

Meeting of the OECD Council
at Ministerial Level

Paris, 23-24 May 2012



OECD
WEEK
2012

NEW APPROACHES TO
ECONOMIC CHALLENGES -
A FRAMEWORK PAPER

New Approaches to Economic Challenges - A Framework Paper



1. The global crisis was a “wake-up call” to policymakers around the world. Market and governance failures have led to the most pressing financial, economic and employment crisis of our lifetimes. The idea of a growth model with a single general equilibrium has been challenged. At the same time, major global trends – i.e. globalisation and shifting wealth, population growth and ageing, environmental challenges and natural resources constraints, and skill-biased technological change – have put additional pressure on our economies. Thus, returning to business-as-usual is not an option. It is now time to reflect, to revisit and to rethink. In line with the 50th Anniversary Vision Statement, the Secretary-General proposes to develop a reflection process on “New Approaches to Economic Challenges” at the OECD. The aim is to respond to the call by several countries for such a reflection, to learn the lessons from the crisis and derive its policy implications, and to build a more solid path for economic growth and well-being.

2. This reflection will happen at a moment in which Member and partner countries are confronted with several interlinked policy challenges related to a hesitant recovery, high unemployment, growing inequality (“*go social*”), high budget deficits and public debt. In this context, the OECD will continue to promote policy measures for growth, open markets and sound institutional frameworks as key drivers of economic development and the well-being of our citizens. At the same time, new sources of growth and competitiveness need to be identified, including innovation, green growth, knowledge-based assets, and skills (“*go structural and go green*”) to put our economies back on a strong, inclusive growth path. Updating and upgrading the regulatory and implementing capacities of governments at all levels, their understanding of how markets function and how to deal with multiple risks will be a key part of the exercise. Restoring household and business confidence in markets, governments and institutions (“*go institutional*”), addressing long-term challenges related to rapidly growing populations in emerging and developing economies, and tackling issues such as ageing in many developed countries, resource scarcity, climate change and global development also have to be added to the policy “to-do” list. We propose to integrate these policy strategies in a horizontal approach, drawing on the value added of the OECD, in particular our in-house expertise, data and recommendations in various interconnected fields of public policy.

3. We are presented with a unique opportunity to tackle these challenges from a different perspective and to present more integrated and coherent answers to interlinked policy issues. A comprehensive reflection process with the first major results to be presented to Ministers at the MCM 2013 could be designed in particular to:

- Revisit and assess whether our analytical frameworks and economic models need to be adapted to the reality of a post-crisis world.
- Identify more clearly the unintended consequences of different policy choices, as well as the trade-offs and synergies between them.
- Strengthen a “whole-of-OECD” approach to policy analysis and advice.
- Further tailor our policy advice to the needs, demands and priorities of Member and partner countries, taking into account the specific institutional and political economy background.
- Support Member and partner countries in policy design and implementation (not only “what to do”, but also “how to do it”), in particular by relying on our unique “peer review mechanism.” This would mean increased efforts on implementation and better delivery, including looking at institutions and administrative capacity to deliver.

4. **As a first step, we propose to undertake a profound analysis of the root causes of the crisis and take stock of the lessons learned from it. An exercise which is already ongoing in many OECD Committees.** In this first phase, we aim to strengthen and consolidate our efforts to learn from the crisis by taking stock of OECD recommendations that had unintended consequences and highlighting those which led to successful policy outcomes, even during the crisis. This phase will focus on identifying links across different areas and potential policy synergies, and could lay a solid foundation to avoid construction flaws at a later stage.

5. **The second step is to draw on these lessons, deriving their policy implications, and relating them to underlying global trends.** The aim of this phase would be to identify key elements of a renewed framework to address complex and interrelated economic challenges.

6. **A key component in developing “New Approaches to Economic Challenges” could be to identify the areas where we may need to adjust our analytical framework (in tandem with the stock-taking exercise and identification of the related policy implications).** This could be achieved by identifying specific areas in which the framework may need to be revisited in a practical way through a broad discussion, taking into account different perspectives. For example, we may want to reflect on how to better understand the balance between adjustment and growth, and the linkages between the financial market and the real economy. We may pay specific attention to the short-term costs and long-term benefits of concrete labour market recommendations, such as, for example, reducing excessive labour protection. They could be reviewed and complemented with analysis that includes the effects of labour market institutions on employment and labour market outcomes. The effectiveness of transmission mechanisms of monetary policy in certain contexts is another area that may merit further analysis. Finally, the right balance of policy interventions of governments vis-a-vis the markets may require additional analysis and could be reviewed.

7. **Issues that should be addressed in this framework include:**

- ❖ *Economic growth, imbalances and the necessity of adjustment:* The crisis, including the euro area crisis, has shown that we need to improve our understanding of the interactions between the micro and macro dimensions of economic adjustment and the role of policies in the adjustment process, including macroeconomic management and structural reforms. More attention may need to be placed on the emergence of imbalances, both within and among countries, and at the macro and micro levels (including through balance-sheet mismatches), and on understanding why such imbalances persist and eventually become unsustainable. Dealing with imbalances effectively may require adjustments of our policy analysis and advice in a number of areas.
- ❖ *The under-pricing of risk:* In the run-up to the crisis, conventional economic modelling was based on “general equilibrium” considerations that resulted in a systematic under-pricing of risk. This created the wrong incentives and led to insufficient and ineffective regulatory and risk management frameworks. The consolidated view on market behaviour also failed to explain how financial markets operate, and their linkages to macroeconomic policy and the real economy. In our quest to reignite stronger growth, better understanding these linkages is an absolute necessity.
- ❖ *Rising inequality:* Income inequality had been on the rise in almost all OECD and G20 countries well before the crisis. OECD work unveiled this reality and also called for a review of some of the most common policy recommendations in many fields (competition, labour markets, innovation) to address the unintended distributional consequences of such policies and their trade-offs. It is now becoming clearer that the benefits of growth do not automatically trickle down and generate more equal societies, which makes it necessary to adopt an inclusive approach to policymaking, looking at a “social equilibrium” alongside an “economic equilibrium”.

- ❖ *The undesirable effects of pro-growth policies*, for example on the environment, are not fully accounted for in conventional analysis. The mainstreaming of Green Growth could be a first step towards incorporating these negative externalities in our growth models and policy advice.
- ❖ *Institutions, the political economy of reform, ineffective implementation, and individual behaviour* need to be better reflected in the way we deal with policy challenges. Strengthening governments' performance and addressing implementation gaps is another important element to improve the working of market economies. This includes strengthening the strategic capacity of governments and their long-term planning and risk management capacities, as well as adding regional and local dimensions to our policy advice.
- ❖ *Global value chains, production networks and consumption patterns revisited*: The evolving nature of global value chains and production networks, and the role of knowledge-based assets in the growth process, will be core elements of the way we look at our economies in the future. The OECD's contribution to open markets and trade and investment liberalisation will remain a key issue in this field.
- ❖ *The shifting wealth dimension and the related need of stronger co-operation* may need to be incorporated further in various aspects of our work for Members and partner countries. The crisis has shown that international co-operation and learning from each other is essential in an interconnected world. Dynamic growth driven by high investment rates, technological progress and fundamentally changed global value chains, as well as remaining poverty and inequality challenges in emerging and developing countries, deserve the joint attention of OECD Member and key partner countries. This could constitute an important pillar for our policy advice to countries at different stages of development.

8. **The various dimensions of stability, green growth, sustainability, equality of opportunity and place-based growth factors could also be considered, as well as their interconnections, trade-offs, synergies and policy spill-overs.** This would require looking at the effect of policies - such as to enhance GDP growth - on the distribution of income, the environment, social cohesion and welfare more generally.

9. We could look closer at the balance between different policy objectives:

- ❖ ***Growth/Inequality/Employment***: A key question is whether growth-enhancing policy reforms might have positive or negative side-effects on income inequality. While inequality cannot be completely avoided, it should be clearly noted that persistent and increasing inequality can have adverse effects on growth. More broadly, in pursuing growth and equality/redistribution strategies simultaneously, policymakers need to be aware of possible complementarities or trade-offs between the two objectives. Many policies could, however, yield a double dividend as they reduce income inequality while at the same time boost long-run GDP growth. Therefore, the distributional impact of policies could be addressed in a more consistent way. Effective employment, education and skills policies are examples of “*double or triple dividend policies*” for growth, employment and equality, and would therefore play a key role in the project.
- ❖ ***Growth/Environment***: There are mutually reinforcing aspects of economic and environmental policies. We need to recognise the full value of natural capital as a factor of production, and its role as a driver of growth. It is important to focus on cost-effective ways of attenuating environmental pressures to affect a transition towards new patterns of growth that will avoid crossing critical local, regional and global environmental thresholds.

- ❖ ***Environment/Inequality:*** The distributional impacts of environmental policies need to be better understood. For example, concerns about competitiveness for a country introducing a carbon tax to tackle climate change or the impact on poor households of raising water tariffs could be addressed in order to make reforms happen.

10. ***The Balance of Growth/Inequality and Environment at different stages of development:*** The nature and intensity of trade-offs and synergies will clearly vary depending on levels of development, which determine the policy priorities of a country. To deliver on these policy priorities, it is important to have appropriate institutions, procedures and rules for policy formulation and implementation in place. Fostering growth, tackling inequalities and overcoming the challenges of poverty requires building institutional capacity to deal with them. Close links to the OECD Development Strategy need to be established in the process, and key partners should be invited to accompany and shape the process from the beginning. Links with other OECD horizontal strategies, such as those on skills, jobs or green growth are also relevant to this analysis.

11. ***The objective of the whole process is to develop “A Strategic OECD Policy Agenda for Inclusive Growth”*** built on the interconnectedness, synergies and choices among different policy objectives. Such an agenda could be built on a revisited analytical framework as well as a complex policy-matrix, covering macroeconomic, structural (employment, social and green) and financial issues, as well as the international dimension. This perspective could inform the work of all Committees at the OECD and further enrich the horizontal character of our work, analysis and policy advice.

12. Ministers are invited to have a first discussion on the “New Approaches to Economic Challenges” during the 2012 MCM, which would lead to a mandate to pursue this effort, with the following basic understanding:

- Ministers are invited to launch the initiative of “New Approaches to Economic Challenges” at the MCM.
- As a first step, Ministers task the OECD Secretary-General to prepare an overview paper on the main lessons from the crisis and the steps forward.
- Throughout the process and under the guidance of Council, Members, relevant Committees and the Secretariat will appropriately participate, according to the overall governance and decision-making framework of the Organisation. The EPC is expected to have a central role in this undertaking, but considering its multi-disciplinarity, its success crucially depends on the strong ownership and participation of other Committees. The Council will be informed of progress on a regular basis in order to give this guidance.
- The exact modalities and scope of its implementation, including the establishment of a group chaired by the Secretary-General and reporting to Council, will be decided by the Council after the MCM and before the Summer break.

Questions for Ministers

- *What are the key policy areas the OECD should focus on in the “New Approaches to Economic Challenges” project? What are the main lessons from the crisis? Do Ministers agree with the proposals outlined in this paper?*
- *What are the key global trends the OECD should look at in this exercise? How could these trends be taken into consideration in our policy analysis? How can Key Partners help in shaping the project? How do we better balance growth, inequality and environmental considerations in our policy analysis and advice?*

OECD WEEK 2012

www.oecd.org

OECD Paris
2, rue André-Pascal, 75775 Paris Cedex 16
Tel.: +33 (0) 1 45 24 82 00