of the working-age population has declined. Even before the crisis, many regions witnessed "jobless growth", and in those regions where employment growth has been achieved it has often been at the expense of the quality of work, resulting in more people having to find jobs in the informal sector or engage in self-employment or unpaid family work. Thus, there has been a significant rise in precariousness, both in developed and developing countries. Since the crisis, progress in reducing the number of the working poor has significantly decelerated.

23. Youth unemployment continues to be a serious challenge. In 2011, the global youth unemployment rate was almost three times as high as the corresponding adult rate. In addition, little progress has been observed in closing the gender gap in labour markets. Women continue to be disproportionately represented in lower-wage sectors and occupations, such as agriculture, and among workers engaged in vulnerable employment, defined as own-account workers and unpaid family workers.

24. Overall, economic growth at the global level during the past decades has not been robust enough to generate sufficient employment opportunities. This situation was further exacerbated by the global financial and economic crisis, in particular in developed countries, where economic growth rates have been significantly lower. The crisis also aggravated the already marked volatility of global financial flows, which has had a negative impact on growth in some developing economies.

25. Consequently, there is a need for policymakers to harmonize and balance price and debt stability objectives with macroeconomic policies that target the real economy, in particular employment creation, productive investment and the sectoral composition of growth.

Successful experiences with economic growth for employment creation

26. Despite the trend of jobless growth globally, several countries have achieved positive macroeconomic results. Since the 1980s, some countries in South-East Asia, such as Indonesia, Malaysia, Thailand and Viet Nam, have been successful in maintaining high, sustained rates of growth, consistently generating employment and reducing poverty, even when inflation was in the range of 10 to 15 per cent. Growth was supported by policies that promote structural change, including agricultural productivity improvements, large-scale investments in rural infrastructure and services and land entitlements for the rural poor, and that increase the capacity to participate in global trade. Growth was further bolstered by strong industrial policies and support for technology development, innovation and diffusion.

27. Earlier, Japan, the Republic of Korea and Singapore also achieved rapid and sustained growth and poverty reduction, building on broad-based development strategies. This sustained growth has positioned the East Asian subregion to meet

[10] ILO, *Global Employment Trends 2012: Preventing a Deeper Jobs Crisis* (Geneva, 2012).

Goal 1, on poverty reduction, of the Millennium Development Goals and to make the cumulative investments necessary for achieving the other Goals.

28. Sustained economic growth must also be based on an equitable distribution of opportunities. In the East Asian experience, more equitable distribution of physical and human capital enabled economic growth that was broadly shared and inclusive. For many of the countries of the region, land and agrarian reforms were central to a more equitable distribution of opportunities at the start of the economic take-off. Universal education and health-care systems also played a vital role in spreading improvements in human development. As a consequence, several countries of the region, such as Indonesia and the Republic of Korea, were able to reduce income inequality as measured by the Gini coefficient.[11]

Macroeconomic policies, employment creation and decent work

29. As the basic instruments of macroeconomic management, fiscal, monetary and exchange rate policies have strategic short- and long-term dimensions. On the long-term side of fiscal policy, Government spending in employment creation and social services can positively affect social welfare and distribution. Spending on infrastructure can significantly contribute to enhancing productive capacity for economic growth and development. Public investment in research and in creating "green" technologies can encourage private investment.

30. On the monetary side, interest rate and credit policies play an important role in creating a favourable business environment and inducing structural change. Reasonable price stability, not necessarily very low single-digit inflation, is also important for fostering orderly growth and employment creation. Management of exchange rate and capital flows also affect growth and the pace of structural change.

31. The main short-term objective is countercyclicality. When economic activity falters because of weaknesses in aggregate demand, it becomes crucial to enact countercyclical fiscal and monetary stimuli to stem employment losses and restart growth and job creation. As the financial and economic crisis unravelled in 2008-2009, Governments across the globe enacted a series of fiscal and monetary expansionary measures that served to mitigate the impending recession. ILO estimates indicate that 21 million jobs were created or saved in the countries of the Group of 20 in 2009 and 2010 by those countries' stimulus packages.[12]

32. In general, countries that were able to implement a consistent set of countercyclical fiscal and monetary policies have fared better through economic cycles. Given the rapid rate of globalization and economic integration, successful stabilization strategies will also require much stronger macroeconomic policy coordination between countries and regions — for example, by coordinating expansionary fiscal and monetary policies to address downturns in the economic cycle.

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[11] Inequality has, however, risen in recent decades in several Asian countries; see Asian Development Bank, *Asian Development Outlook 2012* (Manila, 2012).

[12] ILO, "Accelerating a job-rich recovery in G20 countries: building on experience", paper presented at the Meeting of Group of 20 Labour and Employment Ministers, Washington, D.C., April 2010. Available from www.ilo.org/public/libdoc/jobcrisis/download/g20_report_accelerating.pdf.

33. Once a macroeconomic stimulus has been implemented, it is necessary to determine the timing and sequencing of withdrawal. Too early a withdrawal of stimulus and fiscal consolidation can jeopardize nascent recovery, as experienced during the Great Depression of the 1930s, as well as during the recent crisis. This can have an adverse impact, not only on employment and growth, but also on debt sustainability itself.

34. With respect to Government spending, the focus should not always be low or zero Government budget deficits. Productive Government investment could justify budget deficits if long-term investment returns compensate for current imbalances. Case-by-case assessments are needed to determine if accruing deficits is sound economic policy. Likewise, moderate inflation can be tolerated if it can induce structural change and support productive investment. In fact, there may even be a need for generating inflation to prevent the rise of the real debt burden and to encourage consumer spending.

35. From the perspective of poverty reduction, Governments may have to consider direct job creation programmes, such as rural employment guarantee schemes. These "Government as an employer of last resort" programmes are found to be quite effective in many developing countries, without creating excessive budgetary pressure.

36. In sum, making employment a high priority has implications for fiscal policies, leading to "functional finance", or public finance that adjusts to achieve an objective, such as full employment. Countries that have made progress in employment creation and poverty reduction have often benefited from Government investment in infrastructure and research and development to raise productivity, and in social protection and social services to reduce vulnerability and build social capital. They have often used monetary, credit and exchange rate policies to induce structural change and support labour-intensive small and medium-sized enterprises and agriculture.

Employment growth in the private sector

37. The private sector is a critical partner in employment creation. In addition to creating a predictable macroeconomic environment, macroeconomic policies can play a supportive role in encouraging private investment in employment-intensive and environment-friendly sectors. For example, Governments can make complementary investments in education, health and social protection, which can be considered part of a social wage that helps moderate wage demands; this in turn encourages private investment. In addition, tax incentives and subsidies can also be used to encourage investment.

38. These complementary fiscal measures are unlikely to make budgets unsustainable, as the resultant growth in output and employment boosts revenue. However, taxes and subsidies should be sectoral, not targeted or industry-specific, with a clear provision for withdrawal should the sector fail to grow.

39. Institutional arrangements that foster dialogue between employers and employees are also important for private investment. They help maintain macroeconomic stability as workers moderate wage demands and business reinvests profits; help cope with economic downturns; and mitigate employment loss.

Multi-stakeholder dialogue

40. Macroeconomic policies aimed at development and employment creation require structural transformation and industrial development. A smooth transition through this economic transformation requires increases in education and skills development and social protection schemes that ensure a basic standard of living for the most vulnerable.

41. A smooth transition also requires strengthened dialogue between workers, employers and Governments to ensure broad-based, inclusive economic growth and development with an emphasis on a fair and just distribution of economic gains. Sound industrial relations, effective participation and social dialogue are a means not only to promote better wages and working conditions but also to identify development and macroeconomic policy priorities, thereby fostering inclusiveness and equity. Boxes 1 and 2 provide specific country examples of multi-stakeholder dialogue on macroeconomic and labour policies.

Box 1
Tripartite dialogue and macroeconomic policy-setting in Germany

In Germany there is a tradition of corporatist policymaking, where unions play an important institutional role in the administration of labour market and social policies and are generally consulted on major policy decisions. However, national tripartite pacts are not a characteristic of industrial relations in Germany. The country's response to the economic and financial crisis included tripartite national social dialogue, but only at a consultative level. Nonetheless, union involvement was considerable, in particular at the sectoral and subnational levels.

One of the main measures taken, which emerged from tripartite consultations, was the extension of the short-time working scheme under which the Government provided subsidies allowing people to work fewer hours without a commensurate drop in earnings. The policy permitted the preservation of about 432,000 full-time equivalent jobs. In addition, numerous sectoral collective bargaining agreements exchanged pay freezes for limits on redundancies.

Source: *Social Dialogue during the Financial and Economic Crisis: Results from the ILO/World Bank Inventory using a Boolean Analysis on 44 Countries* (Geneva, ILO, 2011).

Box 2
Social dialogue in Barbados

Collaboration between representatives of the Government, employers and workers on labour-related issues, as well as issues of general economic and social policy, has been a defining feature of the industrial relations environment in Barbados. Since its inception in 1993, the Social Partners, a tripartite organization, has agreed on a number of resolutions, which have taken the form of protocols. By 2005, five different protocols had been put in place. The protocols outline various policies to guide economic and social development through joint efforts between the Government, private sector and workers' unions and increase competitiveness and productivity. They have also served to achieve social peace and good governance. Political will for the success of the partnership and the participation of civil society, including religious groups, are among the key characteristics of this approach.

Source: *Fostering Economic Development through Social Partnership in Barbados* (Geneva, ILO, 2001).

IV. Productive capacity and economic growth

Macroeconomic frameworks and the development of productive capacities

42. The United Nations Conference on Trade and Development (UNCTAD) defines productive capacities as the productive resources, entrepreneurial capabilities and production linkages, which together determine the capacity of a country to produce goods and services.[13] Productive capacities develop through the three processes of capital accumulation (human, physical and natural), technological progress and structural change. In designing and implementing macroeconomic policies, policymakers need to analyse how the policies will interact with each of those core processes.

43. A review of policy statements from 50 developing countries shows that current macroeconomic policies continue to emphasize fiscal adjustment and inflation targeting.[14] This focus of macroeconomic policies on restoring fiscal balance and on low inflation, however, may be too narrow for achieving the desired growth gains and development objectives. Emphasis on balancing public budgets often results in declines in public investment in infrastructure, technology and human capacity development, as well as declines in social spending, all of which are critical for increasing productive capacities and generating sustained, inclusive and equitable economic growth.

44. Depending on its current level of debt and fiscal space, a country may consider deficit spending in support of investments in productive capacity. This could include, for example, aligning fiscal policy with an agreed fiscal rule, such as the "golden rule" in place in certain countries, referring to a provision that budget deficits not exceed investment or capital expenditure.[15] In other words, Government borrowing would be for investment purposes only. However, such a rule must accommodate the need for countercyclical policies. For example, countercyclical policies requiring Government borrowing must be geared to the productive and social sectors.

[13] UNCTAD, *The Least Developed Countries Report 2006: Developing Productive Capacities* (New York and Geneva, 2006).

[14] Report of the Expert Group Meeting on the Challenge of Building Employment for a Sustainable Recovery, held in Geneva on 23 and 24 June 2011. Available from www.un.org/esa/socdev/egms/docs/2011/report-june2011.pdf.

[15] Barry H. Potter and Jack Diamond, *Guidelines for Public Expenditure Management* (IMF, 1999). Available from www.imf.org/external/pubs/ft/expend/index.htm.

45. Regarding monetary policy, including the financial regulatory framework, an enabling model is one where inflation is kept to reasonable levels while facilitating the allocation of credit for enhancing productive capacity investments and poverty reduction programmes. The exchange rate should also be favourable to the export of goods and services and to diversification into activities unrelated to the exploitation of natural resources, especially in extractive, resource-based economies. This may require management of capital flows.

Investment in productive capacity and links to industrial and sectoral policies

46. Industrial and sectoral policies are strongly linked to macroeconomic growth policies, and both can contribute to the development of productive capacity. Structural transformation, in particular the development of competitive manufacturing activities, can play an important role in the promotion of sustained, inclusive and equitable economic growth and is not simply a by-product of this process. As noted earlier, Government action can promote and accelerate structural transformation for growth. Hence, industrial and macroeconomic policies need to be aligned with each other, as well as with other policies, to increase productive capacity.

47. Many developing countries are characterized by an acute concentration of production in agriculture and mining-based commodities, which often experience high market volatility and involve little value addition. Those countries need to diversify away from agriculture or extractive mining towards manufacturing. Diversified economies are also better able to take advantage of export opportunities in global markets, as industrial diversification leads to export diversification. This extends to trade in services as well, in particular business services. A broader productive base results in lower dependency on natural resources for exports, which in turn leads to reduced vulnerability to external price shocks in export commodities, providing longer-term economic stability (see box 3 below for an example of using investments in productive capacity to promote private-sector economic diversification).

Box 3
Productive capacity and the private sector: Botswana

Botswana transitioned from least developed country status at the time of independence in 1966 to middle-income status within three decades, largely owing to the effective use of revenues from large diamond reserves. Public expenditures are geared towards the provision of social services and the development of infrastructure in support of economic diversification, and Botswana now has a relatively well-developed infrastructure after sustained investment. Education and health care account for around 25 and 7 per cent, respectively, of total budget expenditures, while capital spending, which is focused on economic diversification, accounts for some 30 per cent of the budget.

The Government has established special programmes to develop the productive capacity of the private sector. The Citizen Economic Empowerment Programme is among such initiatives and is implemented by the Citizen Entrepreneurial Development Agency and the Local Enterprise Authority. The Programme funds training and mentoring services for individuals wishing to venture into businesses. The Government's decision to outsource services to local groups is aimed at stimulating local production and promoting small and medium-sized enterprises.

Source: *African Economic Outlook 2011* (African Development Bank, OECD, the Economic Commission for Africa and the United Nations Development Programme, 2011).

48. Sectoral policies and investments in agriculture can also contribute to increased productive capacities and economic growth. In particular, increased budget allocations to agriculture and rural development are critical in countries where agriculture is a mainstay and a major employment sector but shows suboptimal performance. Increased investment in agriculture should be directed towards raising the productivity and increasing the resilience of small-scale farmers in developing countries. Focusing on improving production conditions for female workers in agriculture would generate additional economic and social gains, and integrating agricultural and environmental policies into broader rural development policies ensures that ecosystems continue to sustain farming systems.

49. The development of human resources is crucial for enhancing productive capacity and supporting structural transformation. Human resources are increased mainly by investing in education, job training and health care. A better-educated and healthier labour force has important positive externalities, including productivity growth and the ability to attract foreign investors.

50. Technical and vocational training is a key area of investment, especially among women and young people. Measures should also be taken so that persons with disabilities benefit equally from public services, systems and policies, including in the areas of health, education, social protection and labour. Investments in social protection and health-care access also contribute to human resource development and productivity growth.

51. In middle-income countries where primary education is already universal, emphasis should be placed on extending secondary, tertiary and vocational education and training to ensure the productive insertion of their citizens into the labour force. At the same time, Governments should promote continuing education for workers already in the labour force, as well as investments in early childhood care and education. The former need was recognized by leaders of the Group of 20 in September 2009, when they pledged to support robust training efforts in their growth and investment strategies and committed to helping other countries undertake effective skills development.

52. Investments in natural capital can also increase productive capacity. Natural capital, which is defined as natural assets in their role of providing natural resource inputs and environmental services for economic production,[16] is generally considered to comprise three principal categories: natural resource stocks, land and ecosystems. All three are essential to the long-term sustainability of development, as well as to humankind and other living beings. Investments in natural capital need to

[16] Organization for Economic Cooperation and Development, *OECD Glossary of Statistical Terms*. Available from http://stats.oecd.org/glossary/index.htm.

be catalysed and supported by targeted public expenditure, policy reforms and changes in regulations.

53. The recent global crisis has affected the capacity of many Governments to finance new infrastructure projects and maintain and rehabilitate existing infrastructure. Donor and recipient countries should therefore review and adjust the allocation of aid with a view to increasing recipient countries' productive capacities. The capacity of Governments to mobilize domestic financial resources should also be improved through a variety of options, including public-private partnerships with appropriate risk-sharing, which bring greater participation from the private sector in productive capacity development. Box 4 below gives an example of regional initiatives in Eastern Europe that have stimulated investment in infrastructure, including through external financing assistance.

Box 4

Regional initiatives and productive capacity: Belarus, Kazakhstan and the Russian Federation

For advanced European economies with considerable unused production capacity and high levels of unemployment, demand, not supply, remains the binding growth constraint. This excess capacity has created opportunities for Governments to address infrastructure needs and invest additional resources in education and research. However, because of depressed tax revenues, this action required debt financing, which many Governments were reluctant to undertake.

Regional trade policy initiatives, such as the creation by Belarus, Kazakhstan and the Russian Federation of a customs union and the continued implementation of the Central European Free Trade Agreement, have helped to improve economic efficiency and stimulate investment. Regional infrastructure projects involving the construction and maintenance of roads, railways and pipelines have promoted economic integration and investment. External assistance, such as the Aid for Trade initiative and subsidized investments by the European Bank for Reconstruction and Development, has financed some of these undertakings.

Source: *Official Records of the Economic and Social Council, 2011, Supplement No. 17* (E/2011/37).

Technological progress and structural change

54. Productive capacities develop when a country's ability to efficiently and competitively produce a broader range of higher value added goods and services increases. This process occurs not only by expanding investment, as mentioned above, but also by engaging in technological acquisition and innovation. In the area of information and communications technology, Governments have an important role to play in implementing sound policies and infrastructure and facilitating or providing training. The public sector plays a critical role in supporting new forms of market facilitation to stimulate innovation in the information and communications

technology sector by introducing effective regulation and providing public services appropriate to local conditions.

55. Most advanced economies have undergone significant structural changes. One of the key characteristics of change is the growing importance of knowledge in economic activities. These economies developed from an agricultural economy, where land was the central resource, to an industrial economy based on natural resources and labour, and then to a principally knowledge-based economy, with knowledge as the key resource.

56. In developing countries, knowledge and knowledge management can also play an important role in increasing economic growth and facilitating structural change, with skills, know-how and technological change serving as drivers of economic growth. The use of local, indigenous and tacit knowledge can add value to productive capacity as well. Indigenous knowledge is often referred to as knowledge that is unique to a given culture or society.[17] However, many countries lack the capacity to harvest knowledge from these knowledge systems. Increasing a country's productive capacity should also include strengthening of institutions and other strategies to promote investment in research and development to augment the capacity to use local and indigenous knowledge.

V. Achievement of sustainable development

Macroeconomic policies and sustainable development

57. Macroeconomic policies have powerful and widespread impacts on sustainable development. The linkages and relationship between them can be examined through the three major pillars of sustainable development: economic development, social development and environmental protection. The link to the first pillar is direct, as macroeconomic policy is an integral part of economic development.

58. The relationship between macroeconomic policies and social development pertains to the ability of the former, as discussed above, to foster full employment and decent work with a view to poverty eradication, as well as increased revenues for investments and spending on social objectives. Advances in social development, in particular in education and health care, also contribute to economic growth through a country's increased productive capacities in human capital.

59. At the time of the United Nations Conference on Environment and Development (Earth Summit), in Rio de Janeiro, Brazil, in 1992, the link between macroeconomics and the environment was largely unexplored. Historically, the conventional focus had been on maximizing economic growth and ignoring sustainability issues. Since the Earth Summit, however, research has established that macroeconomics and the environment are inextricably linked and that environmental protection plays an essential part in growth and development. Important issues include the ability to generate fiscal revenues for increased Government expenditure towards environmental protection, and investment in green technologies.

60. Macroeconomic policies to foster sustained growth and create productive employment are important elements in the advancement of environmental

[17] See www.worldbank.org/afr/ik/basic.htm.

protection. Conversely, poverty is an important contributor not only to the growth of urban slums but also to deforestation.[18] Countries experiencing stable, sustained growth can more easily prioritize and address environmental issues than those with unstable or stagnant economies.

61. At the same time, environmental problems have the potential to hurt economic growth. There is abundant documented evidence of impediments to growth through lost labour productivity resulting from ill health, forgone crop output from soil degradation, and lost fisheries output and tourism receipts from coastal erosion and marine depletion. Public health expenditures aimed at mitigating or avoiding these and other negative human welfare impacts of environmental degradation can lead to higher fiscal outlays. This can further constrain Government expenditure and divert resources from growth-enhancing investments.

62. Macroeconomic policies and circumstances can have negative environmental repercussions and the potential to either hurt the environment or slow down progress towards sustainable development. During recessions or the implementation of contractionary macroeconomic policies, economic concerns may take priority over environmental concerns among both Government policymakers and the public at large.

63. Macroeconomic policies can also transfer environmental impacts through trade. For example, expansionary macroeconomic policies in developed countries could stimulate growth in developing countries through an increased demand for the latter's exports. Whether that growth results in environmental degradation would depend on the soundness and efficiency of the exporting country's environmental policies and whether the expanding industries involved are more polluting.

64. It is necessary, therefore, to ensure that sound environmental policies are in place in both developed and developing countries. These policies need to be able to withstand macroeconomic instability and policy swings and expand sustainable employment opportunities, in particular for people living in poverty. While it is often suggested that there is a trade-off between economic growth and environmental protection, recent United Nations estimates suggest that, with sufficient investments in shifting development onto a more sustainable and green growth path, it may be feasible to combine fast growth with environmental protection in developing countries.[19]

Economic growth and natural resource consumption

65. In 2011, the International Resource Panel warned that by 2050 the human race could devour 140 billion tons of minerals, ores, fossil fuels and biomass per year — three times its current consumption — unless nations began "decoupling" economic growth rates from the rate of natural resource consumption.[20] The Panel noted that

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[18] Alexander S. P. Pfaff and others, "Effects of poverty on deforestation: distinguishing behaviour from location", Agricultural and Development Economics Division Working Paper, No. 04-19 (Rome, Food and Agriculture Organization of the United Nations, 2004). Available from www.fao.org/docrep/007/ae401e/ae401e00.htm.

[19] *World Economic and Social Survey 2011: The Great Green Technological Transformation* (United Nations publication, Sales No. E.11.II.C.1). Available from www.un.org/en/development/desa/policy/wess/wess_current/2011wess.pdf.

[20] UNEP, *Decoupling Natural Resource Use and Environmental Impacts from Economic Growth* (2011). Available from www.unep.org/resourcepanel/decoupling/files/pdf/decoupling_report_english.pdf.

in developed countries the average per capita consumption of those four key resources amounted to 16 tons, with consumption as high as 40 or more tons per person in some developed countries. By comparison, the average person in India today consumes four tons per year.

66. "Decoupling" refers to the reduction of the amount of resources, such as fossil fuels or water, used in economic activity and the delinking of economic growth and development from environmental deterioration. Resource decoupling means reducing the rate of use of resources per unit of economic activity, while impact decoupling means maintaining economic output while reducing the negative environmental impact of the economic activities undertaken.

67. Resource decoupling is already taking place to a certain degree through technological innovation. Yet, while in some geographical areas local environmental impacts have declined, the overall global impacts on the environment are becoming more severe.

68. There are both potential benefits and adjustments associated with a country's decision to actively pursue decoupling. The benefits are an improved and more efficient use of resources; a reduction of negative environmental impacts — and therefore a positive contribution to the global commons — through reduced levels of resource depletion, carbon emissions and pollution; and positive externalities, such as job creation resulting from investments in new technologies and in research and development.

69. At the same time, a decoupling strategy requires significant changes in Government policies and consumption and production patterns. In the case of decoupling economic growth from fossil fuels and pursuing alternative sources of energy, there could be increased energy costs to be borne by industry and consumers or subsidized by Government, which could, as a consequence, potentially lower rates of economic growth. Such costs are more easily borne by developed countries than by developing ones focusing on poverty eradication.

70. The decision to promote decoupling would also require an informed social dialogue and the support of the general public. Furthermore, it would be necessary to establish an enabling environment, encouraged by fiscal and financial tools and incentives, that promotes innovation and increased scientific research and knowledge, as well as the acquisition of energy-efficient and environmentally sound technologies (see box 5 for an example of efforts to decouple macroeconomic growth from energy consumption).

71. Whether or not a country actively pursues a decoupling strategy, the sustainability of its natural resource base should nonetheless be explicitly considered in its macroeconomic growth policies and should inform policies regarding foreign direct investment in resource extraction industries.

72. Natural resource use and environmental considerations also lead to a rethinking of assumptions about economic growth and the recognized limitations of GDP as a measure of growth and well-being. Research is being conducted to identify appropriate indicators and develop more rigorous, science-based methods of measuring sustainability and well-being with a view to their introduction into national systems of accounts and to better-informed policy decisions. To fully include all the dimensions of sustainable development, new and alternative measures have been proposed to complement GDP measurement or to move beyond

it. Currently, however, there is no broad acceptance of an alternative measure or consensus on this matter.

Box 5

Denmark: macroeconomic growth and energy consumption

Since 1990, Denmark has been decoupling macroeconomic growth and energy consumption, while at the same time reducing greenhouse gas emissions. The country has a long history of consensus-based policymaking and political stability. The Government of Denmark conducted an inclusive and open debate to obtain broad support among stakeholders for a comprehensive vision on energy policy.

The country's long-term energy goal is to become independent of fossil fuel use by 2050. In 2011, the Government of Denmark published *Energy Strategy 2050: From Coal, Oil and Gas to Green Energy*, a policy document that contains a series of new energy policy initiatives to build on existing policies and transform Denmark into a low-carbon society with a stable and affordable energy supply. The inclusion in Danish legislation of the new energy policy initiatives outlined in *Energy Strategy 2050* is to be negotiated in Parliament. The Government is working towards broad agreement on the Strategy's long-term goal and initiatives up to 2020.

Source: *Energy Policies of IEA Countries: Denmark — 2011 Review* (Paris, OECD and International Energy Agency (IEA), 2011), available from www.oecd-ilibrary.org.

Sustainable development and employment

73. In response to the financial crisis in 2009, many large economies adopted green stimulus packages. The green share in overall stimulus packages ranged from 3 per cent in Japan to 81 per cent in the Republic of Korea. Much of the stimulus was allocated to the energy efficiency of buildings, railway networks and power grids, with only a small share for renewable energy.[21] Such stimuli are likely associated with the creation of about 4 million jobs, most of which were debt-financed.

74. The availability of financing for investments will be among the constraints in the shift to low-emissions economies in most developing countries, in particular in small domestic markets for low-emissions technologies. Macroeconomic policies will need to be consistently pro-investment, and institutional reforms, including the recapitalization and refocusing of development banks, will need to be adopted. Such constraints serve as an important reminder that any large-scale push for Government spending by developing countries to move to sustainable development will have a global dimension.

[21] Department of Economic and Social Affairs of the United Nations Secretariat, "Green jobs and social inclusion", Rio 2012 Issues Brief, No. 7 (2011). Available from www.uncsd2012.org/rio20/index.php?menu=138.

75. Jobs are often a main political selling point for sustainable policies, although most actions to pursue sustainable development consider the creation of green jobs a co-benefit and not a primary goal. As there is no generally agreed definition of "green jobs", it is more useful to look at the net employment impact across the economy of policies and measures taken to transition to a green economy.

76. A report commissioned as part of the Green Jobs Initiative of the United Nations Environment Programme (UNEP), ILO, the International Organization of Employers and the International Trade Union Confederation suggests that the number of green jobs in the world might increase from 2.3 million to 20 million from 2006 to 2030,[22] which implies the creation of 750,000 green jobs per year. China alone would have 4.5 million jobs in wind and solar power by 2020. On the other hand, green jobs alone will not be an answer to the global employment challenge to create in the order of 63 million decent new jobs per year by 2050.

77. In the wake of the crisis, the Secretary-General has proposed a Global Green New Deal to accelerate economic recovery and job creation while addressing sustainable development, climate change and food security challenges by front-loading massive public investments in developing countries in renewable energy and smallholder food agriculture, so as to induce complementary private investments. This would need global cross-subsidization and large-scale public investments to attract private investment. Following years of easy credit and overinvestment before the crisis, the world now faces underutilized overcapacity in most profitable economic sectors. In this situation, only well-coordinated cross-border public investments can fund the needed green public goods and induce complementary private investments through public-private partnerships to address these global challenges.

VI. Global coordination for creating an enabling environment

78. The global financial and economic crisis of 2008-2009 elicited an unprecedented level of coordinated actions by Governments and policymakers around the world. Since then, however, there has not been a clearly defined coordinated response to current major challenges, including the high levels of global unemployment. Credible and effective policy coordination needs to be ensured in order to rebalance the global economy and create a more enabling international environment.

79. A robust and resilient global economy will require strong global coordination of macroeconomic policies. Concrete mechanisms need to be implemented and coordinated internationally to maximize the impact of policy decisions and reduce the scope for speculation and competitive gains that could otherwise emerge when countries seek solutions individually. These mechanisms would include coordinated countercyclical policies to mitigate boom-bust cycles, as well as financial regulatory coordination to minimize and contain economic and financial crises and financial volatility.

[22] United Nations Environment Programme, *Green Jobs: Towards Decent Work in a Sustainable, Low-Carbon World* (Nairobi, 2008). Available from www.unep.org/labour_environment/PDFs/Greenjobs/UNEP-Green-Jobs-Report.pdf.

80. While there have been proposals and discussions regarding formal global coordination mechanisms to implement such concrete measures, there is currently no international consensus. The United Nations will continue to be an inclusive forum for the consideration of and deliberations on global coordination. It stands ready to spearhead the implementation of and provide support to an internationally agreed coordination mechanism.

VII. Recommendations

81. The following recommendations are made with respect to macroeconomic policies for the creation of employment, the increase in productive capacities and the achievement of sustainable development and the Millennium Development Goals, in the context of sustained, inclusive and equitable economic growth in pursuit of poverty eradication.

Employment creation and decent work

82. **Countries should consider employment creation and full employment as a priority macroeconomic policy objective in order to address the urgent need for employment creation and decent work.**

83. **Governments should use fiscal policy to contribute to the development of productive capacity for economic growth and job creation. For example, Governments should consider increasing expenditure in infrastructure and promote structural transformation through fiscal incentives.**

84. **Countries should use monetary policy to enhance financial sector stability and promote employment intensive productive sectors, including small and medium-sized enterprises and agriculture.**

85. **Exchange rate and short-term capital flow management policies should complement fiscal and monetary policies aimed at structural transformation and financial sector stability.**

86. **Governments should pursue countercyclical measures to minimize output volatility and mitigate employment loss during economic slowdowns.**

87. **Governments should consider direct job creation, such as rural employment guarantee schemes, as part of their investment in social protection and social services to reduce vulnerability and enable the poorest to participate in and benefit from economic growth.**

88. **Governments should support employment and decent work in the private sector through an enabling environment, including a favourable and responsible regulatory framework and complementary investment, especially in employment-intensive and green technology sectors.**

89. **Governments should identify policies that increase employability and employment for groups with traditionally higher rates of unemployment or vulnerable employment, such as young people, women and persons with disabilities.**

90. **Governments should use social dialogue mechanisms to identify priorities for development and formulate macroeconomic policies that promote better**

wages and working conditions in order to ensure broad-based, inclusive economic growth and development with an emphasis on a fair and just distribution of economic gains.

Productive capacity and economic growth

91. **Policymakers should tap into their country-specific knowledge when formulating and implementing macroeconomic policies for increasing productive capacities. While certain similarities can be drawn between countries, the situation of each country is unique, and there is no one-size-fits-all solution.**

92. **If macroeconomic policies are to help in the development of productive capacities for growth, fiscal policy should generate robust aggregate demand and include sufficient Government investment and spending in skill formation and infrastructure. Monetary policy, including the financial regulatory framework, should enable a sufficient allocation of credit to support investments in productive capacity, such as in research and development.**

93. **A greater fiscal space needs to be created in order to allow Governments of developing countries to carry out investment spending in productive capacities.**

94. **Governments need to pursue a variety of options to finance new infrastructure projects and maintain and rehabilitate existing ones, such as public-private partnerships, with appropriate sharing of contingent liabilities and risk. Regional development banking and other financing initiatives have also proved effective.**

95. **There is a need to create an effective and enabling international environment, and the international community should support poor countries in building their productive capacity with increased aid and affordable access to technology, especially green technology.**

Achievement of sustainable development

96. **Strategies to make development more sustainable must be devised on a country-specific basis, in which local conditions, resource endowments, social needs and the availability of financial resources are considered.**

97. **On the basis of the principle of common but differentiated responsibility, both developed and developing countries should seek to moderate the negative effects of economic growth through policy measures that restructure and decouple growth from natural resources to make growth less resource-intensive and polluting.**

98. **Development policy and macroeconomic policymaking should focus on identifying and implementing win-win strategies that provide simultaneous economic, social and environmental gains. Macroeconomic and other related economic policies, such as trade and privatization, should be designed and shaped to avoid environmental and social damage.**

99. **Macroeconomic researchers and policymakers should explore further the sustainability of long-run economic growth, especially in the context of the**

increasing scarcity of natural resources, the degradation of the global environment, increased carbon emissions and climate change.

Global coordination for an enabling environment

100. **Credible and effective policy coordination needs to be ensured at the global level for a coordinated and sustainable rebalancing of the global economy and the creation of an enabling international environment to address current macroeconomic challenges, in particular the unprecedented high level of global unemployment.**