

Macro-economic policy



WHY IS INTERNATIONAL CO-OPERATION IMPORTANT FOR DEVELOPMENT?

If any demonstration were ever needed of the reality of globalisation, and the interconnectedness of developed and developing countries, the economic crisis has provided it. Closer economic integration through international trade and investment brings benefits to developing and developed countries alike. But it also means that shocks hitting developed countries will have significant repercussions on developing countries – and vice versa. As OECD countries went into recession in 2008-2009, following the failure of some financial institutions and the collapse of confidence in financial markets, growth rates in developing countries fell also.

The impact on developing countries was less severe than in previous global downturns, as low-income countries entered the crisis with more fiscal space and lower government debt. This enabled them to adopt counter-cyclical fiscal packages, helping to mitigate the negative impact on growth, but without the post-crisis debt overhang seen in many mature economies. Nonetheless, the effect

of the crisis was to set back progress towards the MDGs. The World Bank has estimated that 64 million more people were in extreme poverty by the end of 2010 due to the crisis. Its forecasts also show that progress against all MDGs over the next five years is highly sensitive to assumptions on what happens on growth.

Appropriate macroeconomic and structural policies lie at the heart of recovery, provide the foundation for future stable and sustainable growth, and are inextricably linked to virtually every other topic in this report. The crisis demonstrates vividly that, while governments in developing and developed countries alike need to take action nationally, this can only be effective within a framework of policies agreed collectively at the global level, notably within the G20 process.

Key areas for international co-operation are:

- securing a strong, sustained, equitable and balanced global recovery;
- addressing capital mobility;
- strengthening the arrangements for global policy co-ordination.

WHERE ARE WE NOW AND WHAT NEEDS TO HAPPEN NEXT?

(i) Securing a strong, sustained, equitable and balanced global recovery

Achieving a broad-based recovery is the key to sustaining growth in living standards in developed and developing countries alike. The recovery has been underway for some time, following the largest co-ordinated response in history, embracing lower interest rates, fiscal stimulus, and measures to ensure liquidity and restore confidence in financial markets.

Growth has been much stronger in emerging market economies and low-income countries, but remains uneven in the OECD area. Global output growth is expected to be close to 4.25 per cent this year and 4.5 per cent in 2012. Growth in the OECD economies is forecast at 2.5% in 2011 and 2.9% in 2012. Unemployment remains

high in many countries. Emerging and developing economies are forecast to do much better, with growth of around 6.5%. However, global imbalances resulting from divergent growth in demand and savings within and across countries remain wide, and there are concerns that they could risk triggering protectionist moves and threaten the recovery.

The next steps include:

Strong: harnessing the full range of policies, including monetary and fiscal policy, trade and investment, and financial sector and structural reform;

Sustained: transforming economies to base social and economic progress on 'green growth' strategies;

Equitable: narrowing the development gap, thereby generating new poles of growth in the global economy;

Balanced: addressing global imbalances, including through structural reforms to help spur investment in mature economies with current account surpluses, and obviate the need for excessive precautionary savings in surplus emerging market economies.

(ii) Addressing capital mobility

Although capital mobility brings benefits, there are associated risks: sizable inflows are challenging the absorptive capacity of some open emerging-market economies; most of the latter are accumulating foreign reserves in order to insure themselves against the risk of sudden reversals in capital flows.

It is important to deal with these tensions through appropriate policies rather than protectionism and exchange rate manipulation. The OECD Going for Growth 2011 publication shows that there is a combination of policy measures which, if implemented in unison in mature and emerging market economies, would reduce imbalances without impacting negatively on growth.

Structural policies can thus help to mitigate some of these risks. Recent OECD analysis shows that structural policies have a strong effect on gross and net foreign capital positions, and that improved structural policies could help to modify the composition of capital flows towards more stable and productive sources of balance-of-payments financing and reduce the potential risks associated with capital flow reversals. Achieving a more even recovery across countries would also contribute to reducing tensions stemming from the flow of capital to high-growth emerging markets and developing countries.

An important long-term challenge is to reform the international monetary system to equip countries with the necessary policy tools to make the most of international capital movements in sup-

port of long-term growth. There is a case for identifying the features of a common framework for capital account-related policies that would provide a level playing field for countries while preserving their ability to deal with short-term volatility. The next steps include:

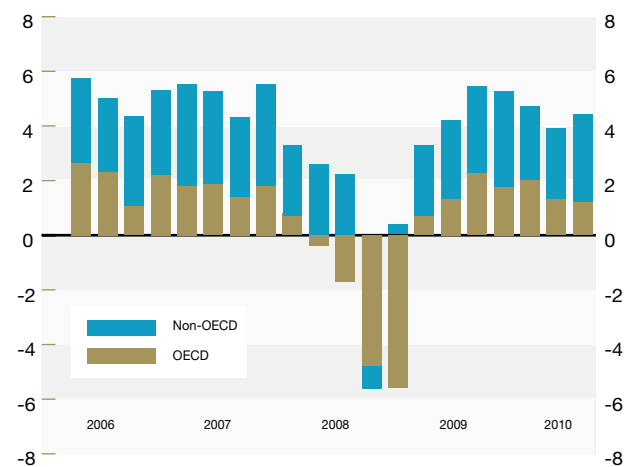
- continued work on the menu of policies which can address capital mobility, including structural policies and international framework for capital account-related policies.

(iii) Strengthening the arrangements for global policy co-ordination

The crisis triggered a step-change in global policy co-ordination through the G20. It has underlined the need for collective action to pursue collective welfare: by catalysing interventions which have positive effects and discouraging those (such as protectionism) which have negative effects. A key element in this is the Mutual Assessment Process (MAP) within the G20, designed to ensure that individual economic policies collectively achieve an outcome of strong sustainable and balanced growth. The Seoul Development Consensus for Shared Growth marked a key step forward in integrating development concerns explicitly into wider policy co-ordination by recognising that 'as a crucial part of this exercise ... we need to enhance the role of developing countries and low income countries (LICs) in particular'.

Global growth continues to be led by emerging economies

Contribution to annualised quarterly world real GDP growth (in percent)



Note : calculated using moving nominal GDP weights, based on national GDP at purchasing power parities. Source: OECD Economic Outlook 89 database.

That being said, policy co-ordination is proving to be challenging. Mature economies are struggling to make headway in reducing unemployment, with growth being hobbled by the urgent need to tackle mounting public debt and households readjusting their balance sheets in the wake of the crisis. In contrast, emerging-market economies are enjoying robust growth on the back of rebounding world trade and rapid catch-up. This difference in performance is leading to a stark divergence in policy priorities and, as a consequence, the global co-ordination of policy is now proving to be considerably more challenging than during and immediately after the crisis.

The next step is:

- continuing to strengthen the MAP and using this to help ensure that macro-economic policies are supportive of our development objectives as well as broader growth objectives.

HOW CAN THE OECD, WORKING WITH OTHER INTERNATIONAL ORGANISATIONS, HELP TO ACHIEVE THIS?

These challenges lie at the very heart of the OECD's mission. The first aim set out in Article 1 of its founding Convention is to promote policies designed 'to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy'. The second aim is to contribute to sound economic expansion in Member as well as partner countries in the process of economic development.

The OECD already undertakes a wide range of activities in this area, including regular surveillance of policies at the multilateral and country levels; embracing macroeconomic analysis and reporting; regular projections of short- and medium-term economic developments; and analysis of the links between economic and structural policies, including trade and investment, financial regulation, labour markets, health, demography, and regulatory reform. It will contribute on each of the key priorities above as follows:

(i) Securing a strong, sustained, equitable and balanced global recovery

The OECD will:

- continue to provide assessments of the global economic situation, prospects, and policy requirements over the short to medium term

through its semi-annual OECD Economic Outlooks (with interim assessments in between), and annual regional Economic Outlooks covering Africa, Latin America, and South East Asia;

- monitor and assess macroeconomic and structural policies through peer reviews of all OECD countries, Enhanced Engagement, and Accession countries in the Economic Surveys;
- continue to analyse the links between macroeconomic and structural policies, and how to boost growth and living standards over the long term, through its 'Going for Growth' reports;
- analyse how to make this growth sustainable through the development of a 'Green Growth' strategy;
- examine long-term trends and challenges through its new Perspectives on Global Development series, the first of which, Shifting Wealth (2010) examined the development implications of the major re-alignment of the global economy that has taken place in the last two decades.

The OECD will also continue to work on the appropriate policy mix which will create a more even recovery, thereby reducing the policy tensions which can lead to negative spill-over effects on developing countries.

(ii) Addressing capital mobility

The OECD Code of Capital Movements has provided a framework for international co-operation on capital flow management for 50 years. Countries have agreed under the Code to well-principals such as transparency, non-discrimination, proportionality and accountability to guide their recourse to capital controls. This limits the risk of "beggar-thy-neighbour" approaches that can have negative collective outcomes. The flexibility of the codes recognises that capital controls can play a role in specific circumstances.

(iii) Strengthening the arrangements for global policy co-ordination

The OECD will continue to play an active role alongside other institutions in G20 processes. It will contribute to International Monetary Fund (IMF) reports on the Framework for Strong, Sustainable and Balanced Growth. At the November G20 Seoul Summit it was tasked, alongside other institutions: i) to assist in developing indicative guidelines aimed at assessing persistent global imbalances; and ii) to help G20 members to implement structural reforms aimed at boosting and sustaining global demand.



From:
Better Policies for Development
Recommendations for Policy Coherence

Access the complete publication at:
<https://doi.org/10.1787/9789264115958-en>

Please cite this chapter as:

OECD (2011), "Macro-economic policy", in *Better Policies for Development: Recommendations for Policy Coherence*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264115958-3-en>

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