

## Editorial

### Shifting gears

**O**ECD countries seem poised for a modest, uneasy, yet much-welcome recovery. This prospect was far from granted a year ago, and owes a great deal to the exceptional monetary, fiscal and financial policies that policymakers across the OECD and beyond have implemented over the past 18 months. However, the recession has left deep scars that will be visible for many years to come. The crisis has lowered living standards and employment on a durable basis, and at the same time, endangered the sustainability of public finances in many OECD countries. Yet there is still time to minimise these scars through appropriate policy action.

A more positive economic outlook means policymakers should increasingly phase out some of the exceptional policy initiatives that they took in a crisis context, while at the same time maintaining or reinforcing other measures, launching new reforms and resisting protectionist and Malthusian temptations in international trade and labour markets. Candidates for gradual removal include the exceptional government support to automotive and other industries, public funding for new infrastructure projects, and crisis-related increases in unemployment benefits where these were already fairly high. By contrast, areas where reform efforts could be strengthened include reductions in anti-competitive product market regulations to boost activity and job creation, increased use of price instruments in green growth policies, and active labour market policies, which will need to cope with the sizeable recent and prospective rise in unemployment better than they did in past downturns. It also makes sense to maintain recent tax support to private R&D and targeted labour tax cuts as long-term growth support measures, but only where these can be financed. Indeed restoring fiscal sustainability will be a daunting task for most OECD governments in the years ahead. Fulfilling this task, while protecting long-term growth, will require reaping efficiency gains on spending, especially in the areas of education and health, and avoiding large increases in harmful labour and capital taxes. These areas have been addressed in previous volumes of *Going for Growth*.

So far, so good. OECD countries have avoided the major structural policy mistakes of certain past crises, such as the protectionist spiral of the 1930s or the misguided labour market policies of the 1970s. In fact, the lead chapter of this year's edition of *Going for Growth* finds that in line with last year's recommendations, many of the measures taken in the areas of R&D, infrastructure, labour taxes and active labour market policies will help to contain the long term damage of the crisis for welfare.

There is no room for complacency, however. Our in-depth assessment of reform progress over the past five years across the OECD (Chapter 2) shows that reforms are more incremental than radical in nature and they infrequently address the thorniest issues. It is not at all clear that structural reform has accelerated since the start of the crisis, as policymakers have understandably focused on the most pressing macroeconomic issues. But with the nadir of the crisis now behind us,

the time has come to move away from crisis management mode towards speeding up the recovery and laying the ground for a more sustainable and fairer economic future. In this spirit, the country notes in this year's edition of *Going for Growth* (Chapter 3) highlight for each OECD country those policy priorities which we think would be most urgent to address at the current juncture.

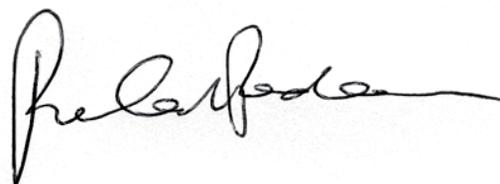
Structural reform in financial, product and labour markets has to be part of the cure. This is fairly obvious for financial market regulation, whose past deficiencies have been a major force behind this crisis and where the crisis response has left new challenges in the form of moral hazard and weak competition. It may seem less obvious at first glance for product and labour market reforms. Indeed, with this crisis having shaken our thinking on financial market regulation, one might naturally wonder whether longstanding policy prescriptions in these other areas should be revisited as well. The broad qualified answer has to be No. As dramatic as they have been, recent events have not radically altered the large income per capita gaps that prevail across the OECD, which a wealth of empirical evidence traces back to cross-country differences in education systems, labour market institutions, product market regulations or the design of tax and welfare systems, among a broad range of factors. In fact, the damage of the crisis on income levels and public budgets, and to some extent the need to address global current account imbalances, have if anything strengthened the case for reform. This of course does not imply that there is a single road to Rome, and indeed different countries can, and often do, opt for different but still efficient trade-offs between growth, risk and equity objectives.

Given the centrality of financial markets to the origins of the crisis, regulators across the OECD need to step up ongoing efforts to strengthen financial market regulation. On this front, our recent analysis summed up in Chapter 6 brings some good news: outside a few specific areas of regulation, there is no evidence of any conflict between banking sector stability and competition objectives. It should thus be possible to strengthen regulatory frameworks while preserving the benefits from competition, in terms of access to and price of financial services. This is a very encouraging message and a call for action, at a time when reform efforts may risk being watered down or even stalled.

With the crisis having revealed the disproportionate gains that high-income households have enjoyed in recent years, income distribution and equity issues, which were already a major policy concern, have moved to centre stage. One key dimension of equity within our societies is intergenerational social mobility, which promotes equal opportunity for individuals and enhances growth by putting all of society's human resources to their best use. OECD work points to major cross-country differences in this regard, and links them to education and income distribution policies (Chapter 5). In a number of OECD countries, there appears to be quite some room for enhancing intergenerational mobility at no cost or even at a benefit through education reform, including by increasing enrolment in early childhood education, avoiding early tracking of students and improving the social mix within schools.

Finally, this year's edition of *Going for Growth* looks for the first time at the long-term prospects and challenges for Brazil, China, India, Indonesia and South Africa to catch up to OECD living standards (Chapter 7). Taken together, the "BIICS" – with which the OECD has established a relationship of "enhanced engagement" – have been an important engine for world growth through this crisis, and they account for a growing share of global output. At the same time, notwithstanding major improvements in human capital that bode well for future productivity trends, our analysis highlights a number of policy areas where reform will be needed to sustain strong growth going forward. With some differences across the BIICS, challenges include moving towards more competition-friendly product market regulation, strengthening property rights and contract enforcement, deepening financial markets and adopting multi-faceted strategies to reduce the size of

informal sectors. Our Going for Growth exercise is an evolving process, and this chapter is a stepping stone towards mainstreaming the “enhanced engagement” countries in future editions, along with the incorporation of OECD accession countries.

A handwritten signature in black ink, appearing to read 'P. Padoa-Schioppa', with a long horizontal flourish extending to the right.

Pier Carlo Padoan  
Deputy Secretary-General and  
Chief Economist, OECD