

Editorial

Policy changes to turn the tide

For the past two years, global growth outcomes and prospects have steadily deteriorated, amidst persistent policy uncertainty and weak trade and investment flows. We now estimate global GDP growth to have been 2.9% this year and project it to remain around 3% for 2020-21, down from the 3.5% rate projected a year ago and the weakest since the global financial crisis. Short-term country prospects vary with the importance of trade for each economy though. GDP growth in the United States is expected to slow to 2% by 2021, while growth in Japan and the euro area is expected to be around 0.7 and 1.2% respectively. China's growth will continue to edge down, to around 5.5% by 2021. Other emerging-market economies are expected to recover only modestly, amidst imbalances in many of them. Overall, growth rates are below potential.

The mix between monetary and fiscal policies is unbalanced. Central banks have been easing decisively and timely, partly offsetting the negative impacts of trade tensions and helping to prevent a further rapid worsening of the economic outlook. Thereby, they have also paved the way for structural reforms and bold public investment to raise long-term growth, such as spending on infrastructure to support digitalisation and climate change. However, to date, other than a few countries, fiscal policy has been only marginally supportive, and not especially of investment, while asset prices have been buoyant.

The biggest concern, however, is that the deterioration of the outlook continues unabated, reflecting unaddressed structural changes more than any cyclical shock. Climate change and digitalisation are ongoing structural changes for our economies. In addition, trade and geopolitics are moving away from the multilateral order of the 1990s. It would be a policy mistake to consider these shifts as temporary factors that can be addressed with monetary or fiscal policy: they are structural. In the absence of clear policy directions on these four topics, uncertainty will continue to loom high, damaging growth prospects.

The lack of policy direction to address climate change issues weighs down investment. The number of extreme weather events is on the rise and insufficient policy action could increase their frequency. They may lead to significant disruptions to economic activity in the short term, and long-lasting damage to capital and land, as well as to disorderly migration flows. Adaptation plans are in their infancy, while mitigation, moving away from fossil fuels, through measures such as carbon taxes, has proved technically and politically challenging. Governments must act quickly: without a clear sense of direction on carbon prices, standards and regulation, and without the necessary public investment, businesses will put off investment decisions, with dire consequences for growth and employment.

Digitalisation is transforming finance, business models and value chains, through three main channels: investment, skills and trade. So far, only a small fraction of businesses appear to have successfully harnessed the strong productivity potential of digital technologies, which partly explains why digitalisation has been unable to offset other headwinds on aggregate productivity. Reaping the full benefits of digital technologies requires complementary investments in computer software and databases, R&D, management skills and training, which remains a challenge for too many firms. Digitalisation is also affecting people and work, because it confers a huge advantage to people whose main tasks require cognitive and creative skills, and penalises those whose work has a large routine element, and at the same time generates new forms of contractual arrangements that escape traditional social protection. But the policy environment to harness new technology – concerning skill upgrading, social protection, access to communication infrastructure, digital platform development, competition in digital markets and regulation of cross-border data flows – lags behind, making it difficult to reap the benefits of digitalisation in full.

The Chinese economy is structurally changing, rebalancing away from exports and manufacturing towards more consumption and services. Increasing self-sufficiency in core inputs for certain manufacturing sectors is reflecting a desire to move away from importing technology towards national production. A shift in energy utilisation to address pollution, and the rise in services also induce additional changes in Chinese demand for imports. China's traditional contribution to global trade growth is set to slow and change in nature. While India is set to grow rapidly, its growth model is different and its contribution to global trade growth will not be enough to substitute for China as a global engine for traditional manufacturing.

Trade and investment are also structurally changing, with digitalisation and the rise of services, but also with geopolitical risks. The rise in trade restrictions is nothing new. About 1500 new trade restrictions have been implemented by G20 economies since the global financial crisis in 2008. Yet, the past two years have seen a surge in trade-restricting measures and an erosion of the rules-based global trading system, which is deep-rooted. Coupled with rising government support across a range of sectors, this induces disruptions in supply chains and reallocations of activities across countries that both exert a drag on current demand by reducing incentives to invest and undermine medium-term growth.

Against this backdrop, there is scope and an urgent need for much bolder policy action to revive growth. Reducing policy uncertainty, rethinking fiscal policy, and acting vigorously to address challenges raised by digitalisation and climate change, all have the potential to reverse the current slippery trend and lift future growth and living standards.

First, a clear policy direction for transitioning towards sustainable growth amidst digitalisation and climate challenges would trigger a marked acceleration of investment. Governments should focus not only on the short-term benefits of fiscal stimulus, but primarily on the long-term gains and to this end they should review their investment policy frameworks. The creation of national investment funds, focused on investing in the future, could help governments design investment plans to address market failures and take account of positive externalities for society as a whole. A number of governments already have dedicated funds of the sort, but their governance could be improved to ensure higher economic and social returns on investment.

Second, greater trade policy predictability and transparency could go a long way to reduce uncertainty and revive growth. For instance, there is a need to bring more transparency to the numerous forms of government support that distort international markets and to agree global rules on the transparency, predictability, reduction and prevention of such support (Focus Note 1).

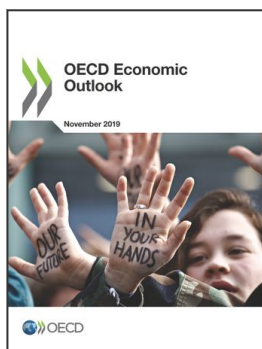
Third, fiscal and monetary policies can be better activated, and to powerful effect if coordination prevails. There is scope to strengthen automatic stabilisers to preserve household income and consumption (Focus Note 5). Active coordination across the euro area would contribute to lift growth now (Focus Note 3). Moreover, should the outlook deteriorate more than we project, coordinated fiscal and monetary action across the G20, even allowing for the limited policy space some central banks have, could efficiently avert a recession, not least because coordination would bolster confidence (Focus Note 4).

The current stabilisation at low levels of economic growth, inflation and interest rates does not warrant policy complacency. The situation remains inherently fragile, and structural challenges – digitalisation, trade, climate change, persistent inequalities – are daunting. Rather, there is a unique window of opportunity to avoid a stagnation that would harm most people: restore certainty and invest for the benefit of all.

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