

Can economic surveillance make a difference? Insights from the OECD

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Abstract

This paper summarizes the results of a larger study evaluating the effectiveness of OECD economic surveillance in 24 randomly selected countries. Because the OECD's advice is only backed by peer pressure, we would expect little evidence that this advice leads countries to adopt policy reforms. Through evaluating subsamples of cases of countries under economic crisis, exploiting within-country variation, and drawing comparisons with more legalized international organizations, we conclude that surveillance can indeed lead to policy reform**.

Policy Implications

- Surveillance through peer review can be useful in building support for economic policy reform, especially for countries facing economic crisis.
- The global economic crisis helps to demonstrate the value of the OECD as an organization that gives members advice on appropriate policies.
- The differences in effectiveness between international organizations using hard and soft law can be overstated.
- The proliferation of international organizations relying on surveillance should not concern policy makers; these findings suggest that these organizations can produce useful advice.

Many international organizations include some sort of system for monitoring and surveillance of member countries as a design feature. We see this in the Article IV procedures of the International Monetary Fund, through the World Trade Organization's Trade Policy Review Mechanism, and in regional organizations as well. Even the G20 has been developing its own Mutual Assessment Process to countries coordinate their macroeconomic policies.

If economic surveillance by international organizations is here to stay, does it in fact work? To answer this, a group of students from the John C. Whitehead School of Diplomacy and International Relations at Seton Hall University developed an assessment of economic surveillance as practiced by the Organization for Economic Co-operation and Development (OECD). The OECD publishes reports every 18 months on the economic situation in each of its 34 member countries. Based on its assessment of the economic situation, each Economic Survey provides detailed recommendations for subsequent economic reforms. These recommendations follow roughly the same pattern for all states. They tend to be neo-liberal, with a strong focus on reducing budget deficits, cutting regulations, and reducing barriers to the private sector. OECD recommendations also touch on broader areas such as climate change, health care, education, and social policy.

This paper builds on a larger study of OECD surveillance in 24 countries that we've completed. The full report is available on the project's [website](#). Below, we offer several pieces of evidence answering the above question in the affirmative. First, we summarize the overall results of our larger study. This establishes an important baseline for our analysis. Second, we compare the rate of OECD recommendation adoption between countries under and not under economic crisis. We find levels of reform adoption increase when countries face economic downturns. Third, we use our data to develop a paired comparison of countries under and not under economic crisis over time, and find that the rate of reform adoption increases. Finally, we compare our findings with evidence from similar studies about the effectiveness of IMF conditionality. Taken as a

whole, our findings suggest that surveillance can indeed make a difference.

Why are we researching this topic?

As the global economic crisis continues, the international organizations in charge of managing the global economy attract added scrutiny. The OECD works as a forum for economic advice, and at this time it is surely worth asking what the impact of this advice has been across member states. Economic reforms are seldom easy to implement, even when times are good, and evaluating OECD surveillance at this time in our history, when politicians have to balance domestic and international imperatives, seems especially vital. Understanding the influence of the OECD, then, especially when economic conditions are difficult, is a serious matter.

In addition, this question speaks to the OECD's own increasingly ambivalent status. Having recently celebrated its 50th anniversary, it now operates in a world in which the distribution of power is shifting away from member countries of the US and Europe and more toward emerging markets, which are not official members. This has given rise to a spirited debate over the OECD's very future (Clifton and Diaz-Fuentes 2011 a-c; Gurria 2011; Mahbuhani 2012). In light of this broader debate, a more focused appraisal of its surveillance can better help us assess the benefits of such an organization moving forward.

There are broader theoretical issues at stake as well. The OECD's recommendations are just that: they are not binding for member countries and there is no mechanism to ensure that states fully adopt the recommendations in the Economic Survey. This approach to designing international organizations is often known as soft law (Abbott, Keohane, Moravcsik, Slaughter, and Snidal 2000; Abbott and Snidal 2000). Soft law represents international rules that do not impose obligations on member countries. Perhaps paradoxically, scholars have noted that international organizations that operate in a soft law setting can achieve considerable benefits. First, countries may be more apt to accept soft law recommendations because they tend to infringe less on state sovereignty (Schafer 2006). Under soft law treaties, countries may still make commitments while maintaining a relatively large amount of independence. Second,

soft law makes OECD recommendations more likely to be incorporated into domestic policy because the international level agreement is more flexible (Schafer 2006). Finally, for an organization that relies on peer review from a relatively homogenous membership, soft law allows for policy learning. Countries can take suggestions about best practices to address policy challenges in a way that allows for experimentation. For example, the recent survey of the United States found that it has the fourth-highest level of income inequality among OECD countries (OECD 2012). Such benchmarks can elevate discussion from whether a problem actually exists to which policies could redress it. Given these distinctions from hard law, soft law allows the OECD to make recommendations without completely alienating countries' willingness to participate.

The lack of strict consequences for failing to implement the OECD's recommendations, then, makes this project theoretically relevant as well. It suggests that the rate of adoption of these recommendations is likely to be low. It also further implies that the constraints of the global economic crisis are certain to further weaken the influence of OECD surveillance. In turn, this raises broader policy questions about the downsides of soft law as a tool of international integration.

Surveillance and study design

Surveillance in the OECD is driven by peer review, which can be defined as an assessment of one country by a group of other countries typically operating under similar parameters (OECD 2007). While the initial country reports are written by OECD staff working in close conjunction with the member country, the reports are ultimately discussed and debated by the full membership, with other members chosen as questioners that take the lead on discussing the review. Following these discussions, the final version of the economic survey is prepared and released.

Effective peer review involves value sharing within the member countries for purposes of evaluation, mutual trust regarding the dissemination of accurate data, confirmation of a standard level of commitment from the member states, and credibility by the OECD as an established organization (Pagani 2002). Transparency serves as a 'force multiplier' for peer review. Making policy

recommendations public can produce discomfort for noncompliant states, encouraging them to comply with at least some portion of the recommendations.

Peer review also gains strength when state delegates serve in posts that require them to oversee OECD recommendations. These civil servants often collaborate with experts and also perform other council duties through postings at OECD headquarters in Paris (Woodward 2009). This serves to both socialize country civil servants into how the process works as well as legitimate it (Marcussen 2004). States are thereby subtly pressured to come to terms with the findings, not only by their peers, but also by their own personnel.

Scholars studying surveillance in other international organizations have adopted various approaches to measure its impact. Rather than rely on interviews with decisionmakers (Momani 2006) or econometric analyses (Glennerster and Shin 2008; Fratzscher and Reynaud 2010), our research strategy to assess the impact of OECD recommendations was inspired by the International Monetary Fund's recent Triennial Surveillance Review, which relied on an analysis of primary documents. Our goal was to ascertain the advice that the OECD gave to a country in a given year, and then assess the extent to which that advice was adopted by the time of a subsequent review. Our source material was the Economic Surveys that the OECD produces for member countries about every 18 months. All of these surveys were downloaded directly from the OECD's I-Library website.

We measured the effectiveness of surveillance by counting the number of recommendations made by the OECD on a given economic issue (fiscal policy, monetary policy, etc.) and tabulating the percentage of them that were adopted. Any official policy change in the spirit of the past OECD recommendations, even if it did not fully meet the recommendation, was considered adopted. This meant that we could not distinguish between those recommendations adopted in full and those adopted only in part. It did, however, give us a view of the total impact of the recommendations, and it also allowed us to avoid any charges of stacking the deck by adopting an overly demanding standard for implementation. Thus our final

definition for “adopted” included legislation that had been approved and met the recommendation in full or in part, bureaucratic rule changes that had been approved and met the recommendation in full or in part, and occasionally a private sector change (for example, by an industry association or trade union) that had been approved and met the recommendation in full or in part.

We also saw evidence of OECD recommendations that were being considered, but had not yet been adopted by the member country. Measures that were considered to be pending, proposed, or under review were not yet policy and might never become policy. However, ignoring these instances would understate the OECD’s impact. For this reason, the percentage of measures that were pending, proposed, or under review was calculated separately. The complete list of OECD recommendations was found in a table in each country survey typically labeled “Progress in Structural Reform.” Our measure was based on

coding the two most recent surveys provided for each of 24 OECD member countries.

Project team members were randomly assigned to two OECD countries. Each country, then, was treated by two students working separately, who independently read the three most recent OECD surveys for their countries and coded each recommendation for each survey as either adopted or pending. The list of the 24 countries in our study appears in Table 1.

Once the initial country reports were completed, both members of each country team met to streamline areas of approval and discuss areas of disagreement. This built redundancy directly into our work and allowed us to check the robustness of our codings. We have made all of the data publicly available on the project’s website: <http://OECDproject.wordpress.com>.

Table 1. Countries Studied			
Australia	France	Italy	Slovakia
Austria	Germany	Japan	Spain
Canada	Greece	Korea	Sweden
Chile	Hungary	Mexico	Turkey
Czech Republic	Iceland	Norway	United Kingdom
Denmark	Ireland	Portugal	United States
Source: Whitehead OECD Project			

Findings

We briefly summarize some of the key findings from the larger study. In each OECD Economic Survey, OECD member countries received anywhere from 35 to 117 recommendations regarding fiscal policy, social policy, the financial sector, and market competition. To demonstrate the extensiveness of the OECD's recommendations and to put these findings into context, we provide some examples below. The advice that the OECD is giving to member states is both far reaching and detailed in scope.

In the area of fiscal policy, the following recommendation appeared in Austria's 2009 Economic Survey: Excise duties on alcohol, mineral oil, and tobacco and cigarettes should be raised. Petrol prices at the pump should be raised to the higher levels prevailing in neighboring countries. Government permits for the emission of CO₂ and other greenhouse gases should be auctioned.

In the area of social policy, the following recommendation appeared in the 2010 Economic Survey of the United States: The No Child Left behind (NCLB) framework of standards, assessment and accountability should be extended through upper secondary education.

In the area of the financial sector, the following recommendation appeared in the 2009 Economic Survey of Japan: Improve the taxation of financial income to make it fair and neutral and upgrade financial education to promote the development of capital markets.

In the area of market competition, the following recommendation appeared in France's 2011 Economic Survey: Simplify entry conditions in certain professions, either by reducing the field of activities over which they hold exclusive rights (architects, notaries, bailiffs) or by reconsidering the required years of study (architects, veterinarians, hairdressers).

Out of the twenty-four OECD member countries surveyed, using the two most recent OECD Economic Surveys—spaced roughly 18 months apart—for each country, the OECD made 1,680 unique recommendations to member countries; an average of 70 recommendations per country. Countries such as Japan and Korea had as many as 117 and 114 recommendations respectively, while countries such as France and Turkey had far fewer, with 48 and 35 recommendations. The median of total recommendations made was 62.

With regard to overall effectiveness of OECD recommendations, we found that member countries adopted 52% of all recommendations made by the OECD. In this study, adopted means any official policy change, regardless of magnitude, in the spirit of prior OECD recommendations. The median level of adoption was 53%. The percent range of recommendations adopted was high, at 50%, with Portugal having adopted the most at 75% and Slovakia having adopted the least at 25%. There were no outliers found within two standard deviations from the mean.

Secondly, we discovered that 28% of all OECD recommendations were coded as pending. The mean percentage of all pending recommendations was 29%, with a median of 27%. The percent range of recommendations pending was 46%, with 61% of recommendations found pending for United Kingdom and 15%. There is only one outlier found in the dataset, the United Kingdom, being outside two standard deviations from the mean at 61%.

These findings raise a simple question. If countries only adopt one-half of the OECD's recommendations, how can one argue that surveillance is consequential? The challenge is an inferential one. We cannot know how many of these recommendations would have been adopted in the absence of the OECD. However, we can approach this problem indirectly through diligent case selection. The claim that OECD surveillance makes a difference gains strength not through looking at a large number of countries facing very different economic challenges, but rather through evaluating the record of surveillance implementation in countries in economic crisis. It is exactly in these situations that economic reforms will be hardest to implement, and we would expect that the level of implementation of OECD

recommendations would be lower in these countries.

The claim that economic policy reforms are hard to implement in challenging times may strike the reader as counterintuitive, but this is not hard to understand. Consider the case of fiscal reform, which is a conventional element in the OECD's advice. Politicians need to close a gap between revenue and expenditure by both raising taxes and cutting expenditures. The political problem is two-fold. First, this offends constituencies dependent on government programs such as subsidies or groups that are harmed by tax increases. Second, the gains from these programs accrue nationally (ostensibly in the form of higher economic growth) and only in the medium term. So the marginal costs of fiscal reforms far outstrip their marginal benefits. In this sense, then, economic reform in hard times is a political problem.

Such a situation is a conventional rationale for conditionality. Countries that are unable to implement austerity are likely to lose access to tranches of an IMF loan. In a case in which the advice is not backed by financial assistance and in which enforcement is unlikely, such as with the OECD, the case against economic reform is compelling. Thus, we expect fewer OECD recommendations adopted in countries facing economic hardships.

To answer this question, we compared the level of recommendation adoption between economic crisis countries and non-crisis countries. We classified a country as in an economic crisis if the country was under an International Monetary Fund adjustment program. Our list of crisis countries was taken from Appendix II of the International Monetary Fund's Annual Reports, which details all of the IMF borrowers in a given fiscal year. Using this data, we

coded five countries as crisis countries during years that an OECD Economic Survey was released. These are Greece (2011), Hungary (2010), Iceland (2009, 2011), Ireland (2009, 2011), and Turkey (2008, 2010). In addition, the IMF created a program called the Flexible Credit Line (FCL) in 2009, which Mexico entered in 2009, renewing its loans in both 2010 and 2011. This classifies it as a crisis country for its two most recent Economic Surveys. The effectiveness of OECD recommendations for these countries then is contrasted with the rest of our data. These findings can be seen in the table below.

First, when looking at net percentages for crisis countries compared to non-crisis countries, important changes can be discerned. The percentage of recommendations adopted in crisis countries was higher than their non-crisis counterparts. Crisis countries adopted 60% of their recommendations, while non-crisis countries adopted 51% of their recommendations. This variation is compelling. The conventional wisdom on economic reform suggests that political constraints tighten in economic crises, giving politicians less room to maneuver. Accordingly, it is quite sensible to suggest that the OECD's recommendations would be less likely to be adopted during years of economic crises. This finding is given greater strength when we consider the nature of the policy advice. The findings from the OECD Economic Surveys are vetted through a peer review process; member countries assess each other's performance. Because there are no monetary rewards for implementation, we would also expect the percentage of recommendations adopted to decrease in crisis years. Our finding that the level of adoption does not decrease, and in fact increases slightly, suggests a genuine impact of OECD surveillance.

Table 2. OECD Recommendation Adoption in Crisis and Non-Crisis Countries		
Crisis	Adopted	Pending
Greece 2011	62%	36%
Hungary 2010	73%	8%
Iceland	43%	23%
Ireland	51%	30%
Turkey	66%	20%
Mexico	66%	16%
TOTAL:	60%	22%
Non-Crisis Mean	51%	29%
Source: Whitehead OECD Project		

Another approach to this question is based on within-country comparisons. Both Greece and Hungary had an OECD Economic Survey conducted both before and during their crisis years. We will use these two instances to further examine directly the effectiveness the OECD had during periods of economic crisis. The two non-crisis years for Greece and Hungary will factor into the non-crisis data as well.

Greece received an IMF loan in 2011 (the IMF's fiscal year runs from April 2010 to April 2011), and Hungary received IMF assistance in both 2009 and 2010. The OECD's Economic Surveys for these countries were released for Greece in 2009 and 2011 and Hungary in 2007 and 2010. This gives us a chance to assess in an alternative fashion the OECD's effectiveness in crisis countries compared to non-crisis countries. When comparing Greece's data between the two reports, a clearer picture emerges. In the report prior to its IMF loan, Greece adopted 46% of OECD recommendations and 24% were categorized as pending. During Greece's time of crisis, it adopted 62% and 36% were classified as pending. This data demonstrates a 16% increase in adopted recommendations and 12% increase in those pending during times of crisis.

Hungary suggests a similar story. Before Hungary sought IMF assistance, it adopted 59% of OECD recommendations and had 28% pending. This is compared to 73% and 8% respectively during time of crisis. Like Greece, Hungary saw a substantial increase in acceptance of OECD recommendations in time of crisis with a 14% upsurge. The percentage of pending recommendations also fell by 20%. Comparing these cases before and during crisis builds on our earlier finding: crises are met with more effort in policy adoption on the part of countries, not less. The strongest possible test of a soft law regulatory body like the OECD is not when times are good. Rather, the key to ascertaining if the OECD "matters" is to assess its impact when times are hard. These crisis periods are those in which the disincentives to reform are highest. In these cases, the OECD should have less of an impact. Both these overall findings and the within-country comparisons suggest that this is precisely when OECD surveillance makes an important difference.

One important objection is worth nothing. A skeptic could argue that the OECD makes fewer demands on countries in crisis, so their level of adopting recommendations reflect not more effort, but less

work in accommodating less advice. On the whole, crisis countries averaged 31 recommendations per Economic Survey, compared to 36 recommendations for non-crisis countries. Pre-crisis Greece had 50 recommendations, contrast to 58 recommendations during crisis. Hungary, however, received 32 recommendations pre-crisis and only 26 during its crisis year. The data do not suggest that economic crises lessen the number of recommendations that the OECD makes. These findings suggest that countries are more willing to adhere to OECD's suggestions when they are experiencing extreme economic hardships, which goes against the conventional wisdom about economic reform, but also about soft law more generally.

One final piece of evidence to bolster our claim that OECD economic surveillance matters involves a different approach to thinking about the baseline for comparison. Our initial thinking was that the soft law nature of the surveillance process, coupled with the lack of financial incentives for adopting reforms, would result in finding little evidence that countries adopt the OECDs recommendations. Overall, we found that the OECD's recommendations are adopted about half of the time, and this increase to adopt 60% of the time when countries face economic crisis.

Another way to provide a baseline would be a comparison with other international organizations that rely on greater levels of enforcement. Arpac, Bird, and Mandilaras (2008) provide such a comparison by looking at the record of implementation of IMF conditionality. They evaluated the extent to which IMF programs negotiated between 1992 and 2004 with 95 member countries that suffered what they call "irreversible interruptions." These occur when scheduled reviews of a country's progress in implementing austerity fail to be conducted and countries lose access to further tranches of the loan. They find that IMF adjustment programs suffer from irreversible interruptions approximately 40% of the time.

In this light, comparing a soft law to a hard law organization, the fact that countries adopted over half of the OECD's recommendations is impressive. As we have mentioned, the scope of the recommendations that appear in the Economic

Surveys are substantive, covering a wide array of areas including banking, housing, taxation, and education policy. Finally, in evaluating the most challenging cases for an organization like the OECD, we found that the level of adoption increases when countries are experiencing economic crisis. Far from being just a talk shop, then, the OECD is providing useful advice to countries when they need it the most.

Broader Implications

Policy makers should not fear soft law surveillance. Our findings suggest that a peer review surveillance system can be effective in producing policy change. Rather than fearing that soft law means that countries won't adopt policy changes, the above evidence suggests that surveillance can aid policy makers in generating support for reforms. The fact that adoption of reforms goes up when countries are in economic crisis demonstrates the value of the OECDs advice.

We fully accept that this empirical overview does not answer the theoretical question of how OECD surveillance works. There are two possible arguments here. First, because every member country undergoes surveillance, peer review can lower the costs of policy adjustment. Because other countries are also adopting recommendations, reciprocity can be used to justify why economic reforms are necessary. Second, OECD surveillance aids policy adoption by encouraging the dissemination of best practices. Policymakers in the United States attempting to reduce structural unemployment can take a page from Germany's educational system and their focus on vocational education. Demonstrating that a policy has been tested abroad and generated needed results helps build a consensus for policy change.

The answer to this question is an important one. As noted above, the OECD faces a challenge of engagement with emerging market economies. As the OECD's membership becomes more heterogenous, whether surveillance in fact becomes less effective may well turn on the mechanism that turns peer review advice into policy action.

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