Policy can brighten the economic outlook

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After five years of crisis, the global economy is weakening again. In this we are not facing a new pattern. Over the recent past, signs of emergence from the crisis have more than once given way to a renewed slowdown or even a double-dip recession in some countries. The risk of a new major contraction cannot be ruled out. A recession is ongoing in the euro area, the US economy is growing but below what was expected earlier this year, and a slowdown has surfaced in many emerging market economies.

The weaker outlook has several causes. A significant drop in confidence is a key driver. Efforts at deleveraging public and private debt and reining in government budgets have had a particularly strong impact on our economies, while weaker global trade adds to the gloom. High unemployment is further depressing confidence and spending. Slow and ineffective policy responses have not helped the situation.

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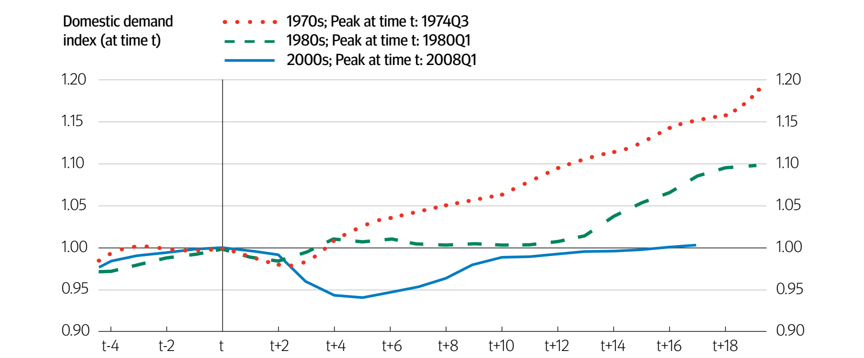
Yet, a strong policy response using every policy tool available can turn the downside scenario around and secure more sustainable growth. However, failure to take such action could push the global economy back into recession.

What can be done? For a start, the monetary policy stance of several economies should be further eased, particularly in the euro area, Japan and some emerging market economies, including China and India. In the US, policy, which has already been eased, is now at an appropriate level and should be held there, given weak inflation prospects and the slow growth in jobs.

This time it's different

OECD-wide domestic demand before and after recessions, quarters; GDP peak at time t



Source: OECD Economic Outlook, Volume 2012/2 StatLink http://dx.doi.org/10.1787/888932742741

On the fiscal front, countries should avoid going too far too quickly, as any knock-on effects on the wider economy are likely to be large. US budgetary tightening should proceed at a more measured pace to avoid the "fiscal cliff" that current legislation implies.

In the euro area, structural budgetary tightening should be limited to current fiscal commitments, and automatic stabilisers be given full leeway around this. To maintain credibility, European governments should announce this commitment in a coordinated fashion. Underlying budget trends are already improving in many euro area countries and debt-to-GDP ratios will start to fall in the coming years, which would in turn bolster confidence.

In Japan, a detailed and credible medium-term fiscal consolidation programme needs to be established. There, the high level of debt limits the room for manoeuvre, and could prevent automatic stabilisers from working properly in the event of a shock.

What if downside risks materialised? First, central banks should provide greater liquidity injections, purchasing private sector financial assets and possibly additional quantitative easing, though being careful to end any unconventional measures as soon as the worst is over. Temporary fiscal stimulus should be provided by countries with robust budgetary positions, particularly Germany and China. Other economies may have to ease up on their budgetary tightening plans.

As to structural reforms, these should be fully implemented, as they could begin delivering sooner than expected in terms of higher growth, better employment performance and more balanced current accounts.

Putting in place strong institutions, such as independent fiscal councils, or drawing up credible fiscal rules, can reassure markets and provide additional support. Moreover, progress towards a fully fledged banking union in the euro area is essential.

The global nature of the current slowdown is a reminder of how interdependent our world has become. Policymakers must take spillovers and transmission channels more seriously on board, particularly in the G20, when addressing global imbalances and the impact of monetary policies on capital flows and exchange rates.

Our common policy challenge is to guide the global economy forward on a new long-term path. This requires departing from the pre-crisis business-as-usual approaches. In addition to repairing the financial system, we must find ways to ensure environmental sustainability and tackle rising inequality. Though potential trade-offs will have to be better measured, new sources of growth, such as green energy and innovation in knowledge-based intangible assets, must play a more central role in the future.

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Spanish immigrants

Twenty years ago Spain was lauded by economists as a new and emerging star. However, in productivity terms it never quite fulfilled its potential. Why? This rather technical but very readable working paper by the OECD's Andrés Fuentes and the Bank of Spain's Juan S Mora Sanguinetti, helps to answer the question, by looking at issues such as poor growth in total factor productivity, which reflects technology and skills, and how labour and capital operate together.

Another issue is how to better avail of immigration: the proportion of foreigners in Spain has increased sharply over the last decade, from 1.6% in 1998 to 12.2% in 2010. Moreover, foreigners are relatively highly educated, yet this immigration has not boosted productivity, partly because many (sometimes over-qualified) immigrants end up in labour intensive sectors with below average productivity. Freeing up the labour market would help resolve such problems, the authors suggest.

Foreign assets

Educational attainment, nationals and immigrants, Spain, Q1 2011

	Nationals 2011 Q1	Foreigners 2011 Q1
Primary education	12.1	19.9
Secondary education (primera etapa y formación e inserción laboral correspondiente)	29.7	21.8
Secondary education (segunda etapa y formación e inserción laboral correspondiente)	21.7	34.8
Tertiary education (except Ph.D)	35.4	21.3

Source: OECD Economics Department Working Papers No 973

Mora Sanguinetti, J. S. and A. Fuentes (2012), "An Analysis of Productivity Performance in Spain Before and During the Crisis: Exploring the Role of Institutions", OECD Economics Department Working Papers, No. 973, OECD Publishing. Available on www.oecd-ilibrary.org