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## NEW APPROACHES TO ECONOMIC CHALLENGES (NAEC) INTERIM REPORT

# **New Approaches to Economic Challenges (NAEC)**

## **Interim Report**



# NEW APPROACHES TO ECONOMIC CHALLENGES

## INTERIM REPORT

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## **1. Introduction**

1. Launched at the 2012 Ministerial Council Meeting (MCM), *New Approaches to Economic Challenges* (NAEC) is an organisation-wide reflection process aimed at continuous improvement in OECD analytical frameworks and policy advice. The global financial and economic crisis is a key motivation for NAEC, but this reflection is also becoming more timely due to the need to adapt OECD analyses and policy advice to evolving policy challenges and developments.

2. As highlighted in the NAEC Framework paper for the 2012 MCM (OECD, 2012a), this reflection is pursued at a time when OECD Member and Partner countries are confronted with several interlinked policy challenges related to a hesitant recovery from the crisis, persistent joblessness, growing inequality and unsustainable public finances. New sources of growth are necessary to put economies on a strong, inclusive and sustainable growth path to support the well-being of populations. They will also be central to encourage future growth and the distribution of its benefits across regions, populations and firms. The need to upgrade the regulatory capacities of governments and to restore confidence in markets, governments and institutions, further adds to the policy challenges.

3. NAEC seeks to address these and other issues in a horizontal approach to lay the groundwork for inclusive and sustainable growth. In doing so, it draws upon the value-added expertise of the OECD (*e.g.* in the area of structural reform), data and policy recommendations, as well as the accumulated experience of its Member and Partner countries in various interconnected policy areas. NAEC takes advantage of the multi-disciplinarity of the work of the OECD.

4. To co-ordinate and drive forward this agenda, a NAEC Group was established, comprising representatives from OECD Member and Partner countries, relevant policy committees<sup>1</sup>, as well as the Business and Industry Advisory Committee (BIAC) and Trade Union Advisory Committee (TUAC).

5. As noted in the NAEC mandate and governance, “[t]he EPC [Economic Policy Committee] is expected to have a central role in this undertaking, but considering its multi-disciplinarity, its success crucially depends upon the strong ownership and participation of other Committees” [[C\(2012\)109/REV1](#)]. This is already underway as several committees have discussed NAEC in their recent meetings and expressed strong support for it. At EPC’s discussion of NAEC on 13 May 2013, delegates welcomed the progress on NAEC and expressed interest in contributing to increase coherence among the various lines of work that relate to EPC’s areas of expertise.

6. The first meeting of the NAEC Group was held on 24 October 2012 to discuss the initiative around four themes: revisiting macroeconomic goals; designing a financial system to support sustainable and equitable growth; revisiting policies to address social and employment consequences; and major trends shaping the global economy and their policy implications.

7. Members of the NAEC Group took the opportunity to discuss these issues with a number of leading experts. The OECD Secretary-General noted that NAEC needs to be open to drawing pertinent and sometimes difficult conclusions from the crisis and, at the same time, examine more deeply the underlying pressures resulting from major global trends. Experts provided their assessment of the causes of, and

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<sup>1</sup> The Economic Policy Committee (EPC), the Economic and Development Review Committee (EDRC), the Committee for Employment, Labour and Social Affairs (ELSAC), the Environment Policy Committee (EPOC), the Committee for Industry, Innovation and Entrepreneurship (CIIE), the Education Policy Committee (EDPC), the Committee on Financial Markets (CMF), the Competition Committee, the Corporate Governance Committee, the Public Governance Committee (PGC), Network of Senior Officials Centres of Government (COGs) and the Trade Committee.

lessons from, the crisis and underscored the need to revisit the objectives of macroeconomic policies. They also highlighted limitations of current macroeconomic models, particularly with regard to their assumptions about the self-equilibrating character of the economy. Moreover, experts identified priorities for reforming the financial sector to better perform its role as an intermediary in supporting productive activities, and highlighted key tensions, such as between growth, stability, inequality and the environment. Several experts, most notably Anthony Atkinson and Nick Stern, emphasised that the crisis has further underscored the need for policies to be better oriented towards promoting well-being more broadly (including through reduced inequality, better jobs, and improved environment), and not just macroeconomic outcomes.

8. A cross-cutting theme that emerged from the discussion at the first NAEC Group meeting was the limitation of existing analytical tools, policy frameworks, and governance arrangements to address the significant rise in interconnectedness and complexity. This includes interconnectedness across and within countries, between the financial sector and the real economy, and at a deeper level, among various global trends that have been building up for decades. These trends include a further integration of large emerging markets in the world economy; technological change; increases in specialisation and international division of labour; population ageing, migration and other demographic shifts; and growing natural resource scarcity, climate change and environmental degradation. Coordinated action is needed to tackle these interconnected issues, including in developing countries. Fully exploiting synergies and complementarities between NAEC and OECD Strategies, such as on Development, Green Growth, Skills and Innovation can leverage the Organisation's contribution to new economic approaches.

9. The rise in interconnectedness has brought benefits. For one, it has supported growth in many countries over a number of years and created possibilities for exploiting niches. At the same time, it has increasingly exposed the limitations of existing macroeconomic and regulatory frameworks targeted at narrow policy objectives, time-horizons or jurisdictions. The interlocking of financial and economic interests across national borders complicates policy design and constrains the ability of governments to achieve domestic objectives when acting on their own. As a consequence, a wide range of policies (monetary, financial sector, exchange rate, tax, competition, environment, among others) call for greater international co-ordination to be truly effective.

10. Interconnectedness has also led to the build-up of systemic risks and allowed for a faster propagation of shocks. For example, the rapid advances in Information and Communications Technologies (ICTs) – in conjunction with significant liberalisation of financial markets and weak oversight – have enabled the creation and dissemination of complex financial products that were at the heart of the financial crisis. These developments have led to greater interdependence between financial institutions, and between the financial sector and governments, with potential implications for financial stability and public debt.

11. More generally, increased interconnectedness has heightened tensions among policy objectives, as reflected, for example, in the effects of population ageing on health care expenditures on the one hand and the higher pressure on public finances on the other. It is thus important to identify the dimensions of these and other linkages and to effectively consider them in analytical frameworks and policy responses.

12. An increasingly complex economic environment and the associated challenges it poses for policy making calls for innovative approaches to identify emerging issues and trends, as well as dealing with the synergies and trade-offs that may arise when setting policies to address multiple policy objectives. Indeed, as noted in the MCM paper, the objective of NAEC is to develop a strategic policy agenda for well-being and sustainable, inclusive growth built on the interconnectedness, complementarities and trade-offs among different policy objectives and instruments. This will be developed as a Synthesis Report, building on multiple lines of horizontal work outlined in Sections 2-4 of this paper.

13. This Interim Report builds upon the discussions at the first and second meeting of the NAEC Group, written comments received from the NAEC Group in early 2013, as well as earlier guidance provided at the 2012 MCM. Detailed proposals for OECD work under NAEC are outlined, drawn from the

work programmes of the participating committees. While not necessarily comprehensive, the proposals have been identified within an overall three-pillar structure to encompass critical dimensions of NAEC.

### ***1.1 What are “New Approaches”?***

14. The term “New Approaches” in the context of this initiative is defined broadly. It involves revisiting some of the fundamental assumptions about the functioning of the economy, particularly with regard to self-stabilisation and efficient markets, and the implications for policy. It also refers to addressing the limitations and extending the capabilities of existing tools for structural analysis and analysing trends over the long term to factor in key linkages and feedbacks – for example between growth, inequality, and the environment. In addition, it entails strengthening the evidence base for examining the linkages between policy drivers and broader well-being outcomes, as such linkages may differ within and across countries. The term “new approach” encompasses the idea that growth is an important means but not an end of policy making. The ultimate goal is improving people’s well-being and making growth inclusive and sustainable.

15. “New approaches” means taking into account the multidimensional nature of the challenge, with the particular understanding that gross domestic product (GDP) captures only a part of economic and social well-being – the production of goods and services – but excludes other dimensions of well-being such as education, health, security, the environment among others, which are also important. It is not enough that growth is sustainable in a non-inflationary context. It must also be inclusive and not come at too high a cost to the environment. Inclusiveness means among other aspects that people have fair opportunities to realise their full potential and contribute to growth independent of their socio-economic background, gender, place of residence or ethnic origin. Moreover, their contribution to growth should yield equitable benefits.

16. There are microeconomic and macroeconomic dimensions to be addressed in this context. As part of the process, we intend to incorporate into our analyses, where relevant, insights from other areas of economics – such as behavioural and experimental economics – while also examining recent cross-disciplinary approaches. Examples of such approaches include complexity science, network analysis and agent-based modelling. Developments in many of these areas may not yet be sufficient to yield concrete policy implications. However, one objective of NAEC is to take stock of the direction of such research and examine the main insights, strengths and limitations, the types of empirical evidence needed to validate results, and the likely implications in the context of updating OECD frameworks and policy recommendations.

17. “New approaches” also includes greater use of micro-data where it helps to better reflect heterogeneity among economic actors and to better link such information to examine aggregate outcomes. Finally, we will also examine new approaches to the rise in interconnectedness and the regulatory, governance and implementation challenges that have been exposed by the crisis.

### ***1.2 Organising structure***

18. To provide a framework and overall structure for organising the NAEC work programme, we have developed three interlinked categories, each with several streams of work. The selection of these categories was derived from the nature of the issues to be addressed. For purposes of exposition, individual projects have been placed where they are most relevant. This helps to illustrate which parts of the OECD are taking the lead or expecting to be involved eventually on which aspects of the work. The categories outlined below serve as a framework for organising the work. The objective going forward is to better integrate the work streams across these categories.

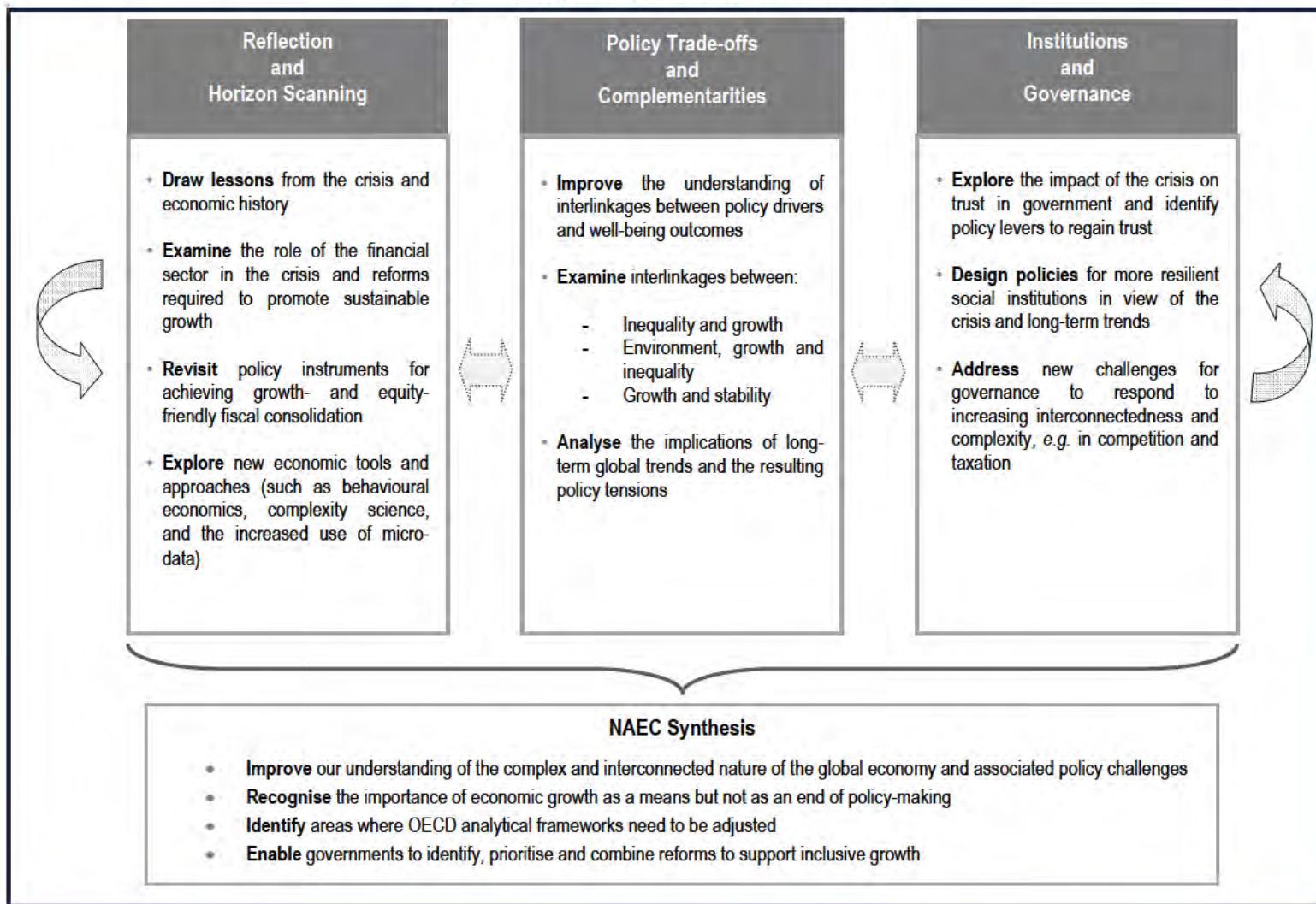
19. The categories are:

- **Reflection** on the crisis, drawing lessons in the context of OECD work, revisiting frameworks to guide immediate policy priorities, and **horizon scanning** for new economic tools and approaches;
- **Analysing policy trade-offs and complementarities** between policy drivers and well-being outcomes, with a particular focus on the interlinkages between growth, inequality, environment and economic stability, as well as on long-term global trends and the resulting policy tensions; and
- **Institutions and governance** issues to manage the pressures in the wake of the crisis as well as long-term challenges, including those resulting from the rise in interconnectedness across national borders.

20. It is important to stress that there are various interlinkages both within categories and across the work streams. Individual projects form parts of broader bilateral or multi-lateral strands, rather than serve as stand-alone exercises. For example, improving the functioning of the financial sector has implications for economic growth and stability, for productivity and innovation via financing of SMEs and entrepreneurship, and for long-term investment and responding to the challenges of ageing and longevity. Similarly, work on assessing the transitional costs and distributional impacts of structural reform is linked with the determination of how much scope exists to achieve growth- and equity-friendly fiscal consolidation and to the work on promoting inclusive growth. Furthermore, sustainable and inclusive growth permeates many of the policy areas that are examined, in line with the NAEC mandate. These are just a few of the examples (other examples are indicated in the footnotes to project descriptions) in which individual projects address a particular aspect of a given issue, according to the expertise of the particular body executing the research, while projects undertaken by other parts of the house address the same issue from a multidisciplinary perspective. The NAEC output should be viewed as the synthesis of these elements.

21. That said, it may be inevitable that individual projects will yield intermediate outputs at different timeframes, depending upon the work programmes and schedules of the different committees and other bodies under which the work would be conducted. The timing of delivery will also be a function of the scale and complexity of particular components. The ultimate objective of the work outlined is the incorporation of the various components into one integrated framework – NAEC. An overview of the lines of work to be pursued within the three categories is provided in Figure 1. A more detailed listing of project proposals is provided in Annexes I and II. Detailed information on budget, committees, as well as lead and participating directorates was separately provided to the Budget Committee for its meeting on 25 April 2013 and to the Council for its meeting on 30 April 2013.

*Figure 1. Organising structure for NAEC work*



## **2. Reflection on the Crisis and Horizon Scanning for New Economic Tools**

22. Until 2007, large parts of the world had enjoyed a long and sustained period of relatively strong economic growth and stability, the so-called “Great Moderation”. While there were signs of weaknesses and risks, most observers tended to underestimate these threats. The OECD was not alone in failing to connect or missing the warning signs. Other institutions involved in international surveillance, many finance ministries, credit rating agencies, national and supra-national financial regulators and financial institutions themselves had been lulled into a sense of complacency during the Great Moderation. Given the analytical models used to examine the financial sector, the extent of the crisis and the subsequent global recession were consistently underestimated, which contributed to significant policy failures. Five years since the crisis began many advanced economies remain fragile, with significant downside risks and high unemployment. In short, OECD countries were generally not prepared for the crisis and were poorly positioned to withstand it.

23. The causes of this crisis have been dissected extensively in hundreds of articles, reports and policy statements (see Annex III for a selective bibliography). Many of the causes identified mask other underlying causes or policy choices dating further back in time, leading to continued academic debate on the relative significance of particular variables and on how to distinguish symptoms from causes. These differences then translate into differing recommendations to better understand and fix the underlying problems. For perspective, the causes of the Great Depression (1929-33) continued to be analysed in the economic literature for the remainder of the century and beyond (*cf.* Keynes, 1936; Friedman and Schwarz, 1963; Bernanke, 1995, 2000). This time, with what some have dubbed the Great Recession, is unlikely to be different.

24. Over the past few years, the OECD has also undertaken substantial work in an effort to better understand the factors that led to the crisis and the lessons that might be drawn from it. This has been addressed in *Financial Market Trends*, in various *Outlooks*, *Economic Surveys*, and publications such as *Going for Growth*, as well as in OECD reports and Working Papers. This work includes an analysis of key developments in the financial sector which made the crisis more likely, if not inevitable (Blundell-Wignall *et al.*, 2008); analysis of the revealed limitations, and priorities for adjusting frameworks for monetary, fiscal, financial market and structural policies (Pain and Röhn, 2011); credit crises and the shortcomings of traditional policy responses (White, 2012); lessons from the surveillance by international institutions (Shigehara and Atkinson, 2011); and corporate governance lessons (Kirkpatrick, 2009), among others.

25. A general audience volume *From Crisis to Recovery: the Causes, Course and Consequences of the Great Depression* that drew on analytical work by the OECD was also published in 2010 (Keeley and Love, 2010). A listing of some of the previous work by the OECD is provided in Annex IV. Drawing on OECD analyses, some policy lessons and open issues in the context of monetary and structural policies, financial sector reform, and social and employment policies are also outlined in the Background Note to the first meeting of the NAEC Group in October 2012 (OECD, 2012b).

26. In addition to undertaking a major reflection on the crisis, the OECD has already begun to significantly adapt its practices and policy recommendations in several areas. This includes, *e.g.* a detailed assessment of how labour market policies and institutions can be reformed to increase labour market resilience to negative economic shocks. The OECD has also conducted a review of the policies to combat high post-crisis unemployment and avoiding that this leads to high structural unemployment or inactivity, as well as developed recommendations to improve corporate governance frameworks. In addition, the OECD has increasingly incorporated financial stability developments in *Economic Outlooks* and *Economic Surveys*, incorporated the Financial Condition Index as an important indicator in the forecast process, and has undertaken research on policies to reduce financial risks and economic instability. NAEC will therefore

not begin in a vacuum, but build upon the wealth of past or on-going work. At the same time, with some distance now from the initial outbreak of the crisis, NAEC offers the opportunity for a more systematic, critical and deeper reflection.

27. In light of work already undertaken by the OECD, as well as the extensive scholarly literature on the causes and lessons from the crisis, the proposals for further work under this category are necessarily selective and targeted towards addressing key gaps and priorities. This work includes: drawing lessons from the crisis and economic history and evaluating OECD forecasting and surveillance; examining the role of the financial system in the crisis and the reforms required for sustainable growth (including fostering long-term investment and responding to the challenges of ageing and longevity, and exploring new approaches to SME financing); revisiting policy instruments for achieving growth- and equity-friendly fiscal consolidation; and exploring new economic tools and approaches (such as behavioural economics, complexity science, and increased use of micro-data) and reviewing country experiences.

## **2.1      *Lessons from economic history and previous crises*<sup>2</sup>**

28. Many macroeconomic models (including computational general-equilibrium models) are built on the assumption that deviations from equilibrium are self-correcting. As such, adjustment may be slow, depending on the rigidities that are embedded in the model, but the possibility that crises or severe economic slumps may emerge endogenously is typically overlooked. Nonetheless, crises have occurred through history.

29. As discussed by Reinhart and Rogoff (2009), despite a number of idiosyncratic elements, the current crisis shares many broad characteristics with previous crisis episodes. Many have featured credit booms which boost spending and contribute to the build-up of asset price bubbles, leading to more leverage and speculation, and eventually a decline in lending standards, further fuelling the bubble. As highlighted by the Chair of the Economic and Development Review Committee (EDRC), Bill White, at the first meeting of the NAEC Group, lessons from the current crisis should not be drawn in isolation but need to be put in the broader context of insights from the history of economic thought – including the pre-World War II period when many theorists acknowledged that the economy could have extended periods of deep slumps, post-War scholarship on the possibility of serious crises from excessive credit creation during boom years, as well as lessons from recent crises such as in Japan, the Nordic countries, and emerging markets in Asia and Latin America. Drawing lessons from history and past policy experiences was also highlighted as a priority at the first meeting of the NAEC Group. To this end, the OECD plans to develop a synthesis paper reviewing existing literature to give NAEC Group members such a perspective.

30. The OECD, like most other forecasters, failed to predict the full scope of the 2008/09 financial crisis. This had a bearing on OECD policy recommendations. In order to strengthen OECD future forecasting capabilities, it is important to assess the reasons for forecasting errors. As a first step, work will be undertaken to assess OECD projections for Member and Partner countries between 2007 and 2012 and compare how they perform relative to the historical track record prior to 2006 and relative to projections by other organisations and the consensus. Second, in contrast to previous post-mortems, the analysis aims to determine whether available information was utilised fully in the OECD projections. Third, to identify priorities for improving OECD forecasting and surveillance capabilities the project will review recent developments in forecasting methodologies and procedures and examine how past financial crises have influenced national forecasting practices. Possibilities for greater integration of Composite Leading Indicators (CLI) will also be examined.

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2 Projects A1 – The crisis: Drawing lessons from history and past policy experiences (e.g. linked to A3 – The role of the financial system in the crisis and reforms required to promote sustainable growth) and A2 – Forecasting in time of crisis: post-mortem of OECD projections.

## **2.2      *Role of the financial sector in the crisis and future reforms*<sup>3</sup>**

31. The crisis erupted against the backdrop of a range of weaknesses, beginning with imbalances on the macroeconomic front and including poor supervision and flawed incentives across the spectrum of financial market participants. It shares with a number of previous crisis episodes a substantial build-up of leverage and accumulation of assets in an environment characterised by very low risk spreads and high concentrations of risk. This was bred in this case by a long period of high growth, low real interest rates, and subdued volatility. It was also supported by evolutions in risk management processes and wider acceptance of instruments for credit risk transfer, including various innovative structured products. The flaws associated with recent financial innovations derived mainly from excessive heterogeneity, complexity, and opacity, which obscured underlying risks, allowing them to build to levels grossly disproportionate to the perceived benefits. Business models for larger banks focused on increasing the return on equity via securities businesses, excess leverage, over-the-counter derivatives and products with non-transparent spreads not subject to market competition. When problems emerged, the collapse of interlinked funding arrangements led to a fundamental shortage of collateral forcing central banks to undertake unconventional policy measures on a massive scale to avoid severe liquidity and thereby solvency issues. While the financial system has grown more complex, efforts to understand and influence it have, “at best, kept pace” (Yellen, 2013), and at worst, arguably the more likely outcome, fallen well behind.

32. One line of analysis will seek ways to deal with complexity and interdependence in the financial system and address major challenges such as destabilising levels of leverage, financial contagion, too-big-to-fail problems, and conflicts of interest. In this context, we will examine the distortions that tended to encourage high levels of leverage and a preference for short term, speculative investments over longer term, more stable and less risky investments. Tax structures have enabled market participants to chase speculative and short-term gains at the expense of these longer-term investments, leading to a less efficient allocation of resources (both labour and materials) and, generally, poorer infrastructure in many OECD countries. This combination of factors has also led to an increase in the risks borne by taxpayers, while putting pressure on public infrastructure budgets. The project will make specific proposals to ensure that the business models of financial firms help to foster SME lending and long-term investment to support a better financial environment for growth. This will include analysis of the main drivers of growing cash piles and subdued investment at corporations and the main barriers to the use of equity financing. The work will also consider policies that affect the ability of investors to engage in long-term investment.

33. In designing and implementing financial sector reforms, there is a need to ensure small and medium-sized enterprises (SMEs) are not disproportionately affected. SMEs have long been heavily reliant on traditional bank finance. While a range of policy interventions have historically been made to ensure SMEs’ access to finance, there is growing awareness of the potential for financial sector reforms undertaken in response to the crisis to have a long-lasting effect on the availability and terms of credit for entrepreneurs and SMEs. At the same time, governments have more limited scope to provide direct funding for these enterprises. There is growing concern among both financial institutions and businesses that credit constraints could become the “new normal” for SMEs, exacerbating an already long-standing

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3 Projects A3 – The role of the financial system in the crisis and reforms required to promote sustainable growth (e.g. linked to A1 – The crisis: Drawing lessons from history and past policy experiences, B12 – Increasing the resilience of economies to exogenous shocks and C1 – Revisiting the social contract: rebuilding trust for sustained economic recovery), A4 – Fostering long-term investment and responding to the challenges of ageing and longevity (e.g. linked to B15 – Ensuring productivity growth and innovation in the long run) and A5 – New approaches to SME and entrepreneurship financing: broadening the range of instruments (e.g. linked to B8 – Trade-offs and synergies between globalisation, innovation and inequality).

problem. The project will aim to help broaden the range of finance options for SMEs and entrepreneurs, in part, by mapping the full range of potential financial instruments and conducting in-depth analysis of the potential for and challenges of new approaches.

34. Another line of work under this heading will address the internationalisation of the financial system and the need for macro-prudential policies that do not unnecessarily restrict the cross-border movement of capital. The OECD Codes of Liberalisation should be reviewed as part of this exercise to ensure that they play their full role as instruments of cooperation on capital flow measures. A further component of the work will address the policy implications of the transfer of risks to households in the financial system (in particular, in mortgage markets, insurance and pensions). In this increasingly complex financial world, consumers need to be educated about risks and better protected.

### **2.3 *Revisiting policy instruments for achieving growth- and equity-friendly fiscal consolidation*<sup>4</sup>**

35. Most OECD governments face significant fiscal consolidation needs to reduce current elevated sovereign debt ratios to more prudent levels and keep them stable thereafter, in an environment characterised by long-term spending pressures on pensions, health and long-term care. This challenge occurs against a short- to medium-term need to boost economic growth, while minimising economic and social hardship and further increases in income and wealth inequality.

36. To address these issues we will review fiscal consolidation instruments from a broader perspective that assesses their effects on growth, equity and the environment both in the short run and over the longer term. For example, OECD analysis suggests that increased use of environmentally-related taxes and the phasing out of fossil fuel subsidies could contribute to achieving fiscal and economic objectives, and to tackling environmental challenges like climate change (OECD, 2012d). The choice and mix of preferred consolidation instruments varies across countries according to their starting points (including their initial fiscal position, the composition of their budgets, their vulnerability to hysteresis effects and their income distribution among other things). The aim is to identify the extent to which substantial trade-offs may arise between consolidation, growth and equity objectives, with a view to assisting OECD Member countries in designing fiscal consolidation strategies that minimise harmful side-effects on income distribution and long-term prosperity.

### **2.4 *Horizon scanning for new economic tools and approaches*<sup>5</sup>**

37. The crisis revealed serious limitations of our existing economic and financial models. The dominance of particular economic frameworks and paradigms that conditioned policy making may have led authorities to become too sanguine during the build-up of vulnerabilities causing them to overlook some of the underlying tensions that led to the crisis. For example, some applied macroeconomic models are built on assumptions which overlook the potential for crises and economic slumps to emerge endogenously. Longer-term global trends and the rise in interconnectedness and complexity pose additional challenges for policy that may need to be met with a broader set of analytical tools, as well as strengthened capacities to apply them.

38. This makes clear that a comprehensive rethinking of current economic paradigms is needed. NAEC will therefore explore innovative economic tools and approaches further, including nonconventional growth models, heterogeneous and agent based models, behavioural and experimental

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4 Project A6 – How much scope to achieve growth- and equity-friendly fiscal consolidation? (e.g. linked to B5 – Assessing the transitional costs and distributional consequences of structural reforms).

5 Project A7 – Applying new tools and approaches for better policy making (e.g. linked to B1 – New approaches to analysing multi-dimensional well-being: trade-offs and synergies).

economics and network analysis. The intent is not to develop new economic theories, but to draw on developments in academia that could better inform policy analysis. At the micro level, we will examine the implications for policy making of approaches which draw on behavioural and experimental economics, and agent-based modelling. Behavioural economics (including ‘nudge’ economics) may be of particular relevance, as highlighted by Daniel Kahneman at the first meeting of the NAEC Group. A broad perspective on human behaviour will help to grasp the complexities of how people interact within an increasingly interconnected economy. The OECD work programme already draws upon insights from behavioural economics to inform policy design in a number of areas, including environmental policy, labour market policy, competition policy, pension systems, consumer policy, governance and regulation, taxation, nutrition choice and obesity. NAEC will identify areas where insights from these approaches can be brought in to promote greater cross-fertilisation and avenues for deepening and extending this work to other areas.

39. Closely linked to these new tools and approaches is greater use of micro data to reflect the heterogeneity among economic actors while forging better linkages between such information and frameworks to examine aggregate economic outcomes. The OECD has been at the forefront in using comparable micro-data, but advances in technology and database management techniques in national statistical offices have enabled greater use of disaggregated statistics and indicators. There is a need and an opportunity to better harvest these data and to integrate them more into OECD work in a cost-efficient way.

40. Finally, some governments have already applied new approaches such as experimental policy and evaluation to aid government learning. NAEC provides an opportunity to take a closer look at these new approaches to policy making and to learn from best practices to improve future policy design and implementation.

### **3. Analysing Policy Trade-offs and Complementarities**

41. For reasons related to measurability, comparability and tractability, economic growth has often been used as a proxy for living standards or well-being and thus the main objective for economic policy. Evidence suggests, however, that while economic growth is a necessary condition for improvements in well-being, it is not sufficient. Furthermore, policies aimed at increasing economic growth can have a mixed effect on the various components of well-being. The multi-dimensional nature of well-being, therefore, leads to numerous potential trade-offs and complementarities when different policy levers and instruments are adopted to maximise one or more dimensions of well-being. These trade-offs and complementarities have become even more relevant since the crisis hit, as they not only confirmed that previous analytical frameworks were unsustainable, but because they confirmed that “business as usual” is not an option in an increasingly interconnected economy.

42. NAEC aims to enable governments to identify, prioritise and combine reforms to support sustainable and inclusive growth. Against this background, the proposed work under this category will examine the impact of various policies on well-being and the economy. Next, this stream will review conceptually and analytically the complex policy trade-offs and interactions in dealing with key dimensions of well-being, from income growth, to income inequality, to environment and economic stability, which have gained centre stage in the policy agenda of governments in OECD and, increasingly, in emerging economies. This work will therefore also draw upon synergies with the work undertaken as part of the follow-up to the OECD Development and Green Growth Strategies. This work will also highlight the need to work towards greener and more inclusive growth, taking into account the multidimensionality of the challenge, the drivers of the distribution of non-monetary dimensions of progress, and the link between policy instruments and the monetary and non-monetary dimensions of well-being. Paramount for this exercise is to develop a workable conceptual definition of inclusive growth that

is measurable and policy relevant. Depending on the outcomes of the projects in this stream, further work could examine other trade-offs and synergies among the dimensions of well-being. Finally, this work stream will provide a longer-term perspective on how global trends may evolve and the challenges they may pose to policy objectives. In this context, structural policies can affect the direction and extent of these global trends. Indeed, one aim will be to illustrate how different evolutions of the global trends will affect the trade-offs between policy objectives.

### **3.1      *Linking policy drivers to well-being outcomes*<sup>6</sup>**

43. An overarching theme of NAEC is that economic and noneconomic dimensions of well-being constitute the ultimate objective of policy making. A key theme then is to identify new tools and approaches for considering the impact of policies on multiple dimensions of well-being. These dimensions are closely interlinked, and include income, consumption possibilities, wealth, health, longevity, the environment, learning and education, civic engagement, housing and safety, among others.

44. As mentioned above, the need to recognise several interlinked objectives can cause tensions, but it can also bring synergies. We will therefore develop a method to assess the trade-offs and complementarities among different well-being dimensions. This will be done by estimating well-being functions for several outcome domains. The analysis will be conducted at the level of both aggregate well-being outcomes for countries and for measures of inequalities in the distribution of these outcomes across the population. Depending on data availability, the analysis will also be extended to outcomes at the individual level. As part of this project, we will also examine the pioneering experiences of a few OECD countries in using multidimensional approaches to well-being in policy making.

45. Another aspect of this strand of work will draw on the results of the Programme for International Assessment of Adult Competencies (PIAAC) to shed light on the linkages between skills, key institutional and policy variables, and well-being outcomes related to earnings, employment and inclusive participation in social and civic life. The particular value of PIAAC is that it provides for a multi-dimensional approach in which trade-offs between different outcomes and their drivers can be explicitly identified. Some results from PIAAC show, for example, that countries with a more unequal distribution of skills tend to have a more unequal distribution of income. The causality may run both ways.

46. In the aftermath of the global financial and economic crisis, many countries are still struggling with high and increasingly persistent unemployment and under-employment. Promoting strong and job-intensive economic growth is a key priority for policy makers. But before the crisis and even more so in its aftermath, an important question to ask is whether it matters what types of jobs are created and for which segments of the population. In this context, one angle of well-being that merits closer attention is job quality. By some metrics, job quality is one of the most powerful determinants of quality of life, as people generally spend a majority of their time at work and work for a significant part of their life. In addition, job quality affects worker commitment, satisfaction, productivity and potentially aggregate economic performance. In several advanced countries, employment growth prior to the global crisis included the creation of many jobs characterised by relatively low pay, limited job stability, career prospects and coverage to social security. During the crisis, job losses have been concentrated on workers holding these jobs, often youth, low-skilled workers and immigrants, while workers holding more stable and frequently permanent contracts have often been spared, contributing to further dualism in the labour market. In many

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6 Projects B1 – New approaches to analysing multidimensional well-being: trade-offs and synergies (e.g. linked to A7 – Applying new tools and approaches for better policy making and B11 – Trade-offs and synergies between environment and inequality), B2 – Measuring and assessing job quality and B3 – Assessing the effects of distribution of skills and key related institutional variables on multi-dimensional well-being outcomes.

emerging economies in-work poverty remains widespread in large part due to the high incidence of informal and un-protected work. Thus, in many countries and especially in the emerging economies the concern is not only to have a job, but to have a productive and rewarding job that allows for a decent standard of living and gives access to social protection. Previous work has also shown that job quality is closely related to skills utilisation and organisational development: innovative workplaces where workers are stimulated to use and develop skills – ‘learning organisations’ – tend to be economically more successful. We will therefore develop an operational framework for analysing job quality in the context of labour market performance and overall well-being, and document different dimensions of job quality. We will also reassess countries’ labour market performance with respect to both job quality and quantity, and analyse the role of policies and institutions for the quality and quantity of job opportunities.

### **3.2      *Inequality and economic growth*<sup>7</sup>**

47. The growing income inequality in most advanced and emerging economies documented in recent OECD work underscores the fact that, even before the crisis, the benefits of economic growth did not trickle down automatically. The OECD publication *Divided We Stand* (OECD, 2011) provides evidence on the complex linkages between structural policies to promote competition and economic growth and distributional outcomes. Building on this evidence, much in-depth work remains to be done, including on how growth-enhancing structural policies affect inequality in the short, medium and long term, how inequality affects social mobility and economic growth, how redistribution can be achieved at least cost, and what new determinants of growth and inequality have emerged. This segment of the NAEC work aims at developing specific proposals to achieve growth that is more inclusive. It will benefit from other OECD initiatives that are being developed to elaborate a conceptual framework on inclusive growth, the tools to measure it and the policies to achieve it. This goes in line with the 2012 MCM mandate on NAEC to develop a strategic policy agenda for inclusive and sustainable growth.

48. We also need to revisit our growth models and empirical analyses to take into account distributional considerations. There is increasing recognition that GDP per capita falls short of accurately measuring living standards of a typical individual or household. In particular, median household income has evolved quite differently from GDP in a number of countries. We will therefore examine whether structural policies that increase economic growth also improve median households’ disposable income. Data and resources permitting, the work will try to identify more precisely the differential effects of structural reforms on incomes of various population groups, thereby providing advice on how to reinforce the breadth and inclusiveness and sustainability of growth-enhancing structural reforms. It will also help assess the channels through which policies and institutions may influence disposable income across countries and over time.

49. Much of the planned work under NAEC on structural policies and inequality will shed light on the long-term effects of structural reforms. However, as these reforms generally involve complex transition phases and costs, a good understanding of these potential transition costs is essential to support policy reforms. The work will complement the other NAEC work on growth and inequality by using simulation tools – including a new generation of dynamic general equilibrium models – to explore the short- and medium-term distributional effects of different structural policy packages. While these models have

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7 Projects B4 – Do policies that increase GDP per capita also increase median income?, B5 – Assessing the transitional costs and distributional consequences of structural reforms (e.g. linked to A6 – How much scope to achieve growth- and equity-friendly fiscal consolidation and C5 – Promoting inclusive growth through better regulation), B6 – Closing the loop: how inequality affects economic growth and social cohesion?, B7 – Analysing growth and equality trade-offs in taxation and B8 – Trade-offs and synergies between globalisation, innovation and inequality (e.g. linked to A5 – New approaches to SME and entrepreneurship financing: broadening the range of instruments and B15 – Ensuring productivity growth and innovation in the long run).

limitations in macroeconomic forecasting, they are a useful means of examining the impact of different types of structural reforms on a range of stylised economies with different assumed underlying institutional and policy settings.

50. To better understand the growth-inequality nexus, it is equally important to examine the effects that inequality and the associated lack of social mobility could have on long-term growth. While some theoretical studies suggest that there is not necessarily a trade-off between equity and efficiency, the empirical evidence is inconclusive on how inequality and the associated lack of social mobility affect long-term growth. Moreover, political economy considerations would skew policies towards the interest of the well-off, who have easier access to policy-makers. We will re-examine the relationship between inequality, social mobility and growth in advanced countries and a selected group of emerging economies. We will look in particular at the impact of inequality on the pace of growth and sustainability of growth spells. We will also assess the role of different policies in shaping these links. An important aim of this work is to mainstream inequality into OECD analytical work, by providing new evidence of possible feedbacks and policy interactions and trade-offs implied by reforms.

51. Building on the increasing awareness of rising inequality and the equity concerns associated with this trend, there is also a need to examine how redistribution can be achieved at least efficiency cost. Previous OECD work on *Taxation and Economic Growth* did not directly address inequality or inclusive growth. Although subsequent work has examined the tax policy implications of the rise in the share of top incomes, there is a need to bring insights from these two strands together to examine the role of taxation in promoting inclusive growth. We plan to examine what type of progressivity/redistribution governments could be aiming to achieve through the tax/benefit system and outline where there are likely to be trade-offs between progressivity and tax incentives and exemptions. We will then consider how tax and benefit reform could in principle support both growth and redistribution.

52. This would set the stage for further work involving more empirical analysis (*e.g.* using micro-simulation modelling) since trade-offs in practice will depend on the shape of the pre-tax income distribution. Building on the initial work, we will analyse the design of individual taxes as well as shifts in the composition of revenues from personal income taxes/social security contributions to consumption or property taxes in order to investigate how efficiency costs of redistribution can be minimised. More specifically, we will analyse the design of measures to increase tax revenues consistent with achieving distributional objectives, investigate the redistribution produced by personal income taxes and social security contributions to inform analyses of the cost-effectiveness of tax measures, and investigate whether the design of some taxes could be improved to increase equality of opportunity.

53. The global dimensions of growth and inequality are also important, notably in the context of global value chains (GVCs). Therefore, when discussing the growth-inequality nexus in a globalised world, it is important to examine new determinants of growth and inequality. Taking into account major global trends, we will also examine where employment is being generated in GVCs through international trade. Previous OECD work on off-shoring has shown that a growing number of jobs are being created by trade in emerging economies, while other jobs are being created in advanced economies. At the same time, much of the value-added generated in GVCs still accrues to advanced economies, owing in part to their specialisation in high value-added activities, but also to the orchestration of value chains by multi-national enterprises and the compensation they receive from knowledge-based assets. An additional, and particularly challenging step, will be to explore the creation and appropriation of income in the context of GVCs. This includes the role that income from knowledge-based capital plays in GVCs, *e.g.* income from royalties, licensing and other knowledge-based assets. Finally, the project will aim to develop a new trade model that would take advantage of the new data generated in the preceding exercise to formulate policy advice.

### **3.3      *Interaction between environment and economic growth /inequality*<sup>8</sup>**

54. Economic growth and human development has always depended on access to natural resources and the environment's ability to absorb waste. The scale of human pressure on these resources is starting to pose potentially large risks to future economic growth and development. The distribution of these risks is likely to be uneven. This theme will examine the interrelationship between economic and environmental policies, their distributional impacts and the potential benefits of environmental policy action, with the aim to create and implement policies that lead to greener growth.

55. Global economic growth over past decades has come at an increasingly significant cost to the environment and has locked-in environmental change that will affect future generations. Unless more significant policy action is taken now, continued environmental degradation in the future is likely to pose risks to the economy and to human well-being. However, while most work in this area has examined the biophysical consequences of inaction to environmental challenges, the economic and social costs of inaction and the benefits of policy action have not yet been quantified. We will therefore use economic scenarios to identify environmental pressures and impacts under different structural and environmental policy assumptions, and will then examine how these pressures may constrain future growth paths. This enhancement of OECD modelling capacity will build on and complement the extensive work on green growth already underway within the OECD, including work on indicators and other measurement tools, sectoral policy analysis (*e.g.* agriculture, energy, and transport), and the integration of green growth considerations into national and multilateral policy surveillance.

56. In addition, a good understanding of the relationship between environmental policies and economic growth is vital for policy-makers aiming to achieve greener growth. Green growth offers an opportunity to foster economic development while ensuring that natural assets are conserved. While OECD work has already examined linkages between structural policy and growth, and between environmental policy and environmental outcomes, it has so far only partially analysed the cross effects of policies on growth and the environment. We will therefore collect new indicators on policy settings and examine empirical evidence on cross-country differences in a wide range of environmental policies and analyse how these policies affect economic growth. This will include examining some of the trade-offs that may exist, as well as highlighting the synergies that can arise when environmental policies are implemented through revenue-raising instruments that can finance growth-enhancing policies or when green growth boosts overall resources devoted to innovation.

57. However, examining linkages between the environment and growth is not enough, and more analysis is warranted on the distributional impacts (benefits and costs) associated with different environmental policies. Thus, we will also provide quantitative insights into the equity impacts of green growth policies across households, sectors and regions, based on an enhanced modelling framework which combines insights from the in-house forward-looking modelling framework with household-level data on income and expenditures. This evidence base can be used to investigate the extent to which market-based environmental policies, such as environmental taxes or emissions permit trading, can contribute to growth objectives (*e.g.* fiscal consolidation and generating government revenues) and are consistent with equity goals. There may be scope to rebalance current consolidation efforts in favour of more equity and greening of the fiscal system.

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8 Projects B9 – Cost of Inaction and Resource Scarcity: Consequences for Long-term Economic Growth / Benefits of Action, B10 – Environmental policies and economic performance (*e.g.* linked to B13 – OECD@100: global trends and policy challenges) and B11 – Trade-offs and synergies between environment and inequality (*e.g.* linked to B1 – New approaches to analysing multidimensional well-being: trade-offs and synergies).

### **3.4 Economic growth and stability<sup>9</sup>**

58. The economic crisis has highlighted the high cost of economic instability and the need to increase the resilience of economies to exogenous shocks. Against this background, it is crucial to assess whether policies pursued in the name of higher income growth exposed economies to greater instability with the concomitant risks. At the same time, policies to ensure greater stability may have implications for sustainable long-term growth. We plan to examine the following dimensions:

- *Structural policies for economic resilience.* A large body of evidence has identified a number of structural policy settings that are generally helpful to the aim of long-term growth. However, much less is known about the effect of structural policy settings on the resilience of economies to shocks, including economic shocks or other events such as natural disasters or social unrest. “Resilience” – understood as the ability of an economy to withstand or bounce back quickly after being hit by a shock – is a desirable feature of an economy, but could potentially be negatively affected by pro-growth structural policy settings as well as appropriate risk management and preparedness. Previous and ongoing OECD work has already looked at how different policy settings have affected economic as well as labour market resilience to shocks. However, there is a need to draw on the experience provided by the crisis to see whether trade-offs exist between long-term growth and resilience, and to consider potential remedies.
- *Macroeconomic policies and stability.* As with structural policies, macroeconomic policy settings that are generally considered to be helpful for long-term growth may also have negative side-effects for economic stability. For example, inflation targets involve trading-off some insurance against instability by allowing real interest rates to become negative in bad times against possible efficiency costs associated with positive inflation. However, this type of trade-off may become more acute in the future when underlying growth may diminish, depending on how trends evolve.
- *Pro-growth policies and external imbalances.* Pro-growth policies may also generate potential trade-offs with respect to stability in the international dimension. Previous OECD work has shed light on the effects of pro-growth structural reforms on savings and investment, which in turn affect the external current account balance. Further empirical work will trace out how pro-growth policy settings affect external imbalances, and identify synergies between pro-growth and external sustainability policies as well as cases where the two are conflicting.

### **3.5 Long-term trends and policy trade-offs<sup>10</sup>**

59. In addition to deepening the empirical evidence base on interlinkages and policy trade-offs (as was discussed in the previous three themes), there is a need for a longer-term perspective on how major global trends will evolve and what challenges they will pose to economic growth and other key policy objectives. Only by taking this long-term perspective can the prospects for rising interconnectedness and

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9 Project B12 – Increasing the resilience of economies to exogenous shocks (e.g. linked to A3 – The role of the financial system in the crisis and reforms required to promote sustainable growth and C2 – Assessing the vulnerabilities of social institutions, and policy responses to enhance resilience).

10 Projects B13 – OECD@100: global trends and policy challenges (e.g. linked to B10 – Environmental policies and economic performance, B14 – Long-term scenarios for food and agriculture, C2 – Assessing the vulnerabilities of social institutions, and policy responses to enhance resilience and C4 – Assessing immigrant characteristics and links to labour market performance), B14 – Long-term scenarios for food and agriculture (e.g. linked to B13 – OECD@100: global trends and policy challenges) and B15 – Ensuring productivity growth and innovation in the long run (e.g. linked to A4 – Fostering long-term investment and responding to the challenges of ageing and longevity and B8 – Trade-offs and synergies between globalisation, innovation and inequality).

associated complexity be elucidated – both as regards economic relations between countries and as regards feedbacks, spillovers and trade-offs between different policy areas. These long-term trends include population ageing, technological progress and the need for different skills, specialisation patterns, the globalisation of value chains, and the use of natural resources, including sources of energy. In comparison to previous scenario analysis, the work will evaluate outcomes in multiple dimensions (*i.e.* in terms of growth, equity, stability and the environment), when assessing scenarios and effects of public policies.

60. We will explore long-term growth scenarios and policy issues for the global economy over the next 50 years. This will include how macroeconomic, structural and institutional policy choices interact to shape global growth prospects and other policy objectives. This work is specifically focussed on identifying feed-backs and spillovers between countries and across policies and, against that background, will identify tensions, trade-offs and synergies, and focus on how these change over time as a result of major global trends. The framework for this work is built around three interconnected modules. The *long-term macro module* will be used to project growth and current-account imbalances in OECD countries and non-OECD G20 countries until 2060. Linked to the work on the benefits of action on environmental challenges outlined earlier, these economic outputs will feed into the *environmental module* to develop projections for the implied use of energy and natural resources, environmental pressures and, eventually, monetised damages. These damages may feed back into the initial growth projections of the macro module to provide more realistic baseline projections of future economic growth. Outputs from the macro module will also serve as input to a *trade and inequality module* to analyse future developments in skills, relative wages, trade and specialisation patterns, and value-added distribution across countries. One of the new empirical findings from OECD work that will be taken on board in this project relates to trade specialisation. As such, we will examine the determinants of trade specialisation, by looking at historical patterns and their consequences for economic growth. This modelling architecture will provide the basis for investigating how different configurations of structural, environmental and macro policies can affect future developments in the global economy.

61. Other long-term trends, such as continued global population growth, urbanisation, globalisation, and resource and environmental constraints, cannot be ignored. We will therefore develop long-term scenarios for global food and agriculture until 2050 (*e.g.* related to agricultural output growth and environmental pressures) to provide estimates of the likely range of resource challenges facing the global food system. Given the importance of climate change, environmental degradation and increased competition for scarce land and water resources for food production, this work links closely to work on environment and growth, and especially on the cost of inaction. Unlike similar efforts to date, the work will emphasise the dialogue between relevant groups of scientists and policy makers as early as in the scenario definition phase. In a first workshop, specific scenarios towards 2050 will be jointly developed by modellers, policy-makers and private stakeholders, which represent different visions of the future of the agro-food system. The scenarios would be oriented towards the expressed needs of decision makers. Around these scenarios, modelling groups will generate quantitative scenarios to identify elements in the food system that are most sensitive to threats, as well as opportunities likely to develop over the coming decades. This should highlight the implications and characteristics of policies for improving the resilience and sustainability of the global food system.

62. We also wish to better understand new drivers of productivity growth in frontier economies, including the role of knowledge-based capital, as well as factors which act to discourage productivity growth. There is considerable uncertainty about the prospects for productivity growth, in particular for economies already close to the frontier. Some of this uncertainty stems from the process of technological progress at the frontier itself. Another part of the uncertainty emerges from the process by which technological progress is turned into productivity growth, with the need for complementary changes and investments at the firm level, as well as knowledge-based entrepreneurship. Moreover, the necessary framework conditions are likely to be different at the frontier of innovation than for firms and economies

that are still in the catch-up phase, where there is scope to benefit from advances in other firms and economies, and where the actual multi-factor productivity growth can be higher than the underlying long-term rates.

63. We will therefore first conduct a prospective analysis of productivity growth, technological change and innovation at the frontier, based on a meta-analysis of studies on future prospects for productivity growth, and an exchange amongst organisations engaged in long-term projections. Then, a retrospective analysis of productivity growth and technological change for a limited number of frontier economies will be conducted to examine how waves of technological change have translated into productivity growth in the past. Finally, micro-analysis will be used to help identify the determinants of productivity, technological change and innovation, including the role of knowledge-based capital, and the implications of structural heterogeneity (whereby the capacity of firms, particularly SMEs, to turn knowledge and technological progress into productivity growth, varies significantly across industries and within sectors). It will also shed light on the policy factors driving growth, which will provide insights about potential future drivers of, and barriers to, productivity growth.

#### **4. Institutions and Governance**

64. Policy makers are facing a number of near-term challenges in the wake of the crisis, including high and rising unemployment, stagnating growth, and weak fiscal positions. Long-term trends, such as population ageing and migration, pose additional challenges. The crisis also sparked a debate on the role of governance failures in the crisis, many of which still need to be addressed. At the same time, there has been increasing demand from citizens for the state to better support inclusive growth and to offer greater transparency and access to information. In addition, new technologies including the internet and various social media have significantly changed the time frame and constraints under which governments operate, particularly in the context of a crisis. These interconnected challenges require a rethinking of the role of the state. Against this background, this category of work will discuss approaches that could help to improve institutions and governance in order for national and sub-national governments to more effectively adopt and implement policies in an increasingly interconnected world. It will also examine how the OECD can better develop its work and assist governments in implementing reforms.

65. There are three streams in this category of work. The first stream will explore the impact of the crisis on trust and effectiveness in government and identify specific policy measures to rebuild them. The second stream will focus on the vulnerability of social institutions to the consequences of the crisis as well as major global trends, with a particular focus on the implications of population ageing. A third stream will take a close look at new challenges for governance, including the importance of effective regulation to support inclusive growth and opportunities for regulation to be adapted to a globalised world. All these aspects aim to provide concrete options to reflect the notion of the ‘smart state’, which was introduced by Philippe Aghion at the first NAEC Group meeting in October 2012 (OECD, 2012c).

##### **4.1 Trust in government<sup>11</sup>**

66. The crisis strained the relationship between affected governments and citizens. Dramatic cuts in public expenditure since then have raised awareness about the effects of fiscal consolidation on equity and how the benefits and costs of structural reforms are distributed among the different social groups. In addition, national and sub-national governments have struggled to communicate a clear vision for recovery. This has undermined the notion of the state as a careful and competent steward of the public

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11 Project C1 – Revisiting the social contract: rebuilding trust for sustained economic recovery (e.g. linked to A3 – The role of the financial system in the crisis and reforms required to promote sustainable growth).

interest. One of the conclusions of the Chair at the first NAEC Group meeting was that NAEC should “examine how to gain back trust in governments” (OECD, 2012c).

67. Trust is now recognised in the economics literature as a key determinant of policy effectiveness, reduced uncertainty and low transaction costs. Without trust in government, public support for ambitious, innovative policies is difficult to mobilise, particularly where short-term sacrifices are involved and where long-term gains might be less tangible. This represents a serious challenge for governments as they search for more effective policies that the NAEC initiative aims to identify.

68. Building upon OECD work on budget transparency, open government, public sector integrity, regulatory compliance, rule of law and public sector efficiency, we will look at how public confidence can be assessed and what measures governments can take to strengthen it. In a first step, we will assess the robustness of existing methodologies to measure trust in government and key institutions, and develop new metrics that are more policy focused. In a second step, we will consider specific complex policy challenges to see how governments can adapt institutions and processes to better cope with major challenges across three dimensions of complexity: (i) multi-sectoral issues that cut across the structure of government; (ii) planning for long-term change; and (iii) risk management in the public sector. The output will be developed by means of seminars and case studies and will focus on the capacity and organisational requirements needed to manage change and maintain public support.

#### **4.2      *Vulnerability of social institutions*<sup>12</sup>**

69. Social institutions (*e.g.* pension and health care systems, and unemployment insurance) in many OECD countries and emerging economies are confronted with various pressures. A better understanding of the vulnerability of social institutions is necessary to identify risks faced, create more transparency, as well as deliver services more effectively. This stream will therefore examine the vulnerability of social institutions, and identify opportunities for making them financially sustainable and more resilient to major global trends. Particular attention will be paid to the impact of population ageing on the key pillars of social protection.

70. We will examine the strain placed on a number of social institutions and their vulnerability to future shocks and longer-term trends. Our examination will compare vulnerabilities to past experiences of strained or collapsed social institutions and seek to estimate the magnitude and composition of risks in each country, which includes both OECD Member countries and emerging economies. It will also analyse the vulnerability and risk-sharing abilities of different types of institutions when exposed to structural change. This will help to examine ways in which financial sustainability can be achieved while continuing to further the social goals that these institutions serve, even in the wake of adverse trends, unforeseen shocks and economic crises.

71. In this context, the financial sustainability of health care systems merits a particularly close look. Access to high-quality health services for all is a key objective to promote well-being. While health spending has continued to climb in recent decades, the recent financial and economic crisis has prompted many governments to ask whether new approaches to defining the boundaries between public and private health spending ought to be considered. At present, around 70 to 80% of total health spending is financed by the public sector, and there has been little change over time. Given rising demand for health services,

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12 Projects C2 – Assessing the vulnerabilities of social institutions, and policy responses to enhance resilience (*e.g.* linked to B13 – OECD@100: global trends and policy challenges), C3 – Can health become an even bigger part of the economy without undermining its financial sustainability? and C4 – Assessing immigrant characteristics and links to labour market performance (*e.g.* linked to B13 – OECD@100: global trends and policy challenges).

however, there will be increasing pressure on national budgets over time unless structural changes are applied. We plan to assist governments in deciding how to best manage the boundaries of the public and private provision of health services in a way that does not exacerbate inequality in access or reduce care quality. This is becoming a critical policy challenge as OECD countries seek to decide which health services to prioritise, while emerging economies seek guidance on which health services to focus upon as they attempt to achieve universal health coverage. We will use empirical analysis of the sources of growth in health spending as well as on different approaches to advise countries on possible scenarios for public/private boundaries of health spending to respond to different population preferences for fairness and public spending.

72. Promoting the economic and social integration of immigrants in host countries is an important component of an inclusive growth strategy. Already in 2010, permanent migrants in OECD countries accounted on average for more than one in four new entries into the working-age population, although a significant fraction still reflected free mobility within Europe. Although labour migration is expected to increase over the next decade, family and humanitarian migration will continue to be a significant share of total migration flows, and policy efforts to better mobilise domestic resources in the context of ageing populations need to take this trend into account more explicitly. Building on past OECD work on the labour market integration of immigrants and their children and taking advantage of newly available data from PIAAC, we will examine the implications for both integration policy and the selection of labour migrants in supply-driven regimes. We will also aim to focus more precisely on the skills of migrants, their use in the labour market and the barriers that migrants face in gaining access to the labour market.

#### **4.3      *New challenges for governance<sup>13</sup>***

73. The past decade has brought a change in perceptions of the role of the state as a regulator. Serious regulatory failures emerged related to poor articulation of regulation across borders, limited enforcement of rules and regulatory capture. This has reawakened the debate on the role of the state as a regulator, and on how and where it should intervene to achieve which objective in an increasingly globalised world.

74. In this context, the issue of how regulatory frameworks need to adapt to spur growth and strengthen social inclusiveness at a domestic and global level while guarding against regulatory failure has emerged as a high priority. Recent OECD work shows that OECD countries engage in a wide range of co-operation arrangements to keep pace with the need to regulate across borders, but without clear understanding of their relative benefits, costs and success factors. We will therefore explore how governments can identify, prioritise and combine regulatory reforms to support inclusive growth individually and collectively to address global challenges. These issues will be discussed in roundtables, through analytical work, and country and case studies of specific regulatory experiences.

75. Another set of issues relates to the implications of globalisation for competition. The world economy is more integrated and interconnected than ever before thanks to technology and a substantial reduction in transactions costs. Companies sell into global markets and produce their goods using supply chains that cross national boundaries many times. Competition law has also spread worldwide, with more than 120 competition authorities. The work of these authorities is usually well-aligned through increasing international co-operation and framework convergence, but they nonetheless enforce competition laws on a national, or at most, a regional level. As the world economies further integrates, and in particular as the

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13 Projects C5 – Promoting inclusive growth through better regulation (e.g. linked to A6 – How much scope to achieve growth- and equity-friendly fiscal consolidation and B5 – Assessing the transitional costs and distributional consequences of structural reforms), C6 – Implications of globalisation for competition and C7 – Securing tax revenues in a globalised economy.

competition agencies in emerging economies flex their muscles, it is important to ensure that global markets and national competition law enforcement promote global economic growth. We seek to increase policy makers' awareness of the implications of national approaches to competition law enforcement and the value of increasing consistency and coherence across jurisdictions in the way it is enforced. To do this, we will relate trends in competition law enforcement to measures of globalisation to illustrate the possible costs of the existing fragmented approach, and the benefits of jurisdictions working together highlighting the ways in which existing soft convergence and voluntary co-operation tools have promoted sound policy and minimised conflicts. Competition policy should not be used at worst as a mechanism for covert protection and at best result in costly inefficiencies in the efforts of global companies to make appropriate investment decisions, be they greenfield or mergers and acquisitions.

76. Another aspect of globalisation and competition arises in the context of state-owned enterprises. While some countries have tried to employ SOE's as agents for inclusive growth, the relative growth in the number of SOEs has also led to concerns about competitive neutrality, as SOEs sometimes receive public subsidies and privileged positions in the marketplace, and/or may be excluded from requirements applied to the private sector. Cross-border activities of SOE's must be on a level playing field basis, regardless of what they do in their own countries with respect to industrial policy. The proposal calls for examining the question of state activism through two lenses: state-owned enterprises (SOEs) and experimental policy and government learning. As such, we will identify policy options that allow governments that wish to use SOEs for inclusive growth to continue doing so, but at the same time safeguard an open and non-discriminatory investment climate. For this purpose, we will rely on a mixture of empirical and dialogue-based fact finding, explore existing sources of data (including corporate and legislative information) and gather new information through questionnaires.

77. As with competition, taxation policies also have to be adapted to an increasingly globalised and interconnected world to ensure that adequate revenues are raised to respond to the challenges of population ageing and maintain sound public finances. In particular, base erosion and profit shifting (BEPS) are widely perceived to be undermining domestic tax bases. The generally accepted principles of taxation were mostly formulated in the context of closed economies, with policies for handling international flows grafted on subsequently. Although domestic and international rules for the taxation of cross-border income flows have evolved since their origins back in the 1920s, the world has changed even more markedly as a result of globalisation (particularly international capital mobility and the growth of trade in services as well as goods) and the rapid growth of the emerging economies. The interaction of the tax regimes of different countries matters much more than in the past in terms of its effects on economic activity, employment and equality (within and between countries). Of particular note in the context of a globalised economy is the mix of source-based taxation (notably the corporate income tax), residence-based taxation (particularly the personal income tax) and destination-based taxation (*e.g.* value-added tax).

78. It is therefore important to have a new approach to tax policy that would secure tax revenues in a globalised economy and ensure that tax regimes have an overall coherence, while contributing to inclusive economic growth, increased employment, improved financial regulation and a more stable macroeconomic environment, and minimising harmful spillovers across countries. Complementary to OECD work on BEPS, which focuses on the international rules for taxing corporate income and on developing comprehensive, internationally-coordinated strategies for countries concerned with base erosion and profit-shifting, we will analyse prospective revenue trends, by bringing together tax revenue and rate information with statistics on the drivers of trends in the structure of revenues (*e.g.* national accounts measures of profit shares in total GDP, data on income distribution, and statistics on international trade and the digital economy).

## **5. Wrap-up and Next Steps**

79. The NAEC exercise will require a multi-year effort. As the work develops, it may lead to further proposals to harness new information and knowledge and/or to a modification of ongoing work. The following milestones and deliverables are envisaged:

- This Interim Report will be delivered to the Ministerial Council Meeting (MCM) of May 2013. It takes into account the various comments received at the February 2013 meeting of the NAEC Group, as well as written comments from delegations and OECD bodies that are members of the NAEC Group (including EPC, ELSAC, EPOC, among others). The present interim report streamlines the proposals in view of the comments received.
- Lines of work under NAEC will continue to advance following the 2013 MCM, and substantive elements of a Synthesis will be delivered to the 2014 MCM.
- A comprehensive Synthesis is envisaged after the 2014 MCM as part of the PWB cycle.

80. By design, NAEC is horizontal in nature, with various projects conducted under the auspices of different OECD committees. Revised budget tables that take into account the streamlining and modification of proposals reflected in this paper have been developed. Individual projects will inevitably yield intermediate outputs at different time frames. The timing of delivery will also be a function of the availability of funding.

81. NAEC is a ground-breaking and challenging initiative for the OECD, with an extensive proposed work programme. It will draw lessons from the crisis, examine the potential for mainstreaming new economic tools and approaches in OECD analysis and advice, improve our understanding of policy trade-offs and complementarities, and develop recommendations to help governments identify, prioritise and implement reforms. Such an agenda will enrich the horizontal character of our work, analysis and policy advice, as well as bring together different policy communities across OECD Committees.

82. In this effort, NAEC aims to improve our understanding of the complex and interconnected nature of the global economy and associated policy challenges. This will include approaches to economic analysis that take a holistic approach to policy goals and seek to better understand policy interlinkages, externalities and trade-offs. For this purpose, it will draw on existing as well as new economic theories and practices.

83. NAEC will recognise the importance of economic growth as means but not as an end of policy-making. Against this background it will recognise the trade-offs and complementarities between several interlinked policy objectives and instruments. NAEC also aims to identify areas where OECD analytical frameworks may need to be adjusted. It seeks to identify what we could do better as an organisation and to embed these lessons in our daily work practices. This will be necessary to ensure that analyses are undertaken thoroughly with the most adequate tools.

84. Finally, NAEC aims to enable governments to identify, prioritise and combine reforms to support sustainable, inclusive growth. It will provide guidance and recommendations on regulation, enforcement, forecasting and the efficacy, efficiency and effectiveness of various policy options.

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## ANNEX I. Overview of project proposals

<b>A. REFLECTION &amp; HORIZON SCANNING</b>	<b>B. POLICY TRADE-OFFS &amp; COMPLEMENTARITIES</b>	<b>C. INSTITUTIONS &amp; GOVERNANCE</b>
<p><b>Lessons from economic history and previous crises</b></p> <p><b>A1</b> - The crisis: Drawing lessons from history and past policy experiences</p> <p><b>A2</b> - Forecasting in time of crisis: post-mortem of OECD projections</p>	<p><b>Linking policy drivers to well-being outcomes</b></p> <p><b>B1</b> - New approaches to analysing multi-dimensional well-being: trade-offs and synergies</p> <p><b>B2</b> - Measuring and assessing job quality</p> <p><b>B3</b> - Assessing the effects of distribution of skills and key related institutional variables on multi-dimensional well-being outcomes</p>	<p><b>Trust in government</b></p> <p><b>C1</b> - Revisiting the social contract: rebuilding trust for sustained economic recovery</p>
<p><b>Role of the financial sector in the crisis and future reforms</b></p> <p><b>A3</b> - The role of the financial system in the crisis and reforms required to promote sustainable growth</p> <p><b>A4</b> - Fostering long-term investment and responding to the challenges of ageing and longevity</p> <p><b>A5</b> - New approaches to SME and entrepreneurship financing: broadening the range of instruments</p>	<p><b>Inequality and economic growth</b></p> <p><b>B4</b> - Do policies that increase GDP per capita also increase median income?</p> <p><b>B5</b> - Assessing the transitional costs and distributional consequences of structural reforms</p> <p><b>B6</b> - Closing the loop: how inequality affects economic growth and social cohesion?</p> <p><b>B7</b> - Analysing growth and equality trade-offs in taxation</p> <p><b>B8</b> - Trade-offs and synergies between globalisation, innovation and inequality</p>	<p><b>Vulnerability of social institutions</b></p> <p><b>C2</b> - Assessing the vulnerabilities of social institutions, and policy responses to enhance resilience</p> <p><b>C3</b> - Can health become an even bigger part of the economy without undermining fiscal sustainability?</p> <p><b>C4</b> - Assessing immigrant characteristics and links to labour market performance</p>
<p><b>Revisiting policy instruments for achieving growth- and equity-friendly fiscal consolidation</b></p> <p><b>A6</b> - How much scope to achieve growth- and equity-friendly fiscal consolidation?</p>	<p><b>Interactions between environment and economic growth/inequality</b></p> <p><b>B9</b> - Cost of Inaction and Resource Scarcity: Consequences for Long-term Economic Growth/Benefits of Action</p> <p><b>B10</b> - Environmental policies and economic performance</p> <p><b>B11</b> - Trade-offs and synergies between environment and inequality</p>	<p><b>New challenges for governance</b></p> <p><b>C5</b> - Promoting inclusive growth through better regulation</p> <p><b>C6</b> - Implications of globalisation for competition</p> <p><b>C7</b> - Securing tax revenues in a globalised economy</p>
<p><b>Horizon scanning for new economic tools and approaches</b></p> <p><b>A7</b> - Applying new tools and approaches for better policy making</p>	<p><b>Economic growth and stability</b></p> <p><b>B12</b> - Increasing the resilience of economies to exogenous shocks</p> <p><b>Long-term trends and policy trade-offs</b></p> <p><b>B13</b> - OECD@100: global trends and policy challenges</p> <p><b>B14</b> - Long-term scenarios for food and agriculture</p> <p><b>B15</b> - Ensuring productivity growth and innovation in the long run</p>	

## ANNEX II. Summaries of project proposals

### A. Reflection and Horizon Scanning

<b>A1.</b>	<b>The crisis: Drawing lessons from history and past policy experiences</b>
<p><i>Summary</i></p> <p>Despite a number of idiosyncratic elements, the current crisis shared many broad characteristics with its predecessors. Lessons from the current crisis therefore cannot be drawn in isolation but need to be put in the broader context of insights from the history of economic thought. The proposed synthesis paper of existing literature will draw lessons about the origins and the resolution of the current crisis from economic history and the history of economic thought. The paper will be based on a high-level overview of the key crisis episodes and experiences internationally, including around the Great Depression, covering the run-up to the crisis, the crisis itself, as well as its aftermath. This would include more recent crises such as in Japan, the Nordic countries, and emerging markets in Asia and Latin America. Insights from a longer-term perspective, covering pre-1914 experience, could also be included.</p> <p>The paper will examine key lessons learnt from the functioning of the economy and financial system during that period, as well as prolonged periods of weak growth, investment and high unemployment in the wake of crises. In addition, the role of debt in triggering crises, the ensuing evolution of debt and the mechanisms for resolution of unsustainable debt across different economic sectors will be discussed. The paper will also review competing explanations of the crises, both current explanations and contemporary or earlier economic thinkers. Lessons will also be drawn from that experience in terms of policy to avoid worst impacts crises and how to resolve the current crisis.</p>	
<b>A2.</b>	<b>Forecasting in time of crisis: post-mortem of OECD projections</b>
<p><i>Summary</i></p> <p>The OECD, like most other forecasters, failed to predict the financial crisis in 2008/09, which affected OECD policy recommendations. In order to improve the relevance and quality of the OECD policy advice and surveillance, it is important to assess the reasons for forecasting errors and draw lessons for the projections in the future. In this context, it will be vital to identify shortcomings in the OECD projection practices in the lead-up to the crisis, and subsequently, in order to strengthen OECD future forecasting capabilities.</p> <p>As a first step, the project will assess performance of OECD projections for Member and Partner countries from 2007 to 2012, comparing how they perform relative to the historical track record prior to 2006 and relative to projections by other organisations. Second, in contrast to previous post-mortems an important part of the study will be to assess whether available information was utilised fully in the OECD projections. This will involve attempting to explain the errors in the projections with a host of variables, including financial indicators, commodity prices, survey indicators and the fiscal stance. Third, the project will review recent developments in forecasting methodologies and procedures in other global and regional institutions in response to the crisis, as well as how past financial crises have influenced national forecasting practices. This will bring new insights into how forecasting institutions, including the OECD, have adapted to perceived shortcomings in their forecasting operations.</p>	

A3.	<b>The role of the financial system in the crisis and reforms required to promote sustainable growth</b>
<i>Summary</i>	<p>The crisis arose as a consequence of deregulation, innovation and regulatory and tax distortions that led to excess leverage, too-big-to-fail interconnectedness and conflicts of interest. Business models for larger banks focused on increasing the return on equity via securities businesses, excess leverage, over-the-counter derivatives and products with non-transparent spreads not subject to market competition. Leverage became extreme in derivatives products with re-hypothecation pyramids leading to a fundamental shortage of collateral that has required central banks to play a massive and unconventional monetary policy role in order to avoid liquidity issues (particularly margin calls) arising from shortening of the path to default. Such disequilibria will lead to changes in business models of banks, and the entry and exit of firms and products into and out of the shadow banking system. In this increasingly complex financial world, unsophisticated consumers need to be educated about risks and better protected.</p> <p>The project aims to strike the right balance between simplified and transparent rules that help to deal with complexity and interdependence in the financial system and address major challenges such as destabilising levels of leverage, financial contagion, too big to fail problems, and conflicts of interest. The project will make specific proposals to ensure that the business models of financial firms help foster SME lending and long-term investment to support a better financial environment for growth. The project will use descriptive analysis (a data focus), analysis relating to incentive structures and wedges within regulations and the financial system and econometric testing of leverage rules and the impact of business structures on lending. It will address developments in OECD countries as well as selected non-OECD economies with large financial systems.</p> <p>The project will also address the internationalisation of the financial system and the need for macro-prudential policies that do not unnecessarily restrict the cross-border movement of capital. The OECD Codes of Liberalisation should be reviewed as part of this exercise to ensure that they play their full role as instruments of cooperation on capital flow measures. A third component of the project will address the policy implications of the risk transfer to households in the financial system (in particular, in mortgage markets, insurance and pensions). The project will combine qualitative and quantitative analysis on the contribution of financial inclusion, financial education, and financial consumer protection to growth and financial stability.</p>

A4.	<b>Fostering long-term investment and responding to the challenges of ageing and longevity</b>
<b>Summary</b>	<p>Prior to the crisis, tax and regulatory distortions accentuated financial and technological innovations to increase leverage and to change the role of intermediaries and relative prices in the funding of investment. It became possible to engineer more tax-efficient financial structures and improve the availability of financial capital for more speculative and risky investments. This, in turn, drove a less efficient allocation of society's real economic resources (labour and materials). In essence, financial resource allocation became more complex, separating fundamental borrowers from ultimate investors. This created information asymmetries and made it more difficult for investors to appraise risks. The crisis has subsequently led to unusually low interest rates and a variety of other unusual factors. Because interest rates are low, debt is cheap. But the low interest rate environment tends to work to the detriment of companies that embark on long-term investment, as long-term investors searching for yield tend to sell their shares in favour of companies that give cash back to shareholders. This behaviour might be encouraged by rules governing pension funds and insurance companies which can favour mechanisms that result in short-termism and low investment. Thus, despite high cash flows in the corporate sector, long-term business investment remains subdued.</p> <p>The project will therefore seek to identify the main drivers of growing cash piles and subdued investment at corporations and suggest ways to increase the use of cash flow for investment. It will also study the main barriers to the use of equity financing and find ways for corporate governance and market rules to help to improve price discovery and strengthen equity markets. The project will also consider policies affecting the ability of investors to engage in long-term investment in a low interest rate environment. It will therefore identify how regulatory frameworks and market practices can be adapted to facilitate investment by institutional investors in long-term assets, including less liquid markets such as unlisted infrastructure projects. Finally, the project will examine the implications of ageing and longevity risk for long-term institutional investors and ask what role governments might play in fostering incentives to postpone retirement, to increase participation in funded schemes (<i>e.g.</i> auto enrolment, matching contributions) and to promote capital market solutions to hedge longevity risk. Finally, the project will identify the problems in financial product markets—such as annuities in the payout phase—that impede hedging of longevity risk.</p>

<b>A5.</b>	<b>New approaches to SME and entrepreneurship financing: broadening the range of instruments</b>
<i>Summary</i>	<p>SMEs have long been heavily reliant on traditional bank finance to fulfil their start-up, cash flow and investment needs, and policy interventions have largely been devoted to easing access to credit, for example through guarantees, or subsidies to provide credit on preferential terms. However, today there is an increasing recognition that the financial sector reforms undertaken in response to the crisis are likely to have a long-lasting effect on the availability and terms of credit for SMEs and entrepreneurs, going beyond the transitory implementation period. At the same time, governments now have a more limited ability to provide direct funding for these enterprises. There is growing concern among both financial institutions and businesses that credit constraints will simply become “the new normal” for SMEs and entrepreneurs, exacerbating an already long-standing structural problem. It is therefore necessary to broaden the range of financing instruments available to these businesses, in order to enable them to continue to play their role in growth, innovation and employment. For sustainable recovery and long-term growth, financial stability, financial inclusion and financial deepening should be considered as mutually reinforcing objectives.</p> <p>This project aims to help broaden the finance options available to SMEs and entrepreneurs, by mapping – for the first time – the full range of potential financial instruments and conducting in-depth analysis on the potential and challenges for new approaches. The analysis will consider in particular innovative policies that build on public-private partnerships and focus on pilot experiences from which transferable lessons can be learned. Analytical studies on financing instruments alternative to straight debt will be carried out based on a literature review, surveys, case studies and policy evaluations. A specific effort will be devoted to improving the evidence base, as a lack of comprehensive data is a major obstacle to the analysis in this field. Expert meetings and workshops will provide the opportunity to discuss assumptions and findings with policy makers, practitioners and representatives of SME associations and financial institutions. The project is expected to make a tangible contribution to government efforts to ease finance constraints, by helping them develop and implement new policy approaches and support well-functioning markets in offering a broader range of finance instruments for SMEs and entrepreneurs.</p>

<b>A6.</b>	<b>How much scope to achieve growth- and equity-friendly fiscal consolidation?</b>
<i>Summary</i>	<p>Most OECD governments face large fiscal consolidation needs to reduce current elevated debt ratios to more prudent levels and keep them stable thereafter, despite long-term spending pressures on pensions, health and long-term care. In this context, it is important to examine policy options to meet these needs while preserving prosperity, minimising short-term economic and social hardship and avoiding increases in income and wealth inequality.</p> <p>The project will look at fiscal consolidation instruments from a new and broader perspective, by simultaneously assessing their effects on growth and equity in the short term and over the longer term in a consistent fashion. A further novelty is that the choice and mix of preferred consolidation instruments varies across countries depending on their starting point (<i>e.g.</i> in terms of their initial fiscal position, the composition of their budget, their vulnerability to hysteresis effects, their income distribution) and constraints (such as the current account position and the scope for monetary support). The project will also examine the margin of manoeuvre that countries possess within different broad tax- and spending areas compared to other OECD countries. Given the available leeway for each instrument and consolidation needs, the project looks at the extent to which substantial trade-offs between consolidation, growth and equity objectives may arise. The project will bring together results from previous empirical analyses and model simulations accumulated through work by the Economics Department in this area and apply them in a new manner, so as to take into account the characteristics of individual countries.</p>

<b>A7.</b>	<b>Applying new tools and approaches for better policy making</b>
<i>Summary</i>	<p>The crisis has revealed serious limitations of our existing economic and financial models in understanding and anticipating events and in helping to put economies back on sustained and sustainable growth paths. In addition, long-term global trends and the rise in interconnectedness and complexity also pose challenges for policy that may need to be met with a broader set of analytical frameworks and tools to better examine the trade-offs and complementarities.</p> <p>NAEC will therefore explore new economic tools and approaches, as well as their current and potential future application in policy making. These new approaches include behavioural and experimental economics, complexity science (including agent-based modelling), and the more systematic use of micro-data. The intent is not to develop new economic theories, but to draw on developments in academia that could better inform policy analysis. One field that may be of particular relevance is behavioural economics. The OECD work programme touches upon a number of areas in which insights from behavioural economics can inform policy design, <i>e.g.</i> in the context of environmental policy, competition policy, pension contributions, consumer policy, taxation, nutrition choice and obesity. NAEC can facilitate greater cross-fertilisation and avenues for deepening work in this area. More generally, experimental economics can be a cost-effective tool for <i>ex ante</i> policy evaluation. Sharing country experience on areas in which laboratory or - preferably field - experiments have been successfully implemented and informed policy choices could be reviewed.</p> <p>Closely linked is the more systematic use of micro-data to better reflect the heterogeneity among economic actors and to facilitate more precise policy recommendations. Micro data can provide much richer insight into the mechanisms underlying trends and correlations at the macro and sectoral level, in particular when the aggregate data reflect large reallocations, <i>e.g.</i> between firms and workers, or important contributions of entry and exit. While the OECD has been at the forefront in using comparable micro-data for policy analysis, there is a need and an opportunity to better integrate them into OECD work in a cost-efficient way. Finally, some governments have already applied new approaches, such as experimental policy and evaluation to government learning. NAEC provides an opportunity to take a closer look at these new approaches to policy making and to learn from best practices to improve policy design and implementation. In this context, meetings with policy makers and other leading experts with experience in the application of these new economic tools and approaches can be held, and papers and/or case studies conducted to inform policy making.</p>

## B. Policy Trade-Offs and Complementarities

<b>B1.</b>	<b>New approaches to analysing multi-dimensional well-being: trade-offs and synergies</b>
<i>Summary</i>	<p>One of the main lessons from the crisis is that it partly reflected a reductionist view about the ultimate ends of policies (<i>i.e.</i> higher economic growth), often seen as a proxy for well-being. Ideally policies should be examined on the way in which they actually enhance (or detract from) well-being (distribution as well as average performance). This is important for a number of reasons. For example, the lack of improvement in well-being outcomes for the median person may have contributed to the crisis through higher consumption, higher debt, vulnerability and financial instability. Similarly, policies that deliver growth but do not improve the well-being of the majority of members in a society will not be sustainable politically over the long term. Ultimately, economic growth is desirable as a means to well-being rather than as an end in itself.</p> <p>The proposed project will help move the analysis of well-being to the centre of policy analysis, by allowing the quantification of trade-offs between different well-being dimensions. At a later stage, it will enable analysis to identify and quantify the impact of different policies on well-being. The core of this project will be to estimate well-being functions for different dimensions of the <i>Better Life Initiative</i>. Each outcome area will therefore be modelled as a function of the other outcomes and of important contextual (and proxy) variables (such as the rate of GDP growth). The analysis will be conducted at the level of both aggregate well-being outcomes for different countries (cross-sectional and over-time) and for measures of inequalities in the distribution of these outcomes across the population. Depending on data availability, it will also be extended to an analysis of outcomes at the individual level. As part of this project, we will also examine the pioneering experiences of a few OECD countries in using multidimensional approaches to well-being in policy making.</p>
<b>B2.</b>	<b>Measuring and assessing job quality</b>
<i>Summary</i>	<p>The crisis has put the spotlight on the need to kick-start job creation. But does it matter what sort of jobs these are? And is there a trade-off between policy measures to encourage greater job creation and the quality of these jobs in terms of pay, working conditions, job security, informality, <i>etc.</i>? Are youth likely to be most at risk in cycling between a range of poor quality jobs interspersed with unemployment? These are important questions which not only concern individual well-being but also the prospect for economic growth and the strength of public support for reforms in both OECD and emerging economies. If these reforms are perceived to lead to little gains in terms of creating good quality jobs and at the cost of increasing greater job insecurity and labour market duality, they may encounter strong public opposition and weakened social cohesion.</p> <p>The aim of this project is to bring job quality to the forefront of the policy debate on how to promote inclusive growth, by arguing that labour market performance should be assessed in terms of the increase in both the number and quality of job opportunities, <i>i.e.</i> policies should seek to promote more and better jobs. Another innovative component of the project will be its focus on job quality in emerging economies especially on the high incidence of informal work. The project will adopt several different and new descriptive and analytical approaches and will document the key dimensions of job quality across countries, demographic groups and over time, and analyse their determinants. In this reassessment of labour market performance — taking explicitly into account different dimensions of job quality in addition to the quantity of jobs — the project will use cross-country time series econometric techniques. These will be further complemented by in-depth micro-based analyses of job-quality dynamics that also allow consideration of individual's and employer's characteristics.</p>

B3.	<b>Assessing the effects of distribution of skills and key related institutional variables on multi-dimensional well-being outcomes</b>
Summary	<p>There is ample literature on how educational attainment relates to productivity at individual and aggregate levels. But the question for NAEC is a different one: How does the distribution of human talent combine with key institutional variables (<i>e.g.</i> education, social and labour market policies as well as labour force structure) to shape the multi-dimensional distribution of outcomes such as earnings, employment, or inclusive participation in social, civic, cultural and political life? With PIAAC, the OECD is in a unique position to provide answers to this. The particular value of PIAAC is that it provides for a multi-dimensional approach in which trade-offs between different outcomes and their determinants can be examined. The PIAAC data will generate new analytical work which was hitherto impossible.</p> <p>As an example, results from PIAAC show that there is not just an important relationship between the level of talent in a country and the level of national income, but also that countries with a more unequal distribution of skills tend to have a more unequal distribution of income. Causality in this relationship may run both ways: Higher degrees of income inequality may cause unequal investment in skills. For example, some research suggests that the distribution of income can affect political, educational and economic mechanisms, among other factors, which can have an indirect effect on economic growth. Conversely, a more unequal skill distribution alongside other factors can contribute to a more unequal distribution of both economic and non-economic benefits. Classical human capital theory and research has led to better understanding of the contribution of skills to productivity and economic growth. But this new analysis will enable us to understand a much broader and multi-dimensional set of relations between skills distribution, various measures of well-being, and inclusive growth.</p>
B4.	<b>Do policies that increase GDP per capita also increase median income?</b>
Summary	<p>There is increasing recognition that GDP per capita falls short of accurately measuring living standards, well-being, and even the economic situation of a typical individual or household. For example, median household income has evolved quite differently from GDP in a number of countries. This project will examine whether structural policies that increase economic growth also improve median households' disposable income. Data and resources permitting, the project will try to identify more precisely the differential effects of structural reforms on incomes of various population groups, providing evidence on the breadth and inclusiveness of growth-enhancing structural reforms. It will also assess the channels through which policies and institutions may influence disposable income across countries and over time by decomposing income into its main components, notably wages and self-employment income versus capital income.</p> <p>The project will be empirical in nature and will rely on cross-country time series panel regressions. As dependent variables, it will make use of: (i) standard national accounts data on household disposable income per capita; (ii) new 'extended' national accounts data to be produced by STD that incorporate distributional aspects; and (iii) distribution data obtained from the aggregation of microeconomic administrative and survey-based sources as used <i>e.g.</i> in <i>Divided We Stand</i>. As explanatory variables, the analysis will make use of standard structural policies indicators as regularly used in <i>Going for Growth</i> (<i>e.g.</i> product and market regulation, level and structure of taxation, social benefits, and education) in association with various indicators of globalisation (<i>e.g.</i> trade and FDI exposure) and other structural features such as technological progress, supply of skilled labour, or employment of women.</p>

<b>B5.</b>	<b>Assessing the transitional costs and distributional consequences of structural reforms</b>
<i>Summary</i>	<p>Much of the planned work under NAEC on structural policies and inequality will shed light on the long-term effects of structural reforms on income distribution and identify trade-offs and synergies between policy levers. However structural reforms often take time to deliver benefits and generally involve substantial transformation with complex transition phases and transitional costs. For policy-makers it is essential to have a good understanding of these potential transition costs that are often concentrated on the most vulnerable. Failure to do so may reduce support for reforms and even jeopardise the reform process itself. This project will therefore complement the other components of the NAEC work on growth and inequality by using simulation tools – including a new generation of dynamic general equilibrium models – to simulate the short- and medium-term distributional effects of different structural policy packages. While these models have been criticised for their limits in macroeconomic forecasting, they provide a useful tool to simulate the impact of different types of structural reforms on a range of stylised economies characterised by different underlying institutional and policy settings.</p> <p>The framework proposed would allow the study of not only distributive and aggregate steady-state effects of reforms, but also the characterisation of the full transition of each variable from the initial point where the reform is implemented to the new steady-state. The applied model makes it possible to evaluate overall reform desirability constructing aggregate welfare measures based not only on steady-state outcomes but also taking into account how the effects are displayed over time along the cross-section of workers. The proposed analysis will improve our ability to shed light on the distributional implications of structural reforms in the short and over the longer run. By simulating the dynamic effects of policy reforms, it will increase awareness of the policy interactions and possible short- and medium-term trade-offs implied by such reforms. If resources permit, these simulations will also be complemented with a review of the distributional impact of selected key reform episodes in OECD countries.</p>
<b>B6.</b>	<b>Closing the loop: how inequality affects economic growth and social cohesion?</b>
<i>Summary</i>	<p>To better understand the growth-inequality nexus, it is also important to examine the effects that inequality and the associated lack of social mobility could have on long-term growth. While some theoretical studies suggest that there is not necessarily a trade-off between equity and efficiency, the empirical evidence is inconclusive on how inequality and the associated lack of social mobility affect long-term growth in both advanced and emerging economies. This project will thus examine the relationship between inequality, social mobility and economic growth in both advanced and emerging economies. This will provide key policy insights for policy makers to be able to identify win-win policies that promote both economic growth and fairer distribution of its benefits, as well as those that involve trade-offs.</p> <p>The project will expand insights provided by the OECD publication <i>Divided We Stand</i> and recent work in the Economics Department (<i>ECO Working Papers 924-930</i>), and: (i) set out an operational framework for analysing the impact of inequality on the pace and pattern of economic growth; (ii) document the key dimensions of this interaction; (iii) look at the impact of inequality on the pace of economic growth and the sustainability of growth spells; (iv) untangle the relationship between innovation/technological change, changes in labour demand and in the distribution of wages; and (v) examine how different forms of inequality can undermine macroeconomic stability. The project will also explore the inequality-growth nexus stemming from the fact that poverty undermines investment in human capital and thus hinders social mobility. The aim of the project is to fully mainstream inequality into OECD analytical work.</p>

<b>B7.</b>	<b>Analysing growth and equality trade-offs in taxation</b>
<p><b>Summary</b></p> <p>To further the OECD analysis of inequality, there is a need to examine how income (and wealth) can be most efficiently redistributed. Previous OECD work on Taxation and Economic Growth did not directly address inequality or inclusive growth. Although subsequent work has examined the tax policy implications of the rise in share of top incomes, there is a need to bring insights from these two strands together to examine the role of taxation in promoting inclusive growth. A first output could be a paper that examines at what type of progressivity/redistribution should governments be aiming to achieve through the tax benefit regime and outline where there are likely to be trade-offs between progressivity and tax incentives/exemptions. It would then consider how tax reform could in principle support both growth and redistribution.</p> <p>This would set the stage for a second stage of work involving more empirical analysis (<i>e.g.</i> using micro-simulation modelling), since trade-offs in practice will depend on the shape of the (pre-tax) income distribution. This project will analyse the design of individual taxes as well as shifts in the composition of revenues from personal income taxes/social security contributions to consumption or property taxes in order to investigate how efficiency costs of redistribution can be minimised. More specifically, the project will analyse the design of measures to increase tax revenues consistent with achieving distributional objectives, investigate the redistribution produced by personal income taxes and social security contributions to inform analyses of the cost-effectiveness of tax measures, and investigate whether the design of some taxes could be improved to increase equality of opportunity.</p>	

<b>B8.</b>	<b>Trade-offs and synergies between globalisation, innovation and inequality</b>
<p><b>Summary</b></p> <p>The global dimensions of growth and inequality are also important, notably in the context of global value chains. When discussing the growth-inequality nexus in a globalised world, it is also important to examine new determinants of growth and inequality. Taking into account major global trends, this project will thus examine where value (in terms of employment) is being generated in global value chains (GVCs) through international trade. Previous OECD work on off-shoring has shown that a growing number of jobs are being created by trade in emerging economies, while other jobs are being created in advanced economies. At the same time, much of the value added generated in GVCs still accrues to advanced economies, due to their specialisation in high value added activities, but also due to multinational enterprises' orchestration of value chains and the compensation they receive from the knowledge-based assets that create value in these value chains. The underlying data infrastructure for the work on Trade in Value Added will also provide the basis for analysis of the carbon embodiment of international trade and production.</p> <p>An additional, and particularly challenging step, will be to explore the creation and appropriation of income in the context of GVCs. Cross-country income flows that are embodied in value chains are affected by the tax planning strategies of multinational firms, where dividends, interest and royalty payments may be channelled through or held in other tax jurisdictions. While this extension is possible in theory, there are important methodological and data constraints which would need to be overcome, <i>e.g.</i> as regards the ownership of firms and capital. If these can be overcome, work would be undertaken in 2014 to make progress on this challenge. Finally, the project will aim to develop a new trade model that is explicitly able to take advantage of this new data to formulate policy advice.</p>	

<b>B9.</b>	<b>Cost of Inaction and Resource scarcity: Consequences for long-term Economic Growth / Benefits of Action</b>
<i>Summary</i>	<p>Global economic growth over past decades has come at a significant cost to the environment. Natural assets have been and continue to be depleted, with the services they deliver already compromised by pollution. However, while most work in this area has examined the consequences of inaction to environmental challenges, the costs of inaction and the benefits of action has not yet been quantified. The Cost of Inaction and Resource Scarcity: Consequences for Long Term Economic Growth (CIRCLE) project will therefore use economic scenarios to identify environmental pressures under different structural and environmental policy assumptions and the associated damages, and will then examine how these pressures may affect economic growth paths. In this endeavour, the project aims to assess the benefits of action to environmental challenges as well as the benefits of undertaking green growth paths. The analysis will be global, looking at the regional costs of inaction and benefits of environmental policy action for developed, emerging and developing economies.</p> <p>Given the ambitious nature of this work, it is proposed to work in two parallel tracks. The first track focuses on the impacts and benefits of action on climate change and local air pollution and aims at getting the fully integrated analysis, <i>i.e.</i> have interactions between economy and environment in both directions, including a feedback from environmental damage to growth. The second track will include other environmental damages (<i>e.g.</i> from lost or impaired ecosystem services). The work will involve investments in the modelling frameworks used by the OECD. It will require new data and expertise, <i>e.g.</i> enhancing the representation of environmental pressures and resources use may require new data sets, and valuation of the economic consequences of environmental impacts and resource scarcity may demand additional expertise. The project will allow for improved growth projections that include feedbacks from the environment. Such improved projections can address some of the major systemic risks stemming from environmental degradation and resource scarcity. The proposed work should also enable modelling-based analyses at the OECD to better assess some of the net benefits of environmental policy action.</p>
<b>B10.</b>	<b>Environmental policies and economic performance</b>
<i>Summary</i>	<p>A good understanding of the relationship between environmental policies and economic growth is vital for policy-makers aiming to achieve greener growth. While OECD work has already examined linkages between structural policy and growth and between environmental policy and the environmental outcomes, it has so far only partially analysed the cross effects of policies on growth and the environment. This project will therefore collect new indicators on policy settings and examine empirical evidence on cross-country differences in a wide range of environmental policies and analyse how these policies affect economic growth. This is not necessarily a story of trade-offs. Synergies may arise when environmental policies switch towards revenue-raising instruments that may finance growth-enhancing policies or when green growth boosts overall resources devoted to innovation.</p> <p>The main contributions of the project will be to construct comparable cross-country measures of environmental policies and explore their effects on various measures of performance in a cross-country context. The methodological approach will draw on experiences with past work on the effects of anti-competitive market regulation and network sector regulation on growth and from work on environmental policies and innovation. It will rely on data gathering and indicator design, drawing largely on OECD experience in work with indicators (<i>e.g.</i> product market regulation and green growth indicators), and econometric analysis to assess the effects of environmental policies on productivity growth at firm, industry and economy level. Meta-analysis techniques will also be applied to heterogeneous micro-econometric studies of the effects of environmental regulation on selected measures of economic and financial performance (<i>e.g.</i> total factor productivity, return on assets, and return on investment).</p>

<b>B11.</b>	<b>Trade-offs and synergies between environment and inequality</b>
<i>Summary</i>	<p>Examining linkages between the environment and economic growth is insufficient, and more analysis is warranted on the distributional impacts (benefits and costs) associated with different environmental policies. One project will therefore provide quantitative insights into the equity impacts of green growth policies across households, sectors and regions. In doing so, the work will combine insights from the in-house forward-looking modelling framework with household level data on income and expenditures.</p> <p>The global modelling tool at ENV (ENV-Linkages) will be expanded to improve the representation of different types of labour, and be coupled to a dedicated external module of representations of household income and expenditure data. With this enhancement, this project will provide quantitative insights into the equity impacts of green growth policies, across households, sectors and regions. The enhanced modelling framework could for instance be used to investigate to which extent market-based environmental policies, such as environmental taxes or emissions permit trading, that can contribute to growth objectives (<i>e.g.</i> fiscal consolidation and generating government revenues) are also consistent with equity goals. There may be scope to rebalance current consolidation efforts in favour of more equity and greening of the fiscal system. One of the major challenges in undertaking this analysis is the lack of reliable data on household expenditures for OECD countries. Resources permitting, the compilation of a database of information on household expenditures and income sources for different household groups will be undertaken.</p>
<b>B12.</b>	<b>Increasing the resilience of economies to exogenous shocks</b>
<i>Summary</i>	<p>The crisis has highlighted the high cost of economic instability. Against this background it is crucial to assess whether policies pursued with the aim of higher income growth expose the economy to greater instability with the concomitant risks. At the same time, policies to ensure greater stability may have implications for long-term growth.</p> <p>This project will examine three dimensions. First, a large body of analysis has identified a number of structural policy settings as generally helpful to the aim of long-term income growth. However, much less is known about the effect of such policy settings on the resilience of economies to shocks. There is thus a need to draw on the experience provided by the crisis to see whether trade-offs exist between long-term growth and resilience and to consider potential remedies. Second, as with structural policies, macroeconomic policy settings generally considered to be helpful for long-term growth may also have negative side-effects for economic stability. For example, inflation targets involve trading-off some insurance against instability by allowing real interest rates to become negative in bad times against possible efficiency costs associated with positive inflation. Such issues can be illustrated and calibrated by means of model simulations. Third, pro-growth policies may also imply potential trade-offs with respect to stability in the international dimension. Further empirical work would trace out how pro-growth policy settings would affect external imbalances and identify cases where there are synergies between pro-growth and external sustainability policies as well as cases where the two are conflicting.</p>

<b>B13.</b>	<b>OECD@100: global trends and policy challenges</b>
<i>Summary</i>	<p>There is a need for a longer-term perspective on how major global trends will evolve and what challenges they are expected to pose to economic growth. These long-term trends include population ageing, technologies, change in skills, specialisation patterns, global value chains and the use of natural resources. This project will explore long-term growth scenarios and policy issues for the global economy over the next 50 years. In particular, it will examine how macroeconomic, structural and institutional policy choices interact to shape global growth prospects and other policy objectives. As such, the project will identify tensions, trade-offs and synergies and focus on how these change over time as a result of major global trends.</p> <p>In comparison to previous scenario analysis, OECD@100 will evaluate outcomes in multiple dimensions (in terms of growth, equity, stability and the environment), when assessing scenarios and effects of public policies. The framework will also provide tools to better analyse interlinkages as well as the interdependencies among countries in the global economy in a consistent fashion. For example, while previous scenario work has highlighted the growth effects of increased human capital formation, OECD@100 aims to highlight its repercussions for specialisation, wage inequality and fiscal pressures in both the origin country and trade-partners. This strategy follows from the conviction that, in an increasingly interconnected world, anticipation and policy responsiveness can only be effective if mutual influences among policy areas and countries, within the OECD and with key non-OECD partners, are duly taken into account. Thus, the main purpose of the OECD@100 project is to provide a systematic and forward-looking perspective of policy interlinkages at the global level with a view of anticipating the build up of imbalances and tensions and identify policy responses. It aims at identifying future policy challenges facing the world economy in a compelling way and at discussing policies to cope with them while supporting gains in well-being that are widely shared and environmentally sustainable.</p> <p>The framework for this project is built around three interconnected modules. The <i>long-term macro module</i> will be used to project growth and current account imbalances in OECD countries and non-OECD G20 countries until 2060. Outputs from this module will feed into the <i>environmental module</i> to develop projections for the implied use of energy and natural resources, environmental pressures, and eventually monetised damages. These damages may be fed back into the initial growth projections of the macro-module. Outputs from the macro module will also serve as input to a <i>trade and inequality</i> module to analyse future developments in skills, relative wages, trade and specialisation patterns, and value added distribution across countries. One of the new empirical findings from OECD work that will be taken on board in this project relates to trade specialisation. As such, we will examine the determinants of trade specialisation by looking at historical patterns and their consequences for economic growth. This modelling architecture will provide the basis for investigating how different configurations of structural, environmental and macro policies can affect future developments in the global economy.</p>

<b>B14.</b>	<b>Long-term scenarios for food and agriculture</b>
<i>Summary</i>	<p>The economic and commodity crisis of recent years have shown a lack of shared views about possible evolving paths of the agro-food systems and how policies can contribute to shape these paths. This project will fill this gap by developing long-term scenarios for global food and agriculture until 2050 to provide estimates of the likely range of resource challenges facing the global food system and to provide a platform to discuss shared and robust policy responses. Unlike similar efforts to date, the project emphasises the dialogue between relevant groups of scientists and policy makers as early as in the scenario definition phase. In a first workshop, specific scenarios towards 2050 would be jointly developed by modellers, experts, OECD and Key Partner policy makers and private stakeholders. This ensures that different but shared visions on possible futures of the agro-food system can be represented, and that views are shared on the challenges for global agriculture, natural resources, and food security – filling an important gap in existing scenario work. While based on key drivers and accounting the relevant interlinkages and trade-offs in the system and consistent with the other macroeconomic, productivity and environmental long run projects in NAEC, the scenarios would be oriented towards the expressed needs of decision makers.</p> <p>A range of modelling groups including from other international organisations such as the FAO and IFPRI will generate quantitative scenarios to identify elements in the food system that are most sensitive to threats, as well as opportunities likely to develop over the coming decades. The project will focus on policies that improve the resilience and sustainability of the global food system. Policy and investment options will be subjected to multiple scenarios for agricultural markets, thereby allowing to assess robustness of policy responses. The outcomes of these scenarios will be discussed both across the modelling teams involved and stakeholders. The common understanding on possible futures, challenges and responses will facilitate policy dialogue and policy advice. A final policy report will highlight the implications and the characteristics of policies for improving the resilience and sustainability of the global food system. This work will incorporate three novelties relative to other scenario approaches: 1) having a varied set of models involved for a systematic identification of challenges; 2) including stakeholders' views in the scenario design; and 3) providing policy advice that accounts for scenario uncertainties.</p>

<b>B15.</b>	<b>Ensuring productivity growth and innovation in the long run</b>
<i>Summary</i>	<p>In the long run, achieving stronger, more sustainable and inclusive growth, and increasing well-being, relies heavily on increases in the productivity of all factor inputs, most of which are finite. Productivity growth, in turn, relies on technological change and innovation, and on how new technologies (such as ICT, biotechnology, nanotechnology and others) are combined with other knowledge-based assets, such as skills and organisational change. However, despite large and growing investments in knowledge-based capital, productivity growth in many countries has slowed in recent years, raising questions on the adequacy of structural policy settings. At the same time, there is an urgent need for more rapid innovation (including its uptake and diffusion) in several key policy areas, such as in environmental policy.</p> <p>To make progress on these questions and strengthen the underpinning of the OECD analytical frameworks on inclusive growth, three strands of work are proposed. First, the project would carry a prospective analysis of productivity growth, technological change and innovation at the frontier, based on a meta-analysis of studies on future prospects, including foresight and scenario studies. Then, the project would conduct a retrospective analysis of productivity growth and technological change for a limited number of frontier economies, to examine how waves of technological change have translated into productivity growth in the past. Finally, the project would encompass a micro-economic analysis of the determinants of productivity, technological change and innovation, including the role of knowledge-based capital, as well as the policy factors driving growth, extending work currently underway across the OECD. This work would have an explicit focus on frontier innovation, which determines the underlying rate of multifactor productivity growth.</p>

## C. Institutions and Governance

<b>C1.</b>	<b>Revisiting the social contract: rebuilding trust for sustained economic recovery</b>
<p><i>Summary</i></p> <p>Against a background of increasing unemployment and widening inequalities, demands from citizens and business are high, but confidence that government can deliver is low in many countries. Without trust in government, public support for ambitious, innovative policies is difficult to mobilise, particularly where short-term sacrifices are involved and where long-term gains might be less tangible. This represents a serious challenge for OECD governments as they search for the more effective policies that the NAEC initiative aims to identify. One of the conclusions of the Chair at the first NAEC Group meeting was that NAEC should “examine how to gain back trust in governments”.</p> <p>This project includes two innovative components, both of which build on areas of OECD expertise, that look at how public confidence can be assessed and what measures governments can take to strengthen it.</p> <ul style="list-style-type: none"> <li>i. <i>Building the evidence base on trust in government:</i> When we start to address the link between trust and policy outcomes, we are moving into new territory for the OECD. Do we have the right measures? Are the methods for measuring trust in institutions, the ones that we would choose? Or do we need to strengthen the metrics so that they meet OECD standards in terms of policy relevance, quality and so on. The project will assess the robustness of existing methodologies to measure trust in government and key institutions, and develop new metrics that are more policy focused, drawing on OECD governance indicators developed for Government at a Glance and guided by G@G Steering Group experts in relevant fields such as budget transparency, open government, integrity, regulatory compliance, rule of law and public sector efficiency. New approaches to measuring trust will be tested through case studies.</li> <li>ii. <i>Managing complex challenges – reliable, competent and legitimate responses in a context of uncertainty and risk:</i> Public confidence depends to a large extent on how governments deal with the big issues. Securing stakeholders’ buy-in and mobilising their active support is essential for political decisions to succeed and have a measurable impact, but that support depends on the government demonstrating its capacity and competence under pressure. The project will look at the specific case of complex policy challenges to see how governments can adapt institutions, and processes to cope better with major cross-department challenges or crises. This pillar would look at the public governance of complex policy challenges across three dimensions of complexity: (a) multi-sectoral issues that cut across the structure of government; (b) planning for long-term change and (c) risk management in the public sector. The work will draw on evidence from OECD public governance reviews and on expertise from the centres of government network, public governance committee and high level risk forum. The output will be developed by means of seminars and case studies and will focus on the capacity and organisational requirements needed to manage change and maintain public support.</li> </ul>	

C2.	<b>Assessing the vulnerabilities of social institutions, and policy responses to enhance resilience</b>
Summary	<p>The recent crisis has revealed the unsustainability of some of the promises made under various social systems. Social institutions have been burdened by the crisis, which makes them particularly vulnerable to future shocks. In this context, it is important to assess the vulnerabilities attached to the main types of social security institutions, covering pensions, health care systems and unemployment insurance, as well as identifying adequate policy responses. In particular, there should be a focus on finding the right balance between achieving financial sustainability while continuing to further the social goals that these institutions serve.</p> <p>The project aims at identifying both general institutional settings and specific institutions that tend to be more (or less) vulnerable to structural shocks. It will propose changes in the design of existing social institutions in different countries in order to make them more resilient to global trends and economic crises. A framework for analysing the vulnerability of different types of social institutions to shocks will be developed. OECD countries will then be grouped based on institutional settings in social institutions in order to identify those that are most at risk. Existing in-house models for institutions, <i>e.g.</i> for pensions or unemployment support, will be used and investigated through exposure to potential shocks. The effects of policy settings in related areas will also be taken into account. To the extent possible, the analysis will be applied to non-OECD G20 countries too.</p>
C3.	<b>Can health become an even bigger part of the economy without undermining fiscal sustainability?</b>
Summary	<p>Access to high-quality health services for all is a key objective to promote well-being. While health spending has continued to climb over past decades, the recent economic and financial crisis has prompted many governments to ask whether new approaches to defining the boundaries between public and private health spending ought to be envisioned. Rather than simply reacting to shocks by cutting or consolidating health spending, governments are asking how they can improve prioritisation models in order to deliver high-quality health services in a fiscally sustainable manner.</p> <p>In the fifteen years prior to the Great Recession, health spending per capita in OECD countries grew, on average, three times faster than income per capita. Employment growth in the sector has continued through the recession, even in some of the countries most hit by the public expenditure crisis. Health and social services are a major source of employment, including low-skilled employment. However, if the expansion of health care is to be a source of jobs and growth, it needs to be financed in a way that is sustainable. At the moment, 70-80% of total health spending is financed by the public sector, and there has been little change over time. If these proportions are maintained as total health spending increases, public budgets will be put under great pressure.</p> <p>The aim of this project is to develop policy scenarios to assist countries in deciding how to best manage the boundaries between the public and private provision of health services in a way that helps manage the impact on equity in access and guards quality of care. This is a critical policy challenge as OECD countries seek to decide which health services to prioritise, while emerging economies seek guidance on which health services to focus upon as they attempt to achieve universal health coverage. The project plans to rely on empirical analysis of the sources of growth in health spending as well as on different approaches based on econometric analysis. It will also advise countries on possible scenarios for public/private boundaries of health spending to respond to different population preferences for fairness and public spending.</p>

<b>C4.</b>	<b>Assessing immigrant characteristics and links to labour market performance</b>
<i>Summary</i>	<p>Promoting the economic and social integration of immigrants in host countries is an important component of an inclusive growth strategy. Already in 2010, on average in the OECD, permanent migrants accounted for more than one in four new entries into the working-age population, although a significant fraction was still accounted for by free mobility within Europe. Although labour migration is expected to increase over the next decade, family and humanitarian migration will continue to be a significant part of total migration flows and policy efforts to better mobilise domestic resources in the context of ageing populations need to take this into account more explicitly.</p> <p>The project will look at the policy requirements needed for migration to play an even stronger role in responding to skill mismatches in complement to other types of policy responses (<i>i.e.</i> activation, mobility, education and training) and for ensuring the best possible use of migrants' skills to support inclusive economic growth. Possible spillover effects across countries will be also considered.</p> <p>Building on past OECD work on the labour market integration of immigrants and their children and taking advantage of newly available PIAAC data, it will provide much needed information on the relative importance of different immigrant characteristics for labour market outcomes, with implications for both integration policy and the selection of labour migrants in supply-driven regimes. It will also seek to focus more precisely on the skills of migrants, their use in the labour market and the barriers that migrants are facing in accessing the labour market.</p>
<b>C5.</b>	<b>Promoting inclusive growth through better regulation</b>
<i>Summary</i>	<p>The financial and economic crisis highlighted serious regulatory failures, be they related to poor articulation of regulation across borders, limited enforcement of rules or regulatory capture. The crisis reawakened debate on the role of the state as a regulator in the economy, and on how and where it should intervene to achieve which objectives. In the aftermath of the crisis, the issue of how better regulation/regulatory frameworks can spur growth and strengthen social inclusiveness while guarding against regulatory failure has emerged as a high priority. Identifying opportunities for promoting growth through the application of regulatory policy and reform remains, however, a challenging task. There is a need to explore more systematically the potential of better rule making at domestic level, but also beyond countries' borders, to unblock critical constraints to growth in specific country contexts and globally.</p> <p>The issue of governance was highlighted at the NAEC Group meeting as an important area for the initiative to explore. Public governance has been a neglected issue in the debate over how countries can recover from the crisis and develop more sustainable and inclusive policies. This project offers an opportunity to review the contribution of regulatory policy — a key dimension of public governance reform — and an area in which OECD has an established track record of thematic and country-level analysis, but also an area in which NAEC could provide impetus for new thinking. The project aims at producing recommendations and good practice based on surveys from OECD countries, analytical work carried with expert inputs, case studies of specific regulatory cooperation experiences, as well as roundtable discussions.</p>

C6.	<b>Implications of globalisation for competition</b>
<i>Summary</i>	<p>Growing interconnectedness across borders has direct implications for competition policy. The world economy is more integrated than ever before, thanks to technology and a substantial reduction in transactions costs. Companies sell into global markets, and produce their goods using supply chains that cross national boundaries many times. Competition law has also spread worldwide, with over 120 competition authorities worldwide, which represents a remarkable convergence of economic policy recognising the benefits of well functioning markets. Although the work of these authorities is usually well-aligned through increasing international co-operation and framework convergence, they enforce competition laws on a national, or at most, a regional level. As the world economies further integrates, and in particular as the competition agencies in emerging economies flex their muscles, it is important to ensure that global markets and national competition law enforcement promote global economic growth. The study will increase policy makers' awareness of the implications of national approaches to competition law enforcement and the value of increasing consistency and coherence across jurisdictions in the way it is enforced. The project will relate trends in competition law enforcement to measures of globalisation to illustrate the possible costs of the existing fragmented approach, and the benefits of jurisdictions working together highlighting the ways in which existing soft convergence and voluntary co-operation tools have promoted sound policy and minimised conflicts. Finally, the study would set out the range of policy responses to the problem. Competition policy should not be used at worst as a mechanism for covert protection and at best result in costly inefficiencies in the efforts of global companies to make appropriate investment decisions – greenfield or M&amp;A.</p> <p>Another aspect of globalisation and competition arises in the context of state-owned enterprises (SOEs). While some countries have tried to employ SOEs as agents for inclusive growth, the relative growth in the number of SOEs has also led to concerns about competitive neutrality, as SOEs sometimes receive public subsidies and privileged positions in the marketplace and/or may be excluded from requirements applied to the private sector. Cross-border activities of SOE's must be on a level playing field basis, regardless of what they do in their own countries with respect to industrial policy. The proposal calls for examining the question of state activism through two lenses: state-owned enterprises (SOEs) and experimental policy and government learning. As such, we will identify policy options that allow governments that wish to use SOEs for inclusive growth to continue doing so, but at the same time safeguard an open and non-discriminatory investment climate. For this purpose, we will rely on a mixture of empirical and dialogue-based fact finding, explore existing sources of data (including corporate and legislative information) and gather new information through questionnaires.</p>

C7.	<b>Securing tax revenues in a globalised economy</b>
<i>Summary</i>	<p>The generally accepted principles of taxation were mostly formulated in the context of closed economies, with policies for handling international flows grafted on subsequently. Domestic and international rules for the taxation of cross-border income flows have evolved since their origins in the 1920s, but the real world has changed even more fundamentally as a result of globalisation (particularly international capital mobility and the growth of trade in services as well as goods) and the rapid growth of the emerging economies. The interaction of the tax regimes of different countries matters as never before in its effects on economic activity, employment and equality (within and between countries). Of particular note in the context of a globalised economy is the mix of source-based taxation (notably the corporate income tax), residence-based taxation (particularly the personal income tax) and destination-based taxation (<i>e.g.</i> value added tax).</p> <p>It is therefore important to have a new approach to tax policy that would secure tax revenues in a globalised economy and ensure that tax regimes have an overall coherence, while contributing to the response to other challenges such as inclusive economic growth, increased employment, improved financial regulation and a more stable macroeconomic environment and minimising harmful spillovers across countries. The project will bring together tax revenue and rate information with statistics on the drivers of trends in the structure of revenues (<i>e.g.</i> national accounts measures of profit shares in total GDP, data on income distribution, and statistics on international trade and the digital economy) to produce an analysis of prospective revenue trends. This will be complemented by literature reviews on core topics, notably international profit shifting and the effective incidence of source-based corporate income tax and residence-based taxes on personal capital income, as well as by empirical analysis of the distributional effects on greater reliance on destination-based taxes (as outlined in project B7).</p> <p>With its emphasis on the implications of global economic trends for domestic tax policies, this project will complement the OECD's work on base erosion and profit shifting (BEPS). The work on BEPS is focused on the international rules for taxing corporate income, and on developing comprehensive, internationally-coordinated strategies for countries concerned with base erosion and profit shifting (while at the same time ensuring a certain and predictable environment for businesses).</p>

### **ANNEX III. Selective bibliography on the roots and lessons of the crisis**

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