G20: Policy must balance fiscal tightening with jobs support

OECD

Remarks by Angel Gurría, Secretary-General of the OECD
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It is a pleasure to be here on the occasion of the G20 Business Summit. I welcome the opportunity to discuss with you the current economic context and the challenges that Leaders will be discussing in the Summit.

A strengthening recovery, but also new risks

The recovery is on its way, but it is uneven across regions. In our latest projections, we project global growth will reach around 4 ¾ % this year and next. The main engines of growth are the emerging market economies. These economies will account for well over half global growth.

However, major challenges remain. First of all, joblessness is unacceptably high. This is the human face of the crisis that we need to continue to address effectively. In OECD countries, and even though unemployment is likely to have peaked, is still at post war high of 8.7 percent in the first quarter of 2010.

The crisis required unprecedented measures to stimulate the economy. And some countries were better prepared to afford this effort. Right now, however, public debt and deficits are also at record high, and in some regions like Europe, financial markets have reacted strongly with rising interest rate spreads on sovereign debt.

Inflationary pressures are emerging in some G20 countries where growth has been vigorous, and are receiving substantial capital flows, contributing to sharply rising asset prices.

Finally, the crisis has reduced the productive capacity of our economies. This is due to the higher cost of capital, and also high unemployment. We estimate that the fall of this productive capacity is around 3 percent in OECD economies.

In this delicate environment, governments face difficult policy choices. First of all policy needs to strike a balance between the imperative of fiscal consolidation and the need to support a job rich recovery. If public debt is left to accumulate at its current pace, the cost of borrowing is likely to rise, crowding out private investment. And private business investment is exactly what we need right now. Private demand needs to replace policy stimulus as the source of recovery in order to be self-sustaining.

But, if countries consolidate too soon, too fast and by too much, the fragile recovery could stall. Job creation, also a driver of a sustained expansion, would in turn be delayed. Moreover, if all countries move to consolidate at the same time, these effects would be exacerbated through trade and financial linkages. Thus getting the balance right is primordial!

This issue is at the core of the G20 Leaders' agenda. The solutions inevitably will be country specific, but through cooperation the trade-offs can be reduced, and growth maximized. At the OECD, we believe that there is no option other than combine sound fiscal policies with specific actions to maintain the momentum for recovery and job creation.

Our view is that fiscal consolidation should be as growth-friendly as possible. Specifically, it means that on the spending side, growth enhancing programmes, such as on education, innovation and infrastructure should be preserved to the extent possible, and efforts, for example, to improve public sector efficiency and phase out inefficient subsidies should be pursued. Moreover, consolidation measures should concentrate first on cutting government spending.

When additional revenue is needed, emphasis should be placed on the least distortive taxes. Our analysis found that such taxes include consumption and property taxes, rather than taxes on labour and business income. Recently announced fiscal consolidation plans in the UK move in this direction. Other options include, putting a price on carbon, via a carbon tax or through tradeable emission permits, which would both raise revenue and help to reduce greenhouse gas emissions.

However, we must ensure that the tax burden is fairly shared, and seen to be fairly shared. This requires a renewed effort to achieve better tax compliance. Here, thanks to the combination of G20 political support and OECD work, the world has achieved important breakthroughs in combating tax evasion. Such is the case of exchange of information for tax purposes, where since November 2008 we made more progress than in the last 10 years. This breakthrough means a more level playing field for international business, where competitiveness depends on the productivity of business enterprises, rather than aggressive tax planning.

In addition to fiscal policy, we must also focus on structural policy reforms. These are essential to speed up the recovery and to lay the groundwork for a more sustainable and fairer economic future. Structural reform will also be needed to reduce global imbalances in a durable manner. For example, action will need to be taken to raise savings in countries with large current account deficits, such as the United States, and to rebalance demand towards domestic sources in surplus countries, such as China and Germany. In such an environment, businesses have a stronger incentive to hire, which in turn boosts household incomes, leading to a virtuous cycle of stronger domestic demand.

The last point I would like to make is that it is not only policy reforms that count. Avoiding policy reversals and mistakes also matters. During the past one-and-a-half years, it is fair to say that the most important lessons from previous crises have been well learned. Leaders avoided misguided labour market policies and committed to open markets as an integral part of getting the world economy out of the crisis.

The OECD, WTO and UNCTAD report to G20 leaders on trade and investment measures conclude that most G20 members are holding to these commitments. The key role that trade is playing in the current upturn is there to remind us of the fundamental benefits of keeping markets open.

But we need to remain vigilant. Protectionist sentiments are likely to increase with low growth, persistent

unemployment and mounting pressures on government finances. And as our last joint report warned, discretion in the application of the many state support and support programmes for troubled firms may be used to favour domestic companies and disguise protectionism.

Bringing the Doha Development Agenda to a successful conclusion would prevent backsliding, bring much needed stability and predictability to international businesses and, in a period of intense fiscal consolidation and other headwinds holding the pace of growth back, give added impetus to the recovery.
In this context, strengthening international dialogue and consolidating the G20 as the prime forum for economic cooperation is key. We have already seen certain decisions taken by G20 governments that go in the right direction to boost productivity and rebalance the global growth. We are certain that the outcomes of this important meeting will have a positive impact. That's why we are here, and why international organisations are committed to contribute to this important process. Business too has a role to play by initiating new investments and hiring to expand productive capacity in order to be ready to take advantage of the recovery. Together we can build a stronger, cleaner, fairer world economy.

Useful links

- Perspectives on Global Development: Shifting Wealth [1] (publication)
- OECD and the G20 [2]

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