



GROUP OF TWENTY

GLOBAL PROSPECTS AND POLICY CHALLENGES

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EXECUTIVE SUMMARY

In an environment of increased uncertainty, three significant transitions weigh on the global outlook: (i) the Federal Reserve is poised to normalize monetary policy while other major currency areas will likely be easing further; (ii) China's economy is experiencing a needed moderation as it embarks on a historic and multi-year rebalancing of its growth model; and (iii) the decade-long commodity super cycle appears to be over. At the same time, international migration has become a pressing economic issue for both sending and receiving countries, particularly in light of the ongoing refugee crisis.

After a modest and uneven expansion in 2015, the global economy is expected to grow next year at 3.6 percent which, given sluggish global growth since the crisis, would be the fastest pace since 2011. The projection is contingent on a confluence of favorable factors, with major advanced economies continuing to benefit from supportive monetary conditions and lower commodity prices. After 5 years of decline—capped by a turbulent summer—emerging market economies would also be expected to pick up next year, as growth in distressed economies is less negative or recovers.

However, if the transitions are not successfully navigated, global growth could be derailed. Fed lift-off could increase financial market volatility, with potentially disruptive moves in capital flows and asset prices. While welcome, China's rebalancing is generating large global spillovers, and, notwithstanding the Chinese economy's sizable buffers, could be bumpy. For commodity exporters, persistently low prices will strain fiscal resources and dampen growth. With global economic prospects repeatedly marked down over the last five years, there is a concrete risk of a world economy persistently mired in sub-par growth, with unacceptably high levels of poverty and unemployment.

To secure a strong and durable recovery, policies need a decisive upgrade. G-20 members are grappling with difficult trade-offs in the face of limited room for maneuver and a need to adapt to new realities. This calls for a policy upgrade that combines structural reforms to raise future growth with effective demand-side measures that support today's growth and maintain stability.

- *Lifting today's growth.* Economic slack and very low inflation justify continued monetary accommodation in most major advanced economies. Meanwhile, fiscal policy needs to be more supportive where conditions allow, even as credible medium-term budget plans are put in place. In emerging and developing economies, demand support should be carefully weighed against the need to manage vulnerabilities.
- *Bolstering resilience.* At the global level, there is a pressing need to complete and implement the regulatory reform agenda—an important policy upgrade. Advanced economies should strengthen regulation and supervision of rapidly expanding financial activities outside the banking system. In emerging market and developing economies, solid policy frameworks will be crucial. Where feasible, exchange rate flexibility should serve as a shock absorber, with a temporary role for both intervention and capital flow management measures under more disorderly market conditions.
- *Safeguarding the future.* Decisive implementation of the G20's growth strategies agreed in Brisbane last year will be a significant policy upgrade. Measures to improve resource allocation and tackle structural rigidities are urgently needed to lift growth potential and improve living standards.
- *International cooperation.* China's economy needs to transition toward a slower, more sustainable growth path. A successful transition will benefit global growth and reduce tail risks. In the short run, the transition process is likely to entail spillovers through trade and commodities, which could be amplified by financial channels. Nonetheless, the international community should support China in this difficult endeavor. Collective efforts also need to be renewed to enhance the global safety net and strengthen the resilience of the International Monetary System. Implementing IMF quota and governance reforms would be crucial in this regard. Global cooperation is vital for addressing the large-scale displacement of people: policies include enhanced global development diplomacy to prevent, contain, and respond to humanitarian crises and more flexible and innovative financing instruments to ensure adequate and effective assistance.

DEVELOPMENTS, OUTLOOK, AND RISKS

Global growth in 2015 remains modest and uneven, as important transitions weigh on the outlook. These transitions include divergence of monetary policy in advanced economies, rebalancing in China, and the end of the global commodity super cycle. Global economic activity is projected to accelerate in 2016, reflecting the continuation of a modest recovery in advanced economies and a rebound in emerging markets, as the growth outlook in distressed economies gradually improves. However, growth remains fragile and could be derailed if transitions are not successfully navigated. In an environment of declining commodity prices, reduced capital flows to emerging markets, and higher financial market volatility, downside risks to the outlook remain elevated, particularly for emerging economies. Moreover, after repeated markdowns of potential output performance in recent years, medium-term risks of stagnation and of protracted sub-par global growth still remain.

1. **In an environment of increased uncertainty, three significant transitions weigh on the global outlook.** Specifically: (i) the Federal Reserve is poised to normalize monetary policy while other major currency areas will likely be easing further; (ii) China's economy is experiencing a needed moderation as it embarks on a historic and multi-year rebalancing of its growth model; and (iii) the decade-long commodity super cycle appears to be over. At the same time, international migration has become a pressing economic issue for both sending and receiving countries, particularly in light of the ongoing refugee crisis.

2. **After a modest and uneven expansion in 2015, the global economy is expected to grow next year at 3.6 percent, which, given sluggish global growth since the crisis, would be the fastest pace since 2011.** The projection is contingent on a confluence of favorable factors, with major advanced economies continuing to benefit from supportive monetary conditions and lower commodity prices. After 5 years of deceleration—capped by a turbulent summer—emerging market and developing economies would also be expected to pick up next year, as growth in distressed economies is less negative or recovers.

- *In **advanced economies**, growth is projected to increase modestly this and next year (Table 1). In the *United States*, growth is supported by lower energy prices, reduced fiscal drag, strengthened balance sheets, and an improving housing market, with the strength in domestic demand and associated robust labor market offsetting weaker net external demand. The moderate euro area recovery is projected to continue, sustained by lower oil prices, monetary easing, and the euro depreciation. The gradual pickup in growth in *Japan* reflects support from higher real compensation and higher equity prices due to the Bank of Japan's additional quantitative and qualitative easing, as well as lower oil and commodity prices. Growth is expected to be solid in the *United Kingdom*. However, the pickup in advanced economies is tempered by lower growth in commodity exporters and advanced Asia.*
- *In **emerging economies**, growth will decline for the fifth year in a row in 2015, before strengthening next year. Growth in *China* is expected to decline as excesses in real estate, credit, and investment continue to unwind. *India's* growth will benefit from recent policy reforms, a consequent pickup in investment, and lower commodity prices. In *Brazil*, weak business and consumer confidence amid difficult political conditions and a needed tightening in the*

macroeconomic policy stance are expected to weaken domestic demand, with investment declining particularly rapidly. In *Russia*, economic distress reflects the interaction of falling oil prices and international sanctions with preexisting structural weaknesses. Emerging-economy growth is projected to rebound in 2016, reflecting mostly a less deep recession or an improvement of conditions in countries in economic distress (e.g., Brazil, Russia, and some countries in Latin America and the Middle East). Strong domestic demand in India should also be a positive factor in 2016.

3. **However, if the world economy's transitions are not successfully navigated, global growth could be derailed.** Prominent risks include: negative spillovers from China's growth transition; further falls in commodity prices; adverse corporate balance-sheet effects and funding challenges related to dollar appreciation and tighter global financing conditions; and capital flow reversals. Any of these could substantially weaken the recovery, particularly in emerging and developing countries.

- *China's rebalancing is generating large spillovers, and notwithstanding the Chinese economy's sizable buffers, could be disruptive abroad.* Either a moderate slowdown or a harder landing over the medium term could produce sizable spillovers via slower global trade, a further weakening of commodity prices, and confidence effects. Lower commodity prices hurt commodity exporters and help importers, but if lower prices also lead to financial stress and broader contagion among commodity exporters, this could affect commodity importers negatively.
- *The Fed's lift-off could increase financial market volatility and lead to disruptive asset price shifts, possibly accompanied by capital flow reversals in emerging economies.* Long-term interest rate term premiums are historically low in some important advanced-economy bond markets, and a sharp decompression of those premiums could disrupt emerging-economy bond asset markets, already volatile owing to commodity-price declines and uncertainty over China's growth prospects.
- *Potential output could turn out lower than expected in both advanced and emerging economies.* In particular, productive capacity could be held back by more protracted weakness in investment, reflecting crisis legacies in advanced economies and structural constraints and less favorable external conditions for investment in emerging economies.
- *The risk of secular stagnation for advanced economies remains relevant in light of broadly depressed investment levels, crisis legacies, and uncertainty about future potential growth.*
- *At the same time, geopolitical tensions and associated spillovers need to be carefully managed.* Geopolitical risks, stemming from ongoing events in Russia/Ukraine, the Middle East and West Africa, could generate spillovers through disruptions in trade and financial transactions. International migration has also become a pressing economic issue for both sending and receiving countries (see the Annex to this note), especially in light of the ongoing refugees crisis.

POLICIES TO SECURE A STRONG AND DURABLE RECOVERY

To secure a strong and durable recovery, policies need a decisive upgrade. Raising both actual and potential output through a combination of demand support and structural reforms remains a key policy

objective. In advanced economies, accommodative monetary policy remains essential. Fiscal policy should be more supportive where conditions allow, even as credible medium-term budget plans are put in place. Many emerging economies have limited scope for monetary and fiscal policy to support growth, with inflation still above target in some economies, and fiscal positions weaker than desirable in others. Where feasible, exchange rate flexibility should serve as a shock absorber, with a temporary role for both intervention and capital flow management measures when market conditions turn disorderly. Joint efforts by deficit and surplus economies to rebalance global demand would reduce excess external imbalances while sustaining growth. Helping China in its difficult transition will also reduce tail risks and facilitate stronger, more durable global growth. Collective effort is also required to further enhance global safety nets and strengthen the International Monetary System.

POLICIES TO REACH FULL EMPLOYMENT AND REVERSE LOW INFLATION IN ADVANCED ECONOMIES

4. **Accommodative monetary policies remain essential in many advanced economies, given still sizable output gaps and low inflation.** With nominal policy rates still at or close to the zero lower bound in many economies, monetary policy must remain accommodative, including through unconventional measures, to reduce risks to activity from low inflation and prolonged weak demand. Accommodative monetary policies should be accompanied by efforts to strengthen balance sheets and credit supply, and by active macroprudential measures that address financial stability risks.

- In the *United States*, the main near-term policy question is the appropriate timing and pace of monetary policy normalization. The Federal Open Market Committee's (FOMC) decision should remain data-dependent, with the first increase in the federal funds rate waiting until continued strength in the labor market is accompanied by firm signs of inflation rising steadily toward the Federal Reserve's 2 percent medium-term inflation objective. An effective monetary policy communication strategy will remain essential, particularly in an environment of higher financial market volatility.
- In the *euro area*, the ECB's expanded asset purchase program has supported confidence and eased financial conditions, but inflation remains low. A strong commitment to fully implement the asset purchase program and adjust the program if needed will help meet ECB's price stability objective. These monetary policy efforts should be supported by measures to strengthen bank balance sheets and thereby improve monetary policy transmission and credit market conditions. Stricter treatment of nonperforming loans and measures to improve insolvency and foreclosure procedures are a priority in this regard.
- In *Japan*, the Bank of Japan should stand ready for further easing, preferably by extending purchases under its quantitative and qualitative monetary easing program to longer-maturity assets. The Bank of Japan should move to a more forecast-oriented monetary policy communication mode to increase the transparency of its price assessments and signal its commitment to the inflation target.

5. **Fiscal policy should be more supportive where conditions allow, even as credible plans to reduce public debt ratios over the longer run are put in place.** Public debt levels are at historic highs; managing them in a low-growth environment will be more challenging once interest rates normalize. Fiscal consolidation should remain growth friendly and be anchored in credible medium

term plans supported by well-designed fiscal frameworks. It should also protect the most vulnerable. In the *United States*, the priority remains to agree on a medium-term fiscal consolidation plan to prepare for rising aging-related costs, including higher tax revenue. The recent Congressional passage of a two-year budget, including a suspended debt ceiling, is a critical step to support the economy. In the *euro area*, countries should adhere to their commitments under EU fiscal rules, but those with fiscal space, notably Germany and the Netherlands, could do more to encourage growth, especially through much-needed public infrastructure investment and supporting structural reforms. In *Japan*, the announced medium-term fiscal consolidation plan provides a useful anchor to guide fiscal policy. The aim should be to put debt on a downward path, based on realistic assumptions and identifying specific revenue and expenditure measures.

POLICIES TO FOSTER GROWTH AND MANAGE VULNERABILITIES IN EMERGING ECONOMIES

6. **Emerging market economies need to strike an appropriate balance between fostering growth and managing vulnerabilities.** While higher foreign exchange reserves and generally stronger policy frameworks leave emerging economies better positioned to manage external shocks, they face a number of challenges and trade-offs. Policy considerations across economies include:

- In many net *commodity importers*, lower commodity prices have alleviated inflation pressure and reduced external vulnerabilities. While the tradeoff between supporting demand and reducing vulnerabilities has become less pronounced as a result, the scope for policy easing has declined as a number of central banks have already reduced interest rates over the past year.
- In *commodity exporters*, fiscal positions have deteriorated and external and fiscal vulnerabilities have increased. While the adjustment to lower commodity prices could be smoothed where fiscal buffers remain and fiscal frameworks are strong, with some of the commodity price decline expected to be permanent, so it will be important to plan for fiscal adjustment. Where inflation pressures are not a concern and large exchange rate depreciations have not affected inflation expectations, exchange rate flexibility can be exploited to mitigate shocks. For emerging economies hosting refugees, the associated fiscal costs pose an additional challenge to public finances (see the Annex).
- In *China*, the challenge is to achieve three objectives simultaneously: avoiding a sharp growth slowdown in the transition to more a sustainable growth model, reducing vulnerabilities from excess leverage after a credit and investment boom, and strengthening the role of market forces in the economy, including in the foreign exchange market. A successful transition will benefit global growth and reduce tail risk. In the short term, the transition process is likely to entail spillovers through trade and commodities, which could be amplified by financial channels. The international community should support China's efforts to reform and rebalance its economy, to give market mechanisms a more decisive role, to eliminate distortions, and to strengthen governance and institutions.

POLICIES TO BOLSTER RESILIENCE AND BOOST POTENTIAL OUTPUT AT A GLOBAL LEVEL

7. **Decisive implementation of the G-20's growth strategies agreed in Brisbane will be needed to boost growth and lift living standards.** In *advanced economies*, after a prolonged period

of demand weakness and persistently high unemployment, including long-term unemployment, there is increasing concern that protracted weakness in demand can permanently reduce productive capacity, as discouraged workers exit the labor force and low investment takes a toll on potential output. Therefore, continued demand support should be combined with structural reforms, with emphasis on measures that also sustain demand in the short term. In *emerging economies*, structural reforms to raise sustainable growth differ across countries. Priorities include: removing infrastructure bottlenecks in the power sector; reduced limits on trade and investment; improving business conditions; improving government service delivery; and reforms to education, labor, and product markets that raise competitiveness and productivity.

8. **At a global level, there is a pressing need to complete and implement the regulatory reform agenda.** Advanced economies should strengthen regulation and supervision of financial activities outside the banking system which are expanding rapidly. In emerging market economies, solid policy frameworks will be crucial. Collective efforts to enhance the global safety net and strengthen the resilience of the International Monetary System (IMS) should be renewed. Past steps to strengthen the policy dialogue on global imbalances, to manage capital flows, and to broaden the global financial safety net have been important. However, the global financial safety net remains underused during periods of turbulence, with uneven access and a multilayered structure (e.g., regional financing arrangements, bilateral swap lines, and Fund financing). More coordination is necessary to avoid fragmentation. Episodes of volatile capital flows and exchange rates, along with continuing precautionary reserve accumulation, also suggest the need for further collective efforts to strengthen the IMS. Specifically, implementing the 2010 quota and governance reforms, including their forward-looking elements, is imperative to provide the resources, credibility, and legitimacy the Fund needs to play an effective role in overseeing the IMS.

9. **Deficit and surplus economies alike should go further to reduce excess imbalances while sustaining growth.** In the years since the crisis, the composition of current account imbalances has changed: the large deficits of the United States and the surpluses of China and oil exporting countries have more than halved, while the current account surplus in the euro area has increased. Overall, there has been little progress in reducing excess imbalances in recent years as the absolute size of imbalances has stalled at a relatively high level. Demand adjustment in deficit economies, absent a demand boost in surplus economies, would be globally contractionary, at a time when world output is still below its potential level. Thus, only joint policy action by both surplus and deficit economies can reduce excess imbalances while supporting growth. Needed actions in debtor economies include medium-term fiscal consolidation and structural reforms to improve competitiveness and facilitate the movement of resources to the tradable sector. In some creditor economies (*Germany*), policies should support stronger domestic demand, including through infrastructure investment. In others (*China*), the focus should be on consumption-friendly rebalancing, while moving toward market-based exchange rates and avoiding an unnecessarily sharp slowdown. (See "[Imbalances and Growth](#)," the 2015 Update of IMF Sustainability Assessment prepared for the G-20 Mutual Assessment Process).

Table 1. Real GDP Growth*(Percent change)*

	Year over Year					
	2013	2014	Projections (from Oct. 2015)		Deviations (from Jul. 2015)	
			2015	2016	2015	2016
World 1/	3.3	3.4	3.1	3.6	-0.2	-0.2
Advanced economies	1.1	1.8	2.0	2.2	-0.1	-0.2
Euro area	-0.3	0.9	1.5	1.6	0.0	-0.1
Emerging market and developing countries 2/	5.0	4.6	4.0	4.5	-0.2	-0.2
Advanced G-20	1.3	1.8	2.0	2.2	0.0	-0.2
Emerging G-20	5.6	5.2	4.5	4.7	-0.1	-0.3
G-20 3/	3.5	3.6	3.3	3.6	-0.1	-0.2
Argentina 4/	2.9	0.5	0.4	-0.7	0.3	-0.7
Australia	2.1	2.7	2.4	2.9	0.1	0.0
Brazil	2.7	0.1	-3.0	-1.0	-1.5	-1.7
Canada	2.0	2.4	1.0	1.7	-0.5	-0.4
China	7.7	7.3	6.8	6.3	0.0	0.0
France	0.7	0.2	1.2	1.5	0.0	0.0
Germany	0.4	1.6	1.5	1.6	-0.1	-0.1
India	6.9	7.3	7.3	7.5	-0.2	0.0
Indonesia	5.6	5.0	4.7	5.1	0.0	0.0
Italy	-1.7	-0.4	0.8	1.3	0.1	0.1
Japan	1.6	-0.1	0.6	1.0	-0.2	-0.2
Korea	2.9	3.3	2.7	3.2	-0.2	-0.4
Mexico	1.4	2.1	2.3	2.8	-0.1	-0.2
Russia	1.3	0.6	-3.8	-0.6	-0.4	-0.8
Saudi Arabia	2.7	3.5	3.4	2.2	0.6	-0.2
South Africa	2.2	1.5	1.4	1.3	-0.6	-0.8
Spain 5/	-1.2	1.4	3.1	2.5	0.0	0.0
Turkey	4.2	2.9	3.0	2.9	0.0	-0.1
United Kingdom	1.7	3.0	2.5	2.2	0.1	0.0
United States	1.5	2.4	2.6	2.8	0.1	-0.2
European Union	0.2	1.5	1.9	1.9	0.0	-0.1

Source: IMF, *World Economic Outlook* October 2015.

1/ The quarterly estimates and projections account for 90 percent of the world purchasing-power-parity weights.

2/ The quarterly estimates and projections account for approximately 80 percent of the emerging market and developing countries.

3/ G-20 aggregations exclude European Union.

4/ The data for Argentina are officially reported data as revised in May 2014. On February 1, 2013, the IMF issued a declaration of censure, and in December 2013 called on Argentina to implement specified actions to address the quality of its official GDP data according to a specified timetable. On June 3, 2015, the Executive Board recognized the ongoing discussions with the Argentine authorities and their material progress in remedying the inaccurate provision of data since 2013, but found that some specified actions called for by the end of February 2015 had not yet been completely implemented. The Executive Board will review this issue again by July 15, 2016, and in line with the procedures set forth in the IMF legal framework.

5/ Permanent invitee.

ANNEX. INTERNATIONAL MIGRATION: RECENT TRENDS, ECONOMIC IMPACTS, AND POLICY IMPLICATIONS¹

International migration is a global phenomenon and has become a pressing economic issue for both sending and receiving countries, particularly in light of the ongoing refugee crisis in the Middle East, North Africa, and Afghanistan. In the coming decades, demographic forces, globalization and climate change will likely increase migration pressures across borders. Understanding evolving trends, underlying drivers, and the economic impact of migration is crucial for designing policies that maximize benefits for both recipient and source countries. Global policy coordination can help establish effective response mechanisms to address surges in humanitarian migration and reduce costs of international labor mobility.

A. Background and Context

International migration has increased over the past few decades, with migrants now accounting for over 3 percent of the global population. Notwithstanding a slowdown in the wake of the global financial crisis, the number of international migrants has increased threefold since 1960, reaching 232 million in 2013.² More than half of global international migrants reside in advanced economies, particularly in Europe and North America. Emerging market economies play an important role as both source and recipient countries (e.g., from the Caucasus and Central Asia to Russia and from South Asia to the Gulf Cooperation Council countries). Low-income developing countries in Sub-Saharan Africa have made a modest, albeit gradually increasing, contribution to international migration. International migrants have been characterized by the dominance of working-age individuals and a significant improvement in their average educational attainment over the last few decades.

The size and pattern of international migration reflects a combination of push and pull factors. Incentives to migrate are shaped by cross-country differences in wages and economic opportunities, demographic structures, social and political inequalities, and natural disasters. The broader impact of economic development on migration, however, depends on the patterns of growth in source and recipient countries.³ The contribution of demographic shifts to migration depends on countries' stage of demographic transition—the asynchronous decline in mortality and fertility and changes in working age populations.⁴ In countries with a youth bulge and limited job opportunities, the excess supply of labor can create a push factor for emigration. In many advanced economies, rapidly aging populations, high old-age dependency ratios, and labor shortages create a pull environment—a trend that could accelerate in the foreseeable future.

¹ Prepared by Balazs Csonato, Lucy Liu, Nujin Suphaphiphat, and Niklas Westelius under the guidance of Era Dabla-Norris.

² Source: UN database on migration. Migrants broadly refer to people living in a country other than the one in which they were born, or in the absence of such data, the number of people of foreign citizenship. While the coverage of the database varies from country to country, it generally includes both economic migrants and refugees.

³ World Bank Group and the International Monetary Fund, 2015, Global Monitoring Report 2015/2016—Global Development Goals in an Era of Demographic Change.

⁴ IMF, 2015, International Migration: Recent Trends, Economic Impacts, and Policy Implications, forthcoming.

Humanitarian migration has surged in recent years, with the number of forced migrants now at the highest level since the 1990s. The number of refugees increased by 40 percent to 14.4 million between 2011 and 2014, as a result of intensifying violence in the Middle East and North Africa region and in Sub-Saharan Africa.⁵ Although flows to Europe have increased recently, refugees are largely concentrated in emerging market and developing countries. Indeed, a number of countries in the Middle East and North Africa region have been dealing with large inflows of refugees for an extended time. Around one-third of global refugees in 2014, mostly from Afghanistan, Iraq and Syria, resided in Lebanon, Pakistan and Turkey. Lebanon, for instance, experienced an inflow of over one million refugees (one-fourth of its population) between 2012 and 2014. Given the high number of internally displaced people (38 million at the end of 2014), the recent spike in the number of asylum-seekers, and protracted conflicts in the Middle East, this number could increase even further in the coming period.⁶

B. Economic Impact of Economic and Humanitarian Migration

The macroeconomic impact of international migrants—both economic migrants and refugees—depends on a range of factors. These include the number and demographic characteristics of migrants, the economic structures of source and recipient economies, and policy responses. The capacity to absorb migrants is affected by business cycle conditions, per capita income, the flexibility of labor markets (e.g., the ability to overcome initial obstacles for migrants to find jobs fast, such as high entry-level wages and skill-recognition) and welfare benefits, existing immigrant networks, and social attitudes towards immigrants.

In recipient countries, immigration has helped increase labor force growth while its impact on labor market outcomes of natives has been muted. Over the past decade, immigration accounted for almost half of the increase in the labor force in the United States and Canada and over two thirds in Europe. Migrants also contributed positively to recipient countries' labor markets by expanding occupations and filling labor needs. This has been particularly true for strongly declining occupations and ones where native workers are in short supply but high-skilled immigration has also contributed positively to many recipient countries. In some cases, however, immigration can exacerbate high unemployment and significant skill-mismatches in labor markets. While some downward pressures on wages for natives can occur in low-skilled sectors, concerns for a broad-based decline in wages and employment opportunities for natives are largely empirically unsubstantiated.⁷ Some recent studies have found that an influx of immigrants has prompted native workers (especially those with high skills) to specialize in more complex occupations, thus raising their productivity and wages.⁸

⁵ In the SSA region, longstanding and recent conflicts (e.g. Burundi, DRC, Somalia, CAR, South Sudan), in conjunction with lack of economic opportunities, have resulted in massive internal displacement and steady influx of about 3 million refugees into neighboring countries.

⁶ The OECD (2015) expects the number of asylum seekers to reach one million in Europe in 2015 alone, with around 350–400 thousand people to be granted refugee or similar status.

⁷ Aiyar et al, 2015, *Europe's Refugee Crisis: Economic Effects and Policy Considerations*, IMF SDN, forthcoming

⁸ See for example Cattaneo and Peri, 2015, "What Happens to the Careers of European Workers when Immigrants 'Take their Jobs,'" *Journal of Human Resources*, 50(3), p 665–93., and Ottaviano, Peri and Wright, 2013. "Immigration, Offshoring, and American Jobs," *American Economic Review*, vol. 103(5), pp. 1925–59.

Ensuring effective integration of immigrants into labor markets of recipient economies is essential to reap the economic benefits of immigration. A large number of studies document that immigrants in Europe have both lower participation and employment rates and earn less than natives. These earnings and employment gaps are particularly pronounced in the initial years and diminish as immigrants improve their language skills or obtain more education. Nonetheless, evidence suggests that gaps can be permanent.⁹ Incomplete assimilation of migrants can also have long-run effects on immigrant's economic and social mobility, running the risk of social exclusion for both first and second-generation immigrants.

The net fiscal impact of immigration tends to be small. Migrants contribute positively to public finances through tax and social security contribution and negatively through dependence on benefits. Like natives, migrants have a negative net fiscal balance at young and old age, and a positive contribution in-between. But relative to natives, immigrants' net balances tend to turn positive later, peak at a lower level, and turn negative earlier.¹⁰ Nevertheless, estimates indicate that the net impact of immigration on public finances rarely exceeds ± 0.5 percent of GDP for advanced economies.¹¹ Immigration can also help reduce long-term expenditure pressures from population aging. For instance, assuming a continuation of current migration trends into more advanced economies, simulations suggest that age-related expenditures could fall by 1 percent of GDP by 2050.¹²

For source countries, remittances constitute the most tangible benefits from migration. Remittance flows to developing countries amounted to over 400 billion US dollars in 2014, more than half of total net FDI inflows, and well over three times as much as official development assistance. For some small countries (e.g., Tajikistan, Nepal, and Moldova) these flows amount to over 25 percent of GDP and provide a significant income source, particularly for poorer households. Moreover, remittances have contributed to economic development through improved education and health outcomes, increasing domestic savings and financial intermediation.¹³ From a macroeconomic perspective, while remittances represent an outflow from recipient countries, they function as a stabilizing force in source countries as they tend to be countercyclical.¹⁴

High-skilled emigration can lead to sizable losses of human capital. The impact of emigration on the labor force has been substantial in some source countries, particularly for high-skilled labor. For instance, Caribbean countries lost over 50 percent of their high-skilled labor between 1965 and 2000. Such "brain drain" or "positive selection" typically occurs due to the need for initial resources to undertake migration, higher returns to education in recipient countries, and more favorable immigration policies for skilled labor. High-skilled emigration can also have an indirect negative impact on productivity in source countries as more educated workers confer externalities or know-

⁹ Anderson, 2015, "Can Immigrants ever Earn as much as Native Workers?" *IZA World of Labor*.

¹⁰ Aiyar et al, 2015, *Europe's Refugee Crisis: Economic Effects and Policy Considerations*, IMF SDN, forthcoming.

¹¹ OECD, 2013, *The Fiscal Impact of Immigration in OECD countries*, International Migration Outlook, 2013.

¹² Clements et al, 2015, *The Fiscal Consequences of Shrinking Populations*, IMF SDN forthcoming.

¹³ Chami et al, 2008, *Macroeconomic Consequences of Remittances*, Occasional Paper 259, IMF.

¹⁴ For recent evidence, see Jidoud, 2015, "Remittances and Macroeconomic Volatility in African Countries," IMF Working Paper.

how transfers to others. There is some evidence that such losses can outweigh the benefits from remittances.¹⁵

Surges in humanitarian migration can put significant strains on economic resources in both source and recipient countries. Relative to economic migration, humanitarian migrant flows occur with larger swings over a short time period, potentially overwhelming both source and recipient countries. In source countries, refugee outflows can result in a significant reduction in the working-age population and human capital, and thus potential growth. For instance, at an average growth rate of 3 percent, it would take 20 years for Syria, whose population is estimated to have shrunk by 20 percent, to recover to its 2010 GDP level. In neighboring countries, large short-term migration inflows can lead to fiscal costs stemming from temporary assistance provided for refugees and increase the share of informal employment, exerting downward pressure on wages and an upward pressure on food and housing prices.¹⁶ While the increase in consumption brought by refugees can contribute positively to economic activity, rising imports to meet the needs of the increasing population can worsen external balances. Final destination countries also face significant fiscal costs associated with health, education, infrastructure, and social programs. For instance, estimates suggest budgetary expenses for asylum seekers in EU countries could increase by a cumulative 0.15 percent of GDP in 2015–16 compared to 2014.¹⁷ The overall economic impact, however, depends on various factors such as the age and skill profile of refugees, and the absorption capacity of recipient economies.

C. Domestic and Global Policy Implications

International migration creates policy challenges and economic opportunities for source and recipient countries and the global community.¹⁸ For many recipient countries, the key challenge is to minimize short-term costs by facilitating smooth integration of migrants into labor markets while taking advantage of long-run opportunities to address demographic pressures. For source countries, the crucial challenge is to reduce barriers that discourage migrants from providing financial support for those that stay behind while implementing policies geared towards retaining and retracting emigrants, particularly high-skilled. There are also significant political and social challenges posed by high / persistent levels of migration. At the global level, enhanced policy coordination is essential to effectively address humanitarian migration crises while leveraging benefits from enhanced international labor mobility.

Recipient countries should design immigration policies that enhance migrants' economic contributions, including by countering population aging and addressing skill-shortages. Given that approximately 80 percent of international migrants are working-age, well above the share of the same cohort in the global population, migration can help mitigate challenges stemming from

¹⁵ Mishra, 2006, "Emigration and Brain Drain: Evidence from the Caribbean" IMF working paper 06/25.

¹⁶ Although difficult to assess, the fiscal costs of receiving refugees could be substantial for neighboring countries. In particular, the direct budgetary costs associated with spending on health, education, infrastructure, and social programs, are estimated at about 1 percent of GDP for Lebanon, and Jordan in 2014.

¹⁷ Aiyar et al, 2015, *Europe's Refugee Crisis: Economic Effects and Policy Considerations*, IMF SDN, forthcoming.

¹⁸ Giovanni, Levchenko, and Ortega, 2015, "A Global View of Cross-Border Migration," *Journal of the European Economic Association*, 13(1), pp. 168–202.

population aging and increasing old-age dependency. Countries could thus actively employ immigration policies to boost labor force participation to improve growth prospects and ensure sustainability of public finances. Introducing economic criteria into migration policies can also help address specific labor needs and skill-shortages. For example, recipient countries could offer benefits (e.g. permanent residence and family reunifications) to migrants with specific skills and introduce programs for temporary migrants, depending on cyclical shifts in labor market demand.

Well-designed integration policies are vital for harnessing the benefits of immigration.

Integration policies should be geared towards strengthening labor market flexibility to integrate the added labor supply. Providing affordable education, language and job training could help achieve a good skill-balance amongst migrant workers, avoid labor market segregation and excess unemployment, and minimize social tensions. Successful integration also requires that full use be made of migrants' skills through the recognition of qualifications. Moreover, proactive job placement and other incentives can help overcome initial obstacles to employment such as high entry wages. Finally, education and housing policies can reduce the risk of social exclusion for both first- and second-generation immigrants.

For source countries, reducing remittance costs can help raise development financing.

Remittance costs have fallen over time, partially reflecting the commitment by the G20 to reduce transaction costs to 5 percent of the amount transferred by 2014. Nonetheless, at an average of 8 percent, transaction costs remain high with significant cross-country variation. Estimates suggest that reducing remittance costs to 1 percent could release savings of 30 billion dollar per year, an amount larger than the entire annual bilateral aid budget to Africa.¹⁹ Given the positive association between remittances and economic development, reducing remittance costs could play an important part in the post-2015 development agenda to raise development financing. In particular, fostering greater competition in the remittance market while mitigating the impact of de-risking by international banks could help address high remittance costs.²⁰ Moreover, other market-based options, such as diaspora bonds, could be further explored by national governments to mobilize savings and strengthen the link between emigration and development.

Source countries could implement comprehensive and targeted policies to retain and re-attract migrants.

This could be facilitated by implementing productivity enhancing policies to raise demand for skilled labor and reorienting education policies to ensure better skill matching. Removal of regulatory and bureaucratic barriers, improved business climate, better recognition of skills acquired abroad, and targeted tax benefits could help attract high-skilled migrants to return.

Policies addressing humanitarian migration should focus on achieving better living conditions for those in need and ensure that their geographical distribution does not overburden the capacity of individual countries.

¹⁹ Ratha, D., 2014, "A \$100 Billion Idea—Tapping Migrants for Financing Development," *People Move* Blog, The World Bank.

²⁰ Concerns have been raised that banks are de-risking remittances to offset the cost of complying with AML/CFT and other requirements, and thereby raising remittance costs. The G20 has asked the World Bank to analyze the impact of the de-risking on the remittances market.

should be improved, including through better access to shelter, care and quality education. Financial assistance from the international community would help in this regard. Moreover, efficient mobilization of resources is required to process asylum seekers. Advanced countries, especially those with favorable labor market conditions, should assess the scope for admitting more refugees and develop policies aimed at facilitating their labor market integration, including issuance of work permits. Transit countries could provide temporary welcome for refugees to mitigate the immediate impact on destination countries, potentially on a cost-sharing basis. However, as transit countries tend to be highly heterogeneous, their capacity to provide support for refugees varies significantly.

Working towards a multilateral framework to better govern international migration and maximize economic benefits is warranted. Migration is likely to become an increasingly important part of globalization, potentially playing a key role in achieving higher and more sustainable global growth, especially in an era of asynchronous demographic transitions. Global policy efforts should focus on encouraging cooperation and dialogue between source and destination countries in order to maximize global benefits of international migration, including by reducing international spillovers from immigration policies, facilitating remittance flows, protecting labor rights and promoting safe and secure working environment for migrants.

Global cooperation is vital for addressing humanitarian migration. Policies addressing refugees require a holistic humanitarian and development responses. These include policies towards enhanced global development diplomacy—aiming to prevent, contain, and respond to humanitarian crises—and more flexible and innovative financing instruments to ensure adequate and effective assistance, and policies facilitating refugees wishing to return home. Specifically, transit, destination and high-income donor countries need to coordinate their approach among themselves and with the UN and other international organizations. For example, the donor community, including international institutions, the G7, the GCC and the EU, should provide financial support to improve conditions for refugees in conflict-neighboring countries. The recent influx of refugees in the EU has also demonstrated the need to develop a new framework that appropriately accounts for heterogeneity within the Union.

The IMF can play a role in fostering macro-stability and confidence in source and recipient countries. As part of its surveillance activities, the IMF is closely monitoring the economic impact of demographic trends as well as the spillovers of the immediate crisis for all the affected countries. Its policy advice in bilateral surveillance is being tailored to countries' individual circumstances and when warranted, program targets under lending arrangements have been adjusted to take into account the impact of the crisis. The Fund has also been providing capacity development assistance in conflict and post-conflict source countries, to help them rebuild stronger institutions and restore governance.