Global policy co-operation would strengthen the recovery from the pandemic

Category: COVID-19,Economic outlook
written by oecdecoscope | June 26, 2020
by Nigel Pain and Véronique Salins, OECD Economics Department

The COVID-19 pandemic saw governments throughout the world impose stringent containment measures to contain the spread of the virus, including the partial or total shutdown of the activity in many sectors. These necessary measures succeeded in slowing the spread of infections and reducing the death toll, but have severely impacted economic activity, with GDP declines of more than 20% in many countries during shutdowns and a surge in unemployment.

Governments reacted quickly, with substantial fiscal measures being used to help preserve the incomes of workers and companies despite the collapse of activity. In addition, monetary policy has been eased and financial policy relaxed to support credit provision by financial institutions. While such measures have helped to limit the short-term costs of the crisis, the path to recovery remains exceptionally uncertain in the absence of a vaccine or adequate treatment of the disease,.

The OECD Economic Outlook, released on June 10, presented two possible scenarios: one in which the virus recedes slowly and remains under control (the single-hit scenario), and one in which a second wave of contagion is assumed to erupt later in 2020 (the double-hit scenario). In both cases, the G20 economies are projected to experience a severe output decline in 2020, followed by a slow and gradual recovery in 2021 with output and incomes remaining well below the levels expected

prior to the pandemic.

Policymakers face exceptional challenges as the recovery gets underway. Government budget deficits are elevated, public debt is set to rise to exceptionally high levels in many countries, monetary policy space is limited, and there are strong risks that a fragile recovery will leave lasting scars.

Should another virus outbreak occur, as assumed in the double-hit scenario, or the recovery proves unexpectedly weak, additional stimulus will need to be supplied mainly by fiscal policy, with monetary policy helping to ensure adequate liquidity and low interest rates along the yield curve. In either scenario, supportive macroeconomic policies will be required for some time to foster a durable recovery. Debt-financed public spending will need to be well targeted on support for the most vulnerable and on public investment in the health, education, digital and environmental infrastructures that are necessary for a sustainable recovery and which lift demand in the near term.

Potential scars in labour and product markets, the necessary reallocation of workers and capital across sectors in the aftermath of the pandemic, and the significant adverse impact of the crisis on living standards also emphasise the urgent need for renewed and well-targeted structural policy reforms in all economies.

Global policy co-operation would enhance the benefits of these actions. Acting together creates confidence and positive spillovers on trade and investment that will be more effective for all countries than if they acted alone. Co-ordinated policy actions across all the major economies are needed to ensure effective healthcare provision around the world and provide the most effective stimulus to the global economy. They would help restore growth more efficiently than country specific actions, with larger effects on trade, consumer and investor confidence and uncertainty.

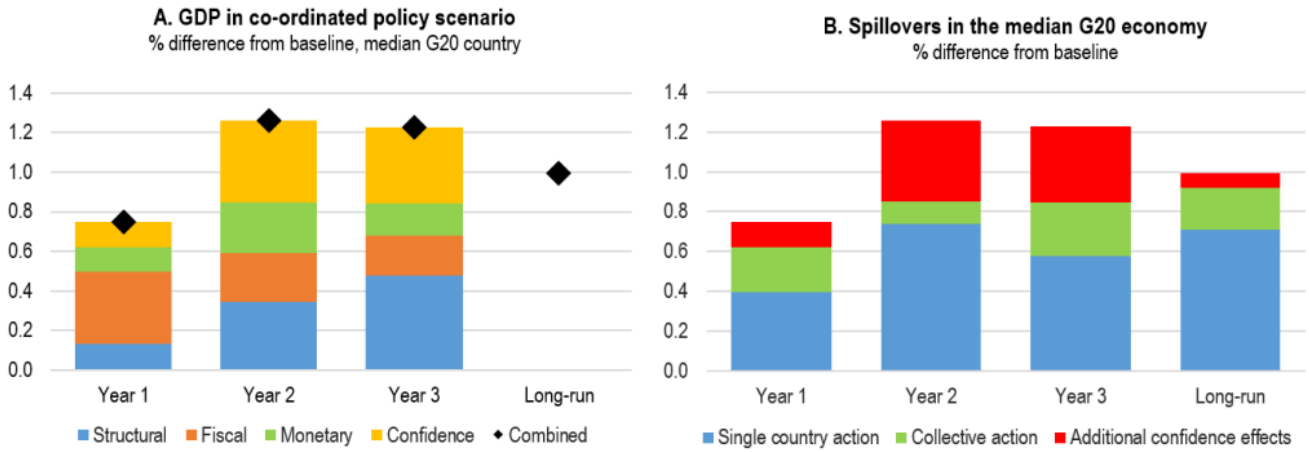
Illustrative policy simulations for the G20 economies highlight the benefits of economic policy co-operation. The particular set of co-ordinated fiscal, monetary and structural measures considered includes a debt-financed fiscal easing of 0.5% of GDP in all countries for three years, reductions in policy interest rates in economies with sufficient policy space, and additional competition-enhancing structural reforms that increase productivity slowly over time. In all of the G20 countries (or wider areas) central banks are also assumed to use forward guidance that helps interest rates to remain low and takes into account the longer-term output gains from the package of policies being undertaken. In addition, a temporary reduction in investment risk premia is incorporated when all countries act together to capture the favourable effects on investor confidence.

Taken together, these policy measures raise the level of GDP by around ¾ per cent in the first year in the median G20 economy (Figure below, Panel A) and by 1¼ per cent in the second year, with the level of output permanently higher in the longer term. The near-term boost to output primarily results from the collective gains from more supportive macroeconomic policies, but the structural reform measures also start to raise output in the short run, with their impact continuing to build over time. The near-term impact on GDP is a little higher in the G20 economies that have space to reduce policy interest rates, reflecting positive effects on demand and investment, but output gains nevertheless remain strong in the other economies.

In all G20 countries, there are clear gains from collective action relative to each country acting by itself (Figure below, Panel B). First, acting together enhances the spillovers through stronger trade growth and higher financial asset prices as firmer external demand boosts exports and incentives to invest. Second, there are additional gains for each country from the boost to global confidence and reduction

in uncertainty that comes from acting together to tackle a common problem. Altogether, the gains from collective actions add nearly one-half and one-third respectively to the output gains in the median G20 economy in the first and second year of the scenario.

The benefits of international economic policy co-operation



Notes: Scenario in Panel A with all G20 economies simultaneously undertaking changes to fiscal, monetary and structural policies. Countries undertake additional debt-financed public expenditure of 0.5% of GDP for three years, monetary policy becomes more accommodative in economies with policy interest rates above zero (all countries excluding Japan, France, Germany and Italy) and productivity-enhancing structural reforms occur raising TFP by 1% after five years. Confidence is modelled by a 50 basis point reduction in investment and equity risk premia for two years, which then fades slowly.

Source: OECD calculations using the NiGEM macroeconomic model

This suggests that co-ordinated policy action across countries remains the most effective response to the large economic disruptions caused by the Covid-19 outbreak and the challenges that result. In practice, it may either not be possible for all countries to undertake actions on all fronts or countries may simply choose to undertake a different mix of fiscal, monetary and structural responses. Nonetheless, it is important that all countries participate in a co-ordinated effort to support growth as this will increase the collective gains and the benefits for each country.