The role of the OECD in the design of macroeconomic and labour market policy: Reflections of a heterodox economist*

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1. Introduction

While nation states remain responsible for their own policy making, they operate within contested transnational knowledge networks in which common policy frameworks are negotiated, if not universally implemented, to address issues in areas including the economy and the environment. Inter-Governmental Organisations (IGOs) are key players in these networks and contribute to policy harmonisation (Mahon and McBride, 2008) and its diffusion both cross-nationally and ‘in emergent venues of global governance’. Thus methodological nationalism is rejected (Stone, 2004).1

The Organisation for Economic Co-operation and Development (OECD) is not merely a major international research organisation but a key IGO in the dissemination of economic policy. ‘Its primary impact comes through efforts to develop and promote international norms for social and economic policy’ (Wolfe, 1993).

The important role of the OECD in the design and dissemination of labour market and macroeconomic policy can be traced back to the early 1990s when it was commissioned by member states to explain their persistently high unemployment. The inability of countries to adapt and innovate in response to economic change was claimed to be the main cause, and so unemployment was considered mainly structural in origin. Consequently, removal of supply side impediments to the operation of national economies was advocated. Jobs Study (1994) also reflected the emerging Washington Consensus with respect to macroeconomic policy which emphasised the need to both reduce structural budget deficits and public sector debt over the medium term, and pursue low inflation (Mitchell and Muysken, 2008).

The OECD Economics Department had sole responsibility for the Jobs Strategy (1995) which operationalised the Jobs Study (Noaksson and Jacobsson 2003:17-18). The reforms, which were implemented unevenly across member countries, had limited success in reducing unemployment. Following a reassessment, OECD (2006a) made concessions about the effectiveness of some supply side reforms. OECD (2006b) recognised two successful policy models, but maintained its orthodox perspective about the conduct of macroeconomic policy. A significant body of literature has challenged the OECD’s interpretation of the degree of compliance (policy convergence) of member countries (Baker et al, 2004, McBride and Williams, 2001); their advocacy of extensive supply side reform (McBride and Williams, 2001; Larsen, 2002; Baker et al, 2004; McBride et al, 2008); and, in normal economic circumstances, their rejection of discretionary fiscal policy (Mitchell and Muysken, 2008).

Since the start of the Global Financial Crisis, the OECD and other IGOs, including the European Union (EU) and International Monetary Fund (IMF), have acknowledged that a fiscal stimulus was required in some countries, but these organisations have continued to advocate sound public finance, through medium term (MT) pursuit of fiscal consolidation (ECB, 2009; Freedman et al, 2009; IMF, 2010; OECD, 2009a,b,c; 2010a,b; Price, 2010). Thus, notwithstanding concessions, the major IGOs remain wedded to a neo-liberal policy framework.

Despite the OECD’s reputation for rigorous and impartial research, we argue that its role in transnational policy formulation and dissemination is informed by an Organisational Discourse (OD) perspective in which its behaviour is motivated by
long-term planning, underpinned by the need for institutional sustainability (Dostal, 2004; Mahon and McBride, 2008).²

The OD perspective embraces a social constructionist and/or a critical perspective, which enhances the theoretical and empirical traction of the new Organisational Development literature (Marshak and Grant, 2008). The former contributes to an understanding of how language and other media transform social reality, influence organisational behavior, shape the mindsets of organisation members and illuminate how common social meanings within organisational contexts are constructed, given the inherent subjectivity of experience. Mindsets and consciousness can be altered and organisational change achieved by ‘(M)eaning making, language and discursive phenomena’ (Marshak and Grant, 2008:S11). The focus of the critical perspective is how power and political processes are used to shape new discourses, which advantage some organisation members over others (Marshak and Grant, 2008:S11-12). So the OECD is not a monolith. Its dominant ODs and ‘the strength and the direction of its potential policy influence’ are ‘constructed through discursive battles between different discourses within the organisation(s)’ (Lehtonen, 2009:391).

The analysis of the behaviour of the OECD (and other IGOs) in responding to the serious anomalies for neo-liberal policy thrown up by the GFC provides a good illustration of the theoretical insights that an OD perspective can provide. While OD contributes to theorising about the dynamics of organisational change (Marshak and Grant, 2008, S9), the OECD, along with other influential IGOs, has tried to ensure that its orthodox premises underpinning macroeconomics are not subject to challenge. Any major concessions would threaten their long term capacity to influence the conduct of macroeconomic policy. Thus the dynamic competition of discourses is not characteristic of all policy domains.

In its public reports, the OECD relies on obfuscation, by adopting sanitised and repetitive forms of exposition, which draw on carefully selected academic research but lack rigour (Dostal, 2004). The chosen terminology, including sound public finance, fiscal consolidation and fiscal sustainability, conveys a sense of authority and impartiality about policy design, despite these terms never being defined in an operational manner and the social and economic consequences of their implementation rarely being explained. Indeed recent OECD documents make no reference to the public purpose of economic policy.

Also no distinction is made between Eurozone countries that, as a condition of membership, have voluntarily accepted major constraints on their conduct of macroeconomic policy and those, including the UK, USA, Japan and Australia, which do not face such constraints. Fiscal consolidation has no meaning for sovereign countries with their own currencies operating under flexible exchange rates (Mitchell and Muysken, 2008; Fullwiler, 2006).

We first examine the structure and operation of the OECD. In Section 3 the theoretical and empirical challenges to its policy agenda are documented, along with its concessions. We then critically assess from an OD perspective the arguments for fiscal sustainability by all countries, independently of their institutional arrangements. Section 5 concludes.
2. Structure and Operation of the OECD

2.1 Introduction

The origin of the OECD and its conceptualisation as a powerful IGO within a dense web of transnational knowledge networks have been documented at length by, amongst others, Bainbridge (2000), McBride and Williams (2001), Noaksson and Jacobsson (2003), Dostal (2004), and Mahon and McBride (2008), so we provide a summary here.

The Ministerial Council is the OECD governing body with representatives from all 30 member states and one from the European Commission. The Secretary-General is the chair. Decisions are adopted by mutual agreement of all members. The Secretary-General leads the Secretariat, which has 15 directorates, including the Economics Department. Over 200 specialised committees, working and expert groups provide assistance. This structure exists alongside informal networks of ad hoc groups, many of them long-standing with their own bureau and elected chair (Dostal, 2004). The Secretariat prepares analytical studies for which the OECD takes responsibility, so that no member state is formally bound by the content.

OECD publications, in particular ad hoc policy documents (e.g. OECD, 2006b, 2008b, 2009a,b,c; 2010a,b) are written in a stylised manner and underpinned by important, but rarely articulated, assumptions which constitute the conventional wisdom. Dostal (2004:444-445) argues that OD is not scientific and cannot be directly compared with epistemic communities:

‘In fact, organizational discourse is not necessarily very discursive. Rather, it is based on the power of discursive closure. Organisations create their own knowledge based on strategically selected issues and aim to disseminate resulting expertise in communication with an organization’s policy-making environment’.

OECD processes are shaped by their own distinctive norms and rules and designed to socialise participants into adopting appropriate behavior (Porter and Webb, 2007:3). There is a high degree of interaction and interdependency between national government departments and the OECD. Despite guidance and oversight by the Economic and Development Review Committee (EDRC), whose membership includes representatives from member states, Secretariat officials, who are mainly economists, have considerable influence on policy deliberations with economic liberalisation being central to their mission (Porter and Webb, 2007:4). On the other hand, methodological debates about new statistical data and technical criteria for OECD benchmarking exercises occur within working groups which facilitates the emergence of epistemic communities (Haas, 1992).

The Economic Policy Committee (EPC) and the EDRC are influential in the design and dissemination of economic policy and participate in the preparation of the Economic Outlook and country based Economic Surveys (Noaksson and Jacobsson, 2003:14).

2.2 The Jobs Study

In response to higher European unemployment in the early 1990s, the Council of Ministers commissioned a comprehensive study of structural issues, drawing on the
OECD’s inter-disciplinary expertise. The main cause of higher unemployment in member countries was viewed as the inability to adapt to rapid economic and social change caused by (i) waves of market deregulation; (ii) more rapid globalisation; and (iii) pervasive technological change.

Like the ‘Washington Consensus’ agenda which was imposed on developing countries, the proposed reforms were based on the primacy of markets, and the imperative to remove the institutional fetters allegedly inhibiting their operation (LaJeunesse et al, 2006). The reforms were mainly directed at labour markets. Unemployment was seen as mainly structural, so it was redefined as an individual problem, arising from poor skills and motivation, rather than a collective, systemic problem characteristic of a capitalist economy. Consequently supply side policies were advocated, including more flexible working-time; greater flexibility of wage and labour costs; reform of employment security provisions; active labour market policies; reform of unemployment and related benefit systems and their interaction with the tax system; and enhancement of product market competition. The agency of the state should be subordinate to market forces whenever possible (Dostal, 2004:447). The Jobs Study was not supposed to adopt an explicitly political or ideological stand (Noaksson and Jacobsson, 2003:44), but the claim that the free market model is devoid of political and ideological content is at best naïve.

OECD (1994:3b) also advocated growth enhancing, macroeconomic policy:

> ‘Macroeconomic policy has two roles in reducing unemployment: over the short term it limits cyclical fluctuations in output and employment; and over the longer term it should provide a framework, based on **sound public finances** and price stability, to ensure that the growth of output and employment is sustainable, *inter alia* through adequate levels of savings and investment’ (my emphasis).

Member countries agreed to implement these recommendations, but the OECD had no power to impose sanctions on recalcitrant members. Most OECD documents between 1994 and 2001 took the Jobs Study assumptions as unproblematic and repeated its findings and conclusions (Dostal, 2004).

### 2.3 Multilateral Surveillance and Peer Review

The Jobs Study recommendations reinforced the OECD’s conversion to a neo-liberal reform agenda, which was also embraced by the World Bank and IMF. This policy framework also informs the way in which the OECD conducts Multilateral Surveillance and Peer Review.

As part of its role as an IGO, the OECD engages in the production of statistics, analytical work in relationship to soft regulation, such as best practice identification through comparative studies, mutual surveillance, recommendations, peer review and peer pressure and the implementation of hard regulation via standard setting and adoption of binding international agreements (Mahon and McBride, 2008).

A major influence of the OECD on transnational governance is through the meditative function undertaken by its Secretariat. Its significant research capacity is used to undertake empirical analysis often employing new measures and benchmarks thereby widening the scope for statistical monitoring of member countries (Mahon and McBride, 2008:10; Marcussen, 2004). These data and cross-country policy analysis
appear in publications, including *Economic Outlook, Employment Outlook*, and *Economics Department Working Papers* which contribute to the organisation’s authority based on impartial analytical work.

‘The organisation aims to depoliticise issues of economic and social policy-making into questions of ‘pure’ expertise to be dealt with from the position of ‘best practice’ and without too much institutionalised interference from interest groups’ (Noaksson and Jacobsson, 2003:10; see also Dostal, 2004:446), but their policies do not always gain universal acceptance (Ougaard, 2009).

The *meditative* activities involve the power to classify, fix meanings and diffuse norms (Barnett and Finnemore, 1999:711; Stone, 2004), which again highlights the importance of OD. In particular, the OECD contributes to the sense of a common identity for members by advocating policies appropriate for modern, liberal-democratic, market friendly countries (Noaksson and Jacobsson, 2003; Porter and Webb, 2007). The OECD tries to achieve policy convergence through arguments, negotiations and persuasion (Marcussen 2002).

With its access to resources, the Economics Department assumes a major role in the *inquisitive* mode of regulation through Peer Review (PR) of each member country on a 12-18 month cycle (Noaksson and Jacobsson, 2003:18). A country is not obliged to follow the recommendations, although there are pressures to conform (Mahon and McBride, 2008), particularly since the OECD reports the degree of compliance to the blueprint (OECD, 2004b:4; March and Olsen, 1998:961, quoted in Porter and Webb, 2007). The OECD provides ‘a controlled environment for the creation, development and dissemination of political discourse’ (Dostal, 2004, 440), which entails the ‘adoption of a shared terminology, similar methods of inquiry, and a unified style of presentation in the OECD’s PR exercises’ (Lehtonen, 2009:390). All countries sign the final report, which is published, after unanimous adoption by the EDRC (Noaksson and Jacobsson, 2003:27-28). Due to the OECD’s role in creating a common identity, members rarely exercise their veto power to reject PR recommendations, because this would be ‘viewed as inappropriate by their peers and, in many cases, domestic public opinion’ (Porter and Webb, 2007:8).

All OECD findings are presented in a non-technical, non-confrontational, stylised manner, which are accessible to non-specialists, particularly policymakers. Policy principles are articulated which can be adapted according to the national circumstances, so country specific recommendations are avoided (Lodge, 2005). In its policy recommendations, there is an unclear relationship between the OECD’s own research and the best available academic evidence, since the OECD discusses the latter in a selective and superficial manner, but draws on its scientific authority (Dostal, 2004:450-451).

### 2.4 Policy Development

The OD perspective is also insightful in directing attention towards first mover situations which leads to policy development that assume hegemonic status within the associated transnational knowledge networks (Dostal, 2004:444). The OECD’s authority in these new areas is enhanced by its capacity to develop new comprehensive statistical databases. Consequently, it has gained a comparative advantage in emerging areas of policy making, including regulation of private health
care and private pensions, thereby broadening its OD at Committees and Ministerial Council meetings and providing guidance to national policy-makers (Dostal, 2004).

Mahon and McBride (2008) contrast the hard neo-liberal economics perspective of the Economics Department, which mainly interacts with national Finance Departments, and has had minimal interaction with civilian society (Ougaard, 2007), with the inclusive or innovative liberalism of the Directorate for Employment, Labour and Social Affairs (DELSA). DELSA communicates with ministries dealing with labour and social issues. “(I)nclusive liberalism” is seen as a distinctive variant of liberalism, of equivalent status to classic, new, or social liberalism and neo-liberalism, but it does not pose a fundamental challenge to neo-liberalism’ (Mahon and McBride, 2008:18). It is designed to enhance the reconciliation of work and family life, and is focused on raising women’s labour market participation and investing in youth and children (Mahon and McBride, 2009:85).

Discourses have also emerged in the OECD drawing on institutional and ecological economics (Lehtonen, 2009). Despite the inclusion of a Sustainable Development (SD) section in a full cycle of Peer Reviews, it failed to become mainstream. Indeed the ERDC removed the section from the PRs once specific funding for its inclusion ceased (Lehtonen, 2007).

The OECD’s failure to reposition itself within international governance may reflect a belief that its comparative advantage and core identity lay elsewhere.

‘Adopting too many elements from ‘environmentalist’ or other heterodox discourses might threaten this very identity. Embarking upon the slippery discursive field of SD may have seemed too risky for an organisation whose influence and authority rely on the production of reliable, ‘objective’ economic analysis’ (Lehtonen, 2009:396).

The OECD’s neo-liberal prescription of supply-side reform and sound macroeconomic policy has been largely unchanged for over 15 years, despite some concessions with respect to the former (see Section 3). ‘(A)ny organization’s comparative advantage in broader policy networks depends at the same time on the ability to sustain its authoritative voice in specific areas of expertise’ (Dostal, 2004:445).

The absence of competing discourses about macroeconomic principles reflects the continued support for the neo-liberal policy framework within other major IGOs, such as the World Bank, International Monetary Fund (IMF) and the European Central Bank (ECB), even though these organisations serve different, albeit overlapping, constituencies and would have the resources to challenge the OECD discourse. Thus, the ongoing, dynamic competition of ideas between IGOs does not occur across all policy domains. Also, there is little meaningful macroeconomic policy debate within most academic economics departments whose graduates are typically the future employees of these organisations. While recognising the influence of Anglo-American–trained professional economists on the OECD’s OD, Mahon and McBride (2008:15) note that directorates develop their own ODs, so they question whether the organisation’s discourse is merely ‘a transmission belt for the ideas dominant in [academic] economics departments’. Certainly neo-liberal ideas had a profound influence in framing the policy template by the OECD Economics Department.
3. Challenges to the OECD Economic Policy Agenda

3.1 Introduction

We now briefly document evidence of non-compliance by member countries and outline theoretical and empirical challenges to the OECD neo-liberal blueprint. We argue that to maintain its credibility as an influential IGO within international knowledge networks, the OECD is locked into ill-defined macroeconomic principles of sound public finance and fiscal sustainability, which are explored in Section 4.

3.2 Compliance

The Jobs Strategy was criticised for its decontextualised benchmarking by requiring the achievement of perfect labour markets (Hemerijck and Visser 2001). Thus countries with traditions of so-called rigidities, such as employment protection, strong trade unions and relatively high employment benefits, were expected to undertake reforms to reduce workers rights, ostensibly to create jobs (Larsson, 1998:412, quoted in Noaksson and Jacobsson, 2003:31), but in fact policy making was conditioned by domestic politics, institutions and extant policies (Armingeon, 2007:906).

OECD (1999a:41) claimed that successful countries had adopted different approaches to reform, but that reforms always followed the main thrust of the Jobs Strategy. Despite implementation of PR, the degree of compliance after the Jobs Strategy was unimpressive (Rueda and Pontusson, 2000:381; Armingeon, 2004). Even when there appeared to be a strong link between OECD recommendations and member country policy, there was mixed evidence that the OECD set the change agenda (Manning 2004:209, Mahon and McBride, 2008:17; Lodge, 2005). McBride and Williams (2001) note major inconsistencies in the OECD’s assessment of the degree of compliance by member countries. Also there was no relationship between a country’s compliance rate and its labour market outcomes.

3.3 Empirical Evidence

Both youth unemployment and overall labour underutilisation had remained high, with the latter partially reflecting rising underemployment (OECD, 2006a). Also income inequality increased, particularly in the USA (OECD, 2008a).


OECD (2006b) acknowledged that no single combination of policies and institutions was required for good labour market performance. Market reliant countries were differentiated from ‘Nordic’ countries which emphasised ‘coordinated collective bargaining and social dialogue’. ‘Nordic’ countries achieved a higher average employment rate, lower income inequality but at a higher budgetary cost (OECD, 2006b:18-19), which revealed that there was no efficiency/equity trade off (Watt, 2006). Despite these concessions, the OECD continued to encourage the adoption of the neo-liberal (market) model, rather than the Nordic model (Watt, 2006).
In its largely unsubstantiated report, OECD (2006b) reaffirmed the importance of sound budget balances for the conduct of macroeconomic policy, and the need to remove obstacles to participation and job creation via supply side initiatives (see also OECD, 2008b). The failure of member countries to achieve full employment and stable inflation was attributed to labour market rigidities and other imperfections (Mahon and McBride, 2008), although flexible labour markets are neither necessary nor sufficient for the achievement of full employment (Lajeunesse et al, 2006). Thus the OECD remains wedded to a macroeconomic model which has no long term role for aggregate demand management, since the unemployment rate is alleged to converge to the NAIRU, a level consistent with stable inflation, via the operation of market forces.

However, Ormerod (1994:203) found that countries which avoided high unemployment rates in the 1970s had a sector operating as an employer of last resort. Modigliani (2000) is unequivocal that aggregate demand determines employment. Mitchell and Muysken (2008) find evidence of unemployment persistence in selected OECD economies (1960-2006) which challenges the claim that departures from the NAIRU are temporary following aggregate demand shocks. Also they find that the NAIRU is cyclically sensitive (see also Sawyer, 2004), which rejects the view of Layard et al (1991:18) that the NAIRU is determined by supply-side factors, such as wage bargaining arrangements.

4. The Conduct of Fiscal Policy

4.1 Introduction

A key aspect of the OECD’s discursive power is its repetition of its policy framework in a range of contexts, so that policy principles are considered part of the conventional wisdom (Dostal, 2004:445; Jackson, 2008). The terms fiscal sustainability and fiscal consolidation reveal a strategic choice of language, as compared to say fiscal austerity. Fiscal consolidation was advocated in the Jobs Study, and appears frequently in OECD documents (e.g. OECD, 2009a, 2010a,b; Price, 2010), with minimal elaboration.

4.2 Fiscal Consolidation and Sustainability

OECD (2009a,b,c; 2010a,b) accepted the implementation of fiscal stimulus measures, particularly in countries with limited scope for monetary policy if interest rates were already low. A charitable explanation of this acceptance of initiatives to boost activity would be that, despite the alleged equilibrating properties of economies, restoration of the unemployment rate in line with the (new?) NAIRU would take time after such a major real private expenditure shock. In short, fiscal stimulus was required to prevent a significant rise in structural unemployment, which is the manifestation of the cyclical shock. These documents also advocate MT fiscal sustainability, however, but the arguments are characterized by obfuscation via inconsistent, incomplete and often unsubstantiated statements. Caution is expressed about further stimulus measures:
‘The scope for further stimulus depends on the degree of government indebtedness. …….. Evidence shows that adverse reactions in financial markets are likely in response to higher government debt and that such reactions may depend on the initial budget situation’ (OECD, 2009b:10-11).

The OECD (2009b:10-11) also differentiates between countries with ‘a weak initial fiscal position’ and those with ‘most scope for fiscal manoeuvre’, but ‘For others, action would only be warranted in case activity looks to turn out even weaker than projected’. Thus member countries are not provided with a clear set of policy principles.

OECD (2010a) argues that the sole MT policy objective is deficit reduction, so there is no policy trade-off. The word unemployment appears just twice, when cuts to public sector employment are considered.9 According to the OECD and other IGOs, fiscal policy should be driven by accounting imperatives, with no consideration of public purpose (Mitchell, 2010a).

OECD (2009b:17) notes that ‘Fiscal stabilisation is particularly important in countries that do not have national monetary policy’, such as Eurozone countries, but fails to explain why some of these countries, including Ireland, and more recently Greece, adopted pro-cyclical, rather than counter-cyclical fiscal policy. In 2010 Ireland had an unemployment rate above 13 percent and a projected gross debt to GDP ratio of 78 percent by year’s end, whereas corresponding Japanese figures were 5.1 percent and above 200 percent. Yet Ireland introduced a contractionary budget in April 2009 and unprecedented cuts in social welfare benefits and public sector pay in the December budget, 2009. In its Economic Survey of Ireland, OECD (2009d:2) is quite clear: ‘It is appropriate that fiscal consolidation has already begun and very substantial further measures will be required, although there is a balance to be struck with the negative effects on economic activity.’

By contrast, Japan introduced a fiscal stimulus projected to be 2 percent of GDP over 2008-2010 (OECD, 2009b). Yet OECD (2009e) appears quite sanguine about Japan: ‘The crisis and the stimulus packages are projected to boost the budget deficit to 10% of GDP in 2010 and gross public debt to 200%, calling for a detailed and credible medium-term fiscal consolidation plan to sustain the confidence of financial markets.’ (my emphasis).10 It is difficult to reconcile these different policy initiatives in view of the universal imperative for MT fiscal consolidation in response to high public debt ratios.

The OECD fails to acknowledge that the conduct of fiscal policy is fundamentally different in Eurozone countries, as the above examples illustrate, because their governments are budget constrained, by choice, under the Stability and Growth Pact, albeit with a temporary relaxation due to the GFC.11 By contrast, countries, including Japan, the USA, UK and Australia, operate with their own fiat currencies under flexible exchange rates and are not budget constrained because, as monopoly suppliers of the currency, they are not required to borrow to finance their expenditure (Mitchell and Muysken, 2008). Thus the OECD trivialises the conduct of fiscal policy by implying that, like prudent households, all national governments are budget constrained.

OECD (2009a:124) acknowledges that the impact of fiscal imbalances (deficits) on long-term interest rates is ‘both mixed and controversial’. Their econometric work
(Box 3.2), analyses the determinants of the interest rate spread, but no justification is provided either of the choice of just Eurozone countries, or the small number of time series observations. This is most unsatisfactory because, in contrast to countries with their own independent fiat currencies, Eurozone countries must formally borrow to finance budget deficits. The behavior of the ECB in setting the short term rate will determine whether higher expected deficits raise long term interest rates in the Eurozone (rather than just the spread).

‘An implication of the finding that higher expected deficits increase long-term interest rates is that a temporary fiscal injection may be more effective than a more sustained fiscal injection which is expected to significantly worsen the long-term fiscal outlook’.12

OECD (2009c) explores the macroeconomic impact of MT scenarios for each member country based on fiscal consolidation at an annual rate of 1 percent of GDP for between 3 and 7 years –depending on the initial fiscal imbalance - in addition to the removal of any fiscal stimulus. Some economists argue that, from the perspective of debt management, a balanced budget over the business cycle is appropriate. This argument recognises that in a downturn automatic stabilisers operate, which drive up the budget deficit, whereas the process operates in reverse in an upturn. These OECD simulations represent a more extreme form of fiscal policy in that it is pro-cyclical, being designed to both remove the discretionary stimulus and offset the budgetary impact of the automatic stabilisers.

Despite OECD support for fiscal stimulus packages to counteract the private expenditure shock, the impact of fiscal consolidation on output growth is finessed. Over the MT scenario, 2011-2017, ‘output gaps are closed as a result of sustained above-trend-growth (despite significant fiscal consolidation)’ (OECD, 2009c:227).13 OECD (2010a:6, footnote 4) is more bullish ‘Even large fiscal contractions can be expansionary because they signal a permanent and decisive change in fiscal policy’, which is linked to greater public acceptance when ‘times are obviously precarious’. By contrast, IMF (2010:45) acknowledges that the removal of the US stimulus will reduce growth in 2011. OECD (2010a:8-11) cites a number of countries which successfully undertook large multi-year adjustments to their fiscal positions, but their impact on growth and unemployment is not analysed.

OECD (2009c:219) asserts that, following a deep recession, the substantial rise in unemployment is partially translated into higher structural unemployment (and lower potential output) via hysteresis effects. Short term unemployment is found to be four times more potent than long term unemployment (LTU) in its impact on wage inflation, so that (conservatively) 66 percent of any rise in LTU is structural, thereby reducing potential output. Thus the unemployment rate corresponding to close to potential output being produced is much higher after a deep recession and the persistence of this high unemployment is at face value largely a structural problem.

OECD (2009c:230) states that, when unemployments are closed as a result of sustained above-trend-growth (despite significant fiscal consolidation)’ (OECD, 2009c:227).13 OECD (2010a:6, footnote 4) is more bullish ‘Even large fiscal contractions can be expansionary because they signal a permanent and decisive change in fiscal policy’, which is linked to greater public acceptance when ‘times are obviously precarious’. By contrast, IMF (2010:45) acknowledges that the removal of the US stimulus will reduce growth in 2011. OECD (2010a:8-11) cites a number of countries which successfully undertook large multi-year adjustments to their fiscal positions, but their impact on growth and unemployment is not analysed.

In the OECD MT scenario, unemployment falls in all countries after 2010, but remains above pre-crisis levels in most European countries. ‘This stems from the assumption that hysteresis effects are asymmetric in the sense that they tend to raise the NAIRU when unemployment rises, but do not lower the NAIRU when unemployment falls’ (OECD, 2009c:230). This assumption errs ‘on the cautious side’, so that without the asymmetry, both potential and actual growth would have been higher and unemployment lower. Thus, by exaggerating the impact of the deep recession on potential output, via an asymmetric hysteretic process, OECD (2009c)
has denied any role for aggregate demand management, because output is allegedly in line with potential by 2017, so there is no cyclical unemployment! Higher structural unemployment then reaffirms the need for more structural reform (OECD, 2009c:214), rather than stimulatory fiscal policy. An alternative view is that economies do not have an automatic tendency to equilibrate at the empirically elusive NAIRU, so a higher level of potential output than is implied by the OECD, due to the presence of symmetric hysteresis effects, would reveal a higher output gap and thus greater cyclical unemployment, thereby justifying stimulatory policy.

Three fiscal strategies are outlined. The most extreme, the structural reform scenario, ‘includes, in addition to fiscal consolidation, a set of reforms that ….. would gradually reduce savings in countries with large current account surpluses and discourage consumption in deficit countries.’ (OECD (2010b:3). Notwithstanding the reduction in domestic expenditure in countries experiencing current account deficits, this scenario also incorporates a cut in the structural unemployment rate in the Eurozone by 2 percentage points over eight years (2010b:4). Thus, despite poor outcomes for OECD economies noted earlier, reforms can significantly reduce structural, and, by implication, actual unemployment rates.

By contrast, the business-as-usual scenario is based on gradual fiscal consolidation. Higher government indebtedness would dampen medium-term growth for OECD countries, due to higher long term interest rates, as outlined above, even though the underlying empirical work is based solely on Eurozone countries. OECD (2010b) concludes that the structural reform scenario outperforms the business-as-usual scenario with respect to growth, government indebtedness and the current account for the period 2021-2025. There is no analysis of the intervening decade and relative unemployment rates are not quoted. Again heroic assumptions are made about structural unemployment.

The IMF (2010a:56) suggests the consideration of common fiscal rules, including ‘close monitoring of fiscal policies and public balance sheets’. This is somewhat ironic since the SGP limits on debt and deficit to GDP ratios have been quite counterproductive.

4.3 A critique

Fiscal sustainability is based on the flawed principle that, like households, governments face an intertemporal budget constraint (Fulwiler 2006). Applying principles of functional finance developed by Abba Lerner (Forstater, 1999), Wray (1998) and Mitchell and Muysken (2008), we argue that, under a floating exchange rate (so that monetary policy is freed from the need to defend foreign exchange reserves) and the monopoly provision of fiat currency by a national government, there are no formal constraints on government spending. This spending is the source of funds that the private sector needs to pay its taxes and to net save.

Inferences drawn from the OECD (2010b) econometric work, outlined above, cannot be applied to non-Eurozone countries with their own fiat currencies. Ceteris paribus, running fiscal deficits increases banking system reserves and places downward pressure on short term (overnight) interest rates in these countries. This can compromise monetary policy and may necessitate the sale of interest bearing government bonds to remove the excess reserves, rather than to finance net government spending (Mitchell and Muysken, 2008). Further, taxpayers do not fund
government spending (cf. OECD, 2010:5; Price, 2010). By contrast, Eurozone countries are subject to a monetary system incorporating a common currency. These countries must borrow to run budget deficits and are subject to SGP rules.

These principles explain how Japan has run persistent deficits, resulting in the largest debt to GDP ratio in the developed world, yet its official interest rate has been below 1 percent since the end of 1995, and yields on 10 year government bonds have been below 2 percent since mid-1999. Hence the claim that ‘In the absence of a plan, creditors will eventually begin to demand an increasing risk premium for holding government debt, which could slow or even choke off the recovery.’ (OECD, 2010:18) is fundamentally wrong.16

Also pursuit of a balanced budget over the cycle is inconsistent with sustained full employment, because, unless the economy is able to achieve large persistent trade surpluses, the required budget surplus at full employment means that the private sector has a net deficit (i.e. saving less than investment), which translates into increasing indebtedness, while full employment is sustained. Further, a balanced budget cannot be construed as a universal, prudent fiscal policy, because in aggregate there is necessarily balanced trade.

Thus, subject to an effective counter-inflation strategy (Mitchell, 1998), a government, operating with its own fiat currency under flexible exchange rates, should run budget deficits to fill any spending gap at full employment. The setting of government spending and taxation parameters is not constrained by past budgetary decisions. The failure to run deficits of sufficient magnitude means that either an economy does not achieve full employment or its private sector becomes increasingly indebted, as noted above, which ultimately leads to a harsh correction via reduced spending when the private sector decides to restore its balance sheets. This has been graphically illustrated by the impact of the GFC on OECD economies, and the consequence for fiscal balances.

Mitchell (1998) argues that the lowest fiscal stimulus required to achieve full employment is to guarantee all unemployed workers a job at the minimum wage. In contrast to Keynesian pump priming, a Job Guarantee (JG) is perfectly calibrated to the level of unemployment, since a job is only created when an unemployed person seeks a job. Thus debates over the timing and magnitude of fiscal stimulus packages and when they should be phased out are redundant. Also the victims of economic fluctuations are targeted, namely the unemployed.

If the common currency is to be retained, EU members should scrap the SGP and introduce a supranational fiscal authority that can spend like a sovereign government and address deficient aggregate demand (Mitchell, 2010b). Then macroeconomic policy could be geared to the achievement of full employment in member countries, but Eurozone countries would have to forego all policy sovereignty.

5. Conclusion

We concur with Dostal (2004) that an OD perspective informs our understanding of the OECD’s operation. Adherence to a neo-liberal policy framework is necessary for the organisation to maintain both its authoritative voice in its specific areas of policy expertise and its influence in broader policy networks. However, there is not a
dynamic competition of ideas between the main IGOs over the conduct of macroeconomic policy.

Despite the OECD apparently exercising considerable trans-national authority in the formulation of a policy framework, its attempts to impose a neo-liberal policy blueprint on member states have not been successful. Even where there appears to be a consensus concerning the efficacy of certain recommendations, implementation practices differ significantly across countries. Given that the organization only has the powers of moral suasion, this is unsurprising. OECD macroeconomic policy prescription remains broadly consistent with the Jobs Study blueprint, so while fiscal stimulus packages were considered appropriate in some countries to address the GFC, the OECD now emphasises fiscal sustainability through MT fiscal consolidation.

The recent policy documents from the OECD (and other IGOs) reveal inconsistent and unconvincing arguments for fiscal consolidation. This example highlights the critical role of symbolic language in the presentation of policy arguments. Also the power of discursive repetition should not be underestimated (Dostal, 2004:445) in reproducing the power structures embodied in discourse (Lehtonen, 2009).

Lehtonen (2009:397) speculates whether ‘the current crisis may provide an opportunity within the OECD for alternative views and marginalised discourses to be heard’. The evidence provided in this paper would suggest that vested interests are continuing to perpetuate a macroeconomic orthodoxy in which the public purpose of enhanced social and economic welfare has been dismissed due to the alleged imperative for sound public finance. A comprehensive macroeconomic framework underpinned by functional finance principles has been summarised. The absence of widespread debate about alternative policy options reflects poorly on the economics profession, but highlights the potency of Organisational Discourse.
References


Mitchell, W.F. (2010a) People are now dying as the deficit terrorists ramp up their attacks, Billy Blog – alternative economic thinking, 6 May. http://bilbo.economicoutlook.net/blog/?p=9632


OECD (2008a) Growing Unequal?: Income Distribution and Poverty in OECD Countries


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Governance is ‘a variety of mechanisms of regulation, operating in the absence of an overarching political authority’ (Mahon and McBride, 2009).

Thus, we reject state-centric rationalist theories of international cooperation (Porter and Webb, 2007:3).

OECD (2009b:14-16) documents new social, financial and other economic statistics to assist in new policy formulation in response to the GFC.

The IMF promoted the adoption of a global fiscal stimulus, but recognized the financial constraints facing some countries and the need for longer term commitment to fiscal discipline (Freedman et al, 2009). ECB (2009) also acknowledged that fiscal policy action was ‘largely justified’, but cautioned that EU countries had obligations under the Treaty and SGP requiring that ‘fiscal policies are conducted within a predictable, medium-term oriented framework’.

For example, ‘The record suggests that the 1994 Jobs Strategy remains an effective tool to strengthen labour market performance. Indeed, reforming countries have in general done better in reducing unemployment’ (OECD, 2006b:9).

By full employment, we mean all those workers who wish to work at the going wages and conditions can do so. We do not mean a NAIRU based level of unemployment.

The views of Layard et al (1991) were influential in the composition of the Jobs Study.

After a cyclical shock, unemployment rises, and if stimulatory policy is not introduced, long term unemployment also rises along with skill atrophy and lower capital investment. Consequently many unemployed workers no longer constitute an alternative labour supply, thereby raising structural unemployment and hence the NAIRU, which lags behind the actual unemployment rate. This is defined as hysteresis.

In an OECD Working Paper (Price, 2010) this word does not appear at all.

Similarly IMF (2010) emphasises the importance of implementing MT fiscal consolidation strategies in 2011, but with fiscal stimulus measures planned in 2010 to be fully implemented, except in countries suffering large increases in risk premiums. The apparently severe Japanese debt problems are noted, but again criticism is muted: ‘developing and communicating credible medium-term consolidation plans would be advisable.’ (IMF, 2010:51).

For example, Ireland is required to restore its budget deficit to 3 percent of GDP or better by 2013.
Likewise, in reference to U.S. fiscal imbalance, IMF (2010:46) recommends ‘a credible plan for fiscal sustainability … to limit the risk of rising long-term interest rates, which would dampen growth’.

Likewise the UK Office for Budget Responsibility (2010) forecasts that by 2015, total employment will have risen an unprecedented 1.3 million despite fiscal austerity measures being adopted by the Cameron Government.

Long-term interest rates are assumed to increase by 4 basis points (1 basis point for Japan) for every additional percentage point increase in the government debt-to-GDP ratio above 75% of GDP’ (OECD, 2010b:3). The smaller increase for Japan is not explained.

Members of the Centre of Full Employment and Equity, headed by Mitchell, and other scholars have written extensively about the conduct of macroeconomic policy (see http://e1.newcastle.edu.au/coffee/index.cfm).

Even if sovereign governments choose to have limited influence over the term structure of interest rates, compromising public purpose in response to the possible adverse reactions of financial markets is an abrogation of their responsibility for the welfare of their citizens.