PIER CARLO PADOAN

Deputy Secretary-General and Chief Economist of the OECD

Merci Jacques. Si vous me le permettez, je ferai mes remarques en anglais.

Lionel, that was a fascinating start to our conversation, and I fully agree that global governance is complicated; if you take a different approach, you end up seeing things that you have not been seeing for a long time, and this is a very healthy approach.

I will try to build on your approach and put some further arguments on the table to suggest that there are some ways to deal with this complicated situation we are in, and I will come to the short-term challenges at the end. The bottom line is the following: one of the new policy dimensions that has taken up a lot of attention at the G20 and elsewhere is the role that structural policies, in a broad sense, can play in international coordination. Structural policies used to be considered mostly, if not exclusively, a national domain, and this is still true to a large extent. The point is that structural policies have very important spill-over effects on the international sphere, and therefore not only do those spill-overs and externalities have to be taken into consideration, but they can be turned around, and structural policies can become useful additional tools.

There is one implication for the possible future agendas for the next G20s if that is the case, which can be stated as follows. There is scope for synergies between the progress that the Framework for Strong, Sustainable and Balanced Growth will make and discourse on the reform of the international monetary system. I will try to argue very briefly that if you bring structural reforms into the picture, that link can come out more clearly with opportunities.

How would you describe the desirable features of a good international monetary system? There are lots of them, but I came up with three very simple ones. Firstly, an international monetary system should be flexible so as to ensure adjustment does not take place too late, meaning that it copes with the mounting of unsustainable imbalances. One of the lessons we have learned from the crisis is that we have not seen them coming. It is not a question of shocks, but of imbalances that have been building up for some time and which suddenly explode for some casual reason. Therefore, you need a system that avoids such a build-up.

The second point concerns the time-honoured issue for the international monetary system, asymmetry, where you would like to see the adjustment borne, if not equally, then at least less unequally between surplus and deficit countries, and pressures for surplus countries to adjust, as we know, are not that strong.

Thirdly, this should not come at the expense of growth; you would like an international monetary system that delivers sustainable growth. How can structural reforms contribute to that? I would like to share some examples with you that come out of OECD research and which are also used as inputs to the G20 exercise.

We all know that innovation-related structural reforms, including in the labour, product and financial markets, are good for growth. They enhance potential output, but there is increasing evidence that they also do other things. One thing I will not discuss is that they can be beneficial for fiscal adjustment. The thing I will talk about is that they can be beneficial for global imbalances. One obvious way is through flexibility in labour markets, where wages adjust more rapidly to productivity changes, which is one lesson which Europe should take more seriously than it has done so far.

Another way, which is perhaps more interesting in this context, is that in countries where high structural savings or low structural investment persist, structural reforms can address savings and investment in a way that eventually reverberate in current account imbalances, and there are several examples there. For instance, if you improve social security systems, such as pensions and health, in emerging countries with high savings, this will address household savings. Financial market liberalisation in those countries will address corporate savings, which are also very high. Liberalising product markets could increase investment in some of those countries. Regarding deficit countries, in addition to flexibility, you could think of productivity enhancing measures that could increase savings.

Regarding surplus countries in advanced economies, and I am thinking of one large member of the Eurozone, liberalisation of the service sector, for instance, would definitely increase a stubbornly low investment rate. Therefore, you would have a rebalancing of the structural determinants of the current account surplus of that country without necessarily doing what the government has said they do not want to do, which is fiscal expansion.

Therefore, there are several examples, but if we accept that point, then we have to look at the implications of bringing this dimension into international monetary system reform. First of all, I am not claiming that by addressing savings and investment structural determinants you have solved the problems of adjustment at the international level. I am saying much more modestly that if you add structural reforms to the toolkit of policy instruments you put in place to address global imbalances, then there is a strengthening of the package. This, again, is the spirit of the G20 Framework for Growth.

The second point is the time dimension. What can we do tomorrow? Tomorrow we can start doing sustainable things that will start bringing results over the medium term, but at least we will move in the right direction. Structural reforms, of course, take a few years to produce impacts on growth and address those macroeconomic variables. Should that be the case, and if those reforms go in the right direction, then other reforms, such as of the exchange rate system in some countries, are reinforced by a situation where the fundamentals are going in the right direction.

Therefore, that reinforces other instruments, and brings back an old policy debate which I am old enough to recollect, namely, the sequencing of reforms. When we ask countries to reform in different ways, do we ask in what order we should do it? No. I think this is a big economic mistake, and it could be an even larger political mistake, because it does not give those countries we are asking to reform the appropriate political timeline. The sequencing of reform is important for that reason.

Structural reforms that address surplus countries' needs provide one, though a partial, solution to the problem of asymmetry. Stan Fisher said in a seminar in Washington last week that we have tried to address the symmetry problem in adjustment for 60 years, and we have not solved it. Pressure on surplus countries to adjust is very small. The issue is whether those countries can be offered a larger menu of options that do not go against their immediate policy preferences, and that eventually make it desirable to take those policy actions which eventually lead to a reduction of the surplus. This might be one case.

. Global current account imbalances underlying savings and investment imbalances should not be totally eliminated; they are good in some cases. There are some good imbalances, because their determinants reflect the right choices in investment that would lead to a larger tradable sector and address fundamental problems. One question I put on the table is whether we can try to understand better the linkage between structural reforms to address different incentives for investment, both in the real and the financial sector in some countries, and the implications for international capital flows.

What kind of international monetary system would we like to see from that point of view? Very simply, I would like to see a system where there is more long-term investment and less volatile investment. My point is that there is scope for the agenda on international economic governance to put together the elements underlying the framework, i.e. rebalancing in the medium to long term as well as in the short term, and the instruments you need to put in place to have a better international monetary system. Let us put aside the very delicate issue of reserve currencies, and look more modestly at the issue, which itself is very important, of financial safety nets. The way you think about financial safety nets could itself be changed if the fundamental adjustments to help structural reforms go in the right directions.

There could be more preference for multilateral and regional solutions to financial safety nets and less so for national solutions, which of course take the form of excessive reserve accumulation. Therefore, there is another synergy.

Finally, the international monetary system, would itself benefit from more explicit attention to structural reforms from a collective viewpoint, because it would give direction to long-term investment choices,.

One final thing on the current situation. There should be more flexibility, but let us not confuse flexibility with instability, which may be extremely detrimental, and many have raised that point. More flexibility is needed; it would complement and be reinforced by structural reform policies. Lionel mentioned the concerns about the current state of monetary tensions, and the perspective he offers is very interesting. Let me add one point which is a source of concern. Tensions are bad economically because they invite retaliation. They can be even worse politically, because they signal that the country's preferences are moving away from a very difficult medium-term cooperative perspective towards a shortcut, short-term solution, which, to me, does not lead very far.