Policy coherence from new data, new research, new mindsets

by
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Recent global economic performance – characterised by sluggish growth, widening inequality, environmental precariousness, and market volatility – is a sobering reminder of the myriad challenges facing policy makers. How can understanding and quantifying the interrelationships between and among policies help design policy packages to improve performance?

New analysis at the OECD, undertaken with new data, new methods, and new mindsets reveals the importance of policy coherence. The essence of policy coherence is to ask, How well do policies – directed toward demand management, structure of markets, environmental sustainability, and frontier innovation – work together to enhance the overall well-being of the citizens of a country and even broader through spillovers to the world? To what extent could a piece-meal approach, rather than an integrated policy assessment, lead us astray?

The mindset of policy coherence seems obvious. But it is in the nature of governments, academia, think tanks, and international organisations to analyse economic policies in silos – e.g. labour, environment, competition, finance, fiscal – because that simplifies the analysis and contains the domain for policy bargaining. The OECD is not immune to the silo tendency. However, the New Approaches to Economic Challenges (NAEC) ushered in a systematic mindset to see economic problems through a new lens to recognise that coherence in research across the silos is required to produce the evidence that yields “better policies for better lives”.

Productivity research is one example of how new data and mindsets promote policy coherence. The traditional approach to policy making (and its research underpinnings) focused on policies to grow the pie (through productivity – enhancing policies such as R&D spending) in isolation from policies to redistribute the pie (through taxes and transfers or through skills development). This is partly because the research datasets to investigate these topics were distinctly separate, as were the interests of the researchers. But also, policy analysis was separated because the policy makers that would implement the policies had separate mandates. In any case, detailed data on firms and workers were not available, which implied that
policy design was founded on the relationships between average firms, average workers, average economies, and average outcomes.

The NAEC approach to policy research on productivity evaluates policies for growing the pie and for its distribution at the same time. The research shows that it is the same type of policies (such as ease of business entry and exit, flexibility of labour markets, robustness of financial firms) that negatively affect productivity growth, negatively affect the matching of skills to firms, with attendant negative consequences for income distribution and its growth. This work reveals negative feedback loops that were not observed before, opening up new recommendations for policy packages. We are able to make this link now between productivity growth and income distribution because our datasets are granular enough and can be matched across objectives, the interests of the researchers came into alignment, and the importance of policy coherence is better appreciated by policy makers too.

Whereas the same type of policies affect productivity growth and income distribution, each country has its own unique combination of those policies, and therefore its own specific set of challenges. A key understanding under NAEC is to promote policy coherence across structural policies as well as demand management policies. The first generation of analysis of structural policies tended to address the implications for GDP growth of flexibility-enhancing labour market policies in isolation from policies to promote product market competition, and with little reference to overall demand conditions and demand management policies such as fiscal spending or monetary expansion. And, potential structural flaws in financial markets were not considered.

This piecemeal approach to policy assessment can lead to misunderstandings of how policies might impact economic performance. For example, increased flexibility in labour markets alongside product markets that lack competition or in which there is slack demand push, the brunt of adjustment onto individuals, raising inequality. On the other hand, robust competition among firms but with rigid labour markets starves competitive firms of resources to grow, hampering productivity. Or, a third example, banking systems that evergreen loans (renew them continuously) to
poorly performing firms dampens overall productivity growth and traps labour, thus raising inequality. A new mindset appreciates the complexity of the interactions between policies. Integrated policy assessments that take into account the unique characteristics of each country help quantify how policy reforms might work together to raise productivity growth and improve income distribution. This integrated policy assessment helps policy makers tailor their approach to improve economic performance and respond to shocks.

We have the tools to quantify structural policies and their impact on firms and individuals in a coherent way, including during business cycle upturns and downturns. We have an understanding of how best to deploy different types of fiscal instruments to achieve inclusive growth. Is our understanding of policy coherence complete? No, not in two key dimensions: macroeconomic spillovers and micro-behaviour and attitude toward change.

On understanding and quantifying spillovers, we still lack the trade and financial linkages and the empirical apparatus to fully understand and quantify how spillovers from one country to another may impinge on achieving policy objectives of greater productivity along with inclusive and sustainable growth. But, these data and tools are available and the OECD is in the process of incorporating these into our integrated policy assessment for economies.

On understanding micro-behaviour and attitude toward change, much more needs to be done, and this is essential for understanding the political economy of reform. The key challenge is that enhanced productivity growth comes only with firm and worker reallocation, but fear of this dynamic can constrain policy makers’ actions. A dynamic environment can strip economic rents from sheltered firms and exposes workers and households to job change and income volatility. As the pace of technological change increases, the imperative for a dynamic economy also increases. If people are not empowered to adjust, the backlash is reflected in policy stasis instead of reform, and worse outcomes, rather than better.

Research examining the behaviour of individuals is starting to give insights on which policies can best help them navigate change,
but more needs to be done. Faster and more efficient resource reallocation helps economies to recover more quickly from adverse shocks, contributing thereby to reduced inequality, enhanced productivity growth, and higher living standards.

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