G20 SUMMIT

Pittsburgh, 24-25 September 2009

OECD NOTE ON GROWTH AND STRUCTURAL REFORMS

Structural reforms are critical in creating the conditions for sustainable growth. They are an essential component of the *Framework for Sustainable Growth*, which will be discussed in Pittsburgh. The *Framework* focuses on a more sustainable, balanced and job friendly global growth. To this end, it encourages G20 countries to exchange best practices on structural policies. The OECD commends this initiative, which will enhance the role of the G20 as a forum where policies are discussed and co-ordinated.

Thanks to its long standing and wide ranging experience with evidence-based analysis, policy dialogue, peer review and peer learning, the OECD is well placed to contribute to the implementation of the *Framework for Sustainable Growth*, The OECD helps to indentify and propose best international policy practices. It works regularly with a wide number of countries including the major emerging economies, with which it has developed an enhanced relationship. The OECD is ready to contribute, in collaboration with other relevant international organisations, to the design and implementation of a process aimed at establishing regular consultations among G20 countries on the role of structural policies and their interactions with macroeconomic policies.

Moving to a self-sustained recovery and boosting potential growth

Much needs to be done to transform the present policy-driven recovery into self-sustaining growth. Yet, good structural policies can help to unleash the power of our productive resources, thus creating a stronger, fairer and greener world economy. The OECD has identified areas that are particularly conducive to stronger opportunities, ultimately leading to higher productivity and growth.

Box 1. Summary of OECD's approach to growth and structural policies

Fostering new sources of growth and the creation of new jobs

- ***Fostering innovation and creating an economic environment conducive to green growth requires an integrated strategy.*** Such a strategy needs to combine labour, product and financial markets, as well as measures to support innovation (investment in initial education, life-long learning and intangible assets like R&D).
- ***Policies should be geared towards a transition to a green economy and low carbon growth.*** Such a transition needs to be supported by an appropriate pricing of environmental degradation resulting from energy use and other polluting activities.
- ***Global markets must be kept open, and protectionist practices resisted.***
- ***Competition is crucial to growth and innovation.*** When competition works well, it increases choices, reduces prices for consumers and increases fairness.
- ***Structural policies in product markets aimed at lowering barriers to entry and supporting competition help the adjustment needed to direct resources towards fast growing sectors.*** Furthermore, they encourage innovation in SMEs.

From fiscal support to fiscal sustainability

- ***Credible fiscal consolidation is required in virtually all G20 countries.*** The present fiscal stance should be maintained in the short term but is not sustainable.
- ***Returning to a path of fiscal sustainability needs that clear signals be sent now that stimulus measures are temporary and will be withdrawn.*** In advanced economies, action to address ageing related issues like pensions and health care should be a priority. G20 economies should also implement institutional budget reforms, including the introduction of fiscal rules.
- ***The objective of fiscal sustainability must be undertaken with a view to the effects of policies on long term growth potential.*** OECD's analysis on how to boost productivity growth and welfare through public spending reforms is extensive – including, education, healthcare and infrastructure. It also identifies those types of taxes more likely to bring additional revenue.

Policies to address global imbalances

- ***Structural policies are also instrumental to addressing global imbalances.*** They can be geared towards adjusting incentives to save and invest and strengthening social safety nets.

Underpinning world growth with social policies

- ***Structural policies will have to help overcome the major challenge of high and persistent unemployment even after the recovery sets in, and help combat growing inequality and poverty.*** To be effective in these tasks, labour market reforms in both advanced and emerging economies will have to be complemented by changes to social safety nets.

Policies to support the most vulnerable countries

- ***Policies must help restore sustained growth and poverty reduction in less advanced countries, many of them in fragile situation.*** These countries should be part of a global effort for green growth and innovation, with strong trade and investment flows, and transparent taxation so that we move towards a fairer, more inclusive global economy.

Fostering new sources of growth and the creation of new jobs

Fostering innovation and creating an economic environment conducive to green growth requires more than just science and technology. It requires an integrated strategy that combines labour, product and financial markets, as well as measures to support innovation such as investment in initial education, life-long learning and intangible assets like R&D. Reforming education systems to lift education performance is instrumental to achieving green growth because it will critically influence our capacities to generate new skills for new jobs.

Policies should be geared towards a transition to a green economy and low carbon growth, supported by an appropriate pricing of environmental degradation resulting from energy use and other polluting activities. The OECD has been working for two years on an *Innovation Strategy* which we will deliver next year and has recently been mandated to produce a *Green Growth Strategy* by 2011. It also regularly produces *Going for Growth* exercise, in which most of the G20 countries already participate.

Policies also require that global markets be kept open, and that protectionist practices, sometimes hidden under labels such as “green” or “smart”, be resisted. The crisis-induced collapse in trade has largely been a result of declining demand, with relatively limited “protectionist” policy responses, at least so far. But significant risks remain as unemployment rises and governments come under increasing pressure from domestic lobbies to raise barriers against trade and investment flows.

Competition is crucial to growth and innovation. We should foster a dynamic environment for enterprises and develop new skills for new jobs. When competition works well, it increases choices, in accelerates innovation, it reduces prices for consumers and, by allowing access of new entrepreneurs to markets, it increases fairness while reducing the weight of dominant players.

Structural policies in product markets aimed at lowering barriers to entry and supporting competition help the adjustment needed to direct resources towards faster growing sectors. Furthermore, as recent OECD analysis confirms, they encourage innovation in SMEs and thus contribute to overall productivity and employment growth.

From fiscal support to fiscal sustainability

Credible fiscal consolidation is required in virtually all G20 countries. The present fiscal stance should be maintained in the short term but, with government indebtedness projected to rise substantially, it is not sustainable. Returning to a path of fiscal sustainability needs that clear signals be sent now that stimulus measures are temporary and will be, eventually withdrawn. In advanced economies, action to address ageing related issues like pensions and health care should be a priority. G20 economies should also implement institutional budget reforms, including the introduction of fiscal rules - the use of performance information to encourage better value for money, entitlement spending reforms, and the preparation of long-term fiscal projections, a sort of fiscal “stress test”.

The objective of fiscal sustainability must be undertaken with an eye on the effects of policies on long term growth potential. The OECD has produced extensive analysis on how to boost productivity growth and welfare through public spending reforms, in particular education, healthcare and infrastructure. The OECD has also identified those types of taxes most likely to bring additional revenue.

Policies to address global imbalances

The reduction in global imbalances observed during the crisis is expected to be at least partly reversed as the recovery gains momentum. There is no room for complacency. Structural factors have contributed to saving and investment imbalances. In a number of deficit countries, inadequate risk pricing led to excess investment, most notably in the housing sector, and distorted incentives led to insufficient saving. In surplus countries, part of the accumulation of saving is precautionary, reflecting the interaction between rapid growth in income and weak social safety nets, including health and pension systems, and limited access to financial markets. Developing financial markets and extending social safety nets in emerging market economies should help reduce future pressures for unduly high domestic saving.

Underpinning world growth with social policies

In advanced economies, a main challenge is for labour and social policies to counter the rise in structural unemployment and prevent people from falling into poverty. The young are suffering especially harsh consequences with unemployment of double the OECD average and, in some countries, a multiple of that. Addressing this requires striking the right balance between effective social safety nets and the preservation of employment incentives. It is a trade-off that can be eased through effective re-employment and skills formation that raise people's earnings capacity and contribute to lowering income inequalities. It also calls for policies that allow for the smooth transfer of workers from contracting to expanding firms and which minimizes costly labour market segmentation, particularly for new entrants. Past mistakes must be avoided, when many countries attempted to reduce unemployment by encouraging early retirement, thereby reducing the labour force and growth potential without providing better job opportunities for those who stayed in the labour market.

In many emerging economies the crisis has added to the ranks of workers in the informal sector, accentuating the need to reduce burdensome regulations in product markets as well as inappropriate regulations on formal sector employment. Widespread informality is a key factor in explaining very high levels of income inequality and poverty in these economies. Promoting formal sector employment provides a stable source of revenue for workers and their families.

Policies to support the most vulnerable countries

Policies must help restore sustained growth and poverty reduction in less advanced countries, many of them in fragile situation. These countries should be part of a global effort for green growth and innovation, with strong trade and investment flows, and transparent taxation systems so that we move towards a fairer, more inclusive global economy. Development finance should favour the investment in human capital, infrastructure and climate adaptation, supported by the corresponding institutional capacities, including for domestic resource mobilisation. Additional financial resources are also being made available to improve food security. It is critical that these funds be committed to activities that generate sustainable results in agriculture productivity and growth. Being home of the Development Assistance Committee, and given our extensive cooperation with FAO, the OECD provides a forum to discuss policy options for achieving food security and for the tracking and monitoring of development assistance commitments and performance by its members.