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**THE ROAD TO RECOVERY**

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## **Where are we in the crisis?**

1. The ongoing global policy response will hopefully shorten the recession and lessen its social impact. Measures taken at the national and international levels provide impressive policy stimulus, resources for international financial institutions, and guidance for reform of financial markets worldwide. Governments have generally held to their commitments to keep markets open for trade and investment and are taking action to put the world economy on a more sustainable and greener growth path.

2. The crisis has threatened the sources of growth. Macroeconomic and structural policies should henceforth be consistent with three broad objectives:

- a) Increasing the medium- and long-term growth potential;
- b) Addressing payment imbalances; and,
- c) Ensuring fiscal sustainability.

3. We are at a point in the crisis. As the recession slowly fades away we face two scenarios. The first, a positive view, is that financial markets will recover, growth will consolidate and move beyond a policy-driven recovery into a stronger, self-sustained path. The second is a negative scenario. The initial “green shoots” will wane or fail to multiply, putting the world economy on the edge of a “double dip”. This would mean sharp and prolonged falls in production, trade, employment and investment, further instability, continued imbalances, and additional stress on public finances. Permanently lower employment and higher unemployment will both sap government revenues and boost spending and will also have negative consequences on potential output. This will make it more difficult for governments to consolidate their fiscal positions and hence their ability to restore government debt onto a sustainable path. The combination of medium-term public spending pressures linked to ageing populations and low taxation receipts could force governments to either, reduce other public expenditures, introduce new taxes or raise existing tax rates. All of these options would weigh further on economic activity

4. The positive scenario is, of course, the one we aim for, and for which we will need a well-designed and properly implemented cooperation between governments, international organisations, business, labour and civil society. This requires, in turn, coherent whole-of-government approaches, linking macroeconomic, structural and regulatory policies with the view to facilitating structural adjustment.

5. The OECD can help to deliver such coherent approaches, by providing a comprehensive set of policy options to tackle the crisis and promote sustainable long-term growth. While OECD thinking goes beyond the crisis, action to build a stronger, cleaner and fairer world economy must start now.

6. Since launching the *Strategic Response to the Financial and Economic Crisis* in 2008, the OECD has intensified its efforts to support governments, covering the key areas of the financial sector, the real economy, social policy, development, environment and innovation. It is undertaking new analysis and has released special reports to help policymakers address the crisis. The OECD actively works with G8, G20 and other global fora, while also addressing regional issues in Europe, Africa, Latin America and Asia-Pacific. Building on its deep and longstanding co-operation with non-OECD countries around the world, the OECD is also monitoring the impact of the crisis on emerging and developing economies.

7. This paper raises the key issues to be addressed going forward, and suggests ways to mobilise OECD’s experience and skills, in co-operation with governments, international organisations and other decision-making bodies.

## Where do we want to go?

8. The post-crisis economy should be **stronger** in order to produce more sustainable growth. Better regulation of financial markets and an effective balance between markets and government will foster a more robust, more resilient, global economy. Global imbalances were growing long before the crisis. Addressing them demands action at both the macroeconomic and structural levels, and can only be done through concerted action by all players.

9. Open markets that are well-regulated remain fundamental for building confidence and strengthening economic performance. Thus we must insist on the need to conclude the Doha Development Agenda (DDA). The widespread and very rapid fall in trade, if not reversed, will undermine the activity of the most dynamic exporting firms, where productivity growth is higher, with potentially disruptive consequences on the global value chains. Open markets also remain key for spreading innovation. Protectionism would choke off the innovation potential of all countries and destroy hard-earned gains.

10. The post crisis economy should be **cleaner**. The crisis offers the opportunity to put the global economy on a low-carbon growth path in line with ongoing efforts to mitigate climate change and to better manage natural resources. Investments which are friendly to the environment should be encouraged as they underpin solid long-term economic growth, and other available alternatives should be harnessed. To be sustainable and equitable, growth must also be supported by good governance, with strong coordinated initiatives to promote corporate responsibility and financial education, fight bribery and corruption, tax evasion, strict bank secrecy and fraud, promote transparency and ethics in business and government, and a clean and level playing field for investment.

11. The post crisis economy should be **fairer**. Thus we must seek more effective trade, investment, and development policies, strong social frameworks and a strengthened global governance structure. This can be achieved by a more integrated cooperation between developed, emerging and developing countries to increase growth and employment opportunities, reduce inequality and focus greater attention on local needs and opportunities. The poor and the most exposed to the risk of exclusion should not be left on their own. Growth must be socially sustainable and based on increasing employment. Unemployment breeds poverty and curtails long term growth. Rising unemployment could exacerbate protectionist measures and create political and social tensions.

## How do we do it in practice?

### *i) From short-term support to long-term growth*

12. Most of the effort has so far been devoted to emergency measures to avoid a collapse in demand and give a short-term boost to economic growth. Looking ahead, however, many such emergency measures being implemented today could pose a threat to long-term growth and fiscal sustainability if not properly unwound. It is thus critical to consider exit strategies now in order to prevent the emergence of new threats down the road. And, of course, care must also be taken to ensure that any industry support measures do not end up becoming protectionist.

13. Going forward, the focus will shift from the immediate need to restore economic vitality, towards structural policies that make growth sustainable. Innovation will be one of the keys to the recovery, not least by putting countries back on a path to sustainable –“greener and smarter” – growth. Many governments have incorporated measures to strengthen innovation in their short-term stimulus packages, often combined with measures to increase energy efficiency.

14. Truly, the need to restore sound public finances after the crisis will present policymakers with tough trade-offs. Considerable expenditure cuts or additional revenue will be needed, but the consolidation

measures will have to be designed in ways that do not hamper the recovery and longer-run economic growth. The crisis has raised new questions about fairness and the role of tax systems in achieving a fair sharing of the costs and benefits of globalisation. The answers will be about redistributing in ways that do not hold back job search, complicate business life or weaken the economy's ability to restructure.

15. ***A close monitoring of these policy measures, involving all major players, would add significantly to the effectiveness of surveillance and enhance synergies with other international bodies. The OECD has the capacity to monitor progress in achieving a more sustainable fiscal environment, sound tax policies, innovation-led recovery and green growth. The OECD, in collaboration with WTO, can also help in identifying and warning against possible protectionist actions, both in trade and investment, as also requested by the G20, and by helping to ensure world markets remain open and fairly regulated.***

Issues for discussion:

*Are we at or near the bottom of the crisis? When should fiscal consolidation begin and what are the relative risks between tightening too soon (risk of choking off recovery) and tightening too late (risk of strong rise in public debt, loss of market confidence and increased risk premia)?*

*How has the crisis changed growth potential and reform priorities?*

*How can fiscal stimulus packages be used to reap the double dividend of supporting short-term activity and putting long-term growth on a more sustainable path?*

*What will it take to put public finances on a sustainable track: are both spending and tax measures needed? What types of tax measures can ensure sustainable revenues without hampering the economic recovery?*

*How can co-ordination and cooperation among all major players be made most effective?*

**ii) *How can governments deal with the severe social consequences?***

16. Labour market conditions are deteriorating rapidly. The latest OECD projections indicate that the unemployment rate in the OECD could exceed 10% by 2010, compared with 5.6% in 2007. This could swell the ranks of the unemployed in the OECD area alone by about 25 million, by far the largest and most rapid increase in OECD unemployment in the post-war period. Worldwide, the ILO sees 40 million more unemployed, a figure that could well climb. As unemployment surges, the most disadvantaged labour-market groups – youth, low-skilled, immigrants and temporary workers – are the first to lose their jobs and, since they also face serious difficulties in finding a new job, they are at high risk of becoming long-term unemployed. Middle classes, both in relatively high-income countries and emerging markets, are also being severely affected by the crisis.

17. Sound employment and social policies are an essential component of a successful growth strategy, to prevent the financial crisis from generating a full-blown social crisis and avoiding possible protectionist responses. Unemployment benefits will automatically step in to sustain the incomes of many job losers, coverage of such benefits is weak or non-existent in some OECD and partner countries. While holes in social safety nets are being plugged, labour market programmes should be scaled up to help reintegrate job losers into employment and avoid a sustained rise in long-term unemployment. Employment-oriented safety nets are also essential to avoid the high long-term costs of “inactive” programmes such as disability or early retirement. More resources will be needed to cope with sudden tides of new job losers. Fiscal stimulus packages have, in most cases, included some resources for these programmes, but more are needed. Particular attention should be paid to the distributional impact of any

tax policy measures in order to arrest the trend of rising income inequality in many OECD and emerging economies. Education policies should focus more on providing innovation related and entrepreneurial skills

18. Pension funds have been severely hit by the crisis and older workers face major losses in retirement savings. While confidence in private pensions is low, public pension systems are also under threat from the downturn and the resulting rise in unemployment. The short-term political pressures on governments to respond are substantial, adding to long-term challenges arising from demographic change and population ageing. The best approach to pension provision is to use a mixture of both public and private sources of retirement income.

19. ***The OECD will continue to monitor and analyse employment and social policies both in terms of their short-term impact, as well as their consistency with long-term growth and fiscal sustainability. The Employment, Labour and Social Affairs Committee will continue to attach considerable importance to the effectiveness of labour market and social policies, comparing experiences and assessing best practices.***

Issues for discussion:

*What exceptional measures can be taken to support jobs in the recession and how can those policies then be unwound?*

*How to ensure that additional funding for labour market policies and social safety nets are used as planned, while at the same time maintaining work incentives and reducing income inequality?*

*How can expertise and experience of employer and workers organisations contribute to government policies and initiatives?*

*How can governments restore confidence in retirement plans and ensure long-term financial sustainability of diverse pension systems?*

**iii) *How to exit from emergency towards a more stable global economy?***

20. The response to the crisis has been impressive in its magnitude, intensity and degree of global coordination. Now governments must plan how to exit from the many exceptional measures they have taken to face the crisis.

21. Reforms are needed in a number of areas to create incentives in financial markets that better align private reward with wider public interests, and to encourage more responsible and prudent risk-taking. It is important to design stable measures and avoid policy reversals later on. As policy makers choose emergency measures and exit strategies, they should seek actions consistent with long-term goals of economic performance in order to reinforce their credibility and market “buy-in”.

22. The OECD is focusing on “exit strategies” to guide governments in unwinding emergency positions when the crisis has passed. This work is meant to help them address fiscal sustainability under conditions of much higher debt levels caused by the recession and the long-term pressures from ageing and health care spending as well as by the fiscal stimulus packages. Tools and goals have to be identified now and have to be perceived as transparent and credible. These goals include: better and more symmetric information flows (transparency) to reduce the risk of liquidity crises; non-distorting regulation; corporate governance and tax regimes that promote incentive structures for better risk control; corporate structures that address contamination risk from affiliates; and most importantly, an overall medium and long-term strategy for fiscal sustainability.

23. ***Ongoing work of the OECD, analyses how temporary emergency measures interact, and how exit strategies will have to be coordinated to minimise market uncertainty, competitive inequalities and regulatory arbitrage opportunities. This is also consistent with G20 requests.***

24. Ensuring a competitive market environment is also important for long-term growth. Competition is a key ingredient for delivering productivity growth, consumer choice and protection, and lower prices. ***The OECD will be assessing and reporting on how measures to meet and exit the crisis affect competitive conditions.***

Issues for discussion:

*How can a better balance between risk management and profit be achieved? What incentive structures, i.e., regulations, tax regimes, and governance structures, are needed?*

*Choosing the appropriate exit strategy from emergency measures and public ownership of banks is more important than speed. What are the challenges for managing such exit from public ownership so that it goes hand in hand with needed reforms?*

*Governance has failed on a number of levels, including at the corporate level, where basic principles of good corporate practice do not appear to have been implemented in a number of banks; also at the regulatory /supervisory level, capture and poor enforcement have been important issues. How can they be addressed? How can the OECD Principles of Corporate Governance be better implemented in the future?*

*What regulatory reforms will be needed to improve behaviours while at the same time providing the right environment for vigorous and dynamic markets?*

***iv) How do we deal with the impact on the poorest of the world?***

25. The crisis has severely hit developing countries. Global policy thinking in the response to the crisis must take this into account much more significantly. Globalisation has lifted millions out of poverty and given traction to previously slow-growing economies, notably via trade but also via investment. In 2007, developing countries accounted for about a third of world trade, up from a fifth in the early 1990s. Thus, countries should strengthen their efforts to conclude the DDA in 2009, not just to benefit development, but for the systemic health of the global economy.

26. Trade finance is an essential tool of growth and it has been badly affected by the crisis. The OECD countries and other large economies have pledged to ensure that sufficient funds are available for exporting companies the world over, including in developing countries. ***The G20 has committed to making available \$250 billion over two years, and the OECD will monitor this commitment through its Export-Credit Steering Group.***

27. However, concerns about developing countries go beyond trade. Their already vulnerable fiscal positions are feeling the impact of the current economic crisis, not least as export prices for their commodities and their remittances from migrant workers are falling. Initiatives such as the Accra Agenda for Action to improve aid effectiveness and donor principles for engagement in fragile states must be harnessed for higher impact results.

28. Extra donor support will be needed to cushion against the effects of the crisis and to keep the Millennium Development Goals (MDGs) on track. ***A review of the OECD Guidelines for Multinational Enterprises should be undertaken to increase their relevance for emerging and developing countries and strengthen the role of the private sector in building trust and confidence in cross-border investments.***

Issues for discussion:

*How can we make sure that donor countries keep their aid commitments?*

*How can countries work together to improve aid effectiveness and governance?*

*What must be done for OECD and non-OECD countries to further open their markets to goods and services from lower income countries and to curtail trade-distorting subsidies?*

*What can be done to promote investment, innovation and new technologies to raise living standards in poor countries?*