SESSION SUMMARY

ECONOMIC OUTLOOK DEBATE

- ***Panel 1: Economic Outlook***
- ***Panel 2:* Bringing People Back to Work**

Wednesday 25 May 2011

Moderator: **Chris Giles**, Economics Editor, *Financial Times*, United Kingdom

Panel 1: Economic Outlook

Panelists: **Andrus Ansip**, Prime Minister, Estonia
Ali Babacan, Deputy Prime Minister, Turkey
Felipe Larraín, Finance Minister, Chile
Olli Rehn, Commissioner for Economic & Monetary Affairs, EU
Stanley Fischer, Governor of the Bank of Israel
Richard Trumka, President, TUAC; President, American Federation of Labor & Congress of Industrial Organizations

Moderator **Chris Giles** opened by saying that the global economy was still recovering from its worst post-war recession. Among the advanced economies, some are now back to pre-crisis growth rates, but others continue to lag behind. Most emerging markets are growing much faster than the developed world. According to most of the panellists, the outlook for economic recovery in many countries is strongly linked to the prospects for deficit and debt reduction. As **Stanley Fischer** summarized, "countries that went in [to the crisis] in good shape have come out pretty rapidly." International convergence is happening more rapidly, setting new standards for other countries.

Olli Rehn stressed that European initiatives to address the financial crises in Ireland, Portugal and Greece had been partly successful. "In the past 15 months we have been able to contain the financial forest fire." In addition, he noted that "we have been able to protect the ongoing economic recovery in Europe." However, he noted that "the job is not done yet." In the immediate term, Greece remains the most challenging case. "The European situation is reflected by dualism; the center, northern, and eastern parts have had solid, sustained recovery while southern countries are facing serious problems due to the sovereign debt crisis."

When asked by the moderator whether the reforms that Estonia had made in order to join the euro zone were worthwhile, **Andrus Ansip** replied that they had made it easier for the country to ride out the financial crisis. "We had to cut public expenditures and make structural reforms," he said. He explained that during the crisis, investors from Finland and Sweden were worried about the likelihood of devaluation of the Estonian crown, and so Estonia's response was to eliminate this doubt by joining the euro zone as soon as possible. In Estonia's case, "quick reaction was less painful than postponed or delayed reactions." Now Estonia is even more attractive for foreign direct investment.

Even though Chile was not heavily impacted by the financial crisis and enjoyed relatively healthy public finances, the government introduced some modest spending cuts earlier this year. **Felipe Larraín** explained that this was not motivated by a need to improve public finances, but as a means to ease some of the burden on monetary policy of counteracting strong capital inflows. Addressing the issue of heavily - indebted countries, he argued that their hopes of growing out of debt were very misleading. "It is virtually impossible for countries … to just grow out of debt," he said. Many governments still "need to make the hard choices."

Richard Trumka suggested that deficit and debt issues were less of a problem than the high rates of unemployment plaguing a number of OECD countries. He warned against "mindlessly cutting" in the interest of deficit reduction. "We need some targeted investment in job creation." In the US, for example, he identified four sources of growth: consumer spending, business investment, net exports, and government spending. With the first two stifled by the recession, and the third negative for at least a decade, the last, he said, should not be sharply cut. "If none are contributing [to growth], this recession could slip back."

The debate then turned to the issue of potentially destabilising capital flows, and the option of introducing controls to prevent economic damage to recipient countries. Mr. Larraín commented that appreciating currencies in a number of regional economies had threatened the emergence of "Dutch disease", characterised by currency overvaluation that chokes off activity in trade-dependent sectors of the economy. Mr. Fischer echoed Mr. Larraín's sentiments, explaining that after following a policy of non-intervention for years, Israel had been obliged to address a 25% appreciation of its currency in mid-2008 by intervening in the foreign exchange market.

Mr. Fischer praised the WTO for limiting any global protectionist trends following the financial crisis, and called for the establishment of a similar international body to develop a framework for dealing with significant and destabilising capital flows. "Until we get to an international understanding, we're going to have this problem every time there is a crisis."

Mr. Ansip countered that Estonia avoided employing any sort of capital controls in the midst of the financial crisis. "We don't have any restrictions on the movement of capital."

Mr. Trumka then argued that judging by government policy responses "it is almost as if the crisis didn't happen." He said that the policies being discussed by the panel, which he described as "neoliberal", were the same policies that led to the financial crisis in the first place.

◆ *Panel 2:* Bringing People Back to Work

Panelists: **Danilo Türk**, President, Republic of Slovenia
Jan Björklund, Minister of Education and Research, Deputy Prime Minister, Sweden
Mari Pangestu, Minister of Trade, Indonesia
Ernesto Cordero Arroyo, Minister of Finance & Public Credit, Mexico
Harold (Terry) McGraw, President & CEO, The McGraw-Hill Companies; President, USCIB; President, BIAC

Opening the second panel session, moderator **Chris Giles** reminded the panel and the audience of the need for structural reforms and increased competitiveness in labour-intensive areas in order to alleviate the problem of unemployment. Joining the debate, **Harold** (**Terry) McGraw** suggested polices that governments should implement in order to help businesses in creating jobs. The focus, he said, should be on the development of the private sector, in particular small and medium-sized enterprises (SMEs). "Governments have to create the environment – the conditions – for companies to be able to invest and grow." This should be done through tax policies, more uniform regulation and, more generally, by boosting productivity. Mr. McGraw stressed the importance of investing in technology and education, in particular digital education. Governments, he said, should also support public/private sector co-operation.

Danilo Türk went on to talk about the political challenges that governments face when introducing structural reforms. Focusing on his experience in Slovenia, he said that "people are not yet prepared for reform – that is a political problem, a real one", and thus electorates would have to adjust to the idea of change.

The moderator then addressed the two trade ministers present on the panel, **Ewa Björling** from Sweden and **Mari Pangestu** from Indonesia, on the need to liberalize trade to increase employment. Ms. Pangestu underlined that, although trade is a means of increasing development, in the case of Indonesia unemployment has remained high despite increases in trade and economic growth. This points to the need for targeted policies to support employment. In particular, she argued, developing countries that do not have the fiscal leeway to afford direct compensation schemes for those hurt by free trade need to focus on targeted subsidies and on complementary policies that encourage the development of domestic SMEs to boost employment.

Ms. Björling underlined the need to "keep up the momentum with free trade and avoid protectionism" and urged the EU to focus more on the external dimension, on increasing its worldwide competitiveness and on providing resources for research.

Ernesto Cordero Arroyo shared the lessons from Mexico's experience during the recession, noting that a modest and targeted loosening of fiscal policy had proved relatively effective at combating the rise in unemployment. While maintaining a budget deficit of less than 1% of GDP, Mexico focussed on a series of policies aimed at increasing access to employment and protecting existing jobs. Although unemployment did rise, the increase was less than half of that experienced during the country's previous downturn. Measures to support the private sector included shifting funds from other areas of the budget, expanding the availability of credit and modest investments in infrastructure. However, in the long term, "you need high productivity to create jobs", and this is achieved through innovation and investment in human capital, he said.

Lastly, the moderator asked the panel for their recommendations on how best to improve educational systems. Most of the speakers agreed that there is, generally, a mismatch between the skills provided by academic systems and those required by the job market, and thus there is a need to put more emphasis on technology in education. Ms. Pangestu also raised the issue of gender equality in education in Indonesia. Mr. Türk remarked on the need for Slovenia to invest in higher education to encourage young people to be entrepreneurial. This view was shared by Ms. Björling, who noted that although Sweden has a very strong track record in research and development (R&D), its record in commercialising the results of that research is less impressive.