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## *Just as in the 1970s, economic policy needs to adjust to underlying change in the global economy*

2016 is off to a turbulent start. There has been market chaos in China, spreading to global markets on the basis of concerns about the outlook for the RMB and China's growth, and the oil price has been in freefall, signalling concerns about global growth.

Even by recent elevated standards, there is an unusually high level of uncertainty about the global economic outlook. View from serious commentators range from a hard landing in China, a US recession, and the unwinding of European integration; to views that the current turbulence is more sentiment-driven than fundamentals-based and that growth – while not stellar – is reasonable and moving in the right direction.

In such an environment of deep uncertainty, it is not surprising that there is policy confusion and large swings in asset prices. Policy-makers and investors are trying to make sense of a landscape that is increasingly unfamiliar and where they are being confronted by a wide array of economic and political challenges. That crises are coming in battalions, not as single spies, suggests that structural economic and political dislocation is underway.

### *1970s redux*

To provide a perspective on these dynamics, it is helpful to consider insights from the historical experience. In particular, the 1970s offer some interesting parallels to the current context.

Four decades ago there was also unprecedented turbulence in oil markets and inflation shocks (albeit in the opposite direction from the current situation of tumbling oil prices and widespread deflationary forces). There was slowing growth and rising unemployment, after 30 years of strong post-war recovery in Europe and elsewhere across the developed world. There were large, growing fiscal deficits in many countries as governments tried to respond to weak economic performance, as well as major external imbalances.

These pressures reflected a fundamental process of transition. The conventional macroeconomic policy approach – the Keynesian Consensus that emphasised economic management through fiscal policy – was breaking down, delivering slowing growth, rising inflation and high unemployment. And the US had unilaterally moved away from the fixed exchange rate regime that had underpinned the post-war global system, leading to a turbulent breakdown in the Bretton Woods exchange rates arrangements.

The underlying nature of the global economic and political system was changing, leading to a loss of effectiveness in the traditional policy instruments. The global economy was becoming more complex and connected with the growth of emerging markets, new technologies, and increasing cross-border flows. Even when conventional economic policies were pushed to extremes, with large fiscal deficits and loose monetary policy, they were insufficient to address the emerging challenges.

A key insight from the 1970s is that particular policy approaches are not right for all time: there are periodic swings in policy effectiveness as the challenges that policies were designed to address also change. The consensus works for a period, and then stops working as well as the world changes. Just as the 1930s had seen disruptive change, with a new policy consensus emerging subsequently, so the 1970s were also a time of fundamental change. Over the next decade, there was a pronounced shift towards a different policy approach that was better suited to an era of fast-paced globalisation.

#### *Another process of transition*

Four decades on in 2016, there are similarities in terms of the underlying dynamics. As then, the global economy has faltered after a sustained period of strong growth. Over the past several years, fiscal policy, and particularly monetary policy, has been pushed beyond conventional limits as governments and central banks have tried to boost growth. These policies are buying time for the global economy, albeit at the cost of creating economic and financial risks, but are not the answer to weak economic performance.

As in the 1970s, this experience signals an underlying change in the functioning of the economy. To this extent, we need to recalibrate our mental models on how the world works and identify policy approaches that are appropriate for the emerging challenges and opportunities. Policy-makers cannot continue to use conventional policy tools for policy challenges that are increasingly unconventional.

Of course, as in the past, it will take time for a new policy consensus to form. And the journey is likely to be bumpy. But there are early signs of policy experimentation as governments around the world wrestle with emerging challenges and opportunities. For example: more active management of international economic integration, particularly with respect to the effects of cross-border capital flows; re-thinking social insurance to adapt it to the more rapid pace of technological change; and rebalancing from demand side policies to investment in innovation, human capital and infrastructure.

Small countries are a good place to look to get a sense of the policy direction of travel. Small advanced economies, including Singapore, are acutely exposed to structural changes in the global economy and are seeing new challenges and opportunities emerge quickly. Already some small countries are at the policy frontier on measures from macro-prudential policy to initiatives that respond to the changing nature of work. Small economy governments are searching for sustainable responses to the emerging structural risks and challenges need to be developed, as well as focusing on investing to capture the many emerging opportunities.

Many small countries did not respond effectively to the initial impact of the challenges in the 1970s. From New Zealand to the Nordics, there was a reliance on loose macroeconomic policy and defensive measures, such as protectionism, to protect domestic activity from these shocks. It was a short-term response to a structural change. But in the 1980s it was small advanced economies that were in the forefront of policy innovation, often leading the way for larger economies to adapt to a new era of globalisation. Small advanced economies should aspire to respond more rapidly and creatively to the current set of challenges than 40 years ago.

*Implications*

This has direct implications for Singapore's economic policy debate. The changes in the global economy are structural, and the policy approaches required to respond effectively will likely have some material differences from the policies that have worked well over the past few decades.

In this sense, the Committee on the Future Economy is a timely process and it should make space for serious discussion of the structural changes that are underway. Singapore's policy model has been very well suited to the global economic environment that has prevailed over the past few decades. But as the global economy changes, Singapore needs to adapt to ensure that its policy approach remains relevant. Making incremental improvements to aspects of an economic policy model that has worked successfully for many years may not be sufficient.

In a similar way to the 1970s, the current pressures and policy uncertainties reflect an underlying process of transition. History suggests that the countries that will do best are those that are able to most effectively and quickly adapt their policy approaches to the new realities. Singapore, as with other small country governments, should ensure that its policies are appropriately calibrated for this emerging environment.

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## About the author

Dr David Skilling is the founding Director of Landfall Strategy Group, which was established in 2011. David advises governments, companies, and financial institutions in several small countries, and writes regularly on global macro, globalisation and geopolitics from a small country perspective. David has recently served as Senior Advisor to the Secretary of Foreign Affairs & Trade in New Zealand, and as a Fellow at Singapore's Civil Service College. Previously, David was an Associate Principal with McKinsey & Company in Singapore, as well as being a Senior Fellow with the McKinsey Global Institute. Before joining McKinsey, David was the founding Chief Executive of the New Zealand Institute, a privately-funded, non-partisan think-tank. Until 2003, David was a Principal Advisor at the New Zealand Treasury. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce degree in Economics from the University of Auckland. David was named as a Young Global Leader by the World Economic Forum in 2008.

## About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides advice on strategic issues to governments, firms, and financial institutions, particularly in small advanced economies. We provide distinctive perspectives on emerging global trends, working with decision-makers to understand key global changes and how governments, firms, and institutions should respond and position themselves in the emerging global economic and political environment.

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