Better policy coordination needed to avert another global slowdown

The global financial crisis of 2008–2009 elicited an unprecedented level of coordinated actions by Governments and central banks around the world. By avoiding many of the mistakes made during the Great Depression of the 1930s, policymakers planted the seeds of recovery for the global economy. That recovery has lost much of its momentum, however, especially because of continued weaknesses in the developed economies, where unemployment rates remain high. To make matters worse, Governments are withdrawing many stimulus measures and the cooperative spirit has been waning. Finger-pointing about who is to blame for the recent slowdown, the global imbalances and exchange-rate instability has become the name of the game.

The United Nations World Economic Situation and Prospects 2011 cautions that the lack of policy coordination could further weaken the already modest recovery, or even precipitate a new global recession. It presents a five-point plan for a change of course and strengthened policy coordination in order to avert such a dangerous scenario and to improve prospects for the global economy (see figure).

Avoiding a repeat of the Great Depression…

Two years ago, the world economy stood at the brink of collapse. The international financial system had threatened a global depression as world trade contracted dramatically; in many countries, real output declined faster than in 1929. The decisiveness with which Governments and central banks all over the world reacted to the crisis prevented a repeat of the Great Depression. Central banks quickly employed conventional and unconventional policy measures to improve financial market stability, increase liquidity and support economic growth. Most importantly, many monetary policy actions in late 2008 and throughout 2009 were coordinated to some degree among the major central banks, enhancing the impact and effectiveness of policy initiatives and reducing negative spillover effects.

At the same time, Governments increasingly used discretionary fiscal policy to stimulate private consumption and investment. The fiscal stimulus measures were far from tightly coordinated among countries, but were complementary and in line with G20 agreements. At the G20 summits in London (April 2009) and Pittsburgh (September 2009), leaders agreed to undertake “an unprecedented and concerted fiscal expansion” and to take steps to strengthen global governance institutions, especially the IMF.

… but laying seeds for a double-dip recession?

Thanks to the massive coordinated policy stimulus around the world, most developed economies were able to end their recessions earlier than initially expected, with global growth resuming in the second half of 2009. However, given the severity of the 2008–2009 crisis and its immense social costs, the pace of the recovery has so far been frustratingly slow, especially in the United States, most of Europe and Japan, where growth has been insufficient to bring down unemployment. Most developing countries have been doing much better thus far, showing much stronger growth, although mostly still below pre-crisis levels. However, the weak outlook in the developed countries is also harming their prospects.

Against this background, it is particularly worrisome that the fleeting moment of coordinated pro-growth macroeconomic policies now seems but a distant memory. Despite recognizing the fragility of the recovery and potential adverse spillover effects of national policies, the G20 meetings in Toronto and Seoul in 2010 failed to provide clearly defined policy leadership in response to current major challenges.
On the fiscal side, large deficits and high public debt levels in developed countries are increasingly being perceived as the major threat to growth and stability. As a result, many Governments, particularly those in Europe, have adopted severe austerity packages that are all but guaranteed to damage recovery prospects, especially since the global jobs crisis continues to impede robust recovery of private demand.

On the monetary side, too, policy responses have been poorly coordinated. The new round of “quantitative easing” in the United States has contributed to exchange-rate instability and induced a new surge of short-term capital flows to developing countries. Uncoordinated monetary expansions have led to more finger-pointing as to whom to blame for the recent instability in currency markets; instead, countries should be jointly seeking how to provide new impetus to the global economy and job creation.

The G20 member countries also failed to effectively address the trade imbalances, which continue to threaten global economic stability.

Five interrelated policy challenges

To redress current trends, World Economic Situation and Prospects 2011 suggests a five point plan.

1. Continued and coordinated stimulus

In the short run, additional fiscal stimulus—combined with appropriate monetary policies—is needed to reinvigorate the global recovery. Many countries, including most members of the G20, continue to have ample fiscal space to provide the stimulus required to get the world economy back up to par. To achieve maximum impact from this additional spending, national macroeconomic policies should be better coordinated among the major economies. Such action would generate stronger external demand for countries forced to undergo massive fiscal consolidation. Improved growth prospects for these economies could, in turn, contribute to greater stability of international debt and currency markets.

2. Redesigning of fiscal stimulus

Fiscal policy needs to be redesigned to strengthen its impact on employment and to ensure a more sustainable growth pattern. In many contexts, increased public investment could play a critical role in this sense, if targeted towards improving infrastructure and generating renewable energy for climate change mitigation. It has been shown that the expansion and improvement of public transportation networks, for instance, tend to create significant amounts of new jobs while also reducing GHG emissions, particularly in rapidly urbanizing environments. Another important element of the redesign is improving social protection and safety nets. This could help cushion the impact of adverse shocks and boost aggregate demand, thus making growth more sustainable.

3. Better coordination of monetary policies

Policymakers need to ensure greater synergy between fiscal and monetary stimulus measures and to prevent damaging international spillover effects of national monetary actions. In particular, there is a need to resolve global currency tensions and limit volatile short-term capital flows. This requires reaching agreement about the magnitude, speed and timing of quantitative easing policies within a broader framework of targets to redress the global imbalances. It will also require far-reaching reforms of international financial regulation, including managing cross-border capital flows, and of the global reserve system, reducing dependence on the United States dollar.

4. More predictable access to development finance

Sufficient resources need to be made available to developing countries, especially those with limited fiscal space and considerable development needs. These resources will be particularly needed to accelerate progress towards achieving the MDGs and to strengthen investment in sustainable and resilient growth. Apart from delivering on existing aid commitments, donor countries should consider mechanisms to delink aid flows from their own business cycles and budgetary volatility so as to prevent delivery shortfalls in times of global crisis, when the need for development aid is particularly urgent.

5. More concrete and enforceable targets for international policy coordination

More credible and effective policy coordination among major economies as just outlined needs to be ensured. Having clear and verifiable targets for a sustainable rebalancing of the global economy can make parties more accountable, and the possible loss of reputation resulting from non-compliance will encourage adherence to commitments.

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