COUNCIL

OECD STRATEGIC RESPONSE TO THE FINANCIAL AND ECONOMIC CRISIS:
CONTRIBUTIONS TO THE GLOBAL EFFORT

(Note by the Secretary-General)

This document contains a revised version of the OECD Strategic Response to the Financial and Economic Crisis. It has been prepared to reflect the comments made by Delegates at the ECSS discussion on 24 November. As agreed at that meeting, Members are invited to provide any additional comments within one week, i.e. by Wednesday, 10 December c.o.b., so that a final version can be produced in advance of the 18 December Council meeting.
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Introduction

1. The world is currently facing the most severe financial and economic crisis in decades. The OECD’s latest Economic Outlook shows that the world economy is now in recession. Projections point to a protracted downturn in the OECD, with GDP likely to decline by a 1/3 of a percent in 2009. In other parts of the world, similar slowdowns are taking place. There remains a large degree of uncertainty about the depth and duration of the financial crisis, which has been the prime driver of the downturn. The spill-over from the financial sector to the real economy has already translated into rising unemployment in many OECD and non-OECD countries, hurting millions of families and communities and leading to public uncertainty and anxiety. Reversing this trend has to be a central priority, along with restoring confidence and stability in the financial system.

2. This crisis has struck at a time of great global interdependence. This makes the breadth and depth of the crisis unprecedented. Just as the causes and consequences of the crisis are rooted in a wide set of inter-related policy areas, identifying and implementing solutions calls for integrated responses: from financial regulation to corporate governance, from fiscal policy to competition, from innovation to financial education, employment, insurance and pensions, and others.

3. The response to these unprecedented events cannot be “business as usual”. New institutional mechanisms are needed to generate truly global and multidimensional responses, a point underlined by the G20 leaders at their meeting in November when they called on international organisations to support their work.

4. The OECD, working hand in hand with emerging economies and other organisations, has a critical role to play in strengthening the global economy. This document presents the OECD’s proposed contributions to address the financial and economic crisis. We believe that it can feed usefully into the G20’s Action Plan as it goes forward, and reinforce other multilateral and national efforts to restore growth and stability.

5. In implementing the Response, countries in the OECD’s accession and enhanced engagement initiatives will be standing partners. Building upon our existing dialogue and co-operation with them, they will contribute to strengthening the relevance and quality of the work and to promoting the necessary collective convergence in policy and action amongst developed as well as major emerging economies.

Key considerations

6. Over the past months, many emergency measures have been taken by government authorities and central banks in an effort to stem the crisis. We welcome the call for a coordinated fiscal stimulus to counter the sharp decline in activity levels as part of the short-term response, which should be timely, targeted and temporary.

7. While policy action has rightly concentrated on dealing with immediate concerns, a comprehensive strategy is also needed to attenuate the impact of the current recession and put the global economy back on a sustained growth trajectory. This will include strengthening the implementation of productivity enhancing reforms to support growth beyond the short term. Stimulus measures that are being rolled out are likely to include important investments in infrastructure, offering an exceptional opportunity to deal with other pressing challenges. For example, packages should have built-in incentives for environment-friendly investments, which are needed to maximise growth and reduce future costs associated with addressing the consequences of climate change. Measures to sustain innovation will contribute to a “green” recovery and stronger long-term growth, and social and regional policies should also be mobilised.
8. Open markets have produced many economic and social benefits, driving progress and growth. However, while thriving markets are critical for growth and prosperity, recent events demonstrate the importance of a strong regulatory framework and proper supervision. Indeed, the crisis is the result of both market failures and policy failures. The task ahead is to build a sound governance and regulatory framework that will align incentives, while maintaining a healthy balance between markets on the one hand, and policy interventions on the other.

9. The recession will narrow the space for fiscal policy due to the expected fall in revenue and rising expenditure demands, not least for social protection, as employment prospects deteriorate further. In such an environment, structural policies should play a key role, but these policies take time to bear fruit. An obvious threat is that the recession, if not addressed properly, could weaken support for reforms, especially if those most adversely affected perceive them as detrimental to their well-being. Therefore, priorities like health care, education and innovation must be maintained and public budgets secured for these items. It will also be critical to strike a balance between short- and long-term responses. How to manage reforms and achieve needed changes will be an important challenge for governments, and the OECD will assist with this process as we move forward.

10. The immediate response has required a major injection of public resources into the private sector, either directly, through liquidity support or outright public capitalisation of banks and financial institutions, or indirectly, through increased use of public subsidies and guarantees. Such massive intervention could produce very undesirable consequences in the medium run by distorting the incentive structure, and threatening to detonate protectionist and/or anti-competitive reflexes. These risks will need to be countered effectively. In addition, a post-crisis exit strategy enabling governments to withdraw from the private sector will have to be designed and implemented as the acute phase of the crisis is left behind.

11. The crisis demands tough decisions now, but it must not turn our attention away from the other serious structural challenges. Efforts to address poverty, inequality and climate change must be maintained, along with commitments to scale up development aid, to keep global flows of trade and investment open, and to develop cleaner energy and production processes. Such global challenges should be seen as opportunities for a new, sustainable and strong growth environment.

12. A sustainable way out of the crisis will require the involvement of all major players. The OECD’s enhanced engagement with major emerging economies will increase the relevance of its analysis of the crisis, as well as the identification of policy responses. An effective global response also requires better coordination and greater coherence among the major international organisations, as already mandated in the 2008 Hokkaido G8 communiqué.

The OECD Strategic Response

13. The OECD Strategic Response, which has been developed with the valuable inputs of the OECD Council and Committees, aims to address the crisis and seize the opportunity to build a stronger world economy. Its guiding principle has been the recognised comparative advantages of the OECD, which, for decades, has advised Member countries and helped coordinate their policies in a cross-cutting way, with very positive results. It suggests a focus on two priority areas which are critical for a well-functioning global economy and a return to sustainable economic growth. Work will thus be organized around these two strands.

14. **Finance, competition and governance.** The OECD provides an institutional framework for an ongoing dialogue between different policy communities, focusing on areas where it has leadership, such as corporate governance, competition, tax, pensions, and financial education, as well as the interaction of policy with institutional and market structure and the overall consistency and efficiency of reforms. Work
will seek to align regulations and incentives in the financial sector to improve oversight and risk management among market operators. In addressing regulatory reform in financial markets, policy issues related to transparency, including tax and corporate governance, will have a prominent role. The OECD will continue to work on strengthening and implementing principles and guidelines effectively in these areas, given its recognised experience and authority. Deliverables will also include inputs for the review and improvement of national policies and better policy coordination at the international level. The focus will be on “smarter”, rather than (necessarily) more regulations.

15. **Restoring long-term growth.** Building on the OECD’s expertise on structural issues and whole-of-government approaches to reform, and on the OECD’s work on open markets, the environment and innovation, work will identify policy options and recommendations for putting countries back on a path of sustainable growth in the context of continued open markets, while increasing the resilience of economies. Such strategies need to ensure that recovery is based on low-carbon paths to growth, on eco-innovation, and on knowledge creation, all within an equitable society that spreads opportunity and affords protection for the most vulnerable.

16. In all of these areas, due consideration will be given to avoiding pitfalls, ensuring a healthy balance between governments and markets, and defining exit strategies enabling governments to withdraw from the private sector in the post-crisis phase.

**Delivering on the Strategic Response**

17. Building on its comparative advantage, the OECD’s Strategic Response will be implemented based on a cross-cutting and holistic view of the different policy areas and government actions involved in making markets work effectively. Using the OECD’s unique structures, it will mobilise experts and national policy makers to build needed analysis and recommendations. Emerging and developing economies will be welcome as standing partners in the efforts to define collective solutions.

18. Deliverables will be of three types - actions taken by Members and non-Members (such as pledges or instruments) (A), policy recommendations (R), and surveillance (S). Many will be rolled out in the coming weeks and months, so that they can feed into the process launched by the G20. Work will proceed in collaboration with other organisations involved in the process. These outputs, along with other more medium-term deliverables, are clearly identified in the sections that follow. An overview is provided in Table 1.

**Communications and dissemination**

19. A communications and dissemination strategy will be put in place for the OECD’s response, to increase its effectiveness and usefulness for Member countries, partners and stakeholders throughout the world. It will be connected to key events, publications and other world-wide initiatives. Communications will be designed to maximise timing and impact and reaffirm the value added of the OECD. This could include selected contacts with major actors dealing with the crisis in Member and non Member countries (especially major emerging markets); participation in public events; and tailor-made presentations to relevant groups. Initiatives with civil society, including universities, could be organized to discuss results.
Table 1. Overview of OECD Strategic Response Deliverables

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<tr>
<th>Finance, competition and governance</th>
<th>Actions (pledges, instruments, etc.)</th>
<th>Policy recommendations</th>
<th>Monitoring/surveillance</th>
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<td>Financial markets</td>
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<td>Corporate governance</td>
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<td>Taxation</td>
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<td>Competition policy</td>
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<td>Consumer protection and education</td>
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<td>Regulatory management quality</td>
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<td>Long-term growth</td>
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<td>Keeping markets open</td>
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<td>Financial stability and resilience</td>
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<td>“Green” and innovation-led recovery</td>
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<td>Development</td>
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I. Finance, competition and governance

20. As the current financial crisis has demonstrated, there are strong interrelationships between regulations on capital, deposit insurance, tax provisions, corporate governance, competition policy, accounting rules and executive compensation, which produce the overall environment in which risk-taking occurs, which must be looked in a holistic way.

A. Financial regulations

21. Policy challenges. Present capital rules have left banks with too little capital, and with procyclical capital variation over the cycle. The features that have contributed most to the build up of excessive risk taking, interacting with tax and governance factors, are: a) coverage (e.g. on and off-balance sheet operations); b) incentives that encourage excessive risk taking in certain products and off-shore locations; and c) uneven treatment of financial institutions, depending on their degree of sophistication, the sector in which they operate, or the jurisdiction in which they reside. These features interact with corporate objectives for business strategy and earnings growth, including location, business structure, choice of products and tax minimisation.

22. Furthermore, mergers and acquisitions have been a part of crisis management with stronger firms taking over weaker or failed high-risk and previously under-regulated investment banks. The effect of capital regulation on the cost of capital due to intra-firm capital allocation processes remains to be seen. After de-leveraging, consideration must be given to the desirable size of the volatile investment bank segment is allowed to re-expand, and to the governance and regulation of these institutions, including possible stronger capital requirements for investment banks.
23. **Short-term deliverables (March 2009)**

- Integrated review of incentive structures needed to underpin a well-functioning and sustainable financial system (financial market, insurance and pension regulation, competition and taxation policy, corporate governance policy and financial education and consumer protection policy). R
- General Guidance and checklist for Effective and Efficient Financial Regulation and policy PHASE I (available). R
- A report on deposit insurance schemes (available). R
- A report on resolution of weak institutions (available). R

24. **Medium-term deliverables**

- General Guidance and checklist for Effective and Efficient Financial Regulation and policy PHASE II. R
- Reports on long-term savings (include life insurance and private pensions) and role of institutional investors. S
- Reports on the regulatory treatment of financial innovation in general and securitization and on the interactions of the various safety net components in times of crisis. S
- Revised Guidelines on governance of insurance companies. R

**B. Corporate governance**

25. **Policy challenges.** International co-operation, including among private sector bodies, should be improved to ensure better coordination and implementation of agreed international corporate governance standards, especially the OECD Principles of Corporate Governance. Remuneration and incentive systems are supposed to align the interests of corporate officials with the long-term interest of the company and the shareholders. Distortions in these structures may lead to a short-term bias of financial and non-financial firms, creating additional risk, a tendency reinforced by tax provisions in many countries. Improvements and analysis are needed in the following areas: effective implementation of risk management; board practices; governance of the remuneration process; and the exercise of shareholder rights.

26. **Short-term deliverables**

- Global Consultation and co-operation with other international organisations, non-Member countries, business and stakeholders to discuss key weaknesses in corporate governance practices and joint efforts to improve monitoring and implementation of the OECD Principles. March 2009. S
- Progress report to the FSF meeting in Singapore. March 2009; and Report to the G20 meeting on “immediate actions”, including the results of the global consultation (April 2009). S
27. **Medium-term deliverables**

- Report to the MCM, including a roadmap for medium-term actions to improve corporate governance (June 2009). R
- Report and recommendations on effective implementation of risk management, board practices, governance of the remuneration process and the exercise of shareholder rights (November 2009). R
- Thematic peer reviews on priority issues such as implementation of risk management and the quality of the regulatory framework. First round April 2010. Second round November 2010. S
- Launch of an OECD web-based clearing house for regulatory impact analysis in the area of corporate governance (summer 2010). S

**C. Taxation**

28. **Policy challenges:** Taxation impacts on and is influenced by developments in financial markets. A number of governments and private sector participants are already examining how tax may have influenced the current financial crisis and what changes in the rules are required to avoid a re-occurrence of recent events. Tax provisions may have encouraged excessive risk taking and reliance on debt by market players; a tendency for top management of financial institutions to focus on the short rather than the medium to long term; and to move to less transparent jurisdictions offshore to evade tax and regulatory provisions. Governments need to examine whether tax systems are providing the right signals and incentives to market operators and whether these incentives are aligned with the other regulatory incentives.

29. To exit from the crisis, it is essential that governments continue to remove tax barriers to the effective functioning of financial markets, particularly at the international level. This would include tax provisions which distort investor choices as to whether to invest directly or by means of collective investment vehicles, and tax provisions which act as a barrier to the use of different financial products which reduce the cost of capital. Governments also need to examine the broad implications for tax of the government bailout packages for financial institutions and how this may influences attitudes of these institutions to risk taking.

30. **Short-term deliverables**

- Reports on Collective Investment Vehicles setting forth recommendations for work to address the legal and procedural issues (February 2009). R

31. **Medium-term deliverables**

- Study on the role of banks and financial institutions, structured financial products and tax compliance (May 2009). R
- Analysis of the tax elements of good corporate governance (May 2009). R
- Interim report on tax haven work to the G8 and the G20 (June 2009). S
- Updates to the Model Tax Convention (2010). A
• Contributions to MCM Report on interaction between the tax and regulatory environment (March 2009).

D. Competition policy

32. **Policy challenges.** In a more concentrated financial system, competition may be weaker, leading to higher costs of credit and other financial services to consumers and businesses. If this is the case, countervailing policies will be needed to restore or improve competitive conditions. Restructuring may integrate within a single institution potentially independent operations, such as consumer banking, SME lending and investment banking; what are the resulting efficiencies and competition risks? Does deposit insurance increase the risk of moral hazard in portfolio decisions and reduce competition between banks? Competition policy has an important role to play in financial sector rescue and restructuring.

33. **Medium-term deliverables**

- A report on competition policy to be delivered in May 2009, examining four areas: R
  
  - Principles: financial sector regulation and competition policy. Competitive solutions must take into account fundamentals of financial sector policy and the role competition has played in achieving policy goals in these markets.

  - Crisis: role of competition policy in financial sector rescue and restructuring. Recent emergency and ad hoc measures by governments have included investments and guarantees, asset purchases and time-sensitive mergers. Competition authorities must consider how to safeguard competition principles in these emergency settings without hampering policy measures that may be necessary to avoid the costs of a slump and of erosion of trust on the financial sector.

  - Real economy: challenges and negative spillovers for competition policy in periods of retrenchment. In the wake of financial crisis, governments are under pressure to support distressed industries through subsidies and protections. Competition authorities may in turn be under pressure to loosen enforcement standards in an effort to favour economic recovery.

  - Going forward: adaptation of competition rules, processes and institutions to current financial sector issues. Looking beyond emergency actions to stabilise financial markets, competition authorities will need to take appropriate action about competition issues in these markets in the medium and long term.

E. Consumer protection and education

34. **Policy challenges.** There is a need for better regulatory standards and international codes of conduct on marketing financial services. Information disclosure on basic issues, such as the true cost of credit, is essential. Current mortgage disclosures failed to convey key mortgage costs and loan terms to many consumers, and studies show that recognition of costs and terms improve with better disclosure, particularly where terms are complex. Effective financial education and awareness campaigns help individuals to understand financial risks and products and thus take decisions better adapted to their personal circumstances. This also helps prudential supervision, as it is more difficult to mislead better educated citizens.
35. **Short-term deliverables (March 2009)**

- Good Practices for Financial Education and Awareness on credit. R

- Multi-country survey (50+ countries) on the potential impacts of the financial crisis on financial education and awareness, and on initiatives and measures that have been developed in response to the crisis. Assessment of the potential role of financial education and consumer protection as possible safeguards against similar market disruptions in the future. S

- Report on consumer credit challenges, (i) describing the situation that consumers faced in credit markets leading up to the financial crisis and (ii) exploring approaches that governments, business and other stakeholders could take to position consumers to make more informed, well reasoned decisions on financial products, taking behavioural biases, information deficiencies and financial market complexities into account. R

- A Consumer Policy Toolkit which covers some of the key demand-side behavioural issues that contributed to the financial crisis, namely the failure of consumers to make well-informed, reasoned choices due to (i) the quality and quantity of information available to borrowers, (ii) the way that the information was framed, and (iii) the exploitation by lenders of consumer short-sightedness, overconfidence, and susceptibility to unfair, high-pressure tactics. R

36. **Medium-term deliverables**

- Reports on risk transfers to households and their impact in the context of a crisis. S

- Stocktaking and comparative analysis of market conduct regulatory regimes and financial consumer protection provisions (e.g. disclosure, usurious interest rates, consumer complaint and recourse mechanisms, business practices, etc) across OECD countries and identification of good practices. R

- Report on the role of financial institutions and intermediaries in consumer protection and awareness – identification of the main policy issues related to "financial advice, marketing and promotion vs. financial education and mandatory disclosure" (conflict of interest, due diligence obligations, remuneration structure of intermediaries, principal-agent problems, etc) and implications for the protection and awareness of the most vulnerable consumers. Identification of good practices and elaboration of guidelines. R

- Analytical report and good practices on the role of credit reporting and credit counselling in informing and protecting financial consumers. R

- Guidelines for incorporating learning from behavioural economics in financial education programme design. R

- Stocktaking, analytical report and guidelines on the elaboration of financial education programmes offered to school children and covering topics such as credit, savings, budgeting, consumer rights & responsibilities, etc. S, R

- Standardised methodologies for assessing the impact of financial education initiatives and for measuring progress in financial literacy levels of consumers over time. S
F. Regulatory management quality

37. **Policy challenges**: Regulatory management principles have not been widely extended to cover financial services. In a number of OECD countries, specific authorities in charge of the financial sector, including central banks, some independent regulatory authorities or ministries of finance, have been exempted from regulatory quality policies.

38. **Short-term deliverables**

- An OECD Action Plan for Regulatory Quality to help streamline countries’ practices, increasing accountability and transparency. The Action Plan will offer guidelines to adopt or improve the use of regulatory quality and risk management tools in the financial sector. These tools could help control the risk of over-reaction through ill-conceived and over-costly regulation.

39. **Medium-term deliverables**

- A report on institutional governance arrangements for ensuring the use of regulatory quality tools by financial regulators. This will address how these regulators review and design existing and new regulations, and assess consistency with better regulation practices (Q4/2009).

II. Long-term growth

40. The key components of a policy strategy to restore sustainable long-term growth can be identified as follows:

- keeping markets open;
- ensuring financial stability and resilience;
- fostering a “green” and innovation-led recovery;
- advancing development.

41. Work will provide guidance on the policy responses to the crisis, seeking to find the right balance between short-term measures and long-term sustainability. It will strengthen OECD surveillance on macroeconomic and structural performance and further develop horizontal work linking together structural and macroeconomic issues.

A. Keeping markets open for trade and investment

42. **Policy challenges**: Maintaining open markets for trade and investment is an essential condition for long-term growth. The threat to open markets is probably even more serious today, as concerns about the consequences of liberalisation and the perception that liberalisation may have contributed to the current crisis grow. Against this background, and following the G20 communiqué, there is an ongoing need to communicate effectively the net benefits of open markets, as well as the costs of protectionism. In addition, the financial crisis is resulting in calls for increased access to official export financing. At the same time, commitment remains high in maintaining the principle of risk-based pricing.

43. Investment protectionism is on the rise among both OECD and non-OECD countries. Protectionist pressure may increase as companies restructure in response to the crisis and as new categories of investors, including state-owned enterprises and SWFs from non-OECD emerging economies become more active. However, restrictions on capital movements can amplify the severity of a crisis and slow economic recovery. With its investment instruments, the OECD provides the only multilateral forum for countering investment protectionism. Developing a better understanding of foreign investment’s role in...
mitigating the crisis and its impacts on the real economy, and strong peer monitoring under the “Freedom of Investment” process and of commitments under the OECD investment instruments will be vital to combating protectionism and its negative consequences.

44. **Short-term deliverables**

- Trade pledge by OECD Members endorsing the Washington Summit commitments on open markets and a successful conclusion to the Doha round (November 2008). A

- A statement on export credits by Members (and some non-Members) that highlights the role export credits can play in the efforts to overcome the current lack of trade finance, without undermining the level playing field across exporting countries (November 2008). A

- The Council's Decision updating all Members’ positions under the OECD Codes to ensure they live up to their legal commitments, including in respect to standstill and elimination of reciprocity (spring 2009). A

- A report on *Globalisation and Emerging Economies*, assessing the trade performance of Brazil, Russia, India, Indonesia, China and South Africa and highlighting priority areas where further liberalisation has the potential to deliver improved economic results (Q4 2008). S

- Launch of a new book entitled *International Trade: Fair, Free and Open?* (OECD Insights series), and communications materials on the benefits of open markets and the pitfalls of protectionism. High profile launches will take place in several capitals (Q1 2009). R

- An report on building trust and confidence in international investment to be presented at the 2009 MCM. First draft December 2008. R

45. **Medium-term deliverables**

- Preliminary reports on a Services Trade Restrictiveness Index (STRI). First results of work on the STRI for three pilot sectors, i.e. construction, telecoms and business services in June 2009. S

- Opening the OECD Codes for adherence to interested non-OECD countries to protect all parties against protectionism. A

- Monitoring of investment measures (ongoing). S

- A report on “Keeping markets open to foreign investment in harsh economic times: Lessons from Fifty Years' Experience in the OECD and Past Crises”(2009). R

- Update of the OECD Guidelines for Multinational Enterprises – a key instrument for fostering public trust in globalisation. A

**B. Sustainable growth and resilience**

46. **Policy challenges:** The financial crisis has worsened the short-run economic outlook considerably. But the implications of the crisis for long-term growth are uncertain, especially if the recessionary phase turns out to be more protracted and deeper than expected. In the current situation, resilience is important, because it influences how broad-based and deep the economic downturn will turn out to be. Work will incorporate the analysis of the impact of financial markets and financial regulation on
long term growth and resilience. This will strengthen OECD surveillance capability both at the general and country specific levels.

47. **Short-term deliverables**

*General surveillance*

- The December 2008 *OECD Economic Outlook* analyses the sources of the financial crisis, the likely consequences for growth, employment and inflation and the role for macroeconomic policy to minimise the cost of recession and restore growth. It also includes analysis of how the financial crisis will impact each of the OECD Member countries, major emerging-market economies and the countries that are in the process of acceding to the OECD. S

- A working paper on the features of the current crisis and how they compare to previous crises (January 2009). S

- A report on gauging financial conditions in the current climate. Since the summer of 2007, financial markets have been hit by a general repricing of risk and some segments of financial and monetary markets have ceased to work properly, pushing spreads in bond and credit markets to very high levels, paralyzing credit and money markets. At the same time, the flight to quality has pushed down government bond yields. These developments will affect GDP, but to what extent? The report will include an index that synthesises how these various factors influence growth in the major OECD economies (January 2009 and June 2009 *Economic Outlook*). S

- Monitoring of financial market developments, their economic consequences and the implications for economic policy (ongoing). S

- Strengthening the countercyclical stance of macroeconomic and macro-prudential policies. A report that investigates how best macroeconomic policies can offset the effects of shocks bearing on the economy. The report will also examine how to structure counter-cyclical macro-prudential financial policies. (March 2009 with Final report in early 2010). S

- The 2009 *Going for Growth* publication will include special chapters on taxation and on infrastructure. The taxation chapter will examine how tax structures could be best designed to promote growth. The infrastructure chapter examines whether infrastructure investment has effects on growth that differ from other categories of investment. Working papers will also take stock of tax reform experiences in OECD countries and provide some indications as to which countries may benefit from augmenting infrastructure in specific sectors (March 2009). S, R

- An issues paper on the relationship between financial market regulation and economic growth (March 2009), followed by a report which quantifies the links, drawing on indicators of financial market regulation and information on prudential regulations from existing sources. The study will focus on regulations related to competition and investor/creditor protection that have long-term impacts on output and take due account of financial stability concerns. S

*Country/regional surveillance*

- The 2008 OECD Economic Survey of the United States includes an in-depth chapter with analysis on the origins of the crisis, the short-term measures to contain disruption and longer term crisis prevention policies, including recommendations on how to reform the supervisory and regulatory structures (December 2008). S
• The 2009 OECD Economic Survey of the euro area will include an in-depth chapter on financial integration, innovation and the monetary policy transmission mechanism, including analysis of how closer financial integration influences and changes the speed and the channels of monetary policy transmission in the euro area. It will also review the prudential and regulatory framework in the EU and the issues involved in managing systemic and cross-border risks to ensure financial stability in an integrated financial market. It will examine the scope for further simplifying and harmonizing the instruments and institutions for regulating cross-border financial flows (January 2009). S

• Forthcoming examinations of Iceland, Italy, the United Kingdom, Switzerland and others, will include chapters on the financial sector and their financial supervision and regulatory frameworks (April, July, September 2009). S

48. Medium-term deliverables

• Housing markets have been at the source of the financial crisis. An issues paper will identify the main channels of housing policies, their fiscal implications, the ways they may interact with other social policies, and the likely consequences on housing prices, credit to households, savings and construction activity. It will also address the impact of the financial crisis on accessibility to credit and interventions aimed at supporting home ownership and well-functioning rental markets (October 2009). S

• A report on the policy determinants of resilience and the impact of the financial crisis. S

• A report on the long-term growth implications of the financial crisis, the channels through which they operate and the policy settings that will minimize negative impacts on long term growth. S

• A policy paper on the tax treatment of debt. R

C. Fostering “green” and innovation-led growth

49. Policy challenges: The post-crisis slowdown should not preclude or weaken policy efforts to achieve long-term low-carbon economic growth. Delaying action might result in very large costs to our economies and societies in a few decades, costs much higher than those being incurred in the current crisis. On the contrary, the crisis provides an important opportunity and an impetus to promote improved efficiency in the use of energy and materials by getting the prices right (with due attention to compensatory social policies). This is also an opportunity to remove subsidies to fossil fuel production and consumption, which would benefit both the environment and public budgets.

50. Also, investment in new eco-friendly technologies can represent an important new source of growth and “win-win” opportunities for both the environment and the economy. Putting a price on carbon emissions is essential as an incentive for the development and diffusion of greener technologies, but a mix of instruments is needed. New low-carbon technologies are key to reducing the future costs of climate change mitigation.

51. In many cases, stimulus measures will include investment in infrastructure, which will remain for the long term. It is important to ensure that these packages do not encourage the locking-in of traditional, polluting energy production, but instead promote cleaner, climate-friendly alternatives. Policies and measures should be designed to encourage adaptation to climate change in an efficient manner.

52. Innovation is a key instrument to boost productivity and strengthen sustainable growth, and strong innovation performance is more important than ever in the current context. Stimulus packages
should be designed in a way that supports innovation, including through: investment in broadband infrastructure; R&D in green technologies; and innovation of education and training systems. The OECD Innovation Strategy, currently under development, is addressing issues related to culture and risk taking that influence individuals and firms.

53. **Short-term deliverables**

- Booklet “Climate change mitigation: what do we do?” (November 2008) and conference on the “Economics of Climate Change” in March 2009 will provide policy recommendations to foster green growth. R


- A report on designing stimulus packages which fuel growth and preserve innovation, including eco-friendly innovation. R

- A report on the role of regional innovation policies in economic recovery and restructuring (March 2009). R

54. **Medium-term deliverables**

- Analyses for Phase 2 of the “economics of climate change” project, focusing on identifying least-cost policy mixes, carbon leakage and competitiveness impacts, financing possibilities and elements for building a world carbon price (mid 2009). R

- Report on “The Economics of Adaptation to Climate Change” in 2010. R

- Selected papers of the OECD/IEA Annex I Expert Group on policies and approaches to address climate change in a post-2012 framework (e.g. incentives to reduce emissions from deforestation, scaled-up use of the Clean Development Mechanism, sectoral approaches, etc.) in 2009-10. R

- Country Innovation Policy Reviews (Greece Q1 2009, Mexico Q1 2009, Turkey Q3 2009, Russia Q4 2009, Italy Q2 2010, Brazil Q2 2010); and follow-on studies (Chile, China, Norway, Korea, Hungary, New Zealand, Switzerland, and Luxembourg–2009). Reviews of Regional Innovation Policies (Mexico, Italy Q1 2009; Spain Q4 2009). S

- A report on Demand-Side Policies for Innovation and Global Challenges (June 2009), focusing on the role of public procurement, regulations, standards, and public-private partnerships in “pulling” innovation performance in big infrastructure projects and in SMEs. R

- Report on expansion of high-speed broadband infrastructure as an economic stimulus (end 2009). S

**D. Development**

55. **Policy challenges:** The impact of the crisis on developing countries will affect economic recovery in the OECD area and confidence in good global governance. At the same time, developing countries risk being hit hard as the crisis spreads globally, with risks for development prospects. In particular, the economic crisis can have implications for agricultural markets and prices and for the affordability of food in poorer developing countries.
56. **Short-term deliverables**

- An aid pledge by DAC Members reaffirming their aid commitments and agreeing to maintain aid flows in line with these commitments (November 2008).
- Report on the role of bilateral donors to assist poorer developing countries in fiscal and financial distress (February 2009, in conjunction with IMF and World Bank).
- Analysis of the current and future impacts of the financial crisis on agricultural markets will be published in the 2009 version of the *OECD-FAO Medium Term Agricultural Outlook*, (mid 2009).
- The Policy Monitoring and Evaluation in Non-Member Economies report will consider the impact of higher costs of borrowing, reduced foreign direct investment, and potentially lower aid flows on agriculture in developing countries (early 2009).
- A discussion of the implications of the economic crisis for the global food and agriculture sector, and for related policies, will be included in Agricultural Policies in OECD Countries: Monitoring and Evaluation 2009 (mid-2009).

57. **Medium-term deliverables**

- The *Global Development Outlook*, to be published in 2010, will explore the fallout of the global credit crisis on the developing world. The regional outlooks (Africa, Latin America) will include a macroeconomic outlook chapter that will be devoted to the region-specific fallout of the economic crisis.

### III. Ensuring the appropriate balance between markets and policies

58. The immediate response to the crisis has required a major injection of public resources into the private sector. Such massive intervention could produce very undesirable consequences in the medium run by distorting the incentive structure, with risks of protectionist and anti-competitive reflexes. It could also distort the structure and size of government budget and debt in ways, endangering fiscal sustainability and reducing resources for long-term growth. These risks will need to be countered effectively. In addition, an exit strategy enabling governments to withdraw from the private sector will have to be designed and implemented as the acute phase of the crisis is left behind.

59. Furthermore, the recession will narrow fiscal policy space due to the expected fall in revenue and growing expenditure demands, including for social protection, as employment prospects deteriorate further. In such an environment, it will be important to find the appropriate balance between short- and long-term responses. One must be mindful to keep the policy debate focused on long-term reform priorities, once the emergency phase of the crisis has passed, to avoid the risk of resuming “business as usual”.

60. The OECD will set up a process to monitor policy development in a number of areas, to assess the impacts and implications of short-term measures on long-term sustainability. This work strand will address a number of inter-related dimensions:

1) How to design short-term social support policies that are not inconsistent with, and preferably reinforce, the incentives of a sustainable social protection mechanism.
2) How to support business activities through policies that are temporary and targeted, and avoid the proliferation of subsidies and retaliation.

3) How to design exit strategies to help governments reduce their public ownership of private companies (in the financial and non-financial sectors) once the crisis phase subsides.

4) How to maintain a healthy balance between short- and long-term objectives in government budgets.

5) How to keep the impetus for structural reforms alive.

6) How to improve capacity to prevent future crises.

A. Social policies

Labour markets

61. **Policy challenges:** Labour market conditions are set to deteriorate further in most OECD countries over the coming months. Labour market and social policies will be facing intensified pressures to help offset the effects of rising unemployment. Longer-term, structural labour market and social policies, as highlighted in the *Reassessed Jobs Strategy*, will continue to have an important role to play to strengthen the resilience to economic shocks.

62. **Short-term deliverables**

- A report on the labour market and social policy response to the economic downturn will be presented to the Working Party on Employment (March 2009). S

63. **Medium-term deliverables**

- A special chapter on how labour market and social policies can help counteract the rise in unemployment and worsening living conditions of low-income families (2009 *Employment Outlook*). It will examine labour market impacts in specific sectors (e.g. construction, financial services, segments of manufacturing) and for those groups (youth, low-skilled, immigrants, older workers) more likely to bear the brunt of the economic downturn. It will also assess how current labour market and social policy settings are geared to tackle growing unemployment and possibly poverty. The paper will also monitor the special labour market programmes put in place to help the unemployed, and assess the likely effectiveness of such measures. S

- A background document for the G8 Labour Ministerial meeting in mid-May 2009. Based on the planned work for the EmO, as well as the monitoring of policy initiatives that Member countries may undertake. S

Pensions

64. **Policy challenges:** The recent losses in pension funds have created much disquiet and given rise to calls for a major rethink of pension provision which would rely much less on risky financial markets. Regulation of pension funds and the appropriate diversification strategy between public and private provision of retirement income must also be considered.

65. **Short-term deliverables**

- Part I of a special report on the financial crisis and private pensions and insurance policies. R
• A special chapter in the Private Pensions Outlook in Issue 5 of the Pension Markets in Focus, S
• Revised Guidelines on governance of pension funds. R

66. Medium-term deliverables

• A Policy Brief and a special chapter in the next issue of Pensions at a Glance 2009. R
• Part I of a special report on the financial crisis and private pensions and insurance policies. R
• Revised Core Principles on regulation of private pensions, including revisiting regulation of investment, funding, etc. R

International migration

67. Policy challenges: The economic crisis is likely to have a significant impact on migration flows and policies, with associated impacts on growth and labour markets in home and host countries.

68. Short-term deliverables

• Ongoing monitoring of trends in migration policies and flows. S
• A note on the potential impact of the economic downturn on migration flows following the SOPEMI meeting (early 2009). S

69. Medium-term deliverables

• A study on the impact of the economic crisis on remittances (June 2009). S
• An analysis of the impact of economic downturns on the integration of immigrants and their children (2010). S

B. Supporting business and preserving competition

70. Policy challenges. Competition policy will play an important role in the current crisis and subsequent recovery. In the wake of financial crisis, governments are under pressure to support national industries and champions through subsidies and protections. Furthermore, in coordination with financial regulators, they have taken emergency and ad hoc measures to shore up financial institutions, in response to severe liquidity shortages and breakdown in lending markets and trust. These measures have included investments and guarantees, asset purchases and time-sensitive mergers.

71. Competition agencies may in turn be under pressure to loosen enforcement standards in order to favour economic recovery. In responding to these pressures, competition policy makers are challenged to show that competition is still part of the solution for benefiting consumers and fostering innovation, competitiveness and productivity. The usual tools of competition analysis and enforcement presuppose stable market conditions. Competition authorities must consider how to safeguard competition principles in these emergency settings without hampering policy measures to avoid the costs of a slump and of erosion of trust on the financial sector.

72. In the crisis, businesses, and SMEs in particular, are vulnerable due to their heavy dependence on bank credit and limited recourse to financial markets. It is necessary to assess the differentiated impact on
sectors and firms and improve the effectiveness of new, innovative and alternative mechanisms to finance local development and to enhance capacities in financial skills for economic development. Questions to be addressed include: Will the economic crisis undermine innovative behaviour? How can governments sustain or rebuild confidence and motivate decisions to be innovative?

73. **Short-term deliverables**

- Report on the impact of the crisis on SME financing and government measures taken to address the problem for the OECD High-Level Round Table on SME and Entrepreneurship Financing and the Global Financial Crisis (March 2009). S, R

- **Impact analysis.** A report on the nature of the current crisis exploring whether it is a temporary dislocation in long-term structural change or a more fundamental shift. The report would look at the differential impact of the crisis, by region, sector, company, to better inform policy making. S

74. **Medium-term deliverables**

- **Risk taking.** The crisis may influence the propensity of individuals and firms to take risks, with possible effects on entrepreneurial and innovative behaviour. A report will provide recommendations for governments in their efforts to sustain or restore confidence and entrepreneurial and innovative behaviour. R

- Report and action plan on “globalisation, entrepreneurship and SMEs” including analysis of SME financing policies in the aftermath of the crisis (October 2010). S, R

C. **Macroeconomic and fiscal policy**

75. **Policy challenges.** Policy makers will have to be very attentive to medium-term inflation trends and unsustainable accumulation of government debt. Correction of the extraordinary monetary easing implemented almost everywhere will have to be swift as recovery goes underway. At the same time, with high and rising public debt in many OECD economies, it will be equally important that a credible fiscal framework is in place to ensure long-run public finance sustainability, especially in the face of spending pressures associated with population ageing. Short-term responses should be timely, targeted and temporary. Efforts will be needed to ensure that fiscal policies remain supportive of long-term growth through innovation, environment support and infrastructure.

76. A key medium-term challenge is to shift more forcefully from macroeconomic policy procyclicality to strong, explicit counter-cyclicality, in order to reduce the likelihood of future bust and booms. This is particularly important for fiscal policy, where adoption of explicit counter-cyclical policy rules is encouraged, especially in those countries where automatic stabilizers are weak and political-economy factors contribute to pro-cyclical discretionary fiscal policy. This will also involve a better targeting of public investment, including better coordination of investment strategies at sub-national level, where much of the capital investment is made.

77. **Short-term deliverables**

- An assessment of measures adopted in OECD Member countries to contain the crisis and to restore more normal financial conditions (January 2009). S

- A Policy Brief on short-run tax policy responses to the crisis that will not harm longer-term growth (February 2009). R
78. Medium-term deliverables

- An analysis of measures undertaken in Member countries in response to the crisis in the area of industry, innovation and entrepreneurship policy, including best practices. S

- A report on governance of strategic public investment across levels of government (Q4 2009). R


D. Fostering exit from public ownership

79. Financial emergency measures were very much needed to avoid a global financial and economic meltdown. However, most measures taken run the risk of planting the seeds of the next boom and bust by encouraging excessive risk taking by households, firms, and financial intermediaries. In other words, financial rescue plans, while necessary for addressing the emergency and avoiding a generalized financial meltdown and a great depression, create massive moral hazard. To overcome this, blanket guarantees on financial institution’s liabilities will have to be revised, public ownership of financial institutions should be reversed, and prudential regulation and supervision of financial institutions and capital markets will require systemic reform at national levels but coordinated internationally.

80. Short-term deliverables

- Building on regular work and enhanced monitoring, the OECD will formulate recommendations for exit strategies in the areas of social policy, competition, macroeconomic and fiscal policy (ongoing). The report on the role of competition policy (paragraph 33) will also contribute. R

81. Medium-term deliverables

- Recommendations for exit strategies in the areas of financial markets, debt management, insurance and private pensions markets. R

E. Implementing reforms

82. Policy challenges: Implementing the reforms necessary for long-term growth will be challenging in the current context, and it will be necessary to ensure that the short-term response does not overtake long-term priorities. The crisis is putting pressure on limited public budgets, and there may be lack of public awareness or support for reforms or resistance by specific groups who may be affected.

83. Short-term deliverables

- A report on developing reform capacity will explore the factors that contribute to success and failures of reforms, including evidence and communication, institutional frameworks, cost and benefits and timing. March 2009. S

84. Medium-term deliverables

- Report on effective ways to achieve policy reform. This report will explore the political economy of reform in policy areas key to sustainable growth, such as social services and pensions, fiscal and tax policy, education, health systems, the labour market, public administration reform, product market
reform, regulatory reform, competition policy and the environment, and identify the factors that contribute to successful reform. Preliminary findings: July 2009; Final report: end 2009. R

F. Long-term crisis prevention

85. **Policy challenges:** There is a need to invest more in detecting potentially disruptive events and tipping points in areas beyond financial markets, through horizon scanning and strategic foresight. Specific areas for investigation include the wider implications of the crisis for financing of investment in long-term infrastructures. The application of complexity science to test the design of future financial regulatory regimes could allow a preliminary evaluation, via modelling and simulation, of the resilience of proposed regulations to major instabilities.

86. **Medium–term deliverables**

- Creation of a network of government foresight and strategic planners will be created to monitor thinking and developments in the field of horizon scanning for potentially disruptive events. S

- Project on complexity models and financial markets (preliminary results in 2010). S