

2nd High-level Conference on Industrial Competitiveness
Brussels, Monday 26 April 2010
Impulse statement by Jorgen Elmeskov, OECD

This session is meant to focus on what we have learnt from the crisis and the policy response. I guess we have all learnt a lot, so I will have to be selective. I will give you nine lessons, which is as much as I have time for.

The first lesson relates to the situation before the crisis and is that **inflation can look docile even as a dangerous bubble is inflating**. This raises the question whether it is enough for monetary policy to focus on stabilising inflation? Or, whether it should sometimes lean against credit and asset price developments? I think we need a new policy paradigm that articulates the relation between monetary policy will sometimes have to lean but within limits.

The second lesson is that **public budgets can be in danger although they look good**. We now know – and, frankly, some of us knew before the crisis but were not listened to – that public budgets can be flattered a lot by high asset prices and by distorted saving and investment patterns in the private sector. Not only that, what starts out as a private leverage problem has a habit of becoming a public debt problem. Countries need to build in safety margins in public budgets to deal with these issues. And that should of course also be reflected in European surveillance processes.

The third lesson is that **one should not ignore current account imbalances**. They can be there for good or for bad reasons. Some of the pre-crisis imbalances were clearly there for bad reasons and contributed to the build-up to the crisis. Think of the structural policy weaknesses that boosted private sector saving and the current account in China. Or of the US double deficit which signalled that fiscal policy was too weak. Or some of the imbalances inside the euro area. It is worth keeping in mind that where there are deficits there must also be surpluses. And that the fault does not always lie exclusively with the deficit countries although they are usually the ones that are hit by financial market pressures.

The fourth lesson is that **prudential policies matter**. Countries with otherwise similar policies up to the crisis had very different financial market fall-outs after the crisis. Compare for example the US and Canada, or Germany and Australia. We have learnt that bad regulation and supervision is indeed bad. It is important that we learn that lesson and not that markets are bad.

The fifth lesson, and here we move to the crisis itself, is that **trouble travels fast in a globalised world**. Shocks spill over across borders through trade and capital flows which have become more important. This time cross-border credit losses and mark-to-market losses that hit bank balance sheets were also important. An implication is that individual countries have a much stronger interest in understanding what goes on elsewhere so as to be able to either influence it or build robustness to it.

The sixth lesson, and here we move to the policy response, is that **old-fashioned Keynesian pump-priming actually works in extreme circumstances**. The fiscal packages were crucial in avoiding disaster. But pump-priming leaves a hang over, when public budgets are weak to begin with. And it worked so well partly because interest rates were at the zero floor. It is unlikely to work so well in different circumstances. Countries now need to get public debt back down again so that when disaster strikes again they can respond.

The seventh lesson, is that **well anchored inflation expectations are crucial**. Well anchored inflation expectations allowed monetary policy to react swiftly and forcefully to the crisis. They may also have helped avoid deflation. The upshot is that this is one boat one does not want to rock.

The eight lesson, is that the **non-OECD economies have become a lot more important**. What is more, many of them are now well run which allowed them to take forceful policy action to stimulate their economies. That helped OECD economies a lot. Given the larger weight of the non-OECD what is happening in these economies will have increasing importance in OECD economies.

Which brings me to my ninth lesson, which is that **lessons are sometimes learnt**. We have not seen the mistakes in this crisis, that we saw in previous deep downturns. I am thinking about protectionist measures and the introduction of early retirement schemes. Lessons seem to have been learnt. It is important that they keep being remembered.